

# NetEase Inc

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Refer to important disclosures at the end of this report

DBS Group Research. Equity

26 May 2022

## HK: BUY (Initiating Coverage)

Last Traded Price (H) (25 May 2022): HK\$155.60 (HSI : 20,171)

Price Target 12-mth (H): HK\$194 (24.7% upside)

## US: BUY (Initiating Coverage)

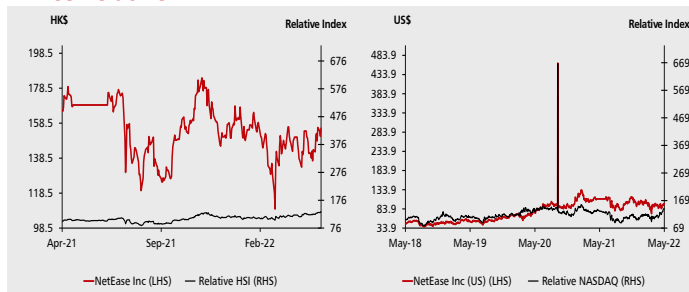
Last Traded Price (A) (25 May 2022): US\$97.49 (NASDAQ : 11,435)

Price Target 12-mth (A): US\$124 (27.2% upside)

### Analyst

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### Price Relative



### Forecasts and Valuation (HK Shares)

FY Dec (RMBm)	2021A	2022F	2023F	2024F
Turnover	87,606	99,054	113,139	127,093
EBITDA	22,860	23,939	28,195	31,487
Pre-tax Profit	21,104	21,939	26,195	29,487
Net Profit	16,857	17,451	20,856	23,489
Core profit)	19,762	20,452	23,857	26,490
Core Profit Gth (%)	34.3	3.5	16.7	11.0
EPS (RMB)	5.07	5.25	6.27	7.06
EPS (HK\$)	5.94	6.15	7.35	8.28
EPS Gth (%)	38.9	3.5	19.5	12.6
Diluted EPS (HK\$)	5.87	6.08	7.26	8.18
DPS (HK\$)	1.74	1.80	2.15	2.42
BV Per Share (HK\$)	33.62	39.27	46.06	53.43
PE (X)	26.2	25.3	21.2	18.8
P/Cash Flow (X)	17.7	17.5	15.4	14.2
P/Free CF (X)	20.2	20.0	17.3	15.7
EV/EBITDA (X)	16.0	14.9	12.1	10.4
Net Div Yield (%)	1.1	1.2	1.4	1.6
P/Book Value (X)	4.6	4.0	3.4	2.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAD(%)	19.0	16.9	17.2	16.7
Core Earnings Rev		New	New	New
Consensus EPS (RMB)		5.99	6.92	7.85
Other Broker Recs:		B: 26	S: 0	H: 0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

## Let's play safe game

- Leading game player with strong game pipeline; expect revenue CAGR of 13% from 2021-2024F
- Overseas games and Cloud Music are new growth drivers
- A safer play due to limited regulatory risk exposure after resumption of game approval
- Initiate coverage on NetEase with a BUY rating and TP of HK\$194/US\$124

**Leading game player with strong game pipeline.** NetEase is the second largest online game player in China with an 18% market share in terms of game revenue in 2021. We expect NetEase's online game revenue to grow at a 13% CAGR during 2021-2024F, backed by sustainable legacy IPs, a robust mobile game pipeline, and international expansion potential.

### Where we differ: More positive about overseas expansion.

Our online game revenue forecast for FY22F/FY23F is 2%/4% higher than the consensus, with a stronger overseas revenue growth forecast of a 40% CAGR for FY21-24F. It is also a safer option due to limited regulatory risk after game approval resumption.

**Other Potential catalyst: Monetisation of Cloud Music.** Paying ratio for music content from 800m Cloud Music users is rising amid COVID-19. We expect continuous profitability improvement after gross margin turning positive in 2021.

### Valuation:

We derive our TPs of HK\$194/US\$124 based on the SOTP methodology: (1) Online games: 25x PE on FY22F Non-GAAP net profit (HK\$184), in line with its five-year historical range; (2) Cloud Music: Based on market value (HK\$4), (3) Youdao: Based on market value (HK\$1), and (4) Innovative businesses: 1x P/S on FY22F revenue (HK\$5).

### Key Risks to Our View:

(1) Business disruptions due to regulatory changes, (2) slower-than-expected overseas expansion, and (3) potential tax rate hike.

### At A Glance

Issued Capital (m shrs)	3,274
Mkt Cap (HKm/US\$m)	509,434 / 66,590
Major Shareholders (%)	
Shining Globe International Limited	40.7
Free Float (%)	59.3
3m Avg. Daily Val. (US\$m)	131.2
GICS Industry: Information Technology / Software & Services	



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**NetEase Inc**

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## NetEase Inc

### Investment Summary

**Leading online game player in China.** Founded in 1997, NetEase is the second largest player in both the PC and mobile game markets in China, with an 18% market share in terms of game revenue. The company generates revenue mainly from fees charged from players of online games and other digital services. NetEase's major business segments are (1) Online game services, (2) Youdao, (3) Cloud Music, and (4) Innovative businesses (e.g., e-commerce, media, etc.), which accounted for 72%, 8%, 6% and 14% of total revenue in FY21, respectively.

**Strong track record of rolling out blockbuster games.**

NetEase has consistently launched long-lasting IP games like Fantasy Westward Journey (梦幻西游, FWJ), Westward Journey Online (大话西游, WWJ), and Onmyoji (阴阳师). NetEase's top five games have been consistently ranked among the top 30 grossing games in China since their launch. We expect its top flagship games to continue to deliver healthy performance supported by key upgrades and a huge, loyal fan base. In 2021, the top five games contributed 29% of total game revenue.

**Driver #1: Strong game launch pipeline in FY22.** NetEase has 20+ games under development and plans to launch seven key titles this year, such as Harry Potter: Magic Awakened international (哈利波特: 魔法觉醒), Diablo Immortal (暗黑破坏神: 不朽), as well as a mobile and console version of Naraka: Bladepoint (永劫无间). These strong IPs combined with NetEase's development capabilities ensure strong gross billings and longevity.

**Driver #2: Overseas expansion acceleration.** We forecast NetEase's overseas online game revenue to grow at a CAGR of 40% for 2021-2024F through market share gain. NetEase has been leveraging the success of commercialised games like Knives Out (荒野行动) and Identity V (第五人格) in overseas markets, and also strengthened cooperation with IP owners to launch co-developed mobile games.

**Driver #3: Narrowing losses of Cloud Music and Youdao.** NetEase's Cloud Music is the second largest online music platform with over 800m registered users. Youdao is the leading online learning platform with 100m MAU in China. We expect Cloud Music and Youdao's revenue to grow at a CAGR of 20% and 9% from 2021 to 2024F, respectively, driven by a higher paying ratio for music content and increasing smart device sales. We expect losses for these two segments to further narrow thanks to improved economies of scale and an optimised cost structure.

**Regulatory overhang removal.** The approval of the first batch of 45 domestic games licenses has marked an official close to the eight-month suspension of license approval, suggesting the overall online gaming industry would have

largely met the compliance requirement pertaining to minor protection and the clean-up of game content. NetEase would be one of the key beneficiaries of the resumption of license approval, as we saw that 72% of its 2021 revenue came from games. Therefore, we assume growth will resume in 2H22.

**Expect a 13% revenue CAGR for FY21-FY24F,** mainly driven by the solid game pipeline as well as accelerated international growth. Factoring in solid game revenue growth and narrowing losses from the non-game segments, especially from Cloud Music, we expect Non-GAAP net earnings to grow at a CAGR of 10% for FY21-FY24F.

**We initiate coverage with a BUY call on NetEase,** for its robust mobile game pipeline and international expansion potential. The sector was de-rated due to regulatory changes, and NetEase has less regulatory risk exposure and is trading at an undemanding valuation of 21x FY22F core profit P/E, lower than its five-year historical average of 25x.

We derive our TPs of HK\$194/US\$124 based on the SOTP methodology: (1) Online games: 25x PE on FY22F Non-GAAP net profit (HK\$184), in line with its five-year historical range; (2) Cloud Music: Based on market value (HK\$4); (3) Youdao: Based on market value (HK\$1); and (4) innovative businesses: 1x P/S on FY22F revenue (HK\$5).

We believe NetEase is a defensive player with less risk exposures (e.g., anti-trust concern) and it is less impacted by the macro slowdown and covid restrictions. NetEase is trading at 21x FY22F Non-GAAP net profit PE, at a discount to 22-25x for its direct peers such as Activision Blizzard and Tencent.

## NetEase Inc

### Valuation & Peer Comparison

We derive our TPs of HK\$194/US\$124 based on the SOTP methodology, offering a 25% upside.

(1) Online games: 25x PE on FY22F Non-GAAP net profit (HK\$184), in line with its five-year historical range. NetEase is trading at 21x FY22F Non-GAAP net profit PE, at a discount to 22-25x for its direct peers such as Activision Blizzard and Tencent.

(2) Cloud Music: Valuation based on market value (HK\$4); we derive a valuation of c.HK\$19.0bn based on its market cap as of 31 Dec 2021. The valuation is adjusted for a 62.5% stake attributed to NetEase.

(3) Youdao: Valuation based on market value (HK\$1); we derive a valuation of HK\$6.5bn, based on its market cap as of 31 Dec 2021. The valuation is adjusted for a 52.1% stake attributed to NetEase.

(4) Innovative businesses: 1x PS on FY22F revenue (HK\$5); we value innovative businesses and others based on 1x FY22 P/S, factoring in lower growth of the e-commerce and ads business due to a recent sector de-rating and macro slowdown. We estimate the segment valuation to be HK\$15.7bn.

### Peer comparison

Company Name	Code	Currency	Price Local\$	Mkt Cap US\$m	Fiscal Yr	EPS		PE		EV/EBITDA		P/S		G. margin	
						22F Local\$	23F Local\$	22F x	23F x	22F x	23F x	22F %	23F %		
<b>Domestic peers</b>															
Tencent Holdings*	700	HK	334.00	409,522	Dec	17.34	21.24	19.3	15.7	12.7	10.5	4.6	4.0	42.0	43.0
Netease*	9999	HK	155.60	66,590	Dec	6.15	7.35	25.3	21.2	14.9	12.1	4.6	4.1	53.1	53.3
37 Intact.Entm.Net. Tgp. 'A'	002555	CH	21.03	7,324	Dec	1.50	1.72	14.0	12.2	13.8	10.9	2.4	2.1	84.9	85.1
Xd	2400	HK	19.24	1,179	Dec	(1.26)	0.14	n.a.	142.1	(7.4)	18.5	2.4	1.8	50.5	53.4
Kingsoft	3888	HK	24.15	4,221	Dec	0.52	0.98	46.5	24.5	5.6	7.2	3.4	2.8	82.3	82.6
Perfect World 'A'	002624	CH	14.54	4,429	Dec	0.95	1.09	15.3	13.4	37.8	10.5	2.8	2.4	62.4	63.1
Igg	799	HK	2.95	450	Dec	(0.32)	0.20	n.a.	14.5	4.2	7.5	0.7	0.6	68.6	69.2
Cmge Technology Group*	302	HK	2.03	717	Dec	0.45	0.60	4.5	3.4	2.1	1.2	0.9	0.7	37.6	39.2
Netdragon Websoft	777	HK	15.52	1,071	Dec	2.86	3.42	5.4	4.5	n.a.	n.a.	0.9	0.7	62.8	62.5
Idreamsky Technology	1119	HK	4.55	824	Dec	0.12	0.33	37.0	13.7	n.a.	n.a.	1.7	1.3	41.7	43.4
Youzu Interactive 'A'	002174	CH	9.00	1,294	Dec	0.87	0.52	10.4	17.3	18.7	60.2	1.8	2.2	45.1	n.a.
<b>Overseas peers</b>															
Activision Blizzard	ATVI	US	77.71	60,760	Dec	2.89	3.93	26.9	19.8	14.0	13.0	7.7	6.4	72.8	74.3
Electronic Arts#	EA	US	137.35	38,626	Mar	7.21	8.20	19.0	16.7	11.7	10.9	4.8	4.5	75.8	76.5
Sony Group#	6758	JT	11205.00	112,485	Mar	714.46	778.49	15.7	14.4	7.5	7.1	1.3	1.2	37.9	37.9
Take Two Intact.Sftw.#	TTWO	US	122.08	19,775	Mar	4.60	7.90	26.6	15.5	17.5	10.7	5.1	3.8	57.5	55.6

# FY23: FY24; FY24: FY25

Source: Thomson Reuters, \*DBS HK

**NetEase Inc**

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**Key Risks****Potential business disruption due to regulatory changes.**

The monetisation of new games requires approval from the Chinese authorities. The approval process was suspended during Mar-Dec 2018 and Aug 2021-Apr 2022. The suspension in 2018 was mainly due to restructuring of regulatory authorities. Preventing minors from indulging in playing games was the key reason for the 2021 suspension. If new incidents trigger stricter game restrictions or another suspension of the game approval process emerges, it might pose negatively impacts to NetEase.

**Slower-than-expected overseas expansion.** NetEase has a limited track record in its overseas games operations. Currently, only two of its games – Knives Out and Identity V – are commercially successful in Japan and North America

since 2017. Due to this limited experience, NetEase might face cultural differences and localisation difficulties when going abroad.

**Potential tax rate hike.** Currently, several subsidiaries of NetEase are classified as “key software enterprises”, which enjoyed a preferential tax rate of 15% from 2019 to 2021. The preferential tax is subject to annual review by the authorities. If NetEase is unable to sustain the title that makes it eligible for the preferential tax, it may have to face an income tax rate that is as high as the uniform tax of 25%. The higher tax rate will negatively impact NetEase’s earnings.

## NetEase Inc

### SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Strong track record of rolling out blockbuster games with long-lasting life cycles</li> <li>• Large IP franchise with high commercialisation potential, including in-house IPs like Fantasy Westward Journey, Onmyoji, etc.</li> <li>• Well-established network and partnership with well-known global IP powerhouses such as Blizzard, Marvel, Warner Bros, etc.</li> <li>• Leading online music platform offers differentiated user experience with vibrant music community</li> </ul>	<ul style="list-style-type: none"> <li>• Limited track record in overseas expansions</li> <li>• Lack of synergy between core game business and non-game business</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>• Rising average spending on games in the China market</li> <li>• Increasing popularity of Chinese-developed games in the overseas market</li> <li>• Higher penetration and improving paying ratio of online learning and music content in China</li> <li>• Lower music copyright fees, benefiting from direct music IP purchases and collaboration with major labels</li> </ul>	<ul style="list-style-type: none"> <li>• Potential business disruption due to suspension of game license approval</li> <li>• Intensifying competition in the games market</li> <li>• Potential tax rate hike</li> </ul>

Source: DBS HK

**NetEase Inc**

**Critical Factors**

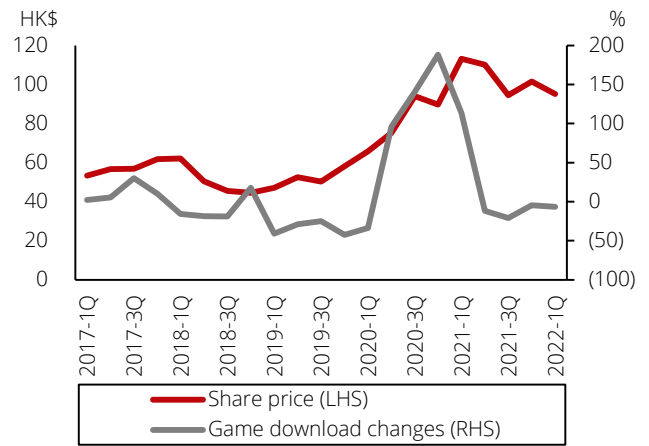
The critical factors of the company are: (1) Number of new games launched, (2) average spending on Chinese mobile games, and (3) overseas growth of China-developed games.

**Critical factor #1: Number of new games launched.** Game revenue accounted for 72% of total revenue in FY21, with newly launched games contributing the majority of incremental gross billings. The number of new games launched is a key driver to download volume. We note a strong correlation of +0.76 between changes in NetEase's game downloads and share prices. From past game launch cycles, we learned that the share price will move positively alongside increasing game downloads.

**Critical factor #2: Average spending on mobile games.** We note a strong correlation of +0.90 between NetEase's share price and average spending on Chinese mobile games per user. As growth in China's mobile game users becomes gradually saturated, growth in average spending becomes a key factor for further market expansion. Average spending on mobile games in China increased at a CAGR of 16% from 2018 to 2021 and is forecasted to grow at a CAGR of 9% in 2021-2024F, supported by diversified game offerings and rising spending power for game content. We believe the solid average spending growth will support the monetisation potential of NetEase's games and its share price.

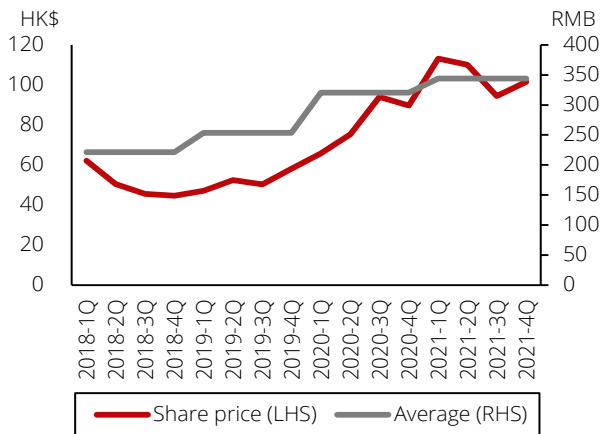
**Critical factor #3: Overseas game revenue as a percentage of total game revenue.** Overseas game revenue becomes a more significant revenue stream for Chinese game developers. China-developed mobile games made US\$16bn in revenue in 2021 in overseas markets, representing a 33% CAGR from 2018 to 2021, according to CNG. The management guided that 30% of total revenue will come from overseas markets in the next three to five years, compared to a low base of 11% in 2021. We forecast NetEase's overseas game revenue to grow at a 40% CAGR during FY21-FY24F, supported by promising overseas game pipelines like Harry Potter: Magic Awakened international and Diablo Immortal.

**Critical factor #1: Changes in NetEase's game downloads**



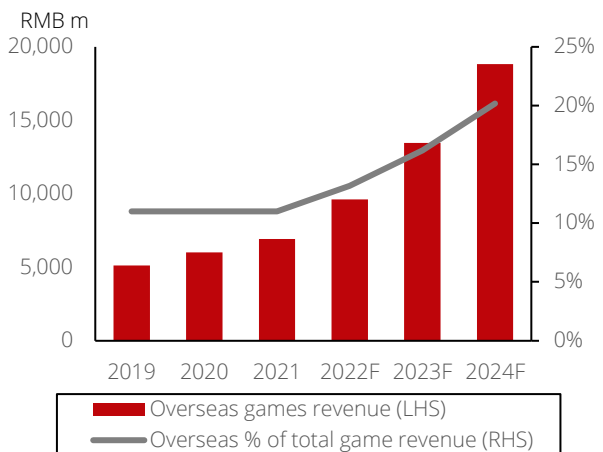
Source: App Annie, Bloomberg Finance L.P., DBS HK

**Critical factor #2: Average spending on mobile games per user in China**



Source: CNG, Bloomberg Finance L.P., DBS HK

**Critical factor #3: Overseas game revenue as a percentage of total game revenue**



Source: Company, DBS HK

## NetEase Inc

### Financials

#### 1Q22 result highlights

Total net revenue grew 15% y-o-y to Rmb23.6bn, above the consensus. By segment, online game revenue grew 15% y-o-y to Rmb17.3bn, higher than market expectation. The solid growth was driven by strong performance of PC game and longevity of flagship titles. As for the non-game businesses, Youdao's revenue rose 20.5% to Rmb1,201m. Cloud Music increased by 39% to Rmb2,067m, while innovative businesses and others increased by 15% to Rmb3,015m. Gross margin increased 3.9ppt to 54.5%, driven by higher revenue contribution from PC games and improved gross margin of cloud music. Non-GAAP net income rose to Rmb5,118m, vs consensus of Rmb4,773m.

#### FY22 financial forecast

**Revenue.** We forecast the company revenue to grow at a CAGR of 13% in FY21-FY24F to HK\$123bn. The growth is mainly driven by (1) its strong game pipeline and accelerated overseas expansion, (2) higher monetisation of music content via music live streaming and subscription fees, and (3) increased sales of Youdao's online learning products.

**Gross profit margin.** We believe the gross profit margin will slightly improve from 53.6% in FY21 to 53.9% in FY24F, given the relatively stable game margin. The expanded margin of Cloud Music is partially offset by the lower margin smart device business of Youdao.

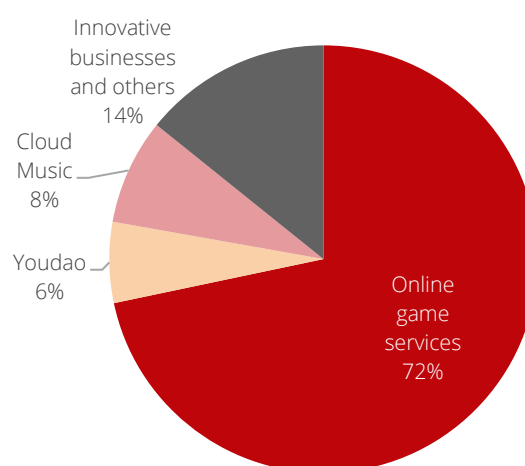
**Operating expenses.** We expect operating expenses as a percentage of revenue to decrease from 34.9% in FY21 to 34.3% in FY24F, due to improving operating leverage and

lower marketing expenses for retaining users of Cloud Music and Youdao.

**Healthy balance sheet.** The group had net cash of Rmb72,230m in FY21. Cash and bank balance (including time deposits) was Rmb93,955m as of Dec 2021. Bank loans were Rmb21,725mn as of Dec 2021. The company has strong financials to support further R&D investments and M&As.

**Dividend policy.** The company committed to pay out 20%-30% of its quarterly net income after tax as quarterly dividends since 2019. We expect a 1.3% dividend yield for FY22.

#### Revenue mix by business segment (FY21)



Source: Company, DBS HK



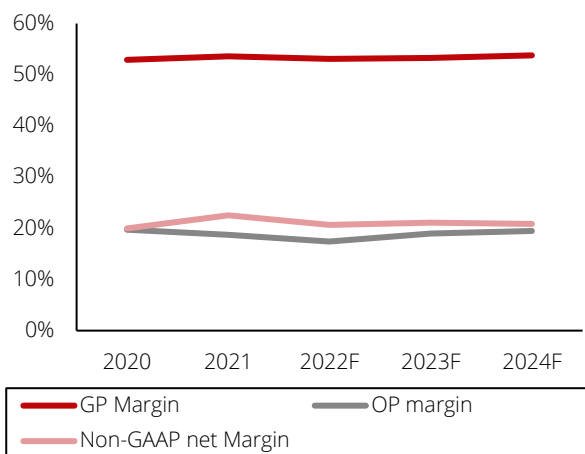
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**Segment breakdown**

NetEase segment breakdown	2021	2022F	2023F	2024F
<b>Revenue (Rmb m)</b>				
Online game services	62,807	72,273	81,920	91,422
Youdao	5,354	4,809	5,720	6,499
Cloud Music	6,998	9,090	11,165	13,332
Innovative businesses and others	12,448	12,881	14,333	15,839
<b>Total</b>	<b>87,606</b>	<b>99,054</b>	<b>113,139</b>	<b>127,093</b>
<b>Y-O-Y growth (%)</b>				
Online game services	15%	15%	13%	12%
Youdao	69%	-10%	19%	14%
Cloud Music	43%	30%	23%	19%
Innovative businesses and others	13%	3%	11%	11%
<b>Total</b>	<b>19%</b>	<b>13%</b>	<b>14%</b>	<b>12%</b>
<b>Gross Margin</b>				
Online game services	64.8%	63.8%	63.9%	64.0%
Youdao	54.3%	51.0%	53.0%	54.0%
Cloud Music	2.0%	9.0%	12.0%	18.0%
Innovative businesses and others	25.8%	25.0%	25.0%	25.0%
<b>Total</b>	<b>53.6%</b>	<b>53.1%</b>	<b>53.3%</b>	<b>53.8%</b>

Source: Company, DBS HK

**Margin trend**



Source: Company, DBS HK

**OPEX as a % of revenue**



Source: Company, DBS HK

**NetEase Inc****Environment, Social, & Governance (ESG)**

**Environmental.** NetEase has optimised its energy consumption per unit of computing power by adjusting internal resources, initiating the replacement of old servers, and decommissioning high-energy-consuming data centres. In 2020, NetEase replaced approximately 7,000 old servers, which saved an average of 1.25m kWh of electricity or 153 tonnes of standard coal per year. Besides, NetEase used 1.4m kWh of electricity for air conditioning during the cooling season (May to Sep 2020), saving 0.3m kWh compared with 2019.

**Social.** NetEase has promoted various public welfare projects that help families in poverty, and in the fields of education, health, and others. In 2020, the company initiated a poverty alleviation campaign that involved purchasing rice from poverty stricken areas and reducing the financial burdens of poor households. In 2020, NetEase purchased 253.5 tonnes of rice from poverty stricken families.

**Talent.** The company has set up an attractive compensation and benefits system for staff. It carries out industry-wide salary research every year to ensure it offers employees competitive salaries. Additionally, they conduct training for staff. In 2020, the training coverage rate was 99.9% of hires. As for improving the R&D skills of new recruits, the company launched MINI training, which spans three months, along with follow-up coaching that lasts two years. This effectively helps reduce the company's talent turnover rate.

**Governance.** The company established an ESG working group in 2020 and launched an ESG committee in 2021. The board of directors oversees the strategy and implementation of ESG initiatives. The company's ESG risks are incorporated in its annual internal assessment as key KPIs for its company governance.

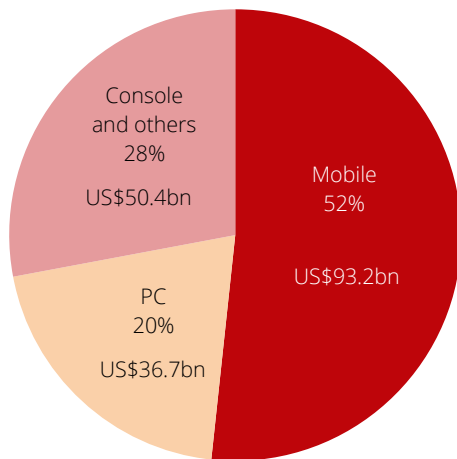
**NetEase Inc**

**Sector Outlook**

**Largest online game market.** China was ranked as the largest game market globally in 2021 in terms of game revenue. The estimated game market size of China in 2021 was Rmb297bn, representing a CAGR of 11.4% from 2018-2021, and is forecasted to grow by a mid to high single digit during 2022-2024F.

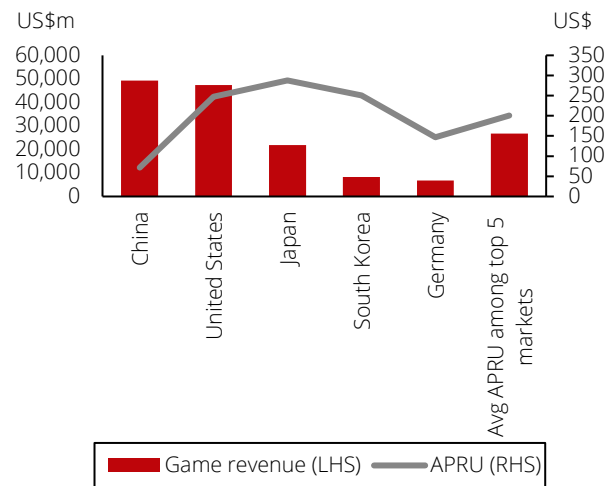
**Rising average spending as the key growth driver.** We expect average spending on games could further increase, driven by increasing consumption power and higher willingness to pay for digital content. Currently, China's average spending on games is only US\$72 (Rmb468) per user per year, far below US\$248 of the US. We believe the gap will narrow, supported by faster disposable income growth in China, leading to the expansion of overall mobile game revenue.

**Global game market share by segment (2021)**



Source: Newzoo, DBS HK

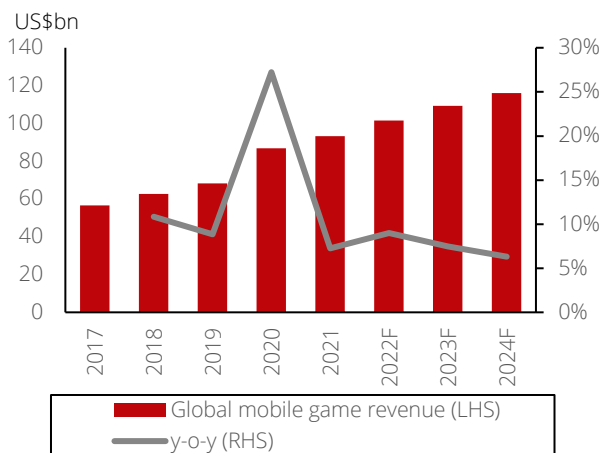
**Average game revenue per user per year by country**



Source: Newzoo, DBS HK

**Robust growth in mobile games.** Mobile gaming revenue grew at a 2018-2021 CAGR of 19% to Rmb226bn in China, outpacing the 11% of China's overall online games. Globally, we expect mobile games will continue to deliver faster than PC and console growth with a CAGR of 7.6% from 2021 to US\$116.1bn in 2024, outpacing the 6.6% of overall online game market growth, according to Newzoo.

**Global mobile game revenue**

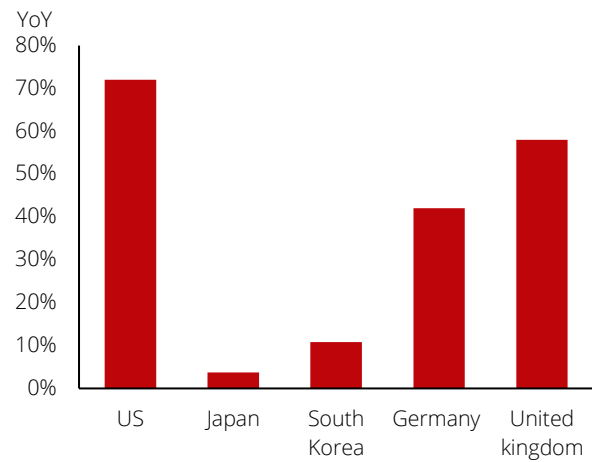


Source: Newzoo, DBS HK

**NetEase Inc**

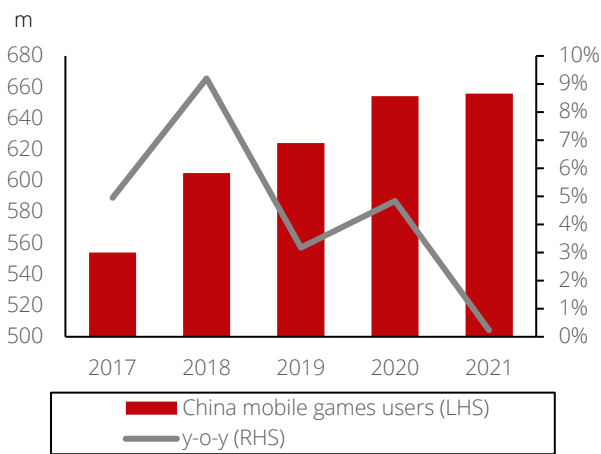
**Overseas expansion acceleration.** Chinese games' overseas revenue has increased 1.5x, from US\$7.3bn in 2016 to US\$18bn in 2021, according to CNG. Chinese developers give more priority to overseas markets to further expand their total addressable market, as domestic games gain more traction overseas. Currently, Chinese games' overseas revenue is primarily generated from the US, Japan, South Korea, Germany, and the UK, and account for 66% of total overseas revenue. However, Chinese games' penetration rate is below 25% in these top five markets. We expect Chinese games to continue to gain market share in these markets.

**Top 100 Chinese mobile games' gross billing growth in major countries (2021)**



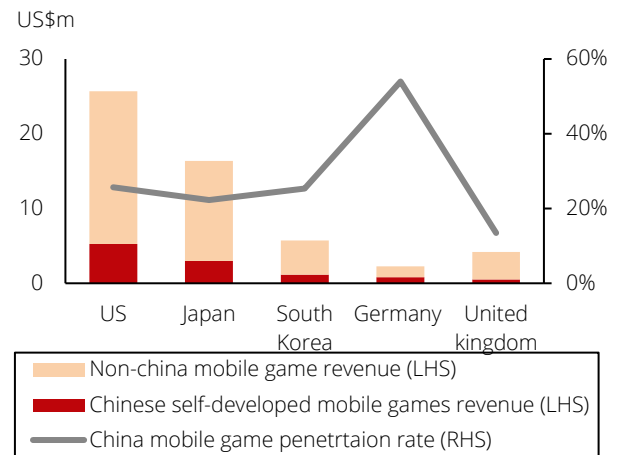
Source: CNG, DBS HK

**China mobile game users**



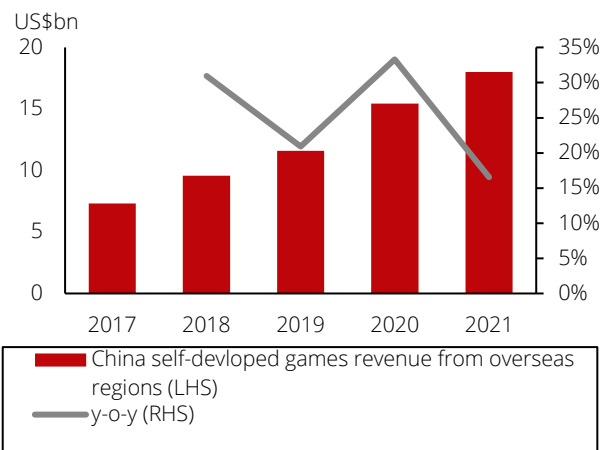
Source: CNG, DBS HK

**Chinese self-developed games' market shares by country**



Source: Newzoo, Statistics, DBS HK

**China self-developed games revenue from overseas markets**



Source: CNG, DBS HK

**NetEase Inc**

**NetEase online game services**

**MOBILE GAMES**

**Self-Developed Mobile Games**



**Licensed Mobile Games From Overseas Developers**



**Launching Mobile Games in Overseas Markets**

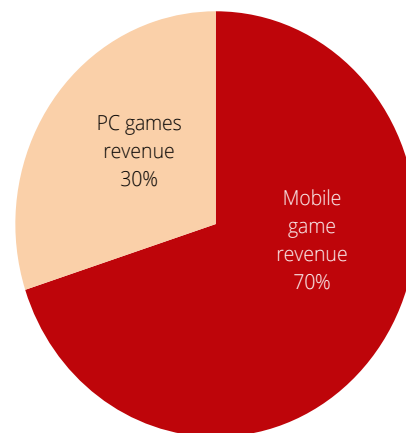


**PC GAMES**

**Flagship Self-Developed PC titles**



**Flagship Licensed PC titles**



Source: Company, DBS HK

## NetEase Inc

### Company Background

**Company history.** Founded in 1997, NetEase is currently the No.2 player in both the PC and mobile game markets in China. The company was listed on NASDAQ in Jun 2000 with an IPO price of US\$0.6 per share. It was secondary listed on the HKEX in Jun 2020 at HK\$120 per share. NetEase's major business segments are (1) Online game services, (2) Cloud Music, (3) Youdao, and (4) Innovative businesses and others, which accounted for 72%, 6%, 8%, and 14% of total revenue in FY21, respectively.

**1. Online game services: Strong game pipeline and accelerated overseas expansion.** NetEase generates the majority of its revenue from online games. Revenue from mobile games accounted for c.70% of total game revenue in FY21 and PC games took up the rest. NetEase's licensed games, i.e., key titles including World of Warcraft (魔獸世界) from Blizzard, accounted for 13% of game revenue in FY21. As for self-developed games, the company has an abundant portfolio of game IPs which covers different game genres, including MMORPGs (massively multiplayer

online role-playing games), CCGs (collectible card games), MOBA (multiplayer online battle arena games), SLGs (simulation games), etc. Its flagship titles like Fantasy Westward Journey (梦幻西游, FWJ), Westward Journey Online (大话西游, WWJ), Onmyoji (陰陽師), and Invincible (率土之濱) have much longer life cycles than other games. For overseas markets, its popular titles are battle arena games Identity V (第五人格) and Knives Out (荒野行動). In 2021, its top five games made up 29% of total game revenue. According to App Annie, NetEase's flagship games like Fantasy Westward Journey and Onmyoji have consistently ranked among the top 30 grossing games in China since their launch.

**Major upcoming game pipeline.** NetEase has 20+ in-house games under development and plans to launch seven key titles this year, such as Harry Potter: Magic Awakened international (哈利波特:魔法覺醒), Diablo Immortal (暗黑破壞神:不朽), Dead by Daylight (黎明死線), as well as a mobile and console version of Naraka: Bladepoint (永劫無間). The self-developed PC game Naraka: Bladepoint was well received by players with great success and named a "Top Seller" on Steam's Best of 2021 games list.

### List of NetEase game portfolio

#### List of key mobile games (2013-2021)

Date of launch	Mobile Games title	Chinese Name	Genre
Jul-13	Mobile Version of Fantasy Westward Journey II	梦幻西游2 口袋版	MMORPG
Mar-15	Fantasy Westward Journey mobile game	梦幻西游手游	MMORPG
Sep-15	Westward Journey Online mobile game	大话西游手游	MMORPG
Oct-15	Invincible	率土之濱	SLG
May-16	New Ghost	倩女幽魂手游	MMORPG
Sep-16	Onmyoji	陰陽師	CCG & RPG
Nov-17	Knives Out Battle Arena	荒野行動	Battle Arena
Nov-17	Rules of Survival	終結戰場	Battle Arena
Jan-18	All About Jianghu	一夢江湖	MMORPG
Jan-18	Onmyoji Arena	決戰:平安京	MOBA
Apr-18	Identity V	第五人格	Battle Arena
Sep-18	Ancient Nocturne	神都夜行錄	CCG & RPG
Nov-18	Life-After	明日之後	RPG
Jun-19	Sky: Children of the Light	光遇	Casual
Oct-19	Xuan Yuan Sword: Dragon Upon the Cloud	軒轅劍龍舞雲山	MMORPG
Dec-19	Fantasy Westward Journey 3D	梦幻西游3D版	3D MMORPG
Dec-19	Onmyoji: The Card Game	陰陽師:百聞牌	CCG
Jun-21	Fantasy Westward Journey H5	梦幻西游	MMORPG
Jul-21	Infinite Lagrange	無盡的拉格朗日	SLG
Jan-21	Revelation	天諭	MMORPG
Sep-21	Harry Potter: Magic Awakened	哈利波特:魔法覺醒	CCG & RPG
Sep-21	The Lord of the Rings: Rise to War	指環王:崛起之戰	MMORPG
Dec-21	The Showbiz: Dream Chaser	絕對演繹	MMORPG

Source: Company, DBS HK

## NetEase Inc

### List of NetEase game portfolio (continued)

#### Selected list of new mobile games pipelines

Date of launch	Mobile Game title	Chinese Name	Genre
Jul-22	Roar of War	戰爭怒吼	MMORPG
Jun-22	Diablo Immortal	暗黑破壞神:不朽	MMORPG
2022	Dead by Daylight	黎明前線	MMORPG
2022	Ghost World Chronicle	倩女幽魂隱世錄	MMORPG
2022	Egg Go	蛋仔派對	Casual
2022	Naraka: Bladepoint	永劫無間	Battle Royale
2022	Onmyoji: Yokai Class	陰陽師: 妖怪小班	CCG

#### List of key PC games

Date of launch	PC games title	Chinese Name	Genre
Aug-02	New Westward Journey Online II	夢幻西遊	MMORPG
Jan-04	Fantasy Westward Journey Online	大話西遊	MMORPG
Oct-11	Tianxia III	天下3	MMORPG
Apr-12	New Ghost (a new version of Ghost II)	新倩女幽魂	MMORPG
Jun-18	Justice 3D	逆水寒	MMORPG
Jul-21	Naraka: Bladepoint	永劫無間	MMORPG
Sep-09	World of Warcraft (Licensed from Blizzard)	魔獸世界	MMORPG
Apr-11	StarCraft II (Licensed from Blizzard)	星際爭霸 II	MMORPG
Jan-14	Hearthstone (Licensed from Blizzard)	爐石傳說	CCG & RPG
Jun-15	Heroes of the Storm (Licensed from Blizzard)	風暴英雄	MMORPG
May-15	Diablo III (Licensed from Blizzard)	暗黑破壞神 III	MMORPG

#### Overseas games presence (2017-2022)

2017	Knives Out	荒野行動	Battle Arena
2018	Identity V	第五人格	Battle Arena
2019	MARVEL Super War	漫威超級戰爭	Battle Arena
2020	MARVEL Duel	漫威對決	CCG
2021	The Lord of the Rings: Rise to War	指環王: 崛起之戰	MMORPG
2021	Naraka: Bladepoint	永劫無間	MMORPG
2022	Harry Potter: Magic Awakened (International)	哈利波特: 魔法覺醒	CCG & RPG
2022	Dead by Daylight	黎明前線	MMORPG

Source: Company, DBS HK

### NetEase games ranking among top 30 grossing games in China

Rank (Dec 2021)	Games Name	Rank ( Apr 2022)	Game Name
4	Fantasy Westward Journey (夢幻西遊)	3	Fantasy Westward Journey (夢幻西遊)
6	Onmyoji (陰陽師)	5	Onmyoji (陰陽師)
11	Westward Journey (大話西遊)	9	Sky: Children of the Light (光遇)
15	Life-After (明日之後)	10	Life-After (明日之後)
16	Invincible (率土之濱)	18	Invincible (率土之濱)
19	Sky: Children of the Light (光遇)	22	Westward Journey (大話西遊)
25	Harry Potter: Magic Awakened (哈利波特: 魔法覺醒)	23	New Ghost (倩女幽魂)
		30	Identity V (第五人格)

Source: App Annie, DBS HK

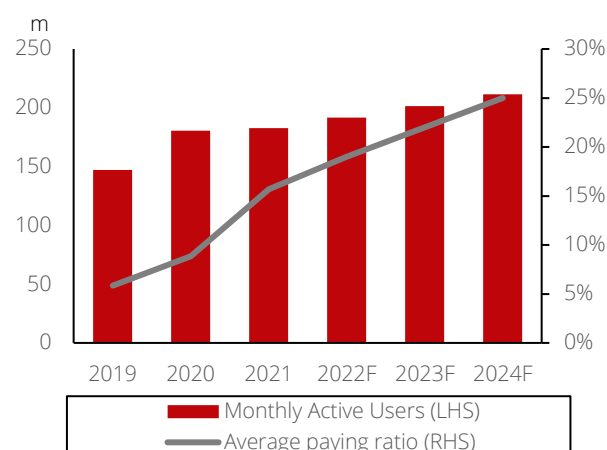
## NetEase Inc

In terms of global presence, NetEase generated 11% of game revenue from the international market in 2021, relatively lower than the c.19% of its domestic peers. We forecast NetEase's overseas game revenue to grow at a CAGR of 40% from 2021 to 2024F, mainly driven by (1) its currently low game exposure to overseas markets and strong upcoming pipeline; (2) its capability to replicate the success of commercialising different game genres in overseas markets, such as launching battle arena game *Knives Out* and RPG game *LifeAfter*; (3) the establishment of IP collaborations with leading global game studios and famous IP owners to co-develop mobile games, which would help in increasing the penetration of NetEase's games in other markets. For example, NetEase partnered with Marvel and Warner Bros and Marvel to launch *Marvel Super War* and *Harry Potter: Magic Awakened* in 2019 and 2021 respectively. Besides, the company has launched a few overseas studios in US, Canada and Japan, focusing on enhancing R&D capabilities by acquiring top talents for game innovation and localisation. The overseas regions the company focuses on include Japan, US, Europe, and Southeast Asia.

**2. Cloud Music: No.2 online music platform in China.** The NetEase Cloud Music streaming platform was launched in 2013 and focuses on delivering a differentiated and premium listening experience in terms of the quality and variety of music offered. Cloud Music (9899 HK) was listed on the HKEX in Dec 2021. It is the second largest online music platform in China, with a 20.5% market share in terms of revenue, after Tencent Music Entertainment which has a 72.8% market share. As of 2021, NetEase Cloud Music had over 800m registered users and over 300k independent artists. Its two key revenue streams are (1) membership subscriptions from online music services and (2) sales of virtual items during live streaming of music.

We expect Cloud Music's revenue to grow at a CAGR of 24% from 2021 to 2024F, mainly driven by (1) increasing paying users of music live streams, as we estimate revenue from streaming to grow at a 27% CAGR from 2021 to 2024F to Rmb7.6bn and (2) improved membership subscription paying ratio. We estimated the paying ratio to increase from 15% in 2021 to 25% in 2024F, driven by rising demand and a higher willingness to spend on digital content. Given that its overseas peers' subscription rates are as high as c.40%, there is huge potential for improvement. Its net loss will continue to narrow, driven by lower music copyright fees and lower marketing expenses due to more rational competition in the sector.

### Cloud Music MAU and paying ratio



Source: Company, DBS HK

**3. Youdao: Online learning business with improving profitability.** Founded in 2006, Youdao develops technologies to provide learning content, applications, and smart devices. It was separately listed on NASDAQ in Oct 2019. One of its key applications Youdao Dictionary (有道词典), which was launched in 2007, has become the top language app with 52m MAUs in China as of 2021. Youdao's revenue mainly consists of (1) learning services, including STEAM courses and adult learning; (2) smart devices, including the Youdao Dictionary Pen and Youdao Pocket Translator; and (3) online market services, including advertising income from apps. The three segments accounted for 48%, 18%, and 11% of total revenue in 2021, respectively.

We expect Youdao's revenue to grow at a CAGR of 7% from 2021 to 2024F, mainly driven by rising demand for online courses and growing sales of smart devices. We expect Youdao to further expand its online product offerings and focus on increasing the customer retention rate and paying ratio to improve overall profitability.



## NetEase Inc

### Youdao – business breakdown

#### LEARNING SERVICES



**Youdao  
Premium Courses**



**China University  
MOOC**



**Youdao  
Smart Cloud**

#### LEARNING PRODUCTS



**Youdao  
Dictionary**



**Youdao  
Translation**



**Youdao  
Dictionary Pen**

Source: company DBS HK

### Innovative businesses – business breakdown



#### NetEase Yanxuan

- Private label consumer brand targeting young professionals in China
- lauched a variety of popular products across core categories such as household cleaning etc



#### Internet Media

- www.163.com is one of China's most visited internet protals, with strong user diversity, reach and stickness
- Mobile News App is one of the most popular news app in China



#### CC Live Streaming

- CC Live streaming platform offers various live streaming content with a primary focus on games



#### E-mail Services

- China's leading e-mail service provider since 1997
- Over 500 million annual active users as of 31 Dec 2021

Source: Company, DBS HK

**4. Innovative businesses: Diversifying revenue stream for sustainable growth.** The innovative businesses mainly include: (1) Yanxuan (網易嚴選), a self-run business (1P) e-commerce platform that offers private label products, such as apparel, homeware, and other general merchandise, sourced from selected manufacturers in China; (2) internet media platforms, including NetEase News mobile (網易新聞) and the www.163.com portal; (3) game broadcasting platform NetEase CC Live streaming; and (4) NetEase Mail (網易郵箱), one of the leading email service providers in China since 1997.

In FY2021, the innovative business segment contributed Rmb12,448m or 14% of NetEase's total revenue. The revenue is mainly generated from (1) sales of products from Yanxuan, (2) ad revenue from media and email services, and (3) revenue from the sale of virtual items via NetEase CC Live streaming.

We expect the revenue of the innovative business segment to grow at a CAGR of 8% from 2021 to 2024F. The growth is mainly contributed by CC Live streaming and Yanxuan, riding on a higher monetisation rate of CC Live streaming and higher GMV growth.

## NetEase Inc

### Management & Strategy

#### Key Management Team

Name	Position	Description
William Lei Ding	Director, founder, and chief executive officer	William Lei Ding established Guangzhou NetEase in June 1997 and served as chief executive officer since November 2005. He has extensive experience of over 20 years in information technology and the online game industry. Ding holds a Bachelor of Science degree in Communication Technology from the University of Electronic Science and Technology of China.
Charles Zhaoxuan Yang	Chief financial officer	Charles Zhaoxuan Yang has served as chief financial officer since June 2017. Yang was an executive director of the China technology, media and telecommunications, and corporate finance teams at JP Morgan Securities. Yang holds a Master's degree in Business Administration from the University of Hong Kong and a Bachelor's degree from Wesleyan University with majors in Economics and Mathematics. He is a qualified member of the CPA in PRC and Taiwan.
Alice Yu-Fen Cheng	Independent director	Alice Yu-Fen Cheng has served as the company's director since June 2007. From 2010 to 2013, Cheng served as a supervisor of Wistron Information Technology Corporation in Taiwan. Cheng received a Master of Business Administration from the Thunderbird School of Global Management in Arizona in 2003.
Denny Ting Bun Lee	Independent director	Denny Ting Bun Lee has served as the company's director since April 2002. Lee previously served as chief financial officer from April 2002 until June 2007 and financial controller from November 2001 until April 2002. Lee graduated with a Professional Diploma in Accounting from the Hong Kong Polytechnic University in November 1990.
Joseph Tze Kay Tong	Independent director	Joseph Tze Kay Tong has served as director since March 2003. Previously, he was the e-commerce director of the Asian Region for Universal Music Limited, where he was responsible for forming e-business development strategies and overseeing new promotional opportunities. Tong received a Bachelor of Social Science degree with honors in Accounting and Statistics from the University of Southampton, England.

Source: Company

**NetEase Inc**

**CRITICAL FACTORS TO WATCH**

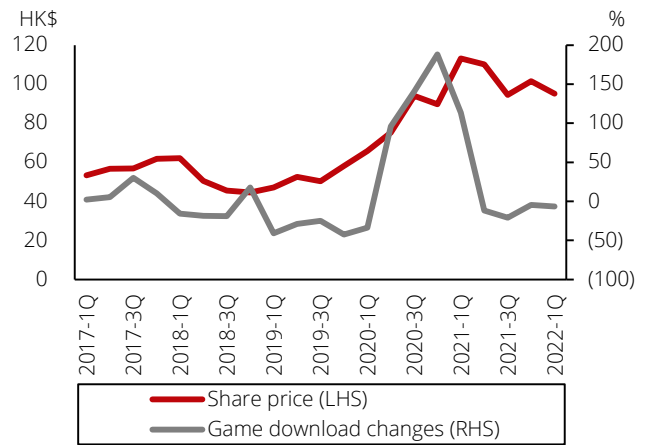
**Critical Factors**

**Critical factor #1: Number of new games launched.** Game revenue accounted for 72% of total revenue in FY21, with newly launched games contributing the majority of incremental gross billings. The number of new games launched is a key driver to download volume. We note a strong correlation of +0.76 between changes in NetEase’s game downloads and share prices. From past game launch cycles, we learned that the share price will move positively alongside increasing game downloads.

**Critical factor #2: Average spending on mobile games per user.** We note a strong correlation of +0.90 between NetEase’s share price and average spending on Chinese mobile games per user. As growth in China’s mobile game users becomes gradually saturated, growth in average spending becomes a key factor for further market expansion. Average spending on mobile games in China increased at a CAGR of 16% from 2018 to 2021 and is forecasted to grow at a CAGR of 9% in 2021-2024F, supported by diversified game offerings and rising spending power for game content. We believe the solid average spending growth will support the monetisation potential of NetEase’s games and its share price.

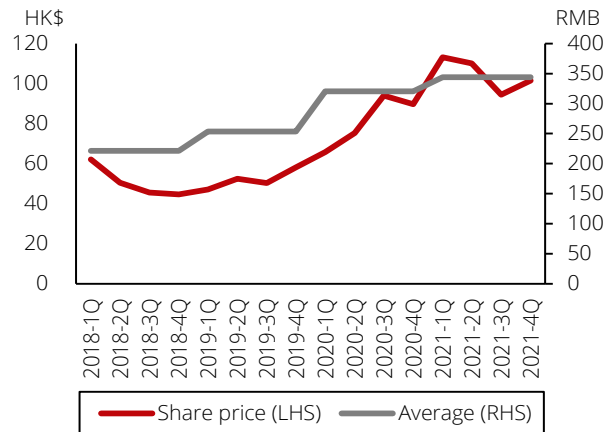
**Critical factor #3: Overseas game revenue** as a percentage of total game revenue. Overseas game revenue from Chinese games becomes a more significant revenue stream. China-developed mobile games made US\$16bn in revenue in 2021 in overseas markets, representing a 33% CAGR from 2018 to 2021, according to CNG. The management guided that 30% of total revenue will come from overseas markets in the next three to five years, compared to a low base of 11% in 2021. We forecast NetEase’s overseas game revenue to grow at a 40% CAGR during FY21-FY24F, supported by overseas game pipelines like Harry Potter: Magic Awakened international and Diablo Immortal

**Critical factor #1: Changes in NetEase’s game downloads**



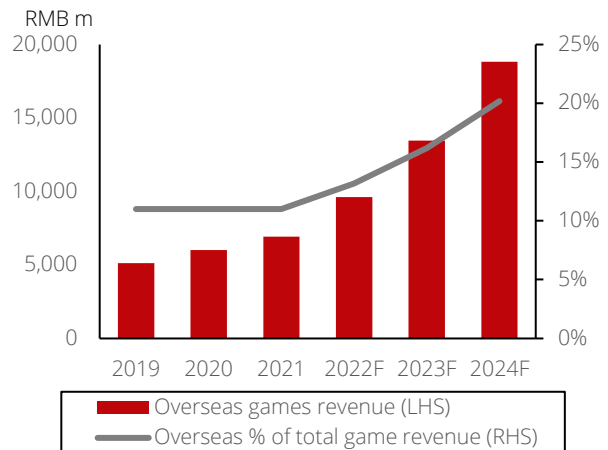
Source: App Annie, Bloomberg Finance L.P., DBS HK

**Critical factor #2: Average spending on mobile games per user in China**



Source: CNG, Bloomberg Finance L.P., DBS HK

**Critical factor #3: Overseas game revenue as a percentage of total game revenue**

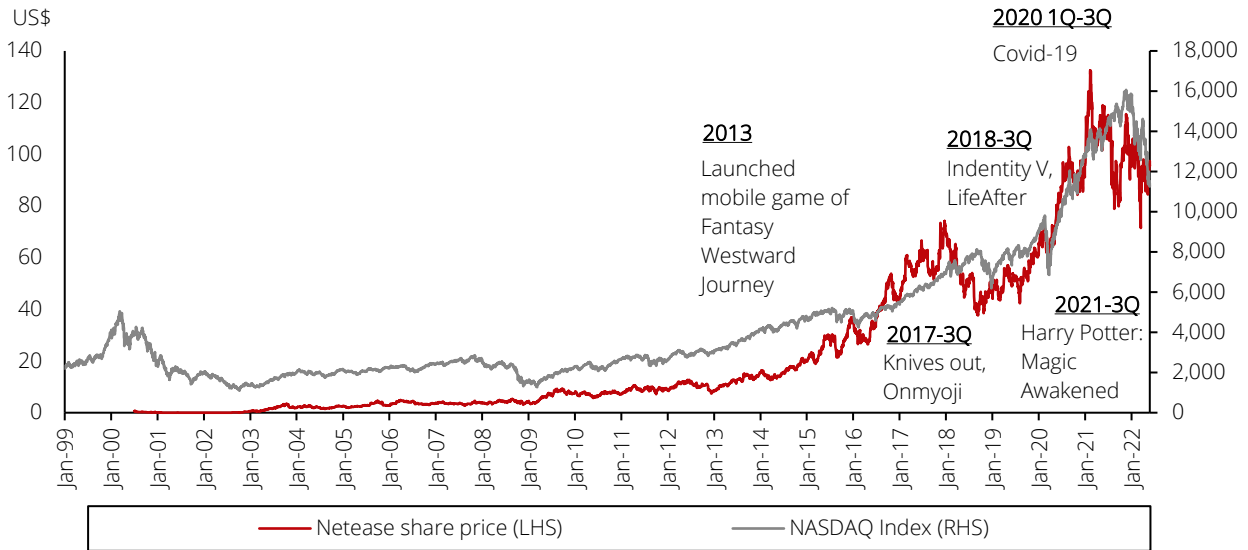


Source: Company, DBS HK

**NetEase Inc**

**Appendix 1: A look at Company's listed history – what drives its share price?**

**NetEase share price chart**



Source: Thomson Reuters, DBS HK

## NetEase Inc

### Balance Sheet:

**Healthy balance sheet.** The group had net cash of Rmb72,230m in FY21. Cash and bank balance (including time deposits) was Rmb93,955m as of Dec 2021. Bank loans were Rmb21,725m as of Dec 2021. The company has strong financials to support further R&D investments and M&As.

### Share Price Drivers:

**Stronger monetisation of overseas games and Cloud Music.**

NetEase's new IP games could potentially contribute higher overseas game revenue with higher average spending. Paying ratio for music content from 800m Cloud Music users is rising amid COVID-19.

### Key Risks:

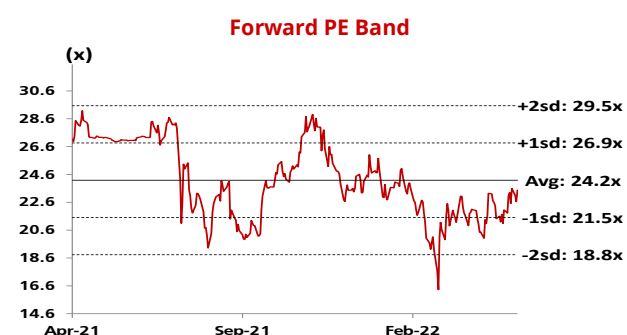
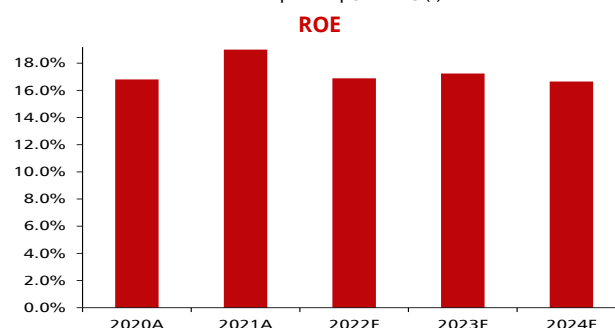
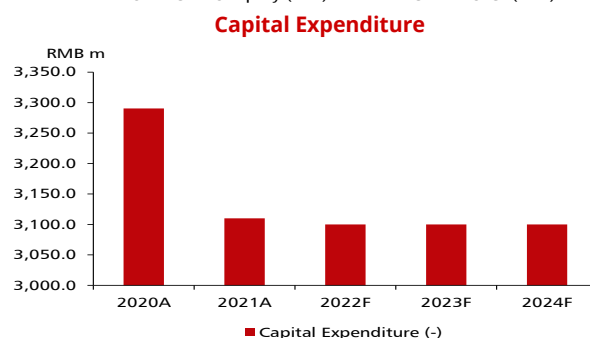
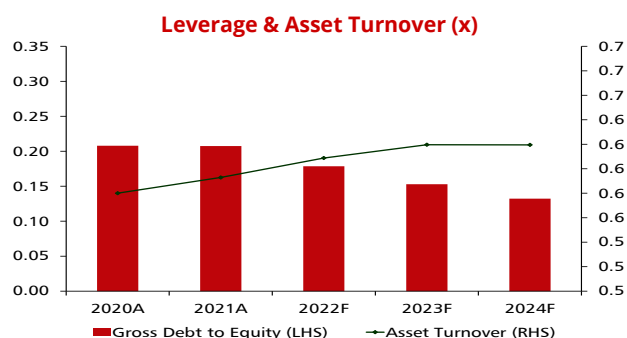
(1) Business disruptions due to regulatory changes, (2) slower-than-expected overseas expansion, and (3) potential tax rate hike.

### Environmental, Social, & Governance:

NetEase's success rides on R&D and talent. The company has set up an attractive compensation and benefits system for its staff. It carries out industry-wide salary research every year to ensure they offer employees competitive salaries. Additionally, it conducts training for staff. In 2020, the training coverage rate was 99.9% of hires. As for improving the R&D skills of new recruits, the company launched MINI training, which spans three months, and provides follow-up coaching over two years, which effectively help lower the talent turnover rate.

### Company Background

Founded in 1997, NetEase is currently the No.2 player in both the PC and mobile game markets in China. The company was listed on NASDAQ in Jun 2000 at US\$0.6 per share and secondary listed on the HKEX in Jun 2020 at HK\$120 per share. NetEase's major business segments are (1) Online game services, (2) Cloud Music, (3) Youdao, and (4) Innovative businesses and others, which accounted for 72%, 8%, 6%, and 14% of total revenue in FY21, respectively.



Source: Company, DBS HK

## NetEase Inc

### Key Assumptions

FY Dec	2020A	2021A	2022F	2023F	2024F
Online game rev growth (%)	17.6	15.0	15.1	13.3	11.6
Cloud music monthly paying users (m)	16.0	28.9	36.1	45.2	56.4
Game gross Margin (%)	63.7	64.8	63.8	63.9	64.0

Source: Company, DBS HK

### Segmental Breakdown (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
<b>Revenues (RMB m)</b>					
Online game services	54,609	62,807	72,273	81,920	91,422
Youdao	3,168	5,354	4,809	5,720	6,499
Cloud Music	4,896	6,998	9,090	11,165	13,332
Innovative businesses and others	10,995	12,448	12,881	14,333	15,839
<b>Total</b>	<b>73,667</b>	<b>87,606</b>	<b>99,054</b>	<b>113,139</b>	<b>127,093</b>

Source: Company, DBS HK

## NetEase Inc

### Income Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenue	73,667	87,606	99,054	113,139	127,093
Cost of Goods Sold	(34,684)	(40,635)	(46,452)	(52,837)	(58,713)
<b>Gross Profit</b>	<b>38,983</b>	<b>46,971</b>	<b>52,601</b>	<b>60,302</b>	<b>68,379</b>
Other Opg (Exp)/Inc	(24,445)	(30,554)	(35,362)	(38,807)	(43,593)
<b>Operating Profit</b>	<b>14,538</b>	<b>16,417</b>	<b>17,239</b>	<b>21,495</b>	<b>24,787</b>
Other Non Opg (Exp)/Inc	(2,375)	220	200	200	200
Associates & JV Inc	1,610	2,948	3,000	3,000	3,000
Net Interest (Exp)/Inc	1,599	1,520	1,500	1,500	1,500
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>15,372</b>	<b>21,104</b>	<b>21,939</b>	<b>26,195</b>	<b>29,487</b>
Tax	(3,042)	(4,128)	(4,388)	(5,239)	(5,897)
Minority Interest	520	418	400	400	400
Preference Dividend	(787)	(537)	(500)	(500)	(500)
<b>Net Profit</b>	<b>12,063</b>	<b>16,857</b>	<b>17,451</b>	<b>20,856</b>	<b>23,489</b>
Net Profit before Except.	12,063	16,857	17,451	20,856	23,489
EBITDA	17,231	22,860	23,939	28,195	31,487
<b>Growth</b>					
Revenue Gth (%)	24.4	18.9	13.1	14.2	12.3
EBITDA Gth (%)	(5.2)	32.7	4.7	17.8	11.7
Opg Profit Gth (%)	5.4	12.9	5.0	24.7	15.3
Net Profit Gth (%)	(43.2)	39.7	3.5	19.5	12.6
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	52.9	53.6	53.1	53.3	53.8
Opg Profit Margin (%)	19.7	18.7	17.4	19.0	19.5
Net Profit Margin (%)	16.4	19.2	17.6	18.4	18.5
ROAE (%)	16.8	19.0	16.9	17.2	16.7
ROA (%)	9.5	11.4	10.7	11.4	11.4
ROCE (%)	11.4	11.1	10.6	11.6	11.8
Div Payout Ratio (%)	30.0	29.3	29.2	29.2	29.2
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS HK

## NetEase Inc

### Quarterly Income Statement (RMB m)

FY Dec	1Q2021	2Q2021	3Q2021	4Q2021	1Q2022
Revenue	20,517	20,525	22,191	24,374	23,556
Cost of Goods Sold	(9,465)	(9,335)	(10,380)	(11,456)	(10,719)
<b>Gross Profit</b>	<b>11,053</b>	<b>11,190</b>	<b>11,811</b>	<b>12,918</b>	<b>12,836</b>
Other Oper. (Exp)/Inc	(6,777)	(7,431)	(8,036)	(8,310)	(7,329)
<b>Operating Profit</b>	<b>4,276</b>	<b>3,758</b>	<b>3,775</b>	<b>4,608</b>	<b>5,507</b>
Other Non Opg (Exp)/Inc	427	(444)	271	(34)	118
Associates & JV Inc	695	889	(265)	1,628	(549)
Net Interest (Exp)/Inc	393	391	356	402	466
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>5,791</b>	<b>4,595</b>	<b>4,137</b>	<b>6,604</b>	<b>5,543</b>
Tax	(1,273)	(1,113)	(808)	(934)	(1,219)
Minority Interest	69	211	6	131	79
<b>Net Profit</b>	<b>4,439</b>	<b>3,542</b>	<b>3,182</b>	<b>5,694</b>	<b>4,394</b>
Net profit bef Except.	4,443	3,547	3,188	5,701	4,402
EBITDA	5,023	5,023	4,593	7,045	5,851
<b>Growth (QoQ)</b>					
Revenue Gth (%)	3.8	0.0	8.1	9.8	(3.4)
EBITDA Gth (%)	204.5	(19.3)	(8.6)	53.4	(16.9)
Opg Profit Gth (%)	42.0	(12.1)	0.5	22.1	19.5
Net Profit Gth (%)	355.0	(20.2)	(10.2)	79.0	(22.8)
<b>Growth (YoY)</b>					
Revenue Gth (%)	20.2	12.9	18.9	23.3	14.8
EBITDA Gth (%)	15.7	(19.1)	31.4	244.8	(6.0)
Opg Profit Gth (%)	(4.7)	(9.9)	31.5	53.0	28.8
Net Profit Gth (%)	25.0	(22.0)	6.1	483.6	(1.0)
<b>Margins</b>					
Gross Margins (%)	53.9	54.5	53.2	53.0	54.5
Opg Profit Margins (%)	20.8	18.3	17.0	18.9	23.4
Net Profit Margins (%)	21.6	17.3	14.3	23.4	18.7

Source: Company, DBS HK



## NetEase Inc

### Balance Sheet (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	8,734	9,542	11,142	12,742	14,342
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	25,310	30,982	35,981	40,981	45,981
Cash & ST Invt	96,521	100,411	110,541	123,903	138,879
Inventory	621	965	965	965	965
Debtors	6,112	6,236	6,548	6,875	7,219
Other Current Assets	4,576	5,508	6,610	7,932	9,518
<b>Total Assets</b>	<b>141,875</b>	<b>153,644</b>	<b>171,786</b>	<b>193,397</b>	<b>216,903</b>
ST Debt	19,505	19,352	19,352	19,352	19,352
Creditors	7,007	9,361	10,297	11,327	12,459
Other Current Liab	20,232	21,788	22,873	24,097	25,468
LT Debt	0	1,275	1,275	1,275	1,275
Other LT Liabilities	1,337	2,444	2,444	2,444	2,444
Shareholder's Equity	82,127	95,328	111,348	130,607	151,509
Minority Interests	11,667	4,096	4,196	4,296	4,396
<b>Total Cap. &amp; Liab.</b>	<b>141,875</b>	<b>153,644</b>	<b>171,786</b>	<b>193,397</b>	<b>216,903</b>
Non-Cash Wkg. Capital	(15,929)	(18,440)	(19,048)	(19,651)	(20,225)
Net Cash/(Debt)	77,016	79,784	89,913	103,275	118,251
Debtors Turn (avg days)	27.1	25.7	23.6	21.7	20.2
Creditors Turn (avg days)	71.9	80.0	83.5	80.0	78.6
Inventory Turn (avg days)	7.4	7.7	8.2	7.1	6.4
Asset Turnover (x)	0.6	0.6	0.6	0.6	0.6
Current Ratio (x)	2.3	2.2	2.4	2.5	2.7
Quick Ratio (x)	2.2	2.1	2.2	2.4	2.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	16.9	15.1	15.0	15.0	15.0
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

### Cash Flow Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	12,330	16,976	17,551	20,956	23,589
Dep. & Amort.	6,121	6,317	7,000	7,000	7,000
Tax Paid	2,046	3,547	4,388	5,239	5,897
Assoc. & JV Inc/(loss)	(27)	(187)	0	0	0
(Pft)/ Loss on disposal of FAs	(721)	(472)	0	0	0
Chg in Wkg.Cap.	4,771	3,188	608	604	574
Other Operating CF	367	(4,443)	(4,388)	(5,239)	(5,897)
<b>Net Operating CF</b>	<b>24,888</b>	<b>24,927</b>	<b>25,159</b>	<b>28,560</b>	<b>31,163</b>
Capital Exp.(net)	(3,290)	(3,110)	(3,100)	(3,100)	(3,100)
Other Invt.(net)	2,565	1,646	0	0	0
Invt in Assoc. & JV	(1,686)	(5,426)	(7,000)	(7,000)	(7,000)
Div from Assoc & JV	2	3	4	5	6
Other Investing CF	(26,784)	(191)	(4)	(5)	(6)
<b>Net Investing CF</b>	<b>(29,192)</b>	<b>(7,078)</b>	<b>(10,100)</b>	<b>(10,100)</b>	<b>(10,100)</b>
Div Paid	(4,280)	(4,240)	(4,931)	(5,098)	(6,087)
Chg in Gross Debt	4,041	1,708	0	0	0
Capital Issues	(11,491)	(12,911)	0	0	0
Other Financing CF	21,643	2,856	0	0	0
<b>Net Financing CF</b>	<b>9,913</b>	<b>(12,586)</b>	<b>(4,931)</b>	<b>(5,098)</b>	<b>(6,087)</b>
Currency Adjustments	162	(55)	0	0	0
Chg in Cash	5,771	5,208	10,128	13,362	14,976
Opg CFPS (RMB)	6.09	6.54	7.38	8.41	9.20
Free CFPS (RMB)	6.53	6.56	6.63	7.66	8.44

Source: Company, DBS HK

## NetEase Inc

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**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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