

YG Entertainment (122870)

12M rating **BUY (Maintain)**

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

Up/downside **-14%**

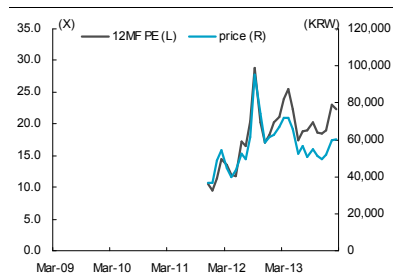
Stock Data

| | |
|------------------------------------|---------------|
| 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

Shiwoo Kim

822-3276-6240

swkim@truefriend.com

Sangung Han

822-3276-4563

sangung@truefriend.com

| Yr to | Sales | OP | EBT | NP | EPS | % chg | EBITDA | 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 |
|--|---|
| Rights offer | |
| 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 |
| Bonus issue | |
| 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 |
| Total | | | W53.2bn | |

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 |

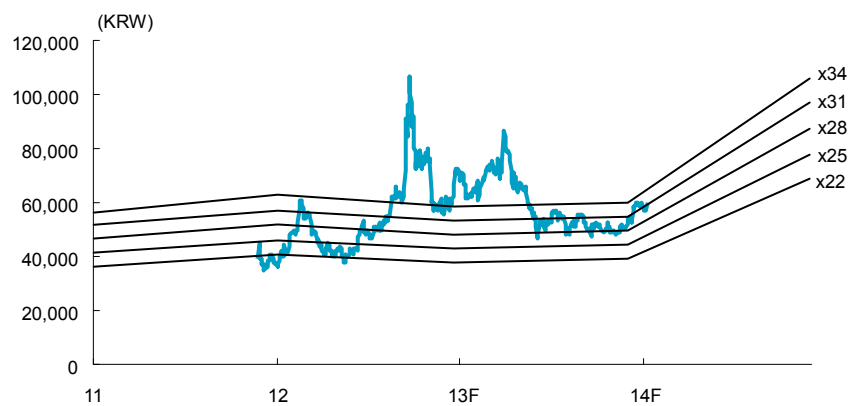
Source: Company data, Korea Investment & Securities

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 |

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 |

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 |

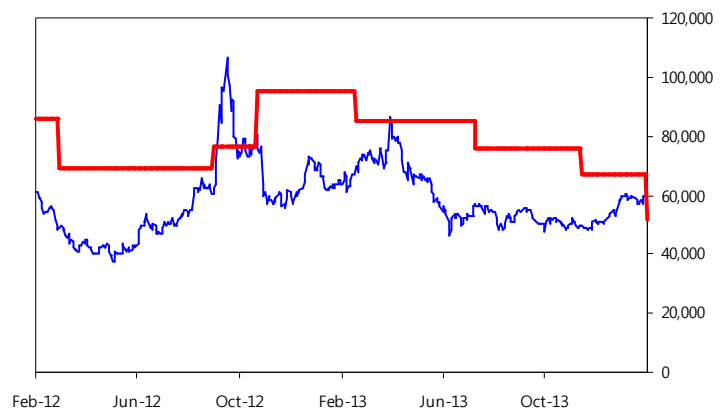
Note: K-IFRS (consolidated)

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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- Underweight: Expected to give a return of -15% or less
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- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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Neither the analysts covering these companies nor their associates own any shares of as of February 17, 2014.

Prepared by: Shiwoo Kim

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