LEADING

Mid-Cap Research

Loen Entertainment (016170 KQ)

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Loen's got talent!

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Leading Traffic Light: Green

Loen Entertainment is…

- ✓ 100% owner of Melon, the largest digital music platform with 45% M/S
- ✓ The agency of a top star singer, IU
- ✓ Vertical integration - production to distribution

Green light because:

- ✓ 20% CAGR of content business, which accounts for over 80% of the revenue
- ✓ Dominant contents distributor delivering 2.2mn songs and distributing 300~400 titles annually

Growth potential:

- ➢ Wide use of mobile devices to fuel the growth of Melon (accounting for 60% of the revenue)
- ➢ Contents business is a major force behind 21% yoy increase in 2012F revenue
- ➢ Top star singer IU to fuel growth

Management and shareholder value:

- ➢ CEO Mr. Shin rose from entry level to CEO and know all the ins and outs of the company
- ➢ Dividend payout ratio of 20% shows the management's concern for shareholders

Value creation:

- ➢ Maintaining mid 20% ROE backed by solid operating profit since the spinoff in 2009

Valuation:

- ➢ Target price assessment at W23,000 by applying the PER of 17.7X
- ➢ 36.1% upside potential from the current share price of W16.900

CAVEAT EMPTOR!!! – Watch out for…

- ➢ While a success of new idol groups is not easy
- ➢ However, Loen seems to have a strong chance of success judging from the prior success in raising new stars, such as IU, ,Zia, and Sunnyhill,

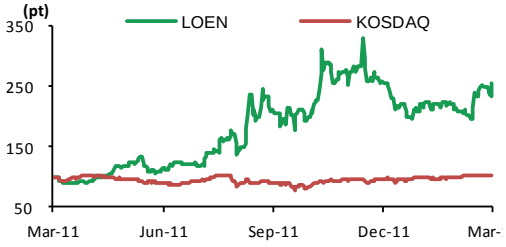
BUY

Target Price (KRW)	**W23,000**
Current Price (KRW)	**W16,900**
Upside potential	**36.1%**

Key Data	**March 9, 2012**
Sector	Media
KOSDAQ	539.55
Market Cap. (Wbn)	427.4
Share Outstanding (m)	25.3
Foreign Ownership (%)	11.5
52 Week High (W)	21,950
52 Week Low (W)	5,940
60-d avg.turnover (Wbn)	6.6
Major Shareholders	**(%)**
SK Planet & 2 others	67.6
Realnetworks	11.3

Performance (%)	**1M**	**6M**	**12M**
Absolute	19.0	19.9	152.2
Relative	15.4	5.3	148.9

Relative Performance



Valuation Forecast

FY	Sales (Wbn)	% chg yoy	OP (Wbn)	OPM (%)	NP (Wbn)	EPS (W)	EPS Growth (%)	PER (x)	EV/EBITDA (x)	ROE (%)	P/B (x)
2008	30.8	(10.1)	0.3	1.0	1.3	51	N/A	312.7	200.5	2.7	5.2
2009	101.4	229.3	6.4	6.3	4.5	178	253.2	88.5	26.7	7.3	6.4
2010	139.0	37.0	16.4	11.8	9.8	386	116.5	40.9	13.3	14.7	5.6
2011E	167.1	20.2	27.4	16.4	21.5	848	119.5	19.2	11.1	25.8	4.3
2012E	202.1	21.0	33.6	16.6	26.5	1,046	23.4	16.2	9.7	24.6	3.6
2013E	246.3	21.9	41.1	16.7	33.0	1,304	24.6	13.0	8.2	24.5	2.9

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Key check points

✓ The success of IU! Waiting for the debut of another IU…

The company's album management capability has not been clearly proven compared to major domestic entertainment companies – SM, YG, JYP. However, the company has produced one of the most successful artists in the modern history of K-Pop, IU(debut in 2009). Loen successfully produced the top star sing IU (also the very first singer Loen produced) only four years after the entry into album production business, which strongly indicates a strong possibility success in singer production. All songs in IU's second full length album (November 2011) placed high on music charts, and there are high expectations for her debut in Japan in March 2012. Furthermore, the company has produced Zia (*Have a drink*) and Sunnyhill (*The grasshopper song*) whose popularity is increasing with several popular songs on music charts. Loen is currently preparing a girl group and a boy group for debut in 2H12 and 1H13, respectively.

✓ Leaping forward with No.1 domestic digital music platform

Loen Entertainment is the 100% owner of the largest digital music platform, Melon, an SKT's spinoff company that generates 60% of total revenue and is a cashcow. With 45%~50% market share, Melon is dominating the domestic online music market consisted of four other major competitors – 'mnet' (CJ E&M), 'Bugsmusic' (Neowiz Internet), Olleh Music (KT music), and Soribada, whose combined market share is about 50%. Melon's position in the market is very solid given that it overwhelms the runner-up 'mnet''s market share by more than 30%. Such dominance is expected to persist given that the company has been the leader in the market since 2004.

✓ Synergy effect with SK Planet expected in 2012F

SKT was the largest shareholder of Loen Entertainment with a 63.5% stake until September 2011. However, following the spinoff in October 2011, SK Planet became the largest share holder with a 63.5% stake and 67.6% including treasury stocks. SK Planet is currently concentrating on developing smartphone application distribution platform that will connect developers and customers. It is also focusing on developing a distribution platform via mobile devices that connects application developers and customers. We expect digital contents distribution and commerce will create synergy for Loen Entertainment and SK Planet.

✓ Target price of W23,000 implies 36.1% upside potential

Loen is a digital music distributor utilizing Melon and album production business utilizing its digital music distribution platform. Melon is the leading digital music distribution platform and is playing the role of a cash cow. It is also the company's future growth potential. Furthermore, the company's early investments in contents secured dominant digital music distribution ability.

Artist/album management business, the growth engine, is expected to begin in full force in 2012F and generate revenue starting 2013F. Therefore, we believe it is suitable to assess the fair target value by applying 2013F valuation of its peers to the company's 2013F EPS.

In determining Loen's appropriate valuation and target price, we used consensus valuation of Neowiz's 2013F PER of 18.0x and entertainment industry's 2013F average PER of 17.4x, which renders 17.7x. Applying the PER of 17.7x to Loen's 2013F EPS of W1,304, we derived a fair share price of W23,000, which implies 36.1% price appreciation potential from the current share price of W16,900.

Section 1-1: Valuation – Target price W23,000

Trading at a premium since 2008 but at a discount compared with its peers

The company is the leader in digital music distribution through Melon and is actively expanding to singer production and management. Loen has been trading at a premium to the market since 2008 and is trading at a 68.5% premium to 2012F market PER. However, it is trading at a discount to Neowiz Internet's 2012F PER of 20.4x (the only comparable company within the same field) and the average 2012F PER of companies (SM and YG) engaged in album management which is 19.2x.

We believe applying the average PER of the peer group is appropriate for following reasons.

1. Digital music division

No 1.Melon
No 1. Sourcing & Distribution
Being an affiliate of SK, potential synergy expected

- The company's digital music platform, Melon, has been maintaining the leading position in the market and is playing the role of a cash cow
- Secured dominant sourcing and distribution capability, delivering over 2.2mn songs to customers
- Being one of SK's affiliates, creation of a great synergy with other affiliates expected (collaboration between SKT and Melon/ contents distribution through SK Planet's platform)

2. Management division

-Super star IU + Zia, Sunnyhill, Run
-Consistent investment in production possible thanks to sufficient cash

- Proved its capability in singer production/management by successfully producing IU(as popular as SNSD), RUN, Zia, and Sunnyhill
- Being in the net cash position of W77.9bn by the end of 2011E, the company can keep focusing on singer/album production which yields high return for high risk

Loen's album management business expected to generate revenue starting 2013F

Loen's growth engine, album management business, will begin in earnest 2012 and begin to generate revenue starting 2013F. Therefore, we believe it is appropriate to apply 2013F PER to 2013F EPS to asses s the fair share price of Loen.

Fair value assessment at W23,000 applying target PER of 17.7x to Loen's 2013F EPS

We derived the fair PER (17.7x) of Loen by averaging Neowiz's 2013F PER of 18.0x and entertainment (celebrity management) industry's 2013F average PER of 17.4x. Therefore applying the target PER of 17.7x to Loen's 2013F EPS of W1,304, we derived a fair share price of W23,000 which implies 36.1% upside potential from the current share price of W16,900.

Exhibit 1. LOEN Valuation VS. Market Valuation

(X, %)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012F	2013F
LOEN year-high EV/EBITDA (X)	10.9	9.0	(159.4)	(27.6)	615.4	(30.8)	86.6	13.0	9.2	15.0	9.6	8.2
Market year-high EV/EBITDA (X)	8.7	7.9	7.1	9.8	11.3	14.2	12.3	11.3	10.3	10.6	8.4	7.5
Premium/(Discount) to market (%)	**25.9**	**14.0**	**NA**	**NA**	**5,354.2**	**NA**	**603.7**	**15.4**	**(10.5)**	**40.9**	**14.2**	**9.4**
LOEN year-high PER	(34.5)	69.3	(34.7)	(43.9)	(138.0)	(12.5)	123.7	39.2	24.1	25.9	16.0	12.9
Market year-high PER	19.9	20.7	9.9	13.9	17.9	22.3	42.4	20.4	16.0	9.7	9.5	8.6
Premium/(Discount) to market (%)	**NA**	**234.8**	**NA**	**NA**	**NA**	**NA**	**191.7**	**92.5**	**51.0**	**166.8**	**68.5**	**49.5**

Source: Company data, Leading Research Center
**Market = KOSPI + KOSDAQ,*

Section 1-2: Valuation – Peer Valuation

Two-tier peer valuation is suitable considering the company's business structure

Loen is engaged in both digital music distribution business and celebrity management business. Therefore, we employed two-tier peer valuation which compares the valuations of both digital music distribution companies and celebrity management companies.

As Loen generates the highest revenue from digital music distribution, we compared valuations of other digital music distributors – Neowiz Internet, KT Music, and Soribada. Furthermore, considering the fact that the company is also engaged in celebrity management business, we selected three most well-known management companies – SM, YG, and JYP – for peer valuation.

We excluded CJ E&M from peer valuation because its business scale is too large for comparison, and it generates revenue mainly from media contents (80% of the revenue) rather than digital music platform.

Highest revenue among companies engaged in digital music distribution business

The company generates the highest revenue among its peers engaged in digital music business. Furthermore, its 2012F OPM is expected to record 16.6% which is the highest among its peers and maintain the uptrend in 2013F as well. As KT music and Soribada are losing their market shares in digital music platform market, Melon and Mnet are expected to hold solid positions. Loen's 2012F and 2013F PER of 15.2X and 12.2x, respectively, will be lower than those of its peers. Considering its superb target revenue and net profit, we believe the company is undervalued compared with peers.

Exhibit 2. Peer valuation – Digital music platform

Year	(Wbn)	Loen (016170 KQ)	Neowiz Internet (104200 KQ)	KT Music (043610 KQ)	Soribada (053110 KQ)
2010	Revenue	139.0	44.3	40.1	28.9
	Net profit	9.8	11.4	0.6	3.1
	PER (x)	22.1	11.1	134.4	16.2
	Market Cap.	216.2	117.5	80.7	49.5
	OPM (%)	11.8	12.6	0.6	16.0
	NPM (%)	7.0	25.8	1.5	10.6
	ROE (%)	14.7	25.2	2.7	19.5
2011	Revenue	167.1	47.4	31.3	26.3
	Net profit	21.5	7.3	(2.4)	4.3
	PER (x)	18.5	23.7	N/A	9.0
	Market Cap.	397.8	173.2	74.8	34.1
	OPM (%)	16.4	15.0	Deficit	12.2
	NPM (%)	12.8	15.4	Deficit	16.3
	ROE (%)	25.8	18.5	N/A	15.5
2012E	Revenue	202.1	59.5	44.5	
	Net profit	26.5	8.1	0.7	
	PER (x)	15.2	20.4	102.0	
	Market Cap.	402.1	165.7	71.4	77.1
	OPM (%)	16.6	14.5	2.5	
	NPM (%)	13.1	13.3	1.6	
	ROE (%)	24.6			
2013F	Revenue	246.3	71.1	46.0	
	Net profit	32.9	9.2	1.2	
	PER (x)	12.2	18.0	89.3	
	Market Cap.	402.1	165.7	71.4	77.1
	OPM (%)	16.7	14.8	3.4	
	NPM (%)	13.4	13.4	2.6	
	ROE (%)	24.5			

Source: Leading Research Center, Fnguide, Thomson Reuter, Bloomberg (Based on data from March8, 2012)

Comparison with three major album management peers – SM, YG, JYP

We compared valuations of three most well-known companies engaged in album/singer management.

One of the most well known management companies is SM (SNSD, Super Junior, BoA, TVSQ, Shinee, F(x), etc.). SM, the leading management company with the most singers, recently hosted 'SM town concert overseas and maintained its dominant position. YG (2NE1, Big Bang, etc.) and JYP (2AM, 2PM, Miss-A, etc.) are also major management companies in Korea.

IU with the highest number of uncle fans

Loen is currently managing IU, Zia, and RUN. Especially, IU who has the highest number of uncle fans (=adult male fans) is an indisputable super star.

Planning to release her album in Japan in March 2012

Loen is planning to release IU's album in Japan in March 2012. IU's debut in Japan may be slower than those of singers in SM and YG. However, we believe she still has potential to record a big hit like SNSD and 2NE1 did as she successfully showcased her music in Tokyo via EMI Music Japan in January 2012.

Ranked 7th on the Oricon chart on the first day of Korean album release

We believe IU has been gaining positive recognition in Japan as her Korean album ranked 7th on the Oricon chart on the first day of the release (December 14, 2011). Once, her album sales and concerts begin in earnest in Japan, the company's revenue is expected to grow.

Judging from IU's success in Japan, we believe Loen proved its singer management capability. Therefore, the company's valuation can be compared to those of major Korean management companies.

Recording the highest revenue thanks to Melon

Loen is outperforming its peers in terms of revenue because the company generates high revenue from its cash cow, Melon. Loen's 2012F net profit will be W26.5bn while SM and YG are expected to post 2012F net profit of W48.9bn and W19.5bn, respectively.

SM's 2012F net profit and market capital will be higher than those of LOEN (1.9x and 2.6x, respectively)

SM's 2012F net profit and market capital will be 1.9x and 2.6x higher than those of Loen's, respectively, resulting in the PER of 21.4x. YG and JYP are expected to post 2012F PER of 20.9x and over 300x, respectively. On the other hand, Loen is trading at a PER of 15.2x, implying that the company is undervalued.

Exhibit 3. Peer valuation – Album/Singer management

Year	(Wbn)	Loen (016170 KQ)	SM (041510 KQ)	YG (122870 KQ)	JYP (035900 KQ)
	Revenue	139.0	86.4	44.8	10.2
	Net profit	9.8	21.8	9.8	(10.4)
	PER (x)	22.1	12.3	N/A	N/A
2010	Market Cap.	216.2	268.1	N/A	26.4
	OPM (%)	11.8	29.5	23.1	(58.7)
	NPM (%)	7.0	25.2	21.8	(102.0)
	ROE (%)	14.7	29.1	63.8	(86.3)
	Revenue	167.1	98.3	75.0	9.9
	Net profit	21.5	18.7	11.2	(-2.2)
	PER (x)	18.5	51.1	49.8	208.8
2011	Market Cap.	397.8	955.6	557.8	182.9
	OPM (%)	16.4	22.8	20.9	적지
	NPM (%)	12.8	19.1	14.9	적지
	ROE (%)	25.8	19.2	42.0	1.9
	Revenue	202.1	152.5	109.1	10.7
	Net profit	26.5	48.9	19.5	0.6
	PER (x)	15.2	21.4	20.9	304.8
2012E	Market Cap.	402.1	1,048.5	557.5	182.9
	OPM (%)	16.6	36.6	22.2	5.0
	NPM (%)	13.1	32.1	16.1	5.7
	ROE (%)	24.6			
	Revenue	246.3	169.8	168.2	11.3
	Net profit	32.9	58.1	32.0	0.7
	PER (x)	12.2	18.0	17.4	261.3
2013F	Market Cap.	402.1	1,048.5	557.5	182.9
	OPM (%)	16.7	38.7	24.8	5.1
	NPM (%)	13.4	34.3	18.2	5.9
	ROE (%)	24.5			

Source: Leading Research Center, Fnguide, Thomson Reuter, Bloomberg (Based on data from March8, 2012)

Section 2: Company Snapshot

Album management to distribution through Melon

- **Album Management: IU, Zia, Sunnyhill**
- **Melon: Largest domestic digital music platform**
- **Distribution: K-pop star, Seung-Gi Lee and various artists**

Vertically integrated company engaged in various music businesses

1978: Established as Seoul Record
2005: Became an SK affiliate
2008: Changed its name to Loen Entertainment

Loen Entertainment has a vertically integrated structure as it is engaged in all kinds of digital music related businesses, ranging from album management to distribution. Established as Seoul Records in 1978, the company was assigned as an SK affiliate after the stock dealing with SKT in 2005. After changing its name to Loen Entertainment in March 2008, the company completed business transfer with SKT in end-2008 and took over Melon business.

Prospects for synergy with SK planet, the largest shareholder

After the spinoff in October 2011, SK Planet became the largest shareholder of Loen Entertainment with a 63.5% stake. After purchasing treasury stocks, SK Planet currently owns 67.6% of the company's shares. Collaborating with SK Planet, which focuses on content delivery business and commerce business, Loen Entertainment can expect the prospects for synergy.

The agency of IU, Zia, and Sunnyhill

Although the company successfully proved its album management capability by producing IU, it has not proven enough to be on the same level as major management companies – SM, JYP, and YG. However, we believe producing IU showed the public that the company has great potential. Furthermore, Sunnyhill and Zia are gaining public's recognition as well.

Melon leading domestic digital music market with 45% MS

In addition to strengthening its album management capability, the company is also focusing on the largest domestic digital music platform, Melon. Backed by 160mn subscribers, Melon, which accounts for 60% of the revenue, is leading the market with Mnet (CJ E&M, 003560KS).

Music distribution – 'I am a singer', 'K-pop Star', Seung-ki Lee, etc.

The company has been maintaining the dominant position in the market after distributing digital music played in "I am a singer" in 1H11. Loen's business was bit sluggish in 2H11 due to the fact that Bugsmusic (Neowiz Internet, 104200 KQ) signed the contract to distribute music played in "I am a singer". However, the company regained its strength by signing the contract to distribute music played in a new audition program, "K-pop Star". We believe the increasing number of new music programs is making a significant contribution to the company's distribution business.

Exhibit 4. Revenue proportion for each division

(Wbn) Division	2011E	Revenue proportion
Products the company invested in (CD and others)	12.0	7.2%
Simple distribution of final products (CD and others)	1.6	1.0%
Revenue from contents sales	146.9	87.9%
Revenue from others (Advertisement, Media)	6.5	3.9%
Total	167.1	100.0%

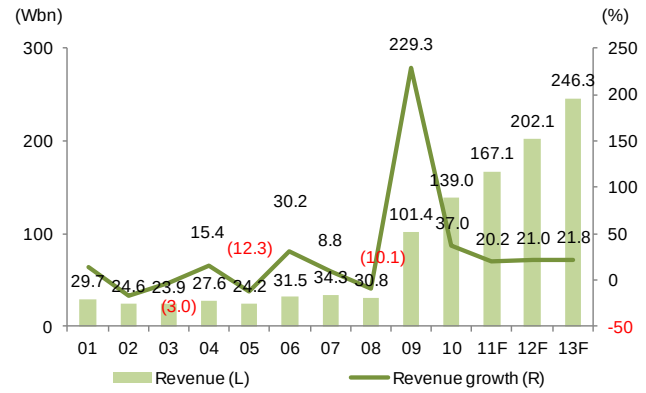
Source: Company data, Leading Research Center

Revenue growth at 20% level expected in 2012F and 2013F

After spinning off from SKT in 2008, the company's 2009 revenue surged thanks to Melon. As Melon, which accounts for 60% of sales, is expected to maintain the uptrend, we expect the company to post 2012F and 2013F revenue of W202.1bn. OPM should also maintain its uptrend – which has been increasing since 2009 – and record 16.6% in 2012F.

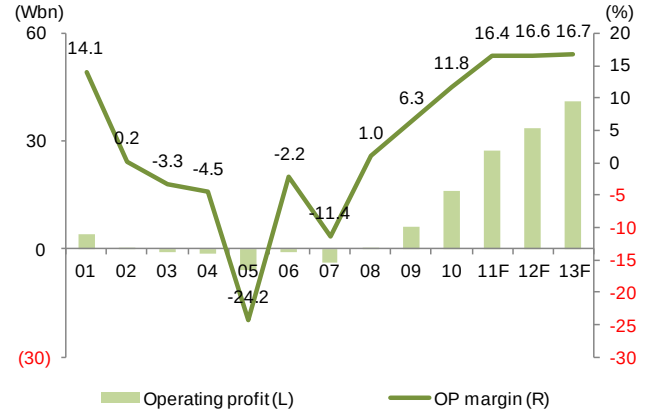
Section 3: Facts & Figures

Exhibit 5. Revenue and growth trend



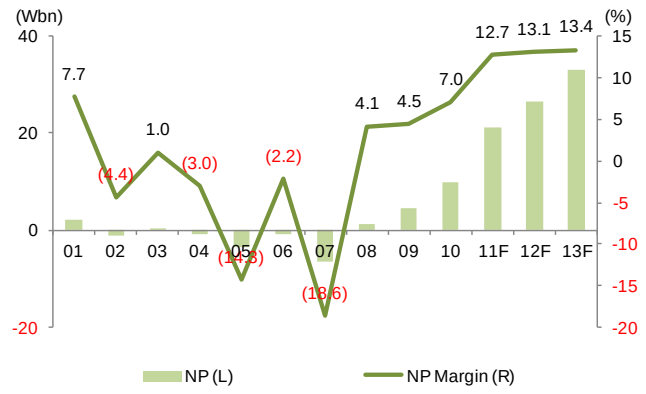
Source: Company data, Leading Research Center

Exhibit 6. Operating profit and OPM trend



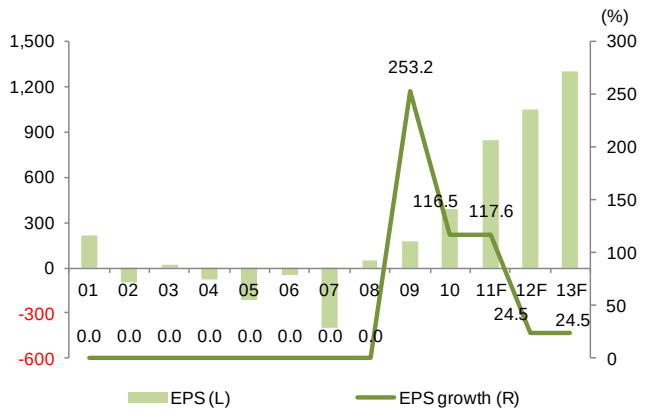
Source: Company data, Leading Research Center

Exhibit 7. Net profit and NPM trend



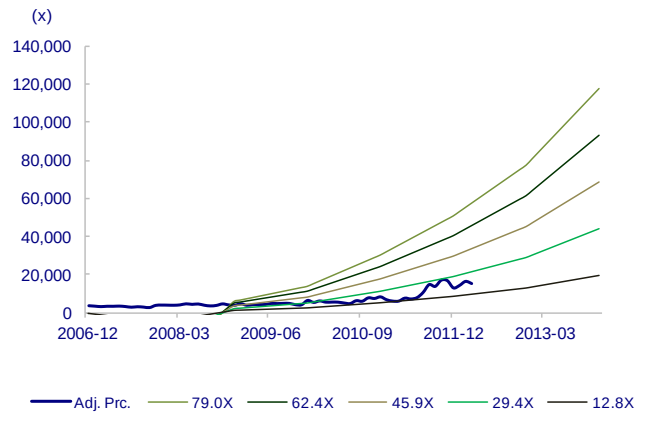
Source: Company data, Leading Research Center

Exhibit 8. EPS and EPS growth



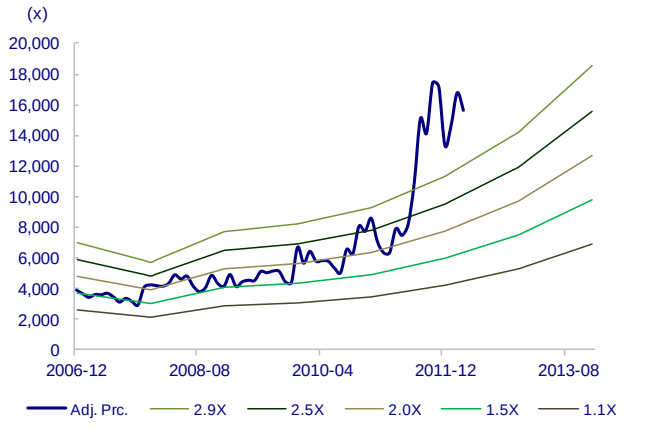
Source: Company data, Leading Research Center

Exhibit 9. PER Band



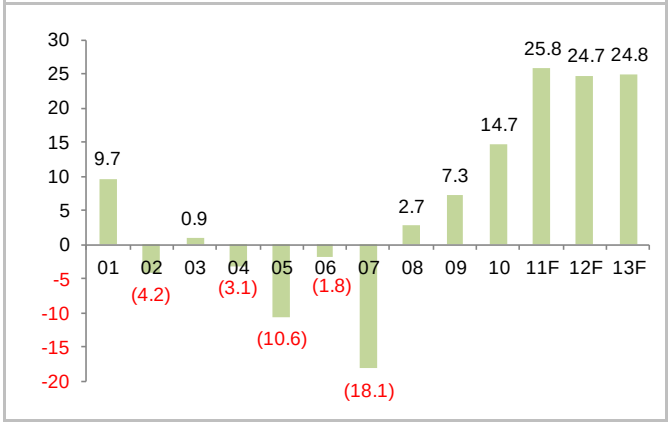
Source: FnGuide

Exhibit 10. PBR Band



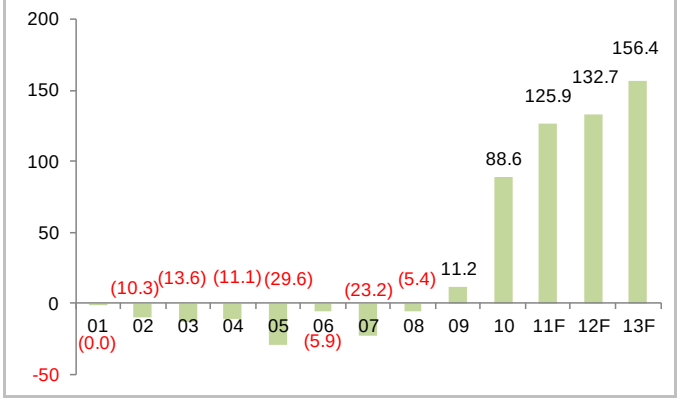
Source: FnGuide

Exhibit 11. ROE (%)



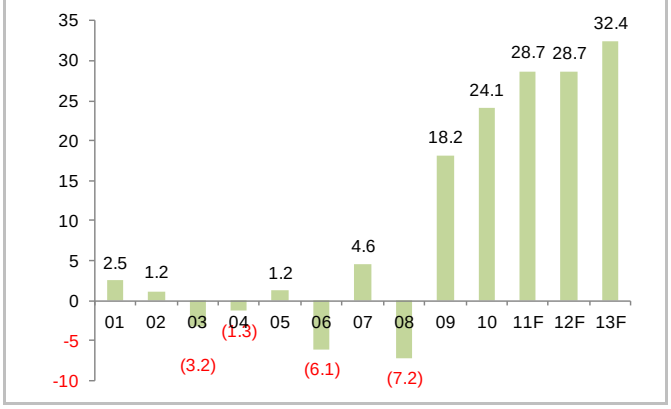
Source: Company data, Leading Research Center

Exhibit 12. EVA: ROIC less WACC (%)



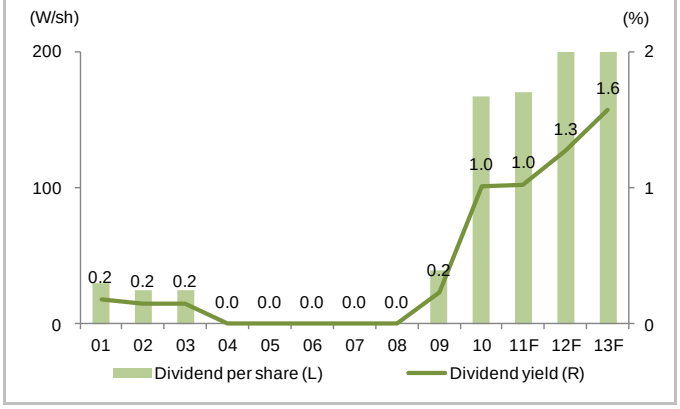
Source: Company data, Leading Research Center

Exhibit 13. Free cashflow trend (Wbn)



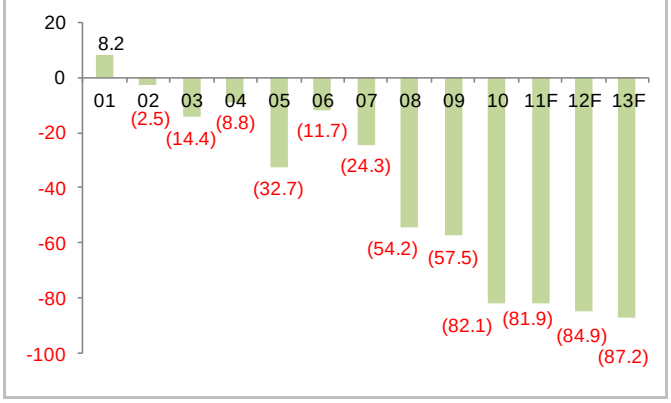
Source: Company data, Leading Research Center

Exhibit 14. Dividend per share and yield trend



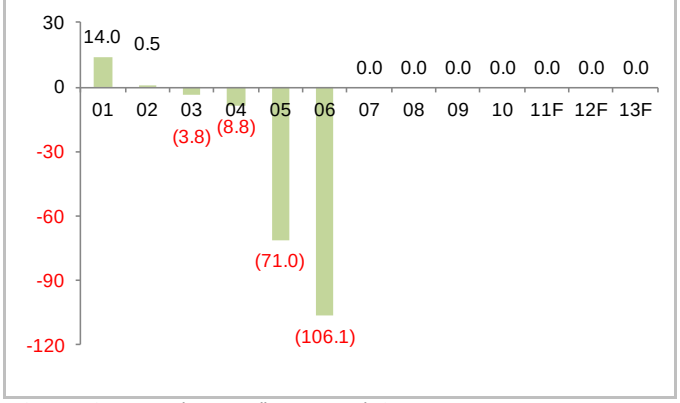
Source: Company data, Leading Research Center

Exhibit 15. Net debt to equity ratio (%)



Source: Company data, Leading Research Center

Exhibit 16. Interest coverage (X)



Source: Company data, Leading Research Center
** Excluded 2007 Interest coverage (1,834), as it is classified as an outlier*

Section 4: What is the management philosophy?

Loen Enteritanment – SK Affiliate

- **CEO who joined SK as an ordinary employee**
- **Launched Melon in 2004 when he was serving as the manager of music business division**

Loen Entertainment is an SK's affiliate. The company's CEO, Won Su Shin, became the CEO after joining SK as an ordinary employee through open recruitment. When he joined Korea Mobile Telecommunications Service (SKT) in March 3, 1983, he was engaged in marketing 이동전화 상품. He joined SKT's portal business division in the early 2000s and launched Melon in November 2004, as a director of music business division.

CEO Won Su Shin, standing in the middle of rapidly changing digital music industry

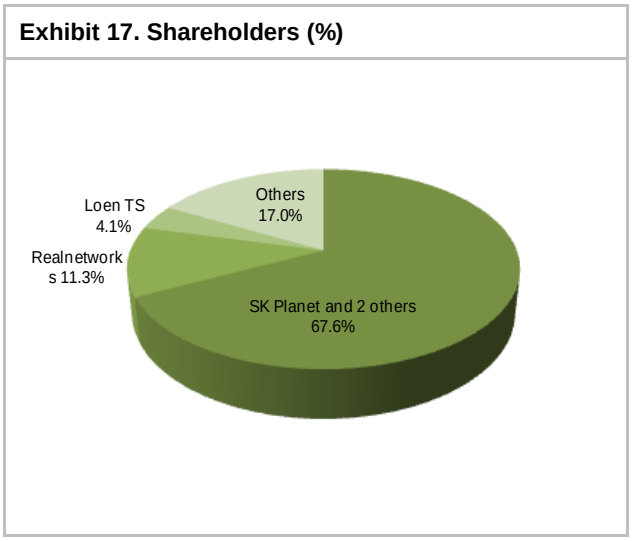
Having a keen interest in mobile music business, SKT developed caller tone and background music for Cyworld which were only available to subscribers. As a result, SKT was in the center of the music industry which was making effort to charge for music files, and CEO Won-Su Shin was with SKT through the process.

Backed by 160mn subscribers, Melon leading the domestic digital music distribution market with 45% M/S

Conventional music industry, which consisted of CD and cassette tapes, was ruined by copyright infringement. Furthermore, Melon was launched after Apple announced its music platform, iTunes, which charged a dollar for a song. Amid a difficult situation, Melon secured 160mn subscribers (130mn paying subscribers) and is maintaining the dominant position in digital music industry with 45% M/S. Delivering approximately 2.2mn songs, Melon currently has the highest number of digital music in Korea.

Management profile

Exhibit 17. Shareholders (%)



Source: Company data, Leading Research Center

Exhibit 18. CEO Profile

CEO Won-Su Shin		Career/Education
Career	2008~	CEO Loen Entertainment
	2004~2007	Head of Contents division ,SKTelcom
Edu.	~1988	B.S Kyung-hee University

Source: Company data, Leading Research Center

Section 5: Operation overview

Loen's growth engine – IU & Melon

Secured a revenue source by acquiring Melon from SKT in December 2008

Loen entertainment secured a solid revenue source by acquiring Melon, of which the revenue has been growing. Melon, which generates 60% of the company's revenue, is playing the role of a cash cow. Furthermore, the company generates 7% of its revenue from CD sales. However, album management business (IU, Zia, and Sunnyhill) is not contributing much to the company's revenue, yet.

Business area (3Q11)

- Contents revenue (Melon + Investments in digital music + Digital music for mobile devices): W107.4bn, 89.2%
- CD/Album revenue: W8.3bn, 7.0%
- Others (Advertising): W4.6bn, 3.8%

The company has fowling three value chains.

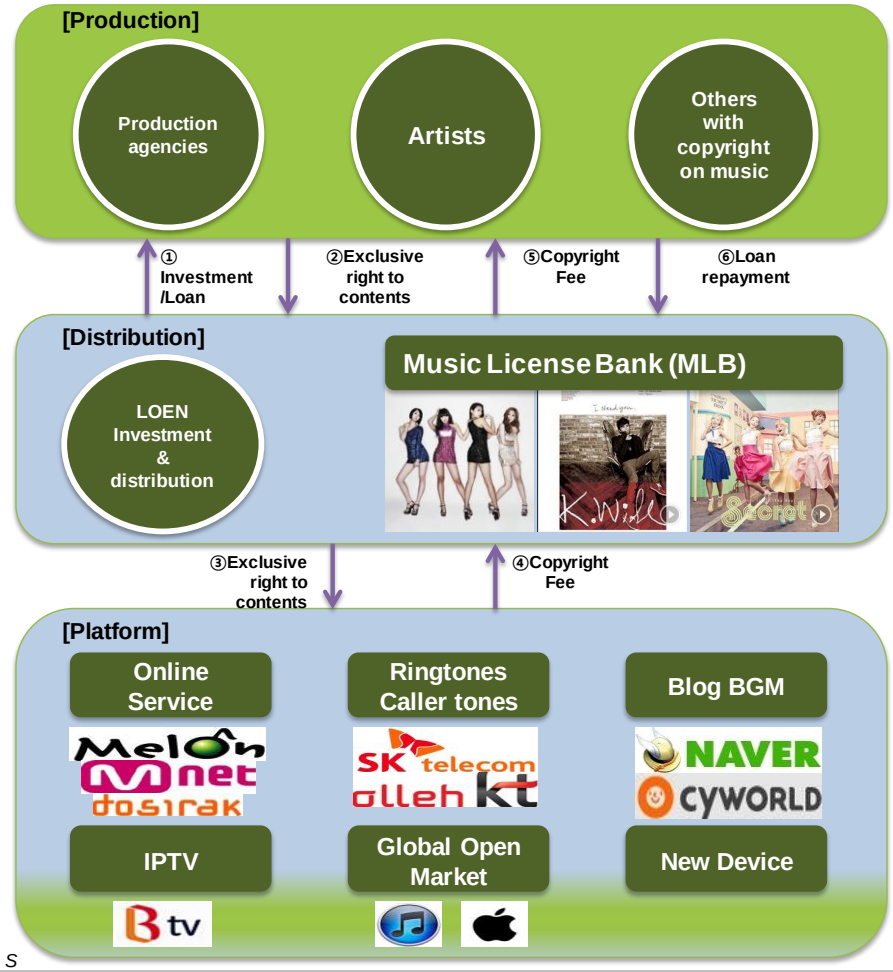
Business area
-Album management: IU, Zia
-Distribution business: Distributing through online platform
-Platform business: Melon

1) **Management business:** Album production and purchasing exclusive rights on contents from other management companies
   The company not only produces singers but also invest in other companies to secure exclusives rights on contents distribution. As the scale of investment in music production business (W0.2bn~W0.4bn) is relatively lower than that of movie and other contents (W4bn~W6bn), it is easier to manage related risks. Furthermore, it is more convenient to coordinate with other digital music distribution websites that provide similar services.

2) **Distribution business:** Managing secure contents and distributing through various platforms
   Making contracts with over 300 license holders, the company has the best sourcing & distribution capability, releasing between 300~400 titles annually. Furthermore, the company established Music License Bank (MLB), which delivers over 2.2mn songs through several platforms.

3) **Platform business:** The owner of the largest domestic digital music platform, Melon
   CJ E&M (mnet), Neowiz Internet (Bugsmusic), Soribada (Soribada), and Olleh Music (Dosirak) are also engaged in music platform business. Loen's platform division generates revenue from distribution of digital music through its platform and sales of caller tone and ringtone to wireless telecommunication companies.

Exhibit 19. Business value chain



So

Source: Company data, Leading research

Loen – Album management

All songs included in IU'S second album – released in November 2011 – ranked among the top on music charts, and her title song is still maintaining popularity. Especially, 'You & I' (the title song of her second album) was ranked first on Gaon Chart (the first week of March 2012) for accumulated music downloads with 4,284,621 downloads only 13 weeks after the release. Considering the fact that T-ara's 'Roly-Poly' was ranked second with 4,240,838 accumulated downloads over 34 weeks, IU's song is being downloaded at a very rapid pace.

Exhibit 20. Top 10 accumulated downloads – Gaon Chart

Rank	Artist	Title	# of downloads	Released for~
1	***IU***	***You & I***	***4,284,621***	***13 wks***
2	T-ara	Roly-Poly	4,240,838	34 wks
3	Wonder girls	Be My Baby	3,664,683	16 wks
4	GG	I cheated	3,625,939	18 wks
5	Troublemaker	Trouble Maker	3,611,999	13 wks
6	SISTAR	So Cool	3,535,303	29 wks
7	IU	Good day	3,516,254	44 wks
8	Davichi	Don't say good bye	3,502,002	26 wks
9	T-ara	Cry cry	3,480,991	16 wks
10	miss A	Good-bye Baby	3,474,821	18 wks

Source: Gaon Chart, Leading research (First week of March, 2012)

According to 2011 Gaon Single Chart (best-selling no physical, digital music sales listed as streaming content, downloads, BGM, and ringtones), IU's 'You &I' ranked 36th. However, given that her album was released in end-November 2011, we believe her performance was very satisfying.

Considering that IU has signed a contract with EMI Music on terms similar to those of SM and YG singers and is set to release her album in March, visible growth momentum is expected. Once IU actively performs in Japan, the company is expected to generate revenue from concerts and albums. Furthermore, album management business, which only accounts for a small portion of the revenue as of now, should rapidly grow.

The company also has other artists preparing for debut in 2H12 and 1H13. A girl group is preparing to debut in 2012, and a boy group is expected to debut either in 2H12 or 1H13. Furthermore, a project group consisted of Korean/Chinese/Japanese artists is also expected to debut in 1H13. In detail, the company has been focusing on album management to strengthen its weakness compared with other companies and is in the process of vertically integrating its business structure.

Loen - Distribution

According to Gaon Chart (posted the first week of March 2012), Loen is in charge of distributing four of top ten songs. The company is actively making effort to secure the sales right for digital music. We believe such investments are enabling the company to maintain a dominant position in distribution market with 25% market share.

Exhibit 21. March 2012 Gaon Chart Top 10 Management/Distribution companies

종합 | 국내 | 국외 — 주간 ◉ 월간 ○ 연간 ○ 2012 년 2012.02.19~2012.02.25

순위	변동	곡명		아티스트	제작/유통	가온지수
1	new	BLUE 빅뱅 미니앨범 5집 ALIVE		빅뱅	YG Entertainment KMP 홀딩스	69,941,965
2	new	Touch Touch		miss A	AQ Entertainment & JYP Entertainment KMP 홀딩스	52,495,585
3	▲4	Heaven Heaven (Digital Single)	LOEN	에일리 (Ailee)	YMC엔터테인먼트 로엔엔터테인먼트	30,729,043
4	new	Falling Knock	LOEN	존 박	뮤직팜 로엔엔터테인먼트	30,473,882
5	▼4	니가 필요해 (I Need You) 니가 필요해 (I Need You) (EP)	LOEN	케이윌 (K.Will)	스타쉽엔터테인먼트 로엔엔터테인먼트	29,183,332
6	▼4	생각날거야 LOVE CALL with 다비치	LOEN	다비치	제이오션스타 로엔엔터테인먼트	24,036,741
7	new	예인 있어요 윤일상 작곡가 21주년 기념 앨범 I'm 21 Part3		김범수	내가 네트워크 네오위즈인터넷	22,635,230
8	▼5	지독하게 GROWN-UP (EP)		F.T Island	F&C Music CJ E&M	21,947,424
9	▼5	시간을 거슬러 해를 품은 달 OST Part2 (린 - 시간을 거슬러)		린	콘엔터테인먼트 한국음원제작자협회	21,946,271
10	▲17	엊었니 신들의 만찬 OST Part1		이승철	대풍콘텐츠 KT 뮤직	20,679,816

Source: Gaonchart, Leading Research Center

Loen - Platform

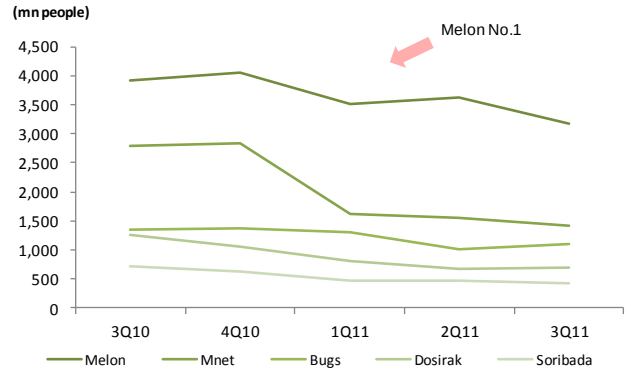
Digital music market M/S

- **1st Melon: 45%~50%**
- **2nd Mnet: 10%~15%**

Melon has been maintaining a dominant position with 45%~ 50% market shares, and the runner-up is mnet which has 10%~ 15% market shares. We believe there will be no dramatic change to the current market trend in the near future.

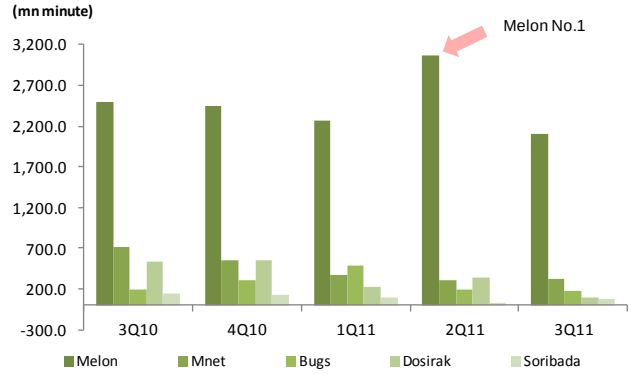
Melon's dominant position can be confirmed by comparing total spent on each platform and the number of visitors. As shown below, the difference between Melon and CJ E&M is very noticeable. We believe the only meaningful competitor among five companies is mnet.com.

Exhibit 22. Unique visitor trends



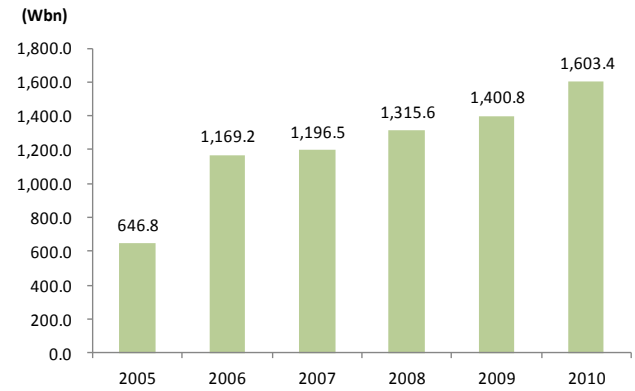
Source: Company data, Leading Research Center

Exhibit 23. Total time spent



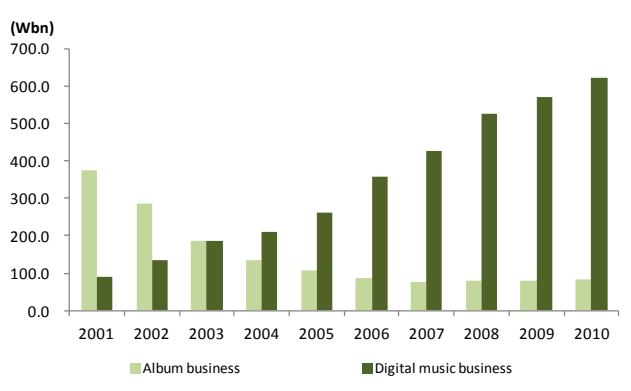
Source: Company data, Leading Research Center

Exhibit 24. Domestic music industry market size



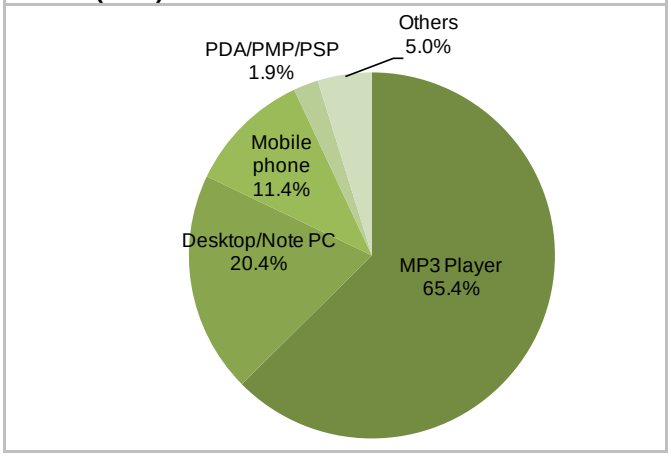
Source: 2011Music industry white paper, Leading Research Center

Exhibit 25. Album business vs. Digital music business



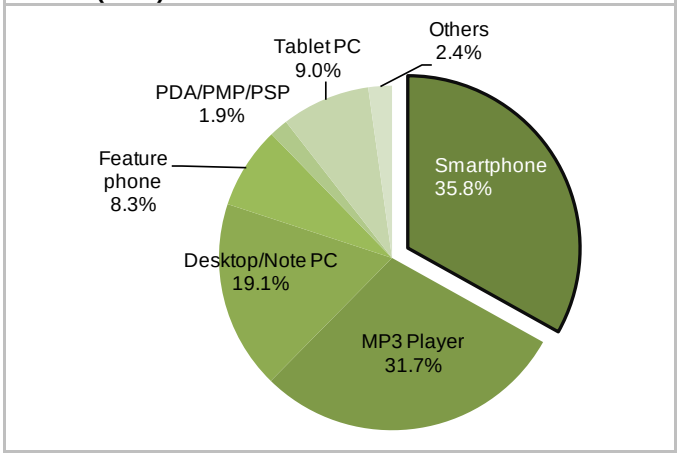
Source: KMCIA, Leading Research Center

Exhibit 26. Devices consumers use to enjoy digital music (2010)



Source: Company data, Leading Research Center

Exhibit 27. Devices consumers use to enjoy digital music (2011)



Source: Company data, Leading Research Center

Summary of financials

Income statement

(Wbn)	02	03	04	05	06	07	08	09	10	11F	12F	13F
Revenue	**24.6**	**23.9**	**27.6**	**24.2**	**31.5**	**34.3**	**30.8**	**101.4**	**139.0**	**167.1**	**202.1**	**246.3**
% chg yoy	(17.1)	(3.0)	15.4	(12.3)	30.2	8.8	(10.1)	229.3	37.0	20.2	21.0	21.9
COGS	11.8	13.1	17.2	14.3	15.5	15.8	7.9	2.2	1.2	2.5	2.4	3.2
Gross profit	**12.8**	**10.8**	**10.3**	**9.9**	**16.0**	**18.5**	**22.9**	**99.2**	**137.8**	**164.6**	**199.7**	**243.1**
GP margin (%)	52.0	45.2	37.4	40.9	50.7	53.9	74.4	97.8	99.2	98.5	98.8	98.7
SG&A	**12.8**	**11.6**	**11.6**	**15.7**	**16.7**	**22.4**	**22.6**	**92.9**	**121.5**	**137.2**	**166.2**	**202.0**
Adjusted OP	**0.1**	**(0.8)**	**(1.2)**	**(5.9)**	**(0.7)**	**(3.9)**	**0.3**	**6.4**	**16.4**	**27.4**	**33.6**	**41.1**
Adj. OP margin (%)	0.2	(3.3)	(4.5)	(24.2)	(2.2)	(11.4)	1.0	6.3	11.8	16.4	16.6	16.7
Net other incomes	(1.5)	0.9	0.2	(0.5)	0.2	0.1	2.7	0.0	(10.6)	(0.9)	(1.5)	(1.4)
Reported OP	0.1	(0.8)	(1.2)	(5.9)	(0.7)	(3.9)	0.3	6.4	16.4	26.5	32.1	39.7
Net equity method gains	0.5	0.4	0.0	0.1	0.2	(1.2)	(1.2)	(0.4)	0.1	(0.3)	(0.0)	0.0
Interest incomes	0.1	0.0	0.1	1.6	0.7	0.3	0.8	1.2	1.4	2.1	2.9	3.8
Interest expenses	0.4	0.3	0.3	0.1	0.1	0.3	0.6	0.3	0.0	0.0	0.0	0.0
Profit before tax	(1.3)	0.2	(1.2)	(4.8)	0.3	(5.1)	2.1	6.3	8.3	28.3	34.9	43.5
Tax	(0.2)	(0.1)	(0.4)	(1.3)	1.0	1.2	0.8	1.8	(1.5)	6.8	8.4	10.6
Tax rate (%)	0.2	(0.3)	0.3	0.3	3.3	(0.2)	0.4	0.3	(0.2)	0.2	0.2	0.2
Net profit	**(1.1)**	**0.2**	**(0.8)**	**(3.5)**	**(0.7)**	**(6.4)**	**1.3**	**4.5**	**9.8**	**21.5**	**26.5**	**33.0**
Controlling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	21.5	26.5	33.0
Non-controlling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other comprehensive inc.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.2)	0.0	0.0
Total comprehensive	(1.1)	0.2	(0.8)	(3.5)	(0.7)	(6.4)	1.3	4.5	9.8	21.3	26.5	33.0

Balance sheet

(Wbn)	02	03	04	05	06	07	08	09	10	11F	12F	13F
Current Assets	**19.9**	**26.3**	**26.7**	**26.5**	**25.7**	**21.9**	**64.5**	**67.3**	**98.4**	**124.3**	**157.2**	**201.6**
Cash and equivalents	0.5	6.2	4.7	5.1	1.8	3.7	19.4	19.6	19.4	20.0	22.5	29.0
Marketable securities	1.9	0.0	0.0	8.0	2.9	4.0	14.4	16.1	39.1	57.9	79.8	101.4
A/R	4.7	5.0	5.5	5.3	9.9	7.3	7.3	21.2	25.3	30.4	37.2	45.6
Inventory	4.1	3.6	4.0	1.7	1.4	1.0	0.3	0.2	0.3	0.6	0.6	0.7
Other current assets	8.7	11.5	12.6	6.5	9.7	5.8	23.1	10.2	14.4	15.4	17.1	24.9
Non-current Assets	**18.3**	**10.2**	**9.6**	**19.8**	**21.7**	**18.6**	**13.9**	**32.1**	**32.9**	**38.2**	**36.6**	**35.7**
Tangible Assets	12.4	6.2	4.8	4.7	5.1	4.6	0.6	6.1	5.0	4.8	4.2	5.1
LT financial assets	2.2	2.1	2.6	1.0	1.0	0.9	0.2	0.1	0.1	0.2	0.2	0.2
Inv in related co's	1.9	0.0	0.0	10.7	11.9	10.1	9.3	8.1	1.4	5.7	2.2	2.5
Other non-current asset	1.8	1.8	2.3	3.3	3.7	3.1	3.9	17.7	26.4	27.5	30.0	27.9
Total Assets	**38.2**	**36.4**	**36.4**	**46.3**	**47.4**	**40.5**	**78.4**	**99.3**	**131.3**	**162.5**	**193.8**	**237.3**
Current Liabilities	**7.4**	**7.8**	**8.5**	**5.8**	**7.6**	**8.0**	**15.9**	**37.2**	**59.9**	**66.8**	**72.7**	**87.6**
Account payables	2.9	2.4	2.6	2.2	2.0	1.0	7.8	25.3	28.7	36.7	39.9	44.1
ST int bear debt	1.4	2.1	2.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other current liabs	3.0	3.4	3.8	3.6	5.5	7.0	8.1	11.9	31.2	30.1	32.8	43.5
Non-current Liabilities	**4.1**	**1.8**	**1.6**	**1.2**	**1.2**	**0.8**	**0.1**	**0.1**	**0.2**	**0.6**	**0.8**	**0.8**
LT payables	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
LT int bear debt	0.3	0.3	0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other LT liabs	3.8	1.5	1.3	1.0	1.1	0.8	0.1	0.1	0.2	0.6	0.8	0.8
Total liabilities	**11.5**	**9.6**	**10.2**	**7.0**	**8.8**	**8.9**	**16.0**	**37.3**	**60.1**	**67.4**	**73.5**	**88.4**
Paid-in capital	5.4	5.4	5.6	8.0	8.0	8.0	12.6	12.6	12.6	12.6	12.6	12.6
Capital surplus	3.7	3.7	4.0	18.2	18.2	18.2	47.5	47.5	47.5	47.5	47.5	47.5
Other comprehensive	0.0	0.0	0.0	0.0	0.0	(0.6)	(0.2)	(0.2)	0.1	0.1	0.1	0.1
Others	0.0	0.0	(0.0)	(0.0)	(0.0)	(0.0)	(4.9)	(9.8)	(9.8)	(3.0)	0.0	0.0
Retained earnings	17.5	17.7	16.6	13.1	12.4	6.1	7.3	11.8	20.7	37.9	60.0	88.7
Non-controlling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	**26.7**	**26.8**	**26.2**	**39.3**	**38.6**	**31.6**	**62.4**	**62.0**	**71.2**	**95.1**	**120.3**	**149.0**

Free cashflow analysis

(Wbn)	02	03	04	05	06	07	08	09	10	11F	12F	13F
Net profit	**(1.1)**	**0.2**	**(0.8)**	**(3.5)**	**(0.7)**	**(6.4)**	**1.3**	**4.5**	**9.8**	**21.5**	**26.5**	**33.0**
Add non-cash expenses	**3.6**	**(0.3)**	**1.4**	**(0.7)**	**0.8**	**2.9**	**1.4**	**10.6**	**10.5**	**7.8**	**8.8**	**8.3**
Depreciation	3.3	2.3	1.1	0.8	0.9	1.3	1.5	7.3	9.2	9.7	10.6	10.7
Allowance for reserves	0.2	0.2	0.3	0.2	0.3	0.4	0.2	0.3	0.4	0.5	0.6	0.7
Net FX gains	(0.0)	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net eq method gains	0.5	0.4	0.0	0.1	0.2	(1.2)	(1.2)	(0.4)	0.1	(0.3)	(0.1)	0.3
Others	0.6	(2.4)	0.1	(1.6)	(0.2)	(0.1)	(1.5)	2.6	1.0	2.7	2.5	2.8
Add. Changes in OP asset &	**(0.7)**	**(2.5)**	**(1.3)**	**5.7**	**(5.2)**	**8.2**	**(9.4)**	**7.7**	**5.4**	**2.5**	**(3.6)**	**(4.3)**
Investment in WC	(2.1)	0.4	0.6	(2.0)	4.5	(1.9)	(7.6)	(3.7)	0.7	(2.5)	3.6	4.3
Others	2.9	2.1	0.7	(3.7)	0.7	(6.3)	17.0	(4.0)	(6.2)	0.0	0.0	0.0
Cash from operation	**1.8**	**(2.5)**	**(0.7)**	**1.6**	**(5.1)**	**4.8**	**(6.7)**	**22.8**	**25.8**	**31.7**	**31.7**	**36.9**
Subtract capital expenditure	0.6	0.7	0.5	0.4	1.0	0.1	0.6	4.6	1.7	3.0	3.0	4.5
Free cash flow	**1.2**	**(3.2)**	**(1.3)**	**1.2**	**(6.1)**	**4.6**	**(7.2)**	**18.2**	**24.1**	**28.7**	**28.7**	**32.4**
Dividend	0.1	0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.9	4.3	4.3	4.3
Net investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.2)	(8.2)	5.0	0.0	0.0
Share issues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Increase in debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cash flow	**0.4**	**(11.4)**	**(2.4)**	**(0.9)**	**(6.2)**	**4.2**	**(14.1)**	**18.4**	**31.3**	**0.6**	**2.5**	**6.5**
Beginning cash	0.2	0.5	6.2	4.7	5.1	1.8	3.7	19.4	19.6	19.4	20.0	22.5
Ending cash	0.5	6.2	4.7	5.1	1.8	3.7	19.4	19.6	19.4	20.0	22.5	29.0

Stability ratio

	02	03	04	05	06	07	08	09	10	11F	12F	13F
Current ratio	268.1	335.6	312.8	453.5	338.6	272.5	404.9	180.8	164.2	186.1	216.2	230.2
Quick ratio	2.5	23.6	17.5	19.2	6.9	16.9	30.1	29.1	19.7	16.1	14.3	14.4
Inventory holding period (days)	117.5	105.2	59.8	39.6	28.7	14.7	11.6	42.0	133.4	87.3	96.3	39.1
A/R collection period (days)	71.7	80.1	71.3	114.4	99.8	78.1	168	83	73	73	73	32
A/P period (days)	91.0	76.5	51.7	73.0	49.9	36.1	226	2,766	8,323	4,184	5,786	4,626
Interest bear debt (Wbn)	1.8	2.4	2.4	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash &equivalents (Wbn)	2.4	6.2	4.7	13.1	4.7	7.7	33.8	35.6	58.4	77.9	102.3	130.4
Net int. bear debt (Wbn)	(0.7)	(3.9)	(2.3)	(12.8)	(4.5)	(7.7)	(33.8)	(35.6)	(58.4)	(77.9)	(102.3)	(130.4)
Net debt/equity (%)	(2.5)	(14.4)	(8.8)	(32.7)	(11.7)	(24.3)	(54.2)	(57.5)	(82.1)	(81.9)	(85.0)	(87.6)
Liability/equity (%)	43.3	35.9	38.8	17.9	22.8	28.0	25.6	60.2	84.5	70.9	61.1	59.3
Interest coverage (X)	0.5	(3.8)	(8.8)	(71.0)	(106.1)	(1,834.0)	N/A	N/A	N/A	N/A	N/A	N/A

Valuations and margins

(Wbn)	02	03	04	05	06	07	08	09	10	11F	12F	13F
EV/EBITDA (X)	24.9	55.0	122.2	(1,139.3)	(50.9)	1,704.2	(101.2)	215.7	28.8	14.4	11.5	9.7
EPS (W)	(99)	23	(73)	(217)	(43)	(399)	51	178	386	848	1,046	1,304
EPS change (%)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	253.2	116.5	119.5	23.4	24.6
PER (X)	N/A	693.5	N/A	N/A	N/A	N/A	334.4	94.7	43.7	19.9	16.2	13.0
BVPS (W)	2,456	2,468	2,368	2,882	2,415	1,979	3,026	2,451	2,814	3,761	4,756	5,890
P/BVPS (X)	6.9	6.8	7.1	5.9	7.0	8.5	5.6	6.9	6.0	4.5	3.6	2.9
Dividend (W)	25	25	N/A	N/A	N/A	N/A	N/A	39	167	170	210	260
Dividend Yield (%)	0.2	0.2	N/A	N/A	N/A	N/A	N/A	0.2	1.1	1.1	1.3	1.7
ROA (%)	(4.2)	0.9	(3.1)	(10.6)	(1.8)	(18.1)	2.7	7.3	14.7	25.8	24.6	24.5
GP Margin (%)	(2.8)	0.7	(2.3)	(8.4)	(1.5)	(14.5)	2.1	5.1	8.5	14.6	14.9	15.3
OPM (%)	52.0	45.2	37.4	40.9	50.7	53.9	74.4	97.8	99.2	98.5	98.8	98.7
NPM (%)	0.2	(3.3)	(4.5)	(24.2)	(2.2)	(11.4)	1.0	6.3	11.8	16.4	16.6	16.7
EBITDA margin (%)	(4.4)	1.0	(3.0)	(14.3)	(2.2)	(18.6)	4.1	4.5	7.0	12.8	13.1	13.4
ROIC (%)	13.5	6.2	(0.6)	(20.9)	0.5	(7.6)	5.9	13.4	18.4	22.2	21.8	21.0
ROIC less WACC (%)	0.2	(4.1)	(3.7)	(16.9)	5.3	(16.7)	0.7	16.5	98.3	138.7	144.5	170.3
EV/EBITDA (X)	10.5	9.5	7.5	12.8	11.3	6.5	6.0	5.3	9.6	12.8	15.1	16.8
EPS (W)	(10.3)	(13.6)	(11.1)	(29.6)	(5.9)	(23.2)	(5.4)	11.2	88.6	125.9	129.4	153.5

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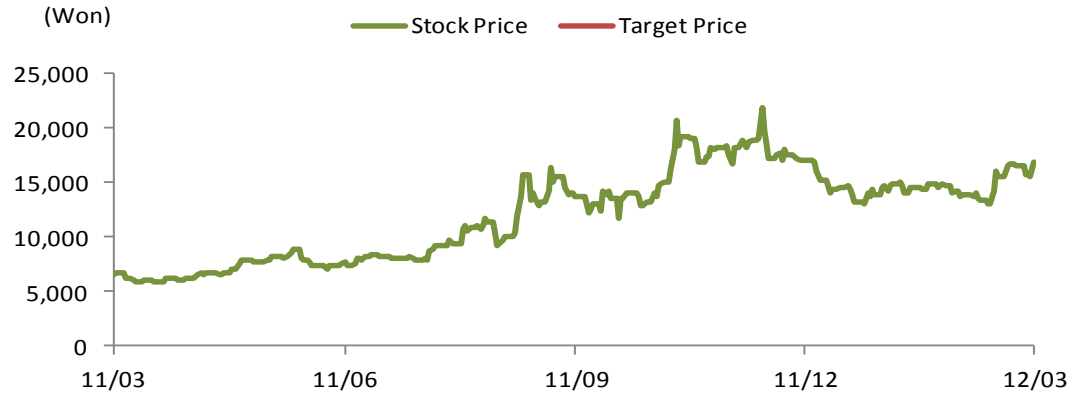
▶ Ratings and target price history in past two years

Loen Entertainment (016170KQ)	
Date	2012-03-12
Ratings	BUY
Target Price	23,000

▶ Target price changes in past two years



▶ Investment period and ratings

Company

BUY	The stock is expected to outperform the market by at least 15%p over the next 12 months.
HOLD	The stock is expected to either outperform or underperform the market by less than 15%p over the next 12 months.
SELL	The stock is expected to underperform the market by at least 15%p over the next 12 months.

Industry

OVERWEIGHT	Industry indicators are expected to outperform the market by at least 5%p over the next 12 months.
NEUTRAL	Industry indicators are expected to be in line with the market within 5%p over the next 12 months.
UNDERWEIGHT	Industry indicators are expected to underperform the market by at least 5%p over the next 12 months.

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