

17 July 2018

Technology | Software & Services

## Kingsoft

**Buy** (Maintained)

Target Price: HKD32.52  
 Price: HKD22.15  
 Market Cap: USD3,851m  
 Bloomberg Ticker: 3888 HK

### Outlook Sturdy Despite Short-Term Pressures

**Maintain BUY, with HKD32.52 TP implying 25x/17x FY18-19F P/E, 47% upside.** We spoke with Kingsoft's IR director yesterday for an update. Overall, its businesses are on track to meet expectations. Cloud revenue should grow 50-60% YoY this year, while the unit's loss as a percentage of group revenue is anticipated to narrow. The WPS unit should deliver >40% YoY revenue growth, from advertising revenue and subscriptions. The performance of its games segment is slightly mixed, with slight delays and minor uncertainties on new launches and market response – but the larger picture is unchanged. Revenue and profit in 2H and FY19 should surge, driven by new mobile games launched in 2H (May-Oct).

**Strong mobile game outlook in 2H and FY19 despite slight delays in mobile game launches.** The new version of *JX World Mobile* was launched two months ago, and its operating data has been better than expected. We now expect its monthly gross billing to be CNY40-50m during the first few months (vs CNY30-40m previously).

*Yunshangyuyi* (YSYY), a 3D costume-changing mobile game based on *JX Online III IP* targeted towards female users, was launched in late June. It should book CNY100m in monthly gross billings, in line with our expectation.

The highly-anticipated *JX Online III Mobile* will be launched on 1 Oct, one month later than what Kingsoft previously announced. We expect it to book over CNY500m in gross billings during that month. Meanwhile, there is some uncertainty over the launch date for *JX Online II Mobile*.

**Stellar growth in office software business.** Kingsoft expects its office software segment to record over 40% YoY revenue growth this year, driven by strong advertising revenue and subscriptions. It also expects to complete the A-share listing of this business by end-2018.

**Cloud revenue growth of 50-60% in FY18 (ie slight pressure).** The company's new guidance is slightly lower than what it previously shared. We believe this points to slight pressure on its cloud business, due to the price war this year. We believe the price war on public cloud services in China is ongoing, and that Kingsoft should be one of the players that can survive in the public cloud field over the long term, due to its edge in game and video cloud, as well as support from Xiaomi.

**2Q18 results preview.** We expect 2Q18 revenue to be CNY1.3bn (slightly higher than 2Q18), driven mainly by its office software and cloud segments. The online games unit should see a sequential decline in revenue, as there is not much contribution from new games – as they were launched towards end-2Q or are scheduled for 2H. We estimate Kingsoft's operating profit margin to be 1%, lower than 1Q's 2.1% – on higher marketing expenses for new games in 2Q, while related revenue has not yet kicked in significantly.

Overall, we expect the company to book a CNY50-100m loss. Our estimate reflects the higher interest expense (non-cash item related to prefer shares of cloud business, estimated at CNY80m per quarter) and foreign exchange loss (as CNY depreciated while Kingsoft holds some USD in cash) amounting to CNY60m for 2Q18.

**Maintain BUY, TP of HKD32.52.** Our SOP-derived TP implies 25x/17x FY18F/19F P/Es, and 0.7x PEG for FY18F. Downside risks include a more severe-than-expected cloud price war and delays in game launches .

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYb)	3.8	5.2	6.9	9.7	12.4
Reported net profit (CNYb)	(0.27)	0.98	1.23	1.99	2.72
Recurring net profit (CNYb)	0.95	1.21	1.50	2.17	2.90
Recurring net profit growth (%)	73.4	27.2	23.8	44.5	33.6
Recurring EPS (CNY)	0.74	0.91	1.10	1.59	2.12
DPS (CNY)	0.09	0.09	0.09	0.09	0.09
Recurring P/E (x)	25.4	20.6	17.1	11.8	8.8
P/B (x)	3.07	2.12	1.94	1.70	1.45
P/CF (x)	26.1	14.5	11.7	9.6	6.6
Dividend Yield (%)	0.5	0.5	0.5	0.5	0.5
EV/EBITDA (x)	10.9	5.4	5.1	3.3	2.3
Return on average equity (%)	(3.4)	9.8	9.7	14.1	16.6
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			(0.6)	5.8	13.9

Source: Company data, RHB

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