

Game

Results Comment
February 8, 2018

(Maintain) **Buy**

Target Price (12M, W) **640,000**

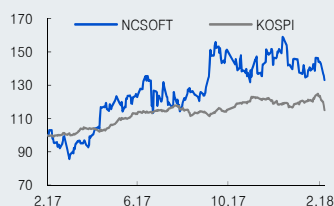
Share Price (02/07/18, W) **409,000**

Expected Return **56%**

OP (17P, Wbn)	585
Consensus OP (17F, Wbn)	606
EPS Growth (17P, %)	61.7
Market EPS Growth (17F, %)	45.3
P/E (17P, x)	22.3
Market P/E (17F, x)	9.8
KOSPI	2,396.56

Market Cap (Wbn)	8,973
Shares Outstanding (mn)	22
Free Float (%)	84.7
Foreign Ownership (%)	46.3
Beta (12M)	0.21
52-Week Low	263,500
52-Week High	488,000

(%)	1M	6M	12M
Absolute	-3.1	6.5	35.9
Relative	1.0	6.6	17.7



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NCsoft

(036570 KS)

Wait for upcoming major titles

4Q17 review: Consensus miss; Declining *Lineage M* revenue, higher marketing spend

NCsoft reported 4Q17 earnings results that missed consensus expectations.

Revenue: Revenue from games related to *Lineage* intellectual property (IP) was weaker than expected. We estimate domestic daily average revenue for *Lineage M* fell to W3.6bn in 4Q17 from W6.4bn in 3Q17 (the period following its initial release on June 21, 2017). However, the mobile title remained the top-grossing game for both Android and iOS, which we attribute to the positive effects of new class and castle siege updates in November. Revenue from PC titles *Lineage* and *Lineage II* slightly contracted QoQ.

On the other hand, revenue from PC titles *Aion*, *Blade & Soul*, and *Guild Wars 2* were in line. *Aion* was boosted by the conversion from monthly subscriptions to a microtransaction model, while *Guild Wars 2* was supported by sales of the second expansion pack.

Expenses: Labor expenses, including special incentives related to *Lineage M*, were broadly in line with our projection. The biggest surprise was marketing spend, which jumped 10% QoQ and 69% YoY, despite the absence of any new major titles. We believe this suggests the company spent as much on promoting *Lineage M*'s massive updates as it typically does on promoting new titles.

2018: *Lineage M* stabilization, easing expenses in 1H; New title effects in 2H

NCsoft has three big titles coming out this year. This is more than in previous cycles, as the company typically releases one new game every three years. We believe new title effects will be backloaded in 2H18.

1H18: We expect *Lineage M* revenue to stabilize and expense pressures to ease. We believe *Lineage M*'s traffic and revenue patterns have steadied following the castle siege content update in November 2017. Our daily average revenue forecast for 2018 is around W3bn. Looking ahead, we see a number of factors that could extend the title's longevity, including content updates, introduction of player-to-player trading, and overseas releases. Meanwhile, we expect OP margin to remain at the 30% level in 1H18, backed by a slower pace of hiring, the removal of incentives, and reduced marketing spend. We also see benefits from a low base of comparison, as operating profit was only W68bn in 1H17.

2H18: Upcoming major mobile MMORPGs—*Blade & Soul II* (expected in late 1H18), *Aion Tempest*, and *Lineage II M* (both expected in 2H18)—should have a positive impact on earnings. This year's new titles are starkly different from the company's most recent release, *Lineage M*, in terms of target audience, worldview, and graphics, and, in our view, are more inclusive of overseas markets.

Reaffirm Buy and TP of W640,000

We reaffirm our Buy call and target price of W640,000 on NCsoft. The company has a relatively high ROE and low P/E compared to sector peers. We see little reason for concern in terms of profit and valuation in 1H18 and see potential for earnings growth and a re-rating in 2H18, driven by new releases.

FY (Dec.)	12/14	12/15	12/16	12/17P	12/18F	12/19F
Revenue (Wbn)	839	838	984	1,758	2,491	2,559
OP (Wbn)	278	237	329	585	998	1,035
OP Margin (%)	33.1	28.3	33.4	33.3	40.1	40.4
NP (Wbn)	230	165	272	441	729	756
EPS (W)	10,486	7,542	12,416	20,081	33,216	34,470
ROE (%)	18.4	10.6	14.9	19.8	25.5	22.2
P/E (x)	17.4	28.2	19.9	22.3	12.3	11.9
P/B (x)	2.7	2.6	2.7	3.6	2.7	2.3
Dividend Yield (%)	1.9	1.3	1.5	1.6	2.4	2.4

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

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Earnings review and forecasts

Table 1. 4Q17 review

(Wbn, %)

	4Q16	3Q17	4Q17P			Growth	
			Preliminary	Mirae Asset Daewoo	Consensus	YoY	QoQ
Revenue	285	727	533	606	544	87.4	-26.7
Operating profit	102	328	189	233	206	86.0	-42.3
OP margin (%)	35.7	45.1	35.5	38.4	37.9		
Net profit	67	275	121	180	161	80.6	-56.1

Note: All figures are based on consolidated K-IFRS.

Source: Company data, FnGuide, Mirae Asset Daewoo Research estimates

Table 2. Quarterly and annual earnings trends

(Wbn, %)

	1Q17	2Q17	3Q17	4Q17P	1Q18F	2Q18F	3Q18F	4Q18F	2016	2017P	2018F
Revenue	240	259	727	533	515	511	752	712	984	1,759	2,491
<i>Lineage</i>	51	34	35	34	34	33	31	33	375	154	131
<i>Lineage II</i>	18	17	16	15	15	15	15	17	77	66	63
<i>Aion</i>	13	11	10	13	14	13	13	12	72	47	52
<i>Blade & Soul</i>	45	39	38	40	40	38	34	33	182	161	145
<i>Guild Wars 2</i>	14	14	20	35	35	20	14	13	77	83	82
Mobile games	23	94	551	327	311	333	577	538	20	995	1,758
Other	11	15	13	11	13	11	11	13	58	50	48
Royalties	64	36	44	60	54	48	58	53	122	203	213
Operating profit	30	38	328	189	200	179	333	285	329	585	998
OP margin	12.7	14.5	45.1	35.5	38.9	35.1	44.3	40.0	33.4	33.3	40.1
Net profit	17	31	275	121	148	133	245	208	271	444	734
NP margin	7.3	11.9	37.8	22.6	28.7	25.9	32.6	29.3	27.6	25.2	29.5
YoY											
Revenue	-0.6	7.5	234.3	87.4	115.1	97.7	3.4	33.5	17.3	78.7	41.7
<i>Lineage</i>	-34.8	-64.2	-57.8	-71.5	-34.4	-2.1	-11.1	-2.4	20.0	-58.9	-15.0
<i>Lineage II</i>	7.7	-12.6	-24.1	-26.0	-17.9	-9.4	-3.4	14.0	22.5	-14.7	-5.0
<i>Aion</i>	-33.9	-38.5	-36.8	-29.6	4.4	21.8	23.4	-5.0	-2.7	-34.6	10.0
<i>Blade & Soul</i>	-17.5	-20.2	-5.2	0.5	-10.0	-2.3	-9.8	-17.8	60.1	-11.6	-10.0
<i>Guild Wars 2</i>	-53.4	-14.7	31.5	134.8	145.4	48.7	-32.7	-61.6	-23.8	8.1	-1.0
Mobile		51,113.1	110,771.6	1,613.2	1,227.6	254.9	4.7	64.5		4,935.0	76.6
Other	-1.5	-14.9	-22.2	-17.4	24.8	-27.9	-19.0	19.1	-22.8	-15.1	-4.0
Royalties	116.1	33.8	80.2	43.2	-15.7	33.4	32.6	-10.6	23.7	66.0	4.9
Operating profit	-59.8	-56.4	403.4	86.0	557.8	377.2	1.7	50.7	38.5	77.9	70.6
Net profit	-73.7	-65.9	474.3	80.6	750.2	330.2	-10.9	72.7	63.1	63.6	65.3

Notes: All figures are based on consolidated K-IFRS; revenue from *Lineage M*, which was released on June 21, 2017, is included in mobile game revenue; *Lineage M*'s daily average revenue is estimated at W3bn in 2018; new releases, including *Blade & Soul II*, are reflected in mobile game revenue; royalties from external developers' games based on NCsoft's IP, including Netmarble Games' *Lineage II: Revolution*, are included in royalty revenue; net profit is attributable to controlling and non-controlling interests

Source: Company data, Mirae Asset Daewoo Research estimates

Table 3. Earnings forecast revisions

(Wbn, W, %)

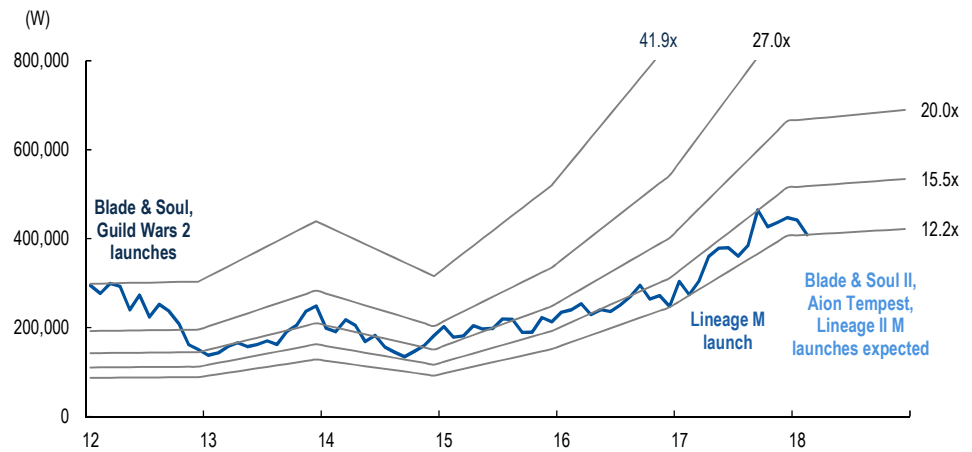
	Previous		Revised		% chg.		Notes
	18F	19F	18F	19F	18F	19F	
Revenue	2,616	2,631	2,491	2,559	-4.8	-2.7	- Revised down mobile game revenue estimates factoring in new game release schedule - Revised down labor cost/commission fee estimates, and revised up marketing spend estimates
Operating profit	957	972	998	1,035	4.3	6.5	
Net profit	723	734	734	761	1.5	3.7	
EPS (W)	32,975	33,482	33,216	34,470	0.7	3.0	
OP margin	36.6	36.9	40.1	40.5			
NP margin	27.6	27.9	29.5	29.8			

Notes: All figures are based on consolidated K-IFRS; EPS is based on net profit attributable to controlling interests.

Source: Mirae Asset Daewoo Research estimates

Valuation

Figure 1. 12 month forward P/E: Target multiple of around 20x



Source: Mirae Asset Daewoo Research

Table 4. Earnings/valuation comparison of global peers: NCsoft has higher ROE, lower P/E than global average

(Wbn, x, %)

Company	Market cap	Revenue		Operating profit		Net profit		P/E		EV/EBITDA		P/B		ROE	
		17F	18F	17F	18F	17F	18F	17F	18F	17F	18F	17F	18F	17F	18F
NCsoft	8,973	1,758	2,491	585	998	444	734	22.3	12.3	12.6	6.2	3.6	2.7	19.8	25.5
Netmarble Games	11,946	2,425	2,597	510	514	363	365	51.5	38.0	24.7	16.6	3.9	2.7	11.6	7.3
Com2uS	1,888	512	573	197	211	145	156	12.1	12.1	5.2	4.9	2.2	2.0	20.8	18.7
Activision Blizzard	57,116	7,689	8,039	2,623	2,929	1,895	2,243	30.7	26.2	20.8	18.2	5.1	4.5	15.1	15.9
Electronic Arts	40,932	5,566	5,611	1,406	1,782	1,111	1,424	32.6	28.8	18.6	19.0	9.3	8.8	26.2	30.6
Take-Two	14,619	2,204	3,160	508	832	405	659	39.0	24.5	26.1	15.1	8.1	6.1	23.2	29.9
Zynga	3,368	921	1,017	119	156	95	130	38.4	26.8	18.6	13.7	2.0	1.9	5.1	6.9
Glu Mobile	527	304	309	-13	13	-10	9	-	48.6	-	36.1	2.7	2.6	-5.4	8.6
Ubisoft	9,887	2,233	2,777	338	536	252	395	39.8	26.8	10.5	8.3	6.0	4.9	14.5	19.0
Nintendo	63,226	10,233	13,288	1,532	2,888	1,242	2,083	43.2	25.3	32.3	17.1	4.1	3.7	9.8	15.9
Nexon	14,785	2,245	2,465	898	1,039	695	824	21.1	17.5	11.2	10.3	3.3	2.8	17.5	17.2
Square Enix	5,321	2,583	2,781	398	446	264	297	19.8	17.7	8.8	7.8	2.7	2.4	14.2	14.1
DeNA	3,309	1,418	1,474	264	304	188	202	17.1	15.7	6.8	6.0	1.3	1.2	7.7	8.1
Gungho Online	2,867	814	770	291	287	182	183	12.2	12.6	7.8	8.1	3.1	2.5	26.1	14.6
GREE	1,633	684	820	84	121	127	79	48.8	19.7	14.7	5.6	1.4	1.3	3.0	7.2
Tencent	546,131	41,335	57,597	14,553	17,807	11,239	14,750	48.3	36.9	35.1	26.4	13.3	9.9	31.0	30.2
NetEase	44,272	9,195	11,769	2,239	2,506	2,229	2,549	19.9	17.6	16.1	13.8	5.4	4.3	28.5	26.8
Kingsoft	4,627	894	1,242	146	239	202	285	17.2	16.5	17.3	11.9	2.5	2.3	11.8	13.2
Youzu Interactive	3,226	579	753	126	177	131	180	22.4	16.5	20.1	14.8	5.4	4.2	24.7	26.9
Changyou	1,670	609	595	130	117	148	139	10.8	12.1	3.9	4.6	1.3	1.2	12.9	9.5
Avg.								28.8	22.6	16.4	13.2	4.3	3.6	15.9	17.3

Note: Data for domestic companies are based on Mirae Asset Daewoo Research estimates; data for overseas companies are based on the consensus
 Source: Bloomberg, Mirae Asset Daewoo Research estimates

Figure 2. Upcoming major mobile MMORPG: *Blade & Soul II* (expected in late 1H18) to target Asian markets, including China



Source: Company data, Mirae Asset Daewoo Research

Figure 3. Upcoming major mobile MMORPG: *Aion Tempest* (expected in 2H18) to target Western markets



Source: Company data, Mirae Asset Daewoo Research

Figure 4. Upcoming major mobile MMORPG: *Lineage II M* (expected in 2H18) to be starkly different from *Lineage M* in terms of graphics



Source: Company data, Mirae Asset Daewoo Research

NCsoft (036570 KS/Buy/TP: W640,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/16	12/17F	12/18F	12/19F
Revenue	984	1,758	2,491	2,559
Cost of Sales	188	211	299	307
Gross Profit	796	1,547	2,192	2,252
SG&A Expenses	467	962	1,194	1,217
Operating Profit (Adj)	329	585	998	1,035
Operating Profit	329	585	998	1,035
Non-Operating Profit	17	25	10	10
Net Financial Income	19	26	28	28
Net Gain from Inv in Associates	7	1	0	0
Pretax Profit	346	610	1,008	1,045
Income Tax	75	167	274	284
Profit from Continuing Operations	271	444	734	761
Profit from Discontinued Operations	0	0	0	0
Net Profit	271	444	734	761
Controlling Interests	272	441	729	756
Non-Controlling Interests	-1	3	5	5
Total Comprehensive Profit	329	763	734	761
Controlling Interests	329	763	733	760
Non-Controlling Interests	0	0	0	0
EBITDA	361	615	1,029	1,066
FCF (Free Cash Flow)	95	621	937	807
EBITDA Margin (%)	36.7	35.0	41.3	41.7
Operating Profit Margin (%)	33.4	33.3	40.1	40.4
Net Profit Margin (%)	27.6	25.1	29.3	29.5

Cash Flows (Summarized)

(Wbn)	12/16	12/17F	12/18F	12/19F
Cash Flows from Op Activities	112	645	937	807
Net Profit	271	444	734	761
Non-Cash Income and Expense	115	156	276	286
Depreciation	27	27	27	27
Amortization	6	3	3	3
Others	82	126	246	256
Chg in Working Capital	-154	136	173	16
Chg in AR & Other Receivables	-71	-37	-81	-7
Chg in Inventories	0	0	0	0
Chg in AP & Other Payables	-5	-4	1	0
Income Tax Paid	-136	-116	-274	-284
Cash Flows from Inv Activities	-139	-93	-874	-276
Chg in PP&E	-15	-24	0	0
Chg in Intangible Assets	-2	-3	0	0
Chg in Financial Assets	-170	-701	-874	-276
Others	48	635	0	0
Cash Flows from Fin Activities	-74	-80	-155	-213
Chg in Financial Liabilities	-	-	-	-
Chg in Equity	-9	1	0	0
Dividends Paid	-60	-81	-155	-213
Others	-	-	-	-
Increase (Decrease) in Cash	-103	469	-105	317
Beginning Balance	248	145	614	509
Ending Balance	145	614	509	827

Source: Company data, Mirae Asset Daewoo Research estimates

Statement of Financial Condition (Summarized)

(Wbn)	12/16	12/17F	12/18F	12/19F
Current Assets	1,192	1,632	1,951	2,503
Cash and Cash Equivalents	145	614	509	827
AR & Other Receivables	161	196	277	285
Inventories	1	0	1	1
Other Current Assets	885	822	1,164	1,390
Non-Current Assets	1,169	1,732	2,256	2,277
Investments in Associates	71	30	43	44
Property, Plant and Equipment	225	225	197	170
Intangible Assets	53	53	50	47
Total Assets	2,361	3,364	4,207	4,780
Current Liabilities	284	455	644	662
AP & Other Payables	28	47	67	69
Short-Term Financial Liabilities	0	0	0	0
Other Current Liabilities	256	408	577	593
Non-Current Liabilities	181	330	405	412
Long-Term Financial Liabilities	150	150	0	0
Other Non-Current Liabilities	31	180	405	412
Total Liabilities	465	784	1,049	1,073
Controlling Interests	1,886	2,565	3,139	3,683
Capital Stock	11	11	11	11
Capital Surplus	432	433	433	433
Retained Earnings	1,544	1,901	2,475	3,019
Non-Controlling Interests	10	14	19	24
Stockholders' Equity	1,896	2,579	3,158	3,707

Forecasts/Valuations (Summarized)

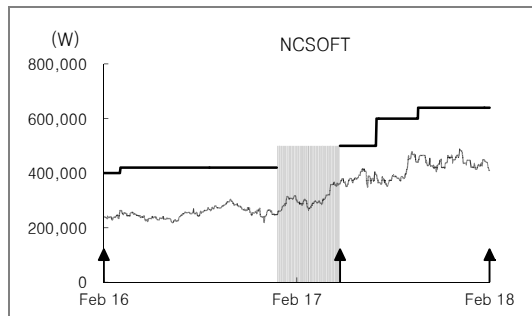
	12/16	12/17F	12/18F	12/19F
P/E (x)	19.9	22.3	12.3	11.9
P/CF (x)	14.1	16.4	8.9	8.6
P/B (x)	2.7	3.6	2.7	2.3
EV/EBITDA (x)	12.7	13.9	7.3	6.5
EPS (W)	12,416	20,081	33,216	34,470
CFPS (W)	17,610	27,323	46,009	47,696
BPS (W)	93,096	124,044	150,209	174,993
DPS (W)	3,820	7,280	10,000	10,000
Payout ratio (%)	29.9	34.9	29.0	27.9
Dividend Yield (%)	1.5	1.6	2.4	2.4
Revenue Growth (%)	17.4	78.7	41.7	2.7
EBITDA Growth (%)	32.7	70.4	67.3	3.6
Operating Profit Growth (%)	38.8	77.8	70.6	3.7
EPS Growth (%)	64.6	61.7	65.4	3.8
Accounts Receivable Turnover (x)	8.0	10.0	10.6	9.2
Inventory Turnover (x)	1,455.7	3,218.3	4,826.3	4,172.0
Accounts Payable Turnover (x)	21.0	44.0	84.1	72.7
ROA (%)	11.9	15.5	19.4	16.9
ROE (%)	14.9	19.8	25.5	22.2
ROIC (%)	61.8	135.1	710.0	4,109.8
Liability to Equity Ratio (%)	24.5	30.4	33.2	29.0
Current Ratio (%)	419.1	358.8	302.9	378.3
Net Debt to Equity Ratio (%)	-44.0	-48.9	-47.2	-54.8
Interest Coverage Ratio (x)	110.4	242.9	0.0	0.0

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
NCSOFT(036570)	09/26/2017	Buy	640,000
	07/09/2017	Buy	600,000
	05/01/2017	Buy	500,000
	01/02/2017	No Coverage	
	03/11/2016	Buy	420,000
	02/05/2016	Buy	400,000



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.
- * Although it is not part of the official ratings at Mirae Asset Daewoo Co., Ltd., we may call a trading opportunity in case there is a technical or short-term material development.
- * The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst’s estimate of future earnings.
- * The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Equity Ratings Distribution & Investment Banking Services

	Buy	Trading Buy	Hold	Sell
Equity Ratings Distribution	75.50%	16.00%	8.50%	0.00%
Investment Banking Services	62.50%	33.33%	4.17%	0.00%

* Based on recommendations in the last 12-months (as of December 31, 2017)

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