

SM Entertainment (041510)

12M rating **BUY (Maintain)**
12M TP **W54,000** from W54,000
Up/downside **+45%**

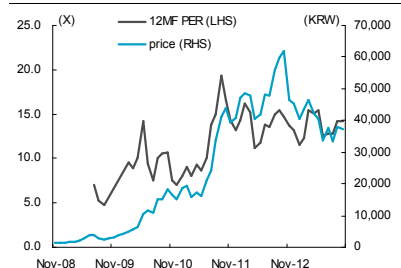
Stock Data

KOSPI (Oct 18, pt)	2,052
Stock price (Oct 18, KRW)	37,300
Market cap (USD mn)	726
Shares outstanding (mn)	21
52-Week high/low (KRW)	69,200/29,350
6M avg. daily turnover (USD mn)	13.6
Free float / Foreign ownership (%)	78.2/10.3
Major shareholders (%)	
Su-Man Lee	21.3
National Pension Service (NPS)	9.4

Performance

	1M	6M	12M
Absolute (%)	4.5	(23.0)	(35.2)
Relative to KOSPI (%p)	2.1	(31.0)	(40.0)

12MF PER trend



Source: WISEfn consensus

[SM Town China concert] China proves to be land of opportunity

Growth on improved artist lineup and regional expansion

Growth at entertainment companies, such as SM, are derived via: 1) improved artist lineups, 2) increased overseas activity, and 3) other businesses utilizing the artist or company's brand power to diversify revenue streams. SM is currently growing in all three segments. As such, earnings should grow in 2H13, and SK C&C is bolstering growth momentum as expected. We maintain BUY with a TP of W54,000 (20.0x PE).

SM has a diverse artist portfolio, including TVXQ, Super Junior, Girls' Generation, SHINee and f(x). And, the company has reinforced its lineup by adding new group, EXO. A systematic training system and label business should increase new artists. After its success in Japan, SM plans to increase artist activities in China. China's music/concert marketing size continues to grow rapidly and we consider China as an opportunity. Super Junior and EXO's activities in China should trigger growth.

China's music/concert market still in early growth stage, China to act as next growth driver

On October 19, SM Town performed at Beijing Olympic Stadium, attracting over 70,000 fans. Many of the groups performed, and EXO and Super Junior were the most popular bands. We believe the SM Town concert should be the start of increased promotions and artist activities in China.

Overseas promotion through a strong artist lineup is the key to SM's success, and growth should be fueled by China. China's music/concert market size is relatively smaller than other countries, but fandom continues to spread throughout China. Furthermore, strategic partnerships with local artist management agencies should accelerate the growth of the market.

China has the third largest content market in the world at USD115.3bn. And, the market should grow at a five-year CAGR of 12%. China has the twentieth largest music market, relatively smaller than the content market. However, digital music demand rose sharply in 2012, and the online music market swelled to CNY1.8bn (W313bn), up 379% YoY.

It is difficult to determine the exact market size for concerts in China. However, if 1% of the population (total 1.3bn) goes to concerts at least once a year (W100,000 ticket price assumed), the concert size would be W1.3tn. Japan has a W4tn market,

Shiwoo Kim

822-3276-6240
swkim@truefriend.com

Sangung Han

822-3276-4563
sangung@truefriend.com

Yr to	Sales	OP	EBT	NP	EPS	% chg	EBITDA	PER	EV/EBITDA	PBR	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2011A	143	26	26	23	1,256	19.2	32	32.4	21.6	6.1	23.1
2012A	241	61	57	40	2,002	59.4	70	22.8	11.8	4.4	24.7
2013F	278	57	59	40	1,948	(2.7)	73	19.1	9.1	3.1	17.3
2014F	354	71	73	50	2,410	23.7	91	15.5	7.0	2.6	18.2
2015F	427	94	95	65	3,164	31.3	118	11.8	5.3	2.2	19.9

Note: Net profit and EPS are based on figures attributed to controlling interest

and considering China's rapidly growing demand for cultural activities, the music/concert market should grow rapidly.

Major Chinese media/entertainment shares have rallied 56-308% YTD thanks to earnings improvement on higher demands for cultural activities. Huayi Brothers and Beijing Enlight Media's 2013F EPS should grow 165% and 31%, respectively. And, a valuation re-rating should occur on SM's increased artist activities in China. Huayi Brothers and Beijing Enlight Media shares trade at 48.3x and 50.1x 12MF PE, respectively.

SM's group synergies likely

SM views should also reflect SM Japan, SM C&C and Dream Maker. SM C&C is involved in travel, actor & actress management and video content production. SM C&C produces content and travel packages related to SM's artists to reinforce group synergies. For the SM Town concert in China, Dream Maker was in charge of planning. Dream Maker is involved in concert planning in concerts outside of Japan and SM Town's concert.

Content (dramas, entertainment programs, musicals, characters) is a good way of increasing artist demand. It is a way of spreading popularity, and these content should lead to higher merchandise demand, diversifying revenue sources.

2H13 earnings to meet guidance

3Q13 separate sales should swell 30.0% to W51.5bn and OP 5.4% YoY to W12.6bn. TVXQ's Dome Tour in Japan (700,000 tickets), Super Junior's Dome Tour in Japan (100,000 tickets) and EXO's album sales (450,000 copies) should be reflected in 3Q13 earnings. 4Q13 sales and OP (separate) should grow QoQ to W53.6bn and W16.3bn, respectively. SM Town's concerts in China and Japan, TVXQ's stadium concerts in Japan (150,000 tickets), EXO and SHINee's album sales should be booked in 4Q13 earnings.

Figure 1. Beijing SM Town concert (1)



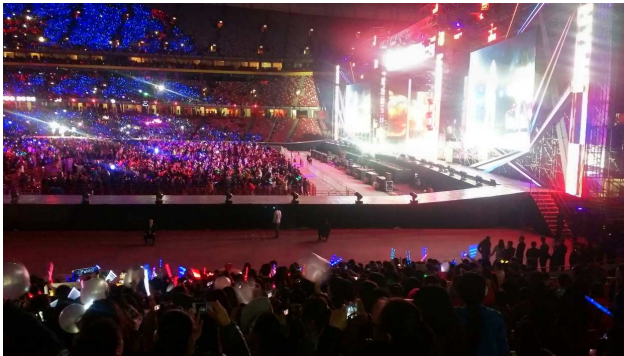
Source: Company data

Figure 2. Beijing SM Town concert (2)



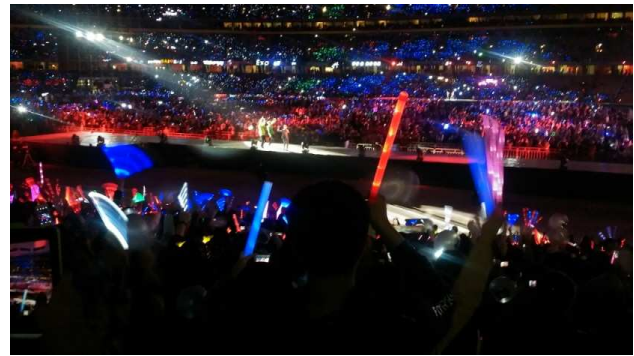
Source: Company data

Figure 3. Beijing SM Town concert (3)



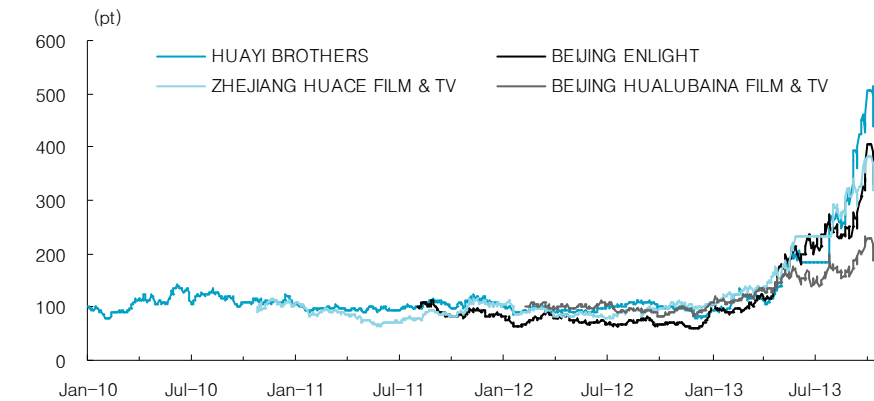
Source: Company data

Figure 4. Beijing SM Town concert (4)



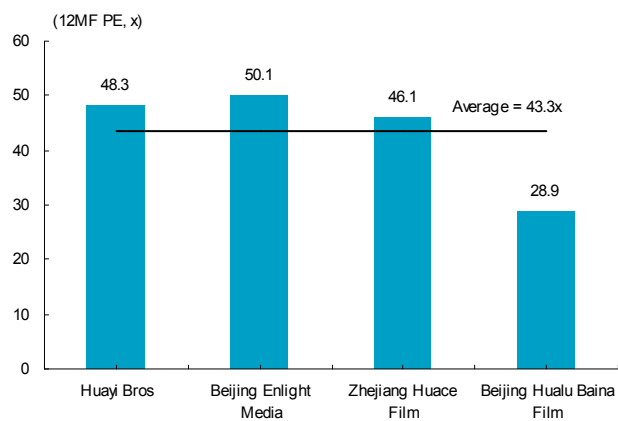
Source: Company data

Figure 5. Chinese media/entertainment companies' share price trend



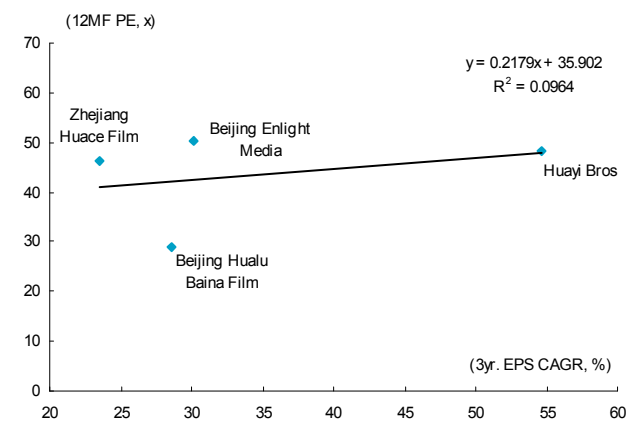
Source: Datastream

Figure 6. 12MF PE of Chinese media/entertainment companies



Source: Company data

Figure 7. Valuation of Chinese media/entertainment companies



Source: Company data

Table 1. Valuation and earnings of Chinese media/entertainment companies

		Huayi Bros	Beijing Enlight Media	Zhejiang Huace Film	Beijing Hualu Baina Film
PE (x)	2009	86.6	NA	NA	NA
	2010	66.7	NA	54.0	NA
	2011	46.5	32.3	41.9	NA
	2012	35.6	27.1	30.0	29.5
	2013E	55.0	58.0	60.3	35.3
	2014E	46.7	48.2	42.6	27.4
PB (x)	2009	6.3	NA	NA	NA
	2010	6.3	NA	5.5	NA
	2011	5.7	3.7	5.0	NA
	2012	4.1	4.2	4.4	3.8
	2013E	12.3	10.1	8.1	5.3
	2014E	10.4	8.9	7.4	4.7
ROE (%)	2009	9.8	29.6	40.9	26.6
	2010	9.8	54.2	14.0	32.1
	2011	12.5	17.4	12.5	49.2
	2012	12.8	16.4	15.6	20.1
	2013E	21.6	16.8	16.8	14.8
	2014E	21.0	18.3	21.6	16.7
OPM (%)	2009	21.5	22.6	44.4	26.5
	2010	16.3	27.2	42.7	24.1
	2011	27.1	30.4	46.2	41.9
	2012	19.2	34.6	35.4	35.4
	2013E	41.0	38.3	37.1	40.0
	2014E	39.1	40.3	36.4	41.3
EPS growth (%)	2009	12.3	387.5	(4.6)	17.0
	2010	37.5	75.6	47.3	(54.7)
	2011	39.1	37.2	26.5	136.0
	2012	17.6	51.0	40.0	8.5
	2013E	164.5	31.0	48.4	30.1
	2014E	17.8	20.2	41.3	28.8

Source: Bloomberg

Table 2. World's top 20 music markets

	Country	Market size (trade value)		Weight			
		USD mn	Growth (%)	Albums (%)	Digital (%)	Others (%)	BGM (%)
1	US	4,481.8	-0.5	34	58	4	4
2	Japan	4,422.0	4.0	80	17	2	1
3	UK	1,325.8	-6.1	49	39	10	2
4	Germany	1297.9	-4.6	75	19	5	1
5	France	907.6	-2.9	64	23	11	2
6	Australia	507.4	6.8	45	47	6	2
7	Canada	453.5	5.8	48	43	7	2
8	Brazil	2,572.0	8.9	62	27	9	2
9	Italy	217.5	-1.8	62	27	9	2
10	Netherlands	216.3	-4.7	58	27	14	1
11	Korea	187.5	-4.3	55	43	2	NA
12	Sweden	176.7	18.7	32	59	8	1
13	Spain	166.6	-5.0	53	27	19	1
14	India	146.7	21.6	31	60	7	2
15	Mexico	144.5	8.2	63	35	1	1
16	Swiss	128.5	-14.2	61	32	7	NA
17	Belgium	121.5	-6.3	64	18	17	NA
18	Norway	118.3	6.7	31	57	11	1
19	Austria	96.2	-12.4	65	21	13	1
20	China	92.4	9.0	18	82	NA	NA
Total		16,480.6	0.2	57	35	6	2

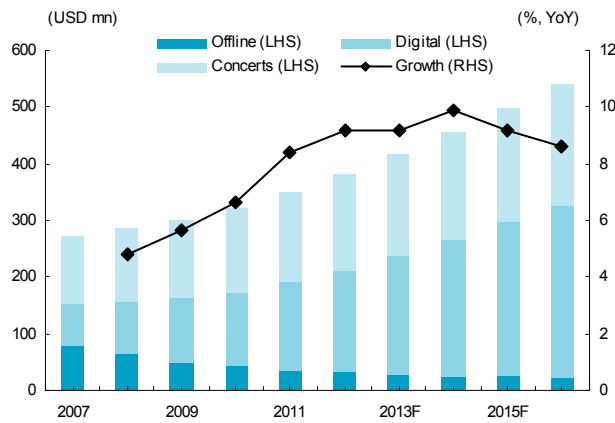
Source: IFPI

Table 3. 2012 Digital music users in China

	Application	Users (2011)	Usage rate	Users (2012)	Usage rate	CAGR
		(00'000)	(%)	(00'000)	(%)	
1	Messenger	41,510	80.9	46,775	82.9	12.7
2	Search engine	40,740	79.4	45,110	80.0	10.7
3	Digital music	38,585	75.2	43,586	77.3	13.0
4	Blogs	31,864	62.1	37,299	66.1	17.1
5	Online TV	32,531	63.4	37,183	65.9	14.3
6	Online games	32,428	63.2	33,569	59.5	3.5
7	Weibo (Twitter)	24,988	48.7	30,861	54.7	23.5
8	Social network	24,424	47.6	27,505	48.8	12.6
9	E-mail	24,578	47.9	25,080	44.5	2.0
10	Online purchase	19,395	37.8	24,202	42.9	24.8

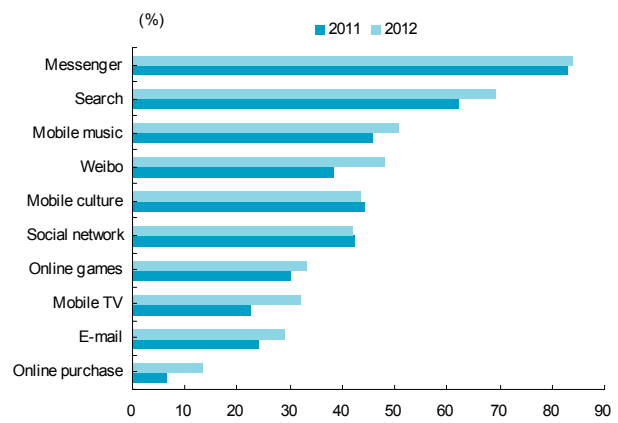
Source: KOCCA

Figure 8. 2007-2012 Chinese music market



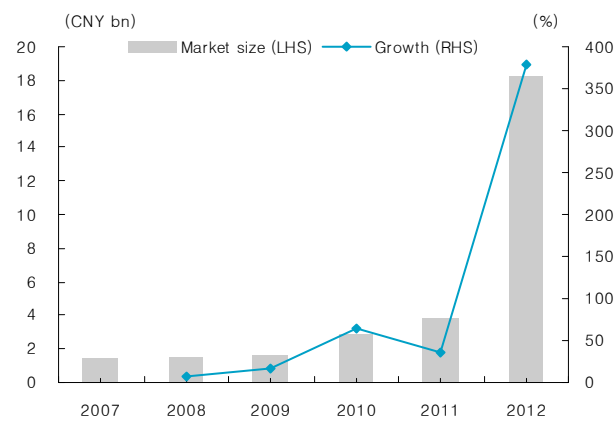
Source: IFPI

Figure 9. Chinese mobile music applications



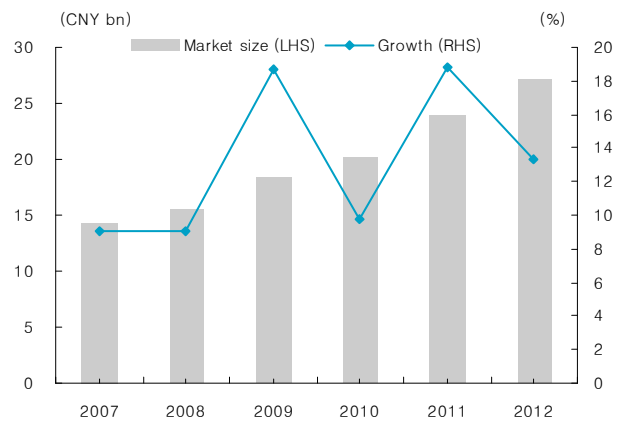
Source: KOCCA

Figure 10. 2007-2012 Chinese online music market



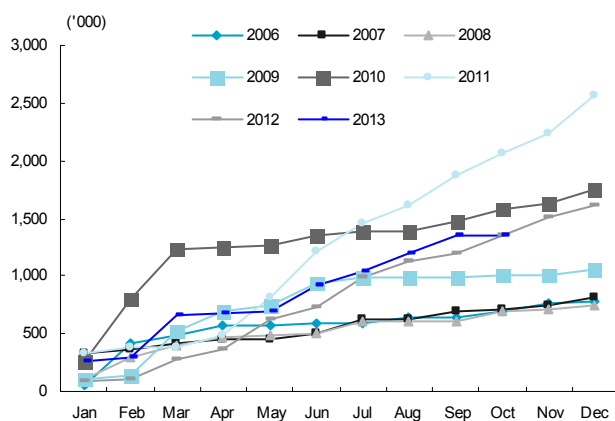
Source: IFPI

Figure 11. 2007-2012 Chinese wireless music market



Source: KOCCA

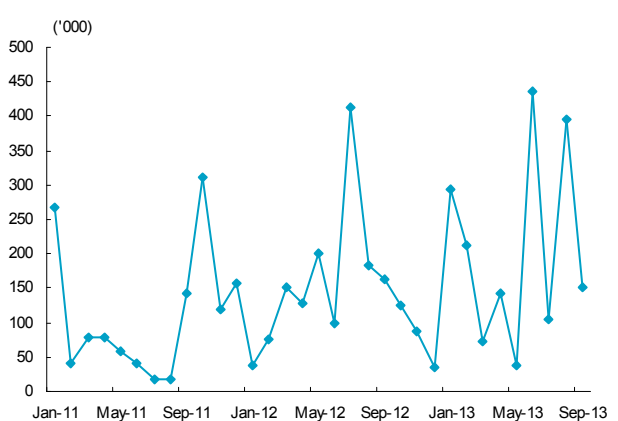
Figure 12. SM: album sales in Japan



Note: includes top 50 figures only

Source: IFPI

Figure 13. SM: domestic album sales



Note: includes top 50 figures only

Source: KOCCA

Table 4. Quarterly earnings (K-IFRS separate)

(W bn, %)

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13F	4Q13F
Sales	38.5	32.4	51.5	46.2	33.2	33.4	51.5	53.6
Albums	3.0	3.7	8.7	6.3	4.9	6.3	7.3	6.6
Digital music	1.9	2.9	2.5	3.2	1.5	1.8	4.1	4.9
Overseas	16.9	7.5	13.1	3.3	11.2	7.5	23.6	16.9
Management	16.7	18.2	27.2	33.4	15.7	17.8	16.5	25.2
COGS	22.9	17.9	34.6	24.6	19.4	24.6	31.6	30.0
SG&A	3.8	4.5	5.0	7.5	6.2	6.6	7.3	7.2
OP	11.8	10.0	11.9	14.1	7.7	2.2	12.6	16.3
EBT	12.1	10.7	12.9	11.8	8.0	3.1	14.2	20.8
NP	9.4	9.7	8.7	9.3	6.4	2.0	11.2	16.4
OPM	30.6	30.9	23.1	30.6	23.1	6.7	24.4	30.5
NPM	24.4	30.0	17.0	20.2	19.2	6.0	21.8	30.7

Source: Company data, Korea Investment & Securities

Table 5. Annual earnings (K-IFRS separate)

(W bn, %)

	2005	2006	2007	2008	2009	2010	2011	2012	2013F	2014F
Sales	22.1	29.9	33.2	43.5	61.8	86.4	109.9	168.6	171.7	208.7
Albums	7.5	7.6	6.3	8.5	11.4	12.7	19.2	21.8	25.1	26.6
Digital music	0.0	1.1	2.8	2.4	3.8	5.2	6.7	10.5	12.3	13.8
Overseas	5.9	4.8	5.5	8.4	15.2	36.3	23.9	40.8	59.2	76.9
Albums	0.1	0.3	0.5	0.6	0.2	0.7	2.0	0.9	1.5	1.9
Royalty	5.8	4.5	5.0	7.8	15.0	35.6	21.9	39.8	57.6	75.0
Management	8.7	16.4	18.7	24.1	31.4	32.3	60.1	95.5	75.1	91.3
Domestic	7.2	15.7	16.8	20.7	28.2	26.8	36.6	36.8	37.9	46.2
Overseas	1.5	0.7	1.9	3.4	3.2	5.5	23.6	58.7	37.2	45.1
COGS	15.6	25.4	29.1	35.8	41.8	48.8	73.1	99.9	105.7	126.8
SG&A	5.3	6.8	7.9	9.3	10.7	12.4	16.4	20.8	27.2	30.8
OP	1.2	(2.3)	(3.7)	(1.7)	9.3	25.3	20.5	47.8	38.8	51.0
EBT	1.1	(2.9)	(7.1)	4.5	6.1	25.3	20.6	47.6	46.2	58.9
NP	1.2	(4.0)	(7.6)	4.3	4.5	24.4	16.5	37.2	36.0	45.9
OPM	5.6	(7.8)	(11.2)	(3.9)	15.0	29.2	18.6	28.4	22.6	24.5
NPM	5.4	(13.5)	(23.0)	9.8	7.2	28.3	15.0	22.1	21.0	22.0

Source: Company data, Korea Investment & Securities

Table 6. Quarterly earnings (K-IFRS consolidated)

(W bn, %)

	1Q13	2Q13	3Q13F	4Q13F
Sales	50.0	56.9	83.1	88.2
Albums	4.9	6.3	6.3	5.8
Digital music	1.1	1.5	2.0	2.7
Domestic management	10.2	9.8	9.4	8.2
Overseas revenue	23.6	27.1	53.2	50.3
Other businesses	10.2	12.2	12.3	21.1
COGS	28.9	38.1	49.2	45.2
SG&A	16.0	15.2	15.0	13.6
OP	5.1	3.7	19.0	29.4
EBT	5.0	4.6	19.4	29.7
NP	2.0	0.7	13.6	21.8
OPM	10.2	6.4	22.9	33.3
NPM	4.0	1.2	16.4	24.8

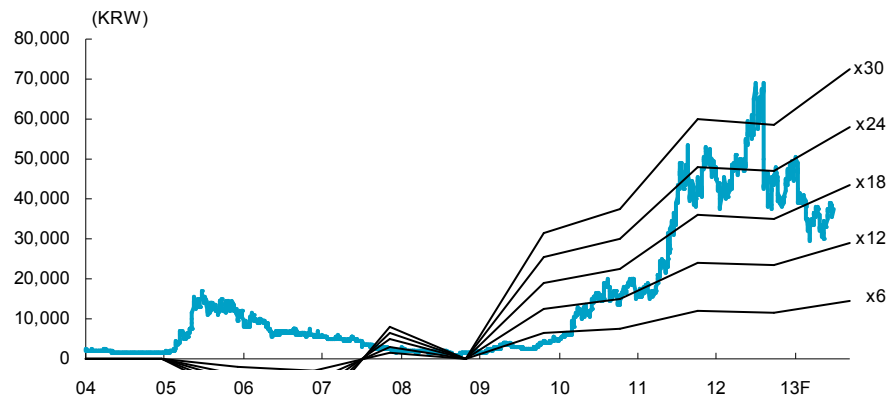
Source: Company data, Korea Investment & Securities

Table 7. Annual earnings (K-IFRS consolidated)

(W bn, %)

	2010	2011	2012	2013F	2014F
Sales	96.8	143.0	241.3	278.2	354.1
Albums	12.7	19.2	21.8	23.3	24.7
Digital music	4.7	6.2	6.4	7.2	8.2
Domestic management	26.8	36.6	36.8	37.7	39.2
Overseas revenue	52.7	81.1	156.8	154.2	192.4
Albums	0.7	2.0	0.9	1.4	1.6
Royalty & guarantee	41.6	46.1	102.7	105.1	131.3
Others	10.4	33.1	53.2	47.7	59.5
Other businesses	0.0	0.0	19.6	55.8	89.5
COGS	52.2	86.5	131.6	161.4	211.5
SG&A	24.7	30.9	49.1	59.7	71.3
OP	19.9	25.6	60.5	57.1	71.3
EBT	17.3	26.2	56.9	58.7	72.7
NP	15.9	21.8	37.3	38.1	50.9
OPM	20.6	17.9	25.1	20.5	20.1
NPM	16.4	15.3	15.5	13.7	14.4

Source: Company data, Korea Investment & Securities

Figure 14. 12MF PE

Note: Based on consolidated earnings
Source: Company data, Korea Investment & Securities

Company overview & Glossary

SM Entertainment is one of the largest artist and talent agencies in Korea, and is involved in the music business. The company has grown into a major entertainment company by expanding other related businesses using its brand power. SM's major artists include TVXQ, Super Junior, Girls' Generation, EXO and f(x).

- Management revenue: Refers to revenue from artist activities including commercials and TV appearances, in addition to album and concert businesses
- Royalty revenue: Overseas promotion is conducted through joint efforts with local agencies and SM is given a specific profit distribution rate for revenue from activities, which are recognized as royalty revenue

Balance sheet

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Current assets	106	198	211	239	282
Cash & cash equivalent	33	100	92	103	107
Accounts & other receivables	14	24	29	39	51
Inventory	3	6	7	8	13
Non-current assets	62	125	143	185	231
Investment assets	21	29	33	52	75
Tangible assets	19	39	45	51	57
Intangible assets	9	43	50	63	76
Total assets	168	323	355	424	513
Current liabilities	52	74	70	91	117
Accounts & other payables	35	56	64	71	90
ST debt & bond	2	2	0	0	0
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	4	10	10	11	11
Debentures	0	2	2	2	2
LT debt & financial liabilities	1	6	6	6	6
Total liabilities	56	84	81	102	128
Controlling interest	111	213	249	296	357
Capital stock	8	10	10	10	10
Capital surplus	55	119	119	119	119
Capital adjustments	2	1	1	1	1
Retained earnings	44	84	124	174	239
Minority interest	2	26	25	26	28
Shareholders' equity	112	239	274	322	385

Income statement

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Sales	143	241	278	354	427
COGS	87	132	161	212	252
Gross profit	56	110	117	143	175
SG&A expense	31	49	60	71	81
Operating profit	26	61	57	71	94
Financial income	2	9	4	5	5
Interest income	2	3	3	3	3
Financial expense	0	4	1	1	1
Interest expense	0	1	1	1	1
Other non-operating profit	(1)	(8)	(2)	(2)	(3)
Gains (Losses) in associates, subsidiaries and JV	(0)	(0)	0	0	0
Earnings before tax	26	57	59	73	95
Income taxes	4	20	21	22	29
Net profit	22	37	38	51	67
Net profit of controlling interest	23	40	40	50	65
Other comprehensive profit	1	(3)	(3)	(3)	(3)
Total comprehensive profit	23	34	35	48	64
Total comprehensive profit of controlling interest	24	37	37	46	62
EBITDA	32	70	73	91	118

Cash flow

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
C/F from operating	32	47	38	83	83
Net profit	22	37	38	51	67
Depreciation	2	2	4	5	6
Amortization	5	7	12	14	17
Net incr. in W/C	5	(4)	(17)	12	(8)
Others	(2)	5	1	1	1
C/F from investing	(17)	(50)	(43)	(72)	(79)
CAPEX	(13)	(23)	(10)	(11)	(12)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	2	(0)	(8)	(21)	(27)
Net incr. in intangible assets	(5)	(19)	(18)	(28)	(30)
Others	(1)	(8)	(7)	(12)	(10)
C/F from financing	2	75	(3)	0	0
Incr. in equity	3	75	0	0	0
Incr. in debts	(1)	0	(3)	0	0
Dividends	0	0	0	0	0
Others	0	0	0	0	0
C/F from others	1	(6)	0	0	0
Increase in cash	18	66	(8)	11	4

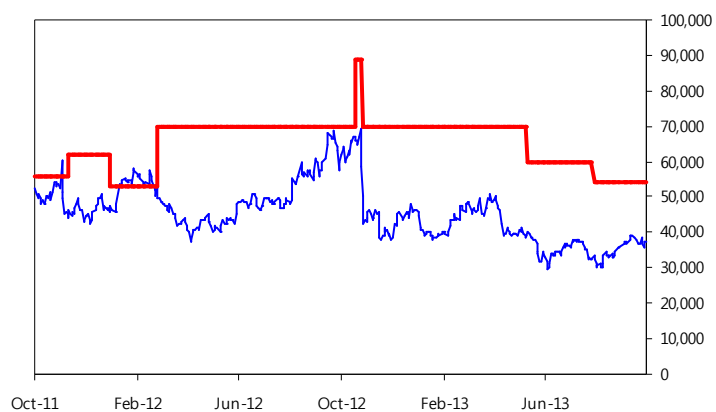
Note: Based on K-IFRS (consolidated)

Key financial data

FY-ending Dec.	2011A	2012A	2013F	2014F	2015F
per share data (KRW)					
EPS	1,256	2,002	1,948	2,410	3,164
BPS	6,682	10,407	12,067	14,312	17,308
DPS	0	0	0	0	0
Growth (%)					
Sales growth	47.7	68.8	15.3	27.3	20.6
OP growth	28.7	136.4	(5.7)	24.8	31.9
NP growth	33.0	75.3	0.1	23.9	31.3
EPS growth	19.2	59.4	(2.7)	23.7	31.3
EBITDA growth	25.5	116.7	4.1	24.2	30.0
Profitability (%)					
OP margin	17.9	25.1	20.5	20.1	22.0
NP margin	15.9	16.5	14.4	14.0	15.2
EBITDA margin	22.6	29.0	26.2	25.6	27.6
ROA	15.1	15.2	11.3	13.1	14.3
ROE	23.1	24.7	17.3	18.2	19.9
Dividend yield	0.0	0.0	0.0	0.0	0.0
Stability					
Net debt (W bn)	(68)	(133)	(134)	(155)	(167)
Debt/equity ratio (%)	3.5	4.4	2.8	2.4	2.0
Valuation (X)					
PER	32.4	22.8	19.1	15.5	11.8
PBR	6.1	4.4	3.1	2.6	2.2
PSR	4.7	3.8	2.8	2.2	1.8
EV/EBITDA	21.6	11.8	9.1	7.0	5.3

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
SM Entertainment (041510)	11-30-11	BUY	W62,000
	01-19-12	BUY	W53,000
	03-16-12	BUY	W70,000
	11-07-12	BUY	W89,000
	11-15-12	BUY	W70,000
	05-31-13	BUY	W60,000
	08-19-13	BUY	W54,000



■ **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on absolute 12-month forward share price performance**

- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of -15% or less
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**

- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

■ **Analyst Certification**

I/We, as the research analyst/analysts who prepared this report, do hereby certify that the views expressed in this research report accurately reflect my/our personal views about the subject securities and issuers discussed in this report. I/We do hereby also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

■ **Important Disclosures**

As of the end of the month immediately preceding the date of publication of the research report or the public appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month), Korea Investment & Securities Co., Ltd., or its affiliates does not own 1% or more of any class of common equity securities of SM Entertainment.

There is no actual, material conflict of interest of the research analyst or Korea Investment & Securities Co., Ltd., or its affiliates known at the time of publication of the research report or at the time of the public appearance.

Korea Investment & Securities Co., Ltd., or its affiliates has not managed or co-managed a public offering of securities for SM Entertainment in the past 12 months;

Korea Investment & Securities Co., Ltd., or its affiliates has not received compensation for investment banking services from SM Entertainment in the past 12 months; Korea Investment & Securities Co., Ltd., or its affiliates does not expect to receive or intends to seek compensation for investment banking services from SM Entertainment in the next 3 months.

Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in SM Entertainment's securities at the time that the research report was published.

Korea Investment & Securities Co., Ltd. does not own over 1% of SM Entertainment shares as of October 21, 2013.

Korea Investment & Securities Co., Ltd. has not provided this report to various third parties.

Neither the analysts covering these companies nor their associates own any shares of as of October 21, 2013.

Prepared by: Shiwoo Kim

This report was written by Korea Investment & Securities Co., Ltd. to help its clients invest in securities. This material is copyrighted and may not be copied, redistributed, forwarded or altered in any way without the consent of Korea Investment & Securities Co., Ltd. This report has been prepared by Korea Investment & Securities Co., Ltd. and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. We make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. The final investment decision is based on the client's judgment, and this report cannot be used as evidence in any legal dispute related to investment decisions.