



網易 NETEASE
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(NTES.US) 2Q16 RESULTS: REVENUE AND EARNINGS BEAT; VR/AR DEVELOPMENT TO PROPEL FUTURE GROWTH

	2Q16	2Q15	YoY Change	QoQ Change
Net Sales (RMB Bil.)	¥8.95	¥4.57	96.0%	13.1%
Gross Margin	59.0%	62.3%	(332) bps	103 bps
Operating Margin	34.0%	31.8%	229 bps	(219) bps
SG&A/Sales	16.8%	19.7%	(284) bps	298 bps
Non-GAAP net income (RMB Bil.)	¥3.22	¥1.59	102.6%	20.8%
Non-GAAP earnings per ADS	¥24.41	¥12.02	103.1%	21.4%

Source: Company reports

- **NetEase, a leading online game service provider in China, reported second quarter revenues of ¥8.95 billion, up 96% year over year and 6% ahead of the consensus estimate. Non-GAAP earnings per American Depositary Share (ADS) was ¥24.41, up 103% year over year and beat the consensus estimate of ¥18.43.**
- **Online game service revenue increased 76% year over year to ¥6.44 billion and accounted for 72% of total revenues. Email, e-commerce and other services posted a revenue growth of 311%.**
- **During the earnings call, management guided the company will leverage on virtual reality (VR) and augmented reality (AR), invest in its core gaming platforms, and expand its advertising business and e-commerce platform to drive future growth.**

2Q16 RESULTS

NetEase reported second-quarter total revenue of ¥8.95 billion (US\$1.35 billion), up 96% year over year. Second-quarter gross profit of ¥5.28 billion was up 86% year over year as the mobile games operations outperformed. Non-GAAP earnings per ADS was ¥24.41, up 103% year over year and beat the consensus estimate of ¥18.43.

COSTS AND MARGINS

The second-quarter gross margin slipped by 3.3% to 59.0%, primarily due to the increased contribution from mobile games, which typically have lower margins. As a percentage of revenue, SG&A expenses declined to 16.8% in 2Q16, below 2Q15's 19.7%, on the back of scale effects. As a result, the operating margin increased to 34.0% from 31.8% in the year-ago period.

SEGMENT OPERATIONS

Online game service registered strong revenue growth of 76% year over year to ¥6.4 billion and accounted for 72% of total revenue. Mobile games were the primary growth driver for second-quarter revenue on the back of new game launches. Mobile game revenue jumped 182% to ¥3.92 billion and comprised 61% of total online game revenue, from just 38% a year ago. PC game revenue was up 11% year over year.



FLASH REPORT

Email, e-commerce and other revenue was ¥1.98 billion, 22% of total revenue and up 311% year over year. The year-over-year growth was driven by an increased contribution from its cross-border e-commerce platform, Kaola.com.

Advertising revenue was ¥0.53 billion, up 24% year over year and comprised 6% of total revenue. Advertising revenue growth was driven by strong demand from the auto, internet services and telecom sectors.

OUTLOOK

During the earnings conference call, management guided for the following future growth areas for the company:

- Develop VR for to enhance user experience in gaming, social broadcasting and online education. NetEase invested in NextVR, a US company that provides live VR broadcast technology, in August 2016. As the business partner of Daydream, Google's VR platform, Netease is developing and hopes to launch its first AR title by end of this year.
- Plan a diverse mobile game pipeline that explores a variety of genres, introduce mobile games which are based on its legacy titles and other licensed games
- Enhance user experience with e-commerce service. The company will further grow their cross-border e-commerce platform, Kaola.com and enhance monetization efforts for their mobile product portfolio.

Consensus estimates for 2016 are for revenues of ¥35.46billion, up 56%, and non-GAAP earnings per ADS of ¥77.7, up 38%.



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