

[Press Release]

SM Entertainment Announces SM 3.0 IP Monetization Strategy To reach sales of KRW 1.2 trillion and an operating margin of 35% in 2025 “We will become the unrivaled leader in K-pop across all relevant industries”

- Immediate improvement in operating profit by overcoming the structural limitations of SM 2.0
 - Expected increase of minimum KRW 31 billion per year
- Increase sales/operating profit through multi-production center/multi-label system
 - Primary IP sales target to reach an average annual growth rate of 26%
- Increase sales of high-profit derivative IP business and strengthen distribution capabilities
 - Sales target of KRW 300 billion by 2025
- Building an integrated fan platform directly supervised and operated by SM, realizing “Fanconomy” and maximizing commerce sales
- Monetization of video contents to achieve sales of KRW 150 billion by 2025

(Feb-21, Seoul) Today, SM Entertainment (hereafter SM) released a video titled 'SM 3.0: IP Monetization Strategy' through SM's official YouTube channel and announced detailed IP monetization plan as the second strategy for implementing 'SM 3.0.'

SM CFO Cheol Hyuk Jang explained that “SM’s IP monetization model largely consists of ‘Primary IP business’ and ‘Derivative IP business’. The primary IP business refers to the foundation of the entertainment business, such as digital music, physical albums, concerts, and artists management.”

Jang added that “SM's growth has been centered on the primary IP business thus far. The unparalleled identity of the market leader and the competitiveness in the main business has served as a driving force behind the 30% growth rate per annum despite the rapid change that took place in the market during the past 3 years as well as the structural limitations within the company. Based on SM's such unique identity and competitiveness, we want to take another leap forward in the age of SM 3.0.”

- Target sales of 1.2 trillion won with operating profit margin of 35% by 2025

The SM 3.0 strategy aims for 2025 sales of KRW 1.2 trillion with and an operating margin of 35%, which is planned to be achieved through improving limitations of ‘SM 2.0’ and adopting the first and second monetization strategies.

1. Immediate improvement in operating profit by overcoming the structural limitations of SM 2.0 – Expected increase of minimum KRW 31 billion per year

SM’s plan to immediately improve operating profit by overcoming the structural limitations of SM 2.0 consists of the following 3 changes; 1) Termination of contract with Like Planning and resolving additional payment agreement issues following the contract termination would increase operating profit margin by 6% and operating profit by KRW 25 billion; 2) Instead of outsourcing core business to SM brand marketing, such as MD , internalizing and directly manage high-profit core business; and 3) Internalization of concerts business, which has been in charge by Dream Maker under the exclusive contract, improve SM concert sales and profitability by eliminating tunneling, and select and partner with global players through competitive bidding.

In regards to the potential success that SM could achieve when the above three changes are made,

Jang explained that “when [SM] interprets the fair and rational operation of outsourcing contracts and reinforcement of SM competency into 2022 P/L(Profit and loss statement), it could lead to an increase of 30 Billion Won in sales and 40 Billion Won in operating profit at minimum. The improvement will be more clearly shown after the improvement of performance after 2023 is reflected.”

2. Increase of Sales /Operating Profit through multi-production center/multi-label system

– Primary IP sales target to reach an average annual growth rate of 26%

Next, he also spoke about the prospect of primary IP business through the previously announced multi-production center. “SM had competency in digital music, physical albums, concerts and artist management business but due to the limitations of a 1-man producer system, it was unable to reach its sales and profit potential 100%. With the adoption of a multi-production center, the foundation for sales growth in key businesses will expand exponentially.”

In specifics, SM targets to 1) reach primary IP business’ averages annual sales growth rate of 26% – KRW 390 billion in 2022 and KRW 760 billion in 2025; 2) launch artist IPs at least twice a year so that more than 21 teams can be active by 2025, and release more than 40 physical albums a year and sell 27 million physical albums a year in 2025; 3) by breaking away from the “maximum number of concerts/live performances” cap imposed by the exclusive contract with Dream Maker, increase the number of global concerts per artist to 20 per year, including concerts/fan meetings, and conducts more than 400 concerts per year; 4) while maintaining the unique SM identity, diversify genre and character with improved quality to expand the digital music business at a low-cost and generate high sales; and 5) optimize logistics costs by improving timeliness and just-in-time release of physical albums

3. Expansion of high-profitability derivative IP and strengthening of distribution capabilities

– Targeting KRW 300 billion in sales by 2025

Jang also added that “The MD/IP sales from Derivative IP business, which stands at KRW 120 billion will be increased to KRW 170 billion Won by 2023, and KRW 300 billion by 2025. Derivative IP, which has much higher profitability compared to Primary IP will become the core growth platform for SM 3.0.”

Specific plans include 1) Creating SM-owned character IPs with the identity of SM artists and continuously incorporating them into all activities of the artist including physical albums and concerts; 2) Actively monetizing SM's unique intellectual property rights, worldview IPs such as SM Culture Universe (SMCU) and KWANGYA, to expand internal and external production and business capabilities for various contents such as webtoons, web novels, and videos; and 3) Expanding IP licensing through agreements with global licensing partners, expanding market coverage through external distribution platforms, and expanding and accelerating IP distribution by establishing dedicated organizations in key regions such as the United States, Europe, and Japan.

4. Establishing an integrated fan platform directly managed and operated by SM, implementing “Fanconomy” and maximizing commerce revenue

SM will develop, build, and operate an integrated platform to optimizes the accessibility of SM's fans, whose digital touch points are currently distributed across a total of 11 mobile platforms including the official app, Kwangya club and &STORE.

Jang stated, "under SM 2.0, we were unable to secure the platform competency which is considered

an important competency element in corporate valuation. In this regard, under SM 3.0, we consider establishment of the consolidated platform that optimizes the fan-experience as one of the top priorities in addition to improvement of corporate governance. We will develop a consolidated platform that allows communication among fan communities/contents/commerce, which will be run and managed by the SM Entertainment.”

5. Monetization of video contents to achieve KRW 150 billion in sales by 2025

Under the SM 3.0 strategy, SM plans to expand video content revenue to KRW 150 billion by 2025. SM has already established the “Video IP Business Center” to expand video content into a core pillar of the derivative IP business, not just for uploading. SM is also in the process of recruiting talents in the production space with experience in creating popular contents to create high-quality video contents.

Through this, SM will 1) establish a structure to ensure profitability by assigning separate profit and loss responsibilities to a dedicated video content organization with increased expertise; 2) establish a production-distribution system that encompasses profitability from all stages of video content creation from production to PPL, MD and OST to secure additional profit; and 3) generate results more quickly by distributing video IP with numerous sustainable revenue sources to a wider range of channels than SM 2.0 such as OTT, broadcasters, and movie theaters.

At the end of the presentation, Cheol Hyuk Jang stated, "the new IP monetization strategy for SM 3.0, including the resolution of the issues in SM 2.0 described today, is a powerful growth engine for SM. The combination of the IP monetization strategy and the effects of the investment strategy we will soon announce, will enable SM to achieve KRW 1.2 trillion in revenue and 35% operating margin on a standalone basis in 2025, becoming the unrivaled leader in K-Pop industry in all aspects. The entire management and employees of SM, including myself, will do our best to keep the promise of meeting “target results” with our shareholders."

[Full Text]

Hello, I am Cheol Hyuk Jang, CFO of SM Entertainment.

On February 3rd, we have briefed you on the 'multi-production center/multi-label system', which is the first step for the leap towards SM 3.0.

We appreciate the understanding and support from you including our shareholders, on the change that SM will go through by adopting the 'multi-production center/multi-label system'.

Today I would like to explain to you about the second strategy towards realizing SM 3.0, which is monetization from IP.

First of all, I would like to help you understand SM's plan of operation and profit maximization from IP created from the multi-production center/multi-label'.

SM's IP monetization model largely consists of "Primary IP business" and "Derivative IP business".

Primary IP business refers to the foundation of the entertainment business such as digital music, physical albums, concerts, artist management.

Derivative IP business refers to businesses that provide additional profit source from the outcome of the Primary IP, namely, MD, IP licensing, fan platform and video content business.

SM's growth has been centered on the Primary IP business thus far.

The unparalleled identity of the market leader and the competitiveness in the main business has served as a driving force behind the 30% growth rate per annum despite the rapid change that took place in the market during the past 3 years as well as the structural limitations within the company.

We plan to take another leap forward in the age of SM 3.0 based on such unique driving force.

The sales target for '25 under SM 3.0 is 1.2 Trillion Won, with 35% operating profit.

These goals will be reached by resolving the issues from SM 2.0 and the IP monetization strategy.

First of all, by fixing the problems from SM 2.0, we will be able to witness immediate improvement in business results.

The governance issue, which had been a point of concern for many people will be resolved with the termination of contract with Like Planning.

Moreover, core businesses that were carried out under exclusive agreements will be internalized or be opened to competitive bids to improve business efficiency.

As introduced to you in the previous presentation, we will strengthen the quality and quantity of the Primary IP by adopting the multi-production center/multi-label system and this will be reflected on the business results immediately. The foundation of SM's business will become even more robust by expanding the producing system to allow the debut of more than 2 artist teams a year.

In addition, we are going to strengthen our contents competitiveness in MD/IP license, fan platform and video to pursue the Derivative IP business more aggressively.

By increasing sales in Derivative IP, which accounts for only 23% of the current Primary IP business, to 40% by '25, we will turn it into a core axis for growth and change the business structure into a high-profit one.

SM has gone through an early termination of contract with Like Planning at the end of 2022.

Moreover, the controversial issue of agreement on additional payment even after the termination of the contract will also be terminated.

Taking this into account, we will be able to realize a 25 billion Korean Won increase in operating profit.

In addition, the role of SM Brand Marketing, which has been exclusively in charge of core businesses such as MD, as an affiliated company, will be internalized into SM Entertainment.

Instead of outsourcing a high-profit core business, SM Entertainment will be in charge from now on.

The concert business, which was run under exclusive contract will also be changed.

We will improve concert sales and profitability by eliminating tunneling, internalizing the planning function in SM Entertainment and signing contracts with global top-tier players through competitive bids.

When we interpret the fair and rational operation of outsourcing contracts and reinforcement of SM competency into 2022 P/L(Profit and loss statement), it could lead to an increase of 30 Billion Won in sales and 40 Billion Won in operating profit at minimum.

The improvement will be more clearly shown after the improvement of performance after 2023 is reflected.

Next, I would like to talk about the prospect of Primary IP business development through the multi-production center, which we have already announced.

The sales for Primary IP are projected to be 510 Billion Won in 2023 and 760 Billion Won in 2025, with an annual growth rate of 26%.

SM had competency in digital music, physical albums, concerts and artist management business but due to the limitations of a 1-man producer system, it was unable to reach its sales and profit potential 100%.

With the adoption of a multi-production center, the foundation for sales growth in key businesses will expand exponentially.

As we have announced in the previous presentation, we will launch artist IPs at least twice a year under SM 3.0 so that more than 21 teams can be active by '25.

Under the SM 3.0, we expect to release more than 40 physical physical albums a year and sell 27 million physical albums a year in 2025.

By breaking away from the "maximum number of concerts/live performances" cap imposed by the exclusive contract,

we will increase the number of concerts/fan meetings. With over 20 global concerts per artist team a year, we will let artists meet with fans more often through more than 400 concerts.

We are also going to fix the profitability which was unnecessarily deteriorated under SM 2.0.

We are going to expand the digital music business, a low-cost, high-sales opportunity by improving streaming and download numbers.

We will keep the unique SM identity while diversifying genre and character with better quality and we will exert more efforts in promotion.

Moreover, we will adopt a systematic and rational decision-making process for producing and creating contents to maintain the high quality SM has always delivered while improving profitability.

We will also optimize logistics cost caused by delayed release of physical albums.

Until now, due to the single producing system, in the event of a delay in decision making, physical albums were shipped by air for fear of being counted out from the 1st-week sales figures.

But from now on, we will optimize logistics cost by improving timeliness and just-in-time release of physical albums.

The MD/IP sales from Derivative IP business, which stands at 120 Billion Won will be increased to 170 Billion Won by 2023 and 300 Billion Won by 2025.

Derivative IP, which has much higher profitability compared to Primary IP will become the core growth platform for SM 3.0

We have applied Derivative IP to a few artists and have generated some notable results in NCT Sanrio and the Kwangya concept.

Based on these success cases, we plan to expand the derivative IP lineup to other artists.

In the case of character IP, we plan to create an SM-owned IP with the artist identity to incorporate into all activities of the artist including physical albums and concerts.

By securing competitiveness as a sole IP, we will launch advertisements and monetize with MD.

We will also make use of the concept of the SM Culture Universe IP that everyone conjures up when they hear SM for monetization to create various contents such as webtoons, web novels and videos. In addition to in-house production, we plan to collaborate with various production houses and platforms to expand business capability.

There are misconceptions that SMCU and Kwangya are owned by former executive producer Soo-Man Lee, but those are proprietary IPs owned by SM.

We are also well aware of the concerns our fans have regarding overuse of these concepts.

SM will only use these concepts in places and situations that are deemed meaningful for the business as well as beneficial to the artist.

During the process, we will sign a contract with a global licensing partner to expand IP licensing and make use of external distribution platform to expand market coverage.

In particular, for global expansion, we will set up special organizations in key regions such as US, Europe and Japan to accelerate IP distribution.

We will also immediately embark on internalization of consolidation of the fan platform, which has been on SM's major internal agenda for a long time.

Digital touch points for SM fans are distributed across a total of 11 mobile platforms including the official app, Kwangya club and &STORE.

As the apps are not functionally consolidated and are operated by different parties, it was difficult to concentrate the competitiveness of the platform into a single place.

We are unable to secure the platform competency which is considered an important competency element in corporate valuation.

In this regard, under SM 3.0, we consider establishment of the consolidated platform that optimizes the fan-experience as one of the top priorities in addition to improvement of corporate governance.

We will develop a consolidated platform that allows communication among fan communities/contents/commerce, which will be run and managed at the SM Entertainment.

Next, I would like to explain to you how profitability from video contents under SM 3.0 could be increased to 150 Billion Won by 2025.

Until now, the video contents have been managed sporadically under a 1-man producer system without a detailed monetization plan.

Under SM 3.0, video contents will be used not just as contents for uploads but as the key axis for the Derivative IP business.

To this end, we have already set up a "Video IP Business Center" and we are in the process of recruiting talents in the production space with experience in creating popular contents to create high-quality video contents.

We will hold the professional video contents team accountable for P/L(Profit and loss statement) to create a structure that secures profitability.

We will also establish a production-distribution system that encompasses profitability from all stages of video content creation from production to PPL, MD and OST to secure additional profit.

The video IP with numerous sustainable revenue source will be distributed to a wider range of channels than SM 2.0 such as OTT, broadcasting companies and movie theaters to generate results more quickly.

In 2022, SM Entertainment has recorded a sales of 510 Billion Won under separate standards and 19% operating margin. Our goal for 2023 is 710 Billion Won of sales and 28% OPM.

I will elaborate on the detailed plans to reach these goals.

First of all, we will see the effect of the resolution of the SM 2.0 governance issue.

The commerce business and fan platform business that was run by SM Brand Marketing will be internalized into SM Entertainment and additional sales of 30 Billion Won will be realized from concerts through termination of exclusive contact

We have terminated the producing contract with Like Planning as of Dec 31, 2022 and any additional payment regarding this contract will also be stopped.

Therefore, there will no longer be the “6 percent of all sales” payment to Like Planning from now on, which will be translated into an increase of 6% in operating margin, immediately.

Secondly, there will be an additional sales of 110 Billion Won from the multi-production center.

Through the multi-production center system, we will increase our ability to produce IP and increase physical album sales from 14 million copies in 2022 to 18 million copies in 2023.

In addition, we will continue to develop artists who will be debuting this year.

We will also establish a music publishing subsidiary to secure more track portfolio to increase the number of high-profitability tracks.

Lastly, we will generate 60 Billion Won of additional sales through MD, IP License and contents business.

When the physical album sales and number of concerts increase in 2023, an increase in related MD sales is also expected. In addition, we will leverage new videos to increase Derivative IP profit.

By increasing high-profitability Derivative IP, we will see a growth in operating margin to 28%.

In addition to monetization from resolving issues from SM 2.0, the strongest growth strategy under SM 3.0 will be the IP monetization strategy.

SM will realize sales of 1.2 Trillion Won and 35% of operating margin by 2025 to become the unrivaled leader in K-Pop across all relevant industries.

The entire management and employees of SM will do our best to keep the promise of meeting “target results” with our shareholders. While it is true that HY BE’s hostile M&A attempts are a hindrance to SM’s progress, all employees, including management, are diligently working to develop SM 3.0. We encourage you to anticipate the future of SM Entertainment with optimism.

So far I have given you an update on the second part of SM 3.0, which is the “IP monetization strategy”. Within February, I’ll be back with the last piece of SM 3.0 puzzle, the Global strategy and Investment Strategy.

I will also brief you on the business strategy and goals from the SM Group perspective, including the affiliated companies so I would appreciate your continued interest.

Thank you very much.