

Baidu, Inc.

May 4, 2015

Mobile Distance Proximity Bidding Targeting a Bigger Customer Base – A Potential Growth Driver; Upgrade to BUY from Hold Rating

Beyond BIDU's mixed 1Q15 result and soft 2Q15 guidance, we believe its search business has significant potential to resume high growth toward 2H2015 driven by its new mobile initiatives, mainly its distance proximity bidding, which allows businesses to conduct search marketing in a locally defined territory. BIDU plans to introduce it to the market in 2Q15. We believe it has the potential to capture customers' needs for location based services and to become a new engine for the company's future growth. As for its earnings, the weakness in 1H15 can be a result of seasonality and business transition. We believe BIDU's continuous efforts in mobile initiatives may ultimately position the company to resume past growth. As such, we upgrade the stock from a Hold to BUY rating with a price target of \$239.

- Distance proximity bidding, a mobile enabled service that has potential to drive customer growth** – Mobile has its unique features compared to the PC, and it is more personal. As such, mobile is equipped for personalized and regionalized marketing or commerce. We believe BIDU's distance proximity bidding (DPB) offering can be one of such products that utilizes these unique features and suits millions of small regional businesses' marketing need of advertising in a defined area locally. We believe potential customers for this service can be new to BIDU, as they are different from the company's current customers that are more for nationwide advertising. BIDU had about 524K active customers in 1Q15, while there are 70M small businesses in China. We believe DPB is the right product to address this big market.
- Upgrade to BUY** – We do believe most of the negatives to BIDU's earnings expectations have come out and from here if BIDU can execute its new strategy and roll out its new mobile services, the upside potential to current earnings expectation can be meaningful. We upgrade our rating from HOLD to BUY with a price target of \$239, which is based on a 22X PE multiple to our 2016 non-GAAP EPS estimate of \$10.87. The 22X PE multiple, we believe, can be supported by the average growth rate of its earnings in three years from 2014 – 2016 at 27.2%. We believe such multiple can be conservative compared with its historical 12-months forward PE at 26X. The stock is currently trading at an 18.6X PE multiple to our 2016 non-GAAP EPS estimate of \$10.87.
- Please see page 2 for risks.**

BIDU: Buy (was HOLD)
Price: \$202.47
Target Price: \$239.00

52 Week Range:	\$251.99 - \$148.44
Market Cap:	\$71.08B
Avg. Daily Vol. (100 day):	3,364,890
3-Yr. Est. EPS CAGR:	28%
Net cash per share:	~\$15.00

FY (Dec)	2014A	2015E	2016E
Q1	\$1,528A	\$2,053A	\$2,953E
Q2	\$1,932A	\$2,674E	\$3,631E
Q3	\$2,203A	\$2,998E	\$3,993E
Q4	<u>\$2,265A</u>	<u>\$3,109E</u>	<u>\$4,134E</u>
Revenue*	\$7,906A	\$10,834E	\$14,711E
Previous Rev.	N/A	\$10,931E	\$14,636E
Q1	\$1.16A	\$1.09A	\$1.68E
Q2	\$1.63A	\$2.15E	\$2.77E
Q3	\$1.79A	\$2.15E	\$2.91E
Q4	<u>\$1.45A</u>	<u>\$2.04E</u>	<u>\$2.95E</u>
GAAP EPS	\$6.01A	\$7.44E	\$10.31E
Previous EPS	N/A	\$6.99E	\$8.74E
P/E	33.7x	27.2x	19.6x

* Indicates total revenue including sales tax;
 Quarters may not add due to currency conversion
 All figures in millions unless otherwise noted

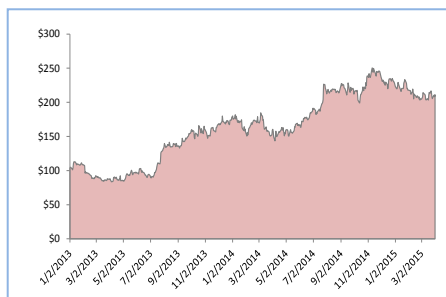
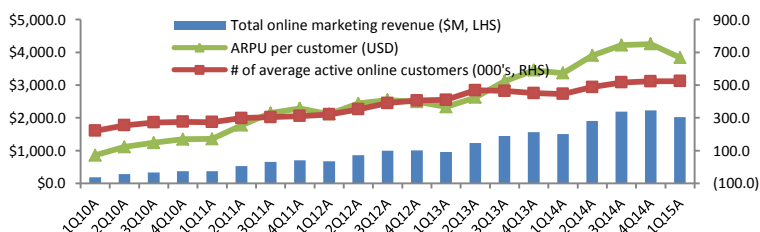


Figure 1: BIDU – Revenue, ARPU and the Number of Customers, 1Q10 – 1Q15



Source: Company data

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- **Risks** – 1) Mobile search revenue may not ramp up as rapidly as the company expected; 2) Over monetization in major sectors such as medical and healthcare may cause decline in revenue; 3) Tencent's monetization of WeChat may cause pressure to BIDU's customer development or ARPU; 4) Potential government policy toward healthcare and medical online advertising could have a negative impact on BIDU; and 5) Macroeconomic slowdown in China.

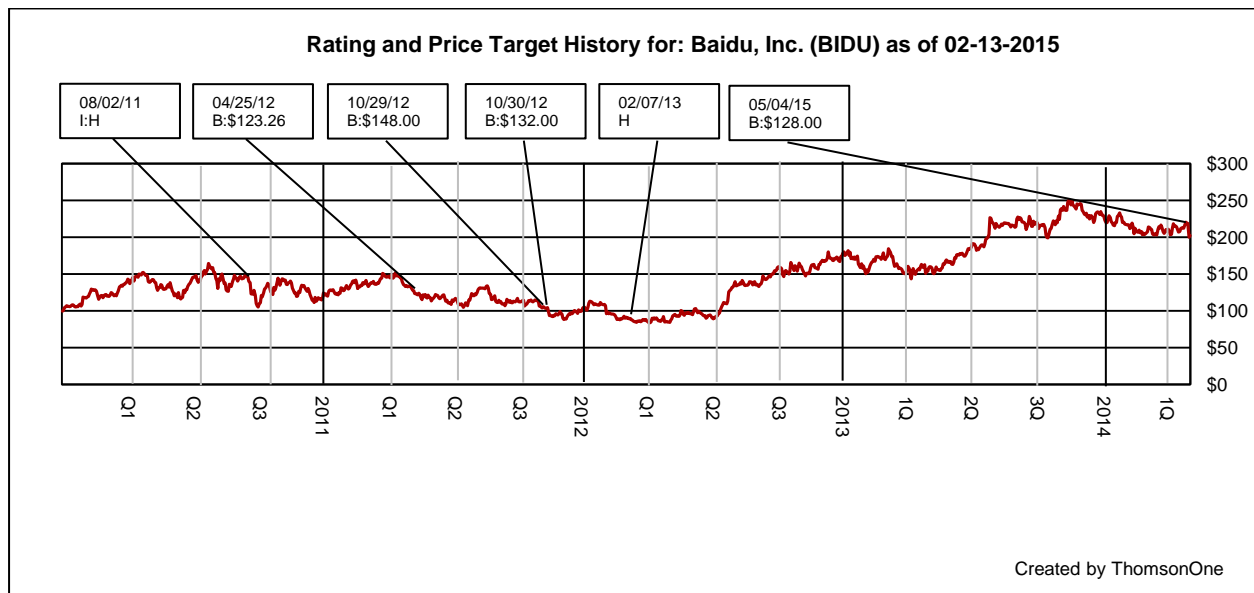
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