

iQIYI (IQ US)

China's online Disney in the making

We keep positive on IQIYI's long-term subs trend and margin improvement, backed by its sizable users, unique original content and valuable IP. We forecast iQIYI to deliver 11% revenue CAGR during FY20-22E, with subs price hike and ads recovery. Given fundraising partly priced in, we think iQIYI's valuation is attractive. Initiate with BUY with DCF-based TP US\$23.2.

- **An online video leader: Not only "Netflix", but more.** iQIYI is a leading online video platform in China, with 105mn subs. Backed by its sizable users, vibrant original content and IP reserve, we forecast iQIYI to deliver 11% rev CAGR in FY20-22E, with subs price hike, ads recovery, and user expansion.
- **Original content makes the difference.** With online video industry growth tapering off, we believe content matters more to users than traffic or subsidies. iQIYI excelled itself with exclusive original content in both popular dramas and variety shows. Moreover, it bore initial fruits from short-episode dramas (e.g. the popularity of The Bad Kids <隐秘的角落>), and would further enrich Light on Series (迷雾剧场) with stronger pipeline. We expect short-episode dramas series to stimulate its subs & brand ads momentum with higher ROI, such as Who is Murderer<谁是凶手> in 2021 pipeline. In the long run, we see high visibility for iQIYI to achieve its 150mn subs target, despite sequential subs decline in next one or two quarters due to price hike.
- **Price hike to unlock membership upside; Ads to bottom out.** iQIYI raised its subs price by 26% for Android customers (3/4) to level iOS, and new subscription pricing plan took effect on 13 Nov. We view it positive in the long run to unlock its ARPU upside (forecasting blended ARPU +12% YoY in 4Q20E). Given Netflix's four major price adjustments in history, we think iQIYI's ARPU was reasonable, and it was still largely behind Netflix of US\$8.99. In terms of ads, we forecast 11% rev CAGR in FY20-22E, with gradual ads demand recovery in post COVID-19 period. Backed by its high-quality content pipeline, as well as enriched ads formats, we expect its ads rev to bottom out, and grow at 14%/9% YoY in FY21/22E.
- **Initiate with BUY.** We set our DCF-based TP at **US\$23.2** (implying **3.8x/3.5x** FY20/21E P/S), below industry average of 6.2x FY21E P/S. Key market concerns lie in the short-term subs fluctuation and fundraising, but have been partly priced in, in our view. Waiting for more catalysts from: 1) hit dramas to be launched; 2) better-than-expected ads recovery; and 3) subs pick up.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	24,989	28,994	29,756	32,395	36,473
YoY growth (%)	43.8	16.0	2.6	8.9	12.6
Adj. net income (RMB mn)	(8,599)	(8,765)	(6,331)	(4,223)	(1,264)
EPS (RMB)	(11.8)	(12.0)	(8.5)	(5.6)	(1.7)
YoY growth (%)	NA	NA	NA	NA	NA
Consensus EPS (RMB)	NA	NA	(9.5)	(5.8)	(2.2)
P/E (x)	NA	NA	NA	NA	NA
P/S (x)	3.3	2.9	2.8	2.6	2.3
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	(49)	(105)	(243)	540	968
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

BUY (Initiation)

Target Price	US\$23.2
Up/Downside	+34.8%
Current Price	US\$17.2

China Internet Sector

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Stock Data

Mkt Cap (US\$ mn)	13,499
Avg 3 mths t/o (US\$ mn)	180.41
52w High/Low (US\$)	28.03/ 14.51
Total Issued Shares (mn)	373

Source: Bloomberg

Shareholding Structure

Morgan Stanley	60.8%
Hillhouse Capital Advisors	10.6%
UBS AG	6.2%

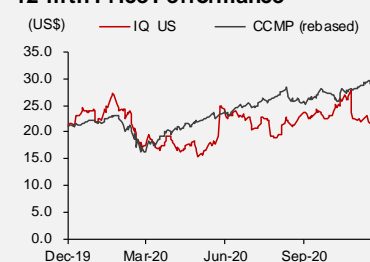
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-23.8%	-28.8%
3-mth	-25.7%	-37.2%
6-mth	-29.6%	-45.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Investment Thesis

An online video leader: Not only “Netflix”, but more.

iQIYI is a leading long-video platform in China, with 105mn subs. Backed by its sizable users, vibrant original content, big data and IP reserve, we forecast iQIYI to deliver 11% revenue CAGR during FY20-22E, thanks to subs price hike, ads recovery, and user expansion.

Original content makes the difference.

With online video industry growth tapering off, we believe content matters more to users, than traffic or subsidies. iQIYI excelled itself with exclusive original content in both popular dramas and variety shows. Moreover, it bore initial fruits from short-episode dramas (e.g. the popularity of The Bad Kids <隐秘的角落>), and would further enrich Light on Series (迷雾剧场) with stronger pipeline. We expect short-episode dramas series to stimulate its subs & brand ads momentum with higher ROI, such as Who is Murderer<谁是凶手> in 2021 pipeline. In the long run, we see high visibility for iQIYI to achieve its 150mn subs target, despite sequential subs decline in next one or two quarters due to price hike.

Price hike to unlock membership upside; Ads to bottom out.

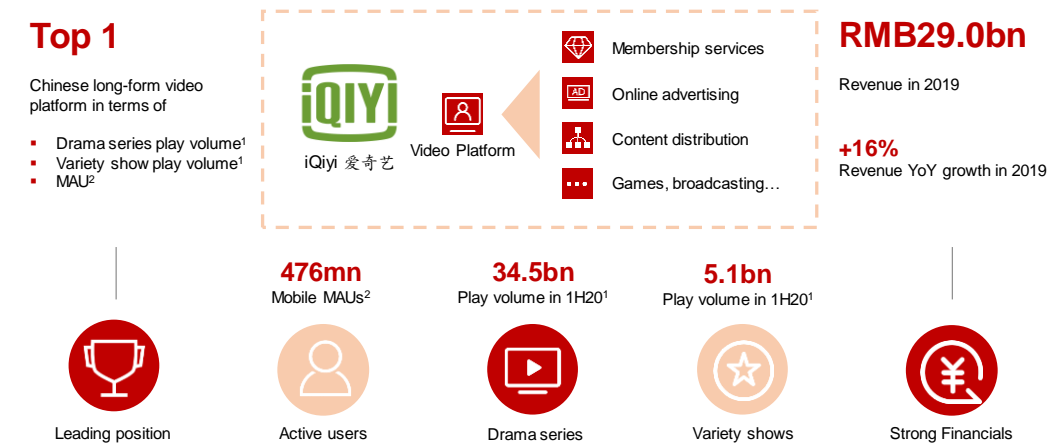
iQIYI raised its subs price by 26% for Android customers (3/4) to level iOS, and new subscription pricing plan took effect on 13 Nov. We view it positive in the long run, to unlock its ARPU upside (forecasting blended ARPU +12% YoY in 4Q20E). Given Netflix's four major price adjustments in history, we think iQIYI's APRU was reasonable, and it was still largely behind Netflix of US\$8.99. In terms of ads, we forecast 11% rev CAGR in FY20-22E, with gradual ads demand recovery in post COVID-19 period. Backed by its high-quality content pipeline, as well as enriched ads formats, we expect its ads rev to bottom out, and grow at 14% /9% YoY in FY21/22E.

Initiate with BUY.

We set our DCF-based TP at US\$23.2 (implying 3.8x/3.5x FY20/21E P/S), far below industry average. Key market concerns lie in the short-term subs fluctuation and margin visibility, but have been well priced in, in our view. Waiting for more catalysts from: 1) hit dramas to be launched; 2) better-than-expected ads recovery; and 3) subs pick up.

Focus Charts

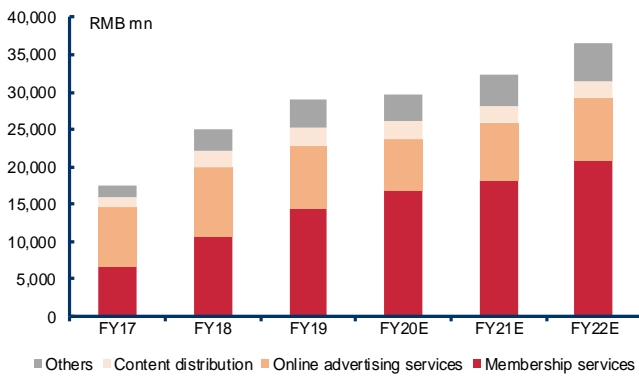
Figure 1: Overview of iQIYI



Source: Company data

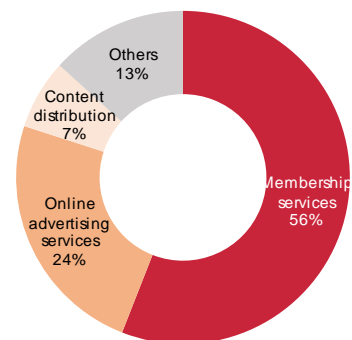
Note: 1) as of 1H20, according to Enlightent; 2) as of 2019

Figure 2: 9% total revenue CAGR in FY20-22E



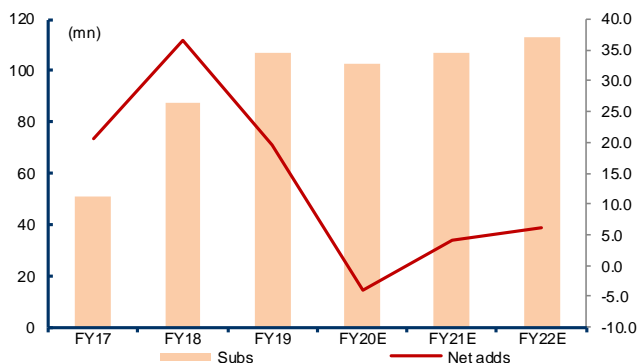
Source: Company data, CMBIS estimates

Figure 3: FY21E revenue breakdown



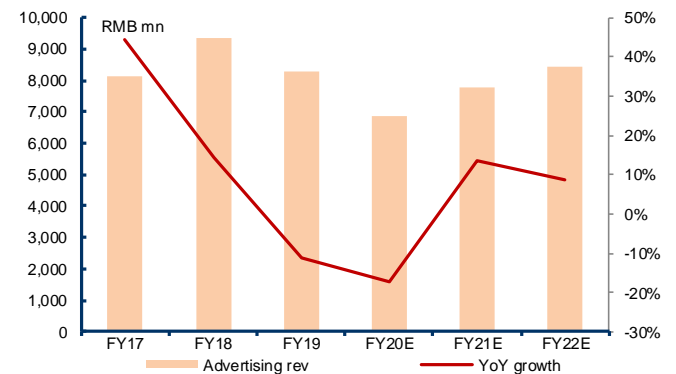
Source: CMBIS estimates

Figure 4: Subs trend



Source: Company data, CMBIS estimates

Figure 5: Ads rev to bottom out in FY20E



Source: Company data, CMBIS estimates

Company Overview

An online video leader: Not only “Netflix”, but more

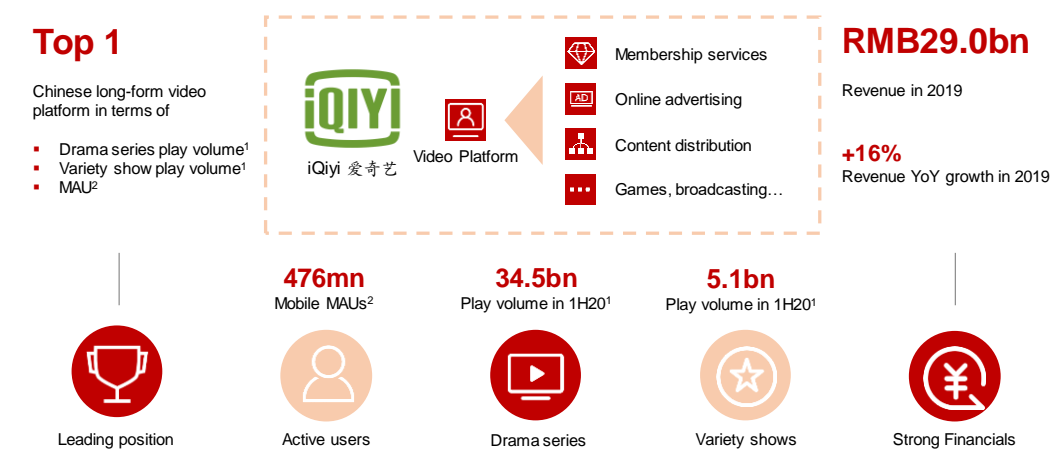
A pioneer in video stream service

Founded in 2010, iQIYI is a leading long-video platform in China that attracts the largest scale of users with blockbuster drama series and variety shows. Apart from being backed by Baidu (as its largest shareholder), the Company also partners with other Chinese Internet companies like JD with joint-membership programs. In 2019, the Company generated diverse revenue from membership services (50%), online advertising (29%), content distribution (9%), and others (13%).

iQIYI takes a leading position against Tencent Video and Alibaba's Youku in terms of subscribing members and drama/variety show play volumes in 2019. In 1Q20, iQIYI also ranked the largest video platform in China in terms of subscribing members, before dropping behind Tencent Video in the last two quarters. According to Questmobile, iQIYI has 567mn MAUs and 103mn DAUs as of Mar 2020, trending closely to that of Tencent Video.

iQIYI is a pioneer among Chinese long-video platforms to produce original content, and the Company attracts and retains users with its high-quality drama series and variety shows. iQIYI supplements its core video platform with fully-fledge online entertainment products, including UGC videos, live streaming, literature, comics, VR, and movies.

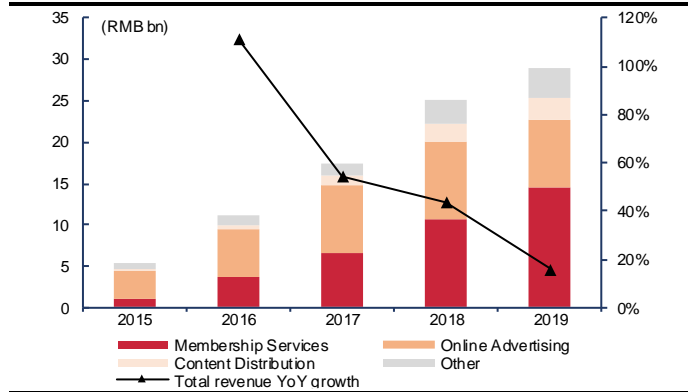
Figure 6: Overview of iQIYI



Source: Company data

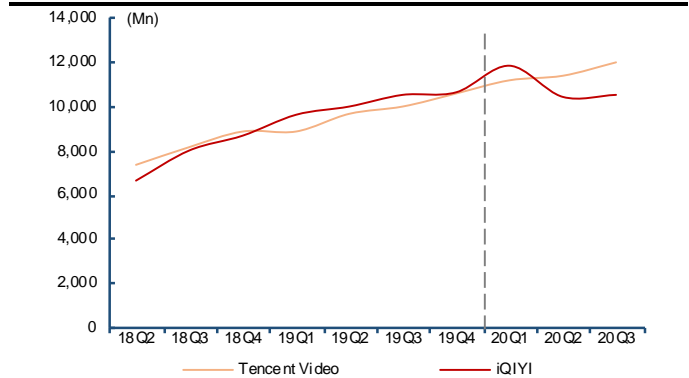
Note: 1) as of 1H20, according to Enlightent; 2) as of 2019

Figure 7: iQIYI's revenue growth and breakdown



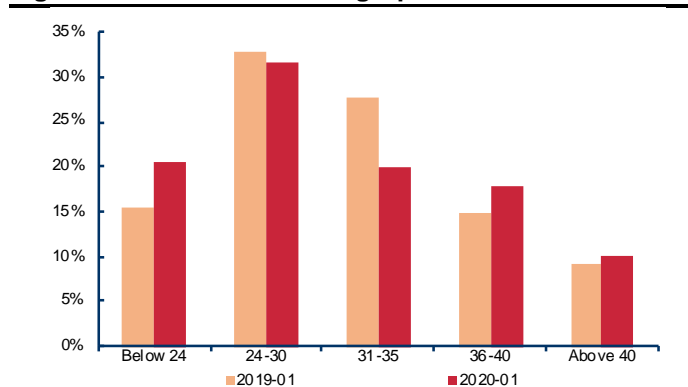
Source: Company data

Figure 8: Top 2 online video platforms by subs



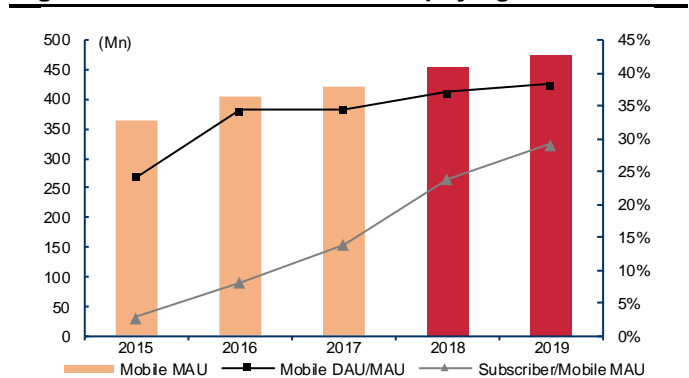
Source: Company data

Figure 9: iQIYI's user demographics



Source: Analysys

Figure 10: iQIYI's user base and paying ratio



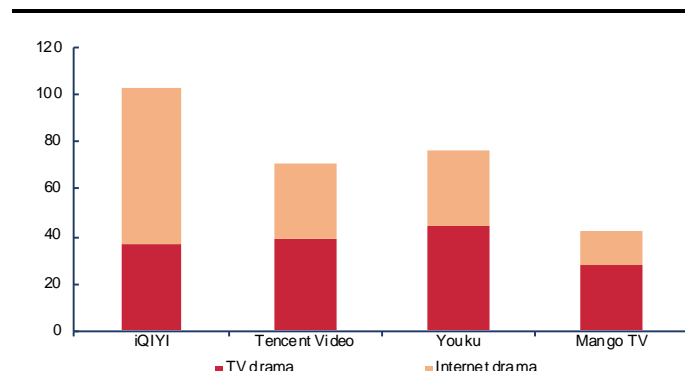
Source: Company data

Unique original content to build high barrier

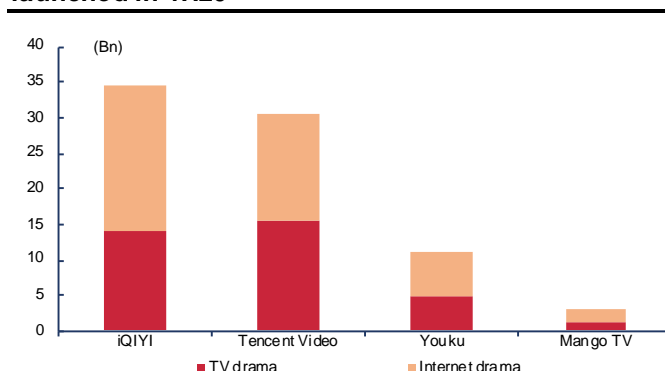
Backed by sizeable data, iQIYI leverages its algorithm to better recommend and create popular content. iQIYI is a pioneer to produce original internet drama, as it launched The Lost Tomb <盗墓笔记> in 2015 and boosted its subscription revenue. In 1H20, iQIYI launched the largest number of licensed and original drama series (37 TV dramas and 66 Internet dramas) among Chinese online video platforms, including exclusive blockbuster title like The Bad Kids <隐秘的角落> and The Long Night <沉默的真相>.

iQIYI also takes the lead in producing in-house and collaborative variety shows. The Company's flagship variety shows, such as The Rap of China <中国新说唱> and Idol Producer <偶像练习生>, have brought the Company massive traffic as well as diverse monetization opportunities. iQIYI launched 31 variety shows in 1H20, slightly fewer than Tencent Video, which launched 39 shows, but the Company's variety show viewership ranked the first with popular content like Youth with You 2 <青春有你 2>.

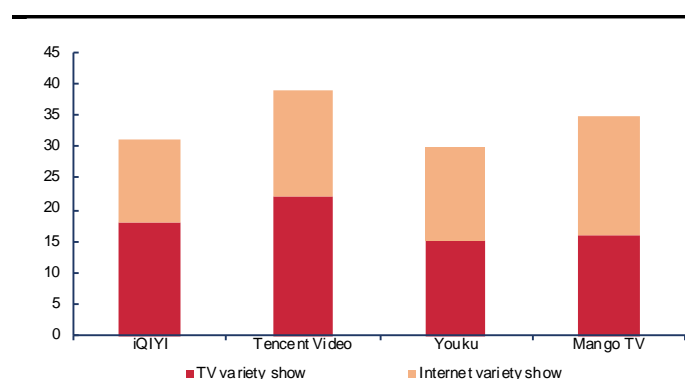
In terms of content cost, iQIYI aims to achieve a balance among in-house production (33%), licensed content (33%), and revenue sharing (33%). The Company is also actively seeking to leverage its content and technology advantage overseas. The Company's blockbuster variety show Youth with You 2 was aired simultaneously in iQIYI International with subtitles in eight languages. The show became the top hit in iQIYI International four hours after launching, and it was also trending high on Twitter globally and especially in the SEA countries.

Figure 11: Number of drama series launched in 1H20

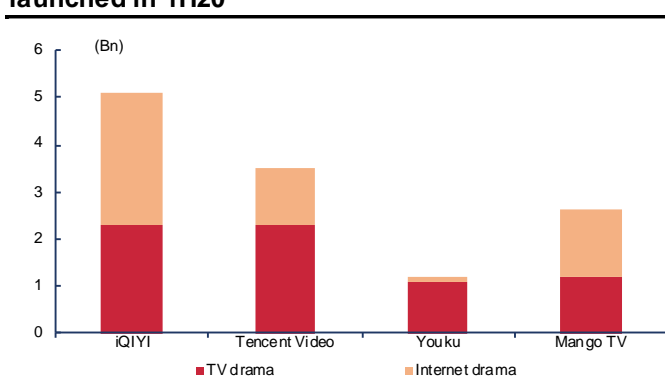
Source: Enlightent

Note: for drama series with single episode duration ≥ 20 minutes**Figure 12: Effective play volume of drama series launched in 1H20**

Source: Enlightent

Note: for drama series with single episode duration ≥ 20 minutes**Figure 13: Number of variety shows launched in 1H20**

Source: Enlightent

Figure 14: Effective play volume of variety shows launched in 1H20

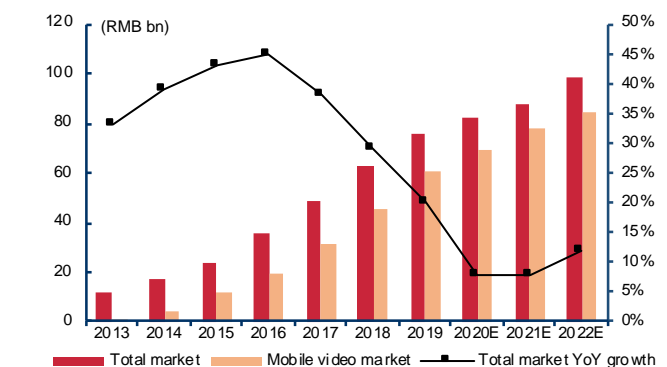
Source: Enlightent

Enhanced monetization with ads and membership

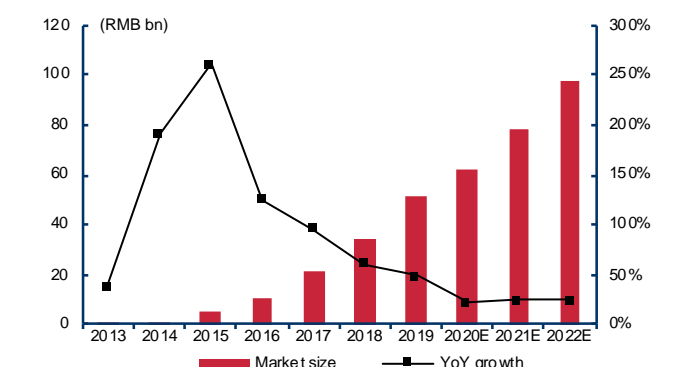
Ads and subscription fees are two primary monetization methods for Chinese video platforms. With more exclusive original and licensed content, iQIYI's subscription fee exceeded ad revenue in 3Q18 for the first time. From 2015 to 2019, the contribution from advertisement revenue decreased from 64% to 29%, while the contribution from subscription revenue increased from 19% to 50%.

iQIYI generated advertisement revenue in diversified forms, including the in-program advertisement where drama actors give the in-character promotion of a product during show intervals. During the pandemic, ads segment suffered pressure since advertisers are more conservative on marketing budget. However, ads rev began to see sequential growth from 2Q20, backed by rising ads demand with macro recovery and strong momentum from online advertisers. We expect ads business to continuously pick up to double-digit YoY growth in 2021-22E.

We expect ARPU to be the next growth engine in iQIYI's membership revenue. iQIYI raised its subs price by 26% for Android customers (3/4) to level iOS, and new subscription pricing plan took effect on 13 Nov. Since 2017, the Company has announced joint membership programs with partners including JD, boosting the demand for its membership programs. We are bullish on its ARPU upside, given iQIYI's membership price and ARPU remains significantly lower than its overseas comps.

Figure 15: China's online video Ad market forecast


Source: Analysys

Figure 16: China's online video subscription forecast


Source: Analysys

Figure 17: Membership programs of iQIYI and top global video platforms

Platform	Membershsip program	Price	Description
iQIYI	Gold VIP (continuous subscription)	RMB19/month	Exclusive content
	Star VIP (continuous subscription)	RMB40/month	Free advance streaming, five channels
	Student VIP (continuous subscription)	RMB12/month	Maximum 24 months, one device
	Sports VIP	RMB8/month	Ad-free, 2 paid live streaming per month, commentary
Netflix (US)	Basic	US\$8.99/month	One device
	Standard	US\$13.99/month	HD content, two devices
	Premium	US\$17.99/month	Ultra HD, four devices
Hulu	Hulu	US\$5.99/month	With advertisement
	Hulu (No Ads)	US\$11.99/month	Ad-free
	Hulu + Live TV	US\$54.99/month	60+ TV channels, offline download
YouTube	YouTube Music	US\$9.99/month	Ad-free music, background play, download
	YouTube Premium	US\$11.99/month	Ad-free, background play, download, YouTube Originals

Source: Culture and Travel Ministry, CMBIS

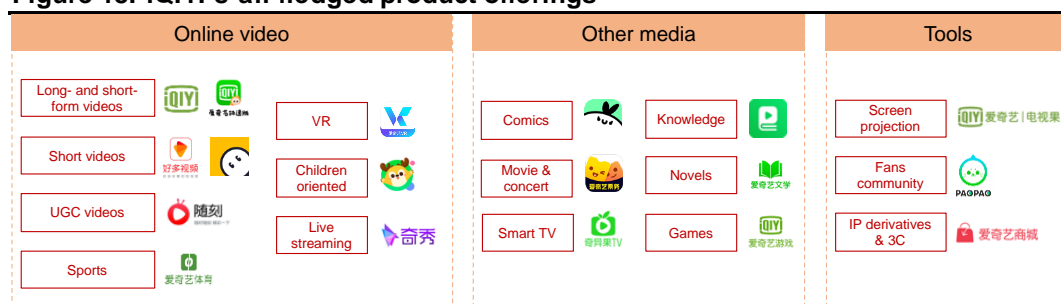
Aim to be China's online Disney in the long run

iQIYI aims to be "China's online Disney" in the long run. Compared to Netflix's business model that solely depends on subscription, iQIYI tends to explore more diversified monetization opportunities and IP-oriented monetization.

Netflix's model cannot be fully duplicated to China, mainly on: 1) Netflix has first-mover advantage to venture into streaming video, but the competition in China's video industry has been fierce. 2) Netflix started as a DVD renting company, and its users have cultivated the habit of paying for its content, while Chinese video platforms started to monetize by ads for moderate user paying willingness.

iQIYI's IP-oriented monetization allows the Company to generate substantial profit from a blockbuster title. Apart from the online video business, iQIYI has also established strong presence in comics, novels, live streaming, e-commerce, and other industries. The Company leverages its abundant video content and IPs to penetration into different user groups.

Figure 18: iQIYI's all-fledged product offerings



Source: Company data

Investment Summary

Original content makes the difference

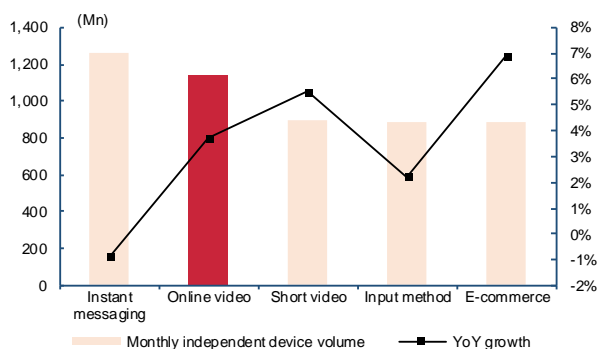
Surfing on the growing video entertainment tailwinds

Long video remains the most popular subcategory in the rapidly growing online video industry, and benefits from online entertainment demand shifted from offline. According to iResearch, online entertainment industry is expected to grow at 23.9% CAGR in 2019-2022, outpacing the total online economy's CAGR of 16.3%. Time spent on online video shrank MoM from Jun 2020 with work resumption, albeit remaining over +26% YoY. An average Chinese netizen spent 0.5 hours per day (or 13% of leisure time) on long videos.

We believe iQIYI is well-positioned to capture the growing video entertainment tailwinds with its high-quality content and fully-fledged ecosystem. According to iResearch, the CR1 (Top 1 player's share of total devices) of long video platforms was below 50% in Jul 2020, while the CR1 of short video platforms is c. 68%. Online video platforms still have upside to gain share.

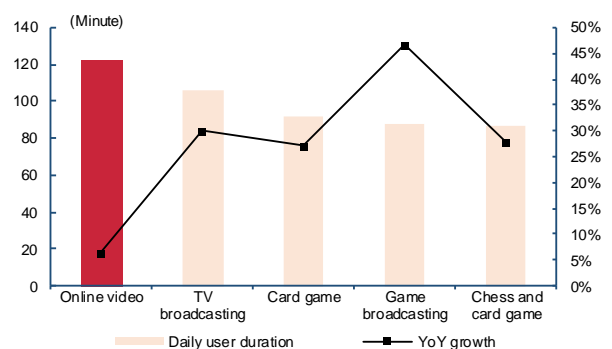
iQIYI has maintained its leading position alongside Tencent Video as first-tier platforms in online video industry. According to QuestMobile, iQIYI and Tencent Video became the Top 2 online video platforms since Sep 2018, as their MAU/DAU fluctuated around 500mn/100mn. Although iQIYI's user/subscriber volume declined moderately during 2Q-3Q20 partly due to content delay, we expect iQIYI's strong content pipeline to support its user base in the long term.

Figure 19: China's top 5 mobile internet subsectors, by monthly independent device volume, in Jul 2020



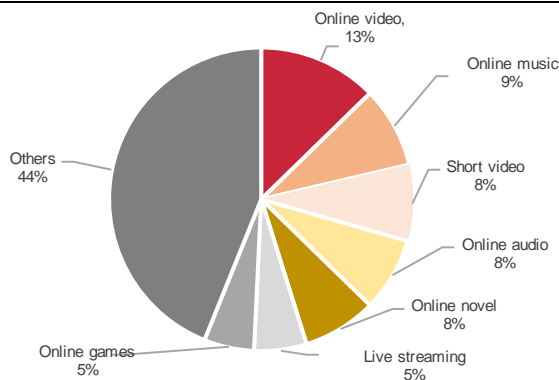
Source: iResearch

Figure 20: China's top 5 mobile internet subsectors, by daily user duration, in Jul 2020



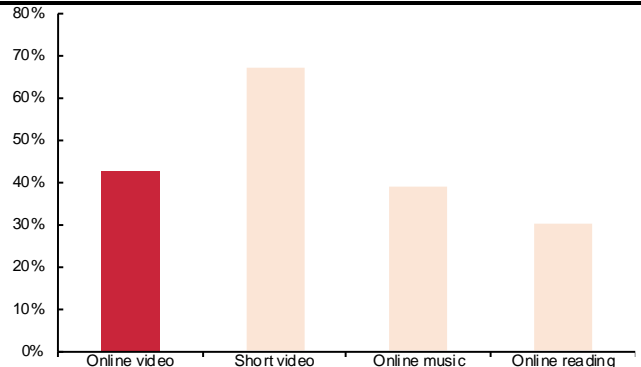
Source: iResearch

Figure 21: Chinese netizen's average daily online time distribution, as of Jul 2020



Source: iResearch

Figure 22: CR1 of pan-entertainment industries in China, Jul 2020



Source: iResearch

Note: CR1 = active device share of the 1st App in the subsector

Distinguishing itself with innovative original content

As a pioneer in producing original content, iQIYI has leveraged its high-quality drama series and variety shows to attract and retain users. The epidemic delayed content production in early 2020 and negatively affected iQIYI's user growth. According to Enlightent, the drama series/variety show viewership across platforms declined 30%/11% YoY in 3Q20, but iQIYI maintained the leading position by taking up 40%/33% of the aggregate views.

iQIYI leads in both drama series and variety show in terms of viewership. Three of iQIYI's hit drama series this year came from its newly launched Light on Series (迷雾剧场), a popular short-episode drama series focusing on suspense themes. The well-received variety show launched in 2020 include both sequels like Youth with You 2 <青春有你 2> and new names such as Fourtury <潮流合伙人>.

Backed by its 30+ in-house studio in FY21E (vs. < 15 in FY20), we expect iQIYI's richer content pipeline in 2021E to provide high visibility to its user expansion and subscription growth. The highly anticipated drama series expected in 4Q20-1Q21E include Yu Zhao Ling <玉昭令> (by the same production team as The Untamed <陈情令>) and The Rebel <叛逆者>, and the blockbuster variety show The Big Band's third season sequel is expected to be launched in 2Q21. Looking ahead, iQIYI would diversify its content category into romance and comedy, in order to cater to tightening regulation and different user preferences.

Figure 23: iQIYI's drama series pipeline

Launching	Title	Producer	Genre
10 Dec 2020	The Lost Tomb: Ultimate Note <终极笔记>	iQIYI, H&R Century Pictures (欢瑞), Linghe Media (灵河)	Fantasy
Expected 4Q20	The World of Fantasy <灵域>	iQIYI, Straw bear Entertainment (稻草熊)	Fantasy
	Last Romance <流金岁月>	New Classics Media (新丽)	Romance
	Dear Uniform <亲爱的戎装>	Xingjiyuan (星纪元), Datai Pictures (大泰影业), Zhenhe Culture (真禾文化)	Romance
	The Penalty Zone <黑白禁区>	Jetsen (捷成世纪), Shidai Fengcai (时代风采)	Crime
	Breath of Destiny <一起深呼吸>	iQIYI, Straw bear Entertainment, Mandala (曼荼罗)	Romance
	Dear Missy <了不起的女孩>	iQIYI, Sugarman (小糖人)	Life
	Palace of Devotion <大宋宫词>	iQIYI, Rosat (荣信达)	Historical
	Like a Flowing River <大江大河 2>	Daylight Entertainment (正午阳光)	Life
	Storm Eye <暴风眼>	Jiaxing Media (嘉行), Youth Hello (青春你好), Perfect World	Spy
	Minning Town <闽宁镇>	Daylight Entertainment	Historical
Expected 1Q21	Thank You Doctor <谢谢你医生>	Jiaxing Media, Xinmeichengpin (新媒诚品), Stellar (恒星引力)	Romance
	Broker <心跳源计划>	Yuekai Entertainment (悦凯), inLee (颖立文化)	Romance
	Court Lady <大唐女儿行>	Huanyu Entertainment (欢娱)	Historical
	The Rebel <叛逆者>	iQIYI, New Classics Media	Spy
	A Little Dilemma <小舍得>	Linmon Pictures (柠萌影业)	Life
	Dt. Appledog's Time <亲爱的挚爱的>	Gcoo Entertainment (华策剧酷)	Romance
	Vocation of Love <假日暖洋洋>	Enlightening Entertainment Pictures (启蒙影业)	Comedy
	The Dragnet <刑警之海外行动>	iQIYI, Liu Bai Entertainment (留白), Donglun Media (东仑)	Crime
	Good Life <生活万岁>	iQIYI	Life
	Yu Zhao Ling <玉昭令>	iQIYI, Yijin (逸锦影业)	Fantasy
Expected 2Q21	CRUSH <原来我很爱你>	iQIYI	Romance
	Cute Dimple in Love <恋恋小酒窝>	iQIYI	Romance
	Brave Heart <勇敢的心 2>	G.H.Y Culture & Media (长信传媒), Beijing Culture (北京文化)	Historical
	Dancing in the Storm <风暴舞>	iQIYI, Ciwen Media (慈文传媒)	Life
	Special Force <特战荣耀>	Youhug Media (耀客传媒)	Military
	Love is True <我是真的爱你>	Haohan (浩瀚影视)	Romance
	My Treasure <生活家>	iQIYI, Yuanxi (远曦), Tomorrow Film (瞳盟)	Life
	Dang Jia Zhu Mu <当家主母>	iQIYI, Huanyu Entertainment	Historical
	Sweet Teeth <世界微尘里>	iQIYI	Romance
	Moonlight <月光变奏曲>	iQIYI, Haoju (好剧影视)	Romance

Expected 3Q21	Start up Together <开心合伙人>	Mahua Fun Age (开心麻花影业)	Comedy
	Make a Wish <喵, 请许愿>	iQIYI	Romance
	My Heart <卿卿我心>	iQIYI	Fantasy
	Out of The Dream <梦见狮子>	iQIYI, Tencent Pictures	Romance
	Your Sensibility My Destiny <公子倾城>	iQIYI	Fantasy
	Unfamiliar Lover <陌生的恋人>	iQIYI, Youhug Media, Tencent Penguin Pictures (企鹅影视)	Romance
	A Love Never Lost <人生若只如初见>	iQIYI, China Media Capital (华人文化), Wu Yuan Culture (五元)	Romance
	Bei Zhe Nan Yuan <北辙南辕>	iQIYI, New Power (新力量)	Life
	Who is Murder <谁是凶手>	iQIYI (Light on Series)	Crime
	Gold Panning <淘金>	iQIYI (Light on Series)	Crime
	Wisher <致命愿望>	iQIYI (Light on Series)	Crime
	Moses on the Plain <平原上的摩西>	iQIYI (Light on Series)	Crime
	Dark Walker <暗夜行者>	iQIYI (Light on Series)	Crime
	Ace Troops <王牌部队>	iQIYI, Jetsen (捷成文化), Times Media (当代时光)	Military
	Now for Action <我和爷爷是战友>	iQIYI, Eternity Pictures (万年影业)	Military
	Enemy <对手>	iQIYI, Eternity Pictures	Crime
	Forever and Ever <一生一世>	iQIYI, Croton (华策克顿新天地)	Romance
	The Master of Cheongsam <一剪芳华>	iQIYI, Xudong (旭东影业)	Historical
	Please! 8 Hours <拜托了 8 小时>	iQIYI, TVZone Media Co (中广天择)	Sci-Fi
Expected 4Q21	The Ideal City <理想之城>	iQIYI, Transmit Enter (传递娱乐)	Life
	Luoyang <风起洛阳>	iQIYI, Liu Bai Entertainment	Historical
	Liang Jing Shi Wu Ri <两京十五日>	iQIYI	Historical
	To Be With You <约定>	iQIYI	Life
	Fox Spirit Matchmaker <涂山小红娘>	iQIYI, Tencent Pictures	Fantasy
	My Heroic Husband <赘婿>	iQIYI, New Classics Media, Tencent Pictures	Historical
	The Lord of Losers <破事精英>	iQIYI	Comedy
	Good Women <女人万岁>	iQIYI	Life
	Her Town <她的城>	iQIYI	Life
	Chen Yuan <尘缘>	iQIYI	Fantasy
	The Gate of Renewal <云襄传>	iQIYI, Youth Hello	Wuxia
	Chang Ling <长陵>	iQIYI	Wuxia
	Song of the Moon <月歌行>	iQIYI, Yide (懿德文化)	Fantasy
	Love under the Full Moon <满月之下请相爱>	iQIYI	Fantasy
	Comic Girl Romance <月刊少女>	Canxing Media (灿星影视)	Comedy
	De Yun Theater <德云瓦舍>	iQIYI, (华夏聚德)	Comedy
	Sisterhood <南洋女儿情>	G.H.Y Culture & Media	Historical
	First Time Love You, It's Not Too Late <初次爱你为时不晚>	iQIYI	Romance
	The Road of Dimsum <点心之路>	iQIYI	Romance
	I Really Am a Superstar <我真是大明星>	iQIYI	Sci-Fi
Expected 2022	Wacko at Law <王牌辩护人>	iQIYI	Legal
	Wild Bloom <野蛮生长>	iQIYI	Life
	The Heart of Genius <天才基本法>	iQIYI, Tencent Pictures	Romance
	Lost in Kunlun <迷航昆仑虚>	iQIYI, Inlook Media (银润传媒)	Sci-Fi
	Blocking The Sky <遮天>	iQIYI, Croton (华策克顿好故事)	Fantasy
	Jiu Xiao Han Ye Nuan <九霄寒夜暖>	iQIYI	Romance
	Traveller of the Night <夜旅人>	Yongle Film and Television (永乐影视)	Romance
	Sw ords and Love <沉鱼记>	iQIYI	Wuxia

Source: Company data, CMBIS

Figure 24: iQIYI's variety show pipeline

Launch Time	Title	Producer	Genre
17 Oct 2020	Dimension Nova <跨次元新星>	iQIYI	Talent show
16 Nov 2020	Hahahahaha <哈哈哈哈哈>	iQIYI, Tencent Video	Comedy
18 Nov 2020	Glory is Back <登场了! 敦煌>	iQIYI, Zhiliaoqingnian (知了青年)	Culture
29 Nov 2020	The Tea Party of Beautiful Girls of the World <姐妹们的茶话会>	iQIYI	Forum discussion
4 Dec 2020	Fourtury2 <潮流合伙人 2>	iQIYI	Business
4Q20	I Can I BB <奇葩说 7>	iQIYI, MeWe (米未)	Comedy/ debate
	Stage Boom <爆裂舞台>	iQIYI	Talent show
	Drama Life <戏剧新生活>	iQIYI	Opera
	Youth with You 3 <青春有你 3>	iQIYI, Caviar Communications (鱼子酱文化)	Talent show
	Winter Ski House <冬日滑雪屋>	iQIYI	Business
	The Romance <我们书写爱情吧>	iQIYI	Romance
	Brother is Here <妹妹有哥在>	iQIYI	Family
	Sister Club <姐妹俱乐部>	iQIYI	Talk Show
	I Want To Live Like This 2 <我要这样生活 2>	iQIYI, Caviar Communications	Life
	Working Mom <上班啦! 妈妈>	iQIYI, The Better Life (沐光时光)	Business
1Q21	Scream Carnival Night <尖叫互动狂欢夜>	iQIYI	Gala
	The Big Band 3 <乐队的夏天 3>	iQIYI, MeWe	Talent show
	New Indie Folk <不插电俱乐部>	iQIYI	Music
	The Adventures of Detective <萌贼探案>	iQIYI, Transmit Entertainment (传递娱乐), Houhai Culture (厚海文化)	Detective
	To the Top <下一站出道>	iQIYI	Talent show
	Mr. Housework 2 <做家务的男人 3>	iQIYI, Yuehua Entertainment (乐华娱乐)	Family
	1/100 <地球百子>	iQIYI	Talent show
	Love Timing <喜欢你我也是 3>	iQIYI, Transmit Entertainment, Houhai Culture	Romance
	Amazing LARP <奇异剧本鲨>	iQIYI	Detective
	Chunri Jiang <春日酱>	iQIYI	Travelling
2Q21	The Rap of China 2021 <中国新说唱 2021>	iQIYI	Talent show
	Hahahahaha 2 <哈哈哈哈哈 2>	iQIYI, Tencent Video	Comedy
	The Adjustment Bureau <命运规划局>	iQIYI	Detective
	Let's Party <非日常派对 2>	iQIYI	Game
	Dimension Nova 2 <跨次元新星 2>	iQIYI	Talent show
	Summer Surf Shop 2 <夏日冲浪店 2>	iQIYI	Business
	Last Winner <最后的赢家>	iQIYI	Detective
	Summer Super Night <夏日超级晚>	iQIYI	Gala

Source: Company data, CMBIS

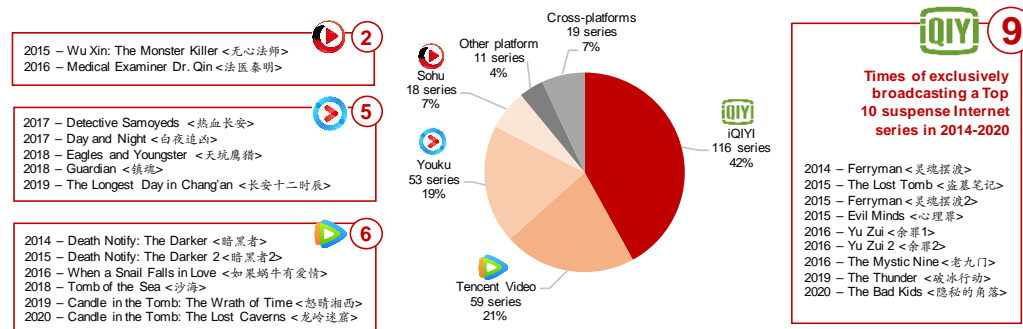
Short series theater to gain tractions with higher ROI

iQIYI launched its short-episode drama series, Light on Series (迷雾剧场), in Jun 2020, which gained wide popularity. The five drama series launched in Light on Series this year all have 12 episodes each, and among them, The Long Night <沉默的真相>, The Bad Kids <隐秘的角落>, Kidnapping Game <十日游戏> were rated 9.2/8.9/7.3 on the Chinese review website Douban. iQIYI has been the long-established leader among Chinese video platforms in suspense drama production. In 2014-2020, the platform launched the largest number of suspense drama series/exclusive suspense drama series ranking Top 10 in the respective year, according to Endata.

The online theater enhances user stickiness by increasing the anticipation for the next series in the theater. The targeted user groups of long-video platforms are highly overlapped, and users typically tend to subscribe the exclusive blockbuster content at the time. Leveraging the success of Light on Series, iQIYI plans to add three new theaters in the coming two years, including Romance Series <甜宠剧场>, Promise Series <约定剧场>, and New Year Series <贺岁剧场>.

iQIYI's priority shift to short series can enhance the overall ROI. In the TV drama era, series length tended to be prolonged as it affects ad revenue and content price. In comparison, short series tend to have higher single-episode quality and lower production cost, and the condensed plot caters to users with fragmented spare time. Therefore, short series prove to be highly effective in acquiring users, ads & subs monetization and improving ROI. According to Endata, Top 10 suspense series' average series length dropped from 39 in 2019 to 22 in Sep 2020. iQIYI took a forward-looking position to shorten the series length in 2018, and it aims to strike a balance of 50%/50% between short and long series in the long run.

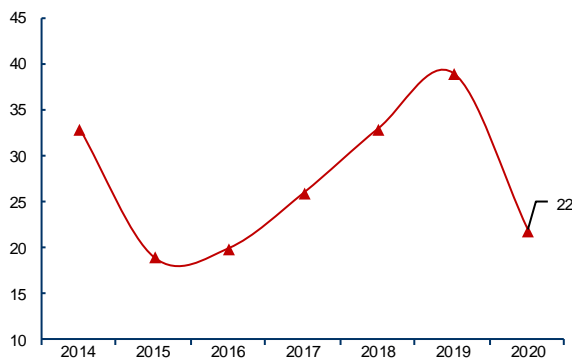
Figure 25: Number of suspense Internet drama series by platform in 2014-2020



Source: Endata

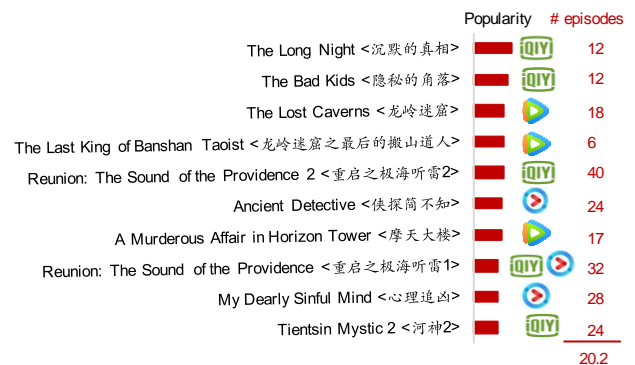
Note: Including Internet drama series launched between 1 Jan 2014 and 20 Sep 2020

Figure 26: Average number of episodes in Top 10 suspense Internet drama series



Source: Endata, including Internet drama series launched between 1 Jan 2014 and 20 Sep 2020

Figure 27: Top 10 acclaimed suspense Internet drama series in Jan-Sep 2020



Source: Endata, including Internet drama series launched between 1 Jan 2014 and 20 Sep 2020

Leveraging valuable IP chain and content ecosystem to expand TAM

iQIYI's fully-fledged pan-entertainment ecosystem laid the foundation for its IP development and monetization. The Company uses multiple Apps to penetrate into users with different demographics and embeds most products into its main App. The main App also redirects users to subcategory Apps, including UGC (Suike), live streaming (Qixiu), and children-oriented videos (Qibabu). The close-knit ecosystem helps to capture users' attention, expand the TAM, and enrich the content offering on the main App.

iQIYI leverages its high-quality original and licensed PGC to develop valuable IP across different media, including drama series, movies, variety shows, comics, and courses. As iQIYI's *The Long Night* became a hit, the Company launched the original novel on iQIYI Literature and crime-related courses on iQIYI Knowledge. After adopting the novel, *The World of Fantasy* <灵域>, into comics, iQIYI later produced animation and drama series to fully monetize the popular IP.

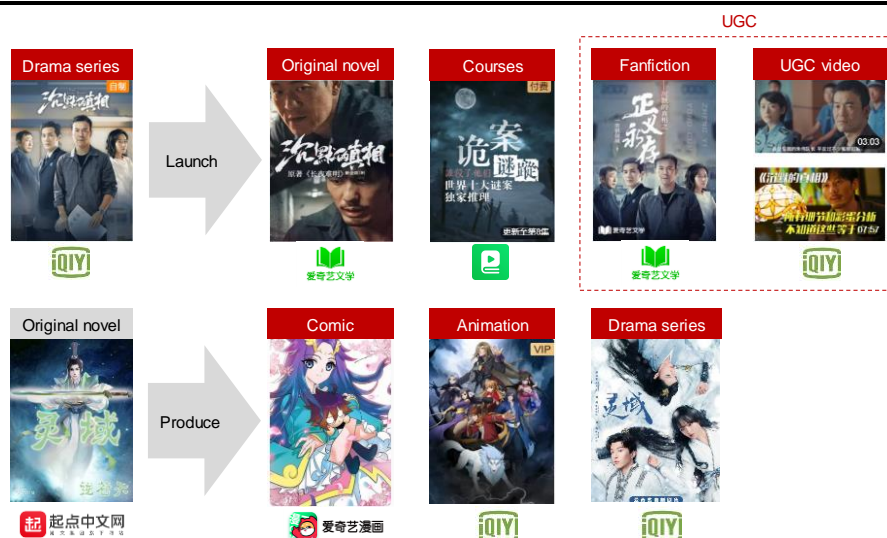
iQIYI's UGC platforms supplement its PGC content and encourage user interaction. After iQIYI launched *The Long Night*, users actively post UGC videos to discuss the plot or write fanfictions to explore alternative plot development possibilities. The UGC platforms enhance the sense of community on iQIYI and sustain iQIYI IPs' life cycle.

Figure 28: iQIYI's pan-entertainment offerings embedded in its main App



Source: Company data

Figure 29: iQIYI's all-around monetization on one IP



Source: Company data

User expansion and price hike to unlock membership upside

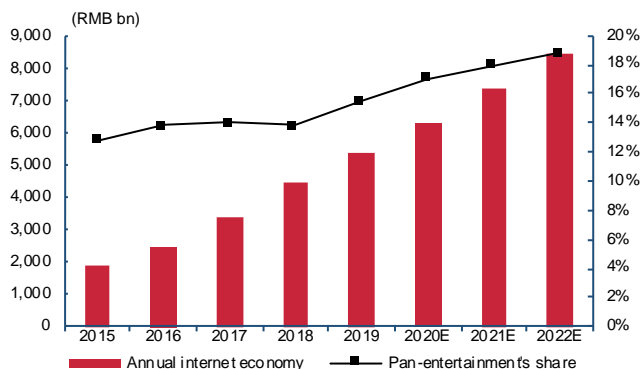
Still room for user expansion

We believe iQIYI has ample room to increase its MAU and subs, and reach an **achievable subs target of 150mn** in the long run. Its subs declined QoQ in recent two quarters due to content delay, and might see subs fluctuation in next one/ two quarters for price hike. However, this new price plan only affects android users (3/4) and non-recurring packages (20% of total subs), and mgmts. stated that acceptable price should be higher than its announced price based on their survey. We see high visibility for iQIYI's subs to recover, with richer content to launch in FY21E. Next growth driver of users would derive from: 1) richer exclusive original content; 2) lower-tier cities penetration with growing paying ratio; and 3) iQIYI's all-screen strategy.

iQIYI is well-positioned to ride on the growing paying willingness trend in lower-tier cities. According to iResearch, the aggregated time spent on online movie ticketing in lower-tier cities increased by over 40% YoY in Sep 2020, suggesting enhanced entertainment spending and online penetration. On top of that, <50% of iQIYI's subscribers came from third-or-lower-tier cities in Sep 2020, based on QuestMobile.

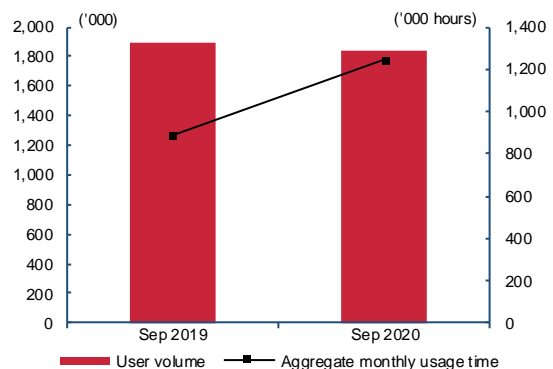
We expect iQIYI to gain share in diversified video entertainment scenarios as iQIYI advances its all-screen strategy with Qiyiguo TV, iQIYI VR, iQIYI smart home, and iQIYI in-car entertainment. The co-membership programs serve as another driver to expand TAM and direct traffic to iQIYI's core App. We believe the rising willingness to pay for high-quality content will boost the paying ratio and subs.

Figure 30: Pan-entertainment expected to gain share in growing online economy



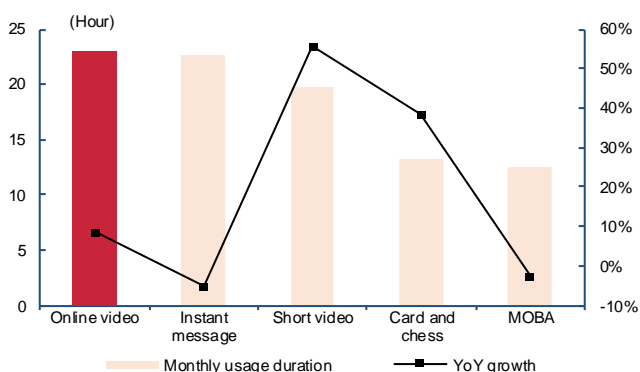
Source: iResearch

Figure 31: Volume and effective time of China's lower-tier city users on online movie ticketing



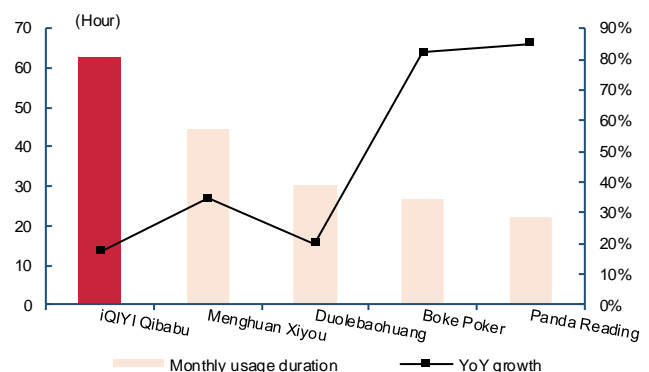
Source: iResearch

Figure 32: Top 5 subsectors in terms of user time growth in lower-tier cities in Aug 2020



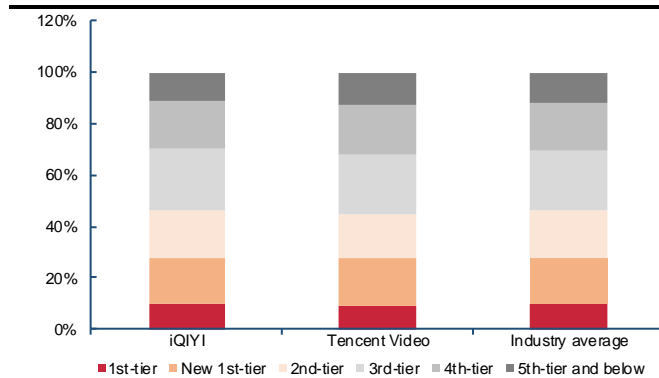
Source: iResearch

Figure 33: Top 5 APP in terms of user time growth in lower-tier cities in Aug 2020



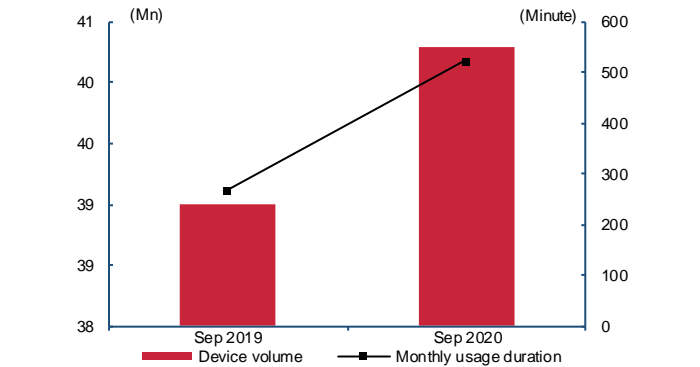
Source: iResearch

Figure 34: iQIYI's subscriber by city tier in Sep 2020



Source: QuestMobile

Figure 35: Smart home device volume and usage duration growth in Sep 2019-Sep 2020



Source: iResearch

ARPU into growth trajectory with initial price hike

We expect iQIYI's ARPU to be another growth driver as it has entered the price hike stage. On 13 Nov 2020, iQIYI raised its pricing for the first time in nine years, lifting Gold VIP and Student VIP prices on android and PC to iOS device's level. We believe the price hike's negative impact on subs volume will be short-term, as iQIYI's current price is still significantly lower than its overseas peers.

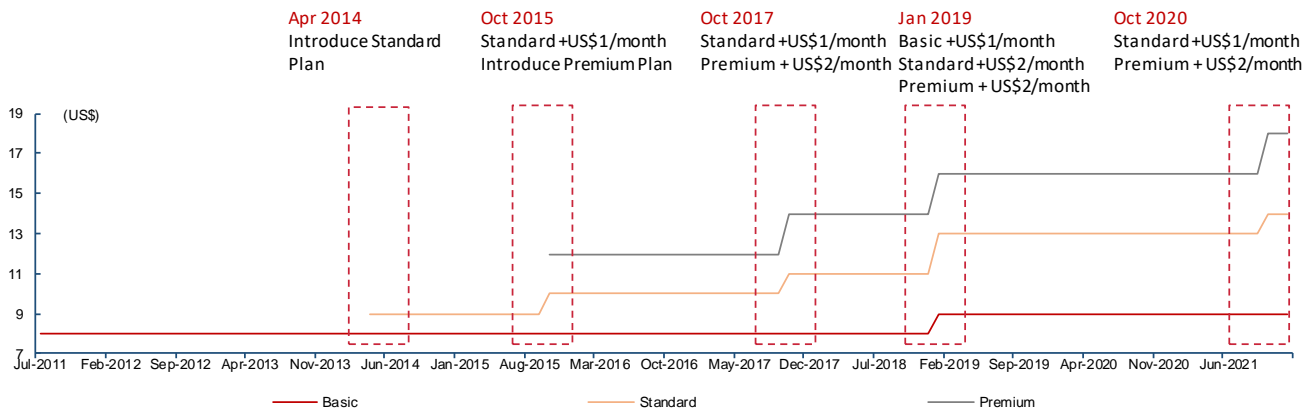
The leading PGC video platform Netflix has increased its price six times while retaining fast-growing user base and healthy financials. To increase subscription revenue, Netflix has launched tiered plans and ramped up the monthly fee by US\$1-2 per price rise. Backed by its abundant quality content, Netflix's price rise creates a virtuous circle, as adequate subscription income allows Netflix to create better content and attract more users.

iQIYI's VAS innovation also drives its ARPU growth. In Dec 2019, iQIYI followed Tencent Video to launch an advance-viewing program on its blockbuster show Joy of Life <庆余年>, allowing users to watch more exclusive content ahead of others after paying a premium for each episode. iQIYI also launched the Star VIP plan in May 2020, which charges RMB40/month for the continuous monthly subscription (vs. Gold VIP's RMB19 after the price rise). Star VIP offers additional privileges than Gold VIP, including advance-viewing and all-screen viewing.

Figure 36: iQIYI and Tencent Video subscription fee comparison

Platform	Type	Device	Continuous subscription (cancel at any time)	Standalone subscription
iQIYI	Gold VIP	iOS, Android, PC	1-month: RMB19	1-month: RMB25
			3-month: RMB58 (RMB19.3/month)	3-month: RMB68 (RMB22.7/month)
			12-month: RMB218 (RMB18.2/month)	12-month: RMB248 (RMB20.7/month)
	Star VIP	iOS, Android, PC	1-month: RMB40	1-month: RMB60
			3-month: RMB118 (RMB39.3/month)	3-month: RMB138 (RMB46.0/month)
			12-month: RMB398 (RMB33.2/month)	12-month: RMB418 (RMB34.8/month)
Tencent Video	Student VIP	iOS, Android, PC	1-month: RMB12	12-month: RMB123 (RMB10.3/month)
			(maximum 24 months)	(maximum 2 years)
	Standard VIP	iOS	1-month: RMB19	
			3-month: RMB53 (RMB17.7/month)	
			12-month: RMB208 (RMB17.3/month)	
	Super VIP	Android, PC	1-month: RMB15	1-month: RMB20
			3-month: RMB45 (RMB15/month)	3-month: RMB45 (RMB15/month)
			12-month: RMB178 (RMB14.8/month)	12-month: RMB198 (RMB17.3/month)
	Super VIP	iOS, Android, PC	1-month: RMB30	1-month: RMB50
			3-month: RMB88 (RMB29.3/month)	3-month: RMB148 (RMB49.3/month)
			12-month: RMB348 (RMB29.0/month)	12-month: RMB488 (RMB40.6/month)

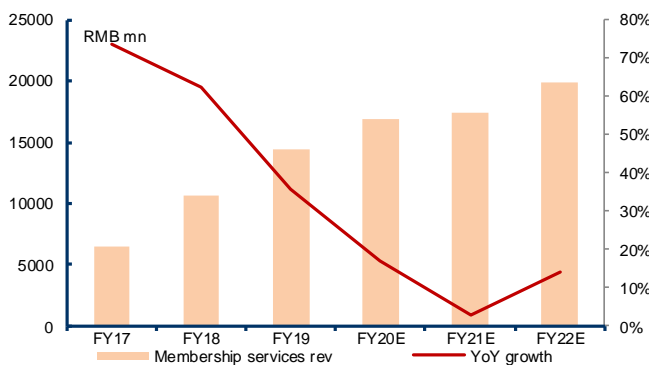
Source: Company data, CMBIS. Not considering new member/limited-time discounts

Figure 37: Netflix's price rise history

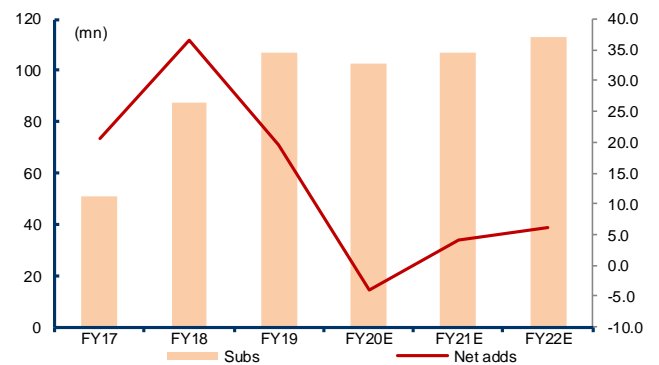
Source: Netflix, CMBIS

Expecting subs to grow at 11% CAGR in FY20-22E

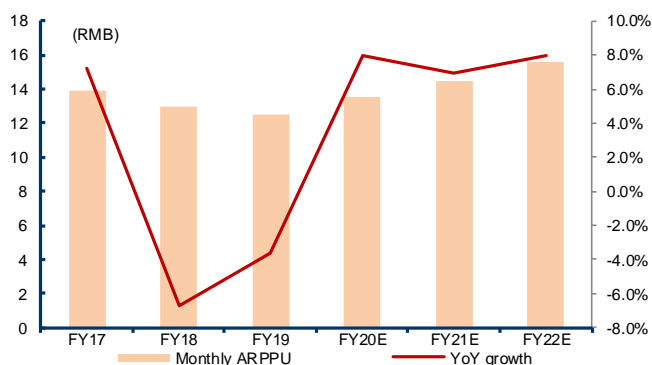
We forecast IQIYI's subs revenue to grow at 11% CAGR in FY20-22E, driven by 5%/7% subs /ARPPU CAGR. Subs would see short-term fluctuation (expecting QoQ decline in 4Q20E) due to price hike, but long-term trend intact. We expect ARPPU to see double-digit YoY growth in 4Q20E.

Figure 38: iQIYI's subscriber rev estimates

Source: Company data, CMBIS estimates

Figure 39: iQIYI's subs trend

Source: Company data, CMBIS estimates

Figure 40: iQIYI's subs ARPPU estimates

Source: Company data, CMBIS estimates

Ads recovery in sight

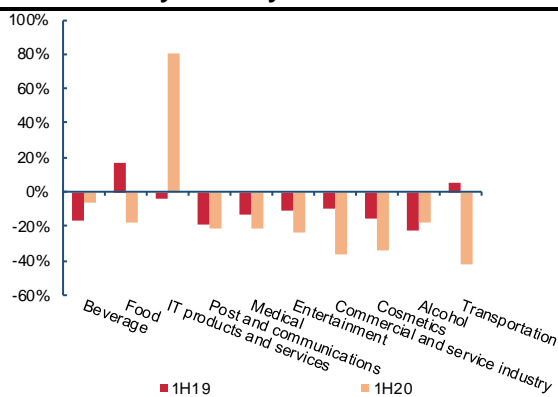
Ads sentiment to recover in post COVID-10 period

Ads saw gradual recovery in post COVID-19 period, backed by rising ads demand & richer ads format under macro recovery. According to CTR, advertisement expense declined YoY in 1H20 for all industries except for IT products and services, with transportation/commercial and services/cosmetics dropping by 42.6%/36.8%/33.7% YoY. With China's effective epidemic prevention and gradual macro recovery, the aggregate ads YoY decline narrowed to -7% in Jul 2020.

The launch of delayed drama series and variety shows also supported iQIYI's ads revenue recovery, since over 50% of brand advertisement is content-directed. According to CTR, the market witnessed a substantial recovery of brand advertisement in drama series and variety shows. In particular, the number of clothes/home appliance/personal care brands appearing in drama series increased by 30% QoQ in 3Q20, so does the number of alcohol/commercial and services/transportation brands showing in variety shows.

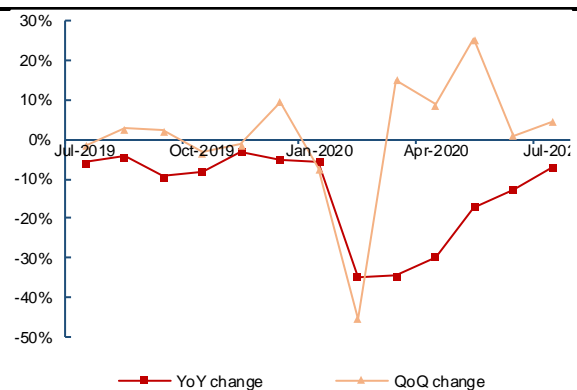
We expect iQIYI's ad revenue to pick up as ads demand and content production recovered from the epidemic. Mgmt. guided a single-digit YoY decrease in ads revenue in 4Q20E.

Figure 41: Advertisement expense YoY change in 1H19 and 1H20 by industry verticals



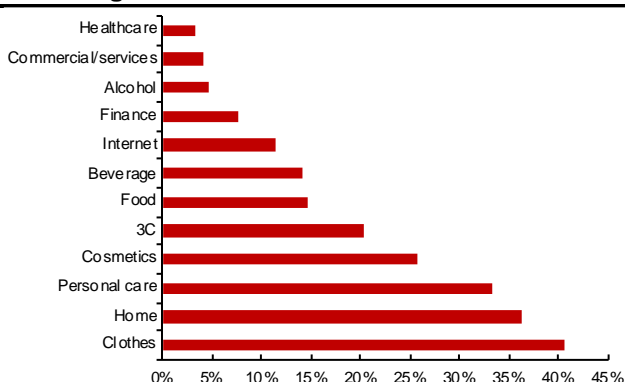
Source: CTR

Figure 42: Advertisement expense changes in Jul 2019 - Jul 2020



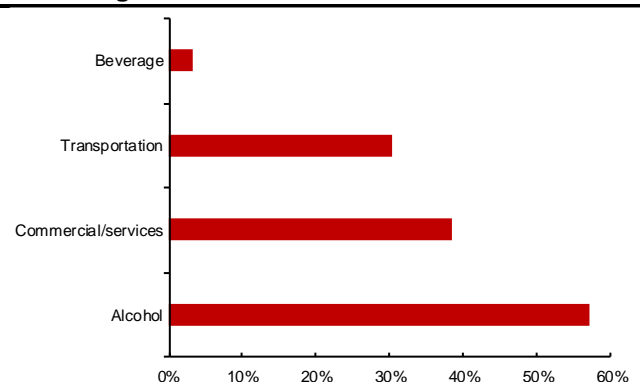
Source: CTR

Figure 43: Drama series advertisement brand name QoQ change in 3Q20



Source: CTR

Figure 44: Variety show advertisement brand name QoQ change in 3Q20



Source: CTR

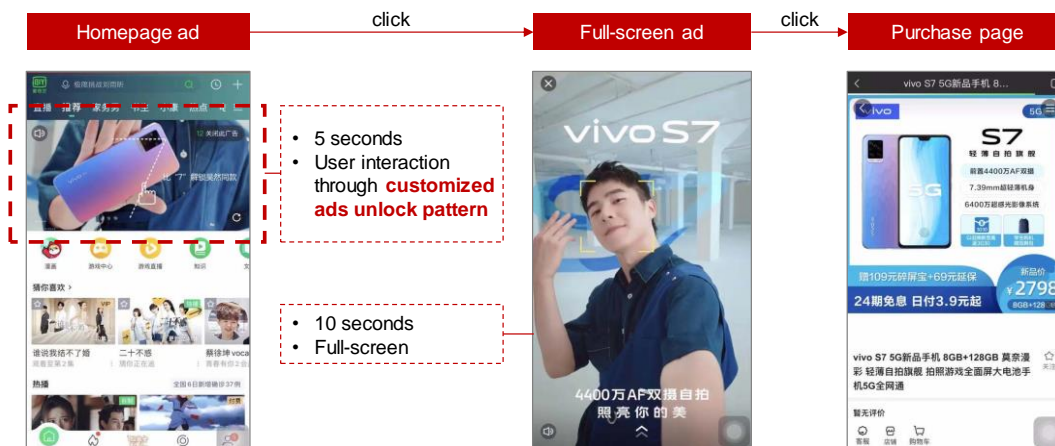
Multiple engines to stimulate ads growth

In the long term, we expect iQIYI's ad revenue to be driven by algorithm optimization and enriched ad formats.

We expect iQIYI's advanced technology to enhance advertising efficiency and stimulate advertisers' paying willingness. iQIYI introduced the QME (Quality, Monitoring, and Evaluation) in Jul 2020 to enhance the efficiency of massive in-frame ads. The QME standard simplifies advertisers' input, and AI will automatically post the ad into pre-determined spots. iQIYI also real-time monitors and evaluates ad effect, reporting average screen share, viewing time, and viewership per person.

To enrich the in-App advertisement, iQIYI launched the huge-screen Plus ad in Aug 2020. The huge-screen ad involves user interaction, as users can use advertiser-customized unlock pattern to click into the full-screen ad. Such an advertisement generates twice the click rate than an ordinary huge-screen ad. iQIYI also cooperates with brand names to launch innovative promotion campaigns, including the crossover between Light on Series and KFC, as well as Mengniu's all-around title sponsorship for Youth with You 2.

Figure 45: iQIYI's huge-screen Plus ad



Source: iResearch, CMBIS

Figure 46: Enriched advertising format for drama series and variety shows

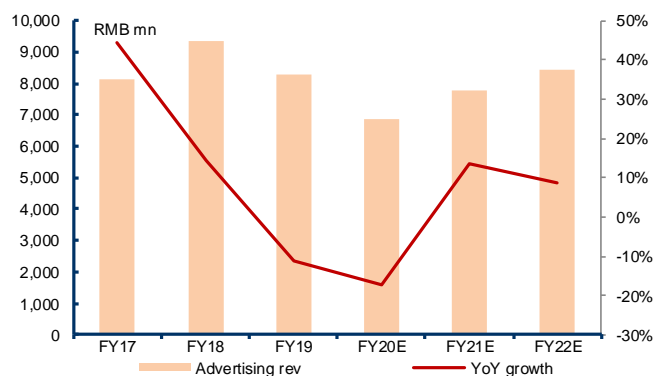


Source: iResearch, CMBIS

Expecting ads to bottom out

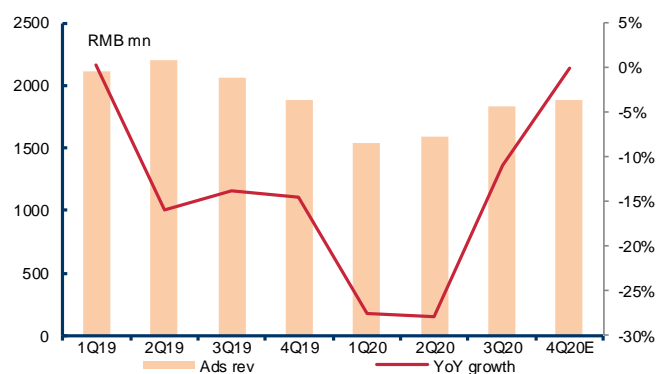
We forecast 11% ad rev CAGR in FY20-22E, with gradual ads demand recovery in post COVID-19 period. Backed by its high-quality content pipeline, as well as enriched ads formats, we expect its ads rev to bottom out, and grow at 14% /9% YoY in FY21/22E. Its ads rev has seen sequential growth since 2Q20, and we forecast it to continuously increase QoQ in next few quarters.

Figure 47: iQIYI's ads rev estimates



Source: Company data, CMBIS estimates

Figure 48: iQIYI's quarterly ads rev trend



Source: Company data, CMBIS estimates

Financial Analysis

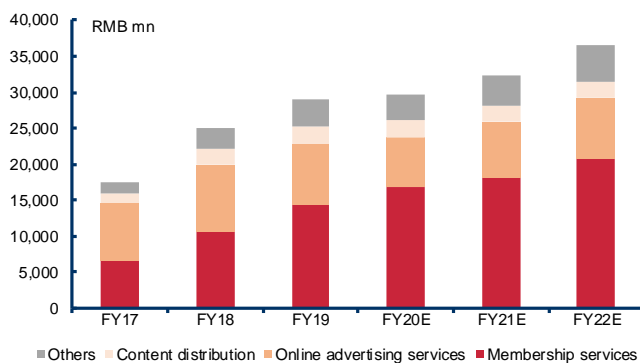
Revenue Breakdown

We forecast iQIYI revenue to grow at 3%/9%/13% in FY20/21/22E, in which membership service continues to be the largest revenue contributor in the long run. By segment, we expect membership/ads to grow at CAGR of 11%/11% in FY20-22E.

Key topline drivers come from:

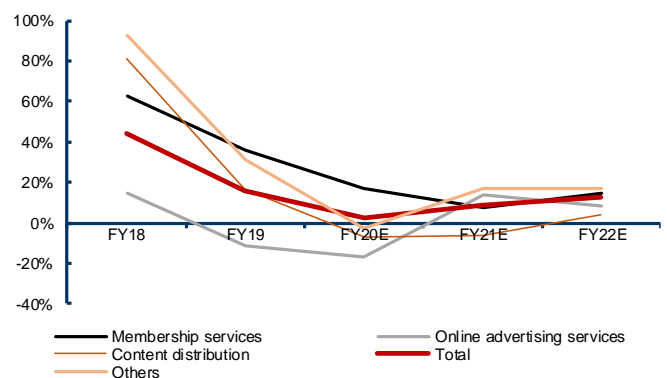
- 1) **Membership:** forecasting 11% rev CAGR in FY20-22E, mainly supported by rising subs & price hike, coupled with enriched original content offerings. We expect its subs to decline QoQ in 4Q20E, as new subscription pricing plan took effect on 13 Nov, while blended ARPU to see low-teens YoY growth. Subscribers would see negative effect from new pricing plan in one or two quarters, but would pick up in 2H21E.
- 2) **Online advertising:** 11% rev CAGR in FY20-22E, with gradual ads demand recovery in post COVID-19 period. Backed by its high-quality content pipeline, as well as enriched ads formats, we expect its ads rev to bottom out, and grow at 14% /9% YoY in FY21/22E.
- 3) **Content distribution & Others:** forecasting this segment with 20% rev mix in FY20-22E. We expect its IP value chain enhancement to unlock its potential, if executed well.

Figure 49: Rev estimates



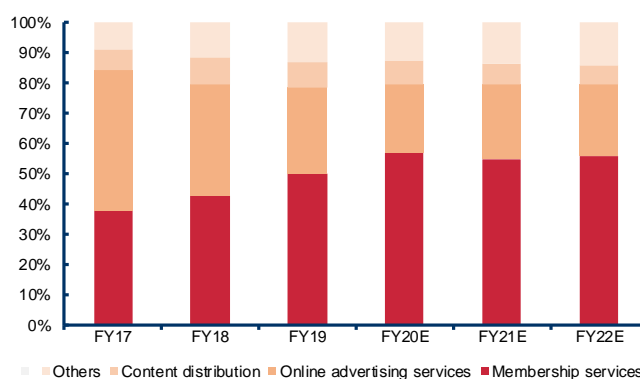
Source: Company data, CMBIS estimates

Figure 50: Rev growth breakdown



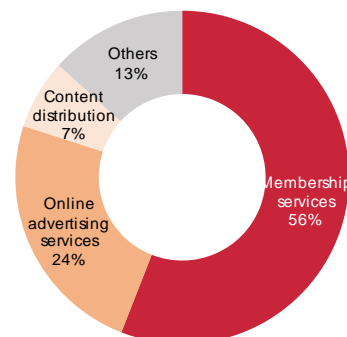
Source: Company data, CMBIS estimates

Figure 51: Rev mix trend



Source: Company data, CMBIS estimates

Figure 52: FY21E revenue breakdown



Source: Company data, CMBIS estimates

Figure 53: Revenue driver estimates

Revenue (RMB mn, Dec-YE)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Membership services	6,536	10,623	14,436	16,901	18,125	20,701
Online advertising services	8,159	9,328	8,271	6,847	7,787	8,463
Content distribution	1,192	2,163	2,519	2,339	2,189	2,277
Others	1,492	2,876	3,768	3,669	4,295	5,033
Total	17,378	24,989	28,994	29,756	32,395	36,473
% YoY	FY17	FY18	FY19	FY20E	FY21E	FY22E
Membership services	74%	63%	36%	17%	7%	14%
Online advertising services	44%	14%	-11%	-17%	14%	9%
Content distribution	138%	81%	16%	-7%	-6%	4%
Others	13%	93%	31%	-3%	17%	17%
Total	55%	44%	16%	3%	9%	13%
% of revenue contribution	FY17	FY18	FY19	FY20E	FY21E	FY22E
Membership services	38%	43%	50%	57%	56%	57%
Online advertising services	47%	37%	29%	23%	24%	23%
Content distribution	7%	9%	9%	8%	7%	6%
Others	9%	12%	13%	12%	13%	14%
Total	100%	100%	100%	100%	100%	100%

Source: Company data, CMBIS estimates

Income Statement

We expect better margin outlook in the long run, but priority is still content initiatives.

As mgmt. prioritizes content enhancement over profitability, iQIYI would still invest in content in the short to middle term, especially in its original content. But in the long run, we expect margin improvement for scale effect, price hike and operating leverage.

We expect gross margin to improve to 5%/12%/19% in FY20/21/22E, in which content cost/rev ratio decreased to 63% in FY22E, from 77% in FY19 (absolute number still increases) for actor salary cap, decreasing production cost & licensed content cost.

We forecast opex ratio to decrease to 22.7% in FY22E from 27.3% in FY19, attributable to 1) scale effect; 2) enhanced productivity and operating leverage; and 3) efficient marketing strategy with moderate discount, under relatively stable competitive landscape.

As a result, we forecast its adj. net loss to reach RMB4.2bn/RMB1.3bn in FY21/22E, with adj. net loss margin narrowing to -3% in FY22E.

Figure 54: Income statement

RMB mn, Dec-YE	FY17	FY18	FY19	FY20E	FY21E	FY22E
Net revenue	17,378	24,989	28,994	29,756	32,395	36,473
Cost of revenue	(17,387)	(27,133)	(30,348)	(28,371)	(28,465)	(29,614)
Gross profit	(8)	(2,144)	(1,355)	1,384	3,930	6,859
Selling and distribution expenses	(2,146)	(3,379)	(3,888)	(3,889)	(4,092)	(4,188)
Administrative expenses	(529)	(789)	(1,348)	(1,352)	(1,384)	(1,175)
R&D	(1,270)	(1,995)	(2,667)	(2,702)	(2,807)	(2,941)
Operating (loss)/profit	(3,953)	(8,306)	(9,258)	(6,559)	(4,352)	(1,445)
Other expenses	209	(676)	(967)	(1,234)	(1,117)	(1,228)
(Loss)/profit before income tax	(3,744)	(8,982)	(10,225)	(7,793)	(5,469)	(2,673)
Income taxes (expense)/credit	8	(79)	(52)	(47)	(50)	(50)
(Loss)/profit for the year	973	(9,409)	(10,325)	(7,858)	(5,519)	(2,723)
Adj. net profit	(3,867)	(8,599)	(8,765)	(6,331)	(4,223)	(1,264)
Margin Analysis						
Gross margin	0%	-9%	-5%	5%	12%	19%
Operating margin	-23%	-33%	-32%	-22%	-13%	-4%
Adj. net margin	-22%	-34%	-30%	-21%	-13%	-3%
Growth Analysis						
Revenue		44%	16%	3%	9%	13%
Gross profit		NA	NA	NA	184%	75%
Operating profit		NA	NA	NA	NA	NA
Adj. net profit		NA	NA	NA	NA	NA

Source: Company data, CMBIS estimates

Figure 55: CMBIS estimates vs consensus

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	29,756	32,395	36,473	29,878	33,855	38,769	-0.4%	-4.3%	-5.9%
Gross Profit	1,384	3,930	6,859	1,262	3,794	6,534	9.7%	3.6%	5.0%
Operating Profit	(6,559)	(4,352)	(1,445)	(6,525)	(4,654)	(1,736)	NA	NA	NA
Adj. net profit	(6,331)	(4,223)	(1,264)	(7,064)	(4,731)	(1,746)	NA	NA	NA
EPS (RMB)	(8.55)	(5.58)	(1.65)	(9.48)	(5.81)	(2.24)	NA	NA	NA
Gross Margin	4.7%	12.1%	18.8%	4.2%	11.2%	16.9%	+0.4ppts	+0.9ppts	+2.0ppts
Operating Margin	-22.0%	-13.4%	-4.0%	-21.8%	-13.7%	-4.5%	-0.2ppts	+0.3ppts	+0.5ppts
Net Margin	-21.3%	-13.0%	-3.5%	-23.6%	-14.0%	-4.5%	+2.4ppts	+0.9ppts	+1.0ppts

Source: Company data, Bloomberg, CMBIS estimates

Balance Sheet

According to our estimates of profit before taxation and change in working capital, MD has solid operating cash flow & financing cash flow in supporting CAPEX in the next three years, despite net loss position in FY19-22E. We expect iQIYI to hold RMB1.4bn/RMB556mn cash and cash equivalent as of 31 Dec of 2020E and 2021E.

Figure 56: Balance Sheet

RMB mn, Dec-YE	FY17	FY18	FY19	FY20E	FY21E	FY22E
Non-current assets	14,500	24,906	24,520	28,622	29,064	30,187
Fixed asset	1,249	1,618	1,754	1,956	2,171	2,483
Long-term investments	568	2,572	2,982	2,982	2,982	2,982
Licensed copyrights, net	4,558	6,641	6,287	6,687	8,312	10,169
Others	8,125	14,075	13,496	16,997	15,600	14,553
Current assets	5,701	19,853	20,273	15,306	14,968	16,588
Cash	733	4,586	5,935	1,404	556	1,030
Restricted cash	0	2,174	975	975	975	975
Short-term investments	780	6,062	4,579	4,579	4,579	4,579
Account receivable	2,235	2,889	3,628	3,263	3,463	3,799
Others	1,952	4,142	5,156	5,085	5,395	6,205
Current liabilities	11,626	19,812	20,173	25,812	30,140	32,147
Account payable	7,041	10,162	8,212	9,172	9,202	9,574
Customer advances and deferred revenue	1,634	2,195	3,081	3,162	3,443	3,876
Accrued liabilities	2,511	3,632	3,795	3,498	3,509	3,651
Short-term borrowings	299	3,046	2,618	7,618	11,618	12,618
Others	140	776	2,466	2,362	2,367	2,428
Non-current liabilities	293	6,792	14,904	14,904	14,904	14,904
Convertible senior notes	0	4,712	12,297	12,297	12,297	12,297
Others	293	2,079	2,608	2,608	2,608	2,608
MI	4	119	42	42	42	42
Total Equity	(14,315)	18,274	9,656	3,152	(1,071)	(2,335)
Shareholders' equity	(14,319)	18,156	9,613	3,110	(1,114)	(2,378)

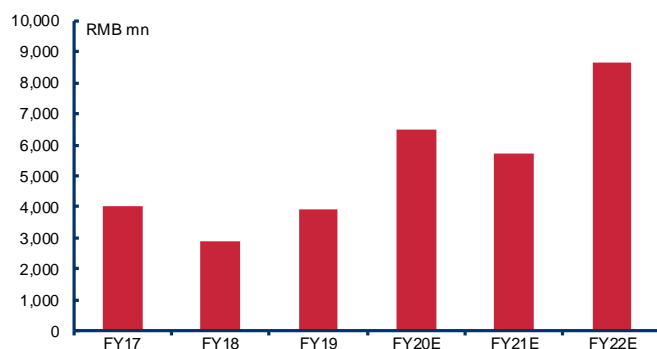
Source: Company data, CMBIS estimates

Cash Flow and Working Capital

Vast user base and solid cross-selling ensure strong operating cash flow

Given its rising subs, price hike and margin improvement, we expect iQIYI to maintain its solid operating cash inflow trend and record RMB6.5bn/ RMB5.7bn/RMB8.6bn of operating cash inflow in FY20/21/22E, respectively.

Figure 57: Operating cash flow projections



Source: Company data, CMBIS estimates

Figure 58: Cash flow and working capital analysis

RMB mn, Dec-YE	FY17	FY18	FY19	FY20E	FY21E	FY22E
Cash Flow						
Operating cash flow	4,012	2,884	3,907	6,468	5,727	8,632
CAPEX	(10,220)	(15,060)	(12,831)	(16,013)	(10,575)	(11,158)
Others	(441)	(5,890)	1,081	(0)	0	0
Investing cash flow	(10,661)	(20,949)	(11,750)	(16,014)	(10,575)	(11,158)
Proceeds from share issuance	46	14,916	107	0	0	0
Others	6,516	8,559	7,774	5,014	4,000	3,000
Financing cash flow	6,561	23,475	7,880	5,014	4,000	3,000
Cash at period end	733	6,760	6,910	2,378	1,530	2,004

Source: Company data, CMBIS estimates

Valuation

Investment Thesis

We initiate BUY with DCF-based TP of **US\$23.2**, implying **3.8x/3.5x** FY20/21E P/S. Despite short-term subs fluctuation for prick hike, we keep confident on iQIYI's long-term sub trend and ads recovery, backed by its vibrant original content pipeline. iQIYI's positive price drivers and catalysts would originate from: 1) hit dramas to be launched; 2) better-than-expected ads recovery; and 3) subs pick up. iQIYI's share price pulled back recently for fundraising dilution (proposed CB and ADS offering on 16 Dec, 2020) and soft subs momentum. We initiate BUY at this moment for its attractive valuation and already-low expectation with potential subs fluctuation in next few quarters.

Initiate with BUY

We use DCF valuation as our primary method since it is suitable to apply DCF valuation to internet companies with healthy cash flows in the long run, but at net loss currently. Assuming a WACC of 13.0% and a terminal growth rate of 3%, our estimated TP is **US\$23.2**, representing **3.8x/3.5x** FY20/21E P/S, still below industry average of **8.0x/6.2x** FY20/21E P/S.

Figure 59: DCF valuation

DCF valuation (RMB mn)										
	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E
EBIT	(5,034)	(2,948)	128	3,652	6,573	10,385	14,280	18,564	23,205	27,846
Tax	(47)	(50)	(50)	(100)	(200)	(250)	(1,035)	(1,517)	(1,688)	(1,850)
D&A	15,662	13,643	13,171	12,136	10,937	10,373	10,379	11,097	11,853	12,468
Working capital	-3,288	-3,693	-3,275	-1,910	-2,948	-2,419	-2,121	-2,288	-1,741	-2,795
CAPEX	(16,013)	(10,575)	(11,158)	(14,030)	(10,224)	(8,462)	(15,831)	(6,898)	(17,731)	(7,154)
FCF	(8,720)	(3,623)	(1,184)	(251)	4,138	9,627	5,671	18,958	13,898	28,516
FCF Growth		-58%	-67%	-79%	-1747%	133%	-41%	234%	-27%	105%
Terminal Value										305,440
PV (FCF+ Terminal Value)	(8,720)	(3,217)	(934)	(176)	2,572	5,315	2,780	8,252	5,372	114,627

Assumptions	
WACC	12.6%
Tax rate	15.0%
Risk free rate	3.6%
Beta	1.10
Market risk return	11.8%
Debt/Assets	0.0%
Terminal growth rate	3.0%
Debt value	0

Equity Value	
PV	125,872
minus: Net cash	13,963
minus: Minority Interest	0
Equity Value	111,909
Shares (mn)	739
Target Price (US\$) based on DCF	23.2

		WACC				
		11%	12%	13%	14%	15%
Growth	1.5%	26.9	22.3	20.0	15.7	13.1
	2.0%	28.4	23.5	21.0	16.3	13.7
	2.5%	30.1	24.7	22.0	17.1	14.3
	3.0%	32.0	26.1	23.2	17.9	14.9
	3.5%	34.1	27.7	24.5	18.8	15.6
	4.0%	36.5	29.5	26.0	19.8	16.4
	4.5%	39.4	31.4	27.6	20.9	17.2

Source: Company data, Bloomberg, CMBIS estimates

Note: FX = 6.53

Peers comparison

As a crosscheck, we selected 4 entertainment giants, 8 subs peers and 5 ads peers for comparison. The industry multiple is 6.2x FY21E P/S, 68% higher than our DCF-based multiple of **3.8x/3.5x** FY20/21E P/S.

Netflix and Mango could be the most comparable one, for the similar business. Currently, Netflix and Mango's FY21E P/S was 8.0x/6.2x, largely above our TP-based multiple of 3.5x. Since Netflix is a clear leader in global market and 98% rev mix from subs, market might prefer to value iQIYI with a multiple at a discount of Netflix. However, iQIYI is now trading at 2.6x FY21E P/S, with attractive valuation. And we think our TP is not demanding for iQIYI, since iQIYI excelled itself with high-quality original content creation, data analytics to better target user preference and valuable IP reserve. Its potential hit drama, ads recovery and subs pick-up would bring further upside, if executed well.

Figure 60: Peers valuation

Company	Ticker	Mkt cap (USD mn)	CMBI Rating	CMBI TP	Currency	Price	PE			PS			EV/EBITDA			FY0-2 EPS
							FY0	FY1	FY2	FY0	FY1	FY2	FY0	FY1	FY2	
iQiyi	IQ US	13,499	BUY	23.2	CNY	17	NA	NA	NA	3.0	2.6	2.3	NA	NA	NA	NA
Internet giants																
Tencent	700 HK	717,294	BUY	669	HKD	580	38.3	30.7	25.5	9.7	7.9	6.6	27.3	22.5	18.7	23%
Alibaba	BABA US	703,466	BUY	359	USD	260	25.4	21.0	17.1	6.6	5.0	4.2	20.6	16.2	13.4	22%
Disney	DIS US	313,015	NR	NA	USD	173	114.3	92.1	36.3	4.8	4.5	3.6	39.1	35.5	21.0	75%
Netflix	NFLX US	236,117	NR	NA	USD	534	80.7	55.6	42.2	9.5	8.0	6.9	48.4	38.5	29.2	38%
Average							64.7	49.9	30.2	7.7	6.3	5.3	33.9	28.2	20.6	40%
VAS & Subscribers																
Mango	300413 CH	17,885	NR	NA	CNY	66	66.2	54.4	45.2	7.5	6.2	5.3	21.5	17.6	14.7	21%
Bilibili	BILI US	29,421	BUY	62	USD	85	NA	NA	2407.9	16.3	11.2	8.3	NA	NA	155.1	NA
TME	TME US	31,303	NR	NA	USD	19	41.6	33.5	26.3	7.0	5.7	4.8	40.3	30.0	23.1	26%
Huya	HUYA US	4,962	NR	NA	USD	21	26.4	19.9	14.8	3.0	2.4	2.0	21.6	13.5	9.4	34%
Douyu	DOYU US	3,880	NR	NA	USD	12	29.5	20.1	15.6	2.6	2.1	1.8	23.8	11.8	7.9	37%
Momo	MOMO US	2,872	HOLD	16	USD	14	7.8	7.3	6.2	1.3	1.2	1.0	4.3	4.6	3.7	12%
YY	YY US	6,663	BUY	130	USD	82	19.8	16.4	11.9	1.7	1.5	1.3	10.3	9.0	6.3	29%
China Literature	772 HK	7,580	NR	NA	HKD	58	NA	36.9	28.1	6.2	4.8	4.0	NA	34.6	24.4	NA
Average							31.9	26.9	319.5	5.7	4.4	3.6	20.3	17.3	30.6	26%
Advertising																
Baidu	BIDU US	65,722	BUY	173	USD	193	20.0	19.1	16.6	4.0	3.5	3.1	13.7	12.2	10.4	10%
Weibo	WB US	10,469	NR	NA	USD	46	23.2	18.6	16.3	6.4	5.6	5.2	19.9	15.5	13.6	19%
Facebook	FB US	787,268	NR	NA	USD	276	27.7	24.8	20.8	9.4	7.5	6.3	16.6	14.4	11.9	15%
Snapchat	SNAP US	78,954	NR	NA	USD	53	NA	270.4	93.6	32.3	22.6	16.9	6233.8	154.3	68.6	NA
Twitter	TWTR US	44,436	NR	NA	USD	56	NA	65.1	48.1	12.3	10.0	8.6	38.1	29.3	24.5	NA
Average							23.6	79.6	39.1	12.9	9.9	8.0	1264.4	45.1	25.8	15%
Total Average							40.1	49.1	169.0	8.0	6.2	5.1	438.6	28.7	26.8	28%

Source: Bloomberg

Note: Data updated by Dec 20, 2020; Snapchat was excluded as an outlier to estimate total average multiple

Key Investment Risks

Key investment risks may derive from: 1) intensified competition landscape; 2) slowdown of subs due to price hike; 3) regulation uncertainty; 4) content delay; 5) slower-than-expected ads recovery for macro uncertainty; and 6) external financing need.

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	24,989	28,994	29,756	32,395	36,473
Membership services	10,623	14,436	16,901	18,125	20,701
Online advertising services	9,328	8,271	6,847	7,787	8,463
Content distribution	2,163	2,519	2,339	2,189	2,277
Others	2,876	3,768	3,669	4,295	5,033
COGS	(27,133)	(30,348)	(28,371)	(28,465)	(29,614)
Gross profit	(2,144)	(1,355)	1,384	3,930	6,859
S&M	(3,379)	(3,888)	(3,889)	(4,092)	(4,188)
Admin.Exp.	(789)	(1,348)	(1,352)	(1,384)	(1,175)
R&D	(1,995)	(2,667)	(2,702)	(2,807)	(2,941)
Operating profit	(8,306)	(9,258)	(6,559)	(4,352)	(1,445)
Other income/(exp), net	(676)	(967)	(1,234)	(1,117)	(1,228)
Pre-tax Income	(8,982)	(10,225)	(7,793)	(5,469)	(2,673)
Income Tax	(79)	(52)	(47)	(50)	(50)
Net profit	(9,409)	(10,325)	(7,858)	(5,519)	(2,723)
Adj. net profit	(8,599)	(8,765)	(6,331)	(4,223)	(1,264)

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	(9,061)	(10,277)	(7,840)	(5,519)	(2,723)
D&A	14,980	17,169	15,662	13,643	13,171
Change in WC	(3,574)	(4,206)	(3,288)	(3,693)	(3,275)
Others	539	1,221	1,935	1,296	1,459
Operating CF	2,884	3,907	6,468	5,727	8,632
Capex	(15,060)	(12,831)	(16,013)	(10,575)	(11,158)
Purchase of long-term investments	(883)	(706)	-	-	-
Others	(5,006)	1,788	(0)	-	-
Investing CF	(20,949)	(11,750)	(16,014)	(10,575)	(11,158)
Equity raised	14,916	107	-	-	-
Change of Debts	3,752	350	5,000	4,000	1,000
Cash from CB raised	5,035	7,910	-	-	2,000
Others	(228)	(486)	14	-	-
Financing CF	23,475	7,880	5,014	4,000	3,000
Net change in cash	6,027	150	(4,532)	(848)	474
Cash (beg of yr)	733	6,760	6,910	2,378	1,530
FX	617	112	-	-	-
Cash (end of yr)	6,760	6,910	2,378	1,530	2,004

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	24,906	24,520	28,622	29,064	30,187
Fixed asset	1,618	1,754	1,956	2,171	2,483
Long-term investments	2,572	2,982	2,982	2,982	2,982
Licensed copyrights, net	6,641	6,287	6,687	8,312	10,169
Others	14,075	13,496	16,997	15,600	14,553
Current assets	19,853	20,273	15,306	14,968	16,588
Cash	4,586	5,935	1,404	556	1,030
Restricted cash	2,174	975	975	975	975
Short-term investments	6,062	4,579	4,579	4,579	4,579
Account receivable	2,889	3,628	3,263	3,463	3,799
Others	4,142	5,156	5,085	5,395	6,205
Current liabilities	19,812	20,173	25,812	30,140	32,147
Account payable	10,162	8,212	9,172	9,202	9,574
Customer advances and deferred revenue	2,195	3,081	3,162	3,443	3,876
Accrued liabilities	3,632	3,795	3,498	3,509	3,651
Short-term borrowings	3,046	2,618	7,618	11,618	12,618
Others	776	2,466	2,362	2,367	2,428
Non-current liabilities	6,792	14,904	14,904	14,904	14,904
Convertible senior notes	4,712	12,297	12,297	12,297	12,297
Others	2,079	2,608	2,608	2,608	2,608
MI	119	42	42	42	42
Total Equity	18,274	9,656	3,152	(1,071)	(2,335)
Shareholders' equity	18,156	9,613	3,110	(1,114)	(2,378)

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Membership services	42.5	49.8	56.8	55.9	56.8
Online advertising services	37.3	28.5	23.0	24.0	23.2
Content distribution	8.7	8.7	7.9	6.8	6.2
Others	11.5	13.0	12.3	13.3	13.8
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	43.8	16.0	2.6	8.9	12.6
Gross profit	26001.2	(36.8)	(202.2)	183.9	74.5
EBIT	NA	NA	NA	NA	NA
Adj. net profit	NA	NA	NA	NA	NA
P&L ratios (%)					
Operating margin	(33.2)	(31.9)	(22.0)	(13.4)	(4.0)
Pre-tax margin	(35.9)	(35.3)	(26.2)	(16.9)	(7.3)
Adj. net margin	(34.4)	(30.2)	(21.3)	(13.0)	(3.5)
Effective tax rate	(0.3)	(0.2)	(0.2)	(0.2)	(0.1)
Returns (%)					
ROE	(49.5)	(105.2)	(242.7)	540.4	968.0
ROA	(19.2)	(19.6)	(14.4)	(9.6)	(2.7)
Per share					
EPS (RMB)	(11.81)	(11.97)	(8.55)	(5.58)	(1.65)
DPS (RMB)	0.00	0.00	0.00	0.00	0.00
BVPS (RMB)	9.33	9.49	3.22	2.02	2.62

Source: Company data, CMBIS estimates

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