

# Studio Dragon (253450 KQ)

HJ Kim  
hoijae.kim@daishin.com

GY Lee  
gayeon.lee@daishin.com

Rating **BUY**  
maintain

6M TP (₩) **115,000**  
maintain

CP (₩)  
(20.06.30) **86,200**

Media

## Growth story unfolding

**BUY; 6M TP maintained at ₩115,000**

- Studio Dragon's earnings tends to grow with the number of dramas it produces or amount they are licensed for.
- The production house has been ramping up its drama portfolio by 2-3 titles a year, with a goal of producing a total of 33 this year. (As a side note, it is capable of creating up to 50 titles a year.) It has also been growing its slate of tentpole dramas (those whose production costs exceed ₩1bn per episode) from two titles a year to four this year. Furthermore, its three-year deal with Netflix –produce seven dramas for joint airing and three Netflix Originals annually – has resulted in better selling prices for its productions.
- But despite this solid growth story, there is a concern about what's next for Studio Dragon in uncharted territory: Can it produce more and find slots in tvN's fully-packed drama roster?

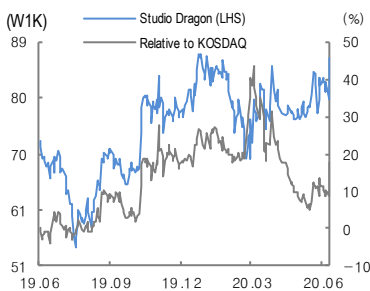
### Growing the bottom line without top line growth

- Here are some ways Studio Dragon could potentially boost earnings without expanding its drama slate.
  - Better recoupment. The production house could focus on titles produced for multi-platform simultaneous release (i.e. TV and Netflix) that have high recoup value (130%). It could better recoup its production costs for the seven dramas it is producing with Netflix. It usually recoups 120-130% of the initial outlay for such titles.
  - More tentpole dramas or fewer loss-makers. Studio Dragon currently earns ₩10-15bn from about eight tentpole dramas it produces, including five that barely break even (or even making small losses). Earnings should grow if it improves the margins on these poor-performing titles.
  - Licensing deals with OTT. Studio Dragon could sell 23 of the 33 titles on its production slate this year (excluding 10 it is producing as part of its deal with Netflix) to the recently launched global OTT platforms such as Disney+, Apple TV+, HBO Max, and Peacock.
  - More production deals from parent company. It could win the CJ ENM dramas currently produced in house or by other production houses. Among the dramas aired on tvN and OCN last year (21 and 10, respectively), four titles were produced in house or by other production houses.
- Expanding its drama slate is also a possibility.
  - More dramas for OCN and tvN. The production house could supply more titles to OCN as it airs only about half the number of dramas tvN airs at the moment. Even tvN could air two more dramas annually if it eliminates the resting period.
  - A focus on TV stations without in-house production capability. Among the three local broadcasters, which air a total of 60 dramas annually, only SBS has launched its own production house in response to the growing drama market. Studio Dragon could target for the other two, MBC and KBS.

Industry 4.0 safety rating ■ **Neutral Green**

KOSDAQ	737.97
Market cap (₩bn)	2,422
Market cap portion (%)	0.95
Paid-in capital (common; ₩bn)	14
52w high/low (₩)	87,000 / 54,000
120d avg. trading volume (₩bn)	24.0
Foreign ownership (%)	8.39
Major shareholders	CJ ENM+5: 61.31%

(%)	1M	3M	6M	12M
Abs. return	13.1	12.8	6.6	26.8
Rel. return	9.4	-17.1	-3.3	18.6



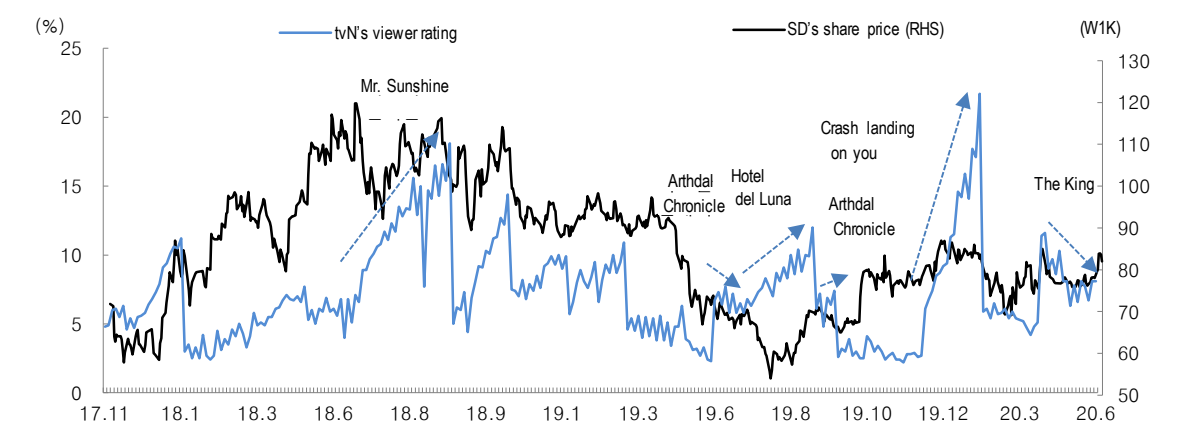
### China, a possible game changer

- All content stocks soared yesterday on the news that China has lifted its ban on Korean content. While whether it should do so remains unclear, the reopening of the Chinese market is likely to offer a big window of opportunity for Korean content producers.
- SBS's *Backstreet Rookie* and MBC's *Dinner Mate* are currently airing on China's largest OTT platform iQIYI Global – a sign of change in China.
- The price of Korean dramas could easily surpass ₩10bn, which is what it used to garner prior to the ban, immediately and significantly boosting Studio Dragon's quarterly earnings (currently ₩10-15bn).

Operating results and major financial data					(Wbn, W, x, %)
	2018A	2019A	2020F	2021F	2022F
Revenue	380	469	483	560	607
OP	40	29	60	78	112
Pretax profit	46	33	65	83	117
NP	36	26	47	62	86
NP (controlling int.)	36	26	47	62	86
EPS	1,278	941	1,688	2,198	3,072
PER	72.3	85.9	51.1	39.2	28.1
BPS	14,312	15,258	16,930	18,379	20,601
PBR	6.5	5.3	5.1	4.7	4.2
ROE	9.3	6.4	10.5	12.5	15.8
Note: EPS, BPS, and ROE are based only on the controlling interest.					
Source: Studio Dragon, Daishin Securities Research Center					

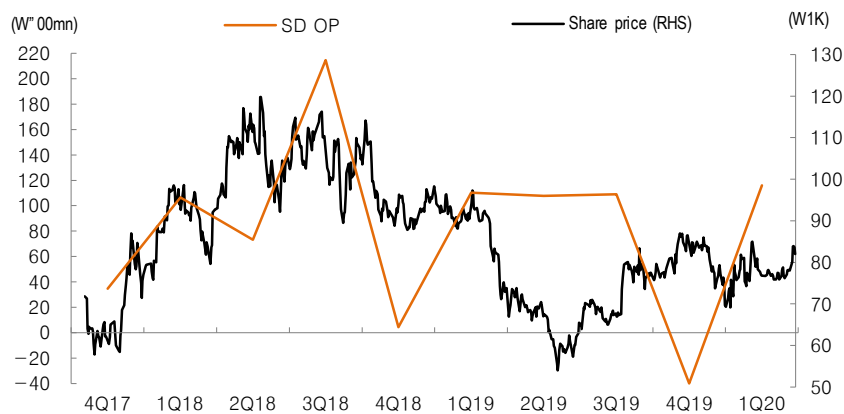
Yearly earnings forecast revision						(Wbn, W, %, %p)
	Previous		Revised		Chg	
	2020F	2021F	2020F	2021F	2020F	2021F
Revenue	535	569	483	560	-9.8	-1.5
SG&A expense	22	23	21	23	-1.4	0.0
OP	70	88	60	78	-14.5	-10.8
OP margin	13.2	15.4	12.5	13.9	-0.7	-1.5
Non-operating profit	4	5	4	5	0.0	0.0
Pretax profit	75	93	65	83	-13.6	-10.2
NP (controlling int.)	55	69	47	62	-13.6	-10.2
NP margin	10.3	12.1	9.8	11.0	-0.4	-1.1
EPS (controlling int.)	1,955	2,448	1,688	2,198	-13.6	-10.2
Source: Studio Dragon, Daishin Securities Research Center						

Fig 1. Studio Dragon's share price is sensitive to viewer ratings of major dramas in the near term



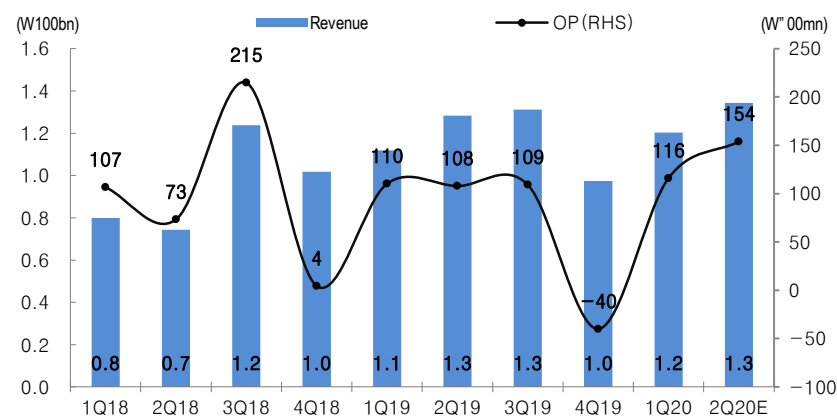
Source: AGB Nielson, Daishin Securities Research Center

Fig 2. Studio Dragon OP vs. share price



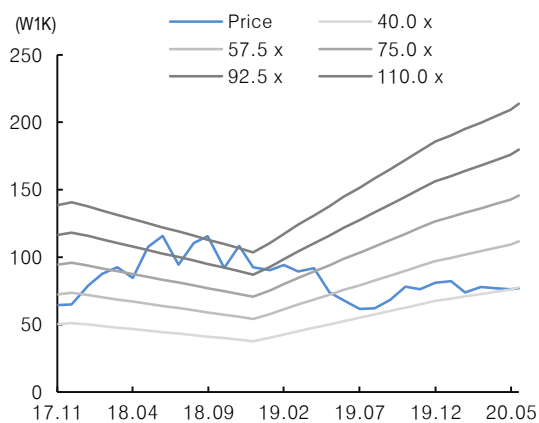
Source: Studio Dragon, Daishin Securities Research Center

Fig 3. Studio Dragon revenue and OP



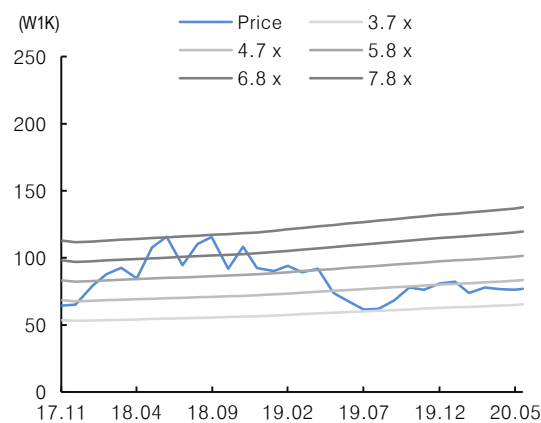
Source: Studio Dragon, Daishin Securities Research Center estimates

Fig 4. 12MF P/E band



Source: FnGuide, Studio Dragon, Daishin Securities Research Center

Fig 5. 12MF P/B band



Source: FnGuide, Studio Dragon, Daishin Securities Research Center

Company profile

Overview

- Spun off from CJ E&M in May 2016
- Listed on the KOSDAQ in Nov 2017
- Revenue ₩468.6bn, OP ₩28.7bn, NP ₩26.5bn (2019)

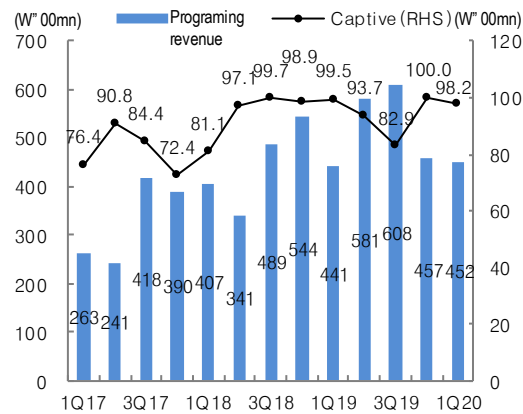
Share price catalysts

- Earnings are rising steadily on increased drama supply to CJ ENM's channels tvN and OCN as well as Netflix.
- The stock price is sensitive to viewer ratings of major dramas, but the stock price volatility has sharply decreased as earnings stabilized thanks to drama sales.

Source: Studio Dragon, Daishin Securities Research Center

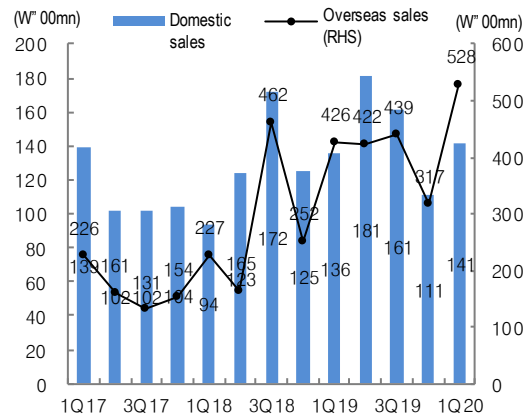
Earnings drivers

Fig 1. Programing revenue; captive customers (1Q20)



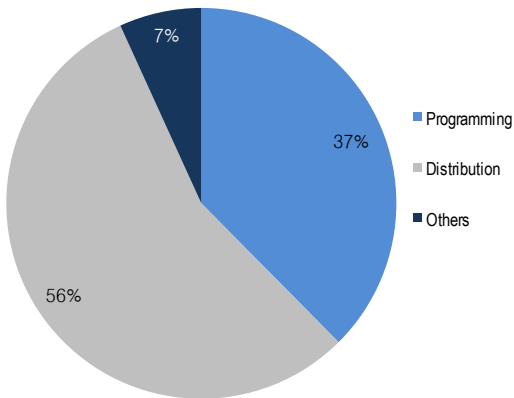
Source: Studio Dragon, Daishin Securities Research Center

Fig 3. Domestic sales vs. overseas sales (1Q20)



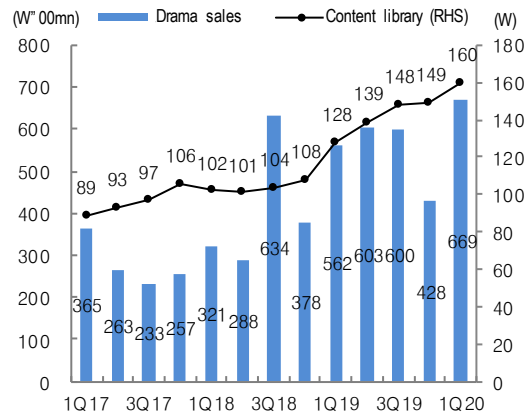
Source: Studio Dragon, Daishin Securities Research Center

Revenue breakdown by business (1Q20)



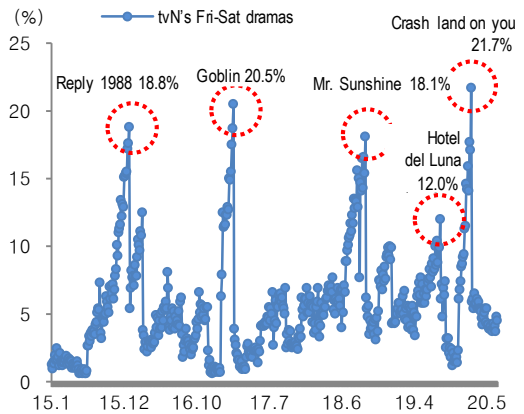
Source: Studio Dragon, Daishin Securities Research Center

Fig 2. Distribution revenue (1Q20)



Source: Studio Dragon, Daishin Securities Research Center

Fig 4. Viewer ratings of tvN's Fri-Sat dramas



Source: AGB Nielson, 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.) <sup>(Note 2)</sup>	47	62	86	103	116	128	141	155	170	187
II	Shareholders' equity (contr. int.) <sup>(Note 2)</sup>	476	516	579	653	732	824	926	1,038	1,162	1,298
	Estimated ROE	10.5	12.5	15.8	15.8	15.9	15.5	15.2	14.9	14.6	14.4
III	Required rate of return <sup>(Note 3)</sup>	4.2									
	Risk free rate of return <sup>(Note 4)</sup>	1.4									
	Market risk premium <sup>(Note 5)</sup>	4.0									
	Beta	0.70									
IV	Spread (estimated ROE – required rate of return)	6.3	8.3	11.6	11.6	11.7	11.3	11.0	10.7	10.4	10.2
V	Required income	18	20	22	24	27	31	35	39	44	49
VI	Residual income (I - V)	29	42	65	79	89	97	106	116	127	138
	Present value factor	0.98	0.94	0.90	0.87	0.83	0.80	0.77	0.73	0.70	0.68
	PV of residual income	29	39	58	68	74	77	81	85	89	94
VII	Sum of residual income	695									
VIII	PV of residual income following forecasting period	2,227									
	Terminal growth (g) <sup>(Note 6)</sup>	0.0%									
IX	Beginning shareholders' equity	428									
X	Fair market cap (VII+VIII+IX)	3,350									
	Total number of shares (thousands)	28,096									
XI	Per share value (W)	119,235									
	Current share price (W)	86,200									
	Potential (%)	38.3%									

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)				
	2018A	2019A	2020F	2021F	2022F	
Revenue	380	469	483	560	607	
Cost of goods sold	324	421	401	459	471	
Gross profit	56	48	82	101	136	
SG&A expenses	16	19	21	23	25	
OP	40	29	60	78	112	
OP margin	10.5	6.1	12.5	13.9	18.4	
EBITDA	115	146	185	216	270	
Non-OP	6	4	4	5	5	
Income from affiliates	0	0	0	0	0	
Financial revenue	7	10	17	13	13	
FX related gains	0	0	0	0	0	
Financial expense	-1	-6	-13	-9	-9	
FX related losses	0	4	0	0	0	
Others	0	0	1	1	1	
Income before taxes	46	33	65	83	117	
Income tax expense	-10	-7	-17	-22	-30	
Income from cont. op.	36	26	47	62	86	
Income from discount op.	0	0	0	0	0	
NP	36	26	47	62	86	
NP margin	9.4	5.6	9.8	11.0	14.2	
NP for non-contr. interest	0	0	0	0	0	
NP for contr. interest	36	26	47	62	86	
Valuation of AFS fin. assets	0	0	0	0	0	
Other compreh. income	-1	-1	-1	-1	-1	
Comprehensive income	35	26	47	61	86	
Comp. income for non-contr. int.	0	0	0	0	0	
Comp. income for contr. int.	35	26	47	61	86	

Valuation metrics		(W, x, %)				
	2018A	2019A	2020F	2021F	2022F	
EPS	1,278	941	1,688	2,198	3,072	
PER	72.3	85.9	51.1	39.2	28.1	
BPS	14,312	15,258	16,930	18,379	20,601	
PBR	6.5	5.3	5.1	4.7	4.2	
EBITDAPS	4,108	5,185	6,572	7,700	9,610	
EV/EBITDA	21.1	14.9	12.2	10.2	7.9	
SPS	13,539	16,698	17,177	19,939	21,601	
PSR	6.8	4.8	5.0	4.3	4.0	
CFPS	4,280	5,346	6,372	7,521	9,417	
DPS	0	0	750	850	1,050	

Financial ratios		(W, x, %)				
	2018A	2019A	2020F	2021F	2022F	
<b>Growth potential</b>						
Sales growth	32.4	23.5	3.0	16.1	8.3	
OP growth	21.0	-28.1	109.9	29.7	42.9	
NP growth	50.3	-26.3	79.5	30.2	39.8	
<b>Profitability</b>						
ROIC	16.0	9.4	17.2	22.9	34.1	
ROA	8.2	5.2	9.9	12.0	15.8	
ROE	9.3	6.4	10.5	12.5	15.8	
<b>Stability</b>						
Debt ratio	27.7	35.8	32.3	30.4	27.4	
Net borrowings ratio	-39.2	-24.9	-36.1	-40.1	-50.8	
Interest coverage ratio	343.0	58.1	0.0	0.0	0.0	

Source: Studio Dragon, Daishin Securities Research Center

Balance sheet		(Wbn)				
	2018A	2019A	2020F	2021F	2022F	
Current assets	247	244	312	361	457	
Cash & cash equiv.	153	60	125	160	248	
Trade & other receive.	69	84	86	100	108	
Inventories	1	0	0	0	0	
Other current assets	25	101	101	101	101	
Long-term assets	265	337	317	312	281	
Tangible assets	1	1	1	1	1	
Investments in affiliates	0	0	0	0	0	
Other long-term assets	264	336	317	311	280	
Total assets	512	582	630	673	738	
Current liabilities	108	145	146	149	151	
Payables & other liab.	60	66	67	70	72	
Borrowings	0	0	0	0	0	
Current portion of LT debts	0	0	0	0	0	
Other current liabilities	48	79	79	79	79	
Long-term liabilities	3	8	8	8	8	
Borrowings	0	0	0	0	0	
Convertible securities	0	0	0	0	0	
Other long-term liab.	3	8	8	8	8	
Total liabilities	111	153	154	157	159	
Controlling interest	401	428	476	516	579	
Capital stock	14	14	14	14	14	
Capital surplus	320	322	322	322	322	
Retained earnings	68	94	141	182	244	
Other capital changes	0	-1	-1	-1	-1	
Non-controlling interest	0	0	0	0	0	
Total shareholder's equity	401	428	476	516	579	
Net borrowings	-157	-106	-172	-207	-294	

Cash flow statement		(Wbn)				
	2018A	2019A	2020F	2021F	2022F	
Operating cash flows	-29	-12	42	62	111	
NP	36	26	47	62	86	
Non-cash items	84	124	132	150	178	
Depreciation	75	117	124	138	158	
FX gains	-1	1	0	0	0	
Equity method gain	0	0	0	0	0	
Others	9	6	7	11	20	
Chg in assets & liab.	-139	-143	-132	-141	-137	
Other cash flows	-10	-19	-5	-9	-17	
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	65	35	87	
Beginning cash balance	51	153	60	125	160	
Ending cash balance	153	60	125	160	248	
NOPLAT	31	23	44	58	83	
FCF	106	139	64	63	114	

[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)
----------------------	-------------------------	---------------------

[Compliance Notice]

In accordance with Subparagraph 5 of Paragraph 1 of Article 4-20 of the supervisory regulations for the financial investment industry, we confirm that no information or content has been shared prior to its release on Daishin's website, and that the analyst has not received nor will receive direct or indirect compensation in exchange for expressing specific opinions. Daishin is not affiliated with the company presented in this report. This report has been presented without any undue external influence or interference, and accurately reflects the personal views of the analyst who is responsible for its content.

This report is distributed for the purpose of helping investors make informed decisions. This report has been prepared from the data and information believed to be correct and reliable, but Daishin Securities does not make any guarantee as to the accuracy thereof. Investors reading this report should make final decisions based on their own judgment.

**For U.S. persons only:** For U.S. persons only: This independent third party research report is a product of Daishin Securities, which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This independent third-party research report is distributed in the United States ("US") to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities and Exchange Act of 1934, as amended) by Maybank Kim Eng Securities USA Inc. ("Maybank KESUSA") and Auerbach Grayson and Company LLC, broker-dealers registered in the US (registered under Section 15 of the Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Maybank KESUSA in the US shall be borne by Maybank KESUSA. All responsibility for the distribution of this report by Auerbach Grayson and Company LLC shall be borne by Auerbach Grayson and Company LLC.

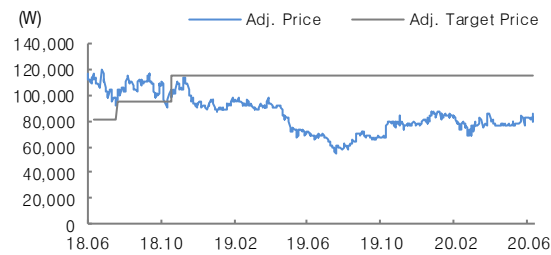
If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor. In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Daishin Securities has entered into an agreement with two U.S. registered broker-dealers, Maybank Kim Eng Securities USA Inc and Auerbach Grayson and Company LLC. All U.S. persons receiving and/or accessing this report and wishing to effect transactions in any security mentioned within must do so with: Maybank Kim Eng Securities USA Inc. 777 Third Avenue 21st Floor New York, New York 1- (212) 688-8886 or Auerbach Grayson and Company LLC 25 West 45th Street, New York, NY 10036 and not with the issuer of this report.

**Analyst Certification of Independence**

The views expressed in this research report accurately reflect the analyst's personal views about any and all of the subject securities or issuers; and no part of the research analyst's compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Date	20.07.01	20.05.07	19.11.07	19.05.07	18.11.07	18.08.08
Rating	Buy	6M passed	6M passed	6M passed	Buy	Marketperform
Target price	115,000	115,000	115,000	115,000	115,000	95,000
Diff. (avr. %)		(31.05)	(31.25)	(40.20)	(17.43)	10.95
Diff. (max./min., %)		(25.04)	(24.35)	(21.39)	(0.78)	22.42

Date	18.07.01
Rating	Marketperform
Target price	81,000
Diff. (avr. %)	29.91
Diff. (max./min., %)	13.83

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

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

Investment rating breakdown and framework (Jun 28, 2020)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	87.4%	12.1%	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.