

NetEase Inc. (NTES US)

Looking into strong pipeline ahead

NetEase delivered a solid 4Q21 result, with inline rev (+23% YoY) and upbeat profit (+3x YoY, 86% above consensus). Game rev +30% YoY, beating our estimate. We view this result as positive and impressive among peers, coupled with its high dividend. Near-term concern might lie in deferred rev decline (-11% QoQ, due to seasonality and one-off copy sales from Naraka), suggesting a slowing 1Q22E. We suggest investors to look into its strong pipeline in 2Q22 and 2H22E, which might drive positive deferred rev growth ahead. We remain bullish on its FY22E momentum, backed by the release of major titles (e.g. Diablo: Immortal, Harry Potter (overseas version), console and mobile versions of Naraka: Bladepoint). We keep its earnings barely changed, with SOTP-based TP at US\$132.

- 4Q21 beat on profit.** 4Q21 rev was RMB24.4bn, up 23.3% YoY, 0%/-1% vs. consensus/our estimate, in which game beat while Youdao & others missed. Non-GAAP net profit surged 3x YoY to RMB6.7bn, 86%/27% above consensus/our estimate. Excluding the FV changes of equity investments, bottom line still beat our estimate. We view this result as positive, coupled with its high dividend. Near-term concern might lie in deferred rev decline (-11% QoQ, due to seasonality and one-off copy sales from Naraka), suggesting a slowing 1Q22E. We suggest investors to look into its strong pipeline in 2Q22 and 2H22E, supporting deferred rev to resume positive growth.
- Strong game pipeline ahead despite license headwinds.** Games +30% YoY in 4Q21 (vs. +15% YoY in 3Q21), PC game +35% YoY (3% above our estimate) and mobile games +22% YoY. Such upbeat performance was mainly driven by steady legacy games and strong key titles. License approvals suspension hurt sector sentiment, but NetEase showed its strong resilience backed by its strong pipeline (with licenses or overseas version). We remain bullish on its FY22E momentum, backed by the potential release of major titles: 1) Diablo: Immortal in 1H22E, 2) Harry Potter (overseas version) in this summer, in which Japan version will be published by NetEase and America/Europe by Warner Bros; 3) console and mobile versions of Naraka: Bladepoint in 22E/23E, and 4) Lord of the Rings in HK, Macau and Taiwan in 2Q22E.
- Maintain BUY.** We slightly trimmed its topline forecast but barely changed our earnings estimates, with SOTP-based TP remained at US\$132 (implying 27.6x/24.2x FY22/23E PE). Further catalysts: 1) upcoming launch of key titles and overseas expansion; and 2) game license resumption.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	73,667	87,607	99,064	109,911	121,829
YoY growth (%)	24.4	18.9	13.1	10.9	10.8
Adj. net income (RMB mn)	14,706	19,979	20,625	23,620	26,692
EPS (RMB)	22.0	29.7	30.4	34.5	38.5
YoY growth (%)	(8.9)	35.1	2.5	13.4	11.7
Consensus EPS (RMB)	NA	26.0	28.6	34.3	40.0
P/E (x)	29.4	21.7	21.2	18.7	16.7
P/S (x)	5.9	5.0	4.4	4.0	3.7
Yield (%)	5.3	1.5	7.1	1.3	1.4
ROE (%)	15.7	18.8	17.9	17.7	17.4
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIGM estimates, Bloomberg. EPS, ROE refers to adj. net income.

BUY (Maintain)

Target Price **US\$132**
 (Previous TP **US\$132**)
 Up/Downside **+32%**
 Current Price **US\$100**

China Internet Sector

Sophie Huang
 (852) 3900 0889
 sophiehuang@cmbi.com.hk

Eason Xu
 (852) 3900 0849
 easonxu@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn)	61,435
Avg 3 mths t/o (US\$ mn)	287.12
52w High/Low (US\$)	84.0/ 78.0
Total Issued Shares (mn)	671

Source: Bloomberg

Shareholding Structure

Invesco	2.98%
UBS AG	1.53%
Lei Ding	1.32%

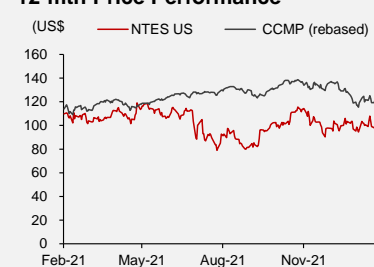
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-5.6%	-0.3%
3-mth	-17.9%	-0.7%
6-mth	7.7%	23.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

- More bullish on 4Q21E & FY22E outlook – 17 Nov 2021
- Initiation: Passion makes difference – 5 Oct 2021

Figure 1: 4Q21 financial review

RMB mn, Dec-YE	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	QoQ	YoY	Consensus	Diff %
Revenue	18,185	18,658	19,762	20,517	20,525	22,191	24,374	9.8%	23.3%	24,273	0%
Operating Profit	4,170	2,870	3,012	4,276	3,758	3,775	4,608	22.1%	53.0%	4,247	9%
Net profit	4,538	2,998	976	4,439	3,542	3,182	5,694	79.0%	483.6%	4,465	28%
Adj. net profit	5,226	3,669	1,598	5,081	4,242	3,870	6,697	73.1%	319.1%	3,605	86%
Adj. EPS (RMB)	7.96	5.35	2.34	7.47	6.26	5.76	10.08	75.1%	330.2%	5.79	74%
Margin (%)											
Gross margin	53.8%	53.0%	50.2%	53.9%	54.5%	53.2%	53.0%			51.9%	
Operating margin	22.9%	15.4%	15.2%	20.8%	18.3%	17.0%	18.9%			17.5%	
Adj. net margin	28.7%	19.7%	8.1%	24.8%	20.7%	17.4%	27.5%			14.9%	
Growth (%)											
Revenue (YoY)	25.9%	27.5%	25.6%	20.2%	12.9%	18.9%	23.3%			22.8%	
Revenue (QoQ)	6.6%	2.6%	5.9%	3.8%	0.0%	8.1%	9.8%			27.0%	
Operating Profit	12.0%	-13.9%	1.2%	-4.7%	-9.9%	31.5%	53.0%			41.0%	
Adj. net profit	33.3%	-22.4%	-56.4%	20.6%	-18.8%	5.5%	319.1%			125.6%	

Source: Company data, Bloomberg

Figure 2: 4Q21 revenue breakdown

RMB mn, Dec-YE	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	QoQ	YoY
Total revenue	18,185	18,658	19,762	20,517	20,525	22,191	24,374	10%	23%
Online game	13,828	13,862	13,400	14,982	14,528	15,899	17,398	9%	30%
Youdao	623	896	1,107	1,340	1,293	1,387	1,334	-4%	21%
Others	3,733	3,900	5,255	4,196	4,703	4,904	5,642	15%	7%

Source: Company data

Figure 3: CMBIGM estimates vs consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	99,064	109,911	121,829	101,603	115,637	125,776	-2.5%	-5.0%	-3.1%
Gross Profit	51,908	58,593	65,612	53,646	61,204	67,469	-3.2%	-4.3%	-2.8%
Operating Profit	18,326	21,334	24,313	20,123	24,269	27,639	-8.9%	-12.1%	-12.0%
Adj. net profit	20,625	23,620	26,692	20,220	23,629	28,385	2.0%	0.0%	-6.0%
EPS (RMB)	30.41	34.48	34.48	28.57	34.28	40.04	6.5%	0.6%	-13.9%
Gross Margin	52.4%	53.3%	53.9%	52.8%	52.9%	53.6%	-0.40ppts	+0.38ppts	+0.21ppts
Operating Margin	18.5%	19.4%	20.0%	19.8%	21.0%	22.0%	-1.31ppts	-1.58ppts	-2.02ppts
Net Margin	20.8%	21.5%	21.9%	19.9%	20.4%	22.6%	+0.92ppts	+1.06ppts	-0.66ppts

Source: Company data, Bloomberg, CMBIGM estimates

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	99,064	109,911	121,829	103,336	118,561	NA	-4.1%	-7.3%	NA
Gross Profit	51,908	58,593	65,612	54,971	63,278	NA	-5.6%	-7.4%	NA
Operating Profit	18,326	21,334	24,313	19,925	23,069	NA	-8.0%	-7.5%	NA
Adj. net profit	20,625	23,620	26,692	20,945	24,173	NA	-1.5%	-2.3%	NA
EPS (RMB)	30.41	34.48	34.48	30.80	35.17	NA	-1.3%	-2.0%	NA
Gross Margin	52.4%	53.3%	53.9%	53.2%	53.4%	NA	-0.80ppts	-0.09ppts	NA
Operating Margin	18.5%	19.4%	20.0%	19.3%	19.5%	NA	-0.80ppts	-0.09ppts	NA
Net Margin	20.8%	21.5%	21.9%	20.3%	20.4%	NA	+0.52ppts	+1.09ppts	NA

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenues	73,667	87,607	99,064	109,911	121,829
Online game	54,609	62,806	71,999	80,801	90,659
Youdao	3,168	5,355	5,451	5,355	5,445
Others	15,891	19,445	21,614	23,755	25,725
COGS	(34,684)	(40,635)	(47,157)	(51,318)	(56,216)
Gross profit	38,983	46,972	51,908	58,593	65,612
S&M	(10,704)	(12,214)	(13,219)	(14,666)	(16,256)
R&D	(10,369)	(14,076)	(15,632)	(17,344)	(19,224)
G&A	(3,372)	(4,264)	(4,731)	(5,249)	(5,818)
Operating profit	14,538	16,418	18,326	21,334	24,313
Other income	834	4,776	3,981	4,378	4,854
Pre-tax Income	15,372	21,194	22,307	25,712	29,168
Income Tax	(3,042)	(4,128)	(5,173)	(5,962)	(6,764)
Net income after tax	12,330	17,066	17,134	19,750	22,404
Deemed dividends	(787)	(537)	(400)	(400)	(400)
Loss to NCI	520	418	424	424	424
Net income	12,063	16,946	17,158	19,773	22,428
Adj. net profit	14,706	19,979	20,625	23,620	26,692

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	12,330	16,946	17,158	19,773	22,428
D&A	3,458	2,628	3,369	4,663	5,209
Change in WC	4,771	491	2,307	(138)	2,381
Others	4,329	3,033	3,467	3,847	4,264
Operating CF	24,888	23,099	26,302	28,146	34,281
CAPEX	(3,290)	(1,836)	(4,492)	(4,663)	(5,001)
Others	(25,902)	(7,108)	0	0	0
Investing cash flow	(29,192)	(8,944)	(4,492)	(4,663)	(5,001)
Repurchase	(11,491)	(6,671)	(6,671)	0	0
Dividends	(4,280)	(1,003)	(4,849)	(5,530)	(6,273)
Others	25,685	1,950	2,146	2,360	2,596
Financing cash flow	9,913	(5,724)	(9,375)	(3,170)	(3,677)
Net change in cash	5,609	8,430	12,435	20,313	25,604
Cash & res cash	6,398	12,169	20,599	33,033	53,346
Fx effect	162	0	0	0	0
Cash & res cash	12,169	20,599	33,033	53,346	78,950
Restrict cash	3,051	3,051	3,051	3,051	3,051
Cash and cash equivalents	9,117	17,547	29,982	50,295	78,950

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	34,044	33,251	34,375	34,375	34,166
PP&E	4,555	3,763	4,886	4,886	4,678
Land use right, net	4,178	4,178	4,178	4,178	4,178
Time deposits	6,630	6,630	6,630	6,630	6,630
Others	18,680	18,680	18,680	18,680	18,680
Current assets	107,831	122,069	135,115	158,889	185,281
Cash and cash eq.	9,117	17,547	29,982	50,295	75,899
Time deposits	71,079	78,187	78,187	78,187	78,187
Short-term investments	13,273	13,273	13,273	13,273	13,273
Other current asset	14,361	13,062	13,673	17,134	17,922
Current liabilities	46,743	47,886	52,950	58,633	64,398
AP & accrued liabilities	1,134	1,245	1,407	1,561	1,731
Salary payables	3,539	3,184	3,601	3,995	4,428
Short-term loan	19,505	21,455	23,601	25,961	28,557
Others	22,566	22,002	24,341	27,116	29,682
Non-current liabilities	1,337	1,337	1,337	1,337	1,337
Other long-term payable	624	624	624	624	624
Deferred tax liabilities	713	713	713	713	713
Shareholders' equity	93,794	106,098	115,203	133,293	153,712

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
Online game	74.1	71.7	72.7	73.5	74.4
Youdao	4.3	6.1	5.5	4.9	4.5
Others	21.6	22.2	21.8	21.6	21.1
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	24.4	18.9	13.1	10.9	10.8
Gross profit	23.6	20.5	10.5	12.9	12.0
EBIT	5.4	12.9	11.6	16.4	14.0
Adj. net profit	(6.1)	35.9	3.2	14.5	13.0
P&L ratios (%)					
Operating margin	19.7	18.7	18.5	19.4	20.0
Pre-tax margin	20.9	24.2	22.5	23.4	23.9
Adj. net margin	20.0	22.8	20.8	21.5	21.9
Effective tax rate	(19.8)	(19.5)	(23.2)	(23.2)	(23.2)
Returns (%)					
ROE	15.7	18.8	17.9	17.7	17.4
ROA	10.4	12.9	12.2	12.2	12.2
Per share					
EPS (RMB)	22.0	29.7	30.4	34.5	38.5
DPS (RMB)	5.3	1.5	7.1	1.3	1.4
BVPS (RMB)	28.0	31.5	34.0	38.9	44.4

Source: Company data, CMBIGM estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIGM

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.