

# KINGSOFT (3888.HK)

Strong 3Q results, 'Buy' rating

Bloomberg | Reuters | POEMS  
3888.HK | 3888.HK | 3888HK  
Industry: Software & Services

Phillip Securities Research Pte Ltd

18 December 2013

Rating: Buy, CP: HKD20.60, TP: HKD24.08

## Company Profile

Kingsoft is a Chinese software and internet service company with main businesses including internet security, office software, entertainment software, cloud computing and on-line translation. Kingsoft provides a range of products and services such as Kingsoft Internet Security (KIS), Kingsoft PowerWord, WPS Office and online games.

## Investment rationales

### 3Q2013 business results:

Kingsoft (KS) presented a strong quarter result; with a reporting revenue of RMB 551mn, up 11% QoQ or 51% YoY. Online game business generated RMB 271mn in revenue (up 28% YoY or flat QoQ) while application software business expanded 78% YoY (or 23% QoQ) to RMB 270mn. The operating profit for the first three quarters cumulated to RMB 504mn, representing a 64% YoY increase.

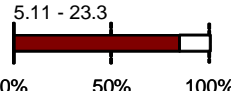
### Mobile games business review:

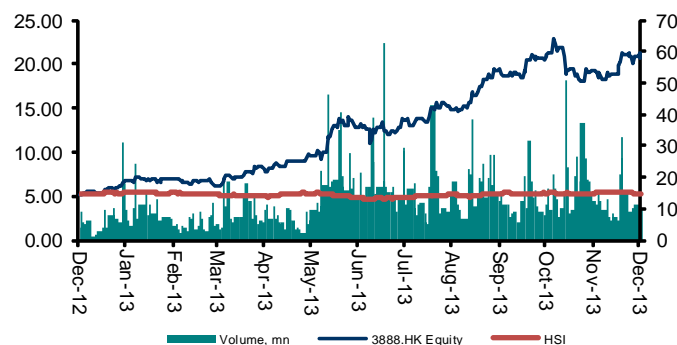
Mobile games segment contributed 8% of KIS revenue in 3Q13, with around 400 games on the company's mobile game platform. With the company started monetization of its mobile user traffic, management sees potentials in mobile advertising revenue in future.

### WPS business review:

WPS business is also an important part of KS's business. Securing big corporate contracts helped revenue from this sector rose 37% QoQ to RMB 78mn, accounting for 14% of its revenue in 3Q13. In addition to the guidelines from State Council instructing the usage of legitimate software, KS, being a leading office software vendor, is expected to benefit largely from the policy.

## KINGSOFT CORP

<b>Rating</b>	<b>1.00</b>	<b>Buy</b>
- Previous Rating	3.00	Neutral
<b>Target Price (HKD)</b>	<b>24.08</b>	
- Previous Target Price (HKD)	19.08	
Closing Price (HKD)	20.60	
Expected Capital Gains (%)	16.9%	
Expected Dividend Yield (%)	0.7%	
<b>Expected Total Return (%)</b>	<b>17.6%</b>	
Market Cap. (HKD mn)	24,314	
Enterprise Value (HKD mn)	21,034	
3M Average Daily T/O (mn)	14.6	
52 week range (HKD)	5.11 - 23.3	
Closing Price in 52 week range		



## Key Financial Summary

FYE	FY11	FY12	FY13E	FY14E
Revenue (RMB mn)	1,021	1,411	2,100	2,700
Net Profit, adj. (RMB mn)	337	450	670	791
EPS, adj. (HKD)	0.37	0.49	0.58	0.69
P/E (X), adj.	7.2	10.9	32.7	27.7
BVPS (HKD)	2.25	2.69	3.20	3.88
P/B (X)	1.2	2.0	6.0	4.9
DPS (HKD)	0.10	0.11	0.12	0.15
Div. Yield (%)	3.7%	2.1%	0.6%	0.8%

Source: Bloomberg, PSR est.

## Valuation Method

PE

## Analyst

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### R&D as a significant cost component:

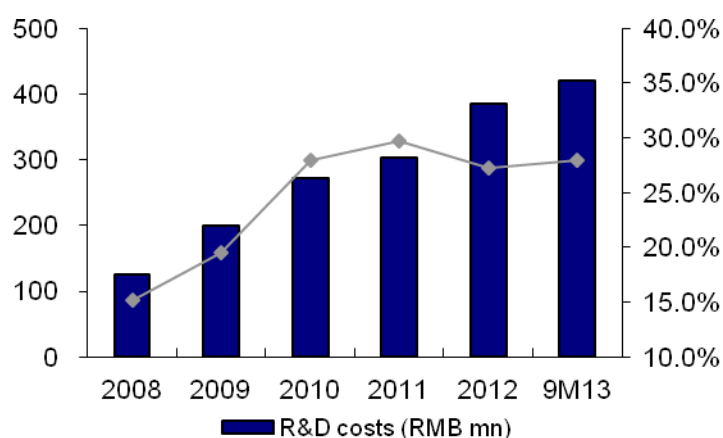
R&D costs for 9M2013 rose to RMB421 mn, which is already 9% higher than the total R&D cost in 2012 (RMB 385 mn), representing 28% of total revenue. With its large investment, the 9 mobile games currently under development might further boost the revenue.

Fig.1 3Q2013 results highlight

(RMB mn)	3Q13	3Q12	YoY	Comments
<b>Revenue</b>	<b>551</b>	<b>365</b>	<b>51.0%</b>	
-Online game	271	211	28.4%	Mainly attributable to JX Online III and new games launched
-Application software	270	152	77.6%	Driven by higher user traffic & growth in WPS business
-Others	10	2	400.0%	
<b>Gross profit</b>	<b>471</b>	<b>321</b>	<b>46.7%</b>	Gross margin dropped 2.5% to 85.5%
<b>PBT</b>	<b>198</b>	<b>135</b>	<b>46.7%</b>	
<b>Net profit</b>	<b>163</b>	<b>108</b>	<b>50.9%</b>	
<b>EPS (HK\$ cents)</b>	<b>14.10</b>	<b>9.40</b>	<b>50.0%</b>	
<b>DPS (HK\$ cents)</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	

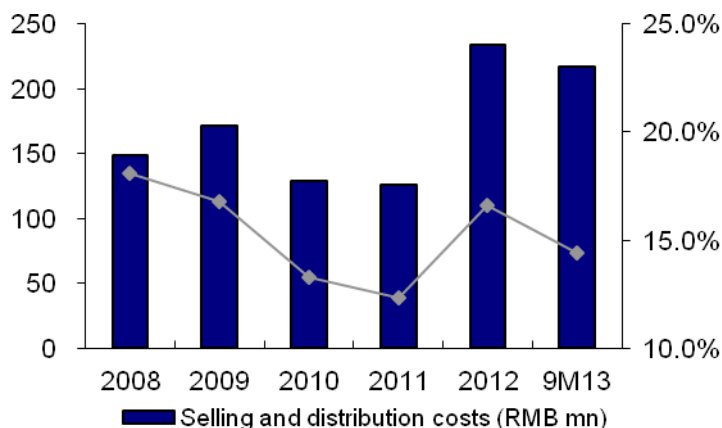
Source: PSR, Bloomberg

Fig.2 R&D costs and % to revenue



Source: PSR, Bloomberg

**Fig.3 Selling and distribution costs and % to revenue**



Source: PSR, Bloomberg

### Valuation

We give a target price of HK\$24.08 based on a sum of parts PE valuation. By applying 10x PE on online game business and 41x PE on application software due to higher growth in the business.

**Fig.4 Valuation**

(HKD mn)	2014E revenue	2014E earnings	Target 2014E PER	Est. fair value	Est. fair value per share (HKD)
Online Games	1,600	650	10	6,500	5.48
Application Software	1,850	460	41	18,860	15.90
2014E cash per share					2.70
Price target (HKD)					<b>24.08</b>

Source: PSR

### Major risks

- The company spent a large proportion of its revenue in R&D. This is an important factor for stronger revenue growth, but in case the market response to new games is under satisfactory, the company might suffer a great loss.

## Financial Status

FYE	FY11	FY12	FY13E	FY14E	FY15E
<b>Valuation Ratios</b>					
P/E (X), reported	7.5	11.3	32.7	27.7	25.4
P/E (X), adj.	7.2	10.9	32.7	27.7	25.4
P/B (X)	1.2	2.0	6.0	4.9	5.8
Dividend Yield (%)	3.7%	2.1%	0.6%	0.8%	0.7%
Dividend payout ratio (%)	26.7%	22.3%	20.6%	21.8%	16.8%
<b>Per share data (HKD)</b>					
EPS, reported	0.36	0.47	0.58	0.69	0.89
EPS, adj.	0.37	0.49	0.58	0.69	0.89
DPS	0.10	0.11	0.12	0.15	0.15
BV/PS	2.25	2.69	3.20	3.88	3.88
<b>Growth &amp; Margins (%)</b>					
<b>Growth</b>					
Revenue	5.1%	38.3%	48.8%	31.0%	24.4%
EBITDA	5.3%	27.1%	47.9%	31.0%	24.4%
Net Income, adj.	-12.2%	33.7%	48.7%	18.1%	29.6%
<b>Margins</b>					
EBITDA margin	38.3%	35.2%	47.0%	48.0%	48.0%
EBIT margin	29.2%	28.9%	27.3%	36.0%	36.0%
Net Profit margin	33.0%	31.9%	31.9%	28.8%	30.0%
<b>Key Ratios</b>					
ROE(%)	16.7%	19.4%	53.3%	21.0%	21.0%
ROA (%)	12.3%	13.5%	36.8%	13.0%	13.0%
Net Gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Income Statement (RMB mn)</b>					
<b>Revenue</b>	<b>1,021</b>	<b>1,411</b>	<b>2,100</b>	<b>2,750</b>	<b>3,420</b>
<b>EBITDA</b>	<b>391</b>	<b>497</b>	<b>735</b>	<b>963</b>	<b>1,197</b>
Depreciation & amortisation	(93)	(89)	(161)	(207)	(60)
<b>EBIT</b>	<b>298</b>	<b>408</b>	<b>574</b>	<b>738</b>	<b>1,137</b>
Net finance (expense)/income	62	89	251	236	113
Associates & JVs	(6)	9	0	0	0
Other items	31	22	0	0	0
<b>Profit before tax</b>	<b>385</b>	<b>528</b>	<b>825</b>	<b>974</b>	<b>1,250</b>
Taxation	(50)	(61)	(70)	(90)	(120)
<b>Profit after tax</b>	<b>335</b>	<b>466</b>	<b>755</b>	<b>884</b>	<b>1,130</b>
Non-controlling interest	(10)	(34)	(85)	(93)	(105)
<b>Net income, reported</b>	<b>325</b>	<b>433</b>	<b>670</b>	<b>791</b>	<b>1,025</b>
<b>Net income, adj</b>	<b>337</b>	<b>450</b>	<b>670</b>	<b>791</b>	<b>1,025</b>

Source: PSR est.

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