

NetEase, Inc.

網易 (9999.HK)

Business Overview

NetEase (“The Company”) is the second largest mobile game company in the world in terms of combined iOS and Google Play user spending in 2019, according to App Annie. NetEase currently offers over 140 mobile and PC games across a wide range of genres, satisfying the ever-growing and diversifying needs of the global gamer community. Leveraging their user insights and execution expertise, the Company also incubated and developed in-house a pipeline of innovative and successful businesses, including intelligent learning and other businesses, ranging from music streaming and private label e-commerce to internet media, e-mail services and others. As of December 31, 2019, the Company had over 1.0 billion registered e-mail users and over 800 million NetEase Cloud Music registered users. The Company also had over 100 million Youdao average MAUs in 2019.

Online Games: the Company is the second largest mobile game company in the world in terms of combined iOS and Google Play user spending in 2019, according to App Annie. Their expertise in developing and operating game content has laid the foundation for successful overseas expansion. In 2019, overseas games revenues accounted for 11% of the total games revenues. The Company generates mobile game revenues primarily from the sale of in-game virtual items within the games. The Company distributes mobile games through partnerships with major Android and iOS-based app stores as well as proprietary distribution channels, such as mobile apps and websites. The Company generates revenue from PC games mainly through sales of prepaid points.

Intelligent Learning: Youdao is an intelligent learning company in China with over 100 million average MAUs in 2019, and has achieved early success in a number of overseas markets. Starting from online knowledge tools, Youdao currently offers a comprehensive suite of learning services and products that are accessible, reliable and trustworthy. For tens of millions of people, Youdao is the go-to destination for looking up a word, translating a foreign

Basic Information

Offer Price

HK\$126

Offer Size

171,480,000 Shares, comprise of Public Offer 5,150,000 Shares and International Offer 166,330,000 Shares (subject to reallocation and Over-allotment Option)

Market Capitalization

\$432.1 billion

Application Period

2 June 2020 – 5 June 2020, Noon

Listing Date

11 June 2020

Board Lot

100 shares

Major Shareholders

Shining Globe International Ltd	44.7%
Orbis Investment Management Ltd	5.1%

Join Sponsors

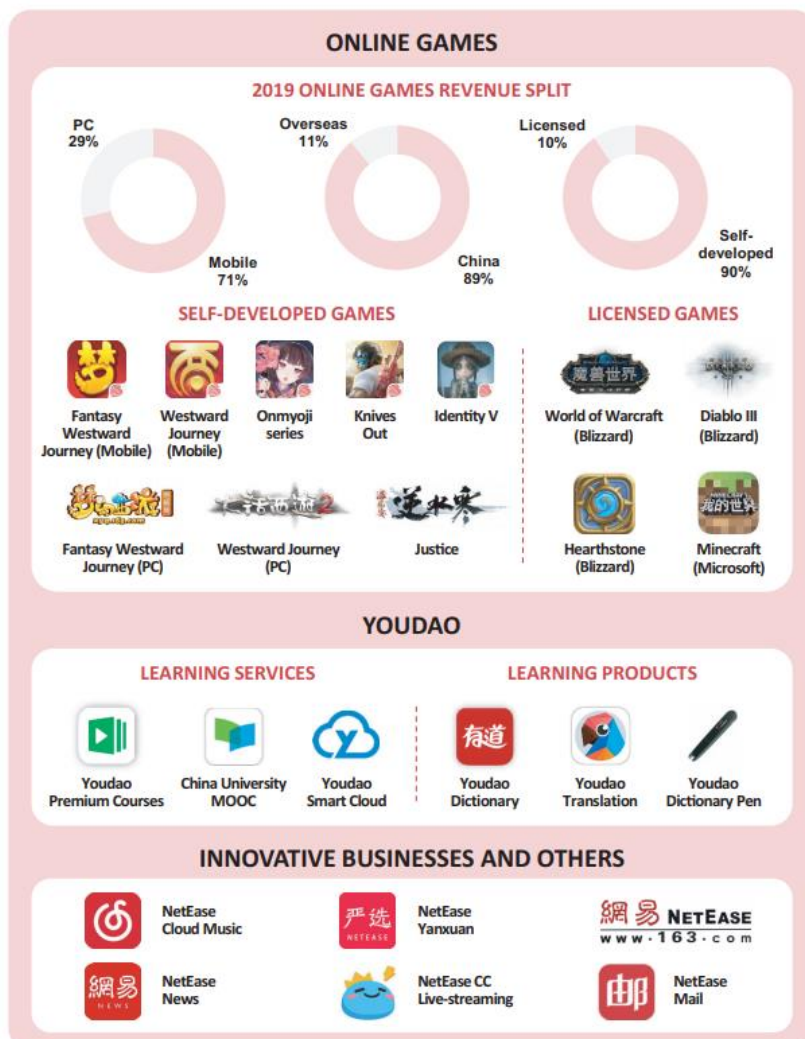
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language, preparing for an exam, or learning a new skill. The Company currently generates the majority of the revenues for Youdao’s learning services and products from its online courses in the form of the tuition fees received from students. The Company also generates revenues from Youdao’s online marketing services through the provision of different formats of advertisements.

Innovative Business and Others: the Company has incubated and developed in-house a number of innovative and thriving businesses. NetEase Cloud Music is a popular music streaming platform in China with over 800 million registered users as of December 31, 2019. It delivers a differentiated and premium user experience in terms of the music offered. NetEase Cloud Music has rapidly grown into the destination of choice for exploring new and independent music among music enthusiasts in China. Yanxuan is e-commerce platform that primarily sells private label products with a strong emphasis on quality and value for money. Product categories include apparel, homeware, kitchenware and other general merchandise which the Company primarily source from original design manufacturers in China. Products and manufacturers are carefully selected with the goal of achieving high value for money. NetEase Media is a well-established internet media platform in China delivering professional news and other quality information to users. Their media platform has three components, the NetEase News mobile application, www.163.com portal and a set of other vertical mobile products. Their media platform offers a wide range of features that promote user interactions and foster a vibrant online user community who actively contribute to the commentary sections.





Financial Highlights

Statement of Operations and Comprehensive Income Data						
For the year ended Dec 31						
	2017		2018		2019	
	in RMB thousands					
Net revenues	44,437,355	100.0%	51,178,575	100.0%	59,241,145	100.0%
COGS	(19,394,314)	43.6%	(23,832,426)	46.6%	(27,685,845)	46.7%
Gross Profit	25,043,041	56.4%	27,346,149	53.4%	31,555,300	53.3%
Selling and marketing expenses	(5,504,613)	12.4%	(6,911,710)	13.5%	(6,221,127)	10.5%
General and administrative expenses	(2,381,842)	5.4%	(3,078,635)	6.0%	(3,130,298)	5.3%
R&D	(4,161,673)	9.4%	(7,378,460)	14.4%	(8,413,224)	14.2%
Operating profit	12,994,913	29.2%	9,977,344	19.5%	13,790,651	23.3%
Other income/expenses	362,113	0.8%	(22,383)	0.0%	1,306,320	2.2%
Interest income	666,616	1.5%	586,671	1.1%	821,774	1.4%
Exchange gains/losses	(455,948)	1.0%	(51,799)	0.1%	25,166	0.0%
Other	271,885	0.6%	586,916	1.1%	439,422	0.7%
Income before tax	13,839,579	31.1%	11,076,749	21.6%	16,383,333	27.7%
Income tax	(2,155,988)	4.9%	(2,460,650)	4.8%	(2,914,726)	4.9%
Net income from continuing operations	11,683,591	26.3%	8,616,099	16.8%	13,468,607	22.7%
Income/loss from discontinued operations	(834,454)	1.9%	(2,138,682)	4.2%	7,962,519	13.4%
Net income	10,849,137	24.4%	6,477,417	12.7%	21,431,126	36.2%
Accretion and deemed dividends in connection with repurchase of redeemable noncontrolling interest	0	0.0%	(248,098)	0.5%	(271,543)	0.5%
Net income/loss attributable to noncontrolling interests and redeemable noncontrolling interests	(141,198)	0.3%	(76,912)	0.2%	77,933	0.1%
Net income attributable to NetEase, Inc.'s shareholders	10,707,939	24.1%	6,152,407	12.0%	21,237,516	35.8%
Net income from continuing operations attributable to NetEase, Inc.'s shareholders	11,542,393	26.0%	8,291,089	16.2%	13,274,997	22.4%
Net income/loss from discontinued operations attributable to NetEase, Inc.'s shareholders	(834,454)	1.9%	(2,138,682)	4.2%	7,962,519	13.4%

Use of Proceed

The company estimates that they will receive net proceeds of approximately HK\$21,279 million after deducting the underwriting fees and expenses payable by them in the Global Offering, assuming no Over-allotment Option is exercised and assuming an Offer Price of HK\$126 per Offer Share.

- approximately 45.0%, or HK\$9,575.6 million, for globalization strategies and opportunities:
 - (i) to improve global presence by expanding online game offerings in overseas markets, such as Japan, the United States, Europe and Southeast Asia and enhancing global R&D and game design capabilities
 - (ii) to explore global opportunities by investing in and collaborating with international game developers, IP and content owners
- approximately 45.0%, or HK\$9,575.6 million, for fueling continued pursuit of innovation:
 - (i) to expand and enhance innovative content offerings, and strengthen innovative technologies
 - (ii) to attract and nurture talents to support further innovation and growth
- approximately 10.0%, or HK\$2,127.8 million, for general corporate purposes:
 - (i) general corporate purposes, working capital needs and potential strategic investments and acquisitions

Risks Factors

Risks Relating to Online Game Business

- If the Company fails to develop and introduce popular, high-quality online games in a timely and successful manner, the Company will not be able to compete effectively and ability to generate revenues will suffer.
- If the Company is unable to continue to extend the life of existing online games that will encourage continued engagement with the games through the addition of new features or functionalities, business may be negatively impacted.
- Any difficulties or delays in receiving approval from the relevant government authorities for new games, or new expansion pack for or material changes to existing games, could adversely affect games' popularity and profitability.

Risks Relating to Operations Overall

- The Company may be unable to compete successfully against new entrants and established industry competitors.
- If the Company fails to keep up with rapid changes in technologies and user behavior, future success may be adversely affected.
- The Company cannot guarantee that efforts to innovate and explore new areas of operations would be successful or bring positive financial impact to the Company.
- The Company's gross profit margin and profitability may be affected by changes in the mix of revenues.
- The Company is exposed to credit risk on accounts receivable, which may be heightened during periods of uncertain economic conditions.

Risks Relating to Corporate Structure

- If the PRC government finds that the contractual arrangements with VIEs do not comply with applicable PRC laws and regulations, or if these regulations or their interpretations change in the future, the Company may be subject to penalties or be forced to relinquish interests in those operations.
- Substantial uncertainties exist with respect to how the 2019 PRC Foreign Investment Law may impact the viability of current corporate structure, corporate governance and business operations.



- The Company's contractual arrangements with VIEs may not be as effective in providing operational control as direct ownership. If the VIEs or their ultimate shareholders violate contractual arrangements with them, the business could be disrupted, the reputation may be harmed and the Company may have to resort to litigation to enforce the rights, which may be time consuming and expensive.
- The corporate structure may restrict the ability to receive dividends from, and transfer funds to, the PRC subsidiaries and VIEs, which could restrict the ability to act in response to changing market conditions and reallocate funds internally in a timely manner.
- The arrangements with certain of their affiliated entities and their respective shareholders may cause a transfer pricing adjustment and may be subject to scrutiny by the PRC tax authorities.

Risk Disclaimer

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