Baidu.com, Inc.
Form 424B4
August 05, 2005
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Filed Pursuant to Rule 424(b)(4)

Registration No. 333-126534

Baidu.com, Inc.

4,040,402 American Depositary Shares

Representing

4,040,402 Class A Ordinary Shares

This is an initial public offering of American depositary shares, or ADSs, of Baidu.com, Inc., or Baidu. Baidu is offering 3,208,696 ADSs, and the selling shareholders disclosed in this prospectus are offering an additional 831,706 ADSs. Each ADS represents one Class A ordinary share. The ADSs are evidenced by American depositary receipts, or ADRs.

Prior to this offering, there has been no public market for the ADSs or the shares. The ADSs have been approved for listing on the Nasdaq National Market under the symbol BIDU.

See Risk Factors beginning on page 10 to read about risks you should consider before buying the ADSs.

Neither the United States Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

	Per ADS	Total
Initial public offering price	US$ 27.00	US$ 109,090,854
Underwriting discount	US$ 1.89	US$ 7,636,360
Proceeds, before expenses, to Baidu	US$ 25.11	US$ 80,570,357

Proceeds, before expenses, to the selling shareholders	US$ 25.11	US$ 20,884,138

The underwriters have an option to purchase up to an additional 481,304 ADSs from Baidu and an additional 82,518 ADSs from certain selling shareholders at the initial public offering price less the underwriting discount.

The underwriters expect to deliver the ADSs evidenced by the ADRs against payment in U.S. dollars in New York, New York on August 10, 2005.

Goldman Sachs (Asia) L.L.C. **Credit Suisse First Boston**

Piper Jaffray

Prospectus dated August 4, 2005.

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No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the ADSs offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information in this prospectus is current only as of the date of this prospectus.

In connection with this offering, Goldman Sachs (Asia) L.L.C., Credit Suisse First Boston LLC or any person acting for either of them may over-allot or effect transactions with a view to supporting the market price of the ADSs at a level higher than that which might otherwise prevail for a limited period of time after the issue date. However, there is no obligation on Goldman Sachs (Asia) L.L.C., Credit Suisse First Boston LLC or their respective agent to do this. Such stabilization, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

This prospectus contains translations of certain RMB amounts into U.S. dollars at specified rates solely for the convenience of the reader. Unless otherwise noted, all translations from RMB to U.S. dollars were made at the noon buying rate in The City of New York for cable transfers in RMB per U.S. dollar as certified for customs purposes by the Federal Reserve Bank of New York, or the noon buying rate, as of June 30, 2005, which was RMB8.2765 to US$1.00. We make no representation that RMB or U.S. dollar amounts referred to in this prospectus could have been or could be converted into U.S. dollars or RMB, as the case may be, at any particular rate or at all. On August 1, 2005, the noon buying rate was

RMB8.1046 to US$1.00.

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PROSPECTUS SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information and financial statements appearing elsewhere in this prospectus. In addition to this summary, we urge you to read the entire prospectus carefully, especially the risks of investing in our ordinary shares and ADSs discussed under Risk Factors, before deciding whether to purchase our ordinary shares or ADSs.

Our Business

We are the leading Chinese language Internet search provider. Our search engine was the most frequently used search engine in China in 2004, according to a survey conducted by Shanghai iResearch Co., Ltd., or iResearch, a market research firm specializing in China s Internet industry. Our Baidu.com website was the second largest website in China and the sixth largest website globally, as measured by user traffic that reflects page views and reach during the three-month period ended July 31, 2005, according to Alexa.com. We offer a unique Chinese language search platform for both users and customers. Our platform consists of our websites and Baidu Union, which is our network of third-party websites.

Our services are designed to enable Internet search users to find relevant information online, including Chinese language web pages, news, images and multimedia files, through links provided on our websites. We provide our users with easy access to an index of over 740 million web pages, 80 million images and 10 million multimedia files. We also offer a query-based online community, Baidu Post Bar, which currently consists of over 820,000 message boards.

Our auction-based pay-for-performance, or P4P, services enable our customers to bid for priority placement of their links in keyword search results. We believe we were the first auction-based P4P service provider in China. Our online advertising services allow customers to use both query sensitive and non-query sensitive advertising services, including text links, graphical advertisements and other forms of online advertising. We design and deliver our services to our P4P and tailored solutions customers based on their online marketing requirements. Our P4P customers are those who primarily use our auction-based P4P services, and our tailored solutions customers are those to whom we provide marketing solutions, which may consist of one or more forms of our online advertising services as well as P4P services. In 2004, we had over 34,600 online marketing customers.

Founded in January 2000, we launched Internet search services on our Baidu.com website and began generating revenues from P4P services in September 2001. We began offering other online marketing services in July 2003. We have grown significantly since we commenced operations. Our total net revenues increased from RMB10.5 million in 2002 to RMB110.9 million (US$13.4 million) in 2004, representing a compound annual growth rate, or CAGR, of 224.6%. In the three months ended March 31, 2005, we generated total net revenues of RMB42.6 million (US$5.2 million).

Our Industry

The Internet search industry in China is evolving rapidly as an increasing number of people seek information, products and services via the Internet. According to iResearch, the number of Internet search users in China is projected to grow from 115 million in 2005 to 187 million in 2007, representing a CAGR of 27.5%. With the growth of Internet usage and the rapid development of China s Internet search market, online marketing has become more widely adopted. According to a 2003 report published by IDC, a leading market research firm, total online marketing revenues in China would amount to approximately US$130 million in 2004. The paid search market is expected to be the fastest growing segment of online marketing in the Asia Pacific region (excluding Japan) through 2007.

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China s Internet search industry presents unique challenges and opportunities. Chinese language search engines must address the needs of Internet users in China, who generally search online for a broad variety of information, including Chinese language web pages, news, multimedia files and images. Chinese language search engines must also develop special language processing technologies to generate relevant results due to the complexities associated with the Chinese language and Chinese keyword searches. Moreover, Chinese language search engines providing paid search services must develop an effective distribution network to acquire customers, collect payments and provide customer service since China s paid search customers are largely comprised of a broad and fragmented base of small to medium-sized enterprises, or SMEs.

Our Strengths, Strategies and Risks

We believe that our leading position in China is primarily attributable to the following strengths:

largest Chinese language search audience as measured by user traffic;

first P4P service provider in China with an extensive customer base across industries;

one of the most widely recognized Internet search brands in China, enhancing our ability to attract both users and customers;

local market experience and expertise in introducing and expanding our services across China and operating in China s rapidly evolving Internet industry;

leading technology with a proven platform providing users with relevant search results and customers with a cost-effective way to reach potential consumers; and

extensive and effective nationwide network of over 200 regional distributors, providing high-quality and consistent customer services.

Our goal is to become a platform that provides Internet users with the best way to find information and allows businesses to reach a broad base of potential customers. We intend to achieve our goal by implementing the following strategies:

enhancing user experience and increasing traffic through the development and introduction of new search-related features and functions;

growing our online marketing business by attracting potential customers and increasing per-customer spending on our services;

expanding Baidu Union by leveraging our brand and offering competitive economic arrangements to Baidu Union members; and

pursuing selective strategic acquisitions and alliances that will allow us to increase user traffic, enlarge our customer base, expand our product offerings and reduce customer acquisition costs.

The successful execution of our strategies is subject to certain risks and uncertainties, including our ability to:

- maintain our leading position in the Internet search industry in China;

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- offer new and innovative products and services to attract and retain a larger user base;
- attract additional customers and increase per-customer spending;
- increase awareness of our brand and continue to develop user and customer loyalty;
- respond to competitive market conditions;
- respond to changes in our regulatory environment;
- manage risks associated with intellectual property rights;
- maintain effective control of our costs and expenses;
- raise sufficient capital to sustain and expand our business;
- attract, retain and motivate qualified personnel; and
- upgrade our technology to support increased traffic and expanded services.

Please see Risk Factors and other information included in this prospectus for a discussion of these risks.

Our Corporate Information

We were incorporated in the Cayman Islands in January 2000. Since our inception, we have conducted our operations principally through Baidu Online Network Technology (Beijing) Co., Ltd., or Baidu Online, our wholly owned subsidiary in Beijing, China. In addition, we have conducted part of our operations through Baidu Netcom Science and Technology Co., Ltd., or Baidu Netcom, a limited liability company in Beijing, China, which holds the licenses and approvals necessary to operate our websites and provide online advertising services. See Corporate Structure for a description of the contractual arrangements among Baidu Online and Baidu Netcom and its shareholders. In June 2005, we established Baidu (China) Co., Ltd., or Baidu China, a wholly owned subsidiary in Shanghai, China. We intend to manage our business and operations in the southern part of China through Baidu China in the future.

Our principal executive offices are located at 12/F, Ideal International Plaza, No. 58 West-North 4th Ring, Beijing 100080, People s Republic of China. Our telephone number at this address is +86 (10) 8262-1188. Our registered office in the Cayman Islands is located at M&C Corporate Services Limited, P.O. Box 309 GT, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands. Our telephone number at this address is +1 (345) 949-8066. We also have regional offices in Shanghai and Shenzhen, China.

Investors should submit any inquiries to the address and telephone number of our principal executive offices set forth above. Baidu.com is our website and the information contained on this website is not a part of this prospectus. Our agent for service of process in the United States is CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011.

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Our Corporate Structure

PRC law currently limits foreign ownership of companies that provide Internet content and advertising services. To comply with these foreign ownership restrictions, we operate our websites and provide online advertising services in China through Baidu Netcom, a PRC limited liability company wholly owned by our co-founder and chief executive officer, Robin Yanhong Li, and our co-founder, Eric Yong Xu, both of whom are PRC citizens. Baidu Netcom holds the licenses and approvals necessary to operate our websites and to provide online advertising services in China. We have contractual arrangements with Baidu Netcom and its shareholders pursuant to which we provide technology consulting services and license our registered domain names, trademarks and certain software to Baidu Netcom. Through these contractual arrangements, we also have the ability to substantially influence Baidu Netcom s daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. As a result of these contractual arrangements, which enable us to control Baidu Netcom, we are considered the primary beneficiary of Baidu Netcom. Accordingly, we consolidate Baidu Netcom s results, assets and liabilities in our financial statements. For a description of these contractual arrangements, see Corporate Structure Contractual Arrangements with Baidu Netcom and its Shareholders.

The following diagram illustrates our current corporate structure and the place of formation, ownership interest and affiliation of each of our subsidiaries and Baidu Netcom as of the date of this prospectus.

** A limited liability company incorporated in the PRC*

Equity interest

Contractual arrangements including business cooperation agreement, operating agreement, license agreements, proxy agreement and exclusive technology consulting service agreement. For a description of these agreements, see Corporate Structure Contractual Arrangements with Baidu Netcom and its Shareholders.

Contractual arrangements including proxy agreement, equity pledge agreement, option agreement, operating agreement, loan agreement and irrevocable power of attorney. For a description of these agreements, see Corporate Structure Contractual Arrangements with Baidu Netcom and its Shareholders.

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The Offering

The following information assumes that the underwriters will not exercise their option to purchase additional ADSs in the offering, unless otherwise indicated.

Offering price	US$27.00 per ADS
ADSs offered by us	3,208,696 ADSs
ADSs offered by the selling shareholders	831,706 ADSs
Class A ordinary shares outstanding immediately after this offering	4,344,877 shares
Class B ordinary shares outstanding immediately after this offering	27,973,716 shares
ADSs to Class A ordinary share ratio	Each ADS represents one Class A ordinary share.
Listing	The ADSs have been approved for listing on the Nasdaq National Market under the symbol BIDU. The ordinary shares and the ADSs will not be listed on any other exchange or traded on any other automated quotation system.
Ordinary shares	Holders of Class A ordinary shares and Class B ordinary shares have the same rights except for voting and conversion rights. Each Class A ordinary share shall be entitled to one vote on all matters subject to shareholders vote, and each Class B ordinary share shall be entitled to 10 votes on all matters subject to shareholders vote. Each Class B ordinary share is convertible into one Class A ordinary share at any time by the holder thereof. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances. Upon any transfer of Class B ordinary shares by a holder thereof to any person or entity which is not an affiliate of such holder, such Class B ordinary shares shall be automatically and immediately converted into the equal number of Class A ordinary shares.
The ADSs	The ADSs will be evidenced by ADRs.

The depositary will hold the shares underlying your ADSs. You will have rights as provided in the deposit agreement.

We do not expect to pay dividends in the foreseeable future. If, however, we declare dividends on our ordinary shares, the depositary will pay you the cash dividends and other distributions it receives on our Class A ordinary shares, after deducting its fees and expenses.

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	You may turn in your ADSs to the depositary in exchange for Class A ordinary shares. The depositary will charge you fees for any such exchange.
	We may amend or terminate the deposit agreement without your consent. If you continue to hold your ADSs, you agree to be bound by the deposit agreement as amended.
	To better understand the terms of the ADSs, you should carefully read the Description of American Depositary Shares section of this prospectus. You should also read the deposit agreement, which is filed as an exhibit to the registration statement that includes this prospectus.
Depositary	The Bank of New York
Options to purchase additional ADSs	We and certain selling shareholders have granted to the underwriters an option, which is exercisable within 30 days from the date of this prospectus, to purchase up to an additional 563,822 ADSs. See Underwriting for more information.
Timing and settlement for ADSs	The ADSs are expected to be delivered against payment on August 10, 2005. The ADRs evidencing the ADSs will be deposited with a custodian for, and registered in the name of a nominee of, The Depository Trust Company, or DTC, in New York, New York. DTC, and its direct and indirect participants, will maintain records that will show the beneficial interests in the ADSs and facilitate any transfer of the beneficial interests.
Use of proceeds	Our net proceeds from this offering are approximately US$77.0 million. We plan to use the net proceeds we receive from this offering: (i) to enhance our user experience; (ii) to expand our customer base; and (iii) for general corporate purposes. See Use of Proceeds for additional information.
	We will not receive any of the proceeds from the sale of ADSs by the selling shareholders.
Lock-up	We have agreed with the underwriters on a lock-up of ADSs or ordinary shares or securities convertible into or exchangeable or exercisable for any ADSs or ordinary shares for a period of 180 days after the date of this prospectus. In addition, our executive officers, directors and certain existing shareholders, who collectively hold approximately 94.8% of our outstanding shares immediately before this offering, have also agreed with the underwriters to a lock-up of ADSs or ordinary shares or securities convertible into or exchangeable or exercisable for any ADSs or ordinary shares for a period of 180 days after the date of this prospectus. Other than

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Google Inc., which holds approximately 2.6% of our total outstanding shares immediately before this offering, shareholders with ownership of 2% or more of our total outstanding ordinary shares on a fully-diluted basis immediately after the closing of this offering have also agreed with the underwriters to be subject to the lock-up restrictions for an additional 540-day period commencing on the date of the expiration of the 180-day lock-up period. Commencing on the date of the expiration of the 180-day lock-up period and at the beginning of each 180-day period thereafter until the expiration of the 540-day extended lock-up period, 25% of the shares held immediately after the completion of this offering of such shareholder will be released from the lock-up restrictions. See Shares Eligible for Future Sale and Underwriting.

In addition, we have instructed The Bank of New York, as depositary, and The Bank of New York has agreed, not to accept any deposit of any ordinary shares or issue any ADSs for 180 days after the date of this prospectus (other than in connection with this offering), unless we otherwise instruct. As a result, ADS holders who cancel their ADSs and withdraw the underlying ordinary shares will not be able to re-deposit such shares for issuance of ADSs until the expiration of the 180-day period described above. See Shares Eligible for Future Sale and Underwriting.

Risk factors	See Risk Factors and other information included in this prospectus for a discussion of risks you should carefully consider before investing in our ADSs.

The number of Class A ordinary shares that will be outstanding immediately after this offering excludes:

- 1,963,996 Class A ordinary shares issuable upon the exercise of options outstanding as of the date of this prospectus, at a weighted average exercise price of US$4.43 per share; and

- 1,214,984 Class A ordinary shares reserved for future issuance under our 2000 option plan.

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SUMMARY CONSOLIDATED FINANCIAL DATA

The following summary consolidated statement of operations data for the years ended December 31, 2002, 2003 and 2004 and the summary consolidated balance sheet data as of December 31, 2004 have been derived from our audited consolidated financial statements included elsewhere in this prospectus. The summary consolidated statement of operations data for the three months ended March 31, 2004 and 2005 and the summary consolidated balance sheet data as of March 31, 2005 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. We have prepared the unaudited consolidated financial information on the same basis as our audited consolidated financial statements. The unaudited financial information includes all adjustments, consisting only of normal and recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the periods presented. Our historical results do not necessarily indicate results expected for any future periods. In addition, our unaudited results for the three months ended March 31, 2005 may not be indicative of our results for the full year ended December 31, 2005.

You should read the summary consolidated financial information for those periods and as of those dates in conjunction with those statements and the accompanying notes and Management s Discussion and Analysis of Financial Condition and Results of Operations. Our consolidated financial statements are prepared and presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP.

	For the Year Ended December 31,				For the Three Months Ended March 31,		
(in thousands except for per share and per ADS data)	2002	2003	2004		2004	2005	
	RMB	RMB	RMB	US$	RMB	RMB	US$
Consolidated Statement of Operations Data							
Net revenues	10,524	38,638	110,909	13,401	17,150	42,628	5,151
Operating costs and expenses(1)	(29,567)	(47,933)	(99,905)	(12,071)	(16,208)	(39,889)	(4,819)
Operating (loss)/profit	(19,043)	(9,295)	11,004	1,330	942	2,739	332
Net (loss)/income	(18,577)	(8,885)	12,005	1,450	1,038	2,501	303
Net (loss)/earnings per share							
Basic	(2.44)	(0.87)	1.09	0.13	0.10	0.22	0.03
Diluted	(2.44)	(0.87)	0.43	0.05	0.04	0.08	0.01
Net (loss)/income per ADS(2)							
Basic	(2.44)	(0.87)	1.09	0.13	0.10	0.22	0.03
Diluted	(2.44)	(0.87)	0.43	0.05	0.04	0.08	0.01
Weighted average number of ordinary shares used in per share calculations							
Basic	7,622	10,189	10,983	10,983	10,876	11,508	11,508
Diluted	7,622	10,189	28,124	28,124	26,930	29,808	29,808
Pro forma net earnings per share on an as converted basis for Class A and Class B ordinary shares(3)							
Basic			0.45	0.05		0.09	0.01
Diluted			0.43	0.05		0.08	0.01
Pro forma weighted average aggregate number of ordinary shares on an as converted basis used in per share calculation for Class A and Class B ordinary shares(3)							
Basic			26,696	26,696		28,157	28,157
Diluted			28,124	28,124		29,808	29,808

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(1) Include share-based compensation expenses as follows:

(in thousands)	For the Year Ended December 31,				For the Three Months Ended March 31,		
	2002	2003	2004		2004	2005	
	RMB	RMB	RMB	US$	RMB	RMB	US$
Share-based compensation expenses	(4,233)	(5,109)	(16,510)	(1,995)	(2,607)	(6,142)	(741)

(2) Each ADS represents one Class A ordinary share.

(3) As holders of Class A and Class B ordinary shares have the same dividend right and the same participation right in our undistributed earnings, the basic and diluted pro forma earnings per share of Class A and Class B ordinary shares are the same for all the periods presented.

The following table presents a summary of our consolidated balance sheet data as of December 31, 2004 and March 31, 2005:

- on an actual basis;

- on a pro forma basis to give effect to the conversion of all of our 11,548,682 outstanding ordinary shares as of March 31, 2005 into 11,548,682 Class B ordinary shares on May 30, 2005 and the automatic conversion of all of our outstanding preferred shares into 16,648,877 Class B ordinary shares immediately prior to the closing of this offering; and

- on a pro forma as adjusted basis to reflect the conversion of all of our 11,548,682 outstanding ordinary shares as of March 31, 2005 into 11,548,682 Class B ordinary shares on May 30, 2005 and the automatic conversion of all of our outstanding preferred shares into 16,648,877 Class B ordinary shares immediately prior to the closing of this offering, the issuance and sale of 3,208,696 Class A ordinary shares by us in this offering, and the sale of 831,706 Class B ordinary shares by certain selling shareholders in this offering which will convert into 831,706 Class A ordinary shares, at the initial public offering price of US$27.00 per share, after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

	As of December 31, 2004		As of March 31, 2005					
(in thousands)	Actual		Actual		Pro Forma		Pro Forma As Adjusted	
	RMB	US$	RMB	US$	RMB	US$	RMB	US$
Consolidated Balance Sheet Data								
Cash and cash equivalents	200,196	24,188	194,255	23,471	194,255	23,471	831,575	100,475
Total assets	262,206	31,680	284,296	34,350	284,296	34,350	921,616	111,354
Total current liabilities	54,192	6,548	67,602	8,168	67,602	8,168	67,602	8,168
Redeemable convertible preferred shares	211,352	25,536	211,352	25,536				
Total shareholders (deficit)/equity	(3,338)	(404)	5,342	646	216,694	26,182	854,014	103,186
Total liabilities, redeemable convertible preferred shares and shareholders equity	262,206	31,680	284,296	34,350	284,296	34,350	921,616	111,354

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RISK FACTORS

You should consider carefully all of the information in this prospectus, including the risks and uncertainties described below, before making an investment in our ordinary shares and ADSs. Any of the following risks could have a material adverse effect on our business, financial condition and results of operations. In any such case, the market price of our ordinary shares and ADSs could decline, and you may lose all or part of your investment.

Risks Related to Our Business

Our limited operating history makes it difficult to evaluate our future prospects and results of operations.

We have a limited operating history. We commenced operations in 2000 and first achieved profitability in the quarter ended March 31, 2004. Accordingly, you should consider our future prospects in light of the risks and uncertainties experienced by early stage companies in evolving industries such as the Internet industry in China. Some of these risks and uncertainties relate to our ability to:

- maintain our leading position in the Internet search market in China;
- offer new and innovative products and services to attract and retain a larger user base;
- attract additional customers and increase spending per customer;
- increase awareness of our brand and continue to develop user and customer loyalty;
- respond to competitive market conditions;
- respond to changes in our regulatory environment;
- manage risks associated with intellectual property rights;
- maintain effective control of our costs and expenses;
- raise sufficient capital to sustain and expand our business;
- attract, retain and motivate qualified personnel; and

upgrade our technology to support increased traffic and expanded services.

If we are unsuccessful in addressing any of these risks and uncertainties, our business may be materially and adversely affected.

We sustained losses in the past and our historical financial information may not be representative of our future results of operations.

We began achieving profitability in the quarter ended March 31, 2004. As of March 31, 2005, we had accumulated losses of approximately RMB44.6 million (US$5.4 million). We have experienced growth in recent periods in part due to the growth in China s online marketing industry, which may not be representative of future growth or be sustainable. We cannot assure you that our historical financial information is indicative of our future operating results or financial performance, or that our profitability will be sustained.

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If the Internet and, in particular, online marketing are not broadly adopted in China, our ability to increase revenue and sustain profitability could be materially and adversely affected.

The use of the Internet as a marketing channel is at an early stage in China. Internet and broadband penetration rates in China are both relatively low compared to those in most developed countries. Many of our current and potential customers have limited experience with the Internet as a marketing channel, and have not historically devoted a significant portion of their marketing budgets to online marketing and promotion. As a result, they may not consider the Internet effective in promoting their products and services as compared to traditional print and broadcast media. Our ability to generate significant revenues may be negatively impacted by a number of factors, many of which are beyond our control, including:

difficulties associated with developing a larger user base with demographic characteristics attractive to customers;

increased competition and potential downward pressure on online marketing prices;

higher customer acquisition costs due in part to SMEs limited experience with the Internet as a marketing channel;

failure to develop an independent and reliable means of verifying online traffic;

ineffectiveness of our online marketing delivery, tracking and reporting systems; and

lack of increase in Internet usage in China.

We face significant competition and may suffer from a loss of users and customers as a result.

We face significant competition in almost every aspect of our business, particularly from other companies that seek to provide Internet search services to users and provide online marketing services to customers. Our main competitors include U.S.-based Internet search providers such as Google, Yahoo! and Microsoft, as well as Chinese Internet companies. These Chinese competitors include Internet portals such as Netease, Sina and Sohu, other Internet search service providers such as Sougou, Yisou and Zhong Sou, and business-to-business, or B2B, service providers such as Alibaba. We compete with these entities for both users and customers on the basis of user traffic, quality (relevance) and quantity (index size) of the search results, availability and ease restriction of use of products and services, the number of customers, distribution channels and the number of associated third-party websites. In addition, we may face greater competition from our U.S. competitors as a result of, among other things, a relaxation on the foreign ownership restrictions of PRC Internet content and advertising companies, improvements in online payment systems and Internet infrastructure in China and our U.S. competitors increased business activities in China.

Many of these competitors have significantly greater financial resources than we do. They also have longer operating histories and more experience in attracting and retaining users and managing customers than we do. They may use their experience and resources to compete with us in a variety of ways, including by competing more heavily for users, customers, distributors and networks of third-party websites, investing more heavily in research and development and making acquisitions. If any of our competitors provides comparable or better Chinese language search experience, our user traffic could decline significantly. Any such decline in traffic could weaken our brand, result in loss of customers and users and have a material adverse effect on our results of operations.

We also face competition from traditional advertising media, such as newspapers, magazines, yellow pages, billboards and other forms of outdoor media, television and radio. Most large companies in China allocate, and will likely continue to allocate, most of their marketing budgets to traditional advertising media and only a small

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portion of their budgets to online marketing. If these companies do not devote a larger portion of their marketing budgets to online marketing services provided by us, or if our existing customers reduce the amount they spend on online marketing, our results of operations and future growth prospects could be adversely affected.

Our business depends on a strong brand, and if we are not able to maintain and enhance our brand, our business and operating results may be harmed.

We believe that recognition of our brand Baidu has contributed significantly to the success of our business. We also believe that maintaining and enhancing the Baidu brand is critical to expanding our base of users, customers and Baidu Union members. As our market becomes increasingly competitive, maintaining and enhancing our brand will depend largely on our ability to remain as an Internet search leader in China, which may be increasingly difficult and expensive.

We have developed our user base primarily by word-of-mouth and incurred limited brand promotion expenses. We have recently initiated brand promotion efforts, but we cannot assure you that our new marketing efforts will be successful in further promoting our brand. If we fail to promote and maintain the Baidu brand, or if we incur excessive expenses in this effort, our business and results of operations could be materially and adversely affected.

If we fail to continue to innovate and provide relevant products and services, we may not be able to generate sufficient user traffic levels to remain competitive.

Our success depends on providing products and services that people use for a high-quality Internet experience. Our competitors are constantly developing innovations in Internet search and online marketing as well as enhancing users online experience. As a result, we must continue to invest significant resources in research and development to enhance our Internet search technology and our existing products and services and introduce additional high quality products and services to attract and retain users. If we are unable to anticipate user preferences or industry changes, or if we are unable to modify our products and services on a timely basis, we may lose users and customers. Our operating results would also suffer if our innovations do not respond to the needs of our users and customers, are not appropriately timed with market opportunities or are not effectively brought to market. As search technology continues to develop, our competitors may be able to offer search results that are, or that are perceived to be, substantially similar to or better than those generated by our search services. This may force us to expend significant resources in order to remain competitive.

If we fail to keep up with rapid technological changes, our future success may be adversely affected.

The online marketing industry is subject to rapid technological changes. Our future success will depend on our ability to respond to rapidly changing technologies, adapt our services to evolving industry standards and improve the performance and reliability of our services. Our failure to adapt to such changes could harm our business. New marketing media could also adversely affect us. For example, the number of people accessing the Internet through devices other than personal computers, including mobile telephones and hand-held devices, has increased in recent years. If we are slow to develop products and technologies that are more compatible with non-PC communications devices, we may not be successful in capturing a significant share of this increasingly important market for media and other services. In addition, the widespread adoption of new Internet, networking or telecommunications technologies or other technological changes could require substantial expenditures to modify or adapt our products, services or infrastructure. If we fail to keep up with rapid technological changes to remain competitive in our rapidly evolving industry, our future success may be adversely affected.

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We may face intellectual property infringement claims and other related claims, particularly in light of the recent Grokster decision, that could be time-consuming and costly to defend and may result in our inability to continue providing certain of our existing services.

Internet, technology and media companies are frequently involved in litigation based on allegations of infringement of intellectual property rights, unfair competition, invasion of privacy, defamation and other violations of third-party rights. The validity, enforceability and scope of protection of intellectual property in Internet-related industries, particularly in China, are uncertain and still evolving. In addition, many parties are actively developing and seeking protection for Internet-related technologies, including seeking patent protection. There may be patents issued or pending that are held by others that cover significant aspects of our technologies, products, business methods or services. As we face increasing competition and as litigation becomes more common in China in resolving commercial disputes, we face a higher risk of being the subject of intellectual property infringement claims.

Our products and services link to materials in which third parties may claim ownership of trademarks, copyrights or other rights. From time to time, we may be subject to trademark or copyright infringement or related claims, in China and/or internationally. For example, we provide search engine facilities capable of finding and accessing links to downloadable MP3 music, movies, images and other multimedia files and/or other items hosted on third-party websites, which may be protected by copyright, including search facilities enabling our users to search for MP3 music files in various ways such as by artist, title, or via lists of most-searched-for titles and artists. In the United States, the legal standards for determining indirect liability for copyright infringement have recently been strengthened by the United States Supreme Court in the decision Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd., No. 04-480, 2005 WL 1499402 (June 27, 2005), or Grokster. The implications of the Grokster decision for search engine services such as our MP3 search service are uncertain and may increase the risk of legal liability. While we conduct our business operations outside the United States, we cannot assure you that we would not be subject to U.S. copyright laws, including the legal standards established by Grokster. Moreover, we cannot assure you that Grokster will not influence the legal standards for determining indirect copyright infringement in other jurisdictions, including China. In light of Grokster and the associated publicity, copyright owners may monitor their copyrighted materials more closely worldwide and may seek to enforce their rights under theories of indirect liability or otherwise. As a result, we face increased risks of being subject to copyright infringement claims relating to our MP3 search service. Furthermore, this same consideration may also lead to decreased availability of third-party MP3 websites. A significant portion of our traffic is generated by users of our MP3 search service. According to Alexa.com, 20% of our traffic went to mp3.baidu.com, our MP3 search platform, as of July 31, 2005. Should we face (as a result of the foregoing considerations or otherwise) a need or decision to substantially modify, limit, or terminate our MP3 search service, our business, financial condition or results of operations could be materially and adversely affected.

In addition, as do many Internet websites, we host certain song lyrics on our websites which may be protected by copyright. As a result, we may be subject to copyright infringement claims. We have received several notice letters from parties asserting trademark and copyright infringement claims against us. Moreover, we may be subject to administrative actions brought by the PRC State Copyright Bureau for alleged copyright infringement, and as a result may be subject to fines and/or other penalties and be required to discontinue infringing activities. In addition, we provide links to images of celebrities and other persons, and may face claims for misappropriation of publicity rights. Finally, since a substantial portion of our search results links to MP3 files and other materials in which third parties may claim to own trademarks, copyrights or publicity rights and since we host certain song lyrics on our websites which may be protected by copyright, we may be required to change our business model and service offerings to minimize this risk, which would adversely affect our business prospects. See Regulation Regulations on Intellectual Property Rights.

Intellectual property litigation is expensive and time consuming and could divert resources and management attention from the operations of our business. We were recently named as a defendant in two copyright infringement suits in China in connection with our MP3 and movie search services, respectively, and the courts have not ruled on these cases. See Business Legal Proceedings. If there is a successful claim of infringement,

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we may be required to pay substantial fines and damages or enter into royalty or license agreements that may not be available on commercially acceptable terms, if at all. Our failure to obtain a license of the rights on a timely basis could harm our business. Any intellectual property litigation could have a material adverse effect on our business, financial condition or results of operations.

We may be subject to patent infringement claims with respect to our P4P platform.

Our technologies and business methods, including those relating to our P4P platform, may be subject to third-party claims or rights that limit or prevent their use. Overture Services Inc., a subsidiary of Yahoo!, had applied for a patent in China relating to a P4P platform prior to our patent application in China covering a P4P platform. We have been advised by East Associates, our special PRC patent counsel, that neither Overture s nor our patent application (nor any similar patent applications relating to a P4P platform) is likely to be granted in China as a P4P platform is regarded by the Chinese patent authorities to be a business method which is not patentable in China. We have been further advised by East Associates that, as of August 4, 2005, no patents relating to a P4P platform had been issued in China. However, the application and interpretation of China s patent laws and the procedures and standards for granting patents in China are still evolving and involve a certain degree of uncertainty. We cannot assure you that Overture or any other party would not obtain a patent covering a P4P platform in China. If Overture obtains a patent covering a P4P platform in China, it may seek to bring a claim against us alleging our infringement of its patent rights in China. We cannot assure you that we will be successful in defending against any such claims relating to the P4P platform used by us because Overture s patent application in China was filed prior to ours and there may be similarities between certain claims covered by the two patent applications.

Moreover, certain U.S.-based companies, including Overture, have been granted patents in the United States relating to P4P platforms or technologies and similar business methods and related technologies. Based on publicly available information, we are aware that Overture has brought a patent infringement claim against Findwhat.com in the United States District Court, Central District of California (Case No. 8:03-cv-00685-CJC-E) related to Overture s United States Patent No. 6,269,361 entitled System and Method for Influencing a Position on a Search Result List Generated by a Computer Network Search Engine, or Patent 361, and the lawsuit is currently pending at the trial court. Patent 361 relates to Overture s P4P platform. We are also aware that Overture filed a patent infringement claim in the U.S. against Google in 2002 related to Patent 361 and that the parties settled this lawsuit in 2004. While we believe that we are not subject to U.S. patent laws since we conduct our business operations outside of the U.S., we cannot assure you that U.S. patent laws would not be applicable to our business operations, or that holders of patents relating to a P4P platform would not seek to enforce such patents against us in the United States or China. Any patent infringement claims, regardless of their merits, could be time-consuming and costly to us. If we were sued for patent infringement claims in the United States or China relating to our P4P platform, and we were found to infringe such patents and were not able to adopt non-infringing technologies, we may be severely limited in our ability to operate our P4P business, which would have a material adverse effect on our results of operations and business prospects.

We may not be able to prevent others from unauthorized use of our intellectual property, which could harm our business and competitive position.

We rely on a combination of copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods to protect our intellectual property rights. The protection of intellectual property rights in China may not be as effective as those in the United States or other countries. The steps we have taken may be inadequate to prevent the misappropriation of our technology. Reverse engineering, unauthorized copying or other misappropriation of our technologies could enable third parties to benefit from our technologies without paying us. Moreover, unauthorized use of our technology could enable our competitors to offer Chinese language search, Baidu Post Bar, P4P or online advertising services that are comparable to or better than ours, which could harm our business and competitive position. From time to time, we may have to enforce our intellectual property rights through litigation. Such litigation may result in substantial costs and diversion of resources and management attention.

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If we fail to retain existing customers or attract new customers for our online marketing services, our business and growth prospects could be seriously harmed.

In 2004 and the three months ended March 31, 2005, we generated approximately 91.0% and 94.2% of our total revenues from online marketing services, respectively, a substantial majority of which was generated from our P4P services. Our online marketing customers will not continue to do business with us if their investment does not generate sales leads and ultimately consumers, or if we do not deliver their web pages in an appropriate and effective manner. Our P4P customers may discontinue their business with us at any time and for any reason as they are not subject to fixed-term contracts. Failure to retain our existing online marketing customers or attract new customers for our online marketing services could seriously harm our business and growth prospects.

Because we primarily rely on distributors in providing our P4P services, our failure to retain key distributors or attract additional distributors could materially and adversely affect our business.

Online marketing is at an early stage of development in China and is not as widely accepted by or available to businesses in China as in the United States. As a result, we rely heavily on a nationwide distribution network of third-party distributors for our sales to, and collection of payment from, our P4P customers. If our distributors do not provide quality services to our P4P customers or otherwise breach their contracts with our P4P customers, we may lose customers and our results of operations may be materially and adversely affected. We do not have long-term agreements with any of our distributors, including our key distributors, and cannot assure you that we will continue to maintain favorable relationships with them. Our distribution arrangements, except for those with our key distributors, are non-exclusive. Furthermore, some of our distributors also contract with our competitors or potential competitors and may not renew their distribution agreements with us. In addition, as new methods for accessing the Internet, including the use of wireless devices, become available, we may need to expand our distribution network. If we fail to retain our key distributors or attract additional distributors on terms that are commercially reasonable, our business and results of operations could be materially and adversely affected.

We rely on our Baidu Union members for a significant portion of our revenues. If we fail to retain existing Baidu Union members or attract additional members, our revenues and growth may be adversely affected.

We pay our Baidu Union members a portion of our revenues generated from click-throughs by users of our Baidu Union websites. In 2004, approximately a quarter of our total revenues was generated from click-throughs by users of our Baidu Union websites. We consider our Baidu Union critical to the future growth of our revenues. Some of our Baidu Union members, however, may compete with us in one or more areas of our business. Therefore, they may decide in the future to terminate their relationships with us. If our Baidu Union members decide to use a competitor s or their own Internet search services, our user traffic may decline, which may adversely affect our revenues. If we fail to attract additional websites to join our Baidu Union, our revenue growth may be adversely affected.

Our strategy of acquiring complementary businesses, assets and technologies may fail.

As part of our business strategy, we have pursued, and intend to continue to pursue, selective strategic acquisitions of businesses, assets and technologies that complement our existing business. For example, in August 2004, we acquired the domain name Hao123.com, at that time the largest traffic contributor to our Baidu.com website among our Baidu Union members. In February 2005, we acquired the business of Shanghai Qilang Science and Technology Co. Ltd., or Qilang, at that time the largest distributor of our P4P services in Shanghai. We may make other acquisitions in the future if suitable opportunities arise. Acquisitions involve uncertainties and risks, including:

potential ongoing financial obligations and unforeseen or hidden liabilities;

failure to achieve the intended objectives, benefits or revenue-enhancing opportunities;

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- costs and difficulties of integrating acquired businesses and managing a larger business; and

- diversion of resources and management attention.

Our failure to address these risks successfully may have a material adverse effect on our financial condition and results of operations. Any such acquisition may require a significant amount of capital investment, which would decrease the amount of cash available for working capital or capital expenditures. In addition, if we use our equity securities to pay for acquisitions, we may dilute the value of your ADSs and the underlying ordinary shares. If we borrow funds to finance acquisitions, such debt instruments may contain restrictive covenants that could, among other things, restrict us from distributing dividends. Such acquisitions may also generate significant amortization expenses related to intangible assets.

We may not be able to manage our expanding operations effectively.

We commenced operations in 2000 and have expanded our operations rapidly. We anticipate significant continued expansion of our business as we address growth in our user and customer base and market opportunities. To manage the potential growth of our operations and personnel, we will be required to improve operational and financial systems, procedures and controls, and expand, train and manage our growing employee base. Furthermore, our management will be required to maintain and expand our relationships with other websites, Internet companies and other third parties. We cannot assure you that our current and planned personnel, systems, procedures and controls will be adequate to support our future operations.

Our operating results may fluctuate, which makes our results difficult to predict and could cause our results to fall short of expectations.

Our operating results may fluctuate as a result of a number of factors, many of which are outside of our control. For these reasons, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. Our quarterly and annual revenues and costs and expenses as a percentage of our revenues may be significantly different from our historical or projected rates. Our operating results in future quarters may fall below expectations. Any of these events could cause the price of our ADSs to fall. Any of the risk factors listed in this Risk Factors section, and in particular, the following risk factors, could cause our operating results to fluctuate from quarter to quarter:

- general economic conditions in China and economic conditions specific to the Internet, Internet search and online marketing;

- our ability to continue to attract users to our website;

- our ability to attract additional customers and increase spending per customer;

- the announcement or introduction of new or enhanced products and services by us or our competitors;

- the amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our businesses, operations and infrastructure;

the results of our acquisitions of, or investments in, other businesses or assets;

PRC regulations or actions pertaining to activities on the Internet, including gambling, online games and other forms of entertainment; and

geopolitical events or natural disasters such as war, threat of war, Severe Acute Respiratory Syndrome, or SARS, or other epidemics.

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Because of our limited operating history and our rapidly growing business, our historical operating results may not be useful to you in predicting our future operating results. Our user traffic tends to be seasonal. For example, we generally experience less user traffic during public holidays in China. In addition, advertising spending in China has historically been cyclical, reflecting overall economic conditions as well as budgeting and buying patterns. Our rapid growth has lessened the impact of the cyclicality and seasonality of our business. As we continue to grow, we expect that the cyclicality and seasonality in our business may cause our operating results to fluctuate.

Our business may be adversely affected by third-party software applications that interfere with our receipt of information from, and provision of information to, our users, which may impair our users experience.

Our business may be adversely affected by third-party malicious or unintentional software applications that make changes to our users computers and interfere with our products and services. These software applications may change our users Internet experience by hijacking queries to our websites, altering or replacing our search results, or otherwise interfering with our ability to connect with our users. The interference often occurs without disclosure to or consent from users, resulting in a negative experience that users may associate with Baidu.com. These software applications may be difficult or impossible to remove or disable, may reinstall themselves and may circumvent other applications efforts to block or remove them. The ability to provide a superior user experience is critical to our success. If our efforts to combat these software applications are unsuccessful, our reputation may be harmed. This could result in a decline in user traffic and, consequently, our revenues.

The successful operation of our business depends upon the performance and reliability of the Internet infrastructure and fixed telecommunications networks in China.

Our business depends on the performance and reliability of the Internet infrastructure in China. Almost all access to the Internet is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Information Industry of China. In addition, the national networks in China are connected to the Internet through international gateways controlled by the PRC government. These international gateways are the only channels through which a domestic user can connect to the Internet. We cannot assure you that a more sophisticated Internet infrastructure will be developed in China. We may not have access to alternative networks in the event of disruptions, failures or other problems with China s Internet infrastructure. In addition, the Internet infrastructure in China may not support the demands associated with continued growth in Internet usage.

We also rely on China Telecommunications Corporation, or China Telecom, and China Netcom Corporation Ltd., or China Netcom, to provide us with data communications capacity primarily through local telecommunications lines and Internet data centers to host our servers. We do not have access to alternative services in the event of disruptions, failures or other problems with the fixed telecommunications networks of China Telecom and China Netcom, or if China Telecom or China Netcom otherwise fail to provide such services. In March 2004, due to a power outage at China Netcom s Internet data center that hosted our servers, we were unable to provide Internet search service for approximately five hours. Any unscheduled service interruption could damage our reputation and result in a decrease in our revenues. Furthermore, we have no control over the costs of the services provided by China Telecom and China Netcom. If the prices that we pay for telecommunications and Internet services rise significantly, our gross margins could be adversely affected. In addition, if Internet access fees or other charges to Internet users increase, our user traffic may decrease, which in turn may harm our revenues.

Our success depends on the continuing efforts of our senior management team and other key personnel and our business may be harmed if we lose their services.

Our future success depends heavily upon the continuing services of the members of our senior management team, in particular our chairman and chief executive officer, Robin Yanhong Li, our chief financial officer,

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Shawn Wang, our chief operating officer, David Hongbo Zhu, our vice president of engineering, Jerry Jianguo Liu, and our vice president of marketing, Dong Liang. If one or more of our senior executives or other key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all, and our business may be disrupted and our financial condition and results of operations may be materially and adversely affected. Competition for senior management and key personnel is intense, the pool of qualified candidates is very limited, and we may not be able to retain the services of our senior executives or key personnel, or attract and retain high-quality senior executives or key personnel in the future.

In addition, if any member of our senior management team or any of our other key personnel joins a competitor or forms a competing company, we may lose customers, distributors, know-how and key professionals and staff members. Each of our executive officers and key employees has entered into an employment agreement with us, which contains confidentiality and non-competition provisions. If any disputes arise between any of our senior executives or key personnel and us, we cannot assure you the extent to which any of these agreements may be enforced.

The initial option grants to many of our senior management and key employees are fully vested. Therefore, these employees may not have sufficient financial incentive to continue to work for our company, and our ability to execute our business model could be impaired if we cannot replace departing senior management and key employees in a timely manner.

Many of our senior management personnel and other key employees have become, or will soon become, substantially vested in their initial share option grants under our 2000 Option Plan. While we often grant additional share options to management personnel and other key employees after their hire dates, the initial grants are usually much larger than subsequent grants. Employees may be more likely to leave us after their initial option grant fully vests, especially if the shares underlying the options have significantly appreciated in value relative to the option exercise price. If any member of our senior management team or other key personnel leaves our company, our ability to successfully operate our business and execute our business strategy could be impaired. We may also have to incur significant costs in identifying, hiring, training and retaining replacements for departing employees.

We rely on highly skilled personnel and, if we are unable to retain or motivate key personnel or hire qualified personnel, we may not be able to grow effectively.

Our performance and future success depends on the talents and efforts of highly skilled individuals. We will need to continue to identify, hire, develop, motivate and retain highly skilled personnel for all areas of our organization. Competition in our industry for qualified employees is intense. Our continued ability to compete effectively depends on our ability to attract new employees and to retain and motivate our existing employees.

As competition in our industry intensifies, it may be more difficult for us to hire, motivate and retain highly skilled personnel. If we do not succeed in attracting additional highly skilled personnel or retaining or motivating our existing personnel, we may be unable to grow effectively.

If we are unable to adapt or expand our existing technology infrastructure to accommodate greater traffic or additional customer requirements, our business may be harmed.

Our Baidu.com website regularly serves a large numbers of users and customers and delivers a large number of daily page views. Our technology infrastructure is highly complex and may not provide satisfactory service in the future, especially as the number of customers using our P4P services increases. We may be required to upgrade our technology infrastructure to keep up with the increasing traffic on our websites, such as increasing the capacity of our hardware servers and the sophistication of our software. If we fail to adapt our technology infrastructure to accommodate greater traffic or customer requirements, our users and customers may become dissatisfied with our services and switch to our competitors   websites, which could harm our business.

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If we fail to detect click-through fraud, we could lose the confidence of our customers and our revenues could decline.

We are exposed to the risk of click-through fraud on our paid search results. Click-through fraud occurs when a person clicks paid search results to generate the revenues we pay to our Baidu Union members or our customers rather than to view the content of search results. If we find evidence of past fraudulent clicks, we may have to issue refunds to our customers. If we fail to detect fraudulent clicks or otherwise are unable to prevent this fraudulent activity, the affected customers may experience a reduced return on their investment in our online marketing services and lose confidence in the integrity of our systems. If this happens, we may be unable to retain existing customers and attract new customers for our online marketing services and our online marketing revenues could decline.

Interruption or failure of our information technology and communications systems could impair our ability to effectively provide our products and services, which could damage our reputation and harm our operating results.

Our ability to provide our products and services depends on the continuing operation of our information technology and communications systems. Any damage to or failure of our systems could interrupt our service. Service interruptions could reduce our revenues and profits, and damage our brand if our system is perceived to be unreliable. Our systems are vulnerable to damage or interruption as a result of terrorist attacks, war, earthquakes, floods, fires, power loss, telecommunications failures, computer viruses, interruptions in access to our websites through the use of denial of service or similar attacks, hacking or other attempts to harm our systems, and similar events. Our servers, which are hosted at third-party Internet data centers, are also vulnerable to break-ins, sabotage and vandalism. Some of our systems are not fully redundant, and our disaster recovery planning does not account for all possible scenarios. The occurrence of a natural disaster or a closure of an Internet data center by a third-party provider without adequate notice could result in lengthy service interruptions.

In April 2004, we failed to provide Internet search results for approximately four hours as a result of an error in operations. If we experience frequent or persistent system failures on our website, our reputation and brand could be permanently harmed. The steps we plan to take to increase the reliability and redundancy of our systems are expensive, reduce our operating margin and may not be successful in reducing the frequency or duration of service interruptions.

Our business could be adversely affected if our software contains bugs.

Our online systems, including our websites, our enterprise search software and other software applications and products, could contain undetected errors or bugs that could adversely affect their performance. We regularly update and enhance our website and our other online systems and introduce new versions of our software products and applications. The occurrence of errors in any of these may cause us to lose market share, damage our reputation and brand name, and materially and adversely affect our business.

Concerns about the security of electronic commerce transactions and confidentiality of information on the Internet may reduce use of our network and impede our growth.

A significant barrier to electronic commerce and communications over the Internet in general has been a public concern over security and privacy, including the transmission of confidential information. If these concerns are not adequately addressed, they may inhibit the growth of the Internet and other online services generally, especially as a means of conducting commercial transactions. If a well-publicized Internet breach of security were to occur, general Internet usage could decline, which could reduce traffic to our destination websites and impede our growth.

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We have limited business insurance coverage.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited business insurance products. We do not have any business liability or disruption insurance coverage for our operations in China. Any business disruption, litigation or natural disaster may result in our incurring substantial costs and the diversion of our resources.

Risks Related to Our Corporate Structure

PRC laws and regulations governing our businesses and the validity of certain of our contractual arrangements are uncertain. If we are found to be in violation, we could be subject to sanctions. In addition, changes in such PRC laws and regulations may materially and adversely affect our business.

There are substantial uncertainties regarding the interpretation and application of PRC laws and regulations, including, but not limited to, the laws and regulations governing our business, or the enforcement and performance of our contractual arrangements with our affiliated Chinese entity, Baidu Netcom, and its shareholders. We and Baidu Online are considered foreign persons or foreign invested enterprises under PRC law. As a result, we and Baidu Online are subject to PRC law limitations on foreign ownership of Internet and advertising companies. These laws and regulations are relatively new and may be subject to change, and their official interpretation and enforcement may involve substantial uncertainty. The effectiveness of newly enacted laws, regulations or amendments may be delayed, resulting in detrimental reliance by foreign investors. New laws and regulations that affect existing and proposed future businesses may also be applied retroactively.

PRC laws currently provide limited guidance as to whether an Internet search provider that provides search result links to domestic news websites is required to obtain an approval from the State Council News Office. PRC laws also do not provide clear guidance as to whether an Internet search provider that provides links to online audio/video products is required to obtain an Internet culture permit from the Ministry of Culture or a license for broadcasting audio/video programs from the State Administration of Radio, Film and Television. If the interpretation of existing laws and regulations changes or new regulations come into effect requiring us to obtain any such licenses, permits or approvals, we cannot assure you that we may successfully obtain them, and we may need to remove links to news and audio/video products until we obtain the requisite licenses, permits and approvals.

The PRC government has broad discretion in dealing with violations of laws and regulations, including levying fines, revoking business and other licenses and requiring actions necessary for compliance. In particular, licenses and permits issued or granted to us by relevant governmental bodies may be revoked at a later time by higher regulatory bodies. We cannot predict the effect of the interpretation of existing or new PRC laws or regulations on our businesses. We cannot assure you that our current ownership and operating structure would not be found in violation of any current or future PRC laws or regulations. As a result, we may be subject to sanctions, including fines, and could be required to restructure our operations or cease to provide certain services. Any of these or similar actions could significantly disrupt our business operations or restrict us from conducting a substantial portion of our business operations, which could materially and adversely affect our business, financial condition and results of operations.

If the PRC government were to classify P4P services as a form of advertising, we may have to conduct our P4P business through Baidu Netcom, which would increase our effective tax rate, and we might be subject to sanctions and required to pay delinquent taxes.

PRC laws and regulations related to advertising do not currently classify P4P as a form of advertising. We conduct our P4P business through Baidu Online, which does not hold an advertising license. However, we cannot assure you that the PRC government will not classify P4P as a form of advertising in the future. If new regulations characterize P4P as a form of advertising, we may have to conduct our P4P business through Baidu

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Netcom. This would increase our consolidated effective tax rate for two reasons. First, advertising revenues generated by Baidu Netcom are subject to a 3% surcharge in addition to the 5% business tax. Second, Baidu Netcom is subject to the 33% statutory enterprise income tax rate, as compared to the preferential enterprise income tax rate of 7.5% enjoyed by Baidu Online as of the date of this prospectus. See Business Taxation for more information on PRC business and enterprise income tax as applicable to Baidu Netcom and Baidu Online. Moreover, if the change in classification of P4P were retroactively applied, we might be subject to sanctions, including payment of delinquent taxes and fines. Any change in the classification of P4P by the PRC government may significantly disrupt our operations and materially and adversely affect our business, results of operations and financial conditions.

We may be adversely affected by complexity, uncertainties and changes in PRC regulation of Internet business and companies, including limitations on our ability to own key assets such as our website.

The PRC government extensively regulates the Internet industry including foreign ownership of, and the licensing and permit requirements pertaining to, companies in the Internet industry. These Internet-related laws and regulations are relatively new and evolving, and their interpretation and enforcement involve significant uncertainty. As a result, in certain circumstances it may be difficult to determine what actions or omissions may be deemed to be a violation of applicable laws and regulations. Issues, risks and uncertainties relating to PRC government regulation of the Internet industry include the following:

- We only have contractual control over our websites. We do not own the websites due to the restriction of foreign investment in businesses providing value-added telecommunication services in China, including online information services.

- There are uncertainties relating to the regulation of the Internet business in China, including evolving licensing practices, means that permits, licenses or operations at some of our companies may be subject to challenge. This may disrupt our business, or subject us to sanctions, requirements to increase capital or other conditions or enforcement, or compromise enforceability of related contractual arrangements, or have other harmful effects on us.

- Certain PRC government authorities have stated publicly that they are in the process of promulgating new laws and regulations that will regulate Internet activities. The areas of regulation may include online advertising, online news displaying, online audio-video program broadcasting and the provision of culture-related information over the Internet. Other aspects of our online operations may be regulated in the future. If our operations do not comply with these new regulations at the time they become effective, we could be subject to penalties.

The interpretation and application of existing PRC laws, regulations and policies and possible new laws, regulations or policies have created substantial uncertainties regarding the legality of existing and future foreign investments in, and the businesses and activities of, Internet businesses in China, including our business.

In order to comply with PRC laws limiting foreign ownership of Internet and advertising businesses, we conduct our ICP and online advertising businesses through Baidu Netcom by means of contractual arrangements. If the PRC government determines that these contractual arrangements do not comply with applicable regulations, our business could be adversely affected.

The PRC government restricts foreign investment in Internet and advertising businesses. Accordingly, we operate our websites and our online advertising business in China through Baidu Netcom, a company wholly owned by our chairman, chief executive officer and co-founder Robin Yanhong Li and our co-founder Eric Yong Xu, both of whom are PRC citizens. Baidu Netcom holds the licenses and approvals necessary to operate our website and our online advertising business in China. We have contractual arrangements with Baidu Netcom and its shareholders that allow us to substantially control Baidu Netcom. We cannot assure you, however, that we will be able to enforce these contracts.

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Although we believe we comply with current PRC regulations, we cannot assure you that the PRC government would agree that these operating arrangements comply with PRC licensing, registration or other regulatory requirements, with existing policies or with requirements or policies that may be adopted in the future. If the PRC government determines that we do not comply with applicable law, it could revoke our business and operating licenses, require us to discontinue or restrict our operations, restrict our right to collect revenues, block our website, require us to restructure our operations, impose additional conditions or requirements with which we may not be able to comply, impose restrictions on our business operations or on our customers, or take other regulatory or enforcement actions against us that could be harmful to our business.

Our contractual arrangements with Baidu Netcom and its shareholders may not be as effective in providing control over these entities as direct ownership.

Since PRC law limits foreign equity ownership in Internet and advertising companies in China, we operate our ICP and advertising businesses through Baidu Netcom. We have no equity ownership interest in Baidu Netcom and rely on contractual arrangements to control and operate such businesses. These contractual arrangements may not be as effective in providing control over Baidu Netcom as direct ownership. For example, Baidu Netcom could fail to take actions required for our business or fail to maintain our website despite its contractual obligation to do so. If Baidu Netcom fails to perform under their agreements with us, we may have to rely on legal remedies under PRC law, which may not be effective. In addition, we cannot assure you that either of Baidu Netcom s shareholders would always act in our best interests.

Our contractual arrangements with Baidu Netcom may result in adverse tax consequences to us.

As a result of our corporate structure and contractual arrangements between Baidu Online and Baidu Netcom, we are effectively subject to the 5% PRC business tax on both revenues generated by Baidu Netcom s operations in China and revenues derived from Baidu Online s contractual arrangements with Baidu Netcom. Moreover, we would be subject to adverse tax consequences if the PRC tax authorities were to determine that the contracts between Baidu Online and Baidu Netcom were not on an arm s length basis and therefore constitute a favorable transfer pricing. As a result, the PRC tax authorities could request that Baidu Netcom adjust its taxable income upward for PRC tax purposes. Such a pricing adjustment could adversely affect us by:

- increasing Baidu Netcom s tax expenses without reducing Baidu Online s tax expenses, which could subject Baidu Netcom to late payment fees and other penalties for under-payment of taxes; and/or
- resulting in Baidu Online s loss of its preferential tax treatment.

The principal shareholder of Baidu Netcom has potential conflicts of interest with us, which may adversely affect our business.

Robin Yanhong Li, our chairman and chief executive officer, is also the principal shareholder of Baidu Netcom. Conflicts of interests between his duties to our company and Baidu Netcom may arise. As Mr. Li is a director and executive officer of our company, he has a duty of loyalty and care to us under Cayman Islands law when there are any potential conflicts of interests between our company and Baidu Netcom. Additionally, Mr. Li has executed an irrevocable power of attorney to appoint the individual designated by us to be his attorney-in-fact to vote on his behalf on all Baidu Netcom matters requiring shareholder approval. We cannot assure you, however, that when conflicts of interest arise, Mr. Li will act completely in our interests or that conflicts of interests will be resolved in our favor. In addition, Mr. Li could violate his employment agreement with us or his legal duties by diverting business opportunities from us to others. If we cannot resolve any conflicts of interest between us and Mr. Li, we would have to rely on legal proceedings, which could result in the disruption of our business.

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Our corporate actions are substantially controlled by our principal shareholders and affiliated entities.

After this offering, our principal shareholders and their affiliated entities will own approximately 72.2% of our outstanding ordinary shares, representing approximately 81.1% of our voting power due to our dual-class ordinary share structure. These shareholders, acting individually or as a group, could exert substantial influence over matters such as electing directors and approving mergers or other business combination transactions. This concentration of ownership may also discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our ADSs. These actions may be taken even if they are opposed by our other shareholders, including those who purchase shares in this offering.

We may be unable to collect long-term loans to the shareholders of Baidu Netcom.

As of March 31, 2005, we had made long-term loans in an aggregate principal amount of RMB2.0 million (US$0.2 million) to the shareholders of Baidu Netcom. We extended these loans to help them fund the initial capitalization of Baidu Netcom. We may in the future provide additional loans to the shareholders of Baidu Netcom in connection with any increase in the capitalization of Baidu Netcom to the extent necessary and permissible under applicable law. Our ability to ultimately collect these loans will depend on the profitability of Baidu Netcom and its operational needs, which are uncertain.

Risks Related to Doing Business in China

Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.

Substantially all of our business operations are conducted in China. Accordingly, our results of operations, financial condition and prospects are subject to a significant degree to economic, political and legal developments in China. China s economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past 20 years, growth has been uneven across different regions and among various economic sectors of China. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. Since early 2004, the PRC government has implemented certain measures to control the pace of economic growth. Such measures may cause a decrease in the level of economic activity in China, which in turn could adversely affect our results of operations and financial condition.

Regulation and censorship of information disseminated over the Internet in China may adversely affect our business and subject us to liability for information linked to our website.

The PRC government has adopted regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is reactionary, obscene, superstitious, fraudulent or defamatory. Failure to comply with these requirements may result in the revocation of licenses to provide Internet content and other licenses and the closure of the concerned websites. In the past, failure to comply with such requirements has resulted in the closure of certain websites. The website operator may also be held liable for such censored information displayed on or linked to the website.

In addition, the Ministry of Information Industry has published regulations that subject website operators to potential liability for content displayed on their websites and the actions of users and others using their systems,

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including liability for violations of PRC laws prohibiting the dissemination of content deemed to be socially destabilizing. The Ministry of Public Security has the authority to order any local Internet service provider to block any Internet website at its sole discretion. From time to time, the Ministry of Public Security has stopped the dissemination over the Internet of information which it believes to be socially destabilizing. The State Secrecy Bureau is also authorized to block any website it deems to be leaking State secrets or failing to meet the relevant regulations relating to the protection of State secrets in the dissemination of online information.

In June 2002, we were required to shut down our server for one week and pay an RMB10,000 fine because our search results contained certain content that the public security authorities considered socially harmful. Although we attempt to monitor the content in our search results and on our Baidu Post Bar, a query-based online community, we are not able to control or restrict the content of other Internet content providers linked to or accessible through our websites, or content generated or placed on our Baidu Post Bar message boards by our users. To the extent that PRC regulatory authorities find any content displayed on our websites objectionable, they may require us to limit or eliminate the dissemination of such information on our websites, which may reduce our user traffic and have an adverse effect on our business. In addition, we may be subject to penalties for violations of those regulations arising from information displayed on or linked to our websites, including a suspension or shutdown of our online operations.

PRC government authorities may deem certain third-party websites unlawful and could require us to remove links to such websites, which may reduce our user traffic and have a material adverse effect on our business.

The Internet industry in China, including the operation of online activities, is extensively regulated by the PRC government. Various PRC government authorities such as the State Council, the Ministry of Information Industry, the State Administration for Industry and Commerce, the State Press and Publication Administration and the Ministry of Public Security are empowered to issue and implement regulations governing various aspects of the Internet and online activities. Substantial uncertainties exist regarding the potential impact of current and future PRC laws and regulations on Internet search providers. We are not able to control or restrict the operation of third-party websites linked to or accessible through our website. If third-party websites linked to or accessible through our websites operate unlawful activities such as online gambling on their websites, PRC regulatory authorities may require us to remove the links to such websites or suspend or shut down the operation of such websites. This in turn may reduce our user traffic and adversely affect our business. In addition, we may be subject to potential liabilities for providing links to third-party websites that operate unlawful activities.

Intensified government regulation of Internet cafes could restrict our ability to maintain or increase user traffic to our website.

In April 2001, the PRC government began tightening its regulation of Internet cafes. In particular, a large number of unlicensed Internet cafes have been closed. In addition, the PRC government has imposed higher capital and facility requirements for the establishment of Internet cafes. Furthermore, the PRC government s policy, which encourages the development of a limited number of national and regional Internet cafe chains and discourages the establishment of independent Internet cafes, may slow down the growth of Internet cafes. Recently, the Ministry of Culture, together with other government authorities, issued a joint notice suspending the issuance of new Internet cafe licenses. It is unclear when this suspension will be lifted. So long as Internet cafes are one of the primary venues for our users to access our website, any reduction in the number, or any slowdown in the growth, of Internet cafes in China could limit our ability to maintain or increase user traffic to our website.

If PRC law were to phase out the preferential tax benefits currently being extended to foreign invested enterprises and new or high-technology enterprises located in a high-tech zone, we would have to pay more taxes, which could have a material and adverse effect on our financial condition and results of operations.

Under PRC laws and regulations, a foreign invested enterprise may enjoy preferential tax benefits if it is registered in a high-tech zone and also qualifies as new or high-technology enterprise . As a foreign invested

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enterprise as well as a certified new or high-technology enterprise located in a high-tech zone in Beijing, Baidu Online is entitled to a three-year exemption from enterprise income tax beginning from its first year of operation, a 7.5% enterprise income tax rate for another three years followed by a 15% tax rate so long as it continues to qualify as a new or high-technology enterprise. Baidu Online is currently subject to a 7.5% enterprise income tax rate and will become subject to a 15% rate beginning in 2006 for so long as its status as a new or high-technology enterprise remains unchanged. Furthermore, Baidu Online may apply for a refund of the 5% business tax levied on its total revenues derived from its technology consulting services. We also intend to apply for similar preferential tax benefits for our newly established subsidiary, Baidu China, in the near future. If the PRC law were to phase out preferential tax benefits currently granted to new or high-technology enterprises and technology consulting services, we would be subject to the standard statutory tax rate, which currently is 33%, and we would be unable to obtain business tax refunds for our provision of technology consulting services. Loss of these preferential tax treatments could have a material and adverse effect on our financial condition and results of operations.

Our subsidiaries and Baidu Netcom are subject to restrictions on paying dividends and making other payments to us.

We are a holding company incorporated in the Cayman Islands and do not have any assets or conduct any business operations other than our investments in our subsidiaries and Baidu Netcom. As a result of our holding company structure, we rely entirely on dividends payments from our subsidiaries in China after they receive payments from Baidu Netcom under various service and other contractual arrangements. However, PRC regulations currently permit payment of dividends only out of accumulated profits, as determined in accordance with PRC accounting standards and regulations. Our subsidiaries and affiliated entity in China are also required to set aside a portion of their after-tax profits according to PRC accounting standards and regulations to fund certain reserve funds. The PRC government also imposes controls on the conversion of RMB into foreign currencies and the remittance of currencies out of China. We may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currency. See Government control of currency conversion may affect the value of your investment. Furthermore, if our subsidiaries or affiliated entity in China incur debt on their own in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments. If we or either of our subsidiaries is unable to receive all of the revenues from our operations through these contractual or dividend arrangements, we may be unable to pay dividends on our ordinary shares and ADSs.

Uncertainties with respect to the PRC legal system could adversely affect us.

We conduct our business primarily through our subsidiaries and Baidu Netcom. Our operations in China are governed by PRC laws and regulations. Our subsidiaries are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to wholly foreign-owned enterprises. The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value.

Since 1979, PRC legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully integrated legal system and recently-enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until some time after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us, our management or the experts named in the prospectus.

We conduct substantially all of our operations in China and substantially all of our assets are located in China. In addition, all of our senior executive officers reside within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon our senior executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our PRC counsel has advised us that the PRC does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts.

Governmental control of currency conversion may affect the value of your investment.

The PRC government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in RMB. Under our current structure, our income is primarily derived from dividend payments from our PRC subsidiaries. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiaries and our affiliated entity to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from the PRC State Administration of Foreign Exchange by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

Recent PRC regulations relating to acquisitions of PRC companies by foreign entities may create regulatory uncertainties that could limit our PRC subsidiaries ability to distribute dividends or otherwise adversely affect the implementation of our acquisition strategy.

The PRC State Administration of Foreign Exchange, or SAFE, issued a public notice in January 2005 concerning foreign exchange regulations on mergers and acquisitions in China. The public notice states that if an offshore company intends to acquire a PRC company, such acquisition will be subject to strict examination by the relevant foreign exchange authorities. The public notice also states that the approval of the relevant foreign exchange authorities is required for any sale or transfer by the PRC residents of a PRC company s assets or equity interests to foreign entities, such as us, for equity interests or assets of the foreign entities.

In April 2005, SAFE issued another public notice clarifying the January notice. In accordance with the April notice, if an acquisition of a PRC company by an offshore company controlled by PRC residents had been confirmed by a Foreign Investment Enterprise Certificate prior to the issuance of the January notice, each of the PRC residents is required to submit a registration form to the local SAFE branch to register his or her respective ownership interests in the offshore company. The SAFE notices do not specify the timeframe during which such registration must be completed. The PRC resident must also amend such registration form if there is a material event affecting the offshore company, such as, among other things, a change to share capital, a transfer of shares, or if such company is involved in a merger and an acquisition or a spin-off transaction or uses its assets in China to guarantee offshore obligations. We have notified our shareholders who are PRC residents to register with the local SAFE branch as required under the SAFE notices. However, we cannot provide any assurances that all of our shareholders who are PRC residents will comply with our request to make or obtain any applicable registrations or approvals required by these SAFE notices. The failure or inability of our PRC resident

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shareholders to comply with the registration procedures set forth therein may subject us to fines and legal sanctions, restrict our cross-border investment activities, or limit our PRC subsidiaries ability to distribute dividends to our company.

As it is uncertain how the SAFE notices will be interpreted or implemented, we cannot predict how these regulations will affect our business operations or future strategy. For example, we may be subject to more stringent review and approval process with respect to our foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, which may adversely affect our results of operations and financial condition. In addition, if we decide to acquire a PRC company, we cannot assure you that we or the owners of such company, as the case may be, will be able to obtain the necessary approvals or complete the necessary filings and registrations required by the SAFE notices. This may restrict our ability to implement our acquisition strategy and could adversely affect our business and prospects.

Fluctuation in the value of RMB may have a material adverse effect on your investment.

The value of RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an approximately 2.0% appreciation of the RMB against the U.S. dollar. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the RMB against the U.S. dollar. Our revenues and costs are mostly denominated in RMB, while a significant portion of our financial assets are denominated in U.S. dollars. We rely entirely on dividends and other fees paid to us by our subsidiaries and affiliated entity in China. Any significant revaluation of RMB may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our ADSs in U.S. dollars. For example, an appreciation of RMB against the U.S. dollar would make any new RMB denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into RMB for such purposes. An appreciation of RMB against the U.S. dollar would also result in foreign currency translation losses for financial reporting purposes when we translate our U.S. dollar denominated financial assets into RMB, as RMB is our reporting currency.

We face risks related to health epidemics and other outbreaks.

Our business could be adversely affected by the effects of SARS or another epidemic or outbreak. China reported a number of cases of SARS in April 2004. Any prolonged recurrence of SARS or other adverse public health developments in China may have a material adverse effect on our business operations. For instance, health or other government regulations adopted in response may require temporary closure of Internet cafes, which is where many users access our websites, or of our offices. Such closures would severely disrupt our business operations and adversely affect our results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of SARS or any other epidemic.

Risks Related to Our ADSs and This Offering

There has been no public market for our ordinary shares or ADSs prior to this offering, and you may not be able to resell our ADSs at or above the price you paid, or at all.

Prior to this initial public offering, there has been no public market for our ordinary shares or ADSs. Our ADSs have been approved for listing on the Nasdaq National Market. Our ordinary shares will not be listed on any exchange or quoted for trading on any over-the-counter trading system. If an active trading market for our ADSs does not develop after this offering, the market price and liquidity of our ADSs will be materially and adversely affected.

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The initial public offering price for our ADSs will be determined by negotiations between us and the underwriters and may bear no relationship to the market price for our ADSs after the initial public offering. We cannot assure you that an active trading market for our ADSs will develop or that the market price of our ADSs will not decline below the initial public offering price.

The market price for our ADSs may be volatile.

The market price for our ADSs may be volatile and subject to wide fluctuations in response to factors including the following:

- actual or anticipated fluctuations in our quarterly operating results;
- changes in financial estimates by securities research analysts;
- conditions in Internet search and online marketing markets;
- changes in the economic performance or market valuations of other Internet search or Internet companies;
- announcements by us or our competitors of new products, acquisitions, strategic partnerships, joint ventures or capital commitments;
- addition or departure of key personnel;
- fluctuations of exchange rates between RMB and the U.S. dollar;
- intellectual property litigation;
- release of lock-up or other transfer restrictions on our outstanding ADSs or sales of additional ADSs; and
- general economic or political conditions in China.

In addition, the securities market has from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our ADSs.

You will experience immediate and substantial dilution in the net tangible book value of ADSs purchased.

The initial public offering price per ADSs will be substantially higher than the net tangible book value per ADS prior to the offering. Consequently, when you purchase ADSs in the offering at the assumed initial public offering price, you will incur immediate dilution of US$23.8 per ADS. See Dilution.

We may need additional capital, and the sale of additional ADSs or other equity securities could result in additional dilution to our shareholders.

We believe that our current cash and cash equivalents, anticipated cash flow from operations and the net proceeds from this offering will be sufficient to meet our anticipated cash needs for the near future. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If our resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

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Substantial future sales or the perception of sales of our ADSs in the public market could cause the price of our ADSs to decline.

Sales of our ADSs or ordinary shares in the public market after this offering, or the perception that these sales could occur, could cause the market price of our ADSs to decline. Upon completion of this offering, we will have 32,318,593 ordinary shares outstanding including 4,344,877 Class A ordinary shares represented by 4,344,877 ADSs, assuming the underwriters do not exercise the over-allotment option. All ADSs sold in this offering, other than the up to 202,020 ADSs sold in our directed share program, will be freely transferable without restriction or additional registration under the Securities Act of 1933, as amended, or the Securities Act. The remaining ordinary shares outstanding after this offering will be available for sale, upon the expiration of the applicable lock-up period beginning from the date of this prospectus, subject to volume and other restrictions as applicable under Rule 144 and Rule 701 under the Securities Act. See Shares Eligible for Future Sale and Underwriting for a detailed description of the lock-up restrictions. Any or all of these shares may be released prior to expiration of the lock-up period at the discretion of the lead underwriters for this offering. To the extent shares are released before the expiration of the lock-up period and these shares are sold into the market, the market price of our ADSs could decline.

In addition, certain holders of our Class B ordinary shares will have the right to cause us to register the sale of an aggregate of 16,275,867 shares under the Securities Act, subject to a 180-day lock-up period in connection with this offering. Registration of these shares under the Securities Act would result in these shares becoming freely tradable without restriction under the Securities Act immediately upon the effectiveness of the registration. Sales of these registered shares in the public market could cause the price of our ADSs to decline.

You may not have the same voting rights as the holders of our ordinary shares and may not receive voting materials in time to be able to exercise your right to vote.

Except as described in this prospectus and in the deposit agreement, holders of our ADSs will not be able to exercise voting rights attaching to the shares evidenced by our ADSs on an individual basis. Holders of our ADSs will appoint the depositary or its nominee as their representative to exercise the voting rights attaching to the shares represented by the ADSs. You may not receive voting materials in time to instruct the depositary to vote, and it is possible that you, or persons who hold their ADSs through brokers, dealers or other third parties, will not have the opportunity to exercise a right to vote. Upon our written request, the depositary will mail to you a shareholder meeting notice which contains, among other things, a statement as to the manner in which your voting instructions may be given, including an express indication that such instructions may be given or deemed given to the depositary to give a discretionary proxy to a person designated by us if no instructions are received by the depositary from you on or before the response date established by the depositary. However, no voting instruction shall be deemed given and no such discretionary proxy shall be given with respect to any matter as to which we inform the depositary that (i) we do not wish such proxy given, (ii) substantial opposition exists, or (iii) such matter materially and adversely affects the rights of shareholders.

You may not be able to participate in rights offerings and may experience dilution of your holdings as a result.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. Under the deposit agreement for the ADSs, the depositary will not offer those rights to ADS holders unless both the rights and the underlying securities to be distributed to ADS holders are either registered under the Securities Act, or exempt from registration under the Securities Act with respect to all holders of ADSs. We are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to cause such a registration statement to be declared effective. In addition, we may not be able to take advantage of any exemptions from registration under the Securities Act. Accordingly, holders of our ADSs may be unable to participate in our rights offerings and may experience dilution in their holdings as a result.

You may be subject to limitations on transfer of your ADSs.

Your ADSs are transferable on the books of the depositary. However, the depositary may close its transfer books at any time or from time to time when it deems expedient in connection with the performance of its duties.

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In addition, the depositary may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary deem it advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

You may face difficulties in protecting your interests, and your ability to protect your rights through the U.S. federal courts may be limited, because we are incorporated under Cayman Islands law, conduct substantially all of our operations in China and all of our officers reside outside the United States.

We are incorporated in the Cayman Islands, and conduct substantially all of our operations in China through our wholly owned subsidiaries in China. All of our officers reside outside the United States and some or all of the assets of those persons are located outside of the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the Cayman Islands or in China in the event that you believe that your rights have been infringed under the securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the Cayman Islands and of China may render you unable to enforce a judgment against our assets or the assets of our directors and officers. There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will generally recognize and enforce a non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits. For more information regarding the relevant laws of the Cayman Islands and China, see Enforceability of Civil Liabilities.

Our corporate affairs are governed by our memorandum and articles of association and by the Companies Law (2004 Revision) and common law of the Cayman Islands. The rights of shareholders to take legal action against our directors and us, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States, and provides significantly less protection to investors. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action before the federal courts of the United States.

As a result of all of the above, our public shareholders may have more difficulty in protecting their interests through actions against our management, directors or major shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States.

Our management will have considerable discretion as to the use of the net proceeds to be received by us from this offering.

We have not allocated the majority of the net proceeds to be received by us of this offering to any particular purpose. Rather, our management will have considerable discretion in the application of the net proceeds received by us. You will not have the opportunity, as part of your investment decision, to assess whether proceeds are being used appropriately. You must rely on the judgment of our management regarding the application of the net proceeds of this offering. The net proceeds may be used for corporate purposes that do not improve our efforts to maintain profitability or increase our share price. The net proceeds from this offering may be placed in investments that do not produce income or that lose value.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud.

We will be subject to reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring

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every public company to include a management report on such company s internal control over financial reporting in its annual report, which contains management s assessment of the effectiveness of the company s internal control over financial reporting. In addition, an independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of the company s internal control over financial reporting. These requirements will first apply to our annual report on Form 20-F for the fiscal year ending December 31, 2006. Our management may conclude that our internal control over our financial reporting is not effective. Moreover, even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may still decline to attest to our management s assessment or may issue a report that is qualified if it is not satisfied with our controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us. Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future. Prior to this offering, we have been a young, private company with limited accounting personnel and other resources with which to address our internal controls and procedures. As a result, when our independent auditors audited our consolidated financial statements for the three years ended December 31, 2004 in connection with this offering, they identified a number of control deficiencies in our internal control procedures which, in the judgment of our independent auditors, could adversely affect our ability to record, process, summarize and report financial data consistent with the assertions of our management in the financial statements. Specifically, the control deficiencies identified by our independent auditors consist of: (i) the lack of a consolidated manual for accounting policies and procedures relating to financial reporting, without which it would be difficult for our accounting and finance personnel to apply proper procedures and controls to transactions; (ii) inadequate approval procedures that involve accounting personnel in approving or amending the terms of contracts which may lead to transactions not properly reflected in the books and records; (iii) the lack of comprehensive credit control policies and procedures to monitor credits provided to customers which may lead to unauthorized credits provided to customers; and (iv) the lack of comprehensive checklists and procedures to address the pre-acquisition due diligence process and the accounting for business combinations, without which it would be difficult for us to reach a conclusion on proper accounting treatment for any acquisition in the most efficient manner. None of the control deficiencies discovered by our auditors were material weaknesses as described in Audit Standard No. 2 of the Public Company Accounting Standards Board, and they were not related to any fraudulent acts. We plan to remediate these control deficiencies in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. If we fail to timely achieve and maintain the adequacy of our internal control, we may not be able to conclude that we have effective internal control over financial reporting at a reasonable assurance level. Moreover, effective internal control over financial reporting is necessary for us to produce reliable financial reports and is important to help prevent fraud. As a result, our failure to achieve and maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading price of our ADSs. Furthermore, we anticipate that we will incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

Our dual-class ordinary share structure with different voting rights could discourage others from pursuing any change of control transactions that holders of our Class A ordinary shares and ADSs may view as beneficial.

On May 30, 2005, our shareholders approved our current memorandum and articles of association to provide for a dual-class ordinary share structure. Our ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares are entitled to one vote per share, while holders of Class B ordinary shares are entitled to 10 votes per share. We will issue Class A ordinary shares represented by our ADSs in this offering. All of our existing shareholders as of May 30, 2005, including our founders, directors, officers and employees, hold our Class B ordinary shares, and our outstanding preferred shares will automatically convert into Class B ordinary shares immediately prior to the closing of this offering. We intend to maintain the dual-class ordinary share structure after the closing of this offering. Each Class B ordinary share is convertible into one Class A ordinary share at any time by the holder thereof. Class A ordinary shares are not

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convertible into Class B ordinary shares under any circumstances. Upon any transfer of Class B ordinary shares by a holder thereof to any person or entity which is not an affiliate of such holder, such Class B ordinary shares shall be automatically and immediately converted into the equal number of Class A ordinary shares. In addition, if at any time our chairman and executive officer, Robin Yanhong Li, and his affiliates collectively own less than 5% of the total number of the issued and outstanding Class B ordinary shares, each issued and outstanding Class B ordinary share shall be automatically and immediately converted into one share of Class A ordinary share, and we shall not issue any Class B ordinary shares thereafter.

Due to the disparate voting powers attached to these two classes, our existing shareholders will have significant voting power over matters requiring shareholder approval, including election of directors and significant corporate transactions, such as a merger or sale of our company or our assets. This concentrated control could discourage others from pursuing any potential merger, takeover or other change of control transactions that holders of Class A ordinary shares and ADSs may view as beneficial.

Our articles of association contain anti-takeover provisions that could adversely affect the rights of holders of our ordinary shares and ADSs.

Our shareholders recently adopted an amended and restated articles of association that will become effective immediately upon the closing of this offering. We have included certain provisions in our new articles of association that could limit the ability of others to acquire control of our company, and deprive our shareholders of the opportunity to sell their shares at a premium over the prevailing market price by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transactions.

We have included the following provisions in our new articles that may have the effect of delaying or preventing a change of control of our company:

- Our new articles provides for a dual-class ordinary share structure.

- Our board of directors has the authority, without approval by the shareholders, to issue up to a total of 10,000,000 shares of preferred shares in one or more series. Our board of directors may establish the number of shares to be included in each such series and may fix the designations, preferences, powers and other rights of the shares of a series of preferred shares.

- Our board of directors has the right to elect directors to fill a vacancy created by the increase of the board of directors or the resignation, death or removal of a director, which prevents shareholders from having the sole right to fill vacancies on our board of directors.

We will incur increased costs as a result of being a public company.

As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act, as well as new rules subsequently implemented by SEC and Nasdaq, have required changes in corporate governance practices of public companies. We expect these new rules and regulations to increase our legal, accounting and financial compliance costs and to make certain corporate activities more time-consuming and costly. In addition, we will incur additional costs associated with our public company reporting requirements. We are currently evaluating and monitoring developments with respect to these new rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequence to U.S. Holders.

Based on the assumed initial public offering price of the ADSs in this offering and the expected price of the ADSs following the offering, we do not expect to be considered a passive foreign investment company, or

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PFIC, for U.S. federal income tax purposes for our current taxable year ending December 31, 2005. However, we must make a separate determination each year as to whether we are a PFIC (after the close of each taxable year) and we cannot assure you that we will not be a PFIC for our current taxable year ending December 31, 2005 or any future taxable year. A non-U.S. corporation will be considered a PFIC for any taxable year if either (1) at least 75% of its gross income is passive income or (2) or least 50% of the value of its assets (based on an average of the quarterly values of the assets during a taxable year) is attributable to assets that produce or are held for the production of passive income. The market value of our assets may be determined in large part by the market price of our ADSs and ordinary shares, which is likely to fluctuate after the offering (and may fluctuate considerably given that market prices of technology companies have been especially volatile). In addition, the composition of our income and assets will be affected by how, and how quickly, we spend the cash we raise in this offering. If we were treated as a PFIC for any taxable year during which a U.S. Holder held an ADS or an ordinary share, certain adverse U.S. federal income tax consequences could apply to the U.S. Holder. See Taxation United States Federal Income Taxation Passive Foreign Investment Company.

When we account for employee share options using the fair value method, such accounting treatment could significantly reduce our net income.

On December 16, 2004, the Financial Accounting Standard Board, or FASB, issued FASB Statement No. 123(R), Share-Based Payment, which requires a public company to recognize, as an expense, the fair value of stock options and other share-based compensation to employees at the first fiscal year that begins on or after June 15, 2005. Currently, we record share-based compensation to the extent that the fair value of the shares on the date of grant exceeds the exercise price of the option. We recognize compensation expense over the related vesting periods. If we had used the fair value method of accounting for share options granted to employees prior to January 1, 2005 using a Black-Scholes option valuation formula assuming zero percent volatility, our net income would have been RMB1.1 million (US$0.1 million) less than reported for the year ended December 31, 2004. For the periods after December 31, 2005, we could have ongoing accounting charges significantly greater than those we would have recorded under our current method of accounting for share options. See Management s Discussion and Analysis of Financial Conditions and Results of Operations Critical Accounting Policies and Note 16 to our consolidated financial statements included in this prospectus for a more detailed presentation of accounting for share-based compensation plans.

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FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that involve risks and uncertainties. All statements other than statements of historical facts are forward-looking statements. The forward-looking statements are contained principally in the sections entitled Prospectus Summary, Risk Factors, Use of Proceeds, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements.

You can identify these forward-looking statements by words or phrases such as may, will, expect, anticipate, aim, estimate, intend, p is/are likely to or other similar expressions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements include:

- our anticipated growth strategies;
- our future business development, results of operations and financial condition;
- expected changes in our margins and certain cost or expense items as a percentage of our net revenues;
- our ability to attract and retain users and customers;
- the outcome of ongoing, or any future, litigation or arbitration, including those relating to copyright, patent or other intellectual property rights;
- competition in the Chinese language Internet search market;
- the expected growth of the Chinese language Internet search market and the number of Internet and broadband users in China; and
- PRC governmental policies relating to the Internet and Internet search providers.

You should read thoroughly this prospectus and the documents that we refer to herein with the understanding that our actual future results may be materially different from or worse than what we expect. We qualify all of our forward-looking statements by these cautionary statements. Other sections of this prospectus include additional factors which could adversely impact our business and financial performance. Moreover, we operate in an emerging and evolving environment. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we access the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Except as required by law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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USE OF PROCEEDS

We estimate that we will receive net proceeds from this offering of approximately US$77.0 million, or approximately US$89.2 million if the underwriters exercise their option to purchase additional ADSs in full, after deducting underwriting discounts and the offering expenses payable by us. We will not receive any of the proceeds from the sale of ADSs by the selling shareholders.

As of the date of this prospectus, we have not allocated any specific portion of the net proceeds of this offering for any particular purpose discussed below. We may use the net proceeds to purchase software, hardware or services, hire personnel, acquire businesses or assets, or for other general corporate purposes. We plan to use the net proceeds we receive from this offering as follows:

- to enhance our user experience by:
  - investing in the research and development of core search engine technology;
  - investing in the development of new products and services, although we have not identified any specific new products or services in which we plan to make significant investments in the near future;
  - acquiring additional bandwidth and servers to expand our network capacity; and
  - acquiring products or technologies that we believe will help us enhance our user experience;
- to expand our customer base by:
  - developing innovative online marketing products and services;
  - improving the effectiveness and efficiency of our distribution network;
  - further promoting our brand and enhancing our efforts to market our products and services; and
  - acquiring businesses that may help us further expand our online marketing services; and
- for general corporate purposes.

We expect to allocate our distribution, branding and marketing resources according to our business needs. We do not have any current plan to concentrate our resources on specific geographic region or industry.

In utilizing the proceeds of this offering, we may make loans to Baidu Online and Baidu Netcom, or we may subscribe to equity interests of these entities. Any loans to or investment in Baidu Online or Baidu Netcom are subject to PRC government approval. For example:

- loans by us to Baidu Online, as a wholly foreign-owned enterprise, to finance its activities cannot exceed statutory limits and must be registered with the SAFE; and

- loans by us to Baidu Netcom, which is a domestic PRC enterprise, must be approved in accordance with PRC law.

We may also decide to finance Baidu Online by subscribing to its equity interest, which is subject to approval of the Ministry of Commerce or its local counterpart. Since Baidu Netcom holds the license for Internet content services, or the ICP license, we are not likely to finance its activities by subscribing to its equity interest

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as regulations limit our ability to hold equity interests in an Internet content provider. We cannot assure you that we can obtain these government registrations or approvals on a timely basis, if at all, with respect to our future loans to or investment in Baidu Online or Baidu Netcom.

The foregoing represents our current intentions based upon our present plans and business conditions to use and allocate the net proceeds of this offering. Our management, however, will have significant flexibility and discretion to apply the net proceeds of this offering. If an unforeseen event occurs or business conditions change, we may use the proceeds of this offering differently than as described in this prospectus.

We intend to invest any additional net proceeds in short-term, interest-bearing, debt instruments or bank deposits. These investments may have a material adverse effect on the U.S. federal income tax consequences of your investment in our ADSs. These consequences are described in more detail in Taxation United States Federal Income Taxation Passive Foreign Investment Company.

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DIVIDEND POLICY

We have never declared or paid any dividends, nor do we have any present plan to pay any cash dividends on our ordinary shares in the foreseeable future. We currently intend to retain most, if not all, of our available funds and any future earnings to operate and expand our business.

Our board of directors has complete discretion whether to distribute dividends. Even if our board of directors decides to pay dividends, the form, frequency and amount of our dividends will depend upon our future operations and earnings, capital requirements and surplus, financial condition, contractual restrictions and other factors that our board of directors may deem relevant. If we pay any dividends, we will pay our ADS holders to the same extent as holders of our ordinary shares, subject to the terms of the deposit agreement, including the fees and expenses payable thereunder. See Description of American Depositary Shares. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

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CAPITALIZATION

The following table sets forth our capitalization as of March 31, 2005:

- on an actual basis;
- on a pro forma basis to give effect to the conversion of all our 11,548,682 ordinary shares issued as of March 31, 2005 into 11,548,682 Class B ordinary shares on May 30, 2005 and the automatic conversion of all of our outstanding preferred shares into 16,648,877 Class B ordinary shares immediately prior to the closing of this offering; and
- on a pro forma as adjusted basis to reflect the conversion of all our 11,548,682 ordinary shares issued as of March 31, 2005 into 11,548,682 Class B ordinary shares on May 30, 2005 and the automatic conversion of all of our outstanding preferred shares into 16,648,877 Class B ordinary shares immediately prior to the closing of this offering, the issuance and sale of 3,208,696 Class A ordinary shares in the form of ADSs by us in this offering, and the sale of 831,706 Class B ordinary shares by certain selling shareholders in this offering which will convert into 831,706 Class A ordinary shares, at the initial public offering price of US$27.00 per share, after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

You should read this table together with our consolidated financial statements and the related notes included elsewhere in this prospectus and the information under Management s Discussion and Analysis of Financial Condition and Results of Operations.

	As of March 31, 2005					
(in thousands except share numbers)	Actual		Pro Forma		Pro Forma As Adjusted	
	RMB	US$	RMB	US$	RMB	US$
Redeemable Convertible Preferred Shares						
Series A, par value US$0.00005 per share; authorized, issued and outstanding 4,800,000 shares	9,307	1,124				
Series B, par value US$0.00005 per share; authorized, issued and outstanding 9,600,000 shares	82,315	9,946				
Series C, par value US$0.00005 per share; authorized, issued and outstanding 2,248,877 shares	119,730	14,466				
	211,352	25,536				
Shareholders equity:	5,342	646	216,694	26,182		
Ordinary shares, par value US$0.00005 per share, 853,751,123 shares authorized, 11,548,682 shares issued and outstanding	5	1				
Class B ordinary shares, par value US$0.00005 per share, 31,326,801 shares authorized, 28,197,559 shares issued and outstanding on a pro forma basis, and 27,365,853 shares issued and outstanding on a pro forma as adjusted basis			12	2	11	2
Class A ordinary shares, par value US$0.00005 per share, 822,424,322 shares authorized, 4,040,402 shares issued and outstanding on a pro forma as adjusted basis					2	
Additional paid-in capital	49,439	5,973	260,784	31,509	898,103	108,513

Statutory reserve	523	63	523	63	523	63
Accumulated losses	(44,625)	(5,392)	(44,625)	(5,392)	(44,625)	(5,392)
Total shareholders equity	5,342	646	216,694	26,182	854,014	103,186
Total capitalization	216,694	26,182	216,694	26,182	854,014	103,186

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DILUTION

Our net tangible book value as of March 31, 2005 was approximately US$0.8 per ordinary share, and US$0.8 per ADS. Net tangible book value per ordinary share represents the amount of total tangible assets, minus the amount of total liabilities, divided by the total number of ordinary shares outstanding. The number of ordinary shares used to calculate dilution assumes that conversion of our outstanding preferred shares into ordinary shares will occur immediately prior to the consummation of this offering. Dilution is determined by subtracting net tangible book value per ordinary share from the assumed public offering price per ordinary share.

Without taking into account any other changes in such net tangible book value after March 31, 2005, other than to give effect to (i) the conversion of all of our preferred shares into ordinary shares, which will occur immediately prior to the closing of this offering, and (ii) our sale of the 3,208,696 ADSs offered in this offering, at the initial public offering price of US$27.00 per ADS and after deduction of underwriting discounts and commissions and estimated offering expenses (assuming the over-allotment option is not exercised), our pro forma net tangible book value at March 31, 2005 would have been US$3.2 per ordinary share, or US$3.2 per ADS. This represents an immediate increase in net tangible book value of US$2.4 per ordinary share, or US$2.4 per ADS, to existing shareholders and an immediate dilution in net tangible book value of US$23.8 per ordinary share, or US$23.8 per ADS, to investors purchasing ADSs in this offering.

The following table illustrates the dilution on a per ordinary share basis at the initial public offering price of US$27.00 per ordinary share and assuming that all ADSs are exchanged for ordinary shares:

Initial public offering price per ordinary share	US$ 27.00
Pro forma tangible book value per ordinary share at March 31, 2005	US$ 3.2
Amount of dilution in net tangible book value per ordinary share to new investors in the offering	US$ 23.8
Amount of dilution in net tangible book value per ADS to new investors in the offering	US$ 23.8

The following table summarizes, on a pro forma basis as of March 31, 2005, the differences between the shareholders as of March 31, 2005 and the new investors with respect to the number of ordinary shares purchased from us, the total consideration paid and the average price per ordinary share paid at the initial public offering price of US$27.00 per ADS before deducting estimated underwriting discounts and commissions and estimated offering expenses. The total number of ordinary shares purchased from us does not include 481,304 shares represented by 481,304 ADSs issuable pursuant to the exercise of the over-allotment option granted to the underwriters.

	Ordinary Shares Purchased		Total Consideration		Average Price Per Ordinary Share	Average Price Per ADS
	Number	Percent	Amount	Percent		
Existing shareholders	28,197,559	89.8%	US$ 31,510,000	26.7%	US$ 1.1	US$ 1.1
New investors	3,208,696	10.2	86,635,000	73.3	27.0	27.0

Total	31,406,255	100.0%	US$ 118,145,000	100.0%

The discussion and tables above also assume no exercise of any outstanding share options. As of the date of this prospectus, there are 1,963,996 ordinary shares issuable upon exercise of outstanding share options at a weighted average exercise price of US$4.43 per share, and there are 1,214,984 ordinary shares available for future issuance upon the exercise of future grants under our 2000 option plan. To the extent that any of these options are exercised, there will be further dilution to new investors.

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EXCHANGE RATE INFORMATION

Our business is primarily conducted in China and all of our revenues are denominated in RMB. However, periodic reports made to shareholders will include current period amounts translated into U.S. dollars using the then current exchange rates, for the convenience of the readers. The conversion of RMB into U.S. dollars in this prospectus is based on the noon buying rate in The City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. Unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this prospectus were made at a rate of RMB8.2765 to US$1.00, the noon buying rate in effect as of June 30, 2005. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign exchange and through restrictions on foreign trade. On August 1, 2005, the noon buying rate was RMB8.1046 to US$1.00.

The following table sets forth information concerning exchange rates between the RMB and the U.S. dollar for the periods indicated.

Period	Noon Buying Rate			
	Period-End	Average (1)	Low	High
	(RMB per U.S. Dollar)			
2000	8.2774	8.2784	8.2799	8.2768
2001	8.2766	8.2770	8.2786	8.2676
2002	8.2800	8.2770	8.2800	8.2669
2003	8.2767	8.2772	8.2800	8.2765
2004	8.2765	8.2768	8.2771	8.2765
2005				
February	8.2765	8.2765	8.2765	8.2765
March	8.2765	8.2765	8.2765	8.2765
April	8.2765	8.2765	8.2765	8.2765
May	8.2765	8.2765	8.2765	8.2765
June	8.2765	8.2765	8.2765	8.2765
July	8.1056	8.2264	8.2765	8.1056
August (through August 1)	8.1046	8.1046	8.1046	8.1046

(1) Annual averages are calculated using the average of month-end rates of the relevant year. Monthly averages are calculated using the average of the daily rates during the relevant period.

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ENFORCEABILITY OF CIVIL LIABILITIES

We were incorporated in the Cayman Islands in order to enjoy the following benefits:

- political and economic stability;
- an effective judicial system;
- a favorable tax system;
- the absence of exchange control or currency restrictions; and
- the availability of professional and support services.

However, there are certain disadvantages of being incorporated in the Cayman Islands. These disadvantages include:

- the Cayman Islands has a less developed body of securities laws as compared to the United States and these securities laws provide significantly less protection to investors; and
- Cayman Islands companies may not have standing to sue before the federal courts of the United States.

Our constituent documents do not contain provisions requiring that disputes, including those arising under the securities laws of the United States, between us, our officers, directors and shareholders, be arbitrated.

Substantially all of our operations are conducted in China, and substantially all of our assets are located in China. A majority of our officers are nationals or residents of jurisdictions other than the United States and a substantial portion of their assets are located outside the United States. As a result, it may be difficult for a shareholder to effect service of process within the United States upon these persons, or to enforce against us or them judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States.

We have appointed CT Corporation System as our agent to receive service of process with respect to any action brought against us in the United States District Court for the Southern District of New York under the federal securities laws of the United States or of any state in the United States or any action brought against us in the Supreme Court of the State of New York in the County of New York under the securities laws of the State of New York.

Maples and Calder, our counsel as to Cayman Islands law, and Commerce & Finance Law Offices, our counsel as to PRC law, have advised us, respectively, that there is uncertainty as to whether the courts of the Cayman Islands and China, respectively, would:

- recognize or enforce judgments of United States courts obtained against us or our directors or officers predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States; or

- entertain original actions brought in each respective jurisdiction against us or our directors or officers predicated upon the securities laws of the United States or any state in the United States.

Maples and Calder has further advised us that a final and conclusive judgment in the federal or state courts of the United States under which a sum of money is payable (other than a sum payable in respect of taxes, fines, penalties or similar charges) may be subject to enforcement proceedings as debt in the courts of the Cayman

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Islands under the common law doctrine of obligation. Moreover, the Cayman Island courts would not recognize or enforce judgments against us to the extent the judgment is punitive or penal; civil liability provisions of the U.S. federal and state securities law permit punitive damages against us. It is uncertain whether a judgment obtained from U.S. courts under civil liability provisions of U.S. federal or state securities law would be regarded by the Cayman Islands courts as penal or punitive in nature. Such a determination has yet to be made by any Cayman Islands court.

Commerce & Finance Law Offices has further advised us that the recognition and enforcement of foreign judgments are provided for under PRC Civil Procedures Law. Under the PRC Civil Procedures Law, courts in China may recognize and enforce foreign judgments pursuant to treaties between China and the country where the judgment is rendered or based on reciprocity arrangements for the recognition and enforcement of foreign judgments between jurisdictions. If there are neither treaties nor reciprocity arrangements between China and a foreign jurisdiction where a judgment is rendered, according to the PRC Civil Procedures Law, matters relating to the recognition and enforcement of a foreign judgment in China may be resolved through diplomatic channels. China does not have any treaties or other arrangements that provide for the reciprocal recognition and enforcement of foreign judgments with the United States or the Cayman Islands. As a result, it is generally difficult to recognize and enforce in China a judgment rendered by a court in either of these two jurisdictions.

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CORPORATE STRUCTURE

Corporate History

On January 18, 2000, our company was incorporated in the Cayman Islands by our founders, Robin Yanhong Li and Eric Yong Xu. On the same date, we established our first wholly owned subsidiary, Baidu Online, in Beijing, China. In June 2005, we established our second wholly owned subsidiary, Baidu China, in Shanghai, China.

We formed an intermediate holding company, Baidu Holdings Limited, in the British Virgin Islands in February 2000. Other than the equity interests in our subsidiaries in China, this company does not own any assets or conduct any operations.

PRC laws restrict foreign ownership of Internet content provision and advertising businesses. To comply with PRC laws, Baidu Netcom was formed by Robin Yanhong Li and Eric Yong Xu on June 5, 2001. Baidu Netcom holds the licenses and permits necessary to operate our websites and provide our online advertising services in China. Our relationships with Baidu Netcom and its shareholders are governed by a series of contractual arrangements. We are able to substantially control Baidu Netcom through these contractual arrangements. Accordingly, we have consolidated Baidu Netcom s historical financial results in our financial statements as a variable interest entity pursuant to U.S. GAAP.

In the opinion of Commerce & Finance Law Offices, our PRC legal counsel, (1) the ownership structure of, Baidu Online and Baidu Netcom, complies with, and immediately after this offering, will comply with, current PRC laws and regulations; (2) our contractual arrangements with Baidu Netcom and its shareholders are valid and binding on all parties to these arrangements, and do not violate current PRC laws or regulations; and (3) the business operations of our company, Baidu Online and Baidu Netcom comply with current PRC laws and regulations.

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Corporate Ownership Structure

The following diagram illustrates our current corporate structure and the place of formation and affiliation of each of our subsidiaries and Baidu Netcom as of the date of this prospectus.

** A limited liability company incorporated in the PRC*

Equity interest

Contractual arrangements including business cooperation agreement, operating agreement, license agreements, proxy agreement, and technology consulting service agreement. For a description of these agreements, see Corporate Structure Contractual Arrangements with Baidu Netcom and its Shareholders.

Contractual arrangements including proxy agreement, equity pledge agreement, option agreement, operating agreement, loan agreement and irrevocable power of attorney. For a description of these agreements, see Corporate Structure Contractual Arrangements with Baidu Netcom and its Shareholders.

Material Operating Entities

Baidu Online. Since our inception, we have conducted our operations in China primarily through Baidu Online, a wholly foreign-owned enterprise in China. Baidu Online operates our P4P and enterprise search software businesses and also provides technology consulting and other related services to Baidu Netcom. See Contractual Arrangements with Baidu Netcom and its Shareholders.

Baidu Netcom. We provide our online advertising and Internet content provider services through Baidu Netcom, a limited liability company established in China. Robin Yanhong Li and Eric Yong Xu, both of whom are PRC citizens, owns 75% and 25% of Baidu Netcom, respectively. Mr. Li is our co-founder, chairman and chief executive officer. Mr. Xu is our co-founder and is not currently involved in our management. Baidu Netcom operates our Baidu.com and Hao123.com websites and holds the licenses and approvals necessary to operate our websites and conduct our online advertising business in China. Baidu Netcom does not separately hire employees to operate the online advertising business. Baidu Online seconds employees to Baidu Netcom for

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the online advertising business. Such arrangement is part of the technology consulting services that Baidu Online provides to Baidu Netcom. In return, Baidu Netcom bears the costs and expenses related to these employees.

Contractual Arrangements with Baidu Netcom and its Shareholders

Our relationships with Baidu Netcom and its shareholders are governed by a series of contractual arrangements. Under PRC laws, each of Baidu Online and Baidu Netcom is an independent legal person and neither of them is exposed to liabilities incurred by the other party. Other than pursuant to the contractual arrangements between Baidu Online and Baidu Netcom, Baidu Netcom does not transfer any other funds generated from its operations to Baidu Online. In March 2005, we restructured these contractual arrangements as follows.

Technology Consulting Service Agreement. Pursuant to the exclusive technology consulting service agreement between Baidu Online and Baidu Netcom, Baidu Online has the exclusive right to provide to Baidu Netcom technology consulting services related to the maintenance of servers, software development and design of advertisements. Baidu Online also seconds employees to Baidu Netcom for whom Baidu Netcom bears the costs and expenses. Baidu Online owns the intellectual property rights related to the software developed by Baidu Online for Baidu Netcom. Baidu Netcom pays monthly service fees to Baidu Online based upon a pre-agreed formula, which takes into account the number of monthly page views and the basic fee for every one thousand page views of advertisements displayed on our websites. The basic fee for every one thousand page views is subject to periodic adjustment. The current rate of the basic fee is RMB0.9. The term of this agreement is ten years from the date thereof.

Business Cooperation Agreement. Pursuant to the business cooperation agreement between Baidu Netcom and Baidu Online, Baidu Netcom provides Internet information services, Internet advertising services and related services to Baidu Online to enable Baidu Online to provide P4P services on the websites owned and operated by Baidu Netcom, and Baidu Online provides search engine technology services to Baidu Netcom. Baidu Online agrees to pay a monthly fee of RMB10,000 to Baidu Netcom. The term of this agreement is ten years from the date thereof.

Operating Agreement. Pursuant to the operating agreement among Baidu Online, Baidu Netcom and the shareholders of Baidu Netcom, Baidu Online provides guidance and instructions on Baidu Netcom s daily operations and financial affairs. The shareholders of Baidu Netcom must designate the candidates recommended by Baidu Online as their representatives on Baidu Netcom s board of directors. Baidu Online has the right to appoint senior executives of Baidu Netcom. In addition, Baidu Online agrees to guarantee Baidu Netcom s performance under any agreements or arrangements relating to Baidu Netcom s business arrangements with any third party. Baidu Netcom, in return, agrees to pledge its accounts receivable and all of its assets to Baidu Online. Moreover, Baidu Netcom agrees that without the prior consent of Baidu Online, Baidu Netcom will not engage in any transactions that could materially affect the assets, liabilities, rights or operations of Baidu Netcom, including, without limitation, incurrence or assumption of any indebtedness, sale or purchase of any assets or rights, incurrence of any encumbrance on any of its assets or intellectual property rights in favor of a third party or transfer of any agreements relating to its business operation to any third party. The term of this agreement is ten years from the date thereof.

Software License Agreement. Under the software license agreement, Baidu Online granted Baidu Netcom a non-exclusive, non-assignable and non-transferrable right to use Baidu Chinese Search Engine and Baidu Internet P4P System software. Baidu Netcom can only use the software on its designated operating systems to process its internal data. The annual license fee for each software is RMB5.0 million. When deciding the amount of the annual license fee, Baidu Online and Baidu Netcom considered several factors, including functionality and quality of the software, past and ongoing research and development costs incurred by Baidu Online in developing and upgrading the software, license fees of other portal search software applications, Baidu Online s enterprise search application license fees, and Baidu Netcom s financial resources and projected operating results. The term of the license agreement is five years from the date thereof.

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Other License Agreements. Under these license agreements, Baidu Online granted Baidu Netcom the right to use the registered domain names, trademarks and web layout for the websites owned and operated by Baidu Netcom on an exclusive basis. The annual license fee under each license agreement is RMB10,000, subject to certain adjustments. The term of each license agreement is five years from the date thereof.

Proxy Agreement. Pursuant to the proxy agreement among Baidu Online, Baidu Netcom and shareholders of Baidu Netcom, the shareholders of Baidu Netcom agree to entrust all the rights to exercise their voting power to the person(s) appointed by Baidu Online. The term of the proxy agreement is 10 years from the date thereof.

Equity Pledge Agreement. Under the equity pledge agreement between the shareholders of Baidu Netcom and Baidu Online, the shareholders of Baidu Netcom pledged all of their equity interests in Baidu Netcom to Baidu Online to guarantee their obligations under the loan agreement and Baidu Netcom s performance of its obligations under the technology consulting agreement. If Baidu Netcom or either of its shareholders breaches its respective contractual obligations, Baidu Online, as pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests. The shareholders of Baidu Netcom agreed not to dispose of the pledged equity interests or take any actions that would prejudice Baidu Online s interest. The equity pledge agreement will expire two years after Baidu Netcom and its shareholders fully perform their respective obligations under the exclusive technology consulting service agreement and the loan agreement.

Option Agreement. Under the option agreement between the shareholders of Baidu Netcom and Baidu Online, the shareholders of Baidu Netcom irrevocably granted Baidu Online or its designated person an exclusive option to purchase, to the extent permitted under PRC law, all or part of the equity interests in Baidu Netcom for the cost of the initial contributions to the registered capital or the minimum amount of consideration permitted by applicable PRC law. Baidu Online or its designated person has sole discretion to decide when to exercise the option, whether in part or in full. The term of this agreement is ten years from the date thereof.

Loan Agreement. Under the loan agreement between the shareholders of Baidu Netcom and Baidu Online, the parties confirmed that Baidu Online had made an RMB2.0 million interest-free loan to the shareholders of Baidu Netcom solely for the latter to fund the initial capitalization of Baidu Netcom in June 2001. The loan can be repaid only with the proceeds from sale of the shareholder s equity interest in Baidu Netcom to Baidu Online. The term of the agreement is ten years from the date thereof.

Irrevocable Power of Attorney. The shareholders of Baidu Netcom have each executed an irrevocable power of attorney to appoint Shawn Wang and David Hongbo Zhu as their attorneys-in-fact to vote on their behalf on all Baidu Netcom matters requiring shareholder approval. The appointment of Shawn Wang and David Hongbo Zhu as attorneys-in-fact will terminate if either person is no longer employed by Baidu Online. The term of each power of attorney is ten years from the date thereof.

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SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated statement of operations data for the three years ended December 31, 2002, 2003 and 2004 and the consolidated balance sheet data as of December 31, 2003 and 2004 have been derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The selected consolidated statement of operations data for the three months ended March 31, 2004 and 2005 and the selected consolidated balance sheet data as of March 31, 2005 have been derived from our unaudited condensed interim consolidated financial statements included elsewhere in this prospectus. We have prepared the unaudited condensed interim consolidated financial information on the same basis as our audited consolidated financial statements. The unaudited financial information includes all adjustments, consisting only of normal and recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the periods presented. Our historical results do not necessarily indicate results expected for any future periods. In addition, our unaudited results for the three months ended March 31, 2005 may not be indicative of our results for the full year ended December 31, 2005. The selected consolidated financial data should be read in conjunction with, and are qualified in their entirety by reference to, our audited consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus.

Our audited consolidated financial statements are prepared and presented in accordance with U.S. GAAP. Our selected consolidated statement of operations data for the two years ended December 31, 2000 and 2001 and our consolidated balance sheet data as of December 31, 2000, 2001 and 2002 have been derived from our unaudited consolidated financial statements which are not included in this prospectus, but which have been prepared on the same basis as our audited consolidated financial statements.

	For the Year Ended December 31,						For the Three Months Ended March 31,		
(in thousands except per share and per ADS data)	2000	2001	2002	2003	2004		2004	2005	
	RMB	RMB	RMB	RMB	RMB	US$	RMB	RMB	US$
Consolidated Statement of Operations Data:									
Revenues:									
Online marketing services		202	4,292	31,775	106,854	12,910	15,695	43,019	5,198
Enterprise search software and related services		366	1,724	2,803	7,958	962	1,412	2,076	251
Portal search services	1,340	5,955	5,004	5,993	2,639	319	867	581	70
Total revenues	1,340	6,523	11,020	40,571	117,451	14,191	17,974	45,676	5,519
Less: Business tax and surcharges	(41)	(295)	(496)	(1,933)	(6,542)	(790)	(824)	(3,048)	(368)
Total net revenues	1,299	6,228	10,524	38,638	110,909	13,401	17,150	42,628	5,151
Operating costs and expenses:									
Cost of revenues	(1,324)	(4,706)	(9,519)	(20,703)	(32,985)	(3,985)	(5,747)	(12,570)	(1,519)
Selling, general and administrative	(5,644)	(10,653)	(11,930)	(16,930)	(39,004)	(4,713)	(5,822)	(15,698)	(1,897)
Research and development	(1,647)	(3,868)	(3,885)	(5,191)	(11,406)	(1,378)	(2,032)	(5,479)	(662)
Share-based compensation	(9,440)	(5,043)	(4,233)	(5,109)	(16,510)	(1,995)	(2,607)	(6,142)	(741)
Total operating costs and expenses	(18,055)	(24,270)	(29,567)	(47,933)	(99,905)	(12,071)	(16,208)	(39,889)	(4,819)
Operating (loss)/profit	(16,756)	(18,042)	(19,043)	(9,295)	11,004	1,330	942	2,739	332
Interest income	1,233	2,679	586	325	1,135	137	31	777	94
Other income (expense), net		(502)	(120)	85	347	42	65		
Taxation					(481)	(59)		(1,015)	(123)
Net (loss)/income	(15,523)	(15,865)	(18,577)	(8,885)	12,005	1,450	1,038	2,501	303
Net (loss)/income per ordinary share:									
Basic	(7.00)	(3.19)	(2.44)	(0.87)	1.09	0.13	0.10	0.22	0.03
Diluted	(7.00)	(3.19)	(2.44)	(0.87)	0.43	0.05	0.04	0.08	0.01

Net (loss)/income per ADS:									
Basic	(7.00)	(3.19)	(2.44)	(0.87)	1.09	0.13	0.10	0.22	0.03
Diluted	(7.00)	(3.19)	(2.44)	(0.87)	0.43	0.05	0.04	0.08	0.01
Weighted average number of ordinary shares used in per share calculations:									
Basic	2,218	4,967	7,622	10,189	10,983	10,983	10,876	11,508	11,508
Diluted	2,218	4,967	7,622	10,189	28,124	28,124	26,930	29,808	29,808
Pro forma net earnings per share on an as converted basis for Class A and Class B ordinary shares									
Basic					0.45	0.05		0.09	0.01
Diluted					0.43	0.05		0.08	0.01
Pro forma weighted average aggregate number of ordinary shares on an as converted basis used in per share calculations for Class A and Class B ordinary shares									
Basic					26,696	26,696		28,157	28,157
Diluted					28,124	28,124		29,808	29,808

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	As of December 31,						As of March 31,	
(in thousands)	2000	2001	2002	2003	2004		2005	
	RMB	RMB	RMB	RMB	RMB	US$	RMB	US$
Consolidated Balance Sheets Data:								
Cash and cash equivalents	80,919	71,511	58,009	62,825	200,196	24,188	194,255	23,471
Total assets	86,481	79,043	67,549	76,703	262,206	31,680	284,296	34,350
Total current liabilities	844	3,973	6,781	19,639	54,192	6,548	67,602	8,168
Redeemable convertible preferred shares	91,622	91,622	91,622	91,622	211,352	25,536	211,352	25,536
Total shareholders (deficit)/equity	(5,985)	(16,552)	(30,854)	(34,558)	(3,338)	(404)	5,342	646
Total liabilities, redeemable convertible preferred shares and shareholders equity	86,481	79,043	67,549	76,703	262,206	31,680	284,296	34,350

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RECENT DEVELOPMENTS

The following is an estimate of our selected preliminary unaudited financial results for the three months ended June 30, 2005. These results are subject to the completion of our normal quarter-end closing procedures and review by our independent auditors in accordance with Statement of Auditing Standards No. 100, which provides guidance on performing reviews of interim financial information. As a result, our preliminary unaudited financial results set forth below may be subject to change. For additional information regarding the various risks and uncertainties inherent in estimates of this type, see Forward-Looking Statements.

We estimate that we generated total revenues of approximately RMB69.7 million (US$8.4 million) in the three months ended June 30, 2005, a 52.5% increase from our total revenues of RMB45.7 million (US$5.5 million) in the three months ended March 31, 2005. This increase was primarily due to a substantial increase in our revenues from online marketing services.

We estimate that we had an operating profit of approximately RMB12.0 million (US$1.4 million) in the three months ended June 30, 2005. This would represent a 344.4% increase from our operating profit of RMB2.7 million (US$0.3 million) in the three months ended March 31, 2005. Our estimated operating profit for the three months ended June 30, 2005 reflected share-based compensation expenses of approximately RMB6.2 million (US$0.7 million). We have used the mid-point of the estimated offering price range, which was determined at the time when our selected preliminary unaudited financial results for the three months ended June 30, 2005 were prepared, to calculate our share-based compensation expenses for options granted in the three months ended June 30, 2005.

We estimate that we had net income of approximately RMB12.1 million (US$1.5 million) in the three months ended June 30, 2005. This would represent a 384.0% increase from our net income of RMB2.5 million (US$0.3 million) in the three months ended March 31, 2005.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the section headed Selected Consolidated Financial Data and our consolidated financial statements and the related notes included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Risk Factors and elsewhere in this prospectus.

Overview

We are the leading Chinese language Internet search provider. Our search engine was the most frequently used search engine in China in 2004, according to iResearch, and our Baidu.com website was the second largest website in China and the seventh largest website globally, as measured by user traffic during the three-month period ended July 31, 2005, according to Alexa.com. We serve three primary constituencies:

Users. We provide our users with Chinese language Internet search services, including access to our frequently updated index of over 690 million web pages, 80 million image files and 10 million multimedia files. In addition, we offer Baidu Post Bar, a query-based online community, which currently consists of over 820,000 message boards.

Customers. We provide online marketing services to our P4P customers and tailored solutions customers. We define customers in a given period as those that contribute revenues to us during the same period. Our P4P customers are those who primarily use our auction-based P4P services, and our tailored solutions customers are those to whom we provide marketing solutions, which may consist of one or more forms of our online advertising services as well as P4P services. Our P4P services allow customers to use our automated online tools to create text-based descriptions of their web pages and bid on keywords that trigger the display of their web page information and links. Our online advertising services allow customers to use both query sensitive and non-query sensitive advertising services, including text links and graphical advertisements. We also offer enterprise search software and related services to companies and government agencies in China.

Baidu Union Members. We have relationships with over 76,000 third-party websites operated in China, which we refer to as Baidu Union. Our Baidu Union members generally place a Baidu search box on their websites to enable their users to access our Baidu.com website by entering a query in the search box. In return, we pay our Baidu Union members a portion of P4P revenues generated from click-throughs on our customers links, which are displayed on our websites in response to search queries of users of our Baidu Union websites or directly on their websites. In 2004, approximately a quarter of our total revenues was generated from click-throughs by users of our Baidu Union websites. We have recently begun to offer some of our Baidu Union members contextual marketing services, which we refer to as ProTheme, allowing the display of our customers links that are relevant to the content on our Baidu Union websites.

We were incorporated in the Cayman Islands in January 2000 and initially provided Internet search solutions to Chinese portals. We launched our Internet search services on Baidu.com and began generating revenues from our P4P services in September 2001. We believe we were the first P4P services provider in China. We began generating revenues from our other online marketing services in July 2003.

We have grown significantly since our inception. Our total net revenues increased from RMB10.5 million in 2002 to RMB110.9 million (US$13.4 million) in 2004. In 2004 and the three months ended March 31, 2005, we recorded net income of RMB12.0 million (US$1.5 million) and RMB2.5 million (US$0.3 million), respectively.

We incurred share-based compensation expenses of RMB16.5 million (US$2.0 million) and RMB6.1 million (US$0.7 million) in 2004 and the three months ended March 31, 2005, respectively. As of March 31, 2005, we had accumulated losses of approximately RMB44.6 million (US$5.4 million). We first attained profitability in the quarter ended March 31, 2004, but experienced net losses prior to that period. We do not account for our results of operations on a geographic or other basis, and we are unable to allocate costs among our various products and services.

PRC law currently limits foreign ownership of companies that provide Internet content and advertising services. To comply with these foreign ownership restrictions, we operate our websites and provide online advertising services in China through Baidu Netcom, a PRC limited liability company wholly owned by our co-founder and chief executive officer, Robin Yanhong Li, and our co-founder, Eric Yong Xu, both of whom are PRC citizens. Baidu Netcom holds the licenses and approvals necessary to operate our websites and provide online advertising services in China. We have contractual arrangements with Baidu Netcom and its shareholders that enable us to substantially control Baidu Netcom. Accordingly, we consolidate Baidu Netcom s results in our financial statements. For a description of these contractual arrangements, see Corporate Structure Contractual Arrangements with Baidu Netcom and its Shareholders.

Our limited operating history makes it difficult to predict future results of operations and, therefore, our recent revenue growth should not be taken as an indication of the rate of revenue growth, if any, that can be expected in the future. In addition, our limited operating history provides us with a limited historical basis to assess the impact of our critical accounting policies.

Revenues

In 2004, we generated total revenues of RMB117.5 million (US$14.2 million), of which RMB106.9 million (US$12.9 million), or 91.0%, was derived from our online marketing services. In the three months ended March 31, 2005, we generated total revenues of RMB45.7 million (US$5.5 million), of which RMB43.0 million (US$5.2 million), or 94.2%, was derived from our online marketing services.

For the year ended December 31, 2004 and for the three months ended March 31, 2005, our total net revenues amounted to RMB110.9 million (US$13.4 million) and RMB42.6 million (US$5.2 million), respectively. Our total net revenues are net of PRC business taxes and related surcharges. Baidu Online s revenues are subject to a 5% business tax. Baidu Netcom s revenues are subject to a 5% business tax rate, as well as an additional 3% surcharge. We deduct these amounts from our gross revenues to arrive at our total net revenues.

Since PRC laws and regulations related to advertising do not currently classify P4P as a form of advertising, we operate our P4P services through Baidu Online, which does not hold an advertising license. However, we cannot assure you that the PRC government authorities will not classify P4P as a form of advertising in the future. If new regulations characterize P4P as a form of advertising, we may have to conduct our P4P business through Baidu Netcom. This would increase the applicable tax rates to our revenues, as revenues from online advertising services provided by Baidu Netcom are subject to an additional 3% surcharge. Any change in the classification of P4P by the PRC government authorities could cause significant disruption to our business operations and materially and adversely affect our results of operations. See Risk Factors Risks Related to Our Corporate Structure If the PRC government were to classify P4P services as a form of advertising, we may have to conduct our P4P business through Baidu Netcom, which would increase our effective tax rate, and we might be subject to sanctions and required to pay delinquent taxes.

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Revenue Composition

We currently derive revenues primarily from three sources:

- online marketing services, which accounted for 38.9%, 78.3%, 91.0% and 94.2% of our total revenues in 2002, 2003, 2004 and the three months ended March 31, 2005, respectively;
- enterprise search software and related services, which accounted for 15.6%, 6.9%, 6.8% and 4.5% of our total revenues in 2002, 2003, 2004 and the three months ended March 31, 2005, respectively; and
- portal search services, which accounted for 45.5%, 14.8%, 2.2% and 1.3% of our total revenues in 2002, 2003, 2004 and the three months ended March 31, 2005, respectively.

Online Marketing Services. We provide online marketing services to our P4P customers and tailored solutions customers. We generated approximately 91.0% of our total revenues in 2004 from online marketing services, a substantial majority of which was derived from our P4P services. Our P4P customers are those who primarily use our auction-based P4P services, and our tailored solutions customers are those to whom we provide marketing solutions, which may consist of one or more forms of our online advertising services as well as P4P services.

Our P4P platform is an online marketplace that introduces Internet search users to customers who bid or pay a fixed fee based on click-throughs for priority placement of their links in the search results. We recognize P4P revenues when a user clicks on a customer s link in the search results, based on the amount that the customer has agreed to pay for each click-through or in some cases, other pre-determined performance measures. We have historically acquired our P4P customers primarily through our network of distributors and, to a lesser extent, through our direct sales force.

To our knowledge, distributors typically require advance RMB cash payments from our customers and then may transfer a portion or all of such payments to us in exchange for buying power for our P4P services, which we refer to in this prospectus as Baidu Currency. We in effect provide discounts to our distributors and customers for our auction-based P4P services, and the level of discounts depends on the specific arrangement we have with a distributor or a customer. As an illustrative example, a distributor pays us RMB100 in cash and may receive 150 Baidu Currency units in its advance payment account maintained with us. In other words, the distributor is effectively paying RMB66.67 for every 100 units of Baidu Currency, receiving a discount of RMB33.33.

We also require each of our auction-based P4P customers to open an advance payment account with us and maintain a minimum balance of Baidu Currency units in this account. For a P4P customer acquired through a distributor, the distributor typically transfers certain number of Baidu Currency units from its advance payment account with us to the customer s account. The distributor decides on the number of Baidu Currency units to be transferred to the customer s account and the timing of such transfer. The number of Baidu Currency units that a customer receives from the distributor for the customer s cash payment to the distributor is determined based on the negotiation between them. We are not involved in such negotiation and do not know the relevant information. Once the customer s account is established, the customer may enter keywords it wishes to bid on, the amount it wishes to bid for each keyword, and a brief description of its product and/or service offerings and information necessary for hypertext linking. Bids are expressed as the number of Baidu Currency units that the customer is willing to pay for each click-through by our Internet search users. Our search results are prioritized based on customers bids for placement within the results, with the highest bidder appearing at the top of the search results. When a user clicks on the customer s link appearing in our search results, we recognize revenue upon such click-through and concurrently deduct the number of Baidu Currency units that the customer bid from its account with us. Our distributors and customers are not entitled to any cash redemption for unused Baidu Currency units in their accounts with us. We do not recognize any unused Baidu Currency as revenue.

As an illustrative example, a distributor pays us RMB100 in cash and receives 150 Baidu Currency units. The distributor then transfers 80 Baidu Currency units to a customer s account with us based on the negotiation between them. If a customer places a bid for one Baidu Currency unit per click-through and there are 50 click-throughs in a given day, we will deduct 50 Baidu Currency units from the customer s account on that day. For

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financial reporting purposes, we recognize the cash value of the 50 Baidu Currency units as our revenue from this customer. As the distributor which introduced the customer to us is effectively paying us RMB0.667 for each Baidu Currency unit, the cash value of each Baidu Currency unit transferred by the distributor to the customer is RMB0.667. Accordingly, we recognize the cash value of 50 Baidu Currency units as our revenue, which equals to RMB33.35 in this example.

We provide tailored solutions customers with marketing solutions which may include one or more forms of online advertising services such as text links and graphical advertisements, as well as P4P services. Our online advertising services may be query sensitive or non-query sensitive. We have acquired our tailored solutions customers primarily through our direct sales force. Our agreements with these customers generally have a term of no more than one year. Our tailored solutions customers generally pay us based on pre-determined performance metrics, such as number of click-throughs, duration of placement, number of converted users and number of telephone calls. In recent months, some of our large tailored solutions customers have increasingly used our auction-based P4P services as one of the means to meet their online marketing needs. We expect to continue to experience such trend in the near future.

The most significant factors that directly or indirectly affect our online marketing revenues are:

- the number of users visiting our websites and our Baidu Union websites;
- the number of searches initiated on our websites and our Baidu Union websites;
- the rate at which users click on paid search results;
- the number of online marketing customers;
- the total online marketing budgets of our customers; and
- the total number of advertisements displayed on our websites.

Historically, our P4P services have primarily been driven by the increase in the number of page views and the number of P4P customers. We believe that an increase in the number of active P4P customers generally leads to an increase in the number of sponsored links and a higher average price per click-through for selected keywords. Our P4P customer growth has primarily been driven by adoption of our P4P services by SMEs, and, to a lesser extent, large enterprises. Our online advertising services have historically been driven by the general increase in our customers online marketing budgets. Most of our tailored solutions customers are medium and large enterprises. We expect the number of our online marketing customers to grow and, as a result, our customer mix may change; however, we expect our online marketing customer base to remain diverse for the foreseeable future. Our online marketing customers are increasingly seeking marketing solutions with measurable results in order to maximize their return on investment, or ROI. To meet our customers needs, we will continue to evaluate the effectiveness of our various products and services and adjust the mix of our service offerings to optimize our customers ROI. We expect that we will continue to earn a substantial majority of our revenues from our online marketing services. As a result, we plan to continue focusing most of our resources on expanding our online marketing services.

Enterprise Search Software and Related Services. We provide enterprise search software and related services to companies and government agencies in China. We develop, market and sell software that employs our search technology to search and manage information on the intranet of our customers and on the Internet. We sell our enterprise search software and related services primarily through our direct sales personnel. We are subject to a PRC value added tax, or VAT, on sales of our enterprise search software, and are eligible to receive rebates for a portion of the VAT paid by us pursuant to applicable PRC tax regulations. We record revenues from our enterprise search software and related services net of the VAT payable by us but include the amount of VAT rebates received or receivable from the PRC tax authorities. We expect that our online marketing services will grow at a faster rate than our other products and services, and revenues from our enterprise search software and related services will decline as a percentage of our total revenues in the future.

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Portal Search Services. We provide search engine services to Chinese Internet portals that offer search results to their own users without displaying our brand. We intend to discontinue our portal search services in the near future.

Revenue Collection

We collect payments for our P4P services primarily from our distributors. We require our P4P distributors or direct customers to pay a deposit before using our P4P services, to maintain a minimum balance in their accounts, and to replenish the accounts immediately or in some cases, within certain grace periods after their account balance falls below the designated amount. We deduct the amount due to us from the deposit paid by a distributor or a customer when a user clicks on the customer s link in the search results.

We generally require payments from customers of our other services within 30 to 90 days of delivery of our products or services. As of March 31, 2005, we had accounts receivable of RMB15.0 million (US$1.8 million), net of provisions, mainly due from customers for our online advertising and enterprise search software and related services.

Operating Costs and Expenses

Our operating costs and expenses consist of cost of revenues, selling, general and administrative expenses and research and development expenses. Our total operating costs and expenses have declined as a percentage of our total revenues from 2002 to 2004 due to economies of scale and the revenue growth we have achieved.

Cost of Revenues

The following table sets forth the components of our cost of revenues both in absolute amount and as a percentage of total net revenues for the periods indicated.

	For the Year Ended December 31,							For the Three Months Ended March 31,				
(in thousands, except percentages)	2002		2003		2004			2004		2005		
	RMB	%	RMB	%	RMB	US$	%	RMB	%	RMB	US$	%
								(unaudited)		(unaudited)	(unaudited)	
Total net revenues	10,524	100.0	38,638	100.0	110,909	13,401	100.0	17,150	100	42,628	5,151	100.0
Cost of revenues:												
Traffic acquisition costs	(4,128)	39.2	(10,638)	27.6	(10,901)	(1,317)	9.8	(2,076)	12.1	(2,339)	(283)	5.5
Bandwidth costs	(1,146)	10.9	(2,217)	5.7	(8,475)	(1,024)	7.6	(1,319)	7.7	(3,821)	(462)	9.0
Depreciation of servers and other equipment	(2,645)	25.2	(4,146)	10.7	(7,072)	(855)	6.4	(1,269)	7.4	(3,719)	(449)	8.7

Operational expenses	(1,600)	15.2	(3,702)	9.6	(6,537)	(789)	5.9	(1,083)	6.3	(2,691)	(325)	6.3
Total cost of revenues	(9,519)	90.5	(20,703)	53.6	(32,985)	(3,985)	29.7	(5,747)	33.5	(12,570)	(1,519)	29.5

Traffic Acquisition Costs. Traffic acquisition costs represent the portion of our P4P revenues that we share with our Baidu Union members. We typically pay a Baidu Union member, based on a pre-agreed arrangement, a portion of the P4P revenues generated from click-throughs by users of that member s website. We expect our traffic acquisition costs to increase as we further expand our Baidu Union network.

Bandwidth Costs. Bandwidth costs are the fees we pay to China Telecom and China Netcom for telecommunications services and for hosting our servers at their Internet data centers. We expect our bandwidth costs, as variable costs, to increase with traffic on our websites. Our bandwidth costs could also increase if China Telecom and China Netcom were to raise their service charges.

Depreciation of Servers and Other Equipment. We include depreciation expenses within our cost of revenues for servers and other computer hardware that are directly related to our business operations and technical support. We expect our depreciation expenses to increase as we purchase additional servers and other computer hardware to meet the needs of our users and customers.

Operational Expenses. Operational expenses include primarily salary and benefits expenses and travel and other expenses incurred by our operating and technical support personnel. Salary and benefits expenses include wages, bonuses, and medical insurance, unemployment insurance and pension benefits.

Operating Expenses

The following table sets forth the components of our operating expenses both in absolute amount and as a percentage of total net revenues for the periods indicated.

	For the Year Ended December 31,							**For the Three Months Ended March 31,**				
(in thousands, except percentages)	**2002**		**2003**		**2004**			**2004**		**2005**		
	RMB	**%**	**RMB**	**%**	**RMB**	**US$**	**%**	**RMB**	**%**	**RMB**	**US$**	**%**
								(unaudited)		(unaudited)	(unaudited)	
Total net revenues	10,524	100.0	38,638	100.0	110,909	13,401	100.0	17,150	100.0	42,628	5,151	100.0
Cost of revenues	(9,519)	90.5	(20,703)	53.6	(32,985)	(3,985)	29.7	(5,747)	33.5	(12,570)	(1,519)	29.5
Selling, general and administrative	(11,930)	113.3	(16,930)	43.8	(39,004)	(4,713)	35.2	(5,822)	33.9	(15,698)	(1,897)	36.8
Selling and marketing	(7,718)	73.3	(9,200)	23.8	(23,345)	(2,821)	21.1	(3,216)	18.7	(8,417)	(1,017)	19.7
General and administrative	(4,212)	40.0	(7,730)	20.0	(15,659)	(1,892)	14.1	(2,606)	15.2	(7,281)	(880)	17.1
Research and development	(3,885)	36.9	(5,191)	13.4	(11,406)	(1,378)	10.3	(2,032)	11.9	(5,479)	(662)	12.9
Share-based compensation	(4,233)	40.2	(5,109)	13.2	(16,510)	(1,995)	14.9	(2,607)	15.2	(6,142)	(741)	14.4
Total costs and operating expenses	(29,567)	280.9	(47,933)	124.0	(99,905)	(12,071)	90.1	16,208	94.5	(39,889)	(4,819)	93.6

Research and Development Expenses

Research and development expenses primarily consist of salaries and benefits for research and development personnel. We expense research and development costs as they are incurred, except for capitalized software development costs that fulfill the capitalization criteria under SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, or FAS 86, Accounting for the Costs of Computer Software to be Sold, Lease, Otherwise Marketed. We anticipate that research and development expenses will increase as we hire additional research and development personnel to further enhance our technology platform and meet the expected growth of our operations.

Selling, General and Administrative Expenses

(1) Selling and Marketing Expenses. Our selling and marketing expenses primarily consist of salaries and benefits and commissions for our sales and marketing personnel and promotional and marketing expenses. We expect to incur higher selling and marketing expenses as we intensify our brand-promotion efforts and hire additional sales and marketing personnel. We also expect our selling and marketing expenses to increase, reflecting the addition of over 100 former Qilang employees, in connection with our acquisition of Qilang s distribution business. To the extent that our direct sales force sells a greater proportion of our online marketing services, we expect that our selling expense will increase as a result of increased sales commissions. We expect that our selling and marketing expenses will increase in absolute amount and may increase as a percentage of our total net revenues in the near term.

(2) General and Administrative Expenses. Our general and administrative expenses primarily consist of salaries and benefits for our general and administrative personnel and fees and expenses for legal, accounting and other professional services. We expect to incur additional general and administrative expenses as we expand our operations and become a U.S.-listed public company.

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Share-based Compensation Expenses

We recognize share-based compensation expenses as we amortize a portion of share-based compensation expenses. We grant options to our employees and record a compensation charge for the excess of the fair value of the shares at the grant date over the amount an employee must pay to acquire the shares. We also grant options to consultants and account for such options under the fair value method. We amortize share-based compensation expenses over the vesting periods of the related options, which are generally four years long. We recorded share-based compensation expenses of RMB4.2 million, RMB5.1 million and RMB16.5 million (US$2.0 million) in 2002, 2003 and 2004, respectively. We had RMB16.8 million (US$2.0 million) and RMB25.2 million (US$3.0 million) of unamortized deferred share-based compensation expenses as of December 31, 2004 and March 31, 2005, respectively. Upon closing of this offering, we will be required to recognize, as an expense, the fair value of share options and other share-based compensation to optionees beginning in 2006. As a result, beginning in 2006, the amortization charges of our share-based compensation expenses are likely to be significantly higher than those we would have recorded under our current method of accounting for share options.

The following table sets forth the allocation of our share-based compensation expenses both in absolute amount and as a percentage of total share-based compensation expenses, among our employees based on the nature of work which they were assigned to perform.

	For the Year Ended December 31,							For the Three Months Ended March 31,				
(in thousands)	2002		2003		2004			2004		2005		
	RMB	%	RMB	%	RMB	US$	%	RMB	%	RMB	US$	%
								(unaudited)		(unaudited)	(unaudited)	
Allocation of Share-based Compensation Expenses												
Cost of revenues	313	7.4%	648	12.7%	1,665	201	10.1%	448	17.2%	228	27	3.7%
Selling, general and administrative	3,055	72.2%	2,669	52.2%	11,720	1,416	71.0%	1,429	54.8%	4,825	582	78.6%
Research and development	865	20.4%	1,792	35.1%	3,125	378	18.9%	730	28.0%	1,089	132	17.7%
Total share-based compensation expenses	4,233	100.0%	5,109	100.0%	16,510	1,995	100.0%	2,607	100%	6,142	741	100.0%

Taxation

Because we, our subsidiaries and Baidu Netcom are incorporated in different jurisdictions, we file separate income tax returns.

Under the current laws of the Cayman Islands and the British Virgin Islands, we and Baidu Holdings Limited are not subject to income or capital gains tax. Additionally, dividend payments made by any of these companies are not subject to withholding tax in those jurisdictions.

PRC Enterprise Income Tax

PRC enterprise income tax is calculated based on taxable income determined under PRC GAAP. In accordance with Income Tax Law of China for Enterprises with Foreign Investment and Foreign Enterprises, or the Income Tax Law, foreign invested enterprises, or FIEs, established in the PRC are generally subject to an enterprise income tax rate of 33%. The Income Tax Law also provides certain favorable tax treatment to an FIE that qualifies as a new or high-technology enterprise and is registered and operates in a specified high-tech zone in the PRC. PRC domestic companies are governed by the Enterprise Income Tax Laws of the PRC and are also generally subject to an enterprise income tax rate of 33%.

Baidu Online, an FIE which is registered and operates in Beijing Zhongguancun Science Park, has been qualified as a new or high-technology enterprise. It is entitled to a preferential enterprise income tax rate of

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15% and other favorable tax treatments based on that status. Furthermore, Baidu Online was entitled to a three-year exemption from the enterprise income tax starting from its first year of operation (which expired on December 31, 2002) and was entitled to a preferential enterprise income tax rate of 7.5% for the succeeding three years (which will expire on December 31, 2005). After December 31, 2005, Baidu Online will be subject to a preferential enterprise income tax rate of 15% so long as it continues to be registered in a high-tech zone and maintains its new or high-technology enterprise status.

To qualify as a new or high-technology enterprise for PRC enterprise income tax purposes, a business entity generally must meet certain financial and non-financial criteria, including:

- a minimum level of revenues generated from high technology related sales or services as a percentage of total revenues;
- a minimum number of employees engaged in research and development; and
- a minimum research and development expense as a percentage of total revenues.

Baidu Online s status as a new or high-technology enterprise is re-assessed every other year. The PRC central or provincial government could determine at any time to immediately eliminate or reduce such preferential tax treatment, and our consolidated effective tax rate would increase as a result.

If Baidu Online no longer qualifies for the preferential enterprise income tax rate, we will consider available options under applicable law that would enable us to qualify for further preferential tax treatment. We recently established Baidu China, a new wholly owned subsidiary in China, and intend to apply in the near future for preferential tax treatment for Baidu China similar to that enjoyed by Baidu Online. To the extent we are unable to offset the impact of the expiration of Baidu Online s preferential tax treatment with new tax exemptions, tax incentives or other tax benefits, the expiration of this preferential tax treatment will cause our effective tax rate to increase. The amount of income tax payable by our PRC subsidiaries in the future will depend on various factors, including, among other things, the results of operations and taxable income of, and the statutory tax rate applicable to, each of the subsidiaries. Our effective tax rate depends partially on the extent of the relative contribution of each of our subsidiaries to our consolidated taxable income.

In addition, so long as we continue to recognize share-based compensation expenses in future periods, our consolidated effective tax rate will exceed the statutory tax rate as a result of such expenses. We calculate consolidated effective tax rate by dividing the net income before tax by the taxation. Our share-based compensation expenses are incurred by Baidu.com, Inc., a Cayman Islands company, which under the laws of Cayman Islands is not subject to income tax. Such expenses are not deductible for PRC income tax purposes since the share options were issued by the Cayman Islands company. As a result, such expenses reduce our consolidated net income before tax while the consolidated taxation remains unchanged, thereby increasing our consolidated effective tax rate. In 2004 and the three months ended March 31, 2005, our consolidated effective tax rate was 3.9% and 28.9%, respectively. Our consolidated effective tax rate for the three months ended March 31, 2005 was substantially higher than that for 2004 primarily as a result of the tax loss carry-over utilized in 2004 and our share-based compensation expenses which are not deductible for PRC income tax purposes. We fully utilized the tax loss carry-over in 2004.

If P4P were classified as a form of advertising in the future, we may have to conduct our P4P business through Baidu Netcom in order to comply with PRC laws and regulations that limit foreign ownership of advertising companies. As a result, our consolidated effective tax rate would increase, as Baidu Netcom is subject to a 33% statutory enterprise income tax rate as of the date of this prospectus. See Risk Factors Risks Related to Our Corporate Structure If the PRC government were to classify P4P services as a form of advertising, we may have to conduct our P4P business through Baidu Netcom, which would increase our effective tax rate, and we might be subject to sanctions and required to pay delinquent taxes.

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PRC Business Tax

Revenues from services provided by Baidu Online and Baidu Netcom are subject to PRC business tax. We pay business tax on gross revenues generated from our online marketing and portal search services. Baidu Online may be entitled to a refund of business tax on revenues derived from technology service contracts. We plan to apply for this refund for our technology service contracts which currently include our P4P contracts.

Recent Acquisitions

In August 2004, we acquired the domain name Hao123.com from its owner unrelated to us. At the time of the acquisition, Hao123.com was the largest traffic contributor to our Baidu.com website among our Baidu Union members. Pursuant to the asset purchase agreement, we paid the seller an aggregate purchase price consisting of RMB11.9 million (US$1.4 million) in cash and 40,000 ordinary shares of our company. In addition, we agreed to make a contingent payment of an additional RMB1.2 million (US$0.1 million) to the seller if certain traffic statistics of Hao123.com are achieved within 12 months of the acquisition. We have accounted for the transaction as an asset purchase and recorded the intangible assets at the purchase price, excluding the contingent payment consideration. Since the acquisition, traffic of Hao123.com has become part of our organic traffic, and we no longer share revenues generated from users of Hao123.com. For additional information, see Note 6 to our consolidated financial statements included as part of this prospectus.

In February 2005, we acquired Qilang s distribution business. At the time of the acquisition, Qilang was the largest distributor of our P4P services in Shanghai. Pursuant to the acquisition agreement, we agreed to pay a purchase price in cash consisting of a fixed payment totaling RMB10.0 million (US$1.2 million) and a variable amount contingent upon the satisfaction of certain performance benchmarks. The maximum purchase price payable by us will not exceed RMB37.0 million (US$4.5 million). We have agreed to pay the purchase price in several installments. We paid the first RMB7.0 million (US$0.8 million) in February 2005. We are obligated to pay an additional RMB3.0 million (US$0.4 million) by September 30, 2005 and make two additional payments within 30 days after Qilang s audited annual financial results for 2005 and 2006 become available. In connection with our acquisition, over 100 Qilang s employees, including certain key management personnel, have become our employees. We accounted for the transaction using the purchase accounting method and have begun consolidating the results of the acquired business into our consolidated financial statements since February 21, 2005. The incremental fixed cost resulting from the Qilang acquisition, particularly in connection with the addition of over 100 employees, is approximately US$30,000 per month immediately after the acquisition, mainly consisting of employee base salary and benefits, office rental, utilities and other fixed office expenses.

Internal Control Over Financial Reporting

During the audits of our consolidated financial statements for the three years ended December 31, 2004, our independent auditors identified a number of significant deficiencies, as defined in the Public Company Accounting Oversight Board s Audit Standard No. 2. The significant deficiencies identified by our independent auditors consist of: (i) the lack of a consolidated manual for accounting policies and procedures relating to financial reporting, without which it would be difficult for our accounting and finance personnel to apply proper procedures and controls to transactions; (ii) inadequate approval procedures that involve accounting personnel in approving or amending the terms of contracts which may lead to transactions not properly reflected in the books and records; (iii) the lack of comprehensive credit control policies and procedures to monitor credits provided to customers which may lead to unauthorized credits provided to customers; and (iv) the lack of comprehensive checklists and procedures to address the pre-acquisition due diligence process and the accounting for business combinations, without which it would be difficult for us to reach a conclusion on proper accounting treatment for any acquisition in the most efficient manner.

We plan to remediate such deficiencies by the end of 2005. We are implementing the following measures to remediate the deficiencies: (i) codification and development of a comprehensive accounting policies and procedures manual to guide the day-to-day operations of accounting and finance personnel and the related training on the policies and procedures; (ii) development of formal sign off procedures to ensure the involvement of accounting personnel on contract approval and amendment process and providing training to the relevant operating personnel; (iii) establishment of a comprehensive credit risk management system for advertising services and enterprises software services customers; (iv) development and implementation of a comprehensive checklist to address all the pre-acquisition due diligence process and the accounting issues in connection with business combinations; (v) hiring and training of personnel as required to implement the relevant policies and procedures; and (vi) establishment of an internal audit function to implement our polices and procedures.

In addition, under the supervision and with the participation of our senior management, including our chief executive officer and chief financial officer, we are in the process of conducting further evaluation of our internal control over financial reporting for compliance with the requirements of Section 404 under the Sarbanes-Oxley Act. In this regard, we have engaged an advisor to assist us in evaluating, designing, implementing and testing internal control over financial reporting intended to comply with the requirements of Section 404. As we are still in the evaluation process, we may identify material weaknesses or significant deficiencies in the future. Should we discover such conditions, we intend to remediate them. We are committed to taking appropriate steps for remediation, as needed.

Critical Accounting Policies

We prepare financial statements in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect the reported amounts of our assets and liabilities and the disclosure of our contingent assets and liabilities at the end of each fiscal period and the reported amounts of revenues and expenses during each fiscal period. We continually evaluate these judgments and estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and assumptions that we believe to be reasonable, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application.

The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors that should be considered when reviewing our financial statements. We believe the following accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

Revenue Recognition

We recognize revenues based on the following revenue recognition principles:

Online Marketing Services

(1) Auction-based P4P Services. Our auction-based P4P platform enables a customer to place its website link or other information on our search result listing. The customer bids to determine how much it is willing to pay for each click-through to its listing in the search results displayed on our website. The ranking of the customer s listing in the search results depends on the amount of the customer s bid. The customer pays cash to us to obtain Baidu Currency which is the medium of exchange that the customer uses to bid for our P4P services. While we operate and maintain

the technology infrastructure for the P4P platform, we primarily rely on distributors to engage and serve customers and collect cash payments.

The amount of revenue recognized is based on the total amount of cash consideration received and not based on the amount of Baidu Currency provided. Revenue is recognized when an Internet user clicks on the customer-

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sponsored listing, there is persuasive evidence of an arrangement, the fee is fixed or determinable as prescribed by Staff Accounting Bulletin No. 104, or SAB 104.

Cash payments received in advance of P4P services are recorded as customer deposits. The distributors and customers are not entitled to any cash redemption for unused Baidu Currency units in their accounts with us. The amount of cash received relating to our unused Baidu Currency is recorded as customers deposits and accounted for as a liability of our company. When the Baidu Currency is used, the corresponding cash amount is recorded as revenue. In the event the Baidu Currency is not used, the corresponding cash amount would remain as a liability of our company. Historically, we have not had material aggregate corresponding cash amount for the unused Baidu Currency that was outstanding for an extended period of time. As a result, we do not have an accounting policy in this regard.

(2) Other Performance-based Online Marketing Services. For online marketing services based on performance criteria other than click-throughs (such as the number of telephone calls brought to our customers, the number of users registered with our customers, or the minimum number of click-throughs), we recognize revenues when (i) the specified performance criteria are met and (ii) applicable revenue recognition criteria as prescribed by SAB 104 (i.e. when there is persuasive evidence of an arrangement, delivery or services to be provided have been performed, fee is fixed or determinable and collection is reasonably assured) are satisfied. Payments received prior to the performance of services are recorded as customer deposits.

(3) Time-based Online Advertising Services. For time-based online advertising services such as text links, banners or other forms of graphical advertisement, we recognize revenues in accordance with SAB 104 on a pro-rata basis over the advertisement period, commencing on the date the customer s advertisement is posted. For certain time-based contractual agreements, we may also provide certain performance guarantees, in which case, we recognize revenues at the later of the expiration of the duration of the advertisement period and the satisfaction of the performance guarantee. Payments received prior to performance of services are recorded as customer deposits.

In cases when time-based online advertising services are provided without persuasive evidence of an arrangement, accounts receivable, together with deferred revenues, are recognized for the determinable value, if available, of service provided. Revenue recognition is deferred until persuasive evidence of an arrangement is established.

(4) Online Marketing Services Involving Baidu Union. We make payments to Baidu Union members for introducing users who click on our customers links on our websites. We recognize revenues in the amount of the fees we receive from our customers because we are considered the primary obligor to our customers. Payments made to Baidu Union members are recorded as traffic acquisition costs under cost of revenues.

(5) Online Marketing Services Arrangements with Multiple Elements. If a sales contract is entered into covering more than one product and the products are considered separate units of accounting in accordance with EITF 00-21, Revenue Arrangements with Multiple Deliverables, the total fee on such arrangements is allocated to the individual deliverables based on their relative fair values.

We have two types of online marketing services arrangements that may include multiple deliverables: P4P services and time-based online advertising services.

We may be requested by certain customers acquired through direct sales to provide additional services such as account set-up, account management, keywords suggestions and performance reporting. We charge an annual service fee for these services. These service fees represent value to customers in addition to standard P4P services which are charged on a per click basis. Pursuant to EITF 00-21, the annual services fees and click-through revenues are considered separate units of accounting. We recognize annual service fees as revenues on a pro-rata basis over the service period of one year.

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For time-based online advertising services, we may provide multiple advertising services in one or more contracts, which may be considered as a single arrangement pursuant to EITF 00-21. We have accounted for such arrangements in accordance with EITF 00-21 whereby each of the advertising services is accounted for separately because (i) it has stand-alone value since we have sold such services on an individual basis to other customers; (ii) the fair value of the advertising services is objectively determinable based on actual sales transactions involving such services on a separate basis; and (iii) there is no general right of refund for those services already provided based on services that have not been provided. Accordingly, we allocate the total fee for such arrangements to each element of the advertising services based on their relative fair values and recognize revenues on a pro-rata basis over the respective service periods.

(6) Barter Transactions. From time to time, we engage in barter transactions for our online marketing services and we recognize such non-monetary transactions at fair value. If such value is not determinable within reasonable limits, we recognize the transaction based on the carrying value of the product or services we provide. The amount of revenues recognized for barter transactions was insignificant for each of the periods presented. In addition, we have not recognized any revenues for any of the periods presented relating to barter transactions involving advertising within the limits of EITF 99-17, Accounting for Advertising Barter Transactions. The volume of such transactions is not significant.

Enterprise Search Software and Related Services

We recognize revenues from our enterprise search software and related services in accordance with Statement of Position 97-2, Software Revenue Recognition, or SOP 97-2, and Statement of Position 98-9, Modification of SOP 97-2 with respect to Certain Transactions, or SOP 98-9. We recognize revenues from our enterprise search software and related services under SOP 97-2 when persuasive evidence of an arrangement exists, when all elements essential to the functionality of the software including installation and training are delivered in accordance with the terms and conditions of the customer contract, when the fee is fixed or determinable, and when collection is reasonably assured. For software arrangements involving multiple elements, we allocate revenues to each element based on vendor-specific objective evidence of relative fair values, when and if available, which are derived by allocating a value to each element that is based upon the prices charged when the element is sold separately. Our products and services are generally sold as part of a contract involving software, maintenance and training. We use vendor-specific objective evidence to determine the relative fair value of these various elements in each of the contracts. If we do not have vendor-specific objective evidence to support the fair value of such multiple element arrangements, we defer revenue recognition until all elements have been delivered or until a fair value can be objectively determined for any of the remaining undelivered elements. When the fair value of a delivered element has not been established, we use the residual method to record revenue if the fair value of all undelivered elements is determinable. Under the residual method, we defer the fair value of the undelivered elements and allocate the remaining portion of the arrangement fee to the delivered elements and recognize it as revenue. If the only undelivered element is post-contract services, for which fair value cannot be established, the entire fee is recognized ratably over the term of the post-contract services arrangement. Payments received or receivable prior to meeting the above revenue recognition criteria are recorded as deferred revenue.

We recognize revenues from sales of our enterprise search software and related services net of VAT payable to, but include the amount of VAT rebates received or receivable from, the relevant PRC tax authorities pursuant to applicable PRC tax regulations. Sales of enterprise search software products in China are subject to a VAT at a rate of 17% of gross sales proceeds. Companies that meet certain conditions set by the relevant PRC tax authorities are entitled to a refund of VAT in an amount equal to the excess over 3% of the contract price paid by customers in any month when output VAT (which is the amount of VAT a company collects for sale of its products) exceeds input VAT (which is the amount of VAT a company pays in connection with its purchases). We record VAT rebates on an accrual basis. We received VAT rebates of RMB182,000, RMB656,000 and RMB604,000 (US$72,978) in 2002, 2003 and 2004, respectively.

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Portal Search Services

We recognized portal search revenues ratably over the service period when there is persuasive evidence of an arrangement, the fees are fixed or determinable, the services have been performed and collection is reasonably assured in accordance with SAB 104.

Share-based Compensation Expenses

Our share-based compensation plans are described in more detail under Management Share Options. We grant options to employees and non-employees. For options granted to employees, we record a compensation charge for the excess of the fair value of the shares at the grant date over the amount an employee must pay to acquire the shares. We then amortize share-based compensation expenses over the vesting periods of the related options, which are generally four years long. For options granted to non-employees, we record share-based compensation expenses based on the fair value at the measurement date and amortize the expenses over the non-employees service periods. We recorded share-based compensation expenses totaling RMB4.2 million, RMB5.1 million, RMB16.5 million (US$2.0 million) and RMB6.1 million (US$0.7 million) in 2002, 2003, 2004 and the three months ended March 31, 2005, respectively.

We have granted options to our employees at exercise prices less than the value of the underlying shares as determined by our board of directors on the date of grant. We record share-based compensation to the extent the fair value of the shares at the date of grant exceeds the exercise price of the option. For purposes of financial accounting, we have determined the values of the shares underlying our options by reference to share transactions with or between third parties and by applying a blended income and market value approach to arrive at the fair values for the shares underlying our options. The fair value is the per share value of our ordinary shares determined by us solely for the purpose of financial accounting for employee share-based compensation.

Determining the fair value of our ordinary shares requires making complex and subjective judgments regarding projected financial and operating results, our unique business risks, the liquidity of our shares and our operating history and prospects at the time of grant. We used the income approach in conjunction with the market value approach by assigning a different weight to each of the approaches to estimate the value of the enterprise when the option was granted. The income approach involves applying appropriate discount rates to estimated cash flows that are based on earnings forecasts. Our revenues and earnings growth rates, as well as major milestones that we have achieved, primarily since late 2002, contributed significantly to the increase in the fair value of our ordinary shares. In addition, the market capitalizations of certain public companies involved in the same or similar lines of business as ours have increased significantly since 2004, which also contributed to the increase in the fair value of our ordinary shares. However, these fair values are inherently uncertain and highly subjective. The assumptions used in deriving the fair values are consistent with our business plan. These assumptions include: no material changes in the existing political, legal, fiscal and economic conditions in China; no major changes in tax law in China or the tax rates applicable to our subsidiaries in China; our ability to retain competent management, key personnel and technical staff to support our ongoing operation; and no material deviation in industry trends and market conditions from economic forecasts. These assumptions are inherently uncertain. The risks associated with achieving our forecasts were assessed in selecting the appropriate discount rates, which ranged from 15% to 28%. If different discount rates had been used, the valuations would have been different and the amount of share-based compensation would also have been different because the fair value of the underlying ordinary shares for the options granted would be different.

During the early stages of our development, we used the current-value method to allocate our enterprise value to preferred and ordinary shares. The allocation to preferred shares was based on their liquidation preferences or conversion values, whichever would be greater. The fundamental assumption of this method is that the manner in which each class of preferred shareholders will exercise its rights and achieve its return is determined by the enterprise value as of the valuation date and not at some future date. Accordingly, depending on the enterprise value and the nature and amount of the various liquidation preferences, preferred shareholders

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will participate in enterprise value allocation either as preferred shareholders or, if conversion would provide them with better economic results, as common shareholders. The method assumes that the value of the preferred shares is represented by the most favorable claim the preferred shareholders have on the enterprise value as of the valuation date. Had we used different estimates of the value of the preferred shares, the allocations between preferred and ordinary shares would have been different.

As our company has developed, we have started to use an option-pricing model to allocate enterprise value to preferred and ordinary shares. The option-pricing method involves making estimates of the anticipated timing of a potential liquidity event such as a sale of our company or an initial public offering and estimates of the volatility of our equity securities. The anticipated timing is based on the plans of our board and management. Estimating the volatility of the share price of a privately held company is complex because there is no readily available market for the shares. We estimated the volatility of our shares to be nil. Had we used different estimates of volatility, the allocations between preferred and ordinary shares would have been different.

Because our option plan covers all of our employees, the change in the amount of share-based compensation expenses will primarily affect our reported net income, earnings per share and each line item of our operating expenses, which includes cost of revenues, selling, general and administrative expenses and research and development expenses.

From January 1, 2004 to March 31, 2005, we granted the following options to our employees and non-employees.

Grant Date	Number of Options	Exercise Price (US$)	Fair Value of Ordinary Shares (US$)	Type of Valuation
01/01/2004	4,000	0.2	5.0	(1)
01/05/2004	2,000	0.2	5.0	(1)
01/14/2004	2,000	0.2	5.0	(1)
01/15/2004	40,000	2.5	5.0	(1)
01/16/2004	4,000	2.5	5.0	(1)
01/28/2004	6,000	2.5	5.0	(1)
02/01/2004	2,000	2.5	5.3	(1)
02/05/2004	2,000	2.5	5.3	(1)
04/01/2004	200,000	2.5	5.8	(1)
04/03/2004	25,000	2.5	5.8	(1)
04/07/2004	78,000	2.5	5.8	(1)
06/08/2004	11,000	4.5	6.3	(2)
07/14/2004	89,500	4.5	6.3	(2)
07/15/2004	322,488	4.5	6.3	(2)
10/19/2004	465,600	5.5	6.9	(1)
1/18/2005	437,000	6.5	10.2	(3)

(1) By a retrospective internal valuation.
(2) Based on the price of the Series C preferred shares that we issued and sold to third parties for cash and third-party cash transactions of our ordinary shares.
(3) By a retrospective unrelated party valuation.

For share options granted from January 2004 through April 2004, we have used a combination of the income approach, also known as the discounted cash flow, or DCF, approach, and the market approach to assess the fair value of ordinary shares underlying the options granted.

The major assumptions used by us in calculating the fair values are as follows:

(1) Weight of DCF and market multiples: We assigned 80% weight to DCF approach and 20% weight to the market multiples approach because we had achieved better visibility of future earnings at the time, which made the DCF approach more meaningful.

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(2) Weighted average costs of capital, or WACC: We decreased our estimated WACC from 28% as of January 2003 to 27% for January 2004 and to 26% for April 2004. This was the combined result of the changes in risk-free rate and the decrease in our company-specific risk as the Company continued to grow and meet important milestones.

(3) Capital market valuation multiples: We obtained and assessed updated capital market valuation data of comparable Chinese and U.S. Internet companies.

(4) Management forecast used in the DCF computation reflect the following significant events:

- increased projected revenue growth of P4P business to reflect traffic expansion and channel expansion in 2003 and early 2004;
- projections for new online advertisement revenue streams based on the actual 2003 and early 2004 data;
- lower enterprise search software and portal search service revenue projections to reflect management s current view on prospects of these businesses at the time;
- increased capital expenditures for 2005 to 2007 to reflect projected growth in traffic and revenue; and
- other relevant costs and operating expenses adjusted up to reflect expanded scale of operations.

We used a combination of the DCF approach and the market approach to assess the fair value of our ordinary shares in October 2004. The major assumptions we used in calculating the fair value of our ordinary shares in October 2004 include the following:

(1) an 18% WACC based on capital market data and our company specific risk as of October 19, 2004;

(2) a 15% discount for lack of marketability derived from the price/earning ratios, or P/E, of public companies versus the P/E of private companies in 2004 obtained form a third-party source;

(3) EV/EBITDA multiple of 33X based on a comparable U.S. company s market data as of October 19, 2004; and

(4) our then-estimated compounded annual revenue growth rate from 2005 to 2011.

We engaged an independent valuator, American Appraisal China Limited, or American Appraisal, to perform an appraisal of the fair value for the ordinary shares underlying the options granted in January 2005. American Appraisal used a 15% WACC in the DCF approach and average market multiples of comparable U.S. companies (which have a global presence) in the market approach to compute the fair value of our ordinary shares. Eight companies were considered in assessing comparable companies for the application of market approach. The enterprise value of our company derived using the market approach was higher than that derived using the DCF approach. The difference between the market approach and the DCF approach was that the 15% WACC in the DCF approach included a 1.11% country risk premium and a 2.86% small size risk premium. In other words, American Appraisal assigned higher risk premiums to us compared with comparable U.S. companies as a result of the perception of the risk of the China market and our smaller size in terms of revenues relative to comparable U.S. companies. The market approach, on the other hand, did not factor in country risk or small size risk. If a 12% WACC (taking out the additional country risk premium and small size risk premium) were to be applied to us instead of a 15% WACC, the enterprise value using the DCF approach would have been similar to the enterprise value using the market approach.

For both October 2004 and January 2005 valuations, we assigned 80% weight to the DCF approach and 20% weight to the market multiples approach. The DCF approach received a higher weight because: (1) we

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believed that we had achieved improved visibility of future earnings at the time, which made the DCF approach more meaningful; and (2) the sample size of the comparable companies used in the market approach was small and consisted of U.S. companies with a global presence, which we believed made the company comparables analysis under the market approach less meaningful.

Our estimated fair value per ordinary share increased by approximately 47% from US$6.92 in October 2004 to US$10.16 in January 2005. The following is a list of the significant factors and events that contributed to the increase:

(1) We used a 15% WACC for the January 2005 valuation compared to a 18% WACC for the October 2004 valuation. This change primarily reflected a lower industry average beta (a measure of the volatility of a stock relative to the overall market) in January 2005.

(2) We believed that our business prospects improved since October 2004 firstly because of a substantial increase in our net revenues and net income for the fourth quarter of 2004, which exceeded our original budget and represented a significant increase as compared to the previous quarter; and secondarily because of the following events:

In January 2005, our website was ranked by Alexa.com as the second largest website in China, as measured by user traffic, which exceeded those of Sohu.com and Netease.com. Sina.com.cn, Sohu.com and Netease.com were commonly viewed as the three largest Internet portals in China in terms of user traffic.

In November 2004, we introduced WAP- and PDA-based Chinese mobile search services. Although we have not generated any revenue from these services, we believe that these services has put us in a favorable position to potentially expand our search engine services to the wireless search market to the extent that a new wireless search market develops.

In December 2004, we hired our vice president of marketing and initiated a plan for new marketing and branding efforts.

The increase in the fair value of our ordinary shares since January 2005 reflected the following factors and events:

(1) The positive share performance of comparable U.S. companies with a global presence since January 2005.

(2) Our user traffic, which is one of the most important drivers and key performance indicators, continued to increase during the first half of 2005. During this period, our user traffic had the largest increase among leading Chinese language Internet websites, according to Alexa.com. Our user traffic maintained its No. 2 position during this period.

(3) We launched two new revenue-generating services during first half of 2005 - ProTheme contextual advertising and subscription based movie search services. Although we have not generated any meaningful revenues from these services, we believe that these services allow us to expand our service offerings and/or enhance our user experience.

(4) In February 2005, we acquired the distribution business of Qilang, which was one of our major distributors. As a result, we expect the direct sales force we acquired from Qilang will contribute to the growth of our revenue in the future.

(5) We further strengthened our management team. We improved our human resources department by hiring a new human resources director, a new recruiting manager and a training manager. We strengthened our middle

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management team by adding five director-level officers and increased the total number of employees to 750 as of June 30, 2005 from 349 as of December 31, 2004.

Furthermore, to arrive at the fair market value of the ordinary shares, we have assumed that all of the Series A, B and C convertible preferred shares have been converted as of the valuation dates and have subtracted the conversion value of the Series A, B and C convertible preferred shares from the enterprise value.

We did not obtain contemporaneous valuations by an independent valuation specialist because when we issued options during this period, our resources were focused on product development, and we had limited financial resources for engaging an independent expert. Subsequently, we reassessed the valuations of ordinary shares relating to grants of options during this period.

Based on the offering price of US$27.00 per share, the intrinsic value of the options outstanding as of March 31, 2005 was US$66.6 million, of which US$21.0 million related to vested options and US$45.6 million related to unvested options. Although it is reasonable to expect that the completion of this offering should increase the value of the shares because of their increased liquidity and marketability, the amount of additional value can be measured with neither precision nor certainty.

Pro forma information regarding net income (loss) and earnings per share is required in order to show our net income (loss) as if we had accounted for employee share options under the fair value method. We use the Black-Scholes option pricing model to compute the fair value of options at the grant date. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected share price volatility. We use the minimum value method in estimating the share price volatility for options issued to employees. Because our employee share options have characteristics significantly different from those of publicly traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the Black-Scholes model may not necessarily provide a reliable single measure of the fair value of our share options.

The effects of applying pro forma disclosures of net income (loss) and earnings per share are not indicative of the pro forma effects on net income and earnings per share in the future years for the following reasons:

- the number of future shares to be issued under these plans is not known; and
- the assumptions used to determine the fair value can vary significantly.

We have granted options to non-employees including third-party consultants. We determine the fair value of the options granted to non-employees using the Black-Scholes option pricing model at the earlier of non-employees performance commitment date or performance completion date under the following assumptions: 100% volatility, no dividends, a risk-free interest rate of 2.79%, 2.79% and 3.60% in 2002, 2003 and 2004, respectively, and an expected option life of three years. If different assumptions were used, our share-based compensation expenses, net income and earnings per share could have been significantly different. We amortize share-based compensation expenses over non-employees service period.

Consolidation of Variable Interest Entities

PRC law currently limits foreign ownership of companies that provide Internet content and advertising services. To comply with these foreign ownership restrictions, we operate our websites and provide online advertising services in China through Baidu Netcom, a PRC limited liability company wholly owned by our co-founder and chief executive officer, Robin Yanhong Li, and our co-founder Eric Yong Xu, both of whom are PRC citizens. Baidu Netcom holds the licenses and approvals necessary to operate our websites and to provide

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online advertising services in China. We have contractual arrangements with Baidu Netcom and its shareholders pursuant to which we provide technology consulting services and license certain software products and registered domain names and trademarks to Baidu Netcom. Through these contractual arrangements, we also have the ability to substantially influence Baidu Netcom s daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. As a result of these contractual arrangements, which enable us to control Baidu Netcom, we are considered the primary beneficiary of Baidu Netcom. Accordingly, we regard Baidu Netcom as a Variable Interest Entity under FASB Interpretation No. 46R, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, or FIN 46R, and consolidate its results, assets and liabilities in our financial statements.

Intangible Assets

We carry intangible assets at cost less accumulated amortization. We compute amortization using the straight-line method over the estimated five-year economic life of the domain name Hao123.com. We review and adjust the carrying value of the intangible assets if the facts and circumstances indicate that the intangible assets may be impaired. The impairment test is applied by comparing the undiscounted cash flow against the carrying value of the assets. If the undiscounted cash flow is less than the carrying value, an impairment loss is recognized as the difference between the carrying value and the fair value of the intangible assets.

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the failure of customers to make required payments. We review the accounts receivable on a periodic basis and make general and specific allowances when there is doubt as to the collectibility of individual balances. In evaluating the collectibility of individual receivable balances, we consider many factors, including the age of the balance, the customer s past payment history and current credit-worthiness and current economic trends.

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Results of Operations

The following table sets forth a summary of our consolidated results of operations for the periods indicated. Our business has evolved rapidly since we commenced operations in 2000. Our limited operating history makes it difficult to predict future operating results. We believe that period-to-period comparisons of operating results should not be relied upon as indicative of future performance.

	For the Year Ended December 31,				For the Three Months Ended March 31,		
(in thousands)	2002	2003	2004		2004	2005	
	RMB	RMB	RMB	US$	RMB	RMB	US$
Consolidated Statement of Operations Data							
Revenues:							
Online marketing services	4,292	31,775	106,854	12,910	15,695	43,019	5,198
Enterprise search software and related services	1,724	2,803	7,958	962	1,412	2,076	251
Portal search services	5,004	5,993	2,639	319	867	581	70
Total revenues	11,020	40,571	117,451	14,191	17,974	45,676	5,519
Less: Business tax and surcharges	(496)	(1,933)	(6,542)	(790)	(824)	(3,048)	(368)
Total net revenues	10,524	38,638	110,909	13,401	17,150	42,628	5,151
Operating costs and expenses:							
Cost of revenues	(9,519)	(20,703)	(32,985)	(3,985)	(5,747)	(12,570)	(1,519)
Selling, general and administrative	(11,930)	(16,930)	(39,004)	(4,713)	(5,822)	(15,698)	(1,897)
Research and development	(3,885)	(5,191)	(11,406)	(1,378)	(2,032)	(5,479)	(662)
Share-based compensation(1)	(4,233)	(5,109)	(16,510)	(1,995)	(2,607)	(6,142)	(741)
Total operating costs and expenses	(29,567)	(47,933)	(99,905)	(12,071)	(16,208)	(39,889)	(4,819)
Operating (loss)/profit	(19,043)	(9,295)	11,004	1,330	942	2,739	332
Interest income	586	325	1,135	137	31	777	94
Other expenses/income, net	(120)	85	347	42	65		
Taxation			(481)	(59)		(1,015)	(123)
Net (loss)/income	(18,577)	(8,885)	12,005	1,450	1,038	2,501	303
(1) Share-based compensation expenses are allocated as follows:							
Cost of revenues	*(313)*	*(648)*	*(1,665)*	*(201)*	*(448)*	*(228)*	*(27)*
Selling, general and administrative	*(3,055)*	*(2,669)*	*(11,720)*	*(1,416)*	*(1,429)*	*(4,825)*	*(582)*
Research and development	*(865)*	*(1,792)*	*(3,125)*	*(378)*	*(730)*	*(1,089)*	*(132)*
	(4,233)	*(5,109)*	*(16,510)*	*(1,995)*	*(2,607)*	*(6,142)*	*(741)*

Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2004

Revenues. Our total net revenues increased by 148.6% from RMB17.2 million in the first quarter of 2004 to RMB42.6 million (US$5.2 million) in the first quarter of 2005. This increase was primarily due to a substantial increase in our revenues from online marketing services and, to a lesser extent, an increase in our revenues from enterprise search software and related services. This increase was partially offset by a decrease in our revenues from portal search services.

Online Marketing Services. Our online marketing revenues increased by 174.1% from RMB15.7 million in the first quarter of 2004 to RMB43.0 million (US$5.2 million) in the first quarter of 2005. This increase was primarily due to our customers increased use of online marketing as a means to promote their products and services, as evidenced by the growth of our customer base and the increase in the

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average online marketing revenue per customer. The number of our online marketing customers increased from 13,879 in the first quarter of 2004 to 31,768 in the first quarter of 2005, mainly due to our more effective distribution network. The average online marketing revenue per customer increased from RMB1,131 in the first quarter of 2004 to RMB1,354 (US$163.6) in the first quarter of 2005, resulting primarily from (i) more intense competitive bidding for keywords reflecting the expansion of our P4P customer base, and (ii) the increase in the number of larger, higher-spending online advertising customers.

Enterprise Search Software and Related Services. Revenues from our enterprise search software and related services increased by 47.0% from RMB1.4 million in the first quarter of 2004 to RMB2.1 million (US$0.3 million) in the first quarter of 2005. This increase was primarily due to increased sales of enterprise search software and performance of related services, as the case may be, during the period.

Portal Search Services. Our portal search revenues decreased 33.0% from RMB0.9 million in the first quarter of 2004 to RMB0.6 million (US$0.1 million) in the first quarter of 2005, primarily due to a decrease in the number of portal search customers.

Total Operating Costs and Expenses. Our total operating costs and expenses increased by 146.1% from RMB16.2 million in the first quarter of 2004 to RMB39.9 million (US$4.8 million) in the first quarter of 2005. This increase was primarily due to increases in our cost of revenues and selling, general and administrative expenses, and, to a lesser extent, increases in our research and development expenses and share-based compensation expenses.

Cost of Revenues. Our cost of revenues increased by 118.7% from RMB5.7 million in the first quarter of 2004 to RMB12.6 million (US$1.5 million) in the first quarter of 2005. This increase was primarily due to substantial increases in bandwidth costs and depreciation expenses of servers and other equipment, and, to a lesser extent, increased traffic acquisition costs and salaries and benefits for our operating and technical support personnel.

Traffic Acquisition Costs. Our traffic acquisition costs increased by 12.7% from RMB2.1 million in the first quarter of 2004 to RMB2.3 million (US$0.3 million) in the first quarter of 2005. This increase is attributable to the increased number of click-throughs by users from our Baidu Union websites. The increase was partially offset by our acquisition of the domain name Hao123.com, which was the largest traffic contributor among our Baidu Union members at the time of our acquisition in August 2004. Following the acquisition, Hao123.com became one of our websites, and we no longer incurred traffic acquisition costs in connection with the revenues generated from click-throughs by users of Hao123.com.

Bandwidth Costs. Our bandwidth costs increased by 189.7% from RMB1.3 million in the first quarter of 2004 to RMB3.8 million (US$0.5 million) in the first quarter of 2005, as a result of increased bandwidth we purchased to support increased traffic on our Baidu.com website and on the Hao123.com website, which became our organic traffic beginning in August 2004.

Depreciation Expenses of Servers and Other Equipment. Our depreciation expenses of servers and other computer hardware increased by 193.1% from RMB1.3 million in the first quarter of 2004 to RMB3.7 million (US$0.4 million) in the first quarter of 2005, as we acquired more servers and computer hardware to meet higher user traffic and accommodate our growing online marketing services business.

Operational Expenses. Our operational expenses increased by 148.5% from RMB1.1 million in the first quarter of 2004 to RMB2.7 million (US$0.3 million) in the first quarter of 2005, primarily due to the increase in the number of our operating and technical support employees to meet the needs of our growing operations.

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Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased by 169.6% from RMB5.8 million in the first quarter of 2004 to RMB15.7 million (US$1.9 million) in the first quarter of 2005. This increase was primarily due to the following factors:

a substantial increase in our marketing and promotional expenses from RMB0.2 million in the first quarter of 2004 to RMB2.4 million (US$0.3 million) in the first quarter of 2005;

an increase in total salaries and benefits for our sales and marketing personnel from RMB2.0 million in the first quarter of 2004 to RMB3.5 million (US$0.4 million) in the first quarter of 2005, primarily due to (i) the increased amount of sales commissions reflecting higher direct sales of our online marketing services achieved by our sales and marketing team and (ii) the increase in the number of sales and marketing personnel; and

a substantial increase in total salaries and benefits for our increased number of general and administrative personnel from RMB1.5 million in the first quarter of 2004 to RMB3.8 million (US$0.5 million) in the first quarter of 2005.

Research and Development Expenses. Our research and development expenses increased by 169.6% from RMB2.0 million in the first quarter of 2004 to RMB5.5 million (US$0.7 million) in the first quarter of 2005, primarily due to an increase in salaries and benefits for our research and development personnel as a result of increased headcount.

Share-based Compensation Expenses. Our share-based compensation expenses increased by 135.6% from RMB2.6 million in the first quarter of 2004 to RMB6.1 million (US$0.7 million) in the first quarter of 2005, primarily due to the increased number of share options granted to employees in the first quarter of 2005.

Operating Profit. As a result of the foregoing, we generated an operating profit of RMB2.7 million (US$0.3 million) in the first quarter of 2005, compared to RMB0.9 million in the first quarter of 2004.

Taxation. Our income tax expenses were RMB1.0 million (US$0.1 million) in the first quarter of 2005, but we did not have any income tax expenses in the first quarter of 2004. We did not recognize deferred tax assets in the first quarter of 2004 because it was more likely than not that these deferred tax assets would not be recognized.

Net Income. As a result of the foregoing, we had net income of RMB2.5 million (US$0.3 million) in the first quarter of 2005, compared to RMB1.0 million in the first quarter of 2004.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Revenues. Our total net revenues increased by 187.0% from RMB38.6 million in 2003 to RMB110.9 million (US$13.4 million) in 2004. This increase was primarily due to a substantial increase in our revenues from online marketing services, and, to a lesser extent, an increase in our revenues from enterprise search software and related services.

Online Marketing Services. Our online marketing revenues increased by 236.3% from RMB31.8 million in 2003 to RMB106.9 million (US$12.9 million) in 2004. This increase was mainly attributable to our customers increased use of online marketing as a means to promote their products and services, as evidenced by the increase in the number of online marketing customers from over 24,700 in 2003 to over 34,600 in 2004, and, to a lesser extent, the increase in the average revenue per customer from approximately RMB1,282 in 2003 to approximately RMB3,083 (US$372.5) in 2004. The increase in our online marketing customers was mainly due to our more effective distribution network. The increase in the average revenue per customer was primarily attributable to (i) more intense competitive bidding for keywords reflecting the expansion of our P4P customer base and (ii) the increase in the number of larger, higher-spending online advertising customers.

Enterprise Search Software and Related Services. Revenues from our enterprise search software and related services increased by 183.9% from RMB2.8 million in 2003 to RMB8.0 million (US$1.0 million) in 2004. This increase was primarily due to the recognition of revenues from the enterprise search-related service contracts which we entered into in 2003 but fully performed in 2004. The increase was also partially attributable to the increase in the average revenue per contract for our enterprise search software products and related services, which resulted partly from our introduction of a higher-priced enterprise search software product.

Portal Search Services. Our portal search revenues decreased 56.0% from RMB6.0 million in 2003 to RMB2.6 million (US$0.3 million) in 2004 primarily due to a decrease in the number of portal search customers.

Total Operating Costs and Expenses. Our total operating expenses increased by 108.4% from RMB47.9 million in 2003 to RMB99.9 million (US$12.1 million) in 2004. This increase was primarily due to increases in our selling, general and administrative expenses and share-based compensation expenses, and, to a lesser extent, increases in our cost of revenues and research and development expenses.

Cost of Revenues. Our cost of revenues increased by 59.3% from RMB20.7 million in 2003 to RMB33.0 million (US$4.0 million) in 2004. This increase was primarily due to substantial increases in bandwidth costs, depreciation expenses of servers and other equipment and salaries and benefits for our operating and technical support personnel.

Traffic Acquisition Costs. Our traffic acquisition costs in 2004 compared with 2003 remained largely unchanged at RMB10.9 million (US$1.3 million). This was primarily due to the increased number of click-throughs by users of our Baidu Union websites. The increase was partially offset by our acquisition of the domain name Hao123.com. In August 2004, we acquired the domain name Hao123.com which was at the time the largest traffic contributor among our Baidu Union members. The traffic acquisition costs associated with click-throughs by users of the Hao123.com website during the period in 2004 prior to our acquisition accounted for approximately 20% of the total traffic acquisition costs in 2004, while the traffic acquisition costs associated with click-throughs by users of the Hao123.com website contributed approximately 18% to the total traffic acquisition costs in 2003. Following the acquisition, Hao123.com became one of our websites, and we no longer incur traffic acquisition costs in connection with the revenues generated from click-throughs by users of Hao123.com.

Bandwidth Costs. Our bandwidth costs increased by 282.3% from RMB2.2 million in 2003 to RMB8.5 million (US$1.0 million) in 2004, as a result of increased bandwidth to support increased traffic on our Baidu.com website and on the Hao123.com website, which became our organic traffic in August 2004.

Depreciation Expenses of Servers and Other Equipment. Our depreciation expenses of servers and other computer hardware increased by 70.6% from RMB4.1 million in 2003 to RMB7.1 million (US$0.9 million) in 2004, as we acquired more servers and computer hardware to meet increased user traffic and accommodate growing online marketing services.

Operational Expenses. Our operational expenses increased by 76.6% from RMB3.7 million in 2003 to RMB6.5 million (US$0.8 million) in 2004, primarily due to the increase in the number of our operating and technical support employees to meet the needs of our growing operations.

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Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased by 130.4% from RMB16.9 million in 2003 to RMB39.0 million (US$4.7 million) in 2004. This increase was primarily due to the following factors:

marketing and promotional expenses of RMB3.0 million (US$0.4 million) that we incurred in 2004 (as compared to no such expenses in 2003);

an increase in total salaries and benefits for our sales and marketing personnel from RMB4.9 million in 2003 to RMB10.0 million (US$1.2 million) in 2004, primarily due to the increased sales commissions in 2004 reflecting higher direct sales of our online marketing services; and

a substantial increase in total salaries and benefits from RMB4.8 million in 2003 to RMB7.4 million (US$0.9 million) in 2004 as a result of the increase in the number of general and administrative personnel.

Research and Development Expenses. Our research and development expenses increased by 119.7% from RMB5.2 million in 2003 to RMB11.4 million (US$1.4 million) in 2004, primarily due to an increase in salaries and benefits resulting from the increased headcount.

Share-based Compensation Expenses. Our share-based compensation expenses increased by 223.2% from RMB5.1 million in 2003 to RMB16.5 million (US$2.0 million) in 2004, primarily because we granted more options in 2004.

Operating (Loss)/Profit. As a result of the foregoing, we generated an operating profit of RMB11.0 million (US$1.3 million) in 2004, compared to an operating loss of RMB9.3 million in 2003.

Taxation. Our income tax expenses were RMB0.5 million (US$0.06 million) in 2004. We did not incur any income tax expenses in 2003 because we were not profitable in 2003. We did not recognize deferred tax assets in 2003 because it was likely that these deferred tax assets would not be recognized.

Net (Loss)/Income. As a result of the foregoing, we had net income of RMB12.0 million (US$1.5 million) in 2004, compared to a net loss of RMB8.9 million in 2003.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Revenues. Our total net revenues increased by 267.1% from RMB10.5 million in 2002 to RMB38.6 million in 2003. This increase was primarily due to a substantial increase in our online marketing revenues and, to a lesser extent, increases in revenues from our enterprise search software and related services and portal search services.

Online Marketing Services. Our online marketing revenues increased by 640.3% from RMB4.3 million in 2002 to RMB31.8 million in 2003. This increase was mainly attributable to the increase in the number of our online marketing customers from over 9,960 in 2002 to over 24,700 in 2003 and, to a lesser extent, the increase in the average revenue per customer from approximately RMB431 in 2002 to approximately RMB1,282 in 2003. The increase in our online marketing customers was mainly as a result of the growing adoption of P4P as a marketing medium by customers. The increase in the average revenue per customer was primarily attributable to the increase in the number of online marketing customers. We first recorded revenues from our tailored solutions customers in July 2003, when we commenced providing our online advertising services to tailored solutions customers.

Enterprise Search Software and Related Services. Revenues from our enterprise search software and related services increased 62.6% from RMB1.7 million in 2002 to RMB2.8 million in 2003. This

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increase was primarily due to an increase in the average revenue per contract for our enterprise search software products and the recognition of revenues from the enterprise search-related service contracts into which we entered in 2002 but fully performed in 2003.

Portal Search Services. Revenues from our portal search services increased by 19.8% from RMB5.0 million in 2002 to RMB6.0 million in 2003 primarily due to the increase in revenues recognized from portal search service contracts into which we entered in 2002 and 2003.

Total Operating Costs and Expenses. Our total operating expenses increased by 62.1% from RMB29.6 million in 2002 to RMB47.9 million in 2003. This increase was primarily due to a substantial increase in our cost of revenues and, to a lesser extent, increases in our other operating expenses.

Cost of Revenues. Our cost of revenues increased by 117.5% from RMB9.5 million in 2002 to RMB20.7 million in 2003. This increase was primarily due to a substantial increase in traffic acquisition costs and, to a lesser extent, increases in other components of our cost of revenues.

Traffic Acquisition Costs. Our traffic acquisition costs increased by 157.7% from RMB4.1 million in 2002 to RMB10.6 million in 2003. We officially began building our Baidu Union relationships in early 2003, which resulted in a substantial increase in our traffic acquisition costs in 2003 as we shared revenues with our Baidu Union members for traffic generated by such members. Traffic acquisition costs as a percentage of total revenues declined from 2002 to 2003 because the organic traffic generated from our Baidu.com website grew more significantly than the traffic generated from our Baidu Union members.

Bandwidth Costs. Our bandwidth costs increased by 93.5% from RMB1.1 million in 2002 to RMB2.2 million in 2003, as a result of our payment for additional bandwidth to support the increased traffic on our Baidu.com website.

Depreciation Expense of Servers and Other Equipment. Our depreciation expenses for servers and other computer hardware increased by 56.7% from RMB2.6 million in 2002 to RMB4.1 million in 2003, as we acquired more servers and computer hardware to meet the needs of our increasing user traffic and growing online marketing services business.

Operational Expenses. Our operational expenses increased by 131.4% from RMB1.6 million in 2002 to RMB3.7 million in 2003, primarily due to the increase in the number of our operating and technical support employees to meet the needs of our growing business operations.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased by 41.9% from RMB11.9 million in 2002 to RMB16.9 million in 2003. This increase was primarily due to the following factors:

an increase in our marketing expenses relating to our general marketing and brand promotion activities; and

an increase in total salaries and benefits for our sales and marketing personnel, primarily due to our increased number of sales and marketing employees and the increased sales commissions related to the direct sales of our online advertising services, which commenced in July 2003.

Research and Development Expenses. Our research and development expenses increased by 33.6% from RMB3.9 million in 2002 to RMB5.2 million in 2003. This increase was primarily attributable to an increase in the compensation to research and development personnel.

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Share-based Compensation Expenses. Our share-based compensation expenses increased by 20.7% from RMB4.2 million in 2002 to RMB5.1 million in 2003, primarily because we granted more options to employees in 2003.

Operating Loss. As a result of the foregoing, our operating loss decreased from RMB19.0 million in 2002 to RMB9.3 million in 2003.

Taxation. Since we had a net loss before tax in 2002 and 2003, we did not incur income taxes in 2002 and 2003.

Net Loss. As a result of the foregoing, our net loss decreased to RMB8.9 million in 2003 from RMB18.6 million in 2002.

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Selected Quarterly Results of Operations

The following table sets forth our unaudited consolidated selected quarterly results of operations for the five quarters ended March 31, 2005. You should read the following table in conjunction with our unaudited financial statements and related notes contained elsewhere in this prospectus. We have prepared the unaudited consolidated financial information on the same basis as our audited consolidated financial statements. The unaudited financial information includes all adjustments, consisting only of normal and recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the quarters presented.

	For the Three Months Ended				
(in RMB thousands)	**March 31, 2004**	**June 30, 2004**	**September 30, 2004**	**December 31, 2004**	**March 31, 2005**
Consolidated Statement of Operations Data					
Revenues:					
Online marketing services	15,695	21,389	29,767	40,003	43,019
Enterprise search software and related services	1,412	2,090	2,062	2,394	2,076
Portal search services	867	669	581	522	581
Total revenues	17,974	24,148	32,410	42,919	45,676
Less: Business tax and surcharges	(824)	(1,320)	(1,922)	(2,476)	(3,048)
Total net revenues	17,150	22,828	30,488	40,443	42,628
Operating costs and expenses:					
Cost of revenues	(5,747)	(6,911)	(8,203)	(12,124)	(12,570)
Traffic acquisition costs	(2,076)	(2,762)	(3,038)	(3,025)	(2,339)
Bandwidth costs	(1,319)	(1,444)	(1,543)	(4,169)	(3,821)
Depreciation of servers and other equipment	(1,269)	(1,429)	(1,842)	(2,532)	(3,719)
Operational costs	(1,083)	(1,276)	(1,780)	(2,398)	(2,691)
Selling, general and administrative	(5,822)	(8,054)	(11,497)	(13,631)	(15,698)
Selling and marketing	(3,216)	(4,929)	(6,792)	(8,408)	(8,417)
General and administrative	(2,606)	(3,125)	(4,705)	(5,223)	(7,281)
Research and development	(2,032)	(2,276)	(3,396)	(3,702)	(5,479)
Share-based compensation(1)	(2,607)	(4,068)	(4,849)	(4,986)	(6,142)
Total operating costs and expenses	(16,208)	(21,309)	(27,945)	(34,443)	(39,889)
Operating profit	942	1,519	2,543	6,000	2,739
Interest income	31	8	356	740	777
Other income, net	65	134	41	107	
Taxation				(481)	(1,015)
Net income	1,038	1,661	2,940	6,366	