

Baidu Inc (BIDU US)

Buy: Launches Apollo Project to reach the next frontier in self-driving cars

- Project Apollo will build an inclusive autonomous driving ecosystem
- Company confident about scale production by 2020
- Maintain Buy and PEG-based TP of USD223

Baidu made a number of announcements at the Shanghai Auto Show (19 April), clarifying its strategy and new partnerships to bring autonomous driving to China.

Project Apollo to build an inclusive ecosystem for autonomous driving players:

There are three key aspects for the initial plan: 1) Baidu will open source its autonomous driving related algorithms to all the ecosystem participants in July this year, including machine vision, route planning, controlling system and high-definition map. Automakers, auto parts and sensor suppliers and others can either customise the algorithms to work better with their specs or develop new models to leverage the open API, similar to the role of Android operating system for handsets. This will help to lower the entry barrier for traditional players throughout the supply chain and unify industry-wide specs. 2) The Apollo ecosystem will provide a comprehensive autonomous driving suite including software and hardware with help from the ecosystem players. 3) Baidu aims to offer the best safety-related technologies with Project Apollo. Also, it will actively work with all parties and government to discuss and set up relevant industry standards, laws and policies to push through a healthy legal environment for the development of autonomous driving. More details about Project Apollo will be announced in July this year. The company is still very confident about its time map for the technology to launch commercial applications in specific routes by year end 2018 and scale production of autonomous driving vehicles (ADVs) by 2020.

Strategic co-operation with Chery Automobile: Baidu signed a strategic corporation yesterday (19 April) with Chery, a domestic auto manufacturer headquartered in Wuhu, Anhui Province, to further strengthen the co-operation on Internet of Vehicles (IoV), high-level partial autonomous driving and fully autonomous driving. The two have already unveiled a fully ADV leveraging on Chery EQ electric car in August 2016. Chery's base is also the first city to allow Baidu to road test its ADVs in a designated area that will gradually be expanded to the whole city in five years.

Strategic co-operation with Bosch: Baidu also announced a co-operation with Bosch on high-definition (HD) map-based autonomous driving on 17 April (partial autonomous driving) and exhibited an ADV capable of partial self-driving tasks on highways, including lane keeping, driver-monitored lane change, speed change while turning, etc. Bosch will share with Baidu its crowd-sourced road data from millions of cars to build up real-time HD map.

EQUITIES INTERNET

China



MAINTAIN BUY

TARGET PRICE (USD)

223.00

PREVIOUS TARGET (USD)

SHARE PRICE (USD)

174.47

(as of 19 Apr 2017)

UPSIDE/DOWNSIDE

+27.8%

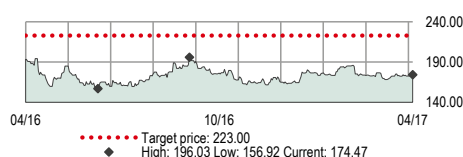
MARKET DATA

Market cap (USDm)	61,312	Free float	100%
Market cap (USDm)	61,312	BBG	BIDU US
3m ADTV (USDm)	714	RIC	BIDU.OQ

FINANCIALS AND RATIOS (CNY)

Year to	12/2016a	12/2017e	12/2018e	12/2019e
HSBC EPS	38.47	46.03	70.98	97.31
HSBC EPS (prev)	-	-	-	-
Change (%)	-	-	-	-
Consensus EPS	27.64	37.96	52.34	66.96
PE (x)	31.2	26.1	16.9	12.3
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	40.0	23.2	13.6	7.7
ROE (%)	12.8	13.1	17.2	19.6

52-WEEK PRICE (USD)



Source: Thomson Reuters IBES, HSBC estimates

Chi Tsang*, CFA

Head of Internet Research, Asia Pacific
The Hongkong and Shanghai Banking Corporation Limited
chitsang@hsbc.com.hk
+852 2822 2590

Qin Wang*

Associate
The Hongkong and Shanghai Banking Corporation Limited
qin1.wang@hsbc.com.hk
+852 2822 4393

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Financials & valuation: Baidu Inc

Buy

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (CNYm)				
Revenue	70,549	88,570	115,706	141,434
EBITDA	11,394	18,173	26,880	36,753
Depreciation & amortisation	-1,345	-5,046	-5,268	-5,581
Operating profit/EBIT	10,049	13,127	21,612	31,171
Net interest	1,184	1,984	3,357	5,541
PBT	14,509	17,176	27,595	40,042
HSBC PBT	14,509	17,176	27,595	40,042
Taxation	-2,914	-2,920	-4,691	-8,008
Net profit	11,632	14,296	22,944	32,074
HSBC net profit	11,632	14,296	22,944	32,074
Cash flow summary (CNYm)				
Cash flow from operations	22,258	34,839	61,175	92,288
Capex	-4,189	-5,248	-6,869	-8,406
Cash flow from investment	-23,889	-5,248	-6,869	-8,406
Dividends	0	0	0	0
Change in net debt	8,302	-34,795	-54,307	-83,882
FCF equity	11,113	27,526	51,680	80,553
Balance sheet summary (CNYm)				
Intangible fixed assets	19,214	19,214	19,214	19,214
Tangible fixed assets	63,024	66,170	70,932	76,133
Current assets	99,759	132,019	190,510	278,830
Cash & others	10,898	40,490	94,797	178,679
Total assets	181,997	217,404	280,657	374,178
Operating liabilities	39,998	58,155	95,270	154,312
Gross debt	44,257	39,054	39,054	39,054
Net debt	33,359	-1,436	-55,743	-139,625
Shareholders' funds	97,766	120,218	146,356	180,835
Invested capital	131,101	118,758	90,590	41,187

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	6.3	25.5	30.6	22.2
EBITDA		59.5	47.9	36.7
Operating profit	-13.9	30.6	64.6	44.2
PBT	-61.7	18.4	60.7	45.1
HSBC EPS	-61.9	19.7	54.2	37.1
Ratios (%)				
Revenue/IC (x)	0.6	0.7	1.1	2.1
ROIC	5.5	9.7	17.8	38.1
ROE	12.8	13.1	17.2	19.6
ROA	7.0	7.1	9.2	9.8
EBITDA margin	16.2	20.5	23.2	26.0
Operating profit margin	14.2	14.8	18.7	22.0
EBITDA/net interest (x)				
Net debt/equity	34.1	-1.2	-38.1	-77.2
Net debt/EBITDA (x)	2.9	-0.1	-2.1	-3.8
CF from operations/net debt	66.7			
Per share data (CNY)				
EPS Rep (diluted)	38.47	46.03	70.98	97.31
HSBC EPS (diluted)	38.47	46.03	70.98	97.31
DPS	0.00	0.00	0.00	0.00
Book value	281.64	346.32	421.63	520.95

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	6.5	4.8	3.2	2.0
EV/EBITDA	40.0	23.2	13.6	7.7
EV/IC	3.5	3.5	4.0	6.9
PE*	31.2	26.1	16.9	12.3
PB	4.3	3.5	2.8	2.3
FCF yield (%)	2.6	6.5	12.2	19.1
Dividend yield (%)	0.0	0.0	0.0	0.0

* Based on HSBC EPS (diluted)

Issuer information

Share price (USD)	174.47	Free float	100%
Target price (USD)	223.00	Sector	Internet
Reuters (Equity)	BIDU.OQ	Country	China
Bloomberg (Equity)	BIDU US	Analyst	Chi Tsang, CFA
Market cap (USDm)	61,312	Contact	+852 2822 2590

Price relative



Source: HSBC

Note: Priced at close of 19 Apr 2017

Valuation and risks

We maintain our PEG-based target price of USD223. It implies 34x 2017e EPS. Our target price is derived by applying a 1 PEG to our 2017e EPS and 2017-20e EPS CAGR of 34% (all unchanged). With 28% upside to our target price, we reiterate our Buy rating.

The key downside risks to our rating are worse-than-expected technology change, execution and competition.

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The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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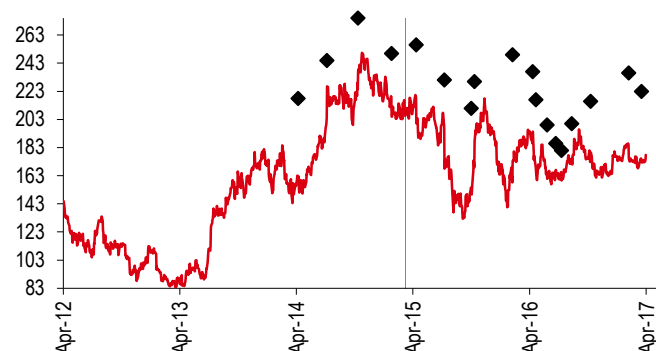
Buy	45%	(25% of these provided with Investment Banking Services)
Hold	40%	(26% of these provided with Investment Banking Services)
Sell	15%	(17% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see "Stock ratings and basis for financial analysis" above.

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Share price and rating changes for long-term investment opportunities

Baidu Inc (BIDU.OQ) share price performance USD Vs HSBC rating history



Source: HSBC

Rating & target price history

From	To	Date	Analyst
Overweight	Buy	26 Mar 2015	Chi Tsang
Target price	Value	Date	Analyst
Price 1	218.00	25 Apr 2014	Chi Tsang
Price 2	245.00	25 Jul 2014	Chi Tsang
Price 3	275.00	30 Oct 2014	Chi Tsang
Price 4	250.00	12 Feb 2015	Chi Tsang
Price 5	256.00	30 Apr 2015	Chi Tsang
Price 6	231.00	28 Jul 2015	Chi Tsang
Price 7	211.00	20 Oct 2015	Chi Tsang
Price 8	230.00	30 Oct 2015	Chi Tsang
Price 9	249.00	26 Feb 2016	Chi Tsang
Price 10	237.00	29 Apr 2016	Chi Tsang
Price 11	217.00	10 May 2016	Chi Tsang
Price 12	199.00	14 Jun 2016	Chi Tsang
Price 13	186.00	11 Jul 2016	Chi Tsang
Price 14	181.00	29 Jul 2016	Chi Tsang
Price 15	200.00	30 Aug 2016	Chi Tsang
Price 16	216.00	28 Oct 2016	Chi Tsang
Price 17	236.00	24 Feb 2017	Chi Tsang
Price 18	223.00	06 Apr 2017	Chi Tsang

Source: HSBC

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Company	Ticker	Recent price	Price date	Disclosure
BAIDU INC	BIDU.OQ	177.81	19 Apr 2017	6

Source: HSBC

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Issuer of report

The Hongkong and Shanghai Banking Corporation Limited

Level 19, 1 Queen's Road Central

Hong Kong SAR

Telephone: +852 2843 9111

Fax: +852 2596 0200

Website: www.research.hsbc.com

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