

### COMPANY RESULTS

#### NetEase (9999 HK)

3Q22: Resilient Earnings Growth; Suspension Of Cooperation With Blizzard Hurts Sentiment

**NetEase's 3Q22 results earnings beat estimates. Revenue grew 10% yoy to Rmb24.4b, in line with consensus estimate. Non-GAAP operating profit inched up 1% yoy while Non-GAAP OPM fell 2ppt yoy to 22.6%. Non-GAAP net profit came in at Rmb7.5b, which includes Rmb2.7b investment and exchange gains due to the appreciation of the US dollar against the renminbi. Excluding the non-recurring items, net profit was in line with our estimate. Maintain HOLD with a lower target price of HK\$110.00 (US\$79.00).**

#### 3Q22 RESULTS

Year to 31 Dec (Rmbm)	3Q21	2Q22	3Q22	QoQ	YoY	UOBKH	Var	Cons	Var
Net revenue	22,191	23,159	24,427	5.5%	10.1%	24,688	(1.1%)	24,386	0.2%
Online games	17,146	18,140	18,699	3.1%	9.1%	19,149	(2.3%)		
PC games	5,281	6,149	5,872	(4.5%)	11.2%	6,606	(11.1%)		
Mobile games	11,865	11,990	12,828	7.0%	8.1%	12,542	2.3%		
Cloud Music	1,925	2,192	2,357	7.6%	22.5%	12,542	(81.2%)		
Youdao	1,387	956	1,402	46.7%	1.1%	1,249	12.3%		
Innovative business and others	1,733	1,872	1,968	5.2%	13.6%	4,291	(54.1%)		
COGS	-10,380	-10,218	-10,683	4.6%	2.9%	-10,926	(2.2%)	-11,028	(3.1%)
Gross profit	11,811	12,941	13,744	6.2%	16.4%	13,762	(0.1%)	13,358	2.9%
Non-GAAP Operating profit	4,451	5,690	5,512	(3.1%)	23.8%	5,181	6.4%	5,103	8.0%
Non-GAAP OPM	20.1%	24.6%	22.6%	-2.0 ppts	2.5 ppts	21.0%	1.6 ppts		
Non-GAAP net income	3,858	5,410	7,470	38.1%	93.6%	4,807	55.4%	4,932	51.5%
Non-GAAP NPM	17%	23%	31%	7.2 ppts	13.2 ppts	19%	11.1 ppts		
GPM	53.2%	55.9%	56.3%	0.4 ppts	3.0 ppts	55.7%	0.5 ppts	54.8%	1.5 ppts
Online games	67.3%	64.9%	65.0%	0.1 ppts	3.7 ppts	65.0%	0.0 ppts		
Youdao	56.6%	42.8%	54.2%	11.4 ppts	-2.4 ppts	45.0%	9.2 ppts		
Innovative businesses	27.2%	25.8%	25.5%	-0.2 ppts	-1.7 ppts	25.0%	0.5 ppts		
Cloud Music	2.2%	13.0%	14.2%	1.1 ppts	11.9 ppts	12.0%			

Source: NetEase, UOB Kay Hian

#### RESULTS

• **Moderated online game growth.** NetEase's online game revenue grew 9% yoy (2Q22: +25%, 3Q21: +24%) to Rmb18.7b, compared with Tencent's flattish yoy growth this quarter. Despite the Banhao suspension, NetEase delivered strong PC game revenue growth of 11.5% yoy, boosted by the strong performance from Naraka Bladepoint and Harry Potter Magic Awakened launches in the international market. Mobile game revenue went up 8% yoy, vs 17%/14% in 3Q21/2Q22 respectively and accounted for 68.6% of total online game revenue in 3Q22 (3Q21: 69.2%, 2Q22: 66.1%), mainly driven by Diablo: Immortal, Naraka: Bladepoint, Identity V and Infinite Lagrange. Gross margin for online games improved by 3.7ppt yoy to 65%. Deferred revenue increased 3% yoy and 13% qoq, pointing to a solid 4Q22 revenue growth. With the visibility of new games pipeline in 2H22 starting late-August such as HP overseas, we believe NetEase is able to break through the uncertainties under the weaker macro backdrop.

• **Cloud music margin meaningfully improved.** Cloud music revenue expanded 22% yoy to Rmb2.4b supported by the healthy growth in monthly paying users despite a weaker monthly ARPU performance. Gross margin (GPM) from the cloud music segment was 14% during 3Q22 (+12ppt yoy) as a result of enhanced content and product innovation for Cloud Music, driving solid growth in net revenues and continued margin improvement.

#### KEY FINANCIALS

Year to 31 Dec (Rmbm)	2020	2021	2022F	2023F	2024F
Net turnover	73,667	88,853	96,529	105,772	120,263
EBITDA	17,996	19,428	31,354	33,987	39,311
Operating profit	14,538	16,619	27,852	31,666	37,037
Net profit (rep./act.)	12,063	17,058	28,036	29,075	33,722
Net profit (adj.)	14,706	17,470	23,260	23,334	26,632
EPS (Fen)	439.1	518.8	704.4	706.6	806.5
PE (x)	21.5	18.2	13.4	13.4	11.7
P/B (x)	3.4	3.3	2.9	2.6	2.4
EV/EBITDA (x)	16.8	15.5	9.6	8.9	7.7
Dividend yield (%)	1.1	1.4	3.3	8.1	9.2
Net margin (%)	16.4	19.2	29.0	27.5	28.0
Net debt/(cash) to equity (%)	7.9	2.1	(12.0)	(20.5)	(29.0)
ROE (%)	14.6	18.1	27.8	26.0	27.2
Consensus net profit	-	-	20,494	23,364	26,087
UOBKH/Consensus (x)	-	-	1.13	1.00	1.02

Source: NetEase, Bloomberg, UOB Kay Hian

### HOLD

(Maintained)

Share Price	HK\$103.50
Target Price	HK\$110.00
Upside	+6.3%
(Previous TP)	HK\$123.00

#### COMPANY DESCRIPTION

NetEase, Inc. is a Chinese Internet technology company providing online services centered on content, community, communications, and commerce.

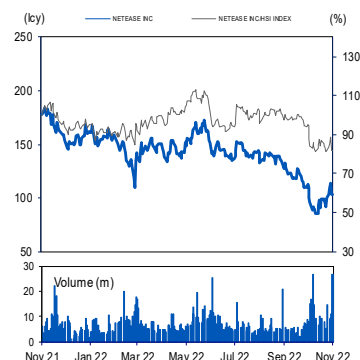
#### STOCK DATA

GICS sector	Communication Services			
Bloomberg ticker:	9999 HK			
Shares issued (m):	3,284.0			
Market cap (HK\$m):	339,893.0			
Market cap (US\$m):	43,434.6			
3-mth avg daily t'over (US\$m):	103.3			
Price Performance (%)				
52-week high/low	HK\$184.40/HK\$109.40			
1mth	3mth	6mth	1yr	YTD
(5.3)	(28.3)	(31.5)	(41.4)	(34.3)

#### Major Shareholders

Lei Ding	42.81
JPMorgan Chase & Co	3.29
BlackRock Inc	2.71
FY22 NAV/Share (Rmb)	31.30
FY22 Net Cash/Share (Rmb)	3.24

#### PRICE CHART



Source: Bloomberg

#### ANALYST(S)

**Julia Pan Meng Yao**  
+8621 5404 7225 ext 808  
juliapan@uobkayhian.com

- **Youdao's margin dragged by higher S&M spending.** Youdao's revenue grew by 1% yoy in 3Q22 (3Q21: +55%; 2Q22: -26%) to Rmb1,402m, attributed to healthy growth with increased contributions from the sales of new services and smart devices. Gross margin contracted by 2.4ppt yoy to 54% with gross profit coming in at Rmb760m in 3Q22. S&M spending as a percentage of total revenue expanded to 15% from 14% a year ago due to expanded S&M headcount for the smart learning devices team.

### STOCK IMPACT

- **Suspension partnership with Blizzard.** NetEase yesterday announced that its licences with Blizzard Entertainment, Inc. in China will expire in accordance with their terms on 23 Jan 23, and will not be renewed. The affected games are World of Warcraft, the StarCraft series, Hearthstone, Heroes of the Storm, Overwatch and Diablo III. The expiration of such licences will have no material impact on NetEase's financial results. The co-development and publishing of Diablo Immortal are covered by a separate long-term agreement and will continue. NetEase has had a partnership with Blizzard since 2008 which helps both parties achieve successful recognition and sufficient grossing in China. However, the detailed revenue sharing schemes and profit split is unacceptable for NetEase in the renewed partnership terms. We expect limited financial impact for NetEase as we estimate only about 4-5% 2022 revenue contribution from Blizzard to NetEase.
- **Management guidance and outlook.** During 3Q22, NetEase had extended the longevity of leading franchise titles including both the Fantasy Westward Journey and Westward Journey Online series, and other hit titles including Identity V and Infinite Lagrange. According to Sensor Tower's October's data the decline in Diablo Immortal and other game titles is offset by top-line growth of Onmyoji which registered a growth of 122% mom after three months of negative growth. Future games will continue to be driven by the pipeline including, content updates of Naraka: Bladepoint and the launch of Naroka mobile game, Justice mobile game and Ghost World Chronicle. There are continued preparations for the roll out of Harry Potter: Magic Awakened in international markets, which is now expected to be launched globally in 2023. Hence, we remain cautiously optimistic on the company. NetEase expects to see the release of game license approval in Nov and Dec this year after the conference. For 2023-24, the company expects to see limited block buster games as the development period of a new game could be longer than expected but management hopes for a double-digit yoy growth in game revenue in 2023 and 2024.

### EARNINGS REVISION/RISK

- We lowered our 4Q22/2022 revenue forecasts by 1.1%/0.6% factoring in the absence of new game launch risk for the company which should represent a 4%/9% yoy growth for the respective periods. We lift our earnings by 0%/13% for 4Q22/2022 on margin improvement. We expect the company's 4Q22/2022 adjusted net margin to be 21.4%/23.1% respectively which we deemed strong despite stringent cost control measures for the rest of the year.
- Risks include weaker-than-expected performance from new games, and lack of new game approval for NetEase.

### VALUATION/RECOMMENDATION

- **We maintain HOLD on the company with a lower target price of HK\$110.00 (US\$79.00),** as we lower 3% of 2023 revenue factoring in the impact from suspension of license with Blizzard. Our target price implies 13x 2023F PE, in line with the company's historical average. The company is currently trading at 14x 12-month forward PE, 0.7SD below its historical mean.

### SHARE PRICE CATALYST

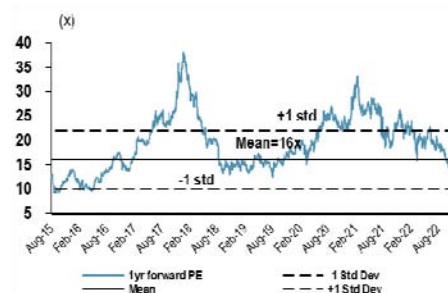
- a) Strong performance of games pipeline, and b) improving profitability of NetEase Cloud Music.

### SOTP VALUATION

	FY23E revenue (Rmb b)	Net margin	FY23E non-GAAP earnings	Valuation 2023 PE/PS	Est. fair value (Rmb b)	Fair values (HK\$)	Fair value per share (HK\$)
Online games	88	25%	22	10x	220	239.7	73
Youdao	6			3x	10	11.2	3
ecommerce Yanxuan	6	5%	0.3	8x	3	2.8	1
Innovative and others	1			2x	3	3.1	1
Total EV					236	256.7	78
Net Cash					108	106.0	32
<b>Target price (HK\$)</b>							<b>110.00</b>

Source: UOB Kay Hian

### 12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

### PROFIT & LOSS

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
Net turnover	88,853	96,529	105,772	120,263
EBITDA	19,428	31,354	33,987	39,311
Deprec. & amort.	2,809	3,502	2,321	2,274
EBIT	16,619	27,852	31,666	37,037
Total other non-operating income	220	2,832	0	0
Associate contributions	2,948	91	0	0
Net interest income/(expense)	1,520	2,077	1,833	1,833
<b>Pre-tax profit</b>	<b>21,306</b>	<b>32,851</b>	<b>33,499</b>	<b>38,870</b>
Tax	(4,128)	(5,288)	(4,904)	(5,625)
Minorities	(119)	472	479	477
<b>Net profit</b>	<b>17,058</b>	<b>28,036</b>	<b>29,075</b>	<b>33,722</b>
Net profit (adj.)	17,470	23,260	23,334	26,632

### BALANCE SHEET

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
Fixed assets	5,434	3,862	3,657	3,788
Other LT assets	35,090	35,090	35,090	35,090
LT debt	n.a.	n.a.	n.a.	n.a.
Cash/ST investment	17,375	32,086	43,370	57,332
Other current assets	95,745	94,463	95,491	97,124
<b>Total assets</b>	<b>153,644</b>	<b>165,500</b>	<b>177,608</b>	<b>193,333</b>
ST debt	19,352	19,352	19,352	19,352
Other current liabilities	31,149	32,102	33,425	35,506
Other LT liabilities	3,719	3,719	3,719	3,719
Shareholders' equity	95,473	106,376	117,162	130,805
Minority interest	3,951	3,951	3,951	3,951
<b>Total liabilities &amp; equity</b>	<b>153,644</b>	<b>165,500</b>	<b>177,608</b>	<b>193,333</b>

### CASH FLOW

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
<b>Operating</b>	<b>24,927</b>	<b>25,482</b>	<b>22,240</b>	<b>25,208</b>
Pre-tax profit	21,306	32,851	33,499	38,870
Tax	(4,128)	(5,288)	(4,904)	(5,625)
Deprec. & amort.	2,809	3,502	2,321	2,274
Working capital changes	2,511	2,236	294	449
Other operating cashflows	2,429	(7,820)	(8,970)	(10,760)
<b>Investing</b>	<b>(7,078)</b>	<b>(1,931)</b>	<b>(2,115)</b>	<b>(2,405)</b>
Capex (growth)	(1,273)	(1,931)	(2,115)	(2,405)
Others	(5,805)	0	0	0
<b>Financing</b>	<b>(12,586)</b>	<b>(8,841)</b>	<b>(8,841)</b>	<b>(8,841)</b>
Dividend payments	(8,841)	(8,841)	(8,841)	(8,841)
Issue of shares	2,140	0	0	0
Loan repayment	4,707	0	0	0
Others/interest paid	(10,593)	0	0	0
<b>Net cash inflow (outflow)</b>	<b>5,263</b>	<b>14,711</b>	<b>11,284</b>	<b>13,962</b>
Beginning cash & cash equivalent	12,169	17,375	32,086	43,370
Changes due to forex impact	(57)	0	0	0
<b>Ending cash &amp; cash equivalent</b>	<b>17,375</b>	<b>32,086</b>	<b>43,370</b>	<b>57,332</b>

### KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
<b>Profitability</b>				
EBITDA margin	21.9	32.5	32.1	32.7
Pre-tax margin	24.0	34.0	31.7	32.3
Net margin	19.2	29.0	27.5	28.0
ROA	11.5	17.6	16.9	18.2
ROE	18.1	27.8	26.0	27.2
<b>Growth</b>				
Turnover	20.6	8.6	9.6	13.7
EBITDA	8.0	61.4	8.4	15.7
Pre-tax profit	38.6	54.2	2.0	16.0
Net profit	41.4	64.4	3.7	16.0
Net profit (adj.)	18.8	33.1	0.3	14.1
EPS	18.2	35.8	0.3	14.1
<b>Leverage</b>				
Debt to total capital	16.3	14.9	13.8	12.6
Debt to equity	20.3	18.2	16.5	14.8
Net debt/(cash) to equity	2.1	(12.0)	(20.5)	(29.0)

## Disclosures/Disclaimers

This report is prepared by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser in Singapore.

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities.

**This report is prepared for general circulation.** It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. Advice should be sought from a financial adviser regarding the suitability of the investment product, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

This report is confidential. This report may not be published, circulated, reproduced or distributed in whole or in part by any recipient of this report to any other person without the prior written consent of UOBKH. This report is not directed to or intended for distribution to or use by any person or any entity who is a citizen or resident of or located in any locality, state, country or any other jurisdiction as UOBKH may determine in its absolute discretion, where the distribution, publication, availability or use of this report would be contrary to applicable law or would subject UOBKH and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by UOBKH to be reliable. However, UOBKH makes no representation as to the accuracy or completeness of such sources or the Information and UOBKH accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. UOBKH and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of UOBKH and its connected persons are subject to change without notice. UOBKH reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) UOBKH, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) UOBKH, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; (3) the officers, employees and representatives of UOBKH may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business"); and (4) UOBKH may otherwise have an interest (including a proprietary interest) in the subject corporation(s) referred to in this report.

As of the date of this report, no analyst responsible for any of the content in this report has any proprietary position or material interest in the securities of the corporation(s) which are referred to in the content they respectively author or are otherwise responsible for.

**IMPORTANT DISCLOSURES FOR U.S. PERSONS**

This research report was prepared by UOBKH, a company authorized, as noted above, to engage in securities activities in Singapore. UOBKH is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution by UOBKH (whether directly or through its US registered broker dealer affiliate named below) to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). All US persons that receive this document by way of distribution from or which they regard as being from UOBKH by their acceptance thereof represent and agree that they are a major institutional investor and understand the risks involved in executing transactions in securities.

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through UOB Kay Hian (U.S.) Inc ("UOBKHUS"), a registered broker-dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through UOBKH.

UOBKHUS accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to and intended to be received by a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of UOBKHUS and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

### Analyst Certification/Regulation AC

Each research analyst of UOBKH who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of UOBKH or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including UOBKH's total revenues, a portion of which are generated from UOBKH's business of dealing in securities.

Reports are distributed in the respective countries by the respective entities and are subject to the additional restrictions listed in the following table.

General	This report is not intended for distribution, publication to or use by any person or entity who is a citizen or resident of or located in any country or jurisdiction where the distribution, publication or use of this report would be contrary to applicable law or regulation.
Hong Kong	This report is distributed in Hong Kong by UOB Kay Hian (Hong Kong) Limited ("UOBKHHK"), which is regulated by the Securities and Futures Commission of Hong Kong. Neither the analyst(s) preparing this report nor his associate, has trading and financial interest and relevant relationship specified under Para. 16.4 of Code of Conduct in the listed corporation covered in this report. UOBKHHK does not have financial interests and business relationship specified under Para. 16.5 of Code of Conduct with the listed corporation covered in this report. Where the report is distributed in Hong Kong and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKHHK (and not the relevant foreign research house) in Hong Kong in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Hong Kong who is not a professional investor, or institutional investor, UOBKHHK accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Indonesia	This report is distributed in Indonesia by PT UOB Kay Hian Sekuritas, which is regulated by Financial Services Authority of Indonesia ("OJK"). Where the report is distributed in Indonesia and contains research analyses or reports from a foreign research house, please note recipients of the analyses or reports are to contact PT UOBKH (and not the relevant foreign research house) in Indonesia in respect of any matters arising from, or in connection with, the analysis or report.
Malaysia	Where the report is distributed in Malaysia and contains research analyses or reports from a foreign research house, the recipients of the analyses or reports are to contact UOBKHM (and not the relevant foreign research house) in Malaysia, at +603-21471988, in respect of any matters arising from, or in connection with, the analysis or report as UOBKHM is the registered person under CMSA to distribute any research analyses in Malaysia.
Singapore	This report is distributed in Singapore by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser regulated by the Monetary Authority of Singapore. Where the report is distributed in Singapore and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKH (and not the relevant foreign research house) in Singapore in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Singapore who is not an accredited investor, expert investor or institutional investor, UOBKH accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Thailand	This report is distributed in Thailand by UOB Kay Hian Securities (Thailand) Public Company Limited, which is regulated by the Securities and Exchange Commission of Thailand.
United Kingdom	This report is being distributed in the UK by UOB Kay Hian (U.K.) Limited, which is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Conduct Authority. Research distributed in the UK is intended only for institutional clients.
United States of America ('U.S.')	This report cannot be distributed into the U.S. or to any U.S. person or entity except in compliance with applicable U.S. laws and regulations. It is being distributed in the U.S. by UOB Kay Hian (US) Inc, which accepts responsibility for its contents. Any U.S. person or entity receiving this report and wishing to effect transactions in any securities referred to in the report should contact UOB Kay Hian (US) Inc. directly.

Copyright 2022, UOB Kay Hian Pte Ltd. All rights reserved.

<http://research.uobkayhian.com>

RCB Regn. No. 197000447W