

Morgan Stanley Asia Limited+

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Stock Rating  
Equal-weight

Industry View  
In-Line

## Kingsoft Corporation

### 4Q14 Result: Operating In Line, Cheetah Outperformed

**Stay EW as we see lack of catalysts from existing businesses. Rollout of new business is key.**

**Cheetah outperformed in revenue growth:** KSFT revenue rose 60% YoY to Rmb1,07bn, 4% below our estimates. (1) Cheetah grew 133% YoY to Rmb582mn, 54% of total. We expect Cheetah continue to outperform as it exploits mobile ad inventory. (2) Online game increased 20% YoY to Rmb346mn. JX3 remains the main revenue driver. (3) WPS and cloud service rose 10% YoY to Rmb144mn. We see robust growth for the cloud business thanks to Xiaomi support, while WPS is softer than expected due to a delay in government procurement.

**Operating margin declined amid heavy investment:** 4Q14 OPM dropped 10 ppts YoY to 18%, in line with our estimates. We expect it continue to decline due to investment in mobile and cloud. We think this is the right strategy, as it should strengthen its long-term position in this fast-moving industry and operating leverage should emerge when discretionary spending stops.

**Outlook:** (1) In 2015, cloud business should be driven mainly by Xiaomi's sound growth of online services. (2) KSFT plans to launch 10 mobile games in 2015. 1H15's main title is 'Relic Of God', a 3D TCG. A JX IP game will launch in 2H. (3) 2015 investment will be mainly in Cheetah and cloud, rather than online game. (4) WPS is likely to see recovery from reopening of government procurement. Mobile WPS will likely start monetization.

**We remain EW on KSFT.** Cheetah is rapidly growing but we prefer it as a standalone. Cloud looks promising due to the Xiaomi link, but still needs two years to grow, in our view. Online game heavily relies on old PC titles and lack of a blockbuster game for mobile. We prefer to remain on the sidelines until we see more significant catalysts, potentially from its new businesses.

#### Key Ratios and Statistics

Reuters: 3888.HK Bloomberg: 3888 HK

China Software & IT Services

Shr price, close (Mar 20, 2015)	HK\$18.14
52-Week Range	HK\$33.42-14.78
Sh out, dil, curr (mn)	1,184
Mkt cap, curr (mn)	Rmb17,181
EV, curr (mn)	Rmb13,696
Avg daily trading value (mn)	Rmb199

Fiscal Year ending	12/14	12/15e	12/16e	12/17e
ModelWare EPS (Rmb)	0.61	0.49	1.02	1.49
Revenue, net (Rmb mn)	3,350	5,239	8,122	11,008
EBITDA (Rmb mn)	678	926	1,991	2,872
ModelWare net inc (Rmb mn)	769	612	1,283	1,888
P/E	20.3	29.5	14.2	9.7
P/BV	3.4	4.0	3.1	2.4
RNOA (%)	96.3	55.5	165.3	186.4
ROE (%)	22.7	13.4	28.2	32.5
EV/EBITDA	18.1	14.6	6.3	3.8
Div yld (%)	1.0	0.5	1.1	1.6
FCF yld ratio (%)	(3.1)	0.6	6.0	10.5
Leverage (EOP) (%)	(91.5)	(74.2)	(82.5)	(91.7)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

e = Morgan Stanley Research estimates

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Kingsoft Corporation

Exhibit 1

**Kingsoft quarterly income statement**

Years Ending December 31	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	4Q14E	YoY	QoQ	vs. Mse
Rmb mn												
<b>INCOME STATEMENT</b>												
<b>Total revenues</b>	<b>457</b>	<b>497</b>	<b>551</b>	<b>669</b>	<b>676</b>	<b>751</b>	<b>852</b>	<b>1,072</b>	<b>1,119</b>	<b>60%</b>	<b>26%</b>	<b>-4%</b>
% change					48%	51%	55%	60%				
<b>Total cost of sales</b>	<b>62</b>	<b>66</b>	<b>80</b>	<b>90</b>	<b>107</b>	<b>116</b>	<b>140</b>	<b>226</b>	<b>261</b>	<b>152%</b>	<b>61%</b>	
<b>Gross profit</b>	<b>395</b>	<b>430</b>	<b>471</b>	<b>579</b>	<b>569</b>	<b>634</b>	<b>712</b>	<b>845</b>	<b>858</b>	<b>46%</b>	<b>19%</b>	<b>-1%</b>
% margin	87%	87%	86%	87%	84%	85%	84%	79%	77%	-8%	-5%	2%
margin expansion/(narrowing)												
Selling and marketing expenses	68	72	78	165	157	166	230	244	247	48%		
Admin expenses	45	44	51	52	66	67	75	90	82	71%		
R&D costs	115	136	170	175	196	223	273	264	264	51%		
SBC	10	19	16	17	21	57	65	59	64	254%		
Others	(5)	(0)	(19)	(14)	(2)	(3)	(1)	(0)	3	-98%		
<b>Total operating expenses</b>	<b>233</b>	<b>271</b>	<b>295</b>	<b>395</b>	<b>439</b>	<b>510</b>	<b>641</b>	<b>657</b>	<b>659</b>	<b>66%</b>	<b>3%</b>	<b>0%</b>
<b>Operating profit</b>	<b>162</b>	<b>159</b>	<b>176</b>	<b>184</b>	<b>130</b>	<b>124</b>	<b>71</b>	<b>188</b>	<b>198</b>	<b>2%</b>	<b>165%</b>	<b>-5%</b>
% margin	35%	32%	32%	28%	19%	17%	8%	18%	18%	-10%	9%	0%
margin expansion/(narrowing)												
<b>Non-operating items</b>	<b>73</b>	<b>27</b>	<b>22</b>	<b>22</b>	<b>148</b>	<b>37</b>	<b>235</b>	<b>28</b>	<b>41</b>	<b>26%</b>	<b>-88%</b>	<b>-32%</b>
<b>Profit before taxation</b>	<b>235</b>	<b>186</b>	<b>198</b>	<b>206</b>	<b>278</b>	<b>161</b>	<b>307</b>	<b>216</b>	<b>239</b>	<b>5%</b>	<b>-30%</b>	<b>-10%</b>
% margin	51%	37%	36%	31%	41%	21%	36%	20%	21%			
Income tax expense	24	16	21	11	23	36	20	16	39	41%	-24%	-60%
% of PBT	10%	8%	10%	5%	8%	22%	7%	7%	16%			
% statutory tax rate	25%	25%	25%	25%	25%	25%	25%	25%	25%			
Non Controlling interests	15	25	14	29	8	7	56	27	79	-7%	-52%	-66%
<b>Net profit</b>	<b>196</b>	<b>145</b>	<b>163</b>	<b>166</b>	<b>246</b>	<b>118</b>	<b>231</b>	<b>174</b>	<b>122</b>	<b>5%</b>	<b>-25%</b>	<b>43%</b>
% margin	43%	29%	30%	25%	36%	16%	27%	16%	11%			
margin expansion/(narrowing)												
Diluted EPS	0.17	0.12	0.14	0.14	0.20	0.09	0.18	0.13	0.11	-5%	-28%	19%

Source: Company Data, Morgan Stanley Research (e) estimates

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>1161</b>	<b>35%</b>	<b>321</b>	<b>41%</b>	<b>28%</b>
<b>Equal-weight/Hold</b>	<b>1459</b>	<b>44%</b>	<b>370</b>	<b>47%</b>	<b>25%</b>
<b>Not-Rated/Hold</b>	<b>101</b>	<b>3%</b>	<b>10</b>	<b>1%</b>	<b>10%</b>
<b>Underweight/Sell</b>	<b>609</b>	<b>18%</b>	<b>88</b>	<b>11%</b>	<b>14%</b>
<b>Total</b>	<b>3,330</b>		<b>789</b>		

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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Stock Rating History: 1/13/14 : NA/A; 6/12/14 : O/A

Price Target History: 6/12/14 : 25.1; 8/20/14 : 32; 10/28/14 : 29.4; 11/11/14 : 28

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —

Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

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Kingsoft Corporation (3888.HK) - As of 3/22/15 in HKD  
Industry : China Software & IT Services



Stock Rating History: 1/5/15 : E/I

Price Target History: 1/5/15 : 18

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —

Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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**Industry Coverage: China Software & IT Services**

Company (Ticker)	Rating (as of)	Price* (03/20/2015)
<b>Alvin Jiang</b> Kingsoft Corporation (3888.HK)	E (01/05/2015)	HK\$18.14

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