

Baidu (BIDU US)

Recovery of advertising business on track

Driven by recovery in offline activities and a low base, Baidu's advertising business is on track to deliver steady recovery in 2Q23, in our view. Cloud business revenue growth re-acceleration could take time, due to softness in demand and strategically focusing more on quality growth. We lowered our SOTP based target price by 2% to US\$195.0 mainly to account for slower than expected recovery for cloud revenue growth. Our TP translates into 20.3x 2023E non-GAAP PE. Maintain BUY.

■ Recovery in offline activities boosted Baidu's advertising business.

We estimate Baidu's core search and feed ads business has inked revenue of RMB19.2bn in 2Q23, up 12.3% YoY (1Q23: 6.3%; 2Q22: -10.1%), aided by the recovery of offline activities and a low base. We slightly lowered full year search and feed ads revenue growth forecast to 9.4% (was 10.0%) to factor in more cautious view on macro recovery outlook, which likely weighs on the recovery of advertising sentiment.

■ Re-acceleration in cloud business revenue growth likely takes time.

We expect YoY revenue growth of Baidu Cloud to decline to 6% in 2Q23E (1Q23: 8%), with total revenue to reach RMB4.5bn, owing to: 1) soft recovery in client-end demand, especially for smart transportation vertical; and 2) Baidu's move to focus more on quality growth and phasing out of low profitability projects. However, cloud revenue growth could reaccelerate in 2H23 given a low base and recovery in enterprise's IT spending along with the recovery in macro, in our view. We forecast 13/10% YoY cloud revenue growth for 2H23/2023.

■ **2Q23 results preview.** We forecast Baidu Core revenue to grow 12.5% YoY to RMB26.1bn, and to record non-GAAP operating profit of RMB6.0bn in 2Q23E, translating into 23.1% OPM, up 1.0pp YoY. For Baidu Group, we forecast total revenue/ non-GAAP net income of RMB33.7/6.1bn, 1/4% better than Bloomberg consensus estimate. As majority of the investment for large language model is front loaded, and Baidu is still pending to receive license for large scale monetization of its large language model (LLM), near term margin impact from the development of LLM should be controllable in our view.

■ **SOTP based target price of US\$195.0 per ADS.** Our SOTP based TP consists of: 1) US\$63.0 for Baidu Core (main business, excluding Apollo and Baidu Cloud), based on 7.0x 2023E non-GAAP PE; 2) US\$22.8 for Apollo ASD, based on 2.0x 2030E revenue and discounted back using a 13.0% WACC; 3) US\$38.3 for Baidu Cloud, based on 4.8x 2023E PS; 4) US\$57.9 net cash; and 5) US\$13.1 for iQIYI and other investments.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	124,493	123,675	137,315	149,519	165,627
YoY growth (%)	16.3	(0.7)	11.0	8.9	10.8
Adjusted net profit (RMB mn)	18,830.0	20,680.0	23,632.9	26,501.0	30,780.1
EPS (Adjusted) (RMB)	53.53	58.90	66.64	73.99	85.08
Consensus EPS (RMB)	na	na	64.00	72.02	82.10
P/E (x)	42.3	40.1	19.9	18.8	16.0
ROE (%)	5.1	3.4	7.7	7.4	7.8

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$195.00

(Previous TP US\$199.40)

Up/Downside 30.7%

Current Price US\$149.21

China Internet

Saiyi HE, CFA

(852) 3916 1739

hesaiyi@cmbi.com.hk

Ye TAO

franktao@cmbi.com.hk

Ji SHI, CFA

(852) 3761 8728

shiji@cmbi.com.hk

Wentao LU, CFA

luwentao@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn)	52,391.4
Avg 3 mths t/o (US\$ mn)	294.1
52w High/Low (US\$)	160.22/76.57
Total Issued Shares (mn)	351.1

Source: FactSet

Shareholding Structure

Robin Yanhong Li 16.5%

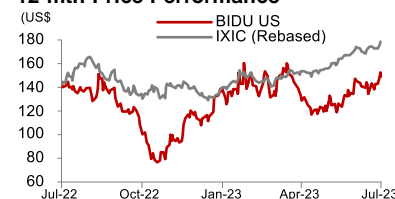
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	1.4%	-2.1%
3-mth	15.9%	-0.5%
6-mth	7.4%	-15.7%

Source: FactSet

12-mth Price Performance



Source: FactSet

Changes in forecast and valuation

Figure 1: Baidu forecast revision

RMB bn	Current			Previous			Change (%)		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	137.3	149.5	165.6	139.3	151.0	167.4	-1.4%	-1.0%	-1.0%
Gross Profit	67.6	74.6	84.1	69.0	75.7	85.4	-2.1%	-1.4%	-1.5%
Non-GAAP net profit	23.6	26.5	30.8	24.4	27.0	31.5	-3.0%	-2.0%	-2.1%
Gross Margin	49.2%	49.9%	50.8%	49.6%	50.1%	51.0%	-0.4 ppt	-0.2 ppt	-0.3 ppt
Non-GAAP net margin	17.2%	17.7%	18.6%	17.5%	17.9%	18.8%	-0.3 ppt	-0.2 ppt	-0.2 ppt

Source: CMBIGM estimates

Figure 2: Baidu Core business segment forecast revision

RMB bn	Current			Previous			Change (%)		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	105.2	114.5	129.1	107.2	115.9	130.9	-1.8%	-1.2%	-1.3%
Non-GAAP Operating Profit	23.1	26.3	30.5	24.0	27.0	31.3	-3.6%	-2.4%	-2.6%
Non-GAAP net profit	22.1	24.4	28.2	22.8	25.0	28.9	-3.2%	-2.2%	-2.3%
Non-GAAP OPM	16.8%	17.6%	18.4%	17.2%	17.9%	18.7%	-0.4 ppt	-0.3 ppt	-0.3 ppt
Non-GAAP NPM	16.1%	16.3%	17.0%	16.4%	16.5%	17.3%	-0.3 ppt	-0.2 ppt	-0.2 ppt

Source: CMBIGM estimates

SOTP valuation of US\$195.0 per ADS

Our SOTP based target price is US\$195.0, which comprises, per ADS:

- 1) US\$63.0 (prior US\$65.0) for Baidu Core (main business, excluding Apollo and Baidu Cloud, mainly including the core search and feed ads business), based on unchanged 7.0x 2023E non-GAAP PE. The trim down in valuation is mainly due to a trim down in non-GAAP net income forecast for advertising business owing to a potential slower than previously expected macro recovery in 2H23.
- 2) US\$22.8 (unchanged) for Apollo ASD, based on 2.0x 2030E revenue, and discounted back using a 13.0% WACC.
- 3) US\$38.3 (prior US\$40.3) for Baidu Cloud, based on unchanged 4.8x 2023E PS. It is in line with the target multiple that we are giving to its Chinese cloud peers, but below the average of 8.1x (Fig.4) for overseas comparable companies because its cloud revenue is on a smaller scale;
- 4) US\$57.9 net cash (prior US\$58.4);
- 5) US\$13.1 (prior US\$12.9) for iQIYI and other investments, with a 30% holding discount applied to the share price of US\$18.7 as of market close on 14 July 2023.

Figure 3: Baidu: SOTP valuation

Segment	NOPAT (US\$mn)	Valuation method/multiple	Valuation (RMBmn)	Valuation (US\$mn)	Baidu's stake	Valuation of Baidu's stake (US\$mn)	USD/ADS	Valuation as % of total (%)
Core business and cash								
1) Baidu core (ex-Apollo and Cloud)	3,217	7.0x 2023E PE	154,626	22,329	100.0	22,329	63.0	32.3
2) Apollo ASD			55,926	8,076	100.0	8,076	22.8	11.7
3) Baidu Cloud (ex-ASD)		4.8x 2023E PS	93,976	13,571	100.0	13,571	38.3	19.6
4) Net cash			142,189	20,533	100.0	20,533	57.9	29.7
Valuation of core business and cash						64,508	181.9	93.3
iQIYI and strategic investment								
1) iQIYI		Market value	35,709	5,157	51.5	2,656	7.5	
2) Trip.com group		Market value	176,609	25,503	10.8	2,754	7.8	
3) Uxin		Market value	525	76	9.1	7	0.0	
4) HAND Enterprise Solutions		Market value	11,099	1,603	5.3	84	0.2	
5) Kuaishou		Market value	228,823	33,043	3.1	1,026	2.9	
6) Yusys Technologies		Market value	15,260	2,204	5.1	113	0.3	
Valuation of iQIYI and investments						6,641	18.7	
Valuation of iQIYI and investment (with 30% holding discount)						4,648	13.1	6.7
Total Baidu valuation (US\$mn)						69,156		
Number of ADS outstanding (mn)						355		
Valuation per ADS (US\$)						195.0		

Source: Company data, CMBIGM estimates

Note: 1) American depositary share (ADS); iQIYI (IQ US); Trip.com Group (TCOM US); Uxin (UXIN US); HAND Enterprise solution (300170 SH); Kuaishou (1024 HK); Yusys Technologies (300674 SH); 2) data as of 14 July 2023 market close.

Our target price translates into 20.3/18.3x 2023/2024E PE on non-GAAP basis, or 14.2/12.8x if excluding net cash. Our previous target price of US\$199.4 translated into 20.1x 2023E PE.

Figure 4: Cloud computing: peers valuation comps

Companies	Ticker	Price	Revenue growth (YoY%)			PS(x)		
		(US\$)	2023E	2024E	2025E	2023E	2024E	2025E
Microsoft	MSFT US	342.7	8.9	11.7	13.2	11.4	10.2	9.0
Google	GOOG US	124.8	6.1	10.7	11.4	6.4	5.8	5.2
Salesforce	CRM US	230.4	11.8	10.9	10.9	6.5	5.8	5.3
Average						8.1	7.3	6.5

Source: Bloomberg, CMBIGM

Note: data as of 14 July 2023

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	107,074	124,493	123,675	137,315	149,519	165,627
Cost of goods sold	(55,158)	(64,314)	(63,935)	(69,757)	(74,889)	(81,545)
Gross profit	51,916	60,179	59,740	67,558	74,629	84,082
Operating expenses	(37,576)	(49,661)	(43,829)	(47,369)	(50,146)	(54,923)
SG&A expense	(18,063)	(24,723)	(20,514)	(23,893)	(24,820)	(26,997)
R&D expense	(19,513)	(24,938)	(23,315)	(23,476)	(25,326)	(27,925)
Operating profit	14,340	10,518	15,911	20,189	24,483	29,160
Share of (losses)/profits of associates/JV	(2,248)	(932)	(1,910)	(1,001)	(633)	(261)
Adjusted EBITDA	27,504	24,914	29,663	33,476	38,319	43,859
Net Interest income/(expense)	2,255	2,130	3,332	4,355	3,096	3,371
Foreign exchange gain/loss	(660)	100	(1,484)	(106)	(85)	(68)
Other income/expense	9,403	(1,038)	(5,737)	1,638	1,654	1,671
Pre-tax profit	23,090	10,778	10,112	25,075	28,516	33,873
Income tax	(4,064)	(3,187)	(2,578)	(5,365)	(7,042)	(8,215)
After tax profit	19,026	7,591	7,534	19,709	21,473	25,658
Minority interest	(3,446)	(2,635)	(25)	916	1,416	1,825
Net profit	22,472	10,226	7,559	18,793	20,058	23,833
Adjusted net profit	22,020	18,830	20,680	23,633	26,501	30,780
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	183,342	213,315	212,850	236,290	265,703	299,781
Cash & equivalents	35,782	36,850	53,156	76,754	103,919	135,060
Restricted cash	758	10,821	11,330	11,330	11,330	11,330
Account receivables	8,668	9,981	11,733	10,158	11,060	12,252
Other current assets	138,134	155,663	136,631	138,048	139,394	141,139
Non-current assets	149,366	166,719	178,123	176,864	179,512	182,228
PP&E	17,508	23,027	23,973	28,017	32,018	36,109
Intangibles	8,457	8,947	8,095	2,792	1,439	64
Goodwill	22,248	22,605	22,477	22,477	22,477	22,477
Other non-current assets	101,153	112,140	123,578	123,578	123,578	123,578
Total assets	332,708	380,034	390,973	413,154	445,215	482,009
Current liabilities	68,385	74,488	79,630	85,582	88,613	91,013
Short-term borrowings	3,016	4,168	5,343	5,343	5,343	5,343
Account payables	36,716	41,384	38,014	42,511	44,241	44,923
Other current liabilities	28,653	28,936	36,273	37,728	39,029	40,747
Non-current liabilities	72,480	81,594	73,538	64,841	63,681	63,103
Long-term borrowings	0	12,629	13,722	0	0	0
Bond payables	60,335	55,772	49,461	54,486	53,326	52,748
Obligations under finance leases	4,693	5,569	4,810	4,810	4,810	4,810
Deferred income	97	129	159	159	159	159
Other non-current liabilities	7,355	7,495	5,386	5,386	5,386	5,386
Total liabilities	140,865	156,082	153,168	150,423	152,294	154,116
Share capital	0	0	0	0	0	0
Capital surplus	47,213	47,548	47,748	47,948	48,148	48,348
Retained earnings	135,483	163,911	175,730	200,455	230,446	265,217
Other reserves	3,102	7,148	8,393	8,393	8,393	8,393
Total shareholders equity	185,798	218,607	231,871	256,796	286,987	321,958
Minority interest	6,045	5,345	5,934	5,934	5,934	5,934
Total equity and liabilities	332,708	380,034	390,973	413,154	445,215	482,009

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	23,090	10,778	10,112	25,075	28,516	33,873
Depreciation & amortization	18,180	16,438	14,725	5,700	5,742	5,654
Tax paid	(4,064)	(3,187)	(2,578)	(5,365)	(7,042)	(8,215)
Change in working capital	(18,207)	(18,691)	(16,758)	6,110	783	(537)
Others	5,201	14,784	20,669	7,013	7,291	7,886
Net cash from operations	24,200	20,122	26,170	38,533	35,289	38,661
Investing						
Capital expenditure	(5,084)	(10,896)	(8,286)	(8,286)	(8,286)	(8,286)
Acquisition of subsidiaries/ investments	(2,396)	(247)	(14)	0	0	0
Net proceeds from disposal of short-term investments	(486)	0	0	0	0	0
Others	(19,586)	(20,301)	4,356	(130)	(104)	(84)
Net cash from investing	(27,552)	(31,444)	(3,944)	(8,416)	(8,390)	(8,370)
Financing						
Net borrowings	12,390	8,840	(6,813)	(13,722)	0	0
Share repurchases	(13,054)	(7,581)	(1,925)	0	0	0
Others	6,329	22,137	2,348	6,452	267	849
Net cash from financing	5,665	23,396	(6,390)	(7,270)	267	849
Net change in cash						
Cash at the beginning of the year	34,439	36,540	47,671	65,236	88,084	115,249
Exchange difference	(212)	(943)	1,729	0	0	0
Cash at the end of the year	36,540	47,671	65,236	88,084	115,249	146,390
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	(0.3%)	16.3%	(0.7%)	11.0%	8.9%	10.8%
Gross profit	16.5%	15.9%	(0.7%)	13.1%	10.5%	12.7%
Operating profit	127.4%	(26.7%)	51.3%	26.9%	21.3%	19.1%
Net profit	992.5%	(54.5%)	(26.1%)	148.6%	6.7%	18.8%
Adj. net profit	21.1%	(14.5%)	9.8%	14.3%	12.1%	16.1%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	48.5%	48.3%	48.3%	49.2%	49.9%	50.8%
Operating margin	13.4%	8.4%	12.9%	14.7%	16.4%	17.6%
Adj. net profit margin	20.6%	15.1%	16.7%	17.2%	17.7%	18.6%
Return on equity (ROE)	12.8%	5.1%	3.4%	7.7%	7.4%	7.8%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)	(0.6)
Current ratio (x)	2.7	2.9	2.7	2.8	3.0	3.3
Receivable turnover days	27.0	27.0	31.6	28.7	25.5	25.3
Payable turnover days	226.5	218.6	223.5	207.8	208.5	196.8
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	13.1	42.3	40.1	19.9	18.8	16.0
P/E (diluted)	13.2	43.2	40.5	20.1	19.0	16.2
P/B	1.6	2.0	1.3	1.5	1.3	1.2
P/CFPS	15.5	47.9	17.1	12.5	14.1	12.7

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong. Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.