

COMPANY RESULTS

Baidu Inc (9888 HK)

3Q23: Earnings Beat; Expecting Monetisation Of ERNIE 4.0

Baidu's 3Q23 earnings beat expectations. Revenue grew 6% yoy to Rmb34b, in line with the street's estimate. Gross margin expanded 2.7ppt yoy to 52.7%, above consensus expectation. Non-GAAP operating profit was Rmb7.6b, up 9% yoy, while non-GAAP operating profit margin came in at 22%, beating our estimate. Despite investments in AI, non-GAAP net profit improved 23% yoy to Rmb7.3b, exceeding consensus estimate by 16%. Maintain BUY with a lower target price of HK\$166.00 (US\$171.00).

3Q23 RESULTS

Year to 31 Dec (Rmbm)	3Q22	2Q23	3Q23	QoQ	YoY	UOBKH	Var	Cons	Var
Total Net revenue	32,540	34,056	34,447	1%	6%	36,176	-4.8%	34,207	0.7%
Online marketing services	19,943	21,081	21,346	1%	7%	22,187	-3.8%		
Others	12,597	12,975	13,101	1%	4%	13,989	-6.3%		
COGS	16,273	16,167	16,294	1%	0%	17,555	-7.2%		
Gross profits	16,267	17,889	18,153	1%	12%	18,621	-2.5%	17,420	4.2%
GPM	50.0%	52.5%	52.7%	0.2 ppts	2.7 ppts	51.5%	1.2 ppts	50.9%	1.8 ppts
Operating expenses	11,034	12,873	12,018	-7%	9%	13,528	-11.2%		
Non-GAAP operating income	6,986	7,334	7,596	4%	9%	7,189	5.7%		
Non-GAAP OPM	21%	22%	22%	0.5 ppts	0.6 ppts	19.87%	2.2 ppts		
Non-GAAP net income	5,889	7,998	7,267	-9%	23%	6,432	13.0%	6,277	15.8%
Non-GAAP EPS (RMB)	2.11	2.75	2.55	-7%	21%	2.21	15.3%	2.20	16.0%
Non-GAAP Net Margin	18.1%	23.5%	21.1%	-2.4 ppts	3.0 ppts	17.8%	3.3 ppts	18.4%	2.7 ppts

Source: Baidu Corp Ltd, UOB Kay Hian

RESULTS

- **Subdued revenue growth momentum in 3Q23.** Baidu Inc's (Baidu) core search revenue climbed 5% yoy to Rmb26.6b in 3Q23 (2Q23: +14 yoy), driven by normalising offline activities. Online marketing revenue growth moderated to 7% yoy vs 15% in 2Q23, primarily due to weaker demand for non-e-commerce ads coupled with a soft macro backdrop. In Sep 23, Baidu App's monthly active users (MAU) reached 663m, up 5% yoy. Managed Page accounted for 53% of Baidu Core's online marketing revenue in 3Q23. iQiyi delivered a softer revenue growth of 7% yoy to Rmb8b (2Q23: +17.2%), with advertising revenue growth of 34% yoy. iQiyi daily subscribers decreased 3.7m qoq to 107.5m, given natural seasonality and weaker content released.
- **Margin overview.** Gross margin edged up 2.7ppt yoy to 52.5%. 3Q23 non-GAAP operating income came in at Rmb7.6b, with non-GAAP operating margin expanding 1ppt yoy to 22%, driven by a sequential decline in headcount and promotional marketing expenses. Baidu Core also delivered 25% core operating profit margin in 3Q23, improving from 3Q22's 25.5%. iQiyi also delivered strong earnings beat with operating margin of 11% in 3Q23, driven by healthy advertising recovery. Non-GAAP net profit was Rmb7.3b, coming in 16% above the street's estimates and translating to non-GAAP net profit margin of 21%. iQiyi's diluted non-GAAP earnings per ADS in 3Q23 was Rmb0.64 (3Q22: Rmb0.21; 2Q23: Rmb0.61). Baidu returned US\$126mn to shareholders in 3Q23, and cumulative repurchase reached US\$351m under its share repurchase programme.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net turnover	124,493	123,221	135,606	147,577	158,515
EBITDA	16,402	21,934	28,938	26,672	28,922
Operating profit	10,518	15,457	21,833	19,778	22,135
Net profit (rep./act.)	7,591	7,534	23,536	19,839	22,393
Net profit (adj.)	18,830	20,680	27,545	28,246	31,472
EPS (Fen)	676.7	728.0	941.5	937.3	1,023.9
PE (x)	14.5	13.5	10.4	10.5	9.6
P/B (x)	1.3	1.2	1.1	1.0	0.9
EV/EBITDA (x)	10.5	7.8	5.9	6.4	5.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net margin (%)	6.1	6.1	17.4	13.4	14.1
Net debt/(cash) to equity (%)	(20.6)	(26.5)	(43.7)	(47.3)	(50.2)
ROE (%)	3.9	3.5	9.8	7.3	7.4
Consensus net profit	-	-	26,227	26,464	29,839
UOBKH/Consensus (x)	-	-	1.05	1.07	1.05

Source: Baidu Inc, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$107.40
Target Price	HK\$166.00
Upside	+54.6%
(Previous TP)	HK\$183.00)

COMPANY DESCRIPTION

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

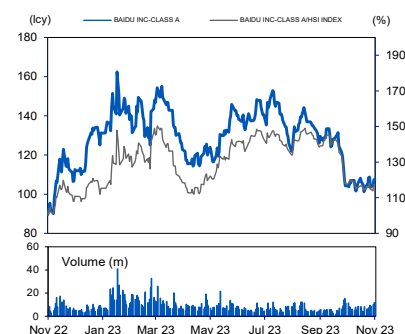
STOCK DATA

GICS sector	Communication Services
Bloomberg ticker:	9888 HK
Shares issued (m):	2,255.4
Market cap (US\$m):	300,373.9
Market cap (US\$m):	38,529.7
3-mth avg daily t'over (US\$m):	96.7

Price Performance (%)

52-week high/low	HK\$162.50/HK\$89.90			
1mth	3mth	6mth	1yr	YTD
3.0	(11.9)	(10.5)	17.1	(3.8)
Major Shareholders				
				%
BlackRock Inc				6.7
BBH & CO				4.9
Vanguard Group Inc				4.0
FY23 NAV/Share (Rmb)				88.74
FY23 Net Cash/Share (Rmb)				38.79

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **Better visibility for AI cloud recovery in 4Q23.** Other revenue delivered 4% yoy growth, moderating from 14.7% yoy in 2Q23, and mainly dampened by lacklustre demand in intelligent transportation projects. AI Cloud revenue grew 15% yoy to Rmb5.2b, partially impacted by the delay in fee collection and cloud project completion. Baidu expects a positive rebound in AI cloud revenue during 4Q23, propelled by the growing momentum generated by AI-related dependency coupled with a lower base.
- **Emerging revenue stream for AI cloud and online ad.** Baidu updated its Ernie LLM 4.0 and opened API access to enterprise clients. The paid version of Ernie Bot was released in Oct 23, with a subscription fee of Rmb49.90 per month for auto-renewal subscriptions. The subscription allows users to make 100 enquiries every three hours via Ernie Bot 4. In addition, Baidu has developed an advertiser-facing marketing platform that helps to enhance advertiser ROI. The AI-driven ads tool targets to improve the billing system and increase in-app conversion/ROI. Advertisers utilising these capabilities likely achieved a high single-digit increase in income conversion in 3Q23.
- **Addressing concerns on US chip restrictions.** Baidu highlighted that the recent US export chip ban will not significantly impact Baidu in the near term. Baidu possesses a substantial reserve of AI chips for continuous enhancements of Ernie Bot over the next year or two.
- **Apollo Go provided 821,000 rides in 3Q23,** surging by 73% yoy. As of end-Sep 23, cumulative rides provided to the public by Apollo Go reached 4.1m. In 3Q23, the proportion of fully driverless orders of Baidu's total products exceeded 40%, vs 35% in 2Q23.

EARNINGS REVISION/RISK

- We lower 4Q23/2023 revenue estimates by 2%/2% in view of softer-than-expected ad and cloud revenue growth. We raise non-GAAP net profit forecast by 6% for 2023 after seeing the higher-than-expected margin improvement in 3Q23. We expect Baidu to deliver adjusted net profit of Rmb27.5b/Rmb28.3b in 2023/2024, which should translate into net margin of 20%/19%.
- Risk: a) Weaker advertising business due to the macro slowdown and fierce competition in China's advertising industry, b) uncertainties over the autonomous driving segment and robotaxi launch, and c) the US' ban on the supply of high-end chips to Chinese tech giants.

VALUATION/RECOMMENDATION

- **Maintain BUY with a lower target price of HK\$166.00 (US\$171.00).** We lower our core PE to 8x from 10x for 2024 given the tempered growth rate. We remain cautiously optimistic on Baidu given its softer ad growth, despite it being bolstered by its early-mover advantage in scalable AIGC monetisation. Our target price implies 3x 2023F P/S and 14.6x 2023F PE. The company is currently trading at 10.4x 12-month forward PE, below its historical mean of 17x.

SHARE PRICE CATALYST

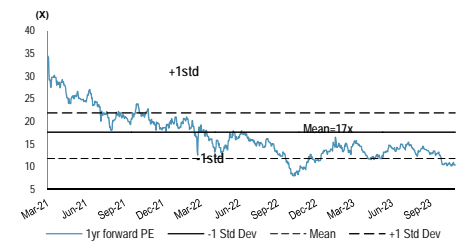
- a) Market share expansion in the AI cloud segment and autonomous driving segment, b) higher monetisation rates across all business units, and c) increase in synergies between Baidu's core business and new initiatives.

SOTP VALUATION

Segment (US\$m)	Rev 24E	NOPAT 24E	NOPAT 24E	P/E (x) 2024E	EV/S (x) 2024E	Valuation (Rmb mn)	Valuation (US\$ mn)	Baidu's stake	To Baidu	\$/share	% of
Core, Advertising	80,553	24,234	3,854	8	0	209,653	30,831	100%	30,831	87.0	51%
Cloud (ex ADE)	1,789				5	60,822	8,944	100%	8,944	25.2	15%
iQiyi, long form video	5,210	136	294		1	21,419	3,150	56%	1,770	5.0	3%
Autos	1,600				4	93,946	13,816	82%	11,277	31.8	19%
- Apollo (ADE, Robotaxi)	1,267				5	55,587	8,175	100%	8,175	23.1	13%
- Intelligent EV	334				4	38,359	5,641	55%	3,103	8.8	5%
Xiaodu	680				2	13,600	2,000	60%	1,200	3.4	2%
Subtotal									54,023	152	89%
Total investments									4,595	13.0	8%
Core op. + investments									57,699	162.7	95%
Net cash									23,171	65.3	38%
NAV	22,213	2,912	3,622	23.0x	3.1x				80,869	228.1	133%
less holdco discount								25%	(20,217)	(57.0)	-33%
Total, in US\$m	22,213			17.0x	2.3x				60,652	171	
Total, in HK\$m									470,053	166	

Source: Baidu, UOB Kay Hian

12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Net turnover	123,221	135,606	147,577	158,515
EBITDA	21,934	28,938	26,672	28,922
Deprec. & amort.	6,477	7,105	6,893	6,787
EBIT	15,457	21,833	19,778	22,135
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	28,513	26,309	29,572
Tax	(2,578)	(4,978)	(6,470)	(7,179)
Minorities	(25)	1,239	970	970
Net profit	7,534	23,536	19,839	22,393
Net profit (adj.)	20,680	27,545	28,246	31,472

CASH FLOW

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Operating	22,213	45,712	40,081	44,011
Pre-tax profit	10,112	28,513	26,309	29,572
Tax	(2,578)	(4,978)	(6,470)	(7,179)
Deprec. & amort.	6,477	7,105	6,893	6,787
Working capital changes	(10,893)	(9,158)	(12,632)	(14,634)
Other operating cashflows	19,095	24,230	25,981	29,464
Investing	6,087	(16,081)	(16,851)	(18,873)
Capex (growth)	(9,915)	(11,403)	(13,113)	(15,080)
Others	16,002	(4,678)	(3,738)	(3,793)
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	27,639	23,565	25,473
Beginning cash & cash equivalent	47,671	86,877	114,516	138,081
Changes due to forex impact	0	0	0	0
Ending cash & cash equivalent	64,486	114,516	138,081	163,554

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	156,692	161,363	166,087
LT debt	n.a.	n.a.	n.a.	n.a.
Cash/ST investment	64,486	114,516	138,081	163,554
Other current assets	148,364	150,909	153,379	155,706
Total assets	390,973	445,490	476,098	508,275
ST debt	5,343	3,016	3,016	3,016
Other current liabilities	74,287	70,338	70,222	68,362
Other LT liabilities	73,538	73,538	73,538	73,538
Shareholders' equity	223,478	255,106	285,830	319,866
Minority interest	8,393	8,393	8,393	8,393
Total liabilities & equity	390,973	445,490	476,098	508,275

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	17.8	21.3	18.1	18.2
Pre-tax margin	8.2	21.0	17.8	18.7
Net margin	6.1	17.4	13.4	14.1
ROA	2.0	5.6	4.3	4.5
ROE	3.5	9.8	7.3	7.4
Growth				
Turnover	(1.0)	10.1	8.8	7.4
EBITDA	33.7	31.9	(7.8)	8.4
Pre-tax profit	(6.2)	182.0	(7.7)	12.4
Net profit	(0.8)	212.4	(15.7)	12.9
Net profit (adj.)	9.8	33.2	2.5	11.4
EPS	7.6	29.3	(0.4)	9.2
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)	(43.7)	(47.3)	(50.2)

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