

# Baidu (BIDU US)

## 3Q19 strong beat on cost efficiency

Baidu delivered eye-catching 3Q19 results, with margin surprise from disciplined cost control. We expect its cost efficiency to continue in FY20E, and ads sentiment stabilized. We raised our earnings forecast by 40%/ 6% in FY19/20E, and lifted TP to US\$156.5. Maintain BUY.

- 3Q19 strong beat.** 3Q19 revenue reached RMB28.1bn (-0.4% YoY, +7% QoQ), 2% above consensus. Non-GAAP net profit declined 35% YoY to RMB4.4bn, 56% above consensus, mainly on lighter TAC, and disciplined S&M expenses. 4Q19 guidance came in with revenue growth of -1% to +6% YoY, with midpoint in line with consensus. Excluding iQiyi's 4Q19 guidance, Baidu Core's guidance was higher than expectation. We view Baidu's results as impressive, given its solid topline with margin surprise, despite ongoing macro uncertainty and rising ads inventory.
- Baidu Core: healthy traffic metrics with enhanced ecosystem.** 3Q19 Baidu core search revenue grew 8% QoQ (-9% YoY), with solid traffic metrics (Baidu App DAU +25% YoY) and user engagement. Mgmt stated that online marketing overall stabilized, in which ads performed well in education, retail and ecommerce sectors. We turned more positive on Baidu's topline outlook, mainly on: 1) Healthcare transition execution well, 2) evolving ecosystem strengthened with mini program, videos and managed page strategies; and 3) ads sentiment stabilization with healthy traffic metrics. 1Q20E might see weak seasonality, but 4Q19E and FY20E outlook seems better than market expectation. We expect its Baidu Core to deliver 9% YoY rev growth in FY20E, backed with on ROI-driven strategy and incremental monetization potential from enriched features.
- Better margin outlook with continuous cost efficiency.** 3Q19 Non-GAAP operating margin came out at 13%, largely higher than our estimate. Looking ahead, mgmt. guide cost control (from S&M and TAC sides) to continue in 2H19E and FY20E. Given its solid 3Q19 results and upbeat net profit, we raise our earnings forecast by 40%/ 6% in FY19/20E.
- Maintain BUY.** We lift our SOTP-based TP from US\$147.6 to US\$156.5. The stock is trading at 21x/18x FY19/20E P/E, valuation is attractive. We think Baidu's tough time was over, and expecting more upside potential from medical transition and mobile ecosystem monetization. Maintain BUY.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	80,060	102,277	106,243	118,253	132,163
YoY growth (%)	20.2	27.7	3.9	11.3	11.8
Adj. net income (RMB mn)	22,270	23,323	14,038	16,621	21,156
Adj. EPS (RMB)	63.7	66.3	39.9	47.3	60.2
YoY growth (%)	67.5	4.1	-39.8	18.4	27.3
P/E (x)	13.2	12.7	21.0	17.8	14.0
P/B (x)	2.5	1.7	1.6	1.5	1.3
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	15.9	16.9	7.7	8.4	9.6
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, CMBIS estimates

### BUY (Maintain)

Target Price	US\$156.5
(Previous TP)	US\$147.6)
Current Price	US\$121.9
Up/Downside	+28.4%

### China Internet Sector

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### Stock Data

Mkt Cap (US\$ mn)	42,097
Avg 3 mths t/o (US\$ mn)	405.2
52w High/Low (US\$)	196/93
Total Issued Shares (mn)	277
Source: Bloomberg	

### Shareholding Structure

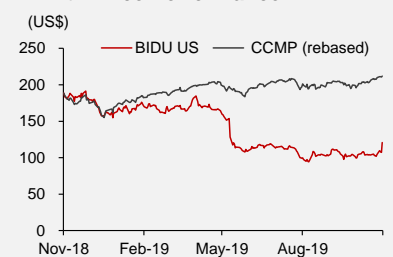
BlackRock	5.2%
Vanguard Group	3.6%
Baillie Gifford	3.5%
Source: HKEx	

### Share Performance

	Absolute	Relative
1-mth	19.0%	11.9%
6-mth	21.8%	13.1%
12-mth	-25.5%	-29.9%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: Ernst & Young

### Related Reports

- Margin surprise on disciplined cost control – 21 Aug 2019
- 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	106,243	118,253	132,163	106,777	117,635	131,490	-0.5%	0.5%	0.5%
Gross Profit	42,669	49,998	58,679	43,196	49,655	57,600	-1.2%	0.7%	1.9%
Operating Profit	8,140	12,393	17,708	4,981	11,110	17,208	63.4%	11.5%	2.9%
Net profit	14,038	16,621	21,156	10,052	15,692	21,093	39.7%	5.9%	0.3%
EPS (RMB)	39.91	47.26	60.15	29.00	45.00	60.00	37.6%	5.0%	0.3%
Gross Margin	40.2%	42.3%	44.4%	40.5%	42.2%	43.8%	-0.3ppts	+0.1ppts	+0.6ppts
Operating Margin	7.7%	10.5%	13.4%	4.7%	9.4%	13.1%	+3.0ppts	+1.0ppts	+0.3ppts
Net Margin	13.2%	14.1%	16.0%	9.4%	13.3%	16.0%	+3.8ppts	+0.7ppts	+0.0ppts

Source: 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	106,243	118,253	132,163	106,362	119,352	134,293	-0.1%	-0.9%	-1.6%
Gross Profit	42,669	49,998	58,679	41,259	48,999	57,771	3.4%	2.0%	1.6%
Operating Profit	8,140	12,393	17,708	3,774	10,078	16,076	115.7%	23.0%	10.2%
Net profit	14,038	16,621	21,156	10,241	15,221	20,548	37.1%	9.2%	3.0%
EPS (RMB)	39.91	47.26	60.15	28.96	44.94	60.19	37.8%	5.1%	-0.1%
Gross Margin	40.2%	42.3%	44.4%	38.8%	41.1%	43.0%	+1.4ppt	+1.2ppts	+1.4ppts
Operating Margin	7.7%	10.5%	13.4%	3.5%	8.4%	12.0%	+4.1ppts	+2.0ppts	+1.4ppts
Net Margin	13.2%	14.1%	16.0%	9.6%	12.8%	15.3%	+3.6ppts	+1.3ppts	+0.7ppts

Source: Company data, Bloomberg, CMBIS estimates

**Figure 3: SOTP valuation**

US\$bn	Valuation		Methodology	Multiple Applied/Implied		Metrics		Shareholding %
	US\$bn	Per share(US\$)		FY19	FY20	FY19	FY19	
Baidu Core	29.3	83.2	EV/EBIT	10.0	9.1	2.9	3.2	100%
iQiyi	8.3	23.5	Mkt cap					57%
Ctrip	2.5	7.0	Mkt cap					12%
Net (Debt)/Cash	15.0	42.7	Cash forecasted on Balance sheet					
<b>Equity Value</b>	<b>55</b>	<b>156.5</b>						

Source: CMBIS estimates

**Figure 4: 3Q19 review**

Rmb mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	QoQ	YoY	Consensus	Diff %
Net revenue	20,907	25,972	28,203	27,195	24,123	26,326	28,080	6.7%	-0.4%	27,535	2%
Revenue	20,907	25,972	22,481	27,195	24,123	26,326	28,080	6.7%	24.9%	27,535	2%
Operating profit	4,568	5,422	4,428	1,112	(936)	233	2355	910.7%	-46.8%	1,376	71%
Net profit	6,694	6,402	12,396	2,081	(327)	2,412	(6,373)	-364.2%	-151.4%	1414	-551%
Adj. net profit	4,585	7,433	6,751	4,703	967	3,635	4,387	20.7%	-35.0%	2,808	56%
Adj. EPS (Rmb)	16.30	21.06	19.01	13.42	2.77	10.11	12.61	24.7%	-33.7%	7.77	62%
<b>Margin (%)</b>											
Gross margin	52.6%	53.8%	49.6%	42.6%	38.5%	38.8%	41.7%			37.3%	
Operating margin	21.8%	20.9%	19.7%	4.1%	-3.9%	0.9%	8.4%			5.0%	
Adj. net margin	16.4%	28.6%	30.0%	17.3%	4.0%	13.8%	15.6%			10.2%	
<b>Growth (%)</b>											
Revenue (YoY)	23.8%	24.4%	-4.3%	15.4%	15.4%	1.4%	24.9%			-2.4%	
Revenue (QoQ)	-11.2%	24.2%	-13.4%	21.0%	-11.3%	9.1%	6.7%			4.6%	
Operating profit	127.8%	28.8%	-5.8%	-76.7%	-120.5%	-95.7%	-46.8%			-68.9%	
Adj. net profit	91.4%	33.4%	-25.6%	-15.5%	-78.9%	-51.1%	-35.0%			-58.4%	

Source: Company data, Bloomberg

**Figure 5: 3Q19 revenue breakdown**

Rmb mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	QoQ	YoY
<b>Total revenue</b>	<b>20,907</b>	<b>25,972</b>	<b>28,203</b>	<b>27,195</b>	<b>24,123</b>	<b>26,326</b>	<b>28,080</b>	<b>7%</b>	<b>0%</b>
Online marketing services	17,169	21,065	22,481	21,197	17,657	19,327	20,434	6%	-9%
Other services	3,738	4,907	5,722	5,998	6,466	7,089	7,646	8%	34%

Source: Company data

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Net Revenue</b>	<b>80,060</b>	<b>102,277</b>	<b>106,243</b>	<b>118,253</b>	<b>132,163</b>
Online marketing	69,051	81,913	77,382	84,600	89,676
Other services	11,010	20,365	28,861	33,653	42,487
COSG	(38,313)	(51,744)	(63,574)	(68,255)	(73,484)
<b>Gross profit</b>	<b>41,748</b>	<b>50,533</b>	<b>42,669</b>	<b>49,998</b>	<b>58,679</b>
R&D	(12,928)	(15,772)	(15,936)	(17,147)	(18,503)
S&GA	(13,128)	(19,231)	(18,593)	(20,458)	(22,468)
<b>Operating profit</b>	<b>15,692</b>	<b>15,530</b>	<b>8,140</b>	<b>12,393</b>	<b>17,708</b>
Interest income	3,154	4,451	4,250	3,548	3,965
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
<b>Pre-tax profit</b>	<b>21,284</b>	<b>27,325</b>	<b>14,386</b>	<b>17,937</b>	<b>23,670</b>
Tax	(2,995)	(4,743)	(2,590)	(3,229)	(4,261)
MI	13	4,991	1,887	1,471	1,165
<b>Net profit</b>	<b>18,302</b>	<b>27,573</b>	<b>13,684</b>	<b>16,180</b>	<b>20,574</b>
Adjustment	3,969	742	354	441	582
<b>Non GAAP Net profit</b>	<b>22,270</b>	<b>23,323</b>	<b>14,038</b>	<b>16,621</b>	<b>21,156</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>100,559</b>	<b>142,472</b>	<b>149,004</b>	<b>156,224</b>	<b>164,563</b>
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
<b>Current assets</b>	<b>151,169</b>	<b>155,094</b>	<b>168,448</b>	<b>179,138</b>	<b>193,783</b>
Cash	11,336	29,827	43,698	53,766	67,691
Account receivable	4,571	6,015	5,498	6,120	6,840
Associates	168	785	785	785	785
Others	135,262	119,252	119,252	119,252	119,252
<b>Current liabilities</b>	<b>82,057</b>	<b>56,853</b>	<b>64,942</b>	<b>68,143</b>	<b>71,718</b>
Borrowings	1,254	3,130	3,130	3,130	3,130
Payables	72,794	42,719	50,808	54,009	57,584
Associates	153	1,727	1,727	1,727	1,727
Others	7,856	9,277	9,277	9,277	9,277
<b>Non-current liabilities</b>	<b>50,321</b>	<b>65,677</b>	<b>65,677</b>	<b>65,677</b>	<b>65,677</b>
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	10,252	8,781	7,616
S/H equity	115,346	162,897	176,581	192,761	213,335
<b>Total Equity</b>	<b>119,350</b>	<b>175,036</b>	<b>186,833</b>	<b>201,541</b>	<b>220,951</b>

Source: Company data, CMBIS estimates

### Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Net income</b>	18,289	22,582	11,797	14,709	19,409
D&A	9,545	9,102	15,175	18,828	22,918
Change in WC	12,194	(5,007)	8,606	2,579	2,855
Others	3,244	4,676	0	0	0
<b>Operating CF</b>	<b>43,271</b>	<b>31,353</b>	<b>35,578</b>	<b>36,115</b>	<b>45,183</b>
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
<b>Investing CF</b>	<b>(48,445)</b>	<b>(37,425)</b>	<b>(21,707)</b>	<b>(26,048)</b>	<b>(31,257)</b>
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
<b>Financing CF</b>	<b>5,360</b>	<b>22,626</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Change in cash</b>	<b>186</b>	<b>16,554</b>	<b>13,871</b>	<b>10,068</b>	<b>13,926</b>
Cash (beg of yr)	10,898	11,084	27,638	41,509	51,577
FX	0	0	0	0	0
<b>Cash (end of yr)</b>	<b>11,084</b>	<b>27,638</b>	<b>41,509</b>	<b>51,577</b>	<b>65,502</b>
Pledge cash	252	2,189	2,189	2,189	2,189
Cash at balance sheet	11,336	29,827	43,698	53,766	67,691

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Online marketing	86.2	80.1	72.8	71.5	67.9
Other services	13.8	19.9	27.2	28.5	32.1
<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	52.1	49.4	40.2	42.3	44.4
Pre-tax margin	26.6	26.7	13.5	15.2	17.9
Net margin	22.8	22.1	11.1	12.4	14.7
Tax rate	14.1	17.4	18.0	18.0	18.0
<b>Balance sheet ratios</b>					
Current ratio (x)	1.8	2.7	2.6	2.6	2.7
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
<b>Returns (%)</b>					
ROE	19.3	17.4	7.9	8.6	9.9
ROA	8.8	7.8	3.8	4.5	5.6
<b>Per share</b>					
EPS (RMB)	64	66	40	47	60
DPS (RMB)	0	0	0	0	0
BVPS (RMB)	3,415	4,977	5,312	5,730	6,282

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