

Kingsoft (3888.HK)

18Q3 Reporting Losses; Expected Improvement Next Year

Hong Kong | TMT | Company report

18 December 2018

Investment Summary

Kingsoft reported loss in 18Q3, given game revenue declined, while cloud services and WPS software delivered notable growth. We maintain the target price of HK\$18.8, BUY rating. (Closing price at 14 Dec 2018)

Business Overview

Losses in 18Q3. Kingsoft reported revenue in 18Q3 of RMB1,537.7mn, up by 18% yoy and 14% quarter-over-quarter. Revenues from online games, cloud services, WPS office software accounted for 44/39/17%, respectively. Gross profit decreased by 7% to RMB694.5mn, up 3% from 18Q2. Gross profit margin was 45%, 12ppts lower than 17Q3 and 5ppts lower than the previous quarter, mainly due to changes in business portfolio. The loss attributable to the parent company is RMB59.3mn (2017Q3: 238.5mn; 18Q2: 100.9mn). Before deducting the cost of share package, the loss attributable to the parent company amounts to RMB21.6mn, representing a net loss rate of -1% (2017Q3: 306.7mn, 12%; 18Q2 138.9mn, 10%).

Online game revenue declined. The revenue of 18Q3 online game business was RMB678.3mn, down by 9% yoy and up 17% qoq. It is because that existing games entered natural decline period, though the decrease is partly offset by the rising contribution of newly launched mobile games (mainly due to the contribution of JX II released on iOS platform in July). Daily average peak concurrent users is about 0.7 million, down 16% yoy and 9% qoq. The average monthly paying accounts is RMB3.4mn, down 16% yoy and up 5% qoq.

Cloud business has grown significantly. It contributes RMB603.3mn in revenue, up 68% yoy and 29% qoq. The growth is mainly due to the steady increase in mobile video and Internet businesses.

WPS office software revenue maintained momentum. This segment reported revenue of RMB256.1mn, up by 29% yoy and down 13% qoq. The growth was mainly attributed to the rapid growth of revenue from WPS Office personal value-added services. By providing members with useful functions and content services, the company improves user stickiness. The decline in revenue was mainly due to seasonal effect.

BUY (Maintain)

CMP HKD12.32

(Closing price at 14 Dec 2018)

TARGET HKD18.8 (+52.6%)

COMPANY DATA

O/S SHARES (MN) :	13,737
MARKET CAP (HKDMN) :	16912
52 - WK HI/LO (HKD):	30.95 /10.06

SHARE HOLDING PATTERN , %

Color Link Mgt Ltd	12.73
Lei Jun	10.39
Topclick Holdings	7.86
TCH Saffron	7.77
FMR LLC	5.11
Xiaomi	2.57

Source: Wind

PRICE PERFORMANCE , %

	1M	3M	1Y
Kingsoft	1.48	-10.73	-45.23
HSI	1.72	-4.37	-10.53

RETURN VS. HSI



Source: Aastocks, Phillip Securities

KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Net Sales	3,834	5,181	5,744	7,555
Net Profit	-259	778	52	676
EPS,RMB	-0.21	2.36	0.04	0.49
PER, x	-58.67	5.22	328.11	25.03
BVPS,RMB	6.05	9.21	0.61	0.04
P/BV, x	2.04	1.34	20.18	304.53
ROE, %	-3.44	32.06	6.15	1216.91

Source: Company, Wind, Phillip Securities Est.

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Valuation & Risks

We maintain our target price of HK\$18.8. Next year is likely to experience improvement. New games (JX II and JX III mobile) will be launched in 19H1, and revenue from game business is expected to recover in 2019. Monetization of WPS office software will continue through providing more qualified value-added services to users. Cloud business will continue to expand leveraging on exploring advantage areas. **Downside risks** include: Revenue growth fails expectations; Exchange rate risk; Policy risks.

Figure: PE Band

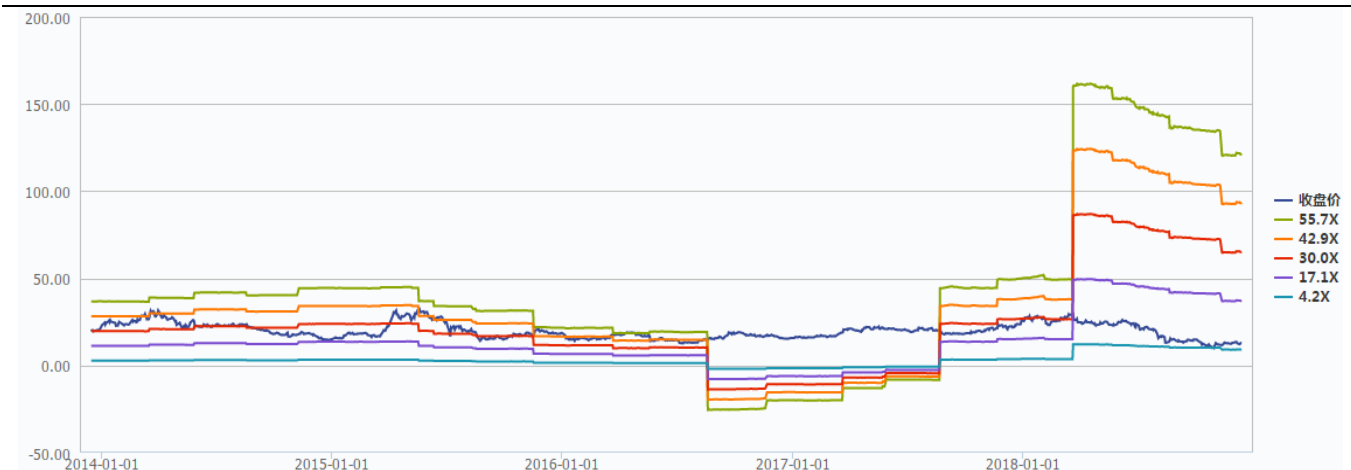
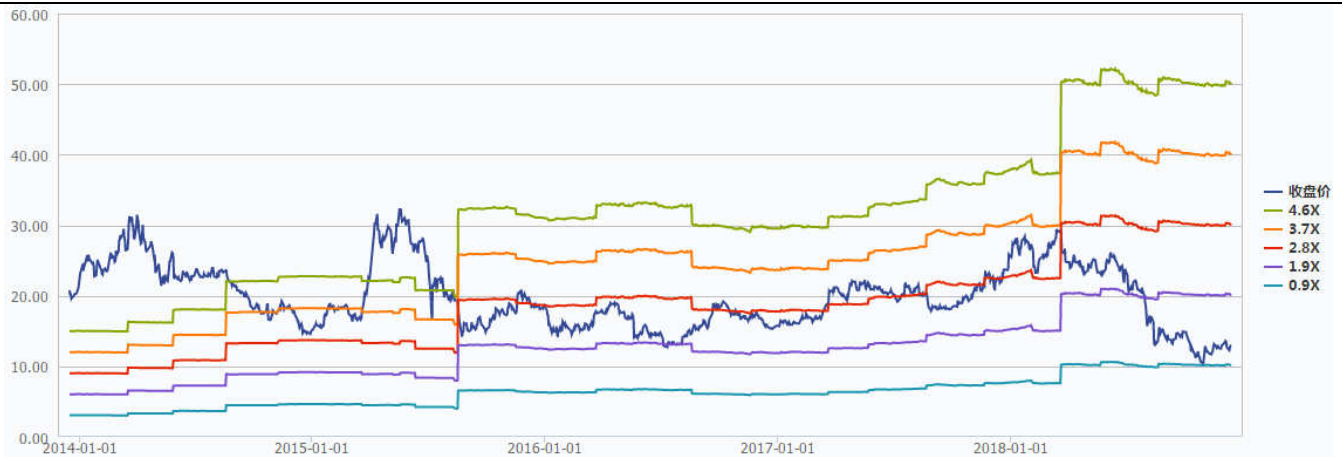


Figure: PB Band



Source: Company, Phillip Securities

Financials

Key Ratios	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation Ratios					
Price to Earnings (P/E)	42.48	-58.67	5.22	328.11	25.03
Price to Book (P/B)	2.04	2.04	1.34	20.18	304.53
Per Share Data (RMB)					
EPS	0.29	-0.21	2.36	0.04	0.49
Book Value Per Share	6.04	6.05	9.21	0.61	0.04
Dividend Per Share	0.08	0.09	0.09	0.10	0.10
Growth & Margins (%)					
Growth					
Revenue	27.49	90.15	35.16	10.86	31.53
Operating Income	-32.56	278.08	-12.02	-98.77	2,950.43
Net Profit	-78.79	-269.73	-400.83	-93.37	1,211.12
Margins					
Gross Profit Margin	75.48	66.29	58.14	51.00	52.00
Operating Profit Margin	12.14	24.13	15.71	0.17	4.03
Net Profit Margin	7.56	-6.75	15.02	0.90	8.95
Returns					
ROE (%)	5.95	-3.44	32.06	6.15	1216.91
ROA (%)	4.80	-0.06	5.80	1.85	365.07
Income Statement (RMB mn)					
Revenue	2,016	3,834	5,181	5,744	7,555
- Cost of Goods Sold	(494)	(1,292)	(2,169)	(2,814)	(3,626)
Gross Income	1,522	2,541	3,012	2,929	3,929
- Operating Expenses	(1,277)	(1,616)	(2,198)	(2,919)	(3,624)
Operating Income	245	925	814	10	304
- Net Non-Operating Expenses	56	(1,007)	98	50	482
Pretax Income	301	-82	912	60	786
- Income Tax Expenses	(148)	(177)	(134)	(8)	(110)
Profit from continuing operation	152	-259	778	52	676

Source: Company, Phillip Securities (HK) Research Estimates

Exchange rate: 0.885RMB/HKD, 6.87RMB/USD (1Y forward contracts prices on Oct 4 from Wind).

(Financial figures as at 14 Dec 2018)

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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