

COMPANY UPDATE

Baidu Inc (9888 HK)

4Q23 Results Preview: AIGC Monetisation To Foster Ads And AI Cloud

4Q23 results will be released in mid-Mar 24. We forecast 4Q23 revenue to grow 7% yoy, mainly anchored by incremental contributions from ad and AI Cloud revenue growth, empowered by AI application. Management expects AI-related ad revenue in 4Q23 to hit hundreds of millions in renminbi, with a low to mid single-digit revenue contribution to AI Cloud. Baidu also expects quarterly revenue from generative AI to surpass Rmb1b in 2024. Maintain BUY with a lower target price of HK\$135.00 (US\$138.00).

WHAT'S NEW

- Reshaping ad features through AIGC.** We forecast 4Q23 core ad revenue to grow at 6.8% yoy vs 5.2% in 3Q23, on soft retail segment growth supported by the monetisation from generative AI-powered ads. According to management, AI-related ad revenue in 4Q23 is expected to reach the scale of hundreds of millions in Rmb (1-2% of Baidu Core ads) by providing selective clients with more comprehensive AI-powered services such as product image generation. For Baidu App, the recent AIGC breakthrough creates a new entry point in facilitating video content generation and supplements growth for feed revenue. In addition, Baidu has developed an advertiser-facing marketing platform that helps to enhance advertiser ROI. The AI-driven ad tool targets to improve the billing system and increase in-app conversion/ROI. In addition, Baidu expects the quarterly revenue contribution from generative AI to surpass Rmb1b in 2024.
- Moderating growth of AI Cloud.** We estimate AI Cloud revenue to grow 10% yoy in 4Q23 (3Q23: 5%), propelled by the growing momentum generated by AI-related dependency coupled with a lower base effect, partially pressured by a tightened government budget. We believe AI Cloud will reaccelerate in 4Q23 given a differentiated cloud offering mix. This bodes well with Baidu's target to achieve double-digit growth in AI Cloud revenue for 2023 and to outperform peers' growth. Baidu expects AI Cloud to achieve double-digit yoy growth and margin improvement in 2024 by leveraging on Ernie Bot through monetisation from the newly released paid version of Ernie Bot in Oct 23, with a subscription fee of Rmb49.90 per month for auto-renewal subscriptions. However, we forecast AI Cloud revenue growth to moderate to 11% yoy for 2024 due the uncertainty in government budgeting.
- Margin outlook.** We expect operating margin to decline 4ppt yoy to 20.6% in 4Q23 given heavy investments for pre-training and continuous advancement of Ernie Bot. Baidu's core operating margin is estimated to drop 1.6ppt qoq to 23.5% in 4Q23. However, leveraging on its early mover advantage through ad monetisation, we believe Baidu will continue to exhibit strong profitability and sustain high-quality growth.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net turnover	124,493	123,221	135,027	146,033	155,378
EBITDA	16,402	21,934	28,850	26,531	28,512
Operating profit	10,518	15,457	21,745	19,638	21,725
Net profit (rep./act.)	7,591	7,534	23,466	19,743	22,096
Net profit (adj.)	18,830	20,680	27,445	28,044	30,960
EPS (Fen)	676.7	728.0	938.1	930.6	1,007.2
PE (x)	14.0	13.0	10.1	10.2	9.4
P/B (x)	1.2	1.2	1.1	1.0	0.9
EV/EBITDA (x)	8.5	6.4	4.8	5.3	4.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net margin (%)	6.1	6.1	17.4	13.5	14.2
Net debt/(cash) to equity (%)	(20.6)	(26.5)	(43.6)	(47.1)	(49.9)
ROE (%)	3.9	3.5	9.8	7.3	7.3
Consensus net profit	-	-	26,769	27,148	30,572
UOBKH/Consensus (x)	-	-	1.03	1.03	1.01

Source: Baidu Inc, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$103.40
Target Price	HK\$135.00
Upside	+30.6%
(Previous TP)	HK\$166.00)

COMPANY DESCRIPTION

Baidu Inc is a leading internet company that offers algorithmic search, enterprise search, news, voice assistance, online storage and navigation services.

STOCK DATA

GICS sector	Communication Services
Bloomberg ticker:	9888 HK
Shares issued (m):	2,255.4
Market cap (HK\$m):	289,186.8
Market cap (US\$m):	36,999.3
3-mth avg daily t'over (US\$m):	113.4

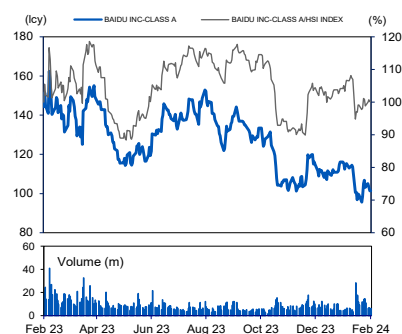
Price Performance (%)

52-week high/low	HK\$162.50/HK\$95.60			
1mth	3mth	6mth	1yr	YTD
(10.9)	(3.5)	(30.5)	(24.0)	(10.9)

Major Shareholders

	%
BlackRock Inc	6.7
BBH & CO	4.9
Vanguard Group Inc	4.0
FY24 NAV/Share (Rmb)	96.42
FY24 Net Cash/Share (Rmb)	45.41

PRICE CHART



Source: Bloomberg

ANALYST(S)

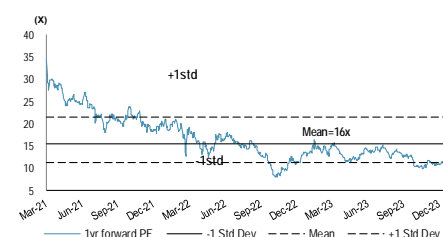
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STOCK IMPACT

- Uncertainties in autonomous driving unit.** The ongoing uncertainties in management changes and intense competition in the autonomous driving (AD) unit may lead to slower monetisation progress. We opine Baidu will continue to pivot its investment focus to Ernie Bot throughout 2024 which may lead to the streamlining of its AD business.
- Baidu denies report of Chinese military ties.** On 15 Jan 24, Baidu clarified that it does not have any partnership with any of China's military organisations after a report linked the Baidu's Ernie Bot technology to the People's Liberation Army (PLA) which oversees cyberwarfare. To mitigate the potential risk in tightening of AI chip export restrictions, there is a prevailing trend of domestic chip substitution. In Nov 23, Baidu ordered 1,600 of Huawei Technologies' 910B Ascend AI chips – which the Chinese firm developed as an alternative to Nvidia's A100 chip – for 200 servers.
- Baidu registers copyright for Baidu's e-commerce brand Youxuan.** On 30 Jan 24, Baidu's software Baidu Youxuan APP (iOS version) was granted copyright registration, and the current version number is v1.0. Baidu Youxuan represents a new generation of intelligent e-commerce platforms driven by AI technology.
- Integration of Ernie bot into Samsung Galaxy S24 handsets.** Samsung Electronics strategically partnered with Baidu to integrate Ernie Bot into Samsung's latest flagship 5G device. It provides on-device empowered functions such as calls and translation and brings users a new AI experience with intelligent summarisation, layout generation, organisation, translation and so on. The Galaxy S24 series will deploy the Ernie LLM to perform the handset's new "Circle to Search" feature that enables users in China to search texts, images or videos via hand gestures.

12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

EARNINGS REVISION/RISK

- We lower our revenue estimates by 2.5%/2% for 4Q23/2024** given soft momentum in ad and AI Cloud revenue growth. We lower our 4Q23/2024 net profit by 2%/2% to Rmb6.5b/Rmb28b, translating to net margin of 18%/19%, in view of heavy investment in development of Ernie Bot.
- Risks:** a) Weaker advertising business due to the slower-than-expected macro economy recovery and fierce competition, b) uncertainties facing the advertising segment and Robotaxi launch, c) shrinking government budget, and d) the US' ban on the supply of high-end chips to Chinese tech giants.

VALUATION/RECOMMENDATION

- Maintain BUY with target price of HK\$135.00 (US\$138.00).** We remain cautiously optimistic on Baidu's growth trajectory in 2024 given soft macro backdrop coupled with solid monetisation from AI application to foster incremental revenue growth for ads and AI Cloud. We forecast 8% yoy growth in revenue and 2% yoy growth in net profit for 2024. The stock is trading at 9.3x 12-month forward PE, below its historical mean of 16.4x. Baidu's net cash per share is standing at HK\$70, or 3.7x PE ex-cash on its Baidu Core business. Our target price implies 12.4x 2024F PE against 22% EPS CAGR over the next three years.

SHARE PRICE CATALYST

- a) Market share expansion in the AI Cloud, b) higher monetisation rates across all business units, and c) synergies between Baidu's core business and new initiatives.**

SOTP VALUATION

Segment (US\$m)	Rev 24E	NOPAT 24E	P/E (x) 2024E	EV/S (x) 2024E	Valuation (Rmb mn)	Valuation (US\$ mn)	Baidu's stake	To Baidu	\$/share
Core, Advertising	11,178	25,465	6	2	152,793	21,520	100%	21,520	60
Cloud (ex ADE)	1,880			3	40,040	5,639	100%	5,639	16
iQiyi, long form video	4,978			1	21,419	3,017	56%	1,695	5
Autos	2,130			4	61,210	8,621	76%	6,553	18
- Apollo (ADE, Robotaxi)	1,248				28,575	4,025	100%	4,025	11
- Intelligent EV	882				32,636	4,597	55%	2,528	7
Xiaodu	781			3	15,620	2,200	60%	1,320	4
Subtotal								36,728	103
Investments									
Total investments								4,562	13
Core op. + investments								40,834	115
Net cash								24,913	70
NAV	22,213	2,912	23.0x	2.5x				65,747	185
less holdco discount							25%	(16,437)	(46)
Total, in US\$m	22,213		17.0x	1.9x				49,310	138
Total, in HK\$m								385,604	135

Source: Baidu, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Net turnover	123,221	135,027	146,033	155,378
EBITDA	21,934	28,850	26,531	28,512
Deprec. & amort.	6,477	7,105	6,893	6,787
EBIT	15,457	21,745	19,638	21,725
Total other non-operating income	(6,527)	3,161	(427)	(603)
Associate contributions	(2,150)	(1,286)	(593)	(269)
Net interest income/(expense)	3,332	4,806	7,551	8,310
Pre-tax profit	10,112	28,426	26,169	29,162
Tax	(2,578)	(4,960)	(6,426)	(7,067)
Minorities	(25)	1,239	970	970
Net profit	7,534	23,466	19,743	22,096
Net profit (adj.)	20,680	27,445	28,044	30,960

CASH FLOW

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Operating	22,213	45,479	39,704	43,294
Pre-tax profit	10,112	28,426	26,169	29,162
Tax	(2,578)	(4,960)	(6,426)	(7,067)
Deprec. & amort.	6,477	7,105	6,893	6,787
Working capital changes	(10,893)	(9,284)	(12,788)	(14,802)
Other operating cashflows	19,095	24,193	25,856	29,213
Investing	6,087	(16,078)	(16,843)	(18,857)
Capex (growth)	(9,915)	(11,403)	(13,113)	(15,080)
Others	16,002	(4,675)	(3,730)	(3,777)
Financing	10,906	(1,992)	335	335
Dividend payments	335	335	335	335
Issue of shares	0	335	335	335
Loan repayment	0	0	0	0
Others/interest paid	10,571	(2,662)	(335)	(335)
Net cash inflow (outflow)	39,206	27,409	23,196	24,772
Beginning cash & cash equivalent	47,671	86,877	114,286	137,482
Changes due to forex impact	0	0	0	0
Ending cash & cash equivalent	64,486	114,286	137,482	162,254

BALANCE SHEET

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Fixed assets	23,973	23,373	23,275	22,928
Other LT assets	154,150	156,691	161,360	166,081
LT debt	n.a.	n.a.	n.a.	n.a.
Cash/ST investment	64,486	114,286	137,482	162,254
Other current assets	148,364	150,804	153,096	155,123
Total assets	390,973	445,154	475,214	506,386
ST debt	5,343	3,016	3,016	3,016
Other current liabilities	74,287	70,107	69,656	67,329
Other LT liabilities	73,538	73,538	73,538	73,538
Shareholders' equity	223,478	255,001	285,511	319,011
Minority interest	8,393	8,393	8,393	8,393
Total liabilities & equity	390,973	445,154	475,214	506,386

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	17.8	21.4	18.2	18.4
Pre-tax margin	8.2	21.1	17.9	18.8
Net margin	6.1	17.4	13.5	14.2
ROA	2.0	5.6	4.3	4.5
ROE	3.5	9.8	7.3	7.3
Growth				
Turnover	(1.0)	9.6	8.2	6.4
EBITDA	33.7	31.5	(8.0)	7.5
Pre-tax profit	(6.2)	181.1	(7.9)	11.4
Net profit	(0.8)	211.5	(15.9)	11.9
Net profit (adj.)	9.8	32.7	2.2	10.4
EPS	7.6	28.8	(0.8)	8.2
Leverage				
Debt to total capital	2.3	1.1	1.0	0.9
Debt to equity	2.4	1.2	1.1	0.9
Net debt/(cash) to equity	(26.5)	(43.6)	(47.1)	(49.9)

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