Flash | Citi Research

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China Internet

Thoughts on Inclusion of BABA & Baidu to US DoD's Latest List

CITI'S TAKE

We view inclusion of Alibaba and Baidu in the US' latest Department of Defense (DoD) list as having limited fundamental impact, in line with historical precedents. First, Alibaba and Baidu do not have direct business exposure to DoD, and both companies have disputed the designation through separate statements to CNBC (8-Jun) and Reuters (9-Jun). We believe the inclusion to the DoD list is unlikely to translate into revenue or earnings impact. Second, the previous case of Tencent, which was added to the same list in January 2025 provides a useful reference point (link). The designation did not trigger operational restrictions or ownership limitations with limited impact on business fundamentals of Tencent. Judging from the relatively muted share-price reaction for BABA and Baidu during Hong Kong trading hours, we believe most investors are aware that inclusion to this list does not necessarily result in actual sanctions or affect fundamental business operations.

Alicia Yap, CFA[AC]

Vicky Wei, CFA

Nelson Cheung

What's new – On June 8, the US Department of Defense (link) added Alibaba, Baidu and other Chinese companies to its updated 1260H list of Chinese companies it views as linked to China's military. Under the rules, the Defense Department will be barred from contracting directly with the listed companies later this month, while restrictions on procuring their products or services indirectly through third parties will take effect from June 2027.

Reactions from Alibaba and Baidu – Alibaba has disputed the designation and pledged to seek its removal. *"There's no basis to conclude that Alibaba should be placed on the Section 1260H List. Alibaba is not a Chinese military company nor part of any military-civil fusion strategy. We will take all available legal action against attempts to misrepresent our company,"* the company said in a statement to CNBC June 8th EST (link). Separately, according to a Reuters report dated June 9th (link), Baidu "categorically" rejected its inclusion on the list, and has said: "*The suggestion that Baidu is a military company is entirely baseless. We will not hesitate to use all options available to us to have the company removed from the list.*" Baidu also issued a press release on June 9th that said: "*The CMC List is not a sanctions list. The U.S. government procurement limitations tied to the list will not impact the business of the Company, and the CMC List does not restrict transacting in the securities of the Company*".

Jan 2025 list – As we noted in aprevious report, Tencent was included in the updated list from January 2025 and we noted at the time that "the inclusion in the list does not necessarily suggest that there is sufficient evidence." More than 1.5 years later, Tencent's fundamentals and business operations appear intact and have not been affected by the inclusion to the list.

Alibaba

(9988.HK; HK$118.8; 1; 08 Jun 26; 16:10)

Valuation

Our target price for Alibaba H-shares of HK$207 is based on 10x P/E on FY2027E Ecommerce Group net profit, 7.0x P/S on FY2027E Cloud Intelligence Group revenue, 2.0x P/S on AIDC Group revenue, and 1.0x P/S on all other businesses. Our target multiples are benchmarked against comps. We also assign a 30% discount to net cash position, in-line with our SOTP for other internet peers. Our SOTP fair value comes to HK$207 per H-share.

Risks

Key downside risks that could prevent the shares from reaching our target price include: (i) failure in executing its new retail strategy; ii) investment spend and margins pressure become worse than expected; iii) slowdown of user traffic and online GMV and losing appeal to brands & merchants; iv) integration risks for newly acquired entities; v) slowdown of the Chinese and global economies and overhang of US-China or other trade disputes; and vi) regulatory risks on poor product quality and integrity of merchants.

Alibaba Group Holding

(BABA.N; US$120.07; 1; 08 Jun 26; 16:00)

Valuation

Our target price for Alibaba N-shares of US$208 is based on 10x P/E on FY2027E Ecommerce group net profit, 7.0x P/S on FY2027E Cloud Intelligence Group revenue, 2.0x P/S on AIDC Group revenue, and 1.0x P/S on all other businesses. Our target multiples are benchmarked against comps. We also assign a 30% discount to net cash position, in-line with our SOTP for other internet peers. Our SOTP fair value comes to US$208 per share.

Risks

Key downside risks that could prevent the shares from reaching our target price include: (i) failure in executing its new retail strategy; ii) investment spend and margins pressure become worse than expected; iii) slowdown of user traffic and online GMV and losing appeal to brands & merchants; iv) integration risks for newly acquired entities; v) slowdown of the Chinese and global economies and overhang of US-China or other trade disputes; and vi) regulatory risks on poor product quality and integrity of merchants.

Baidu.com

(BIDU.O; US$119.1; 1; 08 Jun 26; 16:00)

Valuation

Our SOTP-derived target price for Baidu shares of US$188 is based on:

(1) Baidu Core (search only) P/E of 3x on 2026E non-GAAP estimated core search net profit of US$1.52bn (assuming 20.8% net margins).

(2) Baidu AI Cloud (excluding Kunlunxin revenue) P/S of 3.5x on 2026E AI Cloud revenue only (excluding embedded revenue from Kunlunxin) of US$6.59bn to get US$23bn or US$66.6 per share.

(3) Kunlunxin: We forecast Kunlunxin revenue to reach US$1.43bn in 2026 and apply 20x P/S multiple to get US$28.7bn valuation. Reflecting Baidu likely retaining a 50% stake post potential public listing of Kunlunxin and applying a 25% holdco discount, we arrive at US$10.8bn or US$31.1 per share contribution to SOTP.

(4) Autonomous driving: Given limited information on current robotaxi revenue and that total completed rides by Baidu's robotaxi are higher than Pony's, we believe using the current Pony.ai market value of US$5bn is a reasonable comparison. We also apply a 25% discount to holdco and hence get US$3.75bn or US$10.8 per share.

(5) We include the 48% iQiyi (IQ) stake based on our target price valuation; the 7.1% stake in Trip.com based on conservatively applying a 25% discount to the market value; and a 50% discount to the net cash balance to reflect a portion of the long-term asset potentially being less liquid.

Our US$188 TP implies 24x/21x our consolidated 2026E/27E non-GAAP EPADS, which reflects much lower operating profit from the high-margin core ad business.

Risks

Downside risks that could impede the Baidu shares from reaching our target price include: 1) the search business recovers more slowly than expected and the ad budget loses share to competitors; 2) news feed ads face tougher competition from the incumbents; 3) a further slowdown in China's economy (including from the coronavirus outbreak) affects overall advertising sentiment; and 4) regulatory actions lead to further adjustments in search results inventory.

iQIYI

(IQ.O; US$1.05; 1; 08 Jun 26; 16:00)

Valuation

We use P/S multiple to value iQiyi with target price of US$1.8. We use P/S multiple because there are big swings in recent quarterly earnings depending on content performance and the subscription business model has leverage impact on profit, while iQiyi's revenue scale remains largely predictable.

We assign a 0.5x P/S multiple on 2026E revenue. The 0.5x P/S is at a 90% discount vs industry leader, to reflect iQiyi's smaller size, more intensified competition environment in China, as well as its tight cash flow status.

Risks

Downside risks include: 1) limited visibility of top-line revenue growth and risks of faster-than-expected cash-burn rate; 2) reliance on a content pipeline to retain viewership traffic, with hit-or-miss risks and content delays issues from regulatory headwinds; 3) competitive environment from other entertainment time spent such as short video platforms; and 4) weak capital position vs. some competitors. Any of these risks could impede the shares from reaching our target price.

Tencent Holdings

(0700.HK; HK$446.4; 1; 08 Jun 26; 16:10)

Valuation

Our target price of HK$763 is based on a SOTP approach, which implies 23.0x 2026E and ~21.7x 2027E P/E. Our SOTP is based on the following: 1) Online games – We apply a 12x P/E to our 2027 estimated games net profit of Rmb134bn and yield a valuation of HK$194 per share, or 25% of our target price; 2) Online advertising – We apply a 20x P/E to our 2027 estimated ads profit of Rmb84bn which yields a valuation of HK$202 per share, or 26% of our target price; 3) Social network – While we attribute the non-gaming revs (community platform revs) as overall social network revs, given the WeChat, QQ, and other Tencent apps, we apply a 25x P/E to the estimated profit of Rmb62bn and yield a valuation of HK$187 per share, or 24% of our target price; 4) Fintech – We apply a 15x P/E to our estimated profit of Rmb49bn and yield a valuation of HK$88 per share, or 12% of our target price; 5) Cloud/business services – We apply a 5x P/S (average of China peers) to our 2027 estimated Business services revs of Rmb70bn, which yields a valuation of HK$42 per share, or 6% of our target price; 6) Investment portfolio – We apply a 30% discount to the equity stake in the publicly listed investment portfolio which implies HK$51/share.

Risks

Downside risks that could prevent the Tencent shares from reaching our target price include: i) a faster-than-expected revenue slowdown in core PC games; ii) unsuccessful launches of new mobile games; iii) a decline of Honor of Kings ranking and momentum; iv) a further slowdown in China's economy, which might negatively affect advertising demand; and v) a change in the regulatory environment.