NetEase Games Strategy 2019

NetEase is a Chinese internet technology company that provides online services across content, community, communication and commerce. It is the 2nd largest gaming company in China, by revenue, and the 5th largest game publisher in the world. NetEase is known for its high quality self-developed IP and for localizing hit foreign games from Blizzard (NetEase and Blizzard have a JV in China), Mojang, and others for the China market. In 2019 the company is focused on creating a diverse game portfolio for both the domestic and overseas markets. NetEase recently announced its Q1 2019 financials and held its annual 5.20 gaming conference where it showcased more than 50 titles. This report will explore NetEase’s current games strategy and how it plans to grow in 2019 and beyond.

NetEase had a solid Q1 as legacy games and new games performed strongly

NetEase reported Q1 2019 revenue of $2.74 billion, up 29.5% YoY, with the increase primarily being driven by growth from gaming and e-commerce. Non-GAPP net income was $449.5 million, up 126% YoY. Total games revenues were $1.77 billion, up 35.3% YoY. Mobile games account for approximately 72.1% of revenue compared to 71.8% in Q1 2018. The increase in games revenue was primarily driven by sustained steady performance from existing (legacy) titles, strong performance from recently launched titles and higher overseas revenue. The results reflect NetEase’s continued transition from a domestic games developer and publisher to a global entertainment company.

NetEase has created a diverse portfolio of self-developed games

NetEase is primarily known for its high quality, self-developed, MMORPG games which have remained strong performers since NetEase first entered the games industry in 2001. Legacy titles such as Fantasy Westward Journey, New Westward Journey and Tianxia III demonstrated growth during Q1 2019 with quarterly revenue for Fantasy Westward Journey Online and New Westward Journey Online II achieving a record high. Since 2014, NetEase has been adapting these original PC games for mobile devices and extending the lifecycle of the games, plus overall engagement and spending, by reaching the much larger mobile gaming audience.

Over the last few years, NetEase has leveraged its strong self-development capabilities to create new IP across a diverse number of genres to tap into the overseas market where it previously had
no presence. NetEase has now reported its 4th consecutive quarter where gaming revenue has exceeded $1.5 billion, which is impressive particularly because the company did not launch any new games during the most recent quarter.

Invincible, a war strategy mobile game that launched in 2015, achieved record high revenue during Q1 2019 and active users increased quarter over quarter. Onmyoji, a turn-based fantasy strategy game that launched in 2016, has returned to the top of the iOS grossing chart in China after multiple new updates and events. Knives Out, a battle royale game that launched in 2017, has succeeded globally with more than 250 million downloads. Night Falls: Survival is an open world zombie survival game with sandbox and shooter elements that launched in 2018 and has remained a consistent performer at the top of the grossing charts in China. These games represent a diverse portfolio of games developed by NetEase in multiple genres, moving beyond its reputation as a successful MMORPG developer.

**NetEase continues to import foreign games to China**

In addition to creating a strong line-up of self-developed titles for the domestic market, NetEase has also been successfully licensing and publishing foreign titles in China since its joint venture with Blizzard in 2008 (JV will remain at least until 2023). NetEase currently operates Blizzard’s World of Warcraft, Starcraft, Diablo, Hearthstone and Overwatch in China. Whilst World of Warcraft has been a stable revenue generator, Overwatch has sold more than 10 million copies in China at $32. In addition to publishing Blizzard games in China, NetEase also runs esports tournaments for the games and currently operates an esports team in the Overwatch League.

NetEase partnered with Mojang to bring an official release of Minecraft to China, which launched in October 2017. The Chinese version of Minecraft is free to play and is monetised via skins and servers in game. The game has amassed more than 200 million registered users to date across PC and mobile, which makes it one of China’s fastest growing games.

Most recently, NetEase confirmed that it was working with The Pokémon Company to localise and release Pokemon Quest in China, an action adventure game for smartphones. NetEase has already added a PvP mode to the Chinese version to increase the appeal for Chinese gamers. NetEase partnered with Kabam to bring Marvel Contest of Champions to China with the Android version launching shortly after Endgame released.

NetEase works with fewer partners and distribution channels than Tencent, but is still a formidable force in China. We expect NetEase to continue being a top partner of choice for overseas developers exporting to China, especially as the company carries out its international expansion strategy.
NetEase is focusing on an international expansion strategy

NetEase has taken a number of steps to reach a global audience with its self-developed games, particularly as the domestic market growth rates soften. This international expansion strategy has been key to NetEase’s growth during the temporary game license approval freeze in China, as NetEase waited out China’s gaming regulatory reform during the last nine months of 2018. Today, NetEase is creating games that have a global simultaneous launch, or in some cases, launch outside China first.

Japan and the US have become key markets for NetEase with titles such as Knives Out and Identity V performing well in both countries. Knives Out, the company’s self-developed battle royale game, recently added a battle pass and had an in-game collaboration with the Street of Fighters IP which allowed it to become a top grossing game in Japan during March and May. Identity V, an asymmetrical battle arena game, has also performed well in Japan and the recent addition of a new character helped the game enter the top 5 iOS grossing chart in April. Cyber Hunter, a sci-fi battle royale game, is an example of a title that launched outside China first, with the game topping the Japan download chart in April.

Whilst NetEase is primarily focusing on mobile games, due to the strength of this segment in China, the company has taken steps to port its titles to PC for the overseas market. Onmyoji was released on Steam in the West and Facebook Gamesroom in Asia to try and tap into the large PC gaming audience around the world. NetEase has also started to explore the console market overseas, creating a PlayStation 4 version of Knives Out that is set to launch in Japan this year.

NetEase wants to become a global gaming company

NetEase plans to invest in or acquire overseas games studios that can create new titles for a global audience as well as find partners who will license IP to NetEase so they can develop new games that can be released worldwide. It is through this approach that NetEase aspires to become a global gaming company that has a strong portfolio of self-developed titles that are published domestically and globally, a strong portfolio of licensed overseas games that are published in China, and partnerships with multiple game publishers to create new games based on licensed IP for the global market.

- In 2018 NetEase and Mattel entered into a joint venture game development studio called Mattel163. The studio is developing mobile games and other content based on Mattel’s brands for release in both the China and global markets.
- In 2018, NetEase announced a partnership with Blizzard to create Diablo Immortal, a mobile action RPG for the global market. The game is based on Blizzard’s popular Diablo IP.
- In 2018, NetEase announced a partnership with CCP Games to create a new EVE Online mobile game called EVE: Infinite Galaxy.
- NetEase invested more than $200 million in multiple overseas game developers such as Bungie, Quantic Dream Jumpship and Second Dinner to create games for the global market to be published by NetEase.
- Marvel and NetEase are collaborating to create new original entertainment which includes games, tv shows and comic books based on the Marvel universe. The deal will see NetEase develop and publish approximately 5 or 6 Marvel games in China and overseas.

We believe that these initiatives will allow NetEase to have a much stronger presence on the global gaming stage and increase its overseas gaming revenue from 10% of gaming revenues to approximately 20% by the end of the year.

**NetEase announced 28 new games at its annual 520 conference**

NetEase held its annual 520 conference on May 20, 2019 where it showcased 50 titles including 28 new games. The theme of the conference was ‘Promoting Creativity for Love’ and the event was promoted as an interactive entertainment product launch conference as opposed to a gaming conference. William Ding, CEO of NetEase, said during the opening keynote that the company will aim to promote Chinese culture in its self-developed games, spread Chinese culture and traditions overseas through its global games and deeply invest in esports to promote high level gaming. Finally, Ding gave a speech on the responsibility of game companies in society, something that has been a hot topic in the media given gaming addiction among minors in China. The comments were likely made, at least in part, to appease the government.

**Pan Entertainment content is a key focus to build the value of self-developed IP**

With a broad portfolio of self-developed titles, NetEase has started to build the value of its IP by trying out various pan entertainment formats such as games, movies, TV, music, comics and more. Onmyoji is a key IP for NetEase that has unique gameplay, anime art style and Japanese mythology. After amassing more than 200 million players, NetEase launched a spin off game in the MOBA category called Onmyoji Arena, which helped NetEase gain traction in this category and turned Onmyoji into a franchise.

NetEase is currently working on 4 new Onmyoji games, including Onmyoji: The Card Game and Onmyoji: Yokai Koya which are in the collectible card and simulation genres, respectively. The
other two spin off games will have details released at a later point. Onmyoji has also expanded through merchandise, fan art, a musical stage production, a film and a cartoon series. An Onmyoji-themed Cafe & Shop is also set to open this July. Onmyoji has become a true pan entertainment IP for the company and we expect to see NetEase replicate this model across all of its top IP.

**Collaborations, crossovers and promotions will help NetEase reach a larger audience**

NetEase has started to introduce more collaborations, crossovers and promotions into its games so that it can grow its overall player base. In July 2018, Onmyoji introduced a collaboration with the Inuyasha manga series, a popular IP in Japan. The game jumped from #50 in the iOS game revenue chart to #2 overnight, demonstrating the power of known IP.

During the 520 conference, NetEase announced a number of collaboration events for already published titles to increase the appeal of these games and drive engagement. In June, Knives Out will collaborate with Ele.me and McDonalds to allow players to receive special coupons for food. Knives Out will also collaborate with popular Japanese media franchise Evangelion to bring characters and other content from the anime into the game. Onmyoji will launch an in-game collaboration with Japanese TV animation Bleach, with full details set to be revealed at a later date.

Other collaborations include Meteor Butterfly Sword and Dynasty Warriors 9 where Lu Bu will appear as an enemy officer in the game. Sandbox battle royale game Buildtopia will have a crossover with the character Bumblebee from the Transformers franchise where players can fight as Bumblebee in a new game mode. Non-Human Academy, an anime style 5v5 MOBA has a crossover with TV animation Killer Seven. Dawn of Isles, an MMORPG that includes crafting elements will collaborate with Japanese mascot Kumamon.

**New self-developed titles for PC and Mobile demonstrate a strong and diverse portfolio**

NetEase has found success developing mobile versions of its popular PC games, starting with a mobile version of Fantasy Westward Journey Online that released in 2015. Revelation Online Mobile will be the next mobile adaptation of the PC game by the same name. Revelation Online is a free to play MMORPG game launched in 2015.

Super Mecha Champions is an action shooting game with armored mechs. The game combines futuristic environments with fast paced competitive gameplay to create an innovative game experience. The gameplay shown at the event looked promising and we believe the title could become a popular esports game.
Masterwork Apocolypse is a fantasy multi world RPG mobile game with 3D anime style graphics. The game is based on the idea of reality being modified where only the player can travel across multiple worlds to collect and develop powerful magic books. The games soundtrack will be composed by famous Japanese composer Masaru Yokoyama and the game will be voiced in both Chinese and Japanese. We expect the game to appeal to fans of fantasy and Japanese culture and art.

Rover Rage is the first rover crafting and battle game on mobile where players will create their own rover and then use it to defeat enemies on the map. The game has a rumble mode and battle royale mode where players will defeat other rovers, loot from them and upgrade their own rover in real time. NetEase collaborated with British game developer Payload Studios, who have a similar PC and console game, to create the mobile game. The game will begin testing on July 26th. NetEase has utilised this strategy before with Identity V where they worked with the developers of Dead by Daylight to create a unique mobile version for the global market.

Love is Justice is a mobile game set in the Northern Song Dynasty where players will get to know characters in the game, travel the world with them and build up a relationship. Other new self-developed games announced during the event include Unknown Future (collectable card game), The Bloody Tales 2 (MMO), Ghost World Chronicles (RPG), Nostos (open world VR game) and Stay Silent (VR shooter).

**Esports is a growing focus for NetEase**

China is the largest esports country in the world with more than 300 million fans and an ever growing esports scene. Esports is a key driver behind the growth of the digital games market in China as esports fan have higher, longer engagement and higher spend levels in game. NetEase confirmed in 2018 that it would spend $160 million on esports initiatives in China to create esports tournaments for its games. An additional $47 million was spent to train streamers, shout casters and esports players.

NetEase now operates its own esports tournaments under the NeXT brand. The tournaments, which were introduced in mid 2018, are NetEase’s first entry into the professional esports space. The spring season will have 16 games including titles from both NetEase and Blizzard with total prize money over $1 million. NetEase held a summer and winter season last year that fetched more than 700 million video views, and the live audience exceeded 32,000.

NetEase has been able to successfully promote its NeXT brand thanks to partnerships with more than 20 live streaming platforms and with major brands such as China Union Pay, Nvidia,
Alienware, Zotac and others. NetEase is certainly a late entrant into esports but has had experience in this space with Fantasy Westward Journey PK battles in the past and has worked closely with Blizzard for Overwatch esports. The company is looking to take its esports tournaments overseas in the future.

**NetEase wants to create a gaming ecosystem**

NetEase is planning a gaming ecosystem around 4 key areas: Developers, Users, Live Streaming and Derivative Content.

Developers: NetEase Game Academy and Minecraft developer support program.

Users: Da Shen app is a social platform for players with more than 50 million registered users and many key opinion leaders. The goal is to be akin to a gaming version of Facebook.

Live streaming: Esports, game broadcasts on CC Live, and a $90 million investment into live streamers. Also working on upgrading esports to provide unique content.

Derivative content: Creation of new games, TV shows, movies, comics and other media formats that utilise existing IP. NetEase has an interactive reading platform which hosts animation, comics and interactive novels.

**Summary**

NetEase is transitioning from a company focused on high quality MMORPGs games for China, to a company focused on new titles in multiple genres, global expansion, investing in esports and creating new long-lasting partnerships with overseas developers. NetEase has been able to build up a strong and stable portfolio of games that allowed it to survive the temporary game license approval freeze with ease, and has a more than 28 titles in the pipeline plus its existing hits. NetEase is impressive as they have been able to succeed and differentiate from Tencent.