



YG Entertainment (122870)

Company Report / Entertainment

November 23, 2011

12M rating **BUY (Initiate)**

12M TP **W85,600**

Up/downside

Stock Data

KOSPI (pt)	1,826
IPO price (KRW)	34,000
Mkt cap / Shares Out. (USD mn, mn)	170 / 5
52-Week Low/High (KRW)	NA/NA
6M avg. daily turnover (USD mn)	NA
Free float / Foreign ownership (%)	40.1/0.0
Major shareholders (%)	
Yang Hyun-seok	35.8
Korea Investment M&A Assoc.	11.9

EPS revision (KIS estimates, KRW)

	Previous	Revised	chg. %
2011F	NA	3,090	-
2012F	NA	5,942	-
2013F	NA	7,348	-

Performance

	1M	6M	12M
Absolute (%)	NA	NA	NA
Relative to KOSPI (%p)	NA	NA	NA

Ready to step on the global stage

YG artists increasingly active in Japan, leading to better profitability; Recommend BUY

We initiate coverage of YG Entertainment (YG) with BUY and a target price of W85,600 that equals 14.4x the 2012F EPS of W5,942. The target multiple is a 10% discount to SM Entertainment's (SM) 16x. We recommend BUY on YG given 1) the ample upside for royalty income from Japan, 2) diverse business portfolio and greater efficiency backed by in-house production system and solo projects by members of hit idol groups and 3) the anticipated growth of the digital music market.

Partnership with AVEX to facilitate bigger advance on Japan

Having tied up with AVEX in Jul, YG is poised to advance on the Japanese market at full throttle. The four-member female group 2NE1 released their first single album there on Sep 21 and drew about 70,000 people to the following concerts. YG will further promote Japanese activities by its artists (female singer Gummy and male singers Se7en and PSY alongside Big Bang and 2NE1) and host YG Family concerts there. YG artists' album sales in Japan should reach 850,000 in 2011F and 2.01mn in 2012F, while the number of concert tickets sold should amount to 150,000 and 640,000, respectively. As such, royalty income from Japan is estimated at W11.4bn in 2011F and W49bn in 2012F. Given that it usually takes two to five months to collect royalty income from Japan, greater activities in Japan from 2H11 should increase YG's royalty income 332% YoY in 2012F.

2012F sales and operating profit to soar 67% and 153%

In 2012F, YG's sales and operating profit should spike 66.9% YoY and 152.5% YoY, respectively. For reference, an increase in the number of concertgoers boosts earnings leverage due to greater sales of concert-related merchandise. YG's operating margin should also improve from 20.2% in 2011F to 30.6% in 2012F on a rising portion of royalty income.

	2009A	2010A	2011F	2012F	2013F
Sales (W bn)	36	45	76	126	141
OP (W bn)	7	10	15	39	48
EBT (W bn)	5	13	17	41	51
NP (W bn)	4	10	13	32	39
EBITDA (W bn)	8	12	17	41	51
Net debt (W bn)	(5)	(11)	(47)	(63)	(89)
OP margin (%)	20.7	23.1	20.2	30.6	33.9
ROE (%)	45.9	63.8	31.4	41.3	34.9
Dividend yield (%)	NA	NA	0.0	0.0	0.0
EPS (KRW)	1,030	2,615	3,090	5,942	7,348
chg. (% YoY)	157.5	153.9	18.2	92.3	23.7
BPS (KRW)	2,757	5,442	12,159	18,482	26,302
DPS (KRW)	0	0	0	0	0
PER (x)	NA	NA	11.0	5.7	4.6
PBR (x)	NA	NA	2.8	1.8	1.3
EV/EBITDA (x)	NA	NA	7.2	2.6	1.6

Shiwoo Kim

822-3276-6240

swkim@truefriend.com

Company report focus

What is the report about?

- To approximate a fair price level for YG, scheduled to go public on Nov 23
- To offer an earnings outlook for YG based on its artists' Japanese activities from 4Q11 and estimates for record and concert ticket sales
- To analyze earnings sensitivity to successful performances in Japan

Key assumptions and valuation

- YG artists are increasingly active in Japan; Performances in Japan have a great effect on earnings as the Japanese music market is 25-times bigger than Korea's and its offline (non-digital) music market is bigger than digital

Estimated record and concert ticket sales in Japan

(units, people)

	2010	2011F	2012F	2013F
Record sales	105,637	850,000	2,010,000	2,230,000
Ticket sales	50,000	150,000	640,000	640,000

Source: Korea Investment & Securities

- Our TP equals a PER 14.4x the 2012F EPS ₩5,942
- The PER is 10% discounted to SM's due to YG's late entry to Japan's entertainment market

Sensitivity & scenario analysis

- The table below shows changes to net profit estimates according to greater/fewer record and concert ticket sales in Japan

NP sensitivity to record/ticket sales in Japan

(%)

		Record sales ('000)				
		1,810	1,910	2,010	2,110	2,210
Ticket sales ('000)	440	(24.6)	(23.0)	(21.3)	(19.7)	(18.1)
	540	(14.6)	(13.0)	(11.3)	(9.7)	(8.1)
	640	(4.6)	(2.9)	(1.3)	0.3	1.9
	740	5.4	7.1	8.7	10.3	12.0
	840	15.5	17.1	18.7	20.3	22.0

Source: Korea Investment & Securities

Risks/opportunities

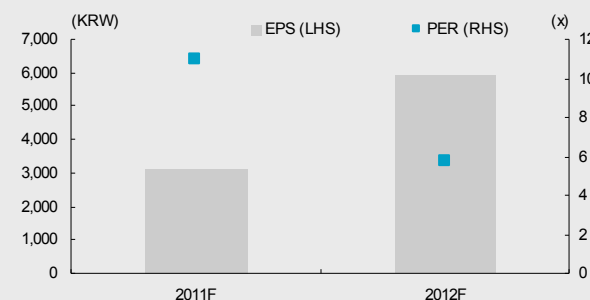
- Risks: 1) Artist missteps or behavior that can spark a backlash, 2) poor performances in Japan

Company highlights

1) Valuation

- At the offer price of ₩34,000, YG's 2011F and 2012F PER stand at 11.0x and 5.7x based on net profit

Offer price-based 2011F and 2012F PER



Source: Company data, Korea Investment & Securities

2) Japan is a crucial market for YG's earnings improvement

- Big Bang and 2NE1 should lead YG's greater presence in Japan; Royalty income from Japan should swell 332% YoY in 2012F
- Constant album sales and concerts would create greater earnings leverage for YG through its artists' ad appearances and additional revenue generation

Major revenue sources to see big sales growth

(₩ bn)

	2010	2011F	2012F	2013F
Overseas royalties	4.6	12.6	54.5	57.0
(% YoY)	36.7	172.6	332.0	4.6
Record and digital music sales	5.8	7.7	9.0	10.9
(% YoY)	(14.6)	32.9	17.0	21.1
Ad appearances	10.5	15.4	18.0	21.8
(% YoY)	51.3	46.5	17.0	21.1
Merchandise sales and others	9.4	13.0	14.8	17.9
(% YoY)	30.1	38.9	13.9	20.8

Source: Company data, Korea Investment & Securities

Peer comparison

- Based on our TP, YG's 2011F and 2012F PER stand at 27.7x and 14.4x, respectively; Given the likely success in Japan and better earnings down the road, we expect YG's stock to re-rate
- See the peer valuation table on page 5

Contents

I. Investment points	2
II. Valuation.....	5
III. Rising profitability on bigger Japan stage	6
1. YG's revenue structure	
2. Japan is a crucial market	
3. In-house production system and solo/sub-group projects	
4. Beneficiary of growing content demand	
5. Look forward to tremendous growth from 2012	
Appendix: YG's major artists	13

I. Investment points

Top-tier talent promoter with firm brand awareness

YG Entertainment (YG) is one of Korea's big-three talent promoters with SM and JYP. The company has built firm brand awareness as a record label and talent agency founded by Yang Hyeon-seok, most notably a former member of the popular dance group Seo Taiji & Boys. Its current roster of recording artists includes Big Bang, 2NE1, Se7en, Gummy, PSY and Tablo. Based on its systemic casting and training program and unique culture, YG manages entertainers that cover diverse genres. YG's artists are increasingly active in Korea and Japan, led by five-member boy group Big Bang and female quartet 2NE1. At present, 32 hopeful stars are being trained intensively for their debuts. YG established YG Japan (subsidiary) in 2007 and YGEX (joint label with AVEX) in Jul 2011. The entities are paving the way for YG's aggressive entry to Japan's entertainment market.

Three investment points: 1) profit maximization with bigger entry to Japan, 2) better profitability on solo projects and in- house production, and 3) growing content demand

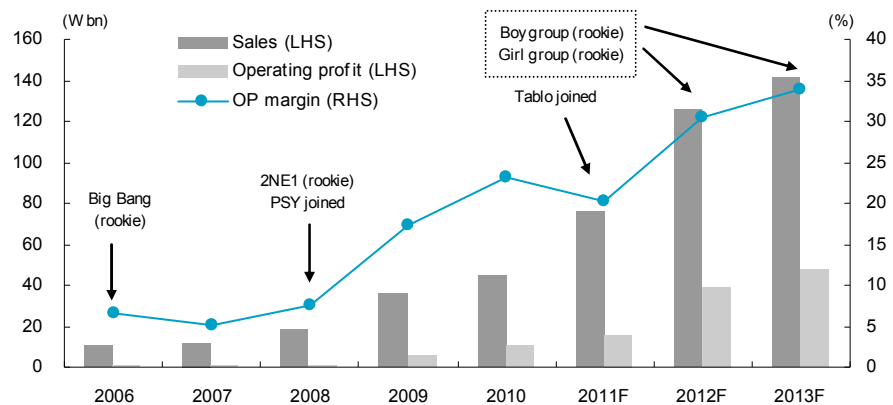
Our investment points for YG can be summed up in three.

1) Growing royalty income backed by bigger entry to Japan and artists' solo or sub-group projects should lift the operating margin from 20.2% in 2011F to 30.6% in 2012F. More activities in Japan are crucial for YG's earnings improvement. Backed by greater activities there, we expect royalty income from the country to swell from W3.6bn in 2010 to W11.4bn in 2011F and W49bn in 2012F. More album and digital music sales in Japan would lead to greater awareness of YG artists, bigger concert audiences and more merchandise sales. As such, becoming big in Japan is critical to YG's earnings.

2) As in the case with Big Bang and 2NE1, YG is promoting solo or sub-group projects by members of groups. The more diverse business portfolio through group segmentation helps reduce risks and maximize profitability at the same time. Moreover, an in-house production system is well-entrenched at YG. Sixteen contracted producers are active at YG, which makes new albums unlikely to fail and shores up profitability.

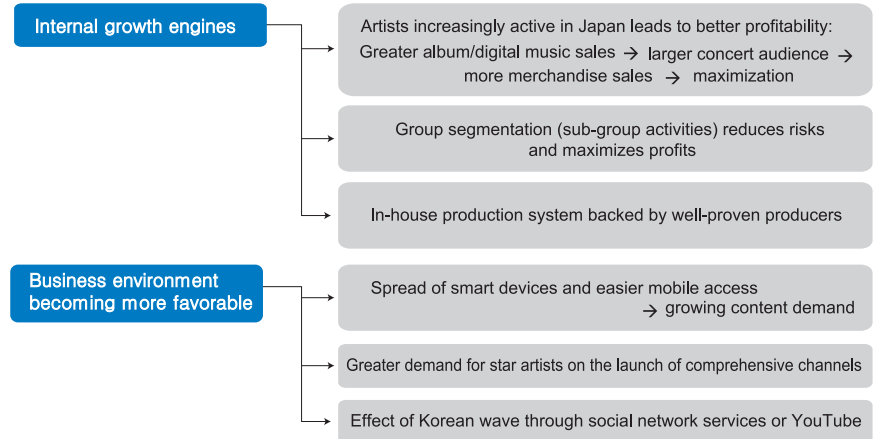
3) YG should enjoy favorable changes from the content market. The popularity of smart devices such as smartphones and tablet PCs drives up content demand and fuels the digital music market. Playing music is one of the most common services enabled by mobile devices. Demand for digital music is expected to rise on easier music streaming thanks to the greater penetration of smart devices and high-speed mobile Internet coverage. The launch of comprehensive channels should also boost demand for star artists. The constant spread of Korean music and video files through social media such as SNS and YouTube looks positive as well.

Major artist signings and YG's earnings trend



Source: Company data, Korea Investment & Securities

Investment points for YG



Source: Korea Investment & Securities

**Risks: Personal issues
of individual artists can
limit group activities**

A potential risk that entertainment companies like YG have in common is limitations for group activities due to personal issues among members. For instance, Big Bang member Daesung was involved in a car accident in May and another member G-Dragon was caught smoking marijuana in Sep and received a suspension of indictment and was let off with a warning. Due to the incident, G-Dragon's solo schedule in Nov in Korea and the release of GD&TOP album in Japan have been delayed indefinitely. By strengthening management skills, YG hopes to guard against any future problems among its artists. But once problems arise, a negative effect on group activities and earnings is unavoidable.

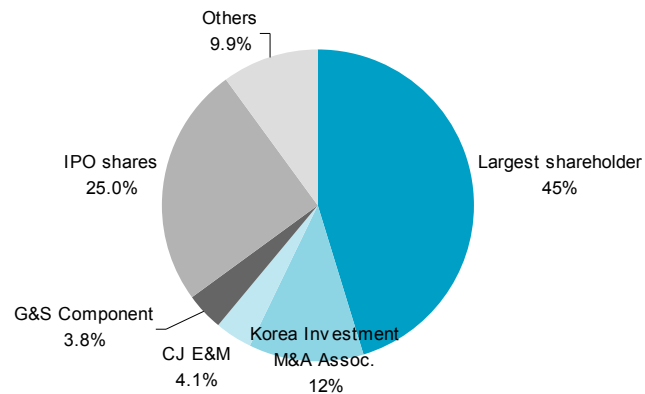
**Artist migration is
unlikely**

YG meets the guidelines of the Fair Trade Commission in its contracts with artists. Its contracts with Big Bang and 2NE1 are valid until 2015 and 2016, respectively. Given the high renewal rate of 78%, chances are not great its artists will leave the company.

***Insignificant overhang
burden***

Post-IPO, the largest shareholders (including CEO Yang Hyeon-seok) will own 45.3% of YG and Korea Investment M&A Association (KIMA) will have an 11.9% stake, or 593,900 shares. Among KIMA's shares, 498,616 can be put up for sale after the one-month lock-up period. G&S Component's (3.8%) stakes are immediately available for disposal after the IPO but the possibility appears slim given its posture as a friendly shareholder.

YG's post-IPO ownership structure



Source: Company data

Lockup period for YG shares

Shareholders	No. of total shares	Stake (%)	No. of shares subject to lockup	Lockup period
Largest shareholder	2,257,017	45.3	2,257,017	One year
KIMA	593,900	11.9	498,616	One month
CJ E&M	202,307	4.1	0	No requirement
G&S Component	191,264	3.8	0	No requirement
Employee stock ownership association	216,095	4.3	216,095	One year

Source: Company data

II. Valuation

TP of W85,600

**Target PER 14.4x the
2012F EPS W5,942**

We initiate coverage of YG with BUY and a target price of W85,600 that equals 14.4x the 2012F EPS of W5,942. The target multiple is 10% discounted to SM's 16x, which is given the average of 2012F domestic/overseas media peers' 15.9x and SM's 2009 PER 16.2x. YG's 10% discount to SM's is attributed to its late entry to Japan's entertainment market (for reference, YG's greater advance on Japan led by Big Bang and 2NE1 and a bigger artist roster on the debut of new female and male groups in 2012 already reflected).

TP calculation

	Note
2012F EPS (won)	5,942
Target PER (x)	14.4
TP (won)	85,620
Current price (won)	34,000
Upside (%)	151.8

Source: Korea Investment & Securities

**High valuation can be
justified with big
potential for growth and
better profitability**

Based on our TP, the 2011F and 2012F PER stand at 27.7x and 14.4x, respectively. We expect YG's sales, operating profit and net profit to record a three-year CAGR of 34.9%, 52.9% and 59.4%, respectively, from 2010. The biggest earnings driver should be artists' greater activities in Japan from 2012, which will boost YG's top and bottom lines at the same time. We view this as sufficient justification for a high valuation.

At the offer price, the 2011F and 2012F PER stand at 11x and 5.7x, respectively. Compared to SM (2011F 46.3x, 2012F 14x) and ROEN Entertainment (2011F W24.5x, 2012F 19.3x), YG's offer price-based PER appears undervalued.

Peer valuation table

		YG*	SM	ROEN**	AVEX***	Cheil Worldwide	CJ E&M
PER	2010	NA	12.6	22.1	35.5	14.6	NM
(x)	2011F	11.0	46.3	24.5	5.7	22.6	16.0
	2012F	5.7	14.0	19.3	6.2	15.5	8.9
PBR	2010	NA	3.2	3.3	1.2	2.3	0.6
(x)	2011F	2.8	8.4	3.8	NA	3.0	1.1
	2012F	1.8	5.3	3.0	NA	2.6	1.0
EV/EBITDA	2010	NA	8.1	5.8	7.6	9.0	8.6
(x)	2011F	7.2	30.8	11.9	3.8	12.9	7.0
	2012F	2.6	9.5	10.0	NA	8.2	5.4
Sales	2010	44.8	86.4	139.0	118.4	1,344.5	99.5
(W bn, JPY bn)	2011F	75.7	100.1	156.1	118.6	1,635.8	1,114.8
	2012F	126.3	173.4	180.0	118.9	1,946.2	1,386.1
OP	2010	10.3	25.5	16.4	5.3	102.8	12.6
(W bn, JPY bn)	2011F	15.3	22.3	26.3	11.9	103.4	84.3
	2012F	38.6	74.1	37.0	11.8	152.3	128.5
NP	2010	9.8	21.8	9.8	1.0	103.5	(0.3)
(W bn, JPY bn)	2011F	12.7	19.3	21.7	6.3	91.5	81.3
	2012F	31.5	63.1	31.3	5.8	133.5	149.3
OP margin	2010	23.1	29.5	11.8	4.5	7.6	12.6
(%)	2011F	20.2	22.3	16.8	10.1	6.3	7.6
	2012F	30.6	42.7	20.6	9.9	7.8	9.3
NP margin	2010	21.8	25.2	7.0	0.8	7.7	(0.3)
(%)	2011F	16.8	19.3	13.9	5.3	5.6	7.3
	2012F	25.0	36.4	17.4	4.8	6.9	10.8
ROE	2010	63.8	29.1	14.7	3.9	17.0	(0.1)
(%)	2011F	31.4	19.9	26.4	21.3	13.5	11.0
	2012F	41.3	46.2	29.4	16.0	17.7	11.9

Note: * 2011-2012F PER, PBR and EV/EBITDA based on the offer price of W34,000

** ROEN figures are consensus

*** AVEX figures in JPY

Source: Bloomberg, FnGuide, Korea Investment & Securities

III. Rising profitability on bigger Japan stage

1. YG's revenue structure

Revenue streams are records, digital music, concerts, ad appearances and overseas royalties

YG's sales in 2010 comprised 18.1% records, 12.9% digital music, 14.3% concerts, 23.4% artist ad appearances, 20.9% management and 10.3% overseas royalties. The most promising growth drivers are overseas royalties, domestic concerts and digital music sales. In particular, the overseas royalties should jump a whopping 172.6% YoY in 2011F and 332% YoY in 2012F. We sketch out each business as follows.

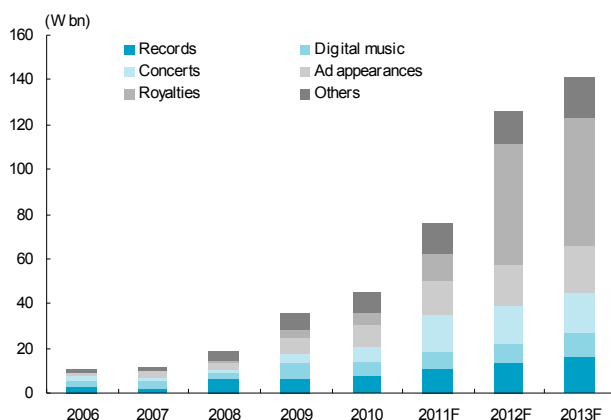
1) Record sales: Although the domestic offline (non-digital) music market continues to slump, the pace of slowdown has become more moderate recently. We note that YG's record sales have kept growing with a CAGR of 30.6% from 2006 to 2010. We expect to see the next three-year record sales CAGR at 18.5% given its pool of chart-topping artists. Gross profit from the record sales is the sum after variable costs (40-50% of sales) and production costs are deducted.

2) Digital music: The music market is going digital, spurred by the growing penetration of MP3 players and other mobile devices. Growth potential is abundant for digital music as platform operators such as Melon, Mnet and Bugs Music would see a growing number of paid subscribers on the introduction of LTE and cloud-computing services. Platform providers pay 20-40% of digital music revenue to YG, a record company.

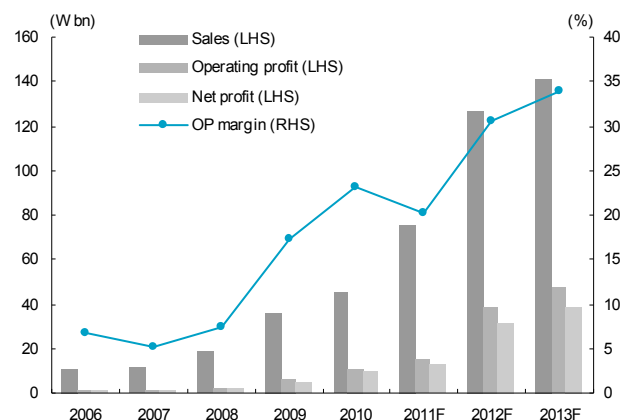
3) Overseas royalties: YG established YGEX, a joint label with AVEX, the biggest record company in Japan, in Jul. YGEX will take charge of all YG's business, such as record sales and concerts, in Japan. For royalties, 20% of record sales and 70% of concert ticket sales after cost deductions go to YG. It usually takes two to five months to recognize royalties from the Japanese business in earnings.

4) Management: After subtracting costs, YG passes on 50% of sales from appearing on broadcasts and in ads to artists.

Sales by division: Royalty income to balloon on growing Japanese business OP margin to improve



Source: Company data, Korea Investment & Securities

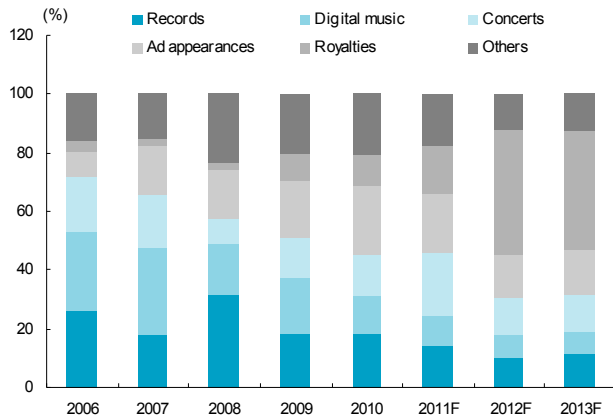


Source: Company data, Korea Investment & Securities

Overseas royalties give the biggest gross margin

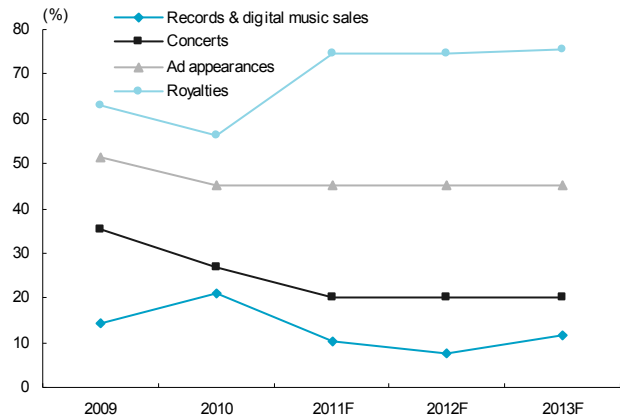
By division, gross margins are estimated at 10% for record and digital music, 20% for concerts, 45% for ad appearances and 75% for royalties. The royalties carry a big margin because through YGEX, AVEX recognizes both sales and costs from business in Japan while YG's cost recognition is mostly confined to revenue shared with artists. Overseas royalties should account for 43.1% of revenue in 2012F.

Sales breakdown: Royalties portion up significantly



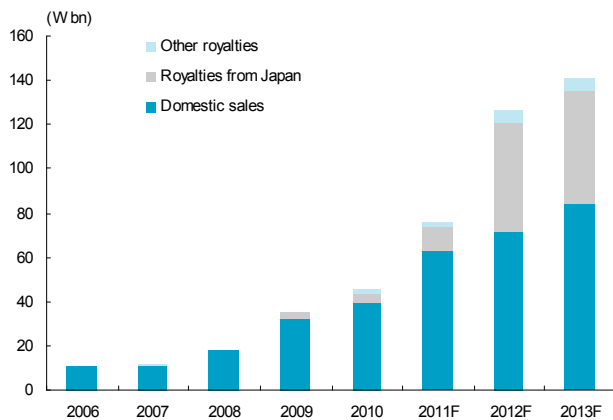
Source: Company data, Korea Investment & Securities

Gross margins by division



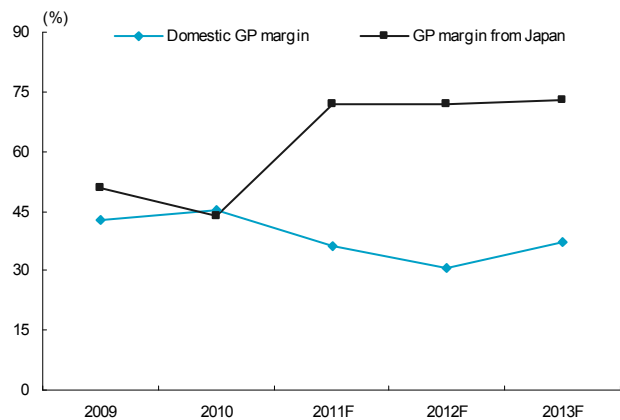
Source: Company data, Korea Investment & Securities

Domestic sales and royalties from Japan



Source: Company data, Korea Investment & Securities

Gross margin: Domestic vs. Japanese business



Source: Company data, Korea Investment & Securities

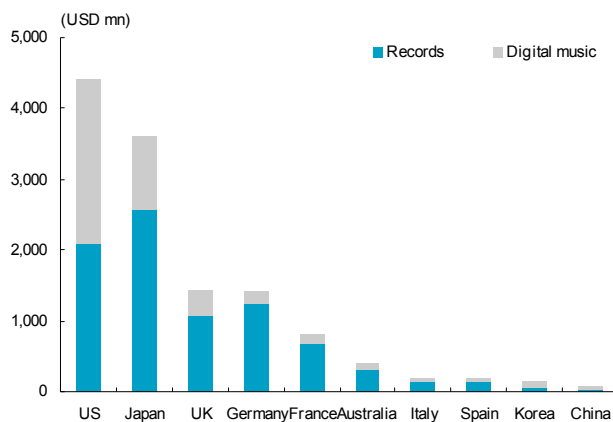
2. Japan is a crucial market

1) Why is it so important to succeed in Japan?

Japan's music market is 25-times bigger than Korea's

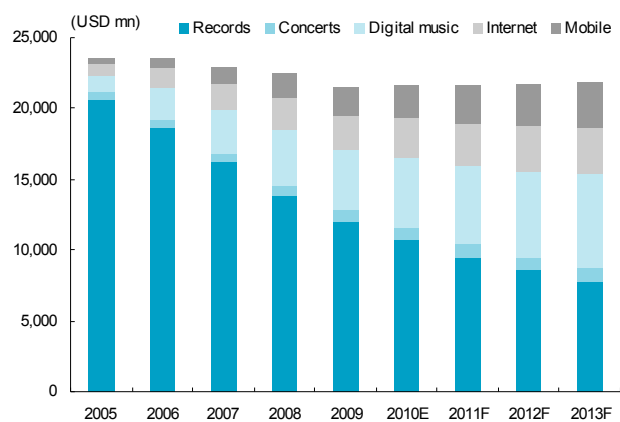
To succeed in Japan is vital as its music market is 25-times bigger than Korea's. In 2010, Japan's music market (including records, digital music and concerts) was worth USD4.48bn, the second-biggest in the world after the US. We believe the Japanese market will be a gateway to more opportunities in Europe and the US. One distinguishing feature of Japan is that traditional hard-copy music sales still exceed digital. This is why advancing on the market is very important to drive up overall record sales. In Japan, albums are priced higher than in Korea. Full-length albums are priced at W40,000-50,000 and mini-albums are W15,000 in Japan, compared to about W15,000 and W6,000, respectively, in Korea.

Music market sizes by country



Note: As of 2010
Source: Korea Creative Content Agency, IFPI

Global music market sizes by type



Source: IFPI (2010c); PWC (2010); eMarketer (2007); Informa (2007); BSA (2010)

2) More Japanese activities via YGEX

Promoting a full lineup of artists in Japan after 2011

YG's advance on Japan started after male solo artist Se7en released three digital singles there in 2005. Before he suspended Japanese activity to prepare his entry to the US market, Se7en released one full-length album and three additional singles there from 2006 to 2007. Big Bang first hit Japan in 2008 and 2NE1 entered the country in earnest in 2011. Earlier in 2007, YG established YG Japan as it was seeking opportunities there. Having tied up with AVEX in Jul, YG is poised to advance on the Japanese market at full throttle. 2NE1 has sold 200,000 copies of their first single album in Japan since its release on Sep 21 and drew about 70,000 people to the following concerts. More recently, there was a fan meeting by Se7en on Nov 6. YG will further promote Japanese activities by its artists (such as Gummy and PSY alongside Big Bang and 2NE1) and host the entertainment company's YG Family concerts there.

Partnership with AVEX is a key to success in Japan

We see a big chance of success in Japan given similar cultural milieus with Korea as an Asian country and K-pop fever in the country. On the back of the favorable environment, a key to success in Japan depends on YGEX. It is critical for YG to take full advantage of AVEX's planning and marketing abilities to make a hit business in Japan.

Big Bang leads YG's advance on Japan

YG's advance on Japan's entertainment market is driven by Big Bang and 2NE1. Big Bang made its debut in Japan with the release of a mini-album on Jan 4, 2008. The group has released a total of 10 titles including two full-length albums, five singles and two mini-albums. Big Bang performed concerts in Oct 2008, Feb

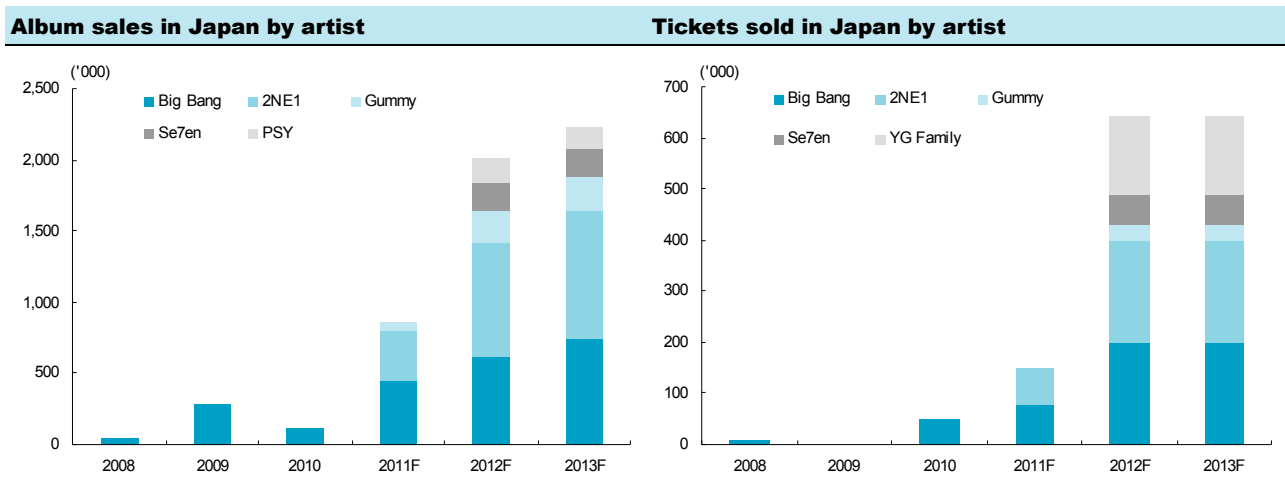
2010 and May 2011 which sold 8,500, 60,000 and 80,000 tickets, respectively. The number of tickets sold has steadily risen and Big Bang is on track to sell more concert tickets and albums. Meanwhile, YG has a new all-boy group and an all-girl group waiting to debut in 2012. The new idol groups will be promoted through various sub-unit projects and YG Family concerts.

Royalty income from Japan to reach W11.4bn in 2011 and W49bn in 2012

YG artists' album sales in Japan should reach 850,000 in 2011F and 2.01mn in 2012F, while the number of concert tickets sold amount to 150,000 and 640,000, respectively. As such, royalty income from Japan is estimated at W11.4bn in 2011F and W49bn in 2012F. Given that it takes two to five months to collect royalty income from Japan, we believe the income will swell in 2012. YG should enjoy greater earnings leverage because the larger a concert audience grows, the greater merchandise sales roll in. Usually, merchandise sales represent 30% or 50% of concert profits. YG makes a strong push for merchandise sales and has its own online shopping mall that sells items modeled after its entertainers.

Look beyond Japan to go global

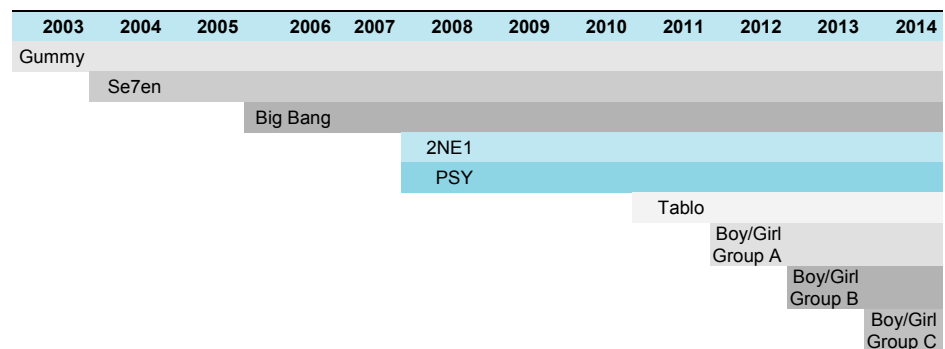
YG seeks to extend its market reach beyond Japan to the rest of Asia, the US and Europe and hopes to build partnerships with Interscope, the largest entertainment company in the US, and Live Nation, a live-event company based in Beverly Hills, California. We think the precondition for YG's overseas expansion will be success in Japan. Big Bang and 2NE1 were named as "2011's Best New Band in the World" by MTV Iggy after fan voting in the UK and US, respectively. We believe the results hint at a great chance of YG's overseas success.



Source: Company data, Korea Investment & Securities

Source: Company data, Korea Investment & Securities

Year of album releases by artist



Source: Company data

3. In-house production system and solo/sub-group projects

In-house album production reduces risk and lifts profitability

Thanks to its systemic training program and high level of music achievement, YG boasts a stellar roster of pop music stars such as Gummy, Se7en, Big Bang and 2NE1, and the list will grow. YG's successful music business is attributed to its in-house production system. Most of YG's hits are produced in-house. YG's music production team includes 16 producers including CEO Yang Hyun-seok and Teddy, a former member of One Time, etc. Moreover, Big Bang's leader GD, PSY and Tablo are singer-song writers. The well-entrenched system makes new albums unlikely to fail and shores up profitability.

YG's artists ranked high on music charts

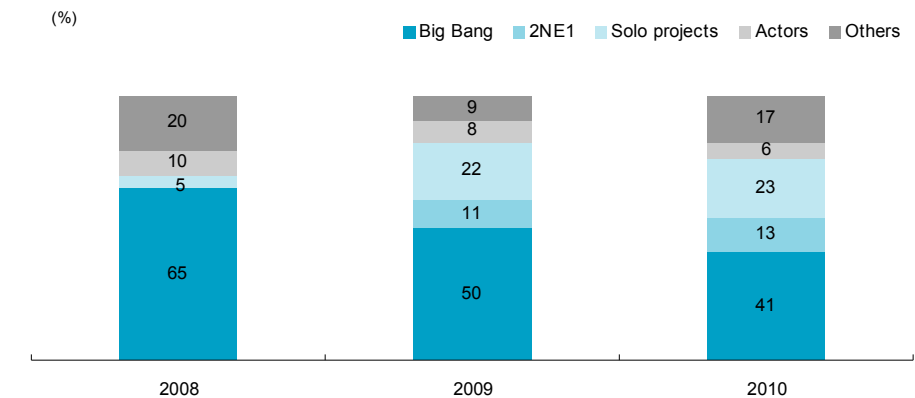
Year	Ranking	Artist	Song	Lyrics	Composition
2011	2	Tablo	Bad	Tablo	Tablo
2011	1	2NE1	Ugly	Teddy	Teddy, Lydia Paek
2011	3	2NE1	Hate you	Teddy	Teddy
2011	2	2NE1	I Am The best	Teddy	Teddy
2011	1	2NE1	Lonely	Teddy	Teddy, e. knock
2011	1	2NE1	Don't Cry	Teddy	Teddy, Lydia Paek
2011	1	Big Bang	Love Song	GD, Teddy	GD, Teddy
2011	1	Big Bang	Tonight	GD	GD, e. knock
2011	3	Big Bang	Café	GD	GD, D.J murf, Peejay
2011	5	Big Bang	What Is Right	GD	GD, D.J murf, Peejay
2011	10	Seungri	What Can I Do	Seungri	Seungri , Choi PK, Bigtone
2011	2	GD/TOP	High High	GD/TOP/Teddy	Teddy
2011	4	GD/TOP	Oh Yeah	GD/TOP	Teddy, Sunwo JA
2010	4	2NE1	Go Away	Teddy	Teddy
2010	13	2NE1	Can't Nobody	Teddy	Teddy
2010	34	Gummy	Love You Till death	Choi GW	Kim DH, Lee HS
2010	35	PSY	Right Now	PSY	PSY, Yoo GH
2010	39	Taeyang (SUN)	I Need A Girl	Jun Kun, Choi GW, GD	Jun Kun
2010	51	2NE1	Clap your hands	e. knock	e. knock
2010	84	Se7en	Better Together	Teddy	Teddy
2010	90	Gummy	Since You're A Man	Teddy	Teddy
2009	1	GD	Heartbreaker (album title)	GD	GD, Jimmy Thornfelt
2009	3	2NE1	I Don't Care (album title)	Teddy, Kush	Teddy, Kush
2009	15	Big Bang	Red Sunset (album title)		

Source: Media reports, Gaon Chart

Solo/sub-group projects help stabilize business portfolio

As in the case with Big Bang and 2NE1, YG is promoting solo or sub-group projects by members of groups. YG has diversified its revenue streams and buttressed the business portfolio through group segmentation. YG's sales mostly came from Big Bang in 2008. But as 2NE1 debuted and some Big Bang members started solo projects in 2009, the sales portion of the projects reached 23% in 2010. As solo projects meld with YG's in-house production system, it can generate greater efficiency. 1) The in-house production system continues to release new songs and needs artists to reach out to the public. But it is costly and time-consuming to train a big group to deliver a full album of songs. But a solo singer or a small group saves time to release the music. 2) Periodic album releases can cause market cannibalization. As such, mini-albums or singles can enhance operating efficiency by filling the gap between regular releases.

Sales breakdown by artist



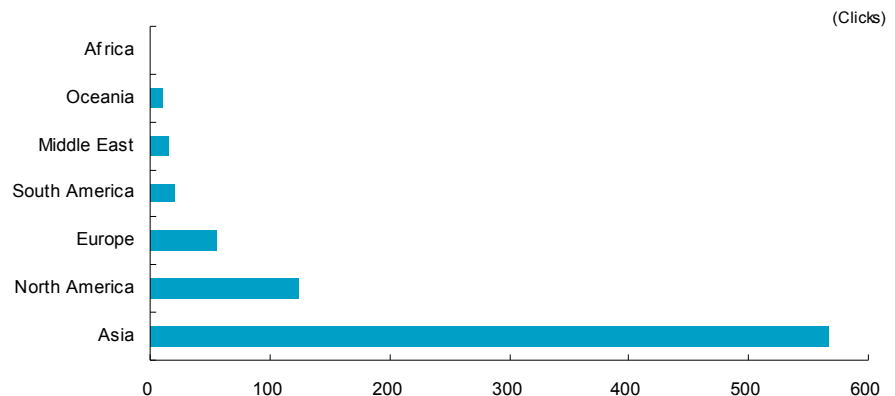
Source: Company data

4. Beneficiary of growing content demand

Popularity of smart devices to drive digital music market

YG should enjoy favorable changes from the content market such as diversified platforms and easier mobile access. The popularity of smart devices such as smartphones and tablet PCs is driving up content demand and fueling the growth of the digital music market. Playing music is one of the most common services enabled by mobile devices. As music files and video footage spread fast through social media such as SNS and YouTube, we see potential revenue sources such as advertising.

Korean artist YouTube hits by continent



Note: YouTube hits in Korea amount to 8.27mn
Source: Korea Investment & Securities

Comprehensive channels to fuel demand for star artists

Top-tier artists should be more in demand when comprehensive channels go on air and they need entertainers for programs such as dramas and variety shows. If a program features celebrities, it is easy to attract viewers. The longer air time an artist has, the bigger boost they can get for their music career, which in return creates greater opportunities to appear on TV programs. Big Bang member Daesung is scheduled to star on the MBN drama *What's Up*. The virtuous cycle mentioned above should bolster sales across the board encompassing songs, concerts and DVDs.

5. Look forward to tremendous growth from 2012

2012F sales and operating profit to jump 66.9% YoY and 152.5% YoY

In 2012F, YG's sales and operating profit should spike 66.9% YoY and 152.5% YoY, respectively, as the company's recording artists will start to step up their activities in Japan from end-2011. For reference, an increase in the number of concertgoers boosts profit leverage due to greater sales of concert-related merchandise. YG's operating margin should also improve from 20.2% in 2011F to 30.6% in 2012F on a rising portion of royalty income.

Estimated earnings

(W bn)

	2006	2007	2008	2009	2010	2011F	2012F
Sales	10.9	11.5	18.5	35.7	44.8	75.7	126.3
Records & digital music	5.8	5.5	9.1	13.3	13.9	18.7	22.2
Records	2.8	2.0	5.9	6.5	8.1	11.0	13.2
Digital music	3.0	3.4	3.3	6.8	5.8	7.7	9.0
Concerts	2.1	2.0	1.5	4.9	6.4	16.0	16.8
Ad appearances	1.0	2.0	3.2	6.9	10.5	15.4	18.0
Royalties	0.3	0.2	0.3	3.4	4.6	12.6	54.5
Others (merchandise, TV commercials, TV & radio appearances, etc.)	1.7	1.8	4.4	7.2	9.4	13.0	14.8
COGS	5.1	6.0	10.2	19.8	24.1	43.5	63.6
SG&A	5.0	4.9	6.9	9.8	10.4	15.4	21.5
Operating profit	0.7	0.6	1.4	6.1	10.3	15.3	38.6
Earnings before profit	1.0	0.7	1.9	5.4	12.7	17.0	41.5
Net profit	0.7	0.5	1.6	4.2	9.8	12.7	31.5
(% YoY)							
Sales		5.8	61.3	92.7	25.4	69.0	66.9
Operating profit		-17.6	132.2	343.3	68.5	47.9	152.5
Net profit		-31.1	217.5	159.9	134.7	30.3	147.8
(%, margin)							
OP margin	6.7	5.2	7.5	17.2	23.1	20.2	30.6
NP margin	6.7	4.4	8.6	11.7	21.8	16.8	25.0

Note: Figures through 2010 use K-GAAP accounting
Source: Company data, Korea Investment & Securities

When record and ticket sales in Japan grow 100,000 each, NP rises 10.3%

Royalty income from Japan is very important to YG's earnings. According to our sensitivity analysis, a 100,000 increase in record sales and concertgoers in Japan would boost net profit by 10.3%. The strong JPY is also favorable as a W50 rise in KRW/JPY100 leads to a 3.7% rise in 2012F net profit.

NP sensitivity to record and concert ticket sales in Japan

(%)

		Records sold				
		1,810,000	1,910,000	2,010,000	2,110,000	2,210,000
Tickets sold	440,000	(24.6)	(23.0)	(21.3)	(19.7)	(18.1)
	540,000	(14.6)	(13.0)	(11.3)	(9.7)	(8.1)
	640,000	(4.6)	(2.9)	(1.3)	0.3	1.9
	740,000	5.4	7.1	8.7	10.3	12.0
	840,000	15.5	17.1	18.7	20.3	22.0

Note: 2012 estimates
Source: Korea Investment & Securities

Earnings sensitivity to KRW/JPY100 changes

(%)


	(100)	(50)	(10)	10	50	100
Sales chg.	(2.7)	(1.3)	(0.3)	0.3	1.3	2.7
OP chg.	(7.4)	(3.7)	(0.7)	0.7	3.7	7.4
NP chg.	(7.4)	(3.7)	(0.7)	0.7	3.7	7.4

Note: 1) 2012 estimates, 2) KRW/JPY100 is W1,494 at year-end and W1,593 on average
Source: Korea Investment & Securities

Appendix: YG's major artists

Big Bang

Members: G-Dragon (GD), Taeyang, TOP, Daesung, Seungri


	Year	Korean discography	Japanese discography
	2006	First, second and third singles, first studio album	-
	2007	First and second mini-albums, first live album	-
	2008	Third mini-album, second studio album, Taeyang's first mini-album, digital singles (two by Big Bang, one by Daesung, one by GD), second live album	First and second mini-albums
	2009	GD's first studio album, third live album, digital singles (two by Taeyang, one by Daesung, one with 2NE1)	First, second and third singles, first studio album
	2010	Taeyang's and GD & TOP's first studio albums, Big Bang & GD's live album, digital singles (Big Bang, Daesung and TOP with Kim Yu-na)	Fourth and fifth singles
	2011	Fourth mini-album, Seungri's first mini-album, fourth live album	Second studio album
	<th>Year</th> <th>Concerts in Korea</th> <th>Concerts in Japan</th>	Year	Concerts in Korea
2006	Olympic Gymnastics Arena (one show)	-	
2007	Nationwide tour (Incheon, Chuncheon, Daegu, Changwon, Jeonju), Olympic Fencing Gymnasium (three shows)	-	
2008	Nationwide tour (Busan, Daegu, Gwangju, Wonju, Seoul), Melon AX Hall (one show by Taeyang)	Stand Up Tour (Osaka, Nagoya, Tokyo)	
2009	Olympic Gymnastics Arena (three shows by Big Bang, two shows by GD)	-	
2010	Olympic Gymnastics Arena (Two shows by Big Bang, two shows by YG Family), The Grand Peace Palace at Kyung Hee University (two shows by Taeyang)	Yokohama Arena (two shows), World Hall in Kobe (two shows), Nippon Budokan in Tokyo (two shows)	
2011	Olympic Gymnastics Arena (three shows by Big Bang)	Osaka Castle Hall (two shows), Makuhari Messe in Chiba (three shows), Nippon Gaishi Hall in Nagoya (three shows)	

2NE1

Members: Park Bom, Sandara, Minzy, CL

	Year	Korean discography	Japanese discography
	2009	First mini-album, two digital singles, digital singles (Sandara/Park Bom/CL & Minzy with Big Bang)	
	2010	First studio album, two digital singles	
	2011	Second mini-album, two digital singles, digital single (one by Park Bom)	Licensed album, first mini-album, first single to be released
	Year	Concerts in Korea	Concerts in Japan
	2011	Olympic Hall at Olympic Park in Seoul (three shows)	Yokohama Arena (one show), World Hall in Kobe (two shows), Makuhari Messe in Chiba (two shows)

Gummy

	Year	Korean discography
	2003	First studio album
	2004	Second studio album, digital single (original soundtrack)
	2005	Third studio album
	2006	Unplugged album
	2007	Digital single (original soundtrack)
	2008	Fourth studio album, three digital singles (original soundtrack)
	2009	Two digital singles (original soundtrack)
	2010	First mini-album, two digital singles (original soundtrack)
	2011	Digital single (original soundtrack)
	Year	Concerts in Korea
	2006	Seoul-AX (two shows)
	2010	AX-Korea in Gwangjang-dong (two shows)

Se7en



Year	Korean discography	Japanese discography	US discography
2003	First studio album	-	-
2004	Digital single, second studio album	-	-
2005	-	First, second and third digital singles	-
2006	Third and fourth studio albums	First studio album, fourth digital single	-
2007	Live album	Fifth and sixth digital singles	-
2008	-	-	-
2009	-	-	Digital single
2010	First mini album, digital single	-	-
Year	Concerts in Korea	Concerts in Japan	Concerts in the US
2003	DOM Art Hall (two shows)	-	-
2005	-	Yokohama Arena (one show)	-
2006	-	-	-
2006	Seoul-AX (two shows)	Yoyogi National Gymnasium in Tokyo (two shows), Osaka International Convention Center (one show)	-
2007	Olympic Gymnastics Arena (one show)	Nagoya, Osaka, Tokyo	-

Balance sheet

(W bn)

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
Current assets	12	22	68	94	124
Cash & cash equivalents	4	9	45	57	75
Accounts & other receivables	2	7	12	20	22
Inventory	1	2	3	5	6
Non-current assets	9	12	21	35	45
Investment assets	2	4	8	15	21
Tangible assets	2	4	6	8	9
Intangible assets	1	1	1	2	2
Total assets	20	33	88	129	169
Current liabilities	9	12	26	35	35
Accounts & other payables	3	6	11	18	20
ST debt & bond	0	0	0	0	0
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	1	1	1	2	2
Debentures	0	0	0	0	0
LT debt & financial liabilities	0	0	0	0	0
Total liabilities	10	13	28	37	37
Controlling interest	10	20	61	92	131
Capital stock	2	2	3	3	3
Capital surplus	4	4	31	31	31
Capital adjustments	0	0	0	0	0
Retained earnings	4	14	27	58	97
Minority interest	0	0	0	0	0
Shareholders' equity	10	20	61	92	131

Cash flow

(W bn)

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
C/F from operations	8	10	18	27	36
Net profit	4	10	13	32	39
Depreciation	0	1	1	2	2
Amortization	0	0	1	1	1
Net incr. in W/C	(1)	0	3	(8)	(6)
Others	4	(2)	0	1	0
C/F from investing	(5)	(5)	(9)	(16)	(18)
Capex	(2)	(3)	(3)	(4)	(3)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(0)	(2)	(3)	(8)	(6)
Net incr. in intangible assets	(0)	(0)	(1)	(2)	(1)
Others	(2)	0	(2)	(3)	(8)
C/F from financing	(2)	0	28	0	0
Incr. in equity	0	0	28	0	0
Incr. in debts	0	0	0	0	0
Dividends	0	0	0	0	0
Others	(2)	0	0	0	0
C/F from others	0	0	0	0	0
Increase in cash	2	5	36	11	18

Note: K-IFRS (consolidated)

Income statement

(W bn)

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
Sales	36	45	76	126	141
Gross profit	17	21	32	63	74
SG&A expenses	10	10	15	22	24
Other operating gains	0	0	(2)	(3)	(3)
Operating profit	7	10	15	39	48
Financial income	0	0	0	1	1
Interest income	0	0	0	1	1
Financial expenses	0	0	0	0	0
Interest expenses	0	0	0	0	0
Other non-operating profit	(2)	1	1	2	2
Gains (Losses) in associates, subsidiaries and JV	0	1	0	0	0
Earnings before tax	5	13	17	41	51
Income taxes	1	3	4	10	12
Net profit	4	10	13	32	39
Net profit of controlling interest	4	10	13	32	39
Other comprehensive profit	0	0	0	0	0
Total comprehensive profit	4	10	13	32	39
Total comprehensive profit of controlling interest	4	10	13	32	39
EBITDA	8	12	17	41	51

Key financial data

FY-ending Dec.	2009A	2010A	2011F	2012F	2013F
Per-share data (KRW)					
EPS	1,030	2,615	3,090	5,942	7,348
BPS	2,757	5,442	12,159	18,482	26,302
DPS	0	0	0	0	0
Growth (%)					
Sales growth	92.7	25.4	69.0	66.9	11.8
OP growth	433.6	40.0	47.9	152.5	24.1
NP growth	159.9	134.7	30.3	147.8	23.7
EPS growth	157.5	153.9	18.2	92.3	23.7
EBITDA growth	289.5	46.9	40.1	143.9	23.7
Profitability (%)					
OP margin	20.7	23.1	20.2	30.6	33.9
NP margin	11.7	21.8	16.8	25.0	27.6
EBITDA margin	23.0	27.0	22.4	32.7	36.2
ROA	22.1	36.4	20.9	29.0	26.2
ROE	45.9	63.8	31.4	41.3	34.9
Dividend yield	NA	NA	0.0	0.0	0.0
Stability					
Net debt (W bn)	(5)	(11)	(49)	(63)	(89)
Debt/equity ratio (%)	0	0	0	0	0
Valuation (x)					
PER	NA	NA	11.0	5.7	4.6
PBR	NA	NA	2.8	1.8	1.3
PSR	NA	NA	1.7	1.3	1.2
EV/EBITDA	NA	NA	7.1	2.6	1.6

■ **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**

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 YG 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 YG Entertainment in the past 12 months;

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

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

Korea Investment & Securities Co., Ltd. and/or its affiliates own 5% or more of YG Entertainment's shares outstanding as of Nov 22, 2011.

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 November 22, 2011.

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.

HEAD OFFICE

WON-JAE RHEE, Executive Managing Director (wonjae@truefriend.com +822 3276 5660)
PAUL CHUNG, Sales Trading (pchung@truefriend.com +822 3276 5843)
27-1 Yoido-dong, Youngdeungpo-ku, Seoul 150-745, Korea
Toll free: US 1 866 258 2552 HK 800 964 464 SG 800 8211 320
Fax: 822 3276 5681~3
Telex: K2296

NEW YORK

DONG KIM, Managing Director (dkim@kisamerica.com +1 212 314 0681)
ELAINE LIM, Head of Sales (Elaine@kisamerica.com +1 212 314 0686)
JU KIM, Sales (jukim@kisamerica.com +1 212 314 0683)
Korea Investment & Securities America, Inc.
1350 Avenue of the Americas, Suite 1110
New York, NY 10019
Fax: 1 201 592 1409

HONG KONG

STEVE KIM, Managing Director (steve.kim@kisasia.com +852 2530 8900)
DANIEL KIM, Managing Director, Head of HK Sales (daniel.kim@kisasia.com +85202530 8950)
SANGME LEE, Merchandising Director (sangme.lee@kisasia.com +852 2530 8910)
DAN SONG, Sales (dan.song@kisasia.com, +852-2530-8900)
JUN HWAN KIM, Sales (jun.kim@kisasia.com, +852-2530-8912)
Korea Investment & Securities Asia, Ltd.
Suite 2201-2, Jardine House
1 Connaught Place, Central, Hong Kong
Fax: 852-2530-1516

SINGAPORE

SUNG NAMGOONG, Managing Director, Head of Singapore Sales (snamgoong@truefriend.com +65 6501 5601)
ALEX JUN, Managing Director (alex.jun@truefriend.com +65 6501 5602)
Korea Investment & Securities Singapore Pte Ltd
1 Raffles Place, #43-04, OUB Center
048616 Singapore
Fax: 65 6501 5617

LONDON

JJ MOON, Managing Director (jamesmoon@kiseurope.com +44 207 065 2765)
MINGOO KANG, Sales (mingookang@kiseurope.com, +44 207 065 2760)
Korea Investment & Securities Europe, Ltd.
2nd Floor, 35 Moorgate
London EC2R 6AR
Fax: 44-207-236-4811
Telex: 8812237

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. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. This report is provided solely for the information of professional investors who are expected to make their own investment decisions without undue reliance on this report and the company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is not intended for the use of private investors.