

Entertainment

Company Report
May 15, 2018

| | |
|---------------------------|---------------|
| (Maintain) | Buy |
| Target Price (12M, W) | 47,000 |
| Share Price (05/14/18, W) | 36,400 |
| Expected Return | 29% |

| | |
|----------------------------|--------|
| OP (18F, Wbn) | 52 |
| Consensus OP (18F, Wbn) | 55 |
| EPS Growth (18F, %) | 674.3 |
| Market EPS Growth (18F, %) | 16.2 |
| P/E (18F, x) | 23.6 |
| Market P/E (18F, x) | 9.5 |
| KOSDAQ | 858.70 |
| Market Cap (Wbn) | 796 |
| Shares Outstanding (mn) | 23 |
| Free Float (%) | 79.5 |
| Foreign Ownership (%) | 23.6 |
| Beta (12M) | 0.62 |
| 52-Week Low | 24,400 |
| 52-Week High | 47,800 |

| (%) | 1M | 6M | 12M |
|----------|-------|-------|------|
| Absolute | -10.5 | 1.8 | 34.8 |
| Relative | -7.0 | -10.3 | 1.1 |



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SM Entertainment

(041510 KQ)

Improving outlook

1Q18 review: Missed forecast, but core earnings were robust

For 1Q18, SM Entertainment reported revenue of W110.6bn (+62.5% YoY) and an operating profit of W10.4bn (+765.8% YoY) on a consolidated basis, with operating profit missing both the market consensus (W13.4bn) and our estimate (W13.2bn). However, given that the consensus and our forecast do not fully reflect accounting changes related to SM Japan, the 1Q18 earnings are viewed as fairly positive results.

Notably, core earnings improved significantly on the back of full utilization of the artist lineup. The combined operating profit of the three core business operators (the parent company, SM Japan, and Dream Maker) jumped 493% YoY to W15.6bn, with an OP margin of 21.3%. Japanese concerts booked total attendees of 620,000, while domestic album sales reached 850,000.

Meanwhile, SM C&C's 1Q18 earnings came in lower than expected, reporting an operating loss of W300mn, weighed down by unfavorable advertising seasonality. As for the company's hit drama, *Should We Kiss First?* (SBS), airing rights revenue and costs were both recognized in 1Q18. Thus, margins on the drama should improve for 2Q18, when the show ended. We believe SM C&C's 1Q18 results, while unlikely to make a meaningful contribution to consolidated earnings, should enhance confidence in the company's production capabilities

Upbeat outlook ahead

For 2Q, we project SM Entertainment's revenue at W120.1bn (+77.4%) and operating profit at W11.5bn (+735.0%). The core businesses are expected to remain strong on the back of active artist lineup. TVXQ is scheduled for three stadium concerts (seating capacity of 75,000 each) in June. Next-generation artists - including EXO-CBX, NCT, and Red Velvet - are seeing rapid growth in their fan bases at home and abroad (in light of their performances in domestic and overseas album charts). They are all scheduled to have their first Japanese concert tours this year. Meanwhile, SM C&C's margins are expected to improve QoQ. While weak seasonality should continue for advertising, content production is expected to generate at least W1bn in profit.

Maintain Buy and TP of W47,000

We maintain our Buy call and target price of W47,000. While the expected rate of earnings improvement in 2018 needs to be adjusted downwards, due to accounting changes related to SM Japan, share price corrections appear to be coming to an end. In our view, it is time to focus on the company's future performance, rather than accounting issues.

Although the recognition of concert revenue was far lower than expected in the 1Q18 earnings results, we confirmed the solid performance of the company's flagship businesses. We believe the company's investment case - i.e., the cultivation of new growth engines (new idol groups, content production, and resumption of China concerts), amid strong earnings growth of flagship businesses - remains intact. We remain bullish on the company's new idol lineup (NCT China to debut this summer), increasing content production competitiveness (production of hit dramas/entertainment shows), and the potential resumption of content copyright sales to China.

Of note, the roles of new affiliates (mobile platform for KeyEast; retail/lifestyle for FNC ADD Culture), as well as the group's growth plans (including the establishment a Southeast Asian subsidiary and joint content production with a Chinese firm) are gradually taking shape.

| FY (12) | 12/14 | 12/15 | 12/16 | 12/17 | 12/18F | 12/19F |
|--------------------|-------|-------|-------|-------|--------|--------|
| Revenue (Wbn) | 287 | 322 | 350 | 365 | 485 | 526 |
| OP (Wbn) | 34 | 38 | 21 | 11 | 52 | 68 |
| OP margin (%) | 11.8 | 11.8 | 6.0 | 3.0 | 10.7 | 12.9 |
| NP (Wbn) | 6 | 22 | 4 | 4 | 35 | 40 |
| EPS (W) | 290 | 1,048 | 169 | 199 | 1,540 | 1,771 |
| ROE (%) | 2.5 | 8.3 | 1.2 | 1.3 | 9.5 | 10.1 |
| P/E (x) | 117.1 | 41.0 | 153.0 | 174.4 | 23.6 | 20.6 |
| P/B (x) | 2.9 | 3.1 | 1.7 | 2.2 | 2.2 | 2.0 |
| 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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Earnings forecasts

Table 1. Quarterly and annual earnings

(Wbn, %, mn %p)

| | 1Q17 | 2Q17 | 3Q17 | 4Q17 | 1Q18P | 2Q18F | 3Q18F | 4Q18F | 2017 | 2018F | 2019F |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|
| Revenue | 68 | 68 | 87 | 143 | 111 | 120 | 123 | 131 | 365 | 485 | 526 |
| SM Ent. | 41 | 40 | 61 | 74 | 59 | 61 | 60 | 58 | 216 | 238 | 256 |
| SM Japan | 13 | 12 | 12 | 22 | 26 | 17 | 20 | 22 | 59 | 85 | 81 |
| Dream Maker | 6 | 16 | 8 | 13 | 7 | 12 | 12 | 10 | 43 | 40 | 50 |
| SM C&C | 15 | 11 | 10 | 52 | 37 | 43 | 45 | 56 | 89 | 182 | 197 |
| Operating profit | 1.2 | 1.4 | 4.6 | 3.7 | 10.4 | 11.5 | 16.6 | 13.9 | 11 | 52 | 68 |
| OP margin (%) | 1.8 | 2.0 | 5.3 | 2.6 | 9.4 | 9.6 | 13.4 | 10.6 | 3.0 | 10.8 | 13.0 |
| Pretax profit | -3.3 | 1.9 | 32.2 | -6.4 | 15.1 | 12.2 | 15.4 | 11.1 | 24 | 54 | 65 |
| Net profit | -8.0 | 3.8 | 12.8 | -13.3 | 11.4 | 8.8 | 11.1 | 8.0 | -5 | 39 | 47 |
| Net margin (%) | -11.8 | 5.6 | 14.8 | -9.3 | 10.3 | 7.3 | 9.0 | 6.1 | -1.3 | 8.1 | 8.9 |
| Net profit attributable to controlling interests | -6.8 | 4.2 | 17.6 | -10.6 | 11.2 | 7.6 | 9.7 | 6.1 | 4.3 | 34.5 | 40.3 |
| YoY | | | | | | | | | | | |
| Revenue | -24.7 | -12.0 | -16.8 | 82.3 | 62.5 | 77.4 | 42.2 | -8.5 | 4.4 | 32.7 | 8.5 |
| SM Ent. | -16.4 | -4.7 | -0.7 | 48.5 | 46.7 | 49.7 | -1.0 | -22.1 | 6.9 | 10.2 | 7.5 |
| SM Japan | -36.8 | 111.1 | -7.6 | 89.3 | 102.3 | 38.6 | 72.9 | -0.4 | 16.2 | 45.0 | -5.5 |
| Dream Maker | -76.1 | 194.4 | -54.0 | 202.8 | 19.6 | -26.2 | 39.5 | -20.0 | -16.7 | -5.5 | 24.0 |
| SM C&C | -27.1 | -55.9 | -64.4 | 153.0 | 150.6 | 282.1 | 339.8 | 7.8 | -7.2 | 105.2 | 8.2 |
| Operating profit | -86.7 | TTB | -65.7 | 502.5 | 765.8 | 735.0 | 258.5 | 270.9 | -47.2 | 378.4 | 30.4 |
| Net profit | TTR | TTB | 49.2 | RR | TTB | 131.2 | -13.3 | TTB | TTR | TTB | 19.6 |
| Key assumption | | | | | | | | | | | |
| Concert ticket sales in Japan | 0.2 | 0.2 | 0.4 | 0.7 | 0.6 | 0.4 | 0.5 | 0.5 | 1.5 | 2.0 | 2.1 |

Notes: All figures are based on consolidated K-IFRS; concert ticket sales volume is based on actual timing of concert and includes our estimates

Source: Company data, Mirae Asset Daewoo Research estimates

Table 1. Earnings forecast revisions

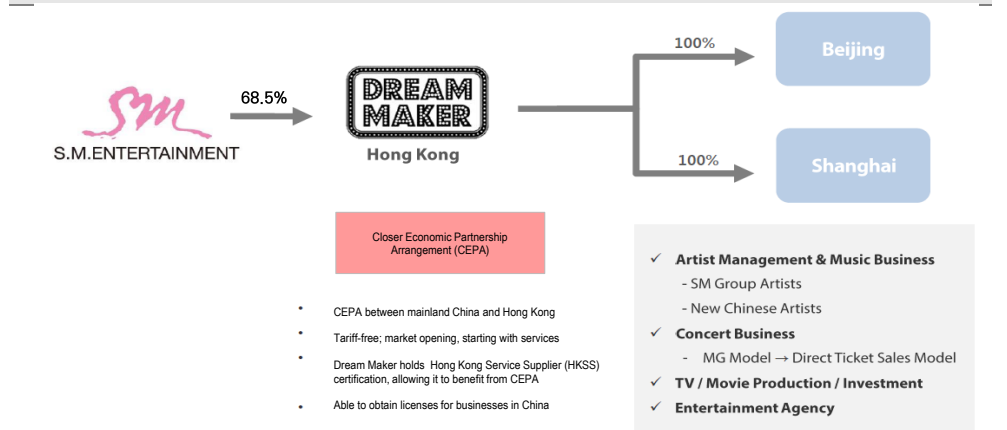
(Wbn, %, %p)

| | Previous | | Revised | | Change | | Notes |
|------------------|----------|------|---------|------|--------|------|--|
| | 18F | 19F | 18F | 19F | 18F | 19F | |
| Revenue | 562 | 578 | 485 | 526 | -13.7 | -9.0 | - Updated concert schedule; reflects consolidated adjustment increases - Revised OP margin of production and ads (SM C&C) downwards |
| Operating profit | 60 | 67 | 52 | 68 | -13.4 | 1.2 | |
| Net profit | 33 | 37 | 35 | 40 | 4.9 | 9.0 | |
| OP margin | 10.8 | 11.7 | 10.8 | 13.0 | 0.0 | 1.3 | |
| Net margin | 5.9 | 6.4 | 7.1 | 7.7 | 1.3 | 1.3 | |

Notes: Based on consolidated K-IFRS; net profit is attributable to controlling interests

Source: Mirae Asset Daewoo Research estimates

Figure 1. SM Ent. stands to benefit most from resumption of China concerts and management



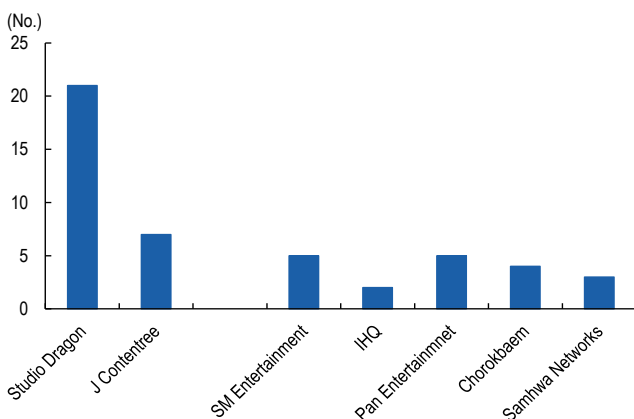
Source: Mirae Asset Daewoo Research

Table 2. SM Entertainment's major drama titles since 2015 (%)

| Production company | Dates | Titles | Broadcaster | Genre | Peak viewership |
|----------------------|-------------------------------|---|---------------|----------------------------------|-----------------|
| SM C&C | 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-May. 2018- | <i>Should We Kiss First?</i> <i>Work of Love</i> | SBS | Romance | 12.5 5.6 |
| KeyEast (Contents K) | 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 |
| 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 | |

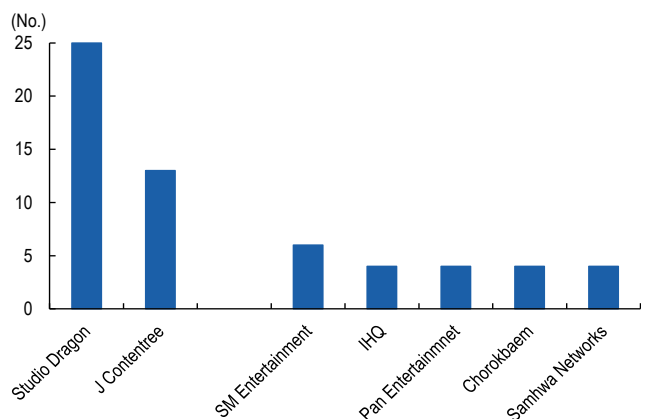
Source: AGB Nielson, Mirae Asset Daewoo Research

Figure 2. SM produced five dramas in 2017



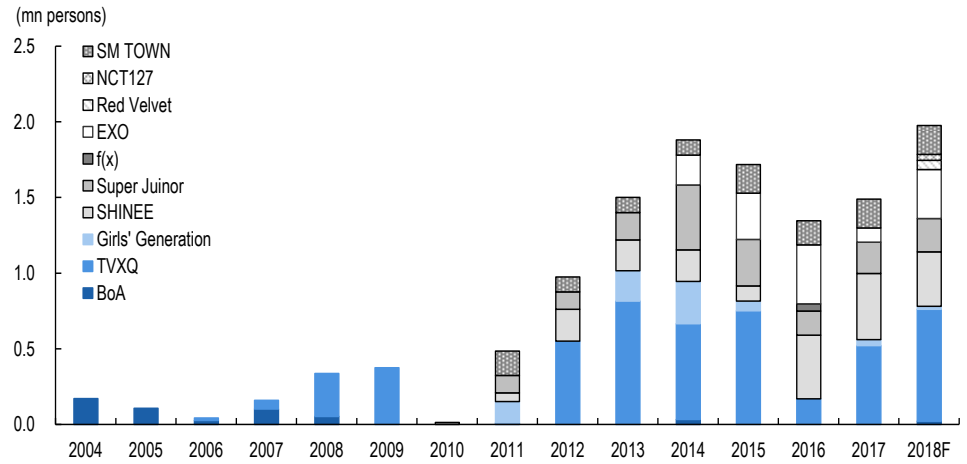
Note: SM Entertainment includes SM C&C, FNC Add Culture, and KeyEast
Source: Mirae Asset Daewoo Research

Figure 3. SM to produce five to six dramas in 2018



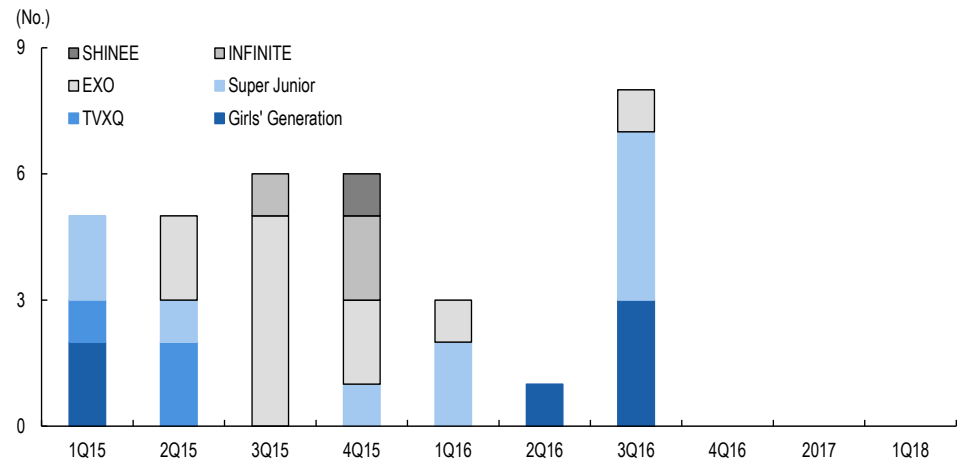
Note: SM Entertainment includes SM C&C, FNC Add Culture, and KeyEast
Source: Mirae Asset Daewoo Research

Figure 4. Japanese concert attendees by artist



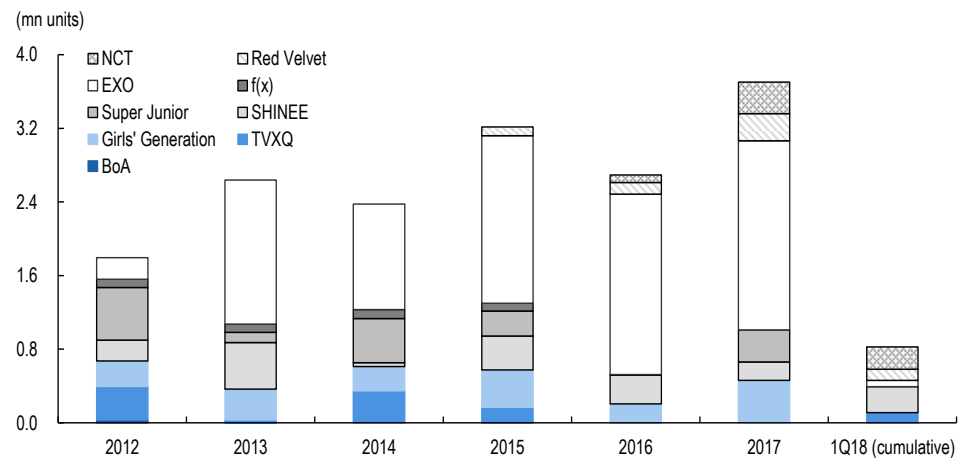
Notes: No. of attendees are based on venue size
 Source: Company data, Mirae Asset Daewoo Research

Figure 5. # of Chinese concerts by artist



Source: Company data, Mirae Asset Daewoo Research

Figure 6. Domestic album sales volume by artist



Source: Gaon Chart, Mirae Asset Daewoo Research

SM Entertainment (041510 KQ/Buy/TP: W47,000)

Comprehensive Income Statement (Summarized)

| (Wbn) | 12/16 | 12/17 | 12/18F | 12/19F |
|-------------------------------------|------------|------------|------------|------------|
| Revenue | 350 | 365 | 485 | 526 |
| Cost of Sales | 248 | 249 | 308 | 335 |
| Gross Profit | 102 | 116 | 177 | 191 |
| SG&A Expenses | 82 | 105 | 124 | 123 |
| Operating Profit (Adj) | 21 | 11 | 52 | 68 |
| Operating Profit | 21 | 11 | 52 | 68 |
| Non-Operating Profit | 2 | 13 | 2 | -3 |
| Net Financial Income | -1 | 0 | -3 | -3 |
| Net Gain from Inv in Associates | 4 | 21 | 0 | 0 |
| Pretax Profit | 23 | 24 | 54 | 65 |
| Income Tax | 17 | 29 | 15 | 18 |
| Profit from Continuing Operations | 6 | -5 | 39 | 47 |
| Profit from Discontinued Operations | -2 | 0 | 0 | 0 |
| Net Profit | 4 | -5 | 39 | 47 |
| Controlling Interests | 4 | 4 | 35 | 40 |
| Non-Controlling Interests | 1 | -9 | 5 | 7 |
| Total Comprehensive Profit | 5 | -12 | 39 | 47 |
| Controlling Interests | 4 | -1 | 32 | 38 |
| Non-Controlling Interests | 1 | -10 | 7 | 9 |
| EBITDA | 44 | 33 | 72 | 84 |
| FCF (Free Cash Flow) | 7 | 67 | 54 | 68 |
| EBITDA Margin (%) | 12.6 | 9.0 | 14.8 | 16.0 |
| Operating Profit Margin (%) | 6.0 | 3.0 | 10.7 | 12.9 |
| Net Profit Margin (%) | 1.1 | 1.1 | 7.2 | 7.6 |

Statement of Financial Condition (Summarized)

| (Wbn) | 12/16 | 12/17 | 12/18F | 12/19F |
|----------------------------------|------------|------------|------------|------------|
| Current Assets | 293 | 441 | 485 | 563 |
| Cash and Cash Equivalents | 170 | 195 | 261 | 317 |
| AR & Other Receivables | 44 | 121 | 111 | 121 |
| Inventories | 11 | 9 | 8 | 9 |
| Other Current Assets | 68 | 116 | 105 | 116 |
| Non-Current Assets | 232 | 357 | 326 | 321 |
| Investments in Associates | 39 | 81 | 75 | 82 |
| Property, Plant and Equipment | 104 | 93 | 84 | 78 |
| Intangible Assets | 37 | 113 | 102 | 93 |
| Total Assets | 525 | 798 | 811 | 884 |
| Current Liabilities | 135 | 330 | 306 | 331 |
| AP & Other Payables | 27 | 124 | 113 | 124 |
| Short-Term Financial Liabilities | 46 | 49 | 49 | 49 |
| Other Current Liabilities | 62 | 157 | 144 | 158 |
| Non-Current Liabilities | 15 | 31 | 30 | 31 |
| Long-Term Financial Liabilities | 11 | 11 | 11 | 11 |
| Other Non-Current Liabilities | 4 | 20 | 19 | 20 |
| Total Liabilities | 150 | 362 | 336 | 362 |
| Controlling Interests | 330 | 345 | 379 | 419 |
| Capital Stock | 11 | 11 | 11 | 11 |
| Capital Surplus | 165 | 170 | 170 | 170 |
| Retained Earnings | 131 | 134 | 169 | 209 |
| Non-Controlling Interests | 46 | 91 | 96 | 103 |
| Stockholders' Equity | 376 | 436 | 475 | 522 |

Cash Flows (Summarized)

| (Wbn) | 12/16 | 12/17 | 12/18F | 12/19F |
|---------------------------------------|------------|-------------|-----------|-----------|
| Cash Flows from Op Activities | 21 | 77 | 54 | 68 |
| Net Profit | 4 | -5 | 39 | 47 |
| Non-Cash Income and Expense | 54 | 53 | 37 | 37 |
| Depreciation | 10 | 11 | 9 | 7 |
| Amortization | 13 | 11 | 11 | 9 |
| Others | 31 | 31 | 17 | 21 |
| Chg in Working Capital | -15 | 46 | -5 | 5 |
| Chg in AR & Other Receivables | -8 | -83 | 10 | -10 |
| Chg in Inventories | -1 | -1 | 1 | -1 |
| Chg in AP & Other Payables | -1 | 97 | -10 | 11 |
| Income Tax Paid | -22 | -17 | -15 | -18 |
| Cash Flows from Inv Activities | -38 | -111 | 4 | -4 |
| Chg in PP&E | -14 | -4 | 0 | 0 |
| Chg in Intangible Assets | -5 | -25 | 0 | 0 |
| Chg in Financial Assets | -2 | 1 | 4 | -4 |
| Others | -17 | -83 | 0 | 0 |
| Cash Flows from Fin Activities | 51 | 64 | 0 | 0 |
| Chg in Financial Liabilities | 11 | 3 | 0 | 0 |
| Chg in Equity | 38 | 6 | 0 | 0 |
| Dividends Paid | 0 | 0 | 0 | 0 |
| Others | 2 | 55 | 0 | 0 |
| Increase (Decrease) in Cash | 36 | 26 | 65 | 57 |
| Beginning Balance | 133 | 170 | 195 | 261 |
| Ending Balance | 170 | 195 | 261 | 317 |

Source: Company data, Mirae Asset Daewoo Research estimates

Forecasts/Valuations (Summarized)

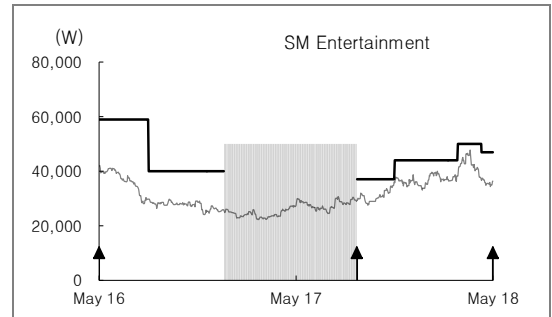
| | 12/16 | 12/17 | 12/18F | 12/19F |
|----------------------------------|--------|--------|--------|--------|
| P/E (x) | 153.0 | 174.4 | 23.6 | 20.6 |
| P/CF (x) | 9.5 | 15.6 | 10.7 | 9.9 |
| P/B (x) | 1.7 | 2.2 | 2.2 | 2.0 |
| EV/EBITDA (x) | 11.0 | 21.5 | 9.5 | 7.6 |
| EPS (W) | 169 | 199 | 1,540 | 1,771 |
| CFPS (W) | 2,720 | 2,218 | 3,411 | 3,680 |
| BPS (W) | 15,144 | 16,077 | 16,871 | 18,642 |
| 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 | 4.3 | 32.9 | 8.5 |
| EBITDA Growth (%) | -26.7 | -25.0 | 118.2 | 16.7 |
| Operating Profit Growth (%) | -44.7 | -47.6 | 372.7 | 30.8 |
| EPS Growth (%) | -83.9 | 17.8 | 673.9 | 15.0 |
| Accounts Receivable Turnover (x) | 8.5 | 4.4 | 4.2 | 4.5 |
| Inventory Turnover (x) | 33.0 | 36.8 | 58.7 | 63.6 |
| Accounts Payable Turnover (x) | 8.1 | 3.3 | 2.6 | 2.8 |
| ROA (%) | 0.9 | -0.7 | 4.9 | 5.5 |
| ROE (%) | 1.2 | 1.3 | 9.5 | 10.1 |
| ROIC (%) | 3.2 | -1.2 | 22.8 | 32.8 |
| Liability to Equity Ratio (%) | 39.8 | 83.1 | 70.8 | 69.4 |
| Current Ratio (%) | 217.9 | 133.4 | 158.3 | 170.1 |
| Net Debt to Equity Ratio (%) | -33.2 | -31.9 | -42.9 | -50.0 |
| Interest Coverage Ratio (x) | 12.1 | 9.1 | 39.5 | 51.5 |

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

| Company (Code) | Date | Rating | Target Price |
|---------------------------|------------|-------------|--------------|
| SM Entertainment (041510) | 04/24/2018 | Buy | 47,000 |
| | 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 | 75.00% | 11.11% | 13.89% | 0.00% |
| Investment Banking Services | 70.73% | 19.51% | 9.76% | 0.00% |

* Based on recommendations in the last 12-months (as of March 31, 2018)

Disclosures

As of the publication date, Mirae Asset Daewoo Co., Ltd. has been acting as a financial advisor to SM Entertainment for its treasury stock trust.

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