



Baidu, Inc.

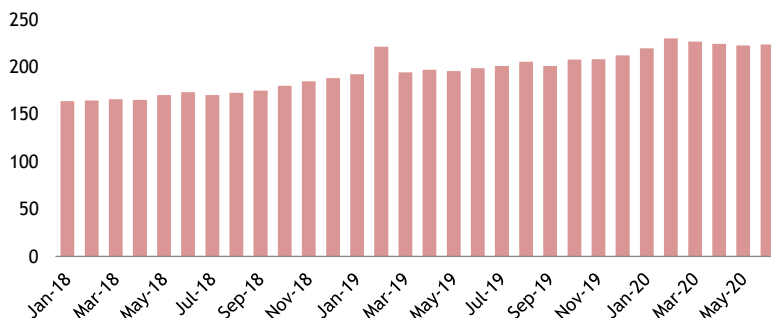
August 6, 2020

Ad Environment Is Still Challenging For The Near-Term; 2020 Is An Investment Year For BIDU

BIDU will report 2Q20 results on August 13th after the markets close followed by a 9:15pm EST conference call. We are cautious on China's advertising market in the near term. We believe the ad environment in 2020 may be challenging for the company. In 2Q20, some of the traditional e-commerce advertising shifted away from traditional platforms to live streaming to market their products. In 3Q20, the seasonal popular sectors of travel, education and business services did not pick up normal growth. These market factors put pressure on BIDU. In addition, IQ's viewership experienced a slowdown post COVID-19, and it is unlikely to pick up during the summer in 3Q20. Based on our data and calculations, we believe BIDU's 2Q20 net revenue is likely to be in line with consensus at RMB 25.816B and within its guidance range of RMB 25.0B – RMB 27.3B.

- Challenging ad environment in 2Q20 and 3Q20** – Since 1Q20, we have seen a shift of e-commerce ads from the traditional platforms to live broadcasting, which enables vendors to increase user reach rate and conversion rate. On top of this, the ad budget for 2020 was already squeezed due to COVID-19 and the slowdown in China's economy. As a result, BIDU's advertising revenue in 2Q20 is likely to be under pressure as live broadcasting platforms are taking a slice out of the overall advertising pie. In 3Q20, we continue to see challenges as seasonal popular sectors including travel, education and business services did not pick up normal growth compared to prior years.
- IQ slowdown post COVID-19** – While iQiyi (IQ, \$22.77, Not Rated) experienced a boost in viewers during lockdown in 1Q20, the company experienced a slowdown in 2Q20 as people returned to work and had less time to watch online shows. Getting into 3Q20, it is a short summer holiday for students, which is also negative to the viewership for IQ. Based on our data and calculations, IQ's subscribing members in 2Q20 is likely to be 108.3M, vs. 118.9M in 1Q20 mainly due to the traffic decline post COVID-19.
- Baidu mobile APP metrics** – Monthly active users of Baidu search APP increased 13.3% Y/Y or down 0.8% Q/Q in 2Q20 (Figure 1). Total time-spend of Baidu increased 65 8.6% Y/Y or decreased 12.0% Q/Q in 2Q20 (Figure 2).

Figure 1: BIDU: Monthly Active Users of Baidu, 1/2018 – 6/2020



Source: T.H. Data (www.thdata.com)

BIDU: Not Rated

Price: \$125.85

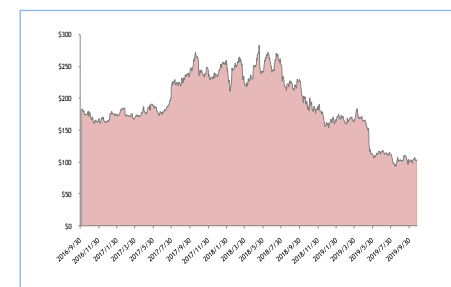
Target Price: N/A

52 Week Range:	\$82.00 - \$147.38
Market Cap:	\$43.4B
Avg. Daily Vol. (100 day):	4,172,110
Net cash per share:	\$32.14

FY (Dec)	2019A	2020E	2021E
Q1	24,123A	22,545A	24,660E
Q2	26,326A	25,714E	28,336E
Q3	28,080A	26,590E	29,500E
Q4	<u>28,884A</u>	<u>28,285E</u>	<u>30,782E</u>
Net Revenue	107,413A	103,134E	113,278E
Q1	2.77A	8.84A	8.95E
Q2	10.37A	9.98E	13.21E
Q3	12.61A	8.95E	15.92E
Q4	<u>26.54A</u>	<u>10.27E</u>	<u>16.96E</u>
EPS*	51.99A	38.03E	55.04E
P/E	16.9x	23.4x	16.2x

*Non-GAAP EPS

All figures in RMB millions unless otherwise noted



Tian X. Hou

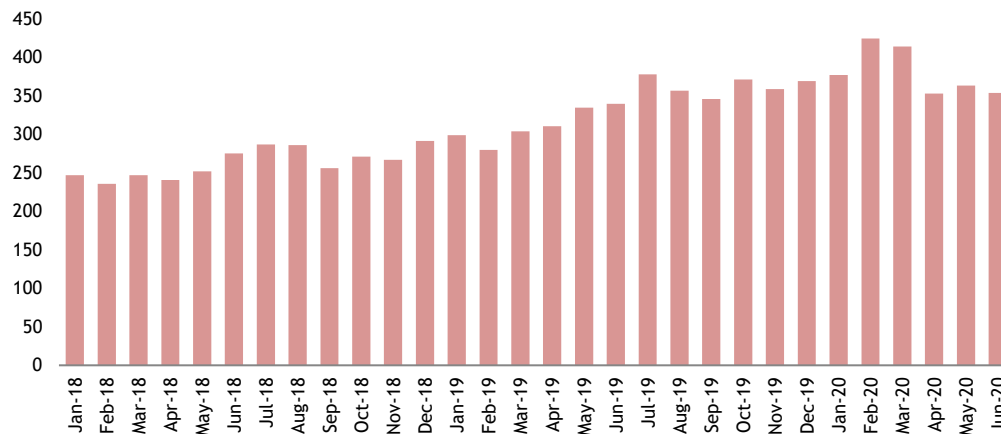
+86 (10) 8567-0989
thou@thdatacapital.com

Jay Dong

+86 (10) 8567-0787
jldong@thdatacapital.com

Gina Chen

(646) 389-8528
gchen@thdatacapital.com

Figure 2: BIDU: Total Time Spend of Baidu, 1/2018 – 6/2020


Source: T.H. Data (www.thdata.com)

- **Valuation** – We believe the near-term price target could be \$150.00, which is based on a 19.6X PE multiple to our new 2021E non-GAAP EPS estimate of \$7.67. The relative higher valuation takes into consideration of BIDU's advantage in AI technology, automatic driving as well as new constructions. At this point, these leading innovations are not getting any valuations.
- **Risks to long** – 1) The growth of news feed business requires more investments with less returns in the near term; 2) Lack of advanced AI technology products for commercialization; 3) Losing its edge in mobile search or news feed if other competing products take off; 4) PC monetization declines faster than expected; 5) Margin contraction due to the investments in AI and IQ content; and 6) Macroeconomic slowdown in China.
- **Risks to short** – 1) AI and self-driving are spinning off and get their own valuation, which will unlock BIDU's underlying valuation; 2) BIDU will IPO in Hong Kong; 3) Tencent (0700.HK, HK\$555.50, Not Rated) invests in IQ; and 4) China's economy grows faster than anticipated.
- **Dial-in information** - BIDU will report 2Q20 results on August 13th after the markets close followed by an 9:15pm EST conference call, which can be accessed by pre-registering at <http://apac.directeventreg.com/registration/event/2568424>.

Figure 3: Earnings Model (in RMB Mlns, except per share)

	FY19A	1Q20A	2Q20E	3Q20E	4Q20E	FY20E	1Q21E	2Q21E	3Q21E	4Q21E	FY21E	FY22E
	12/30/19	3/30/20	6/30/20	9/30/20	12/30/20	12/30/20	3/31/21	7/1/21	10/1/21	12/31/21	12/31/21	12/31/22
Income Statement (m's of RMB)												
Online marketing	78,093.0	14,243.0	18,398.2	19,535.9	20,926.9	73,104.0	16,948.7	20,506.2	21,439.3	22,671.4	81,565.5	93,341.5
Other services	29,320.0	8,302.0	7,315.4	7,054.4	7,358.3	30,030.1	7,711.6	7,829.7	8,060.7	8,110.1	31,712.1	35,482.5
Total revenue	107,413.0	22,545.0	25,713.6	26,590.4	28,285.2	103,134.2	24,660.3	28,335.9	29,499.9	30,781.5	113,277.6	128,824.0
COGS	63,566.4	14,687.0	15,685.3	17,017.8	17,819.7	66,188.4	17,015.6	17,851.6	17,523.0	17,945.6	69,627.8	73,262.4
Gross Profit	43,846.6	7,858.0	10,028.3	9,572.5	10,465.5	36,945.7	7,644.7	10,484.3	11,977.0	12,835.9	43,649.8	55,561.6
SG&A	19,910.0	3,852.0	4,062.7	4,786.3	4,525.6	17,226.6	4,488.2	4,958.8	5,251.0	5,356.0	20,053.9	22,619.6
R&D	18,346.0	4,443.0	4,371.3	4,520.4	4,808.5	18,143.2	4,290.9	4,817.1	4,926.5	4,986.6	19,021.1	21,544.8
Operating expenses	38,256.0	8,295.0	8,434.0	9,306.6	9,334.1	35,369.8	8,779.1	9,775.9	10,177.5	10,342.6	39,075.0	44,164.5
Operating income	6,307.0	(437.0)	1,594.2	265.9	1,131.4	2,554.6	(1,134.4)	708.4	1,799.5	2,493.3	3,866.8	9,671.2
SBC	5,626.0	1,490.0	1,540.0	1,590.0	1,640.0	6,260.0	1,690.0	1,740.0	1,790.0	1,840.0	7,060.0	7,860.0
Amortization of intangible assets	867.0	384.0	300.0	120.0	120.0	924.0	120.0	120.0	120.0	120.0	480.0	480.0
Non-GAAP Operating income	12,800.0	1,437.0	3,434.2	1,975.9	2,891.4	9,738.6	675.6	2,568.4	3,709.5	4,453.3	11,406.8	18,011.2
Net other income	(6,647.0)	(1,043.0)	598.2	704.4	1,126.5	1,386.1	1,365.0	1,314.1	1,358.7	1,445.4	5,483.2	5,971.0
Pretax income	(340.0)	(1,480.0)	2,192.5	970.3	2,257.9	3,940.7	230.6	2,022.5	3,158.2	3,938.7	9,350.1	15,642.2
Income taxes (benefit)	1,948.0	198.0	293.3	129.8	302.1	923.2	30.9	270.6	422.5	526.9	1,250.9	2,092.7
Net income	(2,288.0)	(1,678.0)	1,899.2	840.5	1,955.8	3,017.5	199.8	1,751.9	2,735.7	3,411.8	8,099.2	13,549.6
Non-controlling interest	(4,345.0)	(1,719.0)	(1,127.0)	(1,724.7)	(1,020.8)	(5,591.5)	(1,093.5)	(980.0)	(894.7)	(935.4)	(3,503.6)	(1,174.1)
Net income attributable to Baidu	2,057.0	41.0	3,026.1	2,565.2	2,976.6	8,609.0	1,293.3	2,731.9	3,630.4	3,947.2	11,602.8	14,723.6
SBC	5,126.0	1,348.0	1,698.0	1,748.0	1,798.0	6,592.0	1,823.0	1,873.0	1,923.0	1,973.0	7,592.0	8,292.0
Non-GAAP net income	18,182.0	3,082.0	3,472.1	3,113.2	3,574.6	13,242.0	3,116.3	4,604.9	5,553.4	5,920.2	19,194.8	23,015.6
GAAP EPS, diluted	5.60	0.02	8.70	7.37	8.55	24.64	3.71	7.84	10.41	11.31	33.27	42.12
Non-GAAP EPS	51.99	8.84	9.98	8.95	10.27	38.03	8.95	13.21	15.92	16.96	55.04	65.85
ADSs, diluted	348.8	347.6	347.8	348.0	348.2	347.9	348.4	348.6	348.8	349.0	348.7	349.5
Margins												
COGS	59.2%	65.1%	61.0%	64.0%	63.0%	64.2%	69.0%	63.0%	59.4%	58.3%	61.5%	56.9%
Gross Profit	40.8%	34.9%	39.0%	36.0%	37.0%	35.8%	31.0%	37.0%	40.6%	41.7%	38.5%	43.1%
SG&A	18.5%	17.1%	15.8%	18.0%	16.0%	16.7%	18.2%	17.5%	17.8%	17.4%	17.7%	17.6%
R&D	17.1%	19.7%	17.0%	17.0%	17.0%	17.6%	17.4%	17.0%	16.7%	16.2%	16.8%	16.7%
Operating expenses	35.6%	36.8%	32.8%	35.0%	33.0%	34.3%	35.6%	34.5%	34.5%	33.6%	34.5%	34.3%
Operating income	5.9%	-1.9%	6.2%	1.0%	4.0%	2.5%	-4.6%	2.5%	6.1%	8.1%	3.4%	7.5%
Non-GAAP Operating Margin	11.9%	6.4%	13.4%	7.4%	10.2%	9.4%	2.7%	9.1%	12.6%	14.5%	10.1%	14.0%
Net other income	-6.2%	-4.6%	2.3%	2.6%	4.0%	1.3%	5.5%	4.6%	4.6%	4.7%	4.8%	4.6%
Pretax income	-0.3%	-6.6%	8.5%	3.6%	8.0%	3.8%	0.9%	7.1%	10.7%	12.8%	8.3%	12.1%
Income taxes	-572.9%	13.4%	13.4%	13.4%	13.4%	23.4%	13.4%	13.4%	13.4%	13.4%	13.4%	13.4%
Net income	-2.1%	-7.4%	7.4%	3.2%	6.9%	2.9%	0.8%	6.2%	9.3%	11.1%	7.1%	10.5%
SBC	4.8%	6.0%	6.6%	6.6%	6.4%	6.4%	7.4%	6.6%	6.5%	6.4%	6.7%	6.4%
Non-GAAP net income	16.9%	13.7%	13.5%	11.7%	12.6%	12.8%	12.6%	16.3%	18.8%	19.2%	16.9%	17.9%
Y/Y Growth												
Online marketing	-4.7%	-19.3%	-4.4%	-4.4%	0.8%	-6.4%	19.0%	11.5%	9.7%	8.3%	11.6%	14.4%
Other services	44.0%	28.4%	3.2%	-7.7%	-9.4%	2.4%	-7.1%	7.0%	14.3%	10.2%	5.6%	11.9%
Total revenue	5.0%	-6.5%	-2.3%	-5.3%	-2.1%	-4.0%	9.4%	10.2%	10.9%	8.8%	9.8%	13.7%
COGS	22.8%	-1.0%	-2.7%	3.9%	14.8%	4.1%	15.9%	13.8%	3.0%	0.7%	5.2%	5.2%
Gross Profit	-13.2%	-15.4%	-1.8%	-18.2%	-21.7%	-15.7%	-2.7%	4.5%	25.1%	22.6%	18.1%	27.3%
SG&A	3.5%	-36.4%	-22.5%	2.8%	14.4%	-13.5%	16.5%	22.1%	9.7%	18.3%	16.4%	12.8%
R&D	16.3%	6.6%	-7.7%	-3.6%	1.1%	-1.1%	-3.4%	10.2%	9.0%	3.7%	4.8%	13.3%
Operating expenses	0.093	-18.8%	-15.5%	-0.4%	7.1%	(0.075)	5.8%	15.9%	9.4%	10.8%	0.105	0.130
Operating income	-59.4%	53.3%	584.2%	-88.7%	-75.7%	-59.5%	-159.6%	55.6%	576.7%	120.4%	-51.4%	150.1%
Net income	-110.1%	-408.5%	80.0%	110.4%	-61.3%	231.9%	111.9%	-7.8%	225.5%	74.4%	168.4%	67.3%
SBC	15.1%	23.4%	13.6%	58.0%	25.5%	28.6%	35.2%	10.3%	10.0%	9.7%	15.2%	9.2%
Non-GAAP net income	-24.2%	218.7%	-4.5%	-29.0%	-61.1%	-27.2%	1.1%	32.6%	78.4%	65.6%	45.0%	19.9%
Q/Q Growth												
Online marketing		-31.4%	29.2%	6.2%	7.1%		-19.0%	21.0%	4.6%	5.7%		
Other services		2.3%	-11.9%	-3.6%	4.3%		4.8%	1.5%	3.0%	0.6%		
Net revenue		-21.9%	14.1%	3.4%	6.4%		-12.8%	14.9%	4.1%	4.3%		
COGS		-5.3%	6.8%	8.5%	4.7%		-4.5%	4.9%	-1.8%	2.4%		
Gross Profit		-41.2%	27.6%	-4.5%	9.3%		-27.0%	37.1%	14.2%	7.2%		
SG&A		-2.6%	5.5%	17.8%	-5.4%		-0.8%	10.5%	5.9%	2.0%		
R&D		-6.6%	-1.6%	3.4%	6.4%		-10.8%	12.3%	2.3%	1.2%		
Operating expenses		-6.4%	1.7%	10.3%	0.3%		-5.9%	11.4%	4.1%	1.6%		
Operating income		-109.4%	464.8%	-83.3%	325.5%		-200.3%	162.4%	154.0%	38.6%		
Net income		-99.4%	213.2%	-55.7%	132.7%		-56.6%	-777.1%	56.2%	24.7%		
SBC		-5.9%	26.0%	2.9%	2.9%		1.4%	2.7%	2.7%	2.6%		
Non-GAAP net income		-66.5%	12.7%	-10.3%	14.8%		-12.8%	47.8%	20.6%	6.6%		

Source: Company data and T.H. Capital, LLC estimates

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