

Game

Issue Comment
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Daewoo Securities Co., Ltd.

[Internet/Game/Entertainment]

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NCsoft

(036570 KS/Buy)

Stock appears undervalued

- Some investors are betting on a grim scenario (share price declines after the releases of new games/earnings)
- 1Q *Blade & Soul* royalties are estimated to reach W30bn; Our 2014 estimate of W181.4bn is conservative
- A series of positive events are in the pipeline (commercial launches of *Blade & Soul* and *Guild Wars 2* in China as well as the releases of new mobile games)
- 2014F P/E of 11.2x seems too low in light of peer levels
- Maintain Buy rating with a target price of W310,000

NCsoft appears undervalued after recent pullback

NCsoft has suffered a major pullback despite releasing better-than-expected 4Q earnings and guiding earnings improvement for 2014.

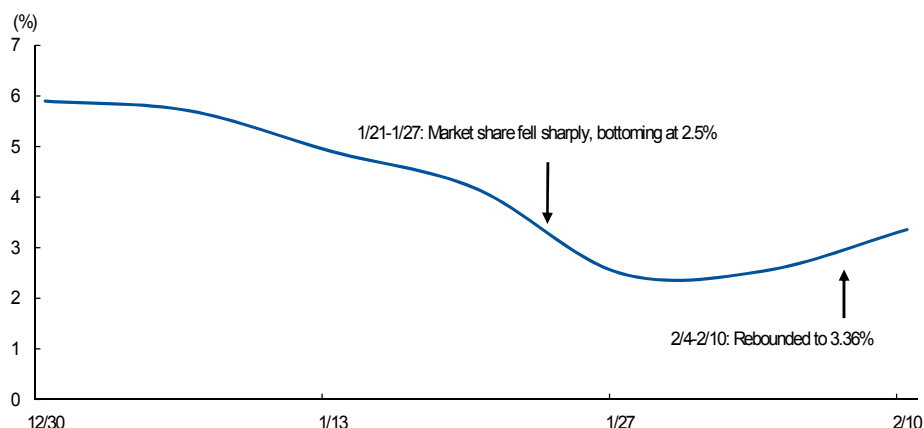
This stock plunge appears largely attributable to the bleak outlook for *Blade & Soul* in China. However, in our opinion, the market's view is too pessimistic, considering that *Blade & Soul*'s share of the Chinese internet café segment has been modestly increasing, even one month after the game's January 15th content update. And the company is slated to release another update in March. As of February 24th, *Blade & Soul* occupies 3.36% of the online game market (based on the number of clicks at internet cafés), the largest share among MMORPGs (vs. 0.58% for *Fantasy Westward Journey* and 0.46% for *World of Warcraft*). *Blade & Soul* has been ranked second in terms of weekly Chinese in-game item sales since the beginning of February. Furthermore, we believe that 1Q *Blade & Soul*-related royalty income in China could exceed our original estimate (W30bn).

We believe that the market consensus for NCsoft's 2014 earnings will likely be revised up thanks to: 1) a rise in ARPU owing to the commercial launch of *Blade & Soul* in China, 2) the success of *Guild Wars 2* in China and *Wild Star* in the US and Europe, and 3) the robust performances of *Blade & Soul* and *Guild Wars 2* in Japan, Russia, and Taiwan.

NCsoft's current share price corresponds to a 2014F P/E of 11.2x. The stock's P/E has ranged from the high-10x level to 40x over the past ten years. Given that NCsoft's major global peers Activision Blizzard and Electronic Arts are trading at 2014F P/Es of over 15x, the company appears significantly undervalued. Most global PC and console game companies are expected to suffer from stagnating margins in 2014. However, NCsoft is scheduled to launch an expansion pack for *Guild Wars 2* in the US and Europe in 2015. *Lineage Eternal*, *Metal Black: Alternative*, and various mobile games are also in the pipeline.

FY (Dec.)	12/10	12/11	12/12	12/13	12/14F	12/15F
Revenue (Wbn)	650	609	754	757	999	1,243
OP (Wbn)	243	136	151	205	389	510
OP margin (%)	37.4	22.3	20.0	27.1	38.9	41.0
NP (Wbn)	167	121	156	159	368	446
EPS (W)	7,656	5,529	7,120	7,236	16,773	20,341
ROE (%)	23.3	14.6	16.8	14.8	27.7	25.9
P/E (x)	27.2	55.6	21.1	34.3	11.2	9.2
P/B (x)	5.0	7.0	3.0	4.4	2.6	2.0

Notes: All figures are based on consolidated K-IFRS; NP refers to profit attributable to controlling interests
Source: Company data, KDB Daewoo Securities Research estimates

Figure 1. PC café market share (based on clicks) of *Blade & Soul*

Source: Barchina, KDB Daewoo Securities Research

Table 1. Earnings metrics of global game companies

(US\$m, %)

	Market cap.	Revenue			Operating profit			OP margin			Net profit			Net margin			EPS		
		13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F
NCsoft	3,840	692	899	990	188	342	395	27.1	38.1	39.9	145	282	327	21.0	31.4	33.1	0.0	13.1	15.2
Neowiz Games	370	405	251	290	88	34	56	21.6	13.6	19.2	42	24	38	10.3	9.5	13.0	-0.5	1.1	1.9
NHN Entertainment	1,304	243	644	691	48	125	149	19.6	19.4	21.6	17	103	120	7.0	15.9	17.4	0.0	6.6	7.6
Gamevil	362	74	106	130	11	20	27	14.9	18.7	20.4	13	19	25	17.2	17.9	19.2	2.9	2.9	3.8
Com2uS	271	74	93	110	7	15	22	9.5	16.2	19.6	18	15	20	24.0	16.1	18.6	1.7	1.5	2.0
Wemade	759	208	248	308	11	32	65	5.4	12.9	21.2	0	25	43	0.0	10.2	14.0	-0.1	1.3	2.4
Nexon	3,930	1,594	1,637	1,741	520	597	633	32.6	36.5	36.4	309	395	417	19.4	24.1	24.0	0.7	0.9	1.0
Activision Blizzard	13,714	4,583	4,619	4,735	1,372	1,503	1,600	29.9	32.5	33.8	1,010	583	732	22.0	12.6	15.5	1.0	1.3	1.4
Electronic Arts	8,669	3,915	4,107	4,383	557	643	779	14.2	15.6	17.8	-127	-3	156	-3.2	-0.1	3.6	1.3	1.5	1.8
Take-Two	1,891	2,381	1,358	1,445	510	123	191	21.4	9.1	13.2	476	81		20.0	6.0	0.0	4.2	1.0	1.3
Zynga	4,078	873	815	938	-55	-67	-19	-6.3	-8.2	-2.0	-37	-91	-50	-4.2	-11.1	-5.3	0.0	0.0	0.0
Gameloft	906	320	366	421	37	55	71	11.4	15.0	16.8	18	36	50	5.5	9.9	11.9	0.2	0.4	0.6
Glu Mobile	366	106	144	170	-21	0	9	-20.0	-0.1	5.1	-20	-14	0	-19.0	-9.5	0.2	-0.3	0.0	0.1
Nintendo	17,380	6,248	6,241	5,235	-81	321	214	-1.3	5.2	4.1	-14	227	150	-0.2	3.6	2.9	0.4	1.8	1.2
Sega Sammy	6,118	4,093	4,243	4,289	617	684	742	15.1	16.1	17.3	437	426	457	10.7	10.0	10.6	1.8	1.8	1.9
Namco Bandai	5,011	4,837	4,920	4,990	466	516	538	9.6	10.5	10.8	292	326	340	6.0	6.6	6.8	1.3	1.5	1.6
Konami	3,601	2,108	2,384	2,385	129	285	271	6.1	12.0	11.4	77	165	156	3.7	6.9	6.5	0.6	1.2	1.1
DeNA	3,251	1,820	1,795	1,853	545	510	488	29.9	28.4	26.3	313	290	290	17.2	16.2	15.7	2.3	2.2	2.1
GREE	2,740	1,331	1,331	1,362	322	318	325	24.2	23.9	23.8	172	187	186	12.9	14.1	13.6	0.7	0.8	0.8
GungHo Online	7,083	1,673	1,666	2,038	936	1,001	1,174	55.9	60.1	57.6	562	592	689	33.6	35.5	33.8	0.5	0.5	0.6
Shanda Games	1,831	728	775	833	246	298	322	33.7	38.4	38.7	234	231	238	32.1	29.8	28.5	0.9	0.9	1.0
NetEase.com	9,272	1,519	1,772	2,014	719	829	930	47.3	46.8	46.2	734	798	902	48.3	45.1	44.8	5.6	6.1	6.9
Tencent	139,149	9,874	13,332	17,146	3,090	4,069	5,234	31.3	30.5	30.5	2,588	3,361	4,271	26.2	25.2	24.9	1.5	1.9	2.4
Kingsoft	3,948	342	460	582	104	146	199	30.5	31.7	34.3	103	134	185	30.1	29.2	31.7	0.1	0.1	0.1
Average								19.3	21.8	23.5				14.2	14.8	16.0			

Notes: Bloomberg consensus; based on February 24th closing prices; EPS is based on US\$

Source: Bloomberg, KDB Daewoo Securities Research

Table 2. Valuation metrics of global game companies

(US\$m, x, %)

	Market cap.	P/E			P/B			P/S			EV/EBITDA			ROE			ROA		
		13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F	13(F)	14F	15F
NCsoft	3,840	N/A	13.4	11.5	3.4	2.8	2.2	N/A	4.3	3.9	N/A	8.6	7.7	N/A	23.0	21.7	N/A	18.2	17.6
Neowiz Games	370	N/A	15.6	9.1	1.3	1.1	1.0	0.7	1.5	1.3	3.2	8.0	5.7	-3.8	9.2	11.7	-1.7	4.4	6.4
NHN Entertainment	1,304	N/A	13.3	11.5	N/A	1.2	1.1	N/A	2.0	1.9	N/A	N/A	N/A	N/A	9.9	9.5	N/A	8.9	9.3
Gamevil	362	18.9	19.4	14.7	2.4	2.3	2.0	4.2	3.4	2.8	N/A	12.8	9.5	14.2	12.5	14.4	13.1	10.5	12.1
Com2uS	271	15.3	17.9	13.3	2.8	2.3	2.0	3.4	2.9	2.5	18.2	13.9	10.0	19.1	13.6	15.9	15.7	12.2	14.5
Wemade	759	N/A	34.3	19.1	2.9	2.6	2.3	3.8	3.1	2.5	34.3	16.2	9.1	-0.4	7.9	12.9	-0.3	7.8	12.9
Nexon	3,930	13.3	9.7	9.1	1.3	1.3	1.1	2.6	2.4	2.3	5.3	4.2	3.9	11.6	13.8	13.8	8.2	15.3	15.5
Activision																			
Blizzard	13,714	19.6	15.3	14.0	2.1	2.1	1.9	4.1	3.0	2.9	8.6	8.6	8.1	11.2	13.5	14.5	7.2	8.7	9.1
Electronic Arts	8,669	21.2	18.5	15.2	5.2	4.7	3.8	2.2	2.1	2.0	9.5	8.7	7.6	18.5	23.9	26.3	9.7	11.5	12.7
Take-Two	1,891	4.6	19.7	14.7	2.6	2.1	1.8	0.8	1.4	1.3	2.6	8.9	6.6	45.3	9.4	9.1	23.7	5.5	5.9
Zynga	4,078	N/A	45.5	11.1	2.2	2.8	2.9	4.6	5.0	4.3	22.0	31.0	18.1	-2.0	0.2	1.6	-1.5	-0.8	2.1
Gameloft	906	50.4	27.1	19.1	4.8	4.0	3.3	2.8	2.5	2.1	15.0	11.1	8.7	8.7	15.8	17.4	N/A	N/A	N/A
Glu Mobile	366	N/A	22.4	43.1	7.9	8.5	8.1	3.4	2.5	2.2	N/A	79.4	22.8	-47.1	6.2	23.5	-25.2	3.1	11.5
Nintendo	17,380	320	68.6	98.4	1.3	1.3	1.3	2.8	2.8	3.3	62.7	18.6	22.1	1.1	1.4	0.6	-1.0	1.8	1.5
Sega Sammy	6,118	12.8	12.9	12.0	1.5	1.3	1.2	1.5	1.4	1.4	6.3	5.6	5.1	12.9	10.0	10.3	9.0	8.8	8.7
Namco Bandai	5,011	17.0	15.2	14.5	1.9	1.7	1.6	1.0	1.0	1.0	6.0	5.4	5.3	11.3	11.8	11.3	11.9	15.4	15.1
Konami	3,601	44.6	21.0	22.1	1.6	1.5	1.4	1.7	1.5	1.5	16.6	9.4	9.0	3.7	6.3	6.5	2.4	6.3	7.6
DeNA	3,251	9.3	10.0	10.1	2.0	1.7	1.5	1.8	1.8	1.8	4.7	5.4	5.6	24.0	18.3	14.8	17.6	12.4	9.6
GREE	2,740	15.5	14.1	14.1	2.4	2.1	1.9	2.1	2.1	2.0	6.3	6.8	6.8	16.1	14.1	12.2	12.0	9.4	8.4
GungHo Online	7,083	13.2	11.3	9.7	9.7	5.3	3.6	4.4	4.3	3.5	8.7	7.3	10.1	120	53.2	34.2	72.8	38.2	21.6
Shanda Games	1,831	7.9	7.5	6.7	2.0	1.6	1.3	2.5	2.4	2.2	5.1	4.3	4.1	28.9	22.5	19.3	16.4	16.4	14.4
NetEase.com	9,272	12.7	11.5	10.3	2.8	2.3	1.9	6.1	5.2	4.6	9.9	7.4	6.5	24.7	22.3	20.5	20.3	17.8	17.0
Tencent	139,149	51.5	39.8	31.4	15.0	11.2	8.6	14.1	10.4	8.1	37.7	29.1	23.4	32.1	31.4	29.9	17.7	17.8	17.9
Kingsoft	3,948	36.9	29.1	23.1	7.2	5.9	5.0	11.6	8.6	6.8	35.3	27.8	20.9	21.1	21.7	22.6	13.8	14.1	14.9
Average		38.0	46.8	23.2	3.7	3.1	2.6	3.7	3.2	2.8	15.9	14.7	10.3	16.9	15.5	15.6	11.5	11.5	11.6

Notes: Bloomberg consensus; based on February 24th closing prices; EPS is based on US\$

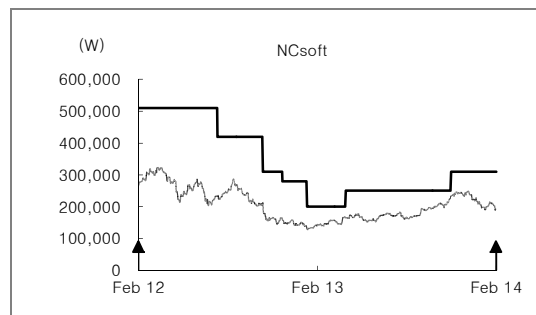
Source: Bloomberg, KDB Daewoo Securities Research

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
NCsoft (036570)	11/26/2013	Buy	310,000
	04/25/2013	Buy	250,000
	02/05/2013	Buy	200,000
	12/17/2012	Buy	280,000
	11/07/2012	Buy	310,000
	08/06/2012	Buy	420,000
	02/16/2012	Buy	510,000



Stock Ratings

Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

Industry Ratings

Overweight	: Fundamentals are favorable or improving
Neutral	: Fundamentals are steady without any material changes
Underweight	: Fundamentals are unfavorable or worsening

Ratings and Target Price History (Share price (—), Target price (—), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

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