

9 July 2018

United States

## EQUITIES

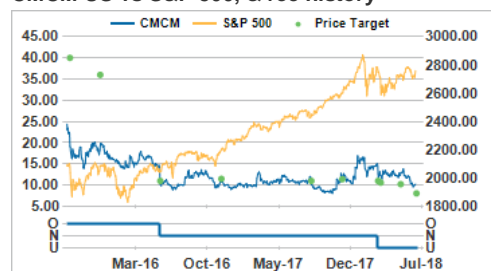
CMCM US Underperform  
Price (at 10:23, 09 Jul 2018 GMT) US\$10.28

Valuation	US\$	8.00-8.10
- PER		
12-month target	US\$	8.06
12-month TSR	%	-21.6
GICS sector	Software & Services	
Market cap	US\$m	1,469
30-day avg turnover	US\$m	8.4
Number shares on issue	m	142.9

## Investment fundamentals

Year end 31 Dec		2017A	2018E	2019E	2020E
Revenue	m	4,974.8	4,676.5	5,163.0	5,623.1
EBIT	m	719.3	527.6	646.9	907.7
Reported profit	m	1,348.2	428.1	460.8	677.3
Adjusted profit	m	1,621.6	480.4	528.9	751.4
Gross cashflow	m	1,801.6	619.1	667.6	890.1
CFPS	Rmb	12.61	4.24	4.53	5.99
CFPS growth	%	258.7	-66.4	6.9	32.2
PGCFPS	x	5.4	16.1	15.1	11.4
EPS adj	Rmb	11.33	3.29	3.59	5.06
EPS adj growth	%	402.5	-71.0	9.2	40.9
PER adj	x	6.0	20.8	19.0	13.5
Total DPS	Rmb	0.00	0.00	0.00	0.00
Total div yield	%	0.0	0.0	0.0	0.0
ROA	%	11.1	6.9	7.6	9.1
ROE	%	41.5	9.8	9.9	11.9
EV/EBITDA	x	10.6	14.5	12.3	9.3
Net debt/equity	%	-9.4	-6.2	-11.3	-18.3
P/BV	x	2.0	2.0	1.7	1.4

## CMCM US vs S&amp;P 500, &amp; rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, July 2018

(all figures in Rmb unless noted, TP in USD)

## Analysts

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## Cheetah Mobile

### Not out of the woods yet

## Key points

- ▶ Cut 18-19E earnings by 7-18% on weaker outlook in utility and content businesses.
- ▶ AI the longer-term driver yet only 2% revenue contribution in 2018E.
- ▶ Reiterate Underperform and lower TP to US\$8.06, 22% potential downside.

## Event

- We cut our 18-19E earnings forecast by 7-18% on the softer-than-expected mobile entertainment business, coupled with continuing weakness in utility business. Also notably, CMCM has the most overseas exposure (two-thirds of its 2017) among our internet coverage.

## Impact

- **Expect a soft 2Q18.** We expect a 12% YoY decline (8% QoQ drop) in CMCM's sales in 2Q18 to Rmb1,057m, on the 16% decline in utility business and 7% decline in mobile entertainment. We expect 8% YoY growth in adjusted net income to Rmb102m but that is mainly thanks to the trim in marketing expense and the lower RD expense on disposal of News Republic.
- **Utility business remains under pressure.** The impact from Google/Facebook's policy change is still ongoing, after they banned certain formats of ads in Dec'17 and mid-2017 and each deprived ~6% of its total revenue. This is in addition to the continuing decline in PC utility business, which is now ~10% of total revenue. The decline of the above is partially offset by the domestic mobile utility business. Overall, we estimate a 12% sales decline in its utility business in 2018.
- **Revise down mobile game revenue growth on delayed launch.** Management guided down its casual mobile game business given certain delays for new titles and weaker-than-expected monetization for existing ones. We now forecast an 11% growth in 2018 for this business (from 35% prior). The company also slowed its investment in live broadcasting business amid keen competition, and is seeing no sales growth for this year.
- **AI is the long-term driver.** AI remains a long-term strategic product for CMCM. After the joint launch of five robotics products with OrionStar in March, the mgmt expects to see some sales contribution from the hardware such as Cheetah speaker in 2H18, albeit with modest margin pressure. We forecast other business (including AI) to contribute 2% of its sales in 2018.

## Earnings and target price revision

- Lower 18-19E adj. earnings by 7-18%. We lower our TP (0.7x PEG based) to US\$8.06 (from US\$10.23).

## Price catalyst

- 12-month price target: US\$8.06 based on a PER methodology.
- Catalyst: 2Q18 results in late August.

## Action and recommendation

- Reiterate UP. The net cash position (1Q18) is 34% as % of its market cap.

Fig 1 2Q18 results preview

(RMB mn)	2Q17	1Q18	2Q18E	QoQ	YoY	BBG	diff
<b>Total revenue</b>	<b>1,202</b>	<b>1,145</b>	<b>1,057</b>	<b>-8%</b>	<b>-12%</b>	<b>1,078</b>	<b>-2%</b>
Utility products and related services	820	745	693	-7%	-16%		
Mobile entertainment	371	392	347	-12%	-7%		
COGS	461	391	374	-4%	-19%		
<b>Gross profit</b>	<b>740</b>	<b>754</b>	<b>683</b>	<b>-9%</b>	<b>-8%</b>	<b>693</b>	<b>-1%</b>
Operating expense	680	629	596	-5%	-12%		
R&D	167	147	147	0%	-12%		
S&M	413	391	372	-5%	-10%		
G&A	100	91	77	-15%	-23%		
Operating income	60	125	87	-30%	44%		
Non-GAAP operating income	85	134	98	-27%	16%		
GAAP net income	70	70	91	30%	29%	93	-2%
<b>Non-GAAP net income</b>	<b>94</b>	<b>79</b>	<b>102</b>	<b>29%</b>	<b>8%</b>	<b>100</b>	<b>1%</b>
GPM	62%	66%	65%	(121 bps)	300 bps	64%	
Non-GAAP OPM	7.0%	11.7%	9.2%	(242 bps)	221 bps	0.0%	
Non-GAAP NPM	7.9%	6.9%	9.6%	272 bps	175 bps	9.3%	

\*only one BBG estimate for 2Q18; Source: Macquarie Research, Bloomberg, Company data, June 2018

Fig 2 Estimate revisions

## New estimates (RMB mn)

	2Q18E	2018E	2019E
Net revenues	1,057	4,676	5,163
Gross profit	683	3,060	3,379
Adjusted operating profit	98	528	647
Adjusted net profit	102	480	529
Adjusted diluted EPS (RMB)	0.70	3.29	3.59
Adjusted NPM	10%	10%	10%

## Old estimates (RMB mn)

	2Q18E	2018E	2019E
Net revenues	1,075	4,884	5,737
Gross profit	694	3,196	3,754
Adjusted operating profit	97	574	729
Adjusted net profit	99	516	645
Adjusted diluted EPS (RMB)	0.68	3.54	4.38
Adjusted NPM	9%	11%	11%

## Estimates revision

	2Q18E	2018E	2019E
Net revenues	-2%	-4%	-10%
Gross profit	-2%	-4%	-10%
Adjusted operating profit	1%	-8%	-11%
Adjusted net profit	3%	-7%	-18%
Adjusted diluted EPS (RMB)	3%	-7%	-18%
Adjusted NPM	42 bps	(30 bps)	(99 bps)

Source: Company data, Macquarie Research, July 2018

Fig 3 Key assumptions and drivers

RMB (mn)	2016A	2017A	2018E	2019E	2020E
Total revenue	4,565	4,975	4,676	5,163	5,623
Utility products and related services	3,871	3,440	3,015	3,195	3,357
Content driven products	204	870	873	957	1,156
Mobile game	527	626	697	839	906
Others	0	39	92	172	204
<b>As % of revenue</b>					
Utility products and related services	85%	69%	64%	62%	60%
Content driven products	4%	17%	19%	19%	21%
Mobile game	12%	13%	15%	16%	16%
Others	0%	1%	2%	3%	4%
<b>YoY growth %</b>					
Total revenue		9%	-6%	10%	9%
Utility products and related services		-11%	-12%	6%	5%
Content driven products		326%	0%	10%	21%
Mobile game		19%	11%	20%	8%
Others					

Source: Macquarie Research, July 2018

Fig 4 Ratios

YE 31 December		2015	2016	2017	2018E	2019E	2020E	17-18E	18E-19E	18E-21E
<b>Per ADR</b>										
EPADS, basic	(USD)	0.20	-0.08	1.49	0.47	0.50	0.73	-69%	7%	24%
EPADS, diluted	(USD)	0.19	-0.08	1.45	0.45	0.48	0.70	-69%	7%	24%
EPADS, non-GAAP	(USD)									
diluted		0.53	0.33	0.62	0.51	0.55	0.78	-18%	9%	23%
BVADS, diluted	(USD)	3.07	3.06	4.63	5.31	6.12	7.18	15%	15%	17%
Net cash per ADR	(USD)	2.04	1.86	3.95	2.62	3.44	4.62	-34%	31%	32%
Avg. ADR, basic	(mn)	138	139	139	141	142	144	1%	1%	1%
Avg. ADR, diluted	(mn)	143	142	143	146	147	149	2%	1%	1%
<b>Value</b>										
EV/Revenue	X	2.1 x	1.8 x	1.5 x	1.6 x	1.5 x	1.4 x	--	--	--
EV/EBITDA	X	27.2 x	145.7 x	12.9 x	12.9 x	10.7 x	7.7 x	--	--	--
EV/FCF	X	5.4 x	128.6 x	19.6 x	9.9 x	10.9 x	7.5 x	--	--	--
Price/ Sales	X	2.6 x	2.2 x	1.9 x	2.1 x	1.9 x	1.7 x	--	--	--
Price/ Book	X	3.3 x	3.4 x	2.2 x	1.9 x	1.7 x	1.4 x	--	--	--
P/E (basic)	X	51.9 x	-123.0 x	6.9 x	22.0 x	20.6 x	14.2 x	--	--	--
Non-GAAP P/E (diluted)	X	19.4 x	31.5 x	16.6 x	20.3 x	18.6 x	13.2 x	--	--	--
Non-GAAP P/E (diluted), ex cash	X	15.6 x	25.8 x	10.2 x	15.1 x	12.4 x	7.3 x	--	--	--
<b>Profit &amp; loss</b>										
Net revenue	(USD mn)	569	657	764	719	794	865	-6%	10%	10%
EBITDA	(USD mn)	43	8	92	91	111	153	-1%	21%	25%
Operating profit	(USD mn)	21	-14	68	73	89	128	7%	22%	28%
Pretax profit	(USD mn)	36	-10	220	72	87	126	-67%	20%	28%
Adjusted Net income	(USD mn)	76	46	88	74	81	116	-16%	10%	24%
<b>Profitability</b>										
Gross margin	%	75%	66%	64%	65%	65%	65%	123 bps	(0 bps)	(1 bps)
EBITDA margin	%	8%	1%	12%	13%	14%	18%	68 bps	125 bps	610 bps
Operating margin	%	4%	-2%	9%	10%	11%	15%	120 bps	105 bps	584 bps
Adjusted net margin	%	13%	7%	12%	10%	10%	13%	(127 bps)	(3 bps)	446 bps
<b>Cash Flow</b>										
Operating Cash Flow	(USD mn)	146	57	95	40	128	177	-58%	217%	74%
Free Cash Flow :	(USD mn)	219	9	60	120	108	158	99%	-9%	17%
+EBIT*(1-t)	(USD mn)	15	-12	66	70	76	109	6%	9%	23%
+SBC	(USD mn)	49	44	11	8	10	11			
+D&A	(USD mn)	23	22	23	18	22	25	-22%	19%	13%
+Capex & Investments	(USD mn)	-24	-23	-24	-24	-24	-24	0%	0%	0%
+Change in NWC	(USD mn)	156	-23	-16	48	25	37	-396%	-49%	-1%
<b>Yield</b>										
Dividend yield	%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0 bps	0 bps	0 bps
FCF yield	%	15.2%	0.6%	4.2%	8.2%	7.3%	10.6%	398 bps	(84 bps)	453 bps
Earnings yield	%	2.0%	-0.8%	14.8%	4.7%	5.0%	7.2%	(1017 bps)	31 bps	414 bps
<b>Balance sheet</b>										
Net debt (cash)	(USD mn)	-293	-264	-563	-382	-507	-686	-32%	33%	33%
Net debt/ equity	(USD mn)	cash	cash	cash	cash	cash	cash	--	--	--
Shareholders' equity	(USD mn)	441	434	660	775	901	1,066	18%	16%	18%
<b>Efficiency</b>										
ROE (average)	%	19%	11%	16%	10%	10%	12%	(542 bps)	(59 bps)	178 bps
ROA (average)	%	12%	6%	9%	6%	6%	8%	(258 bps)	(7 bps)	148 bps
ROIC (average)	%	5%	-3%	10%	9%	10%	12%	(126 bps)	108 bps	361 bps

Source: Company data, Macquarie Research, July 2018

Fig 5 Financials

YE December	2015	2016	2017	2018E	2019E	2020E	17-18E	18E-19E	18E-21E
<b>Consolidated income statement (RMB mn)</b>									
Revenue	3,684	4,565	4,975	4,676	5,163	5,623	-6%	10%	10%
Gross profit	2,749	3,021	3,195	3,060	3,379	3,680	-4%	10%	10%
GP margin	75%	66%	64%	65%	65%	65%	123 bps	(0 bps)	(1 bps)
SG&A (inc.SBC)	2,930	3,424	2,822	2,637	2,868	2,920	-7%	9%	6%
Operating profit	135	(97)	446	475	579	834	7%	22%	103%
OP margin	4%	-2%	9%	10%	11%	15%	120 bps	105 bps	584 bps
Adjusted net income	492	321	574	480	529	751	-16%	10%	24%
GAAP net income	177	(81)	1,348	428	461	677	-68%	8%	25%
EBITDA	281	56	598	594	721	993	6%	10%	14%
EBITDA margin	8%	1%	12%	13%	14%	18%	68 bps	125 bps	610 bps
<b>Consolidated balance sheet (RMB mn)</b>									
<b>Current assets</b>	<b>3,088</b>	<b>3,172</b>	<b>5,397</b>	<b>5,652</b>	<b>6,777</b>	<b>8,259</b>	5%	20%	21%
Cash and cash equivalents	1,999	1,579	2,408	2,619	3,434	4,600	9%	31%	32%
Short-term investments	29	361	1,396	1,535	1,689	1,858	10%	10%	10%
Accounts receivables	633	601	621	584	645	702	-6%	10%	10%
Prepayments and other current assets	360	571	918	863	953	1,038	-6%	10%	10%
Due from related parties	61	44	54	51	56	61	-6%	10%	10%
Deferred tax assets	5	16	-	-	-	-	--	--	--
<b>Non-current assets</b>	<b>1,839</b>	<b>2,369</b>	<b>2,052</b>	<b>2,245</b>	<b>2,414</b>	<b>2,566</b>	9%	8%	6%
<b>Total asset</b>	<b>4,927</b>	<b>5,541</b>	<b>7,449</b>	<b>7,897</b>	<b>9,191</b>	<b>10,825</b>	6%	16%	17%
<b>Current liabilities</b>	<b>1,721</b>	<b>2,066</b>	<b>2,166</b>	<b>2,521</b>	<b>2,990</b>	<b>3,548</b>	16%	19%	19%
Accounts payable	138	195	165	149	165	180	-9%	10%	10%
Accrued expenses and other current liabilities	1,439	1,739	1,869	2,243	2,691	3,229	20%	20%	20%
Redemption right liabilities	0	-	-	-	-	-	--	--	--
Deferred revenue	56	49	-	-	-	-	--	--	--
Due to related parties	57	71	82	82	82	82	0%	0%	0%
<b>Total non-current liabilities</b>	<b>192</b>	<b>274</b>	<b>128</b>	<b>125</b>	<b>130</b>	<b>135</b>	-3%	4%	4%
Bank loans	11	119	-	-	-	-	-	-	-
Deferred tax liabilities	99	112	73	73	73	73	0%	0%	0%
Other liabilities	74	36	55	51	57	62	-6%	10%	10%
<b>Total liabilities</b>	<b>1,913</b>	<b>2,340</b>	<b>2,294</b>	<b>2,646</b>	<b>3,120</b>	<b>3,683</b>	15%	18%	18%
<b>Total shareholders' equity</b>	<b>2,854</b>	<b>3,012</b>	<b>4,293</b>	<b>5,038</b>	<b>5,858</b>	<b>6,929</b>	17%	16%	18%
<b>Non-controlling interests</b>	160	189	213	213	213	213	-	-	-
<b>Total liabilities, mezzanine equity and equity</b>	<b>4,927</b>	<b>5,541</b>	<b>7,449</b>	<b>7,897</b>	<b>9,191</b>	<b>10,825</b>	6%	16%	17%
<b>Consolidated cash flow statement (RMB mn)</b>									
<b>Operating cash flow</b>	<b>948</b>	<b>398</b>	<b>621</b>	<b>262</b>	<b>830</b>	<b>1,153</b>	-58%	217%	74%
Net income (loss)	492	321	574	480	529	751	-16%	10%	24%
Depreciation and Amortisation	147	154	153	119	142	160	-22%	19%	13%
Change in net working capital	1,011	(159)	(106)	312	160	241	-395%	-49%	-1%
<b>Investing cash flow</b>	<b>(341)</b>	<b>(983)</b>	<b>(152)</b>	<b>(312)</b>	<b>(312)</b>	<b>(312)</b>	105%	0%	0%
Capex	(157)	(157)	(157)	(157)	(157)	(157)	0%	0%	0%
Purchase of intangible assets	(155)	(481)	155	(155)	(155)	(155)	-200%	0%	0%
Others	(486)	(152)	(150)	-	-	-	-	-	-
<b>Financing cash flow</b>	<b>82</b>	<b>103</b>	<b>505</b>	<b>261</b>	<b>296</b>	<b>325</b>	-48%	13%	11%
Capital	557	337	(58)	264	291	320	-557%	10%	10%
Debt increase (decrease)	95	82	(146)	(3)	5	5	-98%	-263%	-224%
<b>Net change in cash</b>	<b>689</b>	<b>(482)</b>	<b>974</b>	<b>212</b>	<b>815</b>	<b>1,166</b>	-78%	285%	89%
Effect of exchange rate changes on cash and cash equivalents	39	50	(68)	-	-	-	-	-	-
Net increase in cash and cash equivalents	727	(432)	906	212	815	1,166	-77%	285%	89%
Cash and cash equivalents at the beginning of the year	1,116	1,843	1,411	2,407	2,619	3,434	71%	9%	24%
<b>Cash and cash equivalents at the end of the year</b>	<b>1,843</b>	<b>1,411</b>	<b>2,407</b>	<b>2,619</b>	<b>3,434</b>	<b>4,600</b>	9%	31%	32%

Source: Company data, Macquarie Research, July 2018

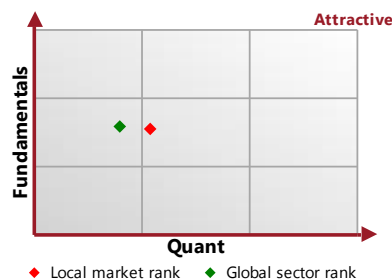
## Macquarie Quant View

The quant model currently holds a reasonably negative view on Cheetah Mobile. The strongest style exposure is Profitability, indicating this stock is efficiently converting investments to earnings; proxied by ratios like ROE or ROA. The weakest style exposure is Price Momentum, indicating this stock has had medium to long term returns which often persist into the future.

### 603/818

Global rank in  
Software & Services

% of BUY recommendations 0% (0/3)  
Number of Price Target downgrades 0  
Number of Price Target upgrades 0

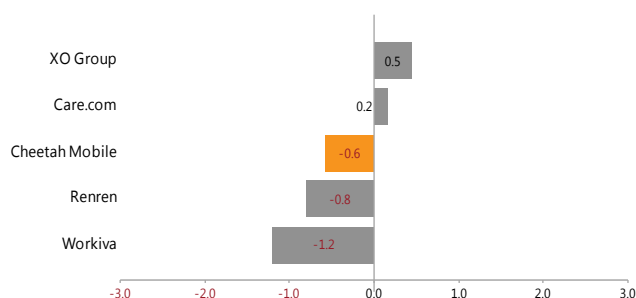


Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.

Two rankings: Local market (China) and Global sector (Software & Services)

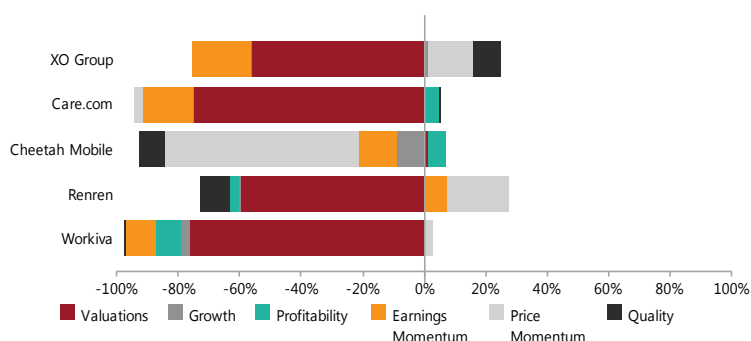
## Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



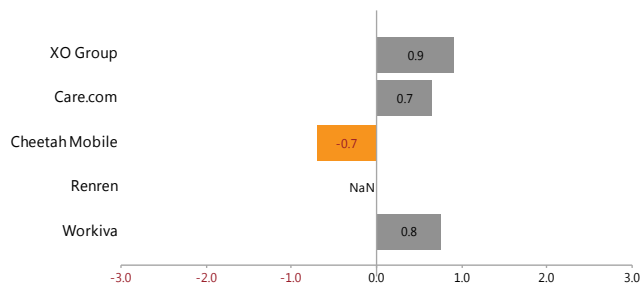
## Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



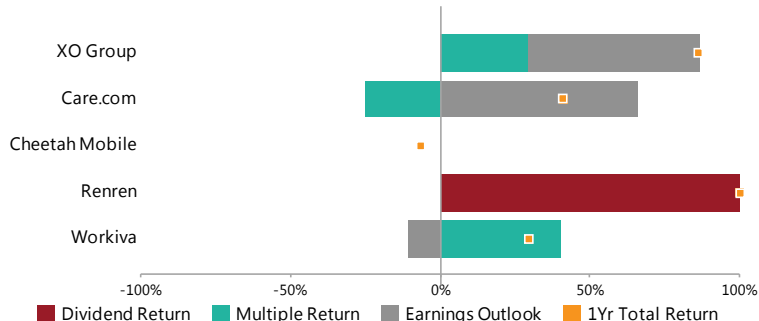
## Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



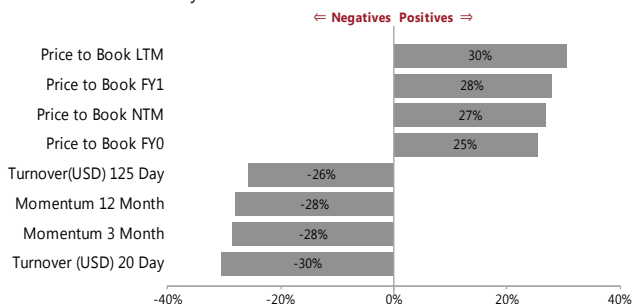
## Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



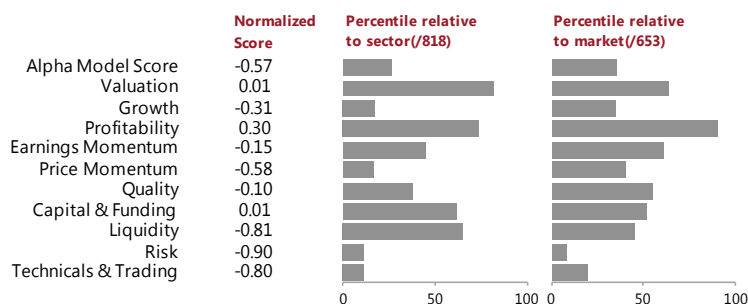
## What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



## How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Research. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group ([cpg@macquarie.com](mailto:cpg@macquarie.com))

## Important disclosures:

## Recommendation definitions

## Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return  
 Neutral – return within 3% of benchmark return  
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

## Macquarie – Asia/Europe

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

## Macquarie – South Africa

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

## Macquarie - Canada

Outperform – return >5% in excess of benchmark return  
 Neutral – return within 5% of benchmark return  
 Underperform – return >5% below benchmark return

## Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
 Neutral (Hold) – return within 5% of Russell 3000 index return  
 Underperform (Sell) – return >5% below Russell 3000 index return

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Asia/Australian/NZ/Canada stocks only

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / efpowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

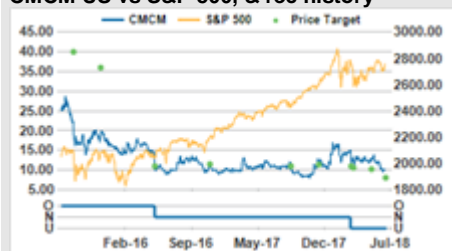
\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 30 June 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	52.87%	61.26%	48.86%	47.54%	69.86%	46.61%	(for global coverage by Macquarie, 3.51% of stocks followed are investment banking clients)
Neutral	34.10%	27.25%	36.36%	46.72%	21.92%	43.22%	(for global coverage by Macquarie, 2.10% of stocks followed are investment banking clients)
Underperform	13.03%	11.49%	14.77%	5.74%	8.22%	10.17%	(for global coverage by Macquarie, 0.00% of stocks followed are investment banking clients)

## CMCM US vs S&amp;P 500, &amp; rec history



(all figures in USD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, July 2018

## 12-month target price methodology

CMCM US: US\$8.06 based on a PER methodology

## Company-specific disclosures:

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Date	Stock Code (BBG code)	Recommendation	Target Price
22-May-2018	CMCM US	Underperform	US\$10.23
22-Mar-2018	CMCM US	Underperform	US\$10.60
14-Mar-2018	CMCM US	Underperform	US\$11.00
25-Nov-2017	CMCM US	Neutral	US\$11.40
23-Aug-2017	CMCM US	Neutral	US\$11.00
22-Nov-2016	CMCM US	Neutral	US\$11.50
20-May-2016	CMCM US	Neutral	US\$11.00
19-Nov-2015	CMCM US	Outperform	US\$36.00
19-Aug-2015	CMCM US	Outperform	US\$40.00

## Target price risk disclosures:

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