

Wemade Entertainment (112040 KS)

ChuanQi IP value assessed above KRW1tr

BUY (Maintain)

CP (Feb. 27) KRW50,900
TP (6 months) KRW65,000
Upside 27.7%

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KOSPI	2,234.79p
KOSDAQ	752.16p
Market cap	KRW855.1bn/USD750.1mn
Par value	KRW500
Outstanding shares	16.8mn
Free float	8.5mn(50.6%)
52-week high/low	KRW60,000/KRW19,900
60-day avg. trading volume	249,579shrs
60-day avg. turnover	KRW8,904mn
Foreign ownership	4.54%
Major shareholders	
Gwan-ho Park and 2 others	47.00%
KB Asset Management	6.33%
Absolute performance	3M 95.4%
	6M 52.6%
	12M -8.8%
Relative performance	3M 82.0%
to KOSDAQ	6M 62.5%
	12M 6.0%

- ◆ License deals with China's 37Games starts off with Lord of the City
- ◆ Ample upside in JV value with size of market in China assessed at KRW4tr-5tr
- ◆ Target price raised to KRW65,000; Lawsuit wins to add additional upside

License deals with China's 37Games starts off with Lord of the City

Wemade Entertainment has sealed its first official license deal with 37Games for the use of The Legend of Mir IP on the Chinese company's most recently released mobile game, Lord of the City (iOS release on December 29, 2018; ranks third in gross sales in China with daily average sales estimated at KRW3bn).

The license deal comes after Wemade Entertainment's lawsuit win (December 28, 2018) against 37Games on the IP infringement by Legend of Dominance Tour, one of the six games released by the Chinese company that are based on The Legend of Mir IP. In our view, the signing of an official license contract with Wemade Entertainment amid ongoing lawsuits on the rest of its games shows that 37Games now acknowledges its infringement of the Legend of Mir IP. We expect to see the two companies sign additional license deals for the other games such as Legend of Dominance Tour, after negotiating the payment of royalties to cover past years in service (estimated around KRW100bn-200bn for four years) and terms for future use of the IP.

Ample upside in JV value with size of market in China assessed at KRW4tr-5tr

The value of ChuanQi IP was assessed at KRW1tr at the 2017 signing of an MOU with the Shangrao provincial government in China. Gross sales of ChuanQi IP-based games in China were estimated at KRW2tr-3tr at that time. Since then, growth of the market for mobile and HTML5 games and the success of several ChuanQi IP-based games likely expanded the market in China to KRW4tr-5tr. With the market now larger by at least 30% on a conservative view, we see ample upside in the value of ChuanQi IP.

Target price raised to KRW65,000; Lawsuit wins to add additional upside

We raise our target price for Wemade Entertainment to KRW65,000, with: 1) JV value projections revised up from KRW1tr to KRW1.3tr in reflection of growth of the market for ChuanQi IP-based games (+30% based on conservative estimates); and 2) discount applied to valuations reduced from 50% to 30% in reflection of favorable developments on ongoing lawsuits.

Moreover, large cash inflows are expected from upcoming court rulings on lawsuits against Kingnet Network (end-March, seeking KRW242bn in damages) and Shanda Games (end-December), as well as additional license deals with 37Games for other games such as Legend of Dominance Tour (KRW100bn-200bn in royalties for the past four years in service). All in all, we see ample upside even after the distribution of 20% of total license revenue from The Legend of Mir IP to Actoz Soft (052790 KS).

Year to December	Sales (bn KRW)	OP (bn KRW)	Pre-tax (bn KRW)	NP (bn KRW)	EPS (KRW)	Growth (%)	BPS (KRW)	PER (x)	EV/EBITDA (x)	PBR (x)	ROE (%)	Net debt ratio (%)
2016	108.0	4.1	(88.6)	(71.0)	(4,224)	RR	17,494	(5.3)	28.2	1.3	(21.7)	(23.6)
2017	109.6	6.0	14.5	9.7	580	TB	17,623	87.0	53.6	2.9	3.3	(68.5)
2018F	127.1	(36.2)	(35.4)	(13.2)	(787)	TR	16,250	(33.0)	(9.0)	1.6	(4.6)	(58.7)
2019F	157.4	23.1	29.8	26.6	1,586	TB	17,250	23.0	16.9	2.1	9.5	(52.6)
2020F	165.3	28.8	35.5	31.7	1,888	19.1	24,506	19.3	10.4	1.5	9.0	(66.4)

Source: Company data, Shinhan Investment Corp. / Note: TB = turn black, TR = turn red, RR = remain red

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1Q19 forecast

(bn KRW, %)	1Q19F	4Q18	% QoQ	1Q18	% YoY	Consensus
Sales	45.8	32.4	41.4	35.1	30.6	32.3
OP	10.7	(39.3)	TB	7.5	43.9	(1.3)
NP	11.4	(24.7)	TB	9.4	20.3	0.0
OPM	23.4	(121.2)		21.2		(4.0)
NPM	24.8	(76.3)		26.9		0.0

Source: Company data, Shinhan Investment Corp.

Sum-of-the-parts valuation

(bn KRW)	Value	Remarks
Fair enterprise value (A = B+C)	1,101.0	
Operating value of mobile games (B)	0	Value of mobile games based on new IP assets assumed at zero in reflection of weak market response to Icarus M
Asset value (C = D+E)	1,101.0	
Value of stake in ChuanQi IP (D)	550	Backed by market growth, ChuanQi IP value now seen 30% higher than USD1bn assessed at signing of MOU in 2017 Discount reduced from 50% to 30% on signing of license deal with 37Games and forecasts for favorable rulings on additional lawsuits
IP value	1,430	
Discount rate (%)	30	
Cash holdings (E)	100.0	
Total outstanding shares (F)	16,800,000	
Fair price (A/F; KRW)	65,536	
Target price (KRW)	65,000	
Current price (KRW)	50,900	
Upside (%)	27.7	

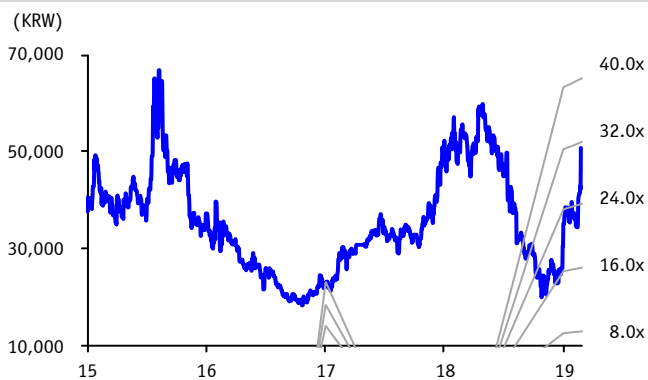
Source: Shinhan Investment Corp.

Earnings forecast revision

(bn KRW)	2019F			2020F		
	Previous	Revised	Change (%)	Previous	Revised	Change (%)
Sales	132.6	157.4	18.7	139.2	165.3	18.8
OP	(2.9)	23.1	TB	1.6	28.8	1,700
NP	6.9	26.6	285.5	14.9	31.7	112.8

Source: Shinhan Investment Corp.

12-month forward PER band



Source: Bloomberg, Shinhan Investment Corp.

12-month forward PBR band



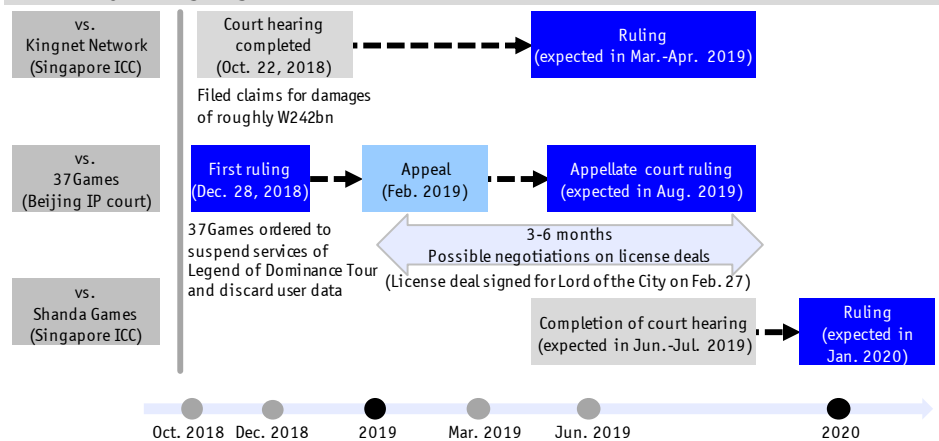
Source: Bloomberg, Shinhan Investment Corp.

Earnings trend and outlook

(bn KRW, %)	1Q18	2Q18	3Q18	4Q18	1Q19F	2Q19F	3Q19F	4Q18F	2017	2018	2019F
Sales	35.1	27.8	31.8	32.4	45.8	38.0	36.2	37.3	109.6	127.1	157.4
(% QoQ)	20.4	(20.9)	14.5	2.0	41.4	(17.0)	(4.8)	3.1			
(% YoY)	3.7	25.2	30.4	11.2	30.6	37.0	13.9	15.1	21.7	16.0	23.9
PC online games	3.7	3.9	4.1	4.2	4.0	4.0	4.0	4.0	23.8	15.9	16.0
Mobile games	6.1	9.7	14.2	9.7	10.4	11.9	11.3	11.3	29.2	39.7	44.9
License revenue	25.2	15.6	13.0	18.1	30.9	21.7	20.4	21.4	56.0	71.8	94.5
SG&A	27.6	27.7	36.2	71.7	35.1	32.5	33.3	33.4	103.6	163.2	134.3
Labor costs	12.6	13.5	14.0	14.6	14.4	14.4	14.6	14.8	48.2	54.7	58.1
Paid commissions	11.0	8.9	11.4	12.4	12.3	11.7	11.3	11.4	28.0	43.7	46.7
Advertising expenses	0.7	1.8	6.5	1.8	4.0	2.0	3.0	2.7	11.4	10.8	11.8
Depreciation expenses	1.3	1.2	1.1	1.1	1.2	1.2	1.2	1.2	6.3	4.8	4.8
Others	2.1	2.2	3.2	41.8	3.2	3.2	3.2	3.2	9.7	49.3	12.9
OP	7.5	0.1	(4.4)	(39.3)	10.7	5.5	2.9	3.9	6.0	(36.2)	23.1
OPM (%)	21.2	0.3	(13.9)	(121.2)	23.4	14.5	8.0	10.5	5.5	(28.5)	14.7
(% QoQ)	37.5	(98.9)	TR	RR	TB	(48.6)	(47.6)	35.9			
(% YoY)	210.8	TB	TR	TR	43.9	6,517.3	TB	TB	TB	(705.2)	TB
Pre-tax profit	8.2	6.6	(5.7)	(44.5)	12.3	7.3	4.6	5.6	14.5	(35.4)	29.8
Income tax	3.7	5.1	1.7	2.6	3.0	1.7	1.1	1.4	15.4	13.1	7.1
NP of controlling interests	9.4	5.8	(3.8)	(24.7)	11.4	7.5	5.5	2.3	9.5	(13.2)	26.6
NPM of controlling interests (%)	26.9	20.9	(11.8)	(76.3)	24.8	19.7	15.1	6.1	8.6	(10.4)	16.9

Source: Company data, Shinhan Investment Corp.

Summary of ongoing IP lawsuits

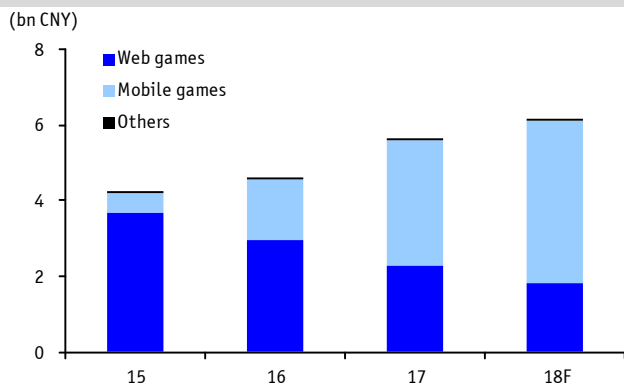


Source: Shinhan Investment Corp.

New game release schedule

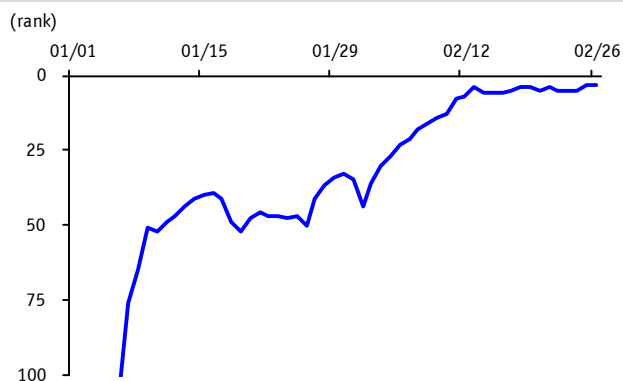
4Q18	2019
The Legend of Mir 2 Reboot (IP deal; Released in Korea on November 21)	Icarus M (Scheduled for release in Japan and Taiwan on February 21) The Legend of Mir 4 (MMORPG; Slated for release in Korea in 1H19) Mir M (MMORPG; Scheduled for release in Korea in 2H19) Mir W (Under development by nDreams; Slated for release in Korea in 2H19-1H20)

Source: Company data, Shinhan Investment Corp.

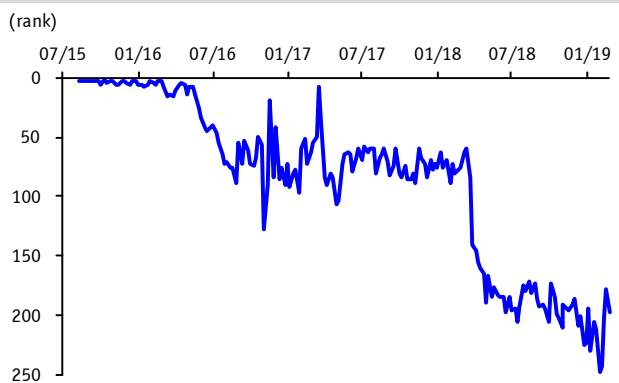
37Games: Game sales breakdown

Source: Company data, Shinhan Investment Corp.

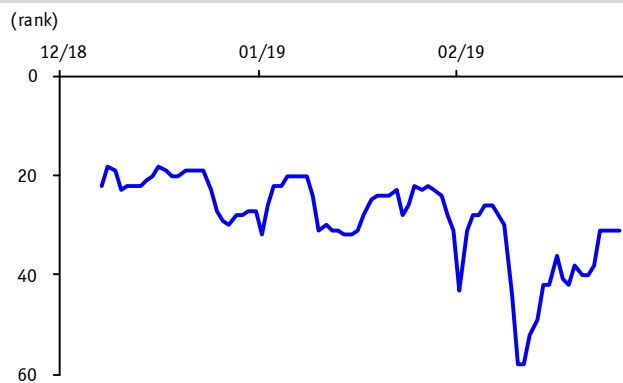
Note: 2018 sales estimated at double the sales of 1H18

Lord of the City: Revenue ranking in China (iOS)

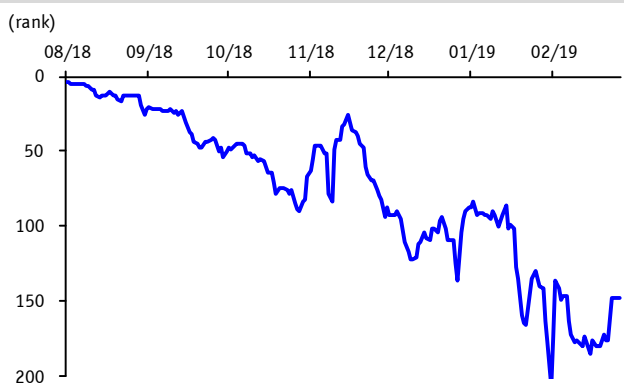
Source: App Annie, Shinhan Investment Corp.

Rexue ChuanQi: Revenue ranking in China (iOS)

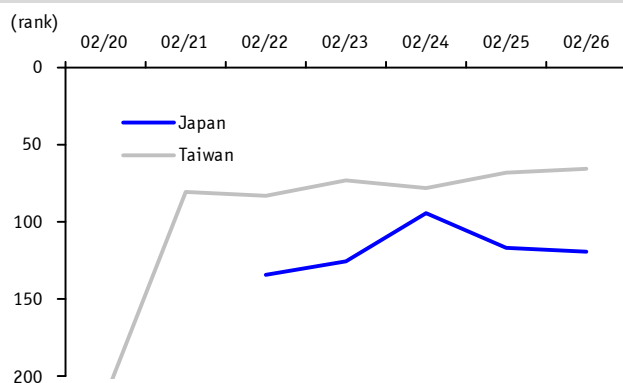
Source: App Annie, Shinhan Investment Corp.

The Legend of Mir 2 Reboot: Revenue ranking in Korea

Source: App Annie, Shinhan Investment Corp. / Note: Google Play ranking

Icarus M: Revenue ranking in Korea (Google Play)

Source: App Annie, Shinhan Investment Corp.

Icarus M: Revenue ranking in Japan and Taiwan (iOS)

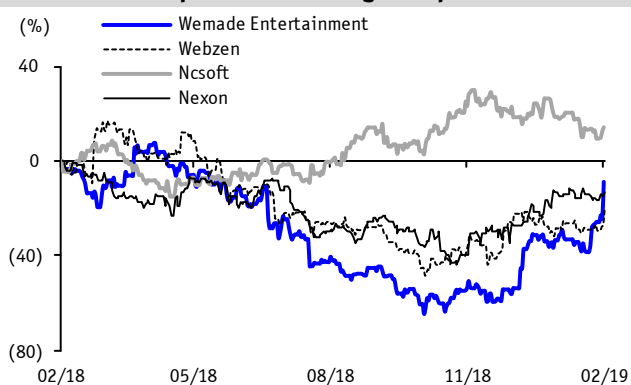
Source: App Annie, Shinhan Investment Corp.

Peer group valuation

Ticker		112040 KS	036570 KS	078340 KS	069080 KS	063080 KS	3659 JP
Company		Wemade Entertainment	NCsoft	Com2uS	Webzen	Gamevil	Nexon
Market cap. (bn KRW)		855.1	9,861.6	1,574.8	780.4	360.1	15,308.5
Sales	2018F	127.1	1,715.1	481.8	218.2	112.5	2,528.6
(bn KRW)	2019F	140.1	1,919.1	577.3	217.6	155.2	2,746.4
	2020F	153.1	2,452.3	648.8	238.1	171.0	2,935.7
OP	2018F	(36.2)	614.9	146.6	68.9	(17.4)	1,066.2
(bn KRW)	2019F	1.3	705.8	185.8	59.9	2.0	1,089.2
	2020F	10.7	1,004.3	212.9	70.9	8.1	1,196.7
OPM	2018F	(28.5)	35.9	30.4	31.6	(15.5)	42.2
(%)	2019F	0.9	36.8	32.2	27.5	1.3	39.7
	2020F	7.0	41.0	32.8	29.8	4.8	40.8
NP	2018F	(13.2)	418.2	126.9	31.9	(5.4)	1,132.5
(bn KRW)	2019F	4.5	534.4	154.2	49.9	28.8	904.9
	2020F	13.7	745.3	178.2	57.5	38.0	948.2
NPM	2018F	(10.4)	24.4	26.3	14.6	(4.8)	44.8
(%)	2019F	3.2	27.8	26.7	22.9	18.5	32.9
	2020F	9.0	30.4	27.5	24.2	22.2	32.3
EPS growth	2018F	TR	49.8	(18.6)	(30.3)	TR	120.9
(% YoY)	2019F	TB	26.9	20.9	38.1	TB	(19.6)
	2020F	197.2	39.7	16.0	15.0	32.6	3.8
PER	2018F	86.0	24.3	13.1	40.5	74.4	11.7
(x)	2019F	188.6	18.4	10.3	15.7	12.5	16.6
	2020F	63.5	13.2	8.8	13.7	9.4	16.0
PBR	2018F	2.8	3.5	2.2	4.6	2.5	2.3
(x)	2019F	3.1	3.1	1.5	2.0	1.3	2.3
	2020F	2.8	2.6	1.3	1.8	1.1	2.0
EV/EBITDA	2018F	50.7	11.4	5.1	20.8	-	7.0
(x)	2019F	125.1	11.7	4.6	10.4	46.4	9.1
	2020F	49.5	8.4	4.0	8.9	34.6	8.3
ROE	2018F	(1.2)	18.4	20.7	12.6	5.4	22.3
(%)	2019F	1.6	18.4	16.2	14.4	10.8	15.4
	2020F	4.8	21.3	16.4	14.3	12.5	13.7

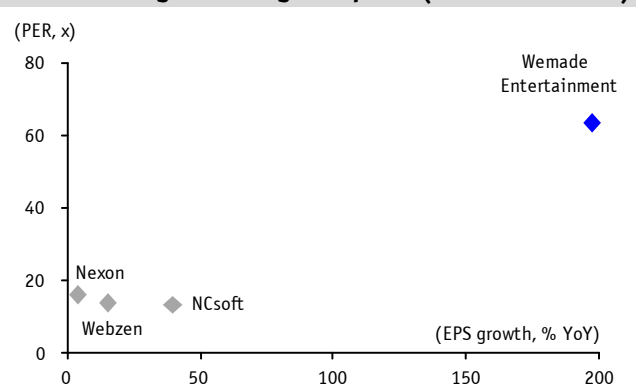
Source: Bloomberg, Shinhan Investment Corp.

Relative share performance vs. global peers



Source: Bloomberg, Shinhan Investment Corp.

PER and EPS growth vs. global peers (2020F consensus)



Source: Bloomberg, Shinhan Investment Corp.

Statement of financial position

Year to December (bn KRW)	2016	2017	2018F	2019F	2020F
Total assets	403.3	453.3	410.5	450.2	574.3
Current assets	132.5	322.1	266.1	276.0	399.9
Cash and equivalents	62.0	127.1	40.0	20.2	131.3
Accounts receivable	31.6	64.8	75.2	93.1	97.7
Inventories	0.0	0.0	0.0	0.0	0.0
Non-current assets	270.9	131.2	144.3	174.2	174.4
Tangible assets	52.8	49.4	45.8	42.6	39.8
Intangible assets	15.5	19.5	18.0	16.8	15.8
Investment assets	195.8	29.7	47.8	82.0	86.1
Other financial assets	0.0	0.0	0.0	0.0	0.0
Total liabilities	55.2	111.3	126.8	153.7	160.7
Current liabilities	20.9	93.6	108.6	134.5	141.2
Short-term borrowings	0.0	0.0	0.0	0.0	0.0
Accounts payable	0.0	0.0	0.0	0.0	0.0
Current portion of long-term debt	0.0	0.0	0.0	0.0	0.0
Non-current liabilities	34.3	17.7	18.2	19.2	19.5
Bonds	0.0	0.0	0.0	0.0	0.0
Long-term borrowings	12.0	14.1	14.1	14.1	14.1
Other financial liabilities	0.0	0.0	0.0	0.0	0.0
Total shareholders' equity	348.2	342.0	283.7	296.5	413.6
Capital stock	8.7	8.7	8.7	8.7	8.7
Capital surplus	159.0	163.8	163.8	163.8	163.8
Other capital	(8.7)	(11.0)	(11.0)	(11.0)	(11.0)
Accumulated other comprehensive income	(2.6)	(2.8)	(2.8)	(2.8)	97.2
Retained earnings	137.5	137.3	114.3	131.1	153.0
Controlling interest equity	293.9	296.0	273.0	289.8	411.7
Non-controlling interest equity	54.3	46.0	10.7	6.7	1.9
*Total debt	12.0	14.1	14.1	14.1	14.1
*Net debt (cash)	(82.3)	(234.3)	(166.6)	(156.1)	(274.7)

Statement of cash flow

Year to December (bn KRW)	2016	2017	2018F	2019F	2020F
Cash flow from operations	9.6	(8.8)	(56.4)	16.8	15.8
Net profit	(73.0)	(0.9)	(48.5)	22.6	27.0
Depreciation expense	4.6	3.9	3.6	3.2	2.8
Amortization expense	3.6	2.4	1.4	1.2	1.0
FX translation loss (gain)	(2.8)	5.4	0.0	0.0	0.0
Asset disposal loss (gain)	0.5	0.1	0.0	0.0	0.0
Equity method loss (gain)	0.2	0.4	0.0	0.0	0.0
Change in working capital	2.4	(20.5)	3.9	6.5	1.7
(Payment of income tax)	(7.7)	(2.8)	(13.1)	(7.1)	(8.5)
Others	81.8	3.2	(3.7)	(9.6)	(8.2)
Cash flow from investments	(17.0)	102.3	(20.8)	(26.8)	105.2
Increase in tangible assets	(1.1)	(1.1)	0.0	0.0	0.0
Decrease in tangible assets	0.2	0.7	0.0	0.0	0.0
Change in intangible assets	(1.2)	(1.1)	0.0	0.0	0.0
Change in investment assets	(9.5)	203.2	(18.1)	(34.2)	95.9
Others	(5.4)	(99.4)	(2.7)	7.4	9.3
Free cash flow	14.5	42.1	(41.4)	27.4	27.1
Cash flow from financing	4.3	(24.9)	(10.0)	(9.8)	(9.8)
Change in borrowings	0.0	(17.3)	0.0	0.0	0.0
Change in treasury stock	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	(10.0)	(10.0)	(9.8)	(9.8)
Others	4.3	2.4	0.0	0.0	0.0
Other cash flow	0.0	0.0	0.0	0.0	0.0
Change in consolidated scope	0.0	0.0	0.0	0.0	0.0
Change in FX rates	1.9	(3.5)	0.0	0.0	0.0
Change in total cash	(1.2)	65.1	(87.1)	(19.9)	111.1
Beginning cash	63.2	62.0	127.1	40.0	20.2
Ending cash	62.0	127.1	40.0	20.2	131.3

Source: Company data, Shinhan Investment Corp.

Statement of comprehensive income

Year to December (bn KRW)	2016	2017	2018F	2019F	2020F
Sales	108.0	109.6	127.1	157.4	165.3
Growth (%)	(14.7)	1.5	16.0	23.9	5.0
COGS	0.0	0.0	0.0	0.0	0.0
Gross profit	108.0	109.6	127.1	157.4	165.3
GPM (%)	100.0	100.0	100.0	100.0	100.0
SG&A	103.8	103.6	163.2	134.3	136.5
Operating profit	4.1	6.0	(36.2)	23.1	28.8
Growth (%)	N/A	44.7	N/A	N/A	24.6
OPM (%)	3.8	5.5	(28.5)	14.7	17.4
Non-operating profit	(92.7)	8.6	0.8	6.7	6.7
Financial profit	(84.1)	9.4	19.6	20.8	20.8
Other non-operating profit	(9.0)	(0.4)	(18.8)	(14.1)	(14.1)
Equity method gain (loss)	0.4	(0.4)	0.0	0.0	0.0
Pre-tax profit	(88.6)	14.5	(35.4)	29.8	35.5
Income tax	(15.6)	15.4	13.1	7.1	8.5
Continuing operations	(73.0)	(0.9)	(48.5)	22.6	27.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Net profit	(73.0)	(0.9)	(48.5)	22.6	27.0
Growth (%)	N/A	N/A	N/A	N/A	19.1
NPM (%)	(67.6)	(0.8)	(38.2)	14.4	16.3
Controlling interest	(71.0)	9.7	(13.2)	26.6	31.7
Non-controlling interest	(2.0)	(10.6)	(35.3)	(4.0)	(4.8)
Comprehensive income	(72.3)	(1.3)	(48.5)	22.6	127.0
Controlling interest	(70.5)	9.6	369.4	(172.3)	(966.5)
Non-controlling interest	(1.9)	(10.9)	(417.9)	195.0	1,093.5
EBITDA	12.3	12.3	(31.2)	27.5	32.6
Growth (%)	N/A	(0.1)	N/A	N/A	18.8
EBITDA margin (%)	11.4	11.2	(24.5)	17.4	19.7

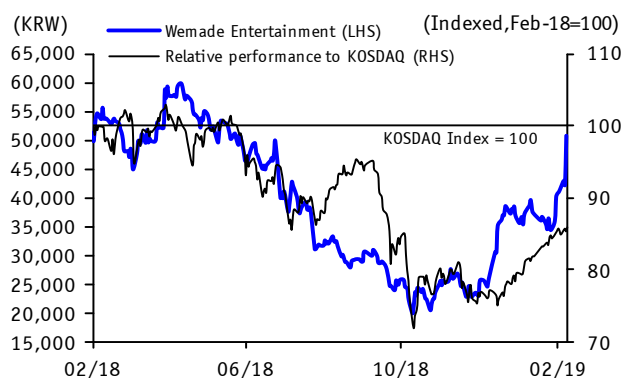
Key ratios

Year to December	2016	2017	2018F	2019F	2020F
EPS (KRW)	(4,345)	(53)	(2,889)	1,348	1,605
EPS of controlling interest (KRW)	(4,224)	580	(787)	1,586	1,888
BPS (KRW)	20,725	20,359	16,885	17,647	24,619
BPS of controlling interest (KRW)	17,494	17,623	16,250	17,250	24,506
DPS (KRW)	600	600	600	600	600
PER (x)	(5.1)	(956.7)	(9.0)	27.1	22.7
PER of controlling interest (x)	(5.3)	87.0	(33.0)	23.0	19.3
PBR (x)	1.1	2.5	1.5	2.1	1.5
PBR of controlling interest (x)	1.3	2.9	1.6	2.1	1.5
EV/EBITDA (x)	28.2	53.6	(9.0)	16.9	10.4
Dividend payout ratio (%)	(14.0)	102.5	(74.4)	36.9	31.0
Dividend yield (%)	2.7	1.2	2.3	1.6	1.6
Profitability					
EBITDA margin (%)	11.4	11.2	(24.5)	17.4	19.7
OPM (%)	3.8	5.5	(28.5)	14.7	17.4
NPM (%)	(67.6)	(0.8)	(38.2)	14.4	16.3
ROA (%)	(16.3)	(0.2)	(11.2)	5.3	5.3
ROE (%)	(21.7)	3.3	(4.6)	9.5	9.0
ROIC (%)	(18.7)	(48.8)	(110.7)	49.0	77.6
Stability					
Debt to equity ratio (%)	15.8	32.5	44.7	51.8	38.8
Net debt ratio (%)	(23.6)	(68.5)	(58.7)	(52.6)	(66.4)
Cash ratio (%)	296.9	135.8	36.9	15.0	93.0
Interest coverage ratio (x)	1.9	2.4	N/A	N/A	N/A
Activity (%)					
Working capital turnover (times)	5.6	(83.1)	(5.9)	(6.1)	(5.6)
Inventory turnover (days)	-	-	-	-	-
Receivable turnover (days)	106.7	160.5	201.0	195.1	210.7

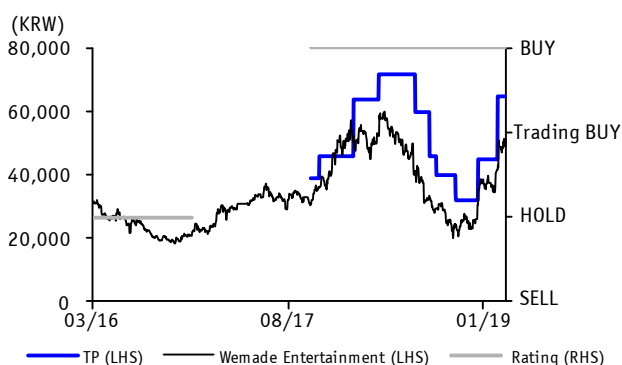
Source: Company data, Shinhan Investment Corp.

Wemade Entertainment (112040 KS)

Share performance



Target price



Date	Rating	Target price (KRW)	Target price gap (%)	
			Average	Max/Min
2016.02.02	HOLD	-	-	-
2016.12.06		No Coverage	-	-
2017.10.18	BUY	39,000	(11.0)	(6.2)
2017.11.10	BUY	46,000	(0.4)	24.6
2018.02.09	BUY	64,000	(20.2)	(12.8)
2018.04.17	BUY	72,000	(29.1)	(16.7)
2018.07.23	BUY	60,000	(40.2)	(28.6)
2018.08.30	BUY	46,000	(36.1)	(31.2)
2018.09.17	BUY	40,000	(35.1)	(22.5)
2018.11.07	BUY	34,000	-	-
2018.11.08	BUY	32,000	(21.6)	9.8
2019.01.06	BUY	45,000	(16.1)	(4.3)
2019.02.27	BUY	65,000	-	-

Note: Calculation of target price gap based on past 6 months

Rating Distribution - SHIC Universe (as of 25 February 2019)

BUY (BUY)	94.47%	Trading BUY (HOLD)	2.76%	HOLD (HOLD)	2.76%	SELL (SELL)	0%
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SHIC Ratings (as of 1 April 2017)

Stock	Sector
<ul style="list-style-type: none"> ◆ BUY: Expected 6-month gain of 10% or more ◆ Trading BUY: Expected 6-month gain of 10% to loss of 10% ◆ HOLD: Expected 6-month loss of 10% to 20% ◆ SELL: Expected 6-month loss of 20% or more 	<ul style="list-style-type: none"> ◆ OVERWEIGHT: Based on market cap, largest share of sector stocks under coverage is rated BUY ◆ NEUTRAL: Based on market cap, largest share of sector stocks under coverage is rated Trading BUY or HOLD ◆ UNDERWEIGHT: Based on market cap, largest share of sector stocks under coverage is rated SELL

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