
Hesai Group
Third Quarter 2023 Earnings Conference Call Script

***Operator:** Hello, ladies and gentlemen. Thank you for standing by for Hesai Group's third quarter 2023 earnings conference call. At this time, all participants are in listen-only mode. Please note that today's conference call is being recorded. I will now turn the call over to our first speaker today, Yuanting Shi, the Company's Investor Relations Director. Please go ahead.*

Yuanting Shi:

Thank you, operator. Hello, everyone, and thank you for joining Hesai Group's third quarter 2023 earnings conference call. Our earnings release is now available on our IR website at investor.hesaitech.com as well as via newswire services.

Today, you'll hear from our CEO, Dr. David Li, who will start the call with an overview of our recent updates. Next, our Global CFO, Mr. Louis Hsieh, will address our financial results before we open the call for questions. We also invite participants to view the slide deck we have prepared for part of our discussion today. This deck is available on our IR website at investor.hesaitech.com in the "financials-filings quarterly-results" section.

Before we continue, I refer you to the safe harbor statement in our earnings press release, which applies to this call, as we will make forward-looking statements. Please also note that the Company will discuss non-GAAP measures today, which are more thoroughly explained and reconciled to the most comparable measures reported under GAAP in our earnings release and SEC filings.

With that, I'm pleased to turn over the call to our CEO, Dr. David Li. David, please go ahead.

David Li:

Thank you, Yuanting, and thank you, everyone, for joining our call today.

We are delighted to report that our third quarter financial performance surpassed our expectations. Our quarterly net revenues rose to reach another record high, and our total deliveries doubled year-over-year. Both metrics outperformed our initial projections. We are also thrilled to announce that we successfully maintained a gross margin of over 30% in the third quarter, despite the challenges posed by the transition and upgrade phases for both robotaxi and ADAS products. The transition of the ADAS product is now fully wrapped up. This accomplishment was made possible through exceptional efforts as well as our robust manufacturing, engineering, and supply chain optimization capabilities. As a result, we not only sidestepped the dip in gross margin at the lower end of the V-shaped trajectory we initially anticipated at the beginning of the year, but made a direct leap into

a stable, long-term gross margin instead.

Upon careful comparison with our six US-listed peers using publicly available information, we can proudly say that our performance metrics have excelled across the entire spectrum. This includes stellar achievements in revenue scale, deliveries, market share, and gross margin. Remarkably, we have maintained a robust balance sheet throughout this process. Of particular significance is the fact that we have achieved positive operating cash flow for the third consecutive quarter, totaling RMB121 million (US\$17 million) for the first nine months of 2023. This places us as the sole standout company among our peers to achieve this feat, demonstrating our unwavering commitment to operational efficiency amid continuing growth. These financial milestones are a testament to our devoted team's hard work and underscore our steadfast dedication to achieving long-term, sustainable growth and profitability.

Let's delve into our third quarter business updates, starting with notable **ADAS** design wins.

We are making significant strides on the **domestic** front. In the third quarter, we achieved a global milestone by proudly announcing the first-of-its-kind series production design win for our long-range, ultra-thin in-cabin ET25 lidar with FAW Group, one of the top OEMs in China, for their next generation EV models under the prestigious Hongqi brand defined by quality, luxury and safety. ET25's revolutionized in-cabin placement protects the lidar unit itself from dirt and grime while allowing OEMs to design car models with diminished aerodynamic resistance and sleek, aesthetically pleasing exteriors. Fueled by our next generation, vertically integrated high-performance module, ET25 has emerged as the in-cabin lidar frontrunner in terms of range detection, achieving an impressive 250 meters at a 10% reflectivity rate. The success of this new design win with FAW Group signifies robust progress in the commercialization of this in-cabin product and marks an immense leap toward its mass production, scheduled to materialize by the first half of 2025.

Furthermore, we recently broadened our client portfolio and secured exclusive partnerships, including multiple new design wins with Great Wall Motor (长城汽车), one of the largest automakers in China, as well as Leapmotor (零跑汽车) and Neta (哪吒汽车), two leading EV automakers in the Chinese market. Their new EV models will feature our flagship AT series lidar and are set to debut starting in 2024 and 2025. It is noteworthy that among these recent design wins, several of them have prior engagements with our industry peers. Their choice to switch to our lidar products for certain existing or future models is a strong endorsement of the superior performance of our high-quality lidar products and our proven record of timely deliveries. We are also excited to witness a rising trend where more OEMs are making the switch over to partner with us while none of our existing OEM customers have made the move to a competitor.

With these recent partnerships, we have secured design wins with 14 OEMs and Tier 1 suppliers (including the Top 5 OEMs in China) across over 50 vehicle models, a robust testament to our global market leadership. We eagerly look forward to contributing to the fulfillment of these automotive manufacturers' vision of creating more intelligent and safer

vehicles.

In **international** developments, we are delighted to announce that we are currently deeply engaged in 9 RFI/RFQ discussions with 6 leading global OEMs from North America and Europe. While none of these were slated for conclusion in the third quarter, we expect 3 RFQs to be finalized in Q4 per customers' projections, including one from a global OEM and two from global OEMs' joint ventures in China. It's worth noting that these vehicles are not exclusive to the Chinese market; some of them are intended for global distribution. For 2 of these global OEMs, we have attained supplier qualification status following an extensive audit procedure that includes evaluations of product quality, production lines, supply chains, certifications, financial stability, and other essential aspects, complemented by multiple rounds of site visits. We are enthusiastic about the potential partnerships that may emerge, and we look forward to sharing more exciting news and developments in the near future.

In addition, we have broadened our collaboration with the prominent European OEM mentioned in our last earnings call to include an additional **strategic development program** focused on the research and development of integrating our cutting-edge lidar technology into a multi-sensor package, targeting car models with SOP dates in 2028 and beyond. This expansion marks a deepened and reinforced partnership with this esteemed OEM, underscoring our acknowledged technical excellence and strategically positioning us for potential future design wins with them. As I highlighted in my previous quarterly update, development programs of this nature are integral to our international market strategy. They provide us with a distinctive opportunity to showcase our technical prowess and engineering capabilities for OEM customers before they make final decisions regarding vendor selection. Given our accelerating number of global and domestic OEM design wins, it is becoming clear that OEMs prefer Hesai lidars' superior performance (in range and resolution) and higher quality to that of our competitors' offerings.

Next, I would like to share an update on our **manufacturing and product enhancements**. As you are aware, Hesai is dedicated to expeditiously advancing new products toward the SOP phase. In September, we celebrated a new milestone with our **FT120**, the world's first fully solid-state blind-spot lidar to attain SOP and to be installed on a series-production vehicle model, Polestone 01 (极石 01), the first full-size luxury SUV model from Rox Motor. By harnessing the advantages of the FT120's ultra-wide Field of View (FOV) and minimal blind spots, coupled with our flagship long-range AT series lidar, the resulting car model features a powerful 3D high-precision perception system, providing a smarter and safer driving experience across a wide range of road scenarios.

Turning our attention to the AT series lidar, in the third quarter, we officially launched **AT128P** model, the upgraded iteration of our flagship AT128 ADAS long-range lidar. AT128P boasts an impressive set of improvements, including a range extension to 240 meters at a 10% reflectivity rate, higher resolution, enhanced point cloud regularity, and a 20% reduction in power consumption. Achieving a seamless transition from SOP to full-scale production at our Hertz Center in Hangzhou represents a momentous achievement that strategically positions us to leverage economies of scale through the highly-

automated production line in this facility, which is specifically tailored for the mass production of our mature products. We are now poised to reap the rewards of improved cost efficiency, with substantial volume shipments expected in the fourth quarter of this year.

The success of our recent product upgrade and the seamless ramp-up of production at Hertz Center not only reflects our unwavering commitment to meeting market demand but also stands as an invaluable learning experience. This endeavor has provided us with crucial insights and knowledge that will play a pivotal role as we contemplate expanding our production capabilities in the future. Moreover, it has strengthened our present market leadership in lidar deliveries, positioning us for sustained success. By leveraging our in-house manufacturing capabilities, we are well-prepared to innovate and thrive in the dynamic landscape of the ever-evolving industry.

Lastly, I would like to share that we have recently completed the construction of our R&D and in-house manufacturing facility, "Maxwell Center," located in Jiading, Shanghai. In addition to actively preparing to produce our new fully solid-state FT120 lidar, this facility is now equipped to spearhead research and development for our next-generation LiDAR products. We have established 90 functional and performance testing programs, with plans to scale this number to hundreds in the near future. The seamless integration of R&D activities and production processes in this state-of-the-art facility not only amplifies efficiency but also expands our capability to introduce groundbreaking solutions to the market. We are enthusiastic about the potential this facility unlocks, driving our research initiatives and enhancing the overall quality and time-to-market of our future product offerings.

To summarize, we steadily and effectively navigated our product transition during the third quarter. This triumph, along with stronger-than-expected quarterly revenue, deliveries, and gross margin, put us on track for a strong finish to the year. Our continuous run of design wins and development programs from leading domestic and global OEMs is not just a remarkable feat; it's a resounding testament to our market leadership and strengthens our foundation and enduring growth. Our steadfast commitment to performance, quality, safety, and reliability will continue to guide our endeavors as we remain dedicated to advancing the cause of autonomous transportation by enhancing safety systems and saving lives worldwide!

I'll now turn the call over to Louis to share more details on our financial performance and outlook. Louis, please go ahead.

Louis Hsieh:

Thank you, David, and hello everyone.

Let's go through our operating and financial figures for the third quarter. To be mindful of the length of our earnings call today, I encourage listeners to refer to our third quarter

earnings release for further details.

We are pleased to see that our net revenues exceeded the top end of our guidance, increasing 33.5% year-over-year reaching another record high of RMB446 million (US\$61 million). We achieved this growth against the high comparable third quarter last year, which benefited from the bounce-back after the Shanghai Covid lockdowns in the second quarter of 2022. Deliveries outperformed as well, more than doubling year-over-year to over 47,000 units in total, further solidifying our leading position in the global lidar market. In terms of gross margin, I would like to remind you that at the beginning of the year, we anticipated a simultaneous product transition for multiple products before we could fully benefit from economies of scale. Hence, Q2 and Q3 were designated as a product transition phase, and we expected a significant drop in gross margin, forming a V-shaped pattern. However, our gross margin for the third quarter of 2023 reached 30.6%, significantly higher than our earlier guidance, driven by continuous improvement in our manufacturing cost structure, as David just mentioned. Continued robust demand for high-margin autonomous mobility products also contributed to the quarter's margin uptick. As a result, both Q2 and Q3, which were previously considered as a product transition phase, have significantly outperformed our initial projections.

Our relentless efforts to improve manufacturing scale and optimize cost structure also led to our unmatched financial strength in the global lidar industry, marked by our third quarter of positive operating cash flow at RMB47.6 million (US\$6.5 million). Our robust year-to-date performance positions us to continue advancing along our path towards profitability and achieve sustainable long-term growth.

Now, turning to our **financial outlook**, where we expect a strong performance. Our robust third quarter results bode well for our seasonally strongest fourth quarter. For the fourth quarter of 2023, we expect net revenues to be between RMB535 million (US\$73.3 million) and RMB555 million (US\$76.1 million), representing a year-over-year increase of approximately 30.7% to 35.6%.

We are pleased to share that, with the shift toward a more optimized AT128P product, we are now entering a mature stage of production for ADAS. Consequently, we anticipate a high level of predictability for ADAS in the future, characterized by stabilized manufacturing processes, controlled cost structures, and a well-managed supply chain. We take pride in having overcome the challenges posed by the transition process and navigating it swiftly and carefully, thanks to our outstanding capabilities in engineering development and adept supply chain management.

We are delighted to announce that we are on track to deliver on our target of 220,000 lidars in total for 2023. In fact, we are seeing growing adoption of ADAS systems equipped with lidar by OEMs globally and we anticipate this momentum will accelerate into 2024. For this reason, we expect our lidar volume to more than double to approximately 500,000 units next year. Based on our customers' order forecasts, by the end of 2024, we anticipate 13 ADAS OEM customers will reach SOP, expanding our portfolio to include over 40 SOP vehicle models. As of now, we have secured design wins with 14 ADAS

OEMs covering over 50 vehicle models in total, and we expect these figures to climb significantly throughout 2024.

Therefore, we reaffirm our annual revenue target of RMB1.8 billion (approximately US\$250 million) in conjunction with a group-level blended gross margin of 30-35% for full-year 2023. By December, we anticipate achieving a monthly delivery rate of 40,000 units, positioning us well ahead of the competition in the global lidar industry.

The above outlook is based on current market conditions and reflects the Company's preliminary estimates of market and operating conditions and customer demand, which are all subject to change.

In summary, while the third quarter was a bridge quarter, we exceeded our own performance expectations in terms of financials and secured major design wins, setting us apart in the market and laying a solid foundation for future growth and development. Bolstered by the momentum we've generated, we are eagerly looking forward to an exceptionally promising fourth quarter as we continue our journey toward profitability.

Ouster

Before going into Q&A, I'd like to take a moment to add my personal opinion on Ouster's tactics and behavior toward Hesai. Specifically, I want to address the recent national origin-based smear campaign of false claims being made or directed by Ouster and other competitors against us. A point-by-point discussion of our competitors' fabricated claims regarding Hesai's lidar technology and possible intended uses and Hesai's responses can be found in the Company's October 12, 2023 press release available on our website and a presentation available on Hesai's IR website at investor.hesaitech.com in the "financials-filings quarterly-results" section.

Ouster and its media and lobbying agents have attempted to discredit Hesai's technology and business practices seeking to ban Hesai products from the U.S. marketplace, relying primarily on baseless IP infringement claims and exploiting heightened China-U.S. geopolitical tensions. I find this line of attack focusing on a company's national origin deplorable and contemptuous. Ouster's claims are unsubstantiated and Hesai denies all allegations and innuendos by Ouster. Ouster has spent millions of dollars on litigation expenses and lobbying fees on Capitol Hill in a desperate attempt to portray Hesai as a Chinese company that steals American IP and is possibly working with the Chinese military to undermine U.S. National Security by potentially using our lidars to spy on Americans, launch cyberattacks and aid the Chinese military in intelligence gathering – ALL ARE PATENTLY FALSE. These underhanded tactics are the actions of a desperate company that is unable to compete effectively on the merits of its products in the lidar marketplace against Hesai. Frankly, Hesai lidars are preferred by customers because they perform much better (range and resolution) and are of higher quality than Ouster's products. As a result, the Ouster/Velodyne combination has seen several years of declining revenues, dwindling lidar shipments, shrinking gross margins and mounting losses (losses of \$335 million for the first nine months of 2023 on just \$59 million in

revenues alone). This is all reflected in declining global autonomous vehicle lidar market share (1% in 2022 for Ouster, compared to Hesai's market-leading 47% share, according to Yole Intelligence), and Ouster's precipitous share price drop of over 95% from its high levels several years ago.

During the ITC investigation, Ouster's desperation became very clear. Earlier this year Ouster/Velodyne attempted to divest the Litigation Settlement and Patent Cross-Licensing Agreement entered into with Hesai which is at the heart of the Ouster-Hesai IP case into a separate legal entity – Adapt Vision Holdings, LLC. Then, Ouster claimed it wasn't bound and did not have to abide by its own contractual obligations contained therein, including the agreement's patent cross-licensing provision (allowing each side to use the other party's' lidar IP for 10 years) and not to sue provisions (designating arbitration as a dispute resolution mechanism). Obviously, Ouster knew the agreement was a major major liability in their case. The ITC judge saw right through Ouster's legal subterfuge and would have none of it. She ruled Ouster is an affiliate of Velodyne via merger. So Ouster could not escape its legal obligations simply by transferring the agreement to a new entity. If only things were just that simple – spin off the contractual obligations you don't like and keep the ones you do like. In this bizarro world, contracts would cease to have a commercial value whatsoever. She then went on to grant Hesai's motion terminate the ITC Case.

As an American, I find Ouster's desperate, national origin-based, xenophobic tactics of attacking Hesai with baseless, stereotypical allegations and innuendo, repugnant and antithetical to American principles and values. In my opinion, such tactics and behavior should not be tolerated. Simply put, I believe Ouster's smear campaign against Hesai is downright UN-AMERICAN!

This concludes our prepared remarks for today. Operator, we are now ready to take questions.