

Studio Dragon (253450 KQ)

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Rating **BUY**
maintain

6M TP (₩) **115,000**
maintain

CP (₩)
(19.11.07) **78,300**

Media

Industry 4.0 safety rating ■ Neutral Green

KOSDAQ	666.15
Market cap (Wbn)	2,200
Market cap portion (%)	0.93
Paid-in capital (common; Wbn)	14
52w high/low (₩)	114,100 / 54,000
120d avg. trading volume (Wbn)	9.0
Foreign ownership (%)	2.92
Major shareholders	CJ ENM+3: 74.33%

(%)	1M	3M	6M	12M
Abs. return	19.0	40.1	-13.8	-19.7
Rel. return	12.0	18.7	-2.5	-17.7



Content takes center stage

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 26% over the next five years and an increase in its annual drama production volume (from the current 25 to 40 titles).

3Q19 results confirm a strong earnings base

- For 3Q19, Studio Dragon reported revenue of W130.0bn (up 6% yoy; up 2% qqq) and OP of W10.9bn (down 49% yoy; up 1% qqq), which are in line with our estimates.
- OP looks decent, in our view, considering the tough comparison (strong performance of *Mr. Sunshine* last year) and break-even performance of the much anticipated *Arthdal Chronicles*. It also remained above the W10bn mark for the third consecutive quarter, proving the company's still-solid earnings base.
- Programming and distribution each accounted for 46% of companywide revenue in 3Q19. The company saw programming revenue from non-captive accounts climb to a record W10.4bn and steady growth in distribution revenue from overseas customers, which offset some shortfalls in domestic distributions and non-captive programming.
- Studio Dragon, a production arm of media titan CJ ENM, has a solid base of captive customers such as tvN and OCN and its content sales to Netflix and other global OTT platforms are increasing at a steady pace.

Content is at the fore front

- Studio Dragon's stock, which plunged on vague concerns about content rather than actual earnings results, is returning to normal, driven by the race to launch OTT platforms both at home and abroad.
- Arthdal Chronicles* reached the break-even point prior to airing. Its average viewership, however, was in the 7% range, which is higher than tvN's total average (5%) but still lower than that of previous tentpole dramas. But it's important to keep in mind that viewer ratings don't directly affect ad rates in the short term.
- Studio Dragon's two new dramas *Catch the Ghost* and *Crash Landing of Love* will air in 4Q19.
- Studio Dragon produced three dramas for non-captive customers (Netflix Original *Love Alarm*, MBC's *Spring Night*, and SBS' *Doctor John*) this year and will ramp up production to six in 2020. At the same time, six of its dramas will air on Netflix that year.
- Netflix is continuing to pour money into producing original content for the Asian audience, while we expect to see a host of new global OTT platforms such as Apple TV+, Disney+, and HBO Max entering the market within a year. While these global players haven't mentioned anything about investing in Korean content, they are likely to invest in Korean content and could even partner with Studio Dragon in 2020.
- Studio Dragon is seeking to push into the US using its content library. Once it sets up a subsidiary there in 1H20, the company plans to begin airing remakes of its popular dramas in 2H20, which should help boost overseas revenue share and strengthen alliances with global OTT platforms.

	3Q18	2Q19	Previous estimate	Result	3Q19			4Q19		
					YoY	QoQ	Consensus	Daishin estimate	YoY	QoQ
Revenue	124	128	137	131	6.0	2.3	128	131	28.9	-0.1
OP	21	11	11	11	-49.2	1.1	12	15	3,305.2	37.6
NP	17	7	11	12	-33.6	56.9	9	14	729.3	25.7

	2017	2018	Previous estimate	Daishin estimate	2019(F)		Growth	
					Chg	Consensus	2018	2019(F)
Revenue	287	380	475	502	5.7	492	32.4	32.3
OP	33	40	49	48	-2.1	47	21.0	19.6
NP	24	36	43	43	-1.2	39	50.3	18.7

Source: Studio Dragon, FnGuide, Daishin Securities Research Center

Operating results and major financial data (Wbn, W, x, %)

	2017A	2018A	2019F	2020F	2021F
Revenue	287	380	502	547	619
OP	33	40	48	74	94
Pretax profit	30	46	57	87	108
NP	24	36	43	64	80
NP (controlling int.)	24	36	43	64	80
EPS	1,050	1,278	1,515	2,286	2,842
PER	61.9	72.3	51.7	34.2	27.6
BPS	16,223	14,312	15,813	17,584	19,676
PBR	4.0	6.5	5.0	4.5	4.0
ROE	9.5	9.3	10.1	13.7	15.3

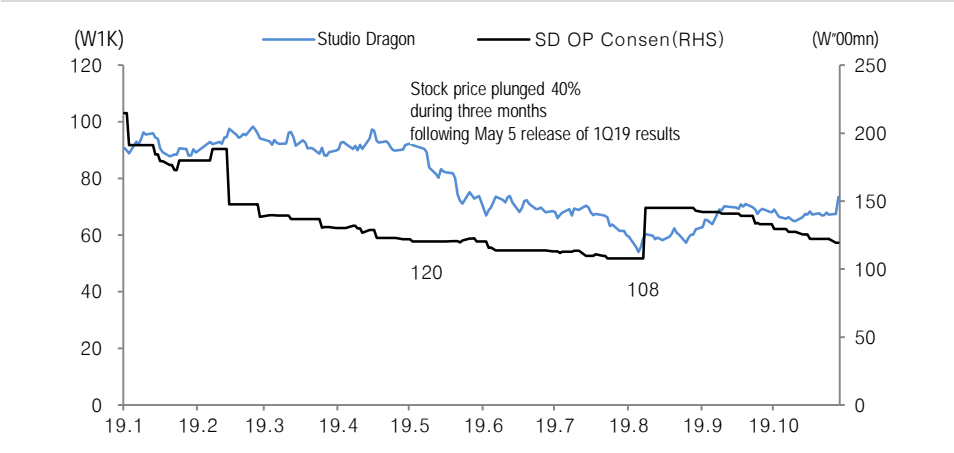
Note: EPS, BPS, and ROE are based only on the controlling interest.
Source: Studio Dragon, Daishin Securities Research Center

Yearly earnings forecast revision (Wbn, W, %, %p)

	Previous		Revised		Chg	
	2019F	2020F	2019F	2020F	2019F	2020F
Revenue	475	519	502	547	5.7	5.4
SG&A expense	14	12	16	12	11.2	0.0
OP	49	74	48	74	-2.1	-0.7
OP margin	10.3	14.3	9.5	13.5	-0.8	-0.8
Non-operating profit	10	13	9	13	-11.0	0.0
Pretax profit	59	87	57	87	-3.6	-0.6
NP (controlling int.)	43	65	43	64	-1.2	-0.6
NP margin	9.1	12.5	8.5	11.8	-0.6	-0.7
EPS (controlling int.)	1,534	2,300	1,515	2,286	-1.2	-0.6

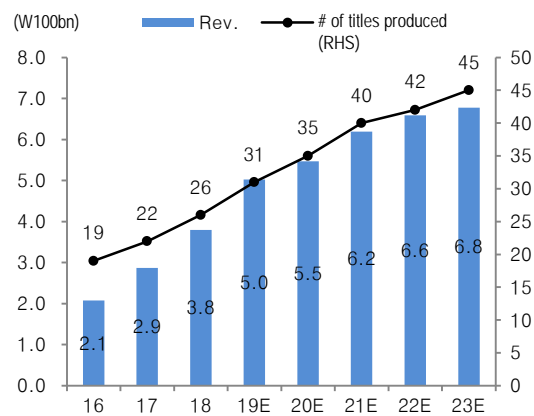
Source: Studio Dragon, Daishin Securities Research Center

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



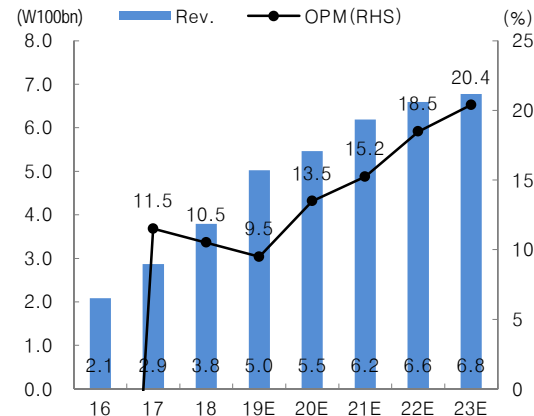
Source: FnGuide, Daishin Securities Research Center

Fig 2. Revenue rising on increased drama production



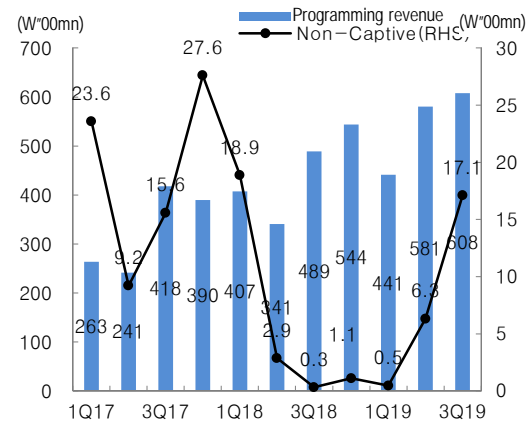
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 3. OP to rise 28% annually through 2023



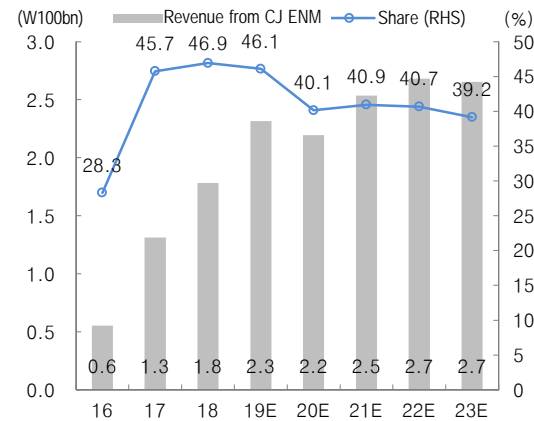
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 4. # of non-captive programming soars



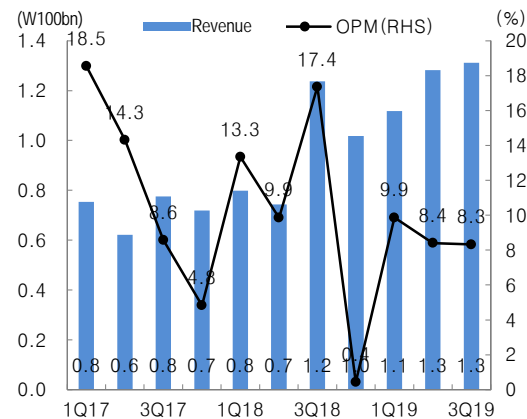
Source: Studio Dragon, Daishin Securities Research Center estimates

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



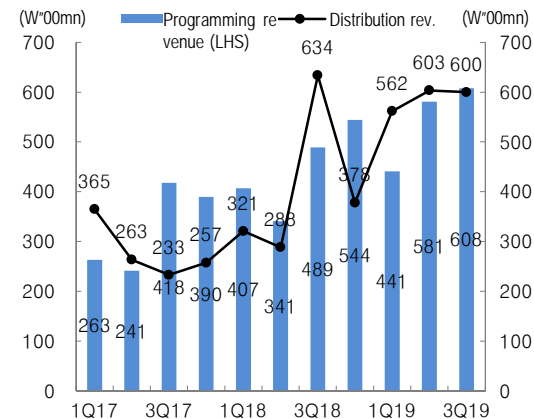
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 6. Quarterly revenue on the rise



Source: Studio Dragon, Daishin Securities Research Center

Fig 7. Both programming and distribution revenue rise



Source: Studio Dragon, Daishin Securities Research Center

1. Company profile

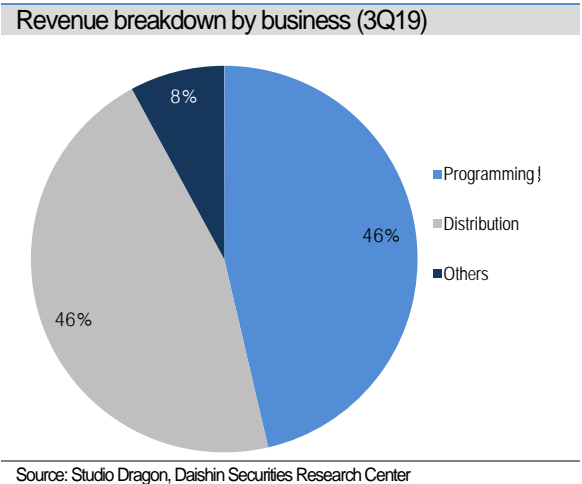
Overview

- Spun off from CJ E&M in May 2016
- Listed on the KOSDAQ in Nov 2017
- Revenue W379.6bn, OP W39.9bn, NP W35.8bn (2018)
- Revenue mix: programming 46%, distribution 46%, others 8% (3Q19)

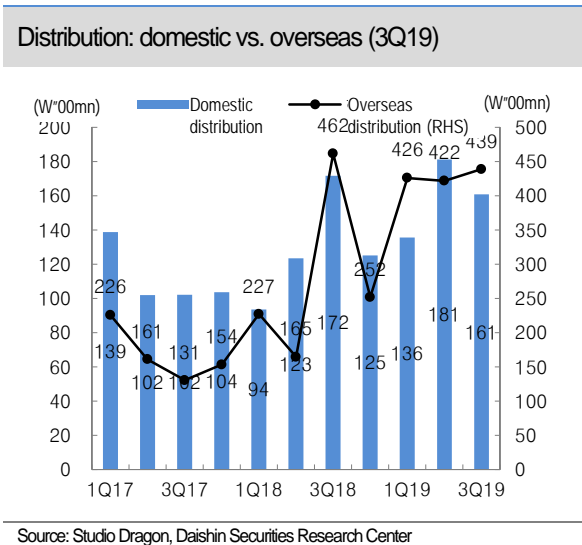
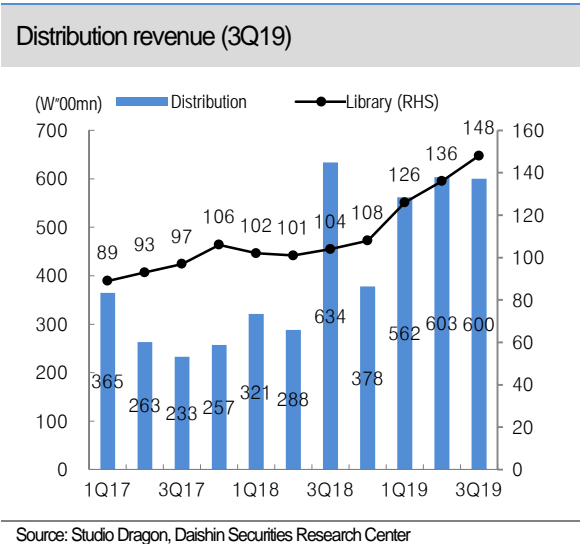
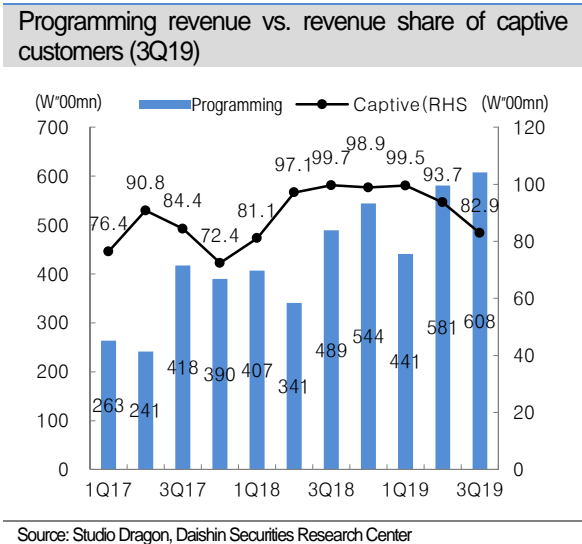
Share price catalysts

- Earnings are rising steadily on increased drama supply to CJ ENM's channels tvN and OCN as well as Netflix.
- But the stock will likely rebound if earnings come in favorable owing to rising viewer ratings of major dramas.

Source: Studio Dragon, Daishin Securities Research Center



2. Earnings drivers



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	64	80	100	113	127	142	159	178	199
II	Shareholders' equity (contr. int.) ^(Note 2)	444	494	553	629	713	803	901	1,010	1,125	1,253
	Estimated ROE	10.1	13.7	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)	5.5	9.1	10.7	11.4	11.3	11.2	11.2	11.1	11.2	11.3
V	Required income	19	20	23	25	29	33	37	41	47	52
VI	Residual income (I - V)	24	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	0.70	0.66
	PV of residual income	24	42	52	65	70	75	80	86	92	98
VII	Sum of residual income	683									
VIII	PV of residual income following forecasting period	2,134									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	401									
X	Fair market cap (VII+VIII+IX)	3,218									
	Total number of shares (thousands)	28,095									
XI	Per share value (W)	114,530									
	Current share price (W)	78.300									
	Potential (%)	46.3%									

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	502	547	619
Cost of goods sold	240	324	439	461	511
Gross profit	47	56	64	86	108
SG&A expenses	14	16	16	12	14
OP	33	40	48	74	94
OP margin	11.5	10.5	9.5	13.5	15.2
EBITDA	74	115	150	177	206
Non-OP	-3	6	9	13	14
Income from affiliates	0	0	0	0	0
Financial revenue	1	7	15	13	14
FX related gains	0	0	0	0	0
Financial expense	-3	-1	-6	-1	-1
FX related losses	1	0	0	0	0
Others	0	0	0	1	1
Income before taxes	30	46	57	87	108
Income tax expense	-6	-10	-14	-23	-28
Income from cont. op.	24	36	43	64	80
Income from discount op.	0	0	0	0	0
NP	24	36	43	64	80
NP margin	8.3	9.4	8.5	11.8	12.9
NP for non-cont. interest	0	0	0	0	0
NP for contr. interest	24	36	43	64	80
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	-1	-1	-1	-1
Comprehensive income	24	35	41	63	79
Comp. income for non-cont. int.	0	0	0	0	0
Comp. income for contr. int.	24	35	41	63	79

Valuation metrics (W, x, %)					
	2017A	2018A	2019F	2020F	2021F
EPS	1,050	1,278	1,515	2,286	2,842
PER	61.9	72.3	51.7	34.2	27.6
BPS	16,223	14,312	15,813	17,584	19,676
PBR	4.0	6.5	5.0	4.5	4.0
EBITDAPS	3,271	4,108	5,351	6,298	7,342
EV/EBITDA	22.1	21.1	13.5	11.2	9.4
SPS	12,628	13,539	17,899	19,455	22,046
PSR	5.1	6.8	4.4	4.0	3.6
CFPS	3,068	3,930	5,240	6,408	7,453
DPS	0	0	500	750	850

Financial ratios (W, x, %)					
	2017A	2018A	2019F	2020F	2021F
Growth potential					
Sales growth	85.7	32.4	32.3	8.8	13.3
OP growth	98.3	21.0	19.6	54.5	28.0
NP growth	192.9	50.3	18.7	51.0	24.3
Profitability					
ROIC	17.0	16.0	15.6	22.3	26.9
ROA	9.4	8.2	8.9	12.5	14.6
ROE	9.5	9.3	10.1	13.7	15.3
Stability					
Debt ratio	24.7	27.7	26.5	24.2	22.3
Net borrowings ratio	-49.5	-39.3	-40.1	-44.8	-46.7
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	290	341	392
Cash & cash equiv.	51	153	173	217	254
Trade & other receive.	55	69	91	99	112
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	561	614	676
Current liabilities	91	108	115	117	121
Payables & other liab.	34	60	66	69	72
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	117	120	123
Controlling interest	368	401	444	494	553
Capital stock	14	14	14	14	14
Capital surplus	320	320	320	320	320
Retained earnings	32	68	110	160	219
Other capital changes	3	0	0	0	0
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	368	401	444	494	553
Net borrowings	-183	-158	-178	-221	-258

Cash flow statement (Wbn)					
	2017A	2018A	2019F	2020F	2021F
Operating cash flows	-7	-29	-6	26	47
NP	0	0	43	64	80
Non-cash items	46	74	105	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	2	13	18
Chg in assets & liab.	-73	-139	-154	-144	-148
Other cash flows	20	36	1	-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	20	43	37
Beginning cash balance	12	51	153	173	217
Ending cash balance	51	153	173	217	254
NOPLAT	26	31	36	55	70
FCF	67	106	30	53	58

[Daishin House View: Industry 4.0 safety rating]

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- 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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[Investment rating & Target price history]

