

Studio Dragon (253450 KQ)

HJ Kim

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Rating

BUY

upgrade

6M TP (W)

115,000

raise

CP (W)
(18.11.07)**97,500**

Media

Expanding beyond Korea

Upgraded to BUY; TP bumped up to W115,000

- We hike our target price for Studio Dragon by 21% as we now see a 41% CAGR for the soap opera production company through 2022, up from our previous projection of 36%.
- Revenue from TV drama rights surged 172% yoy in the latest quarter thanks to the hit show "Mr. Sunshine." We see a strong chance of the company scoring a deal for its new drama "Memories of the Alhambra" with Chinese media firms.

3Q18 highlight: Strong overseas performance

- Studio Dragon's third-quarter performance fell slightly short of our expectations, reporting revenue of W120bn (up 67% qoq; up 60% yoy) and OP of W21.5bn (up 194% qoq; up 223% yoy).
- What's encouraging is the impressive growth in TV rights sales, up 172% to W63.4bn that accounted for more than half (51%) of total revenue in that quarter. The strong performance owes to higher price tag for its dramas (up 154% yoy to W610mn per title) and increased exports* (approximately 73% of TV rights revenue came from overseas business).

* Netflix paid roughly W30bn for the rights to offer "Mr. Sunshine" (highest viewer rating 18.1%) on its streaming platform. The high-price deal shows the strong potential of Korea's tentpole TV shows in the global market.

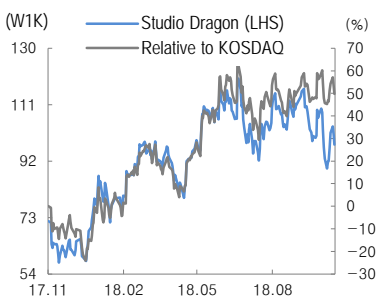
- The company is poised to re-enter the China market with the sale of its new drama "Memories of the Alhambra" (set to go on the air in December), which looks highly likely. It is also pursuing a coproduction agreement with a Chinese partner.
- The renewed China business will help justify the stock's pricey valuation. (See our August report.)
- We project the company to produce 30 new dramas in 2019, up from our previous estimate of 25. OP margin will also increase (to 20% from our prior projection of 16%) in that year as the content creator sees more TV rights revenue flowing in from overseas (Netflix W30bn and China W20bn).

Industry 4.0 safety rating

■ Sky Blue

KOSDAQ	682.37
Market cap (Wbn)	2,734
Market cap portion (%)	1.20
Paid-in capital (common; Wbn)	14
52w high/low (W)	119,800 / 57,800
120d avg. trading volume (Wbn)	20.3
Foreign ownership (%)	2.37
Major shareholders	CJ E&M+3: 75.66%

(%)	1M	3M	6M	12M
Abs. return	-10.2	5.7	16.2	0.0
Rel. return	1.8	21.6	45.8	0.0



	3Q17	2Q18	Previous estimate	Result	3Q18			4Q18		
					YoY	QoQ	Consensus	Daishin estimate	YoY	QoQ
Revenue	78	74	131	124	59.6	66.5	122	91	26.8	-26.3
OP	7	7	26	22	223.4	193.6	24	20	470.6	-7.9
NP	6	9	21	17	205.1	94.4	21	16	690.4	-8.6

Operating results and major financial data

	2016A	2017A	2018F	2019F	2020F
Revenue	154	287	369	435	463
OP	17	33	59	85	117
Pretax profit	10	30	65	93	125
NP	8	24	50	69	93
NP (controlling int.)	8	24	50	69	93
EPS	5,691	1,050	1,776	2,462	3,309
PER	0.0	61.9	54.9	39.6	29.5
BPS	61,763	13,141	14,917	16,780	19,389
PBR	0.0	4.9	6.5	5.8	5.0
ROE	12.0	9.5	12.7	15.5	18.3

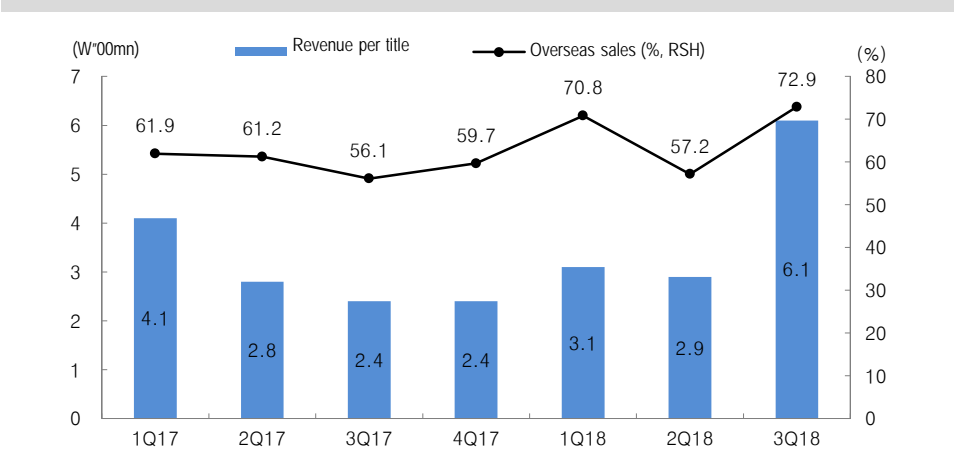
Note: EPS, BPS, and ROE are based only on the controlling interest.
Source: Studio Dragon, Daishin Securities Research Center

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

	Previous		Revised		Chg	
	2018F	2019F	2018F	2019F	2018F	2019F
Revenue	378	420	369	435	-2.4	3.5
S&A expense	13	13	14	13	11.6	-0.2
OP	66	82	59	85	-9.9	3.9
OP margin	17.4	19.5	16.1	19.6	-1.4	0.1
Non-operating profit	8	9	6	8	-25.5	-12.2
Pretax profit	74	91	65	93	-11.6	2.2
NP (controlling int.)	55	68	50	69	-9.9	2.2
NP margin	14.6	16.1	13.5	15.9	-1.1	-0.2
EPS (controlling int.)	1,971	2,408	1,776	2,462	-9.9	2.2

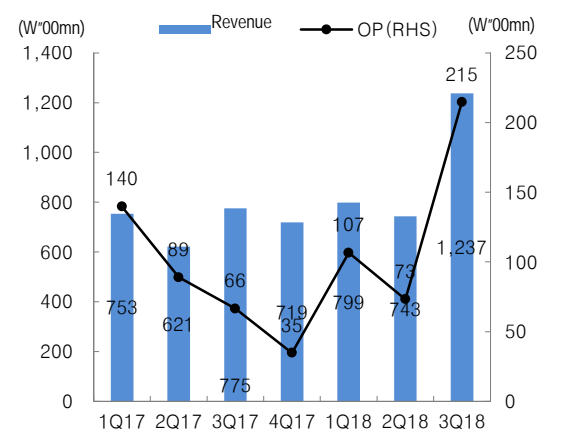
Source: Studio Dragon, Daishin Securities Research Center

Fig 1. Overseas content sales



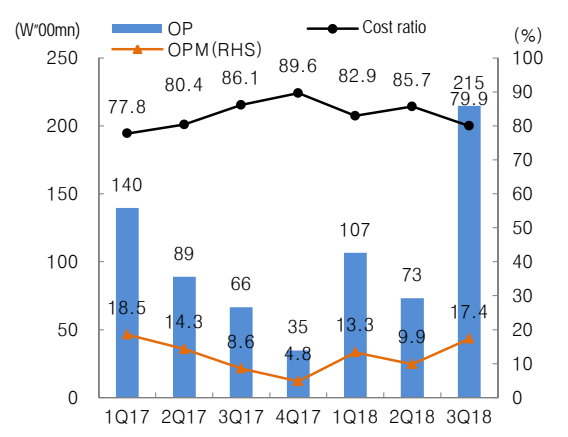
Source: Studio Dragon, Daishin Securities Research Center

Fig 2. Revenue and OP



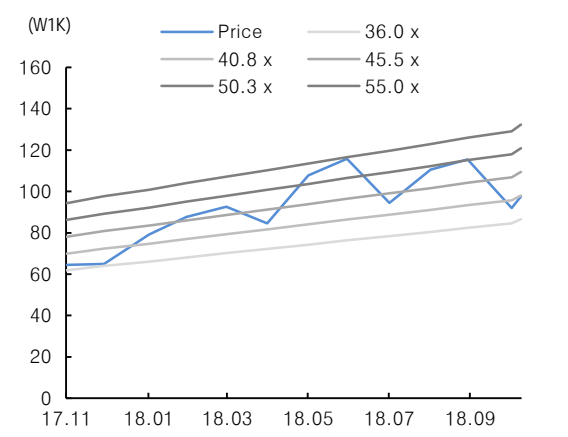
Source: Studio Dragon, Daishin Securities Research Center

Fig 3. OP margin and cost ratio



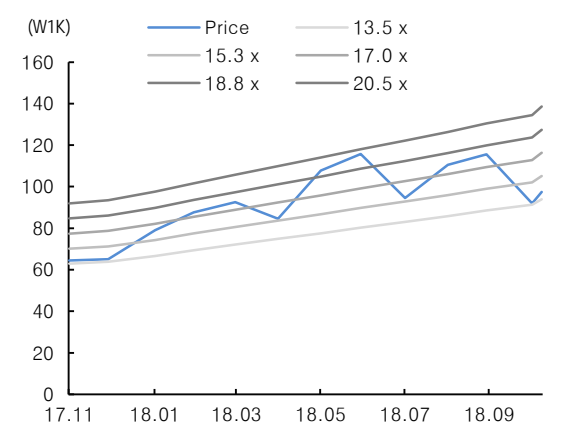
Source: Studio Dragon, Daishin Securities Research Center

Fig 4. 12M FWD PER Band



Source: Wisefn, Daishin Securities Research Center

Fig 5. 12M FWD EV/EBITDA Band



Source: Wisefn, Daishin Securities Research Center

Company profile

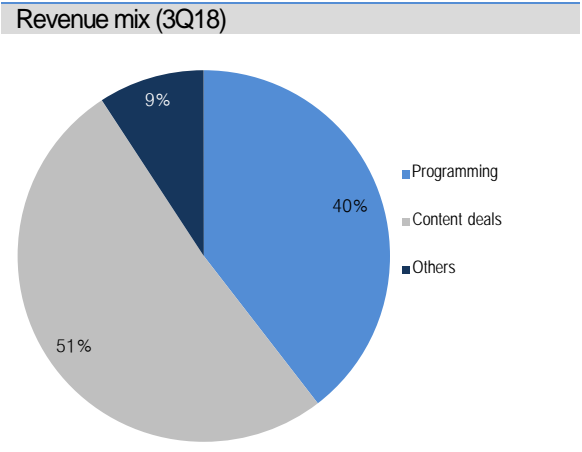
Overview

- Spun off from CJ E&M in May, 2016
- Listed on the KOSDAA in Nov. 2017
- 2017 results (W'00mn): Revenue 2,868, OP 330, NP 79
- 3Q18 revenue mix: Programming 40%, Content deals 51%, Others 9%
- Major shareholder: CJ E&M +6 (75.66%)

Stock catalysts

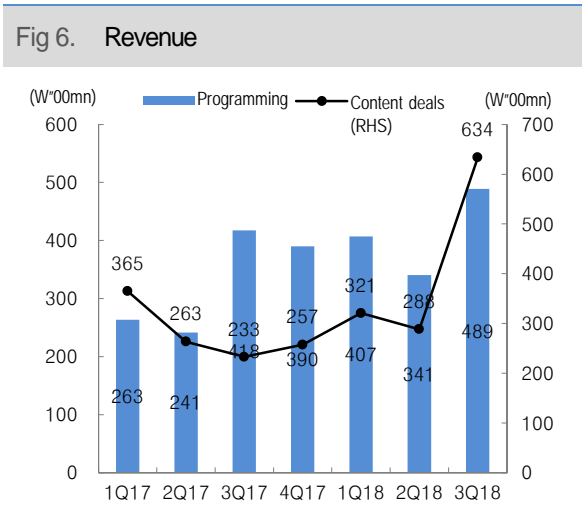
- Drama programming (tvN, OCN)
- Deals with Netflix and Chinese media firms

Source: Studio Dragon, Daishin Securities Research Center

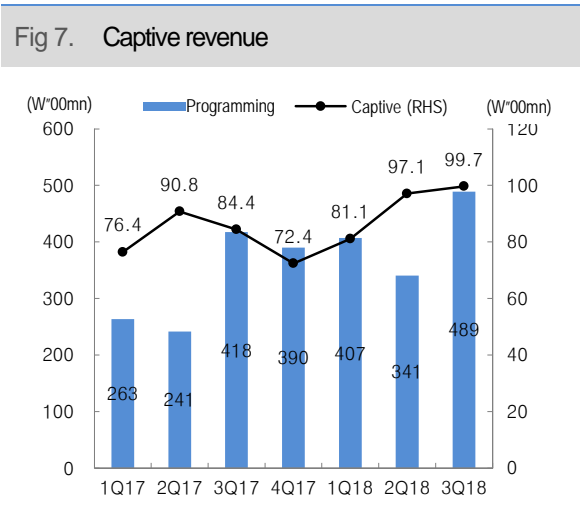


Source: Studio Dragon, Daishin Securities Research Center

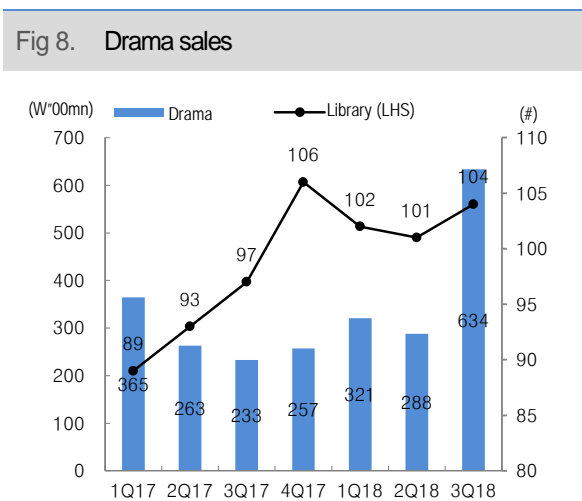
Earnings drivers



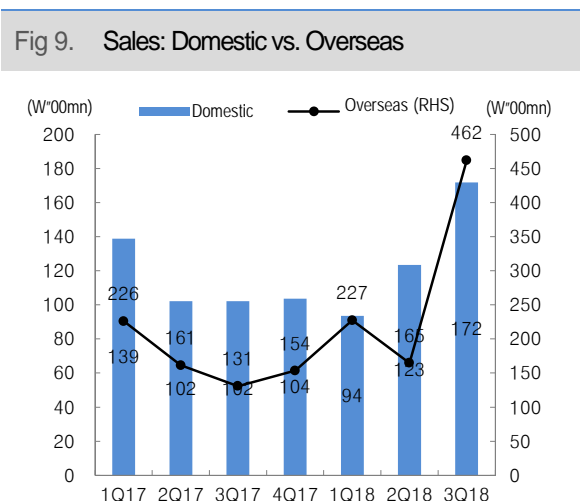
Source: Studio Dragon, Daishin Securities Research Center



Source: Studio Dragon, Daishin Securities Research Center



Source: Studio Dragon, Daishin Securities Research Center



Source: Studio Dragon, Daishin Securities Research Center

Per share intrinsic value

Residual Income Model		(Wbn, W, %)									
		2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
I	NP (contr. int.) ^(Note 2)	50	69	93	116	133	153	176	193	213	234
II	Shareholders' equity (contr. int.) ^(Note 2)	418	470	544	544	637	762	885	1,016	1,152	1,301
	Estimated ROE	12.7	15.5	18.3	21.4	20.9	20.1	19.9	19.0	18.5	18.0
III	Required rate of return ^(Note 3)	5.3									
	Risk free rate of return ^(Note 4)	2.1									
	Market risk premium ^(Note 5)	4.0									
	Beta	0.80									
IV	Spread (estimated ROE – required rate of return)	7.4	10.2	13.0	16.1	15.6	14.8	14.6	13.7	13.2	12.7
V	Required income	20	22	25	29	29	34	40	47	54	61
VI	Residual income (I - V)	30	47	68	87	104	119	135	147	159	173
	Present value factor	1.00	0.95	0.90	0.85	0.81	0.77	0.73	0.69	0.66	0.63
	PV of residual income	30	44	61	74	84	92	99	102	105	108
VII	Sum of residual income	799									
VIII	PV of residual income following forecasting period	2,042									
	Terminal growth (g) ^(Note 6)	0.0%									
IX	Beginning shareholders' equity	368									
X	Fair market cap (VII+VIII+IX)	3,210									
	Total number of shares (1K)	28,037									
XI	Per share value (W)	114,477									
	Current share price (W)	97,500									
	Upside potential (%)	17.4%									

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)				
	2016A	2017A	2018F	2019F	2020F	
Revenue	154	287	369	435	463	
Cost of goods sold	133	240	295	337	333	
Gross profit	22	47	74	98	131	
SG&A expenses	5	14	14	13	14	
OP	17	33	59	85	117	
OP margin	10.8	11.5	16.1	19.6	25.1	
EBITDA	39	74	118	184	216	
Non-OP	-6	-3	6	8	9	
Income from affiliates	0	0	0	0	0	
Financial revenue	1	1	7	8	9	
FX related gains	0	0	0	0	0	
Financial expense	-2	-3	-1	-1	-1	
FX related losses	1	1	0	0	0	
Others	-5	0	0	1	1	
Income before taxes	10	30	65	93	125	
Income tax expense	-2	-6	-15	-24	-33	
Income from cont. op.	8	24	50	69	93	
Income from discount. op.	0	0	0	0	0	
NP	8	24	50	69	93	
NP margin	5.3	8.3	13.5	15.9	20.0	
NP for non-contr. interest	0	0	0	0	0	
NP for contr. interest	8	24	50	69	93	
Valuation of AFS fin. assets	0	0	0	0	0	
Other compreh. income	0	0	0	0	0	
Comprehensive income	8	24	50	69	93	
Comp. income for non-contr. int.	0	0	0	0	0	
Comp. income for contr. int.	8	24	50	69	93	

Valuation metrics		(W, x, %)				
	2016A	2017A	2018F	2019F	2020F	
EPS	5,691	1,050	1,776	2,462	3,309	
PER	0.0	61.9	54.9	39.6	29.5	
BPS	61,763	13,141	14,917	16,780	19,389	
PBR	0.0	4.9	6.5	5.8	5.0	
EBITDAPS	27,127	3,271	4,226	6,569	7,713	
EVEBITDA	0.4	22.1	21.5	13.6	11.3	
SPS	107,949	12,628	13,163	15,504	16,528	
PSR	0.0	5.1	7.6	6.5	6.1	
CFPS	24,684	3,351	4,269	6,670	7,810	
DPS	0	0	600	700	800	

Financial ratios		(W, x, %)				
	2016A	2017A	2018F	2019F	2020F	
Growth potential						
Sales growth	na	85.7	28.7	17.8	6.6	
OP growth	na	98.3	79.8	43.4	37.1	
NP growth	na	192.9	108.8	38.6	34.4	
Profitability						
ROIC	19.4	17.0	23.4	28.3	36.0	
ROA	13.7	9.4	12.3	16.1	19.7	
ROE	12.0	9.5	12.7	15.5	18.3	
Stability						
Debt ratio	77.8	24.7	19.8	17.9	15.6	
Net borrowings ratio	12.1	-49.4	-45.8	-47.9	-52.1	
Interest coverage ratio	19.5	19.0	0.0	0.0	0.0	

Source: Studio Dragon, Daishin Securities Research Center

Balance sheet		(Wbn)				
	2016A	2017A	2018F	2019F	2020F	
Current assets	81	290	305	352	416	
Cash & cash equiv.	12	51	51	85	142	
Trade & other receive.	39	55	71	84	89	
Inventories	0	1	2	2	2	
Other current assets	31	182	182	182	182	
Long-term assets	161	170	196	202	213	
Tangible assets	1	1	1	1	1	
Investments in affiliates	0	0	0	0	0	
Other long-term assets	159	169	195	202	212	
Total assets	242	459	501	555	628	
Current liabilities	84	91	82	84	84	
Payables & other liab.	23	34	36	37	38	
Borrowings	8	0	0	0	0	
Current portion of LT debts	0	10	0	0	0	
Other current liabilities	54	47	47	47	47	
Long-term liabilities	21	0	0	0	0	
Borrowings	20	0	0	0	0	
Convertible securities	0	0	0	0	0	
Other long-term liab.	2	0	0	0	0	
Total liabilities	106	91	83	84	85	
Controlling interest	136	368	418	470	544	
Capital stock	11	14	14	14	14	
Capital surplus	115	320	320	320	320	
Retained earnings	8	32	82	134	207	
Other capital changes	2	3	3	3	3	
Non-controlling interest	0	0	0	0	0	
Total shareholder's equity	136	368	418	470	544	
Net borrowings	16	-182	-192	-226	-283	

Cash flow statement		(Wbn)				
	2016A	2017A	2018F	2019F	2020F	
Operating cash flows	-12	-7	31	93	124	
NP	8	24	50	69	93	
Non-cash items	27	52	70	118	126	
Depreciation	22	41	59	99	100	
FX gains	0	1	0	0	0	
Equity method gain	0	0	0	0	0	
Others	5	10	11	19	26	
Chg in assets & liab.	-46	-73	-80	-78	-71	
Other cash flows	-2	-10	-8	-16	-24	
Investing cash flow	-70	-141	-85	-106	-110	
Investment assets	0	-1	0	0	0	
Tangible assets	-1	0	0	0	0	
Others	-68	-140	-85	-106	-110	
Financing cash flows	93	188	-12	-18	-21	
Short-term borrowings	7	-8	0	0	0	
Bonds payable	20	10	0	0	0	
Long-term borrowings	0	0	0	0	0	
Rights offering	56	208	0	0	0	
Cash dividends	0	0	0	-17	-20	
Others	10	-22	-12	-2	-2	
Net chg in cash	12	40	-1	34	58	
Beginning cash balance	0	12	51	51	85	
Ending cash balance	12	51	51	85	142	
NOPLAT	13	26	45	63	86	
FCF	34	67	19	56	76	

[Daishin House View:1 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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[Investment rating & Target price history]

Studio Dragon (253450 KQ)



Investment rating breakdown and framework (Nov. 5, 2018)

	BUY	MARKETPERFORM	UNDERPERFORM
Ratio	84.3%	14.7%	1.0%

- 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.