SBS Contents Hub (046140 KQ)

Media

Platform diversification and the rise of Korean pop culture

Reinstating coverage with Buy rating and TP of W16,000

We are reinstating coverage of SBS Contents Hub with a Buy rating and target price of W16,000. Our target price was derived by applying a P/E of 11.5x to 2012F EPS, which is equivalent to its historical average forward P/E. Its current P/E of 9.0x 2012F EPS is substantially below its historical average. Last year, key SBS dramas had higher TV viewer ratings amongst its competitions. We believe the increased competiveness of SBS dramas will lead to stronger revenues and earnings at SBS Contents Hub. Over the next three to five years, we expect the company to generate moderate growth owing to the diversification of content distribution platforms (IPTV, web hard, and mobile) and improved prospects for drama exports due to the increased popularity of Korean pop culture.

Platform diversification is the key to further growth

In the past, SBS Contents Hub relied on its websites and cable TV channels for content distribution and revenue generation, as they (PC/broadband and cable TV) were displaying rapid growth. However, these platforms have entered the maturity stages of their development. Meanwhile, smart devices such as tablets and smartphones are showing strong growth potential. The distribution of TV content via these new platforms is in the early stages. Indeed, consumers have just started consuming media content through mobile platforms; in Korea, there are more than 20mn smartphone subscribers and 4mn IPTV subscribers who are starting to consume content in non-traditional ways.

Drama exports to drive growth

We expect SBS Contents Hub to build upon its success in 2010~2011 and display solid drama exports in 2012. Overseas momentum will likely continue thanks to the increased popularity of Korean pop culture in Japan and other countries. Korean dramas also hold a competitive advantage over their Japanese counterparts in terms of production costs. Generally speaking, Japanese dramas cost around W530mn per episode to produce, while Korean dramas cost around W260~70mn. If Korean dramas generate similar TV ratings as Japanese dramas, Japanese broadcasting networks should be better off importing Korean dramas rather than producing their own.

§ Earnings & Valuation Metrics

FY	Revenues (Wbn)	OP (Wbn)	OP Margin (%)	NP (Wbn)	EPS (W)	EBITDA (Wbn)	FCF (Wbn)	ROE (%)	P/E (X)	P/B (X)	EV/EBITDA (X)
12/09	76	11	14.9	10	727	14	8	17.8	12.6	2.9	11.7
12/10	155	29	18.6	20	948	32	12	25.2	14.3	3.4	7.9
12/11P	200	29	14.2	23	1,063	34	42	22.9	11.1	2.4	5.5
12/12F	224	36	16.1	29	1,351	39	18	23.3	9.0	2.0	4.4
12/13F	260	43	16.5	35	1,622	47	23	22.5	7.5	1.6	3.2

Notes: All figures are based on non-consolidated K-IFRS; NP refers to net profit attributable to controlling interests
Source: Company data, KDB Daewoo Securities Research estimates

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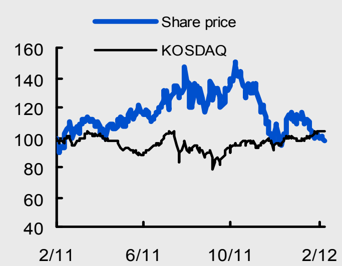
Buy (Reinstate)

Target Price (12M, W)	**16,000**
Share Price (02/27/12, W)	12,100
Expected Return (%)	32.2
EPS Growth (12F, %)	42.5
Market EPS Growth (12F, %)	13.8
P/E (12F, x)	9.0
Market P/E (12F, x)	9.8
KOSDAQ	538.34
Market Cap (Wbn)	260
Shares Outstanding (mn)	21
Avg Trading Volume (60D, '000)	196
Avg Trading Value (60D, Wbn)	3
Dividend Yield (12F, %)	1.2
Free Float (%)	35.0
52-Week Low (W)	11,150
52-Week High (W)	19,300
Beta (12M, Daily Rate of Return)	0.7
Price Return Volatility (12M Daily, %, SD)	3.1
Foreign Ownership (%)	7.7

Major Shareholder(s)
SBS Media Holdings (65%)

Price Performance

(%)	1M	6M	12M
Absolute	-16.3	-18.8	2.5
Relative	-17.6	-30.7	1.1



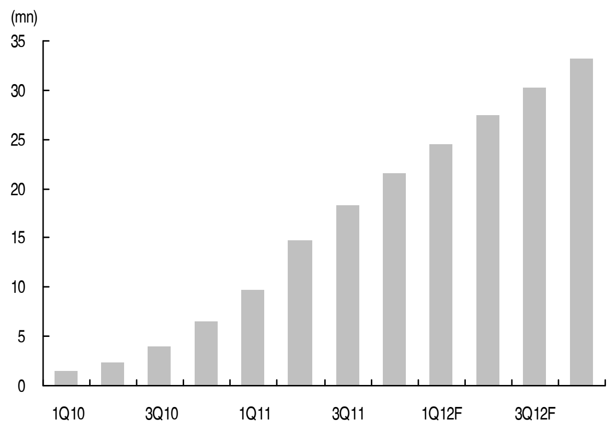
I. Investment summary

1. Platform diversification

Platform diversification to include IPTV and smartphones

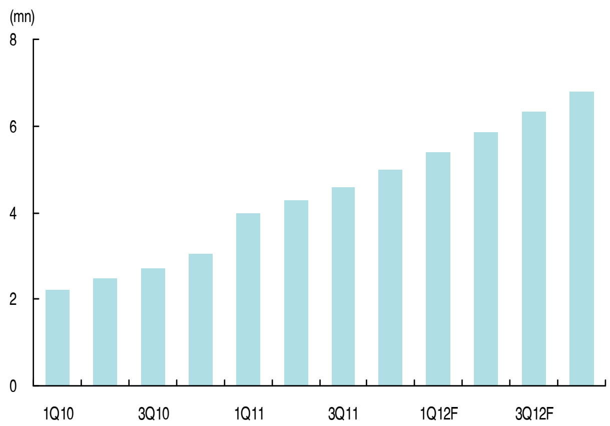
As SBS' multimedia distributor, SBS Contents Hub has focused on developing and expanding media markets (cable TV) for the broadcasting giant's content, adding video-on-demand (VOD) technology to its website, and forging profit–sharing arrangements with peer-to-peer (P2P) broadcasters. The company is now shifting its focus to new platforms. Relatively new platforms for SBS' content include: 1) smartphones and tablet PCs and 2) IPTV and smart TVs (in addition to existing paid cable networks). SBS Contents Hub has already obtained exclusive rights to distribute content in new markets from SBS Media Holdings. As of now, there are more than 20mn smartphone subscribers in Korea, and it is believed that content distribution through smartphones may surpass content distribution via PCs over the next three to five years. Also, Korea has more than 4mn IPTV subscribers, and it appears as though they prefer watching VODs on IPTV over watching them on PCs. In addition, the accelerating shift toward N-Screen (which enables access to content across a wide variety of platforms) further brightens the outlook of related industries.

Figure 1. Smartphone subscriber trend in Korea



Source: Company data, KDB Daewoo Securities Research

Figure 2. IPTV subscriber trend in Korea

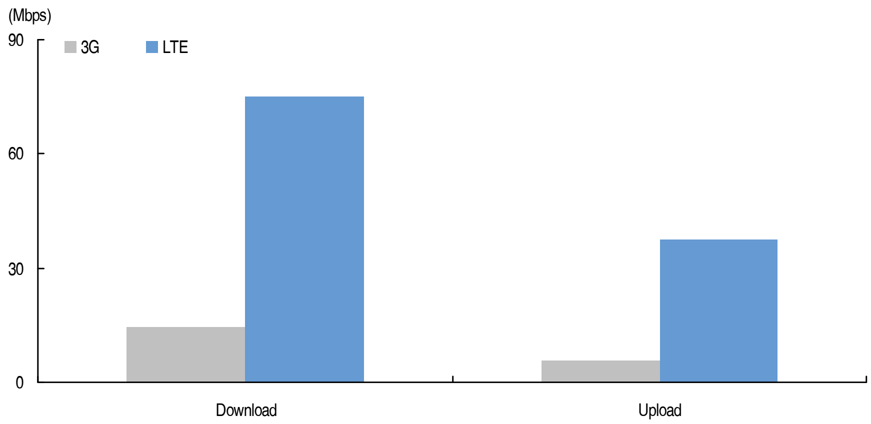


Source: Company data, KDB Daewoo Securities Research

Content distributors to be early beneficiaries of the LTE revolution

Telcos' LTE networks will provide faster internet browsing/download speeds than 3G networks. This could lead to a change in the way people consume multimedia content. Under current unlimited 3G plans, data transfer rates are not particularly fast, and subscribers are giving up on using their phones to watch/listen to multimedia content. However, once LTE is widespread, subscribers are likely to consume more content because of the blazing speeds that new networks can achieve. And typical LTE plans (W62,000 per month for approximately 3GB of data) allow consumers to download an adequate amount of content. Indeed, it appears as though downloading (not streaming) multimedia will be the primary means of consumption. Furthermore, content distributors should be first in line to harvest the fruits of the LTE revolution because they are already prepared to distribute existing content to telecom service providers.

Figure 3. Download and upload speeds of 3G and LTE



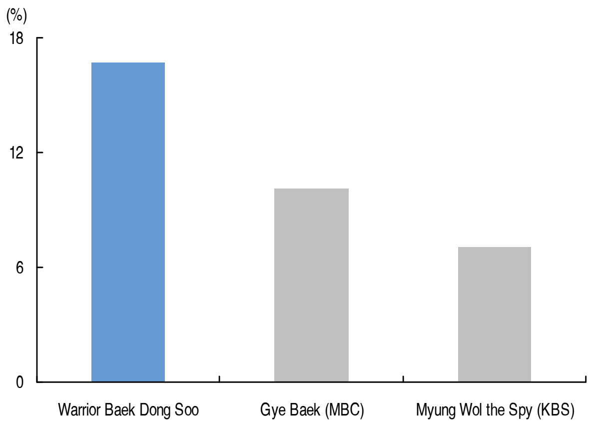
Source: Company data, KDB Daewoo Securities Research

2. Exports

Increased drama exports expected due to structural factors

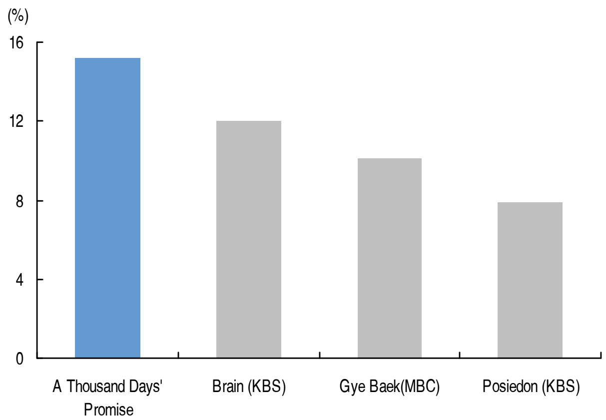
We expect SBS Contents Hub to display solid drama exports in 2012 following its success in 2010~11. Indeed, the increased popularity of Korean pop culture in Japan and other countries will likely lead to continued overseas momentum. In addition, the quality of SBS' TV content should also propel overseas sales, as the company's key dramas generated strong ratings relative to their competitors in 2011.

Figure 4. TV ratings of *Warrior Baek Dong-soo* and its competition



Source: TNS Media Korea, KDB Daewoo Securities Research

Figure 5. TV rating of *A Thousand Days' Promise* and its competition

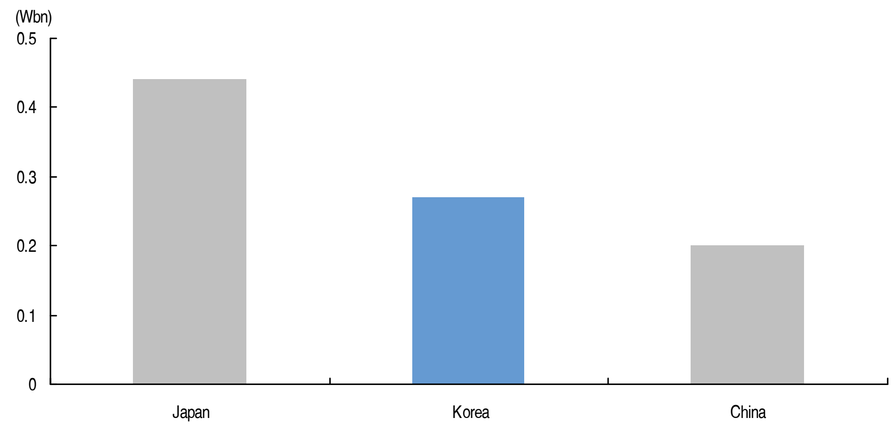


Source: TNS Media Korea, KDB Daewoo Securities Research

Japanese broadcasters have incentive to import Korean dramas and shows

While the increased popularity of Korean pop culture has been a key driver of drama exports, Japanese broadcasters have other incentives to air Korean dramas. Indeed, compared to Korean dramas (production costs of around W260~70mn per episode), Japanese dramas (around W530mn per episode) are expensive to produce. If Korean dramas generate similar TV ratings to Japanese dramas, Japanese broadcasting networks should be better off importing Korean dramas rather then producing their own. While Chinese dramas can be produced even more cheaply, they are not yet attracting interest from Japanese viewers.

Figure 6. Drama production cost comparison

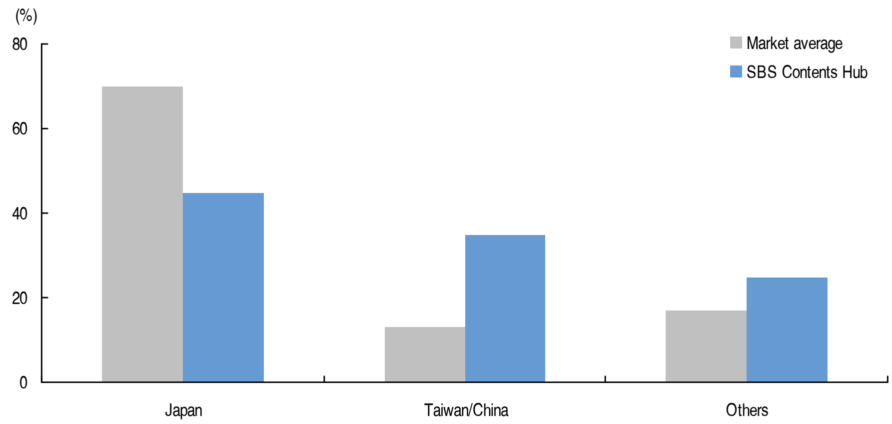


Source: KOCCA, KDB Daewoo Securities Research

SBS Contents Hub is expected to catch up with its competition in Japan

Japan is a major importer of Korean dramas. And, considering the country's distribution network and market size, it is the most critical market for Korean dramas. However, Japan accounts for a relatively small proportion of SBS Contents Hub's overseas exports. Indeed, the company sells dramas directly to Japanese broadcasters without using local sales agencies. Since the company does not utilize Japan's developed distribution network its market share in Japan has been lower than its competitors'. However, going forward, SBS Contents Hub will be relying on local sales agencies, and we expect exports to Japan to grow in the long term. In fact, the company is likely to catch up with its competitors in terms of market share. As such, SBS Contents Hub's upside is more substantial compared to that of other broadcasting networks.

Figure 7. SBS Contents Hub's market shares



Source: Company data, KDB Daewoo Securities Research

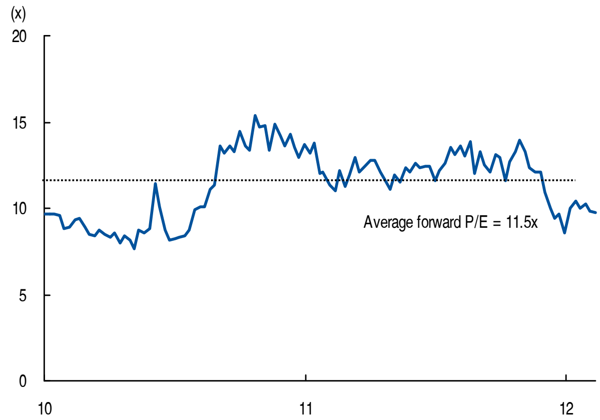
II. Valuation and share price

We expect shares to rebound

Trading at a 2012F P/E of 9.1x

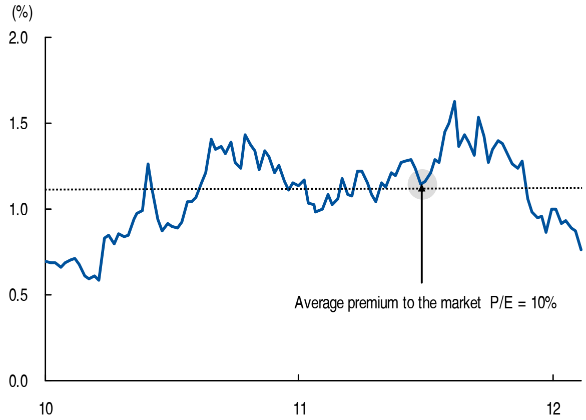
SBS Contents Hub's shares stayed strong at the W17,000~17,800 level in 2H11, and the company showed strong results through 3Q11. However, concerns regarding 4Q11 results and potential increases in competition and production costs (owing to the launches of four new comprehensive cable channels) recently drove SBS Contents Hub's share price down to the W12,000~W13,000 level in 2012. The company's shares are currently trading at a 2012F P/E of 9.0x, which is below the 2010~11 average of 11.5x. However, the emergence of private media representatives (instead of KOBACO handling media matters) could have a beneficial impact on the media business environment, which could lead to earnings improvement and valuation re-rating for SBS Contents Hub. We arrived at our target price of W16,000 applying the company's average one year forward P/E during 2010~11.

Figure 8. One Year forward P/E trend



Source: KDB Daewoo Securities Research

Figure 9. P/E relative to the market



Source: KDB Daewoo Securities Research

Undervalued on both P/E and P/B basis

When we compared SBS Contents Hub's valuations with the KOSPI's, we found that the company's shares have been trading above the market for over the majority of the past couple of years. In contrast, their current discount to the market is over 10% following the recent pullbacks. Since we are expecting the stock to recover in 2H12 and show continued growth into 2013, the company's valuation multiple should catch up to the market's.

III. SBS dramas in 2011

3~5 SBS dramas per year are likely to generate interest overseas

SBS airs around 25 dramas per year. Among these, there are estimated to be 3~5 exportable dramas (mostly Monday~Tuesday and Wednesday~Thursday dramas). Even for dramas that are unlikely to be exported, viewer ratings are important, as cable channels and other platforms (IPTV and VOD) are willing to pay higher price tags for popular programs. The following attributes can make a drama exportable: 1) content that is not particularly culturally-specific; 2) actors and actresses with decent name recognition, and 3) trendy themes. Without these attributes, high TV ratings are the only bargaining chip that a company can possess. Export distribution typically involves foreign broadcasting companies (i.e., NHK of Japan).

Table 1. Notable Korean dramas that achieved overseas success (%)

Title	Network	Start date	End date	Average rating	Peak rating	Notable actors
Winter Sonata	KBS	01/14/02	03/19/02	23.1	28.8	Yong Joon Bae, Jiwoo Choi
All In	SBS	01/15/03	04/03/03	36.8	42.9	Byung Hun Lee, Heykyo Song
Dae Jang Geum	MBC	09/15/03	03/30/04	41.6	55.5	Young Ae Lee, Jinhee Ji
Stairway to Heaven	SBS	12/03/03	02/05/04	38.8	45.3	Jiwoo Choi, Sangwoo Kwon
Full House	KBS	07/14/04	09/04/04	32.1	40.3	Rain, Hyekyo Song
Iris	KBS	10/14/09	12/17/09	31.9	39.9	Byung Hun Lee, Tae Hee Kim
You are Beautiful	SBS	10/07/09	11/26/09	10.1	11.9	Kun Suk Jang, Shinhye Park
Secret Garden	SBS	11/13/10	01/16/11	24.4	31.4	Bin Hyun, Jiwon Ha

Source: SBS, TNS Media Korea

Generating double-digit ratings while beating the competition

In 2011, most of SBS' Monday~Tuesday and Wednesday~Thursday dramas drew double-digit ratings (according to TNS Media Korea). Also, these dramas consistently beat KBS' and MBC's programs. This should give SBS Contents Hub a decent amount of negotiating leverage as it forges distribution deals with IPTV and cable companies.

Table 2. Notable SBS dramas in 2011 (%)

Title	Network	Start date	End date	Average rating	Peak rating	Notable actors
Athena: Goddess of War	Mon~Tue	12/13/10	02/21/11	15.4	25.9	Jung Woo Sung,Cha Seung Won
Midas	Mon~Tue	02/22/11	05/03/11	11.6	13.7	Jang Hyuk, Lee Min Jung
Lie to Me	Mon~Tue	050/9/11	06/28/11	8.4	9.3	Yoon Eun Hye, Kang Ji Hwan
Warrior Baek Dong-soo	Mon~Tue	07/04/11	10/10/11	15.8	19.3	Ji Chang Wook, Yoo Seung Ho
A Thousand Days' Promise	Mon~Tue	10/17/11	12/20/11	15.2	19.6	Kim Rae Won, Soo Ae
Sign	Wed~Thu	01/05/11	03/10/11	14.9	22.1	Park Shin Yang, Kim Ah Joong
49 Days	Wed~Thu	03/16/11	05/19/11	10.8	17.1	Lee Yo Won, Jung Il Woo
City Hunter	Wed~Thu	05/25/11	07/28/11	15.2	19.1	Lee Min Ho, Park Min Young, Koo Hara
Protect the Boss	Wed~Thu	08/03/11	09/29/11	14.1	16.1	Choi Kang Hee, Hero Jaejoong
Tree with Deep Roots	Wed~Thu	10/05/11	12/22/11	18	23.6	Han Suk Kyu, Shin Se Kyung

Source: SBS, TNS Media Korea

After the massive success of *Secret Garden* in early 2011, *Sign, City Hunter, Trees with Deep Roots*, *Protect the Boss*, and *A Thousand Days' Promise* have either drawn high viewer ratings or generated interests. These dramas are highly exportable and feature actors with high overseas profiles. As such, SBS Contents Hub should have some much-needed leverage in their negotiations with overseas broadcasters and distributors.

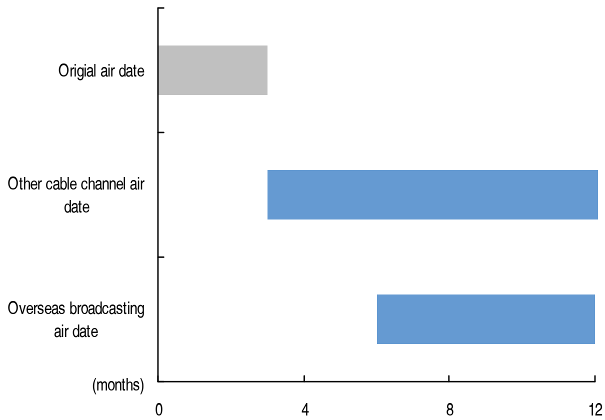
IV. Earnings outlook

Disappointing 4Q11 results

1) 4Q11 Review

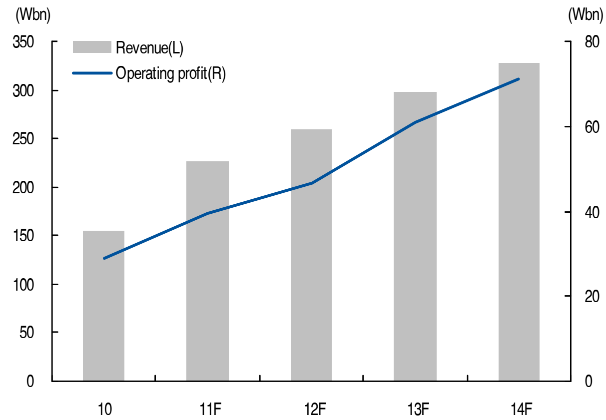
For 4Q11, SBS Contents Hub posted disappointing results. Both revenues and operating profit missed market consensus estimates, coming in at W39bn (down 19.4% YoY; down 55.0% QoQ) and W100mn (down 97.6% YoY; down 99.3% QoQ), respectively. These weak results were attributable to impairment costs and weak exports of dramas.

Figure 10. Timeline of a drama



Source: Company data, KDB Daewoo Securities Research

Figure 11. Annual earnings trend



Source: KDB Daewoo Securities Research

2) Dramas in 2H11

There is a considerable lag between the generation of high TV ratings and results

Two of SBS' mega hits (*Tree with Deep Roots* and *A Thousand Days' Promise*) beat the competition by a wide margin in 4Q11, and we believe that this will lead to brighter revenue and earnings outlook for SBS Contents Hub in 2Q~3Q12. High TV ratings could lead to higher IPTV VOD revenues and overseas exports, which would flow through to SBS Contents Hub's operations six to eighteen months after the ratings were recorded. Indeed, buyers usually initiate purchase negotiations after the ratings of a drama's final episode are tallied.

2012 Outlook

Dramas that aired in 4Q11 to have positive impact on 2012 results

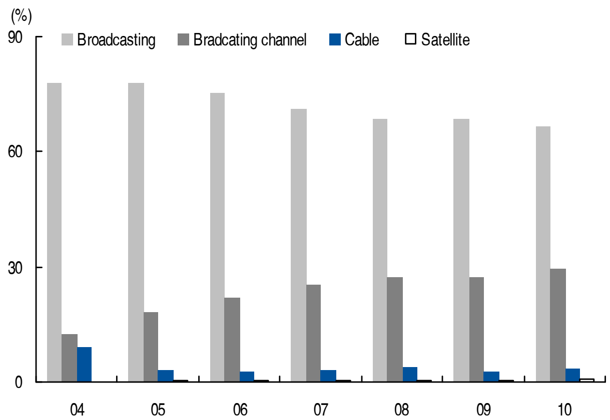
As SBS dramas beat the competition in terms of TV ratings in 2011, we believe that the 2012~13 outlook for SBS Contents Hub (given the aforementioned lag period) is rosy. Furthermore, the success of SBS' 2011 dramas should carry over to 2012~13 as well. We forecast the company's revenues at W222bn (up 10.6% YoY) and W259bn (up 16.8% YoY) in 2012 and 2013, respectively. Also, operating profits are projected at W36.1bn (up 26.7% YoY) and W42.9bn (up 18.8% YoY) over the same periods. And OP margin is expected to improve to 16.5% in 2013, from 14.2% in 2011. Due to changes in media content consumption patterns, SBS Contents Hub is likely to display sustainable OP margin improvement after 2012.

V. Industry outlook

Overall TV revenue growth slowing, but pay TV growing faster

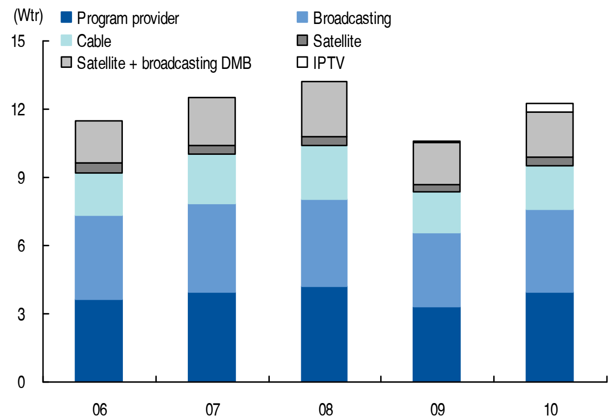
Domestic TV revenues reached W17.5tr at end-2009. Since then, revenues have continued to grow, albeit at a more sluggish pace. The reason behind the slowdown in growth is attributable to slower advertising revenue growth at broadcasting companies. Indeed, the increasing prominence of the internet and mobile devices has given advertisers a wider array of options, which has led to lower ad rates. On the other hand, the pay TV segment has been growing steadily on the back of subscriber growth (especially in the IPTV segment). Over the past five years, revenues of pay TV services grew at a CAGR of 12.5%. Increased subscribers, improved ARPU (via digital services), other value–added services, and increased broadband services have all contributed to the solid growth of the pay TV segment.

Figure 12. Advertising revenue rates by broadcasting media



Source: KCTA, KDB Daewoo Securities Research

Figure 13. Domestic TV revenue



Source: KCTA, KDB Daewoo Securities Research

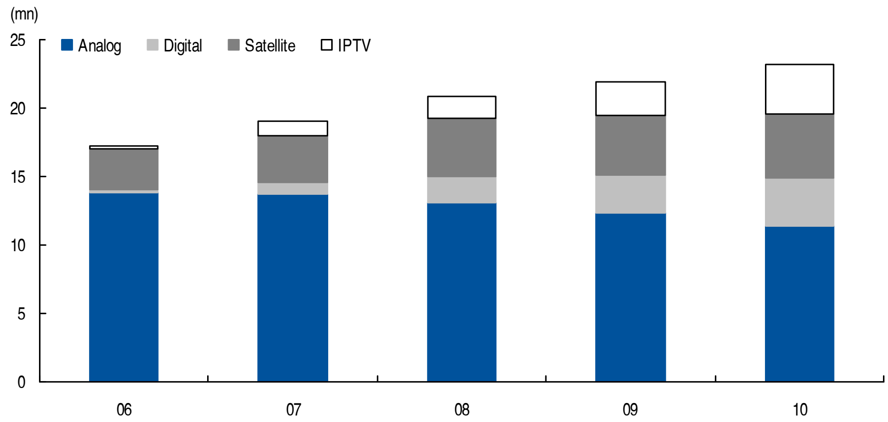
Three major platforms in the pay TV industry are cable TV SO (analog and digital), digital satellite, and IPTV

Although the pay TV industry competes between platforms, it is monopolistic or oligopolistic within each platform. Cable TV operators do not compete directly with one another for subscribers, as the market is divided by assigned "zones." However, cable TV operators as a whole need to compete with IPTV and satellite services. And while IPTV operators (telecom service providers) have relatively stable market shares within their segment, they must compete with other platforms. The pay TV industry consists of three major platforms, the cable TV SOs (analog and digital), digital satellite, and IPTV.

Analog broadcasting will end in Korea by end-2012

Analog broadcasting is slated to be a thing of the past in Korea by end-2012. Currently, migration to digital broadcasting is taking place, and many terrestrial TV viewers (about 2mn households) and analog cable subscribers (about 12mn households) are likely to make the switch. Also, households in areas without access to cable services are likely to sign up for satellite broadcasting to watch digital broadcasts. The average monthly subscription rate for analog cable is in the range of W4,000~6,000, substantially less than digital TV (IPTV and satellite) rates, which average W12,000~13,000. Due to the digitalization of TV services, we believe that IPTV and satellite services will increase subscribers and work in favor of SBS Contents Hub, as it can use these new platforms to distribute content at higher prices.

Figure 14. Pay TV market subscriber trends



Source: KCC, KDB Daewoo Securities Research

No need for "live" viewing

TV viewers increasingly do not need to watch TV "live" as IPTVs are providing high quality HD VOD services. Thus, TV viewers have more options. Since IPTVs provide both real time TV service and VOD, they are becoming more competitive. Also, as SBS Contents Hub can generate higher revenue from IPTV, increased market share by IPTV will work in favor of SBS Contents Hub.

Increased popularity of K-pop to provide synergy

The popularity of K-pop has recently moved beyond Asia to Europe and the US, and is enhancing demand for TV content, including dramas. The most attractive market for Korean TV content and music appears to be Japan, considering distribution channels, market size, and cultural ties between the two countries.

SBS Contents Hub (046140 KQ/Buy/TP: W16,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/10	12/11P	12/12F	12/13F
Revenues	155	200	224	260
Cost of Sales	0	162	177	206
Gross Profit	155	39	47	54
SG&A Expenses	126	8	11	11
Operating Profit (Adj)	29	31	36	43
Operating Profit	29	29	36	43
Non-Operating Profit	-2	0	1	2
Net Financial Income	-1	-2	-3	-3
Net Gain from Inv in Associates	-4	0	0	0
Pretax Profit	26	31	37	45
Income Tax	6	8	8	10
Profit from Continuing Operations	20	23	29	35
Profit from Discontinued Operations	0	0	0	0
Net Profit	20	23	29	35
Controlling Interests	20	23	29	35
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	20	23	29	35
Controlling Interests	20	23	29	35
Non-Controlling Interests	0	0	0	0
EBITDA	32	34	39	47
FCF (Free Cash Flow)	12	42	18	23
EBITDA Margin (%)	20.5	16.8	17.3	17.9
Operating Profit Margin (%)	18.6	14.2	16.1	16.5
Net Profit Margin (%)	13.1	11.4	12.9	13.4

Statement of Financial Condition (Summarized)

(Wbn)	12/10	12/11P	12/12F	12/13F
Current Assets	96	111	133	161
Cash and Cash Equivalents	31	44	62	82
AR & Other Receivables	27	29	32	37
Inventories	0	0	0	0
Other Current Assets	28	12	13	15
Non-Current Assets	45	56	71	86
Investments in Associates	14	13	13	13
Property, Plant and Equipment	13	25	35	46
Intangible Assets	5	5	7	8
Total Assets	140	167	204	248
Current Liabilities	51	57	64	74
AP & Other Payables	18	19	21	25
Short-Term Financial Liabilities	0	0	0	0
Other Current Liabilities	33	38	42	49
Non-Current Liabilities	1	0	2	3
Long-Term Financial Liabilities	0	0	0	0
Other Non-Current Liabilities	0	0	1	3
Total Liabilities	51	57	65	77
Controlling Interests	89	110	139	171
Capital Stock	11	11	11	11
Capital Surplus	25	26	26	26
Retained Earnings	52	73	102	134
Non-Controlling Interests	0	0	0	0
Stockholders' Equity	89	110	139	171

Cash Flows (Summarized)

(Wbn)	12/10	12/11P	12/12F	12/13F
Cash Flows from Op Activities	27	45	32	39
Net Profit	20	23	29	35
Non-Cash Income and Expense	10	15	10	12
Depreciation	1	1	1	1
Amortization	2	2	2	3
Others	-3	-7	-3	-3
Chg in Working Capital	-3	14	1	2
Chg in AR & Other Receivables	-8	-2	-3	-5
Chg in Inventories	0	0	0	0
Chg in AP & Other Payables	4	1	2	3
Income Tax Paid	0	-6	-8	-10
Cash Flows from Inv Activities	-16	-29	-14	-15
Chg in PP&E	-10	-13	-10	-12
Chg in Intangible Assets	-2	-1	-4	-4
Chg in Financial Assets	-3	-17	0	0
Others	-1	2	0	1
Cash Flows from Fin Activities	-3	-3	0	-3
Chg in Financial Liabilities	0	0	0	0
Chg in Equity	0	0	0	0
Dividends Paid	-3	-3	0	-3
Others	0	0	0	0
Increase (Decrease) in Cash	8	13	18	21
Beginning Balance	23	31	44	62
Ending Balance	31	44	62	82

Forecasts/Valuations (Summarized)

	12/10	12/11P	12/12F	12/13F
P/E (x)	14.3	11.1	9.0	7.5
P/CF (x)	12.5	9.9	8.2	6.7
P/B (x)	3.4	2.4	2.0	1.6
EV/EBITDA (x)	7.9	5.5	4.4	3.2
EPS (W)	948	1,063	1,351	1,622
CFPS (W)	1,079	1,195	1,475	1,798
BPS (W)	3,942	4,895	6,164	7,583
DPS (W)	150	150	150	150
Payout ratio (%)	15.8	0.0	11.1	9.3
Dividend Yield (%)	1.1	1.3	1.2	1.2
Revenue Growth (%)	103.2	29.3	11.8	16.1
EBITDA Growth (%)	121.1	6.1	15.1	20.4
Operating Profit Growth (%)	155.0	-1.4	26.7	18.8
EPS Growth (%)	30.4	12.2	27.0	20.1
Accounts Receivable Turnover (x)	7.4	7.8	8.0	8.2
Inventory Turnover (x)				
Accounts Payable Turnover (x)	10.7	11.8	12.1	12.3
ROA (%)	16.3	14.8	15.6	15.4
ROE (%)	25.2	22.9	23.3	22.5
ROIC (%)	94.5	129.0	120.0	99.9
Liability to Equity Ratio (%)	57.6	52.2	47.1	45.1
Current Ratio (%)	188.5	194.2	209.6	218.1
Net Debt to Equity Ratio (%)	-45.8	-63.9	-63.5	-63.8
Interest Coverage Ratio (x)	98.4			

Source: Company data, KDB Daewoo Securities Research estimates

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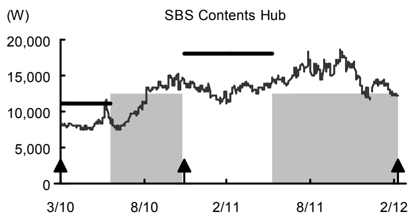
	Trading Buy	Relative performance of 10% or greater, but with volatility
	Hold	Relative performance of -10% and 10%
	Sell	Relative performance of -10%
Industry Ratings	Overweight	Fundamentals are favorable or improving
	Neutral	Fundamentals are steady without any material changes
	Underweight	Fundamentals are unfavorable or worsening



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