Korea Investment
& Securities Co., Ltd.

Golfzon (121440)

Company Report / Leisure & Entertainment

July 15, 2011

BUY (Initiate)

TP: W90,000

Stock Data

KOSPI (Jul 14)	2,130
Stock price (Jul 14)	66,000
Shares outstanding (mn)	12.3
Market cap (USD mn)	766
52-Week Low/High (won)	63,300/86,000
6M avg. daily turnover (USD mn)	14.8
Free float (%)	36.1
EPS (2011F, won)	5,596
BPS (2011F, won)	31,599
Dividend yield (2011F, %)	0.0
Foreign ownership (%)	6.7
Major shareholders (%)	
Won-Il Kim	44.6
Yeong-Chan Kim	16.1

Stock performance	1M	6M	12M
Absolute (%)	(20.5)	NM	NM
Relative to KOSPI (%p)	(23.0)	NM	NM

Contents

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Merry-go-rounds

Initiate coverage with BUY and TP of W90,000

We initiate our coverage of Golfzon, a maker of golf simulators, with BUY and a 12M TP of W90,000. Our TP equals a target PE 14.4x the 2011-2012F average net profit. Our target PE is the average of the online games and leisure/entertainment sectors. We expect the company's sales to continue to grow on the back of a strong presence in the golf simulator market, an increase in fee-paying rounds played on Golfzon's simulators and greater network service sales. We also forecast the operating margin to rise again. Over the mid to long-term, we pin high hopes for overseas momentum, especially in China. The stock pulled back from the IPO price of W85,000 and now trades at a 2012F PE 9.1x.

2012F NP to jump 36% YoY on network service sales growth

Sales should increase 15.6% YoY in 2011F. Although golf simulator sales would drop 7.1%, network service sales should jump 242.0%. The operating margin should fall 4.6%p YoY in 2011F due to heavier labor and marketing costs. Accordingly, operating profit should inch down 0.2% YoY in 2011F. Net profit should shrink 2.8% YoY due to greater corporate taxes. In 2012F, the operating margin should rise 7.2%p YoY to 36.4% on the mounting sales contribution from high-margin network services. We expect operating and net profits to grow 39.3% and 36.2% YoY, respectively.

Runaway popularity of virtual golf in Korea; More rounds being played

The number of golf cafés is estimated at 5,700 nationwide as of end-2010. Golfzon is a dominant player in the simulator market taking up roughly 70% share. It boasts superior technology, network services and competitive content. The penetration rate of virtual golf is high at 61% of 2.26mn golfers in Korea. Virtual golf has become a fast-growing pastime as it is less costly than playing at the country club and more and more makes people feel as though they are at a real course. Virtual golf has gained such huge popularity as an electronic sport (e-sport) in Korea that tournaments have popped up. The number of rounds played on Golfzon's simulators was 10.9mn in 1Q11, up 46.1% YoY.

Chinese market to drive growth over the mid to long-term

As of 2010, there are roughly 5mn Chinese who play golf, which is up 25% YoY. We expect China's golfing population to grow faster as rising incomes are driving demand for leisure activities and entertainment. As of end-2010, there are only 400 golf courses in China. In particular, there are only a handful of facilities where people can learn and practice the sport. Golfzon will first penetrate the market with its Golfzon Driving Range (GDR, an academy specializing in simulation and instruction) business. The company also plans to form a JV with a local partner. It established a subsidiary in Beijing on Jun 3.

I. Valuation & investment points

1. Initiate coverage with BUY and TP of W90,000

TP equals PE 14.4x the 2011-2012F average net profit; PE is the average of online games and entertainment sectors

We initiate coverage of Golfzon with BUY and a 12M TP of W90,000. Our TP equals a target PE 14.4x the 2011-2012F average net profit. Our target PE is the average of the online games and leisure/entertainment sectors and a 31% premium to the KIS Universe average of 11x. We give a premium to Golfzon considering its overwhelming market share (80% in terms of new golf cafés) and growing network service sales that will bolster growth and big profitability. Moreover, tangible results overseas should be a boon for strong growth over the mid to long-term. For reference, online game companies and leisure/entertainment providers receive respective 84% and 50% premiums over the market average.

TP calculation

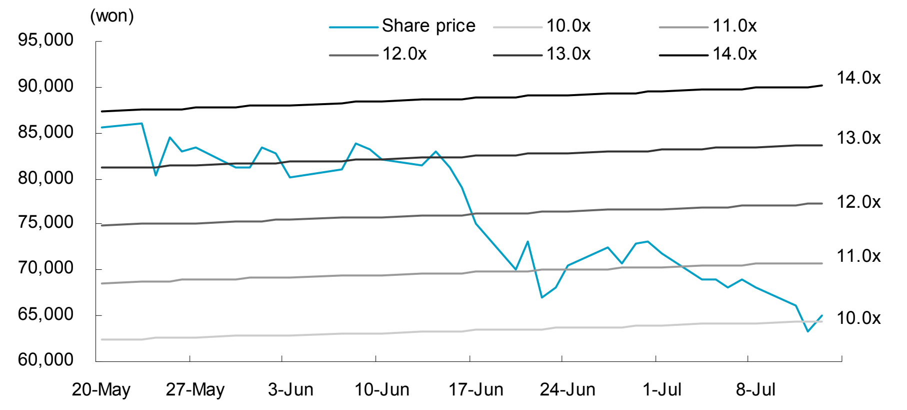
	Value
2011F net profit (W bn)	65.2
2012F net profit (W bn)	88.8
2011-2012 average net profit (W bn)	**77.0**
Target PE (x)	**14.4**
Fair market cap (W bn)	1,109
Shares ('000)	12,283
Fair value per share (won)	**90,323**

Source: Company data, Korea Investment & Securities

Stock 20% down from IPO price

Since its Kosdaq listing on May 20, 2011 (IPO price W85,000 with PE 14x based on the 2011 guidance), Golfzon's stock went up to W95,000 right after the IPO but dropped to W66,000 as of Jul 14. The stock is down roughly 20% from the IPO price due to concern about slowing growth (Jul 14 closing price equals 2011F PE 11.8x).

PE band since IPO



Note: As of Jul 14 closing price.
Source: Korea Investment & Securities

Low valuation compared to online games and leisure/entertainment

As Golfzon's close competitors at home and abroad have not listed yet, we made a valuation comparison with domestic online game companies and leisure/entertainment providers. Golfzon's respective 2011F and 2012F PE multiples are 36.7% and 22.1% less than the online games sector average and 22.1% and 25.8% discounted to the leisure/entertainment average.

Valuation comparison with domestic online game companies

(W bn, won, x, %)

Company	Share price	Market cap	PE			EPS CAGR	PE premium over market	PEG	ROE	EV/EBITDA		EBITDA CAGR
	(won)	(W bn)	2010A	2011F	2012F	(10-12F)	2011F	2011F	2011F	2011F	2012F	(10-12F)
Golfzon	66,000	811	10.0	11.8	9.1	4.7	16.7	2.5	23.6	8.1	4.9	18.1
NCsoft	320,500	6,997	36.5	33.8	19.5	36.6	234.6	0.9	22.5	18.3	10.7	25.6
Neowiz Games	55,100	1,207	62.5	11.7	9.4	157.3	15.5	0.1	36.0	4.9	3.5	24.4
NHN	184,500	8,880	16.8	15.5	13.3	12.5	53.6	1.2	34.8	11.2	9.3	15.8
Wemade	34,300	288	15.0	10.6	7.8	38.6	5.2	0.3	9.9	4.3	2.2	20.6
Gamehi	14,200	470	n/a	24.1	15.2	n/a	138.9	n/a	32.2	10.0	4.7	104.0
Gamevil	37,150	206	14.0	12.5	10.0	18.4	23.9	0.7	26.6	7.6	5.4	16.5
JCE	20,400	233	73.4	22.1	6.7	231.0	119.0	0.1	17.3	8.4	7.6	213.5
Average			28.8	18.6	11.7	82.4	84.4	0.5	25.6	9.3	6.2	60.1

Note: 1. All others are based on I/B/E/S excluding Golfzon; 2. As of Jul 14 closing price.
Source: I/B/E/S, Korea Investment & Securities

Valuation comparison with domestic online game companies

(W bn, won, x, %)

Company	Share price	Market cap	PE			EPS CAGR	PE premium over market	PEG	ROE	EV/EBITDA		EBITDA CAGR
	(won)	(W bn)	2010A	2011F	2012F	(10-12F)	2011F	2011F	2011F	2011F	2012F	(10-12F)
Golfzon	66,000	811	10.0	11.8	9.1	4.7	16.7	2.5	23.6	8.1	4.9	18.1
GKL	21,700	1,342	18.8	18.8	13.3	18.7	85.9	1.0	33.2	9.4	9.0	12.2
Kangwon Land	30,450	6,515	14.7	14.1	13.4	4.9	39.1	2.9	20.5	6.7	6.3	4.3
CJ CGV	29,400	606	18.2	12.5	10.7	30.2	23.9	0.4	17.7	6.4	5.6	13.0
Paradise	7,150	650	13.8	10.0	9.6	20.1	(0.8)	0.5	13.5	3.9	3.5	35.9
Hotel Shilla	28,550	1,121	22.5	19.5	14.1	26.2	93.5	0.7	9.7	10.3	8.2	15.3
Hana Tour	47,050	547	21.5	17.3	13.6	25.5	71.0	0.7	26.0	10.7	7.5	28.4
Mode Tour	36,950	310	18.6	13.8	11.4	27.9	36.6	0.5	29.6	8.0	5.7	29.0
Average			18.3	15.1	12.3	21.9	49.9	1.0	21.5	7.9	6.5	19.7

Note: 1. All others are based on I/B/E/S excluding Golfzon; 2. As of Jul 14 closing price.
Source: I/B/E/S, Korea Investment & Securities

2. Golfzon's three core competencies and investment points

1) Dominant market share of nearly 70%

We sum up Golfzon's core competencies as follows. 1) The company has built superior technology as it funneled abundant funding into extensive R&D. It has a tight grip on the golf simulator market through constant product releases. Virtual golf players tend to stay loyal to simulators they are familiar with. As a pair or foursome usually play a round together, Golfzon with a dominant presence has an advantageous position to entice customers. This explains why Golfzon's new simulator sales have a growing share despite their dearer prices over competitors.

2) Network services a steady source of revenue

2) Golfzon generates steady earnings from network service sales let alone simulators. Network services offer ample sales upside as the business provides varied content such as fee-paying courses.

3) Customers loyal to Golfzon's simulators

3) The number of subscribers to Golfzon's homepage (www.golfzon.com) is estimated at 800,000 as of end-June 2011. Users can check their round score history, analyze their golf swing from video clips and make online reservations on the homepage. Such a loyal customer base is a firm foundation for the company to branch out into diverse areas such as golf merchandise distribution (i.e., online shopping mall Golping).

Investment point 1: Golf cafés not yet saturated; Simulator sales are smooth-sailing

Number of golf cafés up 20% YoY in 2011F

The number of golf cafés is estimated at 5,700 nationwide as of end-2010. We forecast 20% additions in 2011. Golfzon hopes to sell simulators to 930 new golf cafés this year. It has a dominant market share of 80% in the new simulator market backed by competitive technology, network services and website operation. As virtual golf has become a very popular sport, the number of rounds played is rising rapidly and props up big profitability. We expect constant golf café openings in Korea for the time being. Replacement demand should also emerge for the R-model (released early 2011) and a new premium 3R (release at end-2011).

Investment point 2: Brisk growth of network service sales

Network service sales to jump 242% in 2011F and 90% in 2012F

Network service sales (fees for paid courses) should jump 242% YoY in 2011F and 90.2% YoY in 2012F. Golfzon has replaced most of the previous N-model simulators with the R-model. The R-model charges a fee to play on all courses while the N-model allows free play on 15 courses. Accordingly, as much as 59.6% and 83% of rounds will likely be played on fee-paying courses in 2011F and 2012F, respectively, compared with 28.9% in 2010. The paid-course fee is now W2,000 per person but it can be raised and add-on items will contribute to sales as well. We expect the network services to drive Golfzon's domestic sales growth in the mid to long-term.

Investment point 3: Overseas market entry and Chinese potential

China's golfing population exploding on rising incomes

Sales were only W5.3bn in 2010 but should jump to W30bn in 2013F. In Jun 2011, Golfzon established a subsidiary in Beijing to penetrate China's market by forming a JV with a local partner. China's golfing population has been growing rapidly as rising incomes are fuelling demand for leisure activities and entertainment. However, there is a lack of not only golf courses but also facilities where people can learn and practice the sport. In addition to Japan and China, Golfzon's major target markets include North America (Canada) and Europe (Sweden). Even though golf is widely popular in Canada and Sweden, both countries have long winters that shorten the time people can enjoy playing outdoors. Golfzon believes such markets offer ample demand.

Investment point 4: PE 9.1x the 2012F earnings

Net cash holdings of W300bn including IPO funds

Golfzon's stock has dropped roughly 20% from the IPO price of W85,000 to the W60,000 level due to concern about slowing growth. The current share price equals a mere PE 9.1x the 2012F earnings. We think the stock is undervalued with a market cap of W810.7bn when considering net cash holdings at W300bn including W170bn in IPO funds and annual EBITDA generation of more than W70bn. Golfzon deserves a premium over the market average given its dominant presence in the simulator market, growing high-margin network service sales and likely steady earnings growth.

Risk 1: Labor cost burden and swelling marketing spending

OP margin to fall 4.6%p YoY in 2011F

As of end-Mar 2011, Golfzon has 385 employees, up 145 from end-2009. Accordingly, labor costs should jump 36.8% YoY in 2011F. We also expect marketing spending to swell 124.2% YoY to W14bn due to the release of new simulators (R and 3R). The operating margin is expected to fall 4.6%p YoY to 29.2% in 2011F but should bounce back in 2012 thanks to growing high-margin network service sales.

Risk 2: More investment for new businesses

Investment for diversification weighs on short-term earnings

Golfzon is growing beyond being a simple maker of simulators and entering new business areas such as golf academies (GDR), G-Tour (online ranking service) and online golf game development. Expansion is a necessary investment to secure mid to long-term growth engines but may weigh on short-term earnings.

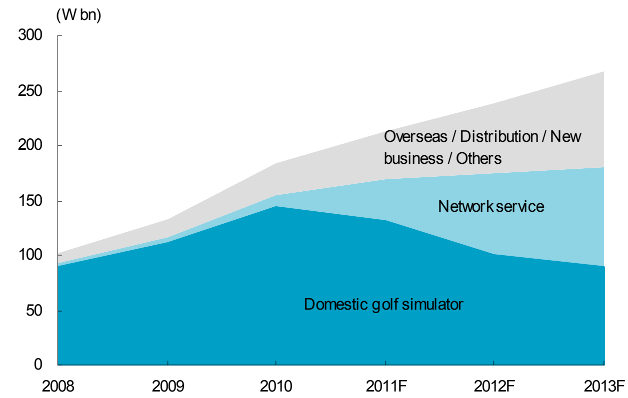
Network service sales structure

Network services sales = Rounds played X % of total rounds played X Fee per person

1. Network service sales are fees for paid courses via Golfzon Live which provides contents and events for Golfzon cafés connected by network (W2,000 person for 18 holes)
2. Considering value-added tax payment and discount offerings, we assume the fee at W1,727, Not W2,000 (5-10% of Golfzon Live fees go to golf café owners beginning in 1Q11)

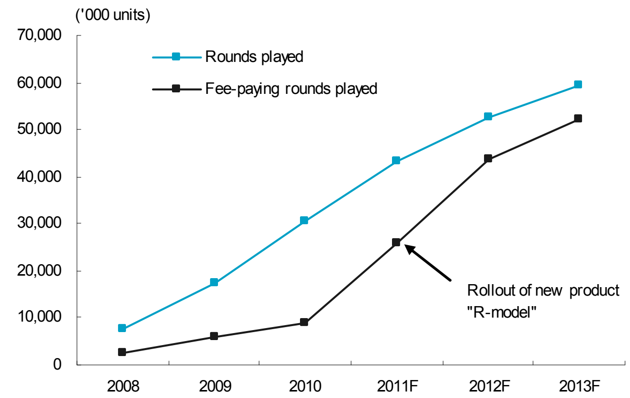
Source: Company data, Korea Investment & Securities

Sustainable growth by sales diversification



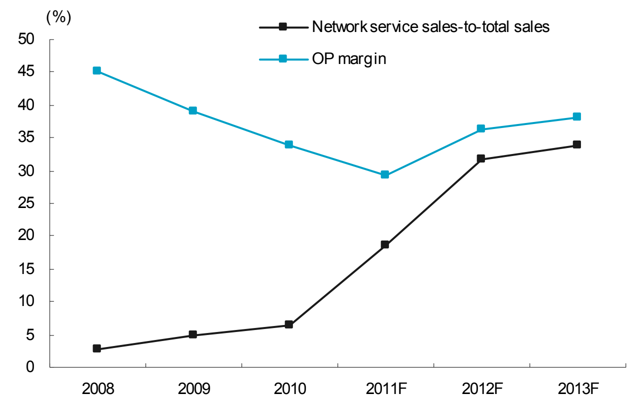
Source: Company data, Korea Investment & Securities

Rapid growth of fee-paying rounds played from 2011F



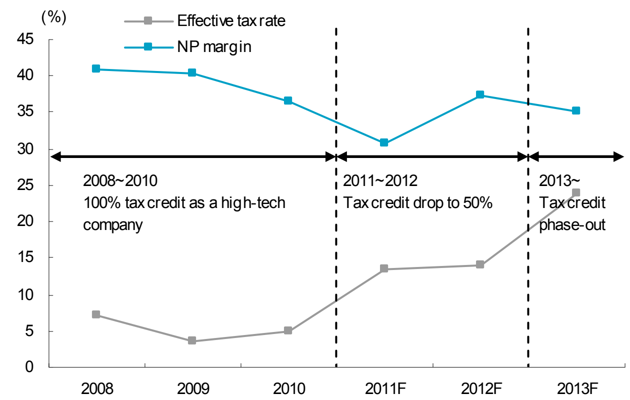
Source: Company data, Korea Investment & Securities

OP to rebound on network service sales growth



Source: Company data, Korea Investment & Securities

NP margin to fall as tax credit drops



Source: Company data, Korea Investment & Securities

II. Earnings forecasts

2Q11 sales rose from a year ago whereas OP slipped

1Q11 OP was down 51.6% YoY (estimate) due to marketing

Golfzon's sales grew 20.7% to W50.3bn in 1Q11 but operating profit is thought to have shed 51.6% YoY to W7.8bn. By division, golf simulator sales rose 5.9% YoY to W35.8bn and network service sales shot up 125.6% YoY to W6.6bn. The jump by network services is attributed to upgrades from the N-model since Jan, which has pushed up the fee-paying round rate (paid rounds as a % of total rounds played). The COGS-to-sales climbed on an actual cost recognition for simulator upgrades. Marketing costs went up as well due to the introduction of the new model. Accordingly, operating margin dipped 23.1%p YoY to 15.5%.

2Q11F sales up 3% YoY while OP drops 16.5% YoY

We peg the 2Q11F sales at W57.8bn, up 3% YoY. The golf simulator sales should fall 15.9% YoY as the number of simulators sold at home dropped 25%. Network service sales should jump 236.2% YoY to W8.4bn as the rate of playing on fee-paying courses is believed to have risen 14.2%p QoQ to 55.1%. Operating profit should lose 16.5% YoY to W20.5bn. We expect both sales and operating profit to increase YoY beginning in 3Q11.

Quarterly earnings (W bn, %)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11F	3Q11F	4Q11F
Sales	41.7	56.1	41.2	45.4	50.3	57.8	52.3	52.6
Golf simulator	33.8	48.3	32.0	34.8	35.8	40.7	31.1	30.9
Domestic	32.7	47.2	30.7	33.0	33.8	39.3	29.0	28.1
Overseas	1.1	1.1	1.3	1.8	2.0	1.4	2.1	2.8
Network services	2.9	2.5	2.9	3.2	6.6	8.4	12.2	12.4
Distribution	4.0	4.5	5.1	6.2	6.9	7.6	7.8	7.8
Others (direct management, ad, etc.)	0.9	0.7	1.1	1.2	1.0	1.1	1.3	1.6
COGS	17.6	22.7	19.6	21.9	27.9	24.8	23.1	21.1
Gross profit	24.1	33.3	21.6	23.5	22.4	33.0	29.3	31.4
SG&A	8.0	8.7	8.0	15.5	14.6	12.4	12.6	14.3
Labor	1.7	1.9	2.1	7.1	4.0	4.3	4.5	4.6
Marketing	1.9	1.6	1.2	1.6	6.0	2.5	2.5	3.0
Commissions paid	1.6	1.3	1.2	1.5	1.6	1.6	1.6	1.7
Others	2.8	4.0	3.4	5.2	3.0	4.0	4.0	5.0
Operating profit	16.1	24.6	13.6	8.0	7.8	20.5	16.6	17.2
EBT	17.7	27.2	15.7	9.9	10.4	24.0	20.6	20.4
Net profit	17.7	24.5	14.8	10.0	9.0	20.8	17.8	17.6
Sales growth (%)	110.2	27.6	6.5	48.0	20.7	3.0	27.1	15.8
OP growth (%)	150.3	4.6	(22.1)	70.1	(51.6)	(16.5)	22.3	115.0
NP growth (%)	122.0	6.8	(21.3)	158.6	(49.3)	(15.4)	20.4	76.1
GP margin (%)	57.8	59.5	52.4	51.7	44.6	57.1	55.9	59.8
OP margin (%)	38.6	43.9	33.0	17.6	15.5	35.6	31.8	32.7
NP margin (%)	42.6	43.8	36.0	22.1	17.9	36.0	34.1	33.5
Golf simulators sold, domestic	1,304	1,807	1,169	1,265	973	1,355	1,000	972
Golf simulators sold, overseas	37	47	52	81	92	52	80	106
Rounds played ('000)	7,458	6,580	7,945	8,470	10,899	9,076	11,000	12,091
Fee-paying rounds played ('000)	2,303	1,963	2,247	2,295	4,457	4,999	7,150	9,068
Golf simulator sales growth, domestic (%)	108.0	20.0	(9.2)	40.9	(25.4)	(25.0)	(14.5)	(23.2)
Golf simulator sales growth, overseas (%)	146.7	30.6	(11.9)	24.6	148.6	10.6	53.8	30.9
Growth in rounds played (%)	100.0	79.8	76.8	50.5	46.1	37.9	38.5	42.7
Growth in fee-paying rounds played (%)	183.7	89.7	78.5	52.3	93.5	154.6	218.2	295.2

Note: A YoY growth basis.
Source: Company data, Korea Investment & Securities

Net profit to jump 36% YoY in 2012F

2011F sales to rise 15.6% YoY

We peg the 2011F sales at W213.0bn, up 15.6% YoY, but operating profit at W62.2bn, down 0.2% YoY. Golf simulator sales should fall 7.1% YoY. In contrast, network service sales should grow 242% YoY as: 1) the number of rounds played increases 41.4% YoY to 43.07mn, and 2) the fee-paying round rate climbs 30.7%p YoY to 59.6%. We forecast 256.7mn rounds will be played for a fee, up a whopping 191.5% YoY in 2011F. Distribution sales should rise 51% YoY as consumer goods sales expand with a rising cumulative number of golf simulators sold and merchandise sales go up as well. The operating margin should fall 4.6%p YoY to 29.2% in 2011F due to a higher COGS-to-sales from the new model release, upgrades of existing products and greater marketing costs.

2012F sales and OP to grow 11.8% and 39.3%, respectively

In 2012F, sales and operating profit should grow 11.8% YoY and 39.3% YoY, respectively. Network service sales are set to increase 90.2% YoY to W75.2bn as the number of fee-paying rounds reaches 83% of total rounds played. More high-margin network service sales should drive up the operating margin 7.2%p YoY to 36.4%. Replacement demand is also expected to emerge. A premium 3R-model scheduled for release at end-2011 could generate sales (including sales from upgrade) of W16.5bn in 2012F and W39bn in 2013F. The 3R-model gives a more accurate golf trajectory and is installed with rough and bunker mats that enhance the customer's experience.

Annual earnings (W bn, %)

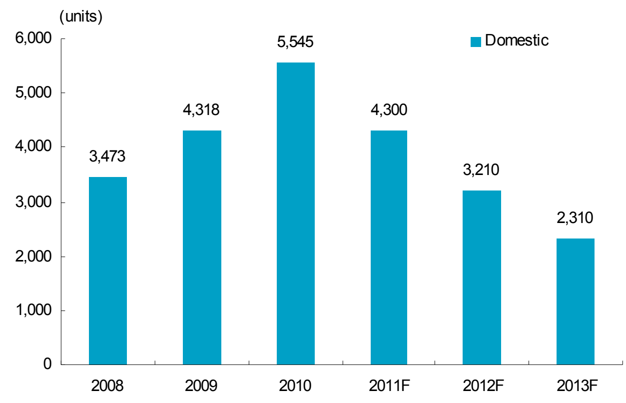
	2008	2009	2010	2011F	2012F	2013F
Sales	101.0	133.1	184.3	213.0	238.1	268.0
Golf simulator	92.8	114.4	149.0	138.4	116.2	119.7
Domestic	89.1	110.2	143.7	130.3	99.4	89.7
Overseas	3.6	4.2	5.3	8.2	16.8	30.0
Network services	2.8	6.5	11.6	39.5	75.2	90.5
Distribution	4.9	11.3	19.9	30.0	37.3	43.4
Others (direct management, ad, etc.)	0.5	0.9	3.9	5.0	9.4	14.5
COGS	39.2	55.0	81.8	96.9	92.5	104.5
Gross profit	61.8	78.1	102.5	116.1	145.6	163.5
SG&A	16.3	25.9	40.2	54.0	59.1	61.1
Labor	5.1	8.5	12.8	17.5	21.1	23.6
Marketing	5.7	7.7	6.2	14.0	13.0	10.0
Commissions paid	1.0	2.5	5.7	6.5	8.0	9.0
Others	4.4	7.3	15.4	16.0	17.0	18.5
Operating profit	45.5	52.1	62.3	62.2	86.6	102.4
EBT	44.3	55.6	70.6	75.4	103.3	123.6
Net profit	41.2	53.7	67.1	65.2	88.8	94.0
Sales growth (%)	221.0	31.8	38.5	15.6	11.8	12.6
OP growth (%)	255.5	14.5	19.5	(0.2)	39.3	18.3
NP growth (%)	260.9	30.3	25.0	(2.8)	36.2	5.8
GP margin (%)	61.2	58.7	55.6	54.5	61.2	61.0
OP margin (%)	45.1	39.2	33.8	29.2	36.4	38.2
NP margin (%)	40.8	40.3	36.4	30.6	37.3	35.1
Golf simulators sold, domestic	3,473	4,318	5,545	4,300	3,210	2,310
Golf simulators sold, overseas	171	175	217	330	600	1,000
Rounds played ('000)	7,437	17,512	30,454	43,066	52,442	59,204
Fee-paying rounds played ('000)	2,561	5,863	8,808	25,674	43,540	52,390
Golf simulator sales growth, domestic (%)	201.5	24.3	28.4	(22.5)	(25.3)	(28.0)
Golf simulator sales growth, overseas (%)	NM	2.3	24.0	52.1	81.8	66.7
Growth in rounds played (%)	403.1	135.5	73.9	41.4	21.8	12.9
Growth in fee-paying rounds played (%)	NM	128.9	50.2	191.5	69.6	20.3

Note: A YoY growth basis.
Source: Company data, Korea Investment & Securities

Golfzon entitled to a 50% tax credit in 2011-2012 that will phase out in 2013

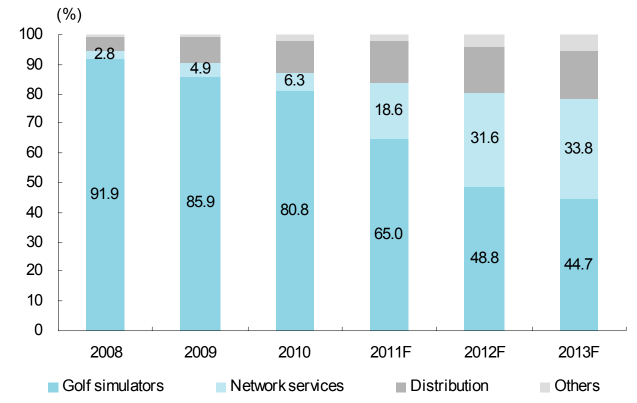
Golfzon has enjoyed tax breaks as a high-tech company headquartered in the Daedeok R&D special district. But the tax credit will drop to 50% for two years starting in 2011. Accordingly, the effective tax rate for Golfzon is lifted from 4-5% during 2008-2010 to 13-14% beginning in 2011. The effective tax rate will climb to a normal 24% in 2013 when the tax credit is phased out.

Domestic golf simulator sales by year



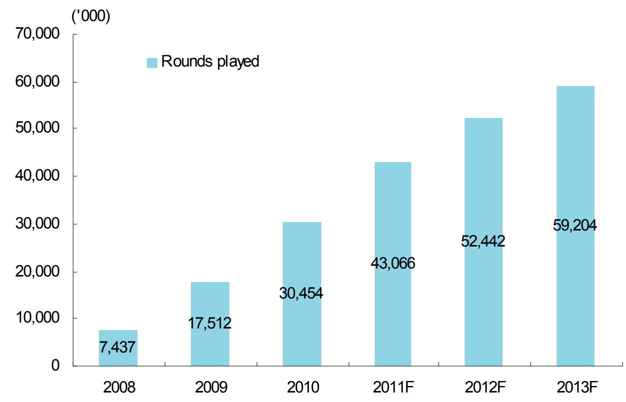
Source: Company data, Korea Investment & Securities

Sales breakdown by year



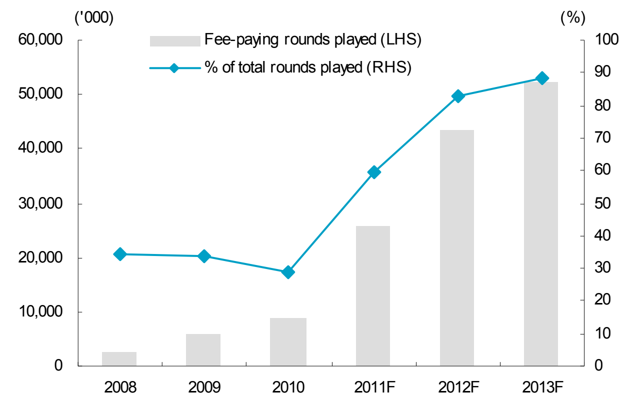
Source: Company data, Korea Investment & Securities

Rounds played by year



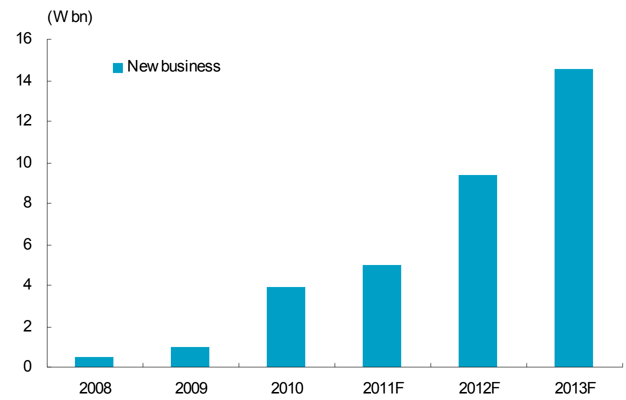
Source: Company data, Korea Investment & Securities

Fee-paying rounds played by quarter



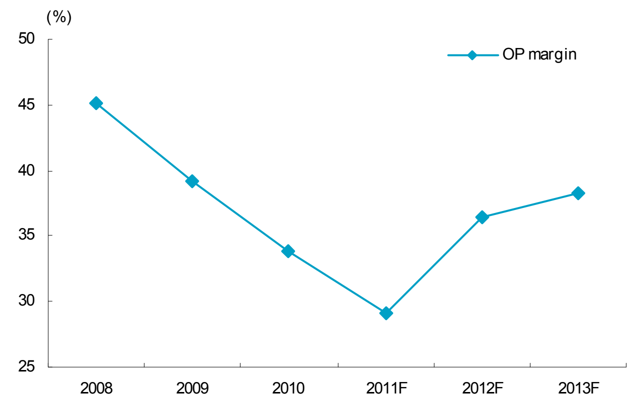
Source: Company data, Korea Investment & Securities

Sales from new business



Source: Company data, Korea Investment & Securities

OP margin by year



Source: Company data, Korea Investment & Securities

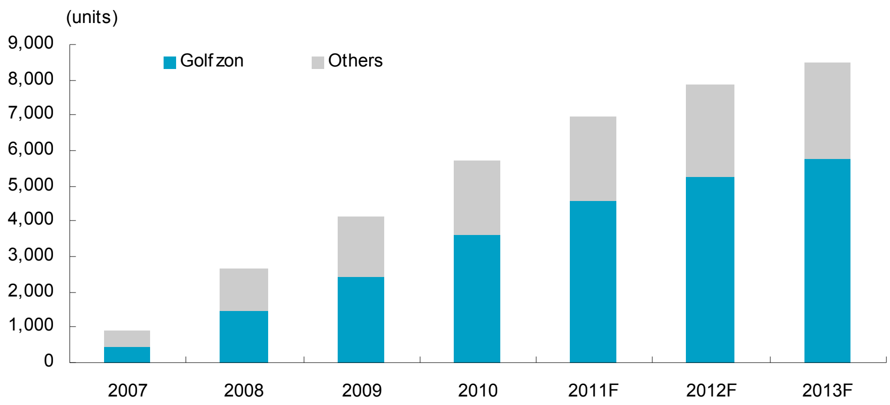
III. Key issues

1. Golf cafés not yet saturated

Strong demand for new golf cafés and simulator replacement

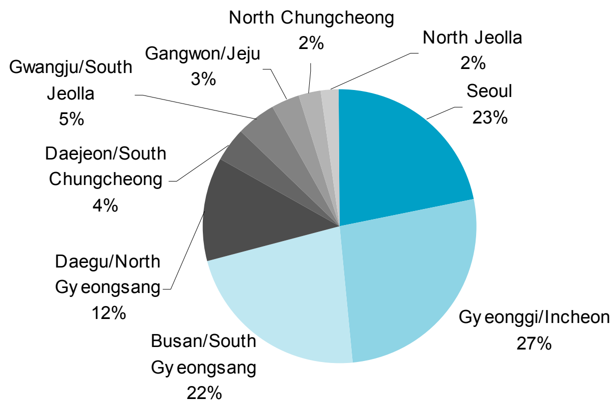
Since its establishment in May 2000, Golfzon has sold roughly 15,500 simulators to approximately 3,500 golf cafés by end-2010. The number of golf cafés is estimated at 5,700 nationwide as of end-2010. Among the 1,500 cafés that opened in 2010, Golfzon commanded more than an 80% share. We expect 935 golf cafés to open in 2011. Although the figure is down 22.9% from 2010, there is still robust demand for new golf cafés in Korea. It is estimated that roughly 500 golf cafés opened in 1H11 and were equipped with 2,300 simulators. Some golf cafés have switched all or a portion of their simulators to Golfzon's products.

Golf cafés



Source: Company data, Korea Investment & Securities

Distribution of golf cafés by region (end-2010, equipped with Golfzon's products)



Source: Company data, Korea Investment & Securities

Short payback period of 2.5 years appeals to new entrants

One of the reasons behind the brisk openings is the short payback period (meaning big profitability for operators). Renting a site spanning 297m² and installing five simulators can cost W300mn (excl. rental deposit). If assuming monthly revenue of W10mn, the payback period would be 2.5 years. The per-player "green" fee for 18 holes is W18,000-25,000 for the N-model simulator and W20,000-30,000 for the new R-model, with an additional per-player charge of W2,000 for fee-paying courses. Food and beverages sales are another source of revenue.

Profitability analysis

Golf café opening costs (W'000)

	Number	Unit cost	Amount	Details
Purchase of golf simulators	5	40,000	200,000	New models
Interior construction	231m²	1,000	70,000	
Consumer electronics and necessary items			20,000	Air conditioners, heaters, golf clubs
Outer construction, permit costs			10,000	
Total			300,000	

Revenue and cost (W'000, time)

		Number	Unit cost	Amount	Details
Revenue	Fees for rounds	1,050	20	21,000	Five simulators x seven rounds per day x 30 days
	Food & beverages sales	1,050	2	2,100	
Total				23,100	
Cost	Rental	297m²	500	4,500	
	Administration			2,000	Commercial arcade administration, electricity fee
	Food & beverages			840	Cost ratio 40%
	Consumables			500	Including mats (for maintenance purposes)
	Staff	2	1,500	3,000	1 full-time and 1 part-time
Total				10,340	
Revenue-cost				12,760	
Corporate tax				2,552	Tax rate 20%
Net profit after tax				**10,208**	
Payback period (month)				**29.4**	**2.5 years**

Note: Excluding rental deposit (estimated at W100mn).
Source: Company data, Korea Investment & Securities

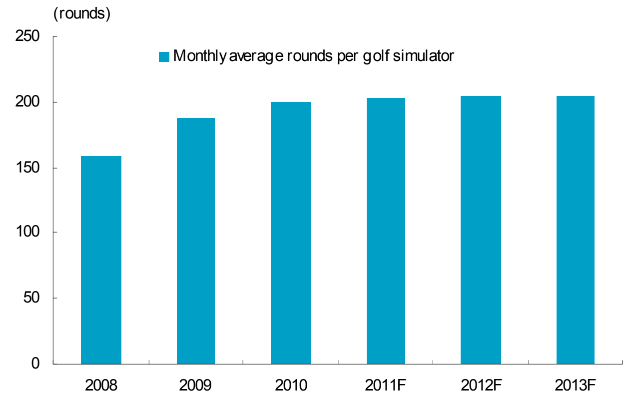
Number of rounds exceeded 30mn in 2010, up 73.9% YoY

Golf cafés generate fat margins thanks to the growing number of rounds played. The number of rounds played was 30.45mn in 2010, up 73.9% YoY. Such a gain outstrips the increase in the number of simulators installed as the annual average number of rounds per simulator is rising. If we divide the number of rounds by simulators (average 12,728), the annual average number of rounds per simulator is 2,393. As the number of rounds played on Golfzon's simulators is roughly 10,000 per year, we peg the daily average round per golf café at 30 and per golf simulator at seven (assuming every golf café has 4.5 simulators on average). If three people play together, there would be 2.3 rounds a day per simulator. As it takes about three to four hours for three golfers to play a round of 18 holes, every simulator is occupied for about half the 15-hour operating time (golf cafés usually open at 11 a.m. and close at 2 a.m.).

Virtual golf spreading like wildfire

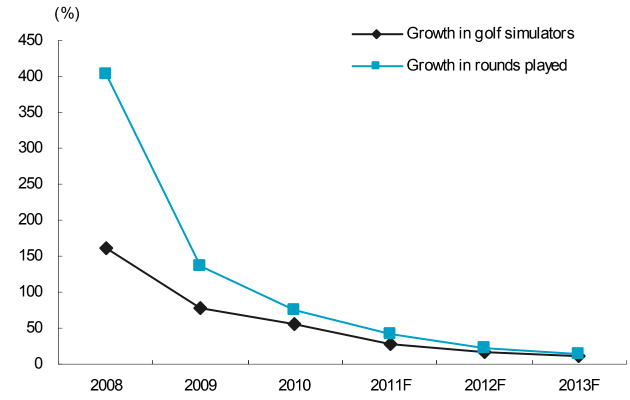
Virtual golf has become a fast-growing pastime as it takes less time and money than playing at the country club. Golfzon is employing diverse marketing strategies by organizing virtual golf tournaments and wide-ranging events. The company plans to promote virtual golf as an e-sport by organizing tournaments for KPGA and KNPGA players with the upcoming release of the premium 3R. The new model has 99% accuracy recognizing balls hit by players.

Monthly average rounds played on Golfzon's simulators



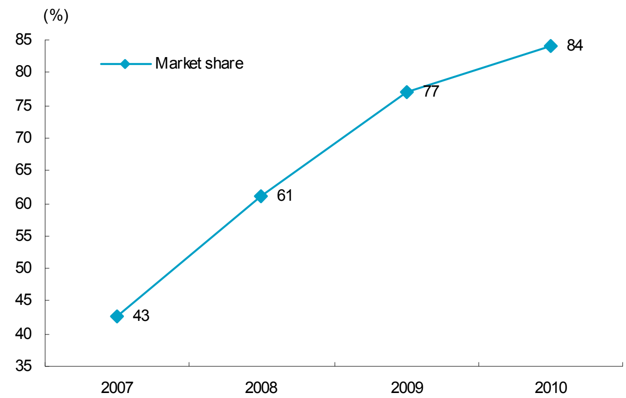
Note: A round of three players is calculated as three rounds.
Source: Company data, Korea Investment & Securities

Growth in simulators and rounds played



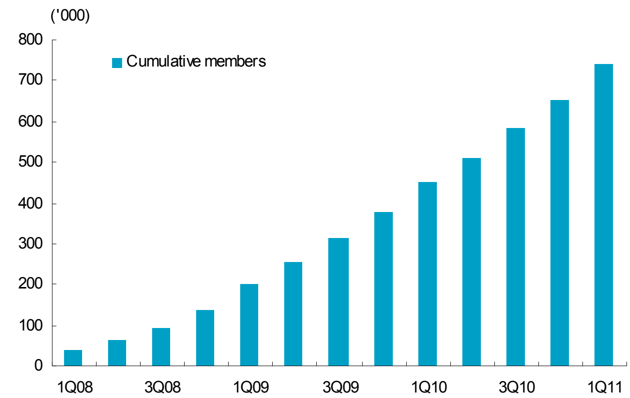
Source: Company data, Korea Investment & Securities

Golfzon's market share (new golf cafés)



Source: Company data, Korea Investment & Securities

Cumulative golfzon.com members



Source: Company data, Korea Investment & Securities

2. Rounds played keep increasing as more people enjoy virtual golf

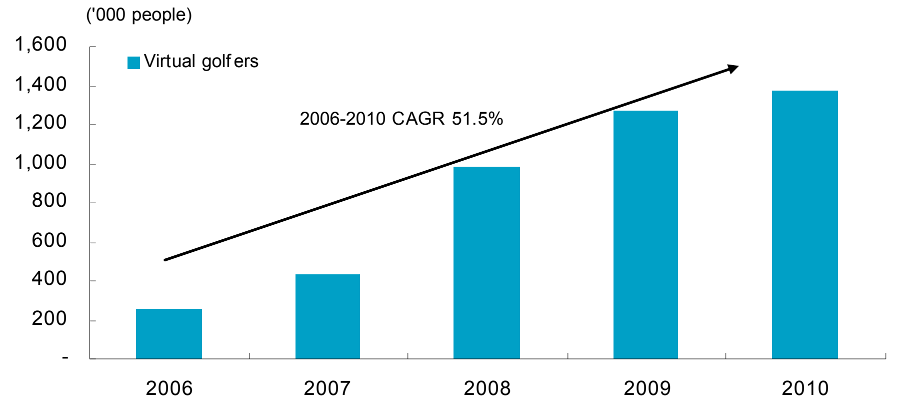
Network service sales to grow 242% in 2011F and 90% in 2012F

Network service sales should expand 242% YoY to W39.5bn in 2011F and 90.2% YoY to W75.2bn in 2012F. We see two drivers for the gains. First, the number of rounds played should increase 41.4% YoY to 43.07mn in 2011F and 21.8% YoY to 52.44mn in 2012F. Second, playing on fee-paying courses should represent 59.6% and 83% of the total in 2011F and 2012F, respectively, up from 28.9% in 2010. This is backed by the N-model being upgraded to the R-model and exclusive sales of the R-model of late, which does not offer a free course.

Fee-paying round rate to reach 75% at end-2011F and 86% at end-2012F

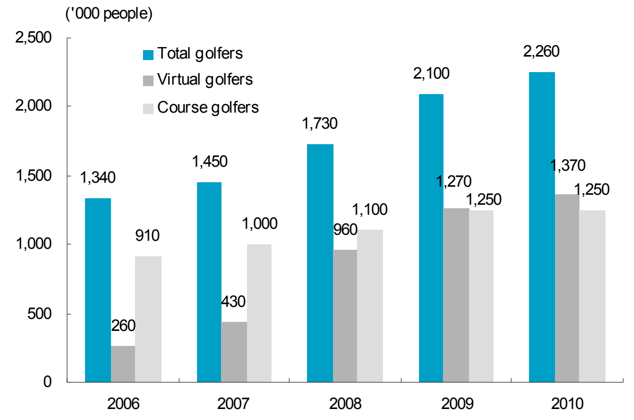
Fee-paying rounds are estimated at 40.9% of the total in 1Q11F and 55.1% in 2Q11F. The figure is less than expected and is particularly so considering the R-model that offers only fee-paying courses represented 80% of its simulators in the market at end-June. Upgrades from the N-model to R-model have been completed for 12,000 simulators out of 15,500 sold until end-2010. But playing on the fee-paying courses has been less than anticipated as users are reluctant to play on the pay courses and free courses are still available on the upgraded N-model. Nonetheless, we are upbeat as most of the simulators have been replaced with the R-model and users are getting accustomed to it. In addition, Golfzon has started promotions such as gifts offered only to R-model players. We expect the fee-paying round rate to reach 75% in 4Q11 and 86% in 4Q12F.

Virtual golfers



Source: Company data

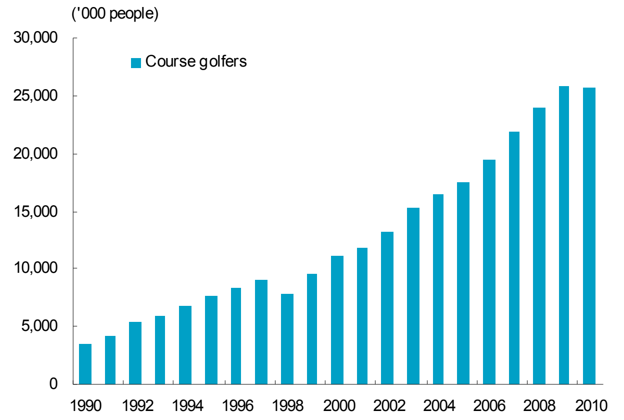
Korea's golfing population



Note: 2006-2009 data based on Gallop and 2010 data based on Korea research

Source: Gallop, Korea research, Company data

Course golfers



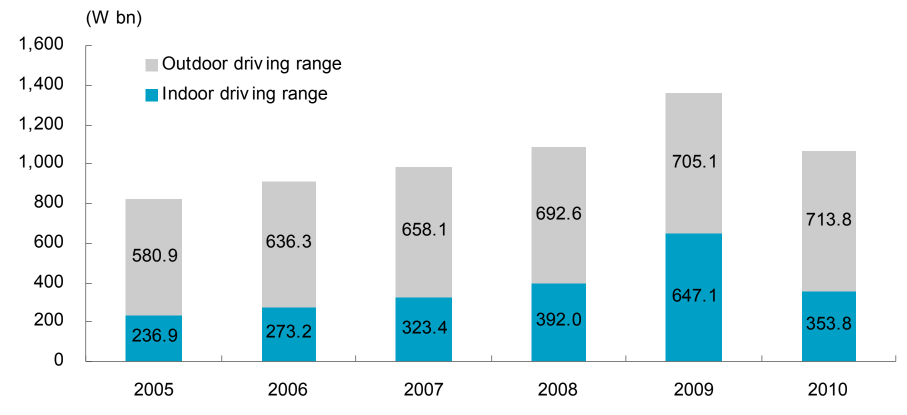
Source: Korea Golf Course Business Association, Leisure White Book 2011

3. New businesses: GDR, G-Tour and online golf game

Aims to open 30 GDRs by 2012

Golfzon started its academy business by opening its first Golfzon Driving Range (GDR, an academy specializing in simulation and instruction) in Samsung-dong on Jun 1. The company plans to open five GDRs in 2011 and expand operations to 30 in 2012. Golfzon has set the business' monthly sales target at W50mn. GDR's monthly membership is W200,000, which is between the fees at indoor and outdoor driving ranges. Members can receive private lessons from professional instructors who are available full-time. Services also include video playback that lets golfers analyze their swing. We think Golfzon will open 10 GDRs before end-2012 and estimate sales to reach W3.4bn in 2012F. Golfzon plans to operate another business called G-Tour, which is a virtual tournament with online rankings. The company will rent a building in Bundang (located south of Seoul) and install 30 simulators, along with a television studio to record and broadcast tournaments. Golfzon is also developing an online golf game set to launch in 2013.

Driving range market size



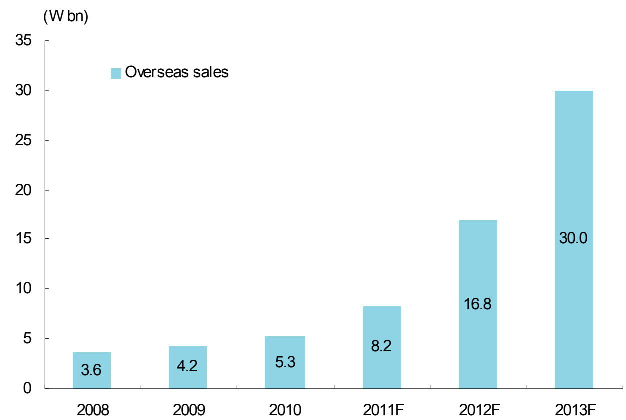
Note: 1. Data post-2009 exclude sales for virtual driving ranges.
2. Market size based on sales.
Source: Leisure Market Report 2011

4. Overseas potential – particularly in China

Overseas sales to reach W8.2bn in 2011F and W16.8bn in 2012F

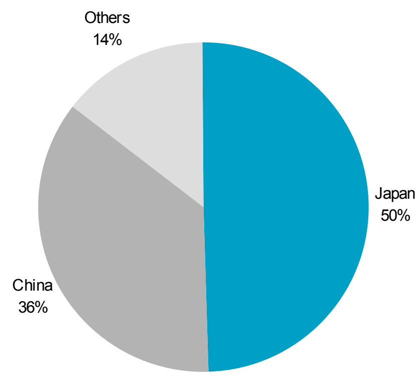
From 2008 to 2010, Golfzon sold 563 simulators overseas, which generated sales of W13.2bn over the three-year span. We forecast overseas sales to reach W8.2bn in 2011F and W16.8bn in 2012F. Until now, Golfzon mostly shipped its simulators to Japan and China. It set up a branch in Japan in 2009 and operates its own golf cafés in Tokyo and Osaka. In Jun 2011, Golfzon established a subsidiary in China and is trying form a JV with a local partner. In May 2011, the company hosted a seminar for entrepreneurs in Canada to introduce its simulator system. Golfzon has supplied golf simulators for two golf cafés in Canada and plans to open five of its own in 2011. Given that golf is widely popular in Canada but its long winter shortens the time Canadians can enjoy playing outdoors, Golfzon believes there is plenty of demand there.

Overseas sales



Source: Company data, Korea Investment & Securities

Overseas sales during 2008-2010 by region (based on simulators sold)



Source: Company data, Korea Investment & Securities

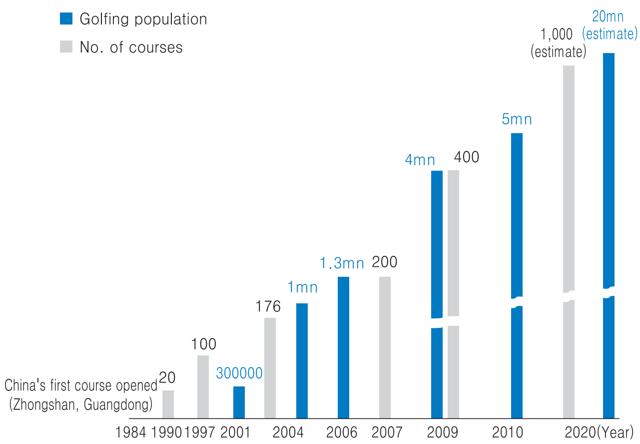
Golf has yet to gain popularity in China and courses are concentrated in sporadic regions but…

We believe Golfzon's growth will depend on how it performs in China over the mid to long-term. As of 2010, there are approximately 5mn Chinese who play golf, which is up 25% YoY, and there are currently about 500 courses in the country. China's golfing population and courses should respectively grow to 20mn and 1,000 by 2020. However, golf's growth in China still faces numerous obstacles. 1) It is not a popular sport and not fully accepted socially. 2) There is a ban that limits the number of courses as the government does not promote the sport. 3) Civil servants are implicitly prohibited from playing. 4) Green fees are not cheaper than in Korea because of heavy taxes. 5) Courses are concentrated in sporadic regions such as Guangdong province.

… golfing population is soaring; Company plans to new attract golfers through GDRs

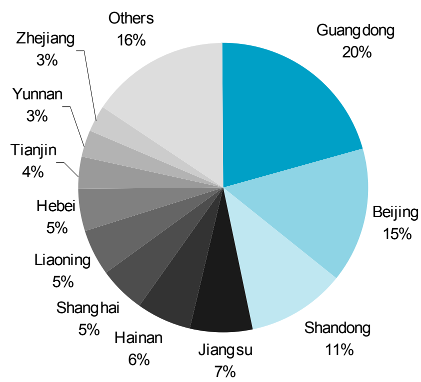
Nevertheless, Golfzon plans to take its GDR business to China as there is a lack of indoor and outdoor driving ranges where people can learn and practice the sport and China's golfing population is ready to explode. Until now, golf cafés focused their business on employees of Korean companies in China or Korean residents but from now on, the company's strategy is to target the local population by opening its own golf cafés. As it is difficult for a foreign company to directly provide online services in China, Golfzon plans to form a JV with a solid local company to open its own golf cafés in areas such as Shanghai.

China's golfing population and courses



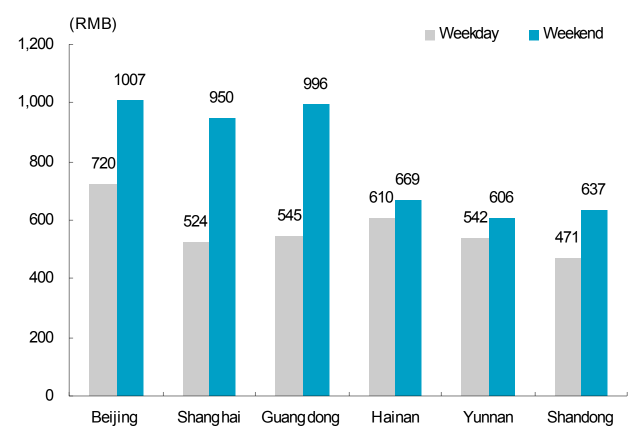
Source: China Golf Association, news articles

China's golf course distribution by city



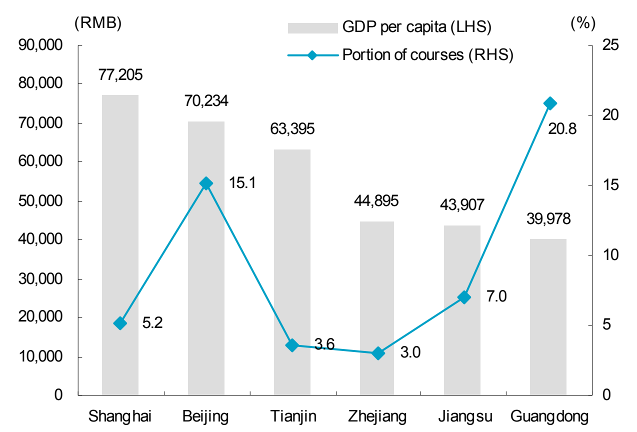
Note: As of 2009.
Source: National Golf Foundation

Avg. amount spent per round by city



Source: National Golf Foundation

GDP per capita and golf course presence by city



Source: National Golf Foundation

IV. Company overview

Golf simulator maker and services provider since 2000

Has 84% domestic market share as of 2010

Golfzon develops and sells simulator hardware and software. It also distributes golf equipment and provides online services. The company was established in May 2000 and holds 84% of Korea's golf simulator market (based on new simulators) as of 2010. Golfzon boasts cutting-edge technologies as 174 of its 372 workers are stationed at the R&D division as of May 2011. Golfzon uses its network services to deliver a retail management system to golf café owners and varied content to users, which makes the company very appealing among golf café entrepreneurs. Golfzon sells simulators through its four exclusive distributors scattered throughout Korea. Its subsidiaries include Golfzon Network (product installation, after-sale service and customer support), Golfzon Japan and Golfzon China. Major shareholders are co-CEOs Kim Won-il (44.6% stake) and Kim Young-chan (16.1%).

Golfzon's businesses

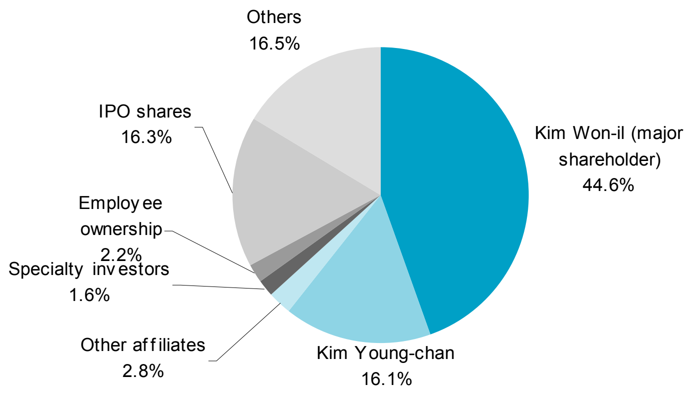
Type	Description
Golf simulator	Develops and sells software and hardware used in simulators
Network service	Golfzon Live (provides varied content and events for all Golfzon cafés in Korea connected by network)
Internet service	Provides user database at golfzon.com and golfers can check their swing and receive various services including information on courses
Distribution	1) B2B: Sells simulator supplies and equipment to golf café owners
	2) B2C: Sells golf equipment on its website
Others	1) Golf café business: Operates its own golf cafés
	2) Advertising/partnership: Forms partnerships to provide ads on simulators or golfzon.com

Source: Company data, Korea Investment & Securities

Golfzon's simulator

Source: Company data

Shareholders (post-IPO)



Source: Financial Supervisory Service's DART, Korea Investment & Securities

Balance Sheet

Fiscal year ending Dec. (W bn)	2009A	2010A	2011F	2012F	2013F
Current assets	67	135	367	455	548
Cash & cash equivalent	8	38	268	355	446
Accounts receivable	4	5	6	6	7
Inventory	1	2	2	3	3
Fixed assets	31	47	51	54	58
Investments	12	25	26	27	28
Tangible assets	9	10	11	12	13
Intangible assets	1	5	5	6	7
Total assets	98	182	418	509	606
Current liabilities	11	19	21	22	25
Accounts payable	2	4	5	5	6
Short-term borrowings	0	0	0	0	0
Current portion of LT debt	0	0	0	0	0
Long-term debt	3	3	4	4	5
Debentures	0	0	0	0	0
Long-term borrowings	0	0	0	0	0
Total liabilities	14	22	25	27	30
Paid-in capital	5	5	6	6	6
Capital surplus	0	9	176	176	176
Capital adjustments	(25)	(0)	(0)	(0)	(0)
Retained earnings	104	146	211	300	394
Shareholders' equity	84	160	393	482	576

Income Statement

Fiscal year ending Dec. (W bn)	2009A	2010A	2011F	2012F	2013F
Sales	133	184	213	238	268
Gross profit	78	102	116	146	164
SG&A expenses	26	40	54	59	61
Operating profit	52	62	62	87	102
Non-op. profit	6	13	16	21	26
Interest income	2	3	7	12	17
FX gains	0	0	0	0	0
Equity gains	1	3	4	5	5
Non-op. expenses	3	5	3	4	5
Interest expenses	0	0	0	0	0
FX losses	0	0	0	0	0
Equity losses	1	0	1	2	3
Earnings before tax	56	71	75	103	124
Income taxes	2	3	10	14	30
Profit from discontinued op.	0	0	0	0	0
Net profit	54	67	65	89	94
EBITDA	53	65	66	91	107

Cash Flow

Fiscal year ending Dec. (W bn)	2009A	2010A	2011F	2012F	2013F
C/F from operations	57	67	63	88	95
Net profits	54	67	65	89	94
Depreciation	1	2	2	3	3
Amortization	0	1	1	2	2
Net incr. in W/C	2	2	1	1	1
Others	(1)	(6)	(7)	(6)	(5)
C/F from investing	(35)	(46)	(1)	(2)	(4)
Capex	(4)	(3)	(3)	(4)	(4)
Decr. in fixed assets	0	0	0	0	0
Net incr. in current assets	(19)	(30)	0	0	0
Incr. in investment	(5)	(11)	6	5	4
Others	(7)	(2)	(3)	(3)	(4)
C/F from financing	(28)	9	168	0	0
Incr. in equity	0	9	168	0	0
Incr. in debt	0	0	0	0	0
Dividends	(3)	0	0	0	0
Others	(25)	0	0	0	0
Increase in cash	(6)	29	231	86	91

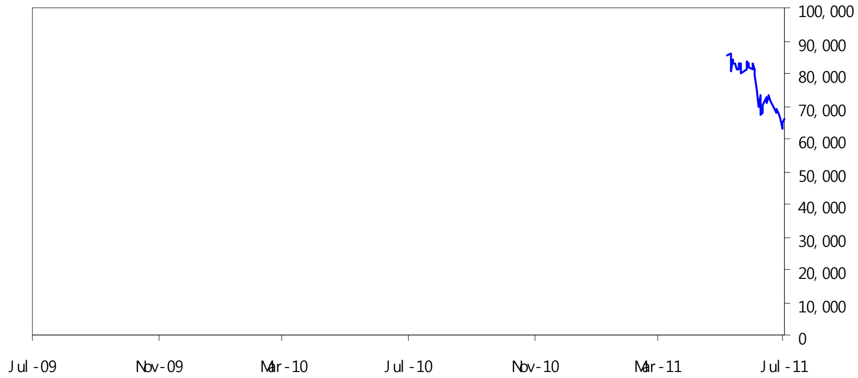
Note: Based on K-GAAP (non-consolidated)

Key Financial Data

Fiscal year ending Dec.	2009A	2010A	2011F	2012F	2013F
Per-share data (won)					
EPS	5,210	6,593	5,596	7,233	7,651
BPS	8,195	15,133	31,599	38,782	46,371
DPS	0	0	0	0	0
SPS	2,475	18,107	18,269	19,385	21,820
Growth (%)					
Sales growth	31.8	38.5	15.6	11.8	12.6
OP growth	14.5	19.5	(0.2)	39.3	18.3
NP growth	30.3	25.0	(2.8)	36.2	5.8
EPS growth	(75.4)	26.5	(15.1)	29.3	5.8
EBITDA growth	14.6	22.3	1.1	37.8	18.0
Profitability (%)					
OP margin	39.2	33.8	29.2	36.4	38.2
NP margin	40.3	36.4	30.6	37.3	35.1
EBITDA margin	40.1	35.4	31.0	38.2	40.0
ROA	63.0	47.8	21.7	19.2	16.9
ROE	75.0	54.9	23.6	20.3	17.8
Dividend yield	NM	NM	0.0	0.0	0.0
Stability					
Net debt (W bn)	(61)	(127)	(358)	(444)	(536)
Int. coverage (x)	240,203.2	NM	NM	NM	NM
D/E ratio (%)	0.0	0.0	0.0	0.0	0.0
Valuation (x)					
PER	NM	NM	11.8	9.1	8.6
PBR	NM	NM	2.1	1.7	1.4
PSR	NM	NM	3.6	3.4	3.0
EV/EBITDA	NM	NM	6.9	4.0	2.6

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Golfzon (121440)	07-15-11	BUY	W90,000



■ **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

■ **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**

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