

China / Hong Kong Company Update

Baidu Inc (HK)

Bloomberg: 9888 HK Equity | BIDU US EQUITY | Reuters: 9888.HK | BIDU.OQ

Refer to important disclosures at the end of this report

DBS Group Research . Equity

20 Oct 2023

HK: BUY

Last Traded Price (19 Oct 2023): HK\$107.70 (HSI : 17,296)
Price Target 12-mth: HK\$186 (72.7% upside) (Prev HK\$204)

US: BUY

Last Traded Price (19 Oct 2023): US\$107.86 (NASDAQ : 13,186)
Price Target 12-mth: US\$188 (74.3% upside) (Prev US\$206)

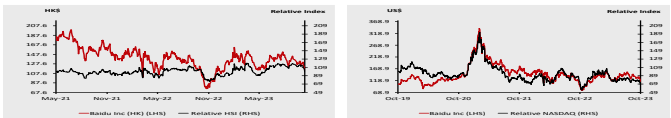
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What's New

- Weaker ad spending from e-commerce platforms due to macro uncertainties
- Expect online marketing revenue to grow only 3% y-o-y in 3Q23, vs. previous market expectations of 8%
- Revised down FY23/FY24/FY25F non-GAAP earnings by 9%/3%/2% accordingly on slower ad growth and higher R&D
- Despite slower 3Q23 growth, expect online marketing revenue growth to pick up in 4Q thanks to shopping festival season, and cloud revenue growth to reaccelerate after launch of Ernie 4.0. Maintain BUY

Price Relative



Forecasts and Valuation (H Shares)

FY Dec (RMBm)	2022A	2023F	2024F	2025F
Turnover	123,675	134,241	147,407	161,188
EBITDA	13,724	22,210	26,059	29,369
Pre-tax Profit	10,112	18,710	22,559	25,869
Net Profit	7,509	15,160	19,009	22,320
Core profit	20,680	25,960	29,809	33,120
Core Profit Gth (Pre-ex)	9.8	25.5	14.8	11.1
EPS (RMB)	2.70	5.45	6.83	8.02
EPS (HK\$)	2.89	5.83	7.31	8.59
EPS Gth (%)	(27.2)	101.9	25.4	17.4
Diluted EPS (HK\$)	2.86	5.78	7.24	8.50
DPS (HK\$)	0.00	0.00	0.00	0.00
BV Per Share (HK\$)	85.51	93.91	103.78	114.92
PE (X)	37.3	18.5	14.7	12.5
P/Cash Flow (X)	10.7	10.9	9.5	8.5
P/Free CF (X)	15.7	16.1	13.2	11.4
EV/EBITDA (X)	14.0	7.6	5.5	3.9
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	1.3	1.1	1.0	0.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	3.5	6.5	7.4	7.8
Core Earnings Rev (%)		(9)	(3)	(2)
Consensus EPS (RMB)		8.55	8.80	9.97
Other Broker Recs:		B:33	S:0	H:1

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

China's 'ChatGPT' to start the journey

Investment Thesis

Leading AI cloud player in China with c.30% market share. We forecast Baidu's cloud revenue will grow at a CAGR of 14% in FY22-FY25F. The cloud business thrives on growing demand for enterprise cloud services and subscription-based personal cloud driven by generative AI product adoption.

Baidu app contributing steady ad revenue. Baidu has dominated the search engine market for years, and the Baidu app continues to generate ad income via its search function and feeds, supported by various new features, including Baijiahao, mini programmes, and Managed Page. We expect Baidu Core's ad revenue to resume 8% growth in FY23F after a 6% decline in FY22, driven by the recovery of ad demand in offline verticals.

Monetisation upside from autonomous driving and AI capability. Baidu is a leading player in the autonomous driving market. Its current products include Robotaxi, Apollo Self Driving (ASD) system, etc. We expect its ASD system and products to generate a 19% CAGR over the next three years. We have not fully factored the growth potential of Robotaxi into our forecast, as it is still at the early stage of commercialisation. In addition, Baidu launched its AI chatbot project 'Ernie bot' for trial earlier this year, with the large-scale rollout awaiting government approval. The stepped up commercialisation of Ernie bot could potentially unlock value for Baidu. Benchmarking OpenAI's valuation of US\$29bn, Ernie bot could potentially bring in c.HK\$98 per share to Baidu. Any further penetration of ASD, Robotaxi, as well as the Ernie bot, should contribute to the valuation re-rating.

We recommend BUY on Baidu with TPs of HK\$186/US\$188 per share (vs. previous TPs of HK\$204/US\$206). We derive our H-share TP based on SOTP valuation: (1) Baidu Core: 12x on FY24F non-GAAP net profit (HK\$141); (2) cloud and autonomous driving: 3x FY24F P/S (HK\$26); and (3) market value of major listed investees (HK\$20). Potential share price catalysts include (1) stronger-than-expected ad demand recovery and (2) faster-than-expected scaling up of the monetisation process via autonomous driving and launch of related technologies.

Key Risks

(1) Macro slowdown, which negatively affects online advertising revenue, and (2) product execution risk in monetising its AI capability.

At A Glance

Issued Capital (m shrs)	2,797
Mkt Cap (HKm/US\$m)	301,237 / 38,503
Major Shareholders (%)	
NIL	
Free Float (%)	100.0
3m Avg. Daily Val. (US\$m)	102.8
GICS Industry: Information Technology / Software & Services	

Baidu Inc (HK)**WHAT'S NEW****Weaker 3Q23 performance due to slower online ad spending and soft cloud demand****3Q23 outlook and preview**

We expect Baidu to deliver revenue growth of 3% y-o-y in 3Q23, below previous market expectations of 8% y-o-y. The downward revision was largely due to slower growth of 3% y-o-y (vs. 15% y-o-y in 2Q23) in Baidu Core's online marketing revenue. Ad spending across major e-commerce platforms was weaker than expected in the off-peak season, and ad demand from franchise activities slowed down due to macro uncertainties. Currently, the top ad verticals are e-commerce, healthcare, and travel, which accounted for around 10%, 10%, and <5% of Baidu Core's online marketing revenue, respectively.

In terms of cloud revenue growth, which accounted for approximately 13% of total revenue in 2Q23, its performance was weaker than expected due to slower progress in smart transportation and government-related projects. Specifically, the government-related smart transportation cloud segment experienced a significant y-o-y decline of around 70% due to budget restrictions, representing a low-single-digit percentage of total revenue (compared to low teens in 3Q22). On the other hand, personal cloud products (Baidu Wangpan, Baidu Wenku) are expected to see double-digit revenue growth as more AI products and functions have been launched for customers use since August 2023. Among the cloud business segments, enterprise cloud and personal cloud accounted for c.60% and 30% of total revenue, respectively.

We expect Baidu Core's non-GAAP operating margin to stand at 22% in 3Q23, vs. 3Q22's 26%. The lower margin was ascribed to (1) investment in R&D (mainly AI-related products); (2) incremental marketing expenses for the launch of its AI products, such as Ernie 4.0; as well as (3) the stock-up of AI chips. We expect Baidu Core's non-GAAP operating margin to stay stable y-o-y in 4Q23, as a larger revenue contribution from the high-margin online ad segment can partially offset an increase in investment on AI development.

Expect 4Q23 ad growth to accelerate to 9% during shopping festival season

Looking ahead, we expect online ad revenue to resume to 9% y-o-y growth in 4Q23, given more online shopping festivals in 4Q, which should boost e-commerce platforms' ad spending on Baidu. Besides, other key verticals like healthcare and travel agency marketing demand remain resilient and continue to drive segment growth. We expect cloud revenue growth to steadily pick up to 7% in 4Q23, thanks to the launch of Ernie 4.0, which drives personal cloud growth the most. We expect personal cloud to sustain double-digit growth in 4Q23, while it will take some time for enterprise cloud to grow, as corporates are just starting to adopt generative AI products.

Earnings revision and recommendation

We revised down our earnings by 9%, 3%, and 2% for FY23F, FY24F, and FY25F, respectively, factoring in slower ad revenue growth and increased R&D investment to AI development. We expect non-GAAP net earnings to increase by 26%, 15%, and 11% for FY23F, FY24F, and FY25F, respectively. We are confident that Baidu's AI development will gradually translate into higher ad ROI and, therefore, higher ad revenue in the next few quarters, despite macro challenges. Its cloud growth will also start compensating for the relatively short-term softness in online ad. Maintain BUY on Baidu with TPs of HK\$186/US\$188 per share. We derive our TPs based on SOTP valuation: (1) Baidu Core: 12x on FY24F non-GAAP net profit (HK\$141); (2) cloud and autonomous driving: 3x FY24F P/S (HK\$26) and (3) market value of major listed investees (HK\$20).

Company Background

Established in 2000 and listed in 2005, Baidu is China's largest search platform in terms of mobile search traffic. In 2010, the company expanded into the online video segment by establishing iQiyi, China's largest online video platform in terms of monthly active users (MAUs). Baidu Core and iQiyi accounted for 72% and 28% of the company's FY20 revenue, respectively. The company's co-founder Robin Yanhong Li (李彦宏) is also its chairman and CEO.

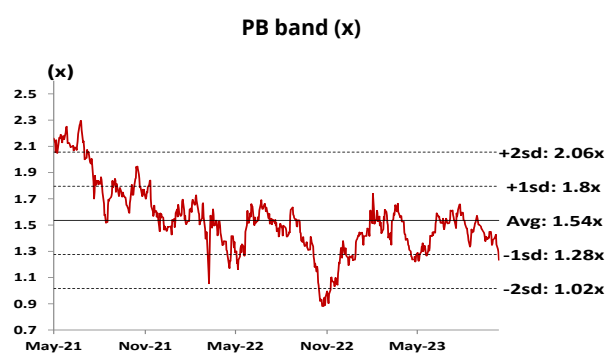
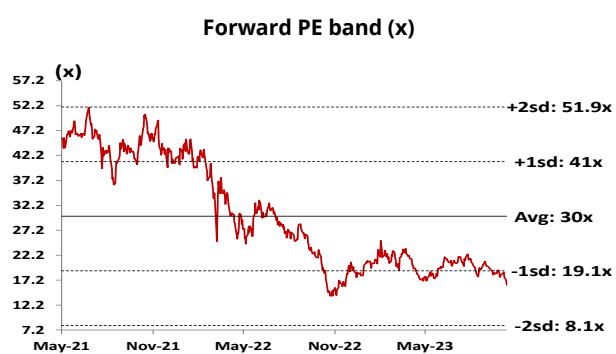
Baidu Inc (HK)

Income Statement (RMB m)

FY Dec	2022A	2023F	% chg	vov
Revenue	123,675	134,241		8.5
Cost of Goods Sold	(63,935)	(63,630)		(0.5)
Gross Profit	59,740	70,611		18.2
Other Opng (Exp)/Inc	(43,829)	(49,401)		12.7
Operating Profit	15,911	21,210		33.3
Other Non Opg (Exp)/Inc	(7,221)	(5,000)		30.8
Associates & JV Inc	(1,910)	(500)		73.8
Net Interest (Exp)/Inc	3,332	3,000		(10.0)
Exceptional Gain/(Loss)	0	0		nm
Pre-tax Profit	10,112	18,710		85.0
Tax	(2,578)	(3,500)		35.8
Minority Interest	(25)	(50)		(100.0)
Net Profit	7,509	15,160		101.9
Net Profit before Except.	7,509	15,160		101.9
EBITDA	13,724	22,210		61.8
Margins & Ratio				
Gross Margins (%)	48.3	52.6		
Opg Profit Margin (%)	12.9	15.8		
Net Profit Margin (%)	6.1	11.3		

Source: Company, DBS HK

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Baidu Inc (HK)

Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
Baidu app MAU (m)	622.0	648.0	686.9	721.2	750.1
iQiyi MAU (m)	96.8	111.6	122.8	125.2	127.7

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (RMB m)					
Baidu core	95,163	95,431	102,330	112,918	124,215
iQiyi	30,554	28,998	32,911	35,489	37,973
Others	(1,224)	(754)	(1,000)	(1,000)	(1,000)
Total	124,493	123,675	134,241	147,407	161,188

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenue	124,493	123,675	134,241	147,407	161,188
Cost of Goods Sold	(64,314)	(63,935)	(63,630)	(69,723)	(76,081)
Gross Profit	60,179	59,740	70,611	77,683	85,107
Other Opng (Exp)/Inc	(49,661)	(43,829)	(49,401)	(52,624)	(56,738)
Operating Profit	10,518	15,911	21,210	25,059	28,369
Other Non Opg (Exp)/Inc	(938)	(7,221)	(5,000)	(5,000)	(5,000)
Associates & JV Inc	(932)	(1,910)	(500)	(500)	(500)
Net Interest (Exp)/Inc	2,130	3,332	3,000	3,000	3,000
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	10,778	10,112	18,710	22,559	25,869
Tax	(3,187)	(2,578)	(3,500)	(3,500)	(3,499)
Minority Interest	2,635	(25)	(50)	(50)	(50)
Preference Dividend	0	0	0	0	0
Net Profit	10,226	7,509	15,160	19,009	22,320
Net Profit before Except.	10,226	7,509	15,160	19,009	22,320
EBITDA	14,833	13,724	22,210	26,059	29,369
Growth					
Revenue Gth (%)	16.3	(0.7)	8.5	9.8	9.3
EBITDA Gth (%)	(45.6)	(7.5)	61.8	17.3	12.7
Opg Profit Gth (%)	(26.7)	51.3	33.3	18.1	13.2
Net Profit Gth (%)	(54.5)	(26.6)	101.9	25.4	17.4

Margins & Ratio

Gross Margins (%)	48.3	48.3	52.6	52.7	52.8
Opg Profit Margin (%)	8.4	12.9	15.8	17.0	17.6
Net Profit Margin (%)	8.2	6.1	11.3	12.9	13.8
ROAE (%)	5.2	3.5	6.5	7.4	7.8
ROA (%)	2.9	1.9	3.8	4.5	5.0
ROCE (%)	2.5	3.6	5.0	5.8	6.2
Div Payout Ratio (%)	0.0	0.0	0.0	0.0	0.0
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS HK

Baidu Inc (HK)

Balance Sheet (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	23,027	23,973	26,259	28,545	30,831
Invts in Associates & JVs	0	0	0	0	0
Other LT Assets	143,692	154,150	145,650	137,150	128,650
Cash & ST Invts	190,914	185,325	208,211	234,947	264,934
Inventory	0	0	0	0	0
Debtors	9,981	11,733	13,493	15,517	17,844
Other Current Assets	12,420	15,792	15,792	15,792	15,792
Total Assets	380,034	390,973	409,405	431,951	458,052
ST Debt	14,675	20,552	20,552	20,552	20,552
Creditors	41,384	38,014	34,973	32,175	29,601
Other Current Liab	18,429	21,064	20,539	20,036	19,552
LT Debt	68,401	63,183	63,183	63,183	63,183
Other LT Liabilities	13,193	10,355	10,355	10,355	10,355
Shareholder's Equity	218,607	231,871	253,819	279,616	308,724
Minority Interests	5,345	5,934	5,984	6,034	6,084
Total Cap. & Liab.	380,034	390,973	409,405	431,951	458,052
Non-Cash Wkg. Capital	(37,412)	(31,553)	(26,227)	(20,902)	(15,517)
Net Cash/(Debt)	107,838	101,590	124,476	151,212	181,199
Debtors Turn (avg days)	27.3	32.0	34.3	35.9	37.8
Creditors Turn (avg days)	245.2	254.3	233.2	193.8	162.0
Inventory Turn (avg days)	N/A	N/A	N/A	N/A	N/A
Asset Turnover (x)	0.3	0.3	0.3	0.4	0.4
Current Ratio (x)	2.9	2.7	3.1	3.7	4.3
Quick Ratio (x)	2.7	2.5	2.9	3.4	4.1
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	13.1	9.9	9.9	9.9	9.9
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

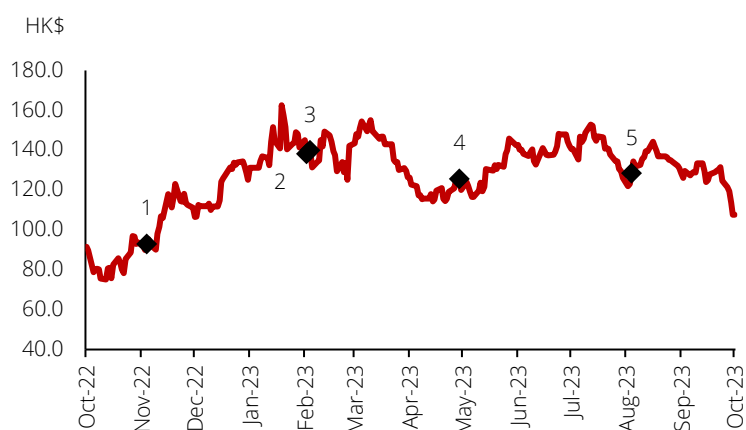
Cash Flow Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	10,778	10,112	18,710	22,559	25,869
Dep. & Amort.	22,559	20,084	14,500	14,500	14,500
Tax Paid	(3,187)	(2,578)	(3,500)	(3,500)	(3,499)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAS	(45)	(868)	0	0	0
Chg in Wkg.Cap.	(18,691)	(16,758)	(5,326)	(5,325)	(5,385)
Other Operating CF	8,708	16,178	1,288	1,288	1,288
Net Operating CF	20,122	26,170	25,672	29,522	32,773
Capital Exp.(net)	(10,896)	(8,286)	(8,286)	(8,286)	(8,286)
Other Invts.(net)	(8,584)	5,103	(500)	(500)	(500)
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(11,964)	(761)	6,000	6,000	6,000
Net Investing CF	(31,444)	(3,944)	(2,786)	(2,786)	(2,786)
Div Paid	0	0	0	0	0
Chg in Gross Debt	31	(7)	0	0	0
Capital Issues	(7,246)	(1,725)	0	0	0
Other Financing CF	(18,003)	(68,165)	(87,372)	(114,108)	(144,095)
Net Financing CF	(25,218)	(69,897)	(87,372)	(114,108)	(144,095)
Currency Adjustments	47,671	64,486	87,372	114,108	144,095
Chg in Cash	11,131	16,815	22,886	26,736	29,987
Opg CFPS (RMB)	14.07	15.43	11.14	12.53	13.72
Free CFPS (RMB)	3.35	6.43	6.25	7.63	8.80

Source: Company, DBS HK

Baidu Inc (HK)

HK Share - Target Price & Ratings 12-mth History

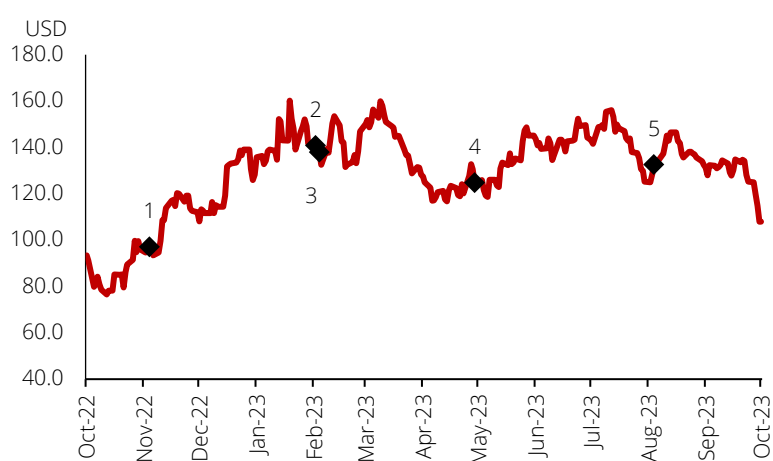


S.No.	Date	Closing Price	Target Price	Rating
1	23-Nov-22	HK\$89.90	HK\$198.00	BUY
2	21-Feb-23	HK\$141.30	HK\$208.00	BUY
3	23-Feb-23	HK\$140.50	HK\$210.00	BUY
4	18-May-23	HK\$123.80	HK\$174.00	BUY
5	23-Aug-23	HK\$123.00	HK\$204.00	BUY

Source: DBS HK

Analyst: Tsz Wang Tam
Lilian Lv

US Share - Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	23-Nov-22	US\$95.08	US\$203.00	BUY
2	21-Feb-23	US\$141.71	US\$213.00	BUY
3	23-Feb-23	US\$137.12	US\$215.00	BUY
4	18-May-23	US\$130.52	US\$178.00	BUY
5	23-Aug-23	US\$128.36	US\$206.00	BUY

Source: DBS HK

Analyst: Tsz Wang Tam
Lilian Lv

Baidu Inc (HK)

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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Baidu Inc (HK)

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