

Internet	Last Close HK\$23.35	Target Price HK\$34.00↓	Upside +46%	23 May 2018
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Kingsoft Corp (3888 HK)

1Q18 in line; JX III launch in late 3Q18

- ⊕ **1Q18 results in line:** Total revenue was RMB1.26bn, up 4% YoY/down 8% QoQ, and 3% higher than our estimate of RMB1.23bn. Non-GAAP net profit was RMB157m, down 51%/59% QoQ/YoY, and 2% above our estimate.
- ⊕ **WPS beat on VAS business:** WPS revenue beat our estimate on solid growth of VAS revenue, which jumped by nearly triple-digit rate YoY. Leveraging on the 100m MAU of WPS personal edition, WPS provides users with resource-sharing services which drove the rapid growth of content value-added services. Gaming business was soft as expected, because (1) JX III PC revamped version still needs time to recover, in our view; (2) old mobile games declined, where monthly average paying accounts declined by 17%/22% QoQ/YoY during 1Q18. Cloud revenue increased by 56% YoY to RMB419m, driven by increasing usage of cloud services in mobile video and internet sectors. Xiaomi contributed less than 25% of total cloud revenue.
- ⊕ **2Q18 and 2018 outlook:** Gaming business remains under pressure in 2Q18 in our view, as no new game will be launched in the quarter. We expect gaming business to recover from 2H18, driven by (1) the launch of new mobile games, such as Yunshangyuyi (云裳羽衣), JX Online II mobile and JX Online III mobile, around Aug/Sep; (2) JX III content update in 2H18 to drive user engagement and revenue growth. We expect 21% YoY revenue growth for the gaming business in 2018, mainly driven by mobile games. We expect WPS/cloud to maintain momentum and post 38%/59% YoY revenue growth in 2018.
- ⊕ **Valuation:** Given the latest game launch plan, we lower our 2018E revenue/profit estimates by 2%. We nudge down our SOTP TP from HK\$35.00 to HK\$34.00, implying 29x/23x 2018E/19E P/E. Despite temporary headwinds for the gaming business which bring margin pressure, we are confident about its growth in 2H18 driven by the launch of new mobile games. Catalyst: (1) new mobile games launch and better-than-expected growth of JX III; (2) A-share IPO of WPS by the end of this year. Maintain **Buy**.

Stock Rating

BUY

1-year stock performance



Source: Bloomberg

Stock data

52w high (HK\$)	31.10
52w low (HK\$)	17.5
Market cap (HK\$ m)	31,596
Avg daily vol (m)	8.31
YTD change (%)	-11.54
200d MA (HK \$)	23.05

Source: Bloomberg

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Financial highlights

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMB m)	3,834	5,181	6,907	9,470	11,364
YoY growth (%)		35	33	37	20
Net profit (RMB m) [^]	842	1,369	1,326	1,701	1,967
EPS (RMB) [^]	0.65	1.01	0.97	1.23	1.40
YoY growth (%)		55	-4	26	14
Previous EPS (RMB)			0.99	1.25	1.42
Change (%)			-2	-2	-1
P/E (x)	22	19	20	16	14
BVPS (RMB)	7.7	7.9	9.0	10.2	10.7
P/B (x)	2.6	2.6	2.1	1.9	1.8

Source: Company data, BOCOM Int'l estimates [^]non-GAAP basis

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Figure 1: 1Q18 results summary

(RMB m) Y/E 31 Dec	1Q17	4Q17	1Q18	QoQ (%)	YoY (%)	BOCOM forecast	Difference (%)	Comments
Revenue	1,213	1,380	1,264	-8	4	1,228	3	
Online games	817	751	632	-16	-23	642	-1	Natural decline from old games
Cloud services	268	402	419	4	56	430	-2	Driven by video cloud services
Office software and services and others	128	227	212	-6	66	157	36	Rapid growth from WPS VAS
Cost of revenue	-509	-612	-648	6	27	-572	13	
Gross profit	704	769	616	-20	-13	656	-6	
<i>Gross margin (%)</i>	58	56	49			53		
R&D, net of gov't grants	-321	-401	-380	-5	18	-344	11	Increased headcount YoY
Selling & distribution	-81	-174	-127	-27	56	-221	-43	Lower promotion activities QoQ
G&A	-56	-79	-83	5	48	-61	35	Increased headcount
Share-based compensation	-49	-51	-58	14	19	-60	-3	
Others	69	75	58			50		
Total opex	-439	-631	-590	-7	34	-636	-7	
Operating profit	265	137	26	-81	-90	19	33	
<i>Operating profit margin (%)</i>	22	10	2			2		
Non-GAAP operating profit	314	189	84	-55	-73	79	6	
<i>Non-GAAP operating margin (%)</i>	26	14	7			6		
Non-GAAP net profit	379	329	157	-52	-59	154	2	
<i>Non-GAAP net margin (%)</i>	31	24	12			13		
Adjusted EPS (diluted) (RMB)	0.29	0.24	0.12	-51	-59	0.11	6	

Source: Company data, BOCOM Int'l

Figure 2: P&L forecasts

(RMB m) Y/E 31 Dec	2Q17	3Q17	4Q17	1Q18	2Q18E	2017	2018E	2019E	2020E
Total revenue	1,284	1,303	1,380	1,264	1,324	5,181	6,907	9,470	11,364
YoY (%)	71	16	7	4	3	36	33	37	20
Game revenue	805	747	751	632	601	3,120	3,781	5,239	5,729
YoY(%)	69	-6	-8	-23	-25	23	21	39	9
Cloud	304	358	402	419	486	1,333	2,121	3,012	4,067
YoY(%)	97	80	57	56	60	81	59	42	35
WPS revenue and others	175	198	227	212	237	729	1,004	1,218	1,568
YoY(%)	46	50	4	67	35	32	38	21	29
Gross profit	796	744	769	616	647	3,012	3,929	5,478	6,496
Gross margin (%)	62	57	56	49	49	58	57	58	57
R&D, net of gov't grants	-368	-355	-401	-380	-384	-1,446	-1,813	-2,511	-2,872
Selling & distribution	-135	-154	-174	-127	-146	-545	-754	-1,046	-1,288
G&A	-59	-63	-79	-83	-86	-257	-360	-473	-568
Share-based compensation	-61	-74	-51	-58	-60	-235	-238	-240	-240
Others	89	53	75	58	50	285	208	200	200
Total opex	-535	-594	-631	-590	-626	-2,198	-2,957	-4,070	-4,768
Operating profit	261	150	137	26	21	814	972	1,408	1,728
Operating margin (%)	20	12	10	2	2	16	14	15	15
Non-GAAP operating margin (%)	25	17	14	7	6	20	18	17	17
Non-GAAP net profit	353	308	329	157	144	1,369	1,326	1,701	1,967
Non-GAAP net margin (%)	28	24	24	12	11	26	19	18	17
Non-GAAP diluted EPS (RMB)	0.27	0.23	0.24	0.12	0.11	1.01	0.97	1.23	1.40
Non-GAAP diluted EPS (HK\$)	0.31	0.27	0.29	0.15	0.13	1.21	1.19	1.50	1.71

Source: Company data, BOCOM Int'l estimates

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Rating System

Analyst Stock Ratings:

Buy: The stock's total return is expected to **exceed** that of the corresponding industry over the next 12 months.

Neutral: The stock's total return is expected to be **in line with** that of the corresponding industry over the next 12 months.

Sell: The stock's total return is expected to be **below** that of the corresponding industry over the next 12 months.

Not-Rated: The analyst **does not have conviction** regarding the outlook of the stock's total return relative to that of the corresponding industry over the next 12 months.

Analyst Industry Views:

Outperform: The analyst expects the industry coverage universe to be **attractive** relative to the relevant broad market benchmark over the next 12 months.

Market perform: The analyst expects the industry coverage universe to be **in line with** the relevant broad market benchmark over the next 12 months.

Underperform: The analyst expects the industry coverage universe to be **unattractive** relative to the relevant broad market benchmark over the next 12 months.

Broad market benchmark for Hong Kong is **the Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

23 May 2018

Kingsoft (3888 HK)



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