Kingsoft Cloud Holdings

Bloomberg: KC US Equity | Reuters: KC.O

Refer to important disclosures at the end of this report

DBS Group Research . Equity 16 Jun 2022

BUY (Initiating Coverage)

Last Traded Price (15 Jun 2022):US$4.70 (NASDAQ : 11,099)
Price Target 12-mth:US$10.90 (131.9% upside)

Analyst
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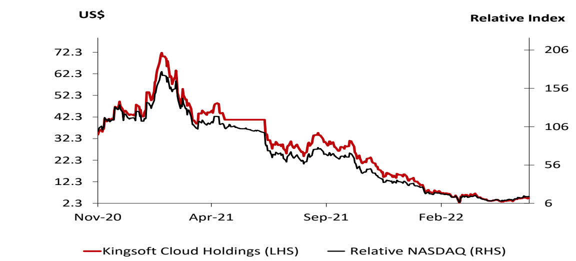
Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2021A	2022F	2023F	2024F
Turnover	9,061	9,719	11,841	14,581
EBITDA	(957)	(773)	(196)	433
Pre-tax Profit	(1,576)	(1,806)	(1,446)	(1,052)
Net Profit	(1,589)	(1,821)	(1,458)	(1,060)
Net Profit Gth (Pre-ex)	(61.8)	(14.6)	19.9	27.3
EPS (RMB)	(6.92)	(7.42)	(5.88)	(4.23)
EPS (US$)	(1.03)	(1.10)	(0.88)	(0.63)
EPS Gth (%)	(12.9)	(7.1)	20.7	28.0
Diluted EPS (US$)	(1.03)	(1.10)	(0.88)	(0.63)
DPS (US$)	0.00	0.00	0.00	0.00
BV Per Share (US$)	6.88	5.59	4.98	4.69
PE (X)	nm	nm	nm	nm
P/Cash Flow (X)	nm	nm	31.1	8.6
P/Free CF (X)	nm	nm	nm	nm
EV/EBITDA (X)	nm	nm	nm	16.0
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	0.7	0.8	0.9	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	(16.9)	(18.4)	(16.6)	(13.1)
Non-GAAP EPS (RMB)	(5.99)	(5.97)	(3.94)	(1.74)
Earnings Rev (%):		New	New	New
Consensus EPS (RMB)		(6.01)	(4.02)	(2.35)
Other Broker Recs:		B:10	S:0	H:3

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Pure cloud player to benefit from multi-cloud adoption

- Riding on China's public cloud market growth of 26.8% p.a. in 2021-2026E
- Benefiting from enterprises' multi-cloud adoption for high-quality performance
- Premium-customer strategy offers higher growth visibility
- Initiate coverage on Kingsoft Cloud with a BUY rating; TP of US$10.9

Pure cloud player to benefit from multi-cloud adoption. Kingsoft Cloud ("KC"), a leading independent cloud service player in China, is well-positioned to ride on enterprises' multi-cloud adoption in China in the backdrop of rising cloud penetration.

Where we differ: We are less concerned about the customer concentration risk, given the strong growth of the KC's existing top customers amid regulatory headwinds. KC is also well on track to diversify its customer base by expanding the enterprise cloud business.

Potential key catalysts: (1) Stronger-than-expected public cloud service revenue growth, (2) continuous margin expansion, (3) secondary listing in Hong Kong, and (4) share repurchase.

Valuation:

We derive our TP of US$10.9 based on 1.5x FY23 PS, lower than its large internet peers with IaaS business due to its smaller scale.

Key Risks to Our View:

(1) Intensified market competition, (2) significant slowdown of cloud services demand, and (3) disruptive cybersecurity incidents or attacks.

At A Glance

Issued Capital (m shrs)	243
Mkt Cap (US$m)	1142.1
Major Shareholders (%)	
Kingsoft Group	39.0
Xiaomi Corp	12.3
First Trust Portfolios L.P.	5.6
Free Float (%)	43.1
3m Avg. Daily Val. (US$m)	33.4
GICS Industry: Information Technology / Software & Services	

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Investment Summary

Largest independent cloud service provider in China. Kingsoft Cloud (KC US, "KC") was founded in 2012 and listed on NASDAQ at US$17 per ADS in 2020 after a spin-off from Chinese software company Kingsoft Group. As at end-2021, Kingsoft Group held a 39% stake in KC. KC is the largest independent cloud service provider in China, according to Frost & Sullivan. It has a 2.89% market share in the IaaS and PaaS public cloud market at the end of 3Q21, according to IDC. The company derives revenue primarily from (1) public cloud services and (2) enterprise cloud services, which contributed 68% and 32% to total revenue in FY21, respectively.

Driver #1: Rising cloud penetration. Cloud penetration in China is still relatively low. Enterprise IT spending only accounted for 1.5% of China's GDP in 2021, compared to 5.3% in the US and 3.2% globally. Public cloud spending was only 12.9% of total enterprise IT spending in China, vs. 16.8% in the US and 13.5% globally. The promotion of digital transformation in the China's 14th Five-Year Plan and the outbreak of the pandemic will help accelerate cloud adoption in China, despite the temporary macro headwinds. China's public cloud market is expected to grow at a CAGR of 26.8% in 2021-2026E to US$109.9bn, according to Gartner. KC is one of the beneficiaries of the rising cloud demand.

Driver #2: Pure cloud player for multi-cloud adoption. Only c.26% of enterprises with over 1,000 employees in China that are using cloud adopted a multi-cloud strategy in 2019, compared with 85.0% in the US. Multi-cloud penetration is expected to increase from the currently low level in China. IDC estimated that 70% of China's top 500 organisations will have implemented a multi-cloud strategy by 2024. As an independent cloud service provider, KC will benefit from the increasing multi-cloud adoption, as its customers can avoid potential conflicts of interest that would arise from using cloud services provided by leading internet players.

Driver #3: Premium-customer strategy offers high growth visibility. KC adopts a premium-customer strategy, focusing on leading enterprises within selected verticals, such as game, video, and financial services, including ByteDance, Bilibili, Kuaishou and Meituan, etc. The premium customers have stronger spending power and higher growth visibility than SMEs, leading to faster business expansion for KC. KC achieved a cloud service revenue CAGR of 74.6% in 2017-2020, which is higher than the 48.2% of the industry in China.

Customer concentration not a major concern. KC has a relatively concentrated revenue contribution of above 50% from the top five customers. However, we are less concerned about this, given the strong growth expectation of 40%+ p.a. for its top customer ByteDance amid the macro headwinds. Meanwhile, KC has been further diversifying its customer base by signing more premium customers. This percentage has been decreasing from 65.7% in 2019 to 50.5% in 2021. We expect KC to further diversify its customer base with the expanding enterprise cloud business.

Potential synergy from the acquisition of Camelot. KC acquired Camelot, a digital enterprise solutions and services provider, in Sep 2021. We expect potential synergy in KC's enterprise cloud services business, leveraging Camelot's large customer base and long-standing client relationships to cross-sell products and solutions; as well as nationwide fulfilment centres across major cities in China for project deployment with lower costs and enhanced efficacy.

Secondary listing in Hong Kong a potential catalyst. KC is on track with the Hong Kong Stock Exchange listing plan, seeking to maintain independent listing status in both Hong Kong and the US to reduce the risks arising from Sino-US tensions. The exact timeline will be subject to market conditions and regulatory approvals. We believe this would be a potential share price catalyst once the timeline is confirmed, as the secondary listing could not only provide an extra funding channel but also expand the domestic investor base.

Sufficient funds to support future expansion. KC's capital expenditure primarily includes the purchase of property and equipment, as well as intangible assets. The capital commitments were Rmb1bn, Rmb1.6bn, and Rmb0.7bn in 2019, 2020, and 2021, respectively. KC had a total debt of Rmb1.8bn and net cash of Rmb1.6bn as of Mar 2022. KC is also able to get additional financing facilities from banks given the current debt level and support from Kingsoft Group. Therefore, we believe KC is able to support its capex in the next few years.

Expect a c.30% core-cloud revenue CAGR for FY21-FY24F. The strong growth of core cloud business (i.e., public cloud computing and storage, and enterprise cloud) is driven by the increasing cloud penetration and multi-cloud adoption in China. We expect KC to achieve positive adjusted EBITDA in 4Q22.

We initiate coverage on KC with a BUY call due to (1) the strong long-term public cloud service demand in China, (2) KC being a pure cloud player poised for multi-cloud penetration, and (3) its high growth visibility with a premium-customer strategy. We derive our TP of US$10.9 based on 1.5x FY23 PS, lower than its large internet peers with IaaS business due to its smaller scale.

Valuation & Peer Comparison

We set our TP at US$10.9 based on 1.5x FY23 PS, which is lower than its large internet peers with IaaS business due to its smaller business scale. KC is currently trading at an undemanding valuation of 0.65x FY23 PS, at a c.70% discount to the average of its peers, due to the smaller scale and relatively higher customer concentration. We expect the valuation discount to narrow with the improving operating margin and further customer diversification.

Peer comparison

Company Name	Code	Currency	Price Local$	Mkt Cap US$m	Fiscal Yr	PE 22F x	PE 23F x	Yield 22F %	Yield 23F %	P/Bk 22F x	P/Bk 23F x	EV/EBITDA 22F x	EV/EBITDA 23F x	ROE 22F %	ROE 23F %	P/S 22F x	P/S 23F x
Kingsoft Cloud*	KC US	USD	4.70	1,145	Dec	n.a.	n.a.	0.0	0.0	0.8	0.9	(6.3)	(14.2)	(17.4)	(18.3)	0.8	0.6
Alibaba*#	BABA US	USD	108.03	291,681	Mar	19.8	16.6	0.0	0.0	1.8	1.6	9.2	7.7	9.8	10.4	2.0	1.8
Tencent Holdings*	700 HK	HKD	379.80	465,057	Dec	22.0	17.9	0.3	0.4	3.3	2.7	14.5	12.0	16.0	16.5	5.3	4.5
Baidu Ads 1:8*	BIDU US	USD	144.82	50,406	Dec	32.6	21.2	0.0	0.0	1.5	1.3	14.3	9.3	4.7	6.6	2.6	2.3
Amazon.Com	AMZN US	USD	107.67	1,095,479	Dec	138.8	40.2	0.0	0.0	6.6	5.2	19.3	14.5	11.0	18.1	2.1	1.8
Microsoft	MSFT US	USD	251.76	1,882,921	Jun	27.1	23.4	1.0	1.0	10.2	7.5	20.3	17.6	45.5	38.1	9.5	8.3
Alphabet A	GOOGL US	USD	2195.29	1,448,854	Dec	19.7	16.6	0.0	0.0	5.1	4.3	12.8	11.2	27.0	28.2	2.6	2.2
Vmware A#	VMW US	USD	120.87	50,940	Jan	18.9	16.5	0.0	0.0	37.2	12.7	12.6	11.5	487.3	91.9	3.8	3.5
Ucloud Technology 'A'	688158 CH	CNY	14.95	1,009	Dec	n.a.	n.a.	n.a.	n.a.	2.6	3.5	n.a.	n.a.	(27.0)	(36.4)	2.0	1.7

 # FY22: FY23; FY23: FY24

*Source: Thomson Reuters, *DBS HK*

Key Risks

Intensified market competition. The cloud services market in China is highly competitive, with multiple players backed by internet giants. Irrational price cut by competitors might lead to an earnings deterioration for KC.

Significant slowdown of cloud services demand. Revenue from public cloud services accounted for nearly 70% of KC's total revenue in FY21. Any significant slowdown in the growth of public cloud services demand will impact KC's revenue growth.

High customer concentration. The top five customers in aggregate accounted for more than 50% of KC's total revenue in FY21. The loss of one or more customers with a large revenue contribuion, or a reduction in usage by any of these customers, would reduce KC's revenue.

Insufficient capital to support ever-changing market environment. KC requires a significant amount of capital to fund business operations and respond to development opportunities. If it fails to obtain sufficient capital, KC may not be able to implement growth strategies, and the business, financial conditions, and operations may be materially and adversely affected.

Cybersecurity incidents and attacks. The occurrence of any disruptive cyber incidents could harm KC's business or damage its brand and reputation, leading to the loss of existing customers.

SWOT Analysis

Strengths	Weaknesses
• Pure cloud business focus; largest independent cloud service provider in China • Premium-customer strategy with focus on leading enterprises within selected verticals • Established leadership in verticals such as online video • Higher growth rate than the industry average	• High revenue contribution from top five customers • Relatively smaller scale compared to cloud service providers backed by internet giants

Opportunities	Threats
• Digital transformation in China to accelerate cloud penetration • Beneficiary of customers' multi-cloud adoption • Resumption of gaming license approvals • Entering new verticals for customer diversification • Potential overseas expansion to catch the rapidly growing cloud market in Southeast Asia	• Intensified market competition in terms of pricing • Logistics constraints and delays in project delivery due to potential intensification of COVID-19 lockdown measures in China • Occurrence of disruptive cybersecurity incidents and attacks

Source: DBS HK

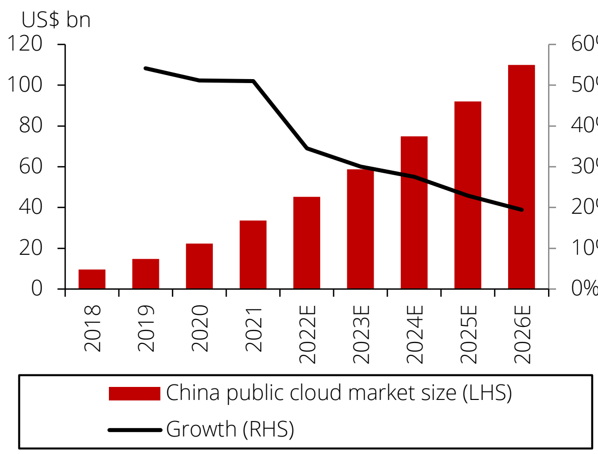
Critical Factors

The critical factors of the company are (1) public cloud market size in China, (2) number of premium customers, and (3) operating efficiency of the cloud service business.

(1) Public cloud market size in China

KC generated c.70% of its revenue from public cloud services in FY21. Its business is significantly affected by the development of China's public cloud industry. Cloud penetration in China is still relatively low. Enterprise IT spending only accounted for 1.5% of China's GDP in 2021, compared to 5.3% in the US and 3.2% globally. Public cloud spending was only 12.9% of total enterprise IT spending in China, vs. 16.8% in the US and 13.5% globally. The promotion of digital transformation in the 14th Five-Year Plan and the outbreak of the pandemic will help accelerate cloud adoption in China. China's public cloud market is expected to grow at a CAGR of 26.8% in 2021-2026E to US$109.9bn, according to Gartner. KC's public cloud services revenue will expand with rising cloud penetration in China.

Public cloud market size in China

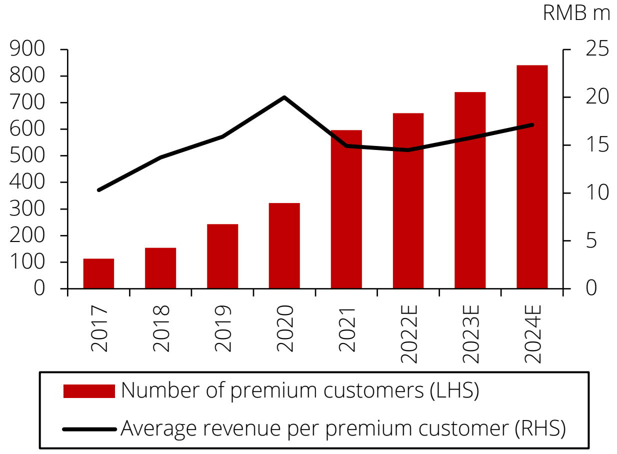


Source: Gartner

(2) Number of premium customers

KC adopts a premium-customer strategy, focusing on leading enterprises within selected verticals. The total revenue generated from premium customers accounted for more than 90% of total revenue in 2017-2021. The number of premium customers expanded from 113 in 2017 to 597 in 2021, with a revenue CAGR of 66.5%. An increasing number of premium customers will lead to higher revenue.

Number of premium customers

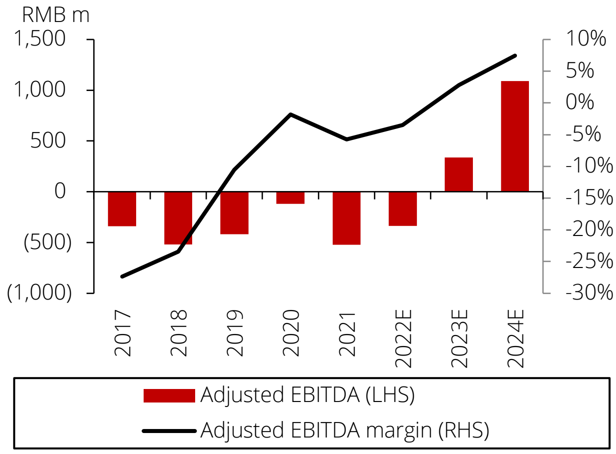


Source: Company, DBS HK

(3) Operating efficiency of cloud service business

Macro headwinds in China have led to weaker-than-expected demand for CDN services in 2021, resulting in a redundancy of underlying resources including IDC and bandwidth, which was planned and committed to on an annual basis at the beginning of 2021. KC proactively initiated a downsizing of its CDN services and focused on core cloud services (i.e., computing, storage, and enterprise cloud businesses) to adapt to the market headwinds. We expect to see improvements in KC's adjusted gross margin and adjusted EBITDA margin with the effect of the strategic initiatives unfolding, and forecast it will achieve a positive adjusted EBITDA margin in 4Q22. Improving operating efficiency will result in higher profitability.

Operating efficiency



Source: Company, DBS HK

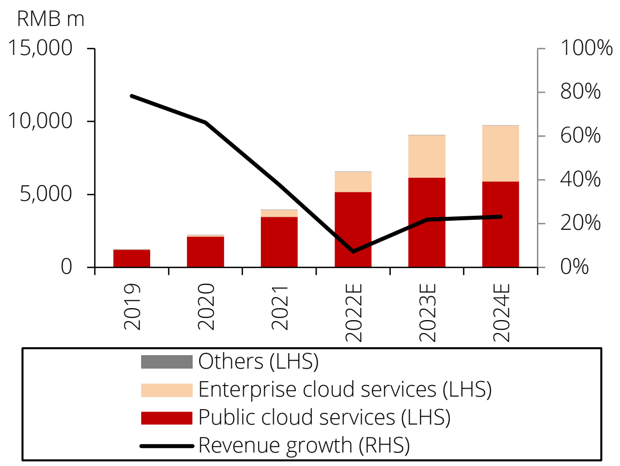
Financials

FY21 results highlights. Revenue increased by 37.8% y-o-y to Rmb9,060.8m, with public cloud services and enterprise cloud services expanding 19.2% and 111.1% y-o-y to Rmb6,159.1m and Rmb2,897.8m, respectively. Public cloud services were negatively impacted by a temporary slowdown in demand from the internet sector. Cost of revenue grew by 43.8% y-o-y to Rmb1,830.2m, with the gross profit margin shrinking 1.5ppts to 3.9%. Adjusted EBITDA was -Rmb522.4m compared to -Rmb119.1m in FY20. Net loss expanded 61.8% y-o-y to Rmb1,588.7m.

1Q22 results highlights. Revenue increased by 19.9% y-o-y to Rmb2,173.8m. Public cloud services revenue declined by 0.8% y-o-y to Rmb1,380.8m, as the increase in computing and storage services was offset by the downsizing of CDN services. Enterprise cloud services revenue grew by 88.7% y-o-y to Rmb792.5m. Gross billings from core cloud services (i.e., computing, storage, and enterprise services) increased by 61.2% y-o-y. Cost of revenue increased by 23.4% y-o-y or decreased by 20.4% q-o-q to Rmb2,631.8m; among which, IDC costs decreased by 19.1% q-o-q to Rmb1,110.3m, in line with the adjustment of CDN services. Gross profit decreased by 31.4% y-o-y to Rmb80m. The gross profit margin dropped 2.7ppts y-o-y or expanded 2.7ppts q-o-q to 3.7%. Adjusted EBITDA was -Rmb152m, compared to -Rmb49m in 1Q21 and -Rmb278m in 4Q21. Adjusted EBITDA margin was -7%, contracting 4.3ppts y-o-y or improving 3.5ppts q-o-q. Net loss expanded 44.7% to Rmb553.2m. Net operating cash flow was -Rmb626m, compared to -Rmb497m in 1Q21 and Rmb38m in 4Q21.

Revenue forecast. We expect revenue to grow by 7%, 22% and 23% for FY22, FY23 and FY24 respectively, with core-cloud revenue growing 31%, 28% and 28% for FY22, FY23 and FY24 respectively. The growth is driven by (1) increasing public cloud penetration and multi-cloud adoption, and (2) expanding enterprise cloud services.

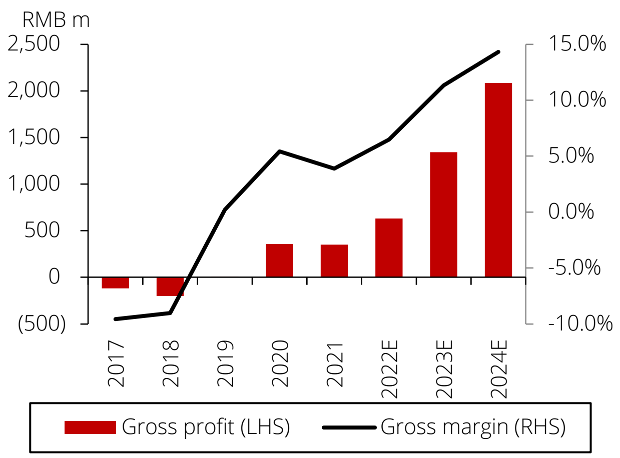
Revenue forecast



Source: Company, DBS HK

Improving gross profit margin. We expect the gross margin to increase from 3.9% in FY21 to 14.3% in FY24, with the increasing economies of scale.

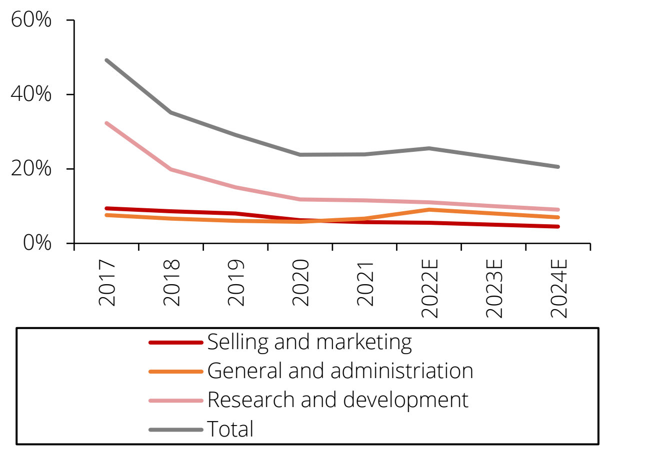
Gross margin



Source: Company, DBS HK

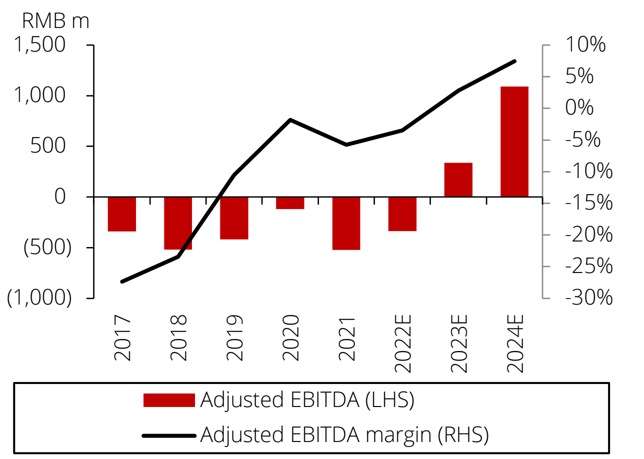
Increasing operating efficiency. We expect KC to gradually improve its operating efficiency after the acquisition of Camelot in 2021. Operating expenses as a percentage of revenue is to decrease from 23.9% in FY21 to 20.5% in FY24.

Operating expenses/revenue ratio



Source: Company, DBS HK

Adjusted EBITDA margin



Source: Company, DBS HK

Healthy balance sheet. KC had a total debt of Rmb1.8bn and net cash of Rmb1.6bn as of Mar 2022. KC's capital expenditure primarily includes the purchase of property and equipment, as well as intangible assets. The capital commitments were Rmb1bn, Rmb1.6bn, and Rmb0.7bn in 2019, 2020, and 2021, respectively. The company guided a capex of Rmb1bn to Rmb1.5bn for FY22.

Sufficient funds from financing activities. KC completed its IPO on NASDAQ in May 2020 at US$17 per ADS with net proceeds of Rmb3.9bn. KC also completed a follow-on offering in Sep 2020 at US$31 per ADS with net proceeds of Rmb1.9bn. KC could also borrow from banks given the current debt level and get support from Kingsoft Group. Overall, the cash inflow from financing activities is generally sufficient to cover the operating loss and investment needs.

Environment, Social, & Governance (ESG)

ESG management is essential to the sustainability of KC's business. As a rapidly growing company, KC will continue to improve its ESG governance, build innovative products, set the highest standards of ethics and compliance across its supply chain, attract and retain the best talent, reduce its carbon footprint, improve suppliers' sustainability performance, and deepen its community engagement.

Environmental

Data centres are considered as high-energy consumption units in the technology industry. Most of KC's data centres are leased from suppliers, which offers more flexibility to reduce the wastage of resources from idle or underutilised data centres. KC also has two self-owned data centres located in Beijing and Tianjin. In line with China's "dual carbon" goals, KC's data centres are developed in a high-efficiency, low-carbon, energy-saving, and renewable way. However, the use of green energy might lead to higher utility costs for KC's data centre operation.

KC has focused on optimising the strategy of energy savings and consumption reduction and has set a target value for PUE in its KPIs. The actual operating performance is lower than that of the data centre's designed values. For instance, the designed annual average PUE of the Beijing data centre is 1.4x, and the actual operating annual average PUE in 2021 is 1.37x. In the long run, KC will continue to improve operation efficiency in its data centres and maintain the PUE below the targets. Total greenhouse gas emissions per million yuan revenue decreased from 3.12 tonnes to 2.72 tonnes.

Social

(1) Employees. KC has established internal rules and policies for employment that include respecting employees and protecting their rights. The internal policies include the Employee Manual, Code of Professional Conduct, and other policies to guide recruitment, compensation and performance, benefits and care, attendance and leave, grievance procedures, integrity, self-discipline, etc. Female employees accounted for 26% of management roles in KC as at end of 2021.

(2) Suppliers. KC not only manages its supply chain in compliance with relevant laws and regulations, but also strives to minimise the negative impact on society and the environment. KC has established internal policies, standards, and implementation frameworks to guide its supplier business partners. The internal policies and programmes include Measures for Procurement, Measures for Bid Invitation, Policy on Supplier Life Cycle Management, and Supplier Performance Evaluation Specifications to guide supplier introduction, evaluation, rating, and exit. In 2021, KC identified a supplier that was not complying with its business ethics requirements and immediately terminated the cooperation with this supplier. As at end of 2021, 100% of suppliers have signed agreements on the commitment to the supplier code of conduct.

(3) Customers. KC adheres to the core value of "customer first, thrive on technology". KC continuously improves the quality of products and services to meet customer demands through innovation. KC accomplished zero product quality or server outage problems in 2021. Besides, KC has achieved 99% overall customer problem resolution rate and 95% customer service satisfaction rate in 2021.

Governance

KC's board of directors oversees the executive management of the company's relevant risks and regularly reviews reports from management covering various business topics. While the board is accountable for the overall risk oversight, it has delegated well-defined responsibilities related to certain risks to the Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee. The board has also adopted a diversity policy to ensure that as a whole, it has a diverse set of qualities, including but not limited to gender, age, cultural and educational background, professional experience, skills, knowledge, and length of service, in order to appropriately fulfil its mandate. KC recently appointed its first independent female board director, enhancing gender diversity and workplace inclusivity.

Sector Outlook

Cloud migration a long-term trend. In recent years, the technology industry has undergone a massive transition from on-premise hardware and software that enterprises purchase to services on the cloud that they rent. Cloud services offer on-demand access to a shared pool of configurable computing and storage resources that can be instantaneously deployed and easily scaled, therefore providing a wide variety of benefits to enterprises compared with the traditional on-premise IT model.

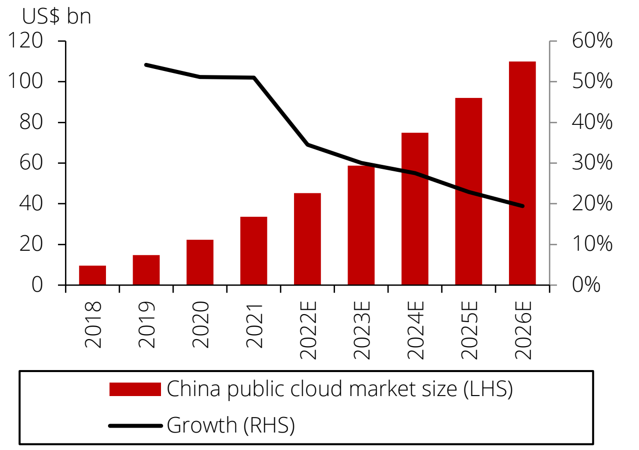
Major benefits of cloud services

	Major benefits of cloud services
Quick deployment	• Shorter deployment time compared to traditional IT
Cost reduction	• Reduce upfront capital expenditures and ongoing expenses for purchasing, installing, maintaining, and upgrading on-premise IT infrastructure and equipment • Enjoy instant, reliable, and cost-efficient services on a pay-as-you-go basis
Flexibility & scalability	• Scale up and down the capacity in response to demands flexibly and in a timely manner • Enjoy ready-to-use cloud capacity that fulfils varying commercial needs
Reliability	• Offer consistent and reliable high-performance services with added benefits for data protection and disaster recovery
Automatic updates	• Both software and security updates are rolled out on a regular basis

Source: Company, DBS HK

Second largest cloud market, but lags in penetration. China is the second largest cloud services market in the world with a market size of US$31.4bn, according to Gartner. However, cloud penetration in China is still relatively low. Enterprise IT spending only accounted for 1.5% of GDP in China in 2021, compared to 5.3% in the US and 3.2% globally. Public cloud spending was only 12.9% of total enterprise IT spending in China, vs. 16.8% in US and 13.5% globally. The promotion of digital transformation in the China's 14th Five-Year Plan and the outbreak of the pandemic will help accelerate cloud adoption in China. Gartner estimated that China's public cloud market will grow at a CAGR of 26.8% in 2021-2026E to US$109.9bn.

China public cloud market size



Source: Gartner

Public cloud market remains competitive. The public cloud service providers in China include both domestic and international players. Domestic cloud service providers include (1) internet cloud service providers, (2) telecommunication operators, (3) and hardware manufacturers.

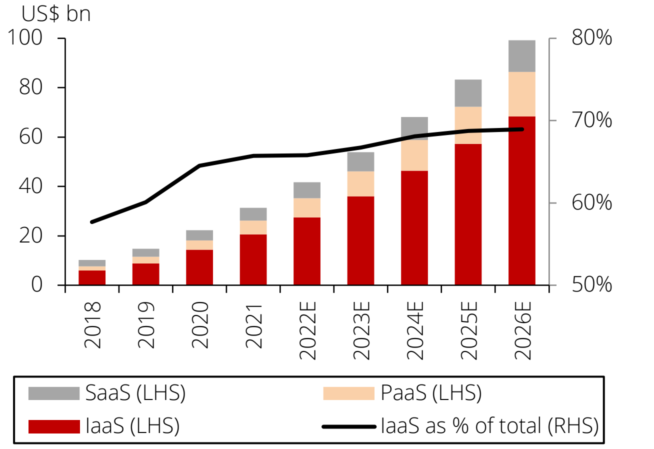
Domestic cloud service providers

	Domestic cloud service providers
Internet cloud service providers	• Alibaba Cloud • Tencent Cloud • Baidu Cloud • Kingsoft Cloud • JD Cloud
Telecommunication operators	• China Telecom • China Mobile • China Unicom
Hardware manufacturers	• Huawei Cloud

Source: Company, DBS HK

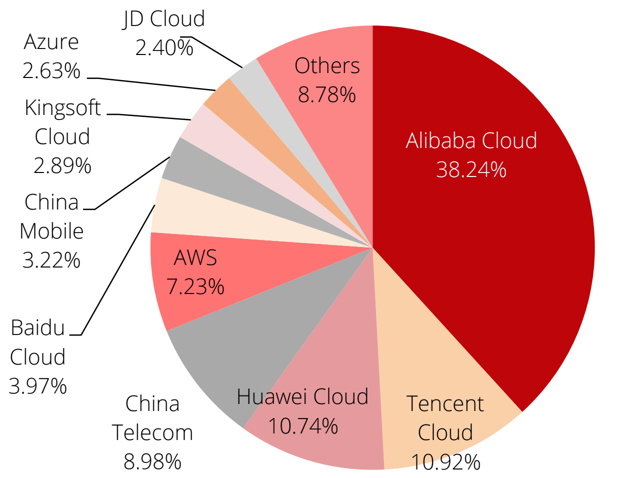
IaaS and PaaS the primary growth driver. The public cloud market can be divided into three sub-sectors, namely IaaS, PaaS, and SaaS. China is still in the early stage of cloud service development. IaaS experienced rapid growth in the past few years and now accounts for the largest part (66% in 2021) of the public cloud market in China. As of 3Q21, the market share in terms of IaaS and PaaS for the top 5 and top 10 players were 76.1% and 91.2%, respectively. Looking forward, as infrastructure and transition from infrastructure to platform remain the major demands in China's public cloud market, IaaS and PaaS are expected to be the primary growth drivers of China's public cloud market. Leading IaaS players, leveraging their extensive infrastructure, advanced cloud technology, and transferrable customer base, are better positioned to extend their spectrum of services to the PaaS market.

Decomposition of China public cloud market



Source: Gartner

IaaS+PaaS market share in China (as of 3Q21)



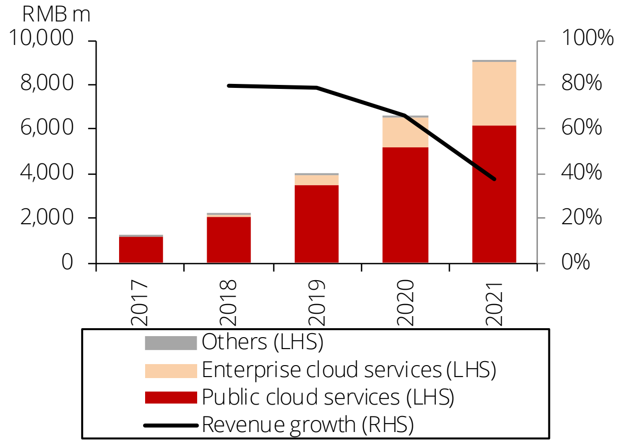
Source: IDC

Increasing multi-cloud adoption. Only c.26% of enterprises with over 1,000 employees in China that are using cloud adopted multi-cloud strategies in 2019, compared with 85% in the US. Multi-cloud penetration is expected to increase from the current low level in China, driven by the need to (1) prevent data loss or downtime due to localised component failure in a single cloud, (2) ensure continued high-quality performance to reduce latency by the geographical distribution of processing requests, and (3) minimise the dependency on a single cloud service provider. IDC estimated that 70% of China's top 500 organisations will implement a multi-cloud strategy by 2024. Moreover, independent cloud service providers' customers could avoid potential conflicts of interest they might face when using cloud services provided by leading internet players.

Company Background

Company history. Kingsoft Cloud, founded in 2012 and listed on NASDAQ at US$17 per ADS in 2020, is the largest independent cloud service provider in China, according to Frost & Sullivan. It has a 2.89% market share in the IaaS and PaaS public cloud market as of 3Q21, according to IDC. The company derives revenue primarily from (1) public cloud services and (2) enterprise cloud services, which accounted for 68% and 32% of total revenue in FY21.

Revenue breakdown by segment

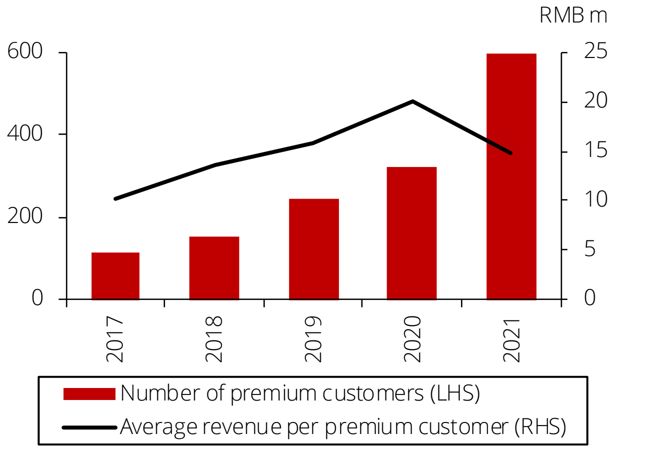


Source: Company, DBS HK

Strong relationship with Kingsoft Group. KC became an associate of Kingsoft Group after separately listing in 2020. Kingsoft Group held a 39% stake in KC as at the end of 2021. KC has jointly promoted cloud-based office solutions with Kingsoft Group by leveraging the sales network of Kingsoft Group through cross referrals.

Adoption of premium-customer strategy. KC adopts a premium-customer strategy, focusing on leading enterprises within selected verticals, such as game, video, and financial services. Major customers include ByteDance, iQiyi, Kuaishou, Bilibili, Zhihu, Meituan and Perfect World, etc. The premium customers have stronger spending power and higher growth visibility than SMEs, leading to a faster business expansion for KC. KC achieved a cloud service revenue CAGR of 74.6% in 2017-2020, which is higher than the 48.2% of the industry in China. The number of premium customers was 243, 322, and 597 for FY19, FY20, and FY21 respectively.

Key operating metrics

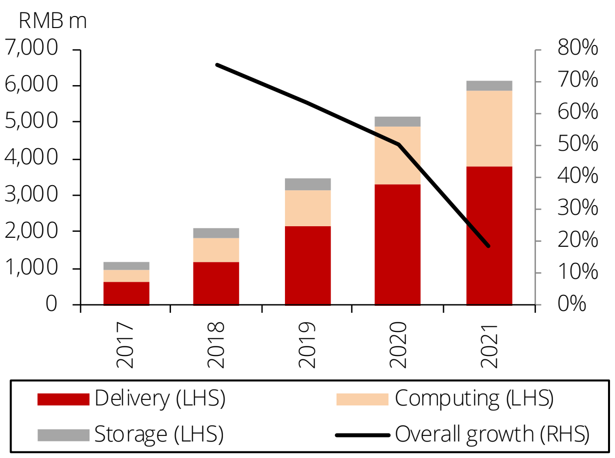


Source: Company, DBS HK

Business segment

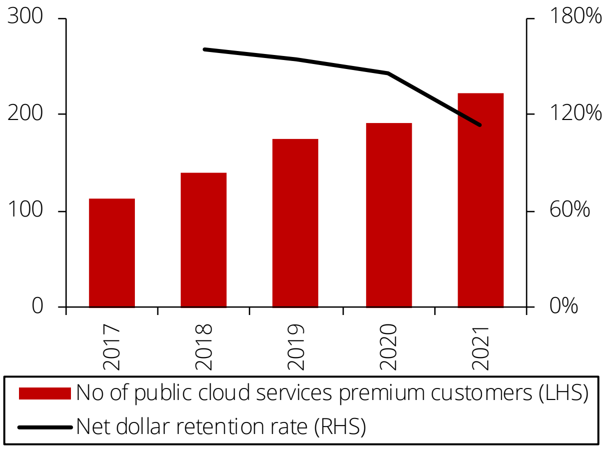
Public cloud services. Public cloud products primarily cover computing, storage, and delivery. KC charges customers based on utilisation and duration. KC also offers credit terms and prepaid subscription packages over a fixed subscription period. KC has a large, loyal, and growing premium customer base increasing spending in various verticals, including video, gaming, intelligent mobility, e-commerce, mobile internet, etc. The number of public cloud premium customers were 175, 191, and 222 for FY19, FY20, and FY21, respectively. The net dollar retention ratio of public cloud services premium customers was 155%, 146%, and 114%, respectively for those years.

Breakdown of gross billings for public cloud services



Source: Company, DBS HK

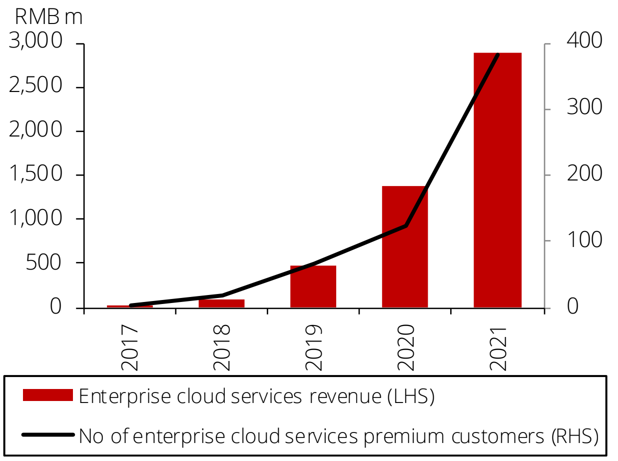
Key operating metrics of public cloud services



Source: Company, DBS HK

Enterprise cloud services. KC offers enterprise-grade cloud products and solutions primarily for traditional enterprises and public service organisations. Enterprise cloud products primarily consist of Galaxy Stack, KingStack, and KBaaS. Enterprise cloud solutions primarily consist of financial service, public service, healthcare, and other solutions. KC charges enterprise cloud service customers on a project basis and also based on performance completed to date. Currently, more than 50% of enterprise cloud services revenue is from the public service sector. The number of enterprise cloud premium customers was 67, 124, and 382 for FY19, FY20, and FY21, respectively. Enterprise cloud service revenue expanded rapidly at a CAGR of 271% from Rmb15.3m in FY17 to Rmb2,897.8m in FY21.

Key operating metrics of enterprise cloud services



Source: Company, DBS HK

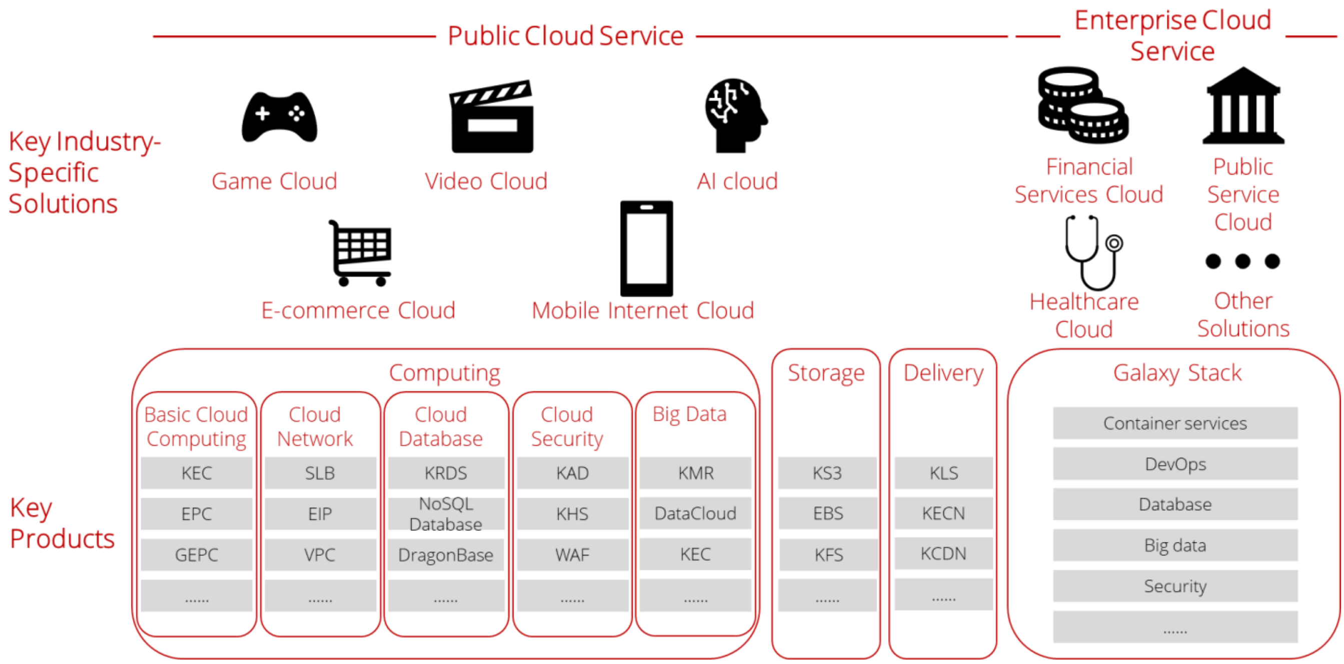
Proactively initiated downsizing of CDN services. KC's public cloud service has a strategic focus on gaming and video sectors, which were impacted by regulations in the past few quarters. KC proactively initiated the downsizing of the CDN services and focuses more on non-CDN services (i.e., computing, storage, and enterprise cloud services) to adapt to market headwinds. Management expects the revenue contribution from CDN services to drop from 40% in FY21 to 25%-30% in FY24. The strategic initiatives to focus on high-value business will facilitate quality and sustained growth.

Potential synergy from the acquisition of Camelot. KC acquired Camelot, a digital enterprise solutions and services provider, in Sep 2021. The acquisition further extended KC's coverage in financial sectors. As at the end of 1Q22, 18 out of China's top 20 banks are KC's customers. We expect potential synergy in KC's enterprise cloud services business, leveraging on Camelot's large customer base and long-standing client relationships to cross-sell products and solutions; as well as nationwide fulfilment centres across major cities in China for project deployment with lower costs and enhanced efficacy.

Secondary listing in Hong Kong in progress. KC is on track with the Hong Kong Stock Exchange listing plan, seeking to maintain independent listing status in both Hong Kong and the US. The final listing decision and timeline is subject to both regulatory approvals and market conditions.

US$100m share repurchase program approved. In Mar 2022, the Board has authorised to adopt a share repurchase program up to US$100m (i.e. 9% of outstanding ADS based on current market price) during a twelve-month period. The total size of US$100m is c.3x the average trading volume in the past three months. The current net cash of Rmb1.6bn is deemed sufficient to fund the share repurchase program. After the significant share price drop since Feb 2021, share repurchase would be a catalyst to the share price.

Key products and solutions



Source: Company, DBS HK

Management & Strategy

Solid industry background. The management team has a solid background in technology with an in-depth understanding of industry verticals. Yulin Wang, the Director and Chief Executive Officer of KC, has over 20 years of internet industry and management experience.

Strong synergy with strategic shareholders. KC has strong synergies with its strategic shareholders, including Kingsoft Group and Xiaomi. KC has jointly promoted cloud-based office solutions with Kingsoft Group by leveraging the sales network of Kingsoft Group through cross referrals. KC also cooperates with Xiaomi and other ecosystem players to develop and promote advanced solutions such as AIoT solutions. Moreover, KC shares technology insights with its strategic shareholders.

Key Management Team

Name	Position	Description
Jun Lei	Director and Chairman of the Board	Mr. Lei is a Director and the Chairman of the Board. Mr. Lei co-founded Xiaomi Corporation (1810 HK) with other partners, and currently serves as the Chairman, CEO, Executive Director, and a member of the remuneration committee of Xiaomi Corporation. He joined Kingsoft Group in 1992 and has held various senior positions in Kingsoft Group (3888 HK), including Chairman of the Board since Jul 2011, non-Executive Director since Aug 2008, Executive Director between July 1998 and August 2008, and CEO between 1998 and Dec 2007. Since Dec 2011, Mr. Lei has served as a Director of Kingsoft Office (688111 CH), a public company listed on the Shanghai Stock Exchange. Mr. Lei received his bachelor's degree in computer science from Wuhan University in July 1991.
Tao Zou	Director and Vice Chairman of the Board	Mr. Zou is a Director and the Vice Chairman of the Board. Mr. Zou joined Kingsoft Group in 1998 and has held various senior positions in Kingsoft Group, including Senior Vice President from Dec 2007 to Dec 2016, Executive Director since Aug 2009, and CEO since Dec 2016. Mr. Zou is also a Director of certain subsidiaries of Kingsoft Group. Mr. Zou is a Director of Seasun Holdings Limited, Director of Cheetah Mobile Inc. (CMCM US), a public company listed on the New York Stock Exchange and Chairman of Kingsoft Office. Mr. Zou also served as a Director of Xunlei Limited (XNET US), a public company listed on the NASDAQ, from Dec 2016 to Apr 2020 and a Director of VNET Group, Inc. (VNET US), which is also a public company listed on the NASDAQ, from Dec 2016 to Dec 2020. Mr. Zou served as CEO of Seasun Holdings until Jan 2018. Mr. Zou received his bachelor's degree in chemistry from Nankai University in Jun 1997.
Yulin Wang	Director and Chief Executive Officer	Mr. Wang is a Director and the CEO of the company. Mr. Wang served as the President from Dec 2012 to Dec 2016. Mr. Wang joined Kingsoft Group in Dec 2012 and served as a Senior Vice President at Kingsoft Group until 2020. Prior to joining Kingsoft Group, Mr. Wang served as the Executive Vice President at Phoenix New Media Limited (FENG US), a public company listed on the New York Stock Exchange, from Mar 2009 to Dec 2012. Mr. Wang received his bachelor's degree of science in chemistry from Nankai University in Jun 1998 and an MBA degree from Tsinghua University in Jan 2008.
Haijian He	Chief Financial Officer	Mr. He is the CFO of the company and is responsible for financial planning, treasury, legal affairs, strategic investments, and investor relations affairs. Prior to joining the company in Jan 2020, Mr. He served as an Executive Director of the TMT group and the mergers and acquisitions group sequentially at Goldman Sachs (Asia) L.L.C. from Sept 2015 to Jan 2020. Mr. He has extensive experience in complex merger and acquisition transactions. Mr. He was an associate of the TMT investment banking division at Bank of America Merrill Lynch from May 2014 to Aug 2015 in Hong Kong, and was a Vice President at Citigroup Global Markets Inc. from Oct 2010 to May 2013 in New York. Mr. He received his bachelor's degree and master's degree in electronic engineering from Southeast University in Jun 2003 and April 2006, respectively, and an MBA from University of Chicago in Mar 2014.
Hangjun Ye	Director	Dr. Ye is a Director of the company since Apr 2021. Dr. Ye has served as a General Manager of the business segment of Xiaomi Corporation since Dec 2021. He joined Xiaomi Corporation in 2012 and served as an engineering Director from Sept 2012 to Feb 2019, a General Manager from Feb 2019 to Feb 2021, and was the Chairman of the technical committee of Xiaomi Corporation from Feb 2021 to Dec 2021. Before joining Xiaomi Corporation, he was a Director of the index download group and search platform department at Tencent Holdings Limited (700 HK) from Oct 2010 to Sep 2012. Prior to that, he was a software engineer at Google Inc. (GOOG US), a public company listed on the NASDAQ, from Feb 2006 to Oct 2010. From Jul 2003 to Feb 2006, he served as a staff research member at IBM (IBM US), a public company listed on the New York Stock Exchange. Dr. Ye received his PhD and bachelor's degree in computer science from Tsinghua University in July 2003 and June 1998, respectively.

Source: Company

CRITICAL FACTORS TO WATCH

Critical Factors

(1) Public cloud market size in China

KC generated c.70% of its revenue from public cloud services in FY21. Cloud penetration in China is still relatively low. Enterprise IT spending only accounted for 1.5% of GDP in China in 2021, compared to 5.3% in the US and 3.2% globally. Public cloud spending was only 12.9% of total enterprise IT spending in China, vs. 16.8% in US and 13.5% globally. China's public cloud market is expected to grow at a CAGR of 26.8% in 2021-2026E to US$109.9bn, according to Gartner. KC's public cloud services revenue will expand with rising cloud penetration in China.

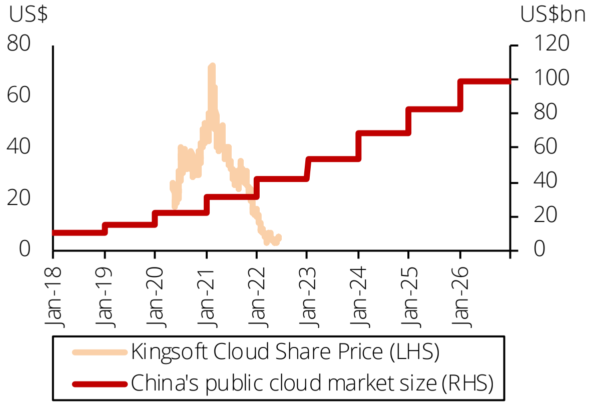
(2) Number of premium customers

KC adopts a premium-customer strategy, focusing on leading enterprises within selected verticals. The total revenue generated from premium customers accounted for more than 90% of total revenue in 2017-2021. The number of premium customers expanded from 113 in 2017 to 597 in 2021, with a revenue CAGR of 65%. An increasing number of premium customers will lead to higher revenue.

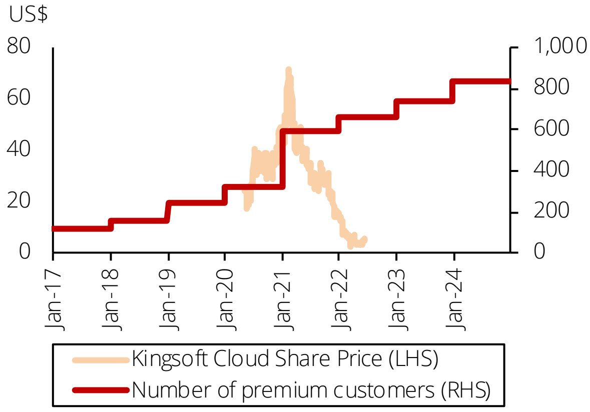
(3) Operating efficiency of cloud service business

KC proactively initiated the downsizing of its CDN services and is focusing on core cloud services (i.e., computing, storage, and enterprise cloud businesses) to adapt to market headwinds. We expect to see improvements in KC's adjusted gross margin and adjusted EBITDA margin, with the effect of the strategic initiatives unfolding, and forecast it will achieve a positive adjusted EBITDA margin in 4Q22. Improving operating efficiency will result in higher profitability.

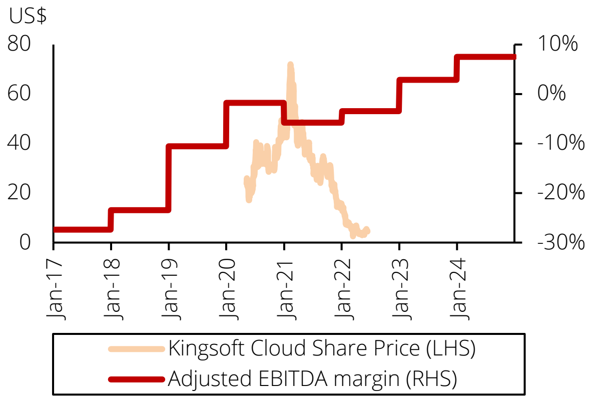
China's public cloud market size



Number of premium customers



Adjusted EBITDA margin



Source: Company, Gartner, Thomson Reuters, DBS HK

Balance Sheet:

Healthy balance sheet. The company has a total debt of Rmb1.8bn and net cash of Rmb1.6bn as at end-FY21. We believe KC could further get financial facilities from banks under the current financial positions or get support from Kingsoft Group, which are adequate to fund its capex in the next few years.

Share Price Drivers:

Stronger-than-expected public cloud demand. The public cloud services in China were negatively impacted by a slowdown in demand from China's internet sector. A stronger-than-expected demand recovery, especially from the internet sector, would be positive for KC.

An increasing number of premium customers. KC adopts a premium-customer strategy, focusing on leading enterprises within selected verticals. The total revenue generated from premium customers accounted for more than 90% of total revenue in 2017-2021. The number of premium customers expanded from 113 in 2017 to 597 in 2021, with a revenue CAGR of 65%. An increasing number of premium customers will lead to higher revenue for KC.

Key Risks:

(1) Intensified market competition, (2) significant slowdown of cloud services demand, and (3) disruptive cybersecurity incidents or attacks.

Environmental, Social, & Governance:

ESG management is essential to the sustainability of KC's business. As a rapidly growing company, KC will continue to improve its ESG governance, build innovative products, set the highest standards of ethics and compliance across its supply chain, attract and retain the best talent, reduce its carbon footprint, improve suppliers' sustainability performance, and deepen its community engagement.

Company Background

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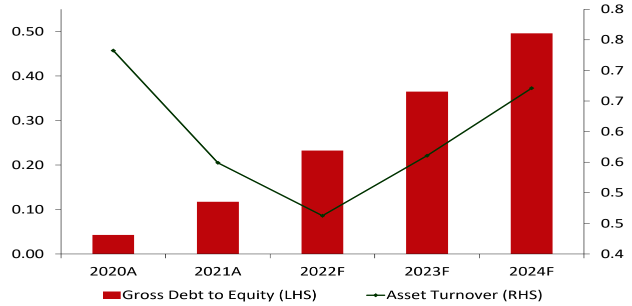
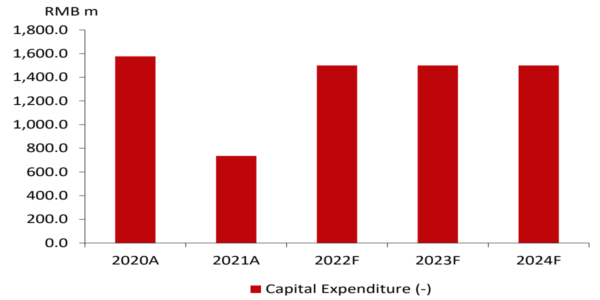
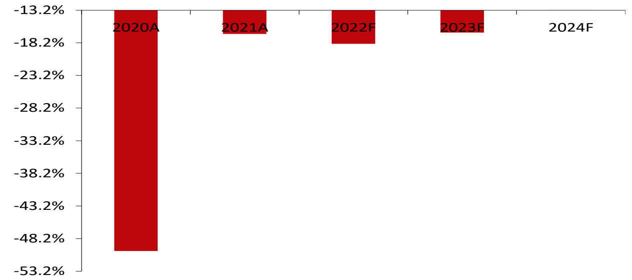
Leverage & Asset Turnover (x)



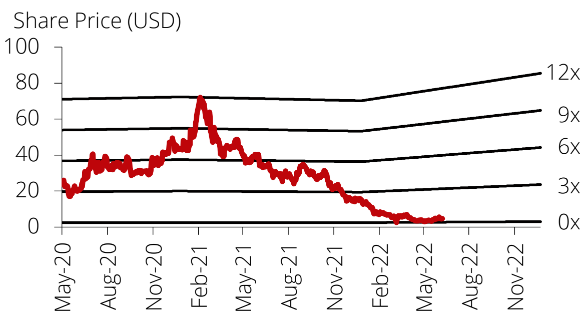
Capital Expenditure



ROE



Forward PS Band



PB Band

Source: Company, DBS HK

Key Assumptions

FY Dec	2020A	2021A	2022F	2023F	2024F
Number of premium customers	322.0	597.0	660.0	740.0	840.0
Average revenues per premium customer (Rmb m)	20.0	14.9	14.5	15.8	17.1
Adjusted EBITDA margin (%)	(1.8)	(5.8)	(3.5)	2.8	7.5

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenues (RMB m)					
Public cloud services	5,167	6,159	5,894	6,687	7,793
Enterprise cloud services	1,373	2,898	3,822	5,151	6,785
Others	38	4	3	3	3
Total	6,577	9,061	9,719	11,841	14,581

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenue	6,577	9,061	9,719	11,841	14,581
Cost of Goods Sold	(6,220)	(8,709)	(9,089)	(10,500)	(12,495)
Gross Profit	357	351	630	1,341	2,086
Other Opng (Exp)/Inc	(1,564)	(2,164)	(2,478)	(2,723)	(2,989)
Operating Profit	(1,207)	(1,812)	(1,848)	(1,382)	(903)
Other Non Opg (Exp)/Inc	192	216	80	50	30
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	68	20	(38)	(114)	(179)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	(947)	(1,576)	(1,806)	(1,446)	(1,052)
Tax	(15)	(16)	(18)	(14)	(11)
Minority Interest	0	3	3	3	3
Preference Dividend	(20)	0	0	0	0
Net Profit	(982)	(1,589)	(1,821)	(1,458)	(1,060)
Net Profit before Except.	(982)	(1,589)	(1,821)	(1,458)	(1,060)
EBITDA	(449)	(957)	(773)	(196)	433
Growth					
Revenue Gth (%)	66.2	37.8	7.3	21.8	23.1
EBITDA Gth (%)	16.7	(113.0)	19.2	74.7	N/A
Opg Profit Gth (%)	5.6	50.1	2.0	(25.2)	(34.7)
Net Profit Gth (%)	15.4	(61.8)	(14.6)	19.9	27.3
Margins & Ratio					
Gross Margins (%)	5.4	3.9	6.5	11.3	14.3
Opg Profit Margin (%)	(18.4)	(20.0)	(19.0)	(11.7)	(6.2)
Net Profit Margin (%)	(14.9)	(17.5)	(18.7)	(12.3)	(7.3)
ROAE (%)	(50.1)	(16.9)	(18.4)	(16.6)	(13.1)
ROA (%)	(10.9)	(9.6)	(8.7)	(6.9)	(4.9)
ROCE (%)	(19.3)	(15.3)	(12.6)	(9.5)	(6.1)
Div Payout Ratio (%)	N/A	N/A	N/A	N/A	N/A
Net Interest Cover (x)	NM	NM	(48.9)	(12.1)	(5.0)

Source: Company, DBS HK

Quarterly Income Statement (RMB m)

FY Dec	1Q2021	2Q2021	3Q2021	4Q2021	1Q2022
Revenue	1,814	2,174	2,414	2,660	2,174
Cost of Goods Sold	(1,697)	(2,055)	(2,325)	(2,632)	(2,094)
Gross Profit	117	118	88	28	80
Other Oper. (Exp)/Inc	(469)	(439)	(557)	(699)	(613)
Operating Profit	(352)	(320)	(469)	(671)	(533)
Other Non Opg (Exp)/Inc	(41)	91	(33)	199	(11)
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	14	12	0	(7)	(13)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	(379)	(217)	(502)	(478)	(556)
Tax	(3)	(3)	(5)	(4)	2
Minority Interest	0	0	(1)	4	2
Net Profit	(382)	(220)	(508)	(478)	(553)
Net profit bef Except.	(382)	(220)	(508)	(478)	(553)
EBITDA	(131)	(131)	(251)	(403)	(245)
Growth (QoQ)					
Revenue Gth (%)	(5.7)	19.9	11.0	10.2	(18.3)
EBITDA Gth (%)	(138.2)	23.5	(90.8)	(60.8)	39.1
Opg Profit Gth (%)	43.5	(9.0)	46.4	43.0	(20.6)
Net Profit Gth (%)	263.5	(42.4)	130.5	(5.9)	15.8
Growth (YoY)					
Revenue Gth (%)	30.4	41.6	39.6	38.3	19.9
EBITDA Gth (%)	(108.2)	37.8	(199.7)	(459.4)	(42.9)
Opg Profit Gth (%)	21.9	(25.5)	93.2	173.4	51.3
Net Profit Gth (%)	(8.8)	47.6	(381.3)	(354.3)	(44.7)
Margins					
Gross Margins (%)	6.4	5.5	3.7	1.0	3.7
Opg Profit Margins (%)	(19.4)	(14.7)	(19.4)	(25.2)	(24.5)
Net Profit Margins (%)	(21.1)	(10.1)	(21.0)	(18.0)	(25.5)

Source: Company, DBS HK

Balance Sheet (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	1,957	2,364	2,739	3,011	3,140
Invts in Associates & JVs	0	0	0	0	0
Other LT Assets	428	6,301	6,353	6,397	6,433
Cash & ST Invts	6,118	6,948	6,037	5,788	6,211
Inventory	0	0	0	0	0
Debtors	2,335	3,571	3,750	3,937	4,134
Other Current Assets	1,092	1,894	2,071	2,160	2,253
Total Assets	11,929	21,078	20,949	21,292	22,170
ST Debt	353	1,348	1,348	1,348	1,348
Creditors	2,903	5,162	5,421	5,692	5,976
Other Current Liab	210	1,005	1,005	1,005	1,005
LT Debt	0	0	1,000	2,000	3,000
Other LT Liabilities	224	2,070	2,070	2,070	2,070
Shareholder's Equity	8,240	10,604	9,220	8,295	7,892
Minority Interests	0	888	885	882	879
Total Cap. & Liab.	11,929	21,078	20,949	21,292	22,170
Non-Cash Wkg. Capital	314	(703)	(605)	(600)	(595)
Net Cash/(Debt)	5,765	5,600	3,688	2,440	1,863
Debtors Turn (avg days)	102.2	119.0	137.5	118.5	101.0
Creditors Turn (avg days)	170.6	187.4	241.0	217.7	190.8
Inventory Turn (avg days)	N/A	N/A	N/A	N/A	N/A
Asset Turnover (x)	0.7	0.5	0.5	0.6	0.7
Current Ratio (x)	2.8	1.7	1.5	1.5	1.5
Quick Ratio (x)	2.4	1.4	1.3	1.2	1.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	446.9	54.5	63.9	44.8	34.5
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	(947)	(1,576)	(1,806)	(1,446)	(1,052)
Dep. & Amort.	758	856	1,075	1,186	1,336
Tax Paid	(15)	(16)	(18)	(14)	(11)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	(17)	(88)	0	0	0
Chg in Wkg.Cap.	(300)	(426)	(99)	(7)	(7)
Other Operating CF	230	541	437	533	656
Net Operating CF	(290)	(709)	(411)	252	923
Capital Exp.(net)	(1,577)	(735)	(1,500)	(1,500)	(1,500)
Other Invts.(net)	(5,608)	(2,568)	91	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	2,870	2,882	0	0	0
Net Investing CF	(4,314)	(422)	(1,409)	(1,500)	(1,500)
Div Paid	0	0	0	0	0
Chg in Gross Debt	178	2,162	1,000	1,000	1,000
Capital Issues	5,810	0	0	0	0
Other Financing CF	136	51	0	0	0
Net Financing CF	6,124	2,212	1,000	1,000	1,000
Currency Adjustments	(118)	(50)	0	0	0
Chg in Cash	1,401	1,032	(820)	(248)	423
Opg CFPS (RMB)	0.06	(1.23)	(1.27)	1.04	3.71
Free CFPS (RMB)	(11.67)	(6.29)	(7.78)	(5.03)	(2.31)

Source: Company, DBS HK

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:
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BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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