

NETEASE COM INC
Form F-3/A
March 09, 2004

As filed with the Securities and Exchange Commission on March 9, 2004

Registration No. 333-109628

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Pre-Effective Amendment No. 2

to

FORM F-3

REGISTRATION STATEMENT

Under

The Securities Act of 1933

NETEASE.COM, INC.

(Exact name of Registrant as specified in its charter)

Cayman Islands
(State or other jurisdiction of
incorporation or organization)

Not Applicable
(I.R.S. Employer
Identification Number)

Suite 1901, Tower E3
The Towers, Oriental Plaza

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Dong Cheng District

Beijing 100738

People s Republic of China

(8610) 8518-0163

(Address, including zip code, and telephone number, including area
code, of Registrant s principal executive offices)

CT Corporation

111 Eighth Avenue

New York, New York 10011

(212) 894-8940

(Name, address, including zip code, and telephone number, including area code,
of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

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If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. "

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. "

CALCULATION OF REGISTRATION FEE

Title of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Share (1)	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Zero Coupon Convertible Subordinated Notes due July 15, 2023	\$ 100,000,000	151.94%	\$ 151,940,000	\$ 12,291.95*
Ordinary Shares, \$0.0001 par value	207,684,320(2)	(2)	(2)	(3)

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) of the Securities Act of 1933, based on the bid and ask prices for the Zero Coupon Convertible Subordinated Notes on October 6, 2003.

(2) Includes 207,684,320 ordinary shares issuable upon conversion of the notes at the initial conversion price of \$0.4815 per share. Pursuant to Rule 416 under the Securities Act, such number of ordinary shares registered hereby shall include an indeterminate number of additional ordinary shares that may be issued from time to time upon conversion of the notes as a result of antidilution adjustments, in circumstances described in the prospectus that is part of this registration statement.

(3)

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Pursuant to Rule 457(i) under the Securities Act, there is no additional filing fee with respect to the ordinary shares issuable upon conversion of the notes because no additional consideration will be received in connection with the exercise of the conversion privilege.

* The registrant previously paid the registration fee at the time of the filing of its initial Registration Statement on October 10, 2003.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED _____, 2004

Preliminary Prospectus

NetEase.com, Inc.

\$100,000,000 Principal Amount

Zero Coupon Convertible Subordinated Notes due July 15, 2023 and Ordinary Shares

Issuable Upon Conversion of the Notes

This prospectus covers resales from time to time by selling securityholders of our Zero Coupon Convertible Subordinated Notes due July 15, 2023, held by the selling securityholders listed in the section entitled, Selling Securityholder , and 207,684,320 of our ordinary shares issuable upon conversion of the notes held by such selling securityholders and subject to adjustment.

The notes have the following provisions:

The interest rate on the notes will be zero, unless we fail to satisfy our obligations to register the notes and the ordinary shares issuable upon conversion of the notes.

The notes are general unsecured obligations of NetEase.com, Inc. and are subordinated to any existing or future senior indebtedness of NetEase.com, Inc.

The notes will mature on July 15, 2023, at which time they will be redeemed at 100% of their principal amount, together with accrued and unpaid interest, if any.

Prior to July 15, 2008, we may not redeem the notes at our option, except upon a Merger Event (as described on page 58 of this prospectus). On or after July 15, 2008, we may redeem for cash all or part of the notes at a price equal to 100% of their principal amount if certain conditions relating to the trading price of our American Depositary Shares, or ADSs, are met (as described on page 54 of this prospectus).

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Holders of the notes may require us to repurchase all or a portion of their notes for cash on July 15, 2006, July 15, 2007, July 15, 2008, July 15, 2013 and July 15, 2018, at a price equal to 100% of the principal amount of the notes, together with accrued and unpaid interest, if any, subject to those additional conditions described on page 54 of this prospectus.

Holders may convert their notes at any time on or before the maturity date at the conversion price (which conversion price may be adjusted as provided on page 49 of this prospectus) under those circumstances described on page 47 of this prospectus. We may pay converting note holders ordinary shares, cash or a combination of cash and ordinary shares for their notes.

For a complete description of the terms and conditions of the notes, see **Description of Notes** beginning on page 47 of this prospectus.

Our ADSs, each representing 100 ordinary shares, are quoted on The Nasdaq National Market, Inc. under the symbol **NTES**. The last reported sale price of our ADSs on March 5, 2004 was \$56.96 per ADS, which results in a reference price of \$0.5696 per share for our ordinary shares.

Investing in the notes and ordinary shares involves risks. See **Risk Factors** beginning on page 8.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is _____, 2004.

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SUMMARY

This summary contains a brief overview of us and the key aspects of the offering. Because it is a summary, it does not contain all of the information that you should consider before investing. You should read this entire prospectus carefully, including the section entitled "Risk Factors" and our financial statements and the notes thereto, some of which are incorporated into this prospectus by reference, before making an investment decision.

Through our subsidiaries and contracts with our affiliates Guangzhou NetEase Computer System Co., Ltd. ("Guangzhou NetEase") and Beijing Guangyitong Advertising Co., Ltd. ("Guangyitong Advertising"), we operate a leading interactive online and wireless community in China and are a major provider of Chinese language content and services through our Internet Portal, Wireless Business and Online Games offerings.

Our business was founded by William Lei Ding, our Chief Architect and one of our directors, in June 1997. Mr. Ding owns 100% of our largest shareholder, Shining Globe International Limited, and 80% of Guangzhou NetEase. The other 20% of Guangzhou NetEase is owned by Bo Ding, the brother of William Lei Ding and a former non-executive employee of NetEase. Guangzhou NetEase has obtained approval from the Guangzhou telecommunications administrative authorities to provide Internet content services, and its 80% owned subsidiary, Guangyitong Advertising, holds a license to operate an advertising business. The other 20% of Guangyitong Advertising is owned by Bo Ding.

We conduct our business in China solely through our wholly owned subsidiaries, NetEase Information Technology (Beijing) Co., Ltd. ("NetEase Beijing"), NetEase Information Technology (Shanghai) Co., Ltd. ("NetEase Shanghai"), NetEase Interactive Entertainment Ltd. and Guangzhou NetEase Interactive Entertainment Limited.

Under current Chinese regulations, there are limitations on the percentage interest foreign companies may have in value-added telecommunications businesses in China, which include the operation of Internet content provision businesses and wireless value-added services such as short-messaging services ("SMS"). In addition, the operation by foreign or foreign-invested companies of advertising businesses in China is subject to government approval. Because of these restrictions, NetEase.com is not permitted directly to wholly own an Internet content provider, wireless value-added services or advertising business. NetEase.com has therefore entered into a series of agreements with Guangzhou NetEase and Guangyitong Advertising. Under these contracts, we provide our Internet and wireless value-added applications, services and technologies and advertising services to Guangzhou NetEase and Guangyitong Advertising, and they operate the NetEase Web sites and the online advertising business. For more information on these agreements, see the section entitled "Related Party Transactions" which is included in our annual report on Form 20-F for the year ended December 31, 2002, which is incorporated by reference in this prospectus. We do not have any direct ownership interest in Guangzhou NetEase or Guangyitong Advertising.

Under our agreements with Guangzhou NetEase, we have agreed to pay the operating costs of Guangzhou NetEase. Under our agreements with Guangyitong Advertising, we have agreed to provide performance guarantees and guarantee loans for working capital purposes to the extent required by Guangyitong Advertising for its operations. Our obligations to Guangzhou NetEase and Guangyitong Advertising are contained in the agreements entered into with those entities in May 2000. Both Guangzhou NetEase and Guangyitong Advertising are prohibited from incurring any debt without our prior approval.

The following diagram shows the current group structure of our subsidiaries and affiliated companies:

NetEase.com and its subsidiaries have no equity interest in either Guangzhou NetEase or Guangyitong Advertising.

We have also recently formed a new affiliated Chinese company, Guangzhou Ling Yi Electronic Technology Co., Ltd., which is 100% owned by William Ding and another PRC individual affiliated with NetEase Beijing. During 2003, this company earned revenue relating to WAP services, which represented an insignificant portion of our wireless value-added services revenue.

NetEase.com generates substantially all of its revenue through Guangzhou NetEase and Guangyitong Advertising.

Any violations by Guangzhou NetEase or Guangyitong Advertising of our agreements with them could disrupt our operations, degrade our services or shutdown our services. See page 14 of this prospectus for a detailed discussion of the risks to NetEase.com regarding its dependency on Guangzhou NetEase and Guangyitong Advertising.

The monthly average daily page views of the NetEase Web sites for the month ended September 30, 2003, exceeded 329.2 million, and as of September 30, 2003, those sites had an accumulated total of approximately 143.8 million registered accounts. Headquartered in Beijing and with regional offices in Shanghai and Guangzhou, we have over 400 employees.

We do not require our users to register in order to browse the NetEase Web sites including the content channels, online shopping mall and classified ads or use the Web directories and Internet search engine. We do require, however, that our users register in order to utilize the other services that we provide, including our fee-based services (such as our wireless value-added services, online games, premium matchmaking and other premium services) as well as our free services such as chat rooms, community forums, basic e-mail services, basic matchmaking, basic personals, and instant messaging. Registration requires a user to provide personal information including the user's name, contact information and other statistical information (such as educational level) and security information (such as a password).

Our basic service offerings on the NetEase Web sites are available without charge to our users and include:

content services (such as news, local information, online entertainment, finance and weather);

chat rooms;

basic e-mail services;

instant messaging;

community forums;

basic matchmaking;

basic personals;

basic alumni directory;

basic clubs;

classified ads;

Web directories;

Web searching; and

online shopping services.

We generate revenue from our:

wireless value-added services and other premium value-added services, such as Web page hosting, premium email services, premium personals, premium matchmaking, premium alumni directories, premium clubs, personal homepages, and electronic greeting cards;

online games; and

advertising services.

Our principal areas of focus are our Wireless Value-Added Services, Online Games and Internet Portal.

Wireless Value-Added Services

Through arrangements with mobile phone operators, China Mobile and China Unicom, we offer a wide-range of services which allow users, for example, to receive news and valuable information such as stock quotes and e-mails on their mobile phones, download ring-tones and logos for their mobile phones and participate in matchmaking communities and interactive games through their mobile phones. Combining content from our Internet Portal (both user-generated and from our content partners) with the applications we have developed in-house, our wireless value-added services staff strives to offer services that are responsive to our users' changing tastes and needs.

Currently, most of our wireless value-added services are provided to users in the form of SMS. NetEase offers over 200 different SMS and subscription packages with pricing between RMB0.10 to RMB2.00 per SMS message or between RMB5.00 to RMB30.00 per subscription per month. We, through Guangzhou NetEase, receive a percentage of this amount from China Mobile and China Unicom, which they bill and collect on our behalf. During the first nine months of 2003 we received between 72% and 79% of the amounts collected each month by China Mobile and China Unicom from mobile phone users for our wireless value-added services.

In addition to our SMS, we have begun introducing services for emerging wireless technology standards, including multimedia messaging (MMS) services and wireless application protocol (WAP) portals which users access with mobile phones that utilize the new GPRS or CDMA1X technology standards. We intend to continue to develop and introduce wireless value-added services, such as Java games, as the market evolves and as new technologies develop.

Online Games

Through our Online Games services, we focus on offering massively multi-player online role-playing games (MMORPGs) to the Chinese market. MMORPGs are played over the Internet in virtual worlds that exist on game servers to which thousands of players simultaneously connect and interact. We both develop and license online games that are targeted at the Chinese market, and we strive to provide the highest quality game playing experience to our users.

To pay for game playing time, players can use our prepaid point card system. Point card distribution channels include wholesalers, as well as major retailers including convenience stores in Guangzhou.

Internet Portal

The NetEase Web sites provide Internet users with Chinese language online services centered around three core services (1) content, (2) community and communication, and (3) commerce. Our Internet portal revenues are generated from advertising services provided to third party advertisers and marketers, and individual users who subscribe to our fee-based premium services.

Content

Through more than 18 channels, the NetEase Web site's content channels provide news, information and online entertainment to the Chinese public. The NetEase Web sites consolidate and distribute content from more than one hundred international and domestic content providers. Content channels include News, Entertainment, Sports, Finance, Information Technology, Automobile, Regional Sites for Guangdong and Shanghai, Astrology and Cartoon channels.

Community and Communication

The NetEase Web sites also provide a broad array of community and communication services, including e-mail, instant messaging, personals, matchmaking, alumni directories, personal homepages, clubs, electronic-cards, chat rooms and community forums. As discussed above, some of these services are provided free of charge to our users with, in some cases, an option to upgrade to a fee-based premium service, whereas others are provided solely on a fee-based premium basis.

Commerce

We offer an online shopping service, providing Internet users in China with the freedom to shop from their homes and offices or in Internet cafes and thereby access products and information which might otherwise not be conveniently available. In turn, our technology platform allows e-commerce and traditional businesses to establish or expand their retail networks via the NetEase Web sites.

In addition, through the NetEase Web sites, advertisers can reach NetEase's large registered user base to conduct integrated marketing campaigns by means of a full range of advertising formats and techniques. These include banner advertising, direct e-mail, interactive media-rich sites, special events, games and contests and other activities.

The NetEase Web sites also provide useful resources to our users, including a Web directory, Web search service and classified ads. Our Web directory is based on an open architecture system with over 3,000 volunteer editors working to build a categorized directory of Chinese Web sites.

For the nine months ended September 30, 2003, approximately 32.0% of our revenue was derived from our online games, approximately 15.0% of our revenue was derived from advertisements, and approximately 53.0% of our revenue was derived from SMS and all other services. For the year ended December 31, 2002, approximately 15.0% of our revenue was derived from advertisements, approximately 69.0% of our revenue was derived from SMS and all other services, and approximately 16.0% of our revenue was derived from our online games. For the year ended December 31, 2001, approximately 50.0% of our revenue was derived from advertisements and approximately 50.0% of our revenue was derived from SMS and all other services; we did not offer online games during 2001.

Corporate Information

NetEase.com, Inc., a Cayman Islands corporation, was formed and commenced operations in 1999. Our predecessor company was formed in 1997. Our principal executive offices are located at Suite 1901, Tower E3, The Towers, Oriental Plaza, Dong Cheng District, Beijing, People's Republic of China 100738. Our telephone number at this location is (86-10) 8518-0163. Our principal corporate Web site is located at <http://www.netease.com>. The information contained on our Web site is not a part of this prospectus.

Please note that in this prospectus, all references to Renminbi and RMB are to the legal currency of China and all references to dollars, USD, and US\$ are to the legal currency of the United States.

The Offering

This prospectus covers the resale of \$100,000,000 aggregate principal amount of the notes and 207,684,320 of our ordinary shares issuable upon conversion of the notes, plus additional ordinary shares that may be issued from time to time upon conversion of the notes as a result of antidilution adjustments in circumstances described on page 49 of this prospectus.

We issued and sold \$75,000,000 aggregate principal amount of the notes on July 14, 2003 and \$25,000,000 aggregate principal amount of the notes on July 31, 2003, in private offerings to Credit Suisse First Boston LLC. We were told by Credit Suisse First Boston LLC that the notes were resold in transactions which were exempt from registration requirements of the Securities Act of 1933, as amended (referred to as the Securities Act in this prospectus) to persons reasonably believed by Credit Suisse First Boston LLC to be qualified institutional buyers (as defined in Rule 144A under the Securities Act).

Ordinary shares may be offered by the selling securityholders following the conversion of their notes.

The following is a brief summary of the terms of the notes. For a more complete description of the notes, see the section entitled Description of Notes in this prospectus.

Notes

\$100,000,000 aggregate principal amount of our Zero Coupon Convertible Subordinated Notes due July 15, 2023.

Interest

Interest on the notes will be zero unless specified defaults under the registration rights agreement occur. See Description of Notes Registration Rights.

Maturity of Notes

July 15, 2023.

Subordination

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The notes will be general unsecured subordinated obligations of NetEase. The notes will be subordinated in right of payment to all existing and future senior indebtedness. The notes will also be effectively subordinated to the existing and future indebtedness and other liabilities of our subsidiaries. As of September 30, 2003, we had approximately \$100.0 million of outstanding indebtedness, and current liabilities of approximately \$10.0 million. On that date, our subsidiaries had no outstanding indebtedness, other than intercompany indebtedness and other normal trade payables and liabilities. As of September 30, 2003, Guangzhou NetEase had no outstanding indebtedness, other than trade payables equal to \$33,760. As of September 30, 2003, we had not guaranteed any indebtedness for Guangyitong Advertising. Under our agreements with Guangzhou NetEase, we are responsible for the liabilities of Guangzhou NetEase. Under our agreements with Guangyitong Advertising, we are obligated to provide any guarantees needed by Guangyitong Advertising for its operation.

Conversion

Note holders may convert their notes into our ordinary shares at a conversion price of \$0.4815 per share, subject to adjustment, at any time prior to maturity:

during any calendar quarter commencing after September 30, 2003, if the average of the reference prices (as defined on page 53 of this prospectus) of our ordinary shares for the last five consecutive trading days of the calendar quarter preceding the quarter in which the conversion occurs is more than 115% of the conversion price per share on the last trading day of the preceding quarter;

if we have called the notes for redemption;

if the average of the trading prices of the notes for any five consecutive trading day period is less than 100% of the average of the conversion value (as defined on page 48 of this prospectus) of the notes during that period; provided, however, that no notes may be converted based on the satisfaction of this condition during the six month period immediately preceding each specified date on which the note holders may require us to repurchase their notes (for example, with respect to the July 15, 2006 repurchase date, the notes may not be converted from January 15, 2006 to July 15, 2006) if on any day during such five consecutive trading day period, the reference price of our ordinary shares is between the conversion price and 115% of the conversion price; or

upon the occurrence of specified corporate transactions, as more fully described on page 49 of this prospectus.

Upon conversion of the notes, we may also choose to deliver cash to you, in lieu of ordinary shares, or a combination of cash and ordinary shares.

A holder may deposit the ordinary shares it receives upon conversion of its notes for the issuance of ADSs if the conditions described on page 66 of this prospectus are met.

Redemption of Notes at Our Option

Beginning on July 15, 2008 and prior to the close of business on the maturity date (July 15, 2023), we may redeem the notes, in whole or in part, for cash at a price equal to 100% of the principal amount thereof, together with accrued and unpaid interest, if any, if the reference price (as described on page 53 of this prospectus) of our ordinary shares for 20 out of any 30 consecutive trading day period, the last of which occurs no more than five days prior to the date upon which notice of such redemption is published, is at least 130% of the conversion price in effect on such last trading day. See [Description of Notes Redemption of Notes at Our Option](#) on page 53 of this prospectus.

We will also redeem all of the notes upon a Merger Event (as defined on page 58 of this prospectus) for cash in an amount equal to the trading price of the notes plus 10% of their principal amount (or 100% of the principal amount of the notes, if greater). See [Description of Notes Merger and Consolidation](#) on page 58 of this prospectus.

Repurchase of the Notes at the Option of the Holder

Holders may require us to repurchase for cash all or a portion of their notes on July 15, 2006, July 15, 2007, July 15, 2008, July 15, 2013 and July 15, 2018, at a price equal to 100% of the principal amount thereof, together with accrued and unpaid interest, if any. See [Description of Notes Repurchase of Notes at the Option of the Holder on Specified Dates](#) on page 54 of this prospectus.

Fundamental Change

If a Fundamental Change (as defined on page 55 of this prospectus) occurs, each holder of notes may require us to repurchase all or a portion of such holder's notes at a price equal to 100% of the principal amount thereof, together with accrued and unpaid interest, if any.

Delisting Event

If our ADSs are no longer listed or quoted for trading on The Nasdaq National Market or our ordinary shares or other securities representing our ordinary shares are not listed or quoted for trading on a U.S. national securities exchange, each holder of notes may require us to repurchase all or a portion of such holder's notes at a price equal to 100% of the principal amount thereof, together with accrued and unpaid interest, if any.

Events of Default

If there is an event of default on the notes, the principal amount of the notes plus accrued and unpaid interest, if any, may be declared immediately due and payable. See "Description of Notes - Events of Default and Notice Thereof" beginning on page 56 of this prospectus.

Use of Proceeds

We will not receive any proceeds from the sale of the notes or the ordinary shares offered by this prospectus.

Form of Notes

The notes were issued in book-entry form and are represented by permanent global certificates deposited with a custodian for and registered in the name of a nominee of The Depository Trust Company, or DTC, in New York, New York.

Beneficial interests in any such securities are shown on, and transfers are effected only through, records maintained by DTC and its direct and indirect participants and any such interest may not be exchanged for certificated securities, except in limited circumstances. See "Description of Notes - Book-Entry Delivery and Form" beginning on page 59 of this prospectus.

Registration Rights

We have agreed to file with the SEC the shelf registration statement of which this prospectus is a part for the resale of the notes and the ordinary shares issuable upon conversion of the notes under a registration rights agreement. In the event that we fail to comply

with our obligation under the registration rights agreement to cause the registration statement to be declared effective, interest will be payable on the notes. See Description of Notes Registration Rights beginning on page 60 of this prospectus.

Trading

Our ADSs, each representing 100 ordinary shares, are traded on The Nasdaq National Market under the symbol NTES.

Trustee for the Notes and Depositary for our American Depositary Shares

The Bank of New York.

RISK FACTORS

Before you make an investment decision regarding the notes or the underlying ordinary shares, you should carefully consider all of the information contained in this prospectus.

Risks Related to Our Company

Our business prospects are difficult to evaluate in part because, over the last several years, we changed our business focus and introduced several new sources of revenue. As a result, we face many risks associated with early-stage companies, particularly our ability to compete in our market.

Our business was established by our predecessor company in June 1997 as an Internet software developer. In mid-1998, our predecessor company changed our business focus to an Internet technology provider, and commenced developing the NetEase Web sites. In July 1999, we commenced our e-commerce services, and in September 1999, we restructured our operations to place our Internet portal operations in Guangzhou NetEase. In 2001, we began focusing on fee-based premium services and online entertainment services, including wireless value-added services, premium e-mail services, online games and other subscription-type services. From 2002 to the first half of 2003, our wireless value-added services and online games have enjoyed greater popularity (and generated greater profit) than our other fee-based premium services, but we cannot be certain whether this trend will continue.

Because we have a limited operating history, when you evaluate our business and prospects you must consider the risks and difficulties frequently encountered by companies in the early stages of development, particularly companies in the new and rapidly evolving Internet service markets. Some of these risks relate to our ability to:

attract buyers for our services;

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attract advertisers;

attract a larger audience to the NetEase Web sites;

derive revenue from our users from fee-based services;

respond effectively to competitive pressures and address the effects of strategic relationships or corporate combinations among our competitors;

maintain our current, and develop new, strategic relationships;

increase awareness of our brand and continue to build user loyalty;

attract and retain qualified management and employees;

upgrade our technology to support increased traffic and expanded services; and

expand the content and services on the NetEase Web sites.

In addition, our change of business focus from developing Web-based software services to developing and providing technological services to the NetEase Web sites and then to also providing e-commerce and other services makes it difficult to evaluate our future prospects. We cannot assure you that we will be able to increase or maintain our revenue from our current service offerings.

We incurred significant losses in the past and may incur additional losses in the future.

Although we had a net profit of US\$2.0 million in 2002 and of US\$27.6 million in the first nine months of 2003, we incurred significant net losses in 2001, 2000 and 1999 and had only minimal profit in 1998. Accordingly, as of September 30, 2003, we had an accumulated deficit of approximately US\$25.3 million. The markets in which we operate are highly competitive, and given the relatively short period of time during which we have achieved profitability, we cannot be certain that we will be able to maintain or increase our profits. Moreover, as our business expands, we may incur additional expenses which would also adversely affect our profitability.

The market for the delivery of wireless value-added services is rapidly evolving, and our ability to generate revenue from our wireless value-added services could suffer if this market does not develop or we fail to address this market effectively.

We must continue to adapt our strategy for wireless value-added services, which contributed the bulk of our fee-based premium services and online entertainment services revenue in 2002 and a significant portion of our fee-based premium services and online entertainment services revenue the first nine months of 2003, to compete in the rapidly evolving wireless value-added services market. We currently offer services for users of SMS and, beginning in 2003, for multi-media messaging services (MMS), both of which enable mobile phone users to communicate with each other and receive information on their phone screens. Competitors have introduced or developed, or are in the process of introducing or developing, competing wireless value-added services accessible through a variety of handheld devices. We cannot assure you that there will be demand for the wireless value-added services provided by us. In addition, there are numerous other technologies in varying stages of development, such as third generation cellular phone technology (3G), which could radically alter or eliminate the SMS and MMS markets. Accordingly, it is extremely difficult to predict which services will be successful in this market or the future size and growth of this market. In addition, given the limited history and rapidly evolving nature of this market, we cannot predict the price that wireless subscribers will be willing to pay for these services. If acceptance of our wireless value-added services is less than anticipated, our results from operations could be impacted.

Currently, we depend on the contractual relationships of Guangzhou NetEase with the two mobile phone operators in China at the national, provincial and local level for our wireless value-added services revenue and the alteration or termination of these relationships could adversely impact our business.

Our wireless value-added services (including SMS) are conducted in conjunction with the two mobile phone operators in China, China Mobile and China Unicom, which together service nearly all of China's mobile phone subscribers. We rely exclusively on the national, provincial and local affiliates of these two companies to deliver our wireless value-added services. If our various contracts with either company are terminated or scaled-back, it may be difficult, if not impossible, to find appropriate replacement partners with the requisite licenses and permits, infrastructure and customer base to offer these services, which could adversely affect our business. Further, we derived approximately 45% of our total revenue through our relationship with China Mobile for the nine months ended September 30, 2003, and are therefore particularly dependent on China Mobile.

Our services are provided through a number of contracts with the provincial and local affiliates of China Mobile and with China Unicom, and each of these contracts is non-exclusive and of a limited term (generally six months or one year). These contracts may also be terminated in advance under certain circumstances. We cannot be certain that we will be able to renew these contracts as necessary or enter into new arrangements with these or other affiliates of China Mobile and China Unicom. We may also be compelled to amend or renew our arrangements with these mobile phone operators in ways which adversely affect our business.

In addition, we are dependent on the policies that may be established from time to time by China Mobile or China Unicom. For example, China Mobile banned all cooperative arrangements known as SMS Website Unions in July 2003, effectively precluding us and other service providers

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from marketing through third party Web sites. In August 2003, China Mobile further banned us and other service providers from using its network to charge customers for services which were deemed by it to be not purely wireless services. In addition, our business and financial condition may be further adversely affected by any future policy changes implemented by China Mobile or China Unicom. China Mobile's adoption of the policies described above contributed to a 20.7% decline in our revenue from SMS and other e-commerce services between the second quarter ended June 30, 2003 and the third quarter ended September 30, 2003.

In the event Guangzhou NetEase's relationships with either China Mobile or China Unicom are adversely altered or terminated, either through a change in the contractual terms of these relationships or a change in the policies of either company, our revenue would likely be adversely affected and we may be unable to find alternatives that would replace such networks and revenue.

We experienced a decline in the rate of growth of our online games which appears to be a result of the outbreak of severe acute respiratory syndrome, or SARS, and any recurrence of SARS or another widespread public health problem could further adversely affect our business and results of operations.

During April and May 2003, we experienced a decline in the rate of growth of our online game services which we believe resulted from the Chinese government's closure of Internet cafes in Beijing and elsewhere to prevent the spread of SARS. Many users of our online game services can only access those services at Internet cafes. A renewed outbreak of SARS or another widespread public health problem in China where virtually all of our revenue is derived and in Beijing, Shanghai and Guangzhou where most of our employees are located could have a negative effect on our operations. Our operations may be impacted by a number of health-related factors, including, among other things:

quarantines or closures of some of our offices which would severely disrupt our operations;

the sickness or death of our key officers and employees;

closure of Internet cafes and other public areas where people access the Internet; and

a general slowdown in the Chinese economy.

Any of the foregoing events or other unforeseen consequences of public health problems could adversely affect our business and results of operations. We will continue to monitor the impact of SARS on our business.

E-commerce and other related services (including wireless value-added services, other fee-based premium services and online games) have become a significant part of our business, constituting approximately 85% of our total revenue for the nine months ended September 30, 2003, but continued growth in the popularity of these services and customers' willingness and ability to pay for them is uncertain.

Our revenue growth depends on the increasing acceptance and use of our e-commerce services, fee-based premium services, wireless value-added services and online game services. We have, however, only limited experience in offering these services and cannot be certain that they will generate sustainable revenue, particularly if we are unable to predict which services will be in demand in the future and offer those services on a timely basis, compete against other companies offering similar services and adapt our services to be compatible with next generation technologies. Further, these services may never become widely accepted for various reasons, many of which are beyond our control, including:

users' inexperience with these technologies, some of which are largely new to China, and users' willingness to pay for online services;

rapid changes in technology and customer tastes which could adversely impact the popularity of our services, such as our fee-based wireless value-added services and online games; and

concerns about security, reliability, cost, ease of deployment, administration and quality of service associated with conducting business over the Internet.

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Further, online payment systems in China are not as widely available or acceptable to consumers in China as in the United States and elsewhere. Although major Chinese banks have instituted online payment systems, these systems are still at an early stage and have not been widely accepted by users. In addition, only a limited number of consumers in China have credit cards or debit cards. The perceived lack of secure online payment systems may limit the number of e-commerce transactions for our services and may limit our growth in these areas. If secure and widely accepted online payment alternatives do not develop, our ability to grow our e-commerce business would be limited. In response to these factors and in connection with the introduction of our first online game, Westward Journey Online, at the end of 2001, we introduced a prepaid debit point card which we developed as an alternative online payment system for our services.

We believe that our prepaid debit point card has facilitated the usability and growth of all of our online game services, although its development and distribution has caused us to incur additional costs. To address the difficulty of making online payments in China, users can buy this card at local stores and other locations in China. The points contained in the card can then be used to pay for online services, such as playing time for online games. We cannot be certain, however, that Internet users in China will be willing to adopt this payment method on a wide-spread and consistent basis or that it will be immune to the security and other concerns which have thus far contributed to the relatively low level of e-commerce activity in China. If the Internet does not become more widely accepted

as a medium for e-commerce and our other fee-based services, our ability to generate increased revenue will be negatively affected. Further, our users who must pay for our services with our prepaid debit point card must take additional and possible inconvenient actions in using our services, such as visiting a store to first purchase the card.

If we fail to develop and introduce new fee-based services timely and successfully, we will not be able to compete effectively and our ability to generate revenue will suffer.

We operate in a highly competitive, quickly changing environment, and our future success depends not only on the popularity of our existing fee-based services but also on our ability to develop and introduce new fee-based services that our customers and users choose to buy. If we are unsuccessful at developing and introducing new fee-based services that are appealing to users with acceptable prices and terms, our business and operating results would be negatively impacted because we would not be able to compete effectively and our ability to generate revenue would suffer. The development of new services can be very difficult and requires high levels of innovation. The development process can also be lengthy and costly, in particular for developing new online games. If we fail to anticipate our users' needs and technological trends accurately or are otherwise unable to complete the development of services in a timely fashion, we will be unable to introduce new services into the market to successfully compete.

The demand for new services is difficult to forecast, in part due to the relative immaturity of the market for our fee-based services in China and relatively short life cycles of Internet-based technologies. As we introduce and support additional services and as competition in the market for our services intensifies, we expect that it will become more difficult to forecast demand. In particular, competition in the online game market is growing as more and more online games are introduced by existing and new market participants.

The revenue that we derive from Guangzhou NetEase's contractual relationships with each of China Mobile and China Unicom depends on records maintained by those companies regarding the fees paid by customers for wireless value-added services.

Each of China Mobile and China Unicom pays us a portion of the fees it receives from its respective customers for the wireless value-added services we provide, based on their internal records. Thus, a significant portion of our revenue is dependent on each company's ability to maintain accurate records. We do not collect fees for our services which are deemed to be billing and transmission failures, which means that the services were undeliverable to the user because the user's phone was turned off for an extended period of time, the user ceased to subscribe to the mobile network or his or her prepaid phone card ran out of value, or the mobile phone operator's networks or our system experienced technical problems. The rate of these billing and transmission failures varies among each mobile phone operator and changes from month to month. Future billing and transmission failures may result in a significant reduction in our wireless value-added services revenue. In recent months billing and transmission failure rates have ranged from 20% to 80%, although occasionally in provinces that do not generate significant revenue, billing and transmission failures may be as high as 90%, and can vary each month and often change without warning or notice. While we maintain our own records regarding the services we provide through their networks, we have no ability to independently monitor the accuracy of billing statements of either mobile phone operator. If there are significant discrepancies between our records and the records of one of the mobile phone operators, after taking into account historic levels of billing and transmission failures, we will typically ask to work with that mobile phone operator to reconcile the difference. Nonetheless, we have no ability to independently test or verify the mobile phone operators' data.

The revenue for our wireless value-added services is normally recognized based on monthly statements from China Mobile and China Unicom, but we occasionally recognize this revenue on an estimated basis if these statements are late.

We normally recognize revenue based on statements that we receive subsequent to a period end from the mobile phone operators, but in very limited circumstances when the mobile phone operators' monthly billing statements are later than the date of our quarterly earnings release, we may recognize revenue on an estimated basis, using our own statistical records and after consultation with the mobile phone operators. For full

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year accounts, we wait until all statements are received before releasing our earnings figures. Consequently, no estimates are involved in determining annual revenue for our wireless value-added services, but from and including the first quarter of 2002 to and including the third quarter of 2003 we have estimated a portion of our wireless value-added services revenue in computing our revenue for particular quarters. The difference between the estimated revenue and the actual revenue as confirmed by the mobile phone operators, as a percentage of total wireless value-added services revenue recognized over the relevant quarter, ranged from 0.1% to 4.5%. Recognizing revenue based on such estimates could potentially require us to later make adjustments in our financial records when the mobile phone operators' statements and cash payments are received.

We expect that a portion of our future revenues will be derived from our advertising services, which represented approximately 15.0% of our total revenue for the nine months ended September 30, 2003, but we may not be able to compete effectively in this market because it is relatively new and intensely competitive, in which case our ability to generate and maintain advertising revenue in the future could be adversely affected.

In addition to revenue generated by our fee-based premium services and online entertainment services, we believe that we will continue to rely on advertising revenue as one of our major sources of revenue for the foreseeable future. Online advertising in China is still relatively new and many of our current and potential advertisers have limited experience with the Internet as an advertising medium, have not traditionally devoted a significant portion of their advertising expenditures or other available funds to Web-based advertising, and may not find the Internet to be effective for promoting their products and services relative to traditional print and broadcast media. Our ability to generate and maintain significant advertising revenue will depend on a number of factors, many of which are beyond our control, including:

the development of a large base of users possessing demographic characteristics attractive to advertisers;

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.

In addition, China's entry into the World Trade Organization, and the resulting gradual opening of its telecommunications sector, may facilitate more foreign participation in the Chinese Internet market by such companies, for example, as Yahoo! and American Online. Many of these Internet companies have longer operating histories in the Internet market, greater name and brand recognition, larger customer bases and databases and significantly greater financial, technical and marketing resources than we have. The entry of additional, highly competitive Internet companies into the Chinese market would further heighten competition for advertising spending in China.

If the Internet does not become more widely accepted as a medium for advertising, our ability to generate increased revenue will be negatively affected.

Our advertising revenue is subject to the overall state of the online advertising industry which is itself subject to general economic conditions.

Expenditures by advertisers tend to be cyclical, reflecting overall economic conditions as well as budgeting and buying patterns. The demand for Internet advertising in China has been generally stabilizing in recent quarters but it still remains relatively soft as companies are reluctant to expand their marketing and advertising budgets or delay spending their budgeted resources. This has resulted in intense market competition which affected the general pricing in the Internet advertising market in China, and we have had to devote significant resources to maintain and enhance our revenue from advertising.

Because a portion of our revenue is derived from Internet advertising services, our future revenue could be materially and adversely affected if we cannot adapt successfully to new Internet advertising pricing models.

It is difficult to predict which Internet advertising pricing model, if any, will emerge as the industry standard. This makes it difficult to project our future online advertising rates and revenue. For example, in past periods, our obligations to advertisers typically included guarantees of a minimum number of impressions or times that an advertisement appears in pages viewed by users. We were largely successful in 2002 in moving to advertising contracts whose fees are based on the actual time period that the advertisements appear on the NetEase Web sites rather than based on guaranteed minimum impressions. We cannot predict whether advertisers will continue to agree to this form of advertising arrangement in the near-term or whether new pricing models will emerge which we can successfully adopt and implement. Our advertising services revenue could be materially and adversely affected if we are unable to adapt to new forms of Internet advertising or if we fail to adopt

the most profitable form.

Our business and our reputation were materially harmed because we had to restate our financial statements.

Our rapid growth has placed and continues to place a significant strain on our resources. In one particular instance in our history, we have not been able to manage our growth effectively. Specifically, in the second quarter of 2001, based on information provided by an employee, our board of directors through its audit committee initiated an investigation into whether the terms of a number of contracts between our company and third party advertisers had been appropriately reflected in our financial statements. The audit committee subsequently determined by the end of the investigation that a portion of our revenue could not be recognized in fiscal year 2000 because:

we could not identify reliable evidence to support the fair value of services provided under advertising contracts or no services had been provided in fiscal year 2000 under advertising contracts, and accordingly, US\$ 1.1 million in revenue was improperly recorded for fiscal year 2000,

revenue from barter transactions did not meet the criteria for recognition under the applicable accounting standards and accordingly, US\$ 2.0 million in revenue was improperly recorded for fiscal year 2000, and,

contracts were found to lack economic substance and accordingly, US\$ 1.2 million in revenue was improperly recorded for fiscal year 2000, and

Our restated total revenues for 2000 were RMB33.0 million, resulting in a net loss of RMB169.3 million or RMB6.78 per American Depositary Share. We had originally reported total revenues for 2000 of RMB68.9 million, with a net loss of RMB142.8 million or RMB5.72 per American Depositary Share. Our total operating expenses for 2000 were reduced by RMB7.2 million as a result of the restatement. The adjustments also decreased our previously reported total assets by RMB72.8 million.

We believe that the improved controls and procedures and structural changes discussed on page 34 of this prospectus have been effective, but it is possible that the same or new problems will arise as our business continues to expand. Further, as noted below, we cannot be certain that we will be able to employ and retain suitable senior managers to oversee the implementation of our controls and procedures in the future. If we make any mistakes in operating our business, our operating results may fluctuate and cause the price of our ADSs to decline.