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Company Update

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Studio Dragon (253450)

A steady performance in 3Q

- Studio Dragon's 3Q operating profit of KRW10.9b (down 49% y-y) met consensus and our forecasts. The decline in operating profit was expected given: 1) a high base from the sale of *Mr. Sunshine* copyright overseas; and 2) *Arthdal Chronicles*' limited contribution. Sales to non-captive clients are on the rise.
- Notably, Studio Dragon is producing more dramas on distribution channel diversification, and its business area expansion is accelerating.
- We raise our target price to KRW94,000 on solid 2020 earnings prospects.

WHAT'S THE STORY?

3Q review: Consolidated 3Q results from Studio Dragon show sales of KRW131.2b (up 6.1% y-y) and operating profit of KRW10.9b (down 49.2% y-y), meeting consensus (which recently declined) and our forecasts. The y-y drop in profit came as no surprise given: 1) a high base from the sale of *Mr. Sunshine* copyright overseas; and 2) a lackluster contribution from *Arthdal Chronicles*. The company diversified its drama distribution channels—*ie*, by providing three dramas to non-captive clients—and booked sales of tent-pole dramas in the quarter.

Distribution channel expansion leads to more drama production: This year, Studio Dragon has supplied three dramas to non-captive customers—namely, *Love Alarm* (its first original program for Netflix), and *One Spring Night* and *Doctor John* (to terrestrial broadcasters). It should further diversify distribution channels next year, driving up the number of dramas it produces. For now, it is scheduled to provide three dramas to unaffiliated customers—namely, *The King* (to SBS), and *Love Alarm 2* and *I Am Alone* (to Netflix)—but this number could increase to six as the firm is in negotiations with other global OTT service providers. Studio Dragon should see earnings ratchet up as it produces more dramas, invests more per drama, and sees its margins improve.

Expanding business areas based on popular IP, production capabilities: Studio Dragon's regional and business-area expansions should gain momentum in 2020. It should wrap up the process of establishing a US subsidiary by early next year at the latest, with the company going active in 2H20. Pilot broadcasting of drama remake *Live* should be decided sometime in 1Q20. The parent will likely make some of its dramas into movies for better use of intellectual property (IP) and to create synergies with established businesses.

AT A GLANCE

SELL HOLD **BUY**

Target price KRW94,000 (20.1%)

Current price KRW78,300

Market cap KRW2.2t/USD1.9b
Shares (float) 28,095,260 (25.3%)
52-week high/low KRW114,100/KRW54,000
Avg daily trading value (60-day) KRW7.0b/USD6.0m

ONE-YEAR PERFORMANCE

	1M	6M	12M
Studio Dragon (%)	19.0	-13.8	-19.7
Vs Kosdaq (%pts)	12.0	-2.5	-17.7

KEY CHANGES

(KRW)	New	Old	Diff
Recommend.	BUY	BUY	
Target price	94,000	88,000	6.8%
2019E EPS	1,438	1,249	15.1%
2020E EPS	2,676	2,210	21.1%

SAMSUNG vs THE STREET

No of estimates	21
Target price	90,048
Recommendation	4.0

BUY★★★: 5 / BUY: 4 / HOLD: 3 / SELL: 2 / SELL★★★: 1

SUMMARY OF 3Q19 RESULTS

(KRWb)	3Q19	Chg		Diff (%)	
		(% y-y)	(% q-q)	Samsung	Consensus
Sales	131.2	6.0	2.3	1.2	2.5
Operating profit	10.9	(49.2)	1.2	(0.1)	(8.6)
Pre-tax profit	13.1	(40.6)	10.1	8.5	11.0
Net profit	11.5	(33.5)	57.1	43.3	22.4
Margins (%)					
Operating profit	8.3				
Pre-tax profit	10.0				
Net profit	8.8				

Source: Company data, Samsung Securities estimates

VALUATION SUMMARY

	2018	2019E	2020E
Multiples (x)			
P/E	61.3	54.5	29.3
P/B	5.5	5.0	4.3
EV/EBITDA	17.8	15.2	10.8
Div yield (%)	0.0	0.0	0.0
EPS growth (% y-y)	21.7	12.5	86.1
ROE (%)	9.3	9.6	15.7
Per-share data (KRW)			
EPS	1,278	1,438	2,676
BVPS	14,305	15,720	18,395
DPS	0	0	0

Moving step-by-step: As we change our valuation base to 2020, we revise up our 12-month target price by 7% to KRW94,000 (based on 15.8x 2020 EV/EBITDA). In 4Q, Studio Dragon should book copyright sales from *Everyone's Lies* (aired on OCN) and *Emergency Lands Of Love* (tvN). In 2020, it should have more business opportunities via the US subsidiary and recognize earnings from movie production. There has been a wide range of news related to China's market opening, but nothing has changed yet. If China opens up, Studio Dragon's earnings should grow substantially via: 1) the sale of its dramas; 2) the recognition of more overseas copyright sales from tent-pole dramas (currently in production); and 3) the sale of Netflix original series to Chinese clients.

Table 1. Summary of 3Q results

(KRWb)	3Q18	2Q19	3Q19	Chg (% q-q)	Chg (% y-y)	Samsung	Diff (%)	Consensus	Diff (%)
Sales	123.7	128.2	131.2	2.3	6.0	129.6	1.2	127.9	2.5
Operating profit	21.5	10.8	10.9	1.2	(49.2)	10.9	(0.1)	11.9	(8.6)
Operating margin(% , %pts)	17.4	8.4	8.3	(0.1)	(9.0)	8.4	(0.1)	9.3	(1.0)
Pre-tax profit	22.1	11.9	13.1	10.1	(40.6)	12.1	8.5	11.8	11.0
Net profit (controlling)	17.3	7.3	11.5	57.1	(33.5)	8.0	43.3	9.4	22.4

Source: Company data, Samsung Securities

Table 2. Studio Dragon: Financial results and forecasts

(KRWb)	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19E	2018	2019E	2020E
Sales	75.3	62.1	77.5	71.9	79.9	74.3	123.7	101.7	111.8	128.2	131.2	124.9	379.6	496.2	598.1
Programing	26.3	24.1	41.8	39.0	40.7	34.1	48.9	54.4	44.1	58.1	60.8	62.7	178.1	225.7	270.5
Distribution	36.5	26.3	23.3	25.7	32.1	28.8	63.4	37.8	56.2	60.3	60.0	51.5	162.1	227.9	282.6
Other	12.5	11.6	12.4	7.2	7.1	11.4	11.4	9.5	11.5	9.8	10.4	10.7	39.4	42.4	44.9
Gross profit	16.8	12.2	10.7	7.4	13.6	10.6	24.8	6.5	15.0	15.4	15.3	17.6	55.6	63.3	91.9
SG&A costs	2.8	3.3	4.0	4.0	3.0	3.3	3.3	6.0	4.0	4.6	4.4	5.7	15.7	18.7	20.5
Operating profit	14.0	8.9	6.6	3.5	10.7	7.3	21.5	0.4	11.0	10.8	10.9	11.8	39.9	44.6	71.4
Non-operating profit	(0.7)	0.1	(0.3)	(1.8)	0.2	3.7	0.6	1.3	2.1	1.1	2.2	1.4	5.7	6.8	10.0
Pre-tax profit	13.2	9.0	6.4	1.7	10.8	11.0	22.1	1.7	13.2	11.9	13.1	13.3	45.7	51.5	81.4
Net profit	13.4	2.8	5.7	2.0	7.9	8.9	17.3	1.7	9.2	7.3	11.5	12.4	35.8	40.4	75.2
Gross margin	22.2	19.6	13.9	10.4	17.1	14.3	20.1	6.4	13.4	12.0	11.7	14.1	14.6	12.8	15.4
Operating margin	18.5	14.3	8.6	4.8	13.3	9.9	17.4	0.4	9.9	8.4	8.3	9.5	10.5	9.0	11.9
Net margin	17.8	4.5	7.3	2.8	9.8	12.0	14.0	1.7	8.2	5.7	8.8	9.9	9.4	8.1	12.6
Chg (% y-y)															
Sales	-	-	-	-	6.0	19.6	59.7	41.5	40.0	72.6	6.0	22.8	32.4	30.7	20.5
Programing	-	-	-	-	54.5	41.1	17.1	39.5	8.4	70.5	24.4	15.3	35.7	26.8	19.8
Distribution	-	-	-	-	(12.0)	9.5	172.0	46.9	75.1	109.2	(5.4)	36.3	44.9	40.7	24.0
Other	-	-	-	-	(43.4)	(1.9)	(8.3)	33.1	63.1	(14.1)	(9.0)	12.4	(9.8)	7.6	5.9
Gross profit	-	-	-	-	(18.6)	(12.8)	131.0	(12.9)	9.9	45.1	(38.4)	171.2	17.9	13.9	45.2
SG&A costs	-	-	-	-	7.3	0.2	(16.6)	51.9	33.1	40.2	31.0	(4.9)	11.5	19.5	9.6
Operating profit	-	-	-	-	(23.7)	(17.6)	223.0	(87.3)	3.5	47.3	(49.2)	2,590.9	21.0	11.7	60.2
Non-operating profit	-	-	-	-	(Turned pos)	3,948.9	(Turned pos)	(Turned pos)	1,160.7	(71.7)	290.9	10.5	(Turned pos)	18.7	46.9
Pre-tax profit	-	-	-	-	(18.2)	23.0	247.7	1.9	22.2	7.6	(40.6)	670.6	51.0	12.6	58.1
Net profit	-	-	-	-	(41.3)	217.4	206.3	(12.6)	17.2	(17.4)	(33.5)	607.8	50.3	12.8	86.0
Gross margin	-	-	-	-	(5.2)	(5.3)	6.2	(4.0)	(3.7)	(2.3)	(8.4)	7.7	(1.8)	(1.9)	2.6
Operating margin	-	-	-	-	(5.2)	(4.5)	8.8	(4.4)	(3.5)	(1.4)	(9.0)	9.0	(1.0)	(1.5)	3.0
Net margin	-	-	-	-	(7.9)	7.5	6.7	(1.1)	(1.6)	(6.2)	(5.2)	8.2	1.1	(1.3)	4.4

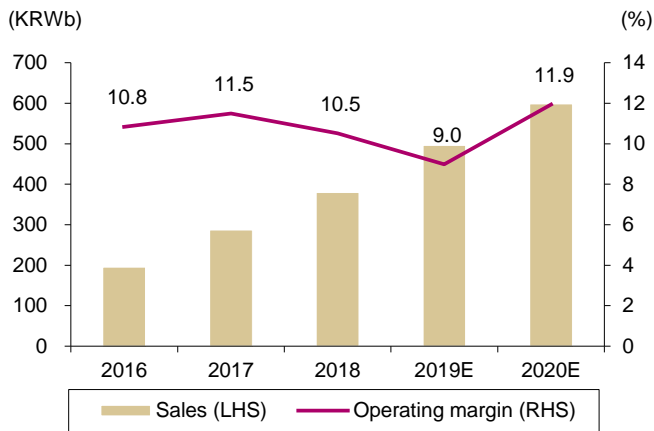
Source: Company data, Samsung Securities estimates

Table 3. 2H19-2020 drama line-up

Year	No.	Channel	Title	Air date	Episodes	Writers	Director	Leading actors	Days
2019	1	tvN	60 Days, Designated Survivor	Jul 1-Aug 20	16	Kim Tae Hui	Yoo Jong-Sun	Jin Ji-hee, Lee Jun-hyuk, Heo Jun-ho	Mon, Tue
	2		Hotel Del Luna	Aug 3-Sep 22	16	Hong Jung-eun, Hong Mi-ran	Oh Chung-hwan	Lee Ji-eun(IU), Yeo Jin-gu	Sat, Sun
	3		Faust	Jul 31-Sep 19	16	No Hye-Young	Min Jin-Ki	Jeong Kyeong-Ho, Go Ah-Sung	Sat, Sun
	4		The great show	Aug.26~	16	Sul Joon-suk	Shin Yong-hwi	Song Seung-hun, Lee Sun-bin	Mon, Tue
	5		Arthdal Chronicles (Season 1, part 3)	Sep 7-Sep 22	6	Kim Young-Hyun, Park Sang-Yeon	Kim, Won-Suk	Song Jong-Ki, Jang Dong-Gun, Kim, Ji-Won	Sat, Sun
	6		Miss Lee	September		Park Jung-hwa	Han Dong-hwa	Lee Hye-ri, Kim Sang-kyeong,	Wed, Thu
	7		Catch the ghost!	Oct 21~		So Won, Lee Young-joo	Shin Yun-sup	Moon Guen-young, Kim Sun-ho	Mon, Tue
	8		Melting Me Softly	Oct 19-Dec 8	16	Baek Mi-kyeong	Shin Woo-chul	Ji Chang-wook, Won Jin-ah, Yoon Se-ah	Sat, Sun
	9		Psychopath Diary	November		Ryu Yong-jae	Lee Jong-jae	Yoon Si-yoon, Jung In-sun	Wed, Thu
	10		Emergency Lands Of Love	December		Park Ji-eun	Lee Jung-hyo	Hyeon Bin, Son Ye-jin, Seo Ji-hye	Sat, Sun
	11	Netflix	Love Alarm (Season 1)	Aug 22	8	Lee Ah-yeon, Seo Bo-ra	Lee Na-jung	Kim So-hyun, Jung Garam, Song Kang	
	12	OCN	Undercover Teacher	Jul 17-Sep 15	16	Jang Hong-Cheol	Seong Yong-il	Yoon Gyun-sang, Geumsae-rok	Wed, Thu
	13		Watcher	Jul 6-Aug 25	16	Han Sang-woon	Ahn Gil-ho	Han Seok-gyu, Seo Kang Jun	Sat, Sun
	14		Strangers From Hell	8.31~	10	Jung Eh-Doh	Lee Chang-hui	Im Si-wan, Lee Dong Wook	Sat, Sun
	15		Running Investigators	September	16	Baek Jung-chul	Kim Yong-su	Lee Yo-won, Choi Kwi-hwa, Jang Hyeon-sung	Wed, Thu
	16		Everyone's Lies	October		Jun Young-shin, Won Yu-jung	Lee Yun-jung	Lee Min-ki, Lee Yu-young, Yoon Jong-suk	Sat, Sun
2020	17	SBS	Doctor John	Jul 19-Sep 7	16	Kim Ji-woon	Jo Su-won, Kim Young-hwan	Ji Sung, Lee Se-young, Lee Kyu-hyung, Hwang Hee	Fri, Sat
	1	tvN	Black Dog	Jan	16	Park Ju Yeon	Hwang Jun Hyeok	Seo Hyeon Jin, Ra Mi Ran	Mon, Tue
	2		Half Of Half	Mar	16	Lee Sook Yeon	Lee Sang Yeob	Jung Hae In, Chae Soo Bin	Mon, Tue
	3		Money Game	2020		Lee Young Mi	Kim Sang Ho	Ko Soo, Sim Eun Kyeong	Wed, Thu
	4		Method	2020		Yeon Sang Ho	Kim Yong Wan	Um Ji Won, Sung Dong Il	
	5		Live (Season 2)	2020			Kim Sang Ho		
	6		Secret Forest (Season 2)	2020		Lee Su Yeon	Park Hyeon Suk	Cho Seun Woo, Yoon Sae Ah	
	7		Signal (Season 2)	2020		Kim Eun Hee		Kim Hye Soo, Jo Jin Woong	
	8		Younger	2020		Jung Hyeon Jung	Lee Jung Hyo	Lee Jong Suk(TBD)	
	9	OCN	Rugal	2020		Do Hyeon	Kang Chul Woo	Park Sung Woong, Choi Jin Hyeok	
	10		Extramarital Investigation	2020		Lee Yu Jin	Kang Hyo Jin	Cha Tae Hyeon(TBD)	
	11		Dark Hole	2020		Jeong I-do			
	12		Call It Like You See It	2020		Ko Young Jae	Lee Jun Hyeong	Jang Hyeok, Jin Su Yeon	
	13		Search	2020					
	14		Possession	2020					
	15		Missing	2020					
	16		Train	2020					
	17		Fifth Column	2020					
	18		Miss & Mrs. Cops	2020					
	19		Island	2020					
	20	Netflix	Love Alarm (Season 2)	2020		Lee Ah-yeon, Seo Bo-ra	Lee Na-jung	Kim So-hyun, Jung Garam, Song Kang	
	21		I am Alone	2020		Ryu Yong-jae	Lee Sang Yeob	Yoon Hyun-min, Go Sung-hee	
	22	SBS	The King: Eternal Monarch	2020	16	Kim Eun-sook	Baek Sang-hoon	Lee Min-ho, Kim Go-eun, Woo Do-hwan	Fri, Sat
	23	TBD	Golden Hour	1H20		So Hyeon Kyeong, On Lee Won			
	24		True Beauty	2020					

Source: Company data, Samsung Securities

Chart 1. Annual sales and operating margin



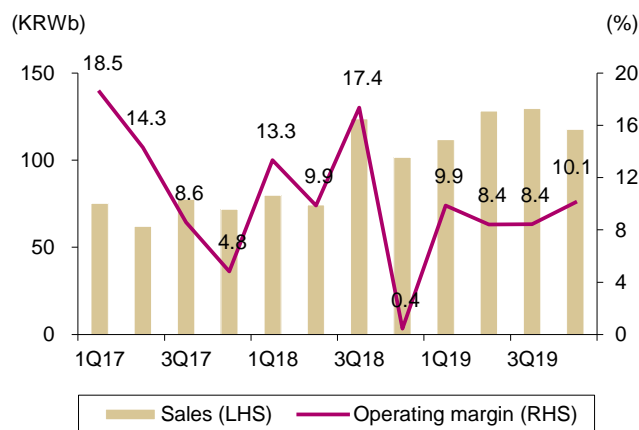
Source: Company data, Samsung Securities

Chart 2. Netflix originals in 2020: Love Alarm 2; I Am Alone



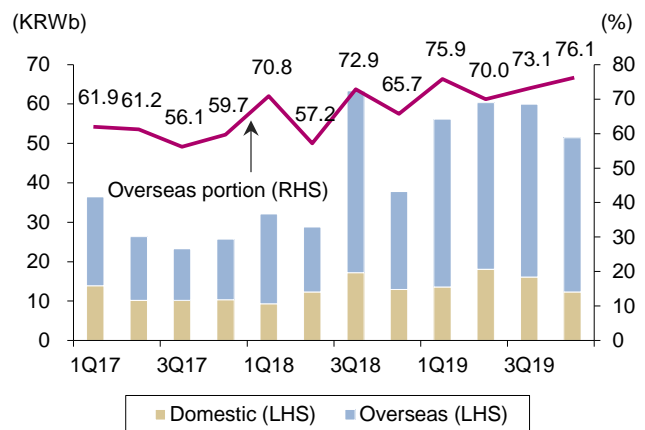
Source: Netflix, Samsung Securities

Chart 3. Quarterly sales and operating margin



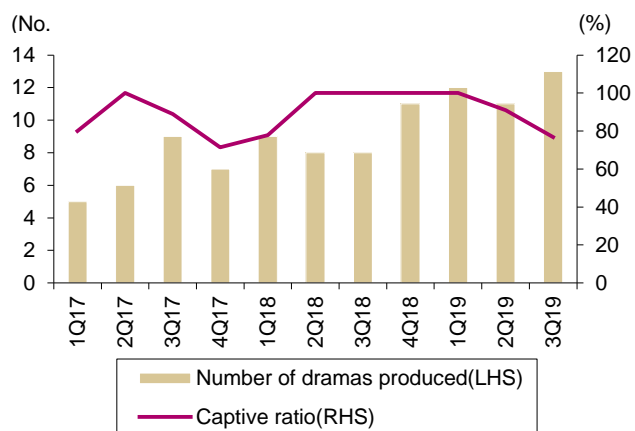
Source: Company data, Samsung Securities estimates

Chart 4. Sales: Domestic and overseas



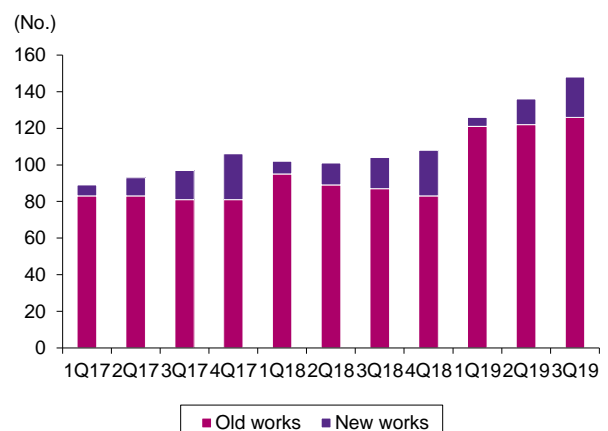
Source: Company data, Samsung Securities estimates

Chart 5. Studio Dragon: Number of dramas produced, by quarter vs captive ratio



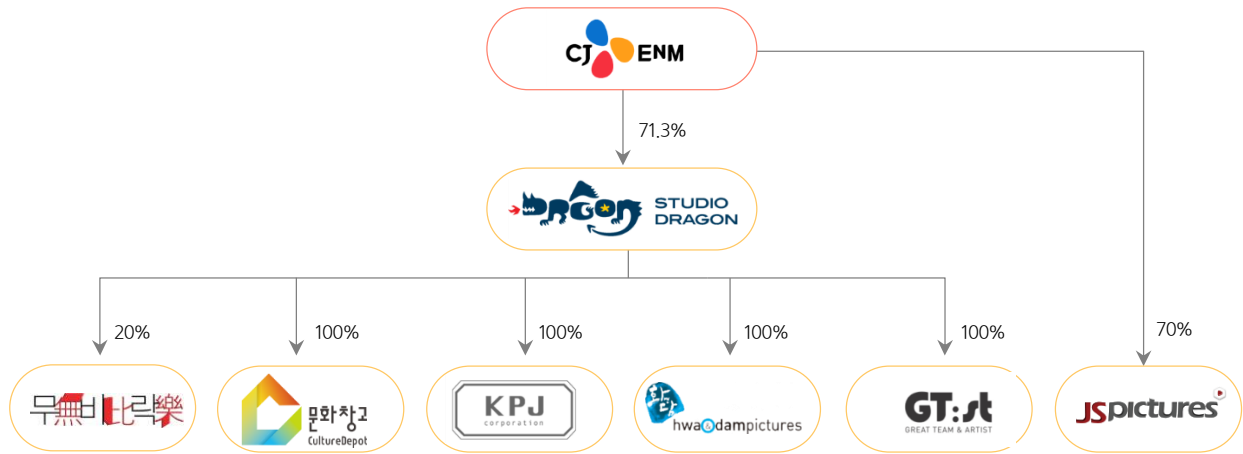
Source: Company data, Samsung Securities

Chart 6. Drama library: Number of dramas sold



Source: Company data, Samsung Securities

Chart 7. Corporate structure



Source: Company data, Samsung Securities

Income statement

Year-end Dec 31 (KRWb)	2017	2018	2019E	2020E	2021E
Sales	287	380	496	598	663
Cost of goods sold	240	324	433	506	554
Gross profit	47	56	63	92	109
Gross margin (%)	16.4	14.6	12.8	15.4	16.4
SG&A expenses	14	16	19	21	22
Operating profit	33	40	45	71	86
Operating margin (%)	11.5	10.5	9.0	11.9	13.0
Non-operating gains (losses)	(3)	6	7	10	12
Financial profit	1	7	14	17	18
Financial costs	3	1	7	6	5
Equity-method gains (losses)	0	0	0	0	0
Other	(0)	(0)	(0)	(0)	(0)
Pre-tax profit	30	46	51	81	99
Taxes	6	10	11	6	8
Effective tax rate (%)	21.2	21.5	21.5	7.6	7.6
Profit from continuing operations	24	36	40	75	91
Profit from discontinued operations	0	0	0	0	0
Net profit	24	36	40	75	91
Net margin (%)	8.3	9.4	8.1	12.6	13.8
Net profit (controlling interests)	24	36	40	75	91
Net profit (non-controlling interests)	0	0	0	0	0
EBITDA	74	115	132	179	204
EBITDA margin (%)	25.9	30.3	26.5	30.0	30.7
EPS (parent-based) (KRW)	1,050	1,278	1,438	2,676	3,247
EPS (consolidated) (KRW)	1,050	1,278	1,438	2,676	3,247
Adjusted EPS (KRW)*	1,050	1,278	1,438	2,676	3,247

Cash flow statement

Year-end Dec 31 (KRWb)	2017	2018	2019E	2020E	2021E
Cash flow from operations	(7)	(29)	129	182	207
Net profit	24	36	40	75	91
Non-cash profit and expenses	46	74	91	110	119
Depreciation	0	0	0	0	0
Amortization	41	75	87	108	117
Other	5	(1)	4	2	2
Changes in A/L from operating activities	(73)	(139)	9	3	4
Cash flow from investments	(141)	141	(126)	(137)	(144)
Change in tangible assets	(0)	(0)	0	0	0
Change in financial assets	(143)	139	(48)	(7)	(15)
Other	2	2	(78)	(130)	(129)
Cash flow from financing	188	(10)	(0)	(0)	(1)
Change in debt	(18)	(8)	0	0	(1)
Change in equity	208	1	0	0	0
Dividends	0	0	0	0	0
Other	(2)	(2)	(0)	(0)	(0)
Change in cash	40	102	4	45	62
Cash at beginning of year	12	51	153	157	202
Cash at end of year	51	153	157	202	264
Gross cash flow	70	110	132	185	210
Free cash flow	(7)	(29)	129	182	207

Note: * Excluding one off items, ** Fully diluted, excluding one-off items

*** From companies subject to equity-method valuation

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2017	2018	2019E	2020E	2021E
Current assets	290	247	322	400	490
Cash & equivalents	51	153	157	202	264
Accounts receivable	55	69	74	99	104
Inventories	1	1	1	1	1
Other current assets	182	25	90	97	120
Fixed assets	170	265	263	290	308
Investment assets	4	4	4	5	6
Tangible assets	1	1	1	1	0
Intangible assets	128	199	213	235	250
Other long-term assets	37	62	45	50	52
Total assets	459	512	585	690	798
Current liabilities	91	108	140	170	188
Accounts payable	6	20	18	26	27
Short-term debt	0	0	0	0	0
Other current liabilities	85	89	122	144	161
Long-term liabilities	0	3	3	3	2
Bonds & long-term debt	0	0	0	0	0
Other long-term liabilities	0	3	3	3	2
Total liabilities	91	111	143	173	190
Owners of parent equity	368	401	442	517	608
Capital stock	14	14	14	14	14
Capital surplus	320	320	320	320	320
Retained earnings	32	68	108	183	274
Other	3	(0)	(0)	(0)	(0)
Non-controlling interests' equity	0	0	0	0	0
Total equity	368	401	442	517	608
Net debt	(183)	(153)	(205)	(256)	(334)

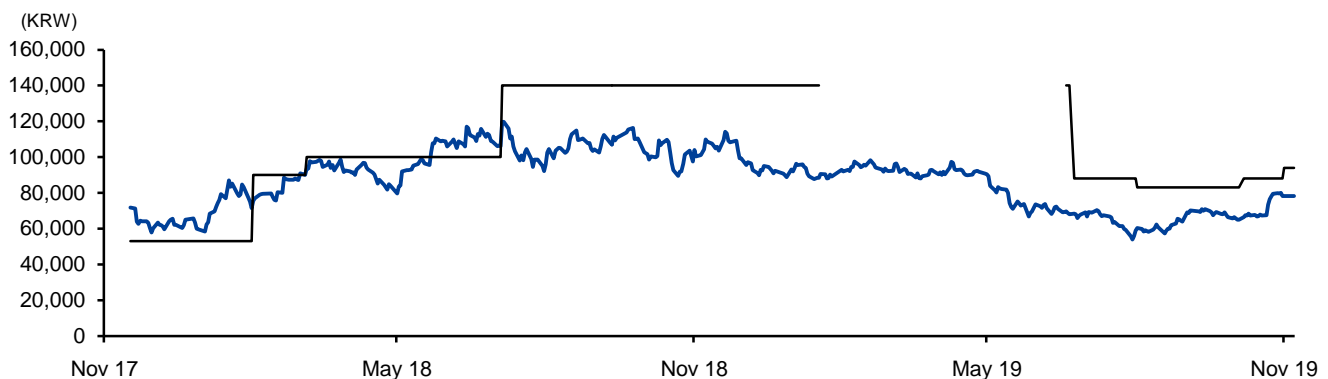
Financial ratios

Year-end Dec 31	2017	2018	2019E	2020E	2021E
Growth (%)					
Sales	85.7	32.4	30.7	20.5	10.9
Operating profit	98.3	21.0	11.7	60.2	21.0
Net profit	192.9	50.3	12.6	86.3	21.3
Adjusted EPS**	84.5	21.7	12.5	86.1	21.3
Per-share data (KRW)					
EPS (parent-based)	1,050	1,278	1,438	2,676	3,247
EPS (consolidated)	1,050	1,278	1,438	2,676	3,247
Adjusted EPS**	1,050	1,278	1,438	2,676	3,247
BVPS	13,141	14,305	15,720	18,395	21,642
DPS (common)	0	0	0	0	0
Valuations (x)					
P/E***	74.6	61.3	54.5	29.3	24.1
P/B***	6.0	5.5	5.0	4.3	3.6
EV/EBITDA	27.2	17.8	15.2	10.8	9.2
Ratios (%)					
ROE	9.5	9.3	9.6	15.7	16.2
ROA	6.8	7.4	7.4	11.8	12.3
ROIC	15.6	15.0	17.3	27.3	30.9
Payout ratio	0.0	0.0	0.0	0.0	0.0
Dividend yield (common)	0.0	0.0	0.0	0.0	0.0
Net debt to equity	(49.5)	(38.2)	(46.3)	(49.5)	(54.9)
Interest coverage (x)	19.0	343.0	1,090.9	1,747.1	2,818.6

Compliance notice

- As of Nov 7, 2019, the covering analyst(s) did not own any shares, or debt instruments convertible into shares, of any company covered in this report.
- As of Nov 7, 2019, Samsung Securities' holdings of shares and debt instruments convertible into shares of each company covered in this report would not, if such debt instruments were converted, exceed 1% of each company's outstanding shares.
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Target price changes in past two years



Rating changes over past two years (adjusted share prices)

Date	2017/11/23	2018/2/8	3/13	7/12	2019/7/1	8/9	10/14	11/8
Recommendation	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY
Target price (KRW)	53,000	90,000	100,000	140,000	88,000	83,000	88,000	94,000
Gap* (average)	29.29	(7.62)	(1.06)	(27.09)	(26.53)	(21.77)	(17.92)	
(max or min)**	64.15	1.11	17.10	(14.43)	(20.00)	(14.46)	(8.98)	

Note: * [(average, maximum, or minimum share price over duration of target price minus target price) / target price] x 100%

** Maximum/minimum share price if new target is higher/lower than market close on the business day prior to target price change

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Company

BUY	Expected to increase in value by 10% or more within 12 months and is highly attractive within sector
HOLD	Expected to increase/decrease in value by less than 10% within 12 months
SELL	Expected to decrease in value by 10% or more within 12 months

Industry

OVERWEIGHT	Expected to outperform market by 5% or more within 12 months
NEUTRAL	Expected to outperform/underperform market by less than 5% within 12 months
UNDERWEIGHT	Expected to underperform market by 5% or more within 12 months

Percentage of ratings in 12 months prior to Sep 30, 2019

BUY (76.6%) | HOLD (23.4%) | SELL (0%)

Global Disclosures & Disclaimers

General

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