



Baidu, Inc.

February 5, 2018

Benefiting From AI In 2H2018 While Maintaining Growth; Maintain BUY

BIDU will report 4Q17 results on Tuesday, February 13, 2018 after the market closes followed by an 8pm EST conference call. We believe BIDU's business is entering a new phase with its aggressive development of news feed and AI. Our data show that the total usage for Baidu search and mobile APP has increased due to news feed, and views and paying users of iQiyi has also increased. While BIDU has many initiatives of AI, we believe the benefit of AI is likely to show in 2H2018, and for the first half of 2018 BIDU's growth is driven purely by marketing – search and news feed, which may not generate any topline surprise. However, we do expect the company to deliver better margins in the first half than consensus expectation as the company does not have to burn cash for O2O business. We maintain our Buy rating on the potential upside in AI, as we believe BIDU is one of the strongest AI players in China.

- **Expect inline 4Q17 revenue but better margin and EPS** – Based on our data and calculations, BIDU's total revenue is likely to be RMB23,353M, largely inline or slightly better than consensus at RMB23,037M (26.5% Y/Y growth). Ever since BIDU started its news feed business, the total usage of Baidu search and mobile Baidu has increased. Our proprietary data shows that the average monthly uses of Baidu increased 51.5% Y/Y to 10.4B, and average monthly time-spend on Baidu increased 11.5% Y/Y to 88.2B minutes in 4Q17 (Figure 1 & 2). In addition, we believe iQiyi video views also grew significantly – in 4Q17, average monthly uses increased 36.8% Y/Y to 19,292M, and average monthly time-spend increased 17.2% Y/Y to 388.2B minutes (Figure 3 & 4). At the same time, the investment in its offline business is down significantly; its Nuomi GMV at RMB4,071M decreased 49.5% Y/Y and 19.6% Q/Q in 4Q17E (Figure 5). As such, we believe its EPS is likely to be better than consensus at RMB10.77.
- **1Q18 guidance is unlikely to be better than consensus** – For 1Q18, we expect the company to guide revenue decline in the range of 11% to 13% Q/Q. Consensus at RMB21,195M (8% Q/Q decline) may be high.
- **Please see page 2 for a discussion of valuation and risks.**

BIDU: Buy

Price: \$233.17

Target Price: \$290.00

52 Week Range: \$166.00 - \$274.97

Market Cap: \$81B

Avg. Daily Vol. (100 day): 2,376,349

Net cash per share: \$39.11

FY (Dec)	2016A	2017E	2018E
Q1	15,821A	16,891A	20,275E
Q2	18,263A	20,874A	24,344E
Q3	18,253A	23,489A	27,148E
Q4	<u>18,212A</u>	<u>22,999E</u>	<u>28,258E</u>
Revenue*	70,549A	84,252E	100,025E
Q1	5.38A	4.63A	5.54E
Q2	6.57A	11.31A	11.58E
Q3	8.51A	24.05A	12.20E
Q4	<u>11.40A</u>	<u>10.41E</u>	<u>11.72E</u>
GAAP EPS	31.86A	50.39E	41.04E
P/E	50.8x	30.8x	37.8x

*Indicates total revenue including sales tax.
All figures in RMB millions unless otherwise noted

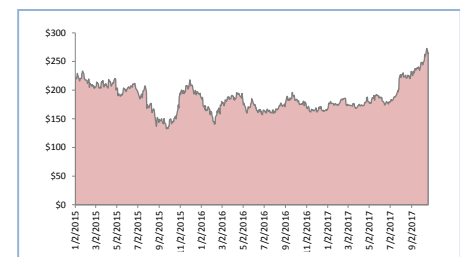
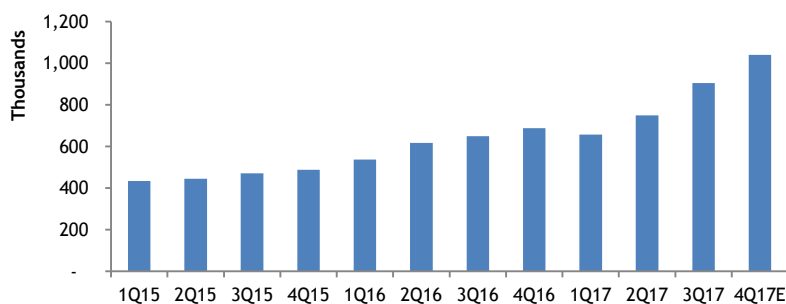


Figure 1: Search: Number of Monthly Uses, 1Q15 – 4Q17E



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

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- **Valuation** - BIDU is at a turning point in its business. The company has established its new strategy – all in AI, which we believe has played into BIDU's strength and it has all it needs to become a leader in AI applications in China. While we haven't seen meaningful monetization from AI initiatives (besides in finance), BIDU has already started its initiatives, including unmanned driving, and DoerOS partnership with Xiaomi and Huawei. We apply a 28.8X PE multiple to our 2019E non-GAAP EPS estimate of \$10.06 and come out with price target of \$290.00.
- **Risks** – 1) Mobile search revenue may not ramp up as rapidly as the company expected; 2) Possibilities of failure in AI initiatives; 3) Losing its edge in mobile search if WeChat's search takes off; 4) PC monetization declines faster than expected; and 5) Macroeconomic slowdown in China.
- **Dial-in information** - BIDU will report 4Q17 results on Tuesday, February 13, 2018 after the market closes followed by an 8pm EST conference call, which can be accessed by dialing 845-675-0437 with the passcode 4299938.

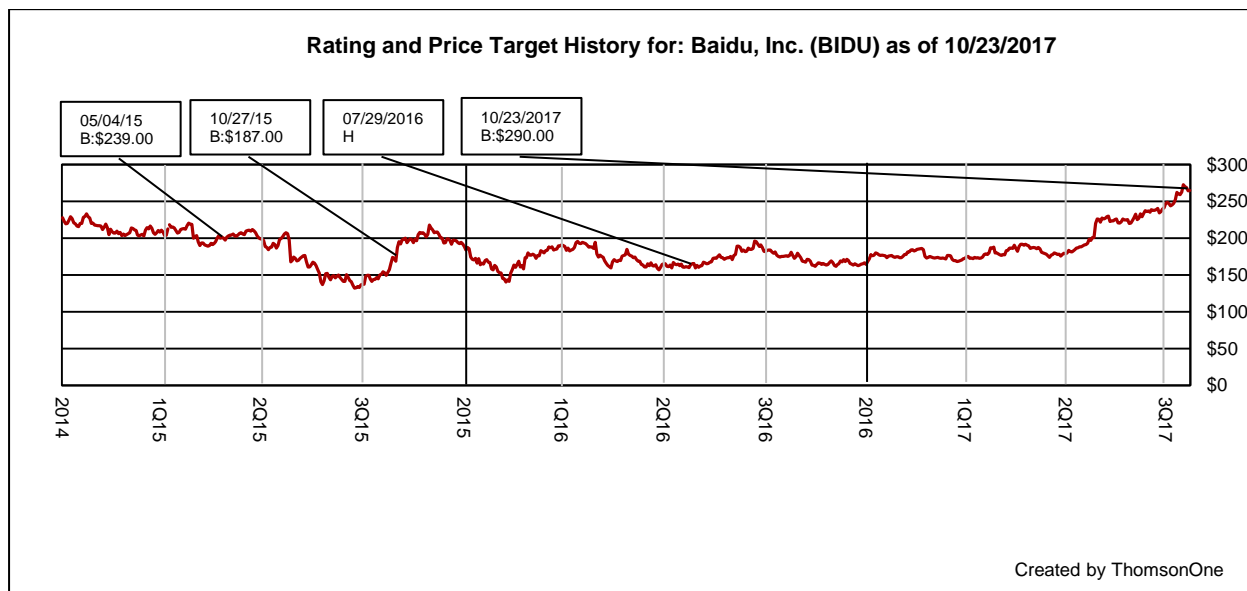
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