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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: 03888)

Announcement of the Unaudited Results For the Three Months Ended September 30, 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 September 30, 2011. These interim results for the three months ended September 30, 2011 have been reviewed by Ernst & Young, the auditors of the Company, and the Company’s audit committee (the “Audit Committee”), comprising three independent non-executive directors of the Company.

FINANCIAL HIGHLIGHTS

	For the three months ended			YoY* Chang %	QoQ* Chang %
	September 30, 2010 RMB'000 (unaudited)	June 30, 2011 RMB'000 (unaudited)	September 30, 2011 RMB'000 (unaudited)		
Revenue	229,237	262,967	242,707	6	(8)
Profit attributable to owners of the parent **	84,990	103,915	74,894	(12)	(28)
	RMB cent (unaudited)	RMB cent (unaudited)	RMB cent (unaudited)		
Basic earnings per share	7.76	9.27	6.63	(15)	(28)
Diluted earnings per share	7.33	8.93	6.42	(12)	(28)

* 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 RMB76.3 million, RMB107.2 million and RMB98.0 million for the three months ended at September 30, 2011, June 30, 2011 and September 30, 2010, respectively. This represents a YoY decrease of 22% and a QoQ decrease of 29%.

OPERATIONAL HIGHLIGHTS

	For the three months ended			YoY change %	QoQ change %
	September 30, 2010	June 30, 2011	September 30, 2011		
Online Games					
Daily Average Peak Concurrent Users	773,349	653,085	608,607	(21)	(7)
Monthly Average Paying Users	1,325,056	1,250,771	1,186,481	(10)	(5)
Monthly Average Revenue per Paying User (RMB)	39	46	46	18	—

The Board announces the unaudited results of the Group for the three months ended September 30, 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		
	September 30, 2010 <i>RMB'000</i> <i>(Unaudited)</i>	June 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>	September 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>
Revenue:			
Entertainment software	155,203	173,004	165,224
Application software	74,034	89,963	77,483
	<u>229,237</u>	<u>262,967</u>	<u>242,707</u>
Cost of revenue	(32,162)	(34,608)	(36,770)
	<u>197,075</u>	<u>228,359</u>	<u>205,937</u>
Gross profit			
Research and development costs, net of government grants	(70,676)	(61,447)	(79,869)
Selling and distribution costs	(34,732)	(31,176)	(33,546)
Administrative expenses	(27,056)	(26,088)	(31,588)
Share-based compensation costs	(12,998)	(3,699)	(1,977)
Other income and gains	26,722	6,350	28,062
Other expenses	(272)	(2,920)	(5,374)
	<u>78,063</u>	<u>109,379</u>	<u>81,645</u>
Operating profit			
Fair value gain on a financial asset at fair value through profit or loss	11,613	305	—
Finance income	8,698	13,791	16,900
Finance costs	(373)	(806)	(1,227)
Share of profits and losses of:			
Associates	3,603	(815)	(1,288)
Jointly-controlled entities	(1,363)	(625)	(316)
	<u>100,241</u>	<u>121,229</u>	<u>95,714</u>
Profit before tax			
Income tax expense	(15,013)	(15,334)	(11,553)
	<u>85,228</u>	<u>105,895</u>	<u>84,161</u>
Profit for the period			
Attributable to:			
Owners of the parent	84,990	103,915	74,894
Non-controlling interests	238	1,980	9,267
	<u>85,228</u>	<u>105,895</u>	<u>84,161</u>
	<i>RMB</i> <i>(Unaudited)</i>	<i>RMB</i> <i>(Unaudited)</i>	<i>RMB</i> <i>(Unaudited)</i>
Earnings per share attributable to ordinary equity holders of the parent			
Basic	0.0776	0.0927	0.0663
Diluted	0.0733	0.0893	0.0642

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	For the three months ended		
	September 30, 2010 <i>RMB'000</i> <i>(Unaudited)</i>	June 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>	September 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>
Profit for the period	85,228	105,895	84,161
Other comprehensive income:			
Exchange differences on translation of foreign operations	149	499	(2,380)
Other comprehensive income/(loss) for the period, net of tax	149	499	(2,380)
Total comprehensive income for the period	<u>85,377</u>	<u>106,394</u>	<u>81,781</u>
Attributable to:			
Owners of the parent	84,496	104,367	72,822
Non-controlling interests	881	2,027	8,959
	<u>85,377</u>	<u>106,394</u>	<u>81,781</u>

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	As at September 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>	As at December 31, 2010 <i>RMB'000</i> <i>(Audited)</i>
Non-current assets		
Property, plant and equipment	389,287	392,767
Goodwill	14,559	11,710
Other intangible assets	70,280	69,045
Lease prepayments	44,377	45,083
Long-term prepayment	80,109	—
Investments in associates	1,121	—
Investments in jointly-controlled entities	10,718	18,793
Available-for-sale investment	4,990	18,675
Other financial asset	13,785	13,785
Loan receivables	4,220	3,542
Deferred tax assets	24,755	25,670
Deferred cost	134	461
	<u>658,335</u>	<u>599,531</u>
Current assets		
Inventories	3,275	2,856
Trade receivables	92,416	98,939
Due from related parties	136,401	13,607
Prepayments, deposits and other receivables	98,633	71,518
Deferred cost	1,060	2,205
Pledged deposit	85,000	—
Cash and cash equivalents	1,835,259	1,656,157
	<u>2,252,044</u>	<u>1,845,282</u>
Current liabilities		
Trade payables	14,682	15,571
Interest-bearing bank loans	348,665	102,108
Dividend payable	834	258
Other payables and accruals	168,199	163,203
Deferred revenue	170,311	161,570
Tax payable	9,250	3,765
	<u>711,941</u>	<u>446,475</u>
Net current assets	<u>1,540,103</u>	<u>1,398,807</u>
Total assets less current liabilities	<u>2,198,438</u>	<u>1,998,338</u>

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

	As at September 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>	As at December 31, 2010 <i>RMB'000</i> <i>(Audited)</i>
Non-current liabilities		
Deferred revenue	16,627	29,139
Deferred tax liabilities	25,478	35,138
	<u>42,105</u>	<u>64,277</u>
Net assets	<u><u>2,156,333</u></u>	<u><u>1,934,061</u></u>
Equity		
Equity attributable to owners of the parent		
Issued capital	4,676	4,527
Share premium account	532,864	408,241
Shares held for share award scheme	(72,497)	(57,773)
Statutory reserves	140,057	140,057
Employee share-based reserve	145,431	207,646
Capital reserve	252,206	16,230
Foreign currency translation reserve	(71,219)	(68,625)
Retained earnings	1,129,278	883,575
Proposed final and special dividends	—	376,000
	<u>2,060,796</u>	<u>1,909,878</u>
Non-controlling interests	<u>95,537</u>	<u>24,183</u>
Total equity	<u><u>2,156,333</u></u>	<u><u>1,934,061</u></u>

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	For the three months ended		
	September 30, 2010 <i>RMB'000</i> <i>(Unaudited)</i>	June 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>	September 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>
Net cash flows from operating activities	63,104	129,728	111,047
Net cash flows used in investing activities	(378,848)	(622,403)	(185,795)
Net cash flows from/(used in) financing activities	965	(78,420)	141,644
	<hr/>	<hr/>	<hr/>
Net increase/(decrease) in cash and cash equivalents	(314,779)	(571,095)	66,896
Cash and cash equivalents at beginning of period	1,180,801	1,457,679	888,751
Effect of foreign exchange rate changes, net	760	2,167	(1,700)
	<hr/>	<hr/>	<hr/>
Cash and cash equivalents at end of period	866,782	888,751	953,947
Time deposits with original maturity of over three months when acquired	560,055	760,850	881,312
	<hr/>	<hr/>	<hr/>
Cash and cash equivalents as stated in the condensed consolidated statement of financial position	<u>1,426,837</u>	<u>1,649,601</u>	<u>1,835,259</u>

NOTES TO THE UNAUDITED 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 the provision of online game services.

The interim condensed consolidated financial statements for the three months ended September 30, 2011 were approved and authorised for issue in accordance with a resolution of the board of directors of the Company on November 24, 2011.

2. Basis of preparation and significant accounting policies

Basis of preparation

The interim condensed consolidated financial statements for the three months ended September 30, 2011 have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* issued by the International Accounting Standards Board ("IASB").

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 SEPTEMBER 30, 2011

Revenue

Revenue for the third quarter of 2011 decreased 8% quarter-over-quarter and increased 6% year-over-year to RMB242.7 million. Revenue from the entertainment and application software business represented 68% and 32%, respectively, of the Group's total revenue.

Revenue from the entertainment software business for the third quarter of 2011 decreased 4% quarter-over-quarter and increased 6% year-over-year to RMB165.2 million. The quarter-over-quarter decrease was mainly due to the adverse impact of summer vacation on our existing games.

Daily average peak concurrent users for the Company's online games for the third quarter of 2011 decreased 7% quarter-over-quarter and 21% year-over-year to 0.61 million. Monthly average paying users for the Company's online game decreased 5% quarter-over-quarter and 10% year-over-year to 1.19 million. The monthly ARPU for the Company's online game held flat quarter-over-quarter and increased 18% year-over-year to RMB46 in the third quarter of 2011.

Revenue from the application software business for the third quarter of 2011 decreased 14% quarter-over-quarter and increased 5% year-over-year to RMB77.5 million. The sequential decrease of revenue was largely due to the seasonal fluctuation of enterprise sales of Kingsoft WPS Office.

Gross Profit and Cost of Revenue

Gross profit for the third quarter of 2011 decreased 10% quarter-over-quarter and increased 4% year-over-year to RMB205.9 million. The Group's gross profit margin decreased by two percentage points quarter-over-quarter and decreased by one percentage point year-over-year to 85%.

Cost of revenue for the third quarter of 2011 increased 6% quarter-over-quarter and 14% year-over-year to RMB36.8 million. The increase in cost of revenue was primarily due to the higher server and bandwidth costs associated with the increasing user base of Kingsoft Internet Security.

Research and Development (“R&D”) Costs

R&D costs, net of government grants, for the third quarter of 2011 increased 30% quarter-over-quarter and 13% year-over-year to RMB79.9 million. The increase in R&D costs was mainly due to (i) the increased R&D investment in mobile application; (ii) increased staff benefits; and (iii) reduced subsidy income recognised relating to specialized project “HEGAOJI (核高基)”.

The following table sets forth a breakdown of our research and development costs for three months ended September 30, 2011, June 30, 2011 and September 30, 2010:

	For the three months ended		
	September 30, 2010 <i>RMB'000</i> <i>(Unaudited)</i>	June 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>	September 30, 2011 <i>RMB'000</i> <i>(Unaudited)</i>
Staff costs	51,257	52,444	62,882
Depreciation & Amortisation	6,087	8,504	8,378
Others	11,316	8,423	11,569
	<u>68,660</u>	<u>69,371</u>	<u>82,829</u>
Less: capitalised software costs (except share-based compensation costs)	(1,342)	(1,453)	(1,389)
Add: amortisation of capitalised software costs	6,855	4,665	1,487
Less: government grants for research and development activities	(3,497)	(11,136)	(3,058)
Total	<u><u>70,676</u></u>	<u><u>61,447</u></u>	<u><u>79,869</u></u>

Selling and Distribution Costs

Selling and distribution costs for the third quarter of 2011 increased 8% quarter-over-quarter and decreased 3% year-over-year to RMB33.5 million. The quarter-over-quarter increase was mainly attributable to moderate promotion of Cheetah Version of Kingsoft Antivirus.

Administrative Expenses

Administrative expenses for the third quarter of 2011 increased 21% quarter-over-quarter and 17% year-over-year to RMB31.6 million. This quarter-over-quarter increase was mainly attributable to the increased staff costs.

Share-based Compensation Costs

Share-based compensation costs for the third quarter of 2011 decreased by 47% quarter-over-quarter and 85% year-over-year to RMB2.0 million.

Other Income and Gains

Other income and gains for the third quarter of 2011 increased 342% quarter-over-quarter and 5% year-over-year to RMB28.1 million. The sequential increase was primarily attributable to financial incentives to our PRC subsidiaries from the local government.

Operating Profit Excluding Share-based Compensation Costs

Operating Profit excluding share-based compensation costs for the third quarter of 2011 decreased by 26% quarter-over-quarter and 8% year-over-year to RMB83.6 million as a result of the combination of above reasons. The margin of operating profit excluding share-based compensation costs for the third quarter of 2011 decreased by nine percentage points quarter-over-quarter and six percentage points year-over-year to 34%.

Finance Income

Finance income for the third quarter of 2011 increased 23% quarter-over-quarter and 94% year-over-year to RMB16.9 million.

Income Tax Expense

Income tax expense decreased 25% quarter-over-quarter and 23% year-over-year to RMB11.6 million. The Group's effective tax rate (excluding the impact of share-based compensation costs) held flat quarter-over-quarter and decreased one percentage point year-over-year to 12%.

Profit Attributable to Owners of the Parent

As a result of the reasons discussed above, profit attributable to owners of the parent for the third quarter of 2011 decreased 28% quarter-over-quarter and 12% year-over-year to RMB74.9 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 utilized by other companies.

Profit attributable to owners of the parent before share-based compensation costs for the third quarter of 2011 decreased 29% quarter-over-quarter and 22% year-over-year to RMB76.3 million. The net profit margin excluding the effect of share-based compensation costs was 31%, 41% and 43% for the three months ended September 30, 2011, June 30, 2011 and September 30, 2010, respectively.

Liquidity and Financial Resource

The Group had a strong cash position towards the end of reporting period. As at September 30, 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 RMB953.9 million, RMB881.3 million, respectively, which totally represented 63% of the Group's total assets.

As at September 30, 2011, the Group's gearing ratio, which represents total liabilities divided by total assets, was 26%, increased from 21% as at December 31, 2010. As at September 30, the Group had USD42.0 million (equivalent of RMB267.1 million) and HKD100.0 million (equivalent of RMB81.6 million) bank loans, which are repayable in full in June 2012.

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 September 30, 2011, RMB193.4 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 and investments.

Deferred Revenue

Deferred revenue (including current and non-current portion) as at September 30, 2011 increased 3% quarter-over-quarter and decreased 1% year-over-year to RMB186.9 million. The increase was primarily due to the increased sales of prepaid cards of online games in the third quarter of 2011.

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 RMB111.0 million, RMB129.7 million and RMB63.1 million for the three months ended September 30, 2011, and June 30, 2011 and September 30, 2010, respectively.

Capital Expenditure

Capital expenditures represent cash payments for acquisition of properties, land use rights, fixed assets and other intangible assets. Cash used for capital expenditures was RMB61.1 million, RMB32.9 million and RMB14.0 million for the three months ended September 30, 2011, June 30, 2011 and September 30, 2010, respectively. The increase was primarily due to a balance payment for the acquisition of a land use right in Chengdu.

Management Comments

“The past quarter was a challenging one for Kingsoft as we chose to extend the testing cycle of our new games and devote more resources to fine tuning our major new game ‘Legend of Moon’,” commented Mr. Hongjiang Zhang, our CEO, “While we are targeting at achieving long-term sustainable growth of new games, the slowdown of new releases did fluctuate our revenue. This, coupled with the adverse impact of summer vacation in China, seasonal fluctuation of sales of Kingsoft Office and sizable R&D investments in mobile application, resulted in the decrease of our bottom line in short term.”

The third quarter continued to show relative stable performance of our existing games. The release of the expansion pack “New JX Online III” of our 3D MMO JX Online III in May has been successful and raised the game’s user base significantly. To enhance the existing games further, we released expansion packs “The Grand Master” (一代宗師) of JX Online III and “LMFJ” (龍門飛劍) of JX World Online in November 2011. The limited open beta testing of our new game title “Legend of Moon” was started in September, 2011 and has gained positive feedback from users. To expand the testing, three groups of new servers were added in November. As a major 2D online game in 2011, Legend of Moon was featured by its “extreme group offense skills” (極限群攻技能) and a number of innovative designs.

The active users base of Kingsoft Internet Security has increased significantly since the launch of the cloud-based Cheetah Version of Kingsoft Antivirus 2012. The launch of “Guarantee Indemnity (敢賠)” plan in August provided additional assurance for online e-commerce users.

Benefiting from the improved copyright protection in China, Kingsoft WPS Office continued to receive strong sales orders both from enterprise customers and government agencies. The mobile versions of Kingsoft WPS Office in Chinese, Japanese and English were issued in September and have received positive feedbacks from users.

“In consideration of the adverse impact of summer vacation, we are satisfied with the performance of our existing games. The fast growing Kingsoft Internet Security has positioned us the solid number two in China consumer PC and internet security market. The performance of WPS has demonstrated the great opportunity of office market in China and overseas.” commented Mr. Jun LEI, Chairman of the Group, “Taking account of long term interests of shareholders, we shall further focus on our products and make sure major new products are thoroughly tested before they are brought to end users. Also, I am very happy that Dr. Hongjiang ZHANG and Mr. Shun Tak WONG have joined in Kingsoft. The new senior management shall focus on establishing the long-term strategies of Kingsoft in the coming months. I am confident that we will lead Kingsoft to great success in the future and bring good return to our shareholders on long run.”

By Order of the Board
Kingsoft Corporation Limited
Jun LEI
Chairman

Hong Kong, November 24, 2011

As at the date of this announcement, the Executive Director is Mr. Tao ZOU; the Non-executive Directors are Messrs. Jun LEI, Pak Kwan KAU and Chi Ping LAU; the Independent Non-Executive Directors are Messrs. Tat Joel, CHANG, Guangming George LU and Chuan WANG.