

August 14, 2022 09:00 PM GMT

China Online Entertainment | Asia Pacific

Limited Recovery

Amid subpar China macro recovery, we prefer companies with 1) market share gain, and 2) strong profitability/margin improvement in 2H22. NetEase and Kuaishou are our only OWs in China online entertainment.

WHAT'S CHANGED?	Weibo Corp (WB.O)	From:	To:
	Price Target		US\$27.00
	NetEase, Inc (NTES.O)		
Price Target		US\$125.00	US\$110.00

Given our China economists' view of a subpar and bumpy recovery for China's macro economy in 2H22 ([report \(27 Jul\)](#)), our 2H22 and 2023 estimates are below consensus for every company in our coverage. We prefer companies with 1) user and monetization share gain, and 2) strong profitability/margin improvement. For regulations, we think those impacting China online entertainment are largely priced-in, with the resumption of game license since April, and implementation of the long-awaited live streaming regulation in June. Most companies should maintain strong cost discipline in 2H22 similar to 1H22 by optimizing S&M, revenue sharing/content, and headcount expenses.

NetEase and Kuaishou - our only OWs in China online entertainment

NetEase - We like NetEase's defensiveness with sustainable EPS growth at 17x 2023e P/E (assuming 10% game revenue growth in 2023) but we expect game revenue growth to slow to 7% YoY in 2H22 due to high base while the next potential blockbuster titles are sometime away. Although *Diablo China's* first month grossing is likely below our earliest estimate of Rmb1bn partly due to limited marketing before its launch, we remain confident in its longevity, with its first week DAU of 8mn and time spent of 144 minutes/user/day, and its steady international performance at US\$1.7mn/day for the first 70 days. Other catalysts - 1) cost discipline in non-game segments, 2) licenses allocation, 3) *Harry Potter Asia* in 4Q22, and *Naraka mobile* and *Justice mobile* in 2H23, 4) potential for a dual-primary listing in HK like Alibaba ([report \(26 Jul\)](#)).

Kuaishou - We expect Kuaishou to see the strongest growth recovery among peers driven by its total time spent growth of >40% YoY in 1H22E (DAU +18% YoY), its ecommerce GMV (>30% YoY in June; also see - [Multi-Year Share Gainer Via E-Commerce \(26 Jul\)](#)) that should also support ad growth (35% revenue from closed-loop), and margin expansion. We expect breakeven timing for the China segment and the group to come earlier than the market expects ([Catalyst Driven Idea \(2 Aug\)](#)), that would form a P/E valuation base from 2023 onwards.

We stay cautious on BILI, TME and live streaming, mainly due to limited new game releases, higher exposure to brand ads and live streaming. Upside risks include 1) **Bilibili** - ramp up of story mode, completion of dual-primary HK listing in early October, 2) **TME** - music ARPPU recovery and music OP breakeven.

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China Internet and Other Services

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With this report, Alex Poon assumes coverage of Weibo and Sohu.

Exhibit 1: Order of preference - China online entertainment

	Rating	P/S		P/GP		P/E		Rev CAGR 2021-23	GP CAGR 2021-23
		2022E	2023E	2022E	2023E	2022E	2023E		
NetEase	OW	4.2	3.8	8.0	7.3	19.7	17.7	10%	9%
Kuaishou	OW	3.1	2.6	7.1	5.6	NM	NM	16%	22%
Bilibili	EW	3.0	2.4	17.8	11.2	NM	NM	20%	22%
Weibo	EW	2.4	2.2	3.1	2.9	9.1	8.2	-4%	-6%
Tencent Music	EW	1.7	1.6	6.1	5.9	13.0	13.2	-5%	-9%
Momo	EW	0.5	0.5	1.2	1.1	4.7	4.0	-6%	-6%
JOYY	EW	0.8	0.8	2.6	2.4	NM	16.3	-3%	1%
Sohu	EW	0.9	1.0	8.1	8.8	NM	NM	-9%	-11%
Huya	UW	0.6	0.7	11.3	19.0	NM	NM	-16%	-59%
Douyu	UW	0.4	0.4	2.6	2.7	NM	NM	-14%	-5%

Source: Refinitiv, Morgan Stanley Research (E) estimates

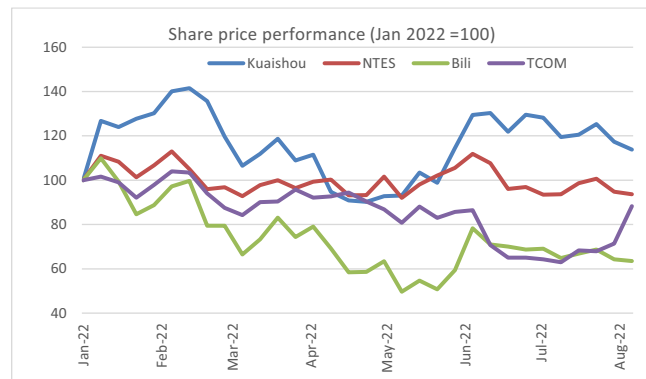
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Summary

Exhibit 2: YTD Share Performance



Source: Refinitiv, Morgan Stanley Research

Stock performances YTD

Kuaishou and **NTES** (both OW) have been the most outperforming stocks in China online entertainment space YTD, driven by stronger growth, and positive margin revision (for Kuaishou).

TCOM (OW) has caught up lately since July driven by Shanghai reopening, shortening of quarantine period in China, and strong recovery during the summer season for both domestic and international travel (domestic YoY growth to be helped by low base from August onwards). If a Shanghai-type lockdown during March-May does not repeat in China, we think there is potential upside to TCOM's Street estimates in 2H22.

Bilibili (EW) continues to underperform due to distant profitability (2024 earliest), and downside risk to its games and advertising businesses, and gross margin in 2H22, in our view.

Our 2H22 and 2023 revenue estimates are below consensus for all companies in our coverage, while there could be more cost savings in 2H22 to offset revenue downside in our view.

In 2H22, we continue to prefer NetEase (the most defensive), and Kuaishou (market share gainer among the video content platforms), and TCOM (both domestic and international travel recovery).

We stay cautious on Bilibili, TME and live streaming

- **Bilibili** - We see downside risks to both games and advertising revenues (higher margin businesses), hence GPM and OPM as well due to limited cost savings, as the company has its user growth target of 400mn by the end of 2023. *Space Hunter 3*, has lost its grossing momentum after the first 5-10 days based on Sensor Tower data. We also think Bilibili's advertising business (mainly brand ads) will take longer to recover amid a weaker China macro environment.
- **TME and live streaming** - Owing to the new live streaming regulation effective in June, we expect full quarter impact starting from 3Q22, driving consensus estimates lower. We expect live streaming revenues of TME, Huya, DouYu and Hello Group to drop by 20-30% YoY in 2H22. For TME, we see two operational and financial improvements - music ARPPU recovery, and music operating margin breakeven as soon as 2Q22. However, we think these upsides are likely already reflected in the share price.

What's Changed

NetEase - We lower our PT from US\$125 to US\$110 due to 1) current CNY/USD of 6.75 instead of 6.5, 2) lower game revenue growth of 11% in 2022 (was 13%) and 10% in 2023 (was 12%), and 3) fine tuning of margin assumptions. Our PT implies 21.7x 2023e P/E.

Sohu - We leave our PT unchanged at US\$17 and change our 2022-24 EPS by 40-150%. The large EPS changes are mainly due to its small profit base, as the company's overall profitability has been fluctuating around the breakeven level in the last four quarters, and we expect the same in 2H22 and 2023, with the company's profitable gaming business offsetting the losses of the video and media portal businesses.

Weibo - We lower our 2022-24 EPS estimates by 25-50% and PT by 15% as we consider slower advertising revenue recovery in 2H22 and 2023 amid the uncertain China macro environment. We also change our valuation methodology from DCF to target 2023e P/E at 10x, as Weibo's product cycle and profitability profile have both matured. Our target multiple of 10x is based on our expectation of 10% revenue and profit growth in 2023.

Exhibit 3: Morgan Stanley vs. Consensus estimates

Rmb mn unless stated	Morgan Stanley			Consensus			Variance		
	2022E	2023E	2024E	2022E	2023E	2024E	2022E	2023E	2024E
Revenue									
NetEase	96,160	106,226	117,451	97,908	110,341	121,181	-2%	-4%	-3%
Kuaishou	92,322	109,290	125,924	94,162	115,353	135,484	-2%	-5%	-7%
Tencent Music	27,176	28,050	29,584	27,360	29,009	30,658	-1%	-3%	-4%
Bilibili	22,634	28,108	33,347	22,782	29,838	37,592	-1%	-6%	-11%
JOYY	15,716	16,128	16,508	17,101	18,674	20,063	-8%	-14%	-18%
Huya	8,876	7,971	7,865	9,298	9,636	10,290	-5%	-17%	-24%
Douyu	7,158	6,786	6,575	7,080	7,240	7,538	1%	-6%	-13%
Momo	12,395	12,802	13,306	12,504	13,084	13,917	-1%	-2%	-4%
Weibo	13,769	15,974	16,891	13,929	15,696	16,955	-1%	2%	0%
Sohu	4,889	4,473	4,465	5,018	4,999	4,964	-3%	-11%	-10%
Gross profit									
NetEase	50,679	56,082	62,515	52,910	60,244	65,678	-4%	-7%	-5%
Kuaishou	39,991	50,758	61,654	40,903	54,368	67,531	-2%	-7%	-9%
Tencent Music	7,548	7,832	8,522	7,708	8,540	9,159	-2%	-8%	-7%
Bilibili	3,803	6,031	8,400	4,017	7,067	10,512	-5%	-15%	-20%
JOYY	5,186	5,501	5,758	5,058	5,678	6,901	3%	-3%	-17%
Huya	422	237	279	542	984	1,246	-22%	-76%	-78%
Douyu	1,032	976	957	981	1,071	1,138	5%	-9%	-16%
Momo	5,269	5,465	5,695	5,206	5,456	5,815	1%	0%	-2%
Weibo	10,778	12,592	13,247	10,984	12,381	13,644	-2%	2%	-3%
Sohu	3,532	3,261	3,253	3,683	3,873	n.a.	-4%	-16%	n.a.
Non-GAAP Operating Profit									
NetEase	22,160	24,726	28,445	20,391	23,790	26,898	9%	4%	6%
Kuaishou	(6,836)	3,875	13,759	(15,300)	(5,881)	4,292	-55%	-166%	221%
Tencent Music	3,490	3,205	3,115	3,171	3,605	3,994	10%	-11%	-22%
Bilibili	(6,477)	(4,823)	(3,057)	(7,204)	(4,927)	(2,455)	-10%	-2%	25%
JOYY	834	1,213	1,392	623	1,029	1,475	34%	18%	-6%
Huya	(811)	(935)	(889)	(715)	(403)	(322)	14%	132%	176%
Douyu	(268)	(375)	(472)	(357)	(242)	(238)	-25%	55%	98%
Momo	1,626	1,811	2,015	1,541	1,706	1,906	5%	6%	6%
Weibo	4,384	5,097	5,321	3,893	4,777	5,547	13%	7%	-4%
Sohu	47	27	168	(31)	75	(45)	n.a.	-64%	n.a.
Non-GAAP Net Profit									
NetEase	20,244	22,226	25,110	20,698	23,918	27,001	-2%	-7%	-7%
Kuaishou	(8,678)	2,103	11,680	(10,113)	(770)	8,473	-14%	n.a.	38%
Tencent Music	3,514	3,468	3,967	3,612	4,011	4,406	-3%	-14%	-10%
Bilibili	(6,637)	(5,131)	(3,334)	(6,734)	(4,563)	(1,548)	-1%	12%	115%
JOYY	376	881	1,146	533	1,100	1,331	-29%	-20%	-14%
Huya	(579)	(717)	(685)	(501)	(158)	(7)	15%	n.a.	n.a.
Douyu	(200)	(314)	(418)	(276)	(62)	24	-27%	n.a.	n.a.
Momo	1,346	1,568	1,830	1,408	1,592	1,779	-4%	-2%	3%
Weibo	4,029	4,778	4,972	3,835	4,539	5,017	5%	5%	-1%
Sohu	(179)	(171)	(23)	(114)	(148)	136	57%	16%	n.a.

Source: Refinitiv, Morgan Stanley Research estimates

In this section, we summarize quarterly revenue, GPM, Opex, OPM and NPM of our coverage. We think Kuaishou will see the strongest revenue and margin YoY growth compared to peers in 2H22.

Exhibit 4: Total revenue

Total revenue		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
NetEase	Rmb mn	20,517	20,525	22,191	24,374	23,556	22,799	24,106	25,699
NetEase - Games	Rmb mn	14,982	14,528	15,899	17,398	17,273	16,535	17,477	18,144
Kuaishou	Rmb mn	17,019	19,139	20,493	24,430	21,067	20,953	23,115	27,187
Bilibili	Rmb mn	3,901	4,495	5,207	5,781	5,054	4,945	5,891	6,745
JOYY	Rmb mn	4,293	4,301	4,229	4,314	4,055	3,881	4,007	4,148
Bigo	Rmb mn	3,879	3,886	3,697	3,745	3,475	3,314	3,429	3,514
YY core	Rmb mn	414	416	532	570	580	567	578	634
Huya	Rmb mn	2,605	2,962	2,976	2,809	2,465	2,238	2,058	2,116
Douyu	Rmb mn	2,153	2,337	2,348	2,328	1,796	1,796	1,785	1,780
Momo	Rmb mn	3,471	3,672	3,759	3,674	3,148	3,038	3,061	3,148
Momo core	Rmb mn	2,902	3,158	3,246	3,237	2,799	2,720	2,728	2,803
Tantan	Rmb mn	568	514	511	437	349	318	333	345
Tencent Music	Rmb mn	7,824	8,008	7,805	7,607	6,644	6,671	6,905	6,956
Weibo	Rmb mn	3,063	3,734	3,948	4,006	3,150	2,952	3,263	3,393
Sohu	Rmb mn	1,482	1,329	1,405	1,254	1,257	1,290	1,241	1,216
iQiyi	Rmb mn	7,968	7,608	7,589	7,389	7,277	6,686	7,460	7,810

YoY growth		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
NetEase	%	20%	13%	19%	23%	15%	11%	9%	5%
NetEase - Games	%	11%	5%	15%	30%	15%	14%	10%	4%
Kuaishou	%	37%	49%	33%	35%	24%	9%	13%	11%
Bilibili	%	68%	72%	61%	51%	30%	10%	13%	17%
JOYY	%	82%	33%	16%	11%	-6%	-10%	-5%	-4%
Bigo	%	86%	32%	11%	8%	-10%	-15%	-7%	-6%
YY core	%	49%	46%	75%	41%	40%	37%	9%	11%
Huya	%	8%	10%	6%	-6%	-5%	-24%	-31%	-25%
Douyu	%	-6%	-7%	-8%	3%	-17%	-23%	-24%	-24%
Momo	%	-3%	-5%	0%	-3%	-9%	-17%	-19%	-14%
Momo core	%	-9%	-5%	7%	6%	-4%	-14%	-16%	-13%
Tantan	%	49%	-1%	-30%	-41%	-39%	-38%	-35%	-21%
Tencent Music	%	24%	16%	3%	-9%	-15%	-17%	-12%	-9%
Weibo	%	37%	41%	24%	14%	3%	-21%	-17%	-15%
Sohu	%	20%	22%	31%	-28%	-15%	-3%	-12%	-3%
iQiyi	%	4%	3%	6%	-1%	-9%	-12%	-2%	6%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 5: Advertising revenue

Advertising revenue (Rmb mn)		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
Tencent	Rmb mn	21,820	22,833	22,495	21,518	17,988	17,055	19,861	23,262
Baidu	Rmb mn	16,277	19,003	19,390	19,058	15,700	17,284	20,217	20,561
Kuaishou	Rmb mn	8,558	9,962	10,909	13,236	11,351	10,793	12,312	15,016
Weibo	Rmb mn	2,603	3,265	3,495	3,580	2,776	2,560	2,857	2,982
Sohu	Rmb mn	1,342	1,547	1,419	1,399	983	1,073	1,197	1,296
iQiyi	Rmb mn	1,917	1,825	1,660	1,665	1,337	1,077	1,494	1,604
Bilibili	Rmb mn	715	1,049	1,172	1,588	1,041	1,145	1,351	1,910
Tencent Music	Rmb mn	521	469	494	500	300	330	380	438
Momo	Rmb mn	39	52	43	25	28	22	22	23
Growth YoY									
Tencent	%	23%	23%	5%	-13%	-18%	-25%	-12%	8%
Baidu	%	28%	18%	6%	1%	-4%	-9%	4%	8%
Kuaishou	%	161%	156%	76%	56%	33%	8%	13%	13%
Weibo	%	37%	40%	23%	15%	7%	-22%	-18%	-17%
Sohu	%	9%	-16%	-27%	-26%	-27%	-31%	-16%	-7%
iQiyi	%	25%	15%	-10%	-10%	-30%	-41%	-10%	-4%
Bilibili	%	234%	201%	110%	120%	46%	9%	15%	20%
Tencent Music	%	109%	57%	27%	-18%	-42%	-30%	-23%	-12%
Momo	%	-32%	36%	-14%	-52%	-28%	-57%	-49%	-10%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 6: Live streaming revenue

Live streaming revenue		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
China (bottom-up)	Rmb mn	19,563	20,075	20,817	21,653	18,591	18,454	18,668	19,229
Kuaishou	Rmb mn	7,250	7,193	7,724	8,827	7,842	8,132	8,376	8,918
Tencent Music (social)	Rmb mn	5,075	5,058	4,917	4,727	4,028	3,793	3,700	3,697
Huya	Rmb mn	2,392	2,579	2,602	2,613	2,152	2,038	1,858	1,920
Douyu	Rmb mn	1,999	2,178	2,211	2,209	1,727	1,731	1,721	1,715
Momo	Rmb mn	1,962	2,101	2,167	2,149	1,609	1,471	1,406	1,416
Momo core	Rmb mn	1,711	1,885	1,932	1,948	1,484	1,365	1,297	1,312
Tantan	Rmb mn	251	217	235	201	125	106	109	104
Bilibili	Rmb mn	884	965	1,196	1,128	1,234	1,289	1,608	1,563
Overseas									
Bigo	US\$ mn	561	576	545	549	513	477	482	491
Growth YoY									
China (bottom-up)	%	-4%	-4%	-1%	1%	-5%	-8%	-10%	-11%
Kuaishou	%	-20%	-14%	-3%	12%	8%	13%	8%	1%
Tencent Music (social)	%	19%	7%	-6%	-15%	-21%	-25%	-25%	-22%
Huya	%	5%	1%	-2%	-7%	-10%	-21%	-29%	-27%
Douyu	%	-5%	-6%	-6%	7%	-14%	-21%	-22%	-22%
Momo	%	-16%	-19%	-9%	-8%	-18%	-30%	-35%	-34%
Momo core	%	-26%	-22%	-2%	1%	-13%	-28%	-33%	-33%
Tantan	%		13%	-41%	-50%	-50%	-51%	-53%	-48%
Bilibili	%	106%	139%	130%	59%	40%	34%	34%	39%
Bigo	%	99%	39%	15%	12%	-9%	-17%	-12%	-10%

Source: Company data, Morgan Stanley Research estimates

Exhibit 7: Gross profit and margin

Gross profit		1Q21	2Q21	3Q21	4Q21	1Q22E	2Q22E	3Q22E	4Q22E
Gross profit (GAAP)									
NetEase	Rmb mn	11,053	11,190	11,811	12,918	12,836	12,060	12,424	13,359
NetEase - Games	Rmb mn	9,679	9,606	10,262	11,158	11,245	10,765	11,011	11,491
Kuaishou	Rmb mn	6,988	8,385	8,509	10,149	8,782	8,882	10,031	12,296
Tencent Music	Rmb mn	2,466	2,437	2,309	2,192	1,860	1,869	1,904	1,915
Bilibili	Rmb mn	938	989	1,018	1,098	807	753	1,001	1,316
YY	Rmb mn	1,336	1,322	1,370	1,453	1,308	1,268	1,325	1,411
Bigo	Rmb mn	1,277	1,244	1,269	1,343	1,196	1,155	1,203	1,273
Huya	Rmb mn	514	581	504	1	334	219	(10)	(121)
Douyu	Rmb mn	260	307	278	245	244	270	265	252
Momo	Rmb mn	1,532	1,601	1,576	1,483	1,327	1,299	1,324	1,319
Sohu	Rmb mn	1,170	1,008	1,036	918	938	939	867	870
Weibo	Rmb mn	2,531	3,132	3,279	3,170	2,469	2,291	2,549	2,654
iQiyi	Rmb mn	859	739	561	881	1,313	1,237	1,342	1,456
Gross profit (GAAP) YoY									
NetEase	%	18%	14%	19%	30%	16%	8%	5%	3%
NetEase - Games	%	12%	9%	16%	32%	16%	12%	7%	3%
Kuaishou	%	64%	89%	29%	19%	26%	6%	18%	21%
Tencent Music	%	25%	12%	-6%	-19%	-25%	-23%	-18%	-13%
Bilibili	%	77%	64%	34%	16%	-14%	-24%	-2%	20%
YY	%	112%	53%	29%	28%	-2%	-4%	-3%	-3%
Bigo	%	102%	47%	22%	24%	-6%	-7%	-5%	-5%
Huya	%	8%	1%	-19%	-100%	-35%	-62%	-102%	-11442%
Douyu	%	-46%	-41%	-25%	34%	-6%	-12%	-5%	3%
Momo	%	-11%	-13%	-10%	-15%	-13%	-19%	-16%	-11%
Sohu	%	40%	38%	46%	-33%	-20%	-7%	-16%	-5%
Weibo	%	47%	42%	24%	9%	-2%	-27%	-22%	-16%
iQiyi	%	-439%	28%	-32%	31%	53%	67%	139%	65%
Gross margin (GAAP)									
NetEase	%	53.9%	54.5%	53.2%	53.0%	54.5%	52.9%	51.5%	52.0%
NetEase - Games	%	64.6%	66.1%	64.5%	64.1%	65.1%	65.1%	63.0%	63.3%
Kuaishou	%	41.1%	43.8%	41.5%	41.5%	41.7%	42.4%	43.4%	45.2%
Tencent Music	%	31.5%	30.4%	29.6%	28.8%	28.0%	28.0%	27.6%	27.5%
Bilibili	%	24.0%	22.0%	19.6%	19.0%	16.0%	15.2%	17.0%	19.5%
YY	%	31.1%	30.7%	32.4%	33.7%	32.2%	32.7%	33.1%	34.0%
Bigo	%	32.9%	32.0%	34.3%	35.9%	34.4%	34.8%	35.1%	36.2%
Huya	%	19.7%	19.6%	16.9%	0.0%	13.5%	9.8%	-0.5%	-5.7%
Douyu	%	12.1%	13.1%	11.9%	10.5%	13.6%	15.0%	14.9%	14.2%
Momo	%	44.2%	43.6%	41.9%	40.4%	42.1%	42.7%	43.2%	41.9%
Sohu	%	78.9%	75.9%	73.7%	73.2%	74.6%	72.8%	69.9%	71.5%
Weibo	%	82.6%	83.9%	83.0%	79.1%	78.4%	77.6%	78.1%	78.2%
iQiyi	%	10.8%	9.7%	7.4%	11.9%	18.0%	18.5%	18.0%	18.6%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 8: Sales and marketing expenses

Sales and marketing		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
NetEase	Rmb mn	(2,767)	(3,013)	(3,134)	(3,300)	(2,915)	(2,669)	(3,144)	(2,999)
Kuaishou	Rmb mn	(11,660)	(11,270)	(11,017)	(10,230)	(9,488)	(9,199)	(9,305)	(8,970)
Huya	Rmb mn	(145)	(167)	(229)	(218)	(145)	(114)	(104)	(107)
Tencent Music	Rmb mn	(672)	(669)	(587)	(750)	(330)	(325)	(363)	(369)
Douyu	Rmb mn	(210)	(295)	(219)	(229)	(186)	(154)	(152)	(140)
Momo	Rmb mn	(614)	(650)	(681)	(660)	(589)	(589)	(624)	(664)
Bilibili	Rmb mn	(1,000)	(1,400)	(1,633)	(1,762)	(1,254)	(1,249)	(1,368)	(1,500)
Weibo	Rmb mn	(961)	(1,004)	(915)	(991)	(815)	(704)	(713)	(746)
Sohu	Rmb mn	(247)	(296)	(295)	(356)	(336)	(354)	(397)	(359)
YY	Rmb mn	(917)	(729)	(691)	(732)	(678)	(669)	(673)	(679)
Bigo	Rmb mn	(835)	(628)	(578)	(597)	(533)	(542)	(557)	(566)

As % of revenue

NetEase	%	13.5%	14.7%	14.1%	13.5%	12.4%	11.7%	13.0%	11.7%
Kuaishou	%	68.5%	58.9%	53.8%	41.9%	45.0%	43.9%	40.3%	33.0%
Huya	%	5.6%	5.6%	7.7%	7.8%	5.9%	5.1%	5.1%	5.0%
Tencent Music	%	8.6%	8.4%	7.5%	9.9%	5.0%	4.9%	5.3%	5.3%
Douyu	%	9.7%	12.6%	9.3%	9.8%	10.4%	8.6%	8.5%	7.9%
Momo	%	17.7%	17.7%	18.1%	18.0%	18.7%	19.4%	20.4%	21.1%
Bilibili	%	25.6%	31.1%	31.4%	30.5%	24.8%	25.2%	23.2%	22.2%
Weibo	%	31.4%	26.9%	23.2%	24.7%	25.9%	23.9%	21.9%	22.0%
Sohu	%	16.7%	22.3%	21.0%	28.4%	26.7%	27.4%	32.0%	29.5%
YY	%	21.4%	16.9%	16.3%	17.0%	16.7%	17.2%	16.8%	16.4%
Bigo	%	21.5%	16.2%	15.6%	15.9%	15.3%	16.4%	16.2%	16.1%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 9: R&D expenses

R&D		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
NetEase	Rmb mn	(3,060)	(3,407)	(3,761)	(3,848)	(3,398)	(3,651)	(3,993)	(4,314)
Kuaishou	Rmb mn	(2,811)	(3,911)	(4,218)	(4,016)	(3,523)	(3,900)	(3,883)	(3,944)
Huya	Rmb mn	(199)	(208)	(206)	(206)	(196)	(199)	(194)	(200)
Douyu	Rmb mn	(111)	(123)	(123)	(133)	(116)	(108)	(106)	(107)
Momo	Rmb mn	(286)	(268)	(261)	(316)	(250)	(256)	(268)	(289)
Bilibili	Rmb mn	(580)	(674)	(788)	(798)	(1,009)	(996)	(996)	(1,000)
Weibo	Rmb mn	(645)	(659)	(772)	(740)	(731)	(729)	(766)	(775)
Sohu	Rmb mn	(463)	(424)	(428)	(445)	(415)	(431)	(463)	(479)
YY	Rmb mn	(581)	(655)	(408)	(190)	(417)	(420)	(431)	(440)
Bigo	Rmb mn	(417)	(475)	(333)	(116)	(303)	(311)	(329)	(320)

As % of revenue

NetEase	%	14.9%	16.6%	16.9%	15.8%	14.4%	16.0%	16.6%	16.8%
Kuaishou	%	16.5%	20.4%	20.6%	16.4%	16.7%	18.6%	16.8%	14.5%
Huya	%	7.6%	7.0%	6.9%	7.3%	8.0%	8.9%	9.4%	9.5%
Douyu	%	5.2%	5.3%	5.2%	5.7%	6.5%	6.0%	6.0%	6.0%
Momo	%	8.3%	7.3%	6.9%	8.6%	7.9%	8.4%	8.7%	9.2%
Bilibili	%	14.9%	15.0%	15.1%	13.8%	20.0%	20.1%	16.9%	14.8%
Weibo	%	21.0%	17.7%	19.6%	18.5%	23.2%	24.7%	23.5%	22.8%
Sohu	%	31.2%	31.9%	30.5%	35.4%	33.0%	33.4%	37.3%	39.4%
YY	%	13.5%	15.2%	9.6%	4.4%	10.3%	10.8%	10.7%	10.6%
Bigo	%	10.7%	12.2%	9.0%	3.1%	8.7%	9.4%	9.6%	9.1%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 10: Operating income and margin

Operating income (Non-GAAP)		1Q21	2Q21	3Q21	4Q21	1Q22E	2Q22E	3Q22E	4Q22E
NetEase	Rmb mn	4,926	4,458	4,463	5,611	6,253	5,457	4,876	5,574
Kuaishou	Rmb mn	(6,713)	(4,949)	(4,933)	(3,156)	(3,112)	(2,647)	(1,832)	755
Tencent Music	Rmb mn	1,194	1,068	994	697	878	887	863	862
Bilibili	Rmb mn	(792)	(1,257)	(1,613)	(1,660)	(1,664)	(1,744)	(1,577)	(1,417)
YY	Rmb mn	(198)	(84)	203	543	216	163	210	266
YY core	Rmb mn	(302)	(217)	(144)	(148)	(199)	(155)	(121)	(98)
Bigo	Rmb mn	104	161	347	691	416	318	330	365
Huya	Rmb mn	242	249	154	(386)	(3)	(86)	(302)	(419)
Douyu	Rmb mn	(92)	(165)	(91)	(169)	(68)	(26)	(40)	(40)
Momo	Rmb mn	661	782	637	507	461	443	388	334
Weibo	Rmb mn	860	1,421	1,583	1,397	882	773	983	1,040
Sohu	Rmb mn	339	161	161	(19)	82	67	(89)	(68)
iQiyi	Rmb mn	(658)	(780)	(1,073)	(515)	327	238	57	(126)
Operating margin (Non-GAAP)		1Q21	2Q21	3Q21	4Q21	1Q22E	2Q22E	3Q22E	4Q22E
NetEase	%	24.0%	21.7%	20.1%	23.0%	26.5%	23.9%	20.2%	21.7%
Kuaishou	%	-39.4%	-25.9%	-24.1%	-12.9%	-14.8%	-12.6%	-7.9%	2.8%
Tencent Music	%	15.3%	13.3%	12.7%	9.2%	13.2%	13.3%	12.5%	12.4%
Bilibili	%	-20.3%	-28.0%	-31.0%	-28.7%	-32.9%	-35.3%	-26.8%	-21.0%
YY	%	-4.6%	-2.0%	4.8%	12.6%	5.3%	4.2%	5.2%	6.4%
YY core	%	-72.9%	-52.2%	-27.1%	-26.1%	-34.4%	-27.3%	-20.9%	-15.5%
Bigo	%	2.7%	4.1%	9.4%	18.5%	12.0%	9.6%	9.6%	10.4%
Huya	%	9.3%	8.4%	5.2%	-13.8%	-0.1%	-3.9%	-14.7%	-19.8%
Douyu	%	-4.3%	-7.1%	-3.9%	-7.2%	-3.8%	-1.5%	-2.3%	-2.2%
Momo	%	19.1%	21.3%	17.0%	13.8%	14.6%	14.6%	12.7%	10.6%
Weibo	%	28.1%	38.0%	40.1%	34.9%	28.0%	26.2%	30.1%	30.6%
Sohu	%	22.9%	12.1%	11.5%	-1.5%	6.6%	5.2%	-7.1%	-5.6%
iQiyi	%	-8.3%	-10.2%	-14.1%	-7.0%	4.5%	3.6%	0.8%	-1.6%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 11: Non-GAAP net profit

Net profit (Non-GAAP)		1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
NetEase	Rmb mn	5,081	4,228	3,858	6,596	5,118	4,816	4,750	5,560
Kuaishou	Rmb mn	(5,896)	(4,770)	(4,616)	(3,569)	(3,722)	(3,045)	(2,230)	319
TME	Rmb mn	1,182	1,117	1,015	832	899	900	863	853
Bilibili	Rmb mn	(890)	(1,323)	(1,613)	(1,652)	(1,653)	(1,801)	(1,634)	(1,475)
YY	Rmb mn	(173)	(23)	208	607	113	111	157	78
YY core	Rmb mn	(236)	(149)	(114)	(66)	(276)	(190)	(156)	(260)
Bigo	Rmb mn	63	126	323	672	389	301	313	338
Huya	Rmb mn	266	250	180	(242)	47	(28)	(244)	(360)
Douyu	Rmb mn	(71)	(145)	(73)	(112)	(52)	(9)	(24)	(22)
Momo	Rmb mn	634	558	572	281	399	361	313	274
Momo core	Rmb mn	694	634	724	418	555	488	455	437
Tantan	Rmb mn	(42)	(45)	(120)	(130)	(159)	(122)	(135)	(119)
Weibo	Rmb mn	(872)	(1,188)	(1,362)	(1,271)	(864)	(688)	(858)	(880)
Sohu	Rmb mn	365	286	5,457	1	61	82	(137)	(115)
iQiyi	Rmb mn	(1,021)	(1,065)	(1,400)	(1,001)	162	(106)	(301)	(559)

Net margin (Non-GAAP)

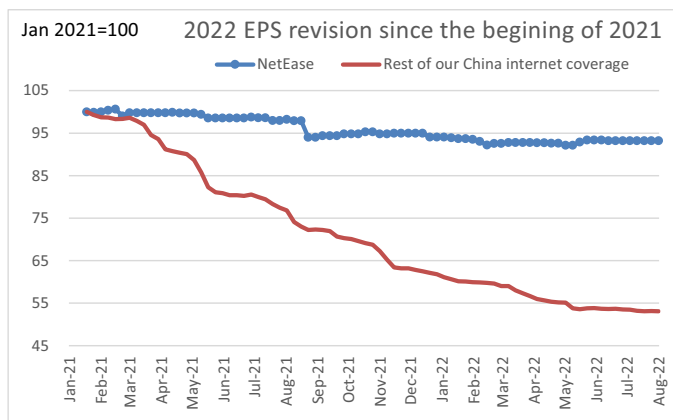
NetEase	%	24.8%	20.6%	17.4%	27.1%	21.7%	21.1%	19.7%	21.6%
Kuaishou	%	-34.6%	-24.9%	-22.5%	-14.6%	-17.7%	-14.5%	-9.6%	1.2%
TME	%	15.1%	13.9%	13.0%	10.9%	13.5%	13.5%	12.5%	12.3%
Bilibili	%	-22.8%	-29.4%	-31.0%	-28.6%	-32.7%	-36.4%	-27.7%	-21.9%
YY	%	-4.0%	-0.5%	4.9%	14.1%	2.8%	2.9%	3.9%	1.9%
YY core	%	-57.0%	-35.9%	-21.5%	-11.5%	-47.6%	-33.5%	-27.0%	-41.0%
Bigo	%	1.6%	3.3%	8.7%	18.0%	11.2%	9.1%	9.1%	9.6%
Huya	%	10.2%	8.4%	6.0%	-8.6%	1.9%	-1.3%	-11.9%	-17.0%
Douyu	%	-3.3%	-6.2%	-3.1%	-4.8%	-2.9%	-0.5%	-1.3%	-1.2%
Momo	%	18.3%	15.2%	15.2%	7.6%	12.7%	11.9%	10.2%	8.7%
Momo core	%	23.9%	20.1%	22.3%	12.9%	19.8%	17.9%	16.7%	15.6%
Tantan	%	-7.4%	-8.7%	-23.6%	-29.7%	-45.4%	-38.5%	-40.6%	-34.6%
Weibo	%	-4.3%	-4.9%	-5.3%	-4.9%	-4.2%	-3.5%	-3.9%	-3.8%
iQiyi	%	-12.8%	-14.0%	-18.4%	-13.5%	2.2%	-1.6%	-4.0%	-7.2%
Sohu	%	24.6%	21.6%	388.5%	0.1%	4.9%	6.4%	-11.0%	-9.5%

Source: Company data, Morgan Stanley Research (E) estimates

Valuation

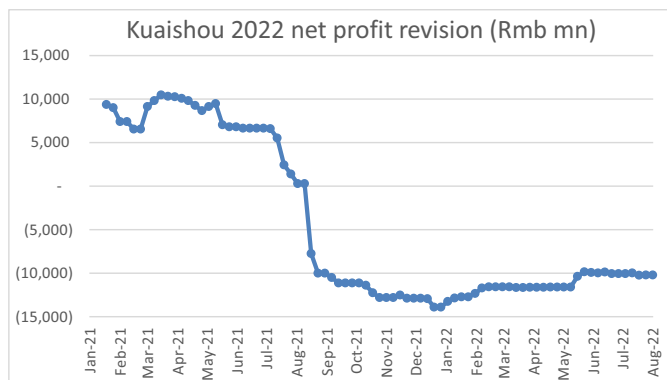
Since the beginning of 2021, **NetEase** has had the least consensus EPS downward revisions, compared to the rest of China internet, while **Kuaishou's** negative EPS revisions have bottomed out since early 2022, and we expect that to continue, mainly driven by strong ecommerce GMV and margin improvement.

Exhibit 12: NetEase 2022 EPS revision vs China internet



Source: Refinitiv, Morgan Stanley Research

Exhibit 13: Kuaishou 2022 EPS revision



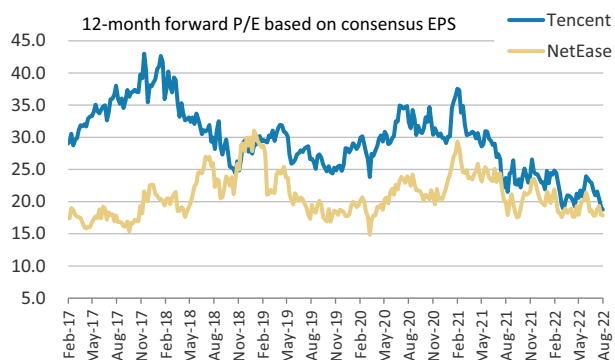
Source: Refinitiv, Morgan Stanley Research

Exhibit 14: Valuation comparison

8/11/2022	Company	Ticker	Sh Px Loc	Mkt cap US\$ mn	EV US\$ mn	P/S 2022E	P/S 2023E	P/GP 2022E	P/GP 2023E	P/E 2022E	P/E 2023E	Revenue	GP	NP	2021-23 CAGR	2022E Margin	Perf YTD
	Tencent	0700.HK	295.60	362,354	357,693	4.3	3.8	10.1	8.7	22.1	18.3	8%	7%	5%	42%	20%	-35%
	NetEase	NTES.O	89.82	60,267	47,755	4.2	3.8	8.0	7.3	19.7	17.7	10%	9%	6%	53%	21%	-12%
	Kuaishou	1024.HK	74.05	42,251	38,764	3.1	2.6	7.1	5.6	NM	NM	16%	22%	NM	43%	-9%	3%
	JOYY	YY.O	26.22	2,045	(1,541)	0.8	0.8	2.6	2.4	NM	16.3	-3%	1%	19%	33%	2%	-42%
	Bilibili	BILI.O	24.27	10,048	9,041	3.0	2.4	17.8	11.2	NM	NM	20%	22%	NM	17%	-29%	-48%
	Weibo	WB.O	19.13	4,513	4,385	2.4	2.2	3.1	2.9	9.1	8.2	-4%	-6%	-12%	78%	26%	-38%
	Momo	MOMO.O	4.59	910	(733)	0.5	0.5	1.2	1.1	4.7	4.0	-6%	-6%	-12%	43%	11%	-49%
	Tencent Music	TME.N	4.14	6,789	3,694	1.7	1.6	6.1	5.9	13.0	13.2	-5%	-9%	-9%	28%	13%	-40%
	iQiyi	IQ.O	3.77	3,015	4,862	0.7	0.6	3.8	3.1	NM	24.5	2%	46%	NM	18%	-3%	-17%
	Sohu	SOHU.O	17.13	655	(811)	0.9	1.0	8.1	8.8	NM	NM	-9%	-11%	NM	11%	-4%	5%
	Huya	HUYA.N	3.21	778	(774)	0.6	0.7	11.3	19.0	NM	NM	-16%	-59%	NM	5%	-7%	-54%
	Douyu	DOYU.O	1.19	391	(530)	0.4	0.4	2.6	2.7	NM	NM	-14%	-5%	NM	14%	-1%	-55%

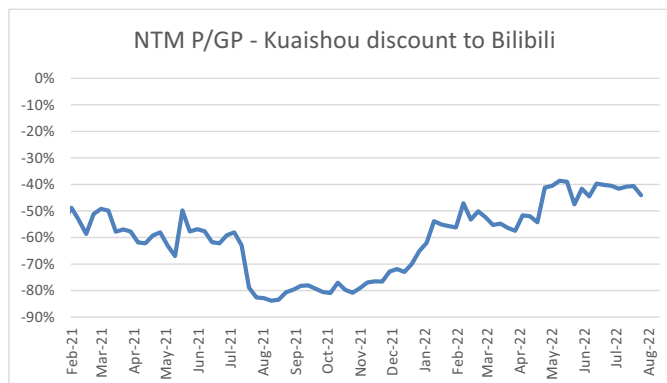
Source: Refinitiv, Morgan Stanley Research (E) estimates

Exhibit 15: Consensus NTM P/E - Tencent vs NetEase



Source: Morgan Stanley Research, Refinitiv

Exhibit 16: Consensus forward P/GP - Kuaishou (discount)/premium to Bilibili



Source: Refinitiv, Morgan Stanley Research

Exhibit 17: NetEase current valuation

Market cap	59,972				
Net cash 1Q22	(12,512)				
Enterprise value	47,460				
Less: music attributable	(1,845)				
Less: Youdao attributable	(367)				
EV for games	45,249				
Financials and valuation multiples	2021	2022E	2023E	2024E	2025E
Net profit (non-GAAP)	2,928	2,999	3,293	3,720	4,601
Add: Youdao attributable net loss	91	63	11	(33)	(56)
Add: Music attributable net loss	91	58	32	6	(51)
Core net profit (non-GAAP)	3,109	3,121	3,336	3,693	4,495
Overall P/E	20.6	19.6	17.6	15.3	12.2
<i>Premium/(Discount) to Tencent</i>	2%	-13%	-5%	7%	10%
Core P/E ex cash, music and Youdao	14.6	14.5	13.6	12.3	10.1
Diluted EPADS (non-GAAP) (Rmb)	29.2	30.7	34.3	39.3	49.4
Diluted EPADS (non-GAAP) (US\$)	4.3	4.6	5.1	5.8	7.3
Overall P/E ex cash	16.2	15.8	14.4	12.8	10.3
EBIT (non-GAAP)	2,883	3,283	3,663	4,214	5,323
Overall EV/EBIT	16.5	14.5	13.0	11.3	8.9
EBIT (non-GAAP)	3,206	3,477	3,736	4,179	5,149
EV/EBIT ex music and Youdao	14.8	13.7	12.7	11.4	9.2
Revenue	12,979	14,246	15,737	17,400	19,579
Overall EV/Sales	3.7	3.3	3.0	2.7	2.4
Operating CF	3,693	3,497	4,209	4,623	5,661
FCFF	2,048	1,788	2,483	2,872	3,874
FCFF Yield	4.3%	3.8%	5.2%	6.1%	8.2%
DPS (US\$)	1.2	1.2	1.4	1.6	2.1
Dividend yield	1.3%	1.4%	1.6%	1.8%	2.3%

Source: Company data, Morgan Stanley Research estimates

User

Short video platforms and Bilibili have had relatively flat DAU and time spent QoQ growth in 2Q while July is tracking a sequential upward trend due to summer vacations.

According to QuestMobile, Bilibili's DAU grew 2% and time spent grew 1% QoQ in 2Q22. Douyin's DAU and time spent both grew 1% while Kuaishou's DAU and time spent dipped 3% and 4% QoQ in 2Q22, respectively. In 3Q22, Bilibili has so far registered strong QoQ growth of 8% in 3Q22 (July) vs. 4% for Kuaishou and 3% for Douyin. Time spent of the video platforms is also increasing with Bilibili growing 17%, Kuaishou growing 11% and Douyin growing 7% QoQ in July.

Exhibit 18: Sequential DAU growth

Sequential DAU Growth	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	Rank	May-22	Jun-22	Jul-22	Rank
Three subsegments	7%	1%	7%	-2%	3%	-1%	3%		-2%	-1%	4%	
Live streaming	-3%	2%	1%	-5%	-1%	3%	-1%		-2%	-1%	0%	
Momo	-5%	7%	1%	-7%	-1%	7%	-1%	19	0%	2%	-2%	24
YY Live	-8%	-5%	3%	3%	1%	6%	-1%	18	-5%	-4%	4%	15
Huya	2%	-5%	2%	-2%	8%	-7%	3%	11	-7%	-3%	7%	5
Douyu	1%	-4%	-4%	-4%	-6%	-2%	1%	14	0%	-9%	7%	6
Tantan	-4%	2%	6%	-8%	-8%	-1%	-8%	27	-6%	1%	-6%	27
Video	9%	0%	9%	-2%	4%	-1%	4%		-2%	0%	5%	
Bilibili	13%	2%	13%	5%	7%	2%	8%	3	-1%	0%	8%	3
Douyin	11%	10%	10%	3%	3%	1%	3%	10	0%	1%	2%	20
Douyin main	8%	9%	9%	3%	2%	1%	2%	12	0%	1%	2%	21
Douyin Express	27%	19%	24%	7%	6%	4%	5%	4	0%	1%	5%	12
Volcano	9%	-6%	-10%	-9%	0%	-4%	1%	15	-5%	-1%	3%	16
Volcano Express	-21%	-40%	-68%	-34%	-13%	-17%	-7%	26	-9%	-1%	-4%	26
Kuaishou	10%	-5%	5%	-1%	2%	-3%	4%	7	-2%	0%	5%	11
Kuaishou main	6%	-7%	0%	-4%	0%	-4%	3%	9	-2%	-1%	4%	14
Kuaishou Express	20%	-1%	14%	4%	6%	-1%	5%	5	-1%	0%	6%	8
Xigua	0%	-6%	5%	0%	13%	-10%	1%	13	-6%	-3%	6%	7
iQiyi	10%	-9%	11%	-16%	2%	-16%	-5%	24	-18%	-1%	3%	17
Tencent Video	0%	-8%	10%	-10%	7%	-11%	10%	2	-6%	7%	8%	4
Youku	14%	-11%	2%	3%	15%	7%	-4%	23	-3%	-18%	11%	2
Mango TV	2%	3%	15%	-30%	0%	37%	23%	1	24%	-3%	17%	1
Music	0%	2%	-3%	0%	-3%	-1%	0%		-2%	-3%	2%	
Tencent Music	0%	2%	-3%	0%	-3%	-1%	0%	16	-2%	-3%	3%	18
Kugou	-3%	4%	-4%	2%	-3%	1%	-1%	20	-1%	-3%	1%	22
QQ Music	-1%	3%	-2%	1%	-3%	1%	4%	6	-1%	-1%	5%	10
Kuwo	1%	7%	-1%	-2%	-3%	-2%	-6%	25	-4%	-5%	-2%	25
WeSing	7%	-7%	-3%	-7%	-4%	-10%	-1%	21	-6%	-6%	5%	9
NetEase Cloud Music	-3%	0%	-5%	1%	-4%	-3%	-2%	22	-4%	-2%	1%	23

Source: QuestMobile, Morgan Stanley Research

Exhibit 19: Sequential time spent growth

Sequential time spent growth	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	Rank	May-22	Jun-22	Jul-22	Rank
Three subsegments	13%	2%	14%	-4%	6%	-1%	8%		-3%	-3%	12%	
Live streaming	-2%	0%	0%	-6%	2%	2%	2%		-3%	-5%	7%	
Momo	-4%	3%	-1%	-9%	0%	6%	1%	17	0%	-4%	4%	22
YY Live	-17%	2%	-8%	-7%	-10%	6%	-6%	25	-8%	-5%	0%	27
Huya	5%	-6%	3%	-1%	12%	-11%	4%	13	-8%	-8%	13%	8
Douyu	0%	-7%	-4%	0%	2%	11%	3%	15	-7%	-8%	11%	12
Tantan	3%	8%	13%	-16%	-11%	2%	5%	12	-5%	0%	7%	17
Video	15%	2%	16%	-4%	7%	-1%	8%		-3%	-3%	12%	
Bilibili	24%	2%	21%	1%	17%	1%	17%	2	2%	-1%	17%	3
Douyin	20%	12%	19%	-2%	8%	1%	7%	10	-3%	-1%	9%	15
Douyin main	18%	9%	18%	-2%	8%	0%	6%	11	-3%	-1%	8%	16
Douyin Express	36%	32%	29%	-2%	9%	5%	11%	5	-1%	-1%	12%	10
Volcano	11%	-5%	-1%	-7%	4%	-4%	4%	14	-5%	-5%	10%	13
Volcano Express	-23%	-47%	-57%	-31%	-8%	-20%	-1%	18	-11%	-1%	4%	24
Kuaishou	16%	-2%	14%	-3%	5%	-4%	11%	6	-3%	-3%	14%	7
Kuaishou main	11%	-4%	9%	-5%	1%	-6%	9%	7	-3%	-3%	13%	9
Kuaishou Express	29%	1%	26%	1%	12%	-2%	14%	4	-3%	-3%	17%	2
Xigua	4%	-6%	6%	-2%	9%	-4%	9%	8	-4%	-7%	16%	4
iQiyi	14%	-13%	11%	-15%	7%	-15%	-9%	27	-22%	-7%	5%	20
Tencent Video	-2%	-10%	15%	-8%	10%	-12%	15%	3	-8%	3%	16%	5
Youku	7%	-12%	-1%	9%	5%	16%	-8%	26	1%	-27%	15%	6
Mango TV	3%	2%	21%	-39%	5%	48%	29%	1	28%	-11%	29%	1
Music	-4%	2%	-9%	-3%	-9%	-2%	-3%		-1%	-10%	5%	
Tencent Music	-4%	2%	-8%	-2%	-9%	-2%	-3%	19	-1%	-10%	5%	19
Kugou Music	-6%	6%	-7%	4%	-13%	-2%	-3%	21	1%	-10%	4%	23
QQ Music	-8%	5%	-13%	-8%	-13%	-1%	2%	16	0%	-9%	9%	14
Kuwo Music	-3%	7%	-7%	-7%	-11%	1%	-4%	22	-1%	-10%	3%	26
WeSing	6%	-10%	-5%	-2%	2%	-6%	-5%	24	-5%	-12%	6%	18
NetEase Cloud Music	-13%	-1%	-28%	-13%	-14%	-7%	-5%	23	-5%	-9%	3%	25

Source: QuestMobile, Morgan Stanley Research

NetEase

We maintain OW as NetEase is one of the most defensive names in China internet with sustainable growth ([Intact Growth, Countering Reopening Risks \(13 Jul\)](#)) driven by its strong content development capabilities. From a catalyst perspective, the biggest catalyst, Diablo China was released on July 25. Going forward, we expect in-line 2Q results, strong 3Q results driven by Diablo's contribution, likely allocation of game license in 2H22, and release of Harry Potter Asia in late 2022. The stock is trading at 18x 2023e P/E (core 14x ex-cash) based on 10% game revenue growth in 2023 and stable margin.

We think the recent termination of WoW mobile project with Blizzard is one-off and does not affect consensus estimates ([Scrapping WoW Mobile has no impact on consensus estimate \(3 Aug 2022\)](#)), as there has not been any announcement of its release. We expect NetEase to continue to operate the existing Blizzard titles in China, which contributed about high single digit to ~10% of game revenue in 2021 we estimate.

2Q22 preview – We expect 1) total revenue of Rmb22.8bn (-3% QoQ, +11% YoY), in line with consensus, driven by game revenue of Rmb16.5bn (-4% QoQ, +14% YoY), -2% vs. consensus, 2) non-GAAP OP of Rmb5.5bn (+22% YoY; margin 23.8%), +6% vs. consensus, and 3) non-GAAP NP of Rmb4.8bn (+13% YoY; margin 21%), +4% vs. consensus.

Diablo China - Although Diablo China's first month grossing is likely less than Rmb1bn partly due to limited marketing before its launch, we remain confident in its longevity, and its steady international performance at US\$1.7mn/day for the first 70 days. The evidence we have got so far:

- International grossing has been very steady at US\$1.7mn/day for the first 70 days since its launch on June 2,
- South Korea has contributed 20% of total international grossing, second to the US market at 40%, despite having just one sixth the population. We think South Korea is a relevant benchmark for China as MMORPG is the biggest game genre in both markets. Yet, we note the grossing in South Korea had dropped by about 60% by the 60th day.
- In the first week of release, Diablo China's DAU of 8mn and time spent of 144 minutes/user/day is much higher than Harry Potter China's corresponding 5-6mn and 98 minutes/user/day.

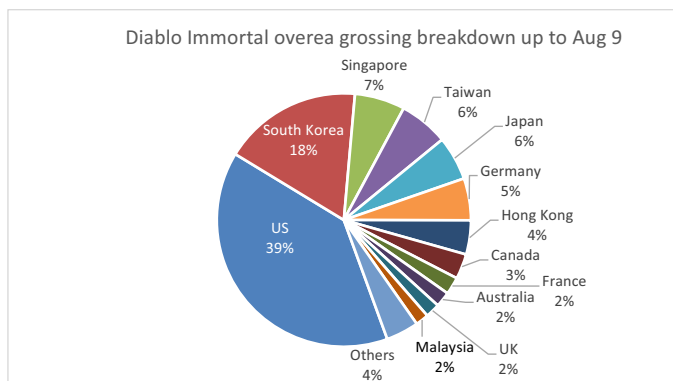
With the above analysis, we forecast Diablo to contribute mobile revenue of ~Rmb700mn in 3Q22 and another Rmb700mn in 4Q22, based on first month grossing of ~Rmb800mn in the first month, and 60% decay by the 60th day similar to South Korea. We expect monthly grossing to stabilize at about Rmb300mn in 4Q22. We have assumed NetEase to recognize 10% of international grossing as net revenue.

2H22 - We expect total game revenue to grow 7% YoY in 2H22 (was 9%), with mobile at 8% YoY and PC at 5% YoY. Although we have slightly lowered our estimate, we see potential further downside risks as Sensor Tower data suggests a weak June and July. Recent CNG data and our recent AlphaWise survey also suggest industry weakness - [China Internet – Gaming in Focus #74: Understanding the Revenue Decline II \(4 Aug 2022\)](#). PC revenue could see meaningful YoY growth deceleration due to the high base last year, from the sales of Naraka Bladepoint copies, partially offset by the FWJ PC expansion pack in 1Q22 that drove total PC game revenue growth of 40% YoY in 1Q22.

Performance of Diablo international

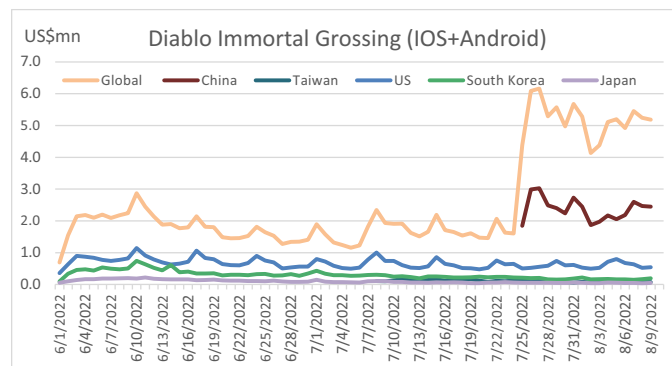
Daily grossing has been steady at US\$1.7mn/day for the first 70 days since its launch on June 2, which suggests strong longevity of the game. DAU has been stable at 1.5mn in the last one month vs. the peak of 4.5mn and average of 3mn in the first 10 days, implying grossing per DAU has doubled since its launch.

Exhibit 20: Daily grossing overseas regional breakdown up to Aug 9



Source: Sensor Tower, Morgan Stanley Research

Exhibit 21: Diablo daily grossing as of Aug 9



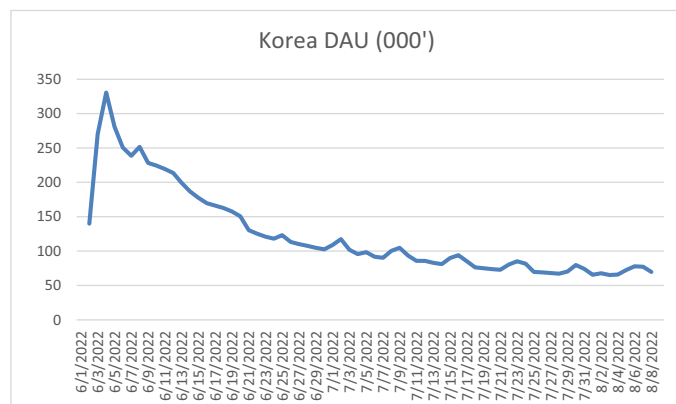
Source: Sensor Tower, Morgan Stanley Research

Using Diablo South Korea as a benchmark for Diablo China

Diablo (action MMORPG) was released in South Korea on June 2 and the market has been the second largest contributing market to Diablo international's grossing at ~20% of the total, half of the US at 40%, despite having just one sixth the population of the US. We think the Korea market is a good benchmark for China because MMORPG is the biggest game genre in both markets.

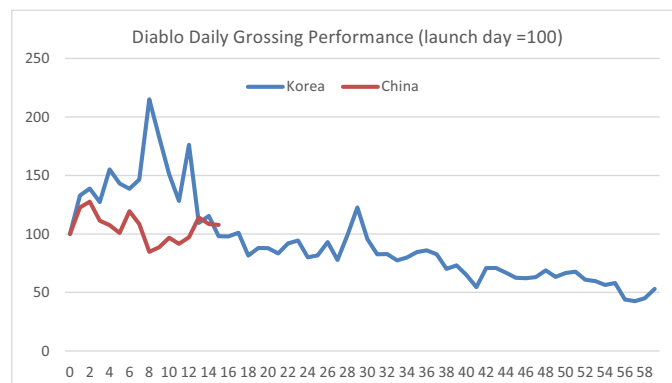
On the 60th day, DAU and grossing of Diablo South Korea have dropped about 60% from the average of the first 10 days we estimate, based on Sensor Tower data.

Exhibit 22: Diablo Korea DAU as of Aug 9



Source: Sensor Tower, Morgan Stanley Research

Exhibit 23: Diablo Korea vs. China



Source: Sensor Tower, Morgan Stanley Research

Our Diablo China forecasts

Exhibit 24: Diablo revenue contribution

Grossing per month			Revenue (overseas)								
Rmb mn	Overseas	Rev share %	April	May	June	July	Aug	Sept	Oct	Nov	Dec
June	361	10%			8	8	8	8	4		
July	348	10%				8	8	8	8	4	-
August	320	10%					7	7	7	7	4
Sept	320	10%						7	7	7	7
Oct	300	10%							7	7	7
Nov	300	10%								7	7
Dec	300	10%									7
Total	2,250		-	-	8	16	23	30	33	38	31
				8			69			101	
				2Q22			3Q22			4Q22	
Grossing per month			Revenue (China)								
Rmb mn	China	Rev share %	April	May	June	July	Aug	Sept	Oct	Nov	Dec
June	-	100%			-	-	-	-	-	-	-
July	266	100%				59	59	59	59	30	-
August	795	100%					177	177	177	177	88
Sept	462	100%						103	103	103	103
Oct	387	100%							86	86	86
Nov	349	100%								77	77
Dec	349	100%									77
Total	1,910		-	-	-	59	236	338	424	550	432
				-			633			1,406	
				2Q22			3Q22			4Q22	
Grossing per month			Revenue (Total)								
Rmb mn	Total		April	May	June	July	Aug	Sept	Oct	Nov	Dec
June	361				8	8	8	8	4	-	-
July	614					67	67	67	67	33	-
August	1,115						184	184	184	184	92
Sept	782							110	110	110	110
Oct	687								93	93	93
Nov	649									84	84
Dec	649										84
Total	3,559		-	-	8	75	259	368	457	588	463
				8			702			1,507	
				2Q22			3Q22			4Q22	

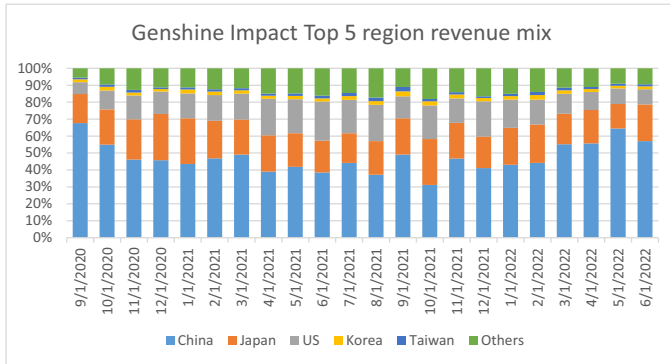
Source: Sensor Tower, Morgan Stanley Research estimates

Comparison with Genshin Impact

Diablo China has contributed about two thirds of total global grossing so far vs. 40-70% for *Genshin Impact* over the last two years.

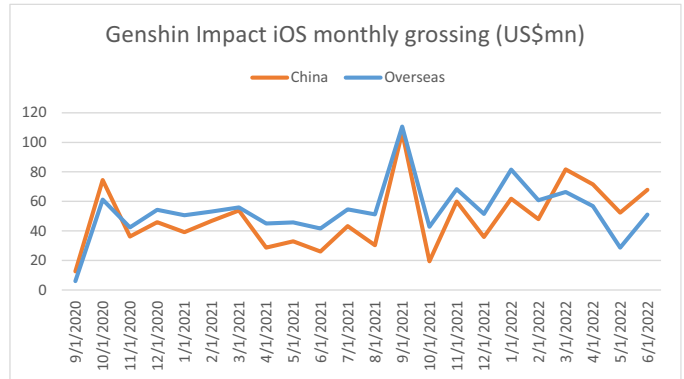
Genshin Impact has had steady monthly iOS grossing of US\$50mn in both China and overseas since its launch in 2020 with China iOS grossing ramping up from ~US\$45mn during the first year after its launch to ~US\$60mn in the most recent 11 months.

Exhibit 25: Genshin impact China vs. Overseas grossing mix



Source: Sensor Tower, Morgan Stanley Research

Exhibit 26: Genshin impact iOS monthly grossing



Source: Sensor Tower, Morgan Stanley Research

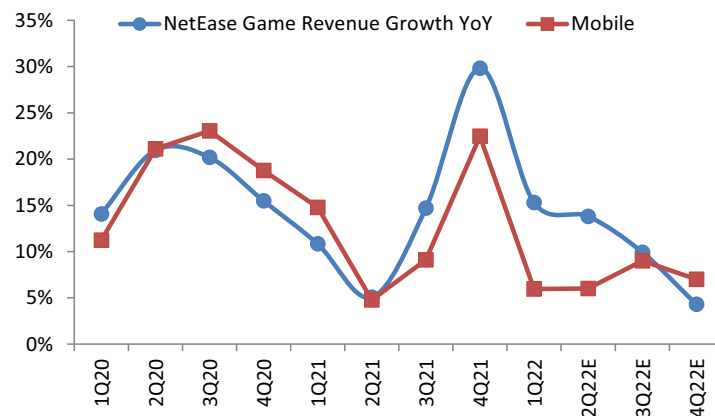
Our games grossing and game revenue forecasts

Exhibit 27: NetEase grossing and game revenue reconciliation

RMB mn	1Q20 Mar-20	2Q20 Jun-20	3Q20 Sep-20	4Q20 Dec-20	1Q21 Mar-21	2Q21 Jun-21	3Q21 Sep-21	4Q21 Dec-21	1Q22	2Q22E Jun-22	3Q22E Sep-22	4Q22E Dec-22
Deferred revenue - NTES core												
NTES core b/f	8,145	9,378	8,664	9,311	9,505	10,464	10,072	12,438	11,033	11,321	10,531	11,331
Online game revenue (P&L)	(13,518)	(13,828)	(13,862)	(13,400)	(14,982)	(14,528)	(15,899)	(17,398)	(17,273)	(16,771)	(16,781)	(18,604)
Change YoY / QoQ	1,914	310	34	(462)	1,582	(454)	1,371	1,498	(125)	(502)	10	1,823
Change YoY (%)	14%	21%	20%	15%	11%	5%	15%	30%	15%	15%	6%	7%
Change YoY / QoQ (%)	16%	2%	0%	-3%	12%	-3%	9%	9%	-1%	-3%	0%	11%
Historical variances	1%	-1%	0%	-5%	1%	-3%	-2%	2%	3%			
Games grossing	14,751	13,114	14,509	13,594	15,941	14,136	18,265	15,992	17,561	15,981	17,581	17,524
Change YoY / QoQ	2,854	(1,637)	1,394	(915)	2,348	(1,806)	4,129	(2,273)	1,569	(1,581)	1,600	(57)
Change YoY (%)	21%	24%	20%	14%	8%	8%	26%	18%	10%	13%	-4%	10%
Change YoY / QoQ (%)	24%	-11%	11%	-6%	17%	-11%	29%	-12%	10%	-9%	10%	0%
NTES core c/f	9,378	8,664	9,311	9,505	10,464	10,072	12,438	11,033	11,321	10,531	11,331	10,251
Change YoY / QoQ	1,233	(714)	646	194	960	(392)	2,366	(1,405)	289	(790)	800	(1,080)
Change YoY / QoQ (%)	15%	-8%	7%	2%	10%	-4%	23%	-11%	3%	-7%	8%	-10%
Change YoY (%)	15%	18%	19%	17%	12%	16%	34%	16%	8%	5%	-9%	-7%

Source: Company data, Morgan Stanley Research estimates

Exhibit 28: NetEase game revenue YoY growth



Source: Company data, Morgan Stanley Research (E) estimates

Update on other key games – Harry Potter China and Naraka Bladepoint

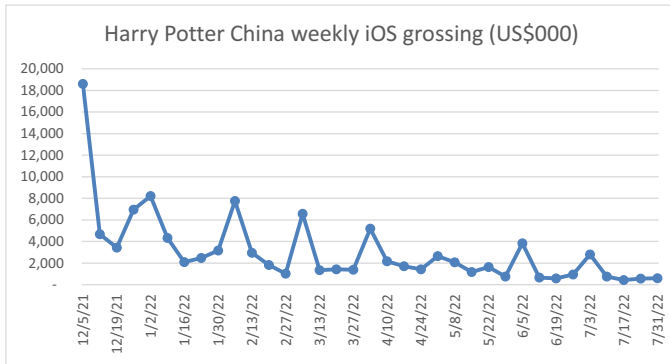
DAU of Naraka on Steam fell 12% QoQ in 2Q and the run-rate in July was 17% below 2Q, hence we believe in-game purchases could have fallen by single digit QoQ in 2Q.

Exhibit 29: Naraka Bladepoint average players on Steam

Month	Avg. Players	Gain	% Gain	Peak Players
Last 30 Days	40,896.6	+68.8	+0.17%	112,215
July 2022	40,827.9	-1,524.3	-3.60%	106,751
June 2022	42,352.2	-7,194.1	-14.52%	109,793
May 2022	49,546.2	-5,540.4	-10.06%	129,636
April 2022	55,086.6	-4,374.0	-7.36%	146,195
March 2022	59,460.6	+5,160.8	+9.50%	165,976
February 2022	54,299.8	+749.0	+1.40%	148,721
January 2022	53,550.8	-7,639.7	-12.49%	138,595
December 2021	61,190.6	+12,265.4	+25.07%	186,707
November 2021	48,925.2	-2,806.0	-5.42%	154,161
October 2021	51,731.2	-12,541.0	-19.51%	141,344
September 2021	64,272.2	+9,104.1	+16.50%	160,720
August 2021	55,168.2	-	-	128,628

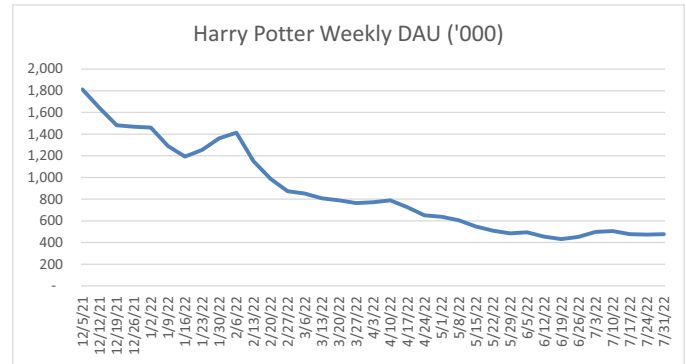
Source: Steam

Exhibit 30: HP China weekly iOS grossing



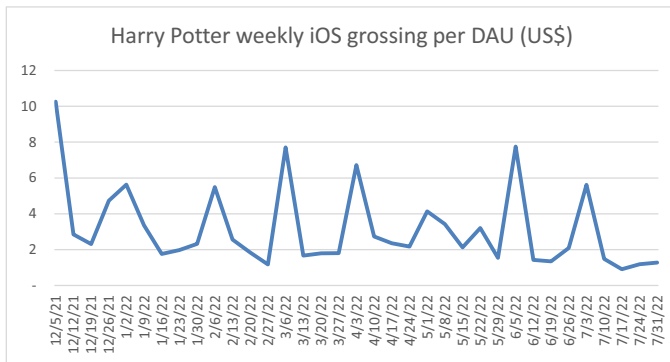
Source: Sensor Tower, Morgan Stanley Research

Exhibit 31: HP China weekly DAU



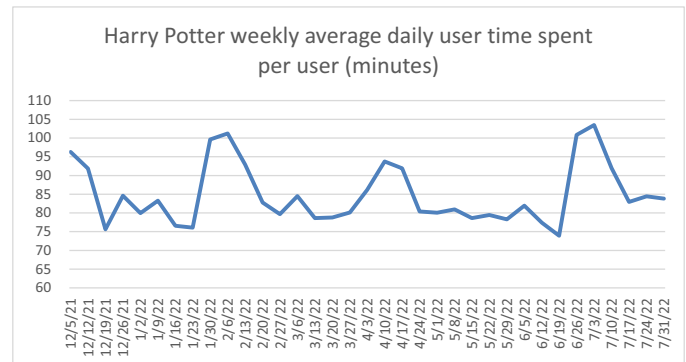
Source: QuestMobile, Morgan Stanley Research

Exhibit 32: HP China weekly iOS grossing/total DAU



Source: Sensor Tower, QuestMobile, Morgan Stanley Research

Exhibit 33: HP China daily user time spent per user



Source: QuestMobile, Morgan Stanley Research

Exhibit 34: Results preview

NetEase												2Q22E	2Q22E
RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	QoQ	YoY
Income Statement													
Online games	13,518	13,828	13,862	13,400	14,982	14,528	15,899	17,398	17,273	16,535	17,477	-4%	14%
Growth YoY	14.1%	20.9%	20.2%	15.5%	10.8%	5.1%	14.7%	29.8%	15.3%	13.8%	9.9%		
Mobile games	9,503	9,998	10,078	9,702	10,907	10,475	10,996	11,883	11,555	11,103	11,985	-4%	6%
Growth YoY	11.2%	21.1%	23.1%	18.8%	14.8%	4.8%	9.1%	22.5%	5.9%	6.0%	9.0%		
PC games	4,015	3,830	3,784	3,698	4,075	4,053	4,903	5,515	5,717	5,431	5,492	-5%	34%
Growth YoY	21.4%	20.5%	13.1%	7.7%	1.5%	5.8%	29.6%	49.1%	40.3%	34.0%	12.0%		
Youdao	541	623	896	1,107	1,340	1,293	1,387	1,334	1,201	925	1,235	-23%	-28%
Music	854	1,124	1,393	1,525	1,491	1,693	1,925	1,889	2,067	2,172	2,259	5%	28%
Innovative business and others	2,149	2,609	2,508	3,730	2,704	3,011	2,980	3,753	3,015	3,167	3,136	5%	5%
Growth YoY	-63.1%	-59.8%	18.4%	23.3%	25.9%	15.4%	18.8%	0.6%	11.5%	5.2%	5.2%		
Net revenues	17,062	18,185	18,658	19,762	20,517	20,525	22,191	24,374	23,556	22,799	24,106	-3%	11%
Growth YoY	-4.6%	-0.3%	33.3%	31.4%	20.2%	12.9%	18.9%	23.3%	14.8%	11.1%	8.6%		
Online games	(4,852)	(5,009)	(5,044)	(4,942)	(5,303)	(4,922)	(5,637)	(6,239)	(6,028)	(5,770)	(6,467)	-4%	17%
Youdao	(306)	(342)	(484)	(581)	(572)	(617)	(602)	(657)	(563)	(511)	(625)	-9%	-17%
Music	(1,083)	(1,292)	(1,444)	(1,672)	(1,545)	(1,651)	(1,882)	(1,812)	(1,816)	(1,998)	(2,056)	10%	21%
Innovative business and others	(1,444)	(1,750)	(1,800)	(2,638)	(2,044)	(2,145)	(2,259)	(2,747)	(2,314)	(2,459)	(2,535)	6%	15%
Cost of revenues	(7,685)	(8,393)	(8,772)	(9,834)	(9,465)	(9,335)	(10,380)	(11,456)	(10,719)	(10,739)	(11,682)	0%	15%
Gross profit	9,378	9,792	9,886	9,928	11,053	11,190	11,811	12,918	12,836	12,060	12,424	-6%	8%
GPM	55.0%	53.8%	53.0%	50.2%	53.9%	54.5%	53.2%	53.0%	54.5%	52.9%	51.5%	-1.6%	-1.6%
Sales and marketing	(1,863)	(2,321)	(3,443)	(3,076)	(2,767)	(3,013)	(3,134)	(3,300)	(2,915)	(2,669)	(3,144)	-8%	-11%
General and administrative	(885)	(893)	(784)	(810)	(950)	(1,011)	(1,140)	(1,162)	(1,016)	(1,021)	(1,150)	1%	1%
Research and development	(2,143)	(2,408)	(2,789)	(3,029)	(3,060)	(3,407)	(3,761)	(3,848)	(3,398)	(3,651)	(3,993)	7%	7%
Operating profit	4,486	4,170	2,870	3,012	4,276	3,758	3,775	4,608	5,507	4,719	4,137	-14%	26%
Interest income	345	397	447	410	389	386	350	395	458	443	443	-3%	15%
Fx gain/(loss) and exceptional	244	17	(1,571)	(1,802)	279	(592)	153	(331)	(98)	0	(0)		
Other income/(expenses)	(43)	1,132	1,390	(133)	843	1,037	(147)	1,925	(332)	-	500	-100%	NM
Profit before tax	5,033	5,716	3,136	1,487	5,787	4,590	4,131	6,597	5,535	5,162	5,080	-7%	12%
Income tax	(1,082)	(1,064)	(343)	(583)	(1,273)	(1,113)	(808)	(934)	(1,219)	(1,121)	(1,105)	-8%	1%
Non-controlling interest	(14)	37	323	172	69	211	6	131	79	70	70	-11%	-67%
Deemed dividends for NCI	(386)	(151)	(118)	(132)	(144)	(145)	(148)	(100)	(1)	-	-	-100%	NM
Net profit	3,551	4,538	2,998	976	4,439	3,542	3,182	5,694	4,394	4,111	4,045	-6%	16%
GAAP Diluted EPS (RMB)	5.42	6.92	4.37	1.43	6.53	5.23	4.73	8.57	6.63	6.23	6.15	-6%	19%
Dividend per share (US\$)	0.23	0.30	0.20	0.06	0.30	0.24	0.23	0.41	0.32	0.29	0.29	-9%	22%
Non-GAAP margin and ratios													
Gross profit	9,586	9,997	10,086	10,110	11,241	11,387	11,991	13,185	13,035	12,262	12,627	-6%	8%
GPM	56.2%	55.0%	54.1%	51.2%	54.8%	55.5%	54.0%	54.1%	55.3%	53.8%	52.4%	-1.5%	-1.7%
GPM - online games	64.1%	63.8%	63.6%	63.1%	64.6%	66.1%	64.5%	64.1%	65.1%	65.1%	63.0%	0.0%	-1.0%
GPM - Youdao	43.5%	45.2%	45.9%	47.5%	57.3%	52.3%	56.6%	50.7%	53.1%	44.7%	49.4%	-8.4%	-7.6%
GPM - music	-26.8%	-14.9%	-3.7%	-9.7%	-3.6%	2.4%	2.2%	4.1%	12.2%	8.0%	9.0%	-4.2%	5.6%
GPM - innovative business	32.8%	32.9%	28.2%	29.3%	24.4%	28.8%	24.2%	26.8%	23.3%	22.4%	19.2%	-0.9%	-6.4%
S&M as % of revenue	10.8%	12.6%	18.3%	15.4%	13.4%	14.6%	14.0%	13.4%	12.2%	11.6%	12.9%	-0.7%	-3.0%
R&D as % of revenue	11.4%	12.1%	13.8%	14.3%	13.9%	15.5%	16.0%	14.4%	13.4%	15.0%	15.6%	1.6%	-0.6%
G&A as % of revenue	3.8%	3.5%	2.9%	3.0%	3.5%	3.7%	4.0%	3.3%	3.1%	3.3%	3.7%	0.2%	-0.4%
Operating profit	5,152	4,862	3,547	3,641	4,926	4,458	4,463	5,611	6,253	5,457	4,876	-13%	22%
Growth YoY	27.4%	19.7%	-9.7%	1.2%	-4.4%	-8.3%	25.8%	54.1%	26.9%	22.4%	9.2%		
Operating margin	30.2%	26.7%	19.0%	18.4%	24.0%	21.7%	20.1%	23.0%	26.5%	23.9%	20.2%	-2.6%	2.2%
Youdao	(168)	(276)	(882)	(438)	(303)	(521)	(109)	(228)	(106)	(372)	(120)	253%	-28%
Ex-Youdao	5,321	5,138	4,429	4,079	5,229	4,979	4,572	5,839	6,359	5,830	4,996	-8%	17%
Operating margin	32.2%	29.3%	24.9%	21.9%	27.3%	25.9%	22.0%	25.3%	28.4%	26.7%	21.8%	-1.8%	0.8%
Net profit (company definition)	4,213	5,226	3,669	1,598	5,081	4,228	3,858	6,596	5,118	4,816	4,750	-6%	14%
Net margin (ex one-off)	24.7%	28.7%	19.7%	8.1%	24.8%	20.6%	17.4%	27.1%	21.7%	21.1%	19.7%	-0.6%	0.5%
Ex-Youdao	4,537	5,698	4,487	2,097	5,462	4,594	4,127	6,802	5,267	5,160	4,927	-2%	12%
Net margin (ex one-off)	27.5%	32.4%	25.3%	11.2%	28.5%	23.9%	19.8%	29.5%	23.6%	23.6%	21.5%	0.0%	-0.3%
Net profit (ex FX & other income)	4,398	4,228	3,969	3,664	4,102	3,928	3,999	5,102	5,549	4,816	4,250	-13%	23%
Net margin (ex one-off)	25.8%	23.2%	21.3%	18.5%	20.0%	19.1%	18.0%	20.9%	23.6%	21.1%	17.6%	-2.4%	2.0%
Ex-Youdao	4,511	4,410	4,553	3,952	4,306	4,259	4,073	5,105	5,603	5,062	4,329	-10%	19%
Net margin (ex one-off)	27.3%	25.1%	25.6%	21.2%	22.5%	22.1%	19.6%	22.2%	25.1%	23.1%	18.9%	-1.9%	1.0%
Diluted EPADS (RMB)	6.43	7.96	5.35	2.34	7.47	6.24	5.74	9.92	7.72	7.29	7.23	-5%	17%
Diluted EPADS (US\$)	0.92	1.12	0.77	0.35	1.16	0.95	0.88	1.51	1.18	1.11	1.10	-5%	17%
Balance sheet													
Deferred revenue	9,981	9,376	10,376	10,945	11,686	11,365	13,571	12,133	12,051	12,185	12,739	1%	7%
- Youdao	603	712	1,066	1,440	1,222	1,293	1,133	1,100	730	1,866	2,049	156%	44%
QoQ change	146	109	354	375	(219)	71	(160)	(33)	(371)	1,136	184		
- Games and others	9,378	8,664	9,311	9,505	10,464	10,072	12,438	11,033	11,321	10,319	10,690	-9%	2%
QoQ change	1,233	(714)	646	194	960	(392)	2,366	(1,405)	289	(1,003)	371		
Net cash	63,265	84,413	83,288	83,646	87,659	84,017	82,135	85,608	84,457	87,003	90,869	3%	4%
QoQ change	2,265	21,148	(1,124)	358	4,013	(3,642)	(1,883)	3,473	(1,151)	2,546	3,866		
Operating data													
Games cash revenue (estimate)	14,751	13,114	14,509	13,594	15,941	14,136	18,265	15,992	17,561	15,981	17,581	-9%	13%
QoQ change	2,854	(1,637)	1,394	(915)	2,348	(1,806)	4,129	(2,273)	1,569	(1,581)	1,600		
Growth YoY	21%	24%	20%	14%	8%	8%	26%	18%	10%	13%	-4%		
Growth QoQ	24%	-11%	11%	-6%	17%	-11%	29%	-12%	10%	-9%	10%		

Source: Company data, Morgan Stanley Research (E) estimates

What's Changed - We lower our game revenue growth estimate to 11% in 2022 (was 13%) and 10% in 2023 (was 12%), implying 7% YoY growth in 2H22 (was 10% YoY). We also update current CNY/USD to 6.75 (was 6.5) and fine tune our margin estimates. Hence our PT drops to US\$110 (was US\$125), implying 22x 2023e P/E.

Exhibit 35: Earnings revision

Earnings revision RMB mn	New			Old			Change		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Online Games	69,429	76,086	84,069	70,720	79,250	89,516	-2%	-4%	-6%
Youdao	4,754	5,981	7,318	4,442	6,697	7,947	7%	-11%	-8%
Innovative businesses	21,978	24,158	26,063	21,736	23,610	25,355	1%	2%	3%
Revenue	96,160	106,226	117,451	96,899	109,558	122,817	-1%	-3%	-4%
Gross profit	50,679	56,082	62,515	51,522	58,773	66,460	-2%	-5%	-6%
Operating profit (GAAP)	19,206	21,782	25,307	19,629	23,307	27,326	-2%	-7%	-7%
Operating profit (Non-GAAP)	22,160	24,726	28,445	22,606	26,343	30,607	-2%	-6%	-7%
Net profit (GAAP)	17,422	19,414	22,113	18,502	21,487	24,625	-6%	-10%	-10%
Net profit (Non-GAAP)	20,244	22,226	25,110	21,345	24,387	27,759	-5%	-9%	-10%
Diluted EPS (GAAP) (Rmb)	26.45	29.93	34.62	28.09	33.12	38.55	-5.8%	-9.6%	-10.2%
Diluted EPS (non-GAAP) (Rmb)	30.73	34.26	39.31	32.40	37.59	43.46	-5.2%	-8.9%	-9.5%
Gross margin	52.7%	52.8%	53.2%	53.2%	53.6%	54.1%	0%	-1%	-1%
Operating margin	20.0%	20.5%	21.5%	20.3%	21.3%	22.2%	-0.3%	-0.8%	-0.7%
Operating margin (Non-GAAP)	23.0%	23.3%	24.2%	23.3%	24.0%	24.9%	-0.3%	-0.8%	-0.7%
Net income margin	18.1%	18.3%	18.8%	19.1%	19.6%	20.1%	-1.0%	-1.3%	-1.2%
Net margin (Non-GAAP)	21.1%	20.9%	21.4%	22.0%	22.3%	22.6%	-1.0%	-1.3%	-1.2%

Source: Morgan Stanley Research (E) estimates

Exhibit 36: Price Target

US\$ mn	Method	FY21 Trailing	FY22E Current	FY23E Forward	% total
Online games (100%)					
Valuation	Target P/E of 19x	55,626	56,982	62,563	87%
Revenue		9,305	10,286	11,272	
Net profit (non-GAAP)		2,928	2,999	3,293	
Net margin		31.5%	29.2%	29.2%	
Music (61.35%)					
Valuation				1,845	3%
Full valuation	Market cap			3,007	
Total revenue		1,037	1,287	1,499	
MAU (mn)		183	184	186	
Education (53%)					
Valuation				956	1%
Full valuation	MS Price Target			1,803	
Cash (100%)					
Valuation				6,256	9%
Net cash 1Q22	Company reported			12,512	
Discount	50%			(6,256)	
GAV		64,682	66,038	71,620	
No of shares (mn)		676	659	649	
NAV per share (US\$)		95.7	100.3	110.4	
Time factor				1.00	
Price Target (US\$)				110	
Price target date				31-Dec-23	
CNY/USD (current)				6.75	

Source: Morgan Stanley Research estimates

Exhibit 37: Financial Summary

Income Statement (Rmb mn)	2020 Dec-20	2021 Dec-21	2022E Dec-22	2023E Dec-23	2024E Dec-24		2020 Dec-20	2021 Dec-21	2022E Dec-22	2023E Dec-23	2024E Dec-24
Online games	54,609	62,806	69,429	76,086	84,069	Margin analysis					
PC games	15,328	18,547	22,071	24,940	27,808	GAAP					
Mobile games	39,281	44,260	47,358	51,147	56,261	Gross margin	52.9%	53.6%	52.7%	52.8%	53.2%
Youdao	3,168	5,354	4,754	5,981	7,318	Online games	63.7%	64.8%	64.1%	64.0%	64.0%
Innovative businesses and others	15,891	19,445	21,978	24,158	26,063	Youdao	45.9%	54.3%	50.3%	51.3%	52.1%
Net revenue	73,667	87,606	96,160	106,226	117,451	Innovative businesses and others	17.4%	17.3%	17.2%	17.9%	18.8%
Online games	(19,848)	(22,101)	(24,917)	(27,389)	(30,282)	Operating margin	19.7%	18.7%	20.0%	20.5%	21.5%
Youdao	(1,713)	(2,448)	(2,362)	(2,912)	(3,503)	Net margin	16.4%	19.2%	18.1%	18.3%	18.8%
Innovative businesses and others	(13,123)	(16,086)	(18,202)	(19,842)	(21,151)	EBITDA	17,996	19,693	22,646	25,394	29,099
Cost of revenues	(34,684)	(40,635)	(45,481)	(50,144)	(54,936)	EBITDA margin	24.4%	22.5%	23.5%	23.9%	24.8%
Gross Profit	38,983	46,971	50,679	56,082	62,515	Basic EPADS (Rmb)	18.2	25.3	26.8	30.3	35.0
Sales and marketing	(10,704)	(12,214)	(11,727)	(12,888)	(14,109)	Diluted EPADS (Rmb)	18.0	24.9	26.4	29.9	34.6
Product development	(10,369)	(14,076)	(15,357)	(16,794)	(18,187)	Non-GAAP					
General and administrative	(3,372)	(4,264)	(4,390)	(4,618)	(4,912)	S&M as % of revenue	14.4%	13.8%	12.1%	12.0%	11.9%
Total operating expenses	(24,445)	(30,554)	(31,473)	(34,300)	(37,208)	R&D as % of revenue	12.9%	14.9%	15.0%	14.9%	14.6%
Operating profit	14,538	16,417	19,206	21,782	25,307	G&A as % of revenue	3.3%	3.6%	3.4%	3.3%	3.2%
Interest income	1,599	1,520	1,771	1,753	1,802	EBITDA	20,660	22,734	25,599	28,338	32,237
FX gain/(loss)	(3,112)	(490)	(98)	-	-	EBITDA margin	28.0%	26.0%	26.6%	26.7%	27.4%
Disposal gain/(loss)	-	-	-	-	-	Gross profit	39,778	47,804	51,489	56,889	63,375
Other income/(expenses)	2,347	3,658	1,000	1,000	1,000	Gross margin	54.0%	54.6%	53.5%	53.6%	54.0%
Profit before tax	15,372	21,104	21,879	24,535	28,109	Operating profit	17,202	19,459	22,160	24,726	28,445
Income taxes	(3,042)	(4,128)	(4,737)	(5,221)	(5,937)	Operating margin	23.4%	22.2%	23.0%	23.3%	24.2%
Profit after tax	12,330	16,976	17,142	19,314	22,172	Net income	14,706	19,762	20,244	22,226	25,110
Non-controlling interest	520	418	281	100	(60)	Net margin	20.0%	22.6%	21.1%	20.9%	21.4%
Deemed dividends repurchase NCI	(787)	(537)	(1)	(0)	(0)	Basic EPADS (Rmb)	22.25	29.63	31.10	34.68	39.80
Net profit	12,063	16,857	17,422	19,414	22,113	Diluted EPADS (Rmb)	21.95	29.23	30.73	34.26	39.31
						Diluted EPADS (US\$)	3.18	4.52	4.80	5.35	6.14
Balance sheet (Rmb mn)						Key drivers					
Cash and cash equivalents	9,117	14,498	12,785	15,049	19,041	Revenue growth	9%	19%	10%	10%	11%
Short term investments	13,273	12,282	13,216	14,149	15,083	Online games growth	18%	15%	11%	10%	10%
Term Deposit	71,079	70,755	67,060	63,365	59,670	PC games	16%	21%	19%	13%	12%
Restricted Cash	3,051	2,877	2,877	2,877	2,877	Mobile games	18%	13%	7%	8%	10%
Accounts receivable, net	4,576	5,508	6,046	6,679	7,384	Innovative businesses and others	-20%	22%	13%	10%	8%
Others	6,734	7,201	7,101	7,153	7,166	SBC as % of revenue	3.6%	3.5%	3.1%	2.8%	2.7%
Current assets	107,831	113,120	109,083	109,272	111,222	Effective tax rate	19.8%	19.6%	21.7%	21.3%	21.1%
Fixed assets, net	4,555	5,434	6,195	6,955	7,716	Domestic game revenue	48,139	56,337	59,959	61,617	64,600
Time Deposit	6,630	5,824	5,824	5,824	5,824	Overseas game revenue	6,469	6,469	9,469	14,469	19,469
Others	22,858	29,266	34,835	40,355	45,824	Cash flow statement					
Total Assets	141,875	153,644	155,937	162,406	170,586	Operating cash flows	24,888	24,927	23,606	28,407	31,208
Deferred revenue	10,945	12,133	12,118	13,979	15,403	Non-cash and other adjustments	7,786	4,763	6,393	6,556	6,930
Short-Term Bank Loans	19,505	19,352	19,352	19,352	19,352	Change in working capital	4,771	3,188	71	2,537	2,106
Accrued liabilities	10,876	13,494	13,900	15,149	16,433	Profit after tax	12,330	16,976	17,142	19,314	22,172
Others	5,417	5,522	5,640	5,753	5,869	Investing cash flows	(29,192)	(7,078)	(7,008)	(7,131)	(7,261)
Current liabilities	46,743	50,501	51,010	54,232	57,057	Change in deposits	(1,656)	3,695	3,695	3,695	3,695
Non-current liabilities	1,337	3,719	3,719	3,719	3,719	Change in investments	4,943	(934)	(934)	(934)	(934)
Total Liability	48,081	54,220	54,729	57,951	60,776	Invest in associated companies	(2,408)	(6,542)	(6,542)	(6,542)	(6,542)
Additional paid-in capital	27,829	37,916	40,870	43,814	46,952	PPE and intangible assets	(3,273)	(3,038)	(3,227)	(3,351)	(3,480)
Retained earnings	53,717	56,992	56,103	56,505	58,662	Others	(26,799)	(259)	-	-	-
Other reserves	11,377	565	565	565	565	Financing cash flows	9,913	(12,586)	(18,312)	(19,012)	(19,956)
Non-controlling interests	871	3,951	3,670	3,570	3,630	Dividends	(4,280)	(3,508)	(5,312)	(6,012)	(6,956)
Total equity	93,794	99,424	101,208	104,455	109,809	Others	14,194	(9,077)	(13,000)	(13,000)	(13,000)
Total liability & equity	141,875	153,644	155,937	162,406	170,586	FX change	162	(55)	-	-	-
Net cash	83,646	86,883	82,408	81,912	83,142	Net change in cash balance	5,771	5,208	(1,714)	2,265	3,992
						Cash at beginning of period	6,397	12,167	17,375	15,661	17,926
						Cash at end of period	12,167	17,375	15,661	17,926	21,918

Source: Company data, Morgan Stanley Research (E) estimates

Kuaishou

We expect Kuaishou's 2Q22 results to beat market expectations, particularly user traffic, e-commerce GMV and margin.

For **e-commerce**, Kuaishou's GMV grew >30% YoY in June, and growth accelerated further in early July, driven by company-specific factors such as higher utilization of public domain traffic, strong traffic growth (>40% YoY in 1H22E), and higher brands/Kwai brands mix.

On **margins**, we expect break-even timing for the China segment and the group to be before consensus expectations of 4Q22 and 2023, respectively, driven by a lower revenue sharing ratio, leverage of staff and other fixed costs, and higher user retention / acquisition efficiency.

But we are concerned about the weak external ads environment (down both QoQ and YoY in 2Q22E), that may not see a strong rebound in 2H22. But its closed-loop ecommerce ads which contributed >35% of ad revenue in 1Q22 and strong traffic growth of >40% YoY in 1H22E (DAU +18% YoY) should support faster ads recovery than peers.

The stock is trading at 2022e P/S of 3x (in line with BILI) and P/GP of 7x (50% discount to BILI). We think earlier breakeven for its China segment and overall group could narrow its P/GP discount to BILI.

For more details, see our previous reports:

[Kuaishou Technology: E-Commerce Conference Reveals More Growth Drivers \(5 Aug 2022\)](#)

[Kuaishou Technology: Catalyst Driven Idea \(2 Aug 2022\)](#)

[Kuaishou Technology: Multi-Year Share Gainer Via E-Commerce \(26 Jul 2022\)](#)

[Kuaishou Technology: 2Q22 Preview: Speedy Recovery \(21 Jul 2022\)](#)

Weibo

2Q Preview - We expect 2Q22 results to be in-line with consensus, with advertising revenue dropping 23% YoY in 2Q22 (+10% YoY in 1Q22) due to weaker China macro environment and high base last year, and non-GAAP operating profit of US\$117mn (-14% QoQ; -47% YoY). Among different ad verticals, games have been more resilient, partly helped by resumption of game license since April. Ecommerce and auto ads could recover later this year driven by double 11 festival and new launches, respectively.

2H22 Outlook - We expect Weibo's recovery in 2H22 to lag other advertising peers due to its higher exposure to brand advertising, but we still expect non-GAAP operating margin to grow HoH to 30% in 2H22 driven by disciplined S&M expenses, despite the increase in content compliance cost (1ppts), cultural construction fee (1.5ppts), content vertical investments (1-2ppts) and operating de-leverage.

Exhibit 38: Earnings Preview

Income statement (US\$ mn)	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	2Q22E QoQ	2Q22E YoY
Advertising and marketing	390	502	538	551	427	386	423	-10%	-23%
Growth YoY	42%	47%	29%	21%	10%	-23%	-21%		
VAS	69	72	70	65	58	59	60	3%	-18%
Growth YoY	44%	54%	42%	9%	-17%	-18%	-14%		
Net Revenue	459	574	607	616	485	446	483	-8%	-22%
Cost of revenues	(80)	(93)	(103)	(129)	(105)	(100)	(106)	-5%	8%
Gross profit	379	482	504	488	380	346	378	-9%	-28%
Gross margin	82.6%	83.9%	83.0%	79.1%	78.4%	77.6%	78.1%	-0.8ppt	-6.3ppt
Sales and marketing	(144)	(154)	(141)	(152)	(125)	(106)	(106)	-15%	-31%
Product development	(97)	(101)	(119)	(114)	(112)	(110)	(113)	-2%	8%
General and administrative	(30)	(33)	(32)	(39)	(39)	(33)	(33)	-16%	0%
Operating profit	109	193	213	183	103	97	125	-6%	-50%
Operating margin	23.7%	33.6%	35.1%	29.6%	21.2%	21.7%	25.9%	0.5ppt	-11.9ppt
Gain on sale of and impairment on investm	(58)	(77)	1	(42)	(178)	-	1	-100%	-100%
Interest and other income, net	14	11	(0)	5	14	8	8	-45%	-30%
Pre-tax profit (loss)	64	128	213	146	(61)	105	133	-273%	-18%
Income tax (expenses) benefits	(15)	(47)	(31)	(46)	(12)	(25)	(31)	113%	-47%
Noncontrolling interest	1	0	(0)	16	5	4	4		
Net profit (Loss) attributable to Weibo	50	81	182	116	(68)	84	107	-224%	3%
Net margin	10.9%	14.1%	29.9%	18.8%	-13.9%	18.8%	22.1%	32.8ppt	4.7ppt
Diluted EPADS (US\$)	0.57	0.80	0.88	0.84	0.56	0.44	0.54	-22%	-45%
Non-GAAP measures									
Gross Profit	381	484	507	490	382	348	379	-9%	-28%
EBITDA	137	227	252	224	144	126	155	-13%	-44%
Non-GAAP EBITDA margin	29.8%	39.5%	41.4%	36.3%	29.8%	28.3%	32.1%	-1.5ppt	-11.2ppt
Operating profit	129	219	244	215	136	117	146	-14%	-47%
Non-GAAP OPM	28.1%	38.0%	40.1%	34.9%	28.0%	26.2%	30.1%	-1.8ppt	-11.8ppt
Net profit (loss) attributable to Weibo	131	183	210	196	133	104	127	-22%	-43%
Non-GAAP NPM	28%	32%	34%	32%	27%	23%	26%	-4.1ppt	-8.5ppt
Opex as % of revenue	55.8%	47.0%	44.3%	45.6%	52.1%	51.8%	48.4%	-0.3ppt	4.8ppt
S&M as % of revenue	30.9%	26.3%	22.4%	23.9%	24.9%	23.0%	21.0%	-1.9ppt	-3.3ppt
G&A as % of revenue	19.3%	15.9%	17.7%	16.1%	20.4%	22.2%	21.3%	1.8ppt	6.4ppt
R&D as % of revenue	5.7%	4.8%	4.1%	5.5%	6.7%	6.6%	6.0%	-0.1ppt	1.7ppt
Operating metrics									
MAU (mn)	530	566	573	623	582	589	596	1%	4%
QoQ(mn)	30	36	7	50	(41)	7	7	-116%	-82%
Mobile MAU (mn)	498	532	539	592	553	559	566	1%	5%
Mobile contribution (%)	94.0%	94.0%	94.0%	95.0%	95.0%	95.0%	95.0%	0.0ppt	1.0ppt
DAU (mn)	230	246	248	272	252	256	259	2%	4%
QoQ(mn)	24	16	2	24	(20)	4	3	-119%	-76%
DAU to MAU Ratio	46.2%	46.2%	46.0%	46.0%	45.6%	45.7%	45.7%	0.2ppt	-0.5ppt
Advertising revenue per MAU (USD)	0.74	0.89	0.94	0.88	0.73	0.66	0.71	-26%	-26%
Advertising revenue per DAU (USD)	1.70	2.04	2.17	2.03	1.69	1.41	1.56	-17%	-31%

Source: Company data, Morgan Stanley Research (E) estimates

What's changed - We lower our 2022-24 non-GAAP EPS estimates by 19-23% and PT by 15% as we assume slower advertising revenue recovery in 2H22 and 2023 amid the uncertain China macro environment. We also change our valuation methodology from DCF to target 2023e P/E at 10x, as Weibo's product cycle and profitability profile have both matured. Our target multiple of 10x is based on our expectation of 10% revenue and profit growth in 2023.

Exhibit 39: What's changed

FYE Dec Income Statement (US\$ mn)	New			Old			% Change		
	2022E	2023E	2024E	2022E	2023E	2024E	2022E	2023E	2024E
Advertising and marketing	1,679	1,842	2,000	1,878	2,216	2,364	-11%	-17%	-15%
VAS and others	238	242	247	241	242	235	-1%	0%	5%
Total net revenues	1,916	2,085	2,247	2,118	2,458	2,599	-10%	-15%	-14%
Cost of revenues (ex-SBC)	(412)	(433)	(475)	(451)	(510)	(550)	-9%	-15%	-14%
Gross profit	1,496	1,643	1,762	1,658	1,937	2,038	-10%	-15%	-14%
Sales and marketing (ex-SBC)	(431)	(500)	(523)	(488)	(601)	(635)	-12%	-17%	-18%
Product development (ex-SBC)	(406)	(435)	(458)	(396)	(439)	(465)	3%	-1%	-1%
General and administrative (ex-SBC)	(120)	(128)	(134)	(121)	(123)	(130)	0%	4%	3%
SBC	(87)	(92)	(97)	(96)	(109)	(112)	-10%	-15%	-14%
Income from operations	459	496	559	566	675	706	-19%	-27%	-21%
Interest and other income (expenses), net	35	59	60	44	59	60	-21%	0%	0%
Income(loss) before income tax	316	556	619	583	735	766	-46%	-24%	-19%
Income tax (expenses) benefits	(99)	(110)	(122)	(99)	(125)	(130)	0%	-12%	-6%
Net income (loss) attributable to Weibo	234	462	514	500	626	653	-53%	-26%	-21%
Income (loss) per ADS - Basic (US\$)	0.99	1.95	2.15	2.13	2.65	2.74	-53%	-26%	-22%
Income (loss) per ADS - Diluted (US\$)	0.99	1.94	2.14	2.08	2.59	2.67	-52%	-25%	-20%
Non-GAAP									
Gross profit	1,504	1,652	1,771	1,667	1,947	2,049	-9.8%	-15.2%	-13.5%
Operating income	552	589	656	675	784	819	-18%	-25%	-20%
Net income	494	554	611	620	735	765	-20%	-25%	-20%
Income (loss) per ADS - Diluted (US\$)	2.09	2.33	2.54	2.58	3.04	3.14	-19%	-23%	-19%
GPM	78.5%	79.2%	78.8%	78.7%	79.2%	78.8%	-0.2%	0.0%	0.0%
OPM	28.8%	28.2%	29.2%	31.8%	31.9%	31.5%	-3.0%	-3.7%	-2.3%
NPM	25.8%	26.6%	27.2%	29.3%	29.9%	29.4%	-3.5%	-3.3%	-2.2%

Source: Morgan Stanley Research estimates

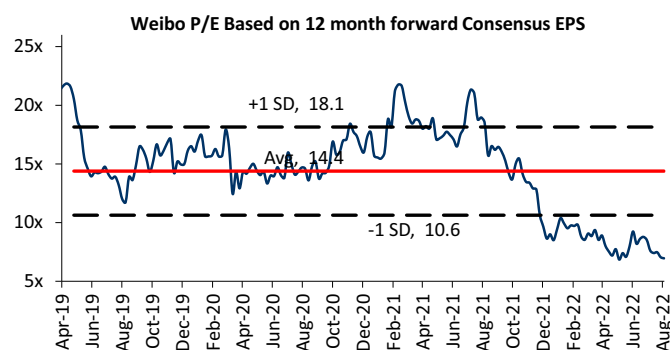
We change our valuation methodology from DCF to target P/E multiple as we think Weibo's product cycle and margin profile have both matured. We use 10x 2023E P/E to value Weibo, which represents one standard deviation below Weibo's average P/E since 2019 to factor in slower growth profile going forward. We use 14x P/E for our bull case (in line with the average since 2019) and 7x for our bear case (near the trough since 2019, reflecting slower growth).

Exhibit 40: Change of valuation methodology

Valuation (US\$m)	2021	2022E	2023E	2024E
Revenue	2,257	1,916	2,085	2,247
Growth YoY	34%	-15%	9%	8%
Gross profit (non-GAAP)	1,861	1,504	1,652	1,771
Gross margin	82%	79%	79%	79%
EBITDA (non-GAAP)	861	590	631	703
Operating margin	38%	31%	30%	31%
Operating profit (non-GAAP)	806	552	589	656
Operating margin	36%	29%	28%	29%
Net profit (non-GAAP)	719	494	554	611
Net margin	32%	26%	27%	27%
Target P/E multiple			10	
Equity value (US\$m)			5,541	
No of diluted ADS (m)			238	
Price Target (US\$)			23.0	
Price Target date			12/31/23	

Source: Company data, Morgan Stanley Research estimates

Exhibit 41: Weibo NTM Consensus P/E



Source: Refinitiv, Morgan Stanley Research

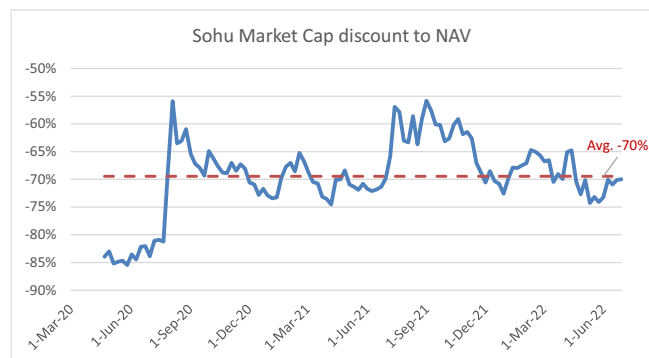
Exhibit 42: Financial Summary

US\$, mn	FY20	FY21	FY22E	FY23E	FY24E
Income Statement					
Advertising and marketing	1,486	1,981	1,679	1,842	2,000
VAS	204	276	238	242	247
Total net revenue	1,690	2,257	1,916	2,085	2,247
Cost of revenues	(302)	(404)	(420)	(441)	(485)
Gross Profit	1,388	1,853	1,496	1,643	1,762
Sales and marketing	(456)	(592)	(448)	(518)	(542)
Product development	(324)	(431)	(451)	(483)	(510)
General and administrative	(101)	(133)	(139)	(146)	(151)
Total Operating expenses	(881)	(1,156)	(1,037)	(1,147)	(1,203)
Operating profit	507	697	459	496	559
Change in FV of investor option liability	-	-	-	-	-
Interest and other income/expenses	44	30	35	59	60
Net income before tax	376	551	316	556	619
Income taxes	(61)	(139)	(99)	(110)	(122)
Net income	315	412	217	445	497
Non-controlling interest	(1)	16	16	16	16
NPAT to Shareholders	313	428	234	462	514
Balance sheet					
Cash and cash equivalents	1,815	2,424	2,020	1,629	2,205
Short term investments	1,682	711	711	711	711
Accounts receivable, net	492	723	614	668	720
Fixed assets, net	61	68	51	44	33
Intangible assets, net	209	297	297	297	297
Others	2,077	3,296	3,250	3,290	3,326
Total Assets	6,335	7,520	6,944	6,639	7,293
Accounts payable	252	342	356	374	411
Accrued liabilities	562	829	829	829	829
Deferred revenues	144	91	77	84	91
Others	2,743	2,911	2,028	1,163	1,199
Total Liability	3,449	3,832	2,935	2,076	2,119
Retained earnings	-	-	234	695	1,209
Total Equity	2,886	3,688	4,009	4,563	5,174

Source: Company data, Morgan Stanley Research (E) estimates

US\$, mn	FY20	FY21	FY22E	FY23E	FY24E
Margin analysis (Non-GAAP)					
Gross Profit	1,393	1,861	1,504	1,652	1,771
EBITDA	612	861	590	631	703
Operating Income	580	806	552	589	656
Net Income	547	719	494	554	611
Gross margin	82.4%	82.5%	78.5%	79.2%	78.8%
EBITDA margin	36.2%	38.1%	30.8%	30.3%	31.3%
Operating margin	34.3%	35.7%	28.8%	28.2%	29.2%
Net margin	32.4%	31.8%	25.8%	26.6%	27.2%
Per share (US\$)					
EPADS	1.38	1.87	0.99	1.95	2.15
Diluted EPADS	1.38	1.86	0.99	1.94	2.14
Non-GAAP EPADS	2.41	3.14	2.10	2.34	2.55
Non-GAAP Diluted EPADS	2.40	3.12	2.09	2.33	2.54
Key drivers					
Revenue growth (% y-y)	-4%	34%	-15%	9%	8%
Non-GAAP S&M expense / Rev	26%	26%	23%	24%	23%
Non-GAAP R&D expense / Rev	17%	17%	21%	21%	20%
Non-GAAP G&A expense / Rev	5%	5%	6%	6%	6%
SBC / Rev	4%	4%	5%	4%	4%
Cashflow and Ratio analysis					
Operating cash flow	742	814	528	528	613
Financing cashflow	792	742	189	(897)	(884)
Investing cashflow	(1,214)	(424)	(35)	(36)	(36)
Changes in cash	362	609	(404)	(391)	577
ROE	11%	12%	6%	10%	10%
ROA	5%	6%	3%	7%	7%
Debt/Asset	38%	20%	9%	10%	9%

Sohu

Exhibit 43: Historical holding discount

Source: Company data, Refinitiv, Morgan Stanley Research

What's changed - We maintain EW and our PT stays unchanged at US\$17 while adjusting our 2022-24 EPS by 40-150%. The large EPS changes are mainly due to its small profit base, as the company's overall profitability has been fluctuating around the breakeven level in the last four quarters, and we expect the same in 2H22 and 2023, with the company's profitable gaming business offsetting the losses of the video and media portal businesses. We use the average discount (70%) of market cap to NAV for Sohu since April 2020 (after the completion of Changyou privatization) in our SOP valuation.

2Q22 Review - Sohu.Com Inc: 2Q22 Profit Beat (8 Aug 2022)**Exhibit 44:** What's changed

US\$ mn	New			Old			Changes		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Net revenue	752	688	687	726	695	692	4%	-1%	-1%
Cost of revenues	(209)	(186)	(186)	(211)	(192)	(190)	-1%	-3%	-2%
Gross Profit	543	502	500	514	504	502	6%	0%	0%
Operating profit	(0)	(3)	19	(37)	(29)	(7)	-99%	-90%	-380%
Net income	(35)	(33)	(10)	(66)	3	22	-46%	-1107%	-148%
Non-GAAP Net income	(28)	(26)	(3)	(58)	10	29	-53%	-353%	-112%
Diluted EPADS (US\$)	(0.99)	(0.93)	(0.29)	(1.65)	0.08	0.55	-40%	-1227%	-153%
Non-GAAP Diluted EPADS (US\$)	(0.78)	(0.74)	(0.10)	(1.47)	0.26	0.72	-47%	-383%	-113%

Source: Morgan Stanley Research estimates

Exhibit 45: SOTP valuation

US\$ mn	Remarks	Stake	2023E	% Total
Sohu Video and Media Portal	Burning cash	100%	-	0%
Changyou	Privatization Value	100%	580	28%
Net Cash (2Q22)	Reported	100%	1,465	72%
Total			2,046	
Holding discount	70.0%		(1,432)	
Discounted NAV			614	
No of shares			36	
Price Target (US\$)			17.0	
Price Target date			31-Dec-23	

Source: Company data, Morgan Stanley Research estimates

Exhibit 46: Financial Summary

(US\$ mn)	2020	2021	2022E	2023E	2024E		2020	2021	2022E	2023E	2024E
	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24		Dec-20	Dec-21	Dec-22	Dec-23	Dec-24
Income statement						Margin analysis					
Online advertising	147	135	106	113	120	GAAP					
Online games	537	638	590	521	514	Gross margin	71%	76%	72%	73%	73%
Others	67	62	57	55	53	Operating margin	10%	12%	0%	0%	3%
Total revenue	750	836	752	688	687	Net margin	-11%	111%	-5%	-5%	-2%
Cost of revenues	(217)	(205)	(209)	(186)	(186)	EBITDA	113	133	141	142	167
Gross profit	532	631	543	502	500	EBITDA margin	15%	16%	19%	21%	24%
Sales and marketing	(160)	(183)	(217)	(178)	(155)	Non-GAAP					
Product development	(242)	(269)	(268)	(268)	(268)	Gross margin	71%	76%	72%	73%	73%
General and administrative	(57)	(82)	(58)	(58)	(58)	Operating margin	12%	13%	1%	1%	4%
Total operating expenses	(459)	(533)	(544)	(505)	(482)	Net income	(48)	949	(28)	(26)	(3)
Operating profit	73	97	(0)	(3)	19	Net margin	-6%	114%	-4%	-4%	-1%
Interest and other income, net	7	16	13	18	19	EBITDA	132	142	148	149	174
Other income, net	26	29	20	20	20	EBITDA margin	18%	17%	20%	22%	25%
Net income before tax	97	132	33	35	58	Segment margin					
Income taxes	(133)	(62)	(68)	(68)	(68)	Non-GAAP gross margin					
Net income before NCI	(37)	69	(35)	(33)	(10)	Online advertising					
Non-controlling interest	42	(6)	0	0	0	- Brand advertising	28%	26%	13%	27%	30%
Net profit	(86)	928	(35)	(33)	(10)	- Search and web directory					
Diluted EPADS (US\$)	(2.18)	23.49	(0.99)	(0.93)	(0.29)	Online games	83%	86%	83%	83%	83%
Diluted EPADS Non-GAAP (US\$)	(1.21)	24.04	(0.78)	(0.74)	(0.10)	Others	70%	72%	72%	72%	72%
Balance sheet						Sohu video					
Cash and cash equivalents	217	999	1,100	1,137	1,202	Revenue	91	88	76	77	77
Short term investments	101	399	399	399	399	Net loss	(44)	(47)	(80)	(69)	(64)
Accounts receivable, net	88	83	74	68	68	Sohu media portal					
Long term investments	32	53	53	53	53	Revenue	86	76	63	68	73
Fixed assets, net	338	330	227	151	73	Net loss	(92)	(134)	(162)	(117)	(102)
Intangible assets, net	5	9	9	9	9	Key drivers					
Goodwill	48	49	49	49	49	Revenue growth	11%	11%	-10%	-9%	0%
Others	1,994	324	313	305	305	Online advertising growth	-16%	-8%	-22%	7%	6%
Total Assets	2,822	2,246	2,224	2,172	2,158	Online games growth	22%	19%	-8%	-12%	-1%
Deferred revenue	108	87	89	80	80	S&M / Rev	21%	22%	29%	26%	23%
Accrued liabilities	158	138	141	131	125	G&A / Rev	7%	9%	10%	12%	11%
Convertible debt	92	0	0	0	0	R&D / Rev	31%	32%	36%	38%	39%
Others	1,433	728	730	723	719	Cash flow statement					
Total Liability	1,790	954	960	933	923	Cash flows from operating activities	(20)	1,843	139	107	135
Additional paid-in capital	1,119	1,127	1,135	1,142	1,149	Cash flows from investing activities	184	(537)	(73)	(70)	(70)
Retained earnings	(666)	(603)	(638)	(672)	(682)	Cash flows from financing activities	102	(425)	0	0	0
Non-controlling interests	685	1	1	1	1	Net change in cash balance	646	41	66	37	66
Others	(106)	767	767	767	767	Cash at end of period	217	999	1,100	1,137	1,202
Total equity	1,032	1,292	1,265	1,238	1,235						
Total liability & equity	2,822	2,246	2,224	2,172	2,158						

Source: Company data, Morgan Stanley Research (E) estimates

Risk Reward – NetEase, Inc (NTES.O) Top Pick

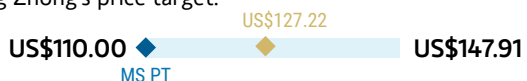
Multi-year product cycle with medium-term margin tailwind

PRICE TARGET US\$110.00

Base case, sum of the parts.

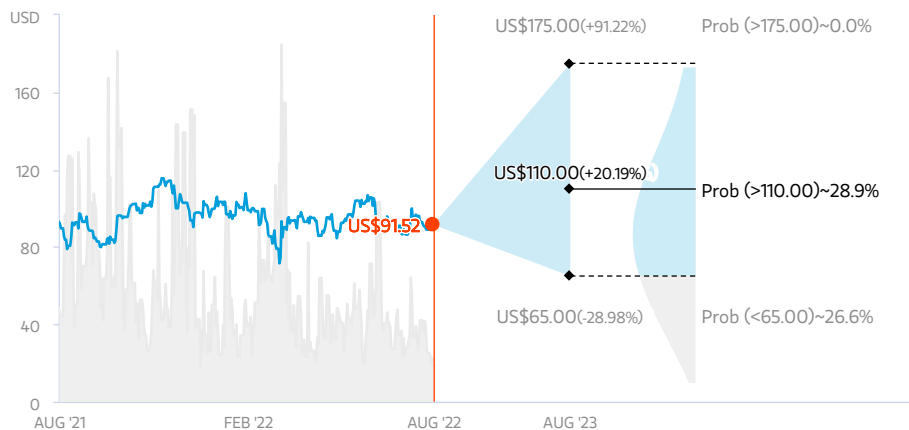
- Games - 19x 2023e P/E, compared to US/EU publishers at 15-35x, because overseas markets are rising in NetEase's game revenue revenue mix.
- Music - Latest market cap adjusted for NTES stake of 61.35%.
- Youdao - Morgan Stanley analyst Sheng Zhong's price target.

Consensus Price Target Distribution



Source: Refinitiv, Morgan Stanley Research

RISK REWARD CHART AND OPTIONS IMPLIED PROBABILITIES (12M)



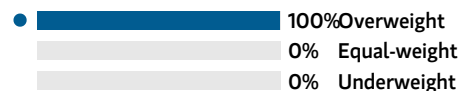
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research, Morgan Stanley Institutional Equities Division. The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of 11 Aug, 2022. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in either three-months' or one-years' time. View explanation of Options Probabilities methodology [here](#)

OVERWEIGHT THESIS

- Its more certain and sustainable low- to mid-teens game revenue and profit CAGRs through 2024 vs. a shrinking number of high-growth companies in China's internet industry.
- Narrowing losses of non-game segments, and share buybacks of US\$2bn, p.a., also help EPS growth.
- NetEase also pays 25-30% of GAAP net profit in dividends quarterly.
- Our SOTP-based price target implies 21x 2023e P/E, reflecting potential upside from the margin tailwind of the decrease in channel fees in the medium term.

Consensus Rating Distribution



● MS Rating

Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Market Share: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE	US\$175.00	BASE CASE	US\$110.00	BEAR CASE	US\$65.00
21x 2023e bull case non-GAAP EPS		22x 2023e base case non-GAAP EPS		24x 2023e bear case non-GAAP EPS	
Stronger-than-expected growth driven by diversification and global expansion: We assume game revenue CAGR of 25% in 2021-23. Non-GAAP operating margin 6ppt above our base case in 2022.		Sustained growth in gaming revenue: Game revenue CAGR of 10% over 2021-23. Non-GAAP operating margin of 23% in 2022.		Gaming revenue growth is capped by competition while margin is eroded by loss-making businesses: Game revenue CAGR of 8% in 2021-23. Non-GAAP operating margin 7ppt below our base case in 2022.	

Risk Reward – NetEase, Inc (NTES.O)

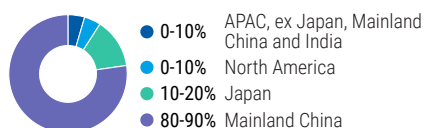
KEY EARNINGS INPUTS

Drivers	2021	2022e	2023e	2024e
Mobile game revenue (Rmb, mn)	44,260	47,358	51,147	56,261
PC game revenue (Rmb, mn)	18,547	22,071	24,940	27,808
Innovative business and others (Rmb, mn)	12,448	13,290	14,039	14,863

INVESTMENT DRIVERS

- Diversification and global expansion
- Game revenue growth
- Margin expansion

GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

SUSTAINABILITY & ESG



RISKS TO PT/RATING

RISKS TO UPSIDE

- Better-than-expected performance of existing and/or new game titles
- Faster-than-expected overseas expansion

RISKS TO DOWNSIDE

- Shorter-than-expected lifecycle of games
- Weaker-than-expected margin, with a drag from loss-making businesses

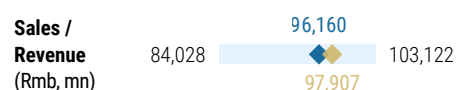
OWNERSHIP POSITIONING

Inst. Owners, % Active	85.5%
HF Sector Long/Short Ratio	2.5x
HF Sector Net Exposure	12%

Refinitiv; MSPB Content. Includes certain hedge fund exposures held with MSPB. Information may be inconsistent with or may not reflect broader market trends. Long/Short Ratio = Long Exposure / Short exposure. Sector % of Total Net Exposure = (For a particular sector: Long Exposure - Short Exposure) / (Across all sectors: Long Exposure – Short Exposure).

MS ESTIMATES VS. CONSENSUS

FY Dec 2022e



◆ Mean ◆ Morgan Stanley Estimates
Source: Refinitiv, Morgan Stanley Research

Risk Reward – Weibo Corp (WB.O)

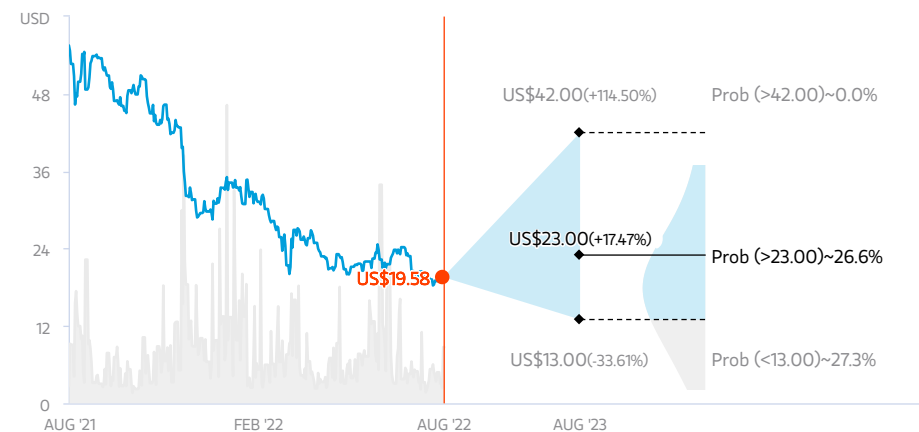
Limited visibility raises lingering concerns; EW

PRICE TARGET US\$23.00

Base case, target P/E of 10x (1 S.D. below the average P/E in the last three years to factor in structural competition from short video) based on 2023E. We assume 9% YoY revenue growth in 2023 and non-GAAP NP margin of 27% in 2023.



RISK REWARD CHART AND OPTIONS IMPLIED PROBABILITIES (12M)



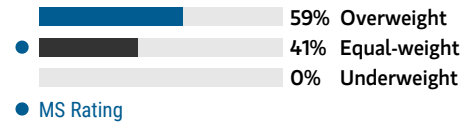
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research, Morgan Stanley Institutional Equities Division. The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of 11 Aug, 2022. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in either three-months' or one-years' time. View explanation of Options Probabilities methodology [here](#)

EQUAL-WEIGHT THESIS

- Weibo is affected by macro and competitive headwinds, which could linger and may take time to fully dissipate.
- We think the structural challenge from the ad inventory increase across the industry will be hard to mitigate in the near term.
- We await more visibility on the ad demand outlook and Weibo's monetization progress amid healthy user momentum.
- We see valuation support at the current multiple, but would suggest revisiting the stock if there is an ad recovery in 2H22.
- Our price target implies 10x P/E on our 2022 non-GAAP EPS forecast vs. the historical trading band of 8x to 21x since 2020, given milder earnings growth trajectory and visibility.

Consensus Rating Distribution



Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Disruption: *Negative*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE

US\$42.00

BASE CASE

US\$23.00

BEAR CASE

US\$13.00

14x bull case non-GAAP 2022e EPADS

Enhanced monetization efficiency driving better-than-expected top-line growth: We assume 14% YoY revenue growth in 2023 and non-GAAP NP margin of 33% in 2023.

10x base case non-GAAP 2023e EPADS

Top-line growth and operating leverage intact: We assume 9% YoY revenue growth in 2023 and non-GAAP NP margin of 27% in 2023.

7x bear case non-GAAP 2022e EPADS

Intense competition leading to slower-than-expected monetization: We assume 4% YoY revenue growth in 2023 and non-GAAP NP margin of 22% in 2023.

Risk Reward – Weibo Corp (WB.O)

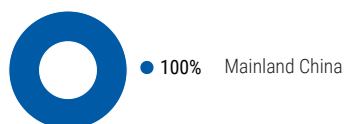
KEY EARNINGS INPUTS

Drivers	2021	2022e	2023e	2024e
MAU (mn)	573.0	595.9	607.8	617.0
Ad Revenue / MAU (US\$)	3.2	2.6	2.8	3.0
KA Ad Revenue Growth (%)	36.2	(3.0)	13.3	8.2
SME Ad Revenue Growth (%)	40.2	(6.1)	13.3	5.2
Non-GAAP EBIT Margin (%)	35.7	28.8	28.2	29.2

INVESTMENT DRIVERS

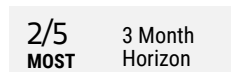
- User base expansion with higher engagement level
- Improving ad efficiency and product offerings attract advertisers to shift budgets to social media platforms
- Operating leverage from prevailing network effect and rational sales marketing expenses

GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

MS ALPHA MODELS



Source: Refinitiv, FactSet, Morgan Stanley Research; 1 is the highest favored Quintile and 5 is the least favored Quintile

SUSTAINABILITY & ESG



RISKS TO PT/RATING

RISKS TO UPSIDE

- Faster top-line growth, driven by shift to social ad and more efficient monetization
- Better operating leverage, leading to healthier margin expansion
- Stronger user engagement from new initiatives

RISKS TO DOWNSIDE

- Macro slowdown and regulatory risks
- Loss of time spent to other content platforms, which may cause lower traffic growth
- Further earnings estimate cuts from elevated content and talent investments

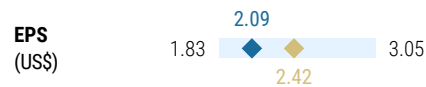
OWNERSHIP POSITIONING

Inst. Owners, % Active	51.3%	
HF Sector Long/Short Ratio	2.5x	
HF Sector Net Exposure	12%	

Refinitiv; MSPB Content. Includes certain hedge fund exposures held with MSPB. Information may be inconsistent with or may not reflect broader market trends. Long/Short Ratio = Long Exposure / Short exposure. Sector % of Total Net Exposure = (For a particular sector: Long Exposure - Short Exposure) / (Across all sectors: Long Exposure – Short Exposure).

MS ESTIMATES VS. CONSENSUS

FY Dec 2022e



◆ Mean ◆ Morgan Stanley Estimates
Source: Refinitiv, Morgan Stanley Research

Risk Reward – Sohu.Com Inc (SOHU.O)

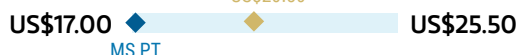
Reinvesting in uncertain times

PRICE TARGET US\$17.00

SOTP

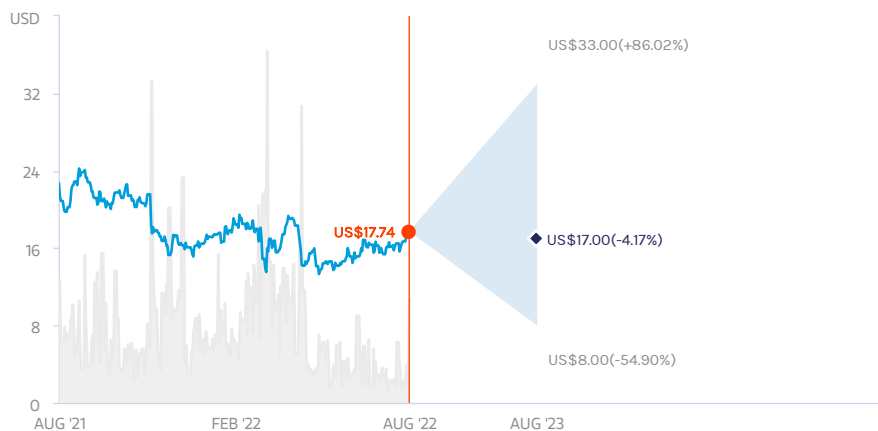
- Zero value to Sohu video and the media portal business given its loss-making status, with limited visibility on standalone profitability
- Privatization value of Changyou
- Latest reported net cash
- We use the average discount (70%) of market cap to NAV for Sohu since April 2020 (after the completion of Changyou privatization) in our SOP valuation.

Consensus Price Target Distribution



Source: Refinitiv, Morgan Stanley Research

RISK REWARD CHART



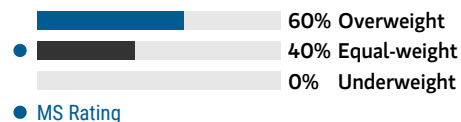
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

EQUAL-WEIGHT THESIS

- We are EW relative to the rest of our China Internet coverage, given Sohu's milder top-line growth vs. peers.
- We are concerned about the ad revenue growth outlook, given gloomy ad sentiment and intensifying competition.
- We are conservative on online game revenue growth from Changyou, owing to limited visibility in game pipeline and natural decline of its legacy games.
- The stock could continue to trade at a discount (we apply a 70% discount to NAV in our SOP valuation) in view of the uncertain timing and magnitude of its long-term profitability, as well as ADR de-listing risk.
- Risks to the upside include a potential asset utilization plan to help unlock Sohu's value.

Consensus Rating Distribution



Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Disruption: *Negative*
Special Situation: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE

US\$33.00

42% holding company discount

Video and portal businesses achieve breakeven: We assume total revenue CAGR of 1% over 2021-23, with non-GAAP net margin 7ppt above our base case in 2022.

BASE CASE

US\$17.00

70% holding company discount

Sustained growth in advertising/gaming: We expect total revenue CAGR of -9% over 2021-23, and non-GAAP net margin to be -4% in 2022.

BEAR CASE

US\$8.00

86% holding company discount

Widening losses, with drag from video and portal businesses: We assume total revenue CAGR of -21% over 2021-23.

Risk Reward – Sohu.Com Inc (SOHU.O)

KEY EARNINGS INPUTS

Drivers	2021	2022e	2023e	2024e
Brand Ad Revenue Growth (%)	(7.9)	(21.8)	6.9	6.3
Online Game Revenue Growth (%)	18.9	(7.6)	(11.8)	(1.3)
Non-GAAP Net Margin (%)	113.6	(3.7)	(3.8)	(0.5)

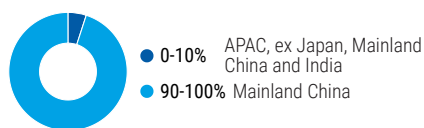
CATALYST CALENDAR

Date	Event	Source: Refinitiv, Morgan Stanley
15 Sep 2022 - 19 Sep 2022	Sohu.com Ltd Annual Shareholders Meeting	

INVESTMENT DRIVERS

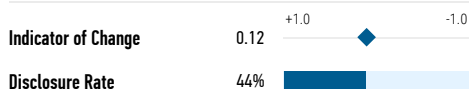
- Expansion of advertisers and average spending per advertiser for its video, search, portal products.
- Expansion of PC/mobile game players, higher paying ratio and ARPU supported by improved monetization.

GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

SUSTAINABILITY & ESG



RISKS TO PT/RATING

RISKS TO UPSIDE

- Cash inflow from the Sogou deal to help narrow Sohu's NAV discount
- Potential asset utilization plan to further unlock Sohu's value
- Stronger game monetization and narrowing losses from core business

RISKS TO DOWNSIDE

- More aggressive reinvestment plan to weigh on profitability and resume cash burn cycle
- Macro slowdown to weigh on overall ad budgets
- Weaker game business outlook

OWNERSHIP POSITIONING

Inst. Owners, % Active	73.4%
HF Sector Long/Short Ratio	2.5x
HF Sector Net Exposure	12%

Refinitiv; MSPB Content. Includes certain hedge fund exposures held with MSPB. Information may be inconsistent with or may not reflect broader market trends. Long/Short Ratio = Long Exposure / Short exposure. Sector % of Total Net Exposure = (For a particular sector: Long Exposure - Short Exposure) / (Across all sectors: Long Exposure - Short Exposure).

MS ESTIMATES VS. CONSENSUS

FY Dec 2022e

Sales / Revenue (US\$, mn) ◆ 752
Note: There are not sufficient brokers supplying consensus data for this metric

EBIT (US\$, mn) ◆ (0)
Note: There are not sufficient brokers supplying consensus data for this metric

EBITDA (US\$, mn) ◆ 141
Note: There are not sufficient brokers supplying consensus data for this metric

Net income (US\$, mn) ◆ (35)
Note: There are not sufficient brokers supplying consensus data for this metric

EPS (US\$) ◆ (0.99)
Note: There are not sufficient brokers supplying consensus data for this metric

◆ Mean ◆ Morgan Stanley Estimates

Source: Refinitiv, Morgan Stanley Research

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(as of July 31, 2022)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	1366	39%	318	42%	23%	593	39%
Equal-weight/Hold	1559	44%	357	47%	23%	708	46%
Not-Rated/Hold	0	0%	0	0%	0%	0	0%
Underweight/Sell	613	17%	91	12%	15%	226	15%
TOTAL	3,538		766			1527	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

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INDUSTRY COVERAGE: China Internet and Other Services

COMPANY (TICKER)	RATING (AS OF)	PRICE* (08/11/2022)
Alex Ko		
Sohu.Com Inc (SOHU.O)	E (08/01/2020)	US\$17.74
Weibo Corp (WB.O)	E (01/08/2019)	US\$19.58
Alex Poon		
Bilibili Inc (BILI.O)	E (01/07/2022)	US\$25.21
DouYu International Holdings Limited (DOYU.O)	U (10/13/2021)	US\$1.19
Hello Group Inc (MOMO.O)	E (09/20/2021)	US\$4.65
HUYA Inc (HUYAN)	U (10/13/2021)	US\$3.32
JOYY Inc. (YY.O)	E (06/02/2022)	US\$27.45
Kuaishou Technology (1024.HK)	O (02/28/2022)	HK\$75.70
NetEase, Inc (NTES.O)	O (12/06/2018)	US\$91.52
Tongcheng Travel Holdings (0780.HK)	O (01/04/2019)	HK\$16.26
Trip.com Group Ltd (TCOMO)	O (05/17/2021)	US\$25.94
Eddy Wang, CFA		
Dingdong Cayman Limited (DDL.N)	U (03/21/2022)	US\$4.41
JD.com, Inc. (JD.O)	O (04/15/2020)	US\$56.94
Kanzhun Ltd (BZ.O)	O (08/04/2021)	US\$22.75
Pinduoduo (PDD.O)	E (07/12/2022)	US\$49.62
Vpshop Holdings Ltd (MPS.N)	E (02/24/2022)	US\$9.98
Gary Yu		
Alibaba Group Holding (BABA.N)	O (11/21/2019)	US\$94.87
Baidu Inc (BIDU.O)	E (09/07/2020)	US\$139.38
Meituan (3690.HK)	O (03/31/2020)	HK\$179.10
Tencent Holdings Ltd. (0700.HK)	O (03/19/2020)	HK\$304.20
Rebecca Xu		
IQIYI Inc (IQ.O)	U (01/12/2021)	US\$3.88
Steven Tsai, CFA		
Autohome Inc (ATHM.N)	E (07/21/2021)	US\$36.01
KE Holdings Inc (BEKE.N)	O (03/16/2022)	US\$15.06
Tongdao Liepin Group (6100.HK)	E (12/11/2019)	HK\$10.88

Stock Ratings are subject to change. Please see latest research for each company.

* Historical prices are not split adjusted.

INDUSTRY COVERAGE: Greater China Media

COMPANY (TICKER)	RATING (AS OF)	PRICE* (08/12/2022)
Alex Poon		
Tencent Music Entertainment Group (TME.N)	E (07/16/2021)	US\$4.40
Rebecca Xu		
37 Interactive Entertainment (002555.SZ)	O (07/04/2022)	Rmb20.18
Alibaba Pictures Group Ltd (1060.HK)	E (03/28/2022)	HK\$0.62
Alpha Group (002292.SZ)	U (05/10/2022)	Rmb4.68
Beijing Enlight Media (300251.SZ)	E (09/04/2020)	Rmb9.10
China Film Co. Ltd. (600977.SS)	E (04/09/2020)	Rmb10.65
China Literature Ltd (0772.HK)	E (03/12/2020)	HK\$31.60
Focus Media Information Technology (002027.SZ)	O (05/20/2020)	Rmb5.93
G-bits Network Technology (603444.SS)	E (07/04/2022)	Rmb334.00
Guangdong South New Media Co.Ltd (300770.SZ)	E (09/14/2021)	Rmb34.59
Huayi Brothers Media Corporation (300027.SZ)	U (09/10/2021)	Rmb2.72
IMAX China (1970.HK)	E (03/28/2022)	HK\$6.86
Mango Excellent Media Co Ltd (300413.SZ)	E (03/21/2022)	Rmb32.01
Maoyan Entertainment (1896.HK)	O (05/10/2022)	HK\$6.89
Oriental Pearl Group Co Ltd (600637.SS)	E (12/18/2020)	Rmb6.70
Perfect World Co Ltd (002624.SZ)	E (07/26/2021)	Rmb15.94
Songcheng Performance Development Co Ltd (300144.SZ)	E (07/26/2021)	Rmb12.76
Wanda Film Holding Co Ltd (002739.SZ)	E (12/09/2021)	Rmb11.68
Zhejiang Huace Film and TV (300133.SZ)	E (01/25/2021)	Rmb4.68

Stock Ratings are subject to change. Please see latest research for each company.

* Historical prices are not split adjusted.