

Entertainment

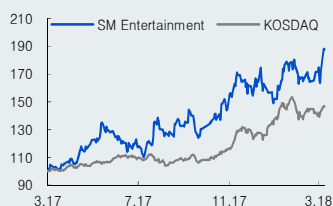
Company Report
March 15, 2018

(Maintain)	Buy
Target Price (12M, W)	50,000
Share Price (03/14/18, W)	41,600
Expected Return	20%

OP (17P, Wbn)	11
Consensus OP (17F, Wbn)	17
EPS Growth (17P, %)	-
Market EPS Growth (17F, %)	45.2
P/E (17P, x)	-
Market P/E (17F, x)	10.4
KOSDAQ	886.92

Market Cap (Wbn)	905
Shares Outstanding (mn)	22
Free Float (%)	79.4
Foreign Ownership (%)	20.4
Beta (12M)	0.66
52-Week Low	22,350
52-Week High	41,700

(%)	1M	6M	12M
Absolute	12.7	31.6	82.5
Relative	7.8	-1.2	26.3



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SM Entertainment

(041510 KQ)

Positive on KeyEast/FNC Add Culture acquisitions

Acquisition of rivals to strengthen content production business; Maintain positive view

We reaffirm our Buy call and target price of W50,000 on SM Entertainment. We continue to maintain a positive view on entertainment firms' entry into content production, and believe SM Entertainment's latest acquisitions will broaden the company's opportunities in this area. We believe investors should focus on new business prospects rather than dilution (4.2%) from the share issue.

Since 2015, the secondary businesses (F&B, fashion, cosmetics) of entertainment firms (including SM Entertainment) have been largely disappointing, weighing on their overall earnings. However, we think there is clear potential for synergy between SM Entertainment's core business and content production, especially in terms of the use of artist-creator resources and the financial compatibility of advertising and content production (stability and profitability).

Acquiring KeyEast (25.1%) and FNC Add Culture (30.5%) for a total of W80bn

Before yesterday's market opening, SM Entertainment announced that it had agreed to acquire a 25.1% stake in KeyEast for W50bn (W2,570 per share) and a 30.5% stake in FNC Add Culture for W30bn. The company will fund the W80bn deal through a combination of private placement, purchase of existing shares, and equity issue participation. More specifically, SM Entertainment will: 1) issue 920,000 new shares (W35bn) to Bae Yong-joon, KeyEast's current largest shareholder; 2) acquire existing shares of KeyEast (W15bn) and FNC Add Culture (W20bn); and 3) participate in FNC Add Culture's equity issue (W10bn).

As the deals include the purchase of shares from the current largest shareholders of KeyEast and FNC Add Culture, SM Entertainment will become the largest shareholder of both companies and will consolidate earnings once the deals are closed.

Acquisition effects: Third-largest drama studio; Benefits over the long term

In the near term, we think the biggest benefit of the acquisition will be an increase in drama productions across the SM group. The company's drama studios (SM C&C, FNC Add Culture, and KeyEast) produced five titles (combined) in 2017. With SM C&C set to produce three dramas in 2018, we think the total number of titles could rise to six or seven this year, making SM the third largest drama studio following Studio Dragon (253450 KQ/Buy/TP: W110,000/CP: W93,700; 25 titles) and J Contentree (036420 KQ/Buy/TP: W5,800/CP: W7,300; 13 titles) in terms of titles produced. Notably, management agencies (SM Entertainment and KeyEast) and production studios (SM C&C, FNC Add Culture, and KeyEast) have a complementary relationship within the content value chain. As drama orders grow and the talent roster expands, we believe the company will strengthen its position in the drama market.

Drama production companies have recently gained attention as beneficiaries of growing demand for content globally. While we expect the number of SM's drama productions to increase, we do not necessarily think the company will immediately benefit from global content demand, as it still lags behind Studio Dragon and J Contentree in several areas, such as captive channels (none), production cost recovery and intellectual property ownership structure, budget size, and know-how. The company will need to make various efforts to enhance its content competitiveness. The recent rise in drama viewership is positive from this perspective.

That said, the company could see benefits earlier than expected if exports to China resume. The company's roster of artists popular in China is a potential tailwind that could enhance management agency-drama production synergy. The recent sale of IHQ's drama *While You Were Sleeping* (starring Lee Jong-suk) to China is worth noting.

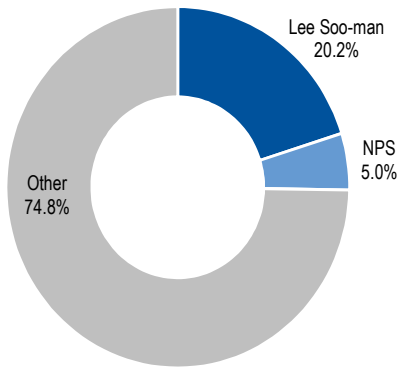
FY (Dec.)	12/14	12/15	12/16	12/17P	12/18F	12/19F
Revenue (Wbn)	287	322	350	377	584	581
OP (Wbn)	34	38	21	11	68	68
OP Margin (%)	11.8	11.8	6.0	2.9	11.6	11.7
NP (Wbn)	6	22	4	-9	36	34
EPS (W)	290	1,048	169	-392	1,659	1,573
ROE (%)	2.5	8.3	1.2	-2.6	10.7	9.2
P/E (x)	117.1	41.0	153.0	-	25.1	26.4
P/B (x)	2.9	3.1	1.7	2.3	2.5	2.3
Dividend Yield (%)	0.0	0.0	0.0	0.0	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

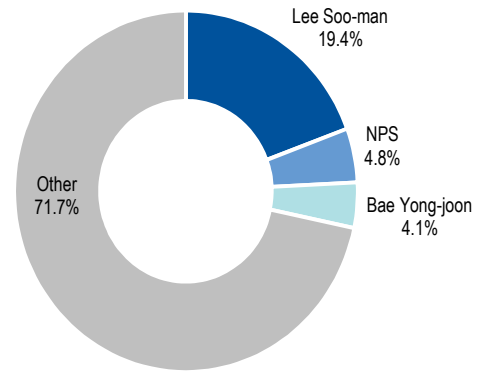
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Figure 1. SM Entertainment's ownership breakdown (current)



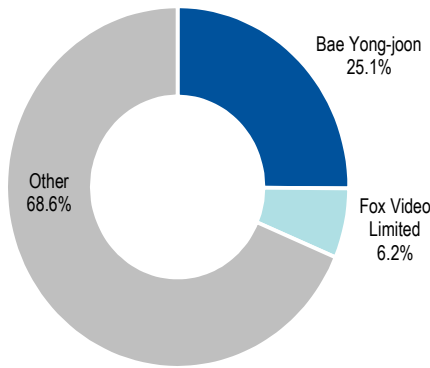
Source: Mirae Asset Daewoo Research

Figure 2. SM Entertainment's ownership breakdown (after acquisitions)



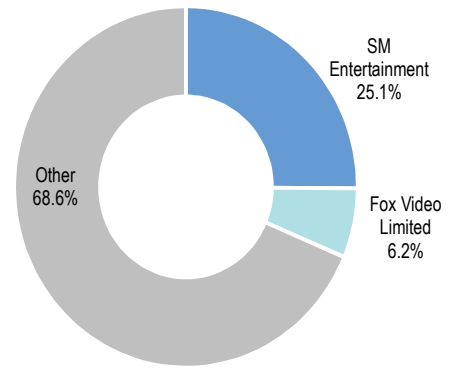
Source: Mirae Asset Daewoo Research

Figure 3. KeyEast's ownership breakdown (current)



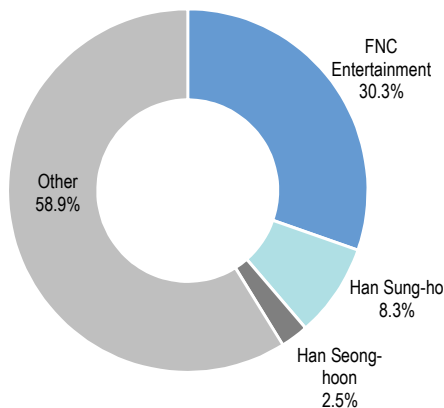
Source: Mirae Asset Daewoo Research

Figure 4. KeyEast's ownership breakdown (after acquisition)



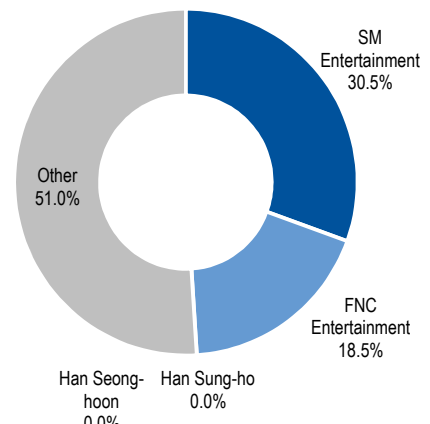
Source: Mirae Asset Daewoo Research

Figure 5. FNC Add Culture's ownership breakdown (current)



Source: Mirae Asset Daewoo Research

Figure 6. FNC Add Culture's ownership breakdown (after acquisition)



Source: Mirae Asset Daewoo Research

Table 1. Balance sheet summaries for KeyEast and FNC Add Culture

(Wbn, %)

	KeyEast		FNC Add Culture	
	2016	2017	2016	2017
Revenue	93.2	106.2	11.4	33.3
Operating profit	-0.3	1.1	-2.4	0.6
OP margin	-0.3	1.0	-21.1	1.8
Net profit	-6.9	0.2	-3.6	0.8
Assets	110.7	106.3	43.6	45.9
Liabilities	28.9	27.7	3.3	4.2
Equity	81.8	78.6	40.3	41.7
Capital stock	7.7	7.7	19.5	19.5

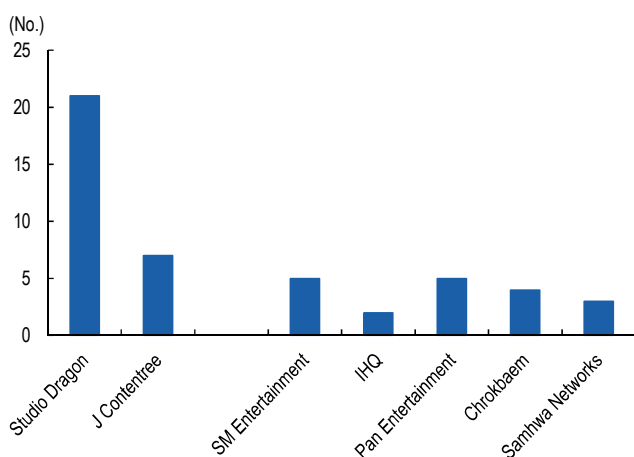
Source: KeyEast, FNC Add Culture, Mirae Asset Daewoo Research

Table 2. SM Entertainment's acquisition of KeyEast and FNC Add Culture

	KeyEast	FNC Add Culture
Market cap (3/13/18)	₩223.5bn	₩79.8bn
Stake acquisition	25.1%	30.5%
Deal size	₩50bn	₩30bn
Current largest stakeholder(s)	Bae Yong-joon	FNC, Han Sung-ho, Han Seong-hoon
Details	New share issue and purchase of existing shares 1) ₩35bn in new SM shares to be issued 2) ₩15bn in existing KeyEast shares to be acquired	Purchase of existing shares and equity issue participation 1) ₩20bn in existing shares to be acquired 2) ₩10bn in new shares to be acquired
Purpose of acquisition	Support for digital/platform business through enhanced entertainment and content (artists, music, MCN, UGC, etc.)	Synergies with SM Entertainment in drama production/broadcasting Global lifestyle businesses including retail, F&B, fashion, and leisure

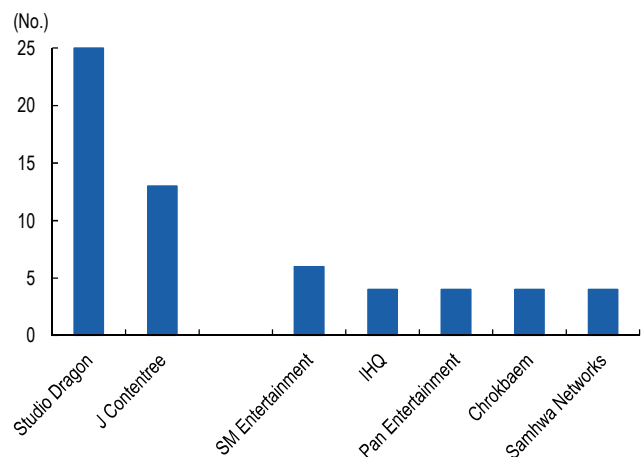
Source: Company data, Mirae Asset Daewoo Research

Figure 7. Combined number of drama productions of SM C&C, FNC Add Culture, and KeyEast in 2017 (five dramas)



Note: SM Entertainment includes SM C&C, FNC Add Culture, and KeyEast
Source: Mirae Asset Daewoo Research

Figure 8. Combined number of drama productions of SM C&C, FNC Add Culture, and KeyEast in 2018 (six dramas expected)



Note: SM Entertainment includes SM C&C, FNC Add Culture, and KeyEast
Source: Mirae Asset Daewoo Research

Table 3. SM C&C's major drama titles

(%)

Dates	Title	Broadcaster	Genre	Peak viewership
Aug.-Oct. 2012	<i>To the Beautiful You</i>	SBS	Romance/comedy/drama	5.2
Dec. 2013-Feb. 2014	<i>Prime Minister and I</i>	KBS 2	Romance/comedy	6.1
Dec. 2013-Feb. 2014	<i>Miss Korea</i>	MBC	Romance/comedy	9.5
Feb.-Mar. 2014	<i>Mimi</i>	Mnet	Romance/mystery/horror/fantasy	
Sep.-Nov. 2015	<i>D-Day</i>	JTBC	Disaster/medical/romance	1.9
Sep. 2015-Feb. 2016	<i>The Merchant: Gaekju 2015</i>	KBS 2	Historical drama	13
Mar.-May 2016	<i>My Lawyer, Mr. Jo</i>	KBS 2	Legal drama	17.3
Aug.-Nov. 2016	<i>Don't Dare to Dream</i>	SBS	Romance/comedy	13.2
Jun. -Aug. 2016	<i>38 Revenue Collection Unit</i>	OCN	Crime	4.6
Jan.-Mar. 2017	<i>Missing 9</i>	MBC	Disaster/drama	4.6
Feb. 2018-	<i>Should We Kiss First?</i>	SBS	Romance	10.9

Source: AGB Nielson, Mirae Asset Daewoo Research

Table 4. KeyEast's major drama titles

(%)

Time	Title	Broadcaster	Genre	Peak viewership
Jan.-Feb. 2011	<i>Dream High season1</i>	KBS 2	School/musical/comedy/romance	17.9
Jan.-Mar. 2012	<i>Dream High season2</i>	KBS 2	School/musical/comedy/romance	10.5
Oct.-Nov. 2012	<i>Ohlala Couple</i>	KBS 2		14.5
Dec. 2012-Jan. 2013	<i>School 2013</i>	KBS 2	Teenage/school	15.8
Sep.-Nov. 2013	<i>Secret</i>	KBS 2	Romance/thriller	18.9
Jan.-Apr. 2014	<i>Emergency Couple</i>	tvN	Romance/thriller/comedy/medical	5.0
Mar.-Apr. 2014	<i>God's Gift: 14 Days</i>	SBS	Thriller/SF/suspense	10.6
Jul.-Sep. 2015	<i>The Scholar Who Walks the Night</i>	MBC	Historical drama/romance/fantasy	8.5
Mar.-Apr. 2016	<i>Pied Piper</i>	tvN	Thriller/crime/action	3.6
Jan.-Mar. 2017	<i>Voice</i>	OCN	Crime	5.7

Source: AGB Nielson, Mirae Asset Daewoo Research

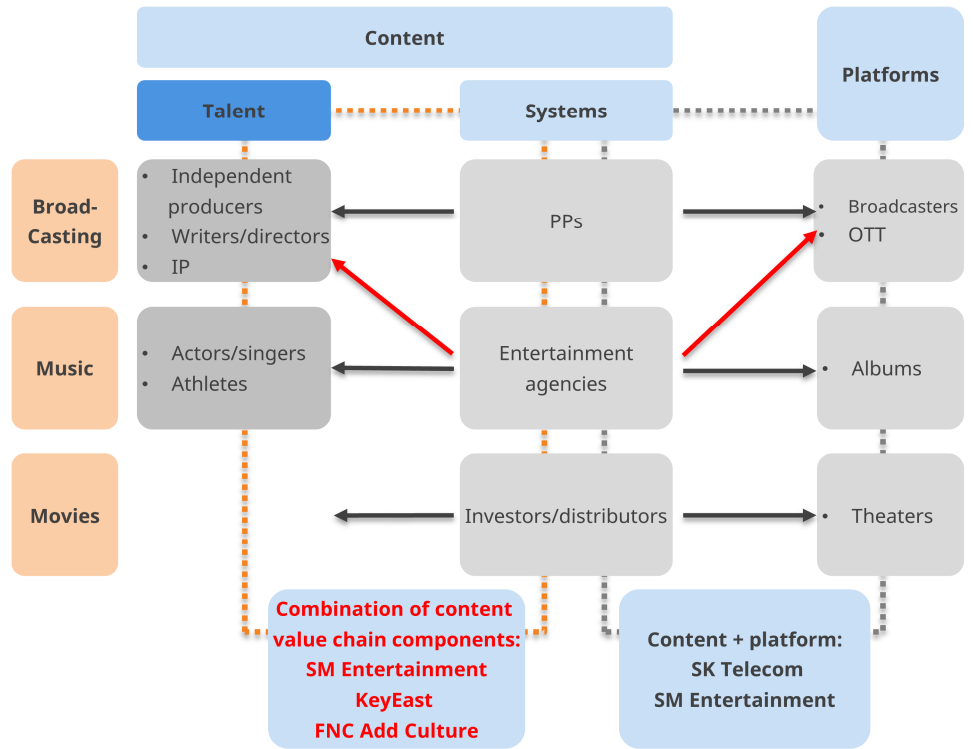
Table 5. FNC Add Culture's major drama titles

(%)

Company	Time	Title	Broadcaster	Genre	Peak viewership
FNC Add Culture	Feb.-Feb. 2015	<i>Thank You, Son</i>	KBS 2		8.0
	Apr.-Jun. 2015	<i>Who Are You: School 2015</i>	KBS 2	Teenage/school	8.2
		<i>Click Your Heart</i>	Web drama	School/romance	
	Jun.-Jun. 2016	<i>Becky's Back</i>	KBS 2	Comedy	10.4
	Jun.-Jun. 2017	<i>My Only Love Song</i>	Netflix	Romance/comedy	
	Apr.-Oct. 2017	<i>Band of Sisters</i>	SBS	Comedy/thriller/romance	17.9
	Jun.-Dec. 2017	<i>Sweet Enemy</i>	SBS	Romance	9.2
	Sep.-Oct. 2017	<i>Girls' Generation 1979</i>	KBS 2	Romance/drama	5.3

Source: AGB Nielson, Mirae Asset Daewoo Research

Figure 9. Acquisition deals to sharply boost SM's influence in drama production chain



Source: Mirae Asset Daewoo Research

Figure 10. Entertainment firms' entry into content production to create synergies

Company			Artist	1996-	2001-	2006-	2011-	2014-	1H16	2H16	1H17	2H17	1H18	2H18	2019	
Music/mgmt	Album sales Digital sales Concert revenue Commercials Broadcasts	SM	H.O.T.													
			S.E.S.													
			BoA													
			TVXQ													
			Super Junior													
		Girls' Generation														
		SHINee														
		f(x)														
		EXO														
		YG	Big Bang													
2NE1																
Winner																
iKON																
Black Pink																
Other businesses	SM	Merchandise sales														
		Travel packages														
		F&B														
		Content production														
		Ad agency														
	YG	Merchandise sales														
		Fashion/beauty														
		F&B														
		Content Production														
		Ad agency														

Source: Mirae Asset Daewoo Research

Table 3. Quarterly and annual earnings

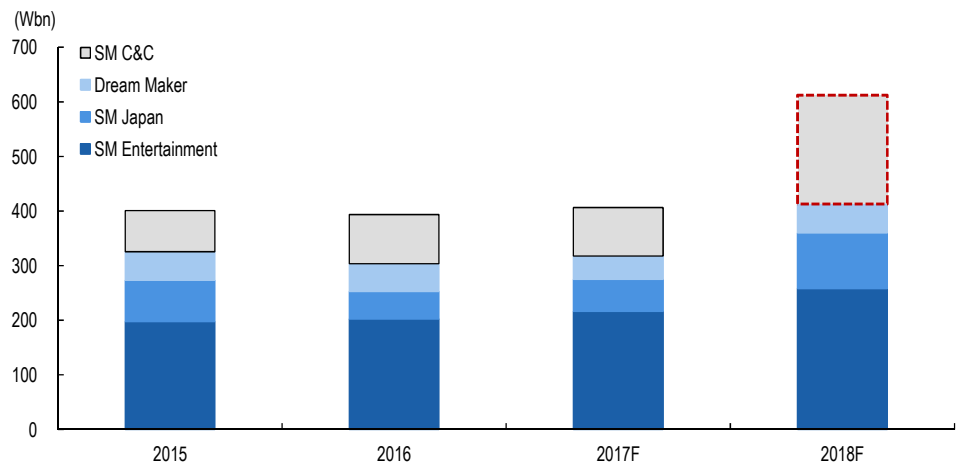
(Wbn, %, mn, %p)

	1Q17	2Q17	3Q17	4Q17P	1Q18F	2Q18F	3Q18F	4Q18F	2016	2017P	2018F
Revenue	68	68	87	155	174	121	133	156	350	378	584
SM Entertainment	41	40	61	75	71	54	63	70	202	216	258
SM Japan	13	12	12	22	40	17	22	22	51	59	102
Dream Maker	6	16	8	13	16	10	13	15	51	43	53
SM C&C	15	11	10	52	56	46	41	56	90	89	199
Consolidation adj./other	-6	-12	-4	-6	-9	-6	-6	-7	-44	-29	-28
Operating profit	1.2	1.4	4.6	3.7	24.4	12.2	20.1	11.4	21	11	68
OP margin (%)	1.8	2.0	5.3	2.4	14.0	10.1	15.2	7.3	5.9	2.9	11.7
Pretax profit	-3.3	1.9	32.2	-6.4	22.9	12.9	19.0	6.6	23	24	61
Net profit	-8.0	3.8	12.8	-13.3	15.6	8.8	12.9	4.5	4	-5	42
Net margin (%)	-11.8	5.6	14.8	-8.6	9.0	7.2	9.7	2.9	1.2	-1.2	7.2
Net profit (controlling)	-6.8	4.2	17.6	-23.5	13.0	7.5	12.1	3.5	3.6	-8.5	36.1
YoY											
Revenue	-24.7	-12.0	-16.8	97.7	155.9	79.1	53.2	0.4	8.6	7.9	54.7
SM Entertainment	-16.4	-4.7	-0.7	48.6	75.1	33.8	4.5	-6.5	2.4	7.0	19.4
SM Japan	-36.8	111.1	-7.6	89.3	206.1	43.1	89.3	2.2	-33.0	16.2	73.1
Dream Maker	-76.1	194.4	-54.0	202.8	186.9	-38.6	52.5	14.3	-3.4	-16.7	24.7
SM C&C	-27.5	-55.4	-57.6	154.8	279.8	306.0	303.7	7.8	19.8	-1.6	125.0
Operating profit	-86.7	TTB	-65.7	495.9	1,935.2	786.6	335.4	208.9	-46.1	-47.4	525.6
Net profit	TTR	TTB	49.2	RR	TTB	131.0	0.7	TTB	-50.4	-51.2	304.5
Key assumptions											
Concert ticket sales in Japan	0.2	0.2	0.4	0.7	0.6	0.3	0.5	0.5	1.3	1.5	1.8

Notes: Based on consolidated K-IFRS; concert ticket sales are based on the actual date of each concert and include our estimates

Source: Company data, Mirae Asset Daewoo Research estimates

Figure 11. SM C&C's contribution to consolidated revenue to rise sharply



Source: Mirae Asset Daewoo Research

SM Entertainment (041510 KQ/Buy/TP: W50,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/16	12/17P	12/18F	12/19F
Revenue	350	377	584	581
Cost of Sales	248	265	375	375
Gross Profit	102	112	209	206
SG&A Expenses	82	102	141	138
Operating Profit (Adj)	21	11	68	68
Operating Profit	21	11	68	68
Non-Operating Profit	2	13	-7	-9
Net Financial Income	-1	1	0	0
Net Gain from Inv in Associates	4	25	0	0
Pretax Profit	23	24	61	59
Income Tax	17	29	20	19
Profit from Continuing Operations	6	-5	42	40
Profit from Discontinued Operations	-2	0	0	0
Net Profit	4	-5	42	40
Controlling Interests	4	-9	36	34
Non-Controlling Interests	1	4	6	6
Total Comprehensive Profit	5	-5	42	40
Controlling Interests	4	-3	57	54
Non-Controlling Interests	1	-2	-15	-14
EBITDA	44	33	88	84
FCF (Free Cash Flow)	7	-31	61	54
EBITDA Margin (%)	12.6	8.8	15.1	14.5
Operating Profit Margin (%)	6.0	2.9	11.6	11.7
Net Profit Margin (%)	1.1	-2.4	6.2	5.9

Cash Flows (Summarized)

(Wbn)	12/16	12/17P	12/18F	12/19F
Cash Flows from Op Activities	21	-24	61	54
Net Profit	4	-5	42	40
Non-Cash Income and Expense	54	34	40	35
Depreciation	10	11	11	9
Amortization	13	10	9	7
Others	31	13	20	19
Chg in Working Capital	-15	-32	0	-3
Chg in AR & Other Receivables	-9	-36	0	-7
Chg in Inventories	-1	-14	0	-2
Chg in AP & Other Payables	-1	23	0	4
Income Tax Paid	-22	-20	-20	-19
Cash Flows from Inv Activities	-38	-90	0	-8
Chg in PP&E	-14	-5	0	0
Chg in Intangible Assets	-5	-21	0	0
Chg in Financial Assets	-2	-48	0	-8
Others	-17	-16	0	0
Cash Flows from Fin Activities	51	-6	0	0
Chg in Financial Liabilities	11	-1	0	0
Chg in Equity	38	6	0	0
Dividends Paid	0	0	0	0
Others	2	-11	0	0
Increase (Decrease) in Cash	36	-110	61	39
Beginning Balance	133	170	60	121
Ending Balance	170	60	121	160

Source: Company data, Mirae Asset Daewoo Research estimates

Statement of Financial Condition (Summarized)

(Wbn)	12/16	12/17P	12/18F	12/19F
Current Assets	293	304	366	426
Cash and Cash Equivalents	170	60	121	160
AR & Other Receivables	44	87	87	94
Inventories	11	22	22	24
Other Current Assets	68	135	136	148
Non-Current Assets	232	305	286	281
Investments in Associates	39	77	77	84
Property, Plant and Equipment	104	91	80	70
Intangible Assets	37	47	38	31
Total Assets	525	609	652	707
Current Liabilities	135	225	225	240
AP & Other Payables	43	84	85	92
Short-Term Financial Liabilities	46	50	50	50
Other Current Liabilities	46	91	90	98
Non-Current Liabilities	15	14	14	15
Long-Term Financial Liabilities	11	6	6	6
Other Non-Current Liabilities	4	8	8	9
Total Liabilities	150	239	240	255
Controlling Interests	330	319	355	389
Capital Stock	11	11	11	11
Capital Surplus	165	170	170	170
Retained Earnings	131	123	159	193
Non-Controlling Interests	46	51	57	63
Stockholders' Equity	376	370	412	452

Forecasts/Valuations (Summarized)

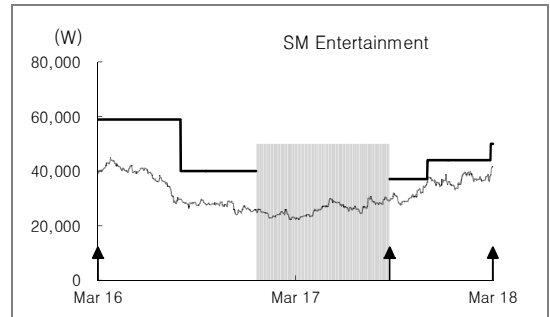
	12/16	12/17P	12/18F	12/19F
P/E (x)	153.0	-	25.1	26.4
P/CF (x)	9.5	25.9	11.1	12.1
P/B (x)	1.7	2.3	2.5	2.3
EV/EBITDA (x)	11.0	23.9	9.9	9.9
EPS (W)	169	-392	1,659	1,573
CFPS (W)	2,720	1,340	3,746	3,445
BPS (W)	15,144	14,906	16,565	18,138
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Revenue Growth (%)	8.7	7.7	54.9	-0.5
EBITDA Growth (%)	-26.7	-25.0	166.7	-4.5
Operating Profit Growth (%)	-44.7	-47.6	518.2	0.0
EPS Growth (%)	-83.9	-	-	-5.2
Accounts Receivable Turnover (x)	8.5	5.8	6.7	6.4
Inventory Turnover (x)	33.0	22.6	26.3	25.1
Accounts Payable Turnover (x)	8.1	6.6	7.0	6.7
ROA (%)	0.9	-0.8	6.6	5.9
ROE (%)	1.2	-2.6	10.7	9.2
ROIC (%)	3.2	-1.2	26.0	28.4
Liability to Equity Ratio (%)	39.8	64.6	58.2	56.4
Current Ratio (%)	217.9	135.4	162.4	177.4
Net Debt to Equity Ratio (%)	-33.2	-7.5	-21.5	-28.7
Interest Coverage Ratio (x)	12.1	9.0	52.6	52.2

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
SM Entertainment (041510)	03/11/2018	Buy	50,000
	11/14/2017	Buy	44,000
	09/05/2017	Buy	37,000
	01/02/2017	No Coverage	
	08/15/2016	Buy	40,000
	2016.08.10	AFTER 1YR	
	08/10/2015	Buy	59,000



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)

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