

Baidu (BIDU US)

Solid 2Q20 but guidance soft

Baidu delivered mixed 2Q20 results, with topline/bottom line -1%/+46% YoY, 1%/57% above consensus. 3Q20E revenue guidance missed 1% on weak iQiyi. Stock price might see short term pressure for iQiyi's SEC investigation and 3Q20 uncertainty. But we are positive on Baidu Core's long-term recovery, coupled with further catalysts (e.g. potential listing of subsidiaries). We cut our topline estimates by 7%/10%/9%, but raised earnings forecast by 21%/2%/3% in FY20/21/22E for better cost control. Maintain BUY with unchanged TP of US\$151.

- **2Q20 beat, while 3Q20 guidance soft on iQiyi.** 2Q20 revenue was RMB26.0bn, dropped 1% YoY, 1% above consensus. Non-GAAP EPS grew 46% YoY, 57% above consensus. Margin surprised on higher gross margin (optimized TAC), narrowing iQiyi loss and disciplined cost control. 3Q20E guidance came in at RMB26.3-28.7bn, -6% YoY to +2% YoY, with midpoint 1% below consensus. 3Q20 guidance is soft on iQiyi's weak guidance (10% below consensus), while Baidu Core is in-line.
- **Prudent on short-term ads recovery.** 2Q20 Baidu Core declined 3% YoY (vs. -13% in 1Q20), in line with our expectation. Baidu App DAU reached 204mn, -8% QoQ, with traffic normalization after epidemic. Mgmt guided Baidu Core's rev at -7%~+3% YoY in 3Q20E, largely in line, backed by increasing contribution with managed page initiatives and improved targeting (higher eCPM). However, iQiyi's weak guidance reflects slower-than-expected ads recovery, for soft brand ads demand amid macro uncertainty.
- **Disciplined cost control to continue.** 2Q20 Baidu Core's non-GAAP operating margin came in at 34% (vs. 22% in 1Q20), above our estimate of 28%, for stringent cost saving. In the long run, mgmt. expected potential margin expansion with higher productivity, effective cost control and narrowing loss of AI initiatives.
- **Maintain BUY.** To reflect iQiyi's slower recovery, we cut our topline estimates by 7%/10%/9%, but raised earnings forecast by 21%/2%/3% in FY20/21/22E for better cost control. Given little change on FY21E earnings, our SOTP-based TP is maintained at US\$151 (16x FY21E P/E). The stock is trading at 13x FY21E P/E, and valuation is not demanding in our view.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	102,277	107,413	106,216	117,300	129,963
YoY growth (%)	27.7	5.0	-1.1	10.4	10.8
Adj. net income (RMB mn)	23,323	21,375	18,896	22,543	27,921
Adj. EPS (RMB)	66.3	61.8	54.6	65.1	80.7
YoY growth (%)	4.1	-6.9	-11.6	19.3	23.9
Consensus EPS	NA	NA	43.7	57.8	70.5
P/E (x)	12.2	13.1	15.0	12.5	10.1
P/B (x)	1.6	1.6	1.5	1.4	1.2
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	16.9	1.3	10.1	10.4	11.3
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	US\$151
(Previous TP	US\$151)
Up/Downside	+29.4%
Current Price	US\$116.7

China Internet Sector

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Stock Data

Mkt Cap (US\$ mn)	43,549
Avg 3 mths t/o (US\$ mn)	481.9
52w High/Low (US\$)	147/82
Total Issued Shares (mn)	273

Source: Bloomberg

Shareholding Structure

BlackRock	4.8%
Vanguard Group	3.8%
Harding Loevner	3.1%

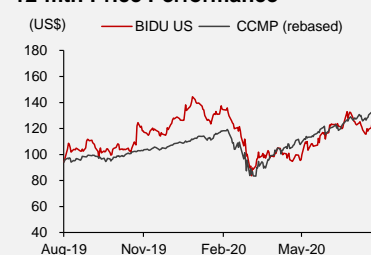
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-4.7%	-8.1%
3-mth	29.4%	5.8%
6-mth	-8.3%	-19.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

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Figure 1: 2Q20 financial review

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY	Consensus	Diff %
Net revenue	24,123	26,326	28,080	28,884	22,545	26,034	15.5%	-1.1%	25,728	1%
Revenue	24,123	26,326	28,080	28,884	22,545	26,034	15.5%	-1.1%	25,728	1%
Operating profit	(936)	233	2355	4,655	(437)	233	-153.3%	0.0%	2,209	-89%
Net profit	(327)	2,412	(6,373)	6,345	41	3,579	8629.3%	48.4%	2,030	76%
Adj. net profit	967	3,635	4,387	9,193	3,082	5,082	64.9%	39.8%	3,274	55%
Adj. EPS (Rmb)	2.77	10.11	12.61	26.54	8.84	14.73	66.6%	45.7%	9.36	57%
Margin (%)										
Gross margin	38.5%	38.8%	41.7%	46.3%	34.9%	49.6%			40.0%	
Operating margin	-3.9%	0.9%	8.4%	16.1%	-1.9%	0.9%			8.6%	
Adj. net margin	4.0%	13.8%	15.6%	31.8%	13.7%	19.5%			12.7%	
Growth (%)										
Revenue (YoY)	15.4%	1.4%	24.9%	6.2%	-6.5%	-1.1%			-2.3%	
Revenue (QoQ)	-11.3%	9.1%	6.7%	2.9%	-21.9%	15.5%			14.1%	
Operating profit	-120.5%	-95.7%	-46.8%	318.6%	-53.3%	0.0%			848.1%	
Adj. net profit	-78.9%	-51.1%	-35.0%	95.5%	218.7%	39.8%			-9.9%	

Source: Company data, Bloomberg

Figure 2: 2Q20 revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY
Total revenue	24,123	26,326	28,080	28,884	22,545	26,034	15%	-1%
Online marketing services	17,657	19,327	20,434	20,765	14,243	17,688	24%	-8%
Other services	6,466	7,089	7,646	8,119	8,302	8,346	1%	18%

Source: Company data

Figure 3: CMBIS estimates vs consensus

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	106,216	117,300	129,963	108,197	123,494	138,674	-1.8%	-5.0%	-6.3%
Gross Profit	47,384	53,944	63,209	43,988	53,501	61,846	7.7%	0.8%	2.2%
Operating Profit	13,926	18,402	24,870	9,072	14,428	22,943	53.5%	27.5%	8.4%
Adj. net profit	18,896	22,543	27,921	14,728	19,679	23,837	28.3%	14.6%	17.1%
EPS (RMB)	54.59	65.13	80.66	43.70	57.77	70.46	24.9%	12.7%	14.5%
Gross Margin	44.6%	46.0%	48.6%	40.7%	43.3%	44.6%	+4.0ppts	+2.7ppts	+4.0ppts
Operating Margin	13.1%	15.7%	19.1%	8.4%	11.7%	16.5%	+4.7ppts	+4.0ppts	+2.6ppts
Net Margin	17.8%	19.2%	21.5%	13.6%	15.9%	17.2%	+4.2ppts	+3.3ppts	+4.3ppts

Source: Company data, Bloomberg, CMBIS estimates

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	106,216	117,300	129,963	113,569	129,597	142,039	-6.5%	-9.5%	-8.5%
Gross Profit	47,384	53,944	63,209	47,416	56,853	65,321	-0.1%	-5.1%	-3.2%
Operating Profit	13,926	18,402	24,870	10,733	16,937	23,419	29.7%	8.6%	6.2%
Adj. net profit	18,896	22,543	27,921	15,586	22,151	27,189	21.2%	1.8%	2.7%
EPS (RMB)	54.59	65.13	80.66	45.03	63.86	78.55	21.2%	2.0%	2.7%
Gross Margin	44.6%	46.0%	48.6%	41.8%	43.9%	46.0%	+2.9ppts	+2.1ppts	+2.6ppts
Operating Margin	13.1%	15.7%	19.1%	9.5%	13.1%	16.5%	+3.7ppts	+2.4ppts	+2.6ppts
Net Margin	17.8%	19.2%	21.5%	13.7%	16.8%	19.1%	+4.1ppts	+2.4ppts	+2.3ppts

Source: Company data, CMBIS estimates

Figure 5: SOTP valuation

US\$bn	Valuation		Methodology	Multiple Applied/Implied		Metrics		Shareholding %
	US\$bn	Per share(US\$)		FY20E	FY21E	FY20E	FY21E	
Baidu Core	26.9	77.8	EV/EBIT	9.0	8.5	3.0	3.2	100%
iQiyi	8.1	23.4	Mkt cap					57%
Ctrip	2.0	5.9	Mkt cap					12%
Net (Debt)/Cash	15.2	43.9	Cash forecasted on Balance sheet					
Equity Value	52	151.0						

Source: CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net Revenue	102,277	107,413	106,216	117,300	129,963
Online marketing	81,913	78,093	78,353	83,054	88,868
Other services	20,365	29,320	27,863	34,246	41,095
COSG	(51,744)	(62,850)	(58,832)	(63,356)	(66,754)
Gross profit	50,533	44,563	47,384	53,944	63,209
R&D	(15,772)	(18,346)	(15,401)	(16,422)	(17,545)
S&GA	(19,231)	(19,910)	(18,057)	(19,120)	(20,794)
Operating profit	15,530	6,307	13,926	18,402	24,870
Interest income	4,451	6,060	5,992	6,618	7,332
Interest exp.	(1,883)	(2,960)	(2,849)	(2,849)	(2,849)
Exchange loss	(122)	(33)	0	0	0
Loss from E.M.I	(79)	(1,254)	0	0	0
Other income	9,428	(8,460)	0	0	0
Pre-tax profit	27,325	(340)	17,069	22,171	29,353
Tax	(4,743)	(1,948)	(3,072)	(3,991)	(5,284)
MI	4,991	4,345	4,479	2,909	1,685
Net profit	27,573	2,057	18,476	21,089	25,755
Adjustment	742	19,318	420	1,454	2,166
Non GAAP Net profit	23,323	21,375	18,896	22,543	27,921

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	142,472	135,754	143,456	151,548	160,617
Fixed asset	17,903	18,311	21,393	25,220	29,912
Long term investment	80,454	69,410	69,410	69,410	69,410
Intangible assets	27,717	26,137	30,756	35,021	39,399
Others	16,398	14,564	14,564	14,564	14,564
Current assets	155,094	165,562	169,767	182,209	198,978
Cash	29,827	34,439	39,419	51,168	67,146
Account receivable	6,015	7,416	6,641	7,334	8,125
Associates	785	1,594	1,594	1,594	1,594
Others	119,252	123,707	123,707	123,707	123,706
Current liabilities	56,853	57,380	55,290	57,644	59,411
Borrowings	3,130	3,355	3,355	3,355	3,355
Payables	42,719	43,763	41,673	44,027	45,794
Associates	1,727	2,231	2,231	2,231	2,231
Others	9,277	8,031	8,031	8,031	8,030
Non-current liabilities	65,677	72,230	72,230	72,230	72,230
Long term liabilities	50,191	45,894	45,894	45,894	45,894
Deferred taxation	4,099	3,273	3,273	3,273	3,273
Others	11,387	23,063	23,063	23,063	23,063
MI	12,139	8,107	3,628	719	966
S/H equity	162,897	163,599	182,075	203,164	228,919
Total Equity	175,036	171,706	185,703	203,883	227,953

Source: Company data, CMBIS estimates

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	22,582	(2,288)	13,997	18,180	24,070
D&A	9,102	19,879	15,090	19,258	23,751
Change in WC	(5,007)	(1,270)	(1,315)	1,661	976
Others	4,676	5,626	0	0	0
Operating CF	31,353	21,948	27,772	39,099	48,797
Capex	(18,089)	(18,993)	(22,792)	(27,350)	(32,820)
Associates	0	0	0	0	0
Others	(19,336)	3,506	0	0	0
Investing CF	(37,425)	(15,488)	(22,792)	(27,350)	(32,820)
Chg in capital	16,677	(353)	0	0	0
Change of Debts	16,255	(4,072)	0	0	0
Others	(10,306)	3,770	0	0	0
Financing CF	22,626	(655)	0	0	0
Change in cash	16,554	5,805	4,980	11,749	15,977
Cash (beg of yr)	11,084	27,638	33,443	38,423	50,172
FX	0	0	0	0	0
Cash (end of yr)	27,638	33,443	38,423	50,172	66,150
Pledge cash	2,189	996	996	996	996
Cash at balance sheet	29,827	34,439	39,419	51,168	67,146

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Online marketing	80.1	72.7	73.8	70.8	68.4
Other services	19.9	27.3	26.2	29.2	31.6
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross margin	49.4	41.5	44.6	46.0	48.6
Pre-tax margin	26.7	-0.3	16.1	18.9	22.6
Net margin	22.1	-2.1	13.2	15.5	18.5
Tax rate	17.4	-573.5	18.0	18.0	18.0
Balance sheet ratios					
Current ratio (x)	2.7	2.9	3.1	3.2	3.3
Debtors turnover	18.9	22.8	22.8	22.8	22.8
Creditors turnover	249.6	189.9	189.9	189.9	189.9
Inventory turnover	0.0	0.0	0.0	0.0	0.0
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	17.4	13.1	10.4	11.1	12.2
ROA	7.8	5.7	4.6	5.9	7.3
Per share					
EPADS (RMB)	66	62	55	65	81
DPS (RMB)	0	0	0	0	0
BVPADS (RMB)	498	496	536	589	659

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