

## NetEase, Inc

# Mobile game remains resilient with positive pipeline, lift payout ratio

Reiterate Rating: BUY | PO: 142.00 USD | Price: 112.28 USD

## Mobile game remains resilient, rich game pipeline

We expect NetEase's mobile game growth trend and game pipeline to remain positive, despite a reported miss for 4Q due to a low season of legacy games and higher S&M for Egg Party. We believe 29% YoY mobile game growth in 4Q23 remained resilient amid macro uncertainties and was above peers. Co has several key games in pipeline - **Condor Hero** on 28 March, **Naraka mobile** likely in 2Q24, and **Where Winds Meet** likely later this year. We also expect a successful expansion of game genre for NetEase in '23 which would bring more growth beyond MMO and potential overseas opportunities, and we expect Egg Party's good momentum during CNY (DAU over 40mn) to continue in '24E. Hence, we model decent growth in mobile game /total game rev of 13%/8% YoY in '24E amid rich pipeline. In addition, we expect co. to remain ROI focused on new game promotion and expect relatively controlled spending on party games given the good performance of Egg Party. Overall, we lower our 24-25E EPS by 8-9% post 4Q result and higher S&M on new game promotions. Our PO lowers to US\$142/HK\$223 (from US\$150/HK\$236) on the same 20x 2024E ex-cash P/E. However, we reiterate our Buy rating on positive pipeline and decent shareholder return.

## 4Q: rev miss on lower games, profit miss on higher S&M

Total revenue was RMB27.1bn (up 7% YoY), below consensus of RMB28.2b due to lower-than-expected game biz. Game rev was RMB19.5bn, down 4% QoQ & up 12% YoY, below our expectation of 17% YoY on weak PC game rev (down 23% YoY) and lowered mobile game rev (29% YoY & down 5% QoQ, vs our estimate of 35% YoY) partially due to greater declines in existing games amid the low season. GM was 62%, slightly above consensus' 61.4% on game channel optimization. Adj NP was RMB7.4bn (up 53% YoY) with NM of 27.2%, slightly below consensus' RMB7.9bn due to higher S&M expenses (up 24% YoY & up 19% QoQ). Deferred rev was down 6% QoQ & up 7% YoY, likely due to shorter defer period of new games. Co announced US\$1.08 dividend per ADS in 4Q with payout ratio up to ~75% vs. 30% in past several quarters and we expect the total shareholder return amount (div+ buyback) to continue grow in '24E.

Estimates (Dec) (CNY)	2021A	2022A	2023E	2024E	2025E
Net Income (Adjusted - mn)	16,857	19,713	29,417	26,998	30,465
EPS	25.03	29.90	45.23	41.50	46.71
EPS Change (YoY)	39.0%	19.5%	51.2%	-8.3%	12.6%
Dividend / Share	6.29	10.20	13.57	12.45	14.01
Free Cash Flow / Share	34.63	38.85	48.40	43.91	47.65
Common EPS (CNY)	5.01	5.98	9.05	8.30	9.34
Common Dividend / Share (CNY)	1.26	2.04	2.71	2.49	2.80
<b>Valuation (Dec)</b>					
P/E	28.59x	26.10x	17.61x	19.48x	17.31x
Dividend Yield	0.880%	1.31%	1.70%	1.54%	1.73%
EV / EBITDA*	25.54x	22.37x	17.15x	15.72x	13.52x
Free Cash Flow Yield*	4.34%	4.77%	5.86%	5.32%	5.79%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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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.**

12665841

Timestamp: 29 February 2024 03:30PM EST

01 March 2024

### Equity

#### Key Changes

(CNY)	Previous	Current
Price Obj.	US\$150.00	US\$142.00
2023E EPS	46.92	45.23
2024E EPS	46.31	41.50
2025E EPS	52.00	46.71

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### Stock Data

Price (ADR / Common)	112.28 USD / 176.20 HKD
Price Objective	142.00 USD / 223.00 HKD
Date Established	01-Mar-2024 / 01-Mar-2024
Investment Opinion	B-1-8 / B-1-8
52-Week Range	76.85 USD-118.90 USD
Market Value (mn)	74,621 USD
Shares Outstanding (mn)	664.6 / 3,323.0
Average Daily Value (mn)	196.63 USD
Free Float	54.9%
BofA Ticker / Exchange	NTES / NAS
BofA Ticker / Exchange	NETTF / HKG
Bloomberg / Reuters	NTES US / NTES.OQ
ROE (2023E)	24.5%
Net Dbt to Eqty (Dec-2022A)	2.4%

CNY: Chinese New Year

DAU: daily active user

ROI: return on investment

MMO: massively multiplayer online role-playing games

# iQprofile<sup>SM</sup> NetEase, Inc

Key Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(CNY Millions)					
Sales	87,606	96,496	103,468	112,514	118,163
Gross Profit	46,971	52,766	63,063	69,477	74,496
Sell General & Admin Expense	(15,254)	(16,763)	(17,618)	(20,713)	(20,503)
Operating Profit	16,417	19,629	27,709	30,083	34,816
Net Interest & Other Income	4,687	4,622	6,348	641	764
Associates	NA	NA	NA	NA	NA
Pretax Income	21,104	24,250	34,057	30,724	35,580
Tax (expense) / Benefit	(4,128)	(5,032)	(4,700)	(3,785)	(4,739)
Net Income (Adjusted)	16,857	19,713	29,417	26,998	30,465
Average Fully Diluted Shares Outstanding	674	659	650	651	652

Key Cash Flow Statement Data					
Net Income	16,857	19,713	29,417	26,998	30,465
Depreciation & Amortization	3,276	2,858	1,622	1,916	2,375
Change in Working Capital	3,188	3,497	2,529	2,277	1,970
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	1,606	1,641	59	59	(376)
Cash Flow from Operations	24,927	27,709	33,627	31,251	34,433
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)	(8,825)	(8,100)	(9,139)
Cash Flow from Financing	(12,586)	(10,238)	(8,917)	(8,079)	(9,137)
Free Cash Flow	23,325	25,609	31,483	28,571	31,083
Net Debt	6,129	2,642	(14,666)	(30,295)	(48,799)
Change in Net Debt	(3,673)	(5,546)	(17,307)	(15,629)	(18,504)

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	36,045	35,928	35,807
Trade Receivables	5,508	5,003	5,449	6,018	6,418
Cash & Equivalents	14,498	24,889	42,196	57,826	76,330
Other Current Assets	93,114	101,711	106,679	112,445	118,018
Total Assets	153,644	172,761	197,445	220,705	247,142
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	35,688	39,093	41,828
Total Liabilities	54,220	63,888	66,353	68,551	71,182
Total Equity	99,424	108,873	130,973	153,175	177,367
Total Equity & Liabilities	153,644	172,761	197,445	220,705	247,142

iQmethod <sup>SM</sup> - Bus Performance*					
Return On Capital Employed	12.2%	13.2%	17.9%	15.1%	15.0%
Return On Equity	17.4%	18.9%	24.5%	19.0%	18.4%
Operating Margin	18.7%	20.3%	26.8%	26.7%	29.5%
EBITDA Margin	22.5%	23.3%	28.3%	28.4%	31.5%

iQmethod <sup>SM</sup> - Quality of Earnings*					
Cash Realization Ratio	1.5x	1.4x	1.1x	1.2x	1.1x
Asset Replacement Ratio	0.5x	0.7x	1.3x	1.4x	1.4x
Tax Rate (Reported)	19.6%	20.7%	13.8%	12.3%	13.3%
Net Debt-to-Equity Ratio	6.2%	2.4%	-11.2%	-19.9%	-27.7%
Interest Cover	NA	NA	NA	NA	NA

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> 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	4.1x

## Key Changes

(CNY)	Previous	Current
Price Obj.	HK\$235.00	HK\$223.00
2023E EPS	9.38	9.05
2024E EPS	9.26	8.30
2025E EPS	10.40	9.34

## Price objective basis & risk

### NetEase, Inc (NTES / NETTF)

Our PO of US\$142 (HK\$223 per share) is based on 1) Core game value of US\$118 with 2024E EPS of US\$5.9 on about 20x 2024E P/E (similar to our valuation of other game businesses), and 2) asset value of US\$24 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
<b>BUY</b>				
	Agora	API	API US	Daley Li, CFA
	AiHuiShou	REER	REER 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	XWJF	9899 HK	Lei Zhang
	Com2uS Corp	XOYAF	078340 KS	Jeehoon Jeong, CFA
	DBAPPSecurity	XDBAF	688023 CH	Daley Li, CFA
	Delhivery	XDVLV	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
	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



**APR - Internet, Media and Software Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Nine Entertainment Company	NNMTF	NEC AU	Ware Kuo
	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	RGRF	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	Ware Kuo
	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	WTCF	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	XSTS F	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
	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



**APR - Internet, Media and Software Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	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

**iQmethod<sup>SM</sup> 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 &amp; 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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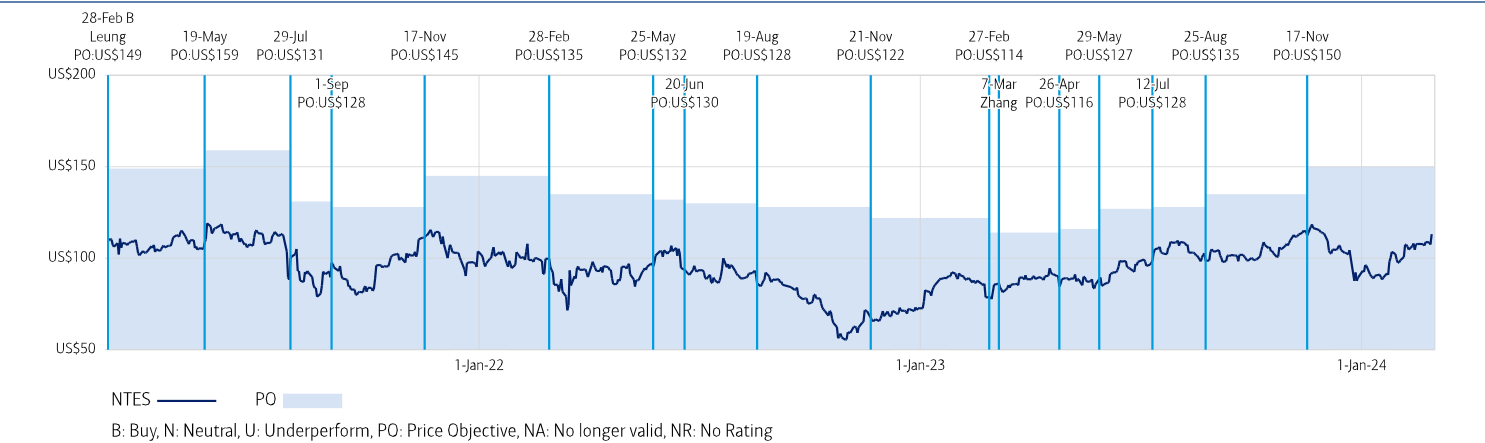
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# Disclosures

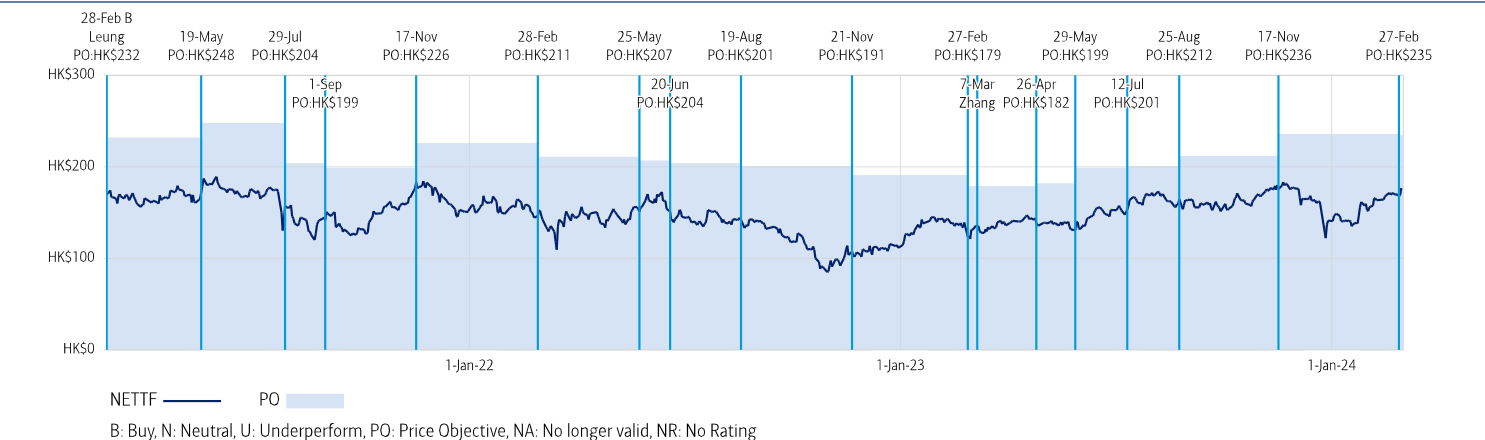
## Important Disclosures

NetEase, Inc (NTES) Price Chart



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



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.

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

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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 <sup>R1</sup>	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%

<sup>R1</sup> 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 <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup>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.

**INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

Price Charts for the securities referenced in this research report are available on the [Price Charts website](#), or call 1-800-MERRILL to have them mailed.

BofAS or one of its affiliates acts as a market maker for the equity securities recommended in the report: NetEase, Inc.

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