

Baidu's stock has declined over the past year as concerns about competition and a weaker Chinese economy pressure the company. However, the company is trading at relatively attractive multiple and has investments in other companies that represent a substantial portion of its market capitalization. We believe that Baidu's stock may present an attractive investment opportunity at current levels.

Company Description

Baidu operates three distinct product lines:

- Search Services: With an over 80% market share in 2018, Baidu operates the largest search engine in China, according to Statista, which also showed that the company is the fourth largest in the world.[1]
- Transaction Services: The company's transaction services group offers online services such as food delivery, entertainment ticketing, dining, hotel reservations, health and beauty services. The unit also offers payment services through its Baidu wallet platform as well as cloud services.
- iQiyi: Baidu owns a 58% stake in online video platform iQiyi (IQ), according to an iQIYI 13D filing.

Additionally, Baidu owned a 19% stake in online travel website Ctrip.com International (CTRP) as of 12/31/17, according to the company's annual report.

Stock Price Decline

Baidu's current stock price of \$162.54 (as of 2/28/19) is down over 40% from its high of over \$284 that it reached during May of 2018. This gives the company a market capitalization of nearly \$57 billion. Concerns about the company's losing ground to rivals and a slowdown in the Chinese economy which is pinching advertising revenue has pressured Baidu's stock.

But, is Baidu's stock price justified or does the current stock price offer potential value?

Breaking Down Baidu

Baidu's 58% stake in iQiyi is worth \$11.3B (based on IQ's 2/28 market cap of \$19.5B). Its 19% stake in Ctrip.com is worth \$3.5B (based on CTRP's 2/28 market cap of \$18.6B). Together, that totals nearly \$15B or 25% of Baidu's market cap. In addition, the company has nearly \$16B in excess capital (in the form of short-term investments on its 12/31/18 balance sheet). Taken together, these items total half of Baidu's market cap.

Therefore, you are only paying \$30B, or about \$81 per share for Baidu (50% of Baidu's 2/28/19 stock price). What are you getting for that price?

Baidu's 2018 Results

According to the company's fourth quarter earnings release, Baidu's 2018 total revenues increased 28% over 2017 to \$14.88. Baidu Core revenues (which excluded iQiyi) increased 22%. Baidu's App daily active users (DAU) increased 24% over 2017. iQiyi added 36.6 million users to reach 87.4 million users by year-end. Operating income decreased by 1% during the year owing to increased spending at iQiyi. Core operating income increased 21% over 2017. Income to Baidu and Baidu Core increased 51% and 52%, respectively.

What May Drive Future Growth?

Baidu has invested heavily in the autonomous driving area. Additionally, Baidu, through its research group, is investing in artificial intelligence as well as areas such as computer vision, healthcare, quantum computing, natural language, robotics, machine and deep learning, and high-performance computing.

Valuation

Baidu is trading at a forecasted P/E of 13.4 (based on estimates from Yahoo Finance). The company is also trading at P/B of 2.36. But effectively, these ratios can be cut in half when factoring out the value of Baidu's stake in iQiyi, Ctrip and its excess capital.

Summary

Baidu certainly faces challenges going forward. Competition is intense and will only increase in China's internet industry. A weak Chinese economy may continue to pressure Baidu's advertising revenue. Additionally, the company will need to continue to spend to develop newer technologies to fuel growth.

However, the company is trading at much lower multiples than companies such as Alibaba (BABA) and Tencent (TCEHY) – companies with which Baidu is often compared (collectively, Baidu, Alibaba, and Tencent make up China's BATS stocks). Additionally, the company's investments in iQiyi, Ctrip and its excess capital provide a potential cushion on the downside.

At the same time, growth of 22% is still decent. And the company continues to develop new technologies as it aims to fuel future growth.

Baidu's recent stock decline may be a potentially advantageous investment opportunity.

[1] Search engine market share in China, 1st quarter 2018, Statista

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