MIRAE ASSET
Building on principles

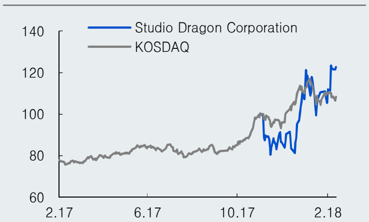
Media

Initiation Report
March 7, 2018

(Initiate)	**Buy**
Target Price (12M, W)	**110,000**
Share Price (03/06/18, W)	88,100
Expected Return	25%

OP (17P, Wbn)	33
Consensus OP (17F, Wbn)	36
EPS Growth (17P, %)	327.2
Market EPS Growth (17F, %)	45.2
P/E (17P, x)	-
Market P/E (17F, x)	10.1
KOSDAQ	859.21
Market Cap (Wbn)	2,470
Shares Outstanding (mn)	28
Free Float (%)	23.9
Foreign Ownership (%)	1.3
Beta (12M)	0.96
52-Week Low	57,800
52-Week High	88,600

(%)	1M	6M	12M
Absolute	17.5	-	-
Relative	17.3	-	-



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[Media]

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Studio Dragon Corporation
(253450 KQ)

Riding the global content distribution wave

Initiate coverage with Buy and TP of W110,000

We initiate our coverage on Studio Dragon with a Buy rating and target price of W110,000. We derived our target price by applying an EV/EBITDA of 19.7x to our 12-month forward EBITDA of W149.1bn. We used the EV/EBITDA method to reflect the licensing value of previously-aired content and considered the average multiple of Zhejiang Huace Film & TV and Huayi Brothers Media, two Chinese firms with large exposure to content licensing.

Studio Dragon's stock currently trades at a 2018F P/E of 51.6x and 2019F P/E of 37.3x. While valuation may look pricey, we recommend aggressively overweighting the stock, as we see strong net profit growth ahead (+100.6% in 2018F and +38.4% in 2019F) and believe the company is poised to become one of the biggest global beneficiaries of the battle for content. To put the stock's high P/E into perspective, we note that Fuji Media Holdings' licensing business fetched a P/E of around 85x three years ago, as it was about to produce original content for Netflix (similar to Studio Dragon's current position).

Global content distribution growth to continue

The global over-the-top (OTT) market is growing at an exceptional pace. Through 2020, the market is expected to expand 27% CAGR to W90tr, led by Asia. Against this backdrop, the battle for leadership among platforms is intensifying, as new media players expand their geographical footprints and traditional media players also join the race. Online platforms, like Netflix and Amazon, are competitively spending on content, while traditional media firm Walt Disney is looking to beef up Hulu once its deal to acquire 21st Century Fox goes through. As platform competition persists, the value of content is naturally becoming more prominent. As such, we expect a simultaneous rise in price and volume across the global content distribution market.

Big beneficiary of growing global content distribution

Studio Dragon is one of Asia's leading TV drama production companies and probably the most preferred option for multinational streaming platforms targeting the Asian audience. We believe the company will enjoy greater benefits from growth in content distribution than many domestic and foreign rivals.

1) Production capabilities: Studio Dragon played a critical role in raising tvN's profile over the past five years by creating a string of popular shows, which we attribute to the company's focus on strengthening its production capabilities over the long term, on the back of captive demand. The company is continuing to increase programming (quantity), bring novel ideas (quality), and build a strong talent pool. We expect Studio Dragon to maintain its production competitiveness going forward.

2) Business structure: Ownership of intellectual property (IP) is essential in order to benefit from the growth of content distribution. Studio Dragon has established a business model in which production costs are mostly covered, while IP rights are still held by the company. This means potential losses are limited (less than 20%), whereas maximum expected returns are fairly high. We believe such dynamics will be maintained (or strengthened) going forward, as the media environment becomes increasingly favorable to content producers with global influence.

3) Financing capabilities: In the current seller-driven content market, Studio Dragon's solid financial resources (its own and parent's) particularly stand out. With production costs rising faster than advertising revenue across the industry, few competitors are able to replicate the company's massive spending. If the parent company's merger is approved, this could further bolster Studio Dragon's financing capabilities.

FY (12)	12/14	12/15	12/16	12/17P	12/18F	12/19F
Revenue (Wbn)	NA	NA	196	287	383	525
OP (Wbn)	NA	NA	21	33	62	85
OP margin (%)	NA	NA	10.7	11.5	16.2	16.2
NP (Wbn)	NA	NA	13	24	48	66
EPS (W)	NA	NA	907	3,874	1,706	2,361
ROE (%)	NA	NA	9.5	16.1	25.9	27.4
P/E (x)	NA	NA	-	-	51.6	37.3
P/B (x)	NA	NA	-	-	11.9	9.0
Dividend yield (%)	NA	NA	-	-	0.0	0.0

Note: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests
Source: Company data, Mirae Asset Daewoo Research estimates

C O N T E N T S

I. Valuation

Initiate coverage with Buy and TP of W110,000

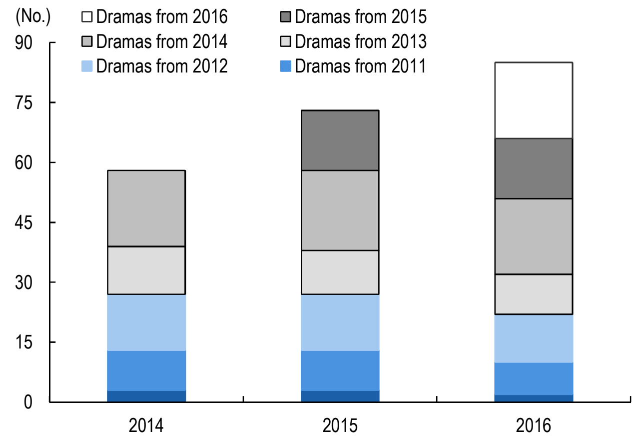
We initiate our coverage on Studio Dragon with a Buy rating and target price of W110,000. We derived our target price by applying an EV/EBITDA of 19.7x to our 12-month forward EBITDA of W149.1bn. The company's future earnings will come not only from TV dramas that will be newly produced, but also from the IP of its library (107 titles). To reflect their potential profit contribution, we used the EV/EBITDA method to value the company. With global content licensing sales (including to China) expected to serve as a key driver of earnings growth, we considered the multiples of Zhejiang Huace Film & TV and Huayi Brothers Media, two Chinese firms with a large exposure to content production and distribution.

Most of Studio Dragon's amortization/depreciation expenses consist of amortization of TV dramas for which more than a quarter of a year has passed since airing (70% of production costs are initially expensed; the remaining 30% is amortized on a straight-line basis over 1.5 years). Because the useful life (1.5 years) applied is more conservative than the typical content lifecycle, many of the company's content assets for which amortization is already completed continue to generate sales (60% of the 85 titles sold in 2016 were more than two years old). Thus, we think EBITDA is a reasonable metric to capture the potential value of not only new content (which is likely to make a larger contribution to revenue), but older assets, as well.

Aside from some organic growth (resulting from increased programming and VoD market growth), our revenue estimates only take into account tentpole content licensing sales to Netflix (one title per quarter), and the production of one Netflix original program in 2019. While we have not factored in licensing sales to China, it should be noted that the company owns a number of hit TV dramas that have not yet been licensed to China, due to worsening bilateral relations since 2H16. Once we gain visibility on the resumption of exports, we plan to reflect this into our operating earnings estimates, and may consider adopting a P/E valuation.

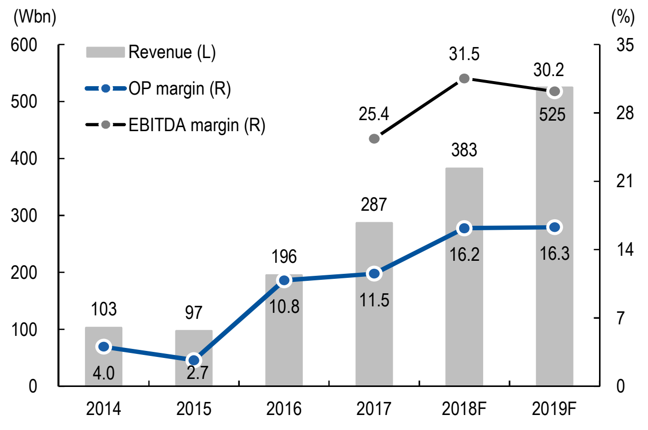
Studio Dragon's stock currently trades at a 2018F P/E of 51.6x and 2019F P/E of 37.3x. While valuation may look pricey, we think the stock's multiples could come down quickly on the back of strong profit growth. We see net profit growing 100.6% in 2018 and 38.4% in 2019. We believe Studio Dragon is one of the biggest beneficiaries, both domestically and globally, of the emerging battle for content. As such, we recommend aggressively overweighting the stock from a long-term perspective. Licensing sales to Netflix have stabilized since mid-2017, while original content production is set to commence in 2019. Furthermore, we see strong chances of partnerships/licensing deals with other major platforms, such as Amazon and Disney (Hulu).

Figure 1. Older content still generating sales



Source: Mirae Asset Daewoo Research

Figure 2. Earnings forecasts



Source: Mirae Asset Daewoo Research

We do not see the stock's high P/E multiple as a cause for concern. A good reference point is provided by Japan's Fuji Media Holdings, which has produced original content for Netflix since 2015. Fuji Media Holdings owns Japan's largest private broadcast networks (Fuji TV and Nippon TV) and content producers (video and music), and is similar to CJ E&M (which owns 71% of Studio Dragon) from an overall business perspective. Looking at the licensing business alone, the Japanese firm bears similarities with Studio Dragon. Along with TBS (Tokyo Broadcasting System), Fuji Media Holdings has been one of Netflix's leading partners in Japan, producing shows for the platform since 2H15, including the popular program *Terrace House*.

To identify the P/E multiples of the Japanese firm's licensing business in 2014-15, we used the operating profit shares of its licensing and non-licensing businesses. Our analysis shows the content licensing business commanded a P/E of 99x in 2014 and 78x in 2015 (Table 2). As original content is widely seen as an extension of the licensing business, this suggests that Studio Dragon, a pure content player, is not unreasonably expensive on a P/E basis.

Table 1. Target price calculation (Wbn, x)

	18F	19F	12MF	Note
EBITDA	121	159	149	
Target EV/EBITDA	22.1	18.9	19.7	Avg. of Zhejiang Huace Film & TV, Huayi Brothers Media
Fair EV	2,664	2,997	2,936	
Net debt (net cash)	-181.6			
Fair market cap	2,845	3,178	3,118	
Target price (W)	101,489	113,358	111,192	
Upside potential (%)	15.2	28.7	26.2	

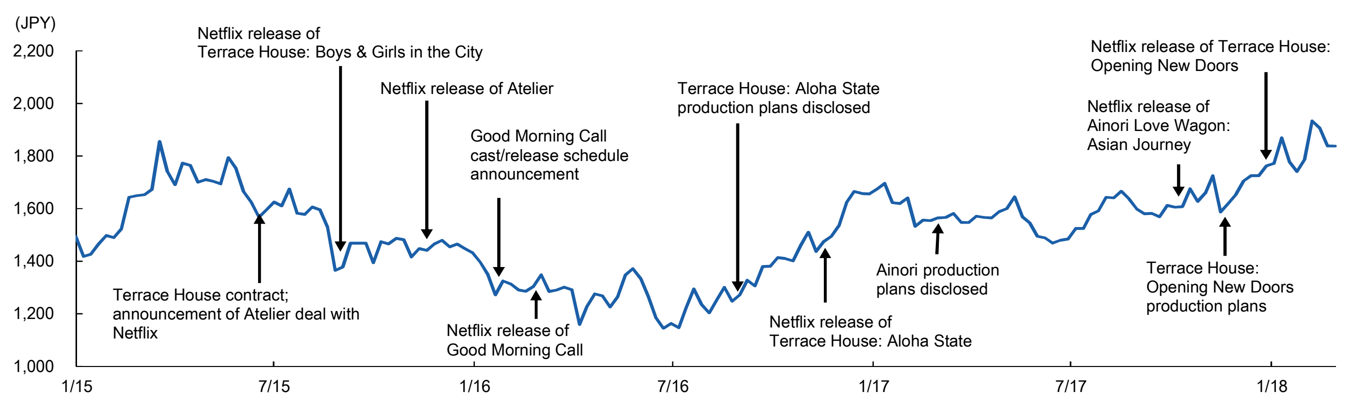
Source: Mirae Asset Daewoo Research estimates

Table 2. Analysis of Fuji Media Holdings' content licensing business (JPYmn, %, x)

	2014	2015		2014	2015
Market cap	438,721	394,074			
Operating profit	31,525	25,627			
Non-licensing	29,306	24,467	Licensing	2,219	1,160
Non-licensing portion	93.0	95.5	Licensing portion	7.0	4.5
Net profit	18,065	19,908			
Non-licensing (estimates)	16,793	19,007	Licensing (estimates)	1,272	901
Implied P/E	18.7	17.0	Implied P/E	98.5	77.7
Value of non-licensing	313,466	324,032	Value of licensing	125,255	70,042

Notes: Non-licensing implied P/E based on average of major US/Japanese media companies (Walt Disney, Time Warner, Comcast, Nippon TV, TBS)
Source: Bloomberg, Mirae Asset Daewoo Research estimates

Figure 3. Production of original titles is major investment point for Fuji Media Holdings



Source: Mirae Asset Daewoo Research

Table 3. Global media/content companies' earnings and forecasts (Wbn, %)

Company	Revenue			Operating profit			OP margin			Net profit			EPSG		
	17(F)	18F	19F	17(F)	18F	19F	17(F)	18F	19F	17(F)	18F	19F	17(F)	18F	19F
CJ E&M	1,750	1,956	2,147	63	110	135	3.6	5.6	6.3	429	144	173	NA	-67.3	23.2
Studio Dragon	287	378	469	33	69	103	11.5	18.4	22.0	8	56	83	NA	NA	47.8
Jcontentree	419	541	611	35	57	71	8.3	10.6	11.6	19	33	40	NA	NA	23.6
Showbox	103	131	138	10	14	18	10.1	10.6	13.2	13	11	15	NA	NA	39.9
NEW	95	182	224	-5	9	11	-5.4	4.7	4.8	4	8	12	NA	NA	29.2
IHQ	127	139	161	16	23	31	12.3	16.3	19.3	4	17	24	NA	NA	40.0
WALT DISNEY (America)	63,068	62,499	64,944	15,756	15,740	15,880	25.0	25.2	24.5	10,272	12,631	12,172	-0.5	24.3	8.2
COMCAST	95,571	97,043	98,423	20,337	20,286	21,228	21.3	20.9	21.6	25,682	12,751	13,559	167.0	21.9	11.3
TIME WARNER	35,357	34,769	36,784	8,955	9,282	9,818	25.3	26.7	26.7	5,933	6,415	6,857	34.6	0.9	6.9
21CFOX	32,510	32,414	34,149	7,118	6,964	7,530	21.9	21.5	22.1	3,367	4,865	4,437	14.1	6.1	11.8
VIACOM	15,171	13,825	14,276	2,847	3,010	3,117	18.8	21.8	21.8	2,144	1,856	1,890	29.3	4.3	6.6
Netflix	13,221	17,090	20,913	948	1,710	2,755	7.2	10.0	13.2	632	1,313	2,027	193.2	90.5	59.5
FUJI MEDIA HOLDINGS (Japan)	6,438	6,493	6,566	228	229	248	3.5	3.5	3.8	207	205	222	-24.3	-0.8	8.1
NIPPON TELEVISION NETWORK	4,235	4,321	4,417	490	511	493	11.6	11.8	11.2	334	382	375	-18.1	14.1	-2.6
ZHEJIANG HUACE FILM & TV (China)	910	1,142	1,351	115	152	197	12.7	13.3	14.6	106	136	179	31.1	26.0	25.1
HUAYI BROTHERS MEDIA	663	837	990	170	216	254	25.6	25.8	25.7	151	175	204	6.6	18.1	16.4
BEIJING ENLIGHT MEDIA	362	461	565	141	188	234	39.0	40.7	41.4	144	186	231	16.0	28.3	21.5
CIWEN MEDIA	389	505	634	91	117	153	23.3	23.1	24.1	71	90	116	43.9	27.6	27.5
Avg.							**15.5**	**17.2**	**18.0**				**41.1**	**14.9**	**20.9**

Note: All figures are based on Bloomberg consensus on 5th, May. 2018
Source: Bloomberg, Mirae Asset Daewoo Research estimates

Table 4. Global media/content companies' valuations/forecasts (%, Wbn, x)

Company	Stock price growth		Market cap	ROE			PER			PBR			EV/EBITDA		
	-1M	-3M		17(F)	18F	19F	17(F)	-1M	-3M	17(F)	17(F)	18F	19F	18F	-1M
CJ E&M	-4.1	-1.7	3,339	25.0	6.6	7.6	7.3	23.8	19.3	1.6	1.6	1.5	5.6	6.1	6.3
Studio Dragon	13.2	37.9	2,448	NA	14.4	15.5	NA	43.8	29.6	12.6	5.9	4.9	NA	21.5	15.2
Jcontentree	11.7	36.0	858	8.1	20.6	20.0	62.6	26.3	21.3	4.9	4.3	3.6	14.4	15.9	13.4
Showbox	7.3	3.7	369	8.5	7.6	9.9	34.0	35.2	25.2	2.8	2.6	2.4	3.3	4.5	4.9
NEW	-2.6	-1.5	228	-2.9	6.9	8.2	NA	24.7	19.1	1.7	1.6	1.4	NA	12.5	11.6
IHQ	3.6	1.1	399	4.3	7.2	9.3	39.8	22.9	16.4	1.7	1.6	1.5	3.5	5.1	6.1
WALT DISNEY (America)	-1.6	-3.9	167,465	25.3	24.2	23.8	17.1	14.5	13.4	3.6	3.5	3.3	11.2	10.1	10.1
COMCAST	-6.9	-7.7	183,269	37.1	17.0	18.4	17.8	14.5	13.1	2.5	2.5	2.4	9.0	7.9	7.5
TIME WARNER	-1.9	2.7	78,917	19.9	19.0	17.1	12.6	12.4	11.6	2.6	2.1	1.8	10.7	10.0	9.7
21CFOX	0.6	10.2	72,479	24.2	21.4	20.0	21.8	17.8	15.9	3.7	3.4	3.0	12.4	11.5	10.8
VIACOM	9.0	15.2	15,118	36.6	24.2	21.8	10.5	9.7	9.1	2.4	2.1	1.8	8.3	8.0	7.7
Netflix	18.4	63.4	141,270	17.9	25.8	28.0	225.6	98.4	61.7	36.4	28.5	20.5	95.4	69.8	45.0
FUJI MEDIA HOLDINGS (Japan)	-5.2	5.4	4,355	3.1	2.9	2.9	20.0	20.2	18.7	0.6	0.6	0.6	11.2	10.9	11.2
NIPPON TELEVISION NETWORK	-1.6	-1.9	5,414	5.2	5.6	5.2	15.2	13.3	13.7	0.8	0.7	0.7	6.5	6.2	6.0
ZHEJIANG HUACE FILM & TV (China)	6.6	28.3	3,893	9.1	10.7	12.4	36.4	28.9	23.1	3.2	2.9	2.6	31.1	24.3	19.3
HUAYI BROTHERS MEDIA	-6.6	18.5	4,640	8.8	9.7	10.4	31.7	26.8	23.1	2.7	2.5	2.2	25.6	19.8	18.5
BEIJING ENLIGHT MEDIA	4.2	33.2	6,509	11.5	13.2	14.4	44.8	34.9	28.8	5.1	4.5	3.9	49.4	36.3	29.1
CIWEN MEDIA	11.4	4.8	2,052	25.9	25.3	25.6	26.7	21.0	16.4	7.0	5.4	4.2	21.3	16.2	11.7
Avg.	**2.5**	**12.1**		**15.7**	**14.6**	**15.0**	**39.0**	**26.2**	**20.6**	**4.9**	**4.1**	**3.4**	**19.9**	**16.2**	**13.5**

Note: All figures are based on Bloomberg consensus on 5th May, 2018
Source: Bloomberg, Mirae Asset Daewoo Research estimates

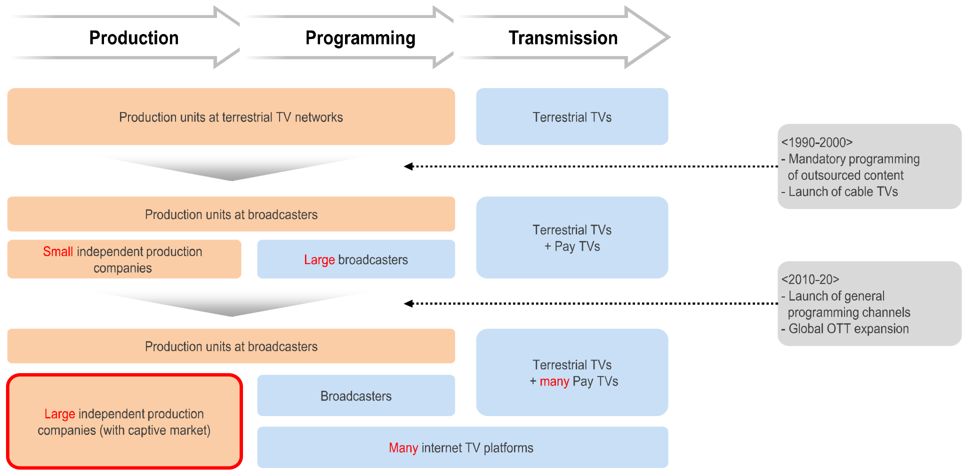
II. Media content: Global distribution growth has just begun

1. Increasing demand for TV drama content

The global over-the-top (OTT) market is growing at an exceptional pace. Most institutes project the market to grow at a CAGR of around 20%. In particular, PwC forecasts the market to expand at a CAGR of 20.3% to US$81.7bn in 2020 (versus US$39.1bn in 2016), while the Korea Communications Commission (KCC) forecasts a CAGR of 27.2% through 2020. These projections are based on the sum of the online (PC and mobile) video ad and VOD/subscription-based content markets, which will likely display well-balanced growth.

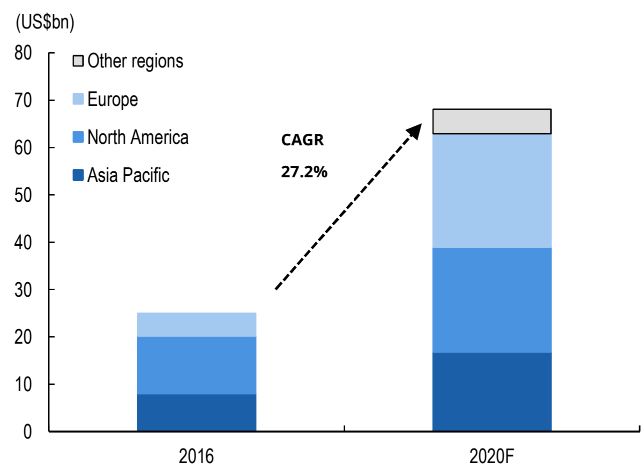
As such, competitive production companies are well positioned to benefit, as the rapid expansion of new media is creating massive additional demand for TV drama content. In addition to demand volume growth, the status of content (price and negotiating power) is also rising, as OTT service providers turn to content to differentiate their platforms. With second- and third-tier content distribution deals increasing, companies' production capabilities are frequently subject to market evaluation.

Figure 4. TV drama production companies benefit from increasing demand sources



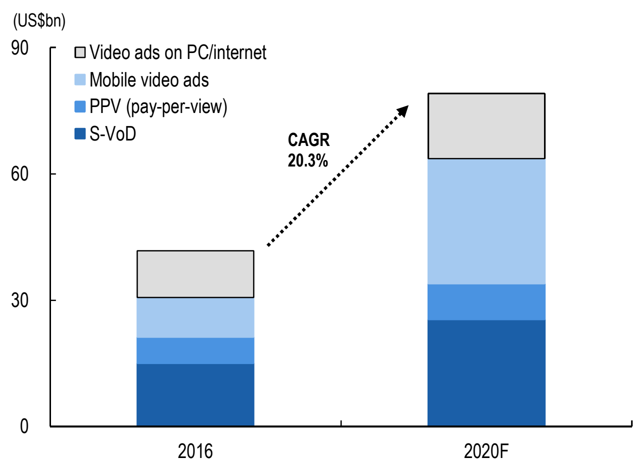
Source: Mirae Asset Daewoo Research

Figure 5. Global OTT market outlook (KCC)



Source: Korea Communications Commission, Mirae Asset Daewoo Research

Figure 6. Global OTT market outlook (PwC)



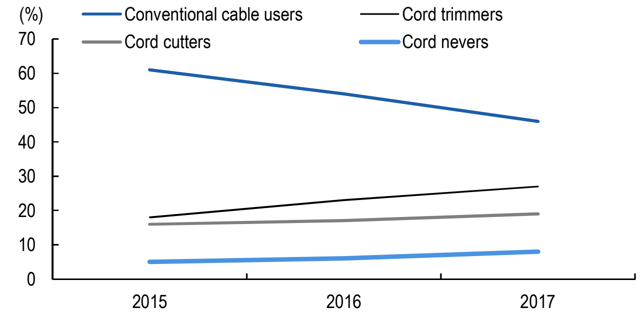
Source: PwC, Mirae Asset Daewoo Research

Until 2017, OTT market expansion was driven by the US. The OTT market took off rapidly, aided by: 1) Netflix's aggressive investments in high-quality content; and 2) relatively high cable TV subscription fees. In the US, with cord cutting progressing significantly, the leading OTT player's (Netflix) subscriber base has outnumbered (1.15x) the three major cable TV operators' combined subscribers. In addition, the US OTT market accounts for 40% of the global market.

Looking ahead, we expect Asia to lead OTT market growth. Over the next five years, the Asian market is anticipated to grow at a CAGR of 18.4%, 3%p higher than global CAGR, as: 1) US OTT players are increasing overseas investments to attract subscribers, amid slowing US subscriber growth; and 2) local platforms in Asian countries are seeing solid inflows of subscribers. The Asian market, which has a large population and advanced network infrastructure, has recently seen the culture of content purchasing take root. Given its significantly low penetration relative to Western markets, the Asian OTT market has high growth potential, in our view.

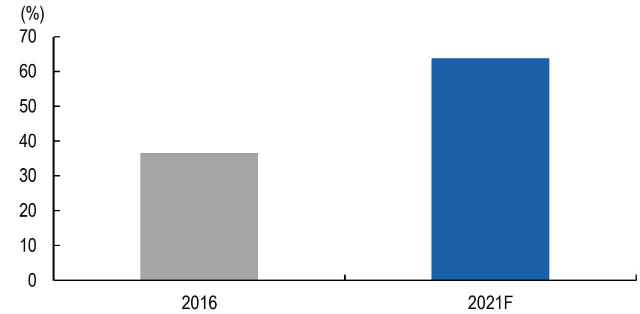
Korean content is useful to expand Asian OTT subscribers, as well as secure diverse content libraries, given its multi-national popularity and diverse genres, coupled with low production budgets. The value of Korean content is likely to rise via a variety of production partnerships and licensing deals, creating new opportunities (co-production with foreign firms, production outsourcing deals, etc.).

Figure 7. Cord cutting continues in US



Source: PwC, Mirae Asset Daewoo Research

Figure 8. VOD penetration in Southeast Asian market



Source: Muvi, Mirae Asset Daewoo Research

Table 5. Netflix's Korean TV drama library approaches 50 shows

Title	Air date in Korea	No. of episodes	Distributor	Title	Air date in Korea	No. of episodes	Distributor	Title	Air date in Korea	No. of episodes	Distributor
Quiz From God	**2010.01**	**10**	**OCN**	**I Need Romance 3**	**2014.01**	**16**	**tvN**	My Horrible Boss	2016.03	16	JTBC
Sungkyunkwan Scandal	2010.08	20	KBS	**Cheo Yong**	**2014.02**	**10**	**OCN**	Secret Healer	2016.05	20	JTBC
Playful Kiss	2010.09	16	MBC	Secret Affair	2014.03	16	JTBC	Hello, My Twenties!	2016.07	12	JTBC
I Need Romance 2012	**2011.06**	**16**	**tvN**	12 Years Promise	2014.03	26	JTBC	Moon Lovers: Scarlet Heart Ryeo	2016.08	20	SBS
Heaven's Garden	2011.12	30	ChannelA	**Gap Dong**	**2014.04**	**20**	**tvN**	My Wife's Having an Affair this Week	2016.10	12	JTBC
A Gentleman's Dignity	2012.05	20	SBS	**It's Okay, That's Love**	**2014.07**	**16**	**SBS**	Night Light	2016.11	20	MBC
Immortal Classic	2012.03	20	ChannelA	The Night Watchman's Journal	2014.08	24	MBC	Solomon's Perjury	2016.12	12	JTBC
Reply 1997	2012.07	16	tvN	The Greatest Marriage	2014.09	16	TV Chosun	Strong Woman Do Bong Soon	2017.02	16	JTBC
Can We Get Married?	2012.11	20	JTBC	Tomorrow's Cantabile	2014.10	16	KBS	Man to Man	2017.04	16	JTBC
Missing You	2012.11	21	MBC	**Misaeng**	**2014.11**	**20**	**tvN**	**Stranger**	**2017.06**	**16**	**tvN**
Reply 1994	2013.01	21	tvN	Let's Eat 2	2015.04	18	tvN	The Lady in Dignity	2017.06	20	JTBC
Nine: Nine Time Travels	2013.03	20	tvN	Fall in Love with Soon Jung	2015.04	16	JTBC	Strongest Deliveryman	2017.08	16	KBS
When a Man Falls in Love	2013.04	20	MBC	My Love, Eun Dong	2015.05	16	JTBC	**Argon**	**2017.09**	**8**	**tvN**
Empress Ki	2013.10	51	MBC	**Oh My Ghost**	**2015.07**	**16**	**tvN**	**Black**	**2017.10**	**18**	**OCN**
Let's Eat	2013.11	16	tvN	Last	2015.07	16	JTBC	Prison Playbook	2017.11	16	tvN
Bad Guys	**2014.01**	**11**	**OCN**	Good-bye Mr. Black	2016.03	20	MBC	**A Korean Odyssey**	**2017.12~**	**20**	**tvN**

Notes: Studio Dragon titles in bold; among complete series, only Studio Dragon productions are Cheo Yong (Season 2) and Quiz From God (Season 3, 4)
Source: Netflix, Studio Dragon, Mirae Asset Daewoo Research

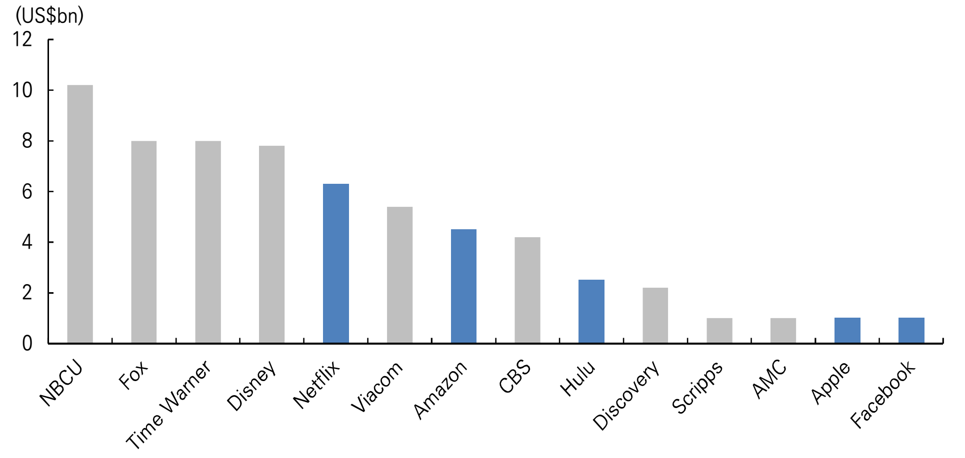
2. Demand growth to continue: Amazon and Walt Disney could follow in footsteps of Netflix

We believe the battle for leadership among OTT platforms will persist in the long-term, as: 1) new media players expand their geographical footprints; and 2) traditional media players adopt new media platforms. We think domestic content producers should seek growth opportunities from changes in the global platform/content ecosystem.

So far, Netflix has been the most aggressive in securing non-US subscribers. Netflix's efforts to source content targeting the Asian audience have borne fruit sooner than expected. For Korean content, since it bought licensing rights to *Stranger* (Studio Dragon) and *Man to Man* (JTBC Content Hub) in 2Q17, the company has uploaded dozens of TV dramas, entertainment shows, and movies in its library.

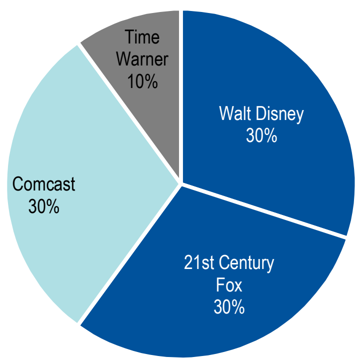
Of note, although a single OTT player has just stepped up its efforts to secure Korean content, the value of related domestic firms is climbing at an explosive pace. The fact that a new content market has formed rapidly is positive, but even more encouraging is the signs that platform competition is boosting content demand. In our view, OTT-driven environmental changes have just begun.

Figure 9. Content investments by US media firm in 2017



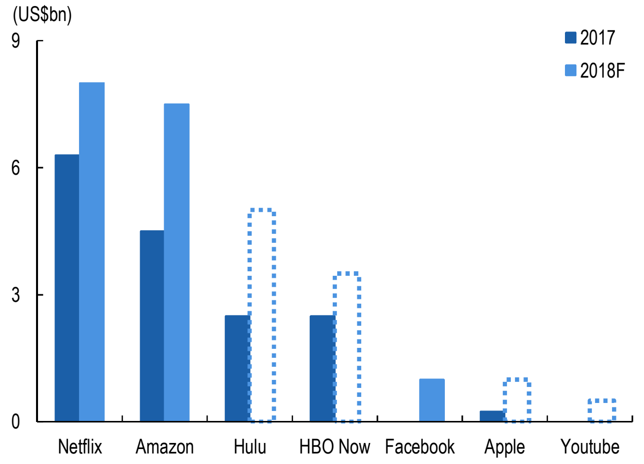
Source: Wall Street Journal, Mirae Asset Daewoo Research

Figure 10. Hulu ownership breakdown: Walt Disney to beef up Hulu



Source: Company data, Mirae Asset Daewoo Research

Figure 11. Global OTT content players to expand content investments



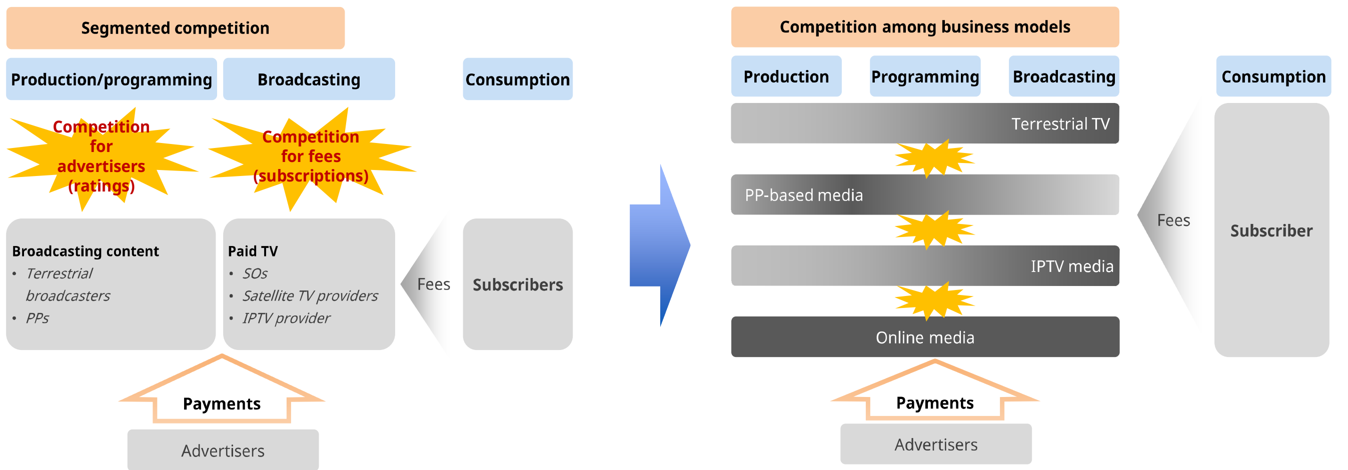
Source: Company data, Mirae Asset Daewoo Research

Recently, competition between traditional media firms (Walt Disney and Comcast) to acquire 21st Century Fox attracted keen attention, as the winner would secure management control of the online streaming platform Hulu. In December 2017, Walt Disney announced a deal to buy most of 21st Century Fox, including Fox's 30% stake in Hulu and film/TV assets (worth W58tr). Once the deal is approved by the Justice Department, Walt Disney will own an in-house online platform (ownership to increase from 30% to 60%) and is likely to beef up Hulu through aggressive investments. Of note, Walt Disney announced during its 3Q17 earnings call that it would halt its content supply to Netflix starting in 2019. Given that its existing content has strong global brand awareness and generates economies of scale (SVOD), the company should adopt a geographical expansion strategy for Hulu.

In addition, other internet firms (Amazon, Facebook, YouTube, etc.) and traditional media firms (Time Warner, AT&T, etc.) are also jumping on the bandwagon by increasing global content investments and acquiring stakes in OTT players. In particular, traditional media firms' efforts to adjust to the changing environment, including Time Warner's launch of HBO NOW, and AT&T's acquisition of DirecTV, warrant attention.

We also note that US traditional media firms have ample room for content investments (stable cash flows from cable program providers and system operators), thanks to their comprehensive value chain (content-platform-network). Walt Disney and 21st Century Fox's combined investments were double those of Netflix in 2017, and a significant portion of investments will likely be made in their in-house OTT services in 2018-19. In 2019, platform competition should enter into a second round and intensify. Content will likely be key to media firms' competitiveness, creating a favorable environment for production companies

Figure 12. Traditional media's entry into OTT market to change overall competitive landscape



Source: Mirae Asset Daewoo Research

III. Studio Dragon: Asia's leading content maker

1. Outstanding production capabilities raise tvN's profile

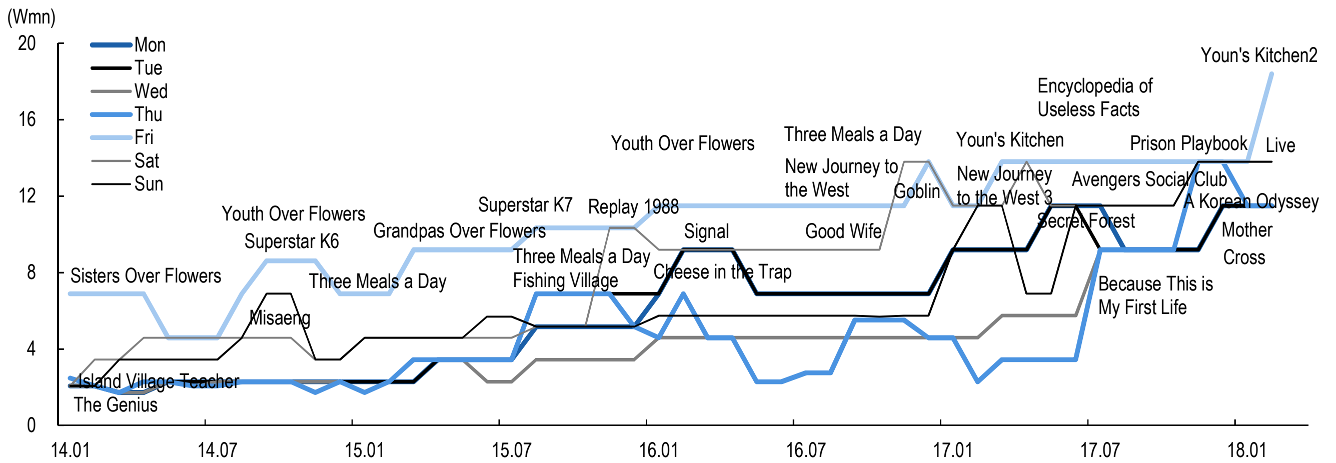
tvN, the flagship channel of CJ E&M, Studio Dragon's parent company, has become as influential as terrestrial TV networks, despite its limited accessibility. Studio Dragon (formerly CJ E&M's drama production unit) played a critical role in raising tvN's profile by creating a string of popular, quality content, including *Misaeng, Signal, Another Miss Oh, Goblin (Guardian: The Lonely and Great God)*, and *A Korean Odyssey*.

We attribute the success of Studio Dragon's content to its efforts to: 1) strengthen its production capabilities over the long term, on the back of captive demand; and 2) and build a strong talent pool.

Terrestrial TV networks make profits mainly from the difference between ad revenue and the costs of outsourced content production, as they are required to assign a significant portion of their slots to outsourced content, due to regulations. However, as cable channels are not subject to the regulations, Studio Dragon has been able to acquire time slots for more than 14 titles annually from tvN. Of note, CJ E&M has been able to focus on long-term competitiveness (channels and content), rather than short-term profitability (cost reduction and ad revenue maximization), thanks to its 100% in-house content production. This strategy has allowed Studio Dragon to utilize differentiated stories and novel ideas, driving up the success rate of its TV dramas.

In addition, Studio Dragon has steadily expanded its talent pool to respond to increased programming and VoD export growth, arising from its increasingly popular TV dramas. Currently, the company has around 150 creators (77 writers, 35 program directors, and 37 producers). Of note, Studio Dragon acquired Culture Depot (writer Park Ji-eun), Hwa&Dam Pictures (writer Kim Eun-sook), and KPJ (writer Kim Young-hyun and Park Sang-yeon) in 2016, further bolstering its relationships with creators. The production staff of the three fully-owned subsidiaries is well-recognized by both domestic and overseas viewers.

Figure 13. CJ E&M's ad prices by day of the week on steady uptrend



Note: Based on highest ad rate for each day of the week
Source: AGB Nielson, CJ E&M, Mirae Asset Daewoo Research

Studio Dragon is highly likely to further strengthen its production competitiveness going forward.

The firm is continuing to increase programming (quantity) and bring novel ideas (quality). The increase in programing, in particular, has been driven mainly by stronger captive demand. Leading captive channels, such as tvN and OCN (focusing on TV dramas with genre-oriented elements), have recently been providing more TV dramas, with O'live and other channels also highly likely to service TV dramas. Studio Dragon produced 16 TV dramas in 2015, 18.5 in 2016, and 21.5 in 2017, while looking to release 25 TV dramas on captive channels in 2018. Via terrestrial channels, the firm launched one TV drama in 2014, two in 2015, and three each in 2016 and 2017. In addition, the firm plans to launch TV dramas on terrestrial channels in 2018. Notably, Studio Dragon is planning to produce original content for overseas OTT platform Netflix, the first-ever event for a large-sized Korean production firm. In addition, the firm's TV dramas offer fresh stories in diverse genres (history, time-slip, ghost stories), as well evidenced by its highly-anticipated upcoming shows, such as *Mr. Sunshine* (history, time-slip), and *Alhambra: Memories of the Kingdom* (fantasy).

The firm is also striving to expand its talent pool over the long term. For example, O'PEN Drama Storyteller Exhibition should play a key role in incubating new writers, in response to growing demand in both Korea and overseas. About half of the stories created by writers selected from O'PEN will be produced into short (one or two episodes) TV dramas or mini-series and aired in 2018.

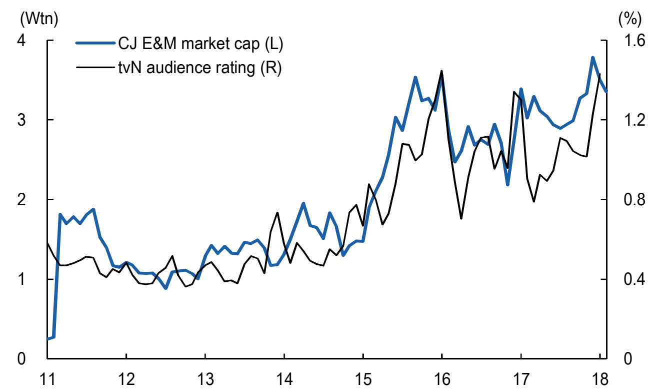
High-quality content comes from creative talents, and the firm has established the system to incubate new talents. Supported by its well-established production system, customer diversification (captive/terrestrial channels and overseas OTT platforms) and strong talent pool, we expect the firm to maintain its strong production competitiveness going forward

Table 6. Major writers and producers of Studio Dragon

Creator		Major titles
Writer	Kim Eun-sook	Goblin, Descendants of the Sun, A Gentleman's Dignity, Secret Garden, Lovers in Paris
	Park Ji-eun	Legend of the Blue Sea , The Producers , My Love from the Star, My Husband Got a Family
	Kim Young-hyun	Six Flying Dragons, Deep Rooted Tree, Queen Seondeok, Dae Jang Geum, Royal Family
	Park Sang-yeon	Six Flying Dragons, Deep Rooted Tree, Queen Seondeok, Royal Family
	Hong sisters (Hong Jung-eun, Hong Mi-ran)	Master's Sun, The Greatest Love, Couple or Trouble, My Girl, Hong Gil-dong
Director	Kim Won-seok	Misaeng, Signal, Sungkyunkwan Scandal , King Sejong the Great, Cinderella's Sister
	Kim Cheol-kyu	On the Way to the Airport, Chicago Typewriter , Hwang Jini, More Beautiful Than a Flower, Summer Scent
	Lee Eung-bok	Goblin, Descendants of the Sun, Discovery of Love, Secret, School 2013
	Kim Do-hoon	The Moon Embracing the Sun, Royal Family, Spotlight
	Kim Yoon-cheol	Que Sera Sera, My Lovely Sam Soon, Love in Your Arms, The Last Match, Jealousy
	Park Hong-kyun	The Greatest Love, Queen Seondeok, New heart, Age of Heroes

Source: Company data, Mirae Asset Daewoo Research

Figure 14. Strong content competitiveness drives up viewing rates, boosting enterprise value



Source: CJ E&M, Mirae Asset Daewoo Research

Figure 15. O'PEN supports new writers

Source: Company data, Mirae Asset Daewoo Research

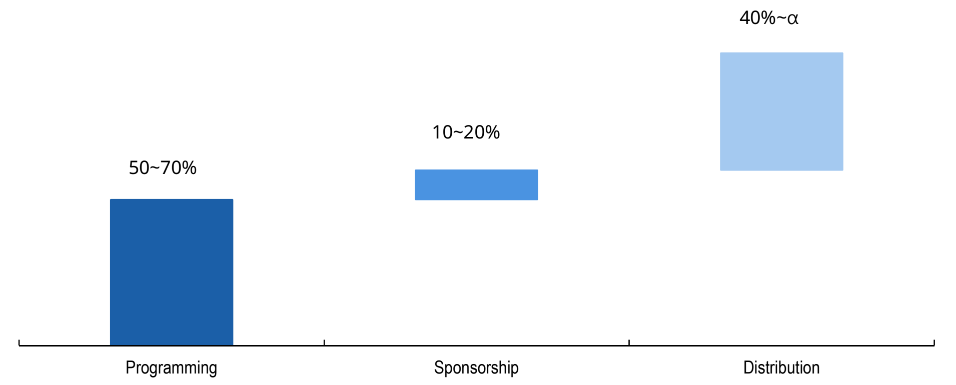
2. Business model: Ample upside, but downside limited

Currently, the rivalry is fierce between new media and traditional media, which is striving to regain its market share lost to internet TV. If the current competitive environment continues, we believe Studio Dragon will be one of the primary beneficiaries, backed by its solid business model.

The firm recoups roughly 70% of its content production costs via the sale of broadcasting rights to domestic broadcasting channels (mostly captive channels), and 10-20% via sponsorships (e.g. product placements), while generating additional revenue through VOD sales in Korea and copyright sales overseas (overseas broadcasting channels and OTT platforms). While the bulk of its production costs are offset by proceeds from the sale of broadcasting rights to captive channels, the firm retains the intellectual property rights for its content. Under this business model, losses are limited to -20%, while return can exceed 100%.

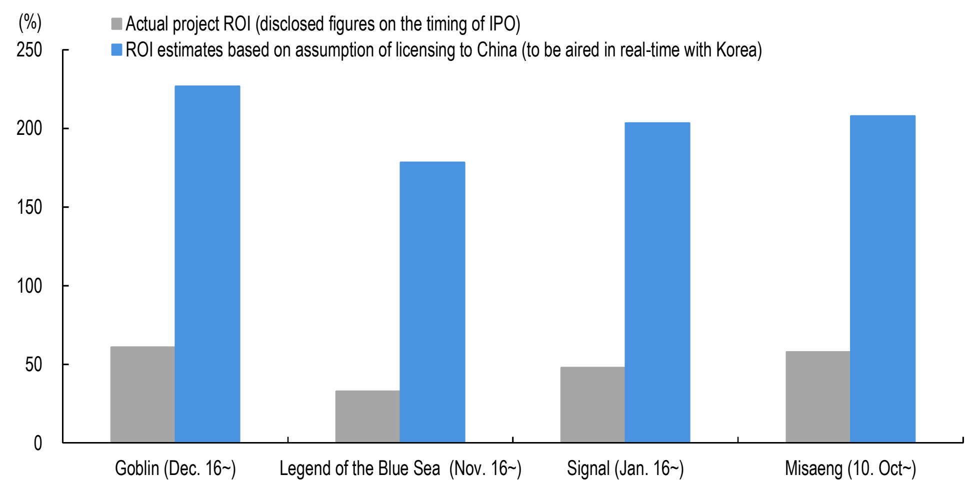
Indeed, Studio Dragon's popular TV show productions, Goblin, The Legend of the Blue Sea, Signal, and Misaeng (Incomplete Life), posted high ROI (61%, 33%, 48%, and 58%, respectively), despite the absence of copyright sales to Netflix and exports to China. In light of the full-fledged copyright purchases by Netflix since 2017 and the potential for a resumption of China-bound exports of Korean content, we believe the ROI for hit TV dramas could exceed 100%. Assuming that its TV dramas can fetch W7bn per episode from Netflix and/or 60% of total production costs from Chinese broadcasters, we estimate that ROI for major programs will exceed 200%.

Figure 16. Revenue as % of total production costs: Ample upside, but downside limited



Source: Company data, Mirae Asset Daewoo Research

Figure 17. ROI for major TV dramas



Note: We assumed Goblin, The Legend of the Blue Sea, Signal, and Misaeng (Incomplete Life) would be sold to Chinese broadcaster for W10bn, W10bn, W4bn, and 2bn, respectively
Source: Mirae Asset Daewoo Research

It is worth noting that ownership of intellectual property (IP) is essential to ensure high profits for content producers. The business model, in which IP rights are still held by the content maker, was first introduced to the market about three years ago, with the huge success of Descendants of the Sun, which had a unique investment structure. Indeed, the smash hit Korean TV drama allowed iQiyi, one of China's biggest OTT streaming service providers, to sharply expand both its subscriber base and ad revenue. The new business model is viewed as the result of increased sources of content demand amid the domestic advertising market slump; the proliferation of new media platforms has led to weakened pricing power of conventional platforms (broadcasting channels) over content producers, resulting in adjustments to profit-sharing ratios between market participants, and a shift in IP ownership to content producers.

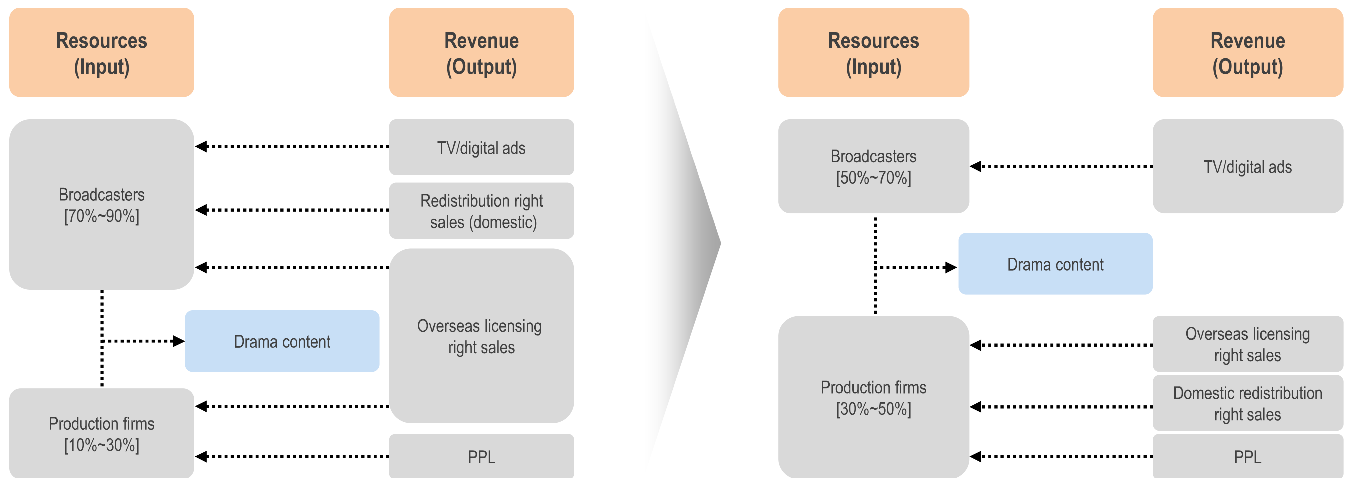
Against this backdrop, Studio Dragon has established its low-risk, high-profit business model, backed by support from its parent company. We believe such dynamics will be maintained (or strengthened) going forward, as the media environment becomes increasingly favorable to content producers with global influence. The global OTT market is growing at a faster pace than the domestic advertising market, resulting in expansion of content sourcing by global OTT platform operators. Amid the ongoing shift to OTT in the media space, traditional media firms are poised to join the competition for new media market leadership. Against this background, if content producers can prevent brain drain and entry barriers remain high, their revenue model could expand beyond the current IP ownership into revenue sharing with broadcasters over the long term.

Table 7. Co-production expected with global firms

	Company	Plans
Asia	Amazon	Distribute TV dramas in Japan
	True CJ Creations	Remake of TV drama based on IP (targeting the Thai market)
	CJ Blue	Remake of TV drama based on IP (targeting the Vietnamese market)
	Other	Sign JV and M&A deals with local producers
North America	Warner Bros.	Signed co-production MOU Co-produce global TV dramas
	Netflix	Distribute new dramas Black, A Korean Odyssey and Live Co-produce global TV dramas
	AMC	Co-produce global TV dramas
	iTV	Co-produce global TV dramas
	Other	Sign JV and M&A deals with local producers

Source: Company data, Mirae Asset Daewoo Research

Figure 18. Changes in TV drama production investment structure: Increased pricing power of content producers



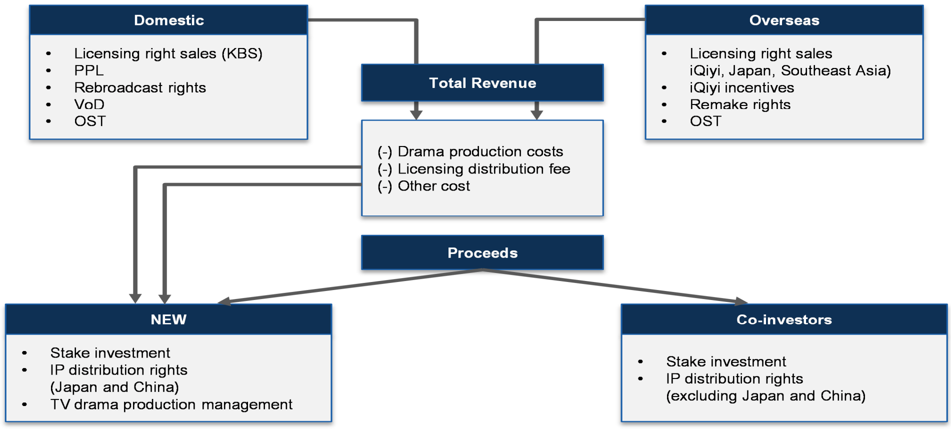
Source: Mirae Asset Daewoo Research

Table 8. Major global OTT platform players' investment plans for 2018

	Content investment budget for 2018
Netflix	US$7.5-US$8bn (February 2018)
Amazon	Estimated at US$7.5-US$8bn (February 2018)
Facebook	US$1bn (original content) (September 2017)
YouTube	US$100mn (original content) (February 2018)
Apple	US$1bn (original content) (September 2017) US$4.2bn by 2022 (original content) (November 2017)
Disney	US$7.8bn (excluding ESPN) in 2017 (2018 data unavailable.)
Hulu	US$2.5bn in 2017 (2018 data unavailable.)
Time Warner	US$8bn in 2017 (2018 data unavailable.)
HBO Now	US$2.5bn in 2017 (2018 data unavailable)

Source: Each company's data, Mirae Asset Daewoo Research

Figure 19. Descendants of the Sun with differentiated profit structure



Source: NEW, Mirae Asset Daewoo Research

Table 9. 2018 TV drama lineup for tvN and OCN: Focus on tentpoles slated for release in 2H

	Title	Distributor	No. of episodes	Air date	Director	Writer	Stars
1Q18	**A Korean Odyssey**	**tvN**	20	**23th, Dec. 2017**	**Park Hong-kyun**	**Hong Jung-eun**	**Lee Seung-gi, Cha Seung-won**
	My First Love	OCN	10	8th, Jan	Min Yeon-hong	Park Ga-yeon	Lee Jung-shin, Seo Ji-hoon
	Mother	tvN	16	24th, Jan	Kim Cheol-kyu	Chung Seo-kyung	Lee Bo-young, Lee Jae-yoon
	Cross	tvN	16	29th, Jan	Shin Yong-hwi	Choi Min-seok	Go Kyung-pyo, Jeon So-min
2Q18	Children of a Lesser God	OCN	16	3th, Mar	Kang Shin-hyo	Han Woo-ri	Kang Ji-hwan. Kim Ok-bin
	Live	**tvN**	16	10th, Mar	**Kim Kyu-tae**	**Noh Hee-kyung**	**Jung Yu-mi, Lee Kwang-soo**
	Evergreen	OCN	10	5th, Mar	Lee Chul-min	Jung Yoo-sun	Lee Jong-hyun, Kim So-eun
	My Mister	tvN	16	21th, Mar	Kim Won-seok	Park Hae-young	Lee Sun-kyun, IU
	A Poem a Day	tvN	16	26th, Mar	Han Sang-jae	Myung Soo-hyun	Lee Yu-bi, Lee Chae-young
	Mistresses	OCN	NA	April	Han Ji-seung	Go Jung-woon	Han Ga-in, Goo Jae-yi
	About Time	tvN	NA	May	Kim Hyung-sik	Chu Hye-mi	Lee Sang-yoon, Lee Sung-kyung
2H18	**Mr. Sunshine**	**tvN**	24	**July**	**Lee Eung-bok**	**Kim Eun-sook**	**Lee Byung-hun, Kim Tae-ri**
	Voice 2	OCN	NA	NA	NA	NA	Lee Ha-na
	Hundred Million Stars From the Sky	tvN	NA	NA	Yoo Jae-won	NA	NA
	Fall From the Sky	tvN	NA	NA	Kim Sang-ho	Nam Ji-eun	Yoon Hyun-min, Ahn Woo-yeon
	Memories of the Alhambra	**tvN**	**NA**	**November**	**Ahn Gil-ho**	**Song Jae-jung**	**NA**
	Let's Eat 3	tvN	NA	NA	Choi Kyu-shik	Im Soo-mi	Yoon Doo-joon
	Life On Mars	OCN	NA	NA	Lee Jeong-hyu	NA	Seo Ji-hun

Source: Press materials, Mirae Asset Daewoo Research

3. Solid financing capabilities enter spotlight in current seller's market

The recent changes in media environment have led to a shift in content market driver to sellers. In the current seller-driven content market, Studio Dragon's solid financial resources (its own and parent's) particularly stand out. Supported by its ample financial resources and strong captive demand, we believe the company will be able to maintain strong profitability for a prolonged period of time. While the market is in the early development phase and supply remains tight, the firm is now ready to sharply expand production, which we believe is a key valuation premium factor.

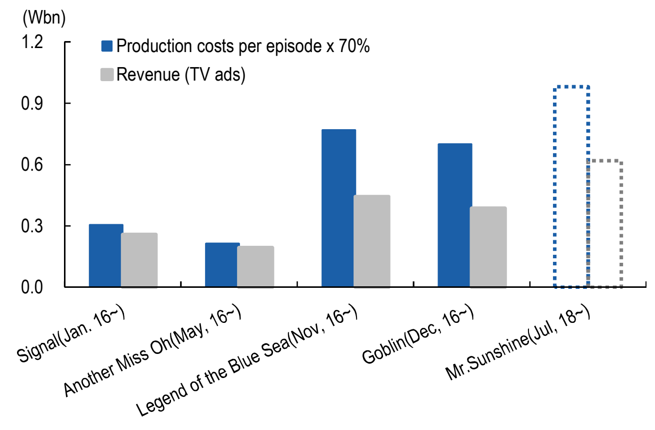
As highlighted repeatedly, Studio Dragon boasts far greater production capacity than rivals; the firm has signed (continuous) partnership agreements (not content-based agreements) with nearly 30% of domestic screenwriters, while having a vast pool of talented production staff. In addition, the firm represents over 20% of roughly 90-120 annually-aired TV shows (TV dramas), backed by strong demand from affiliated (captive) channels. A particularly encouraging development is the recent increase in its content released on non-captive channels, thanks to Studio Dragon's robust content competitiveness.

As a differentiation point for Studio Dragon, production financing capabilities should also prove critical. The firm has been able to carry out larger production projects than rivals, mainly because the parent company has been enjoying stable cash flow from conventional ad sales. However, it is now facing the need to expand into other (non-ad) revenue sources; although ad rates are continuing to rise at some channels, ad revenue alone is not sufficient to cover production costs, which are rising at a faster pace.

Amid the uptrend in production costs, the company's (including affiliates') solid financial resources should come into focus going forward, as evidenced by its production of blockbuster TV drama series. We estimate the firm's per-episode TV drama ad revenue at W500mn-600mn, considering that: 1) ad time is limited to 10% of each episode's running time; and 2) CJ E&M's maximum ad rate (based on contract renewed in February 2018) is W18.4mn/15 seconds (10 p.m. on Friday). Even with the inclusion of digital ad revenue (e.g., NAVER TV), we think the firm's per-episode ad revenue is unlikely to exceed W1bn. Nevertheless, the company is looking to produce blockbusters (e.g., Mr. Sunshine), whose production costs cannot be covered by ad revenue. We believe this suggests that the firm is confident in its distribution network, global licensing sales, and strategic focus on content, a trio of advantages that rivals would be hard-pressed to match.

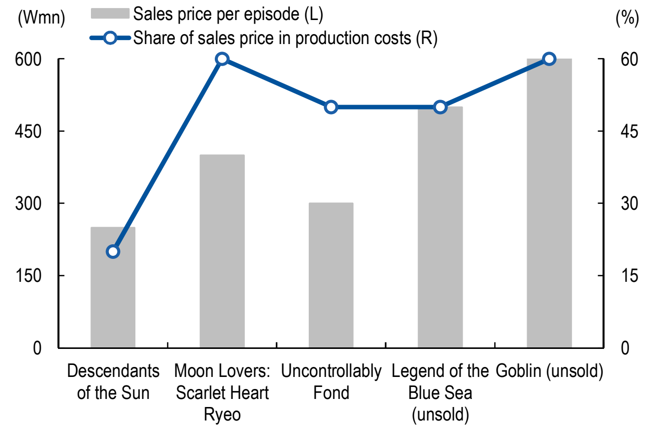
Once CJ E&M's merger with CJ O Shopping is approved, the parent company's financing support should strengthen further, benefiting Studio Dragon as a result. If the merger allows the parent to expand its annual earnings stream by over W200bn, we estimate Studio Dragon will be able to increase its per-episode production cost by over W1.5bn. We are positive on the company's strategy of increasing leverage by expanding production scale, as the content market is highly likely to remain a seller's market for the time being. Its business structure - based on solid financing capacity - is also highly likely to garner attention going forward, given the significant impact of production costs on content prices.

Figure 20. Production budget to increase further



Note: Production cost estimate is based on press materials
Source: Mirae Asset Daewoo Research

Figure 21. Production costs vs. China-bound content export prices



Note: Based on press materials
Source: Mirae Asset Daewoo Research

IV. Next up: Original content production

Original content production on the horizon

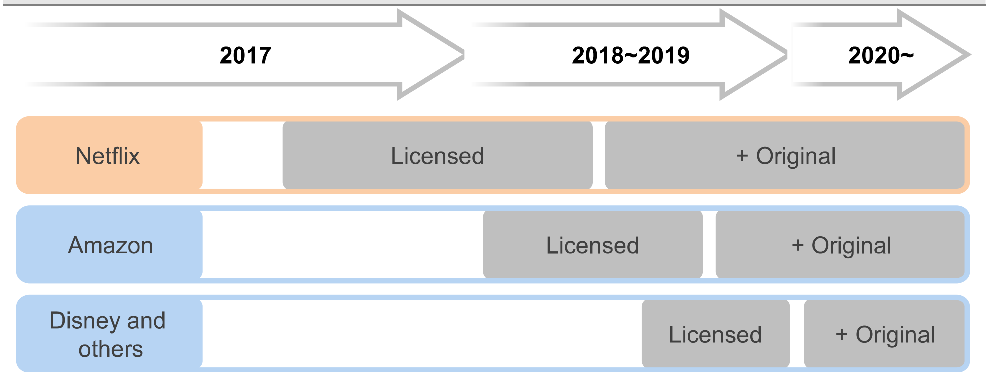
As Netflix-bound licensing sales have somewhat stabilized since 2H17, we expect Studio Dragon to focus on producing original content for overseas platform players (e.g., TV channels, OTT) going forward. One of Hulu's original TV series won the Emmy Award for best TV drama series for 2017. Netflix is also indicating an increase in its quarterly content investments and expansion in the portion of original TV dramas in its total investments. The recent conference call also confirmed the company's plan to invest more in original programing, diversify content, and secure additional subscribers in new markets (despite the fact that its replay numbers remain negligible in the US).

Studio Dragon's first partner for its first original series will also likely become Netflix. Netflix sources deals for international original content (currently mainly in Germany/Japan/South America) by directly contacting local producers (or being contacted by producers) after selecting its target market. So far, well-recognized broadcasters or content producers with proven track records have been selected as its local partners. In our view, Studio Dragon is ideally equipped to satisfy Netflix's needs and sourcing standards. Currently, Korea is one of only about 10 countries that export TV dramas. Studio Dragon has a large pool of writers (over 30% of Korea's TV drama writers).

In our view, through the production of original content for outside platforms, Studio Dragon will be able to generate large-scale revenue (and profits), with minimal risk, by utilizing existing capacities. Given that the company currently has a pool of 80 contracted writers, its maximum annual TV drama production capacity is estimated at 40 titles per year, of which about 30 are provided to captive channels. The number of TV drama titles to be provided to captive (e.g., tvN, OCN, etc.) and terrestrial networks is unlikely to exceed 35 per year, even based on aggressive assumptions. Accordingly, at current capacity, Studio Dragon will be capable of producing at least five additional TV dramas annually. Meanwhile, Netflix sets content prices at 110-120% of total expected production costs, as it holds intellectual property rights to the content. If Studio Dragon secures a fixed production margin of 20% from original content deals with Netflix, the level comparable to our estimate for the company's GP margin for 2018-2019, it should be able to expand its profits without risks of losses.

Meanwhile, the production of Netflix original content should also enhance the company's profile in the global market, which could boost demand from other major platforms, like Amazon and Disney. Currently, the company's first project with Netflix is believed to be in the planning stage, with airing scheduled for 2019. We estimate the project will generate around W20bn in revenue and W5bn in profit. Meanwhile, Netflix's first Korean original series, *Kingdom (produced by Astory)*, is currently in production. Written by Kim Eun-hee and directed by Kim Seong-hoon, the new series fuses the historical TV drama and zombie-action-thriller genres, and boasts large-scale production costs (over W20bn for six episodes), all of which is in line with Netflix's original content production standards.

Figure 22. Production of Netflix original series to boost demand from other major platforms



Source: Mirae Asset Daewoo Research

Case study: Netflix's foreign language original series

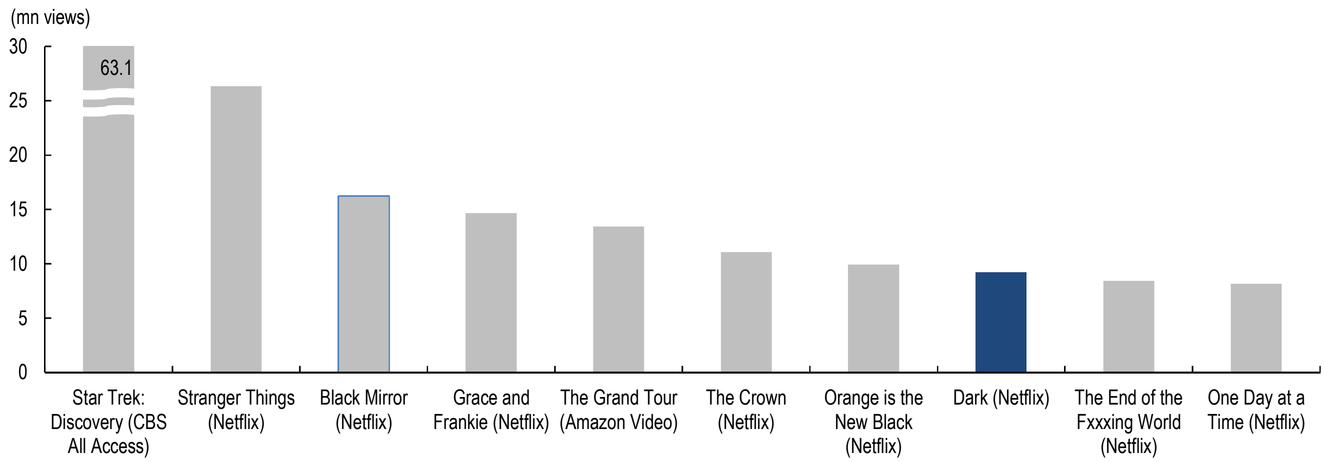
1) *Dark*

Dark is Netflix's first German-language original series, produced by Wiedermann & Berg Television (unlisted; one of Germany's major drama/film producers). The mystery thriller series is believed to be one of Netflix's most-watched foreign-language shows. The producer is known to have proposed an over-one-year partnership with Netflix, and Netflix is believed to have accepted the deal to expand its viewer base in Europe. The shooting of the first season took five months, while the exact production costs are unknown. The series now has the eighth-highest average demand expression tally, and has received the go-ahead for a second season on Netflix. The success of the first season of *Dark* is believed to have been a major catalyst for Netflix's decision to pursue aggressive investments in local content.

2) *Midnight Diner: Tokyo Stories* (season 4)

Released in October 2016, *Midnight Diner: Tokyo Stories* was produced by Tokyo Broadcasting System and Netflix Japan, with Netflix holding the exclusive IP. Given that Netflix is highly interested in producing sequels for successful series, the show appears to have been selected based on the popularity of the previous seasons. The show is popular in Korea, where the season-based system of TV dramas is still uncommon (unlike variety entertainment). The dramas for which the production of sequels is being considered include *Voice* (OCN), *Stranger* (tvN), and *Misaeng* (tvN).

Figure 23. Most popular digital original television shows based on audience demand in US



Note: Based on demand expansion between January 25th and 31st, 2018
Source: Statista, Mirae Asset Daewoo Research

Figure 24. *Dark*

Source: Mirae Asset Daewoo Research

Figure 25. *Midnight Diner: Tokyo Stories*

Source: Mirae Asset Daewoo Research

Netflix secures content in three ways

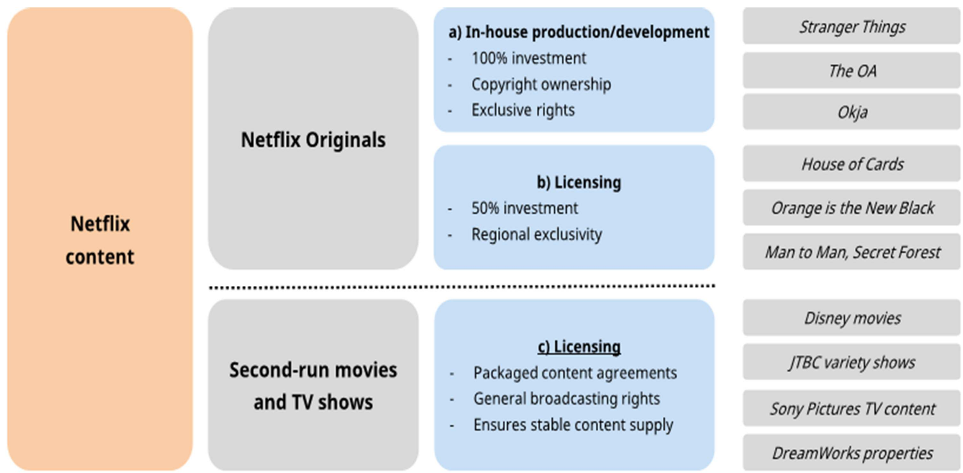
In the subscription-based OTT market, which is likely to drive the overall media industry, Netflix boasts an unparalleled market share, thanks to its aggressive efforts to secure content. Netflix secures content in the following three ways, which are likely to take root as content trading standards in the market:

1) Self-produced Netflix Original: Under these contracts, Netflix holds all intellectual property rights to content, including broadcasting rights and copyrights, as the company engages in planning and production staff selection, as well as shouldering most of the production costs. Cases in point include *Okja, Stranger Things*, and *Kingdom* (to be released in 2018). In addition, the cases of purchasing copyrights to content produced by external production companies (such as *The Irishman*) can also be categorized into this type, as this content is not released on other platforms.

2) Licensed Netflix Original: Under these deals**,** Netflix secures exclusive broadcasting rights to content in certain areas by paying licensing fees to individual production companies. The exclusive broadcasting rights are effective only in those areas, with production companies holding the copyrights. The value of broadcasting rights is estimated at half of the production cost. *Orange is the New Black* and *House of Cards* belong in this category. *House of Cards* was produced by MRC, an individual production company, and Netflix has secured exclusive broadcasting rights to it for the US and Canada, but does not own the rights to broadcast it in Europe and India. Among Korean TV drama content, Netflix purchased joint (domestic) and exclusive (overseas) broadcasting rights to *Man to Man* and *Stranger* for W6bn and W3.5bn, respectively.

3) Licensed Content: Netflix also secures general broadcasting rights to all or some of a production company's content, typically based on a time-based contact. Licensing fees are lower than those of the second category. For example, in 2010, Netflix clinched a W220bn deal with EPIX, a TV drama PP and film distributor, allowing the company to broadcast EPIX movies 90 days after they become available on premium cable channels. EPIX also signed a similar contract with Amazon Prime. In addition, Netflix has recently signed a W340bn deal with The Walt Disney Company. This deal includes the exclusive US broadcasting rights to Disney/Marvel/Lucasfilm/Pixar movies released in 2016 or later and joint broadcasting rights to those released before 2016. For domestic content, Netflix secured a 600-hour content supply contract with JTBC. Under this contract, JTBC has supplied a variety of content, including *Can We Get Married?* (TV drama), *Begin Again* (entertainment show), and *Abnormal Summit* (entertainment show).

Figure 26. Netflix's methods of securing content



Source: Mirae Asset Daewoo Research

V. Earnings outlook

1. EBITDA to grow 47.7% CAGR for 2018-19

For 2018, we forecast Studio Dragon to deliver revenue of W382.8bn (+33.5% YoY; all growth figures hereafter are YoY), operating profit of W61.9bn (+87.3%), and net profit of W47.8bn (+100.6%). For 2018-19, we expect revenue, operating profit, and net profit CAGRs of 35.3%, 60.8%, and 66.6%, respectively.

1) Programming revenue has a major impact on licensing and other revenues and thus sets the tone for overall earnings. We expect programming revenue to expand 25.7% CAGR through 2019, backed by growth in volume (for both captive and terrestrial networks) and price (higher production costs).

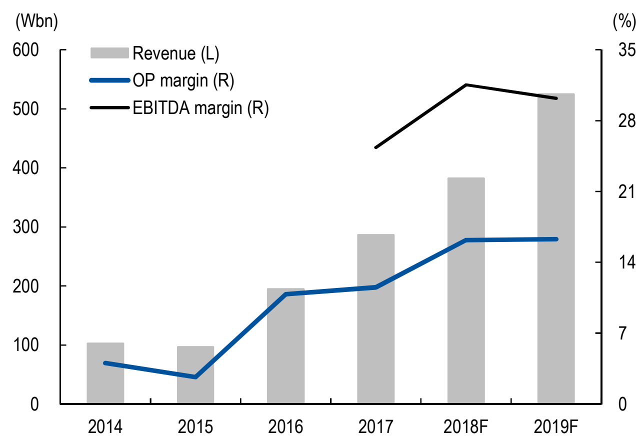
2) We forecast licensing revenue to increase 38.8% CAGR through 2019. Because licensing revenue is what the company makes after recovering most of its production costs (70-90%), it has the strongest operating leverage effect. We believe volume (number of clients) and price will simultaneously increase, as the market for content licensing continues to expand.

3) We project other revenue (which includes product placements) to increase 28.4% CAGR. We believe Studio Dragon has several unique advantages in this area, such as superior targeting to captive channels and high content quality, which make native advertising possible. Thanks to these advantages, we expect other revenue as a percentage of programming revenue to remain in the 30% range, despite higher production costs.

In forecasting earnings, we started with the company's existing operations, including domestic programming, domestic licensing (VoD, reruns, etc.), overseas licensing (not including Netflix and China), and product placements. We then reflected: 1) licensing sales to Netflix (one title per quarter); and 2) the production of one Netflix original program (airing in 2Q19; production cost of W25bn). We did not incorporate licensing sales to China. While chances are high that sales of existing titles will resume once bilateral relations normalize, this could cause wide variations in profits, depending on the actual timing of sales.

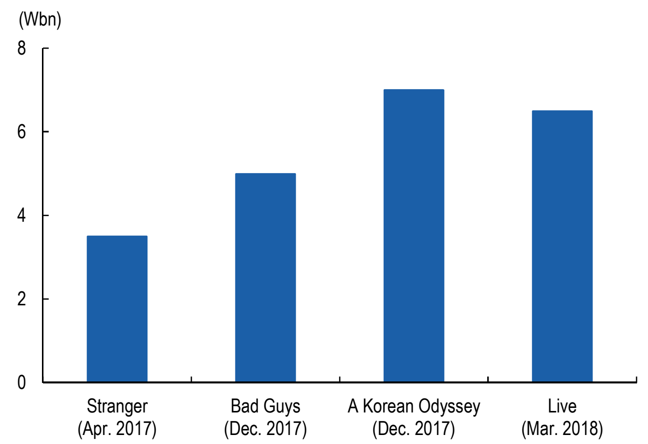
Because we only accounted for revenue sources with an established pattern or those in the planning stage, we view our estimates as conservative. We would revise our forecasts upwards if we are able gain visibility on several unconfirmed variables, including: 1) higher-than-projected price (W7bn) and volume (one title per quarter) of content licensing to Netflix; 2) faster-than-expected execution of original production (current expectation is 2Q19), or the execution of multiple programs at the same time; and 3) the resumption of licensing exports to China.

Figure 27. Earnings forecast



Source: Mirae Asset Daewoo Research

Figure 28. Netflix-bound content prices on the rise



Source: Media reports, Mirae Asset Daewoo Research

Table 3. Earnings and forecasts (Wbn, %, no.)

	1Q17	2Q17	3Q17	4Q17P	1Q18F	2Q18F	3Q18F	4Q18F	2017P	2018F	2019F
Revenue	75	62	77	72	98	82	102	101	287	383	525
Programming	26	24	42	39	41	35	41	41	131	158	207
Licensing	36	26	23	26	42	36	46	45	112	169	216
Other	13	12	12	7	14	11	15	15	44	55	72
Original production contracting	0	0	0	0	0	0	0	0	0	0	30
Costs	59	50	67	64	76	68	80	81	240	304	420
Production costs (excl. originals)	25	25	41	39	43	37	43	43	130	166	220
Commission fees	7	5	5	5	8	7	9	9	22	34	43
Depreciation expenses on tangible/intangible assets	9	9	10	11	13	14	15	16	39	58	73
Other	17	10	11	9	12	10	12	12	47	46	60
Production costs for originals	0	0	0	0	0	0	0	0	0	0	24
SG&A	3	3	4	4	3	4	5	5	14	16	20
EBITDA	23	18	17	15	32	25	33	32	73	121	159
Operating profit	14	9	7	3	19	11	17	15	33	62	85
OP margin	18.5	14.3	8.6	4.8	19.0	13.0	17.1	15.2	11.5	16.2	16.3
Pretax profit	13	9	6	2	18	11	17	15	30	61	85
Net profit	13	3	6	2	14	8	13	12	24	48	66
Net margin	17.8	4.5	7.3	2.8	14.7	10.0	13.2	11.7	8.3	12.5	12.6
YoY											
Revenue	-	-	-	-	29.5	32.8	31.5	40.3	46.7	33.5	37.1
Programming	-	-	-	-	57.2	47.1	-2.4	4.5	49.5	20.7	30.8
Licensing	-	-	-	-	16.0	35.0	98.0	76.0	48.3	51.4	27.4
Other	-	-	-	-	10.8	-1.7	20.5	106.9	35.3	26.0	30.9
EBITDA	-	-	-	-	38.6	37.2	95.4	111.2	-	66.0	31.3
Operating profit	-	-	-	-	32.6	20.2	162.4	340.5	56.1	87.3	38.0
Net profit	-	-	-	-	7.0	193.3	138.2	490.9	83.8	100.6	38.4
Major assumptions											
No. of titles aired	4.0	4.5	6.5	6.5	7.0	6.0	6.5	6.5	21.5	26.0	30.0
No. of titles licensed to Netflix	0.0	1.0	1.0	1.1	1.4	0.5	1.0	1.0	3.1	3.9	4.0
YoY											
No. of titles aired	-	-	-	-	75.0	33.3	0.0	0.0	16.2	20.9	15.4
No. of titles licensed to Netflix	-	-	-	-	-	-50.0	0.0	-9.1	-	25.8	2.6

Source: Mirae Asset Daewoo Research

2. Growth to continue in both volume and price; licensing sales key to earnings growth

1) Programming revenue

We expect Studio Dragon to record programming revenue of W158.4bn (+20.7% YoY) in 2018 and W207.2bn (+30.8% YoY) in 2019. The most important factors affecting programming revenue are: 1) the number of titles aired and production costs; and 2) license fees from broadcasting networks as a percentage of production costs. The number of aired titles is largely determined by captive channels' daily TV drama slots. Currently, the company produces almost all of the TV dramas aired on CJ E&M channels, with the exception of only one or two titles annually. In addition, it also produces around two TV dramas for terrestrial channels on an annual basis. As tvN increased its TV drama slots in May 2017, the number of Studio Dragon-produced TV drama airings on tvN rose to 21.5 in 2017 from 18.5 in 2016. For 2018, 25 of the company's titles will be aired on tvN. A potential increase in TV drama slots on terrestrial or other captive channels could further boost the number of aired titles of Studio Dragon.

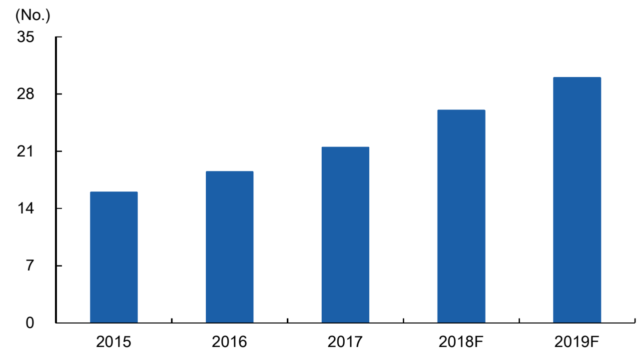
The proportion of license fees out of production costs determines the level of GP margin from licensing sales. As a significant proportion (50-70%) of production costs is covered by programming revenue, the amount of license fees should highly affect a project's profitability. Currently, programming revenue from captive and non-captive channels is estimated to correspond to 70% and 50% of production costs, respectively. We project the proportion of license fees from captive channels out of production costs will trend steadily downwards to 60%, in line with the increase in production volume. In light of CJ E&M channels' ad-based business model, they will likely face difficulties in raising license fees in accordance with growth in content production costs. However, CJ E&M's capital power is expected to strengthen after a planned merger with CJ O Shopping. Thus, the percentage of license fees out of production costs is unlikely to decline sharply. In addition, despite an expected fall in the coverage of production costs by license fees, licensing sales are anticipated to expand sharply, boosting the overall profitability of the company.

2) Other revenue

We project Studio Dragon's other revenues at W55.1bn (+26.0% YoY) in 2018 and W72.1bn (+30.9% YoY) in 2019. Sources of other revenue include product placements, sales of TV drama merchandise, original soundtracks, and DVDs. Revenue from CultureDepot, a talent agency and wholly-owned subsidiary of Studio Dragon, is also included in other revenue. Normally, product placement revenue, which moves line with programming revenue, accounts for the lion's share of other revenues.

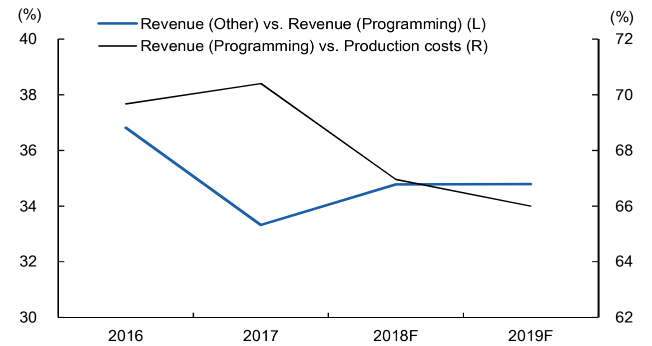
We believe Studio Dragon has several unique advantages in this area, such as superior targeting to captive channels and high content quality from production capabilities, which make native advertising possible Thanks to these advantages, we expect other revenue as a percentage of programming revenue to remain in the 30% range, despite higher production costs. Of note, we see a steep increase in product placements in modern and/or high-budget TV dramas.

Figure 29. Number of Studio Dragon's aired TV drama titles



Source: Mirae Asset Daewoo Research

Figure 30. Trends of other revenues relative to programming revenue and programming revenue relative to production costs



Source: Mirae Asset Daewoo Research

3) Licensing revenue

We project Studio Dragon's licensing revenue at W169.3bn (+51.4% YoY) in 2018 and W215.6bn (+27.4% YoY) in 2019. Licensing revenue consists of domestic VoD sales, and licensing sales to overseas channels and OTTs.

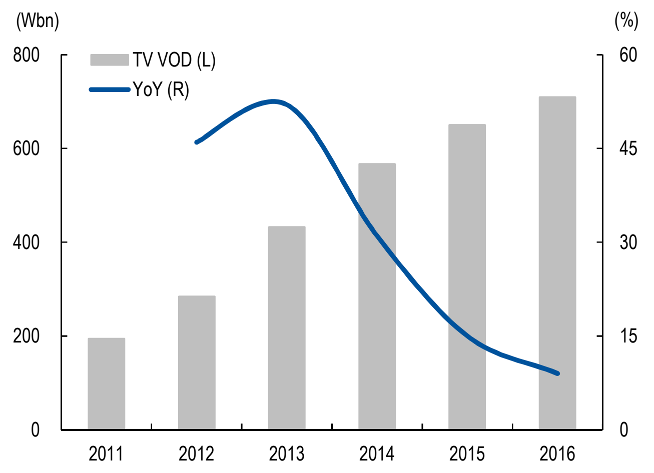
Because licensing revenue is what the company makes after recovering most of its production costs (about 85%), it has the strongest operating leverage effect. We believe volume (number of clients) and price will simultaneously increase as the market for content licensing continues to expand. Generally, 80% of the licensing revenue exclusive of 15% of production costs is recorded as profit (the gross profit margin of about 80% is attributable to the fact that content sales commissions for CJ E&M are included in production costs).

We conservatively assumed Studio Drago's licensing revenue (from domestic VoD services, Netflix, and ex-China overseas channels) will grow at a CAGR of 30% from 2018 onwards. The steady growth of the domestic VoD market (a CAGR of around 10%), as well as increases in the number of company's TV drama productions and sales to various overseas channels are expected to push up the company's licensing revenue. Amid the absence of China-bound exports, the company's content sales expanded by W36.4bn (+48.3% YoY) in 2017, with the number of aired titles rising 16% YoY. In 2018, the number of aired TV dramas is projected to increase by over 20%. Accordingly, our forecast for a 30% CAGR in licensing revenue is perceived to be reasonable.

Any licensing sales to China and global OTTs should further boost the company's licensing revenue. We reflected: 1) licensing sales to Netflix (one title per quarter); and 2) the production of one Netflix original program (airing in 2Q19; production cost of W25bn). Starting with *Stranger* in 2Q17, the company's licensing revenue has been increasing at a faster-than-expected pace, with the licenses of *A Korean Odyssey* and *Live* also sold recently. Going forward, the company will likely sell the licenses of at least one tentpole titles per quarter, recording W7bn in licensing sales per title. Meanwhile, we did not incorporate licensing sales to China. While chances are high that sales of existing titles will resume once bilateral relations normalize, this could cause wide variations in profits, depending on the actual timing of sales.

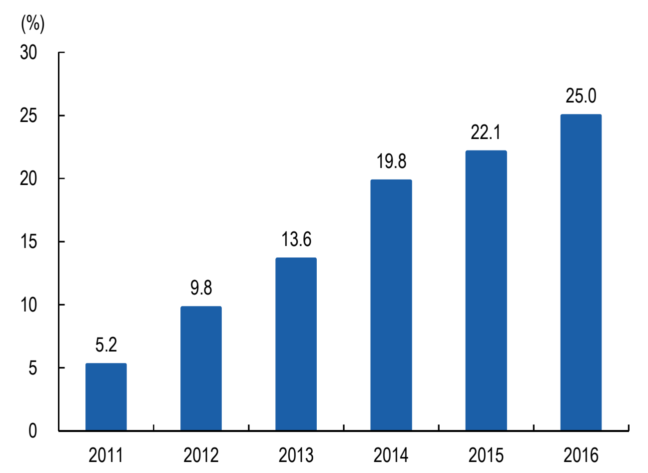
From a long-term perspective, we see additional upside to content prices. The company has steadily reduced its dependence on Netflix by establishing a pool of non-Netflix clients, including OTTs and channel operators in foreign countries. In addition, the emergence of the OTTs of Amazon and Disney as potential clients should further enhance the company's bargaining power.

Figure 31. Growth of TV VoD market



Source: Mirae Asset Daewoo Research

Figure 32. TV program VoD service usage rate trend



Source: Mirae Asset Daewoo Research

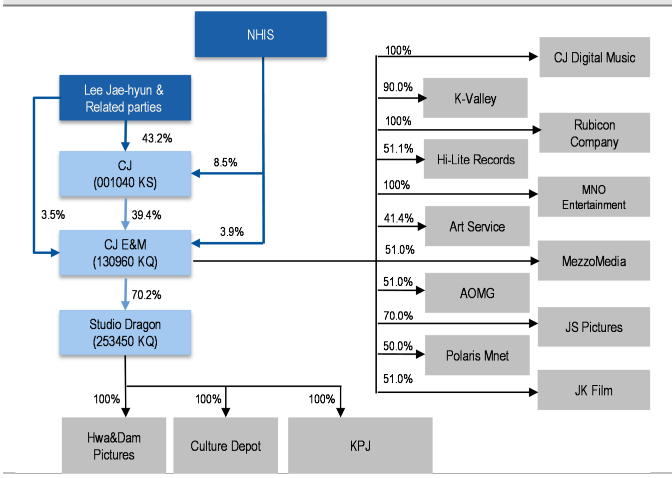
Appendix

Corporate overview

Studio Dragon is the largest TV drama production company in Korea, with its market share standing at around 20% (based on the number of TV dramas aired in 2017). The company was established on May 2016 as a spin-off from its parent company's TV drama production division. We believe the spin-off decision is aimed at increasing content sales to other platforms (terrestrial TV channels and overseas platforms), as well as captive channels. From May to September 2016, the company acquired three production companies—Culture Depot, Hwa&Dam Pictures, and KPJ—via equity swaps. In November 2017, the company secured W210bn via listing on the KOSDAQ market. We expect the proceeds from the IPO to be spent on global content production and M&As.

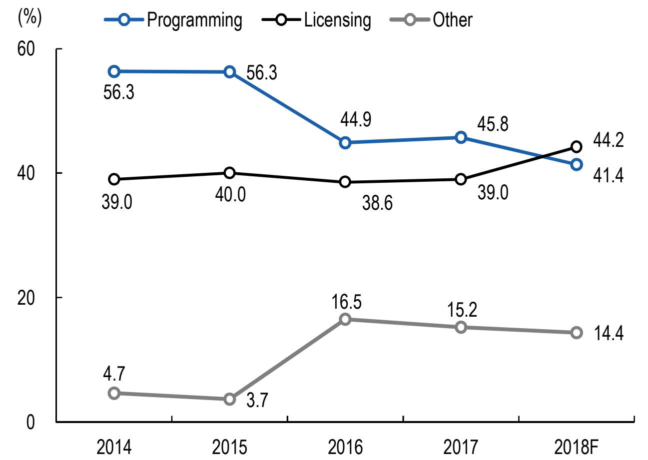
Based on its long-term approach toward strengthening production capabilities, the company has striven to secure talented writers and produce story-oriented content, making its TV dramas superior in quality and influence relative to other companies' TV dramas. The company generates revenue from programming (airing on domestic TV channels), content licensing (content sales to domestic channels and overseas platforms), and others (product placement, digital music, management agency businesses, etc.). With global demand for video content increasing full swing, growth will likely be driven by licensing sales going forward.

Figure 33. Studio Dragon and CJ E&M's governance structure



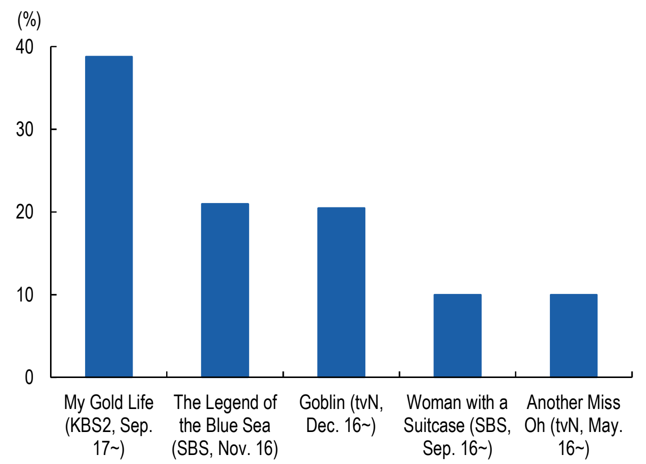
Source: FSS, Mirae Asset Daewoo Research

Figure 34. Annual revenue breakdown



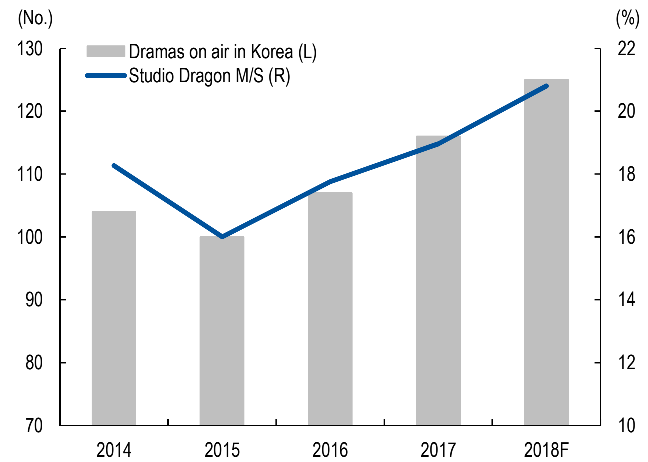
Source: Studio Dragon, Mirae Asset Daewoo Research

Figure 35. Highest ratings of Studio Dragon's major TV dramas



Source: AGB Nielson, Mirae Asset Daewoo Research

Figure 36. Market share based on number of TV dramas produced

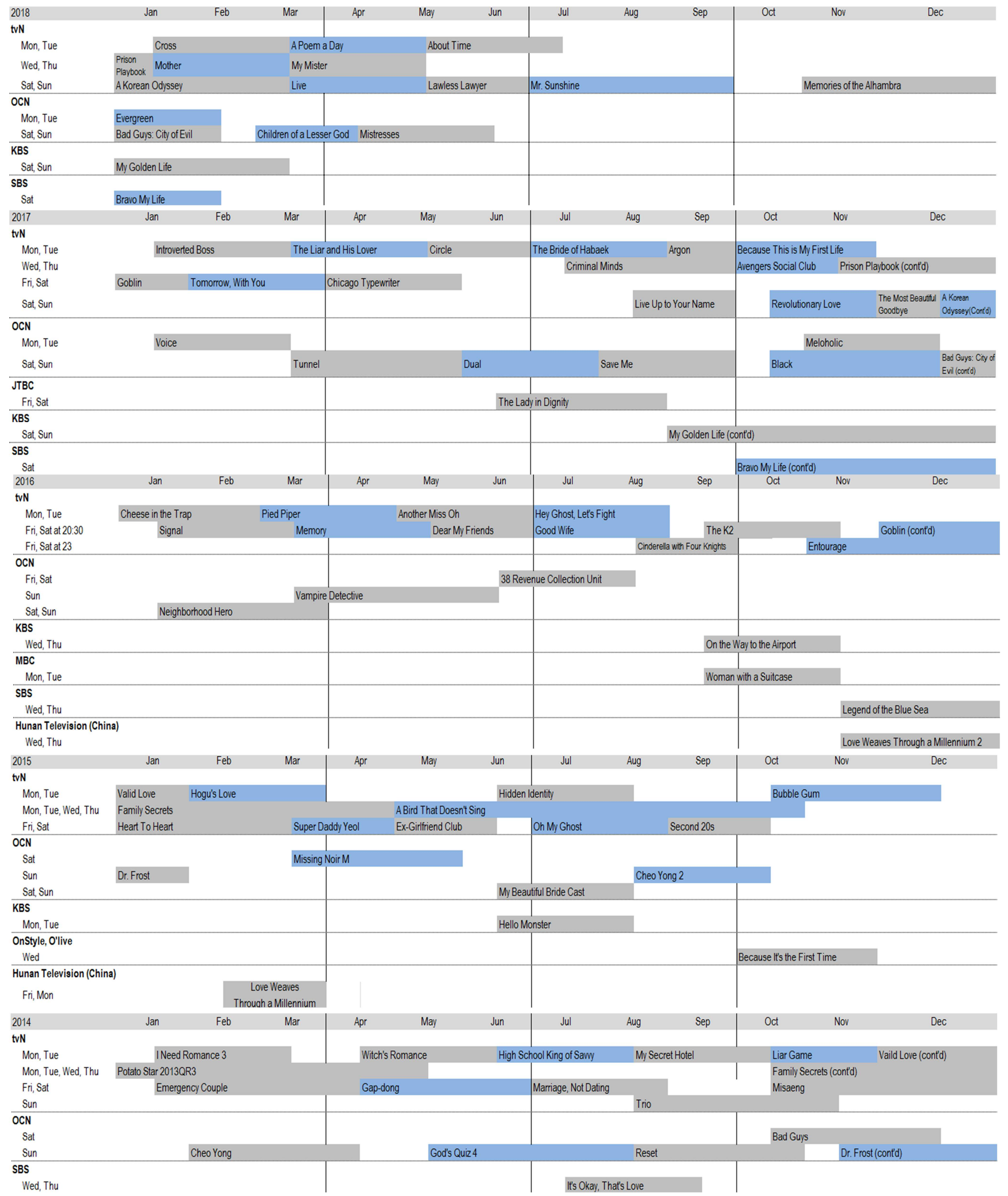


Note: Total number of TV dramas aired could vary

Source: Mirae Asset Daewoo Research

Studio Dragon's dramas

Figure 37. Studio Dragon's dramas arranged by channels and dates



Source: Mirae Asset Daewoo Research

Studio Dragon Corporation (253450 KQ/Buy/TP: W110,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/16	12/17P	12/18F	12/19F
Revenue	**196**	**287**	**383**	**525**
Cost of Sales	**168**	**240**	**304**	**420**
Gross Profit	**28**	**47**	**79**	**105**
SG&A Expenses	**6**	**14**	**16**	**20**
Operating Profit (Adj)	**21**	**33**	**62**	**85**
Operating Profit	**21**	**33**	**62**	**85**
Non-Operating Profit	**-6**	**-3**	**-1**	**0**
Net Financial Income	-1	0	0	0
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	15	30	61	85
Income Tax	2	6	13	19
Profit from Continuing Operations	8	14	48	66
Profit from Discontinued Operations	0	0	0	0
Net Profit	13	24	48	66
Controlling Interests	13	24	48	66
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	**8**	**14**	**48**	**66**
Controlling Interests	8	14	48	66
Non-Controlling Interests	0	0	0	0
EBITDA	-	73	121	159
FCF (Free Cash Flow)	-13	7	51	71
EBITDA Margin (%)	-	25.4	31.5	30.2
Operating Profit Margin (%)	10.7	11.5	16.2	16.2
Net Profit Margin (%)	6.6	8.4	12.5	12.6

Statement of Financial Condition (Summarized)

(Wbn)	12/16	12/17P	12/18F	12/19F
Current Assets	**81**	**104**	**182**	**297**
Cash and Cash Equivalents	12	34	84	154
AR & Other Receivables	39	39	55	81
Inventories	0	0	0	0
Other Current Assets	30	31	43	62
Non-Current Assets	**161**	**171**	**172**	**173**
Investments in Associates	0	0	0	0
Property, Plant and Equipment	1	1	1	1
Intangible Assets	124	128	128	128
Total Assets	**242**	**275**	**354**	**470**
Current Liabilities	**84**	**103**	**134**	**183**
AP & Other Payables	20	20	28	41
Short-Term Financial Liabilities	8	26	26	26
Other Current Liabilities	56	57	80	116
Non-Current Liabilities	**21**	**11**	**12**	**13**
Long-Term Financial Liabilities	20	10	10	10
Other Non-Current Liabilities	1	1	2	3
Total Liabilities	**106**	**114**	**146**	**196**
Controlling Interests	**136**	**160**	**208**	**274**
Capital Stock	11	11	11	11
Capital Surplus	115	115	115	115
Retained Earnings	8	32	80	146
Non-Controlling Interests	**0**	**0**	**0**	**0**
Stockholders' Equity	**136**	**160**	**208**	**274**

Cash Flows (Summarized)

(Wbn)	12/16	12/17P	12/18F	12/19F
Cash Flows from Op Activities	**-12**	**7**	**51**	**71**
Net Profit	13	24	48	66
Non-Cash Income and Expense	27	0	13	19
Depreciation	0	0	0	0
Amortization	22	0	0	0
Others	5	0	13	19
Chg in Working Capital	-46	-1	3	5
Chg in AR & Other Receivables	-27	-2	-15	-24
Chg in Inventories	0	2	0	0
Chg in AP & Other Payables	11	2	2	4
Income Tax Paid	-2	0	-13	-19
Cash Flows from Inv Activities	**-70**	**0**	**-1**	**-2**
Chg in PP&E	-1	0	0	0
Chg in Intangible Assets	0	0	0	0
Chg in Financial Assets	-2	0	-1	-2
Others	-67	0	0	0
Cash Flows from Fin Activities	**93**	**-1**	**0**	**0**
Chg in Financial Liabilities	28	8	0	0
Chg in Equity	126	0	0	0
Dividends Paid	0	0	0	0
Others	-61	-9	0	0
Increase (Decrease) in Cash	**12**	**34**	**50**	**70**
Beginning Balance	0	0	34	84
Ending Balance	12	34	84	154

Forecasts/Valuations (Summarized)

	12/16	12/17P	12/18F	12/19F
P/E (x)	-	-	51.6	37.3
P/CF (x)	-	16.5	40.3	29.1
P/B (x)	-	11.4	11.9	9.0
EV/EBITDA (x)	-	25.1	20.1	14.7
EPS (W)	907	3,874	1,706	2,361
CFPS (W)	2,806	3,938	2,187	3,027
BPS (W)	6,176	5,722	7,428	9,788
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	-	0.0	0.0	0.0
Revenue Growth (%)	-	46.4	33.4	37.1
EBITDA Growth (%)	-	-23.3	87.9	37.1
Operating Profit Growth (%)	-	57.1	87.9	37.1
EPS Growth (%)	-	327.1	-56.0	38.4
Accounts Receivable Turnover (x)	5.3	7.8	8.6	8.2
Inventory Turnover (x)	0.0	0.0	0.0	0.0
Accounts Payable Turnover (x)	29.2	41.5	43.9	42.1
ROA (%)	5.4	9.3	15.2	16.1
ROE (%)	9.5	16.1	25.9	27.4
ROIC (%)	11.8	16.7	30.4	43.0
Liability to Equity Ratio (%)	77.8	71.3	70.0	71.4
Current Ratio (%)	96.4	101.1	136.4	162.5
Net Debt to Equity Ratio (%)	12.1	1.4	-23.0	-42.9
Interest Coverage Ratio (x)	24.8	0.0	0.0	0.0

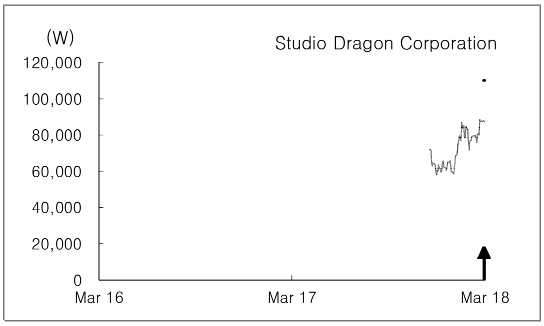
Source: Company data, Mirae Asset Daewoo Research estimates

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Studio Dragon Corporation (253450)	03/06/2018	Buy	110,000



Stock Ratings	
Buy	: Relative performance of 20% or greater
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

Ratings and Target Price History (Share price (─), Target price (▬), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))
* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.
* Although it is not part of the official ratings at Mirae Asset Daewoo Co., Ltd., we may call a trading opportunity in case there is a technical or short-term material development.
* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.
* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Equity Ratings Distribution & Investment Banking Services

	Buy	Trading Buy	Hold	Sell
Equity Ratings Distribution	75.50%	16.00%	8.50%	0.00%
Investment Banking Services	62.50%	33.33%	4.17%	0.00%

* Based on recommendations in the last 12-months (as of December 31, 2017)

Disclosures

We managed the IPO of Studio Dragon Corporation with one year.

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