

Studio Dragon (253450 KQ)

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Rating **BUY**
maintain

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

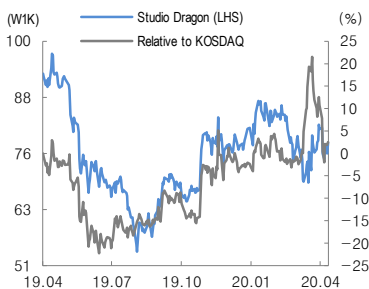
CP (W)
(20.04.14) **77,800**

Media

Industry 4.0 safety rating ■ **Neutral Green**

KOSDAQ	610.29
Market cap (Wbn)	2,186
Market cap portion (%)	0.93
Paid-in capital (common; Wbn)	14
52w high/low (W)	97,300 / 54,000
120d avg. trading volume (Wbn)	17.0
Foreign ownership (%)	9.27
Major shareholders	CJ ENM+5: 69.33%

(%)	1M	3M	6M	12M
Abs. return	12.3	-9.7	17.2	-13.9
Rel. return	-3.6	0.4	23.2	8.3



Why it's different this time

Media top pick; 6M TP reiterated at W115,000

- Our W115,000 target price for the company is based on a residual income model.

New tentpole drama *The King: Eternal Monarch* to premiere April 17

- The stock started nose-diving from May 2019 following the release of *Arthdal Chronicles*, shedding more than half of its value as doubts emerged over the company's ability to recover the tentpole drama's huge production cost of more than W50bn. It later regained about 70% of what it lost after the company's 2Q19 results confirmed the drama broke even thanks to its deals with CJ ENM and Netflix.
- Another one of Studio Dragon-produced big-budget drama series is set to air on SBS on April 17 – *The King: Eternal Monarch*, written by Kim Eun-suk, the writer of *Goblin* (aired in 2017; 20.5% peak rating) and *Mr. Sunshine* (2018; 18.1%). With production costs already covered via content deals with SBS and Netflix as well as product placements, margins on the show are estimated to top 30%.

A textbook example for content companies

- Since spinning off from CJ ENM in May 2016, Studio Dragon has acquired small production houses in an effort to bulk up drama production capacity. It can now push out more than 40 trendy and tentpole dramas a year.
 - While rival J Contentree was first to specialize in drama production, it was slower to carry out M&As (only started in 2017) and has less capacity (about 15 dramas a year). Local broadcaster SBS on April 1 launched its in-house drama production company Studio S by spinning off its drama production unit and merging it with its existing subsidiary The Story Works in a bid to produce more consumer-friendly drama series. Its production capacity amounts to about 20 titles a year.
- CJ ENM, the parent of Studio Dragon, recently struck a three-year deal with Netflix to jointly produce and air about 20 drama series beginning January 2020. The production house is also expected to create three original series for the streaming giant in 2020. Margins on these originals are likely to rise by about 10%p.
 - Similarly, J Contentree recently signed a three-year deal with Netflix (to begin providing 20 or so dramas in May 2020, which will be made simultaneously available through its broadcasting unit JTBC and Netflix outside Korea, and producing three original series for Netflix). Korean OTT service Wavve also clinched a three-year production deal with NBC Universal for about 15 dramas.
- With Korean content now a crucial element of Netflix' push into Asia, a move triggered by intensifying competition in the US market, we believe a good window of opportunity has opened up for Korea's content companies.
- Shares in Netflix have been under pressure since Disney's OTT platform Disney+ debuted late last year. Disney's stock rose 9% during the first two days of the platform's US release in November 2019. Netflix's shares fell 4% in that period. Following a 17% jump in two days after the service was launched in six European countries in March 2020, shares in Netflix dropped 5%.

Operating results and major financial data

(Wbn, W, x, %)

	2018A	2019A	2020F	2021F	2022F
Revenue	380	469	537	596	638
OP	40	29	75	94	117
Pretax profit	46	33	80	99	122
NP	36	26	59	73	90
NP (controlling int.)	36	26	59	73	90
EPS	1,278	941	2,114	2,616	3,205
PER	72.3	85.9	36.8	29.7	24.3
BPS	14,312	15,258	17,356	19,221	21,577
PBR	6.5	5.3	4.5	4.0	3.6
ROE	9.3	6.4	13.0	14.3	15.7

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

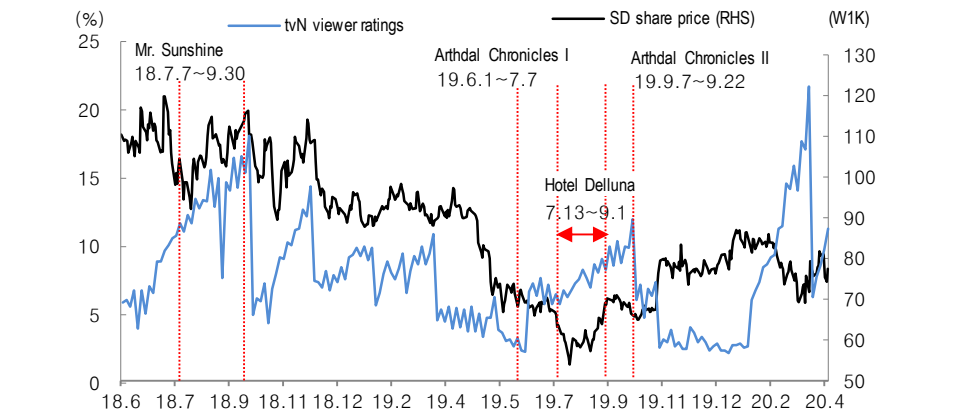
Source: Studio Dragon, Daishin Securities Research Center

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

	Previous		Revised		Chg	
	2020F	2021F	2020F	2021F	2020F	2021F
Revenue	537	596	537	596	0.0	0.0
SG&A expense	20	21	20	22	0.1	0.4
OP	75	94	75	94	0.0	-0.2
OP margin	14.0	15.8	14.0	15.8	0.0	0.0
Non-operating profit	5	5	5	5	0.0	0.0
Pretax profit	80	99	80	99	0.0	-0.2
NP (controlling int.)	59	74	59	73	0.0	-0.2
NP margin	11.1	12.3	11.1	12.3	0.0	0.0
EPS (controlling int.)	2,113	2,620	2,114	2,616	0.0	-0.2

Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Viewer ratings of tvN's major dramas vs. Studio Dragon share price



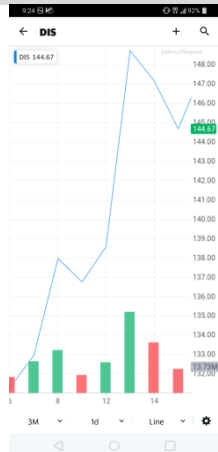
Source: AGB Nielson, Daishin Securities Research Center

Fig 2. Platform – drama production house structure



Source: Daishin Securities Research Center

Fig 3. 19.11.12 Disney+ released in US. DIS +9%



Source: Yahoo, Daishin Securities Research Center
Note: 11/11 136.74 → 11/13 148.72

Fig 4. 19.11.12 Disney+ released in US. NFLX -4%



Source: Yahoo, Daishin Securities Research Center
Note: 11/11 294.18 → 11/13 283.11

Fig 5. 20.3.24 Disney+ released in Europe. DIS +17%



Source: Yahoo, Daishin Securities Research Center
Note: 3/23 85.76 → 3/25 100.73

Fig 6. 20.3.24 Disney+ released in Europe. NFLX -5%



Source: Yahoo, Daishin Securities Research Center
Note: 3/23 360.27 → 3/25 342.39

1. Company profile

Overview

- Spun off from CJ E&M in May 2016
- Listed on the KOSDAQ in Nov 2017
- Revenue W468.6bn, OP W28.7bn, NP W26.5bn (2019)

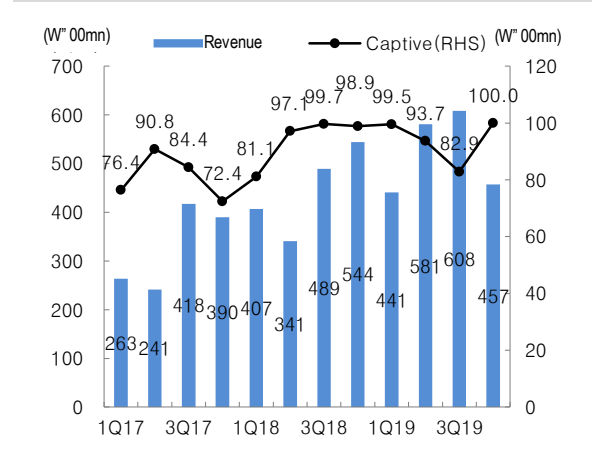
Share price catalysts

- 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

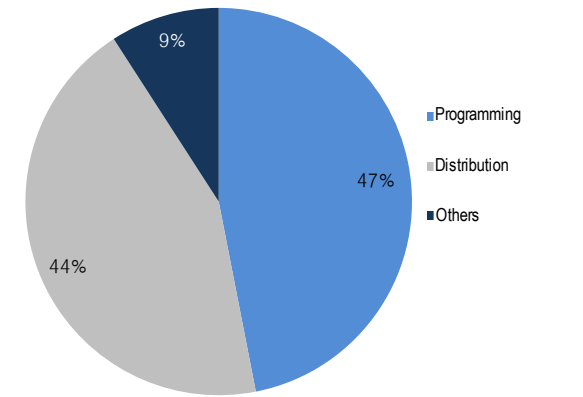
2. Earnings drivers

Fig 1. Programming revenue (4Q19)



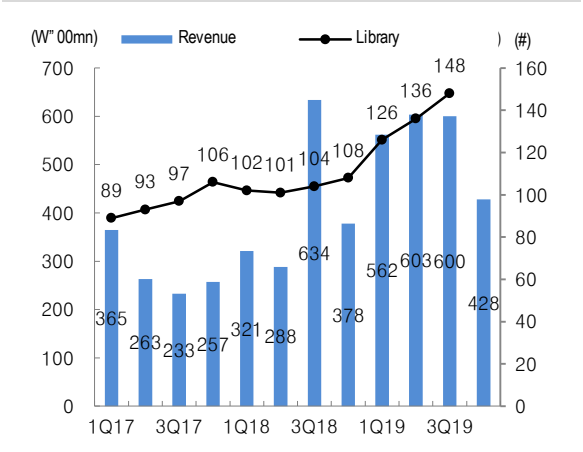
Source: Studio Dragon, Daishin Securities Research Center

Revenue breakdown by business (4Q19)



Source: Studio Dragon, Daishin Securities Research Center

Fig 2. Distribution revenue (4Q19)



Source: Studio Dragon, Daishin Securities Research Center

Per share intrinsic value

Residual Income Model		(Wbn, W, %)									
		2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F
I	NP (contr. int.) ^(Note 2)	59	74	90	110	123	135	148	163	180	197
II	Shareholders' equity (contr. int.) ^(Note 2)	488	540	606	687	773	871	979	1,098	1,228	1,372
	Estimated ROE	13.0	14.3	15.7	16.0	15.9	15.5	15.2	14.9	14.6	14.4
III	Required rate of return ^(Note 3)	4.2									
	Risk free rate of return ^(Note 4)	1.4									
	Market risk premium ^(Note 5)	4.0									
	Beta	0.70									
IV	Spread (estimated ROE – required rate of return)	8.8	10.1	11.5	11.8	11.7	11.3	11.0	10.7	10.4	10.2
V	Required income	18	21	23	26	29	33	37	41	46	52
VI	Residual income (I - V)	41	53	67	85	94	102	112	122	133	146
	Present value factor	0.97	0.93	0.90	0.86	0.82	0.79	0.76	0.73	0.70	0.67
	PV of residual income	40	50	60	73	77	81	85	89	93	98
VII	Sum of residual income	746									
VIII	PV of residual income following forecasting period	2,332									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	428									
X	Fair market cap (VII+VIII+IX)	3,507									
	Total number of shares (thousands)	28,096									
XI	Per share value (W)	124,803									
	Current share price (W)	77,800									
	Potential (%)	60.4%									

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)	Balance sheet						(Wbn)
	2018A	2019A	2020F	2021F	2022F		2018A	2019A	2020F	2021F	2022F		
Revenue	380	469	537	596	638	Current assets	247	244	326	386	486		
Cost of goods sold	324	421	442	481	499	Cash & cash equiv.	153	60	129	179	271		
Gross profit	56	48	95	115	140	Trade & other receive.	69	84	96	106	114		
SG&A expenses	16	19	20	22	23	Inventories	1	0	0	0	0		
OP	40	29	75	94	117	Other current assets	25	101	101	101	101		
OP margin	10.5	6.1	14.0	15.8	18.3	Long-term assets	265	337	317	312	281		
EBITDA	115	146	200	232	275	Tangible assets	1	1	1	1	1		
Non-OP	6	4	5	5	5	Investments in affiliates	0	0	0	0	0		
Income from affiliates	0	0	0	0	0	Other long-term assets	264	336	317	311	280		
Financial revenue	7	10	13	13	13	Total assets	512	582	644	698	766		
FX related gains	0	0	0	0	0	Current liabilities	108	145	148	150	152		
Financial expense	-1	-6	-9	-9	-9	Payables & other liab.	60	66	69	71	73		
FX related losses	0	4	2	2	2	Borrowings	0	0	0	0	0		
Others	0	0	1	1	1	Current portion of LT debts	0	0	0	0	0		
Income before taxes	46	33	80	99	122	Other current liabilities	48	79	79	79	79		
Income tax expense	-10	-7	-21	-26	-32	Long-term liabilities	3	8	8	8	8		
Income from cont. op.	36	26	59	73	90	Borrowings	0	0	0	0	0		
Income from discount. op.	0	0	0	0	0	Convertible securities	0	0	0	0	0		
NP	36	26	59	73	90	Other long-term liab.	3	8	8	8	8		
NP margin	9.4	5.6	11.1	12.3	14.1	Total liabilities	111	153	156	158	160		
NP for non-contr. interest	0	0	0	0	0	Controlling interest	401	428	488	540	606		
NP for contr. interest	36	26	59	73	90	Capital stock	14	14	14	14	14		
Valuation of AFS fin. assets	0	0	0	0	0	Capital surplus	320	322	322	322	322		
Other compreh. income	-1	-1	-1	-1	-1	Retained earnings	68	94	153	205	272		
Comprehensive income	35	26	59	73	89	Other capital changes	0	-1	-1	-1	-1		
Comp. income for non-contr. int.	0	0	0	0	0	Non-controlling interest	0	0	0	0	0		
Comp. income for contr. int.	35	26	59	73	89	Total shareholder's equity	401	428	488	540	606		
						Net borrowings	-157	-106	-176	-226	-317		
Valuation metrics						(W, x, %)	Cash flow statement						(Wbn)
	2018A	2019A	2020F	2021F	2022F		2018A	2019A	2020F	2021F	2022F		
EPS	1,278	941	2,114	2,616	3,205	Operating cash flows	-29	-12	43	73	112		
PER	72.3	85.9	35.7	28.9	23.6	NP	36	26	59	73	90		
BPS	14,312	15,258	17,356	19,221	21,577	Non-cash items	84	124	132	150	176		
PBR	6.5	5.3	4.4	3.9	3.5	Depreciation	75	117	124	138	158		
EBITDAPS	4,108	5,185	7,109	8,262	9,788	FX gains	-1	1	-3	-3	-3		
EV/EBITDA	21.1	14.9	9.7	8.2	6.6	Equity method gain	0	0	0	0	0		
SPS	13,539	16,698	19,123	21,216	22,715	Others	9	6	11	15	21		
PSR	6.8	4.8	3.9	3.6	3.3	Chg in assets & liab.	-139	-143	-140	-138	-136		
CFPS	4,280	5,346	6,813	7,966	9,477	Other cash flows	-10	-19	-8	-13	-19		
DPS	0	0	750	850	1,050	Investing cash flow	141	-81	-128	-156	-150		
						Investment assets	138	-57	0	0	0		
						Tangible assets	0	0	0	0	0		
						Others	3	-23	-127	-155	-150		
						Financing cash flows	-10	0	-2	-23	-26		
						Short-term borrowings	0	0	0	0	0		
						Bonds payable	0	0	0	0	0		
						Long-term borrowings	0	0	0	0	0		
						Rights offering	0	2	0	0	0		
						Cash dividends	0	0	0	-21	-24		
						Others	-10	-2	-2	-2	-2		
						Net chg in cash	102	-93	69	50	92		
						Beginning cash balance	51	153	60	129	179		
						Ending cash balance	153	60	129	179	271		
						NOPLAT	31	23	56	69	86		
						FCF	106	139	75	75	117		

[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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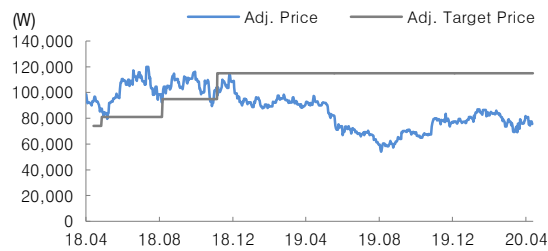
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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	20.04.14	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. %)		(31.27)	(40.20)	(17.43)	10.95	26.80
Diff. (max./min., %)		(24.35)	(21.39)	(0.78)	22.42	(1.73)
Date	18.04.15					
Rating	Marketperform					
Target price	74,000					
Diff. (avr. %)	24.09					
Diff. (max./min., %)	15.27					
Date						
Rating						
Target price						
Diff. (avr. %)						
Diff. (max./min., %)						
Date						
Rating						
Target price						
Diff. (avr. %)						
Diff. (max./min., %)						

Investment rating breakdown and framework (Apr 10, 2020)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	86.4%	13.1%	0.5%

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