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Danny Lee Analyst
Internet, Game, Media, Leisure
82-2-6114-2960 drlee@kbf.com

Jeonghoon Son RA
82-2-6114-2910
jhson@kbf.com

Maintain BUY with target price of KRW130,000; Present stock as our industry top pick in 2019

We maintain our BUY rating and a target price of KRW130,000 on Studio Dragon. We present the stock as our industry top pick due to expectations of structural growth continuing on the back of increased clients for contents in 2019.

Earnings growth continues due to growing content production and increasing ASP

Studio Dragon's organic growth is expected to be spearheaded by a rising number of productions and increased production fees as the number of clients is rising. The company is expanding its client base from captive (CJ ENM) to terrestrial and OTT clients based on its production capability. The number of drama productions is expected to increase from 26 in 2018 to around 30 in 2019 thanks to rising captive demand and an expanded number of programs licensed to be made by other producers. The number of tentpole dramas (each costing more than KRW1bn) is expected to increase from three in 2018 to four to five in 2019, boosting production costs.

Increasing investments in video platforms at home and abroad positive for Studio Dragon's pricing power

Studio Dragon is expected to see its price bargaining power strengthen further, because companies at home and abroad are expanding investments in video platforms and demand for premium contents is rising. Netflix is expected to become the biggest client of Studio Dragon following CJ ENM in 2019. Netflix is estimated to have purchased the copyrights of flagship contents at around 70% of production costs. In addition, a slew of copyright contracts are in the offing in 2019. Meanwhile, Studio Dragon is expected to win additional original content orders beginning with a contract for "Love Alarm" in Sep 2018 (based on a webtoon IP, to be aired in 1H19).

Buy maintain

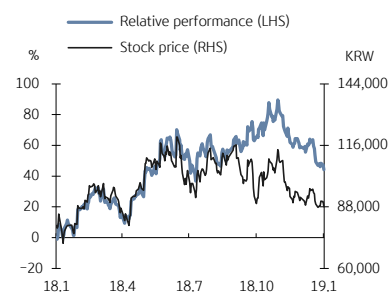
Target Price (maintain)	KRW130,000
Upside/Downside	47.7%
Current price (Jan 29)	KRW88,000
Consensus Target Price	KRW137,316
Market cap	USD2.2bn

Trading Data	
Free float	25.2%
Avg T/O Val (3M, KRWbn)	17.1
Foreign ownership	2.1%
Major shareholders	CJ E&M Corporation and 3 others
	74.4%

Share price performance				
(%)	1M	3M	6M	12M
Absolute	-4.8	-1.7	-15.8	10.6
Relative	-9.5	-12.9	-8.3	44.1

Forecast earnings & valuation

FY-end	2017A	2018E	2019E	2020E
OR (KRWbn)	287	380	491	571
OP (KRWbn)	33	51	95	122
NP to parent (KRWbn)	24	43	77	100
EPS (KRW)	1,050	1,548	2,747	3,554
EPS Growth (%)	84.5	47.4	77.5	29.4
PER (x)	61.9	59.7	32.0	24.8
EV/EBITDA (x)	22.1	20.1	14.9	13.9
PBR (x)	4.9	6.3	5.1	4.2
ROE (%)	9.5	11.2	17.2	18.6
Div. Yield (%)	NA	0.0	0.0	0.0

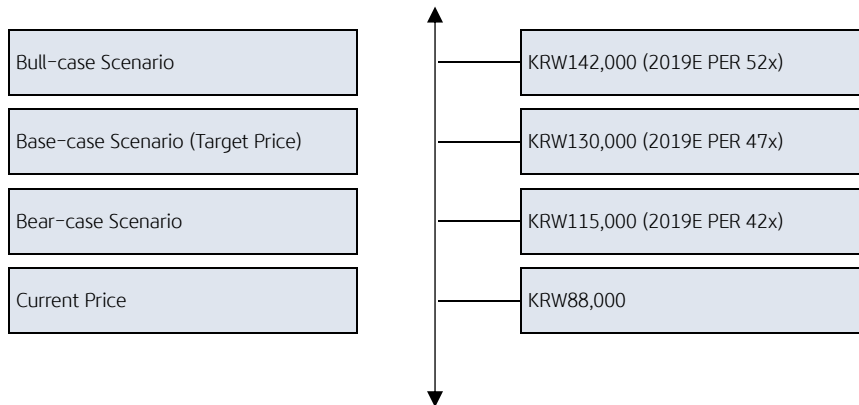


Source: Studio Dragon, KB Securities estimates

Revenues to China expected to become apparent in 2019

Anticipation is heightening over a resumption of drama sales to China. Korean dramas have yet to resume broadcasts in China, but sales of Korean drama and movie copyrights to China started again. Tencent produced and aired “Produce 101” in China after signing an official license agreement for the dance group audition program. Contents supply contracts with China are expected to materialize in 2019. In particular, high hopes are pinned on the sales of blockbuster contents, including “Asadal Chronicles,” which are 100% pre-produced.

Investment opinion and risks



Base-case Scenario: Catalysts

- 1) Produce Netflix original dramas
- 2) Sales to China rise in 2019

Bull-case Scenario: Upside risks

- 1) Increased number of Netflix original drama productions
- 2) Sales to China soar in 2019

Bear-case Scenario: Downside risks

- 1) Decreased number of Netflix original drama productions
- 2) Sales to China decrease in 2019

Revised earnings estimates

(KRWbn, %)	Previous		Revised		Change	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	380	491	380	491	-	-
OP	51	95	51	95	-	-
NP to parent	43	77	43	77	-	-

Source: KB Securities estimates

Difference vs. Consensus

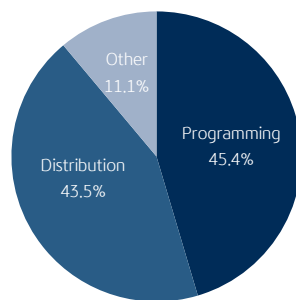
(KRWbn, %)	KB est.		Consensus		Difference	
	2018E	2019E	2018E	2019E	2018E	2019E
OR	380	491	383	213	-0.7	-4.2
OP	51	95	54	95	-6.6	0.0
NP to parent	43	77	46	77	-4.7	0.6

Source: FnGuide, KB Securities estimates

Valuation and target price calculation

- 1) Valuation method:
PER Valuation
- 2) Target price calculation:
2020E EPS KRW 3,554 X PER of 36.5x
- 3) Target price range
KRW142,000 ~ KRW115,000
- 4) Target price valuation
2019E PER 47x

OR composition (2019E, %)



Source: KB Securities estimates

Earnings sensitivity analysis

(%)	EPS change	
	2018E	2019E
1) 1%p rise in interest rate	+2.1	+2.1
2) 1% rise in FX rate	+0.4	+0.4

Peer group comparison

(KRWbn, X, %)	Market cap.	PER		PBR		EV/EBITDA		ROE		Dividend Yield	
		2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
Jcontentree	704	29.7	22.7	2.7	2.5	10.7	9.0	10.9	12.2	n/a	n/a
Netflix	163,883	104.4	73.1	29.3	20.2	76.4	49.0	25.7	28.4	0.0	0.0
Zhejiang Huace Film&TV	2,199	17.3	13.6	1.7	1.6	14.8	12.0	10.4	11.9	0.6	0.7
Beijing HualuBaina Film&TV	622	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: Bloomberg, KB Securities

Profit & Loss					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	154	287	380	491	571
Cost of sales	133	240	317	381	432
Gross profit	22	47	64	110	139
SG&A expenses	5	14	13	15	17
Operating profit	17	33	51	95	122
EBITDA	39	74	119	145	146
Non-operating accounts	-6	-3	5	4	5
Interest income	0	1	4	5	6
Interest expenses	1	2	0	1	1
Profit on equity method	0	0	0	0	0
Net other non-operating income	-5	0	0	0	0
Profit before tax	11	30	56	98	127
Income tax expense	2	6	12	21	28
Net profit	8	24	43	77	100
NP to parent	8	24	43	77	100
Adj. net profit	8	24	43	77	100

Operating Statistics & Ratios					
(%)	2016A	2017A	2018E	2019E	2020E
OR growth	NA	85.7	32.6	29.1	16.3
OP growth	NA	98.3	53.7	87.3	28.8
EBITDA growth	NA	91.4	60.5	21.3	1.0
NP growth of parent	NA	193.0	82.0	77.5	29.4
GP margin	14.0	16.4	16.7	22.4	24.4
OP margin	10.8	11.5	13.3	19.3	21.4
EBITDA margin	25.1	25.9	31.4	29.5	25.6
EBT margin	6.8	10.6	14.7	20.1	22.3
NP margin	5.3	8.3	11.4	15.7	17.5

Cash Flow					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
Cash flow from operating activities	-12	-7	10	134	132
Net profit	8	24	43	77	100
Depreciation & amortization	22	41	69	50	24
Other non-cash adjustments	5	5	10	21	28
Investments in working capital	-46	-73	-101	7	8
Decrease(Increase) in Receivables	-27	-14	-38	-3	-3
Decrease(Increase) in Inventories	0	-2	0	0	0
Increase(Decrease) in Payables	11	9	19	2	2
Other operating cash flow	-2	20	-11	-21	-28
Cash flow from investing activities	-70	-141	1	-15	-16
Capital expenditure	-1	0	-1	-1	-1
Investments in intangibles	0	0	0	-1	-1
Changes in investment assets	0	-1	-1	0	0
Other investment cash flow	-68	0	1	-7	-8
Cash flow from financing activities	93	188	-10	0	0
Proceeds from (repayments of) debt	27	-18	-10	0	0
Changes in equity	56	208	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flow	10	-2	0	0	0
Other cash flow	0	0	0	0	0
Increase/decrease in cash	12	40	1	119	116
Cash and cash equivalents at FYE	12	51	52	171	287
Free cash flow	-14	-7	9	133	131
Net cash flow	0	199	9	125	122
Net cash (net debt)	-16	182	191	316	438

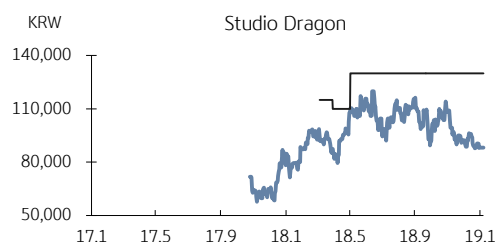
Source: Studio Dragon, KB Securities estimates

Statement of financial position					
(KRWbn)	2016A	2017A	2018E	2019E	2020E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Total assets	242	459	503	591	704
Current assets	81	290	286	414	540
Cash and cash equivalents	12	51	52	171	287
Current financial assets	0	141	139	145	151
Trade receivables	37	55	74	77	80
Inventories	0	1	2	2	2
Other current assets	33	41	19	19	20
Non-current assets	161	170	217	177	164
Investment assets	2	4	4	5	5
Property, plant and equipment	1	1	1	2	3
Intangible assets	124	128	153	105	82
Other non-current assets	33	36	56	63	71
Total liabilities	106	91	94	105	117
Current liabilities	84	91	87	98	111
Trade payables	6	6	14	15	17
Short-term financial liabilities	8	10	0	0	0
Other current liabilities	71	75	74	83	93
Non-current liabilities	21	0	6	7	7
Non-current financial liabilities	20	0	0	0	0
Other non-current liabilities	0	0	5	6	6
Total equity	136	368	410	487	586
Issued capital	11	14	14	14	14
Share premium	115	320	320	320	320
Other equity interest	2	3	0	0	0
Accumulated other comprehensive income	0	0	0	0	0
Retained earnings	8	32	75	152	252
Equity attributable to owners of parent	136	368	410	487	586
Non-controlling Interests	0	0	0	0	0

Key Ratio					
(X, %, KRW)	2016A	2017A	2018E	2019E	2020E
Multiples					
PER	NA	61.9	59.7	32.0	24.8
PBR	NA	4.9	6.3	5.1	4.2
PSR	NA	5.1	6.8	5.0	4.3
EV/EBITDA	0.4	22.1	20.1	14.9	13.9
EV/EBIT	1.0	49.7	47.4	22.7	16.6
Dividend yield, ordinary (%)	NA	NA	0.0	0.0	0.0
EPS	569	1,050	1,548	2,747	3,554
BPS	6,176	13,141	14,598	17,345	20,899
SPS	10,795	12,628	13,564	17,502	20,352
DPS (Annual, Ordnry.)	0	0	0	0	0
Cash dividends payout ratio (%)	0.0	0.0	0.0	0.0	0.0
Operating performance					
ROE	6.0	9.5	11.2	17.2	18.6
ROA	3.4	6.8	9.0	14.1	15.4
ROIC	16.9	15.6	20.1	39.5	62.4
Financial structure (%)					
Total liab./equity	77.8	24.7	22.9	21.5	20.0
Net debt/equity	12.1	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio	1.0	3.2	3.3	4.2	4.9
Interest coverage (x)	19.5	19.0	134.1	79.1	101.9
Activity ratios					
Asset turnover (x)	0.0	0.8	0.8	0.9	0.9
Receivables turnover (x)	0.0	6.2	5.9	6.5	7.3
Inventory turnover (x)	0.0	0.0	237.2	256.7	298.5

Disclosures

Rating and Target Price Changes (Share price —, Target Price —)



Studio Dragon (253450)

Date	Rating	Target Price (KRW)	Differential (%)	
			Avg.	Max/Min
18-04-03	Buy	115,000	-20.05	-15.74
18-04-29	Buy	110,000	-15.81	-2.00
18-06-01	Buy	130,000		

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Proportion of investment rating (as of December 31, 2018)

Buy	Hold	Sell
70.6	29.4	-

* Note: Based on reports presented with investment ratings over the past one year

Classification and Standards for Investment Rating

Investment Rating for Company

(based on estimation of six-month absolute returns)

Buy: +15% or beyond	Hold: Between 15% and -15%	Sell: -15% or beyond
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Note: KB Securities's classification of investment ratings has shifted from four stages (Strong BUY, BUY, Marketperform, Underperform) to three stages (Buy, Hold, Sell) based on Korean reports since February 23, 2017.

Investment Rating for Industry

(based on estimation of six-month absolute returns)

Positive:	Neutral:	Negative:
To outperform market	To match market performance	To underperform market

Notes: The industry rating system of KB Securities has shifted from (Overweight, Neutral, Underweight) to (Positive, Neutral, Negative) as of Jun 28, 2017

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