

NetEase Inc. (NTES US)

Eyes on new titles launch

NetEase delivered solid 1Q22 result, with rev/adj. NP +15%/1% YoY (4%/7% above consensus). Game rev +15% YoY, beating our estimate on strong PC (+40% YoY). Deferred revenue (ex-Youdao) +3% YoY (-1% QoQ). We suggest investors to look into its strong pipeline in Jun and 2H22E, which might boost 2H22E acceleration. 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). Diablo: Immortal launch (global version on 3 Jun, China version on 23 Jun) and next batch of game license would be near term catalysts. We view NetEase as a defensive name, for its resilience on epidemic, clear drivers, better margin outlook and high dividend. We keep its earnings barely changed, with TP at US\$132.

- 1Q22 beat.** 1Q22 rev +15% YoY, 4%/0% above consensus/our estimate, in which game & others beat. Deferred rev (ex. Youdao) +3% YoY (-1% QoQ). Non-GAAP net profit +1.2% YoY to RMB5.14bn, 7%/7% above consensus/our estimate, mainly on higher-than-expected GPM and effective operating leverage. We view this result as positive, coupled with its high dividend and solid 2H22E outlook despite epidemic resurgence.
- New titles to bring further upside.** Games +15% YoY in 1Q22 (vs. +30% YoY in 4Q21), in which PC game +40% YoY (6% above our estimate, mainly on strong Naraka) and mobile games +6% YoY (moderate on flat HP). In 2Q22E, PC grossing should decline QoQ for seasonality and lockdown limits, while mobile games should give a smoother trend (Apr mobile grossing of NTES to see teens growth MoM, based on sensor tower). Looking ahead, we expect its strong pipeline to boost 2H22E acceleration, including *HP international*, *Diablo: Immortal* and console and mobile versions of *Naraka: Bladepoint*. The launch of highly-anticipated *Diablo: Immortal* (global version on 3 Jun, China version on 23 Jun) could be a further catalyst.
- Maintain BUY.** We 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) next batch of game license to release.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	73,667	87,093	98,228	109,407	121,830
YoY growth (%)	24.4	18.2	12.8	11.4	11.4
Adj. net income (RMB mn)	14,706	19,465	20,646	23,518	26,700
EPS (RMB)	22.0	28.9	30.4	34.3	38.5
YoY growth (%)	(8.9)	31.6	5.3	12.8	12.3
Consensus EPS (RMB)	NA	26.0	29.9	34.9	39.7
P/E (x)	29.1	22.1	21.0	18.6	16.6
P/S (x)	5.8	4.9	4.4	4.0	3.6
Yield (%)	0.8	1.1	1.1	1.2	1.4
ROE (%)	15.7	19.2	18.7	18.3	17.9
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	+37.5%
Current Price	US\$96.0

China Internet Sector

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Stock Data

Mkt Cap (US\$ mn)	63,624
Avg 3 mths t/o (US\$ mn)	249.88
52w High/Low (US\$)	119.6/ 68.6
Total Issued Shares (mn)	657

Source: Bloomberg

Shareholding Structure

Invesco	2.47%
UBS AG	1.47%
Lei Ding	1.35%

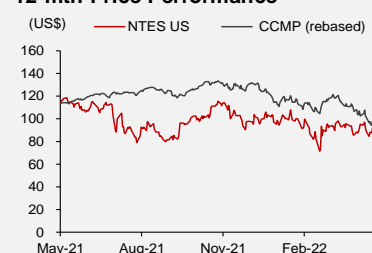
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	12.8%	27.6%
3-mth	6.0%	24.9%
6-mth	-14.5%	19.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 1Q22 financial review

RMB mn, Dec-YE	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	18,658	19,762	20,517	20,525	22,191	24,374	23,556	-3.4%	14.8%	22,592	4%	23,553	0%
Operating Profit	2,870	3,012	4,276	3,758	3,775	4,608	5,507	19.5%	28.8%	4,371	26%	5,046	9%
Net profit	2,998	976	4,439	3,542	3,182	5,694	4,394	-22.8%	-1.0%	4,120	7%	3,916	12%
Adj. net profit	3,669	1,598	5,081	4,242	3,870	6,697	5,140	-23.2%	1.2%	4,798	7%	4,660	10%
Adj. EPS (RMB)	5.35	2.34	7.47	6.26	5.76	10.08	7.75	-23.1%	3.7%	7.21	7%	7.24	7%
Margin (%)													
Gross margin	53.0%	50.2%	53.9%	54.5%	53.2%	53.0%	54.5%			53.4%		53.7%	
Operating margin	15.4%	15.2%	20.8%	18.3%	17.0%	18.9%	23.4%			19.3%		21.4%	
Adj. net margin	19.7%	8.1%	24.8%	20.7%	17.4%	27.5%	21.8%			21.2%		19.8%	
Growth (%)													
Revenue (YoY)	27.5%	25.6%	20.2%	12.9%	18.9%	23.3%	14.8%			10.1%		14.8%	
Revenue (QoQ)	2.6%	5.9%	3.8%	0.0%	8.1%	9.8%	-3.4%			9.2%		-3.4%	
Operating Profit	-13.9%	1.2%	-4.7%	-9.9%	31.5%	53.0%	28.8%			2.2%		18.0%	
Adj. net profit	-22.4%	-56.4%	20.6%	-18.8%	5.5%	319.1%	1.2%			-5.6%		-8.3%	

Source: Company data, Bloomberg, CMBIGM estimates

Figure 2: 1Q22 revenue breakdown

RMB mn, Dec-YE	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	QoQ	YoY
Total revenue	18,658	19,762	20,517	20,525	22,191	24,374	23,556	-3%	15%
Online game	13,862	13,400	14,982	14,528	15,899	17,398	17,273	-1%	15%
Youdao	896	1,107	1,340	1,293	1,387	1,334	1,201	-10%	-10%
Others	3,900	5,255	4,196	4,703	4,904	5,642	5,083	-10%	21%

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	98,228	109,407	121,830	98,514	112,006	122,026	-0.3%	-2.3%	-0.2%
Gross profit	49,092	57,994	65,369	52,391	59,883	65,800	-6.3%	-3.2%	-0.7%
Operating profit	13,117	20,143	23,373	19,574	23,455	26,908	-33.0%	-14.1%	-13.1%
Adj. net profit	20,646	23,518	26,700	20,319	23,607	26,885	1.6%	-0.4%	-0.7%
EPS (RMB)	30.44	34.33	34.33	29.86	34.88	39.72	1.9%	-1.6%	-13.6%
Gross margin	50.0%	53.0%	53.7%	52.8%	52.9%	53.6%	-2.82ppts	+0.08ppts	+0.01ppts
Operating margin	13.4%	18.4%	19.2%	19.9%	20.9%	22.1%	-6.52ppts	-2.53ppts	-2.87ppts
Net margin	21.0%	21.5%	21.9%	20.6%	21.1%	22.0%	+0.39ppts	+0.42ppts	-0.12ppts

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	98,228	109,407	121,830	99,064	109,911	121,829	-0.8%	-0.5%	0.0%
Gross profit	49,092	57,994	65,369	51,908	58,593	65,612	-5.4%	-1.0%	-0.4%
Operating profit	13,117	20,143	23,373	18,326	21,334	24,313	-28.4%	-5.6%	-3.9%
Adj. net profit	20,646	23,518	26,700	20,625	23,620	26,692	0.1%	-0.4%	0.0%
EPS (RMB)	30.44	34.33	34.33	30.41	34.48	34.48	0.1%	-0.4%	-0.4%
Gross margin	50.0%	53.0%	53.7%	52.4%	53.3%	53.9%	-2.42ppts	-0.29ppts	-0.24ppts
Operating margin	13.4%	18.4%	19.2%	18.5%	19.4%	20.0%	-5.15ppts	-0.99ppts	-0.81ppts
Net margin	21.0%	21.5%	21.9%	20.8%	21.5%	21.9%	+0.22ppts	0.00ppts	+0.02ppts

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenues	73,667	87,093	98,228	109,407	121,830
Online game	54,609	62,806	79,419	82,139	91,525
Youdao	3,168	5,070	4,293	4,831	5,508
Others	15,891	19,216	21,540	23,770	25,831
COGS	(34,684)	(40,635)	(49,136)	(51,413)	(56,461)
Gross profit	38,983	46,457	49,092	57,994	65,369
S&M	(10,704)	(12,214)	(14,248)	(14,991)	(16,632)
R&D	(10,369)	(14,076)	(16,701)	(17,572)	(19,496)
G&A	(3,372)	(4,264)	(5,027)	(5,289)	(5,868)
Operating profit	14,538	15,904	13,117	20,143	23,373
Other income	834	4,776	4,062	4,474	4,971
Pre-tax Income	15,372	20,680	17,179	24,617	28,344
Income Tax	(3,042)	(4,128)	(5,266)	(6,011)	(6,837)
Net income after tax	12,330	16,551	11,913	18,606	21,507
Deemed dividends	(787)	(537)	(400)	(400)	(400)
Loss to NCI	520	418	80	80	80
Net income	12,063	16,432	17,208	19,689	22,436
Adj. net profit	14,706	19,465	20,646	23,518	26,700

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	12,330	16,432	17,208	19,689	22,436
D&A	3,458	2,613	3,378	4,668	5,212
Change in WC	4,771	518	1,796	(163)	2,361
Others	4,329	3,033	3,438	3,829	4,264
Operating CF	24,888	22,595	25,819	28,022	34,273
CAPEX	(3,290)	(1,825)	(4,504)	(4,668)	(5,003)
Others	(25,902)	(7,108)	0	0	0
Investing cash flow	(29,192)	(8,933)	(4,504)	(4,668)	(5,003)
Repurchase	(11,491)	(6,671)	(6,671)	0	0
Dividends	(4,280)	(4,962)	(4,936)	(5,602)	(6,372)
Others	25,685	1,950	2,146	2,360	2,596
Financing cash flow	9,913	(9,683)	(9,462)	(3,242)	(3,776)
Net change in cash	5,609	3,979	11,854	20,112	25,494
Cash & res cash	6,398	12,169	16,148	28,001	48,114
Fx effect	162	0	0	0	0
Cash & res cash	12,169	16,148	28,001	48,114	73,607
Restrict cash	3,051	3,051	3,051	3,051	3,051
Cash and cash equivalents	9,117	13,096	24,950	45,062	73,607

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	34,044	33,256	34,382	34,382	34,174
PP&E	4,555	3,768	4,894	4,894	4,685
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	117,569	130,002	153,601	179,938
Cash and cash eq.	9,117	13,096	24,950	45,062	70,556
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	13,012	13,592	17,078	17,922
Current liabilities	46,743	47,862	52,384	58,066	63,867
AP & accrued liabilities	1,134	1,237	1,395	1,554	1,731
Salary payables	3,539	3,166	3,570	3,977	4,428
Short-term loan	19,505	21,455	23,601	25,961	28,557
Others	22,566	22,004	23,817	26,575	29,151
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	101,626	110,664	128,579	148,908

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
Online game	74.1	72.1	73.7	73.9	74.3
Youdao	4.3	5.8	4.4	4.4	4.5
Others	21.6	22.1	21.9	21.7	21.2
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	24.4	18.2	12.8	11.4	11.4
Gross profit	23.6	19.2	5.7	18.1	12.7
EBIT	5.4	9.4	(17.5)	53.6	16.0
Adj. net profit	(6.1)	32.4	6.1	13.9	13.5
P&L ratios (%)					
Operating margin	19.7	18.3	13.4	18.4	19.2
Pre-tax margin	20.9	23.7	17.5	22.5	23.3
Adj. net margin	20.0	22.3	21.0	21.5	21.9
Effective tax rate	(19.8)	(20.0)	(30.7)	(24.4)	(24.1)
Returns (%)					
ROE	15.7	19.2	18.7	18.3	17.9
ROA	10.4	12.9	12.6	12.5	12.5
Per share					
EPS (RMB)	22.0	28.9	30.4	34.3	38.5
DPS (RMB)	0.8	1.1	1.1	1.2	1.4
BVPS (RMB)	28.0	30.2	32.6	37.5	43.0

Source: Company data, CMBIGM estimates

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