

Pearl Abyss (263750)

4Q18 Review: Increasing Uncertainties Regarding Release Schedule

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Maintain BUY rating; Target price cut to KRW247,000 to reflect poor 4Q18 earnings and delayed release of key new games

4Q18 earnings miss consensus by large margin; Poor earnings attributable to decreasing revenues of existing games and one-off expenses

Risk highlighted by delayed releases of key new games; Main source of momentum in 1H19 to be Japanese release of "Black Desert Mobile" on Feb 26

We retain our BUY rating on Pearl Abyss, while cutting the target price 8.5% to KRW247,000. The target price was derived by applying a PER of 13.4x (peer group average) to a 2019 EPS of KRW16,820. The target price was adjusted as 2019 OR and OP estimates were each revised down 4.5% and 6.3% to accommodate disappointing 4Q18 earnings and mounting uncertainties over the release schedules of key new games.

Pearl Abyss suffered an earnings shock in 4Q18, turning in OR of KRW99.1bn (-15.3% QoQ, +299.1% YoY) and OP of KRW18.2bn (-69.9% QoQ, +175.8% YoY). PC game revenues rose 37.9% QoQ thanks to the booking of 70-day revenues from CCP Games (KRW12.9bn), while mobile game revenues plunged 31.5%. The domestic daily average revenue of "Black Desert Mobile" is estimated to have dropped KRW0.8bn QoQ to KRW0.5bn. The OP drop was spearheaded by one-off expenses (estimated KRW7.0bn stemming from the acquisition of CCP Games and KRW5.0bn related to servers in Russia) and rises in labor costs (+81.3% QoQ) resulting from employee recruitments.

Uncertainties over release schedules of key new games will mount in 2019. There is a strong chance that the North American and European releases of "Black Desert Mobile" will be delayed from 2Q19 to 2H19. If the game is released in Southeast Asia first, the North American and European releases may be delayed even further. The releases of "Project K" and "Project V" are reported to have been delayed by the development and application of a new engine. OR and OP are forecast to improve QoQ in 1Q19 thanks to numerous factors, including the Japanese launch of "Black Desert Mobile",

Buy maintain

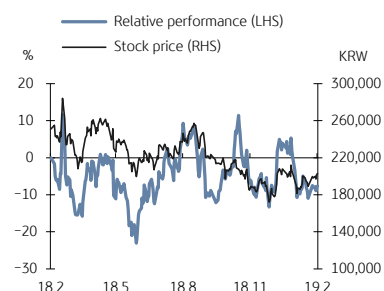
Target Price (lowered)	KRW247,000
Upside/Downside	21.7%
Current price (Feb 14)	KRW202,900
Consensus Target Price	KRW265,923
Market cap	USD2.3bn

Trading Data	
Free float	46.1%
Avg T/O Val (3M, KRWbn)	12.7
Foreign ownership	10.5%
Major shareholders	Dae-Il Kim and 9 others 46.7%

Share price performance				
(%)	1M	3M	6M	12M
Absolute	3.9	8.7	-17.7	-19.2
Relative	-4.4	-1.7	-15.5	-7.6

Forecast earnings & valuation

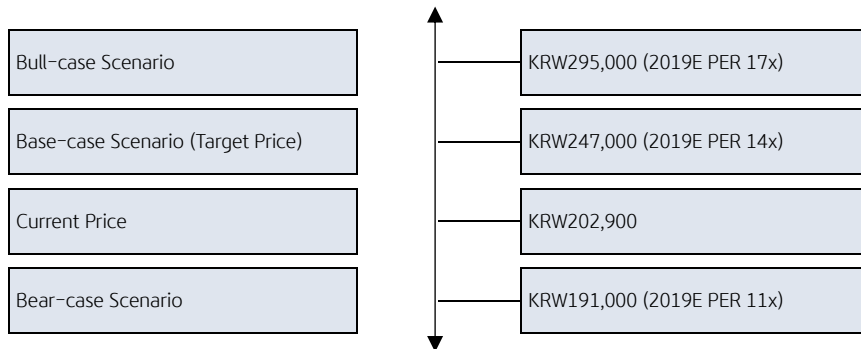
FY-end	2018E	2019E	2020E	2021E
OR (KRWbn)	404	560	621	702
OP (KRWbn)	167	257	305	368
NP to parent (KRWbn)	146	225	273	331
EPS (KRW)	11,558	17,385	21,102	25,550
EPS Growth (%)	793.9	50.4	21.4	21.1
PER (x)	18.0	11.7	9.6	7.9
EV/EBITDA (x)	13.6	7.7	5.6	3.8
PBR (x)	6.4	4.1	2.9	2.1
ROE (%)	41.9	42.2	34.9	30.5
Div. Yield (%)	0.0	0.0	0.0	0.0



Source: Pearl Abyss, KB Securities estimates

the release of the console version of “Black Desert” and the booking of full-quarter contributions from CCP Games. However, it is necessary to lower expectations over the company’s earnings growth in 2019. The largest source of momentum in 1H19 is expected to be the upcoming Japanese release of “Black Desert Mobile” on Feb 26. We expect Black Desert Mobile to be successful in Japan early on (daily average revenue of KRW0.5bn in 1Q19) because 1) there are a number of cases in which “Lineage 2: Revolution,” “Talion” and other Korean MMORPGs achieved success in Japan early on and 2) “Black Desert Online” is already being serviced in Japan and Pearl Abyss is expected to launch a massive marketing campaign within Feb.

Investment opinion and risks



Base-case Scenario: Catalysts

- 1) "Black Desert" console released
- 2) "Black Desert Mobile" launched in Japan

Bull-case Scenario: Upside risks

- 1) "Black Desert" console sales rise
- 2) "Black Desert Mobile" is popular in Japan

Bear-case Scenario: Downside risks

- 1) "Black Desert" console release delayed
- 2) "Black Desert Mobile" launch in Japan delayed

Revised earnings estimates

(KRWbn, %)	Previous		Revised		Change	
	2018P	2019E	2018E	2019E	2018P	2019E
OR	415.4	586.4	404.3	559.8	-2.7	-4.5
OP	179.4	274.0	166.9	256.7	-7.0	-6.3
NP to parent	158.9	247.4	145.3	221.4	-8.6	-10.5

Source: KB Securities estimates

Difference vs. Consensus

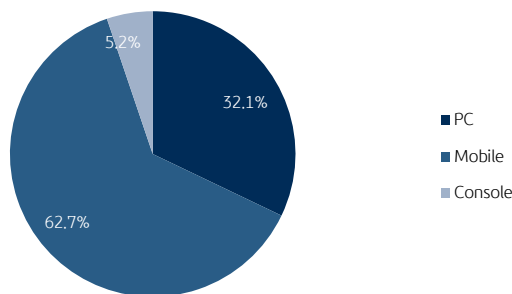
(KRWbn, %)	KB est.		Consensus		Difference	
	2018P	2019E	2018E	2019E	2018P	2019E
OR	404.3	559.8	417.3	615.2	-3.1	-9.0
OP	166.9	256.7	186.1	292.4	-10.3	-12.2
NP to parent	145.3	221.4	162.3	244.6	-10.5	-9.5

Source: WISEfn, KB Securities estimates

Valuation and target price calculation

- 1) Valuation method:
PER Valuation
- 2) Target price calculation:
12M fwd. EPS KRW16,820
X multiple 13.4x
- 3) Target price range:
KRW295,000 ~ KRW191,000
- 4) Target price valuation:
2019E PER of 14x

OR composition (2019E, %)



Source: Company data, KB Securities

Earnings sensitivity analysis

(%)	EPS change	
	2018E	2019E
1% rise in FX Rate	+0.3	+0.3
1%p rise in interest rate	+1.2	+1.2

Peer group comparison

(KRWbn, X, %)	Market cap.	PER		PBR		EV/EBITDA		ROE		Dividend Yield	
		2019E	2020E	2019E	2020E	2019E	2020E	2019E	2020E	2019E	2020E
NCSOFT	9,765	21.3	18.0	3.4	3.1	12.7	11.4	16.6	18.9	1.7	1.7
Com2us	1,585	11.9	10.3	1.8	1.6	5.7	4.6	16.5	16.3	1.1	1.3
NEXON	15,181	14.7	16.2	2.7	2.3	9.3	9.0	19.0	15.3	0.1	0.1
Activision Blizzard	38,280	17.1	19.7	3.0	2.7	12.1	12.8	17.2	13.3	0.8	0.9

Source: Bloomberg, KB Securities

Table 1. Pearl Abyss's 4Q18 consolidated earnings review

(KRWon, %, %p)	4Q18P	3Q18	QoQ	4Q17	YoY	KB estimates	Diff.	Consensus	Diff.
OR	99.1	117.0	(15.3)	24.8	299.1	110.2	(10.1)	112.2	(11.7)
OP	18.2	60.3	(69.9)	6.6	175.8	30.6	(40.8)	37.5	(51.6)
<i>OP margin</i>	<i>18.3</i>	<i>51.6</i>	<i>(33.2)</i>	<i>26.5</i>	<i>(8.2)</i>	<i>27.8</i>	<i>(9.5)</i>	<i>33.4</i>	<i>(15.1)</i>
NP to parent	13.6	51.7	(73.8)	1.4	887.6	27.2	(50.1)	31.9	(57.5)
<i>NP margin</i>	<i>13.7</i>	<i>44.2</i>	<i>(30.5)</i>	<i>5.5</i>	<i>8.2</i>	<i>24.7</i>	<i>(11.0)</i>	<i>28.5</i>	<i>(14.8)</i>

Source: FnGuide, KB Securities estimates

Table 2. Pearl Abyss's consolidated earnings trend and estimates

(KRWbn)	1Q18	2Q18	3Q18	4Q18P	1Q19E	2Q19E	3Q19E	4Q19E	2017	2018P	2019E	2020E
OR	75.5	112.7	117.0	99.1	119.9	132.6	155.7	151.6	117.3	404.3	559.8	621.2
(QoQ %)	204.2	49.2	3.8	(15.3)	21.1	10.6	17.4	(2.6)	-	-	-	-
(YoY %)	137.4	241.2	323.8	299.1	58.8	17.7	33.1	53.0	-	244.7	38.5	11.0
PC	33.9	29.9	27.3	37.6	40.4	42.1	40.3	51.6	117.3	128.7	174.4	195.8
Korea	6.0	3.9	3.5	3.2	3.0	3.1	3.3	3.2	19.4	16.6	12.6	12.8
Asia	14.7	15.1	14.8	10.7	10.3	12.1	11.8	10.8	56.0	55.3	45.0	43.7
North America/Europe	13.2	10.9	9.0	10.9	10.6	10.3	8.5	11.0	41.9	44.0	40.4	40.8
New game	-	-	-	12.9	16.6	16.6	16.6	26.6	-	12.9	76.3	98.5
Mobile	41.6	82.8	89.7	61.4	74.5	82.5	111.4	93.4	-	275.5	361.8	400.1
Console	-	0.0	0.0	0.0	5.0	8.0	4.0	6.6	-	0.0	23.6	25.3
OP	33.6	54.8	60.3	18.2	49.1	58.5	75.2	73.9	64.8	166.9	256.7	305.1
(QoQ %)	410.2	63.2	10.0	(69.9)	170.7	19.1	28.4	(1.7)	-	-	-	-
(YoY %)	60.8	147.1	299.0	175.8	46.3	6.7	24.6	307.0	-	157.6	53.8	18.8
<i>OP margin (%)</i>	<i>44.5</i>	<i>48.7</i>	<i>51.6</i>	<i>18.3</i>	<i>41.0</i>	<i>44.1</i>	<i>48.3</i>	<i>48.7</i>	<i>55.2</i>	<i>41.3</i>	<i>45.9</i>	<i>49.1</i>
NP to parent	27.8	52.2	51.7	13.6	42.5	50.5	64.7	63.7	49.7	145.3	221.4	269.5
(QoQ %)	1,926.7	87.4	(0.9)	(73.8)	213.3	18.9	28.1	(1.6)	-	-	-	-
(YoY %)	83.1	165.9	283.3	887.6	52.6	(3.2)	25.2	369.7	-	192.4	52.4	21.7
<i>NP margin (%)</i>	<i>36.9</i>	<i>46.3</i>	<i>44.2</i>	<i>13.7</i>	<i>35.4</i>	<i>38.1</i>	<i>41.6</i>	<i>42.0</i>	<i>42.4</i>	<i>35.9</i>	<i>39.6</i>	<i>43.4</i>

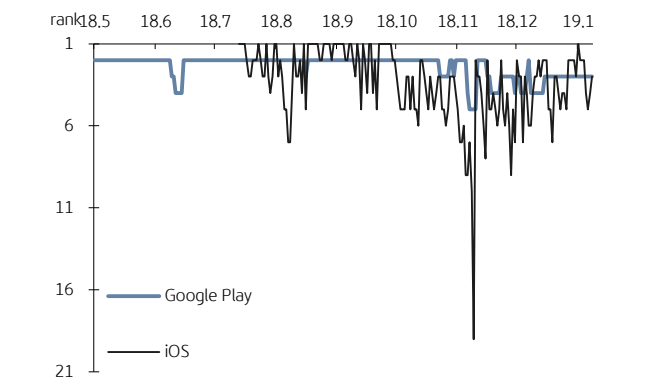
Source: Company data, KB Securities estimates

Table 3. Comparison of revised earnings estimates

(KRWbn, %, %p)	2018P					2019E				
	Changed	Previous	Diff.	Cons.	Diff.	Changed	Previous	Diff.	Cons.	Diff.
OR	404.3	415.4	(2.7)	417.3	(3.1)	559.8	586.4	(4.5)	615.2	(9.0)
OP	166.9	179.4	(7.0)	186.1	(10.3)	256.7	274.0	(6.3)	292.4	(12.2)
<i>OP margin</i>	<i>41.3</i>	<i>43.2</i>	<i>(1.9)</i>	<i>44.6</i>	<i>(3.3)</i>	<i>45.9</i>	<i>46.7</i>	<i>(0.9)</i>	<i>47.5</i>	<i>(1.7)</i>
NP to parent	145.3	158.9	(8.6)	162.3	(10.5)	221.4	247.4	(10.5)	244.6	(9.5)
<i>NP margin</i>	<i>35.9</i>	<i>38.3</i>	<i>(2.3)</i>	<i>38.9</i>	<i>(3.0)</i>	<i>39.6</i>	<i>42.2</i>	<i>(2.6)</i>	<i>39.8</i>	<i>(0.2)</i>

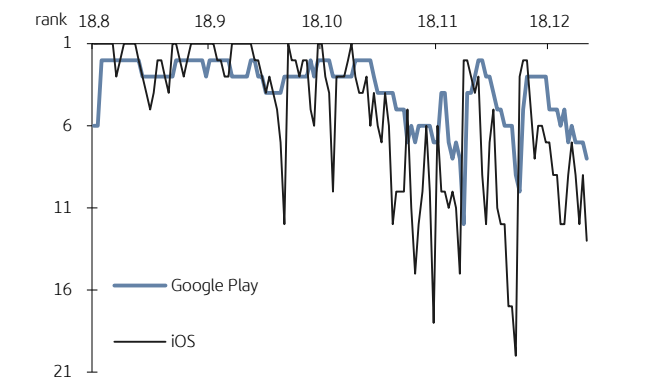
Source: FnGuide, KB Securities estimates

Fig 1. Black Desert Mobile's sales trend in Korea



Source: Appannie, KB Securities

Fig 2. Black Desert Mobile's sales trend in Taiwan



Source: Appannie, KB Securities

Profit & Loss					
(KRWbn)	2017A	2018E	2019E	2020E	2021E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Operating revenue	52	404	560	621	702
Cost of sales	0	0	0	0	0
Gross profit	52	404	560	621	702
SG&A expenses	31	237	303	316	334
Operating profit	22	167	257	305	368
EBITDA	23	168	258	306	369
Non-operating accounts	-4	9	9	18	23
Interest income	1	3	5	13	17
Interest expenses	0	0	0	0	0
Profit on equity method	0	0	0	0	0
Net other non-operating income	0	0	0	0	0
Profit before tax	18	176	266	323	391
Income tax expense	3	29	40	48	59
Net profit	15	147	226	274	332
NP to parent	15	146	225	273	331
Adj. net profit	15	146	225	273	331

Operating Statistics & Ratios					
(%)	2017A	2018E	2019E	2020E	2021E
OR growth	55.5	671.8	38.5	11.0	13.0
OP growth	-23.0	670.4	53.8	18.9	20.6
EBITDA growth	-20.5	640.8	53.5	18.8	20.5
NP growth of parent	-39.7	891.4	54.1	21.4	21.1
GP margin	100.0	100.0	100.0	100.0	100.0
OP margin	41.4	41.3	45.9	49.1	52.4
EBITDA margin	43.3	41.5	46.0	49.3	52.6
EBT margin	33.8	43.5	47.5	51.9	55.7
NP margin	28.1	36.3	40.4	44.1	47.3

Cash Flow					
(KRWbn)	2017A	2018E	2019E	2020E	2021E
Cash flow from operating activities	27	148	227	276	333
Net profit	15	147	226	274	332
Depreciation & amortization	1	1	1	1	1
Other non-cash adjustments	9	29	40	49	59
Investments in working capital	7	1	0	0	0
Decrease(Increase) in Receivables	6	-1	-1	-1	-1
Decrease(Increase) in Inventories	0	0	0	0	0
Increase(Decrease) in Payables	0	0	0	0	0
Other operating cash flow	-4	-29	-40	-48	-59
Cash flow from investing activities	-8	-3	-3	-3	-3
Capital expenditure	-4	-1	-1	-1	-1
Investments in intangibles	-1	-1	-1	-1	-1
Changes in investment assets	-2	0	0	0	0
Other investment cash flow	-1	0	0	0	0
Cash flow from financing activities	179	5	2	1	1
Proceeds from (repayments of) debt	-1	0	0	0	0
Changes in equity	185	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flow	-6	5	2	1	1
Other cash flow	-3	0	0	0	0
Increase/decrease in cash	194	150	226	273	331
Cash and cash equivalents at FYE	241	390	617	890	1,222
Free cash flow	23	147	226	275	332
Net cash flow	236	151	228	275	333
Net cash (net debt)	262	413	640	915	1,247

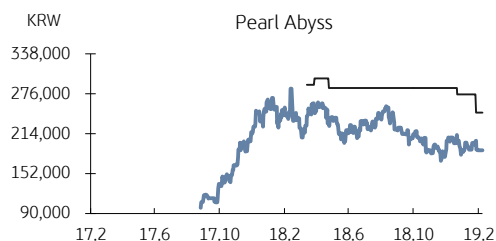
Source: Pearl Abyss, KB Securities estimates

Statement of financial position					
(KRWbn)	2017A	2018E	2019E	2020E	2021E
(Reporting standard)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)	(IFRS-C)
Total assets	297	449	678	954	1,289
Current assets	280	432	660	936	1,269
Cash and cash equivalents	241	390	617	890	1,222
Current financial assets	21	22	23	24	26
Trade receivables	16	17	18	18	19
Inventories	0	0	0	0	0
Other current assets	2	3	3	3	3
Non-current assets	17	17	18	19	19
Investment assets	3	3	4	4	4
Property, plant and equipment	6	7	7	7	7
Intangible assets	4	4	5	5	5
Other non-current assets	1	1	1	1	1
Total liabilities	21	27	31	33	35
Current liabilities	20	21	22	24	25
Trade payables	0	0	0	0	0
Short-term financial liabilities	0	0	0	0	0
Other current liabilities	20	21	22	23	24
Non-current liabilities	2	6	8	9	10
Non-current financial liabilities	0	0	0	0	0
Other non-current liabilities	1	1	1	1	1
Total equity	275	422	648	922	1,254
Issued capital	6	6	6	6	6
Share premium	181	181	181	181	181
Other equity interest	3	3	3	3	3
Accumulated other comprehensive income	-1	-1	-1	-1	-1
Retained earnings	85	231	456	729	1,060
Equity attributable to owners of parent	275	421	646	919	1,250
Non-controlling Interests	0	1	1	3	4

Key Ratio					
(X, %, KRW)	2017A	2018E	2019E	2020E	2021E
Multiples					
PER	191.5	18.0	11.7	9.6	7.9
PBR	10.9	6.4	4.1	2.9	2.1
PSR	53.8	6.5	4.7	4.2	3.7
EV/EBITDA	120.3	13.6	7.7	5.6	3.8
EV/EBIT	125.9	13.7	7.7	5.6	3.8
Dividend yield, ordinary (%)	NA	0.0	0.0	0.0	0.0
EPS	1,293	11,558	17,385	21,102	25,550
BPS	22,807	32,545	49,929	71,031	96,581
SPS	4,599	31,997	43,253	47,995	54,218
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	9.9	41.9	42.2	34.9	30.5
ROA	8.6	39.3	40.1	33.6	29.6
ROIC	1,095.6	1,629.6	2,542.7	2,953.0	3,457.2
Financial structure (%)					
Total liab./equity	7.8	6.5	4.7	3.5	2.8
Net debt/equity	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio	14.2	20.3	29.4	39.6	51.0
Interest coverage (x)	3,009.6	0.0	0.0	0.0	0.0
Activity ratios					
Asset turnover (x)	0.3	1.1	1.0	0.8	0.6
Receivables turnover (x)	4.2	24.8	32.7	34.5	37.1
Inventory turnover (x)	0.0	0.0	0.0	0.0	0.0

Disclosures

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



Pearl Abyss (263750)

Date	Rating	Target Price (KRW)	Differential (%)	
			Avg.	Max/Min
18-04-02	Buy	290,000	-13.43	-10.00
18-04-16	Buy	300,000	-16.01	-12.50
18-05-13	Buy	285,000	-21.73	-9.82
18-11-13	6 month later	285,000	-32.64	-25.65
19-01-10	Buy	275,000	-29.52	-26.07
19-02-14	Buy	247,000		

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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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