

NCsoft

(036570 KS)

Solid 3Q earnings results

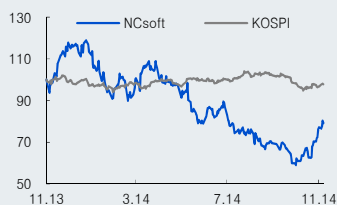
Game

Results Comment
November 14, 2014

| | |
|---------------------------|----------------|
| (Maintain) | Buy |
| Target Price (12M, W) | 220,000 |
| Share Price (11/13/14, W) | 165,500 |
| Expected Return | 33% |

| | |
|----------------------------|----------|
| OP (14F, Wbn) | 261 |
| Consensus OP (14F, Wbn) | 249 |
| EPS Growth (14F, %) | 51.9 |
| Market EPS Growth (14F, %) | 2.5 |
| P/E (14F, x) | 15.0 |
| Market P/E (14F, x) | 12.7 |
| KOSPI | 1,960.51 |
| Market Cap (Wbn) | 3,629 |
| Shares Outstanding (mn) | 22 |
| Free Float (%) | 75.9 |
| Foreign Ownership (%) | 37.8 |
| Beta (12M) | 0.35 |
| 52-Week Low | 123,500 |
| 52-Week High | 248,500 |

| (%) | 1M | 6M | 12M |
|----------|------|-------|-------|
| Absolute | 29.8 | -16.6 | -19.1 |
| Relative | 27.6 | -15.7 | -18.9 |



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3Q review: Revenue and OP up 24.7% and 164.7% YoY, respectively

For 3Q, NCsoft reported revenue of W211.6bn (+24.7% YoY) and operating profit of W81.3bn (+164.7% YoY). Operating profit reached the highest level since 1Q13, despite a marked decline in royalty income from *Guild Wars 2*, and *Blade & Soul China*.

Lineage I revenue jumped 20.4% QoQ, confirming the title's solid footing in the gaming community. *Aion* demonstrated its strong potential with revenue soaring 79.5% QoQ thanks to in-game item promotions over the summer. However, *Blade & Soul China* performed poorly, failing to gain new players even after its official launch in August. This, combined with the dissipation of the strong initial sales of the CD version of *Guild Wars 2* in China and *WildStar* in the US and Europe, caused overseas revenue to fall 30.2% QoQ.

Marketing expenses declined sharply due to the absence of new releases in 3Q (in contrast to in 2Q), pushing down overall operating expenses by W18.6bn QoQ and thus boosting operating profit.

Impact of *Lineage I* microtransaction events to increase in 4Q

In 4Q, we expect overall expenses to remain stable, aside from some marketing spending for the commercialization of *Blade & Soul* in Taiwan. *Lineage I* revenue should continue to grow QoQ, supported by the recognition of in-game item sales carried over from 3Q, as well as major microtransaction events planned in December for the holiday season.

Maintain Buy and TP of W220,000; All eyes on G-Star 2014 trade show

We raise our 2014F and 2015F EPS by 1.4% and 0.8%, respectively, but keep our target price of W220,000 unchanged, as our revisions to forecasts are minimal.

Despite solid 3Q earnings, we believe microtransactions and margin gains through cost savings alone are not sufficient to raise investor expectations. One bright spot, however, is the company's robust assets. The stock is currently trading at a 2014F P/E of 15x, but stripping away cash, property, and treasury stock holdings (valued at W1.6tr), shares would trade at about 8x.

Next week, NCsoft is anticipated to reveal more details of its business road map, first at its G-Star 2014 premiere event on November 18th, and then at the trade show itself in Busan from November 20th-23rd. We expect the company to unveil new upcoming titles, including *Master X Master (MXM)*, *Lineage Eternal*, and *Project HON*, and also provide a clearer picture of its mobile game strategy.

| FY (Dec.) | 12/11 | 12/12 | 12/13 | 12/14F | 12/15F | 12/16F |
|---------------|-------|-------|-------|--------|--------|--------|
| Revenue (Wbn) | 609 | 754 | 757 | 809 | 910 | 1,057 |
| OP (Wbn) | 136 | 151 | 205 | 261 | 294 | 336 |
| OP margin (%) | 22.3 | 20.0 | 27.1 | 32.3 | 32.3 | 31.8 |
| NP (Wbn) | 121 | 156 | 159 | 241 | 258 | 295 |
| EPS (W) | 5,529 | 7,120 | 7,245 | 11,005 | 11,787 | 13,465 |
| ROE (%) | 14.6 | 16.8 | 14.8 | 19.2 | 17.3 | 16.8 |
| P/E (x) | 55.6 | 21.1 | 34.3 | 15.0 | 14.0 | 12.3 |
| P/B (x) | 7.0 | 3.0 | 4.4 | 2.5 | 2.1 | 1.8 |

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

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Table 1. Quarterly and annual earnings

(Wbn, %)

| | 1Q13 | 2Q13 | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14P | 4Q14F | 2012 | 2013 | 2014F |
|--------------------------|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 185 | 192 | 170 | 210 | 178 | 214 | 212 | 206 | 754 | 757 | 809 |
| <i>Lineage I</i> | 66 | 85 | 62 | 75 | 41 | 57 | 69 | 75 | 205 | 288 | 242 |
| <i>Lineage II</i> | 14 | 14 | 13 | 16 | 12 | 14 | 15 | 14 | 65 | 57 | 54 |
| <i>Aion</i> | 28 | 23 | 23 | 22 | 22 | 18 | 33 | 20 | 141 | 96 | 93 |
| <i>Blade & Soul</i> | 17 | 14 | 20 | 18 | 19 | 19 | 20 | 19 | 62 | 69 | 78 |
| <i>Guild Wars 2</i> | 36 | 29 | 24 | 34 | 25 | 22 | 20 | 26 | 165 | 123 | 93 |
| <i>WildStar</i> | 0 | 0 | 0 | 0 | 0 | 28 | 16 | 8 | 0 | 0 | 52 |
| Royalties | 11 | 13 | 10 | 32 | 45 | 38 | 22 | 25 | 64 | 66 | 129 |
| Other | 13 | 14 | 17 | 14 | 14 | 18 | 18 | 19 | 51 | 58 | 69 |
| Revenue breakdown | | | | | | | | | | | |
| <i>Lineage I</i> | 35.7 | 44.2 | 36.7 | 35.6 | 23.0 | 26.6 | 32.4 | 36.6 | 27.2 | 38.0 | 29.9 |
| <i>Lineage II</i> | 7.7 | 7.4 | 7.7 | 7.4 | 6.5 | 6.3 | 7.0 | 6.9 | 8.6 | 7.6 | 6.7 |
| <i>Aion</i> | 15.3 | 12.1 | 13.3 | 10.3 | 12.5 | 8.6 | 15.6 | 9.5 | 18.8 | 12.7 | 11.5 |
| <i>Blade & Soul</i> | 8.9 | 7.4 | 12.0 | 8.5 | 10.8 | 8.9 | 9.3 | 9.4 | 8.2 | 9.1 | 9.6 |
| <i>Guild Wars 2</i> | 19.7 | 15.1 | 14.4 | 16.0 | 14.1 | 10.4 | 9.3 | 12.7 | 21.9 | 16.3 | 11.5 |
| <i>WildStar</i> | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 13.1 | 7.6 | 3.7 | 0.0 | 0.0 | 6.4 |
| Royalties | 5.8 | 6.8 | 5.8 | 15.4 | 25.0 | 17.6 | 10.5 | 11.9 | 8.5 | 8.7 | 15.9 |
| Other | 6.9 | 7.1 | 10.1 | 6.8 | 8.1 | 8.4 | 8.3 | 9.4 | 6.7 | 7.6 | 8.6 |
| Operating profit | 56 | 62 | 31 | 57 | 45 | 65 | 81 | 70 | 151 | 205 | 261 |
| OP margin | 30.0 | 32.4 | 18.1 | 27.0 | 25.0 | 30.4 | 38.4 | 34.1 | 20.1 | 27.1 | 32.3 |
| Net profit | 52 | 34 | 26 | 46 | 37 | 53 | 76 | 76 | 154 | 159 | 241 |
| Net margin | 28.3 | 17.8 | 15.5 | 21.8 | 20.5 | 24.8 | 35.8 | 36.9 | 20.4 | 21.0 | 29.8 |
| YoY growth | | | | | | | | | | | |
| Revenue | 31.0 | 30.8 | -6.8 | -25.9 | -3.6 | 11.4 | 24.7 | -2.1 | 23.8 | 0.4 | 7.0 |
| <i>Lineage I</i> | 51.3 | 45.1 | 62.7 | 15.2 | -37.9 | -32.9 | 10.0 | 0.5 | 4.9 | 40.3 | -16.1 |
| <i>Lineage II</i> | -22.8 | -15.5 | -1.8 | -5.4 | -18.5 | -5.1 | 13.7 | -9.1 | -35.3 | -12.2 | -5.2 |
| <i>Aion</i> | -46.6 | -36.0 | -16.1 | -13.7 | -21.4 | -21.1 | 45.7 | -9.7 | -36.7 | -32.2 | -2.9 |
| <i>Blade & Soul</i> | - | - | -37.8 | -33.5 | 16.5 | 35.2 | -2.7 | 8.4 | - | 10.8 | 12.6 |
| <i>Guild Wars 2</i> | - | - | -46.6 | -71.8 | -30.9 | -23.1 | -19.6 | -22.3 | - | -25.2 | -24.5 |
| Royalties | -29.5 | -23.9 | -34.0 | 92.1 | 314.9 | 188.4 | 125.9 | -24.0 | 13.3 | 2.9 | 95.6 |
| Operating profit | 348.4 | -660.3 | -16.5 | -49.9 | -19.8 | 4.3 | 164.7 | 23.6 | 12.3 | 35.7 | 27.2 |
| Net profit | 321.7 | -537.4 | -44.2 | -55.2 | -30.1 | 54.8 | 187.9 | 66.2 | 28.3 | 3.2 | 52.1 |
| QoQ growth | | | | | | | | | | | |
| Revenue | -34.8 | 3.9 | -11.6 | 23.7 | -15.2 | 20.0 | -1.0 | -2.8 | | | |
| <i>Lineage I</i> | 1.8 | 28.4 | -26.5 | 20.0 | -45.1 | 38.7 | 20.4 | 9.7 | | | |
| <i>Lineage II</i> | -13.6 | 0.6 | -8.7 | 19.2 | -25.5 | 17.1 | 9.3 | -4.7 | | | |
| <i>Aion</i> | 12.9 | -17.8 | -2.8 | -4.4 | 2.8 | -17.4 | 79.5 | -40.7 | | | |
| <i>Blade & Soul</i> | -38.7 | -14.3 | 43.5 | -11.9 | 7.5 | -0.5 | 3.3 | -1.9 | | | |
| <i>Guild Wars 2</i> | -69.4 | -20.6 | -15.3 | 37.1 | -25.1 | -11.6 | -11.4 | 32.5 | | | |
| Royalties | -36.2 | 21.3 | -24.4 | 228.0 | 37.9 | -15.7 | -40.7 | 10.3 | | | |
| Operating profit | -51.0 | 12.1 | -50.6 | 84.7 | -21.5 | 45.9 | 25.2 | -13.8 | | | |
| Net profit | -48.7 | -34.6 | -23.1 | 73.8 | -20.0 | 44.7 | 43.0 | 0.4 | | | |

Note: All figures are based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research estimates

Table 2. Earnings forecast revisions

(Wbn, W, %, %p)

| | Previous | | Revised | | Change | |
|------------------|----------|--------|---------|--------|--------|-------|
| | 2014F | 2015F | 2014F | 2015F | 2014F | 2015F |
| Revenue | 817 | 906 | 809 | 910 | -1.0 | 0.4 |
| Operating profit | 248 | 289 | 261 | 294 | 5.2 | 1.7 |
| Pretax profit | 291 | 314 | 295 | 319 | 1.4 | 1.6 |
| Net profit | 238 | 256 | 241 | 258 | 1.3 | 0.8 |
| EPS | 10,851 | 11,696 | 11,005 | 11,787 | 1.4 | 0.8 |
| OP margin | 30.4 | 31.9 | 32.3 | 32.3 | 1.9 | 0.4 |
| Net margin | 29.1 | 28.3 | 29.8 | 28.4 | 0.7 | 0.1 |

Note: All figures are based on consolidated K-IFRS

Source: Company data, KDB Daewoo Securities Research estimates

NCsoft (036570 KS/Buy/TP: W220,000)

Comprehensive Income Statement (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|-------------------------------------|------------|------------|------------|--------------|
| Revenue | 757 | 809 | 910 | 1,057 |
| Cost of Sales | 220 | 208 | 233 | 271 |
| Gross Profit | 537 | 601 | 677 | 786 |
| SG&A Expenses | 331 | 341 | 382 | 450 |
| Operating Profit (Adj) | 205 | 261 | 294 | 336 |
| Operating Profit | 205 | 261 | 294 | 336 |
| Non-Operating Profit | 11 | 34 | 25 | 39 |
| Net Financial Income | 16 | 22 | 29 | 38 |
| Net Gain from Inv in Associates | 4 | 4 | 4 | 4 |
| Pretax Profit | 216 | 295 | 319 | 375 |
| Income Tax | 58 | 54 | 61 | 80 |
| Profit from Continuing Operations | 159 | 241 | 258 | 295 |
| Profit from Discontinued Operations | 0 | 0 | 0 | 0 |
| Net Profit | 159 | 241 | 258 | 295 |
| Controlling Interests | 159 | 241 | 258 | 295 |
| Non-Controlling Interests | 0 | 0 | 0 | 0 |
| Total Comprehensive Profit | 148 | 241 | 258 | 295 |
| Controlling Interests | 151 | 246 | 263 | 301 |
| Non-Controlling Interests | -3 | -5 | -5 | -6 |
| EBITDA | 241 | 292 | 321 | 360 |
| FCF (Free Cash Flow) | 135 | 285 | 312 | 359 |
| EBITDA Margin (%) | 31.8 | 36.1 | 35.3 | 34.1 |
| Operating Profit Margin (%) | 27.1 | 32.3 | 32.3 | 31.8 |
| Net Profit Margin (%) | 21.0 | 29.8 | 28.4 | 27.9 |

Cash Flows (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|--------------------------------|------------|------------|------------|------------|
| Cash Flows from Op Activities | 236 | 285 | 312 | 359 |
| Net Profit | 159 | 241 | 258 | 295 |
| Non-Cash Income and Expense | 99 | 60 | 55 | 63 |
| Depreciation | 29 | 25 | 22 | 20 |
| Amortization | 6 | 5 | 5 | 4 |
| Others | 64 | 30 | 28 | 39 |
| Chg in Working Capital | -16 | 13 | 27 | 40 |
| Chg in AR & Other Receivables | -9 | -6 | -11 | -16 |
| Chg in Inventories | 1 | 0 | 0 | 0 |
| Chg in AP & Other Payables | 1 | 1 | 1 | 1 |
| Income Tax Paid | -26 | -54 | -61 | -80 |
| Cash Flows from Inv Activities | -214 | -40 | -76 | -113 |
| Chg in PP&E | -101 | 0 | 0 | 0 |
| Chg in Intangible Assets | -1 | 0 | 0 | 0 |
| Chg in Financial Assets | -112 | -40 | -76 | -113 |
| Others | 0 | 0 | 0 | 0 |
| Cash Flows from Fin Activities | -17 | -12 | -12 | -12 |
| Chg in Financial Liabilities | -15 | 0 | 0 | 0 |
| Chg in Equity | 1 | 0 | 0 | 0 |
| Dividends Paid | -12 | -12 | -12 | -12 |
| Others | 9 | 0 | 0 | 0 |
| Increase (Decrease) in Cash | 0 | 232 | 221 | 230 |
| Beginning Balance | 123 | 123 | 355 | 576 |
| Ending Balance | 123 | 355 | 576 | 805 |

Source: Company data, KDB Daewoo Securities Research estimates

Statement of Financial Condition (Summarized)

| (Wbn) | 12/13 | 12/14F | 12/15F | 12/16F |
|----------------------------------|--------------|--------------|--------------|--------------|
| Current Assets | 786 | 1,064 | 1,373 | 1,732 |
| Cash and Cash Equivalents | 123 | 355 | 576 | 805 |
| AR & Other Receivables | 83 | 90 | 101 | 117 |
| Inventories | 1 | 1 | 1 | 1 |
| Other Current Assets | 579 | 618 | 695 | 809 |
| Non-Current Assets | 694 | 666 | 645 | 630 |
| Investments in Associates | 23 | 24 | 27 | 32 |
| Property, Plant and Equipment | 248 | 223 | 200 | 181 |
| Intangible Assets | 112 | 107 | 102 | 98 |
| Total Assets | 1,480 | 1,730 | 2,018 | 2,362 |
| Current Liabilities | 252 | 269 | 302 | 351 |
| AP & Other Payables | 23 | 24 | 27 | 32 |
| Short-Term Financial Liabilities | 3 | 3 | 3 | 3 |
| Other Current Liabilities | 226 | 242 | 272 | 316 |
| Non-Current Liabilities | 69 | 73 | 82 | 94 |
| Long-Term Financial Liabilities | 5 | 5 | 5 | 5 |
| Other Non-Current Liabilities | 64 | 68 | 77 | 89 |
| Total Liabilities | 321 | 342 | 384 | 445 |
| Controlling Interests | 1,141 | 1,371 | 1,617 | 1,901 |
| Capital Stock | 11 | 11 | 11 | 11 |
| Capital Surplus | 221 | 221 | 221 | 221 |
| Retained Earnings | 1,017 | 1,246 | 1,493 | 1,776 |
| Non-Controlling Interests | 18 | 17 | 17 | 17 |
| Stockholders' Equity | 1,159 | 1,388 | 1,634 | 1,918 |

Forecasts/Valuations (Summarized)

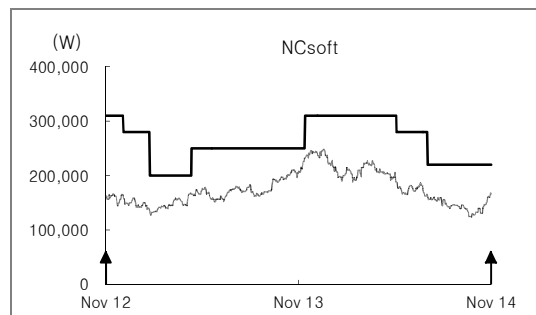
| | 12/13 | 12/14F | 12/15F | 12/16F |
|----------------------------------|--------|---------|---------|---------|
| P/E (x) | 34.3 | 15.0 | 14.0 | 12.3 |
| P/CF (x) | 21.1 | 12.0 | 11.6 | 10.1 |
| P/B (x) | 4.4 | 2.5 | 2.1 | 1.8 |
| EV/EBITDA (x) | 19.9 | 9.3 | 7.5 | 5.8 |
| EPS (W) | 7,245 | 11,005 | 11,787 | 13,465 |
| CFPS (W) | 11,778 | 13,743 | 14,299 | 16,313 |
| BPS (W) | 56,765 | 67,187 | 78,427 | 91,346 |
| DPS (W) | 600 | 600 | 600 | 600 |
| Payout ratio (%) | 7.5 | 5.0 | 4.6 | 4.1 |
| Dividend Yield (%) | 0.2 | 0.4 | 0.4 | 0.4 |
| Revenue Growth (%) | 0.4 | 6.9 | 12.5 | 16.2 |
| EBITDA Growth (%) | 26.8 | 21.2 | 9.9 | 12.1 |
| Operating Profit Growth (%) | 35.8 | 27.3 | 12.6 | 14.3 |
| EPS Growth (%) | 1.8 | 51.9 | 7.1 | 14.2 |
| Accounts Receivable Turnover (x) | 9.6 | 9.6 | 9.8 | 10.0 |
| Inventory Turnover (x) | 509.0 | 836.8 | 856.9 | 870.5 |
| Accounts Payable Turnover (x) | 30.9 | 26.7 | 27.3 | 27.7 |
| ROA (%) | 11.4 | 15.0 | 13.8 | 13.5 |
| ROE (%) | 14.8 | 19.2 | 17.3 | 16.8 |
| ROIC (%) | 42.6 | 97.8 | 135.9 | 208.0 |
| Liability to Equity Ratio (%) | 27.7 | 24.7 | 23.5 | 23.2 |
| Current Ratio (%) | 311.9 | 395.5 | 454.6 | 494.1 |
| Net Debt to Equity Ratio (%) | -57.8 | -67.7 | -75.5 | -82.0 |
| Interest Coverage Ratio (x) | 636.0 | 1,515.3 | 1,708.8 | 1,951.8 |

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

| Company (Code) | Date | Rating | Target Price |
|-----------------|------------|--------|--------------|
| NCsoft (036570) | 07/16/2014 | Buy | 220,000 |
| | 05/18/2014 | Buy | 280,000 |
| | 11/26/2013 | Buy | 310,000 |
| | 04/25/2013 | Buy | 250,000 |
| | 02/05/2013 | Buy | 200,000 |
| | 12/17/2012 | Buy | 280,000 |
| | 11/08/2012 | Buy | 310,000 |
| | | | |



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 (◆))

* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

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