

Studio Dragon

(253450 KQ/Buy)

Priced to buy

- 3Q19 review: In-line results
- Production companies to benefit from platform competition in 2020
- Downside risk is limited; Accumulate shares in anticipation of 2020

3Q19 review: In-line results

For 3Q19, Studio Dragon reported consolidated revenue of W131.2bn (+6.0% YoY; all growth figures hereafter are YoY) and operating profit of W10.9bn (-49.3%). Operating profit was consistent with the consensus (W11.9bn) and our estimate (W10.9bn). Profit contracted YoY, affected by weaker licensing revenue caused by a high base of comparison (related to *Mr. Sunshine*). However, revenue reached a quarterly record, driven by the production of a new original drama (*Love Alarm*), the scaling up of intellectual properties, and an increase in the number of titles produced. Major globally licensed titles in the quarter included *Designated Survivor: 60 Days* (Netflix [NFLX/CP: US\$289.57]), *Hotel Del Luna* (regional sales), and *Arthdal Chronicles* (eight episodes to Netflix).

Platform competition to intensify in 2020

In 2020, we believe the media industry will once again face seismic changes due to competition among OTT platforms, leading to more bargaining power for content producers. In Korea, existing broadcast networks are strategically increasing content investments (SBS will air *The King: Eternal Monarch*), as are new platforms such as Wavve (broadcast networks + SK Telecom; W300bn in total by 2023). Overseas, Disney (DIS/CP: US\$132.96), Apple (AAPL/CP: US\$259.43), Warner Media, and NBCUniversal have launched OTT platforms, signaling intensifying content competition.

With new platforms likely to pursue regional expansion to achieve economies of scale, we expect production companies, including Studio Dragon, to benefit. This should materialize into key earnings variables, such as bigger production budgets across new platforms and higher pricing. For Studio Dragon's third original title (to air in 2020), we believe the cost per episode and margins are around double current levels. Global contract wins by production companies bear close watching going forward.

Accumulate shares in anticipation of 2020

We maintain our Buy call and target price of W87,000 on Studio Dragon. We see a number of potential tailwinds in 2020, including: 1) increases in budgets and pricing due to the emergence of multi-OTTs; 2) content collaboration in Western countries (launch of US subsidiary is imminent); and 3) the opening of the Chinese market. We believe Studio Dragon is well-positioned to benefit from upcoming industry changes, given its undisputed market leadership. That said, the outlook for 4Q19 looks less promising, as the number of titles produced (i.e., top line) is set to decrease due to less content on the OCN channel. There are also upside risks to amortization expenses related to the changes in useful life applied since 3Q18. Still, we believe investors should accumulate shares, looking beyond the 4Q19 earnings headwinds to the company's transition into a global player in 2020.

FY (Dec.)	12/16	12/17	12/18	12/19F	12/20F	12/21F
Revenue (Wbn)	0	287	380	481	613	666
OP (Wbn)	0	33	40	39	71	80
OP Margin (%)	-	11.5	10.5	8.1	11.6	12.0
NP (Wbn)	0	24	36	33	57	61
EPS (W)	0	1,050	1,278	1,162	2,041	2,175
ROE (%)	0.0	12.9	9.3	7.8	12.4	11.7
P/E (x)	-	61.9	72.3	67.4	38.4	36.0
P/B (x)	-	4.9	6.5	5.1	4.5	4.0
Dividend Yield (%)	-	0.0	0.0	0.0	0.0	0.0

Note: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests

Source: Company data, Mirae Asset Daewoo Research estimates

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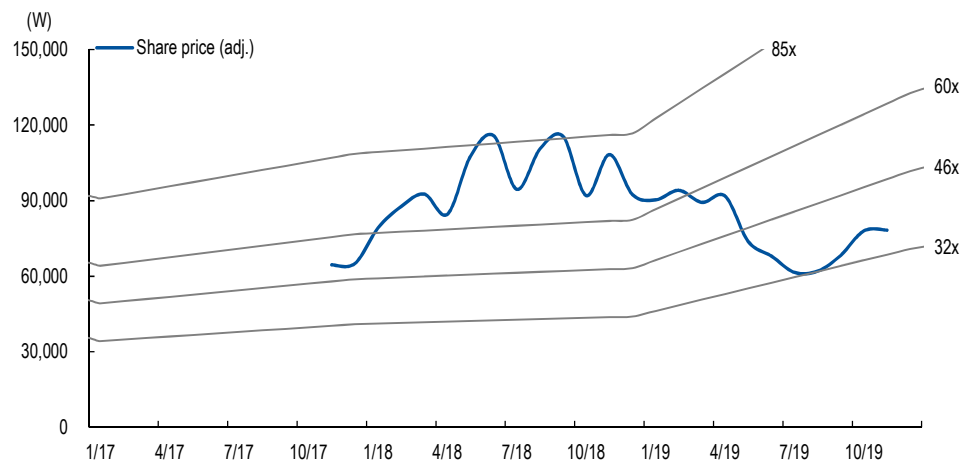
Table 1. Earnings and forecasts

(Wbn, %)

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19P	4Q19F	2018	2019F	2020F
Revenue	80	74	124	102	112	128	131	110	380	481	613
Programming	41	34	49	54	44	58	61	56	178	219	314
Licensing	32	29	63	38	56	60	60	44	162	221	254
Other	7	11	11	10	12	10	10	10	39	42	46
Costs	66	64	99	95	97	113	116	98	324	423	521
Production costs (excl. originals)	33	45	48	60	49	65	70	50	186	233	248
Commission fees	9	7	22	-1	15	10	15	11	37	51	63
Depreciation expenses on tangible/intangible assets	18	8	23	26	27	32	29	28	75	116	118
Other	7	4	6	10	6	6	2	2	27	16	18
Production costs for originals (Netflix)	0	0	0	0	0	0	8	7	0	15	48
Production costs for originals (China)	0	0	0	0	0	0	0	0	0	0	26
SG&A	3	3	3	6	4	5	4	6	16	19	21
EBITDA	28	15	45	26	38	43	40	35	115	156	190
Operating profit	11	7	22	0	11	11	11	7	40	39	71
OP margin	13.3	9.8	17.4	0.3	9.9	8.4	8.3	6.1	10.5	8.2	11.5
Pretax profit	11	11	22	2	13	12	13	6	46	44	74
Net profit	8	9	17	2	9	7	12	4	36	32	57
Net margin	9.8	12.0	14.0	1.6	8.2	5.7	8.8	4.1	9.4	6.7	9.4
YoY											
Revenue	6.0	19.6	59.7	41.5	40.0	72.5	6.0	8.3	32.4	26.8	27.4
Programming	54.5	41.1	17.1	39.5	8.4	70.5	24.4	2.1	35.7	22.7	43.6
Licensing	-12.0	9.5	172.0	46.9	75.1	109.2	-5.4	16.8	44.9	36.1	15.0
Other	-43.4	-1.9	-8.3	33.1	63.1	-14.1	-9.0	10.0	-9.8	7.1	8.0
EBITDA	17.9	-21.8	186.0	77.0	34.7	182.5	-10.8	31.7	54.7	36.0	21.1
Operating profit	-23.7	-18.4	224.0	-90.6	3.5	48.8	-49.3	1,965.4	20.3	-0.7	78.5
Net profit	-41.3	217.1	205.8	-18.2	16.1	-17.8	-33.1	174.1	49.6	-9.0	76.5
Major assumptions											
No. of titles aired	7.0	5.0	6.0	7.5	6.5	7.5	7.0	6.0	25.5	27.0	28.0
No. of titles licensed to Netflix	2.0	0.5	1.0	1.0	1.5	2.5	1.5	0.5	4.5	6.0	6.5

Note: Based on consolidated K-IFRS

Source: Company data, Mirae Asset Daewoo Research estimates

Figure 1. 12-month forward P/E: Historical trough multiple prior to the airing of *Arthdal Chronicles* was 45x

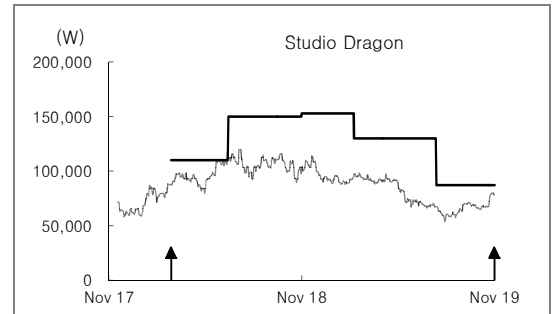
Source: WISEfn, Mirae Asset Daewoo Research estimates

APPENDIX 1

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2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Studio Dragon (253450)	07/21/2019	Buy	87,000
	02/15/2019	Buy	130,000
	11/08/2018	Buy	153,000
	06/22/2018	Buy	150,000
	03/06/2018	Buy	110,000



Stock Ratings

Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

Industry Ratings

Overweight	: Fundamentals are favorable or improving
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Ratings and Target Price History (Share price (—), Target price (—), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

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