The Analysis of Profitability for iQIYI and Netflix

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Abstract: The profitability analysis in this report compares the return on equity (ROE), marginal income, and return on net operating assets (RNOA) of iQIYI and Netflix. Regarding ROE, iQIYI has been experiencing negative ROE, indicating that the company has been operating at a loss and its profitability is below average. In contrast, Netflix has maintained a positive ROE, indicating profitability and value generation for shareholders. However, iQIYI's net loss has been declining, and its ROE has been increasing, suggesting a gradual recovery in profitability. The differences in ROE between iQIYI and Netflix can be attributed to their financial performance, business models, and cost structures. Netflix's positive ROE is a result of consistent growth, increasing net profit, and successful equity investments. On the other hand, iQIYI's negative ROE reflects financial challenges and losses incurred in recent years. The analysis of marginal income reveals that Netflix outperforms iQIYI in terms of net income and sales, with Netflix's sales being approximately six times larger. Factors contributing to the differences in marginal income include market dominance, content offerings, pricing strategy, and operational efficiency. Netflix's global recognition, high-quality content, pricing strategy, and operational scale have enabled higher sales and profitability compared to iQIYI.The analysis of RNOA shows that Netflix has a significantly higher RNOA ratio compared to iQIYI, indicating higher efficiency in generating profit from operating activities. iQIYI's negative RNOA ratio suggests its inability to generate profits from operating activities. However, iQIYI's RNOA ratio has shown significant improvement in 2020 compared to 2019, indicating enhanced profitability. Factors contributing to the differences in RNOA ratios include competition, content production costs, subscriber growth, cost optimization measures, and monetization strategies. In conclusion, Netflix demonstrates better profitability than iQIYI in terms of ROE, marginal income, and RNOA. Netflix's consistent growth, international expansion, high sales, and operational efficiency contribute to its superior profitability. iQIYI, although facing challenges, shows signs of improvement in its profitability indicators. The differences between the two companies can be attributed to various factors such as financial performance, business models, cost structures, market reach, content offerings, pricing strategies, and operational efficiency.

Keywords: Profitability; Marginal Income; Stock Performance

1. Profitability analysis

The profitability of an enterprise reflects the ability of an enterprise to earn profits and is also an important evaluation standard for the development of an enterprise. The profitability of an enterprise is usually analyzed from three aspects: operating activities, investment activities and financial activities. So, this report will use Excel to conduct ROE analysis on the financial statements of iQIYI and Netflix to measure the profitability of these companies in the above three activities.

Table 1: ROE analysis for iQIYI and Netflix (¥ in thousands)

	iQIYI		Netflix	
	2019	2020	2019	2020
Net Profit	-10,276,739	-7,007,153	1,866,916	2,761,395
Shareholders' equity	9,613,390	9,335,669	7,582,157	11,065,240
Average shareholders' equity	13,884,695	9,474,530	6,410,461	9,323,699
ROE (%)	-74.01%	-73.96%	29.12%	29.62%

According to the analysis of return on equity of iQIYI and Netflix in **Table 1**, it can be seen that ROE of iQIYI, and Netflix are significantly different. Because iQIYI has been losing money in recent years, its return on equity has remained negative. On the other hand, Netflix has maintained a good momentum of development in recent years, with its net profit increasing year by year and its ROE in 2020 improving to some degree compared to that in 2019. However, it is worth noting that iQIYI's net loss has been declining year after year and its ROE has been increasing. Therefore, the report concludes that although Netflix's profitability is better than iQIYI's, the profitability of iQIYI and Netflix is both growing overall.

iQIYI has been experiencing negative ROE in recent years. This indicates that the company's net income is insufficient to generate a positive return on the shareholders' equity. The negative ROE suggests that iQIYI has been operating at a loss, and its profitability is below average.In contrast to iQIYI, Netflix has maintained a positive ROE in recent years. This signifies that Netflix's net income has been able to generate a favorable return on the shareholders' equity. The positive ROE indicates that Netflix has been profitable and has been able to generate value for its shareholders.Despite the negative ROE, iQIYI has shown a trend of improvement in recent years. The net loss of iQIYI has been declining, and this has contributed to an increase in its ROE. Although the ROE remains negative, the improvement suggests that iQIYI's profitability is gradually recovering.

The main reason for the difference in ROE between iQIYI and Netflix lies in their financial performance. Netflix has been able to maintain a positive ROE due to its consistent growth and increasing net profit. This demonstrates that Netflix has been successful in generating higher returns on its equity investments. On the other hand, iQIYI's negative ROE is indicative of its financial challenges, such as losses incurred in recent years.Another factor contributing to the differences in ROE is the business model of the two companies. Netflix operates as a global streaming platform and has experienced significant international expansion, resulting in a large subscriber base and increased revenue. iQIYI, on the other hand, primarily operates in the Chinese market and faces intense competition, which may have impacted its profitability and ROE.

Variations in the cost structures and operational efficiency between iQIYI and Netflix can also influence their ROE. Netflix has made significant investments in original content production, which has attracted a large subscriber base and contributed to its profitability. iQIYI's cost structure and operational efficiency might not have been as optimized, leading to lower profitability and negative ROE.

In conclusion, the analysis shows that iQIYI and Netflix have distinct differences in their ROE. Netflix has maintained a positive ROE and strong profitability, while iQIYI has been experiencing negative ROE but with signs of improvement. The variations in their financial performance, business models, and cost structures contribute to these disparities.

Table 2: Marginal income analysis for iQIYI and Netflix (¥ in thousands)

	iQIYI		Netflix	
	2019	2020	2019	2020
Net Profit	-10,276,739	-7,007,153	1,866,916	2,761,395
Sales	28,993,658	29,707,215	20,156,447	24,996,056
Profit margin (%)	-35.44%	-23.59%	9.26%	11.05%

Then, this report conducts a more detailed ROE analysis on the profitability of the enterprise by analyzing the marginal income, asset turnover and equity multiplier. **Table 2** shows the profit margins of iQIYI and Netflix. Obviously, Netflix far outperforms than iQIYI in both net income and sales, with sales about six times larger than iQIYI's. As a result, Netflix's outperformance of profit margin over iQIYI is also an important reason for the apparent difference in ROE. However, the total sales revenue of both companies is increasing year by year, and growth rate of iQIYI from 2019 to 2020 is faster than that of Netflix. Hence, there is an optimistic outlook for the company that has been listed on NASDAQ only for three years.

There are significant differences in marginal income between iQIYI and Netflix. Marginal income refers to the additional income generated from each additional unit of sales or revenue. In this case, it indicates the difference in profitability between the two companies when comparing their respective levels of sales.

Netflix outperforms iQIYI in terms of both net income and sales. Netflix's sales are approximately six times larger than iQIYI's. This substantial difference in sales directly impacts the marginal income for each company.

The reasons for the differences in marginal income between iQIYI and Netflix can be attributed to several factors: First of all, Netflix is a globally recognized streaming service with a strong market presence. It has successfully captured a significant share of the streaming market, resulting in a larger customer base and higher sales revenue. iQIYI, on the other hand, may have a more limited market reach, leading to comparatively lower sales figures. Secondly, the content libraries of Netflix and iQIYI may differ in terms of quality, quantity, and appeal to the target audience. Netflix has invested heavily in producing and acquiring high-quality original content, which has gained popularity worldwide. This extensive and diverse content catalog attracts more subscribers, contributing to higher sales and profitability. iQIYI's content portfolio might not have achieved the same level of international recognition or appeal. Thirdly, the pricing strategy employed by each company could impact their respective marginal incomes. If Netflix charges higher subscription fees and attracts a larger paying user base, it would generate more revenue per customer and increase its profitability. iQIYI's pricing strategy may be different, potentially resulting in lower revenue per user.Finally, differences in operational efficiency and cost management practices can affect marginal income. Netflix's global operations and scale might allow for economies of scale, lower production costs, and more efficient distribution methods. These factors can contribute to higher profit margins compared to iQIYI.

Overall, the differences in marginal income between iQIYI and Netflix can be attributed to factors such as market dominance, content offerings, pricing strategy, and operational efficiency. Netflix's superior performance in these areas has allowed it to generate higher sales and profitability, resulting in a higher marginal income compared to iQIYI.

This report analyzes the operating activities of two enterprises through net operating profit after tax (NOPAT) and net operating asset (NOA). Through these two data, the ratio of operating return on invested assets can be obtained. Return on net operating assets (NROA) is one of the core indicators to improve ROE of DuPont system, which reflects the contribution of operating activities to ROE.

Table 3: RNOA analysis for iQIYI and Netflix (¥ in thousands)

	iQIYI		Netflix	
	2019	2020	2019	2020
Sales	28,993,658	29,707,215	20,156,447	24,996,056
Operating expenses	30,348,977	27,884,675	12,403,425	15,276,553
EBIT	-10,224,837	-6,983,877	2,062,453	3,199,767
NOPAT	-10,277,453	-7,007,433	1,867,537	2,761,443
Cash	5,934,742	10,915,282	5,018,547	8,206,539
Accounts receivable	3,627,749	3,344,433	1,160,067	1,556,030
Inventory	813,960	627,198	565,221	960,183
PPE	19,122	29,448	253,664	498,397
Goodwill	2,412,989	2,412,989	2,727,645	3,175,633
Accounts payable	-654,987	-605,394	-674,638	-656,198
Tax payable	-51,852	-23,276	-195,437	-438,245
NOA	12,101,723	16,700,680	9,050,506	13,740,584
RNOA	-0.85	-0.42	0.21	0.20

According to **Table 3**, Netflix's RNOA ratio is significantly higher than iQIYI, but compared to its 2019 ratio, its 2020 RNOA ratio is lower. It shows that in terms of operating activities, its profitability has declined, but it is basically maintained at a relatively stable level. Additionally, although iQIYI has always been a negative ratio, its RNOA ratio in 2020 has increased significantly compared with that in 2019, which indicates that the profitability of iQIYI's operating activities in 2020 has been improved to a large extent.

Netflix's RNOA ratio is significantly higher than iQIYI's. This suggests that Netflix is more efficient in generating profit from its net operating assets compared to iQIYI. iQIYI has consistently shown a negative RNOA ratio, indicating that it has not been able to generate profits from its operating activities. However, there has been a significant improvement in iQIYI's RNOA ratio in 2020 compared to 2019.

Netflix's RNOA ratio declined from 2019 to 2020, indicating a decrease in profitability from operating activities. This decline might be attributed to various factors, such as increased competition, rising content production costs, or changes in subscriber growth.Netflix has been investing heavily in content production and international expansion, which can impact short-term profitability. Additionally, if the company experiences a slowdown in subscriber growth or faces challenges in price increases, it could lead to a lower RNOA ratio.

iQIYI's RNOA ratio experienced a significant improvement from 2019 to 2020, suggesting enhanced profitability from operating activities. This improvement might be attributed to several factors, such as cost optimization measures, increased subscriber base, or successful monetization strategies. iQIYI might have implemented efficiency measures to reduce costs, negotiated favorable content licensing deals, or improved its advertising revenue streams. Furthermore, if iQIYI managed to attract more subscribers or increase user engagement, it would positively impact its RNOA ratio.

Overall, the differences in RNOA ratios between iQIYI and Netflix can be attributed to various factors, including differences in business strategies, market dynamics, content investments, subscriber growth, and cost management. It is important to consider these factors in analyzing the profitability of the two companies' operating activities.

2. Stock performance

The following section will analyze the stock performance of iQIYI and Netflix, and this part will examine EPS and P/E ratio.

2.1 Earnings per share

Earnings per share (EPS) is an important basis for evaluating the stock performance of an enterprise and comparing the operating conditions of different enterprises. Investors attach great importance to the assessment and analysis of this index before making investment decisions.

Table 4: EPS analysis for iQIYI and Netflix (¥ in thousands)

	iQIYI			Netflix(US)		
	2019	2020	Change%	2019	2020	Change%
Profit	-10,224,837	-6,983,877	0.32	2,062,453	3,199,767	0.55
Average shares	723,114	733,601	0.01	484,144	511,145	0.06
EPS	-14.14	-9.52	0.33	4.26	6.26	0.47

In the **Table 4**, the average quantity of ordinary shares of iQIYI is ¥733,601 ,thousand (¥723,114 thousand in 2019) in 2020 compared with ¥511,145 ,thousand (¥484,144 thousand in 2019) for Netflix. To be more specific, both companies have increased their share issuance, and Netflix has increased the number even more. Based on the EPS observation of the two companies, it can be found that the EPS value of Netflix is larger, and the overall performance is also better than iQIYI. Although iQIYI's EPS has always been negative, compared with 2019, iQIYI's EPS in 2020 will show an upward trend, with a year-on-year growth of 33%. Given that the value of earnings per share of both companies has increased by a certain amount, both companies are likely to continue to do well.

Netflix has a higher EPS compared to iQIYI. This means that Netflix generates more earnings for each outstanding share of its ordinary stock than iQIYI does. The higher EPS value of Netflix suggests that the company is performing better in terms of profitability and generating stronger returns for its shareholders. On the other hand, iQIYI has consistently reported negative EPS, indicating that it has been incurring losses. Both companies have increased their share issuance, but Netflix has done so at a higher rate. This could impact the EPS values because when more shares are outstanding, the earnings are spread across a larger number of shares, potentially reducing the EPS. Although iQIYI's EPS remained negative, the observation states that it showed an upward trend in 2020 compared to 2019, with a year-on-year growth of 33%. This improvement suggests that iQIYI's efforts to control costs, increase revenues, or enhance operational efficiency may be starting to bear fruit.

One of the reason for the differences is the revenue growth. Netflix has been experiencing strong revenue growth, driven by its global subscriber base and expansion into new markets. Higher revenues can contribute to increased earnings and, consequently, a higher EPS.And Netflix may have implemented effective cost management strategies, ensuring that its expenses are controlled and optimized. This can positively impact earnings and EPS. Moreover, Netflix has made significant investments in content creation and acquisition, which have attracted a large subscriber base and contributed to its revenue growth. High-quality content can drive customer retention and increase profitability.Finally, the competitive landscape may also play a role in the EPS differences. Netflix operates on a global scale and faces competition from various streaming platforms. The intensity of competition and the ability to differentiate the offerings can affect profitability and EPS.

2.2 P/E ratio

Price-to-earnings ratio is one of the most commonly used indexes to evaluate .whether the level of stock prices is reasonable, and it is a stock market guide with great reference value. It is calculated by dividing the price per share by the earnings per share. A higher P/E ratio generally indicates higher market expectations for future growth and profitability.

Table 5: P/E ratio of iQIYI and Netflix (¥ in thousands)

	iQIYI	Netflix
Stock price	13.64	484.53
EPS	-9.52	6.26
Price-to-Earnings	-1.43	77.40

Table 5 is the calculation result of P/E ratio. By comparison, the report concludes that Netflix's P/E ratio is significantly higher than iQIYI's. For a more accurate evaluation of the performance of the two companies' stocks, this report refers to the average P/E ratio of the entertainment industry as of December 31, 2020, which is published by the China Securities Index. Compared to the entertainment industry, which has an average P/E of 30.30, iQIYI and Netflix are different. iQIYI has a negative P/E ratio because its profit is still negative. However, Netflix, as the world's fastest growing video site, has a price-to-earnings ratio that is well above the industry level, indicating good growth potential for its stock. Therefore, IQIYI will need to get out of negative earnings as soon as possible if it wants to attract investors. Moreover, the losses of iQIYI have been gradually reduced in recent years, and there is a tendency to turn losses into profits. As a result, the future performance of its shares is worth looking forward to.

It is obvious that Netflix's P/E ratio is significantly higher than iQIYI's. This suggests that investors have a more positive outlook on Netflix's growth potential compared to iQIYI. The report attributes this difference to the following reasons: iQIYI has a negative P/E ratio because it is currently not profitable, meaning it has been reporting losses. On the other hand, Netflix, being the world's fastest-growing video site, has a P/E ratio well above the industry average. This indicates that Netflix has been able to generate consistent profits, which is appealing to investors. And the report compares the P/E ratios of iQIYI and Netflix to the average P/E ratio of the entertainment industry. It states that the industry average P/E ratio as of December 31, 2020, was 30.30. Since iQIYI has a negative P/E ratio and Netflix has a much higher P/E ratio, it suggests that Netflix is outperforming the industry and has a strong growth potential.

3. Suggestions

Based on the analysis above, here are some suggestions to improve iQIYI’s financial performance:

1.Cost Control: iQIYI should focus on optimizing its cost structure and improving operational efficiency. This can be achieved through measures such as streamlining operations, renegotiating contracts with content providers, and implementing cost-saving initiatives. By effectively managing costs, iQIYI can reduce losses and improve its profitability.

2. Content Strategy: iQIYI should continue to invest in high-quality and popular content to attract and retain subscribers. A strong content library will not only help in increasing user engagement but also enable the company to negotiate better licensing deals and potentially raise subscription prices. Developing original content and securing exclusive rights can give iQIYI a competitive edge and drive subscriber growth.

3. Monetization Opportunities: iQIYI should explore additional revenue streams beyond subscription fees. This could include targeted advertising, sponsorship deals, and partnerships with brands. By diversifying its revenue sources, iQIYI can reduce its reliance on subscription fees and generate additional income to improve its financial performance.

4. International Expansion: iQIYI could consider expanding its operations beyond the Chinese market. By tapping into international markets, the company can reach a broader audience and increase its revenue potential. However, this would require careful market research and localization efforts to cater to the preferences and demands of different regions.

5. Partnerships and Collaborations: Collaborating with other media and entertainment companies can provide iQIYI with access to new content, distribution channels, and technological expertise. Strategic partnerships can help iQIYI expand its content offerings

and enhance its competitive position in the market.

6. Enhancing User Experience: Improving the user experience on the iQIYI platform can increase customer satisfaction and engagement. This can be achieved through intuitive interface design, personalized recommendations, and interactive features. By delivering an exceptional user experience, iQIYI can encourage customer loyalty and reduce churn rates.

7. Financial Restructuring: iQIYI may need to evaluate its financial structure and consider potential options such as debt restructuring, equity financing, or partnerships with investors. Strengthening its financial position can provide the necessary resources to support growth initiatives and improve its profitability.

8. Improve Profitability: iQIYI needs to focus on turning its losses into profits as soon as possible. By implementing effective cost management, revenue growth strategies, and content monetization models, iQIYI can work towards achieving profitability. This will attract investors and improve the P/E ratio.

9. Enhance Growth Potential: iQIYI should invest in innovative content production, expand its user base, and explore new revenue streams. By continuously improving its offerings, iQIYI can demonstrate its ability to compete with global industry leaders like Netflix. This can increase investor confidence and improve the company's P/E ratio.

10. Communicate Future Plans: iQIYI should transparently communicate its strategies and initiatives to investors. This can help build trust and demonstrate the company's commitment to growth and profitability. Clear communication about efforts to reduce losses and achieve profitability can positively influence the perception of iQIYI's future performance and, in turn, impact the P/E ratio.

11. Capitalize on Industry Trends: The entertainment industry is constantly evolving, with changing consumer preferences and technological advancements. iQIYI should stay updated with these trends and adapt its business model accordingly. By staying ahead of the curve, iQIYI can position itself as a leader in the industry, attracting investors and positively impacting its P/E ratio.

It is important for iQIYI to carefully assess and prioritize these suggestions based on its specific circumstances, market conditions, and long-term goals. Implementing a combination of these strategies can help iQIYI address its financial challenges, improve profitability, and ultimately enhance its financial performance.

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