

# Global Offering



Stock Code: 9999

Joint Sponsors, Joint Global Coordinators and Joint Bookrunners  
(in alphabetical order)

**CICC**

**Credit Suisse**

**J.P. Morgan**

Joint Bookrunners  
(in alphabetical order)

**ABCI BOCI CCBI Citigroup CMBI HSBC HTSC ICBCI UBS**

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## IMPORTANT

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If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.



### NetEase, Inc.

*(incorporated in the Cayman Islands with limited liability)*

#### GLOBAL OFFERING

Number of Offer Shares under the Global Offering	: 171,480,000 Shares (subject to the Over-allotment Option)
Number of Hong Kong Offer Shares	: 5,150,000 Shares (subject to adjustment)
Number of International Offer Shares	: 166,330,000 Shares (subject to adjustment and the Over-allotment Option)
Maximum Public Offer Price	: HK\$126.00 per Offer Share, plus brokerage of 1.0%, SFC transaction levy of 0.0027% and Hong Kong Stock Exchange trading fee of 0.005% (payable in full on application in Hong Kong dollars and subject to refund)
Par Value	: US\$0.0001 per Share
Stock Code	: 9999

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A copy of this document, having attached thereto the documents specified in "Documents Available for Inspection — Documents Delivered to the Registrar of Companies" in Appendix V, has been registered by the Registrar of Companies in Hong Kong as required by Section 342C of the *Companies (Winding Up and Miscellaneous Provisions) Ordinance* (Chapter 32 of the Laws of Hong Kong). The Securities and Futures Commission of Hong Kong and the Registrar of Companies in Hong Kong take no responsibility for the contents of this document or any of the other documents referred to above.

We expect to determine the pricing of the Offer Shares by agreement with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on or about Friday, June 5, 2020 and, in any event, not later than Wednesday, June 10, 2020. The Public Offer Price will be not more than HK\$126.00 per Offer Share, unless otherwise announced. If, for any reason, we do not agree with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on the pricing of the Offer Shares by Wednesday, June 10, 2020, the Global Offering will not proceed and will lapse.

We may set the International Offer Price at a level higher than the maximum Public Offer Price if, (a) the Hong Kong dollar equivalent of the closing trading price of the ADSs on Nasdaq on the last trading day on or before the Price Determination Date (on a per-Share converted basis) were to exceed the maximum Public Offer Price as stated in this document; and/or (b) we believe that it is in the best interests of the Company as a listed company to set the International Offer Price at a level higher than the maximum Public Offer Price based on the level of interest expressed by professional and institutional investors during the bookbuilding process. If the International Offer Price is set at or lower than the maximum Public Offer Price, the Public Offer Price must be set at such price that is equal to the International Offer Price. Under no circumstance will we set the Public Offer Price above the maximum Public Offer Price as stated in this document or the International Offer Price.

The Joint Global Coordinators (for themselves and on behalf of the Underwriters) may, with our consent, reduce the number of Offer Shares being offered pursuant to the Global Offering at any time on or prior to the morning of the last day for lodging applications under the Hong Kong Public Offering. Further details are set out in the sections headed "Structure of the Global Offering" and "How to Apply for Hong Kong Offer Shares" in this document.

Prior to making an investment decision, prospective investors should carefully consider all of the information set out in this document, including the risk factors set out in "Risk Factors." The obligations of the Hong Kong Underwriters under the Hong Kong Underwriting Agreement are subject to termination by the Joint Global Coordinators (for themselves and on behalf of the Hong Kong Underwriters) if certain events occur prior to 8:00 a.m. on the Listing Date. See "Underwriting — Underwriting Arrangements and Expenses — Hong Kong Public Offering — Grounds for termination" in this document. It is important that you refer to that section for further details.

Our ADSs, each representing 25 ordinary shares, are listed for trading on Nasdaq under the symbol "NTES." The reported sale price of the ADSs on Nasdaq on May 29, 2020 was US\$382.90 per ADS. In connection with the Global Offering, we have filed a registration statement on Form F-3 and a preliminary prospectus supplement and plan to file a final prospectus supplement with the SEC to register the sale of Shares under the U.S. Securities Act.

NEITHER THE SEC NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS DOCUMENT IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

**Prospective investors should make the decision to invest in the Company only after due and careful consideration.**

June 2, 2020

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## IMPORTANT

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### IMPORTANT NOTICE TO INVESTORS

#### 1. FULLY ELECTRONIC APPLICATION PROCESS

We have adopted a fully electronic application process for the Hong Kong Public Offering. We will not provide printed copies of this document or printed copies of any application forms to the public in relation to the Hong Kong Public Offering.

This document is available at the website of the Hong Kong Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk) under the “*HKEXnews > New Listings > New Listing Information*” section and our website at <http://ir.netease.com/>. If you require a printed copy of this document, you may download and print from the website addresses above.

#### 2. PAYMENT OF Q1 DIVIDEND

The Q1 Dividend will be paid in U.S. dollars. All investors who have applied for Offer Shares through CCASS EIPO service and been successfully allocated Offer Shares will be entitled to the Q1 Dividend provided that the Global Offering becomes unconditional, irrespective of whether they sell or otherwise dispose of their corresponding allocated Offer Shares on the Hong Kong Stock Exchange immediately after dealing commences on the Listing Date, unless such investors (i) conduct any non-exchange trades and the ownership of the Shares are transferred to a third party on or before the Record Date, or (ii) withdraw physical certificates of such Shares from CCASS and subsequently sell or otherwise dispose of their corresponding Shares by lodging completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar before 4:30 p.m. (Hong Kong Time) on the Record Date for transferring the title to a third party.

Shareholders and potential investors should note that those who have chosen to apply through White Form eIPO services and to have physical share certificates issued to themselves will NOT be entitled to the Q1 Dividend, if they sell or otherwise dispose of their corresponding Shares, by lodging completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar before 4:30 p.m. (Hong Kong Time) on the Record Date (being Friday, June 12, 2020) for transferring such title to a third party. Any subsequent purchasers who acquire the relevant Offer Shares from such holders of physical share certificate and lodge completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar by 4:30 p.m. (Hong Kong time) on the Record Date, WILL BE entitled to the Q1 Dividend.

Investors who purchase the Company’s Shares on the Hong Kong Stock Exchange AFTER the commencement of dealings will NOT receive the Q1 Dividend.

In the event that there are unforeseen reasons (including but not limited to bad weather, Extreme Conditions or other events in the nature of force majeure, together the “Unforeseen Reasons”) that result in the Listing Date being delayed to a date after the Record Date but no later than June 18, 2020 (the “Delay”) and the Delay is solely due to the Unforeseen Reasons, the Company undertakes to pay investors of the Global Offering an amount equal to the Q1 Dividend (based on the investor’s corresponding number of Offer Shares allocated in the Global Offering) if the investor would have been entitled to the Q1 Dividend had the Delay not otherwise occurred.

Investors who are interested in participating in the Global Offering, if choosing to refer to our ADS prices during the Hong Kong Public Offering period prior to the Price Determination Date, should note that such trading prices will be cum dividend. Upon commencement of dealings in our Shares on the Hong Kong Stock Exchange on the Listing Date, our Shares will trade ex-dividend, and may not be comparable to the price of our ADSs during the Hong Kong Public Offering period, on the Price Determination Date and on the day immediately before the Listing Date (all cum dividend). Such discrepancy will, at least in part, be the result of the different entitlement rights with respect to Q1 Dividend. However, investors should not interpret such difference as a discount on the price of our Shares offered for the Global Offering.

In addition, payment of the Q1 Dividend may affect the value of our Shares and the trading price of our ADSs and Shares in the U.S. and Hong Kong markets, respectively. Accordingly, Shareholders and potential investors should exercise caution when dealing in our Shares.

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## IMPORTANT

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### IMPORTANT NOTICE TO INVESTORS: FULLY ELECTRONIC APPLICATION PROCESS

**We have adopted a fully electronic application process for the Hong Kong Public Offering. We will not provide printed copies of this document or printed copies of any application forms to the public in relation to the Hong Kong Public Offering.**

**This document is available at the website of the Hong Kong Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk) under the “*HKEXnews > New Listings > New Listing Information*” section, and our website at <http://ir.netease.com/>. If you require a printed copy of this document, you may download and print from the website addresses above.**

To apply for the Hong Kong Offer Shares, you may:

- (1) apply online through the **White Form eIPO** service at [www.eipo.com.hk](http://www.eipo.com.hk);
- (2) apply through the **CCASS EIPO** service to electronically cause HKSCC Nominees to apply on your behalf, including by:
  - (i) instructing your **broker** or **custodian** who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf; or
  - (ii) (if you are an existing **CCASS Investor Participant**) giving **electronic application instructions** through the CCASS Internet System (<https://ip.ccass.com>) or through the CCASS Phone System by calling +852 2979 7888 (using the procedures in HKSCC’s “An Operating Guide for Investor Participants” in effect from time to time). HKSCC can also input **electronic application instructions** for CCASS Investor Participants through HKSCC’s Customer Service Centre at 1/F, One & Two Exchange Square, 8 Connaught Place, Central, Hong Kong by completing an input request.

If you have any question about the application for the Hong Kong Offer Shares, you may call the enquiry hotline of our Hong Kong Share Registrar and **White Form eIPO Service Provider**, Computershare Hong Kong Investor Services Limited, both at +852 2862 8646 on the following dates:

**Tuesday, June 2, 2020 – 9:00 a.m. to 9:00 p.m.**  
**Wednesday, June 3, 2020 – 9:00 a.m. to 9:00 p.m.**  
**Thursday, June 4, 2020 – 9:00 a.m. to 9:00 p.m.**  
**Friday, June 5, 2020 – 9:00 a.m. to 12:00 noon**

We will not provide any physical channels to accept any application for the Hong Kong Offer Shares by the public. The contents of the electronic version of this document are identical to the printed document as registered with the Registrar of Companies in Hong Kong pursuant to Section 342C of the Companies (WUMP) Ordinance.

If you are an **intermediary, broker** or **agent**, please remind your customers, clients or principals, as applicable, that this document is available online at the website addresses above.

Please refer to “How to Apply for Hong Kong Offer Shares” for further details on the procedures through which you can apply for the Hong Kong Offer Shares electronically.

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## IMPORTANT

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Your application through the **White Form eIPO** service or the **CCASS EIPO** service must be for a minimum of 100 Hong Kong Offer Shares and in one of the numbers set out in the table. You are required to pay the amount next to the number you select.

No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$	No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$	No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$	No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$
100	12,726.97	2,500	318,174.26	30,000	3,818,091.06	600,000	76,361,821.20
200	25,453.94	3,000	381,809.11	40,000	5,090,788.08	700,000	89,088,791.40
300	38,180.91	3,500	445,443.96	50,000	6,363,485.10	800,000	101,815,761.60
400	50,907.88	4,000	509,078.81	60,000	7,636,182.12	900,000	114,542,731.80
500	63,634.85	4,500	572,713.66	70,000	8,908,879.14	1,000,000	127,269,702.00
600	76,361.82	5,000	636,348.51	80,000	10,181,576.16	1,500,000	190,904,553.00
700	89,088.79	6,000	763,618.21	90,000	11,454,273.18	2,000,000	254,539,404.00
800	101,815.76	7,000	890,887.91	100,000	12,726,970.20	2,575,000 <sup>(1)</sup>	327,719,482.65
900	114,542.73	8,000	1,018,157.62	200,000	25,453,940.40		
1,000	127,269.70	9,000	1,145,427.32	300,000	38,180,910.60		
1,500	190,904.55	10,000	1,272,697.02	400,000	50,907,880.80		
2,000	254,539.40	20,000	2,545,394.04	500,000	63,634,851.00		

Note:

(1) Maximum number of Hong Kong Offer Shares you may apply for.

No application for any other number of the Hong Kong Offer Shares will be considered and any such application is liable to be rejected.

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## EXPECTED TIMETABLE<sup>(1)</sup>

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Hong Kong Public Offering commences .....9:00 a.m. on Tuesday,  
June 2, 2020

Latest time for completing electronic applications  
under **White Form eIPO** service through  
the designated website [www.eipo.com.hk](http://www.eipo.com.hk)<sup>(2)</sup> .....11:30 a.m. on Friday,  
June 5, 2020

Application lists open<sup>(3)</sup> .....11:45 a.m. on Friday,  
June 5, 2020

Latest time for (a) completing payment for  
**White Form eIPO** applications by effecting internet  
banking transfer(s) or PPS payment transfer(s) and  
(b) giving **electronic application instructions** to HKSCC<sup>(4)</sup> .....12:00 noon on Friday,  
June 5, 2020

If you are instructing your **broker** or **custodian** who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf, you are advised to contact your **broker** or **custodian** for the latest time for giving such instructions which may be different from the latest time as stated above.

Application lists close<sup>(3)</sup> .....12:00 noon on Friday,  
June 5, 2020

Expected Price Determination Date<sup>(5)</sup> .....Friday, June 5, 2020

Announcement of the Public Offer Price and  
the International Offer Price on our website  
at <http://ir.netease.com/><sup>(6)</sup> and the website of  
the Hong Kong Stock Exchange  
at [www.hkexnews.hk](http://www.hkexnews.hk) on or around .....Friday, June 5, 2020

Announcement of the level of indications of interest in  
the International Offering, the level of applications  
in the Hong Kong Public Offering and the basis  
of allocation of the Hong Kong Offer Shares on  
our website at <http://ir.netease.com/> and  
the website of the Hong Kong Stock Exchange  
at [www.hkexnews.hk](http://www.hkexnews.hk) on or before .....Wednesday, June 10, 2020

The results of allocations in the  
Hong Kong Public Offering (with successful applicants'  
identification document numbers, where appropriate)  
to be available through a variety of channels, including:

- in the announcement to be posted on  
our website and the website of  
the Hong Kong Stock Exchange at  
<http://ir.netease.com/> and  
[www.hkexnews.hk](http://www.hkexnews.hk), respectively .....Wednesday, June 10, 2020

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## EXPECTED TIMETABLE<sup>(1)</sup>

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- from the designated results of allocations website at [www.iporeresults.com.hk](http://www.iporeresults.com.hk) (alternatively: English <http://www.eipo.com.hk/en/Allotment>; Chinese <http://www.eipo.com.hk/zh-hk/Allotment>) with a “search by ID” function from . . . . . 8:00 a.m. on Wednesday, June 10, 2020 to 12:00 midnight on Tuesday, June 16, 2020
  
- from the allocation results telephone enquiry by calling +852 2862 8555 between 9:00 a.m. and 6:00 p.m. from . . . . . Wednesday, June 10, 2020 to Monday, June 15, 2020

Share certificates in respect of wholly or partially successful applications to be dispatched or deposited into CCASS on or before<sup>(7)(9)</sup> . . . . . Wednesday, June 10, 2020

White Form e-Refund payment instructions/refund checks in respect of wholly or partially successful applications (if applicable) or wholly or partially unsuccessful applications to be dispatched on or around<sup>(8)(9)</sup> . . . . . Wednesday, June 10, 2020

Dealings in the Shares on the Hong Kong Stock Exchange expected to commence at 9:00 a.m. on . . . . . Thursday, June 11, 2020

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Notes:

- (1) All dates and times refer to Hong Kong local dates and time, except as otherwise stated.
- (2) You will not be permitted to submit your application through the designated website at [www.eipo.com.hk](http://www.eipo.com.hk) after 11:30 a.m. on the last day for submitting applications. If you have already submitted your application and obtained an application reference number from the designated website at or before 11:30 a.m., you will be permitted to continue the application process (by completing payment of application monies) until 12:00 noon on the last day for submitting applications, when the application lists close.
- (3) If there is/are a tropical cyclone warning signal number 8 or above, a “black” rainstorm warning and/or Extreme Conditions in force in Hong Kong at any time between 9:00 a.m. and 12:00 noon on Friday, June 5, 2020, the application lists will not open or close on that day. See “How to Apply for Hong Kong Offer Shares — Effect of bad weather and Extreme Conditions on the opening and closing of the application lists.”
- (4) Applicants who apply for Hong Kong Offer Shares by giving **electronic application instructions** to HKSCC via CCASS or instructing your **broker** or **custodian** to apply on your behalf via CCASS should refer to “How to Apply for Hong Kong Offer Shares — Applications for the Hong Kong Offer Shares — Applying through CCASS EIPO service.”
- (5) The Price Determination Date is expected to be on or around Friday, June 5, 2020 and, in any event, not later than Wednesday, June 10, 2020. If, for any reason, we do not agree with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on the pricing of the Offer Shares by Wednesday, June 10, 2020, the Global Offering will not proceed and will lapse.
- (6) None of the websites set out in this section or any of the information contained on the websites forms part of this document.

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## EXPECTED TIMETABLE<sup>(1)</sup>

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- (7) Share certificates will only become valid at 8:00 a.m. on the Listing Date provided that the Global Offering has become unconditional and the right of termination described in “Underwriting — Underwriting Arrangements and Expenses — Hong Kong Public Offering — Grounds for Termination” has not been exercised. Investors who trade Shares on the basis of publicly available allocation details or prior to the receipt of Share certificates or the Share certificates becoming valid do so entirely at their own risk.
- (8) e-Refund payment instructions/refund checks will be issued in respect of wholly or partially unsuccessful applications pursuant to the Hong Kong Public Offering and also in respect of wholly or partially successful applications in the event that the final Public Offer Price is less than the price payable per Offer Share on application. Part of the applicant’s Hong Kong identity card number or passport number, or, if the application is made by joint applicants, part of the Hong Kong identity card number or passport number of the first-named applicant, provided by the applicant(s) may be printed on the refund check, if any. Such data would also be transferred to a third party for refund purposes. Banks may require verification of an applicant’s Hong Kong identity card number or passport number before encashment of the refund check. Inaccurate completion of an applicant’s Hong Kong identity card number or passport number may invalidate or delay encashment of the refund check.
- (9) Applicants who have applied on **White Form eIPO** for 1,000,000 or more Hong Kong Offer Shares may collect any refund checks (where applicable) and/or Share certificates in person from our Hong Kong Share Registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong from 9:00 a.m. to 1:00 p.m. on Wednesday, June 10, 2020 or such other date as notified by us as the date of dispatch/collection of Share certificates/e-Refund payment instructions/refund checks. Applicants being individuals who are eligible for personal collection may not authorize any other person to collect on their behalf. Individuals must produce evidence of identity acceptable to our Hong Kong Share Registrar at the time of collection.

Applicants who have applied for Hong Kong Offer Shares through **CCASS eIPO** service should refer to “How to Apply for Hong Kong Offer Shares — Despatch/collection of share certificates/e-refund payment instructions/refund checks — Personal Collection — If you apply through **CCASS eIPO** service” for details.

Applicants who have applied through the **White Form eIPO** service and paid their applications monies through single bank accounts may have refund monies (if any) dispatched to the bank account in the form of e-Refund payment instructions. Applicants who have applied through the **White Form eIPO** service and paid their application monies through multiple bank accounts may have refund monies (if any) dispatched to the address as specified in their application instructions in the form of refund checks by ordinary post at their own risk.

Share certificates and/or refund checks for applicants who have applied for less than 1,000,000 Hong Kong Offer Shares and any uncollected Share certificates and/or refund checks will be dispatched by ordinary post, at the applicants’ risk, to the addresses specified in the relevant applications.

Further information is set out in “How to Apply for Hong Kong Offer Shares — Refund of application monies” and “How to Apply for Hong Kong Offer Shares — Despatch/collection of share certificates/e-refund payment instructions/refund checks.”

The above expected timetable is a summary only. For details of the structure of the Global Offering, including its conditions, and the procedures for applications for Hong Kong Offer Shares, please refer to “Structure of the Global Offering” and “How to Apply for Hong Kong Offer Shares,” respectively.

If the Global Offering does not become unconditional or is terminated in accordance with its terms, the Global Offering will not proceed. In such a case, we will publish an announcement as soon as practicable thereafter.



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### IMPORTANT NOTICE TO INVESTORS

This document is issued by us solely in connection with the Hong Kong Public Offering and the Hong Kong Offer Shares and does not constitute an offer to sell or a solicitation of an offer to buy any security other than the Hong Kong Offer Shares offered by this document pursuant to the Hong Kong Public Offering. This document may not be used for the purpose of making, and does not constitute, an offer or invitation in any other jurisdiction or in any other circumstances. No action has been taken to permit the distribution of this document in any jurisdiction other than Hong Kong. The distribution of this document and the offering of the Offer Shares in other jurisdictions are subject to restrictions and may not be made except as permitted under the applicable securities laws of such jurisdictions pursuant to registration with or authorization by the relevant securities regulatory authorities or an exemption therefrom.

You should rely only on the information contained in this document to make your investment decision. We have not authorized anyone to provide you with information that is different from what is contained in this document. Any information or representation not made in this document must not be relied on by you as having been authorized by us, the Joint Sponsors, Joint Global Coordinators and Joint Bookrunners, the Underwriters, any of our or their respective directors or any other person or party involved in the Global Offering.

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## LETTER FROM OUR FOUNDER AND CEO

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### **“Believing in the Power of Passion”**

CEO William Ding’s Letter to Investors  
On NetEase’s 20<sup>th</sup> Listing Anniversary

Dear NetEase Investors,

When NetEase went public on Nasdaq in June 2000, we began a new journey, which coincided with the start of a new century. We were all curious about what the future would hold.

NetEase’s share price has risen significantly in the 20 years since listing, and we have maintained a regular quarterly dividend for the last six consecutive years, a trend that strongly demonstrates our commitment to returning value to shareholders and symbolises our youthful vigor and vitality.

We are truthful, high-spirited, enthusiastic and curious, rather than complicated and calculating. The contrast of our uncomplicatedness to a world full of complications often makes NetEase an “enigmatic” company. I’d like to take this opportunity to dispel some of the confusion and misconceptions that may exist about our business.

#### **1. Some say they don’t understand NetEase’s strategies.**

In my view, the term “strategy” has become an overly metaphysical concept, which one associates with an ambitious blueprint and elaborate planning. However, the attractiveness of business lies precisely in the fact that unexpected occurrences often undo carefully calculated plans.

For NetEase, our business strategy is by no means derived from some grand masterplan. Before embarking on new businesses, we usually ask ourselves three questions: *Does this product truly address user needs? Are we passionate about it? Are we capable of delivering superior services and products compared to our competitors?*

This is our philosophy — one that is centred on user demand, driven by dedication and empowered by capability. Our philosophy embodies a relentless pursuit of our vision and an unwavering belief that we will find our answers in the end.

As such, the notion of being “user centric” and “passionate” is manifest in the history of our company. Through these ideas, one can truly understand us. In an ever-changing world, our ethos and perpetual desire to meet users’ demands remain constant.

NetEase believes in the power of people.

#### **2. Some say they don’t understand NetEase’s pace.**

When it comes to the internet, being perceived as being slow seems to be a “sin” to some. However, the mere desire for speed comes at the cost of the inability to appreciate beauty and what is really important to users and what makes a product great. NetEase has never feared to progress at its own pace. Instead of being driven by short-term goals, we focus on innovation and delivering premium content and an excellent experience to users. This is the path that we have chosen and adhered to since our early days.

Developing “premium content and product excellence” involves years of hard work. It requires us to dig deep and gain insights into user needs and to attend to the most intricate product details. We are okay with spending two decades to fine-tune a game or several years to perfect a music app. Our principle is an unwavering belief in proceeding at our own pace, come what may.

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## LETTER FROM OUR FOUNDER AND CEO

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Running a company is not a 100-meter sprint but rather a marathon. One does not simply win the race with a faster start. As we focus on our long-term goals, we strive to create wonders for our users and the best possible products and services.

NetEase believes in the power of time.

### **3. Some say they don't know how to define NetEase.**

NetEase has experienced and withstood numerous market cycles. Our resilience through difficult circumstances is not a result of wit or luck, but a testament to our respect of and adherence to the fundamental driver of long-term business success: the creation of true value for our users and society at large.

From e-mail services, web portals and interactive entertainment to Youdao products, open courses, music streaming and e-commerce services, etc., we don't define ourselves as a specific type of company nor limit ourselves to one particular field. As long as we believe in our ability to make a difference, we are willing to go the extra mile to achieve it.

Such philosophy sometimes comes at a potential cost of missing short-term gains or being misunderstood, and sometimes being mocked. However, we embrace these obstacles with an unwavering faith in our mission and our values.

We hope to bring a little more positivity and a little more wonderfulness to the world every time that we can. When there is a clash between idealism and practicality, our approach is to lean toward the former. Our thinking is grounded in the belief that if we stick with our principles, wonderfulness will gradually come and be evident in our offerings.

Such is the underlying ethos for success.

NetEase believes in the power of faith.

### **The Future of NetEase**

NetEase's growth will continue to be transparent and driven by our faith and passion. This remains our blueprint for the next 20 years, one which we will adhere to and persevere with. Going forward, we are committed to the following four causes:

#### **1. Building an organization that is self-evolving and entrepreneurial**

Since the end of 2018, we have enacted a series of organizational and structural adjustments to streamline and stay focused on our core businesses, which we believe has made us more resilient to global crises. Our next step is to prioritise organizational development. We recently revisited our corporate culture, accentuating key notions of our corporate values such as "passion" and "connection with users" with our employees — values we intend to embody and uphold.

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## LETTER FROM OUR FOUNDER AND CEO

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NetEase became listed on Nasdaq when I was 29 years old. At that time, we had 221 employees. Today, the number of our employees has grown almost a hundred-fold to over 20,000, while the average age of our employees has remained under 29. A coincidence, but also a perfect reflection of NetEase: seasoned and mature, yet young and entrepreneurial.

We will continue to aggressively search for youthful, intelligent, dedicated and intrepid talents to train and nurture. We want them to have the right opportunity to grow quickly and shine. This will be of great importance.

### **2. Advancing NetEase’s strategy of quality and excellence to continue delivering products and services that make us proud**

2020 will no doubt be a year of uncertainties and challenges, but our pursuit of excellence remains unchanged. NetEase strives to run businesses and develop products that withstand the test of time. We aim to exceed user expectations, not merely meet them.

We aspire to create products and services that our employees are proud of and our users truly love. While such pursuit of excellence may bring forth competition and imitation, it will further drive us to reflect and continue to innovate in order to be an industry leader — a positive cycle that ultimately improves the user experience.

### **3. Embracing global opportunities while further solidifying our position in China**

In the last several years, NetEase has started to explore global opportunities. While some people may not have noticed these efforts, we have seen remarkable results in these early explorations.

Becoming more global is a crucial part of and an inevitable step in NetEase’s growth. Our vision to “foster collaboration and realize people’s aspiration for a better life through technology and innovation” calls for a bigger platform. Going forward, as we continue to solidify our position in China, we will also further expand overseas, driving innovation and breakthroughs through incubation, investment, collaboration, and strategic partnerships. We strongly believe that high-quality Chinese products and services deserve more spotlight on the international stage.

### **4. Empowering individuals with more accessible resources**

The start of NetEase was inspired by the spirit of the internet. We will continue to adhere to this spirit of openness, fairness and sharing as we march forward. We are not only driven by short-term profits and hope our stakeholders can understand and support our philosophy.

The post-COVID-19 era may be different but also presents unique opportunities for growth. NetEase will continue to help our community in areas such as basic human needs and empower people with innovations and technology in areas such as education and entertainment.

So to the shareholders of NetEase, I wish to say that when NetEase first became public 20 years ago, our youthfulness was the biggest barrier to gaining trust from the investment community and the media. But as you have witnessed, it was exactly our youthfulness that fuelled our enthusiasm for hope and opportunity in the decades that followed.

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## LETTER FROM OUR FOUNDER AND CEO

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As we come to NetEase's 20th listing anniversary this month, we are at another new starting point. We are also preparing our secondary listing on the Stock Exchange of Hong Kong, bringing our established brand back to China. I believe that returning to a market that is closer to our roots will further fuel our passion in our business and our users.

We would like to thank our colleagues and users for accompanying us on NetEase's long journey. And a big thank you to our shareholders. I would like to conclude with a phrase I used in 2003 at my alma mater:

“To date, we have yet to achieve success and are still growing.”

William Ding

Founder and CEO of NetEase

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## SUMMARY

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This summary aims to give you an overview of the information contained in this document. As it is a summary, it does not contain all the information that may be important to you and is qualified in its entirety by and should be read in conjunction with the full prospectus. You should read the whole document before you decide to invest in the Offer Shares. There are risks associated with any investment. Some of the particular risks in investing in the Offer Shares are set out in “Risk Factors.” You should read that section carefully before you decide to invest in the Offer Shares.

### OVERVIEW

#### Our mission

Our mission is to create wonders through delivering premium content and excellent service to users. (以優質的內容和服務，為用戶創造驚喜).

This mission has guided us through the past 23 years in delivering premium content and services. We started as a Chinese internet portal in the late 1990s, and established our media and e-mail services that continue to thrive today; strategically expanded into online games in 2001, which now makes us the second largest mobile game company in the world in terms of combined iOS and Google Play user spending in 2019, according to App Annie; launched our Youdao business in 2006 that eventually became an NYSE-listed intelligent learning platform; introduced NetEase Cloud Music, a music streaming platform, in 2013; and opened our e-commerce platform Yanxuan in 2016, which quickly emerged as a destination for private label merchandise.

#### Our vision

Founded by William Lei Ding in 1997, our Company has a vision of fostering collaboration and realizing people’s aspiration for a better life through technology and innovation (網聚人的力量，用科技創新締造美好生活).

#### Our core values

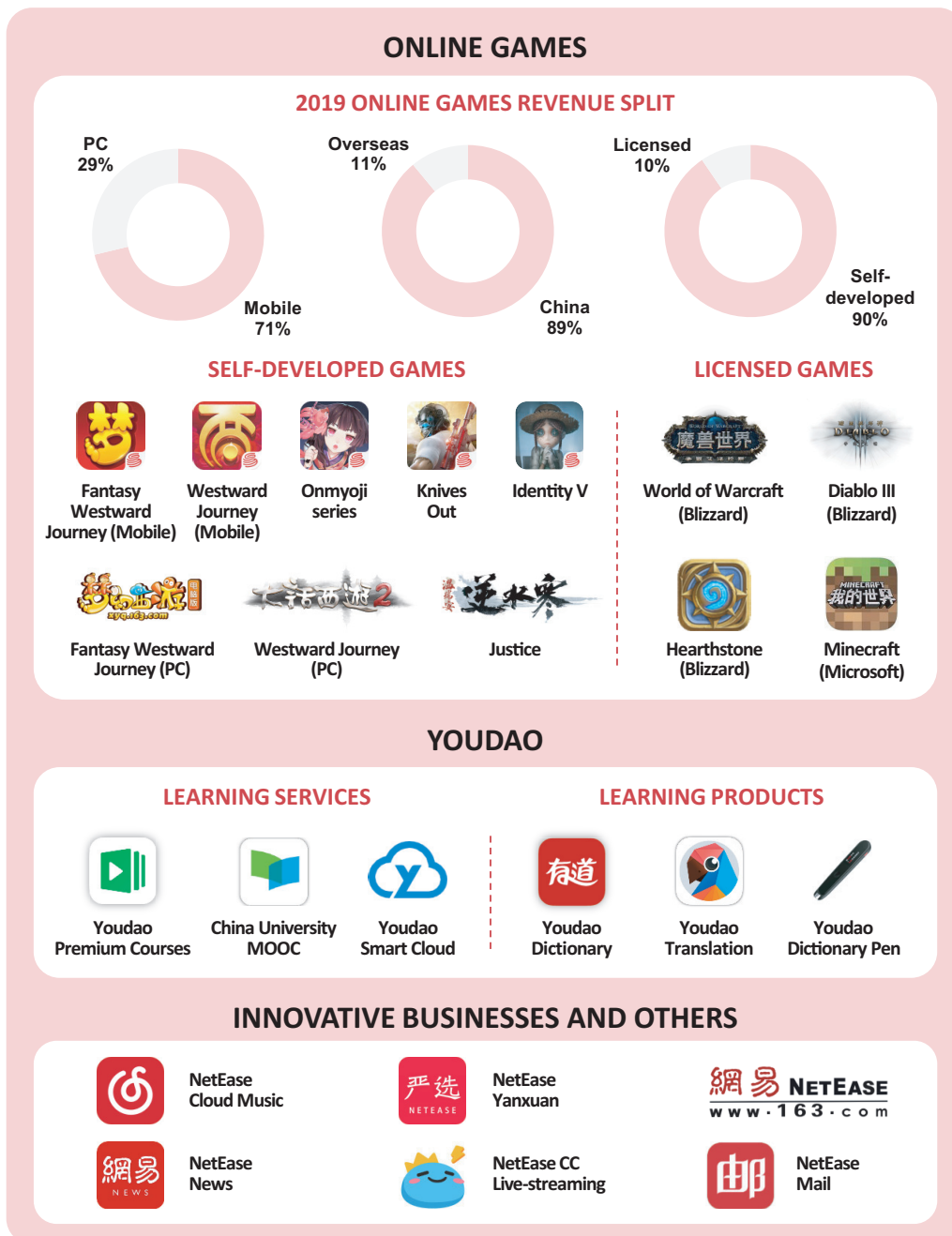
The following integrated concepts form the fundamentals of our corporate values:

- Passion;
- User-centricity;
- Innovation; and
- Harmony.

Since Day 1, we have persistently focused on our core values, which solidify our services and products, motivate us to create and grow new ideas, and serve as the compass for our endless exploration of new initiatives and opportunities.

# SUMMARY

## Who we are today



We have a successful online game business, developing and operating a rich portfolio of highly popular titles. We currently offer over 140 mobile and PC games across a wide range of genres, satisfying the ever-growing and diversifying needs of the global gamer community. Leveraging our user insights and execution expertise, we also incubated and developed in-house a pipeline of innovative and successful businesses, including intelligent learning and other businesses, ranging from music streaming and private label e-commerce to internet media, e-mail services and others. As of December 31, 2019, we had over 1.0 billion registered e-mail users and over 800 million NetEase Cloud Music registered users. We also had over 100 million Youdao average MAUs in 2019.



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## SUMMARY

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### ***Online games***

We are the second largest mobile game company in the world in terms of combined iOS and Google Play user spending in 2019, according to App Annie. Our expertise in developing and operating game content has laid the foundation for successful overseas expansion. In 2019, overseas games revenues accounted for 11% of our total games revenues.

Meticulously crafted and imbued with operational expertise distilled from decades of experience, many NetEase games have secured their places among the most successful IP franchises in the history of online games. Over the past two decades, we have consistently rolled out blockbuster game titles, and maintained their longevity and vitality through frequent content updates and other operational innovations. Our first major flagship game franchise *Westward Journey Online*, which debuted in 2001, remains popular with gamers today as a result of continued content and format updates, as well as innovation in play modes over the past 19 years. Just to name a couple more examples among our star-studded line-up of popular online games, *Onmyoji* topped the China iOS grossing chart multiple times in 2019, and *Knives Out* topped Japan's iOS grossing chart multiple times in 2019, testifying to the global appeal of our games.

As a true testament to our in-house game development and operational strengths, we have established a distinguished track record of long-term collaborations with revered global IP powerhouses and studios such as Blizzard, Marvel, Microsoft and Warner Brothers. With Blizzard, our collaboration initially started with PC game licensing for the China market in 2008 and has since been broadened to the co-development of *Diablo® Immortal™*, a milestone in Blizzard's foray into mobile games with its iconic *Diablo* franchise. *MARVEL Super War*, our collaboration with Marvel Entertainment, has gained widespread popularity since its official launch in December 2019 and topped many iOS download charts in Southeast Asia.

### ***Intelligent learning***

Youdao is an intelligent learning company in China with over 100 million average MAUs in 2019, and has achieved early success in a number of overseas markets. Starting from online knowledge tools, Youdao currently offers a comprehensive suite of learning services and products that are accessible, reliable and trustworthy. For tens of millions of people, Youdao is the go-to destination for looking up a word, translating a foreign language, preparing for an exam, or learning a new skill.

In 2007, Youdao launched its flagship Youdao Dictionary, which had over 50 million average MAUs in 2019. The early success of Youdao Dictionary and other learning tools has enabled us to attract a massive user base, build a strong brand, and channel this organic user traffic into a broad range of services and products addressing lifelong learning needs of pre-school, K-12 and college students as well as adult learners, including online learning services and products and smart devices. Our smart devices seamlessly integrate advanced AI algorithms and data analytics, which serve to supplement our online courses and learning products and further enhance users' learning experience and efficiency.

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## SUMMARY

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### *Innovative businesses and others*

We have incubated and developed in-house a number of innovative and thriving businesses.

NetEase Cloud Music is a popular music streaming platform in China with over 800 million registered users as of December 31, 2019. It delivers a differentiated and premium user experience in terms of the music offered. Focused on discovering and promoting emerging musicians, NetEase Cloud Music has rapidly grown into the destination of choice for exploring new and independent music among music enthusiasts in China. Our vibrant community had attracted over 100,000 independent musicians as of December 31, 2019, generating over 270 billion playbacks of their songs in 2019.

Yanxuan is our e-commerce platform that primarily sells private label products with a strong emphasis on quality and value for money. Product categories include apparel, homeware, kitchenware and other general merchandise which we primarily source from original design manufacturers in China. Products and manufacturers are carefully selected with the goal of achieving high value for money. Yanxuan has established close partnerships with its selection of quality manufacturers. It utilizes data analytics to help these suppliers enhance their efficiency and product appeal, particularly in terms of merchandise design and production.

NetEase Media is a well-established internet media platform in China delivering professional news and other quality information to our users. Our media platform has three components, the NetEase News mobile application, [www.163.com](http://www.163.com) portal and a set of other vertical mobile products. Our media platform offers a wide range of features that promote user interactions and foster a vibrant online user community who actively contribute to the commentary sections. Our drive for journalistic integrity and high-quality content offerings has enabled us to attract a coveted demographic of engaged users.

Other innovative businesses include NetEase CC Live streaming, a platform offering various live streaming content with a primary focus on game broadcasting, and NetEase Mail, an email service provider in China with over one billion registered users as of December 31, 2019.

Our persistent focus on core values, coupled with solid execution, has enabled us to weather the numerous seismic global challenges since the late 1990s and thrive in the complex and competitive Chinese internet ecosystem, consistently delivering top- and bottom-line growth and value to our shareholders. Net revenues for fiscal year 2019 were RMB59,241.1 million, growing by 15.8% year-over-year from RMB51,178.6 million for fiscal year 2018. Net income from continuing operations attributable to our shareholders for fiscal year 2019 totaled RMB13,275.0 million, increasing by 60.1% from RMB8,291.1 million for fiscal year 2018. We have instituted quarterly dividend payments since 2014 and have announced several share repurchase programs since 2011.

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## SUMMARY

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### WHAT WE HAVE LEARNED FROM THE PAST 23 YEARS

We feel fortunate to have chosen the path of pursuing original content creation and building our proprietary know-how and R&D capabilities since the beginning of our journey. Looking back at the past two decades, only through such pursuit can we truly sustain our leadership position amidst fierce competition in complex business environments, elevate the standards of the Chinese internet industry, and secure an enduring legacy for each of our people who devoted themselves to this worthy endeavor. As we navigated new market trends and tackled new challenges over the years, the following key insights secured our success. Here is what worked for us:

- At the end of the day, it comes down to original content creation;
- Sharpening operational know-how is time-consuming, but is of critical importance to sustained long-term growth on a global scale;
- We strive for longevity and scalability in our games and beyond;
- We take pride in our user-centric culture to build long-lasting brand recognition;
- R&D investment in innovative technologies is essential, but must be purpose-driven; and
- Ultimately, it depends on the people.

### WHAT WE PLAN TO FOCUS ON IN THE FUTURE

We will continue to think long-term. All future strategies will be formed, evaluated, adjusted, re-formed, re-evaluated, and re-adjusted around a long-term vision of sustainable excellence and financial success. We will continue to be prudent regarding capital allocation, with value-creation for shareholders as a priority. Our future strategies include a focus on:

- Strengthening our content creation capability;
- Pursuing operational excellence;
- Growing the community of happy users;
- Investing in technology and innovation;
- Expanding our global footprint; and
- Cultivating a deeper bench of talents.

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## SUMMARY

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### SUMMARY OF HISTORICAL FINANCIAL INFORMATION

The selected consolidated statements of operations and comprehensive income data for the years ended December 31, 2017, 2018 and 2019 and the selected consolidated balance sheet data as of December 31, 2017, 2018 and 2019 have been derived from our audited consolidated financial statements contained in the Accountant's Report in Appendix IA. The selected consolidated statements of operations and comprehensive income data for the three months ended March 31, 2019 and 2020 and the selected consolidated balance sheet data as of March 31, 2020 have been derived from our unaudited condensed interim consolidated financial information included in this document and have been prepared on the same basis as our audited consolidated financial statements. Our consolidated financial statements have been prepared in accordance with U.S. GAAP.

The following selected consolidated financial data for the periods and as of the dates indicated are qualified by reference to and should be read in conjunction with the Accountant's Report in Appendix IA and "Financial Information."

The summary of historical financial information set forth below includes translations of financial data in Renminbi into U.S. dollars for the convenience of the reader. These translations were made at a rate of RMB7.0808 to US\$1.00, the exchange rate on March 31, 2020 as set forth in the H.10 statistical release of the U.S. Federal Reserve Board.

Our historical results for any prior period do not necessarily indicate our results to be expected for any future period.

#### **Factors affecting our results of operations**

The following are the primary factors affecting our results of operations:

- Our ability to continue to deliver original and compelling content and service offerings and effectively operate our existing products;
- Our ability to grow our user base and drive user engagement and loyalty;
- Our ability to continue to develop proprietary technologies and apply them meaningfully;
- Our ability to manage our costs and expenses effectively across all business segments; and
- Our ability to make successful strategic investments and acquisitions.

For additional information, see "Financial Information — Factors Affecting Our Results of Operations."

## SUMMARY

### Selected consolidated statements of operations and comprehensive income data

The following table sets forth our selected consolidated statements of operations and comprehensive income data for the periods indicated:

	For the year ended December 31,			For the three months ended March 31,		
	2017	2018	2019	2019	2020	
	RMB	RMB	RMB	RMB	RMB	US\$
				(unaudited)	(unaudited)	(unaudited)
				(in thousands)		
<b>Net revenues:</b>						
Online game .....	36,281,642	40,190,057	46,422,640	11,850,184	13,518,244	1,909,141
Youdao .....	455,746	731,598	1,304,883	225,731	541,388	76,459
Innovative businesses and others .....	7,699,967	10,256,920	11,513,622	2,346,294	3,002,735	424,067
Total net revenues .....	44,437,355	51,178,575	59,241,145	14,422,209	17,062,367	2,409,667
Cost of revenues .....	(19,394,314)	(23,832,426)	(27,685,845)	(6,684,535)	(7,684,745)	(1,085,293)
<b>Gross profit .....</b>	<b>25,043,041</b>	<b>27,346,149</b>	<b>31,555,300</b>	<b>7,737,674</b>	<b>9,377,622</b>	<b>1,324,374</b>
<b>Operating expenses:</b>						
Selling and marketing expenses .....	(5,504,613)	(6,911,710)	(6,221,127)	(1,158,090)	(1,863,071)	(263,116)
General and administrative expenses ..	(2,381,842)	(3,078,635)	(3,130,298)	(786,850)	(885,434)	(125,047)
Research and development expenses ..	(4,161,673)	(7,378,460)	(8,413,224)	(2,037,694)	(2,142,649)	(302,600)
Total operating expenses .....	(12,048,128)	(17,368,805)	(17,764,649)	(3,982,634)	(4,891,154)	(690,763)
<b>Operating profit .....</b>	<b>12,994,913</b>	<b>9,977,344</b>	<b>13,790,651</b>	<b>3,755,040</b>	<b>4,486,468</b>	<b>633,611</b>
<b>Other income/(expenses):</b>						
Investment income/(losses), net .....	362,113	(22,383)	1,306,320	155,824	(109,731)	(15,497)
Interest income, net .....	666,616	586,671	821,774	172,206	345,184	48,749
Exchange (losses)/gains .....	(455,948)	(51,799)	25,166	(39,520)	244,057	34,467
Other, net .....	271,885	586,916	439,422	37,164	66,708	9,421
<b>Income before tax .....</b>	<b>13,839,579</b>	<b>11,076,749</b>	<b>16,383,333</b>	<b>4,080,714</b>	<b>5,032,686</b>	<b>710,751</b>
Income tax .....	(2,155,988)	(2,460,650)	(2,914,726)	(1,266,685)	(1,082,033)	(152,812)
Net income from continuing operations .....	11,683,591	8,616,099	13,468,607	2,814,029	3,950,653	557,939
Net (loss)/income from discontinued operations <sup>(1)</sup> .....	(834,454)	(2,138,682)	7,962,519	(350,755)	-	-
<b>Net income .....</b>	<b>10,849,137</b>	<b>6,477,417</b>	<b>21,431,126</b>	<b>2,463,274</b>	<b>3,950,653</b>	<b>557,939</b>

## SUMMARY

	For the year ended December 31,			For the three months ended March 31,		
	2017	2018	2019	2019	2020	
	RMB	RMB	RMB	RMB	RMB	US\$
			(unaudited)	(unaudited)	(unaudited)	
	(in thousands)					
<b>Other comprehensive income</b>						
Unrealized losses on available-for-sale securities, net of tax . . . . .	(23,321)	–	–	–	–	–
Foreign currency translation adjustment . . . . .	(1,573)	18,624	(93,774)	(58,761)	150,103	21,199
<b>Total other comprehensive (loss)/income . . . . .</b>	<b>(24,894)</b>	<b>18,624</b>	<b>(93,774)</b>	<b>(58,761)</b>	<b>150,103</b>	<b>21,199</b>
<b>Total comprehensive income . . . . .</b>	<b>10,824,243</b>	<b>6,496,041</b>	<b>21,337,352</b>	<b>2,404,513</b>	<b>4,100,756</b>	<b>579,138</b>
Comprehensive (income)/loss attributable to noncontrolling interests and redeemable noncontrolling interests . . . . .	(141,198)	(76,912)	83,685	(12,373)	(22,830)	(3,224)
<b>Comprehensive income attributable to NetEase, Inc.’s shareholders . . . . .</b>	<b>10,683,045</b>	<b>6,419,129</b>	<b>21,421,037</b>	<b>2,392,140</b>	<b>4,077,926</b>	<b>575,914</b>

Note:

- (1) On September 6, 2019, we entered into an agreement with a subsidiary of Alibaba Group Holding Limited to sell our e-commerce platform Kaola for approximately US\$1.9 billion. Following the completion of the transaction, Kaola was deconsolidated and its historical financial results were accordingly reflected in our consolidated financial statements as discontinued operations.

We achieved strong operating results during the Track Record Period. For a discussion and analysis of the reasons for the changes in our key financial statement line items across periods, please refer to “Financial Information — Components of Results of Operations” and “Financial Information — Results of Operations.”

## SUMMARY

### Selected consolidated balance sheet data

The table below sets forth our selected consolidated balance sheet data as of the dates indicated:

	As of December 31,			As of March 31,	
	2017	2018	2019	2020	
	RMB	RMB	RMB	RMB	US\$
	(in thousands)			(unaudited)	(unaudited)
Cash and cash equivalents .....	2,467,467	4,977,432	3,246,373	5,592,847	789,861
Time deposits — current .....	30,603,369	32,900,287	53,487,075	50,515,092	7,134,094
Restricted cash — current .....	5,886,367	4,692,050	3,150,354	3,507,105	495,298
Accounts receivable, net .....	3,539,594	4,002,487	4,169,358	4,559,441	643,916
Inventories, net .....	984,228	1,065,615	650,557	562,117	79,386
Prepayments and other current assets .....	3,126,796	3,925,205	4,817,422	6,060,421	855,895
Short-term investments .....	9,702,609	11,674,775	15,312,595	19,373,366	2,736,042
Property, equipment and software, net .....	3,490,130	4,672,079	4,621,712	4,569,982	645,405
Long-term investments .....	2,683,776	5,245,108	9,293,868	9,217,017	1,301,691
Other long-term assets .....	1,088,089	2,930,069	5,666,610	5,670,163	800,780
<b>Total assets .....</b>	<b>71,031,415</b>	<b>86,967,928</b>	<b>112,124,371</b>	<b>118,653,818</b>	<b>16,757,120</b>
Accounts payable .....	1,070,976	1,201,210	1,212,303	1,197,007	169,050
Salary and welfare payables .....	2,076,160	2,799,212	2,957,360	2,429,147	343,061
Taxes payable .....	1,561,920	2,260,646	3,156,513	4,390,606	620,072
Short-term loans .....	6,623,502	13,658,554	16,828,226	19,624,535	2,771,514
Deferred revenue .....	6,049,903	7,718,485	8,602,227	9,981,353	1,409,636
Accrued liabilities and other payables .....	4,331,937	5,005,190	5,292,774	5,546,607	783,331
Short-term operating lease liabilities .....	—	—	191,454	238,071	33,622
Deferred tax liabilities .....	212,854	392,598	382,030	625,578	88,348
<b>Total liabilities .....</b>	<b>23,981,579</b>	<b>35,556,347</b>	<b>39,082,916</b>	<b>44,460,267</b>	<b>6,278,989</b>
NetEase, Inc.'s shareholders' equity .....	45,732,007	45,231,636	61,453,699	62,597,346	8,840,434
Noncontrolling interests .....	703,133	794,209	1,139,156	1,210,794	170,997
<b>Total shareholders' equity .....</b>	<b>46,435,140</b>	<b>46,025,845</b>	<b>62,592,855</b>	<b>63,808,140</b>	<b>9,011,431</b>

We recorded net current assets of RMB38,197.6 million, RMB33,606.7 million, RMB46,862.0 million and RMB46,813.7 million (US\$6,611.4 million), respectively, as of December 31, 2017, 2018 and 2019 and March 31, 2020. For a detailed discussion on our cash position as well as material changes in the various working capital items, see “Financial Information — Liquidity and Capital Resources.”

### Dividend policy

In May 2014, our board of directors approved a quarterly dividend policy commencing in 2014. Under this policy, quarterly dividends were set at an amount equivalent to approximately 25% of our anticipated net income after tax in each fiscal quarter. In the second quarter of 2019, our board of directors determined that quarterly dividends will be set at an amount equivalent to approximately 20%-30% of our anticipated net income after tax in each fiscal quarter. The determination to make dividend distributions and the amount of such distributions in any particular quarter will be made at the discretion of our board of directors and will be based upon our operations and earnings, cash flow, financial condition and other relevant factors. Our board of directors declared dividends of US\$0.69, US\$1.04, US\$4.14 and US\$1.02 per ADS for the first, second, third and fourth quarters of 2019, respectively. Our board of directors also approved an additional special dividend equivalent to US\$3.45 per ADS in the third quarter of 2019. All dividends declared in 2019 have been paid.

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## SUMMARY

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### THE Q1 DIVIDEND

In May 2020, our board of directors approved the Q1 Dividend, and we expect to make dividend payments of approximately US\$158 million in aggregate on June 23, 2020 to Shareholders of record as of the close of business on June 12, 2020, the Record Date. The Q1 Dividend will be paid in U.S. dollars.

Prior to June 11, 2020 (U.S. Eastern Time), the price of our ADSs traded on Nasdaq reflects the entitlement of such ADS holders to receive the Q1 Dividend. June 11, 2020 (U.S. Eastern Time) is the first day of trading when the buyers of our ADSs are no longer entitled to the Q1 Dividend, because trades executed on June 11, 2020 (U.S. Eastern Time) will settle the day after the Record Date of the Q1 Dividend, making it too late for the buyers to receive the Q1 Dividend. Therefore, the price of our ADSs will be adjusted down on June 11, 2020 (U.S. Eastern Time) to reflect the ex-dividend nature of ADSs bought on or after such date.

After our Listing on the Hong Kong Stock Exchange on June 11, 2020, our Shares will immediately begin to trade *ex-dividend*. If you purchase our Shares through the open market, you will not be entitled to receive the Q1 Dividend. The trading price of our Shares immediately after our Listing on the Hong Kong Stock Exchange on June 11, 2020 may be lower than the comparable closing price of our ADSs on June 10, 2020. However, you should not interpret such difference as a discount on the price of our Shares offered to investors. Rather such discrepancy is, at least in part, the result of the different entitlement rights with respect to the Q1 Dividend. For additional information, see “Financial Information — Dividend Policy.”

#### Summary of key dates for the Q1 Dividend

Ex dividend date	:	June 11, 2020, the Listing Date
Closure of register of members	:	N/A
Record Date	:	June 12, 2020
Latest time for lodging transfer documents for registration with the Hong Kong Share Registrar	:	4:30 p.m. (Hong Kong Time) on June 12, 2020, the Record Date
Payment date	:	June 23, 2020

*All dates and times are Hong Kong Times for the purpose of the Q1 Dividend arrangement and solely in the context of the Global Offering.*

#### IMPORTANT NOTICE TO INVESTORS:

**The Q1 Dividend will be paid in U.S. dollars. All investors who have applied for Offer Shares through CCASS EIPO service and been successfully allocated Offer Shares will be entitled to the Q1 Dividend provided that the Global Offering becomes unconditional, irrespective of whether they sell or otherwise dispose of their corresponding allocated Offer Shares on the Hong Kong Stock Exchange immediately after dealing commences on the Listing Date, unless such investors (i) conduct any non-exchange trades and the ownership of the Shares are transferred to a third party on or before the Record Date, or (ii) withdraw physical certificates of such Shares from CCASS and subsequently sell or otherwise dispose of their corresponding Shares by lodging completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar before 4:30 p.m. (Hong Kong Time) on the Record Date for transferring the title to a third party.**



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## SUMMARY

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Shareholders and potential investors should note that those who have chosen to apply through White Form eIPO services and to have physical share certificates issued to themselves will NOT be entitled to the Q1 Dividend, if they sell or otherwise dispose of their corresponding Shares, by lodging completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar before 4:30 p.m. (Hong Kong Time) on the Record Date (being Friday, June 12, 2020) for transferring such title to a third party. Any subsequent purchasers who acquire the relevant Offer Shares from such holders of physical share certificate and lodge completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar by 4:30 p.m. (Hong Kong Time) on the Record Date, WILL BE entitled to the Q1 Dividend.

Investors who purchase the Company's Shares on the Hong Kong Stock Exchange AFTER the commencement of dealings will NOT receive the Q1 Dividend.

In the event that there are unforeseen reasons (including but not limited to bad weather, Extreme Conditions or other events in the nature of force majeure, together the "Unforeseen Reasons") that result in the Listing Date being delayed to a date after the Record Date but no later than June 18, 2020 (the "Delay") and the Delay is solely due to the Unforeseen Reasons, the Company undertakes to pay investors of the Global Offering an amount equal to the Q1 Dividend (based on the investor's corresponding number of Offer Shares allocated in the Global Offering) if the investor would have been entitled to the Q1 Dividend had the Delay not otherwise occurred.

Investors who are interested in participating in the Global Offering, if choosing to refer to our ADS prices during the Hong Kong Public Offering period, prior to the Price Determination Date, should note that such trading prices will be cum dividend. Upon commencement of dealings in our Shares on the Hong Kong Stock Exchange on the Listing Date, our Shares will trade ex-dividend, and may not be comparable to the price of our ADSs during the Hong Kong Public Offering period, on the Price Determination Date and on the day immediately before the Listing Date (all cum dividend). Such discrepancy will, at least in part, be the result of the different entitlement rights with respect to Q1 Dividend. However, investors should not interpret such difference as a discount on the price of our Shares offered for the Global Offering.

In addition, payment of the Q1 Dividend may affect the value of our Shares and the trading price of our ADSs and Shares in the U.S. and Hong Kong markets, respectively. Accordingly, Shareholders and potential investors should exercise caution when dealing in our Shares.

## SHAREHOLDING AND CORPORATE STRUCTURE

### Our major shareholders and controlling shareholders

Shining Globe International Limited holds 1,456,000,000 Shares as of the Latest Practicable Date, representing approximately 42.5% of our total issued share capital immediately after the Global Offering (assuming the Over-allotment Option is not exercised and no additional Shares are issued under the RSU Plans), and together with the entities and person that control it,

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## SUMMARY

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including William Lei Ding, as set out in “Relationship with our Controlling Shareholders” are our controlling shareholders. Orbis Investment Management Limited and Allan Gray Australia Pty Limited are interested in and control 167,410,775 Shares, representing approximately 5.1% of our total issued share capital as at the Latest Practicable Date and approximately 4.9% of our total issued share capital immediately after the Global Offering (assuming the Over-allotment Option is not exercised and no additional Shares are issued under the RSU Plans), and will no longer remain our major shareholder immediately after the Global Offering.

See “Major Shareholders,” “History” and “Relationship with our Controlling Shareholders.”

### **Our VIE structure**

Due to legal restrictions and prohibitions on foreign investment in Chinese companies providing, among other things, value-added telecommunications services, internet cultural services and internet publication services, we conduct all of our business segments through the variable interest entities and their subsidiaries, with which we have entered into contractual arrangements. We describe our VIE structure and a typical set of contractual arrangements with the variable interest entities in the sub-sections “Variable interest entity structure,” “Transferring the economic benefits under the contractual arrangements” and “Ensuring effective control over the variable interest entities under the contractual arrangements” in “History.” As a result, we are able to consolidate the financial results of the variable interest entities and their subsidiaries into our Company’s consolidated financial statements.

### **RISK FACTORS**

There are certain risks involved in our business and industries, our corporate structure, our business operations in China, investing in our Shares and ADSs, the Listing and the Global Offering, many of which are beyond our control. For example, these risks include, among others, the following risks relating to our business:

- If we fail to develop and introduce popular, high-quality online games in a timely and successful manner, we will not be able to compete effectively and our ability to generate revenues will suffer;
- If we are unable to continue to extend the life of existing online games that will encourage continued engagement with the games through the addition of new features or functionalities, our business may be negatively impacted;
- Any difficulties or delays in receiving approval from the relevant government authorities for the games operated by us or any expansion packs for, or material changes to, such games could adversely affect such games’ popularity and profitability;
- The success and future growth of our Youdao business will be affected by the user acceptance and market trend of integration of technology and learning;
- Our intelligent learning, music streaming, e-commerce and other innovative businesses are subject to a broad range of laws and regulations. Any lack of requisite approvals, licenses or permits applicable to these businesses or any failure to comply with applicable laws or regulations may have a material and adverse impact on our business, financial condition and results of operations; and

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## SUMMARY

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- We may be unable to compete successfully against new entrants and established industry competitors.

### USE OF PROCEEDS

We estimate that we will receive net proceeds from the Global Offering of approximately HK\$21,279.0 million after deducting estimated underwriting fees and the estimated offering expenses payable by us and based upon an indicative offer price of HK\$126.00 per Offer Share for both Hong Kong Public Offering and International Offering, and assuming the Over-allotment Option is not exercised, or HK\$24,486.8 million if the Over-allotment Option is exercised in full. We plan to use the net proceeds we will receive from the Global Offering for the following purposes:

- approximately 45% (approximately HK\$9,575.6 million, assuming the Over-allotment Option is not exercised) for globalization strategies and opportunities. We will continue to improve our global presence by expanding our online game offerings in overseas markets, such as Japan, the United States, Europe and Southeast Asia and enhancing our global R&D and game design capabilities. We will also continue to explore global opportunities by investing in and collaborating with international game developers, IP and content owners. Furthermore, we aim to grow our intelligent learning and other innovative businesses in overseas markets with large potential user bases and favorable demographic characteristics.
- approximately 45% (approximately HK\$9,575.6 million, assuming the Over-allotment Option is not exercised) for fueling our continued pursuit of innovation. We will continue to expand and enhance our innovative content offerings, and strengthen our innovative technologies. Our R&D approach will remain focused on bringing commercially viable technologies into specific applications that can further enhance user experience. In addition, we will continue to attract and nurture talents to support further innovation and growth.
- approximately 10% (approximately HK\$2,127.8 million, assuming the Over-allotment Option is not exercised) for general corporate purposes. We will use the remaining proceeds for general corporate purposes, working capital needs and potential strategic investments and acquisitions, although we have not identified any specific investments or acquisition opportunities at this time.

See “Use of Proceeds” for further details.

### THE LISTING

Our ADSs have been listed and traded on Nasdaq since June 30, 2000. Dealings in our ADSs on Nasdaq have been conducted in U.S. dollars. We have applied for a listing of our Shares on the Main Board under Chapter 19C (Secondary Listings of Qualifying Issuers) of the Hong Kong Listing Rules. Dealings in our Shares on the Hong Kong Stock Exchange will be conducted in Hong Kong dollars. Our Shares will be traded on the Hong Kong Stock Exchange in board lots of 100 Shares. For additional information, see “Information about This Document and the Global Offering.”

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## SUMMARY

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### WAIVERS AND EXEMPTIONS

As we are applying for listing under Chapter 19C of the Hong Kong Listing Rules, we will not be subject to certain provisions of the Hong Kong Listing Rules, including, among others, rules on notifiable transactions, connected transactions, share option schemes, content of financial statements as well as certain other continuing obligations. In addition, in connection with the Listing, we have applied for a number of waivers and/or exemptions from strict compliance with the Hong Kong Listing Rules, the Companies (WUMP) Ordinance and the SFO, and a ruling under the Takeovers Codes. For additional information, see “Waivers and Exemptions.”

Among the various waivers that we have applied for, we have applied to the Hong Kong Stock Exchange for a waiver from strict compliance with the requirements in Paragraph 3(b) of Practice Note 15 to the Hong Kong Listing Rules such that we are able to spin off a subsidiary entity and list it on the Hong Kong Stock Exchange within three years of the Listing. While we do not have any specific plans with respect to the timing or details of any potential spin-off listing on the Hong Kong Stock Exchange as at the date of this document, we continue to explore the ongoing financing requirements for our various businesses and may consider a spin-off listing on the Hong Kong Stock Exchange for one or more of those businesses (other than our online game business) within the three-year period subsequent to the Listing. The waiver granted by the Hong Kong Stock Exchange is conditional upon us confirming to the Hong Kong Stock Exchange in advance of any spin-off that it would not render our Company incapable of fulfilling the eligibility requirements under Rule 19C.05 of the Hong Kong Listing Rules based on the financial information of the entity or entities to be spun off at the time of the Listing (calculated cumulatively if more than one entity is spun off). We cannot assure you that any spin-off will ultimately be consummated, whether within the three-year period after the Listing or otherwise, and any such spin-off will be subject to market conditions at the time. In the event that we proceed with a spin-off, the Company’s interest in the entity to be spun-off will be reduced accordingly.

We enjoy exemptions from certain obligations under U.S. securities laws and the Nasdaq rules as a foreign private issuer as defined under the U.S. Exchange Act. Investors should exercise care when investing in our Shares and/or ADSs. See “Information about This Document and the Global Offering — Summary of Exemptions as a Foreign Private Issuer in the U.S.”

### ARTICLES OF ASSOCIATION

We are an exempted company incorporated in the Cayman Islands with limited liability and our affairs are governed by our Articles of Association, the Cayman Companies Law, as well as the common law of the Cayman Islands. The laws of Hong Kong differ in certain respects from the Cayman Companies Law, and our Articles of Association are specific to us and include certain provisions that may be different from common practices in Hong Kong. See “Risk Factors — Risks related to our Shares, the ADSs, the Listing and the Global Offering — Holders of our Shares and ADSs may have difficulty effecting service of process and enforcing judgments obtained against us, our directors and our management, the ability of U.S. authorities to bring actions in the PRC may also be limited, and our Articles of Association include certain provisions that may be different from common practices in Hong Kong.” See “Information about This Document and the Global Offering” and “Waivers and Exemptions — Shareholder Protection Requirements.”

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## SUMMARY

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### OFFERING STATISTICS

**Based on the indicative  
offer price per Offer  
Share of HK\$126.00  
for Both Hong Kong  
Public Offering and  
International Offering**

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Our market capitalization <sup>(1)</sup> .....	HK\$432.1 billion
Unaudited pro forma adjusted net tangible assets per Share <sup>(2)</sup> .....	RMB23.85 or HK\$26.07

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Notes:

- (1) The calculation of market capitalization is based on 3,429,395,456 Shares that will be in issue immediately following the Global Offering, without taking into account any allotment and issuance of Shares upon exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time and any issuance or repurchase and cancellation of Shares and/or ADSs that we may make after the Latest Practicable Date.
- (2) The unaudited pro forma adjusted net tangible assets per Share is based on a total of 3,429,395,456 Shares that will be in issue assuming that the Global Offering had been completed on March 31, 2020, without taking into account any allotment and issuance of Shares upon exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time and any issuance or repurchase and cancellation of Shares and/or ADSs that we may make after the Latest Practicable Date.

### LISTING EXPENSES

We expect to incur listing expenses of up to approximately RMB299.6 million (assuming that the Global Offering is conducted at the indicative offer price per Offer Share of HK\$126.00 for both Hong Kong Public Offering and International Offering and the Over-allotment Option is not exercised). We expect to recognize RMB9.8 million as general and administrative expenses in the fiscal year ending December 31, 2020 and RMB289.8 million as a deduction in equity directly.

### NO MATERIAL ADVERSE CHANGE

Our directors confirm that, as of the date of this document, there has been no material adverse change in our financial or trading position since December 31, 2019 (being the date on which the latest audited consolidated financial information of our Group was prepared) and there has been no event since December 31, 2019 that would materially affect the information shown in our consolidated financial statements included in the Accountant's Report in Appendix IA.

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## SUMMARY

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### RECENT DEVELOPMENTS

The following sets forth our selected unaudited financial data for the three months ended March 31, 2019 and 2020. Please refer to “Financial Information” and “Risk Factors” included elsewhere in this document for information regarding trends and other factors that may affect our results of operations.

- Net revenues increased by 18.3% to RMB17,062.4 million (US\$2,409.7 million) for the three months ended March 31, 2020 from RMB14,422.2 million for the three months ended March 31, 2019.
  - Net revenues from online game services increased by 14.1% to RMB13,518.2 million (US\$1,909.1 million) for the three months ended March 31, 2020 from RMB11,850.2 million for the three months ended March 31, 2019.
  - Net revenues from Youdao increased by 139.8% to RMB541.4 million (US\$76.5 million) for the three months ended March 31, 2020 from RMB225.7 million for the three months ended March 31, 2019.
  - Net revenues from innovative businesses and others increased by 28.0% to RMB3,002.7 million (US\$424.1 million) for the three months ended March 31, 2020 from RMB2,346.3 million for the three months ended March 31, 2019.
- Gross profit increased by 21.2% to RMB9,377.6 million (US\$1,324.4 million) for the three months ended March 31, 2020 from RMB7,737.7 million for the three months ended March 31, 2019.
- Total operating expenses were RMB4,891.2 million (US\$690.8 million) for the three months ended March 31, 2020, representing an increase of 22.8% from RMB3,982.6 million for the three months ended March 31, 2019.
- Net income from continuing operations attributable to our shareholders increased by 29.9% to RMB3,551.0 million (US\$501.5 million) for the three months ended March 31, 2020 from RMB2,732.9 million for the three months ended March 31, 2019.
- Net income attributable to our shareholders increased by 49.1% to RMB3,551.0 million (US\$501.5 million) for the three months ended March 31, 2020 from RMB2,382.1 million for the three months ended March 31, 2019.
- Basic net income from continuing operations per ADS for the three months ended March 31, 2020 was US\$3.88.

In addition, the COVID-19 outbreak has caused and may continue to cause us to implement temporary adjustments of work schemes allowing employees to work from home. We prioritize the health and safety of our employees, and have also taken various other preventative and quarantine measures across our Group, including monitoring our employees’ health and optimizing our technology systems to better serve a remote working environment. These measures have enabled us to continue carrying out our business without disruption.

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## SUMMARY

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The deterioration in economic conditions in connection with the global outbreak has caused, and may continue to cause, decreases or delays in advertising and marketing service spending and budgets of customers across our platforms. Our online games and intelligent learning businesses have not been materially impacted by the pandemic as of the date of this document. The extent to which the COVID-19 outbreak impacts our results will depend on future developments, which are highly uncertain and cannot be predicted. As of the date of this document, we are not aware of any material adverse effects on our financial statements as a result of the COVID-19 outbreak.

On May 20, 2020, the U.S. Senate passed S. 945, the Holding Foreign Companies Accountable Act (the “**Kennedy Bill**”). If passed by the U.S. House of Representatives and signed by the U.S. President, the Kennedy Bill could cause investor uncertainty for affected issuers, including us, the market price of our ADSs could be adversely affected, and we could be delisted from Nasdaq if we are unable to meet the Public Company Accounting Oversight Board inspection requirement proposed by the Kennedy Bill in time. For additional information, see “Risk Factors — Risks related to our Shares, the ADSs, the Listing and the Global Offering — Our auditor of the consolidated financial statements included in our annual report on Form 20-F filed with the SEC, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and consequently you are deprived of the benefits of such inspection.”

In May 2020, our board of directors approved the Q1 Dividend, and we expect to make dividend payments of approximately US\$158 million in aggregate on June 23, 2020 to Shareholders of record as of the close of business on June 12, 2020. For additional information, see “Financial Information — Dividend Policy.”

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## DEFINITIONS

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In this document, unless the context otherwise requires, the following terms shall have the meanings set out below.

“2019 PRC Foreign Investment Law”	the <i>PRC Foreign Investment Law</i> (《中華人民共和國外商投資法》), promulgated by the National People’s Congress in March 2019, which became effective on January 1, 2020
“ADS(s)”	American Depositary Shares (each representing 25 Shares)
“Articles” or “Articles of Association”	our amended and restated articles of association (as amended from time to time), adopted on May 12, 2000 and amended by a special resolution passed on June 5, 2003, a summary of which is set out in Appendix III
“board” or “board of directors”	our board of directors
“business day”	any day (other than a Saturday, Sunday or public holiday) on which banks in Hong Kong or other relevant jurisdictions are generally open for business
“BVI”	British Virgin Islands
“Cayman Companies Law”	the <i>Companies Law</i> , Cap.22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, as amended or supplemented or otherwise modified from time to time
“CCASS”	the Central Clearing and Settlement System established and operated by HKSCC
“CCASS Clearing Participant”	a person admitted to participate in CCASS as a direct participant or a general clearing participant
“CCASS Custodian Participant”	a person admitted to participate in CCASS as a custodian participant



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## DEFINITIONS

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“CCASS EIPO”	the application for the Hong Kong Offer Shares to be issued in the name of HKSCC Nominees and deposited directly into CCASS to be credited to your or a designated CCASS Participant’s stock account through causing HKSCC Nominees to apply on your behalf, including by (i) instructing your broker or custodian who is a CCASS Clearing Participant or a CCASS Custodian Participant to give <b>electronic application instructions</b> via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf, or (ii) if you are an existing CCASS Investor Participant, giving <b>electronic application instructions</b> through the CCASS Internet System ( <a href="https://ip.ccass.com">https://ip.ccass.com</a> ) or through the CCASS Phone System (using the procedures in HKSCC’s “An Operating Guide for Investor Participants” in effect from time to time). HKSCC can also input <b>electronic application instructions</b> for CCASS Investor Participants through HKSCC’s Customer Service Centre by completing an input request
“CCASS Investor Participant”	a person admitted to participate in CCASS as an investor participant who may be an individual or joint individuals or a corporation
“CCASS Participant”	a CCASS Clearing Participant, a CCASS Custodian Participant or a CCASS Investor Participant
“China” or “the PRC”	the People’s Republic of China, excluding, for the purposes of this document only, Taiwan and the special administrative regions of Hong Kong and Macau, except where the context otherwise requires
“CNNIC”	China Internet Network Information Center (中國互聯網信息中心)
“Companies Ordinance”	the <i>Companies Ordinance</i> (Chapter 622 of the Laws of Hong Kong), as amended or supplemented from time to time
“Companies (WUMP) Ordinance”	the <i>Companies (Winding Up and Miscellaneous Provisions) Ordinance</i> (Chapter 32 of the Laws of Hong Kong), as amended or supplemented from time to time
“Company,” “our Company,” “we” or “us”	NetEase, Inc., an exempted company incorporated in the Cayman Islands with limited liability on July 6, 1999 and, where the context requires, its subsidiaries (which includes the consolidated affiliated entities) from time to time
“connected person(s)”	has the meaning ascribed to it under the Hong Kong Listing Rules

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## DEFINITIONS

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“connected transaction(s)”	has the meaning ascribed to it under the Hong Kong Listing Rules
“controlling shareholder(s)”	has the meaning ascribed to it under the Hong Kong Listing Rules and unless the context otherwise requires, refers to Shining Globe International Limited and the entities and person that control it, as set out in “Relationship with our Controlling Shareholders”
“CSRC”	the China Securities Regulatory Commission (中國證券監督管理委員會)
“Deposit Agreement”	the deposit agreement, dated as of July 6, 2000, as amended, among us, the Bank of New York Mellon and holders and beneficial owners of our ADSs from time to time
“director(s)”	member(s) of our board
“DTC”	The Depository Trust Company, the central book-entry clearing and settlement system for equity securities in the United States and the clearance system for our ADSs
“EIT”	enterprise income tax
“Extreme Conditions”	any extreme conditions or events, the occurrence of which causes interruption to the ordinary course business operations in Hong Kong and/or that may affect the Price Determination Date or the Listing Date
“foreign private issuer”	as such term is defined in Rule 3b-4 under the U.S. Exchange Act
“Global Offering”	the Hong Kong Public Offering and the International Offering
“Green Application Form(s)”	the application form(s) to be completed by the <b>White Form eIPO</b> Service Provider, Computershare Hong Kong Investor Services Limited
“Group,” “our Group,” “the Group,” “we,” “us,” or “our”	our Company and our subsidiaries (including the consolidated affiliated entities) from time to time
“HK\$” or “Hong Kong dollars” or “HK dollars”	Hong Kong dollars, the lawful currency of Hong Kong
“HKSCC”	Hong Kong Securities Clearing Company Limited, a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited

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## DEFINITIONS

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“HKSCC Nominees”	HKSCC Nominees Limited, a wholly-owned subsidiary of HKSCC
“Hong Kong” or “HK”	the Hong Kong Special Administrative Region of the PRC
“Hong Kong Listing Rules”	the <i>Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited</i> , as amended or supplemented from time to time
“Hong Kong Offer Shares”	the Shares offered pursuant to the Hong Kong Public Offering
“Hong Kong Public Offering”	the offer of the Hong Kong Offer Shares for subscription by the public in Hong Kong at the Hong Kong Offer Price on the terms and conditions described in this document
“Hong Kong Share Registrar”	Computershare Hong Kong Investor Services Limited
“Hong Kong Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Hong Kong Underwriters”	the underwriters of the Hong Kong Public Offering listed in “Underwriting — Hong Kong Underwriters”
“Hong Kong Underwriting Agreement”	the underwriting agreement dated May 31, 2020, relating to the Hong Kong Public Offering and entered into by, among others, the Hong Kong Underwriters and us
“independent director(s)”	our directors who are “independent” under applicable U.S. regulations and considered “independent non-executive directors” for the purpose of Rule 3.10 of the Hong Kong Listing Rules
“independent third party(ies)”	person(s) or company(ies) and their respective ultimate beneficial owner(s), who/which, to the best of our directors’ knowledge, information and belief, having made all reasonable enquiries, is/are not connected with our Company
“International Offer Price”	the final offer price per International Offer Share in Hong Kong dollars (exclusive of brokerage of 1%, SFC transaction levy of 0.0027% and Hong Kong Stock Exchange trading fee of 0.005%)
“International Offer Shares”	the Shares offered pursuant to the International Offering together with, where relevant, any additional Shares which may be issued by us pursuant to the exercise of the Over-allotment Option

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## DEFINITIONS

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“International Offering”	the offer of the International Offer Shares at the International Offer Price pursuant to the shelf registration statement on Form F-3ASR that was filed with the SEC and became effective on May 29, 2020, and the preliminary prospectus supplement filed with the SEC on June 1, 2020 and the final prospectus supplement to be filed with the SEC on or about June 5, 2020
“International Underwriters”	the group of underwriters, led by the Joint Global Coordinators, that expects to enter into the International Underwriting Agreement to underwrite the International Offering
“International Underwriting Agreement”	the international underwriting agreement relating to the International Offering, which is expected to be entered into by, among others, the Joint Global Coordinators, the International Underwriters and us on or about June 5, 2020
“Joint Bookrunners”	the joint bookrunners as named in “Directors and Parties Involved in the Global Offering”
“Joint Global Coordinators”	the joint global coordinators as named in “Directors and Parties Involved in the Global Offering”
“Joint Policy Statement”	the Joint Policy Statement Regarding the Listing of Overseas Companies jointly issued by the Hong Kong Stock Exchange and the SFC on September 27, 2013
“Joint Sponsors”	the Joint Sponsors of the listing of the Shares on the Main Board of the Hong Kong Stock Exchange as named in “Directors and Parties Involved in the Global Offering”
“Latest Practicable Date”	May 25, 2020, being the latest practicable date prior to the date of this document for the purpose of ascertaining certain information contained in this document
“Law(s)”	includes all applicable law, regulations, rules, interpretations and guidance, as appropriate in the context
“Listing”	the listing we are seeking on the Hong Kong Stock Exchange under Chapter 19C of the Hong Kong Listing Rules
“Listing Committee”	the Listing Committee of the Hong Kong Stock Exchange

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## DEFINITIONS

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“Listing Date”	the date, expected to be on or about June 11, 2020, on which the Shares are listed on Main Board and from which dealings in the Shares are permitted to commence on the Main Board
“Main Board”	the stock market (excluding the option market) operated by the Hong Kong Stock Exchange which is independent from and operated in parallel with the Growth Enterprise Market of the Hong Kong Stock Exchange
“Memorandum” or “Memorandum of Association”	our memorandum of association (as amended from time to time), a summary of which is set out in Appendix III to this document
“MII” (and later “MIIT”)	Ministry of Information Industry of the PRC (中華人民共和國信息產業部), which later became the Ministry of Industry and Information Technology (中華人民共和國工業和信息化部) (“MIIT”)
“MOC” (and later “MOCT”)	Ministry of Culture of the PRC (中華人民共和國文化部), which later became the Ministry of Culture and Tourism (中華人民共和國文化和旅游部) (“MOCT”)
“MOF”	Ministry of Finance of the PRC (中華人民共和國財政部)
“MOFCOM”	Ministry of Commerce of the PRC (中華人民共和國商務部)
“Nasdaq”	Nasdaq Global Select Market
“Nasdaq rules”	<i>The Nasdaq Stock Market LLC Rules</i> , or the rules applicable to issuers listed on the Nasdaq, and as amended from time to time
“NBS”	National Bureau of Statistics of China (國家統計局)
“NDRC”	National Development and Reform Commission (中華人民共和國發展和改革委員會)
“Negative List”	the <i>Special Administrative Measures (Negative List) for Foreign Investment Access</i> , most recently jointly promulgated by the MOFCOM and the NDRC on June 30, 2019 and which became effective on July 30, 2019, as amended, supplemented or otherwise modified from time to time
“Offer Share(s)”	the Hong Kong Offer Shares and the International Offer Shares together with, where relevant, any additional Shares that we may issue pursuant to the exercise of the Over-allotment Option

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## DEFINITIONS

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“Over-allotment Option”	the option we expect to grant to the International Underwriters, exercisable by the Joint Global Coordinators (for themselves and on behalf of the International Underwriters) under the International Underwriting Agreement, which may require us to allot and issue up to an aggregate of 25,722,000 additional Shares at the International Offer Price to cover over-allocations in the International Offering, if any
“PBOC”	People’s Bank of China
“PCAOB”	the Public Company Accounting Oversight Board
“PFIC”	passive foreign investment company
“PRC Company Law”	the <i>Company Law of the PRC</i> (《中華人民共和國公司法》), enacted by the Standing Committee of the Eighth National People’s Congress on December 29, 1993 and effective on July 1, 1994, and most recently amended on October 26, 2018, and as amended, supplemented or otherwise modified from time to time
“PRC Legal Adviser”	Zhong Lun Law Firm, our legal adviser as to the laws of the PRC
“Price Determination Agreement”	the agreement to be entered into by the Joint Global Coordinators (for themselves and on behalf of the Underwriters) and us on the Price Determination Date to record and fix the pricing of the Offer Shares
“Price Determination Date”	the date, expected to be on or about Friday, June 5, 2020, on which the International Offer Price and Public Offer Price will be determined, or such later time as the Joint Global Coordinators (for themselves and on behalf of the Underwriters) and we may agree, but in any event, not later than Wednesday, June 10, 2020
“Principal Share Registrar”	Maples Fund Services (Cayman) Limited
“Public Offer Price”	the final offer price per Hong Kong Offer Share in Hong Kong dollars (exclusive of brokerage of 1%, SFC transaction levy of 0.0027% and Hong Kong Stock Exchange trading fee of 0.005%)
“Q1 Dividend”	the dividend of US\$0.0464 per Share (equivalent to US\$1.16 per ADS of the Company, representing 25 Shares) for the first quarter of 2020 approved by the board of directors of the Company, which is expected to be paid by the Company on June 23, 2020

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## DEFINITIONS

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“Qualifying Issuer”	has the meaning given to it under Chapter 19C of the Hong Kong Listing Rules
“Record Date”	June 12, 2020 (Hong Kong Time)
“Regulation S”	Regulation S under the U.S. Securities Act
“Relevant Persons”	the Joint Sponsors, the Joint Global Coordinators, Underwriters, any of their or the Company’s respective directors, officers, employees, partners, agents, advisers and any other parties involved in the Global Offering
“RMB” or “Renminbi”	Renminbi, the lawful currency of the PRC
“RSU(s)”	restricted share unit(s)
“SAFE”	State Administration of Foreign Exchange of the PRC (中華人民共和國國家外匯管理局), the PRC governmental agency responsible for matters relating to foreign exchange administration, including local branches, when applicable
“SAIC”	State Administration for Industry and Commerce of the PRC (中華人民共和國國家工商行政管理總局), currently known as SAMR
“SAMR”	State Administration for Market Regulation of the PRC (中華人民共和國國家市場監督管理總局)
“SAPPRFT”	State Administration of Press, Publication, Radio, Film and Television of the PRC (中華人民共和國國家新聞出版廣電總局), formerly the General Administration of Press and Publication of the PRC (中華人民共和國新聞出版總署) and the State Administration of Radio, Film and Television of the PRC (中華人民共和國國家廣播電影電視總局), and since March 2018 has been reformed and became the National Radio and Television Administration (國家廣播電視總局) and the National Press and Publication Administration (National Copyright Administration) (國家新聞出版署(國家版權局))
“SEC”	the United States Securities and Exchange Commission
“SFC”	the Securities and Futures Commission of Hong Kong
“SFO” or “Securities and Futures Ordinance”	the <i>Securities and Futures Ordinance</i> (Chapter 571 of the Laws of Hong Kong), as amended or supplemented from time to time
“Share(s)”	ordinary share(s) in our share capital with par value of US\$0.0001 each

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## DEFINITIONS

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“Share Incentive Plans” or “RSU Plans”	the 2009 RSU Plan and the 2019 RSU Plan, and summarized in “Directors and Senior Management — Share Incentive Plans,” and any other share incentive plans adopted by the company from time to time
“shareholder(s)”	holder(s) of Shares and, where the context requires, ADSs
“Significant Subsidiaries”	our subsidiaries and consolidated affiliated entities as identified in “History — Corporate Structure — Significant Subsidiaries”
“Stabilizing Manager”	J.P. Morgan Securities (Asia Pacific) Limited
“Stock Borrowing Agreement”	the stock borrowing agreement expected to be entered into on or around the Price Determination Date between Shining Globe International Limited and J.P. Morgan Securities plc pursuant to which J.P. Morgan Securities plc may borrow up to 25,722,000 Shares from Shining Globe International Limited to facilitate the settlement of over-allocations
“subsidiary” or “subsidiaries”	has the meaning ascribed thereto in the Hong Kong Listing Rules and includes the consolidated affiliated entities
“Takeovers Codes”	the Codes on Takeovers and Mergers and Share Buy-backs issued by the SFC
“Track Record Period”	the years ended December 31, 2017, 2018 and 2019
“Underwriters”	the Hong Kong Underwriters and the International Underwriters
“Underwriting Agreements”	the Hong Kong Underwriting Agreement and the International Underwriting Agreement
“U.S.” or “United States”	the United States of America, its territories, its possessions and all areas subject to its jurisdiction
“U.S. Exchange Act”	the <i>United States Securities Exchange Act of 1934</i> , as amended, and the rules and regulations promulgated thereunder
“U.S. GAAP”	accounting principles generally accepted in the United States
“U.S. Securities Act”	the <i>United States Securities Act of 1933</i> , as amended, and the rules and regulations promulgated thereunder



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## DEFINITIONS

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“US\$” or “U.S. dollars”	United States dollars, the lawful currency of the United States
“variable interest entities,” “VIE” or “VIEs”	our variable interest entities, or any one of them, the financial results of which are consolidated into our consolidated financial statements as if they were our subsidiaries
“VAT”	value-added tax; all amounts are exclusive of VAT in this document except where indicated otherwise
“VIE equity holder(s)”	the individual or ultimate shareholders of the variable interest entities
“VIE structure” or “Contractual Arrangements”	variable interest entity structure, and where the context requires, and the agreements underlying it
“White Form eIPO”	the application for Hong Kong Offer Shares to be issued in the applicant’s own name by submitting applications online through the designated website of the <b>White Form eIPO Service Provider</b> , <a href="http://www.eipo.com.hk">www.eipo.com.hk</a>
“White Form eIPO Service Provider”	Computershare Hong Kong Investor Services Limited

In this document, the terms “associate(s),” “close associate(s),” “controlling shareholder(s),” “core connected person(s)” and “substantial shareholder(s)” shall have the meanings given to such terms in the Hong Kong Listing Rules, unless the context otherwise requires.

Unless otherwise expressly stated or the context otherwise requires, all data in this document is as of the date of this document.

The English names of PRC entities, PRC laws or regulations, and PRC governmental authorities referred to in this document are translations from their Chinese names and are for identification purposes. If there is any inconsistency, the Chinese names shall prevail.

Certain amounts and percentage figures included in this document have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures preceding them.

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## GLOSSARY

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The following is a glossary of certain terms used in this document in connection with us and/or our business. As such, these terms and their meanings may not correspond to standard industry meanings or usage of these terms.

“AI”	artificial intelligence
“App Annie”	App Annie Inc., a global mobile application intelligence platform
“AR”	augmented reality
“Boguan”	Guangzhou Boguan Telecommunication Technology Co., Ltd., a company established under PRC laws and a Significant Subsidiary; see “History” on the date and place of establishment
“CAGR”	compound annual growth rate
“CCGs”	collectible card games
“GB”	gigabytes
“GDP”	gross domestic product
“Guangzhou NetEase”	Guangzhou NetEase Computer System Co., Ltd., a company established under PRC laws and a Significant Subsidiary; see “History” on the date and place of establishment
“Hangzhou Leihuo”	Hangzhou NetEase Leihuo Technology Co., Ltd. (formerly known as Hangzhou NetEase Leihuo Network Co., Ltd. for identification purposes), a company established under PRC laws and a Significant Subsidiary; see “History” on date and place of establishment
“HNTEs”	High and New Technology Enterprises
“Hong Kong NetEase”	Hong Kong NetEase Interactive Entertainment Limited, a company incorporated under Hong Kong laws and a Significant Subsidiary; see “History” on date and place of establishment
“ICP(s)”	Internet content provider(s)
“NetEase Hangzhou”	NetEase (Hangzhou) Network Co., Ltd., a company established under PRC laws and a Significant Subsidiary; see “History” on date and place of establishment

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## GLOSSARY

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“Machine learning”	an application of AI that provides systems the ability to automatically learn and improve from experience without being explicitly programmed
“MAUs” for Youdao	for a specified period, with respect to each of Youdao’s products and services (except for smart devices), refers to the average of the monthly number of unique mobile or PC devices, as the case may be, through which such product and service is accessed at least once in that month (duplicate access to different products and services is not eliminated from the calculation). MAUs for Youdao are calculated using internal company data, treating each distinguishable device as a separate MAU even though some users may access Youdao’s products and services using more than one device and multiple users may access our services using the same
“MMORPGs”	massively multi-player online role-playing games
“MOBA”	multi-player online battle arena
“Newzoo”	Newzoo, a global market research firm focused games
“NMT”	neural machine translation
“OCR”	optical character recognition
“R&D”	research and development
“RPGs”	role-playing games
“SLGs”	simulation games
“VR”	virtual reality
“Yanxuan”	Hangzhou NetEase Yanxuan Trading Co., Ltd., a company established under PRC laws and a Significant Subsidiary; see “History” on date and place of establishment
“Youdao”	Youdao, Inc., a company incorporated under Cayman Islands laws in November 2014, and listed on The New York Stock Exchange under the symbol “DAO” in October 2019 and a majority-controlled subsidiary of our Company

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## GLOSSARY

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“Youdao Computer”	Beijing NetEase Youdao Computer System Co., Ltd, a company established under PRC laws and a Significant Subsidiary; see “History” on date and place of establishment
“Youdao Information”	NetEase Youdao Information Technology (Beijing) Co., Ltd., a company established under PRC laws and a Significant Subsidiary; see “History” on date and place of establishment

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## FORWARD-LOOKING STATEMENTS

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Certain statements in this document are forward looking statements that are, by their nature, subject to significant risks and uncertainties. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as “will,” “expect,” “anticipate,” “estimate,” “believe,” “going forward,” “ought to,” “may,” “seek,” “should,” “intend,” “plan,” “projection,” “could,” “vision,” “goals,” “aim,” “aspire,” “objective,” “target,” “schedules” and “outlook”) are not historical facts, are forward-looking and may involve estimates and assumptions and are subject to risks (including but not limited to the risk factors detailed in this document), uncertainties and other factors some of which are beyond our Company’s control and which are difficult to predict. Accordingly, these factors could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements.

Our forward-looking statements have been based on assumptions and factors concerning future events that may prove to be inaccurate. Those assumptions and factors are based on information currently available to us about the businesses that we operate. The risks, uncertainties and other factors, many of which are beyond our control, that could influence actual results include, but are not limited to:

- our operations and business prospects;
- our business and operating strategies and our ability to implement such strategies;
- our ability to develop and manage our operations and business;
- competition for, among other things, capital, technology and skilled personnel;
- our ability to control costs;
- our dividend policy;
- changes to regulatory and operating conditions in the industry and geographical markets in which we operate; and
- all other risks and uncertainties described in “Risk Factors.”

Since actual results or outcomes could differ materially from those expressed in any forward-looking statements, we strongly caution you against placing undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as at the date on which such statement is made, and, except as required by the Hong Kong Listing Rules, we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. Statements of or references to our intentions or those of any of our directors are made as at the date of this document. Any such intentions may change in light of future developments.

All forward-looking statements in this document are expressly qualified by reference to this cautionary statement.

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## RISK FACTORS

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You should carefully consider all of the information set out in this document before making an investment in the Shares, including the risks and uncertainties described below in respect of our business and our industry and the Global Offering. You should pay particular attention to the fact that we are a company incorporated in the Cayman Islands and that our principal operations are conducted in China and are governed by a legal and regulatory environment that in some respects differs from what prevails in other countries. Our business could be affected materially and adversely by any of these risks.

### RISKS RELATED TO OUR COMPANY AND OUR INDUSTRY

#### Risks related to our online games business

*If we fail to develop and introduce popular, high-quality online games in a timely and successful manner, we will not be able to compete effectively and our ability to generate revenues will suffer.*

We operate in a highly competitive, quickly changing environment, and player preferences for online games are difficult to predict. Our future success depends not only on the popularity of our existing online games but also on our ability to develop new high-quality online games and expand our game portfolio with games in a variety of genres that are in line with market trends and to successfully monetize such games. The development of successful new online games can be challenging and requires high levels of innovation, a deep understanding of the online game industry in China and the other markets where our games are published (including with respect to evolving business models), and an ability to anticipate and effectively respond to changing interests and preferences of game players in a timely manner. Moreover, each of our new games requires long periods of time for research and development and testing and also typically experiences a long ramp-up period as players become familiar with the game. If we are unsuccessful at developing and introducing new online games that are appealing to players with acceptable pricing and terms, our business, financial condition and results of operations will be negatively impacted because we would not be able to compete effectively and our ability to generate revenues would suffer.

In addition, new technologies in online game programming or operations could render our current online titles or games in development obsolete or unattractive to our players, thereby limiting our ability to recover development costs and potentially adversely affecting our future revenues and profitability. For example, the online game industry in China has been transitioning to mobile games, which have become increasingly popular as internet users in China rely more and more on mobile devices, such as smart phones and tablets, to access the internet. In response to this trend, we devote significant resources to developing games that can be operated on mobile devices. We have commercially launched over 100 in-house developed and licensed mobile games as of December 31, 2019 including the *Fantasy Westward Journey* mobile game, *Westward Journey Online* mobile game, *Onmyoji*, the mobile version of *New Ghost*, *Invincible*, *Knives Out*, *All About Jianghu*, *Identity V*, *Ancient Nocturne*, *Xuan Yuan Sword: Dragon Upon the Cloud* and *Fantasy Westward Journey 3D*. As the market for mobile games is rapidly evolving, with games in an expanding range of genres being introduced by us and our competitors, we cannot guarantee that we will be able to effectively compete in the mobile game market. We will also need to continue investing in the development of new technologies and bring new features and functionalities to our games, as well as enhance the user experience on our various platforms.

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## RISK FACTORS

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We are not able to predict if or when we will commercially launch additional new games and the pace at which our new games will penetrate the online game market in China or elsewhere, if at all. A number of factors, including technical difficulties, lack of sufficient game development capabilities, personnel and other resources and failure to obtain or delays in obtaining relevant governmental authorities' approvals could result in delayed launching of our new games or the cancelation of the development of our pipeline games. Any delays in product releases or problems arising following the commercial release of one or more new online games such as programming errors, or "bugs," could negatively impact our business and reputation and could cause our results of operations to be materially different from expectations. We believe that expectations of players regarding the quality, performance and integrity of our online games and services are high, and if any of these issues occurs, players may stop playing our online games and may be less likely to return to such games as often in the future, which may negatively impact our business.

***If we are unable to continue to extend the life of existing online games that will encourage continued engagement with the games through the addition of new features or functionalities, our business may be negatively impacted.***

To prolong the lifespan of our online games, we need to continually improve and update them on a timely basis with new features and functionalities that appeal to existing game players, attract new game players and improve overall player loyalty to such games. As a result, we have devoted, and expect to continue to devote, significant resources to maintain and raise the popularity of our online games through the release of new versions and/or expansion packs on a periodic basis. Developing successful updates and expansion packs for our existing games depends on our ability to anticipate market trends in the online game industry. We must also collect and analyze player behavior data and feedback from our online community in a timely manner and utilize this information to effectively incorporate features into our updates and expansion packs to improve the variety and attractiveness of our gameplay and any virtual items sold within the games.

In the course of operating online games, including the release of updates and expansion packs to existing games, certain game features may periodically be introduced, changed or removed. We cannot assure you that the introduction, change or removal of any game feature will be well received by our game players, who may decide to reduce or eliminate their playing time in response to any such introduction, change or removal. As a result, any introduction, change or removal of game features may adversely impact our business, financial condition and results of operations.

We are unable to predict whether these activities will be successful or adversely affect our profitability given the significant resources required. Moreover, because of the rapidly evolving nature of the online games market in China and elsewhere, we cannot estimate the total life cycle of any of our games, particularly our more recently launched mobile or PC games, and changes in players' tastes or in the overall market for online games in China and elsewhere could alter the life cycle of each version or upgrade or even cause our players to stop playing our games altogether.

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## RISK FACTORS

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***Any difficulties or delays in receiving approval from the relevant government authorities for our new games, or new expansion packs for or material changes to our existing games, could adversely affect our games' popularity and profitability.***

All games we release in China require government approvals. Moreover, even after certain games have received government approvals, any expansion packs for or material changes to the content of those games may require further government approvals. We cannot be certain of the duration of any necessary approval processes, and any delay in receiving such government approvals may adversely affect the profitability and popularity of such games. In particular, game approvals in 2018 experienced certain delays, although the approvals resumed starting from the end of 2018. Since then, China's game regulatory authority has officially published a few lists of newly approved game titles, including a number of our online games, and the approval processes for game titles appears to have returned to normal in 2019. There was, however, a decline in the number of games which received approvals in 2019 compared to previous years. We are not certain of the cause of the delays in 2018 or reduced number of approvals in 2019. In addition, no laws, regulations or official clarifications had been promulgated or published in relation to such delay and resumption of the assessment and approval procedures, and it is unclear whether there will be any similar delays in the future. We cannot predict the effect any future delay in approvals may have on our results of operations. We received our most recent regulatory approval for a new online game in May 2020.

According to several news reports in December 2018, PRC regulators established the Online Games Ethics Committee for the purpose of reviewing online games, and based on the assessment conducted by the Online Games Ethics Committee, PRC regulators reviewed and rejected nine of an initial batch of 20 games. As of the date of this document, no official laws and regulations had been promulgated or published in relation to the assessment criteria and procedures of the Online Games Ethics Committee. However, the formation of the Online Games Ethics Committee and its assessment criteria and procedures could impact our ability to launch and publish new games going forward, and require us to spend more time and costs in preparing and receiving the approvals necessary to launch our games. In addition, our games that have already received the relevant approval may also be subject to further review by the Online Games Ethics Committee, and we may be required to modify the content of our games, which will further add to our regulatory compliance costs and expenses.

***Reports of violence and crimes related to online games or any claims of our gaming contents to be, among others, obscene, superstitious, defamatory or impairing public interest, may result in negative publicity or a governmental response that could have a material and adverse impact on our business.***

The media in China has reported incidents of violent crimes allegedly inspired by online games and theft of virtual items between users in online games. While we believe that such events were not related to our online games, it is possible that our reputation, as one of the leading online game providers in China, could be adversely affected by such behavior. In response to the media reports, in August 2005 the Chinese government enacted regulations to prohibit all minors under the age of 18 from playing online games in which players are allowed to kill other players, an activity that has been termed player kills. The Chinese government has also taken steps to limit online game playing time for all minors under the age of 18. See below “— Risks related to doing business in China — The Chinese government has taken steps to limit online game playing time for all minors and to otherwise control the content and operation of online games. These and any other new restrictions on online games may materially and adversely impact our business and results of operations.” If the Chinese government determines that online games have a negative impact on society, it may impose certain additional restrictions on the online game industry, which could in turn have a material and adverse effect on our business and results of operations.



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## RISK FACTORS

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In addition, the Chinese government and regulatory authorities prohibit any internet content that, among other things, violates PRC laws and regulations, endangers the national security of China, or is obscene, superstitious, violent or defamatory. When internet content providers and internet publishers, including online game operators, find that information falling within the above-mentioned scope is transmitted on their websites or is stored in their electronic bulletin service systems, they are required to terminate the transmission of such information or delete such information immediately, keep records, and report to relevant authorities. Failure to comply with these requirements could result in the revocation of our ICP license and other required licenses to operate our business. Internet content providers like us may also be held liable for prohibited information displayed on, retrieved from or linked to their websites. In addition, any claim of us failing to comply with these prohibitions may result in negative publicity and government actions, which in turn could have a material and adverse impact on our business.

***Because our long-term growth strategy involves further expansion of our online game services to players outside of China, our business will be susceptible to risks associated with international operations.***

An important component of our growth strategy involves the further expansion of our online game services and game player base internationally. In particular, we have launched our popular games *Knives Out* and *Identity V* in Japan, North America and other markets across the globe, and *MARVEL Super War* in several Southeast Asia markets. In the future, we may launch our online games in other international markets. The expansion of our online game services to markets outside of China will involve a variety of risks, including:

- difficulties in anticipating the preferences of game players in markets outside of China;
- challenges in formulating effective local sales and marketing strategies targeting users from various jurisdictions and cultures;
- challenges in identifying appropriate local business partners, including local game operators, and establishing and maintaining good working relationships with them;
- changes in a specific country's or region's political or economic conditions;
- unexpected changes in regulatory requirements, taxes or trade laws;
- difficulties in managing a business in new markets with diverse cultures, languages, customs, legal systems, alternative dispute systems and regulatory systems;
- more stringent regulations relating to data security and the unauthorized use of, or access to, commercial and personal information;
- currency exchange rate fluctuations and the resulting effect on our revenue and expenses, and the cost and risk of entering into hedging transactions if we choose to do so in the future;
- laws and business practices favoring local competitors or general preferences for local vendors;
- limited or insufficient intellectual property protection; and

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## RISK FACTORS

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- adverse tax burdens and foreign exchange controls that could make it difficult to repatriate earnings and cash.

Our limited experience in operating our business outside of China increases the risk that any potential future expansion efforts that we may undertake will not be successful. If we invest substantial time and resources to expand our international operations and are unable to do so successfully and in a timely manner, our business and operating results will suffer.

***We rely on third-party platforms to distribute our mobile games and collect payments. If we fail to maintain our relationships with these platforms, or if our revenue-sharing arrangements with these platforms change to our detriment, our mobile games business may be adversely affected.***

In addition to our proprietary distribution channels, we publish our mobile games through the Apple iOS app store and other mobile application stores or platforms owned and operated by third parties. We rely on these third parties to promote and distribute our mobile games, record gross billings, maintain the security of their platforms to prevent fraudulent activities, provide certain user services and, in some instances, process payments from users. Further, we believe that our games benefit from the strong brand recognition, large user base and the stickiness of these mobile platforms.

We are subject to these third parties' standard terms and conditions for application developers, which govern the promotion, distribution and operation of games and other applications on their platforms. If we violate, or if a platform provider believes that we have violated, its terms and conditions, the particular platform provider may discontinue or limit our access to that platform, which could harm our business. Our business could also be harmed if these platforms decline in popularity with users or modify their discovery mechanisms for games, the communication channels available to developers, their terms of service or other policies such as distribution fees, how they label free-to-play games or payment methods for in-app purchases. These platforms' operators could also develop their own competitive offerings that could compete with our mobile games.

Furthermore, a few of these third-party platforms dominate the mobile application distribution channels. Any changes in the revenue-sharing arrangements that we have with any of the major third-party application distribution platforms may materially impact our revenue and profitability. In addition, changes in the credit period or the settlement cycle terms of these third-party platforms may materially and adversely affect our cash flow. Disputes with third-party platforms, such as disputes relating to intellectual property rights, distribution fee arrangements and billing issues, may also arise from time to time and we cannot assure you that we will be able to resolve such disputes in a timely manner or at all. If our collaboration with a major third-party platform terminates for any reason, we may not be able to find a replacement in a timely manner or at all and the distribution of our games may be adversely affected. Any failure on our part to maintain good relationships with a sufficient number of popular platforms for the distribution of our games could cause the number of our game downloads and activations to decrease, which will have a material adverse effect on our business, financial condition and results of operations.

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## RISK FACTORS

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***Our business, financial condition and results of operations depend in part on the overall growth of the online game industry in China and the other markets where our games are operated, the growth of which is subject to a number of factors that are beyond our control.***

Our business, financial condition and results of operations depend in part on continued growth of the online game industry in China and other markets where our games are published, particularly the Asia-Pacific region and North America. The online game industry is affected by a number of factors that are beyond our control, including:

- general economic conditions and the level of discretionary spending devoted by players to non-essentials such as acquiring in-game virtual items;
- the availability and popularity of other forms of interactive entertainment, particularly games on console systems which are more popular in North America, Europe and Japan, and other leisure activities;
- the availability of reliable telecommunication and internet infrastructure and sufficient server bandwidth in the markets where we operate;
- evolving PC, smartphone and tablet technologies;
- changes in game player demographics and public tastes and preferences;
- any government restrictions on the playing of online games; and
- the availability and popularity of alternative gameplay models such as cloud-gaming services.

There is no assurance that the online game industry will continue to grow in future periods at any particular rate or at all.

***We may not be successful in making our mobile games profitable, and our profits from mobile games may be relatively lower than the profits we have enjoyed historically for PC games.***

We generate a large portion of revenue in our online games segment from our mobile games. 70.8%, 71.0%, 71.4% and 70.3% of our total net game revenues were generated from mobile games for the years ended December 31, 2017, 2018 and 2019 and the three months ended March 31, 2020, respectively. In addition, 57.8%, 55.8%, 56.0% and 55.7% of our total net revenues were generated from mobile games for the years ended December 31, 2017, 2018 and 2019 and the three months ended March 31, 2020, respectively, and 23.9%, 22.8%, 22.4% and 23.5% of our total net revenues were generated from our PC games for the same periods, respectively. Our profits from our mobile games, even if the games are successful, are generally lower than our profits generated from PC games, because, in order to gain access to our games on mobile application stores, which are the primary distribution channel for our mobile games, we must enter into revenue-sharing arrangements that result in lower profit margins compared with those of our PC games. In addition, our mobile games tend to cover a wider variety of genres, some of which have historically had relatively lower profitability than that of our PC games. Furthermore, we are releasing more of our mobile games overseas, which may involve additional marketing and distribution costs and further impact the profitability of our mobile games.

We have devoted and expect to continue to devote a significant amount of resources to the development of our mobile games, but the relatively lower profit margins and other uncertainties make it difficult to predict whether we will continue to succeed in making our mobile game operations profitable. If we do not succeed in doing so, our business, financial condition and results of operations will be adversely affected.

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## RISK FACTORS

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***A significant portion of our revenue from online game services is generated from the sale of virtual items within the games, and if we do not develop desirable virtual items and properly price them or if this revenue model ceases to be successful, our business, financial condition and results of operations may be materially and adversely affected.***

All of our mobile games and many of our PC games currently utilize the item-based revenue model. Under this revenue model, our game players are able to play the games for free, but are charged for the purchase of virtual items in the games. We believe that this attracts a wider audience of players and increases the number of potential paying users. However, the success of this business model largely depends on whether we can attract game players to play our games and whether we can successfully encourage more players to purchase virtual items. Game players will only pay for virtual items if they are perceived to provide value and enhance their playing experience, and we must closely monitor and analyze in-game consumption patterns and player preferences to understand what items will be appealing and the appropriate price for them. Moreover, we must offer sufficient in-game purchasing opportunities to make our games profitable, while ensuring that the games are fun to play including for players who purchase no virtual items. We might fail to accurately identify and introduce new and popular virtual items or price them properly or may not be able to market our virtual items effectively. In addition, the item-based revenue model may not continue to be commercially successful and in the future we may need to change our revenue model to a time-based or other revenue model. Any change in revenue model could result in disruption of our game operations and a decrease in the number of our game players and thereby materially and adversely affect our business, financial condition and results of operations.

***Providing a high level of customer service for our players is crucial to maintaining and growing the popularity of our online games, and any failure to do so could harm our reputation and our business.***

We devote significant resources to provide high quality customer services to our game players 24 hours a day, seven days a week, through telephone and online support. We also maintain a team of highly trained “Game Masters” which supervise the activities within our games to provide assistance to players as needed and stop any cheating or unfair behavior to ensure the game has an atmosphere of fun and fair play. These activities are crucial to retaining our existing game players and attracting new players who expect a high quality playing experience from our online games. In addition, our license agreements with third-party developers may also require us to provide specified minimum levels of customer support, and any breach of such obligations could result in the developer terminating our license agreement with them and other damages.

We have recently experienced increased complaints with regards to server capacity due to the larger than average number of game players during the COVID-19 outbreak in China. If we fail to maintain effective player support which meets the expectations of players, it could harm our reputation and the popularity of our online games, which may materially and adversely affect our business, financial condition and results of operations.

***We may not be able to maintain stable relationships with our existing game licensors, and we may experience difficulties in the operation of the online games licensed from them.***

In addition to our internally-developed games, we also offer several mobile and PC games licensed from third-party developers, which accounted for 8.8%, 7.5%, 7.5% and 9.6% of our total net revenues in 2017, 2018, 2019 and the three months ended March 31, 2020, respectively. For example, starting in August 2008, Blizzard Entertainment, Inc. (together with its affiliated companies, “**Blizzard**”) agreed to license certain online games developed by it to Shanghai EaseNet Network Technology Co., Ltd. (the “**Shanghai EaseNet**”) for operation in

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## RISK FACTORS

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the PRC. Shanghai EaseNet is a PRC company owned by William Lei Ding, our founder, director and chief executive officer, and has contractual arrangements with us and with the joint venture established between Blizzard and us. In January 2019, Shanghai EaseNet and Blizzard extended the term of the existing game licenses by Blizzard to Shanghai EaseNet to January 2023. These games include *World of Warcraft*<sup>®</sup>, *StarCraft*<sup>® II</sup>, *Diablo*<sup>® III</sup>, *Hearthstone*<sup>®</sup>, *Heroes of the Storm*<sup>®</sup> and *Overwatch*<sup>®</sup>, all of which have been commercially launched. We are also currently co-developing *Diablo Immortal*<sup>™</sup>, a mobile MMO action-RPG, with Blizzard. In addition to our relationship with Blizzard, in May 2016, we entered into a five-year exclusive agreement with Mojang AB, a subsidiary of Microsoft, pursuant to which Microsoft and Mojang agreed to license the operation of Minecraft in the PRC to us until 2022. In May 2019, we extended the term of the Minecraft license for an additional year to August 2023. If we are unable to maintain stable relationships with our existing game licensors, or if any of our licensors establishes similar or more favorable relationships with our competitors in violation of its contractual arrangements with us or otherwise, we may not be able to ensure the smooth operation of these licensed online games, and our licensors could terminate or fail to renew the license agreements with us, which could harm our operating results and business.

Moreover, the success of our arrangements with our game licensors depends on the popularity of the games licensed to us by them in the Chinese market, which is affected by, among other things, the frequency and success of updates and expansion packs to those games developed by them over which we have no control. Any failure of such licensors to provide game updates, enhancements and new versions in a timely manner and that are appealing to game players, provide assistance that enables us to effectively promote the games, or otherwise fulfill their obligations under our license agreements could adversely affect the game-playing experience of our game players, damage our reputation, or shorten the life-spans of those games, any of which could result in the loss of game players, acceleration of our amortization of the license fees we have paid for those games, or a decrease in or elimination of our revenues from those games.

In addition, certain events may limit our licensors' ability to develop or license online games, such as claims by third parties that their online games infringe such third parties' intellectual property rights or their inability to acquire or maintain licenses to use another party's intellectual property in their online games. In the case of such events, our licensors may be unable to continue licensing online games to us or to continue participating in any joint venture with us, regardless of the stability of our relationship with them.

We also cannot be certain that these licensed online games will be viewed by the regulatory authorities as complying with content restrictions, will be attractive to users or will be able to compete with games operated by our competitors. We may not be able to fully recover the costs associated with licensing these online games if the games are not popular among users in the PRC, and any difficulties in the operation of these licensed games could harm our business, financial condition and results of operations.

***We receive relatively lower profits from the operation of online games that we license from third-party developers, and we are subject to certain financial obligations in connection with such licenses.***

Our revenue sharing arrangements for games that we license from third-party developers provide us with relatively less profit than games that we develop in-house. Moreover, to secure the rights to games from such developers, we are required, as licensee of the games, to pay them royalties for the games over the terms of the licenses, to make minimum marketing expenditure commitments, or to provide funds for hardware to operate the games. See “Our Business — Our Services — Online game services — Our games — Our game library — Licensed games” for details about these arrangements. In some cases, we may not be able to

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recoup our investments in such games. We often must make such commitments and investments without knowing whether the games we are licensing will be successful and generate sufficient revenues to enable us to recoup our costs or for the games to be profitable.

***Future alliances may expose us to potential risks, including those associated with the assimilation of new operation technologies and personnel, unforeseen or hidden liabilities, and potential business disputes with our partners, among others.***

Strategic alliances with key players in the online game industry and other related industry sectors form part of our strategy to expand our portfolio of online games. In some cases, such alliances may involve our investment into strategic partners, as we have done with a number of game development studios in various countries. However, our ability to grow through future alliances, including through joint ventures and direct investments, will depend on the availability of suitable partners at reasonable terms, our ability to compete effectively to attract these partners, the availability of financing to complete larger joint ventures and investments, and our ability to obtain any required governmental approvals. Further, the benefits of an alliance may take considerable time to develop, and we cannot be certain that any particular alliance will produce its intended benefits.

Future alliances could also expose us to potential risks, including risks associated with the assimilation of new operation technologies and personnel, unforeseen or hidden liabilities, the inability to generate sufficient revenue to offset the costs and expenses of alliances and potential loss of, or harm to, our relationships with employees, customers, licensors and other suppliers as a result of integration of new businesses. Further, we may not be able to maintain a satisfactory relationship with our partners, which could adversely affect our business and results of operations. We have relatively limited experience in identifying, financing or completing strategic alliances compared with some of our competitors. Such transactions and the subsequent integration process would require significant attention from our management. The diversion of our management's attention and any difficulties encountered with respect to the alliances or in the process of integration could have an adverse effect on our ability to manage our business.

***Termination of our material intellectual property licenses could have a material adverse effect on our business.***

Certain of our online games rely on intellectual property license agreements which give us the right to use certain names, characters, logos or storylines in connection with online games developed by us. For example, we have a partnership with Marvel Entertainment to create mobile games based on Marvel characters and storylines. If we were to breach any material term of these license agreements, the licensor could terminate the agreement. If the licensor were to terminate our rights to use any such intellectual property for this reason or any other reason, or if a licensor decides not to renew a license agreement upon the expiration of the license term, the loss of such rights could have a material adverse effect on our business. In addition, it can be difficult to identify a suitable intellectual property that can be adapted for use in online games and is recognizable to players in China and elsewhere, and we face significant competition for the rights to such intellectual property from other online game companies. Obtaining license rights, and particularly exclusive license rights, to use third-party intellectual property for use in online games can involve significant expense. In addition, we have previously obtained, and intend to continue to seek to obtain, license rights for works from certain intellectual property owners based outside of China, and our ability to utilize their intellectual property in China may be adversely affected by the scrutiny of such arrangements by the relevant Chinese authorities.

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Even if we obtain license rights for such intellectual property, we cannot assure you that games that we develop utilizing it will be popular and commercially successful and that we will be able to recoup the amounts we pay for the license rights. Moreover, after the expiration of the terms of our license agreements with the relevant copyright holders, we may not be able to renew the agreements with commercial terms that are favorable to us, if at all. Our inability to renew such agreements could force us to discontinue the related online games and have a significant adverse impact on our online game operations and revenues.

***Our new games may attract game players away from our existing games, which may have a material adverse effect on our business, financial condition and results of operations.***

Our new online games, including mobile games and PC games, may attract game players away from our existing games and shrink the player base of our existing online games, which could in turn make those existing games less attractive to other game players, resulting in decreased revenues from our existing games. Players of our existing games may also spend less money to purchase time or virtual items in our new games than they would have spent if they had continued playing our existing games. In addition, our game players may migrate from our existing games with a higher profit margin to new games with a lower profit margin. The occurrence of any of the foregoing could have a material and adverse effect on our business, financial condition and results of operations.

***Illegal game servers and acts of cheating by players of online games could harm our business and reputation and materially and adversely affect our results of operations.***

Several of our competitors have reported in past years that certain third parties have misappropriated the source codes of their games and set up illegal game servers and let their customers play such games on illegal servers without paying for the game playing time. While we already have in place numerous internal control measures to protect the source codes of our games from being stolen and to address illegal server usage and, to date, our games have not to our knowledge experienced such usage, our preventive measures may not be effective. The misappropriation of our game server installation software and installation of illegal game servers could harm our business and reputation and materially and adversely affect our results of operations.

In addition, acts of cheating by players of online games could lessen the popularity of our online games and adversely affect our reputation and our results of operations. There have been a number of incidents in previous years where users, through a variety of methods, were able to modify the rules of our online games. Although these users did not gain unauthorized access to our systems, they were able to modify the rules of our online games during gameplay in a manner that allowed them to cheat and disadvantage our other online game users, which often has the effect of causing players to stop using the game and shortening the game's lifecycle. While we have taken a number of steps to deter our users from engaging in cheating when playing our online games, we cannot assure you that we or the third parties from whom we license some of our online games will be successful or timely in taking corrective steps necessary to prevent users from modifying the rules of our online games.

If we suspect a player of installing cheating programs on our online games, or of engaging in other types of unauthorized activities, we may freeze that player's game account or even ban the player from logging on to our games and other media. Such activities to regulate the behavior of our users are essential to maintain a fair playing environment for our users. However, if any of our regulatory activities are found to be wrongly implemented, our users may institute legal proceedings against us for damages or claims. Our business, financial condition and results of operations may be materially and adversely affected as a result.

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*Our online games will be less likely to be successful if we cannot adopt and implement innovative and effective marketing strategies to attract attention to our games from game players in our targeted demographic groups.*

A relatively large number of mobile and PC games are typically available at any given time in the markets in which we launch and operate our online games, and such games compete for attention from the same game player population that we target. Our ability to successfully promote and monetize our online games will depend on our ability to adopt and effectively implement innovative marketing strategies, and particularly marketing through online media such as our 163.com website, social media sites, game live streaming sites and other online game forums, and our ability to cross-market new games to players of our current online games. We also engage in a wide range of other promotional activities such as hosting game tournaments and a forum that provides an online community for elite game players, key opinion leaders and masters of the online game industry to interact. If we fail to adopt and implement such marketing and cross-marketing strategies, or if the marketing strategies of our competitors are more innovative and effective than ours, our online games will be less likely to be successful and as a result we may not be able to achieve an acceptable level of revenue from those games.

*Some of our players make sales and purchases of our game accounts and virtual items through third-party auction websites, which may have a negative effect on our net revenues.*

Some of our players make sales and purchases of our game accounts and virtual items through unauthorized third-party auction websites in exchange for real money, which we do not and are unable to track or monitor. We do not generate any net revenues from these transactions. Accordingly, purchases and sales of our game accounts or virtual items on third-party websites could lead to decreased sales by us and also put downward pressure on the prices that we charge players for our virtual items and services, all of which could result in lower revenues generated for us by our games. New players may decide not to play our games as a result of any rule changes we might implement to restrict the players' ability to trade in game accounts or virtual items, which could materially adversely affect our business, financial condition and results of operations.

In addition, such trading activities could run afoul of PRC regulations on virtual currency and subject traders and us to potential liability. See “— Risks related to doing business in China — Restrictions on virtual currency may adversely affect our online game revenues.”

### **Risks related to our other businesses**

*The success and future growth of our Youdao business will be affected by the user acceptance and market trend of integration of technology and learning.*

We offer online courses and a number of other learning services and products via our majority-controlled subsidiary, Youdao. Youdao operates in the intelligent learning industry, and its business model features integrating technology closely with learning to provide a more efficient and engaging learning experience. Intelligent learning remains a relatively new concept in China, and there are limited proven methods to project user demand or preference or available industry standards. For example, even with the proliferation of internet and mobile devices in China, we believe that some of Youdao's target students may still be inclined to choose traditional face-to-face courses over online courses as they find the former more intimate and reliable. We cannot assure you that Youdao's services and products will continue to be attractive to its users in the future. If Youdao's offering of learning services and products become less appealing to its users, the financial condition and results of operations of our Youdao business could be materially and adversely affected.



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***If we fail to develop and apply our technologies to support and expand Youdao’s product and service offerings or if we fail to timely respond to the rapid changes in industry trends and user preferences, our Youdao business may be materially and adversely affected.***

Over the years, we have developed a number of core technologies to support Youdao’s comprehensive suite of services and products. We also rely on technologies to build and maintain Youdao’s information technology infrastructure. The intelligent learning industry is subject to rapid technological changes and innovations and is affected by unpredictable product lifecycles and user preferences. Our technologies may become obsolete or insufficient, and we may have difficulties in following and adapting to technological changes in the intelligent learning industry in a timely and cost-effective manner. New technologies and solutions developed and introduced by Youdao’s competitors could render its offerings less attractive or obsolete thus materially affecting Youdao’s business and prospects. In addition, our substantial investments in Youdao’s technology may not produce expected results. If we fail to continue to develop, innovate and utilize our technologies to support and expand Youdao’s product and service offerings or if our competitors develop or apply more advanced technologies, the financial condition and results of operations of our Youdao business could be materially and adversely affected.

***Our intelligent learning, music streaming, e-commerce and other innovative businesses are subject to a broad range of laws and regulations. Any lack of requisite approvals, licenses or permits applicable to these businesses or any failure to comply with applicable laws or regulations may have a material and adverse impact on our business, financial condition and results of operations.***

Our intelligent learning, music streaming, e-commerce and other innovative businesses are subject to a broad range of laws and regulations, and future laws and regulations may impose additional requirements and other obligations.

For example, the private education industry in the PRC is subject to various regulations, and certain aspects of Youdao’s business operations may be deemed not to be in full compliance with them. Among other things, a “private school” is required to obtain approval or a permit from the relevant government authorities in China. However, it remains unclear in practice as to whether and how an online education service providers, in particular those that provide, among other things, after-school training services to primary and secondary school students, need to comply with the operating permit requirement under applicable PRC law. In addition, various PRC regulations require that Youdao make certain filings with the relevant provincial regulatory authorities for education and to comply with certain regulatory requirements for its intelligent learning business. As of the date of this document, we have not received any written notice of warning from, or been subject to penalties imposed by the relevant authorities for alleged failure by Youdao to comply with any applicable regulations and have completed or submitted applications for the filings required by such applicable regulations for most of the mobile apps Youdao operates. We are also preparing the required filings for Youdao’s newly launched and other learning apps. We cannot assure you, however, that we will complete all such filings and comply with other regulatory requirements in a timely manner, or at all.

Our e-commerce business is also subject to numerous PRC laws and regulations that regulate retailers generally or govern online retailers specifically. See below “— Risks related to doing business in China — We are subject to consumer protection laws that could require us to modify our current business practices and incur increased costs.” We may also be required to obtain licenses and permits from different regulatory authorities in order to sell certain categories of products on our e-commerce platform. In addition, the online activities of all of these businesses are subject to PRC regulations governing foreign ownership of companies in the internet industry and the licensing requirements pertaining to them, as well as internet

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access and the distribution of online content including music, music videos, online educational content and other forms of content over the internet. See below “— Risks Related to Our Corporate Structure” and “— Risks related to doing business in China.”

If the PRC governmental authorities determine that we are not in compliance with all the requirements under applicable laws and regulations, we may be subject to fines and/or other sanctions, and our operations could be disrupted. As these industries are evolving rapidly in China, it is also uncertain whether and how the PRC government would promulgate additional laws and regulations regarding our intelligent learning, music streaming, e-commerce and other innovative businesses. If the PRC government requires additional licenses or permits or provides more strict supervision requirements in the future in order for us to conduct these businesses, there is no guarantee that we would be able to obtain such licenses or permits or meet all the supervision requirements in a timely manner, or at all. Failure to maintain or regain compliance may materially and adversely affect our business, financial condition and results of operations.

***Our controlling interest in Youdao may be diluted if Youdao raises additional capital with the issuance and sale of additional equity in the future.***

Youdao, our majority-controlled subsidiary listed on the New York Stock Exchange, may need additional capital in the future to fund its continued operations and support its business growth. As Youdao will continue to invest heavily in sales, marketing and branding efforts and in improving technologies, hiring qualified faculty and R&D personnel and offering additional products, services and content, Youdao may not generate sufficient revenue to offset such expenses. In the future, should Youdao require additional liquidity and capital resources to fund its business and operations, Youdao may need to obtain additional financing, including issuing and selling additional equity or equity-linked securities, or issuing additional equity awards to incentivize its employees, which would dilute our interest in Youdao.

***We may be unable to obtain licenses for the music content necessary to provide our music streaming services or to obtain such licenses at an economically viable cost.***

Our ability to offer online music streaming services through our music streaming platform, NetEase Cloud Music, depends upon maintaining commercially viable licenses or arrangements with copyright owners for music content which is popular in China. The majority of our agreements with copyright owners are usually non-exclusive, while some of our competitors have been entering into exclusive arrangements for music distribution rights in China. Therefore, our competitors offer certain music content that we do not have and we may lose users if those music content caters to their preferences. The competition in China for exclusive or non-exclusive licenses to distribute music content is fierce. As a result, certain owners of music content or exclusive rights to distribute music content have increased the fees they charge us for their content or distribution rights. This trend could increase our costs and operating expenses and could adversely affect our ability to obtain music content at an economically viable cost.

Furthermore, there is no guarantee that the licenses or arrangements we have now will be renewed in the future. If we are unable to secure and maintain the licenses or similar arrangements that we desire, the size and quality of our music catalog offered by our music streaming platform and the financial condition and results of operations of this business may be materially and adversely affected, which in turn could negatively impact the attractiveness of our brand name and online services in general to our users.

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***If we fail to anticipate user preferences to provide online music streaming content catering to user demands, or maintain the activeness of our user community, our ability to attract and retain users may be materially and adversely affected.***

The success of our music streaming business relies on our ability to anticipate changes in user preferences and industry dynamics, and respond to such changes in a timely, appropriate and cost-effective manner. Music that was once popular with our users may become less attractive if user preferences evolve. If we fail to cater to the tastes and preferences of our users, or fail to deliver superior user experiences, we may suffer from reduced user traffic and engagement, and the financial condition and results of operations of this business may be materially and adversely affected.

***We expect that a portion of our future revenues will continue to come from our advertising services, but we may not be able to compete effectively in this market because it is evolving and intensely competitive, in which case our ability to generate and maintain advertising revenue in the future could be adversely affected.***

Although we anticipate that the revenues generated by our online games will continue to constitute the major portion of our future revenues, we believe that we will continue to rely on advertising as an important source of revenue for the foreseeable future. The popularity of online advertising in China has been growing quickly in recent years, and many of our current and potential advertisers have gained experience with using the internet as an advertising medium. Our ability to generate and maintain significant advertising revenue will depend on a number of factors, many of which are beyond our control, including:

- macroeconomic conditions and the general level of advertiser spending;
- the development of a large base of users possessing demographic characteristics attractive to advertisers;
- competition with other major and emerging online advertising platforms;
- the development of software that blocks internet advertisements before they appear on a user's screen;
- downward pressure on online advertising prices; and
- the effectiveness of our advertising delivery and tracking system.

Changes in government policy could also restrict or curtail our online advertising services.

***Our e-commerce business is subject to challenges and risks, which may have a negative impact on our financial performance.***

We established our e-commerce platform, Yanxuan, in April 2016. Yanxuan primarily sells our private label products, including electronic products, food, apparel, homeware, kitchenware and other general merchandise which we primarily source directly from original design manufacturers in China. This business exposes us to challenges and risks that could negatively impact our financial performance. We have incurred significant expenses on a variety of different marketing and brand promotion efforts designed to enhance the recognition of our Yanxuan platform and increase sales of our products on such platform. However, our brand promotion and marketing activities may not be well received by our customers and may not result in the levels of product sales that we anticipate.

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We face intense competition from other e-commerce players, private label manufacturers and retailers. The e-commerce industry in China is subject to rapid market change, the introduction of new business models, and the entry of new and well-funded competitors. If we are unable to compete effectively, our e-commerce business's financial condition and results of operations would be materially and adversely affected. To effectively compete with our competitors in the e-commerce industry, we are also required to adjust and refine our marketing approaches or to introduce new marketing approaches because the marketing approaches and tools in the consumer products market in China are constantly evolving. If we are unable to design marketing activities that will appeal to the Chinese consumers or market in a cost-effective manner, revenues from our e-commerce business will be adversely affected. In addition, our e-commerce business requires us to manage a large volume of inventory effectively and requires a large amount of working capital. If we fail to manage our inventory effectively, we may be subject to a heightened risk of inventory obsolescence, a decline in inventory values, and significant inventory write-downs or write-offs, which may materially and adversely affect our e-commerce business and financial position.

Moreover, the future growth of our e-commerce business depends on our ability to continue to attract new customers as well as new purchases from existing customers. Constantly changing consumer preferences have affected and will continue to affect the online retail industry. We must stay abreast of emerging consumer preferences and anticipate product trends that will appeal to existing and potential customers. If we are unable to offer products that attract new customers and new purchases from existing customers, our e-commerce business may be materially and adversely affected.

Furthermore, our profit margin from the e-commerce business, even if the business is successful, is likely to be relatively lower than our profit margin from certain of our other businesses, such as our online game business and advertising business. If we cannot successfully address challenges specific to the e-commerce business and compete effectively, we may not be able to recover the costs of our investments, and our future results of operations and growth prospects may be materially and adversely affected.

### **Risks related to our operations overall**

*We may be unable to compete successfully against new entrants and established industry competitors.*

The Chinese market for internet content and services is intensely competitive and rapidly changing. Our competition primarily comes from global online game developers and operators, such as Tencent, established online and offline education service providers in China, as well as leading digital media and entertainment providers. Some of our current and potential competitors are much larger than we are, and currently offer, and could further develop or acquire, content and services that compete with us. We mainly compete to:

- attract, engage and retain users based on the design, quality, popularity and efficacy of our content offerings, the overall user experience of our products and services, as well as the effectiveness of our marketing activities;
- attract and retain motivated and capable talent, including engineers, game designers, product developers and creative professionals to build compelling content, tools and functions; and

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- win collaboration relationships with game studios and content owners based on our level of expertise in systematically developing original games, delivering a compelling user experience through operational know-how and customizing established game titles for rapid expansion into overseas markets.

Our ability to compete depends on a number of other factors as well, some of which may be beyond our control, including alliances, acquisitions or consolidations within our industries that may result in stronger competitors, and changes in the regulatory environment in the markets we operate. Existing and new competitors may leverage their established platforms or market positions, or introduce innovative business models, to launch highly-engaging content, products or services that may attract a large user base and achieve rapid growth, which may materially and adversely affect our business expansion and results of operations. We increasingly face competition from domestic and international players operating in our markets. Because many of our existing competitors as well as a number of potential competitors have longer operating histories in the internet market, greater name and brand recognition, better connections with the Chinese government, larger customer bases and databases and significantly greater financial, technical and marketing resources than we have, we cannot assure you that we will be able to compete successfully against our current or future competitors or that competition will not have a material and adverse effect on our business, financial condition and results of operations.

***If we fail to keep up with rapid changes in technologies and user behavior, our future success may be adversely affected.***

Our future success will depend on our ability to respond to rapidly changing technologies, adapt our products and services to evolving industry standards and improve the performance and reliability of our products and services. Our failure to adapt to such changes could harm our business. In addition, changes in user behavior resulting from technological developments may also adversely affect us. For example, the number of people accessing the internet through mobile devices, including mobile phones, tablets and other hand-held devices, has increased in recent years, and we expect this trend to continue while 4G, 5G and more advanced mobile communications technologies are broadly implemented. If we fail to develop products and technologies that are compatible with all mobile devices, or if the products and services we develop are not widely accepted and used by users of various mobile devices, we may not be able to penetrate the mobile markets. In addition, the widespread adoption of new internet, networking or telecommunications technologies or other technological changes could require substantial expenditures to modify or integrate our products, services or infrastructure. If we fail to keep up with rapid technological changes to remain competitive, our future success may be adversely affected.

***We cannot guarantee that our efforts to innovate and explore new areas of operations would be successful or bring positive financial impact to us.***

In addition to our existing businesses, we continue to invest significant resources in innovation and exploring new products, services and technologies to cater to the rapidly changing customer demands and trends in the internet industry. However, the success of new products and services depends on a number of factors including the quality of our products or services, the acceptance by the targeted customers and our assessment of market demands and trends.

Furthermore, our competitors are constantly developing innovations, on both mobile devices and personal computers, to enhance users' online experience in areas that we currently operate or areas that we wish to expand our operations into. As a result, our efforts to continually

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innovate and explore new growth strategies and introduce new products and services to attract more customers to our services, may not be successful, and we cannot guarantee that our innovation efforts could bring positive financial impact to us.

***Our gross profit margin and profitability may be affected by changes in our mix of revenues.***

Our gross profit may fluctuate from period to period due to a shifting mix of services and products we sell due to changes in the relative demand for them in the marketplace. Shifts in the mix of our revenue contributed by our different business lines (or by shifts in the sales of individual services or products within such businesses) can impact our gross profit because they generally produce a different level of gross margin. For example, in general our Youdao and innovative businesses and others segments have had lower gross profit margins compared to our online game services segment. These individual gross margins in turn can be impacted in any given period by factors such as competition, the implementation of new regulatory requirements and other factors. If the mix of services and products sold shifts from higher margin business lines to lower margin lines as a result of differing growth rates among such lines (or to lower margin services and products within business lines), our overall gross profit margin and profitability may be adversely affected.

***We are exposed to credit risk on our accounts receivable, which may be heightened during periods of uncertain economic conditions.***

Our outstanding accounts receivable are not covered by collateral or credit insurance. While we have procedures to monitor and limit exposure to credit risk on our accounts receivable, which risk is heightened during periods of uncertain economic conditions, there can be no assurance such procedures will effectively limit our credit risk and enable us to avoid losses, which could have a material adverse effect on our financial condition and operating results.

***A prolonged slowdown in the PRC or global economy may materially and adversely affect our results of operations, financial condition, prospects and future expansion plans.***

We derive a substantial portion of our revenue from China. As a result, our revenue and net income are impacted to a significant extent by economic conditions in China and globally, as well as economic conditions specific to online and mobile internet usage and advertising. The global economy, markets and levels of consumer spending are influenced by many factors beyond our control, including consumer perception of current and future economic conditions, political uncertainty, levels of employment, inflation or deflation, real disposable income, interest rates, taxation and currency exchange rates.

The rate of economic growth in the PRC has been experiencing a slowdown, and China's GDP decreased by 6.8% in the first quarter of 2020 compared to the same period in 2019, primarily as a result of the COVID-19 pandemic. In addition, any future escalation of the ongoing trade war between the United States and China or ongoing impact of the coronavirus may negatively impact the growth in both the Chinese economy and the global economy as a whole. Although the PRC government has implemented a number of measures to address the slowdown, we cannot be certain that these measures will be successful. Any continuing or worsening slowdown could significantly reduce domestic commerce in China, including through the internet generally and within our ecosystem. An economic downturn, whether actual or perceived, a further decrease in economic growth rates or an otherwise uncertain economic outlook in China or any other market in which we may operate could have a material adverse effect on our business, financial condition and results of operations.

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*We are subject to a variety of laws and other obligations regarding data protection, and our failure to comply with any of them could result in proceedings against us by governmental entities or others and harm our public image and reputation, which could have a material adverse effect on our business, results of operations and financial condition.*

We are subject to laws in China relating to the collection, use, sharing, retention, security and transfer of confidential and private information, such as personal information and other data. These laws apply not only to third-party transactions, but also to transfers of information between our company and our subsidiaries and VIEs and among our company, our subsidiaries, VIEs and other parties with which we have commercial relations. These laws are continuing to develop, and the PRC government may adopt other rules and restrictions in the future. According to the *Cyber Security Law of the PRC* (the “**Cyber Security Law**”) which was promulgated by the National People’s Congress Standing Committee on November 7, 2016, and took effect on June 1, 2017, we, as a network operator, are obligated to provide technical assistance and support to public security and national security authorities in order to protect national security or assist with criminal investigations. In addition, the Cyber Security Law provides that personal information and important data collected and generated by an operator of critical information infrastructure in the course of its operations in the PRC must be stored in the PRC. We have undertaken significant measures in an effort to ensure compliance with the Cyber Security Law.

In addition, the General Administration of Quality Supervision, Inspection and Quarantine and Standardization Administration issued the *Standard of Information Security Technology — Personal Information Security Specification (2017 edition)*, which took effect in May 2018, and the *Standard of Information Security Technology — Personal Information Security Specification (2020 edition)*, which will take effect in October 2020. Pursuant to these standards, any entity or person who has the authority or right to determine the purposes for and methods of using or processing personal information are seen as a personal data controller. Such personal data controller is required to collect information in accordance with applicable laws, and prior to collecting such data, the information provider’s consent is required. Furthermore, the Cyberspace Administration of China (the “CAC”) issued the *Provisions on the Cyber Protection of Children’s Personal Information* (the “**Children’s Provisions**”) which took effect on October 1, 2019. According to the Children’s Provisions, no organization or individual is allowed to produce, release or disseminate information that infringes upon the personal information security of children under 14. Network operators collecting, storing, using, transferring or disclosing children’s personal information are required to enact special protections for such information. We generally comply with industry standards and have established privacy policies to ensure such compliance. However, compliance with any additional laws could be expensive, and may place restrictions on the conduct of our business and the manner in which we interact with our customers. Any failure to comply with applicable regulations could also result in regulatory enforcement actions against us.

Recently, there has been an increased focus on ensuring that mobile apps comply with privacy regulations. The *Announcement of Launching Special Crackdown Against Illegal Collection and Use of Personal Information by Apps* was issued with effect on January 23, 2019 and commenced a coordinated effort among the CAC, the MIIT, the Ministry of Public Security and the SAMR to combat the illegal collection and use of personal information by mobile apps throughout the PRC. On October 31, 2019, the MIIT issued the *Notice on the Special Rectification of Apps Infringing Users’ Rights and Interests*, pursuant to which app providers were required to promptly rectify issues the MIIT designated as infringing app users’ rights such as collecting personal information in violation of PRC regulations and setting obstacles for user account deactivation. If any of our mobile apps are not in compliance with these regulations, we could be subject to potentially serious penalties, including revocation of our business licenses and permits.

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Furthermore, we may be subject to similar data protection laws and other obligations in jurisdictions outside of China where we operate, including the *General Data Protection Regulation* (the “GDPR”). Complying with emerging and changing requirements may cause us to incur substantial costs or require us to change our business practices. Non-compliance could result in penalties or significant legal liability, including for example, penalties calculated as a percentage of global revenue under the GDPR.

Our privacy policies and practices concerning the use and disclosure of data are posted on the NetEase websites and other online and mobile platforms. Any failure by us, our business partners or other parties with whom we do business to comply with its posted privacy policies or with other applicable privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others, which could have a material adverse effect on our business, financial condition and results of operations. In addition, any negative publicity on our website or platform’s safety or privacy protection mechanism and policy could harm our public image and reputation and have a material and adverse effect on our business, results of operations and financial condition.

***We may be subject to breaches of our information technology systems, including security breaches and improper access to or disclosure of our data or user data, which could materially adversely affect our reputation and our results of operations and financial position and expose us to liability claims.***

Any compromise of the security of our information technology systems could materially adversely affect the operations of NetEase’s websites and other online and mobile platforms, and result in improper disclosure of personal information and other data. We transmit and store over our systems confidential and private information of our users, such as personal information, including names, user IDs and passwords, and payment or transaction related information. For example, we rely on our information technology systems to record and monitor the purchase and consumption of virtual items by our game players, which constitute a significant portion of the revenue generated from our online games. In addition, in relation to our e-commerce business, almost all of the orders and some of the payments for products we offer are made through our websites and our mobile applications, and some online payments for our products are settled through third-party online payment services. We also share certain personal information about our customers with contracted third-party couriers, such as their names, addresses, phone numbers and transaction records. Moreover, we have accumulated a large volume of data, which covers customer’s browsing and consumption behavior information, product manufacturing and sales information, warehousing and distribution information and customer service information, among others.

Hackers develop and deploy viruses, worms, and other malicious software programs to attack websites or other online and mobile platforms and gain access to networks and data centers, and there have been a number of well-publicized malicious attacks against a variety of companies worldwide to gain access to non-public information. Hackers may also act in a coordinated manner to launch distributed denial of service attacks, or other coordinated attacks, that may cause service outages or other interruptions. In addition, we distribute our contents to users based on user interest levels indicated by their past viewing behavior. As a result, our content distribution platforms and the results of our user behavior analysis are subject to attempts of improper access or creating false or undesirable user accounts for purposes of spreading misinformation.

Although we believe that we have not experienced any hacking activity or security breach that allowed unauthorized access to any information stored on our information technology systems or caused any loss or corruption of personal information and other data, software or other computer equipment, we have been subject to denial of service attacks that have caused



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portions of our network to be inaccessible for limited periods of time. Although these are industry wide problems that affect many companies worldwide, we anticipate that we may be subject to additional attacks in the future because of the high profile of our company in the Chinese internet industry.

We take a number of measures to ensure that our information technology systems are secure, including ensuring that our servers are hosted at physically secure sites and limiting access to server ports. We also use encryption and authentication technologies to secure the transmission and storage of data. These security measures may be compromised as a result of third-party security breaches, employee error, malfeasance, faulty password management, or other irregularities. Third parties may also attempt to fraudulently induce employees or customers into disclosing user names, passwords or other sensitive information, which may in turn be used to access our information technology systems. We expect that we will be required to continue to expend significant resources on system security, data encryption, and other security measures to protect our systems and data, but these security measures cannot provide absolute security.

In the case of a breach of our systems, our data on the purchase and consumption of virtual items by our game players and other personal information of our users such as users of our intelligent education and e-commerce products may be compromised. As a result, our ability to accurately recognize revenues from certain of our online games and the playing experience of our game players could be materially and adversely affected. Moreover, if a computer security breach allows unauthorized access or release of personal information and other data of our users, our reputation and brand could be materially damaged and use of the NetEase websites and other online and mobile platforms could decrease. We could also be exposed to a risk of loss or litigation and possible liability, which could result in a material adverse effect on our business, results of operations and financial condition.

***The success of our business is dependent on our ability to retain our existing key employees and to add and retain senior officers to our management.***

We depend on the services of our existing key employees. Our success will largely depend on our ability to retain these key employees and to attract and retain qualified senior and middle level managers to our management team. Future changes in management could cause material disruptions to our business. We also depend on our ability to attract and retain in the future highly skilled technical, editorial, marketing and customer service personnel, especially experienced online game software developers. We cannot assure you that we will be able to attract or retain such personnel or that any personnel we hire in the future will successfully integrate into our organization or ultimately contribute positively to our business. In particular, the market for experienced online game software programmers is intensely competitive in China. While we believe we offer compensation packages that are consistent with market practice, we cannot be certain that we will be able to hire and retain sufficient experienced programmers to support our online games business. We may also be unsuccessful in training and retaining less-experienced programmers on a cost-effective basis. The loss of any of our key employees would significantly harm our business. We do not maintain key person life insurance on any of our employees.

***Unexpected network interruption caused by system failures may reduce visitor traffic and harm our reputation.***

Both the continual accessibility of the NetEase websites and other online and mobile platforms and the performance and reliability of our technical infrastructure are critical to our reputation and the ability of the NetEase websites and other online and mobile platforms to attract and retain users and advertisers. Any system failure or performance inadequacy that causes

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interruptions in the availability of our services or increases the response time of our services could reduce user satisfaction and traffic, which would reduce the NetEase websites and other online and mobile platforms' appeal to users and advertisers. As the number of NetEase websites, mobile applications and traffic increase, we cannot assure you that we will be able to scale our systems proportionately. Any system failures and electrical outages could materially and adversely impact our business.

***Our operations are vulnerable to natural disasters, widespread public health problems and other events.***

We have limited backup systems and have experienced system failures and electrical outages from time to time in the past, which have disrupted our operations. Most of our servers and routers are currently located at several different locations in China. Our disaster recovery plan may not fully ensure safety in the event of damage from fire, floods, typhoons, earthquakes, power loss, telecommunications failures, break-ins and similar events. If any of the foregoing occurs, we may experience a system shutdown. We do not carry any business interruption insurance. To improve performance and to prevent disruption of our services, we may have to make substantial investments to deploy additional servers. We carry property insurance with low coverage limits that may not be adequate to compensate us for all losses, particularly with respect to loss of business and reputation that may occur.

***Our business could be adversely affected by widespread public health or other outbreaks and epidemics.***

COVID-19, a novel strain of coronavirus, has spread worldwide. This outbreak has caused, and may continue to cause us and certain of our business partners, including game licensors, suppliers, customers, advertisers and manufacturers, to implement temporary adjustments of work schemes allowing employees to work from home. We have taken measures to reduce the impact of this outbreak, including monitoring our employees' health and optimizing our technology system to support potential growth in game player traffic. However, we and certain of our business partners might still experience lower work efficiency and productivity, which may adversely affect our service quality. This outbreak has also caused restrictions on our employees' and our business partners' ability to travel. In addition, the deterioration in economic conditions in connection with the outbreak globally has caused, and may continue to cause, decreases or delays in advertising and marketing service spending and budgets of customers across our platforms. As a result of any of the above developments, our business, financial condition and results of operations could be materially and adversely affected.

The extent to which COVID-19 impacts our results will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of COVID-19 and the actions to contain the coronavirus or treat its impact, among others. There have also been other outbreaks of epidemics in China and globally in recent years. Our operations could be disrupted if any future outbreak occurs in China, where substantially all of our revenue is derived, or in Beijing, Shanghai, Guangzhou and Hangzhou, where most of our employees are located. Our operations may be impacted due to closures of our offices or the sickness or death of our key officers and employees. Our operations could also be severely disrupted if such health problems or outbreak lead to a general slowdown in the Chinese economy or if our suppliers, customers or business partners were affected by such natural disasters, outbreaks or health epidemics.

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*From time to time we may evaluate and consummate strategic investments or acquisitions, which could require significant management attention, disrupt our business and adversely affect our financial results.*

We from time to time evaluate and enter into discussions regarding a wide array of potential long-term investments, merger or acquisition transactions. Any transactions that we enter into could be material to our financial condition and results of operations. The process of integrating with another company or integrating an acquired company, business, asset or technology may create unforeseen operating difficulties and expenditures. The areas where we face risks include:

- significant costs of identifying and consummating acquisitions;
- diversion of management time and focus from operating our business to acquisition integration challenges;
- difficulties in integrating the management, technologies and employees of the acquired businesses;
- implementation or remediation of controls, procedures and policies at the acquired company;
- coordination of products and services, engineering and sales and marketing functions;
- retention of employees from the businesses we acquire;
- liability for activities of the acquired company before the acquisition;
- potential significant impairment losses related to goodwill and other intangible assets acquired or investments in other businesses;
- litigation or other claims in connection with the acquired company;
- significant expenses in obtaining approvals for the transaction from shareholders and relevant government authorities in China;
- in the case of overseas acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political and regulatory risks associated with specific countries; and
- failure to achieve the intended objectives, benefits or revenue-enhancing opportunities.

Our failure to address these risks or other problems encountered in connection with our future acquisitions and investments could cause us to fail to realize the anticipated benefits of such acquisitions or investments, incur unanticipated liabilities and expenses and harm our business generally.

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If we use our equity securities to pay for acquisitions, we may dilute the value of our ADSs and the underlying Shares. If we borrow funds to finance acquisitions, such debt instruments may contain restrictive covenants that could, among other things, restrict us from distributing dividends. Such acquisitions and investments may also lead to significant amortization expenses related to intangible assets, impairment charges or write-offs.

***We face risks associated with our long-term and short-term investments.***

We currently invest a portion of our capital in long-term and short-term investments. As of March 31, 2020, our long-term investments mainly consisted of investment in equity method investees, equity investments with readily determinable fair values and equity investments without readily determinable fair values, and our short-term investments mainly consisted of financial products issued by commercial banks in China with a variable interest rate indexed to the performance of underlying assets and a maturity date within one year when purchased. These investments may earn yields substantially lower than anticipated, and any failure to realize the benefits we expected from these investments may materially and adversely affect our business and financial results.

We had investment income of RMB362.1 million, investment losses of RMB22.4 million, investment income of RMB1,306.3 million and investment losses of RMB109.7 million (US\$15.5 million) for the years ended December 31, 2017, 2018 and 2019 and for the three months ended March 31, 2020, respectively. We also had unrealized losses on available-for-sale securities recorded in “other comprehensive income,” net of tax of RMB23.3 million for the year ended December 31, 2017, and zero for the years ended December 31, 2018 and 2019 and the three months ended March 31, 2020, respectively.

***If our server and bandwidth service providers fail to provide these services, our business could be materially curtailed.***

We rely on affiliates of China Telecom, China Unicom, and China Mobile to provide us with server and bandwidth service for internet users to access the NetEase websites and other online and mobile platforms. If China Telecom, China Unicom, and China Mobile or their affiliates fail to provide such services or raise prices for their services, we may not be able to find a reliable and cost-effective substitute provider on a timely basis or at all. If this happens, our business could be materially curtailed.

We also rely on cloud servers maintained by third-party cloud service providers particularly for our overseas games. We do not control the operation of these providers or their facilities, and the facilities are vulnerable to damage, interruption or misconduct. Unanticipated problems at these facilities could result in lengthy interruptions in our services. Problems with our cloud service providers or the telecommunications network providers with whom they contract could adversely affect the experience of our users. Any change in service levels at our cloud servers or any errors, defects, disruptions, or other performance problems with our platform could harm our business or reputation or we could be required to retain the services of replacement providers, which could increase our operating costs.

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***We may be held liable for information or content displayed on, retrieved from or linked to the NetEase websites and other NetEase's online and mobile platforms.***

We may face liability for defamation, negligence, copyright, patent or trademark infringement and other claims based on the nature and content of the materials that are published on the NetEase websites and other online and mobile platforms. We are involved in intellectual property infringement claims or actions from time to time and are occasionally subject to defamation claims or infringement claims related to individual's publicity rights. We believe that the amounts claimed in these actions, in the aggregate, are not material to our business. However, these amounts may be increased for a variety of reasons as the claims progress, and we and our affiliates could be subject to additional defamation or infringement claims which, singly or in the aggregate, could have a material adverse effect on our business and results of operations, if successful. We also could be subject to copyright, defamation and other claims based upon user-generated content that is accessible on the NetEase websites or other online and mobile platforms such as content and materials posted or uploaded by users on message boards, online communities, social media platforms, voting systems, chat rooms or our other online and mobile platforms including NetEase Cloud Music, NetEase CC live streaming platform and the NetEase News App. By providing technology for hypertext links to third-party websites, we may be held liable for copyright or trademark violations by those third-party sites. Third parties could assert claims against us for losses incurred in reliance on any erroneous information distributed by us. Moreover, users of the NetEase web-based e-mail services could seek damages from us for:

- unsolicited e-mails;
- lost or misplaced messages;
- illegal or fraudulent use of e-mail; or
- interruptions or delays in e-mail services.

We may incur significant costs in investigating and defending these claims, even if they do not result in liability.

***Divestitures of businesses and assets may have a material and adverse effect on our business and financial condition.***

We have undertaken, and may undertake in the future, partial or complete divestitures or other disposal transactions in connection with certain of our businesses and assets, particularly ones that are not closely related to our core focus areas or might require excessive resources or financial capital, to help our company meet its objectives. For example, in September 2019, we sold our e-commerce platform Kaola. These decisions are largely based on our management's assessment of the business models and likelihood of success of these businesses. However, our judgment could be inaccurate, and we may not achieve the desired strategic and financial benefits from these transactions. Our financial results could be adversely affected by the impact from the loss of earnings and corporate overhead contribution/allocation associated with divested businesses. In addition, as our net (loss)/income from discontinued operations are non-recurrent, it may be difficult for investors and analysts to predict our future earnings potential based on our historical financial performance.

Dispositions may also involve continued financial involvement in the divested business, such as through guarantees, indemnities or other financial obligations. Under these arrangements, performance by the divested businesses or other conditions outside of our control could affect our future financial results. We may also be exposed to negative publicity as a result of the potential misconception that the divested business is still part of our consolidated group. On

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the other hand, we cannot assure you that the divesting business would not pursue opportunities to provide services to our competitors or other opportunities that would conflict with our interests. If any conflicts of interest that may arise between the divesting business and us cannot be resolved in our favor, our business, financial condition, results of operations could be materially and adversely affected.

Furthermore, reducing or eliminating our ownership interests in these businesses might negatively affect our operations, prospects, or long-term value. We may lose access to resources or know-how that would have been useful in the development of our own business. Our ability to diversify or expand our existing businesses or to move into new areas of business may be reduced, and we may have to modify our business strategy to focus more exclusively on areas of business where we already possess the necessary expertise. We may sell our interests too early, and thus forego gains that we otherwise would have received had we not sold. Selecting businesses to dispose of or spin off, finding buyers for them (or the equity interests in them to be sold) and negotiating prices for what may be relatively illiquid ownership interests with no easily ascertainable fair market value will also require significant attention from our management and may divert resources from our existing business, which in turn could have an adverse effect on our business operations.

We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the requirements in Paragraph 3(b) of Practice Note 15 to the Hong Kong Listing Rules such that we are able to list a subsidiary entity (other than one involving our online game business) on the Hong Kong Stock Exchange within three years of the Listing. While we currently do not have any plan with respect to any spin-off listing on the Hong Kong Stock Exchange, we may consider a spin-off listing on the Hong Kong Stock Exchange for one or more of our businesses (other than our online game business) within the three year period subsequent to the Listing. The waiver granted by the Hong Kong Stock Exchange is conditional upon us confirming to the Hong Kong Stock Exchange in advance of any spin-off that it would not render our Company incapable of fulfilling the eligibility requirements under Rule 19C.05 of the Hong Kong Listing Rules based on the financial information of the entity or entities to be spun-off at the time of the Company's Listing (calculated cumulatively if more than one entity is spun-off). For additional information, see "Waivers and Exemptions — Three-year Restriction on Spin-offs."

### **Risks related to our corporate structure**

***If the PRC government finds that the contractual arrangements with our VIEs do not comply with applicable PRC laws and regulations, or if these regulations or their interpretations change in the future, we may be subject to penalties or be forced to relinquish our interests in those operations.***

Due to legal restrictions on foreign investment in Chinese companies providing value-added telecommunications services and holding ICP licenses and other regulated licenses, we operate all of our business segments through contractual arrangements with the VIEs and their equity holders. The contractual arrangements enable us to: (i) hold effective control over the VIEs; (ii) receive substantially all of the economic benefits of our VIEs; and (iii) have an exclusive option to purchase all or part of the equity interests in the VIEs when and to the extent permitted by PRC law or request any existing shareholders of the VIEs to transfer any or part of the equity interest in the relevant VIE to another PRC person or entity designated by us at any time at our discretion. Because of the contractual arrangements, we are the primary beneficiary of the VIEs and their respective subsidiaries and consolidate the results of operations of the VIEs into ours. Our VIEs and their respective subsidiaries hold the licenses, approvals and key assets that are essential for our business operations.

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If the PRC government finds that our contractual arrangements do not comply with the existing or future restrictions on foreign investment, or if the PRC government otherwise finds that we, the VIEs or any of their subsidiaries are in violation of the existing or future PRC laws or regulations or lack the necessary permits or licenses to operate our business, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations or failures, including, without limitation:

- revoking our business and operating licenses;
- discontinuing or restricting our operations;
- imposing fines or confiscating any of our income that they deem to have been obtained through illegal operations;
- imposing conditions or requirements with which we may not be able to comply;
- requiring us to restructure the relevant ownership structure or operations;
- restricting our financing activities to finance the business and operations of our VIEs; or
- taking other regulatory or enforcement actions that could be harmful to our business.

Any of these actions could cause significant disruption to our business operations, and may materially and adversely affect our business, financial condition and results of operations. In addition, it is unclear what impact the PRC government actions would have on us and on our ability to consolidate the financial results of any of the VIEs in our consolidated financial statements, if the PRC governmental authorities find our legal structure and contractual arrangements to be in violation of PRC laws, rules and regulations. If any of these penalties results in our inability to direct the activities of VIEs that most significantly impact their economic performance and/or our failure to receive the economic benefits from the VIEs, we may not be able to consolidate the VIEs and their respective subsidiaries into our consolidated financial statements. Please also see the below risk factors “— Substantial uncertainties exist with respect to how the 2019 PRC Foreign Investment Law may impact the viability of our current corporate structure, corporate governance and business operations” and “— Risks related to doing business in China — The Chinese government restricts the ability for foreign investors to invest in and operate in certain types of telecommunications and internet businesses.”

***Substantial uncertainties exist with respect to how the 2019 PRC Foreign Investment Law may impact the viability of our current corporate structure, corporate governance and business operations.***

On March 15, 2019, the Standing Committee of National People’s Congress promulgated the 2019 PRC Foreign Investment Law, which became effective on January 1, 2020. The 2019 PRC Foreign Investment Law replaces the trio of existing laws regulating foreign investment in China, namely, the *Wholly Foreign-owned Enterprises Law*, the *Sino-foreign Equity Joint Ventures Law*, and the *Sino-foreign Cooperative Joint Ventures Law*, together with their implementation rules and ancillary regulations, and embodies an expected PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. However, uncertainties still exist in relation to interpretation and implementation of the 2019 PRC Foreign Investment Law, especially in

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regard to, including, among other things, the nature of VIE structure, the promulgation schedule of both the “negative list” under the 2019 PRC Foreign Investment Law and specific rules regulating the organization form of foreign-invested enterprises within the five-year transition period.

The VIE structure has been adopted by many PRC-based companies, including us, to obtain necessary licenses and permits in the industries that are currently subject to foreign investment restrictions in China. See “History — Corporate Structure — Variable interest entity structure.” While the 2019 PRC Foreign Investment Law and its implementation regulations which took effect on January 1, 2020 do not define contractual arrangements as a form of foreign investment explicitly, we cannot assure you that future laws and regulations will not provide for contractual arrangements as a form of foreign investment. Therefore, there can be no assurance that our control over our VIEs through contractual arrangements will not be deemed as foreign investment in the future.

In the event that any possible future laws, administrative regulations or provisions deem contractual arrangements as a way of foreign investment, or if any of our operations through contractual arrangements is classified in the “restricted” or “prohibited” industry in the future “negative list” under the 2019 PRC Foreign Investment Law, our contractual arrangements may be deemed as invalid and illegal, and we may be required to unwind the VIE contractual arrangements and/or dispose of any affected business. Also, if future laws, administrative regulations or provisions mandate further actions to be taken with respect to existing contractual arrangements, we may face substantial uncertainties as to whether we can complete such actions in a timely manner, or at all. In addition, the 2019 PRC Foreign Investment Law provides that foreign invested enterprises established according to the existing laws regulating foreign investment may maintain their structure and corporate governance within a five-year transition period, which means that we may be required to adjust the structure and corporate governance of certain of our PRC subsidiaries after such transition period. Failure to take timely and appropriate measures to cope with any of these or similar regulatory compliance challenges could materially and adversely affect our current corporate structure, corporate governance and business operations.

***Our contractual arrangements with our VIEs may not be as effective in providing operational control as direct ownership. If our VIEs or their ultimate shareholders violate our contractual arrangements with them, our business could be disrupted, our reputation may be harmed and we may have to resort to litigation to enforce our rights, which may be time consuming and expensive.***

Our VIEs are owned by shareholders whose interests may differ from ours and those of our shareholders because they own a larger percentage of such companies than of our company. These affiliated companies or their ultimate shareholders could violate our arrangements with them by, among other things, failing to operate and maintain the NetEase websites and other online and mobile platforms, or their various businesses in an acceptable manner, failing to remit revenue to us on a timely basis or at all or diverting customers or business opportunities from our company. In addition, the operation of the online games licensed from Blizzard is dependent on Shanghai EaseNet, which is owned by William Lei Ding, our founder, director and chief executive officer, and has contractual arrangements with us and with the joint venture established between Blizzard and us. The interests of Mr. Ding and the joint venture may differ from ours and those of our shareholders. A violation of the foregoing agreements could disrupt our business and adversely affect our reputation in the market. If these companies or their ultimate shareholders violate our agreements with them, we may have to incur substantial costs and expend significant resources to enforce those arrangements and rely on legal remedies under the PRC laws. Many PRC laws, rules and regulations are relatively new, and because of the limited volume of published decisions and their non-binding nature, the interpretation and



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enforcement of these laws, rules and regulations involve substantial uncertainties. These uncertainties may impede our ability to enforce these agreements, or cause us to suffer significant delay or other obstacles in the process of enforcing these agreements, and may materially and adversely affect our results of operations and financial position.

***Because our contractual arrangements with certain of our affiliated entities and their ultimate shareholders do not detail the parties' rights and obligations, our remedies for a breach of these arrangements are limited.***

Our current relationship with certain affiliated entities, including Guangzhou NetEase, Hangzhou Leihuo, Youdao Computer, Shanghai EaseNet, and their ultimate shareholders is based on a number of contracts, and these affiliated companies are considered our VIEs for accounting purposes. The terms of these agreements are often statements of general intent and do not detail the rights and obligations of the parties. Some of these contracts provide that the parties will enter into further agreements on the details of the services to be provided. Others contain price and payment terms that are subject to monthly adjustment. These provisions may be subject to differing interpretations, particularly on the details of the services to be provided and on price and payment terms. It may be difficult for us to obtain remedies or damages from these affiliated entities or their ultimate shareholders for breaching our agreements. Because we rely significantly on these companies for our business, the realization of any of these risks may disrupt our operations or cause degradation in the quality and service provided on, or a temporary or permanent shutdown of, the NetEase websites or other online and mobile platforms.

***One of our shareholders has significant influence over our company.***

Our founder, director and chief executive officer, William Lei Ding, beneficially owned, as at the Latest Practicable Date, approximately 44.7% of our total issued share capital and is our largest shareholder. Accordingly, Mr. Ding has significant influence in determining the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations, the sale of all or substantially all of our assets, election of directors and other significant corporate actions. He also has significant influence in preventing or causing a change in control. In addition, without the consent of this shareholder, we may be prevented from entering into transactions that could be beneficial to us. The interests of Mr. Ding may differ from the interests of our other shareholders.

***A majority of the share capital of certain of our affiliated entities are held by our major shareholder, who may cause these agreements to be amended in a manner that is adverse to us.***

William Lei Ding, directly or indirectly holds the majority interest in certain of our VIEs. As a result, Mr. Ding may be able to cause the agreements related to those companies to be amended in a manner that will be adverse to our company, or may be able to cause these agreements not to be renewed, even if their renewal would be beneficial for us. Although we have entered into an agreement that prevents the amendment of these agreements without the approval of the members of our board of directors other than Mr. Ding, we can provide no assurances that these agreements will not be amended in the future to contain terms that might differ from the terms that are currently in place. These differences may be adverse to our interests. In addition, William Lei Ding also holds the entire share capital of Shanghai EaseNet, and we can provide no assurance that Mr. Ding will not cause the agreements related to Shanghai EaseNet to be amended in the future in a manner that will be adverse to us or to contain terms that might differ from the terms that are currently in place. These differences may be adverse to our interests.

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***We may not be able to conduct our operations without the services provided by certain of our affiliated entities.***

Our operations are currently dependent upon our commercial relationships with our VIEs, and we derive most of our revenues from these companies. If these companies are unwilling or unable to perform the agreements which we have entered into with them, we may not be able to conduct our operations in the manner in which we currently do. In addition, our VIEs may seek to renew these agreements on terms that are disadvantageous to us. Although we have entered into a series of agreements that provide us with substantial ability to control these companies, we may not succeed in enforcing our rights under them. If we are unable to renew these agreements on favorable terms, or to enter into similar agreements with other parties, our business may not expand, and our operating expenses may increase.

***Our corporate structure may restrict our ability to receive dividends from, and transfer funds to, our PRC subsidiaries and VIEs, which could restrict our ability to act in response to changing market conditions and reallocate funds internally in a timely manner.***

NetEase, Inc. is a holding company with no significant assets other than cash on hand and its equity interests in its directly and indirectly-owned subsidiaries, including those set forth in the organizational diagram appearing in “History — Corporate Structure — Our corporate structure.” As a result, our primary internal source of funds for our cash and financing requirements is dividend payments and other distributions on equity from our subsidiaries. If these subsidiaries incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other distributions to us, which in turn would limit our ability to pay dividends on our ADSs and service any debt we may incur. PRC tax authorities may also require us to amend our contractual arrangements with our VIEs and their respective shareholders in a manner that would materially and adversely affect the ability of our subsidiaries to pay dividends and other distributions to us. In addition, Chinese legal restrictions permit payment of dividends only out of net income as determined in accordance with Chinese accounting standards and regulations. Under Chinese law, our PRC subsidiaries and VIEs are also required to set aside a portion of their net income each year to fund certain reserve funds, except in cases where a company’s cumulative appropriations have already reached the statutory limit of 50% of that company’s registered capital. These reserves are not distributable as cash dividends. Also see “— Risks related to doing business in China — We may be treated as a resident enterprise for PRC tax purposes under the PRC Enterprise Income Tax Law, which may subject us to PRC income tax on our global income and result in dividends payable by us to our foreign investors, and gains on the sales of our ordinary shares or ADSs, becoming subject to taxes under PRC tax laws, which may materially reduce the value of your investment” for further details. Any limitation on the ability of our PRC subsidiaries and VIEs to transfer funds to us in the form of dividends or other distributions could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay debt or dividends, and otherwise fund and conduct our business.

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In addition, any transfer of funds from us to any of our PRC subsidiaries or VIEs, either as a shareholder loan or as an increase in registered capital, is subject to certain statutory limit requirements and registration or approval of the relevant PRC governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority.

Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our PRC subsidiaries or VIEs. These limitations on the free flow of funds between us and our PRC subsidiaries and VIEs could restrict our ability to act in response to changing market conditions and reallocate funds internally in a timely manner.

***Our arrangements with certain of our affiliated entities and their respective shareholders may cause a transfer pricing adjustment and may be subject to scrutiny by the PRC tax authorities.***

We could face material and adverse tax consequences if the PRC tax authorities determine that our contracts with our VIEs and their respective shareholders were not entered into based on arm's-length negotiations. Although our contractual arrangements are similar to those of other companies conducting similar operations in China, if the PRC tax authorities determine that these contracts were not entered into on an arm's-length basis, they may adjust our income and expenses for PRC tax purposes in the form of a transfer pricing adjustment which may result in an increase in our taxes. In addition, the PRC tax authorities may also impose late payment interest.

***A transfer of shares of certain of our affiliated entities may trigger tax liability.***

If we need to cause the transfer of shareholdings of our VIEs from their current respective shareholders to any other individual, we may be required to pay individual income tax in the PRC on behalf of the transferring shareholder. Such individual income tax would be based on any gain deemed to have been realized by such shareholder on such transfer, and may be calculated based on a tax rate of 20% applied to the transferring shareholder's interest in net book value of the entity whose shares are being transferred minus the original investment cost. A significant tax obligation arising from any such transfer of shares could materially adversely affect our business and results of operations.

***We may lose the ability to use and enjoy assets held by any of our principal VIEs that are important to the operation of our business if such VIE declares bankruptcy or becomes subject to a dissolution or liquidation proceeding.***

Our principal VIEs hold assets that are material to our business operations, such as our certain intellectual property and core licenses and permits. Although the VIE contracts between our subsidiaries and VIEs and the shareholders of our VIEs contain terms that prohibit the shareholders of our VIEs from adversely affecting the existence of the VIEs, in the event the shareholders breach this obligation and voluntarily liquidate our VIEs, or if any of our VIEs declare bankruptcy and all or part of its assets become subject to liens or rights of third-party creditors, we might be unable to continue some or all of our business operations. Furthermore, if any of our VIEs were to undergo a voluntary or involuntary liquidation proceeding, its shareholders or unrelated third-party creditors might claim rights to some or all of such VIE's assets and their rights could be senior to our rights under the VIE contracts, thereby hindering our ability to operate our business.

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### Risks related to doing business in China

*Changes in government regulations of the telecommunications and internet industries in China may result in uncertainties in interpretation and/or the Chinese government requiring us to obtain additional licenses or other governmental approvals to conduct our business, both of which may restrict our operations.*

The telecommunications and internet industry, including ICP services and online games, is highly regulated by the Chinese government. In addition, the telecommunication and internet-related laws and regulations are relatively new and constantly evolving, and their interpretation and enforcement involve significant uncertainties. As a result, in certain circumstances, it may be difficult to determine what actions or omissions may be deemed to be in violation of applicable laws and regulations in this area.

The evolving PRC regulatory system for the telecommunications and internet industries may lead to the establishment of new regulatory agencies. For example, in May 2011, the State Council, in collaboration with the State Council Information Office, the MIIT and the Ministry of Public Security, announced the establishment of the CAC, whose primary role is to facilitate the policy-making and legislative development in the telecommunications and internet industries by coordinating with other relevant governmental agencies in connection with online content administration and handling cross-ministry regulatory matters in relation to such industries.

In addition, we are uncertain as to whether the Chinese government will reclassify our business as a media or retail company, due to our acceptance of fees for internet advertising, online games, e-commerce, and other innovative services as sources of revenues, or as a result of our current corporate structure. Such reclassification could subject us to penalties, fines or significant restrictions on our business. Moreover, NetEase, Inc. may have difficulties enforcing its rights under the agreements with our VIEs if any of these parties breaches any of the agreements with them because NetEase, Inc. does not have approval from appropriate Chinese authorities to provide internet content services, internet advertising services, e-commerce services or other innovative services. Future changes in Chinese government policies affecting the provision of information services, including the provision of online services, internet access, e-commerce services, online advertising and online gaming may impose additional regulatory requirements on us or our service providers or otherwise harm our business.

*The Chinese government restricts the ability for foreign investors to invest in and operate in certain types of telecommunications and internet businesses.*

Foreign ownership of certain types of telecommunications and internet businesses which we operate, including value-added telecommunications services, internet cultural services and internet publication services, is subject to restrictions under applicable PRC laws. For example, on September 28, 2009, General Administration of Press and Publication (the “GAPP”) together with the National Copyright Administration and National Office of Combating Pornography and Illegal Publications issued a *Notice Regarding the Consistent Implementation of the “Regulation on Three Provisions” of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Examination and Approval of Online Games and the Examination and Approval of Imported Online Games* (the “Circular 13”). According to Circular 13, foreign investors are not permitted to invest in online game operating businesses in China via wholly-owned, equity joint venture or cooperative joint venture investments and it expressly prohibits foreign investors from gaining control over or participating in domestic online game operators through indirect ways such as establishing other joint venture companies, or

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contractual or technical arrangements. In addition, the *Rules for the Administration of Online Publishing Service* jointly issued by the SAPPRFT and MIIT, effective on March 10, 2016, forbids foreign investments in the online publishing business.

With respect to our internet media business, the CAC's *Provisions for the Administration of Internet News Information Services*, which became effective from June 1, 2017, expressly prohibit any Sino-foreign equity joint venture or cooperative joint venture or any foreign-funded enterprise to conduct internet-based news information services. We believe we are in compliance with such requirement because our internet media business is conducted through our contractually controlled VIEs that are PRC entities. Additionally, in accordance with the *Several Opinions on the Introduction of Foreign Capital to the Culture Sector (Wen Ban Fa [2005] No. 19)* issued by the MOC (later superseded by the MOCT) on July 6, 2005, foreign investors (excluding Hong Kong and Macau) are prohibited from establishing or operating internet-based cultural institutions. It is unclear what activities count as "operating internet-based cultural institutions," however certain services we provide in our innovative businesses and others segment are likely to be deemed as such. We believe we are also in compliance with this requirement because we operate our other innovative businesses and other services through our contractually controlled VIEs.

It is unclear whether the authorities will deem our VIE structure as a kind of "indirect way" for foreign investors to gain control over or participate in domestic online game operators, internet-based news information services or internet-based cultural institutions. If our VIE structure is deemed as one such "indirect way," our VIE structure may be challenged by the authorities and the authorities may require us to restructure our VIE structure and take action to prohibit or restrict our business operations. In such case, we may not be able to operate or control business in the same manner as we currently do and may not be able to consolidate the VIEs. Please also see "— Risks related to our corporate structure" above for a discussion of the risks associated with our VIE structure.

In recent years, the PRC government has been promoting foreign investment reform in some sectors and purported to loosen the foreign investment restrictions in those sectors. For example, the *Notice of the Ministry of Industry and Information Technology on Removing the Restrictions on Foreign Equity Ratios in Online Data Processing and Transaction Processing (Operating E-commerce) Business* promulgated by the MIIT on June 19, 2015, allows foreign investors hold up to 100% of the equity interests in an online data processing and transaction processing business (operational e-commerce) in China. In addition, the NDRC and the MOFCOM jointly published the Negative List, which came into effect on July 30, 2019. The Negative List removes some of the previous restrictions on value-added telecommunications providers by allowing foreign investors to hold up to 100% of the equity interests in e-commerce, domestic multi-party communication, e-storage and forwarding and call center businesses in China. It is unclear how these new policies will be implemented. More generally, the authorities in China have broad discretion in the determination and interpretation of the rules and regulations regarding foreign investment in the telecommunications and internet business, which may adversely impact our financial statements, operations and cash flows.

***The Chinese government has taken steps to limit online game playing time for all minors and to otherwise control the content and operation of online games. These and any other new restrictions on online games may materially and adversely impact our business and results of operations.***

As part of its anti-addiction online game policy, the Chinese government has taken several steps to discourage minors under the age of 18 from continuously playing online games once they exceed a set number of hours of continuous play. For example, in July 2005, the MOC (later superseded by the MOCT) and the MII (later superseded by the MIIT) jointly issued an

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opinion which requires online game operators to develop systems and software for identity certification, to implement anti-addiction modifications to game rules and to restrict players under 18 years of age from playing certain games. Subsequently, in August 2005, GAPP proposed an online game anti-addiction system that would have reduced and eliminated experience points that a user can accumulate after three and five hours of consecutive playing, respectively. In March 2006, GAPP amended its proposal to require players to register with their real names and identity card numbers and to apply the anti-addiction system only to players under 18 years of age. In April 2007, GAPP and several other government authorities jointly promulgated the *Notice Concerning the Protection of Minors' Physical and Mental Well-being and Implementation of Anti-addiction System on Online Games* (the “**Anti-Addiction notice**”) which confirmed the real-name verification proposal and required online game operators to develop and test their anti-addiction systems from April 2007 to July 2007, after which no online games can be registered or operated without an anti-addiction system in accordance with the Anti-Addiction Notice. Accordingly, we implemented our anti-addiction system to comply with the Anti-Addiction Notice. Since its implementation, we have not experienced a significant negative impact on our business as a result of the Anti-Addiction Notice.

To identify that a game player is a minor and is thus subject to the online game anti-addiction system, a real-name registration system must be adopted to require players to register their real identity information before playing online games. Pursuant to the *Notice Regarding the Initiation of Work on the Online Games Real-Name Verification System to Prevent Online Gaming Addiction* (the “**Commencement of Real-Name Authentication Notice**”) issued by eight government authorities on July 1, 2011, online game (excluding mobile game) operators must submit the identity information of game players which needs to be further verified to the National Citizen Identity Information Center, a subordinate public institution of the Ministry of Public Security, for verification since October 1, 2011, in an effort to prevent minors from using an adult’s ID to play online games. Violation of the Anti-Addiction Notice and the Commencement of Real-Name Authentication Notice could result in the termination of the operation of online games. On August 30, 2018, the *Implementation Scheme on Comprehensive Prevention and Control of Adolescent Myopia* (the “**Implementation Scheme**”) was issued jointly by eight PRC regulatory authorities at the national level, including the National Press and Publication Administration (the “**NPPA**”) and the National Radio and Television Administration (the “**NRTA**”). The Implementation Scheme provides that as a part of the plan to prevent myopia among children, the NPPA will control the number of new online games and take steps to restrict the amount of time children spend on playing online games. On October 25, 2019, the NPPA promulgated the *Notice on Preventing Minors from Indulging in Online Games*, according to which the length of minors’ use of online games should be strictly controlled. It requires all online game users to register their identification information. The total length of time for minors to access online games must be limited on a daily basis. Every day from 22:00 to 8:00 the next day, online game companies are not permitted to provide game services to minors in any form. Game services provided to minors must not exceed 3 hours per day on public holidays and 1.5 hours on other days. In addition, online transactions are capped monthly at RMB200 or RMB400, depending on a minor’s age. We have updated our anti-addiction systems accordingly to comply with the above-mentioned requirements. We do not believe that the Implementation Scheme has any material impact on our gaming operations, but we cannot assure you that any future regulations or restrictive rules will not adversely affect our operations.

On July 10, 2019, the MOCT announced the abolishment of the *Interim Measures for the Administration of Online Games* (the “**Online Games Measures**”) which had previously regulated activities related to the online game industry, including requirements that game operators follow new registration procedures, publicize information about the content and suitability of their games, prevent access by minors to inappropriate games, avoid certain types

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of content in games targeted to minors, avoid game content that compels players to kill other players, manage virtual currency in certain ways and register users with their real identities. As of the date of this document, no laws and regulations had been promulgated or published to replace the Online Games Measures. We cannot be sure if or when any future regulations or restrictive rules in this regard will be promulgated and whether they would negatively impact our operations, including by increasing our compliance costs and negatively impacting our ability to launch and operate new games.

***The Chinese government has not enacted any laws regarding virtual asset property rights and, accordingly, it is not clear what liabilities, if any, online game providers may have for virtual assets.***

One of the features of our PC and mobile MMORPG which helps to build a large user base and maintain loyalty is that users can accumulate virtual tools, powers and rankings as they play the games. We believe that these virtual assets are highly valued by our users, particularly long-term users, and are traded among users. However, on occasion, such assets can be lost if, for example, a user's identity is stolen by another user or we experience a system error or crash. Other than the *General Rules on the Civil Law of the PRC*, which was passed by the National People's Representative Meeting on March 15, 2017 and took effect on October 1, 2017, which prescribes that network virtual property will be protected according to the laws stipulating the protection of such property, the Chinese government has not yet enacted any specific laws regarding virtual property rights. Accordingly, we have no basis to determine what are the legal rights, if any, associated with virtual assets and what liabilities we could be exposed to for the loss or destruction of virtual assets. We could therefore potentially be held liable for the way in which we handle and protect virtual assets.

***Restrictions on virtual currency may adversely affect our online game revenues.***

A large part of our online game revenues are collected through the sale of prepaid points, as described elsewhere on this document.

On February 15, 2007, the MOC (later superseded by the MOCT), the PBOC, and 12 other PRC regulatory authorities jointly issued the *Notice on the Reinforcement of the Administration of Internet Cafés and Online Games* (the "**Internet Cafés Notice**") which strengthens the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. Under the Internet Cafés Notice, the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a clear distinction between virtual transactions and real transactions, so that virtual currency should only be used to purchase virtual items.

On June 4, 2009, the MOC (later superseded by the MOCT) and the MOFCOM jointly issued the *Notice on Strengthening Administration on Online Game Virtual Currency* (the "**Online Game Virtual Currency Notice**"), which defined "Virtual Currency" as a type of virtual exchange instrument that is issued by online game operators, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the online game operators in electronic record format and represented by specific numeric units. In addition, the Online Game Virtual Currency Notice categorizes companies involved with virtual currency as either issuers or trading platforms and prohibits companies from simultaneously engaging both as issuers and as trading platforms. The Online Game Virtual Currency Notice's objective is to limit the circulation of virtual currency and thereby reduce concerns that it may impact real world inflation. To accomplish this, the Online Game Virtual Currency Notice requires online game operators to report the total amount of their issued virtual currencies on a quarterly basis and

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to refrain from issuing disproportionate amounts of virtual currencies in order to generate revenues. In addition, the Online Game Virtual Currency Notice reiterates that virtual currency can only be provided to users in exchange for an RMB payment and can only be used to pay for virtual goods and services of the issuers. Online game operators are strictly prohibited from conducting lucky draws or lotteries in which participants pay cash or virtual currency to win game items or virtual currency. The Online Game Virtual Currency Notice also requires online game operators to keep transaction data records for no less than 180 days and to not provide virtual currency trading services to minors.

In order to comply with the requirements of the Online Game Virtual Currency Notice, we may need to change our prepaid point card distribution and database systems, resulting in higher costs of our online game operation, lower sales of our prepaid cards, or other changes in our business model. Such changes may therefore have an adverse effect on our revenues from online games.

***Information displayed on, retrieved from or linked to the NetEase websites and other online and mobile platforms may subject us to claims of violating PRC laws.***

Internet companies in China are subject to a variety of existing and new rules, regulations, policies, and license and permit requirements on the distribution of information over the mobile and internet. Under these rules and regulations, content service providers are prohibited from posting or displaying over the mobile or internet content that, among others, violates PRC laws and regulations, impairs the national security of China, is obscene, superstitious, defamatory, or may be deemed by relevant government authorities as “socially destabilizing” or leaking “state secrets” of China. Violations or perceived violations of Chinese laws arising from information displayed on, retrieved from or linked to the NetEase websites and other online and mobile platforms could result in significant penalties, including a temporary or complete cessation of our business.

Multiple organizations are involved in the administering of such regulations, including the Propaganda Department of the Chinese Communist Party, which has been given the responsibility to censor news published in China to ensure a particular political ideology, and the CAC, which has been given the responsibility to protect, supervise and administer cyber security issues in China. In addition, the MIIT has published implementing regulations that subject online information providers to potential liability for content included in their media and the actions of subscribers and others using their systems, including liability for violation of PRC laws prohibiting the distribution of content deemed to be socially destabilizing. The Ministry of Public Security has also from time to time prohibited the distribution over the internet of information which it believes to be socially destabilizing.

The Ministry of Public Security has the authority to require any local internet service provider to block any website maintained outside China at its sole discretion. The State Secrecy Bureau, which is directly responsible for the protection of state secrets of all PRC government and Chinese Communist Party organizations, is authorized to block any website it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the distribution of online information. The term “state secrets” has been broadly interpreted by Chinese governmental authorities in the past. We may be liable under any of these pronouncements for content and materials posted, uploaded or transmitted by users on our platform. User-generated content is accessible on the NetEase websites and our other online and mobile platforms including NetEase News App and NetEase Cloud Music, such as content and materials posted or uploaded by users on message boards, online communities and social media platforms. We have implemented an efficient and thorough content screening and monitoring mechanism for NetEase Cloud Music and our other platforms which involve both



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automated filtering and manual review, to timely remove any inappropriate or illegal content, including interactive content on our platform. However, such procedures may not prevent all illegal or inappropriate content or comments from being posted, and our editorial staff may fail to review and screen such content or comments effectively. Failure to identify and prevent illegal or inappropriate content from being distributed on our platform may subject us to liability. To the extent that PRC regulatory authorities find any content on our platform objectionable, they may require us to limit or eliminate the dissemination of such content on our platform in the form of takedown orders or otherwise. In addition, PRC laws and regulations are subject to interpretation by the relevant authorities, and it may not be possible to determine in all cases the types of content that could result in our liability as a platform operator.

In addition, under the relevant regulations, internet companies which provide bulletin board systems, chat rooms or similar services, such as our company, must apply for the approval of the State Secrecy Bureau. As the implementing rules of these regulations have not been issued, we do not know how or when we will be expected to comply, or how our business will be affected by the application of these regulations.

***We may not be able to adequately protect our intellectual property, and we may be exposed to infringement claims by third parties.***

We rely on a combination of copyright, trademark, patent and trade secrecy laws and contractual restrictions on disclosure to protect our intellectual property rights. Our efforts to protect our proprietary rights may not be effective in preventing unauthorized parties from copying or otherwise obtaining and using our technology or imitating our name, private label merchandise or other intellectual property. Monitoring unauthorized use of our intellectual property is difficult and costly, and we cannot be certain that the steps we take will effectively prevent misappropriation of our technology or other intellectual property.

From time to time, we may have to resort to litigation to enforce our intellectual property rights, which could result in substantial costs and diversion of our resources. In addition, our current and future business activities, including our portal service and private label merchandise, may infringe upon the proprietary rights of others, and third parties may assert infringement claims against us, including claims alleging, among other things, copyright, trademark or patent infringement. Third parties have initiated litigation against us for alleged infringement of their proprietary rights, and additional claims may arise in the future. In the event of a successful claim of infringement and our failure or inability to develop non-infringing technology or content or to license the infringed or similar technology or content on a timely basis, our business could suffer. Moreover, even if we are able to license the infringed or similar technology or content, license fees that we pay to licensors could be substantial or uneconomical. See “Our Business — Intellectual Property.”

***We are subject to consumer protection laws that could require us to modify our current business practices and incur increased costs.***

Our e-commerce business is subject to numerous PRC laws and regulations that regulate retailers generally or govern online retailers specifically, such as the *PRC Consumer Protection Law*. If these regulations were to change or if we or our suppliers were to violate them, the costs of certain products or services could increase, or we could be subject to fines or penalties or suffer reputational harm, which could reduce demand for the products or services offered on our e-commerce platform and hurt our business and results of operations. For example, the amended *PRC Consumer Protection Law*, which became effective in March 2014, strengthens the protection of consumers and imposes more stringent requirements and obligations on

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business operators, with a particular focus on businesses that operate via the Internet. Pursuant to the *PRC Consumer Protection Law*, consumers are generally entitled to return goods purchased within seven days upon receipt without giving any reasons if the purchases are made through the Internet. Consumers whose interests have been harmed due to their purchase of goods or acceptance of services on e-commerce platforms may claim damages from sellers or service providers.

Laws and regulations regarding consumer protection, particularly those involving transactions conducted over the Internet, frequently change and are subject to interpretation. We are therefore unable to predict the ultimate cost of compliance of the relevant laws or regulations or their effect on our operations. We may be required to make significant expenditures or modify our business practices to comply with existing or future laws and regulations, which may increase our costs and materially limit our ability to operate our business.

***Regulatory restrictions on financial transactions may adversely affect the operation and profitability of our business.***

On June 14, 2010, the PBOC issued the *Measures for the Administration of Non-financial Institutions Engaging in Payment and Settlement Services* (the “**PBOC Measures**”) which became effective on September 1, 2010 and require that non-financial institutions engaging in the business of effecting payments and settlements before September 1, 2010 obtain a permit from the PBOC by August 31, 2011 to continue operating their business. We currently operate an online payment platform used by both distributors of our prepaid points and end-users of our online services, which requires a permit under the PBOC Measures. In addition, on December 28, 2015, the PBOC issued a notice regarding the *Administrative Measures for Internet Payment Services of Non-banking Payment Institutions* (the “**PBOC Notice 43**”) which took effect on July 1, 2016. According to the PBOC Notice 43, a payment institution is required to follow the principles of “know your clients,” and maintain records on its clients using their real names when opening payment accounts for its clients. Pursuant to the PBOC Notice 43, a payment institution shall not engage in, including in a disguised form, such businesses as securities, insurance, credit loans, financing, wealth management, guarantee, trust, currency exchange, cash deposit and withdrawal services. In addition, a payment institution is required to, based on client identity, conduct affiliated management of all the payment accounts opened by the same client. On January 13, 2017, the PBOC issued the *Notice of the PBOC on Matters concerning Implementing the Centralized Deposit of the Funds of Pending Payments of Clients of Payment Institutions*, which requires that from April 17, 2017, payment institutions transfer a portion of customer reserve funds to a specifically designated bank account upon the request of the PBOC and that no interest be allowed to accrue upon the transferred customer reserve funds. On June 29, 2018, the PBOC issued a further notice that requires payment institutions to cause up to 100% of the customer reserve funds to be transferred to the above-mentioned account.

We are in compliance with the PBOC Notice 43 and the recent PBOC requirement to transfer our customer reserve funds to its designated bank account with no interest accrual, however, we cannot predict how the regulations relating to financial transactions will evolve or be certain that we will be able to maintain compliance with all relevant regulations at a reasonable cost. Any inability to continue operating our current online payment platform would likely materially and adversely affect the operation and profitability of our business.

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***The uncertain legal environment in China could limit the legal protections available to you.***

The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have less precedential value. In the late 1970s, the Chinese government began to promulgate a comprehensive system of laws and regulations governing economic matters. The overall effect of legislation enacted over the past 40 years has significantly enhanced the protections afforded to foreign invested enterprises in China. However, many of these laws, regulations and legal requirements are relatively recent and are evolving rapidly, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to foreign investors.

***Contract drafting, interpretation and enforcement in China involve significant uncertainty.***

We have entered into numerous contracts governed by PRC law, many of which are material to our business. As compared with contracts in the United States, certain contracts governed by PRC law may contain less detail and may not be as comprehensive in defining contracting parties' rights and obligations in some instances. As a result, those contracts are more vulnerable to disputes and legal challenges. In addition, contract interpretation and enforcement by the court in China is not as developed as in the United States, and the result of contract dispute in certain cases is subject to significant uncertainties. Therefore, we cannot assure you that we will not be subject to disputes under our material contracts, and if such disputes arise, we cannot assure you that we will prevail. Any dispute involving material contracts, even without merit in plaintiff's regard, may materially and adversely affect our reputation and our business operations, and may cause the price of our ADSs to decline.

***Changes in China's political and economic policies could harm our business.***

The economy of China has historically been a planned economy subject to governmental plans and quotas and has, in certain aspects, been transitioning to a more market-oriented economy. Although we believe that the economic reform and the macroeconomic measures adopted by the Chinese government have had a positive effect on the economic development of China, we cannot predict the future direction of these economic reforms or the effects these measures may have on our business, financial position or results of operations. In addition, the Chinese economy differs from the economies of most countries belonging to the Organization for Economic Co-operation and Development (the "OECD"). These differences include:

- economic structure;
- level of government involvement in the economy;
- level of development;
- level of capital reinvestment;
- control of foreign exchange;
- inflation rates;
- methods of allocating resources; and
- balance of payments position.

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As a result of these differences, our business may not develop in the same way or at the same rate as might be expected if the Chinese economy were similar to those of the OECD member countries.

***Our business benefits from certain PRC government incentives. Expiration of, or changes to, these incentives and PRC tax laws could have a material adverse effect on our operating results.***

Under the *PRC Enterprise Income Tax Law*, the EIT rate payable by domestic and foreign-invested enterprises is 25.0%. Preferential tax treatments are granted to entities that conduct business in encouraged sectors and to entities that are classified as HNTEs, or “Software Enterprises” or “Key Software Enterprises,” whether such entities are foreign invested enterprises or domestic companies.

A number of our subsidiaries enjoy preferential tax rates by being recognized as an HNTE and/or a “Key Software Enterprise.” For example, Boguan, NetEase Hangzhou and certain other PRC subsidiaries were qualified as HNTEs and enjoyed a preferential tax rate of 15% for 2017, 2018 and 2019. In addition, Boguan, NetEase Hangzhou and certain other subsidiaries were each qualified as a Key Software Enterprise in 2017, 2018 and 2019 and enjoyed tax benefits in 2017, 2018 and 2019 relating to a further reduced preferential tax rate of 10%. See “Financial Information — Components of Results of Operations — Income taxes.”

Although we will attempt to obtain or maintain similar preferential tax statuses for our subsidiaries in the future, we cannot assure you that we will obtain or maintain any particular preferential tax status, and typically the relevant government agencies do not confirm that we have obtained or maintained a particular tax status until late in a given tax year or the following tax year. The qualifications for HNTE or “Software Enterprise” or “Key Software Enterprise” status are subject to an annual assessment by the relevant government authorities in China. Without any preferential tax status, the standard EIT rate of 25.0% will apply. Moreover, if there are further changes to the relevant income tax laws and their implementation, our subsidiaries and VIEs may need to pay additional taxes, which could have a material adverse effect on our results of operations.

***We may be treated as a resident enterprise for PRC tax purposes under the PRC Enterprise Income Tax Law, which may subject us to PRC income tax on our global income and result in dividends payable by us to our foreign investors, and gains on the sales of our ordinary shares or ADSs, becoming subject to taxes under PRC tax laws, which may materially reduce the value of your investment.***

Under the *PRC Enterprise Income Tax Law*, enterprises established outside of the PRC whose “de facto management bodies” are located in the PRC are considered “resident enterprises,” and will generally be subject to the uniform 25.0% EIT rate for their global income. Under the implementation rules of the *PRC Enterprise Income Tax Law*, “de facto management body” is defined as the body that has material and overall management control over the business, personnel, accounts and properties of the enterprise. In April 2009, the PRC tax authority promulgated a circular to clarify the criteria for determining whether the “de facto management bodies” are located within the PRC for enterprises established outside of the PRC that are controlled by entities established within the PRC. However, the relevant laws and regulations remain unclear regarding treatment of an enterprise established outside the PRC that is not controlled by entities established within the PRC.

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Some of our management is currently located in the PRC. Accordingly, we may be considered a “resident enterprise” and may therefore be subject to the EIT rate of 25.0% of our global income, and as a result, the amount of dividends we can pay to our shareholders could be reduced. We cannot confirm whether we will be considered a “resident enterprise” because the implementation rules are unclear at this time.

Under the implementation rules of the *PRC Enterprise Income Tax Law*, dividends paid to “non-resident enterprises” by “resident enterprises” on profits earned after January 1, 2008 are regarded as income from “sources within the PRC” and therefore subject to a 10.0% withholding income tax, while dividends on profits earned before January 1, 2008 are not subject to the withholding income tax. Similarly, gains realized on the transfer of ordinary shares or ADSs by “non-resident enterprises” are also subject to a 10.0% PRC EIT if such gains are regarded as income derived from sources within the PRC. A lower withholding income tax rate of 5.0% is applied if the “non-resident enterprises” are registered in Hong Kong or other jurisdictions that have a favorable tax treaty arrangement with China. Nevertheless, the *Announcement on Issues Concerning “Beneficial Owners” in Tax Treaties* (the “**SAT Circular 9**”) which was issued on February 3, 2018 by the SAT and effective on April 1, 2018, provides that a “non-resident enterprise” which does not engage in substantive business activities may not be deemed to be a beneficial owner that is entitled to the above-mentioned reduced income tax rate of 5%. It is unclear at this stage whether SAT Circular 9 applies to dividends from our PRC subsidiaries paid to us through our Hong Kong subsidiaries. It is possible that under SAT Circular 9 our Hong Kong subsidiaries would not be considered to be the beneficial owners of any such dividends, and that, if such dividends are subject to withholding, such withholding rate would be 10% rather than the favorable 5% rate generally applicable under the tax treaty between mainland China and Hong Kong.

Because we may be treated as a “resident enterprise,” any dividends paid to the investors which are considered “non-resident enterprises” and individual shareholders who are non-PRC residents may be subject to withholding income tax, and gains realized on the transfer of our ordinary shares or ADSs by such investors may be subject to PRC income tax if such dividends or gains are deemed to be from PRC sources, which may adversely and materially affect the value of the investment in our shares or ADSs. The tax rate for gains and dividends is 10% for “non-resident enterprise” shareholders and 20% for non-PRC individual shareholders, subject to any reduction or exemption set forth in applicable tax treaties. However, it is unclear whether in practice non-PRC shareholders would be able to obtain the benefits of income tax treaties entered into between PRC and their countries or areas.

***We and our shareholders face uncertainties with respect to indirect transfers of equity interests in PRC resident enterprises by a non-PRC company.***

On February 3, 2015, the SAT issued the *Bulletin on Issues of Enterprise Income Tax on Indirect Transfers of Assets by Non-PRC Resident Enterprises* (the “**Bulletin 7**”) which has been further amended by the *Announcement on Issues Concerning the Withholding of Enterprise Income Tax at Source on Non-PRC Resident Enterprises* (the “**Bulletin 37**”) issued by the State Administration of Taxation on October 17, 2017 and amended on June 15, 2018. Pursuant to these bulletins, subject to a safe harbor for purchase and sale of equity securities through a public securities market, an “indirect transfer” of assets, including equity interests in a PRC resident enterprise, by non-PRC resident enterprises may be re-characterized and treated as a direct transfer of PRC taxable assets, if the arrangement does not have a reasonable commercial purpose and was established for the purpose of avoiding payment of PRC enterprise income tax. As a result, gains derived from this indirect transfer may be subject to PRC enterprise income tax.

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***Fluctuation in Renminbi exchange rates could adversely affect the value of our ADSs and any cash dividend declared on them.***

The value of the RMB against the U.S. dollar and other currencies is affected by changes in China's political and economic conditions and by China's foreign exchange policies, among other things. On July 21, 2005, the PRC government changed its policy of pegging the value of the RMB to the U.S. dollar, and the RMB appreciated more than 20% against the U.S. dollar over the following three years. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the RMB and the U.S. dollar remained within a narrow band. Then, the RMB had appreciated more than 10% since June 2010 until it began to depreciate against the U.S. dollar in January 2014. Between January 2014 and December 2019, the RMB depreciated against the U.S. dollar by approximately 15%. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the RMB and the U.S. dollar in the future. In addition, there remains significant international pressure on the PRC government to adopt a substantial liberalization of its currency policy, which could result in more uncertainties in the value of the RMB against the U.S. dollar. Our revenues are primarily denominated in Renminbi, and any significant depreciation of the RMB may affect the value of, and dividends (if any) payable on, our ADSs in U.S. dollar terms.

***Restrictions on currency exchange may limit our ability to utilize our revenues effectively.***

Most of our revenues and operating expenses are denominated in Renminbi. The Renminbi is currently freely convertible under the "current account" which includes dividends, trade and service-related foreign exchange transactions, but not under the "capital account" which includes foreign direct investment and loans.

Under existing PRC foreign exchange regulations, payments of current account items, including payment of dividends, interest payments and trade and service-related foreign exchange transactions, can be made in foreign currencies without prior approval of the SAFE by complying with certain procedural requirements. Our PRC subsidiaries and affiliates may also retain foreign exchange in its current account to satisfy foreign exchange liabilities or to pay dividends.

Since a significant amount of our future revenues will be denominated in Renminbi, the existing and any future restrictions on currency exchange may limit our ability to utilize revenues generated in Renminbi to fund our business activities outside China, if any, or expenditures denominated in foreign currencies. In order to limit the flow of capital out of China, the overall current regulatory environment relating to foreign exchange controls in China suggests that, as a matter of practice, SAFE has been making it increasingly difficult to obtain foreign exchange approvals for offshore dividend payments or capital account settlement.

In addition, foreign exchange transactions under the capital account are subject to limitations and require registration with or approval by the relevant PRC governmental authorities. In particular, any transfer of funds from us to any of our PRC subsidiaries or VIEs, either as a shareholder loan or as an increase in registered capital, is subject to certain statutory limit requirements and registration or approval of the relevant PRC governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. Our ability to use the U.S. dollar proceeds of the sale of our equity or debt to finance our business activities conducted through our PRC subsidiaries or VIEs will depend on our ability to obtain these governmental registrations or approvals. In addition, because of the regulatory issues related to foreign currency loans to, and foreign investment in, domestic PRC enterprises, we may not be able to finance the operations of our PRC subsidiaries or VIEs

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by loans or capital contributions. We cannot assure you that we can obtain these governmental registrations or approvals on a timely basis, if at all. Any future restrictions imposed by SAFE or tightened foreign exchange control by SAFE as a matter of practice may adversely affect our ability to utilize our revenues effectively and pay dividends to our shareholders.

***Failure to comply with PRC regulations regarding the registration requirements for employee equity incentive plans may subject our PRC citizen employees or us to fines and other legal or administrative sanctions.***

On February 15, 2012, SAFE issued the *Notices on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas-Listed Company* (the “**Stock Incentive Plan Rule**”). Under the Stock Incentive Plan Rule, PRC citizens who are granted share options or other employee equity incentive awards by an overseas publicly-listed company are required, through a qualified PRC agent or a PRC subsidiary of such overseas publicly-listed company, to register with SAFE and complete certain other procedures related to the share options or other employee equity incentive plans. If we or such PRC participants fail to comply with these regulations, we or such PRC participants may be subject to fines and other legal or administrative sanctions.

***The Chinese government has strengthened the regulation of investments made by Chinese residents in offshore companies and reinvestments in China made by these offshore companies. Our business may be adversely affected by these restrictions.***

The SAFE has adopted certain regulations that require registration with, and approval from, Chinese government authorities in connection with direct or indirect control of an offshore entity by Chinese residents. The term “control” under SAFE regulation is broadly defined as the operation rights, beneficiary rights or decision-making rights acquired by PRC residents in the offshore special purpose vehicles or PRC companies by means of acquisition, trust, proxy, voting rights, repurchase, convertible bonds or other arrangements. The SAFE regulations retroactively require registration of investments in non-Chinese companies previously made by Chinese residents. In particular, the SAFE regulations require Chinese residents to register with SAFE information about offshore companies in which they have directly or indirectly invested and to make follow-up registrations in connection with certain material transactions involving such offshore companies, such as mergers or division, capital increases and decreases, equity transfer or exchange. A newly established enterprise in China which receives foreign investments is also required to provide detailed information about its controlling shareholders and to certify whether it is directly or indirectly controlled by a domestic entity or resident.

In the event that a Chinese shareholder with a direct or indirect stake in an offshore parent company fails to make the requisite SAFE registration, the Chinese subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the Chinese subsidiaries. Further, failure to comply with the various SAFE registration requirements described above can result in liability under Chinese law for foreign exchange evasion.

These regulations may have a significant impact on our present and future structuring and investment. We have requested our shareholders who to our knowledge are PRC residents to make the necessary applications, registrations and amendments as required under these regulations. We intend to take all necessary measures to ensure that all required applications and registrations will be duly made and all other requirements will be met. We further intend to structure and execute our future offshore acquisitions in a manner consistent with these regulations and any other relevant legislation. However, because it is presently uncertain how

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the SAFE regulations, and any future legislation concerning offshore or cross-border transactions, will be interpreted and implemented by the relevant government authorities in connection with our future offshore financings or acquisitions, we cannot provide any assurances that we will be able to comply with, qualify under, or obtain any approvals required by the regulations or other legislation. Furthermore, we cannot assure you that any PRC shareholders of our company or any PRC company into which we invest will be able to comply with those requirements. The inability of our company or any PRC shareholder to secure required approvals or registrations in connection with our future offshore financings or acquisitions may subject us to legal sanctions, restrict our ability to pay dividends from our Chinese subsidiaries to our offshore holding company, and restrict our overseas or cross-border investment activities or affect our ownership structure.

### **Risks related to our Shares, the ADSs, the Listing and the Global Offering**

*As a company applying for listing under Chapter 19C, we adopt different practices as to certain matters as compared with many other companies listed on the Hong Kong Stock Exchange.*

As we are applying for listing under Chapter 19C of the Hong Kong Listing Rules, we will not be subject to certain provisions of the Hong Kong Listing Rules pursuant to Rule 19C.11, including, among others, rules on notifiable transactions, connected transactions, share option schemes, content of financial statements as well as certain other continuing obligations. In addition, in connection with the Listing, we have applied for a number of waivers and/or exemptions from strict compliance with the Hong Kong Listing Rules, the Companies (WUMP) Ordinance, the Takeovers Codes and the SFO. As a result, we will adopt different practices as to those matters as compared with other companies listed on the Hong Kong Stock Exchange that do not enjoy those exemptions or waivers. For additional information, see “Waivers and Exemptions.”

Furthermore, if 55% or more of the total worldwide trading volume, by dollar value, of our Shares and ADSs over our most recent fiscal year takes place on the Hong Kong Stock Exchange, the Hong Kong Stock Exchange will regard us as having a dual primary listing in Hong Kong and we will no longer enjoy certain exemptions or waivers from strict compliance with the requirements under the Hong Kong Listing Rules, the Companies (WUMP) Ordinance, the Takeovers Codes and the SFO, which could result in our incurring of incremental compliance costs.

*The trading price of ADSs has been and is likely to continue to be, and the trading price of our Shares can be, volatile, which could result in substantial losses to holders of our Shares and/or the ADSs.*

The trading price of ADSs has been and is likely to continue to be volatile and could fluctuate widely in response to a variety of factors, many of which are beyond our control. The trading price of our Shares, likewise, can be volatile for similar or different reasons. For example, the trading prices of ADSs ranged from US\$209.01 to US\$325.00 per ADS in 2019. In addition, the performance and fluctuation of the market prices of other companies with business operations located mainly in China, especially internet and technology companies, that have listed their securities in Hong Kong and/or the United States may affect the overall investor attitude towards Chinese public companies. The securities of some of these companies have experienced and may continue to experience significant volatility, resulting from, among other things, underperformance and deteriorating financial results, negative news or perceptions



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about inadequate corporate governance practices, and fraudulent behaviors of such companies. Consequently, the trading performance of our Shares and/or the ADSs may be adversely and materially affected, regardless of our actual operation performance.

In addition to market and industry factors, the price and trading volume for our Shares and/or the ADSs may be highly volatile for factors specific to our operation, including the followings:

- variations in our results of operations that are not in line with market or research analyst expectations or changes in financial estimates by securities research analysts;
- announcements of studies and reports relating to the quality of our product and service offerings or those of our competitors;
- changes in the economic performance or market valuations of other market players in our industries;
- announcements made by us or our competitors of new features or functionalities or other product and service offerings, investments, acquisitions, strategic relationships, joint ventures or capital commitments;
- press and other reports, whether or not true, about our business, including negative reports published by short sellers, regardless of their veracity or materiality to us;
- litigation and regulatory allegations or proceedings that involve us and our directors;
- additions to or departures of our management;
- political or market instability or disruptions, and actual or perceived social unrest in the markets where we operate;
- fluctuations of exchange rates among the Renminbi, the Hong Kong dollar and the U.S. dollar;
- sales or perceived potential sales or other dispositions of existing or additional Shares and/or ADSs or other equity or equity-linked securities;
- any actual or alleged illegal acts of our senior management or other key employees;
- any share repurchase program; and
- regulatory developments affecting us or our industry, customers, licensors and other suppliers.

In particular, our revenues and results of operations have varied significantly in the past and may continue to fluctuate in the future, which may adversely impact the trading price of our ADSs and Shares. Historically, usage of our online games has generally increased around the Chinese holidays, particularly the winter and summer school holidays. Our Youdao platform tends to have larger student enrollments in the second and fourth quarters when it offers more courses including, for example, test preparation courses for school exams in the spring and fall semesters and China's national college entrance exams, national postgraduate entrance exams and college English tests, compared to the rest of the year. Revenues from innovative

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businesses and others, including advertising services, have followed the same general seasonal trend throughout each year, with the first quarter of the year being the weakest quarter due to the Chinese New Year holiday and the traditional close of customers' annual budgets, and the fourth quarter as the strongest. Our e-commerce business revenues are relatively lower during the Chinese New Year holiday season in the first quarter of each year, while sales in the fourth quarter are higher than each of the preceding three quarters due to a variety of promotional activities conducted by retail and e-commerce businesses in China. Accordingly, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance. It is possible that future fluctuations may cause our results of operations to be below the expectations of market analysts and investors. This could cause the trading price of our ADSs or any other securities of ours which may become publicly traded to decline.

Furthermore, the stock market in general experiences price and volume fluctuations that are often unrelated or disproportionate to the operating performance of companies like us, such as the large decline in share prices in the United States in early 2020. These market and industry fluctuations may significantly affect the trading price of our Shares and/or ADSs. In the past, following periods of instability in the market price of a company's securities, shareholders have often instituted securities class action suits against that company.

Furthermore, our directors and employees may face additional exposure to claims and lawsuits as a result of their position in other public companies. For example, one of our directors, Mr. Denny Lee, was named as a defendant in ongoing securities class action lawsuits filed in the U.S. against NIO Inc., a company listed on the New York Stock Exchange (ticker: NIO), together with certain current, former directors and/or senior officers of NIO Inc., regarding an alleged misrepresentation in the registration statement and the prospectus filed in connection with the company's initial public offering. Mr. Lee's appointment as the independent director of NIO Inc. was effective immediately after the SEC's declaration of effectiveness of NIO Inc.'s registration statement on Form F-1, of which its prospectus is a part. Mr. Lee has also been named as a defendant in a putative class action lawsuit against another U.S.-listed company. All of these cases concern Mr. Lee in his capacity as an independent director of such U.S.-listed companies. The existence of litigation, claims, investigations and proceedings against our directors and employees, even if they do not involve our company, may harm our reputation and adversely affect the trading price of our Shares and/or ADSs.

***Substantial future sales or perceived potential sales of our Shares, ADSs, or other equity or equity-linked securities in the public market could cause the price of our Shares and/or ADSs to decline.***

Sales of our Shares, ADSs, or other equity or equity-linked securities in the public market, or the perception that these sales could occur, could cause the market price of our Shares and/or ADSs to decline significantly. All of our Shares represented by ADSs were freely transferable by persons other than our affiliates without restriction or additional registration under the U.S. Securities Act. The Shares held by our affiliates are also available for sale, subject to volume and other restrictions as applicable under Rule 144 of the U.S. Securities Act, under trading plans adopted pursuant to Rule 10b5-1 or otherwise.

Divestiture in the future of our Shares and/or ADSs by shareholders, the announcement of any plan to divest our Shares and/or ADS, or hedging activity by third-party financial institutions in connection with similar derivative or other financing arrangements entered into by shareholders, could cause the price of our Shares and/or ADSs to decline.

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Furthermore, although all of our directors and executive officers have agreed to a lock-up of their Shares, any major disposal of our Shares and/or ADSs by any of them upon expiration of the relevant lock-up periods (or the perception that these disposals may occur upon the expiration of the lock-up period) may cause the prevailing market price of our Shares and/or ADSs to fall which could negatively impact our ability to raise equity capital in the future.

***The different characteristics of the capital markets in Hong Kong and the U.S. may negatively affect the trading prices of our Shares and/or ADSs.***

Upon the Listing, we will be subject to Hong Kong and SEC requirements and Nasdaq rules concurrently. The Hong Kong Stock Exchange and Nasdaq have different trading hours, trading characteristics (including trading volume and liquidity), trading and listing rules, and investor bases (including different levels of retail and institutional participation). As a result of these differences, the trading prices of our Shares and our ADSs may not be the same, even allowing for currency differences. Fluctuations in the price of our ADSs due to circumstances peculiar to the U.S. capital markets could materially and adversely affect the price of the Shares, or vice versa. Certain events having significant negative impact specifically on the U.S. capital markets may result in a decline in the trading price of our Shares notwithstanding that such event may not impact the trading prices of securities listed in Hong Kong generally or to the same extent, or vice versa. Because of the different characteristics of the U.S. and Hong Kong capital markets, the historical market prices of our ADSs may not be indicative of the trading performance of the Shares after the Global Offering.

***Exchange between our Shares and our ADSs may adversely affect the liquidity and/or trading price of each other.***

Our ADSs are currently traded on Nasdaq. Subject to compliance with U.S. securities law and the terms of the Deposit Agreement, holders of our Shares may deposit Shares with the depository in exchange for the issuance of our ADSs. Any holder of ADSs may also withdraw the underlying Shares represented by the ADSs pursuant to the terms of the Deposit Agreement for trading on the Hong Kong Stock Exchange. In the event that a substantial number of Shares are deposited with the depository in exchange for ADSs or vice versa, the liquidity and trading price of our Shares on the Hong Kong Stock Exchange and our ADSs on Nasdaq may be adversely affected.

***The time required for the exchange between Shares and ADSs might be longer than expected and investors might not be able to settle or effect any sale of their securities during this period, and the exchange of Shares into ADSs involves costs.***

There is no direct trading or settlement between Nasdaq and the Hong Kong Stock Exchange on which our ADSs and the Shares are respectively traded. In addition, the time differences between Hong Kong and New York and unforeseen market circumstances or other factors may delay the deposit of Shares in exchange for ADSs or the withdrawal of Shares underlying the ADSs. Investors will be prevented from settling or effecting the sale of their securities during such periods of delay. In addition, there is no assurance that any exchange of Shares into ADSs (and vice versa) will be completed in accordance with the timelines investors may anticipate.

Furthermore, the depository for the ADSs is entitled to charge holders fees for various services including for the issuance of ADSs upon deposit of Shares, cancelation of ADSs, distributions of cash dividends or other cash distributions, distributions of ADSs pursuant to share dividends or other free share distributions, distributions of securities other than ADSs and annual service fees. As a result, shareholders who exchange Shares into ADSs, and vice versa, may not achieve the level of economic return the shareholders may anticipate.

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*As a company incorporated in the Cayman Islands, we are permitted to adopt certain home country practices in relation to corporate governance matters that differ significantly from Nasdaq rules.*

As a Cayman Islands exempted company listed on Nasdaq, we are subject to Nasdaq rules. However, Nasdaq rules permit a foreign private issuer like us to follow the corporate governance practices of its home country. Certain corporate governance practices in the Cayman Islands, which is our home country, may differ significantly from Nasdaq rules applicable to U.S. domestic issuers. For instance, we are not required to:

- have a majority of the board be independent (although all of the members of the audit committee must be independent under the U.S. Exchange Act);
- have a compensation committee or a nominating or corporate governance committee consisting entirely of independent directors;
- have regularly scheduled executive sessions for non-management directors; or
- have executive sessions of solely independent directors each year.

We have relied on and intend to continue to rely on some of these exemptions. Specifically, our board of directors adopted our 2009 RSU Plan and 2019 RSU Plan without seeking shareholder approval which is generally required under Rule 5635(c) of the Nasdaq Marketplace Rules. There is no specific requirement under Cayman Islands law for shareholder approval to be obtained with respect to the establishment or amendment of equity compensation arrangements. In situations where we choose to follow home country practices, our shareholders may be afforded less protection than they otherwise would under Nasdaq rules applicable to U.S. domestic issuers.

*We are a foreign private issuer within the meaning of the rules under the U.S. Exchange Act, and as such we are exempt from certain provisions applicable to U.S. domestic public companies.*

Because we qualify as a foreign private issuer under the U.S. Exchange Act, we are exempt from certain provisions of the securities rules and regulations in the United States that are applicable to U.S. domestic issuers, including:

- the rules under the U.S. Exchange Act requiring the filing with the SEC of quarterly reports on Form 10-Q or current reports on Form 8-K;
- the sections of the U.S. Exchange Act regulating the solicitation of proxies, consents, or authorizations in respect of a security registered under the U.S. Exchange Act;
- the sections of the U.S. Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and liability for insiders who profit from trades made in a short period of time; and
- the selective disclosure rules by issuers of material nonpublic information under Regulation FD.

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We are required to file an annual report on Form 20-F within four months of the end of each fiscal year. In addition, we intend to continue to publish our results on a quarterly basis as press releases, distributed pursuant to Nasdaq rules. Press releases relating to financial results and material events will also be furnished to the SEC on Form 6-K. However, the information we are required to file with or furnish to the SEC will be less extensive and less timely compared to that required to be filed with the SEC by U.S. domestic issuers. As a result, holders of our ADSs may be afforded less protection or information than they would under the U.S. Exchange Act rules applicable to U.S. domestic companies.

***The voting rights of holders of ADSs are limited by the terms of the Deposit Agreement.***

Holders of ADSs may exercise their voting rights with respect to the underlying Shares represented by their ADSs only in accordance with the provisions of the Deposit Agreement. Upon receipt of voting instructions from them in the manner set forth in the Deposit Agreement, the depositary will endeavor, in so far as practicable, to vote the underlying Shares represented by their ADSs in accordance with these instructions. However, the depositary and its agents may not be able to send voting instructions to holders of ADSs or carry out their voting instructions in a timely manner. We will make all reasonable efforts to cause the depositary to extend voting rights to holders of ADSs in a timely manner, but they may not receive the voting materials in time to ensure that they can instruct the depositary to vote the underlying Shares represented by their ADSs. Furthermore, the depositary and its agents will not be responsible for any failure to carry out any instructions to vote, for the manner in which any vote is cast or for the effect of any vote. As a result, holders of ADSs may not be able to exercise their rights to vote and they may lack recourse if the underlying Shares represented by their ADSs are not voted as they requested.

***Except in limited circumstances, the depositary will give us a discretionary proxy to vote our Shares underlying the ADSs if holders of these ADSs do not give voting instructions to the depositary, which could adversely affect the interests of holders of Shares and/or the ADSs.***

Under the Deposit Agreement, the depositary will give us a discretionary proxy to vote the Shares underlying the ADSs at shareholders' meetings if holders of these ADSs do not give voting instructions to the depositary, unless:

- we have instructed the depositary that we do not wish a discretionary proxy to be given;
- we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting;
- a matter to be voted on at the meeting would have a material adverse impact on shareholders; or
- voting at the meeting is made on a show of hands.

The effect of this discretionary proxy is that, if holders of ADSs fail to give voting instructions to the depositary, they cannot prevent our Shares underlying their ADSs from being voted, except under the circumstances described above. This may make it more difficult for shareholders to influence our management. Holders of our Shares are not subject to this discretionary proxy.

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***Holders of ADSs may be subject to limitations on transfer of their ADSs.***

ADSs are transferable on the books of the depository. However, the depository may close its transfer books at any time or from time to time when it deems expedient in connection with the performance of its duties. In addition, the depository may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depository are closed, or at any time if we or the depository deems it advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the Deposit Agreement, or for any other reason.

***Holders of ADSs may not receive distributions on our Shares if the depository decides it is impractical or unlawful to make such distributions.***

The depository has agreed to pay cash to holders of ADSs to the extent that we decide to distribute cash dividends or other cash distributions on our Shares or other deposited securities. In the second quarter of 2019, our board of directors determined that quarterly dividends will be set at an amount equivalent to approximately 20%-30% of our anticipated net income after tax in each fiscal quarter. Our board of directors also approved an additional special dividend equivalent to US\$3.45 per ADS in the third quarter of 2019.

To the extent that there is a distribution in shares, rights or other securities and properties, the depository has agreed to distribute to holders of ADSs the shares, rights or other distributions it or the custodian receives on our Shares or other deposited securities after deducting its fees and expenses. ADS holders will receive these distributions in proportion to the number of Shares their ADSs represent. However, the depository may, at its discretion, decide that it is impractical to make a distribution available to holders of ADSs. For example, it would be unlawful to make a distribution to a holder of ADSs if it consists of securities that require registration under the U.S. Securities Act but that are not properly registered or distributed pursuant to an applicable exemption from registration. We have no obligation to take any other action to permit the distribution of shares, rights or anything else to holders of ADSs. This means that holders of ADSs may not receive the distributions we make on our Shares if it is impractical for us to make them available. These restrictions may materially reduce the value of the ADSs.

***If we fail to maintain an effective system of internal control over financial reporting, we may lose investor confidence in the reliability of our financial statements which in turn could negatively impact the trading price of our Shares and/or the ADSs or otherwise harm our reputation.***

The SEC, as required under Section 404 of the Sarbanes-Oxley Act of 2002, has adopted rules requiring public companies to include a report of management on the effectiveness of such companies' internal control over financial reporting in their respective annual reports. In addition, an independent registered public accounting firm for a public company may be required to issue an attestation report on the effectiveness of such company's internal control over financial reporting.

Our management conducted an evaluation of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting was effective as of December 31, 2017, 2018 and 2019. Our independent registered public accounting firm has also, in its audit report, concluded that our internal control over financial reporting was effective in all material aspects as of December 31, 2017, 2018 and 2019. However, if we fail to maintain effective internal control over financial reporting in the future, our management and our independent registered public accounting firm may not be able to

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conclude that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act of 2002. Moreover, effective internal control over financial reporting is necessary for us to produce reliable financial reports. As a result, any failure to maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could negatively impact the trading price of our Shares and/or ADSs or otherwise harm our reputation. Furthermore, we may need to incur additional costs and use additional management and other resources to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and other requirements going forward.

***Our auditor of the consolidated financial statements included in our annual report on Form 20-F filed with the SEC, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and consequently you are deprived of the benefits of such inspection.***

Our auditor of the consolidated financial statements included in our annual report on Form 20-F filed with the SEC, the independent registered public accounting firm, as an auditor of companies that are registered with the SEC and traded publicly in the United States and a firm registered with the PCAOB, is subject to the laws in the United States pursuant to which the PCAOB conducts regular inspections to assess its compliance with the applicable professional standards. It is located in, and organized under the laws of, the PRC, which is a jurisdiction where the PCAOB has been unable to conduct inspections without the approval of the Chinese authorities.

On May 24, 2013, the PCAOB announced that it had entered into a Memorandum of Understanding on Enforcement Cooperation (the “MOU”) with the CSRC and the MOF. The MOU establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the U.S. and the PRC. The PCAOB continues to engage in discussions with the CSRC and the MOF to permit joint inspections in China of audit firms that are registered with the PCAOB and audit China-based companies that trade on U.S. exchanges. However, the implementation procedures of the MOU remain uncertain.

On December 7, 2018, the SEC and the PCAOB issued a joint statement highlighting continued challenges faced by the U.S. regulators in their oversight of financial statement audits of U.S.-listed companies with significant operations in China. On April 21, 2020, the SEC and the PCAOB issued another joint statement reiterating the greater risk that disclosures will be insufficient in many emerging markets, including China, compared to those made by U.S. domestic companies. In discussing the specific issues related to the greater risk, the statement again highlights the PCAOB’s inability to inspect audit work paper and practices of accounting firms in China, with respect to their audit work of U.S. reporting companies. However, it remains unclear what further actions, if any, the SEC and PCAOB will take to address the problem.

This lack of PCAOB inspections in China prevents the PCAOB from fully evaluating audits and quality control procedures of our independent registered public accounting firm. As a result, we and our investors are deprived of the benefits of such PCAOB inspections. The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our independent registered public accounting firm’s audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections, which could cause investors and potential investors in us to lose confidence in our audit procedures and reported financial information and the quality of our financial statements.

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As part of a continued regulatory focus in the United States on access to audit and other information currently protected by national law, in particular China's, in June 2019, a bipartisan group of lawmakers introduced bills in both houses of Congress that would require the SEC to maintain a list of issuers for which the PCAOB is not able to inspect or investigate an auditor report issued by a foreign public accounting firm. The Ensuring Quality Information and Transparency for Abroad-Based Listings on our Exchanges (EQUITABLE) Act prescribes increased disclosure requirements for such issuers and, beginning in 2025, the delisting from national securities exchanges such as Nasdaq of issuers included for three consecutive years on the SEC's list. On May 20, 2020, the U.S. Senate passed S. 945, the Holding Foreign Companies Accountable Act (the "**Kennedy Bill**"). If passed by the U.S. House of Representatives and signed by the U.S. President, the Kennedy Bill would amend the Sarbanes-Oxley Act of 2002 to direct the SEC to prohibit securities of any registrant from being listed on any of the U.S. securities exchanges or traded "over-the-counter" if the auditor of the registrant's financial statements is not subject to PCAOB inspection for three consecutive years. Enactment of any of such legislations or other efforts to increase U.S. regulatory access to audit information could cause investor uncertainty for affected issuers, including us, the market price of our ADSs could be adversely affected, and we could be delisted if we are unable to cure the situation to meet the PCAOB inspection requirement in time. It is unclear if and when any of such proposed legislations will be enacted. Furthermore, there have been recent media reports on deliberations within the U.S. government regarding potentially limiting or restricting China-based companies from accessing U.S. capital markets. If any such deliberations were to materialize, the resulting legislation may have material and adverse impact on the stock performance of China-based issuers listed in the United States.

*We may be adversely affected by the outcome of the administrative proceedings brought by the SEC against the Big Four PRC-based Accounting Firms.*

In December 2012, the SEC brought administrative proceedings against the Chinese affiliates of the "big four" accounting firms (the "**Big Four PRC-based Accounting Firms**"), including our independent registered public accounting firm, alleging that these accounting firms had violated U.S. securities laws and the SEC's rules and regulations thereunder by failing to provide to the SEC the firms' audit papers and other documents related to certain PRC-based companies that are publicly traded in the United States.

In January 2014, the administrative law judge presiding over the matter reached an initial decision that the Big Four PRC-based Accounting Firms had each violated the SEC's rules of practice by failing to produce the audit work papers and related documents directly to the SEC. The initial decision further determined that each of the firms should be censured and barred from practicing before the SEC for a period of six months.

In February 2015, the Big Four PRC-based Accounting Firms each agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC and to audit U.S.-listed companies. The settlement required the Big Four PRC-based Accounting Firms to follow detailed procedures and to seek to provide the SEC with access to these firms' audit documents via the CSRC. Under the terms of the settlement, the underlying proceeding against the Big Four PRC-based Accounting Firms was deemed dismissed with prejudice four years after entry of the settlement. The four-year anniversary occurred on February 6, 2019. While we cannot predict if the SEC will further challenge the Big Four PRC-based Accounting Firms' compliance with U.S. law in connection with U.S. regulatory requests for audit work papers or if the results of such a challenge would result in the SEC imposing penalties such as suspensions, if the Big Four PRC-based Accounting Firms are subject to additional remedial measures, we may not be able to continue to meet our



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reporting obligations under the Exchange Act, which may ultimately result in our deregistration by the SEC and delisting from the Nasdaq, in which case our market capitalization may decline sharply and the value of your investment in our Shares and/or ADSs may be materially and adversely affected.

***Holders of our Shares and ADSs may have difficulty effecting service of process and enforcing judgments obtained against us, our directors and our management, the ability of U.S. authorities to bring actions in the PRC may also be limited, and our Articles of Association include certain provisions that may be different from common practices in Hong Kong.***

We are a Cayman Islands company, and the major portion of our assets are located outside the United States and Hong Kong. A substantial portion of our current operations are conducted in the PRC. In addition, some of our directors and executive officers are nationals and residents of countries or areas other than the United States and Hong Kong. A substantial portion of the assets of these persons are located outside the United States and Hong Kong. As a result, it may be difficult or impossible for holders of our Shares and ADSs to effect service of process within the United States or Hong Kong upon these persons, or to bring an action against us or against these individuals in the United States or Hong Kong in the event that they believe that their rights have been infringed under the U.S. federal securities laws, Hong Kong laws or otherwise. Even if shareholders are successful in bringing an action of this kind, the laws of the Cayman Islands and China may render them unable to enforce a judgment against our assets or the assets of our directors and officers. There is uncertainty as to whether the courts of the Cayman Islands or the PRC would recognize or enforce judgments. Furthermore, class action lawsuits, which are available in the United States for investors to seek remedies, are generally uncommon in the Cayman Islands and the PRC.

The SEC, the U.S. Department of Justice and other U.S. authorities may also have difficulties in bringing and enforcing actions against us or our directors or executive officers in the PRC. The SEC has stated that there are significant legal and other obstacles to obtaining information needed for investigations or litigation in China. China has recently adopted a revised securities law which provides, among other things, that without governmental approval in China, no entity or individual in China may provide documents and information relating to securities business activities to overseas regulators which could present significant legal and other obstacles to obtaining information needed for investigations and litigation conducted outside of China.

Furthermore, our Articles of Association are specific to us and include certain provisions that may be different from common practices in Hong Kong, such as the absence of requirements that the appointment, removal and remuneration of auditors must be approved by a majority of our shareholders. See “Information about This Document and the Global Offering” and “Waivers and Exemptions.”

As a result of the foregoing, our public shareholders may have more difficulty in protecting their interests through actions against us, our management, our directors or our major shareholders than they would as public shareholders of a company incorporated in the United States or Hong Kong.

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## RISK FACTORS

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***It may be difficult for overseas regulators to conduct investigations or collect evidence within China.***

Shareholder claims or regulatory investigation that are common in the United States generally are difficult to pursue as a matter of law or practicality in China. For example, in China, there are significant legal and other obstacles to providing information needed for regulatory investigations or litigation initiated outside China. Although the authorities in China may establish a regulatory cooperation mechanism with the securities regulatory authorities of another country or region to implement cross-border supervision and administration, such cooperation with the securities regulatory authorities in the United States may not be efficient in the absence of mutual and practical cooperation mechanisms. Furthermore, according to Article 177 of the PRC Securities Law, or Article 177, which became effective in March 2020, no overseas securities regulator is allowed to directly conduct investigation or evidence collection activities within the territory of the PRC. While detailed interpretations of or implementation rules under Article 177 have yet to be promulgated, the inability for an overseas securities regulator to directly conduct investigation or evidence collection activities within China may further increase difficulties you may face in protecting your interests.

***If we are classified as a PFIC for United States federal income tax purposes, such classification could result in adverse U.S. federal income tax consequences to U.S. investors.***

We could be classified as a PFIC by the U.S. Internal Revenue Service for U.S. federal income tax purposes. Such characterization could result in adverse U.S. federal income tax consequences to you if you are a U.S. investor. For example, U.S. investors who owned our Shares or ADSs during any taxable year in which we were a PFIC generally are subject to increased U.S. tax liabilities and reporting requirements for that taxable year and all succeeding years, regardless of whether we actually continue to be a PFIC, although a shareholder election to terminate such deemed PFIC status may be available in certain circumstances.

The determination of whether or not we are a PFIC is made on an annual basis and depends on the composition of our income and assets, including goodwill, from time to time. Specifically, we will be classified as a PFIC for U.S. tax purposes for a taxable year if either (a) 75% or more of our gross income for such taxable year is passive income, or (b) 50% or more of the average percentage of our assets during such taxable year either produce passive income or are held for the production of passive income. For such purposes, if we directly or indirectly own 25% or more of the shares of another corporation, we generally will be treated as if we (a) held directly a proportionate share of the other corporation's assets, and (b) received directly a proportionate share of the other corporation's income.

We do not believe that we were a PFIC for the taxable years 2017, 2018 and 2019. Based on certain estimates and assumptions, we do not expect to be a PFIC for taxable year 2020. The PFIC determination is highly fact intensive and made at the end of each taxable year. We hold and will continue to hold a substantial amount of cash and cash equivalents, and our PFIC status may depend in large part in the market price of our ADSs and Shares which is likely to fluctuate. For these reasons, there can be no assurance that we will not be a PFIC in taxable year 2020 or that we will not be a PFIC in any future taxable year or that the U.S. Internal Revenue Service will not challenge our determination concerning our PFIC status.

If we are or become a PFIC, and, if so, if one or more of our subsidiaries or VIEs are treated as PFICs, U.S. investors would be subject to adverse U.S. federal income tax consequences, such as increased tax liability on capital gains and actual or deemed dividends, interest charges on certain taxes treated as deferred, and additional reporting requirements under U.S. federal

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income tax laws and regulations. Whether U.S. investors make (or are eligible to make) a timely mark-to-market election may affect the U.S. federal income tax consequences to U.S. investors with respect to the acquisition, ownership and disposition of our Shares and ADSs and any distributions such U.S. investors may receive. We do not expect to provide the information regarding our income that would be necessary in order for a U.S. investor to make a qualified electing fund (the “QEF”) election if we are classified as a PFIC. Investors should consult their own tax advisors regarding all aspects of the application of the PFIC rules to our Shares and ADSs.

If we are a PFIC in any year with respect to a U.S. investor, the U.S. investor will be required to file an annual information return on IRS Form 8621 (or other then applicable IRS Form or statement) regarding distributions received on our Shares or ADSs and any gain realized on the disposition of our Shares or ADSs, and certain U.S. investors will be required to file an annual information return (also on IRS Form 8621 or other then applicable IRS Form or statement) relating to their ownership of our Shares or ADSs. U.S. investors should consult their tax advisors regarding the potential application of the PFIC regime and related reporting requirements.

***An active trading market for our Shares on the Hong Kong Stock Exchange might not develop or be sustained and trading prices of our Shares might fluctuate significantly.***

Following the completion of the Global Offering, we cannot assure you that an active trading market for our Shares on the Hong Kong Stock Exchange will develop or be sustained. The trading price or liquidity for our ADSs on Nasdaq might not be indicative of those of our Shares on the Hong Kong Stock Exchange following the completion of the Global Offering. If an active trading market of our Shares on the Hong Kong Stock Exchange does not develop or is not sustained after the Global Offering, the market price and liquidity of our Shares could be materially and adversely affected.

In 2014, the Hong Kong, Shanghai and Shenzhen Stock Exchanges collaborated to create an inter-exchange trading mechanism called Stock Connect that allows international and mainland Chinese investors to trade eligible equity securities listed in each other’s markets through the trading and clearing facilities of their home exchange. Stock Connect currently covers over 2,000 equity securities trading in the Hong Kong, Shanghai and Shenzhen markets. Stock Connect allows mainland Chinese investors to trade directly in eligible equity securities listed on the Hong Kong Stock Exchange, known as Southbound Trading. Without Stock Connect, mainland Chinese investors would not otherwise have a direct and established means of engaging in Southbound Trading. However, it is unclear whether and when the Shares of our Company with a secondary listing in Hong Kong upon the Listing, will be eligible to be traded through Stock Connect, if at all. The ineligibility or any delay of our Shares for trading through Stock Connect will affect mainland Chinese investors’ ability to trade our Shares and therefore may limit the liquidity of the trading of our Shares on the Hong Kong Stock Exchange.

***Since there will be a gap of several days between pricing and trading of our Shares, the price of our ADSs traded on Nasdaq may fall during this period and could result in a fall in the price of our Shares to be traded on the Hong Kong Stock Exchange.***

The pricing of the Offer Shares will be determined on the Price Determination Date. However, our Shares will not commence trading on the Hong Kong Stock Exchange until they are delivered, which is expected to be about four Hong Kong business days after the Price Determination Date. As a result, investors may not be able to sell or otherwise deal in our Shares during that period. Accordingly, holders of our Shares are subject to the risk that the trading price of our Shares could fall when trading commences as a result of adverse market

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conditions or other adverse developments that could occur between the Price Determination Date and the time trading begins. In particular, as our ADSs will continue to be traded on Nasdaq and their price can be volatile, any fall in the price of our ADSs may result in a fall in the price of our Shares to be traded on the Hong Kong Stock Exchange.

***There is uncertainty as to whether Hong Kong stamp duty will apply to deposits of our ordinary shares into or withdrawal of our ordinary shares from the ADS facility or trading of our ADSs following our initial public offering in Hong Kong and listing of our Shares on the Hong Kong Stock Exchange.***

In connection with our initial public offering of Shares in Hong Kong, we will establish a branch register of members in Hong Kong (the “**Hong Kong share register**”). Our Shares that are traded on the Hong Kong Stock Exchange, including those to be issued in the Global Offering and those represented by ADSs, will be registered on the Hong Kong share register, and the trading of these Shares on the Hong Kong Stock Exchange will be subject to the Hong Kong stamp duty. To facilitate conversion between ADSs and Shares and their respective trading on Nasdaq and the Hong Kong Stock Exchange, we also intend to move a portion of our issued Shares, including all of the ordinary shares deposited in our ADS program, from our Cayman share register to our Hong Kong share register.

Under the Hong Kong Stamp Duty Ordinance, any person who effects any sale or purchase of Hong Kong stock, defined as stock the transfer of which is required to be registered in Hong Kong, is required to pay Hong Kong stamp duty. The stamp duty is currently set at a total rate of 0.2% of the greater of the consideration for, or the value of, shares transferred, with 0.1% payable by each of the buyer and the seller. See “Information about This Document and the Global Offering — Dealings and Settlement of Ordinary Shares in Hong Kong.”

To the best of our knowledge, Hong Kong stamp duty has not been levied in practice on the trading of ADSs representing shares of companies that are listed in both the United States and Hong Kong and that have maintained all or a portion of their ordinary shares, including ordinary shares underlying ADSs, in their Hong Kong share registers, or on the deposit of shares in or withdrawal of shares from ADS facilities of that kind. However, it is unclear whether, as a matter of Hong Kong law, the trading of ADSs representing shares of these dual-listed companies or the deposit of shares in or withdrawal of shares from those ADS facilities constitutes a sale or purchase of the underlying Hong Kong-registered ordinary shares that is subject to Hong Kong stamp duty. We advise investors to consult their own tax advisors on this matter. If Hong Kong stamp duty is determined by the competent authority to apply to the trading of those ADSs or deposits of shares in or withdrawal of shares from those ADS facilities, the trading price and the value of your investment in our Shares and/or the ADSs may be affected.

***Purchasers of our Shares in the Global Offering will experience immediate dilution and may experience further dilution if we issue additional Shares in the future.***

The Public Offer Price of our Shares is higher than the net tangible assets per Share of the Shares issued to our existing shareholders immediately prior to the Global Offering. Therefore, purchasers of our Shares in the Global Offering will experience an immediate dilution in terms of the pro forma net tangible asset value. In addition, we may consider offering and issuing additional Shares, ADSs or equity-related securities in the future to raise additional funds, finance acquisitions or for other purposes. Purchasers of our Shares may experience further dilution in terms of the net tangible asset value per Share, ADS or equity-related security if we issue additional Shares in the future at a price that is lower than the net tangible asset value per Share.

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## **INFORMATION ABOUT THIS DOCUMENT AND THE GLOBAL OFFERING**

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### **DIRECTORS' RESPONSIBILITY STATEMENT**

This document, for which our directors collectively and individually accept full responsibility, includes particulars given in compliance with the Companies (WUMP) Ordinance, the Securities and Futures (Stock Market Listing) Rules (Chapter 571V of the Laws of Hong Kong) and the Hong Kong Listing Rules for the purpose of giving information with regard to us. Our directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief, the information contained in this document is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this document misleading.

### **THE HONG KONG PUBLIC OFFERING AND THIS DOCUMENT**

This document is published solely in connection with the Hong Kong Public Offering, which forms part of the Global Offering. For applicants under the Hong Kong Public Offering, this document sets out the terms and conditions of the Hong Kong Public Offering.

The Hong Kong Offer Shares are offered solely on the basis of the information contained and representations made in this document and on the terms and subject to the conditions set out herein and therein. No person is authorized to give any information in connection with the Global Offering or to make any representation not contained in this document, and any information or representation not contained herein must not be relied upon as having been authorized by our Company, the Joint Sponsors, the Joint Global Coordinators, the Joint Bookrunners and any of the Underwriters, any of their respective directors, agents, employees or advisers or any other party involved in the Global Offering.

The Listing is sponsored by the Joint Sponsors and the Global Offering is managed by the Joint Global Coordinators. The Hong Kong Public Offering is fully underwritten by the Hong Kong Underwriters under the terms and conditions of the Hong Kong Underwriting Agreement and is subject to us and the Joint Global Coordinators (for themselves and on behalf of the Underwriters) agreeing on the pricing of the Hong Kong Offer Shares. The International Offering is expected to be fully underwritten by the International Underwriters subject to the terms and conditions of the International Underwriting Agreement, which is expected to be entered into on or around the Price Determination Date.

Neither the delivery of this document nor any offering, sale or delivery made in connection with the Shares should, under any circumstances, constitute a representation that there has been no change or development reasonably likely to involve a change in our affairs since the date of this document or imply that the information contained in this document is correct as of any date subsequent to the date of this document.

### **PROCEDURES FOR APPLICATION FOR THE HONG KONG OFFER SHARES**

The procedures for applying for the Hong Kong Offer Shares are set out in "How to Apply for Hong Kong Offer Shares."

### **STRUCTURE AND CONDITIONS OF THE GLOBAL OFFERING**

Details of the structure of the Global Offering, including its conditions, are set out in "Structure of the Global Offering."

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## **INFORMATION ABOUT THIS DOCUMENT AND THE GLOBAL OFFERING**

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### **OVER-ALLOTMENT OPTION AND STABILIZATION**

Details of the arrangements relating to the Over-allotment Option and stabilization are set out in “Structure of the Global Offering.”

### **RESTRICTIONS ON OFFERS AND SALES OF SHARES**

Each person acquiring the Hong Kong Offer Shares under the Hong Kong Public Offering will be required to, or be deemed by his/her acquisition of Offer Shares to, confirm that he/she is aware of the restrictions on offers of the Offer Shares described in this document.

No action has been taken to permit a public offering of the Offer Shares (except for a registration of Offer Shares on a registration statement on Form F-3 filed with the SEC) or the general distribution of this document in any jurisdiction other than in Hong Kong or the United States. Accordingly, this document may not be used for the purposes of, and does not constitute, an offer or invitation in any jurisdiction or in any circumstances in which such an offer or invitation is not authorized or to any person to whom it is unlawful to make such an offer or invitation. The distribution of this document and the offering of the Offer Shares in other jurisdictions are subject to restrictions and may not be made except as permitted under the applicable securities laws of such jurisdictions and pursuant to registration with or authorization by the relevant securities regulatory authorities or an exemption therefrom.

### **COMMENCEMENT OF DEALINGS IN OUR SHARES**

We expect that dealings in our Shares on the Hong Kong Stock Exchange will commence on Thursday, June 11, 2020. The Shares will be traded in board lots of 100 Shares each. The stock code of our Shares will be 9999.

### **SHARES WILL BE ELIGIBLE FOR ADMISSION INTO CCASS**

If the Hong Kong Stock Exchange grants the listing of, and permission to deal in, the Shares and we comply with the stock admission requirements of HKSCC, our Shares will be accepted as eligible securities by HKSCC for deposit, clearance and settlement in CCASS with effect from the Listing Date or any other date as determined by HKSCC. Settlement of transactions between participants of the Hong Kong Stock Exchange is required to take place in CCASS on the second business day after any trading day.

All activities under CCASS are subject to the General Rules of CCASS and CCASS Operational Procedures in effect from time to time.

Investors should seek the advice of their stockbroker or other professional advisers for details of the settlement arrangement as such arrangements may affect their rights and interests. All necessary arrangements have been made to enable our Shares to be admitted into CCASS.

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## **INFORMATION ABOUT THIS DOCUMENT AND THE GLOBAL OFFERING**

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### **PROFESSIONAL TAX ADVICE RECOMMENDED**

You should consult your professional advisers if you are in any doubt as to the taxation implications of subscribing for, purchasing, holding or disposing of, or dealing in, our Shares or ADSs or exercising any rights attaching to our Shares. We emphasize that none of our Company, the Joint Sponsors, the Joint Global Coordinators, the Joint Bookrunners, the Underwriters, any of our or their respective directors, officers or representatives or any other person involved in the Global Offering accepts responsibility for any tax effects or liabilities resulting from your subscription, purchase, holding or disposing of, or dealing in, our Shares or ADSs or your exercise of any rights attaching to our Shares for ADSs.

### **REGISTER OF MEMBERS AND STAMP DUTY**

Our principal register of members will be maintained by our Principal Share Registrar in the Cayman Islands, and our Hong Kong register of members will be maintained by our Hong Kong Share Registrar, Computershare Hong Kong Investor Services Limited, in Hong Kong.

Dealings in our Shares registered on our Hong Kong share register will be subject to Hong Kong stamp duty. The stamp duty is charged to each of the seller and purchaser at the ad valorem rate of 0.1% of the consideration for, or (if greater) the value of, our Shares transferred. In other words, a total of 0.2% is currently payable on a typical sale and purchase transaction of our Shares. In addition, a fixed duty of HK\$5.00 is charged on each instrument of transfer (if required).

To facilitate deposits of Shares to and withdrawals of Shares from the ADS facility, we also intend to move a portion of our issued Shares, including all of the ordinary shares deposited in our ADS program, from our Cayman share register to our Hong Kong share register. It is unclear whether, as a matter of Hong Kong law, the trading of ADSs representing Shares constitutes a sale or purchase of the underlying Hong Kong-registered ordinary shares that is subject to Hong Kong stamp duty. We advise investors to consult their own tax advisors on this matter. See “Risk Factors — Risks related to our Shares, the ADSs, the Listing and the Global Offering — There is uncertainty as to whether Hong Kong stamp duty will apply to deposits of our ordinary shares into or withdrawal of our ordinary shares from the ADS facility or trading of our ADSs following our initial public offering in Hong Kong and listing of our Shares on the Hong Kong Stock Exchange.”

### **EXCHANGE RATE CONVERSION**

Our reporting currency is Renminbi. This document contains translations of financial data in Renminbi and Hong Kong dollar amounts into U.S. dollars at specific rates solely for the convenience of the reader. Unless otherwise stated: (i) all translations of financial data in Renminbi into U.S. dollars and from U.S. dollars into Renminbi in this document were made at a rate of RMB7.0808 to US\$1.00, the noon buying rate on March 31, 2020 as set forth in the H.10 statistical release of the U.S. Federal Reserve Board and (ii) all translations of financial data in Hong Kong dollars into U.S. dollars and from U.S. dollars into Hong Kong dollars in this document were made at a rate of HKD7.7513 to US\$1.00, the noon buying rate on March 31, 2020 as set forth in the H.10 statistical release of the U.S. Federal Reserve Board.

On May 22, 2020, the noon buying rate for Renminbi and Hong Kong dollars was RMB7.1269 to US\$1.00 and HK\$7.7561 to US\$1.00, respectively.

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## **INFORMATION ABOUT THIS DOCUMENT AND THE GLOBAL OFFERING**

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No representation is made that any amounts in Renminbi or U.S. dollars were or could have been or could be converted into Hong Kong dollars at such rates or any other exchange rates on such date or any other date.

### **ROUNDING**

Certain amounts and percentage figures included in this document have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures preceding them.

### **LANGUAGE**

If there is any inconsistency between the English version of this document and its Chinese translation, the English version shall prevail, provided that if there is any inconsistency between the Chinese names of the entities or enterprises established in the PRC mentioned in this document and their English translations, the Chinese names shall prevail. The English translations of the Chinese names of such PRC entities or enterprises are provided for identification purposes only.

### **OTHER**

Unless otherwise specified, all references to any shareholdings in our Company following the completion of the Global Offering assume that the Over-allotment Option is not exercised.

### **THE LISTING**

We have applied for a listing of our Shares on the Main Board under Chapter 19C (Secondary Listings of Qualifying Issuers).

We have a track record of good regulatory compliance of at least two full financial years on Nasdaq as required by Rule 19C.04 of the Hong Kong Listing Rules for the purposes of our Listing.

We have applied to the Listing Committee for the listing of, and permission to deal in, our Shares in issue and to be issued pursuant to the Global Offering (including the Shares which may be issued pursuant to the exercise of the Over-allotment Option) and the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time.

Our ADSs are currently listed and traded on Nasdaq. Other than the foregoing, no part of our Shares or loan capital is listed on or traded on any other stock exchange and no such listing or permission to list is being or proposed to be sought. All Offer Shares will be registered on the Hong Kong share register in order to enable them to be traded on the Hong Kong Stock Exchange.

Under section 44B(1) of the Companies (WUMP) Ordinance, any allotment made in respect of any application will be invalid if the listing of, and permission to deal in, our Shares on the Hong Kong Stock Exchange is refused before the expiration of three weeks from the date of the closing of the application lists, or such longer period (not exceeding six weeks) as may, within the said three weeks, be notified to us by or on behalf of the Hong Kong Stock Exchange.



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## INFORMATION ABOUT THIS DOCUMENT AND THE GLOBAL OFFERING

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### REGISTRATION OF SUBSCRIPTION, PURCHASE AND TRANSFER OF SHARES

Our register of members holding unlisted Shares not represented by the ADSs will be maintained by our Principal Share Registrar in the Cayman Islands, and our register of members holding Shares listed on the Hong Kong Stock Exchange and our Shares represented by the ADSs will be maintained by our Hong Kong Share Registrar in Hong Kong.

### OWNERSHIP OF ADSs

An owner of ADSs may hold his/her ADSs either by means of an ADR (evidencing certificated ADSs) registered in his/her name, through a brokerage or safekeeping account, or through an account established by the depository bank in his/her name reflecting the registration of uncertificated ADSs directly on the books of the depository bank, commonly referred to as the “direct registration system,” or DRS. The direct registration system reflects the uncertificated (book-entry) registration of ownership of ADSs by the depository bank. Under the direct registration system, ownership of ADSs is evidenced by periodic statements issued by the depository bank to the holders of the ADSs. The direct registration system includes automated transfers between the depository bank and DTC. If an owner of ADSs decides to hold his/her ADSs through his/her brokerage or safekeeping account, he/she must rely on the procedures of his/her broker or bank to assert his/her rights as an ADS owner. Banks and brokers typically hold securities such as the ADSs through clearing and settlement systems such as DTC. All ADSs held through DTC will be registered in the name of a nominee of DTC.

### DEALINGS AND SETTLEMENT OF ORDINARY SHARES IN HONG KONG

Our Shares will trade on the Hong Kong Stock Exchange in board lots of 100 Shares. Dealings in our Shares on the Hong Kong Stock Exchange will be conducted in Hong Kong dollars.

The transaction costs of dealings in our ordinary shares on the Hong Kong Stock Exchange include:

- (a) Hong Kong Stock Exchange trading fee of 0.005% of the consideration of the transaction, charged to each of the buyer and seller;
- (b) SFC transaction levy of 0.0027% of the consideration of the transaction, charged to each of the buyer and seller;
- (c) trading tariff of HK\$0.50 on each and every purchase or sale transaction. The decision on whether or not to pass the trading tariff onto investors is at the discretion of brokers;
- (d) transfer deed stamp duty of HK\$5.00 per transfer deed (if applicable), payable by the seller;
- (e) *ad valorem* stamp duty at a total rate of 0.2% of the value of the transaction, with 0.1% payable by each of the buyer and the seller;
- (f) stock settlement fee, which is currently 0.002% of the gross transaction value, subject to a minimum fee of HK\$2.00 and a maximum fee of HK\$100.00 per side per trade;

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- (g) brokerage commission, which is freely negotiable with the broker (other than brokerage commissions for IPO transactions which are currently set at 1% of the subscription or purchase price and will be payable by the person subscribing for or purchasing the securities); and
- (h) the Hong Kong share registrar will charge between HK\$2.50 to HK\$20, depending on the speed of service (or such higher fee as may from time to time be permitted under the Hong Kong Listing Rules), for each transfer of ordinary shares from one registered owner to another, each share certificate canceled or issued by it and any applicable fee as stated in the share transfer forms used in Hong Kong.

Investors must settle their trades executed on the Hong Kong Stock Exchange through their brokers directly or through custodians. For an investor who has deposited his/her ordinary shares in his/her stock account or in his/her designated CCASS participant's stock account maintained with CCASS, settlement will be effected in CCASS in accordance with the General Rules of CCASS and CCASS Operational Procedures in effect from time to time. For an investor who holds the physical certificates, settlement certificates and the duly executed transfer forms must be delivered to his/her broker or custodian before the settlement date.

### EXCHANGES BETWEEN SHARES TRADING IN HONG KONG AND ADSs

In connection with the initial public offering of our Shares in Hong Kong, or the Hong Kong Public Offering, we have established a branch register of members in Hong Kong, or the Hong Kong share register, which will be maintained by our Hong Kong Share Registrar, Computershare Hong Kong Investor Services Limited. Our principal register of members, or the Cayman share register, will continue to be maintained by our Principal Share Registrar, Maples Fund Services (Cayman) Limited.

All Shares offered in the Hong Kong Public Offering will be registered on the Hong Kong share register in order to be listed and traded on the Hong Kong Stock Exchange. As described in further detail below, holders of ordinary shares registered on the Hong Kong share register will be able to exchange those ordinary shares for ADSs and vice versa.

### Our ADSs

Our ADSs representing our ordinary shares are currently traded on Nasdaq. Dealings in our ADSs on Nasdaq are conducted in U.S. Dollars.

ADSs may be held either:

- (a) directly: (i) by having an American Depositary Receipt, also referred to as an ADR, which is a certificate evidencing a specific number of ADSs registered in the holder's name; or (ii) by having uncertificated ADSs registered in the holder's name; or
- (b) indirectly, by holding a security entitlement in ADSs through a broker or other financial institution that is a direct or indirect participant in The Depository Trust Company, also called DTC.

The depository for our ADSs is The Bank of New York Mellon, whose office is located at 240 Greenwich Street, New York, New York 10286, United States.

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### **Depositing Shares trading in Hong Kong for delivery of ADSs**

An investor who holds the Shares registered in Hong Kong and wishes to receive delivery of ADSs that trade on the Nasdaq must deposit or have his/her broker deposit the ordinary shares with the depositary's Hong Kong custodian, The Hong Kong and Shanghai Banking Corporation Limited, or the custodian, in exchange for ADSs.

A deposit of Shares trading in Hong Kong in exchange for ADSs involves the following procedures:

- (a) If the Shares have been deposited with CCASS, the investor must transfer the Shares to the depositary's account with the custodian within CCASS by following the CCASS procedures for transfer and submit and deliver a duly completed and signed ADS delivery form to the custodian via his/her broker.
- (b) If the Shares are held outside CCASS, the investor must arrange for the registration of a transfer of his/her Shares into the depositary's name and delivery of evidence of that registration to the custodian, and must sign and deliver an ADS delivery form to the depositary.
- (c) Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, if applicable, the depositary will register the corresponding number of ADSs in the name(s) requested by an investor and will deliver the ADSs as instructed in the ADS delivery form.

For Shares deposited in CCASS, under normal circumstances, the above steps generally require two business days, provided that the investor has provided timely and complete instructions. For Shares held outside CCASS in physical form, the above steps may take 14 business days, or more, to complete. Temporary delays may arise. For example, the transfer books of the depositary may from time to time be closed to ADS issuances. The investor will be unable to trade the ADSs until the procedures are completed.

### **Surrender of ADSs for delivery of ordinary shares trading in Hong Kong**

An investor who holds ADSs and wishes to receive Shares that trade on the Hong Kong Stock Exchange must cancel the ADSs the investor holds and withdraw the Shares from our ADS program and cause his/her broker or other financial institution to trade such Shares on the Hong Kong Stock Exchange.

An investor that holds ADSs indirectly through a broker or other financial institution should follow the procedures of the broker or financial institution and instruct the broker to arrange for cancellation of the ADSs, and transfer of the underlying Shares from the depositary's account with the custodian within the CCASS system to the investor's Hong Kong stock account.

For investors holding ADSs directly, the following steps must be taken:

- (a) To withdraw the Shares from our ADS program, an investor who holds ADSs may turn in such ADSs at the office of the depositary (and the applicable ADR(s) if the ADSs are held in certificated form), and send an instruction to cancel such ADSs to the depositary. Those instructions must have a Medallion signature guarantee.

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- (b) Upon payment or net of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, if applicable, the depositary will instruct the custodian to deliver the Shares underlying the canceled ADSs to the CCASS account designated by the investor.
- (c) If an investor prefers to receive the Shares outside CCASS, he/she must so indicate in the instruction delivered to the depositary.

For the Shares to be received in CCASS, under normal circumstances, the above steps generally require two business days, provided that the investor has provided timely and complete instructions. For the Shares to be received outside CCASS in physical form, the above steps may take 14 business days, or more, to complete. The investor will be unable to trade the ordinary shares on the Hong Kong Stock Exchange until the procedures are completed.

Temporary delays may arise. For example, the transfer books of the depositary may from time to time be closed to ADS cancelations. In addition, completion of the above steps and procedures for delivery of Shares in a CCASS account is subject to there being a sufficient number of Shares on the Hong Kong share register to facilitate a withdrawal from the ADS program directly into the CCASS system. We are not under any obligation to maintain or increase the number of Shares on the Hong Kong share register to facilitate such withdrawals.

### **Depositary requirements**

Before the depositary delivers ADSs or permits withdrawal of the Shares, the depositary may require:

- (a) production of satisfactory proof of the identity and genuineness of any signature or other information it deems necessary; and
- (b) compliance with procedures it may establish, from time to time, consistent with the deposit agreement, including completion and presentation of transfer documents.

The depositary may refuse to deliver, transfer, or register issuances, transfers and cancelations of ADSs generally when the transfer books of the depositary or of the Hong Kong Share Registrar are closed or at any time if the depositary or we determine it advisable to do so.

All costs attributable to the transfer of the Shares to effect a withdrawal from or deposit of the Shares into our ADS program will be borne by the investor requesting the transfer or deposit. In particular, holders of Shares and ADSs should note that the Hong Kong Share Registrar will charge between HK\$2.50 to HK\$20, depending on the speed of service (or such higher fee as may from time to time be permitted under the Hong Kong Listing Rules), for each transfer of the Shares from one registered owner to another, each share certificate canceled or issued by it and any applicable fee as stated in the share transfer forms used in Hong Kong. In addition, holders of the Shares and ADSs must pay up to US\$5.00 per 100 ADSs (or portion thereof) for each issuance of ADSs and each cancelation of ADSs, as the case may be, in connection with the deposit of the Shares into, or withdrawal of the Shares from, the ADS facility.

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### SUMMARY OF EXEMPTIONS AS A FOREIGN PRIVATE ISSUER IN THE U.S.

As required by Rule 19C.14 of the Hong Kong Listing Rules, set out below is a summary of the exemptions from obligations under U.S. securities laws and Nasdaq rules that we enjoy as a foreign private issuer in the U.S.

#### Exemptions from Nasdaq rules

Foreign private issuers are exempted from certain Nasdaq rules. Foreign private issuers are permitted to follow home country practice, *i.e.*, for us, the practice of the Cayman Islands, in lieu of such corporate governance requirements, as long as they disclose any significant ways in which their corporate governance practices differ from those required under the Nasdaq listing standards and explain the basis for the conclusion that the exemption is applicable. Specifically, we are currently entitled to rely upon the exemptions from the requirements to:

- (a) have a majority of independent directors;
- (b) regularly schedule executive sessions without management at which the non-management directors must meet;
- (c) have a nominating/corporate governance committee composed entirely of independent directors;
- (d) have a compensation committee composed entirely of independent directors, whose members must satisfy the additional independence requirements specific to compensation committee membership; and
- (e) give shareholders the opportunity to vote on:
  - (i) all equity-compensation plans and material revisions thereto, with limited exceptions;
  - (ii) the issuance of securities in connection with the acquisition of the stock or assets of another company if: (i) where, due to the present or potential issuance of common stock, including shares issued pursuant to an earn-out provision or similar type of provision, or securities convertible into or exercisable for common stock, other than a public offering for cash: (A) the common stock has or will have upon issuance voting power equal to or in excess of 20% of the voting power outstanding before the issuance of stock or securities convertible into or exercisable for common stock; or (B) the number of shares of common stock to be issued is or will be equal to or in excess of 20% of the number of shares of common stock outstanding before the issuance of the stock or securities; or (ii) any director, officer or Substantial Shareholder (as defined by Rule 5635(e)(3) of the Nasdaq rules) of the Company has a 5% or greater interest (or such persons collectively have a 10% or greater interest), directly or indirectly, in the company or assets to be acquired or in the consideration to be paid in the transaction or series of related transactions and the present or potential issuance of common stock, or securities convertible into or exercisable for common stock, could result in an increase in outstanding common shares or voting power of 5% or more;

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- (iii) private placements (other than a bona fide private placement), if the number of shares of common stock, or of securities convertible into or exercisable for common stock to be issued equals or exceeds 20% of the shares of common stock outstanding before the issuance; or
- (iv) an issuance that will result in a change of control of the listed company.

### **Exemptions from SEC rules and regulations under U.S. federal securities laws**

Foreign private issuers are exempted from Regulation FD under the U.S. Exchange Act. Regulation FD provides that when a U.S. domestic issuer, or someone acting on its behalf, discloses material nonpublic information to certain persons (including securities analysts, other securities market professionals, and holders of the issuer's securities who could reasonably be expected to trade on the basis of the information), it must make simultaneous public disclosure of that information (in the case of intentional disclosure) or prompt public disclosure (in the case of non-intentional disclosure). However, the SEC expects foreign private issuers to conduct themselves in accordance with the basic principles underlying Regulation FD.

Section 16 of the U.S. Exchange Act does not apply to foreign private issuers. Therefore, directors, executive officers and 10% beneficial owners of foreign private issuers are not required to file Forms 3, 4 and 5 with the SEC, and are not required to disgorge to the issuer any profits realized from any non-exempt purchase and sale, or non-exempt sale and purchase, of the issuer's equity securities or security-based swap agreements within a period of less than six months.

Foreign private issuers are exempt from the SEC's rules prescribing the furnishing and content of proxy statements under the U.S. Exchange Act, which specify the procedures and required documentation for soliciting shareholder votes. Accordingly, foreign private issuers are not required to disclose certain information in their annual proxy statements, such as whether the work of any compensation consultant has played any role in determining or recommending the form or amount of executive and director compensation has raised a conflict of interest, and, if so, the nature of the conflict and how it is being addressed.

Foreign private issuers are also not required under the U.S. Exchange Act to file periodic reports and financial statements with the SEC as frequently or as promptly as U.S. domestic issuers with securities registered under the U.S. Exchange Act. As a result, our shareholders may be afforded less protection than they would under the U.S. Exchange Act rules applicable to U.S. domestic issuers. Unlike U.S. domestic issuers, foreign private issuers are not required to file quarterly reports (including quarterly financial information) on Form 10-Q. They also are not required to use Form 8-K for current reports, and instead furnish (not file) current reports on Form 6-K with the SEC.

Annual reports on Form 10-K by U.S. domestic issuers are due within 60, 75, or 90 days after the end of the issuer's fiscal year, depending on whether the company is a "large accelerated filer," a "accelerated filer," or a "non-accelerated filer." By contrast, the deadline for foreign private issuers to file annual reports on Form 20-F is four months after the end of their fiscal year.

### **OUR ARTICLES OF ASSOCIATION**

We are an exempted company incorporated in the Cayman Islands with limited liability and our affairs are governed by our Memorandum and Articles of Association, the Cayman Companies Law and the common law of the Cayman Islands.

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The laws of Hong Kong differ in certain respects from the Cayman Companies Law, and our Articles of Association are specific to us and include certain provisions that may be different from common practices in Hong Kong.

For example, Rule 19C.07 of the Hong Kong Listing Rules provides that the Hong Kong Stock Exchange will consider that an issuer such as our Company seeking a listing under Chapter 19C has met the requirements of Rule 19.30(1)(b) of the Hong Kong Listing Rules for standards of shareholder protection if it has met the shareholder protection standards by reference to eight criteria set out in Rule 19C.07. Rule 19C.07(3) of the Hong Kong Listing Rules requires a change to the auditors or their remuneration to be approved by the shareholders or another body independent of the board of directors of the issuer; however, our Articles of Association does not explicitly include a similar article. See “Waivers and Exemptions” for further information on how we otherwise provide for this protection. See “Summary of our Constitution and Cayman Companies Law” in Appendix III for a further discussion on our Articles of Association.

### **COMPLIANCE ADVISOR**

We have appointed Credit Suisse (Hong Kong) Limited as our compliance advisor, or the Compliance Advisor, upon the Listing in compliance with Rule 3A.19 of the Hong Kong Listing Rules. Pursuant to Rule 3A.23 of the Hong Kong Listing Rules, the Compliance Advisor will provide advice to us upon our request in the following circumstances:

- (a) before the publication of any regulatory announcement, circular, or financial report;
- (b) where a transaction, which might be a notifiable or connected transaction, is contemplated, including share issues and share repurchases;
- (c) where we propose to use the proceeds of the Global Offering in a manner different from that detailed in this document or where the business activities, development or results of our Company deviate from any forecast, estimate or other information in this document;
- (d) where the Hong Kong Stock Exchange makes an inquiry to the Company regarding unusual movements in the price or trading volume of its listed securities or any other matters in accordance with Rule 13.10 of the Hong Kong Listing Rules;

The term of the appointment shall commence on the Listing Date and end on the date on which we distribute our annual report in respect of our financial results for the first full fiscal year commencing after the Listing Date.

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## WAIVERS AND EXEMPTIONS

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In preparation for the Listing, we have sought the following waivers and exemptions from strict compliance with the relevant provisions of the Hong Kong Listing Rules, the SFO and the Companies (WUMP) Ordinance and have applied for a ruling under the Takeovers Codes:

No.	Rules	Subject matter
1.	Rule 2.07A of the Hong Kong Listing Rules	Printed Corporate Communications
2.	Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules	Investments and Acquisitions after the Track Record Period
3.	Rules 4.04(3)(a), 4.05(2) and 4.13 of the Hong Kong Listing Rules and Paragraph 31(3)(b) of the Third Schedule to the Companies (WUMP) Ordinance	Disclosure Requirements Relating to the Accountant's Report
4.	Rule 9.09(b) of the Hong Kong Listing Rules	Dealings in Shares prior to Listing
5.	Rule 10.04 and Paragraph 5(2) of Appendix 6 to the Hong Kong Listing Rules	Subscription for Shares by Existing Shareholders
6.	Rules 12.04(3), 12.07 and 12.11 of the Hong Kong Listing Rules	Printed Prospectuses
7.	Rule 13.25B of the Hong Kong Listing Rules	Monthly Return
8.	Rule 19C.07(3) of the Hong Kong Listing Rules	Shareholder Protection Requirements in Relation to Approval, Removal and Remuneration of Auditors
9.	Paragraphs 13 and 26 of Appendix 1A to the Hong Kong Listing Rules and Paragraphs 11, 14 and 25 of the Third Schedule to the Companies (WUMP) Ordinance	Particulars of any Commissions, Discounts and Brokerages, Alterations of Capital and Authorized Debentures
10.	Paragraph 29(1) of Appendix 1A to the Hong Kong Listing Rules and Paragraph 29 of the Third Schedule to the Companies (WUMP) Ordinance	Disclosure of Information on Subsidiaries Whose Profits or Assets Make Material Contribution to Us



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## WAIVERS AND EXEMPTIONS

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No.	Rules	Subject matter
11.	Paragraph 27 of Appendix 1A to the Hong Kong Listing Rules and Paragraph 10 of the Third Schedule to the Companies (WUMP) Ordinance	Disclosure Requirements of Options
12.	Guidance Letter HKEX-GL37-12	Timing Requirement of Liquidity Disclosure
13.	Paragraphs 33(2), 33(3), 46(2), 46(3) of Appendix 1A to the Hong Kong Listing Rules	Disclosure Requirements of the Remuneration of Directors and Five Individuals Whose Emoluments Were Highest
14.	Section 4.1 of the Introduction to the Takeovers Codes	Determination of Whether a Company is a “Public Company in Hong Kong”
15.	Part XV of the SFO	Disclosure of Interests
16.	Paragraphs 41(4) and 45 of Appendix 1A to and Practice Note 5 of the Hong Kong Listing Rules	Disclosure of Interests Information
17.	Paragraph 3(b) of Practice note 15 to the Hong Kong Listing Rules	Three-Year Restriction on Spin-offs
18.	Paragraph 15(2)(c) of Appendix 1A to the Hong Kong Listing Rules	Disclosure of Offer Price
19.	Paragraph 4.2 of Practice Note 18 of the Hong Kong Listing Rules	Clawback Mechanism
20.	Paragraphs 28(1)(b)(i), (ii) and (v) of Appendix 1A to the Hong Kong Listing Rules	Disclosure Requirements in Respect of Suppliers

### PRINTED CORPORATE COMMUNICATIONS

Rule 2.07A of the Hong Kong Listing Rules provides that a listed issuer may send or otherwise make available to the relevant holders of its securities any corporate communication by electronic means, provided that either the listed issuer has previously received from each of the relevant holders of its securities an express, positive confirmation in writing or the shareholders of the listed issuer have resolved in a general meeting that the listed issuer may send or supply corporate communications to shareholders by making them available on the listed issuer’s own website or the listed issuer’s constitutional documents contain provision to that effect, and certain conditions are satisfied.

Our ADSs have been listed on the Nasdaq since 2000. We have a diverse shareholder base with ADS holders globally.

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## WAIVERS AND EXEMPTIONS

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We do not currently produce or send out any corporate communications to our shareholders or holders of ADSs in printed form unless requested or in limited circumstances. We publicly file or furnish various corporate communications with the SEC which are posted on the SEC's website. Our annual reports on Form 20-F and current reports on Form 6-K and all amendments to these reports, are also available free of charge on our website as soon as reasonably practicable after they are filed with or furnished to the SEC. Further, we will post our proxy materials and notices to our shareholders and holders of ADSs on a publicly accessible website. In addition, the depository bank which administers our ADS program will send a notice as well as an ADS voting instruction card to our ADS holders.

Apart from the Hong Kong Offer Shares that we will offer for subscription by the public in Hong Kong, the International Offer Shares will be placed to professional, institutional, corporate and other investors in Hong Kong and elsewhere in the world. Given our diverse shareholder base and the potential number of countries in which our shareholders are located, we consider that it would not be practicable for us to send printed copies of all our corporate communications to all of our shareholders. Further, we consider that it would also not be practicable for us to approach our existing shareholders individually to seek confirmation from them of their wish to receive corporate communications in electronic form, or to provide them with the right to request corporate communications in printed form instead.

We have applied for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with Rule 2.07A of the Hong Kong Listing Rules on the conditions that we will:

- (a) issue all future corporate communications as required by the Hong Kong Listing Rules on our own website in English and Chinese, and on the Hong Kong Stock Exchange's website in English and Chinese;
- (b) provide printed copies of proxy materials in English to our shareholders at no costs upon request; and
- (c) ensure that the "Investor Relations" page of our website ([ir.netease.com](http://ir.netease.com)) will direct investors to all of our future filings with the Hong Kong Stock Exchange.

### INVESTMENTS AND ACQUISITIONS AFTER THE TRACK RECORD PERIOD

Pursuant to Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules, the accountant's report to be included in the listing document must include the income statements and balance sheets of any subsidiary or business acquired, agreed to be acquired or proposed to be acquired since the date to which its latest audited accounts have been made up in respect of each of the three financial years immediately preceding the issue of the listing document.

We may increase our direct or indirect equity interest in entities that are already majority controlled and are consolidated in our financial statements. As these increases in equity interests do not involve the acquisition of a company or a business, and the financial contribution of the relevant entities are already reflected in our financial statements, we do not believe that such transactions represent an acquisition for the purpose of Rules 4.04(2) and 4.04(4) of the Hong Kong Listing Rules.

Pursuant to the Hong Kong Stock Exchange's Guidance Letter HKEX-GL32-12 ("**GL32-12**"), acquisitions of business include acquisitions of associates and any equity interest in another company. Pursuant to GL32-12, the Hong Kong Stock Exchange may consider granting a

## WAIVERS AND EXEMPTIONS

waiver of the requirements under Rules 4.04(2) and 4.04(4) of the Hong Kong Listing Rules on a case-by-case basis, and having regard to all relevant facts and circumstances and subject to certain conditions set out thereunder.

### Ordinary course Investments since December 31, 2019

During the Track Record Period, we have made minority investments in a large number of companies both in China and overseas in the ordinary and usual course of business to further our strategic objectives. Since December 31, 2019 and up to the Latest Practicable Date, we have made or propose to make minority investments in a number of companies, and we expect to continue to enter into further minority investments subsequent to the Latest Practicable Date and prior to the date of this document (collectively, the “Investments”). Details of the Investments up to the Latest Practicable Date include:

Investment <sup>(1)(3)</sup>	Consideration <sup>(2)</sup> (approximately RMB million)	Percentage of shareholding/ equity interest <sup>(2)</sup>	Principal business activities
Company A	147.40	12%	Internet Business
Company B	134.42	22%	Game Business
Company C	69.76	20%	Game Business
Company D	62.79	34%	Game Business
Company E	60.00	20%	Game Business
Company F	45.96	16%	Game Business
Company G	32.79	21%	Game Business
Company H	31.82	16%	Game Business
Company I	31.39	25%	Game Business
Company J	14.00	24%	Game Business
Company K	11.67	20%	Music Business
Company L	8.00	6%	Education Business
Company M	5.50	2%	Education Business
Company N	5.00	5%	Education Business
Company O	3.50	11%	Education Business

Notes:

- (1) Given that we have not yet entered into legally binding agreements for certain of the above Investments as at the Latest Practicable Date, the terms and information set out above might be subject to further changes.
- (2) The approximate consideration disclosed in the table represents each of the Investment after December 31, 2019. The percentage of shareholding/equity interest represents our total *pro forma* shareholding in each of the Investments after the completion of the disclosed transaction.
- (3) None of the core connected persons at the level of our Company is a controlling shareholder of any of the Investments. The investment amounts for the Investments are the result of commercial arm’s length negotiations, based on factors including, market dynamics, a mutually agreed valuation, and/or capital need of the relevant company’s operations.

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## WAIVERS AND EXEMPTIONS

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We confirm that the investment amounts for the Investments are the result of commercial arm's length negotiations, based on factors including market dynamics, a mutually agreed valuation, and/or capital need of the relevant company's operations.

### **Conditions for granting the waiver and its scope in respect of the Investments**

We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules in respect of the Investments on the following grounds:

#### ***Ordinary and usual course of business***

We make equity investments in sectors relating to our business as part of our ordinary and usual course of business. We have a history of making minority investments and have conducted a number of minority investments during the Track Record Period.

#### ***The percentage ratios of each Investment are all less than 5% by reference to the most recent fiscal year of the Track Record Period***

The relevant percentage ratios calculated in accordance with Rule 14.07 of the Hong Kong Listing Rules for each of the Investments are all significantly less than 5% by reference to the most recent fiscal year of the Track Record Period. We do not believe that the Investments are subject to aggregation under Rule 14.22 of the Hong Kong Listing Rules, because (i) each of the Investments involves the acquisition of interests in a different company and (ii) the Investments were entered into, or are expected to be entered into, with different counterparties.

Accordingly, we believe that the Investments have not resulted in or are not expected to result in any significant changes to our financial position since December 31, 2019, and all information that is reasonably necessary for potential investors to make an informed assessment of our activities or financial position has been included in this document. As such, we consider that a waiver from compliance with the requirements under Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules would not prejudice the interests of the investors.

#### ***We are not able to exercise any control over the underlying company or business***

We only hold and/or will only hold a minority equity interest in each of the Investments and do not control their boards of directors, and expect this to remain the case for any subsequent Investments. We are also not involved in the day to day management of these Investments and only enjoy minority strategic shareholder rights. The minority rights given to us are generally commensurate to our status as a minority shareholder and are for the protection of our interests as a minority stakeholder in the Investments. These rights are neither intended, nor sufficient to compel or require the relevant companies to prepare or to disclose in this document audited financial statements for the purposes of compliance with Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules. These disclosures are also not required pursuant to applicable U.S. securities laws. It could be prejudicial and potentially harmful to our portfolio relationships and commercial interests to make such disclosures. In addition, as some portfolio companies are private, disclosing this information could harm their interests and bring them into an unfavorable competitive position. Accordingly, as we do not expect the Investments to result in any material changes to our financial position after the Track Record Period, we do not believe the non-disclosure of the required information pursuant to Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules would prejudice the interest of investors.

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## WAIVERS AND EXEMPTIONS

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### *Alternative disclosure of the Investments in this document*

We have disclosed alternative information about the Investments in this document. Such information includes that which would be required for a discloseable transaction under Chapter 14 of the Hong Kong Listing Rules that our directors consider to be material, including, for example, descriptions of the principal business activities, the investment amounts, and a statement that none of the core connected persons at the level of our Company is a controlling shareholder of any of the Investments. We have however excluded disclosure on the names of certain companies in connection with the Investments in this document because (i) we have entered into confidentiality agreements with these companies and do not have consent for such disclosure and/or (ii) given that we have not yet entered into legally binding agreements with respect to all of the Investments as of the Latest Practicable Date and the competitive nature of the industries in which we operate, disclosure of the names of the relevant companies in this document is commercially sensitive and may jeopardize our ability to consummate the proposed Investments. It is commercially sensitive to disclose the identities of the companies we invested in or propose to invest in as such information may enable our competitors to anticipate our strategy. Since the relevant percentage ratio of each Investment is less than 5% by reference to the most recent fiscal year of our Track Record Period, we believe the current disclosure is adequate for potential investors to form an informed assessment of us. We do not expect to use any proceeds from the Listing to fund the Investments.

### *Acquisitions since December 31, 2019*

Since December 31, 2019, we have made or proposed to make a number of acquisitions of a majority interest in certain companies and up to the Latest Practicable Date, and we expect to continue to enter into further acquisitions subsequent to the Latest Practicable Date and prior to the date of this document (collectively, the “**Acquisitions**”). Details of the Acquisition(s) up to the Latest Practicable Date include (other than those, the considerations of which were less than RMB one million — being less than 0.005% of our total assets as of December 31, 2019 and revenue and profit for the year ended December 31, 2019):

<b>Targets<sup>(1)(2)</sup></b>	<b>Consideration<sup>(3)</sup></b> <b>(approximately</b> <b>RMB million)</b>	<b>Percentage of</b> <b>shareholding/</b> <b>equity interest<sup>(3)</sup></b>	<b>Principal business activities</b>
Company P	168.31	63%	Game Business
Company Q	29.50	85%	Education Business
Company R	7.70	93%	Education Business

Notes:

- (1) Given that we have not yet entered into legally binding agreements for certain of the above Acquisitions as at the Latest Practicable Date, the terms and information set out above might be subject to further changes.
- (2) None of the core connected persons at the level of our Company is a controlling shareholder of the Acquisition(s).
- (3) The approximate consideration disclosed in the table represents the Acquisition(s) after December 31, 2019. The percentage of shareholding/equity interest represents our total pro forma shareholding in the Acquisition(s) after the completion of disclosed transaction.

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## WAIVERS AND EXEMPTIONS

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The acquisition amounts for the Acquisitions are the result of commercial arm's length negotiations, based on factors including market dynamics, a mutually agreed valuation, and/or capital required for the target company's operations.

### **Conditions for granting the waiver and its scope in respect of the Acquisitions**

We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules in respect of the Acquisitions on the following grounds:

#### ***The percentage ratios of each Acquisition are all less than 5% by reference to the most recent fiscal year of our Track Record Period***

The relevant percentage ratios calculated in accordance with Rule 14.07 of the Hong Kong Listing Rules for the Acquisitions are all significantly less than 5% by reference to the most recent fiscal year of the Track Record Period. We do not believe that the Acquisitions are subject to aggregation under Rule 14.22 of the Hong Kong Listing Rules, because (i) each of the Acquisitions involves the acquisition of interests in a different company and (ii) the Acquisitions were entered into, or are expected to be entered into, with different counterparties.

Accordingly, the Acquisitions have not resulted in or are not expected to result in any significant changes to our financial position since December 31, 2019, and all information that is reasonably necessary for the potential investors to make an informed assessment of our activities or financial position has been included in this document. As such, a waiver from compliance with Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules would not prejudice the interests of the investors.

#### ***The historical financial information of the targets is not available and would be unduly burdensome to obtain or prepare***

The targets do not have available historical financial information which is readily available for disclosure in this document in accordance with the Hong Kong Listing Rules. In addition, it would require considerable time and resources for us and our reporting accountant to fully familiarize ourselves with the management accounting policies of the targets and compile the necessary financial information and supporting documents for disclosure in this document. As such, we believe it would be impractical and unduly burdensome for us to disclose the audited financial information of the targets as required under Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules.

In addition, having considered the Acquisitions immaterial and that we do not expect the Acquisitions to have any material effect on our business, financial condition or operations, we believe that it would not be meaningful and would be unduly burdensome for us to prepare and include the financial information of the targets during the Track Record Period in this document. As we do not expect the Acquisitions to result in any material changes to our financial position after the Track Record Period, we do not believe the non-disclosure of the required information pursuant to Rules 4.04(2) and 4.04(4)(a) of the Hong Kong Listing Rules would prejudice the interest of investors.

#### ***Alternative disclosure of the Acquisitions in this document***

We have provided alternative information about the Acquisitions in this document. Such information includes that which would be required for a discloseable transaction under Chapter 14 of the Hong Kong Listing Rules that our directors consider to be material, including, for

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## WAIVERS AND EXEMPTIONS

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example, descriptions of the targets' principal business activities, the investment amounts, and a statement that none of the core connected persons at the level of our Company is a controlling shareholder of any of the targets. We have however excluded disclosure on the names of certain targets in connection with the Acquisitions because (i) we have entered into confidentiality agreements with these companies and do not have consent from all of them for such disclosure and/or (ii) given that we have not yet entered into legally binding agreements with respect to all of these Acquisitions as of the Latest Practicable Date and the competitive nature of the industries in which we operate, disclosure of the names of the relevant companies in this document is commercially sensitive and may jeopardize our ability to consummate the proposed Acquisitions. It is commercially sensitive to disclose the identities of the companies we invested in or propose to invest in as such information may enable our competitors to anticipate our investment strategy. Since the relevant percentage ratio of each Acquisition is less than 5% by reference to the most recent fiscal year of our Track Record Period, we believe the current disclosure is adequate for potential investors to form an informed assessment of us. We do not expect to use any proceeds from the Listing to fund the Acquisitions.

### DISCLOSURE REQUIREMENTS RELATING TO THE ACCOUNTANT'S REPORT

Rules 4.04(3)(a), 4.05(2) and 4.13 of the Hong Kong Listing Rules and Paragraph 31(3)(b) of the Third Schedule to the Companies (WUMP) Ordinance set out certain historical financial information to be included in a listing document that is not required to be disclosed under U.S. GAAP, including in particular:

- (a) balance sheet at a company level;
- (b) aging analysis of accounts receivables;
- (c) aging analysis of accounts payables; and
- (d) adjustments made to show profits of all periods in accordance with the relevant accounting standards in relation to the last fiscal year reported on.

In accordance with U.S. GAAP, we have applied the modified retrospective method or prospective method to account for the impact of the adoption of certain new accounting standards in the Track Record Period. Under the modified retrospective method and prospective method adopted by our Group, comparative periods in the latest consolidated financial statements are not retrospectively adjusted.

During the Track Record Period, we adopted, among other new accounting standards that did not have a material impact on our consolidated financial statements, Accounting Standards Update 2014-09 "*Revenue from Contracts with Customers (Topic 606)*" and related amendments and implementation guidance, or ASC 606, Accounting Standards Update 2016-01 "*Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*," including related technical corrections and improvements, or ASU 2016-01, and "*Accounting Standards Update 2016-02 "Leases" (Topic 842)*," including certain transitional guidance and subsequent amendments, or ASC 842. The relevant accounting policies upon the adoption of these new accounting standards are disclosed in the "Accountant's Report" in Appendix IA.

ASC 606 was adopted on January 1, 2018 using the modified retrospective method. Results for fiscal year 2018 are presented under ASC 606, while results for the comparative periods have not been adjusted and were reported in accordance with the previous revenue recognition

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## WAIVERS AND EXEMPTIONS

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standard under U.S. GAAP. The cumulative-effect adjustment upon adoption of ASC 606 includes a reduction of deferred revenue of RMB81.7 million and a net increase to beginning retained earnings on January 1, 2018 of RMB27.4 million, net of tax.

ASU 2016-01 was adopted on January 1, 2018 using the modified retrospective method to account for the cumulative-effect adjustments to the balance sheet, except for fair value adjustments of equity securities for which we have elected to account for under the measurement alternative. The Financial Accounting Standards Board provides clear guidance within ASU 2016-01 that fair value adjustments of equity securities for which the measurement alternative is elected should be applied prospectively to equity securities that exist as of the date of the adoption and no retrospective method is permitted.

Upon the adoption of ASU 2016-01, fair value changes related to equity securities previously classified as available-for-sale were recorded in the consolidated statements of operations, whereas the fair value changes of these securities were recorded in other comprehensive income in previous fiscal years prior to the adoption. Upon the adoption of ASU 2016-01, net unrealized gains on these equity securities recorded in accumulated other comprehensive income as of December 31, 2017 of RMB38.2 million, net of tax, were reclassified into beginning retained earnings as of January 1, 2018.

In addition, prior to the adoption of ASU 2016-01, equity securities without readily determinable fair values was accounted for using the cost method. Starting January 1, 2018, upon the adoption of ASU 2016-01, our Group elected to measure these equity securities investments at cost, less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer (referred to as the measurement alternative). Fair value adjustments, including impairments, from applying the measurement alternative were recorded in the consolidated statements of operations. As required under ASU 2016-01, we prospectively applied the measurement alternative on these equity securities, and our consolidated financial statements for the comparative periods were not retrospectively adjusted. As of December 31, 2018 and 2019, the amount of equity securities for which we elected to record using the measurement alternative amounted to RMB3,896.1 million and RMB4,604.5 million, respectively.

The full retrospective application of ASU 2016-01 is not permitted under U.S. GAAP. Any adjustments to the historical financial information in the comparative periods arising from the full retrospective application of ASU 2016-01 will create confusion to the existing investors in the U.S. market and it may be misleading to disclose such information in the “Accountant’s Report” in Appendix IA.

ASC 842 was adopted on January 1, 2019 using the modified retrospective method by applying the new lease standard to all leases existing as of January 1, 2019, the date of initial application, and no adjustments were made to the comparative periods. Adoption of the new lease standard resulted in the recognition of operating lease right-of-use assets and operating lease liabilities on the consolidated balance sheet as of January 1, 2019. The adoption of the new lease standard does not have any significant impact on the consolidated statements of operations and comprehensive income and cash flows and there was no adjustment to the beginning retained earnings on January 1, 2019.



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The following alternative disclosures with respect to certain items identified above which are relevant to us have been included in this document:

- (a) for certain new accounting standards that came into effect in the latest fiscal year, the accounting policies as well as the impact of adoption, if any, to the beginning retained earnings of initial application (*i.e.*, January 1, 2018 and 2019) has been disclosed in the “Accountant’s Report” in Appendix IA in accordance with the relevant requirements under U.S. GAAP; and
- (b) disclosure of the relevant accounting policies adopted for the Track Record Period in the “Accountant’s Report” in Appendix IA.

As this document has included the above alternative disclosures and the current disclosure contains all information which is necessary for investors to make an informed assessment of the business, asset and liability, financial position, trading position, management and prospect of our Group, we believe that it would be of no material value to the Hong Kong investors and be unduly burdensome for the “Accountant’s Report” in Appendix IA to include certain required information pursuant to Rules 4.04(3)(a), 4.05(2) and 4.13 of the Hong Kong Listing Rules and Paragraph 31(3)(b) of the Third Schedule to the Companies (WUMP) Ordinance and that the non-disclosure of such information will not prejudice the interests of investors.

We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the requirements under Rules 4.04(3)(a), 4.05(2) and 4.13 of the Hong Kong Listing Rules. We have applied for, and the SFC has granted, an exemption from the requirements under Paragraph 31(3)(b) of the Third Schedule to the Companies (WUMP) Ordinance. The SFC has granted an exemption referred to above on the conditions that: (i) the particulars of such exemption are set out in this prospectus; and (ii) this prospectus will be issued on or before June 2, 2020.

### DEALINGS IN SHARES PRIOR TO LISTING

According to Rule 9.09(b) of the Hong Kong Listing Rules, there must be no dealing in the securities of a new applicant for which listing is sought by any core connected person of the issuer from four clear business days before the expected hearing date until listing is granted (the “**Relevant Period**”).

We have approximately 129 subsidiaries and operating entities as of December 31, 2019, and our ADSs are widely held, publicly traded and listed on the Nasdaq. We are therefore not in a position to control the investment decisions of our shareholders or the investing public in the U.S. Solely based on public filings with the SEC as of the Latest Practicable Date, other than William Lei Ding, our founder, director and chief executive officer, there are no shareholders who hold more than 10% of our total issued share capital.

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William Lei Ding (our founder, director and chief executive officer) may from time to time use his Shares as security (including charges and pledges) in connection with financing activities. As of the Latest Practicable Date, William Lei Ding, through Shining Globe International Limited, beneficially owned 1,456,000,000 Shares (see “Major Shareholders” for details) and none of his Shares was used as security.

On the basis of the above, we consider that the following categories of persons (collectively, the “**Permitted Persons**”) should not be subject to the dealing restrictions set out in Rule 9.09(b) of the Hong Kong Listing Rules:

- (a) William Lei Ding (our founder, director and chief executive officer), in respect of use of his Shares as security (including, for the avoidance of doubt, using Shares as security in connection with entering into financing transactions during the Relevant Period as well as satisfying any requirements to top-up security under the terms of financing transactions entered into prior to the Relevant Period), provided that there will be no change in the beneficial ownership of the Shares at the time of entering into any such transactions during the Relevant Period (“**Category 1**”);
- (b) our directors other than William Lei Ding, and the directors and chief executives of our Significant Subsidiaries, in respect of their respective use of the Shares as security (including, for the avoidance of doubt, using Shares as security in connection with entering into financing transactions during the Relevant Period as well as satisfying any requirements to top-up security under the terms of financing transactions entered into prior to the Relevant Period), provided that there will be no change in the beneficial ownership of the Shares at the time of entering into any such transactions during the Relevant Period (“**Category 2**”);
- (c) directors, chief executives and substantial shareholders of our non-Significant Subsidiaries and their close associates (“**Category 3**”); and
- (d) any other person (whether or not an existing Shareholder) who may, as a result of dealings, become our substantial shareholder and who is not our director or chief executive, or a director or chief executive of our subsidiaries, or their close associates (“**Category 4**”).

For the avoidance of doubt,

- (a) as the foreclosure, enforcement or exercise of other rights by the lenders in respect of a security interest over the Shares (including, for the avoidance of doubt, any security interest created pursuant to any top-up of security) will be subject to the terms of the financing transaction underlying such security and not within the control of the pledgor, any change in the beneficial owner of the Shares during the Relevant Period resulting from the foreclosure, enforcement or exercise of other rights by the lenders in respect of such security interest will not be subject to Rule 9.09(b) of the Hong Kong Listing Rules; and
- (b) persons in Category 1 and Category 2 who use their respective Shares other than as described above in “Dealings in the Shares prior to Listing” are subject to the restrictions under Rule 9.09(b) of the Hong Kong Listing Rules.

We believe, subject to the conditions set forth below, the dealings in our securities by our core connected persons will not prejudice the interests of our potential investors and are aligned with the principles in the Hong Kong Stock Exchange’s Guidance Letter GL42-12.

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We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with Rule 9.09(b) of the Hong Kong Listing Rules subject to the following conditions:

- (a) Where Categories 1 and 2 of the Permitted Persons use the Shares as security, there will be no change in the beneficial ownership of the Shares during the Relevant Period;
- (b) Categories 3 and 4 of the Permitted Persons do not have any influence over the Global Offering and do not possess any of our non-public inside information given that such persons are not in a position with access to information that is considered material to us taken as a whole. Given the large number of our subsidiaries and our vast ADS holder base, we and our management do not have effective control over the investment decisions of Categories 3 and 4 of the Permitted Persons in our ADSs;
- (c) we will promptly release any inside information to the public in the United States and Hong Kong in accordance with the relevant laws and regulations of the U.S. and Hong Kong. Accordingly, the Permitted Persons (other than Category 1 and Category 2 persons) are not in possession of any non-public inside information of which we are aware;
- (d) we will notify the Hong Kong Stock Exchange of any breaches of the dealing restrictions by any of our core connected persons during the Relevant Period when we become aware of the same other than dealings by the core connected persons who are Permitted Persons within the permitted scopes set out above; and
- (e) prior to the Listing Date, other than within the permitted scopes set out above, our directors and chief executive and the directors and chief executives of our Significant Subsidiaries and their close associates will not deal in the Shares or the ADSs during the Relevant Period provided that such prohibited dealing in the Shares shall not include the granting, vesting, payment or exercise (as applicable) of RSUs, incentive and non-statutory options, restricted shares, dividend equivalents, and share payments under our Group's share incentive plans.

### **SUBSCRIPTION FOR SHARES BY EXISTING SHAREHOLDERS**

Rule 10.04 of the Hong Kong Listing Rules requires that existing shareholders may only subscribe for or purchase any securities for which listing is sought that are being marketed by or on behalf of a new applicant either in his or its own name or through nominees if the conditions in Rule 10.03 of the Hong Kong Listing Rules are fulfilled. Paragraph 5(2) of Appendix 6 to the Hong Kong Listing Rules states that, without the prior written consent of the Hong Kong Stock Exchange, no allocations will be permitted to be made to directors, existing shareholders of a listing applicant or their close associates, unless the conditions set out in Rules 10.03 and 10.04 are fulfilled.

The Hong Kong Stock Exchange's Guidance Letter HKEX-GL85-16 provides that the Hong Kong Stock Exchange will consider granting a waiver from Rule 10.04 and consent pursuant to Paragraph 5(2) of Appendix 6 to the Hong Kong Listing Rules allowing an applicant's existing shareholders or their close associates to participate in an initial public offering if any actual or perceived preferential treatment arising from their ability to influence the applicant during the allocation process can be addressed.

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As a company listed on the Nasdaq, we are not in a position to prevent any person or entity from acquiring our listed securities prior to the allocation of shares in connection with the Global Offering. It would therefore be unduly burdensome for us to seek the prior consent of the Hong Kong Stock Exchange for each of our existing shareholders or their close associates who subscribe for Shares in the Global Offering. Since we do not require shareholders' approval in order to proceed with the Global Offering, any persons (other than our directors and senior management) who may, as a result of dealings, become our shareholders (together, the "**Permitted Existing Shareholders**") would have no influence over the Global Offering and would not be in possession of any non-public inside information and would therefore effectively be in the same position as any of our public investors.

We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the requirements of Rule 10.04 and Paragraph 5(2) of Appendix 6 of the Hong Kong Listing Rules in respect of the restriction on Permitted Existing Shareholders to subscribe for or purchase Shares in the Global Offering, subject to the following conditions:

- (a) each Permitted Existing Shareholder is interested in less than 10% of our issued share capital immediately before the Listing;
- (b) each Permitted Existing Shareholder is neither our director nor member of our senior management;
- (c) the Permitted Existing Shareholders do not have the power to appoint directors or any other special rights in us;
- (d) the Permitted Existing Shareholders do not have influence over the offering process and will be treated the same as other applicants and places in the Global Offering;
- (e) the Permitted Existing Shareholders and their close associates will be subject to the same book-building and allocation process as other investors in the Global Offering; and
- (f) we, the Joint Global Coordinators and the Joint Sponsors, to the best of our knowledge and belief (and based on discussions between us and the Joint Global Coordinators and confirmations required to be submitted to the Hong Kong Stock Exchange by the Company and the Joint Global Coordinators), will or have confirmed to the Hong Kong Stock Exchange in writing that no preferential treatment will be given to the Permitted Existing Shareholders and their close associates in the allocation process by virtue of their relationship with us.

Allocation to the Permitted Existing Shareholders and/or their close associates will not be disclosed in our allotment results announcement (other than to the extent that such Permitted Existing Shareholders or close associates subscribe for shares as cornerstone investors) unless such Permitted Existing Shareholders are interested in 5% or more of our issued share capital after the Global Offering as disclosed in any public filings with the SEC, as it would be unduly burdensome for us to disclose such information given that there is no requirement to disclose interests in equity securities under the U.S. Exchange Act unless the beneficial ownership of such person (including directors and officers of the company concerned) reaches more than 5% of equity securities registered under Section 12 of the U.S. Exchange Act.

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## WAIVERS AND EXEMPTIONS

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### PRINTED PROSPECTUSES

Pursuant to Rules 12.04(3), 12.07 and 12.11 of the Hong Kong Listing Rules, we are required to make available copies of the Prospectus in printed form.

We do not intend to provide printed copies of the prospectus or of the white and yellow application forms to the public in relation to the Hong Kong Public Offering. The proposed waiver from the requirements to make available printed copies of the Prospectus is in line with recent amendments to the Hong Kong Listing Rules relating to environmental, social and governance (“ESG”) matters. As the Hong Kong Stock Exchange noted on page 1 of its Consultation Conclusions on Review of the Environmental, Social and Governance Reporting Guide and Related Listing Rules dated December 2019, such amendments relating to ESG matters “*echo the increasing international focus on climate change and its impact on business.*” Electronic, *in lieu of* printed, prospectuses and application forms will help mitigate the environmental impact of printing, including the exploitation of precious natural resources such as trees and water, the handling and disposal of hazardous materials, air pollution, among others.

We also note that in light of the severity of the ongoing COVID-19 pandemic, the provision of printed prospectuses and printed white and yellow application forms will elevate the risk of contagion of the virus through printed materials. As of the Latest Practicable Date, the government of Hong Kong has put in place social distancing measures to restrict public gatherings. While the government of Hong Kong may relax such restrictions as the local COVID-19 situation improves, it is possible that stricter social distancing measures may be necessary later if the number of cases of infection in the territory dramatically increases. In any event, it is impossible to accurately predict the development of the COVID-19 pandemic as of the Latest Practicable Date. In this uncertain environment, an electronic application process with a paperless prospectus will reduce the need for prospective investors to gather in public, including branches of the receiving bank and other designated points of collection, in connection with the Hong Kong Public Offering.

We have adopted a fully electronic application process for the Hong Kong Public Offering and we will not provide printed copies of this prospectus or printed copies of any application forms to the public in relation to the Hong Kong Public Offering. Our Hong Kong Share Registrar has implemented enhanced measures to support **White Form eIPO** Service, including increasing its server capacity and making available a telephone hotline to answer investors’ queries in connection with the fully electronic application process. For details of the telephone hotline and the application process, please see “How to Apply for Hong Kong Offer Shares.”

We will publish a formal notice of the Global Offering on the official websites of the Hong Kong Stock Exchange and our Company and in selected English and Chinese local newspapers describing the fully electronic application process including the available channels for share subscription and the enhanced support provided by our Hong Kong Share Registrar in relation to the Hong Kong Public Offering and reminding investors that no printed prospectuses or application forms will be provided. We will also issue a press release to highlight the available electronic channels for share subscription.

We have applied for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with the requirements under Rule 12.04(3), Rule 12.07 and Rule 12.11 of the Hong Kong Listing Rules in respect of the availability of copies of the prospectus in printed form based on our specific and prevailing circumstances.

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## WAIVERS AND EXEMPTIONS

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### MONTHLY RETURN

Rule 13.25B of the Hong Kong Listing Rules requires a listed issuer to publish a monthly return in relation to movements in its equity securities, debt securities and any other securitized instruments, as applicable, during the period to which the monthly return relates.

Under the Joint Policy Statement, this common waiver is subject to the condition that the issuer can meet one of the following three conditions:

- (a) it has received a relevant partial exemption from Part XV of the SFO; or
- (b) it publishes a “next day disclosure return” in strict compliance with Rule 13.25A of the Hong Kong Listing Rules, regardless of the waiver of general effect from this Rule for secondary listed issuers; or
- (c) it is subject to overseas laws or regulations that have a similar effect to Rule 13.25B of the Hong Kong Listing Rules and any differences are not material to shareholder protection.

As we have obtained a partial exemption from strict compliance with Part XV of the SFO from the SFC, we have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the continuing obligations under Rule 13.25B of the Hong Kong Listing Rules. We will disclose information about share repurchases, if material, in our quarterly earnings releases and annual reports on Form 20-F which are furnished or filed with the SEC in accordance with applicable U.S. rules and regulations.

### SHAREHOLDER PROTECTION REQUIREMENTS

For an overseas issuer seeking a secondary listing on the Hong Kong Stock Exchange, Rule 19.30(1)(b) of the Hong Kong Listing Rules requires the overseas issuer’s primary listing is or is to be on an exchange where the standards of shareholder protection are at least equivalent to those provided in Hong Kong. Rule 19C.06 of the Hong Kong Listing Rules provides that Appendix 3 and Appendix 13 of the Hong Kong Listing Rules do not apply to an overseas issuer that is a Non-Greater China Issuer (as defined in the Hong Kong Listing Rules) or a Grandfathered Greater China Issuer seeking a secondary listing under Chapter 19C of the Hong Kong Listing Rules. Rule 19C.07 of the Hong Kong Listing Rules provides that the Hong Kong Stock Exchange will consider that a Non-Greater China Issuer or a Grandfathered Greater China Issuer seeking a secondary listing has met the requirements of Rule 19.30(1)(b) of the Hong Kong Listing Rules if it has met the shareholder protection standards by reference to eight criteria set out in Rule 19C.07 of the Hong Kong Listing Rules. We are a Grandfathered Greater China Issuer under Chapter 19C of the Hong Kong Listing Rules.

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## WAIVERS AND EXEMPTIONS

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### Approval, removal and remuneration of auditors

Rule 19C.07(3) of the Hong Kong Listing Rules requires the appointment, removal and remuneration of auditors to be approved by a majority of the Qualifying Issuer's members or other body that is independent of the issuer's board of directors (the "**Auditors Provision**"). However, our Articles of Association do not contain an equivalent Auditors Provision. We have applied for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with Rule 19C.07(3) of the Hong Kong Listing Rules for the following reasons:

- (a) while our Articles of Associations do not contain an equivalent Auditors Provision, the charter of our audit committee, as determined by the Board, provides that it is responsible for appointing an auditor, determining its compensation and overseeing its work. Our audit committee is akin to an independent body of the Board on the basis of the independence requirements set out in applicable U.S. laws and the Nasdaq rules. Our audit committee comprises of three members, all of whom are independent directors as required by the U.S. Exchange Act and applicable Nasdaq rules;
- (b) since 2002, we have put forth a resolution at each annual general meeting for shareholders to ratify auditors' appointment, and the ratification resolution in each year has been passed with an overwhelming majority of votes in favor (for example, over 99% of the votes approved the ratification resolution from 2016 to 2019);
- (c) the nomination and appointment of our directors are governed by the rules of the Nasdaq and the laws of our place of incorporation, which is the Cayman Islands. Pursuant to Nasdaq Stock Market Rule 5605(e) ("**Nasdaq Rule 5605(e)**"), director nominees, including independent director nominees, must be selected, or recommended for the board's selection, either by: (i) a majority of the independent directors or (ii) a nominations committee comprised solely of independent directors. While Nasdaq Rule 5605(e) is not mandatory for a foreign private issuer incorporated in the Cayman Islands, such as us, we had chosen to follow this rule on a voluntary basis;
- (d) to ensure that auditors are independent of their audit clients, Rule 10A-3 promulgated under the U.S. Exchange Act mandates that the audit committee, whose voting members must consist entirely of independent directors, be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged (including resolution of disagreements between management and the auditor regarding financial reporting). We believe that this legislative mandate effectively prohibits the Board from revoking the power delegated to our audit committee relating to the operation of the Auditors Provision; and
- (e) we are seeking a listing on the Hong Kong Stock Exchange under Chapter 19C of the Hong Kong Listing Rules.

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## WAIVERS AND EXEMPTIONS

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### **PARTICULARS OF ANY COMMISSIONS, DISCOUNTS AND BROKERAGES AND ALTERATIONS OF CAPITAL**

Paragraphs 13 and 26 of Part A of Appendix 1 to the Hong Kong Listing Rules and Paragraphs 11 and 14 of the Third Schedule of the Companies (WUMP) Ordinance require the listing document to include the particulars of any commissions, discounts, brokerages or other special terms granted within two years immediately preceding the issue of the listing document in connection with the issue or sale of any capital of any member of our Group and the particulars of any alterations of capital within two years immediately preceding the issue of the listing document.

Paragraph 25 of the Third Schedule of the Companies (WUMP) Ordinance requires particulars of our authorized debentures and that of our subsidiaries to be disclosed in this document.

We have identified 8 entities as our Significant Subsidiaries. For further details, see “History — Corporate Structure — Significant Subsidiaries.” We had approximately 129 subsidiaries and operating entities as of December 31, 2019. We believe that it would be unduly burdensome for us to disclose this information in respect of all of our subsidiaries as we would have to incur additional costs and devote additional resources in compiling and verifying the relevant information for such disclosure, which would not be material or meaningful to investors.

By way of illustration, based on the book value of the Significant Subsidiaries and taking into account of major adjustments for intra-group transactions, the net revenues of the Significant Subsidiaries accounted for more than 80% of our total net revenues for the year ended December 31, 2019. As such, we have disclosed the particulars of the changes in our share capital and the Significant Subsidiaries in “Statutory and General Information — Further Information about Us” in Appendix IV, and particulars of the commissions, discounts, brokerage fee and authorized debentures in respect of us and our Significant Subsidiaries are set out in “Statutory and General Information — Other Information — Miscellaneous” of Appendix IV.

We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from the requirements under Paragraphs 13 and 26 of Part A of Appendix 1 to the Hong Kong Listing Rules. We have applied for, and the SFC has granted, an exemption from the requirements under Paragraphs 11, 14 and 25 of the Third Schedule of the Companies (WUMP) Ordinance. The SFC has granted an exemption referred to above on the conditions that: (i) the particulars of such exemption are set out in this prospectus; and (ii) this prospectus will be issued on or before June 2, 2020.

### **DISCLOSURE OF INFORMATION ON SUBSIDIARIES WHOSE PROFITS OR ASSETS MAKE MATERIAL CONTRIBUTIONS TO US**

Paragraph 29(1) of Part A of Appendix 1 to the Hong Kong Listing Rules and Paragraph 29 of the Third Schedule to the Companies (WUMP) Ordinance require the listing document to include information in relation to the name, date and country of incorporation, the public or private status and the general nature of the business, the issued capital and the proportion thereof held or intended to be held, of every company the whole of the capital of which or a substantial proportion thereof is held or intended to be held by us, or whose profits or assets make, or will make, a material contribution to the figures in our accountant’s report or our next published accounts.



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## WAIVERS AND EXEMPTIONS

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We believe that it would be unduly burdensome for us to procure this information for the reasons as set out in “Particulars of any Commissions, Discounts and Brokerages and Alternations of Capital” above. As such, only the particulars in relation to the Significant Subsidiaries are set out in “History — Corporate Structure — Significant Subsidiaries” and “Statutory and General Information — Further Information About Us” in Appendix IV, which should be sufficient for potential investors to make an informed assessment of us in their investment decisions.

We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the requirements under paragraph 29(1) of Part A of Appendix 1 to the Hong Kong Listing Rules. We have applied for, and the SFC has granted, an exemption from the requirements under Paragraph 29 of the Third Schedule of the Companies (WUMP) Ordinance. The SFC has granted an exemption referred to above on the conditions that: (i) the particulars of such exemption are set out in this prospectus; and (ii) this prospectus will be issued on or before June 2, 2020.

### DISCLOSURE REQUIREMENTS OF OPTIONS

Paragraph 27 of Part A of Appendix 1 to the Hong Kong Listing Rules requires us to set out in the listing document particulars of any capital of any members of our Group which is under option, or agreed conditionally or unconditionally to be put under option, including the consideration for which the option was or will be granted and the price and duration of the option, and the name and address of the grantee.

Paragraph 10 of the Third Schedule to the Companies (WUMP) Ordinance further requires us to set out in the listing document, among other things, details of the number, description and amount of any of our shares or debentures which any person has, or is entitled to be given, an option to subscribe for, together with the certain particulars of the option, namely the period during which it is exercisable, the price to be paid for shares or debentures subscribed for under it, the consideration given or to be given (if any) and the names and addresses of the persons to whom it was given.

The only options over the capital of any member of our Group are those issued under the equity incentive plans that some of our subsidiaries adopted, including the share incentive plan adopted in 2015 (the “**2015 Share Incentive Plan**”), and amended in 2018, by Youdao, Inc. (“**Youdao**”), our majority-controlled subsidiary listed on the New York Stock Exchange. None of these equity incentive plans is subject to Chapter 17 of the Hong Kong Listing Rules pursuant to Rule 19C.11 of the Hong Kong Listing Rules. The equity incentive plans adopted by our subsidiaries allow the relevant subsidiaries to grant options or other awards to certain of our Group’s directors, employees and consultants. The waiver and exemption therefore only relate to the options that are granted or may be granted under these equity incentive plans. The options under these equity incentive plans expire in five to ten years from the date of grant and either vest or have a vesting commencement date upon certain conditions being met, and the awards can become 100% vested on the vesting commencement date, or vest in two, three, four or five substantially equal annual installments with the first installment vesting on the vesting commencement date.

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## WAIVERS AND EXEMPTIONS

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In particular, the 2015 Share Incentive Plan provides for the granting of options, restricted shares, RSUs and any other type of awards that a committee of the board or the board may decide. The outstanding options under the 2015 Share Incentive Plan accounted for approximately 7.78% of Youdao's total outstanding shares as of March 31, 2020. As of March 31, 2020, the options held by Youdao's directors and executive officers and their affiliates under the 2015 Share Incentive Plan represented approximately less than 1% of Youdao's total outstanding shares.

Details of the 2015 Share Incentive Plan are disclosed in “Statutory and General Information — Further Information About Us — Share incentive plan of Youdao” in Appendix IV and a brief summary of the other equity incentive plans adopted by our subsidiaries is set out in “Directors and Senior Management — Compensation — Our share incentive plans.” These disclosures are substantially the same as those in Youdao's and our 20-F filings and comply with applicable U.S. laws and regulations. Accordingly, the current disclosure in this document is not in strict compliance with the requirements under Paragraph 27 of Part A of Appendix 1 to the Hong Kong Listing Rules and Paragraph 10 of the Third Schedule to the Companies (WUMP) Ordinance.

For the reasons stated above, we believe that strict compliance with the above requirements would be unduly burdensome, unnecessary and/or inappropriate for us, and would not be material or meaningful to potential investors.

We have applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the requirements under Paragraph 27 of Part A of Appendix 1 to the Hong Kong Listing Rules. We have applied for, and the SFC has granted, an exemption from the requirements under Paragraph 10 of the Third Schedule of the Companies (WUMP) Ordinance. The SFC has granted an exemption referred to above on the conditions that: (i) the particulars of such exemption are set out in this prospectus; and (ii) this prospectus will be issued on or before June 2, 2020.

### TIMING REQUIREMENT OF LIQUIDITY DISCLOSURE

Paragraph 32 of Part A of Appendix 1 to the Hong Kong Listing Rules requires a listing document to include a statement (or an appropriate negative statement) of a new applicant's indebtedness as at a specified most recent practicable date (the “**Most Recent Practicable Date**”), and a commentary on its liquidity, financial resources and capital structure (together, the “**Liquidity Disclosure**”).

In accordance with the Hong Kong Stock Exchange's Guidance Letter HKEX-GL37-12 (“**GL37-12**”), the Hong Kong Stock Exchange normally expects that the Most Recent Practicable Date for the Liquidity Disclosure, including, among other things, commentary on liquidity and financial resources such as net current assets (liabilities) position and management discussion on this position, in a listing document to be dated no more than two calendar months before the final date of the listing document.

As this document is published in June 2020, we would otherwise be required to make the relevant indebtedness and liquidity disclosures no earlier than April 2020 pursuant to GL37-12. Given that we included in this document a report of our interim financial information for the three months ended March 31, 2020 (*i.e.*, financial information for our first quarter in 2020), which were reviewed in accordance with Hong Kong Standard on Review Engagements 2410

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## WAIVERS AND EXEMPTIONS

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“Review of Interim Financial Information Performed by the Independent Auditor of the Entity,” it would be unduly burdensome for us to re-arrange information for similar liquidity disclosures on a consolidated basis shortly after the end of the first quarter of our current financial year.

Strict compliance with the Liquidity Disclosure requirements would constitute an additional one-off disclosure by us of our liquidity position on a date that would fall within the second quarter of our financial year, which would otherwise not be required to be disclosed to investors in the U.S. under applicable U.S. regulations and Nasdaq listing rules, because we are required to announce quarterly results at the end and not in the middle of each quarter of our financial year. Such a one-off disclosure would likely confuse our existing investors and deviate from our customary practice and that of other Nasdaq listed companies.

In any event, if there are any material changes to such disclosures, we would be required to make an announcement pursuant to U.S. regulations and Nasdaq rules and disclose relevant material facts in this document pursuant to the Hong Kong Listing Rules.

In the event that there is no material change to such disclosures, any similar disclosures made pursuant to GL37-12 would not give additional meaningful information to investors.

We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the timing requirement for Liquidity Disclosure in the listing document under GL37-12, such that the reported date of indebtedness and liquidity information in the listing document will not exceed the requirement under GL37-12 by one calendar month (*i.e.*, the time gap between the reported date of the Company’s indebtedness and liquidity information and the date of the listing document would be no more than three calendar months).

### **DISCLOSURE REQUIREMENTS OF THE REMUNERATION OF DIRECTORS AND FIVE INDIVIDUALS WHOSE EMOLUMENTS WERE HIGHEST**

Paragraph 33(2) of Part A of Appendix 1 to the Hong Kong Listing Rules requires the listing document to include information in respect of directors’ emoluments during the three financial years ended December 31, 2017, 2018 and 2019. Paragraph 46(2) of Part A of Appendix 1 to the Hong Kong Listing Rules requires the listing document to include the aggregate of the remuneration paid and benefits in kind granted to our directors in respect of the last completed financial year, and Paragraph 46(3) of Part A of Appendix 1 to the Hong Kong Listing Rules requires information in relation to an estimate of the aggregate remuneration and benefits in kind payable to directors in respect of the current financial year to be set out in the listing document.

Paragraph 33(3) of Part A of Appendix 1 to the Hong Kong Listing Rules requires the listing document to include information with respect to the five individuals whose emoluments were highest in our Group for the year if one or more individuals whose emoluments were the highest have not been included under Paragraph 33(2) of Part A of Appendix 1 to the Hong Kong Listing Rules.

The aggregate fees, salaries and benefits paid and accrued to our directors and executive officers as a group are disclosed in “Directors and Senior Management — Compensation.” We confirm that the current disclosure complies with U.S. annual reporting requirements and is in line with our disclosure in our annual reports on Form 20-F.

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## WAIVERS AND EXEMPTIONS

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We believe that additional disclosure required by Paragraphs 33(2), 33(3), 46(2) and 46(3) of Part A of Appendix 1 to the Hong Kong Listing Rules would be unduly burdensome and would not provide additional meaningful disclosure for potential Hong Kong investors.

We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the requirements under Paragraphs 33(2), 33(3), 46(2) and 46(3) of Part A of Appendix 1 to the Hong Kong Listing Rules.

### **NOT A PUBLIC COMPANY IN HONG KONG**

Section 4.1 of the Introduction to Takeovers Codes provides that the Takeovers Codes apply to takeovers, mergers and share buy-backs affecting, among others, public companies in Hong Kong and companies with a primary listing in Hong Kong. According to the Note to Section 4.2 of the Introduction to the Takeovers Codes, a Grandfathered Greater China Issuer within the meaning of Rule 19C.01 of the Hong Kong Listing Rules with a secondary listing on the Hong Kong Stock Exchange will not normally be regarded as a public company in Hong Kong under Section 4.2 of the Introduction to the Takeovers Codes. We have applied for, and the SFC has granted, a ruling that we are not a “public company in Hong Kong” for the purposes of the Takeovers Codes. Therefore, the Takeovers Codes do not apply to us. In the event that the bulk of trading in our Shares migrates to Hong Kong such that we would be treated as having a dual-primary listing pursuant to Rule 19C.13 of the Hong Kong Listing Rules, the Takeovers Codes will apply to us.

### **DISCLOSURE OF INTERESTS UNDER PART XV OF SFO**

Part XV of the SFO imposes duties of disclosure of interests in Shares. Under the U.S. Exchange Act, which we are subject to, any person (including directors and officers of the company concerned) who acquires beneficial ownership, as determined in accordance with the rules and regulations of the SEC and which includes the power to direct the voting or the disposition of the securities, of more than 5% of a class of equity securities registered under Section 12 of the U.S. Exchange Act must file beneficial owner reports with the SEC, and such person must promptly report any material change in the information provided (including any acquisition or disposition of 1% or more of the class of equity securities concerned), unless exceptions apply. Therefore, compliance with Part XV of the SFO would subject our corporate insiders to a second level of reporting, which would be unduly burdensome to them, would result in additional costs and would not be meaningful, since the statutory disclosure of interest obligations under the U.S. Exchange Act that apply to us and our corporate insiders would provide our investors with sufficient information relating to the shareholding interests of our significant shareholders.

We have applied for, and the SFC has granted, a partial exemption under section 309(2) of the SFO from the provisions of Part XV of the SFO (other than Divisions 5, 11 and 12 of Part XV of the SFO), on the conditions that (i) the bulk of trading in the Shares is not considered to have migrated to Hong Kong on a permanent basis in accordance with Rule 19C.13 of the Hong Kong Listing Rules; (ii) all disclosures of interest filed with the SEC are also filed with the Hong Kong Stock Exchange as soon as practicable, which will then publish such disclosures in the same manner as disclosures made under Part XV of the SFO; and (iii) we will advise the SFC if there is any material change to any of the information which has been provided to the SFC, including any significant changes to the disclosure requirements in the U.S. and any significant changes in the volume of our worldwide share turnover that takes place on the Hong Kong Stock Exchange. This exemption may be reconsidered by the SFC in the event there is a material change in information provided to the SFC.

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## WAIVERS AND EXEMPTIONS

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### DISCLOSURE OF INTERESTS INFORMATION

Part XV of the SFO imposes duties of disclosure of interests in shares. Practice Note 5 and Paragraphs 41(4) and 45 of Part A of Appendix 1 to the Hong Kong Listing Rules require the disclosure of interests information in respect of shareholders' and directors' interests in the listing document.

We have applied for, and the SFC has granted, a partial exemption from strict compliance with Part XV of the SFO as set out above under sub-section headed "Disclosure of Interest under Part XV of SFO."

The U.S. Exchange Act and the rules and regulations promulgated thereunder require disclosure of interests by shareholders that are broadly equivalent to Part XV of the SFO. Relevant disclosure in respect of the substantial shareholder's interests can be found in "Major Shareholders."

We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with Practice Note 5 and Paragraphs 41(4) and 45 of Part A of Appendix 1 to the Hong Kong Listing Rules on the following conditions:

- (a) the SFC granting us and our shareholders a partial exemption from strict compliance with Part XV of the SFO;
- (b) our undertaking to file with the Hong Kong Stock Exchange, as soon as practicable, any declaration of shareholding and securities transactions filed with the SEC; and
- (c) our undertaking to disclose in present and future listing documents any shareholding interests as disclosed in an SEC filing and the relationship between our directors, officers, members of committees and their relationship to any controlling shareholders.

### THREE-YEAR RESTRICTION ON SPIN-OFFS

Rule 19C.11 of the Hong Kong Listing Rules provides that, among other things, Paragraphs 1 to 3(b) and 3(d) to 5 of Practice note 15 to ("PN15") the Hong Kong Listing Rules do not apply to a Qualifying Issuer that has, or is seeking, a secondary listing on the Hong Kong Stock Exchange. This exception is limited to circumstances where the spun-off assets or businesses are not to be listed on the Hong Kong Stock Exchange's markets and the approval of shareholders of the Parent is not required. Paragraph 3(b) of PN15 provides that the Listing Committee would not normally consider a spin-off application within three years of the date of listing of the Parent, because the original listing of the Parent will have been approved on the basis of the Parent's portfolio of businesses at the time of listing, and the expectation of investors at that time would have been that the Parent would continue to develop those businesses.

We from time to time consider different opportunities to bring value to our shareholders, including spinning off any of our business subsidiaries when they have reached a desirable level of maturity. The exact timing of any potential spin-off would depend on the development of each of our business subsidiaries and market conditions. In some cases, it is possible that a spin-off within three years of the Listing may be appropriate. As of the Latest Practicable Date, we have not identified any target for a potential spin-off; as a result we do not have any information relating to the identity of any spin-off target or any other details of any spin-off and accordingly, there is no material omission of any information relating to any possible

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## WAIVERS AND EXEMPTIONS

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spin-off in this document. Any potential spin-offs by us will be subject to our compliance with all applicable requirements under the Hong Kong Listing Rules, including PN15, unless otherwise waived by the Hong Kong Stock Exchange.

We have applied for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with the three-year restriction under Paragraph 3(b) of PN15 on the following grounds:

- (i) no shareholders' approval with respect to a potential spin-off will be required under the Articles under applicable U.S. regulations and Nasdaq listing rules. Further, as our Company is a Grandfathered Greater China Issuer and therefore exempt from the requirements under Chapter 14 of the Hong Kong Listing Rules pursuant to Rule 19C.11, no shareholders' approval will be required under the Hong Kong Listing Rules as well;
- (ii) the effect of a spin-off to our shareholders should be the same regardless of whether or not the businesses to be potentially spun-off are to be listed on the Hong Kong Stock Exchange (save with respect to any preferential rights to subscribe for shares that are commonly provided in spin-offs on the Hong Kong Stock Exchange). Given the fact that certain spin-offs by Grandfathered Greater China Issuers are allowed within three years after their listing in Hong Kong pursuant to Rule 19C.11 of the Hong Kong Listing Rules, we believe that the three-year restriction on spin-offs on the Hong Kong Stock Exchange should also be waived and shall not apply to a potential spin-off by our Company;
- (iii) our Company and any subsidiary in respect of which a potential spin-off is contemplated will be subject to compliance with all other applicable requirements under the Hong Kong Listing Rules, including the remaining requirements of Practice Note 15 and the applicable listing eligibility requirements under the Hong Kong Listing Rules, unless otherwise waived by the Hong Kong Stock Exchange;
- (iv) under U.S. securities laws and Nasdaq rules, we are not subject to any restrictions similar to the three-year restriction under Paragraph 3(b) of PN15 in relation to the spin-offs of our business subsidiaries, nor is there any requirement for us to disclose any details of our potential spin-off entities when such information is not available because of the absence of any concrete spin-off plan; and
- (v) our directors owe fiduciary duties to our Company, including the duty to act in what they consider in good faith to be in the best interests of our Company; as such they will only pursue a potential spin-off if there are clear commercial benefits both to our Company and the entity to be spun off; and our directors will not direct our Company to conduct any spin-off if they believe it will have an adverse impact on the interests of our shareholders.

The waiver was granted by the Hong Kong Stock Exchange subject to the following conditions:

- (a) we will not within three years after the Listing spin off any of our business subsidiaries until we confirm with the Hong Kong Stock Exchange with basis that the potential spin-off would not render us, excluding the subsidiary to be spun off, failing to meet the eligibility requirements under Rule 19C.05 of the Hong Kong Listing Rules based on the financial information of the subsidiary to be spun off at the time of our Listing, and where more than one subsidiary is to be spun off, the assessment will be made on a cumulative basis;

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## WAIVERS AND EXEMPTIONS

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- (b) we will disclose in this document our intention relating to any potential spin-off within three years after the Listing and the risks relating to the uncertainty and timing of any potential spin-offs (see “Risk Factors — Divestitures of businesses and assets may have a material and adverse effect on our business and financial condition”);
- (c) any potential spin-offs by us will be subject to the requirements of PN15 (other than Paragraph 3(b) thereof), including that each of our Company and our business subsidiary to be spun off will satisfy the applicable listing eligibility requirements on a standalone basis;
- (d) any potential spin-offs within the parameters permitted by this waiver will not involve our online game business; and
- (e) disclosure of this waiver in this document.

### DISCLOSURE OF OFFER PRICE

Paragraph 15(2)(c) of Part A of Appendix 1 to the Listing Rules provides that the issue price or offer price of each security must be disclosed in the prospectus. Pursuant to Paragraph 3.1 of the Guidance Letter HKEx-GL-90-18, the Hong Kong Stock Exchange also allows an indicative offer price range to be included in the prospectus, as an alternative to the disclosure of a fixed offer price. Paragraph 9 of Part 1 of the Third Schedule to the Companies (WUMP) Ordinance further provides that the amount payable on application and allotment on each share must be specified in the prospectus.

Our ADSs have been listed and traded on Nasdaq since June 30, 2000. The Public Offer Price will be determined by reference to, among other factors, the closing price of the ADSs on Nasdaq on the last trading day on or before the Price Determination Date. We have no control over the market price of our ADSs traded on Nasdaq.

As our ADSs will continue to be traded on Nasdaq, setting a fixed price or a price range with a low end of International Offer Price or Public Offer Price may adversely affect the market price of the ADSs and the Hong Kong Offer Shares.

For the information of the potential investors, we will disclose the historical prices of our ADSs and trading volume on Nasdaq for the period from January 1, 2019 up to the Latest Practicable Date in “Structure of the Global Offering — Pricing and allocation — Determining the Offer Price”

It is further submitted that the disclosure of the maximum Public Offer Price in this document shall constitute sufficient disclosure of the “amount payable” on application and allotment on the Offer Shares and hence, shall be in compliance with the disclosure requirement under the Companies (WUMP) Ordinance.

We have applied for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with Paragraph 15(2)(c) of Part A of Appendix 1 to the Listing Rules so that we will only disclose the maximum Public Offer Price for the Hong Kong Offer Shares in this document.

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We will set the pricing for the Offer Shares by agreement with the Joint Global Coordinators (for themselves and on behalf of the Underwriters). The Public Offer Price will be determined by reference to, among other factors, the closing price of our ADSs on Nasdaq on the last trading day on or before the Price Determination Date.

We may set the International Offer Price at a level higher than the maximum Public Offer Price if (a) the Hong Kong dollar equivalent of the closing trading price of our ADSs on Nasdaq on the last trading day on or before the Price Determination Date (on a per-Share converted basis) were to exceed the maximum Public Offer Price as stated in this document and/or (b) we believe that it is in our best interests as a listed company to set the International Offer Price at a level higher than the maximum Public Offer Price based on the level of interest expressed by professional and institutional investors during the book-building process.

If the International Offer Price is set at or lower than the maximum Public Offer Price, the Public Offer Price must be set at such price which is equal to the International Offer Price. In no circumstances will we set the Public Offer Price above the maximum Public Offer Price as stated in this document or the International Offer Price.

See “Structure of the Global Offering — Pricing and allocation — Determining the Offer Price” in this prospectus for the historical prices of our ADS and trading volume on Nasdaq.

### CLAWBACK MECHANISM

Paragraph 4.2 of Practice Note 18 of the Hong Kong Listing Rules requires a clawback mechanism to be put in place, which would have the effect of increasing the number of Hong Kong Offer Shares to certain percentages of the total number of Offer Shares offered in the Global Offering if certain prescribed total demand levels are reached. Subject to the Hong Kong Stock Exchange granting the waiver described as below, the Hong Kong Public Offering and the International Offering will initially account for 3.0% and 97.0% of the Global Offering, respectively, subject to the clawback mechanism described below. We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted to us, a waiver from strict compliance with the requirements of Paragraph 4.2 of Practice Note 18 to the Hong Kong Listing Rules such that the allocation of the Offer Shares in the Hong Kong Public Offering will be adjusted as follows:

- if the number of the Offer Shares validly applied for under the Hong Kong Public Offering represents 10 times or more but less than 15 times the number of the Offer Shares initially available for subscription under the Hong Kong Public Offering, then Offer Shares will be reallocated to the Hong Kong Public Offering from the International Offering, so that the total number of Offer Shares available under the Hong Kong Public Offering will be 10,290,000 Offer Shares, representing approximately 6.0% of the Offer Shares initially available under the Global Offering;
- if the number of the Offer Shares validly applied for under the Hong Kong Public Offering represents 15 times or more but less than 20 times the number of the Offer Shares initially available for subscription under the Hong Kong Public Offering, then the number of Offer Shares to be reallocated to the Hong Kong Public Offering from the International Offering will be increased so that the total number of the Offer Shares available under the Hong Kong Public Offering will be 15,440,000 Offer Shares, representing approximately 9.0% of the Offer Shares initially available under the Global Offering; and



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## WAIVERS AND EXEMPTIONS

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- if the number of the Offer Shares validly applied for under the Hong Kong Public Offering represents 20 times or more the number of the Offer Shares initially available for subscription under the Hong Kong Public Offering, then the number of Offer Shares to be reallocated to the Hong Kong Public Offering from the International Offering will be increased, so that the total number of the Offer Shares available under the Hong Kong Public Offering will be 20,580,000 Offer Shares, representing approximately 12.0% of the Offer Shares initially available under the Global Offering.

In each case, the additional Offer Shares reallocated to the Hong Kong Public Offering will be allocated between pool A and pool B and the number of Offer Shares allocated to the International Offering will be correspondingly reduced in such manner as the Joint Global Coordinators deem appropriate. In addition, the Joint Global Coordinators would have discretion to allocate Offer Shares from the International Offering to the Hong Kong Public Offering to satisfy valid applications under the Hong Kong Public Offering. On the other hand, if the Hong Kong Public Offering is not fully subscribed, the unsubscribed Offer Shares under the Hong Kong Public Offering may be reallocated to the International Offering.

See “Structure of the Global Offering — The Hong Kong Public Offering — Reallocation” for further details.

### **DISCLOSURE REQUIREMENTS IN RESPECT OF SUPPLIERS**

Paragraphs 28(1)(b)(i) and (ii) of Part A of Appendix 1 to the Hong Kong Listing Rules require the listing document to include a statement of the percentage of purchases attributable to the group’s largest supplier and a statement of the percentage of purchases attributable to the group’s five largest suppliers combined, respectively.

Paragraph 28(1)(b)(v) of Part A of Appendix 1 to the Hong Kong Listing Rules requires the listing document to include a statement of the interest of any of the directors, their close associates; or any shareholder (which to the knowledge of the directors owns more than 5% of the number of issued shares of the issuer) in the group’s top five suppliers. Sub-paragraph (vi) further provides that in the event that the percentage which would fall to be disclosed under sub-paragraphs (i), (ii) and (v) above is less than 30, a statement of that fact shall be given and the information required in sub-paragraphs (i), (ii) and (v) (in respect of suppliers) may be omitted.

Rule 19.36(1) of the Hong Kong Listing Rules provides that certain disclosure requirements under Parts A and B of Appendix 1 to the Hong Kong Listing Rules may be inappropriate and allows such requirements to be appropriately adapted so that equivalent information is given.

#### ***Percentages of our purchases from our largest supplier and from our top five suppliers***

We believe that the specific percentage figures required to be disclosed by Paragraphs 28(1)(b)(i) and (ii) of Part A of Appendix 1 to the Hong Kong Listing Rules are commercially sensitive and could be exploited by our competitors. We have not publicly disclosed the information strictly required by Paragraphs 28(1)(b)(i) and (ii) of Appendix 1A to the Hong Kong Listing Rules in our SEC filings, nor are we required to do so under U.S. laws and regulations. We have however disclosed that our five largest suppliers accounted for less than 41% of our purchases for each of the years over the Track Record Period and none of them individually accounted for more than 30% of our annual purchases over this same period in

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## WAIVERS AND EXEMPTIONS

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“Our Business – Customers and Suppliers.” We, taking into account that we are seeking a secondary listing on the Hong Kong Stock Exchange, believe that the current disclosure in this document provides sufficient information to investors to make an informed assessment of our business.

### *Statement of interests in our top five suppliers*

Our five largest suppliers accounted for less than 41% of our purchases for each of the years over the Track Record Period; and none of them individually accounted for more than 30% of our annual purchases over this same period. Several of our top five suppliers are public companies whose shares are traded on various stock exchanges.

As a Nasdaq-listed company, we are not in a position to compel our public shareholders who own more than 5% in our issued shares based on public filings to disclose to us (in this case Orbis Investment Management Limited) their shareholding interests in our top five suppliers during the Track Record Period. It would also be unduly burdensome for these public shareholders of ours to ascertain their shareholding interests in our top five suppliers (especially the companies whose shares are publicly traded), because the disclosure requirements under Paragraph 28(1)(b)(v) of Part A of Appendix 1 to the Hong Kong Listing Rules are not subject to any materiality or de minimis exemptions or “safe harbours” provisions. The same difficulties would apply to our directors who are otherwise required to disclose their, and their close associates’, shareholding interests in our top five suppliers including the companies whose shares are publicly traded. As of the Latest Practicable Date, based on publicly available information, none of our directors or their close associates (as defined in the Hong Kong Listing Rules) or Shining Globe International Limited, our controlling shareholder, held a 5% or more shareholding interest in our top five suppliers.

In addition, we do not believe that the information strictly required by Paragraph 28(1)(b)(v) of Part A of Appendix 1 to the Hong Kong Listing Rules would provide any additional meaningful information to investors given that we will not in any event be subject to the connected transaction requirements under Chapter 14A of the Hong Kong Listing Rules, and details of our related party transactions are disclosed in “Related Party Transactions.”

For the above reasons, taking into account the alternative disclosures outlined above, we have applied for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with the disclosure requirements under Paragraphs 28(1)(b)(i), (ii) and (v) of Part A of Appendix 1 to the Hong Kong Listing Rules, to the extent not strictly met by the current disclosure in this document.

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**DIRECTORS AND PARTIES INVOLVED IN THE GLOBAL OFFERING**

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**DIRECTORS**

<b>Name</b>		<b>Address</b>	<b>I.D. issuing countries/ territories</b>
William Lei Ding	丁磊	No. 16 Keyun Road, Tianhe District Guangzhou, Guangdong China	China
Alice Cheng <sup>(1)</sup>	鄭玉芬	Unit 34-G, Tower 6, The Residencia Macau, 237 Rua da Pérola Oriental, Macau	Taiwan
Denny Lee	李廷斌	4, Dianthus Road Kowloon, Hong Kong	Hong Kong
Joseph Tong <sup>(1)</sup>	唐子期	House 6, Moritz Avenue, Valais II, 33 Kwu Tung Road, Sheung Shui Hong Kong	Hong Kong
Lun Feng	馮倫	22-3002, Central Park, #6 Chaowai Avenue, Beijing 100020 China	China
Michael Leung <sup>(1)</sup>	梁民傑	Flat A, 16th Floor, Ho King View 2 Braemar Hill Road Hong Kong	Hong Kong
Michael Tong	董瑞豹	Flat 22D, Tower 2 80 Robinson Road Mid-levels West, Hong Kong	Hong Kong

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Note:

(1) Member of our audit, compensation, and nominating committees.

Further information about our directors and other senior managers are set out in “Directors and Senior Management.”

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## DIRECTORS AND PARTIES INVOLVED IN THE GLOBAL OFFERING

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### PARTIES INVOLVED IN THE GLOBAL OFFERING

#### **Joint Sponsors**

*(in alphabetical order)*

#### **China International Capital Corporation Hong Kong Securities Limited, or CICC**

29th Floor, One International Finance Centre  
1 Harbour View Street  
Central, Hong Kong

#### **Credit Suisse (Hong Kong) Limited, or Credit Suisse**

88th Floor, International Commerce Centre  
1 Austin Road West  
Kowloon, Hong Kong

#### **J.P. Morgan Securities (Far East) Limited, or J.P. Morgan**

28th Floor, Chater House  
8 Connaught Road Central  
Hong Kong

#### **Joint Global Coordinators and Joint Bookrunners**

*(in alphabetical order)*

#### **China International Capital Corporation Hong Kong Securities Limited, or CICC**

29th Floor, One International Finance Centre  
1 Harbour View Street  
Central, Hong Kong

#### **Credit Suisse (Hong Kong) Limited, or Credit Suisse**

88th Floor, International Commerce Centre  
1 Austin Road West  
Kowloon, Hong Kong

#### **J.P. Morgan Securities (Asia Pacific) Limited, or J.P. Morgan**

*(Joint Global Coordinator and Joint Bookrunner in relation to the Hong Kong Public Offering only)*

28/F, Chater House  
8 Connaught Road Central  
Hong Kong

#### **J.P. Morgan Securities plc, or J.P. Morgan**

*(Joint Bookrunner in relation to the International Offering only)*

25 Bank Street  
Canary Wharf  
London E14 5JP  
United Kingdom

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## DIRECTORS AND PARTIES INVOLVED IN THE GLOBAL OFFERING

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**J.P. Morgan Securities LLC, or J.P. Morgan**  
*(Joint Bookrunner in relation to the International Offering only)*  
383 Madison Avenue  
New York, NY 10179  
United States of America

**Joint Bookrunners**  
*(in alphabetical order)*

**ABCI Capital Limited, or ABCI**  
11/F, Agricultural Bank of China Tower  
50 Connaught Road Central  
Hong Kong

**BOCI Asia Limited, or BOCI**  
26/F, Bank of China Tower  
1 Garden Road  
Central, Hong Kong

**CCB International Capital Limited, or CCBI**  
12/F, CCB Tower  
3 Connaught Road Central  
Central, Hong Kong

**Citigroup Global Markets Asia Limited, or Citigroup**  
*(Joint Bookrunner in relation to the Hong Kong Public Offering only)*  
50/F, Champion Tower  
3 Garden Road  
Central, Hong Kong

**Citigroup Global Markets Limited, or Citigroup**  
*(Joint Bookrunner in relation to the International Offering only)*  
33 Canada Square  
Canary Wharf  
London E14 5LB  
United Kingdom

**CMB International Capital Limited, or CMBI**  
45/F, Champion Tower  
3 Garden Road  
Central, Hong Kong

**The Hongkong and Shanghai Banking Corporation Limited, or HSBC**  
1 Queen's Road Central  
Hong Kong

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## DIRECTORS AND PARTIES INVOLVED IN THE GLOBAL OFFERING

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**Huatai Financial Holdings (Hong Kong) Limited,  
or HTSC**  
62/F The Center  
99 Queen's Road Central  
Hong Kong

**ICBC International Capital Limited, or ICBCI**  
37/F, ICBC Tower  
3 Garden Road  
Hong Kong

**US Tiger Securities, Inc., or Tiger Brokers**  
*(Joint Bookrunner in relation to the International  
Offering only)*  
437 Madison Ave 27th Floor  
New York 10022  
United States of America

**UBS AG Hong Kong Branch, or UBS**  
52/F, Two International Finance Centre  
8 Finance Street  
Hong Kong

### **Our Legal Advisers**

*As to Hong Kong and U.S. laws:*

**Skadden, Arps, Slate, Meagher & Flom and  
affiliates**  
42nd Floor, Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

*As to PRC laws:*

**Zhong Lun Law Firm**  
6/10/11/16/17F, Two IFC  
8 Century Avenue, Pudong New Area  
Shanghai 200120, China

*As to Cayman Islands laws:*

**Maples and Calder (Hong Kong) LLP**  
26th Floor, Central Plaza  
18 Harbour Road  
Wan Chai, Hong Kong

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## DIRECTORS AND PARTIES INVOLVED IN THE GLOBAL OFFERING

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**Legal Advisers to the Joint  
Sponsors and the  
Underwriters**

*As to Hong Kong and U.S. laws:*

**Davis Polk & Wardwell**

18th Floor, The Hong Kong Club Building  
3A Chater Road  
Central, Hong Kong

*As to PRC laws:*

**JunHe LLP**

20th Floor, China Resources Building  
8 Jianguomenbei Avenue  
Beijing 100005, China

**Auditor and Reporting  
Accountant**

**PricewaterhouseCoopers**

*Certified Public Accountants*

*Registered Public Interest Entity Auditor*

22nd Floor, Prince's Building  
Central, Hong Kong

**Receiving Bank**

**Bank of China (Hong Kong) Limited**

1 Garden Road  
Hong Kong

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## CORPORATE INFORMATION

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<b>Registered Office</b>	PO Box 309, Uglan House Grand Cayman, KY1-1104 Cayman Islands
<b>Principal Executive Offices of Main Operations</b>	NetEase Building 599 Wangshang Road, Binjiang District Hangzhou 310052, China
<b>Address in Hong Kong</b>	8th Floor, Chuang's Tower 30-32 Connaught Road Central Hong Kong
<b>Company's Website</b>	<a href="http://ir.netease.com/">http://ir.netease.com/</a> <i>(The information on the website does not form part of this document)</i>
<b>Authorized Representatives</b>	<b>Charles Zhaoxuan Yang/ Cary Ka Lee Cheng</b> 8th Floor, Chuang's Tower 30-32 Connaught Road Central Hong Kong
<b>Cayman Islands Principal Share Registrar</b>	<b>Maples Fund Services (Cayman) Limited</b> PO Box 1093, Boundary Hall Cricket Square Grand Cayman, KY1-1102 Cayman Islands
<b>Hong Kong Share Registrar</b>	<b>Computershare Hong Kong Investor Services Limited</b> Shops 1712-1716, 17th Floor Hopewell Centre 183 Queen's Road East Wan Chai, Hong Kong
<b>Compliance Advisor</b>	<b>Credit Suisse (Hong Kong) Limited</b> 88th Floor, International Commerce Centre 1 Austin Road West Kowloon, Hong Kong
<b>Principal Banks</b>	<b>Industrial and Commercial Bank of China</b> 55 Fuxingmennei Avenue Xicheng District Beijing, China  <b>Agricultural Bank of China</b> No. 69, Jianguomen Nei Avenue Dongcheng District Beijing, China  <b>The Hongkong and Shanghai Banking Corporation Limited</b> 1 Queen's Road Central Hong Kong



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## HISTORY

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### OUR KEY MILESTONES

Our business was founded in June 1997 and our Company was incorporated on July 6, 1999 under the Cayman Companies Law. Our key business milestones are summarized below:

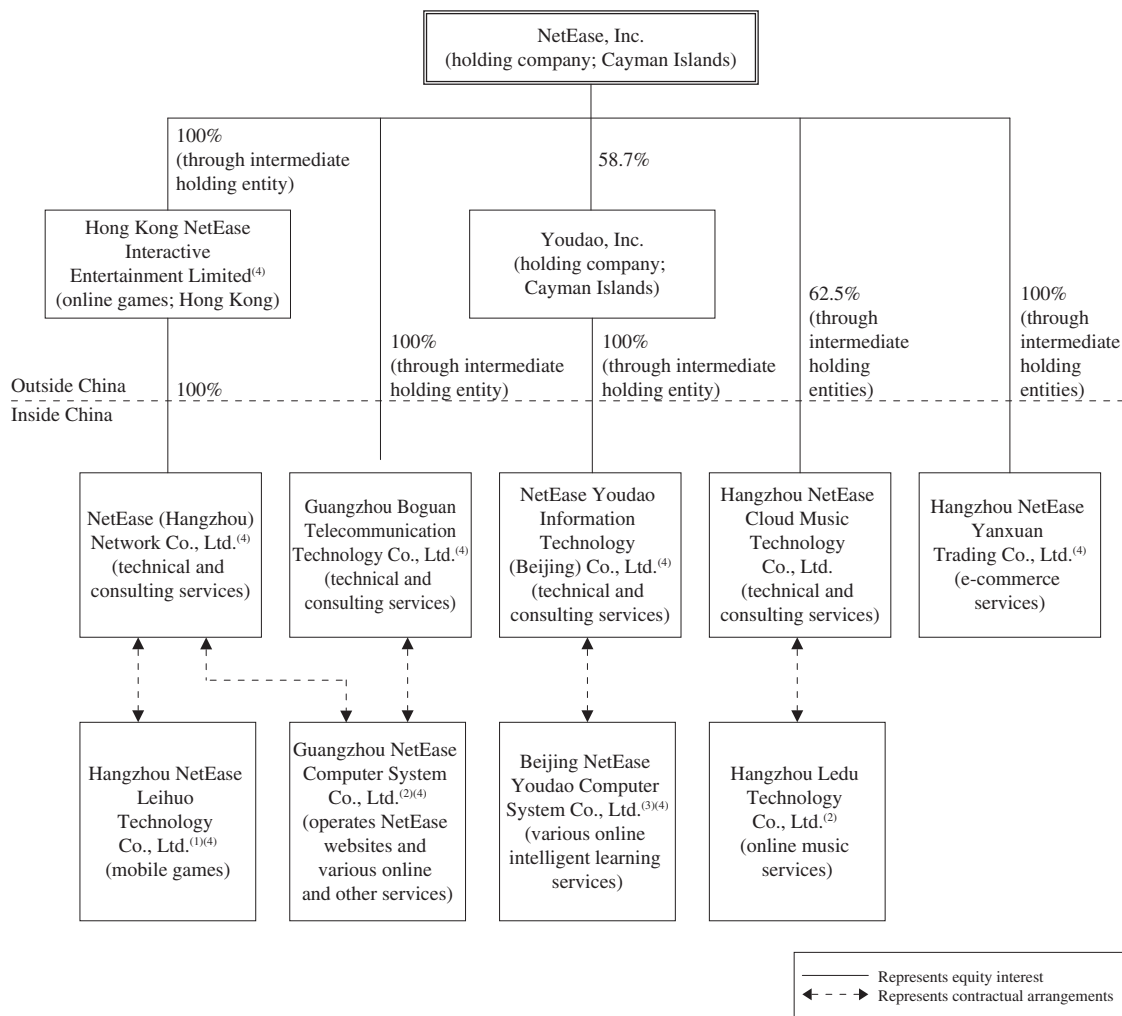
- Founding of our business 1997
- Launch of free web-based e-mail services 1998
- Business model shifted from software development to internet technology with the launch of our NetEase website (“**www.163.com**”)
- Launches of advertisement services, online platforms, online shopping malls, and other internet services in China 1999
- Listing on Nasdaq 2000
- Introduction of fee-based premium services and online entertainment services, including online games, wireless value-added services and other subscription-type services 2001
- Launch of our first PC-client MMORPG game, *Westward Journey Online*, our widely popular in-house developed game series 2001
- Launch of our *Fantasy Westward Journey* series, our second widely popular original game series 2004
- Founding of Youdao, an intelligent learning company that now offers online learning services and products, as well as online marketing services 2006
- Launch of NetEase Cloud Music, our music streaming platform 2013
- Launch of our first mobile game, the mobile version of *Fantasy Westward Journey II* 2013
- Launch of our e-commerce platform, Kaola 2015
- Launch of Yanxuan, our private label e-commerce business 2016
- Sale of Kaola to Alibaba 2019
- Listing of Youdao on the New York Stock Exchange 2019

# HISTORY

## CORPORATE STRUCTURE

### Our corporate structure

For illustrative purposes, we summarize our corporate group structure in the diagram below:



#### Notes:

- (1) Hangzhou NetEase Leihuo Technology Co., Ltd. is owned by two of our employees.
- (2) Each of Guangzhou NetEase Computer System Co., Ltd. and Hangzhou Ledu Technology Co., Ltd. is 99.0% owned by William Lei Ding, our founder, director and chief executive officer, and 1.0% by two of our employees, respectively. Our indirect, wholly owned subsidiary NetEase Information Technology (Beijing) Co., Ltd. is also a party to certain contractual arrangements with Guangzhou NetEase Computer System Co., Ltd..
- (3) Beijing NetEase Youdao Computer System Co., Ltd. is 71.1% owned by William Lei Ding and 28.9% owned by the chief executive officer of Youdao.
- (4) Our Significant Subsidiaries, see “— Significant Subsidiaries,” of which Hangzhou NetEase Leihuo Technology Co., Ltd., Guangzhou NetEase Computer System Co., Ltd. and Beijing NetEase Youdao Computer System Co., Ltd. (collectively, the “**VIE Entities**”) are variable interest entities.

## HISTORY

- (5) Starting in August 2008, Blizzard Entertainment, Inc., (and together with its affiliated entities, “**Blizzard**”) agreed to license certain online games to Shanghai EaseNet Network Technology Co., Ltd. (“**Shanghai EaseNet**”) for operation in the PRC. Shanghai EaseNet is a PRC company wholly-owned by William Lei Ding, our founder, director and chief executive officer, and has contractual arrangements with the joint venture established between, and owned equally by, Blizzard and us. The joint venture was established concurrently with the licensing of games from Blizzard in August 2008 and provides technical services to Shanghai EaseNet. See “Our Business — Our Services — Online game services — International partnership and investment” and “Financial Information — Capital expenditures” and “Related Party Transactions” for details of our cooperation with Blizzard. See also Note 1(b) to the Accountant’s Report in Appendix IA for information on Shanghai EaseNet being treated as a consolidated entity under accounting principles.

### Significant Subsidiaries

As of December 31, 2019, we conducted our business operations across approximately 129 subsidiaries, of which eight are our Significant Subsidiaries. The Significant Subsidiaries cover all of our reporting segments and collectively accounted for more than 80% of the Company’s total net revenues for the financial year ended December 31, 2019. We summarize the principal business activities and date of establishment of each of our Significant Subsidiaries below:

<u>Reporting segment</u>	<u>Name of company</u>	<u>Principal business activity</u>	<u>Date and jurisdiction of establishment</u>
<i>Online Game Services</i>	Guangzhou NetEase	Operates online games, NetEase websites and various online and other services.	June 24, 1997, Guangzhou, China
	Boguan	Provides technical consulting and related services.	December 8, 2003, Guangzhou, China
	NetEase Hangzhou	Provides technical consulting and related services.	June 2, 2006, Hangzhou, China
	Hong Kong NetEase	Operates the online games business outside of China.	November 26, 2007, Hong Kong
	Hangzhou Leihuo	Primarily involved in the operation of the mobile games business.	April 15, 2009, Hangzhou, China
<i>Youdao</i>	Youdao Information	Provides technical consulting and related services.	March 21, 2006, Beijing, China
	Youdao Computer	Primarily involved in the operation of the Youdao business.	September 4, 2007, Beijing, China
<i>Innovative Businesses and Others</i>	Yanxuan	Primarily involved in the operation of the Yanxuan business.	April 13, 2016, Hangzhou, China

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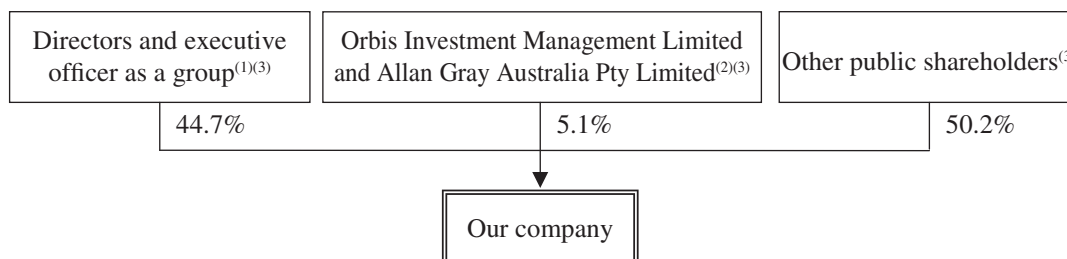
## HISTORY

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For more details on the related party transactions with the above entities, see “Related Party Transactions.”

### Shareholding structure

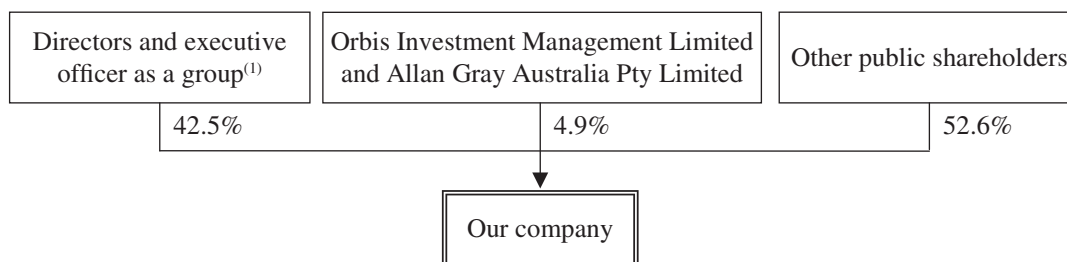
The following diagram illustrates our shareholding structure as at the Latest Practicable Date:



Notes:

- (1) Represents an aggregate of 1,456,907,000 Shares, of which approximately 1,456,000,000 Shares are beneficially held by William Lei Ding, representing approximately 44.7% of our total issued share capital. See “Major Shareholders” for more information on the interest of William Lei Ding.
- (2) Represents 167,410,775 Shares; based on the number of ADSs included in the Schedule 13F dated May 15, 2020, filed with the SEC by the reporting manager of Orbis Investment Management Limited and Allan Gray Australia Pty Limited, which is the most updated information published on the SEC as at Latest Practicable Date.
- (3) The percentages are calculated based on the total issued share capital of our Company as at the Latest Practicable Date. “Other public shareholders” also includes 8,806,925 bulk Shares issued for the purpose of the RSU Plans and 53,284,125 Shares representing repurchased ADSs.

The following diagram illustrates our shareholding structure immediately upon the completion of the Global Offering (assuming all major shareholders’ shareholding remain unchanged as of the Latest Practicable Date, the Over-allotment Option is not exercised, and no additional Shares are issued under the RSU Plans):



See the Notes to the previous shareholding structure.

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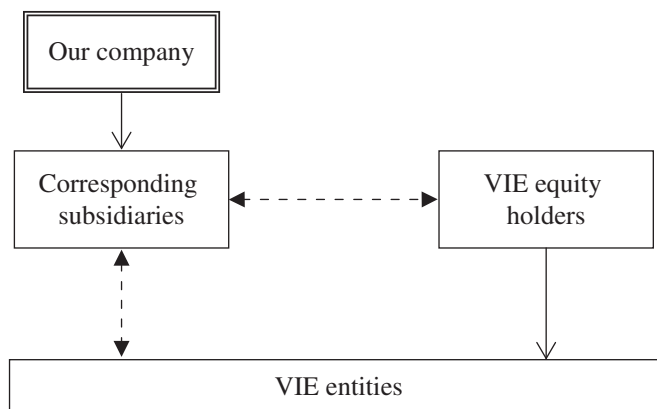
## HISTORY

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### Variable interest entity structure

We conduct our business in China through our subsidiaries, including the variable interest entities. Due to legal restrictions and prohibitions on foreign investment in Chinese companies providing, among other things, value-added telecommunications services, internet cultural services and internet publication services, we operate all of our business segments through contractual arrangements with the variable interest entities and their VIE equity holders.

The diagram below illustrates the general structure of the economic flow and control under the VIE structure created by the contractual arrangements:



Notes:

- (1) “—>” denotes the direction of legal and beneficial ownership.
- (2) “- ->” denotes the contractual arrangements among the VIE entities, VIE equity holders, and our corresponding subsidiaries.

The contractual arrangements enable us to: (a) collectively exercise effective control over the variable interest entities and their subsidiaries; (b) receive substantially all of the economic benefits of our variable interest entities and their subsidiaries; and (c) have an exclusive option to purchase all or part of the equity interests in our variable interest entities when and to the extent permissible under PRC laws.

The variable interest entities hold ICP licenses and other regulated licenses in which foreign investment is restricted or prohibited, and operate our internet businesses and other businesses. Under the contractual arrangements, we provide our computer software, mobile applications, technologies and relevant services to the variable interest entities and they operate the NetEase online game services, online learning products and services, websites, as well as our other online businesses.

As a result of the contractual arrangements, we bear the risks of, and enjoy the rewards associated with, and therefore are the primary beneficiary of these variable interest entities.

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## HISTORY

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### **Terms of the contractual arrangements**

A typical set of contractual arrangement documents for our Group is described below. For the purpose of this section and unless the context specifies otherwise, “us,” “we,” and “our” refer to our company and/or the corresponding subsidiaries.

#### *Transferring the economic benefits under the contractual arrangements*

##### Cooperation agreement

Under a cooperation agreement, the variable interest entity receives technical and related services from us, through the corresponding subsidiaries, in exchange for substantially all of the variable interest entity’s net profits. A typical cooperation agreement is entered into by us and the variable interest entity for an indefinite term unless terminated by the parties or to the extent required by law.

#### *Ensuring effective control over the variable interest entities under the contractual arrangements*

##### Exclusive purchase option agreement

The variable interest entity and its VIE equity holders enter into an exclusive purchase option agreement with us, pursuant to which: (a) the variable interest entity grants to us an option to purchase all or part of the assets held by that variable interest entity and its subsidiaries at a price equal to the net book value of the assets; and (b) the VIE equity holders grant to us, an exclusive option to purchase all or part of the equity interests in the variable interest entity at a subscription price equal to the original and any additional paid-in capital paid by the VIE equity holders. The variable interest entity and its VIE equity holders agree not to transfer, mortgage or permit any security interest to be created on any equity interest in or assets of the variable interest entity without our prior written consent. The agreement remains in effect until the equity interest or assets being the subject of the agreement is acquired by us or otherwise unilaterally terminated by us.

##### Loan agreement; equity pledge agreement

We grant interest-free loans to the VIE equity holders to be used by the VIE equity holders for the purpose of acquiring their equity interest in the variable interest entity. The term of each loan is ten years from the date of the loan agreement, and the loan agreement shall be automatically extended another ten years unless otherwise indicated by us at any time prior to its expiration. The loans are repayable at any time, at our discretion, by either the VIE equity holders transferring their interests in the variable interest entity to us, or by an alternative method determined by us.

The VIE equity holders enter into equity pledge agreements with us, pursuant to which the VIE equity holders pledge their interest in the variable interest entity as security for the outstanding amount advanced to the VIE equity holders under the loans and for the VIE equity holders performing their obligations under the contractual arrangements. Under the agreement, the VIE equity holder agrees not to transfer or pledge their equity interest in the variable interest entity without our prior written consent. The agreement remains binding until the VIE equity holder discharges all of their obligations under the loan agreement and the other agreements under the contractual arrangements.

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## HISTORY

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### Shareholder voting rights trust agreement; proxy agreement

Each VIE equity holder irrevocably entrusts a person designated by us to exercise all of his/her/their voting rights and other shareholder's rights to which the VIE equity holder is entitled as an ultimate shareholder of a variable interest entity in accordance with PRC Laws and the variable interest entity's articles of association. The agreement continues for as long as the VIE equity holder continues to have equity in a variable interest entity, or until unilaterally terminated by us.

### Operating agreement

The variable interest entity and its VIE equity holders enter into an operating agreement with us, pursuant to which, the variable interest entity and its VIE equity holders jointly agree that: (a) the variable interest entity shall not enter into any transaction outside of its ordinary course of business that would materially affect its assets, liabilities, rights, or operations without our prior written consent; (b) they shall comply with any guidance relating to corporate policies provided to them by us, from time to time; and (c) the VIE equity holders agree that, upon instruction from us, they would appoint the board members, president, chief financial officer, and other senior executive officers, of the variable interest entity as nominated by us. The term of the agreement is 20 years from the date of execution and can be extended with our prior written consent.

The remaining VIE entities (including Beijing NetEase Media Co., Ltd.) have also entered into varying sets of contractual arrangements, each of which has the same effect of allowing us to receive the economic benefits from its operations, obtain effective control over the variable interest entity and its subsidiaries, and allow the financial results of that VIE entity and its subsidiaries to be consolidated into our consolidated financial statements.

See "Related Party Transactions" for more information on the agreements between us and our related parties, including the variable interest entities.

### **Confirmations and risks relating to the variable interest entity structure**

Our PRC Legal Adviser is of the opinion that:

- (a) the ownership structures of the VIE Entities and our corresponding subsidiaries in China do not and will not violate any applicable PRC laws and regulations currently in effect;
- (b) each of the contractual arrangements entered into by the VIE Entities, the corresponding subsidiaries and the respective VIE equity holders governed by PRC laws and regulations is valid, legal and binding, and does not and will not violate any applicable PRC laws and regulations or their respective articles of association currently in effect; and
- (c) each of the contractual arrangements entered into by the VIE Entities, the corresponding subsidiaries and the respective VIE equity holders governed by PRC laws and regulations will not be deemed as "concealment of illegal intentions with a lawful form" and void under the PRC Contract Law.

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## HISTORY

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Based on the above, our directors believe that the agreements underlying the contractual arrangements as described above that confer significant control and economic benefits from the variable interest entities to us are enforceable under the relevant laws. Nevertheless, any violations by the variable interest entities of our agreements with them could disrupt our operations or adversely affect our services. See “Risk Factors — Risks related to our corporate structure.”

Additionally, we have been advised by our PRC Legal Adviser that there are substantial uncertainties regarding the interpretation and application of current and future PRC Laws. Accordingly, PRC regulatory authorities or courts may take a view that is contrary to the opinion of our PRC Legal Adviser. It is uncertain whether any new PRC Laws relating to contractual arrangements will be adopted, or if adopted, what the Laws would provide. If we or any of our VIE entities are found to be in violation of existing or future PRC Laws, or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authority would have broad discretion to take action in dealing with the violation or failure, in which case, we could be subject to severe penalties, including being prohibited from continuing our operations or unwinding the contractual arrangements. See “Risk Factors — Risks related to our corporate structure” and “Risk Factors — Risks related to doing business in China.”

We have considered the costs and difficulties of acquiring insurance on commercially reasonable terms, and consider it impractical for us to have insurance to cover these risks. Accordingly, we have not purchased insurance to cover the risks relating to the contractual arrangements.

As of the Latest Practicable Date, we had not encountered any interference or encumbrance from any PRC regulators in operating our business through variable interest entities under the contractual arrangements.

### **Listing on Nasdaq**

On June 30, 2000, we listed our ADSs on Nasdaq under the symbol “NTES.”

We believe that the Listing on the Hong Kong Stock Exchange would afford us greater access to capital markets, and in particular, capital markets in Asia, and would attract a broader Asian and international investor profile that would be more representative of our Chinese and international user base.

In October 2019, we separately listed the ADSs of our subsidiary, Youdao, on the New York Stock Exchange under the symbol “DAO.”

### **Disposal of Kaola**

On September 6, 2019, we entered into an agreement with a subsidiary of Alibaba Group Holding Limited (“**Alibaba**”) to sell our e-commerce platform Kaola for approximately US\$1.9 billion. The consideration was comprised of approximately US\$1.6 billion in cash payable to us and Kaola equity award holders, as well as approximately 14.3 million ordinary shares of Alibaba issued to us. Following the completion of the transaction, Kaola was deconsolidated and its historical financial results prior to the disposal were accordingly reflected in our consolidated financial statements as discontinued operations.



## OUR MARKET OPPORTUNITIES

The information presented in this section is derived from various government publications and other publicly available sources. We believe that the sources of such information are appropriate and we have taken reasonable care in extracting and reproducing such information. We have no reason to believe that such information is false or misleading or that any fact has been omitted that would render such information false or misleading in any material respect. The information included herein has not been independently verified by our Company, the Joint Sponsors, Joint Global Coordinators, and Joint Bookrunners, the Underwriters, any of our or their respective directors, officers or representatives or any other person or party involved in the Global Offering, and no representation is given as to its accuracy, completeness or fairness of such information. The information and statistics may not be consistent with other information and statistics compiled within or outside of China. Statistical data in these publications and sources also include estimates and future projections based on a number of assumptions. If any one or more of the assumptions underlying the market data are later found to be inaccurate, actual results may differ from the projections based on these assumptions. Accordingly, such information should not be unduly relied upon.

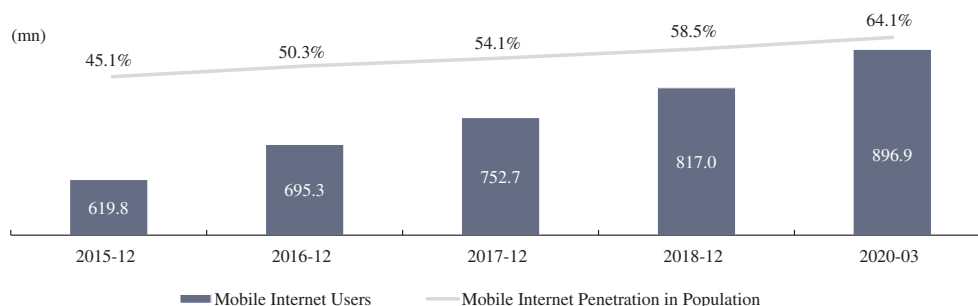
### FAVORABLE MACRO TRENDS FOR DIGITAL CONTENT AND SERVICE CONSUMPTION IN CHINA

The high penetration of the mobile internet in China, combined with the sustained growth in its GDP and disposable income per capita, has changed consumption habits and driven the demand for digital content and services in recent years. In particular, China's digital content and service consumption is driven by the following favorable macro trends.

***Rising spending power and demand for content and services.*** With China's robust economic growth and rising income, Chinese consumers are expanding their consumption from goods to content and services. Per capita consumption expenditure on education, cultural and recreation increased at a CAGR of 9.9% from 2015 to 2019, outpacing the overall GDP and consumption growth, according to the NBS.

***China represents the largest internet and mobile internet population in the world.*** According to the CNNIC, the number of internet users in China reached 903.6 million in March 2020. The number of mobile internet users reached 896.9 million in March 2020, representing 64.1% of the total population in China as of December 31, 2019, according to NBS, and approximately 2.7 times of the total population of the United States as of December 31, 2018, according to the World Bank.

#### Significant Penetration of Mobile Internet in China, 2015-2020

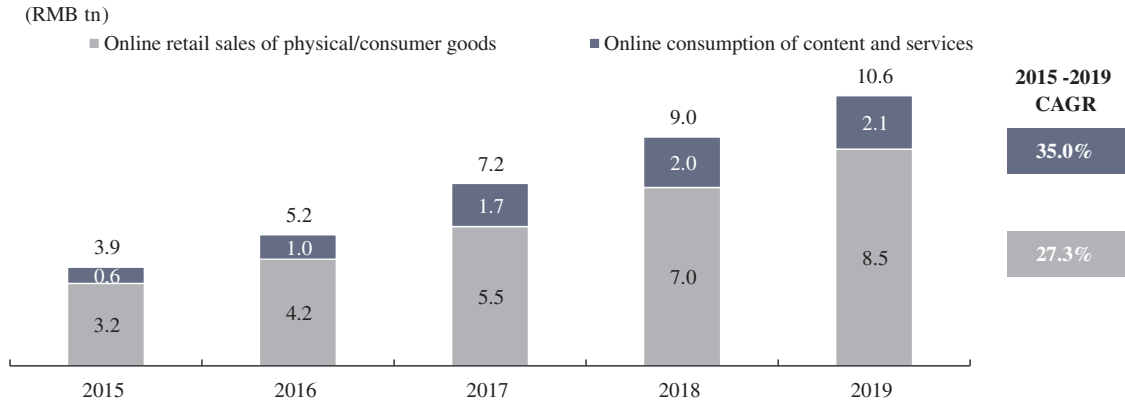


Source: CNNIC (for mobile internet users) and NBS (for total population as of 2015-2019 year-end)

## OUR MARKET OPPORTUNITIES

***Well-established infrastructure to boost digital content and service consumption.*** Enabled by the high penetration and wide coverage of mobile network, total mobile data usage in China amounted to 122 billion GB in 2019, or nearly 60 times of that in 2014, according to the MIIT. In addition, 85.0% of Chinese netizens were using digital payment in March 2020. As a result, consumers in China can easily access, enjoy and pay for premium digital content and data-intensive services. Total digital consumption of content and services in China reached RMB2.1 trillion in 2019, representing a CAGR of 35.0% since 2015 and outgrowing that of online retail sales of physical/consumer goods, according to the NBS.

### Rising Digital Consumption in China, 2015-2019



Source: NBS

Note: Total digital consumption figures include online retail sales of physical goods and non-physical goods (including content and services).

***Evolving demand for quality content and services.*** We believe that the massive internet population and the general trends of consumption upgrade in China will further drive the demand and willingness to pay for more diverse and quality digital content and services. At the same time, empowered by various new technologies, content and service providers have more capabilities to explore innovative formats, enrich user interaction, offer quality experience and fulfill evolving consumer needs. We see tremendous opportunities in delivering and innovating in major digital content and service segments, including games, intelligent learning and music streaming.

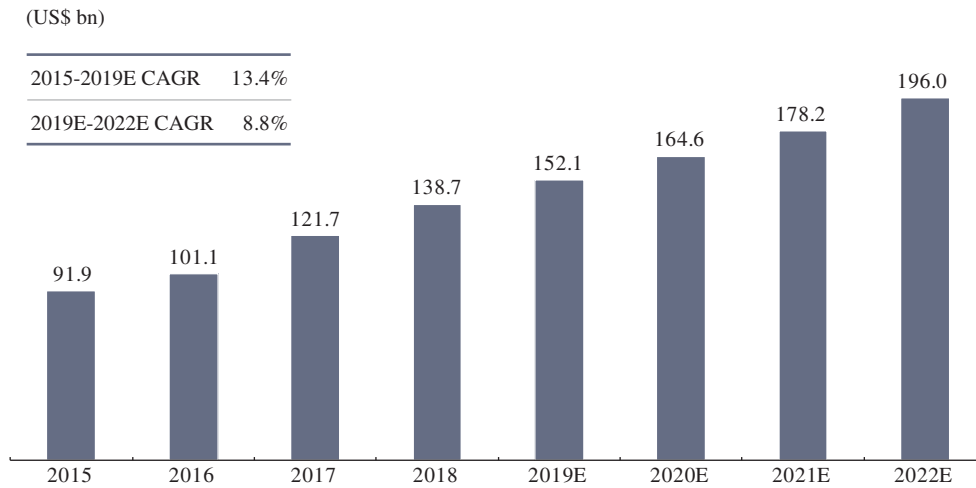
## GLOBAL GAMES MARKET

### Overview of the global games market

The estimated market size of global games market in 2019 was US\$152.1 billion, representing a CAGR of 13.4% from 2015, and is forecasted to further grow to US\$196.0 billion in 2022, according to Newzoo.

## OUR MARKET OPPORTUNITIES

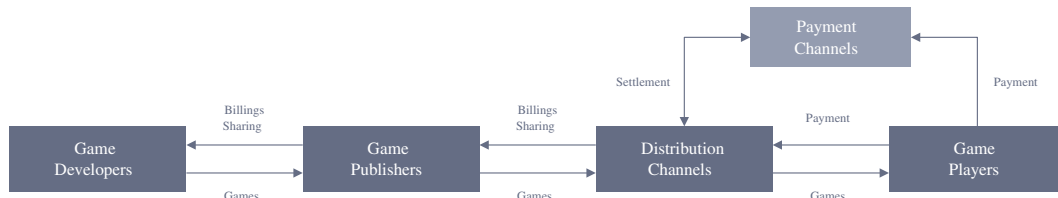
### Global Games Market Size in Terms of Revenue, 2015-2022E



Source: Newzoo

Participants in the games market primarily comprise game developers and other IP holders, game publishers, game distribution channels and game players. Certain market participants take multiple roles along the industry value chain and develop, publish and distribute games from time to time.

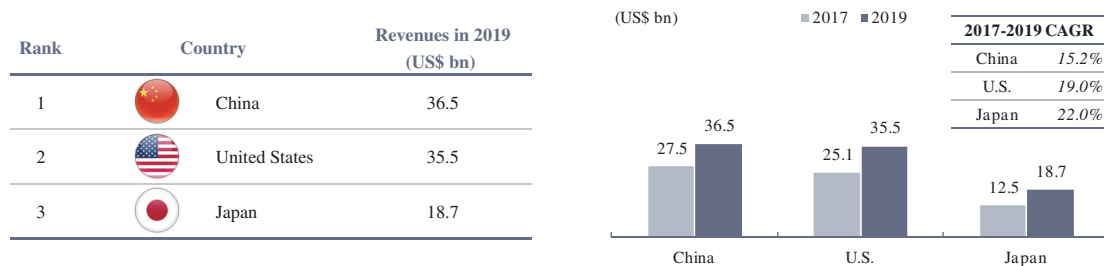
#### Typical Games Market Value Chain Illustration



#### Top Three Games Markets: China, the United States and Japan

China, the United States and Japan ranked as the three largest games markets globally in 2019 in terms of revenue estimates, according to Newzoo. The combined market size of these top three games markets was estimated to be US\$90.7 billion in 2019, taking up approximately 60% of the global games market, according to Newzoo.

#### Top Three Global Games Markets and Their Growth



Source: Newzoo

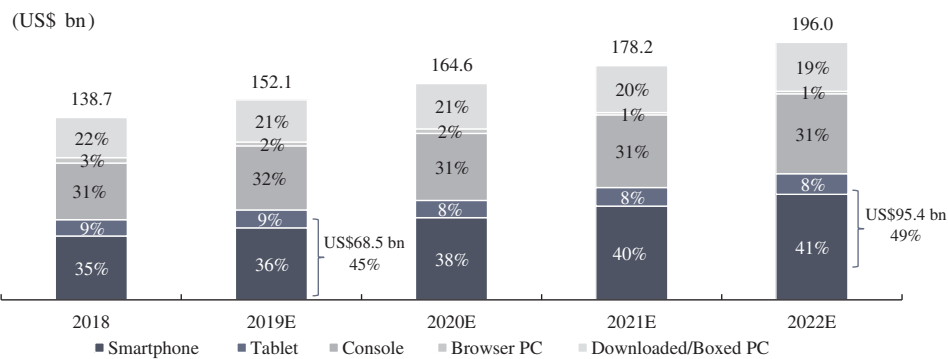
## OUR MARKET OPPORTUNITIES

### Shift towards mobile games

#### *Size and fast growth of the global mobile games market*

Benefitting from the proliferation of mobile internet, penetration of smart devices and shifting user habits, mobile games has become the largest and fastest-growing segment in the overall games market. In 2019, mobile gaming was estimated to generate revenues of US\$68.5 billion, accounting for approximately 45% of the total global games market, according to Newzoo. Mobile gaming is expected to generate revenues of US\$95.4 billion in 2022 at a CAGR of 11.7% from 2019 to 2022, and account for almost half of the entire global games market in 2022, outpacing growth of other segments and the overall games market, according to Newzoo.

**Breakdown of Global Games Markets by Segment in Terms of Revenue, 2018-2022E**



Source: Newzoo

#### *Competitive landscape of global mobile games market*

In 2019, NetEase ranked as the second largest mobile app publisher globally in terms of combined iOS and Google Play revenue estimates, according to App Annie.

**Top 10 Global Mobile App Publishers in Terms of Combined iOS and Google Play Revenue, 2019**

Rank	Company	Nationality
1	Tencent	China
2	NetEase	China
3	Activision Blizzard	United States
4	Supercell	Finland
5	BANDAI NAMCO	Japan
6	Netmarble	South Korea
7	Playrix	Ireland
8	Sony	Japan
9	Playtika	Israel
10	InterActiveCorp (IAC)	United States

Source: App Annie

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## OUR MARKET OPPORTUNITIES

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### Market opportunities for Chinese game companies

China ranked as the largest games market in the world in terms of revenue estimates in 2019, according to Newzoo. The number of game players in China reached approximately 531.8 million in March 2020, compared to approximately 417.0 million in December 2016, according to CNNIC. The domestic market therefore provides massive opportunities for Chinese game developers and publishers. At the same time, overseas markets also represent further opportunities for Chinese game developers to expand their footprint.

In light of the geographical concentration and rising share of mobile gaming in the global games market, we believe participants with an established presence in top markets such as China, the United States and Japan and in-depth expertise in developing and operating mobile games are well-positioned to capture future opportunities.

### Key market trends affecting competition in China's online and mobile games markets

We have observed the following key market and competitive trends of China's online and mobile games markets:

- *Focus on game quality and innovation.* As game players become increasingly sophisticated, we believe that the quality and innovative features of games, such as new and engaging gameplay elements, attractive visuals and intriguing narratives, are key in ensuring a superior user experience and attracting and retaining users.
- *Overseas markets expansion.* Market participants in China's online and mobile games industries continue to launch games in global markets as well as partner with or invest in international game studios to enhance development capabilities and operational experience.
- *IP ownership.* As the online and mobile games industries continue to attract new entrants, strong capabilities in developing and maintaining in-house IPs are key for building solid game pipelines, attracting large and engaged player bases and competing effectively.

The online and mobile games markets are fast-evolving. The emergence of new technologies, such as migration from 4G to 5G and the widespread adoption of AR/VR games, might enable new formats of gameplay, further boost online content consumption, and create space for new entrants. Online game companies also constantly compete with providers of other pan-entertainment services such as online video, online music live streaming, news feed and social media for user traffic, time and spending. Established companies, including us, face challenges in keeping up with the shifting trend, consistently producing popular new content and effectively engaging users.

The ability to continually creating original content and differentiated user experience is crucial for success in the online and mobile game markets. Such capabilities rely on multiple factors, including established brand and IPs, deep user insights, technology, R&D and operational expertise. It typically takes significant investment and years of time for new entrants to build strong brands and IPs, gain market expertise and insights and build a pipeline that can produce popular content in a systematic manner.

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## OUR MARKET OPPORTUNITIES

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### OTHER DIGITAL CONTENT AND SERVICE MARKETS IN CHINA

#### Online learning market

Benefiting from the development of internet and other technologies, as well as the increasing demand and recognition for remote and flexible learning, the user base of the broader online education sector in China increased almost threefold from 110.1 million in December 2015 to 423.0 million in March 2020, according to CNNIC.

Market trends that are expected to drive the development of online learning market in China mainly include further integration of technology with learning, increasing coverage of more learning scenarios, use of smart devices and AI tutoring, competition over high-quality teaching resources, rising user acquisition costs, the shift from exam-oriented to quality-oriented learning and favorable government policies. Market players that can adapt well to these trends are expected to compete more effectively in the industry.

#### Other digital content and service markets

The rapid development and penetration of the internet has further propelled the growth of various other digital content and services, such as media, e-commerce and online music. Users continue to seek high-quality and reliable content and services, and the availability of vast user data enables the creation of a more user-centric experience based on customized recommendation, real-time content delivery and vibrant online communities. Digital services including media, e-commerce and music streaming have accumulated sizable internet and mobile user bases in China and represent diverse market opportunities.

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## OUR BUSINESS

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### OVERVIEW

#### Our mission

Our mission is to create wonders through delivering premium content and excellent service to users. (以優質的內容和服務，為用戶創造驚喜).

This mission has guided us through the past 23 years in delivering premium content and services. We started as a Chinese internet portal in the late 1990s, and established our media and e-mail services that continue to thrive today; strategically expanded into online games in 2001, which now makes us the second largest mobile game company in the world in terms of combined iOS and Google Play user spending in 2019, according to App Annie; launched our Youdao business in 2006 that eventually became an NYSE-listed intelligent learning platform; introduced NetEase Cloud Music, a music streaming platform, in 2013; and opened our e-commerce platform Yanxuan in 2016, which quickly emerged as a destination for private label merchandise.

#### Our vision

Founded by William Lei Ding in 1997, our Company has a vision of fostering collaboration and realizing people's aspiration for a better life through technology and innovation (網聚人的力量，用科技創新締造美好生活).

#### Our core values

The following integrated concepts form the fundamentals of our corporate values.

***Passion*** — From the grand pursuits of excellence in user experience, content creation and operation, to the everyday focus on taking care of our employees, our collective passion for being a good company is manifest in every aspect of our operations.

***User-centricity*** — We follow the user-centric philosophy to run all of our businesses. While our core businesses have evolved throughout the decades, one thing that remains constant is our ability to predict and address the shifting trends in user behavior and preferences.

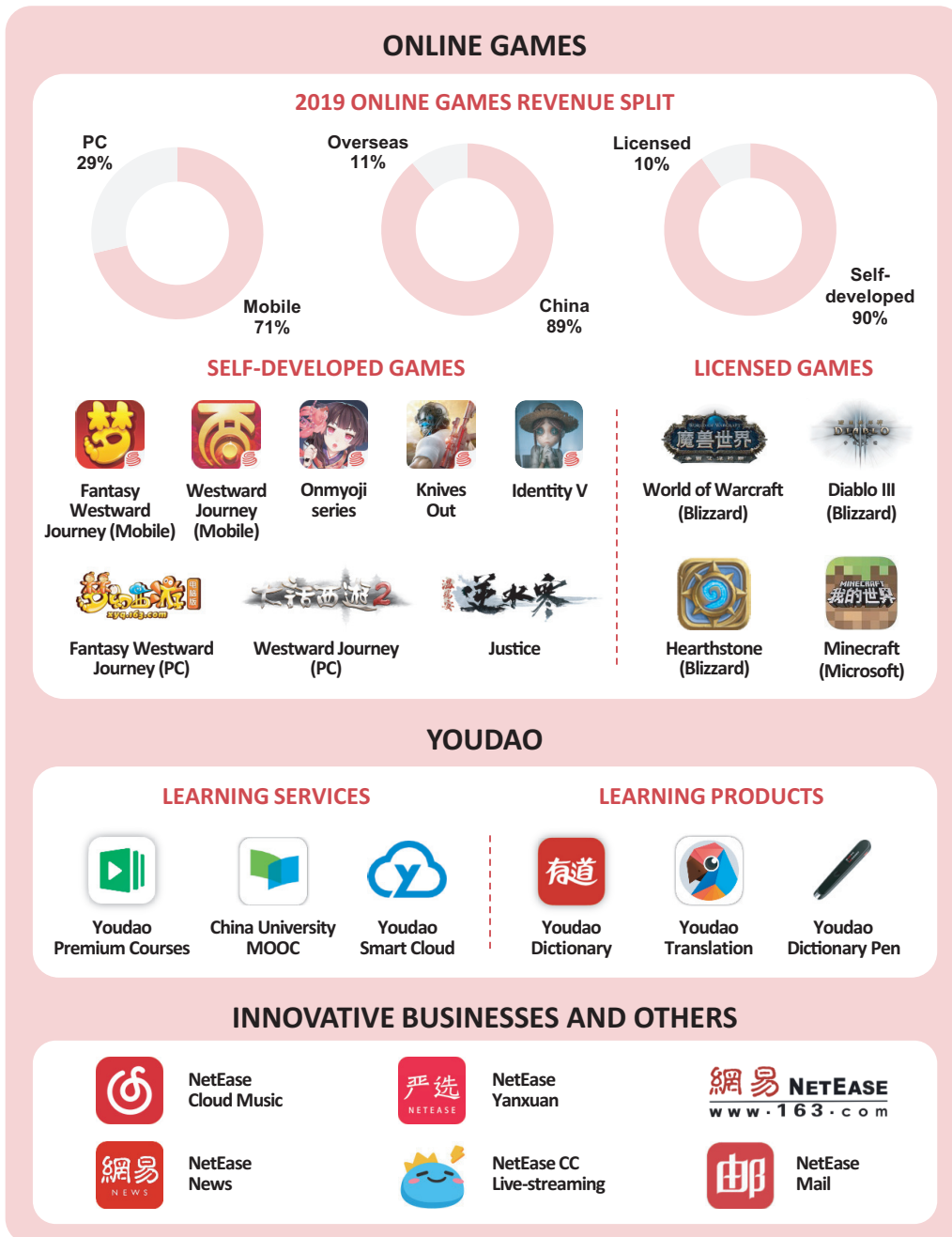
***Innovation*** — At the core of our relentless innovation is our ability to effectively execute and deliver tangible results from these ideas and technologies.

***Harmony*** — We empower all stakeholders of our communities, and draw creativity and inspiration from our users, employees and business partners around the world to achieve our mission.

Since Day 1, we have persistently focused on our core values, which solidify our services and products, motivate us to create and grow new ideas, and serve as the compass for our endless exploration of new initiatives and opportunities.

## OUR BUSINESS

### Who we are today



We have a successful online game business, developing and operating a rich portfolio of highly popular titles. We currently offer over 140 mobile and PC games across a wide range of genres, satisfying the ever-growing and diversifying needs of the global gamer community. Leveraging our user insights and execution expertise, we also incubated and developed in-house a pipeline of innovative and successful businesses, including intelligent learning and other businesses, ranging from music streaming and private label e-commerce to internet media, e-mail services and others. As of December 31, 2019, we had over 1.0 billion registered e-mail users and over 800 million NetEase Cloud Music registered users. We also had over 100 million Youdao average MAUs in 2019.



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## OUR BUSINESS

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### *Online games*

We are the second largest mobile game company in the world in terms of combined iOS and Google Play user spending in 2019, according to App Annie. Our expertise in developing and operating game content has laid the foundation for successful overseas expansion. In 2019, overseas games revenues accounted for 11% of our total games revenues.

Meticulously crafted and imbued with operational expertise distilled from decades of experience, many NetEase games have secured their places among the most successful IP franchises in the history of online games. Over the past two decades, we have consistently rolled out blockbuster game titles, and maintained their longevity and vitality through frequent content updates and other operational innovations. Our first major flagship game franchise *Westward Journey Online*, which debuted in 2001, remains popular with gamers today as a result of continued content and format updates, as well as innovation in play modes over the past 19 years. Just to name a couple more examples among our star-studded line-up of popular online games, *Onmyoji* topped the China iOS grossing chart multiple times in 2019, and *Knives Out* topped Japan's iOS grossing chart multiple times in 2019, testifying to the global appeal of our games.

As a true testament to our in-house game development and operational strengths, we have established a distinguished track record of long-term collaborations with revered global IP powerhouses and studios such as Blizzard, Marvel, Microsoft and Warner Brothers. With Blizzard, our collaboration initially started with PC game licensing for the China market in 2008 and has since been broadened to the co-development of *Diablo Immortal*<sup>TM</sup>, a milestone in Blizzard's foray into mobile games with its iconic *Diablo* franchise. *MARVEL Super War*, our collaboration with Marvel Entertainment, has gained widespread popularity since its official launch in December 2019 and topped many iOS download charts in Southeast Asia.

We generate our mobile game revenues primarily from the sale of in-game virtual items within the games. We distribute our mobile games through partnerships with major Android and iOS-based app stores as well as proprietary distribution channels, such as our mobile apps and websites. We generate revenue from our PC games mainly through sales of prepaid points.

### *Intelligent learning*

Youdao is an intelligent learning company in China with over 100 million average MAUs in 2019, and has achieved early success in a number of overseas markets. Starting from online knowledge tools, Youdao currently offers a comprehensive suite of learning services and products that are accessible, reliable and trustworthy. For tens of millions of people, Youdao is the go-to destination for looking up a word, translating a foreign language, preparing for an exam, or learning a new skill.

In 2007, Youdao launched its flagship Youdao Dictionary, which had over 50 million average MAUs in 2019. The early success of Youdao Dictionary and other learning tools has enabled us to attract a massive user base, build a strong brand, and channel this organic user traffic into a broad range of services and products addressing lifelong learning needs of pre-school, K-12 and college students as well as adult learners, including online learning services and products and smart devices. Our smart devices seamlessly integrate advanced AI algorithms and data analytics, which serve to supplement our online courses and learning products and further enhance users' learning experience and efficiency.

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## OUR BUSINESS

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We currently generate the majority of the revenues for Youdao's learning services and products from its online courses in the form of the tuition fees received from students. We also generate revenues from Youdao's online marketing services through the provision of different formats of advertisements.

### *Innovative businesses and others*

We have incubated and developed in-house a number of innovative and thriving businesses.

NetEase Cloud Music is a popular music streaming platform in China with over 800 million registered users as of December 31, 2019. It delivers a differentiated and premium user experience in terms of the music offered. Focused on discovering and promoting emerging musicians, NetEase Cloud Music has rapidly grown into the destination of choice for exploring new and independent music among music enthusiasts in China. Our vibrant community had attracted over 100,000 independent musicians as of December 31, 2019, generating over 270 billion playbacks of their songs in 2019.

Yanxuan is our e-commerce platform that primarily sells private label products with a strong emphasis on quality and value for money. Product categories include apparel, homeware, kitchenware and other general merchandise which we primarily source from original design manufacturers in China. Products and manufacturers are carefully selected with the goal of achieving high value for money. Yanxuan has established close partnerships with its selection of quality manufacturers. It utilizes data analytics to help these suppliers enhance their efficiency and product appeal, particularly in terms of merchandise design and production.

NetEase Media is a well-established internet media platform in China delivering professional news and other quality information to our users. Our media platform has three components, the NetEase News mobile application, [www.163.com](http://www.163.com) portal and a set of other vertical mobile products. Our media platform offers a wide range of features that promote user interactions and foster a vibrant online user community who actively contribute to the commentary sections. Our drive for journalistic integrity and high-quality content offerings has enabled us to attract a coveted demographic of engaged users.

Other innovative businesses include NetEase CC Live streaming, a platform offering various live streaming content with a primary focus on game broadcasting, and NetEase Mail, an email service provider in China with over one billion registered users as of December 31, 2019. We derive our innovative businesses and others revenues primarily from Yanxuan, NetEase Cloud Music, NetEase CC Live streaming, advertising services, premium e-mail and other value-added services.

Our persistent focus on core values, coupled with solid execution, has enabled us to weather the numerous seismic global challenges since the late 1990s and thrive in the complex and competitive Chinese internet ecosystem, consistently delivering top- and bottom-line growth and value to our shareholders. Net revenues for fiscal year 2019 were RMB59,241.1 million, growing by 15.8% year-over-year from RMB51,178.6 million for fiscal year 2018. Net income from continuing operations attributable to our shareholders for fiscal year 2019 totaled RMB13,275.0 million, increasing by 60.1% from RMB8,291.1 million for fiscal year 2018. We have instituted quarterly dividend payments since 2014 and have announced several share repurchase programs since 2011.

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## OUR BUSINESS

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### What we have learned from the past 23 years

We feel fortunate to have chosen the path of pursuing original content creation and building our proprietary know-how and R&D capabilities since the beginning of our journey. Looking back at the past two decades, only through such pursuit can we truly sustain our leadership position amidst fierce competition in complex business environments, elevate the standards of the Chinese internet industry, and secure an enduring legacy for each of our people who devoted themselves to this worthy endeavor. As we navigated new market trends and tackled new challenges over the years, the following key insights secured our success. Here is what worked for us:

#### *At the end of the day, it comes down to original content creation*

The ultimate secret sauce for our user acquisition and retention is high-quality original content. This is true now more than ever, and will increasingly be the touchstone of success in the future. More specifically on content creation and innovation, we focus on developing IP franchises, as we quickly realized their tremendous potential for multi-platform development and application and multi-channel monetization, and we are proactive in distilling transferable know-how obtained from game development into actionable formulas that benefit the development of our other business ventures.

IP franchises have accelerated our evolution from PC to mobile. Our evergreen flagship title, *Fantasy Westward Journey*, initially launched in 2004, with its massive PC user base, provided fertile grounds for the successful debut of *Fantasy Westward Journey Mobile* in 2015, which later served as the catalyst for the development of *Fantasy Westward Journey 3D* in 2019.

Developing content franchises in-house also allows us to unleash the full monetization potential of our IP. For example, *Onmyoji*, our acclaimed original IP franchise, has already spun off three mobile games, including *Onmyoji Arena* (MOBA game), *Onmyoji: The Card Game* (CCG), and *Onmyoji: Yokai Koya* (simulation game), each a hit in its own right. As an initial step beyond games, *Onmyoji* has been adapted into a feature motion picture and a musical and inspired a themed coffee shop.

We attribute our repeated success in launching original IP franchises to the following: (i) accumulated native know-how that we leveraged to systematically create high-quality, interactive online content for live, dynamic, every-day enjoyment; (ii) continually optimizing content and driving user interactions through innovative mechanics, data analytics and technology; and (iii) the ability to attract and manage massive online user bases and stimulate user engagement, by creating fun, differentiated and compelling user experience.

By emulating the essence of our approach to game IP franchise creation, our subsequent ventures into other verticals have been remarkably successful. Youdao is now widely recognized for its proprietary learning services and products with an abundance of gamified features, as well as effective online course materials. NetEase Cloud Music introduced differentiated value propositions to users and has fostered a blossoming community featuring a coveted demographic of music lovers. For example, we had more than 100,000 independent musicians as of December 31, 2019, and their songs were played back more than 270 billion times in 2019.

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## OUR BUSINESS

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*Sharpening operational know-how is time-consuming, but is of critical importance to sustained long-term growth on a global scale*

Looking back at the past 23 years, it has become abundantly clear to us that, fortunately, there is no shortcut to sharpening operational know-how. Only through such painstaking efforts could we build formidable entry barriers that distinguish us from other players in the industry. We spent the past two decades tirelessly and diligently honing our operational expertise across various fields.

Our evergreen game IP franchises owe much of their longevity to the operational excellence that has kept users engaged throughout the years. For example, our *Fantasy Westward Journey* franchise has been in operation since 2004 and remains highly popular today, with its mobile version ranking second in China and seventh globally in terms of user spending in 2019, according to App Annie. Much of this achievement results from the almost 30 major expansion packs that we have released during its lifetime so far, as well as our excellence in operating in-game campaigns, carrying out user community maintenance and launching innovative marketing initiatives. These efforts represent the culmination of years of analysis in user behavior, constantly providing differentiated and compelling user experience that has allowed the franchise to thrive among multiple generations of players.

Our operational expertise, along with our content creation capabilities, uniquely positions us to form more in-depth, mutually beneficial relationships with many global leading IP powerhouses and revered game developers. For example, we are developing *Harry Potter: Magic Awakened*, which will be jointly published with Warner Brothers Studio.

Through successfully customizing international IP franchises for the Chinese market, we extrapolate the know-how to power the introduction of our domestic games to the world. The success of *Knives Out* as a shooting game in Japan and its seamless cross-over with Japanese anime IP manifests the powerful content localization capability that we have built throughout the decades. The chart-topping *Identity V* is a battle arena game that further secured our position as a leading player in Japan, one of the largest game markets in the world.

*We strive for longevity and scalability in our games and beyond*

In games and across other business sectors, we always emphasize on not only delivering that initial impression of excitement and freshness, but also ensuring that our products are developed for long-term lifecycle and scalability. As a result, we consistently introduce games and other products that exhibited remarkable longevity, and replicate proven business models into new business areas with success. Longevity and scalability of our businesses allows us to maintain a superior cash profile with enhanced revenue visibility.

NetEase has a unique and distinguished track record in building long-lasting games spanning decades. We are capable of creating long life-cycles amongst our gamers through immersive user experiences and innovative game features. Our flagship online game titles consistently provide solid support for our online game business with ever-increasing longevity. The *Westward Journey Online* mobile game, which traces its origin to the PC-client game under the same title launched in 2001, ranked sixth in terms of user spending among all mobile games in China in 2019, according to App Annie.

Our systematic approach to developing game content has led to our consistent track record in creating blockbuster titles. Sharing a powerful centralized reservoir of technology and operational know-how, our game development studios function as creative hubs, each focusing on its respective genres. The creative sparks are then rigorously evaluated and scrupulously

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## OUR BUSINESS

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refined for commercial viability. Together, this model of content development allows us to replicate the success at the product level at scale, with consistent high quality. Not only did we operate four out of the top ten grossing online games in China in 2019, but our prolific streak also saw consistent roll-out of native blockbuster titles each year, from *Onmyoji* in 2016, *Knives Out* in 2017, to *Identity V* in 2018 and *Fantasy Westward Journey 3D* in 2019. Consistent contributions from legacy products and a robust pipeline of new games will continue to drive our revenue visibility and diversification.

Scalability also goes to the ability of our other businesses to efficiently leverage the know-how from our game development and operational expertise. For example, Youdao leverages a “studio” model of educational content development, which traces our game development roots. This studio model combines the key aptitudes of our course designers, instructors and engineers into a standardized process on top of which our teachers overlay their pedagogic know-how and subject matter knowledge, creating units of course content that can be deployed and replicated at scale.

### *We take pride in our user-centric culture to build long-lasting brand recognition*

What we mentioned above allowed us to quickly acquire a massive user base early on, but we did not stop there. Our relentless efforts in delivering amazing user experience shaped our brand image for quality content and services of the highest caliber. The trusted nature of our brand was in turn highly conducive to driving the willingness of users to contribute where they feel their views are appreciated, valued and impactful toward building a better community.

Looking back, we have come a long way in building our user community and expanding the scope of our service offerings. As mentioned in our U.S. IPO prospectus, at the time of our listing in the U.S., we primarily offered two types of services: our NetEase website had 4.9 million registered members and our NetEase Mail had 3 million accounts, as of May 31, 2000. Two decades later, we offered more than a dozen services for our users and had over 1.0 billion registered e-mail users and over 800 million NetEase Cloud Music registered users as of December 31, 2019, as well as over 100 million Youdao average MAUs in 2019. As of December 31, 2019, we offered over 140 online games across a wide range of genres through mobile devices and PCs, satisfying the ever-growing and diversifying needs of the global gamer community.

Our user-centric culture has paid off handsomely in terms of valuable know-how for product improvement, optimizing user acquisition cost, and unleashing monetization potential. Our close attention to shifts in user behavior allowed us to successfully anticipate and capture the rising trend of mobile games, with our first mobile game launched in 2013, the same year that saw the launch of the 4G network in China. In 2019, 71.4% of our net revenues from online game services were contributed by mobile games. In addition, we take pride in having built a vibrant online community of users actively contributing to the commentary sections of NetEase Media products. We also created the Cloud Village community for NetEase Cloud Music, which encourages music listeners to be more engaged with the visual content on our mobile app, thereby extending consumer touchpoints and interaction formats of the traditionally audio-centric content. Initiatives such as this changed the landscape of how people consume music and unlocked significant potential for continued innovations.

Being user-centric not only shaped our brand, but also defines who we are as a company. While the nature of our core business has evolved throughout the decades, one thing that remained constant is our acute sense of the shifting trends in user behavior and preferences. This user-centric approach, coupled with our NetEase brand, is the unifying theme of our various businesses and what propels us into the future.

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## OUR BUSINESS

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### *R&D investment in innovative technologies is essential, but must be purpose-driven*

The importance of strengthening our technological prowess through investments in R&D efforts has always been well recognized and heeded. More broadly speaking, we always believe that proprietary technological advancement is the lever to uplift the Chinese internet industry onto the world stage. But it has also been our experience through the decades that at least for us, R&D must be purpose-driven, guided by the principles of commercial viability and applicability to meaningfully improve user experience and efficiency. As of December 31, 2019, we had more than 10,000 in-house programmers, network engineers and graphic designers dedicated to our R&D activities, accounting for approximately half of our total employee headcount.

Let's look at a few examples of our technological initiatives. Our world-class game R&D efforts focus on proprietary game engines that offer creative freedom to game developers, as well as cutting-edge AI know-how that can be adopted in real life, commercially viable use cases to improve the user experience. Like so many other strategic choices we took, we decided to develop proprietary game engines precisely because it is not an easy path, because it would provide our developers with greater flexibility and self-sufficiency, and because it would pave the way for us to smoothly expand from PC to mobile, as well as to capture the opportunities that future technological breakthroughs may bring. While we continue to leverage third-party engines to supplement our game development efforts, it is our proprietary game engines, NeoX and Messiah, that set us apart. In addition, our in-house NetEase *Fuxi Lab* is one of the leading research institutions in game AI technology globally, which focuses on researching big data, user persona, reinforcement learning, computer vision and graphics, natural language processing, speech synthesis and music generation. Aside from game R&D, we were unique in our ability to fully incorporate smart devices into an effective hybrid online and offline learning experience, under a variety of use cases such as translation, dictionary searches and online courses.

In addition to in-house R&D, we embrace collaboration with partners around the globe to advance the common cause of technological development. In 2018, Google announced an automated testing solution developed by us — Airtest Project, which provided much faster test-diagnose-fix cycles for developers than ever before. Over the years, we have also made strategic investments in multiple overseas game studios with advanced R&D capabilities. These strategic investments further supplement and improve our in-house knowledge and capability of developing high quality game content across a broad spectrum of genres.

### *Ultimately, it depends on the people*

First and foremost, we owe our success to our founder, director and CEO, William Lei Ding, a well-regarded visionary and thought leader in China's internet industry. Mr. Ding has been instrumental in the strategic direction, branding, platform architecture, content, product design and development of NetEase since 1997.

Two other things about the management teams of our business units really stand out. First, the senior management teams of our business units have been remarkably stable, which has guaranteed the unity of our corporate culture through the decades. Second, by staying true to the philosophy of approaching new businesses cautiously and steadily pursuing sustainable and differentiated growth, our senior management teams have led our core businesses into established industry leaders with broad user recognition.

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## OUR BUSINESS

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We have a passionate workforce with an average age of 29 as of December 31, 2019, allowing us to stay abreast of the latest trends among the young generation of netizens making up the majority of our user base. We made it a priority to have our people be happy on and off our campuses and be proud to recommend what they have created at work to their families and friends. Our people reciprocated by putting their hearts and souls into advancing our common enterprise.

We stand out among our peers in our commitment to gender equality. In recognition of our dedication, the 2020 Bloomberg Gender-Equality Index included us in its global list of 325 public companies that are committed to gender equality in the workplace, an accolade that we are enormously proud of. We focus on systematic training in order to put our people on the path to long-term career success. In 2019, our training programs for games staff received the “2019 ATD Excellence in Practice Awards” from the Association for Talent Development, the world’s largest association dedicated to talent development within organizations.

### **What we plan to focus on in the future**

We will continue to think long-term. All future strategies will be formulated, evaluated, adjusted, re-formulated, re-evaluated, and re-adjusted around a long-term vision of sustainable excellence and financial success. We will continue to be prudent regarding capital allocation, with value-creation for shareholders as a priority.

***Strengthening our content creation capability.*** We will continue to maintain a competitive edge in content creation. Innovation and originality are critically important in content development. To enrich and expand our content offerings, we will also enhance our game pipeline across diversified genres to target different user profiles and capture the underserved segments of the market globally. We also plan to continually deliver premium and differentiated content through our *Youdao* and other innovative businesses.

***Pursuing operational excellence.*** Once we create a great product, the best way to maintain product longevity and popularity is through continued innovation and updates. Building on a wealth of operational experience harvested from more than two decades of cultivation in the Chinese internet industry, we will accelerate the pace of innovation in our operational methods, which we believe will further strengthen our IP franchises and global collaborations.

***Growing the community of happy users.*** We will continue to place users as our first priority and seek to consistently grow our loyal user base. The purpose of creating high-quality content and enhancing operational efficiency is to serve our users better: bring value to them, create an amazing user experience, and in return, users will be attached to our service and product offerings.

***Investing in technology and innovation.*** Technology has been and will continue to serve as the foundation of our long-term success. We believe there is no shortcut to investing more capital and human resources into our own future. Our R&D approach will remain focused on bringing commercially viable technologies into specific applications that can further enhance user experience.

***Expanding our global footprint.*** We will continue our global expansion, more actively than before. We execute our globalization strategy with a humble heart. We aim to pass the knowledge accumulated from our early success onto the development and operation of other NetEase games, and enhance our ability to deliver popular titles to gamers in Japan, the United

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## OUR BUSINESS

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States, Europe, Southeast Asia and other markets. We also see a significant opportunity for our intelligent learning and other innovative businesses to grow in overseas markets with large potential user bases and favorable demographic characteristics.

*Cultivating a deeper bench of talents.* Attracting and nurturing the right people passionate about our mission is vital to our future growth. We have done well in the past to promote home-grown talents across our organization. In the future, we will continue to attract more talents and take good care of our people.

**We hope one day in the future, we will be widely recognized globally as a progressive company, a unique company, and a good company.**

### OUR SERVICES

We have a successful online game business, developing and operating a rich portfolio of highly popular titles. We currently offer over 140 mobile and PC games across a wide range of genres, satisfying the ever growing and diversifying needs of the global gamer community. Leveraging on our user insights and execution expertise, we have also incubated and developed in-house a pipeline of innovative and successful businesses, including intelligent learning and other businesses, ranging from music streaming and private label e-commerce to internet media, e-mail services and others. As of December 31, 2019, we had over 1.0 billion registered e-mail users and more than 800 million NetEase Cloud Music registered users. We also had over 100 million Youdao average MAUs in 2019.

#### Online game services

##### *Our games*

Our game products and services include in-house developed mobile and PC games as well as games licensed from renowned global developers. As a global early mover that anticipated and captured the trend toward mobile games, we have significantly expanded our portfolio of mobile game offerings in recent years. At the same time, our flagship titles continue to provide solid support for our online games business with persistent longevity and user loyalty. In addition, while solidifying our leadership position in the Chinese domestic market, we have also expanded globally with launches in Japan, Southeast Asia, the U.S. and other international markets.

##### Our game library

##### *Mobile games*

Mobile games have gained increasing popularity and an expanding user base as internet users in China and across the world rely more and more on mobile devices to access the internet. We are one of the largest mobile game providers globally in terms of game revenue, having commercially launched over 100 mobile games of various genres as of December 31, 2019, including in-house developed and licensed MMORPGs, CCGs, first-person shooter games, battle arena games, and SLGs. Revenues from mobile games accounted for 71.4% of our net revenues from online game services in 2019.

To date, the majority of our most popular mobile games are in-house developed games. We have launched the mobile versions of our in-house developed flagship MMORPGs, including the *Fantasy Westward Journey* and *Westward Journey Online* mobile games. We distribute our mobile games through partnerships with major Android-and iOS-based application stores in



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## OUR BUSINESS

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China, as well as our proprietary distribution channels. We offer a variety of in-game virtual items that players can purchase, including avatars, skills, privileges and other in-game consumables, features and functionalities.

The table below sets forth our major mobile games developed in-house:

Mobile Game	Genre	Date of Initial Launch
Mobile Version of Fantasy Westward Journey II (夢幻西遊2口袋版)	Turn-based MMORPG	July 2013
Mini Westward Journey (迷你西遊)	CCG	April 2014
Battle to the West (亂鬥西遊)	CCG & MOBA	October 2014
Fantasy Westward Journey mobile game (夢幻西遊手遊)	Turn-based MMORPG	March 2015
Westward Journey Online mobile game (大話西遊手遊)	Turn-based MMORPG	September 2015
Invincible (率土之濱)	SLG	October 2015
The mobile version of New Ghost (倩女幽魂手遊)	Real-time MMORPG	May 2016
Onmyoji (陰陽師)	CCG & RPG	September 2016
Knives Out (荒野行動)	Battle Arena	November 2017
Rules of Survival	Battle Arena	November 2017
All About Jianghu (一夢江湖)	Real-time MMORPG	January 2018
Identity V (第五人格)	Battle Arena	April 2018
Ancient Nocturne (神都夜行錄)	CCG & RPG	September 2018
Life-After (明日之後)	Cooperative Survival RPG	November 2018
Xuan Yuan Sword: Dragon Upon the Cloud (軒轅劍龍舞雲山)	MMORPG	October 2019
Fantasy Westward Journey 3D (夢幻西遊三維版)	3D MMORPG	December 2019

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## OUR BUSINESS

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### *PC games*

We launched our first PC based MMORPG, *Westward Journey Online*, in December 2001. Subsequently, we launched *Westward Journey Online II* in August 2002 and our second original PC based MMORPG, *Fantasy Westward Journey*, in January 2004. *Westward Journey Online II* and *Fantasy Westward Journey* were upgraded to *New Westward Journey Online II* and *Fantasy Westward Journey Online* in 2013. Both game series remain popular with gamers today as a result of continued content updating and innovation in play modes over the past two decades.

PC game players can purchase prepaid points to pay for game playing time, virtual items and other fee-based services that enhance their playing experience such as special powers, costumes, weapons and other accessories. We regularly introduce new virtual items and other fee-based services, as well as change the features of virtual items based on player feedback, market trends and other factors.

The table below sets forth our major PC games developed in-house:

<u>PC Game</u>	<u>Genre</u>	<u>Date(s) of Launch and Major Upgrade</u>
New Westward Journey Online II (a comprehensive upgrade of Westward Journey Online II) (大話西遊2經典版)	2D MMORPG, classical Chinese setting	August 2002 September 2013
Fantasy Westward Journey Online (previously known as Fantasy Westward Journey II) (夢幻西遊電腦版)	2D MMORPG, classical Chinese setting	January 2004 July 2013
Tianxia III (天下3)	3D MMORPG, classical Chinese setting	October 2011
New Ghost (a new version of Ghost II) (新倩女幽魂)	2.5D MMORPG, classical Chinese setting	April 2012 September 2015
Justice (逆水寒)	3D MMORPG, classical Chinese setting	June 2018

### *Licensed games*

In addition to our in-house developed mobile and PC games, we also offer games licensed from other international game developers, including Blizzard and Microsoft. See “— International partnership and investment.” Revenues from licensed games accounted for 10.8%, 9.5% and 9.6% of our total games revenues in 2017, 2018 and 2019, respectively.

### Global presence

We continue to advance our games and make inroads that expand our reach in overseas markets. We have launched more than 50 mobile games in global markets since 2015. Our mobile game, *Knives Out*, has remained popular in Japan since its launch in 2017 and topped

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Japan's iOS grossing chart multiple times in 2019. *Identity V*, which we launched in Japan in 2018, also topped Japan's iOS grossing chart in September 2019, further evidencing our potential to operate a diverse range of games in overseas markets over the long term.

In addition to our success in Japan, we have expanded our footprint across more regions. In December 2019, we launched *MARVEL Super War* in several Southeast Asian markets where it topped many of the iOS download charts. We have also further enhanced our global R&D capabilities by launching a video game studio in Canada in 2019.

### ***International partnership and investment***

Building on our strong in-house content development capabilities, we have formed strategic partnerships and collaborations with world-famous game studios and content owners. As a leader in online games in China, we have successfully attracted leading international game studios and content owners with our development and operational capabilities, such as Blizzard, Marvel, Microsoft and Warner Brothers, to co-develop and/or operate games in China and abroad. We also invest in leading global studios across the world to strengthen our development capabilities and diversity.

For example, we have been partnering with Blizzard since 2008 to exclusively operate a number of its games in China, including *World of Warcraft*, the *StarCraft II* series, *Diablo III*, *Hearthstone*, *Heroes of the Storm* and *Overwatch*. Blizzard has also licensed on an exclusive basis in China its Battle.net<sup>®</sup> platform to us, which enables multi-player interaction within these games and other online services. In January 2019, we further extended our partnership for a four-year term. Furthermore, we are currently co-developing *Diablo Immortal*<sup>™</sup> with Blizzard, an MMO action-RPG. We have also entered into a partnership with Marvel in May 2019 to create original entertainment content based on internationally beloved Marvel characters and stories. We are jointly developing products including games, television series and comic books that feature Marvel characters for users in China and beyond.

In addition, in May 2016, we entered into a five-year exclusive agreement with Microsoft, pursuant to which Microsoft agreed to license both the mobile and PC versions of *Minecraft* to us for operation in China until 2022. In May 2019, we extended the term of the *Minecraft* license for an additional year to August 2023. We successfully introduced both versions of *Minecraft* in China across various platforms in 2017.

We continue to establish and deepen collaboration with other leading international game studios, including entering into a joint development agreement with Codemasters, a leading UK game studio focusing on racing games, as well as making minority investments in Bungie, an independent game studio in the United States, Quantic Dream, an independent game studio based in Paris, and Behaviour Interactive Inc., Canada's leading independent game studio.

### ***Game design and development***

Building upon the success of our classic titles, we have accumulated a better and deeper understanding of our users in terms of their interests and preferences in style, aesthetics and gameplay. We have integrated our experience and know-how into the design of our new games, enhancing our ability to deliver popular titles to users. We have established multiple studios of game developers to research and develop new games and expansion packs.

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### Our franchises

We continue to build upon existing successful games to offer multi-dimensional content by leveraging our in-house developed franchises and intellectual property. Our *Fantasy Westward Journey* and *Westward Journey Online* franchises remain popular and have been instilled in the collective memory of generation of Chinese players. We further expanded the reach of these franchises through the introduction of *Fantasy Westward Journey 3D* in December 2019, captivating both returning fans and new players.

In addition to growing and strengthening our existing franchise, we have continually incubated new ideas and delivered new and long-lasting game titles to our users. For example, *Onmyoji* is one of our younger franchises built in-house. As we introduced more innovative new storylines, characters and other content, the influence of *Onmyoji*'s IP continues to grow and resonate with more game players. *Onmyoji* topped the China iOS grossing chart multiple times during 2019 after more than three years of operation, and it has spun off three successful mobile games, been adapted into a feature motion picture and a musical and inspired a themed coffee shop. Another in-house developed young IP is *Identity V*, which we believe has the potential to become another successful NetEase franchise. We are continually enriching this IP through a variety of initiatives, including e-sports, IP collaborations and off-line activities. We have hosted a number of high-profile events featuring *Identity V*, including both international and regional series tournaments.

The prerequisite to building a successful franchise is the ability to create popular game IPs in-house, which is propelled by our strong R&D capabilities. Over the past two decades, we have built a large in-house R&D team with talented and passionate game creators. We empower each of our talent with our game-enthusiastic corporate culture and our carefully-designed training program. For more description on our R&D capabilities, see “— Game R&D and technologies.”

### Content quality and user experience

We focus on providing an innovative and superior user experience in game design and development and strive to make games of the highest quality. From the initial proposal to final launch, our games will typically go through a number of carefully designed steps including market research, proposal, demo, repeated prototype review and beta testing to ensure that the best quality and user experience can be delivered to our players.

In addition to creating a highly realistic and immersive gaming experience through the use of advanced technologies, we also employ innovative gamification thinking that takes into consideration both the in-game and out-of-game user experience. We have also launched offline gaming experience stores to allow for dynamic and spontaneous offline interactions among game players, as well as create an offline user feedback channel.

### ***Game R&D and technologies***

Our consistent and significant investment in innovative game research and development is a key contributor to the success of our online game business and has been widely recognized in the games industry. In 2019, we were awarded the “Top Ten Game Research and Development Companies in China” award by the China Audio-video and Digital Publishing Association.

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### Our proprietary game R&D capabilities

Proprietary R&D is the key focus of our game business. We continually strengthen and upgrade our game R&D infrastructure through recruiting and cultivating top talent, optimizing our game production pipeline, and fostering a culture of creativity and innovation. We have founded a number of in-house research institutions to explore the application of various technologies in games.

We strive to recruit and grow the best talent in the industry. Our training programs at *NetEase Games Academy* are widely recognized in China as a premier online games training institution for creative minds. Two of our training programs were awarded the “2019 ATD Excellence in Practice Awards” by the Association for Talent Development, one of the most authoritative international awards in the global talent development industry. Having built a virtuous cycle among our talent, established development pipeline and dynamic culture of innovation and craftsmanship, our strong R&D capabilities continue to enable high-quality production and expansion of successful games.

### Key game technologies

Our game R&D is centered around using technologies to deliver a superior and differentiated user experience. The key areas of our proprietary game technologies include:

*Proprietary game engines:* In addition to game development, we have continually invested in proprietary game engine R&D. Since the initial launch of our first game engine, NeoX, in 2005, we have continually expanded and optimized our proprietary engines to systematically support enhanced game features and aesthetics. As part of our early strategy to focus on mobile games, we successfully adapted NeoX to iOS and Android systems as well as developed Messiah, a 3D game engine specifically designed for mobile platforms. We believe that our R&D in game engines and games reinforces each other and promotes a virtuous cycle of innovation. NeoX and Messiah enable us to systematically develop mobile games with the highest quality in lighting, audio, special effects, physics and animation, and other key game features, while our drive for better games in turn motivates development of more powerful engines.

*User profile analytics:* We perform an in-depth analysis of our users profile by analyzing activities and performances in games, in-game purchasing preferences and other data and information with AI technologies. We leverage our user data on an aggregate basis to guide game development and upgrades, marketing and other activities.

*Intelligent non-player characters (NPCs):* Enabled by deep learning technology, we have created intelligent NPCs that can join players’ in-game activities, simulate real-life interactions, facial expressions and body language and enable a more engaging gaming experience. We also deploy multiple reinforcement learning technologies to produce NPCs with diverse styles and difficulty levels, catering to a wide range of player preferences.

*Natural language processing (NLP):* We apply NLP technology in our games to enable players to develop their own storyline by carrying out conversations with NPCs and explore hidden elements in the game, creating an immersive gaming experience for players.

*Advanced game graphics:* Our advanced game graphics enable game players to create unique characters with customized facial features. We also offer automatic character customization based on real-life photographs uploaded by players. In addition, we deploy high-quality 3D game graphics and automatic scene generation in our games.

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### Intelligent learning services — Youdao

#### *Youdao's services and products*

We founded Youdao in 2006 and launched the flagship Youdao Dictionary in 2007, which remains the top language app in China in terms of MAUs. Youdao experienced rapid growth since its founding and completed its public listing on the New York Stock Exchange in October 2019.

Building on the early success of Youdao Dictionary, we have attracted a massive user base, built a strong brand, and expanded into a broad range of services and products addressing lifelong learning needs of pre-school, K-12 and college students as well as adult learners.

#### Learning services

*Online courses.* We have developed a comprehensive offering of online courses catering to the diverse learning needs of different age groups. Our online course offerings currently consist of Youdao Premium Courses, NetEase Cloud Classroom and China University MOOC.

*Interactive learning apps.* We offer a wide range of interactive learning apps to nearly all age groups. We are committed to delivering a fun and effective learning experience across these apps through an abundance of gamified features, as well as social functions allowing users and students to share their learning progress with friends through social media. Our current key interactive learning apps include *Youdao Math*, *Youdao Fun Reading*, and *Youdao Vocabulary Builder*.

*Enterprise services.* We offer Youdao Smart Cloud, a cloud-based platform that allows third-party app developers, smart device brands and manufacturers to access our advanced Optical Character Recognition (OCR) capability and Neural Machine Translation (NMT) engine and incorporate them into their apps, devices, and services through application programming interfaces. We also license our OCR and NMT technologies and solutions to customers on a non-cloud basis. In addition, in collaboration with the Higher Education Press, we also provide colleges and universities with a cloud-based platform for them to build their online course offerings, as well as a range of ancillary technological support services.

#### Online knowledge products

*Youdao Dictionary.* Launched in 2007, Youdao Dictionary is our first major product and flagship online language tool. Today, it remains China's most popular and trusted online dictionary and translation tool with 51.9 million MAUs in 2019. As of December 31, 2019, Youdao Dictionary offered over 30 million entries across 108 languages.

*Youdao Cloudnote.* Youdao Cloudnote is an independent note-taking tool that offers a comprehensive suite of features for users to make a note of their ideas and inspirations anytime and anywhere. Users can also use the Youdao Cloud Pen with the Cloudnote, which digitizes their handwriting and saves it to the user's Youdao Cloudnote account.

*Other online dictionary and translation tools.* In addition to Youdao Dictionary, we also offer Youdao Translation, a tool specifically designed to support translation needs of business and leisure travelers across over 30 languages via camera and speech translation, U-Dictionary, an online dictionary and translation app we offer in India and Indonesia and other overseas markets, and Youdao Kids' Dictionary, a K-12 focused smart and fun tool that offers translation services in Chinese and English.

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### Smart devices

We develop and offer smart devices, including Youdao Smart Pen, Youdao Dictionary Pen and Youdao Pocket Translator to make learning more productive and efficient for our users. Our smart devices are developed and designed by us or in collaboration with third parties, while the manufacturing of such devices is outsourced to third-party manufacturers under original equipment manufacturer agreements. As of December 31, 2019, we have distributed 459,180 units of our smart devices.

### *Technology-driven learning experience*

We integrate technologies into every major aspect of the learning and teaching process to ensure a superb learning experience across Youdao's services and products. Over the years, we have built proprietary OCR, NMT, language data mining and voice recognition technologies and data analytics that serve as the foundation to our services and products. Such technologies are iteratively refined based on the vast data generated by our users.

For example, we offer a set of advanced AI-based technologies to make learning more personalized and efficient while maintaining a high level of human touch. We have also built massive "knowledge graphs" depicting different knowledge points, concepts and learning objectives, supported by a large quiz bank curated by our course development professionals to help students understand the subject matter. In addition, we have adopted an adaptive learning approach which tracks each student's learning progress and dynamically adapts teaching to the student's unique learning needs. We collect student learning and behavior data throughout their learning cycles to help us understand their learning progress and predict through our adaptive learning model how they will perform to achieve future learning objectives.

We also offer a seamless online and offline hybrid learning experience through the use of our smart devices. We encourage students to use our Youdao Smart Pen, which automatically converts the student's handwriting into data that is synced up with our systems, allowing the student to view automatic grading results of exercises completed, correct answers and explanations, and suggested exercises to reinforce what is learnt, in almost real time. This has significantly improved our students' learning efficiency and allowed us to deepen our insights into our students' learning progress.

### **Other innovative businesses and services**

#### *NetEase Cloud Music*

We launched the NetEase Cloud Music streaming platform in April 2013. Since then, NetEase Cloud Music has focused on delivering a differentiated and premium listening experience in terms of the quality and variety of music offered. Its pursuit of offering an excellent user experience has led to a highly loyal and active user base. As of December 31, 2019, NetEase Cloud Music had over 800 million registered users.

NetEase Cloud Music is home to a large number of independent musicians. We focus on discovering and promoting rising artists with big data analytics. More than 100,000 independent musicians were on our platform as of December 31, 2019, and their songs were played back more than 270 billion times in 2019. In addition, we offer musicians tools and solutions to promote and monetize their work.

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We also diversify and further enrich our music offerings with sub-licensed content. NetEase Cloud Music operates under a freemium business model in which basic services are free while some enhanced features are available on a paid basis. In addition to providing the main music playback, download and search services, we also provide music social functions, such as song reviews, song list recommendations based on historical playback records and geographic location identification.

In August 2019, we also added a new community module, *Cloud Village*, to further develop a music community that fosters discussion, creation and sharing of personalized expression around music. We launched a live streaming app, *Look Live Streaming*, in 2018 to provide an additional platform for independent musicians to showcase their music talents and interact directly with their audience. Fans can leave comments and send virtual gifts to artists while they perform live. In early 2020, we hosted an online music festival where more than 50 artists live streamed their performances to a massive audience across China.

### ***Yanxuan***

Our e-commerce platform, Yanxuan, primarily sells our private label products, including consumer electronics, food, apparel, homeware, kitchenware and other general merchandise which we primarily source from original design manufacturers (ODM) in China. With its slogan *Quality Products, for Quality Life* (嚴選好物，用心生活), Yanxuan is dedicated to helping consumers build a quality yet affordable life by providing selected daily life products with outstanding quality and design.

Under Yanxuan's ODM model, it partners with selected manufacturers in China to design and manufacture products and sells them directly to customers. The ODM model enables Yanxuan to provide quality goods with lower cost by eliminating brand premium and channel intermediaries such as distributors and retailers. In addition to the online platform, we have also opened four offline stores in Hangzhou and Shanghai, inviting more consumers to discover the popular items on Yanxuan through experiential retail.

### ***Other innovative services***

We also offer a wide range of other innovative services, including NetEase Media, our internet media services, NetEase Mail, our email service, NetEase CC Live streaming, our live streaming platform with a primary focus on game broadcasting, and NetEase Pay, our payment platform.

Our internet media platform is a well-established brand with strong innovations in its content offerings and user experience. Our NetEase News App offers content channels covering news, information, popular sports events, industry forums, celebrity close-ups, technology and fashion trends, and online entertainment to the Chinese public via a variety of mobile devices. As one of the largest e-mail services providers in China in terms of registered email users, we offer both free and fee-based e-mail services to over one billion individual and corporate users as of December 31, 2019. In addition, the main homepage of the NetEase websites, "www.163.com," serves as a one-stop gateway for users to conveniently access our other online services, such as online games, e-mail, e-commerce, video and music streaming, e-reading and a set of other websites and mobile applications.



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### TECHNOLOGIES AND IT INFRASTRUCTURE

As one of the inaugural class of internet platforms and one of the first to provide e-mail services to the masses in China, we have consistently prioritized investing in technologies since our inception. With our strong R&D capabilities and advanced technologies, we successfully digitalized traditional offline services, such as music and learning, and significantly transformed entertainment, learning and other activities. We focus on exploring viable applications of cutting-edge technologies to meaningfully enhance our service offerings and deliver a superior experience for our users. Empowered by advanced AI, big data analytics and other core proprietary technologies, we deliver engaging content and services that are highly individualized and personalized across our businesses.

#### AI and machine learning

Our powerful AI and machine learning capabilities enable us to effectively process ultra-large-scale data generated from across our services and products, optimize recommendations, personalize offerings and predict user behavior. Our key AI and machine learning capabilities include:

- (a) *Industry-leading technologies focusing on user experience:* Based on the vast text, pictures, audio and video content generated by our users, we have developed advanced technologies such as natural language processing, automatic speech recognition (ASR) and text-to-speech (TTS) technologies that enable us to deliver an enjoyable and effective user experience.
- (b) *AI-powered applications, such as content recommendation and customization:* We are a leader in developing and adopting AI technologies in content recommendation and customization, which enables us to achieve greater user engagement and stickiness.

#### Big-data analytics

We take a holistic approach to big data innovation, with a focus on gaining deeper understanding of our users in order to provide better services, products and experience. Building on technologies that can process and analyze bulk data generated by millions of users instantaneously, our platform adopts a service-oriented architecture that allows easy up-scaling and frequent upgrading of the products. Our key data analytics capabilities include:

- (a) *Scale:* We have accumulated a massive user base and vast and complex user data across our online games, intelligent learning, music and media businesses. The data generated every day not only provides us with high-quality profile information, but also contains a large amount of user-generated content and interactions, including text, images, audio and video. We maintain a high standard of data protection and privacy while productively using our data to inform our business operations and development.
- (b) *High-value data:* Content, relationships and behavioral data based on user activities and interactions enable us to create more accurate user profiles. Based on this data, we can be more intuitive and comprehensive in reflecting user interests and preferences, and provide valuable user reference data for a wide spectrum of R&D, marketing, user engagement and other strategic initiatives.

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- (c) *Leading data analytical technology*: Our big data analytical capability enables comprehensive analysis of services and products offered and timely adjustments.

### Graphics and AR/VR

We have developed numerous technologies to create immersive and effective entertainment and learning experiences. In addition to creating quality 3D game graphics and automatic scene generations in games, we launched our VR game, *Nostos*, in 2019 to offer game players a lifelike, free and dynamic open world game experience. Outside of games, NetEase Cloud Music has also leveraged augmented reality in its marketing and user engagement activities.

### IT infrastructure

Our infrastructure and technology have been designed for reliability, scalability and flexibility and are administered by our technical staff. Our NetEase websites and other online and mobile platforms are made available primarily through network servers co-located in the facilities of China Telecom's affiliates, China Unicom's affiliates and China Mobile's affiliates. As of December 31, 2019, there were approximately 106,000 of such co-located servers, including servers supporting the operation of the games licensed to Shanghai EaseNet by Blizzard, using leased dedicated lines mainly from various affiliates of China Telecom, China Unicom and China Mobile. We also utilize certain cloud-based servers maintained by third parties such as Amazon.

In addition, we have developed our own systems to facilitate sales planning, targeting, trafficking, inventory management and reporting tools, such as advertisement tracking systems for our advertising services. We have also established a comprehensive user profile system which we monitor and review on a regular basis. We also deploy a single sign-on system that allows users to easily access our services offered through the various NetEase products. We intend to continue to use a combination of internally developed software products as well as third-party products to enhance our products and services in the future.

### SALES AND MARKETING

We employ a variety of online and traditional sales and marketing programs and promotional activities to build our brand as part of our overall marketing strategy. We focus on building brand awareness through online marketing campaigns, proactive public relations and other offline advertising. We invest in a series of marketing activities to further strengthen our brand image and continue to grow our user base, including collaborating with leading social media, video and live streaming platforms, TV, movie and stage production companies as well as book and comic publishers to extend our brand to a broader potential user group.

### Online game services

Our mobile games are available on the Apple App Store for iOS and third-party Android app stores. In addition, to leverage our existing user bases, we also publish our mobile games through our own internet properties. We conduct in-game marketing campaigns in connection with special holiday editions or launches of new games or expansion packs throughout the year. We have also promoted our games in collaboration with online and offline third-party promoters.

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### **Youdao**

Youdao generates user traffic and leads primarily from online channels. As a key sales and marketing strategy, Youdao cross-sells its comprehensive portfolio of services and products, which allows it to effectively scale its business with modest traffic acquisition and marketing spending. In addition, Youdao also employs mobile marketing, such as brand advertisements and marketing campaigns on app stores, leading mobile news apps and social media platforms, as well as through optimization techniques designed to improve its ranking in popular search engines' results. Youdao also engages in offline marketing and branding to supplement its overall sales and marketing strategies.

### **Innovative businesses and others**

For our innovative businesses and other online services, content and services are generally provided through mobile applications or their respective websites. Users purchase our services either at a pre-determined package rate or on an item-based basis, and payments are made using third-party online payment platforms or NetEase Pay. We attract users through a variety of channels, such as our sponsored searches, social and online advertising, internet video and television advertising and other advertising channels. We also offer our customers special pricing discounts in connection with promotion activities and strive to expand our products selection to attract more visitors. Advertising services are conducted through our dedicated advertising services sales force, or through online advertising sales networks and advertising agencies.

### **INTELLECTUAL PROPERTY**

We rely on a combination of copyright, trademark, patent and trade secrecy laws and contractual restrictions on disclosure to protect our intellectual property rights. We require our employees to enter into agreements requiring them to keep confidential all information relating to our customers, methods, business and trade secrets during and after their employment with us. Our employees are required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes, whether or not patentable or copyrightable, made by them during their employment are our property. They also sign all necessary documents to substantiate our sole and exclusive rights to those works and to transfer any ownership that they may claim in those works to us.

We have registered a number of domain names. We have also successfully registered numerous trademarks with China's Trademark Office, including marks incorporating the words "NetEase" and "Yeah!" in English and for marks for "NetEase" as written in Chinese in traditional and simplified Chinese characters. In addition, we have registered trademarks involving Chinese characters and phrases that have meanings relating to our web pages, products and services, including our online games, intelligent learning services, online music services, chat services, e-commerce and certain other online services. In addition, we have registered a number of trademarks involving the "NetEase" name as well as the names and logos of our products and services in the United States, the European Union, the Republic of Korea, Japan, Hong Kong, Macau, Taiwan, Thailand, and other jurisdictions.

In addition, we have registered our various in-house developed games and other online products with the Copyright Protection Center of China. Moreover, we have filed certain patent applications with the National Intellectual Property Administration of China, U.S. Patent and Trademark Office, European Patent Office and Japan Patent Office, and have obtained Certificates of Design Patent, Utility Model Patent and/or Invention Patent for technologies related to our games, live video, news, educational products, e-commerce and finance, NetEase

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Cloud Music, hardware products, cloud technology, augmented reality technology, computer technology and e-mail from the National Intellectual Property Administration of China, as well as Certificates of Utility Patent for games in the United States and Certificates of Design Patent in Japan.

In addition, Youdao owns the intellectual property relating to in-house developed content used on its platform and the registrations of the core trademarks “Youdao.” We also own the intellectual property (other than the content) relating to the NetEase websites and other online and mobile platforms, and the technology that enables online community, personalization, online games, news sharing, instant messaging, video streaming, NetEase Cloud Music, Yanxuan and other services on those platforms. We license content from various freelance providers and other content providers.

While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. See “Risk Factors — Risks related to doing business in China — We may not be able to adequately protect our intellectual property, and we may be exposed to infringement claims by third parties.”

### COMPETITION

Our competition primarily comes from global online game developers and operators, such as Tencent, established online and offline education service providers in China, as well as leading digital media and entertainment providers. Some of our current and potential competitors are larger than we are, and currently offer, and could further develop or acquire, content and services that compete with us. The areas in which we compete primarily include:

*User traffic, time and spending.* We compete to attract, engage and retain users based on the design, quality, popularity and efficacy of our content offerings, the overall user experience of our products and services, as well as the effectiveness of our marketing activities.

*Talent.* We compete for motivated and capable talent, including engineers, game designers, product developers and creative professionals to build compelling content, tools and functions.

*Global collaboration opportunities.* We compete to win collaboration relationships with well-known global IP and content owners based on our level of expertise in systematically developing in-house developed games, delivering a compelling user experience through operational know-how and customizing established game titles for rapid expansion into overseas markets.

There can be no assurance that we will be able to compete successfully against our current or future competitors or that competition will not have a material adverse effect on our business, results of operations and financial condition.

### CORPORATE SOCIAL RESPONSIBILITY

Since our founding, we have been highly committed to environmental, social and corporate responsibility matters. Through our product and service offerings, we aim to improve people’s lives by leveraging technologies to offer innovative services such as online games, intelligent learning and music streaming. For example, aspiring to make high-quality education and learning services and products accessible to everyone, we have been making headway in improving and promoting online and live-streamed courses, which make it possible for users

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in less-developed regions to access quality and diverse educational resources. We also promote the use of games as educational tools to make learning fun. In 2018, we localized *CodeCombat*, a well-known platform for students to learn software programming while playing games.

Furthermore, our Cloud Music platform has become an important avenue for raising awareness for social issues, such as animal protection and children's wellbeing, through its music and fund-raising campaigns. Yanxuan has also leveraged its business platform to help local artisans and merchants sell their products in a bid to contribute to China's poverty reduction efforts.

In addition, we stand out in our commitment to equality and diversity in our recruitment and promotion policies. We are included in the Bloomberg Gender-Equality Index's 2020 global list of 325 public companies that are committed to gender equality in the workplace, an accolade that we are enormously proud of. We also value diversity highly and currently have employees from more than 30 countries and regions, including the United States, Japan, South Korea and Canada. We empower each of our talent with our carefully-designed training program. Two of our training programs were awarded the "2019 ATD Excellence in Practice Awards" by the Association for Talent Development, one of the most authoritative international awards in the global talent development industry.

Given that the majority of our operations are conducted online, we leave limited impact on the environment with a small carbon footprint. We are committed to carbon mitigation measures and will continue to explore ways to further improve energy efficiency. All our servers are compliant with industry energy efficiency standards in China, and we intentionally choose partners with a strong commitment to carbon emission reduction in our collaboration with third-party cloud servers.

### **RISK MANAGEMENT AND INTERNAL CONTROL**

We have devoted ourselves to establishing and maintaining risk management and internal control systems consisting of policies and procedures that we consider to be appropriate for our business operations, and we are dedicated to continuously improving these systems.

We have adopted and implemented comprehensive risk management policies in various aspects of our business operations, such as financial reporting, information system, internal control, human resources and investment management.

#### **Financial reporting risk management**

We have in place a set of accounting policies in connection with our financial reporting risk management, such as financial reporting management policies, budget management policies, treasury management policies, financial statements preparation policies and finance department and staff management policies. We have various procedures and IT systems in place to implement our accounting policies, and our finance department reviews our management accounts based on such procedures. We also provide regular training to our finance department employees to ensure that they understand our financial management and accounting policies and implement them in our daily operations.

#### **Information system risk management**

Sufficient maintenance, storage and protection of user data and other related information is critical to our business. We have implemented various internal procedures and controls to ensure that user data is protected and that leakage and loss of such data is avoided.

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We believe it is crucial that our users understand how we handle their information so that they can make informed choices in deciding how such information is used and shared. To this end, we collect personal information and data from users only with their prior consent, and we offer our users opt-out or opt-in options. We have established and implemented a strict company-wide policy on data collection, usage, disclosure, transfer and storage. In accordance with our policy, we are required to go through the following procedures: (i) providing notice to users as to why and how their data is being collected and used; (ii) providing users with the choice to opt-out or opt-in; (iii) making continuous efforts to prevent loss or leakage of user data; and (iv) providing users with access to their own personal information collected by us.

We have implemented a network of process and software controls to protect individual personal information and privacy. We encrypt user data in network transmission. For back-end storage, we also use various encryption technologies at software and hardware levels to protect sensitive user data. To minimize the risk of data loss or leakage, we conduct regular data backup and data recovery tests.

We prioritize user data security and privacy by strictly following our defined policy. We have obtained the certificates of ISO 27001 and filing certificates of Classified Protection of Information Security. We have established a coordination mechanism with third-party agencies to handle information security threats in a timely manner.

At the enterprise level, we established a systematic and universal user account authorization and management mechanism based on which we periodically review the status of user accounts and the related authorization information. We regularly perform security configuration assessment on our databases and servers and implement procedures for system log management.

We have put in place a series of back-up management procedures. We deploy different back-up mechanisms, including local back-ups and offsite back-ups, depending on the needs of our business, to minimize the risk of user data loss or leakage. We have also established protocols for the design, implementation and monitoring of offsite back-ups. We also require any access to or processing of user data to go through strict assessment and approval procedures in order to ensure that only valid and legitimate requests are executed.

We provide information security training to our employees and conduct ongoing trainings, and we discuss any issues or necessary updates from time to time. We also have an emergency response mechanism to evaluate critical risks, formulate disaster response plans and perform emergency drills on a regular basis. In addition, each of our business units is responsible for ensuring that the usage, maintenance and protection of user data are in compliance with our internal information security policy and the applicable laws and regulations.

### **Internal control risk management**

We have designed and adopted strict internal procedures to ensure the compliance of our business operations with the relevant rules and regulations. Our internal control team works closely with our legal, compliance and finance departments as well as our business units to: (a) perform risk assessments and give advice on risk management strategies; (b) improve business process efficiency and monitor internal control effectiveness; and (c) promote risk awareness throughout our Company.

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In accordance with our internal procedures, our in-house legal department performs the basic function of reviewing and updating the form of contracts we enter into with our consumers, merchants and relevant third-parties. Our legal department examines the contract terms and reviews relevant documents for our business operations, and the necessary underlying due diligence materials, before we enter into any contract or business arrangements.

Our in-house legal department reviews our services for regulatory compliance before they are made available to the general public. Our in-house legal department works with relevant business units to obtain requisite governmental approvals or consents, including preparing and submitting all necessary documents for filing with relevant government authorities within the prescribed regulatory timelines.

We continually review the implementation of our risk management policies and measures to ensure our policies and implementation are effective and sufficient.

### **Human resources risk management**

We provide regular and specialized training tailored to: (a) the needs of our employees in different departments, and (b) our anti-bribery & corruption policy. We regularly organize internal training sessions conducted by senior employees or outside consultants.

We have in place an employee handbook and a code of conduct approved by our management and have distributed them to all our employees. The handbook contains internal rules and guidelines regarding work ethics, fraud prevention mechanisms, negligence and corruption. We provide employees with regular training as well as resources to explain the guidelines contained in the employee handbook.

We have in place an anti-bribery and corruption policy to safeguard against any corruption within our Company. The policy explains potential bribery and corruption conduct and our anti-bribery and corruption measures. We make our internal reporting channel open and available for our staff to report any bribery and corruption acts, and our staff can also make anonymous reports to our ethics committee. Our ethics committee is responsible for investigating the reported incidents and taking appropriate measures.

### **Investment risk management**

We invest in or acquire businesses that are complementary to our business, such as businesses that can expand the services we offer and strengthen our R&D capabilities.

In general, we intend to hold our investments for the long term. In order to protect our interests as shareholders and control the potential risks associated with our investments, we generally request our investee companies to grant us customary investor protective rights.

Our finance department monitors the deal performance on a regular basis. Our finance and legal departments cooperate with deal team on deal analysis, communication, execution, risk control and reporting. Any material factors will be timely reported to the senior management or board of director for further decision.

### **Audit committee experience and qualification and board oversight**

We have established an audit committee to monitor the implementation of our risk management policies across our company on an ongoing basis to ensure that our internal control system is effective in identifying, managing and mitigating risks involved in our business operations.

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## OUR BUSINESS

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The audit committee consists of three members, namely Michael Leung, Alice Cheng and Joseph Tong, all of whom are independent non-executive directors. Michael Leung is the chairperson of the audit committee. For the professional qualifications and experiences of the members of our audit committee, see “Directors and Senior Management.”

We also maintain an internal audit department which is responsible for reviewing the effectiveness of internal controls and reporting to the audit committee and senior management on any issues identified. Our internal audit department members hold regular meetings with management to discuss any internal control issues we face and the corresponding measures to implement toward resolving such issues. The internal audit department reports to the audit committee to ensure that any major issues identified are channeled to the committee on a timely basis. The audit committee then discusses the issues and reports to the board of directors, if necessary.

### **Ongoing measures to monitor the implementation of risk management policies**

Our audit committee, internal audit department and senior management together monitor the implementation of our risk management policies on an ongoing basis to ensure our policies and implementation are effective and sufficient.

### **SEASONALITY**

Historically, usage of our online games has generally increased around the Chinese holidays, particularly the winter and summer school holidays. Our Youdao platform tends to have larger student enrollments in the second and fourth quarters when it offers more courses including, for example, test preparation courses for school exams in the spring and fall semesters and China’s national college entrance exams, national postgraduate entrance exams and college English tests, compared to the rest of the year. Revenues from innovative businesses and others, including advertising services, have followed the same general seasonal trend throughout each year, with the first quarter of the year being the weakest quarter due to the Chinese New Year holiday and the traditional close of customers’ annual budgets, and the fourth quarter as the strongest. Our e-commerce business revenues are relatively lower during the Chinese New Year holiday season in the first quarter of each year, while sales in the fourth quarter are higher than each of the preceding three quarters due to a variety of promotional activities conducted by retail and e-commerce businesses in China.

### **CUSTOMERS AND SUPPLIERS**

We have a broad base of customers, and our five largest customers accounted for less than 3% of our total revenues for each of the years over the Track Record Period.

Our five largest suppliers accounted for less than 41% of our purchases for each of the years over the Track Record Period; and none of them individually accounted for more than 30% of our annual purchases over this same period. As of the Latest Practicable Date, based on publicly available information, none of our directors or their close associates (as defined in the Hong Kong Listing Rules) or Shining Globe International Limited, our controlling shareholder, held a 5% or more shareholding interest in our top five suppliers.



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## OUR BUSINESS

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### EMPLOYEES

As of December 31, 2017, 2018 and 2019, we had 18,129, 22,726 and 20,797 full-time employees, respectively. A substantial majority of our employees are based in China. We believe that we have a good working relationship with our employees, and we have not experienced any significant labor disputes.

The following table sets forth information regarding our staff as of December 31, 2019. Our R&D staff consisted of 10,279 employees as of December 31, 2019.

<u>Segment</u>	<u>Number</u>
Online Game Services .....	11,592
Youdao .....	1,699
Innovative Businesses and Others .....	7,506
Total .....	<u>20,797</u>

All employees of our company and of our affiliated companies are employed under employment contracts which specify, among other things, the employee's responsibilities, remuneration and grounds for termination of employment. Each employee signs a confidentiality agreement in respect of our intellectual property rights.

### INSURANCE

We consider our insurance coverage to be adequate as we have in place all the mandatory insurance policies required by Chinese laws and regulations and in accordance with the commercial practices in our industry. Our employee-related insurance consists of pension insurance, maternity insurance, unemployment insurance, work-related injury insurance, medical insurance and housing funds, as required by Chinese laws and regulations. We also purchase supplemental commercial medical insurance and accident insurance for our employees.

In line with general market practice, we do not maintain any business interruption insurance or product liability insurance, which are not mandatory under PRC laws. We do not maintain keyman life insurance, insurance policies covering damages to our network infrastructures or information technology systems. We carry property insurance with low coverage limits that may not be adequate to compensate us for all losses, particularly with respect to loss of business and reputation that may occur. We also do not maintain insurance policies against risks relating to the Contractual Arrangements. During the Track Record Period, we did not make any material insurance claims in relation to our business.

### PROPERTIES

Our principal executive offices are currently located at NetEase Building, No. 599 Wangshang Road, Binjiang District, Hangzhou, People's Republic of China 310052. In addition, as of December 31, 2019, we leased office, warehouse and store facilities with an aggregate of approximately 332,000 square meters of space at properties mainly in Beijing, Shanghai, Guangzhou and Hangzhou.

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## OUR BUSINESS

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We own and occupy several research and development centers in Hangzhou and Guangzhou, China with a total floor area of approximately 304,000 and 75,000 square meters, respectively, where our online game and innovative businesses and other services developers, as well as their related sales, marketing, technology, management and administrative functions are located. We also own and occupy an office building in Beijing with an aggregate total estimated floor area of 95,000 square meters, where our advertising services and Youdao are located.

We are in the process of constructing several new office buildings and warehouses, primarily located in Guangzhou, Hangzhou and Shanghai. As of December 31, 2019, we had incurred construction in progress costs of RMB466.0 million for these new office buildings and warehouses, which primarily comprise costs for building construction.

We continue to assess our needs with respect to office space and may, in the future, vacate or add additional facilities. We believe that our current facilities and those under construction will be adequate for our needs in the immediate and foreseeable future.

As of December 31, 2019, we owned approximately 106,000 network servers co-located mainly in the facilities of China Telecom's affiliates, China Unicom's affiliates and China Mobile's affiliates for which we paid server and bandwidth service fees, and we leased dedicated lines mainly from various affiliates of China Telecom, China Unicom and China Mobile pursuant to short term contracts. Our server and bandwidth service fees were RMB1,309.3 million for the year ended December 31, 2019.

### LEGAL PROCEEDINGS AND COMPLIANCE

From time to time, we become subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights, and a variety of claims arising in connection with our e-mail, message boards and other communications and community features, such as claims alleging defamation or invasion of privacy. However, such legal proceedings or claims, even if not meritorious, could result in the expenditure of significant financial and management resources.

In April 2018, PUBG Corporation and PUBG Santa Monica, Inc. (collectively "PUBG"), filed a lawsuit against defendants NetEase, Inc., NetEase Information Technology Corp. and NetEase (Hong Kong) Limited in the U.S. District Court for the Northern District of California. PUBG subsequently dropped all claims against NetEase (Hong Kong) Limited, and added Hong Kong NetEase Interactive Entertainment Limited to the lawsuit. PUBG's complaint generally alleged that two of NetEase's mobile games, *Rules of Survival* and *Knives Out*, infringed PUBG's copyrights and trade dress in their competing game, *Battlegrounds*. On March 11, 2019, NetEase entered into a settlement agreement with PUBG, and the lawsuit was dismissed. On October 15, 2019, PUBG filed a second lawsuit against the same NetEase defendants, also in the U.S. District Court for the Northern District of California, claiming NetEase had allegedly breached the settlement agreement. On March 3, 2020, the court dismissed PUBG's new lawsuit, without prejudice, for lack of subject matter jurisdiction. On March 4, 2020, NetEase initiated a declaratory judgment action against PUBG in the Superior Court of California for the County of San Mateo, requesting a declaration that NetEase had not breached the settlement agreement. NetEase's lawsuit against PUBG is on-going.

We are not currently a party to, nor are we aware of, any other legal proceeding, investigation or claim which, in the opinion of our management, is likely to have a material adverse effect on our business, financial condition or results of operations.

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## OUR BUSINESS

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Our PRC Legal Adviser is of the opinion that, during the Track Record Period, the Significant Subsidiaries have complied with relevant PRC laws and regulations currently in effect in all material respects, and obtained all material requisite licenses and approvals from relevant governmental authorities for their operations in the PRC, and that as at the Latest Practicable Date, these licenses and approvals remained valid and in effect to the extent required for their operations and that no material legal impediment to their renewal existed. Additionally, our Company confirms the same with respect to our Group and, in particular, confirms that during the Track Record Period and as of the Latest Practicable Date, our Group has complied with all relevant Laws currently in effect in all material respects, including obtaining all material licenses and approvals.

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## FINANCIAL INFORMATION

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The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included in the Accountant's Report in Appendix IA, the Unaudited Condensed Interim Financial Information in Appendix IB and in "Our Business." This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set out under "Risk Factors" and elsewhere in this document. We have prepared our consolidated financial statements in accordance with U.S. GAAP. Our fiscal year ends on December 31 and references to fiscal years 2017, 2018 and 2019 are to the fiscal years ended December 31, 2017, 2018 and 2019, respectively.

### OVERVIEW

We have a successful online game business, developing and operating a rich portfolio of highly popular titles. Leveraging on our user insights and execution expertise, we have also incubated and developed in-house a pipeline of successful businesses, including our intelligent learning platform, Youdao, and other innovative businesses, ranging from music streaming and private label e-commerce to internet media and e-mail services, among others.

We achieved strong operating results during the Track Record Period. We generated net revenues of RMB44,437.4 million, RMB51,178.6 million, RMB59,241.1 million and RMB17,062.4 million (US\$2,409.7 million) in 2017, 2018 and 2019 and the three months ended March 31, 2020, respectively. Our net income from continuing operations was RMB11,683.6 million, RMB8,616.1 million, RMB13,468.6 million and RMB3,950.7 million (US\$557.9 million) in 2017, 2018 and 2019 and the three months ended March 31, 2020, respectively.

### FACTORS AFFECTING OUR RESULTS OF OPERATIONS

#### **Our ability to continue to deliver original and compelling content and service offerings and effectively operate our existing products**

We take pride in being an original content provider. Our continued success in producing and delivering original and compelling content and services to our users largely depends on our ability to stay abreast of users' evolving needs and preferences and dynamics in the digital content and service industries. We seek to identify trend-setting content and services while striving to maintain the longevity and vitality of our existing products by effectively leveraging our rich operational know-how. In particular, as we generate a substantial amount of revenues from our online game services, our ability to successfully update and expand our existing game franchises and maintain a pipeline of new games across diversified genres and geographic regions will affect our future revenue and financial results.

#### **Our ability to grow our user base and drive user engagement and loyalty**

We have built a massive and highly engaged user base across our business segments. We generate a substantial part of our revenues through sales of in-game virtual items and play time, merchandise sales, music streaming, advertising services and tuition fees for online courses. Our ability to generate these revenues is affected by the size of our user base and the level of their engagement. Our ability to continue to grow our user base and engagement is driven by various factors, including our ability to offer diverse, attractive and relevant content and services, deliver differentiated and superior user experiences, improve the community features on our platforms and enhance our brand reputation.

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### **Our ability to continue to develop proprietary technologies and apply them meaningfully**

We have demonstrated capabilities in developing proprietary technologies and applying technology to enhance our products and services and improve our user experience, which is a critical competitive advantage of ours and a key factor that affects our operations and financial results. We have successfully developed industry-leading proprietary game, AI, big data and other technologies and integrate these technologies into our products and services, and we will continue to significantly invest in developing and upgrading our technology with a focus on optimizing our products and services and delivering a superior and differentiated user experience.

### **Our ability to manage our costs and expenses effectively across all business segments**

Our results of operations are affected by our ability to effectively control our costs and expenses across all of our business segments. We incur revenue sharing costs, including fees shared with distribution channel providers, game developers and other third parties related to mobile games, course instructors related to Youdao's services and others in connection with our other innovative businesses, which may increase in absolute amounts in the near term as we continue to scale up our operations across our business segments. We may also incur higher content costs in the near term as we continue to expand our product and service offerings to cater to the evolving user needs. Our ability to continue to manage and control our cost of revenues, including revenue sharing costs and content costs, while maintaining the high-quality and attractiveness of our products and services will have a significant impact on our business, financial condition and results of operations.

We have incurred substantial R&D expenses as we developed more products and improved our content offerings and technologies to deliver high quality services and value to our users. We strongly believe that R&D must be guided by the principles of commercial viability and applicability, and we plan to continue making purpose-driven investment in technologies. We have also been able to maintain our sales and marketing expenses as a relatively low percentage of our net revenues due to our strong brand reputation. Our ability to sell and market our products and services cost-effectively depends on our ability to continue to leverage our existing brand value, grow and monetize our user bases, and improve our sales and marketing efficiency.

### **Our ability to make successful strategic investments and acquisitions**

We have made, and intend to make, strategic investments and acquisitions. Our investment and acquisition strategy is focused on strengthening our content development and R&D capabilities, creating strategic synergies across our businesses, and enhancing our overall value. Our strategic investments and acquisitions may affect our future financial results, including our margins and net income. In addition, some of our acquisitions and investments may not be successful. We have recorded net investment losses in equity method investees and impairment provisions related to certain equity investments in the past and may incur net investment losses or impairment provisions in the future.

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### COMPONENTS OF RESULTS OF OPERATIONS

#### Revenue

The following table sets forth our revenue by segment for the periods indicated:

	For the year ended December 31,						For the three months ended March 31,					
	2017		2018		2019		2019		2020			
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	US\$	%	
							(unaudited)		(unaudited)	(unaudited)		
							(in thousands, except for percentages)					
<b>Net revenues:</b>												
Online game services ...	36,281,642	81.6	40,190,057	78.5	46,422,640	78.4	11,850,184	82.2	13,518,244	1,909,141	79.2	
Youdao .....	455,746	1.0	731,598	1.4	1,304,883	2.2	225,731	1.6	541,388	76,459	3.2	
Innovative businesses and others .....	7,699,967	17.4	10,256,920	20.1	11,513,622	19.4	2,346,294	16.2	3,002,735	424,067	17.6	
Total net revenues .....	44,437,355	100.0	51,178,575	100.0	59,241,145	100.0	14,422,209	100.0	17,062,367	2,409,667	100.0	

We generate our revenues from the provision of online game services, Youdao and other innovative businesses and services. No customer individually accounted for greater than 10% of our total net revenues for the years ended December 31, 2017, 2018, 2019 and the three months ended March 31, 2020, respectively.

#### *Online game services*

We generate our mobile game revenues primarily from the sale of in-game virtual items, including avatars, skills, privileges or other in-game consumables, features or functionality, within the games. We distribute our mobile games through partnerships with major Android- and iOS-based app stores as well as proprietary distribution channels, such as our mobile apps and websites. Users have a variety of payment options for in-game virtual items, including using prepaid points or by making online payments through app stores and other online payment channels. Our mobile game portfolio now consists of over 100 diverse games, and we expect to continue introducing new mobile games each year for the foreseeable future, which we believe will contribute to future growth in net revenues from online game services.

We generate revenue from our PC games mainly through sales of prepaid points. Customers can purchase prepaid points on our NetEase online platforms through debit or credit cards or online payment platforms through which players can directly credit points to their accounts. Customers also can purchase virtual or physical point cards through our third-party retailers. Customers can use the points to play our PC games, either to pay for playing time or to purchase virtual items within the games, and use our other fee-based services.

#### *Youdao*

Youdao's revenue consists of two parts: learning services and products and online marketing services. We currently generate the majority of the revenues for Youdao's learning services and products from its online courses in the form of the tuition fees received from students. We generate revenues from Youdao's online marketing services through the provision of different formats of advertisements.

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### *Innovative businesses and others*

We derive our innovative businesses and others revenues primarily from e-commerce, music streaming, video streaming, advertising services, premium e-mail and other value-added services.

### **Cost of revenues**

The following table sets forth our cost of revenues by segment for the periods indicated:

	For the year ended December 31,						For the three months ended March 31,				
	2017		2018		2019		2019		2020		
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	US\$	%
							(unaudited)		(unaudited)	(unaudited)	
							(in thousands, except for percentages)				
<b>Cost of revenues:</b>											
Online game services . . .	(13,473,339)	(69.5)	(14,617,656)	(61.3)	(16,974,234)	(61.3)	(4,299,345)	(64.3)	(4,851,831)	(685,209)	(63.1)
Youdao . . . . .	(293,807)	(1.5)	(515,133)	(2.2)	(934,261)	(3.4)	(172,836)	(2.6)	(305,663)	(43,168)	(4.0)
Innovative businesses and others . . . . .	(5,627,168)	(29.0)	(8,699,637)	(36.5)	(9,777,350)	(35.3)	(2,212,354)	(33.1)	(2,527,251)	(356,916)	(32.9)
Total cost of revenues . . . .	<u>(19,394,314)</u>	<u>(100.0)</u>	<u>(23,832,426)</u>	<u>(100.0)</u>	<u>(27,685,845)</u>	<u>(100.0)</u>	<u>(6,684,535)</u>	<u>(100.0)</u>	<u>(7,684,745)</u>	<u>(1,085,293)</u>	<u>(100.0)</u>

### *Online game services*

Cost of revenues for our online game services consists primarily of revenue sharing costs paid to distribution channel providers and game developers, staff costs, royalties and consultancy fees related to our licensed games, server and bandwidth service fees, service fees related to online payments, depreciation and amortization of computers and software and other direct costs of providing these services.

### *Youdao*

Our cost of revenues of Youdao consists primarily of revenue sharing costs paid to Youdao's course instructors, teaching assistants and course development personnel, staff costs, costs of course materials, costs relating to the sales of smart devices, server and bandwidth costs and traffic acquisition costs.

### *Innovative businesses and others*

Cost of revenues related to our innovative businesses and others segment consists primarily of content costs, cost of merchandise sold in our e-commerce business and revenue sharing costs with broadcasters. We pay content fees to third-party partners, record labels, and newspaper and magazine publishers for the right to use proprietary content developed and licensed by them, such as copyrights of music, headline news and articles.

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### Operating expenses

The following table sets forth our operating expenses for the periods indicated:

	For the year ended December 31,						For the three months ended March 31,					
	2017		2018		2019		2019		2020			
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	US\$	%	
							(unaudited)		(unaudited)	(unaudited)		
	(in thousands, except for percentages)											
<b>Operating expenses:</b>												
Selling and marketing expenses .....	(5,504,613)	(45.7)	(6,911,710)	(39.8)	(6,221,127)	(35.0)	(1,158,090)	(29.1)	(1,863,071)	(263,116)	(38.1)	
General and administrative expenses .....	(2,381,842)	(19.8)	(3,078,635)	(17.7)	(3,130,298)	(17.6)	(786,850)	(19.8)	(885,434)	(125,047)	(18.1)	
Research and development expenses .....	(4,161,673)	(34.5)	(7,378,460)	(42.5)	(8,413,224)	(47.4)	(2,037,694)	(51.1)	(2,142,649)	(302,600)	(43.8)	
Total operating expenses .....	<u>(12,048,128)</u>	<u>(100.0)</u>	<u>(17,368,805)</u>	<u>(100.0)</u>	<u>(17,764,649)</u>	<u>(100.0)</u>	<u>(3,982,634)</u>	<u>(100.0)</u>	<u>(4,891,154)</u>	<u>(690,763)</u>	<u>(100.0)</u>	

### *Selling and marketing expenses*

Selling and marketing expenses consist primarily of salary and welfare expenses, shipping and handling costs, compensation costs for our sales and marketing staff, and marketing and advertising expenses payable to third-party vendors, internet companies and agents.

### *General and administrative expenses*

General and administrative expenses consist primarily of salary and welfare expenses, compensation costs for our general administrative and management staff, office rental, legal, professional and consultancy fees, bad debt expenses, recruiting expenses, travel expenses and depreciation charges.

### *Research and development expenses*

Research and development expenses consist principally of salary and welfare expenses and compensation costs for our research and development professionals.



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### Share-based compensation cost

The following table sets forth the allocation of our share-based compensation costs for the periods indicated:

	For the year ended December 31,			For the three months ended March 31,		
	2017	2018	2019	2019	2020	
	RMB	RMB	RMB	RMB	RMB	US\$
				(unaudited)	(unaudited)	(unaudited)
				(in thousands)		
Share-based compensation cost included in:						
Cost of revenues . . .	(818,101)	(757,341)	(758,810)	(199,209)	(207,915)	(29,363)
Selling and marketing expenses . . . . .	(90,271)	(102,638)	(84,920)	(25,247)	(24,811)	(3,504)
General and administrative expenses . . . . .	(576,629)	(787,200)	(797,120)	(197,858)	(230,371)	(32,535)
Research and development expenses . . . . .	(499,850)	(824,552)	(763,239)	(198,485)	(202,717)	(28,629)
Total . . . . .	<u>(1,984,851)</u>	<u>(2,471,731)</u>	<u>(2,404,089)</u>	<u>(620,799)</u>	<u>(665,814)</u>	<u>(94,031)</u>

### *NetEase 2009 and 2019 Restricted Share Unit Plans*

In October 2019, we adopted our 2019 Restricted Share Unit Plan (the “**2019 RSU Plan**”) for our employees, directors and consultants. We have reserved 322,458,300 ordinary shares for issuance under this plan. The 2019 RSU Plan was adopted by a resolution of the board of directors and became effective on October 15, 2019 for a term of ten years unless sooner terminated.

In November 2009, we adopted our 2009 Restricted Share Unit Plan (the “**2009 RSU Plan**”) for our employees, directors and consultants. We reserved 323,694,050 ordinary shares for issuance under this plan. The 2009 RSU Plan expired on November 16, 2019 in accordance with its terms.

For the years ended December 31, 2017, 2018 and 2019 and the three months ended March 31, 2019 and 2020, we recorded share-based compensation cost of RMB1,984.9 million, RMB2,471.7 million, RMB2,404.1 million, RMB620.8 million and RMB665.8 million (US\$94.0 million), respectively, for awards granted under the 2009 RSU Plan and 2019 RSU Plan, as well as the other share incentive plans discussed as below. This cost has been allocated to: (i) cost of revenues, (ii) selling and marketing expenses, (iii) general and administrative expenses, and (iv) research and development expenses, depending on the responsibilities of the relevant employees.

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As of March 31, 2020, total unrecognized compensation cost related to unvested awards granted under the 2009 RSU Plan and 2019 RSU Plan, adjusted for estimated forfeitures, was RMB3,872.6 million (US\$546.9 million), which is expected to be recognized through the remaining vesting period of each grant. As of March 31, 2020, the weighted average remaining vesting period was 2.35 years.

### *Other share incentive plans*

Beginning in 2014, certain of our subsidiaries granted options exercisable for ordinary shares to certain of our employees. The options expire five to ten years from the date of grant and either vest or have a vesting commencement date upon certain conditions being met. The awards can become 100% vested on the vesting commencement date, or vest in two, three, four or five substantially equal annual installments with the first installment vesting on the vesting commencement date. For the years ended December 31, 2017, 2018 and 2019 and the three months ended March 31, 2019 and 2020, we recorded RMB91.5 million, RMB32.0 million, RMB56.2 million, RMB7.2 million and RMB23.4 million (US\$3.3 million), respectively, in compensation expenses for the share options granted under these plans.

While certain share options which have been granted will become vested or would commence vesting upon their applicable vesting commencement date, the occurrence of the applicable vesting conditions is not within our control and is not deemed probable to occur for accounting purposes until the vesting commencement date. For such share options, zero compensation expenses were recorded. As of March 31, 2020, there were RMB314.8 million (US\$44.5 million) in unrecognized share-based compensation expenses related to such share options which are expected to be recognized when the relevant vesting conditions are met.

### **Income taxes**

#### *Cayman Islands*

Under the current laws of the Cayman Islands, we and our intermediate holding companies which are incorporated in the Cayman Islands, are not subject to tax on income or capital gain. Additionally, upon payments of dividends by us to our shareholders or by our intermediate holding companies in the Cayman Islands to us, no Cayman Islands withholding tax will be imposed.

#### *British Virgin Islands (“BVI”)*

Our subsidiaries in the BVI are exempted from income tax on their foreign-derived income in the BVI. There are no withholding taxes in the BVI.

#### *Hong Kong*

Our subsidiaries in Hong Kong were subject to income tax on their taxable income generated from operations in Hong Kong at a rate of 16.5% in 2017. For the years 2018 and 2019, the first HK\$2 million of profits earned by one of our subsidiaries incorporated in Hong Kong is taxed at a rate of 8.25%, while the remaining profits will continue to be taxed at the 16.5% tax rate. The payments of dividends by these companies to us are not subject to any Hong Kong withholding tax.

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### *China*

The PRC Enterprise Income Tax Law subjects Foreign Invested Enterprises (“**FIEs**”) and domestic companies to EIT at a uniform rate of 25%, and preferential tax treatments may be granted to FIEs or domestic companies which conduct businesses in certain encouraged sectors and to entities otherwise classified as “High and New Technology Enterprises” (“**HNTEs**”), “Software Enterprises” or “Key Software Enterprises.”

Boguan, NetEase Hangzhou and certain of our other PRC subsidiaries and affiliated entities were qualified as HNTEs and enjoyed a preferential tax rate of 15% for 2017, 2018 and 2019. In 2017, 2018 and 2019, Boguan, NetEase Hangzhou and certain of our other PRC subsidiaries and affiliated entities were each also qualified as a Key Software Enterprise and enjoyed a further reduced preferential tax rate of 10% for 2016, 2017 and 2018. The related tax benefit was recorded in 2017, 2018 and 2019, respectively.

The foregoing preferential income tax rates, however, are subject to periodic review and renewal by PRC authorities.

### **Sales tax**

Pursuant to the *Provisional Regulation of the PRC on Value Added Tax* and its implementation rules (the “**Provisional VAT Regulation**”) our PRC subsidiaries and VIEs are generally subject to VAT at a rate of 6% for revenues earned from rendering services. Our sales of general goods to our customers in the PRC are also subject to VAT, which was 17% until May 1, 2018, 16% from May 1, 2018 to April 1, 2019 and 13% thereafter.

We are also subject to cultural development fees on the provision of advertising services in China. The applicable tax rate was 3% of our advertising services revenues until July 1, 2019 when it was reduced to 1.5%.

### **Change in segment reporting**

Effective in the third quarter of 2019, we changed our segment disclosure to add the financial results of certain advertising services and Yanxuan into “innovative businesses and others.” We sold our Kaola e-commerce business in September 2019. In addition, we have commenced separately reporting the results of our majority-controlled subsidiary Youdao which completed its initial public offering and listing on the New York Stock Exchange in October 2019. As a result, we now report the following segments: (1) online game services; (2) Youdao; and (3) innovative businesses and others. This change in segment reporting aligns with the manner in which our chief operating decision maker (the “**CODM**”) currently receives and uses financial information to allocate resources and evaluate the performance of reporting segments. We retrospectively revised prior period segment information to conform to current period presentation.

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### RESULTS OF OPERATIONS

The following table sets forth a summary of our consolidated results of operations for the periods indicated. In September 2019, we sold our Kaola e-commerce business to Alibaba Group Holding Limited. As a result, Kaola has been deconsolidated and Kaola's historical financial results are reflected in our consolidated financial statements as discontinued operations accordingly. Unless otherwise stated, financial results discussed herein refer to our continuing operations.

	For the year ended December 31,						For the three months ended March 31,				
	2017		2018		2019		2019		2020		
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	US\$	%
	(unaudited)						(unaudited)		(unaudited)		
	(in thousands, except for percentages)										
<b>Statements of Operations and Comprehensive Income Data:</b>											
Net revenues: .....	44,437,355	100.0	51,178,575	100.0	59,241,145	100.0	14,422,209	100.0	17,062,367	2,409,667	100.0
Cost of revenues: .....	(19,394,314)	(43.6)	(23,832,426)	(46.6)	(27,685,845)	(46.7)	(6,684,535)	(46.3)	(7,684,745)	(1,085,293)	(45.0)
Gross profit .....	25,043,041	56.4	27,346,149	53.4	31,555,300	53.3	7,737,674	53.7	9,377,622	1,324,374	55.0
Operating expenses:											
Selling and marketing expenses .....	(5,504,613)	(12.4)	(6,911,710)	(13.5)	(6,221,127)	(10.5)	(1,158,090)	(8.0)	(1,863,071)	(263,116)	(10.9)
General and administrative expenses .....	(2,381,842)	(5.4)	(3,078,635)	(6.0)	(3,130,298)	(5.3)	(786,850)	(5.5)	(885,434)	(125,047)	(5.2)
Research and development expenses .....	(4,161,673)	(9.4)	(7,378,460)	(14.4)	(8,413,224)	(14.2)	(2,037,694)	(14.1)	(2,142,649)	(302,600)	(12.6)
Total operating expenses .....	(12,048,128)	(27.2)	(17,368,805)	(33.9)	(17,764,649)	(30.0)	(3,982,634)	(27.6)	(4,891,154)	(690,763)	(28.7)
Operating profit .....	12,994,913	29.2	9,977,344	19.5	13,790,651	23.3	3,755,040	26.1	4,486,468	633,611	26.3
Other income/(expenses):											
Investment income/(losses), net .....	362,113	0.8	(22,383)	-	1,306,320	2.2	155,824	1.1	(109,731)	(15,497)	(0.6)
Interest income, net .....	666,616	1.5	586,671	1.1	821,774	1.4	172,206	1.2	345,184	48,749	2.0
Exchange (losses)/gains .....	(455,948)	(1.0)	(51,799)	(0.1)	25,166	-	(39,520)	(0.3)	244,057	34,467	1.4
Other, net .....	271,885	0.6	586,916	1.1	439,422	0.7	37,164	0.3	66,708	9,421	0.4
Income before tax .....	13,839,579	31.1	11,076,749	21.6	16,383,333	27.6	4,080,714	28.4	5,032,686	710,751	29.5
Income tax .....	(2,155,988)	(4.9)	(2,460,650)	(4.8)	(2,914,726)	(4.9)	(1,266,685)	(8.8)	(1,082,033)	(152,812)	(6.3)
Net income from continuing operations .....	11,683,591	26.2	8,616,099	16.8	13,468,607	22.7	2,814,029	19.6	3,950,653	557,939	23.2
Net (loss)/income from discontinued operations .....	(834,454)	(1.9)	(2,138,682)	(4.2)	7,962,519	13.4	(350,755)	(2.4)	-	-	-

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	For the year ended December 31,						For the three months ended March 31,					
	2017		2018		2019		2019		2020			
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	US\$	%	
	(in thousands, except for percentages)						(unaudited)		(unaudited)		(unaudited)	
Net income .....	10,849,137	24.3	6,477,417	12.6	21,431,126	36.1	2,463,274	17.2	3,950,653	557,939	23.2	
Accretion and deemed dividends in connection with repurchase of redeemable noncontrolling interests .....	-	-	(248,098)	(0.5)	(271,543)	(0.5)	(68,783)	(0.5)	(386,019)	(54,516)	(2.3)	
Net (income)/loss attributable to noncontrolling interests and redeemable noncontrolling interests .....	(141,198)	(0.3)	(76,912)	(0.2)	77,933	0.1	(12,373)	(0.1)	(13,628)	(1,925)	(0.1)	
Net income attributable to NetEase, Inc.'s shareholders ..	10,707,939	24.0	6,152,407	11.9	21,237,516	35.7	2,382,118	16.6	3,551,006	501,498	20.8	
Including:												
Net income from continuing operations attributable to NetEase, Inc.'s shareholders .....	11,542,393	25.9	8,291,089	16.1	13,274,997	22.3	2,732,873	19.0	3,551,006	501,498	20.8	
Net (loss)/income from discontinued operations attributable to NetEase, Inc.'s shareholders .....	(834,454)	(1.9)	(2,138,682)	(4.2)	7,962,519	13.4	(350,755)	(2.4)	-	-	-	
Share-based compensation cost included in:												
Cost of revenues .....	818,101	1.8	757,341	1.5	758,810	1.3	199,209	1.4	207,915	29,363	1.2	
Selling and marketing expenses .....	90,271	0.2	102,638	0.2	84,920	0.1	25,247	0.2	24,811	3,504	0.1	
General and administrative expenses .....	576,629	1.3	787,200	1.5	797,120	1.3	197,858	1.4	230,371	32,535	1.4	
Research and development expenses .....	499,850	1.1	824,552	1.6	763,239	1.3	198,485	1.4	202,717	28,629	1.2	

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### Three months ended March 31, 2020 compared to three months ended March 31, 2019

We have organized our operations into the following segments: online game services, Youdao and innovative business and others. These segments reflect the way we evaluate, view and run our business operations. The following table sets forth the net revenues and cost of revenues by segment for the periods presented as derived from our unaudited condensed interim consolidated financial information.

	For the three months ended March 31,		
	2019	2020	2020
	RMB	RMB	US\$
	(unaudited in thousands)		
<b>Net revenues:</b>			
Online game services . . . . .	11,850,184	13,518,244	1,909,141
Youdao . . . . .	225,731	541,388	76,459
Innovative businesses and others . . . . .	2,346,294	3,002,735	424,067
Total net revenues . . . . .	14,422,209	17,062,367	2,409,667
<b>Cost of revenues:</b>			
Online game services . . . . .	(4,299,345)	(4,851,831)	(685,209)
Youdao . . . . .	(172,836)	(305,663)	(43,168)
Innovative businesses and others . . . . .	(2,212,354)	(2,527,251)	(356,916)
Total cost of revenues . . . . .	(6,684,535)	(7,684,745)	(1,085,293)

#### *Net revenues*

Total net revenues increased by 18.3% to RMB17,062.4 million (US\$2,409.7 million) in the three months ended March 31, 2020 from RMB14,422.2 million in the corresponding period of 2019. Net revenues from online game services, Youdao and innovative businesses and others constituted 79.2%, 3.2% and 17.6%, respectively, of our total net revenues in the three months ended March 31, 2020, compared with 82.2%, 1.6% and 16.2%, respectively, in the corresponding period of 2019.

#### Online game services

Net revenues from online game services increased by 14.1% to RMB13,518.2 million (US\$1,909.1 million) in the three months ended March 31, 2020 from RMB11,850.2 million in the corresponding period of 2019. The increase was principally attributable to higher net revenues from our mobile games and PC games. The growth in net revenues mainly resulted from mobile games such as *Fantasy Westward Journey 3D*, *Identity V*, *Onmyoji*, and *Onmyoji: The Card Game* and *Fantasy Westward Journey* mobile game, as well as PC games such as *Fantasy Westward Journey Online* and *New Westward Journey Online II*. Our mobile game portfolio now consists of over 100 diverse games. Net revenues from mobile games and PC games represented 70.3% and 29.7% of total net revenues from online game services in the

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three months ended March 31, 2020, respectively, compared to 72.1% and 27.9% in the corresponding period of 2019, respectively. The following table sets forth a breakdown by mobile games and PC games as a percentage of our net revenues from online games services for the periods indicated:

	<b>For the three months ended March 31,</b>	
	<b>2019</b>	<b>2020</b>
	%	%
<b>Online game services net revenues:</b>		
Mobile games .....	72.1	70.3
PC games .....	27.9	29.7
Total online game services net revenues .....	100.0	100.0

Net revenues from our in-house developed games increased by 9.8% to RMB11,871.7 million (US\$1,676.6 million) in the three months ended March 31, 2020 from RMB10,810.4 million in the corresponding period of 2019 as a result of the expansion in our offering of in-house developed games, in particular our mobile games. Net revenues from licensed games increased by 58.3% to RMB1,646.5 million (US\$232.5 million) in the three months ended March 31, 2020 from RMB1,039.8 million in the corresponding period of 2019, which was mainly attributable to certain of our games licensed from international game developers. Net revenues generated from licensed games represented 9.6% and 7.2% of our total net revenues in the three months ended March 31, 2020 and the corresponding period of 2019, respectively. The following table sets forth a breakdown by in-house developed games and licensed games as a percentage of our net revenues from online games services for the periods indicated:

	<b>For the three months ended March 31,</b>	
	<b>2019</b>	<b>2020</b>
	%	%
<b>Online game services net revenues:</b>		
In-house developed games .....	91.2	87.8
Licensed games .....	8.8	12.2
Total online game services net revenues .....	100.0	100.0

### Youdao

Net revenues from our Youdao segment increased by 139.8% to RMB541.4 million (US\$76.5 million) in the three months ended March 31, 2020 from RMB225.7 million in the corresponding period of 2019. The increase was mainly attributable to increased revenue from its learning services and products.

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### Innovative businesses and others

Net revenues from the innovative businesses and others segment increased by 28.0% to RMB3,002.7 million (US\$424.1 million) in the three months ended March 31, 2020 from RMB2,346.3 million in the corresponding period of 2019. This increase mainly resulted from increases in revenue contribution by our NetEase Cloud Music, NetEase CC live streaming and Yanxuan e-commerce businesses.

### *Cost of revenues*

Our cost of revenues increased by 15.0% to RMB7,684.7 million (US\$1,085.3 million) in the three months ended March 31, 2020 from RMB6,684.5 million in the corresponding period of 2019. The increase was mainly due to an increase in revenue sharing costs with distribution channel providers, game developers and other third parties and content costs. In the three months ended March 31, 2020, costs relating to online game services, Youdao and innovative businesses and others represented 63.1%, 4.0% and 32.9% of total cost of revenues, respectively, as compared with 64.3%, 2.6% and 33.1% of the total cost of revenues, respectively, in the corresponding period of 2019.

### Online game services

Cost of revenues from our online game services increased by 12.9% to RMB4,851.8 million (US\$685.2 million) in the three months ended March 31, 2020 from RMB4,299.3 million in the corresponding period of 2019. The increase in cost of revenues was primarily due to an increase in revenue sharing costs with distribution channel providers, game developers and other third parties related to mobile games, which was primarily due to the launch of various in-house developed and licensed mobile games in the first quarter of 2020.

### Youdao

Cost of revenues from Youdao increased by 76.9% to RMB305.7 million (US\$43.2 million) in the three months ended March 31, 2020 from RMB172.8 million in the corresponding period of 2019, which was primarily attributable to increased traffic acquisition costs and revenue sharing costs with key instructors to support the promotion and expansion of Youdao's online course offerings.

### Innovative businesses and others

Cost of revenues from our innovative businesses and others increased by 14.2% to RMB2,527.3 million (US\$356.9 million) in the three months ended March 31, 2020 from RMB2,212.4 million in the corresponding period of 2019. The increase in cost of revenues was primarily due to increased content costs and revenue sharing costs related to our NetEase CC live streaming and NetEase Cloud Music platforms.

### *Gross profit*

Our gross profit increased by 21.2% to RMB9,377.6 million (US\$1,324.4 million) in three months ended March 31, 2020 from RMB7,737.7 million in the corresponding period of 2019.



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The following table sets forth the consolidated gross profits and gross profit margins of our business activities for the periods indicated as derived from our condensed consolidated financial information. The gross profit margins in three months ended March 31, 2019 and 2020 were calculated by dividing our gross profits over our net revenues for the corresponding type of services.

	<b>For the three months ended March 31,</b>		
	<b>2019</b>	<b>2020</b>	<b>2020</b>
	<b>RMB</b>	<b>RMB</b>	<b>US\$</b>
	<b>(unaudited in thousands)</b>		
<b>Gross profit:</b>			
Online game services . . . . .	7,550,839	8,666,413	1,223,932
Youdao . . . . .	52,895	235,725	33,291
Innovative businesses and others . . . . .	133,940	475,484	67,151
	7,737,674	9,377,622	1,324,374
<b>Gross profit margin:</b>			
Online game services . . . . .	63.7%	64.1%	64.1%
Youdao . . . . .	23.4%	43.5%	43.5%
Innovative businesses and others . . . . .	5.7%	15.8%	15.8%
	53.7%	55.0%	55.0%

Gross profit margin for online game services in the three months ended March 31, 2020 remained stable compared to the corresponding period of 2019. The increase of gross profit margin for Youdao was mainly due to increased revenues, improved economies of scale and faculty compensation structure optimization related to its learning services and products. The increase in gross profit margin for innovative businesses and others was mainly due to increased net revenues from NetEase Cloud Music.

### *Operating expenses*

Total operating expenses increased by 22.8% to RMB4,891.2 million (US\$690.8 million) in the three months ended March 31, 2020 from RMB3,982.6 million in the corresponding period of 2019 as a result of increases across selling and marketing expenses, general and administrative expenses as well as research and development expenses. The following table sets forth our operating expenses for the periods indicated as derived from our condensed consolidated financial information.

	<b>For the three months ended March 31,</b>		
	<b>2019</b>	<b>2020</b>	<b>2020</b>
	<b>RMB</b>	<b>RMB</b>	<b>US\$</b>
	<b>(unaudited in thousands)</b>		
<b>Operating expenses:</b>			
Selling and marketing expenses . . . . .	(1,158,090)	(1,863,071)	(263,116)
General and administrative expenses . . . . .	(786,850)	(885,434)	(125,047)
Research and development expenses . . . . .	(2,037,694)	(2,142,649)	(302,600)
	(3,982,634)	(4,891,154)	(690,763)

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Selling and marketing expenses increased by 60.9% to RMB1,863.1 million (US\$263.1 million) in the three months ended March 31, 2020 from RMB1,158.1 million in the corresponding period of 2019, primarily due to the increased marketing spending on our online games and Youdao learning services and products.

General and administrative expenses increased slightly by 12.5% to RMB885.4 million (US\$125.0 million) in the three months ended March 31, 2020 from RMB786.9 million in the corresponding period of 2019, primarily due to an increase in credit losses related to our accounts receivable.

Research and development expenses increased by 5.2% to RMB2,142.6 million (US\$302.6 million) in the three months ended March 31, 2020 from RMB2,037.7 million in the corresponding period of 2019, primarily due to an increase in staff-related costs, mainly as a result of increased headcount for our online game services and Youdao as well as higher salaries, bonuses and other benefits paid to our research and development teams during the first quarter of 2020, including share-based compensation.

### *Other income/(expenses)*

The following table sets forth our other income/(expenses) for the periods indicated as derived from our condensed consolidated financial information.

	<b>For the three months ended March 31,</b>		
	<b>2019</b>	<b>2020</b>	<b>2020</b>
	<b>RMB</b>	<b>RMB</b>	<b>US\$</b>
	<b>(unaudited in thousands)</b>		
<b>Other income/(expenses):</b>			
Investment income/(losses), net . . . . .	155,824	(109,731)	(15,497)
Interest income, net . . . . .	172,206	345,184	48,749
Exchange (losses)/gains . . . . .	(39,520)	244,057	34,467
Other, net . . . . .	37,164	66,708	9,421

Other income/(expenses) in the three months ended March 31, 2020 mainly consisted of investment income related to short-term investments, interest income, foreign exchange gain, offset in part by foreign exchange losses, government incentives, impairment provisions related to certain equity investments, net investment gain in equity method investees and fair value change related to our equity investments with readily determinable fair value and other financial instruments.

Investment losses were RMB109.7 million (US\$15.5 million) in the three months ended March 31, 2020 compared to investment income of RMB155.8 million in the corresponding period of 2019. Investment losses in the three months ended March 31, 2020 consists primarily of: (i) an unrealized loss from fair value change of RMB327.0 million (US\$46.2 million) in the three months ended March 31, 2020 compared to an unrealized gain from fair value change of RMB129.9 million in the corresponding period of 2019, and (ii) impairment provisions related to certain investments of RMB6.6 million (US\$0.9 million) in the three months ended March 31, 2020 compared to RMB96.1 million in the corresponding period of 2019, which was offset in part by investment income related to short-term investments of RMB153.1 million (US\$21.6 million), compared to RMB124.6 million in the corresponding period of 2019.

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Interest income increased to RMB345.2 million (US\$48.7 million) in the three months ended March 31, 2020 from RMB172.2 million in the corresponding period of 2019, primarily due to an increase in our net cash balance, which included total cash and cash equivalents, time deposits and restricted cash balance minus short-term loans. We incurred interest expenses of RMB98.5 million (US\$13.9 million) in the three months ended March 31, 2020 related to our short-term loans.

We incurred net foreign exchange gains of RMB244.1 million (US\$34.5 million) in the three months ended March 31, 2020, compared to net foreign exchange losses of RMB39.5 million in the corresponding period of 2019, both of which are primarily due to the translation gains and losses arising from our U.S. dollar-denominated bank deposit and short-term loan balances as the exchange rate of the U.S. dollar against the RMB fluctuated over these periods.

Other, net increased to RMB66.7 million (US\$9.4 million) in the three months ended March 31, 2020 from RMB37.2 million in the corresponding period of 2019. We received and recognized unconditional government incentives of RMB115.4 million (US\$16.3 million) in the three months ended March 31, 2020, compared to RMB36.1 million in the corresponding period of 2019. In the three months ended March 31, 2020, we also made donations of RMB75.7 million (US\$10.7 million) to provide support to fight against the COVID-19 pandemic.

### *Income tax*

Income tax decreased to RMB1,082.0 million (US\$152.8 million) in the three months ended March 31, 2020 from RMB1,266.7 million in the corresponding period of 2019. Our effective tax rate in the three months ended March 31, 2019 and 2020 was 31.0% and 21.5%, respectively, which represents certain estimates by the Company as to the tax obligations and benefits applicable to it in each quarter.

### *Net income*

Net income attributable to our shareholders in three months ended March 31, 2020 comprised of a net income from continuing operations attributable to our shareholders of RMB3,551.0 million (US\$501.5 million) and net income from discontinued operations attributable to our shareholders of zero, compared to a net income from continuing operations of RMB2,732.9 million and a net loss from discontinued operations of RMB350.8 million in the corresponding period of 2019.

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### Year ended December 31, 2019 compared to year ended December 31, 2018

The following table sets forth the net revenues and cost of revenues by segment for the periods presented as derived from our audited financial statements.

	For the year ended December 31,	
	2018	2019
	RMB	RMB
	(in thousands)	
<b>Net revenues:</b>		
Online game services .....	40,190,057	46,422,640
Youdao .....	731,598	1,304,883
Innovative businesses and others .....	10,256,920	11,513,622
Total net revenues .....	51,178,575	59,241,145
<b>Cost of revenues:</b>		
Online game services .....	(14,617,656)	(16,974,234)
Youdao .....	(515,133)	(934,261)
Innovative businesses and others .....	(8,699,637)	(9,777,350)
Total cost of revenues .....	(23,832,426)	(27,685,845)

#### *Net revenues*

Total net revenues increased by 15.8% to RMB59,241.1 million in 2019 from RMB51,178.6 million in 2018. Net revenues from online game services, Youdao and innovative businesses and others constituted 78.4%, 2.2% and 19.4%, respectively, of our total net revenues in 2019, compared with 78.5%, 1.4% and 20.1%, respectively, in 2018.

#### Online game services

Net revenues from online game services increased by 15.5% to RMB46,422.6 million in 2019 from RMB40,190.1 million in 2018. The increase was principally attributable to higher net revenues from our mobile games which totaled RMB33,160.1 million in 2019 compared to RMB28,536.9 million in 2018. The growth in net revenues from mobile games mainly resulted from mobile games such as *Life-After*, *Invincible* and *Identity V*, which gained popularity over the course of 2019. Net revenues from mobile games and PC games represented 71.4% and 28.6% of total net revenues from online game services in 2019, respectively, compared to 71.0% and 29.0% in 2018, respectively.

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	For the year ended December 31,	
	2018	2019
	%	%
<b>Online game services net revenues:</b>		
Mobile games .....	71.0	71.4
PC games .....	29.0	28.6
Total online game services net revenues .....	100.0	100.0

Net revenues from our in-house developed games increased by 15.4% to RMB41,965.6 million in 2019 from RMB36,363.6 million in 2018 as a result of the expansion in our offering of in-house developed games, in particular our mobile games. Net revenues from licensed games increased by 16.5% to RMB4,457.0 million in 2019 from RMB3,826.5 million in 2018, which was mainly attributable to the increased revenue as a result of the release of *World of Warcraft Classic* licensed from Blizzard Entertainment, Inc. (together with its affiliated companies, “**Blizzard**”) in August 2019, as well as certain other licensed games. Net revenues generated from licensed games represented 7.5% and 7.5% of our total net revenues in 2019 and 2018, respectively. The following table sets forth a breakdown by in-house developed games and licensed games as a percentage of our net revenues from online games services for the periods indicated:

	For the year ended December 31,	
	2018	2019
	%	%
<b>Online game services net revenues:</b>		
In-house developed games .....	90.5	90.4
Licensed games .....	9.5	9.6
Total online game services net revenues .....	100.0	100.0

### Youdao

Net revenues from our Youdao segment increased by 78.4% to RMB1,304.9 million in 2019 from RMB731.6 million in 2018. The increase was mainly attributable to increased revenue from its learning services and products.

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### Innovative businesses and others

Net revenues from the innovative businesses and others segment increased by 12.3% to RMB11,513.6 million in 2019 from RMB10,256.9 million in 2018. This increase mainly resulted from increases in revenue contribution by our NetEase Cloud Music, NetEase CC live streaming and Yanxuan e-commerce businesses.

### *Cost of revenues*

Our cost of revenues increased by 16.2% to RMB27,685.8 million in 2019 from RMB23,832.4 million in 2018. The year-over-year increase was mainly due to an increase in revenue sharing costs with distribution channel providers, game developers and other third parties and content costs. In 2019, costs relating to online game services, Youdao and innovative businesses and others represented 61.3%, 3.4% and 35.3% of total cost of revenues, respectively, as compared with 61.3%, 2.2% and 36.5% of the total cost of revenues, respectively, in 2018.

### Online game services

Cost of revenues from our online game services increased by 16.1% to RMB16,974.2 million in 2019 from RMB14,617.7 million in 2018. The increase in cost of revenues in 2019 was primarily due to an increase in revenue sharing costs with distribution channel providers, game developers and other third parties related to mobile games, which was primarily due to the launch of various in-house developed and licensed mobile games in 2019.

### Youdao

Cost of revenues from Youdao increased by 81.4% to RMB934.3 million in 2019 from RMB515.1 million in 2018, which was primarily attributable to increased traffic acquisition costs and revenue sharing costs with key instructors to support the promotion and expansion of Youdao's online course offerings.

### Innovative businesses and others

Cost of revenues from our innovative businesses and others increased by 12.4% to RMB9,777.4 million in 2019 from RMB8,699.6 million in 2018. The increase in cost of revenues in 2019 was primarily due to increased content costs and revenue sharing costs related to our NetEase CC live streaming and NetEase Cloud Music platforms.

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### *Gross profit*

Our gross profit increased by 15.4% to RMB31,555.3 million in 2019 from RMB27,346.1 million in 2018.

The following table sets forth the consolidated gross profits and gross profit margins of our business activities for the periods indicated as derived from our audited financial statements. The gross profit margins in 2018 and 2019 were calculated by dividing our gross profits over our net revenues for the corresponding type of services.

	<b>For the year ended December 31,</b>	
	<b>2018</b>	<b>2019</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
<b>Gross profit:</b>		
Online game services .....	25,572,401	29,448,406
Youdao .....	216,465	370,622
Innovative businesses and others .....	1,557,283	1,736,272
Total gross profit .....	27,346,149	31,555,300
<b>Gross profit margin:</b>		
Online game services .....	63.6%	63.4%
Youdao .....	29.6%	28.4%
Innovative businesses and others .....	15.2%	15.1%
Total gross profit margin .....	53.4%	53.3%

Our gross profit margin for online game services, Youdao and innovative businesses and others in 2019 remained stable compared to 2018.

### *Operating expenses*

Total operating expenses increased by 2.3% to RMB17,764.6 million in 2019 from RMB17,368.8 million in 2018 as a result of an increase in general and administrative expenses and research and development expenses, which was partially offset by a decrease in selling and marketing expenses. The following table sets forth our operating expenses for the periods indicated as derived from our audited financial statements.

	<b>For the year ended December 31,</b>	
	<b>2018</b>	<b>2019</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
<b>Operating expenses:</b>		
Selling and marketing expenses .....	(6,911,710)	(6,221,127)
General and administrative expenses .....	(3,078,635)	(3,130,298)
Research and development expenses .....	(7,378,460)	(8,413,224)
Total operating expenses .....	(17,368,805)	(17,764,649)

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## FINANCIAL INFORMATION

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Selling and marketing expenses decreased by 10.0% to RMB6,221.1 million in 2019 from RMB6,911.7 million in 2018, primarily due to the decreased marketing spending on our online games, as well as media and outdoor branding promotion for our innovative businesses and others, which was partially offset by increased marketing spending on Youdao.

General and administrative expenses increased slightly by 1.7% to RMB3,130.3 million in 2019 from RMB3,078.6 million in 2018, primarily due to an increase in staff-related costs driven by higher compensation levels.

Research and development expenses increased by 14.0% to RMB8,413.2 million in 2019 from RMB7,378.5 million in 2018, primarily due to an increase in staff-related costs, mainly as a result of increased headcount for our online game services and Youdao and higher salaries, bonuses and other benefits paid to our research and development teams during 2019, including share-based compensation.

### *Other income/(expenses)*

The following table sets forth our other income/(expenses) for the periods indicated as derived from our audited financial statements.

	<b>For the year ended December 31,</b>	
	<b>2018</b>	<b>2019</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
Other income/(expenses):		
Investment (losses)/income, net . . . . .	(22,383)	1,306,320
Interest income, net . . . . .	586,671	821,774
Exchange (losses)/gains . . . . .	(51,799)	25,166
Other, net . . . . .	586,916	439,422

Other income/(expenses) in 2019 mainly consisted of investment income related to short-term investments, interest income, foreign exchange gain, offset in part by foreign exchange losses, government incentives, impairment provisions related to certain equity investments, net investment gain in equity method investees and fair value change related to our equity investments with readily determinable fair value and other financial instruments.

Investment income was RMB1,306.3 million in 2019 compared to investment loss of RMB22.4 million in 2018, consisting primarily of: (i) an unrealized gain from fair value change of RMB751.7 million related to the equity investments with readily determinable fair value and other financial instruments in 2019 compared to an unrealized loss from fair value change of RMB248.2 million in 2018, and (ii) investment income related to short-term investments of RMB657.6 million in 2019, compared to RMB463.5 million in 2018, which was offset in part by impairment provisions related to certain investments of RMB176.4 million in 2019, compared to RMB159.7 million in 2018.



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## FINANCIAL INFORMATION

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Interest income increased to RMB821.8 million in 2019 from RMB586.7 million in 2018, primarily due to an increase of RMB16.4 billion in our net cash balance, which includes total cash and cash equivalents, time deposits and restricted cash balance minus short-term loans. We incurred interest expenses of RMB419.1 million in 2019 related to our short-term loans.

Other, net decreased to RMB439.4 million in 2019 from RMB586.9 million in 2018. We received and recognized unconditional government incentives of RMB368.2 million in 2019, compared to RMB316.7 million in 2018.

We also incurred net foreign exchange gains of RMB25.2 million in 2019, compared to net foreign exchange losses of RMB51.8 million in 2018, both of which are primarily due to the translation gains and losses arising from our U.S. dollar-denominated bank deposit and short-term loan balances as the exchange rate of the U.S. dollar against the RMB fluctuated over these periods.

### *Income tax*

Income tax increased to RMB2,914.7 million in 2019 from RMB2,460.7 million in 2018. Our effective tax rate in 2019 was 17.8% compared with 22.2% in 2018. The change in the effective tax rate was mainly due to the fact that certain of our subsidiaries experienced smaller operating losses in 2019.

### *Net income*

Net income attributable to our shareholders in 2019 comprised of a net income from continuing operations of RMB13,275.0 million and net income from discontinued operations of RMB7,962.5 million, which includes a one-time net gain on disposal of discontinued operations of RMB8,751.2 million related to the sale of our Kaola e-commerce business, offset in part by its net loss prior to such sale, compared to a net income from continuing operations of RMB8,291.1 million and a net loss from discontinued operations of RMB2,138.7 million in 2018.

### **Year ended December 31, 2018 compared to year ended December 31, 2017**

To facilitate the comparison of our operating results and trends in 2017 and 2018, the financial results of our Kaola e-commerce platform in 2017 and 2018 are reflected in our consolidated financial statements as discontinued operations, to present such results on the same basis as they are presented for 2019.

## FINANCIAL INFORMATION

The following table sets forth the net revenues and cost of revenues by segment for the period presented as derived from our audited financial statements.

	<b>For the year ended December 31,</b>	
	<b>2017</b>	<b>2018</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
<b>Net revenues:</b>		
Online game services .....	36,281,642	40,190,057
Youdao .....	455,746	731,598
Innovative businesses and others .....	7,699,967	10,256,920
	44,437,355	51,178,575
<b>Cost of revenues:</b>		
Online game services .....	(13,473,339)	(14,617,656)
Youdao .....	(293,807)	(515,133)
Innovative businesses and others .....	(5,627,168)	(8,699,637)
	(19,394,314)	(23,832,426)

### *Net revenues*

Total net revenues increased by 15.2% to RMB51,178.6 million in 2018 from RMB44,437.4 million in 2017. Net revenues from online game services, Youdao and innovative businesses and others constituted 78.5%, 1.4% and 20.1%, respectively, of our total net revenues in 2018, compared with 81.6%, 1.0% and 17.4%, respectively, in 2017.

### Online game services

Net revenues from online game services increased by 10.8% to RMB40,190.1 million in 2018 from RMB36,281.6 million in 2017. The increase was principally attributable to higher net revenues from our mobile games which totaled RMB28,536.9 million in 2018 compared to RMB25,678.6 million in 2017. The growth in net revenues from mobile games mainly resulted from mobile games such as *Knives Out*, which gained popularity over the course of 2018 and the newly released game *All About Jianghu*. Our PC game, *Justice*, which was released in June 2018, also achieved a high revenue performance in 2018. Net revenues from mobile games and PC games represented 71.0% and 29.0% of total net revenues from online game services in 2018, respectively, compared to 70.8% and 29.2% in 2017, respectively.

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## FINANCIAL INFORMATION

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	<b>For the year ended December 31,</b>	
	<b>2017</b>	<b>2018</b>
	%	%
<b>Online game services net revenues:</b>		
Mobile games .....	70.8	71.0
PC games .....	29.2	29.0
Total online game services net revenues .....	100.0	100.0

Net revenues from our in-house developed games increased by 12.3% to RMB36,363.6 million in 2018 from RMB32,371.4 million in 2017 as a result of the expansion in our offering of in-house developed games, in particular our mobile games. Net revenues from licensed games decreased slightly by 2.1% to RMB3,826.5 million in 2018 from RMB3,910.2 million in 2017, which was mainly attributable to the decrease in net revenues from games licensed from Blizzard. Net revenues generated from licensed games represented 7.5% and 8.8% of our total net revenues in 2018 and 2017, respectively. The following table sets forth a breakdown by in-house developed games and licensed games as a percentage of our net revenues from online games services for the periods indicated:

	<b>For the year ended December 31,</b>	
	<b>2017</b>	<b>2018</b>
	%	%
<b>Online game services net revenues:</b>		
In-house developed games .....	89.2	90.5
Licensed games .....	10.8	9.5
Total online game services net revenues .....	100.0	100.0

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## FINANCIAL INFORMATION

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### Youdao

Net revenues from our Youdao segment increased by 60.5% to RMB731.6 million in 2018 from RMB455.7 million in 2017. The increase was mainly attributable to increased revenues from online courses, which was driven by a combination of factors, including an increase in the number of paid student enrollments for certain online courses, a relatively higher level of gross billings per paid student enrollment, as well as a higher tuition fees for certain popular courses.

### Innovative businesses and others

Net revenues from the innovative businesses and others segment increased by 33.2% to RMB10,256.9 million in 2018 from RMB7,700.0 million in 2017. This increase mainly resulted from increases in revenue contribution by our NetEase Cloud Music streaming and Yanxuan business.

### ***Cost of revenues***

Our cost of revenues increased by 22.9% to RMB23,832.4 million in 2018 from RMB19,394.3 million in 2017. The year-over-year increase was mainly due to an increase in both the cost of revenue sharing with distribution channel providers, game developers and other third parties and content costs. In 2018, costs relating to online game services, Youdao and innovative businesses and others represented 61.3%, 2.2% and 36.5% of total cost of revenues, respectively, as compared with 69.5%, 1.5% and 29.0% of the total cost of revenues, respectively, in 2017.

### Online game services

Cost of revenues from our online game services increased by 8.5% to RMB14,617.7 million in 2018 from RMB13,473.3 million in 2017. The increase in cost of revenues in 2018 was primarily due to an increase in revenue sharing costs with distribution channel providers, game developers and other third parties related to mobile games, which was primarily due to the launch of various in-house developed and licensed mobile games in 2018.

### Youdao

Cost of revenues from Youdao increased by 75.3% to RMB515.1 million in 2018 from RMB293.8 million in 2017, which was primarily attributable to increased revenue sharing costs with key instructors and payroll related expenses to support the expansion of Youdao's online course offerings.

### Innovative businesses and others

Cost of revenues from our innovative businesses and others segment increased by 54.6% to RMB8,699.6 million in 2018 from RMB5,627.2 million in 2017. The increase in cost of revenues in 2018 was primarily due to increased content costs related to our NetEase Cloud Music and advertising businesses and increased costs of merchandise sold, which were in line with the increase in revenue of our Yanxuan e-commerce business.

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## FINANCIAL INFORMATION

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### *Gross profit*

Our gross profit increased by 9.2% to RMB27,346.1 million in 2018 from RMB25,043.0 million in 2017.

The following table sets forth the consolidated gross profits and gross profit margins of our business activities for the periods indicated as derived from our audited financial statements. The gross profit margins in 2017 and 2018 were calculated by dividing our gross profits over our net revenues for the corresponding type of services.

	<b>For the year ended December 31,</b>	
	<b>2017</b>	<b>2018</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
<b>Gross profit:</b>		
Online game services .....	22,808,303	25,572,401
Youdao .....	161,939	216,465
Innovative businesses and others .....	2,072,799	1,557,283
	<u>25,043,041</u>	<u>27,346,149</u>
<b>Gross profit margin:</b>		
Online game services .....	62.9%	63.6%
Youdao .....	35.5%	29.6%
Innovative businesses and others .....	26.9%	15.2%
	<u>56.4%</u>	<u>53.4%</u>

The increase of gross profit margin for online game services was mainly due to the increased revenues contribution from our in-house developed PC games, which have relatively higher gross profit margin, as a percentage of our total online game revenues. The decrease of gross profit margin for Youdao was mainly due to increased revenues from learning services and products which had a lower margin than online marketing services. The decrease in gross profit margin for innovative businesses and others was mainly due to increased content and information sourcing costs related to our music and advertising businesses.

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## FINANCIAL INFORMATION

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### *Operating expenses*

Total operating expenses increased by 44.2% to RMB17,368.8 million in 2018 from RMB12,048.1 million in 2017 as a result of an increase in selling and marketing expenses, general and administrative expenses and research and development expenses. The following table sets forth our operating expenses for the periods indicated as derived from our audited financial statements.

	<b>For the year ended December 31,</b>	
	<b>2017</b>	<b>2018</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
<b>Operating expenses:</b>		
Selling and marketing expenses . . . . .	(5,504,613)	(6,911,710)
General and administrative expenses . . . . .	(2,381,842)	(3,078,635)
Research and development expenses . . . . .	(4,161,673)	(7,378,460)
Total operating expenses . . . . .	(12,048,128)	(17,368,805)

Selling and marketing expenses increased by 25.6% to RMB6,911.7 million in 2018 from RMB5,504.6 million in 2017, primarily due to: (i) the increased marketing spending on our various online games, Youdao, as well as media and outdoor branding promotion for our innovative businesses and others, and (ii) an increase in staff-related costs of our sales team, primarily driven by increased headcount and higher compensation levels and performance-related bonus accruals.

General and administrative expenses increased by 29.3% to RMB3,078.6 million in 2018 from RMB2,381.8 million in 2017, primarily due to an increase in staff-related costs driven by increased headcount and higher compensation levels.

Research and development expenses increased by 77.3% to RMB7,378.5 million in 2018 from RMB4,161.7 million in 2017, primarily due to: (i) an increase in staff-related costs mainly as a result of increased headcount for our online game services and innovative businesses and others and higher salaries, bonuses and other benefits paid to our research and development teams during 2018, including share-based compensation, (ii) an increase in technology costs mainly for game content design, and (iii) an increase in other miscellaneous cost such as depreciation and amortization costs, rental and utilities expenses.

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## FINANCIAL INFORMATION

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### *Other income/(expenses)*

The following table sets forth our other income/(expenses) for the periods indicated as derived from our audited financial statements.

	<b>For the year ended December 31,</b>	
	<b>2017</b>	<b>2018</b>
	<b>RMB</b>	<b>RMB</b>
	<b>(in thousands)</b>	
Other income/(expenses):		
Investment income/(losses), net .....	362,113	(22,383)
Interest income, net .....	666,616	586,671
Exchange losses .....	(455,948)	(51,799)
Other, net .....	271,885	586,916

Other income/(expenses) in 2018 mainly consisted of investment income related to short-term investments, interest income, foreign exchange gain, offset in part by foreign exchange losses, government incentives, impairment provisions related to certain equity investments, net investment losses in equity method investees and fair value change related to our equity investments with readily determinable fair value and other financial instruments.

Investment loss was RMB22.4 million in 2018 compared to investment income of RMB362.1 million in 2017, consisting primarily of: (i) investment income related to short-term investments of RMB463.5 million in 2018, compared to RMB389.5 million in 2017, and (ii) cash dividend of RMB17.1 million from equity investments in 2018, compared to RMB29.6 million in 2017, which was offset in part by: (i) impairment provisions related to certain investments and a net investment loss in equity method investees totaling RMB258.0 million in 2018, compared to RMB70.7 million in 2017, and (ii) an unrealized fair value change of RMB248.2 million related to the equity investments with readily determinable fair value and other financial instruments in 2018 compared to zero in 2017.

Interest income decreased to RMB586.7 million in 2018 from RMB666.6 million in 2017, primarily due to a decrease of RMB3.4 billion in our net cash balance, which includes total cash and cash equivalents, time deposits and restricted cash balance minus short-term loans. We incurred interest expense of RMB315.9 million in 2018 related to our short-term loans.

Other, net increased to RMB586.9 million in 2018 from RMB271.9 million in 2017. We received and recognized unconditional government incentives of RMB316.7 million in 2018, compared to RMB242.8 million in 2017.

We also incurred net foreign exchange losses of RMB51.8 million in 2018, compared to net foreign exchange losses of RMB455.9 million in 2017, both of which are primarily due to the translation gains and losses arising from our U.S. dollar-denominated bank deposit and short-term loan balances as the exchange rate of the U.S. dollar against the RMB fluctuated over these periods.

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## FINANCIAL INFORMATION

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### *Income tax*

Income tax increased to RMB2,460.7 million in 2018 from RMB2,156.0 million in 2017. Our effective tax rate in 2018 was 22.2% compared with 15.6% in 2017. The change in the effective tax rate was mainly due to the fact that certain of our subsidiaries experienced higher operating losses in 2018.

### *Net income*

Net income attributable to our shareholders in 2018 comprised net income from our continuing operations attributable to our shareholders of RMB8,291.1 million and net loss from discontinued operations of RMB2,138.7 million, compared to net income from our continuing operation of RMB11,542.4 million and net loss from discontinued operations of RMB834.5 million in 2017.

## LIQUIDITY AND CAPITAL RESOURCES

To date, we have financed our operations primarily through operating cash flows and existing capital resources. As of December 31, 2019, we had RMB3,246.4 million in cash and cash equivalents, RMB55,847.1 million in time deposits and RMB15,312.6 million in short-term investments. As of March 31, 2020, we had RMB5,592.8 million (US\$789.9 million) in cash and cash equivalents, RMB54,365.1 million (US\$7,677.8 million) in time deposits and RMB19,373.4 million (US\$2,736.0 million) in short-term investments. Net cash provided by continuing operating activities was RMB16,911.0 million in 2019 and RMB6,500.6 million (US\$918.1 million) in the three months ended March 31, 2020. We had short-term borrowings of RMB16,828.2 million and RMB19,624.5 million (US\$2,771.5 million) as of December 31, 2019 and March 31, 2020, respectively. On August 9, 2018, we entered into a three-year US\$500.0 million revolving loan facility agreement with a group of four arrangers. The facility was priced at 95 basis points over LIBOR and has a commitment fee of 0.20% on the undrawn portion. As of December 31, 2019 and March 31, 2020, we had an undrawn balance of US\$300.0 million and US\$300.0 million, respectively, under this credit facility. We also entered into several uncommitted loan credit facility agreements provided by certain financial institution. As at December 31, 2019 and March 31, 2020, US\$1,015.7 million and US\$1,034.5 million, respectively, of such credit facilities has not been utilized.

We believe that our current levels of cash and cash equivalents, cash flows from operations and short-term investments will be sufficient to meet our anticipated cash needs for at least the next 12 months. However, we may need additional cash resources if we experience changed business conditions or other developments. We may also need additional cash resources if we find and wish to pursue opportunities for investment, acquisition, strategic cooperation or other similar action. If we determine that our cash requirements exceed our amounts of cash and cash equivalents on hand, we may seek to issue debt or equity securities or obtain a credit facility. Any issuance of equity securities could cause dilution for our shareholders. Any incurrence of indebtedness could increase our debt service obligations and cause us to be subject to restrictive operating and finance covenants. It is possible that, when we need additional cash resources, financing will only be available to us in amounts or on terms that would not be acceptable to us or financing will not be available at all.



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### Cash flows

The following table sets forth summary consolidated cash flow data for the periods indicated as derived from our consolidated financial statements. We sold our Kaola e-commerce business in September 2019, and Kaola's historical financial results are reflected in our consolidated financial statements as discontinued operations accordingly. Unless otherwise stated, cash flows discussed herein refer to our continuing activities only.

	For the year ended December 31,			For the three months ended March 31,		
	2017	2018	2019	2019	2020	
	RMB	RMB	RMB	RMB	RMB	US\$
				(unaudited)	(unaudited)	(unaudited)
				(in thousands)		
Net cash provided by continuing operating activities .....	14,864,452	14,659,843	16,910,971	2,625,861	6,500,649	918,067
Net cash used in continuing investing activities .....	(15,956,509)	(14,999,696)	(21,304,489)	(4,037,261)	(2,478,387)	(350,015)
Net cash (used in)/provided by financing activities .....	(1,302,728)	1,587,419	1,082,525	411,135	(1,393,899)	(196,856)

### *Continuing operating activities*

Cash provided by continuing operating activities was RMB6,500.6 million (US\$918.1 million), RMB2,625.9 million, RMB16,911.0 million, RMB14,659.8 million and RMB14,864.5 million for the three months ended March 31, 2020 and 2019 and years ended December 31, 2019, 2018 and 2017, respectively.

For the three months ended March 31, 2020, cash provided by continuing operating activities consisted primarily of: (i) our net income from continuing operations of RMB3,950.7 million (US\$557.9 million), (ii) an increase in deferred revenue of RMB1,379.1 million (US\$194.8 million), (iii) an increase in tax payable of RMB1,234.1 million (US\$174.3 million), (iv) depreciation and amortization charges of RMB690.1 million (US\$97.5 million), (v) share-based compensation cost of RMB665.8 million (US\$94.0 million), (vi) fair value change of equity security investments and other financial instruments of RMB327.0 million (US\$46.2 million) and (vii) impairment loss for investment of RMB6.6 million (US\$0.9 million), partially offset by (A) an increase in accounts receivable, prepayments and other current assets of RMB1,534.3 million (US\$216.7 million) and (B) fair value changes of short-term investments of RMB153.1 million (US\$21.6 million).

For the three months ended March 31, 2019, cash provided by continuing operating activities consisted primarily of: (i) our net income from continuing operations of RMB2,463.3 million, (ii) share-based compensation cost of RMB620.8 million, (iii) depreciation and amortization charges of RMB581.2 million, (iv) an increase in deferred revenue of RMB151.6 million, and (v) impairment loss for investment of RMB96.1 million, partially offset by (A) an increase in accounts receivable, prepayments and other current assets of RMB1,588.5 million and, (B) fair value change of equity security investments and other financial instruments of RMB129.9 million and (C) fair value changes of short-term investments of RMB124.6 million.

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For the year ended December 31, 2019, cash provided by continuing operating activities consisted primarily of: (i) our net income from continuing operations of RMB13,468.6 million, (ii) depreciation and amortization charges of RMB2,613.8 million, (iii) share-based compensation cost of RMB2,404.1 million, (iv) an increase in deferred revenue of RMB883.7 million, (v) a decrease in inventories of RMB415.1 million, and (vi) impairment loss for investment of RMB177.6 million, partially offset by, (A) an increase in accounts receivable, prepayments and other current assets of RMB1,499.9 million, (B) fair value change of equity security investments and other financial instruments of RMB751.7 million, and (C) fair value changes of short-term investments of RMB657.6 million.

For the year ended December 31, 2018, cash provided by continuing operating activities consisted primarily of: (i) our net income from continuing operations of RMB8,616.1 million, (ii) share-based compensation cost of RMB2,471.7 million, (iii) depreciation and amortization charges of RMB2,060.1 million, (iv) an increase in deferred revenue of RMB1,757.9 million, (v) an increase in accounts payable and other liabilities of RMB641.8 million, including content fees, bandwidth cost, bonuses and marketing expenses, (vi) an increase in taxes payable of RMB685.0 million, (vii) fair value change of equity security investments and other financial instruments of RMB248.2 million, and (viii) impairment loss for investment of RMB159.7 million, partially offset by, (A) an increase in accounts receivable, prepayments and other current assets of RMB1,331.7 million, (B) fair value changes of short-term investments of RMB463.5 million, and (C) gains on disposal of long-term investments, business and subsidiaries of RMB213.3 million.

For the year ended December 31, 2017, cash provided by continuing operating activities consisted primarily of: (i) our net income from continuing operations of RMB11,683.6 million, (ii) an increase in accounts payable and other liabilities of RMB2,167.6 million, including content fees, bandwidth cost, bonuses and marketing expenses, (iii) share-based compensation cost of RMB1,984.9 million, (iv) depreciation and amortization charges of RMB791.8 million, (v) a decrease in accounts receivable, prepayments and other current assets of RMB798.0 million, (vi) unrealized exchange losses of RMB440.5 million, and (vii) allowance for provision for doubtful debts of RMB60.8 million, partially offset by, (A) an increase in inventories of RMB754.9 million, (B) a decrease in deferred revenue of RMB1,375.8 million, (C) deferred income taxes of RMB438.3 million, (D) fair value changes of short-term investments of RMB389.8 million, and (E) a decrease in taxes payable of RMB170.1 million.

### *Continuing investing activities*

Cash used in continuing investing activities was RMB2,478.4 million (US\$350.0 million), RMB4,037.3 million, RMB21,304.5 million, RMB14,999.7 million and RMB15,956.5 million for the three months ended March 31, 2020 and 2019 and years ended December 31, 2019, 2018 and 2017, respectively.

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For the three months ended March 31, 2020, cash used in continuing investing activities mainly consisted of: (i) placement/rollover of matured time deposits of RMB11,667.5 million (US\$1,647.8 million), (ii) purchase of short-term investments of RMB10,070.0 million (US\$1,422.2 million), (iii) net change in short-term investments with terms of three months or less of RMB780.5 million (US\$110.2 million), (iv) purchase of intangible assets, content and licensed copyrights of RMB306.8 million (US\$43.3 million), (v) investment in equity method investees and other long-term investments of RMB205.0 million (US\$29.0 million) and (vi) purchase of property, equipment and software of RMB164.3 million (US\$23.2 million), partially offset by (A) proceeds from maturity of time deposits of RMB13,640.6 million (US\$1,926.4 million), (B) proceeds from maturity of short-term investments with terms over three months of RMB6,888.0 million (US\$972.8 million) and (C) proceeds from disposal of long-term investments and businesses of RMB197.0 million (US\$27.8 million).

For the three months ended March 31, 2019, cash used in continuing investing activities mainly consisted of: (i) placement/rollover of matured time deposits of RMB16,596.5 million, (ii) purchase of short-term investments of RMB4,890.0 million, (iii) purchase of intangible assets, content and licensed copyrights of RMB851.6 million, (iv) investment in equity method investees and other long-term investments of RMB392.0 million and (v) purchase of property, equipment and software of RMB369.6 million, partially offset by (A) proceeds from maturity of time deposits of RMB15,959.5 million, (B) proceeds from maturity of short-term investments with terms over three months of RMB2,311.3 million, (C) amounts received from disposed businesses of RMB651.2 million and (D) proceeds from sale of property, equipment and software of RMB3.8 million.

For the year ended December 31, 2019, cash used in continuing investing activities mainly consisted of: (i) placement/rollover of matured time deposits of RMB77,083.4 million, (ii) purchase of short-term investments of RMB22,370.0 million, (iii) purchase of intangible assets, content and licensed copyrights of RMB2,119.3 million, (iv) purchase of property, equipment and software of RMB1,209.5 million, (v) acquisitions of other long-term investments of RMB1,111.5 million, (vi) net change in short-term investments with terms of three months or less of RMB1,023.2 million, and (vii) investment in equity method investees of RMB450.7 million, partially offset by, (A) proceeds from maturity of time deposits of RMB54,381.6 million, (B) proceeds from maturity of short-term investments of RMB20,225.3 million, (C) proceeds received from discontinued operations of RMB9,031.1 million, and (D) proceeds from disposals of investment in equity method investees and other equity investments of RMB406.7 million.

For the year ended December 31, 2018, cash used in continuing investing activities mainly consisted of: (i) placement/rollover of matured time deposits of RMB41,553.4 million, (ii) purchase of short-term investments of RMB13,393.0 million, (iii) purchase of property, equipment, software and land use rights of RMB5,096.2 million, (iv) acquisitions of other long-term investments of RMB2,751.0 million, (v) amounts paid to discontinued operations of RMB1,889.6 million, (vi) purchase of intangible assets, content and licensed copyrights of RMB1,741.2 million, (vii) net change in short-term investments with terms of three months or less of RMB1,172.3 million, and (viii) investment in equity method investees of RMB272.5 million, partially offset by, (A) proceeds from maturity of time deposits of RMB39,924.5 million, and (B) proceeds from maturity of short-term investments of RMB13,071.4 million.

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For the year ended December 31, 2017, cash used in continuing investing activities mainly consisted of: (i) placement/rollover of matured time deposits of RMB33,984.1 million, (ii) purchase of short-term investments of RMB12,491.0 million, (iii) amounts paid to discontinued operations of RMB3,296.4 million, (iv) purchase of property, equipment, software and land use rights of RMB1,661.0 million, (v) acquisitions of other long-term investments of RMB900.7 million, (vi) net change in short-term investments with terms of three months or less of RMB895.3 million, (vii) purchase of intangible assets, content and licensed copyrights of RMB791.6 million, and (viii) investment in equity method investees of RMB235.8 million, partially offset by, (A) proceeds from maturity of time deposits of RMB22,429.6 million, (B) proceeds from maturity of short-term investments of RMB15,615.5 million, and (C) proceeds from disposal of equity investment of RMB350.4 million.

### Long-term investments

The following table sets forth a breakdown of our long-term investments by accounting treatment as of the dates indicated:

	December 31, 2017	December 31, 2018	December 31, 2019	March 31, 2020	
	RMB	RMB	RMB	RMB	US\$
				(unaudited)	(unaudited)
	(in thousands)				
Investments in equity method investees . . . . .	563,896	736,551	1,137,774	1,178,773	166,475
Equity investments with readily determinable fair values . . . . .	828,260	612,465	3,551,545	3,264,128	460,983
Equity investments without readily determinable fair values . . . . .	1,291,620	3,896,092	4,604,549	4,774,116	674,234
Total long-term investments . . . . .	<u>2,683,776</u>	<u>5,245,108</u>	<u>9,293,868</u>	<u>9,217,017</u>	<u>1,301,692</u>

During the Track Record Period, our significant equity method investees primarily included Zhejiang Yixin Technology Co., Ltd. (formerly known as Hangzhou Yixin Technology Co., Ltd.), a joint venture we established with China Telecom, and two limited partnerships engaging in investments in online game businesses.

As of March 31, 2020, our investees of equity investments with readily determinable fair values primarily included Alibaba, Huatai Securities Company Limited and Shenzhen Transsion Holding Limited.

Equity investments without readily determinable fair value represent investments in privately held companies with no readily determinable fair value. We do not have significant influence on these investees, or the investments are not common stock or in substance common stock.

We recorded equity share of losses of RMB12.2 million, RMB98.3 million and equity share of earnings of RMB4.3 million and RMB46.2 million (US\$6.5 million) for the years ended December 31, 2017, 2018, and 2019 and the three months ended March 31, 2020, respectively, which was included in “investment income, net” in our consolidated statements of operations and comprehensive income.

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We recorded fair value loss of RMB215.8 million, fair value gain of RMB763.2 million and fair value loss of RMB327.0 million (US\$46.2 million) related to the equity investments with readily determinable fair value for the year ended December 31, 2018 and 2019 and March 31, 2020, respectively, which was included in “investment income, net” in our consolidated statements of operations and comprehensive income. Prior to adoption of ASU 2016-01, we recorded an unrealized fair value loss of RMB23.3 million in other comprehensive income for the year ended December 31, 2017.

We recognized a gain of RMB9.6 million, zero, RMB86.1 million and RMB20.3 million (US\$2.9 million) related to the disposal of our investments in equity securities without readily determinable fair value as “investment income, net” in our consolidated statements of operations and comprehensive income for the years ended December 31, 2017, 2018 and 2019 and the three months ended March 31, 2020.

We recognized impairment provision of RMB58.5 million, RMB133.6 million, RMB168.4 million and RMB6.6 million (US\$0.9 million) related to certain of the equity investments as “investment income, net” in our consolidated statements of operations and comprehensive income for the years ended December 31, 2017, 2018 and 2019 and three months ended March 31, 2020, respectively.

### Short-term investments

As of December 31, 2017, 2018, 2019 and March 31, 2020, our short-term investments mainly consisted of financial products issued by commercial banks in China with a variable interest rate indexed to the performance of underlying assets and a maturity date within one year when purchased. As of December 31, 2017, 2018, 2019 and March 31, 2020, the effective yields of our short-term investments ranged from 2.00% to 5.30% per annum, 1.90% to 5.50% per annum, 2.00% to 4.25% per annum, and 2.00% to 4.13% per annum, respectively.

In 2017, 2018, 2019 and the three months ended March 31, 2020, we recorded investment income related to short-term investments of RMB389.5 million, RMB463.5 million, RMB657.6 million and RMB153.1 million (US\$21.6 million), respectively.

### *Financing activities*

For the three months ended March 31, 2019 and 2020 and years ended December 31, 2017, 2018 and 2019, cash provided by or used in financing activities was all from continuing operations. There were no financing activities from discontinued operations for these years.

Cash provided by continuing financing activities was RMB1,082.5 million and RMB1,587.4 million and RMB411.1 million for the years ended December 31, 2019 and 2018 and the three months ended March 31, 2019, respectively, and cash used in continuing financing activities was RMB1,393.9 million (US\$196.9 million) and RMB1,302.7 million for the three months ended March 31, 2020 and the year ended December 31, 2017, respectively.

For the three months ended March 31, 2020, cash used in continuing financing activities mainly resulted from: (i) cash paid for repurchase of our shares and purchase of Youdao’s shares of RMB2,560.9 million (US\$361.7 million) and (ii) dividends paid in the amount of RMB926.5 million (US\$130.9 million), partially offset by net changes in short-term loans with terms of three months or less of RMB2,539.6 million (US\$358.7 million).

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For the three months ended March 31, 2019, cash provided by continuing financing activities mainly resulted from: (i) net changes in short-term loans with terms of three months or less of RMB741.1 million and (ii) capital contribution from noncontrolling interests and redeemable noncontrolling interests shareholders, net of RMB68.6 million, partially offset by dividends paid in the amount of RMB413.6 million.

For the year ended December 31, 2019, cash provided by continuing financing activities mainly resulted from: (i) proceeds from issuance of redeemable noncontrolling shareholder interests and noncontrolling interests, net of issuance costs of RMB6,941.0 million and (ii) net proceeds in short-term loan of RMB2,971.5 million, partially offset by dividends paid in the amount of RMB8,840.6 million.

For the year ended December 31, 2018, cash provided by continuing financing activities mainly resulted from: (i) net proceeds in short-term loan of RMB6,209.6 million and (ii) proceeds from issuance of redeemable noncontrolling shareholder interests, net of issuance cost of RMB5,294.2 million, partially offset by repurchase of shares of RMB7,516.7 million, dividends paid in the amount of RMB1,440.2 million, and repurchase of noncontrolling interests and redeemable noncontrolling interests of RMB975.0 million.

For the year ended December 31, 2017, cash used in continuing financing activities mainly resulted from dividends paid in the amount of RMB3,257.6 million and repurchase of shares of RMB2,061.6 million, partially offset by net proceeds of short-term bank loan of RMB3,105.0 million.

### **Management of capital resources**

In managing our capital, we seek to maintain a reasonable amount of liquidity to support new business growth and maximize returns on our capital resources, while at the same time focusing on the preservation of capital and complying with applicable legal requirements. Our capital resources include primarily cash on hand, demand deposits and time deposits mainly placed with banks in Hong Kong and China and short-term investments. Although we consolidate the results of our subsidiaries and VIEs in our consolidated financial statements, we do not have direct access to the cash and cash equivalents or future earnings of our subsidiaries and VIEs. As of December 31, 2019, these subsidiaries and VIEs had RMB59.0 billion in cash and cash equivalents, demand deposits and short-term and long-term time deposits. Our cash and cash equivalents, demand deposits, time deposits and short-term investments held outside of China are mainly denominated in U.S. dollars, Renminbi and HK dollars.

To fund any cash requirements we may have, we may need to rely on dividends and other distributions on equity paid by our subsidiaries. Since substantially all of our operations are conducted through our PRC subsidiaries and VIEs, our subsidiaries may need to rely on dividends, loans or advances made by another PRC subsidiary or VIE. Certain of these payments are subject to PRC taxes, including sales taxes, which effectively reduce the received amount. In addition, the PRC government could impose restrictions on such payments or change the tax rates applicable to such payments. In 2017, 2018, 2019 and the three months ended March 31, 2020, we accrued RMB707.1 million, RMB679.4 million, RMB846.6 million and RMB270.1 million (US\$38.1 million) withholding tax liabilities, respectively, associated with our quarterly dividends and cash expected to be distributed from our PRC subsidiaries to companies in our corporate group outside of China for general corporate purposes. We repatriated a portion of these earnings and paid related withholding income tax in 2017, 2018, 2019 and the three months ended March 31, 2020. For the foreseeable future, we intend to reinvest all remaining undistributed earnings as at March 31, 2020 in our PRC subsidiaries, and accordingly no other withholding tax is expected to be incurred.

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In addition, the payment of dividends by entities established in the PRC is subject to limitations. Regulations in the PRC currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in the PRC. Each of our PRC subsidiaries that is a domestic company is also required to set aside at least 10.0% of its after-tax profit based on PRC accounting standards each year to its general reserves or statutory capital reserve fund until the accumulative amount of such reserves reach 50.0% of its respective registered capital. These restricted reserves are not distributable as cash dividends. As a result of these and other restrictions under PRC laws and regulations, our PRC subsidiaries and VIEs are restricted in their ability to transfer a portion of their net assets to us either in the form of dividends, loans or advances, which restricted portion amounted to approximately RMB14.1 billion, or 23% of our total consolidated net assets, as of December 31, 2019. In addition, if any of our PRC subsidiaries incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us.

Furthermore, any transfer of funds from us to any of our PRC subsidiaries or VIEs, either as a shareholder loan or as an increase in registered capital, is subject to certain statutory limit requirements and registration or approval of the relevant PRC governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our PRC subsidiaries or VIEs. These limitations on the free flow of funds between us and our PRC subsidiaries and VIEs could restrict our ability to act in response to changing market conditions and reallocate funds internally in a timely manner.

For additional information, see “Risk Factors — Risks related to our corporate structure — Our corporate structure may restrict our ability to receive dividends from, and transfer funds to, our PRC subsidiaries and VIEs, which could restrict our ability to act in response to changing market conditions and reallocate funds internally in a timely manner” and “Risk Factors — Risks related to doing business in China — Restrictions on currency exchange may limit our ability to utilize our revenues effectively.”

### CAPITAL EXPENDITURES

Our principal capital expenditures for the three months ended March 31, 2020 consisted mainly of new servers in connection with the operation of our businesses for a total of RMB164.3 million (US\$23.2 million). Our principal capital expenditures for 2019 consisted mainly of the construction of our new office buildings and warehouses in Guangzhou and Hangzhou in China, acquisition of new servers in connection with the operation of our online games and developing the expansion packages of such games, and upgrades of our online service infrastructure for a total of approximately RMB1,209.5 million. Our principal capital expenditures for 2018 consisted mainly of the construction of our new office buildings in Hangzhou and Guangzhou in China, acquisition of new servers in connection with the operation of our online games and developing the expansion packages of such games, and upgrades of our online service infrastructure, for a total of RMB2,169.4 million. Our principal capital expenditures for 2017 consisted mainly of costs incurred for the construction of our new office buildings in Zhoushan, Guangzhou and Hangzhou in China, acquisition of new servers in connection with the operation of our online games and developing the expansion packages of such games, and upgrades of our online service infrastructure, for a total of approximately RMB1,654.5 million. In addition, in connection with the licensing of certain online games by

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Blizzard to Shanghai EaseNet for operation in the PRC, during the respective terms of the licenses, Shanghai EaseNet as licensee of the games is required to pay royalty fees to Blizzard for the games, have a minimum marketing expenditure commitment, and provide funds for hardware to operate the games.

As of December 31, 2019, we had capital expenditure commitments of RMB1,472.6 million for 2020 onwards, which primarily consist of commitments made in connection with the construction of new office buildings in Guangzhou and Shanghai. Our capital expenditures in 2019 have been, and future capital expenditures are expected to continue to be, funded by operating cash flows and our existing capital resources.

### HOLDING COMPANY STRUCTURE

Our company was incorporated in the Cayman Islands. NetEase, Inc. conducts its business in China through its subsidiaries and VIEs. Under current Chinese regulations, there are restrictions and prohibitions on foreign investment in Chinese companies providing, among other things, value-added telecommunications services, internet cultural services and internet publication services, which include the provision of online game, online education and other internet content and services. In order to comply with these restrictions and other Chinese rules and regulations, NetEase, Inc. and certain of its subsidiaries have entered into a series of contractual arrangements for the provision of such services with certain affiliated companies, including Guangzhou NetEase, Hangzhou Leihuo, Youdao Computer, Shanghai EaseNet and certain other affiliated companies. These affiliated companies are considered “variable interest entities” for accounting purposes, and are referred to collectively in this document as “VIEs.” These contractual arrangements allow us to exercise effective control over the VIEs and their subsidiaries. The VIEs hold ICP licenses and other regulated licenses in which foreign investment is restricted or prohibited and operate our Internet businesses and other businesses. The revenue earned by the VIEs largely flows through to NetEase, Inc. and its subsidiaries pursuant to such contractual arrangements. Based on these agreements, NetEase Hangzhou, Boguan and certain other affiliated companies provide technical consulting and related services to the VIEs. In addition, Guangzhou NetEase has a wholly-owned subsidiary, Wangyibao (the operator of our NetEase Pay online payment platform).

As of December 31, 2019, the total assets of all the consolidated VIEs of our company were RMB14.4 billion, mainly comprising cash and cash equivalents, time deposits, accounts receivable, prepayments and other current assets and fixed assets. As of December 31, 2019, the total liabilities of the consolidated VIEs were RMB12.3 billion, mainly comprising accounts payable, deferred revenue, accrued liabilities and other payables.

We believe that our present operations are structured to comply with the relevant Chinese laws. However, many Chinese regulations are subject to extensive interpretive powers of governmental agencies and commissions. We cannot be certain that the Chinese government will not take action to prohibit or restrict our business activities. Future changes in Chinese government policies affecting the provision of information services, including the provision of online games, online education, internet access, online advertising and online payment services, may impose additional regulatory requirements on us or our service providers or otherwise harm our business.



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### INFLATION

Inflation in China has not materially impacted our results of operations in recent years. According to the National Bureau of Statistics of China, the year-over-year increase in the consumer price index in calendar years 2017, 2018 and 2019 was 1.6%, 2.1% and 2.9%, respectively. Although we have not been materially affected by inflation in the past, we can provide no assurance that we will not be affected in the future by higher inflation rates in China.

### CONTRACTUAL OBLIGATIONS

We have operating lease commitments, which are the lease commitments under the lease agreements for our corporate offices, warehouses and retail stores. We also have contractual obligations in respect of the construction of new office buildings and warehouse facilities in Guangzhou, Shanghai and Hangzhou, capital expenditures related to computer equipment and server and bandwidth service fee. In addition, we have contractual obligations in connection with the games licensed from Blizzard. The following sets forth our contractual obligations for server and bandwidth service fees, long-term payables, capital expenditures and office machine and other obligations related to content and services purchases, including the royalties and minimum marketing expenditure commitment for the games licensed to us by Blizzard, as of December 31, 2019:

	Operating Lease Commitments	Server and Bandwidth Serve Fee Commitments	Capital Commitments	Royalties and Expenditure for Licensed Content Commitments	Office Machines and Other Commitments	Total
	RMB	RMB	RMB	RMB	RMB	RMB
	(in thousands)					
2020 .....	195,945	210,343	467,344	2,057,962	135,903	3,067,497
2021 .....	175,286	368,206	578,011	2,166,368	29,304	3,317,175
2022 .....	97,639	218,863	217,001	1,707,765	17,886	2,259,154
2023 .....	20,338	77,616	209,284	1,311,465	17,619	1,636,322
Beyond						
2023....	12,930	52,848	1,000	849,159	-	915,937
	<u>502,138</u>	<u>927,876</u>	<u>1,472,640</u>	<u>8,092,719</u>	<u>200,712</u>	<u>11,196,085</u>

Other than the obligations set forth above, we do not have any long-term commitments.

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### WORKING CAPITAL

We recorded net current assets of RMB38,197.6 million, RMB33,606.7 million, RMB46,862.0 million and RMB46,813.7 million (US\$6,611.4 million), respectively, as of December 31, 2017, 2018 and 2019 and March 31, 2020. The following table sets forth a breakdown of our current assets and liabilities as of the dates indicated.

	December 31, 2017	December 31, 2018	December 31, 2019	March 31, 2020	
	RMB	RMB	RMB	RMB	US\$
	(in thousands)				
	(unaudited)				(unaudited)
Current assets:					
Cash and cash equivalents . . . . .	2,467,467	4,977,432	3,246,373	5,592,847	789,861
Time deposits . . . . .	30,603,369	32,900,287	53,487,075	50,515,092	7,134,094
Restricted cash . . . . .	5,886,367	4,692,050	3,150,354	3,507,105	495,298
Accounts receivable, net . . . . .	3,539,594	4,002,487	4,169,358	4,559,441	643,916
Inventories, net . . . . .	984,228	1,065,615	650,557	562,117	79,386
Prepayments and other current assets . . . . .	3,126,796	3,925,205	4,817,422	6,060,421	855,895
Short-term investments . . . . .	9,702,609	11,674,775	15,312,595	19,373,366	2,736,042
Assets held for sale . . . . .	5,637,330	5,477,869	271,278	50,751	7,167
<b>Total current assets . . . . .</b>	<b><u>61,947,760</u></b>	<b><u>68,715,720</u></b>	<b><u>85,105,012</u></b>	<b><u>90,221,140</u></b>	<b><u>12,741,659</u></b>
Current liabilities:					
Accounts payable . . . . .	1,070,976	1,201,210	1,212,303	1,197,007	169,050
Salary and welfare payables . . . . .	2,076,160	2,799,212	2,957,360	2,429,147	343,061
Taxes payable . . . . .	1,561,920	2,260,646	3,156,513	4,390,606	620,072
Short-term loans . . . . .	6,623,502	13,658,554	16,828,226	19,624,535	2,771,514
Deferred revenue . . . . .	6,049,903	7,718,485	8,602,227	9,981,353	1,409,636
Accrued liabilities and other payables . . . . .	4,331,937	5,005,190	5,292,774	5,546,607	783,331
Short-term operating lease liabilities . . . . .	–	–	191,454	238,071	33,622
Liabilities held for sale . . . . .	2,035,716	2,465,713	2,156	87	12
<b>Total current liabilities . . . . .</b>	<b><u>23,750,114</u></b>	<b><u>35,109,010</u></b>	<b><u>38,243,013</u></b>	<b><u>43,407,413</u></b>	<b><u>6,130,298</u></b>

For a detailed discussion on our cash position, being the balance sheet item that has material impact on our liquidity, as well as material changes in the various working capital items, see “— Liquidity and Capital Resources.”

Taking into account cash and cash equivalents on hand, our operating cash flows, the available bank facilities and the estimated net proceeds available to us from the Global Offering, our directors believe that we have sufficient working capital for our present requirements and for at least the next 12 months from the date of this document.

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### OFF-BALANCE SHEET ARRANGEMENTS

We did not have any material off-balance sheet arrangements in the years ended December 31, 2017, 2018 or 2019 and the three months ended March 31, 2020.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Interest rate risk

Our exposure to market rate risk for changes in interest rates relates primarily to the interest income generated by excess cash invested in fixed-rate corporate bonds of well-known Chinese companies and financial products issued by commercial banks in China, as well as interest expenses payable on our short-term bank borrowings. All of our short-term bank borrowings as of March 31, 2020 were at fixed rates. Interest instruments carry a degree of interest rate risk. We have not been exposed nor do we anticipate being exposed to material risks due to changes in interest rates. However, our future net interest income may fall short of expectations due to changes in interest rates. Based on our interest instruments as of March 31, 2020, a 10% change in the interest rate would result in an increase or decrease of RMB34.5 million (US\$4.9 million) of our total amount of net interest income or of RMB15.3 million (US\$2.2 million) of our total amount of investment income from short-term investments for the three months ended March 31, 2020.

#### Foreign currency risk

A significant majority of our revenues and expenses are denominated in Renminbi, but as noted above, a certain portion of our cash is kept in U.S. dollars, HK dollars and Euro. Although we believe that, in general, our exposure to foreign exchange risks should be limited, the value of our ADSs will be affected by the foreign exchange rate between U.S. dollars, HK dollars, Euro and Renminbi. For example, to the extent that we need to convert U.S. dollars, HK dollars or Euro into Renminbi for our operational needs and the Renminbi appreciates against the U.S. dollars, HK dollars or Euro at that time, our financial position and the price of our ADSs may be adversely affected. Conversely, if we decide to convert our Renminbi into U.S. dollars for the purpose of declaring dividends on our ADSs or otherwise and the U.S. dollar, HK dollars or Euro appreciates against the Renminbi, the U.S. dollar equivalent of our earnings from our subsidiaries and controlled entities in China would be reduced.

The conversion of RMB into foreign currencies, including U.S. dollars, is based on rates set by the PBOC. The PRC government allowed the RMB to appreciate by more than 20% against the U.S. dollar between July 2005 and July 2008. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the RMB and the U.S. dollar remained within a narrow band. Since June 2010, RMB has fluctuated against the U.S. dollar, at certain times significantly and unpredictably. With the development of the foreign exchange market progressing towards interest rate liberalization and Renminbi internationalization and economic uncertainties in both China and the world, the PRC government may in the future announce further changes to the exchange rate system and we cannot assure you that the Renminbi will not appreciate or depreciate significantly in value against the U.S. dollar in the future. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the RMB and the U.S. dollar in the future.

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We translate our monetary assets and liabilities which are denominated in currencies other than Renminbi into Renminbi as of each accounting period end, in accordance with applicable accounting standards. As a result of this foreign currency translation, we reported net foreign exchange gain of RMB25.2 million in 2019 and RMB244.1 million (US\$34.5 million) in the three months ended March 31, 2020, compared to net foreign exchange losses of RMB51.8 million in 2018 and RMB39.5 million in the three months ended March 31, 2019. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure. Accordingly, we may incur economic losses in the future due to foreign exchange rate fluctuations, which could have a negative impact on our financial condition and results of operations.

As of December 31, 2019 and March 31, 2020, we had U.S. dollar-denominated debt outstanding of US\$2,178.0 million and US\$2,533.0 million, respectively. If the U.S. dollar had appreciated/depreciated by 10% against the Renminbi, our interest payments on this debt in Renminbi terms would have increased/decreased by RMB35.7 million and RMB27.1 million (US\$3.8 million), respectively.

As of December 31, 2019 and March 31, 2020, we had U.S. dollar-denominated cash and cash equivalents and time deposits of US\$4,609.5 million and US\$4,824.8 million, respectively. If the U.S. dollar had appreciated/depreciated by 10% against the Renminbi, our U.S. dollar-denominated cash and cash equivalents and time deposits as of December 31, 2019 and March 31, 2020 would have increased/decreased by RMB3,209.1 million and RMB3,416.3 million, respectively, in Renminbi terms.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our significant accounting policies are set forth in Note 2 to the Accountant's Report in Appendix IA. The preparation of our consolidated financial statements requires our management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Our management periodically re-evaluates these estimates and assumptions based on historical experience and other factors, including expectations of future events that they believe to be reasonable under the circumstances. Actual results may differ significantly from those estimates and assumptions. We have identified the following accounting policies and estimates as the most critical to an understanding of our financial position and results of operations, because the application of these policies requires significant and complex management estimates, assumptions and judgment, and the reporting of materially different amounts could result if different estimates or assumptions were used or different judgments were made.

#### Basis of consolidation

Our consolidated financial statements include the financial statements of our subsidiaries and VIEs for which we are the primary beneficiary with the ownership interests of minority shareholders reported as noncontrolling interests. All significant transactions and balances among the Company, our subsidiaries and VIEs have been eliminated upon consolidation. We consolidate a VIE if we have the power to direct matters that most significantly impact the activities of the VIE, and have the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

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## FINANCIAL INFORMATION

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### **Revenue recognition**

On January 1, 2018, we adopted Topic 606 using the modified retrospective method applied to all contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Under Topic 606, revenues from contracts with customers are recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services, reduced by estimates for return allowances, promotional discounts, rebates and VAT. The recognition of revenues involves certain management judgments, including estimated lives of virtual items purchased by game players, estimated breakage of game points, return allowance for goods sold, the estimation of the fair value of an advertising-for-advertising barter transaction, and the volume of sales rebates. The amount and timing of our revenues can be different if management made different judgments or utilized different estimates.

We operate mobile games and PC games. We are the principal of all games we operate, including both in-house developed games and licensed games. As all these games are hosted on our servers, we have the pricing discretion, and are responsible for the sale and marketing of the games as well as any related customer services. Fees paid to game developers, distribution channels (for example, app stores) and payment channels are recorded as cost of revenues.

### ***Mobile games***

We generate mobile game revenues from the sale of in-game virtual items, including avatars, skills, privileges or other in-game consumables, features or functionality, within the games. The performance obligation is to provide on-going game services to the game players who have purchased such virtual items and is satisfied over the average playing period of the paying players. Accordingly, we recognize the revenues ratably over the estimated average playing period of these paying players.

We consider the average period that players typically play the games and other game player behavior patterns, as well as various other factors to arrive at the best estimates for the estimated playing period of the paying players for each game based on players' historical churn rate. If a new game is launched and only a limited period of paying player data is available, then we consider other qualitative factors, such as the playing patterns for paying users for other games with similar characteristics and playing patterns of paying players, such as targeted players and purchasing frequency. While we believe our estimates to be reasonable based on available game player information, we may revise such estimates based on new information indicating a change in the game player behavior patterns and any adjustments are applied prospectively.

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## FINANCIAL INFORMATION

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### *PC games*

We sell prepaid points to players of our PC games. Customers can purchase “virtual” prepaid points online or from the vendors who register the points in our system via debit and credit cards or bank transfers via the online payment services platforms, and receive the prepaid point information over the internet. Our game players can use the points to play our PC games, pay for in-game items and use other fee-based services. Proceeds received from the sales of prepaid points to players are recorded as deferred revenues.

We earn revenue through providing PC game services to players under two types of revenue models: the time-based revenue model and item-based revenue model. For PC games using the time-based model, players are charged based on the time they spend playing games. Revenues are recognized ratably over the game playing period as the performance obligations are satisfied.

Under the item-based model, the basic game play functions are free of charge, and players are charged for purchases of in-game items. In-game items have different life patterns: one-time use, limited life and permanent life. Revenues from the sales of one-time use in-game items are recognized upon consumption. Limited life items are either limited by the number of uses (for example, 10 times) or limited by time (for example, three months). Revenues from the sales of limited life in-game items are recognized ratably based on the extent of time passed or expired or when the items are fully used. Players are allowed to use permanent life in-game items without any use or time limits. Revenues from the sales of permanent life in-game items are recognized ratably over the estimated average playing period of the paying players.

We consider the average period that players typically play the games and other game player behavior patterns, as well as various other factors, including the acceptance and popularity of expansion packs, promotional events launched and market conditions to arrive at the best estimates of the estimated average playing period of the paying players for the permanent in-game items of each PC game based on players’ historical churn rate. This estimate is re-assessed on a quarterly basis. Adjustments arising from changes in the estimated playing period of paying players are applied prospectively as such changes result from new information indicating a change in the game player behavior patterns.

### *Youdao’s online courses services*

Youdao’s services consist of online courses delivered via live streaming, other activities during the online live streaming period and content playback services. The aforementioned services are highly interdependent and interrelated in the context of the contract and are only considered accessory services to the online live streaming courses, and therefore are not distinct and are not sold standalone. As a result, a live streaming course is accounted for as a single performance obligation which is satisfied over its learning period. The revenues generated from our live streaming courses are recognized ratably over an average of the learning periods of our live streaming courses. We consider the average length of period during which students typically spend time on viewing the courses, as well as other learning behavior patterns, to arrive at the best estimates for the length of the period during the students view playback of the course recordings.

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## FINANCIAL INFORMATION

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### *Advertising services*

We derive our advertising revenues principally from short-term online advertising contracts. Advertising service contracts may consist of multiple performance obligations with a typical term of less than three months. In arrangements where we have multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price. We generally determine standalone selling prices based on the prices charged to customers. If the performance obligation has not been sold separately, we estimate the standalone selling price by taking into consideration of the pricing for advertising areas of our platform with a similar advertisement with similar formats and quoted prices from competitors as well as other market conditions. The price allocated to each performance obligation is recognized as revenue over the advertisement display period, which is usually within three months.

We also enter into performance-based advertising arrangements with customers. For cost per mile or cost per thousand impressions advertising arrangements with customers, we recognize revenues based on the number of times that the advertisement has been displayed; and for cost per action advertising arrangements with customers, including Youdao online marketing services, we recognize revenues based on the number of actions completed through the advertisements, e.g., when users click on links.

Certain customers may receive volume rebates, which are accounted for as variable consideration. We estimate annual expected revenue volume with reference to their historical results and reduce revenues recognized.

We recognize revenue from providing advertising service in exchange for non-cash consideration, usually advertising services, promotional benefits, content, consulting services and software provided by counterparties, at the fair value of the non-cash consideration measured as of contract inception date. If we are not able to reliably determine the fair value of noncash consideration, the value of the noncash consideration received is measured indirectly by reference to the standalone selling price of advertising services provided by us.

### *E-commerce*

Our e-commerce revenue is primarily from our private label e-commerce platform Yanxuan. We are the principal for the online direct sales, as we control the inventory before the goods are transferred to customers. We have the primary responsibility for fulfilling the contracts, bear the inventory risk, and have sole discretion in establishing the prices. E-commerce revenues from online direct sales are recognized when control of the goods is transferred to the customer, which generally occurs upon delivery to the customer. We also provide discount coupons to our customers for use in purchases on the Yanxuan platform, which are treated as a reduction of revenue when the related transaction is recognized.

Return allowances, which reduce revenue and cost of sales, are estimated using historical experience. Liabilities for return allowances and rights to recover products from customers associated with our liabilities are recorded as “Accrued liabilities and other payables” and “Inventories, net,” respectively, on our consolidated balance sheets.

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## FINANCIAL INFORMATION

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### *Fee-based premium services*

Fee-based premium services revenues, mostly operated on either consumption-basis or a monthly subscription basis, are derived principally from providing premium live streaming services, online music services, online reading, e-mail and other innovative services. Prepaid subscription fees collected from customers are deferred and are recognized as revenue on a straight-line basis by us over the subscription period, during which customers can access the premium online services provided by us. Fees collected from customer to be consumed to purchase online services are recognized as revenue when related services are rendered.

We generate revenue from the operation of its live streaming platforms whereby users can enjoy live performances provided by the hosts and interact with the hosts. Most of the hosts host the performance on their own. We create and sell virtual items to users so that the users present them simultaneously to hosts to show their support. The virtual items sold by us comprise of either (i) consumable items or (ii) time-based item, such as privilege titles etc. Under the arrangements with the hosts, we share with them a portion of the revenues derived from the sales of virtual items. Revenues derived from the sale of virtual items are recorded on a gross basis as we act as the principal to fulfill all obligations related to the sale of virtual items. Accordingly, revenue is recognized when the virtual item is delivered and consumed if the virtual item is a consumable item or, in the case of time-based virtual item, recognized ratably over the period each virtual item is made available to the user.

### *Practical expedients*

We have used the following practical expedients as allowed under ASC 606:

- (a) The effects of a significant financing component are not taken into account for contracts if we expect, at contract inception, that the period between when we transfer a promised good or service to the customer and when the customer pays for that good or service will be one year or less.
- (b) We apply the portfolio approach in determining the commencement date of consumption of permanent virtual items and the estimated average playing period of paying players for our PC games and mobile games for the recognition of online game revenue given that the effect of applying a portfolio approach to a group game players' behaviors does not differ materially from considering each one of them individually.
- (c) We elect to expense the costs to obtain a contract as incurred when the expected amortization period is one year or less.

### *Contract balances*

Timing of revenue recognition may differ from the timing of invoicing to customers. Accounts receivables represent amounts invoiced and revenue recognized prior to invoicing, when we have satisfied our performance obligations and have the unconditional right to payment. We closely monitor the collection of our accounts receivables and record a reserve for doubtful accounts against aged accounts and for specifically identified non-recoverable amounts. If the economic situation and the financial condition of the customer deteriorates resulting in an impairment of the customer's ability to make payments, additional allowances might be required. Accounts receivables balances are written off when they are determined to be uncollectible.



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## FINANCIAL INFORMATION

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### Investments

#### *Short-Term Investments*

Short-term investments include investments in financial instruments with a variable interest rate indexed to performance of underlying assets and investments that we intend, and have the ability, to hold to maturity.

In accordance with ASC 825, for investments in financial instruments with a variable interest rate indexed to performance of underlying assets, we elected the fair value method at the date of initial recognition and carried these investments at fair value. Changes in the fair value are reflected in the consolidated statements of operations and comprehensive income as other income/(expense). Fair value is estimated based on quoted prices of similar products provided by banks at the end of each period. We classify the valuation techniques that use these inputs as Level 2 of fair value measurements.

#### *Long-Term Investments*

Long-term investments are comprised of equity investments in publicly traded companies, privately-held companies and limited partnerships.

Equity investments in publicly traded companies are reported at fair value. Prior to January 1, 2018, they were classified as available-for-sale equity securities under long-term investments, with unrealized gains or losses, if any, recorded in accumulated other comprehensive income/(loss) in shareholders' equity. The treatment of a decline in the fair value of an individual security is based on whether the decline is other-than-temporary. We assess available-for-sale equity securities for other-than-temporary impairment by considering factors including, but not limited to, our ability and intent to hold the individual security, severity of the impairment, expected duration of the impairment and forecasted recovery of fair value. If we determine a decline in fair value is other-than-temporary, the cost basis of the individual security is then written down to fair value as a new cost basis and the amount of the write-down is accounted for as a realized loss charged to the consolidated statements of comprehensive income. The fair value of the investment would then become the new cost basis of the investment and is not adjusted for subsequent recoveries in fair value. Starting January 1, 2018, upon the adoption of ASU 2016-01, unrealized gains and losses during the year of 2018 are recognized in other income/(expense).

Prior to January 1, 2018, for investments in common stock or in-substance common stocks issued by privately-held companies over which we did not have significant influence, and investments in privately-held companies' equity securities that are not common stock or in-substance common stocks, as these securities do not have readily determinable fair value, we carried such investments at cost and only adjusted for other-than-temporary declines in fair value and distributions of earnings that exceeded our share of earnings since our investment. Starting January 1, 2018, upon the adoption of ASU 2016-01, we have elected to measure these investments in equity securities without readily determinable fair value at cost, less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the same or a similar investment in the same issuer (referred to as the measurement alternative). All gains and losses on these equity securities, realized and unrealized, are recognized in other income/(expense), net.

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## **FINANCIAL INFORMATION**

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Investments in common stock or in-substance common stock of investees and limited partnership investments in which we are in a position to exercise significant influence by participating in, but not controlling or jointly controlling, the financial and operating policies are accounted for using the equity method.

Management regularly evaluates the impairment of the investments in privately-held companies without readily determinable fair value and equity method investments at each balance sheet date, or more frequently if events or circumstances indicate that the carrying amount may not be recoverable. For investments without readily determinable fair values, management performs a qualitative assessment of the fair value of the equity interest in comparison to its carrying amount to determine if there is an indication of potential impairment. If such indication exists, management estimates the fair value of the investment and records an impairment in the consolidated statements of comprehensive income to the extent the carrying amount exceeds the fair value. Significant judgments management applies in the impairment assessment for these equity investments include: (i) the determination as to whether any impairment indicators exist during the year; (ii) the selection of valuation methods; (iii) the determination of significant assumptions used to value the equity investments, including selection of comparable companies and multiples, timing and probabilities of different scenarios, estimated volatility rate, risk-free rate and discount for lack of marketability; and (iv) judgments as to whether a decline in value of equity method investments was other than temporary. For equity method investments, management considers an investment impaired when events or circumstances suggest the carrying amount may not be recoverable and recognizes any impairment charge in the consolidated statements of comprehensive income for a decline in value that is determined to be other than temporary.

### **RECENTLY ISSUED AND ADOPTED ACCOUNTING POLICIES**

Please refer to Note 2(z) to the Accountant's Report in Appendix IA and Note 2(e) to the Unaudited Condensed Interim Financial Information in Appendix IB.

### **DIVIDEND POLICY**

In May 2014, our board of directors approved a quarterly dividend policy commencing in 2014. Under this policy, quarterly dividends were set at an amount equivalent to approximately 25% of our anticipated net income after tax in each fiscal quarter. In the second quarter of 2019, our board of directors determined that quarterly dividends will be set at an amount equivalent to approximately 20%-30% of our anticipated net income after tax in each fiscal quarter. The determination to make dividend distributions and the amount of such distributions in any particular quarter will be made at the discretion of our board of directors and will be based upon our operations and earnings, cash flow, financial condition and other relevant factors. Our board of directors declared dividends on our ordinary shares which were equivalent to US\$0.69, US\$1.04, US\$4.14 and US\$1.02 per ADS for the first, second, third and fourth quarters of 2019, respectively. Our board of directors also approved an additional special dividend equivalent to US\$3.45 per ADS in the third quarter of 2019. All dividends declared in 2019 have been paid. In May 2020, our board of directors approved the Q1 Dividend, and we expect to make dividend payments of approximately US\$158 million in aggregate on June 23, 2020 to shareholders of record as of the close of business on June 12, 2020.

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## FINANCIAL INFORMATION

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Prior to June 11, 2020 (U.S. Eastern Time), the price of our ADSs traded on Nasdaq reflects the entitlement of such ADS holders to receive the Q1 Dividend. June 11, 2020 (U.S. Eastern Time) is the first day of trading when the buyers of our ADSs are no longer entitled to the Q1 Dividend, because trades executed on June 11, 2020 will settle the day after the Record Date of the Q1 Dividend, making it too late for the buyers to receive the dividend. Therefore, the price of our ADSs will be adjusted down on June 11, 2020 to reflect the ex-dividend nature of ADSs bought on or after such date.

After our listing on the Hong Kong Stock Exchange on June 11, 2020, our Shares will immediately begin to trade *ex-dividend*. If you purchase our Shares through the open market, you will not be entitled to receive the Q1 Dividend. The trading price of our Shares immediately after our listing on the Hong Kong Stock Exchange on June 11, 2020 may be lower than the comparable closing price of our ADSs on June 10, 2020. However, you should not interpret such differential as a discount on the price of our Shares offered to investors. Rather such discrepancy is, at least in part, the result of the different entitlement rights with respect to the Q1 Dividend.

We are a holding company incorporated in the Cayman Islands, and our ability to pay dividends to our shareholders depends upon dividends, loans or advances that we receive from our subsidiaries and VIEs. Please refer to “Risk Factors — Risks related to our corporate structure — Our corporate structure may restrict our ability to receive dividends from, and transfer funds to, our PRC subsidiaries and VIEs, which could restrict our ability to act in response to changing market conditions and reallocate funds internally in a timely manner.”

Holders of our ADSs will be entitled to receive dividends, if any, subject to the terms of the deposit agreement (including the fees and expenses payable thereunder), to the same extent as the holders of our ordinary shares. Cash dividends will be paid to the depository in U.S. dollars, which will distribute them to the holders of ADSs according to the terms of the deposit agreement. Other distributions, if any, will be paid by the depository to the holders of ADSs in any means it deems legal, fair and practical.

### **NO MATERIAL ADVERSE CHANGE**

After due and careful consideration, our directors confirm that, up to the date of this document, there has not been any material adverse change in our financial or trading position or prospects since December 31, 2019, and there is no event since December 31, 2019 which would materially affect the information shown in the Accountant’s Report in Appendix IA.

### **LISTING EXPENSES**

We expect to incur listing expenses of up to approximately RMB299.6 million (assuming that the Global Offering is conducted at the indicative offer price per Offer Share of HK\$126.00 for both Hong Kong Public Offering and International Offering and the Over-allotment Option is not exercised). We expect to recognize RMB9.8 million as general and administrative expenses in the fiscal year ending December 31, 2020 and RMB289.8 million as a deduction in equity directly.

## FINANCIAL INFORMATION

### UNAUDITED PRO FORMA ADJUSTED NET TANGIBLE ASSETS

The following unaudited pro forma adjusted net tangible assets prepared in accordance with Rule 4.29 of the Hong Kong Listing Rules are set out below for the purpose of illustrating the effect of the Global Offering on the consolidated net tangible assets attributable to the ordinary shareholders of the Company as at March 31, 2020 as if the Global Offering had taken place on that date.

The unaudited pro forma adjusted net tangible assets has been prepared for illustrative purposes only and because of its hypothetical nature, it may not give a true picture of the consolidated net tangible assets of the Company, had the Global Offering been completed as of March 31, 2020 or at any future dates. It is prepared based on the consolidated net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020 as derived from the Unaudited Condensed Interim Financial Information, the text of which is set out in Appendix IB to this prospectus, and adjusted as described below.

	Unaudited consolidated net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020		Unaudited pro forma adjusted net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020		Unaudited pro forma adjusted net tangible assets per Share	Unaudited pro forma adjusted net tangible assets per ADS	Unaudited pro forma adjusted net tangible assets per Share	Unaudited pro forma adjusted net tangible assets per ADS
	Estimated net proceeds from the Global Offering							
	(in thousands of RMB)	(in thousands of RMB)	(in thousands of RMB)	RMB	RMB	HK\$	HK\$	
	(Note 1)	(Note 2)		(Note 3)	(Note 4)	(Note 5)	(Note 5)	
Based on Maximum Public Offer Price of HK\$126.00 per Offer Share	62,333,728	19,466,053	81,799,781	23.85	596.31	26.07	651.85	

Notes:

- (1) The unaudited consolidated net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020 is calculated based on the unaudited consolidated net assets attributable to ordinary shareholders of the Company as of March 31, 2020 of RMB62,597,346,000 with adjustment for intangible assets attributable to the ordinary shareholders of the Company of RMB263,618,000.
- (2) The estimated net proceeds from the Global Offering is based on the Maximum Public Offer price of HK\$126.00 per Share, after deduction of the estimated underwriting fees and other related expenses payable by the Company subsequent to March 31, 2020 and without taking into account any allotment and issuance of Shares upon exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time, and any issuance or repurchase and cancellation of Shares and/or ADSs by the Company.

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## FINANCIAL INFORMATION

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- (3) The unaudited pro forma adjusted net tangible assets per Share is arrived at after the adjustments referred to in the preceding paragraphs and on the basis that 3,429,395,456 Shares were in issue assuming that the Global Offering had been completed on March 31, 2020 without taking into account any allotment and issuance of Shares upon exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time, and any issuance or repurchase and cancellation of Shares and/or ADSs by the Company after the Latest Practicable Date.
- (4) The unaudited pro forma adjusted net tangible assets per ADS is arrived at after the adjustments referred to in the preceding paragraphs and on the basis that one ADS represent twenty-five Shares.
- (5) For the purpose of this unaudited pro forma adjusted net tangible assets, the balances stated in Renminbi are converted into Hong Kong dollars at the rate of RMB1.000 to HK\$1.0931. No representation is made that Renminbi amounts have been, could have been or may be converted into Hong Kong dollars, or vice versa, at that rate.
- (6) The unaudited pro forma adjusted net tangible assets does not take into account the dividend of US\$1.16 per ADS for the first quarter of 2020, which is approved in May 2020 and expected to be paid on June 23, 2020 to shareholders of record as of the close of business on June 12, 2020.
- (7) No adjustment has been made to reflect any trading result or other transactions of the Company entered into subsequent to March 31, 2020.

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## RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

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### CONTROLLING SHAREHOLDERS

Immediately following the Global Offering, Shining Globe International Limited will hold 1,456,000,000 Shares, representing approximately 42.5% of our total issued share capital (assuming the Over-allotment Option is not exercised and no additional Shares are issued under the RSU Plans), and will be our controlling shareholder.

Shining Globe International Limited is wholly-owned by Shining Globe Holding Limited, which is in turn wholly-owned by Shining Globe Trust (the “**Trust**”), for which TMF (Cayman) Ltd. acts as the trustee. William Lei Ding, our founder, chief executive officer and a director, is the sole director of Shining Globe International Limited and the settlor of the Trust, retaining the investment and dispositive powers with respect to the assets of the Trust, with the beneficiaries of the Trust being William Lei Ding and his family; as such, Shining Globe International Limited, together with the entities and person that control it, will be our controlling shareholders.

### INDEPENDENCE FROM CONTROLLING SHAREHOLDERS

Having considered the following factors, our directors are satisfied that we are capable of carrying on our business independently of our controlling shareholders and their close associates after the Listing.

#### Management independence

Our business is managed and conducted by our board and senior management. Our board consists of seven directors, of whom six are independent directors unrelated to our controlling shareholders. For more information, please see “Directors and Senior Management.”

Our directors consider that our board and senior management will function independently of our controlling shareholders because:

- (a) each director is aware of his/her fiduciary duties as a director, which require, among other things, that he/she acts for the benefit, and in the interests, of our Company and does not allow any conflict between his/her duties as a director and his/her personal interests;
- (b) our daily management and operations are carried out by our senior management, all of whom have substantial experience in our Group’s business and/or the industry in which we operate, and will be able to make decisions that are in our best interest;
- (c) we have six independent directors and certain matters of our Company will always be referred to them for review and/or approval;
- (d) in the event that there is a potential conflict of interest arising out of any transaction to be entered into between our Group and our directors or their respective associates, the interested director(s) is required to declare the nature of his/her interest before voting at the relevant meeting(s) in respect of that transaction; and
- (e) we have adopted a series of corporate governance measures to manage conflicts of interest, if any, between our Group and our controlling shareholders that would support our independent management; see “— Corporate Governance Measures.”

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## **RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS**

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### **Operational independence**

Our Group is not operationally dependent on our controlling shareholders. Our Group (through our subsidiaries) holds all material licenses and owns all relevant intellectual properties and research and development facilities necessary to carry on our business. We have sufficient capital, facilities, equipment and employees to operate our business independently of our controlling shareholders. Our access to, and relationship with, our customers and suppliers are independent of our controlling shareholders, and we have an independent management team that operates our business.

### **Financial Independence**

We have independent internal control and accounting systems. We also have an independent finance department responsible for discharging the treasury function, and an audit committee comprising solely of independent directors to oversee our accounting and financial reporting processes. We are capable of obtaining financing from third parties, if necessary, without reliance on our controlling shareholders.

No loans or guarantees provided by, or granted to, our controlling shareholders or their respective associates will be outstanding as of the Latest Practicable Date.

Based on the above, our directors believe that our board as a whole and together with our senior management team are able to manage, operate and carry on our business independently of, and do not place undue reliance on, our controlling shareholders and their respective close associates.

### **DISCLOSURE UNDER RULE 8.10 OF THE HONG KONG LISTING RULES**

Our controlling shareholders and/or our directors may, from time to time, make minority investments or hold non-executive board positions in entities that operate in, or have subsidiaries that operate in, the broader industries in which all of our business segments also operate. As our controlling shareholders and/or directors have no executive or shareholding control over any of these entities, and these entities have separate businesses with separate management and shareholder bases that control their entities, our controlling shareholders will not inject any of their interested entities into our Group; and to the extent our directors hold non-executive board positions or make minority investments in these entities, we believe that this strengthens the experience and diversity of our directors, as a group, and signifies their passion for the industries in which we operate.

Our controlling shareholders and directors confirm that as of the Latest Practicable Date, they did not have any interest in a business, apart from the business of our Group, which competes or is likely to compete, directly or indirectly, with our business that would require disclosure under Rule 8.10 of the Hong Kong Listing Rules.

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## RELATIONSHIP WITH OUR CONTROLLING SHAREHOLDERS

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### CORPORATE GOVERNANCE MEASURES

Our directors recognize the importance of good corporate governance in protecting our shareholders' interests. We have adopted the following measures to ensure good corporate governance standards and to avoid potential conflicts of interest between our Group and our controlling shareholders:

- (a) where our directors reasonably request the advice of independent professionals, such as financial advisors, the appointment of such independent professionals will be made at our Company's expense;
- (b) we have appointed Credit Suisse (Hong Kong) Limited as our compliance advisor to provide advice and guidance to us in respect of compliance with the applicable Laws, as well as the Hong Kong Listing Rules, including various requirements relating to corporate governance; and
- (c) we have established our audit committee, compensation committee, nominating and corporate governance committee with written terms of reference in compliance with the rules of the Nasdaq. All of the members of our audit committee, including the chairman, are independent directors.

Based on the above, our directors are satisfied that we have sufficient corporate governance measures in place to manage conflicts of interest that may arise between our Group and our controlling shareholders, and to protect our minority shareholders' interests after the Listing.



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## DIRECTORS AND SENIOR MANAGEMENT

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### OVERVIEW

The following table sets out certain information in respect of our directors and senior management:

Name	Age	Position(s)	Date of appointment as director or senior manager	Year of joining our Group <sup>(4)</sup>
William Lei Ding	48	Director, and chief executive officer	July 6, 1999	1997
Charles Zhaoxuan Yang	36	Chief financial officer	June 30, 2017	2017
Alice Cheng <sup>(2)</sup>	58	Independent director	June 1, 2007	N/A
Denny Lee <sup>(4)</sup>	52	Independent director	April 1, 2002	2001
Joseph Tong <sup>(2)(3)</sup>	57	Independent director	March 25, 2003	N/A
Lun Feng	60	Independent director	July 28, 2005	N/A
Michael Leung <sup>(2)</sup>	66	Independent director	July 11, 2002	N/A
Michael Tong <sup>(4)</sup>	49	Independent director	December 1, 1999	2003

Notes:

- (1) Except for William Lei Ding and Charles Zhaoxuan Yang, the remaining persons are all independent directors under applicable U.S. regulations and independent non-executive directors for the purpose of the Hong Kong Listing Rules. There are no family relationships among any of the directors or executive officers of our company.
- (2) Alice Cheng, Joseph Tong and Michael Leung are members of the audit, compensation and nominating committees.
- (3) Joseph Tong is currently designated as the “audit committee financial expert” under the applicable rules of the SEC and he also has the appropriate professional accounting or financial management experience for the purpose of Rule 3.10(2) of the Hong Kong Listing Rules.
- (4) Being the year in which the director or senior manager joined our Group as an executive, officer or employee. Denny Lee and Michael Tong no longer hold positions within our Group other than their directorships on our board.

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## DIRECTORS AND SENIOR MANAGEMENT

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### BIOGRAPHIES

#### Our directors

Our board consists of seven directors, including six independent directors. See “— Board Practices” for the functions and duties of our board. Our board is responsible for exercising other powers, functions and duties in accordance with the Articles of Association, and all applicable laws, including the Hong Kong Listing Rules.

*Lei Ding*, also known as William Lei Ding, our founder, has served as our director since July 1999 and as our chief executive officer since November 2005. From March 2001 until November 2005, Mr. Ding served as our chief architect, and from June 2001 until September 2001, he served as our acting chief executive officer and acting chief operating officer. From July 1999 until March 2001, Mr. Ding served as co-chief technology officer, and from July 1999 until April 2000, he also served as our interim chief executive officer. Mr. Ding established Guangzhou NetEase and Shanghai EaseNet, our affiliates, in June 1997 and January 2008. Mr. Ding holds a Bachelor of Science degree in Communication Technology from the University of Electronic Science and Technology of China.

*Alice Yu-Fen Cheng*, also known as Alice Cheng, has served as our director since June 2007. Ms. Cheng has been the chief financial officer of BBK Electronics Corp., Ltd., a PRC-based manufacturer of audio-visual equipment, since May 2005. From 2010 to 2013, Ms. Cheng served as a supervisor of Wistron Information Technology Corporation in Taiwan, an information technology company with operations in Taiwan, China and Japan. From 2002 to 2005, Ms. Cheng served as financial controller of Wistron Corporation, a Taiwanese original design manufacturer of notebook computers and other electronics. Prior to that, Ms. Cheng held various positions with Acer Inc., a Taiwanese computer manufacturer, culminating in the position of financial controller. Ms. Cheng received a Bachelor of Accounting from the Chinese Culture University in Taiwan in 1983 and a Masters of Business Administration from the Thunderbird School of Global Management in Arizona in 2003; Ms. Cheng is also licensed as a certified public accountant in Taiwan and the PRC.

*Denny Ting Bun Lee*, also known as Denny Lee, has served as our director since April 2002. Mr. Lee previously served as our chief financial officer from April 2002 until June 2007 and our financial controller from November 2001 until April 2002. Prior to joining our company, Mr. Lee worked in the Hong Kong office of KPMG for more than ten years. Mr. Lee graduated with a Professional Diploma in Accounting from the Hong Kong Polytechnic University in November 1990, and is a member of the Hong Kong Institute of Certified Public Accountants, and the Association of Chartered Certified Accountants. Mr. Lee currently serves as the chairman of the audit committees and an independent non-executive director on the boards of New Oriental Education & Technology Group Inc., (stock code: EDU), Concord Medical Services Holdings Limited (stock code: CCM), NIO Inc. (stock code: NIO), and Jianpu Technology Inc. (stock code: JT), which are listed on the New York Stock Exchange, as well as China Metal Resources Utilization Limited, which is listed on the Hong Kong Stock Exchange (stock code: 1636). See also “Risk Factors – Risks related to our Shares, the ADSs, the Listing and the Global Offering – The trading price of ADSs has been and is likely to continue to be, and the trading price of our Shares can be, volatile, which could result in substantial losses to holders of our Shares and/or the ADSs” for further information on certain pending litigation involving some of the U.S. listed companies of which Mr. Lee is an independent director.

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## DIRECTORS AND SENIOR MANAGEMENT

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*Joseph Tze Kay Tong*, also known as Joseph Tong, has served as our director since March 2003. Mr. Tong has been a director of Parworld Investment Management Limited, which provides financial and investment advisory services, since January 2003. From December 2002 until April 2004, Mr. Tong was engaged in establishing offices and operations in Hong Kong and China, setting up accounting and internal control policies and overseeing the overall operations for TLM Apparel Co., Ltd., a garment trading company operating in Hong Kong and China which he co-founded. Prior to that, from September 2000 to September 2002, Mr. Tong was the e-commerce director of the Asia Region for Universal Music Limited where he was responsible for forming e-business development strategies and overseeing new promotional opportunities. Mr. Tong received a Bachelor of Social Science degree with honors in Accounting and Statistics from the University of Southampton, England. He is a member of the American Institute of Certified Public Accountants, an associate member of the Hong Kong Institute of Certified Public Accountants.

*Lun Feng* has served as our director since July 2005. Mr. Feng served as the chairman and/or director of Vantone Holdings Co., Ltd., a private real estate investment company in China, from 1993 to 2017. Mr. Feng currently is the executive director of Beijing Sifang Yufeng Investment Co., Ltd, an investment firm in China. Mr. Feng serves as an independent director on the boards of Youzu Interactive Co., Ltd. (stock code: 002174), which is listed on the Shenzhen Stock Exchange, as well as Bank of Xi'An Co., Ltd. (stock code: 600928) and Shanghai Xinnanyang Only Education & Technology Co., Ltd. (stock code: 600661), both of which are listed on the Shanghai Stock Exchange. Mr. Feng was an independent non-executive director on the board of China Everbright Bank Company Limited (stock code: 6818), a company dual listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange, until July 2019; Mr. Feng continues to perform his duties on the board of this listed company until the qualifications of the succeeding independent non-executive director are approved by the China Banking and Insurance Regulatory Commission. Mr. Feng was also an independent non-executive director of Haitong Securities Co., Ltd. (stock code: 6837) from December 2014 to June 2019. Mr. Feng has a *Juris Doctor* from the Chinese Academy of Social Sciences, a Masters of Law degree from the Party School of the Chinese Communist Party, and a Bachelor of Arts in Economics from Northwest University.

*Michael Man Kit Leung*, also known as Michael Leung, has served as our director since July 2002. Mr. Leung is currently a responsible officer of Grand Moore Capital Limited since September 2019. Mr. Leung was appointed executive director of Unitas Holdings Limited (stock code: 8020) from September 2011 to November 2018, and served as a responsible officer from May 2011 to November 2018 of Chanceton Capital Partners Limited, a subsidiary of Unitas Holdings Limited. Previously, Mr. Leung was a director of Emerging Markets Partnership (Hong Kong) Limited, the principal adviser to the AIG Infrastructure Fund L.P, in 1999. Mr. Leung also held senior positions in the Hong Kong Branch of the Swiss Bank Corporation, SG Securities (HK) Limited (formerly known as Crosby Securities (Hong Kong) Limited) and Peregrine Capital Limited. Mr. Leung currently is an independent non-executive director and chairman of the audit committee for Orange Sky Golden Harvest Entertainment (Holdings) Limited (stock code: 1132) and Luye Pharma Group Ltd. (stock code: 2186), all of which are companies listed on the Hong Kong Stock Exchange. Mr. Leung also serves as an independent non-executive director on the board of China Ting Group Holdings Limited (stock code: 3398), a company listed on the Hong Kong Stock Exchange. Mr. Leung was previously an independent non-executive director and chairman of the audit committee of China Electronics Optics Valley Union Holding Company Limited (stock code: 0798) from March 2014 to May 2020 and China Huiyuan Juice Group Limited (stock code: 1886) from 2012 to 2019, both of which are companies listed on the Hong Kong Stock Exchange. Mr. Leung received a Bachelor's Degree in Social Sciences from the University of Hong Kong in October 1977 with a major in Accounting, Management and Statistics.

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## DIRECTORS AND SENIOR MANAGEMENT

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*Michael Sui Bau Tong*, also known as Michael Tong, has served as our director since December 1999. Mr. Tong joined our company as an executive from 2003 to 2009 and served as our co-chief operating officer from 2004 to 2009. Mr. Tong is an independent non-executive director and chairman of the audit committee of Koolearn Technology Holding Limited (stock code: 1797), a company listed on the Hong Kong Stock Exchange. Mr. Tong graduated with a Bachelor of Business Administration from the University of Wisconsin, Madison with a major in Accounting and an extra concentration in Computer Science in 1993.

Save as disclosed in this document, and in “Risk Factors — Risks related to our Shares, the ADSs, the Listing and the Global Offering — The trading price of ADSs has been and is likely to continue to be, and the trading price of our Shares can be, volatile, which could result in substantial losses to holders of our Shares and/or the ADSs,” there is no other matter that is material and required to be disclosed pursuant to Rule 13.51(2) of the Hong Kong Listing Rules.

### **Senior management (aside from our directors)**

*Charles Zhaoxuan Yang* has served as our chief financial officer since June 2017. Prior to joining us, Mr. Yang was an executive director of the China technology, media and telecommunications, and corporate finance team at J.P. Morgan Securities (Asia Pacific) Limited and based in Hong Kong for almost a decade. Mr. Yang currently serves as an independent director on the board of So-Young International Inc. (stock code: SY), a company listed on the Nasdaq. Mr. Yang holds a master’s degree in Business Administration from the University of Hong Kong, and a bachelor’s degree from Wesleyan University with majors in Economics and Mathematics. Mr. Yang is a Certified Public Accountant licensed in the State of Michigan.

## **COMPENSATION**

### **Compensation of our directors and senior managers**

For the three fiscal years ended December 31, 2019, we paid an aggregate amount of RMB8.2 million, RMB7.2 million and RMB17.6 million, respectively, to our directors and senior managers as a group, and granted restricted share unit awards under the 2009 RSU Plan to each of our independent directors, representing less than 1% of our total outstanding Shares per annum in settlement of the awards upon vesting.

For each of the three fiscal years ended December 31, 2019, we also granted RSU awards under our 2009 RSU Plan to our chief financial officer, representing less than 1% of our total outstanding Shares per annum in settlement of the awards upon vesting. In addition, certain of our subsidiaries, including Youdao, granted options pursuant to their respective share incentive plans to our chief financial officer, which are exercisable for ordinary shares of those subsidiaries representing less than 1% of their total outstanding shares; see “— Share incentive plans of our subsidiaries.”

For equity-based grants to our directors and executive officers, see “— Our share incentive plans.”

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## DIRECTORS AND SENIOR MANAGEMENT

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### **Director indemnification agreements**

All of our current directors have entered into indemnification agreements in which we agree to indemnify, to the fullest extent allowed by Cayman Islands law, our charter documents or other applicable law, those directors from any liability or expenses, unless the liability or expense arises from the director's own willful negligence or willful default. The indemnification agreements also specify the procedures to be followed with respect to indemnification.

We do not have service contracts with any of our directors that provide for benefits upon termination.

### **Employment agreements**

We have entered into employment and related agreements with each of our executive officers. These agreements include: (i) a covenant that prohibits the executive officer from engaging in any activities that compete with our business during and for one to two years after their employment with us; (ii) a requirement that executive officers assign all rights in company-related inventions to us and to keep our proprietary information confidential; and (iii) provisions for severance payments in the event the executive officer is terminated without cause or resigns for good reason.

### **Our share incentive plans**

We have adopted two share incentive plans: (a) the 2009 RSU Plan that was adopted in November 2009 and expired in November 2019; and (b) the 2019 RSU Plan that was adopted in October 2019 as a replacement of the 2009 RSU Plan and has a ten-year term, expiring in October 2029.

The purpose of our RSU Plans is to attract and retain the best available personnel, to provide additional incentive to employees, directors and consultants and to promote the success of our business. The RSU Plans provide for the granting of incentive awards of restricted share units, which may or may not be granted with dividend equivalent rights. Participants under the RSU Plans will not receive any account status reports.

See Note 20 in the Accountant's Report at Appendix IA for more information on grants.

We summarize the other key terms of our RSU Plans below:

#### ***Plan administration***

Our board has designated our compensation committee to administer the RSU Plans, and it may designate one or more of our officers to exercise its authority from time to time.

#### ***Securities subject to the RSU Plans***

Under the 2009 RSU Plan, the maximum aggregate number of Shares issuable pursuant to all awards under the plan is 323,694,050 Shares. The 2009 RSU Plan has expired and no new awards may be granted under this plan.

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## DIRECTORS AND SENIOR MANAGEMENT

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Under the 2019 RSU Plan, the maximum aggregate number of Shares issuable pursuant to all awards under the plan is 322,458,300 Shares. These Shares may, in whole or in part, be authorized but unissued shares or shares that will have been or may be reacquired by us. It is anticipated that all future awards to our employees, directors and consultants will be granted pursuant to the 2019 RSU Plan or any other future plan adopted by our board and, if appropriate, our shareholders.

The 2009 RSU Plan provides that in the event of certain corporate transactions, including specified types of mergers and acquisition transactions, each outstanding award granted under the 2009 RSU Plan shall automatically become fully vested and be released from any restrictions on transfer and repurchase or forfeiture rights, immediately prior to the specified effective date of such corporate transaction, unless the award is assumed by the successor company or its parent company in connection with the corporate transaction. Upon consummation of such corporate transactions, each outstanding award shall be terminated unless the award is assumed by the successor company or its parent company in connection with the applicable corporate transaction. Our board will determine whether an award was assumed in the manner contemplated by the 2009 RSU Plan.

The 2019 RSU Plan provides that in the event of certain corporate transactions, including specified types of mergers and acquisition transactions, the administrator may: (i) accelerate the vesting, in whole or in part, of any award; (ii) purchase any award for an amount of cash or ordinary shares of our company equal to the value that could have been attained upon the exercise of the award or the realization of the plan participant's rights had the award been currently exercisable or payable or fully vested; or (iii) provide for the assumption, conversion or replacement of any award by the successor corporation, or a parent or subsidiary of the successor corporation, with other rights or property selected by the plan administrator in its sole discretion, or the assumption or substitution of the award by the successor or surviving corporation, or a parent or subsidiary of the surviving or successor corporation, with appropriate adjustments as to the number and kind of shares and prices as the plan administrator deems, in its sole discretion, reasonable, equitable and appropriate.

### *Eligibility*

Awards can be issued to participants of the RSU Plans, which include employees, directors or consultants of us, our subsidiaries, our VIEs and certain other related entities.

### *Awards under the RSU Plans*

Awards under the RSU Plans are evidenced by an award agreement that contains, among other things, such provisions concerning how the restricted share unit may be settled upon vesting and forfeiture upon termination of employment or the consulting arrangement (by reason of death, disability, retirement or otherwise) as have been determined by our board.

Restricted share units do not represent any actual ownership interest in us. The units granted correspond in number and value to a specified number of our Shares. No actual shares are issued. Instead, the units are tracked in a bookkeeping account. The units may be subject to forfeiture provisions to replicate the treatment of restricted shares. The units can ultimately be paid in cash or Shares, as our board determines and as set forth in the applicable award agreement. Dividend equivalents may be paid on the units. A dividend equivalent right entitles the participant to receive cash compensation measured by the dividends paid with respect to our Shares. The dividend equivalents may be paid out at the time of the dividend or may be credited to the participant's account and converted to additional units.

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## DIRECTORS AND SENIOR MANAGEMENT

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### *Conditions of awards*

Our board, either acting directly or through our compensation committee or one or more of our officers, is authorized to determine the provisions, terms and conditions of each award, including the award vesting schedule, repurchase provisions, rights of first refusal, forfeiture provisions, settlement of the award, payment contingencies and satisfaction of any performance criteria established by our board. Partial achievement of the specified criteria may result in a payment or vesting corresponding to the degree of achievement as specified in the award agreement.

### *Amendment; termination*

Under the RSU Plans, our board may at any time terminate, suspend, or amend the RSU Plans in any respect, except that no termination, suspension or amendment will be effective without shareholder approval if such approval is required to comply with any law, regulation or stock exchange rule and no such change may adversely affect any award previously granted without the written consent of the recipient.

### *Non-transferability of awards*

Under the RSU Plans, awards may not be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of, except by will or by the laws of descent and distribution and during the lifetime of the participants, to the extent and in the manner provided in the award agreement. The RSU Plans permit the designation of beneficiaries by holders of awards in the event of the participant's death. After any such transfer, the original recipient shall continue to remain subject to the withholding tax requirements described below.

### *Payment of taxes*

No Shares shall be delivered under the RSU Plans to any participant or other person until the participant or other person has made arrangements acceptable to us regarding payment of Chinese, Cayman Islands, U.S. and any other federal, state, provincial, local or other taxes required by law. Alternatively, we will withhold or collect from the participant an amount sufficient to satisfy such tax obligations.

### **Share incentive plans of our subsidiaries**

In addition, certain of our other subsidiaries have adopted their own equity incentive plans, which allow the relevant subsidiaries to grant options or other awards to certain of our employees. The options under these plans expire in five to ten years from the date of grant and either vest or have a vesting commencement date upon certain conditions being met. The awards can become 100% vested on the vesting commencement date, or vest in two, three, four or five substantially equal annual installments, with the first installment vesting on the vesting commencement date. See “Statutory and General Information — Further Information About Us — Share incentive plan of Youdao” in Appendix IV for more information on the share incentive plan of our separately listed entity, Youdao.

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## DIRECTORS AND SENIOR MANAGEMENT

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### BOARD PRACTICES

#### Nomination and terms of our directors

At each annual general meeting of our shareholders, our shareholders are asked to elect the directors nominated to serve for the ensuing year or until their successors are elected and duly qualified, or until such director's earlier death, bankruptcy, insanity, resignation or removal. We have no specific policy with respect to director attendance at our annual general meetings of Shareholders, and no director attended the annual general meeting of shareholders held on September 13, 2019.

#### Duties of our directors

Under Cayman Islands law, all of our directors owe us fiduciary duties, including a duty of loyalty, a duty to act honestly and a duty to act in good faith and in a manner they believe to be in our best interests. Our directors also have a duty to exercise the skill they actually possess and the care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to us, our directors must ensure compliance with our Articles of Association, as amended and restated from time to time. We have the right to seek damages if a duty owed by any of our directors is breached.

#### Independence of our directors

Each of our six non-executive directors has been determined by our board to be "independent" under applicable U.S. regulations and act as an "independent non-executive director" for the purpose of the Hong Kong Listing Rules; they have each given a confirmation on their "independence" to us and the Hong Kong Stock Exchange, addressing the factors set out in Rule 3.13 of the Hong Kong Listing Rules. Joseph Tong is currently designated as the "audit committee financial expert" under the applicable rules of the SEC and he also has the appropriate professional accounting or financial management experience for the purpose of Rule 3.10(2) of the Hong Kong Listing Rules.

#### Board committees

Our board has three committees, the audit committee, the compensation committee and the nominating committee. The audit, compensation and nominating committees are composed solely of non-employee directors, as defined in Rule 16b-3 under the Exchange Act and our board has determined that all the members are "independent" as defined in Rule 5605(a)(2) of the Nasdaq rules. See Note 2 to the table set out in "— Overview" for the members of our three board committees.

#### Audit committee

Our board has adopted a written audit committee charter, pursuant to which the audit committee is responsible for overseeing the accounting and financial reporting processes of our company, including the appointment, compensation and oversight of the work of our independent auditors, monitoring compliance with our accounting and financial policies and evaluating management's procedures and policies relative to the adequacy of our internal accounting controls. Joseph Tong currently acts as the "audit committee financial expert" under the applicable rules of the SEC.



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## DIRECTORS AND SENIOR MANAGEMENT

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### **Compensation committee**

Our board has adopted a written compensation committee charter, pursuant to which the compensation committee is responsible for, among other things, annually reviewing and approving our company's corporate goals and objectives relevant to the compensation of our chief executive officer, evaluating such officer's performance in light of those goals and objectives, and, either as a committee or together with the other independent directors (as directed by our board), determining and approving the chief executive officer's compensation level based on this evaluation. The committee annually reviews and makes recommendations to our board with respect to non-chief executive officer compensation, incentive compensation plans and equity based plans, administers our incentive compensation plans and equity-based plans as in effect and as adopted from time to time by our board (our board retains, however, the authority to interpret such plans), and approves any new equity compensation plan or any material change to an existing plan where shareholders' approval has not been obtained.

### **Nominating committee**

Our board has adopted a written nominating committee charter, pursuant to which the nominating committee is responsible for monitoring the size and composition of our board and considering and making recommendations to our board with respect to the nominations or elections of the directors of our company.

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## MAJOR SHAREHOLDERS

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Unless specifically noted, the following table summarizes the beneficial ownership of our Shares held as at the Latest Practicable Date by:

- (a) each of our directors and our executive officer;
- (b) our directors and our executive officer as a group; and
- (c) each person known to us to beneficially own more than 5% of our total outstanding Shares.

The calculations are based on 3,257,915,456 Shares issued as at the Latest Practicable Date.

Beneficial ownership is determined in accordance with SEC rules and regulations. In calculating the number of Shares beneficially owned by a person and the percentage of ownership held by that person, we have included Shares that the person has a right to acquire within 60 days, including through the exercise of any option, warrant or other right, the vesting of any RSUs, or the conversion of any other security; these Shares are not included when calculating the percentage of ownership held by any other person.

	<b>Number of Shares Beneficially Owned</b>	
	<b>Number</b>	<b>Percentage</b>
<b>5% shareholders</b>		
Shining Globe International Limited/ William Lei Ding <sup>(1)</sup> c/o NetEase, Inc., NetEase Building, No. 599 Wangshang Road, Binjiang District, Hangzhou, People's Republic of China 310052.....		
	1,456,000,000	44.7%
Orbis Investment Management Limited c/o Orbis House, 25 Front Street, Hamilton HM 11, Bermuda and Allan Gray Australia Pty Limited c/o Level 2, Challis House, 4 Martin Place, Sydney NSW2000, Australia.....		
	167,410,775 <sup>(2)</sup>	5.1% <sup>(2)</sup>

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## MAJOR SHAREHOLDERS

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	Number of Shares Beneficially Owned	
	Number	Percentage
<b>Our directors and executive officers</b>		
Charles Zhaoxuan Yang .....	*	*
Alice Cheng .....	*	*
Denny Lee .....	*	*
Joseph Tong .....	*	*
Lun Feng .....	*	*
Michael Leung .....	*	*
Michael Tong .....	*	*
All current directors and executive officers as a group (eight persons) <sup>(3)</sup> .....	1,456,907,000	44.7%

Notes:

\* Less than 1%.

- (1) Shining Globe International Limited is the record owner of 1,456,000,000 Shares, consisting of 1,406,000,000 Shares and 2,000,000 ADSs. Shining Globe International Limited is wholly-owned by Shining Globe Holding Limited, which is in turn wholly-owned by Shining Globe Trust (the “Trust”), for which TMF (Cayman) Ltd. acts as the trustee. William Lei Ding, our founder, chief executive officer and a director, is the sole director of Shining Globe International Limited and the settlor of the Trust, retaining the investment and dispositive powers with respect to the assets of the Trust. The beneficiaries of the Trust are William Lei Ding and his family.
- (2) Based on the number of ADSs included in the Schedule 13F dated May 15, 2020, filed with the SEC by the reporting manager of Orbis Investment Management Limited and Allan Gray Australia Pty Limited.
- (3) Shares owned by all of our current directors and executive officers as a group include Shares beneficially owned by William Lei Ding. This amount includes Shares issuable upon the vesting of RSUs held by our directors and executive officers as a group.

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## RELATED PARTY TRANSACTIONS

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We are seeking a listing on the Hong Kong Stock Exchange pursuant to Chapter 19C of the Hong Kong Listing Rules. Pursuant to Rule 19C.11 of the Hong Kong Listing Rules, Chapter 14A of the Hong Kong Listing Rules, governing connected transactions, does not apply to us. The following discussion of related party transactions has been prepared pursuant to the requirements of Form 20-F of the SEC, and is included in this document for disclosure purposes only.

### TRANSACTIONS WITH THE VARIABLE INTEREST ENTITIES

PRC laws limit foreign ownership of companies engaged in certain businesses in China, including value-added telecommunications services. Due to these restrictions, we operate our relevant business through contractual arrangements with the variable interest entities. See “History — Corporate Structure — Variable interest entity structure.”

#### VIE Agreements

Our Company and certain of our wholly owned subsidiaries have entered into a series of agreements with Guangzhou NetEase, Hangzhou Leihuo, Youdao Computer and certain other affiliated entities and the shareholders of these entities, under which we provide our computer software, mobile applications, technologies and relevant services to Guangzhou NetEase, Hangzhou Leihuo, Youdao Computer and certain other affiliated entities, and they in turn provide certain of our online games and operate the NetEase websites, our e-commerce platforms, our online advertising business, and e-mail and certain of our other fee-based premium services. We believe that the terms of each agreement are no less favorable than the terms that we could obtain from disinterested third parties and that the shareholders of Guangzhou NetEase, Hangzhou Leihuo, Youdao Computer and certain other affiliated entities will not receive material benefits from these agreements except as shareholders of our Company (also “NetEase”). The agreements with Guangzhou NetEase, Hangzhou Leihuo and Youdao Computer are described below.

#### Agreements with Guangzhou NetEase

William Lei Ding, our chief executive officer, and Xiaojun Hui, our vice president of game development, own 99.0% and 1.0% of the equity interest in Guangzhou NetEase, respectively.

***Domain name license agreement between NetEase and Guangzhou NetEase.*** Our company granted Guangzhou NetEase the right to use certain domain names in China for license fees of RMB10,000 per year. NetEase may waive this fee at any time.

***Copyright license agreement between NetEase Beijing and Guangzhou NetEase.*** NetEase Information Technology (Beijing) Co., Ltd. (“NetEase Beijing”) granted Guangzhou NetEase the right to use NetEase Beijing’s web page layout in China for a royalty of RMB10,000 per year. NetEase Beijing may waive this fee at any time.

***Trademark license agreement between NetEase Beijing and Guangzhou NetEase.*** NetEase Beijing granted Guangzhou NetEase a license to use NetEase Beijing’s registered trademarks on the NetEase websites in China for license fees of RMB10,000 per year. NetEase Beijing may waive this fee at any time.

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## RELATED PARTY TRANSACTIONS

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**Cooperative agreements.** Guangzhou NetEase has entered into cooperative agreements with each of NetEase Beijing, Boguan and NetEase Hangzhou pursuant to which such subsidiaries have agreed to provide the following services: (i) research and development of computer software (including, but not limited to, online games software) and technical support and maintenance for the operation of computer software; (ii) technical service for internet media, including, but not limited to, server maintenance and development, update and upgrade of relevant application software; and (iii) research and development of electronic publishing technology and relevant technical assistance and support. Guangzhou NetEase has agreed to pay a monthly service fee to each such subsidiary in accordance with a formula based on their respective expenses incurred. The cooperative agreements with each of NetEase Beijing, Boguan and NetEase Hangzhou were effective from September 1, November 1, and December 1, 2012, respectively, and each will continue to be effective unless any one of the two respective parties terminates such agreement by written notice.

**Online advertising agreement between Guangzhou NetEase and NetEase Advertising.** Guangzhou NetEase sells all of the banner space on the NetEase websites to Beijing NetEase Media Co., Ltd (previously named Beijing Guangyitong Advertising Co., Ltd.) (“**NetEase Advertising**”) and publishes the advertisements provided by NetEase Advertising on the banner space purchased by NetEase Advertising. NetEase Advertising pays Guangzhou NetEase RMB10,000 per year. Guangzhou NetEase may waive this fee at any time. The term of the foregoing agreement is automatically renewable for successive one-year term.

**Trademark transfer agreement between Guangzhou NetEase and NetEase Beijing.** Under this agreement, Guangzhou NetEase transferred its registered trademarks to NetEase Beijing.

**Supplemental agreement between NetEase Beijing and Guangzhou NetEase.** NetEase Beijing may not grant the license to use its domain name, copyright and trademark to any third party without Guangzhou NetEase’s consent and may not provide technical service to any third party.

**Shareholder voting rights trust agreement among NetEase Beijing and the Individual Shareholders of Guangzhou NetEase.** William Lei Ding and Xiaojun Hui agreed to irrevocably appoint NetEase Beijing to represent him to exercise all voting rights to which he is entitled as a shareholder of Guangzhou NetEase. The term of this agreement is 20 years from May 12, 2010. This agreement was amended and novated on May 1, 2014 in connection with Mr. Hui’s acquisition of his equity interest in Guangzhou NetEase from a prior shareholder and further amended and restated on November 30, 2015 in connection with the equity transfer of NetEase Advertising to William Lei Ding and Li Li.

**Agreement between NetEase Beijing and Guangzhou NetEase.** NetEase Beijing agrees to pay the operating costs of Guangzhou NetEase.

**Letter of agreement.** Each of William Lei Ding and Xiaojun Hui have agreed that any amendments to be made to the shareholder voting rights trust agreement, the equity pledge agreement (described below) and the loan agreement (described below), as well as all other agreements to which our company, NetEase Beijing and/or their respective affiliates is a party, on the one hand, and any of their VIEs and/or the shareholders of such entities, on the other hand, shall be subject to the approval by the vote of a majority of our board, excluding the vote of William Lei Ding. Messrs. Ding and Hui have also agreed that, if any amendments to the above-mentioned agreements require a vote of the shareholders of our company or Guangzhou NetEase, as applicable, both of them will vote in their capacity as direct or indirect shareholders of these companies to act based upon the instructions of our board. The term of this agreement is 20 years from May 12, 2010, and this agreement was amended and novated

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## RELATED PARTY TRANSACTIONS

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on May 1, 2014 in connection with Mr. Hui's acquisition of his equity interest in Guangzhou NetEase from a prior shareholder and further amended and restated on November 30, 2015 in connection with the equity transfer of NetEase Advertising to William Lei Ding and Li Li.

***Loan agreement and equity pledge agreement.*** Concurrent with Mr. Hui's acquisition of his equity interest in Guangzhou NetEase from a prior shareholder, Mr. Hui entered into a loan agreement and equity pledge agreement with NetEase Beijing, each dated May 1, 2014. Under the loan agreement, NetEase Beijing provided Mr. Hui with an interest-free loan in the principal amount of RMB0.2 million to Mr. Hui, which funds were used by Mr. Hui to pay the consideration to acquire such 1.0% equity interest. The loan can be repaid by transferring such 1.0% equity interest to NetEase Beijing or its designee or through such other method as NetEase Beijing shall determine. The term of the loan is 10 years from the date of the agreement and can be extended upon the mutual consent of both parties. Under the equity pledge agreement, Mr. Hui pledges his 1.0% equity interest in Guangzhou NetEase to NetEase Beijing to secure his respective obligations under the loan agreement and shareholder voting rights trust agreement. Mr. Hui agrees he shall not transfer, pledge or encumber his 1.0% equity interest without the prior written consent of NetEase Beijing. During the term of this agreement, NetEase Beijing is entitled to all dividends and other distributions made by Guangzhou NetEase. The equity pledge agreement will remain binding until Mr. Hui discharges all his obligations under the above-mentioned agreements.

### **Agreements relating to Hangzhou Leihuo**

Prior to April 18, 2019, Zhipeng Hu and Tianlei Hu, two of our employees, each owned 50.0% of the equity interest in Hangzhou Leihuo. On April 18, 2019, pursuant to a supplementary agreement of assignment, the equity interest in Hangzhou Leihuo owned by Tianlei Hu and the contractual obligations described below were assigned to Long Cheng, another employee of ours. As of the date of this document, each of Zhipeng Hu and Long Cheng owns 50.0% of the equity interest in Hangzhou Leihuo.

***Loan agreements and equity pledge agreements between NetEase Hangzhou and each of the ultimate shareholders of Hangzhou Leihuo.*** Each of the ultimate shareholders of Hangzhou Leihuo has entered into a loan agreement and an equity pledge agreement with NetEase Hangzhou, each dated December 1, 2015. Under the loan agreements, NetEase Hangzhou provided each of the ultimate shareholders of Hangzhou Leihuo with an interest-free loan in the principal amount of RMB5.0 million, which funds were used by each of the ultimate shareholders of Hangzhou Leihuo to pay the consideration to acquire their 50.0% equity interests in Hangzhou Leihuo. Each loan can be repaid by transferring the ultimate shareholder's equity interest in Hangzhou Leihuo to NetEase Hangzhou or its designee or through such other method as NetEase Hangzhou shall determine. The term of each loan agreement is 10 years from the date of the agreement and will be automatically extended for further ten-year terms unless otherwise decided by NetEase Hangzhou. Under the equity pledge agreements, each of the ultimate shareholders of Hangzhou Leihuo pledges his 50.0% equity interest in Hangzhou Leihuo to NetEase Hangzhou to secure his respective obligations under the loan agreement as well as the exclusive purchase option agreement, the shareholder voting rights trust agreement and the operating agreement. Each of the ultimate shareholders of Hangzhou Leihuo agrees he shall not transfer, assign or pledge his equity interest in Hangzhou Leihuo without the prior written consent of NetEase Hangzhou. The equity pledge agreements will remain binding until the pledgor discharges all his obligations under the above-mentioned agreements.

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## RELATED PARTY TRANSACTIONS

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***Exclusive purchase option agreements among NetEase Hangzhou, Hangzhou Leihuo and each of the ultimate shareholders of Hangzhou Leihuo.*** Under the exclusive purchase option agreements, each dated December 1, 2015, each of the ultimate shareholders of Hangzhou Leihuo has granted NetEase Hangzhou an option to purchase all or a portion of his equity interest in Hangzhou Leihuo at a price equal to the original and any additional paid-in capital paid by the ultimate shareholder. In addition, Hangzhou Leihuo has granted NetEase Hangzhou an option under the exclusive purchase option agreements to purchase all or a portion of the assets held by Hangzhou Leihuo or its subsidiaries at a price equal to the net book value of such assets. Each of Hangzhou Leihuo and the ultimate shareholders of Hangzhou Leihuo agrees not to transfer, mortgage or permit any security interest to be created on any equity interest in or assets of Hangzhou Leihuo without the prior written consent of NetEase Hangzhou. Each exclusive purchase option agreement shall remain in effect until all of the equity interests in or assets of Hangzhou Leihuo have been acquired by NetEase Hangzhou or its designee or until NetEase Hangzhou unilaterally terminates the agreement by written notice.

***Shareholder voting rights trust agreement between NetEase Hangzhou and each of the ultimate shareholders of Hangzhou Leihuo.*** Under these agreements, each dated December 1, 2015, each of the ultimate shareholders of Hangzhou Leihuo has agreed to irrevocably entrust a person designated by NetEase Hangzhou to represent him to exercise all the voting rights and other shareholders' rights to which he is entitled as a shareholder of Hangzhou Leihuo. Each agreement shall remain effective for as long as such shareholder remains a shareholder of Hangzhou Leihuo unless NetEase Hangzhou unilaterally terminates the agreement by written notice.

***Operating agreement among NetEase Hangzhou, Hangzhou Leihuo and the ultimate shareholders of Hangzhou Leihuo.*** To ensure the successful performance of the various agreements between the parties, Hangzhou Leihuo and its ultimate shareholders have agreed that, except for transactions in the ordinary course of business, Hangzhou Leihuo will not enter into any transaction that would materially affect the assets, liabilities, rights or operations of Hangzhou Leihuo without the prior written consent of NetEase Hangzhou. NetEase Hangzhou has also agreed that it will provide performance guarantees and, at NetEase Hangzhou's discretion, guarantee loans for working capital purposes to the extent required by Hangzhou Leihuo for its operations. Furthermore, the ultimate shareholders of Hangzhou Leihuo have agreed that, upon instruction from NetEase Hangzhou, they will appoint Hangzhou Leihuo's board members, president, chief financial officer and other senior executive officers. The term of this agreement is 20 years from December 1, 2015 and can be extended with the written consent of NetEase Hangzhou.

***Cooperation agreement between NetEase Hangzhou and Hangzhou Leihuo.*** Under this Cooperation Agreement, NetEase Hangzhou has agreed to provide the following services: (i) the development of computer software (including, but not limited to, online games) and technical support and maintenance for computer software operation; (ii) the provision of broadband internet access and other operational support; and (iii) jointly with Hangzhou Leihuo, the provision of value-added telecommunication and other services to users of the Leihuo website and relevant products. Hangzhou Leihuo has agreed to pay a monthly service fee to NetEase Hangzhou in accordance with a formula based on its expenses incurred. This agreement was effective from January 1, 2010 and will continue to be effective unless it is terminated by written notice of NetEase Hangzhou or, in case of a material breach of the agreement, it is terminated by written notice of the non-breaching party.

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## RELATED PARTY TRANSACTIONS

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### **Agreements with Youdao Computer**

Prior to November 20, 2017, William Lei Ding and certain employees or former employees of Youdao Computer owned 71.1% and 28.9% of the equity interest in Youdao Computer, respectively. As a result of an internal reorganization completed on November 20, 2017, Feng Zhou, the chief executive officer of Youdao, became the holder of the 28.9% equity interest in Youdao Computer, with William Lei Ding continuing to hold 71.1% of the equity interest in Youdao Computer.

***Loan agreements between Youdao Information and each of William Lei Ding and Feng Zhou.*** Each of William Lei Ding and Feng Zhou entered into a loan agreement with Youdao Information, dated September 26, 2016 and November 20, 2017, respectively. Under these loan agreements, Youdao Information provided each of William Lei Ding and Feng Zhou with an interest-free loan in the principal amount of approximately RMB3.6 million and RMB1.4 million, respectively. These funds were used by each of William Lei Ding and Feng Zhou to pay the consideration to acquire his respective equity interest in Youdao Computer. Such loans can be repaid by transferring each of William Lei Ding and Feng Zhou's respective equity interest in Youdao Computer to Youdao Information or its designee or through such other method as Youdao Information shall determine. The term of each of the loan agreements is 10 years from the date of such agreement and will be automatically extended for a further 10-year term unless otherwise decided by Youdao Information.

***Equity pledge agreements between Youdao Information and each of William Lei Ding and Feng Zhou.*** Each of William Lei Ding and Feng Zhou entered into an equity pledge agreement with Youdao Information, dated September 26, 2016 and November 20, 2017, respectively. Under such equity pledge agreements, each of William Lei Ding and Feng Zhou pledged his respective equity interest in Youdao Computer to Youdao Information to secure his obligations under the applicable loan agreement, exclusive purchase option agreement, shareholder voting rights trust agreement, and Operating Agreement. Each of William Lei Ding and Feng Zhou further agreed to not transfer or pledge his respective equity interest in Youdao Computer without the prior written consent of Youdao Information. Each of the equity pledge agreement will remain binding until the respective pledger, William Lei Ding or Feng Zhou, as the case may be, discharges all his obligations under the above-mentioned agreements.

***Exclusive purchase option agreements.*** Under the exclusive purchase option agreements entered into by Youdao Information, Youdao Computer and each of William Lei Ding and Feng Zhou, dated September 26, 2016 and November 20, 2017, respectively, each of William Lei Ding and Feng Zhou granted Youdao Information an option to purchase all or a portion of his respective equity interest in Youdao Computer at a price equal to the original and any additional paid-in capital paid by him. In addition, under each exclusive purchase option agreement, Youdao Computer has granted Youdao Information an option to purchase all or a portion of the assets held by Youdao Computer or its subsidiaries at a price equal to the net book value of such assets. Each of Youdao Computer, William Lei Ding and Feng Zhou agreed not to transfer, mortgage or permit any security interest to be created on any equity interest in or assets of Youdao Computer without the prior written consent of Youdao Information. Each exclusive purchase option agreement shall remain in effect until all of the equity interests in or assets of Youdao Computer have been acquired by Youdao Information or its designee or until Youdao Information unilaterally terminates the agreement by written notice.

***Shareholder voting rights trust agreements between Youdao Information and each of William Lei Ding and Feng Zhou.*** Under the shareholder voting rights trust agreements between Youdao Information and each of William Lei Ding and Feng Zhou, dated September 26, 2016 and November 20, 2017, respectively, each of William Lei Ding and Feng Zhou,



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## RELATED PARTY TRANSACTIONS

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agreed to irrevocably entrust a person designated by Youdao Information to represent him to exercise all the voting rights and other shareholders' rights to which he is entitled as a shareholder of Youdao Computer. Each shareholder voting rights trust agreement shall remain effective for as long as William Lei Ding or Feng Zhou, as applicable, remains a shareholder of Youdao Computer unless Youdao Information unilaterally terminates the agreement by written notice.

***Operating agreements among Youdao Computer, Youdao Information and each of William Lei Ding and Feng Zhou.*** To ensure the successful performance of the various agreements between the parties, each of Youdao Computer, William Lei Ding and Feng Zhou agreed that, except for transactions in the ordinary course of business, Youdao Computer will not enter into any transaction that would materially affect the assets, liabilities, rights or operations of Youdao Computer without the prior written consent of Youdao Information. Youdao Information also agreed that it would provide performance guarantees and, at Youdao Information's discretion, guarantee loans for working capital purposes to the extent required by Youdao Computer for its operations. Furthermore, each of William Lei Ding and Feng Zhou agreed that, upon instruction from Youdao Information, he would appoint Youdao Computer's board members, president, chief financial officer and other senior executive officers. The term of each Operating Agreement is 20 years from the date of execution and can be extended with the written consent of Youdao Information.

***Cooperation agreement between Youdao Information and Youdao Computer.*** Under this Cooperation Agreement, Youdao Information has agreed to provide the following services: (i) the development of computer software (including, but not limited to, the computer software related to generating, distribution, monitoring and maintenance of online advertisement) and technical support and maintenance for computer software operation; (ii) the design, development, updating and upgrading of platforms for online advertisement; and (iii) the provision of technology support, including, but not limited to, server maintenance, development of software and related maintenance and updates. Youdao Computer has agreed to share its monthly income (after tax and expenses) with Youdao Information in accordance with certain formulas as specified in the Cooperation Agreement. This agreement was effective from July 1, 2015 and will continue to be effective unless it is terminated by written notice of Youdao Information or, in case of a material breach of the agreement, it is terminated by written notice of the non-breaching party.

### **Transactions with Shanghai EaseNet**

In connection with the licensing of certain online games by Blizzard to Shanghai EaseNet for operation in the PRC starting in August 2008, there are certain contractual arrangements among Shanghai EaseNet, the joint venture established between Blizzard and us, and us. As a result of these arrangements, Shanghai EaseNet is a controlled VIE, and William Lei Ding, our founder, director and chief executive officer, does not receive any benefits in his capacity as the shareholder of Shanghai EaseNet or exercise any personal control over it. We have consolidated Shanghai EaseNet into our financial statements as of and for the years ended December 31, 2017, 2018 and 2019. Mr. Ding's role as the shareholder of Shanghai EaseNet is designed to address Chinese regulations which place restrictions on the percentage interest foreign or foreign-invested companies may have in Chinese companies providing value-added telecommunications services in China, which include the provision of online games.

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## RELATED PARTY TRANSACTIONS

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### SUBSIDIARY GUARANTEES

As of December 31, 2019, we have entered into several guarantee agreements in the aggregate amount of US\$1,062.0 million in respect of certain credit facilities taken by our subsidiaries; US\$240.0 million of such credit facilities had not been utilized.

### AGREEMENTS WITH YOUDAO

Youdao became listed on the New York Stock Exchange in October 2019. It is currently our majority-controlled subsidiary. We have entered into agreements with Youdao with respect to various ongoing relationships between us, which became effective upon the completion of Youdao's initial public offering in October 2019. These include a master transaction agreement, a transitional services agreement, a non-competition agreement, a cooperation framework agreement and an intellectual property license agreement, each of which is summarized below.

***Master transaction agreement.*** We have entered into a master transaction agreement with Youdao to govern certain key aspects of our relationship with Youdao, including the allocation of liabilities. Pursuant to the master transaction agreement, Youdao is responsible for, among other things, the liabilities associated with the "Online Learning Business," which is defined to include the online learning products and online learning services offered by Youdao as of the date of the master transaction agreement, excluding the NetEase open online courses and the K-12 curriculum course offered by us as of the date of the master transaction agreement and certain other specified businesses, and we are responsible for, among other things, the liabilities arising on or after June 30, 2019 associated with the "NetEase Business," which is defined to include the business conducted by the NetEase as of the date of the master transaction agreement and any business that is derived from such businesses. The master transaction agreement will automatically terminate five years following the earlier of: (i) the first date when we no longer own at least 20% of the voting power of Youdao's then outstanding voting securities; and (ii) the first date when we cease to be the largest beneficial owner of Youdao's then outstanding voting securities. We refer to such earlier date as the "Control Ending Date." It can also be terminated early or extended by mutual written consent of Youdao and us. The termination of the master transaction agreement will not affect the validity and effectiveness of the other business cooperation agreements described below.

***Transitional services agreement.*** Under the transitional services agreement, we have agreed that, during the service period as described below, we will provide Youdao with various corporate support and services such as legal support, human resources support, financial reporting, internal control and internal audit support, technology and operational support, and administrative support. The price to be paid for the services provided under the transitional services agreement is calculated by multiplying the sum of the actual "direct costs" and "indirect costs" of providing such services by 100% plus a reasonable mark-up rate as determined by us. Direct costs include labor-related compensation and travel expenses, materials and supplies consumed in and agency fees arising from performing the services. Indirect costs include office occupancy, information technology support and other overhead costs of the departments incurring the direct costs of providing the services. The service period under the transitional services agreement commenced upon the completion of Youdao's initial public offering and will end on the earliest of: (i) the fifth anniversary of the completion of Youdao's initial public offering; (ii) one year after the Control Ending Date; and (iii) the date the transitional services agreement is terminated by Youdao or us, whichever is earlier.

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## RELATED PARTY TRANSACTIONS

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***Non-competition Agreement.*** Under the non-competition agreement, Youdao and we have each agreed to be subject to certain non-compete restrictions during a “Non-competition Period,” beginning from the completion of Youdao’s initial public offering and ending on the earlier of: (i) five years after the Control Ending Date; (ii) the date on which Youdao’s ADSs cease to be listed on the New York Stock Exchange; and (iii) the tenth anniversary of the completion of Youdao’s initial public offering. Specifically, we have agreed not to compete with Youdao in the provision of the Online Learning Business, provided that such non-compete restrictions shall not prevent the us from: (i) engaging in the Online Learning Business through or on behalf of Youdao; (ii) continuing to engage in the NetEase Business; (iii) owning a noncontrolling interest in any company engaging in any business that is of the same nature as the Online Learning Business; or (iv) engaging in any other business that we and Youdao may agree from time to time. Youdao has agreed not to compete with us in the NetEase Business or business of a similar nature, provided that such non-compete restrictions shall not prevent Youdao from: (i) engaging in the NetEase Business or business of a similar nature through us or on our behalf; (ii) continuing to engage in any business that we operate as of the date of the non-competition agreement; (iii) owning a noncontrolling interest in any company engaging in any business that is of the same nature as the NetEase Business; and (iv) engaging in any other business that we and Youdao may agree from time to time.

The non-competition agreement provides that if there is any ambiguity in the scope of business subject to the foregoing non-compete restrictions, our interpretation shall prevail.

In addition, we and Youdao have each undertaken to each other that during the Non-competition Period, should a party have a business or investment opportunity relating to the other party’s businesses covered by the foregoing non-compete restrictions, it shall notify the other party of such opportunity in writing. If the party receiving the notice elects not to or otherwise fails to take up the opportunity within 30 days, the notifying party may proceed to take up such business or investment opportunity.

The non-competition agreement also provides for a mutual non-solicitation obligation that neither Youdao nor we may, during the Non-competition Period, hire, or solicit for hire, any active employees of or individuals providing consulting services to the other party, or any former employees of or individuals providing consulting services to the other party within six months of the termination of their employment or consulting services, without the other party’s consent, except for solicitation activities through generalized non-targeted advertisement not directed to such employees or individuals that do not result in a hiring within the Non-competition Period. In addition, during the Non-competition Period, we and Youdao have each agreed not to solicit business falling within the other party’s business scope from the other party’s customer, supplier, distributor or similar third parties.

***Cooperation Framework Agreement.*** Under the cooperation framework agreement, we and Youdao have agreed to cooperate with each other in the marketing and promotion of each other’s services and products on our respective platforms. Also, we have agreed to purchase Youdao’s translation services and to allow our users to log on Youdao’s platforms with their NetEase Passports. The cooperation framework agreement became effective on the date of completion of Youdao’s initial public offering and will expire on the earlier of: (i) the fifteenth anniversary of the effective date of such agreement; or (ii) five year after the Control Ending Date.

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## RELATED PARTY TRANSACTIONS

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***Intellectual property license agreement.*** Under the intellectual property license agreement, we and Youdao grant to each other a worldwide, fully paid-up, non-sublicensable (subject to certain specified exceptions), non-transferable, limited and non-exclusive license of certain intellectual properties for a royalty as agreed by both parties solely to use, reproduce, modify, prepare derivative works of, perform, display, or otherwise exploit the licensed intellectual property within the term of such agreement. This agreement became effective on the completion of Youdao's initial public offering and expires on the earlier of: (i) the fifteen anniversaries of the effective date of such agreement; and (ii) one year after the Control Ending Date with respect to the sharing of information and data and user registration information, or five years after the Control Ending Date with respect to other licenses under such agreement.

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## REGULATIONS

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### REGULATIONS RELEVANT TO FOREIGN INVESTMENT AND OUR BUSINESS

#### Regulations on foreign investment

On March 15, 2019, the National People's Congress promulgated the 2019 PRC Foreign Investment Law, which became effective on January 1, 2020, and replaced the *Wholly Foreign-owned Enterprises Law* (《中華人民共和國外資企業法》), the *Sino-foreign Equity Joint Ventures Law* (《中華人民共和國中外合資經營企業法》), and the *Sino-foreign Cooperative Joint Ventures Law* (《中華人民共和國中外合作經營企業法》). On June 30, 2019, MOFCOM and the NDRC jointly promulgated the Negative List. To comply with the above foreign investment restrictions and to obtain necessary licenses and permits in industries that are currently subject to foreign investment restrictions in China, we operate in China through our variable interest entities. See “Risk Factors — Risks related to our corporate structure.”

According to the 2019 PRC Foreign Investment Law, foreign investment shall enjoy “pre-entry national treatment,” which generally means that at an investment-entrance stage, foreign investment should be treated no less favorably than domestic investment, except for foreign investments in industries deemed to be “restricted” or “prohibited” in the “negative list.” The 2019 PRC Foreign Investment Law provides that foreign invested entities operating in “restricted” or “prohibited” industries will require entry clearance and other approvals. However, uncertainties still exist when it comes to interpreting or implementing the 2019 PRC Foreign Investment Law and its implementation rules. For example, the 2019 PRC Foreign Investment Law does not comment on the concept of “de facto control” or contractual arrangements with variable interest entities. It does, however, have a catch-all provision under the definition of “foreign investment,” which includes investments made by foreign investors in China through means stipulated by laws or administrative regulations or other methods prescribed by the State Council. As such, there remains a leeway for future Laws to define contractual arrangements as a form of “foreign investment.” Furthermore, the 2019 PRC Foreign Investment Law provides that foreign invested enterprises established according to the existing laws regulating foreign investment may maintain their structure and corporate governance for five years after the 2019 PRC Foreign Investment Law is implemented, which means that foreign invested enterprises may be required to adjust their structure and corporate governance after five years. See “Risk Factors — Risks related to our corporate structure.”

On December 26, 2019, the State Council promulgated the *Implementation Rules to the Foreign Investment Law* (《中華人民共和國外商投資法實施條例》), which became effective on January 1, 2020, and repealed the *Provisional Regulations on the Duration of Sino-Foreign Equity Joint Venture Enterprise* (《中外合資經營企業合營期限暫行規定》), the *Regulations on Implementing the Wholly Foreign-Invested Enterprise Law of the PRC* (《中華人民共和國外資企業法實施細則》), and the *Regulations on Implementing the Sino-Foreign Cooperative Joint Venture Enterprise Law of the PRC* (《中華人民共和國中外合作經營企業法實施細則》). The implementation rules further clarified and elaborated on the relevant provisions of the 2019 PRC Foreign Investment Law. However, given that these implementation rules were only recently enacted, a number of uncertainties still exist in relation to the interpretation and implementation of the 2019 PRC Foreign Investment Law.

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## REGULATIONS

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On December 30, 2019, the MOFCOM and the SAMR, jointly promulgated the *Measures for Information Reporting on Foreign Investment* (《外商投資信息報告辦法》), which became effective on January 1, 2020. Pursuant to the measures, where a foreign investor directly or indirectly carries out investment activities in China, the foreign investor or the foreign-invested enterprise must submit the investment information to the competent commerce department for further handling.

### Regulations on telecommunication services

In September 2000, China's State Council promulgated the *Telecommunications Regulations of the PRC* (《中華人民共和國電信條例》) (the “**Telecom Regulations**”), which was revised in February 2016. The Telecom Regulations categorized all telecommunications businesses in China as either a “basic telecommunications business” or “value-added telecommunications business.” ICP services, e-mail services, and other telecommunications businesses operated by us are classified as value-added telecommunications businesses. According to the Telecom Regulations, the commercial operator of these services must obtain an operating license. The Telecom Regulations also set out extensive guidelines with respect to different aspects of telecommunications operations in China.

On December 28, 2015, MIIT issued the *Telecommunication Services Classification Catalog* (2015 Edition) (《電信業務分類目錄(2015年版)》), which replaced the then-operative *Telecommunication Services Classification Catalog* (2003 Edition) (《電信業務分類目錄(2003年版)》). The 2015 Catalog took effect on March 1, 2016 and was amended on June 6, 2019. The Catalog divided the information services business into an additional five sub-categories and reclassified the online data processing and transaction processing services business from a “basic telecommunications business” to a “value-added telecommunications business.” In 2017, MIIT issued the new version of the *Measures for the Administration of Telecom Business Licensing* (《電信業務經營許可管理辦法》) (the “**MIIT Measures 2017**”), which became effective on September 1, 2017. Similar to the 2009 version, the MIIT Measures 2017 require companies who are engaged in telecommunications businesses to have a Telecom Business License. However, the MIIT Measures 2017 removed the previous requirement to file trans-regional value-added telecommunications business permits.

In December 2001, in order to comply with China's commitments with respect to its entry into the WTO, the State Council promulgated the *Regulation for the Administration of Foreign-invested Telecommunications Enterprises* (《外商投資電信企業管理規定》) (the “**FITE Regulations**”), which was last revised in February 2016. The FITE Regulations set out detailed requirements with respect to capitalization, investor qualifications, and application procedures in connection with establishing a foreign invested telecom enterprise. Pursuant to the FITE Regulations, foreign investors may hold an aggregate of no more than 50% of the total equity in any value-added telecommunications business in China. The *Notice of the Ministry of Industry and Information Technology on Removing the Restrictions on Foreign Equity Ratios in Online Data Processing and Transaction Processing (Operating E-commerce) Business* (《工業和信息化部關於放開在線數據處理與交易處理業務(經營類電子商務)外資股比限制的通告》) issued by the MIIT in June 2015 set out an exception, under which, foreign investors may hold up to the entire equity interest in online data processing and transaction processing (operating e-commerce) businesses. However, the FITE Regulations do not define “online data processing and transaction processing (operating e-commerce) business,” and its interpretation and enforcement involve significant uncertainties. In addition, the Negative List removes some of the previous restrictions on value-added telecommunications providers by allowing foreign investors to hold up to the entire equity interest in domestic multi-party communication, e-storage and forwarding and call center businesses in China. However, other requirements provided by the SAPPRFT and MIIT regulations still apply.

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## REGULATIONS

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The *Circular of the MII on Intensifying the Administration of Foreign Investment in Value-Added Telecommunication Services* (《信息產業部關於加強外商投資經營增值電信業務管理的通知》) (the “**2006 MII Circular**”), was promulgated by MII (later superseded by the MIIT) on July 13, 2006. The 2006 MII Circular provides that: (i) any domain name used by a value-added telecommunications service provider must be legally owned by the service provider or its shareholder(s); (ii) any trademark used by a value-added telecommunications service provider must be legally owned by the service provider or its shareholder(s); (iii) the operation site and facilities of a value-added telecommunications service provider must be installed within the scope prescribed by the operating licenses obtained by the service provider and must correspond to the value-added telecommunications services that the service provider has been approved to provide; and (iv) a value-added telecommunications service provider must establish or improve the measures of ensuring information security. Companies that have obtained operating licenses for value-added telecommunications services are required to conduct self-examination and self-correction according to the requirements above and report their results to MII (later superseded by the MIIT).

### **Regulations on internet information services**

The *Measures for the Administration of Internet Information Services* (《互聯網信息服務管理辦法》) (the “**ICP Measures**”), issued by the State Council went into effect on September 25, 2000 and was revised on January 8, 2011. Under the ICP Measures, any entity that provides information to internet users must obtain an operating license from the MII, (later superseded by the MIIT) or its local branch at the provincial level in accordance with the Regulations on Telecommunication Services described above.

The *Provisional Regulations for the Administration of Website Operation of News Publications* (《互聯網站從事登載新聞業務管理暫行規定》), which was jointly issued by the State Council Information Office of the PRC (the “**SCIO**”), and MII (later superseded by the MIIT) on November 6, 2000, stipulates that websites of non-news organizations shall not publish news items produced by themselves, and that their websites shall be approved by SCIO after securing permission from SCIO at the provincial level. On June 1, 2017, the latest *Provisions for the Administration of Internet News Information Services* (《互聯網新聞信息服務管理規定》), promulgated by the Cyberspace Administration of China (the “**CAC**”), came into effect, which superseded the previous regulations. According to the revised provisions, to provide internet-based news information services to the public via internet websites, applications, forums, blogs, micro-blogs, public accounts, instant communication tools and online live-stream, providers must obtain an Internet News Information Service License, issued by the CAC or a local cyberspace administration. In addition, the provisions prohibit organizations from establishing foreign, partially or wholly owned, entities that invest or operate internet-based news information services. The CAC and the local cyberspace administrative offices are responsible for the supervision, management and inspection of internet-based news information services.

In December 2016, the MOC (later superseded by the MOCT) issued the *Circular on the Administrative Measures for Business Activities Relating to Online Performance* (《文化部關於印發〈網絡表演經營活動管理辦法〉的通知》), pursuant to which an internet platform operator that provides online performance shall: (i) apply for a Network Culture Operation License with the relevant provincial-level authority; (ii) notify the MOC of any access or performance channels created for domestic performers within ten days; and (iii) submit an application to the MOC before creating any access or performance channels for foreign performers. On June 19, 2018, the MOCT issued the *National Cultural Market Blacklist*

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## REGULATIONS

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*Management Measures* (《全國文化市場黑名單管理辦法》), which created a public ‘blacklist’ for companies that did not comply with the regulations on internet culture activities and imposed penalties and credit restrictions for non-compliance.

In addition, the SAPPRFT issued a *Notice on Strengthening the Management of Live-Streaming Service for the Network Audio-visual Programs* (《關於加強網絡視聽節目直播服務管理有關問題的通知》) in September 2016, pursuant to which an internet live-streaming service provider shall: (i) provide necessary censorship on the content of live-streams; (ii) establish a mechanism to timely identify unlawful content, prevent any unlawful content from being distributed and replace the content with backup programs; and (iii) record live-streaming programs and keep the records for at least 60 days. Shortly after this notice, in November 2016, the CAC promulgated the *Administrative Provisions on Internet Live-Streaming Services* (《互聯網直播服務管理規定》), pursuant to which an internet live-streaming service provider shall: (i) establish a live-streaming content review platform; (ii) require authentication for the registration of live-streaming content providers; and (iii) enter into a service agreement with live-streaming service users to specify each of the live-streaming service user’s and the content provider’s rights and obligations.

In November 2018, the CAC, together with the Ministry of Public Security, published the *Provisions on the Safety Assessment for Internet Information Services Capable of Creating Public Opinions or Social Mobilization* (《具有輿論屬性或社會動員能力的互聯網信息服務安全評估規定》). These provisions require certain internet information service providers to conduct safety assessment in relation to the: (i) the legal compliance status of their information services, new technologies and new applications; (ii) effectiveness of their implementation of safety measures as required by applicable laws and regulations; and (iii) effectiveness of their safety and risk control measures.

On June 27, 2002, the MII (later superseded by the MIIT) and the General Administration of Press and Publication (the “GAPP”) jointly promulgated the *Provisional Measures for the Administration of Internet Publishing* (《互聯網出版管理暫行規定》), which was replaced by the *Rules for the Administration of Online Publishing Service* (《網絡出版服務管理規定》) jointly issued by SAPPRFT and MIIT that became effective on March 10, 2016. These rules require online publishers to secure approval from the SAPPRFT for their operations. The term “online publication service” refers to providing online publications to the public through information networks. The term “online publications” is defined as the digital works with publishing features such as editing, production or processing provided to the public through information networks (including contents from books, newspapers, periodicals, audio and video products, electronic publications that have already been formally published or works that have been made public in other media format, and the electronic public publications of literature, art and science). These rules also forbid foreign investment in the online publishing sector.

On July 8, 2004, State Food and Drug Administration of China issued the *Measures for the Administration of Internet Drug Information Services* (《互聯網藥品信息服務管理辦法》), which was amended in 2017. The measures stipulate that websites publishing drug-related information must obtain a license from local food and drug administrations.



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Pursuant to the *Measures for the Administration of Internet E-mail Services* (《互聯網電子郵件服務管理辦法》) (the “**Internet E-mail Measures**”), which was issued by MII (later superseded by the MIIT) on February 20, 2006, e-mail service providers must obtain value-added telecommunications business operating licenses or file for recordation as non-profit internet service providers. In addition, each e-mail service provider must keep a record of the timing, sender’s or recipient’s e-mail address and IP address of each e-mail transmitted through its servers for 60 days. The Internet E-mail Measures also state that an internet e-mail service provider is obligated to keep confidential the users’ personal registered information and internet e-mail addresses. An internet e-mail service provider and its employees may not illegally use any user’s personal registered information or internet e-mail address, and may not, without consent of the user, divulge the user’s personal registered information or internet e-mail address, unless otherwise prescribed by another Law.

The State Administration of Radio, Film and Television (the “**SARFT**”) and MII (later superseded by the MIIT) jointly issued the *Regulations for the Administration of Internet Audiovisual Program Services* (《互聯網視聽節目服務管理規定》) (the “**Audiovisual Regulations**”) on December 20, 2007, which was revised on August 28, 2015. The Audiovisual Regulations require that online audio and video service providers obtain a permit from SARFT in accordance with the Audiovisual Regulations.

On November 18, 2019, the CAC, the MOCT and the National Radio and Television Administration (the “**NRTA**”) jointly issued the *Promulgation of the Administrative Provisions on Online Audio and Video Information Services* (《網絡音視頻信息服務管理規定》) (the “**Audio and Video Provisions**”), which took effect on January 1, 2020. The Audio and Video Provisions require that online audio and video information service providers: (i) acquire relevant qualifications required by law and regulations; (ii) adopt rules and policies in relation to, for example, user registration, information distribution and review, information security management, emergency disposal, educational training for employees, the protection of minors and intellectual property rights protection; (iii) verify personal information submitted by users as required under applicable laws; and (iv) undertake technical and other necessary measures to ensure network security and stable operations. Organizations and individuals are prohibited from utilizing online audio and video information services and the related information technology to carry out illegal activities that infringe upon the legitimate rights and interests of others. The Audio and Video Provisions further set out requirements for the creation, distribution and transmission of audio videos based on new technologies and applications such as deep learning and virtual reality, including requirements for safety evaluation, labeling requirements and mechanisms for refuting fake rumors.

On October 23, 2015, the MOC (later superseded by the MOCT) issued its *Notice on Further Strengthening and Improving the Management of Online Music Content* (《文化部關於進一步加強和改進網絡音樂內容管理工作的通知》). According to this notice, entities should examine and verify the content of online music by themselves, while the culture management administration should supervise compliance upon and following the content’s publication.

On August 7, 2014, the CAC issued the *Interim Provisions on Managing the Development of Public Information Services on Instant Messaging Tools* (《即時通信工具公眾信息服務發展管理暫行規定》) (the “**Instant Messaging Interim Provisions**”), which stipulate that instant messaging tool service providers must enter into an agreement with their users during account registration to require them to abide by “Seven Principals,” including, without limitation, compliance with applicable laws and social ethics.

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On December 29, 2011, MIIT issued the *Several Provisions on Regulating the Market Order for Internet Information Services* (《規範互聯網信息服務市場秩序若干規定》) (the “**Market Order Provisions**”). According to the provisions, internet information service providers (“**IISP(s)**”), are prohibited from a wide range of activities that would infringe upon the rights and interests of users or other IISPs, including but not limited to, maliciously forcing incompatibility on services and products provided by other IISPs; deceiving, misleading or forcing users to use or not to use services and products provided by other IISPs; changing users’ browser configurations or other configurations without notifying and obtaining permission from the users; and bundling their terminal software with other software without providing clear notice to users. In addition, IISPs are prohibited from collecting information that is related to users and can serve to identify users’ identities solely or in conjunction with other information without the users’ consent or providing other people with the information, unless otherwise permitted or required under Laws.

On April 17, 2015, the National Copyright Administration issued the *Circular on Regulating the Order of Internet Reproduction of Copyrighted Works* (《關於規範網絡轉載版權秩序的通告》) was issued. Under this circular, in order to reproduce the work of others, internet media must comply with relevant provisions of the copyright laws and regulations and, unless otherwise provided by law or regulation, must obtain permission from, and pay remuneration to, the owner of the copyrighted work, and must indicate the name of the author as well as the title and the source of the work, and may not infringe any other rights or interests of the copyright owner. Moreover, when reproducing the works of others, internet media must not make material alterations to the content of the work.

On June 28, 2016, the CAC published the first regulation of mobile applications in the PRC, the *Administrative Provisions on Information Services for Mobile Internet Applications* (《移動互聯網應用程序信息服務管理規定》) (the “**App Administrative Provisions**”). These provisions expressly require mobile application providers to obtain the relevant operation licenses and hold the mobile application providers strictly responsible for the implementation of information security management regarding the applications they distribute or operate. The App Administrative Provisions also require mobile application providers to: (i) verify the identity and contact information of their registered users; (ii) establish an appropriate mechanism to protect its users’ personal data; (iii) develop an adequate censorship mechanism for any information published through their applications; (iv) protect their users’ rights to be informed if their applications need to gain access to the users’ personal details and refrain from accessing the functions unrelated to the relevant applications without the users’ consent; (v) protect their users’ intellectual property rights; and (vi) maintain internal records of users’ activities for 60 days.

On December 15, 2019, the CAC issued the *Provisions on the Ecological Governance of Network Information Content* (《網絡信息內容生態治理規定》), which took effect on March 1, 2020. For the purpose of these provisions, the term “ecological governance of network information contents” refers to the relevant activities carried out by governments, enterprises, society, internet users and other parties to promote positive energy, and dispose of illegal and harmful information. According to these provisions, a network information content service platform has a duty to act as the information content administrator, to strengthen the ecological governance of the network information content on the platform and to promote the formation of positive cyber culture towards kindness. Network information content service platforms are required to set up the mechanism of ecological governance of the network information content, develop detailed rules for ecological governance of network information content on the

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platform, and improve the systems for user registration, account management, information release and examination, post and comments examination, ecological page management, real-time inspection, emergency response, and disposal of cyber rumors and black industry chain information.

### Regulations on information security and censorship

Regulations governing information security and censorship include:

- *The Law of the PRC on the Preservation of State Secrets* (《中華人民共和國保守國家秘密法》) (1988, revised in 2010) and its *Implementation Rules* (2014);
- *The Counter-espionage Law of the PRC* (《中華人民共和國反間諜法》) (2014);
- *The Rules of the PRC for Protecting the Security of Computer Information Systems* (《中華人民共和國計算機信息系統安全保護條例》) (1994, revised in 2011);
- *The Administrative Measures for Protection of the Security of International Internetworking of Computer Information Networks* (《計算機信息網絡國際聯網安全保護管理辦法》) (1997, revised in 2011);
- *Provisions for the Administration of Keeping Secrets in the International Internetworking of Computer Information Systems* (《計算機信息系統國際聯網保密管理規定》) (2000);
- *The Notice issued by the Ministry of Public Security of the PRC Regarding Issues Relating to the Implementation of the Administrative Measure for the Security Protection of International Connections to Computer Information Networks* (《中華人民共和國公安部關於執行〈計算機信息網絡國際聯網安全保護管理辦法〉中有關問題的通知》) (2000);
- *The Decision of the Standing Committee of the National People's Congress Regarding the Safeguarding of Internet Security* (《全國人民代表大會常務委員會關於維護互聯網安全的決定》) (2000, revised in 2009);
- *The Provisions on the Technical Measures for the Protection of the Security of the Internet* (《互聯網安全保護技術措施規定》) (2006);
- *The Administrative Regulations for the Classified Protection of Information Security* (《信息安全等級保護管理辦法》) (2007);
- *The Decision of the Standing Committee of the National People's Congress on Strengthening Network Information Protection* (《全國人民代表大會常務委員會關於加強網絡信息保護的決定》) (2012);
- *Provisions on Protection of Personal Information of Telecommunication and Internet Users* (《電信和互聯網用戶個人信息保護規定》) (2013);
- *Internet User Account Name Management Regulations* (《互聯網用戶賬號名稱管理規定》) (2015);
- *Cyber Security Law of the PRC* (《中華人民共和國網絡安全法》, the “**Cyber Security Law**”) (2017 Edition);

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- *Provisions on the Cyber Protection of Children's Personal Information* (《兒童個人信息網絡保護規定》), the “**Children's Provisions**”) (2019);
- *Interpretation of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues Concerning the Application of Law in the Handling of Criminal Cases Involving Illegal Use of Information Networks and Assistance in Criminal Activities Committed through Information Networks* (《最高人民法院最高人民檢察院關於辦理非法利用信息網絡、幫助信息網絡犯罪活動等刑事案件適用法律若干問題的解釋》), the “**Fa Shi No. 15**”) (2019); and
- *Announcement of Launching Special Crackdown against Illegal Collection and Use of Personal Information by Apps* (《關於開展App違法違規收集使用公民個人信息專項治理的公告》) (2019); and
- *Measures for Cybersecurity Censorship* (《網絡安全審查辦法》) (2020).

Under various Laws, ICP operators and internet publishers are prohibited from posting or displaying any content that:

- opposes the fundamental principles set out in China's Constitution;
- compromises state security, divulges state secrets, subverts state power or damages national unity;
- harms the dignity or interests of the state;
- incites ethnic hatred or racial discrimination or damages inter-ethnic unity;
- sabotages China's religious policy or propagates heretical teachings or feudal superstitions;
- disseminates rumors, disturbs social order or disrupts social stability;
- propagates obscenity, pornography, gambling, violence, murder or fear or incites the commission of crimes;
- insults or slanders a third party or infringes upon the lawful rights and interests of a third party; or
- includes other content prohibited by laws or administrative regulations.

Failure to comply with the content censorship requirements may result in the revocation of licenses and the closing down of the concerned websites or other online and mobile platforms. In addition, it is mandatory for internet companies in the PRC to complete security-filing procedures and regularly update information security and censorship systems for their websites and other online and mobile platforms with the local public security bureau. On June 22, 2007, the Ministry of Public Security, the State Secrecy Bureau, the State Cryptography Administration Bureau and the SCIO jointly issued the *Administrative Regulations for the Classified Protection of Information Security*, according to which websites should determine the protection classification of their information systems pursuant to a classification guideline and file their classification with the Ministry of Public Security or its bureaus at or above the municipal level with subordinate districts.

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On December 28, 2012, the Standing Committee of the National People's Congress issued the *Decision on Strengthening Network Information Protection* (the “**Information Protection Decision**”), which provides that electronic information through which a citizen's identity can be identified or in which a citizen's privacy is involved (“**Personal Information**”), is protected and no person shall steal, illegally obtain, sell or illegally provide to others any Personal Information. Also, according to the Information Protection Decision, where a network service provider provides website access service, or handles network access formalities for fixed-line telephones or mobile phones, or provides information publication services to its users, it shall require users to provide authentic identity information when concluding agreements or confirming provisions of its service with the users.

On July 16, 2013, MII (later superseded by the MIIT) issued the *Provisions on Protection of Personal Information of Telecommunication and Internet Users*, which defines “Personal Information” as information that can identify the user either on its own or in combination with other information that is collected in the course of providing services by telecommunication business operators and internet information service providers, and sets out detailed provisions concerning the collection and utilization of Personal Information.

On February 4, 2015, the CAC issued the *Internet User Account Name Management Regulations*, which defines “Internet User Account Name” as an account name registered or used in internet information services, including without limitation, blogs, micro-blogs, instant communication tools, forums and thread comments. In addition, according to the regulations, internet information service providers must prohibit their users from using any illegal or harmful information in their account name, avatar, profile or other registration information.

On November 7, 2016, the Standing Committee of the National People's Congress promulgated the Cyber Security Law, which became effective on June 1, 2017. In accordance with the Cyber Security Law, network operators must comply with applicable laws and regulations and fulfill their obligations to safeguard network security in conducting business and providing services. Network service providers must take technical and other necessary measures as required by Laws to safeguard the operation of networks, respond to network security effectively, prevent illegal and criminal activities, and maintain the integrity, confidentiality and usability of network data. In addition, network operators must not collect personal information irrelevant to their services. In the event of any unauthorized disclosure, damage or loss of collected personal information, network operators must take immediate remedial measures, notify the affected users and report the incidents to the relevant authorities in a timely manner.

On April 11, 2017, the CAC released the *Draft Measures on Security Assessment of the Cross-Border Transfer of Personal Information and Important Data* (《個人信息和重要數據出境安全評估辦法(徵求意見稿)》) (the “**Draft Cross-Border Transfer Measures**”), which require personal information and important data collected or produced by network operators during their operations in China to be stored within China. According to the Draft Cross-Border Transfer Measures, assessment by relevant regulatory authority or the national cyberspace authority under certain circumstances must be completed before transferring the data overseas. Furthermore, data may not be transferred overseas without consent from the concerned individual(s), or if the transfer endangers the interests of individuals or public security. The CAC completed the solicitation of comments on the Draft Cross-Border Transfer Measures in May 2017, but there remain substantial uncertainties with respect to its final content and enactment timetable.

The *Administrative Provisions on the Information Services Provided through Official Accounts of Internet Users* (《互聯網用戶公眾賬號信息服務管理規定》), the *Administrative Provisions on the Administration of Information Services Provided through Chat Groups on the Internet*

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(《互聯網群組信息服務管理規定》), the *Administrative Provisions on Internet Follow-up Comment Services* (《互聯網跟帖評論服務管理規定》), and the *Administrative Provisions on Internet Forum and Community Services* (《互聯網論壇社區服務管理規定》) each requires that providers of the aforesaid services shall, under the principle of requiring “mandatory registration of legal name of users and encouraged voluntary use of real name as screen name,” authenticate the identity of each of their registered users and take necessary measures to protect their users’ personal identity.

On April 13, 2020, the CAC and several other government authorities jointly promulgated the *Measures for Cybersecurity Censorship* (the “**Censorship Measures**”), which will take effect on June 1, 2020. In accordance with the Censorship Measures, any purchase of network products and services by critical information infrastructure operators, which affects or may affect state security, shall be subject to cybersecurity censorship fields. Since the measures were recently promulgated, there exists uncertainties with respect to their interpretation and implementation.

As we expand our operations internationally, we may be also subject to privacy laws and data security laws of other jurisdictions in which we operate, including the *General Data Protection Regulation* (the “**GDPR**”). The GDPR applies directly in all European Union member states from May 25, 2018 and applies to companies with an establishment in the European Economic Area, or EEA, and to certain other companies not in the EEA that offer or provide goods or services to individuals located in the EEA or monitor individuals located in the EEA. The GDPR implements stringent operational requirements for controllers of personal data, including, for example, expanded disclosures on how personal information is to be used, limitations on retention of information and pseudonymized data, increased cyber security requirements, mandatory data breach notification requirements and higher standards for controllers to demonstrate that they have obtained a valid legal basis for certain data processing activities. Failure to comply with European Union laws, including failure under the GDPR and other laws relating to the security of personal data may result in fines up to €20,000,000 or up to 4% of the total worldwide annual turnover of the preceding financial year, if greater, and other administrative penalties including criminal liability.

### **Regulations on online games**

Pursuant to the *Provisional Regulations for the Administration of Online Culture* (《互聯網文化管理暫行規定》) promulgated by the MOC (later superseded by the MOCT) in May 2003, and last revised in December 2017, online game operators are required to obtain an Internet Culture Operating License from relevant local departments of the MOC (later superseded by the MOCT). On May 14, 2019, the General Office of the MOCT issued the *Circular on Adjusting the Scope of Examination and Approval of Online Culture Business Permit and Further Regulating the Work Concerning Examination and Approval* 《關於調整<網絡文化經營許可證>審批範圍進一步規範審批工作的通知》 (the “**MOCT Notice 81**”), pursuant to which, the MOCT is no longer responsible for the administration and supervision of online games and local counterparts of the MOCT may no longer approve Internet Culture Operating Licenses that involve online game operation via information networks (with or without distribution of virtual currency of online games) and virtual currency of online games trading operation via information networks. Internet Culture Operating Licenses that are already issued and only contain the above business scope will remain effective until their expiration. As of the Latest Practicable Date, no laws, regulations or official guidelines have been promulgated on whether the responsibility of MOCT for regulating online games will be undertaken by another governmental department.

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On June 4, 2009, the MOC (later superseded by the MOCT) and MOFCOM jointly issued the *Notice on Strengthening Administration on Online Game Virtual Currency* (《關於加強網絡遊戲虛擬貨幣管理工作的通知》) (the “**Online Game Virtual Currency Notice**”). According to this notice, online game virtual currency should only be used to exchange virtual services provided by the issuing enterprise for a designated extent and time, and is strictly prohibited from being used to purchase tangible products or any service or product of another enterprise. In addition, the Online Game Virtual Currency Notice requires the issuing enterprise to give users 60 days prior notice and refund in the form of legal tender or other forms acceptable to users in case it plans to terminate the provision of its products or services.

The publication of online games also requires approval from SAPPRT in accordance with the Rules for the Administration of Online Publishing Service. In March 2018, the Central Committee of the Communist Party of China issued the *Plans for Deepening the Institutional Reform of the Party and State* (《深化黨和國家機構改革方案》) and the National People’s Congress issued the *Institutional Reform Plan of the State Council* (《國務院機構改革方案》) (collectively, the “**Institutional Reform Plans**”). According to the Institutional Reform Plans, the SAPPRT is reformed and became the NRTA (國家廣播電視總局) under the State Council and NPPA (國家新聞出版署(國家版權局)) under the Propaganda Department of the Central Committee of the Communist Party of China (中共中央宣傳部), and the MOC is reformed and became the MOCT (文化和旅遊部). Starting from March 2018, the SAPPRT at the national level temporarily suspended its approval of online games, which was later resumed in December 2018. Since the first quarter of 2019, the National Press and Publication Administration (the “**NPPA**”) has kept publishing the Online Game Approval Lists on its website.

In addition, in April 2007, GAPP and several other government authorities jointly promulgated the *Notice Concerning the Protection of Minors’ Physical and Mental Well-being and Implementation of Anti-addiction System on Online Games* (《關於保護未成年人身心健康實施網絡遊戲防沉迷系統的通知》) (the “**Anti-Addiction Notice**”), which confirms the real-name verification scheme and anti-addiction system standard made by GAPP in previous years and requires online game operators to develop and test their anti-addiction systems from April 2007 to July 2007, after which no online games can be registered or operated without an anti-addiction system, in accordance with the Anti-Addiction Notice. On January 15, 2011, the MOC (later superseded by the MOCT) and several other government authorities jointly issued the *Notice on Implementation Program of Online Game Monitoring System of the Guardians of Minors* (《關於印發<“網絡遊戲未成年人家長監護工程”實施方案>的通知》) (the “**Monitoring System Notice**”), which requires online game operators to adopt certain measures to maintain an interactive system for the protection of minors. Through communication with online game operators, parents may monitor and restrict online game activities by minors, including restriction or suspension of playtime. On July 1, 2011, GAPP and several other government authorities jointly issued the *Notice Regarding the Initiation of Work on the Online Games Real-Name Verification System to Prevent Online Gaming Addiction* (《關於啟動網絡遊戲防沉迷實名驗證工作的通知》), which requires that online game operators be responsible for data registration and identification of online game users, and that online game operators shall duly submit user identification information for verification with the Ministry of Public Security’s National Citizen Identity Information Center (the “**NCIIC**”), which will be in charge of real-name verification for the national anti-addiction system. In addition, online game operators must ensure that, via the NCIIC real-name verification, users with fraudulent identification data be enrolled in the operators’ anti-addiction systems.

On July 25, 2014, the SAPPRT issued the *Notice Regarding the Implementation of the Anti-Addiction and Real-Name Verification System in Online Games* (《國家新聞出版廣電總局辦公廳關於深入開展網絡遊戲防沉迷實名驗證工作的通知》), which requires online game

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operators to submit their real-name verification procedure for online games when applying for publication of online games. On August 30, 2018, the *Implementation Scheme on Comprehensive Prevention and Control of Adolescent Myopia* (《綜合防控兒童青少年近視實施方案》) (the “**Implementation Scheme**”) was issued jointly by eight PRC regulatory authorities at the national level, including the NPPA and the NRTA. The Implementation Scheme provides that as a part of the plan to prevent myopia among children, the NPPA will control the number of new online games, and take steps to restrict the amount of time children spend on playing online games. On October 25, 2019, the NPPA promulgated the *Notice on Preventing Minors from Indulging in Online Games* (《關於防止未成年人沉迷網絡遊戲的通知》), according to which the length of minors’ use of online games should be strictly controlled. It requires all online game users to register their identification information. The total length of time for minors to access online games must be limited on a daily basis. Every day from 22:00 to 8:00 the next day, online game companies are not permitted to provide game services to minors in any form. Game services provided to minors must not exceed three hours per day on public holidays and 1.5 hours on other days. In addition, online transactions are capped monthly at RMB200 or RMB400, depending on a minor’s age.

On September 7, 2009, the Office of the Central Institutional Organization Commission issued the *Notice on Interpretation of the Office of the Central Institutional Organization Commission on Several Provisions relating to Animation, Online Games and Comprehensive Law Enforcement in the Culture Market in the “Three Provisions” jointly promulgated by the MOC, the SARFT and the GAPP* (《關於印發〈中央編辦對文化部、廣電總局、新聞出版總署〈“三定”規定〉中有關動漫、網絡遊戲和文化市場綜合執法的部分條文的解釋〉的通知》) (“**Circular 35**”). According to this Circular 35, GAPP shall be responsible for the examination and approval of online games made available on the internet, and once an online game is available on the internet, it shall be solely and completely administrated by the MOC (later superseded by the MOCT). The circular further clarifies that the GAPP shall be responsible for the examination and approval of the game publications authorized by overseas copyright owners to be made available on the internet, and all other imported online games shall be examined and approved by the MOC (later superseded by the MOCT). However, according to the MOCT Notice 81, the MOCT shall no longer be responsible for administration and supervision of online games and the local counterparts of the MOCT shall no longer approve or issue online culture business permits that involve business scope such as online game operation via information network. As of the Latest Practicable Date, Circular 35 has not been repealed and is still effective. Given that the MOCT Notice 81 is relatively new and it is unclear how these three Provisions will be amended, we are unable to fully assess what impact, if any, these new requirements may have on our business.

On September 28, 2009, GAPP, the National Copyright Administration and the National Office of Combating Pornography and Illegal Publications jointly published the *Notice Regarding the Consistent Implementation of the “Regulation on Three Provisions” of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Examination and Approval of Online Games and the Examination and Approval of Imported Online Games* (《關於貫徹落實國務院〈“三定”規定〉和中央編辦有關解釋,進一步加強網絡遊戲前置審批和進口網絡遊戲審批管理的通知》) (“**Circular 13**”). According to Circular 13, no entity should engage in the operation of online games without receiving an Internet Publishing License and the approval from GAPP. Circular 13 expressly prohibits foreign investors from participating in online game operating business via wholly owned, equity joint venture or cooperative joint venture investments in China, and from controlling and participating in these businesses directly or indirectly through contractual or technical support arrangements. Moreover, for online games that have been approved by GAPP, when the operational entity changes, or when new versions, expansion packs or new content is implemented, the operating entity shall once again undertake the same procedures for examination and approval by GAPP of the changed operating entity, new versions,



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expansion packs or new content. On May 24, 2016, SAPPRFT issued the *Circular on the Administration over Mobile Game Publishing Services* (《國家新聞出版廣電總局辦公廳關於移動遊戲出版服務管理的通知》) (“**Circular 44**”), which came into effect on July 1, 2016, and provides that no mobile game shall be published and operated online without the approval of the SAPPRFT.

The *Interim Measures for the Administration of Online Games* (《網絡遊戲管理暫行辦法》) (the “**Online Games Measures**”) were issued by the MOC (later superseded by the MOCT) in June 2010 and repealed on July 10, 2019. The Online Games Measures set forth certain requirements regarding online games, including requirements that game operators follow certain registration procedures, publicize information about the content and suitability of their games, prevent access by minors to inappropriate games, avoid certain types of content in games targeted at minors, avoid game content that compels players to kill other players, manage virtual currency in certain ways and register users with their real identities. Accordingly, the *Notice on Implementing Interim Measures for the Administration of Online Games* (《關於貫徹實施〈網絡遊戲管理暫行辦法〉的通知》) (the “**Online Games Notice**”), in which several provisions of the Online Games Measures are supplemented, has also been repealed. In addition, since June 2018, the MOCT at the national level has closed the post-filing recording online system, through which the domestic online games were filed according to the post-filing requirements under the Online Games Measures and the Online Game Notice. As of the Latest Practicable Date, no government authority has issued or promulgated any provisions to replace the above-mentioned regulations.

On February 18, 1994, the State Council promulgated the *Rules of the PRC for Protecting the Security of Computer Information Systems*, and amended in 2011, which defines “Security Products for Computer Information Systems” as software and hardware products designed for the protection of computer information security and stipulates that a license must be obtained before selling Security Products for Computer Information Systems. The Ministry of Public Security issued the *Measures for the Administration of Security Products for Computer Information Systems Examination and Sales License* (《計算機信息系統安全專用產品檢測和銷售許可證管理辦法》) on December 12, 1997 confirming that a license for the sale of security products for computer information systems must be obtained as a precondition for sales of these products.

The *Regulations for the Administration of Audio and Video Products* (《音像製品管理條例》), which was released by the State Council on December 25, 2001 and last amended in February 2016, requires that the publication, production, duplication, importation, wholesale, retail and renting of audio and video products are subject to a license issued by competent authorities.

On June 19, 2018, the MOCT issued the *National Cultural Market Blacklist Management Measures*, according to which the cultural administrative department or the comprehensive law enforcement agency of the cultural market shall list the entities and persons in the cultural market that have seriously violated laws and have broken their trust in the national cultural market blacklist, and shall make it public, and adopt credit constraints and joint punishment.

The CAC issued the *Children’s Provisions*, which took effect on October 1, 2019. According to the Children’s Provisions, no organization or individual is allowed to produce, release or disseminate information that infringes upon the personal information security of children under 14. Network operators collecting, storing, using, transferring or disclosing children’s personal information are required to enact special protections for this information.

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Recently, there has been an increased focus on ensuring that mobile apps comply with privacy regulations. The *Announcement of Launching Special Crackdown Against Illegal Collection and Use of Personal Information by Apps* (《關於開展App違法違規收集使用個人信息專項治理的公告》) was issued with effect on January 23, 2019, and commenced a coordinated effort among the CAC, the MIIT, the Ministry of Public Security and the SAMR to combat the illegal collection and use of personal information by mobile apps throughout the PRC. On October 31, 2019, the MIIT issued the *Notice on the Special Rectification of Apps Infringing Users' Rights and Interests* (《工業和信息化部關於開展APP侵害用戶權益專項整治工作的通知》), pursuant to which app providers were required to promptly rectify issues the MIIT designated as infringing app users' rights such as collecting personal information in violation of PRC regulations and setting obstacles for user account deactivation.

On October 21, 2019, the Supreme People's Court and the Supreme People's Procuratorate jointly issued the Fa Shi No. 15, which became effective on November 1, 2019. The Fa Shi No. 15 interpreted several issues concerning the application of law in handling criminal cases such as refusing to fulfil the obligation of managing the security of information networks, illegally using information networks and assisting in criminal activities committed through information networks, in accordance with the Criminal Law of the PRC and the Criminal Procedure Law of the PRC.

### Regulations on private education

The PRC Education Law (《中華人民共和國教育法》) (the “**Education Law**”), sets forth provisions relating to the fundamental education systems of the PRC, including a school system of pre-school education, primary education, secondary education and higher education, a system of nine-year compulsory education and a system of education certificates. The Education Law stipulates that the government formulates plans for the development of education, establishes and operates schools and other types of educational institutions, and in principle, enterprises, institutions, social organizations and individuals are encouraged to operate schools and other types of educational organizations in accordance with PRC Laws.

On December 28, 2002, the Standing Committee of the National People's Congress, promulgated the *Law for Promoting Private Education* (《中華人民共和國民辦教育促進法》) (the “**Private Education Law**”), which was last amended on December 29, 2018. Under the amended Private Education Law, sponsors of private schools may choose to establish non-profit or for-profit private schools at their own discretion and the establishment of the private schools shall be subject to approvals granted by relevant government authorities and registered with relevant registration authorities.

On August 10, 2018, the Ministry of Justice, or MOJ, published the draft amendment to the *Regulations on the Implementation of the Law for Promoting Private Education of the PRC* (《中華人民共和國民辦教育促進法實施條例(修訂草案)(送審稿)》) (the “**MOJ Draft**”), for public comment. As of the Latest Practicable Date, the MOJ Draft is still pending for final approval and is not in effect. The MOJ Draft stipulates that private schools using internet technology to provide online diploma-awarding educational courses shall obtain the private school operating permit of similar academic education at the same level, as well as the internet operating permit. Institutions that use internet technology to provide training and educational activities, vocational qualification and vocational skills training, or providing an internet technology service platform for the above activities, would need to obtain the corresponding internet operating permit and file with the administrative department for education or the department of human resources and social security at the provincial level where the institution is domiciled, and these institutions shall not provide educational and teaching activities that

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requires the private school operating permit. The internet technology service platform that provides the training and educational activities shall review and register the identity information of institutions or individuals applying for access to the platform.

The MOJ Draft further stipulates that the establishment of private training and educational organizations enrolling students of kindergarten, primary school, middle and high school age and providing activities relating to cultural and educational courses at school, or examination-related and further education-related tutoring and other cultural and educational activities, shall obtain a private school operating permit from the administrative departments for education at or above the county level. The establishment of private training and educational organizations that provide activities aiming at quality promotion, personality development in the areas of linguistic competence, arts, physical activities, technology, and activities targeting at cultural education for adults and non-degree continuing education, can apply to register as the legal person directly; however, such private training and/or educational organizations shall not carry out the cultural and educational activities mentioned above, which requires a private school operating permit. In addition, entities implementing group-based education shall not control non-profit schools by merger, acquisition, franchise or contractual arrangements.

Uncertainties exist with respect to the interpretation and application of the existing and future Laws governing the online private education industry, as well as when and how the MOJ Draft would come into effect and how the local government would promulgate implementing rules relating to the specific requirements applicable to online education service providers.

### **Regulations on after-school tutoring and educational apps**

On February 13, 2018, the Ministry of Education, or the MOE, the Ministry of Civil Affairs, the Ministry of Human Resources and Social Security and the SAIC (currently known as the SAMR) jointly promulgated the *Circular on Alleviating After-school Burden on Elementary and Secondary School Students and Implementing Inspections on After-school Training Institutions* (《關於切實減輕中小學生課外負擔開展校外培訓機構專項治理行動的通知》) (“**Circular 3**”). Pursuant to Circular 3, the above government authorities will carry out a series of inspections on after-school training institutions and order those with material potential safety risks to suspend business for self-inspection and rectification, and those without proper establishment licenses or school operating permits to apply for relevant qualifications and certificates under the guidance of competent government authorities. Moreover, after-school training institutions must file with the local education authorities and make public the classes, courses, target students, class hours and other information relating to their academic training courses (including primarily courses on Chinese and mathematics). After-school training institutions are prohibited from providing academic training services beyond the scope or above the level of school textbooks, or organizing any academic competitions or level tests for students of elementary or middle schools. In addition, elementary or middle schools may not reference a student’s performance in the after-school training institutions as part of their admission criteria.

On August 6, 2018, the State Council issued the *Opinion on the Regulation of the Development of After-school Training Institutions* (《國務院辦公廳關於規範校外培訓機構發展的意見》) (“**State Council Circular 80**”), which primarily regulates after-school training institutions targeting K-12 students. State Council Circular 80 reiterates prior guidance that after-school training institutions must obtain a private school operating permit, and further requires these institutions to meet certain minimum requirements. According to the circular, after-school training institutions are required to disclose and file relevant information regarding the institution, including their training content, schedule, targeted students and school timetable to the relevant education authority, and their training classes may not end later than 8:30 p.m.

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each day or otherwise conflict with the teaching time of local primary and secondary schools. In relation to online education service providers, State Council Circular 80 generally provides that regulatory authorities of networking, culture, information technology, radio and television industries shall cooperate with the education department in supervising online education within their relevant industry.

On November 20, 2018, the General Office of the MOE, the General Office of the SAMR and the General Office of the Ministry of Emergency Management of the PRC jointly issued the *Notice on Improving the Specific Governance and Rectification Mechanisms of After-school Education Institutions* (《關於健全校外培訓機構專項治理整改若干工作機制的通知》) (“**Circular 10**”), which provides that provincial education departments shall be responsible for the filing of training institutions that uses internet technology to provide online training for primary and middle school students. Provincial education departments shall regulate the online after-school training institutions based on the management policies governing offline after-school training institutions. In addition, online after-school education institutions shall file the information of their courses, such as names, contents, target students, syllabi and schedules with the provincial education departments and shall publish the name, photo, class schedule and certificate number of the teacher qualification license of each teacher on their websites.

On December 25, 2018, the General Office of the MOE issued the *Notice on Strictly Forbidding Harmful APP Entering Primary and Secondary Schools* (《關於嚴禁有害APP進入中小學校園的通知》), which stipulates, among other things, that: (i) local primary schools, secondary schools and education departments, shall conduct comprehensive investigation on apps used on campus, and shall call off using any apps that contain harmful content such as commercial advertisements and internet games, or increase the burden on students; and (ii) the filing and reviewing system of learning apps shall be established.

The Central Committee of the Communist Party and the State Council jointly issued the *Opinions on the Further Reform of Education and Teaching and Comprehensive Improvement on the Compulsory Education Quality* (《關於深化教育教學改革全面提高義務教育質量的意見》) (the “**Opinions**”), which became effective on June 23, 2019. The Opinions stipulates, among other things, that: (i) the State Administration for Market Regulation and its local counterparts shall be responsible for the registrations and filings of all after-school training institutions and shall supervise and govern their operational behaviors, such as advertising, fee collecting, and antitrust competitions; and (ii) the integrated application of information technology and education shall be promoted, and the “education plus internet” operation model shall be encouraged, but in the meantime, the approval and supervision system for digital educational resource applied by schools shall be established.

Moreover, the MOE, jointly with certain other PRC government authorities, issued the *Opinions on Guiding and Regulating the Orderly and Healthy Development of Educational Mobile Apps* (《關於引導規範教育移動互聯網應用有序健康發展的意見》) on August 10, 2019 (the “**Opinions on Educational Apps**”), which requires, among others, mobile apps that provide services for school teaching and management, student learning and student life, or home-school interactions, with school faculty, students or parents as the main users, and with education or learning as the main application scenarios (the “**Educational Apps**”), be filed with competent provincial regulatory authorities for education before the end of 2019. The Opinions on Educational Apps also requires, among others, that: (i) before filing, the Educational App’s provider obtain the ICP license or complete the ICP filing and obtain the certificate and the grade evaluation report for graded protection of cybersecurity; (ii) Educational Apps whose main users are under the age of 18 must limit the use time, specify the range of suitable ages, and have strictly monitored content; (iii) before an Educational App is introduced as a mandatory app to students, the Educational App must be approved by the

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applicable school through its collective decision-making process and be filed with the competent education authority; and (iv) Educational Apps adopted by education authorities and schools as their uniformly used teaching or management tools shall not charge the students or parents any fee, and not offer any commercial advertisements or games. On November 11, 2019, MOE issued the *Administrative Measures on Filing of Educational Mobile Apps* (《教育移動互聯網應用程序備案管理辦法》), which requires, among other things, that filings of existing Educational Apps be completed before January 31, 2020.

On September 19, 2019, the MOE, jointly with certain other PRC government authorities, issued the *Guidance Opinions on Promoting the Healthy Development of Online Education* (《關於促進在線教育健康發展的指導意見》), which provides, among other things, that: (i) social forces are encouraged to establish online education institutions, develop online education resources, and provide high quality education services; and (ii) an online education negative list shall be promulgated and industries not included in the negative list are open for all types of entities to enter into.

The MOE, jointly with certain other PRC government authorities, promulgated the *Implementation Opinions on Regulating Online After-School Training* (《關於規範校外線上培訓的實施意見》) (the “**Online After-School Training Opinions**”), effective on July 12, 2019. The Online After-School Training Opinions are intended to regulate academic after-school training involving internet technology provided to students in primary and secondary schools. Among other things, the Online After-School Training Opinions requires that online after-school training institutions file with the competent provincial education regulatory authorities before October 31, 2019 and that the education regulatory authorities shall, jointly with other provincial government authorities, review the filings and the qualifications of the online after-school training institutions submitting these filings.

With respect to the filing requirements, the Online After-School Training Opinions provides, among other things: (i) an online after-school training institution shall file with the competent provincial education regulatory authorities at the place of its domicile after it has obtained the ICP license and the certificate and the grade evaluation report for the graded protection of cyber security, and furthermore, shall file before October 31, 2019 if it has already conducted online after-school training; (ii) the online after-school training institutions shall file, among other things, (x) materials related to the institution itself, including information on their respective ICP licenses and other relevant licenses and the materials related to certain management systems regarding the protection of personal information and cyber security, (y) materials related to the training content, and (z) materials related to the training personnel; and (iii) the competent provincial education regulatory authorities shall promulgate local implementing rules on the filing requirements, focusing on training institutions, training content and training personnel. The Online After-School Training Opinions further provides that the competent provincial education regulatory authorities shall, jointly with other provincial government authorities, review the filings and the qualification of the online after-school training institutions submitting the filings before the end of December 2019.

### **Regulations on e-commerce**

The *E-Commerce Law of the PRC* (《中華人民共和國電子商務法》), which was promulgated on August 31, 2018 and became effective on January 1, 2019, set out detailed obligations for operators of e-commerce businesses and e-commerce platforms and guidelines in terms of contract performance and dispute resolutions in relation to e-commerce. Pursuant to this law, e-commerce operators shall, for example: (i) present unbiased search results and general product recommendations that are not based on a potential customer’s particular purchase history and personal profile in addition to tailored product recommendations and services; and

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(ii) not cite any provision of a form contract or any other means to invalidate an agreement with a customer after it has received payment from that customer. In addition, e-commerce platform operators shall: (i) report information such as identity and tax information of third-party vendors to relevant authorities; (ii) make platform service agreement or web-links thereto prominently displayed and accessible on its homepage; (iii) be jointly liable in the event that the platform operator fails to take necessary measures when it has or should have the knowledge that any vendor using its platform has infringed consumers' rights; and (iv) be jointly liable for any damage or threat to a customer's personal health and wellbeing caused by the products sold on its platform if a platform operator fails to examine the qualifications of its vendor using its platform or fails to protect its customers' safety in respect of goods or services that may affect a customer's health. We are subject to this new law as both an e-commerce business operator and e-commerce platform operator. Failure to comply with this law could subject us to civil liabilities or administrative penalties.

The *PRC Consumer Protection Law* (《中華人民共和國消費者權益保護法》), as amended on October 25, 2013, sets out the obligations of business operators and the rights and interests of consumers. Pursuant to this law, business operators must guarantee that the commodities they sell satisfy the requirements for personal or property safety, provide consumers with authentic information about the commodities, and guarantee the quality, function, usage and term of the validity of commodities. The amendment in 2013 further strengthens the protection of consumers and imposes more stringent requirements and obligations on business operators, especially on the businesses operating through the internet. For example, consumers are entitled to return the goods (except for certain specified goods) within seven days upon receipt without any reasons when they purchase the goods from business operators via the internet. When a consumer purchases products (including cosmetics and food) or accepts services via an online trading platform and his/her interests are prejudiced, if the online trading platform provider fails to provide the name, address and valid contact information of the seller, the manufacturer or the service provider, the consumer is entitled to demand compensation from the online trading platform provider. Failure to comply with this law may subject business operators to civil liabilities such as refunding purchase prices, replacement of commodities, repairing or ceasing damages, compensation, and restoring the reputation, and could subject business operators or the responsible individuals to criminal penalties when personal damages are involved or if the circumstances are severe.

On January 26, 2014, SAIC issued the *Administrative Measures for Online Trading* (《網絡交易管理辦法》) (the “**Online Trading Measures**”), which replaced its previous *Interim Measures for the Administration of Online Commodities Transaction and Relevant Services* (《網絡商品交易及有關服務行為管理暫行辦法》). The Online Trading Measures aim to regulate online commodity trading and relevant services, setting standards for online commodity trading operators and relevant services providers, including third-party trading platform operators, concerning qualifications, after-sale services, terms of use, user privacy protection, data preservation, compliance with applicable laws in respect of intellectual property rights protection and unfair competition. On January 5, 2015, SAIC issued the *Measures for the Punishment of Conduct Infringing the Rights and Interests of Consumers* (《侵害消費者權益行為處罰辦法》) (the “**Consumer Conduct Measures**”), which became effective on March 15, 2015. According to these measures, business operators are prohibited from a wide range of activities that would infringe upon the rights and interests of consumers, including but not limited to collecting and using information related to consumers without their consent, illegally providing third parties with this information in any form, or sending promotional message to consumers despite their express refusal. On September 2, 2015, SAIC issued the *Interim Provisions on the Administration of Centralized Online Promotional Activities for Goods and Services* (《網絡商品和服務集中促銷活動管理暫行規定》), which requires the organizer of centralized online promotion activities to publish the methods, terms

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and rules of the activities in advance in an obvious place on its website. On January 6, 2017, SAIC issued the *Interim Measures for Return of Online Purchases within seven Days without Reason* (《網絡購買商品七日無理由退貨暫行辦法》) (the “**Online Return Measures**”), which became effective on March 15, 2017. According to these measures, any consumer goods purchased online could be returned without any reason, if in good condition and are returned within seven days of receipt with signature from the consumers, except for customized products, fresh or live products, perishable goods, digital products, newspapers, periodicals and the goods confirmed to be exempted from the Online Return Measures by consumers at the time of purchase. On November 21, 2019, the SAMR issued the *Interim Provisions on Administration of Consumer Product Recalls* (《消費品召回管理暫行規定》), which became effective on January 1, 2020. The provisions clarify the recall obligations and responsibilities of both the producers of consumer goods and the operators selling, leasing, or repairing consumer goods. Defects are defined in the provisions as unreasonable danger found commonly in the same batch, model number or type of consumer goods due to design, manufacturing, or labeling etc., which compromises personal safety and property safety. According to the provisions, manufacturers are accountable for the safety of consumer goods manufactured by them, and, where there are defects, the manufacturer must recall the goods.

The *Food Safety Law of the PRC* (《中華人民共和國食品安全法》), promulgated on February 28, 2009 and effective on June 1, 2009, was amended on December 29, 2018 with effect from the same date. This amendment sets out a new and stricter regulation framework for the production and circulation of food. On October 11, 2019, the State Council revised and adopted the *Implementing Regulation for the Food Safety Law of the PRC* (《中華人民共和國食品安全法實施條例》), which became effective on December 1, 2019. The regulation underscores tougher supervision, requiring governments above county levels to establish a uniform and authoritative supervision mechanism to enhance supervisory capabilities. The regulation clarifies the primary responsibilities of producers and business operators in food safety, specifies the duties of major corporate leaders, regulates the storage and transportation of food products, bans false promotion of food products, and improves the management of special foods. Under the regulation, legal persons, persons in charge, managers who are directly in charge and individuals who are directly responsible will be fined if the entity they worked for was found to be intentionally committing an illegal act. However, it currently remains unclear if food distributed through the recently established cross-border e-commerce industry is required to comply with all the requirements set forth in the new *Food Safety Law of the PRC* and its implementing regulation.

### **Regulations on online advertising**

According to the *Regulations for the Administration of Advertising* (《廣告管理條例》) promulgated by the State Council, which took effect on December 1, 1987, websites engaged in advertising must apply for a business license to conduct such business.

On February 9, 2012, SAIC and several other government authorities jointly issued the *Rules on Review of Advertisement Release by Public Media* (《大眾傳播媒介廣告發佈審查規定》), which, among other things, states that public media (including internet information service providers) shall have advertisement reviewers, who must participate in and pass trainings in relation to advertisement laws, regulations and business, after which, the reviewers should perform tasks including reviewing advertisements to be released and managing advertisement review archives.

On April 24, 2015, the Standing Committee of the National People’s Congress enacted the *Advertising Law of the PRC* (《中華人民共和國廣告法》) (the “**New Advertising Law**”), and amended on October 26, 2018. The New Advertising Law, which was a major overhaul of an

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advertising law enacted in 1994, increases the potential legal liability of advertising services providers, and includes provisions intended to strengthen identification of false advertising and the power of regulatory authorities. The New Advertising Law forbids the usage of certain words or phrases in advertisements, such as “national,” “supreme,” or “best” and provides a more detailed definition of “false advertisement.” The New Advertising Law also forbids sending advertisements to residences, vehicles, fixed or mobile telephones or personal email addresses if the advertisement is not invited or the receiver of the advertisement has rejected the advertising.

On July 4, 2016, SAIC promulgated the *Provisional Measures of Internet Advertising Management* (《互聯網廣告管理暫行辦法》), which took effect on September 1, 2016. According to these measures: (i) an internet advertisement should be identifiable and clearly labeled as “advertisement”; (ii) paid search advertisements should be clearly distinguished from natural search results; (iii) advertisements published in the form of pop-up or other forms should be clearly marked with a “Close” sign to ensure “Single Click to Close”; and (iv) no entity or individual may induce users to click on the contents of an advertisement through deception, or attach advertisements in any form to an e-mail without user’s permission.

### **Regulations on internet live streaming services**

On November 4, 2016, the CAC issued *Administrative Provisions on Internet Live-Streaming Services*, which became effective on December 1, 2016. Under the regulation, “internet live streaming” refers to the activities of continuously releasing real-time information to the public based on the internet in forms such as video, audio, images and texts, and “internet live-streaming service providers” refers to the operators that provide internet live-streaming platform services. In addition, the internet live-streaming service providers shall take various measures when operating its services, such as examining and verifying the authenticity of the identification information and file this information for record.

On July 12, 2017, the CAC issued a *Notice on Development of the Filing Work for Enterprises Providing Internet Live Streaming Services* (《關於開展互聯網直播服務企業備案工作的通知》), which provides that all the companies providing internet live streaming services shall file with the local authority from July 15, 2017, otherwise the CAC or its local counterparts may impose administrative sanctions on such companies.

Pursuant to the *Circular on Tightening the Administration of Internet Live Streaming Services* (《關於加強網絡直播服務管理工作的通知》) jointly issued by the MIIT, the MOCT, and several other government agencies on August 1, 2018, live streaming services providers are required to file with the local public security authority within 30 days after it commences the service online.

### **Regulations on online music**

On November 20, 2006, the Ministry of Culture issued the *Several Opinions of the Ministry of Culture on the Development and Administration of Online Music* (《文化部關於網絡音樂發展和管理的若干意見》), which became effective on the same date. The opinions provide that, among other things, an internet music service provider must obtain an Online Culture Operating Permit.

In 2010 and 2011, the MOC greatly intensified its regulations on online music products by issuing a series of circulars regarding online music industry, such as the *Circular on Regulating the Market Order of Online Music Products and Renovating Illegal Conducts of Online Music Websites* (《文化部文化市場司關於規範網絡音樂市場秩序整治網絡音樂網站違規行為的通



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告》) and the *Circular on Investigating Illegal Online Music Websites* (《文化部辦公廳關於查處違法網絡音樂網站的通知》) in 2010. In addition, the Ministry of Culture issued the *Circular on Clearing Illegal Online Music Products* (《文化部辦公廳關於清理違規網絡音樂產品的通告》) in 2011, which clarified that entities engaging in any of the following conducts will be subject to relevant penalties or sanctions imposed by the Ministry of Culture: (i) providing online music products or relevant services without obtaining corresponding qualifications; (ii) importing online music products that have not been reviewed by the Ministry of Culture; or (iii) providing domestically developed online music products that have not been filed with the Ministry of Culture.

On July 8, 2015, the National Copyright Administration issued the *Circular regarding Ceasing Transmitting Unauthorized Music Products by Online Music Service Providers* (《國家版權局關於責令網絡音樂服務商停止未經授權傳播音樂作品的通知》), which requires that: (i) all unauthorized music products on the platforms of online music services providers be removed prior to July 31, 2015, and (ii) the National Copyright Administration investigate and punish online music services providers who continue to transmit unauthorized music products following July 31, 2015. On October 23, 2015, the Ministry of Culture promulgated the *Circular on Further Strengthening and Improving the Content Administration of Online Music* (《文化部關於進一步加強和改進網絡音樂內容管理工作的通知》), effective as of January 1, 2016, which provides that internet culture operating entities shall report through a nationwide administrative platform: (i) its content administration system, department, staffing, job responsibilities, monitoring process and specifications *etc.*, to its local provincial cultural administrative department; and (ii) the details of its self-monitoring activities to the Ministry of Culture on a quarterly basis.

### Regulations on payment and finance services

On May 4, 2008, the China Banking Regulatory Commission (the “**CBRC**,” and later superseded by the China Banking and Insurance Regulatory Commission (the “**CBIRC**”) and the People’s Bank of China (the “**PBOC**”) jointly issued the *Guiding Opinions of China Banking Regulatory Commission and the People’s Bank of China on the Pilot Operation of Small Loan Companies* (《中國銀行業監督管理委員會、中國人民銀行關於小額貸款公司試點的指導意見》) (the “**Guiding Opinions**”). According to the Guiding Opinions, to apply for setting up a small loan company, the applicant is required to file a formal official application with the competent department of the provincial government, and, upon approval, it shall apply to the local administrative department for industry and commerce for handling the registration formalities and to receive the business license. It is also required to file the relevant materials with the local public security bureau, the dispatch office of the CBRC (later superseded by the CBIRC) and the branch institution of the PBOC within five working days after approval. The major sources of funds of a small loan company shall be the capital paid by shareholders, donated capital and the capital borrowed from a maximum of two banking financial institutions. The balance of the capital borrowed from banking financial institutions shall not exceed 50% of the net capital within the scope as prescribed by the Laws. Furthermore, the balance of loans granted by a small loan company to a single borrower shall not exceed 5% of the net capital of the company.

In addition, on June 14, 2010, the PBOC issued the *Measures for the Administration of Non-financial Institutions Engaging in Payment and Settlement Services* (《非金融機構支付服務管理辦法》) (the “**PBOC Measures**”), which became effective on September 1, 2010. The PBOC Measures requires that non-financial institutions engaging in the business of effecting payments and settlements before September 1, 2010 obtain a permit, the Payment Service Permit, from the PBOC by August 31, 2011 to continue operating their business. On December 1, 2010, the PBOC issued the *Implementation Rules for the Measures for the Administration*

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## REGULATIONS

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*of Non-financial Institutions Engaging in Payment and Settlement Services* (《非金融機構支付服務管理辦法實施細則》), which further elaborates on the application qualification, material and procedure for the Payment Service Permit and further measures aiming at protecting the rights and interests of clients, including prominent disclosure of service rates, prior notice to clients before any modification can be made to the service rates or payment service agreement between a payment service provider and its clients. On December 28, 2015, the PBOC issued the *Administrative Measures for Internet Payment Services of Non-banking Payment Institutions* (《非銀行支付機構網絡支付業務管理辦法》), which became effective on July 1, 2016, and requires that non-banking payment institutions implement the real-name verification system for payment accounts and take effective measures to verify the personal information of clients. The measures also require that if non-banking payment institutions engage in transferring money between payment accounts and bank accounts, all of these accounts shall be owned by the same client. On January 13, 2017, the PBOC issued the *Notice of the PBOC on Matters concerning Implementing the Centralized Deposit of the Funds of Pending Payments of Clients of Payment Institutions* (《中國人民銀行辦公廳關於實施支付機構客戶備付金集中存管有關事項的通知》), which requires that, from April 17, 2017, a payment institution shall deposit a certain percentage of the funds from its clients, pending payment from such clients, in a special deposit account with a designated financial institution where no interest on the percentage of funds shall accrue.

On June 7, 2013, the PBOC issued the *Measures for the Custody of Clients' Reserves of Payment Institutions* (《支付機構客戶備付金存管辦法》), which defines "Clients' Reserves" as funds actually received by payment institutions when processing payments for clients and payable upon clients' order, and requires payment institutions to fully deposit the Clients' Reserves into a dedicated deposit account held in the custody of banking institutions. On June 29, 2018, the PBOC issued a further notice that required payment institutions to cause up to 100% of the customer reserve funds to be transferred to this account.

On July 18, 2015, PBOC, MIIT, Ministry of Public Security, MOF, SAIC, Legislative Affairs Office of the State Council, CBRC (later superseded by the CBIRC), the CSRC, China Insurance Regulatory Commission and the CAC jointly issued the *Guiding Opinions on Promoting the Healthy Development of Internet Finance* (《關於促進互聯網金融健康發展的指導意見》), which was imperative in encouraging innovation, and support the steady development of internet finance. According to the above-mentioned Guiding Opinions, internet enterprises would be supported to set up internet payment institutions, online lending platforms, equity crowd-funding platforms and online financial product sales platforms in compliance with the law, and a multi-level financial services system that serves the real economy would be established to better meet the investment and financing needs of medium, small and micro-sized enterprises and individuals, and further expand the breadth, and increase the depth, of inclusive finance. According to the above-mentioned Guiding Opinions, e-commerce enterprises would be encouraged to build and improve their own online financial services systems under the premise of compliance with financial laws and regulations, and effectively expand the supply chain operations of e-commerce enterprises.

### **Regulations on intellectual property rights**

The PRC has adopted comprehensive legislation governing intellectual property rights, including patents, trademarks, copyrights and domain names.

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## REGULATIONS

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### ***Patent***

According to the *Patent Law of the PRC* (Revised in 2008) (《中華人民共和國專利法》(2008年修訂)) promulgated by the Standing Committee of the National People's Congress, and its *Implementation Rules* (Revised in 2010) (《中華人民共和國專利法實施細則》(2010年修訂)) promulgated by the State Council, the State Intellectual Property Office of the PRC is responsible for administering patent affairs in the PRC. The patent administration departments of provincial or autonomous regions or municipal governments are responsible for administering patent affairs within their respective jurisdictions. The Patent Law of the PRC and its implementation rules provide for three types of patents, "invention," "utility model," and "design." Invention patents are valid for twenty years, while design patents and utility model patents are valid for ten years, commencing from the date of application. The Chinese patent system adopts a "first to file rule," which means that where more than one person files the patent application for the same invention, a patent will be granted to the person who files the application first. To be patentable, invention or utility models must meet three criteria: novelty, inventiveness and practicability.

### ***Trademark***

According to the *Trademark Law of the PRC* (《中華人民共和國商標法》) promulgated by the Standing Committee of the National People's Congress in August 1982, and recently amended in April 2019, and its *Implementation Regulations* promulgated in August 2002 and amended in April 2014 by the State Council, the period of validity for a registered trademark is ten years, commencing from the date of registration. The registrant must go through the formalities for renewal within twelve months prior to the expiry date of the trademark if continued use is intended. Where the registrant fails to do so, a grace period of six months may be granted. The validity period for each renewal of registration is ten years, commencing from the day immediately after the expiry of the preceding period of validity for the trademark. In the absence of a renewal upon expiry, the registered trademark will be canceled. The *Trademark Law of the PRC* and its *Implementation Regulation* also stipulate rules regarding trademark infringement and compensation. Industrial and commercial administrative authorities have the authority to investigate any alleged infringement of the exclusive right under a registered trademark. If there is a suspected criminal offense, the case shall be timely referred to and decided by a judicial authority.

### ***Copyright***

The Standing Committee of National People's Congress adopted the *Copyright Law of the PRC* (《中華人民共和國著作權法》) in 1990 and amended it in 2001 and 2010, respectively. The amended Copyright Law extends copyright protection to internet activities, products disseminated over the internet and software products.

In order to further implement the *Copyright Law of the PRC*, the *Regulations of the PRC for the Implementation of Copyright Law* (《中華人民共和國著作權法實施條例》) was promulgated by the State Council on September 15, 2002 and last amended on January 30, 2013.

Pursuant to the *Copyright Law* and its implementation rules, creators of protected works enjoy personal and property rights, including, among others, the right of disseminating the works through information networks. In addition, the *Regulations for the Protection of Information Network Transmission Right* (《信息網絡傳播權保護條例》) promulgated by the State Council on May 18, 2006, and amended on January 30, 2013, specify the rules on a safe harbor for use of copyrights and copyright management technology.

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## REGULATIONS

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In order to further implement the *Regulations for the Protection of Computer Software* (計算機軟件保護條例) promulgated by the State Council on December 20, 2001 and last amended on January 30, 2013, the State Copyright Bureau issued the *Registration of Computer Software Copyright Procedures* (計算機軟件著作權登記辦法) on February 20, 2002, which applies to software copyright registration, license contract registration and transfer contract registration.

### *Domain name*

Domain names are protected under the *Administrative Measures on the Internet Domain Names* (《互聯網域名管理辦法》) promulgated by the MIIT on August 24, 2017. The MIIT is the major regulatory body responsible for the administration of the PRC internet domain names. The registration of domain names adopts a first-to-file rule. On November 27, 2017, the MIIT promulgated the *Notice of the Ministry of Industry and Information Technology on Regulating the Use of Domain Names in Providing Internet-based Information Services* (《工業和信息化部關於規範互聯網信息服務使用域名的通知》), which became effective on January 1, 2018. Pursuant to the notice, the domain name used by an internet-based information service provider in providing internet-based information services must be registered and owned by such provider in accordance with the law. If the internet-based information service provider is an entity, the domain name registrant must be the entity (or any of the entity's shareholders), or the entity's principal or senior manager.

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## SHARE CAPITAL

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### AUTHORIZED AND ISSUED SHARE CAPITAL

The following is a summary of our Company's authorized and issued share capital immediately prior to, and upon the completion of, the Global Offering.

#### Authorized share capital

	Shares	Approximate aggregate nominal value of Shares  US\$
Authorized share capital . . . . .	1,000,300,000,000	100,030,000

#### Issued, fully paid or credited to be fully paid

	Shares	Nominal value of shares  US\$	Approximate percentage of authorized share capital  %
Issued share capital . . . . .	3,257,915,456	0.0001	0.326
<i>Shares to be issued under the Global Offering . . . . .</i>	<i>171,480,000</i>	<i>0.0001</i>	<i>0.017</i>
Issued share capital upon the completion of the Global Offering . . . . .	3,429,395,456	0.0001	0.343

#### Assumptions

The above table assumes that the Global Offering becomes unconditional and the Shares are issued pursuant to the Global Offering. The above does not account for any allotment and issuance of Shares upon the exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time, and any issuance or repurchase and cancellation of Shares and/or ADSs that we may make after the Latest Practicable Date.

#### Ranking

The Shares are ordinary shares in the share capital of our Company and rank equally with all Shares currently in issue or to be issued and, in particular, will rank in full for all dividends or other distributions declared, made or paid on the Shares in respect of the Record Date.

#### General meetings

See "Summary of our Constitution and Cayman Companies Law" in Appendix III.

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## SHARE CAPITAL

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### Share Incentive Plans

See “Director and Senior Management — Our share incentive plans.”

### Share purchases of our Company and of Youdao

#### *Repurchase of our Company’s ADSs*

On November 14, 2018, we announced a share repurchase program authorized by our board, pursuant to which we were authorized to purchase up to US\$1.0 billion worth of our issued and outstanding ADSs on the Nasdaq. This share repurchase program expired on November 16, 2019. The table below shows the ADSs that we have repurchased under this program as of November 15, 2019, being the last day of the program.

<u>Period</u>	<u>Total Number of ADSs Purchased<sup>(1)</sup></u>	<u>Average Dollar Value per ADS US\$</u>	<u>Dollar Value of ADSs Purchased as Part of Publicly Announced Plans or Programs US\$</u>	<u>Approximate Maximum Dollar Value of ADSs that May Yet Be Purchased Under the Plans or Programs US\$</u>
August 2019 . . . . .	1,015	209.94	213,091	999,786,909
Total . . . . .	<u>1,015</u>		<u>213,091</u>	

Note: Our ADS to Share ratio is one ADS for every 25 Shares.

On February 26, 2020, we announced a share repurchase program authorized by our board of directors pursuant to which we were authorized to purchase up to US\$1.0 billion of our outstanding ADSs for a period not to exceed 12 months.

In May 2020, our board approved an amendment to the share repurchase program to expand the authorized repurchase amount to US\$2.0 billion.

#### *Purchase of Youdao’s ADSs*

On November 20, 2019, we announced a share purchase program authorized by our board, pursuant to which we were authorized to purchase up to US\$20.0 million worth of Youdao’s outstanding ADSs on the New York Stock Exchange. The share purchase program will expire on November 25, 2020. As of December 31, 2019, approximately 50,000 ADSs of Youdao had been purchased under this program.

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## USE OF PROCEEDS

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We estimate that we will receive net proceeds from the Global Offering of approximately HK\$21,279.0 million after deducting estimated underwriting fees and the estimated offering expenses payable by us and based upon an indicative offer price of HK\$126.00 per Offer Share for both the Hong Kong Public Offering and the International Offering, and assuming that the Over-allotment Option is not exercised, or HK\$24,486.8 million if the Over-allotment Option is exercised in full.

The International Offer Price in the International Offering may be higher than, or the same as, the Public Offer Price in the Hong Kong Public Offering. See “Structure of the Global Offering — Stabilization — Pricing and allocation.”

We plan to use the net proceeds we will receive from the Global Offering for the following purposes:

- (a) **approximately 45% (approximately HK\$9,575.6 million, assuming the Over-allotment Option is not exercised) for globalization strategies and opportunities.** We will continue to improve our global presence by expanding our online game offerings in overseas markets, such as Japan, the United States, Europe and Southeast Asia and enhancing our global R&D and game design capabilities. We will also continue to explore global opportunities by investing in and collaborating with international game developers, IP and content owners. Furthermore, we aim to grow our intelligent learning and other innovative businesses in overseas markets with large potential user bases and favorable demographic characteristics.
- (b) **approximately 45% (approximately HK\$9,575.6 million, assuming the Over-allotment Option is not exercised) for fueling our continued pursuit of innovation.** We will continue to expand and enhance our innovative content offerings, and strengthen our innovative technologies. Our R&D approach will remain focused on bringing commercially viable technologies into specific applications that can further enhance user experience. In addition, we will continue to attract and nurture talents to support further innovation and growth.
- (c) **approximately 10% (approximately HK\$2,127.8 million, assuming the Over-allotment Option is not exercised) for general corporate purposes.** We will use the remaining proceeds for general corporate purposes, working capital needs and potential strategic investments and acquisitions, although we have not identified any specific investments or acquisition opportunities at this time.

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## UNDERWRITING

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### HONG KONG UNDERWRITERS

China International Capital Corporation Hong Kong Securities Limited

Credit Suisse (Hong Kong) Limited

J.P. Morgan Securities (Asia Pacific) Limited

ABCI Securities Company Limited

BOCI Asia Limited

CCB International Capital Limited

Citigroup Global Markets Asia Limited

CMB International Capital Limited

The Hongkong and Shanghai Banking Corporation Limited

Huatai Financial Holdings (Hong Kong) Limited

ICBC International Securities Limited

UBS AG Hong Kong Branch

### UNDERWRITING

This document is published solely in connection with the Hong Kong Public Offering. The Hong Kong Public Offering is fully underwritten by the Hong Kong Underwriters on a conditional basis. The International Offering is expected to be fully underwritten by the International Underwriters. If, for any reason, we do not agree with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on the pricing of the Offer Shares, the Global Offering will not proceed and will lapse.

The Global Offering comprises the Hong Kong Public Offering of initially 5,150,000 Hong Kong Offer Shares and the International Offering of initially 166,330,000 International Offer Shares, subject, in each case, to reallocation on the basis as described in “Structure of the Global Offering” as well as to the Over-allotment Option (in the case of the International Offering).

### UNDERWRITING ARRANGEMENTS AND EXPENSES

#### **Hong Kong Public Offering**

#### *Hong Kong Underwriting Agreement*

Pursuant to the Hong Kong Underwriting Agreement, we are offering the Hong Kong Offer Shares for subscription on the terms and conditions set out in this document and the Hong Kong Underwriting Agreement at the Public Offer Price.



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## UNDERWRITING

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Subject to: (a) the Listing Committee granting approval for the listing of, and permission to deal in, the Shares in issue and to be issued pursuant to the Global Offering (including the Shares which may be issued pursuant to the exercise of the Over-allotment Option) and the Shares to be issued pursuant to the RSU Plans on the Main Board of the Hong Kong Stock Exchange and such approval not having been subsequently revoked prior to the commencement of trading of the Shares on the Stock Exchange and (b) certain other conditions set out in the Hong Kong Underwriting Agreement, the Hong Kong Underwriters have agreed severally but not jointly to procure subscribers for, or themselves to subscribe for, their respective applicable proportions of the Hong Kong Offer Shares being offered which are not taken up under the Hong Kong Public Offering on the terms and conditions set out in this document and the Hong Kong Underwriting Agreement.

The Hong Kong Underwriting Agreement is conditional on, among other things, the International Underwriting Agreement having been executed and becoming unconditional and not having been terminated in accordance with its terms.

### *Grounds for termination*

If any of the events set out below occur at any time prior to 8:00 a.m. on the Listing Date, the Joint Global Coordinators (for themselves and on behalf of the Hong Kong Underwriters) shall be entitled, in their absolute discretion and by giving written notice to the Company to terminate the Hong Kong Underwriting Agreement with immediate effect:

- (a) trading generally shall have been suspended or materially limited on, or by, as the case may be, any of the New York Stock Exchange, the American Stock Exchange, Nasdaq or the Hong Kong Stock Exchange;
- (b) trading of any of our securities shall have been suspended on any exchange or in any over-the-counter market;
- (c) a material disruption in securities settlement, payment or clearance services in the United States, the Cayman Islands, the PRC or Hong Kong shall have occurred;
- (d) any moratorium on commercial banking activities shall have been declared by United States Federal, New York State, the Cayman Islands, the PRC or Hong Kong authorities; or
- (e) there shall have occurred any outbreak or escalation of hostilities, or any change in financial markets, currency exchange rates or controls or any calamity or crisis that, in the reasonable judgment of the Joint Global Coordinators, is material and adverse and which, singly or together with any other event specified in this paragraph, makes it, in the reasonable judgment of the Joint Global Coordinators, impracticable to proceed with the offer, sale or delivery of the Offer Shares on the terms and in the manner contemplated in this prospectus, and the registration statement, the general disclosure package and the final prospectus to be filed or issued by us in connection with the International Offering.

### *Undertakings Pursuant to the Hong Kong Underwriting Agreement*

We have undertaken to each of the Joint Global Coordinators, the Joint Sponsors and the Hong Kong Underwriters that for the period commencing on the Price Determination Date and ending on, and including, the date that is 90 days after the Price Determination Date (the “**Lock-Up Period**”), or such earlier date that the Joint Sponsors (for themselves and on behalf

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## UNDERWRITING

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of the Underwriters) consent to in writing, and unless in compliance with the requirements of the Hong Kong Listing Rules, we will not, directly or indirectly, take any of the following actions with respect to our Shares or ADSs, or any securities convertible into or exchangeable or exercisable for any of our Shares or ADSs (“**Lock-Up Securities**”):

- (a) offer, sell, issue, pledge, contract to sell or otherwise dispose of Lock-Up Securities;
- (b) offer, sell, issue, contract to sell, contract to purchase or grant any option, right or warrant to purchase Lock-Up Securities;
- (c) establish or increase a put equivalent position or liquidate or decrease a call equivalent position in Lock-Up Securities within the meaning of Section 16 of the U.S. Exchange Act; or
- (d) file with the SEC a registration statement under the U.S. Securities Act relating to Lock-Up Securities, other than registration statements on Form S-8 relating to the issuance, vesting, exercise or settlement of equity awards granted or to be granted pursuant to any employee benefit plan described in this prospectus,

without the prior written consent of the Joint Sponsors, provided, however, that we shall be permitted during the Lock-Up Period to:

- (1) sell, or cause to be sold, the Offer Shares to be sold and/or issued hereunder, including, for avoidance of doubt, any Shares to be loaned and sold pursuant to the borrowing arrangement by and among the Joint Sponsors (for themselves and on behalf of the Underwriters) and Shining Globe International Limited, which arrangement is intended to facilitate stabilizing activities in connection with the Global Offering;
- (2) issue Shares or ADSs or the grant of options to purchase Shares, restricted shares, RSUs or any other equity-linked rights issuable under our share incentive plans existing on the date of the Hong Kong Underwriting Agreement, including the effect of one or more bulk issuances of Shares, or ADSs upon deposit of Shares with the depository, and delivered to our brokerage accounts existing on the date of the Hong Kong Underwriting Agreement, in contemplation of future issuance under our share incentive plans existing on the date of the Hong Kong Underwriting Agreement;
- (3) effect any capitalization issue, capital reduction or consolidation or sub-division of the Shares;
- (4) issue securities upon the exercise of an option or a warrant, the vesting of a restricted share unit or the conversion of a security outstanding on the date of the Hong Kong Underwriting Agreement;
- (5) issue any securities by us in connection with our acquisition of one or more businesses, assets, products or technologies, joint ventures, commercial relationships or other strategic corporate transactions, provided that the recipients of such securities execute a lock-up agreement in favor of the Underwriters containing substantially the same obligations as those to be set forth in the applicable exhibit to the International Underwriting Agreement; and
- (6) repurchase securities pursuant to our share repurchase programs.

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## UNDERWRITING

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### **International Offering**

#### ***International Underwriting Agreement***

In connection with the International Offering, we expect to enter into the International Underwriting Agreement with among others, the Joint Global Coordinators (for themselves and on behalf of the International Underwriters) on the Price Determination Date. Under the International Underwriting Agreement and subject to the Over-allotment Option, the International Underwriters would, subject to certain conditions set out therein, agree severally but not jointly to procure subscribers for, or themselves to subscribe for, their respective applicable proportions of the International Offer Shares initially being offered pursuant to the International Offering. The International Offering will consist of a U.S. offering and a non-U.S. offering. It is expected that the International Underwriting Agreement may be terminated on similar grounds as the Hong Kong Underwriting Agreement. Potential investors should note that in the event that the International Underwriting Agreement is not entered into, the Global Offering will not proceed. See “Structure of the Global Offering — The International Offering.”

#### ***Over-allotment Option***

We expect to grant to the International Underwriters the Over-allotment Option, exercisable by the Joint Global Coordinators on behalf of the International Underwriters at any time from the date of International Underwriting Agreement until 30 days after the last day for lodging applications under the Hong Kong Public Offering, pursuant to which we may be required to issue up to an aggregate of 25,722,000 Shares, representing not more than 15% of the number of Offer Shares initially available under the Global Offering, at the International Offer Price, to cover over-allocations in the International Offering, if any. See “Structure of the Global Offering — The International Offering — Over-allotment Option.”

#### **Commissions and expenses**

The Underwriters will receive an underwriting commission of up to 1% of the aggregate offer price of all the Offer Shares (including any Offer Shares to be issued by us pursuant to the exercise of the Over-allotment Option), out of which they will pay any sub-underwriting commissions and other fees.

For any unsubscribed Hong Kong Offer Shares reallocated to the International Offering, the underwriting commission will not be paid to the Hong Kong Underwriters but will instead be paid, at the rate applicable to the International Offering, to the relevant International Underwriters.

The aggregate underwriting commissions and fees together with the Hong Kong Stock Exchange listing fees, the SFC transaction levy and the Hong Kong Stock Exchange trading fee, SEC registration fees, legal and other professional fees and printing and all other expenses relating to the Global Offering are estimated to be up to approximately HK\$360.7 million (assuming an indicative offer price of HK\$126.00 per Offer Share for both Hong Kong Public Offering and International Offering and the exercise of the Over-allotment Option in full) and will be paid by our Company.

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## UNDERWRITING

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### ACTIVITIES BY SYNDICATE MEMBERS

The underwriters of the Hong Kong Public Offering and the International Offering (together, the “**Syndicate Members**”) and their affiliates may each individually undertake a variety of activities (as further described below) which do not form part of the underwriting or stabilizing process.

The Syndicate Members and their affiliates are diversified financial institutions with relationships in countries around the world. These entities engage in a wide range of commercial and investment banking, brokerage, funds management, trading, hedging, investing and other activities for their own account and for the account of others. In the ordinary course of their various business activities, the Syndicate Members and their respective affiliates may purchase, sell or hold a broad array of investments and actively trade securities, derivatives, loans, commodities, currencies, credit default swaps and other financial instruments for their own account and for the accounts of their customers. Such investment and trading activities may involve or relate to assets, securities and/or instruments of the Company and/or persons and entities with relationships with the Company and may also include swaps and other financial instruments entered into for hedging purposes in connection with the Group’s loans and other debt.

In relation to the Shares, the activities of the Syndicate Members and their affiliates could include acting as agent for buyers and sellers of the Shares, entering into transactions with those buyers and sellers in a principal capacity, including as a lender to initial purchasers of the Shares (which financing may be secured by the Shares) in the Global Offering, proprietary trading in the Shares, and entering into over the counter or listed derivative transactions or listed or unlisted securities transactions (including issuing securities such as derivative warrants listed on a stock exchange) which have as their underlying assets, assets including the Shares. Such transactions may be carried out as bilateral agreements or trades with selected counterparties. Those activities may require hedging activity by those entities involving, directly or indirectly, the buying and selling of the Shares, which may have a negative impact on the trading price of the Shares. All such activities could occur in Hong Kong and elsewhere in the world and may result in the Syndicate Members and their affiliates holding long and/or short positions in the Shares, in baskets of securities or indices including the Shares, in units of funds that may purchase the Shares, or in derivatives related to any of the foregoing.

In relation to issues by Syndicate Members or their affiliates of any listed securities having the Shares as their underlying securities, whether on the Stock Exchange or on any other stock exchange, the rules of the stock exchange may require the issuer of those securities (or one of its affiliates or agents) to act as a market maker or liquidity provider in the security, and this will also result in hedging activity in the Shares in most cases.

All such activities may occur both during and after the end of the stabilizing period described in “Structure of the Global Offering.” Such activities may affect the market price or value of the Shares, the liquidity or trading volume in the Shares and the volatility of the price of the Shares, and the extent to which this occurs from day to day cannot be estimated.

It should be noted that when engaging in any of these activities, the Syndicate Members will be subject to certain restrictions, including the following:

- (a) the Syndicate Members (other than the Stabilizing Manager or any person acting for it) must not, in connection with the distribution of the Offer Shares, effect any transactions (including issuing or entering into any option or other derivative

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## UNDERWRITING

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transactions relating to the Offer Shares), whether in the open market or otherwise, with a view to stabilizing or maintaining the market price of any of the Offer Shares at levels other than those which might otherwise prevail in the open market; and

- (b) the Syndicate Members must comply with all applicable laws and regulations, including the market misconduct provisions of the SFO, including the provisions prohibiting insider dealing, false trading, price rigging and stock market manipulation.

Certain of the Syndicate Members or their respective affiliates have provided from time to time, and expect to provide in the future, investment banking and other services to the Company and each of its affiliates for which such Syndicate Members or their respective affiliates have received or will receive customary fees and commissions.

In addition, the Syndicate Members or their respective affiliates may provide financing to investors to finance their subscriptions of Offer Shares in the Global Offering.

### **LOCK-UP UNDERTAKINGS BY OUR DIRECTORS AND EXECUTIVE OFFICERS**

All of our directors and all of our executive officers have each agreed with the International Underwriters that, during the period commencing on the Price Determination Date and ending at the close of business of the 90th day after the Price Determination Date, without the prior written consent of the Joint Global Coordinators (for themselves and on behalf of the Underwriters), they will not, among other things, directly or indirectly: (i) offer, sell, contract to sell, pledge, grant any option to purchase, purchase any option or contract to sell, make any short sale or otherwise dispose of any ADSs or Shares or any securities of the Company that are substantially similar to the ADSs or Shares, or any options or warrants to purchase any ADSs or Shares, or any securities convertible into, exchangeable for or that represent the right to receive ADSs or Shares, whether now owned or hereinafter acquired, owned directly by them (including holding as a custodian) or with respect to which they have beneficial ownership within the rules and regulations of the SEC and/or the SFO (such securities collectively, the “Director & Executive Officer Lock-Up Securities”); (ii) engage in any hedging or other arrangements which is designed to or which reasonably could be expected to lead to or result in a sale or disposition or transfer of any economic consequences of ownership, in whole or in part, directly or indirectly, of any Director & Executive Officer Lock-Up Securities; (iii) enter into any hedging, swap or other agreement or transaction that transfers, in whole or in part, any of the economic consequences of ownership of the Director & Executive Officer Lock-Up Securities; (iv) make any demand for, or exercise any right with respect to, the registration of any Director & Executive Officer Lock-Up Securities, or (v) publicly disclose the intention to do any of (ii) to (iv) above, in each case subject to limited exceptions as described further below. For the purposes of the foregoing lock-up restrictions, the term “Director & Executive Officer Lock-Up Securities” shall not include, and nothing in the foregoing lock-up restrictions shall prohibit, any transaction relating only to, (i) ADSs or Shares purchased in open market transactions after the Price Determination Date (excluding, for the avoidance of doubt, any Shares purchased in the Global Offering), or (ii) ADSs or Shares acquired in private transactions after the Price Determination Date from third parties to the extent such acquired ADSs or Shares are not subject to any lock-up or similar transfer restrictions.

Among certain other exceptions, the restrictions described above do not apply to transfer of the Director & Executive Officer Lock-Up Securities:

- (i) as a bona fide gift or gifts;

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## UNDERWRITING

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- (ii) to any trust for the direct or indirect benefit of the locked-up person or the immediate family of the locked-up person, or if the locked-up person is a trust, to a trustor or beneficiary of the trust or to the estate of a beneficiary of such trust, provided that any such transfer shall not involve a disposition for value;
- (iii) by will or intestate succession upon the death of the locked-up person;
- (iv) by operation of law, such as pursuant to a qualified domestic order, divorce settlement, divorce decree or separation agreement;
- (v) by surrender or forfeiture of any Director & Executive Officer Lock-Up Securities to the Company or sale or transfer of any Director & Executive Officer Lock-Up Securities to satisfy (x) tax withholding obligations upon exercise or vesting or (y) the exercise price upon a cashless net exercise, in each case, of share options, equity awards, warrants or other right to acquire Shares or ADSs pursuant to the Company's equity incentive plans described in the offering documents relating to this offering;
- (vi) to the Company or an affiliate of the Company arising as a result of the termination of employment or directorship of the locked-up person where the Company or such affiliate of the Company has the option to repurchase such Director & Executive Officer Lock-Up Securities or a right of first refusal with respect to transfers of such Director & Executive Officer Lock-Up Securities;
- (vii) with the prior written consent of the Joint Global Coordinators (for themselves and on behalf of the Underwriters); or
- (viii) to a partnership, limited liability company or other entity of which the locked-up person and the immediate family of the locked-up person are the legal and beneficial owner of all of the outstanding equity securities or similar interests.

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## STRUCTURE OF THE GLOBAL OFFERING

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### THE GLOBAL OFFERING

This document is published in connection with the Hong Kong Public Offering as part of the Global Offering. China International Capital Corporation Hong Kong Securities Limited, Credit Suisse (Hong Kong) Limited and J.P. Morgan Securities (Asia Pacific) Limited (in alphabetical order) are the Joint Global Coordinators of the Global Offering.

The listing of the Shares on the Main Board of the Hong Kong Stock Exchange is sponsored by the Joint Sponsors. The Joint Sponsors have made an application on our behalf to the Listing Committee of the Hong Kong Stock Exchange for the listing of, and permission to deal in, the Shares in issue and to be issued as mentioned in this document.

171,480,000 Offer Shares will initially be made available under the Global Offering comprising:

- (a) the Hong Kong Public Offering of initially 5,150,000 Shares (subject to reallocation) in Hong Kong as described in the sub-section “The Hong Kong Public Offering” in this section below; and
- (b) the International Offering of initially 166,330,000 Shares (subject to reallocation and the Over-allotment Option) pursuant to the shelf registration statement on Form F-3ASR that was filed with the SEC and became effective on May 29, 2020, and the preliminary prospectus supplement filed with the SEC on June 1, 2020 and the final prospectus supplement to be filed with the SEC on or about June 5, 2020.

Investors may either:

- (a) apply for Hong Kong Offer Shares under the Hong Kong Public Offering; or
- (b) apply for or indicate an interest for International Offer Shares under the International Offering,

but may not do both.

The Offer Shares will represent approximately 5.00% of the total Shares in issue immediately following the completion of the Global Offering, assuming the Over-allotment Option is not exercised and no Shares are issued pursuant to the RSU Plans. If the Over-allotment Option is exercised in full, the Offer Shares will represent approximately 5.71% of the total Shares in issue immediately following the completion of the Global Offering and the full exercise of the Over-allotment Option (assuming no Shares are issued pursuant to the RSU Plans).

References in this document to applications, application monies or the procedure for applications relate solely to the Hong Kong Public Offering.

### THE HONG KONG PUBLIC OFFERING

#### Number of Offer Shares initially offered

We are initially offering 5,150,000 Shares for subscription by the public in Hong Kong at the Public Offer Price, representing approximately 3.00% of the total number of Offer Shares initially available under the Global Offering. The number of Offer Shares initially offered under the Hong Kong Public Offering, subject to any reallocation of Offer Shares between the

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## STRUCTURE OF THE GLOBAL OFFERING

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International Offering and the Hong Kong Public Offering, will represent approximately 0.15% of the total Shares in issue immediately following the completion of the Global Offering (assuming the Over-allotment Option is not exercised and no Shares are issued pursuant to the RSU Plans).

The Hong Kong Public Offering is open to members of the public in Hong Kong as well as to institutional and professional investors. Professional investors generally include brokers, dealers, companies (including fund managers) whose ordinary business involves dealing in shares and other securities and corporate entities that regularly invest in shares and other securities.

Completion of the Hong Kong Public Offering is subject to the conditions set out in “Conditions of the Global Offering” below.

### **Allocation**

Allocation of Offer Shares to investors under the Hong Kong Public Offering will be based solely on the level of valid applications received under the Hong Kong Public Offering.

The basis of allocation may vary, depending on the number of Hong Kong Offer Shares validly applied for by applicants. Such allocation could, where appropriate, consist of balloting, which could mean that some applicants may receive a higher allocation than others who have applied for the same number of Hong Kong Offer Shares, and those applicants who are not successful in the ballot may not receive any Hong Kong Offer Shares.

For allocation purposes only, the total number of Hong Kong Offer Shares available under the Hong Kong Public Offering (after taking into account any reallocation referred to below) will be divided equally (to the nearest board lot) into two pools: pool A and pool B. The Hong Kong Offer Shares in pool A will be allocated on an equitable basis to applicants who have applied for Hong Kong Offer Shares with an aggregate price of HK\$5 million (excluding the brokerage, the SFC transaction levy and the Hong Kong Stock Exchange trading fee payable) or less. The Hong Kong Offer Shares in pool B will be allocated on an equitable basis to applicants who have applied for Hong Kong Offer Shares with an aggregate price of more than HK\$5 million (excluding the brokerage, the SFC transaction levy and the Hong Kong Stock Exchange trading fee payable) and up to the total value in pool B.

Investors should be aware that applications in pool A and applications in pool B may receive different allocation ratios. If any Hong Kong Offer Shares in one (but not both) of the pools are unsubscribed, such unsubscribed Hong Kong Offer Shares will be transferred to the other pool to satisfy demand in that other pool and be allocated accordingly. For the purpose of the immediately preceding paragraph only, the “price” for Hong Kong Offer Shares means the price payable on application therefor (without regard to the Public Offer Price as finally determined). Applicants can only receive an allocation of Hong Kong Offer Shares from either pool A or pool B and not from both pools. Multiple or suspected multiple applications under the Hong Kong Public Offering and any application for more than 2,575,000 Hong Kong Offer Shares is liable to be rejected.

### **Reallocation**

The allocation of the Offer Shares between the Hong Kong Public Offering and the International Offering is subject to reallocation. Paragraph 4.2 of Practice Note 18 of the Hong Kong Listing Rules requires a clawback mechanism to be put in place which would have the effect of increasing the number of Offer Shares under the Hong Kong Public Offering to a



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## STRUCTURE OF THE GLOBAL OFFERING

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certain percentage of the total number of Offer Shares offered under the Global Offering if certain prescribed total demand levels are reached. We have applied to the Hong Kong Stock Exchange for, and the Hong Kong Stock Exchange has granted us, a waiver from strict compliance with Paragraph 4.2 of Practice Note 18 of the Hong Kong Listing Rules such that, in the event of over-subscription, the alternative clawback mechanism shall be applied.

5,150,000 Offer Shares are initially available in the Hong Kong Public Offering, representing approximately 3.0% of the Offer Shares initially available under the Global Offering. The allocation of Shares between the Hong Kong Public Offering and the International Offering is subject to adjustment.

If the number of Offer Shares validly applied for under the Hong Kong Public Offering represents: (a) 10 times or more but less than 15 times, (b) 15 times or more but less than 20 times and (c) 20 times or more of the total number of Offer Shares initially available under the Hong Kong Public Offering, then Offer Shares will be reallocated to the Hong Kong Public Offering from the International Offering. As a result of such reallocation, the total number of Offer Shares available under the Hong Kong Public Offering will be increased to 10,290,000 Offer Shares (in the case of (a)), 15,440,000 Offer Shares (in the case of (b)) and 20,580,000 Offer Shares (in the case of (c)), representing approximately 6.0%, 9.0% and 12.0% of the total number of Offer Shares initially available under the Global Offering, respectively (before any exercise of the Over-allotment Option). In each case, the additional Offer Shares reallocated to the Hong Kong Public Offering will be allocated between pool A and pool B and the number of Offer Shares allocated to the International Offering will be correspondingly reduced in such manner as the Joint Global Coordinators deem appropriate.

In addition, the Joint Global Coordinators may reallocate Offer Shares from the International Offering to the Hong Kong Public Offering to satisfy valid applications under the Hong Kong Public Offering.

If the Hong Kong Public Offering is not fully subscribed, the Joint Global Coordinators may reallocate all or any unsubscribed Hong Kong Offer Shares to the International Offering, in such proportions as the Joint Global Coordinators deem appropriate.

The Offer Shares to be offered in the Hong Kong Public Offering and the Offer Shares to be offered in the International Offering may, in certain circumstances, be reallocated between these offerings at the discretion of the Joint Global Coordinators. In accordance with the Guidance Letter HKEX-GL91-18 issued by the Hong Kong Stock Exchange, if such reallocation is done other than pursuant to the clawback mechanism above, the maximum total number of Offer Shares that may be reallocated to the Hong Kong Public Offering following such reallocation shall be not more than double the initial allocation to the Hong Kong Public Offering (*i.e.*, 10,300,000 Shares, representing approximately 6.0% of the total number of Offer Shares initially available under the Global Offering).

### **Applications**

Each applicant under the Hong Kong Public Offering will be required to give an undertaking and confirmation in the application submitted by him/her that he/she and any person(s) for whose benefit he/she is making the application has not applied for or taken up, or indicated an interest for, and will not apply for or take up, or indicate an interest for, any International Offer Shares under the International Offering. Such applicant's application is liable to be rejected if such undertaking and/or confirmation is/are breached and/or untrue (as the case may be) or if he/she has been or will be placed or allocated International Offer Shares under the International Offering.

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## STRUCTURE OF THE GLOBAL OFFERING

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Applicants under the Hong Kong Public Offering are required to pay, on application, the maximum Public Offer Price of HK\$126.00 per Offer Share in addition to the brokerage, the SFC transaction levy and the Hong Kong Stock Exchange trading fee payable on each Offer Share, amounting to a total of HK\$12,726.97 for one board lot of 100 Shares. If the Public Offer Price, as finally determined in the manner described in “Pricing and allocation” is less than the maximum Public Offer Price of HK\$126.00 per Offer Share, appropriate refund payments (including the brokerage, the SFC transaction levy and the Hong Kong Stock Exchange trading fee attributable to the surplus application monies) will be made to successful applicants, without interest. Further details are set out in “How to Apply for Hong Kong Offer Shares.”

### THE INTERNATIONAL OFFERING

#### Number of Offer Shares initially offered

The International Offering will consist of an offering of initially 166,330,000 Offer Shares, representing approximately 97.00% of the total number of Offer Shares initially available under the Global Offering (subject to reallocation and the Over-allotment Option). The number of Offer Shares initially offered under the International Offering, subject to any reallocation of Offer Shares between the International Offering and the Hong Kong Public Offering, will represent approximately 4.85% of the total Shares in issue immediately following the completion of the Global Offering (assuming the Over-allotment Option is not exercised and no Shares are issued pursuant to the RSU Plans).

#### Allocation

The International Offering will include U.S. offering of Offer Shares in the United States as well as non-U.S. offering to institutional and professional and other investors in other jurisdictions outside the United States. Professional investors generally include brokers, dealers, companies (including fund managers) whose ordinary business involves dealing in shares and other securities and corporate entities that regularly invest in shares and other securities. Allocation of Offer Shares pursuant to the International Offering will be effected in accordance with the “book-building” process described in “Pricing and allocation” and based on a number of factors, including the level and timing of demand, the total size of the relevant investor’s invested assets or equity assets in the relevant sector and whether or not it is expected that the relevant investor is likely to buy further Shares and/or hold or sell its Shares after the Listing. Such allocation is intended to result in a distribution of the Shares on a basis which would lead to the establishment of a solid professional and institutional shareholder base to the benefit of the Group and the Shareholders as a whole.

The Joint Global Coordinators (for themselves and on behalf of the Underwriters) may require any investor who has been offered Offer Shares under the International Offering and who has made an application under the Hong Kong Public Offering to provide sufficient information to the Joint Global Coordinators so as to allow them to identify the relevant applications under the Hong Kong Public Offering and to ensure that they are excluded from any allocation of Offer Shares under the Hong Kong Public Offering.

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## STRUCTURE OF THE GLOBAL OFFERING

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### **Reallocation**

The total number of Offer Shares to be issued or sold pursuant to the International Offering may change as a result of the clawback arrangement described in “The Hong Kong Public Offering — Reallocation,” the exercise of the Over-allotment Option in whole or in part and/or any reallocation of unsubscribed Offer Shares originally included in the Hong Kong Public Offering.

### **Over-allotment Option**

In connection with the Global Offering, we expect to grant the Over-allotment Option to the International Underwriters, exercisable by the Joint Global Coordinators (for themselves and on behalf of the International Underwriters).

Pursuant to the Over-allotment Option, the International Underwriters will have the right, exercisable by the Joint Global Coordinators (for themselves and on behalf of the International Underwriters) at any time from the Listing Date until 30 days after the last day for lodging applications under the Hong Kong Public Offering, to require us to issue up to an aggregate of 25,722,000 additional Shares, representing not more than 15% of the total number of Offer Shares initially available under the Global Offering, at the International Offer Price under the International Offering to cover over-allocations in the International Offering, if any.

If the Over-allotment Option is exercised in full, the additional Offer Shares to be issued pursuant thereto will represent approximately 0.74% of the total Shares in issue immediately following the completion of the Global Offering assuming no Shares are issued pursuant to the RSU Plans. If the Over-allotment Option is exercised, an announcement will be made.

### **STABILIZATION**

Underwriters use stabilization in some markets to facilitate the distribution of securities. To stabilize, the underwriters may bid for, or purchase, the securities in the secondary market during a specified period of time, to retard and, if possible, prevent a decline in the initial public market price of the securities below the offer price. Such transactions may be effected in all jurisdictions where it is permissible to do so, in each case in compliance with all applicable laws and regulatory requirements, including those of Hong Kong. In Hong Kong, the price at which the stabilization is effected is not permitted to exceed the Public Offer Price.

In connection with the Global Offering, the Stabilizing Manager (or any person acting for it), on behalf of the Underwriters, may over-allocate or effect transactions with a view to stabilizing or supporting the market price of the Shares at a level higher than that which might otherwise prevail for a limited period after the Listing Date in the Hong Kong market. However, there is no obligation on the Stabilizing Manager (or any person acting for it) to conduct any such stabilizing action. Such stabilizing action, if taken: (a) will be conducted at the absolute discretion of the Stabilizing Manager (or any person acting for it) and in what the Stabilizing Manager reasonably regards as our best interest; (b) may be discontinued at any time; and (c) is required to be brought to an end within 30 days after the last day for lodging applications under the Hong Kong Public Offering. The Company will not, and will cause its affiliates or any of its or its affiliates' respective directors, officers, employees, or any person acting on its behalf or on behalf of any of the foregoing persons not to conduct any stabilizing action.

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## STRUCTURE OF THE GLOBAL OFFERING

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Stabilization action permitted in Hong Kong pursuant to the *Securities and Futures (Price Stabilizing) Rules* of the SFO includes: (a) over-allocating for the purpose of preventing or minimizing any reduction in the market price of the Shares; (b) selling or agreeing to sell the Shares so as to establish a short position in them for the purpose of preventing or minimizing any reduction in the market price of the Shares; (c) purchasing, or agreeing to purchase, the Shares pursuant to the Over-allotment Option in order to close out any position established under Paragraphs (a) or (b) above; (d) purchasing, or agreeing to purchase, any of the Shares for the sole purpose of preventing or minimizing any reduction in the market price of the Shares; (e) selling or agreeing to sell any Shares in order to liquidate any position established as a result of those purchases; and (f) offering or attempting to do anything as described in Paragraphs (b), (c), (d) or (e) above.

Specifically, prospective applicants for and investors in the Offer Shares should note that:

- (a) the Stabilizing Manager (or any person acting for it) may, in connection with the stabilizing action, maintain a long position in the Shares;
- (b) there is no certainty as to the extent to which and the time or period for which the Stabilizing Manager (or any person acting for it) will maintain such a long position;
- (c) liquidation of any such long position by the Stabilizing Manager (or any person acting for it) and selling in the open market may have an adverse impact on the market price of the Shares;
- (d) no stabilizing action can be taken to support the price of the Shares for longer than the stabilization period, which will begin on the Listing Date, and is expected to expire on Sunday, July 5, 2020, being the 30th day after the last day for lodging applications under the Hong Kong Public Offering. After this date, when no further stabilizing action may be taken, demand for the Shares, and therefore the price of the Shares, could fall;
- (e) the price of the Shares cannot be assured to stay at or above the Public Offer Price by the taking of any stabilizing action; and
- (f) stabilizing bids or transactions effected in the course of the stabilizing action may be made at any price at or below the Public Offer Price and can, therefore, be done at a price below the price paid by applicants for, or investors in, the Offer Shares.

We will ensure or procure that an announcement in compliance with the *Securities and Futures (Price Stabilizing) Rules* of the SFO will be made within seven days of the expiration of the stabilization period.

In addition, stabilization transactions with respect to the ADSs may be effected by one of the Underwriters or its affiliates before the listing of the Shares on the Hong Kong Stock Exchange in accordance with applicable laws and regulations.

### **Over-allocation**

Following any over-allocation of Shares in connection with the Global Offering, the Stabilizing Manager (or any person acting for it) may cover such over-allocations by, among other methods, exercising the Over-allotment Option in full or in part, by using Shares purchased by the Stabilizing Manager (or any person acting for it) in the secondary market at prices that do not exceed the Public Offer Price or through the Stock Borrowing Agreement as detailed below, or through a combination of these means.

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## STRUCTURE OF THE GLOBAL OFFERING

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### Stock Borrowing Agreement

To cover any over-allocation of Shares in connection with the Global Offering, J.P. Morgan Securities plc may choose to borrow up to 25,722,000 Shares (being the maximum number of Shares which may be issued pursuant to the exercise of the Over-allotment Option) from Shining Globe International Limited, pursuant to the Stock Borrowing Agreement, which is expected to be entered into between J.P. Morgan Securities plc and Shining Globe International Limited on or about the Price Determination Date.

The same number of Shares so borrowed must be returned to Shining Globe International Limited, on or before the fifth business day or in the event that the Stabilizing Manager conducts stabilizing action by purchasing ADSs in the U.S. market, the seventh business day, following the earlier of (a) the last day on which the Over-allotment Option may be exercised and (b) the day on which the Over-allotment Option is exercised in full, or such earlier time as agreed in writing between the J.P. Morgan Securities plc and Shining Globe International Limited.

The Shares borrowing arrangement described above will be effected in compliance with all applicable laws, rules and regulatory requirements in Hong Kong. No payment will be made to Shining Globe International Limited by the J.P. Morgan Securities plc (or any person acting for it) in relation to such Shares borrowing arrangement.

### Pricing and allocation

#### *Determining the Offer Price*

We will determine the pricing for the Offer Shares for the purpose of the various offerings under the Global Offering on the Price Determination Date, which is expected to be on or about Friday, June 5, 2020 and, in any event, no later than Wednesday, June 10, 2020, by agreement with the Joint Global Coordinators (for themselves and on behalf of the Underwriters), and the number of Offer Shares to be allocated under the various offerings will be determined shortly thereafter.

We will determine the Public Offer Price by reference to, among other factors, the closing price of the ADSs on Nasdaq on the last trading day on or before the Price Determination Date, and the Public Offer Price will not be more than HK\$126.00 per Hong Kong Offer Share. The historical prices of our ADSs and trading volume on Nasdaq are set out below.

<b>Period</b>	<b>High</b>	<b>Low</b>	<b>ADTV</b>
	<b>(US\$)</b>	<b>(US\$)</b>	<b>(ADSs)<sup>(1)</sup></b>
Fiscal year ended December 31, 2019 . . . . .	319.24	211.88	715,215
Fiscal year of 2020 (up to the Latest Practicable Date) . . . . .	401.76	270.43	806,358

Note:

(1) Average daily trading volume (“ADTV”) represents daily average number of our ADSs traded over the relevant period.

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## STRUCTURE OF THE GLOBAL OFFERING

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Applicants under the Hong Kong Public Offering must pay, on application, the maximum Public Offer Price of HK\$126.00 per Offer Share plus brokerage of 1.0%, SFC transaction levy of 0.0027% and Hong Kong Stock Exchange trading fee of 0.005%, amounting to a total of HK\$12,726.97 for one board lot of 100 Shares.

We may set the International Offer Price at a level higher than the maximum Public Offer Price if (a) the Hong Kong dollar equivalent of the closing trading price of the ADSs on the Nasdaq on the last trading day on or before the Price Determination Date (on a per-Share converted basis) were to exceed the maximum Public Offer Price as stated in this document and/or (b) we believe that it is in its best interest as a listed company to set the International Offer Price at a level higher than the maximum Public Offer Price based on the level of interest expressed by professional and institutional investors during the book-building process.

If the International Offer Price is set at or lower than the maximum Public Offer Price, the Public Offer Price must be set at such price which is equal to the International Offer Price. In no circumstances will we set the Public Offer Price above the maximum Public Offer Price as stated in this document or the International Offer Price.

We reserve the right not to proceed with the Hong Kong Public Offering or the International Offering on or at any time until the Price Determination Date if, for any reason, including as a result of volatility in the price of our ADSs or other changes in market conditions, we do not agree with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on the pricing of the Offer Shares by Wednesday, June 10, 2020.

The International Underwriters will be soliciting from prospective investors' indications of interest in acquiring Offer Shares in the International Offering. Prospective professional and institutional investors will be required to specify the number of Offer Shares under the International Offering they would be prepared to acquire either at different prices or at a particular price. This process, known as "book-building," is expected to continue up to, and to cease on or about, the last day for lodging applications under the Hong Kong Public Offering.

The Joint Global Coordinators (for themselves and on behalf of the Underwriters) may, where they deem appropriate, based on the level of interest expressed by prospective investors during the book-building process in respect of the International Offering, and with our consent, reduce the number of Offer Shares offered below as stated in this document at any time on or prior to the morning of the last day for lodging applications under the Hong Kong Public Offering. In such a case, we will, as soon as practicable following the decision to make such reduction, and in any event not later than the morning of the last day for lodging applications under the Hong Kong Public Offering, cause to be published on our website and the website of the Hong Kong Stock Exchange at <http://ir.netease.com/> and [www.hkexnews.hk](http://www.hkexnews.hk), respectively, notices of the reduction.

Upon the issue of such a notice, the revised number of Offer Shares will be final. If the number of Offer Shares is reduced, applicants under the Hong Kong Public Offering will be entitled to withdraw their applications, unless positive confirmations from the applicants to proceed are received.

Before submitting applications for the Hong Kong Offer Shares, applicants should have regard to the possibility that any announcement of a reduction in the number of Offer Shares may not be made until the last day for lodging applications under the Hong Kong Public Offering. Such notice will also include confirmation or revision, as appropriate, of the working capital

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## STRUCTURE OF THE GLOBAL OFFERING

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statement and the Global Offering statistics as currently set out in this document, and any other financial information which may change as a result of any such reduction. In the absence of any such notice so published, the number of Offer Shares will not be reduced.

The final pricing of the Offer Shares, the level of indications of interest in the International Offering, the level of applications in the Hong Kong Public Offering, the basis of allocations of the Hong Kong Offer Shares and the results of allocations in the Hong Kong Public Offering are expected to be made available through a variety of channels in the manner described in “How to Apply for Hong Kong Offer Shares — Publication of Results.”

### UNDERWRITING

The Hong Kong Public Offering is fully underwritten by the Hong Kong Underwriters under the terms and conditions of the Hong Kong Underwriting Agreement and is subject to, among other things, our agreeing with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on the pricing of the Offer Shares.

We expect to enter into the International Underwriting Agreement relating to the International Offering on the Price Determination Date.

These underwriting arrangements, including the Underwriting Agreements, are summarized in “Underwriting.”

### CONDITIONS OF THE GLOBAL OFFERING

Acceptance of all applications for Offer Shares will be conditional on:

- (a) the Listing Committee granting approval for the listing of, and permission to deal in, the Shares in issue and to be issued pursuant to the Global Offering (including the Shares which may be issued pursuant to the exercise of the Over-allotment Option) and the Shares to be issued pursuant to the RSU Plans, on the Main Board of the Hong Kong Stock Exchange and such approval not subsequently having been withdrawn or revoked prior to the Listing Date;
- (b) the pricing of the Offer Shares having been agreed between the Joint Global Coordinators (for themselves and on behalf of the Underwriters) and us;
- (c) the execution and delivery of the International Underwriting Agreement on or around the Price Determination Date; and
- (d) the obligations of the Hong Kong Underwriters under the Hong Kong Underwriting Agreement and the obligations of the International Underwriters under the International Underwriting Agreement becoming and remaining unconditional and not having been terminated in accordance with the terms of the respective agreements,

in each case on or before the dates and times specified in the respective Underwriting Agreements (unless and to the extent such conditions are validly waived on or before such dates and times) and, in any event, not later than the date which is 30 days from the date of this document.

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## STRUCTURE OF THE GLOBAL OFFERING

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If, for any reason, we do not agree with the Joint Global Coordinators (for themselves and on behalf of the Underwriters) on the pricing of the Offer Shares on or before Wednesday, June 10, 2020, the Global Offering will not proceed and will lapse.

The consummation of each of the Hong Kong Public Offering and the International Offering is conditional upon, among other things, the other offering becoming unconditional and not having been terminated in accordance with its terms.

If the above conditions are not fulfilled or waived prior to the dates and times specified, the Global Offering will lapse and the Hong Kong Stock Exchange will be notified immediately. Notice of the lapse of the Hong Kong Public Offering will be published by us on our website and the website of the Hong Kong Stock Exchange at <http://ir.netease.com/> and [www.hkexnews.hk](http://www.hkexnews.hk), respectively, on the next day following such lapse. In such a situation, all application monies will be returned, without interest, on the terms set out in “How to Apply for Hong Kong Offer Shares — Refund of application monies.” In the meantime, all application monies will be held in separate bank account(s) with the receiving bank or other bank(s) in Hong Kong licensed under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong).

Share certificates for the Offer Shares will only become valid at 8:00 a.m. on Thursday, June 11, 2020, provided that the Global Offering has become unconditional in all respects at or before that time.

### DEALINGS IN THE SHARES

Assuming that the Hong Kong Public Offering becomes unconditional at or before 8:00 a.m. in Hong Kong on Thursday, June 11, 2020, it is expected that dealings in the Shares on the Hong Kong Stock Exchange will commence at 9:00 a.m. on Thursday, June 11, 2020.

The Shares will be traded in board lots of 100 Shares each and the stock code of the Shares will be 9999.



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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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### IMPORTANT NOTICE TO INVESTORS:

#### 1. FULLY ELECTRONIC APPLICATION PROCESS

**We have adopted a fully electronic application process for the Hong Kong Public Offering. We will not provide any printed copies of this document or any printed copies of any application forms for use by the public.**

This document is available at the website of the Hong Kong Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk) under the “*HKEXnews > New Listings > New Listing Information*” section, and our website at <http://ir.netease.com/>. If you require a printed copy of this document, you may download and print from the website addresses above.

The contents of the electronic version of the prospectus are identical to the printed prospectus as registered with the Registrar of Companies in Hong Kong pursuant to Section 342C of the Companies (WUMP) Ordinance.

Set out below are procedures through which you can apply for the Hong Kong Offer Shares electronically. We will not provide any physical channels to accept any application for the Hong Kong Offer Shares by the public.

If you are an intermediary, broker or agent, please remind your customers, clients or principals, as applicable, that this document is available online at the website addresses above.

If you have any questions about the application for the Hong Kong Offer Shares, you may call the enquiry hotline of our Hong Kong Share Registrar and **White Form eIPO** Service Provider, Computershare Hong Kong Investor Services Limited, at +852 2862 8646 from 9:00 a.m. to 9:00 p.m. on Tuesday, June 2, 2020, Wednesday, June 3, 2020 and Thursday, June 4, 2020 and from 9:00 a.m. to 12:00 noon on Friday, June 5, 2020.

#### 2. PAYMENT OF Q1 DIVIDEND

The Q1 Dividend will be paid in U.S. dollars. All investors who have applied for Offer Shares through **CCASS eIPO** service and been successfully allocated Offer Shares will be entitled to the Q1 Dividend provided that the Global Offering becomes unconditional, irrespective of whether they sell or otherwise dispose of their corresponding allocated Offer Shares on the Hong Kong Stock Exchange immediately after dealing commences on the Listing Date, unless such investors (i) conduct any non-exchange trades and the ownership of the Shares are transferred to a third party on or before the Record Date, or (ii) withdraw physical certificates of such Shares from CCASS and subsequently sell or otherwise dispose of their corresponding Shares by lodging completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar before 4:30 p.m. (Hong Kong Time) on the Record Date for transferring the title to a third party.

Shareholders and potential investors should note that those who have chosen to apply through **White Form eIPO** services and to have physical share certificates issued to themselves will **NOT** be entitled to the Q1 Dividend, if they sell or otherwise dispose of their corresponding Shares, by lodging completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar before 4:30 p.m. (Hong Kong Time) on the Record Date (being Friday, June 12, 2020) for transferring such title to a third party. Any subsequent purchasers who acquire the relevant Offer Shares from such holders of physical share certificate and lodge completed transfer forms accompanied by the relevant share certificates with the Hong Kong Share Registrar by 4:30 p.m. (Hong Kong time) on the Record Date, **WILL BE** entitled to the Q1 Dividend.

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Investors who purchase the Company's Shares on the Hong Kong Stock Exchange **AFTER** the commencement of dealings will **NOT** receive the Q1 Dividend.

In the event that there are unforeseen reasons (including but not limited to bad weather, Extreme Conditions or other events in the nature of force majeure, together the "**Unforeseen Reasons**") that result in the Listing Date being delayed to a date after the Record Date but no later than June 18, 2020 (the "**Delay**") and the Delay is solely due to the Unforeseen Reasons, the Company undertakes to pay investors of the Global Offering an amount equal to the Q1 Dividend (based on the investor's corresponding number of Offer Shares allocated in the Global Offering) if the investor would have been entitled to the Q1 Dividend had the Delay not otherwise occurred.

Investors who are interested in participating in the Global Offering, if choosing to refer to our ADS prices during the Hong Kong Public Offering period prior to the Price Determination Date, should note that such trading prices will be cum dividend. Upon commencement of dealings in our Shares on the Hong Kong Stock Exchange on the Listing Date, our Shares will trade ex-dividend, and may not be comparable to the price of our ADSs during the Hong Kong Public Offering period, on the Price Determination Date and on the day immediately before the Listing Date (all cum dividend). Such discrepancy will, at least in part, be the result of the different entitlement rights with respect to Q1 Dividend. However, investors should not interpret such difference as a discount on the price of our Shares offered for the Global Offering.

In addition, payment of the Q1 Dividend may affect the value of our Shares and the trading price of our ADSs and Shares in the U.S. and Hong Kong markets, respectively. Accordingly, Shareholders and potential investors should exercise caution when dealing in our Shares.

### APPLICATIONS FOR THE HONG KONG OFFER SHARES

#### How to apply

*We will not provide any printed application forms for use by the public.*

To apply for the Hong Kong Offer Shares, you may:

- (1) apply online through the **White Form eIPO** service at [www.eipo.com.hk](http://www.eipo.com.hk); or
- (2) apply through **CCASS EIPO** service to electronically cause HKSCC Nominees to apply on your behalf, including by:
  - (a) instructing your **broker** or **custodian** who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf;  
or

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- (b) (if you are an existing **CCASS Investor Participant**) giving **electronic application instructions** through the CCASS Internet System (<https://ip.ccass.com>) or through the CCASS Phone System by calling +852 2979 7888 (using the procedures in HKSCC’s “An Operating Guide for Investor Participants” in effect from time to time). HKSCC can also input **electronic application instructions** for CCASS Investor Participants through HKSCC’s Customer Service Centre at 1/F, One & Two Exchange Square, 8 Connaught Place, Central, Hong Kong by completing an input request.

If you apply through channel (1) above, the Hong Kong Offer Shares successfully applied for will be issued in your own name.

If you apply through channels (2)(a) or (2)(b) above, the Hong Kong Offer Shares successfully applied for will be issued in the name of HKSCC Nominees and deposited directly into CCASS to be credited to your or a designated CCASS Participant’s stock account.

None of you or your joint applicant(s) may make more than one application, except where you are a nominee and provide the required information in your application.

We, the Joint Global Coordinators, the **White Form eIPO** Service Provider and their respective agents may reject or accept any application, in full or in part, for any reason at their discretion.

### **Who can apply**

#### *Eligibility for the Application*

You can apply for the Hong Kong Offer Shares if you or any person(s) for whose benefit you are applying:

- (a) are 18 years of age or older; and
- (b) have a Hong Kong address.

If an application is made by a person under a power of attorney, we and the Joint Global Coordinators may accept it at their discretion, and on any conditions we think fit, including requiring evidence of the attorney’s authority.

The number of joint applicants may not exceed four and they may not apply by means of the **White Form eIPO** service for the Hong Kong Offer Shares.

Unless permitted by the Hong Kong Listing Rules or any relevant waivers that have been granted by the Hong Kong Stock Exchange (details of the relevant waivers are set out in “Waivers and Exemptions — Subscription For Shares By Existing Shareholders” and “Waivers and Exemptions — Dealings In Shares Prior To Listing,” you cannot apply for any Hong Kong Offer Shares if:

- (a) you are an existing beneficial owner of Shares and/or a substantial shareholder of any of the Company’s subsidiaries;
- (b) you are the Company’s director or chief executive and/or a director or chief executive officer of its subsidiaries;

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- (c) you are a close associate of any of the above persons;
- (d) you are a core connected person of the Company or a person who will become a core connected person of the Company immediately upon the completion of the Global Offering; or
- (e) you have been allocated or have applied for any International Offer Shares or otherwise participate in the International Offering.

### *Items Required for the Application*

If you apply for the Hong Kong Offer Shares online through the **White Form eIPO** service, you must:

- (a) have a valid Hong Kong identity card number; and
- (b) provide a valid e-mail address and a contact telephone number.

If you are applying for the Hong Kong Offer Shares online by instructing your **broker** or **custodian** who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals, please contact them for the items required for the application.

### **Terms and conditions of an application**

By applying through the application channels specified in this document you:

- (a) undertake to execute all relevant documents and instruct and authorize the Company and/or the Joint Global Coordinators (or their agents or nominees), as their agents, to execute any documents for you and to do on your behalf all things necessary to register any Hong Kong Offer Shares allocated to you in your name or in the name of HKSCC Nominees as required by the Articles of Association;
- (b) agree to comply with the Company's Memorandum and Articles of Association, the Companies (WUMP) Ordinance and the Cayman Companies Law;
- (c) confirm that you have read the terms and conditions and application procedures set out in this document and agree to be bound by them;
- (d) confirm that you have received and read this document and have relied only on the information and representations in this document in making your application and will not rely on any other information or representations, except those in any supplement to this document;
- (e) confirm that you are aware of the restrictions on the Global Offering set out in this document;
- (f) agree that none of the Company, the Relevant Persons and the **White Form eIPO** Service Provider is or will be liable for any information and representations not in this document (and any supplement to this document);

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- (g) undertake and confirm that you or the person(s) for whose benefit you have made the application have not applied for or taken up, or indicated an interest for, and will not apply for or take up, or indicate an interest for, any International Offer Shares nor participated in the International Offering;
- (h) agree to disclose to the Company, the Hong Kong Share Registrar, the receiving bank and the Relevant Persons any personal data that any of them may require about you and the person(s) for whose benefit you have made the application;
- (i) if the laws of any place outside Hong Kong apply to your application, agree and warrant that you have complied with all such laws and neither the Company nor the Relevant Persons will breach any laws outside Hong Kong as a result of the acceptance of your offer to purchase, or any action arising from your rights and obligations under the terms and conditions in this document;
- (j) agree that once your application has been accepted, you may not rescind it because of an innocent misrepresentation;
- (k) agree that your application, any acceptance of it and the resulting contract will be governed by, and construed in accordance with the laws of Hong Kong;
- (l) warrant that the information you have provided is true and accurate;
- (m) agree to accept the Hong Kong Offer Shares applied for or any lesser number allocated to you under the application;
- (n) authorize (i) the Company to place your name(s) or the name of HKSCC Nominees on the Company's register of members as the holder(s) of any Hong Kong Offer Shares allocated to you and such other registers as required under the Company's Memorandum and Articles of Association and (ii) the Company and/or its agents to send any Share certificate(s) and/or any e-Refund payment instructions and/or any refund check(s) to you or the first-named applicant for joint applications by ordinary post at your own risk to the address stated on the application, unless you have fulfilled the criteria mentioned in "— Personal Collection" below to collect the Share certificate(s) and/or refund check(s) in person;
- (o) declare and represent that this is the only application made and the only application intended by you to be made to benefit you or the person for whose benefit you are applying;
- (p) understand that the Company, its directors and the Joint Global Coordinators will rely on your declarations and representations in deciding whether or not to allocate any of the Hong Kong Offer Shares to you and that you may be prosecuted for making a false declaration;
- (q) (if the application is made for your own benefit) warrant that no other application has been or will be made for your benefit by giving **electronic application instructions** to HKSCC directly or indirectly or through the **White Form eIPO** service or by any one as your agent or by any other person; and

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- (r) (if you are making the application as an agent for the benefit of another person) warrant that (i) no other application has been or will be made by you as agent for or for the benefit of that person or by that person or by any other person as agent for that person by giving **electronic application instructions** to HKSCC and (ii) you have due authority to give **electronic application instructions** on behalf of that other person as its agent.

For the avoidance of doubt, the Company and all other parties involved in the preparation of this document acknowledge that each applicant and CCASS Participant who gives or causes to give **electronic application instructions** is a person who may be entitled to compensation under Section 40 of the Companies (WUMP) Ordinance (as applied by Section 342E of the Companies (WUMP) Ordinance).

### Minimum application amount and permitted numbers

Your application through the **White Form eIPO** service or the **CCASS EIPO** service must be for a minimum of 100 Hong Kong Offer Shares and in one of the numbers set out in the table. You are required to pay the amount next to the number you select.

No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$	No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$	No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$	No. of Hong Kong Offer Shares applied for	Amount payable on application HK\$
100	12,726.97	2,500	318,174.26	30,000	3,818,091.06	600,000	76,361,821.20
200	25,453.94	3,000	381,809.11	40,000	5,090,788.08	700,000	89,088,791.40
300	38,180.91	3,500	445,443.96	50,000	6,363,485.10	800,000	101,815,761.60
400	50,907.88	4,000	509,078.81	60,000	7,636,182.12	900,000	114,542,731.80
500	63,634.85	4,500	572,713.66	70,000	8,908,879.14	1,000,000	127,269,702.00
600	76,361.82	5,000	636,348.51	80,000	10,181,576.16	1,500,000	190,904,553.00
700	89,088.79	6,000	763,618.21	90,000	11,454,273.18	2,000,000	254,539,404.00
800	101,815.76	7,000	890,887.91	100,000	12,726,970.20	2,575,000 <sup>(1)</sup>	327,719,482.65
900	114,542.73	8,000	1,018,157.62	200,000	25,453,940.40		
1,000	127,269.70	9,000	1,145,427.32	300,000	38,180,910.60		
1,500	190,904.55	10,000	1,272,697.02	400,000	50,907,880.80		
2,000	254,539.40	20,000	2,545,394.04	500,000	63,634,851.00		

Note:

- (1) Maximum number of Hong Kong Offer Shares you may apply for.

No application for any other number of the Hong Kong Offer Shares will be considered and any such application is liable to be rejected.

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### Applying through the White Form eIPO Service

#### *General*

Individuals who meet the criteria in “— Who can apply” above may apply through the **White Form eIPO** service for the Offer Shares to be allocated and registered in their own names through the designated website at [www.eipo.com.hk](http://www.eipo.com.hk).

Detailed instructions for application through the **White Form eIPO** service are set out on the designated website. If you do not follow the instructions, your application may be rejected and may not be submitted to the Company. If you apply through the designated website, you authorize the **White Form eIPO** Service Provider to apply on the terms and conditions in this document, as supplemented and amended by the terms and conditions of the **White Form eIPO** Service Provider.

If you have any questions on how to apply through the **White Form eIPO** service for the Hong Kong Offer Shares, please contact the telephone enquiry line of the **White Form eIPO** Service Provider at +852 2862 8646 which is available from 9:00 a.m. to 9:00 p.m. on Tuesday, June 2, 2020, Wednesday, June 3, 2020 and Thursday, June 4, 2020, and from 9:00 a.m. to 12:00 noon on Friday, June 5, 2020.

#### *Time for submitting applications under the White Form eIPO service*

You may submit your application through the **White Form eIPO** service through the designated website at [www.eipo.com.hk](http://www.eipo.com.hk) (24 hours daily, except on the last day for applications) from 9:00 a.m. on Tuesday, June 2, 2020 until 11:30 a.m. on Friday, June 5, 2020 and the latest time for completing full payment of application monies in respect of such applications will be 12:00 noon on Friday, June 5, 2020, the last day for applications, or such later time as described in “Effect of bad weather and Extreme Conditions on the opening and closing of the application lists” below.

#### *Commitment to sustainability*

The obvious advantage of **White Form eIPO** service is to save the use of paper via the self-serviced and electronic application process. Computershare Hong Kong Investor Services Limited, being the designated **White Form eIPO** Service Provider, will contribute HK\$2 for each “NetEase, Inc.” **White Form eIPO** application submitted via [www.eipo.com.hk](http://www.eipo.com.hk) to support sustainability.

### Applying through CCASS EIPO service

#### *General*

You may instruct your broker or custodian who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf. CCASS Participants may give **electronic application instructions** to apply for the Hong Kong Offer Shares and to arrange payment of the money due on application and payment of refunds under their participant agreements with HKSCC and the General Rules of CCASS and the CCASS Operational Procedures.

If you are a **CCASS Investor Participant**, you may give these **electronic application instructions** through the CCASS Internet System (<https://ip.ccass.com>) or through the CCASS Phone System by calling +852 2979 7888 (using the procedures in HKSCC’s “An

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Operating Guide for Investor Participants” in effect from time to time). HKSCC can also input **electronic application instructions** for CCASS Investor Participants through HKSCC’s Customer Service Centre at 1/F, One & Two Exchange Square, 8 Connaught Place, Central, Hong Kong by completing an input request.

You will be deemed to have authorized HKSCC and/or HKSCC Nominees to transfer the details of your application to the Company, the Joint Sponsors, the Joint Global Coordinators and the Hong Kong Share Registrar.

### *Applying through CCASS EIPO service*

Where you have applied through **CCASS EIPO** service (either indirectly through a **broker** or **custodian** or directly) and an application is made by HKSCC Nominees on your behalf:

- (a) HKSCC Nominees will only be acting as a nominee for you and is not liable for any breach of the terms and conditions of this document; and
- (b) HKSCC Nominees will do the following things on your behalf:
  - agree that the Hong Kong Offer Shares to be allocated shall be registered in the name of HKSCC Nominees and deposited directly into CCASS for the credit of the CCASS Participant’s stock account on your behalf or your CCASS Investor Participant’s stock account;
  - agree to accept the Hong Kong Offer Shares applied for or any lesser number allocated;
  - undertake and confirm that you have not applied for or taken up, or indicated an interest for, and will not apply for or take up, or indicate an interest for, any International Offer Shares nor participated in the International Offering;
  - declare that only one set of **electronic application instructions** has been given for your benefit;
  - (if you are an agent for another person) declare that you have only given one set of **electronic application instructions** for the other person’s benefit and are duly authorized to give those instructions as its agent;
  - confirm that you understand that the Company, its directors and the Joint Global Coordinators will rely on your declarations and representations in deciding whether or not to allocate any of the Hong Kong Offer Shares to you and that you may be prosecuted for making a false declaration;
  - authorize the Company to place HKSCC Nominees’ name on its register of members as the holder of the Hong Kong Offer Shares allocated to you, and despatch Share certificate(s) and/or refund monies in accordance with the arrangements separately agreed between the Company and HKSCC;
  - confirm that you have read the terms and conditions and application procedures set out in this document and agree to be bound by them;



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- confirm that you have received and read this document and have relied only on the information and representations in this document in causing the application to be made and will not rely on any other information or representations, except those in any supplement to this document;
- agree that neither the Company nor any of the Relevant Persons is or will be liable for any information and representations not in this document (and any supplement to this document);
- agree to disclose to the Company, the Hong Kong Share Registrar, the receiving bank and the Relevant Persons any personal data which they may require about you;
- agree (without prejudice to any other rights which you may have) that once HKSCC Nominees' application has been accepted, it cannot be rescinded for innocent misrepresentation;
- agree that any application made by HKSCC Nominees on your behalf is irrevocable on or before the fifth day after the time of the opening of the application lists (excluding any days which is a Saturday, Sunday or public holiday in Hong Kong), such agreement to take effect as a collateral contract with the Company, and to become binding when you give the instructions and such collateral contract to be in consideration of the Company's agreement that it will not offer any Hong Kong Offer Shares to any person on or before the fifth day after the time of the opening of the application lists (excluding any days which is a Saturday, Sunday or public holiday in Hong Kong) except by means of one of the procedures referred to in this document. However, HKSCC Nominees may revoke the application on or before the fifth day after the time of the opening of the application lists (excluding any days which is a Saturday, Sunday or public holiday in Hong Kong) if a person responsible for this document under Section 40 of the Companies (WUMP) Ordinance (as applied by Section 342E of the Companies (WUMP) Ordinance) gives a public notice under that section on or before the fifth day after the time of the opening of the application lists (excluding any day which is a Saturday, Sunday or public holiday in Hong Kong) which excludes or limits that person's responsibility for this document;
- agree that once HKSCC Nominees' application is accepted, neither that application nor your **electronic application instructions** can be revoked, and that acceptance of that application will be evidenced by the Company's announcement of the results of the Hong Kong Public Offering;
- agree to the arrangements, undertakings and warranties under the participant agreement between you and HKSCC, read with the General Rules of CCASS and the CCASS Operational Procedures, for giving **electronic application instructions** to apply for the Hong Kong Offer Shares;

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- agree with the Company, for itself and for the benefit of each shareholder (and so that the Company will be deemed by its acceptance in whole or in part of the application by HKSCC Nominees to have agreed, for the Company and on behalf of each shareholder, with each CCASS Participant giving **electronic application instructions**) to observe and comply with its Memorandum and Articles of Association, the Companies (WUMP) Ordinance and the Cayman Companies Law; and
- agree that your application, any acceptance of it and the resulting contract will be governed by, and construed in accordance with the laws of Hong Kong.

### *Effect of Applying through CCASS EIPO service*

By applying through **CCASS EIPO** service, you (and, if you are joint applicants, each of you jointly and severally) are deemed to have done the following things. Neither HKSCC nor HKSCC Nominees will be liable to the Company or any other person in respect of the things mentioned below:

- (a) instructed and authorized HKSCC to cause HKSCC Nominees (acting as nominee for the relevant CCASS Participants) to apply for the Hong Kong Offer Shares on your behalf;
- (b) instructed and authorized HKSCC to arrange payment of the maximum Public Offer Price, brokerage, SFC transaction levy and Hong Kong Stock Exchange trading fee by debiting your designated bank account and, in the case of a wholly or partially unsuccessful application and/or if the Public Offer Price is less than the maximum Public Offer Price initially paid on application, refund of the application monies (including brokerage, SFC transaction levy and Hong Kong Stock Exchange trading fee) by crediting your designated bank account; and
- (c) instructed and authorized HKSCC to cause HKSCC Nominees to do on your behalf all the things stated in this document.

### *Time for inputting electronic application instructions<sup>(1)</sup>*

CCASS Clearing/Custodian Participants can input **electronic application instructions** at the following times on the following dates:

**Tuesday, June 2, 2020 – 9:00 a.m. to 8:30 p.m.**  
**Wednesday, June 3, 2020 – 8:00 a.m. to 8:30 p.m.**  
**Thursday, June 4, 2020 – 8:00 a.m. to 8:30 p.m.**  
**Friday, June 5, 2020 – 8:00 a.m. to 12:00 noon**

CCASS Investor Participants can input **electronic application instructions** from 9:00 a.m. on Tuesday, June 2, 2020 until 12:00 noon on Friday, June 5, 2020 (24 hours daily, except on Friday, June 5, 2020, the last day for applications).

The latest time for inputting your **electronic application instructions** will be 12:00 noon on Friday, June 5, 2020, the last day for applications, or such later time as described in “Effect of bad weather and Extreme Conditions on the opening and closing of the application lists” below.

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If you are instructing your **broker** or **custodian** who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf, you are advised to contact your **broker** or **custodian** for the latest time for giving such instructions which may be different from the latest time as stated above.

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Note:

- (1) The times in this subsection are subject to change as HKSCC may determine from time to time with prior notification to CCASS Clearing Participants, CCASS Custodian Participants and/or CCASS Investor Participants.

### *Personal data*

The following Personal Information Collection Statement applies to any personal data held by the Company, the Hong Kong Share Registrar, the receiving bank and the Relevant Persons about you in the same way as it applies to personal data about applicants other than HKSCC Nominees. By applying through **CCASS EIPO** service, you agree to all of the terms of the Personal Information Collection Statement below.

### *Personal information collection statement*

This Personal Information Collection Statement informs applicant for, and holder of, the Hong Kong Offer Shares, of the policies and practices of the Company and its Hong Kong Share Registrar in relation to personal data and the Personal Data (Privacy) Ordinance (Chapter 486 of the Laws of Hong Kong).

### *Reasons for the collection of your personal data*

It is necessary for applicants and registered holders of the Hong Kong Offer Shares to supply correct personal data to the Company or its agents and the Hong Kong Share Registrar when applying for the Hong Kong Offer Shares or transferring the Hong Kong Offer Shares into or out of their names or in procuring the services of the Hong Kong Share Registrar.

Failure to supply the requested data may result in your application for the Hong Kong Offer Shares being rejected, or in delay or the inability of the Company or its Hong Kong Share Registrar to effect transfers or otherwise render their services. It may also prevent or delay registration or transfers of the Hong Kong Offer Shares which you have successfully applied for and/or the dispatch of share certificate(s) to which you are entitled.

It is important that the holders of the Hong Kong Offer Shares inform the Company and the Hong Kong Share Registrar immediately of any inaccuracies in the personal data supplied.

### *Purposes*

Your personal data may be used, held, processed, and/or stored (by whatever means) for the following purposes:

- (a) processing your application and refund check, where applicable, verification of compliance with the terms and application procedures set out in this document and announcing results of allocation of the Hong Kong Offer Shares;

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- (b) compliance with applicable laws and regulations in Hong Kong and elsewhere;
- (c) registering new issues or transfers into or out of the names of the holders of the Company's Shares including, where applicable, HKSCC Nominees;
- (d) maintaining or updating the Company's Register of Members;
- (e) verifying identities of the holders of the Company's Shares;
- (f) establishing benefit entitlements of holders of the Company's Shares, such as dividends, rights issues, bonus issues, etc.;
- (g) distributing communications from the Company and its subsidiaries;
- (h) compiling statistical information and profiles of the holder of the Company's Shares;
- (i) disclosing relevant information to facilitate claims on entitlements; and
- (j) any other incidental or associated purposes relating to the above and/or to enable the Company and the Hong Kong Share Registrar to discharge their obligations to holders of the Company's Shares and/or regulators and/or any other purposes to which the securities' holders may from time to time agree.

### *Transfer of personal data*

Personal data held by the Company and its Hong Kong Share Registrar relating to the holders of the Hong Kong Offer Shares will be kept confidential but the Company and its Hong Kong Share Registrar may, to the extent necessary for achieving any of the above purposes, disclose, obtain or transfer (whether within or outside Hong Kong) the personal data to, from or with any of the following:

- (a) the Company's appointed agents such as financial advisers, receiving bankers and overseas principal share registrar;
- (b) where applicants for the Hong Kong Offer Shares request a deposit into CCASS, HKSCC or HKSCC Nominees, who will use the personal data for the purposes of operating CCASS;
- (c) any agents, contractors or third-party service providers who offer administrative, telecommunications, computer, payment or other services to the Company or the Hong Kong Share Registrar in connection with their respective business operation;
- (d) the Hong Kong Stock Exchange, the SFC and any other statutory regulatory or governmental bodies or otherwise as required by laws, rules or regulations; and
- (e) any persons or institutions with which the holders of the Hong Kong Offer Shares have or propose to have dealings, such as their bankers, solicitors, accountants or stockbrokers etc.

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### *Retention of personal data*

The Company and its Hong Kong Share Registrar will keep the personal data of the applicants and holders of the Hong Kong Offer Shares for as long as necessary to fulfil the purposes for which the personal data were collected. Personal data which is no longer required will be destroyed or dealt with in accordance with the *Personal Data (Privacy) Ordinance*.

### *Access to and correction of personal data*

Holders of the Hong Kong Offer Shares have the right to ascertain whether the Company or the Hong Kong Share Registrar hold their personal data, to obtain a copy of that data, and to correct any data that is inaccurate. The Company and the Hong Kong Share Registrar have the right to charge a reasonable fee for the processing of such requests. All requests for access to data or correction of data should be addressed to the Company, at the Company's registered address disclosed in "Corporate Information" or as notified from time to time, for the attention of the secretary, or the Company's Hong Kong Share Registrar for the attention of the privacy compliance officer.

### **Warning for electronic applications**

The application for the Hong Kong Offer Shares by **CCASS EIPO** service (directly or indirectly through your **broker** or **custodian**) is only a facility provided to CCASS Participants. Similarly, the application for the Hong Kong Offer Shares through the **White Form eIPO** service is only a facility provided by the **White Form eIPO** Service Provider to public investors. Such facilities are subject to capacity limitations and potential service interruptions and you are advised not to wait until the last day for applications to make your electronic application. The Company, the Relevant Persons, the **White Form eIPO** Service Provider take no responsibility for such applications and provide no assurance that any CCASS Participant applying through **CCASS EIPO** service or person applying through the **White Form eIPO** service will be allocated any Hong Kong Offer Shares.

To ensure that CCASS Investor Participants can give their **electronic application instructions**, they are advised not to wait until the last minute to input their instructions to the systems. In the event that CCASS Investor Participants have problems in the connection to CCASS Phone System/CCASS internet System for submission of **electronic application instructions**, they should go to HKSCC's Customer Service Centre to complete an input request form for **electronic application instructions** before 12:00 noon on Friday, June 5, 2020.

### **How many applications can you make**

Multiple applications for the Hong Kong Offer Shares are not allowed except by nominees.

**All** of your applications will be rejected if more than one application through the **CCASS EIPO** service (directly or indirectly through your **broker** or **custodian**) or through the **White Form eIPO** service is made for your benefit (including the part of the application made by HKSCC Nominees acting on **electronic application instructions**), and the number of Hong Kong Offer Shares applied by HKSCC Nominees will be automatically reduced by the number of Hong Kong Offer Shares for which you have given such instructions and/or for which such instructions have been given for your behalf.

For the avoidance of doubt, giving an **electronic application instruction** under the **White Form eIPO** service more than once and obtaining different application reference numbers without effecting full payment in respect of a particular reference number will not constitute

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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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an actual application. However, any **electronic application instructions** to make an application for the Hong Kong Offer Shares given by you or for your behalf to HKSCC will be deemed to be an actual application for the purposes of considering whether multiple applications have been made.

If an unlisted company makes an application and:

- (a) the principal business of that company is dealing in securities; and
- (b) you exercise statutory control over that company,

then the application will be treated as being made for your benefit.

“**Unlisted company**” means a company with no equity securities listed on the Hong Kong Stock Exchange.

“**Statutory control**” means you:

- (a) control the composition of the board of directors of the company;
- (b) control more than half of the voting power of the company; or
- (c) hold more than half of the issued share capital of the company (not counting any part of it which carries no right to participate beyond a specified amount in a distribution of either profits or capital).

### **How much are the Hong Kong Offer Shares**

The maximum Public Offer Price is HK\$126.00 per Offer Share. You must also pay brokerage of 1.0%, SFC transaction levy of 0.0027% and Hong Kong Stock Exchange trading fee of 0.005%. This means that for one board lot of 100 Hong Kong Offer Shares, you will pay HK\$12,726.97.

You must pay the maximum Public Offer Price, together with brokerage, SFC transaction levy and Hong Kong Stock Exchange trading fee, in full upon application for the Hong Kong Offer Shares.

You may submit an application through the **White Form eIPO** service or the **CCASS EIPO** service in respect of a minimum of 100 Hong Kong Offer Shares. If you make an **electronic application instruction** for more than 100 Hong Kong Offer Shares, the number of Hong Kong Offer Shares you apply for must be in one of the specified numbers set out in “How To Apply for Hong Kong Offer Shares — Applications for the Hong Kong Offer Shares — Minimum application amount and permitted numbers.”

If your application is successful, brokerage will be paid to the Exchange Participants (as defined in the Hong Kong Listing Rules), and the SFC transaction levy and the Hong Kong Stock Exchange trading fee will be paid to the Hong Kong Stock Exchange (in the case of the SFC transaction levy, collected by the Hong Kong Stock Exchange on behalf of the SFC).

For further details on the Public Offer Price, see “Structure of the Global Offering — Pricing and allocation.”

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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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### Effect of bad weather and Extreme Conditions on the opening and closing of the application lists

The application lists will not open or close if there is/are:

- a tropical cyclone warning signal number 8 or above;
- a “black” rainstorm warning; and/or
- Extreme Conditions

in force in Hong Kong at any time between 9:00 a.m. and 12:00 noon on Friday, June 5, 2020. Instead, they will open between 11:45 a.m. and 12:00 noon on the next business day which does not have any of those warnings or Extreme Conditions in force in Hong Kong at any time between 9:00 a.m. and 12:00 noon.

If the application lists do not open and close on Friday, June 5, 2020 or if there is/are a tropical cyclone warning signal number 8 or above, a “black” rainstorm warning signal and/or Extreme Conditions in force in Hong Kong that may affect the dates mentioned in “Expected Timetable,” the Company will make an announcement on its website at <http://ir.netease.com/> and the website of the Hong Kong Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk).

### Publication of results

The Company expects to announce the pricing of the Offer Shares on Friday, June 5, 2020 on its website at <http://ir.netease.com/> and on the website of the Hong Kong Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk).

The Company expects to announce the level of indications of interest in the International Offering, the level of applications in the Hong Kong Public Offering and the basis of allocations of the Hong Kong Offer Shares on Wednesday, June 10, 2020 on its website at <http://ir.netease.com/> and the website of the Hong Kong Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk).

The results of allocations and the Hong Kong identity card/passport/Hong Kong business registration numbers of successful applicants under the Hong Kong Public Offering will be available at the times and dates and in the manner set out below:

- (a) in the announcement to be posted on the Company’s website and the website of the Hong Kong Stock Exchange at <http://ir.netease.com/> and [www.hkexnews.hk](http://www.hkexnews.hk), respectively, by no later than Wednesday, June 10, 2020;
- (b) from the designated results of allocations website at [www.iporesults.com.hk](http://www.iporesults.com.hk) (alternatively: English <https://www.eipo.com.hk/en/Allotment>; Chinese <https://www.eipo.com.hk/zh-hk/Allotment>) with a “search by ID function” on a 24 hour basis from 8:00 a.m. on Wednesday, June 10, 2020 to 12:00 midnight on Tuesday, June 16, 2020; and
- (c) from the allocation results telephone enquiry line by calling +852 2862 8555 between 9:00 a.m. and 6:00 p.m. from Wednesday, June 10, 2020 to Monday, June 15, 2020.

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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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If the Company accepts your offer to purchase (in whole or in part), which the Company may do by announcing the basis of allocations and/or making available the results of allocations publicly, there will be a binding contract under which you will be required to purchase the Hong Kong Offer Shares if the conditions of the Global Offering are satisfied and the Global Offering is not otherwise terminated. Further details are set out in “Structure of the Global Offering.”

You will not be entitled to exercise any remedy of rescission for innocent misrepresentation at any time after acceptance of your application. This does not affect any other right you may have.

### **Circumstances in which you will not be allocated the Hong Kong Offer Shares**

You should note the following situations in which the Hong Kong Offer Shares will not be allocated to you:

#### ***If your application is revoked:***

By applying through the **CCASS EIPO** service or through the **White Form eIPO** service, you agree that your application or the application made by HKSCC Nominees on your behalf cannot be revoked on or before the fifth day after the time of the opening of the application lists (excluding any days which is a Saturday, Sunday or public holiday in Hong Kong). This agreement will take effect as a collateral contract with the Company.

Your application or the application made by HKSCC Nominees on your behalf may only be revoked on or before the fifth day after the time of the opening of the application lists (excluding any days which is a Saturday, Sunday or public holiday in Hong Kong) in the following circumstances:

- (a) if a person responsible for this document under Section 40 of the Companies (WUMP) Ordinance (as applied by Section 342E of the Companies (WUMP) Ordinance) gives a public notice under that section on or before the fifth day after the time of the opening of the application lists (excluding any day which is a Saturday, Sunday or public holiday in Hong Kong) which excludes or limits that person’s responsibility for this document; or
- (b) if any supplement to this document is issued, in which case the Company will notify applicants who have already submitted an application that they are required to confirm their applications. If applicants have been so notified but have not confirmed their applications in accordance with the procedure to be notified, all unconfirmed applications will be deemed revoked.

If your application or the application made by HKSCC Nominees on your behalf has been accepted, it cannot be revoked. For this purpose, acceptance of applications which are not rejected will be constituted by notification in the press of the results of allocation, and where such basis of allocation is subject to certain conditions or provides for allocation by ballot, such acceptance will be subject to the satisfaction of such conditions or results of the ballot, respectively.



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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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***If the Company or its agents exercise their discretion to reject your application:***

The Company, the Joint Global Coordinators, the **White Form eIPO** Service Provider and their respective agents or nominees have full discretion to reject or accept any application, or to accept only part of any application, without giving any reasons.

***If:***

- (a) you make multiple applications or are suspected of making multiple applications;
- (b) you or the person for whose benefit you apply for, have applied for or taken up, or indicated an interest for, or have been or will be placed or allocated (including conditionally and/or provisionally) the Hong Kong Offer Shares and the International Offer Shares;
- (c) your payment is not made correctly;
- (d) your **electronic application instructions** through the **White Form eIPO** service are not completed in accordance with the instructions, terms and conditions on the designated website at [www.eipo.com.hk](http://www.eipo.com.hk);
- (e) you apply for more than 2,575,000 Hong Kong Offer Shares, being 50% of the 5,150,000 Hong Kong Offer Shares initially available under the Hong Kong Public Offering;
- (f) the Company or the Joint Global Coordinators believe that by accepting your application, a violation of applicable securities or other laws, rules or regulations would result; or
- (g) the Underwriting Agreements do not become unconditional or are terminated.

**Refund of application monies**

If an application is rejected, not accepted or accepted in part only, or if the Public Offer Price as finally determined is less than the maximum Public Offer Price per Offer Share (excluding brokerage, SFC transaction levy and Hong Kong Stock Exchange trading fee payable thereon) paid on application, or if the conditions of the Global Offering as set out in “Structure of the Global Offering — Conditions of the Global Offering” are not satisfied or if any application is revoked, the application monies, or the appropriate portion thereof, together with the related brokerage, SFC transaction levy and Hong Kong Stock Exchange trading fee, will be refunded, without interest.

Any refund of your application monies will be made on or around Wednesday, June 10, 2020.

**Despatch/collection of share certificates/e-refund payment instructions/refund checks**

You will receive one Share certificate for all Hong Kong Offer Shares allocated to you under the Hong Kong Public Offering (except pursuant to applications made through the **CCASS EIPO** service where the Share certificates will be deposited into CCASS as described below).

The Company will not issue temporary document of title in respect of the Offer Shares. The Company will not issue receipt for sums paid on application.

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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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Subject to arrangement on despatch/collection of Share certificates and refund checks as mentioned below, any refund checks and Share certificate(s) are expected to be posted on or around Wednesday, June 10, 2020. The right is reserved to retain any Share certificate(s) and any surplus application monies pending clearance of check(s) or banker's cashier order(s).

Share certificates will only become valid at 8:00 a.m. on Thursday, June 11, 2020, provided that the Global Offering has become unconditional in all respects at or before that time and the right of termination described in "Underwriting" has not been exercised.

Investors who trade Shares on the basis of publicly available allocation details or prior to the receipt of the Share certificates or prior to the Share certificates becoming valid do so entirely at their own risk.

### *Personal Collection*

If you apply through **White Form eIPO** service:

- (a) If you apply for 1,000,000 Hong Kong Offer Shares or more through the **White Form eIPO** service and your application is wholly or partially successful, you may collect your Share certificate(s) (where applicable) in person from the Hong Kong Share Registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, from 9:00 a.m. to 1:00 p.m. on Wednesday, June 10, 2020, or any other place or date notified by the Company.
- (b) If you do not personally collect your Share certificate(s) within the time specified for collection, they will be sent to the address specified in your application instructions by ordinary post and at your own risk.
- (c) If you apply for less than 1,000,000 Hong Kong Offer Shares through the **White Form eIPO** service, your Share certificate(s) (where applicable) will be sent to the address specified in your application instructions on or before Wednesday, June 10, 2020 by ordinary post and at your own risk.
- (d) If you apply and pay the application monies from a single bank account, any refund monies will be despatched to that bank account in the form of e-Refund payment instructions. If you apply and pay the application monies from multiple bank accounts, any refund monies will be despatched to the address specified in your application instructions in the form of refund check(s) by ordinary post and at your own risk.

If you apply through **CCASS EIPO** service:

### *Allocation of the Hong Kong Offer Shares*

- (a) For the purposes of allocating the Hong Kong Offer Shares, HKSCC Nominees will not be treated as an applicant. Instead, each CCASS Participant who gives **electronic application instructions** or each person for whose benefit instructions are given will be treated as an applicant.

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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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### *Deposit of Share Certificates into CCASS and Refund of Application Monies*

- (a) If your application is wholly or partially successful, your Share certificate(s) will be issued in the name of HKSCC Nominees and deposited into CCASS for the credit of your designated CCASS Participant's stock account or your CCASS Investor Participant stock account on Wednesday, June 10, 2020 or on any other date determined by HKSCC or HKSCC Nominees.
- (b) The Company expects to publish the application results of CCASS Participants (and where the CCASS Participant is a broker or custodian, the Company will include information relating to the relevant beneficial owner), your Hong Kong identity card/passport/Hong Kong business registration number or other identification code (Hong Kong business registration number for corporations) and the basis of allocations of the Hong Kong Offer Shares in the manner as described in "—Publication of results" above on Wednesday, June 10, 2020. You should check the announcement published by the Company and report any discrepancies to HKSCC before 5:00 p.m. on Wednesday, June 10, 2020 or such other date as determined by HKSCC or HKSCC Nominees.
- (c) If you have instructed your **broker** or **custodian** who is a CCASS Clearing Participant or a CCASS Custodian Participant to give **electronic application instructions** via CCASS terminals to apply for the Hong Kong Offer Shares on your behalf, you can also check the number of the Hong Kong Offer Shares allocated to you and the amount of refund monies (if any) payable to you with that **broker** or **custodian**.
- (d) If you have applied as a CCASS Investor Participant, you can also check the number of the Hong Kong Offer Shares allocated to you and the amount of refund monies (if any) payable to you via the CCASS Phone System and the CCASS Internet System (under the procedures contained in HKSCC's "An Operating Guide for Investor Participants" in effect from time to time) on Wednesday, June 10, 2020. Immediately following the credit of the Hong Kong Offer Shares to your stock account and the credit of the refund monies to your bank account, HKSCC will also make available to you an activity statement showing the number of the Hong Kong Offer Shares credited to your CCASS Investor Participant stock account and the amount of refund monies (if any) credited to your designated bank account.
- (e) Refund of your application monies (if any) in respect of wholly and partially unsuccessful applications and/or difference between the Public Offer Price and the maximum Public Offer Price per Offer Share initially paid on application (including brokerage, SFC transaction levy and Hong Kong Stock Exchange trading fee but without interest) will be credited to your designated bank account or the designated bank account of your broker or custodian on Wednesday, June 10, 2020.

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## HOW TO APPLY FOR HONG KONG OFFER SHARES

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### **Admission of the Shares into CCASS**

If the Hong Kong Stock Exchange grants the listing of, and permission to deal in, the Shares and the Company complies with the stock admission requirements of HKSCC, the Shares will be accepted as eligible securities by HKSCC for deposit, clearance and settlement in CCASS with effect from the date of commencement of dealings in the Shares on the Hong Kong Stock Exchange or any other date HKSCC chooses. Settlement of transactions between Exchange Participants (as defined in the Hong Kong Listing Rules) is required to take place in CCASS on the second business day after any trading day.

All activities under CCASS are subject to the General Rules of CCASS and CCASS Operational Procedures in effect from time to time.

Investors should seek the advice of their stockbroker or other professional adviser for details of the settlement arrangements as such arrangements may affect their rights and interests.

The Company has made all necessary arrangements to enable the Shares to be admitted into CCASS.

The following is the text of a report set out on pages IA-1 to IA-2, received from the Company's reporting accountant, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this prospectus. It is prepared and addressed to the directors of the Company and to the Joint Sponsors pursuant to the requirements of HKSIR 200 Accountants' Reports on Historical Financial Information in Investment Circulars issued by the Hong Kong Institute of Certified Public Accountants.



羅兵咸永道

**ACCOUNTANT'S REPORT ON HISTORICAL FINANCIAL INFORMATION TO THE DIRECTORS OF NETEASE, INC. AND CHINA INTERNATIONAL CAPITAL CORPORATION HONG KONG SECURITIES LIMITED, CREDIT SUISSE (HONG KONG) LIMITED AND J.P. MORGAN SECURITIES (FAR EAST) LIMITED**

**Introduction**

We report on the historical financial information of NetEase, Inc. and its subsidiaries (together, the “**Company**”) set out on pages IA-3 to IA-77, which comprises the consolidated balance sheets as at December 31, 2017, 2018 and 2019, and the consolidated statements of operations and comprehensive income, the consolidated statements of shareholders' equity and the consolidated statements of cash flows for each of the years then ended (the “**Track Record Period**”) and a summary of significant accounting policies and other explanatory information (together, the “**Historical Financial Information**”). The Historical Financial Information set out on pages IA-3 to IA-77 forms an integral part of this report, which has been prepared for inclusion in the prospectus of the Company dated June 2, 2020 (the “**Prospectus**”) in connection with the listing of shares of the Company on the Main Board of The Stock Exchange of Hong Kong Limited.

**Directors' responsibility for the Historical Financial Information**

The directors of the Company are responsible for the preparation of Historical Financial Information that gives a true and fair view in accordance with the basis of presentation set out in Note 2(b) to the Historical Financial Information, and for such internal control as the directors determine is necessary to enable the preparation of Historical Financial Information that is free from material misstatement, whether due to fraud or error.

**Reporting accountant's responsibility**

Our responsibility is to express an opinion on the Historical Financial Information and to report our opinion to you. We conducted our work in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 200, *Accountants' Reports on Historical Financial Information in Investment Circulars* issued by the Hong Kong Institute of Certified Public Accountants (“**HKICPA**”). This standard requires that we comply with ethical standards and plan and perform our work to obtain reasonable assurance about whether the Historical Financial Information is free from material misstatement.

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Our work involved performing procedures to obtain evidence about the amounts and disclosures in the Historical Financial Information. The procedures selected depend on the reporting accountant's judgment, including the assessment of risks of material misstatement of the Historical Financial Information, whether due to fraud or error. In making those risk assessments, the reporting accountant considers internal control relevant to the entity's preparation of Historical Financial Information that gives a true and fair view in accordance with the basis of presentation set out in Note 2(b) to the Historical Financial Information in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Our work also included evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the Historical Financial Information.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Opinion**

In our opinion, the Historical Financial Information gives, for the purposes of the accountant's report, a true and fair view of the consolidated financial position of the Company as at December 31, 2017, 2018 and 2019 and of its consolidated financial performance and its consolidated cash flows for the Track Record Period in accordance with the basis of presentation out in Note 2(b) to the Historical Financial Information.

### **Report on matters under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Hong Kong Listing Rules") and the Companies (Winding Up and Miscellaneous Provisions) Ordinance**

#### *Adjustments*

The Historical Financial Information is stated after making such adjustments to the Historical Financial Statements as defined on page IA-3 as were considered necessary.

#### *Dividends*

We refer to Note 23 to the Historical Financial Information which contains information about the dividends paid by NetEase, Inc. in respect of the Track Record Period.

**PricewaterhouseCoopers**  
Certified Public Accountants  
Hong Kong  
June 2, 2020

**I. HISTORICAL FINANCIAL INFORMATION OF THE COMPANY****Preparation of Historical Financial Information**

Set out below is the Historical Financial Information which forms an integral part of this accountant's report.

The Historical Financial Information in this report was prepared by the directors of the Company based on the consolidated financial statements of the Company for the years ended December 31, 2017, 2018 and 2019 (collectively referred as "**Historical Financial Statements**"). The consolidated financial statements for the years ended December 31, 2017, 2018 and 2019 were audited by PricewaterhouseCoopers Zhong Tian LLP, PRC, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("**PCAOB**") relating to the financial statements and the effectiveness of internal control over financial reporting.

The Historical Financial Information is presented in Renminbi and United States Dollars. All values are rounded to the nearest thousand except when otherwise indicated.

**Consolidated Balance Sheets**  
(in thousands except per share data)

		December 31, 2017	December 31, 2018	December 31, 2019	December 31, 2019
	<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	2(f)	2,467,467	4,977,432	3,246,373	466,312
Time deposits	2(f)	30,603,369	32,900,287	53,487,075	7,682,937
Restricted cash	2(f)	5,886,367	4,692,050	3,150,354	452,520
Accounts receivable, net		3,539,594	4,002,487	4,169,358	598,891
Inventories, net	2(h)	984,228	1,065,615	650,557	93,447
Prepayments and other current assets	5	3,126,796	3,925,205	4,817,422	691,979
Short-term investments	6	9,702,609	11,674,775	15,312,595	2,199,517
Assets held for sale	3	5,637,330	5,477,869	271,278	38,967
		<u>61,947,760</u>	<u>68,715,720</u>	<u>85,105,012</u>	<u>12,224,570</u>
Total current assets					
Non-current assets:					
Property, equipment and software, net	7	3,490,130	4,672,079	4,621,712	663,867
Land use rights, net	8	439,526	3,271,512	3,707,179	532,503
Operating lease right-of-use assets, net	9	–	–	463,688	66,605
Deferred tax assets	12(c)	823,495	1,064,295	903,904	129,838
Time deposits	2(f)	100,000	100,000	2,360,000	338,993
Restricted cash	2(f)	200	–	–	–
Long-term investments	10	2,683,776	5,245,108	9,293,868	1,334,980
Other long-term assets	11	1,088,089	2,930,069	5,666,610	813,958
Assets held for sale	3	458,439	969,145	2,398	344
		<u>9,083,655</u>	<u>18,252,208</u>	<u>27,019,359</u>	<u>3,881,088</u>
Total non-current assets					
		<u>71,031,415</u>	<u>86,967,928</u>	<u>112,124,371</u>	<u>16,105,658</u>
Total assets					



**Consolidated Balance Sheets (Continued)**  
**(in thousands except per share data)**

	December 31, 2017	December 31, 2018	December 31, 2019	December 31, 2019
<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
<b>Liabilities, redeemable noncontrolling interests and Shareholders' equity</b>				
Current liabilities:				
Accounts payable (including accounts payable of the consolidated VIEs without recourse to the primary beneficiaries of RMB892,401, RMB909,449 and RMB846,893 as of December 31, 2017, 2018 and 2019, respectively)	1,070,976	1,201,210	1,212,303	174,136
Salary and welfare payables (including salary and welfare payables of the consolidated VIEs without recourse to the primary beneficiaries of RMB106,192, RMB108,699 and RMB97,636 as of December 31, 2017, 2018 and 2019, respectively)	2,076,160	2,799,212	2,957,360	424,798
Taxes payable (including taxes payable of the consolidated VIEs without recourse to the primary beneficiaries of RMB22,058, RMB84,118 and RMB122,179 as of December 31, 2017, 2018 and 2019, respectively)	13 1,561,920	2,260,646	3,156,513	453,405
Short-term loans (including short-term loans of the consolidated VIEs without recourse to the primary beneficiaries of nil, RMB129,900 and RMB197,420 as of December 31, 2017, 2018 and 2019, respectively)	14 6,623,502	13,658,554	16,828,226	2,417,223
Deferred revenue (including deferred revenue of the consolidated VIEs without recourse to the primary beneficiaries of RMB5,853,904, RMB6,672,715 and RMB7,634,637 as of December 31, 2017, 2018 and 2019, respectively)	16 6,049,903	7,718,485	8,602,227	1,235,633

**Consolidated Balance Sheets (Continued)**  
**(in thousands except per share data)**

		December 31, 2017	December 31, 2018	December 31, 2019	December 31, 2019
	<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
Accrued liabilities and other payables (including accrued liabilities and other payables of the consolidated VIEs without recourse to the primary beneficiaries of RMB1,966,427, RMB1,865,978 and RMB1,919,549 as of December 31, 2017, 2018 and 2019, respectively)	15	4,331,937	5,005,190	5,292,774	760,259
Short-term operating lease liabilities (including short-term operating lease liabilities of the consolidated VIEs without recourse to the primary beneficiaries of nil, nil and RMB14,683 as of December 31, 2017, 2018 and 2019, respectively)	9	–	–	191,454	27,501
Liabilities held for sale	3	2,035,716	2,465,713	2,156	310
<b>Total current liabilities</b>		<u>23,750,114</u>	<u>35,109,010</u>	<u>38,243,013</u>	<u>5,493,265</u>
Non-current liabilities:					
Deferred tax liabilities	12(c)	212,854	392,598	382,030	54,875
Long-term operating lease liabilities (including long-term operating lease liabilities of the consolidated VIEs without recourse to the primary beneficiaries of nil, nil and RMB12,133 as of December 31, 2017, 2018 and 2019, respectively)	9	–	–	279,949	40,212
Other long-term payable (including long-term payable of the consolidated VIEs without recourse to the primary beneficiaries of RMB7,500, RMB7,500 and nil as of December 31, 2017, 2018 and 2019, respectively)		18,250	48,921	176,963	25,419
Liabilities held for sale	3	361	5,818	961	138
<b>Total non-current liabilities</b>		<u>231,465</u>	<u>447,337</u>	<u>839,903</u>	<u>120,644</u>
<b>Total liabilities</b>		<u><u>23,981,579</u></u>	<u><u>35,556,347</u></u>	<u><u>39,082,916</u></u>	<u><u>5,613,909</u></u>

**Consolidated Balance Sheets (Continued)**  
**(in thousands except per share data)**

		December 31, 2017	December 31, 2018	December 31, 2019	December 31, 2019
	<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
Commitments and contingencies	22				
Redeemable noncontrolling interests	17	614,696	5,385,736	10,448,600	1,500,847
Shareholders' equity:					
Ordinary shares, US\$0.0001 par value: 1,000,300,000 shares authorized, 3,283,217 shares issued and outstanding as of December 31, 2017, 3,199,018 shares issued and outstanding as of December 31, 2018 and 3,228,531 shares issued and outstanding as of December 31, 2019		2,678	2,620	2,640	379
Additional paid-in capital		1,753,439	–	3,913,656	562,162
Statutory reserves	2(s)	1,206,224	1,214,578	1,215,208	174,554
Accumulated other comprehensive income/(loss)		36,585	17,050	(71,445)	(10,262)
Retained earnings		42,733,081	43,997,388	56,393,640	8,100,439
NetEase, Inc.'s shareholders' equity		45,732,007	45,231,636	61,453,699	8,827,272
Noncontrolling interests	17	703,133	794,209	1,139,156	163,630
Total shareholders' equity		46,435,140	46,025,845	62,592,855	8,990,902
Total liabilities, redeemable noncontrolling interests and shareholders' equity		71,031,415	86,967,928	112,124,371	16,105,658

**Consolidated Statements of Operations and Comprehensive Income**  
(in thousands except per share data or per ADS data)

		For the year ended December 31,			
		2017	2018	2019	2019
<i>Notes</i>		<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
<b>Net revenues:</b>					
Online game	26	36,281,642	40,190,057	46,422,640	6,668,195
Youdao	26	455,746	731,598	1,304,883	187,435
Innovative businesses and others	26	7,699,967	10,256,920	11,513,622	1,653,828
Total net revenues		44,437,355	51,178,575	59,241,145	8,509,458
Cost of revenues	26	(19,394,314)	(23,832,426)	(27,685,845)	(3,976,823)
<b>Gross profit</b>		<b>25,043,041</b>	<b>27,346,149</b>	<b>31,555,300</b>	<b>4,532,635</b>
<b>Operating expenses:</b>					
Selling and marketing expenses		(5,504,613)	(6,911,710)	(6,221,127)	(893,609)
General and administrative expenses		(2,381,842)	(3,078,635)	(3,130,298)	(449,639)
Research and development expenses		(4,161,673)	(7,378,460)	(8,413,224)	(1,208,484)
Total operating expenses		(12,048,128)	(17,368,805)	(17,764,649)	(2,551,732)
<b>Operating profit</b>		<b>12,994,913</b>	<b>9,977,344</b>	<b>13,790,651</b>	<b>1,980,903</b>
<b>Other income/(expenses):</b>					
Investment income/(losses), net		362,113	(22,383)	1,306,320	187,641
Interest income, net		666,616	586,671	821,774	118,040
Exchange (losses)/gains		(455,948)	(51,799)	25,166	3,615
Other, net		271,885	586,916	439,422	63,119
<b>Income before tax</b>		<b>13,839,579</b>	<b>11,076,749</b>	<b>16,383,333</b>	<b>2,353,318</b>
Income tax	12(a)	(2,155,988)	(2,460,650)	(2,914,726)	(418,674)
Net income from continuing operations		11,683,591	8,616,099	13,468,607	1,934,644
Net (loss)/income from discontinued operations		(834,454)	(2,138,682)	7,962,519	1,143,744
<b>Net income</b>		<b>10,849,137</b>	<b>6,477,417</b>	<b>21,431,126</b>	<b>3,078,388</b>
Accretion and deemed dividends in connection with repurchase of redeemable noncontrolling interests		–	(248,098)	(271,543)	(39,005)
Net (income)/loss attributable to noncontrolling interests and redeemable noncontrolling interests		(141,198)	(76,912)	77,933	11,194

**Consolidated Statements of Operations and Comprehensive Income (Continued)**  
**(in thousands except per share data or per ADS data)**

	Notes	For the year ended December 31,			
		2017	2018	2019	2019
		RMB	RMB	RMB	US\$ Note 2(o)
<b>Net income attributable to NetEase, Inc.'s shareholders</b>		<b>10,707,939</b>	<b>6,152,407</b>	<b>21,237,516</b>	<b>3,050,577</b>
Including:					
Net income from continuing operations attributable to NetEase, Inc.'s shareholders		11,542,393	8,291,089	13,274,997	1,906,833
Net (loss)/income from discontinued operations attributable to NetEase, Inc.'s shareholders	3	(834,454)	(2,138,682)	7,962,519	1,143,744
<b>Net income</b>		<b>10,849,137</b>	<b>6,477,417</b>	<b>21,431,126</b>	<b>3,078,388</b>
<b>Other comprehensive income</b>					
Unrealized losses on available-for-sale securities, net of tax		(23,321)	–	–	–
Foreign currency translation adjustment		(1,573)	18,624	(93,774)	(13,470)
<b>Total other comprehensive (loss)/income</b>		<b>(24,894)</b>	<b>18,624</b>	<b>(93,774)</b>	<b>(13,470)</b>
<b>Total comprehensive income</b>		<b>10,824,243</b>	<b>6,496,041</b>	<b>21,337,352</b>	<b>3,064,918</b>
Comprehensive (income)/loss attributable to noncontrolling interests and redeemable noncontrolling interests		(141,198)	(76,912)	83,685	12,021
<b>Comprehensive income attributable to NetEase, Inc.'s shareholders</b>		<b>10,683,045</b>	<b>6,419,129</b>	<b>21,421,037</b>	<b>3,076,939</b>
Net income/(loss) per share, basic		3.25	1.90	6.59	0.95
— Continuing operations		3.51	2.56	4.12	0.59
— Discontinued operations		(0.26)	(0.66)	2.47	0.36

**Consolidated Statements of Operations and Comprehensive Income (Continued)**  
**(in thousands except per share data or per ADS data)**

		For the year ended December 31,			
		2017	2018	2019	2019
<i>Notes</i>		<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
Net income/(loss) per ADS, basic		81.36	47.54	164.86	23.68
— Continuing operations		87.70	64.07	103.05	14.80
— Discontinued operations		(6.34)	(16.53)	61.81	8.88
Net income/(loss) per share, diluted	21	3.23	1.89	6.53	0.94
— Continuing operations		3.48	2.55	4.08	0.59
— Discontinued operations		(0.25)	(0.66)	2.45	0.35
Net income/(loss) per ADS, diluted		80.74	47.26	163.37	23.47
— Continuing operations		87.03	63.69	102.12	14.67
— Discontinued operations		(6.29)	(16.43)	61.25	8.80
Weighted average number of ordinary shares outstanding, basic	21	3,290,312	3,235,324	3,220,473	3,220,473
Weighted average number of ADS outstanding, basic		131,612	129,413	128,819	128,819
Weighted average number of ordinary shares outstanding, diluted	21	3,315,478	3,254,689	3,249,972	3,249,972
Weighted average number of ADS outstanding, diluted		132,619	130,188	129,999	129,999

**Consolidated Statements of Shareholders' Equity**  
(in thousands)

	Ordinary shares		Additional paid-in capital	Treasury stock		Statutory reserves	Accumulated other comprehensive income	Retained earnings	Noncontrolling interests	Total shareholders' equity
	Share	Amount		Share	Amount					
	RMB	RMB		RMB	RMB					
Balance as of December 31, 2016	3,281,480	2,676	1,637,953	-	-	1,160,161	61,479	35,328,812	271,860	38,462,941
Ordinary shares issued upon settlement of restricted share units	29,805	21	(21)	-	-	-	-	-	-	-
Share-based compensation	-	-	2,177,079	-	-	-	-	-	-	2,177,079
Appropriation to statutory reserves	-	-	-	-	-	46,063	-	(46,063)	-	-
Net income attributable to NetEase, Inc. and noncontrolling interest shareholders	-	-	-	-	-	-	-	10,707,939	126,502	10,834,441
Repurchase of shares	-	-	-	(28,068)	(2,061,591)	-	-	-	-	(2,061,591)
Cancellation of treasury stock	(28,068)	(19)	(2,061,572)	28,068	2,061,591	-	-	-	-	-
Net change in unrealized gains on available-for-sale securities	-	-	-	-	-	-	(23,321)	-	-	(23,321)
Capital injection in subsidiaries by noncontrolling interest shareholders	-	-	-	-	-	-	-	-	311,500	311,500
Dividends to shareholders	-	-	-	-	-	-	-	(3,257,607)	-	(3,257,607)
Foreign currency translation adjustment	-	-	-	-	-	-	(1,573)	-	-	(1,573)
Deconsolidation of a subsidiary	-	-	-	-	-	-	-	-	(6,729)	(6,729)
Balance as of December 31, 2017	3,283,217	2,678	1,753,439	-	-	1,206,224	36,585	42,733,081	703,133	46,435,140

**Consolidated Statements of Shareholders' Equity (Continued)**  
(in thousands)

	Ordinary shares		Additional paid-in capital	Treasury stock		Statutory reserves	Accumulated other comprehensive income	Retained earnings	Noncontrolling interests	Total shareholders' equity
	Share	Amount		Share	Amount					
Cumulative effect of changes in accounting principles related to revenue recognition and financial instruments	-	-	-	-	-	-	(38,159)	65,608	12,367	39,816
Ordinary shares issued upon settlement of restricted share units	30,709	19	(19)	-	-	-	-	-	-	-
Share-based compensation	-	-	2,397,798	-	-	-	-	-	131,852	2,529,650
Appropriation to statutory reserves	-	-	-	-	-	8,354	-	(8,354)	-	-
Net income attributable to NetEase, Inc. and noncontrolling interest shareholders	-	-	-	-	-	-	-	6,400,505	76,912	6,477,417
Repurchase of shares	-	-	-	(114,908)	(7,592,598)	-	-	-	-	(7,592,598)
Cancellation of treasury stock	(114,908)	(77)	(4,151,218)	114,908	7,592,598	-	-	(3,441,303)	-	-
Repurchase of noncontrolling interests and redeemable noncontrolling interests	-	-	-	-	-	-	-	(223,243)	(131,143)	(354,386)
Capital injection in subsidiaries by noncontrolling interest shareholders	-	-	-	-	-	-	-	-	15,510	15,510
Dividends to shareholders	-	-	-	-	-	-	-	(1,440,194)	-	(1,440,194)
Foreign currency translation adjustment	-	-	-	-	-	-	18,624	-	-	18,624
Disposal of a subsidiary	-	-	-	-	-	-	-	-	(5,654)	(5,654)
Accretion of redeemable noncontrolling interests	-	-	-	-	-	-	-	(88,712)	(8,768)	(97,480)
Balance as of December 31, 2018	3,199,018	2,620	-	-	-	1,214,578	17,050	43,997,388	794,209	46,025,845



**Consolidated Statements of Shareholders' Equity (Continued)**  
(in thousands)

	Ordinary shares		Additional paid-in capital	Treasury stock		Statutory reserves	Accumulated other comprehensive income	Retained earnings	Noncontrolling interests	Total shareholders' equity					
	Share	Amount		Share	Amount						RMB	RMB	RMB	RMB	RMB
Ordinary shares issued upon settlement of restricted share units	29,513	20	(1,487)	25	1,467	-	-	-	-	-					
Share-based compensation	-	-	2,341,078	-	-	-	-	-	46,100	2,387,178					
Appropriation to statutory reserves	-	-	-	-	-	11,129	-	(11,129)	-	-					
Net income attributable to NetEase, Inc. and noncontrolling interest shareholders	-	-	-	-	-	-	-	21,509,059	(77,933)	21,431,126					
Repurchase of shares	-	-	-	(25)	(1,467)	-	-	-	-	(1,467)					
Repurchase of noncontrolling interests and redeemable noncontrolling interests	-	-	(4,279)	-	-	-	-	-	(53)	(4,332)					
Capital injection in subsidiaries by noncontrolling interest shareholders	-	-	1,153,528	-	-	-	-	-	378,654	1,532,182					
Conversion of Youdao's preferred shares recognized as redeemable noncontrolling interests to ordinary shares	-	-	468,788	-	-	-	-	-	27,757	496,545					
Dividends to shareholders	-	-	-	-	-	-	-	(8,840,634)	-	(8,840,634)					
Foreign currency translation adjustment	-	-	-	-	-	-	(88,022)	-	(5,752)	(93,774)					
Disposal of subsidiaries	-	-	(43,972)	-	-	(10,499)	(473)	10,499	(11,807)	(56,252)					
Accretion of redeemable noncontrolling interests	-	-	-	-	-	-	-	(271,543)	(12,019)	(283,562)					
Balance as of December 31, 2019	3,228,531	2,640	3,913,656	-	-	1,215,208	(71,445)	56,393,640	1,139,156	62,592,855					

**Consolidated Statements of Cash Flows**  
(in thousands)

	For the year ended December 31,			
	2017	2018	2019	2019
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
<b>Cash flows from operating activities:</b>				
Net income	10,849,137	6,477,417	21,431,126	3,078,388
Net loss/(income) from discontinued operations	834,454	2,138,682	(7,962,519)	(1,143,744)
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	791,778	2,060,135	2,613,782	375,446
Fair value change of equity security investments and other financial instruments	–	248,169	(751,693)	(107,974)
Investment impairment	58,537	159,703	177,567	25,506
Share-based compensation cost	1,984,851	2,471,731	2,404,089	345,326
Allowance for/(Reversal of) doubtful accounts	60,826	50,954	(28,583)	(4,106)
Loss/(Gain) on disposal of property, equipment and software	5,072	(1,385)	5,122	736
Unrealized exchange losses/(gains)	440,529	31,998	(9,981)	(1,434)
Gain on disposal of long-term investments, business and subsidiaries	(9,595)	(213,339)	(98,489)	(14,147)
Deferred income taxes	(438,307)	(70,621)	150,629	21,637
Net equity share of losses/(gains) from equity method investees	12,232	98,301	(4,322)	(621)
Fair value changes of short-term investments	(389,793)	(463,483)	(657,606)	(94,459)
Changes in operating assets and liabilities:				
Accounts receivable	596,054	(612,656)	(11,314)	(1,625)
Inventories	(754,889)	(81,440)	415,057	59,619
Prepayments and other assets	201,931	(719,035)	(1,488,564)	(213,819)
Accounts payable	116,906	112,435	13,229	1,900
Salary and welfare payables	649,460	725,515	146,146	20,993
Taxes payable	(170,130)	685,024	(133,801)	(19,219)
Deferred revenue	(1,375,811)	1,757,874	883,742	126,942
Accrued liabilities and other payables	1,401,210	(196,136)	(182,646)	(26,235)
Net cash provided by continuing operating activities	14,864,452	14,659,843	16,910,971	2,429,110
Net cash (used in)/provided by discontinued operating activities	(2,975,214)	(1,243,966)	305,487	43,880
Net cash provided by operating activities	11,889,238	13,415,877	17,216,458	2,472,990

**Consolidated Statements of Cash Flows (Continued)**  
(in thousands)

	For the year ended December 31,			
	2017	2018	2019	2019
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
<b>Cash flows from investing activities:</b>				
Purchase of property, equipment and software	(1,654,486)	(2,169,404)	(1,209,477)	(173,731)
Proceeds from sale of property, equipment and software	4,425	6,688	60,601	8,705
Purchase of intangible assets, content and licensed copyrights	(791,580)	(1,741,225)	(2,119,307)	(304,419)
Purchase of land use right	(6,488)	(2,926,795)	–	–
Net change of short-term investments with terms of three months or less	(895,298)	(1,172,326)	(1,023,165)	(146,969)
Purchase of short-term investments	(12,491,000)	(13,393,000)	(22,370,000)	(3,213,249)
Proceeds from maturities of short-term investments	15,615,544	13,071,359	20,225,342	2,905,189
Investment in equity method investees	(235,769)	(272,451)	(450,695)	(64,738)
Acquisitions of other equity investments	(900,712)	(2,751,040)	(1,111,493)	(159,656)
Proceeds from disposal of investment in equity method investees and other equity investments	350,418	–	406,702	58,419
Placement/rollover of time deposits	(33,984,148)	(41,553,428)	(77,083,350)	(11,072,330)
Proceeds from maturity of time deposits	22,429,597	39,924,525	54,381,647	7,811,435
Change in other long-term assets	(100,646)	(133,039)	(42,345)	(6,082)
Amounts (paid to)/received from disposed businesses	(3,296,366)	(1,889,560)	9,031,051	1,297,229
Net cash used in continuing investing activities	(15,956,509)	(14,999,696)	(21,304,489)	(3,060,197)
Net cash provided by/(used in) discontinued investing activities	3,101,239	1,430,181	(832,252)	(119,546)
Net cash used in investing activities	(12,855,270)	(13,569,515)	(22,136,741)	(3,179,743)
<b>Cash flows from financing activities:</b>				
Net proceeds from short-term loan with terms of three months or less	3,095,465	6,194,113	2,538,267	364,599
Proceeds of short-term loan	9,505	34,256	730,087	104,870
Repayment of short-term loan	–	(18,761)	(296,823)	(42,636)
Dividends paid to shareholders	(3,257,607)	(1,440,194)	(8,840,634)	(1,269,878)
Repurchase of redeemable noncontrolling interests	–	(780,000)	–	–
Proceeds from issuance of redeemable noncontrolling interest shareholders, net of issuance cost	600,000	5,294,174	5,242,180	752,992

**Consolidated Statements of Cash Flows (Continued)**  
(in thousands)

	For the year ended December 31,			
	2017	2018	2019	2019
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(o)</i>
Repurchase of noncontrolling interests	–	(195,000)	–	–
Capital injection from noncontrolling interest shareholders	311,500	15,510	1,698,810	244,019
Cash (paid for)/refund received from share repurchase	(2,061,591)	(7,516,679)	10,638	1,528
Net cash (used in)/provided by financing activities*	(1,302,728)	1,587,419	1,082,525	155,494
<b>Effect of exchange rate changes on cash, cash equivalents and restricted cash held in foreign currencies</b>	(12,766)	81,511	29,080	4,177
<b>Net (decrease)/increase in cash, cash equivalents and restricted cash</b>	(2,281,526)	1,515,292	(3,808,678)	(547,082)
<b>Cash, cash equivalents and restricted cash, beginning of the year</b>	10,972,772	8,691,246	10,206,538	1,466,077
<b>Cash, cash equivalents and restricted cash, end of the year</b>	8,691,246	10,206,538	6,397,860	918,995
Less: Cash, cash equivalents and restricted cash of held for sales at end of the year	337,212	537,056	1,133	163
Cash, cash equivalents and restricted cash of continuing operations, end of the year	<u>8,354,034</u>	<u>9,669,482</u>	<u>6,396,727</u>	<u>918,832</u>
<b>Supplemental disclosures of cash flow information of continuing operation:</b>				
Cash paid for income taxes, net of tax refund	2,705,804	2,003,158	3,193,802	458,761
Cash paid for interest expenses	84,708	301,761	431,395	61,966
<b>Supplemental schedule of non-cash investing and financing activities of continuing operation:</b>				
Fixed asset purchases financed by accounts payable and accrued liabilities	293,045	351,610	304,944	43,802

\* There is no financing activity from discontinued operations.

## II. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts expressed in Renminbi (“RMB”), unless otherwise stated)

### 1. Organization and Nature of Operations

#### (a) The Group

NetEase.com, Inc. was incorporated in the Cayman Islands on July 6, 1999 and changed its name to “NetEase, Inc.” (the “**Company**”) with effect from March 29, 2012. The Company completed its initial public offering in July 2000 in connection with its listing on the Nasdaq National Market (now the Nasdaq Global Select Market) in the United States of America. As of December 31, 2019, the Company has wholly-owned and majority-owned subsidiaries incorporated in countries and jurisdictions mainly in the People’s Republic of China (“**PRC**” or “**China**,” references to “China” and “PRC” are to the People’s Republic of China, excluding, for the purposes of the financial statements only, Hong Kong, Macau and Taiwan), Hong Kong, Cayman Islands and British Virgin Islands (“**BVI**”). The Company also effectively controls a number of variable interest entities (“**VIEs**”) for which the Company is the primary beneficiary. The Company, its subsidiaries and VIEs are hereinafter collectively referred to as the “**Group**.”

In September 2019, the Company sold its Kaola e-commerce business. As a result, Kaola has been deconsolidated from the Company and its historical financial results are reflected in the Company’s consolidated financial statements as discontinued operations accordingly. See additional discussion on the discontinued operation in Note 3 to the consolidated financial statements.

On October 26, 2019, Youdao, Inc. (“**Youdao**”), one of the Company’s majority-controlled subsidiaries completed its initial public offering (“**IPO**”) on the New York Stock Exchange. After Youdao’s offering, the Company continues to control Youdao and consolidates Youdao as its controlling shareholder.

The major subsidiaries and VIEs through which the Company conducts its business operations as of December 31, 2019 are described below:

<b>Major Subsidiaries</b>	<b>Place and year of incorporation</b>
Guangzhou Boguan Telecommunication Technology Co., Ltd. (“ <b>Boguan</b> ”)	Guangzhou, China 2003
NetEase (Hangzhou) Network Co., Ltd. (“ <b>NetEase Hangzhou</b> ”)	Hangzhou, China 2006
Hong Kong NetEase Interactive Entertainment Limited	Hong Kong, China 2007
<b>Major VIEs and VIEs’ subsidiaries</b>	<b>Place and year of incorporation</b>
Guangzhou NetEase Computer System Co., Ltd. (“ <b>Guangzhou NetEase</b> ”)	Guangzhou, China 1997
Shanghai EaseNet Network Technology Co., Ltd. (“ <b>Shanghai EaseNet</b> ”)	Shanghai, China 2008
StormNet Information Technology (Hong Kong) Limited (“ <b>StormNet IT HK</b> ”)	Hong Kong, China 2008
StormNet Information Technology (Shanghai) Co., Ltd. (“ <b>StormNet IT SH</b> ”)	Shanghai, China 2008
Hangzhou NetEase Leihuo Technology Co., Ltd. (“ <b>HZ Leihuo</b> ,” formerly known as Hangzhou NetEase Leihuo Network Co., Ltd.)	Hangzhou, China 2009

## 1. Organization and Nature of Operations (Continued)

### (a) The Group (Continued)

Guangzhou NetEase, a major VIE of the Company, was incorporated in June 1997 in China and owned by William Lei Ding, or Mr. Ding, the Company's founder, director and chief executive officer, and another Chinese employee of the Group. It is responsible for providing online game, e-mail and other value-added telecommunication services.

HZ Leihuo was incorporated in April 2009 in China by two Chinese employees of the Group and currently operates the Company's mobile game business.

In addition, Shanghai EaseNet is a PRC company owned by Mr. Ding, and has contractual arrangements with StormNet IT HK (a joint venture established between, and owned equally by, Blizzard Entertainment, Inc. ("Blizzard") and the Company), and with the Company. StormNet IT HK, together with its wholly owned subsidiary, StormNet IT SH, was established concurrently with the licensing of certain online games in August 2008 and provides technical services to Shanghai EaseNet.

The following combined financial information of the Group's VIEs was included in the accompanying consolidated financial statements of the Group as follows:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Total assets	9,678,794	10,355,050	14,400,564
Total liabilities	8,848,482	9,778,359	12,272,634
<b>For the year ended December 31,</b>			
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Net revenues	40,566,998	43,231,277	49,455,146
Net income	355,697	224,253	344,134
<b>For the year ended December 31,</b>			
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Net cash (used in)/provided by operating activities	(152,931)	356,907	(249,387)
Net cash provided by/(used in) investing activities	122,286	(720,675)	(495,160)
Net cash provided by financing activities	4,000	229,862	26,520

**1. Organization and Nature of Operations (Continued)****(a) The Group (Continued)**

In accordance with various contractual agreements, the Company has the power to direct the activities of the VIEs and can have assets transferred out of the VIEs. Therefore, the Company considers that there are no assets in the respective VIEs that can be used only to settle obligations of the respective VIEs, except for the registered capital of the VIEs amounting to approximately RMB536.2 million, RMB542.2 million and RMB501.2 million, respectively, as of December 31, 2017, 2018 and 2019, as well as certain non-distributable statutory reserves amounting to approximately RMB27.0 million, RMB31.5 million and RMB42.1 million, respectively, as of December 31, 2017, 2018 and 2019. As the respective VIEs are incorporated as limited liability companies under the PRC Company Law, creditors do not have recourse to the general credit of the Company for the liabilities of the respective VIEs.

Currently, there are certain contractual arrangements between the Company and several of its VIEs which require the Company to provide additional financial support or guarantees to its VIEs, where necessary. Please see Note 1(b) for additional information.

There is no entity in the Company's group for which the Company has a variable interest but is not the primary beneficiary as of December 31, 2017, 2018 and 2019.

**(b) Nature of operations**

The Group generates revenues mainly from providing online game services, online courses services, advertising services, e-commerce, and other fee-based premium services.

The industry in which the Group operates is subject to a number of industry-specific risk factors, including, but not limited to, rapidly changing technologies; government regulations of the Internet, online game, online education and e-commerce industry in China; numbers of new entrants; dependence on key individuals; competition of similar services from larger companies; customer preferences; and the need for the continued successful development, marketing and selling of its services.

*VIE Arrangements with major VIEs*

The Group conducts its business mainly in China. The Chinese government regulates Internet access, telecommunications services, the distribution of news and other information and the provision of commerce through strict business licensing requirements and other governmental regulations, which include, among others, those restricting foreign ownership in Chinese companies providing Internet advertising and other Internet or telecommunications value-added services. To comply with the existing Chinese laws and regulations, the Company and certain of its subsidiaries have entered into a series of contractual arrangements with its major VIEs with respect to the operation of the NetEase websites, operation of self-developed and licensed PC and mobile games, Internet content and wireless value-added services, as well as the provision of advertising services.

**1. Organization and Nature of Operations (Continued)****(b) Nature of operations (Continued)**

Based on the agreements with these VIEs, certain of the Company's subsidiaries provided technical consulting and related services to these VIEs. The principal agreements that transfer economic benefits of Guangzhou NetEase and HZ Leihuo to the Company and its subsidiaries are:

- *Cooperative agreements with Guangzhou NetEase* — under these agreements, certain of the Company's subsidiaries, including Boguan and NetEase Hangzhou provide various technical consulting and related services to Guangzhou NetEase in exchange for substantially all of Guangzhou NetEase's net profits.
- *Cooperative agreement with HZ Leihuo* — under this agreement, NetEase Hangzhou provides various technical consulting and related services to HZ Leihuo in exchange for substantially all of HZ Leihuo's net profits.

Each cooperative agreement will remain in effect indefinitely unless any one of the contract parties terminates such agreement by written notice or otherwise required by law.

Each VIE, the relevant subsidiary of the Company and the relevant VIE shareholders have entered into a series of agreements that give the Company effective control over the VIE. The principal agreements that provide the Company and its subsidiaries effective control over Guangzhou NetEase are:

- **Shareholder Voting Rights Trust Agreement** among the VIE shareholders and the Company's subsidiary, NetEase Information Technology (Beijing) Co., Ltd. ("**NetEase Beijing**"). Each of the VIE shareholders irrevocably appoints NetEase Beijing to represent him to exercise all the voting rights to which he is entitled as a shareholder of Guangzhou NetEase. The term of this agreement was 10 years from May 12, 2000, which was extended on June 10, 2011 with a term of 20 years from May 12, 2010.
- **Letter of Agreement.** Each of the VIE shareholders have agreed that any amendments to be made to the agreements to which the Company, NetEase Beijing and/or their respective affiliates is a party, on the one hand, and any of their variable interest entities and/or the shareholders of such entities, on the other hand, shall be subject to the approval by the vote of a majority of the Board of the Company, excluding the vote of Mr. Ding. The VIE shareholders have also agreed that, if any amendments to the above mentioned agreements require a vote of the shareholders of the Company or Guangzhou NetEase, as applicable, both of them will vote in their capacity as direct or indirect shareholders of these companies to act based upon the instructions of the Company's Board. The term of this agreement is 20 years from May 12, 2010.
- **Other Governance Arrangements.** The parties have agreed that upon the Company's determination and at any time when NetEase Beijing or its affiliates are able to obtain approval to invest in and operate all or any part of any business operated by Guangzhou NetEase, NetEase Beijing or its affiliates may acquire all or any part of the assets or equity interests of Guangzhou NetEase, to the extent permitted by Chinese law.



**1. Organization and Nature of Operations (Continued)****(b) Nature of operations (Continued)**

The principal agreements that provide the Company and its subsidiaries effective control over HZ Leihuo, are:

- Operating Agreement among NetEase Hangzhou, HZ Leihuo and the VIE shareholders of Hangzhou Leihuo. To ensure the successful performance of the various agreements between the parties, HZ Leihuo and its VIE shareholders have agreed that, except for transactions in the ordinary course of business, HZ Leihuo will not enter into any transaction that would materially affect the assets, liabilities, rights or operations of HZ Leihuo without the prior written consent of NetEase Hangzhou. NetEase Hangzhou has also agreed that it will provide performance guarantees and, at NetEase Hangzhou's discretion, guarantee loans for working capital purposes to the extent required by HZ Leihuo for its operations. Furthermore, the VIE shareholders of HZ Leihuo have agreed that, upon instruction from NetEase Hangzhou, they will appoint HZ Leihuo's board members, president, chief financial officer and other senior executive officers. The term of this agreement is 20 years from December 1, 2015 and can be extended with the written consent of NetEase Hangzhou.
- Shareholder Voting Rights Trust Agreement among NetEase Hangzhou and the VIE shareholders of HZ Leihuo. Under these agreements, each dated December 1, 2015, each of the VIE shareholders of HZ Leihuo agreed to irrevocably entrust a person designated by NetEase Hangzhou to represent him to exercise all the voting rights and other shareholders' rights to which he is entitled as a shareholder of HZ Leihuo. Each agreement shall remain effective for as long as the VIE shareholder remains a shareholder of HZ Leihuo unless NetEase Hangzhou unilaterally terminates the agreement by written notice.
- Exclusive Purchase Option Agreements among NetEase Hangzhou, HZ Leihuo and the VIE shareholders of HZ Leihuo. Under the Exclusive Purchase Option Agreements, each dated December 1, 2015, each of the VIE shareholders has granted NetEase Hangzhou an option to purchase all or a portion of his equity interest in HZ Leihuo at a price equal to the original paid-in capital paid by the VIE shareholder. In addition, HZ Leihuo has granted NetEase Hangzhou an option to purchase all or a portion of the assets held by HZ Leihuo or its subsidiaries at a price equal to the net book value of such assets. Each of HZ Leihuo and the VIE shareholders of HZ Leihuo agrees not to transfer, mortgage or permit any security interest to be created on any equity interest in or assets of HZ Leihuo without the prior written consent of NetEase Hangzhou. Each Exclusive Purchase Option Agreement shall remain in effect until all of the equity interests in or assets of HZ Leihuo have been acquired by NetEase Hangzhou or its designee or until NetEase Hangzhou unilaterally terminates the agreement by written notice.

The principal agreements amongst the other VIEs, the relevant subsidiaries and VIE shareholders that provide the Company effective control over these VIEs contains substantially the same terms as those aforementioned agreements related to HZ Leihuo, except that contract expiry date varies.

**1. Organization and Nature of Operations (Continued)****(b) Nature of operations (Continued)***The Joint Venture*

In addition to the foregoing, in connection with the licensing of certain online games by Blizzard to Shanghai EaseNet for operation in the PRC, there are certain contractual arrangements among the Company and Shanghai EaseNet, the joint venture established between Blizzard and the Company.

StormNet IT HK, StormNet IT SH and Shanghai EaseNet (collectively referred to as the “**JV Group**”) are variable interest entities as equity investment at risk is not sufficient to permit the JV Group to finance its activities without additional subordinated financial support provided by any parties. As Blizzard receives its interest as an indirect contribution from NetEase, Blizzard and the Company are considered related parties for purposes of identifying which party is the primary beneficiary under ASC 810. Since the aggregate variable interests held by Blizzard and NetEase would, if held by a single party, identify that party as the primary beneficiary, either Blizzard or the Company will be the primary beneficiary. Based on the assessment of all relevant facts and circumstances, the Company determined that the Company is most closely associated with the JV Group and therefore is the primary beneficiary. As a result, the JV Group’s results of operations, assets and liabilities have been included in the Company’s consolidated financial statements.

The Company conducts substantially all of its business through the various VIEs discussed above and their subsidiaries, and therefore these companies directly affect the Company’s financial performance and cash flows. As discussed below, if the Chinese government determines the VIE agreements do not comply with applicable laws and regulations and requires the Company to restructure its operations entirely or discontinue all or any portion of its business, or if the uncertainties in the PRC legal system limit the Group’s ability to enforce these contractual agreements, the Group’s business operations will be significantly disrupted and the Group might be unable to consolidate these companies in the future. In the opinion of management, the likelihood of loss in respect of the Group’s current ownership structure or the contractual arrangements with its VIEs is remote.

*Risks related to the VIE arrangements*

The Company believes that its contractual arrangements with the VIEs are in compliance with PRC law and are legally enforceable. Mr. Ding, who is the major shareholder of Guangzhou NetEase, Shanghai EaseNet and certain of the Company’s other VIEs, is the largest shareholder of the Company. He therefore has no current interest in seeking to act contrary to the contractual arrangements. However, uncertainties in the PRC legal system could limit the Company’s ability to enforce these contractual arrangements and if Mr. Ding were to reduce his interest in the Company, his interests may diverge from that of the Company and that may potentially increase the risk that he would seek to act contrary to the contractual terms, for example by influencing the VIEs not to pay the service fees when required to do so. If the VIEs or their respective shareholder fail to perform their respective obligations under the current contractual arrangements, the Company may have to incur substantial costs and expend significant resources to enforce those arrangements and rely on legal remedies under Chinese laws. The Chinese laws, rules and regulations are relatively new, and because of the limited volume of published decisions

**1. Organization and Nature of Operations (Continued)****(b) Nature of operations (Continued)**

and their non-binding nature, the interpretation and enforcement of these laws, rules and regulations involve substantial uncertainties. These uncertainties may impede the ability of the Company to enforce these contractual arrangements, or suffer significant delay or other obstacles in the process of enforcing these contractual arrangements and materially and adversely affect the results of operations and the financial position of the Company.

In addition, many Chinese regulations are subject to extensive interpretive powers of governmental agencies and commissions, and there are substantial uncertainties regarding the interpretation and application of current and future Chinese laws and regulations. Accordingly, the Company cannot be assured that Chinese regulatory authorities will not ultimately take a contrary view to its belief and will not take action to prohibit or restrict its business activities. The relevant regulatory authorities would have broad discretion in dealing with any deemed violations which may adversely impact the financial statements, operations and cash flows of the Company (including the restriction on the Company to carry out the business). It is unclear, however, how such restructuring could impact the Company's business and operating results, as the Chinese government has not yet found any such contractual arrangements non-compliant. If the legal structure and contractual arrangements were found to be in violation of any existing PRC laws and regulations, the PRC government could potentially:

- revoke the Group's business and operating licenses;
- require the Group to discontinue or restrict operations;
- restrict the Group's right to collect revenues;
- block the Group's websites;
- require the Group to restructure the operations in such a way as to compel the Group to establish a new enterprise, re-apply for the necessary licenses or relocate the Group's businesses, staff and assets;
- impose additional conditions or requirements with which the Group may not be able to comply; or
- take other regulatory or enforcement actions against the Group that could be harmful to the Group's business.

The imposition of any of these penalties may result in a material and adverse effect on the Group's ability to conduct the Group's business. In addition, if the imposition of any of these penalties causes the Group to lose the rights to direct the activities of the VIEs or the right to receive their economic benefits, the Group would no longer be able to consolidate the VIEs. The Group does not believe that any penalties imposed or actions taken by the PRC government would result in the liquidation of the Company, its subsidiaries or the VIEs.

**2. Principal Accounting Policies****(a) Basis of consolidation**

The consolidated financial statements include the financial statements of the Company, its subsidiaries and VIEs for which the Company is the primary beneficiary with the ownership interests of minority shareholders reported as noncontrolling interests. All significant transactions and balances among the Company, its subsidiaries and VIEs have been eliminated upon consolidation. The Company consolidates a VIE if the Company has the power to direct matters that most significantly impact the activities of the VIE, and has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

**(b) Basis of presentation**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“**US GAAP**”). The consolidated financial statements are prepared based on the historical cost convention.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reporting periods. Actual results might differ from those estimates. Critical accounting estimates and assumptions include, but are not limited to, assessing the following: average playing period of paying players of online games and impairment of long-term investments.

**(c) Revenue recognition**

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (Topic 606) “Revenue from Contracts with Customers.” Topic 606 supersedes the revenue recognition requirements in Topic 605 “Revenue Recognition” (Topic 605), and requires entities to recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. On January 1, 2018, the Group adopted Topic 606 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Group’s historical accounting under Topic 605. The Group recognized the cumulative effect of initially applying the new revenue accounting standard as an adjustment to the beginning retained earnings on January 1, 2018.

**2. Principal Accounting Policies (Continued)****(c) Revenue recognition (Continued)**

The adoption of Topic 606 primarily impacts the accounting of the recognition of breakage associated with the Group's unused online points in a personal game account as a result of recording revenue based upon estimates of breakage under the new revenue standard. Under Topic 605, revenue for unused points was not recorded until the points expired. Thus, for unused points, revenue is recorded earlier under the new standard. The cumulative-effect adjustment upon adoption includes a reduction of its deferred revenue of approximately RMB81.7 million and a net increase to its retained earnings of approximately RMB27.4 million (net of tax). Revenues of related game points would have been recorded in the consolidated statements of operations and comprehensive income for the year ended December 31, 2018 under Topic 605 based on its actual expiry date. Therefore, adoption of the new revenue accounting standard impacted the Group's consolidated statements of operations and comprehensive income for the year ended December 31, 2018 by reducing RMB81.7 million of revenues. This impact of adopting the new revenue standard was not material to the consolidated financial statements.

For the year ended December 31, 2018 and 2019, net revenue recognized from sources other than contracts with customers under ASC 606 was immaterial.

Revenues from contracts with customers are recognized when control of the promised goods or services is transferred to the Group's customers, in an amount that reflects the consideration the Group expects to be entitled to in exchange for those goods or services, reduced by estimates for return allowances, promotional discounts, rebates and Value Added Tax ("VAT"). The recognition of revenues involves certain management judgments, including estimated lives of virtual items purchased by game players, estimated breakage of game points, return allowance for goods sold, the estimation of the fair value of an advertising-for-advertising barter transaction, volume sales rebates. The amount and timing of the Group's revenues could be different if management made different judgments or utilized different estimates.

The Group's revenues are mainly generated from online game services, online learning services from Youdao, advertising services, e-commerce and other fee-based premium services. Refer to "Note 26 — Segment Information" for disaggregation of revenue.

**(i) Online game services**

The Group operates mobile games and PC games. The Group is the principal of all games it operates, including both self-developed games and licensed games. As all these games are hosted on the Group's servers, the Group has the pricing discretion, and is responsible for the sale and marketing of the games as well as customer services. Fees paid to game developers, distribution channels (app stores) and payment channels are recorded as cost of revenues.

**2. Principal Accounting Policies (Continued)****(c) Revenue recognition (Continued)****(i) Online game services (Continued)***Mobile games*

The Group generates mobile game revenues from the sale of in-game virtual items, including items, avatars, skills, privileges or other in-game consumables, features or functionality, within the games. The Group's performance obligation is to provide on-going game services to players who purchased virtual items to gain an enhanced game-playing experience. This performance obligation is satisfied over the playing period of the paying players. Accordingly, the Group recognizes the revenues ratably over the estimated average playing period of these paying players.

The Group considers the average period that players typically play the games and other game player behavior patterns, as well as various other factors to arrive at the best estimates for the estimated playing period of the paying players for each game based on historical players' churn rates. If a new game is launched and only a limited period of paying player data is available, then the Group considers other qualitative factors, such as the playing patterns for paying users for other games with similar characteristics and playing patterns of paying players, such as targeted players and purchasing frequency. While the Group believes its estimates to be reasonable based on available game player information, the Group may revise such estimates based on new information indicating a change in the game player behavior patterns and any adjustments are applied prospectively.

*PC games*

The Group sells prepaid points to the end users. Customers can purchase "virtual" prepaid points online or from the vendors who register the points in the Group's system via debit and credit cards or bank transfers via the online payment services platforms, and receive the prepaid point information over the Internet. Customers can use the points to play the Group's PC games, pay for in-game items and use other fee-based services. Proceeds received from the sales of prepaid online points to players are recorded as deferred revenues.

The Group earns revenue through providing PC game services to players under two types of revenue models: time-based revenue model and item-based revenue model. For PC games using the time-based model, players are charged based on the time they spend playing games. Revenues are recognized ratably over the game playing period as the performance obligations are satisfied.

**2. Principal Accounting Policies (Continued)****(c) Revenue recognition (Continued)****(i) Online game services (Continued)***PC games (Continued)*

Under the item-based model, the basic game play functions are free of charge, and players are charged for purchases of in-game items. In-game items have different life patterns: one-time use, limited life and permanent life. Revenues from the sales of one-time use in-game items are recognized upon consumption. Limited life items are either limited by the number of uses (for example, 10 times) or limited by time (for example, three months). Revenues from the sales of limited life in-game items are recognized ratably based on the extent of time passed or expired or when the items are fully used. Players are allowed to use permanent life in-game items without any use or time limits. Revenues from the sales of permanent life in-game items are recognized ratably over the estimated average playing period of the paying players.

The Group considers the average period that players typically play the games and other game player behavior patterns, as well as various other factors, including the acceptance and popularity of expansion packs, promotional events launched and market conditions to arrive at the best estimates for the estimated average playing period of the paying players for the permanent in-game items of each PC game based on historical players' churn rate. This estimate is re-assessed on a quarterly basis. Adjustments arising from the changes of estimated playing period of the paying players are applied prospectively as such changes are resulted from new information indicating a change in the game player behavior patterns.

**(ii) Online Courses Services**

The Group offers various types of integrated learning services through Youdao, which primarily cover a wide spectrum of topics and target people from broad age groups through its diverse offerings of K-12 tutoring courses, foreign languages, professional and interest education services as well as IT computer skills, etc. Youdao's online courses services consist of online live streaming, other activities during the online live streaming period, as well as the content playback service. The aforementioned services are highly interdependent and interrelated in the context of the contract and are only considered accessory services to the online live streaming courses and therefore are not distinct and are not sold standalone. Therefore, the Group's online courses services are accounted for as a single performance obligation, which is satisfied over the learning period of the students. Accordingly, the Group recognizes the revenues ratably over the estimated average learning period for different courses. The Group considers the average period that students typically spend time on the courses and other learning behavior patterns to arrive at the best estimates for the estimated learning period for each course.

**2. Principal Accounting Policies (Continued)****(c) Revenue recognition (Continued)****(iii) Advertising services**

The Group derives its advertising revenues principally from short-term online advertising contracts. Advertising service contracts may consist of multiple performance obligations with a typical term of less than three months. In arrangements where the Group has multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price. The Group generally determines standalone selling prices based on the prices charged to customers. If the performance obligation has not been sold separately, the Group estimates the standalone selling price by taking into consideration of the pricing for advertising areas of the Group's platform with a similar popularities and advertisements with similar formats and quoted prices from competitors as well as other market conditions. Considerations allocated to each performance obligation is recognized as revenue over the advertisement display period, which is usually within three months.

The Group also enters into performance-based advertising arrangements with customers.

For cost per mille ("CPM"), or cost per thousand impressions, advertising arrangements with customers, the Group recognizes revenues based on the number of times that the advertisement has been displayed.

For cost per action ("CPA") advertising arrangements with customers, including Youdao online marketing services, the Group recognizes revenues based on the number of actions completed resulted from the advertisements, including but not limited to when users click on links.

Certain customers may receive volume rebates, which are accounted for as variable consideration. The Group estimates annual expected rebate volume with reference to their historical results and reduce revenues recognized.

The Group recognizes revenue from providing advertising service in exchange for non-cash consideration, usually advertising services, promotional benefits, content, consulting services and software provided by counterparties, at the fair value of the non-cash consideration measured as of contract inception date. If the Group is not able to reliably determine the fair value of non-cash consideration in some situations, the value of the non-cash consideration received is measured indirectly by reference to the standalone selling price of advertising services provided by the Group. For the year ended December 31, 2017, 2018 and 2019, revenue from rendering advertng services in exchange for non-cash consideration is insignificant.



**2. Principal Accounting Policies (Continued)****(c) Revenue recognition (Continued)****(iv) E-commerce**

The Group's e-commerce revenue is primarily from its E-commerce platform Yanxuan, which was established in April 2016. Yanxuan sells its private label products, including apparel, homeware, kitchenware and other general merchandise which are sourced primarily directly from original design manufacturers in China through online direct sales. The Group is the principal for the online direct sales, as it controls the inventory before they are transferred to customers. The Group has the primary responsibility for fulfilling the contracts, bears the inventory risk, and has sole discretion in establishing the prices. E-commerce revenues from online direct sales are recognized when control of the goods is transferred to the customer, which generally occurs upon delivery to the customer. The Group also provides discount coupons to its customers for use in purchases on the Yanxuan platform, which are treated as a reduction of revenue when the related transaction is recognized.

Return allowances, which reduce revenue and cost of sales, are estimated using historical experience. Liabilities for return allowances and rights to recover products from customers associated with the Group's liabilities are recorded as "Accrued liabilities and other payables" and "Inventories, net," respectively, on the Group's consolidated balance sheets. Both of the balances are not material as of December 31, 2017, 2018 and 2019.

**(v) Fee-based premium services**

Fee-based premium services revenues, mostly operated on either consumption-basis or a monthly subscription basis, are derived principally from providing premium live-streaming services, online music services, online reading, e-mail and other innovative businesses. Prepaid subscription fees collected from customers are deferred and are recognized as revenue on a straight-line basis by the Group over the subscription period, during which customers can access the premium online services provided by the Group. Fees collected from customer to be consumed to purchase online services are recognized as revenue when related services are rendered.

The Group generates revenue from the operation of its live streaming platforms whereby users can enjoy live performances provided by the hosts and interact with the hosts. Most of the hosts host the performance on their own. The Group creates and sells virtual items to users so that the users present them simultaneously to hosts to show their support. The virtual items sold by the Group comprise of either (i) consumable items or (ii) time-based item, such as privilege titles etc. Under the arrangements with the hosts, the Group shares with them a portion of the revenues derived from the sales of virtual items. Revenues derived from the sale of virtual items are recorded on a gross basis as the Group acts as the principal to fulfill all obligations related to the sale of virtual items. Accordingly, revenue is recognized when the virtual item is delivered and consumed if the virtual item is a consumable item or, in the case of time-based virtual item, recognized ratably over the period each virtual item is made available to the user.

## 2. Principal Accounting Policies (Continued)

### (c) Revenue recognition (Continued)

#### *Practical Expedients*

The Group has used the following practical expedients as allowed under ASC 606:

- (i) The effects of a significant financing component has not been adjusted for contracts which the Group expects, at contract inception, that the period between when the Group transfers a promised good or service to the customer and when the customer pays for that good or service will be one year or less.
- (ii) The Group applied the portfolio approach in determining the commencement date of consumption and the estimated average playing period of paying players for PC games permanent virtual items and of mobile games for the recognition of online game revenue given that the effect of applying a portfolio approach to a group game players' behaviors would not differ materially from considering each one of them individually.
- (iii) The Group elects to expense the costs to obtain a contract as incurred when the expected amortization period is one year or less.

#### *Contract Balances*

Timing of revenue recognition may differ from the timing of invoicing to customers. Accounts receivable represent amounts invoiced and revenue recognized prior to invoicing, when the Group has satisfied its performance obligations and has the unconditional right to payment. The Group closely monitors the collection of its accounts receivables and records a reserve for doubtful accounts against aged accounts and for specifically identified non-recoverable amounts. If the economic situation and the financial condition of the customer deteriorate resulting in an impairment of the customer's ability to make payments, additional allowances might be required. Accounts receivables balances are written off when they are determined to be uncollectible.

The following table sets out the movements of the allowance for doubtful accounts for the years ended December 31, 2017, 2018 and 2019:

	<b>Balance at January 1</b>	<b>Charged to/ (Write-back against) expenses</b>	<b>Write-off of receivable balances and corresponding provisions</b>	<b>Balance at December 31</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
2017	24,136	60,826	(53)	84,909
2018	84,909	50,954	(5,215)	130,648
2019	130,648	(30,946)	(22,555)	77,147

**2. Principal Accounting Policies (Continued)****(c) Revenue recognition (Continued)***Contract Balances (Continued)*

Under Topic 606, the Group's right to consideration in exchange for goods or services that the Group has transferred to a customer is recognized as a contract asset. Contract assets as of December 31, 2018 and 2019 were not material.

A contract liability is the Group's obligation to transfer goods or services to a customer for which the Group has received consideration (or an amount of consideration is due) from the customer. Contract liabilities are presented as "Deferred Revenue" on the consolidated balance sheets of the Group. Refer to Note 16 — Deferred revenue for further information, including changes in deferred revenue during the year.

**(d) Cost of revenues**

Costs of revenues consist primarily of revenue sharing cost, staff costs, royalties fees related to licensed games, traffic acquisition cost, content acquisition cost, service fees related to online payments, server and bandwidth service fee, depreciation and amortization of servers, computers and software, and other direct costs of providing these services, as well as cost of merchandise sold. These costs are charged to the consolidated statements of operations and comprehensive income as incurred.

**(e) Research and development costs**

Research and development costs mainly consist of personnel-related expenses and technology service costs incurred for the development of online games, as well as development and enhancement of the Group's new products, websites and application platforms.

For internal use software, the Group expenses all costs incurred for the preliminary project stage and post implementation-operation stage of development, and costs associated with repair or maintenance of the existing platforms. Costs incurred in the application development stage are capitalized and amortized over the estimated useful life. Since the amount of the Group's research and development expenses qualifying for capitalization has been immaterial for the years ended December 31, 2017, 2018 and 2019, as a result, all development costs incurred for development of internal used software have been expensed as incurred.

For external use software, costs incurred for development of external use software have not been capitalized for the years ended December 31, 2017, 2018 and 2019, because the period after the date technical feasibility is reached and the time when the software is marketed is short historically, and the amount of costs qualifying for capitalization has been immaterial.

**2. Principal Accounting Policies (Continued)****(f) Cash, cash equivalents and time deposits**

Cash and cash equivalents mainly represent cash on hand, demand deposits placed with large reputable banks in Hong Kong and/or China, and highly liquid investments that are readily convertible to known amounts of cash and with original maturities from the date of purchase with terms of less than three months. As of December 31, 2017, there were cash at bank and demand deposits with terms of less than three months denominated in U.S. dollars, HK dollars and Euro amounting to approximately US\$104.1 million, HK\$2.7 million and Euro0.1 million, respectively (equivalent to approximately RMB680.3 million, RMB2.2 million and RMB0.8 million, respectively). As of December 31, 2018, there were cash at bank and demand deposits with terms of less than three months denominated in U.S. dollars, HK dollars and Euro amounting to approximately US\$244.2 million, HK\$90.6 million and Euro0.2 million, respectively (equivalent to approximately RMB1,675.9 million, RMB79.4 million and RMB1.5 million, respectively). As of December 31, 2019, there were cash at bank and demand deposits with terms of less than three months denominated in U.S. dollars, HK dollars and Euro amounting to approximately US\$226.6 million, HK\$21.3 million and Euro0.4 million, respectively (equivalent to approximately RMB1,580.7 million, RMB19.0 million and RMB2.7 million, respectively).

Time deposits represent time deposits placed with banks with original maturities of three months or more. As of December 31, 2017, there were time deposits denominated in U.S. dollars amounting to approximately US\$2,547.8 million (equivalent to approximately RMB16,648.1 million). As of December 31, 2018, there were time deposits denominated in U.S. dollars amounting to approximately US\$2,456.3 million (equivalent to approximately RMB16,857.9 million). As of December 31, 2019, there were time deposits denominated in U.S. dollars amounting to approximately US\$4,382.9 million (equivalent to approximately RMB30,576.3 million).

As of December 31, 2017, 2018 and 2019, the Group had approximately RMB15.1 billion, RMB12.5 billion and RMB14.8 billion cash and cash equivalents and time deposits held by its PRC subsidiaries and VIEs, representing 45.4%, 32.8% and 25.0% of total cash and cash equivalents and time deposits of the Group, respectively.

**2. Principal Accounting Policies (Continued)****(f) Cash, cash equivalents and time deposits (Continued)**

As of December 31, 2017, 2018 and 2019, the Group had a restricted cash balance approximately RMB5,886.6 million, RMB4,692.1 million and RMB3,150.4 million, respectively, comprising as follows (in millions):

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Customer deposit of NetEase			
Pay accounts	1,554.8	1,364.4	1,523.3
Pledge deposits for short-term			
bank borrowings — Current	4,091.0	2,695.0	1,595.0
Pledge deposits for Letter of			
Guarantee	230.5	623.6	—
Others	10.3	9.1	32.1
	<u>5,886.6</u>	<u>4,692.1</u>	<u>3,150.4</u>
Total	<u>5,886.6</u>	<u>4,692.1</u>	<u>3,150.4</u>

The Group had no other lien arrangements during 2017, 2018 and 2019.

**(g) Fair value of financial instruments**

Accounting guidance defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

Accounting guidance establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Accounting guidance establishes three levels of inputs that may be used to measure fair value:

- Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets
- Level 2 — Include other inputs that are directly or indirectly observable in the marketplace
- Level 3 — Unobservable inputs which are supported by little or no market activity

**2. Principal Accounting Policies (Continued)****(g) Fair value of financial instruments (Continued)**

The Group's financial instruments include cash and cash equivalents and time deposits, accounts receivable, prepayments and other current assets, short-term investments, accounts payable, short-term loans, deferred revenue and accrued liabilities and other payables, which the carrying values approximate their fair value. Please see Note 27 for additional information.

**(h) Inventories, net**

Inventories, net mainly represent products for the Group's e-commerce business, are stated at the lower of cost or net realizable value in the consolidated balance sheets. Cost of inventory is determined using the weighted average cost method. Adjustments are recorded to write down the cost of inventory to the estimated net realizable value due to slow-moving merchandise and damaged goods, which is dependent upon factors such as historical and forecasted consumer demand, and promotional environment. The Group takes ownership, risks and rewards of the products purchased. Write downs are recorded in cost of revenues in the consolidated statements of operations and comprehensive income. Certain costs attributable to buying and receiving products, such as purchase freights, are also included in inventories.

**(i) Investments**

Short-term investments

Short-term investments include investments in financial instruments with a variable interest rate indexed to performance of underlying assets, all of which are with an original maturities of less than 12 months.

In accordance with ASC 825, for investments in financial instruments with a variable interest rate indexed to performance of underlying assets, the Group elected the fair value method at the date of initial recognition and carried these investments at fair value. Changes in the fair value are reflected in the consolidated statements of operations and comprehensive income as other income/(expense), net. Fair value is estimated based on quoted prices of similar products provided by banks at the end of each period. The Group classifies the valuation techniques that use these inputs as Level 2 of fair value measurements. Please see Note 6 and Note 27 for additional information.

Long-term investments

Long-term investments are comprised of equity investments in publicly traded companies, privately-held companies and limited-partnership.

**2. Principal Accounting Policies (Continued)****(i) Investments (Continued)**

## Long-term investments (Continued)

Equity investments in publicly traded companies are reported at fair value as equity investment with readily determinable fair value. Prior to January 1, 2018, they were classified as available-for-sale equity securities under long-term investments, with unrealized gains or losses, if any, recorded in accumulated other comprehensive income/(loss) in shareholders' equity. The treatment of a decline in the fair value of an individual security was based on whether the decline was other-than-temporary. The Group assessed its available-for-sale equity securities for other-than-temporary impairment by considering factors including, but not limited to, its ability and intent to hold the individual security, severity of the impairment, expected duration of the impairment and forecasted recovery of fair value. If the Group determines a decline in fair value was other-than-temporary, the cost basis of the individual security was written down to fair value as a new cost basis and the amount of the write-down was accounted for as a realized loss charged to the consolidated statements of comprehensive income. The fair value of the investment would then become the new cost basis of the investment and were not adjusted for subsequent recoveries in fair value.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01 (ASU No. 2016-01) "Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The Group adopted this guidance on January 1, 2018, and RMB38.2 million of accumulated other comprehensive income for the Group's available-for-sale equity securities that existed as of January 1, 2018 was reclassified into retained earnings on January 1, 2018 upon the adoption. Starting January 1, 2018, unrealized gains and losses during the year are recognized in other income/(expense), net.

Prior to January 1, 2018, investments in common stock or in-substance common stock issued by privately-held companies on which the Group does not have significant influence, and investments in privately-held companies' shares that are not ordinary shares or in substance ordinary shares, as these equity securities do not have readily determinable fair value, the Group carried these investment at cost and only adjusts for other-than-temporary declines in fair value and distributions of earnings that exceed the Group's share of earnings since its investment. Starting January 1, 2018, upon the adoption of ASU 2016-01, the Group elects to measure these equity securities investments without readily determinable fair value at cost, less impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer (referred to as the measurement alternative). All gains and losses on these equity securities, realized and unrealized, are recognized in other income/(expense), net. The Group did not record any changes to the carrying value of equity investments without readily determinable fair value for the year ended December 31, 2018 and 2019.

**2. Principal Accounting Policies (Continued)****(i) Investments (Continued)**

## Long-term investments (Continued)

Investments in common stock or in-substance common stock of investees and limited-partnership investments in which the Group is in a position to exercise significant influence by participating in, but not controlling or jointly controlling, the financial and operating policies are accounted for using the equity method.

Management regularly evaluates the impairment of the investments in privately-held companies without readily determinable fair value and equity method investments at each balance sheet date, or more frequently if events or circumstances indicate that the carrying amount may not be recoverable. For investments without readily determinable fair values, management performs a qualitative assessment of the fair value of the equity interest in comparison to its carrying amount to determine if there is an indication of potential impairment. If such indication exists, management estimates the fair value of the investment, and records an impairment in the consolidated statements of comprehensive income to the extent the carrying amount exceeds the fair value. Significant judgments management applies in the impairment assessment for these equity investments include: (i) the determination as to whether any impairment indicators exist during the year; (ii) the selection of valuation methods; (iii) the determination of significant assumptions used to value the equity investments, including selection of comparable companies and multiples, timing and probabilities of different scenarios, estimated volatility rate, risk-free rate and discount for lack of marketability; and (iv) judgments as to whether a decline in value of equity method investments was other than temporary. For equity method investments, management considers if the investment is impaired when events or circumstances suggest the carrying amount may not be recoverable, and recognizes any impairment charge in the consolidated statements of comprehensive income for a decline in value that is determined to be other than temporary.

**(j) Lease**

On January 1, 2019, the Group adopted ASU 2016-02, "Leases (Topic 842)," including certain transitional guidance and subsequent amendments within ASU 2018-01, ASU 2018-10, ASU 2018-11, ASU 2018-20 and ASU 2019-01 (collectively, including ASU 2016-02, "ASC 842").

ASC 842 supersedes the lease requirements in ASC 840 "Leases" and generally requires the recognition on the balance sheet of right-of-use assets and lease liabilities for all long-term leases, including operating leases, on the balance sheet and to provide enhanced disclosures surrounding the amount, timing and uncertainty of cash flows arising from leasing arrangements. Leases that transfer substantially all of the benefits and risks incidental to the ownership of assets are accounted for as finance leases as if there was an acquisition of an asset and incurrence of an obligation at the inception of the lease. All other leases are accounted for as operating leases. As of December 31, 2019, the Group has no finance leases.



## 2. Principal Accounting Policies (Continued)

### (j) Lease (Continued)

Prior to the adoption of ASC 842, leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the period of the leases. The Group adopted the new lease standard using the modified retrospective method by applying the new lease standard to all leases existing as of January 1, 2019, the date of initial adoption, and no adjustments were made to the comparative periods. The Group elected the package of practical expedients permitted under the transition guidance, which allowed the Group to carry forward previous lease classification, the assessment on whether a contract was or contained a lease, and the initial direct costs for any leases that existed prior to January 1, 2019. The Group recognized approximately RMB577.0 million as total right-of-use (“ROU”) assets as well as total lease liabilities for the operating leases on its consolidated balance sheet as of January 1, 2019. The adoption of the new lease standard does not have any significant impact on the consolidated statements of comprehensive income and cash flows and there was no adjustment to the beginning retained earnings on January 1, 2019. See Note 9 Leases for additional information.

Under ASC 842, the Group determines if an arrangement is a lease at inception. The Group is the lessee in a lease contract when the Group obtain the right to control the asset. Operating leases are included in operating lease ROU assets, and short-term and long-term operating lease liabilities in the Group’s consolidated balance sheets. ROU assets represent the Group’s right to use an underlying asset for the lease term and lease liabilities represent the Group’s obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Group’s leases do not provide an implicit rate, the Group generally uses its incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Lease expense is recognized on a straight-line basis over the lease term.

For leases with a term of twelve months or less (“**short-term leases**”), the Group has elected not to recognize lease liabilities and associated ROU assets. Lease payments on short-term leases are recognized as lease expense within cost of revenues or operating expenses on the consolidated statements of operations and comprehensive income, depending on the nature of the lease, on a straight-line basis over the lease term.

**2. Principal Accounting Policies (Continued)****(k) Property, equipment and software**

Property, equipment and software are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line basis over the following estimated useful lives, taking into account any estimated residual value:

Building	20 years
Decoration	5 years
Leasehold improvements	lesser of the term of the lease and the estimated useful lives of the assets
Furniture, fixtures, office and other equipment	3-10 years
Vehicles	5 years
Servers and computers	3 years
Software	3 years

Repairs and maintenance expenditures, which are not considered improvements and do not extend the useful life of the property and equipment, are expensed as incurred.

**(l) Land use rights**

Land use rights represent lease prepayments to the local government authorities. As of December 31, 2017, and 2018, land use rights were carried at cost less accumulated amortization and any impairment loss. Amortization is provided to write off the cost of lease prepayments on a straight-line basis over the remaining term of the land use right period.

Upon the adoption of ASC 842 on January 1, 2019, land use rights, net were identified as operating lease right-of-use assets, which is separately disclosed as "Land use rights" in the Group's consolidated balance sheets. Accordingly, the Group disclosed the cash used for obtaining the land use rights in operating cash flow activities for the year ended December 31, 2019, with no adjustments made to the comparative periods.

**(m) Intangible assets**

Finite-lived intangible assets are tested for impairment if impairment indicators arise. The Group amortizes its finite-lived intangible assets using the straight-line method:

License right	over the license period
Technology	10 years

The Group obtains music content for customers through licensing agreements. When the license fee for music title is determinable or reasonably estimable and the content is available for streaming, the Group recognizes an asset representing the fee and a corresponding liability for the amounts owed. The Group relieves the liability as payments are made and the Group amortizes the asset to "Cost of revenues" on a straight-line basis over the term of the respective licensing agreements.

**2. Principal Accounting Policies (Continued)****(n) Advertising expenses**

The Group expenses advertising costs as incurred and reports these costs under selling and marketing expense. Advertising expenses totaled approximately RMB1,998.4 million, RMB2,222.2 million and RMB1,679.3 million (US\$241.2 million) for the years ended December 31, 2017, 2018, and 2019, respectively.

**(o) Foreign currency translation**

The Group's reporting currency is RMB. The Company and its subsidiaries and VIEs, with an exception of several subsidiaries incorporated in Cayman Islands, use RMB as their functional currency. In 2017, several of the Company's subsidiaries incorporated in Cayman Islands changed their functional currency from RMB to US\$. The determination of the respective functional currency is based on the criteria of ASC 830, Foreign Currency Matters and such change has not resulted in any material effect on the Group's financial statements.

Transactions in currencies other than the functional currency are measured and recorded in the functional currency using the exchange rate in effect at the date of the transaction. At the balance sheet date, monetary assets and liabilities that are denominated in currencies other than the functional currency are translated into the functional currency using the exchange rate at the balance sheet date. The resulting exchange differences are included in the consolidated statements of operations and comprehensive income.

Assets and liabilities of the Group companies are translated from their respective functional currencies to the reporting currency at the exchange rates at the balance sheet dates, equity accounts are translated at historical exchange rates and revenues and expenses are translated at the average exchange rates in effect during the reporting period. The exchange differences for the translation of group companies with non-RMB functional currency into the RMB functional currency are included in foreign currency translation adjustments, which is a separate component of shareholders' equity on the consolidated financial statements.

Translations of amounts from RMB into United States dollars for the convenience of the reader were calculated at the noon buying rate of US\$1.00 = RMB6.9618 on the last trading day of 2019 (December 31, 2019) as set forth in the H.10 statistical release of the U.S. Federal Reserve Board. No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at such rate.

## 2. Principal Accounting Policies (Continued)

### (p) Share-based compensation

Under its 2009 Restricted Share Unit Plan and 2019 Restricted Share Unit Plan (see Note 20(a)), the Company issues restricted share units (RSUs) to its employees, directors and consultants with performance conditions and service vesting periods ranging from one year to five years. Some of the RSUs issued are to be settled, at the Company's discretion, in stock or cash upon vesting based on the stock price at grant date. At each reporting period, the Company evaluates the likelihood of performance conditions being met. Share-based compensation costs are then recorded for the number of RSUs expected to vest on a graded-vesting basis, net of estimated forfeitures, over the requisite service period. The compensation cost of the RSUs to be settled in stock only is measured based on the fair value of stock when all conditions to establish the grant date have been met. The compensation cost of RSUs to be settled either in stock or cash at the Company's discretion is remeasured until the date when settlement in stock or cash is determined by the Company.

The Company records share-based compensation to the consolidated statements of operations and comprehensive income with the corresponding credit to the additional paid-in-capital for share options and RSUs to the extent that such awards are to be settled only in stock.

Certain subsidiaries of the Company granted options exercisable for ordinary shares to certain of the Group's employees. The options expire five to ten years from the date of grant and either vest or have a vesting commencement date upon certain conditions being met ("**Vesting Commencement Date**"). The Group adopts the binomial option pricing model to determine the fair value of stock options and accounts for share-based compensation cost using an estimated forfeiture rate.

Forfeitures were estimated based on the Group's weighted average historical forfeiture rate of the past five years. Differences between actual and estimated forfeitures are expensed in the period that the differences occur. See Note 20 for further information regarding share-based compensation assumptions and expense.

### (q) Taxation

Income tax expense is recognized in accordance with the laws of the relevant taxing authorities, with deferred taxes being provided for temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. Tax rate changes are reflected in income during the period the changes are enacted.

A deferred income tax asset or liability is computed for the expected future impact of differences between the financial reporting and tax bases of assets and liabilities as well as the expected future tax benefit to be derived from tax loss and tax credit carry forwards.

Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount "more likely than not" to be realized in future tax returns.

**2. Principal Accounting Policies (Continued)****(q) Taxation (Continued)**

For a particular tax-paying component of an enterprise and within a particular tax jurisdiction, all deferred tax assets and liabilities are offset and presented as a single amount. The Group does not offset deferred tax assets and liabilities attributable to different tax-paying components of the enterprise or to different tax jurisdictions.

The Group reports tax-related interest expense and penalty in Other, net in the consolidated statements of operations and comprehensive income, if there is any. The Group did not incur any material penalty or interest payments in connection with tax positions during the years ended December 31, 2017, 2018 and 2019.

The Group did not have any significant unrecognized uncertain tax positions as of December 31, 2017, 2018 and 2019.

In order to assess uncertain tax positions, the Group applies a more likely than not threshold and a two-step approach for the tax position measurement and financial statement recognition. Under the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

**(r) Net earnings per share (“EPS”) and per American Depositary Share (“ADS”)**

Basic earnings per share is computed on the basis of the weighted-average number of ordinary shares outstanding during the period under measurement. Diluted earnings per share are based on the weighted-average number of ordinary shares outstanding and potential ordinary shares. Potential ordinary shares result from the assumed exercise of outstanding stock options, RSUs or other potentially dilutive equity instruments, when they are dilutive under the treasury stock method or the if-converted method.

**(s) Statutory reserves**

The Company's subsidiaries and VIEs incorporated in China are required to make appropriations to certain non-distributable statutory reserves. In accordance with the laws applicable to foreign invested enterprises in China, its subsidiaries have to make appropriations from its after-tax profit as reported in their PRC statutory accounts to non-distributable statutory reserves including (i) general reserve fund, (ii) enterprise expansion fund and (iii) staff bonus and welfare fund. The appropriation to the general reserve fund is at least 10% of the after-tax profits as reported in the PRC statutory accounts. Appropriation is not required if the reserve fund has reached 50% of the registered capital of the respective company. The appropriation to the other reserve funds is at the discretion of the board of directors of the respective company. At the same time, the Company's VIEs, in accordance with the China Company Laws, must make appropriations from their after-tax profit as reported in their PRC statutory accounts to non-distributable statutory reserves including (i) statutory surplus fund and (ii) discretionary surplus fund. The appropriation to the statutory surplus fund is at least 10% of the after-tax profits as reported in their PRC statutory accounts. Appropriation is not required if the statutory surplus fund has reached 50% of the registered capital of the respective company. Appropriation to the discretionary surplus fund is made at the discretion of the board of directors of the respective companies.

**2. Principal Accounting Policies (Continued)****(s) Statutory reserves (Continued)**

The general reserve fund and statutory surplus fund are restricted to set off against losses, expansion of production and operation or increase in the registered capital of the respective companies. The staff bonus and welfare fund is available to fund payments of special bonuses to staff and for collective welfare benefits. Upon approval by the board of directors, the discretionary surplus and enterprise expansion fund can be used to offset accumulated losses or to increase capital.

**(t) Noncontrolling interests and redeemable noncontrolling interests**

Noncontrolling interests are recognized to reflect the portion of the equity of majority-owned subsidiaries and VIEs which is not attributable, directly or indirectly, to the controlling shareholder. The noncontrolling interests will continue to be attributed its share of losses even if that attribution results in a deficit noncontrolling interests balance.

Redeemable noncontrolling interests represent redeemable equity interests issued by the Group's subsidiaries to certain investors (see Note 17), and have been classified as mezzanine noncontrolling interests in the consolidated financial statements as these redeemable interests are contingently redeemable upon the occurrence of certain conditional events, which is not solely within the control of the Group. The Group accreted the redeemable equity interests to their redemption value, which is purchase price plus interest per year over the period since issuance to the earliest redemption date. The accretions were recorded against retained earnings, or in the absence of retained earnings, by charges against additional paid-in capital. Once additional paid-in capital had been exhausted, additional charges were recorded by increasing the accumulated deficit.

**(u) Related parties**

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or significant influence, such as a family member or relative, stockholder, or a related corporation.

**(v) Comprehensive income**

Comprehensive income is defined as the change in equity of the Group during a period arising from transactions and other events and circumstances excluding transactions resulting from investments by shareholders and distributions to shareholders.

Comprehensive income for the years ended December 31, 2017 includes net income, change in unrealized gains/(losses) on marketable securities classified as available-for-sale securities (net of tax) and foreign currency translation adjustment. Starting from January 1, 2018, upon adoption of ASU 2016-01, gain/(losses) on marketable securities are recognized in other income/(expense), net.

**2. Principal Accounting Policies (Continued)****(w) Segment reporting**

The Group's internal organizational structure as well as information about geographical areas, business segments and major customers in financial statements is set out in detail under Note 26.

**(x) Dividends**

Dividends of the Company are recognized when declared.

**(y) Reclassification of comparative figures**

On January 1, 2018, the Group adopted ASU 2016-18 "Statement of Cash Flows (Topic 230): Restricted Cash" on a retrospective transition method. The guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown in the statements of cash flows. The standard should be applied using a retrospective transition method to each period presented. Pursuant to the new guidance, the net change of cash, cash equivalents and restricted cash decreased RMB393.8 million for the year ended December 31, 2017, compared to the amounts presented under previous guidance.

In addition, the Group reclassified comparative figures as of December 31, 2017 and 2018 and for the years ended related to the discontinued operations, see Note 3.

**(z) Recently issued accounting pronouncements**

In June 2016, the FASB issued ASU 2016-13 "Financial Instruments — Credit Losses (Topic 326)," which requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost. This guidance is effective for the Group beginning on January 1, 2020. The Group does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

### 3. Discontinued Operations

#### *Disposal of Kaola e-commerce business*

In September 2019, the Group signed a series of agreements with a subsidiary of Alibaba Group Holding Limited (“Alibaba”) to sell its e-commerce platform Kaola for a consideration of approximately US\$1.9 billion. The consideration is comprised of approximately US\$1.6 billion in cash payable to the Group and Kaola equity award holders, as well as approximately 14.3 million Alibaba ordinary shares issued to the Group. Upon completion of the transaction, Kaola was deconsolidated from the Group and its historical financial results are reflected in the Group’s consolidated financial statements as discontinued operations accordingly. Additionally, the related assets and liabilities associated with discontinued operations in the prior year consolidated balance sheets were classified as assets/liabilities held for sale to provide the comparable financial information.

The following tables set forth the assets, liabilities, statements of operations and cash flows of discontinued operations which were included in the Group’s consolidated financial statements:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>
	<i>RMB</i>	<i>RMB</i>
Cash and cash equivalents	295,179	400,747
Restricted cash	40,539	125,290
Accounts receivable, net	70,929	169,794
Inventories, net	4,490,701	3,952,208
Prepayments and other current assets	513,168	493,563
<b>Total current assets</b>	<b>5,410,516</b>	<b>5,141,602</b>
Property, equipment and software, net	278,110	705,432
Land use rights, net	153,753	231,058
Other long-term assets	18,724	31,248
<b>Total non-current assets</b>	<b>450,587</b>	<b>967,738</b>
<b>Total assets</b>	<b>5,861,103</b>	<b>6,109,340</b>
Accounts payable	1,369,150	1,183,143
Salary and welfare payables	107,760	188,683
Taxes payable	2,578	11,212
Deferred revenue	188,066	234,770
Accrued liabilities and other payables	360,190	843,073
<b>Total current liabilities</b>	<b>2,027,744</b>	<b>2,460,881</b>
Deferred tax liabilities	361	1,083
Other long-term payable	–	4,735
<b>Total non-current liabilities</b>	<b>361</b>	<b>5,818</b>
<b>Total liabilities</b>	<b>2,028,105</b>	<b>2,466,699</b>



## 3. Discontinued Operations (Continued)

	For the year ended December 31,		
	2017	2018	2019**
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Net revenues	9,664,664	15,977,878	10,571,406
Cost of revenues	<u>(8,795,012)</u>	<u>(14,920,531)</u>	<u>(9,620,388)</u>
<b>Gross profit</b>	869,652	1,057,347	951,018
<b>Operating expenses:</b>			
Selling and marketing expenses	(1,452,983)	(2,614,760)	(1,258,413)
General and administrative expenses	(48,016)	(112,902)	(79,985)
Research and development expenses	<u>(209,755)</u>	<u>(414,090)</u>	<u>(326,127)</u>
Total operating expenses	(1,710,754)	(3,141,752)	(1,664,525)
Operating loss	<u>(841,102)</u>	<u>(2,084,405)</u>	<u>(713,507)</u>
Other income/(expenses):	13,023	(48,246)	(69,282)
Loss from discontinued operations	<u>(828,079)</u>	<u>(2,132,651)</u>	<u>(782,789)</u>
Income tax	(6,375)	(6,031)	(5,857)
Loss from discontinued operations, net of tax	<u>(834,454)</u>	<u>(2,138,682)</u>	<u>(788,646)</u>
Gains on disposal, net of tax	<u>–</u>	<u>–</u>	<u>8,751,165</u>
Net (loss)/income from discontinued operations	<u><u>(834,454)</u></u>	<u><u>(2,138,682)</u></u>	<u><u>7,962,519</u></u>
	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019**</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Net cash (used in)/provided by discontinued operating activities	(2,975,214)	(1,243,966)	305,487
Net cash provided by/(used in) discontinued investing activities	3,101,239	1,430,181	(832,252)

\*\* Represented financial results of discontinued operations from January 1, 2019 to September 6, 2019.

#### 4. Concentrations and Risks

##### (a) Server and bandwidth service provider

The Group relied on telecommunications service providers and their affiliates for server and bandwidth service to support its operations during fiscal years 2017, 2018 and 2019 as follows:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
Total number of telecommunications service providers	23	49	79
Number of service providers provided by 10% or more of the Group's server and bandwidth service expenditure	3	3	2
Total% of the Group's server and bandwidth service expenditure provided by 10% or greater service providers	67.8%	57.8%	56.3%

##### (b) Credit risk

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash and cash equivalents, time deposits, restricted cash, accounts receivable and short-term investments. As of December 31, 2017, 2018 and 2019, substantially all of the Group's cash equivalents, time deposits and restricted cash were held in major financial institutions located in the PRC or Hong Kong, which management consider being of high credit quality. Accounts receivable are typically unsecured and are generally derived from revenue earned from mobile games services (mainly related to remittances from distribution channels) and advertising services.

One distribution channel had a receivable balance exceeding 10% of the total accounts receivable balance for the year ended December 31, 2017, 2018 and 2019, as follows:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
Distribution channel A	34.6%	22.2%	24.7%
Allowance for doubtful accounts	Not applicable	Not applicable	Not applicable

Short-term investments consist of financial products issued by commercial banks in China with a variable interest rate indexed to performance of underlying assets, which have a maturity date within one year as of the purchase date. The effective yields of the short-term investments range from 1.9% to 5.5% per annum. Any negative events or deterioration in financial well-being with respect to the counterparties of the above investments and the underlying collateral may cause a material loss to the Group and have a material effect on the Group's financial condition and results of operations.

**4. Concentrations and Risks (Continued)****(c) Major Customers**

No single customer represented 10% or more of the Group's total net revenues for the years ended December 31, 2017, 2018 and 2019.

**(d) Online Games**

The Group derived 53.9%, 39.6% and 36.8% of its total net revenues from its top 5 online games for the years ended December 31, 2017, 2018 and 2019, respectively.

Additionally, 70.8%, 71.0% and 71.4% of the Group's total net game revenues were generated from mobile games for the years ended December 31, 2017, 2018 and 2019, respectively.

**5. Prepayments and Other Current Assets**

The following is a summary of prepayments and other current assets:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Guarantee payment made to Blizzard — royalty fees	42,697	97,642	356,033
Prepayment for royalties, revenue sharing cost	1,479,817	2,000,327	2,627,048
Interest and other operating income receivable	417,843	511,364	524,069
Prepayments of content and marketing cost and other operational expenses	356,363	664,523	569,122
Prepayment for sales tax and deductible value added tax	566,364	312,852	483,547
Bridge loans in connection with ongoing investments	30,575	19,540	21,259
Deposits	112,530	107,254	11,882
Employee advances	54,818	44,337	79,823
Advance to suppliers	45,506	76,009	26,664
Others	20,283	91,357	117,975
	<u>3,126,796</u>	<u>3,925,205</u>	<u>4,817,422</u>

In accordance with the license agreements of *World of Warcraft*<sup>®</sup>, the *StarCraft II* series, *Hearthstone*<sup>®</sup>, *Heroes of the Storm*<sup>®</sup>, *Diablo III* and *Overwatch*<sup>®</sup>, the Group made certain guarantee payments to Blizzard on behalf of Shanghai EaseNet for the minimum guaranteed royalties as of December 31, 2017, 2018 and 2019. The guarantee amounts will be released to the Group when actual royalties are paid by Shanghai EaseNet to Blizzard.

**5. Prepayments and Other Current Assets (Continued)**

As of December 31, 2017, 2018 and 2019, prepayments for royalties and revenue sharing cost represented prepaid royalties or revenue sharing cost related to operations of licensed PC and mobile games.

The amount of employee advances listed above included staff housing loan balances of RMB48.5 million, RMB43.1 million and RMB43.0 million repayable within 12 months from December 31, 2017, 2018 and 2019, respectively (see Note 11). No advances were made directly or indirectly to the Group's executive officers for their personal benefit for the years ended December 31, 2017, 2018 and 2019.

**6. Short-term Investments**

As of December 31, 2017, 2018 and 2019, the Group's short-term investments mainly consisted of financial products issued by commercial banks in China with a variable interest rate indexed to the performance of underlying assets and a maturity date within one year when purchased. As of December 31, 2017, 2018 and 2019, the effective yields of short-term investments ranged from 2.00% to 5.30% per annum, 1.90% to 5.50% and 2.00% to 4.25% per annum respectively.

The following is a summary of short-term investments:

	<b>December 31, 2017</b>		
	<b>Cost</b>	<b>Unrealized Gains/(Losses)</b>	<b>Estimated Fair Value</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Short-term investments	9,557,381	145,228	9,702,609
	<b>December 31, 2018</b>		
	<b>Cost</b>	<b>Unrealized Gains/(Losses)</b>	<b>Estimated Fair Value</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Short-term investments	11,528,300	146,475	11,674,775
	<b>December 31, 2019</b>		
	<b>Cost</b>	<b>Unrealized Gains/(Losses)</b>	<b>Estimated Fair Value</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Short-term investments	15,116,330	196,265	15,312,595

During the years ended December 31, 2017, 2018, and 2019, the Group recorded investment income related to short-term investments of RMB389.5 million, RMB463.5 million and RMB657.6 million in the consolidated statements of operations and comprehensive income, respectively.

## 7. Property, Equipment and Software

The following is a summary of property, equipment and software:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Building and decoration	1,405,618	1,408,343	2,987,003
Leasehold improvements	98,197	164,745	153,145
Furniture, fixtures and office equipment	123,208	135,611	198,909
Vehicles	67,693	76,192	74,487
Servers and computers	2,571,232	3,852,805	4,066,925
Software	86,557	96,092	181,223
Construction in progress	901,476	1,567,091	465,993
	<u>5,253,981</u>	<u>7,300,879</u>	<u>8,127,685</u>
Less: accumulated depreciation	<u>(1,763,851)</u>	<u>(2,628,800)</u>	<u>(3,505,973)</u>
Net book value	<u><u>3,490,130</u></u>	<u><u>4,672,079</u></u>	<u><u>4,621,712</u></u>

Depreciation expense was RMB516.2 million, RMB939.8 million and RMB1,119.1 million for the years ended December 31, 2017, 2018 and 2019, respectively.

As of December 31, 2017, 2018 and 2019, the construction in progress balance were mainly comprised of construction of office buildings and warehouses in Hangzhou, Guangzhou, Jiangxi and Shanghai that have not yet been placed in service for the Group's intended use. All the related cost is capitalized in construction in progress to the extent it is incurred for the purposes of bringing the construction development to a usable state.

**8. Land Use Rights**

Land use rights represent acquired right to use the land on which the Group's offices and warehouses are built. In 2017, 2018 and 2019, the Group obtained the land use rights in Guangzhou and Shanghai from the local authorities. Amortization of the land use right is made over the remaining term of the land use right period from the date when the land was made available for use by the Group. The land use rights are summarized as follows:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Cost	475,556	3,338,843	3,846,660
Incentive payment from local government	(15,000)	(15,000)	(15,000)
Accumulated amortization	(21,030)	(52,331)	(124,481)
Land use right, net	<u>439,526</u>	<u>3,271,512</u>	<u>3,707,179</u>

The total amortization expense for each of the years ended December 31, 2017, 2018 and 2019 amounted to approximately RMB9.2 million, RMB31.3 million and RMB72.2 million, respectively.

**9. Leases**

The Group has operating leases for corporate offices, warehouses and retail stores. In addition, upon the adoption of ASC 842, land use rights, net with total carrying amount of RMB3,271.5 million and RMB3,707.2 million (Note 8) were identified as operating lease right-of-use assets as of January 1, 2019 and December 31, 2019, respectively.

The Group's leases have remaining lease terms of 4 months to 49 years, some of which include options to terminate the leases within certain periods. The Group considers these options in determining the classification and measurement of the leases when it is reasonably certain that the Group will exercise that option.

The following table provides information related to the Group's operating leases:

	<b>Year ended December 31, 2019</b>
	<i>RMB</i>
Operating lease cost <sup>(i)</sup>	360,383
Cash paid for amounts included in the measurement of operating lease liabilities	284,969
Right-of-use assets obtained in exchange for operating lease obligations	<u>179,350</u>

(i) Included short-term lease cost of RMB65.6 million and amortization expenses of land use rights of RMB72.2 million for the year ended December 31, 2019.

The weighted average remaining lease term and discount rate for operating leases as of December 31, 2019 were 1.93 years and 4.35%, respectively.

**9. Leases (Continued)**

Prior to adoption of ASC 842, the Group incurred rental expenses in the amounts of approximately RMB172.1 million, and RMB280.7 million for the years ended December 31, 2017 and 2018, respectively.

Maturities of operating lease liabilities as of December 31, 2019 were as follows:

	<u>RMB</u>
2020	195,945
2021	175,286
2022	97,639
2023	20,338
2024	9,960
Thereafter	<u>2,970</u>
Total operating lease payments	502,138
Less: imputed interest	<u>(30,735)</u>
Total	<u><u>471,403</u></u>

The following table summarizes the minimum lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year under ASC 840 as of December 31, 2018:

	<u>RMB</u>
2019	230,042
2020	172,290
2021	146,999
2022	47,625
Thereafter	<u>7,844</u>
Total operating lease payments	<u><u>604,800</u></u>

The following table summarizes the minimum lease payments under noncancellable operating leases with initial or remaining lease terms in excess of one year under ASC 840 as of December 31, 2017:

	<u>RMB</u>
2018	200,003
2019	118,473
2020	83,650
2021	72,446
Thereafter	<u>48,403</u>
Total operating lease payments	<u><u>522,975</u></u>

**10. Long-term Investments**

The following is a summary of long-term investments:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Investments in equity method investees	563,896	736,551	1,137,774
Equity investments with readily determinable fair values	828,260	612,465	3,551,545
Equity investments without readily determinable fair values	<u>1,291,620</u>	<u>3,896,092</u>	<u>4,604,549</u>
	<u><u>2,683,776</u></u>	<u><u>5,245,108</u></u>	<u><u>9,293,868</u></u>

**(a) Investments in equity method investees**

The Group recorded equity share of losses of RMB12.2 million, RMB98.3 million and equity share of earnings of RMB4.3 million for the years ended December 31, 2017, 2018, and 2019, respectively, which was included in “investment income, net” in the consolidated statements of operations and comprehensive income. Significant equity method investments are summarized as follows.

- (1) In August 2013, the Group established a joint venture with China Telecom Corp. Ltd. (“**China Telecom**”), Zhejiang Yixin Technology Co., Ltd. (“**Yixin**”, formerly know as Hangzhou Yixin Technology Co., Ltd.) to launch “YiChat,” a proprietary social instant messaging application for smart phones. The Group contributed RMB200.0 million cash in exchange for a 27.0% equity interest in Yixin. In July 2015, the Group increased its equity shares in Yixin to 35.0% with a cash consideration of approximately RMB127.5 million.
- (2) As of December 31, 2018, the Group invested an aggregated cash consideration of RMB295.1 million in two limited partnerships as a limited partner, and in 2019, the Group further contributed RMB326.9 million cash in these two limited partnerships. The objective of these limited partnerships are to engage in investment in on-line game business. The Group accounted such investments under the equity method.



**10. Long-term Investments (Continued)****(b) Equity investments with readily determinable fair values (“Available-for-sale securities” prior to adoption of ASU 2016-01)**

As of December 31, 2019, equity investments with readily determinable fair values included RMB2,650.4 million invested in shares of Alibaba, RMB578.9 million invested in shares of Huatai Securities Company Limited (“**Huatai**”) and RMB322.3 million invested in shares of Shenzhen Transsion Holding Limited (“**Transsion**”). The Group recorded fair value loss of RMB215.8 million and fair value gain of RMB763.2 million related to the equity investments with readily determinable fair value for the year ended December 31, 2018 and 2019, respectively.

The Group also received cash dividends of RMB20.9 million, RMB12.7 million and RMB12.7 million from Huatai for the years ended December 31, 2017, 2018, and 2019, respectively.

**(c) Equity investments without readily determinable fair value (“Equity investments” prior to adoption of ASU 2016-01)**

Equity investments without readily determinable fair value represent investments in privately held companies with no readily determinable fair value. The Group does not have significant influence on these investees, or the investments are not common stock or in substance common stock. Prior to January 1, 2018, the Group accounted for investments in these equity securities at cost less impairment. On January 1, 2018, the Group adopted ASU 2016-01 prospectively. These investments are classified as equity investments without readily determinable fair value, and are carried at cost less impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. For the year ended December 31, 2018 and 2019, there's no upward adjustments to the carrying value of equity securities without readily determinable fair value resulted from such transactions.

The Group recognized a gain of RMB9.6 million, nil and RMB86.1 million related to the disposal of the Group's investments in equity securities without readily determinable fair value as “investment income, net” in the consolidated statements of operations and comprehensive income for the years ended December 31, 2017, 2018 and 2019.

The Group recognized impairment provision of RMB58.5 million, RMB133.6 million and RMB168.4 million related to certain of the equity investments as “investment income, net” in the consolidated statements of operations and comprehensive income for the years ended December 31, 2017, 2018 and 2019, respectively.

**11. Other Long-term Assets**

The following is a summary of other long-term assets:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Copyrights, licenses and domain names	818,903	2,461,377	3,639,211
Long-term receivable	–	–	1,599,524
Staff housing loans	107,203	98,244	71,997
Non-current deposits	85,874	105,984	140,869
Others	76,109	264,464	215,009
	<u>1,088,089</u>	<u>2,930,069</u>	<u>5,666,610</u>

Balances of copyrights and licenses represents prepaid minimum royalties for exploitation of related intellectual properties, which was amortized over the term of the respective licensing agreements or estimated amortization periods.

Balance of long-term receivable represents receivables from Alibaba for disposal of Kaola which was expected to receive in two years.

The Group made housing loans to its employees (excluding executive officers) for house purchases via a third-party commercial bank in China. Each individual staff housing loan is collateralized either by the property for which the loan is extended or by approved personal guarantees for the loan amount granted. The repayment term is five years from the date of drawdown. The interest rate is fixed varying from 1.5% to 4.75% per annum for the years ended December 31, 2017, 2018 and 2019, respectively. The outstanding portion of the staff housing loans repayable within 12 months as of December 31, 2017, 2018 and 2019 amounted to approximately RMB48.5 million, RMB43.1 million and RMB43.0 million, respectively, and are reported under prepayments and other current assets in the consolidated balance sheets (see Note 5).

**12. Taxation****(a) Income taxes*****Cayman Islands***

Under the current laws of the Cayman Islands, the Company, and its intermediate holding companies in the Cayman Islands are not subject to tax on income or capital gain. Additionally, upon payments of dividends by the Company or its subsidiaries in the Cayman Islands to their shareholders, no Cayman Islands withholding tax will be imposed.

***British Virgin Islands (“BVI”)***

Subsidiaries in the BVI are exempted from income tax on its foreign-derived income in the BVI. There are no withholding taxes in the BVI.

***Hong Kong***

Subsidiaries in Hong Kong are subject to 16.5% income tax on their taxable income generated from operations in Hong Kong. Commencing from the year of assessment of 2018 and 2019, the first HK\$2 million of profits earned by one of the Company's subsidiaries incorporated in Hong Kong is taxed at half the current tax rate (*i.e.*, 8.25%) while the remaining profits will continue to be taxed at the existing 16.5% tax rate. The payments of dividends by these companies to their shareholders are not subject to any Hong Kong withholding tax.

***China***

On March 16, 2007, the National People's Congress of PRC enacted the Enterprise Income Tax Law, under which Foreign Invested Enterprises (“**FIEs**”) and domestic companies would be subject to enterprise income tax (“**EIT**”) at a uniform rate of 25%. Preferential tax treatments will continue to be granted to FIEs or domestic companies which conduct businesses in certain encouraged sectors and to entities otherwise classified as “Software Enterprises,” “Key Software Enterprises” and/or “High and New Technology Enterprises” (“**HNTes**”). The Enterprise Income Tax Law became effective on January 1, 2008.

Boguan, NetEase Hangzhou and certain other PRC subsidiaries were qualified as HNTes and enjoyed a preferential tax rate of 15% for 2017, 2018 and 2019. In 2017, 2018 and 2019, Boguan, NetEase Hangzhou and certain other PRC subsidiaries were also qualified as a Key Software Enterprise and enjoyed a further reduced preferential tax rate of 10% for 2016, 2017 and 2018. The related tax benefit was recorded in 2017, 2018 and 2019, respectively.

The aforementioned preferential tax rates are subject to annual review by the relevant tax authorities in China.

**12. Taxation (Continued)****(a) Income taxes (Continued)**

The following table presents the combined effects of EIT exemptions and tax rate reductions enjoyed by the Group for the years ended December 31, 2017, 2018 and 2019 (in thousands except per share data):

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Aggregate amount of EIT exemptions and tax rate reductions	<u>1,464,587</u>	<u>1,621,063</u>	<u>1,665,199</u>
Earnings per share effect, basic	<u>0.45</u>	<u>0.50</u>	<u>0.52</u>
Earnings per share effect, diluted	<u>0.44</u>	<u>0.50</u>	<u>0.51</u>

The following table sets forth the component of income tax expenses of the Group for the years ended December 31, 2017, 2018 and 2019:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Current tax expense	2,594,295	2,531,271	2,764,097
Deferred tax (benefit)/expense	<u>(438,307)</u>	<u>(70,621)</u>	<u>150,629</u>
Income tax expenses	<u>2,155,988</u>	<u>2,460,650</u>	<u>2,914,726</u>

**12. Taxation (Continued)****(a) Income taxes (Continued)**

The following table presents a reconciliation of the differences between the statutory income tax rate and the Group's effective income tax rate for the years ended December 31, 2017, 2018 and 2019:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	%	%	%
Statutory income tax rate	25.0	25.0	25.0
Permanent differences	(0.6)	(0.1)	(2.8)
Effect due to different tax rates applicable to overseas entities	(0.7)	2.8	(0.9)
Effect of lower tax rate applicable to Software Enterprises, Key Software Enterprise and HNTEs	(15.4)	(19.4)	(13.6)
Change in valuation allowance	2.2	7.8	4.9
Effect of withholding income tax	5.1	6.1	5.2
Effective income tax rate	<u>15.6</u>	<u>22.2</u>	<u>17.8</u>

As of December 31, 2019, certain entities of the Group had net operating tax loss carry forwards as follows:

	<u>RMB</u>
Loss expiring in 2020	3,123
Loss expiring in 2021	181,883
Loss expiring in 2022	903,855
Loss expiring in 2023	3,618,659
Loss expiring after 2024	3,594,379
	<u>8,301,899</u>

Full valuation allowance was provided on the related deferred tax assets as the Group's management does not believe that sufficient positive evidence exists to conclude that recoverability of such deferred tax assets is more likely than not to be realized.

**12. Taxation (Continued)****(b) Sales tax**

Pursuant to the provision regulation of the PRC on VAT and its implementation rules, the Company's subsidiaries and VIEs are generally subject to VAT at a rate of 6% from revenues earned from services provided or 17% from sales of general goods. Effective from May 1, 2018, the 17% VAT rates was reduced to 16% and effective from April 1, 2019, the 16% VAT rates was further reduced to 13%.

The Group is also subject to cultural development fee on the provision of advertising services in China. The applicable tax rate is 3% of the advertising services revenue and subject to a 50% reduction which is effective from July 1, 2019.

**(c) Deferred tax assets and liabilities**

The following table presents the tax impact of significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2017, 2018 and 2019:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Deferred tax assets:			
Deferred revenue, primarily for advanced payments from online games customers	285,919	507,982	484,637
Accruals	491,227	589,322	478,484
Depreciation of fixed assets	3,697	5,103	4,827
Amortization of intangible assets	23,848	16,059	9,360
Net operating tax loss carry forward	491,193	1,215,444	2,075,475
	<u>1,295,884</u>	<u>2,333,910</u>	<u>3,052,783</u>
Less: valuation allowance	(472,389)	(1,269,615)	(2,148,879)
	<u>823,495</u>	<u>1,064,295</u>	<u>903,904</u>
<b>Total</b>	<b><u>823,495</u></b>	<b><u>1,064,295</u></b>	<b><u>903,904</u></b>
	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Deferred tax liabilities:			
Withholding income tax <sup>(d)</sup>	183,281	391,862	382,030
Others	29,573	736	–
	<u>212,854</u>	<u>392,598</u>	<u>382,030</u>
<b>Total</b>	<b><u>212,854</u></b>	<b><u>392,598</u></b>	<b><u>382,030</u></b>

**12. Taxation (Continued)****(c) Deferred tax assets and liabilities (Continued)**

The Group does not believe that sufficient positive evidence exists to conclude that the recoverability of deferred tax assets of certain entities of the Group is more likely than not to be realized. Consequently, the Group has provided full valuation allowances for certain entities of the Group on the related deferred tax assets. The following table sets forth the movement of the aggregate valuation allowances for deferred tax assets for the periods presented:

	<b>Balance at January 1</b>	<b>Provision/ (Write-off) for the year</b>	<b>Balance at December 31</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
2017	241,394	230,995	472,389
2018	472,389	797,226	1,269,615
2019	1,269,615	879,264	2,148,879

**(d) Withholding income tax**

The Enterprise Income Tax Law also imposes a withholding income tax of 10% on dividends distributed by a FIE to its immediate holding company outside of China. A lower withholding income tax rate of 5% is applied if the FIE's immediate holding company is registered in Hong Kong or other jurisdictions that have a tax treaty arrangement with China. Such withholding income tax was exempted under the previous income tax law. On February 22, 2008, the Ministry of Finance and State Administration of Taxation jointly issued a circular which stated that for FIEs, all profits accumulated up to December 31, 2007 are exempted from withholding tax when they are distributed to foreign investors. Based on the interpretation of the current tax laws, management believes that the Company and all its non-PRC subsidiaries are not considered as a "resident enterprise" in China for corporate income tax purposes, but it cannot be certain that the relevant PRC tax authorities will agree with this determination. Except for the foregoing withholding taxes, the Company's non-PRC subsidiaries, which are currently all incorporated in Hong Kong, the British Virgin Islands or Cayman Islands are not subject to taxation on dividends they receive from the Company's PRC subsidiaries.

The Group accrued RMB707.1 million, RMB679.4 million and RMB846.6 million (US\$121.6 million) withholding tax liabilities associated with its quarterly dividend and cash expected to be distributed from its PRC subsidiaries to overseas for general corporate purposes in 2017, 2018 and 2019, respectively. The Group have repatriated a portion of these earnings and paid related withholding income tax in 2017, 2018 and 2019.

As of December 31, 2017, 2018 and 2019, there were approximately RMB1,075.0 million, RMB1,057.7 million and RMB993.3 million (US\$142.7 million) unrecognized deferred tax liabilities related to undistributed earnings of the Group's PRC subsidiaries, respectively. And the Group still intends to indefinitely reinvest these remaining undistributed earnings in its PRC subsidiaries.

**13. Taxes Payable**

The following is a summary of taxes payable as of December 31, 2017, 2018 and 2019:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Sales tax payable	128,170	256,350	541,175
Withholding individual income taxes for employees	160,547	183,681	190,340
Enterprise income taxes	1,248,198	1,775,908	2,377,655
Others	25,005	44,707	47,343
	<u>1,561,920</u>	<u>2,260,646</u>	<u>3,156,513</u>

**14. Short-term Loans**

As of December 31, 2017, 2018 and 2019, the short-term loans balances represent short-term loan arrangements with banks which were repayable within a maturity term ranging from one week to one year and charged at a fixed interest rates ranging from 0.78% to 2.42%, 0.74% to 4.57% and 0.68% to 4.57% per annum, respectively. As of December 31, 2017, 2018 and 2019, the weighted average interest rate for the outstanding short-term loans was approximately 2.13%, 3.14% and 2.38%, respectively. The short-term loans are denominated in US\$, EUR, GBP, CAD, HK\$, JPY or CNY.

As of December 31, 2017, 2018 and 2019, certain short-term loans were secured by RMB deposits of the Group in onshore branches of the banks in the amount of RMB4,091.0 million, RMB2,695.0 million and RMB1,595.0 million (US\$229.1 million), which was recognized as restricted cash (see Note 2(f)).

On August 9, 2018, the Group entered into a three year US\$500 million syndicated facility agreement with a group of four mandated lead arrangers and bookrunners. The facility is priced at 95 basis points over London interbank offered rate (“**LIBOR**”) and has a commitment fee of 0.20% on the undrawn portion. There were US\$200.0 million of borrowings outstanding under the syndicated facility as of December 31, 2019. The Group was subject to certain covenants under the syndicated facility agreement and was in compliance with these covenants as of December 31, 2019.

In 2019, the Group also entered into several uncommitted loan credit facility agreements provided by certain financial institutions. As at December 31, 2019, US\$1,015.7 million of such credit facilities has not been utilized.

In the year ended December 31, 2019, the Group also entered into several guarantee agreements in the aggregate amount of US\$1,062.0 million in respect of certain credit facilities taken by its subsidiaries. As at December 31, 2019, US\$240.0 million of such credit facilities had not been utilized.



**15. Accrued Liabilities and Other Payables**

The following is a summary of accrued liabilities and other payables as of December 31, 2017, 2018 and 2019:

	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Customer deposits on NetEase			
Pay accounts	1,554,789	1,369,672	1,539,417
Marketing expenses and promotion materials	1,286,455	1,723,766	1,672,096
Accrued fixed assets related payables	294,779	354,388	304,379
Server and bandwidth service fees and technical charges	232,395	257,066	231,868
Accrued revenue sharing	187,838	373,559	578,940
Content cost	406,890	299,837	403,402
Professional fees	65,096	243,106	88,041
Accrued freight and warehousing charge	86,218	109,716	47,524
Other staff related cost	37,803	80,013	69,849
Others	179,674	194,067	357,258
	<u>4,331,937</u>	<u>5,005,190</u>	<u>5,292,774</u>

**16. Deferred Revenue**

Deferred revenue represents sales proceeds from prepaid points sold, unamortized mobile game in-game spending, prepaid products fees before delivery and prepaid subscription fees for internet value-added services for which services are yet to be provided as of the balance sheet dates.

For the year ended December 31, 2019, the additions to the deferred revenue balance were primarily due to cash payments received or due in advance of satisfying the Group's performance obligations, while the reductions to the deferred revenue balance were primarily due to the recognition of revenues upon fulfillment of the Group's performance obligations, both of which were in the ordinary course of business. During the year ended December 31, 2018 and 2019, RMB5,737.3 million and RMB7,319.4 million of revenues recognized were included in the deferred revenue balance at the beginning of the year, respectively.

As of December 31, 2019, the aggregate amount of transaction price allocated to the unsatisfied performance obligations is RMB8,602.2 million, which includes the deferred revenues balances and amounts to be invoiced and recognized as revenue in future periods. The Group expect to recognize a significant majority of this balance as revenue over the next 12 months, and the remainder thereafter. This balance does not include an estimate for variable consideration arising from sales rebates to advertising service customers and estimated breakage for online points.

**17. Noncontrolling Interests and Redeemable Noncontrolling Interests****NetEase Cloud Music**

In the first quarter of 2017, pursuant to the agreements entered into by certain of the Group's subsidiaries and VIE (together referred as "**NetEase Cloud Music**") and some investors, one of NetEase Cloud Music's PRC subsidiary ("**Hangzhou Cloud Music**") issued equity interests with preferential rights to certain investors for a total cash consideration of RMB600.0 million. In addition, Hangzhou Cloud Music issued equity interest to one investor for a total cash consideration of RMB150.0 million. After the issuance of the equity interests, the investors together held approximately 12.59% equity interests in NetEase Cloud Music.

The Group determined that the equity interests with preferential rights of RMB600.0 million should be classified as redeemable noncontrolling interests since they are contingently redeemable upon the occurrence of a conditional event, which is not solely within the control of the Company. The redemption price equals initial investment plus annual interests. Equity interests issued of RMB150.0 million was classified as noncontrolling interests.

In the first quarter of 2018, due to the changes of NetEase Cloud Music financing plan, the Group repurchased all of the redeemable noncontrolling interests and noncontrolling interests issued in China by Hangzhou Cloud Music at a cash consideration of RMB780.0 million and RMB195.0 million, respectively (the "**Onshore Repurchase**"). The Group accounted for the Onshore Repurchase as an equity transaction, no gains or losses were recognized from the repurchase. The excess of the consideration transferred over the carrying amount of the noncontrolling interests surrendered, amounting to RMB63.9 million was recorded as a reduction to retained earnings. The excess of the consideration transferred over the carrying amount of the redeemable noncontrolling interests surrendered, amounting to RMB159.4 million was recognized as a deemed dividend to preferred shareholders, which also reduces the numerator for EPS calculation. The repurchased redeemable noncontrolling interests and noncontrolling interests of NetEase Cloud Music were then retired.

Following the Onshore Repurchase, during 2018 and 2019, Cloud Village Inc., the Cayman holding company of NetEase Cloud Music issued preferred shares ("**NetEase Cloud Music Preferred Shares**") to certain investors for an aggregated cash consideration of US\$716.3 million and US\$711.6 million (the "**Offshore Issuance**"), respectively.

As of December 31, 2019, the NetEase Cloud Music Preferred Shares investors together held approximately 37.4% issued and outstanding interests in NetEase Cloud Music. The Company still maintains in control of NetEase Cloud Music.

The NetEase Cloud Music Preferred Shares were entitled to certain preferences and privileges with respect to redemption. The Group determined that the preferred shares should be classified as redeemable noncontrolling interests since they are contingently redeemable upon the occurrence of a conditional event or a deemed redemption event, which is not solely within the control of the Group. The redemption price equals to the net initial investment amount plus annual interests, if any.

**17. Noncontrolling Interests and Redeemable Noncontrolling Interests (Continued)****Youdao**

In April 2018, Youdao issued equity interests with preferential rights (“**Youdao Preferred Shares**”) to two investors for a total cash consideration of US\$70.0 million. The Group determined that the equity interests with preferential rights should be classified as redeemable noncontrolling interests since they are contingently redeemable upon the occurrence of a conditional event, which is not solely within the control of the Company. The redemption price equals to the net initial investment amount plus annual interests. Upon completion of the IPO of Youdao in October 2019, all Youdao Preferred Shares held by external preferred shareholders were automatically re-designated and converted on a one-for-one basis into Class A ordinary shares of Youdao.

Each issuance of the preferred shares is recognized at the respective issue price at the date of issuance net of issuance costs. The Group records accretions on the redeemable noncontrolling interests to the redemption value from the issuance dates to the earliest redemption dates if redemption is probable. The accretions using the effective interest method, are recorded as deemed dividends to preferred shareholders, which reduces retained earnings and equity classified noncontrolling interests, and earnings available to common shareholders in calculating basic and diluted earnings per share.

**18. Capital Structure**

The holders of ordinary shares in the Company are entitled to one vote per share and to receive ratably such dividends, if any, as may be declared by the board of directors of the Company. In the event of liquidation, the holders of ordinary shares are entitled to share ratably in all assets remaining after payment of liabilities. The ordinary shares have no preemptive, conversion, or other subscription rights.

**19. Employee Benefits**

The Company’s subsidiaries and VIEs incorporated in China participate in a government-mandated multi-employer defined contribution plan under which certain retirement, medical, housing and other welfare benefits are provided to employees. Chinese labor regulations require the Company’s Chinese subsidiaries and VIEs to pay to the local labor bureau a monthly contribution at a stated contribution rate based on the monthly basic compensation of qualified employees. The relevant local labor bureau is responsible for meeting all retirement benefit obligations; hence, the Group has no further commitments beyond its monthly contribution.

**19. Employee Benefits (Continued)**

The following table presents the Group's employee welfare benefits expense for the years ended December 31, 2017, 2018 and 2019 (in millions):

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Contributions to medical and pension schemes	594.5	788.7	903.4
Other employee benefits	389.1	548.6	631.8
	<u>983.6</u>	<u>1,337.3</u>	<u>1,535.2</u>

**20. Share-based Compensation****(a) Restricted share units plan***2009 Restricted Share Unit Plan*

In November 2009, the Company adopted a restricted share unit plan for the Company's employees, directors and consultants (the "**2009 Plan**"). The Company has reserved 323,694,050 ordinary shares for issuance under the plan. The 2009 Plan was adopted by a resolution of the board of directors on November 17, 2009 and became effective for a term of ten years unless sooner terminated. The 2009 Plan was expired on November 16, 2019.

*2019 Restricted Share Unit Plan*

In October 2019, the Company adopted a 2019 restricted share unit plan (the "**2019 Plan**") for the Company's employees, directors and others. The 2019 Plan has a ten-year term and a maximum number of 322,458,300 ordinary shares available for issuance pursuant to all awards under the plan.

**20. Share-based Compensation (Continued)****(b) Share-based compensation expense**

The Group recognizes share-based compensation cost in the consolidated statements of operations and comprehensive income based on awards ultimately expected to vest, after considering estimated forfeitures. Forfeitures are estimated based on the Group's historical experience over the last five years and revised in subsequent periods if actual forfeitures differ from those estimates.

The table below presents a summary of the Group's share-based compensation cost for the years ended December 31, 2017, 2018 and 2019:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Cost of revenues	818,101	757,341	758,810
Selling and marketing expenses	90,271	102,638	84,920
General and administrative expenses	576,629	787,200	797,120
Research and development expenses	499,850	824,552	763,239
	<u>1,984,851</u>	<u>2,471,731</u>	<u>2,404,089</u>

As of December 31, 2019, total unrecognized compensation cost related to unvested awards under the 2009 Plan and the 2019 Plan, adjusted for estimated forfeitures, was RMB2,291.8 million (US\$329.2 million) and is expected to be recognized through the remaining vesting period of each grant. As of December 31, 2019, the weighted average remaining vesting periods was 2.22 years.

**20. Share-based Compensation (Continued)****(c) Restricted share units award activities**

The following table presents a summary of the Company's RSUs award activities for the years ended December 31, 2017, 2018 and 2019:

	<b>Number of RSUs</b>	<b>Weighted average grant date fair value</b>
	<i>(in thousands)</i>	<i>US\$</i>
Outstanding at January 1, 2017	1,663	131.08
Granted	1,260	295.95
Vested	(1,192)	152.96
Forfeited	(59)	177.14
	<u>1,672</u>	<u>238.18</u>
Outstanding at December 31, 2017	<u>1,672</u>	<u>238.18</u>
Outstanding at January 1, 2018	1,672	238.18
Granted	2,073	271.21
Vested	(1,228)	250.53
Forfeited	(92)	238.34
	<u>2,425</u>	<u>260.12</u>
Outstanding at December 31, 2018	<u>2,425</u>	<u>260.12</u>
Outstanding at January 1, 2019	2,425	260.12
Granted	1,763	231.51
Vested	(1,182)	256.12
Forfeited	(191)	244.09
	<u>2,815</u>	<u>244.99</u>
Outstanding at December 31, 2019	<u>2,815</u>	<u>244.99</u>

The aggregate intrinsic value of RSUs outstanding as of December 31, 2019 was US\$863.1 million. The intrinsic value was calculated based on the Company's closing stock price of US\$306.64 per ADS as of December 31, 2019.

It is the Company's policy to issue new shares upon vesting of RSUs. The number of shares available for future grant under the Company's 2019 RSU Plan was 322,055,900 as of December 31, 2019.

**20. Share-based Compensation (Continued)****(d) Other Share Incentive Plan**

Certain of the Company's subsidiaries have adopted stock option plans, which allow the related subsidiaries to grant options to certain employees of the Group. The options expire in five to ten years from the date of grant and either vest or have a vesting commencement date upon certain conditions being met ("**Vesting Commencement Date**"). The award can become 100% vested on the Vesting Commencement Date, or vests in two, four or five substantially equal annual installments with the first installment vesting on the Vesting Commencement Date.

The Group has used the binomial model to estimate the fair value of the options granted. For the years ended December 31, 2017, 2018 and 2019, RMB91.5 million, RMB32.0 million and RMB56.2 million compensation expenses were recorded for the share options granted.

While certain share options granted will become vested or commence vesting beginning on the Vesting Commencement Date, the effectiveness of the conditions is not within the control of the Group and is not deemed probable to occur for accounting purposes until the Vesting Commencement Date. For such share options, no compensation expenses were recorded. As of December 31, 2019, there were RMB307.4 million unrecognized share-based compensation expenses are related to such share options for which the service condition had been met and are expected to be recognized when the conditions are achieved.

**21. Net Income Per Share**

The following table sets forth the computation of basic and diluted net income per share for the years ended December 31, 2017, 2018 and 2019:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
<b>Numerator (RMB in thousands):</b>			
Net income from continuing operations attributable to NetEase, Inc.'s shareholders	11,542,393	8,291,089	13,274,997
Net (loss)/income from discontinued operations attributable to NetEase, Inc.'s shareholders	(834,454)	(2,138,682)	7,962,519
Net income attributable to NetEase, Inc.'s shareholders for basic/dilutive net income per share calculation	<u>10,707,939</u>	<u>6,152,407</u>	<u>21,237,516</u>
<b>Denominator (No. of shares in thousands):</b>			
Weighted average number of ordinary shares outstanding, basic	3,290,312	3,235,324	3,220,473
Dilutive effect of employee stock options and restricted share units	25,166	19,365	29,499
Weighted average number of ordinary shares outstanding, diluted	<u>3,315,478</u>	<u>3,254,689</u>	<u>3,249,972</u>
Net income per share from continuing operations attributable to NetEase, Inc.'s shareholders, basic (RMB)	<u>3.51</u>	<u>2.56</u>	<u>4.12</u>
Net (loss)/income per share from discontinued operations attributable to NetEase, Inc.'s shareholders, basic (RMB)	<u>(0.26)</u>	<u>(0.66)</u>	<u>2.47</u>
<b>Net income per share, basic (RMB)</b>	<b><u>3.25</u></b>	<b><u>1.90</u></b>	<b><u>6.59</u></b>
Net income per share from continuing operations attributable to NetEase, Inc.'s shareholders, diluted (RMB)	<u>3.48</u>	<u>2.55</u>	<u>4.08</u>
Net (loss)/income per share from discontinued operations attributable to NetEase, Inc.'s shareholders, diluted (RMB)	<u>(0.25)</u>	<u>(0.66)</u>	<u>2.45</u>
<b>Net income per share, diluted (RMB)</b>	<b><u>3.23</u></b>	<b><u>1.89</u></b>	<b><u>6.53</u></b>



**21. Net Income Per Share (Continued)**

Basic net income per share is computed using the weighted average number of the ordinary shares outstanding during the year. Diluted net income per share is computed using the weighted average number of ordinary shares and potential ordinary shares outstanding during the year. For the years ended December 31, 2017, 2018 and 2019, options to purchase ordinary shares and RSUs that were anti-dilutive and excluded from the calculation of diluted net income per share totaled approximately 3.8 million shares, 19.6 million shares and 11.4 million shares, respectively.

**22. Commitments and Contingencies****(a) Commitments**

As of December 31, 2019, future minimum payment for server and bandwidth service fee commitments, capital commitments, royalties and other expenditures commitments related to licensed contents, including the royalties and minimum marketing expenditure commitment for the games licensed by Blizzard, as well as other commitments related to office machines and services purchases, were as follows:

	Server and Bandwidth Service Fee Commitments	Capital Commitments	Royalties and Expenditure for Licensed Content Commitments	Office Machines and Other Commitments	Total
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
2020	210,343	467,344	2,057,962	135,903	2,871,552
2021	368,206	578,011	2,166,368	29,304	3,141,889
2022	218,863	217,001	1,707,765	17,886	2,161,515
2023	77,616	209,284	1,311,465	17,619	1,615,984
Beyond 2023	52,848	1,000	849,159	–	903,007
	<u>927,876</u>	<u>1,472,640</u>	<u>8,092,719</u>	<u>200,712</u>	<u>10,693,947</u>

**(b) Litigation****Overview**

From time to time, the Group is involved in claims and legal proceedings that arise in the ordinary course of business. Based on currently available information, management does not believe that the ultimate outcome of these unresolved matters, individually and in the aggregate, is reasonably possible to have a material adverse effect on the Group's financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and the Group's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Group's financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods. The Group records a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The Group reviews the need for any such liability on a regular basis. The Group has not recorded any material liabilities in this regard as of December 31, 2018 and 2019.

**22. Commitments and Contingencies (Continued)****(b) Litigation (Continued)***Litigation*

In April 2018, PUBG Corporation and PUBG Santa Monica, Inc. (collectively “PUBG”), filed a lawsuit against defendants NetEase, Inc., NetEase Information Technology Corp. and NetEase (Hong Kong) Limited in the U.S. District Court for the Northern District of California. PUBG subsequently dropped all claims against NetEase (Hong Kong) Limited, and added Hong Kong NetEase Interactive Entertainment Limited to the lawsuit. PUBG’s complaint generally alleged that two of the Group’s mobile games, *Rules of Survival* and *Knives Out*, infringed PUBG’s copyrights and trade dress in their competing game, *Battlegrounds*. On March 11, 2019, the Group entered into a settlement agreement with PUBG, and the lawsuit was dismissed. On October 15, 2019, PUBG filed a second lawsuit against the same NetEase defendants, also in the U.S. District Court for the Northern District of California, claiming the Group had allegedly breached the settlement agreement. On March 3, 2020, the court dismissed PUBG’s new lawsuit, without prejudice, for lack of subject matter jurisdiction. On March 4, 2020, the Group initiated a declaratory judgment action against PUBG in the Superior Court of California for the County of San Mateo, requesting a declaration that the Group had not breached the settlement agreement. As at the date of this report, this lawsuit against PUBG is on-going.

**23. Dividends***Quarterly Dividend Policy*

In May 2014, the Company’s board of directors approved a new quarterly dividend policy. Under this policy, the Company intends to make quarterly cash dividend distributions at an amount equivalent to approximately 25% of the Group’s anticipated net income after tax in each fiscal quarter. In the second quarter of 2019, the Company’s board of directors determined that quarterly dividends will be set at an amount equivalent to approximately 20%-30% of the Company’s anticipated net income after tax in each fiscal quarter. The Company’s board of directors also approved an additional special dividend equivalent to US\$3.45 per ADS in the third quarter of 2019.

Dividends are recognized when declared. There is no dividend payable as of December 31, 2017, 2018 and 2019, respectively. The cash dividend declared related to the net profits of fiscal year 2017, 2018 and fiscal year 2019 was RMB2,656.0 million, RMB1,538.3 million and RMB9,353.6 million (US\$1,343.6 million) in total, respectively.

The determination to make dividend distributions and the amount of such distributions in any particular quarter will be made at the discretion of the Company’s board of directors and will be based upon its operations and earnings, cash flow, financial condition, capital and other reserve requirements and surplus, any applicable contractual restrictions, the ability of the Company’s PRC subsidiaries to make distributions to their offshore parent companies, and any other conditions or factors which the board deems relevant and having regard to the directors’ fiduciary duties.

**24. Share Repurchase Programs**

The Company accounts for repurchased ordinary shares under the cost method and includes such treasury stock as a component of the common shareholders' equity. Cancellation of treasury stock is recorded as a reduction of ordinary shares, additional paid-in-capital and retained earnings, as applicable. An excess of purchase price over par value is allocated to additional paid-in-capital first with any remaining excess charged entirely to retained earnings.

In November 2017, the Company announced that its board of directors approved a new share repurchase program of up to US\$1.0 billion of the Company's outstanding ADSs for a period not to exceed 12 months. On June 11, 2018, the Company announced that its board of directors approved an amendment to its share repurchase program, authorizing the repurchase of up to an additional US\$1.0 billion of the Company's outstanding ADSs. This expands the US\$1.0 billion repurchase program that was approved on November 15, 2017 for a period not to exceed 12 months, bringing the total authorized repurchase amount to US\$2.0 billion. As of expiration date of the program, the Company has repurchased approximately 4.6 million ADSs (equivalent to 114.9 million ordinary shares) for approximately US\$1,178.5 million under this program.

In November 2018, the Company announced that its board of directors approved a new share repurchase program of up to US\$1.0 billion of the Company's outstanding ADSs for a period not to exceed 12 months. As of expiration date of the program, the Company has repurchased approximately 1,015 ADSs (equivalent to 25,375 ordinary shares) for approximately US\$0.2 million under this program.

In November 2019, the Company announced that its board of directors has approved a share purchase program of up to US\$20.0 million of Youdao's outstanding ADSs for a period not to exceed 12 months. As of December 31, 2019, approximately 50,000 ADSs had been purchased under this program.

In February 2020, the Company announced that its board of directors had approved a share repurchase program of up to US\$1.0 billion of the Company's outstanding ADSs for a period not to exceed 12 months.

**25. Related Party Transactions**

The Group had no material transactions with related parties for the year ended December 31, 2017, 2018 and 2019, and no material related parties' balances as of December 31, 2019.

**26. Segment Information****(a) Description of segments**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker (“**CODM**”), or decision making group, in deciding how to allocate resources and in assessing performance. The Group’s CODM is the chief executive officer.

The Group’s organizational structure is based on a number of factors that the CODM uses to evaluate, view and run its business operations which include, but are not limited to, customer base, homogeneity of products and technology. The Group’s operating segments are based on this organizational structure and information reviewed by the Group’s CODM to evaluate the operating segment results.

Effective in the third quarter of 2019, the Group changed its segment disclosure to add the financial results of its certain advertising services and Yanxuan into innovative businesses and others. In addition, the Group has commenced separately reporting the results of Youdao, which completed its initial public offering and listing on the New York Stock Exchange in October 2019. As a result, the Group now reports segments as online game services, Youdao and innovative businesses and others. This change in segment reporting aligns with the manner in which the Group’s CODM currently receives and uses financial information to allocate resources and evaluate the performance of reporting segments. This change in segment presentation does not affect consolidated balance sheets, consolidated statements of operations and comprehensive income or consolidated statements of cash flows. The Group retrospectively revised prior year segment information, to conform to current year presentation.

**26. Segment Information (Continued)****(b) Segment data**

The table below provides a summary of the Group's operating segment results for the years ended December 31, 2017, 2018 and 2019. The Group does not allocate any operating costs or assets to its business segments as the Group's CODM does not use this information to measure the performance of the operating segments. There was no significant transaction between reportable segments for the years ended December 31, 2017, 2018 and 2019.

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Net revenues:			
Online game services	36,281,642	40,190,057	46,422,640
Youdao	455,746	731,598	1,304,883
Innovative businesses and others	7,699,967	10,256,920	11,513,622
Total net revenues	<u>44,437,355</u>	<u>51,178,575</u>	<u>59,241,145</u>
Cost of revenues:			
Online game services	(13,473,339)	(14,617,656)	(16,974,234)
Youdao	(293,807)	(515,133)	(934,261)
Innovative businesses and others	(5,627,168)	(8,699,637)	(9,777,350)
Total cost of revenues	<u>(19,394,314)</u>	<u>(23,832,426)</u>	<u>(27,685,845)</u>
Gross profit:			
Online game services	22,808,303	25,572,401	29,448,406
Youdao	161,939	216,465	370,622
Innovative businesses and others	2,072,799	1,557,283	1,736,272
Total gross profit	<u>25,043,041</u>	<u>27,346,149</u>	<u>31,555,300</u>

The following table set forth the breakdown of net revenues by type of good or service for the years ended December 31, 2017, 2018 and 2019:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Online game services	36,281,642	40,190,057	46,422,640
Youdao learning services and products	149,915	428,716	851,870
Advertising services	2,449,558	2,769,337	2,581,623
Others	5,556,240	7,790,465	9,385,012
Total Net revenue	<u>44,437,355</u>	<u>51,178,575</u>	<u>59,241,145</u>

**26. Segment Information (Continued)****(b) Segment data (Continued)**

The following table presents the total depreciation and amortization expenses of property and equipment and land use rights by segment for the years ended December 31, 2017, 2018 and 2019:

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2018</b>	<b>2019</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Online game services	157,695	235,896	256,181
Youdao	2,160	3,863	6,076
Innovative businesses and others	98,997	201,707	218,850
Total depreciation and amortization expenses of property and equipment and land use rights	<u>258,852</u>	<u>441,466</u>	<u>481,107</u>

As substantially all of the Group's long-lived assets are located in the PRC and substantially all of the Group's revenue of reportable segments are derived from China based on the geographical locations where services and products are provided to customers, no geographical information is presented.

**27. Financial Instruments**

The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of December 31, 2017:

	<b>Fair Value Measurements</b>		
	<b>Total</b>	<b>Quoted Prices in Active Market for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>
		<i>RMB</i>	<i>RMB</i>
Time deposits-short term	30,603,369	30,603,369	–
Time deposits-long term	100,000	100,000	–
Equity investments with readily determinable fair values	828,260	828,260	–
Short-term investments	9,702,609	–	9,702,609
Total	<u>41,234,238</u>	<u>31,531,629</u>	<u>9,702,609</u>

## 27. Financial Instruments (Continued)

The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of December 31, 2018:

	<b>Fair Value Measurements</b>		
	<b>Total</b>	<b>Quoted Prices in Active Market for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Time deposits-short term	32,900,287	32,900,287	–
Time deposits-long term	100,000	100,000	–
Equity investments with readily determinable fair values	612,465	612,465	–
Short-term investments	11,674,775	–	11,674,775
<b>Total</b>	<b>45,287,527</b>	<b>33,612,752</b>	<b>11,674,775</b>

The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of December 31, 2019:

	<b>Fair Value Measurements</b>		
	<b>Total</b>	<b>Quoted Prices in Active Market for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Time deposits-short term	53,487,075	53,487,075	–
Time deposits-long term	2,360,000	2,360,000	–
Equity investments with readily determinable fair values	3,551,545	3,551,545	–
Short-term investments	15,312,595	–	15,312,595
<b>Total</b>	<b>74,711,215</b>	<b>59,398,620</b>	<b>15,312,595</b>

**27. Financial Instruments (Continued)**

The rates of interest under the loan agreements with the lending banks were determined based on the prevailing interest rates in the market. The Group classifies the valuation techniques that use these inputs as Level 2 of fair value measurements of short-term bank loans. For other financial assets and liabilities with carrying values that approximate fair value, if measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy. As of December 31, 2017, 2018 and 2019, certain equity investments without determinable fair value (Note 10) were measured using significant unobservable inputs (Level 3) and written down from their respective carrying value to fair value, with impairment charges of RMB58.5 million, RMB133.6 million and RMB168.4 million incurred and recorded in earnings for the years then ended.

**28. Restricted Net Assets**

Relevant PRC laws and regulations permit PRC companies to pay dividends only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. Additionally, the Company's PRC subsidiaries and VIEs can only distribute dividends upon approval of the shareholders after they have met the PRC requirements for appropriation to the general reserve fund and the statutory surplus fund respectively. The general reserve fund and the statutory surplus fund require that annual appropriations of 10% of net after-tax income should be set aside prior to payment of any dividends. As a result of these and other restrictions under PRC laws and regulations, the PRC subsidiaries and VIEs are restricted in their ability to transfer a portion of their net assets to the Company either in the form of dividends, loans or advances, which restricted portion amounted to approximately RMB14.1 billion, or 23% of the Company's total consolidated net assets, as of December 31, 2019. Even though the Company currently does not require any such dividends, loans or advances from the PRC subsidiaries and VIEs for working capital and other funding purposes, the Company may in the future require additional cash resources from its PRC subsidiaries and VIEs due to changes in business conditions, to fund future acquisitions and developments, or merely declare and pay dividends to or distributions to the Company's shareholders.

**29. Subsequent Events**

After the outbreak of Coronavirus Disease 2019 (“**COVID-19 outbreak**”) in early 2020, a series of precautionary and control measures have been and continued to be implemented across the country. The Group prioritizes the health and safety of its employees, and has taken various preventative and quarantine measures across the Group soon after the outbreak. The Group will pay close attention to the development of the COVID-19 outbreak and evaluate its impact on the financial position and operating results of the Group. As at the date on which this set of financial statements were authorized for issue, the Group was not aware of any material adverse effects on the financial statements as a result of the COVID-19 outbreak.

In May 2020, the Company's board of directors approved a dividend of US\$1.16 per ADS for the first quarter of 2020, which is expected to be paid on June 23, 2020 to shareholders of record as of the close of business on June 12, 2020.

In May 2020, the Company announced that its board of directors had approved an amendment to the share repurchase program to expand the authorized repurchase amount to US\$2.0 billion.



**III. SUBSEQUENT FINANCIAL STATEMENTS**

No audited financial statements have been prepared by the Company in respect of any period subsequent to December 31, 2019 and up to the date of this report. Save as disclosed in this report, no dividend or distribution has been declared or made by the Company in respect of any period subsequent to December 31, 2019.

The following is the text of a report set out on pages IB-1 to IB-2, received from the Company's reporting accountant, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this prospectus. The information set out below is the unaudited condensed interim financial information of the Company for the three months ended March 31, 2020, and does not form part of the Accountant's Report from the Company's reporting accountant, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, as set out in Appendix IA to this prospectus, and is included herein for information purpose only.



羅兵咸永道

**REPORT ON REVIEW OF INTERIM FINANCIAL INFORMATION  
TO THE BOARD OF DIRECTORS OF NETEASE, INC.**

(incorporated in the Cayman Islands with limited liability)

**Introduction**

We have reviewed the interim financial information set out on pages IB-3 to IB-30, which comprises the condensed consolidated balance sheet of NetEase, Inc. and its subsidiaries (together, the "Company") as at March 31, 2020 and the condensed consolidated statement of operations and comprehensive income, the condensed consolidated statement of shareholders' equity and the condensed consolidated statement of cash flows for the three-month period then ended, and a summary of significant accounting policies and other explanatory notes. The directors of the Company are responsible for the preparation and presentation of this interim financial information in accordance with accounting policies generally accepted in the United States of America. Our responsibility is to express a conclusion on this interim financial information based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

**Scope of Review**

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Hong Kong Institute of Certified Public Accountants. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the interim financial information of the Company is not prepared, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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**Other Matter**

The comparative information for the condensed consolidated statements of operations and comprehensive income, shareholders' equity and cash flows, and related explanatory notes, for the period ended March 31, 2019 has not been audited or reviewed.

**PricewaterhouseCoopers**  
Certified Public Accountants  
Hong Kong  
June 2, 2020

**Unaudited Condensed Consolidated Balance Sheets**  
(in thousands except per share data)

		December 31, 2019	March 31, 2020	March 31, 2020
	<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(a)</i>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	2(d)	3,246,373	5,592,847	789,861
Time deposits	2(d)	53,487,075	50,515,092	7,134,094
Restricted cash	2(d)	3,150,354	3,507,105	495,298
Accounts receivable, net		4,169,358	4,559,441	643,916
Inventories, net		650,557	562,117	79,386
Prepayments and other current assets	5	4,817,422	6,060,421	855,895
Short-term investments		15,312,595	19,373,366	2,736,042
Assets held for sale		271,278	50,751	7,167
		<u>85,105,012</u>	<u>90,221,140</u>	<u>12,741,659</u>
Total current assets				
Non-current assets:				
Property, equipment and software, net	6	4,621,712	4,569,982	645,405
Land use rights, net	7	3,707,179	3,687,971	520,841
Operating lease right-of-use assets, net	7	463,688	502,941	71,029
Deferred tax assets		903,904	934,604	131,991
Time deposits	2(d)	2,360,000	3,850,000	543,724
Long-term investments	8	9,293,868	9,217,017	1,301,691
Other long-term assets	9	5,666,610	5,670,163	800,780
Assets held for sale		2,398	—	—
		<u>27,019,359</u>	<u>28,432,678</u>	<u>4,015,461</u>
Total non-current assets				
		<u>112,124,371</u>	<u>118,653,818</u>	<u>16,757,120</u>
Total assets				
<b>Liabilities, Redeemable noncontrolling interests and Shareholders' equity</b>				
Current liabilities:				
Accounts payable		1,212,303	1,197,007	169,050
Salary and welfare payables		2,957,360	2,429,147	343,061
Taxes payable	10(b)	3,156,513	4,390,606	620,072
Short-term loans	11	16,828,226	19,624,535	2,771,514
Deferred revenue	13	8,602,227	9,981,353	1,409,636
Accrued liabilities and other payables	12	5,292,774	5,546,607	783,331
Short-term operating lease liabilities		191,454	238,071	33,622
Liabilities held for sale		2,156	87	12
		<u>38,243,013</u>	<u>43,407,413</u>	<u>6,130,298</u>
Total current liabilities				

**Unaudited Condensed Consolidated Balance Sheets (Continued)**  
**(in thousands except per share data)**

		<b>December 31,</b>	<b>March 31,</b>	<b>March 31,</b>
		<b>2019</b>	<b>2020</b>	<b>2020</b>
	<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i>
				<i>Note 2(a)</i>
Non-current liabilities:				
Deferred tax liabilities		382,030	625,578	88,348
Long-term operating lease liabilities		279,949	282,892	39,952
Other long-term payable		176,963	144,384	20,391
Liabilities held for sale		961	—	—
		<u>839,903</u>	<u>1,052,854</u>	<u>148,691</u>
Total non-current liabilities				
		<u>839,903</u>	<u>1,052,854</u>	<u>148,691</u>
Total liabilities		<u>39,082,916</u>	<u>44,460,267</u>	<u>6,278,989</u>
Commitments and contingencies	<i>17</i>			
Redeemable noncontrolling interests	<i>14</i>	10,448,600	10,385,411	1,466,700
Shareholders' equity:				
Ordinary shares, US\$0.0001 par value:				
1,000,300,000 shares authorized,				
3,228,531 shares issued and				
outstanding as of December 31,				
2019 and 3,221,331 shares issued				
and outstanding as of March 31,				
2020		2,640	2,654	375
Additional paid-in capital		3,913,656	4,687,742	662,036
Treasury Stock		—	(2,395,815)	(338,354)
Statutory reserves		1,215,208	1,215,208	171,620
Accumulated other comprehensive				
(loss)/income		(71,445)	69,456	9,809
Retained earnings		56,393,640	59,018,101	8,334,948
		<u>61,453,699</u>	<u>62,597,346</u>	<u>8,840,434</u>
NetEase, Inc.'s shareholders' equity				
Noncontrolling interests	<i>14</i>	1,139,156	1,210,794	170,997
		<u>62,592,855</u>	<u>63,808,140</u>	<u>9,011,431</u>
Total shareholders' equity				
		<u>62,592,855</u>	<u>63,808,140</u>	<u>9,011,431</u>
Total liabilities, redeemable noncontrolling				
interests and shareholders' equity		<u>112,124,371</u>	<u>118,653,818</u>	<u>16,757,120</u>

The accompanying notes form an integral part of these unaudited condensed consolidated financial statements.

**Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income  
(in thousands except per share data or per ADS data)**

	<i>Notes</i>	<b>For the three months ended March 31,</b>		
		<b>2019</b>	<b>2020</b>	<b>2020</b>
		<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(a)</i>
<b>Net revenues:</b>				
Online game	20	11,850,184	13,518,244	1,909,141
Youdao	20	225,731	541,388	76,459
Innovative businesses and others	20	2,346,294	3,002,735	424,067
Total net revenues		14,422,209	17,062,367	2,409,667
Cost of revenues	20	(6,684,535)	(7,684,745)	(1,085,293)
<b>Gross profit</b>		<u>7,737,674</u>	<u>9,377,622</u>	<u>1,324,374</u>
<b>Operating expenses:</b>				
Selling and marketing expenses		(1,158,090)	(1,863,071)	(263,116)
General and administrative expenses		(786,850)	(885,434)	(125,047)
Research and development expenses		(2,037,694)	(2,142,649)	(302,600)
Total operating expenses		<u>(3,982,634)</u>	<u>(4,891,154)</u>	<u>(690,763)</u>
<b>Operating profit</b>		3,755,040	4,486,468	633,611
<b>Other income/(expenses):</b>				
Investment income/(losses), net		155,824	(109,731)	(15,497)
Interest income, net		172,206	345,184	48,749
Exchange (losses)/gains		(39,520)	244,057	34,467
Other, net		37,164	66,708	9,421
<b>Income before tax</b>		4,080,714	5,032,686	710,751
Income tax	10(a)	<u>(1,266,685)</u>	<u>(1,082,033)</u>	<u>(152,812)</u>
Net income from continuing operations		2,814,029	3,950,653	557,939
Net loss from discontinued operations		<u>(350,755)</u>	<u>—</u>	<u>—</u>
<b>Net income</b>		2,463,274	3,950,653	557,939
Accretion and deemed dividends in connection with repurchase of redeemable noncontrolling interests		(68,783)	(386,019)	(54,516)
Net income attributable to noncontrolling interests and redeemable noncontrolling interests		<u>(12,373)</u>	<u>(13,628)</u>	<u>(1,925)</u>

**Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income  
(Continued)**

(in thousands except per share data or per ADS data)

	<b>For the three months ended March 31,</b>		
	<b>2019</b>	<b>2020</b>	<b>2020</b>
<i>Notes</i>	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(a)</i>
<b>Net income attributable to NetEase, Inc.'s shareholders</b>	2,382,118	3,551,006	501,498
Including:			
Net income from continuing operations attributable to <b>NetEase, Inc.'s</b> shareholders	2,732,873	3,551,006	501,498
Net loss from discontinued operations attributable to <b>NetEase, Inc.'s</b> shareholders	(350,755)	—	—
<b>Net income</b>	<u>2,463,274</u>	<u>3,950,653</u>	<u>557,939</u>
<b>Other comprehensive income</b>			
Foreign currency translation adjustment	(58,761)	150,103	21,199
<b>Total other comprehensive (loss)/income</b>	<u>(58,761)</u>	<u>150,103</u>	<u>21,199</u>
<b>Total comprehensive income</b>	<u>2,404,513</u>	<u>4,100,756</u>	<u>579,138</u>
Comprehensive loss attributable to noncontrolling interests and redeemable noncontrolling interests	(12,373)	(22,830)	(3,224)
<b>Comprehensive income attributable to NetEase, Inc.'s shareholders</b>	<u>2,392,140</u>	<u>4,077,926</u>	<u>575,914</u>
Net income/(loss) per share, basic	<u>0.74</u>	<u>1.10</u>	<u>0.16</u>
— Continuing operations	<u>0.85</u>	<u>1.10</u>	<u>0.16</u>
— Discontinued operations	<u>(0.11)</u>	<u>—</u>	<u>—</u>
Net income/(loss) per ADS, basic	<u>18.57</u>	<u>27.47</u>	<u>3.88</u>
— Continuing operations	<u>21.31</u>	<u>27.47</u>	<u>3.88</u>
— Discontinued operations	<u>(2.74)</u>	<u>—</u>	<u>—</u>

**Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income  
(Continued)**  
(in thousands except per share data or per ADS data)

	<i>Notes</i>	For the three months ended March 31,		
		2019	2020	2020
		<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(a)</i>
Net income/(loss) per share, diluted	<i>16</i>	<u>0.74</u>	<u>1.08</u>	<u>0.15</u>
— Continuing operations		<u>0.85</u>	<u>1.08</u>	<u>0.15</u>
— Discontinued operations		<u>(0.11)</u>	<u>—</u>	<u>—</u>
Net income/(loss) per ADS, diluted		<u>18.43</u>	<u>27.12</u>	<u>3.83</u>
— Continuing operations		<u>21.14</u>	<u>27.12</u>	<u>3.83</u>
— Discontinued operations		<u>(2.71)</u>	<u>—</u>	<u>—</u>
Weighted average number of ordinary shares outstanding, basic	<i>16</i>	<u>3,206,194</u>	<u>3,231,395</u>	<u>3,231,395</u>
Weighted average number of ADS outstanding, basic		<u>128,248</u>	<u>129,256</u>	<u>129,256</u>
Weighted average number of ordinary shares outstanding, diluted	<i>16</i>	<u>3,231,321</u>	<u>3,273,999</u>	<u>3,273,999</u>
Weighted average number of ADS outstanding, diluted		<u>129,253</u>	<u>130,960</u>	<u>130,960</u>

The accompanying notes form an integral part of these unaudited condensed consolidated financial statements.



**Unaudited Condensed Consolidated Statements of Changes in Shareholders' Equity**  
(in thousands)

	Ordinary shares		Additional paid-in capital		Treasury stock		Statutory reserves	Accumulated other comprehensive income	Retained earnings	Noncontrolling interests	Total shareholders' equity					
	Share	Amount	RMB	Share	Amount	RMB						RMB	RMB	RMB	RMB	RMB
<b>Balance as of January 1, 2019</b>	3,199,018	2,620	—	—	—	1,214,578	17,050	43,997,388	794,209	46,025,845						
Ordinary shares issued upon settlement of restricted share units	20,832	14	(14)	—	—	—	—	—	—	—						
Share-based compensation	—	—	626,814	—	—	—	—	—	8,384	635,198						
Net income attributable to NetEase, Inc. and noncontrolling interest shareholders	—	—	—	—	—	—	—	2,450,901	12,373	2,463,274						
Dividends to shareholders	—	—	—	—	—	—	—	(413,589)	—	(413,589)						
Foreign currency translation adjustment	—	—	—	—	—	—	(58,761)	—	—	(58,761)						
Accretion of redeemable noncontrolling interests	—	—	—	—	—	—	—	(68,783)	(2,923)	(71,706)						
<b>Balance as of March 31, 2019</b>	3,219,850	2,634	626,800	—	—	1,214,578	(41,711)	45,965,917	812,043	48,580,261						
<b>Balance as of January 1, 2020</b>	3,228,531	2,640	3,913,636	—	—	1,215,208	(71,445)	56,393,640	1,139,156	62,592,855						
Ordinary shares issued upon settlement of restricted share units	20,577	14	(14)	—	—	—	—	—	—	—						
Share-based compensation	—	—	639,895	—	—	—	—	—	17,285	657,180						
Net income attributable to NetEase, Inc. and noncontrolling interest shareholders	—	—	—	—	—	—	—	3,937,025	13,628	3,950,653						
Repurchase of shares	—	—	—	(27,777)	(2,395,815)	—	—	—	—	(2,395,815)						
Repurchase of noncontrolling interest and redeemable noncontrolling interests	—	—	(10,045)	—	—	—	—	(237,723)	(3,068)	(250,836)						
Capital injection in subsidiaries by noncontrolling interest shareholders	—	—	144,250	—	—	—	—	—	37,380	181,630						
Dividends to shareholders	—	—	—	—	—	—	—	(926,545)	—	(926,545)						
Foreign currency translation adjustment	—	—	—	—	—	—	140,901	—	9,202	150,103						
Accretion of redeemable noncontrolling interests	—	—	—	—	—	—	—	(148,296)	(2,789)	(151,085)						
<b>Balance as of March 31, 2020</b>	3,249,108	2,654	4,687,742	(27,777)	(2,395,815)	1,215,208	69,456	59,018,101	1,210,794	63,808,140						

The accompanying notes form an integral part of these unaudited condensed consolidated financial statements.

**Unaudited Condensed Consolidated Statements of Cash Flows  
(in thousands)**

	For the three months ended March 31,		
	2019	2020	2020
	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(a)</i>
<b>Cash flows from operating activities:</b>			
Net income	2,463,274	3,950,653	557,939
Net loss from discontinued operations	350,755	—	—
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	581,177	690,057	97,455
Fair value change of equity security investments	(129,912)	327,040	46,187
Investment impairment	96,099	6,600	932
Share-based compensation cost	620,799	665,814	94,031
(Reversal of)/ allowance for doubtful debts	(18,319)	49,939	7,053
Loss on disposal of property, equipment and software	2,738	37	5
Unrealized exchange losses/(gains)	41,806	(242,508)	(34,249)
Gain on disposal of long-term investments, business and subsidiaries	(11,978)	(15,433)	(2,180)
Deferred income taxes	303,052	212,848	30,060
Net equity share of losses/(gains) from equity method investees	17,454	(46,211)	(6,526)
Fair value changes of short-term investments	(124,648)	(153,106)	(21,623)
Changes in operating assets and liabilities:			
Accounts receivable	(609,092)	(430,535)	(60,803)
Inventories	163,004	88,440	12,490
Prepayments and other assets	(979,373)	(1,103,798)	(155,886)
Accounts payable	94,147	(98,679)	(13,936)
Salary and welfare payables	(484,045)	(537,907)	(75,967)
Taxes payable	939,359	1,234,078	174,285
Deferred revenue	151,641	1,379,126	194,770
Accrued liabilities and other payables	(842,077)	524,194	74,030
Net cash provided by continuing operating activities	2,625,861	6,500,649	918,067
Net cash provided by discontinued operating activities	760,713	—	—
Net cash provided by operating activities	3,386,574	6,500,649	918,067

Unaudited Condensed Consolidated Statements of Cash Flows (Continued)  
(in thousands)

	For the three months ended March 31,		
	2019	2020	2020
	RMB	RMB	US\$ Note 2(a)
<b>Cash flows from investing activities:</b>			
Purchase of property, equipment and software	(369,590)	(164,320)	(23,206)
Proceeds from sale of property, equipment and software	3,820	772	109
Purchase of intangible assets, content and licensed copyrights	(851,560)	(306,835)	(43,333)
Net change of short-term investments with terms of three months or less	(40,255)	(780,535)	(110,233)
Purchase of short-term investments	(4,890,000)	(10,070,000)	(1,422,156)
Proceeds from maturities of short-term investments	2,311,322	6,887,976	972,768
Investment in equity method investees	(11,200)	(9,643)	(1,362)
Acquisitions of other equity investments	(380,816)	(195,362)	(27,590)
Proceeds from disposal of subsidiaries, investment in equity method investees and other equity investments	208,682	196,952	27,815
Placement/rollover of time deposits	(16,596,540)	(11,667,487)	(1,647,764)
Proceeds from maturity of time deposits	15,959,459	13,640,617	1,926,423
Change in other long-term assets	(31,759)	(10,522)	(1,486)
Amounts received from disposed businesses	651,176	—	—
Net cash used in continuing investing activities	(4,037,261)	(2,478,387)	(350,015)
Net cash used in discontinued investing activities	(704,004)	—	—
Net cash used in investing activities	(4,741,265)	(2,478,387)	(350,015)
<b>Cash flows from financing activities:</b>			
Net proceeds from short-term loan with terms of three months or less	741,113	2,539,570	358,656
Proceeds of short-term loan	15,000	100,000	14,123
Repayment of short-term loan	—	(98,395)	(13,896)
Dividends paid to shareholders	(413,589)	(926,545)	(130,853)
Repurchase of redeemable noncontrolling interests	—	(462,632)	(65,336)
Proceeds from issuance of redeemable noncontrolling interest shareholders, net of issuance cost	68,611	—	—
Capital injection from noncontrolling interest shareholders	—	15,000	2,118
Cash paid for repurchase of NetEase's ADSs/ purchase of Youdao's ADSs	—	(2,560,897)	(361,668)
Net cash provided by/(used in) financing activities*	411,135	(1,393,899)	(196,856)

\* There is no financing activity from discontinued operations.

**Unaudited Condensed Consolidated Statements of Cash Flows (Continued)**  
(in thousands)

	For the three months ended March 31,		
	2019	2020	2020
	<i>RMB</i>	<i>RMB</i>	<i>US\$</i> <i>Note 2(a)</i>
Effect of exchange rate changes on cash, cash equivalents and restricted cash held in foreign currencies	(17,894)	74,100	10,465
Net (decrease)/increase in cash, cash equivalents and restricted cash	(961,450)	2,702,463	381,661
Cash, cash equivalents and restricted cash, beginning of the period	<u>10,206,538</u>	<u>6,397,860</u>	<u>903,550</u>
Cash, cash equivalents and restricted cash, end of the period	9,245,088	9,100,323	1,285,211
Less: Cash, cash equivalents and restricted cash of held for sales at end of the period	<u>580,979</u>	<u>371</u>	<u>52</u>
Cash, cash equivalents and restricted cash of continuing operations, end of the period	<u><u>8,664,109</u></u>	<u><u>9,099,952</u></u>	<u><u>1,285,159</u></u>
<b>Supplemental disclosures of cash flow information of continuing operation:</b>			
Cash paid for income taxes, net of tax refund	535,723	202,044	28,534
Cash paid for interest expenses	108,664	96,711	13,658
<b>Supplemental schedule of non-cash investing and financing activities of continuing operation:</b>			
Fixed asset purchases financed by accounts payable and accrued liabilities	253,232	377,564	53,322

The accompanying notes form an integral part of these unaudited condensed consolidated financial statements

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED MARCH 31, 2019 AND 2020**

(Amounts expressed in Renminbi (“RMB”), unless otherwise stated)

**1. Organization and Nature of Operations**

**(a) The Group**

NetEase.com, Inc. was incorporated in the Cayman Islands on July 6, 1999 and changed its name to “NetEase, Inc.” (“the Company”) with effect from March 29, 2012. The Company completed its initial public offering in July 2000 in connection with its listing on the Nasdaq National Market (now the Nasdaq Global Select Market) in the United States of America. As of March 31, 2020, the Company has wholly-owned and majority-owned subsidiaries incorporated in countries and jurisdictions mainly in the People’s Republic of China (“PRC” or “China”, references to “China” and “PRC” are to the People’s Republic of China, excluding, for the purposes of the financial statements only, Hong Kong, Macau and Taiwan), Hong Kong, Cayman Islands and British Virgin Islands (“BVI”). The Company also effectively controls a number of variable interest entities (“VIEs”) for which the Company is the primary beneficiary. The Company, its subsidiaries and VIEs are hereinafter collectively referred to as the “Group.”

In September 2019, the Company sold its Kaola e-commerce business. As a result, Kaola has been deconsolidated from the Company and its historical financial results are reflected in the Company’s consolidated financial statements as discontinued operations accordingly. See additional discussion on the discontinued operation in Note 3 to the condensed consolidated financial statements.

On October 26, 2019, Youdao, Inc. (“Youdao”), one of the Company’s majority-controlled subsidiaries completed its initial public offering (“IPO”) on the New York Stock Exchange. After Youdao’s offering, the Company continues to control Youdao and consolidates Youdao as its controlling shareholder.

The major subsidiaries and VIEs through which the Company conducts its business operations as of March 31, 2020 are described below:

<b>Major Subsidiaries</b>	<b>Place and year of Incorporation</b>
Guangzhou Boguan Telecommunication Technology Co., Ltd. (“Boguan”)	Guangzhou, China 2003
NetEase (Hangzhou) Network Co., Ltd. (“NetEase Hangzhou”)	Hangzhou, China 2006
Hong Kong NetEase Interactive Entertainment Limited	Hong Kong, China 2007
<b>Major VIEs and VIEs’ subsidiaries</b>	<b>Place and year of Incorporation</b>
Guangzhou NetEase Computer System Co., Ltd. (“Guangzhou NetEase”)	Guangzhou, China 1997
Shanghai EaseNet Network Technology Co., Ltd. (“Shanghai EaseNet”)	Shanghai, China 2008
StormNet Information Technology (Hong Kong) Limited (“StormNet IT HK”)	Hong Kong, China 2008
StormNet Information Technology (Shanghai) Co., Ltd. (“StormNet IT SH”)	Shanghai, China 2008
Hangzhou NetEase Leihuo Technology Co., Ltd. (“HZ Leihuo”, formerly known as Hangzhou NetEase Leihuo Network Co., Ltd.)	Hangzhou, China 2009

**1. Organization and Nature of Operations (Continued)****(a) The Group (Continued)**

Guangzhou NetEase, a major VIE of the Company, was incorporated in June 1997 in China and owned by William Lei Ding, or Mr. Ding, the Company's chief executive officer, director and major shareholder, and another Chinese employee of the Group. It is responsible for providing online game, e-mail and other value-added telecommunication services.

HZ Leihuo was incorporated in April 2009 in China by two Chinese employees of the Group and currently operates the Group's mobile game business.

In addition, Shanghai EaseNet is a PRC company owned by Mr. Ding, and has contractual arrangements with StormNet IT HK (a joint venture established between, and owned equally by, Blizzard Entertainment, Inc. ("Blizzard") and the Company), and with the Company. StormNet IT HK, together with its wholly owned subsidiary, StormNet IT SH, was established concurrently with the licensing of certain online games in August 2008 and provides technical services to Shanghai EaseNet.

**(b) Nature of operations**

The Group generates revenues mainly from providing online game services, online courses services, advertising services, e-commerce, and other fee-based premium services.

The industry in which the Group operates is subject to a number of industry-specific risk factors, including, but not limited to, rapidly changing technologies; government regulations of the Internet, online game, online education and e-commerce industry in China; numbers of new entrants; dependence on key individuals; competition of similar services from larger companies; customer preferences; and the need for the continued successful development, marketing and selling of its services.

**2. Summary of Significant Accounting Policies****(a) Basis of presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by US GAAP for a complete set of financial statements. Certain information and note disclosures normally included in our annual financial statements prepared in accordance with US GAAP have been condensed or omitted consistent with Article 10 of Regulation S-X.

The unaudited condensed consolidated financial statements have been prepared on the same basis as the audited financial statements and include all adjustments as necessary for the fair statement of the Group's financial position as of March 31, 2020, and the results of operations and cash flows for the three months ended March 31, 2019 and 2020. The consolidated balance sheet at December 31, 2019 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by US GAAP. The unaudited condensed consolidated financial statements and related disclosures have been prepared with the presumption that users of the unaudited

**2. Summary of Significant Accounting Policies (Continued)****(a) Basis of presentation (Continued)**

condensed consolidated financial statements have read or have access to the audited consolidated financial statements for the preceding fiscal years. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements and related footnotes for the years ended December 31, 2019. Results for the three months ended March 31, 2020 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

Translations of balances in the condensed consolidated balance sheets, condensed consolidated statements of operations and comprehensive income and condensed consolidated statement of cash flows from Renminbi (“RMB”) into the United States Dollar (“US\$”) as of and for the three months ended March 31, 2020 are solely for the convenience of the readers and are calculated at the rate of US\$1.00 = RMB7.0808, representing the exchange rate set forth in the H.10 statistical release of the Federal Reserve Board on March 31, 2020. No representation is made that the RMB amounts could have been, or could be, converted, realized or settled into US\$ at this rate, or at any other rate.

**(b) Basis of consolidation**

The condensed consolidated financial statements include the financial statements of the Company, its subsidiaries and VIEs for which the Company is the primary beneficiary with the ownership interests of minority shareholders reported as noncontrolling interests. All significant transactions and balances among the Company, its subsidiaries and VIEs have been eliminated upon consolidation. The Company consolidates a VIE if the Company has the power to direct matters that most significantly impact the activities of the VIE, and has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. The nature of the businesses and activities of the consolidated VIEs have not changed materially from the preceding fiscal year.

**(c) Use of estimates**

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reporting periods. Actual results might differ from those estimates. Critical accounting estimates and assumptions include, but are not limited to, assessing the following: average playing period of paying players of online games and impairment of long-term investments.

**(d) Cash, cash equivalents and time deposits**

Cash and cash equivalents mainly represent cash on hand, demand deposits placed with large reputable banks in Hong Kong and/or China, and highly liquid investments that are readily convertible to known amounts of cash and with original maturities from the date of purchase with terms of less than three months. As of December 31, 2019, there were cash at bank and demand deposits with terms of less than three months denominated in US dollars, HK dollars and Euro amounting to approximately US\$226.6 million, HK\$21.3 million and Euro0.4 million, respectively (equivalent to approximately RMB1,580.7 million, RMB19.0 million and RMB2.7 million, respectively). As of March 31, 2020,

2. Summary of Significant Accounting Policies (Continued)

(d) Cash, cash equivalents and time deposits (Continued)

there were cash at bank and demand deposits with terms of less than three months denominated in US dollars, HK dollars and Euro amounting to approximately US\$327.4 million, HK\$5.0 million and Euro0.4 million, respectively (equivalent to approximately RMB2,319.5 million, RMB4.5 million and RMB2.8 million, respectively).

Time deposits represent time deposits placed with banks with original maturities of three months or more. As of December 31, 2019, there were time deposits denominated in US dollars amounting to approximately US\$4,382.9 million (equivalent to approximately RMB30,576.3 million). As of March 31, 2020, there were time deposits denominated in US dollars amounting to approximately US\$4,497.4 million (equivalent to approximately RMB31,864.5 million).

As of December 31, 2019 and March 31, 2020, the Group had approximately RMB14.8 billion and RMB17.6 billion cash and cash equivalents and time deposits held by its PRC subsidiaries and VIEs, representing 25.0% and 29.3% of total cash and cash equivalents and time deposits of the Group, respectively.

As of December 31, 2019 and March 31, 2020, the Group had a restricted cash balance approximately RMB3,150.4 million and RMB3,507.1 million, respectively, comprising as follows (in millions):

	<b>December 31, 2019</b>	<b>March 31, 2020</b>
	<i>RMB</i>	<i>RMB</i>
Customer deposit of NetEase Pay accounts	1,523.3	1,879.1
Pledge deposits for short-term bank borrowings	1,595.0	1,595.0
Others	32.1	33.0
Total	<u>3,150.4</u>	<u>3,507.1</u>

The Group had no other lien arrangements during the three months ended March 31, 2019 and 2020.

(e) Credit Losses

In June 2016, the FASB issued ASU 2016-13 “Financial Instruments-Credit Losses (Topic 326)”, which requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost. The Company adopted the new standard effective January 1, 2020 on a modified retrospective basis. The cumulative impact of adopting Topic 326 on the beginning retained earnings as of January 1, 2020 and on the Company’s operating results for the three months ended March 31, 2020 is immaterial.



**3. Discontinued operations**

In September 2019, the Group signed a series of agreements with a subsidiary of Alibaba Group Holding Limited (“Alibaba”) to sell its e-commerce platform Kaola for a consideration of approximately US\$1.9 billion. The consideration is comprised of approximately US\$1.6 billion in cash payable to the Group and Kaola equity award holders, as well as approximately 14.3 million Alibaba ordinary shares issued to the Group. Upon completion of the transaction in September 2019, Kaola was deconsolidated from the Group and its historical financial results are reflected in the Group’s consolidated financial statements as discontinued operations. The financial results of Kaola in the prior period are reflected on the same basis to provide the comparable financial information.

**4. Concentrations and Risks**

**(a) Credit risk**

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash and cash equivalents, time deposits, restricted cash, accounts receivable and short-term investments. As of December 31, 2019 and March 31, 2020, substantially all of the Group’s cash equivalents, time deposits and restricted cash were held in major financial institutions located in the PRC or Hong Kong, which management consider being of high credit quality. Accounts receivable are typically unsecured and are generally derived from revenue earned from mobile games services (mainly related to remittances from distribution channels) and advertising services. Only one distribution channel had a receivable balance exceeding 10% of the total accounts receivable balance as of December 31, 2019 and March 31, 2020.

**(b) Major Customers**

No single customer represented 10% or more of the Group’s total net revenues for the three months ended March 31, 2019 and March 31, 2020.

**5. Prepayments and Other Current Assets**

The following is a summary of prepayments and other current assets (in thousands):

	<b>December 31, 2019</b>	<b>March 31, 2020</b>
	<i>RMB</i>	<i>RMB</i>
Guarantee payment made to Blizzard — royalty fees	356,033	1,129,699
Prepayment for royalties, revenue sharing cost	2,627,048	2,809,860
Interest and other operating income receivable	524,069	708,548
Prepayments of content and marketing cost and other operational expenses	569,122	598,214
Prepayment for sales tax and deductible value added tax	483,547	461,822
Bridge loans in connection with ongoing investments	21,259	21,578
Deposits	11,882	38,017
Employee advances	79,823	76,816
Advance to suppliers	26,664	55,179
Others	117,975	160,688
	<u>4,817,422</u>	<u>6,060,421</u>

**6. Property, Equipment and Software**

The following is a summary of property, equipment and software (in thousands):

	<b>December 31, 2019</b>	<b>March 31, 2020</b>
	<i>RMB</i>	<i>RMB</i>
Building and decoration	2,987,003	2,989,873
Leasehold improvements	153,145	157,514
Furniture, fixtures and office equipment	198,909	198,813
Vehicles	74,487	75,048
Servers and computers	4,066,925	4,248,148
Software	181,223	184,393
Construction in progress	465,993	505,061
	<u>8,127,685</u>	<u>8,358,850</u>
Less: accumulated depreciation	<u>(3,505,973)</u>	<u>(3,788,868)</u>
Net book value	<u><u>4,621,712</u></u>	<u><u>4,569,982</u></u>

Depreciation expense was RMB266.4 million and RMB285.1 million for the three months ended March 31, 2019 and 2020, respectively.

**7. Leases**

The Group has operating leases for corporate offices, warehouses and retail stores. In addition, upon the adoption of ASC 842, land use rights, net with total carrying amount of RMB3,707.2 million and RMB3,688.0 million were identified as operating lease right-of-use assets as of December 31, 2019 and March 31, 2020, respectively.

The Group's leases have remaining lease terms of 1 months to 49 years, some of which include options to terminate the leases within certain periods. The Group considers these options in determining the classification and measurement of the leases when it is reasonably certain that the Group will exercise that option.

**8. Long-term Investments**

The following is a summary of long-term investments (in thousands):

	<b>December 31, 2019</b>	<b>March 31, 2020</b>
	<i>RMB</i>	<i>RMB</i>
Investments in equity method investees	1,137,774	1,178,773
Equity investments with readily determinable fair values	3,551,545	3,264,128
Equity investments without readily determinable fair values	4,604,549	4,774,116
	<u>9,293,868</u>	<u>9,217,017</u>

**8. Long-term Investments (Continued)**

**(a) Investments in equity method investees**

The Group recorded equity share of losses of RMB17.5 million and equity share of earnings of RMB46.2 million for the three months ended March 31, 2019, and 2020, respectively, which was included in “investment income, net” in the condensed consolidated statements of operations and comprehensive income.

**(b) Equity investments with readily determinable fair values**

As of March 31, 2020, equity investments with readily determinable fair values included RMB2,468.2 million invested in shares of Alibaba Group Holding Limited (“Alibaba”), RMB493.6 million invested in shares of Huatai Securities Company Limited (“Huatai”) and RMB302.3 million invested in shares of Shenzhen Transsion Holding Limited (“Transsion”). The Group recorded fair value gain of RMB141.9 million and fair value loss of RMB327.0 million related to the equity investments with readily determinable fair value for the three months ended March 31, 2019 and 2020, respectively.

**(c) Equity investments without readily determinable fair value**

The Group recognized impairment provision of RMB87.7 million and RMB6.6 million related to certain of the equity investments as “investment income/(losses), net” in the condensed consolidated statements of operations and comprehensive income for the three months ended March 31, 2019 and 2020, respectively.

**9. Other Long-term Assets**

The following is a summary of other long-term assets (in thousands):

	<b>December 31, 2019</b>	<b>March 31, 2020</b>
	<i>RMB</i>	<i>RMB</i>
Copyrights, licenses and domain names	3,639,211	3,459,151
Long-term receivable	1,599,524	1,621,304
Staff housing loans	71,997	62,487
Non-current deposits	140,869	139,546
Others	215,009	387,675
	<u>5,666,610</u>	<u>5,670,163</u>

**10. Taxation****(a) Income taxes*****Cayman Islands***

Under the current laws of the Cayman Islands, the Company, and its intermediate holding companies in the Cayman Islands are not subject to tax on income or capital gain. Additionally, upon payments of dividends by the Company or its subsidiaries in the Cayman Islands to their shareholders, no Cayman Islands withholding tax will be imposed.

***British Virgin Islands (“BVI”)***

Subsidiaries in the BVI are exempted from income tax on its foreign-derived income in the BVI. There are no withholding taxes in the BVI.

***Hong Kong***

Subsidiaries in Hong Kong are subject to 16.5% income tax on their taxable income generated from operations in Hong Kong. For the three months ended March 31, 2019 and 2020, the first HK\$2 million of profits earned by one of the Company’s subsidiaries incorporated in Hong Kong is taxed at half the current tax rate (*i.e.*, 8.25%) while the remaining profits will continue to be taxed at the existing 16.5% tax rate. The payments of dividends by these companies to their shareholders are not subject to any Hong Kong withholding tax.

***China***

On March 16, 2007, the National People’s Congress of PRC enacted the Enterprise Income Tax Law, under which Foreign Invested Enterprises (“FIEs”) and domestic companies would be subject to enterprise income tax (“EIT”) at a uniform rate of 25%. Preferential tax treatments will continue to be granted to FIEs or domestic companies which conduct businesses in certain encouraged sectors and to entities otherwise classified as “Software Enterprises”, “Key Software Enterprises” and/or “High and New Technology Enterprises” (“HNTEs”). The Enterprise Income Tax Law became effective on January 1, 2008.

Boguan, NetEase Hangzhou and certain PRC subsidiaries were qualified as HNTEs and enjoyed a preferential tax rate of 15% for the three months ended March 31, 2019 and 2020. Certain PRC subsidiaries were also qualified as a Key Software Enterprise and enjoyed a further reduced preferential tax rate of 10% and the related tax benefit was recorded in the period in which the Key Software Enterprise status is recognized and notified.

**10. Taxation (Continued)**

The following table sets forth the component of income tax expenses of the Group for the three months ended March 31, 2019 and 2020 (in thousands):

	<b>For the three months ended March 31,</b>	
	<b>2019</b>	<b>2020</b>
	<i>RMB</i>	<i>RMB</i>
Current tax expense	963,633	869,185
Deferred tax expense	303,052	212,848
	<u>1,266,685</u>	<u>1,082,033</u>

**(b) Taxes Payable**

The following is a summary of taxes payable as of December 31, 2019 and March 31, 2020 (in thousands):

	<b>December 31,</b>	<b>March 31,</b>
	<b>2019</b>	<b>2020</b>
	<i>RMB</i>	<i>RMB</i>
Sales Tax payable	541,175	359,579
Withholding individual income taxes for employees	190,340	948,952
Enterprise income taxes	2,377,655	3,044,903
Others	47,343	37,172
	<u>3,156,513</u>	<u>4,390,606</u>

**11. Short-term Loans**

As of December 31, 2019 and March 31, 2020, the short-term loans balances represent short-term loan arrangements with banks which were repayable within a maturity term within one year and charged at a fixed interest rates ranging from 0.68% to 4.57% and 0.68% to 2.41% per annum, respectively. As of December 31, 2019 and March 31, 2020, the weighted average interest rate for the outstanding short-term loans was approximately 2.38% and 1.54%, respectively. The short-term loans are denominated in US\$, EUR, GBP, CAD, HK\$, JPY or CNY.

As of December 31, 2019 and March 31, 2020, certain short-term loans were secured by RMB deposits of the Group in onshore branches of the banks in the amount of RMB1,595.0 million and RMB1,595.0 million (US\$225.3 million), which was recognized as restricted cash (see Note 2(d)).

On August 9, 2018, the Group entered into a three year US\$500 million syndicated facility agreement with a group of four mandated lead arrangers and bookrunners. The facility is priced at 95 basis points over London interbank offered rate (“LIBOR”) and has a commitment fee of 0.20% on the undrawn portion. There were US\$200.0 million of borrowings outstanding under the syndicated facility as of March 31, 2020. The Group was subject to certain covenants under the syndicated facility agreement and was in compliance with these covenants as of March 31, 2020.

**12. Accrued Liabilities and Other Payables**

The following is a summary of accrued liabilities and other payables as of December 31, 2019 and March 31, 2020 (in thousands):

	<b>December 31, 2019</b>	<b>March 31, 2020</b>
	<i>RMB</i>	<i>RMB</i>
Customer deposits on NetEase Pay accounts	1,539,417	1,933,706
Marketing expenses and promotion materials	1,672,096	1,343,975
Accrued fixed assets related payables	304,379	291,400
Server and bandwidth service fees and technical charges	231,868	206,128
Accrued revenue sharing	578,940	623,924
Content cost	403,402	561,872
Professional fees	88,041	130,740
Accrued freight and warehousing charge	47,524	49,846
Other staff related cost	69,849	150,127
Others	357,258	254,889
	<u>5,292,774</u>	<u>5,546,607</u>

**13. Deferred Revenue**

Deferred revenue represents sales proceeds from prepaid points sold, unamortized mobile game in-game spending, prepaid products fees before delivery and prepaid subscription fees for internet value-added services for which services are yet to be provided as of the balance sheet dates.

For the three months ended March 31, 2020, the additions to the deferred revenue balance were primarily due to cash payments received or due in advance of satisfying the Group's performance obligations, while the reductions to the deferred revenue balance were primarily due to the recognition of revenues upon fulfillment of the Group's performance obligations, both of which were in the ordinary course of business.

As of March 31, 2020, a significant majority of the balances of deferred revenue are generally recognized as revenue over the next 12 months, and the remainder thereafter. This balance does not include an estimate for variable consideration arising from sales rebates to advertising service customers and estimated breakage for online points.

**14. Noncontrolling Interests and Redeemable Noncontrolling Interests****NetEase Cloud Music**

During 2018 and 2019, Cloud Village Inc. (“Cloud Village”), the Cayman holding company of NetEase Cloud Music issued preferred shares (“NetEase Cloud Music Preferred Shares”) to certain investors for an aggregated cash consideration of US\$716.3 million and US\$711.6 million, respectively.

In the first quarter of 2020, pursuant to the agreements entered between one of the redeemable noncontrolling interest and Cloud Village, Cloud Village repurchased this redeemable noncontrolling interest at a cash consideration of US\$66.3 million. The Group accounted for the repurchase as an equity transaction, no gains or losses were recognized from the repurchase. The excess of the consideration transferred over the carrying amount of the redeemable noncontrolling interests surrendered, amounting to RMB240.6 million was recognized as a deemed dividend to preferred shareholders, which also reduces the numerator for EPS calculation.

As of March 31, 2020, the NetEase Cloud Music Preferred Shares investors together held approximately 36.5% issued and outstanding interests in NetEase Cloud Music. The Company still maintains in control of NetEase Cloud Music.

The NetEase Cloud Music Preferred Shares were entitled to certain preferences and privileges with respect to redemption. The Group determined that the preferred shares should be classified as redeemable noncontrolling interests since they are contingently redeemable upon the occurrence of a conditional event or a deemed redemption event, which is not solely within the control of the Group. The redemption price equals to the net initial investment amount plus annual interests, if any.

**Youdao**

In April 2018, Youdao issued equity interests with preferential rights (“Youdao Preferred Shares”) to two investors for a total cash consideration of US\$70.0 million. The Group determined that the equity interests with preferential rights should be classified as redeemable noncontrolling interest since they are contingently redeemable upon the occurrence of a conditional event, which is not solely within the control of the Company. The redemption price equals to the net initial investment amount plus annual interests. Upon completion of the IPO of Youdao in October 2019, all Youdao Preferred Shares held by external preferred shareholders were automatically re-designated and converted on a one-for-one basis into Class A ordinary shares of Youdao.

Each issuance of the preferred shares is recognized at the respective issue price at the date of issuance net of issuance costs. The Group records accretions on the redeemable noncontrolling interest to the redemption value from the issuance dates to the earliest redemption dates if redemption is probable. The accretions using the effective interest method, are recorded as deemed dividends to preferred shareholders, which reduces retained earnings and equity classified noncontrolling interests, and earnings available to common shareholders in calculating basic and diluted earnings per share.

**15. Share-based Compensation**

**(a) Restricted share units plan**

*2019 Restricted Share Unit Plan*

In October 2019, the Company adopted a 2019 restricted share unit plan (the “2019 Plan”) for the Company’s employees, directors and others. The 2019 Plan has a ten-year term and a maximum number of 322,458,300 ordinary shares available for issuance pursuant to all awards under the plan.

**(b) Share-based compensation expense**

The Group recognizes share-based compensation cost in the condensed consolidated statements of operations and comprehensive income based on awards ultimately expected to vest, after considering estimated forfeitures. Forfeitures are estimated based on the Group’s historical experience over the last five years and revised in subsequent periods if actual forfeitures differ from those estimates.

The table below presents a summary of the Group’s share-based compensation cost for the three months ended March 31, 2019 and 2020 (in thousands):

	<b>For the three months ended</b>	
	<b>March 31,</b>	
	<b>2019</b>	<b>2020</b>
	<i>RMB</i>	<i>RMB</i>
Cost of revenues	199,209	207,915
Selling and marketing expenses	25,247	24,811
General and administrative expenses	197,858	230,371
Research and development expenses	198,485	202,717
	<u>620,799</u>	<u>665,814</u>

As of March 31, 2020, total unrecognized compensation cost related to unvested awards under the restricted share unit plans, adjusted for estimated forfeitures, was US\$546.9 million (RMB3,872.6 million) and is expected to be recognized through the remaining vesting period of each grant. As of March 31, 2020, the weighted average remaining vesting periods was 2.35 years.



**15. Share-based Compensation (Continued)**

**(c) Restricted share units award activities**

The following table presents a summary of the Company’s RSUs award activities for the three months ended March 31, 2020:

	<b>Number of RSUs</b>	<b>Weighted average grant date fair value</b>
	<i>(in thousands)</i>	<i>US\$</i>
Outstanding at January 1, 2020	2,815	244.99
Granted	1,005	312.75
Vested	(823)	231.99
Forfeited	(16)	251.46
	<u>2,981</u>	<u>271.39</u>
Outstanding at March 31, 2020	<u>2,981</u>	<u>271.39</u>

The aggregate intrinsic value of RSUs outstanding as of March 31, 2020 was US\$956.6 million. The intrinsic value was calculated based on the Company’s closing stock price of US\$320.96 per ADS as of March 31, 2020.

The number of shares available for future grant under the Company’s 2019 RSU Plan was 304,776,175 as of March 31, 2020.

**(d) Other Share Incentive Plan**

Certain of the Company’s subsidiaries have adopted stock option plans, which allow the related subsidiaries to grant options to certain employees of the Group. The options expire in five to ten years from the date of grant and either vest or have a vesting commencement date upon certain conditions being met (“Vesting Commencement Date”). The award can become 100% vested on the Vesting Commencement Date, or vests in two, three, four or five substantially equal annual installments with the first installment vesting on the Vesting Commencement Date.

The Group has used the binomial model to estimate the fair value of the options granted. For the three months ended March 31, 2019 and 2020, RMB7.2 million and RMB23.4 million compensation expenses were recorded for the share options granted.

While certain share options granted will become vested or commence vesting beginning on the Vesting Commencement Date, the effectiveness of the conditions is not within the control of the Group and is not deemed probable to occur for accounting purposes until the Vesting Commencement Date. For such share options, no compensation expenses were recorded. As of March 31, 2020, there were RMB314.8 million unrecognized share-based compensation expenses are related to such share options for which the service condition had been met and are expected to be recognized when the conditions are achieved.

**16. Net Income Per Share**

The following table sets forth the computation of basic and diluted net income per share for the three months ended March 31, 2019 and 2020:

	<b>For the three months ended March 31,</b>	
	<b>2019</b>	<b>2020</b>
<b>Numerator (RMB in thousands):</b>		
Net income from continuing operations attributable to NetEase, Inc.'s shareholders	2,732,873	3,551,006
Net loss from discontinued operations attributable to NetEase, Inc.'s shareholders	(350,755)	—
Net income attributable to NetEase, Inc.'s shareholders for basic/dilutive net income per share calculation	<u>2,382,118</u>	<u>3,551,006</u>
<b>Denominator (No. of shares in thousands):</b>		
Weighted average number of ordinary shares outstanding, basic	3,206,194	3,231,395
Dilutive effect of employee stock options and restricted share units	25,127	42,604
Weighted average number of ordinary shares outstanding, diluted	<u>3,231,321</u>	<u>3,273,999</u>
Net income per share from continuing operations attributable to NetEase, Inc.'s shareholders, basic (RMB)	<u>0.85</u>	<u>1.10</u>
Net loss per share from discontinued operations attributable to NetEase, Inc.'s shareholders, basic (RMB)	<u>(0.11)</u>	<u>—</u>
<b>Net income per share, basic (RMB)</b>	<u>0.74</u>	<u>1.10</u>
Net income per share from continuing operations attributable to NetEase, Inc.'s shareholders, diluted (RMB)	<u>0.85</u>	<u>1.08</u>
Net loss per share from discontinued operations attributable to NetEase, Inc.'s shareholders, diluted (RMB)	<u>(0.11)</u>	<u>—</u>
<b>Net income per share, diluted (RMB)</b>	<u>0.74</u>	<u>1.08</u>

**16. Net Income Per Share (Continued)**

Basic net income per share is computed using the weighted average number of the ordinary shares outstanding during the year. Diluted net income per share is computed using the weighted average number of ordinary shares and potential ordinary shares outstanding during the year. For the three months ended March 31, 2019 and 2020, options to purchase ordinary shares and RSUs that were anti-dilutive and excluded from the calculation of diluted net income per share totaled approximately 34.2 million shares and 17.4 million shares, respectively.

**17. Contingencies****Litigation***Overview*

From time to time, the Group is involved in claims and legal proceedings that arise in the ordinary course of business. Based on currently available information, management does not believe that the ultimate outcome of these unresolved matters, individually and in the aggregate, is reasonably possible to have a material adverse effect on the Group's financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and the Group's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Group's financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods. The Group records a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The Group reviews the need for any such liability on a regular basis. The Group has not recorded any material liabilities in this regard as of December 31, 2019 and March 31, 2020.

*Litigation*

In April 2018, PUBG Corporation and PUBG Santa Monica, Inc. (collectively "PUBG"), filed a lawsuit against defendants NetEase, Inc., NetEase Information Technology Corp. and NetEase (Hong Kong) Limited in the U.S. District Court for the Northern District of California. PUBG subsequently dropped all claims against NetEase (Hong Kong) Limited, and added Hong Kong NetEase Interactive Entertainment Limited to the lawsuit. PUBG's complaint generally alleged that two of the Group's mobile games, *Rules of Survival* and *Knives Out*, infringed PUBG's copyrights and trade dress in their competing game, *Battlegrounds*. On March 11, 2019, the Group entered into a settlement agreement with PUBG, and the lawsuit was dismissed. On October 15, 2019, PUBG filed a second lawsuit against the same NetEase defendants, also in the U.S. District Court for the Northern District of California, claiming the Group had allegedly breached the settlement agreement. On March 3, 2020, the court dismissed PUBG's new lawsuit, without prejudice, for lack of subject matter jurisdiction. On March 4, 2020, the Group initiated a declaratory judgment action against PUBG in the Superior Court of California for the County of San Mateo, requesting a declaration that the Group had not breached the settlement agreement. As at the date of this report, this lawsuit against PUBG is on-going.

## 18. Dividends

### Quarterly Dividend Policy

In May 2014, the Company's board of directors approved a new quarterly dividend policy. Under this policy, the Company intends to make quarterly cash dividend distributions at an amount equivalent to approximately 25% of the Group's anticipated net income after tax in each fiscal quarter. In the second quarter of 2019, the Company's board of directors determined that quarterly dividends will be set at an amount equivalent to approximately 20%-30% of the Company's anticipated net income after tax in each fiscal quarter.

Dividends are recognized when declared. There is no dividend payable as of December 31, 2019 and March 31, 2020, respectively.

The determination to make dividend distributions and the amount of such distributions in any particular quarter will be made at the discretion of the Company's board of directors and will be based upon its operations and earnings, cash flow, financial condition, capital and other reserve requirements and surplus, any applicable contractual restrictions, the ability of the Company's PRC subsidiaries to make distributions to their offshore parent companies, and any other conditions or factors which the board deems relevant and having regard to the directors' fiduciary duties.

## 19. Share Repurchase Programs

The Company accounts for repurchased ordinary shares under the cost method and includes such treasury stock as a component of the common shareholders' equity. Cancellation of treasury stock is recorded as a reduction of ordinary shares, additional paid-in-capital and retained earnings, as applicable. An excess of purchase price over par value is allocated to additional paid-in-capital first with any remaining excess charged entirely to retained earnings.

In November 2019, the Company announced that its board of directors had approved a share purchase program of up to US\$20.0 million of Youdao's outstanding ADSs for a period not to exceed 12 months. As of March 31, 2020, approximately 134,000 Youdao's ADSs had been purchased under this program for a total cost of US\$2.1 million.

In February 2020, the Company announced that its board of directors had approved a share repurchase program of up to US\$1.0 billion of the Company's outstanding ADSs for a period not to exceed 12 months.

As of March 31, 2020, approximately 1.1 million ADSs had been purchased under this program for a total cost of US\$341.9 million.

**20. Segment Information**

**(a) Description of segments**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker (“CODM”), or decision making group, in deciding how to allocate resources and in assessing performance. The Group’s CODM is the chief executive officer.

The Group’s organizational structure is based on a number of factors that the CODM uses to evaluate, view and run its business operations which include, but are not limited to, customer base, homogeneity of products and technology. The Group’s operating segments are based on this organizational structure and information reviewed by the Group’s CODM to evaluate the operating segment results.

Effective in the third quarter of 2019, the Group changed its segment disclosure to add the financial results of its certain advertising services and Yanxuan into innovative businesses and others. In addition, the Group has commenced separately reporting the results of Youdao, which completed its initial public offering and listing on the New York Stock Exchange in October 2019. As a result, the Group now reports segments as online game services, Youdao and innovative businesses and others. This change in segment reporting aligns with the manner in which the Group’s CODM currently receives and uses financial information to allocate resources and evaluate the performance of reporting segments. This change in segment presentation does not affect condensed consolidated balance sheets, condensed consolidated statements of operations and comprehensive income or condensed consolidated statements of cash flows. The Group retrospectively revised prior year segment information, to conform to current year presentation.

**(b) Segment data**

The table below provides a summary of the Group’s operating segment results for the three months ended March 31, 2019 and 2020. The Group does not allocate any operating costs or assets to its business segments as the Group’s CODM does not use this information to measure the performance of the operating segments. There was no significant transaction between reportable segments for the three months ended March 31, 2019 and 2020 (in thousands).

	<b>For the three months ended March 31,</b>	
	<b>2019</b>	<b>2020</b>
	<i>RMB</i>	<i>RMB</i>
Net revenues:		
Online game services	11,850,184	13,518,244
Youdao	225,731	541,388
Innovative businesses and others	2,346,294	3,002,735
Total net revenues	<u>14,422,209</u>	<u>17,062,367</u>
Cost of revenues:		
Online game services	(4,299,345)	(4,851,831)
Youdao	(172,836)	(305,663)
Innovative businesses and others	(2,212,354)	(2,527,251)
Total cost of revenues	<u>(6,684,535)</u>	<u>(7,684,745)</u>

20. Segment Information (Continued)

(b) Segment data (Continued)

	For the three months ended March 31,	
	2019	2020
	<i>RMB</i>	<i>RMB</i>
Gross profit:		
Online game services	7,550,839	8,666,413
Youdao	52,895	235,725
Innovative businesses and others	133,940	475,484
Total gross profit	<u>7,737,674</u>	<u>9,377,622</u>

The following table set forth the breakdown of net revenues by type of good or service for the three months ended March 31, 2019 and 2020 (in thousands):

	For the three months ended March 31,	
	2019	2020
	<i>RMB</i>	<i>RMB</i>
Online games services	11,850,184	13,518,244
Youdao learning services and products	135,455	442,138
Advertising services	483,153	473,912
Others	1,953,417	2,628,073
Total net revenue	<u>14,422,209</u>	<u>17,062,367</u>

The following table presents the total depreciation and amortization expenses of property and equipment and land use rights by segment for the three months ended March 31, 2019 and 2020 (in thousands):

	For the three months ended March 31,	
	2019	2020
	<i>RMB</i>	<i>RMB</i>
Online game services	52,485	66,703
Youdao	1,085	1,604
Innovative businesses and others	60,325	49,916
Total depreciation and amortization expenses of property and equipment and land use rights	<u>113,895</u>	<u>118,223</u>

As substantially all of the Group's long-lived assets are located in the PRC and substantially all of the Group's revenue of reportable segments are derived from China based on the geographical locations where services and products are provided to customers, no geographical information is presented.

**21. Subsequent Events**

After March 31, 2020, the extent and duration of the COVID-19 pandemic remains uncertain. The Group will pay close attention to the development of the COVID-19 outbreak and evaluate its impact on the financial position and operating results of the Group. As at the date on which this set of financial statements were authorised for issue, the Group was not aware of any material adverse effects on the financial statements as a result of the COVID-19 outbreak.

In May 2020, the Company's board of directors approved a dividend of US\$1.16 per ADS for the first quarter of 2020, which is expected to be paid on June 23, 2020 to shareholders of record as of the close of business on June 12, 2020.

In May 2020, the Company announced that its board of directors had approved an amendment to the share repurchase program to expand the authorized repurchase amount to US\$2.0 billion.

## APPENDIX II      UNAUDITED PRO FORMA FINANCIAL INFORMATION

The following information does not form part of the Accountant's Report from PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, the Company's reporting accountant, and the unaudited condensed interim financial information for the three months ended March 31, 2020 (the "Unaudited Condensed Interim Financial Information"), as set out in Appendix IA and IB to this prospectus, respectively, and is included for information purposes only. The unaudited pro forma financial information should be read in conjunction with the section headed "Financial Information" in this prospectus and the Accountant's Report and Unaudited Condensed Interim Financial Information set out in Appendix IA and IB to this prospectus.

### A. UNAUDITED PRO FORMA STATEMENT OF ADJUSTED NET TANGIBLE ASSETS

The following unaudited pro forma adjusted net tangible assets prepared in accordance with Rule 4.29 of the Hong Kong Listing Rules are set out below for the purpose of illustrating the effect of the Global Offering on the consolidated net tangible assets attributable to the ordinary shareholders of the Company as at March 31, 2020 as if the Global Offering had taken place on that date.

The unaudited pro forma adjusted net tangible assets has been prepared for illustrative purposes only and because of its hypothetical nature, it may not give a true picture of the consolidated net tangible assets of the Company, had the Global Offering been completed as of March 31, 2020 or at any future dates. It is prepared based on the consolidated net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020 as derived from the Unaudited Condensed Interim Financial Information, the text of which is set out in Appendix IB, and adjusted as described below.

Unaudited consolidated net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020	Estimated net proceeds from the Global Offering	Unaudited pro forma adjusted net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020	Unaudited pro forma adjusted net tangible assets per Share	Unaudited pro forma adjusted net tangible assets per ADS	Unaudited pro forma adjusted net tangible assets per Share	Unaudited pro forma adjusted net tangible assets per ADS
<i>(in thousands of RMB) (Note 1)</i>	<i>(in thousands of RMB) (Note 2)</i>	<i>(in thousands of RMB)</i>	<i>RMB (Note 3)</i>	<i>RMB (Note 4)</i>	<i>HK\$ (Note 5)</i>	<i>HK\$ (Note 5)</i>

Based on Maximum  
Public Offer Price of  
HK\$126.00 per Offer  
Share

62,333,728	19,466,053	81,799,781	23.85	596.31	26.07	651.85
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Notes:

- (1) The unaudited consolidated net tangible assets attributable to ordinary shareholders of the Company as of March 31, 2020 is calculated based on the unaudited consolidated net assets attributable to ordinary shareholders of the Company as of March 31, 2020 of RMB62,597,346,000 as set out in Appendix 1B with adjustment for intangible assets attributable to the ordinary shareholders of the Company of RMB263,618,000.



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**APPENDIX II                      UNAUDITED PRO FORMA FINANCIAL INFORMATION**

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- (2) The estimated net proceeds from the Global Offering is based on the Maximum Public Offer Price of HK\$126.00 per Share, after deduction of the estimated underwriting fees and other related expenses payable by the Company subsequent to March 31, 2020 and without taking into account any allotment and issuance of Shares upon exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time, and any issuance or repurchase and cancellation of Shares and/or ADSs by the Company.
- (3) The unaudited pro forma adjusted net tangible assets per Share is arrived at after the adjustments referred to in the preceding paragraphs and on the basis that 3,429,395,456 Shares were in issue assuming that the Global Offering had been completed on March 31, 2020 without taking into account any allotment and issuance of Shares upon exercise of the Over-allotment Option, the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options or the vesting of RSUs or other awards that have been or may be granted from time to time, and any issuance or repurchase and cancellation of Shares and/or ADSs by the Company after the Latest Practicable Date.
- (4) The unaudited pro forma adjusted net tangible assets per ADS is arrived at after the adjustments referred to in the preceding paragraphs and on the basis that one ADS represent twenty-five Shares.
- (5) For the purpose of this unaudited pro forma adjusted net tangible assets, the balances stated in Renminbi are converted into Hong Kong dollars at the rate of RMB1.000 to HK\$1.0931. No representation is made that Renminbi amounts have been, could have been or may be converted into Hong Kong dollars, or vice versa, at that rate.
- (6) The unaudited pro forma adjusted net tangible assets does not take into account the dividend of US\$1.16 per ADS for the first quarter of 2020, which is approved in May 2020 and expected to be paid on June 23, 2020 to shareholders of record as of the close of business on June 12, 2020.
- (7) No adjustment has been made to reflect any trading result or other transactions of the Company entered into subsequent to March 31, 2020.

**B. REPORT FROM THE REPORTING ACCOUNTANT ON UNAUDITED PRO FORMA FINANCIAL INFORMATION**

*The following is the text of a report set out on pages II-3 to II-5, received from the Company's reporting accountant, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this prospectus.*



羅兵咸永道

**INDEPENDENT REPORTING ACCOUNTANT'S ASSURANCE REPORT ON THE COMPILATION OF UNAUDITED PRO FORMA FINANCIAL INFORMATION**

To the Directors of NetEase, Inc.

We have completed our assurance engagement to report on the compilation of unaudited pro forma financial information of NetEase, Inc. and its subsidiaries (collectively the “**Company**”) by the directors of the Company (the “**Directors**”) for illustrative purposes only. The unaudited pro forma financial information consists of the unaudited pro forma statement of adjusted net tangible assets of the Company as at March 31, 2020, and related notes (the “**Unaudited Pro Forma Financial Information**”) as set out on pages II-1 to II-2 of the Company's prospectus dated June 2, 2020, in connection with the proposed listing of the shares of the Company (the “**Prospectus**”). The applicable criteria on the basis of which the Directors have compiled the Unaudited Pro Forma Financial Information are described on pages II-1 to II-2 of the Prospectus.

The Unaudited Pro Forma Financial Information has been compiled by the Directors to illustrate the impact of the proposed listing of shares on the Company's financial position as at March 31, 2020 as if the proposed listing of shares had taken place at March 31, 2020. As part of this process, information about the Company's financial position has been extracted by the Directors from the Company's financial information for the three months ended March 31, 2020, on which a review report has been published.

**Directors' Responsibility for the Unaudited Pro Forma Financial Information**

The Directors are responsible for compiling the Unaudited Pro Forma Financial Information in accordance with paragraph 4.29 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Hong Kong Listing Rules**”) and with reference to Accounting Guideline 7, *Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars* (“**AG 7**”) issued by the Hong Kong Institute of Certified Public Accountants (“**HKICPA**”).

**Our Independence and Quality Control**

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the HKICPA, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Our firm applies Hong Kong Standard on Quality Control 1 issued by the HKICPA and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

**Reporting Accountant's Responsibilities**

Our responsibility is to express an opinion, as required by paragraph 4.29(7) of the Hong Kong Listing Rules, on the Unaudited Pro Forma Financial Information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the Unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, issued by the HKICPA. This standard requires that the reporting accountant plans and performs procedures to obtain reasonable assurance about whether the Directors have compiled the Unaudited Pro Forma Financial Information in accordance with paragraph 4.29 of the Hong Kong Listing Rules and with reference to AG 7 issued by the HKICPA.

For purposes of this engagement, we are not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the Unaudited Pro Forma Financial Information, nor have we, in the course of this engagement, performed an audit or review of the financial information used in compiling the Unaudited Pro Forma Financial Information.

The purpose of unaudited pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. Accordingly, we do not provide any assurance that the actual outcome of the proposed listing of shares at March 31, 2020 would have been as presented.

A reasonable assurance engagement to report on whether the unaudited pro forma financial information has been properly compiled on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the directors in the compilation of the unaudited pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether:

- The related pro forma adjustments give appropriate effect to those criteria; and
- The unaudited pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information.

The procedures selected depend on the reporting accountant's judgment, having regard to the reporting accountant's understanding of the nature of the company, the event or transaction in respect of which the unaudited pro forma financial information has been compiled, and other relevant engagement circumstances.

The engagement also involves evaluating the overall presentation of the unaudited pro forma financial information.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our work has not been carried out in accordance with auditing standards or other standards and practices generally accepted in the United States of America or auditing standards of the Public Company Accounting Oversight Board (United States) and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

### **Opinion**

In our opinion:

- (a) the Unaudited Pro Forma Financial Information has been properly compiled by the Directors on the basis stated;
- (b) such basis is consistent with the accounting policies of the Company; and
- (c) the adjustments are appropriate for the purposes of the Unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 4.29(1) of the Hong Kong Listing Rules.

**PricewaterhouseCoopers**  
Certified Public Accountants  
Hong Kong  
June 2, 2020

## SUMMARY OF OUR CONSTITUTION

**1. Memorandum of Association**

Our Memorandum of Association, as currently in effect, states, inter alia, that the liability of the members of our Company is limited, that the objects for which our Company is established are unrestricted and our Company shall have full power and authority to carry out any object not prohibited by the Cayman Companies Law or any other law of the Cayman Islands.

Our Memorandum of Association is available for inspection at the address specified in “Documents Available for Inspection” in Appendix V.

**2. Articles of Association**

Our Articles of Association, as currently in effect, include provisions to the following effect:

***General***

Our corporate objectives and purpose are unrestricted.

***Disclosure of interest in contracts with the Company or any of our Subsidiaries***

A director may vote in respect of any contract or transaction in which he is interested, provided however, that the nature of the interest of any director in any such contract or transaction shall be disclosed by him at or prior to its consideration and any vote on that matter. A general notice or disclosure to our directors or otherwise contained in the minutes of a meeting or a written resolution of our directors or any committee thereof that a director is a shareholder of any specified firm or company and is to be regarded as interested in any transaction with such firm or company shall be sufficient disclosure and after such general notice it shall not be necessary to give special notice relating to any particular transaction.

***Directors’ remuneration***

The remuneration of the directors may be determined by the directors themselves. No independent quorum is required.

***Directors’ borrowing powers***

Our directors may exercise all the powers of our Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital or any part thereof, to issue debentures, debenture stock and other securities whenever money is borrowed or as security for any of our debts, liabilities, or obligations or those of any third party.

*Shareholding qualification for Directors*

A shareholding qualification for directors may be fixed by our Company in a general meeting, but unless and until so fixed, there are no shareholding qualifications. Further, there are no age limitations or retirement requirements and no share ownership qualifications for our directors unless so fixed by our Shareholders in a general meeting.

*Shares*

All of our issued and outstanding Shares are fully paid and non-assessable. Certificates representing our Shares are issued in registered form. Our Shareholders who are non-residents of the Cayman Islands may freely hold and vote their Shares.

*Dividends*

The holders of our Shares are entitled to such dividends as may be declared by our Board. Under Cayman Islands law, dividends may be declared and paid only out of funds legally available therefor, namely out of either profit or our share premium account, and provided further that a dividend may not be paid if this would result in our Company being, immediately following such payment, unable to pay its debts as they fall due in the ordinary course of business. There are no provisions in our Articles governing the time limit after which entitlement to dividend lapses and an indication of the party in whose favor the lapse operates.

*Voting rights*

Each Share is entitled to one vote on all matters upon which our Shares are entitled to vote, including the election of directors. Voting at any meeting of Shareholders is by show of hands unless a poll is demanded. A poll may be demanded by our Chairman or any other Shareholder present in person or by proxy. A quorum required for a meeting of Shareholders consists of at least two Shareholders present in person or by proxy.

Any ordinary resolution to be made by our Shareholders requires the affirmative vote of a simple majority of the votes attaching to our Shares cast in a general meeting, while a special resolution requires the affirmative vote of no less than two-thirds of the votes cast attaching to our Shares. A special resolution is required for matters such as a change of our name. Holders of our Shares may by ordinary resolution, among other things, elect directors, appoint auditors, and increase our share capital. Both ordinary resolutions and special resolutions may also be passed by a unanimous written resolution signed by all Shareholders.

*Liquidation*

On a return of capital on winding up or otherwise (other than on conversion, redemption or purchase of shares) assets available for distribution among the holders of our Shares shall be distributed among the holders of our Shares pro rata. If the assets available for distribution are insufficient to repay all of the paid-up capital, the assets will be distributed so that the losses are borne by our Shareholders proportionately.

*Calls on Shares and forfeiture of Shares*

Our Board may from time to time make calls upon Shareholders for any amounts unpaid on their Shares in a notice served to such Shareholders at least 14 days prior to the specified time or times of payment. Our Shares that have been called upon and remain unpaid are subject to forfeiture.

*Redemption, repurchase and surrender of Shares*

Subject to the provisions of the Cayman Companies Law and our Memorandum and Articles, we may issue Shares on the terms that they are, or at our option or at the option of the holders are, subject to redemption on such terms and in such manner as we may determine by special resolution. Subject to the provisions of the Cayman Companies Law and our Memorandum and Articles, we may also repurchase any of our shares provided that the manner of such purchase has first been approved by ordinary resolution of our Shareholders. Under the Cayman Companies Law, the redemption or repurchase of any share may be paid out of our profits or out of the proceeds of a fresh issue of shares made for the purpose of such redemption or repurchase, or out of capital (including share premium account and capital redemption reserve) if we can, immediately following such payment, pay our debts as they fall due in the ordinary course of business. In addition, under the Cayman Companies Law no such Share may be redeemed or repurchased (a) unless it is fully paid up, (b) if such redemption or repurchase would result in there being no shares outstanding, or (c) if we have commenced liquidation. In addition, we may accept the surrender of any fully paid Share for no consideration.

*Variations of rights of Shares*

The rights attached to any class of our Shares (unless otherwise provided by the terms of issue of our Shares of that class) may, subject to the provisions of the Cayman Companies Law, be varied either with the consent in writing of the holders of three-fourths of our issued Shares of that class or with the sanction of a special resolution passed at a general meeting of the holders of our Shares of that class.

*General meetings of shareholders*

Our directors may whenever they think fit, and they shall on the requisition of our Shareholders holding not less than one-tenth of our paid-up capital as at the date of the deposit of the requisition carries the right of voting at general meetings of our Company, proceed to convene a general meeting of our Company. If our directors do not within 21 days from the date of the deposit of the requisition duly proceed to convene a general meeting, the requisitionists, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene a general meeting, but any meeting so convened shall not be held after the expiration of three months after the expiration of such 21 days. Advanced notice of at least five days is required for the convening of the annual general meeting and other Shareholders meetings.

*Limitations on the right to own Shares*

There are no limitations on the right to own our Shares.

*Limitations on transfer of Shares*

There are no provisions in our Memorandum or Articles that would have an effect of delaying, deferring or preventing a change in control and that would operate only with respect to a merger, acquisition or corporate restructuring.

*Disclosure of shareholder ownership*

There are no provisions in our Memorandum or Articles governing the ownership threshold above which shareholder ownership must be disclosed.

*Changes in capital*

We may from time to time by ordinary resolution increase our share capital by such sum, to be divided into shares of such amount, as the resolution shall prescribe. Our new Shares shall be subject to the same provisions with reference to the payment of calls, lien, transfer, transmission, forfeiture and otherwise as our Shares in the original share capital. We may by ordinary resolution:

- (a) consolidate and divide all or any of our share capital into Shares of larger amount than our existing Shares;
- (b) sub-divide our existing Shares, or any of them into Shares of smaller amount than is fixed by our Memorandum of Association or into Shares without nominal or par value; and
- (c) cancel any Shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person.

We may by special resolution reduce our share capital and any capital redemption reserve fund in any manner authorized by the Cayman Companies Law.

**3. Undertaking to the Hong Kong Stock Exchange**

We have undertaken to the Hong Kong Stock Exchange that we will give at least 14 days' notice for a general meeting.

**SUMMARY OF CAYMAN COMPANIES LAW AND TAXATION****1. Introduction**

The Cayman Companies Law is derived, to a large extent, from the older Companies Acts of England, although there are significant differences between the Cayman Companies Law and the current Companies Act of England. Set out below is a summary of certain provisions of the Cayman Companies Law, although this does not purport to contain all applicable qualifications and exceptions or to be a complete review of all matters of corporate law and taxation which may differ from equivalent provisions in jurisdictions with which interested parties may be more familiar.

**2. Incorporation**

Our Company was incorporated in the Cayman Islands as an exempted company with limited liability on July 6, 1999 under the Cayman Companies Law. As such, its operations must be conducted mainly outside the Cayman Islands. Our Company is required to file an annual return each year with the Registrar of Companies of the Cayman Islands and pay a fee which is based on the size of its authorized share capital.



### 3. Share capital

The Cayman Companies Law permits a company to issue ordinary shares, preference shares, redeemable shares or any combination thereof.

The Cayman Companies Law provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the value of the premia on those shares shall be transferred to an account called the “share premium account.” At the option of a company, these provisions may not apply to premia on shares of that company allotted pursuant to any arrangement in consideration of the acquisition or cancelation of shares in any other company and issued at a premium. The Cayman Companies Law provides that the share premium account may be applied by a company, subject to the provisions, if any, of its memorandum and articles of association, in such manner as the company may from time to time determine including, but without limitation:

- (a) paying distributions or dividends to members;
- (b) paying up unissued shares of the company to be issued to members as fully paid bonus shares;
- (c) in the redemption and repurchase of shares (subject to the provisions of section 37 of the Cayman Companies Law);
- (d) writing-off the preliminary expenses of the company;
- (e) writing-off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; and
- (f) providing for the premium payable on redemption or purchase of any shares or debentures of the company.

No distribution or dividend may be paid to members out of the share premium account unless immediately following the date on which the distribution or dividend is proposed to be paid the company will be able to pay its debts as they fall due in the ordinary course of business.

The Cayman Companies Law provides that, subject to confirmation by the Grand Court of the Cayman Islands, a company limited by shares or a company limited by guarantee and having a share capital may, if so authorized by its articles of association, by special resolution reduce its share capital in any way.

Subject to the detailed provisions of the Cayman Companies Law, a company limited by shares or a company limited by guarantee and having a share capital may, if so authorized by its articles of association, issue shares which are to be redeemed or are liable to be redeemed at the option of the company or a shareholder. In addition, such a company may, if authorized to do so by its articles of association, purchase its own shares, including any redeemable shares. The manner of such a purchase must be authorized either by the articles of association or by an ordinary resolution of the company. The articles of association may provide that the manner of purchase may be determined by the directors of the company. At no time may a company redeem or purchase its shares unless they are

fully paid. A company may not redeem or purchase any of its shares if, as a result of the redemption or purchase, there would no longer be any member of the company holding shares. A payment out of capital by a company for the redemption or purchase of its own shares is not lawful unless immediately following the date on which the payment is proposed to be made, the company shall be able to pay its debts as they fall due in the ordinary course of business.

There is no statutory restriction in the Cayman Islands on the provision of financial assistance by a company for the purchase of, or subscription for, its own or its holding company's shares. Accordingly, a company may provide financial assistance if the directors of the company consider, in discharging their duties of care and to act in good faith, for a proper purpose and in the interests of the company, that such assistance can properly be given. Such assistance should be on an arm's-length basis.

#### **4. Dividends and distributions**

With the exception of section 34 of the Cayman Companies Law, there are no statutory provisions relating to the payment of dividends. Based upon English case law which is likely to be persuasive in the Cayman Islands in this area, dividends may be paid only out of profits. In addition, section 34 of the Cayman Companies Law permits, subject to a solvency test and the provisions, if any, of the company's memorandum and articles of association, the payment of dividends and distributions out of the share premium account (see Paragraph 3 above for details).

#### **5. Shareholders' suits**

The Cayman Islands' courts can be expected to follow English case law precedents. The rule in *Foss v. Harbottle* (and the exceptions thereto which permit a minority shareholder to commence a class action against or derivative actions in the name of the company to challenge (a) an act which is *ultra vires* the company or illegal, (b) an act which constitutes a fraud against the minority where the wrongdoers are themselves in control of the company, and (c) an action which requires a resolution with a qualified (or special) majority which has not been obtained) has been applied and followed by the courts in the Cayman Islands.

#### **6. Protection of minorities**

In the case of a company (not being a bank) having a share capital divided into shares, the Grand Court of the Cayman Islands may, on the application of members holding not less than one-fifth of the shares of the company in issue, appoint an inspector to examine into the affairs of the company and to report thereon in such manner as the Grand Court shall direct.

Any shareholder of a company may petition the Grand Court of the Cayman Islands which may make a winding up order if the court is of the opinion that it is just and equitable that the company should be wound up.

Claims against a company by its shareholders must, as a general rule, be based on the general laws of contract or tort applicable in the Cayman Islands or their individual rights as shareholders as established by the company's memorandum and articles of association.

The English common law rule that the majority will not be permitted to commit a fraud on the minority has been applied and followed by the courts of the Cayman Islands.

**7. Disposal of assets**

The Cayman Companies Law contains no specific restrictions on the powers of directors to dispose of assets of a company. As a matter of general law, in the exercise of those powers, the directors must discharge their duties of care and to act in good faith, for a proper purpose and in the interests of the company.

**8. Accounting and auditing requirements**

The Cayman Companies Law requires that a company shall cause to be kept proper books of account with respect to:

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods by the company; and
- (c) the assets and liabilities of the company.

Proper books of account shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

**9. Register of members**

An exempted company may, subject to the provisions of its articles of association, maintain its principal register of members and any branch registers at such locations, whether within or without the Cayman Islands, as its directors may from time to time think fit. There is no requirement under the Cayman Companies Law for an exempted company to make any returns of members to the Registrar of Companies of the Cayman Islands. The names and addresses of the members are, accordingly, not a matter of public record and are not available for public inspection.

**INSPECTION OF BOOKS AND RECORDS**

Members of a company will have no general right under the Cayman Companies Law to inspect or obtain copies of the register of members or corporate records of the company. They will, however, have such rights as may be set out in the company's articles of association.

**1. Special resolutions**

The Cayman Companies Law provides that a resolution is a special resolution when it has been passed by a majority of at least two-thirds of such members as, being entitled to do so, vote in person or, where proxies are allowed, by proxy at a general meeting of which notice specifying the intention to propose the resolution as a special resolution has been duly given, except that a company may in its articles of association specify that the required majority shall be a number greater than two-thirds, and may additionally so provide that such majority (being not less than two-thirds) may differ as between matters

required to be approved by a special resolution. Written resolutions signed by all the members entitled to vote for the time being of the company may take effect as special resolutions if this is authorized by the articles of association of the company.

## **2. Subsidiary owning shares in parent**

The Cayman Companies Law does not prohibit a Cayman Islands company acquiring and holding shares in its parent company provided its objects so permit. The directors of any subsidiary making such acquisition must discharge their duties of care and to act in good faith, for a proper purpose and in the interests of the subsidiary.

## **3. Mergers and consolidations**

The Cayman Companies Law permits mergers and consolidations between Cayman Islands companies and between Cayman Islands companies and non-Cayman Islands companies. For these purposes, (a) “merger” means the merging of two or more constituent companies and the vesting of their undertaking, property and liabilities in one of such companies as the surviving company, and (b) “consolidation” means the combination of two or more constituent companies into a consolidated company and the vesting of the undertaking, property and liabilities of such companies to the consolidated company. In order to effect such a merger or consolidation, the directors of each constituent company must approve a written plan of merger or consolidation, which must then be authorized by (a) a special resolution of each constituent company and (b) such other authorization, if any, as may be specified in such constituent company’s articles of association. The written plan of merger or consolidation must be filed with the Registrar of Companies of the Cayman Islands together with a declaration as to the solvency of the consolidated or surviving company, a list of the assets and liabilities of each constituent company and an undertaking that a copy of the certificate of merger or consolidation will be given to the members and creditors of each constituent company and that notification of the merger or consolidation will be published in the Cayman Islands Gazette. Dissenting shareholders have the right to be paid the fair value of their shares (which, if not agreed between the parties, will be determined by the Cayman Islands court) if they follow the required procedures, subject to certain exceptions. Court approval is not required for a merger or consolidation which is effected in compliance with these statutory procedures.

## **4. Reconstructions**

There are statutory provisions which facilitate reconstructions and amalgamations approved by a majority in number representing 75% in value of shareholders or creditors, depending on the circumstances, as are present at a meeting called for such purpose and thereafter sanctioned by the Grand Court of the Cayman Islands. Whilst a dissenting shareholder would have the right to express to the Grand Court his view that the transaction for which approval is sought would not provide the shareholders with a fair value for their shares, the Grand Court is unlikely to disapprove the transaction on that ground alone in the absence of evidence of fraud or bad faith on behalf of management and if the transaction were approved and consummated the dissenting shareholder would have no rights comparable to the appraisal rights (*i.e.*, the right to receive payment in cash for the judicially determined value of his shares) ordinarily available, for example, to dissenting shareholders of United States corporations.

**5. Take-overs**

Where an offer is made by a company for the shares of another company and, within four months of the offer, the holders of not less than 90% of the shares which are the subject of the offer accept, the offeror may at any time within two months after the expiration of the said four months, by notice require the dissenting shareholders to transfer their shares on the terms of the offer. A dissenting shareholder may apply to the Grand Court of the Cayman Islands within one month of the notice objecting to the transfer. The burden is on the dissenting shareholder to show that the Grand Court should exercise its discretion, which it will be unlikely to do unless there is evidence of fraud or bad faith or collusion as between the offeror and the holders of the shares who have accepted the offer as a means of unfairly forcing out minority shareholders.

**6. Indemnification**

Cayman Islands law does not limit the extent to which a company's articles of association may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy (e.g. for purporting to provide indemnification against the consequences of committing a crime).

**7. Liquidation**

A company may be placed in liquidation compulsorily by an order of the court, or voluntarily (a) by a special resolution of its members if the company is solvent, or (b) by an ordinary resolution of its members if the company is insolvent. The liquidator's duties are to collect the assets of the company (including the amount (if any) due from the contributories (shareholders)), settle the list of creditors and discharge the company's liability to them, rateably if insufficient assets exist to discharge the liabilities in full, and to settle the list of contributories and divide the surplus assets (if any) amongst them in accordance with the rights attaching to the shares.

**8. Stamp duty on transfers**

No stamp duty is payable in the Cayman Islands on transfers of shares of Cayman Islands companies except those which hold interests in land in the Cayman Islands.

**9. Taxation**

Pursuant to section 6 of the Tax Concessions Law (2018 Revision) of the Cayman Islands, our Company may obtain an undertaking from the Financial Secretary of the Cayman Islands:

- (a) that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits, income, gains or appreciations shall apply to our Company or its operations; and
- (b) in addition, that no tax to be levied on profits, income, gains or appreciations or which is in the nature of estate duty or inheritance tax shall be payable:
  - (i) on or in respect of the shares, debentures or other obligations of our Company; or

- (ii) by way of the withholding in whole or in part of any relevant payment as defined in section 6(3) of the Tax Concessions Law (2018 Revision).

The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciations and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to our Company levied by the Government of the Cayman Islands save certain stamp duties which may be applicable, from time to time, on certain instruments executed in or brought within the jurisdiction of the Cayman Islands. The Cayman Islands are not party to any double tax treaties that are applicable to any payments made by or to our Company.

**10. Exchange control**

There are no exchange control regulations or currency restrictions in the Cayman Islands.

**11. General**

Maples and Calder (Hong Kong) LLP, our legal advisers on Cayman Islands law, have sent to us a letter of advice summarizing aspects of Cayman Islands company law. This letter, together with a copy of the Cayman Companies Law, is available for inspection as referred to in “Documents Available for Inspection” in Appendix V. Any person wishing to have a detailed summary of Cayman Islands company law or advice on the differences between it and the laws of any jurisdiction with which he/she is more familiar is recommended to seek independent legal advice.

## FURTHER INFORMATION ABOUT US

## Our incorporation

Our Company was incorporated in the Cayman Islands under the Cayman Companies Law as an exempted company with limited liability on July 6, 1999 and changed its name to “NetEase, Inc.” on March 29, 2012. We have registered with the Registrar of Companies in Hong Kong as a non-Hong Kong company under Part 16 of the Companies Ordinance with an address at 8th Floor, Chuang’s Tower, 30-32 Connaught Road Central, Hong Kong. Cary Ka Lee Cheng has been appointed as our authorized representative for the acceptance of service of process and notices in Hong Kong.

As we were incorporated in the Cayman Islands, our corporate structure and Memorandum and Articles of Association are subject to the relevant laws and regulations of the Cayman Islands. A summary of the relevant laws and regulations of the Cayman Islands and of the Memorandum and Articles of Association is set out in “Summary of our Constitution and Cayman Companies Law” in Appendix III.

## Changes in our share capital

As at the Latest Practicable Date, we had an authorized share capital of US\$100,030,000, divided into 1,000,300,000,000 Shares of par value US\$0.0001 per Share, and a total of 3,257,915,456 Shares were issued.

The tables below set out the changes in the share capital of our Company during the periods presented in this document, excluding bulk Shares issued for the purpose of the RSU Plans.

	<b>Fiscal year ended December 31, 2017</b>	
	<b>Shares</b>	<b>Shareholders’ Equity<sup>(1)</sup></b>
		<i>(US\$)</i>
Balance as at January 1, 2017	3,281,479,806	328,147.98
Issuance of Shares	29,805,575	2,980.56
Repurchase of Shares <sup>(2)</sup>	(28,067,925)	(2,806.79)
	<u>3,283,217,456</u>	<u>328,321.75</u>
Balance as at December 31, 2017	<u>3,283,217,456</u>	<u>328,321.75</u>
	<b>Fiscal year ended December 31, 2018</b>	
	<b>Shares</b>	<b>Shareholders’ Equity<sup>(1)</sup></b>
		<i>(US\$)</i>
Balance as at January 1, 2018	3,283,217,456	328,321.75
Issuance of Shares	30,709,100	3,070.91
Repurchase of Shares <sup>(2)</sup>	(114,908,150)	(11,490.82)
	<u>3,199,018,406</u>	<u>319,901.84</u>
Balance as at December 31, 2018	<u>3,199,018,406</u>	<u>319,901.84</u>

	Fiscal year ended December 31, 2019	
	Shares	Shareholders' Equity <sup>(1)</sup> (US\$)
Balance as at January 1, 2019	3,199,018,406	319,901.84
Issuance of Shares	29,538,350	2,953.84
Repurchase of Shares <sup>(2)</sup>	(25,375)	(2.54)
Balance as at December 31, 2019	<u>3,228,531,381</u>	<u>322,853.14</u>

*Notes:*

- (1) Calculated based on a par value of US\$0.0001 per Share.
- (2) Includes Shares underlying repurchased ADSs.

**Changes in the share capital of our Significant Subsidiaries**

The following alterations in the share capital of our Significant Subsidiaries have taken place within the two years immediately preceding the date of this document:

**Youdao Information:** the registered share capital of Youdao Information has changed in the following manner: (i) on May 21, 2018, the registered share capital increased from US\$200,000 to US\$15.2 million; (ii) on November 1, 2018, the registered share capital increased from US\$15.2 million to US\$35.2 million; (iii) on April 22, 2019, the registered share capital increased from US\$35.2 million to US\$55.2 million; and (iv) on November 7, 2019, the registered share capital increased from US\$55.2 million to US\$105.2 million.

**Share incentive plan of Youdao**

Our separately listed entity, Youdao, adopted an employee share incentive plan (the “**Youdao Plan**”) adopted in February 2015 and amended in April 2018. The purpose of the Youdao Plan is to promote the success and enhance the value of Youdao and its subsidiaries by linking the personal interests of the employees, directors and consultants to those of Youdao’s shareholders and by providing such individuals with an incentive for outstanding performance to generate superior returns to Youdao’s shareholders. The maximum aggregate number of ordinary shares that Youdao is authorized to issue pursuant to equity awards granted under the Youdao Plan is 10,222,222 shares. As of March 31, 2020, options to purchase a total of 8,698,800 ordinary shares were outstanding and 4,806,900 of these options had vested and become exercisable under the Youdao Plan.

We summarize the key terms of the Youdao Plan below:

- (a) **Types of Awards.** The Youdao Plan permits the award of options, restricted shares, restricted share units, share appreciation rights, dividend equivalents, share payments, deferred shares and other type of awards, as designed and approved by the plan administrator.
- (b) **Plan Administration.** The Youdao Plan shall be administrated by Youdao’s board of directors (“**Youdao’s board**”) or a committee of Youdao’s board, as determined by Youdao’s board.
- (c) **Eligibility.** Any employee, director or consultant of Youdao shall be eligible to participate in the Youdao Plan, as determined by the plan administrator.



- (d) ***Award Agreement.*** Each award under the Youdao Plan shall be evidenced and governed exclusively by an award agreement executed by Youdao and the participants, including any amendments thereto. The award agreement may include the term of an award, the provisions applicable in the event the participant's employment or service terminates, and Youdao's authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind an award. The award agreement shall also include such additional provisions as may be specified by the plan administrator.
- (e) ***Conditions of Award.*** The plan administrator of the Youdao Plan shall determine the provisions, terms, and conditions of each award including, but not limited to, the types of awards, award vesting schedule, number of awards to be granted and the number of shares to be covered by the awards, exercise price, any restrictions or limitations on the award and term of each award.
- (f) ***Acceleration of Awards upon Change in Control.*** Upon a change of control of Youdao, any award previously granted pursuant to the Youdao Plan shall vest immediately unless the plan administrator determines otherwise.
- (g) ***Protection against Dilution.*** In the event of any dividend, share split, combination or exchange of shares, amalgamation, arrangement or consolidation, spin-off, recapitalization or other distribution (other than normal cash dividends) of Youdao's assets to Youdao's shareholders, or any other change affecting the share capital, the plan administrator shall make such proportionate adjustments, if any, as necessary to reflect such change with respect to: (i) the aggregate number and type of shares that may be issued under the Youdao Plan; (ii) the terms and conditions of any outstanding awards (including, without limitation, any applicable performance targets or criteria with respect thereto); and (iii) the grant or exercise price per share for any outstanding awards under the Youdao Plan.
- (h) ***Amendment, Suspension or Termination of the Youdao Plan.*** With the approval of Youdao's board, the plan administrator may terminate, amend or modify the Youdao Plan; provided, however, that to the extent necessary and desirable to comply with any applicable law, regulation, or stock exchange rule, unless Youdao decides to follow its home country's practice not to seek Youdao's shareholder approval for any amendment or modification of the Youdao Plan, Youdao shall obtain shareholder approval of any plan amendment in such a manner and to such a degree as required. No termination, amendment, or modification of the Youdao Plan shall adversely affect in any material way any award previously granted pursuant to the Youdao Plan without the prior written consent of the participant.

The following table summarizes, as of March 31, 2020, the number of Youdao's ordinary shares underlying outstanding options that were granted to Youdao's directors and executive officers:

	Ordinary Shares Underlying Options Granted	Exercise Price (US\$/Share)	Date of Grant	Date of Expiration
William Lei Ding	-	-	-	-
Feng Zhou	-	-	-	-
Harry Heung Yeung Shum	*	US\$4.0	February 25, 2020	February 25, 2026
Jimmy Lai	*	US\$4.0	February 25, 2020	February 25, 2026
Yinghui Wu	-	-	-	-
Lei Jin	-	-	-	-
Renlei Liu	*	US\$1.5 to US\$2.5	February 11, 2015 and January 17, 2017	February 11, 2021 and January 17, 2023
Peng Su	*	US\$3.5	May 30, 2019	May 30, 2025
Yongwei Li	*	US\$3.5 to US\$4.0	May 30, 2019 and January 14, 2020	May 30, 2025 and January 14, 2026
			February 11, 2015, January 17, 2017, May 30, 2019, January 14, 2020 and February 25, 2020	February 11, 2021, January 17, 2023, May 30, 2025, January 14, 2026 and February 25, 2026
<b>All directors and executive officers as a group</b>	*	US\$1.5 to US\$4.0		

\* Less than 1% of Youdao's outstanding shares.

For information on our Company's share incentive plans, see "Directors and Senior Management — Compensation."

## FURTHER INFORMATION ABOUT OUR BUSINESS

### Summary of material contracts

The following contracts (not being contracts entered into in the ordinary course of business) were entered into by our Group within the two years preceding the date of this document and are material:

1. a supplementary agreement of assignment dated April 18, 2019, entered into among 網易(杭州)網絡有限公司, 杭州網易雷火科技有限公司, 胡志鵬, 胡天磊, and 程龍, pursuant to which 胡天磊 assigned all and any of his rights and obligations under the following agreements to 程龍:
  - (a) an amended and restated operating agreement dated December 1, 2015, entered into among NetEase (Hangzhou) Network Co., Ltd. ("**Party A**"), Hangzhou NetEase Leihuo Network Co., Ltd. ("**Party B**"), Hu Zhipeng, and Hu Tianlei, pursuant to which, among other things, Party A agreed to be the guarantor of Party B in the contracts, agreements or transactions entered into between Party B and any third party in connection with Party B's business and operations, and to provide full guarantees for the performance of such contracts, agreements or transactions by Party B, in exchange for Party B pledging the accounts receivable in its operations and all of its assets to Party A;

- (b) an amended and restated loan agreement dated December 1, 2015, entered into between NetEase (Hangzhou) Network Co., Ltd. (“**Lender**”) and Hu Tianlei (“**Borrower**”), pursuant to which the Lender provided to the Borrower a loan in the aggregate amount of RMB5 million, and any additional loans at the Lender’s absolute discretion, solely for the purpose of paying the Borrower’s capital contribution amount in the registered capital of Hangzhou NetEase Leihuo Network Co., Ltd. for a term of ten years with an automatic extension for another ten years;
- (c) an amended and restated equity pledge agreement dated December 1, 2015, entered into between NetEase (Hangzhou) Network Co., Ltd. (“**Pledgee**”) and Hu Tianlei (“**Pledgor**”), pursuant to which the Pledgor pledged to the Pledgee a first security interest in all of the Pledgor’s rights, title and interests, whether then legally owned or thereafter acquired by the Pledgor in all of the equity interests of Hangzhou NetEase Leihuo Network Co., Ltd. which are legally owned by the Pledgor during the term of the amended and restated equity pledge agreement;
- (d) an amended and restated exclusive purchase option agreement dated December 1, 2015, entered into among NetEase (Hangzhou) Network Co., Ltd. (“**Party A**”), Hu Tianlei (“**Party B**”), and Hangzhou NetEase Leihuo Network Co., Ltd. (“**Party C**”), pursuant to which Party B irrevocably granted to Party A an option (exercisable one or more times) to purchase or cause any one or more persons designated by Party A to purchase at any time from Party B a portion of, or all of, the 50% of the equity interest in Party C held by Party B at a price specified under the agreement;
- (e) a shareholder voting right trust agreement dated December 1, 2015, entered into between NetEase (Hangzhou) Network Co., Ltd. (“**Party A**”) and Hu Tianlei (“**Party B**”), and acknowledged and accepted by Hangzhou NetEase Leihuo Network Co., Ltd., pursuant which Party B irrevocably entrusted a person designated by Party A with full authority to exercise on his/her behalf all shareholder’s voting rights and other shareholder’s rights at the shareholders’ meeting of Hangzhou NetEase Leihuo Network Co., Ltd.; and

2. the Hong Kong Underwriting Agreement.

**Our intellectual property rights**

We regard our trademarks, copyrights, patents, domain names, know-how, proprietary technologies, and similar intellectual property as critical to our success; and we rely on copyright, trademark and patent law, confidentiality, invention assignment and non-compete agreements with our employees and other parties to protect our proprietary rights.

As of March 31, 2020, we had more than 20,000 patents, trademarks, copyrights and domain names registered or applied for registration inside and outside China, a number of which we consider material to our business and future development, including registered trademarks for “NetEase” (網易 NETEASE), “NetEase Games” (网易游戏), “Fantasy Westward Journey” (梦幻西游), “NetEase Yanxuan” (网易严选), “NetEase Cloud Music” (网易云音乐) and domain names for “163.com” and “netease.com.” Our separately listed entity, Youdao, which operates our intelligent learning platform, alone has more than 75 patents, 61 trademarks, 75 copyrights, and 30 domain names, registered with the relevant intellectual property regulatory authorities in China as of March 31, 2020, including “Youdao” and “有道.”

## **FURTHER INFORMATION ABOUT DIRECTORS AND EXECUTIVE OFFICERS**

### **Disclosure of interests**

See “Major Shareholders” for disclosure of interests of our directors and executive officers.

### **Director service contracts and remuneration**

We have entered into employment agreements with each of our directors who is also an officer. See “Directors and Senior Management — Compensation — Employment agreements.”

Each of our directors was nominated pursuant to our Articles of Association. Each of our directors shall hold office until the expiration of their term as provided in their respective agreement or until they are removed or resign from our board.

We grant share-based awards to our independent directors under the Share Incentive Plans. See “Directors and Senior Management — Compensation — Compensation of our directors and senior managers.”

### **Disclosures relating to our directors and experts**

Save as disclosed in this document:

- (a) none of our directors nor any of the persons listed in “— Other Information — Qualification of experts” below is materially interested in the promotion of, or in any assets which have been, within the two years immediately preceding the issue of this document, acquired or disposed of by or leased to our subsidiaries and our consolidated affiliated entities, or are proposed to be acquired or disposed of by or leased to our subsidiaries and our consolidated affiliated entities.

- (b) none of our directors nor any of the persons listed in “— Other Information — Qualification of experts” below is materially interested in any contract or arrangement with us subsisting at the date of this document which is unusual in its nature or conditions or which is significant in relation to our business as a whole.
  
- (c) none of the persons listed in “— Other Information — Qualification of experts” below has any shareholding in us or any of our Significant Subsidiaries or has the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in us or any of our Significant Subsidiaries.

## **OTHER INFORMATION**

### **Estate duty**

Our directors have been advised that no material liability for estate duty is likely to fall on our Company or any of our subsidiaries.

### **Litigation**

See “Our Business — Legal Proceedings and Compliance” for further information.

### **Joint Sponsors**

The Joint Sponsors have applied on behalf of our Company to the Listing Committee for the listing of, and permission to deal in, the Shares in issue, the Shares to be issued pursuant to the Global Offering (including the additional Shares that may be issued pursuant to the exercise of the Over-allotment Option), and the Shares to be issued pursuant to the Share Incentive Plans, including pursuant to the exercise of options, the vesting of or vested but outstanding RSUs, or other awards that have been or may be granted from time to time. All necessary arrangements have been made to enable the Shares to be admitted into CCASS.

China International Capital Corporation Hong Kong Securities Limited, Credit Suisse (Hong Kong) Limited, and J.P. Morgan Securities (Far East) Limited, listed in alphabetical order, satisfy the independence criteria applicable to sponsors set out in Rule 3A.07 of the Hong Kong Listing Rules.

The sponsor fee payable to each of the Joint Sponsors is US\$500,000 and is payable by our Company.

### **No material adverse change**

Our directors confirm that there has been no material adverse change in our financial or trading position since December 31, 2019 (being the date to which our latest audited consolidated financial statements were prepared).

**Qualification of experts**

The following are the qualifications of the experts (as defined under the Hong Kong Listing Rules and the Companies (WUMP) Ordinance) who have given opinions or advice which are contained in this document:

<b>Name</b>	<b>Qualification</b>
China International Capital Corporation Hong Kong Securities Limited	A licensed corporation under the SFO to conduct Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 6 (advising on corporate finance) regulated activities as defined under the SFO
Credit Suisse (Hong Kong) Limited	A licensed corporation under the SFO to conduct Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities as defined under the SFO
J.P. Morgan Securities (Far East) Limited	A licensed corporation under the SFO to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities as defined under the SFO
PricewaterhouseCoopers	Certified Public Accountant under the Professional Accountants Ordinance (Chapter 50 of the Laws of Hong Kong)  Registered Public Interest Entity Auditor under Financial Reporting Council Ordinance (Chapter 588 of the Laws of Hong Kong)
Zhong Lun Law Firm	Legal adviser to Company as to PRC law
Maples and Calder (Hong Kong) LLP	Legal adviser to Company as to Cayman Islands law

**Consents of experts**

Each of the experts above has given and has not withdrawn its consent to the issue of this document with the inclusion of its report and/or letter and/or legal opinion (as the case may be) and references to its name included in the form and context in which it respectively appears.

None of the experts named above has any shareholding interests in our Company or any of our subsidiaries or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in our Company or any of our subsidiaries.

**Promoter**

Our Company has no promoter for the purpose of the Hong Kong Listing Rules. Save as disclosed in this document, within the two years immediately preceding the date of this document, no cash, securities or other benefit has been paid, allotted or given nor are any proposed to be paid, allotted or given to any promoters in connection with the Global Offering and the related transactions described in this document.

**Binding effect**

This document shall have the effect, if an application is made in pursuance of this document, of rendering all persons concerned bound by all of the provisions (other than the penal provisions) of Sections 44A and 44B of the Companies (WUMP) Ordinance insofar as applicable.

**Bilingual document**

The English language and Chinese language versions of this document are being published separately, in reliance upon the exemption provided by Section 4 of the *Companies (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice* (Chapter 32L of the Laws of Hong Kong).

**Miscellaneous**

Save as disclosed in this document, or otherwise waived or exempted from disclosure pursuant to the waivers and exemptions disclosed in this document (see “Waivers and Exemptions”), within the two years immediately preceding the date of this document:

- (a) to the best of our knowledge, neither we nor any of our Significant Subsidiaries has issued or agreed to issue any share or loan capital fully or partly paid up either for cash or for a consideration other than cash;
- (b) no Share or loan capital of our Company is under option or is agreed conditionally or unconditionally to be put under option;
- (c) no commissions, discounts, brokerage or other special terms have been granted in connection with the issue or sale of any share capital or debentures of our Company or any of our Significant Subsidiaries;
- (d) no founder, management or deferred Shares of our Company or any of our Significant Subsidiaries has been issued or agreed to be issued; and

- (e) there is no arrangement under which future dividends are waived or agreed to be waived.

Our branch register of members will be maintained in Hong Kong by our Hong Kong Share Registrar, Computershare Hong Kong Investor Services Limited. Unless the directors otherwise agree, all transfers and other documents of title of Shares must be lodged for registration with and registered by our share register in Hong Kong and may not be lodged in the Cayman Islands. All necessary arrangements have been made to enable the Shares to be admitted to CCASS.

Our directors confirm that:

- (a) there has not been any interruption in our business that may have or has had a material adverse effect on our financial position in the 12 months immediately preceding the date of this document; and
- (b) we and our Significant Subsidiaries have no outstanding debentures or convertible debt securities.

The English version of this document shall prevail over the Chinese version.



**DOCUMENTS DELIVERED TO THE REGISTRAR OF COMPANIES**

The following documents, among others, were delivered to the Registrar of Companies in Hong Kong for registration together with this document:

- (a) a copy of the **GREEN** Application Form;
- (b) a copy of each of the material contracts referred to in “Statutory and General Information — Further Information About Us — Summary of material contracts” in Appendix IV;
- (c) the written consents referred to in “Statutory and General Information — Other Information — Consents of experts” in Appendix IV; and
- (d) a copy of the statement of adjustments relating to the Accountant’s Report from PricewaterhouseCoopers.

**DOCUMENTS AVAILABLE FOR INSPECTION**

Copies of the following documents will be available for inspection at the offices of Skadden, Arps, Slate, Meagher & Flom and affiliates at 42<sup>nd</sup> Floor, Edinburgh Tower, The Landmark, 15 Queen’s Road Central, Hong Kong during normal business hours for 14 days from the date of this document (both dates inclusive):

- (a) the Memorandum and Articles of Association;
- (b) our audited consolidated financial statements for the three years ended December 31, 2019;
- (c) the Accountant’s Report from PricewaterhouseCoopers, the text of which is set out in Appendix IA, together with the associated statement of adjustments;
- (d) the report on review of interim financial information from PricewaterhouseCoopers, the text of which is set out in Appendix IB;
- (e) the report on the unaudited pro forma financial information from PricewaterhouseCoopers, the text of which is set out in Appendix II;
- (f) the legal opinion issued by our PRC Legal Adviser on certain aspects of our Group;
- (g) the letter of advice prepared by Maples and Calder (Hong Kong) LLP, our Cayman Islands legal adviser, summarizing certain aspects of the Cayman Companies Law referred to in Appendix III;
- (h) the material contracts referred to in “Statutory and General Information — Further Information About Us — Summary of material contracts” in Appendix IV;
- (i) the written consents referred to in “Statutory and General Information — Other Information — Consents of experts” in Appendix IV; and
- (j) the Cayman Companies Law.

網易 NETEASE