NetEase (9999 HK)

2Q26: Resilient Game Growth And Strong Margin Expansion; Pipeline Outlook Remains Cautious

Analyst(s)

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Highlights

- NetEase's 2Q26 earnings came in within expectations. Revenue grew 7.9% yoy to Rmb30.1b. Gross profit grew 17.5% yoy to Rmb21.2b, with gross margin rising 5.8ppt yoy to 70.5%. Non-GAAP operating profit grew 28.7% yoy to Rmb12.9b, well above our estimate by 23%. Non-GAAP net profit slumped 18.7% yoy to Rmb7.7b, below our and consensus estimates. Net margin shrank 8.4ppt yoy to 26% in 2Q26.
- Maintain BUY with an unchanged target price of HK$252.00 (US$160.00).

2Q26 Results

Year to 31 Dec (Rmbm)	2Q25	1Q26	2Q26	QoQ	YoY	UOBKH	Var	Cons	Var
Net revenue	27,892	30,591	30,107	(1.6%)	7.9%	29,724	1.3%	29,447	2.2%
Online games	22,806	25,713	25,023	(2.7%)	9.7%	24,460	2.3%		
Cloud music	1,969	1,981	1,977	(0.2%)	0.4%	2,140	(7.6%)		
Youdao	1,418	1,348	1,467	8.8%	3.5%	1,559	(5.9%)		
Innovative business	1,699	1,549	1,639	5.8%	(3.5%)	1,565	4.7%		
COGS	-9,839	-9,374	-8,889	(5.2%)	(9.7%)	-9,387	(5.3%)		
Gross profit	18,052	21,217	21,217	0.0%	17.5%	20,337	4.3%	19,739	7.5%
GPM	64.7%	69.4%	70.5%	1.1 ppts	5.8 ppts	68.4%	2.1 ppts	67.0%	3.4 ppts
Non-GAAP OP	9,992	13,258	12,855	(3.0%)	28.7%	10,430	23.3%		
Non-GAAP OPM	35.8%	43.3%	42.7%	-0.6 ppts	6.9 ppts	35.1%	7.6 ppts		
Non-GAAP NP	9,532	11,275	7,747	(31.3%)	(18.7%)	10,248	(24.4%)	10,189	(24.0%)
Non-GAAP NPM	34%	37%	26%	-11.1 ppts	-8.4 ppts	34%	-8.7 ppts		
Non-GAAP diluted EPS	14.81	17.47	12.02	(31.2%)	(18.8%)	15.88	(24.3%)		

Source: NetEase, UOB Kay Hian

Analysis

- **Solid online game growth; deferred revenue acceleration supports visibility.** NetEase's online game revenue grew 10% yoy (2Q25: +14%, 1Q26: +7%) to Rmb25.7b, driven by Fantasy Westward Journey and Where Winds Meet. Gross margin for online games expanded 5.9ppt yoy to 76.1%, benefitting from a higher mix of PC/high-margin titles. Deferred revenue grew 14% yoy in 2Q26 (1Q26: 23%), supporting better revenue visibility and solid growth momentum in the coming quarters.
- **New-game pipeline outlook remains cautious; existing titles remain solid.** Ananta (无限大) remains under active development, with management set to disclose its latest progress at Gamescom, although no official launch date has been announced. Sea of Remnants had a softer-than-expected initial launch, with management acknowledging weaknesses in the early player experience. The team is responding by refining onboarding, incorporating player feedback, adding content and preparing for longer-term operations; an overseas rollout is unlikely in the near term as management prioritises improvements to the domestic version first. Meanwhile, existing titles remain resilient, with Eggy Party delivering a strong summer performance and Sword of Justice reaching a two-year high of concurrent users following its anniversary update.

Key Financials

Year to 31 Dec (Rmbm)	2024	2025	2026F	2027F	2028F
Net turnover	105,295	112,648	121,655	130,851	140,242
EBITDA	37,663	43,094	53,423	53,463	59,801
Operating profit	34,853	40,847	50,916	51,169	57,346
Net profit (rep./act.)	34,966	38,772	41,735	42,225	47,394
Net profit (adj.)	33,511	37,344	39,705	45,362	50,757
EPS	1,037.2	1,159.6	1,228.8	1,403.9	1,570.9
PE	16.0	14.3	13.5	11.8	10.6
P/B	3.8	3.3	5,594.5	15.5	7.2
EV/EBITDA	13.8	12.1	9.7	9.7	8.7
Dividend yield	2.2	1.8	2.1	2.4	2.7
Net margin	33.2	34.4	34.3	32.3	33.8
Net debt/(cash) to equity	(30.7)	(28.1)	(15,439.4)	(15.1)	(60.4)
ROE	26.6	25.9	52.0	245.3	87.8
Consensus net profit	-	-	38,841.8	43,180.4	47,259.7
UOBKH/Consensus (x)	-	-	1.02	1.05	1.07

Source; NetEase, Bloomberg, UOB Kay Hian

BUY (Maintained)

Share Price	HK$193.40
Target Price	HK$252.00
Upside	30.3%

Stock Data

Sector	Communication Services
Bloomberg ticker	9999 HK
Shares issued (m)	3,201.3
Market cap (US$m)	619,121.9
Market cap (US$m)	78,935.4
3-mth avg daily t'over (US$m)	229.8

Price Performance (%)

52-week high/low HK$248.00/HK$168.80

1mth	3mth	6mth	1yr	YTD
(8.3)	7.2	3.3	(4.1)	(9.9)

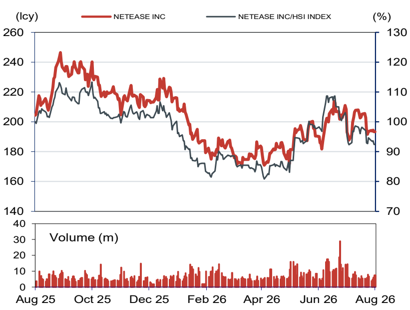
Major Shareholders (%)

Lei Ding	44.1
JP Morgan Chase & Co	3.4
BlackRock Inc	2.9

Balance Sheet Metrics

FY26 NAV/Share (Rmb$)	0.03
FY26 Net Debt/Share (Rmb$)	4.58

Price Chart



Source: Bloomberg

Company Description

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

- **Stable Cloud Music; steady Youdao growth with margin expansion.** Cloud Music revenue remained flattish with a 0.4% yoy growth (2Q25: -4%; 1Q26: 7%) to Rmb2b, supported by continued growth in membership subscriptions and improved music-oriented monetisation. Gross margin of the cloud music segment was 37.4% in 2Q26 (+1.3ppt yoy). Youdao revenue grew steadily by 3% yoy in 2Q26 (2Q25: +7%; 1Q26: +4%) to Rmb1.5b, supported by higher revenue from learning services. Youdao's gross margin rose 5.9ppt yoy to 48.9%, with gross profit coming in at Rmb717m for 2Q26. In addition, revenue of the innovative business and others fell 4% yoy to Rmb1.6b.
- **Margin overview.** Gross margin expanded 5.8ppt yoy to 70.5% in 2Q26, with games and VAS gross margin reaching 76.1% (+5.9ppt yoy), primarily driven by lower platform revenue-sharing costs. S&M expenses accounted for 12.2% of revenue vs 12.8% in 2Q25, while R&D remained broadly stable at 15.4% vs 15.6%, reflecting continued investment in innovation and content development. Adjusted operating profit increased 28.7% yoy to Rmb12.9b, with margin expanding to 42.7%. However, non-GAAP net profit declined 18.7% yoy to Rmb7.7b, primarily due to investment losses, while the effective tax rate increased to 25.5%.
- **2H26 outlook remains portfolio-driven rather than dependent on major new launches**. Management provided no top-down guidance for bookings, revenue or S&M, reiterating its focus on long-term user experience rather than quarterly monetisation targets. Existing franchises including Fantasy Westward Journey, Eggy Party, Marvel Rivals and Naraka: Bladepoint should provide support, while Where Winds Meet overseas engagement has stabilised after its initial launch peak.
- **Consistent shareholder returns.** NetEase declared a 2Q26 dividend of US$0.096/share (US$0.480/ADS), implying a payout ratio of around 30%. During the reporting period, the company repurchased 2.8m ADSs for US$324m, bringing cumulative repurchases under its current programme to 24.9m ADSs for a total cost of US$2.3b as of Jun 26. NetEase's US$5.0b share repurchase programme has been extended to Jan 29, providing continued flexibility for shareholder returns.

Valuation/Recommendation

- Maintain BUY with an unchanged target price of HK$252.00 (US$160.00). Our target price implies 18x 2026F PE, in view of the promising game pipeline and AI adoption progress. The company is currently trading at 14x 2026F PE, lower than its historical mean of 15x.

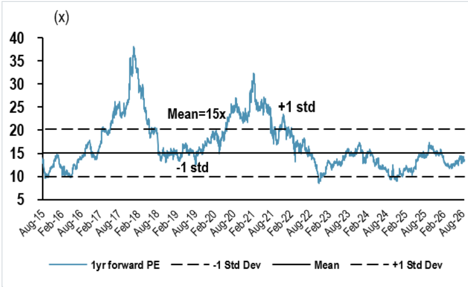
Earnings Revision/Risk

- We keep our 3Q26 revenue and non-GAAP net profit estimates largely unchanged, which implies revenue growth of 8% yoy, in view of solid online games deferred revenue. We keep our 2026 revenue estimate unchanged but cut non-GAAP net profit by 6.4% to Rmb39.7b, translating to a net margin of 33% respectively.
- Risks include weaker-than-expected performance of new games and uncertain performance of evergreen games.

Share Price Catalyst

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

12-Month Forward PE Band



Source: Bloomberg

SOTP-Based Valuation

	2027F revenue (Rmb b)	Net margin	2027F non-GAAP earnings	Valuation (2027) PE/PS (x)	Est fair value (Rmb b)	Fair values (HK$)	Fair value per share (HK$)
Online games	116	31%	35%	15	531	578	179
Cloud music	9			3	26	28	9
Youdao	7			3	12	13	4
Innovative and others	7			1	7	8	2
Total EV					577	627	194
Net Cash					171	187	58
Target price (HK$)							252.00

Source: NetEase, UOB Kay Hian

Profit & Loss

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Net turnover	112,647.9	121,654.7	130,851.5	140,242.0
EBITDA	43,094.3	53,422.9	53,463.4	59,800.9
Deprec. & amort.	2,247.4	2,506.6	2,294.2	2,455.1
EBIT	40,846.8	50,916.3	51,169.2	57,345.8
Total other non-operating income	310.6	(393.9)	(393.9)	(393.9)
Associate contributions	731.5	(1,948.2)	(1,948.2)	(1,948.2)
Net interest income/(expense)	3,953.5	3,692.6	3,712.6	3,732.6
Pre-tax profit	45,842.4	52,266.8	52,539.7	58,736.3
Tax	(6,032.7)	(9,848.7)	(9,457.1)	(10,572.5)
Minorities	(1,038.0)	(683.5)	(857.5)	(769.4)
Net profit	38,771.8	41,734.5	42,225.0	47,394.3
Net profit (adj.)	37,343.7	39,705.4	45,361.9	50,756.9

Balance Sheet

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Fixed assets	8,425.3	8,180.3	8,503.1	8,852.8
Other LT assets	32,374.3	31,964.2	31,964.2	31,964.2
Cash/ST investment	51,487.2	27,262.0	17,793.6	57,113.1
Other current assets	129,128.2	164,801.6	167,201.4	168,162.4
Total assets	221,415.1	232,208.1	225,462.3	266,092.5
ST debt	6,384.4	12,604.2	12,604.2	12,604.2
Other current liabilities	45,984.5	43,014.0	41,618.7	42,925.8
LT debt	0.0	0.0	0.0	0.0
Other LT liabilities	3,942.1	5,028.3	5,028.3	5,028.3
Shareholders' equity	160,387.4	94.9	34,336.8	73,660.0
Minority interest	4,716.6	4,376.2	4,376.2	4,376.2
Total liabilities & equity	221,415.1	65,117.6	97,964.2	138,594.5

Cash Flow

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Operating	50,739.8	38,540.2	41,581.7	50,965.0
Profit fo the year	45,842.4	52,266.8	52,539.7	58,736.3
Tax	(6,032.7)	(9,848.7)	(9,457.1)	(10,572.5)
Deprec. & amort.	2,247.4	2,506.6	2,294.2	2,455.1
Associates	(731.5)	1,948.2	1,948.2	1,948.2
Working capital changes	7,094.0	(1,508.6)	(3,795.0)	346.1
Non-cash items	0.0	0.0	0.0	0.0
Other operating cashflows	2,320.1	(6,824.1)	(1,948.2)	(1,948.2)
Investing	(33,181.3)	(29,819.2)	(3,228.1)	(2,804.8)
Capex (growth)	(2,253.0)	(2,433.1)	(2,617.0)	(2,804.8)
Investment	0.0	0.0	0.0	0.0
Others	(30,928.4)	(27,386.1)	(611.1)	0.0
Financing	(20,159.8)	(71,927.6)	(8,840.6)	(8,840.6)
Dividend payments	(8,840.6)	(8,840.6)	(8,840.6)	(8,840.6)
Proceeds from borrowings	0.0	0.0	0.0	0.0
Loan repayment	3,096.3	(726.1)	0.0	0.0
Others/interest paid	(14,415.5)	(62,360.9)	0.0	0.0
Net cash inflow (outflow)	(2,601.3)	(63,206.6)	29,512.9	39,319.5
Beginning cash & cash equivalent	54,469.7	51,487.2	(11,719.3)	17,793.6
Changes due to forex impact	(381.1)	0.0	0.0	0.0
Ending cash & cash equivalent	51,487.2	(11,719.3)	17,793.6	57,113.1

Key Metric

Year to 31 Dec (%)	2025	2026F	2027F	2028F
Profitability				
EBITDA margin	38.3	43.9	40.9	42.6
Pre-tax margin	40.7	43.0	40.2	41.9
Net margin	34.4	34.3	32.3	33.8
ROA	18.6	18.4	18.5	19.3
ROE	25.9	52.0	245.3	87.8
Growth				
Turnover	7.0	8.0	7.6	7.2
EBITDA	14.4	24.0	0.1	11.9
Pre-tax profit	11.8	14.0	0.5	11.8
Net profit	10.9	7.6	1.2	12.2
Net profit (adj.)	11.4	6.3	14.2	11.9
EPS	11.8	6.0	14.2	11.9
Leverage				
Debt to total capital	3.7	73.8	24.6	13.9
Debt to equity	4.0	13,276.2	36.7	17.1
Net debt/(cash) to equity	(28.1)	(15,439.4)	(15.1)	(60.4)