

Netease (NTES US)

Solid pipeline to fuel FY24 revenue growth

NetEase reported 4Q23 financial results on 29 Feb: total revenue grew by 7% YoY to RMB27.1bn, below our/consensus estimate of RMB28.8/28.2bn. Non-GAAP net income was up by 53% YoY to RMB7.4bn, but 7% shy of consensus estimate, mainly due to the higher-than-expected marketing expenses (+24% YoY). Full-year total revenue/non-GAAP net income grew by 7%/43% YoY in FY23 respectively. Game revenue growth was slower than our expectation due to soft PC games and intensified competition, and thus we slightly lower FY24-25E revenue forecast by 1-2%. Nonetheless, we are upbeat on NetEase's game pipeline and expect the company will continue to seize market share in FY24. We fine-tuned our SOTP-derived target price to US\$130.5 (previous: US\$132.5). Maintain BUY.

- **Upbeat on FY24 game pipeline despite deceleration in 4Q revenue growth.** Games & related VAS revenue grew by 10% YoY to RMB20.9bn in 4Q23, 4% below the consensus estimate. Mobile/PC/VAS revenue was +28/-21/-12% YoY respectively in 4Q23. Mobile game business remained strong, with Eggy Party's making a breakthrough of 40mn DAUs during 2024 CNY and Justice franchises reaching a new milestone of 100mn active users. With expanding user base, we expect Eggy Party's revenue to further grow YoY in FY24 despite the high base. Several highly-anticipated titles are lined up for launch in 2024, including *SheDiao (1Q24E)*, *Where Winds Meet* and *Naraka: Bladepoint Mobile (2Q24E)*. Supported by the quality game pipeline, we forecast games revenue to grow by 9% YoY in FY24E.
- **Non-gaming businesses deliver steady growth with margin improvement.** Revenue from innovative business and others was up 13% YoY to RMB2.8bn in 4Q23 (10% of total revenue), mainly due to strength in Yanxuan, which recorded double-digit YoY growth in certain e-commerce channels. Cloud music revenue dropped by 16% YoY to RMB2.0bn in 4Q23 (7% of total revenue), due to the adjustment of social entertainment business. Music GPM improved by 12.5ppt YoY to 30.3% on operating leverage and cost optimization in 4Q23. Youdao revenue grew by 2% YoY to RMB1.5bn in 4Q23 (6% of total revenue).
- **Solid GPM improvement on favourable revenue mix shift.** NetEase's GPM improved by 9.8ppt YoY to 62.0% in 4Q23, mainly due to the game margin enhancement. Games GPM was up by 10.4ppt YoY to 69.5% in 4Q23, primarily attributable to the increased revenue contribution from higher-margin channels and self-developed games. S&M expenses were up by 24% YoY in 4Q23 (3Q23/2Q23: -5/-1% YoY), as NetEase increased marketing expenditure on key title Eggy Party to fend off competition. Overall OPM improved by 7.8ppt YoY to 25.3% in 4Q23 and we expect OPM will continue to rise in FY24 on enhanced GPM and operating leverage. NetEase remains committed to shareholder return, with total dividend + share repurchase reaching RMB13.2bn in FY23 (c.3% of mkt cap).

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	96,496	103,468	112,533	118,557	122,742
YoY growth (%)	10.1	7.2	8.8	5.4	3.5
Gross margin (%)	54.7	60.9	61.5	61.7	62.0
Operating profit (RMB mn)	19,629	27,709	32,007	34,276	36,297
Adjusted net profit (RMB mn)	22,808.4	32,608.3	33,170.7	35,119.9	37,277.7
EPS (Adjusted) (RMB)	34.95	50.69	51.00	54.00	57.31
Consensus EPS (RMB)	34.95	50.69	51.28	57.16	61.99
P/E (x)	19.2	15.0	17.5	16.3	15.3

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	US\$130.50
(Previous TP)	US\$132.50
Up/Downside	16.2%
Current Price	US\$112.28

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Stock Data

Mkt Cap (US\$ mn)	72,228.8
Avg 3 mths t/o (US\$ mn)	227.4
52w High/Low (US\$)	118.47/81.41
Total Issued Shares (mn)	643.3

Source: FactSet

Shareholding Structure

William Lei Ding	44.2%
Invesco	2.2%

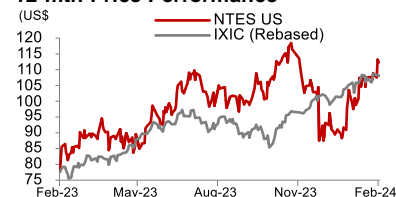
Source: Company data

Share Performance

	Absolute	Relative
1-mth	15.0%	9.3%
3-mth	-1.1%	-11.7%
6-mth	8.5%	-4.5%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: NetEase: earnings revision

RMB bn	Current			Previous			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	112.5	118.6	122.7	114.7	119.8	NA	-1.9%	-1.0%	NA
Gross profit	69.3	73.2	76.1	70.7	73.9	NA	-2.0%	-1.0%	NA
Operating profit	32.0	34.3	36.3	33.6	35.1	NA	-4.8%	-2.3%	NA
Adjusted net profit	33.2	35.1	37.3	34.4	35.6	NA	-3.5%	-1.5%	NA
Adjusted EPS (RMB)	51.0	54.0	57.3	52.8	54.7	NA	-3.3%	-1.3%	NA
Gross margin	61.5%	61.7%	62.0%	61.6%	61.7%	NA	-0.1 ppt	0.0 ppt	NA
Operating margin	28.4%	28.9%	29.6%	29.3%	29.3%	NA	-0.9 ppt	-0.4 ppt	NA
Adjusted net margin	29.5%	29.6%	30.4%	30.0%	29.8%	NA	-0.5 ppt	-0.1 ppt	NA

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB bn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	112.5	118.6	122.7	116.5	128.3	137.3	-3.4%	-7.6%	-10.6%
Gross profit	69.3	73.2	76.1	71.2	78.9	84.8	-2.7%	-7.3%	-10.3%
Operating profit	32.0	34.3	36.3	33.4	37.5	41.8	-4.0%	-8.5%	-13.2%
Adjusted net profit	33.2	35.1	37.3	33.4	37.2	41.4	-0.6%	-5.5%	-9.9%
Adjusted EPS (RMB)	51.0	54.0	57.3	51.3	57.2	62.0	-0.6%	-5.5%	-7.5%
Gross margin	61.5%	61.7%	62.0%	61.1%	61.5%	61.7%	0.4 ppt	0.2 ppt	0.2 ppt
Operating margin	28.4%	28.9%	29.6%	28.6%	29.2%	30.4%	-0.2 ppt	-0.3 ppt	-0.9 ppt
Adjusted net margin	29.5%	29.6%	30.4%	28.6%	29.0%	30.1%	0.8 ppt	0.6 ppt	0.2 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: NetEase: key financial data forecasts

(RMB mn)	4Q22	1Q23	2Q23	3Q23	4Q23	Cons.	Diff%	CMBI	Diff%
Online games revenue	19,086	20,066	18,799	21,780	20,921	21,830	-4.2%	22,732	-8.0%
YoY%	1.6%	7.6%	3.6%	16.5%	9.6%	14.4%		19.1%	
As % of total revenue	75.3%	80.1%	78.3%	79.9%	77.1%				
Youdao revenue	1,454	1,163	1,207	1,539	1,481	1,598	-7.4%	1,556	-4.8%
YoY%	9.0%	-3.1%	26.2%	9.7%	1.8%	9.9%		7.0%	
As % of total revenue	5.7%	4.6%	5.0%	5.6%	5.5%				
Cloud Music revenue	2,376	1,960	1,949	1,973	1,986	2,048	-3.0%	1,978	0.4%
YoY%	25.8%	-5.2%	-11.1%	-16.3%	-16.4%	-13.8%		-16.7%	
As % of total revenue	9.4%	7.8%	8.1%	7.2%	7.3%				
Innovative businesses	2,438	1,858	2,057	1,979	2,753	2,555	7.7%	2,506	9.9%
YoY%	3.4%	12.8%	9.9%	0.5%	12.9%	4.8%		2.8%	
As % of total revenue	9.6%	7.4%	8.6%	7.3%	10.1%				
Total revenue	25,354	25,046	24,011	27,270	27,140	28,198	-3.8%	28,772	-5.7%
YoY%	4.0%	6.3%	3.7%	11.6%	7.0%	11.2%		13.5%	
Gross profit margin (%)	52.2%	59.5%	59.9%	62.2%	62.0%				
S&M expenses ratio (%)	13.5%	11.6%	13.6%	13.1%	15.6%				
R&D expenses ratio (%)	16.1%	15.0%	16.3%	15.9%	16.5%				
Non-GAAP NPM (%)	19.0%	30.2%	37.6%	31.7%	27.2%				
Non-GAAP net profit	4,811	7,566	9,017	8,645	7,379	7,945	-7.1%	7,345	0.5%
YoY%	-27.1%	47.8%	66.7%	15.7%	53.4%	65.1%		52.7%	

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\$130.5, comprising:

- 1) US\$121.6 for the online game business (93.2% of total valuation), based on 14x 2024E EV/EBIT which is on par with the industry average;
- 2) US\$2.2 for Youdao (1.7% of total valuation), based on 3.3x 2024E EV/revenue, on par with the industry average;
- 3) US\$2.4 (1.8% of total valuation) for the Cloud Music business, based on 2.1x 2024E EV/revenue, on par with the industry average;
- 4) US\$2.1 (1.6% of total valuation) for the innovative businesses and others, based on 1.1x 2024E EV/revenue, on par with the industry average;
- 5) US\$2.2 for net cash.

Figure 4: NetEase: SOTP Valuation

(RMBmn)	Valuation basis	Multiple (x)	2024E sales	2024E EBIT	Valuation	Shareholding (%)	Valuation to NetEase	Valuation per ADS (US\$)
Online games	EV/EBIT	14.0	89,197	40,228	563,187	100.0%	563,187	121.6
Youdao	EV/revenue	3.3	5,820		19,207	54.2%	10,412	2.2
Cloud Music	EV/revenue	2.1	8,524		17,900	60.9%	10,899	2.4
Innovative businesses	EV/revenue	1.1	8,992		9,892	100.0%	9,892	2.1
Enterprise value							594,390	
Net cash							9,960	2.2
Equity value							604,350	
RMB/US\$							7.20	
Valuation (US\$mn)							83,937	
No. of ADSs (mn)							643	
Value per ADS (US\$)							130.5	

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games

Companies	Ticker	Price (LC)	EBIT growth (YoY %)			EV/EBIT (x)		
			FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Tencent	700 HK	277.0	6	17	13	14	12	11
Electronic Arts	EA US	140.1	(16)	5	6	18	17	16
Take Two	TTWO US	147.5	17	(65)	305	NA	NA	24
Nexon	3659 JP	2,426.0	20	2	14	10	10	8
Nintendo	7974 JP	8,400.0	(20)	(2)	(11)	16	16	18
Bandai Namco	7832 JP	2,893.0	5	(22)	26	12	15	12
Perfect World	002624 CH	11.3	(51)	66	26	27	16	13
37 Interactive	002555 CH	19.1	1	21	14	11	9	8
Average EV/EBIT						15	14	14

Source: Bloomberg consensus estimates, CMBIGM

Note: data as of market close on 28 Feb

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

Companies	Ticker	Price (LC)	Revenue growth (YoY %)			EV/revenue (x)		
			FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Education								
New Oriental	EDU US	91.8	(4)	40	23	3.9	2.8	2.3
TAL Education	TAL US	14.6	(77)	44	28	6.4	4.4	3.4
Gaotu	GOTU US	7.6	11	51	33	3.9	2.6	2.0
Average						4.7	3.3	2.6
Community								
TME	TME US	10.3	(7)	2	11	3.7	3.7	3.3
Spotify	SPOT US	252.3	12	17	13	3.3	2.8	2.5
BiliBili	BILI US	9.7	(2)	14	12	1.0	0.9	0.8
Kuaishou	1024 HK	44.4	17	15	12	1.4	1.2	1.1
Average						2.4	2.1	1.9
E-commerce								
Alibaba	BABA US	74.6	5	8	8	0.9	0.8	0.7
JD	JD US	22.8	(1)	7	7	0.1	0.1	0.1
Pinduoduo	PDD US	125.0	73	42	27	4.3	3.0	2.4
Vipshop	VIPS US	19.5	4	5	5	0.5	0.4	0.4
Average						1.4	1.1	0.9

Source: Bloomberg consensus estimates, CMBIGM

Note: data as of market close on 28 Feb

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	87,606	96,496	103,468	112,533	118,557	122,742
Cost of goods sold	(40,635)	(43,730)	(40,405)	(43,277)	(45,394)	(46,676)
Gross profit	46,971	52,766	63,063	69,256	73,163	76,065
Operating expenses	(30,554)	(33,138)	(35,354)	(37,248)	(38,887)	(39,768)
Selling expense	(12,214)	(13,403)	(13,969)	(14,629)	(15,175)	(15,343)
Admin expense	(4,264)	(4,696)	(4,900)	(5,064)	(5,217)	(5,278)
R&D expense	(14,076)	(15,039)	(16,485)	(17,555)	(18,495)	(19,148)
Operating profit	16,417	19,629	27,709	32,007	34,276	36,297
Investment gain/loss	2,948	54	1,307	653	327	163
Other gains/(losses)	710	847	1,054	0	0	0
Interest income	1,520	2,150	4,120	4,214	4,851	5,534
Foreign exchange gain/loss	(490)	1,571	(133)	0	0	0
Pre-tax profit	21,104	24,250	34,057	36,875	39,454	41,994
Income tax	(4,128)	(5,032)	(4,700)	(7,375)	(7,891)	(8,399)
After tax profit	16,976	19,218	29,357	29,500	31,563	33,595
Minority interest	(119)	494	59	295	316	336
Net profit	16,857	19,713	29,417	29,795	31,879	33,931
Adjusted net profit	19,762	22,808	32,608	33,171	35,120	37,278
BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	113,120	131,603	142,693	162,697	183,663	203,981
Cash & equivalents	14,498	24,889	21,429	30,114	39,139	46,633
Restricted cash	2,877	2,699	2,777	2,916	3,062	3,215
Account receivables	5,508	5,003	6,422	6,845	7,068	7,171
Inventories	965	994	695	745	781	803
Prepayment	6,236	5,448	6,077	6,477	6,687	6,785
ST bank deposits	70,755	84,948	100,856	110,942	122,036	134,239
Other current assets	12,282	7,623	4,436	4,658	4,891	5,135
Non-current assets	40,524	41,158	43,232	47,838	53,184	59,469
PP&E	5,434	6,342	8,075	10,281	13,090	16,666
Other non-current assets	35,090	34,815	35,157	37,557	40,094	42,802
Total assets	153,644	172,761	185,925	210,534	236,847	263,449
Current liabilities	50,501	56,829	53,842	57,480	61,475	64,414
Short-term borrowings	19,352	23,876	19,240	20,154	22,244	23,946
Account payables	985	1,507	881	944	990	1,018
Tax payable	4,537	2,813	2,572	2,797	2,947	3,051
Other current liabilities	16,266	17,252	18,219	19,735	20,768	21,462
Accrued expenses	9,361	11,381	12,930	13,850	14,527	14,937
Non-current liabilities	3,719	7,059	3,998	4,321	4,544	4,690
Other non-current liabilities	3,719	7,059	3,998	4,321	4,544	4,690
Total liabilities	54,220	63,888	57,841	61,801	66,019	69,104
Total shareholders equity	95,328	104,731	124,286	145,231	167,640	191,493
Minority interest	4,096	4,142	3,798	3,503	3,188	2,852
Total equity and liabilities	153,644	172,761	185,925	210,534	236,847	263,449

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	21,104	24,250	34,057	36,875	39,454	41,994
Depreciation & amortization	3,276	2,858	3,055	4,038	5,141	6,545
Tax paid	(4,128)	(5,032)	(4,700)	(7,375)	(7,891)	(8,399)
Change in working capital	3,188	3,497	376	1,851	1,437	1,014
Others	1,487	2,135	2,543	0	0	0
Net cash from operations	24,927	27,709	35,331	35,388	38,141	41,154
Investing						
Capital expenditure	(3,038)	(2,602)	(4,266)	(6,198)	(7,904)	(10,076)
Net cash from investing	(7,078)	(7,370)	(17,043)	(18,629)	(21,591)	(25,131)
Financing						
Dividend paid	(4,240)	(6,724)	(8,014)	(8,850)	(9,469)	(10,079)
Net borrowings	3,992	5,119	(8,305)	914	2,090	1,702
Proceeds from share issues	(2,297)	(274)	0	0	0	0
Others	(10,040)	(8,359)	(5,148)	0	0	0
Net cash from financing	(12,586)	(10,238)	(21,467)	(7,936)	(7,379)	(8,377)
Net change in cash						
Cash at the beginning of the year	12,169	17,376	27,588	24,207	33,030	42,200
Exchange difference	(55)	110	(202)	0	0	0
Others	0	0	0	0	0	0
Cash at the end of the year	17,376	27,588	24,207	33,030	42,200	49,848
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	18.9%	10.1%	7.2%	8.8%	5.4%	3.5%
Gross profit	20.5%	12.3%	19.5%	9.8%	5.6%	4.0%
Operating profit	12.9%	19.6%	41.2%	15.5%	7.1%	5.9%
Net profit	39.7%	16.9%	49.2%	1.3%	7.0%	6.4%
Adj. net profit	34.4%	15.4%	43.0%	1.7%	5.9%	6.1%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	53.6%	54.7%	60.9%	61.5%	61.7%	62.0%
Operating margin	18.7%	20.3%	26.8%	28.4%	28.9%	29.6%
Adj. net profit margin	22.6%	23.6%	31.5%	29.5%	29.6%	30.4%
Return on equity (ROE)	19.0%	19.7%	25.7%	22.1%	20.4%	18.9%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.7)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)
Current ratio (x)	2.2	2.3	2.7	2.8	3.0	3.2
Receivable turnover days	22.9	18.9	22.7	22.2	21.8	21.3
Payable turnover days	8.8	12.6	8.0	8.0	8.0	8.0
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	26.6	19.2	15.0	17.5	16.3	15.3
P/E (diluted)	27.0	19.4	15.1	17.6	16.5	15.5
P/B	4.7	3.6	3.5	3.6	3.1	2.7

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

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