

## YG Entertainment (122870)

12M rating **BUY (Maintain)**

12M TP **W51,500** from W67,000

Up/downside **-14%**

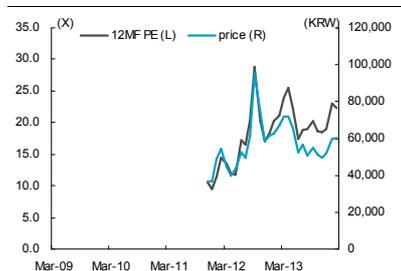
### Stock Data

KOSPI (Feb 14, pt)	1,940
Stock price (Feb 14, KRW)	60,100
Market cap (USD mn)	588
Shares outstanding (mn)	10
52-Week high/low (KRW)	86,600/46,300
6M avg. daily turnover (USD mn)	4.9
Free float / Foreign ownership (%)	58.5/4.4
Major shareholders (%)	
Hyunsuk Yang and 2 others	41.5

### Performance

	1M	6M	12M
Absolute (%)	3.1	9.7	(7.1)
Relative to KOSPI (%p)	3.4	8.8	(5.1)

### 12MF PE trend



Source: WISEfn consensus

## Rights and bonus issue in preparation to soar

### Outstanding shares likely up 44.4% on capital increase

YG announced a rights and bonus issue after the market close on February 14. It plans a W53.2bn rights issue at W46,250 per share. The first allocation is for current shareholders with the forfeited shares offered for public auction. The subscription period is April 23-24 and new shares are scheduled to list on May 20. New shares from the rights issue should number 1.15mn, or 11.5% of the current outstanding. YG also decided a bonus issue of 0.3 share for each common share for a total 3.47mn new shares. If combining both offers, YG's outstanding shares will increase 44.4% from 10.4mn to 15.02mn.

Investors gaining new shares from the rights offer may also receive shares from the bonus issue. We believe the company is making a bonus issue to dissipate market concerns about the rights issue. In January 2012 when YG decided a 100% bonus issue, shares pulled back 8% over the next two days. But since then, they rallied 11% before the ex-rights date and 31% over a month after the bonus issue was announced.

### 24% 2014F EPS dilution; Mid to long-term growth prospects intact

We lower the TP from W67,000 to W51,500 (27.7x 12MF PE) to reflect 24% EPS dilution from the rights offer and bonus issue. Shares should experience a short-term retreat due to the issues. The largest shareholder will probably participate in the rights offer but may sell a portion of the current stake beforehand. Meanwhile, YG will soon release 4Q13 results that will likely be down from a year ago.

But we maintain BUY and recommend investors accumulate the shares when the price dips given the following. First, the artist momentum remains constant with the scheduled debut of WINNER, album releases by 2NE1, PSY, a Big Bang side-project and Akdong Musician and the world tour featuring 2NE1 and YG Family starting in March. Second, record-high OP of ~W9bn is expected in 1Q14F. Third, three-year forward OP CAGR of 22% will be achievable on a greater artist lineup and new businesses gathering pace.

### Rights offer for facility investment, buying stakes in other firms, etc.

The proceeds from the rights offer (W53.2bn) will be used to 1) expand the company headquarters and build a training center, 2) participate in a rights offer by a subsidiary (Next Interactive K) engaged in the 3D hologram business, 3) strategically invest to grow the actor management business, 4) prepare new businesses and 5) advance on the US market. As such, we believe the rights offer

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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)	(%)
2011A	78	18	18	13	1,661	(35.6)	20	22.2	15.2	2.4	26.5
2012A	107	21	25	19	1,849	11.3	24	33.3	23.5	6.5	21.6
2013F	118	23	24	18	1,716	(7.2)	26	30.3	18.3	4.8	17.4
2014F	149	31	33	25	1,820	6.0	35	33.0	15.7	4.9	16.8
2015F	174	39	43	32	2,084	14.5	45	28.8	12.0	4.3	16.1

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

is part of YG's plan to steer the company onto higher ground. Of note, YG's artist lineup is expanding and it has secured more actors with several recently signing exclusive contracts.

Sales are projected to expand from W35.7bn in 2009 to W118bn in 2013F. For further top-line expansion and the production of competitive content, it is essential to expand facilities and make strategic investment. YG's capital injection to subsidiary NIK is aimed at providing more content for its new 3D hologram business, which we view as positive in the mid to long-term. The company's desire to enter the US market may raise concerns. But the move could be lucrative for YG as the investment is to ensure stable album production and concerts in the US amid the growing popularity of PSY and YG's other artists.

**Table 1. Summary of YG rights offer and bonus issue**

	Note
<b>Rights offer</b>	
Share class	Common shares
New shares	1,150,000 shares
Pre-issue outstanding shares	10,402,012 shares
Purpose of capital increase	Facility investment W34.2bn, equity investment W5bn, others W14bn
Capital increase process	Allotted to shareholders and forfeited shares put up for public auction
New shares allotment date (fixed)	April 18, 2014
Issue price per share	W46,250
New shares allotment date	March 5, 2014
Rights offer amount	W53.2bn
Priority allotment to employee ownership association	20%
	Employee stock ownership (begins April 23, ends April 24)
	Current shareholders (begins April 23, ends April 24)
Payment date	May 2, 2014
New shares listing date	May 20, 2014
<b>Bonus issue</b>	
Share class	Common shares
New shares	3,465,604 shares
Par value	W500
Pre-issue outstanding shares	11,552,012 shares
New shares allotment date	May 7, 2014
Allotment for each share	0.300000034 share
New shares delivery date	May 26, 2014
New shares listing date	May 27, 2014

Source: Company data

**Table 2. Detailed use of proceeds from capital increase**

	Priority	Investment purpose	Amount	Period
Headquarters	1	Purchase a building on a site for the new headquarters	W2bn	June 2014-June 2017
		Reconstruction	W6bn	
		Equipment and soundproofing facility	W5bn	
		Goods purchase	W2.2bn	
		Sub-total	W15.2bn	
Training center	2	Land and building purchase	W6bn	June 2014-June 2017
		Reconstruction	W3bn	
		Soundproofing facility	W2bn	
		Recording equipment, etc.	W3bn	
		Sub-total	W14bn	
Participate in subsidiary rights offer	3	Participate in rights offer by Next Interactive K Ltd.	W5bn	June 2014-June 2015
Strategic investment for management business	4	Strategic investment for management business	W4bn	June 2014-June 2015
Reinforced zone for new businesses	5	Reinforced zone for new businesses	W5bn	June 2014-December 2016
Overseas investment for entry to North American market	6	Overseas investment for entry to North American market	W10bn	June 2014-December 2016
<b>Total</b>			<b>W53.2bn</b>	

Source: Company data

**Table 3. Quarterly earnings forecast**

(W/bn)

	1Q13	2Q13	3Q13	4Q13F	1Q14F	2Q14F	3Q14F	4Q14F
Sales	29.8	30.6	29.7	28.0	43.1	33.9	37.5	34.1
Albums and digital music	5.1	4.2	8.1	7.3	7.6	7.3	7.6	6.8
Albums	2.3	1.9	5.4	4.6	4.4	4.2	4.4	3.9
Digital music	2.8	2.3	2.7	2.7	3.3	3.1	3.3	2.9
Concert sales	5.2	12.4	1.7	11.4	9.3	8.8	8.8	8.3
Advertising	2.8	3.2	3.7	3.0	3.6	3.5	3.5	3.4
Royalty revenue	11.5	6.1	11.4	1.4	18.0	8.9	12.2	9.5
Others	5.2	4.7	4.8	5.0	4.5	5.3	5.3	6.2
OP	6.3	5.5	6.4	4.5	9.2	6.8	8.4	6.3
EBT	6.2	6.4	6.1	5.7	8.9	6.7	8.5	9.1
NP	4.2	5.5	3.9	4.6	6.2	5.4	5.9	7.5
(%)								
OPM	21.1	18.0	21.4	16.1	21.4	20.1	22.3	18.6
NPM	14.0	17.9	13.3	16.4	14.3	15.9	15.6	22.1

Source: Company data, Korea Investment & Securities

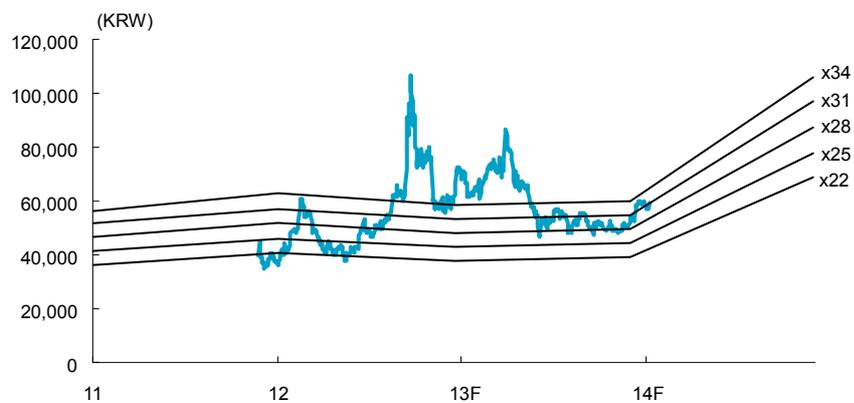
**Table 4. Annual earnings forecast**

(W/bn)

	2008	2009	2010	2011	2012	2013F	2014F
Sales	18.5	35.7	57.5	78.1	106.6	118.1	148.6
Albums and digital music	9.1	13.3	13.9	20.4	28.7	24.7	29.4
Albums	5.9	6.5	8.1	12.0	17.8	14.3	16.8
Digital music	3.3	6.8	5.8	8.4	10.9	10.4	12.6
Concert sales	1.5	4.9	6.4	17.4	24.2	30.7	35.3
Advertising	3.2	6.9	10.5	11.9	11.9	12.7	14.0
Royalty revenue	0.3	3.4	4.6	7.4	22.6	30.5	48.6
Others	4.4	7.2	22.1	21.0	19.1	19.6	21.3
COGS	10.2	19.8	33.1	47.0	64.5	73.1	89.7
SG&A	6.9	9.8	11.5	13.4	20.6	22.4	28.2
OP	1.4	6.1	12.9	17.8	21.5	22.7	30.7
EBT	1.9	5.4	13.5	17.6	24.8	24.4	33.3
NP	1.6	4.2	9.6	12.9	18.8	18.2	24.9
(%)							
OPM	7.5	17.2	22.4	22.7	20.1	19.2	20.7
NPM	8.6	11.7	16.7	16.6	17.6	15.4	16.8

Source: Company data, Korea Investment & Securities

**Figure 1. 12MP PE band**



Source: Company data, Korea Investment & Securities

**Company overview & Glossary**

YG Entertainment is one of the largest entertainment agencies in Korea, along with SM Entertainment and JYP Entertainment. The company was established by Hyunsuk Yang, a member of Seo Taiji and the Boys. YG has built a strong musical brand and currently has major artists such as Big Bang, 2NE1, Psy, Epik High, Hai Lee, Se7en and Gummy. YG fosters various trainees through systematic training and utilizes its unique cultural code to transform these trainees into artists. Albums and music are the basis of sales, using produced music to generate management revenue.

- Royalty revenue: YG's artist activities in Japan are in cooperation with AVEX; Profit from Japan is shared with AVEX and profit distributed to YG is based on royalty revenue

**Balance sheet**

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Current assets	74	92	89	104	120
Cash & cash equivalents	37	53	41	45	49
Accounts & other receivables	6	13	15	18	20
Inventory	3	4	5	6	7
Non-current assets	16	26	48	103	133
Investment assets	5	7	18	27	34
Tangible assets	6	10	22	52	70
Intangible assets	5	8	8	10	13
Total assets	90	117	137	208	252
Current liabilities	14	20	25	23	41
Accounts & other payables	7	13	18	22	26
ST debt & bonds	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	14	20	25	23	41
Controlling interest	76	97	112	185	211
Capital stock	3	5	5	8	8
Capital surplus	45	47	47	97	97
Capital adjustments	2	1	1	1	1
Retained earnings	26	45	60	80	107
Minority interest	0	0	0	0	0
Shareholders' equity	76	97	112	185	211

**Cash flow**

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
C/F from operations	16	14	24	6	47
Net profit	13	19	18	25	32
Depreciation	1	1	1	2	3
Amortization	2	2	2	2	3
Net incr. in W/C	(1)	(8)	3	(23)	10
Others	1	0	0	0	(1)
C/F from investing	(33)	1	(32)	(52)	(38)
Capex	(2)	(6)	(13)	(32)	(21)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(25)	11	(12)	(9)	(6)
Net incr. in intangible assets	(6)	(4)	(2)	(5)	(6)
Others	0	0	(5)	(6)	(5)
C/F from financing	41	1	(3)	50	(5)
Incr. in equity	41	1	0	53	0
Incr. in debt	0	0	0	0	0
Dividends	0	0	(3)	(3)	(5)
Others	0	0	0	0	0
C/F from others	0	(1)	0	0	0
Increase in cash	24	16	(12)	4	4

Note: K-IFRS (consolidated)

**Income statement**

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Sales	78	107	118	149	174
COGS	47	64	73	90	101
Gross profit	31	42	45	59	73
SG&A expenses	13	21	22	28	34
Operating profit	18	21	23	31	39
Financial income	1	2	2	2	3
Interest income	0	2	2	2	2
Financial expenses	0	3	2	1	1
Interest expenses	0	0	0	0	0
Other non-operating profit	(1)	5	1	1	1
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	1
Earnings before tax	18	25	24	33	43
Income taxes	5	6	6	8	11
Net profit	13	19	18	25	32
Net profit of controlling interest	13	19	18	25	32
Other comprehensive profit	0	(1)	(1)	(1)	(1)
Total comprehensive profit	13	18	17	24	31
Total comprehensive profit of controlling interest	13	18	17	24	31
EBITDA	20	24	26	35	45

**Key financial data**

FY-ending Dec.	2011A	2012A	2013F	2014F	2015F
Per-share data (KRW)					
EPS	1,661	1,849	1,716	1,820	2,084
BPS	15,320	9,437	10,740	12,293	14,067
DPS	0	300	300	300	300
Growth (%)					
Sales growth	35.8	36.4	10.8	25.8	17.4
OP growth	37.7	20.9	5.6	35.7	27.1
NP growth	34.3	45.0	(3.1)	37.2	27.8
EPS growth	(35.6)	11.3	(7.2)	6.0	14.5
EBITDA growth	44.1	20.1	6.4	35.0	29.6
Profitability (%)					
OP margin	22.7	20.1	19.2	20.7	22.4
NP margin	16.6	17.6	15.4	16.8	18.3
EBITDA margin	25.9	22.8	21.9	23.5	26.0
ROA	20.3	18.0	14.3	14.5	13.9
ROE	26.5	21.6	17.4	16.8	16.1
Dividend yield	0.0	0.5	0.6	0.5	0.5
Stability					
Net debt (W bn)	(64)	(70)	(65)	(75)	(84)
Debt/equity ratio (%)	0.0	0.0	0.0	0.0	0.0
Valuation (x)					
PE	22.2	33.3	30.3	33.0	28.8
PB	2.4	6.5	4.8	4.9	4.3
PS	1.9	5.9	4.5	5.4	5.2
EV/EBITDA	15.2	23.5	18.3	15.7	12.0

**Changes to recommendation and price target**

Company (Code)	Date	Recommendation	Price target
YG Entertainment (122870)	03-16-12	BUY	W69,000
	09-16-12	BUY	W76,500
	11-07-12	BUY	W95,000
	03-05-13	BUY	W85,000
	07-26-13	BUY	W76,000
	11-29-13	BUY	W67,000
	02-16-14	BUY	W51,500



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