

Baidu (BIDU US)

More aggressive in Gen-AI empowered ads business transformation

Baidu announced (22 Aug) its 2Q24 results: revenue was RMB33.9bn, down 0.4% YoY and largely in line with Bloomberg consensus; non-GAAP net income was RMB7.4bn, 9% better than consensus, thanks to better-than-expected sales and marketing expense control. Baidu is becoming more determined in driving user experience improvement, guiding to aim for a further increase in the contribution of Gen-AI generated results in search results page, and prioritize user experience improvement over monetization in the short term. Although the transformation will likely bring incremental headwinds to ads revenue growth in the near term, Baidu's long-term monetization prospects should be enhanced, in our view, with enhanced user stickiness, and potential innovative cost per sale (CPS) ads formats. We fine-tune our SOTP-based TP to US\$180.5 (was US\$183.0). Maintain BUY.

■ **Increase in adoption of GPU cloud aids cross-selling for CPU cloud.** In 2Q24, non-ad revenue was up 10% YoY to RMB7.5bn and accounted for 28.2% of Baidu Core revenue (2Q23: 25.8%). Baidu Cloud revenue reached RMB5.1bn in 2Q24, up 14% YoY (2Q23: 5%; 1Q24: 12%), thanks to the ramp-up in revenue generation from AI-related GPU cloud revenue, and cross-selling of CPU cloud services to GPU cloud customers. Management highlighted that: 1) Gen-AI and foundation model contributed 9% of AI cloud revenue in 2Q24 (4Q23/1Q24: 4.8%/6.9%); 2) cloud business continued to deliver non-GAAP OP and improved OPM aided by the scale effect and increase in revenue contribution from GPU cloud services. We estimate YoY rev growth of Baidu Cloud to further accelerate to 16% YoY in 3Q24E (3Q23: -2% YoY) aided by the strong demand of AI cloud.

■ **Greater determination in driving search experience improvement brings additional ST headwinds but should benefit LT.** In 2Q24, Baidu Core's online ads revenue was RMB19.2bn, down 2.2% YoY, but was 1% better than consensus. Currently, about 18% of Baidu's search results pages are filled with Gen-AI generated results (mid-May 2024: 11%). Management highlighted a positive user retention trend follows the Gen-AI empowered business transformation in 2Q, and guided to drive more aggressive transformation in 3Q. It will prioritize user experience improvement over monetization in the short term, to better foster long-term business development. Monetization should follow, in our view, with enhanced user stickiness, and the innovation of ads formats, although ads revenue growth is likely to see incremental headwinds in the near term. We forecast Baidu Core revenue growth of 0.6% YoY, among which we estimate ads business to ink a 3.4% YoY decline to RMB19.0bn in 3Q24E.

■ **More stringent cost control to partly mitigate short-term cost impact from increase in internal Gen-AI related product usage.** Baidu Core's GPM was 59.4% in 2Q24, down 1.1ppt YoY. Non-GAAP OPM for Baidu Core was 26.1% (2Q23: 24.7%), 1.4ppt better than Bloomberg consensus, thanks to better-than-expected cost control on sales and marketing expenses. However, with increase in internal usage of Gen-AI related products, and with short-term headwinds on revenue growth of relative high-margin ads business, Baidu Core's operating margin may see some short-term pressure, but the stringent cost control should partly mitigate the negative impact, in our view. We estimate Baidu Core to ink a non-GAAP OPM of 24.5% in 3Q24E (3Q23: 25.1%).

BUY (Maintain)

Target Price **US\$180.50**
 (Previous TP) **US\$183.00**
Up/Downside **101.1%**
Current Price **US\$89.74**

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Stock Data

Mkt Cap (US\$ mn)	32,141.3
Avg 3 mths t/o (US\$ mn)	81.4
52w High/Low (US\$)	146.47/82.01
Total Issued Shares (mn)	358.2

Source: FactSet

Shareholding Structure

Robin Yanhong Li	16.5%
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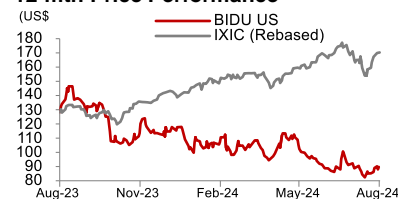
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-2.7%	-2.3%
3-mth	-12.4%	-17.8%
6-mth	-18.9%	-27.4%

Source: FactSet

12-mth Price Performance



Source: FactSet

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	123,675	134,598	135,827	146,971	157,928
YoY growth (%)	(0.7)	8.8	0.9	8.2	7.5
Adjusted net profit (RMB mn)	20,680.0	28,747.0	27,963.7	28,723.8	31,938.2
YoY growth (%)	9.8	39.0	(2.7)	2.7	11.2
EPS (Adjusted) (RMB)	58.90	81.06	78.08	79.41	87.42
Consensus EPS (RMB)	na	80.85	78.71	80.88	88.05
P/E (x)	29.5	11.1	10.7	10.1	9.0
ROE (%)	3.4	8.4	7.9	7.6	7.7

Source: Company data, Bloomberg, CMBIGM estimates

Figure 1: Baidu: quarterly financial results

(RMBbn)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	2Q24 Consensus	Diff%
Baidu Group												
Online marketing	16.9	18.3	19.9	19.6	18.0	21.1	21.3	20.8	18.5	20.6	20.6	0.2%
YoY growth (%)	-6.4%	12.3%	-5.3%	-5.6%	6.2%	15.4%	7.0%	6.3%	2.9%	-2.2%		
Other services	11.5	11.4	12.6	13.5	13.2	13.0	13.1	14.1	13.0	13.3	13.5	-1.6%
YoY growth (%)	14.4%	8.1%	15.9%	9.2%	14.7%	14.0%	4.0%	4.7%	-1.1%	2.6%		
Total revenue	28.4	29.6	32.5	33.1	31.1	34.1	34.4	35.0	31.5	33.9	34.1	-0.5%
YoY growth (%)	1.0%	-5.4%	1.9%	0.0%	9.6%	14.9%	5.9%	5.7%	1.2%	-0.4%		
Gross profit	12.9	14.5	16.3	16.1	16.0	17.9	18.2	17.5	16.2	17.5	17.6	-0.3%
Operating profit	2.6	3.4	5.3	4.6	5.0	5.2	6.3	5.4	5.5	5.9	6.8	12.5%
Non-GAAP net profit	3.9	5.5	5.9	5.4	5.7	8.0	7.3	7.8	7.0	7.4	6.7	10.7%
YoY growth (%)	-10%	3%	16%	32%	48%	44%	23%	44%	22%	-8%		
GPM (%)	45.3%	48.8%	50.0%	48.8%	51.3%	52.5%	52.7%	50.2%	51.5%	51.7%	51.6%	0.1 ppt
OPM (%)	9.2%	11.5%	16.3%	13.9%	16.0%	15.3%	18.2%	15.4%	17.4%	17.5%	19.9%	-2.4 ppt
Non-GAAP NPM (%)	13.7%	18.7%	18.1%	16.2%	18.4%	23.5%	21.1%	22.2%	22.2%	21.8%	19.6%	2.2 ppt
Baidu Core												
Revenue	21.4	23.2	25.2	25.7	23.0	26.4	26.6	27.5	23.8	26.7	26.5	0.8%
YoY growth (%)	4.4%	-3.7%	2.3%	-1.2%	7.6%	14.0%	5.3%	7.2%	3.5%	1.1%		
Baidu Core - online marketing	15.6	17.1	18.7	18.0	16.6	19.6	19.7	19.2	17.0	19.2	19.0	0.7%
YoY growth (%)	-3.6%	10.1%	-3.6%	-5.5%	6.3%	14.7%	5.2%	6.3%	2.7%	-2.2%		
Baidu Core - Others	5.8	6.1	6.5	7.6	6.4	6.8	6.9	8.3	6.8	7.5	7.4	1.2%
YoY growth (%)	34.4%	20.8%	24.1%	10.4%	11.1%	12.1%	5.5%	9.1%	5.7%	10.3%		
Non-GAAP OP	3.7	5.1	6.7	5.5	5.4	6.5	6.7	6.2	5.6	7.0	6.5	7.9%
Non-GAAP NP	3.8	5.4	5.8	4.9	5.3	7.7	7.0	7.5	6.6	7.3	6.1	19.3%
YoY growth (%)	21.9%	-8.3%	-1.5%	6.3%	38.5%	41.2%	20.6%	52.6%	25.8%	-5.3%		
Non-GAAP OPM (%)	17.2%	22.1%	26.4%	21.4%	23.3%	24.7%	25.1%	22.5%	23.5%	26.1%	24.4%	1.7 ppt
Non-GAAP NPM (%)	17.8%	23.5%	22.8%	19.2%	22.9%	29.1%	26.2%	27.3%	27.8%	27.3%	23.1%	4.2 ppt

Source: Company data, Bloomberg, CMBIGM

Changes in forecast and valuation

Figure 2: Baidu forecast revision

RMB bn	Current			Previous			Change (%)		
	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E
Revenue	135.8	147.0	157.9	138.5	149.4	159.7	-1.9%	-1.6%	-1.1%
Gross Profit	69.7	76.2	82.6	71.6	78.3	84.8	-2.7%	-2.7%	-2.6%
Non-GAAP net profit	28.0	28.7	31.9	27.7	29.6	33.0	1.1%	-3.0%	-3.3%
Gross Margin	51.3%	51.8%	52.3%	51.7%	52.4%	53.1%	-0.4 ppt	-0.6 ppt	-0.8 ppt
Non-GAAP net margin	20.6%	19.5%	20.2%	20.0%	19.8%	20.7%	0.6 ppt	-0.3 ppt	-0.4 ppt

Source: CMBIGM estimates

SOTP valuation of US\$180.5 per ADS

Our SOTP-based target price is fine-tuned to US\$180.5, which translates into 16.7x/16.4x 2024E/2025E PE on a non-GAAP basis, or 10.8x/10.6x if excluding net cash. Our new SOTP-based target price comprises, per ADS:

- 1) US\$71.6 (was US\$69.2) for Baidu Core (main business, excluding Apollo and Baidu Cloud, mainly including the core search and feed ads business), based on unchanged 7.0x 2024E non-GAAP PE.
- 2) US\$1.8 for Apollo ASD (was US\$1.8), based on 2.0x 2030E revenue, and discounted back using a 13.0% WACC.
- 3) US\$32.2 for Baidu Cloud (unchanged), based on 3.9x 2024E revenue; the lowering in valuation was mainly due to the lowering of target multiple which is in line with that of industry peers covered by us.
- 4) US\$64.1 in net cash (was US\$64.6).
- 5) US\$10.8 (was US\$15.2) for iQIYI and other investments, with a 30% holding discount applied to the share price of US\$21.7 as of 22 Aug market close.

Figure 3: Baidu: SOTP valuation

Segment	NOPAT (USDmn)	Valuation method/multiple	Valuation (RMBmn)	Valuation (USDmn)	Baidu's stake	Valuation of Baidu's stake (USDmn)	USD/ADS	Valuation as % of total (%)
Core business and cash								
1) Baidu core (ex-Apollo and Cloud)	3,664	7.0	185,202	25,651	100.0	25,651	71.6	39.7
2) Apollo ASD			4,740	656	100.0	656	1.8	1.0
3) Baidu Cloud (ex-ASD)		3.9	83,214	11,526	100.0	11,526	32.2	17.8
4) Net cash			165,703	22,951	100.0	22,951	64.1	35.5
Valuation of core business and cash						60,784	169.7	94.0
iQIYI and strategic investment								
1) iQIYI		Market value	21,341	2,956	51.5	1,522	4.3	
2) Trip.com group		Market value	209,604	29,031	10.8	3,135	8.8	
3) Uxin		Market value	2,293	318	9.1	29	0.1	
4) HAND Enterprise Solutions (300170 SH)		Market value	6,037	836	5.3	44	0.1	
5) Kuaishou		Market value	161,425	22,358	3.1	694	1.9	
6) Yusys Technologies (300674 SH)		Market value	15,260	2,114	5.1	109	0.3	
Valuation of iQIYI and investments						5,533	15.4	
Valuation of iQIYI and investment (with 30% holding discount)						3,873	10.8	
Total Baidu valuation (USDmn)						64,657		6.0
Number of ADS outstanding (mn)						358		
Valuation per ADS (USD)						180.5		

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 CH); Kuaishou (1024 HK); Yusys Technologies (300674 CH); 2) data as of 22 Aug 2024 market close.

Risks

- 1) Slower-than-expected ramp-up in revenue generation from Gen-AI related business.
- 2) Slower-than-expected margin expansion.

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	124,493	123,675	134,598	135,827	146,971	157,928
Cost of goods sold	(64,314)	(63,935)	(65,031)	(66,161)	(70,809)	(75,308)
Gross profit	60,179	59,740	69,567	69,666	76,162	82,621
Operating expenses	(49,661)	(43,829)	(47,711)	(46,509)	(49,776)	(52,700)
SG&A expense	(24,723)	(20,514)	(23,519)	(22,547)	(24,250)	(25,742)
R&D expense	(24,938)	(23,315)	(24,192)	(23,961)	(25,525)	(26,958)
Operating profit	10,518	15,911	21,856	23,158	26,386	29,921
Share of (losses)/profits of associates/JV	(932)	(1,910)	(3,799)	(844)	(879)	(879)
Adjusted EBITDA	24,914	29,663	35,824	35,963	39,839	43,950
Net Interest income/(expense)	2,130	3,332	4,761	5,123	5,417	6,517
Foreign exchange gain/loss	100	(1,484)	595	401	321	257
Other income/expense	(1,038)	(5,737)	1,785	(729)	(736)	(744)
Pre-tax profit	10,778	10,112	25,198	27,109	30,508	35,071
Income tax	(3,187)	(2,578)	(3,649)	(4,967)	(6,628)	(7,905)
After tax profit	7,591	7,534	21,549	22,142	23,880	27,166
Minority interest	(2,635)	(25)	1,234	952	1,258	1,544
Net profit	10,226	7,559	20,315	21,189	22,622	25,623
Adjusted net profit	18,830	20,680	28,747	27,964	28,724	31,938

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	213,315	212,850	230,255	257,634	289,612	323,313
Cash & equivalents	36,850	53,156	25,231	54,069	83,949	115,541
Restricted cash	10,821	11,330	11,503	11,503	11,503	11,503
Account receivables	9,981	11,733	10,848	10,047	10,872	11,682
Other current assets	155,663	136,631	182,673	182,015	183,287	184,587
Non-current assets	166,719	178,123	176,504	174,153	176,869	179,788
PP&E	23,027	23,973	27,960	32,018	36,109	40,418
Intangibles	8,947	8,095	7,848	1,439	64	(1,326)
Goodwill	22,605	22,477	22,586	22,586	22,586	22,586
Other non-current assets	112,140	123,578	118,110	118,110	118,110	118,110
Total assets	380,034	390,973	406,759	431,787	466,481	503,101
Current liabilities	74,488	79,630	76,451	78,475	79,337	79,583
Short-term borrowings	4,168	5,343	10,257	10,257	10,257	10,257
Account payables	41,384	38,014	37,717	40,190	39,863	38,941
Other current liabilities	28,936	36,273	28,477	28,028	29,216	30,385
Non-current liabilities	81,594	73,538	67,700	62,594	62,046	60,479
Long-term borrowings	12,629	13,722	14,223	0	0	0
Bond payables	55,772	49,461	43,134	52,251	51,703	50,136
Obligations under finance leases	5,569	4,810	5,040	5,040	5,040	5,040
Deferred income	129	159	200	200	200	200
Other non-current liabilities	7,495	5,386	5,103	5,103	5,103	5,103
Total liabilities	156,082	153,168	144,151	141,068	141,383	140,062
Share capital	0	0	0	0	0	0
Capital surplus	73,888	79,855	87,099	87,202	87,305	87,408
Retained earnings	137,571	143,623	156,527	184,535	218,811	256,649
Other reserves	7,148	8,393	9,465	9,465	9,465	9,465
Total shareholders equity	218,607	231,871	253,091	281,202	315,581	353,522
Minority interest	5,345	5,934	9,517	9,517	9,517	9,517
Total equity and liabilities	380,034	390,973	406,759	431,787	466,481	503,101

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	10,778	10,112	25,198	27,109	30,508	35,071
Depreciation & amortization	16,438	14,725	14,908	5,742	5,654	5,435
Tax paid	(3,187)	(2,578)	(3,649)	(4,967)	(6,628)	(7,905)
Change in working capital	(18,691)	(16,758)	(13,067)	3,482	(1,235)	(1,864)
Others	14,784	20,669	13,225	6,564	6,935	7,211
Net cash from operations	20,122	26,170	36,615	37,930	35,234	37,948
Investing						
Capital expenditure	(10,896)	(8,286)	(11,190)	(8,286)	(8,286)	(8,286)
Acquisition of subsidiaries/ investments	(247)	(14)	(115)	0	0	0
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	(20,301)	4,356	(39,092)	(104)	(84)	(67)
Net cash from investing	(31,444)	(3,944)	(50,397)	(8,390)	(8,370)	(8,353)
Financing						
Net borrowings	8,840	(6,813)	(13,093)	(14,223)	0	0
Share repurchases	(7,581)	(1,925)	(4,764)	0	0	0
Others	22,137	2,348	3,695	12,681	3,017	1,997
Net cash from financing	23,396	(6,390)	(14,162)	(1,542)	3,017	1,997
Net change in cash						
Cash at the beginning of the year	36,540	47,671	65,236	37,574	65,572	95,452
Exchange difference	(943)	1,729	282	0	0	0
Cash at the end of the year	47,671	65,236	37,574	65,572	95,452	127,044
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	16.3%	(0.7%)	8.8%	0.9%	8.2%	7.5%
Gross profit	15.9%	(0.7%)	16.4%	0.1%	9.3%	8.5%
Operating profit	(26.7%)	51.3%	37.4%	6.0%	13.9%	13.4%
Net profit	(54.5%)	(26.1%)	168.8%	4.3%	6.8%	13.3%
Adj. net profit	(14.5%)	9.8%	39.0%	(2.7%)	2.7%	11.2%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	48.3%	48.3%	51.7%	51.3%	51.8%	52.3%
Operating margin	8.4%	12.9%	16.2%	17.0%	18.0%	18.9%
Adj. net profit margin	15.1%	16.7%	21.4%	20.6%	19.5%	20.2%
Return on equity (ROE)	5.1%	3.4%	8.4%	7.9%	7.6%	7.7%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)	(0.6)
Current ratio (x)	2.9	2.7	3.0	3.3	3.7	4.1
Receivable turnover days	27.0	31.6	29.0	26.5	25.6	25.7
Payable turnover days	218.6	223.5	220.6	222.7	203.5	188.4
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	21.6	29.5	11.1	10.7	10.1	9.0
P/E (diluted)	22.0	29.7	11.2	10.8	10.2	9.1
P/B	1.0	1.0	0.9	0.8	0.7	0.7
P/CFPS	24.4	12.6	8.9	7.7	8.6	7.9

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

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