

Baidu (BIDU US)

Margin surprise on disciplined cost control

SUMMARY. Baidu delivered solid 2Q19 results, with margin surprise from disciplined cost control, similar to most internet peers. We expect its effective cost control to continue in 2H19E. With multiple ad headwinds partly priced in, Baidu's valuation at 25x/16x FY19/20E P/E looks attractive. We keep our TP of **US\$147.6** unchanged.

- **2Q19 beat on margin.** 2Q19 revenue reached RMB26.3bn (+1.4% YoY, +9% QoQ), 2% above consensus. Non-GAAP net profit declined 51% YoY to RMB3,635mn, 78% above consensus, mainly on lighter content cost, and disciplined expense control. 3Q19 guidance came in with revenue growth of -5% to +1% YoY (or -1% to +5% YoY excluding divestitures), with midpoint in line with consensus. iQiyi's 3Q19 guidance missed 5%, while Baidu Core's guidance was higher than expectation. We view Baidu's results as solid, given macro uncertainty, rising ads inventory and tightening regulations.
- **Baidu Core: growth not bad despite multiple headwinds around.** 2Q19 Baidu core revenue grew 3% YoY (ex-divested businesses), and beat on other revenue. 2Q19 guidance midpoint implied -1% YoY growth for Baidu core, which was above already-low market expectation. Ads still experienced softness in top sectors, including healthcare, games, financial services, and auto/logistics sectors. Healthcare ads declined by double-digit percentage in 2Q19, as stated by mgmt. Mgmt. expects wide usage of its mini program to enhance precise recommendation and user engagement, thus improving ads ROI.
- **Effective cost control to continue.** 2Q19 adj. net margin reached 14% (vs. 4% in 1Q19, 29% in 2Q18). We are impressed by its disciplined cost control, vs. previous guidance on continuous investment in content cost and short video. Looking ahead, mgmt. guides cost control to continue in 2H19E, with COGS & OPEX in 3Q19 close to 2Q19. Given its solid 2Q19 results and guidance, we slightly raised our earnings forecast by 1%/ 1% in FY19/20E.
- **Maintain BUY.** The stock is trading at 25x/16x FY19/20E P/E, valuation is attractive. Multiple ads headwinds have been partly priced in. Wait for its organic transition and ads long-term recovery. We keep our SOTP-based TP of US\$148 unchanged. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	80,060	102,277	110,777	127,635	146,490
YoY growth (%)	20.2	27.7	8.3	15.2	14.8
Adj. net income (RMB mn)	22,270	23,323	10,052	15,692	21,093
Adj. EPS (RMB)	63.7	66.3	28.6	44.6	60.0
YoY growth (%)	67.5	4.1	-56.9	56.1	34.4
P/E (x)	11.3	10.8	25.1	16.1	12.0
P/B (x)	2.1	1.4	1.4	1.3	1.2
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	15.9	16.9	5.7	8.1	9.8
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	US\$147.6
(Previous TP	US\$147.6)
Current Price	US\$104.2
Up/Downside	+41.7%

China Internet Sector

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Stock Data

Mkt Cap (US\$ mn)	36,479
Avg 3 mths t/o (US\$ mn)	459.2
52w High/Low (US\$)	235/93
Total Issued Shares (mn)	278
Source: Bloomberg	

Shareholding Structure

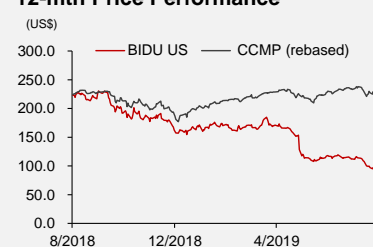
Baillie Gifford	5.4%
BlackRock	5.2%
Vanguard Group	3.6%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	-7.2%	-5.5%
6-mth	-18.8%	-20.7%
12-mth	-39.6%	-43.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Reports

1Q19 miss; A challenging year – 20 May 2019

Figure 1: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	110,777	127,635	146,490	110,777	127,635	146,490	0.0%	0.0%	0.0%
Gross Profit	44,196	55,655	67,600	44,079	55,519	67,600	0.3%	0.2%	0.0%
Operating Profit	4,981	11,110	17,208	4,864	10,975	17,208	2.4%	1.2%	0.0%
Net profit	10,052	15,692	21,093	9,937	15,567	21,093	1.2%	0.8%	0.0%
EPS (RMB)	29	45	60	28.25	44.26	59.97	1.2%	0.8%	0.0%
Gross Margin	39.9%	43.6%	46.1%	39.8%	43.5%	46.1%	+0.1ppts	+0.1ppts	+0.0ppts
Operating Margin	4.5%	8.7%	11.7%	4.4%	8.6%	11.7%	+0.1ppts	+0.1ppts	+0.0ppts
Net Margin	9.1%	12.3%	14.4%	9.0%	12.2%	14.4%	+0.1ppts	+0.1ppts	+0.0ppts

Source: Company data, CMBIS estimates

Figure 2: CMBI estimates vs consensus

RMB mn, Dec-YE	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	110,777	127,635	146,490	107,578	122,810	140,028	3.0%	3.9%	4.6%
Gross Profit	44,196	55,655	67,600	43,953	52,664	63,608	0.6%	5.7%	6.3%
Operating Profit	4,981	11,110	17,208	3,554	10,282	17,482	40.2%	8.1%	-1.6%
Net profit	10,052	15,692	21,093	9,699	15,018	20,486	3.6%	4.5%	3.0%
EPS (RMB)	28.58	44.62	59.97	29.03	44.67	61.07	-1.5%	-0.1%	-1.8%
Gross Margin	39.9%	43.6%	46.1%	40.9%	42.9%	45.4%	-1.0ppt	+0.7ppts	+0.7ppts
Operating Margin	4.5%	8.7%	11.7%	3.3%	8.4%	12.5%	+1.2ppts	+0.3ppts	-0.7ppts
Net Margin	9.1%	12.3%	14.4%	9.0%	12.2%	14.6%	+0.1ppts	+0.1ppts	-0.2ppts

Source: Company data, Bloomberg

Figure 3: SOTP valuation

US\$bn	Valuation		Methodology	Multiple Applied/Implied		Metrics		Shareholding %
	US\$bn	Per share(US\$)		FY19	FY20	FY19	FY19	
Baidu Core	25.9	73.6	EV/EBIT	8.0	7.2	3.2	3.6	100%
iQiyi	7.5	21.2	Mkt cap					57%
Ctrip	3.7	10.6	Mkt cap					19%
Net (Debt)/Cash	14.8	42.1	Cash forecasted on Balance sheet					
Equity Value	52	147.6						

Source: CMBIS estimates

Figure 4: 2Q19 review

Rmb mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	QoQ	YoY	Consensus	Diff %
Net revenue	20,907	25,972	28,203	27,195	24,123	26,326	9.1%	1.4%	25,772	2%
Revenue	20,907	25,972	22,481	27,195	24,123	26,326	9.1%	1.4%	25,772	2%
Operating profit	4,568	5,422	4,428	1,112	(936)	233	-124.9%	-95.7%	749	-69%
Net profit	6,694	6,402	12,396	2,081	(327)	2412	-837.6%	-62.3%	1008	139%
Adj. net profit	4,585	7,433	6,685	4,703	967	3,635	275.9%	-51.1%	2,040	78%
Adj. EPS (Rmb)	16.30	21.06	19.01	13.42	2.77	10.11	265.0%	-52.0%	6.30	60%
Margin (%)										
Gross margin	52.6%	53.8%	49.6%	42.6%	38.5%	38.8%			40.3%	
Operating margin	21.8%	20.9%	19.7%	4.1%	-3.9%	0.9%			2.9%	
Adj. net margin	16.4%	28.6%	29.7%	17.3%	4.0%	13.8%			7.9%	
Growth (%)										
Revenue (YoY)	23.8%	24.4%	-4.3%	15.4%	15.4%	1.4%			-0.8%	
Revenue (QoQ)	-11.2%	24.2%	-13.4%	21.0%	-11.3%	9.1%			6.8%	
Operating profit	127.8%	28.8%	-5.8%	-76.7%	-120.5%	-95.7%			-86.2%	
Adj. net profit	91.4%	33.4%	-26.3%	-15.5%	-78.9%	-51.1%			-72.6%	

Source: Company data, Bloomberg

Figure 5: 2Q19 revenue breakdown

Rmb mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	QoQ	YoY
Total revenue	20,907	25,972	28,203	27,195	24,123	26,326	9%	1%
Online marketing services	17,169	21,065	22,481	21,197	17,657	19,237	9%	-9%
Other Services	3,738	4,907	5,722	5,998	6,466	7,089	10%	44%

Source: Company data

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net Revenue	80,060	102,277	110,777	127,635	146,490
Online marketing	69,051	81,913	85,570	95,050	108,599
Other services	11,010	20,365	25,207	32,585	37,890
COSG	(38,313)	(51,744)	(66,581)	(71,981)	(78,889)
Gross profit	41,748	50,533	44,196	55,655	67,600
R&D	(12,928)	(15,772)	(17,060)	(19,656)	(22,559)
S&GA	(13,128)	(19,231)	(22,155)	(24,889)	(27,833)
Operating profit	15,692	15,530	4,981	11,110	17,208
Interest income	3,154	4,451	3,323	3,829	4,395
Interest exp.	(1,615)	(1,883)	(2,199)	(2,199)	(2,199)
Exchange loss	(482)	(122)	0	0	0
Loss from E.M.I	(63)	(79)	0	0	0
Other income	4,598	9,428	4,196	4,196	4,196
Pre-tax profit	21,284	27,325	10,301	16,936	23,599
Tax	(2,995)	(4,743)	(1,854)	(3,048)	(4,248)
MI	13	4,991	1,352	1,389	1,161
Net profit	18,302	27,573	9,799	15,276	20,512
Adjustment	3,969	742	253	417	581
Non GAAP Net profit	22,270	23,323	10,052	15,692	21,093

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	100,559	142,472	149,004	156,224	164,563
Fixed asset	12,475	17,903	20,737	24,301	28,707
Long term investment	56,283	80,454	80,454	80,454	80,454
Intangible assets	21,273	27,717	31,415	35,070	39,004
Others	10,528	16,398	16,398	16,398	16,398
Current assets	151,169	155,094	167,154	177,514	193,250
Cash	11,336	29,827	42,169	51,656	66,417
Account receivable	4,571	6,015	5,733	6,605	7,581
Associates	168	785	785	785	785
Others	135,262	119,252	119,252	119,252	119,252
Current liabilities	82,057	56,853	66,998	70,690	75,414
Borrowings	1,254	3,130	3,130	3,130	3,130
Payables	72,794	42,719	52,864	56,556	61,280
Associates	153	1,727	1,727	1,727	1,727
Others	7,856	9,277	9,277	9,277	9,277
Non-current liabilities	50,321	65,677	65,677	65,677	65,677
Long term liabilities	35,812	50,191	50,191	50,191	50,191
Deferred taxation	3,375	4,099	4,099	4,099	4,099
Others	11,134	11,387	11,387	11,387	11,387
MI	4,004	12,139	10,787	9,399	8,238
S/H equity	115,346	162,897	172,696	187,971	208,484
Total Equity	119,350	175,036	183,483	197,370	216,721

Source: Company data, CMBIS estimates

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	18,289	22,582	8,447	13,887	19,351
D&A	9,545	9,102	15,175	18,828	22,918
Change in WC	12,194	(5,007)	10,427	2,820	3,748
Others	3,244	4,676	0	0	0
Operating CF	43,271	31,353	34,049	35,535	46,018
Capex	(12,475)	(18,089)	(21,707)	(26,048)	(31,257)
Associates	0	0	0	0	0
Others	(35,970)	(19,336)	0	0	0
Investing CF	(48,445)	(37,425)	(21,707)	(26,048)	(31,257)
Chg in capital	521	16,677	0	0	0
Change of Debts	(691)	16,255	0	0	0
Others	5,530	(10,306)	0	0	0
Financing CF	5,360	22,626	0	0	0
Change in cash	186	16,554	12,342	9,487	14,760
Cash (beg of yr)	10,898	11,084	27,638	39,980	49,467
FX	0	0	0	0	0
Cash (end of yr)	11,084	27,638	39,980	49,467	64,228
Pledge cash	252	2,189	2,189	2,189	2,189
Cash at balance sheet	11,336	29,827	42,169	51,656	66,417

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Online marketing	86.2	80.1	77.2	74.5	74.1
Other services	13.8	19.9	22.8	25.5	25.9
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross margin	52.1	49.4	39.9	43.6	46.1
Pre-tax margin	26.6	26.7	9.3	13.3	16.1
Net margin	22.8	22.1	7.6	10.9	13.2
Tax rate	14.1	17.4	18.0	18.0	18.0
Balance sheet ratios					
Current ratio (x)	1.8	2.7	2.5	2.5	2.6
Debtors turnover	19.8	18.9	18.9	18.9	18.9
Creditors turnover	628.9	249.6	249.6	249.6	249.6
Inventory turnover	0.0	0.0	0.0	0.0	0.0
Net gearing (%)	21.6	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	19.3	17.4	5.8	8.3	10.1
ROA	8.8	7.8	2.8	4.3	5.6
Per share					
EPS (RMB)	64	66	29	45	60
DPS (RMB)	0	0	0	0	0
BVPS (RMB)	3,415	4,977	5,217	5,612	6,162

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