

SenseTime (20 HK)

Focus on Generative AI business development

SenseTime announced 1H23 financial results on 28 Aug: total revenue resumed positive YoY growth of 1% and reached RMB1.43bn; adjusted net loss narrowed by 7% YoY to RMB2.39bn, in line with our estimate. SenseTime optimized its business strategy: reduce exposure to non-core Smart City business and focus on the development of its Generative AI business, revenue of which has already accounted for 20% of 1H23 total revenue. We expect the adjustment will refuel total revenue to grow 18% YoY and unleash operating leverage in 2H23E. In view of the adjustment to Smart City business, we lower FY23-25E revenue forecast by 10-13%; but we also expect narrower adjusted net loss of RMB3.5/3.0/2.2bn (previous: RMB3.8/3.3/2.6bn) in FY23-25E on more stringent opex control (especially on R&D-related staff costs). Our target price of HK\$2.30 (previous: HK\$3.45) is based on 13x FY23 EV/sales, which is on par with the average EV/Sales of Global AI peers. Maintain BUY.

- **Robust Smart Business growth on ramp-up of Generative AI.** Smart Business revenue grew by 50% YoY to RMB854mn in 1H23 (60% of total revenue), primarily driven by the ramp-up of Generative AI business. Smart Life revenue was RMB312mn (+7% YoY) and accounted for 22% of total revenue in 1H23, boosted by incremental revenue contribution from AIGC products like SenseChat & SenseMirage, and the mass production of ISP chips. Smart City remains under pressure, with revenue down by 58% YoY to RMB184mn in 1H23 (13% of total revenue), as SenseTime adjusted its strategy to focus on quality clients and optimize revenue structure. Smart Auto revenue dropped by 31% YoY to RMB84mn in 1H23 (6% of total revenue), as certain customers shift their collaboration mode from pure R&D service to pre-installed products. We expect Smart Auto revenue to resume YoY growth in 2H23E, driven by strong pre-installed production business.
- **Generative AI evolves as the key growth driver.** With the launch of Generative AI product suite based on SenseCore AI infrastructure, SenseTime's Generative AI business revenue achieved robust YoY growth of 670% and represented 20% of total revenue in 1H23 (2022: 10%); and management expects its revenue contribution will further rise to 40% by FY25E, as the company continues to diversify AI service offerings and accelerate commercialization. SenseTime owns one of the most solid AI infrastructures in China, with the number of its GPUs already rising to 30,000 (vs 27,000 in Mar) and computational capacity scaling to 6 ExaFLOPS in August (vs 5 ExaFLOPS in Mar).
- **Maintain BUY.** SenseTime GPM decreased by 21pct YoY to 45.3% in 1H23, mainly due to early-stage investment in AI infrastructure. We expect the Generative AI business GPM will gradually improve and drive overall GPM back to c.50% in the long term, as the commercialization improves. We see SenseTime is well-positioned to capture the Generative AI opportunities in China, given its 1) solid AI infrastructure; 2) strong development experience and know-how in large model and; 3) abundant use cases in different verticals. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	4,700	3,809	4,380	5,704	7,208
YoY growth (%)	36.4	(19.0)	15.0	30.2	26.4
EPS (Reported) (RMB cents)	(173.64)	(18.93)	(13.43)	(11.21)	(8.94)
Consensus EPS (RMB cents)	(173.64)	(18.93)	(10.73)	(8.49)	(5.94)
EV/Sales (x)	3.9	7.3	7.0	5.8	4.8
ROE (%)	(316.7)	(19.9)	(16.4)	(15.6)	(14.5)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$2.30
(Previous TP)	HK\$3.45)
Up/Downside	53.2%
Current Price	HK\$1.50

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Stock Data

Mkt Cap (HK\$ mn)	47,937.7
Avg 3 mths t/o (HK\$ mn)	420.9
52w High/Low (HK\$)	3.33/1.17
Total Issued Shares (mn)	31958.5

Source: FactSet

Shareholding Structure

ESOP	14.9%
Softbank	14.8%

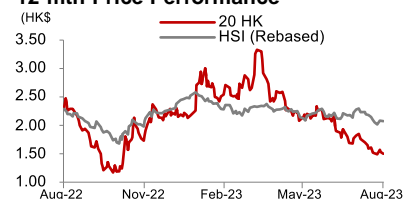
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-17.6%	-9.5%
3-mth	-28.6%	-26.9%
6-mth	-40.5%	-35.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: SenseTime: forecast revision

RMBm	2023E			2024E			2025E		
	New	Old	%Diff	New	Old	%Diff	New	Old	%Diff
Sales	4,380	4,980	-12%	5,704	6,355	-10%	7,208	8,267	-13%
Gross profit	2,095	2,867	-27%	2,744	3,531	-22%	3,641	4,611	-21%
Operating profit	-3,963	-4,298	NA	-3,620	-3,776	NA	-2,779	-3,003	NA
Adj. EBITDA	-2,772	-3,097	NA	-2,071	-2,425	NA	-1,039	-1,496	NA
Adj. Net profit	-3,511	-3,796	NA	-3,039	-3,314	NA	-2,232	-2,570	NA
EPS	-0.13	-0.13	NA	-0.11	-0.11	NA	-0.09	-0.09	NA
Margins									
GM	47.8%	57.6%	-973 bps	48.1%	55.6%	-746 bps	50.5%	55.8%	-527 bps
OPM	-90.5%	-86.3%	-418 bps	-63.5%	-59.4%	-404 bps	-38.6%	-36.3%	-223 bps
Adj. EBITDA margin	-63.3%	-62.2%	-111 bps	-36.3%	-38.2%	184 bps	-14.4%	-18.1%	369 bps
Net margin	-80.2%	-86.3%	609 bps	-53.3%	-60.2%	691 bps	-31.0%	-37.5%	655 bps

Source: CMBIGM estimates

Figure 2: SenseTime: CMBIGM estimates vs consensus

RMBm	2023E			2024E			2025E		
	CMBI	Street	Diff	CMBI	Street	Diff	CMBI	Street	Diff
Sales	4,380	5,200	-16%	5,704	7,282	-22%	7,208	10,179	-29%
Gross profit	2,095	3,123	-33%	2,744	4,260	-36%	3,641	5,769	-37%
Operating profit	-3,963	-4,257	NA	-3,620	-2,817	NA	-2,779	-1,988	NA
Adj. EBITDA	-2,772	-2,109	NA	-2,071	-1,398	NA	-1,039	-288	NA
Adj. Net profit	-3,511	-3,537	NA	-3,039	-2,938	NA	-2,232	-2,141	NA
EPS	-0.13	-0.11	NA	-0.11	-0.08	NA	-0.09	-0.06	NA
Margins									
GM	47.8%	60.1%	-1224 bps	48.1%	58.5%	-1040 bps	50.5%	56.7%	-617 bps
OPM	-90.5%	-81.9%	-863 bps	-63.5%	-38.7%	-2477 bps	-38.6%	-19.5%	-1902 bps
Adj. EBITDA margin	-63.3%	-40.6%	-2274 bps	-36.3%	-19.2%	-1711 bps	-14.4%	-2.8%	-1158 bps
Net margin	-80.2%	-68.0%	-1214 bps	-53.3%	-40.3%	-1292 bps	-31.0%	-21.0%	-993 bps

Source: Bloomberg, CMBIGM estimates

Valuation

Figure 3: Global AI companies: valuation comparison

Companies	Ticker	Price (Local)	2023E	PS(x) 2024E	2025E	EV/Sales (x)			Rev CAGR 2023E-2025E
China									
Arcsoft	688088 CH	33.6	21.0	17.1	13.4	18.1	14.7	11.5	27%
Cloudwalk	688327 CH	14.7	18.8	12.9	9.1	17.7	12.2	8.6	13%
Ainnovation	2121 HK	18.4	4.0	2.5	1.6	3.3	2.1	1.3	55%
Hikvision	002415 CH	33.3	3.6	3.2	2.8	3.3	2.9	2.5	12%
Dahua	002236 CH	19.4	1.9	1.7	1.4	1.9	1.7	1.4	14%
		Mean	9.8	7.5	5.7	8.9	6.7	5.1	
Overseas									
Palantir	PLTR US	14.1	14.1	11.9	9.8	13.7	11.5	9.5	19%
UiPath	PATH US	14.6	8.2	6.6	5.6	8.5	6.9	5.8	19%
C3.ai	AI US	28.8	13.0	11.2	9.3	10.3	8.9	7.5	13%
Nvidia	NVDA US	471.6	42.2	21.9	15.0	41.8	21.7	14.9	42%
Ambarella	AMBA US	69.3	8.2	10.5	8.2	7.6	9.6	7.6	1%
		Mean	17.1	12.4	9.6	16.4	11.7	9.0	
		Global Mean	13.5	9.9	7.6	12.6	9.2	7.1	

Source: Bloomberg, CMBIGM

Note: data are as of 28 Aug 2023

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	3,446	4,700	3,809	4,380	5,704	7,208
Cost of goods sold	(1,014)	(1,423)	(1,266)	(2,285)	(2,961)	(3,568)
Gross profit	2,432	3,278	2,542	2,095	2,744	3,641
Operating expenses	(4,580)	(6,594)	(6,483)	(6,058)	(6,364)	(6,419)
Selling expense	(537)	(682)	(901)	(910)	(961)	(968)
Admin expense	(1,590)	(2,298)	(1,568)	(1,575)	(1,641)	(1,659)
R&D expense	(2,454)	(3,614)	(4,014)	(3,573)	(3,761)	(3,792)
Operating profit	(2,148)	(3,316)	(3,941)	(3,963)	(3,620)	(2,779)
Interest income	175	188	261	197	173	167
Interest expense	(113)	(34)	(55)	(90)	(130)	(190)
Other income/expense	(10,234)	(13,979)	(2,597)	(852)	(354)	(334)
Pre-tax profit	(12,319)	(17,142)	(6,333)	(4,709)	(3,931)	(3,136)
Income tax	161	(36)	240	178	149	119
After tax profit	(12,158)	(17,177)	(6,093)	(4,531)	(3,782)	(3,017)
Minority interest	(0)	(37)	(48)	(36)	(30)	(24)
Net profit	(12,158)	(17,140)	(6,045)	(4,495)	(3,752)	(2,994)
Adjusted net profit	(878)	(1,381)	(4,688)	(3,476)	(3,009)	(2,208)

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	31,726	28,084	21,524	19,770	20,098	20,136
Cash & equivalents	11,428	16,530	7,963	6,952	7,136	7,127
Account receivables	4,584	5,776	6,072	4,944	4,752	4,475
Inventories	716	496	617	1,002	1,338	1,662
Financial assets at FVTPL	0	273	632	632	632	632
Other current assets	14,977	4,991	6,213	6,213	6,213	6,213
Contract assets	22	19	27	27	27	27
Non-current assets	6,753	8,860	15,903	16,301	16,510	16,560
PP&E	1,906	2,909	6,999	7,375	7,563	7,597
Right-of-use assets	336	432	315	315	315	315
Intangibles	108	225	333	356	376	392
Other non-current assets	4,402	5,294	8,256	8,256	8,256	8,256
Total assets	38,479	36,944	37,427	36,071	36,608	36,696
Current liabilities	9,822	2,795	3,323	4,893	6,908	8,378
Short-term borrowings	594	0	321	386	668	866
Account payables	1,724	2,290	2,473	3,947	5,608	6,797
Other current liabilities	7,744	177	460	525	806	1,005
Contract liabilities	244	172	208	239	311	393
Non-current liabilities	49,589	2,162	5,090	5,300	7,602	9,239
Long-term borrowings	423	340	2,907	4,501	6,778	8,385
Bond payables	66	45	12	12	12	12
Other non-current liabilities	49,100	1,778	2,171	787	813	842
Total liabilities	59,411	4,957	8,413	10,193	14,511	17,617
Share capital	0	0	0	0	0	0
Retained earnings	(21,713)	(40,149)	(46,194)	(50,689)	(54,441)	(57,434)
Other reserves	645	72,042	75,164	76,560	76,560	76,560
Total shareholders equity	(21,068)	31,893	28,970	25,871	22,119	19,126
Minority interest	136	95	44	8	(22)	(46)
Total equity and liabilities	38,479	36,944	37,427	36,071	36,608	36,696

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	(12,319)	(17,142)	(6,333)	(4,709)	(3,931)	(3,136)
Depreciation & amortization	570	658	968	1,024	1,159	1,289
Tax paid	(13)	(38)	(11)	178	149	119
Change in working capital	(1,290)	(2,026)	(101)	2,259	1,616	1,254
Others	11,823	16,062	2,393	(106)	(43)	23
Net cash from operations	(1,229)	(2,485)	(3,084)	(1,354)	(1,050)	(452)
Investing						
Capital expenditure	(1,306)	(1,266)	(5,167)	(1,422)	(1,368)	(1,339)
Others	(5,765)	(283)	(4,131)	197	173	167
Net cash from investing	(7,070)	(1,548)	(9,298)	(1,226)	(1,194)	(1,172)
Financing						
Dividend paid	0	0	0	0	0	0
Net borrowings	13,327	4,769	3,389	1,659	2,558	1,806
Proceeds from share issues	0	4,643	0	0	0	0
Others	(141)	(34)	(60)	(90)	(130)	(190)
Net cash from financing	13,186	9,378	3,329	1,569	2,428	1,616
Net change in cash						
Cash at the beginning of the year	6,673	11,428	16,530	7,963	6,952	7,136
Exchange difference	(131)	(243)	487	0	0	0
Cash at the end of the year	11,428	16,530	7,963	6,952	7,136	7,127
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	13.9%	36.4%	(19.0%)	15.0%	30.2%	26.4%
Gross profit	41.5%	34.8%	(22.4%)	(17.6%)	31.0%	32.7%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	70.6%	69.7%	66.8%	47.8%	48.1%	50.5%
Operating margin	(62.3%)	(70.6%)	(103.5%)	(90.5%)	(63.5%)	(38.6%)
Adj. net profit margin	(25.5%)	(29.4%)	(123.1%)	(79.3%)	(52.7%)	(30.6%)
Return on equity (ROE)	na	(316.7%)	(19.9%)	(16.4%)	(15.6%)	(14.5%)
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	na	(0.5)	(0.1)	(0.1)	0.0	0.1
Current ratio (x)	3.2	10.0	6.5	4.0	2.9	2.4
Receivable turnover days	293.5	319.3	493.6	345.5	241.9	169.3
Inventory turnover days	206.2	155.4	160.5	160.0	165.0	170.0
Payable turnover days	227.8	128.9	189.9	175.3	200.9	206.9
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/B	na	4.1	3.8	1.8	2.1	2.4
EV	22,993.5	18,335.0	27,937.4	30,607.6	32,981.8	34,795.8
EV/Sales	6.7	3.9	7.3	7.0	5.8	4.8

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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