Expanding in Korea’s growing online music market

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- Leading online music-service provider in Korea  
- It expects to benefit from revenue growth in domestic online music market  
- It expects synergies to emerge from having a vertically-integrated business platform

■ Background
Loen Entertainment (Loen) is the leading music-service provider in Korea. At our recent visit to the company, Loen said it was benefitting increasingly from the revenue growth in the online music market, and had established its vertically-integrated platform by taking over an entertainment company.

■ Highlights
Largest provider of paid-music downloads and streaming in Korea. Loen has more than a 50% share of Korea’s paid-music downloads and streaming market in terms of revenue and unique visitors. Melon, the company’s online paid-music service platform, had 2.7m paying users as at end-2Q14 (end-2012: 1.7m; end-2013: 2.4m), and offers digital song downloads and a streaming service both online and on mobile devices. On 18 July 2013, SK Planet (Not listed), a subsidiary of SK Telecom, sold its entire 52.6% stake in Loen to Star Invest Holdings Ltd (Not listed).

Government efforts to revive the music industry. In January 2013, the Ministry of Culture, Sports, and Tourism announced it was raising the absolute price for each song and bundled products, and cutting the share of revenue that online music-service providers receive from sales of songs (from 46-57.5% to an across-the-board rate of 40%). This has been negative for Loen, but it believes the higher absolute price for each song and bundled product is offsetting this and will drive sales growth in Korea’s online music market. For 2013, Loen’s revenue rose by 36.5% YoY to KRW252.6bn and operating profit was up 23.9% YoY to KRW37.3bn.

Melon: the dominant domestic online music-service platform. At our meeting, management claimed the company has 3 competitive advantages. First, management notes the strong subscriber base. It stated that its number of total subscribers has risen by more than 10% annually since 2010, and expects this growth rate to continue for the next few years, supported by its joint marketing with SK Telecom. Loen has been adding more than 20,000 new paying subscribers a month since 2010, and expects this trend to continue going forward, backed by an increase in unlimited data-plan users at SK Telecom, which accounted for 60% of Loen’s new subscribers in 2Q14.

Second, Loen had 3.4m songs available for download at end-2Q14, compared with 3.0m for KT Music (the No. 2 player in the market). Loen has invested about KRW2bn annually over the past few years to enhance its digital-song offerings.

Third, Loen believes it can attract more users by introducing a new version of Melon (launched in July this year). This new version allows users to view the schedules and activities of Leon’s artists under contract through Melon. By helping subscribers to connect more closely with their favourite artists and introducing its own video clips and showing programmes to them, Loen expects to retain its subscribers and improve its revenue mix continually.

Ready for next step to be a content provider. Management said it had established its vertically-integrated business platform by taking over Starship Entertainment in December 2013. It expects to see strong synergies from streamlining its core services and ramping up new businesses (such as expanding its line-up of new artists and in-house content) from 2H14.

■ Valuation
The Loen stock trades currently at PERs of 17.6x for 2014 and 14.7x for 2015, based on the Bloomberg-consensus EPS forecasts.

Share price performance

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<th>(KRW)</th>
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<tr>
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<td>Aug-14</td>
<td>126.5</td>
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12-month range: 12,650.00-34,750.00  
Market cap (USDbn): 0.78  
3m avg daily turnover (USDm): 3.20  
Source: FactSet, Daiwa
**Melon and competitors: market shares in Korea’s online paid-music services (1Q14)**

![Market Share Pie Chart]

- **Melon:** 54.3%
- **Genie:** 18.4%
- **Bugs:** 6.5%
- **Mnet.com:** 14.7%
- **Soribada:** 6.1%

Source: Korean Click, based on total PC/Mobile usage

**Loen: revenue breakdown by business (1Q14)**

![Revenue Breakdown Pie Chart]

- **Online music stores:** 90.2%
- **Product sales:** 6.1%
- **Others:** 3.7%

**Korea: revenue-sharing breakdown on downloaded songs (>100 songs package)**

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<tr>
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<th>2014E</th>
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<td>Online music-service operators</td>
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<tr>
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<td>6.3</td>
<td>7.2</td>
<td>8.1</td>
<td>9</td>
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<td>Composers</td>
<td>6</td>
<td>10.5</td>
<td>12</td>
<td>13.5</td>
<td>15</td>
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<tr>
<td><strong>Total</strong></td>
<td>66.7</td>
<td>105</td>
<td>120</td>
<td>135</td>
<td>150</td>
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Source: Company

**Melon: annual trend in number of paying users**

![Number of Paying Users Graph]

- **2010:** 200,000
- **2011:** 250,000
- **2012:** 300,000
- **2013:** 350,000
- **2014:** 400,000

Source: Company

**Loen: shareholding structure (end-March 1Q14)**

![Shareholding Structure Pie Chart]

- **Star Invest Holdings:** 61.4%
- **SK Planet:** 15.0%
- **Others:** 23.6%
Share price and Daiwa recommendation trend

Loen Entertainment: share price and Daiwa recommendation trend

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Source: Daiwa
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