

Baidu, Inc. (NASDAQ:[BIDU](#)) Q4 2015 Earnings Call February 25, 2016 8:00 PM ET

## **Executives**

Sharon Ng - Director, Investor Relations

Robin Li - Co-Founder, Chairman and Chief Executive Officer

Jennifer Li - Chief Financial Officer

## **Analysts**

Dick Wei - Credit Suisse (Hong Kong) Ltd.

Eddie Leung - Merrill Lynch Far East Ltd.

Chi Tsang - The Hongkong & Shanghai Banking Corp. Ltd. (Broker)

Wendy Huang - Macquarie Capital Securities Ltd.

Ming Zhao - 86Research Ltd.

Piyush Mubayi - Goldman Sachs (Asia) LLC

Natalie Wu - CICC

Claire Cao - Morgan Stanley Asia Ltd.

Thomas Chong - Citigroup Global Markets Asia Ltd.

Bo Pang - Oppenheimer & Co., Inc. (Broker)

Erica Poon Werkun - UBS Securities Co. Ltd.

## **Operator**

Hello. Thank you for standing by for the Baidu's Fourth Quarter and Full Year 2015 Earnings Conference Call. At this time, all participants are in a listen-only mode. After management's prepared remarks, there will be a question-

and-answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to your host for today's conference, Sharon Ng, Baidu's Director of Investor Relations. Please go ahead.

**Sharon Ng - Director, Investor Relations**

Hello, everyone, and welcome to Baidu's fourth quarter and full-year 2015 earnings conference call. Baidu's earnings release was distributed earlier today and you can find a copy on our website, as well as on Newswire services.

Today, you'll hear from Robin Li, Baidu's Chief Executive Officer; and Jennifer Li, Baidu's Chief Financial Officer. After their prepared remarks, Robin and Jennifer will answer your questions.

Before we continue, please note that the discussion today will contain forward-looking statements made under the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. Potential risks and uncertainties include, but are not limited to, those outlined in our public filings with the SEC, including our Annual Report on Form 20-F. Baidu does not undertake any obligation to update any forward-looking statements except as required under applicable law.

Our earnings press release and this call include discussions of certain unaudited non-GAAP financial measures. Our press release contains a reconciliation of the unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures, and is available on our IR website at [ir.baidu.com](http://ir.baidu.com).

As a reminder, this conference is being recorded. In addition, a webcast of this conference call will also be available on Baidu's IR website.

I will now turn the call over to Baidu's CEO, Robin Li.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Hello, everyone, and thanks for joining today's call. We had another quarter and year of strong performance driven by solid growth in our core search business, and Transaction Services continue to demonstrate clear momentum.

Over a year ago, we set forth our ambitious mission and laid the ground work to connect people with services and build an integrated online marketing and transaction services platform. From the solid mobile foundation of our leading search and Maps gateway products, in 2014, we launched cornerstone pieces of our closed-loop offerings Baidu Nuomi, Takeout Delivery and Baidu Wallet.

In 2015, with all the key pieces in place, we saw Baidu Nuomi, Takeout Delivery and Baidu Wallet truly ramp. And at the end of 2015, we launched our new Local Express initiative. I'm immensely proud of the progress we've made to redefine search and expand the scope of what search can deliver in the age of mobile.

At the largest most extensive online marketing platform in China, our core capabilities in technology and data are unparalleled. We continue to provide a unique value proposition to users to help them find whatever it is they are looking for at the exact time, at the exact place in the best most intuitive and convenient way possible.

More than ever, we are seeing our vision of the next Baidu really take shape, underpinned by the cross-pollination and integration of gateway content, transaction services product across our platform. While we monitor the progress of our products individually, the real beauty is in the integration. The true potential of products such as map, Baidu Nuomi, Takeout Delivery and Baidu Wallet lies in the way the product support each other and elevate the whole platform. The end result is a seamless, closed-loop transaction of

discovery, connection and payment that delivers a delightful and enriched experience to our users further reinforcing Baidu as the go-to partner for our merchants.

Starting with our core search business. Our core P4P search business, which account for the large majority of Baidu's revenue, continues to see very solid growth on the strength of mobile. For P4P search, overall traffic continued to grow driven by mobile with mobile accounting for about two-thirds of the total search traffic.

Key monetization metrics, CPM and click-through rates continue a clear upward trend with mobile search monetization showing particular strengths. As of the fourth quarter, the P4P search CPM monetization gap between PC and mobile narrowed to less than 20%. The consistent and apparent upward trend of mobile monetization is due in no small part to the investment we have made in artificial intelligence, which has helped make search results faster, more structured and more personalized.

As we shared previously, mobile encourages longer and more frequent engagement, allows for more innovative ad formats and generates richer data. We have confidence that mobile monetization has ample headroom for growth, and will eventually exceed PC. In addition to monetization improvements, we see tremendous potential in the growth of verticals that we service.

Even as China's overall gross slows, service and domestic consumption are growing faster. This growth in service is outpacing overall GDP in 2015. Providing an additional tailwind is the Chinese government's Internet Plus initiative, which is pushing traditional industries to work more closely with Internet companies, bringing structural change to those sectors.

Baidu largely services these growing sectors. With our top revenue verticals by broad classification including retail ecommerce, local services, healthcare, financial services and education. We are confident in our outlook for Baidu and China's growing sectors. Baidu plays a vital role as the platform to

connect users and merchants in these verticals. And we stand to benefit from their growth and transformation. In particular, we see tremendous potential to further penetrate the massive incremental local opportunity nascent in both online marketing and online transactions.

No platform is better positioned to service local merchants than Baidu. We already have the local traffic with intent, the gateways, the technology, the extensive sales force and ever-expanding infrastructure.

Local Express and infrastructure initiative we launched in late October last year enables local merchants to easily be part of our platform and we are very happy with the progress. By mid-February, well over 100,000 new and existing customers in local services and verticals including housekeeping, auto repair, wedding services and moving companies have adopted Local Express.

And the early feedback has been great. For example, one Hubei-based housekeeping service saw its revenue close to double, with nearly all mobile transactions coming from Local Express after joining in January.

Another local service merchant, a Xiamen-based wedding photography studio saw its overall revenue double after signing on at the end of November crediting over 50% of their revenue to Local Express.

On the user side, over the past few years, through our investments in machine-learning and deep learning in particular, we made significant strides in voice and image search. The most intuitive, accessible and naturalistic interfaces for mobile devices.

Our AI scientists at Baidu Research use deep learning algorithms and massive neuron networks to achieve breakthroughs in speech recognition. We lead the industry in speech and image technology and saw voice and image activated traffic across our product far more than double in the fourth quarter compared to the year prior.

The same algorithms that allows our deep speech system to produce industry-leading results in English speech recognition 10 with almost no modification also learn to transcribe Mandarin Chinese. Just this week, our effort in speech recognition was named one of the top 10 Breakthrough Technologies in 2016 by MIT Technology Review. We believe that speech will continue to open up access to and transform the mobile experience for hundreds of millions of users.

Now, moving to Transaction Services. Momentum continues to build in our Transaction Services, excluding Qunar, overall GMV grew nearly fourfold year-on-year in Q4. Baidu Nuomi, Takeout Delivery and Baidu Wallet, continued to show momentum. And we broadened our platform with key partnerships with player such Ctrip and Uber. And with other third-party service providers such as eDaixi, we further leveraged our large sales force to extend coverage to local services verticals.

Baidu Map is an indispensable service to help online users navigate, discover and transact in the offline world. With over 300 million monthly active users and over 70% market share by daily active users, Baidu Map is a high intent, local gateway that continues to expand its closed-loop ecosystem. Map has the largest points of interest database of which, 1.2 million POIs, up from 1 million in Q3 enabled closed-loop transactions. Our users expressed intent for local services when they use our map. 40% of map queries are for local services, up from 30% in Q3 last year.

China now has 150 million private cars and 75 million monthly users rely on Baidu's real-time navigation system. Maps integrated Ctrip's hotel inventory in December and the growth in hotel bookings over the past few months, on holidays and events in particular, has been very encouraging. Baidu Nuomi continues to show a clear upward trajectory, with GMV growing nearly three times from Q1 to Q4 and more than fourfold full year 2015 over 2014.

By the end of December, Nuomi has over 1 million merchants, more than doubling from the beginning of the year. On the user front, ARPU and the

number of orders per user continued to trend higher. Nuomi showed particular strength in the movie theater vertical, and it's now neck and neck for the market lead. Many movie cinemas are anchor tenants in shopping malls in China, and movie ticketing, it's a strategic vertical to cross-sell into other verticals such as restaurants.

Our 2015 data shows 65% of our existing users who discovered the Nuomi platform through movie ticketing, not only stayed on our platform, but also purchased the products in categories outside of movie ticket within the year.

We now are users and we use personalized recommendations to cross-sell this product in other categories. Nuomi continues to expand as a platform and has the most third-party partners in the industry complementing its core vertical top restaurants and movie tickets with partners in industries like travel, event ticketing, laundry, housekeeping and auto services.

Baidu Takeout Delivery continue to grow strongly, increasing GMV nearly eight times from Q1 to Q4. We continue to differentiate from the competition by focusing on the less price sensitive, more quality conscious, working age demographic and by working with high quality licensed restaurants.

Nearly 50% of orders are delivered last mile by Baidu, the highest portion in the industry. This is enabled by the largest multipoint-to-multipoint on-demand logistics delivery system in China. We've expanded into a number of other popular verticals including pharmacies, convenience store, grocery store, florists and cake shops.

At the end of Q4, Baidu Wallet had 53 million activated accounts, up from 45 million in September and continuing to grow at a rapid pace. Nuomi and Takeout Delivery customers are increasingly using Baidu Wallet to complete transactions. And the portion of transactions paid with Baidu Wallet continues to grow. As of February, over 50% of Nuomi's transactions were completed with Baidu Wallet. Baidu Wallet gives us better visibility on consumer behavior and help us to improve our service to both merchants and users.

Baidu's core competence is in data and technology and our vision underscore our commitment to changing the world through technology. 2015 was a great year for import new technology initiative at Baidu. In December, we held very successful road test of our autonomous car. The car passed a series of tests with flying colors, performing maneuvers in different traffic and road conditions. Our strength in AI, computer vision and high-definition mapping were key to this success.

We see a very bright future for autonomous driving, especially here in China where we face severe pollution, frequent traffic jams and high mortality rates from traffic accidents. Baidu believes, we can transform transportation as we know it. We'll keep you updated with new divestments from this exciting area.

We are beginning to see encouraging traction on international products. Apps like DU Battery Saver and DU Speed Booster have helped to guide local MAUs of international apps to 260 million in Q4 of 2015. We continue to expand our international presence with focus on mobile products in Japan and in emerging markets including Brazil, Indonesia, Thailand, Egypt and India.

In November, we announced two important new initiatives in Internet finance. We submitted an application for direct banking license in partnership with CITIC Bank, and submitted one for online insurance license in partnership with Allianz and Hillhouse Capital.

iQiyi continue to perform very well with full year 2015 revenue nearly doubling over 2014. In the fourth quarter, iQiyi reached new milestones with ad and subscription revenues reaching historical highs off the back of a popular variety show, Running Man 3 and half self-produced content. iQiyi has rapidly expanded it's paying subscriber base, which surpassed the 10 million mark in December.

As you may already be aware, Baidu has received a non-binding offer from myself and iQiyi CEO, Gong Yu, to acquire Baidu's stake in the company.



While I cannot comment on that offer at this time, I do want to assure you that Baidu intends to adhere to the strictest standard in corporate governance and has established a special committee to independently evaluate the offer on the advice of retained legal and financial advisors. Whatever the outcome, iQiyi will continue to be an important strategic partner for Baidu.

To wrap up, we are extremely pleased with the solid foundation we've laid for future growth. Our phase in the transformative power of technology is only stronger. So too is our commitment to our mission of providing the best and most equitable way for people to find what they're looking for.

This mission has very naturally broadened from connecting people with the information to include connecting people with services. We ended the Year of the Monkey, my own year, with terrific momentum in our transaction business and unshakable confidence and of course we've chartered in the enormous value that remains for us to unlock and in the capabilities of our ARPU. The wind is squarely at our back and we are at full sails.

With that, I'll now turn the call over to Jennifer for an update on the financials.

**Jennifer Li - Chief Financial Officer**

Thank you, Robin. Hello, everyone. We're very pleased to deliver a strong set of results in the fourth quarter. In 2015, we further executed our vision to connect people with services. We deploy the significant resources to ramp Nuomi, Takeout Delivery and Wallet and drove great momentum. We also supported the stellar growth of iQiyi.

Looking into full-year 2016, we remain very confident in the growth outlook ahead of us. As Robin highlighted, the Baidu platform plays a key role in connecting users with merchants in growing consumer-oriented service sectors. These sectors are ongoing transformational changes and above the overall softness felt in China's to be manufacturing and infrastructure

sectors. Under a broader classification of verticals with some previously sub-verticals rolled up, Baidu's squarely services, the growing verticals of retail e-commerce, local services, financial services, healthcare and education to name a few of our top verticals. We have limited exposure to to-be manufacturing and infrastructure.

This year, we'll continue to execute our plan to build out the Next Baidu. We'll continue to spend to support Nuomi, Baidu Takeout Delivery and Baidu Wallet. Key investment arrears include sales and marketing and operational costs. We'll continue to focus on generating value to our users and merchants and closely monitor ROI. We'll continue to support iQiyi, which performed exceedingly well in 2015, and has truly differentiated itself from the competition through its content and business model. For 2016, the key investment focus for iQiyi remains content acquisition, both licensed and self-produced.

In the fourth quarter, we deconsolidated Qunar's financial after October 26, 2015. Baidu's exchange of Qunar's shares with Ctrip impacted a number of line items, on our P&L, including revenue, expense items, effective tax expense and net income. Also note that was Qunar was excluded in operating metrics of GMV, online active customers and head count in the fourth quarter, and it will be continued to be excluded in subsequent quarters.

Starting the first quarter of 2016, we will have equity pickup from our minority stake in Ctrip, on a quarter-lag basis. In the first quarter of 2016, we will get two months of equity pick-up of Ctrip's fourth quarter 2015 net income based on our minority stake in Ctrip.

Now moving to the financials. All monetary amounts are in RMB unless state otherwise. Reported historical financials include Qunar up to October 26, 2015. For the fourth quarter, total revenues were RMB 18.7 billion, representing a 33% increase year-over-year. Total revenue for the full year 2015 were RMB 66.4 billion, an increase of approximately 35% from 2014.

During the fourth quarter, Baidu had approximately 565,000 (sic) [555,000] active online marketing customers, a 6% increase from the corresponding period in 2014 and 11% decrease from the previous quarter. Revenue per online marketing customer for the fourth quarter was RMB 31,000, a 17% increase from the corresponding period in 2014 and an increase of 10% from the previous quarter.

For the full year 2015, active online marketing customers increased by 29% and the revenue per online marketing customer increased by 2% over the full year 2014 figures. Excluding Qunar on an apple-to-apples basis for the full year 2015, active online marketing customers increased by 18% and revenue per online marketing customer increased by 11% over the full year 2014 figures.

Traffic acquisition cost, as a component of cost of revenue in Q4, was RMB 2.6 billion or 14% of total revenues, compared to 13.4% in the corresponding period in 2014 and 13.1% in the third quarter of 2015. Full-year 2015 TAC as a percent of revenue was 13.3% up from 12.9% for 2014. Bandwidth and depreciation cost, as a percent of revenue in Q4 were 5.4% and 3.7% respectively, compared to 5.3% and 4% in the corresponding period in 2014. In 2015, bandwidth and depreciation costs, as a percent of revenue decreased to 5.6% and 3.9% respectively, compared to 5.8% and 4.1% respectively in 2014.

Operational cost as a component of cost of revenue in Q4 were RMB 1.2 billion, representing 6.3% of total revenues, compared to 4.4% in corresponding period in 2014. Total operational costs for 2015 were RMB 3.9 billion, representing 5.8% of total revenues, compared to 4.6% in 2014. This increase was mainly due to sales force, delivery and payment costs associated with Transaction Services and iQiyi related operating costs. In 2016, as we grow Transaction Services and iQiyi related operational costs are expected to increase at a similar rate, but slightly more moderately as compared to last year.

Content costs, as a component of cost of revenue in Q4 were RMB 1.4 billion, representing 7.4% of total revenue, compared to 4.2% in the corresponding period in 2014. Total content cost for 2015 were RMB 3.7 billion, representing 5.6% of total revenue, compared to 3.7% in 2014. This increase was mainly due to iQiyi's increased content cost. In 2016, we also expect a step-up investment in content cost, but at a slightly more moderate pace than 2015. Content cost will be used to invest in high-quality licensed and self-produced content for iQiyi.

SG&A expenses in Q4 were RMB 4.5 billion, an increase of 28% year-on-year. Total SG&A expenses for 2015 was RMB 17.1 billion, a 64% increase from 2014. The increase was primarily due to an increase in promotional spending for transaction services. As we move forward to further ramp Transaction Services, we expect a similar run rate for SG&A in 2016 as for second half of 2015. We plan to engage in cross-platform marketing and promotional campaigns and will monitor effectiveness closely.

R&D expenses in Q4 were RMB 2.5 billion, an increase of 16% over the corresponding period in 2014. Total R&D expenses for 2015 were RMB 10.2 billion, a 46% increase from 2014. The increase was primarily due to increased R&D-related personnel cost.

Share-based compensation expenses, which were allocated to related operating costs and expense line items increased in aggregate to RMB 341 million in Q4 from RMB 339 million in the corresponding period in 2014. SBC expenses for 2015 increased 44% over the 2014 level.

Operating profit for Q4 was RMB 3.5 billion, increase of 20% over Q4 last year. Operating profit for the full year 2015 decreased to 8.8% from 2014. Total head count on a consolidated basis, including invested entities, as of December 31, 2015, was about 41,500, a decrease of 18% as compared to the end of last quarter. The decrease was mainly due to the deconsolidation of Qunar.

Other income, net, was RMB 24.3 billion in the fourth quarter of 2015. The increase from RMB 96.1 million of the corresponding period in 2014 was primarily attributable to the investment gain recognized in Baidu's exchange of Qunar shares with Ctrip. For the full year, other income, net, was RMB 24.7 billion in 2015 compared to RMB 261 million in 2014.

Income tax expenses were RMB 3.6 billion for the fourth quarter. The effective tax rate for the fourth quarter was 12.7% compared to 15.6% in Q4 2014. For the full year, our effective tax rate was 14.4% compared to 15.4% in 2014. There was a 10% tax accrual on gain associated with Baidu's exchange of Qunar shares with Ctrip. For 2016, we expect our effective tax rate to be in the low 20%s.

Net income attributable to Baidu for Q4 was RMB 24.7 billion, a 663% increase from the corresponding period in 2014. Basic and diluted earnings attributable to Baidu per ADS for the fourth quarter amounted to RMB 71.1 and RMB 70.92, respectively. Diluted earnings attributable to Baidu per ADS, excluding net gain recognizing Baidu's exchange of Qunar shares with Ctrip for the fourth quarter of 2015, was RMB 7.61. Net income attributable for Baidu for the full year, increased by 155%.

Net income attributable to Baidu, excluding share-based compensation expenses, a non-GAAP measure, for Q4, was RMB 25.1 billion, a 600% increase year-on-year. Basic and diluted earnings attributable to Baidu per ADS, excluding share-based compensation expenses, both non-GAAP measures, were RMB 72.09 and RMB 71.90, respectively. Net income attributable to Baidu, excluding share-based compensation expenses for the full year, increased by 148%.

As of Q4, the company had cash, cash equivalents and short-term investments of RMB 67.9 billion. Net operating cash flow and capital expenditures for the fourth quarter were RMB 6.1 billion and RMB 1.4 billion, respectively. Full-year net operating cash inflow and capital expenditures were RMB 19.4 billion and RMB 5.2 billion, respectively.

Now let me provide you with our top line guidance for the first quarter of 2016. We currently expect total revenue for the first quarter to be between RMB 15.41 billion and RMB 15.97 billion, representing a 21.1% to 25.5% year-over-year increase. On an apples-to-apples basis, excluding Qunar from Baidu's financials, the guidance represents a 27.8% to 32.5% year-over-year increase. Please note, this forecast reflects Baidu's current and preliminary view, which is subject to change.

I will now open the call to questions. Operator, please go ahead.

### **Question-and-Answer Session**

#### **Operator**

Thank you. The question-and-answer session of this conference call will start in a moment. Your first question comes from the line of Dick Wei from Credit Suisse. Please go ahead.

#### **Dick Wei - Credit Suisse (Hong Kong) Ltd.**

Hi. Good morning. Thanks for taking my question. I have a question in the fourth quarter marketing revenue. I wonder if you can give some more color on the dynamics. I guess, marketing services was down quarter-over-quarter slightly. The customer number down pretty significantly while you launched the Local Express. So, if you can kind of comment on what kind of color we see in the core search and maybe other marketing services and how the trend going to be like in 2016? That will be good. Thank you.

#### **Jennifer Li - Chief Financial Officer**

Hi, Dick. For Q4, the marketing expenses have come down sequentially compared to Q3. The big reason is because of the deconsolidation of Qunar, Qunar's result was included for one month. And so the sequential decrease in sales and marketing expenses, the biggest component is because of Qunar.

Also what's happening in Q4 was, we have increased focus on measuring the effectiveness of the promotional events related to our Transaction Services. And we're continuing on that effort going into 2016. So, the sequential sales and marketing expense reduction is mainly because of that.

At the same time, when you look at active online marketing customers, the sequential decrease is again mainly attributable to the deconsolidation of Qunar. Net-net, as I mentioned in the earlier comment, year-on-year, there is about 18% increase on active online marketing customers, if we look at apples-to-apples comparison. And sequentially, if without the Qunar's impact, there is a sequential online marketing customer increase as well.

We launched the Local Express business last year. And the full speed ahead of adding these customers online for the service is mainly happening this year, and as Robin mentioned in his prepared remarks. So, as you are looking at Q4 numbers, these active online marketing customers are now yet included in there.

**Operator**

Thank you. Your next question comes from the line of Eddie Leung from Merrill Lynch. Please go ahead.

**Eddie Leung - Merrill Lynch Far East Ltd.**

Good morning. Thank you for taking my question. Just have a question on mobile monetization. We heard Robin saying that, he expects mobile monetization one day could surpass PC. So just wondering, if we can get a little bit granularity on his thought, qualitatively. Are we thinking about from an inventory point of view that mobile could have more inventory than PC, or are we thinking about the conversion rate and click through rates could be better than PC and why? Thanks.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Yeah. When I talk about mobile monetization capabilities, it has nothing to do with inventory. Of course, mobile traffic continue to grow at a very solid rate, but I was more talking about the monetization capability measured by CPM, where, how much money we can make by each search query on mobile.

I think, that the click-through rate and conversion can be higher than it is on PC, because on mobile, we can be more targeted and we know more about the users, we know the location, exact location of the user and we can enable all kind of user actions on the mobile. Because of the smaller screen for mobile phones, actually the click-through rate can naturally be higher, because the nature of the queries on mobile are more towards local services, which inherently have more commercial value than those more content-driven query. And because we have more service-oriented query on mobile and relatively less content-driven query on mobile, I think eventually the monetization capability for mobile will be higher than the PC.

**Eddie Leung - Merrill Lynch Far East Ltd.**

That's all. Very helpful. Thank you.

**Operator**

Thank you. Your next question comes from the line of Chi Tsang from HSBC. Please go ahead.

**Chi Tsang - The Hongkong & Shanghai Banking Corp. Ltd. (Broker)**

Good morning. Thanks for taking my questions. I have two questions. My first question is, revolves around machine-learning. So, machine-learning has already helped your core search business driving relevant results in click-through rates. I'm wondering over the next two years to five years what are some of the other commercial applications for your investment in machine-learning, and also how big is your lead in machine learning relative to your competitors?



And secondly, in regards to O2O – I was wondering if you can sort of comment on the overall competitive intensity in the marketplace today. And I'm wondering whether or not you've moved past the stage of heavy subsidies and on to more customer retention. Thanks so much.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Yeah. Our machine learning is a fundamental technology to (40:20). Five years ago, search was pretty much based on statistical tactics. These days, the search algorithm itself is pretty much machine-learning. So far, a lot of our existing products and services including the algorithmic search, pay search, the query side based on voice, based on images, those are all very heavily driven by machine learning, especially deep learning technologies. And I'm actually very proud of our speech recognition capability.

So, now when you talk to Mobile Baidu, the accuracy is very high and generally the result is very relevant. So, people are increasingly using Mobile Baidu in the voice format, query format. So, those are all very valuable and not exactly directly making money, but it enhances the stickiness of our search service, therefore, it will be able to make more money for us going forward.

And there are those other new areas that can also benefit from machine-learning and the self-driving car is one apparent example. You asked for two years to five years of horizon, but I think self-driving car can become a commercial product probably within the next five years. So that is very dependent on our machine learning and artificial intelligence capabilities.

And on the O2O competitive landscape, yeah, the reality is that it's not that heavily subsidized (42:42) for the past quarter or so. But more importantly, I think Baidu's O2O initiative is tightly integrated with our search services, and will be even integrated tighter going forward. So, people who goes through Mobile Baidu or goes through Nuomi or goes through Baidu Maps, they have a clear impression that they can get quality local services or O2O services from our offerings.

And for those very high frequent O2O activities, such as movie tickets, restaurant, it will continue to be low margin or we will not be able to make money out of it any time soon, but it actually drives the stickiness to our service offerings. Therefore, we can make money out of those lower frequency activities such as auto repairing, moving services. So, I think longer term, the overall Baidu platform will benefit deeply from our O2O initiative.

### **Operator**

Thank you. Your next question comes from the line of Wendy Huang from Macquarie. Please go ahead.

### **Wendy Huang - Macquarie Capital Securities Ltd.**

Thank you. So, the number of the advertisers decreased sequentially. I just wonder whether that has anything to do with macro slowdown in China. And also on another hand, it actually reflects – ARPU increased significantly, whether it was more driven by the key accounts ARPU expansion, or it was more due to the mobile CPC expansion that you mentioned earlier? Also a small question, so what percentage of your search traffic right now is video related? Thank you.

### **Jennifer Li - Chief Financial Officer**

The sequential customer count decreased as well as the ARPU that you were seeing, is the resulting effect of the deconsolidation of Qunar. So, basically, the Qunar's whole population of customers are now counted in this number. And overall, on balance, Qunar's customer also has a lower ARPU on balance. So, as a result, you see the reduction in active online marketing customers and somewhat step-up in ARPU.

### **Wendy Huang - Macquarie Capital Securities Ltd.**

So, what's the organic advertisers number in Q4 then? Is the difference between two quarters is the pure Qunar number?

**Jennifer Li - Chief Financial Officer**

There should be a net increase of less than 30,000 customers.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Yeah. On the video content, it has been a very important vertical for Baidu, a lot of users search for videos and content on Mobile Baidu, that has been said that I think we need to continue to improve the user experience, so that we'll be able to match those independent native apps related to video.

**Wendy Huang - Macquarie Capital Securities Ltd.**

Thank you.

**Operator**

Thank you. Your next question comes from the line of Ming Zhao from 86Research. Please go ahead.

**Ming Zhao - 86Research Ltd.**

Thank you for taking my question. Jennifer, I want to ask about your guidance for the expense. You said that 2016, the expense would be the run rate of second half's expense. Can you clarify if the second half's expense includes Qunar's expense or not, and relating to this question just on the O2O business, so we have seen the consolidation in the market.

Your expense, how does that compare with the RMB 20 billion expense invested in this area? You guys said before, is it more or less what are you currently thinking about the O2O business? Are you still trying to gain market share or have you started working on the monetization a little bit? Thank you.

**Jennifer Li - Chief Financial Officer**

Basically, we're trying to give you some visibility into the movement of the different line items. As you know that, we typically do not provide guidance,

but whenever there are significant changes in our business, we'll try to provide as much clarity as possible. So basically, I highlighted three line items of expenses to bring to your attention, these are related to transaction services cost as well as iQiyi. So for transaction services cost, the two line items, one is the operational cost and one is SG&A. And so last year, the operational cost is stepped up mainly because of the handling expenses related to Transaction Services and also there is a component for iQiyi as well. And going into 2016, as I mentioned earlier, you should expect a similar but a slightly more moderate rate of increase for operational expenses.

For SG&A, if you recall, we kicked in the full throttle our efforts for the transaction services in the second half of the year. And so, the major step-up in SG&A last year is because of Qunar, it's because of Baidu's own effort. And the run rate you see for the second half of last year is representative as we move into the 2016 level. So you can see that is basically kind of the momentum has been built, the investment has kicked in action and there is no major swings of the activity or focus that we're doing. So, that momentum will carry on in 2016.

With regards to the RMB 20 billion that we refer to last year that was related to Nuomi, our O2O service platform, that is an investment that is still ongoing and there is no change in the plan. When you look at Transaction Services, included in there is not only Nuomi, there is also Takeout Delivery service, there is also Wallet and other services like Map are all included in the Transaction Services. So, the RMB 20 billion you mentioned is a component of the overall Transaction Services.

### **Robin Li - Co-Founder, Chairman and Chief Executive Officer**

So for the success of O2O, it's not really measured by market share. We care more about the service quality and the user experience people get from Baidu Nuomi, from Baidu Maps and Mobile Baidu. So, we care more about the coverage, how many restaurant do we cover, the price, are we giving

our consumers the best price on the market and how convenient it is for users to buy from us. So, as far as we can provide the best service quality in a most of convenient way for people to buy from the Baidu platform, I think eventually we will all be able to make money. So, the overall goal is not to drive our market share, but to ensure service quality.

**Ming Zhao - 86Research Ltd.**

Thank you.

**Operator**

Thank you. Your next question comes from the line of Piyush Mubayi from Goldman Sachs. Please go ahead.

**Piyush Mubayi - Goldman Sachs (Asia) LLC**

Thank you for the opportunity. Robin, I have a question first on the long-term outlook for search both you could spell that out in terms of the number of years you could expect search to outperform overall ad spend or any other metric that you think is a better way to express that?

And a second question and very quick one is, an initial sense of the sort of take rates we can expect in the different O2O segments, food delivery, cinema tickets, local repair, et cetera. Thank you.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

I think search is still quickly evolving. It's actually in the mobile age. I talked a lot about integrating services into search offerings. And so, I think it largely depend on how did we execute on our strategy. If we can provide the best experience for people – to connect people with services, I think the long-term growth rate for search will be able to outpace the overall advertising market. If we cannot do a good job on this kind of new initiative then it will probably on par or even grow slower than the overall advertising market.

And the take rate for O2O business will vary from one vertical to another. Restaurant could be different, Takeout Delivery could be different and auto repairing or moving services can all be very different. In the near-to-mid-term, it's largely driven by competition, but longer term I think many of the verticals can have take rate as high as like 20%, but the more frequent that activities are the lower the take rate will be.

**Piyush Mubayi - Goldman Sachs (Asia) LLC**

Thank you.

**Operator**

Thank you. Your next question comes from the line of Natalie Wu from CICC. Please go ahead.

**Natalie Wu - CICC**

Hi. Good morning, Robin, Jennifer and Sharon. Thanks for taking my question. I have two questions actually. The first one, you have mentioned in your transcript that number of outstanding customers and ARPU does not include Nuomi and Qunar in the fourth quarter. So, if I multiply those two items and subtract from online marketing revenue, also take out Qunar one-month contribution, should it be the revenue of Nuomi, mainly Nuomi, if the calculation right? So, how come what I generate is the negative number?

And the second one is in terms of your search business. So, just wondering, what's the current contributions from your direct sales, also from your agency? And what's the current contributions from KA and SME? And have you noticed any difference in terms of KA and SME spending, PC or mobile, especially during economic headwind? Thank you.

**Jennifer Li - Chief Financial Officer**

Natalie, to your first question, I'm not sure, I fully understand. For Qunar because of the deconsolidation, they are excluded from the customer account. Excluding the Qunar's effect, on apples-to-apples basis

sequentially, there is a customer count increase. And the Nuomi's customers, because it's a different model. It's not an online advertising, online marketing model, so their customer count are never included in the online marketing customer base.

**Natalie Wu - CICC**

Yes. But just that I multiplied the customer number with the ARPU and I got a number, and I subtract that number from your online marketing revenue, also I take out the Qunar one-month contribution from your online marketing revenue. So, should I get the revenue of Nuomi by that method?

**Jennifer Li - Chief Financial Officer**

No, because Nuomi's revenue is not online marketing. But I think, Natalie, I don't clearly understand the question, your calculation, maybe we can follow-up with you.

**Natalie Wu - CICC**

Sure. Sure. So, what about the second question?

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Okay. On the second question from the sales point of view, we have three segments, the direct sales, channel sales and the KA sales. Direct sales is pretty much 100% direct. We don't use the agency. And channel sales, we rely on our channel partners. They generally do not use agency either. For the KA sales, I think, majority of its revenue comes from agency.

**Natalie Wu - CICC**

Okay. Thanks, Robin. What's that current maybe contribution percentage, can management share a little bit color on that?

**Jennifer Li - Chief Financial Officer**

We have not in a path to a breakdown the components of the different sales unit, but what you should know is, majority of our revenue comes from SME. KA is a very important component as well. And so, I think the pattern itself hasn't really changed over the years. And I think these three are equally important for us.

**Natalie Wu - CICC**

Okay. Thank you, Jennifer and Robin.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Thank you.

**Operator**

Thank you. Your next question comes from the line of Claire Cao from Morgan Stanley. Please go ahead.

**Claire Cao - Morgan Stanley Asia Ltd.**

Hi, management. Thanks for taking my questions. I'm asking on behalf of Rob Lin. I have two questions. The first one is that, we noticed that local services is growing well, but mobile map MAU declined 7% quarter-on-quarter. Just wondering what's the reason behind that. And the second question is that, can we have a decomposition of other revenue? What's the contribution of Qunar and iQiyi for the quarter? Thanks.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

I didn't quite get the first question. What's declining?

**Claire Cao - Morgan Stanley Asia Ltd.**

The MAU of our mobile map.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**



MAU. Mobile map. It's purely seasonal. During the summer holiday people travel more, so, they all use map more. So, on year-over-year basis, the growth pattern is very normal.

**Claire Cao - Morgan Stanley Asia Ltd.**

Okay. Thanks. Then, how about the second question?

**Jennifer Li - Chief Financial Officer**

We I think that we do have segment reporting due in the 20-F timeframe. And you would have a view of the full picture for iQiyi. And the Qunar has been included in Transaction Services. And in particular for this one quarter, it's results is going to be included in the Ctrip's results. And I don't think it's time for them yet to report on their results yet. So, we're not in a position to disclose that.

**Claire Cao - Morgan Stanley Asia Ltd.**

Understood. Thanks.

**Operator**

Thank you. Your next question comes from the line of Thomas Chong from Citigroup. Please go ahead.

**Thomas Chong - Citigroup Global Markets Asia Ltd.**

Hi. Thanks for taking my questions. My first question is about your Baidu Wallet strategy. Given the number of wallet users is over 50 million compared to your competitors, which have a much bigger scale. So, I just want to get a sense about how your Wallet strategy in 2016 will help you to catch-up with the leading players?

And my second question is, about your use of cash. How we should think about – management think about paying dividends et cetera? Thanks.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Yeah. On the Wallet, I have said during the prepared remarks, we care more about integration than the competition. We strive to provide the best user experience when people initiate their query on Baidu. They could search on Mobile Baidu; they could search Baidu Maps; they could search something on Baidu Nuomi. From their query until transaction is completed. We want to make sure that this kind of experience is the best. And we cover hundreds of millions of users on our Mobile Baidu app and Mobile Maps.

So, we would like to cover this users to Baidu Wallet too. That's why we've been driving the adoption rate of Baidu Wallet. By having this fully-integrated experience, we think we can monetize all the users through all kinds of steps of their online activities. So, our goal is not to catch up to other payment platforms, our goal is to integrate with our existing services.

**Jennifer Li - Chief Financial Officer**

And then for the cash balance, we do have about RMB 68 billion of cash. And the business has a very strong cash generation capability, and, we continue to generate positive and very strong operating cash flows. Having said that, as you can also see, we're in a strong investment mode to take the opportunity that's really presented by the mobile developments. We are investing significantly in the Transaction Services area. And so, there, we still see a lot of opportunities ahead of us. And we want to retain the cash as our strategic tool to build organic services as well as use it for M&A purposes.

Having said that, I think we do keep in mind that if we have excess cash, we'll be open minded to deploy that through different ways of shareholder payback. Dividend may not be in the plan as of now, but we do have share buyback plans proposed by the board. So when the opportunity is right and we see the good return for our cash, we'll deploy the cash accordingly.

**Thomas Chong - Citigroup Global Markets Asia Ltd.**

Thanks, Robin and Jennifer.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Thank you.

**Operator**

Thank you. Your next question comes from the line of Jason Helfstein from Oppenheimer. Please go ahead.

**Bo Pang - Oppenheimer & Co., Inc. (Broker)**

Thank you, management for taking my question. This is Bo, asking question on behalf of Jason. So, I have two questions, basically. The first one, just want to follow-up on the core search revenue growth. So, if my calculation is correct, the fourth quarter and potentially the one quarter guidance implying a mid-20% to high-20% year-over-year growth. Just want to clarify on that.

And trying to correctly understand the trend going forward, as Robin just commented that as we better collected and analyzed the data point. So, we're potentially seeing the mobile monetization capability to continue to grow and catch up on the PC monetization, and ultimately drive the ARPU or accelerate the ARPU going forward. And also, as we continue to on-board more and more local transaction accounts, we're seeing the number of advertisers to continue to grow as well. So basically, we are seeing the strengths coming from both the number of advertiser and revenue per advertiser. Just want to clarify on that as well.

And my second question is basically that trying to follow-up on the margin impact from the non-core business, including particularly iQiyi and O2O business. Thank you.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Yeah. That's a lot of questions, but the simple answer is that, for the first question that your calculation is correct. And for the second question, you are right, the number of customers and the monetization capability will all grow. I did not get the third question.

**Jennifer Li - Chief Financial Officer**

Didn't quite understand your margin question.

**Bo Pang - Oppenheimer & Co., Inc. (Broker)**

Yeah. So, previously management provided the operating margin impact from iQiyi and Nuomi separately. So that we have better visibility on the core search operating margin. So, just want to know if management can continue to provide that color.

**Jennifer Li - Chief Financial Officer**

Yes, certainly. We did do that in this release as well, and we are providing the full segment reporting in 20-F as well.

**Bo Pang - Oppenheimer & Co., Inc. (Broker)**

Okay. Thank you, management.

**Operator**

Thank you. Your next question comes from the line of Erica Poon from UBS. Please go ahead.

**Erica Poon Werkun - UBS Securities Co. Ltd.**

Hello. Thank you. Hi, Robin. Just in light of the softer macro, how do you expect the industry's online advertising budget to change in 2016 versus last year. And do you expect Baidu's overall market share of this budget to go up or down combining search, online video, Transaction Services, et cetera?  
Thank you.

**Robin Li - Co-Founder, Chairman and Chief Executive Officer**

Yeah. I've said this repeatedly. Search is a very unique in the sense that it's always traffic bound instead of budget bound. The supermajority of our customer's online, marketing customers, they always want to buy more

traffic from us. So, our focus has always been to try to improve the user experience, try to provide better ways for people to find what they're looking for. And as long as we can provide that, we can generate inventory. There's enough appetite to buy this kind of inventory from us. So, it's not that proving to the pinnacle.

**Erica Poon Werkun - UBS Securities Co. Ltd.**

Great. Thank you.

**Operator**

Thank you. Ladies and gentlemen, thank you for the participation in today's conference. This concludes the presentation. You may now disconnect. Good day.