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ASIA PACIFIC INSIGHT

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Asia Technology

China AI 2.0 – Entering a New Phase

China is on a path to drive simultaneous AI advancements across frontier sectors, spanning robotics, new-energy vehicles, and LLMs. Its "AI Plus" initiative is rapidly injecting its newfound AI capabilities and AI agents into world-class smart products, services and embodied intelligence.



China's AI is entering a new phase – one defined less by catching up in capability and more by capturing value. The narrative has shifted decisively from training to inference, from technology to application, and from potential to real earnings. Rather than competing purely at the frontier, China is optimizing for speed, cost efficiency, and system-level integration, enabling AI to diffuse rapidly across the real economy. At the same time, China semiconductor self-sufficiency rate continues to improve from 41% in 2025 to 86% by 2030 in our estimates, supporting a more resilient and cost-efficient deployment.

At the macro level, AI will become a medium-term productivity lever. We estimate that AI could lift China's total factor productivity growth by ~3ppt cumulatively over the next decade, partly offsetting the aging population and bringing 2035 potential GDP to a level 3.5ppt higher than the trajectory without AI adoption. But its near-term growth impact will likely be muted, with positives from AI-related capex cycle and modest initial productivity gains offset by transitional labor disruption.

Capturing the "rate of change". AI adoption is broadening, with enabler/adopter penetration rising to ~51% of coverage from 43% in two years. Our latest 1H26 AlphaWise China CIO survey indicates that 47% plan to start their first AI project within the next year (an increase on 40% in 2H25). The economics are becoming tangible: AI adopters have seen NTM EPS rise by 62% in the past two years, significantly outperforming MSCI China at 10%, alongside 12-13ppt EBIT margin expansion to 16-17% by 2027E, well ahead of the broader market.

Investment Implications. While enablers and foundational models remain the key investment thesis at the current stage, widespread adoption brings potential investment opportunities to those who reap the fruits of AI.

- **Beisen (9669.HK), Meitu (1357.HK), Beijing Roborock (688169.SS), Midea Group (000333.SZ)** and **Ecovacs Robotics (603486.SS)** stand out in our risk-reward analysis among AI adopters.
- **MiniMax (0100.HK)** and **Z.ai (2513.HK)** are the key foundational model providers in China AI, while **Alibaba (BABA.N)** is the best-positioned full-

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stack AI platform in our coverage.

- We highlight **CATL (300750.SZ/3750.HK), Yingliu (603308.SS)** and **Sieyuan (002028.SZ)** as the key names in power
- We continue to like **Cambricon (688256.SS), Iluvatar (9903.HK), NAURA (002371.SZ), AMEC (688012.SS), ACMR (ACMR.O), SMIC (0981.HK)** and **Unimicron (3037.TW)** as the key AI enablers that benefit from China Semiconductor localization secular trend.

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Executive Summary

China's AI story is no longer about catching up – it is about rewriting the rules of the game.

Over the past year, the market narrative has shifted decisively. China was once seen as a structurally constrained AI ecosystem – limited by access to leading-edge chips and frontier research – but it has since demonstrated a different kind of strength: the ability to scale, adapt, and commercialize AI faster than anywhere else. This divergence is not a weakness. It is China's defining edge.

As we highlighted in last year's Blue Paper (*China AI: The Sleeping Giant Awakens*), China's AI model is fundamentally different — state-coordinated, data-rich, and industrially integrated. Today, that model is moving from framework to execution. AI is no longer confined to labs or hyperscaler capex cycles but it is spreading rapidly across the real economy, embedding itself into energy systems, manufacturing processes, consumer platforms, and urban infrastructure.

A Shift in the Center of Gravity. The global AI race is often framed around model supremacy, but China is playing a different game. Rather than chasing the absolute frontier, China is optimizing for speed of deployment, cost efficiency, and system-level integration. As AI development is moving from training to inference and applications, three key trends have emerged in the past 12 months.

- **AI has moved from infrastructure to earnings**. China AI adopters are now achieving tangible financial results – rising earnings expectations and structurally expanding margins. AI is driving efficiency gains and operating leverage, not just revenue growth, reinforcing its role as a productivity engine.
- **The bottleneck has shifted — from compute to power and deployment**. The constraint is no longer whether AI can be built, but whether it can be powered, scaled, and delivered in real time. This is driving a new investment cycle in energy systems, particularly storage and grid flexibility, as AI infrastructure collides with physical-world limitations. The exponential demand is colliding with real-world power constraints, making energy storage and grid intelligence critical enablers.
- **The new battlegrounds are moving to new energy systems and physical AI**. From humanoid robots to autonomous vehicles, AI is becoming embodied. China's advantage — its manufacturing base, supply chain depth, and real-world data — positions it uniquely to lead in this next phase of "physical AI."

What Has Changed?

China has made meaningful progress in several foundational areas:

- **AI commercialization at scale:** Leveraging its large domestic market and super-app ecosystem, China is accelerating adoption across both consumer (2C) and enterprise (2B) use cases, particularly via low-cost, open-source models and integrated platforms.
- **Infrastructure and ecosystem buildout:** Hyperscaler capex, data center expansion, and AI cloud growth (72% CAGR expected through 2029) are enabling large-scale

deployment and inference growth.

- **More self-sufficient:** Domestic AI chips and system-level optimization are narrowing the compute gap, with self-sufficiency improving and competitiveness increasingly evaluated on cost-performance rather than leading-edge nodes.

What Still Needs Developing?

Despite these advances, several structural constraints remain:

- **Compute and semiconductor bottlenecks:** Limited access to cutting-edge nodes, EDA tools, and advanced manufacturing continues to constrain frontier innovation.
- **Monetization lag in enterprise AI:** While adoption is accelerating, especially in cost-efficiency use cases, revenue generation — particularly in 2B applications — remains nascent and uneven.
- **Labor and macro adjustment risks:** AI's near-term impact is likely to be disruptive, with potential labor displacement preceding productivity gains, posing challenges for income growth and demand stability.

Macro Implications

AI raises China's potential growth, but as a medium-term productivity story rather than a near-term cyclical boost: We estimate that AI could lift China's total factor productivity growth by around 3ppt cumulatively over the next decade, leaving the level of potential GDP roughly 3.5ppt higher by 2035 than under a no-AI counterfactual. In the near term, however, the contribution to headline growth is likely to be muted: while an AI-driven capex upcycle and early task-level efficiency gains provide support, these are largely offset by transitional labour disruptions.

Indeed, despite lower aggregate AI job exposure than in the US, China's rapid diffusion pace and starting point of weak corporate earnings mean displacement effects could materialise faster than job creation over the next 2–3 years. This risk would be amplified by the broad-based nature of AI substitution, spanning junior white-collar roles (exacerbating youth unemployment), mid-level professional jobs (adding pressure to the already stressed middle-income group), and even labour-intensive services (the main absorber of employment losses in recent years). This would add to deflationary pressures if not addressed properly.

Policy mitigation is thus expected to intensify. But protection is likely to skew toward labour-intensive services, while higher-end cognitive roles face greater adjustment to preserve GenAI competitiveness — implying only a partial offset to near-term growth drags.

Investment Implications

AI "rate of change" underpriced by the market. Over the past 12 months, AI enablers — particularly power, semiconductors and infrastructure — have continued to outperform, driven by the initial capex cycle and strong revenue visibility across the supply chain. However, we believe the next phase of the China AI cycle will be characterized by a meaningful catch-up in application-layer performance, as AI adoption broadens and begins

to translate into tangible incremental earnings and margin expansion.

AI adoption accelerating. According to our China CIO survey, AI/Machine Learning/ Process Automation demand stayed strong and edged closer to the peak in 1H25 with biggest biannual increase in spending expectations. Expectations for AI/LLM-related IT investments entering production in 2026 have decreased slightly but remain widespread. Currently, 27% of organizations have launched their first AI/LLM project (a decline from 30% in 2H25), while 47% plan to start within the next year (an increase on 40% in 2H25), and 15% expect to begin in two years or later (down from 20% in 2H25).

AI adopters have seen NTM EPS rise ~60% since late 2023 and EBIT margins expand by 12–13ppt through 2027E, significantly outperforming the broader market. **Beisen, Meitu, Beijing Roborock, Midea Group, Ecovacs Robotics** stand out on risk-reward among AI adopter stocks (more details: *China AI Adopter*).

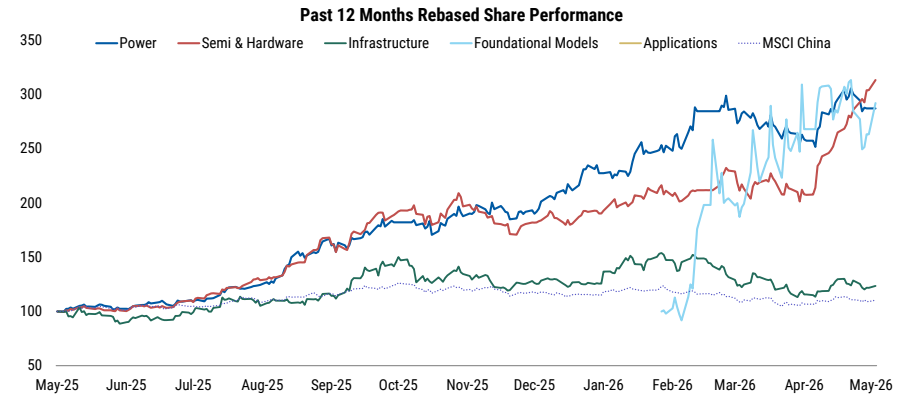
Across the stack, **Minimax** and **Z.ai** are key foundational model provides in China AI, and we continue to see structural leadership among China's internet platforms. We view **Alibaba** as the best-positioned full-stack AI platform, while **Tencent** remains strongest in the application layer, leveraging its ecosystem to drive monetization and user engagement. **Cambricon, Iluvatar, Naura, AMEC, ACMR, SMIC** continue to be our key picks under semi localization themes. We like **Unimicron, Shennan Circuit, Shengyi Tech** and **Zhen Ding** as well for their substrate/PCB/CCL exposure to AI servers using local AI chips; server OEM/ODM like **Inspur** and **Lenovo** also stand out to us as beneficiaries of an increasingly localized AI server supply chain, alongside **Delta** for its AI server power management/cooling solutions. We also highlight **CATL**, **Yingliu** and **Sieyuan** as the key names in power.

Exhibit 1: China AI 65



Source: Morgan Stanley Research; Red box highlights the newly added names compared to previous version

Exhibit 2: China AI 65 Share Price Performance comparison



Source: FactSet, Morgan Stanley Research

Methodology: Constructing the "China AI 65" Universe

The "China AI 65" framework is designed to identify companies with meaningful and monetizable exposure to AI across the full value chain. Our methodology combines a top-down thematic screening process with bottom-up analyst validation and quality control to ensure robustness. This approach builds on our proprietary **Global AI Mapping Survey** and sector research, which track both the degree of AI exposure and its financial materiality across our Greater China coverage universe.

Screening

Leveraging our Global AI Mapping Survey, we construct an initial universe based on AI exposure and categorization (enabler, adopter, wildcard etc) in Greater China coverage universe. Then, rather than focusing solely on static levels of AI exposure, we prioritize companies where AI relevance is increasing compared to the survey last year — either through strengthening strategic positioning and narrative, or material EPS impact for the next 12 months.

Details of the screening results: China AI Survey – AI Impact Broadening Out

Bottom-up Validation and Quality Control

Bottom-up analyst input is then applied to validate each name. Sector teams assess how AI translates into revenue growth, cost efficiency, or margin expansion, supported by product integration, customer adoption, and competitive positioning (e.g., data, ecosystem, or scale advantages). We rely on analysts research and judgement to avoid "AI washing". Names with purely narrative-driven exposure or without a credible monetization pathway are excluded.

Details of individual stock narrative: *China AI Adopter*

Risks and Limitations

- AI monetization — particularly in enterprise use cases — remains early and uneven, and rapid technological change may shift competitive positioning over time.
- Data transparency varies across sectors, and the framework may favor companies with more visible near-term impact, potentially underweighting

earlier-stage opportunities.

- Outcomes also remain sensitive to macro and policy factors, including semiconductor constraints and infrastructure availability.

Performance

To analyze equity market performance across the AI ecosystem, we classify China AI 65 companies into five thematic segments spanning the AI value chain. Thematic basket performance is calculated using fixed point-in-time constituents as of May 2025. Constituents remain unchanged throughout the analysis period, with no subsequent additions, deletions, or category migration incorporated into returns. We adopt this methodology to maintain consistency and comparability across performance series over time.

China AI Survey – AI Impact Broadening Out

Our fifth Global AI Mapping Survey shows broadening AI adoption across the MS coverage universe while the latest thematic ranking shows China's AI path retaining top rank, given earnings prospects and valuations.

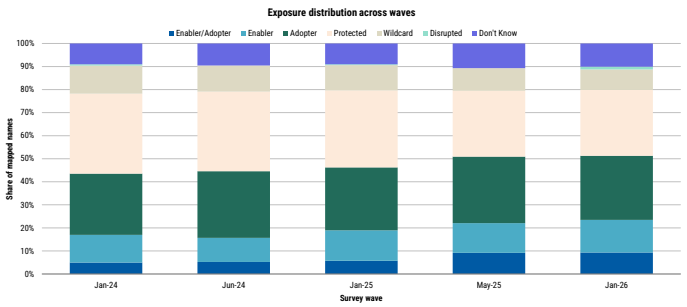
In this section, we leverage the global survey data to dive into the latest trends in China AI adoption.

Relevant link: Asia Thematic Alpha: Mapping AI Adoption and Disruption Opportunities (February 11, 2026)

Steady Growth in AI Adoption

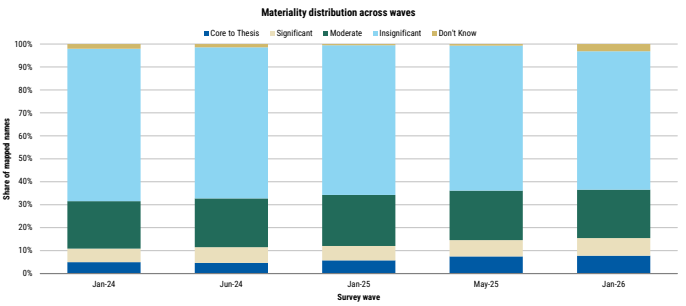
China markets continue to see AI adoption broadening out, with the share of Adopters and Enabler/Adopters, as identified by our analysts, rising from 31% in our inaugural survey (two years ago) to 37% in the latest survey. The materiality of AI impact has also increased: the share of companies who faces "Core to thesis" and "Significant" impact from AI increased from 11% to 16% over the last two years, with at least 37% of the companies now see moderate AI impact vs. 32% two years ago.

Exhibit 3: AI adoption broadening – enabler/adopter increased from 43% to 51% in 2 years



Source: Morgan Stanley Research

Exhibit 4: 16% of the companies saw significant AI impact

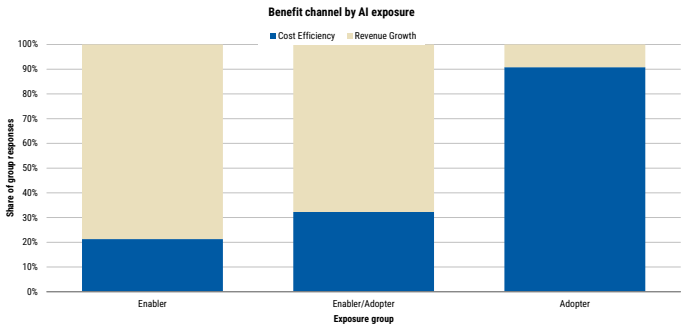


Source: Morgan Stanley Research

AI Adopters To Benefit From Cost Efficiency First

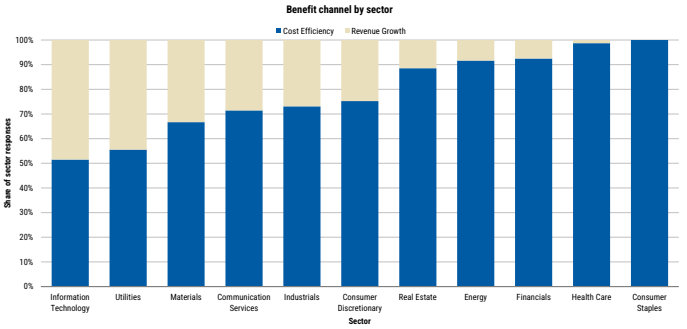
Similar to what we've seen in the global survey, most AI adopters in China will first benefit from cost efficiency (91% in China vs. 74-90% in global survey) vs. revenue growth (9% vs. 10-26% in global survey), reinforcing the view that AI initially will have more impact on margins than on top-line acceleration. Revenue growth at the current stage dominates among the AI enablers, where 79% of the enablers see the impact, consistent with what we've seen on the aggressive AI capex that benefit the entire supply chain (IT) as well as infrastructure companies (utilities, materials). Excluding the enabler concentrated segments, consumer discretionary (EV, home appliances) and real estate (property management) see the most significant revenue growth from AI.

Exhibit 5: 91% of the adopters benefit from cost efficiency



Source: Morgan Stanley Research

Exhibit 6: IT, Utilities and Materials see the most significant revenue growth from AI

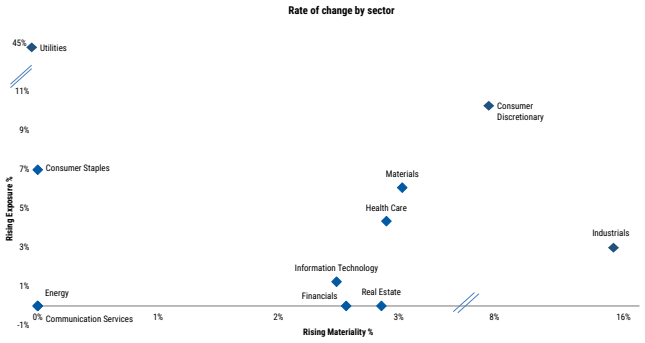


Source: Morgan Stanley Research

Rate of Change to Drive Outperformance

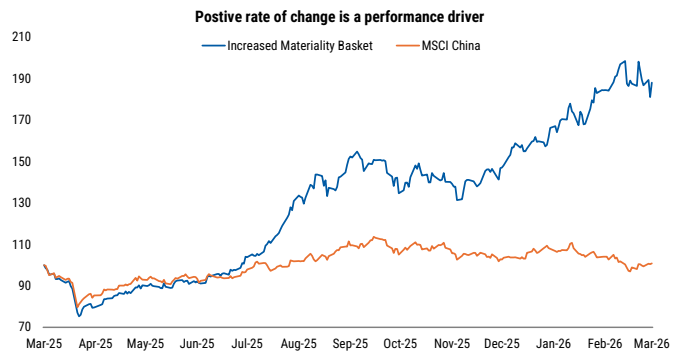
To assess the relevance of AI's rate of change, we looked at the performance of stocks for which our China analysts identified a change in materiality and exposure as part of the re-mapping exercise. We see substantial outperformance for stocks where the rate of change is positive. Comparing the fifth wave of mapping to the fourth, consumer discretionary groups show a notable rise in both materiality and exposure. Within this segment, 9% saw an increase in materiality and 11% an increase in exposure. Within Utilities, 44% saw an increase in exposure due to increasing relevance of power to data center build out. In industrials, materiality rose for 16% driven by the humanoid-related supply chain.

Exhibit 7: Rate of change breakdown by segment



Source: Morgan Stanley Research

Exhibit 8: Companies with increased AI impact materiality outperformed MSCI China by 88ppt in the past year



Source: Morgan Stanley Research

China AI Adopter

Leveraging our Global AI Survey and analyst insights, we've selected 39 names under our Greater China coverage as the AI adopters that would win through cost efficiency and top-line/margin growth in the AI era.

AI Adopters See a Forward Earnings Boost

China AI adopters have seen a clear forward earnings up-trend since late 2023, with NTM EPS rising from c.100 (Dec-23 rebased) to around 167 by May-26, materially outperforming MSCI China, which stayed broadly flat over the same period (Exhibit 9). This suggests the market has increasingly priced in stronger NTM earnings expectations for companies with clearer AI adoption stories.

Please refer to the table at the end of this section on how AI drives individual stocks narrative

Margin Expansion Supports the AI Adoption Case

EBIT margins for China AI adopters have expanded steadily from around 4% in 2021 to 16-17% by 2027E, implying 12-13ppt of cumulative margin expansion over the period. The trajectory reinforces our view that, at this stage, AI adoption is translating first into efficiency gains and operating leverage rather than purely top-line acceleration.

Who are better positioned?

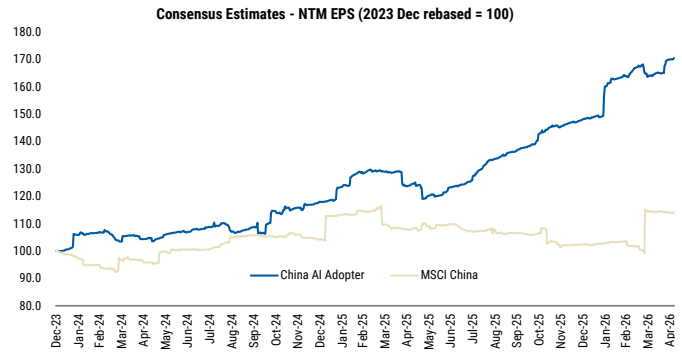
On our risk-reward framework, **Beisen Holding, Meitu** and **Beijing Roborock Technology** screen as the most attractive names, combining the strongest risk-adjusted base return with favorable skew. More broadly, stocks positioned in the upper-right quadrant in Exhibit 55 look best placed to outperform, in our view. We also compared 2027e ROE vs. current valuation relative to past three year average to see if the AI upside potential has been fully captured by current market expectations, **Midea Group** and **Ecovacs Robotics** stand out in the screening in addition to the names highlighted above. FII, China Resources Mixc Lifestyle Services, Futu and CATL stand out in ROE return while the valuation reflects that market has already partially priced in the AI potential.

- **Beisen**: We like Beisen for its incremental revenue from AI with high profitability and market share gain, with AI ARR, and we expect it to grow 10x from Rmb6mn+ in FY25 to Rmb60mn+ in FY26.
- **Meitu**: We expect Meitu to successfully monetize AI through its photo, video, and design applications with paying ratio to double in three years to 8-10% by 2028.
- **Beijing Roborock Technology**: Advanced AI algorithms to support premium positioning, faster replacement cycle, and improving gross margin with future potential in home-use service robots supported by its robotic cleaners with mechanical arms and wheel-leg.
- **Midea Group**: Key AI beneficiary as one of the global leading robot producers (KUKA) and increase quickly in China. It is transforming from a traditional home appliances company to a smart manufacturing/intelligent building technology/ energy solution provider. End-to-end AI development (smart appliances + "factory brain" automation) supports both top-line growth via whole-home intelligence ecosystems and manufacturing/industrial scenario and applications, which also

drives structural margin expansion via highly automated production.

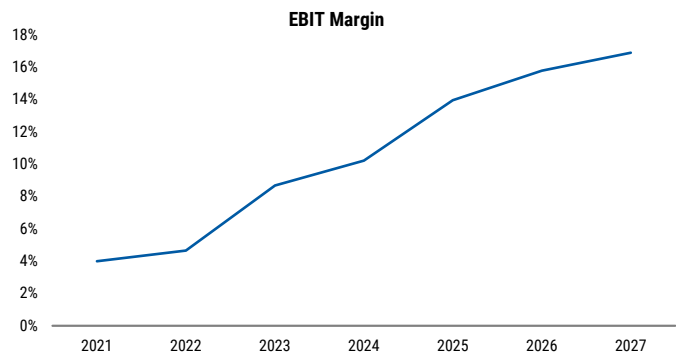
- **Ecovacs Robotics**: AI powered perception and navigation upgrades enable production premiumization and TAM expansion.

Exhibit 9: AI Adopters NTM EPS trend outpaced MSCI China



Source: Morgan Stanley Research

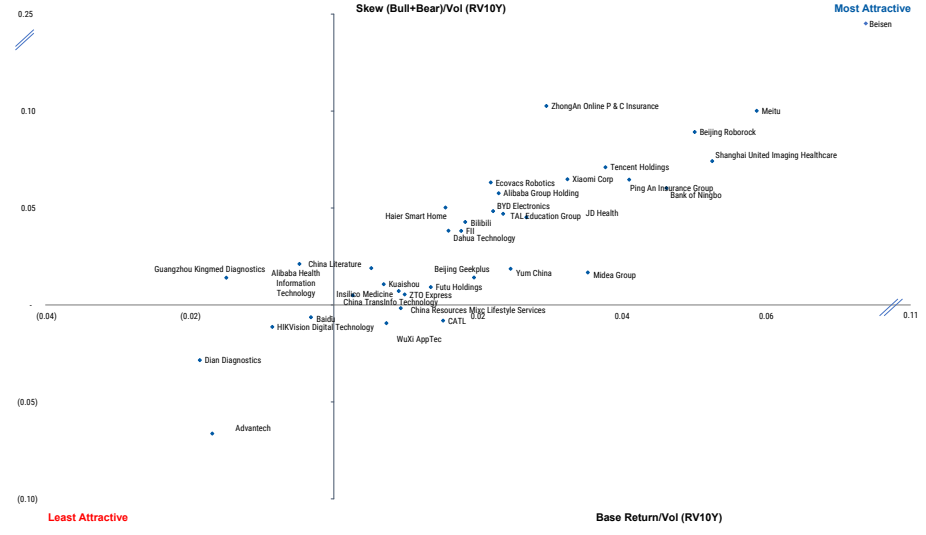
Exhibit 10: AI Adopters Are Seeing EBIT Margin Expansion



Source: Morgan Stanley Research

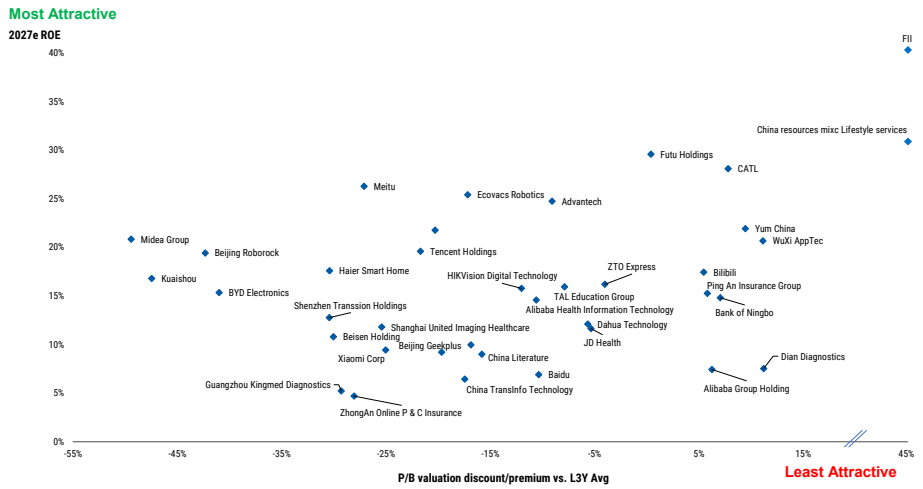
Exhibit 11:

Risk-Reward Skew (Bull+Bear)



Source: Morgan Stanley Research

Exhibit 12: P/B vs. ROE



Source: Morgan Stanley Research

Company	AI Story	Analyst	Report
Beisen Holding Limited	Beisen is a rare B2B software provider in China that can generate incremental revenue from AI with high profitability (80-90% gross margins), as its HCM AI translates to actual IT spending increases by taking wallet share from human HR personnel and offline training institutions, with AI ARR expected to grow 10x from Rmb6mn+ in FY25 to Rmb60mn+ in FY26.	Lin, Lydia	Beisen Holding Limited: 1HF26 Results: Beat and Raise (26 Nov 2025)
Meitu Inc	Meitu successfully monetizing AI through its photo, video, and design applications with paying ratio expected to double in 3 years to 8-10% by 2028.	Lin, Lydia	Meitu Inc: Is AI Eating Apps? It's the Last Mile that Matters (2 Sep 2025)
Beijing Roborock Technology Co Ltd	Advanced AI algorithms (mapping, obstacle avoidance, automation) support premium positioning and faster replacement cycles, sustaining revenue growth with improving gross margins. Company has launched robotic cleaners with mechanical arms and a "wheel-leg" which we see as key for further developing home-use service robots.	Ling, Hildy	Beijing Roborock Technology Co Ltd: 3Q25 mild profit miss; 4Q operation is still tracking healthy (30 Oct 2025)
Midea Group Co Ltd.	An AI enabler as the one of leading robot producers. Midea's automation business KUKA is one of the leading automation/robotics player globally and increase quickly in China.It's transforming from a traditional home appliances company to a smart manufacturing/intelligent building technology/energy solution provider. End-to-end AI development (smart appliances + "factory brain" automation) supports both top-line growth via whole-home intelligence ecosystems and manufacturing/industrial scenario and applications, which also drives structural margin expansion via highly automated production.	Lou, Lillian	Midea Group Co Ltd.: 3Q25 Results: Solid Execution (29 Oct 2025)
Ecovacs Robotics Co Ltd	AI-powered perception and navigation upgrades enable product premiumization (higher ASP robotic cleaners) and expand TAM into service robotics. The company is expanding product categories horizontally and developing cleaning robots in various scenarios (e.g. floors, windows, swimming pools, etc).	Ling, Hildy	Ecovacs Robotics Co Ltd: 3Q25's solid growth and healthy momentum should carry over to 4Q (26 Oct 2025)

ZhongAn Online P & C Insurance Co Ltd	Its digital bank business has shown very strong growth momentum since it was set up. The company's Tech exports have maintained solid growth in both domestic and overseas markets. ZhongAn has deployed its stablecoins business, including investments in potential stablecoin issuers RD InnoTech and ZA Bank, which can provide reserve banking services.	Zhao, Rick	ZhongAn Online P & C Insurance Co Ltd: 1H25 – Strong Earnings Growth and Superior CoR; Bank Turned Profitable (20 Aug 2025) ZhongAn Online P & C Insurance Co Ltd: Revaluation Backed by Healthy P&C and Strong Tech Presence (11 Jul 2025)
Alibaba Group Holding	Alibaba owns the biggest cloud infrastructure in China and globally #4, pursuing infrastructure-led AI strategy centered on AliCloud. Cloud infrastructure to AliCloud is key, be it chips, data centers, cloud platforms or AI models.	Yu, Gary	China's Emerging Frontiers: China's AI Path: Monetizing Surging Token Use via AI Cloud (16 Mar 2026)
Bank of Ningbo Co. Ltd	Bank of Ningbo has been investing ~5% of revenue annually into technology and R&D (vs 2-3% at other major banks), allowing digital transformation across financial products, service channels, marketing and customer management as well as operational risk control. For example, it aggregates customs data from over 200 countries, cleans and standardizes the data, and builds database that clients can directly use for analysis and decision-making. With broader AI adoption under its "Technology+" strategy, the bank can further improve product development efficiency and embed more AI-enabled functionalities into products, which will help enhance customer stickiness and increase the conversion rate into financial business.	Xu, Richard	Bank of Ningbo Co. Ltd: Small Gem Shines Big Again (17 Mar 2026)
Xiaomi Corp	Integrates AI capabilities across smartphone, EVs, and smart home devices. Rising investment in AI infrastructure and large language model (LLM) to enhance competitiveness.	Meng, Andy	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
Shanghai United Imaging Healthcare Co	AI powered imaging software and workflow automation enhance diagnostic accuracy and recurring software value, strengthening UIH's high end modality competitiveness.	Yan, Alexis	China Healthcare: AI Diffusion in China Healthcare – The DeepSeek Effect (10 Mar 2025)
Tencent Holdings Ltd.	Tencent is adopting a more application-driven AI strategy. Rather than emphasizing infrastructure leadership, Tencent focuses on leveraging the WeChat ecosystem, staying on the top of the funnel. (Wechat + Yuanbao)	Yu, Gary	China's Emerging Frontiers: China's AI Path: Monetizing Surging Token Use via AI Cloud (16 Mar 2026)
Haier Smart Home Co Ltd	Vertical AI models and ecosystem integration enable recurring revenue from smart home services and potential in-home robotics, while enhancing product ASP through personalized experiences.	Lou, Lillian	Haier Smart Home Co Ltd: 3Q25 Results – Growth in Line (30 Oct 2025)
Ping An Insurance Group Co of China Ltd	The company focuses on cutting edge applications and has built full stack AI capabilities. High quality training data and proprietary training algorithms and code provide clear advantages versus peers. P&C stands to benefit most from AI and refined management practices, while other subsidiaries should also gain from higher productivity, stronger risk control, better claims handling, greater operational efficiency, and improved sales support over time.	Xu, Richard	Ping An Insurance Group Co of China Ltd: Trip Takeaways - Improving ROE on Solid Group Strategy and Synergies; AI Impresses in Favorable Environment (1 Feb 2026) Ping An Insurance Group Co of China Ltd: Reaching New Pinnacles (4 Dec 2025)

BYD Electronics	Expanded into AI data center and related components businesses.	Meng, Andy	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
China Literature Ltd	China Lit is on its way to further monetize its IP library in short drama and short animation drama. We believe the ongoing upgrading AI tech would help China Lit to produce such content at a faster pace and with lower cost. Hence, we believe China Lit is one of the AI adopters in China.	Xu, Rebecca	China Literature Ltd: Revenue Growth Driven by AI and IP Strength (17 Mar 2026)
Foxconn Industrial Internet Co. Ltd.	FII uses digital twins integrating NVIDIA Omniverse libraries to design, deploy, and manage complex, high-volume production facilities, including those for AI server systems production.	Shih, Sharon	Foxconn Industrial Internet Co. Ltd.: AI Exposure Also Drives Margin Expansion; Price Target Up to Rmb82 (13 Nov 2025)
TAL Education Group	TAL leverages AI to transition from traditional tutoring to an integrated "Content x AI x Software & Hardware" model, aimed at delivering truly individualized teaching that was previously unscalable	Wang, Eddy	TAL Education Group: Strong F3Q26 Margin Should Trigger Further Re-rating (30 Jan 2026)
JD Health International Inc.	AI supports O2O healthcare logistics, online consultation triage and operational efficiency, with ROI balanced against upfront investment intensity.	Yan, Alexis	China Healthcare: AI Diffusion in China Healthcare (16 Jul 2024)
Dahua Technology Co. Ltd.	Deploys Xinghan large-scale AI models to power video-centric AIoT solutions for intelligent surveillance, traffic management, and smart cities.	Meng, Andy	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
Guangzhou Kingmed Diagnostics	AI and LLM integration optimize lab workflows, automate test interpretation and enable scalable patient follow up, creating cost efficiencies and future data monetization optionality.	Yan, Alexis	China Healthcare: AI Diffusion in China Healthcare – The DeepSeek Effect (10 Mar 2025)
Alibaba Health Information Technology	AI improves traffic monetization, merchant marketing efficiency and clinical service matching, leveraging Alibaba's LLM and data ecosystem.	Yan, Alexis	China Healthcare: AI Diffusion in China Healthcare (16 Jul 2024)
Shenzhen Transsion Holdings Co Ltd	Partnership with leading AI companies to offer AI features in mid-to-low-end smartphones.	Meng, Andy	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
Baidu Inc	Baidu has been most aggressive in transforming core business into AI-driven services as a solution to AI disruption of search. It utilizes the Ernie LLM through search ads transformation, AI cloud infra, and Apollo Go.	Yu, Gary	China's Emerging Frontiers: China's AI Path: Monetizing Surging Token Use via AI Cloud (16 Mar 2026)
Bilibili Inc	Bilibili will benefit from: 1) increasing advertising budget from the AI model developers; 2) internal adoption of AI to enhance advertising efficiencies and drive higher ECPM; and 3) developing its own AI tools for video makers.	Liu, Yang	Bilibili Inc: Solid Growth But More Investment (5 Mar 2026)
Kuaishou Technology	Kuaishou's Kling is a leading text-to-video model being ranked first on Artificial Analysis. Kuaishou has reported ARR reaching US$240mn as of Dec 2025.	Liu, Yang	Kuaishou Technology: Kling ARR Beat (13 Jan 2026)
Beijing Geekplus Technology Co., Ltd.	Geekplus is the largest global warehouse fulfillment solution provider. We believe that AI will empower the company's algorithm of its warehouse automation solution, based on its huge accumulated data. In addition, the company launched its first wheel-based humanoid robot in early 2026, with the strategy to greatly develop embodied AI in the long term.	Zhong, Sheng	China's Emerging Frontiers: Geekplus: Robots Defining Warehouses (16 Oct 2025)

Futu Holdings Ltd	AI shows meaningful benefits to mid and back office efficiency improvement. Management has indicated efficiency gains were notable within some departments even though overall headcount looks stable – mainly driven by the growth in new businesses and markets. Given Futu's key competitive edge is its R&D, which supports infrastructure and product development, we see potential for this to be improved by AI's coding capability. This underpins our assumptions of continued margin expansion – by about 2ppts a year – if revenue can grow at mid-to-high teens in the next two years. AI is also becoming a more important part of Futu's integrated offerings to clients to empower on information gathering and analysis. We think this could increase client stickiness and make client assets more resilient through the cycle.	Huang, Chiyao	Futu Holdings Ltd: Multiple Catalysts Await in 2026 (2 Feb 2026)
Yum China Holdings Inc.	Yum China embraces AI in all operational functions covering customer engagement, product development, store management, supply chain, franchisee management and back office, driving sales growth, operational efficiency improvements and leads its peers in store growth, branding, menu innovation and profitability.	Lou, Lillian	Yum China Holdings Inc.: Growth Led by Well-balanced Strategy; Reiterate OW (5 Feb 2026)
Advantech	Edge AI helping accelerate IoT deployment and use cases.	Yang, Derrick	Advantech: Solid Order Outlook with Manageable Cost Pressure (4 Mar 2026)
ZTO Express	While digitalization and automation have driven the leading players' share gain in China's express delivery segment, AI will be part of the key technology tools that leading players leverage to further expand their competitive advantage in terms of service quality and cost efficiency. ZTO is the largest player in the segment, with strong balance sheet to fund innovation, and has been actively combining AI tools with daily operations and management decision making process. We believe ZTO will expand its relative advantage vs. peers and continue its market share gain, powered by the adoption of AI.	Fan, Qianlei	ZTO Express: Market Share Gain Fueling Earnings Upgrades; Reiterate OW (18 Mar 2026)
Insilico Medicine	A leader in AI drug discovery models with a more mature asset-generation and licensing monetization engine.	Lin, Jack	Insilico Medicine: Leading AIDD Into the Validation Era (2 Feb 2026)
HIKVision Digital Technology	Launched Guanlan large-scale AI models to provide AI-driven solutions in security, traffic, and industrial automation.	Meng, Andy	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
China Resources Mixc Lifestyle Services	Leverage on AI for better understanding on consumption trend and customer behavior, to customize its marketing and promotion activities to improve mall retail sales, leading to higher rental income.	Cheung, Stephen	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
China TransInfo Technology	Leverages full-stack AI capabilities for vehicle-road-cloud integration and smart transportation.	Meng, Andy	Greater China Technology Hardware: Big Smartphone Downturn Ahead – Prefer Apple Supply Chain to Android Supply Chain (22 Mar 2026)
WuXi AppTec	AI-enabled early discovery and data-driven chemistry accelerate hit identification and improve R&D productivity.	Tam, Laurence	China Healthcare - The WuXi Group: At the Cutting Edge; Top Pick WuXi AppTec A (21 Nov 2025)

Dian Diagnostics Group Co Ltd	AI and LLM integration optimize lab workflows, automate test interpretation and enable scalable patient follow up, creating cost efficiencies and future data monetization optionality	Yan, Alexis	China Healthcare: AI Diffusion in China Healthcare – The DeepSeek Effect (10 Mar 2025)
Contemporary Amperex Technology Co. Ltd.	Power for AI has emerged as a US$1.5tr theme. We see energy storage as the next wave of growth, with the focus shifting from power availability to power flexibility. Compelling LCOE and infrastructure deferral value enhance the economic case for ESS. Data centers could double demand in five years. We see CATL as a major beneficiary.	Lu, Jack	Power for AI: Flexible Power – The Next Wave of Growth in AI (17 Mar 2026)

Exhibit 13: Comps table

Company name		MS	Share Price	Close price date	YTD Perf	Price Target	Upside	Mkt Cap	P/E		P/B		EV/EBITDA		ROE		Div Yield		Coverage
			(Local Curr)		(%)	(Local Curr)	(%)	($ mn)	2026E	2027E	2026E	2027E	2026E	2027E	2026E	2027E	2026E	2027E	Analyst
Communication Services																			
Meitu Inc	1357.HK	OW	4.72 HKD	07/05/2026	(32.6%)	10.50 HKD	122%	2,778 USD	14.0 e	10.9 e	2.9 e	2.4 e	7.9 e	5.5 e	23.9% e	26.3% e	2.9% e	3.7% e	Lin, Lydia
Bilibili Inc	BILI.O	OW	22.37 USD	06/05/2026	(9.0%)	31.00 USD	39%	10,237 USD	23.3 e	16.4 e	4.0 e	3.2 e	12.1 e	7.2 e	12.1% e	17.5% e	0.0% e	0.0% e	Liu, Yang
Baidu Inc	BIDU.O	EW	140.59 USD	06/05/2026	7.6%	135.00 USD	-4%	48,152 USD	18.6 e	16.5 e	1.1 e	1.1 e	3.3 e	1.8 e	6.6% e	6.9% e	NA	NA	Yu, Gary
Tencent Holdings Ltd.	0700.HK	OW	477.40 HKD	07/05/2026	(20.3%)	650.00 HKD	36%	565,450 USD	16.4 e	14.4 e	2.8 e	2.4 e	9.0 e	7.3 e	20.3% e	19.6% e	1.1% e	1.3% e	Yu, Gary
Kuaishou Technology	1024.HK	EW	48.40 HKD	07/05/2026	(24.3%)	55.00 HKD	14%	27,776 USD	13.4 e	11.4 e	1.9 e	1.6 e	6.4 e	4.7 e	17.3% e	16.8% e	0.0% e	0.0% e	Liu, Yang
China Literature Ltd	0772.HK	EW	27.18 HKD	07/05/2026	(17.6%)	29.00 HKD	7%	3,513 USD	16.6 e	14.2 e	1.3 e	1.2 e	8.9 e	7.1 e	8.3% e	9.0% e	0.0% e	0.0% e	Xu, Rebecca
Mean										14.0		2.0				16.0%		1.0%	
Median										14.3		2.0				17.1%		0.0%	
Consumer Discretionary																			
Alibaba Group Holding	BABA.N	OW	141.44 USD	06/05/2026	(3.5%)	180.00 USD	27%	335,942 USD	23.0 e	28.6 e	1.9 e	2.0 e	15.0 e	11.4 e	8.9% e	7.4% e	NA	NA	Yu, Gary
Ecovacs Robotics Co Ltd	603486.SS	EW	66.48	07/05/2026	(17.6%)	92.00	38%	5,627 USD	18.1 e	14.6 e	3.7 e	3.1 e	11.6 e	8.5 e	24.1% e	25.4% e	1.7% e	2.2% e	Ling, Hildy
Beijing Roborock Technology Co Ltd	688169.SS	OW	118.10	07/05/2026	(22.3%)	205.00	74%	4,481 USD	12.2 e	9.4 e	1.8 e	1.6 e	7.6 e	4.8 e	17.3% e	19.4% e	0.8% e	1.1% e	Ling, Hildy
Midea Group Co Ltd.	0300.HK	OW	85.30 HKD	07/05/2026	0.4%	103.00 HKD	21%	88,482 USD	12.1 e	10.9 e	2.4 e	2.2 e	7.1 e	6.1 e	20.9% e	21.7% e	5.7% e	6.1% e	Lou, Lillian
Haier Smart Home Co Ltd	6690.HK	EW	21.78 HKD	07/05/2026	(10.3%)	25.00 HKD	15%	28,700 USD	8.6 e	7.9 e	1.4 e	1.3 e	5.3 e	4.5 e	17.3% e	17.6% e	6.7% e	7.6% e	Lou, Lillian
Yum China Holdings Inc.	YUMC.N	OW	48.71	06/05/2026	2.0%	60.00	23%	17,245	16.7 e	15.0 e	3.3 e	3.1 e	8.5 e	7.6 e	18.9% e	21.5% e	2.6% e	3.0% e	Lou, Lillian
TAL Education Group	TAL.N	OW	11.44	06/05/2026	4.9%	16.00	40%	2,326	3.5	3.8 e	0.6	0.5 e	(4.8)	(4.0) e	15.2%	15.1% e	NA	NA	Wang, Eddy
Mean										12.9		2.0				18.3%		4.0%	
Median										10.9		2.0				19.4%		3.0%	
Financials																			
Futu Holdings Ltd	FUTU.O	OW	168.00 USD	06/05/2026	2.3%	225.00 USD	34%	23,754 USD	14.3 e	11.8 e	3.5 e	2.7 e	11.9 e	9.8 e	32.5% e	29.6% e	0.0% e	0.0% e	Huang, Chiyao
Bank of Ningbo Co. Ltd	002142.SZ	OW	32.46	07/05/2026	15.6%	45.00	39%	31,473 USD	6.8 e	5.8 e	0.9 e	0.8 e	6.5 e	5.6 e	14.3% e	14.8% e	3.5% e	4.1% e	Xu, Richard
Ping An Insurance Group Co of China Ltd	2318.HK	OW	66.00 HKD	07/05/2026	1.3%	92.00 HKD	39%	156,712 USD	7.0 e	6.2 e	1.0 e	0.9 e	9.6 e	9.0 e	14.9% e	15.4% e	5.0% e	5.3% e	Xu, Richard
ZhongAn Online P & C Insurance Co Ltd	6060.HK	OW	12.15 HKD	07/05/2026	(24.5%)	18.10 HKD	49%	2,613 USD	16.3 e	14.3 e	0.7 e	0.6 e	24.7 e	21.0 e	4.3% e	4.7% e	0.0% e	0.0% e	Zhao, Rick
Mean										9.5		1.2				16.1%		2.3%	
Median										9.0		0.8				15.1%		2.0%	
Health Care																			
Alibaba Health Information Technology	0241.HK	UW	4.62 HKD	07/05/2026	(8.5%)	4.20 HKD	-9%	9,542 USD	38.8 e	28.2 e	3.6 e	3.1 e	30.3 e	21.0 e	10.5% e	12.7% e	0.0% e	0.0% e	Yan, Alexis
JD Health International Inc.	6618.HK	EW	46.60 HKD	07/05/2026	(16.0%)	66.00 HKD	42%	19,032 USD	19.3 e	16.5 e	1.9 e	1.7 e	13.6 e	9.4 e	11.0% e	11.6% e	0.0% e	0.0% e	Yan, Alexis
Dian Diagnostics Group Co Ltd	300244.SZ	EW	20.50	07/05/2026	29.3%	15.60	-24%	1,881 USD	33.2 e	23.9 e	1.8 e	1.7 e	9.5 e	7.4 e	5.7% e	7.5% e	0.4% e	0.5% e	Yan, Alexis
Guangzhou Kingmed Diagnostics	603882.SS	UW	27.78	07/05/2026	(2.0%)	22.00	-21%	1,889 USD	45.3 e	34.3 e	1.9 e	1.8 e	12.0 e	10.1 e	4.2% e	5.4% e	0.7% e	0.9% e	Yan, Alexis
Shanghai United Imaging Healthcare Co	688271.SS	EW	111.25	07/05/2026	(11.4%)	164.00	47%	13,462 USD	40.8 e	32.9 e	3.9 e	3.5 e	26.5 e	21.2 e	10.4% e	11.8% e	0.2% e	0.3% e	Yan, Alexis
Insilico Medicine	3696.HK	OW	65.40 HKD	07/05/2026	76.1%	74.00 HKD	13%	657	142.7 e	44.3 e	10.1 e	8.3 e	9.7 e	0.7 e	4.2% e	22.9% e	0.0% e	0.0% e	Lin, Jack
WuXi AppTec Co Ltd	2359.HK	OW	139.80 HKD	07/05/2026	41.6%	155.00 HKD	11%	47,777 USD	20.2 e	18.1 e	4.2 e	3.6 e	11.3 e	9.6 e	22.0% e	21.3% e	1.7% e	1.8% e	Tam, Laurence
Mean										28.3		3.4				13.3%		0.5%	
Median										28.2		3.1				11.8%		0.3%	
Industrials																			
Contemporary Amperex Technology Co. Ltd.	3750.HK	OW	665.00 HKD	07/05/2026	32.7%	815.00 HKD	23%	317,644 USD	28.2 e	20.7 e	6.7 e	5.6 e	14.7 e	10.6 e	28.1% e	32.5% e	1.3% e	1.8% e	Lu, Jack
Beijing Geekplus Technology Co., Ltd.	2590.HK	OW	19.58 HKD	07/05/2026	(10.5%)	29.00 HKD	48%	3,342 USD	361.1 e	71.1 e	6.6 e	6.0 e	176.0 e	51.9 e	1.8% e	9.2% e	NA	NA	Zhong, Sheng
ZTO Express	ZTO.N	OW	25.88 USD	06/05/2026	23.9%	28.50 USD	10%	20,466 USD	13.4 e	11.6 e	1.9 e	1.7 e	6.9 e	5.5 e	15.7% e	16.2% e	0.0% e	3.1% e	Fan, Qianlei
Mean										34.5		4.4				19.3%		2.5%	
Median										20.7		5.6				16.2%		2.5%	
Information Technology																			
Beisen Holding Limited	9669.HK	OW	3.36 HKD	07/05/2026	(53.7%)	11.30 HKD	236%	309 USD	44.1 e	17.7 e	2.2 e	1.7 e	82.9 e	13.2 e	5.3% e	10.8% e	0.0% e	0.0% e	Lin, Lydia
China Transinfo Technology Co Ltd	002373.SZ	EW	9.17	07/05/2026	(22.1%)	10.00	9%	2,127 USD	20.4 e	17.4 e	1.1 e	1.1 e	7.5 e	3.8 e	5.8% e	6.4% e	0.0% e	0.0% e	Meng, Andy
Advantech	2395.TW	OW	444.00	07/05/2026	54.2%	400.00	-10%	12,219 USD	30.1 e	26.2 e	6.5 e	6.0 e	23.5 e	20.2 e	22.9% e	24.8% e	2.2% e	2.4% e	Yang, Derrick
Dahua Technology Co. Ltd.	002236.SZ	EW	18.36	07/05/2026	(3.1%)	21.80	19%	8,827 USD	13.5 e	11.8 e	1.4 e	1.3 e	10.0 e	8.0 e	11.1% e	12.1% e	3.8% e	4.4% e	Meng, Andy
BYD Electronics	0285.HK	OW	28.42 HKD	07/05/2026	(15.5%)	39.00 HKD	37%	8,174 USD	12.3 e	9.4 e	1.4 e	1.3 e	5.3 e	4.2 e	12.7% e	15.4% e	2.4% e	3.2% e	Meng, Andy
Xiaomi Corp	1810.HK	OW	31.12 HKD	07/05/2026	(20.8%)	45.00 HKD	45%	106,041 USD	36.5 e	26.9 e	2.5 e	2.3 e	30.2 e	20.8 e	7.5% e	9.4% e	0.0% e	0.0% e	Meng, Andy
HIKVision Digital Technology	002415.SZ	EW	35.96	07/05/2026	20.5%	33.00	-8%	49,346 USD	21.9 e	20.2 e	3.2 e	3.0 e	15.6 e	14.1 e	15.9% e	15.8% e	2.2% e	2.5% e	Meng, Andy
Shenzhen Transsion Holdings Co Ltd	688036.SS	EW	57.57	07/05/2026	(13.0%)	60.00	4%	9,639 USD	106.0 e	26.8 e	3.4 e	3.1 e	128.9 e	16.2 e	3.0% e	12.8% e	0.0% e	0.0% e	Meng, Andy
Foxconn Industrial Internet Co. Ltd.	601138.SS	OW	64.18	07/05/2026	3.4%	82.80	29%	176,967 USD	20.9 e	15.9 e	7.4 e	7.2 e	14.4 e	11.5 e	36.6% e	46.7% e	4.4% e	5.8% e	Shih, Sharon
Mean										8.7		24.4				9.5%		2.0%	
Median										4.4		7.2				4.8%		2.4%	
Real Estate																			
China Resources Mixc Lifestyle Services	1209.HK	OW	49.48 HKD	07/05/2026	15.2%	55.47 HKD	12%	14,416 USD	22.5 e	20.1 e	6.3 e	6.2 e	13.3 e	11.9 e	28.3% e	31.3% e	4.5% e	5.0% e	Cheung, Stephen
Mean										20.1		6.2				31.3%		5.0%	
Median										20.1		6.2				31.3%		5.0%	

Source: Factset, Morgan Stanley Research

What Does AI Adoption Mean for China's Economy?

Robin Xing, Jenny Zheng

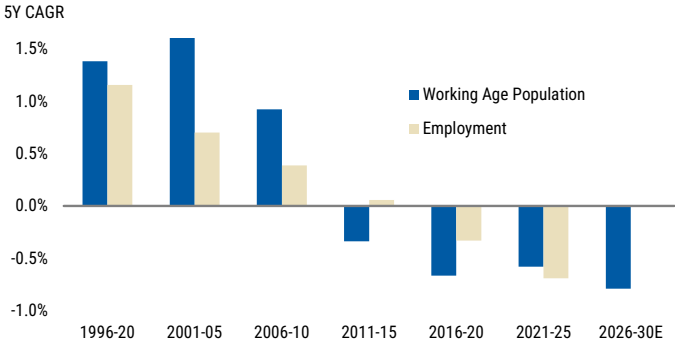
In our last China AI Bluepaper, we argued that while AI offers long-term productivity gains and could help offset demographic headwinds, near-term support would mainly come from an AI capex boom, yet labor market disruptions during transition could be a risk to watch. Rapid AI adoption is now bringing this dynamic into focus. We estimate AI could lift China's total factor productivity growth by around 3ppt cumulatively over the next decade, raising the level of potential GDP by about 3.5ppt by 2035 relative to a no-AI trajectory. Near-term net contributions to headline growth, however, would be muted, as gains from AI-related capex and early productivity improvements could be largely offset by labour adjustment frictions. Although China's aggregate AI job exposure is lower than in the US, weak demand conditions mean displacement effects could materialise faster than job creation over the next 2–3 years. Policy mitigation is expected to step up later this year, but it may only offer a partial offset, as Beijing could exercise greater caution in labor-intensive services while allow faster adoption in higher-end cognitive roles, to maintain China's competitiveness in GenAI.

AI+ is elevated as the centerpiece in China's 2026-30 Five Year Plan...

AI is deemed imperative for China's medium-term growth. With population aging and a shrinking labor force, China's growth model increasingly depends on raising output per worker. AI is therefore positioned as a macro-level productivity lever over the longer run — enhancing labor efficiency, reallocating human capital toward higher value-added activities, and accelerating innovation diffusion across sectors. Beyond growth arithmetic, persistent US–China strategic competition has further elevated AI's role, reinforcing Beijing's focus on technology self-sufficiency and supply-chain resilience.

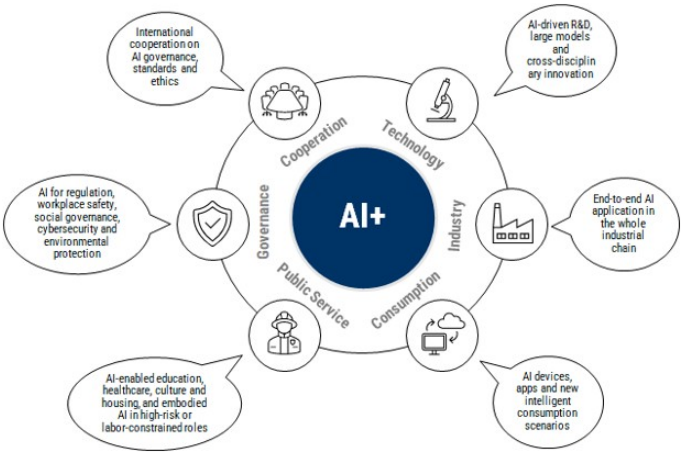
The 15th Five-Year Plan (FYP) institutionalizes "AI+" as a productivity strategy. It embeds AI across core development objectives, explicitly linking digital and intelligent upgrading to sustained productivity gains and targeting labor-productivity growth that outpaces GDP growth. AI+ is integrated throughout the planning framework— from computing infrastructure and data governance to large-scale adoption across industry, services, and public administration — signaling a clear shift from frontier breakthroughs toward deployment at scale. At the same time, the Plan strengthens alignment around domestic AI supply chains and efficiency-driven development paths, encouraging hardware–software co-optimization, open-source models, and cost-effective diffusion. Together with deeper integration into national standards and governance frameworks, this approach positions AI as a general-purpose enabler of structural upgrading, supporting medium-term growth and extending China's influence over global AI deployment norms.

Exhibit 14: Rising demand for labor productivity boost given aging population



Source: Haver, NBS, UN, Morgan Stanley Research. E=UN estimate

Exhibit 15: The 15th FYP elevated "AI+" as a cross-cutting productivity strategy

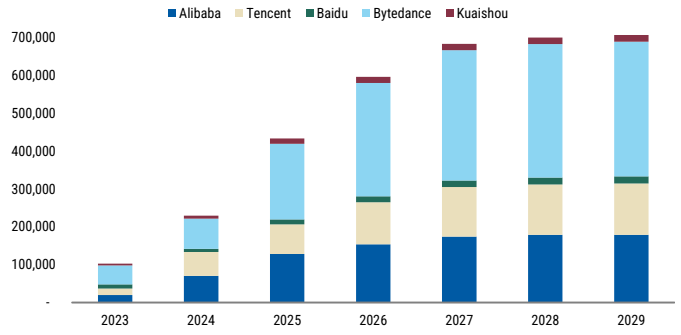


Source: Government website, Morgan Stanley Research

...anchoring the AI capex upcycle in the near term

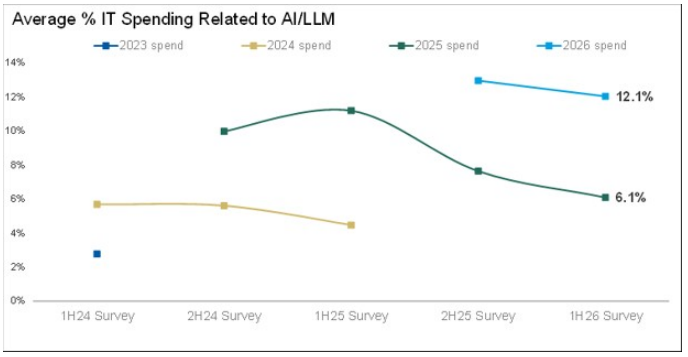
Given that AI is no longer treated as a standalone emerging industry, but as a foundational input to future growth, akin to digital and physical infrastructure, we expect more AI-related capex in compute, data centers, energy, and downstream deployment across the real economy over coming few years. Our Internet team expects China's major technology companies to increase AI-related capex by 38% this year, to Rmb597bn (US$85bn), and further up to Rmb711bn (US$101bn) by 2030 (10% CAGR over 2025-30). Our 1H26 China CIO Survey also shows that the share of AI in IT spending would remain high at 12.1% in 2026 (vs. 7.7% in 2025), and 40% surveyed CIOs expected to launch their first AI projects within 12 months. **We thus estimate that the strong AI-driven capex growth in emerging industries to bring a 0.2-0.3ppt boost to real GDP growth in next two years**, offsetting the drag from continued sluggish property investment.

Exhibit 16: Hyperscalers to step up AI-related capex spending significantly in next two years



Source: Company data, Morgan Stanley Research estimates.

Exhibit 17: 1H26 China CIO Survey: AI share in IT spending budget to remained high at 12.1% this year



Source: AlphaWise, Morgan Stanley Research

But productivity gains take time to emerge

Recent international studies (here and here) and historical innovation waves suggest that

major technological breakthroughs typically generate a J-curve in productivity rather than an immediate uplift. Even if the speed, breadth, and depth of AI diffusion are likely to exceed those of earlier innovations, the underlying dynamics would be similar. In the near term, AI adoption entails adjustment costs — ranging from learning frictions and process disruption to the need for complementary investments in capital, skills, and organizational change — temporarily weighing on measured productivity. Sustained gains in total factor productivity typically emerge only later, as firms restructure workflows, labor reallocates toward higher-value tasks, and more effective human–AI collaboration are embedded across a broader set of tasks, functions, and decision-making processes.

Near-term job disruption risk in focus

China has relatively lower job market exposure to AI than the US: According to the OECD, jobs with high AI intensity are those concentrated in knowledge – and information-based services, such as IT, finance, media, and scientific R&D – and jobs with medium-high AI intensity, such as professional services and education. In contrast, jobs with low AI intensity are in construction, hospitality, traditional manufacturing, and primary sectors. Applying this taxonomy, only about 12% of China's total employment falls into medium-high or high AI-intensity sectors, as compared to ~30% in the US, while share of employment in jobs with low AI intensity is 38% in China and 15% in the US.

But China's rapid AI diffusion and weak demand starting point suggest that near-term disruption risks should not be underestimated. The net labor impact of AI depends on the interaction between adoption speed, job destruction, re-skilling, new job creation, and policy mitigation. Our latest China AI Survey shows that AI adoption has broadened rapidly over the past year. Against a backdrop of weak corporate earnings, firms in China may be more inclined to substitute labor with AI to protect margins, potentially leading to faster job displacement than job creation over the next 2-3 years. This risk is amplified by the broad-based nature of AI-driven substitution: GenAI is displacing junior white-collar work (exacerbating the already elevated youth unemployment), agentic AI is beginning to encroach on mid-level professional roles (adding pressures to the already stressed middle-income group), and physical AI – from drones to humanoid robots and autonomous vehicles – threatens parts of labor-intensive service jobs, the main absorber of employment losses in recent years. If not managed properly, these dynamics could reinforce deflationary pressures, weigh on corporate profitability, and ultimately constrain resources available for AI innovation.

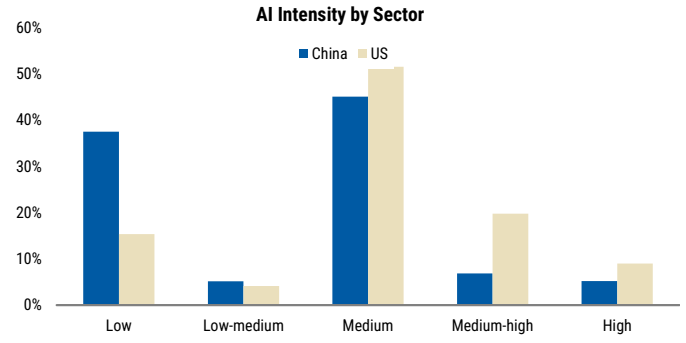
- **Elevated youth unemployment:** Global empirical studies (here and here) suggest that junior-level white-collar roles are among the most exposed to AI replacement risk. In China, youth unemployment has stayed in the high-teens over the past two years, even after the NBS excluded job-seeking students from the headline measure in December 2023. Meanwhile, we estimate the number of university graduates could rise from 12.2mn in 2025 to 14.5mn by 2030, with a continued preference for white-collar employment. If AI adoption outpaces graduate reskilling and new job creation, pressures on youth employment are likely to intensify.

- **Stressed middle income group:** Middle-income households are already under strain from slowing wage growth and negative housing wealth effects. Given that

knowledge – and information-based sectors – the typical higher-paid, middle-income jobs – are more exposed to the rising agentic AI, should near-term labor displacement outweigh complementary effects, wage and job pressures could rise, further weighing on consumption and reinforcing the housing downturn.

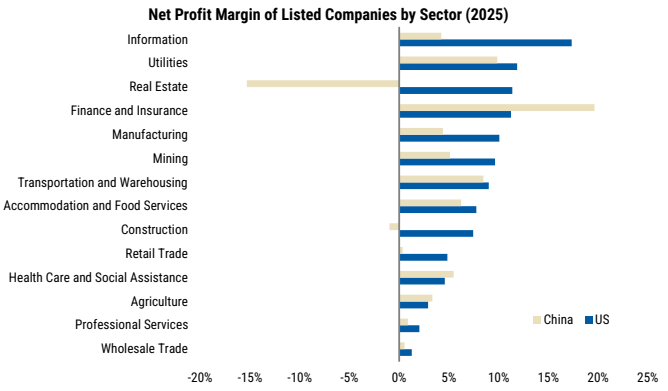
- **Rising automation risk in lower-end service jobs.** Contrary to perceptions that these roles are insulated, labor-intensive services, such as food delivery and ride-hailing, are increasingly exposed to automation. Delivery drones and autonomous driving pilots – rolled out by firms including Meituan, JD.com, and Baidu Apollo Go – highlight that even traditional employment buffers for low-skill labor face rising substitution risks, adding to concerns over broader job stability.

Exhibit 18: China's job market is less exposed to AI diffusion than the US...



Source: OECD, CEIC, Morgan Stanley Research

Exhibit 19: ...but weaker corporate earnings in China means higher risk of AI-induced labor replacement



Source: Factset, Morgan Stanley Research

Exhibit 20:
Broad-based nature of AI substitution risk exacerbating deflationary pressures in China



Source: Morgan Stanley Research

What to expect on policy mitigation?

The 15th FYP signals caution on AI-induced job disruptions: Against concerns over job displacement, rising income inequality, and social stability, the Plan emphasizes human-

machine collaboration, enterprise-led upskilling, and large-scale vocational training to address structural labor mismatches. The directive to *promote the application of embodied intelligence in positions facing labor shortages and high-risk working environments* further highlights a preference for selective, context-specific automation where substitution is most defensible, rather than broad-based labor displacement.

Policy protection, however, is likely to tilt toward labor-intensive service sectors. As Beijing seeks to narrow the gap with global peers in Gen-AI adoption among higher-end, knowledge-intensive white-collar roles, it may grant firms greater flexibility in labor adjustment to accelerate diffusion and productivity gains. By contrast, in areas where China is already near the technological frontier – such as AI-enabled delivery drones and autonomous driving – and where adoption directly affects large pools of service-sector employment, policymakers are likely to proceed more cautiously, trying to strike a balance between technological progress and labor-market stability.

Expecting more concrete mitigating measures later in the year: Beijing disclosed in late January that it is contemplating a document addressing the impact of AI on employment. Consistent with the 15th FYP's framework, possible measures include:

- **Expanded support for job reskilling and vocational training**, particularly to facilitate worker transitions alongside AI adoption.
- **Policies fostering new high-tech and modern service-sector job creation** to absorb displaced labor and upgrade employment structure.
- **Strengthened social protections**, including broader unemployment, healthcare and pension coverage for flexible and gig-economy workers.
- **More calibrated automation in labor-intensive service sectors**, such as delivery, healthcare support, and consumer services.

Quantifying AI's impact on China's economy

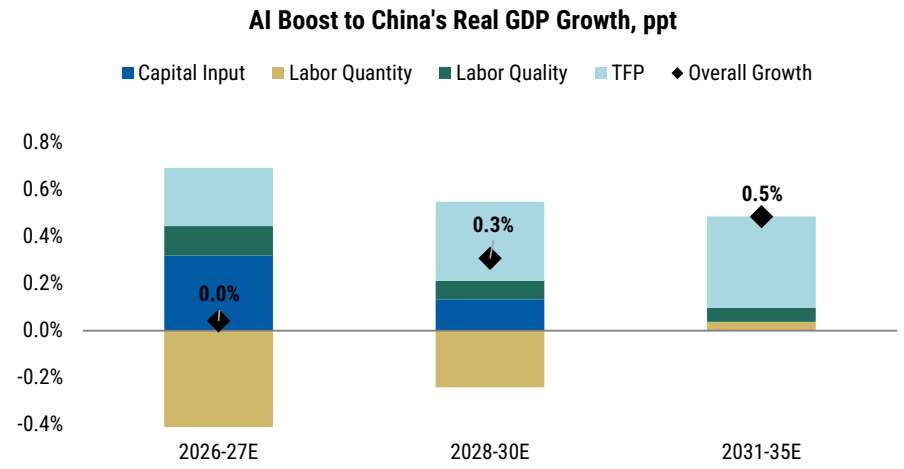
Near-term effects are likely neutral or even slightly negative, with positives from AI-related capex cycle and modest initial productivity gains... For 2026-27, the primary growth impulse from AI will stem from a capex expansion cycle spanning computing infrastructure, data centers, energy, and downstream deployment. We estimate this could add 0.2-0.3ppt to annual real GDP growth. Early productivity gains, however, are likely to be modest, with task-level efficiency gains in a narrow set of knowledge-intensive activities rather than broad-based, economy-wide uplift, as adoption remains uneven and organizational adjustment incomplete.

...largely offset by transitional labor disruptions: Given the starting point of sluggish corporate earnings, AI displacement effect will likely well outweigh complementarity effects and new job creation over next 2-3 years, particularly for junior level knowledge- and information-based jobs. More policy mitigation are expected, but the protection will likely lean towards lower-end, labor-intensive service jobs, not white-collar jobs. This means AI's net contribution to headline GDP growth will likely remain largely muted in 2026-27.

Over the longer term, AI would emerge as a structural driver of productivity and

potential growth: As AI capabilities mature and diffusion across the economy, we expect the technology to follow a trajectory consistent with prior transformative technological shifts: the emergence of new industries, the reshaping of market leadership, and deepening human-AI collaboration across enterprise workflows. Critically, this dynamic address one of China's structural headwinds – a shrinking working age population. **We estimate AI could cumulatively lift China's Total Factor Productivity (TFP) by ~3pp over the next decade**, with gains meaningfully back-loaded as adoption scales across the economy. Combined with AI-related capex upcycle, we expect a **potential GDP level ~3.5pp higher by 2035 compared to a trajectory absent AI adoption**.

Exhibit 21: AI's impact on China's GDP growth: Near-term neutral, long-term positive



Source: CEIC, Morgan Stanley Research estimates

Risks to watch

Key swing factors to our baseline forecast are AI diffusion speed & scale and policy reaction

- **Downside risk – Disruptive AI replacement across the economy, limited policy mitigation:** Under this scenario, AI diffusion accelerated across both junior white-collar roles and labor-intensive services, such as autonomous driving, delivery drones, and service robots, while policy mitigation is limited, with focus more skewed towards tech upgrading over labor market stabilization and social welfare supports. Under the prevailing weak demand environment, this means firm would tend to deploy AI primarily as a cost-cutting tool, translating productivity gains into massive layoffs than output gains. This would add to deflationary pressures, eroding corporate earnings and possibly constraining firms ability to invest beyond essential AI adoption. In turn, a negative feedback loop would be formed, in which AI boosts micro efficiency but acts as a macro demand headwind, delaying the emergence of longer-term productivity gains.

- **Upside risk – More measured AI diffusion, more demand-centric policy direction:** Under this scenario, AI adoption remains rapid but more gradual and augmentation-focused, with firms prioritizing productivity enhancement over outright labor replacement. At the same time, policy response is more proactive,

combining reskilling, vocational training, and stronger social protection with a clearer shift toward consumption-led rebalancing. Improved income security limits precautionary saving, supports consumption, and helps stabilize the housing market, easing deflationary pressures. Stronger demand allows productivity gains to flow through to corporate earnings rather than pure cost compression, enabling firms to scale AI capex alongside complementary investments in organization, data, and human-AI workflows. As profitability improves, new tasks and roles emerge more quickly, allowing job creation to catch up or even outpace displacement. In turn, AI becomes a reinforcing force for growth – supporting a virtuous cycle of firmer demand, stronger earnings, higher investment, and faster innovation diffusion.

Key Developments in Strength – Power, Humanoids, Autonomous Driving

Power

Eva Hou, Jack Lu, Tom Li

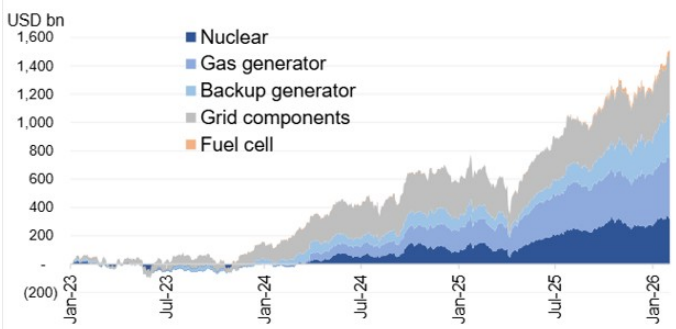
Flexible Power – The Next Wave of Growth in AI

China Power and Grid Equipment: Global Supercycle Ongoing; Looking for the Next Leg Up

Power for AI has emerged as a US$1.5tr theme. We see energy storage as the next wave of growth, with the focus shifting from power availability to power flexibility. Compelling levelised cost of energy (LCOE) and infrastructure deferral value enhance the economic case for ESS. Demand from data centers could double in five years.

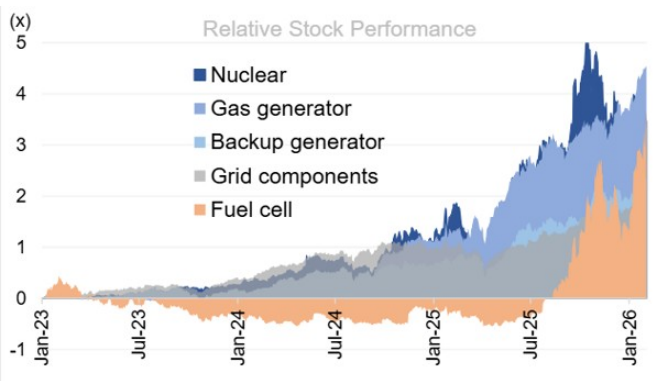
The next wave of change around "Powering AI": The quest to power the AI boom has significantly re-rated the global power value chain, creating a market worth over US$1.5tr in the past two years. This re-rating has catalyzed a rotation from nuclear power to grid facilities, backup/gas generators, and more recently to fuel cells. While power capacity is facing supply chain constraints across the board, we believe the next opportunity will be in energy storage systems (ESS), as investment in AI infrastructure continues to accelerate and inference workloads inflect, shifting the focus on AI from energy availability to power volatility, system flexibility, and time-to-power. We believe the thematic rotation toward energy storage is not just a logical step but a necessity. It is not about energy storage replacing generators, but the system rebalancing itself from one that built ahead of demand to one that creates a buffer against future demand, using inventory.

Exhibit 22: Global Power for AI Basket: >US$1tr market value accretion



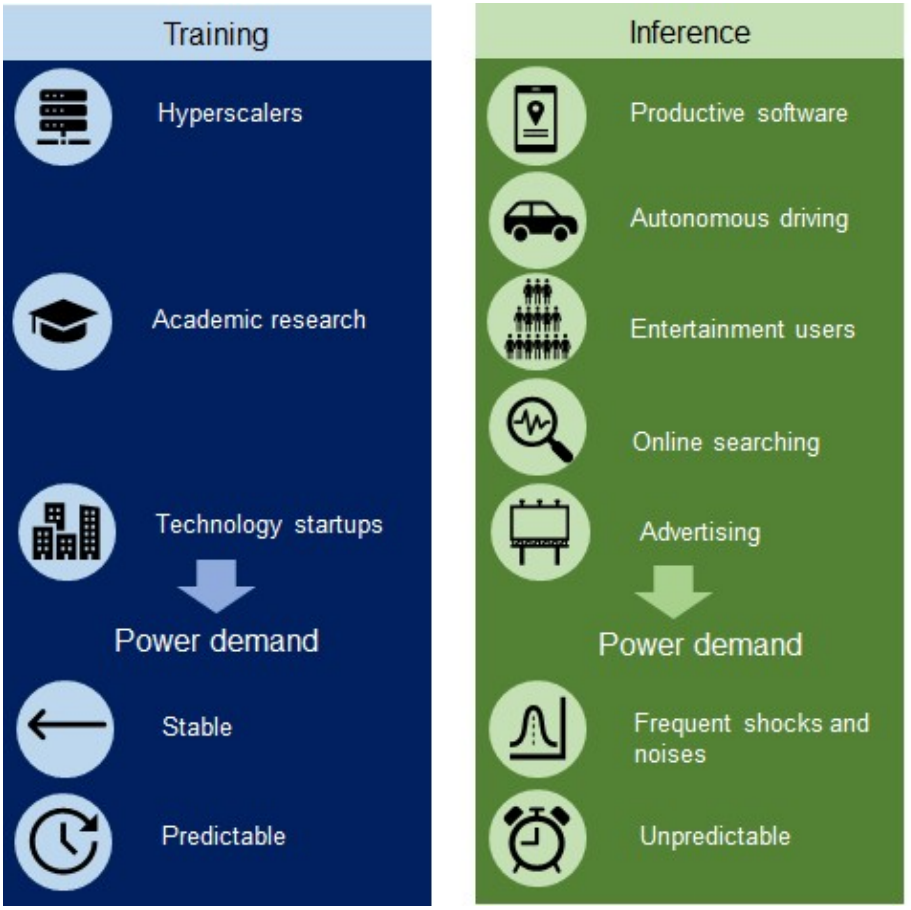
Source: Factset, Morgan Stanley Research

Exhibit 23: Segment rotations from nuclear, gas/backup generators to fuel cells; the next opportunity should be energy storage



Source: Factset, Morgan Stanley Research

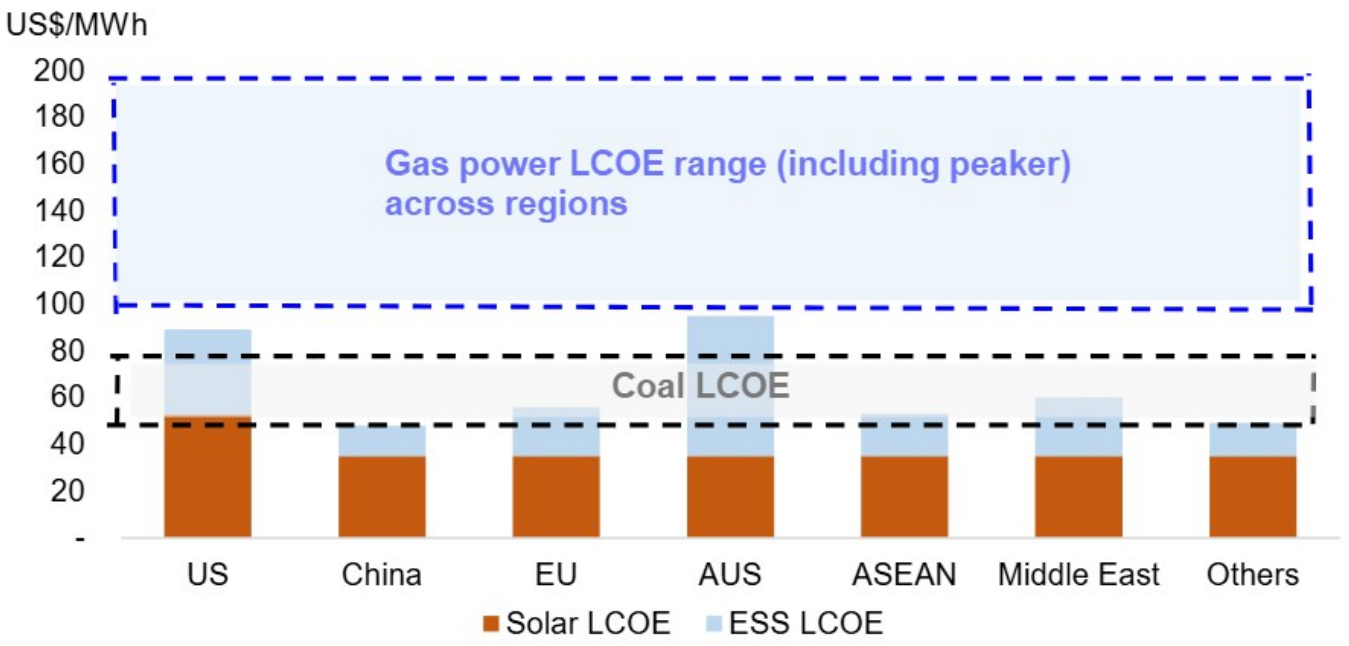
Exhibit 24:
Power consumption shifting from training workload to inference



Source: Morgan Stanley Research

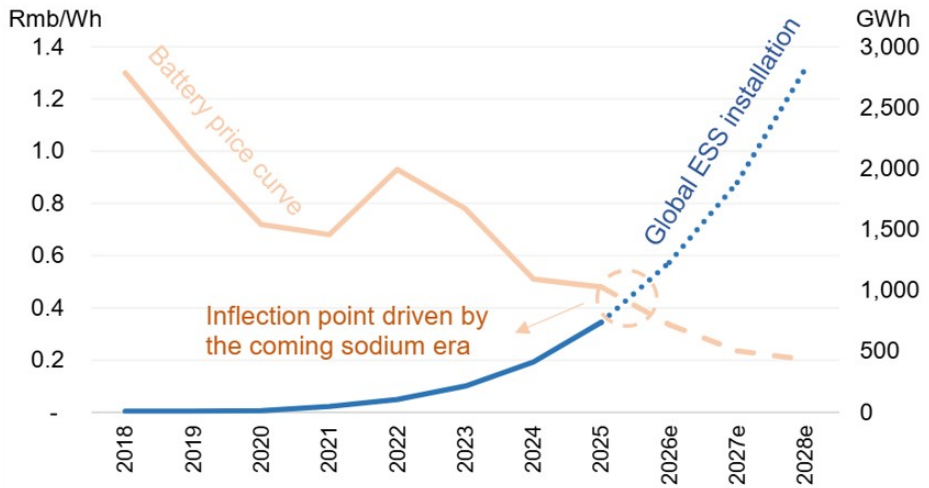
ESS cost advantages beyond LCOE comparisons: The ESS cost advantage can be seen not only in its LCOE, but more importantly in the ability of electricity inventory to defer or downsize the high opportunity costs of traditional capital-intensive power infrastructure. This time-to-power flexibility and infrastructure deferral value meaningfully enhance the economic case for storage. Battery costs will likely continue to evolve with the coming of the sodium-ion era – cheaper and safer, with the ability to deliver steady energy at low temperatures.

Exhibit 25: Solar integrated ESS LCOE across regions vs. gas power LCOE across regions



Source: Morgan Stanley Research estimates

Exhibit 26: Battery cost evolution driving "inventory" building for power

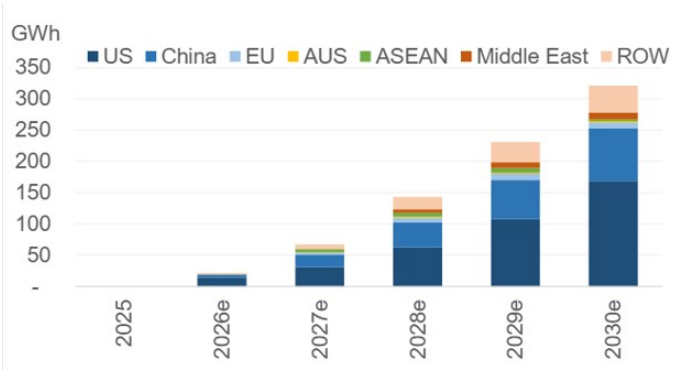


Source: Wind, Morgan Stanley Research estimates

Quantification: As AI data centers develop at an unprecedented pace and scale, the binding constraint is no longer demand or capital, but time-to-power and peak-load management, in our view. ESS will likely emerge as a natural, economically efficient approach at a turning point in the cycle. We map out global ESS demand from data centers in the next five years, considering: 1) peak-shaving demand from inference, and 2) deployment required to mitigate shortages in traditional power capacity. We forecast global ESS annual incremental deployment from data centers at ~321GWh by 2030 – 169GWh in the US, 85GWh in China, and 68GWh in ROW, vs. a global power market utility scale of 325GWh in 2025, which we also expect to increase at a 22% CAGR by 2030e, driven by the economic energy transition. Overall, we expect a 30% CAGR in global ESS

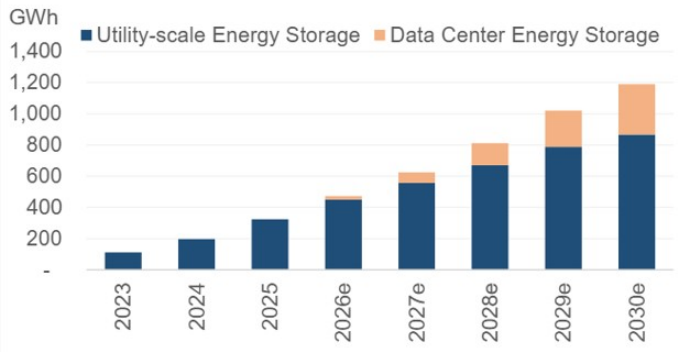
annual incremental deployment by 2030e.

Exhibit 27: Global ESS annual incremental deployment forecast for data centers...



Source: Rystad, Morgan Stanley Research (e) estimates

Exhibit 28: ...including utility-scale ESS in power markets



Source: Rystad, Morgan Stanley Research (e) estimates

Exhibit 29:

Heat map of potential beneficiaries in power-for-AI ESS

Company name	Business model	Why it benefits?
Tier 1: Direct, High-Conviction Beneficiaries		
CATL	World-leading battery cell manufacturer with growing system-level ESS integration (data center dominance)	CATL captures value across cell manufacturing, system design, and increasingly software-enabled storage solutions. Its scale, cost leadership, and readiness to commercialize sodium-ion batteries position it to drive ESS LCOE materially lower, expanding adoption across AI data centers and grids.
TESLA	Vertically integrated ESS system provider (Megapack) with rapid deployment capability	Tesla is a leading AC-side integrator for grid-scale and data-center storage, capturing full-system economics and benefiting from time-to-power urgency in AI infrastructure.
LG Energy Solution	Tier-1 global battery cell supplier with strong exposure to stationary storage and long-term utility contracts	LGES monetizes ESS growth through long-duration cell supply and stable OEM relationships, offering leveraged but lower-risk exposure to ESS volume expansion.
FLUENCE A Siemens and AES Company	Pure-play ESS system integrator and software platform (hardware-agnostic)	Fluence monetizes ESS adoption through turnkey deployment, digital optimization, and long-term services—well aligned with AI data centers' need for reliability, flexibility, and fast response
BYD	Vertically integrated battery and ESS manufacturer with strong DC-side presence	BYD captures cell-to-system margins and benefits from large-scale ESS rollout in China and emerging markets tied to AI and grid stabilitY
Tier 2: Enablers & Upstream Leverage		
SAMSUNG SDI	Advanced battery cell manufacturers with optionality in stationary storage	Participation in ESS expansion via high-performance chemistries, though capital allocation remains partially anchored to EV cycles
GanfengLithium	Upstream lithium resource and processing supplier	ESS growth diversifies lithium demand away from EV cyclicality, improving long-term volume visibility
TINCI 璞泰来 PUTAILAI SEMCORP 恩捷股份	Electrolyte, cathode, and anode material suppliers	ESS deployment supports incremental materials demand, but value capture remains indirect and chemistry-dependent
Tier 3: Grid & Electrical Components		
ABB	Global electrical equipment and grid automation provider	Incremental demand from ESS-related substations, converters, and grid reinforcement, but exposure is diluted across a broad industrial portfolio
Sieyuan EATON	Transmission, distribution, and control equipment	ESS deployment drives incremental grid capex, though AI-linked ESS is not yet a dominant revenue driver

Source: Morgan Stanley Research

Exhibit 30: Bull/base/bear case for ESS shipment forecasts

Scenario	ESS Shipments by 2030	Core Driver	Economics Bias	Key Risk / Catalyst
Bull	**>2000 GWh**	Larger than expected inference volatility → flexibility becomes mandatory	LCOE down / IRR up (scale + chemistry optionality), attractive infra-deferral value	Faster policy monetization; sodium penetration accelerates
Base	**1,200 GWh**	Steady grid + data-center ESS adoption	"Investable" IRR, gradual cost down	Stable capacity mechanisms; shipments continue > installs
Bear	**600 GWh**	Policy delay + slower AIDC ramp	IRR pressure (financing/utilization)	Monetization delays; inventory digestion; weaker spreads

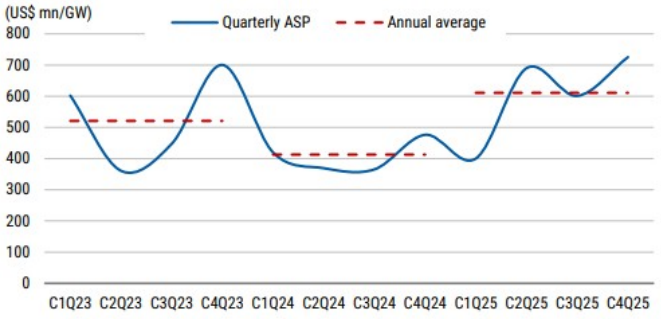
Source: Morgan Stanley Research estimate

Besides ESS, we are bullish on **gas turbines** and **high-voltage grid equipment (such as transformers)**. With AIDC boom, the global electricity system is shifting from stagnation to expansion, amid inadequate infrastructure, leading to a multi-year export upcycle for China. We believe global gas turbine demand is likely to increase from ~60GW p.a. to >100GW in the next ten years, with higher ASP. In addition, on the grid side, we foresee grid capex CAGRs of 9%/12%/8.5% for China/Europe/US in 2025-27E, respectively, compared with the global grid capex CAGR of 6-7% in 2020-25, driving the demand for large power transformers.

On the supply side, we view equipment makers' capex plans as still disciplined, as the capex-to-sales ratio remains largely stable. This should continue to foster a sustainable uptrend in lead time (2-3x vs. the normal level) and pricing (up 30-50% in 2025).

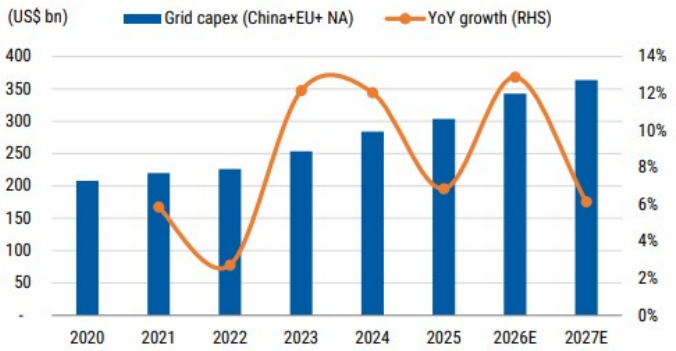
Therefore, we see sufficient upside surprise for China's equipment exporters along the gas turbine and transformer supply chains. Our most preferred plays are **Yingliu** (gas turbine vanes and blades) and **Sieyuan** (power transformer and HV switchgear). We expect a 40-70% earnings CAGR in 2025-27E for these two companies, underpinned by solid backlog and rising global market share. Our analysis indicates that every 1ppt global share gain can lead to 21-31% EPS upside in 2027E for both companies. On valuation, they are trading at close to or below 1.0x PEG in 2026E, which seems attractive compared to global peers at ~1.7x on average.

Exhibit 31: ASP of GE Vernova's gas turbine orders



Source: Company data, Morgan Stanley Research. Note: The pricing also includes other non-Gas Power businesses (steam, nuclear, misc.).

Exhibit 32: Grid capex in North America, Europe, and China in 2020-27E



Source: IEA, S&P Global Market Intelligence, CEC, Morgan Stanley Research estimates

Humanoid / Robotics

Sheng Zhong

Focus shifting from locomotion to "brain". China humanoids' locomotion capability improved meaningfully in 2025, becoming the de facto leader, highlighted by the impressive performance at the 2026 Spring Festival Gala, showing faster transitions and higher-difficulty maneuvers. Meanwhile, we see the importance of the robot "brain" rises in 2026 as model capability will become the key differentiator. While model architectures have yet to converge (still debate over VLA or World Model), we see China's strong advantages in extensive real-robot data collection and effort in diverse directions. Compared with Western players, Chinese players are taking a pragmatic approach, deploying robots across a wide range of specific tasks, collecting data to train the brain, and iterating body hardware in parallel to improve capabilities.

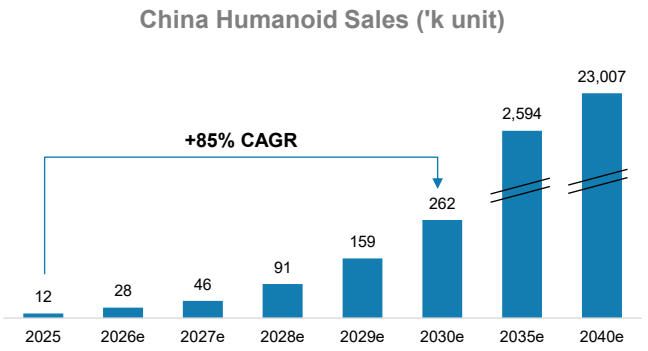
Strong support from the China government keeping it ahead in the robotics race. The 15th FYP named robotics as a strategic emerging industry for the first time, alongside with next-gen IT, NEV, biomedicine, and aerospace. China also released its first national standard system for humanoid and embodied AI. The continued top-level government support is critical to push early adoption and drive the scale flywheel, in our view.

We estimate China deliveries will double to 28k units in 2026. Most industry shipments are currently for R&D, education, and entertainment, including Unitree 5.5k units of humanoid sales in 2025. But as highlighted in our 2026 outlook, we expect sales to businesses to be the key driver this year. China integrators are pushing trials across as many applications as possible. While current humanoids can only handle specific tasks with limited generalization, we believe that after accumulating enough data and developing practical models with proven commercial value in 2026/27, a wave of scale adoption could start in 2028. We expect China's annual sales volume to exceed 100k/1mn/10mn units by 2029e/34e/38e and reach 54mn by 2050e. This implies a US $1trn market opportunity in China alone. Combined with our global forecast, the humanoid market could be worth US$7.5trn by 2050.

- *For a copy of our Global Humanoid Model and Robot Model with forecasts across the full range of embodied AI (not just humanoids), please reach out to your*

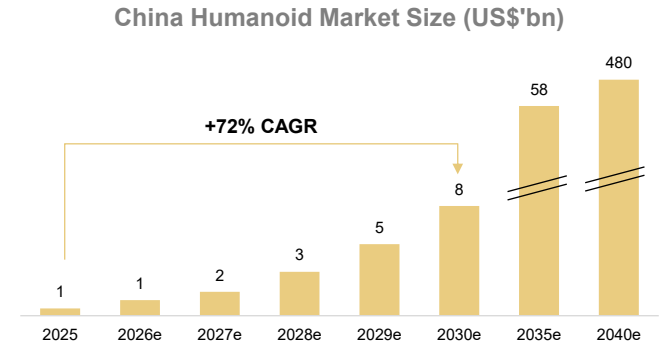
Morgan Stanley representative.

Exhibit 33: We have revised our sales estimate to 28k units in 2026



Source: Morgan Stanley Research (e) estimates

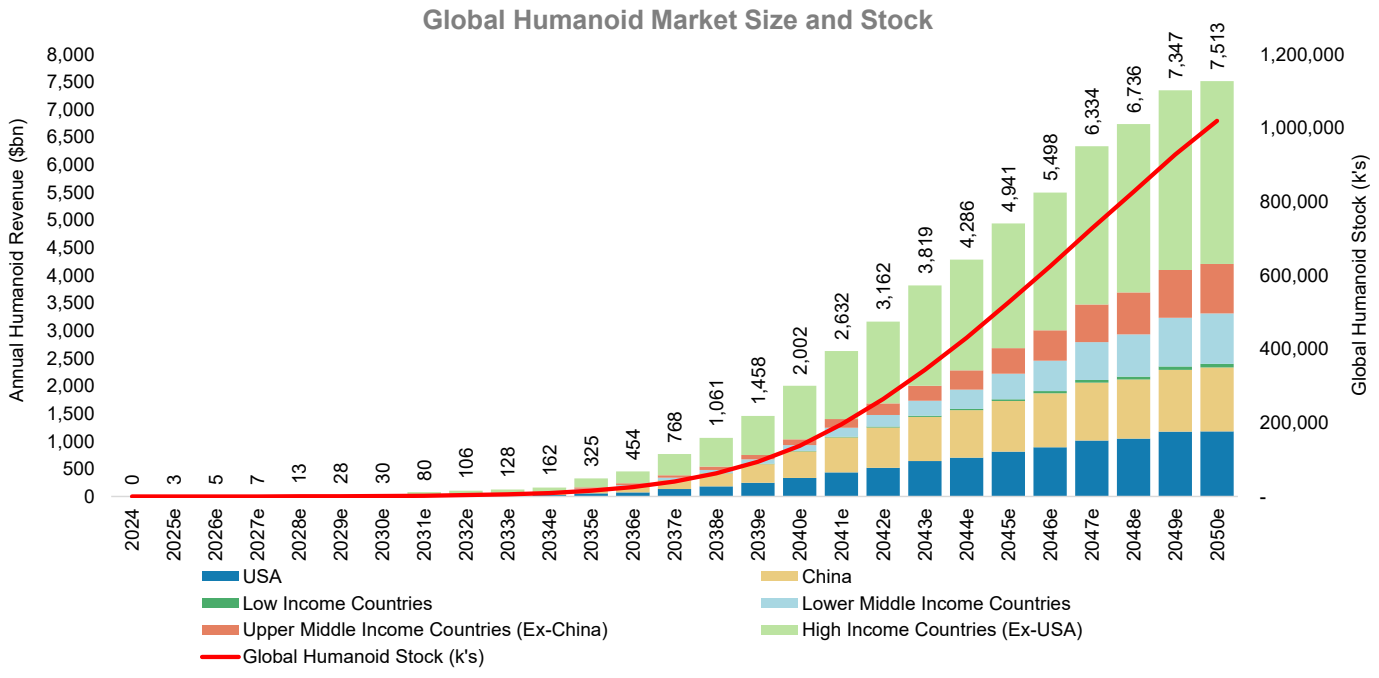
Exhibit 34: We expect the market to grow to US$480bn by 2040



Source: Morgan Stanley Research (e) estimates

Exhibit 35:

Combining with Morgan Stanley Global Humanoid Forecast, the humanoid market could be worth US$7.5trn by 2050



Source: Morgan Stanley Research estimates

Autonomous Driving

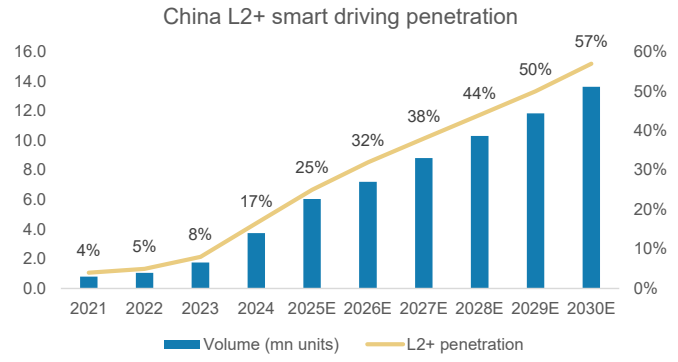
Tim Hsiao

As highlighted in our Bluepaper and 2026 outlook, the automotive industry is approaching an AI-driven inflection point. In early 2025, regulators introduced new policies to support AD deployment, and the first batch of L3 autonomous driving permits has been granted to OEMs, including Changan, BAIC Arcfox, Voyah, XPeng, Li Auto, and Xiaomi. Combined with rapid improvements in edge computing, this is set to accelerate the standardization of L2+ features, shifting them from differentiation to baseline functionality. We expect L2+

penetration in China to rise from ~25% in 2025 to ~32% in 2026 and exceed 50% by 2030.

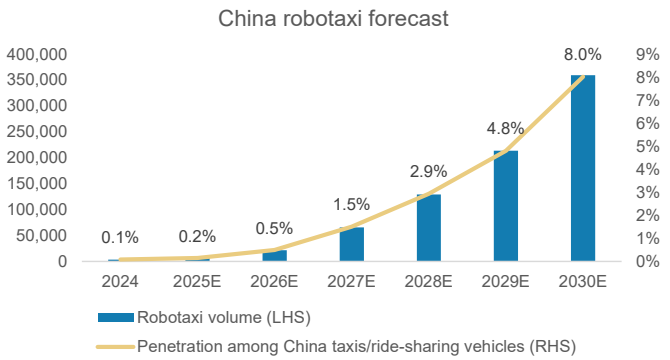
Looking ahead, while we expect L3 to anchor near-term industry narratives, L4/robotaxi development will also drive the next phase of global growth. Intensifying competition between Waymo and Tesla is catalyzing global ride-hailing platforms such as Uber, Lyft, and Grab to partner with Chinese robotaxi players, including WeRide and Pony.ai, to expand deployments across the UAE, ASEAN, and eventually Europe. This wave of commercialization is likely to further accelerate China's robotaxi roadmap. By 2030, we estimate L4+ robotaxis could account for ~8% of China's taxi and ride-hailing fleet (c. 360,000-400,000 units), with upside potential as regulatory and technological progress continues to advance.

Exhibit 36: We expect L2+ smart driving penetration to reach 32% in 2026 and 50%+ in 2030 (vs. 25% in 2025)



Source: NE Times, Morgan Stanley Research estimates (E)

Exhibit 37: We expect China's robotaxi fleet size to reach 360-400k units by 2030, accounting for 8% of total taxi/ride-sharing fleet size, or 25% in major cities



Source: Morgan Stanley Research estimates (E)

China AI Enabler

China AI accelerators, China foundry and China WFE

Charlie Chan, Daisy Dai, Henry Zhao

China's AI Accelerators – Who's Poised to Win?

China AI GPUs – Closing the Gap with the US

Our key enabler list

Cambricon (688256.SH, OW, PT Rmb2,000): Cambricon plays a foundational role in advancing China's AI compute self-sufficiency, particularly in large-scale training and inference within CSP environments. Its MLU series chips have already been deployed in core workloads such as search, advertising, and recommendation, demonstrating that domestic alternatives can support production-grade AI systems. As China shifts toward inference-driven scaling, Cambricon's continued product iteration and growing software ecosystem help narrow the gap with global leaders, while its transition toward a more localized supply chain enhances long-term resilience. Overall, Cambricon contributes to building a viable domestic AI compute stack, reducing reliance on imported GPUs.

Iluvatar (9903.HK, OW, PT HK$600): Iluvatar contributes to China's AI ecosystem by providing a commercially viable, scalable GPGPU alternative with strong supply chain resilience and improving software compatibility. Its TianGai series chips, supported by near-CUDA compatibility, lower migration barriers for existing AI workloads, enabling faster adoption across domestic cloud and enterprise environments. The company's diversified foundry strategy, including access to overseas capacity, strengthens supply stability at a time of tightening export controls. As shipments ramp and profitability approaches, Iluvatar is positioned to accelerate the deployment of domestic AI infrastructure, particularly in both training and inference scenarios, supporting China's broader localization push.

Naura (002371.SZ, OW, PT Rmb600): Naura plays a critical role in advancing China's semiconductor manufacturing self-sufficiency, particularly in WFE. The company continues to increase penetration in advanced logic tools, including etch and deposition, while expanding toward a more platform-based offering that covers a broader range of wafer processing steps. As demand for advanced-node manufacturing rises alongside AI chip development, we believe Naura is increasingly important in enabling the domestic production of high-performance AI semiconductors.

AMEC (688012.SS, OW, PT Rmb450): AMEC is another key participant in China's effort to localize advanced semiconductor equipment, with particular strength in high-end etch technologies. The company is expanding its presence in advanced logic nodes while pursuing platformization to broaden process coverage (~60% by 2030). In our view, AMEC's technology roadmap and growing adoption at domestic foundries position it as a critical supplier supporting the manufacturing infrastructure required for China's AI compute expansion.

SMIC (0981.HK, OW, PT at HK$70): We see SMIC as the central manufacturing pillar of

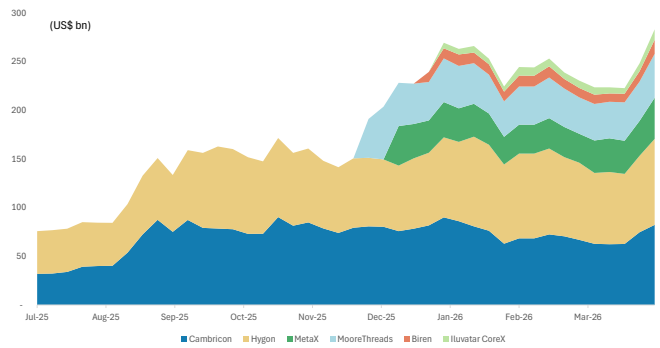
China's AI semiconductor ecosystem. Its advanced-node capacity (N+1/N+2) represents the primary production base for domestic AI GPUs and ASICs. While still constrained by tooling and process limitations, SMIC's continued capacity expansion and yield improvement are essential to scaling local AI compute supply. In our view, the company's ability to support increasingly complex chip designs will remain a key determinant of China's progress toward AI hardware self-sufficiency.

Transitioning toward commercial scale with localization tailwinds

China's AI GPU market is evolving into a more commercially driven stage, as the industry focus shifts from the feasibility of domestic chip participation to the competitive positioning of vendors in capturing incremental share amid accelerating inference demand. In our view, two structural dynamics are underpinning this transition: (1) a sharp expansion in AI inference workloads, supported by broader commercialization across both consumer-facing and enterprise use cases; and (2) ongoing export restrictions, which we believe will entrench localization as a long-term characteristic of China's AI compute landscape rather than a cyclical policy-driven adjustment.

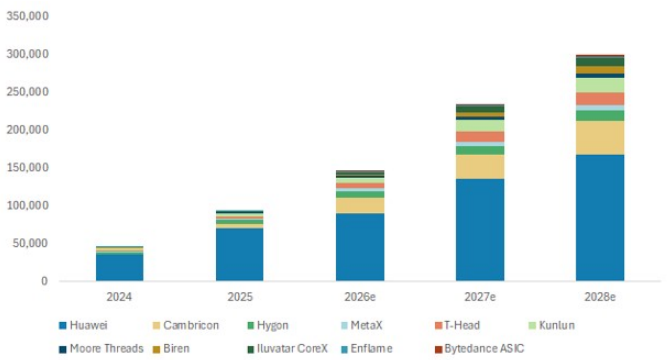
Taken together, these factors not only broaden the total addressable market for domestic AI accelerators but also enhance the visibility of sustained substitution trends. This perspective is consistent with our broader framework, under which we estimate China's AI semiconductor TAM could reach approximately US$67bn by 2030, with domestic supply penetration increasing to around 86%.

Exhibit 38: China AI accelerators' market cap trend



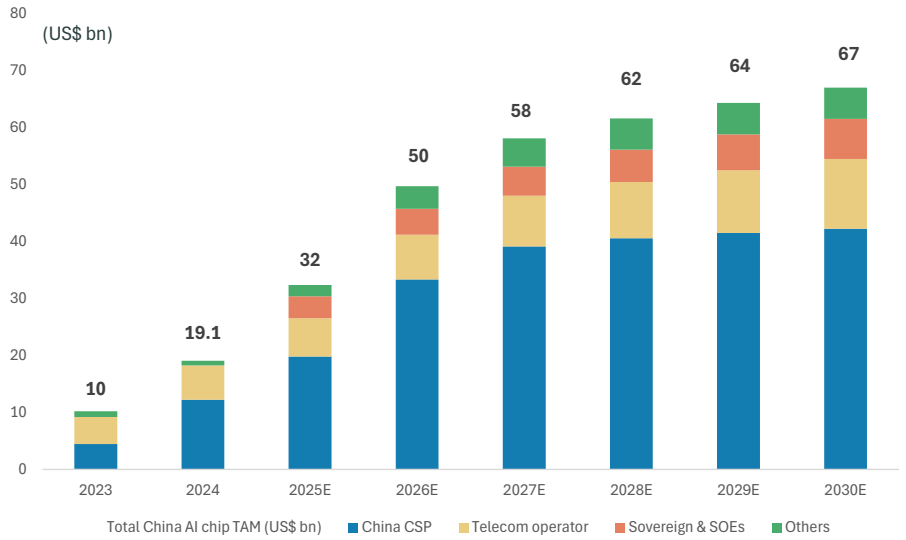
Source: FactSet, Morgan Stanley Research

Exhibit 39: China AI accelerators' revenue trend



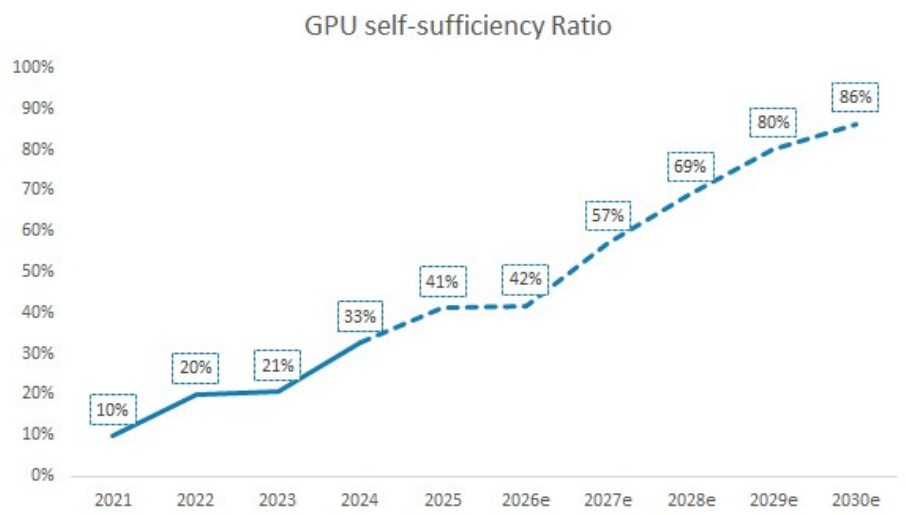
Source: Company data, Morgan Stanley Research estimates

Exhibit 40:
We expect China AI chip TAM to grow to US$67bn by 2030E



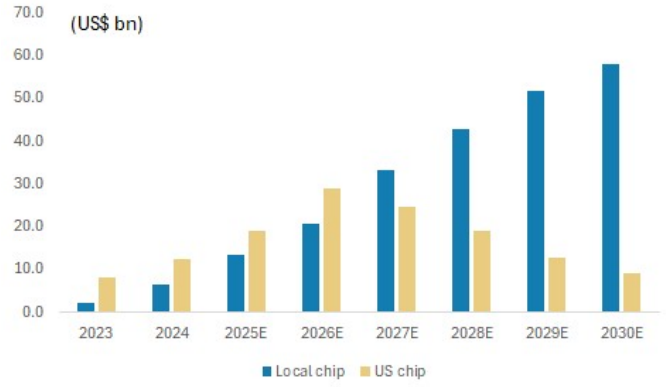
Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 41: We expect China AI chip self-sufficiency to reach 86% in 2030e



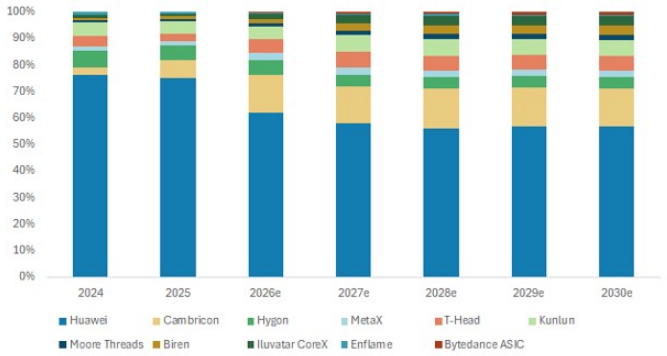
Source: Company data, Morgan Stanley Research (e) estimates

Exhibit 42: We expect local chips to surpass US chips in terms of value in 2027



Source: Company data, Morgan Stanley Research (e) estimates

Exhibit 43: We expect Huawei's share to remain above 50% in local AI chips throughout 2026-30



Source: Company data, Morgan Stanley Research (e) estimates

System-level capabilities driving global competitiveness

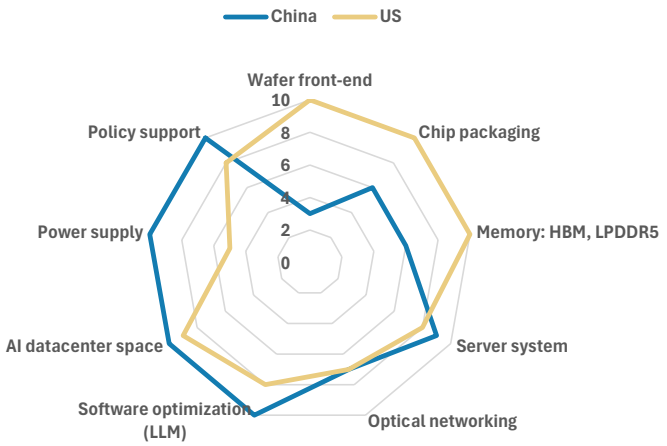
More broadly, we view China's AI GPU competition as increasingly extending beyond pure chip-level specifications. While domestic silicon continues to lag leading US products by approximately two generations, the effective performance gap is being mitigated through advancements in multi-die architectures, advanced packaging techniques, rack-scale system design, optical interconnects, and tighter software-hardware co-optimization. As a result, we believe system-level capabilities are becoming the more relevant determinant of competitiveness. In an environment increasingly shaped by inference workloads and utilization efficiency, vendors that can deliver superior real-world token economics – at manageable software migration costs – are better positioned to capture customer spending, even without access to leading-edge process nodes.

From an investment standpoint, we do not view the sector as a uniform policy-driven theme. Instead, differentiation is critical. Investors should distinguish between companies with credible pathways to shipment scale, ecosystem development, and disciplined pricing, versus those that may face challenges in translating technical progress into sustainable revenue growth and margin expansion. In this context, we apply a two-dimensional analytical framework of economics × execution. This incorporates quantitative metrics such as total cost of ownership (TCO), cost per token, throughput (TPS), and performance-per-dollar, alongside qualitative considerations including foundry access, software ecosystem maturity, relationships with cloud service providers (CSP), and roadmap visibility. In our view, this framework provides a robust lens for identifying likely long-term leaders versus participants at risk of marginalization as industry consolidation progresses.

Our recent channel checks further reinforce that adoption decisions are increasingly driven by economic considerations rather than policy orientation. At our 2026 China Summit, leading LLM developers indicated a willingness to deploy domestic GPUs, provided token-level economics remain competitive. This is consistent with our broader analysis, which suggests that domestic AI accelerators already offer meaningfully lower TCO compared with NVIDIA products currently available in China, while achieving broad

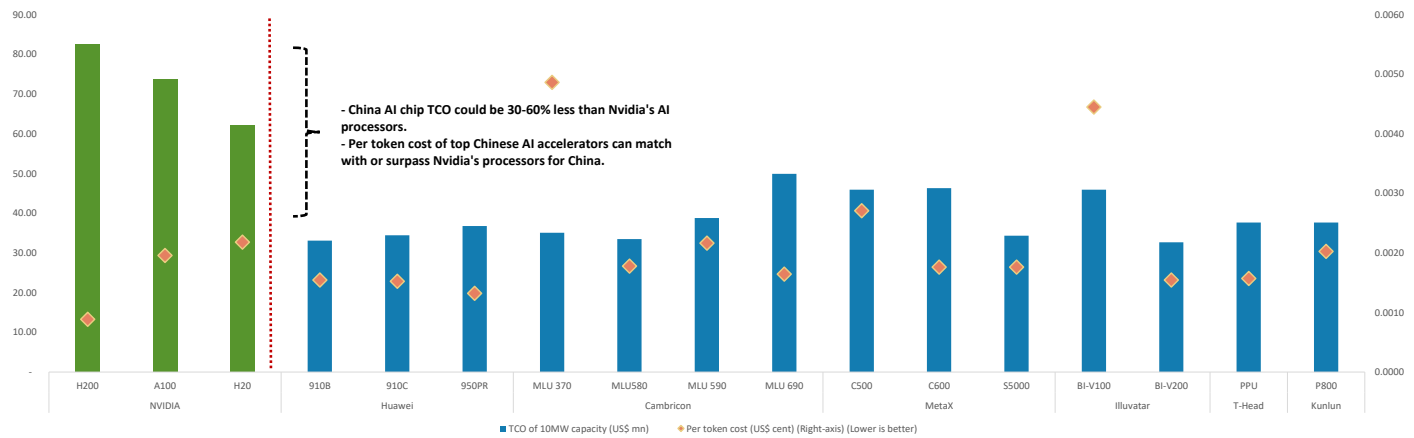
parity in cost per token for inference workloads. In practical terms, procurement decisions are shifting toward deployable cost efficiency rather than peak theoretical performance. This shift is particularly relevant as China's AI demand profile becomes more inference-intensive, recurring in nature, and utilization-driven – dynamics that structurally favor solutions optimized for cost efficiency, software adaptability, and supply availability over benchmark leadership alone.

Exhibit 44: Relative strengths of US and China AI industries



Source: Morgan Stanley Research

Exhibit 45: Domestic chips have lower TCO and comparable per token cost (AI LLM inference) vs. NVIDIA's processors for China



Source: Company data, Morgan Stanley Research estimates

Who is best positioned in China's AI semi market?

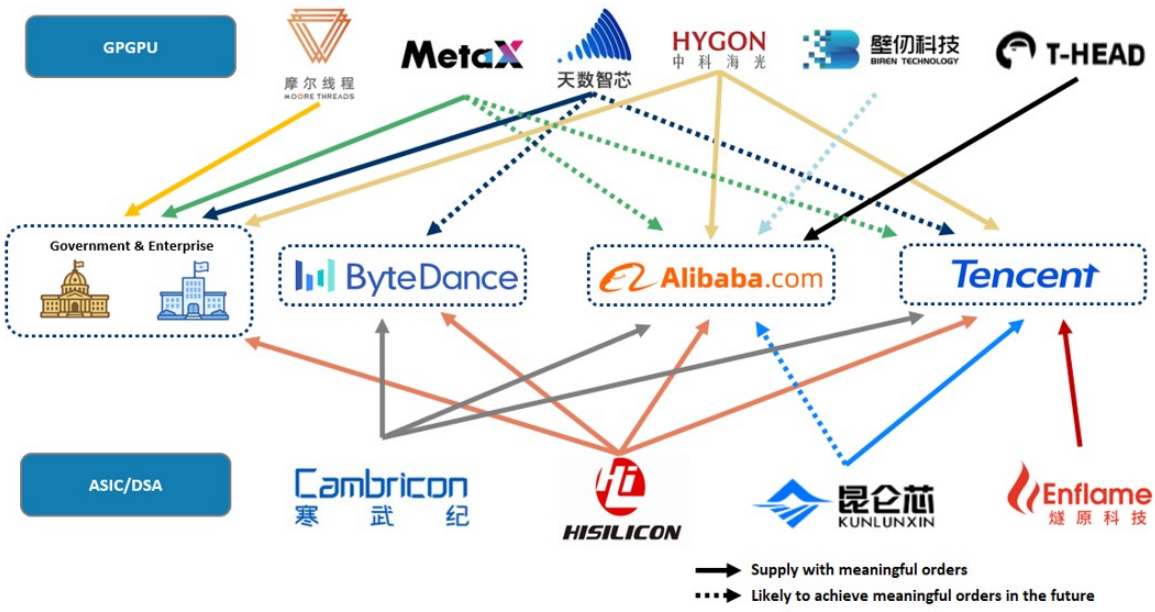
China's AI accelerator landscape spans merchant semiconductor vendors, state-backed entities, and in-house chip design teams affiliated with leading CSPs. We evaluate this competitive set within a broader global GPU/ASIC framework, benchmarking relative positioning across performance, cost structure, and execution capability, while applying a consistent valuation methodology to identify the most compelling risk/reward profiles. Our channel checks with CSPs indicate that although cost per token remains the primary

quantitative KPI, factors such as software optimization and the strength of strategic customer relationships are more influential in procurement decisions than previously assumed.

Based on recent shipment data, customer allocation trends, evolving market share, and an earlier-than-expected onset of pricing pressure, we believe the next phase of competition will be driven less by peak theoretical performance and more by execution on commercialization, software readiness, and customer acquisition.

From a competitive standpoint, segmentation by end-customer is increasingly important. Among top-tier CSPs and leading LLM developers, per-token cost has become a central decision metric, but it is not sufficient in isolation. Software stack maturity, framework compatibility, cluster-level optimization, and the depth of strategic partnerships are often decisive in determining order allocation. In contrast, for sovereign AI initiatives, telecom operators, state-owned enterprises (SOE), and government-linked demand, considerations, such as supply security, domestic controllability, and alignment with policy objectives carry greater weight. As a result, we expect differentiated winners across distinct end-markets. Vendors with strong co-development ties to CSPs and credible software ecosystems are better positioned to capture high-volume cloud inference deployments, while those with stronger domestic supply chain control or government relationships may have an advantage in public sector and sovereign AI projects.

Exhibit 46: Order placement and potential orders for domestic AI accelerators developers, according to our industry checks



Source: Morgan Stanley Research

Within this framework, we see clear differentiation across Cambricon, MetaX, and Iluvatar.

Cambricon appears well positioned along the ASIC/DSA pathway, where its inference efficiency, established customer base, and integrated hardware-software optimization underpin attractive deployment economics, particularly in large-scale cloud environments.

Iluvatar differentiates through a diversified foundry approach, improved supply visibility, and a relatively pragmatic migration pathway supported by software compatibility. MetaX, in our view, represents one of the more credible domestic GPGPU players, supported by comparatively stronger CUDA-like ecosystem compatibility and a manufacturing roadmap that could prove more scalable in the near term.

In summary, Cambricon appears best positioned in terms of current cloud inference traction (second only to Huawei Ascend), Iluvatar stands out for supply chain resilience and commercial optionality, while MetaX offers a differentiated pathway in scalable GPGPU deployment.

Exhibit 47: Comparison among Cambricon, MetaX and Iluvatar

	Cambricon 寒武纪	MetaX 沐曦	天数智芯 Iluvatar CoreX
Ticker	688256-SH	688802-SH	9903-HK
Product	MLU 220/270/370/580/590/690 (AI Training + inference)	C Series (AI training + inference) N Series (AI Inference) G Series (Graphic rendering)	Tiangai 100/150/200/300 (AI training + inference) Zhikai 100 (AI inference)
GPGPU/ASIC	ASIC	GPGPU	GPGPU
Chip suppliers	SMIC	SMIC	tsmc
Process node for latest products	7nm/N+2	12nm/N+1	7nm
Secured orders from major CSPs	✓	X	✓
Sovereign fund as major shareholder	X	✓	X
Per token cost performance	↑	→	→
2025 Revenue (Rmb mn)	CNY 6,497	CNY 1,644	CNY 1,034
Profitablity	✓	X	X

Source: Company data, Morgan Stanley Research

Upstream supply constraints continue to bind China's AI accelerator scaling

Evaluating China's capacity to deliver competitive AI GPUs at scale requires a bottom-up assessment of the semiconductor supply chain, with foundry capacity and upstream dependencies as the key gating factors. While China has made progress in localizing

portions of wafer front-end equipment (WFE), structural bottlenecks remain, most notably in lithography and inspection capabilities. Despite a surge in DUV tool imports from ASML in 2025, constraints in advanced inspection and metrology – particularly at leading-edge nodes within SMIC – continue to impose trade-offs between throughput and yield. At the same time, electronic design automation (EDA) remains a critical structural gap. Domestic providers, including Empyrean, have yet to establish full-stack capabilities for advanced-node design, while ongoing US export controls limit access to best-in-class tools. This combination continues to constrain China's ability to migrate toward leading-edge process nodes, reinforcing upstream supply-side limitations in the near to medium term.

Exhibit 48: China AI GPU supply chain – from equipment, fabs and design to system



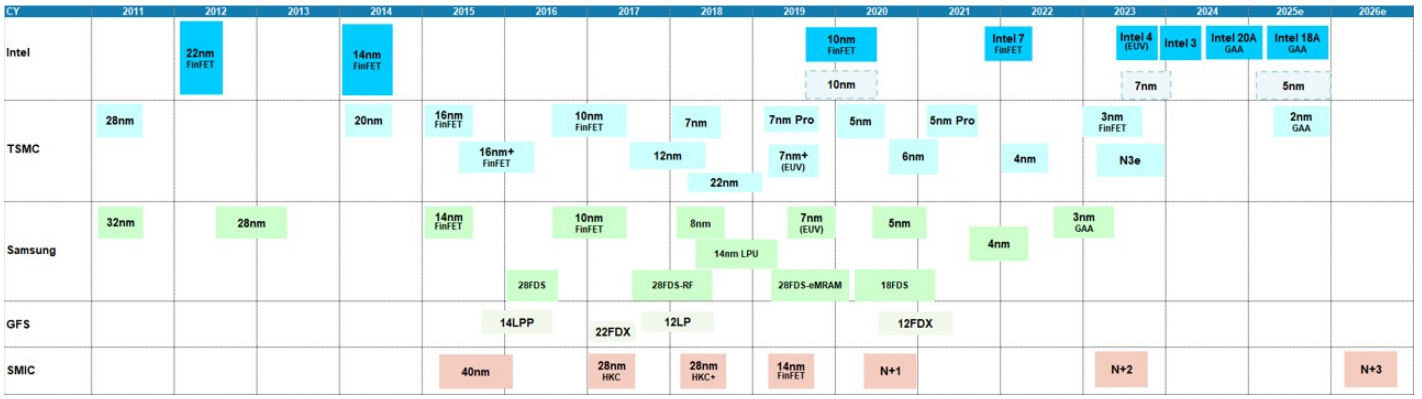
Source: Company data, Morgan Stanley Research

SMIC expansion shifts bottlenecks downstream without resolving them

Limitations in upstream tooling and process maturity have effectively concentrated China's leading-edge manufacturing capacity within SMIC, making it the primary bottleneck for domestic AI chip production. While SMIC has progressed to its N+2 node (broadly comparable to ~7nm) and may extend further through multi-patterning techniques, overall capacity remains constrained and subject to competing demand from end-markets such as smartphones and automotive.

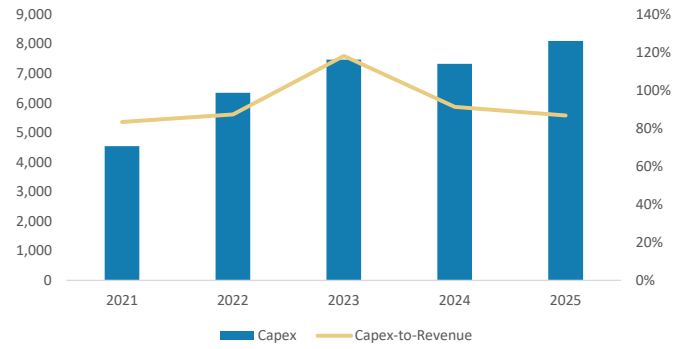
We estimate SMIC's N+2 capacity could scale from approximately ~22k wafers per month (wpm) in 2025 to ~51k wpm by 2027; however, allocation to AI GPU production is unlikely to be the dominant use case. Against this backdrop, some domestic vendors are opting to tape out on the more mature N+1 node to prioritize manufacturability and yield stability. This trade-off comes at the expense of compute density and power efficiency, effectively positioning such chips for inference-oriented workloads rather than large-scale training deployments.

Exhibit 49: SMIC's N+2 (7nm) is the key node for domestic AI chip production in 2025, followed by N+3 (5nm) node in 2026



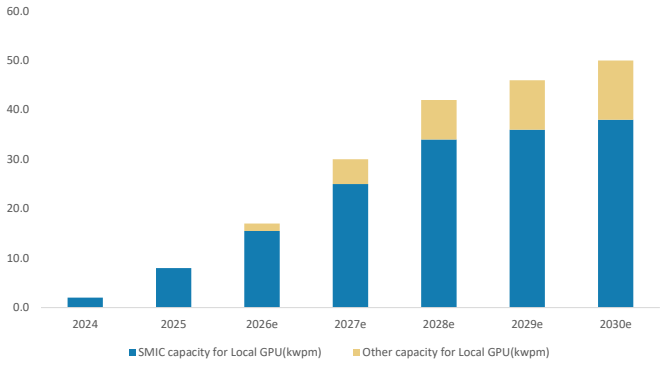
Source: Company data, Morgan Stanley Research.

Exhibit 50: SMIC's capex-to-revenue ratio remains high



Source: Company data, Morgan Stanley Research estimate.

Exhibit 51: We estimate advanced node capacity could increase at a CAGR of 44% over 2025-30



Source: Morgan Stanley Research (e) estimates.

Exhibit 52: Key WFE and EDA bottlenecks for China to expand advanced node capacity



Source: Company data, Morgan Stanley Research.

Greater China Internet, Software and IT Services

Owning the full AI stack forms a structural advantage

Gary Yu, Joanne Lau

China's Emerging Frontiers: China's AI Path: Owning the Full AI Stack via In-house Chips (11 Mar 2026)

China's leading Internet companies are accelerating investments across the entire AI value chain, with a growing emphasis on developing proprietary AI chips. This shift reflects rising geopolitical constraints on advanced semiconductor imports and the increasing strategic importance of computing power for large language models. In our view, ownership of the full AI stack – chips, cloud infrastructure, models, and applications – will differentiate long-term AI winners from laggards: Companies capable of integrating these layers internally can optimize performance, lower costs, and mitigate regulatory or supply-chain risks. As such, we view Alibaba as the best-positioned AI platform.

By designing their own chips, companies can optimize hardware specifically for their workloads, reduce reliance on third-party suppliers, improve power efficiency, and lower inference costs. The integration of chips with internal cloud infrastructure and AI software stacks further improves utilization and performance at scale.

On this premise, we view Alibaba (OW) as a global AI winner: It has top-tier in-house AI chips (T-Head), China's #1 and the world's #4 cloud infrastructure provider (AliCloud), the world's most adopted SOTA open-weight foundation models (Qwen models), and consumption-centric applications (Qwen apps).

Exhibit 53: Analysis of four-layer AI stack of CSPs

	Alibaba	Baidu	Bytedance	Tencent
Chips	✓✓✓	✓✓✓	✓	✓
Cloud	✓✓✓	✓	✓✓	✓✓
Models	✓✓✓	✓✓	✓✓	✓
Applications	✓✓	✓	✓✓✓	✓✓✓

Source: Morgan Stanley Research

China's AI chip market TAM could reach US$67bn by 2030 (demand based on GPU-related capex)

We estimate China's AI chip TAM to US$67bn by 2030, with Chinese CSPs driving the majority of this demand – contributing US$42bn in 2030 (>60% of the mix) – supported by:

1. Sustained capex investment (we expect CSP capex to expand further to Rmb711bn (US$101bn) by 2030 – a 10% CAGR over 2025–30,
2. Rising tokens output (China's open source artificial intelligence models now account for nearly 30% of global usage).
3. 2C applications usage surge (Qwen, Quark, Tuanbao, Doubao, Ernie etc.),
4. Broader 2B adoption

5. Emerging new use cases, such as Clawbot (Open Claw)

At the supply end, we expect China's local AI chip revenue to rise to Rmb356bn (US$51bn) in 2030, a 42% CAGR (2024-30), with self-sufficiency to rise to 76% in 2030e, mainly from expanding capacity from SMIC.

We expect the market structure to remain broadly consistent, with Cambricon's revenue reaching Rmb38bn (US$5bn) by 2030 with THead and Kunlunxin ranking behind. Our supply chain checks indicate that Huawei will likely remain the largest player in the China AI GPU space.

AI Cloud in China set for a 72% CAGR over 2024-29E

China's Emerging Frontiers: China's AI Path: Monetizing Surging Token Use via AI Cloud

We define China's AI Cloud market as the combination of GenAI-related IaaS (infrastructure as a service) and MaaS (model as a service, which is a part of PaaS (Platform as a Service) by the classical definition in the cloud era) with a TAM size of Rmb15bn in 2024. By the end of 2029, global market intelligence company IDC expects TAM to rise to Rmb218bn, a CAGR of 72%.

As a percentage of IaaS + PaaS, IDC expects GenAI to rise from 6% of the mix in 2024 to 39% by end-2029: We view this as the key driver for hyperscalers:

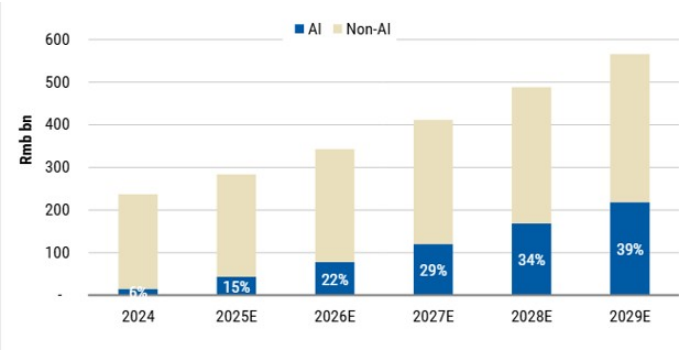
- Demand is surging: Demand for tokens is growing rapidly, driven by demand for both training and inference. Inference demand is the top driver of future growth, in our view. Our AlphaWise China CIO Survey indicated that hyperscalers are the go-to choice for AI deployment, demonstrating an improving intention to adopt more public cloud deployment from CIOs. This would benefit hyperscalers looking to expand their businesses.
- Supply constraints exist but are improving: Domestic chipset capacity is expanding, which should help increase supply for cloud players. Architecture and software innovation also help the hyperscalers to extract more workload from the available computing resources.
- We also highlight that data security could be the key concern over the long term for CIOs deciding between a public/private cloud deployment. Our AlphaWise China CIO Survey indicates a preference for hybrid deployment over the long run.

Exhibit 54: How the AI era differs from traditional cloud

	Cloud era	AI era
Datacenter	CPU based Tier 1 cities	GPU based Remote area
IaaS	Computing Storage Networking	Model training Model inferencing
PaaS/MaaS	Database Middleware Operating system	Vector database MaaS
SaaS	ERP Office software CRM	Chatbot Coding agent

Source: Company data, Morgan Stanley Research.

Exhibit 55: AI to take a rising share of IaaS + PaaS in China



Source: IDC (E) estimates, Morgan Stanley Research

2) Competition reshuffle – AliCloud and ByteDance to prevail

We see two trends emerging in the competitive landscape:

1. Hyperscalers regaining share from SOEs: The trend of hyperscalers losing cloud market share to the telcos and Huawei has been reversing since late 2024 with the help of AI. We cite better models and swift innovation as well as more access to the supply chain as the top reasons for the reversal.
2. ByteDance is the new disrupter: ByteDance is gaining rapid share in the public cloud market, according to IDC, because it is strongly preferred in the AI IaaS market, where it holds a ~15% share (vs. no significant share in the traditional cloud market). IDC believes this trend will likely continue, backed by aggressive investments in infrastructure.

So who might prevail in this contest for AI Cloud market share? We compare the participants using three key criteria:

1. Supply and capacity: Chipset capacity remains the top priority, and Alibaba, ByteDance, and Tencent currently hold the biggest advantage, based on their size of investment and relationships with suppliers.
2. Product matrix: We see five important product categories: 1) in-house ASIC, 2) foundational model, 3) multi-modal models, 4) MaaS, and 5) applications. Alibaba, as a full-stack provider with leading model capabilities, should be viewed as the most advantaged in each of these categories, in our view.
3. Service quality: Compared with Neoclouds, incumbents look more reliable and hold strong track records in solving customers' various problems, given their years of experience in the market.

Exhibit 56: What each cloud player offers

	Alibaba	ByteDance	Tencent	Baidu
	Alicloud	Volcengine	Tencent Cloud	Baidu Cloud
Cloud	阿里云		Tencent Cloud	
Chipset	T-head	Developing	N/A	Kunlunxin
Model family	Qwen Wan AI	Doubao/ Seed Seedance Seedream	Hunyuan Youtu	Ernie
MaaS/PaaS	Bailian (model studio) PAI	Volcano Ark Coze HiAgent	Tencent Cloud Platform T1 Platform ADP	Qianfan Paddlepaddle
2C Apps	Qwen chatbot Quark Amap	Doubao CapCut Dreamina	Yuanbao ima AI search	Ernie Chatbot AI search Baidu Drive
2B/Agents	Lingma JVS Claw DingTalk	Trae Agent ArkClaw Lark	Qclaw CodeBuddy Workbuddy Tencent Meeting/Wecom	DuClaw Comate

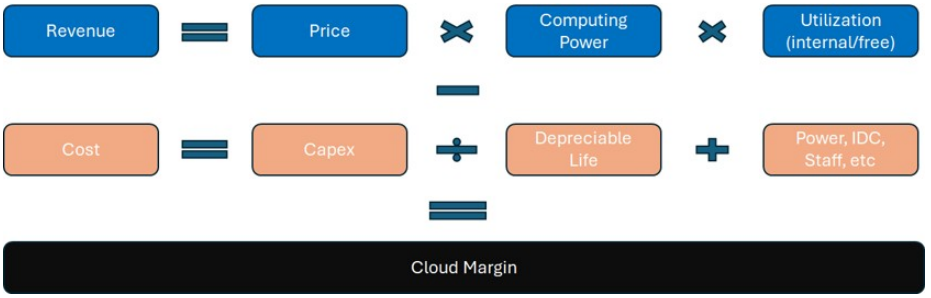
Source: Company data, Morgan Stanley Research.* Green box represents industry-leading position. Pink means lagging position. Grey means the product is yet to be released.

3) Margin expansion opportunities are here

Historically, pricing in China's cloud market has been deflationary in nature, and margins have been much lower relative to US peers (for example, AliCloud has an estimated EBITA margin in the high-single digits in F26E vs. operating margins for global players at 30-40%). We see trends emerging that could help China's domestic hyperscalers improve margins, including:

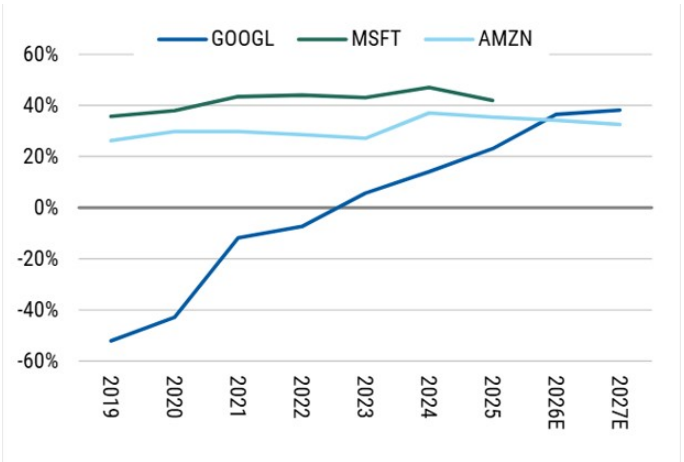
- A shift towards AI inference: We see inference workloads generating stronger margins than training workloads thanks to: 1) a better pricing mechanism and more value added services (VAS) bundle; 2) software/architecture innovation driving more token generation; and 3) better resource allocation (such as batching) leading to improved utilization.
- In-house ASICs allow cheaper infra capex as well as optimization with in-house models that could improve MFU (model flops utilization) and token generation.
- GPU renting vs. self procurement could make a difference as rental means that hyperscalers need to pay a margin to the supplier.
- Price hikes: After seeing the global hyperscalers raise their cloud prices in response to surging demand and rising supply chain costs (AWS and GCP both raised prices; AWS raised prices 15% for machine learning in 2026), we think a similar scenario could play out in China. Small players, like Wangsu hiking its CDN (content delivery network) prices, could be an early sign (link), followed by UCloud (link). However, we also need to watch for competition from ByteDance, which has been the most aggressive on AI cloud pricing.

Exhibit 57: Key factors determining the EBIT margin



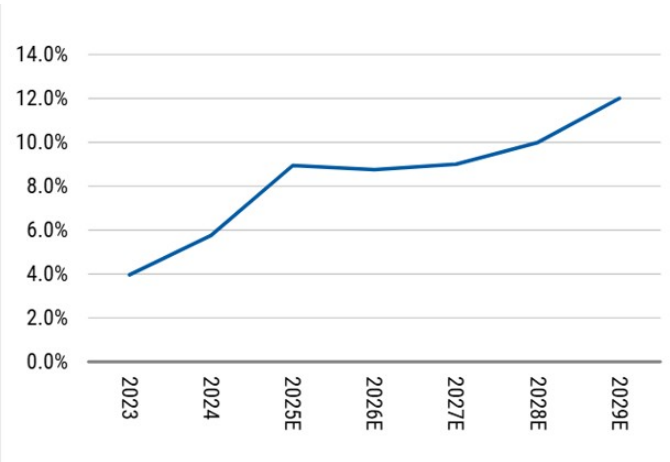
Source: Morgan Stanley Research

Exhibit 58: US hyperscalers – cloud operating margin



Source: Company data, Morgan Stanley Research (E) estimates.

Exhibit 59: Alibaba Cloud – EBITA margin



Source: Company data, Morgan Stanley Research (E) estimates.

Key stock calls

Alibaba (BABA.N, OW) is our Top Pick and best AI infra play: We stay bullish on its full stack AI solutions across chipsets, GPU-based IaaS, AI models, MaaS, and applications. We recently raised our AliCloud growth forecast for F27 to 45% from 40% (link). We estimate that a 10% increase in overall contract pricing would lead to a 4ppt EBITA margin expansion, assuming 20% of the existing contracts are renewed every year, all else being equal. This could also drive a higher P/S multiple, which is currently not in our base case valuation. Our midpoint SOTP approach derives a value of US$245 per share with US$91 contributed by cloud.

Tencent (0700.HK, OW) is still our best AI application play: We continue to view Tencent as the best AI enabler with its strong social network and ecosystem. We note that more AI adoption within its ecosystem and application portfolio could be a key re-rating catalyst for the stock.

GDS (GDS.O, OW) and VNET (VNET.O, OW): We stay bullish on the two IDC ADRs with exposure to the data center expansion in the remote areas of China, mainly driven by the aggressive capex plans of ByteDance and Alibaba.

Baidu (BIDU.O, EW): Baidu also has full stack solutions, but we note that its cloud presence, model, and application layers all lag the leading players – hence, our EW rating.

Datacenter – Key Beneficiary of AI Adoption

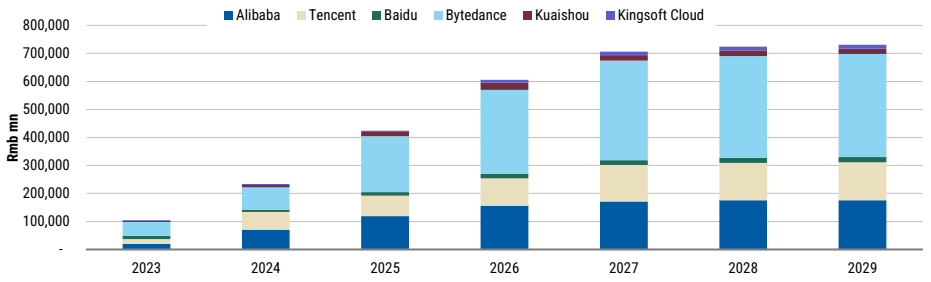
Yang Liu, Tom Tang

We forecast that the Chinese hyperscalers' capex will grow by a further 43%YoY in 2026, reaching Rmb606bn with more aggressive spending from Bytedance (based on our checks with suppliers) and Alibaba. This, in our view, will be driven by a combination of token demand surge and increasing capacity at the Chinese foundry.

We think datacenter vendors are a key likely beneficiary of increasing AI adoption which would translate into more computing capex. However, we want to highlight that we continue to prefer datacenters in the remote areas than the core tier 1 cities given: 1) larger scale, 2) more available power quota and 3) cheaper operating cost. We identify key areas including Ulanqab in Inner Mongolia and Zhongwei in Ningxia as the most preferred region.

We continue recommend leading IDC vendors - GDS and VNET to play the datacenter upcycle.

Exhibit 60: Chinese hyperscaler capex



Source: Company data, Morgan Stanley Research estimates.

Relevant reports:

China's Emerging Frontiers: China's AI Path: Monetizing Surging Token Use via AI Cloud (16 Mar 2026)

China's Emerging Frontiers – Data Centers: Inflection and Disruption in Remote Areas (21 Jan 2026)

LLMs – More Bang for Bulk

Gary Yu, Lydia Lin

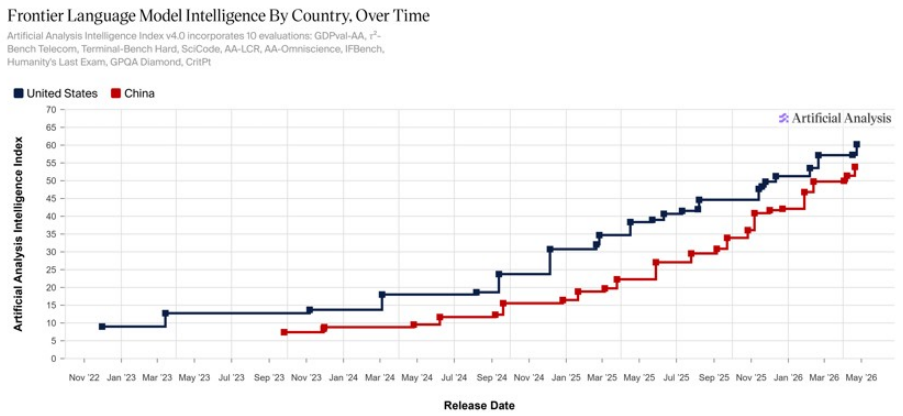
Benchmark story – China vs. US gap is narrowing: Although US AI labs continue to see breakthroughs in foundation model capabilities that exceed our expectations, the US-China AI race remains tight, with China following by just 3-6 months. According to OpenRouter, top Chinese LLMs grew their token-usage market share from 5% in April 2025 to 32% in March 2026 (vs. top US models down from 58% to 19%). MiniMax, Zhipu, and BABA reported 4-6x token-usage increases in February and March vs. December on breakthroughs in model intelligence, particularly coding and agentic capabilities.

Exhibit 61: Latest leading Chinese LLMs

AI lab	Alibaba	MiniMax	Z.ai	Moonshot	DeepSeek
Model	**Qwen3.6-Plus**	**M2.7**	**GLM-5.1**	**K2.6**	**V4**
Release date	Apr-26	Mar-26	Apr-26	Apr-26	Apr-26
License	Proprietary	Open Weight	Open Weight	Open Weight	Open Weight
Total parameter (B)	n.a	230	754	1000	1600
Context window (K)	1000	205	200	256	1000
API price (Rmb/mn tokens)					
Input (uncached)	5.00	2.10	7.00	6.50	12.00
Input (cached read)	n.a	0.42	1.65	1.10	0.10
Output	30.00	8.40	24.28	27.00	24.00
AA Intelligence Index	50	50	51	54	52
ARR (US$mn)	n.a	150 (Feb)	250 (Mar)	n.a	n.a
Valuation (US$bn)	n.a	37	56	18	n.a

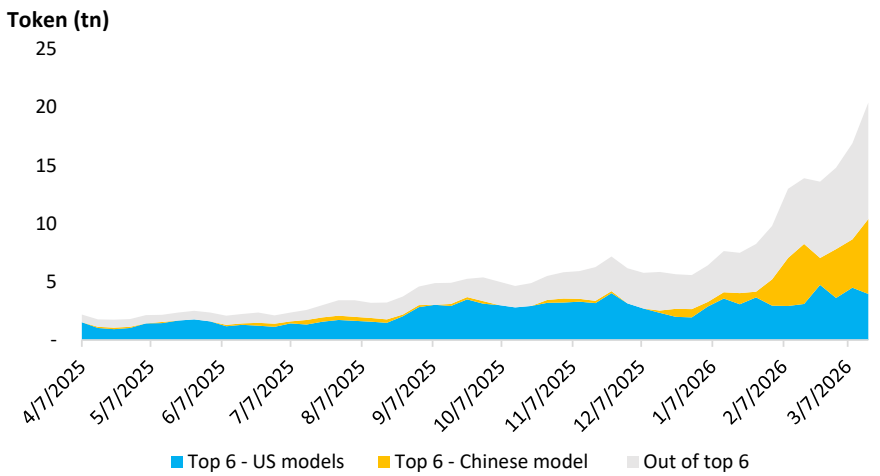
Source: Company data, Artificial Analysis, Morgan Stanley Research

Exhibit 62: Frontier LLM intelligence trend by country



Source: Artificial Analysis. Note: Updated by Apr 2026.

Exhibit 63: Weekly token consumption of models across OpenRouter



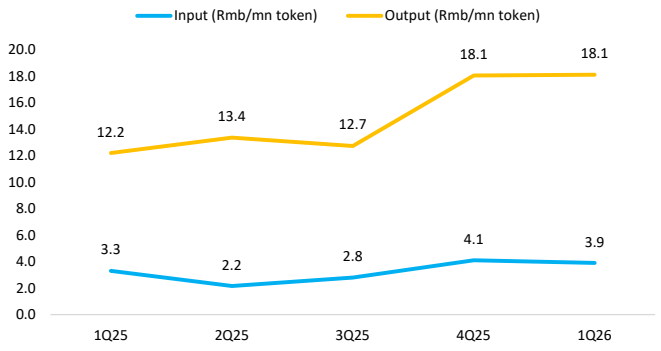
Source: OpenRouter Note: Updated Mar 2026.

Frontier Chinese models started to show pricing power – end of commoditization trend. Since the LLM price war began with DeepSeek-V2 priced at Rmb1/mn tokens in

2Q24, Chinese AI labs generally have cut their API prices by 70-90% across their product offerings, and this quick deflation soon made Chinese frontier LLMs much cheaper than US peers. However, we observed that this price war started to ease after its peak in 2Q25. Leading Chinese AI labs, including Alibaba, Bytedance, Baidu, Tencent, MiniMax, Z.ai, Moonshot and DeepSeek, generally raised API prices for new flagship models from 3Q25. From 2Q25 to 1Q27, the average input price has been raised by 80%, and the average output price has gone up by 36%. Z.ai is leading the trend with API price up 200%+ from GLM-4.5 in 2Q25 to GLM-5 1Q26.

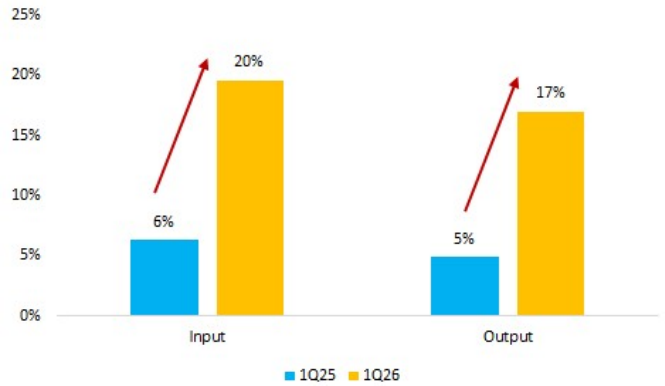
The price hikes of Chinese LLMs are not driven by rising costs but by performance improvements, as shown in an expanding API gross margin, indicating a meaningful shift away from pure commoditization towards performance-based monetization.

Exhibit 64: Frontier Chinese AI LLMs API price



Source: Company official pricing, Morgan Stanley Research. Averaged API price of Alibaba (Qwen2.5-Max, Qwen3, Qwen3-Max, Qwen3.5), Bytedance (Doubao-1.5-pro, Doubao-seed-1.6, Doubao-seed-1.8, Doubao-seed-2.0-pro), Baidu (Ernie 4.5, Ernie x1, Ernie x1.1, Ernie 5.0-Thinking-Preview), Tencent (Hunyuan-T1, HY-2.0), MiniMax (MiniMax-Text-01, MiniMax-M1, MiniMax-M2, MiniMax-M2.1, MiniMax-M2.5, MiniMax-M2.7), Z.AI (GLM-4-Plus, GLM-4.5, GLM-4.6, GLM-4.7, GLM-5), Moonshot (Kimi-latest-128k, K2, K2.5), DeepSeek (DeepSeek-R1, DeepSeek-V3.2). Input price averaged with cached and uncached.

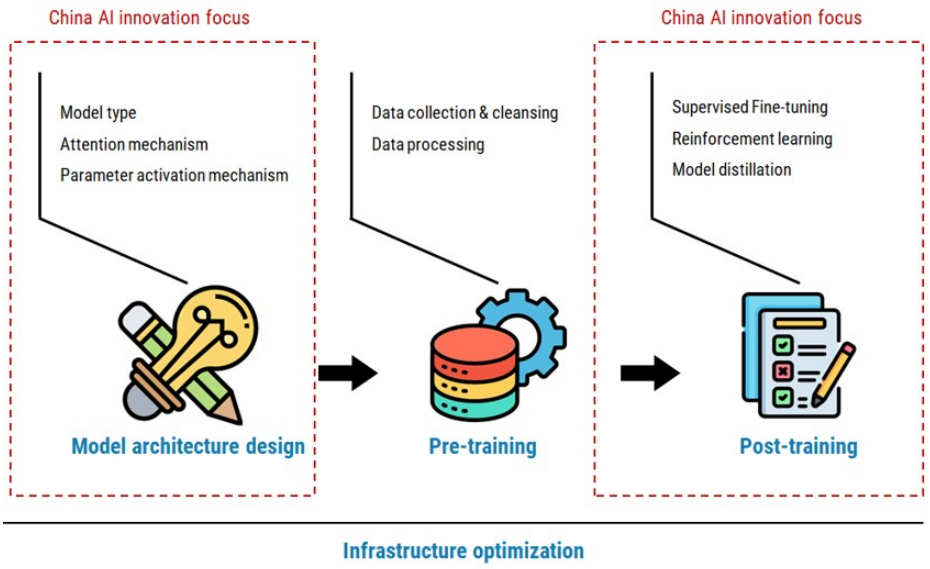
Exhibit 65: Frontier Chinese LLMs average API price as % of US LLMs



Source: Company official pricing, Morgan Stanley Research

China's AI path – High intelligence density per token cost: Beyond smaller model sizes (parameters), we highlight engineering-efficiency gains in: 1) architecture (dense vs. MoE, attention mechanisms), 2) post-training (reinforcement learning, model distillation), and 3) inferencing infrastructure (hardware optimization, KV cache efficiency). The recent launch of DeepSeek-V4 further proved Chinese models' efforts in efficiency. As a result, China AI labs deliver similar model intelligence to the US at only 15-20% of inference costs.

Exhibit 66: China AI innovation focus



Source: Morgan Stanley Research

Key stock calls

MiniMax (0100.HK, OW, PT): We believe the market is underestimating MiniMax's near-term ARR growth, which we see as being in line with, or stronger than, peers' at US$1bn, supported by multi-modal capabilities, global exposure, and infra advantages. We see multiple catalysts over the next 2-3 months, including product launches, model upgrades, price hikes, and potential index inclusion. We recently raised our DCF-based price target by 18% to HK$1,100 (link) with upward revenue revisions of 104%, 71% and 99% in 2026-28. Our price target implies 36x 2027 P/S.

Z.ai / Knowledge Atlas (2513.HK, OW, PT): Z.ai has demonstrated exceptional near-term momentum, with ARR guided to rise 10x within a year from <US$100mn at end-2025 to US$1bn ARR by end-2026, strengthening our OW investment thesis. The company's ability to raise API prices across model iterations signals high recognition of its foundation model intelligence by customers. Key catalysts includes model upgrades, potential index inclusion and A-share listing. Compute constraints remain key to watch. We recently raised our DCF-based price target by 77% to HK$990 (link) with upward revenue revisions of 138%, 138% and 163% in 2026-28. Our price target implies 38x 2027 P/S.

Alibaba (Top Pick in China Internet): We view BABA as the key China AI winner with a comprehensive full stack offerings (chips, infrastructure, model and applications). BABA has been stepping up AI developments recently with the establishment of the Alibaba token hub and key AI model launches/updates. The newly launched Qwen3.6 has topped daily, weekly, and trending leaderboards on OpenRouter. BABA sees Alicloud external revenue of US$100bn in five years (40%+ CAGR) and a long-term cloud margin of 20% (vs high-single-digit % now), while MaaS will become the key longer-term growth driver (estimated >50% of cloud revenue). In our high-end SOTP analysis of US$350, we estimate Qwen ARR at US$1bn, and value Qwen at US$27bn based on 30x EV/S, implying US$12/share.

Relevant reports:

China's Emerging Frontiers: China's AI Path: More Bang For The Buck (27 Apr 2026)

MiniMax: Correction: Multiple Near-term Catalysts (22 Apr 2026)

Software: Terminal value at risk

Yang Liu, Lydia Lin

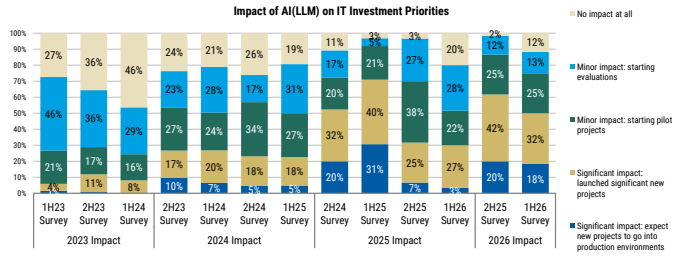
China's software and IT services industry is experiencing rapid change, given the fast iteration of underlying technology. It was viewed as a key beneficiary at the beginning of AI cycle since 2023 as software companies can adopt the new AI technology to improve their product and monetize. With the consistently expanding capability boundary of AI models, the lingering global debate over whether AI will eat software saw the market narrative change 180 degrees in early 2026 to the view that software (especially SaaS) is being disrupted by AI.

We believe the AI technology, especially the agentic AI, will bring a paradigm shift to the enterprise software space, including how people use software (becoming agents using software) and how software is built (much lower hurdle to personalize software). Most software companies are rolling out their new AI enhanced or AI native products and start to book incremental contributions. However, most of the AI benefit has been more than offset by macro deflation, leading to earnings downgrade for the sector. Whether incumbents' moat can work or not against the emerging AI products becomes a big question mark, putting the terminal value of software players at risk. We believe the tool type software is at higher risk, while for enterprise grade software it is quite difficult to envisage near term disruption. We also think the overall disruption risk is lower in China than in the US, given the lack of seat-based subscription model.

Even after the YTD de-rating, Chinese software players are still trading at a significant valuation premium over global peers. **We are EW or UW on most of China software and IT services companies: Kingdee (EW), Kingsoft Corp (EW), Sangfor (EW), Chinasoft International (UW), Kingsoft Office (UW), Yonyou (UW).**

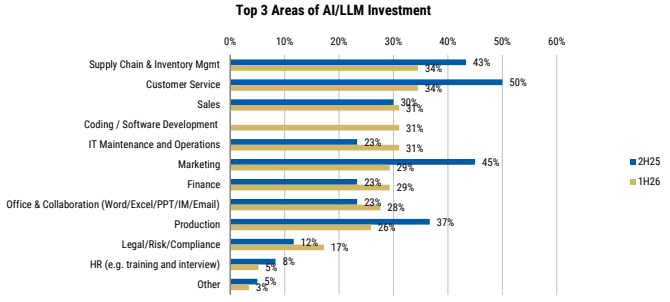
In our 2026 1H AlphaWise survey, China CIOs demonstrated strong interest in AI adoption, but their procurement behavior still follows the technology and macro cycle: 1) Enterprise AI adoption is slower than consumer, and the adoption has been delayed due to premature technology performance. 2) Overall enterprise IT budget is capped by the macro environment, so higher AI investment will cannibalize other areas.

Exhibit 67: AI impact on IT investment priorities



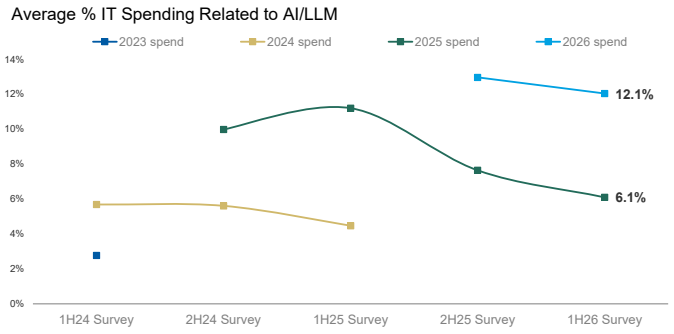
Source: AlphaWise, Morgan Stanley Research

Exhibit 68: Top 3 areas of AI investment



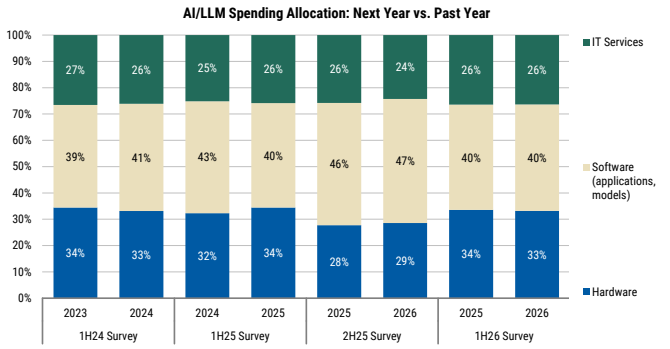
Source: AlphaWise, Morgan Stanley Research

Exhibit 69: AI gaining IT budget share YoY



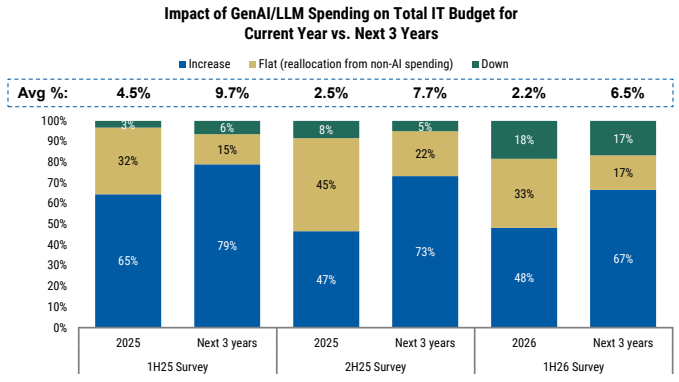
Source: AlphaWise, Morgan Stanley Research

Exhibit 70: Hardware gained wallet share in 2025 and 2026



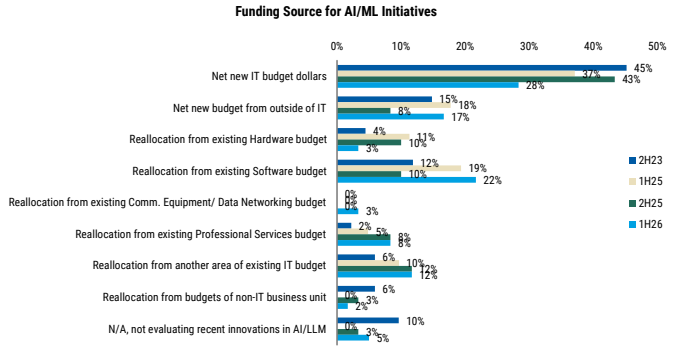
Source: AlphaWise, Morgan Stanley Research

Exhibit 71: Impact of AI spending on total IT budget



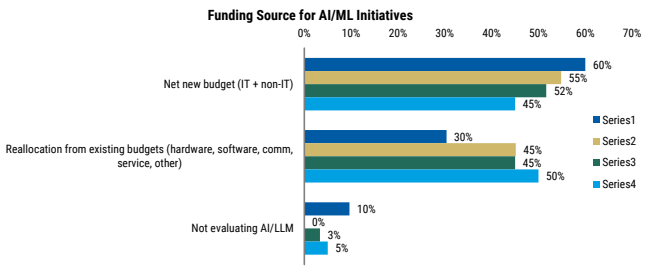
Source: AlphaWise, Morgan Stanley Research

Exhibit 72: Less new IT budgets for funding AI



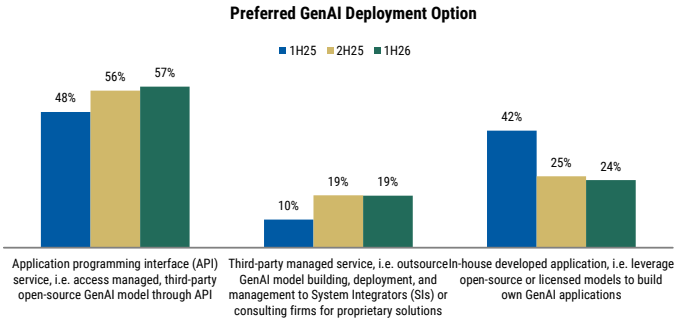
Source: AlphaWise, Morgan Stanley Research

Exhibit 73: More AI funding coming from software budget reallocation



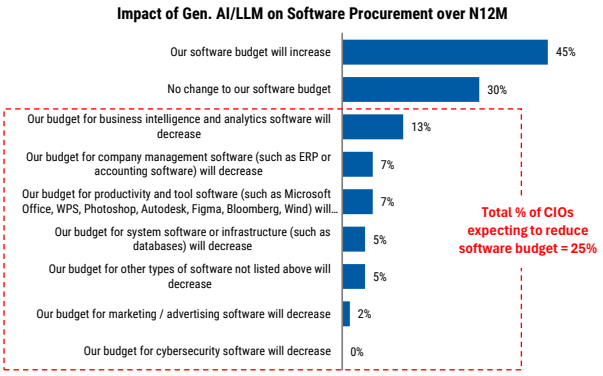
Source: AlphaWise, Morgan Stanley Research

Exhibit 74: Preference of "buying" AI applications rather than "building" increased



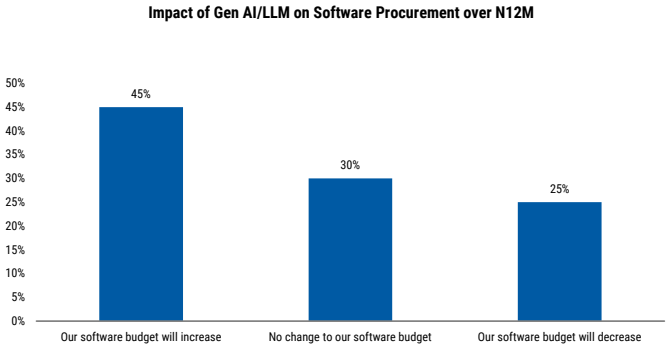
Source: AlphaWise, Morgan Stanley Research

Exhibit 75: Impact of AI on software procurement



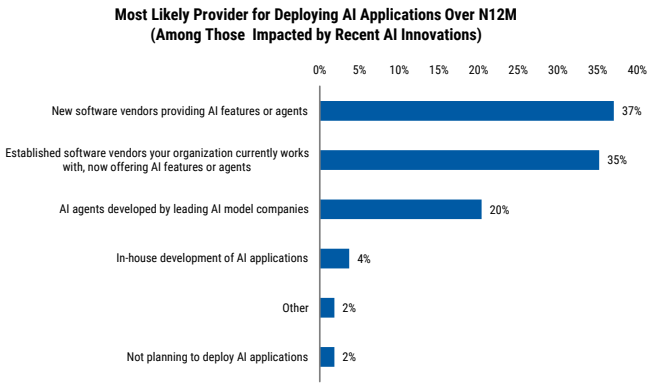
Source: AlphaWise, Morgan Stanley Research

Exhibit 76: Most CIOs would still increase software procurement with AI



Source: AlphaWise, Morgan Stanley Research

Exhibit 77: New software vendors with AI features are most preferred



Source: AlphaWise, Morgan Stanley Research

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SK Square Co Ltd., TAL Education Group, Tencent Holdings Ltd., VNET Group Inc, WuXi AppTec Co Ltd, Xiaomi Corp, Yonyou Network Technology Co Ltd, ZhongAn Online P & C Insurance Co Ltd.

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Global Stock Ratings Distribution

(as of April 30, 2026)

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	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1546	42%	467	51%	30%	709	44%
Equal-weight/Hold	1568	43%	358	39%	23%	715	44%
Not-Rated/Hold	4	0%	0	0%	0%	1	0%
Underweight/Sell	555	15%	84	9%	15%	202	12%
Total	3,673		909			1627	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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INDUSTRY COVERAGE: S. Korea Technology

COMPANY (TICKER)	RATING (AS OF)	PRICE* (05/08/2026)
Ryan Kim		
Ecopro BM (247540.KQ)	U (03/20/2023)	W237,500
Fadu Inc (440110.KQ)	O (09/21/2025)	W92,400
Hanmi Semiconductor Co. Ltd. (042700.KS)	O (08/16/2024)	W390,000
HD Hyundai Electric Co Ltd (267260.KS)	O (03/25/2025)	W1,403,000
Isu Petasys Co. Ltd. (007660.KS)	O (02/03/2025)	W141,100
L&F Co Ltd (066970.KS)	E (04/03/2025)	W195,800
Leeno Industrial Inc. (058470.KQ)	O (04/03/2025)	W112,600
Lotte Energy Materials Corp (020150.KS)	U (04/03/2025)	W71,400
LS Electric (010120.KS)	O (01/22/2026)	W313,000
POSCO FUTURE M (003670.KS)	U (04/03/2025)	W290,000
SK IE Technology (361610.KS)	U (04/03/2025)	W26,400
SK Square Co Ltd. (402340.KS)	O (05/06/2026)	W1,098,000
Wonik IPS Co Ltd (240810.KQ)	O (08/08/2025)	W132,900
Shawn Kim		
LG Display (034220.KS)	E (06/11/2025)	W12,330
LG Electronics (066570.KS)	E (04/07/2025)	W154,100
LG Innotek (011070.KS)	E (03/12/2025)	W624,000
Samsung Electro-Mechanics (009150.KS)	O (07/31/2025)	W914,000
Samsung Electronics (005935.KS)	O (11/18/2019)	W182,700
Samsung Electronics (005930.KS)	O (11/18/2019)	W268,500
Seoul Semiconductor (046890.KQ)	U (04/04/2018)	W18,000
SK hynix (000660.KS)	O (09/21/2025)	W1,686,000

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