

Kingsoft Corporation Limited (3888.HK)

Launch of Serial Mobile Games Supports Significant Growth

Hong Kong | TMT | Company report

27 JUNE 2016

1Q Revenues Maintained High Growth

In 1Q16, the total revenues of Kingsoft stood at RMB1.75 billion, down 1.5% over 4Q15 but up 57.9% over 1Q15. Besides, the net profit attributable to shareholders of parent company amounted to RMB134 million, representing a year-on-year increase of 16.5%.

In respect of business, the revenue from online games was RMB460 million, increasing by 40.6% YoY and accounting for 26% of the total revenues. This is mainly attributable to the exceptional performance of JX online III after promotion. Also, the monthly average revenue per paying user of the online games grew by 7% over last month and 42% over last year to RMB47. Additionally, the income from Cheetah Mobile amounted to RMB1.09 billion, representing a year-on-year increase of 56.8% and taking up 62% of the total revenues. Besides, the income from WPS and other businesses registered RMB210 million, skyrocketing by 125.8% over the same period last year, representing 12% of the total revenues. This primarily results from the rapid growth of the cloud business, whose revenue soared by more than 200% over 1Q15.

Buy (Maintain)

CMP: HKD 14.86
(Closing price as at 23 June 2016)
TARGET: HKD 19.10 (+28.5%)

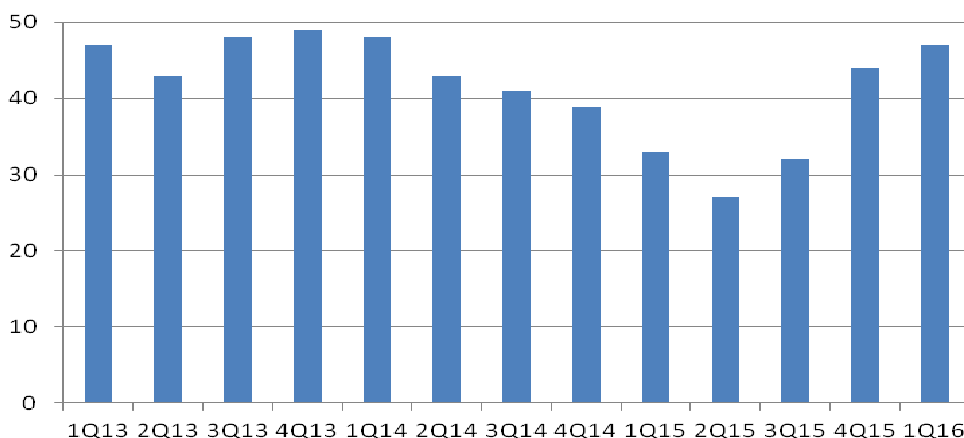
COMPANY DATA

O/S SHARES (MN) :	1,303
MARKET CAP (HKDMN) :	19,357
52 - WK HI/LO (HKD):	29.05/ 13.90

SHARE HOLDING PATTERN , %

Lei Jun :	29.38
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Recovered monthly ARPU of online games business (RMB)



Source: Company reports, Phillip Securities (HK) Research

PRICE PERFORMANCE , %

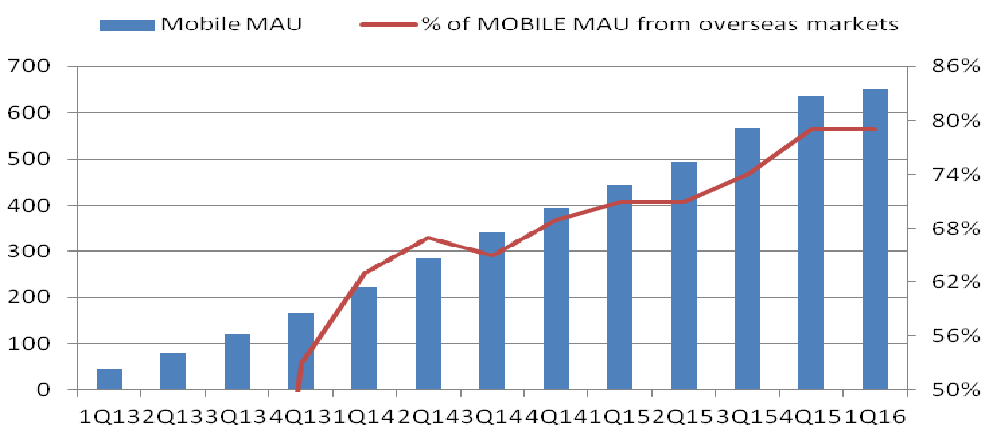
	1M	3M	1Y
Kingsoft	3.05	-16.70	-47.77
HSI	-2.18	-19.27	-23.92

PRICE VS. HSI



Source: Phillip Securities (HK) Research

Mobile MAU of CM (mn)



Source: Company reports, Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	3350	5676	7440	9456
Net Profit	769	369	566	774
EPS, CNY	0.66	0.29	0.44	0.61
PER, x	18.8	42.7	28.0	20.5
BVPS, CNY	3.85	6.04	6.38	6.93
P/BV, x	3.2	2.1	1.9	1.8
ROE, %	15.5	4.6	5.6	7.2
Debt/Equity (%)	69.73	56.24	53.85	53.85

Source: Company reports, Phillip Securities Est.

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However, the company's profitability declined, leading its result growth to fall behind the growth of revenues. Owing to the increase in traffic cost and in investment in cloud business, the gross profit margin in 1Q16 was only 73.2%, lower than 76.4% in 4Q15 and 79.8% in 1Q15. Moreover, the increase in promotional activities caused the sales and distribution expenses to surge by 69.9% to RMB490 million.

Launch of Serial Mobile Games Supports Significant Growth

Kingsoft is one of the few enterprises owing high-quality intellectual property (IP) content in China's online game industry. Recently, the company teamed up with Tencent to unveil the first "JX" mobile game. The second version is expected to work with Xiaomi and to be launched at the end of 3Q16 or at the beginning of 4Q16, while the third version is projected to be marketed in 1Q17. Given the company's strong IP appeal and cooperation channels, the monthly trading volume of each product is expected to exceed RMB100million, thereby driving the income of games to maintain a significant growth.

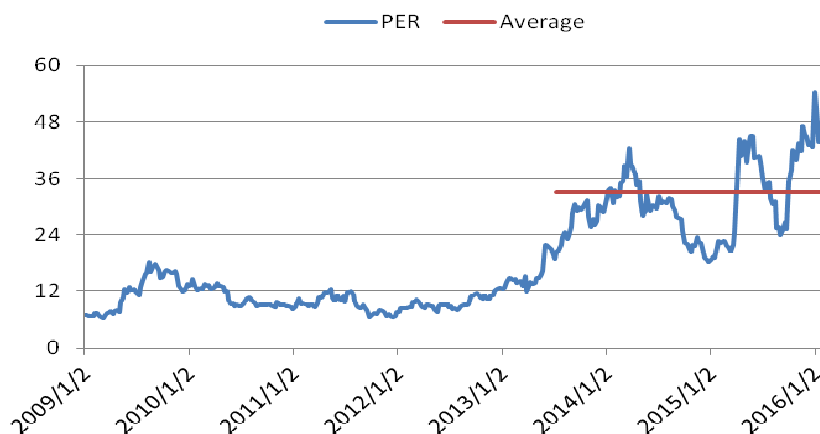
More Optimistic Outlook of Cloud Services

The company's cloud business still maintains a high growth. Specifically, the revenue from the cloud computing business overtook that from WPS, and the corporate customers of the cloud business are approximately 1,000. This is mainly because the mobile video cloud services seized the recent opportunity of popular live videos and the demand for cloud solutions. Furthermore, Kingsoft Cloud added more than 60 games in 1Q16 and hence solidified its leading position in the cloud game market. From our perspective, Kingsoft takes a lead in cloud computing. Its vertical product layout targeting different customer groups as well as expansion of service scope to PaaS and SaaS will continue to explore the company's competitive edge in the cloud computing market and will drive its high growth. However, because of the industry's price war, it is projected that the cloud services are still difficult to achieve break even this year.

Valuation

Overall, the company's "Transforming into Mobile Internet" strategy has been successfully implemented, and the strategic layout with cloud computing being a new starting point has been basically formed. Moreover, it is based on interactive entertainment, Internet security and office software. Its main businesses are in the period of rapid revenue growth and the performance is expected to be gradually released. Although the 1Q16 performance of Cheetah Mobile did not live up to expectation, it has a high user loyalty. Also, large numbers of users can create a strong enough barrier and the future monetization space should not be overly pessimistic. We give the company an estimation of 36x EPS in 2016 and the target price is HK\$19.1, with the "Buy" rating maintained.

Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

Risk

The growth of Cheetah mobile users is slower than expected;

Price competition of cloud business exceeds expectation;

The progress in the mobile game business falls short of expectation.

Financials

Periodicity:	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	21.3x	18.8x	42.7x	28.0x	20.5x
Price to Book	4.3x	3.2x	2.1x	1.9x	1.8x
Dividend Yield	0.8%	0.8%	0.8%	0.5%	0.7%
Per share data(RMB)					
EPS Adjusted	0.58	0.66	0.29	0.44	0.61
Book Value Per Share	2.86	3.85	6.04	6.38	6.93
Dividends Per Share	0.10	0.10	0.10	0.06	0.09
Growth & Margin					
Revenue growth	54.01%	54.15%	69.43%	31.07%	27.10%
Gross profit growth	53.25%	47.13%	57.83%	28.06%	27.95%
Net profit growth	55.05%	14.62%	-52.00%	53.39%	36.83%
Key ratios					
Gross Margin	86.3%	82.4%	76.8%	75.0%	75.5%
Operating Margin	26.0%	15.4%	9.5%	7.7%	8.2%
Net Profit Margin	30.9%	22.9%	6.5%	7.6%	8.2%
Dividend Payout Ratio %	16.6%	15.5%	34.5%	13.6%	14.9%
Income Statement(RMB: mn)					
Revenue	2,173	3,350	5,676	7,440	9,456
- Cost of Goods Sold	297	590	1,319	1,860	2,317
Gross Income	1,876	2,760	4,357	5,580	7,139
- Selling, General & Admin Expenses	1,358	2,273	3,962	5,059	6,430
Operating Income	564	517	542	573	777
- Interest Expense	24	76	78	85	90
- Net Non-Operating Losses (Gains)	-285	-515	-105	-180	-220
Pretax Income	825	962	542	668	907
- Income Tax Expense	71	95	201	67	91
Income Before XO Items	754	867	342	601	816
- Minority Interests	83	98	-28	35	42
Net Profit	671	769	369	566	774

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 23 June 2016)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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