

Studio Dragon (253450 KQ)

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Rating

BUY

maintain

6M TP (W)

115,000

maintain

CP (W)
(19.12.03)

77,300

Media

2020 top pick in media; TP reiterated at W115,000

- The W115,000 target price for Studio Dragon is based on our residual income model, which assumes a 26% NP CAGR over the next five years for the TV production company. The assumption is based on the company's long-term goal of boosting its annual drama slate to up to 40 titles by 2021, up from the current 25.

Latest deal a testament to Studio's creative power

- CJ E&M, the parent of Studio Dragon, recently struck a three-year deal with Netflix to jointly produce over 21 drama series beginning 2020. The agreement is believed to contain favorable terms for CJ E&M and Studio Dragon, including a higher recoup rate (streaming fees relative to programming costs) and more margins on Netflix's original shows they produce. (Studio Dragon is expected to produce three original series for Netflix in 2020, up from just one). The deal comes as the streaming giant faces growing competition both at home (Apple TV+, Disney+ and HBO Max) and overseas (Korea's Wavve and Seezn).
- Under the deal, CJ will have the right to sell a 4.99% (out of a total of 71.2%) stake in Studio Dragon within a year from November 21, 2019. The selling price will be based on the average closing prices in the previous five sessions before the day of the sale. Once sold, shares will be locked up for 18 months and Netflix will have to maintain at least 1% of Studio Dragon over the life of the contract.
- The latest deal with the streaming juggernaut (annual revenue W19tn, subscriber base 160 million, annual content investment W1.7tn) underscores Korea's emergence as a content powerhouse on the global stage. In the wake of the CJ deal, Netflix inked a three-year contract with another local TV production house J Contentree (owned by cable TV operator JTBC) to distribute some 20 primetime drama series to global audiences (excluding in Korea) starting from 1H20.
- Such developments, coupled with the low base of this year created by *Arthdal Chronicles*, which cost the production house an estimated W54bn, are expected to propel Studio Dragon's performance in 2020 – revenue up 21% to W570bn and OP up 95% to W76bn. The fantasy epic, which broke even this year, is forecast to add some W1.6bn to the company's profit next year. (Profit margins for tentpole projects like *Arthdal Chronicles* are typically around 30%.)
- In the short term, Studio Dragon's share price will be affected by the performance of its new lineup. One of them is a romantic story starring Sohn Ye-jin and Hyun Bin that will air on December 14. The company is thought to have secured a favorable deal with Netflix (in terms of recoup rate) for the show.
- We have a very positive view of the stock's long-term trajectory given the growing appetite for content both at home and abroad, which should translate to higher earnings.

(Wbn, W, %)	2017A	2018A	2019F	2020F	2021F
Revenue	287	380	472	572	619
OP	33	40	39	76	92
Pretax profit	30	46	48	89	106
NP	24	36	36	66	78
NP (controlling int.)	24	36	36	66	78
EPS	1,050	1,278	1,280	2,334	2,784
PER	61.9	72.3	60.4	33.1	27.8
BPS	16,223	14,312	15,578	17,395	19,429
PBR	4.0	6.5	5.0	4.4	4.0
ROE	9.5	9.3	8.6	14.2	15.1

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

Source: Studio Dragon, Daishin Securities Research Center

Industry 4.0 safety rating ■ Sky Blue

KOSDAQ	629.58
Market cap (Wbn)	2,172
Market cap portion (%)	0.92
Paid-in capital (common; Wbn)	14
52w high/low (W)	109,100 / 54,000
120d avg. trading volume (Wbn)	9.1
Foreign ownership (%)	2.36
Major shareholders	CJ E&M+5: 74.33%

(%)	1M	3M	6M	12M
Abs. return	-2.8	18.0	15.5	-29.1
Rel. return	2.3	16.2	28.0	-20.1

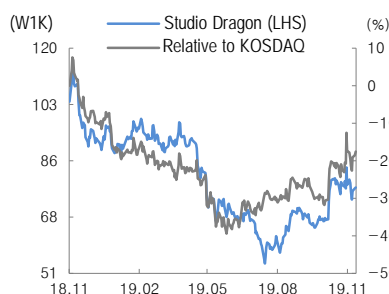
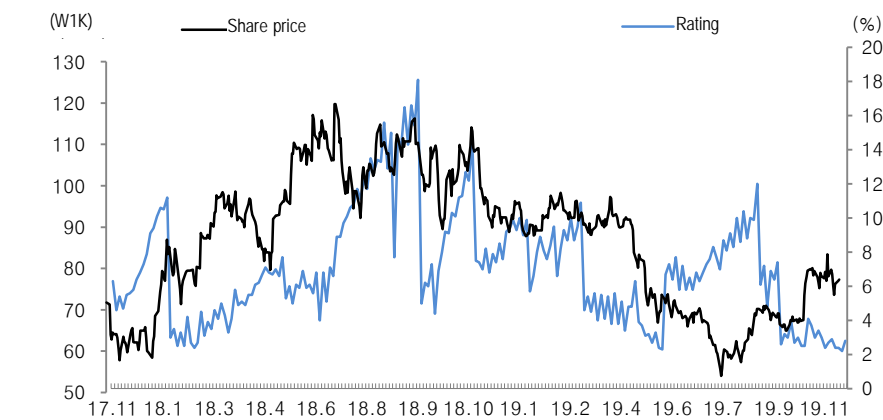
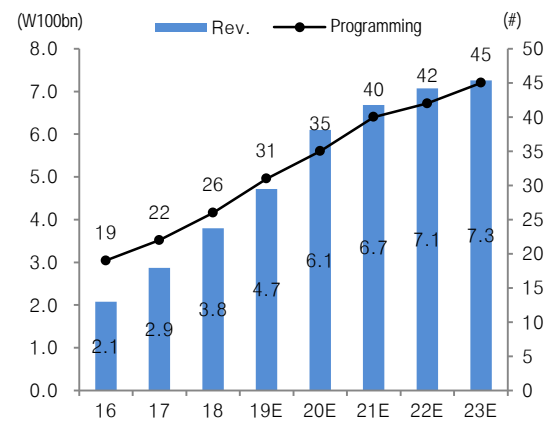


Fig 1. Viewer ratings vs. Studio Dragon's share price



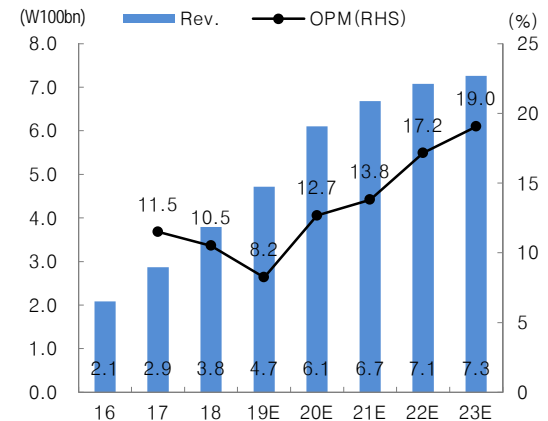
Source: AGB Nielson, Daishin Securities Research Center

Fig 2. Programming lineup vs. revenue



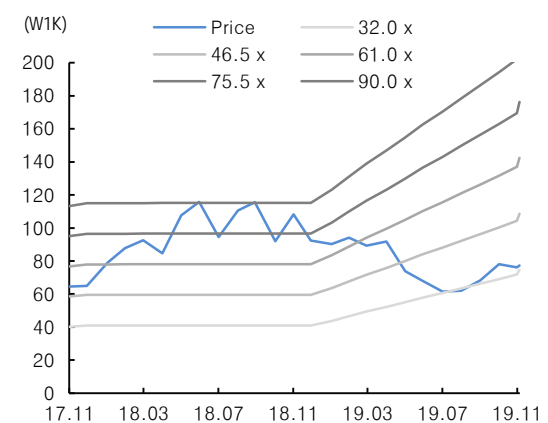
Source: Studio Dragon, Daishin Securities Research Center

Fig 3. Recoup ratio vs. margins



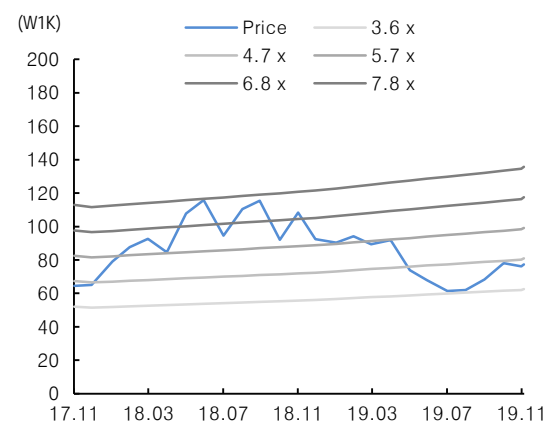
Source: Studio Dragon, Daishin Securities Research Center

Fig 4. 12-month forward PER



Source: FnGuide, Daishin Securities Research Center

Fig 5. 12-month forward PBR



Source: FnGuide, Daishin Securities Research Center

Company profile

Overview

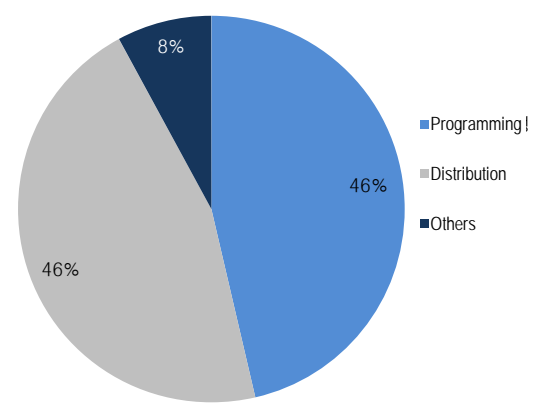
- Spun off from CJ E&M in May 2016
- Listed on the KOSDAQ in Nov 2017
- Revenue ₩379.6bn, OP ₩39.9bn, NP ₩35.8bn (2018)
- Revenue mix: programming 46%, distribution 46%, others 8% (3Q19)

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

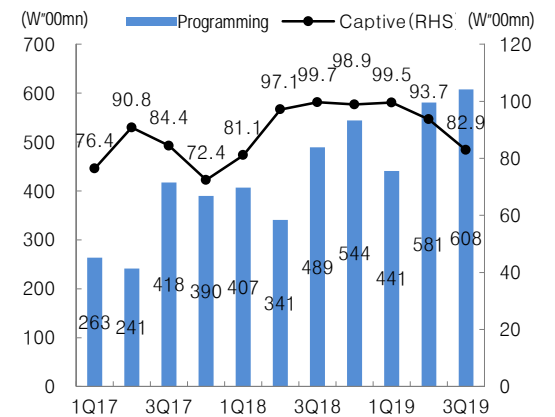
Revenue breakdown by business (3Q19)



Source: Studio Dragon, Daishin Securities Research Center

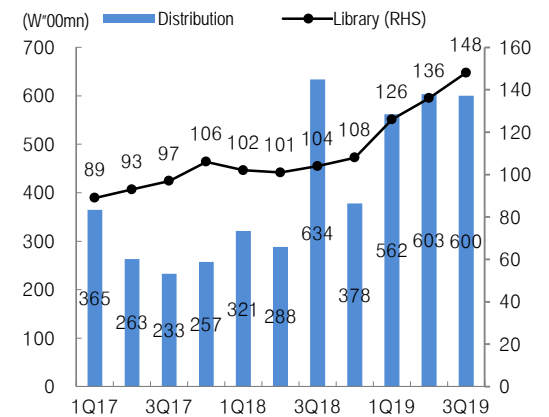
Earnings drivers

Programming revenue vs. revenue share of captive customers (3Q19)



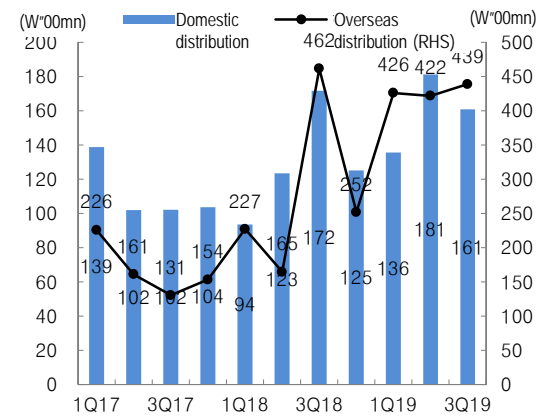
Source: Studio Dragon, Daishin Securities Research Center

Distribution revenue (3Q19)



Source: Studio Dragon, Daishin Securities Research Center

Distribution: domestic vs. overseas (3Q19)



Source: Studio Dragon, 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)	40	66	78	100	113	125	137	151	166	182
II	Shareholders' equity (contr. int.) ^(Note 2)	437	489	546	622	706	794	887	990	1,096	1,212
	Estimated ROE	8.6	14.2	15.1	16.1	16.0	15.7	15.4	15.2	15.1	15.0
III	Required rate of return ^(Note 3)	4.3									
	Risk free rate of return ^(Note 4)	1.5									
	Market risk premium ^(Note 5)	4.0									
	Beta	0.70									
IV	Spread (estimated ROE – required rate of return)	4.3	9.9	10.8	11.8	11.7	11.4	11.1	10.9	10.8	10.7
V	Required income	17	19	21	24	27	30	34	38	43	47
VI	Residual income (I - V)	19	47	57	77	86	94	103	112	123	135
	Present value factor	1.00	0.96	0.92	0.88	0.85	0.81	0.78	0.74	0.71	0.68
	PV of residual income	19	45	53	68	73	76	80	84	88	93
VII	Sum of residual income	677									
VIII	PV of residual income following forecasting period	2,151									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	401									
X	Fair market cap (VII+VIII+IX)	3,230									
	Total number of shares (thousands)	28,096									
XI	Per share value (W)	114,955									
	Current share price (W)	77.300									
	Potential (%)	48.7%									

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	472	572	619
Cost of goods sold	240	324	417	484	513
Gross profit	47	56	55	88	106
SG&A expenses	14	16	16	12	14
OP	33	40	39	76	92
OP margin	11.5	10.5	8.2	13.2	14.9
EBITDA	74	115	141	179	204
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	48	89	106
Income tax expense	-6	-10	-12	-23	-27
Income from cont. op.	24	36	36	66	78
Income from discount. op.	0	0	0	0	0
NP	24	36	36	66	78
NP margin	8.3	9.4	7.6	11.5	12.6
NP for non-contr. interest	0	0	0	0	0
NP for contr. interest	24	36	36	66	78
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	0	-1	-1	-1	-1
Comprehensive income	24	35	35	64	77
Comp. income for non-contr. int.	0	0	0	0	0
Comp. income for contr. int.	24	35	35	64	77

Valuation metrics					(W, x, %)
	2017A	2018A	2019F	2020F	2021F
EPS	1,050	1,278	1,280	2,334	2,784
PER	61.9	72.3	60.4	33.1	27.8
BPS	16,223	14,312	15,578	17,395	19,429
PBR	4.0	6.5	5.0	4.4	4.0
EBITDAPS	3,271	4,108	5,037	6,361	7,264
EV/EBITDA	22.1	21.1	14.1	11.0	9.4
SPS	12,628	13,539	16,810	20,351	22,046
PSR	5.1	6.8	4.6	3.8	3.5
CFPS	3,068	3,930	4,927	6,472	7,374
DPS	0	0	500	750	850

Financial ratios					(W, x, %)
	2017A	2018A	2019F	2020F	2021F
Growth potential					
Sales growth	85.7	32.4	24.3	21.2	8.3
OP growth	98.3	21.0	-2.4	94.0	22.0
NP growth	192.9	50.3	0.2	82.5	19.3
Profitability					
ROIC	17.0	16.0	12.8	22.9	26.1
ROA	9.4	8.2	7.3	13.0	14.4
ROE	9.5	9.3	8.6	14.2	15.1
Stability					
Debt ratio	24.7	27.7	26.5	24.8	22.6
Net borrowings ratio	-49.5	-39.3	-40.1	-43.5	-46.0
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	282	337	385
Cash & cash equiv.	51	153	171	208	247
Trade & other receive.	55	69	85	104	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	553	610	669
Current liabilities	91	108	113	118	121
Payables & other liab.	34	60	65	70	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	116	121	123
Controlling interest	368	401	437	489	546
Capital stock	14	14	14	14	14
Capital surplus	320	320	320	320	320
Retained earnings	32	68	104	155	212
Other capital changes	3	0	0	0	0
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	368	401	437	489	546
Net borrowings	-183	-158	-175	-213	-251

Cash flow statement					(Wbn)
	2017A	2018A	2019F	2020F	2021F
Operating cash flows	-7	-29	-9	20	49
NP	0	0	36	66	78
Non-cash items	46	74	102	116	129
Depreciation	41	75	102	103	112
FX gains	1	-1	0	0	0
Equity method gain	0	0	0	0	0
Others	4	0	0	13	17
Chg in assets & liab.	-73	-139	-150	-152	-145
Other cash flows	20	36	3	-10	-14
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	18	37	39
Beginning cash balance	12	51	153	171	208
Ending cash balance	51	153	171	208	247
NOPLAT	26	31	29	56	68
FCF	67	106	23	55	56

[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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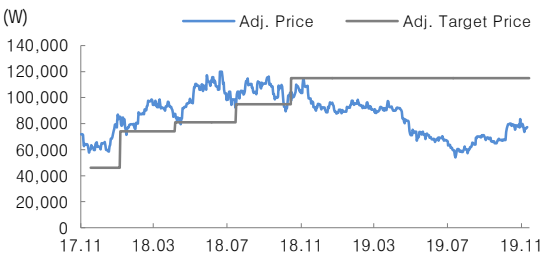
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	19.12.04	19.11.07	19.05.07	18.11.07	18.08.08	18.04.29
Rating	Buy	6M passed	6M passed	Buy	Marketperform	Marketperform
Target price	115,000	115,000	115,000	115,000	95,000	81,000
Diff. (avr. %)		(32.37)	(40.20)	(17.43)	10.95	26.80
Diff. (max/min., %)		(27.48)	(21.39)	(0.78)	22.42	(1.73)

Date	18.01.28	17.12.10
Rating	Marketperform	Buy
Target price	74,000	46,000
Diff. (avr. %)	19.40	46.87
Diff. (max/min., %)	(3.51)	26.96

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

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

Investment rating breakdown and framework (Nov. 22, 2019)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	87.1%	12.4%	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.