招銀国际
CMB INTERNATIONAL
招商银行全资附属机构
A Wholly Owned Subsidiary Of China Merchants Bank

NetEase (NTES US)

Inline 3Q24 results; eyes on new game launch in December

BUY (Maintain)

Target Price	**US$125.50**
(Previous TP	US$130.00)
Up/Downside	**64.5%**
Current Price	**US$76.28**

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Stock Data

Mkt Cap (US$ mn)	49,089.2
Avg 3 mths t/o (US$ mn)	52.1
52w High/Low (US$)	118.47/76.28
Total Issued Shares (mn)	643.5

Source: FactSet

Shareholding Structure

William Lei Ding	44.2%
Invesco	2.2%

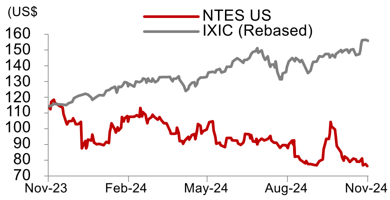
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-10.3%	-13.7%
3-mth	-13.0%	-22.2%
6-mth	-22.7%	-33.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

NetEase announced 3Q24 financial results: total revenue declined by 4% YoY to RMB26.2bn, largely in line with Bloomberg consensus estimate; operating profit was down by 5% YoY to RMB7.15bn, in line with consensus estimate of RMB7.22bn. 3Q24 revenue was down YoY, mainly due to the high-base effect and softer-than-expected performance of certain new game titles. Looking ahead, we expect the launch of *Marvel Rivals* and *Where Winds Meet* in December will be the key catalysts to watch, the performance of which shall be the key drivers of NetEase valuation and revenue growth in FY25E. We lower our FY24-26E total revenue forecast by 5-6% to reflect the softer-than-expected performance of certain new titles. We fine-tune our SOTP-derived target price to US$125.5 (previous: US$130.0). Maintain BUY.

- **Games revenue under pressure due to high-base effect.** Games & related VAS revenue declined by 4% YoY to RMB20.9bn in 3Q24. Mobile games revenue was down by 10% YoY to RMB14.3bn in 3Q24, primarily due to the high-base effect (*Justice Mobile* was launched a year ago) and limited incremental revenue contribution from new titles launched in 2024. PC games revenue grew by 29% YoY to RMB5.9bn in 3Q24, mainly driven by the relaunch of *World of Warcraft* and *Hearthstone* in China. DAUs of *World of Warcraft* and *Hearthstone* grew by 50% and over 150% respectively, compared to the levels before their shutdown. Looking ahead, the highly-anticipated titles *Where Winds Meet* and *Marvel Rivals* are both set for launch in December, which may become the key driver of games revenue growth in FY25E. The company also plans to launch a round of offline technical tests for its highly-anticipated ACG open-world title *Project Mugen* by the end of this year.
- **Steady development of non-gaming businesses.** NetEase Cloud Music revenue was up by 1% YoY to RMB2.0bn in 3Q24, underpinned by the healthy revenue growth momentum of online music business. Youdao revenue was up by 2% YoY to RMB1.6bn in 3Q24, driven by the solid revenue growth of smart devices and online marketing services, but this was partially offset by the decline in learning services revenue. Innovative business and others revenue declined by 10% YoY to RMB1.8bn in 3Q24, primarily due to decrease in advertising revenue from news media services.
- **Accelerating share repurchase to enhance shareholder return.** NetEase OPM was slightly down by 0.4ppt YoY to 27.3% in 3Q24, mainly due to the stepped-up investment in S&M and R&D expenses. The company accelerated its pace of share repurchase in 3Q24, during which 6.3mn ADSs were repurchased for a total cost of US$543mn (+98% QoQ, representing c.1% of market cap as of 14 Nov). NetEase's current valuation of 10x FY25E PE is at a 31% discount to its 2-year historical average PE, which offers attractive risk-reward in our view. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	96,496	103,468	106,020	113,155	119,557
Gross margin (%)	54.7	60.9	62.9	63.3	63.4
Adjusted net profit (RMB mn)	22,808.4	32,608.3	32,527.9	35,318.7	37,537.9
EPS (Adjusted) (RMB)	34.95	50.69	50.15	54.45	57.87
Consensus EPS (RMB)	34.95	50.69	49.90	53.31	60.73
P/S (x)	3.7	3.4	3.3	3.1	3.0
P/E (x)	18.2	12.1	12.3	11.2	10.5

Source: Company data, Bloomberg, CMBIGM estimates

Business forecasts update and valuation

Figure 1: NetEase: earnings revision

	Current			Previous			Change (%)		
RMB bn	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	106.0	113.2	119.6	111.4	119.6	127.3	-4.8%	-5.4%	-6.1%
Gross profit	66.7	71.6	75.9	70.3	76.3	81.4	-5.0%	-6.2%	-6.9%
Operating profit	29.1	32.9	36.3	31.4	35.6	39.7	-7.3%	-7.6%	-8.6%
Adjusted net profit	32.5	35.3	37.5	33.9	36.9	40.2	-4.1%	-4.2%	-6.6%
Adjusted EPS (RMB)	50.2	54.5	57.9	52.3	56.9	62.0	-4.1%	-4.2%	-6.6%
Gross margin	62.9%	63.3%	63.4%	63.1%	63.8%	64.0%	-0.1 ppt	-0.5 ppt	-0.5 ppt
Operating margin	27.4%	29.1%	30.3%	28.2%	29.8%	31.2%	-0.7 ppt	-0.7 ppt	-0.8 ppt
Adjusted net margin	30.7%	31.2%	31.4%	30.4%	30.8%	31.6%	0.2 ppt	0.4 ppt	-0.2 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

	CMBIGM			Consensus			Diff (%)		
RMB bn	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	106.0	113.2	119.6	106.9	116.2	124.8	-0.9%	-2.6%	-4.2%
Gross profit	66.7	71.6	75.9	67.0	72.9	78.8	-0.4%	-1.8%	-3.7%
Operating profit	29.1	32.9	36.3	29.7	33.7	37.0	-2.2%	-2.3%	-2.0%
Adjusted net profit	32.5	35.3	37.5	32.4	34.6	38.7	0.5%	2.1%	-2.9%
Adjusted EPS (RMB)	50.2	54.5	57.9	49.9	53.3	60.7	0.5%	2.1%	-4.7%
Gross margin	62.9%	63.3%	63.4%	62.6%	62.7%	63.1%	0.3 ppt	0.5 ppt	0.3 ppt
Operating margin	27.4%	29.1%	30.3%	27.8%	29.0%	29.7%	-0.4 ppt	0.1 ppt	0.7 ppt
Adjusted net margin	30.7%	31.2%	31.4%	30.3%	29.8%	31.0%	0.4 ppt	1.5 ppt	0.4 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: NetEase: key financial data forecasts

(RMB mn)	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	Cons.	Diff%
Online games revenue	20,066	18,799	21,780	20,921	21,460	20,056	20,864	20,711	0.7%
YoY%	7.6%	3.6%	16.5%	9.6%	7.0%	6.7%	-4.2%		
As % of total revenue	80.1%	78.3%	79.9%	77.1%	79.9%	78.7%	79.6%		
Youdao revenue	1,163	1,207	1,539	1,481	1,392	1,322	1,573	1,687	-6.8%
YoY%	-3.1%	26.2%	9.7%	1.8%	19.7%	9.5%	2.2%		
As % of total revenue	4.6%	5.0%	5.6%	5.5%	5.2%	5.2%	6.0%		
Cloud Music revenue	1,960	1,949	1,973	1,986	2,030	2,041	1,999	2,049	-2.4%
YoY%	-5.2%	-11.1%	-16.3%	-16.4%	3.6%	4.7%	1.3%		
As % of total revenue	7.8%	8.1%	7.2%	7.3%	7.6%	8.0%	7.6%		
Innovative businesses	1,858	2,057	1,979	2,753	1,970	2,067	1,774	2,066	-14.1%
YoY%	12.8%	9.9%	0.5%	12.9%	6.1%	0.5%	-10.3%		
As % of total revenue	7.4%	8.6%	7.3%	10.1%	7.3%	8.1%	6.8%		
Total revenue	**25,046**	**24,011**	**27,270**	**27,140**	**26,852**	**25,486**	**26,210**	**26,589**	-1.4%
YoY%	6.3%	3.7%	11.6%	7.0%	7.2%	6.1%	-3.9%		
Gross profit margin (%)	59.5%	59.9%	62.2%	62.0%	63.4%	62.9%	62.9%		
S&M expenses ratio (%)	11.6%	13.6%	13.1%	15.6%	15.0%	13.7%	14.5%		
R&D expenses ratio (%)	15.0%	16.3%	15.9%	16.5%	15.5%	17.5%	16.9%		
Non-GAAP NPM (%)	30.2%	37.6%	31.7%	27.2%	31.7%	30.7%	28.6%		
Non-GAAP net profit	**7,566**	**9,017**	**8,645**	**7,379**	**8,511**	**7,819**	**7,499**	**7,968**	-5.9%
YoY%	47.8%	66.7%	15.7%	53.4%	12.5%	-13.3%	-13.3%	-7.8%	

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$118.4 for the online game business (94.3% of total valuation), based on 15x 2025E EV/EBIT which is on par with the industry average.

2) US$0.7 for Youdao (0.6% of total valuation), based on 1.0x 2025E EV/revenue, on par with the industry average;

3) US$3.2 (2.6% of total valuation) for the NetEase Cloud Music business, based on 2.8x 2025E EV/revenue, on par with the industry average;

4) US$1.5 (1.2% of total valuation) for the innovative businesses and others, based on 0.8x 2025E EV/revenue, on par with the industry average;

5) US$1.7 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$)
Online games	EV/EBIT	15.0	89,332	36,626	549,394	100.0%	549,394	118.4
Youdao	EV/revenue	1.0	6,285		6,285	54.2%	3,407	0.7
Cloud Music	EV/revenue	2.8	8,721		24,418	60.9%	14,868	3.2
Innovative businesses	EV/revenue	0.8	8,817		7,053	100.0%	7,053	1.5
Enterprise value							**574,722**	
Net cash							7,752	1.7
Equity value							**582,475**	
RMB/US$							7.2	
Valuation (US$mn)							80,787	
No. of ADSs (mn)							644	
Value per ADS (US$)							**125.5**	

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games

Companies	Ticker	Price	EBIT growth (YoY %)			EV/EBIT (x)		
		(Local)	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Tencent	700 HK	403.8	20	13	9	17	15	14
Electronic Arts	EA US	162.7	11	8	2	18	17	17
Take Two	TTWO US	181.9	(31)	13	143	NA	NA	23
Nexon	3659 JP	2,137.0	4	8	5	8	7	7
Nintendo	7974 JP	8,197.0	(6)	(30)	30	16	22	17
Bandai Namco	7832 JP	3,324.0	(36)	69	0	21	12	12
Perfect World	002624 CH	12.2	NA	NA	31	NA	23	17
Sanqi Interactive	002555 CH	17.6	(16)	12	11	12	11	10
Average EV/EBIT						**15**	**15**	**15**

Source: Bloomberg consensus estimates, CMBIGM
Note: data as of market close on 13 Nov

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

Companies	Ticker	Price (Local)	Revenue growth (YoY %) FY24E	FY25E	FY26E	EV/revenue (x) FY24E	FY25E	FY26E
Education								
New Oriental	EDU US	55.4	46	21	21	1.2	1.0	0.8
TAL Education	TAL US	9.5	44	49	30	2.1	1.4	1.1
Gaotu	GOTU US	2.7	55	39	32	0.6	0.5	0.3
Average						**1.3**	**1.0**	**0.8**
Community								
TME	TME US	10.7	2	10	11	3.6	3.3	3.0
Spotify	SPOT US	467.4	16	15	13	5.4	4.7	4.1
BiliBili	BILI US	21.3	18	14	10	2.3	2.0	1.8
Kuaishou	1024 HK	52.0	12	11	10	1.4	1.3	1.1
Average						**3.2**	**2.8**	**2.5**
E-commerce								
Alibaba	BABA US	92.0	7	8	8	1.1	1.0	1.0
JD	JD US	35.7	5	6	6	0.2	0.2	0.2
Pinduoduo	PDD US	113.4	72	26	19	2.1	1.7	1.4
Vipshop	VIPS US	13.9	(4)	1	2	0.3	0.3	0.3
Average						**1.0**	**0.8**	**0.7**

Source: Bloomberg consensus estimates, CMBIGM
Note: data as of market close on 13 Nov

Risks

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

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	**87,606**	**96,496**	**103,468**	**106,020**	**113,155**	**119,557**
Cost of goods sold	(40,635)	(43,730)	(40,405)	(39,296)	(41,550)	(43,705)
Gross profit	**46,971**	**52,766**	**63,063**	**66,724**	**71,605**	**75,853**
Operating expenses	**(30,554)**	**(33,138)**	**(35,354)**	**(37,637)**	**(38,699)**	**(39,573)**
Selling expense	(12,214)	(13,403)	(13,969)	(15,479)	(16,068)	(16,499)
Admin expense	(4,264)	(4,696)	(4,900)	(4,559)	(4,526)	(4,543)
R&D expense	(14,076)	(15,039)	(16,485)	(17,599)	(18,105)	(18,531)
Operating profit	**16,417**	**19,629**	**27,709**	**29,087**	**32,906**	**36,279**
Investment gain/loss	2,948	54	1,307	1,045	836	418
Other gains/(losses)	710	847	1,054	0	0	0
Interest income	1,520	2,150	4,120	5,002	4,638	4,123
Foreign exchange gain/loss	(490)	1,571	(133)	0	0	0
Pre-tax profit	**21,104**	**24,250**	**34,057**	**35,135**	**38,380**	**40,821**
Income tax	(4,128)	(5,032)	(4,700)	(5,622)	(6,908)	(7,348)
After tax profit	**16,976**	**19,218**	**29,357**	**29,513**	**31,471**	**33,473**
Minority interest	(119)	494	59	(590)	315	335
Net profit	**16,857**	**19,713**	**29,417**	**28,923**	**31,786**	**33,808**
Adjusted net profit	**19,762**	**22,808**	**32,608**	**32,528**	**35,319**	**37,538**

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	**113,120**	**131,603**	**142,693**	**162,808**	**183,669**	**203,839**
Cash & equivalents	14,498	24,889	21,429	31,065	39,837	46,903
Restricted cash	2,877	2,699	2,777	2,916	3,062	3,215
Account receivables	5,508	5,003	6,422	6,449	6,746	6,985
Inventories	965	994	695	676	715	752
Prepayment	6,236	5,448	6,077	6,102	6,382	6,609
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**	**47,740**	**53,103**	**59,420**
PP&E	5,434	6,342	8,075	10,281	13,090	16,666
Other non-current assets	35,090	34,815	35,157	37,458	40,013	42,754
Total assets	**153,644**	**172,761**	**185,925**	**210,548**	**236,771**	**263,259**
Current liabilities	**50,501**	**56,829**	**53,842**	**57,796**	**61,736**	**64,560**
Short-term borrowings	19,352	23,876	19,240	23,313	25,113	25,955
Account payables	985	1,507	881	857	906	953
Tax payable	4,537	2,813	2,572	2,635	2,812	2,971
Other current liabilities	16,266	17,252	18,219	18,416	19,608	20,694
Accrued expenses	9,361	11,381	12,930	12,576	13,297	13,986
Non-current liabilities	**3,719**	**7,059**	**3,998**	**4,009**	**4,262**	**4,495**
Other non-current liabilities	3,719	7,059	3,998	4,009	4,262	4,495
Total liabilities	**54,220**	**63,888**	**57,841**	**61,805**	**65,998**	**69,054**
Total shareholders equity	**95,328**	**104,731**	**124,286**	**144,355**	**166,700**	**190,465**
Minority interest	4,096	4,142	3,798	4,389	4,074	3,739
Total equity and liabilities	**153,644**	**172,761**	**185,925**	**210,548**	**236,771**	**263,259**

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	**21,104**	**24,250**	**34,057**	**35,135**	**38,380**	**40,821**
Depreciation & amortization	3,276	2,858	3,055	4,038	5,141	6,545
Tax paid	(4,128)	(5,032)	(4,700)	(5,622)	(6,908)	(7,348)
Change in working capital	3,188	3,497	376	(152)	1,525	1,479
Others	1,487	2,135	2,543	0	0	0
Net cash from operations	**24,927**	**27,709**	**35,331**	**33,399**	**38,137**	**41,497**
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)**	**(18,843)**	**(21,577)**	**(25,078)**
Financing						
Dividend paid	(4,240)	(6,724)	(8,014)	(8,854)	(9,441)	(10,042)
Net borrowings	3,992	5,119	(8,305)	4,073	1,800	842
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)**	**(4,781)**	**(7,642)**	**(9,199)**
Net change in cash						
Cash at the beginning of the year	12,169	17,376	27,588	24,207	33,981	42,899
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**	**33,981**	**42,899**	**50,118**

GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	18.9%	10.1%	7.2%	2.5%	6.7%	5.7%
Gross profit	20.5%	12.3%	19.5%	5.8%	7.3%	5.9%
Operating profit	12.9%	19.6%	41.2%	5.0%	13.1%	10.3%
Net profit	39.7%	16.9%	49.2%	(1.7%)	9.9%	6.4%
Adj. net profit	34.4%	15.4%	43.0%	(0.2%)	8.6%	6.3%

PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	53.6%	54.7%	60.9%	62.9%	63.3%	63.4%
Operating margin	18.7%	20.3%	26.8%	27.4%	29.1%	30.3%
Adj. net profit margin	22.6%	23.6%	31.5%	30.7%	31.2%	31.4%
Return on equity (ROE)	19.0%	19.7%	25.7%	21.5%	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	21.7	18.2	12.1	12.3	11.2	10.5
P/E (diluted)	22.0	18.4	12.2	12.4	11.2	10.6
P/B	3.8	3.4	2.9	2.5	2.1	1.9

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

Disclosures & Disclaimers

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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
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OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
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