

NetEase (NTES US)

Steady 4Q24 performance; new game titles to support FY25 revenue growth

NetEase reported 4Q24 results on 20 Feb: total revenue was down by 1.4% YoY to RMB26.7bn, largely in line with consensus estimates; operating profit grew by 13.9% YoY to RMB7.8bn, 8% ahead of consensus estimates, mainly attributable to the prudent control of S&M expenses (-33% YoY). Total revenue and operating profit grew by 2% and 7% YoY in FY24 respectively. Looking into FY25E, we expect new game titles such as *Marvel Rivals* and *Where Winds Meet* to drive reacceleration of games revenue growth. We lower our FY25-26E total revenue forecast by 2-3%, but raise FY25-26E non-GAAP net income forecast by 2-3% in view of the prudent opex control. We maintain our SOTP-derived target price of US\$125.5. Maintain BUY.

■ **Solid PC title performance supports games revenue growth.** Games & related VAS revenue grew by 1.5% YoY to RMB21.2bn in 4Q24, 2% ahead of consensus estimates thanks to strong growth of PC games revenue. PC games revenue grew by 57% YoY to RMB7.2bn in 4Q24, mainly driven by the return of Blizzard titles in China and solid performance of legacy titles. *Marvel Rivals* has accumulated over 40mn registered users and topped the Steam's global top sellers chart several times since its launch. *Where Winds Meet* also achieved initial success, with the number of PC and mobile players surpassing 15mn. Mobile games revenue declined by 11% YoY to RMB13.4bn in 4Q24, mainly due to the lack of new mobile games and the high base effect. For FY25E, several highly-anticipated titles are planned for global launch, including *Fragpunk* (Mar 2025), *Destiny: Rising* and *MARVEL Mystic Mayhem*, which should help NetEase further expand its game genres and diversify game portfolio, in our view.

■ **Non-gaming businesses to focus on quality growth.** NetEase Cloud music revenue declined by 5.3% YoY to RMB1.9bn in 4Q24, primarily due to decreased social entertainment revenue. Youdao revenue was down by 9.5% YoY to RMB1.3bn in 4Q24, as Youdao focuses on a more selective customer acquisition approach and prioritizes higher ROI engagements. Innovative business and others revenue was down by 17.0% YoY to RMB2.3bn in 4Q24, mainly attributable to decreased revenue from Yanxuan and advertising businesses.

■ **Prudent opex control bolsters OPM expansion.** NetEase's OPM improved by 3.9ppts YoY to 29.2% in 4Q24, mainly thanks to the effective control of S&M expenses (-33% YoY). We expect NetEase will continue to maintain prudent opex control and support OPM improvement in FY25E. The company had a relatively high level of shareholder return in FY24, returning RMB20.0bn (c.67/4% of net income/mkt cap) to shareholders through dividend and share buyback.

Earnings Summary

(YE 31 Dec)	FY23A	FY24A	FY25E	FY26E	FY27E
Revenue (RMB mn)	103,468	105,295	110,661	117,143	121,905
Gross margin (%)	60.9	62.5	63.4	63.5	63.6
Adjusted net profit (RMB mn)	32,608.3	33,510.6	36,036.2	38,588.6	40,520.3
YoY growth (%)	43.0	2.8	7.5	7.1	5.0
EPS (Adjusted) (RMB)	50.69	52.35	55.77	59.72	62.71
Consensus EPS (RMB)	50.69	52.35	53.68	59.25	64.35
P/S (x)	4.7	4.6	4.4	4.1	4.0
P/E (x)	16.6	16.4	15.0	14.0	13.3

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$125.50
Up/Downside 20.5%
Current Price US\$104.17

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Stock Data

Mkt Cap (US\$ mn)	66,678.2
Avg 3 mths t/o (US\$ mn)	118.4
52w High/Low (US\$)	113.14/76.28
Total Issued Shares (mn)	640.1

Source: FactSet

Shareholding Structure

William Lei Ding	44.2%
Invesco	2.2%

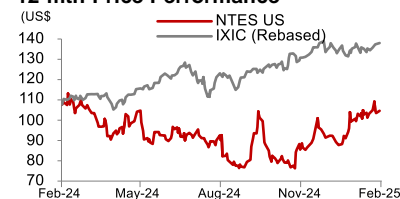
Source: Company data

Share Performance

	Absolute	Relative
1-mth	4.4%	2.2%
3-mth	19.0%	12.5%
6-mth	15.5%	2.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: NetEase: earnings revision

RMB bn	Current			Previous			Change (%)		
	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Revenue	110.7	117.1	121.9	113.2	119.6	NA	-2.2%	-2.0%	NA
Gross profit	70.2	74.4	77.6	71.6	75.9	NA	-2.0%	-1.9%	NA
Operating profit	33.7	36.8	39.5	32.9	36.3	NA	2.4%	1.5%	NA
Adjusted net profit	36.0	38.6	40.5	35.3	37.5	NA	2.0%	2.8%	NA
Adjusted EPS (RMB)	55.8	59.7	62.7	54.5	57.9	NA	2.4%	3.2%	NA
Gross margin	63.4%	63.5%	63.6%	63.3%	63.4%	NA	0.2 ppt	0.1 ppt	NA
Operating margin	30.4%	31.4%	32.4%	29.1%	30.3%	NA	1.4 ppt	1.1 ppt	NA
Adjusted net margin	32.6%	32.9%	33.2%	31.2%	31.4%	NA	1.4 ppt	1.5 ppt	NA

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB bn	CMBIGM			Consensus			Diff (%)		
	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Revenue	110.7	117.1	121.9	114.9	122.8	132.9	-3.7%	-4.6%	-8.2%
Gross profit	70.2	74.4	77.6	71.7	77.1	81.6	-2.1%	-3.5%	-5.0%
Operating profit	33.7	36.8	39.5	33.4	36.6	40.0	1.0%	0.5%	-1.1%
Adjusted net profit	36.0	38.6	40.5	34.7	37.8	39.8	3.9%	2.1%	1.7%
Adjusted EPS (RMB)	55.8	59.7	62.7	53.7	59.2	64.4	3.9%	0.8%	-2.5%
Gross margin	63.4%	63.5%	63.6%	62.4%	62.8%	61.4%	1.0 ppt	0.8 ppt	2.2 ppt
Operating margin	30.4%	31.4%	32.4%	29.0%	29.8%	30.1%	1.4 ppt	1.6 ppt	2.4 ppt
Adjusted net margin	32.6%	32.9%	33.2%	30.2%	30.8%	30.0%	2.4 ppt	2.2 ppt	3.3 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: NetEase: key financial data forecasts

(RMB mn)	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	Cons.	Diff%
Online games revenue	20,066	18,799	21,780	20,921	21,460	20,056	20,864	21,242	20,898	1.6%
YoY%	7.6%	3.6%	16.5%	9.6%	7.0%	6.7%	-4.2%	1.5%		
As % of total revenue	80.1%	78.3%	79.9%	77.1%	79.9%	78.7%	79.6%	79.4%		
Youdao revenue	1,163	1,207	1,539	1,481	1,392	1,322	1,573	1,340	1,523	-12.0%
YoY%	-3.1%	26.2%	9.7%	1.8%	19.7%	9.5%	2.2%	-9.5%		
As % of total revenue	4.6%	5.0%	5.6%	5.5%	5.2%	5.2%	6.0%	5.0%		
Cloud Music revenue	1,960	1,949	1,973	1,986	2,030	2,041	1,999	1,880	2,064	-8.9%
YoY%	-5.2%	-11.1%	-16.3%	-16.4%	3.6%	4.7%	1.3%	-5.3%		
As % of total revenue	7.8%	8.1%	7.2%	7.3%	7.6%	8.0%	7.6%	7.0%		
Innovative businesses	1,858	2,057	1,979	2,753	1,970	2,067	1,774	2,285	2,611	-12.5%
YoY%	12.8%	9.9%	0.5%	12.9%	6.1%	0.5%	-10.3%	-17.0%		
As % of total revenue	7.4%	8.6%	7.3%	10.1%	7.3%	8.1%	6.8%	8.5%		
Total revenue	25,046	24,011	27,270	27,140	26,852	25,486	26,210	26,748	27,248	-1.8%
YoY%	6.3%	3.7%	11.6%	7.0%	7.2%	6.1%	-3.9%	-1.4%		
Gross profit margin (%)	59.5%	59.9%	62.2%	62.0%	63.4%	62.9%	62.9%	60.8%		
S&M expenses ratio (%)	11.6%	13.6%	13.1%	15.6%	15.0%	13.7%	14.5%	10.5%		
R&D expenses ratio (%)	15.0%	16.3%	15.9%	16.5%	15.5%	17.5%	16.9%	16.7%		
Non-GAAP NPM (%)	30.2%	37.6%	31.7%	27.2%	31.7%	30.7%	28.6%	36.2%		
Non-GAAP net profit	7,566	9,017	8,645	7,379	8,511	7,819	7,499	9,682	8,030	20.6%
YoY%	47.8%	66.7%	15.7%	53.4%	12.5%	-13.3%	-13.3%	31.2%		

Source: Company data, CMBIGM estimates

We use sum-of-the-parts (SOTP) valuation methodology to value NetEase's four main business segments. Our SOTP-derived target price is US\$125.5, comprising:

- 1) US\$110.5 for the online game business (88.0% of total valuation), based on 15x 2025E EV/EBIT which is on par with the industry average.
- 2) US\$1.0 for Youdao (0.8% of total valuation), based on 1.4x 2025E EV/revenue, on par with the industry average;
- 3) US\$3.8 (3.0% of total valuation) for the Cloud Music business, based on 3.5x 2025E EV/revenue, on par with the industry average;
- 4) US\$1.8 (1.5% of total valuation) for the innovative businesses and others, based on 1.1x 2025E EV/revenue, on par with the industry average;
- 5) US\$8.5 for net cash.

Figure 4: NetEase: SOTP Valuation

(RMBmn)	Valuation basis	Multiple (x)	2025E sales	2025E EBIT	Valuation	Shareholding (%)	Valuation to NetEase	Valuation per ADS (US\$)
Online games	EV/EBIT	15.0	88,632	34,407	516,104	100.0%	516,104	110.5
Youdao	EV/revenue	1.4	5,907		8,270	54.2%	4,483	1.0
Cloud Music	EV/revenue	3.5	8,268		28,939	60.9%	17,621	3.8
Innovative businesses	EV/revenue	1.1	7,854		8,639	100.0%	8,639	1.8
Enterprise value							546,847	
Net cash							39,578	8.5
Equity value							586,425	
RMB/US\$							7.3	
Valuation (US\$mn)							80,332	
No. of ADSs (mn)							640	
Value per ADS (US\$)							125.5	

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games

Companies	Ticker	Price (LC)	EBIT growth (YoY %)			EV/EBIT (x)		
			FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Tencent	700 HK	497.8	19	14	12	20	18	16
Electronic Arts	EA US	129.3	11	(11)	7	14	16	15
Take Two	TTWO US	215.2	(31)	13	184	NA	NA	23
Nexon	3659 JP	2,013.0	(10)	(8)	8	9	10	9
Bandai Namco	7832 JP	4,820.0	(36)	103	(2)	33	16	16
Perfect World	002624 CH	11.6	(209)	(198)	57	NA	23	15
Sanqi Interactive	002555 CH	16.1	(20)	14	12	11	10	9
Average EV/EBIT						17	15	15

Source: Bloomberg consensus estimates, CMBIGM

Note: data as of market close on 19 Feb

Figure 6: Peer comparison: education, online music, and e-commerce

		Price	Revenue growth (YoY %)			EV/revenue (x)		
Companies	Ticker	(L)	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Education								
New Oriental	EDU US	53.7	46	16	19	1.2	1.0	0.9
TAL Education	TAL US	14.6	44	56	35	3.7	2.4	1.8
Gaotu	GOTU US	2.7	51	30	26	0.8	0.6	0.5
Average						1.9	1.4	1.0
Community								
TME	TME US	13.1	1	10	10	4.7	4.3	3.9
Spotify	SPOT US	642.7	13	17	15	7.7	6.6	5.7
BiliBili	BILI US	20.3	18	13	9	1.9	1.7	1.5
Kuaishou	1024 HK	58.9	11	11	9	1.6	1.5	1.3
Average						4.0	3.5	3.1
E-commerce								
Alibaba	BABA US	125.8	7	9	8	1.7	1.6	1.5
JD	JD US	39.2	5	6	5	0.4	0.4	0.3
Pinduoduo	PDD US	124.4	67	25	19	2.4	1.9	1.6
Vipshop	VIPS US	14.6	(4)	(0)	2	0.4	0.4	0.4
Average						1.2	1.1	0.9

Source: Bloomberg consensus estimates, CMBIGM

Note: data as of market close on 19 Feb

Risks

Decline in revenue of legacy games; intensifying competition; tightening of regulations in the gaming sector.

Financial Summary

INCOME STATEMENT	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec (RMB mn)						
Revenue	96,496	103,468	105,295	110,661	117,143	121,905
Cost of goods sold	(43,730)	(40,405)	(39,488)	(40,455)	(42,723)	(44,326)
Gross profit	52,766	63,063	65,807	70,206	74,420	77,579
Operating expenses	(33,138)	(35,354)	(36,223)	(36,518)	(37,603)	(38,034)
Selling expense	(13,403)	(13,969)	(14,148)	(14,386)	(14,994)	(15,238)
Admin expense	(4,696)	(4,900)	(4,551)	(4,426)	(4,451)	(4,510)
R&D expense	(15,039)	(16,485)	(17,525)	(17,706)	(18,157)	(18,286)
Operating profit	19,629	27,709	29,584	33,688	36,817	39,545
Investment gain/loss	54	1,307	355	284	142	114
Other gains/(losses)	847	1,054	602	0	0	0
Interest income	2,150	4,120	4,921	4,157	3,930	3,325
Foreign exchange gain/loss	1,571	(133)	255	0	0	0
Pre-tax profit	24,250	34,057	35,718	38,130	40,889	42,983
Income tax	(5,032)	(4,700)	(5,461)	(6,101)	(6,542)	(6,877)
After tax profit	19,218	29,357	30,256	32,029	34,347	36,106
Minority interest	494	59	(559)	320	343	361
Net profit	19,713	29,417	29,698	32,349	34,690	36,467
Adjusted net profit	22,808	32,608	33,511	36,036	38,589	40,520
BALANCE SHEET	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec (RMB mn)						
Current assets	131,603	142,693	153,325	181,517	210,095	239,872
Cash & equivalents	24,889	21,429	51,383	70,964	90,018	109,624
Restricted cash	2,699	2,777	3,086	3,241	3,403	3,573
Account receivables	5,003	6,422	5,669	5,839	6,057	6,177
Inventories	994	695	572	586	618	642
Prepayment	5,448	6,077	6,417	6,609	6,856	6,992
ST bank deposits	84,948	100,856	75,441	82,985	91,284	100,412
Other current assets	7,623	4,436	10,756	11,294	11,859	12,452
Non-current assets	41,158	43,232	42,667	40,982	39,568	38,370
PP&E	6,342	8,075	8,520	8,990	9,485	10,008
Other non-current assets	34,815	35,157	34,147	31,993	30,083	28,362
Total assets	172,761	185,925	195,992	222,500	249,663	278,242
Current liabilities	56,829	53,842	49,668	53,604	56,496	59,636
Short-term borrowings	23,876	19,240	11,805	14,337	14,979	16,499
Account payables	1,507	881	721	738	780	809
Tax payable	2,813	2,572	2,759	2,900	3,070	3,194
Other current liabilities	17,252	18,219	19,982	20,876	22,087	22,969
Accrued expenses	11,381	12,930	14,401	14,753	15,580	16,165
Non-current liabilities	7,059	3,998	3,830	3,981	4,210	4,375
Other non-current liabilities	7,059	3,998	3,830	3,981	4,210	4,375
Total liabilities	63,888	57,841	53,497	57,585	60,706	64,011
Total shareholders equity	104,731	124,286	138,686	161,426	185,812	211,447
Minority interest	4,142	3,798	3,809	3,488	3,145	2,784
Total equity and liabilities	172,761	185,925	195,992	222,500	249,663	278,242

CASH FLOW	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	24,250	34,057	35,718	38,130	40,889	42,983
Depreciation & amortization	2,858	3,055	2,418	4,260	4,495	4,743
Tax paid	(5,032)	(4,700)	(5,461)	(6,101)	(6,542)	(6,877)
Change in working capital	3,497	376	3,652	1,029	1,751	1,341
Others	2,135	2,543	3,351	0	0	0
Net cash from operations	27,709	35,331	39,677	37,318	40,592	42,189
Investing						
Capital expenditure	(2,602)	(4,266)	(2,192)	(4,829)	(5,092)	(5,370)
Net cash from investing	(7,370)	(17,043)	17,916	(10,511)	(11,715)	(13,100)
Financing						
Dividend paid	(6,724)	(8,014)	(11,165)	(9,609)	(10,304)	(10,832)
Net borrowings	5,119	(8,305)	(7,476)	2,532	642	1,520
Proceeds from share issues	(274)	0	0	0	0	0
Others	(8,359)	(5,148)	(8,694)	0	0	0
Net cash from financing	(10,238)	(21,467)	(27,336)	(7,077)	(9,662)	(9,312)
Net change in cash						
Cash at the beginning of the year	17,376	27,588	24,207	54,475	74,204	93,420
Exchange difference	110	(202)	11	0	0	0
Others	0	0	0	0	0	0
Cash at the end of the year	27,588	24,207	54,475	74,204	93,420	113,197
GROWTH	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec						
Revenue	10.1%	7.2%	1.8%	5.1%	5.9%	4.1%
Gross profit	12.3%	19.5%	4.4%	6.7%	6.0%	4.2%
Operating profit	19.6%	41.2%	6.8%	13.9%	9.3%	7.4%
Net profit	16.9%	49.2%	1.0%	8.9%	7.2%	5.1%
Adj. net profit	15.4%	43.0%	2.8%	7.5%	7.1%	5.0%
PROFITABILITY	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec						
Gross profit margin	54.7%	60.9%	62.5%	63.4%	63.5%	63.6%
Operating margin	20.3%	26.8%	28.1%	30.4%	31.4%	32.4%
Adj. net profit margin	23.6%	31.5%	31.8%	32.6%	32.9%	33.2%
Return on equity (ROE)	19.7%	25.7%	22.6%	21.6%	20.0%	18.4%
GEARING/LIQUIDITY/ACTIVITIES	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec						
Net debt to equity (x)	(0.8)	(0.8)	(0.8)	(0.9)	(0.9)	(0.9)
Current ratio (x)	2.3	2.7	3.1	3.4	3.7	4.0
Receivable turnover days	18.9	22.7	19.7	19.3	18.9	18.5
Payable turnover days	12.6	8.0	6.7	6.7	6.7	6.7
VALUATION	2022A	2023A	2024A	2025E	2026E	2027E
YE 31 Dec						
P/E	25.1	16.6	16.4	15.0	14.0	13.3
P/E (diluted)	25.4	16.8	16.5	15.2	14.1	13.4
P/B	4.7	3.9	3.5	3.0	2.6	2.3

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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