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Kingsoft Corporation Limited

金山軟件有限公司

(Continued into the Cayman Islands with limited liability)

(Stock Code: 3888)

Announcement of the Unaudited Results For the Three Months ended March 31, 2011

The Board (“Board”) of directors (the “Directors”) of Kingsoft Corporation Limited (the “Company”) announces the unaudited results of the Company and its subsidiaries (the “Group” or “Kingsoft”) for the three months ended March 31, 2011. These interim results for the three months ended March 31, 2011 have been reviewed by Ernst & Young, the auditors of the Company, and the Company’s audit committee (the “Audit Committee”), comprising a majority of the independent non-executive directors of the Company.

FINANCIAL HIGHLIGHTS

	For the three months ended			YtoY* Change %	QtoQ* Change %
	March 31, 2010 RMB'000 (unaudited)	December 31, 2010 RMB'000 (unaudited)	March 31, 2011 RMB'000 (unaudited)		
Revenue	245,698	250,148	231,276	(6)	(8)
Profit attributable to owners of the parent**	89,741	130,833	66,894	(25)	(49)
	RMB cent (unaudited)	RMB cent (unaudited)	RMB cent (unaudited)		
Basic earnings per share	8.34	11.87	5.97	(28%)	(50%)
Diluted earnings per share	7.75	11.42	5.73	(26%)	(50%)

* YoY change % represents a comparison between the current reporting period and the same period last year. QoQ change % represents the comparison between the current reporting period and the previous period.

** Profit attributable to owners of the parent excluding the effect of share-based compensation cost is RMB74.4 million, RMB138.0 and RMB96.9 million for the three months ended at March 31, 2011, December 31, 2010 and March 31, 2010, respectively. This represents a YoY decrease of 23% and a QoQ decrease of 46%.

OPERATIONAL HIGHLIGHTS

	For the three months ended			YoY change %	QoQ change %
	March 31, 2010	December 31, 2010	March 31, 2011		
Online Games					
Daily Average Peak Concurrent Users	915,212	771,352	684,023	(25)	(11)
Monthly Average Paying Users	1,457,101	1,347,806	1,258,525	(14)	(7)
Monthly Average Revenue per Paying User in (RMB)	36	41	43	19	5
VIP Security Value-added Services					
Daily Average Paying Users	8,416,136	3,671,877*	2,357,540	(72)	(36)
Monthly Average Revenue per Paying User in (RMB)	2.0	3.0	4.9	145	63

* A number of subscribers for online services of Kingsoft Internet Security migrated to be fee-based VIP security value-added service subscribers since we announced the offerings of the free edition on November 10, 2010. As a result of that, most of the traditional off-line subscribers and particularly those of OEMs continued to be our users of the free edition. From the fourth quarter of 2010, daily average paying users represent fee-based VIP security value-added service subscribers.

The Board announces the unaudited results of the Group for the three months ended March 31, 2011.

The unaudited condensed consolidated income statement, unaudited condensed consolidated statement of comprehensive income, unaudited condensed consolidated statement of financial position and unaudited condensed consolidated statement of cash flows of the Group are listed below:

CONDENSED CONSOLIDATED INCOME STATEMENT

	For the three months ended		
	March 31, 2010 RMB'000 (Unaudited)	December 31, 2010 RMB'000 (Unaudited)	March 31, 2011 RMB'000 (Unaudited)
Revenue:			
Entertainment software	161,742	165,048	163,376
Application software	82,233	80,986	64,297
Others	1,723	4,114	3,603
	<u>245,698</u>	<u>250,148</u>	<u>231,276</u>
Cost of revenue	(30,767)	(36,635)	(32,790)
Gross profit	214,931	213,513	198,486
Research and development costs, net of government grants	(55,848)	(87,153)	(74,308)
Selling and distribution costs	(27,352)	(33,518)	(19,845)
Administrative expenses	(28,029)	(28,901)	(28,355)
Share-based compensation costs	(7,122)	(7,182)	(7,532)
Other income and gains	485	4,171	1,185
Other expenses	(739)	(27,243)	(190)
Operating profit	96,326	33,687	69,441
Fair value gain on a financial asset at fair value through profit or loss	—	2,172	—
Gain on disposal of an associate	—	105,189	—
Finance income	6,889	9,862	13,047
Finance costs	—	(348)	(118)
Share of profits and losses of:			
Associates	4,616	3,040	(1,776)
Jointly-controlled entities	(1,762)	(1,522)	(853)
Profit before tax	106,069	152,080	79,741
Income tax expense	(15,855)	(20,793)	(11,481)
Profit for the period	<u>90,214</u>	<u>131,287</u>	<u>68,260</u>
Attributable to:			
Owners of the parent	89,741	130,833	66,894
Non-controlling interests	473	454	1,366
	<u>90,214</u>	<u>131,287</u>	<u>68,260</u>
	RMB (Unaudited)	RMB (Unaudited)	RMB (Unaudited)
Earnings per share attributable to ordinary equity holders of the parent			
Basic	0.0834	0.1187	0.0597
Diluted	0.0775	0.1142	0.0573

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	For the three months ended		
	March 31, 2010 RMB'000 (Unaudited)	December 31 2010 RMB'000 (Unaudited)	March 31, 2011 RMB'000 (Unaudited)
Profit for the period	90,214	131,287	68,260
Other comprehensive income:			
Exchange differences on translation of foreign operations	567	(863)	(1,914)
Other comprehensive income/(loss) for the period, net of tax	567	(863)	(1,914)
Total comprehensive income for the period	<u>90,781</u>	<u>130,424</u>	<u>66,346</u>
Attributable to:			
Owners of the parent	90,304	129,565	65,920
Non-controlling interests	477	859	426
	<u>90,781</u>	<u>130,424</u>	<u>66,346</u>

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	As at March 31, 2011 RMB'000 (Unaudited)	As at December 31, 2010 RMB'000 (Audited)
Non-current assets		
Property, plant and equipment	389,401	392,767
Goodwill	14,559	11,710
Other intangible assets	79,177	69,045
Lease prepayments	44,847	45,083
Long-term prepayments	38,252	—
Investments in associates	1,724	—
Investments in jointly-controlled entities	17,668	18,793
Available-for-sale investment	18,675	18,675
Other financial asset	13,785	13,785
Loan receivables	3,416	3,542
Deferred tax assets	21,515	25,670
Deferred cost	392	461
	<u>643,411</u>	<u>599,531</u>
Current assets		
Inventories	2,431	2,856
Trade receivables	85,754	98,939
Prepayments, deposits and other receivables	94,695	85,125
Deferred cost	1,789	2,205
Cash and cash equivalents	1,682,393	1,656,157
	<u>1,867,062</u>	<u>1,845,282</u>
Current liabilities		
Trade payables	16,795	15,571
Interest-bearing bank loan	101,076	102,108
Dividend payable	191	258
Other payables and accruals	150,343	163,203
Deferred revenue	149,165	161,570
Income tax payable	4,482	3,765
	<u>422,052</u>	<u>446,475</u>
Net current assets	<u>1,445,010</u>	<u>1,398,807</u>
Total assets less current liabilities	<u>2,088,421</u>	<u>1,998,338</u>

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

	As at March 31, 2011 RMB'000 (Unaudited)	As at December 31, 2010 RMB'000 (Audited)
Total assets less current liabilities	<u>2,088,421</u>	<u>1,998,338</u>
Non-current liabilities		
Deferred revenue	25,158	29,139
Deferred tax liabilities	<u>28,840</u>	<u>35,138</u>
	<u>53,998</u>	<u>64,277</u>
Net assets	<u><u>2,034,423</u></u>	<u><u>1,934,061</u></u>
Equity		
Equity attributable to owners of the parent		
Issued capital	4,562	4,527
Share premium	439,366	408,241
Shares held for share award scheme	(55,168)	(57,773)
Statutory reserves	140,057	140,057
Employee share-based reserve	191,342	207,646
Capital reserve	26,257	16,230
Foreign currency translation reserve	(69,599)	(68,625)
Retained earnings	951,105	883,575
Proposed final and special dividends	<u>376,000</u>	<u>376,000</u>
	2,003,922	1,909,878
Non-controlling interests	<u>30,501</u>	<u>24,183</u>
Total equity	<u><u>2,034,423</u></u>	<u><u>1,934,061</u></u>

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	For the three months ended		
	March 31, 2010 RMB'000 (Unaudited)	December 31, 2010 RMB'000 (Unaudited)	March 31, 2011 RMB'000 (Unaudited)
Net cash flows from operating activities	59,594	171,146	61,531
Net cash flows from investing activities	512,770	142,789	191,267
Net cash flows from financing activities	9,393	8,403	20,842
Net increase in cash and cash equivalents	581,757	322,338	273,640
Cash and cash equivalents at beginning of period	405,595	866,782	1,186,711
Effect of foreign exchange rate changes, net	614	(2,409)	(2,672)
Cash and cash equivalents at end of period	987,966	1,186,711	1,457,679
Time deposits with original maturity of over three months when acquired	326,502	469,446	224,714
Cash and cash equivalents as stated in the condensed consolidated statement of financial position	<u>1,314,468</u>	<u>1,656,157</u>	<u>1,682,393</u>

NOTES TO THE UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Corporate Information

The Company was incorporated under the Companies Act of the British Virgin Islands on March 20, 1998 as a tax exempted company with limited liability. On November 15, 2005, the Company was redomiciled to Cayman Islands under the Company Law (2004 revision) of the Cayman Islands. The Company's shares have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since October 9, 2007.

The Group is principally involved in the research, development, operation and distribution of application software products and entertainment software products.

The interim condensed consolidated financial statements were approved and authorised for issue in accordance with a resolution of the board of directors of the Company on May 26, 2011.

2. Basis of Preparation and Significant Accounting Policies

Basis of preparation

The interim condensed consolidated financial statements for the three months ended March 31, 2011 have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* issued by the International Accounting Standards Board.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements as at December 31, 2010.

Significant accounting policies

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended December 31, 2010, which have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), except for the adoption of new Standards and Interpretations applicable to the Group as of January 1, 2011, noted below:

Impact of New and Revised IFRSs

The Group has adopted the following new and revised IFRSs for the first time for the current period's financial statements. The adoption of these new and revised IFRSs has had no significant effect on these financial statements.

IAS 32 (Amendment) *Financial Instruments: Presentation*
Improvements to IFRSs (issued May 2010)

The Group has not early adopted any other standard, interpretation or amendment that was issued but is not yet effective.

MANAGEMENT DISCUSSION AND ANALYSIS

For the Three Months Ended March 31, 2011

Revenue

Revenue decreased by 8% quarter-over-quarter and 6% year-over-year to RMB231.3 million. Revenue from the entertainment and application software business represented 71% and 28%, respectively, of the Group's total revenue for the first quarter of 2011.

Revenue from the entertainment software business decreased by 1% quarter-over-quarter and increased by 1% year-over-year to RMB163.4 million. The quarter-over-quarter decrease was primarily due to the decrease of revenue from Vietnam. The year-over-year increase was mainly attributable to the steady performance of existing games in Mainland China.

Daily average peak concurrent users decreased by 11% quarter-over-quarter and 25% year-over-year to 0.68 million. Monthly average paying users decreased by 7% quarter-over-quarter and 14% year-over-year to 1.26 million. The sequential decrease in daily average peak concurrent users and monthly average paying users was mainly due to the underperformance of Kingsoft games in Vietnam.

The monthly ARPU for the Group's online game increased by 5% quarter-over-quarter and 19% year-over-year to RMB43 in the first quarter of 2011.

Revenue from the application software business decreased by 21% quarter-over-quarter and 22% year-over-year to RMB64.3 million. The decrease from the fourth quarter of 2010 primarily reflected the seasonality of enterprise sales of Kingsoft WPS Office in China. The year-over-year decrease was largely due to the decline in revenue from Kingsoft Internet Security as we launched the free edition in November 2010.

The number of daily average fee-based VIP security value-added service subscribers decreased by 36% quarter-over-quarter and 72% year-over-year to 2.4 million. The decrease primarily reflected impact of the new statistics that paying users from OEM channel has been classified as free-based users since the free edition of Kingsoft Internet Security was launched on November 10, 2010.

Monthly ARPU for fee-based VIP security value-added services increased by 63% quarter-over-quarter and 145% year-over-year to RMB4.9 due to the same reason described above.

Gross Profit and Cost of Revenue

Gross profit decreased by 7% quarter-over-quarter and 8% year-over-year, respectively to RMB198.5 million. The Group's gross profit margin increased by one percentage point quarter-over-quarter and decreased by one percentage point year-over-year to 86%.

Cost of revenue decreased by 10% quarter-over-quarter and increased by 7% year-over-year to RMB32.8 million.

Research and Development ("R&D") Costs

R&D costs, net of government grants, decreased by 15% quarter-over-quarter and increased by 33% year-over-year to RMB74.3 million. This quarter-over-quarter decrease was mainly due to a decline in staff costs as year-end bonuses were accrued in the fourth quarter of 2010. The year-over-year increase was mainly due to the decrease of capitalised R&D costs.

The following table sets forth a breakdown of our R&D costs for the three months ended March 31, 2011, December 31, 2010 and March 31, 2010:

	For the three months ended		
	March 31, 2010 RMB'000 (Unaudited)	December 31 2010 RMB'000 (Unaudited)	March 31, 2011 RMB'000 (Unaudited)
Staff cost	50,018	66,554	52,229
Depreciation & Amortisation	7,297	8,190	8,492
Others	9,482	13,201	11,231
	<u>66,797</u>	<u>87,945</u>	<u>71,952</u>
Less: Capitalised software costs (except share-based compensation costs)	(9,397)	(1,436)	(1,533)
Add: Amortisation of capitalised software costs	1,258	6,854	6,015
Less: Government grants for research and development activities	<u>(2,810)</u>	<u>(6,210)</u>	<u>(2,126)</u>
Total	<u><u>55,848</u></u>	<u><u>87,153</u></u>	<u><u>74,308</u></u>

Selling and Distribution Costs

Selling and distribution costs decreased by 41% quarter-over-quarter and 27% year-over-year to RMB19.8 million. The decline was largely due to the reduced market and promotional expenses as no new game was released in the first quarter of 2011.

Administrative Expenses

Administrative expenses decreased by 2% quarter-over-quarter and increased by 1% year-over-year to RMB28.4 million.

Share-based Compensation Costs

Share-based compensation costs increased by 5% quarter-over-quarter and 6% year-over-year to RMB7.5 million.

Operating Profit Excluding Share-based Compensation Costs

Operating Profit excluding share-based compensation costs increased by 88% quarter-over-quarter and decreased by 26% year-over-year to RMB77.0 million as a result of the combination of above reasons. The margin of operating profit excluding share-based compensation costs increased by seventeen percentage points quarter-over-quarter and decreased by nine percentage points year-over-year to 33%.

Gain on Disposal of an Associate

Gain on disposal of an associate recorded nil, as compared to RMB105.2 million in the fourth quarter of 2010.

Finance Income

Finance income increased by 32% quarter-over-quarter and 89% year-over-year to RMB13.0 million. The increase in finance income was primarily due to the increased interest rate of cash deposits.

Income Tax Expense

Income tax expense decreased by 45% quarter-over-quarter and 28% year-over-year to RMB11.5 million. The Group's effective tax rate (excluding the impact of share-based compensation costs) held flat quarter-over-quarter and decreased by one percentage point year-over-year to 13%.

Profit Attributable to Owners of the Parent

As a result of the reasons discussed above, profit attributable to owners of the parent decreased by 49% quarter-over-quarter and 25% year-over-year to RMB66.9 million.

Profit Attributable to Owners of the Parent before Share-based Compensation Costs

Profit attributable to owners of the parent before share-based compensation costs, which is defined as profit attributable to owners of the parent excluding the effect of share-based compensation costs attributable to owners of the parent, a measure supplementary to the consolidated financial statements presented in accordance with IFRSs.

We believe the profit attributable to owners of the parent before share-based compensation costs will enhance investors' overall understanding of the Group's operating performance. When assessing our operating performance, you should not consider this data in isolation or as a substitute for our profit or any other operating performance measure that is calculated in accordance with IFRSs. In addition, our profit attributable to owners of the parent before share-based compensation costs may not be comparable to similarly titled measures utilised by other companies.

Profit attributable to owners of the parent before share-based compensation costs decreased by 46% quarter-over-quarter and 23% year-over-year to RMB74.4 million. The net profit margin excluding the effect of share-based compensation costs was 32%, 55% and 39% for the three months ended March 31, 2011, December 31, 2010 and March 31, 2010, respectively.

Liquidity and Financial Resource

The Group had a strong cash position towards the end of reporting period. As at March 31, 2011, the group had major financial resources in the forms of cash and cash equivalents, time deposits with initial term of over three months amounting to RMB1,457.7 million, RMB224.7 million, respectively, which totally represented 67% of the Group's total assets.

As at March 31, 2011, the Group's gearing ratio, which represents total liabilities divided by total assets, was 19%, decreased from 21% as at December 31, 2010. As at March 31, 2011, the Group had HKD120.0 million (RMB101.1 million) bank loan. The loan is repayable in full before June 14, 2011 and bears interest of HIBOR plus 1.1%.

Foreign Currency Risk Management

Certain expenses of the Group were denominated in currencies other than the RMB. The Group generated foreign currency revenue either from license sales made in other Asia countries or from its overseas subsidiaries. RMB against USD, HKD, JPY and MYR have been comparatively stable in the past. The Group adopted "natural immunity" method to match the income and payment in foreign currencies by arrange some expenses and expenditures denominated in foreign currencies.

As at March 31, 2011, RMB234.1 million of the Group's financial assets were held in deposits denominated in non-RMB currencies. As there are no cost-effective hedges against the fluctuation of RMB, there is a risk that we may experience a loss as a result of any foreign currency exchange rate fluctuation in connection with our deposits.

Deferred Revenue

Deferred revenue (including current and non-current portion) decreased by 9% quarter-over-quarter and 10% year-over-year to RMB174.3 million as at March 31, 2011. This was primarily due to: (i) the reduced sales of Kingsoft Internet Security product through traditional distribution channel since the free edition of Kingsoft Internet Security was launched, and (ii) the sales promotion of prepaid cards of online games was held in the fourth quarter of 2010.

Net Cash Generated from Operating Activities

Cash generated by the operating activities reflects the Group's profit for the three months periods, as the case may be, as adjusted for non-cash items, such as depreciation, amortisation of capitalised software costs, and share-based compensation costs, as well as the effect of changes in certain items of statement of financial position, such as deferred revenue, other payables and accruals.

Net cash generated by operating activities was RMB61.5 million, RMB171.1 million and RMB59.6 million for the three months ended March 31, 2011, and December 31, 2010 and March 31, 2010, respectively.

Capital Expenditure

Capital expenditures represent cash payments for acquisition of property, land use right, fixed assets and intangible assets. Cash used for capital expenditures was RMB52.1 million, RMB34.9 million and RMB21.2 million for the three months ended March 31, 2011, December 31, 2010 and March 31, 2010, respectively. The increase was primarily due to a partial payment of RMB37.8 million for a land use right in Chengdu in the first quarter of 2011.

Management Comments

Mr. Pak Kwan KAU, our Chairman and CEO commented, "our revenue decreased sequentially in the first quarter of 2011 as no new game title was released and the adverse seasonality for enterprise software business. However, our existing games continued to be stable."

We completed restructuring of Westhouse studios and issued new shares of Kingsoft Internet Security to the key management of the business. These restructuring and shares incentives will support Kingsoft's long-term sustainable growth in this competitive internet industry.

On May 13, 2011, limited close beta testing for the Legend of Moon (「月影傳說」), the masterpiece of Westhouse studios, was launched. Rush team (「熱血戰隊」) is targeting to begin unlimited close beta testing on May 31, 2011. Limited close beta testing for Dream Fantasy (「大話紅樓」) is expected to be launched in June. We also released an expansion pack for JX Online III on May 19, 2011. In the later second quarter of 2011, updated versions of JX Online II and JX world, with enhanced contents and features, are expected to be released. We believe all these would support the growth of revenue of online games.

Kingsoft Internet security continues to expand user base and provide more value-added services. This reflects a smooth transition from subscription model to free-based VAS model.

On May 6, 2011, Kingsoft Kuaipan cloud-based storage service was listed by Zhongguancun Innovation Park Zone as one of the nine cloud-based service platforms. On May 11, 2011, Kingsoft Office Android version was released.

By Order of the Board
Kingsoft Corporation Limited
Pak Kwan KAU
Chairman

Hong Kong, May 26, 2011

As at the date of this announcement, the Executive Directors are Messrs. Pak Kwan KAU, Donghui WANG and Tao ZOU; the Non-executive Directors are Messrs. Jun LEI and Shuen Lung CHEUNG; the Independent Non-Executive Directors are Messrs. Shun Tak WONG, Guangming George LU and Mingming HUANG.