

Studio Dragon (253450 KQ)

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Rating **BUY**
maintain

6M TP (W) **115,000**
maintain

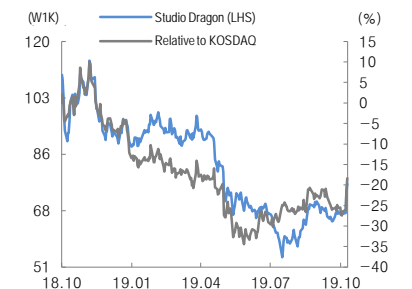
CP (W)
(19.10.30) **76,400**

Media

Industry 4.0 safety rating ■ Neutral Green

KOSDAQ	655.04
Market cap (Wbn)	2,146
Market cap portion (%)	0.95
Paid-in capital (common; Wbn)	14
52w high/low (W)	114,100 / 54,000
120d avg. trading volume (Wbn)	9.4
Foreign ownership (%)	2.74
Major shareholders	CJ ENM+5: 74.33%

(%)	1M	3M	6M	12M
Abs. return	11.9	24.2	-16.8	-16.9
Rel. return	6.2	18.7	-4.1	-18.2



All attention on content

BUY and 6M TP of W115,000 maintained

- The target price of W115,000 for Studio Dragon is based on our residual income model, which we believe is an appropriate valuation method given its projected NP CAGR of 25% over the next five years and an increase in its annual drama production volume (from the current 25 to 40 titles).

All eyes on content: Wavve ups content spend, OTT entrants enter US market

- Recent activities in the content market including launches of OTT platforms at home and abroad are likely to rekindle investor interest in content, which has begun to fizzle out since *Arthdal Chronicles* turned in poor results in May 2019.
- This September, we saw the launch of a joint streaming platform Wavve (mobile carrier SK Telecom's OTT service Oksusu and broadcasters' jointly owned Pooq), which unveiled plans to spend W300bn on content over the next five years. Its first drama *The Joseon Romantic Comedy: The Tale of Nok-du*, which is currently airing on KBS2 and Wavve, is doing well (viewer rating of over 7%). Wavve has attracted 2.6 million paid subscribers within two months of its launch.
- On October 28, SK Telecom and Kakao announced a strategic partnership. This is a very powerful combination of SK Telecom's massive subscribership (31 million wireless telecom customers, 8.2 million IPTV users, and 2.6 million Wavve subscribers) and Kakao's extensive content library and production capabilities. Kakao distributes webtoons and webnovels via mobile content platform Kakao Page and offers movie and music content (Starship, King Kong) and produces drama (MegaMonster) via entertainment arm Kakao M.
- At its recent 3Q19 earnings conference, Netflix disclosed it spent \$13bn on expanding its content line-up last year and intends to spend \$14bn this year. (Content acquisition costs have increased about 30% yoy this year for the industry as a whole.) The streaming giant recently announced the sequel to its original content *Kingdom* (slated for March 2020).
- Apple will launch Apple TV+ in the US on November 1 and has plans to invest \$6bn on original content.
- Disney's streaming platform Disney+ will be available in the US on November 12. It hopes to lure in 60-90 million subscribers by 2024. The entertainment company plans to spend \$1bn on original content in 2019 and an additional \$2bn by 2024.
- AT&T has decided to launch HBO Max in May 2020 with the goal of attracting 75-90 million subscribers (including 25-40 million subscribers outside the US) by 2025. The company, which owns Warner Brothers, DC Network, HBO, and Cartoon Network, plans to invest \$2bn over the next couple of years.
- As these global players haven't mentioned anything about investing in Korean content, it's fair to assume that the recent surge in Studio Dragon was driven solely by expectations. But as they are likely to invest in Korean content in 2020, we are still optimistic about Korean content from a long-term perspective.
- Studio Dragon's stock had been under pressure on vague concerns about content rather than actual earnings results. But we believe that will return to normal as global major companies race to launch OTT platforms.

Operating results and major financial data

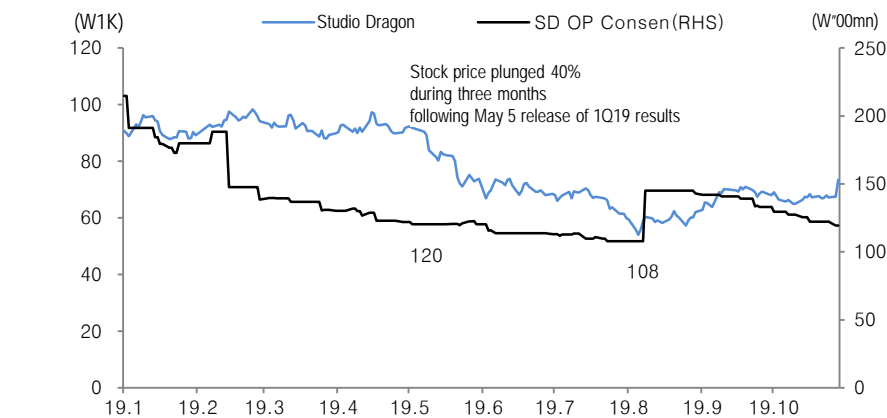
(Wbn, W, x, %)

	2017A	2018A	2019F	2020F	2021F
Revenue	287	380	475	519	579
OP	33	40	49	74	95
Pretax profit	30	46	59	87	108
NP	24	36	43	65	80
NP (controlling int.)	24	36	43	65	80
EPS	1,050	1,278	1,534	2,300	2,851
PER	61.9	72.3	49.8	33.2	26.8
BPS	16,223	14,312	15,834	17,624	19,725
PBR	4.0	6.5	4.8	4.3	3.9
ROE	9.5	9.3	10.2	13.8	15.3

Note: EPS, BPS, and ROE are based only on the controlling interest.

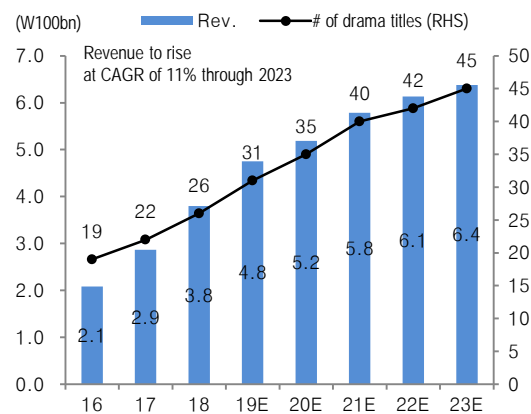
Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Stock rebound following the release of less weak than expected earnings results



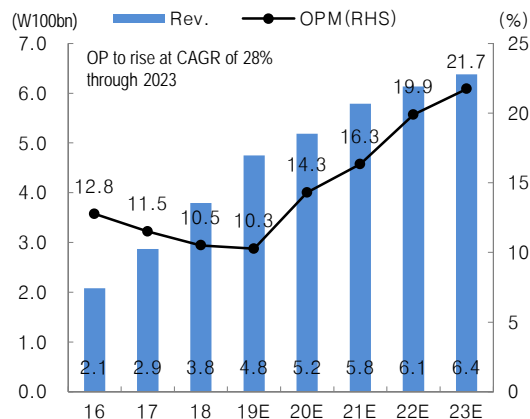
Source: FnGuide, Daishin Securities Research Center

Fig 2. Revenue rising on increased drama production



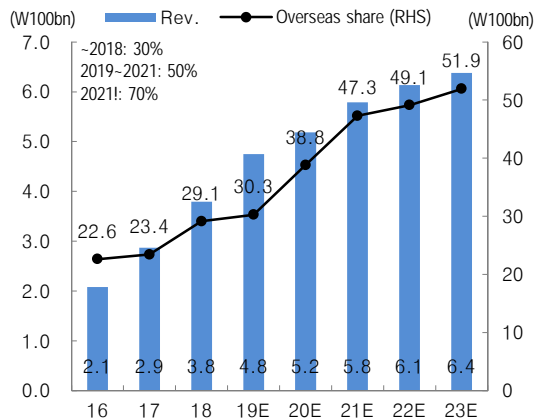
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 3. OP to rise 28% annually through 2023



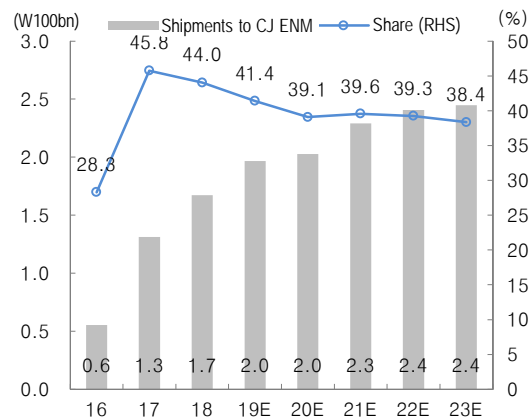
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 4. Rising overseas distribution holds key to revenue growth



Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 5. Growing on captive customers (tvN, OCN)



Source: Studio Dragon, Daishin Securities Research Center estimates

1. Company profile

Overview

- Spun off from CJ E&M in May 2016
- Listed on the KOSDAQ in Nov 2017
- Revenue ₩379.6bn, OP ₩39.9bn, NP ₩35.8bn (2018)
- Revenue mix: programming 45%, distribution 47%, others 8% (2Q19)

Share price catalysts

- Drama programming (tvN, OCN)
- Deals with Netflix
- Growing production of tent-pole dramas has led to market concerns over heavy production cost burden, hurting the share price.
- But the stock will rebound if earnings come in favorable owing to rising viewer ratings of major dramas.

Source: Studio Dragon, Daishin Securities Research Center

2. Earnings drivers

Programming revenue vs. revenue share of captive customers (2Q19)

Quarter	Programming revenue (₩'00mn)	Captive(RHS) (₩'00mn)
1Q17	263	76.4
2Q17	241	90.8
3Q17	418	84.4
4Q17	390	72.4
1Q18	407	81.1
2Q18	341	97.1
3Q18	489	99.7
4Q18	544	98.9
1Q19	441	99.5
2Q19	581	93.6

Source: Studio Dragon, Daishin Securities Research Center

Revenue breakdown by business (2Q19)

Source: Studio Dragon, Daishin Securities Research Center

Distribution revenue (2Q19)

Quarter	Distribution revenue (₩'00mn)	Drama library (RHS) (₩'00mn)
1Q17	365	89
2Q17	263	93
3Q17	233	97
4Q17	257	106
1Q18	321	102
2Q18	288	101
3Q18	634	104
4Q18	378	108
1Q19	562	126
2Q19	603	136

Source: Studio Dragon, Daishin Securities Research Center

Distribution: domestic vs. overseas (2Q19)

Quarter	Domestic sales (LHS) (₩'00mn)	Overseas sales (RHS) (₩'00mn)
1Q17	226	139
2Q17	161	102
3Q17	131	102
4Q17	154	104
1Q18	227	94
2Q18	165	123
3Q18	172	462
4Q18	252	125
1Q19	136	426
2Q19	181	422

Source: Studio Dragon, Daishin Securities Research Center

Fig 6. Viewer ratings of tvN weekend dramas

Source: AGB Nielson, Daishin Securities Research Center

Per share intrinsic value

Residual Income Model		(Wbn, W, %)									
		2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
I	NP (contr. int.) ^(Note 2)	43	65	80	101	113	127	142	159	179	200
II	Shareholders' equity (contr. int.) ^(Note 2)	444	495	554	631	715	805	903	1,013	1,127	1,256
	Estimated ROE	10.2	13.8	15.3	16.0	15.9	15.8	15.8	15.7	15.8	15.9
III	Required rate of return ^(Note 3)	4.6									
	Risk free rate of return ^(Note 4)	1.8									
	Market risk premium ^(Note 5)	4.0									
	Beta	0.70									
IV	Spread (estimated ROE – required rate of return)	5.6	9.2	10.7	11.4	11.3	11.2	11.2	11.1	11.2	11.3
V	Required income	19	20	23	26	29	33	37	42	47	52
VI	Residual income (I - V)	25	44	57	75	84	94	105	118	132	148
	Present value factor	0.99	0.95	0.91	0.87	0.83	0.80	0.76	0.72	0.69	0.66
	PV of residual income	24	42	52	65	70	75	80	85	91	98
VII	Sum of residual income	683									
VIII	PV of residual income following forecasting period	2,131									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	401									
X	Fair market cap (VII+VIII+IX)	3,215									
	Total number of shares (thousands)	28,095									
XI	Per share value (W)	114,437									
	Current share price (W)	76,400									
	Potential (%)	49.8%									

Note 1: Under the residual income model (RIM), we add the current shareholders' equity to the residual income based on the earnings forecast for the next ten years before adding the result to the residual income after the forecasting period to derive the value of shareholders' stakes. The RIM is considered less subjective than similar valuation models such as DDM, DCF, and EVA.

Note 2: The RIM reflects consolidated subsidiaries' earnings not in their entirety but only for the stake controlled by the company.

Note 3: The required rate of return (i.e., cost of equity) is the rate of return expected by the shareholders who take risks. It is derived by the capital asset price model: Cost of equity = Risk-free interest rate + Beta * Market risk premium.

Note 4: The yield on five-year government bonds was used as the proxy for the risk-free interest rate.

Note 5: Market risk premium refers to the gap between the expected return on the market portfolio and the risk-free interest rate. It has been lowered from 6-8% to 3-5% in reflection of the current low-growth environment.

Note 6: The terminal growth was assumed to be zero.

Financial statements

Income statement (Wbn)					
	2017A	2018A	2019F	2020F	2021F
Revenue	287	380	475	519	579
Cost of goods sold	240	324	412	432	471
Gross profit	47	56	63	87	109
SG&A expenses	14	16	14	12	14
OP	33	40	49	74	95
OP margin	11.5	10.5	10.3	14.3	16.3
EBITDA	74	115	151	177	207
Non-OP	-3	6	10	13	14
Income from affiliates	0	0	0	0	0
Financial revenue	1	7	13	13	14
FX related gains	0	0	0	0	0
Financial expense	-3	-1	-4	-1	-1
FX related losses	1	0	0	0	0
Others	0	0	0	1	1
Income before taxes	30	46	59	87	108
Income tax expense	-6	-10	-16	-23	-28
Income from cont. op.	24	36	43	65	80
Income from discount op.	0	0	0	0	0
NP	24	36	43	65	80
NP margin	8.3	9.4	9.1	12.5	13.8
NP for non-cont. interest	0	0	0	0	0
NP for contr. interest	24	36	43	65	80
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	-1	-1	-1	-1
Comprehensive income	24	35	42	63	79
Comp. income for non-cont. int.	0	0	0	0	0
Comp. income for contr. int.	24	35	42	63	79

Valuation metrics (W, x, %)					
	2017A	2018A	2019F	2020F	2021F
EPS	1,050	1,278	1,534	2,300	2,851
PER	61.9	72.3	49.8	33.2	26.8
BPS	16,223	14,312	15,834	17,624	19,725
PBR	4.0	6.5	4.8	4.3	3.9
EBITDAPS	3,271	4,108	5,387	6,318	7,357
EV/EBITDA	22.1	21.1	13.0	10.8	9.1
SPS	12,628	13,539	16,932	18,467	20,618
PSR	5.1	6.8	4.5	4.1	3.7
CFPS	3,068	3,930	5,373	6,429	7,467
DPS	0	0	500	750	850

Financial ratios (W, x, %)					
	2017A	2018A	2019F	2020F	2021F
Growth potential					
Sales growth	85.7	32.4	25.2	9.1	11.6
OP growth	98.3	21.0	22.1	52.3	27.5
NP growth	192.9	50.3	20.1	50.1	23.9
Profitability					
ROIC	17.0	16.0	15.6	22.8	27.5
ROA	9.4	8.2	9.1	12.6	14.7
ROE	9.5	9.3	10.2	13.8	15.3
Stability					
Debt ratio	24.7	27.7	26.1	23.9	21.9
Net borrowings ratio	-49.5	-39.3	-40.9	-45.6	-47.8
Interest coverage ratio	19.0	343.0	0.0	0.0	0.0

Source: Studio Dragon, Daishin Securities Research Center

Balance sheet (Wbn)					
	2017A	2018A	2019F	2020F	2021F
Current assets	290	247	289	341	391
Cash & cash equiv.	51	153	177	221	260
Trade & other receive.	55	69	86	94	105
Inventories	1	1	1	1	1
Other current assets	182	25	25	25	25
Long-term assets	170	265	271	272	285
Tangible assets	1	1	1	1	1
Investments in affiliates	0	0	0	0	0
Other long-term assets	169	264	270	271	284
Total assets	459	512	560	613	675
Current liabilities	91	108	113	115	118
Payables & other liab.	34	60	65	67	70
Borrowings	0	0	0	0	0
Current portion of LT debts	10	0	0	0	0
Other current liabilities	47	48	48	48	48
Long-term liabilities	0	3	3	3	3
Borrowings	0	0	0	0	0
Convertible securities	0	0	0	0	0
Other long-term liab.	0	3	3	3	3
Total liabilities	91	111	116	118	121
Controlling interest	368	401	444	495	554
Capital stock	14	14	14	14	14
Capital surplus	320	320	320	320	320
Retained earnings	32	68	111	161	220
Other capital changes	3	0	0	0	0
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	368	401	444	495	554
Net borrowings	-183	-158	-182	-226	-265

Cash flow statement (Wbn)					
	2017A	2018A	2019F	2020F	2021F
Operating cash flows	-7	-29	-2	27	49
NP	0	0	43	65	80
Non-cash items	46	74	108	116	130
Depreciation	41	75	102	103	112
FX gains	1	-1	0	0	0
Equity method gain	0	0	0	0	0
Others	4	0	5	13	18
Chg in assets & liab.	-73	-139	-151	-144	-146
Other cash flows	20	36	-2	-10	-15
Investing cash flow	-141	141	-106	-101	-121
Investment assets	-141	138	0	0	0
Tangible assets	0	0	0	0	0
Others	0	3	-105	-101	-121
Financing cash flows	188	-10	0	-14	-21
Short-term borrowings	-8	0	0	0	0
Bonds payable	10	0	0	0	0
Long-term borrowings	0	0	0	0	0
Rights offering	208	0	0	0	0
Cash dividends	0	0	0	-14	-21
Others	-22	-10	0	0	0
Net chg in cash	40	102	24	44	39
Beginning cash balance	12	51	153	177	221
Ending cash balance	51	153	177	221	260
NOPLAT	26	31	36	55	70
FCF	67	106	30	54	58

[Daishin House View: Industry 4.0 safety rating]

- Daishin Securities assigns safety ratings to individual sectors and companies based on analyses and discussions by our analysts.
- Depending on whether Industry 4.0 will have a positive, neutral, or negative impact, each industry and company is assigned one of three safety ratings:

Dark Gray (negative)	Neutral Green (neutral)	Sky Blue (positive)
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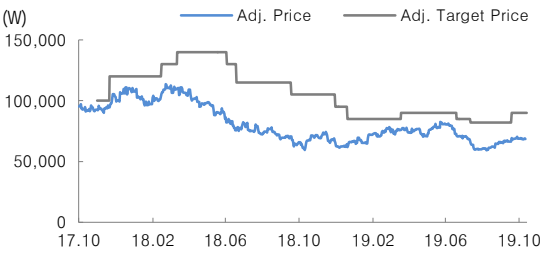
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	19.10.31	19.05.07	18.11.07	18.08.08	18.04.29	18.01.28
Rating	BUY	6M passed.	BUY	MKTPERF.	MKTPERF.	MKTPERF.
Target price	115,000	115,000	115,000	95,000	81,000	74,000
Diff. (avr. %)		(40.71)	(17.43)	10.95	26.80	19.40
Diff. (max/min., %)		(21.39)	(0.78)	22.42	(1.73)	(3.51)

Date	17.11.25
Rating	BUY
Target price	46,000
Diff. (avr. %)	44.64
Diff. (max/min., %)	25.65

Date	
Rating	
Target price	
Diff. (avr. %)	
Diff. (max/min., %)	

Date	
Rating	
Target price	
Diff. (avr. %)	
Diff. (max/min., %)	

Investment rating breakdown and framework (Oct 28, 2019)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	88.6%	10.4%	0.0%

Sector ratings breakdown

- Overweight: industry indicators are expected to outperform the market over the next six months.
- Neutral: industry indicators are expected to be in line with the market over the next six months.
- Underweight: industry indicators are expected to underperform the market over the next six months.

Company ratings breakdown

- Buy: the stock is expected to outperform the market by at least 10%p over the next six months.
- Marketperform: the stock is expected to either outperform or underperform the market by less than 10%p over the next six months.
- Underperform: the stock is expected to underperform the market by at least 10%p over the next six months.