

China Technology

EQUITY: TECHNOLOGY

Key takeaways from Corporate Day 2023

Quick Note

We hosted China Cloud/Software Corporate Day 2023 on 10-11 Jan. During the two-day conference, we held meetings with SenseTime (20 HK, Not Rated), Chinasoft (354 HK, Buy) and Kingsoft Office (688111 CH, Neutral). Below are key takeaways:

SenseTime: AI (artificial intelligence) leader further engages in business development

While 2022 turned out to be a challenging year for the business considering COVID-19 situation as well as macro environment, SenseTime continued to develop its business and further enhance its market capabilities in providing AI software, solutions and AI as a service.

As of 1H22, the company has 5k+ employees while two-thirds are R&D staff. SenseTime has accumulated more than 50k AI models and more than 10k IP (intellectual property) And the computing power in its AIDC (artificial intelligence data center) has reached 2.5 exaFLOPS (while 1.0 exaFLOPS is available for providing AI as a service to customers). While still facing some impact from COVID during 2H22, management expressed that it will continue to proactively develop its AI business, targeting at extending its computing power to 5 exaFLOPS in its AIDC by end-2023.

Within its four business sectors, namely smart city, smart business, smart life, and smart auto, the company sees business for smart life, and smart auto now playing a more important role in its overall business, and believes that these two segments will contribute more to total revenue in the coming few years.

For its smart auto business, SenseAuto (a brand of auto related business for SenseTime) now has about 1k employees with accumulated 30+OEM clients and has already signed for 60+ car models using SenseTime AI models/solutions. Looking forward, SenseTime will continue to focus on business opportunities within cockpit and smart driving segments, and also leverage from its knowhow in smart city projects. Meanwhile, its 2.5 exaFLOPS within its AIDC should help customers to train their autonomous driving algorithms, especially for the vision (camera) system.

On the potential impact from US-China tension on AI chips, management commented that it has adequate inventory on hand for AI chips while Nvidia's (NVDA US) A800 could be an alternative if more needed. Therefore, the company expects limited impact in the short-term. Meanwhile, within SenseTime's AIDC, about 15% (260+ PTOPS) are now using China domestic AI chips, in line with the independent and controllable technology trend. Therefore, from another angle, local substitution might help on improving computing power for local AI companies in the long run.

Chinasoft: expecting potential recovery trend into 2023

Considering the overall macro environment in the China market in 2022, COVID impact as well as industry slowdown including its key customer Huawei (unlisted), the company expressed that 2H22 might be the toughest half-year period for it and the entire IT industry. On the other hand, management expects to see a recovery trend for both top line and margins into 2023, should both macro environment and situation for its customers improving.

According to management, given the independent and controllable technology trend in the China market, Chinasoft will try to ride on such opportunities and enjoy healthy growth on rising demand, especially for its OpenHarmony-related business. Chinasoft is also focusing on business opportunities within the smart vehicle segment, by providing OS

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(operating system) based on OpenHarmony in near future.

Within its cornerstone business, management commented that its software factory should eventually help the company to achieve cost reduction and higher efficiency with fewer people involved. And it will be an ongoing change in the next few years, which will not happen within a short period of time. For its cloud business, with more SOEs (state-owned enterprise) embracing cloud infrastructure, the company expects a solid outlook for such business demand into 2023.

Kingsoft Office: user experience optimization to be the key for its long-term growth

Regarding short-term impact from COVID situation, management commented that there might be some negative impact on the institution subscription business into 4Q22 as some projects might be delayed. Meanwhile, the individual subscription business should remain intact and KO's staff can generally work from home in Beijing, hence limited impact on other business segments.

On the demand related to independent and controllable technology trend, KO has separated this into business from government and from SOEs. Demand from government is categorized as licensing business model and the company believes such demand is generally policy-driven, therefore currently difficult to predict the outlook into 2023. Meanwhile, for demand arising from SOEs, management categorized those businesses into institution subscription business while it provides both office software based on Linux system (again related to independent and controllable technology trend) as well as products based on Windows system. As the actual penetration for such products within SOEs is still relatively low, KO targets to further improve the penetration of such subscription model in the future.

For its individual subscription business, due to some weakness in the demand for smartphone and PCs in 2022, the company's MAU (monthly active user) remained stabilized in the past two quarters. Looking forward, KO targets at further improving its pay ratio and ARPU (average revenue per unit) level, leveraging from its advantage compared to Microsoft (MSFT US) in the China market, by providing some unique functions and upgraded membership system.

Looking at the market after reopening in China, management expects to see demand rising from middle-to-small size enterprises or SOEs while demand from large-size SOEs and individuals should remain relatively stable. Overall, while the institution business (both licensing and subscription) might be more or less driven by policies, the company will continue to focus on product upgrades and user experience optimization to further develop its business and be prepared when demand arises. On 2023 marketing and R&D budget, management believes that the company will try to maintain a reasonable expense ratio as a percentage of revenue into the new year.

Appendix A-1

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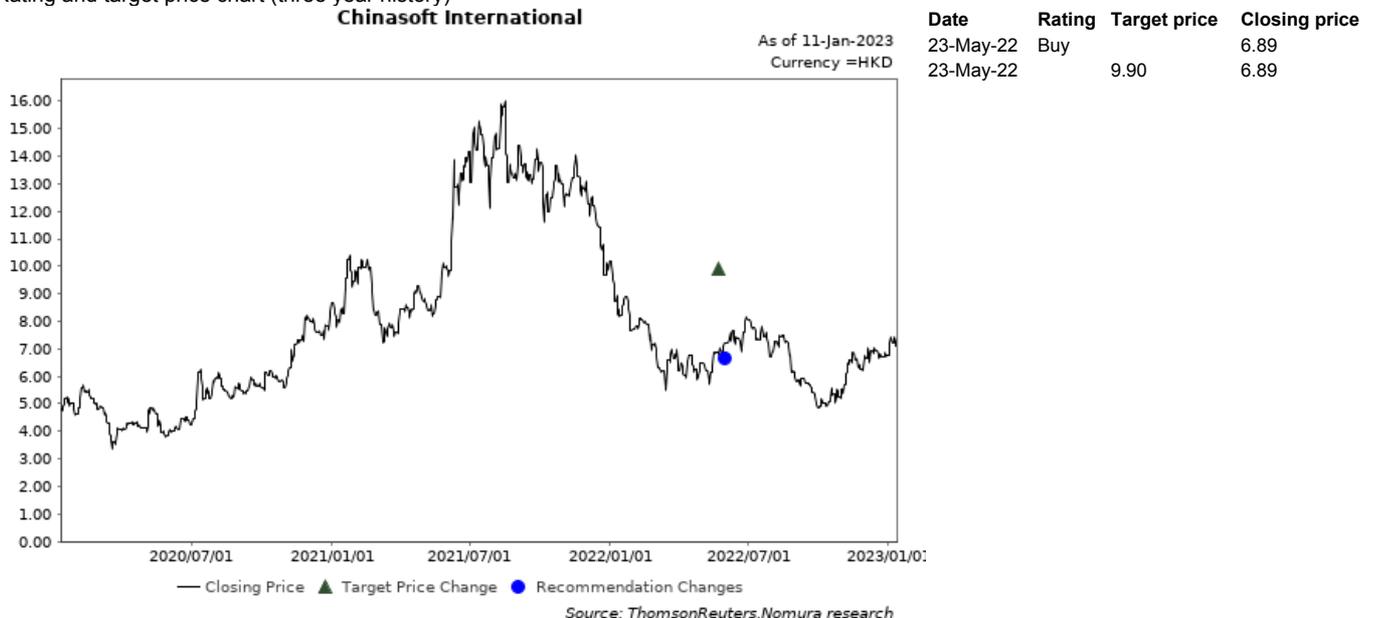
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Chinasoft International	354 HK	HKD 7.12	11-Jan-2023	Buy	N/A	
Kingsoft Office	688111 CH	CNY 267.56	11-Jan-2023	Neutral	N/A	

Chinasoft International (354 HK)

HKD 7.12 (11-Jan-2023) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of HKD9.90 is based on 16x 2023F EPS of CNY0.53. The target multiple we use is above its historical average, which is below our 2021-24F earnings CAGR of 21% for Chinasoft. The benchmark index for this stock is HSI Index.

Risks that may impede the achievement of the target price Downside risks include: 1) slower-than-expected cornerstone business expansion with key customers due to the loss of wallet share or slower growth rate from key customers; 2) slower-than-expected development of cloud intelligent business due to market competition or self-development issue; and 3) lower-than-expected operating efficiency which has a negative impact on the company's profitability.

Kingsoft Office (688111 CH)

CNY 267.56 (11-Jan-2023) Neutral (Sector rating: N/A)

Rating and target price chart (three year history)

Kingsoft Office

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of CNY256.00 is based on DCF valuation method. Our DCF valuation assumes a WACC of 8.7%, market risk premium of 8.7% and terminal growth rate of 3.5% while we discounted back cash flow to 2023 as a 12-month forward valuation. Our TP implies a 30x/23x P/S 2022F/2023F. The benchmark index for this stock is CSI 300.

Risks that may impede the achievement of the target price Downside risks include: 1) weaker-than-expected demand from independent and controllable technology initiative in the China market; 2) slower-than-expected development of the subscription business; and 3) increasing competition for the collaboration business in the SaaS market. Upside risks include: 1) stronger-than-expected demand from independent and controllable technology initiative in the China market and 2) faster-than-expected development of the subscription business.

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