

April 20, 2022

HEARTCORE ENTERPRISES INC.

(NasdaqCM: HTCR)

HeartCore Enterprises, Inc., based in Japan, develops and provides website management software as well as process mining, task mining, and robotics process automation software for companies and government agencies. The company primarily serves the Japanese market, and is expanding its nascent customer base in the U.S. HeartCore completed an initial public offering and listed its shares on Nasdaq on February 10, 2022.

COMPANY HIGHLIGHTS

- * HTCR: Helping Commercial Customers Manage Their Digital Interactions
- * In our view, HeartCore has developed a robust suite of commercial software programs enabling companies to manage digital interactions with users and customers. With an established customer base of over 800 major commercial and government customers in its domestic Japanese market, we see HeartCore as well positioned to roll out new products across this base, while also growing its nascent U.S. business.
- * Since its inception more than 12 years ago, HeartCore has developed and commercialized a customer experience management (CMX) platform, which accounted for approximately 80% of its 2021 revenues. Over the past four years, the company has developed a Digital Transformation (DX) platform for data mining, task mining, and robotic process automation, which we view as still in the early stages of customer adoption.
- * Over the coming years, we expect HeartCore to integrate its DX Platform further into its core CMX software, thus supporting its customers' shift to cloud computing, and also develop peripheral products around both platforms. Given our favorable view of steady 90%-plus retention rates for paying customers of its CMX business, we think the company is likely to improve the adoption of paying DX customers, as business conditions normalize following COVID-19 related disruptions, which reduced retention in that segment since 2020.

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KEY STATISTICS

Key Stock Statistics

Recent price (4/18/22)	\$2.31
Fair Value Estimate	\$6.00
52 week high/low	\$6.19-\$1.94
Shares outstanding (M)	18.9
Market cap (M)	\$44
Dividend	Nil
Yield	Nil

Sector Overview

Sector	Information Technology
Sector % of S&P 500	27.9%

Financials (\$M, as of 12/31/21)

Cash & Mkt Securities	3.1
Debt	6.2
Working Capital (\$M)	0.1
Current Ratio	1.0
Total Debt/Equity (%)	NM
Payout ratio	NM
Revenue (M) TTM	10.8
Net Income (M) TTM	NM
Net Margin	NM

Risk

Beta	NA
Inst. ownership	0%

Valuation

P/E forward EPS	58
Price/Sales (TTM)	4.0
Price/Book (TTM)	NA

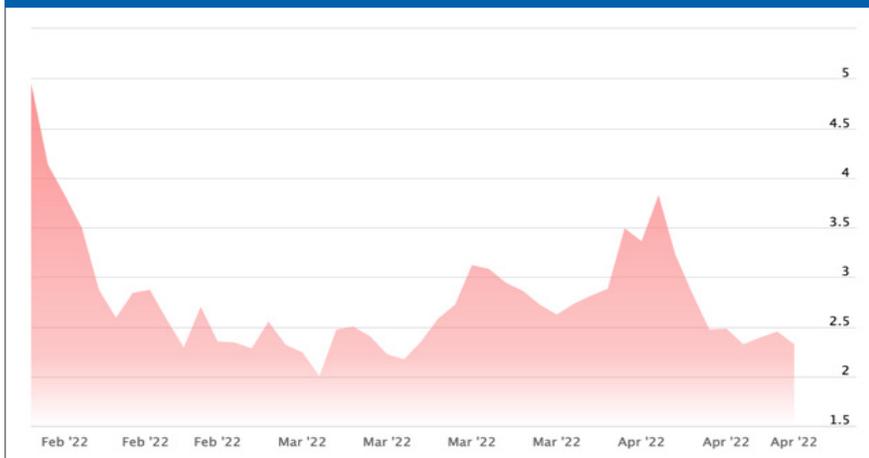
Top Holders

NA
NA
NA

Management

President/CEO/Chairman	Mr. Sumitaka Kanno
CFO	Mr. Qizhi Gao
COO	Mr. Kimio Hosaka
Company website	https://heartcore-enterprises.com

PRICE CHART



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* As of December 31, 2021, HeartCore had \$3.1 million in cash on its balance sheet. Subsequently, the company raised more than \$15 million in net proceeds from an initial public offering in February 2022. As a result, we view HeartCore as adequately funded to invest in its expansion into the U.S. market, build key personnel, and potentially engage in merger and acquisition (M&A) activities.

* Based on our enterprise value (EV) to revenues analysis, we arrive at a fair value estimate of \$6 per share.

INVESTMENT THESIS

HeartCore Enterprises markets software for large commercial and governmental customers, that helps them secure and manage all digital customer interactions, as well as gain insights from, and partly automate, many work processes. The company has a significant installed user base of business and government agency customers, mostly in its domestic Japanese market. HeartCore is also at the very early stages of establishing a presence in the U.S. market.

As of December 31, 2021, HeartCore's total business had 839 total customers in Japan, of which 69% were paying customers. The balance consisted of non-paying or trial customers. Outside of Japan, the company had 24 customers, of which all but two were trial users.

HeartCore has over 12 years' of experience with its flagship customer experience management software (CXM) platform, which helps large organizations effectively manage, update, and keep secure, all their digital interactions with customers. More recently, the company leveraged its experience in the commercial software market to create a complementary business, the DX Platform, which includes process analysis and task automation.

The company's customers include major global brands including Japan Airlines, Hitachi and Seibu Railway. We view its customer diversification favorably, noting that only one customer accounted for more than 10% of revenues in 2021.

HeartCore's CXM Platform includes content management software (CMS), which helps large corporate and government users create, manage, and modify content on their corporate websites. Such websites tend to be vast, consisting of over 100,000 pages of information that need to be kept current, thus requiring sophisticated content management software. HeartCore's CMS offering features a user-friendly interface, quick deployment, ease of maintenance, search engine optimization, and extendable functionality, among other features.

Its CXM platform accounted for 81.5% of total revenues in 2021 and showed solid growth in 2021, increasing by more than 28% to \$8.8 million. We note that this growth rate exceeds the 10.7% segment growth rate seen in 2020. We are encouraged by the continued strong net retention rate of paying customers of

HeartCore's CXM business, which has been approximately 95% in recent years. In our view, this customer "stickiness" positions the company to attract new customers, while adding new paid products to the installed base.

We view the global market for customer experience management software as large and fast growing. According to a 2020 report from Prescient & Strategic Intelligence, the global market for web content management software was \$5.9 billion in 2019, with an expected ten-year compound annual growth rate over 18%. Thus, we see this segment as well positioned to continue to experience double-digit revenue growth, driven by expansion in both Japan and the U.S.

In our view, providing cyber-security for client websites is among the key selling points for the company's CMS offering. We note that this capability is of particular relevance to its government users, which often face sophisticated hacking schemes from hostile countries. Such websites have elevated security requirements for safeguarding customer, governmental, and corporate data and we believe this feature has been instrumental in securing wide acceptance in Japan.

Moreover, the CXM Platform offers significant functionalities beyond website content management. Its software helps companies to manage customer data and deliver personalized content based on users' behavior, device, location, and context. These capabilities include E-commerce, smartphone sites, smartphone apps, social networking services, blogs, and digital signage. We see the aggregation of user data and the ability to offer personalized advertising and content as a key driver of future growth for many technology products moving forward.

Building upon the success in its customer experience management business, HeartCore has developed a complementary business to address the growing shift towards automation solutions among many of its corporate and governmental clients, particularly in the accounting and human resources areas. HeartCore's Digital Transformation Business (DX Platform) addresses these market needs with software for robotics process automation, task mining, and process mining, which help customers automate many business functions, and generate measurable metrics through task mining and process mining technologies.

The DX Platform and other businesses generated approximately \$2 million of revenues in 2021, representing 18.5% of the total. Although near-term customer retention results have varied in recent years, which we attribute to some customers cancelling contracts as a result of the COVID-19 pandemic, we expect the DX line to grow at a rate that will contribute up to 50% of total revenues in the future, as global business conditions continue to normalize.

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PEER COMPARISON

Company	Ticker	Recent Price (\$)	52-Week High (\$)	52-Week Low (\$)	Mkt. Cap (\$MIL)	1-yr Price Change (%)	1-yr Rev Growth (%)	1 YR EPS Growth (%)	P/E Ratio	Beta	Yield (%)
HEARTCORE ENTERPRISES INC	NASDAQ: HTCR	2.31	6.19	1.94	44	-53	20	NA	NA	NA	NA
LIVEVOX HOLDING INC	NASDAQ: LVOX	3.12	10.39	2.5	307	-69	16	NA	NA	0.06	NA
VERB TECHNOLOGY CO INC	NASDAQ: VERB	0.69	3.97	0.65	55	-40	6	NA	NA	0.54	NA
INFOBIRD CO LTD	NASDAQ: IFBD	0.70	11.25	0.51	17	-88	-20	NA	NA	NA	NA

Its Robotic Process Automation (RPA) software facilitates automation for HR and accounting. HeartCore's RPA software (robots) can emulate most human-computer interactions at high volume and speed, without human error. Common tasks that can be automated by RPA include invoice processing, sales orders, account reconciliation, data entry for finance, human resources, manufacturing, supply chain, services, and procurement, payroll, employee onboarding, and data queries.

HeartCore's Task Mining software enables organizations to discover, understand, and analyze the tasks employees perform as they relate to completing larger processes. Task mining software monitors user actions through an installed recorder that captures application data such as keystrokes, clicks, and data entry, all of which can provide actionable insights for companies to improve processes and workflow, both manual and automated, to enhance operational efficiency, reduce errors, and improve employee engagement.

Like task mining, process-mining technologies can help improve processes on an enterprise level, with the ideal goal of automating them to enhance customer and employee experiences. Process mining technology investigates large volumes of enterprise event log data to discover and present end-to-end processes that the organization is performing to complete work and can lead to actionable suggestions on how to optimize and improve its processes.

As mentioned earlier, we believe customer "stickiness" in its core CMX platform positions HeartCore to add new products into its installed base of paying customers. Among its primary growth strategies is the integration of the DX Platform (including RPA, Task Mining, and Process Mining) with its core customer experience CMX platform. Management expects that many of its established CMX users will likely see value in its DX offering, which would provide significant cross-selling opportunities. We also note that to date, HeartCore has achieved growth despite a modest field sales organization consisting of only 16 employees. We think that expanded resources provided by the proceeds from its February 2022 initial public offering (IPO), should enable expansion of the company's sales infrastructure, which can drive long-term growth.

Another of HeartCore's growth strategies is to allow customers to try its software for free. The free (trial) version of the software has full functionality but can only be updated if the customer converts to paying status. We expect the expansion of its offering, including the integration of the two platforms to drive enhanced status of current trial users, over time.

RECENT DEVELOPMENTS

HeartCore completed an initial public offering at \$5.00 per share, after listing its shares on Nasdaq on February 10, 2022. Since the IPO, the stock has declined more than 50%, compared with a 2% decline for the S&P 500. We attribute the weakness to a challenging market environment for technology stocks, as well as a "risk-off" equity market environment due to the Russia/Ukraine war and rising U.S. interest rates.

In March 2022, HeartCore reported financial results for the year ended December 31, 2021, which was highlighted by 20% revenue growth to \$10.8 million, from \$9.0 million in the prior year. Gross

profits rose 29% to \$5.2 million, reflecting the lower cost of revenues, as a percentage of sales. This was offset by higher G&A spending, partly attributable to expenses related to the Nasdaq listing.

In April 2022, the company announced the launch of Go IPO, a consulting service offering for Japanese companies interested in listing on the Nasdaq Stock Market.

On February 14, 2022, HeartCore announced the closing of its initial public offering (IPO) of 3,000,000 shares of its common stock at a public offering price of \$5.00 per share, for aggregate gross proceeds of \$15.0 million and net proceeds of \$13.8 million. Including the exercise of the underwriter's options, net proceeds were \$15.9 million. The company's stock trades on the Nasdaq Capital Market, with the symbol HPCR.

EARNINGS & GROWTH ANALYSIS

In 2021, revenues increased 20% to \$10.8 million, which compares with 25% growth in 2020. Its core CXM (Customer Experience Management) platform, increased by 28.4%, and was the primary contributor of revenue growth for the year. Among the newer DX business lines, Task Mining software increased 97% from the prior year, which was partially offset by Process Mining and Robotic Process Automation, which combined, declined by 28%.

For 2022, we expect total revenues of \$15 million, which would represent 40% growth. We expect both of its platforms to benefit from additional marketing efforts, both in Japan and in the U.S. We expect the nascent U.S. market, which had 22 of 24 customers on free trial status, to convert some of these trial customers to paying status, and for the total customer count to expand, driven by robust sales and marketing initiatives. For 2023, we forecast total revenues of approximately \$20 million, which would represent 33% growth.

We project the cost of revenues to be 50%, as compared to 52.1% in 2021 and 55.5% in 2020. We expect G&A expenses, which were elevated in 2021 at nearly 40% due to the costs of going public, to recede to 35% of revenues in 2022 and 2023. In total, we expect total operating expenses, which were an elevated 47.4% in 2021, and 41.6% in 2020, to be about 42% in 2022 and 2023.

We forecast earnings per share (EPS) of \$0.04 in 2022, and \$0.06 in 2023, up from a loss per share of \$0.02 in 2021. Our estimates reflect a current share count of 18.9 million shares, on a fully diluted basis.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on HeartCore is Medium, reflecting the company's solid revenue growth and positive operating profitability in the last two years. Further, we view positively its resources to invest in its growth strategy, resulting from proceeds from the February 2022 IPO, which yielded net proceeds of \$15.9 million, and our projection of net profitability in 2022 and 2023.

As of December 31, 2021, the company held \$3.1 million in cash and equivalents on its balance sheet, which was subsequently increased from its IPO proceeds, as mentioned above.

At December 31, 2021, the company had current assets of \$4.6 million on its balance sheet, and current liabilities of the same amount, resulting in a current ratio of 1.0x. Again, we see the IPO proceeds enhancing its liquidity and capital resources positively.

In 2021, net cash flows provided by operating activities were \$766,300, compared with \$745,748 in 2020. Net cash used in investing activities were \$179,029, compared with \$401,150 in 2020. Net cash used by financing activities were \$257,353, compared with net cash provided by financing activities of \$ 2,063,166 in 2020.

As of December 31, 2021, HeartCore had 15.5 million shares outstanding. Following the IPO in February 2022, and exercise of the underwriter's option, shares outstanding increased to 18.9 million, on a fully diluted basis. We expect the company to likely issue shares as primary consideration for acquisitions, and we think that a recovery in its stock price over time should limit shareholder dilution.

HeartCore does not pay a cash dividend on its common stock, and we do not expect it to initiate one in the near term.

MANAGEMENT

Mr. Sumitaka Kanno (Yamamoto) is the founder of HeartCore Co and has served as the chief executive officer and member of the board of directors since June 2009. Mr. Kanno owns approximately 11 million shares of the company's stock, which represents roughly 58.0% of the voting power of the outstanding capital stock. As a result of this offering, the public, including large shareholders, holds about 41% of the company's shares, while officers and directors hold about 59%.

HeartCore's board of directors has seven members, five of whom are classified as independent, which we view positively for corporate governance purposes, since the company is classified as a "controlled company" under Nasdaq Capital Market rules, due to CEO Sumitaka Kanno's majority share ownership.

RISKS

Risks for HeartCore include maintaining robust levels of demand for its products and services, the ability to access capital markets on favorable terms, competition from other software providers, and the company's ability to manage its growth effectively. Additional risks include protection of intellectual property, the effects of the COVID-19 pandemic on customer retention, interruptions

in service from third party data providers, and the potential for government sanctions. While we see risk in customer concentration for enterprise software companies, we note that HeartCore has done well in this regard, as only one customer, with 15.2% of revenues in 2021, accounted for more than 10% of its total revenues.

COMPANY DESCRIPTION

HeartCore Enterprises is a software development company, providing software through two business units. The first business unit includes customer experience management, and the second business unit is a digital transformation business, which provides customers with robotics process automation, process mining and task mining. The company is based in Tokyo, Japan.

VALUATION

Since completing its IPO and listing on Nasdaq in February 2022, HTCR's stock has traded in a range of \$6 and \$2. We attribute its weakness since the IPO, which has seen the stock decline by approximately 50%, to a challenging stock market environment for technology stocks, as well as a "risk-off" equity market environment due to the Russia/Ukraine war, and rising U.S. interest rates.

In our view, the recent market capitalization near \$45 million and a pro-forma enterprise value near \$35 million do not reflect what we see as HeartCore's strong fundamentals and prospects for successfully expanding both product adoption and its geographic footprint in the coming years.

On a pro-forma Enterprise Value-to-revenues basis, using our 2022 revenue estimate of \$15 million, HeartCore is currently trading at a multiple near 2.2x, which is well below the 8-9 times multiple for a basket of global enterprise software peers. Given our view of 40% and 33% revenue growth over the next two years along with profitability in both periods, we believe the stock should trade at a level that is more aligned with its peer group.

As such, we apply an 8-times multiple to our 2022 revenue estimate of \$15 million, resulting in a target enterprise value of \$116 million, after adjusting for pro-forma expected cash of \$10 million at year-end. Using a share count of 18.9 million, we arrive at a fair value estimate of \$6 for HTCR shares.

Steve Silver,
Argus Research Analyst

INCOME STATEMENT

Growth Analysis (\$MIL)	2020	2021	Q1 2022E	Q2 2022E	Q3 2022E	Q4 2022E	2022E	Q1 2023E	Q2 2023E	Q3 2023E	Q4 2023E	2023E
Revenue	9.0	10.8	3.5	3.7	3.8	4.0	15.0	4.4	4.9	5.1	5.6	20.0
Gross Profit	4.0	5.2					7.5					10.0
SG&A	3.4	4.6					5.7					7.6
R&D	0.3	0.5					0.6					0.8
Operating Income	0.3	0.1					1.2					1.6
Interest Expense	0.1	0.0					0.0					0.0
Pretax Income	0.2	0.1					1.2					1.6
Tax Rate (%)	32	NA					32					32
Net income	0.2	-0.3					0.8					1.1
Diluted Shares	14.4	15.2					18.9					19.0
EPS	0.01	-0.02	0.01	0.01	0.01	0.01	0.04	0.01	0.01	0.01	0.03	0.06
Dividend	NA	NA					NA					NA
Growth Rates (%)												
Revenue	NM	20					67					33
Operating Income	NM	NM					NA					33
Net Income	NM	NM					NA					38
EPS	NM	NM					NA					50
Valuation Analysis												
Price (\$): High	NA	NA					NA					NA
Price (\$): Low	NA	NA					NA					NA
PE: High	NA	NA					NA					NA
PE: Low	NA	NA					NA					NA
PS: High	NA	NA					NA					NA
PS: Low	NA	NA					NA					NA
Yield: High	NA	NA					NA					NA
Yield: Low	NA	NA					NA					NA
Financial & Risk Analysis (\$MIL)												
Cash/Restricted Cash	3.1	3.1					NA					NA
Working Capital	0.6	0.1					NA					NA
Current Ratio	1.2	1.0					NA					NA
LTDebt/Equity (%)	NA	NA					NA					NA
Total Debt/Equity (%)	NA	NA					NA					NA
Ratio Analysis												
Gross Profit Margin	44%	48%					50%					50%
Operating Margin	NA	NA					8%					8%
Net Margin	NA	NA					5%					6%
Return on Assets (%)	NA	NA					NA					NA
Return on Equity (%)	NA	NA					NA					NA
Op Inc/Int Exp	NA	NA					NA					NA
Div Payout	NA	NA					NA					NA

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