

# Baidu (BIDU US)

## Solid 3Q20; Acquiring YY Live to bring synergy

Baidu delivered solid 3Q20 results, with revenue/adj. EPS +0.5% YoY/+61% YoY, 3%/51% above consensus. 4Q20 rev guidance beat 3%. Baidu has entered into an agreement with JOYY to acquire "YY Live" at US\$3.6bn in cash. We keep positive on its ads recovery, backed by strong feeds & video penetration, increasing contribution with managed page initiatives. Moreover, its AI monetization and YY synergy would bring further upside if executed well. We slightly lifted its earnings by 3%/2%/0% in FY20/21/22E, with higher SOTP-based TP of US\$173 (on higher Baidu Core earnings and investment valuation).

- **3Q20 beat.** 3Q20 revenue was RMB28.2bn, +0.5% YoY, 3% above consensus. Non-GAAP EPS grew 61% YoY, 51% above consensus. Margin surprised on higher gross margin (optimized TAC) and disciplined cost control. 4Q20E guidance came in at RMB28.6-31.3bn, -1% to +8% YoY, with midpoint 3% above consensus.
- **Ads gradual recovery trends well.** 3Q20 Baidu Core +2% YoY (vs. -3% in 2Q20), 2% above our expectation. Baidu App DAU reached 206mn, +1% QoQ. Excluding iQiyi's rev guidance of -3% to +3% YoY, Baidu Core will grow at -1% to +10% YoY in 4Q20E, 3% midpoint above our estimate. We believe this solid guidance was mainly attributable to ads sentiment recovery, increasing contribution with managed page initiatives, and improved targeting.
- **Acquiring YY Live to bring synergy and diversify revenue.** Baidu would acquire YY Live (JOYY's domestic live streaming business, including YY mobile app, YY.com website, and PC YY) for a purchase price of US\$3.6bn in cash. The closing of the transaction is subject to certain conditions and is currently expected to occur in 1H21. The valuation is estimated to be 11x FY21E P/E for YY Live (38% above our prior valuation of US\$2.6bn, 8x FY21E P/E). Mgmt expects YY live to bring synergy, in which YY Live could benefit from Baidu's large traffic and thriving mobile ecosystem, while Baidu will receive immediate operational experience for social media development and creator network.
- **Maintain BUY.** To reflect better ads outlook and margin trend, we slightly lifted its earnings by 3%/2%/0% in FY20/21/22E, with higher TP of US\$173 (18x FY21E P/E) from US\$151. The stock is trading at 15x FY21E P/E, not demanding in our view. We expect solid ads sentiment in next few quarters, and AI initiatives to unlock long-term potential.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	102,277	107,413	106,216	121,231	132,478
YoY growth (%)	27.7	5.0	(1.1)	14.1	9.3
Adj. net income (RMB mn)	23,323	21,375	19,505	22,910	28,010
Adj. EPS (RMB)	66.3	61.8	56.3	66.2	80.9
YoY growth (%)	4.1	(6.9)	(8.8)	17.5	22.3
Consensus EPS	NA	NA	50.18	60.63	72.51
P/E (x)	15.1	16.2	17.8	15.1	12.4
P/B (x)	20.1	20.2	18.6	16.9	15.1
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	16.9	1.3	10.4	10.5	11.2
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Maintain)

Target Price	US\$173
(Previous TP	US\$151)
Up/Downside	+20.9%
Current Price	US\$143

### China Internet Sector

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### Stock Data

Mkt Cap (US\$ mn)	49,483
Avg 3 mths t/o (US\$ mn)	428.8
52w High/Low (US\$)	148/82
Total Issued Shares (mn)	270
Source: Bloomberg	

### Shareholding Structure

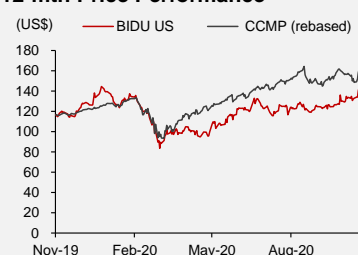
BlackRock	4.7%
Renaissance Technologies	3.9%
Vanguard Group	3.7%
Source: Bloomberg	

### Share Performance

	Absolute	Relative
1-mth	11.6%	10.5%
3-mth	24.3%	15.8%
6-mth	45.3%	10.7%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: Ernst & Young

### Related Reports

1. Solid 2Q20 but guidance soft – 17 Aug 2020
2. Ads recovery on track – 20 May 2020
3. Moving into long-term recovery - 2 Mar 2020

**Figure 1: 3Q20 financial review**

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	QoQ	YoY	Consensus	Diff %
Net revenue	24,123	26,326	28,080	28,884	22,545	26,034	28,232	8.4%	0.5%	27,521	3%
Revenue	24,123	26,326	28,080	28,884	22,545	26,034	28,232	8.4%	0.5%	27,521	3%
Operating profit	(936)	233	2355	4,655	(437)	3,644	6,156	68.9%	161.4%	4,785	29%
Net profit	(327)	2,412	(6,373)	6,345	41	3,579	13,678	282.2%	NA	3,020	353%
Adj. net profit	967	3,635	4,387	9,193	3,082	5,082	6,988	37.5%	59.3%	4,581	53%
Adj. EPS (Rmb)	2.77	10.11	12.61	26.54	8.84	14.73	20.35	38.2%	61.4%	13.46	51%
<b>Margin (%)</b>											
Gross margin	38.5%	38.8%	41.7%	46.3%	34.9%	49.6%	54.6%			46.0%	
Operating margin	-3.9%	0.9%	8.4%	16.1%	-1.9%	14.0%	21.8%			17.4%	
Adj. net margin	4.0%	13.8%	15.6%	31.8%	13.7%	19.5%	24.8%			16.6%	
<b>Growth (%)</b>											
Revenue (YoY)	15.4%	1.4%	24.9%	6.2%	-6.5%	-1.1%	0.5%			-2.0%	
Revenue (QoQ)	-11.3%	9.1%	6.7%	2.9%	-21.9%	15.5%	8.4%			5.7%	
Operating profit	-120.5%	-95.7%	-46.8%	318.6%	-53.3%	1463.9%	161.4%			103.2%	
Adj. net profit	-78.9%	-51.1%	-35.0%	95.5%	218.7%	39.8%	59.3%			4.4%	

Source: Company data, Bloomberg

**Figure 2: 3Q20 revenue breakdown**

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	QoQ	YoY
<b>Total revenue</b>	<b>24,123</b>	<b>26,326</b>	<b>28,080</b>	<b>28,884</b>	<b>22,545</b>	<b>26,034</b>	<b>28,232</b>	<b>8%</b>	<b>1%</b>
Online marketing services	17,657	19,327	20,434	20,765	14,243	17,688	20,201	14%	-1%
Other services	6,466	7,089	7,646	8,119	8,302	8,346	8,031	-4%	5%

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	121,231	132,478	105,716	119,595	132,108	0.5%	1.4%	0.3%
Gross Profit	47,721	55,880	64,432	46,366	54,728	62,671	2.9%	2.1%	2.8%
Operating Profit	14,476	18,541	24,821	13,486	17,945	23,855	7.3%	3.3%	4.0%
Adj. net profit	19,505	22,910	28,010	17,445	21,587	25,448	11.8%	6.1%	10.1%
EPS (RMB)	56.35	66.19	80.92	50.18	60.63	72.51	12.3%	9.2%	11.6%
Gross Margin	44.9%	46.1%	48.6%	43.9%	45.8%	47.4%	+1.1ppts	+0.3ppts	+1.2ppts
Operating Margin	13.6%	15.3%	18.7%	12.8%	15.0%	18.1%	+0.9ppts	+0.3ppts	+0.7ppts
Net Margin	18.4%	18.9%	21.1%	16.5%	18.1%	19.3%	+1.9ppts	+0.8ppts	+1.9ppts

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	121,231	132,478	106,216	117,300	129,963	0.0%	3.4%	1.9%
Gross Profit	47,721	55,880	64,432	47,384	53,944	63,209	0.7%	3.6%	1.9%
Operating Profit	14,476	18,541	24,821	13,926	18,402	24,870	3.9%	0.8%	-0.2%
Adj. net profit	19,505	22,910	28,010	18,896	22,543	27,921	3.2%	1.6%	0.3%
EPS (RMB)	56.35	66.19	80.92	54.59	65.13	80.66	3.2%	1.6%	0.3%
Gross Margin	44.9%	46.1%	48.6%	44.6%	46.0%	48.6%	+0.3ppts	+0.1ppts	0.0ppts
Operating Margin	13.6%	15.3%	18.7%	13.1%	15.7%	19.1%	+0.5ppts	-0.4ppts	-0.4ppts
Net Margin	18.4%	18.9%	21.1%	17.8%	19.2%	21.5%	+0.6ppts	-0.3ppts	-0.3ppts

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	31.3	90.5	EV/EBIT	9.8	9.0	3.2	3.5	100%
iQiyi	9.8	28.3	Mkt cap					57%
Ctrip	2.5	7.1	Mkt cap					12%
Net (Debt)/Cash	16.2	46.7	Cash forecasted on Balance sheet					
<b>Equity Value</b>	<b>60</b>	<b>172.7</b>						

Source: CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Net Revenue</b>	<b>102,277</b>	<b>107,413</b>	<b>106,216</b>	<b>121,231</b>	<b>132,478</b>
Online marketing	81,913	78,093	78,353	85,404	91,383
Other services	20,365	29,320	27,863	35,827	41,095
COSG	(51,744)	(62,850)	(58,495)	(65,351)	(68,046)
<b>Gross profit</b>	<b>50,533</b>	<b>44,563</b>	<b>47,721</b>	<b>55,880</b>	<b>64,432</b>
R&D	(15,772)	(18,346)	(15,401)	(17,215)	(18,150)
S&GA	(19,231)	(19,910)	(17,844)	(20,124)	(21,461)
<b>Operating profit</b>	<b>15,530</b>	<b>6,307</b>	<b>14,476</b>	<b>18,541</b>	<b>24,821</b>
Interest income	4,451	6,060	5,992	6,840	7,474
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
<b>Pre-tax profit</b>	<b>27,325</b>	<b>(340)</b>	<b>17,619</b>	<b>22,532</b>	<b>29,447</b>
Tax	(4,743)	(1,948)	(3,171)	(4,056)	(5,300)
MI	4,991	4,345	4,623	2,956	1,690
<b>Net profit</b>	<b>27,573</b>	<b>2,057</b>	<b>19,071</b>	<b>21,432</b>	<b>25,837</b>
Adjustment	742	19,318	433	1,478	2,173
<b>Non GAAP Net profit</b>	<b>23,323</b>	<b>21,375</b>	<b>19,505</b>	<b>22,910</b>	<b>28,010</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Net income</b>	<b>22,582</b>	<b>(2,288)</b>	<b>14,448</b>	<b>18,476</b>	<b>24,146</b>
D&A	9,102	19,879	15,090	19,258	23,751
Change in WC	(5,007)	(1,270)	(1,491)	2,629	699
Others	4,676	5,626	0	0	0
<b>Operating CF</b>	<b>31,353</b>	<b>21,948</b>	<b>28,048</b>	<b>40,363</b>	<b>48,597</b>
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
<b>Investing CF</b>	<b>(37,425)</b>	<b>(15,488)</b>	<b>(22,792)</b>	<b>(27,350)</b>	<b>(32,820)</b>
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
<b>Financing CF</b>	<b>22,626</b>	<b>(655)</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Change in cash</b>	<b>16,554</b>	<b>5,805</b>	<b>5,256</b>	<b>13,013</b>	<b>15,776</b>
Cash (beg of yr)	11,084	27,638	33,443	38,699	51,711
FX	0	0	0	0	0
<b>Cash (end of yr)</b>	<b>27,638</b>	<b>33,443</b>	<b>38,699</b>	<b>51,711</b>	<b>67,488</b>
Pledge cash	2,189	996	996	996	996
Cash at balance sheet	29,827	34,439	39,695	52,707	68,484

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>142,472</b>	<b>135,754</b>	<b>143,456</b>	<b>151,548</b>	<b>160,617</b>
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
<b>Current assets</b>	<b>155,094</b>	<b>165,562</b>	<b>170,042</b>	<b>183,994</b>	<b>200,473</b>
Cash	29,827	34,439	39,695	52,707	68,484
Account receivable	6,015	7,416	6,641	7,579	8,283
Associates	785	1,594	1,594	1,594	1,594
Others	119,252	123,707	123,707	123,707	123,706
<b>Current liabilities</b>	<b>56,853</b>	<b>57,380</b>	<b>55,114</b>	<b>58,682</b>	<b>60,084</b>
Borrowings	3,130	3,355	3,355	3,355	3,355
Payables	42,719	43,763	41,497	45,065	46,467
Associates	1,727	2,231	2,231	2,231	2,231
Others	9,277	8,031	8,031	8,031	8,030
<b>Non-current liabilities</b>	<b>65,677</b>	<b>72,230</b>	<b>72,230</b>	<b>72,230</b>	<b>72,230</b>
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	3,484	528	-1,163
S/H equity	162,897	163,599	182,670	204,102	229,939
<b>Total Equity</b>	<b>175,036</b>	<b>171,706</b>	<b>186,154</b>	<b>204,630</b>	<b>228,776</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Online marketing	80.1	72.7	73.8	70.4	69.0
Other services	19.9	27.3	26.2	29.6	31.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>P&amp;L ratios (%)</b>					
Gross margin	49.4	41.5	44.9	46.1	48.6
Pre-tax margin	26.7	-0.3	16.6	18.6	22.2
Net margin	22.1	-2.1	13.6	15.2	18.2
Tax rate	17.4	-573.5	18.0	18.0	18.0
<b>Balance sheet ratios</b>					
Current ratio (x)	2.7	2.9	3.1	3.1	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
<b>Returns (%)</b>					
ROE	17.4	13.1	10.7	11.2	12.2
ROA	7.8	5.7	4.7	5.9	7.3
<b>Per share</b>					
EPADS (RMB)	66	62	56	66	81
DPS (RMB)	0	0	0	0	0
BVPADS (RMB)	498	496	538	591	661

Source: Company data, CMBIS estimates

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