

Loen Entertainment (016170)

12M rating **BUY (Maintain)**
12M TP **W19,600** from W19,600
Up/downside **+43%**

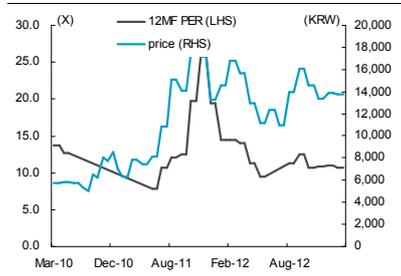
Stock Data

KOSPI (Jan 2, pt)	2,031
Stock price (Jan 2, KRW)	13,750
Market cap (USD mn)	327
Shares outstanding (mn)	25
52-Week high/low (KRW)	17,550/10,000
6M avg. daily turnover (USD mn)	3.7
Free float / Foreign ownership (%)	32.4/9.0
Major shareholders (%)	
SK Planet Co.,Ltd. and 2 others	67.6
RealNetworks Inc	9.8

Performance

	1M	6M	12M
Absolute (%)	3.0	9.6	4.6
Relative to KOSPI (%p)	(2.1)	(0.1)	(6.6)

12MF PER trend



Source: WISEfn consensus

Music price hikes, a catalyst for greater B2C sales

Shares to rise on greater music prices, subscribers and production

Loen Entertainment (Loen) shares fell to W11,600 at end-Dec 2012, but have recovered to the mid-W13,000 range with the announcement of a price hike for streaming services. Loen's new rate plan took effect on Jan 1, 2013. Although rates have gone up, total subscribers should increase 3% YoY in 2013F thanks to greater streaming subscribers. We believe shares will rise gradually as growing subscribers and average revenue per user (ARPU), expanding platform and music distribution businesses and greater investment in content production should bolster Loen's competitiveness. We maintain BUY and a TP of W19,600, which equals 16.7x PE (two-year trailing average, 12MF EPS).

Despite price hikes, subscriber additions will not shrink

With the higher pricing plan, the monthly price for a 40-track bundled package (downloads and unlimited streaming) has risen from W7,000 to W10,000, up 42.9%. The price for a 150-track bundled product also increased 50% (see table 6). Despite the hikes, joint marketing with SKT and the spread of smartphones (including LTE) should lead to a 2.9% YoY growth in Melon subscribers in 2013 and 12.4% YoY increase in 2014. Lower-than-nominal ARPU growth and a wider age range of music consumers should accelerate subscriber additions. We forecast actual ARPU growth from Melon subscribers to be lower than the nominal increase. 1) There is a 30-50% discount for SKT subscribers who buy Melon services (SKT subscribers account for more than 50% of Melon's flat-rate service users), and 2) average product prices should fall on Loen's product diversification efforts to ease resistance to higher music prices. There were only 40 and 150-track products for MP3 downloads and bundled packages, but with the price hikes, the product mix has expanded to include three more options (30 to 150 tracks). Competition is intensifying between platform operators, and promotion capability should play a more important role in attracting subscribers after the price hikes. Given SKT's membership discounts for Melon subscribers, Loen's subscriber share will not likely shrink.

2013F B2C sales to rise 17% YoY

Eventual expansion of the digital music market, following the price increase, will be crucial for music-related companies, such as platform operators and content producers. While some worry that customer resistance to the price increase could shrink the market, we expect potential ARPU growth to outpace any subscriber decline. We forecast B2C (Melon) sales will jump 16.5% YoY in 2013F and 33.9% YoY in 2014F thanks to higher digital music prices and more subscribers.

Shiwoo Kim
822-3276-6240
swkim@truefriend.com

Dongyeon Lee
822-3276-6276
dongyeon@truefriend.com

Yr to	Sales	OP	EBT	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2010A	139	7	10	11	467	140.8	15	18.3	9.9	2.6	16.2
2011A	167	27	28	21	882	88.8	36	15.1	7.6	3.1	23.7
2012F	188	30	32	24	964	9.2	43	14.4	6.6	2.7	20.5
2013F	215	35	37	28	1,108	15.0	49	12.4	5.5	2.3	20.0
2014F	275	44	47	36	1,416	27.8	61	9.7	4.0	1.9	21.4

Earnings outlook “cloudy” for short-term, but “sunny” for 2013

4Q12 profitability should be on par YoY. While Melon sales should post W50.4bn (+7.7% YoY), OP should grow a mere 3.5% YoY to W5.8bn. As more people subscribe to Melon’s flat-rate services, content sales should add 14.4% and drive total sales growth. But increased promotions and marketing expenses to secure subscribers before the music price hikes should limit OP growth. Higher music prices effective from Jan 1 and steady subscriber growth should expand B2C sales, and B2B sales should also increase as the market grows. As such, we expect Loen’s 2013F sales to increase 14.6% YoY and OP 14.7% YoY. The content production business looks also promising, given the reinforced artist line-up and investment expansion. The planned comeback of IU who accounts for the majority of Loen’s production sales is encouraging as well.

Table 1. Quarterly earnings trend

(W bn)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12F
Sales	34.6	42.7	43.1	46.8	44.0	46.0	47.1	50.4
Product	1.3	3.0	2.8	4.6	2.2	3.2	2.4	3.9
Merchandise	0.3	0.4	0.6	0.5	0.7	1.1	1.1	0.4
Contents	32.1	37.3	37.9	39.3	39.3	38.7	38.6	45.0
Others	0.9	2.0	1.7	2.4	1.9	2.9	5.0	1.1
OP expenses	27.6	33.9	38.0	41.2	35.9	37.7	39.0	44.6
OP	6.9	8.8	5.2	5.6	8.1	8.3	8.1	5.8
EBT	7.5	9.2	5.7	6.1	9.0	9.0	8.9	5.0
NP	5.4	6.8	4.3	4.9	7.0	6.3	6.7	4.4
(%, YoY)								
Sales growth					27.3	7.6	9.3	7.7
OP growth					17.3	(5.9)	56.0	3.5
NP growth					29.3	(7.8)	55.1	(9.5)
(%, QoQ)								
Sales growth		23.7	0.9	8.5	(6.0)	4.5	2.5	6.9
OP growth		27.4	(41.2)	8.2	44.6	2.2	(2.5)	(28.2)
NP growth		25.5	(36.3)	13.2	43.0	(10.5)	7.1	(33.9)

Source: Company data, Korea Investment & Securities

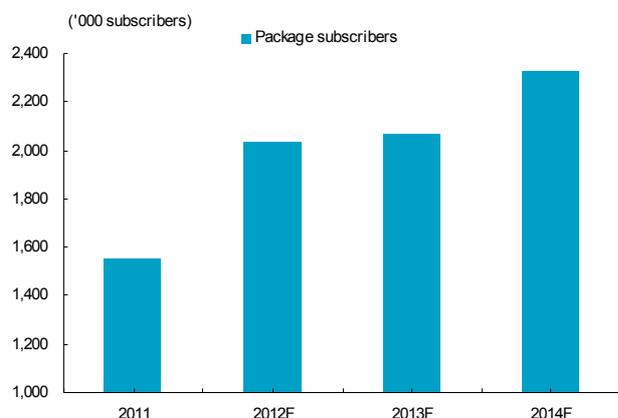
Table 2. Annual earnings trend

(W bn)

	2008	2009	2010	2011	2012F	2013F	2014F
Sales	30.8	101.4	139.1	167.3	187.5	214.8	275.1
Product	7.1	4.9	6.9	11.7	11.7	12.5	12.7
Merchandise	3.3	2.0	0.5	1.7	3.3	3.7	3.8
Contents	18.2	94.1	129.4	146.7	161.6	188.4	247.8
Others	0.7	0.4	2.3	7.1	10.9	10.2	10.8
OP expenses	30.5	95.1	132.1	140.7	157.2	180.0	230.7
OP	0.3	6.4	7.0	26.6	30.3	34.8	44.4
EBT	2.1	6.3	9.7	28.4	31.9	36.7	47.1
NP	1.3	4.5	10.8	21.4	24.4	28.0	35.8
(%, YoY)							
Sales growth		(10.1)	229.3	37.1	20.3	12.1	14.6
OP growth		(107.6)	2,057.0	9.9	279.9	14.2	14.7
NP growth		(120.1)	253.2	140.2	97.3	13.9	15.0
(%, margin)							
OP margin		1.0	6.3	5.0	15.9	16.2	16.2
NP margin		4.1	4.5	7.8	12.8	13.0	13.0

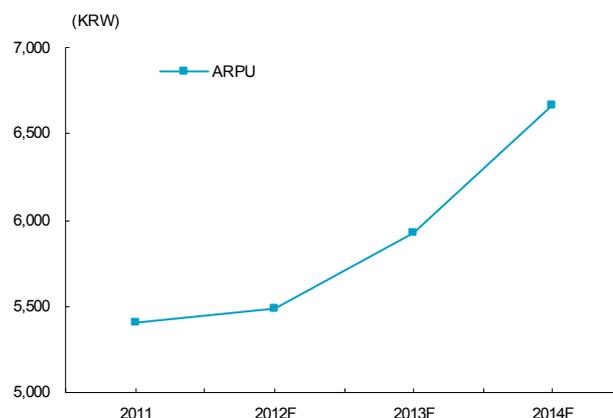
Source: Company data, Korea Investment & Securities

Figure 1. Melon flat-rate subscribers forecast



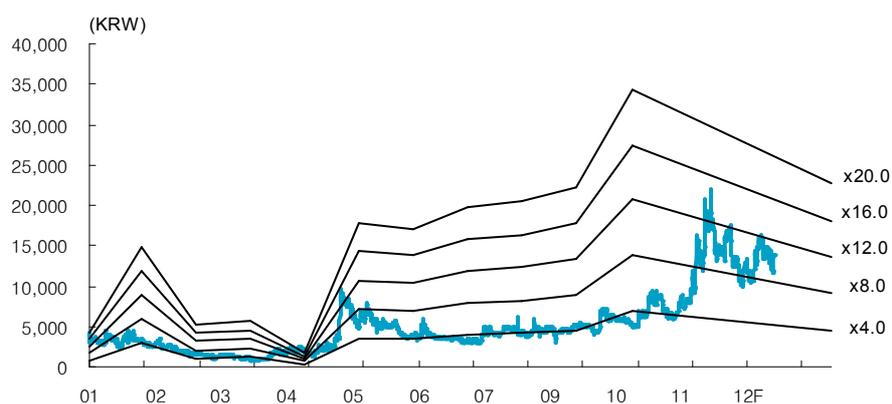
Source: Company data, Korea Investment & Securities

Figure 2. Melon ARPU forecast



Source: Company data, Korea Investment & Securities

Figure 3. 12MF PE band chart



Source: Korea Investment & Securities

Table 3. Previous service types and monthly rates for Melon's major products

Product	Service type	Monthly rate (KRW)
Streaming club	Unlimited streaming	3,000
Free club	DCF unlimited download + unlimited streaming	4,500
MP3 40	Download	5,000
MP3 40 plus	40 downloads + unlimited streaming	7,000
MP3 150	150 downloads	9,000
MP3 150 plus	150 downloads + unlimited streaming	11,000

Note: DCF is a downloaded file via Melon with digital rights management (DRM) applied

Source: Company data, Korea Investment & Securities

Table 4. Revised service types and monthly rates for Melon's major products

Type	Details		Rate (KRW)	Remarks	
MP3 download + unlimited streaming	30 downloads + unlimited streaming	Regular members	9,000	Monthly payment	
		50% discount for SKT members	4,500	Monthly payment	
		Passes (for purchase or gifts)	9,500	30-day pass	
	40 downloads + unlimited streaming	Regular members	10,000	Monthly payment	
		50% discount for SKT members	5,000	Monthly payment	
		Passes (for purchase or gifts)	10,500	30-day pass	
	50 downloads + unlimited streaming	Regular members	11,000	Monthly payment	
		50% discount for SKT members	5,500	Monthly payment	
		Passes (for purchase or gifts)	11,500	30-day pass	
	100 downloads + unlimited streaming	Regular members	13,000	Monthly payment	
		50% discount for SKT members	6,500	Monthly payment	
		Passes (for purchase or gifts)	13,500	30-day pass	
150 downloads + unlimited streaming	Regular members	16,500	Monthly payment		
	50% discount for SKT members	8,250	Monthly payment		
	Passes (for purchase or gifts)	17,000	30-day pass		
DRM download + unlimited streaming	Unlimited mobile download + unlimited streaming (Allows simultaneous use of unlimited streaming on PCs and smartphones)	Regular members	8,000	Monthly payment	
		50% discount for SKT members	5,600	Monthly payment	
		Passes (for purchase or gifts)	8,500	30-day pass	
	Unlimited mobile download + unlimited mobile streaming	Regular members	7,500	Monthly payment	
		50% discount for SKT members	5,250	Monthly payment	
		Passes (for purchase or gifts)	8,000	30-day pass	
	100 downloads + unlimited mobile streaming	Regular members	7,000	Monthly payment	
		Passes (for purchase or gifts)	7,500	30-day pass	
	200 downloads + unlimited mobile streaming	Regular members	9,000	Monthly payment	
		Passes (for purchase or gifts)	9,500	30-day pass	
	Unlimited streaming	Unlimited streaming (Allows simultaneous use of unlimited streaming on PCs and smartphones)	Regular members	6,000	Monthly payment
			50% discount for SKT members	4,200	Monthly payment
Passes (for purchase or gifts)			6,500	30-day pass	
Unlimited mobile streaming		Regular members	5,000	Monthly payment	
		50% discount for SKT members	3,500	Monthly payment	
		Passes (for purchase or gifts)	5,500	30-day pass	
MP3 downloads	30 downloads	Regular members	6,000	Monthly payment	
		50% discount for SKT members	3,000	Monthly payment	
		Passes (for purchase or gifts)	6,500	30-day pass	
	40 downloads	Regular members	7,000	Monthly payment	
		50% discount for SKT members	3,500	Monthly payment	
		Passes (for purchase or gifts)	7,500	30-day pass	
	50 downloads	Regular members	8,000	Monthly payment	
		50% discount for SKT members	4,000	Monthly payment	
		Passes (for purchase or gifts)	8,500	30-day pass	
	100 downloads	Regular members	10,000	Monthly payment	
		50% discount for SKT members	5,000	Monthly payment	
		Passes (for purchase or gifts)	10,500	30-day pass	
150 downloads	Regular members	13,500	Monthly payment		
	50% discount for SKT members	6,750	Monthly payment		
	Passes (for purchase or gifts)	14,000	30-day pass		
Single downloads	Single downloads not included in products		600	Per song	

Source: Korea Investment & Securities

Table 5. Loen's 2013 B2C sales outlook depending on market growth

(W bn)

		Online music distribution market growth				
		(5)	0	5	10	15
Loen's B2C	41.0	96.9	102.0	107.1	112.2	117.3
sales share (%)	43.0	101.6	106.9	112.3	117.6	123.0
	45.0	106.3	111.9	117.5	123.1	128.7
	47.0	111.0	116.9	122.7	128.6	134.4
	49.0	115.8	121.9	128.0	134.1	140.1

Source: Korea Investment & Securities

Table 6. Loen's 2013 B2C sales growth YoY depending on market growth (%)

		Online music distribution market growth				
		(5)	0	5	10	15
Loen's B2C	41.0	(13.1)	(8.5)	(3.9)	0.6	5.2
sales share (%)	43.0	(8.8)	(4.0)	0.8	5.6	10.4
	45.0	(4.6)	0.4	5.4	10.5	15.5
	47.0	(0.4)	4.9	10.1	15.4	20.6
	49.0	3.9	9.4	14.8	20.3	25.8

Source: Korea Investment & Securities

Company overview & Glossary

Loen is a comprehensive music company that operates Melon, Korea's largest digital music platform. The company is also involved in digital music/album distribution, music content investment/production and artist management (such as IU).

- ARPU: Average revenue per user
- Digital music fee collection scheme: Charging subscribers to download or stream digital music from a platform

Balance sheet

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Current assets	98	115	124	146	186
Cash & cash equivalent	19	22	25	26	33
Accounts & other receivables	24	27	28	35	45
Inventory	0	1	1	1	1
Non-current assets	34	42	49	57	69
Investment assets	1	6	7	8	10
Tangible assets	6	8	10	12	14
Intangible assets	16	18	22	25	29
Total assets	132	157	174	203	255
Current liabilities	60	48	45	50	72
Accounts & other payables	43	30	34	39	49
ST debt & bond	0	0	0	0	0
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	0	0	0	0	0
Debentures	0	0	0	0	0
LT debt & financial liabilities	0	0	0	0	0
Total liabilities	60	48	45	51	72
Paid-in capital	13	13	13	13	13
Capital surplus	47	57	57	57	57
Capital adjustments	(10)	0	0	0	0
Retained earnings	22	39	59	83	114
Shareholders' Equity	72	109	129	152	183

Income statement

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Sales	139	167	188	215	275
Gross profit	138	164	183	211	270
SG&A expense	120	135	153	178	227
Other operating gains	(11)	(3)	0	0	0
Operating profit	7	27	30	35	44
Financial income	2	2	2	2	3
Interest income	2	2	2	2	3
Financial expense	0	0	0	0	0
Interest expense	0	0	0	0	0
Other non-operating profit	0	0	0	0	0
Gains (Losses) in associates, subsidiaries and JV	1	(0)	0	0	0
Earnings before tax	10	28	32	37	47
Income taxes	(1)	7	8	9	11
Net profit	11	21	24	28	36
Other comprehensive profit	0	(0)	(0)	(0)	(0)
Total comprehensive profit	11	21	24	28	36
EBITDA	15	36	43	49	61

Cash flow

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
C/F from operating	26	8	29	35	52
Net profit	11	21	24	28	36
Depreciation	1	2	2	2	3
Amortization	6	8	10	12	14
Net incr. in W/C	10	(28)	(8)	(7)	1
Others	(2)	5	1	0	(2)
C/F from investing	(25)	(23)	(21)	(30)	(41)
CAPEX	(2)	(4)	(4)	(4)	(5)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(15)	(7)	(1)	(1)	(2)
Net incr. in intangible assets	(8)	(12)	(14)	(15)	(18)
Others	0	0	(2)	(10)	(16)
C/F from financing	(1)	18	(4)	(4)	(4)
Incr. in equity	0	22	0	0	0
Incr. in debts	0	0	0	0	0
Dividends	(1)	(4)	(4)	(4)	(4)
Others	0	0	0	0	0
C/F from others	0	0	0	0	0
Increase in cash	(0)	3	3	0	7

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

Key financial data

FY-ending Dec.	2010A	2011A	2012F	2013F	2014F
per share data (KRW)					
EPS	467	882	964	1,108	1,416
BPS	3,238	4,299	5,081	6,009	7,244
DPS	167	170	170	170	170
Growth (%)					
Sales growth	37.0	20.3	12.2	14.6	28.1
OP growth	9.9	279.9	14.2	14.7	27.7
NP growth	140.2	97.3	13.9	15.0	27.8
EPS growth	140.8	88.8	9.2	15.0	27.8
EBITDA growth	8.7	146.2	16.9	14.8	24.6
Profitability (%)					
OP margin	5.0	15.9	16.2	16.2	16.1
NP margin	7.8	12.8	13.0	13.0	13.0
EBITDA margin	10.7	21.8	22.7	22.8	22.2
ROA	9.4	14.8	14.7	14.9	15.6
ROE	16.2	23.7	20.5	20.0	21.4
Dividend yield					
	2.0	1.3	1.2	1.2	1.2
Stability					
Net debt (W bn)	(58)	(63)	(68)	(78)	(100)
Debt/equity ratio (%)	0.0	0.0	0.0	0.0	0.0
Valuation (X)					
PER	18.3	15.1	14.4	12.4	9.7
PBR	2.6	3.1	2.7	2.3	1.9
PSR	1.6	2.0	1.9	1.6	1.3
EV/EBITDA	9.9	7.6	6.6	5.5	4.0

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Loen Entertainment, Inc. (016170)	10-30-12	BUY	W19,600



■ **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 Loen Entertainment, Inc..

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 Loen Entertainment, Inc. in the past 12 months;

Korea Investment & Securities Co., Ltd., or its affiliates has not received compensation for investment banking services from Loen Entertainment, Inc. 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 Loen Entertainment, Inc. in the next 3 months.

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

Korea Investment & Securities Co., Ltd. does not own over 1% of Loen Entertainment, Inc. shares as of January 3, 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 January 3, 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.