Soft power means hard money

- **Gangnam Style** is just the latest in a long-running series of
  Korean entertainment exports
- The continuing popularity of Korean pop music and TV shows
  globally is reflected in the country’s growing “soft power”
- Content providers should be direct beneficiaries; there are halo
  effects for cosmetics and F&B players, as well as major exporters

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**What’s new**

In our 24 August *Seoul Searching*, we focused on the rise in the number of Mainland Chinese visiting Korea as a result of the increasing popularity of Korean culture. In this edition, we trace the development of the K-wave phenomenon back to its inception in the mid-1990s and look at ways to gain exposure to the lasting implications of this for “Brand Korea”.

**A long-term trend**

The huge success of Korean rapper PSY’s *Gangnam Style*, the video for which has received over 700m views on YouTube, has brought the K-wave into sharper focus, particularly in western markets. But it would be wrong to view the K-wave as a fad.

*Gangnam Style* is just the latest chapter in a long-running story. The song is a blockbuster of global proportions, but it follows in the footsteps of a string of breakthrough successes dating back to the mid-to-late 1990s. Indeed, the term K-wave was coined in mid-1999 by a group of Beijing journalists who were surprised at the fast-growing popularity of Korean entertainment in China back then.

**Evolution of the K-wave**

The first stage of the K-wave was driven by TV dramas, which found a new audience outside Korea, particularly in China. The second stage saw expansion into Japan, the biggest music and entertainment market in Asia, where K-pop started to find favour with Japan’s music fans, adding to the inroads made by TV shows. The third stage was spearheaded by K-pop, underlining the success of the major Korean entertainment companies’ well-honed training programmes for marketable singers and dancers. Savvy use of Internet media, such as Youtube, Twitter and Facebook, during this stage helped expand the reach of K-pop from Asia to all parts of the world, including North America and Europe.

**Exports of K-wave content**

![Graph showing exports of K-wave content](image)

Source: KOCCA

**Stocks to watch**

We think there are three groups of companies that stand to benefit from the rise of the K-wave and increased consumer awareness of Brand Korea. These are:

1. **The share prices of entertainment companies SM Entertainment (Not rated) and YG Entertainment (Not rated)** have fallen sharply over the past week in the face of disappointing 3Q12 results. The entertainment industry is a highly uncertain field, as consumer tastes change and developing and promoting artists can be costly. But, in our view, such companies need to have a strong pipeline of artists if they are to continue to ride the K-wave. Since the K-wave is a long-term trend, we would view these share-price corrections as growing pains rather than the start of a prolonged downturn. Content players such as CJ E&M (Not rated) and SBS Contents Hub (Not rated) should also emerge as companies to watch.

2. Cosmetics and food & beverage (F&B) products, which are often promoted by K-wave stars, are potential beneficiaries, in our view. Korean-made cosmetics have recorded strong export growth in recent months; we highlight AmorePacific (090430 KS, KRW1,315,000, Outperform [2]).

3. Major Korean exporters look well placed to monetise increased interest in Korean culture. **Samsung Electronics (005930 KS, KRW1,384,000, Buy [1])** uses K-wave personalities in its advertising. Big exporters that don’t use K-wave artists in their marketing campaigns could benefit through greater consumer acceptance of Korean goods and services.

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See important disclosures, including any required research certifications, beginning on page 17
How the K-wave has evolved

Dates back to the 1990s

Three stages in the trend

Many people think of the K-wave as a recent phenomenon. In fact, it has been around for more than 15 years, during which it has evolved in three distinctive stages.

First stage: the term ‘K-wave’ is coined in China
Also known as Hanryu, the Korean wave, or K-wave, refers to the surge in the popularity of Korean culture and entertainment outside Korea. The term was coined in mid-1999 by a group of Beijing journalists who were surprised at the fast-growing popularity of Korean entertainment in China.

Although Korean TV dramas started to be broadcast in Asia as early as 1990, they did not become extremely popular until the late 1990s. It was only when a drama called What is love? was watched by about 150m people in Mainland China that the K-wave began in earnest. Other TV dramas kept up the momentum; What is love? was followed by other successful series such as Stars in My Heart and All about Eve. Meanwhile, movies such as Swiri and My Sassy Girl performed well at the box offices in Hong Kong, Taiwan, and China.

K-pop started to turn heads a little later. The first idol group (arguably), H.O.T., and techno-music duo Clon released albums in China in 1998 and 1999, respectively. Both groups became the biggest K-pop stars at the time, not only in China but in Taiwan and Hong Kong. These two groups laid the foundations for the popularity of K-pop in Asia. After their success, a series of boy and girl bands, such as NRG and Babyvox, released albums and went on concert tours in China and Taiwan in the early 2000s.

Second stage: K-wave spreads to Japan and other Asian countries
The second stage of the K-wave was characterised by the trend expanding into Japan and other markets in Asia. It was also the time when the trend broadened into a greater interest in Korean culture overall rather than just popular music, TV dramas and movies.

This stage started in 2003, when the Korean TV drama Winter Sonata became a massive hit in terms of audience ratings and commercial success in Asia, especially in Japan. It led to the so-called ‘Yonsama phenomenon’ (‘Yonsama’ means ‘Sir Yon’) which refers to Bae Young-joon, the main actor in Winter Sonata. Such was Bae Young-joon’s popularity that in Japan he was looked upon as something of a fantasy figure. Following this, a series of Korean TV dramas were aired on the major channels in Japan, and were very popular.

K-pop also achieved meaningful success in Japan during this period. Korean female artist BoA began to gain popularity in Japan in 2000. By the mid-2000s, she had become one of the most popular female artists in Japan, and has sold about 10m records (non-digital format) in Japan to date. A boy band, TVXQ, which entered the Japan market in 2006, has achieved a similar level of success; about 700,000 people have attended the band’s concerts in the country. Many other K-pop stars have gone on to find success in Japan.

Korean entertainment has also become popular in Southeast Asia and China. K-pop stars have had No.1 in hits in China, Taiwan, and other Asia countries, while dramas such as Doe Jang Geum have become commercial successes not only in the region but in the Middle East and elsewhere.

This popularity has led to increased interest in Korea beyond pop music and dramas. Interest in the Korean language and food has risen, and the number of tourists visiting the country has increased significantly. The places where dramas or movies had been filmed have become meccas for K-wave fans (for instance, Namism, a location where Winter Sonata was filmed welcomed 426,000 foreign tourists in 2011.) With this, other forms of Korean entertainment, especially online games, have hit the spot overseas.

Third stage: going global
In the third stage of the K-wave, Korean entertainment has established itself as a mainstay in Asia. Although the popularity of Korean dramas and movies appears to have peaked, such content is broadcast frequently on the major TV channels in Japan and China. K-pop is now driving the K-wave. The well-honed training programmes of Korea’s major entertainment
companies have produced a steady stream of commercially successful artists. In addition, due to Internet platforms such as Youtube, Twitter and Facebook, K-pop has spread around the globe, including to North America and Europe.

While K-pop has secured a foothold in Japan, its popularity has spread rapidly in Southeast Asia and China. More interestingly, it has begun attracting attention outside Asia. Some K-pop performers have undertaken world tours, taking in the US and Europe, over the past few years. In addition, there is the rap artist PSY, whose *Gangnam Style* song has become a worldwide phenomenon. The accompanying video is one of the most-watched on Youtube, while the song itself has reached the No.1 spot on several music charts worldwide and was No.2 on the US Billboard Hot 100 chart for seven weeks.

**Korean rap artist PSY: now a global phenomenon**

![Source: YG Entertainment](image)

**Recent examples of K-pop’s success outside Asia**

<table>
<thead>
<tr>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SM Town</strong></td>
<td><strong>SM Town</strong></td>
</tr>
<tr>
<td>In June 2012, performed a concert in Paris (to an audience numbered about 15,000).</td>
<td>SM Town’s Live World Tour 3 features concerts in the US, Taiwan, Japan, Singapore, and other nations. (The Los Angeles concert drew 12,000 people.)</td>
</tr>
<tr>
<td>In October 2012, performed a concert at Madison Square Garden, New York (to an audience of about 15,000).</td>
<td></td>
</tr>
<tr>
<td><strong>Super Junior</strong></td>
<td><strong>Super Junior</strong></td>
</tr>
<tr>
<td>In June 2012, performed a concert in Paris (to an audience of 7,000).</td>
<td></td>
</tr>
<tr>
<td><strong>JYJ</strong></td>
<td><strong>JYJ</strong></td>
</tr>
<tr>
<td>In March 2012, performed concerts in Chile and Peru (to audiences of 3,000 in Chile and 6,000 in Peru).</td>
<td></td>
</tr>
<tr>
<td><strong>Big Bang</strong></td>
<td><strong>Big Bang</strong></td>
</tr>
<tr>
<td>Alive Galaxy Tour 2012 (in the US, its Los Angeles and New Jersey concerts were sold out, and the tour will move on to Peru and the UK later this year).</td>
<td></td>
</tr>
<tr>
<td><strong>2NE1</strong></td>
<td><strong>2NE1</strong></td>
</tr>
<tr>
<td>Its first world tour, New Evolution 2012, it drew more than 200,000 people worldwide (14,000 in the US).</td>
<td></td>
</tr>
</tbody>
</table>

Source: Various media sources, Daiwa

Although they have not reached the heights of the Yonsama era, Korean dramas and movies continue to be broadcast in Asia. On the back of the success of the drama, *You are so beautiful*, the actor Jang Keun-suk is emerging as a post-Yonsama star in Japan.

What’s so special about the K-wave?

There are several factors that account for the success of the K-wave. In addition, due to following factors, we believe the phenomenon can be sustained and could expand going forward. These factors are: 1) distinctive themes and content, 2) a successful global strategy and systematic training programmes by entertainment companies, and 3) the ability to adapt to the latest trends and capitalise on new media.

Initially regarded as ‘something new’

Prior to the K-wave, the entertainment business in Asia was influenced heavily by Japanese culture. J-pop, manga, and Japanese TV dramas were widely watched throughout the region. Hong Kong film noir was also popular. By the late 1990s, however, people appeared to have become bored with this type of content.

Korean dramas were different in that their themes had an everyman quality – for example centring on true love and the family, as opposed to, say, Hong Kong’s underworld. The dramas’ relevance and realistic themes were regarded as fresh and even quite shocking at the time by Chinese and Japanese viewers.

The hip-hop and techno music of H.O.T. and Clon were new to those in the Mainland in the late 1990s.

Adopting the strategies of successful Korean exporters: targeting overseas markets from the outset

While it was the novelty of the K-wave that kick-started the phenomenon, it is the entertainment companies that have expanded its appeal and sustained it. From the recruitment process to public launch, Korean musicians and actors typically undergo 3-7 years of training. These programmes are combined with international strategies that have helped the companies produce big stars.

The Korean entertainment companies generally recruit potential performers not only from domestic auditions but also from abroad. Recruiting from overseas facilitates the companies’ expansion abroad: for example, Victoria from f(x) is Chinese, and Wonder Girls also has a Chinese member, Hae Lim. In the case of SM Entertainment, about 300,000 people take part in domestic and overseas auditions each year.

According to the entertainment companies, it takes about 3-7 years to train one performer. The training covers not only dancing, vocals and acting, but also
language classes, including Chinese, Japanese and English. Korean stars' fluency in foreign languages has been quite effective in enabling them to appeal to overseas audiences. For instance, the members of Kara have been successful in Japan due in part to their fluency in the Japanese language. They have recorded their songs in Japanese, which enabled them to achieve considerable success in the music charts there. In addition, their fluency in Japanese has enabled them to be cast in the main roles in a Japanese TV drama, Urakara!, which was one of most popular late-night TV programmes in 2011. According to SM Entertainment, it costs several billion Won to launch one performer. But the systematic training programmes have reduced the risk of failure, making the investment in the performers a risk worth taking.

Even so, all of the training would probably have been worthless without a well-thought-out global strategy. Korean entertainment companies' affiliations with major overseas record companies and entertainment businesses have minimised the risk of performers' failure abroad, especially in Japan. The general concept of performers is devised in Korea, with the detailed aspects of local modification, and access to local distribution networks, undertaken by the local companies.

Adapting to trends
The Korean entertainment companies have adapted well to the changing trends of the past decade. This is one reason why the K-wave has been so successful. The Korean entertainment businesses, especially K-pop, have successfully absorbed the public's rapidly-changing tastes, surviving amid an unpredictable global entertainment industry.

To accommodate the rapid changes in the industry, the Korean entertainment companies often cooperate with other entertainment companies and/or world-famous artists. For example, SM Entertainment invites several hundred composers and musicians from around the world to participate in conferences twice a year. In the case of Girls Generations' mega-hit EP, Tell me your wish (Genie), the Norwegian song-writing/production company DsSign Music participated in the song writing and production, while famed Japanese-American choreographer Rino Nakasone choreographed the piece. The famous girl group 2NE1 has cooperated with American musician Will.i.am from the band, Black Eyed Peas.

Another way in the Korean entertainment companies have ensured their survival is through the effective use of social media, such as Facebook, YouTube and Twitter. Doing this has helped the Korean companies to increase their exposure in the US and European markets. Word-of-mouth advertising through social network services (SNS) is much more powerful — and certainly cheaper — than conventional advertising. Most of the companies' recent success in the US and European markets has relied considerably on this form of Internet media, according to companies. A good example of this is the rap artist PSY.

PSY's song Gangnam Style, which was initially aimed at the Korean market, has become a mega-hit worldwide. As various cover versions of Gangnam Style have spread across the Internet, more and more people have become interested in the quirky music video. Gangnam Style has become one of the most watched videos on YouTube; more than 700m views have been recorded so far, and the song reached the No.1 spot on the music charts in many European nations and held the No.2 spot on the US Billboard Hot 100 chart for seven weeks.

Other Korean groups also communicate with their global fans through social networks, and have held successful concerts in non-Asian regions (as seen in the preceding table.) The management companies are also exploiting Internet ads as a means of promoting artists.
Interestingly, the major entertainment companies’ strategy of penetrating the global market is similar to that employed by successful Korean manufacturing companies for decades: target overseas markets at the design stage and embrace localisation to appeal more to target markets. In our view, this type of strategy brings the intended results over time. Even though the trend is called K-wave, its components have evolved into being more than just Korean. For example, the girl and boy groups often have one or two non-Koreans, and world-famous song writers and choreographers work with the K-pop artists.

### Historical overview of K-pop artists

- 1996
  - Clon (1996–)
- 1997
  - NRG (1997–)
- 1998
  - SHINHWA (1998–)
- 2000
  - BoA (2000–)
- 2002
  - Rain (2002–)
- 2003
  - SE7EN (2003)
- 2004
  - TVXQ (2004–)
  - Super Junior (2005–)
  - Big Bang (2006–)
  - KARA (2007–)
  - Girls’ Generation (2007–)
- 2005
  - SHINee (2008–)
- 2006
  - BIGBANG (2006–)
- 2007
  - F(x) (2009–)
- 2009
  - 2NE1 (2009–)
- 2012
  - EXO (2012–)

* Splits into two groups (TVXQ and FTV)

Source: Publicity photos, Daiwa

### Historical overview of Korean TV dramas

- 1990s
  - What is love? (1991/1997, China)
  - Autumn in My Heart (2000)
- 2000
  - Winter Sonata (2002)
  - Full House (2004)
- 2006
  - Princess Hours (2006)
  - You’re Beautiful (2009)
- 2007
  - Jamoung (2006)
  - Boys over Flowers (2009)
- 2009
  - The First Shop of Coffee Prince (2007)
  - Secret Garden (2011)
- 2011
  - The Moon Embracing the Sun (2011)

Source: Publicity photos, Daiwa
Potential beneficiaries of the K-wave

Three distinct groups of companies stand to benefit

1. Entertainment companies and content providers

Producers of music and video content

Based on our market research, we have identified two companies that appear to have a competitive advantage in producing music and broadcasting content. In terms of music content, SM Entertainment and YG Entertainment are the two major producers. In terms of video content, CJ E&M and SBS Contents Hub appear potentially as the major beneficiaries.

SM Entertainment, founded in 1995, has been the leader in terms of music-content development in Korea up until now. The company has the largest number of K-pop stars leading the K-wave under its management, such as Girls Generation, f(x), SHINee and Super Junior. The company’s core competitive advantage appears to lie in its ability to completely develop a K-pop star (from casting, training, producing and managing). While the company’s areas of business range from TV dramas to online content, its major business areas are music and live entertainment (such as producing albums and concerts).

SM Entertainment recorded 73% YoY revenue growth for 9M12, backed by strong growth in overseas revenue (up 168% YoY). The music and royalty revenue for its K-pop stars is increasing rapidly globally, especially in Japan. The company has stated that its main revenue-growth area will be the expansion of its content (music and concerts) to overseas markets other than Japan.

In addition, SM Entertainment’s acquisition in October this year of SM C&C (unlisted) appears to have signalled the start of SM Entertainment’s drama production and travel agency businesses. Management has stated that SM C&C is expected to sell self-produced dramas and movies, both in Korea and abroad. Taking into account that many K-pop stars have acting careers or have been trained for acting careers, SM Entertainment’s new drama-production business could create synergies, and could boost SM Entertainment’s earnings, in our opinion, based on talks with the company. Furthermore, with the acquisition of SM C&C, SM Entertainment appears to have diversified its line-up by attracting top-class actors and comedians, such as Ho-dong Kang, Dong-hyup Shin and Dong-gun Jang.

YG Entertainment, founded in 1996, has emerged as a second major entertainment company in Korea. YG Entertainment possesses an in-house production system similar to that of SM Entertainment, and is able to develop its own K-pop stars. By the mid-2000s, it had established a solid line-up of artists comparable to those of SM Entertainment. Now, YG Entertainment has overtaken SM Entertainment in terms of the diversity of its K-pop performer line-up. In the late 2000s, YG Entertainment launched a series of mega-hit K-pop groups, such as Big Bang and 2NE1. The rapid success of Hi Lee, a female artist who released her first single on 29 October this year, suggests that YG Entertainment is now level with SM Entertainment in terms of its ability to find new talent, training and music production. Recent deals with PSY and Epick High have diversified YG Entertainment’s artist line-up further.

YG Entertainment had lower overseas revenue exposure, at 38% of its total revenue for 1H12, compared with SM Entertainment, which derived 65% of its 1H12 revenue from overseas. For 1H12 the company’s revenue declined by 12% YoY, while its overseas revenue fell by 20% YoY due to a lack of large concerts and album launches. In 1H13, however, YG Entertainment’s artists such as PSY and 2NE1 plan to release new albums, and the company plans to launch a new girl group in 2013. Adding to this, revenue from world tours for 2NE1 and Big Bang should boost YG Entertainment’s earnings performance in 2H12 and 1H13, in our view based on the talks with the company.

Timetable for SM Entertainment

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>Girls’ Generation to launch new album in Japan during Nov 12</td>
</tr>
<tr>
<td>2013</td>
<td>Super Junior to launch new album</td>
</tr>
<tr>
<td></td>
<td>SM C&amp;C plans to produce two or three TV dramas and two TV shows in 2013</td>
</tr>
</tbody>
</table>

Source: SM Entertainment, Daiwa

This page has been generated by an automatically process.
In addition, YG Entertainment’s recent decision to expand into the apparel business by setting up a joint venture with Cheil Industries could improve its earnings stability, as there have been many cases of brands that have been endorsed by K-pop stars becoming more popular in Asia.

**Timetable for YG Entertainment**

<table>
<thead>
<tr>
<th>2H12</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>New album</td>
<td></td>
</tr>
<tr>
<td>Hi Lee, a female artist, debuted in October</td>
<td>PSY plans to release a new album in 1H13</td>
</tr>
<tr>
<td>2NE1’s world tour is ongoing (ends in November 2012)</td>
<td>It plans to launch a new girl group in 2013</td>
</tr>
<tr>
<td>Concert</td>
<td></td>
</tr>
<tr>
<td>Big Bang’s world tour is ongoing (ends in January 2013)</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
</tr>
<tr>
<td>Natural 9, a new apparel business with Cheil industries, is to be launched May–June 2013</td>
<td></td>
</tr>
</tbody>
</table>

Source: YG Entertainment, Daiwa

CJ E&M was the largest multiple programme provider (MPP) in Korea in 1H12, with a 23.2% share of the pay TV market in terms of viewership ratings. The company also has online game, movie and music businesses.

Compared to SM Entertainment and YG Entertainment, CJ E&M currently has low exposure to overseas markets, which accounted for 12% of its revenue for 1H12. The company is a K-content producer with a strong content-sourcing ability in Korea, as well as in-house production capabilities, ranging from TV shows, online games and movies to music. The company has produced popular TV programmes, such as *Superstar K*, and is continuously sourcing TV content for its popular TV channels. It has an in-house production system to develop K-pop stars, although their overseas presence is low. The company also invests in and distributes Korean movies.

We believe CJ E&M would be unlikely to benefit from the K-wave in the near term given its low exposure to overseas markets. However, if the K-wave begins to expand to Korean TV programmes, other than TV dramas, or to Korean movies, then CJ E&M could be a major beneficiary of the trend given its broad portfolio of K-content.

SBS Contents Hub is the distributor of broadcasting content produced by SBS, one of the four terrestrial broadcasters in Korea.

SBS Contents Hub has been increasing its content distribution overseas, supported by the popularity of the K-wave. In the first nine months of 2012, the proportion of the company’s overseas revenue increased to 47%, compared with 39% for 2011. The company recorded revenue growth in Japan (up 13.8% YoY) and ex-Asia countries (up 12.3% YoY) for 9M12. Although the revenue proportion for ex-Asia countries accounted for only 1.3% of its overseas revenue for the period, the K-wave’s expansion worldwide could enable it to generate more revenue in these regions.

**Tackling the challenges**

The share prices of the main Korean entertainment companies have fallen significantly over the past week because the companies did not meet investors’ high earnings expectations. However, the entertainment industry intrinsically carries a considerable degree of uncertainty, as there are often many costs associated with promoting artists that are unexpected and can result in sizable earnings swings. In our view, however, provided that the artists’ pipeline is on track and the K-wave’s momentum continues as a long-term trend, it is more appropriate to focus on the mid/long-term business outlooks of the entertainment companies.

For K-content to continue to expand its presence worldwide, we believe the following issues would need to be resolved: 1) the steady monetisation of the K-wave, and 2) the K-wave’s unbalanced revenue breakdown by region and content type.

**K-content: overseas revenue growth for different content**

Despite the rapid expansion globally of the K-wave, so far achieving a steady monetisation of K-content remains an issue, in our view. According to the Korea Creative Content Agency (KOCCA), Korean game exports, which have been expanding irrespective of the rising popularity of the K-wave, accounted for 54% of K-content exports in 2011 and have seen annual revenue growth of 15-40% YoY since 2005. Music and TV broadcasting, which should be generating revenue from the K-wave given its popularity, accounted for only 4-5% of K-content exports in 2011, despite revenue growth for 2011 of 112% YoY and 2YoY, respectively. Movie exports accounted for only 0.7% of total K-content exports in 2011. Moreover, revenue has been volatile for this K-wave related K-content, with music content’s export-revenue growth ranging from
-25% YoY to 160% YoY, and export-revenue growth of TV broadcasts ranging from 0% YoY to 13% YoY over the 2006-11 period. Given that the global music and movie markets are more than three times larger by revenue than the global online game market, where most of the K-content revenue is currently generated, monetising the K-wave in these industries is likely to be the key focus for the K-content producers in Korea.

**K-content: overseas revenue mix by content type (2011)**

The geographical imbalance is another issue for the promotion of the K-wave. In 2010, music and TV broadcasts generated 98.8% and 95.3%, respectively, of overseas revenue from Asia. Although there is no exact figure, according to the management of SM Entertainment, more than 80% of overseas revenue was from Japan in 2011. As the third stage of the K-wave’s development is reaching larger regions than the first and the second stages did, expanding K-content geographically should be a key focus point for the companies involved. We believe this will also be important in order to monetise the K-wave, as the paying-user ratio is low in Asia ex-Japan compared with North America and Europe.

**Korean music: overseas revenue by region (2011)**

Korea’s main entertainment companies appear to be starting to tackle the issues of monetisation and the geographical imbalance. The managements of SM Entertainment and YG Entertainment both acknowledge the need to diversify revenue sources, other than from Japan. In China and Southeast Asia, the K-wave’s presence is as strong as in Japan, but the first two areas’ revenue contribution is relatively very low due to content piracy issues. In order to increase revenue, both companies plan to expand their live concert business in the China market.

The China concert market is much larger in terms of audience numbers and royalties received by artists than the Korea and Japan markets. According to SM Entertainment, the royalties received by its artists for Mainland concerts are around 1.5-2 times higher than for a Korean concert. Moreover, since China has a much higher population than Korea, there is more scope to hold more concerts in China. YG Entertainment has not given exact figures, but has stated that the ticket price for a concert for the band Big Bang in China is usually 3-4 times more expensive than one in Korea. In our view, leveraging the popularity of the K-wave in China and monetising it through more concerts in China appears a practical and effective route for Korea’s entertainment companies.

In addition, Korea’s entertainment companies are starting other businesses, which are likely to bring them stable revenue streams in the future, in our view. The market is awaiting the launch of SM Entertainment’s new video-content business, through its affiliate SM C&C. Along with its acquisition of SM C&C in October, SM Entertainment has also brought top-class comedians and actors under its management. With new top-class comedians, actors and K-Pop stars having joined the company, SM Entertainment should be able to generate synergies between its businesses and thus improve its earnings, in our view. Taking into account the popularity of K-Pop artists in Asia, we believe YG Entertainment’s new apparel business with
Cheil Industries (Not rated) is likely to be successful in Asia because the clothes will be endorsed by pop stars. YG Entertainment has disclosed that its apparel business will target not only Korea but also the global market.

2. Cosmetics and F&B players

The K-wave has an impact on consumer habits

The K-wave has not only led to a rapid surge in the popularity of Korean entertainment globally; it has also raised the profile of Brand Korea. The enhanced brand image of Korea has led to an increase in the number of tourists visiting Korea and more interest in Korean products from foreign markets, especially beauty-related products and food and drink. Thus, we also believe cosmetics companies and the F&B companies are potential beneficiaries of the K-wave.

- How much does the K-wave affect the purchasing of Korean products?

![Survey Chart]

Source: IIT
Note: The survey period is September-October 2011; people from Taiwan (128), Vietnam (266), Japan (446) and China (339) participated in this survey.

It is hard to measure precisely the correlation between the K-wave and its impact on other industries. Still, according to a survey conducted by the Institute for International Trade (IIT) in the latter part of 2011, the majority (62%) of respondents said that the K-wave has influenced them to buy Korean products, as seen in the preceding chart.

Also, K-wave stars have been used to promote Korean products successfully, especially food and drink and cosmetics. K-wave stars such as Kara, Girls’ Generation, and Keun-suk Jang are often used to market products, and such marketing often leads to significant sales increases of these products. For instance, last year Lotte Liquor (Not listed), a subsidiary of Lotte Chilsung (Not rated), saw a strong increase in sales of its Korean traditional alcoholic drink ‘makegeolli’ after star Keun-suk Jang starred in a 2011 commercial to promote the product in Japan. Some 36m cans of the drink were sold in 2011, twice the company’s sales target for the year.

- Korea: exports of cosmetics products, and food and drink products

![Graph]

Source: Korean Customs Service

As such, we think AmorePacific and LG Household & Health Care (LG H&H) (051900 KS, KRW660,000, Hold [3]) will continue to benefit from the K-wave phenomenon. In our opinion, AmorePacific and AmorePacific Group (Not rated) have the best brand portfolios in Korea’s cosmetics space, for both low- and high-end products. AmorePacific’s premium skincare brands Sulwhasoo and Laneige are perceived by many Asian consumers as high-end cosmetics brands (being positioned in those department-store channels where high-end cosmetics brands are sold and competing with Shiseido and Estee Lauder, for instance).

Our research shows that Amorepacific has an effective marketing strategy for its brands overseas as well as in Korea. Its brands have become very popular in countries such as China and Southeast Asian countries, where the sales growth for Amorepacific brands rose by more than 30% YoY for 9M12. In addition, AmorePacific Group’s low-end brands such as Etude House and Innisfree (skincare and makeup) have seen their sales growth in Korea accelerate this year due to the strong influx of tourists from China. Also, we learned from the company that one K-wave star who is popular in China was used in a promotional launch of its Innisfree shop in China in April this year, and the company believes that its strategy of including K-wave stars to promote its products has been effective.

We believe the above are good examples of how Korean companies outside the entertainment industry are reaping the benefits from the strong K-wave in other countries.

We have an Outperform (2) rating on Amorepacific with a DCF-based six-month target price of
KRW1,360,000. The main downside risk to our earnings forecasts, target price and rating would be a more short-lived recovery in the company’s door-to-door channel sales than we expect and a slowdown in its sales-growth momentum in China.

We have a Hold (3) rating on LG H&H with a DCF-based six-month target price of KRW600,000. The company, for 2012 year-to-date, posted in-line quarterly earnings, suggesting to us that its share price should remain resilient during the current equity-market downturn. Still, we see limited share-price appreciation potential unless drivers emerge for us to revise up our earnings forecasts for this stock, given what we consider as its high valuation (trading at a 25x PER for 2013E based on our EPS forecast and its latest closing share price). We see the main potential stock catalyst as a value-accretive M&A announcement and the main risk as earnings coming in below expectations for the new assets.

3. Major exporters

Korea’s ‘soft power’ is on the rise: halo effects for major exporters

Using K-pop and K-drama stars to advertise and promote Korean products is not confined just to consumer products and not to Asia alone.

A good example of this is Samsung Electronics’ (SEC, 005930 KS, KRW1,384,000, Buy [1]) promotion of its Galaxy SIII smartphone by sponsoring Big Bang’s World Tour from July this year until 15 December 2012. The name of the tour is Big Bang Alive Galaxy Tour 2012. The locations of the tour include three cities in China (Shanghai, Beijing and Guangzhou), Singapore, Thailand, Indonesia, Taiwan, the Philippines, Malaysia, Hong Kong, the US, Peru and London. After learning about the tour from SEC and obtaining details from YG Entertainment, we found out that this is the first global music tour outside Korea to be sponsored by a Korean company. We expect promotions like this of Korean products by other Korean companies to continue into and beyond 2013.

Moreover, the younger generation, now familiar with Korean music, movies and TV soaps, is now much more likely to consider buying a Samsung Galaxy SIII or a Hyundai Motor (HMC) car, in our view. ‘Made in Korea’ is not a barrier to entry for young buyers in the way that it might be for older consumers – in fact, it might now be a reason to purchase. Winning the hearts of the younger generation is a promising factor for Korean companies to secure long-term business-growth potential, because as younger consumers get older their purchasing power tends to increase. Over time, therefore, durable goods could be promoted through the use of this halo effect.

Thus, as we believe the K-wave is not a fad but a long-term trend, we think all Korean companies selling products/services overseas – ie, SEC, LG Electronics (066570 KS, KRW76,400, Hold [3]), Hyundai Motor (005380 KS, KRW212,500, Buy [1]), Kia Motors (000270 KS, KRW54,700, Hold [3]) and others – could benefit directly (using actors/singers/songs in their own ads) or indirectly (essentially by being Korean entities) from this rise in popularity of all things Korean.

When we refer to the rankings of the best global brands, as according to Interbrand (see following chart), we can see that the brand images of Samsung and Hyundai have been improving over time. Samsung’s rank as a global brand has improved from 42 in 2001 to 9 in 2012. In the case of Hyundai, its rank improved from 84 in 2005 to 53 in 2012. In the same chart, we also include the market capitalization of the respective companies as a means of comparison.

Our view is underpinned by our look at ‘soft power’, a measure of a country’s global influence through non-military means (ie, in politics, diplomacy, business, culture, sport and education). Monocle magazine measures soft power by looking at 50 factors, ranging from the number of cultural missions, Olympic medals and foreign students, to the quality of a country’s cuisine, architecture and businesses. Aside from Japan, Korea is the only Asian country in the top 20 this year (up 3 spots from 14th place last year.).
**Soft-power rankings (globally) (2012)**

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Nation</th>
<th>Strengths</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>UK</td>
<td>Olympics, pop music, James Bond, Harry Potter, the Internet</td>
</tr>
<tr>
<td>2</td>
<td>US</td>
<td>Leadership and global contribution in terms of environment, poverty and peace making</td>
</tr>
<tr>
<td>3</td>
<td>Germany</td>
<td>Football, business, intellectualism</td>
</tr>
<tr>
<td>4</td>
<td>France</td>
<td>Museums, food, art</td>
</tr>
<tr>
<td>5</td>
<td>Sweden</td>
<td>Functional and friendly nation with excellent music and culture</td>
</tr>
<tr>
<td>6</td>
<td>Japan</td>
<td>Fashion, retail, design, pop music</td>
</tr>
<tr>
<td>7</td>
<td>Denmark</td>
<td>Culture (TV programmes, music, art, architecture and design)</td>
</tr>
<tr>
<td>8</td>
<td>Switzerland</td>
<td>Reputation for being reliable and professional</td>
</tr>
<tr>
<td>9</td>
<td>Australia</td>
<td>Reputation for friendliness</td>
</tr>
<tr>
<td>10</td>
<td>Canada</td>
<td>Multiculturalism, economic resilience</td>
</tr>
<tr>
<td>11</td>
<td>South Korea</td>
<td>K-pop, advanced technology</td>
</tr>
<tr>
<td>12</td>
<td>Norway</td>
<td>Diplomacy and integrity</td>
</tr>
<tr>
<td>13</td>
<td>Finland</td>
<td>Excellent designers, architects/growing tourism</td>
</tr>
<tr>
<td>14</td>
<td>Italy</td>
<td>Design, fashion, slow food movement</td>
</tr>
<tr>
<td>15</td>
<td>Holland</td>
<td>Progressive society, leading contemporary culture</td>
</tr>
<tr>
<td>16</td>
<td>Spain</td>
<td>Food, cinema</td>
</tr>
<tr>
<td>17</td>
<td>Brazil</td>
<td>Diversity</td>
</tr>
<tr>
<td>18</td>
<td>Austria</td>
<td>Hamorous mix of old fashion, new trends</td>
</tr>
<tr>
<td>19</td>
<td>Belgium</td>
<td>Scores highly for diplomacy, business and education</td>
</tr>
<tr>
<td>20</td>
<td>Turkey</td>
<td>Increased interest in seizing global opportunities</td>
</tr>
</tbody>
</table>

Source: Monocle magazine

In conclusion, we see the content providers and entertainment companies as potentially direct beneficiaries of the K-wave. We also highlight two groups that we think will benefit indirectly through the halo effects for Brand Korea: 1) cosmetics and F&B players that advertise their products and services using K-wave personalities, and 2) the major Korean exporters, which are arguably best placed to monetise increased international consumer acceptance of Korean goods and services.

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**Korea cosmetics manufacturers: valuation summary**

<table>
<thead>
<tr>
<th>Company</th>
<th>Code</th>
<th>Market cap (USDm)</th>
<th>Price (KRW)</th>
<th>PBR (x)</th>
<th>PER (x)</th>
<th>ROE (%)</th>
<th>EPS (KRW)</th>
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<tr>
<td>AmorePacific</td>
<td>090430 KS</td>
<td>7,101.0</td>
<td>1,315,000</td>
<td>2.9</td>
<td>3.0</td>
<td>2.6</td>
<td>22.2</td>
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<td>LG Household and Health Care</td>
<td>051900 KS</td>
<td>9,522.0</td>
<td>660,000</td>
<td>7.2</td>
<td>7.8</td>
<td>6.2</td>
<td>30.9</td>
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<tr>
<td>AmorePacific Group*</td>
<td>002790 KS</td>
<td>3,578.0</td>
<td>485,500</td>
<td>1.0</td>
<td>3.0</td>
<td>2.3</td>
<td>13.9</td>
</tr>
</tbody>
</table>

Source: Bloomberg (*), companies, Daiwa forecasts

Note: based on share prices as at 21 November 2012

**Korea entertainment companies and content producers: valuation summary**

<table>
<thead>
<tr>
<th>Company</th>
<th>Code</th>
<th>Market cap (USDm)</th>
<th>Price (KRW)</th>
<th>PBR (x)</th>
<th>PER (x)</th>
<th>ROE (%)</th>
<th>EPS (KRW)</th>
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</thead>
<tbody>
<tr>
<td>SM Entertainment</td>
<td>122870 KS</td>
<td>837.0</td>
<td>44,350</td>
<td>6.8</td>
<td>4.9</td>
<td>3.1</td>
<td>33.1</td>
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<tr>
<td>YG Entertainment</td>
<td>041510 KS</td>
<td>571.0</td>
<td>59,900</td>
<td>4.8</td>
<td>5.4</td>
<td>4.4</td>
<td>22.2</td>
</tr>
<tr>
<td>CJ E&amp;M</td>
<td>130960 KS</td>
<td>972.0</td>
<td>27,750</td>
<td>1.0</td>
<td>1.2</td>
<td>1.1</td>
<td>21.7</td>
</tr>
<tr>
<td>SBS Content Hub</td>
<td>046140 KS</td>
<td>264.7</td>
<td>13,350</td>
<td>2.3</td>
<td>2.2</td>
<td>1.8</td>
<td>11.1</td>
</tr>
</tbody>
</table>

Source: Bloomberg, companies

Note: based on share prices as at 21 November 2012

---

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<th>Fax</th>
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</thead>
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</tr>
<tr>
<td>Daiwa Securities Capital Markets Co. Ltd, Hanoi Representative Office</td>
<td>Suite 405, Pacific Palace Building, 83BL, Ly Thuong Kiet Street, Hoan Kiem Dist. Hanoi, Vietnam</td>
<td>(84) 4 3946 0460</td>
<td>(84) 4 3946 0461</td>
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</table>

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Share price and Daiwa recommendation trend

Amorepacific: share price and Daiwa recommendation trend

<table>
<thead>
<tr>
<th>Date</th>
<th>Target price</th>
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<th>Date</th>
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<th>Date</th>
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Hyundai Motor: share price and Daiwa recommendation trend

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Source: Daiwa
Kia Motors: share price and Daiwa recommendation trend

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LG Household & Health Care: share price and Daiwa recommendation trend

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<th>Date</th>
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<td>Hold</td>
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Source: Daiwa
Samsung Electronics: share price and Daiwa recommendation trend

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Source: Daiwa

LG Electronics: share price and Daiwa recommendation trend

<table>
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Source: Daiwa
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