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BIDU: Expanding Reach to Drive Growth

Price \$94.88

Growth Holding

November 16, 2022

- BIDU stock has pulled back from its high of \$283 in February 2021.
- Repositioning away from traditional advertising toward SaaS.
- Autonomous driving paving the way for the next decade in addressable market growth.
- First of-its-kind Robo-taxi service which has already delivered 280k autonomous fare-rides in China's largest cities.
- Strong balance sheet and high cash flow coupled with a low valuation.
- Biden-Xi talks indicated a thaw in China-US relations after the countries agreed to more open dialogue.

Investment Thesis

Baidu (BIDU) is a Chinese technology company that made a name for itself being the largest search engine in China. Baidu's shares collapsed amidst macroeconomic and political risk. Contributing to this negative outlook was a plateau in revenue from advertising and a much slower monthly active user (MAU) growth than in previous years.

While advertising remains the core revenue driver for Baidu, it has begun to expand far beyond its origins into cloud infrastructure and autonomous driving. Cloud infrastructure and software as a service industry in China are still developing. Baidu's AICloud now represents just under 30% of total revenues for the company. In 2Q22 this represented a 22% year over year to \$906 million. Over the same period the online marketing business reported a 10% year over year reduction in revenue. While much of this can be attributed to the Zero-COVID policy, advertising revenues across tech giants have been slowing.

The reposition away from advertising is showing signs of success. Beating expected results in 2Q22 for both revenue and earnings per share, BIDU stock jumped in price. While high geopolitical risks remain, Baidu is an attractive growth company with a compelling valuation for entry.



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Estimated Fair Value = EFV

EFV = E2023 EPS times P/E (Price / Earnings Ratio)

EFV = \$7.70 X 19 = \$146.00 per share

Baidu (BIDU)	E2022	E2023	E2024
Price-to-Sales	1.8	1.6	1.4
Price-to-Earnings	11.0	10.0	8.5

Baidu Core

The primary driver of Baidu is their mobile and desktop ecosystem, comprising a dozen or so apps in a similar format to Alphabet. The flagship is simply called the “Baidu App” and is a search engine and feed aggregation app. Advertising makes up the primary revenue generation tool for Baidu’s core business, and functions similarly to any other advertiser. Users and companies bid for advertising space and promoted links and are charged on a per impression basis.

Traditional impression advertising has traditionally made up a large share of Baidu’s revenue. The novel Managed Page grew 10% year over year in 2Q22 to move its way up to 49% of Baidu’s core revenue. Managed Page allows developers and website owners alike to provide Baidu users with a native experience without needing to spend the money on development or maintenance. In addition, Managed Page includes Customer Relationship Management (CRM) software, facilitating small business sales.

Through 1H22, the Monthly Active Users (MAUs) of Baidu’s core app profile expanded to 630 million people, with 84% of MAUs logging in at least once per day.

Baidu operates a public cloud Infrastructure as a Service (IaaS) and Software as a Service (SaaS) under the name AI Cloud. Chinese internet infrastructure for companies is still largely dominated by traditional internal server architecture, with the SaaS market remaining tiny at just \$5.2 billion. For reference, the US market for SaaS is over \$120 billion. Internal server architecture is extremely limited in how quickly it can expand. The market for offloading cloud workloads to external providers is growing. The total addressable market for cloud service providers is expected to grow to \$30 –



\$70 billion per year by 2025 with public cloud accounting for 45% of this addressable market and 55% being private cloud.

While globally AWS and Azure still dominate, Chinese firms expressed a 70% preference for Chinese-owned providers. While the dynamics of this industry are still developing, Baidu has rifled forward with 31% revenue growth year over year. In 2021, Baidu's AI Cloud was the 4th largest in China and increased its market share by 55%.

Self-Driving Project

Apollo Go is Baidu's autonomous driving development which is already providing ride hailing service. Already, Apollo Go has had 1 million accumulated fully autonomous rides since its launch in 2017. In Early 2022 the Chinese government granted Baidu a permit to collect cab revenues from the Apollo Go service in portions of Beijing. It is now present in 10 cities in China, including all of the largest cities in the country. This completely dwarves any other project domestically in China or internationally. This includes the new RT6 vehicle, produced without a steering wheel, compared to previous models which were retrofits. While specific data on the revenues of the company are not yet available, it is unlikely this division is yet profitable. However, it is now starting to be monetized with over 280,000 paid fare-rides in 2Q22.

The Chinese autonomous vehicle market is expected to grow from \$1.5 billion in 2021 to \$100 billion in 2030. This represents a 60% CAGR, Compounded Annual Growth Rate.

iQIYI

iQIYI is a video streaming service. It was one of the first services of its type available in China. Competitive launches have reduced market share, revenues, and cash flow. iQIYI has lost roughly 3 million subscribers since 2Q21 and has decreased its revenue by 13% over the same period. It is presently in an analogous situation to Netflix. Being the first of its kind meant it quickly gained market share and huge revenues which have now begun to be chipped away by competitors.

In an effort to expand revenue beyond subscriptions and advertising, iQIYI has licensed its original content to other services or television, and has dabbled in distribution of online games, live streaming, and literature.



Risk

Baidu has very little reach outside of China and mainly operates within the “walled garden” of the Chinese internet. While they do have the lion’s share of Chinese domestic traffic for many services, their expansion outside of China has been limited. In China, Baidu has approximately 80% search market share, whereas outside of China, it drops to an insignificant less than 2%.

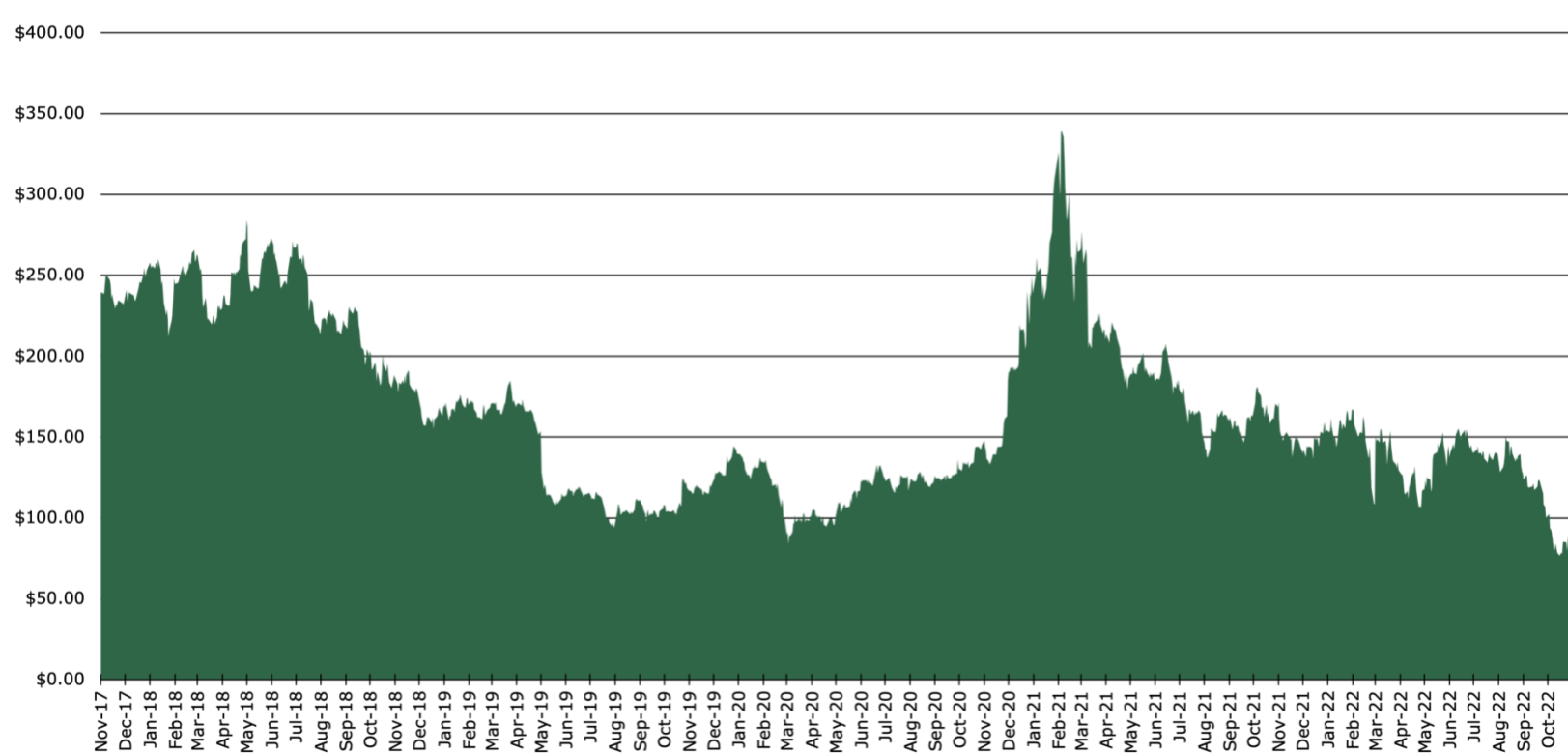
Chinese equity listings on Western stock markets have seen a string of crackdowns by the Chinese government in FY21 with several high profile delistings. These companies are traded through a complex series of loopholes, as foreigners are not permitted to own shares of internet companies and are prohibited from voting even by proxy. Frequently, the authoritarian regime has made harsh and arbitrary decisions regarding these companies. But from a practical perspective; it would be silly to cut off a mass of western money flowing into what amounts to a domestic company.

However, during the Biden-Xi talks which took place on November 15th, both countries acknowledged that conflict, economically or otherwise, is not the goal or in the best interest of either country. Additionally, the two world leaders promised more open communications between the two superpowers.

Peer Comparisons

Estimated Next 12 Months	EV-to-EBITDA	Price-to-Sales	Price-to-Earnings
Baidu (BIDU)	5.5	1.7	13.6
Alibaba (BABA)	6.9	1.3	16.3
Snap (SNAP)	51.8	4.0	Neg
Pinterest (PINS)	32.4	5.8	Neg
Tencent (TCEHY)	14.8	4.2	14.5
Alphabet (GOOG)	12.3	4.5	19.6

Baidu (BIDU)



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