

NetEase, Inc

4Q23 preview: expect in-line results; CNY key game trend on track

Reiterate Rating: BUY | PO: 150.00 USD | Price: 107.48 USD

CNY key games trend on track, pending for new games

NetEase is due to report its 4Q23 results on Thursday, 29 February, 2024. We expect a largely in-line 4Q result with online game growth at 18% YoY and 1% QoQ (vs consensus of 17% YoY) and mobile game growth of 37% YoY and 1% QoQ (vs. consensus of 33%), on good game momentum. We also see its key game **Egg Party** regaining momentum during the Chinese New Year (CNY) with DAU hitting an all-time high of over 40mn and ranked among the top-5 in terms of game grossing, vs Tencent's **Dream Star** No.20 rank during the CNY. Furthermore, its 2Q23 game launch **Justice Mobile** and legacy game **FWJ** see solid performance with the top-10 game rankings in January 24, per Sense Tower.

Since existing game momentum remains good, we believe it has not rushed to launch new games and we still see many key games in pipeline - **Condor** announced to be released on 28 March, while **Where Winds Meet** and **Mission Zero** have no updates so far. We believe **Mission Zero** is likely to be released in 2Q24, while **Where Winds Meet** is still being tested and could need further optimization. The Company also obtained game license for **Naraka: Blade point mobile** on Feb 27, 2024, and the game is basically ready, which we expect to see in coming months.

4Q: expect in-line game business and better profit trend

We model a 4Q total revenue of RMB28.3bn (vs RMB28.8bn earlier), up 12% YoY and 4% QoQ, largely in line with consensus' RMB28.2bn, driven by unchanged games-related revenue growth of RMB22bn (up 16% YoY) with 18% YoY of online game and 38% YoY of mobile game on good momentum of new games. We lower non-game-related revenue to RMB6.3bn (from RMB6.8bn) amid macro uncertainties and restructuring of music business. We estimate GPM of 61.5% (vs. 62.2% in 3Q23), in line with consensus of 61.4% on higher games GPM. Our Non-GAAP net profit estimate is RMB8.4bn with NPM of 30%, above consensus of RMB8bn on better cost control estimated. Overall, we fine tune our 2023-25E EPS while we maintain our price objective (PO) at US\$150 on 20x 2024E ex-cash P/E. We reiterate our Buy rating on positive mobile game trend and margin expansion.

Estimates (Dec) (CNY)	2021A	2022A	2023E	2024E	2025E
Net Income (Adjusted - mn)	16,857	19,713	30,504	30,066	33,848
EPS	25.03	29.90	46.92	46.31	52.00
EPS Change (YoY)	39.0%	19.5%	56.9%	-1.3%	12.3%
Dividend / Share	6.29	10.20	14.08	13.89	15.60
Free Cash Flow / Share	34.63	38.85	50.67	49.67	54.53
Common EPS (CNY)	5.01	5.98	9.38	9.26	10.40
Common Dividend / Share (CNY)	1.26	2.04	2.82	2.78	3.12
Valuation (Dec)					
P/E	27.37x	24.99x	16.25x	16.71x	14.88x
Dividend Yield	0.919%	1.37%	1.85%	1.80%	2.02%
EV / EBITDA*	27.50x	24.08x	17.78x	14.95x	13.20x
Free Cash Flow Yield*	4.54%	4.98%	6.41%	6.27%	6.90%

* For full definitions of *IQmethod™* measures, see page 5.

27 February 2024

Equity

Key Changes

(CNY)	Previous	Current
2023E EPS	47.82	46.92
2024E EPS	47.59	46.31
2025E EPS	53.34	52.00

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Stock Data

Price (ADR / Common)	107.48 USD / 169.00 HKD
Price Objective	150.00 USD / 235.00 HKD
Date Established	17-Nov-2023 / 27-Feb-2024
Investment Opinion	B-1-8 / B-1-8
52-Week Range	76.85 USD-118.90 USD
Market Value (mn)	71,431 USD
Shares Outstanding (mn)	664.6 / 3,323.0
Average Daily Value (mn)	191.22 USD
Free Float	54.9%
BofA Ticker / Exchange	NTES / NAS
BofA Ticker / Exchange	NETTF / HKG
Bloomberg / Reuters	NTES US / NTES.OQ
ROE (2023E)	25.4%
Net Dbt to Eqty (Dec-2022A)	2.4%

CNY: Chinese New Year

DAU: daily active user

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Refer to important disclosures on page 6 to 9. Analyst Certification on page 3. Price Objective Basis/Risk on page 3.

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Timestamp: 27 February 2024 08:52AM EST

iQprofileSM NetEase, Inc

Key Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(CNY Millions)					
Sales	87,606	96,496	104,607	115,836	121,801
Gross Profit	46,971	52,766	63,652	71,930	77,186
Sell General & Admin Expense	(15,254)	(16,763)	(16,995)	(18,006)	(17,967)
Operating Profit	16,417	19,629	28,830	34,294	38,647
Net Interest & Other Income	4,687	4,622	6,408	2,917	2,948
Associates	NA	NA	NA	NA	NA
Pretax Income	21,104	24,250	35,238	37,211	41,595
Tax (expense) / Benefit	(4,128)	(5,032)	(5,030)	(7,442)	(8,319)
Net Income (Adjusted)	16,857	19,713	30,504	30,066	33,848
Average Fully Diluted Shares Outstanding	674	659	650	649	651

Key Cash Flow Statement Data					
Net Income	16,857	19,713	30,504	30,066	33,848
Depreciation & Amortization	3,276	2,858	1,622	1,916	2,375
Change in Working Capital	3,188	3,497	2,659	2,654	2,048
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	1,606	1,641	296	296	572
Cash Flow from Operations	24,927	27,709	35,081	34,932	38,844
Capital Expenditure	(1,602)	(2,100)	(2,144)	(2,680)	(3,350)
(Acquisition) / Disposal of Investments	(3,771)	(4,444)	(5,130)	(5,126)	(5,122)
Other Cash Inflow / (Outflow)	(1,532)	(647)	0	0	0
Cash Flow from Investing	(6,905)	(7,191)	(7,274)	(7,806)	(8,472)
Shares Issue / (Repurchase)	(10,054)	(8,359)	0	0	0
Cost of Dividends Paid	(4,240)	(6,724)	(9,151)	(9,020)	(10,155)
Cash Flow from Financing	(12,586)	(10,238)	(9,294)	(9,301)	(10,404)
Free Cash Flow	23,325	25,609	32,937	32,252	35,494
Net Debt	6,129	2,642	(15,685)	(34,345)	(55,099)
Change in Net Debt	(3,673)	(5,546)	(18,327)	(18,659)	(20,755)

Key Balance Sheet Data					
Property, Plant & Equipment	5,434	6,342	6,864	7,628	8,603
Other Non-Current Assets	35,090	34,815	36,332	37,364	38,392
Trade Receivables	5,508	5,003	5,509	6,196	6,615
Cash & Equivalents	14,498	24,889	43,216	61,875	82,630
Other Current Assets	93,114	101,711	106,756	112,578	118,172
Total Assets	153,644	172,761	198,749	225,877	254,841
Long-Term Debt	1,275	3,655	3,655	3,655	3,655
Other Non-Current Liabilities	2,444	3,404	3,404	3,404	3,404
Short-Term Debt	19,352	23,876	23,876	23,876	23,876
Other Current Liabilities	31,149	32,953	35,956	39,911	42,765
Total Liabilities	54,220	63,888	66,922	70,715	73,495
Total Equity	99,424	108,873	131,639	154,895	181,075
Total Equity & Liabilities	153,644	172,761	198,749	225,877	254,841

iQmethod SM - Bus Performance*					
Return On Capital Employed	12.2%	13.2%	18.5%	16.7%	16.3%
Return On Equity	17.4%	18.9%	25.4%	21.0%	20.1%
Operating Margin	18.7%	20.3%	27.6%	29.6%	31.7%
EBITDA Margin	22.5%	23.3%	29.1%	31.3%	33.7%

iQmethod SM - Quality of Earnings*					
Cash Realization Ratio	1.5x	1.4x	1.2x	1.2x	1.1x
Asset Replacement Ratio	0.5x	0.7x	1.3x	1.4x	1.4x
Tax Rate (Reported)	19.6%	20.7%	14.3%	20.0%	20.0%
Net Debt-to-Equity Ratio	6.2%	2.4%	-11.9%	-22.1%	-30.4%
Interest Cover	NA	NA	NA	NA	NA

Key Metrics

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Internet/e-Commerce

Company Description

NetEase was incorporated in June 1997 and listed in Nasdaq in July 2000. It provides web portal services, online value added services such as audio content, education and smart devices, eCommerce and online games business. In-house developed games include Fantasy Westward Journey, Westward Journey Online, The Ghost, Onmyoji etc. NetEase is also publishing games in overseas markets including but not limited to Japan.

Investment Rationale

We expect NetEase to maintain a solid revenue base with its existing core games, which consist mainly of high-margin self-developed games. The company has a strong cash balance that supports dividends, share buyback programs and investments. The company is on track to diversify into mobile games, and to increase revenue contribution from subscription, live broadcasting and online education. Mix shift of business segments will affect gross margins but op expenses are under control, in our view.

Stock Data

Shares / Common	0.20
Price to Book Value	3.9x

Key Changes

(CNY)	Previous	Current
Price Obj.	HK\$236.00	HK\$235.00
2023E EPS	9.56	9.38
2024E EPS	9.52	9.26
2025E EPS	10.67	10.40

Price objective basis & risk

NetEase, Inc (NTES / NETTF)

Our PO of US\$150 (HK\$236 per share) is based on 1) Core game value of US\$128 with 2024E EPS of US\$6.4 on about 20x 2024E P/E (similar to our valuation of other game businesses), and 2) asset value of US\$22 including ex-Youdao net cash, financial investments, and various investees such as DAO US based on market value for listed companies, and a 30% liquidity discount for private entities.

Risks to our PO are 1) fast deterioration of old hit games, especially key mobile games, 2) uncertainty in new games' popularity, 3) government regulation, including US delisting of ADRs and domestic policies on media, games, content and lottery ticket sales, 4) competition from mobile, console and virtual reality games, 5) value-destructive acquisitions or investment due to the large cash balance, 6) restriction in user time spent or spending in various digital entertainment including games and streaming, 7) higher costs to support new initiatives such as hardware and private label eCommerce, 8) high marketing, licensing and channel costs for various digital entertainment businesses.

Analyst Certification

I, Lei Zhang, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

APR - Internet, Media and Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Agora	API	API US	Daley Li, CFA
	AiHuiShou	RERE	RERE US	Joyce Ju
	Alibaba Group	BABA	BABA US	Joyce Ju
	Alibaba Group	BABAF	9988 HK	Joyce Ju
	Alibaba Health	ALBHF	241 HK	Miranda Zhuang, CFA
	Baidu.com	BIDU	BIDU US	Miranda Zhuang, CFA
	Baidu.com	BAIDF	9888 HK	Miranda Zhuang, CFA
	Bilibili	BILI	BILI US	Lei Zhang
	Bilibili	BLBLF	9626 HK	Lei Zhang
	CAR Group	CRSLF	CAR AU	Sriharsh Singh
	Chinasoft International	CFTLF	354 HK	Daley Li, CFA
	Cloud Music	XVWJF	9899 HK	Lei Zhang
	Com2uS Corp	XOYAF	078340 KS	Jeehoon Jeong, CFA
	DBAPPSecurity	XDBAF	688023 CH	Daley Li, CFA
	Delhivery	XDVLF	DELHIVER IN	Sachin Salgaonkar
	Dingdong	DDL	DDL US	Joyce Ju
	East Money	XEQTF	300059 CH	Michael Li
	Grab Holdings	GRAB	GRAB US	Sachin Salgaonkar
	Hello Group	MOMO	MOMO US	Lei Zhang
	Huntsun Technologies	XYTGF	600570 CH	Daley Li, CFA
	iQIYI	IQ	IQ US	Lei Zhang
	JD Health	JDHIF	6618 HK	Miranda Zhuang, CFA
	JD.com	JD	JD US	Joyce Ju
	JD.com	JDCMF	9618 HK	Joyce Ju
	Kingdee International Software	KGDEF	268 HK	Daley Li, CFA
	Kingsoft Corporation	KSFTF	3888 HK	Daley Li, CFA



APR - Internet, Media and Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Kuaishou	KUASF	1024 HK	Lei Zhang
	Makemytrip Limited	MMYT	MMYT US	Sachin Salgaonkar
	Meituan	MPNGF	3690 HK	Lei Zhang
	NetEase	NETTF	9999 HK	Lei Zhang
	NetEase, Inc	NTES	NTES US	Lei Zhang
	Nine Entertainment Company	NNMTF	NEC AU	Alice Lei, CFA
	Pinduoduo Inc.	PDD	PDD US	Joyce Ju
	Plan B Media PCL	XMKTf	PLANB TB	Thititthep Nophaket
	PT Bukalapak.com	BKLPF	BUKA IJ	Sachin Salgaonkar
	PVR-Inox Ltd	PVRLF	PVRINOX IN	Sachin Salgaonkar
	REA Group	RPGRF	REA AU	Sriharsh Singh
	Tencent Holdings	TCTZF	700 HK	Miranda Zhuang, CFA
	Tencent Music	TME	TME US	Lei Zhang
	Tencent Music	XWFWF	1698 HK	Lei Zhang
	Tongcheng Travel	TNGCF	780 HK	Janet Yang
	Trip.com Group	TCOM	TCOM US	Joyce Ju
	Trip.com Group	TRPCF	9961 HK	Joyce Ju
	TUHU Car	XTCRF	9690 HK	Miranda Zhuang, CFA
	Venustech	XVCGF	002439 CH	Daley Li, CFA
	Vipshop Holdings	VIPS	VIPS US	Joyce Ju
	Xero Limited	XROLF	XRO AU	Sriharsh Singh
	YY	YY	YY US	Lei Zhang
	Zomato Limited	XMWRF	ZOMATO IN	Sachin Salgaonkar
NEUTRAL				
	Autohome	ATHM	ATHM US	Miranda Zhuang, CFA
	Autohome	XXYZF	2518 HK	Miranda Zhuang, CFA
	Baozun	BZUN	BZUN US	Joyce Ju
	Glodon Company	XGCOF	002410 CH	Daley Li, CFA
	GoTo Group	GTOFF	GOTO IJ	Sachin Salgaonkar
	Huya	HUYA	HUYA US	Lei Zhang
	KE Holdings	BEKE	BEKE US	Miranda Zhuang, CFA
	KE Holdings	XSQRF	2423 HK	Miranda Zhuang, CFA
	Kingsoft Cloud	KC	KC US	Daley Li, CFA
	Kingsoft Cloud	KCLHF	3896 HK	Daley Li, CFA
	Nykaa	XQQGF	NYKAA IN	Sachin Salgaonkar
	PB Fintech	XPFXF	POLICYBZ IN	Sachin Salgaonkar
	Sea Limited	SE	SE US	Sachin Salgaonkar
	Seek Limited	SKLTF	SEK AU	Sriharsh Singh
	Seven West Media	WANHF	SWM AU	Alice Lei, CFA
	The ONE Enterprise	XUFCF	ONEE TB	Thititthep Nophaket
	VGI Public Company Limited	XZQHF	VGI TB	Thititthep Nophaket
	Weimob	WEMXF	2013 HK	Daley Li, CFA
	WiseTech Global Limited	WTCHF	WTC AU	Ware Kuo
	XD Inc.	XDNCF	2400 HK	Lei Zhang
	Yonyou Network	XYNIF	600588 CH	Daley Li, CFA
UNDERPERFORM				
	Appen Ltd	APPEF	APX AU	Ware Kuo
	BEC World	XBJHF	BEC TB	Thititthep Nophaket
	Douyu	DOYU	DOYU US	Lei Zhang
	Indiamart InterMesh Limited	XEITF	INMART IN	Sachin Salgaonkar
	Info Edge	IFOEF	INFOE IN	Sachin Salgaonkar
	Kingsoft Office	XBKOF	688111 CH	Daley Li, CFA
	Ming Yuan Cloud	XWTAF	909 HK	Daley Li, CFA
	NavInfo	XWLHF	002405 CH	Daley Li, CFA
	Ping An Healthcare and Technology	PANHF	1833 HK	Miranda Zhuang, CFA
	Qi An Xin	XQTDF	688561 CH	Daley Li, CFA
	Technology One Limited	THNOF	TNE AU	Ware Kuo
	ThunderSoft	XSTSf	300496 CH	Daley Li, CFA
	Weibo Corporation	WB	WB US	Miranda Zhuang, CFA
	Weibo Corporation	WEIBF	9898 HK	Miranda Zhuang, CFA
	Zee Entertainment Enterprises	XZETF	Z IN	Sachin Salgaonkar
	Zip Co Limited	ZIZTF	ZIP AU	Ware Kuo
RVW				
	AfreecaTV	WNTHF	067160 KS	Susie Lee

APR - Internet, Media and Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	CJ ENM	CJHOF	035760 KS	Susie Lee
	Coupang	CPNG	CPNG US	Susie Lee
	Dada Nexus	DADA	DADA US	Lei Zhang
	HYBE	XBGOF	352820 KS	Susie Lee
	JYP Entertainment	ALNNF	035900 KS	Susie Lee
	Kakao Corp.	DAUCF	035720 KS	Susie Lee
	Kakao Games	XKKGF	293490 KS	Susie Lee
	Krafton	XKINF	259960 KS	Susie Lee
	Naver Corporation	NHNCF	035420 KS	Susie Lee
	NCSOFT	NCSCF	036570 KS	Susie Lee
	Netmarble	XLGHF	251270 KS	Susie Lee
	Paytm	XUXBF	PAYTM IN	Sachin Salgaonkar
	PearlAbyss Corp	XEPAF	263750 KS	Susie Lee
	YG Entertainment	XYEIF	122870 KS	Susie Lee

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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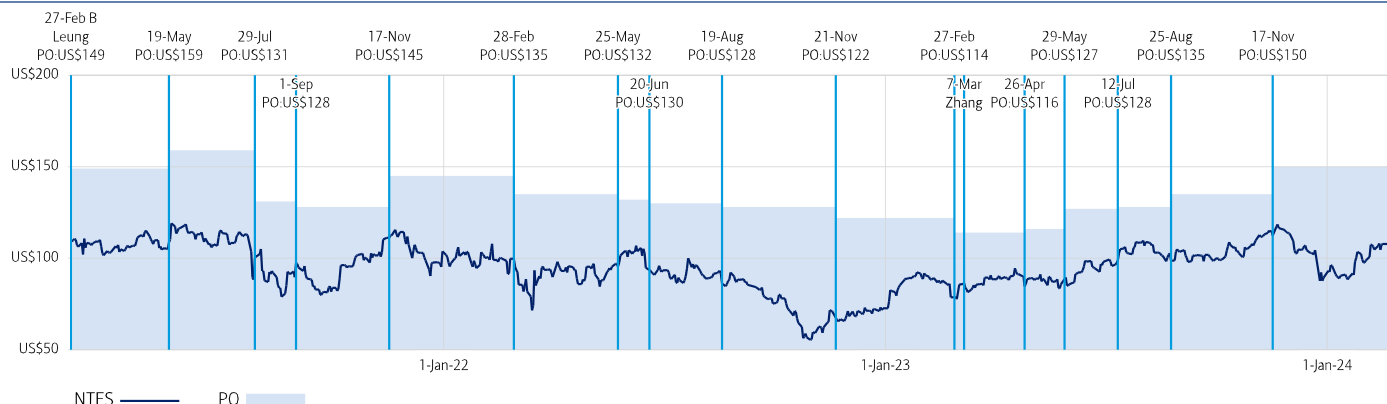
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Disclosures

Important Disclosures

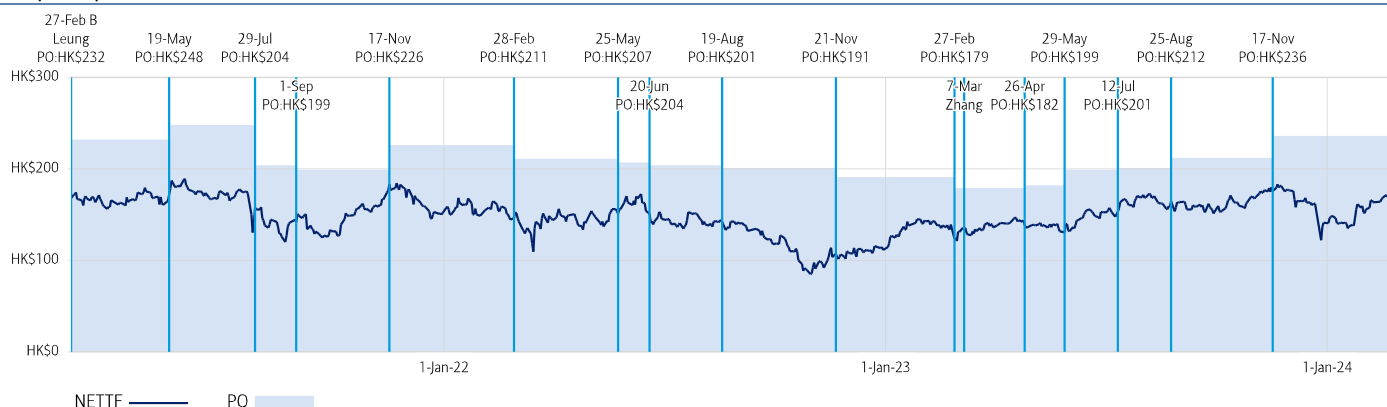
NetEase, Inc (NTES) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

NetEase (NETTF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2}Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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