

16 May 2018

Technology | Software & Services

## Kingsoft

**Buy** (Maintained)

Target Price: HKD34.20

Price: HKD24.40

Market Cap: USD4,270m

Bloomberg Ticker: 3888 HK

### Margin Pressure Before New Game Launches

**Maintain BUY with an unchanged TP of HKD34.20 – offering a 40% upside. Kingsoft is expected to release its 1Q18 earnings on the morning of May 23 before market opens. We expect it to post revenue of CNY12.8bn and non-GAAP net profit of CNY117m. We see margin pressure continuing until Kingsoft launches the first new mobile game of this year – either in July or August. We also see the launch times of the *JX Online Mobile II* and *III* games as a swing factor to its full year earnings. We believe its cloud and office software businesses are also on track.**

**1Q/2Q18 preview – margin pressure should continue prior to the launch of a new game in summer.** For 1Q18, we expect Kingsoft to post CNY12.8bn in revenue, down 7% QoQ, mainly due to seasonality and up 5% YoY on a high base of 1Q17. We expect non-GAAP net profit to be at CNY117m, lower than current Bloomberg consensus. We see a sequential decline in revenue from its key mobile game *JX Online Mobile I*, which saw its monthly gross billing – by RHB estimates – drop to ~CNY130m from ~CNY180m in 4Q17 and ~CNY230m in 1Q17. We believe that the decline is normal, given that the game has been available for almost two years but it does result in the slowdown of YoY revenue growth rate and margin pressure for 1Q18. On the bright side, we see very healthy growth from its office software and cloud businesses.

For 2Q18, we expect the total revenue to resume sequential growth on favourable seasonality, and the margin pressure to continue as there will not be any P&L contributions from new games in 2Q18.

**Short-term concerns involve the timing of new game launches.** Kingsoft targets to launch three new mobile games over the next few quarters, all of which would be published by Tencent (700 HK, BUY, TP: HKD540.00). We expect Kingsoft to launch the first new game in summer (likely July or August), – a 3D costume changing game called *Yungshangyuyi*, based on *JX IP* and time travel story lines. We guesstimate that this game would be able to hit over CNY100m monthly gross billing during the promotion period in the first few months, based on this game's unique strengths and the past record of similar games. On the other two new games – *JX Online Mobile II* and *JX Online Mobile III* – as they are expected to have very high monthly gross billings, the timing of their respective launches would be a swing factor to its total FY18 earnings.

**Cloud and office software businesses are on track.** We think that the cloud business is on track to achieve a 60% YoY growth for FY18, despite the recent price wars in the public cloud market in China. For its office software business, we expect revenue growth to be strong YoY driven by monetisation from its *WPS Office* personal editions. We also expect the software business to complete its proposed A-share IPO listing in 2H18.

**Maintain BUY with the same SOP-derived TP of HKD34.20**, implying 32x/24x FY18F-19F P/Es, and 0.6x PEG for FY18F. Downside risks include a potential cloud price war and delay in new game launches.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	3,834	5,181	7,208	10,147	12,998
Reported net profit (CNYm)	(271)	978	1,415	2,069	2,780
Recurring net profit (CNYm)	954	1,213	1,619	2,328	3,111
Recurring net profit growth (%)	73.4	27.2	33.4	43.8	33.6
Recurring EPS (CNY)	0.74	0.91	1.18	1.70	2.28
DPS (CNY)	0.09	0.09	0.09	0.09	0.09
Recurring P/E (x)	26.6	21.6	16.6	11.6	8.7
P/B (x)	3.22	2.23	2.01	1.76	1.50
P/CF (x)	27.3	15.2	11.3	9.6	6.7
Dividend Yield (%)	0.5	0.4	0.5	0.5	0.5
EV/EBITDA (x)	10.7	4.1	4.1	2.8	2.0
Return on average equity (%)	(3.4)	9.8	11.1	14.4	16.7
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			1.5	8.8	

Source: Company data, RHB

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