



iQIYI, Inc. 2022 Letter to Investors

February 22, 2023

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Dear Investors,

First, I would like to extend our sincerest gratitude for your trust and long-standing support. I am pleased to take this opportunity to share our business updates and some strategic considerations.

2022 was a challenging year for many, and also for us. Nevertheless, 2022 was a year of breakthroughs, a miraculous year for iQIYI, as we completed an iconic turnaround under extremely volatile market conditions. We made substantial breakthroughs in gaining market share, upgrading business operations and improving financial performance. Our long-term commitment to original content yielded exceptional results. iQIYI's brand perception was elevated, from "iQIYI can create blockbusters" to "iQIYI is a blockbuster powerhouse". Particularly in Q4'22, our market share, membership revenues, operating profits, operating cash flow and free cashflow all reached record highs. To be specific:

- We significantly improved our ability to produce and deliver high-quality original content of wide appeal to the public, enabling us to deliver a continuing stream of blockbusters. Take Q4'22 as an example: we launched 6 blockbuster dramas in a single quarter. The time spent by subscribers grew by over 40% year-over-year and by 30% quarter-over-quarter, which is unprecedented. In the meantime, we remained the dominant player in the content business and strengthened our leading position in the market. According to Enlightent, our market share in the exclusive drama category increased by 20 percentage points annually and 13 percentage points sequentially.
- Strong content drove strong revenue performance. In Q4'22, our core membership services business recorded its highest quarterly revenue, up 15% annually and 13% sequentially. In Q4'22, our average daily number of total subscribing members was 111.6 million, representing a sequential net addition of more than 10 million. The number of subscribing members as of the end of December 2022 was 119.7 million, representing a net addition of over 13 million compared with the end of September 2022. In the meantime, the advertising business continued to recover, with revenue increasing by 25% quarter-over-quarter.
- In terms of profitability, we had a record-setting quarter in Q4'22. Operating income reached a record high and operating margin expanded for a fifth consecutive quarter. The strong performance demonstrated the operating leverage embedded in our business model.
- We have successfully transformed into a cash-generating business. In Q4'22, we generated positive operating cash flow for three consecutive quarters.

It took three things to make a miraculous year:

1. We took one step back and two steps forward by courageously changing what we could:

By the end of 2021, the long-form video industry had changed tremendously and no longer blindly pursued market share. Content quality and profitability were tightly aligned. We were the first to foresee that these changes would lead to a new stage of rational development in the entire industry. The focus of long-form video competition would shift from content quantity to content quality, and more players would pursue improvements in operational efficiency and profitability. Our strategic insights urged us to take actions to optimize cost and increase efficiency and reach operating break-even. With this shift in priority, we launched a series of measures. We took one step back by focusing on our core businesses and downsizing our non-core businesses. At the same time, since content is the key component of our investment, we took two steps forward by further investing in premium original content, leading to significantly improved investment efficiency in content. Despite noise from the media and the market, we stuck to our strategy and never blinked.

With these initiatives, we achieved our strategic goals and outperformed what we promised. We generated operating income of RMB1.3 billion in 2022, compared to operating loss of RMB4.5 billion in 2021. Our non-GAAP operating income reached RMB2.2 billion in 2022, a sharp reversal from a loss of RMB3.0 billion in 2021. Meanwhile, our cash flow significantly improved.

More importantly, while we saw a major turnaround in financial performance, premium content flourished on our platform. Our long-term strategic commitment to original content began to demonstrate its power, creating a wider competitive moat and strengthening our dominant position in the industry. Our sophisticated content production methodology and superior operational capacity constitute our unique core competitiveness, and together have enabled us to produce a series of blockbusters. As of 2022, we have launched 7 dramas altogether in our operating history with an iQIYI popularity index of over 10,000, with 5 of the releases in 2022. Of these 5 dramas, 4 were our original content. In the first quarter of 2023, The Knockout (狂飙) became a mega-hit, and was the 8th drama to break the popularity index of 10,000. It broke records across every key metric: the speed record in breaking the popularity index of 10,000, the highest peak popularity index, highest daily user time spent, largest daily audience, and highest membership revenue. The Knockout is a true nation-wide phenomenon. Its success demonstrates that the production and operation of our original content have entered into a virtuous circle, releasing a flywheel effect. The stable supply of premium content drives user growth, improves cost efficiency and profitability, and supports the company to create more premium content. Therefore, we firmly believe the success is replicable.

2. We were resilient and adaptive to the conditions that we could not change:

About 3-4 years ago, during the bull market, we issued a series of convertible bonds. Market condition deteriorated in the past two years, due to

escalating geopolitical tensions, the outbreak of Covid-19 pandemic and the macroeconomic downturn.

Knowing for a fact that we could do little to change the market, we did everything we could to strengthen the balance sheet and protect the interests of our shareholders and bondholders. In the past 12 months, we have completed three rounds of capital raising. With proceeds of approximately US\$1.3 billion, we successfully removed the debt overhang and significantly improved our capital structure. More importantly, through this process, we found valuable investors who remained firm supporters despite market volatility, including Baidu, PAG, Oasis and many others who are confident in the prospects of iQIYI. Our experience in the market downturn made us more resilient, and now that we have a sufficient cash reserve we can focus on business development for the next 3-5 years.

3. True wisdom – we committed to our vision, focused on execution, and built a sustainable long-term business:

We stand by our commitment to user interests and premium content. As mentioned in our last shareholder letter in 2021, we firmly believe that there is a fundamental demand for long-form video in the mass entertainment market. Although users may spend more time on short-form videos (we refer them as "delicious video"), only high-quality long-form videos can meet users' demand in consumption upgrade over the long term. As evidence, a growing number of users enjoyed our premium content and signed up for our subscription package in 2022, and the strong momentum continues. Time is our best friend. Our strong commitment to our original content strategy has secured our market leadership and differentiated us from competitors. I believe this true wisdom will support our sustainable development in the long run.

The ability to produce premium content is our core competitive moat, and we have been consistent in developing our original content strategy. For 2022, our original drama hits have become the major contributor in terms of content offering and revenue during the new release window for hit dramas. We can attribute this success to our long-term commitment to our original content strategy. We believe that our capacity for original drama production is unique, and cannot be imitated easily. There are no short cuts in creating blockbusters. To get where we are today, we invested numerous resources, including time, capital, talent and technology.

We initiated our original content strategy back in 2014, and made substantial breakthroughs in 2022, after nearly a decade of persistent efforts. In the past two years, our investment in original content reached nearly RMB20 billion. Meanwhile, our multi-studio model ensures the execution of our original content strategy. We have also gradually established a complex, data-driven and highly efficient decision-making system that can capture every critical moment in the content production cycle. As a result, we witnessed the gradual ramping-up of high-quality original content. Among the key dramas we launched each year, the proportion of original productions increased from 20% in 2018, to over 50% in 2022.

In addition, digital technology is the cornerstone of our strategy of industrializing long-form video production, giving us an edge in long-term competition. The long-form video production industry in China is shifting from the traditional workshop-style operation to industrialized production. We actively promoted such transformation, and will continue to invest in this area in the future. For example, our proprietary production management system serves as an effective tool assisting our production teams to improve project management and efficiency, and better control content quality and cost. We have also applied virtual production technology to content production. Virtual production eliminates the impact of weather and location during the filming process, and virtual assets can be used for many projects. In addition, virtual production helps to bring forward some post-production and shortens the production and launch cycles. Virtual assets can be applied to other businesses to create new revenue streams, such as digital asset operations, IP based value-added services, the metaverse and more.

We will also keep a close eye on industry opportunities powered by technical advancement such as artificial intelligence generated content (AIGC) and other innovative technologies. We will explore AIGC application scenarios in the long-form video industry together with our strategic partner Baidu, in areas such as improving content production efficiency, content distribution and promotion. We believe our AIGC strategy will unlock even more potential, further improve our overall business efficiency and generate greater value.

We are committed to providing users with the most appealing content, superior viewing experience and diverse benefits for subscribers. For example, we continued to improve our smart recommendation system to help users access their desired content as quickly and easily as possible. We provide industry-leading immersive content experience through interactive videos, which have been widely adopted in our drama and variety shows. Special APP modes were launched for teenagers, seniors and visually impaired users to meet their unique demands. We continued to expand our exclusive membership benefit package, including exclusive IP-based souvenirs, time-limited discount offers and exclusive fan events.

In summary, we completed an iconic turnaround in 2022 and created a miraculous year for iQIYI. Looking ahead at 2023, our goal is to achieve "high-quality growth", focusing on growing both revenue and operating profit. In order to realize "high-quality growth", we will continue to emphasize investing in core businesses while cautiously evaluating new business opportunities. We will continue to invest in top class premium content, maintain a high-quality yet diversified content portfolio, and modestly increase marketing spend while ensuring desirable ROI.

We also suggest that our investors to look beyond iQIYI's specific achievements, and re-assess the long-form video industry as a whole. While iQIYI continued to outperform in 2022, during the year ROI performance for the entire industry recovered quickly, driven by structural changes, especially a more concentrated supply of platform-originated content. This will lead to a healthier industry and every player in the industry will benefit from it.

The future we have outlined will only come through sustained effort. We will stick to our commitments, and bring higher value to our users, business partners and our investors. We believe our best days are yet to come.

Sincerely,

Yu Gong

Founder, Director, and Chief Executive Officer

iQIYI, Inc.

Safe Harbor Statement

This letter contains forward-looking statements. These statements are made under the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by terminology such as "will," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates," "confident" and similar statements. Among other things, iQIYI's strategic and operational plans in this letter contain forward-looking statements. iQIYI may also make written or oral forward-looking statements in its periodic reports to the U.S. Securities and Exchange

Commission, in its annual report to shareholders, in press releases and other written materials and in oral statements made by its officers, directors or employees to third parties. Statements that are not historical facts, including but not limited to statements about iQIYI's beliefs and expectations, are forward-looking statements. Forward-looking statements involve inherent risks and uncertainties. A number of factors could cause actual results to differ materially from those contained in any forward-looking statement, including but not limited to the following: iQIYI's strategies; iQIYI's future business development, financial condition and results of operations; iQIYI's ability to retain and increase the number of users, members and advertising customers, and expand its service offerings; competition in the online entertainment industry; changes in iQIYI's revenues, costs or expenditures; Chinese governmental policies and regulations relating to the online entertainment industry, general economic and business conditions globally and in China and assumptions underlying or related to any of the foregoing. Further information regarding these and other risks is included in iQIYI's filings with the Securities and Exchange Commission. All information provided in this letter is as of the date of the letter, and iQIYI undertakes no duty to update such information, except as required under applicable law.

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