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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the iQIYI Third Quarter 2019 Earnings Conference Call. (Operator Instructions) I must advise you that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Investor Relations Director of iQIYI, Dahlia Wei. Thank you. Please go ahead.

Dahlia Wei - *iQIYI, Inc. - Director of IR*

Thank you, operator. Hello, everyone, and thank you all for joining iQIYI's Third Quarter 2019 Earnings Conference Call. The company's results were released earlier today and are available on the company's Investor Relations website at ir.iqiyi.com.

On the call today are Dr. Yu Gong, our Founder, Director and CEO; and Mr. Xiaodong Wang, our CFO. Dr. Gong will give a brief overview of our company's business operations and highlights, followed by Xiaodong who will go through the financials and guidance. After their prepared remarks, we will hold a Q&A session.

Before we proceed, please note that the discussion today will contain forward-looking statements made under the safe harbor provision of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from current expectations. Potential risks and uncertainties include, but are not limited to, those outlined in our public filings with the SEC. iQIYI does not undertake any obligation to update any forward-looking statements except as required under applicable law.

With that, I will now turn the call over to Dr. Gong. Please go ahead.

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

Hello, everyone. Thank you for joining us for the third quarter 2019 earnings call. Despite a challenging environment, we delivered another quarter of growth, with total revenues increasing 7% year-over-year to RMB $7.4 billion. We continued to strengthen our platform, expand our user base and improve user engagement by offering high-quality content and a superior entertainment experience. We solidified our leading industry position with mobile app MAU, DAU and the user time spent ranked first in most of the months throughout the year, according to various third-party data sources.

Let me start our membership business. As of September 30, 2019, total subscribers reached 105.8 million, a 31% increase year-over-year and a quarterly net addition of 5.3 million. Subscription revenues grew 30% year-over-year and contributed more than half of our total quarterly revenues for the first time. We continued to make strides in delivering our premium content, upgrading membership experiences and penetrating further into low-tier cities, which have collectively contributed to subscriber growth.

High-quality content remains the primary motivation for users to pay for the subscription. We released multiple premium titles during the quarter that were immensely popular among our subscribers, including original dramas series, Arsenal Military Academy; Love and Destiny; licensed titles, Go Go Squid!, A Little Reunion; exclusive drama, My Mowgli Boy; and the new episodes for our exclusive animation series, One Piece, among others.

In the third quarter, we started to adapt a privileged releasing strategy for some of our self-produced variety shows. Subscribers were granted early access to Mr. Housework, a reality show that features men doing housework, which quickly became one of the top contributors for subscriber conversion. We also released member-exclusive content for some of our popular variety shows, including The Rap of China 2019 and The Big Band. These exclusive privileges form a key part of premium membership experience that help convert fans into subscribers and then strengthening member retention.

Low-tier cities have always been an important demographic market for China's Internet companies to penetrate. According to QuestMobile, there are more than 600 million mobile Internet users in the third-tier and below cities. These users' time spent is significantly higher and is growing at a faster pace than that in first- and second-tier cities. Going forward, we believe subscriber growth will mainly be driven by users in low-tier cities, and we have rolled out a series of initiatives to improve penetration. For instance, we are diversifying our content offerings to cover more vertical genres that cater to a wide variety of tastes among low-tier city users. We are also employing additional indicators in our AI algorithm to glean more user insight, hence, allowing us to better target them through regional and demographic strategy.

In addition, we expanded our alliance membership program to include an increasing number of online and off-line partners, aiming to expand our user reach, deepen subscriber penetration and enhanced membership benefits for users in lower-tier cities.

As an experimental step, we started to explore opportunities in overseas market. In August of this year, we soft launched our multilingual iQIYI app that can be downloaded globally from App Store and Google Play. We will be gradually expanding our global footprint with local language support in 6 Southeastern Asian countries, including Malaysia, Indonesia and Thailand, among others. As well as Greater China regions, including Hong Kong, Macau and Taiwan. Our iQIYI app also facilitates English language interface and title that cater to users elsewhere in the world.

Moving on to our advertising business, the challenging macroeconomic environment and the delay in content launches continued to weigh on the broader industry. As a result, our advertising revenue continued to fall but at a lower pace than last quarter, decreasing 14% year-over-year.

Despite these headwinds, we remain committed to better serving our advertisers and have rapidly adapted our ad products through optimized solutions. Leveraging the visual/audio recognition and synthetic technology, we are able to integrate advertisements seamlessly into content. We further upgraded our theater-mode advertising product which now accounts for approximately 1/3 of the content-designated ad revenues for our drama channel. During the third quarter, we introduced China's very first interactive ad, which was integrated into The Rap of China Season 3. It represents another innovative move forward for the industry. Interactive ads facilitate greater integration between brands and the users, and resulted in a 30% increase in ad impressions. It also generates enormous high-quality user behavioral data that helps enhance targeting and improve our advertising value.

For performance ads, we continued to strengthen our products and algorithm, and have regained growth momentum compared to the first half of the year. The adaptability of our cutting-edge AI technology allows advertisements to be tailored to different scenarios and reach our users as they watch videos, search for content or interact with other users on our platform.

For in-feed ads, we are fine-tuning our product matrix and actively applying optimized CPX tools to our ad inventory. As I mentioned the last [quarter] (corrected by company after the call), our TrueView ad product is increasingly well received by advertisers. Audiences can choose to watch or close an advertisement, and only truly viewed ads will be billed. Many of our brand advertisers are also opting to use our performance-based ads. True-view ads and in-feed ads now serve as the dual engine for the future growth of our performance-based advertising business.

Turning to our content strategy, we continue to produce distinctive and original content by innovating and enhancing our production capabilities. Our content, with emphasis on positive values, traditional Chinese culture and social themes, not only appeals to general public but also caters to the diversified taste of various vertical audience groups. During the quarter, we launched a number of drama series covering themes that vary from urban romance, heroism, suspense, environmental protection, campus life to military legend and many more. The best performers included: Go Go Squid!, Destiny and Love, No Way for Stumer, My Mowgli Boy, Waiting for You in the Future and The Eyas. According to Enlightent, 6 out of the top 10 titles taking up users' screen time in September were iQIYI original or exclusive dramas.

Our variety show content continue to build reputation for its distinguished originality. The Big Band and The Rap of China 3, both aired their season finales in August with stellar ratings and audience reviews. In addition to content that caters to wide swaths of society, we are also producing variety shows in vertical genres. For example, our original show, Mr. Housework, categorized as a slow reality show, performed particularly well in low-tier cities in terms of popularity and viewership.

Our original content is increasingly being recognized for its quality and have received numerous internationally respected awards. Most recently, our original drama series, The Golden Eyes, was awarded the Golden Bird Prize at the Seoul International Drama Awards. Our original variety shows were recognized with 13 different awards at the China Variety Show Summit 2019, including Producer of the Year, Director of the Year, Photography of the Year and Visual and Effects of the Year, among others. Our co-produced film, Balloon, was shortlisted for the 76th Venice International Film Festival. Our original content was also well received across international markets. So far, we have distributed more than 2,000 episodes of original content to over 200 territories around the world.

We continue to execute our multi-dimensional IP development strategy to strengthen our ecosystem. Positioning ourselves as an IP incubator and distributor, we have launched partnership initiatives in more than 10 vertical areas to drive growth and create synergies. One good example is the Welkin Project, which is designed to adapt comics and animations to films, dramas and games. So far, it has successfully incubated more than 20 IPs. During the third quarter, we released a drama adapted from an online comics, Conspiracy of Love, which generated over RMB 10 million in revenue-sharing within the first 8 days of its release. The Great Master, another drama title adapted from animation series of the same name, is scheduled to launch in the fourth quarter.

We have a strong content pipeline heading into the fourth quarter of 2019 and the full year of 2020. Our content reflects our mainstream values and dedication to Chinese culture. Apart from our original drama, Hot-Blooded Youth, and flagship Qipa Talk Season 6, that we already released so far in Q4, Other major titles scheduled for the rest of the year include: Sword Dynasty, The Great Master, Fearless, FOURTRY and Qing Yu Nian. Looking ahead into 2020, we have over 200 titles planned for release, including over 100 dramas, 30 variety shows, 5 vertical short dramas and 90 other titles which range from animation to documentaries. In addition, iQIYI's Sports will broadcast UEFA EURO 2020, La Liga, 2022 FIFA World Cup qualification games in Asia as well as the Australian Open, Wimbledon Championships, WTA, PGA Tour and other top sporting tournaments.

As a technology-based entertainment service, our growth is driven by continuous technology innovation. AI in particular serves as the cornerstone for our development. So far this year, 60% of the 800 patent applications we have submitted were related to AI. AI has been applied to almost all aspects of our business, including content creation, production, distribution, recommendation, marketing and monetization.

Leveraging our cutting-edge AI technology, we are also exploring new runways for growth such as short-form video products and content. Our AI-based "iQIYI Lite app", mainly providing short-form video content based on intelligent recommendations, saw rapid DAU and video view growth in recent quarters.

Recently in October, our next-generation content delivery network, CDN, system, Qisubo, received the China Computer Federation Science and Technology Award for Outstanding Technology Advances at the 2019 China National Computer Congress, the largest and the most respected academic computer science event in China. Using MEC technology to store, compute and analyze content in close proximity to users, Qisubo breaks through limits of bandwidth and latency, localizes certain processes and seamlessly delivers video content through 4K, 8K and VR viewing experience. Meanwhile, Qisubo's brand new content-dispatching solutions helps us to realize the batch deployment of CDN, which enables users to enjoy the ultimate entertainment experience regardless of where or how they watch videos, which will greatly drive the commercial application of 5G technology.

In summary, we made solid progress during the quarter as we continued to execute our strategy. We are faced with both challenges and opportunities as the external environment constantly changes, while user behavior and the monetization models continues to evolve. We are confident in the long-term prospec of online entertainment industry as we see increasing demand from consumers for high-quality content. With the rapid development of AI and 5G technological advancements such as optimized bandwidth and enhanced video quality will not only improve users' viewing experience but also promote greater integration between media and technology.

AI and 5G combined with create astonishing new opportunities and make possible new breakthroughs in content production, distribution and entertainment formats. As a participant and a leader in the digital entertainment industry, we will continue to push forward AI innovation and the convergence between technology and art, produce more original blockbuster content, strengthen our ecosystem and incubate premium IPs as we create deeper value and greater prospective for the future.

With that, I will pass the call to Xiaodong to go over our financials.

Xiaodong Wang - *iQIYI, Inc. - CFO*

Good morning, everyone. Let me go through our financial highlights. For the third quarter of year 2019, iQIYI's total revenues were RMB 7.4 billion, up 7% year-over-year. Membership services revenue was RMB 3.7 billion, up 30% year-over-year. This was driven by the solid growth in the number of subscribing members, which reached 105.8 million at the end of third quarter, thanks to our premium content as well as our various operational initiatives.

Online advertisement service revenue were RMB 2.1 billion, down 14% year-over-year mainly due to the challenging macroeconomic environment in China, delay of certain content launches and the intensified competition in in-feed advertising.

Content distribution revenue were RMB 680.4 million, down 18% year-over-year mainly due to the delay of certain content launches this quarter as well as the high base in the same period of previous year.

Other revenue were RMB 932.3 million, up 12% year-over-year. The increase was mainly driven by the growth of game business following several new game launches this year by Skymoons.

Moving on to cost of revenues. Our cost of revenues were RMB 8.2 billion, up 7% year-over-year. The increase was primarily driven by the higher content costs as well as other cost items. Content cost were RMB 6.2 billion, up 3% year-over-year.

Turning to the operating expenses. SG&A expenses were RMB 1.3 billion, up 4% year-over-year primarily due to increased sales and marketing expenses of game business associated with the consolidation of Skymoons as well as the higher marketing spending for certain iQIYI apps.

Our R&D expenses were RMB 703.2 million, up 26% year-over-year. The increase was primarily due to the -- due to our continued investment in R&D personnel.

Operating loss were RMB 2.8 billion compared with operating loss of RMB 2.6 billion in the same period last year. Operating loss margin was 38% compared to the operating loss margin of 37% in the same period last year.

Total other expenses were RMB 826.8 million compared with total other expense of RMB 539.4 million during the same period last year. The year-over-year increase was mainly due to the increased interest expenses associated with our financing activities and the higher foreign exchange loss related to exchange rate fluctuation.

Loss before income tax was RMB 3.7 billion compared with a loss of RMB 3.1 billion in the same period last year.

Income tax expense was RMB 16 million compared to the income tax benefit of RMB 6.1 million in the same period in 2018.

Net loss attributable to iQIYI was RMB 3.7 billion compared with a loss of RMB 3.1 billion during the same period of year 2018. Diluted net loss attributable to iQIYI per ADS were RMB 5.04.

As of September 30, 2019, the company had cash, cash equivalents, restricted cash and short-term investments of RMB 13.9 billion.

Turning to the fourth quarter 2019 guidance, we expect total revenues to be between RMB 6.86 billion and RMB 7.28 billion, representing an increase of minus 2% to 4% year-over-year. This forecast reflects iQIYI's current and preliminary view, subject to change.

This concludes our prepared remarks. Now we're open to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Thomas Chong from Jefferies.

Thomas Chong - *Jefferies LLC, Research Division - Equity Analyst*

(foreign language) I have a question on the 2020 strategies, in particular on online advertising as well as our net adds in membership for next year. Given the fact that we are penetrating into lower-tier cities, is there any differences in the user acquisition strategies versus top-tier cities in the past? And my second question is relating to the content cost. Is there any color about how we should think about this line next year?

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Dahlia Wei - *iQIYI, Inc. - Director of IR*

[Interpreted] I will answer your first question on advertising. We have 2 kinds of advertising, one is brand ads and the other is performance-based ads. For brand ads, because given the macro -- challenging macro environment, we actually haven't seen any sign of improvement for next year so we tend to be conservative on brand advertising. For performance ads because we have taken a lot of initiatives to refine our technology and products so we are relatively more optimistic on the performance ads versus brand ads.

And for membership penetration into lower-tier cities, you are very right that we are already at a very high penetration ratio in first- and second-tier cities compared to lower-tier cities. So we are trying to focus more on the third-, fourth- and fifth-tier cities. And the initiatives we are taking to improve penetration include: one, we are incubating more long-tail content which caters to the diversified needs of the lower-tier city users; and secondly, we are taking more targeted marketing and operational efforts. For example, we are launching more joint memberships to attract users. And also some targeted marketing.

And in terms of ARPU, I think we will be gradually increasing the ARPU level by first narrowing some of the discounts we offer in our marketing campaigns. And secondly, there's potential that we could increase the pricing in the future.

And I will comment on a little bit of content cost and Xiaodong will add more comments. As you all know, the licensed content is on a gradually declining -- the unit price is declining. So if you look at our content cost in year 2019 versus 2018, the growth rate actually decelerated a lot compared to previous years. And looking ahead into 2020, because the licensed content, the price is declining and the volume is -- was more or less very stable. But on the other hand, we are investing more in our self-produced content. So whether that 2 will offset each other, it depends. But overall, we think the content cost will grow at a slower pace. I will let Xiaodong add more comment on that.

Xiaodong Wang - *iQIYI, Inc. - CFO*

I think we explained before content cost itself coming in the absolute dollar amount, it doesn't tell much about the status of our business because we think content cost is kind of investment. For example, licensed copyrights you can call it passive investments. Originals or self-produced content, you can call it active investments. All these investments are actually necessary for the business. As Dr. Gong Yu just explained, I don't think those passive investments or the licensed copyrights still account for a major part of our business because as we explained before, the importance of iQIYI originals. So we will keep an eye and focus on the investment on iQIYI originals. And then for this active investment, I think the important thing is whether we have enough return for this investment instead of absolute dollar amount. So let's get back to the sort of original target about the content cost as a percentage of revenue, we will continue to keep original targets to lower the number down to somewhere below 70% next year. I think that's still consistent with our original targets. Thank you.

Operator

Your next question comes from the line of Ella Ji from China Renaissance.

Diying Ji - *China Renaissance Securities (US) Inc., Research Division - Head of TMT Research*

(foreign language) So my first question is if Dr. Gong can provide us an update of the regulation environment in the current quarter and the outlook for next year. My second question is regarding the ROI of the lower-tier city market. How is your ARPU -- how is the ARPU comparing to major-tier cities? And how is the content cost comparing to the major-tier -- comparing to the contents that major-tier cities people like?

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Dahlia Wei - *iQIYI, Inc. - Director of IR*

[Interpreted] For the content regulation, we have seen some gradual loosen up after the October 1 holiday. For example, for the costume drama genre, we have launched a new drama called (foreign language) that's targeted for the young generations in low-tier cities. And also, there is another type is we call it a remake of some classic video content. Those are 2 already released. But again, the content approval is not like all of a sudden, overnight, it's all approved. It will take some time. It's a gradual process.

And for penetration into low-tier cities, we have incubating many genres or vertical types of content. For example, some are targeted for youth groups and some are targeted for female-oriented groups in low-tier cities. And you need to keep in mind that the content don't have a very clear border line between first-tier cities and low-tier cities. For example, when we make some content for lower-tier cities, we also need to at least cater to a part -- a partial of the higher-tier cities as well. So indeed, the content cost and ROI does not vary that much in high-tier cities and low-tier cities.

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Dahlia Wei - *iQIYI, Inc. - Director of IR*

[Interpreted] I want to add some comments. In the pipeline I just mentioned, for example, The Great Master, the Sword Dynasty and the Qing Yu Nian, those are all used to be the type of content that -- under content regulation. We expect those contents will be gradually released either towards later of fourth quarter or the beginning of the first quarter next year.

Operator

Your next question comes from the line of Wendy Chen from Goldman Sachs.

Zhi Yi Chen - *Goldman Sachs Group Inc., Research Division - Research Analyst*

(foreign language) So translating myself. I have a question for the CEO. I wonder how do we see the long-form video positioning in the overall video space, especially potential opportunity in the 5G era. And my question for the CFO, Xiaodong, this is for the fourth quarter guidance, which we are still seeing revenue deceleration despite the pipeline has been supposedly recover after the restriction. So just wondering what's driven this potential deceleration. And if I may add in one question on why we're seeing the other revenue growth decelerate so much this quarter.

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Dahlia Wei - *iQIYI, Inc. - Director of IR*

[Interpreted] I think there are 3 types of video platform in China. One is the long-form professional video, which focuses on the movie, drama or variety show content, which basically is accompanying the content from the traditional cinema and TV screens to the streaming platform. And number two is, we call it the mini video or the live broadcasting platform, which focuses on the Internet celebrities or we call it Internet influencers, this kind of content. And we also have the short-form video which I'm talking about something like Xigua or Haokan from Baidu. I think if you look at the long-form video, if you look at MAU and the growth rate it's actually at low -- at a single digit right now. The good thing is we have a lot of monetization model for long-form video, including advertising, membership and many others.

For brand ads, as you all know, the macro environment impacted that growth, but we hope it will regain momentum in the future. And for membership, we have seen a dramatic growth in the past years, and we hope in the next year and the year after, we'll continue to see relatively high-growth rate. And we also developed other monetization channels including gaming, licensing and other derivative revenues for long-form video. And for short-form video, we actually also have some initiatives there. We launched iQIYI Jisuban recently and that's a [Lite] app and we will be monetizing that through performance ads. Thank you.

Xiaodong Wang - *iQIYI, Inc. - CFO*

Good morning, Wendy, this is Xiaodong. Okay, it's November 7 and almost half of the fourth quarter has passed. But we still feel the future tense tells what we're talking about, the potential content release in the fourth quarter. So you now will have that sense that most of those contents that will be released at the end of the fourth quarter, which would contribute limited financials in this quarter. So that's why we provide a relatively soft guidance even we see a better trend now.

And about the other revenue, it also has something to do with the content because there's 2 kind of other revenues. One is like the further monetization of our traffic. Another one is the further monetization of our IP. So for the traffic part, because of the game business, we can see a manager to contribute some in the past few quarters. But for the IP-related other revenues, because of lag on the control of certain content, we don't have a lot of new IP released this year. That's why you see a relatively slowing down trend of other revenue. But once we are back to the normal track next quarter or even next year, you will see more iQIYI originals come online, more IP will generate from those content offering. And then gradually, we'll see the increase of other revenue. Thank you.

Operator

Your next question comes from the line of Binnie Wong from HSBC.

Wai Yan Wong - *HSBC, Research Division - Head of Internet Research of Asia Pacific & Analyst*

(foreign language) Sorry, I'll translate my question. On the first question here is that on the softer outlook, right? Actually, do you see that the softness is actually due to in terms of the advertising or actually on the subscription revenue side. And then in terms of the recovery trend, as you said that, like, the blockbuster movies, are we expecting that those were happening more into -- like, are we confident that the blockbuster ones will get approval and we will be releasing in Q1 2020? Or is it that it could might still see some delay? Is it okay, do we say that the worst in terms of the regulatory environment should be over? And then into 2020, we should expect a better outlook? There's recovery from here?

And then second question is also on the advertising side. I wanted a better understanding, is it on structurally because of the rising inventories in the short video space on the competition side that because -- that's why they also affect the long-form video advertising? Or is it not really structurally, it's more just because of the regulation environment here and that we will see the recovery trend again pretty much as soon as the content approval release that, and then we'll see the recovery trend right away?

And then last question is also on the content cost. Basically content costs this quarter spiked up to 84% of revenue. So earlier guidance in terms of retaining at a range of 70% to 80%, is it still realistic to see?

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Xiaodong Wang - *iQIYI, Inc. - CFO*

I think...

Dahlia Wei - *iQIYI, Inc. - Director of IR*

I'll translate first. [Interpreted] So I think since Q2 and Q3, we do have some -- the content regulation that has some impact on our pipeline, especially on the costume dramas. If you look at these 3 platforms since June, actually, only 1 costume drama for each platform so far. So you can see the regulation is quite strict at the time. But as I said, the content process is gradually getting released, and we are able to release more drama in our pipeline and still I think, as I said, the 2 kind of content costume drama as well as the remake of classic video content, we can gradually see some boosting up. But I cannot guarantee like 100% when that will be released. But my estimation is we should be able to release the delayed content or the backlog pipeline of this year in Q4 or in Q1 next year. That's my best estimation.

And also for your second question on advertising, we do see some impact from short-form video platform, including Douyin and Kuaishou, especially on the competition on the users' time spent. I will let Xiaodong comment more on that.

Xiaodong Wang - *iQIYI, Inc. - CFO*

Regarding the content cost as percentage of revenue this year, I think we are still on track. The target we mentioned before would still be somewhere between 70% or 80%.

Operator

Your next question comes from line of Eddie Leung from Bank of America.

Eddie Leung - *BofA Merrill Lynch, Research Division - MD in Equity Research and Analyst*

(foreign language) So my 2 questions are kind of related to the lower-tier cities subscribers. The first one is about the auto renewal user proportion. Would that -- would the increase in lower-tier city subscribers affect the retention rate or the auto renewal user proportion? And secondly, how's the price sensitivity of the lower-tier city subscribers amid our potential raising prices next year?

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Dahlia Wei - *iQIYI, Inc. - Director of IR*

[Interpreted] On your first question, we actually didn't see any obvious change on the mix of auto renewal subscribers.

And your second question, we don't have a plan to differentiate the pricing strategy in the lower-tier cities versus the higher-tier cities. If you look at Netflix, we actually are on the same curve but maybe at a slower pace or a later time schedule because Netflix also penetrates into the higher-tier cities or more developed areas first, and then to the lower-tier cities. That's the same thing here in China, but maybe it takes longer and it takes -- will happen in a later stage. That's the answer for your question. Thank you.

Xiaodong Wang - *iQIYI, Inc. - CFO*

I think we're providing unique unified service for all the users across the country. So it doesn't make a lot of sense to charge different tier price in different-tier cities, especially in this year in China because you know the population move around from low-tier cities to high-tier cities so it is almost impossible for us to divide those users or label them as on the second-tier city user. So basically, I think we won't do something like what you just said. Thank you.

Operator

We still have time for 1 last question. And our final question comes from the line of Alicia Yap from Citigroup.

Alicia Yap - *Citigroup Inc, Research Division - MD and Head of Pan-Asia Internet Research*

My question is related to the overall ad potential and perhaps on the short video. Since this -- it seems like the traditional pre-roll ads are facing difficulty to increase in the inventory and also pricing. So will we see a recovery if the macro recover on the pre-roll ads side from the brand?

And then for iQIYI, given we are pushing more into the short video clips, will that help to draw more ad budget to the fee-based ad opportunity down the road? (foreign language)

Tim Gong Yu - *iQIYI, Inc. - Founder, CEO & Director*

(foreign language)

Dahlia Wei - *iQIYI, Inc. - Director of IR*

[Interpreted] Okay. For brand advertising, actually, the bottleneck isn't about inventory. It's more about the advertiser's budget. Since this year, we have seen quite a lot of budget cuts in brand advertising. So our inventory is -- the sell-through rate and it isn't very high because of the advertising budget cuts. That's the problem of brand advertising. It's not about inventory.

And talking about short-form video, we think these Douyin and Kuaishou that's all about the Internet celebrities, what we call (foreign language) it's -- that's more for that kind of mini-form video platform. But our nature is -- allow us to explore more opportunities in the short-form video, which we will have some new products in that regard and we will launch more technology on content in that regard. But that will not happen in 1 year. It will take some time to see some significant growth there.

Xiaodong Wang - *iQIYI, Inc. - CFO*

This is Xiaodong. I want to add one thing. Even for the branding advertisement because I think the growth of our ad business comes from those innovative ad solutions which has less to do with those inventory of this pre-rolled ads. So basically, I don't think the inventory will be the bottleneck of ad business growth in the next few years. So we'll focus on providing more innovative ad solutions to attract more budget from the customers, that's the strategy of our ad business. Thank you.

Operator

I would now like to hand the conference back to the management. Please continue.

Dahlia Wei - *iQIYI, Inc. - Director of IR*

Okay. Thank you, everyone, for joining this call. If you have any other questions, please feel free to contact us. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may all disconnect.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]

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