

PROSPECTUS

4,500,000 American Depositary Shares



Netease.com, Inc.

Representing 450,000,000 Ordinary Shares

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This is Netease.com's initial public offering. Netease.com is selling 4,500,000 American Depositary Shares. Each ADS represents 100 ordinary shares. The U.S. underwriters are offering 2,250,000 ADSs in the U.S. and Canada and the international managers are offering 2,250,000 ADSs outside the U.S. and Canada.

Prior to this offering, no public market existed for the ADSs. The ADSs have been approved for quotation on the Nasdaq National Market under the symbol "NTES".

Investing in the ADSs involves risks that are described in the "Risk Factors" section beginning on page 9 of this prospectus.

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	<u>Per ADS</u>	<u>Total</u>
Public offering price.....	US\$15.50	US\$69,750,000
Underwriting discount.....	US\$1.085	US\$4,882,500
Proceeds, before expenses, to Netease.com.....	US\$14.415	US\$64,867,500

The U.S. underwriters may also purchase up to an additional 337,500 ADSs from Netease.com at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus to cover over-allotments. The international managers may similarly purchase up to an additional 337,500 ADSs from Netease.com.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The ADSs will be ready for delivery on or about July 6, 2000.

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Merrill Lynch Far East Limited

Merrill Lynch & Co.

Deutsche Banc Alex. Brown

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The date of this prospectus is June 29, 2000.

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You should rely only on the information contained in this prospectus. Information contained on the Web sites operated by Guangzhou Netease Computer System Co., Ltd., or the Netease Web sites, does not constitute part of this prospectus. We have not, and the underwriters have not, authorized any person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

PROSPECTUS SUMMARY

In addition to this summary, we urge you to read the entire prospectus carefully, especially the risks of investing in the ADSs discussed under "Risk Factors," before deciding whether to buy any ADSs.

Netease.com, Inc.

Our Business

We are a leading Internet technology company in China. We pioneered the development of applications, services and other technologies for the Internet in China. Using our Internet technologies, the Web sites operated by our affiliate, Guangzhou Netease Computer System Co., Ltd., or the Netease Web sites, offer Chinese Internet users Chinese language-based online content, community and electronic commerce, or e-commerce, services. According to a survey by the China Internet Network Information Center, or CNNIC, dated January 2000, the Netease Web sites were ranked the second most recommended by Chinese Internet users. We believe we were the first Internet technology company in China to offer a free Web-based e-mail service that supports both the Chinese and English languages. Unlike many other Internet companies that provide Chinese language Internet services, we are focused on Internet users in China. Most of our employees are Chinese nationals; their cultural and linguistic insights enable us to tailor our services to the needs of Chinese Internet users. Our average daily page views for the seven-day period ended May 31, 2000 exceeded 20 million.

The Netease Web sites provide a destination for Chinese Internet users to identify and access resources, services, content and information on the Internet. The Netease Web sites aggregate, organize and provide access to 15 separate channels of online content through content distribution relationships with over 140 international and domestic Chinese language content providers. We believe we were the first Internet technology company in China to offer an online service that allows users to create a profile to organize and receive information of personal interest, or a personalization service. In addition, the Netease Web sites contain over 378,000 Web pages created and maintained by our users, or personal home pages, enabling users to express themselves, to share ideas, interests and areas of expertise and to publish personal content accessible by other Chinese Internet users.

We believe we were one of the first Internet companies in China to offer online interactive community services. Our community services allow users who register with the Netease Web sites to communicate with other registered community members through a variety of community products and services. Our community offers over 200 community forums where registered community members can post messages and articles for viewing by other users. The Netease Web sites contain over 13,700 personal community forums, where registered community members create their own forum topics. Netease registered community members can chat, participate in surveys and send instant messages to other registered members.

We believe we were the first Internet company to offer online auction services in China. We offer a permanent business-to-consumer auction service on the Netease Web sites, featuring a wide range of products. Our e-commerce applications, services and technologies, or e-commerce platform, accept a variety of online payment options, including online credit and debit cards. Users may also pay by check or choose cash-on-delivery. We have established alliances with logistics providers, allowing vendors on our platform to arrange delivery of their goods at reduced rates.

We incurred a net loss of approximately US\$6.3 million in 1999. As of March 31, 2000 we had an accumulated deficit of approximately US\$9.2 million.

Our Market Opportunity

The online advertising market and the e-commerce market in China are in their early stages of development. In addition, China has only recently begun to build out its Internet infrastructure. The limited availability of Internet access in China, as well as the relatively high cost of personal computers, has inhibited growth in the number of Chinese Internet users. According to the survey report issued by CNNIC in January 2000, the total number of Internet users in China as of December 31, 1999 reached 8.9 million. We expect China's Internet market to experience relatively rapid growth over the next few years. For example, according to a report issued by International Data Corporation, or IDC, the number of Internet users in China is expected to increase to 33.1 million by 2004. We believe that a continued reduction in Internet access costs and personal computer prices in China will further promote Internet use in China. We believe that the potential for Internet access through television-based devices using cable or satellite technology and wireless devices may further accelerate Internet growth.

We believe that the potential for growth in the Internet industry in China presents a significant opportunity for companies that focus on the Chinese Internet market. In addition, there are few China-based Web sites that offer Chinese Internet users a combination of content, community and e-commerce in the Chinese language.

Our Strengths and Strategy

We are focused on providing Internet technology and solutions to the developing Internet market in China. We believe that by offering an integrated platform of online content, community and e-commerce services, we are well positioned to capitalize on the growth of the Internet market in China. Our goal is to make the Netease Web sites the leading online network in China. Key strategies for achieving our goal are to:

- Aggressively extend our brand name recognition to make the Netease, “网易” (“Netease” as written in Chinese), and 163.com brand names synonymous with the Internet among users in China.
- Continue to develop user-friendly Internet technology focused on the market in China by adapting and modifying existing technologies for Chinese language-based Internet applications as well as developing our own proprietary Chinese language-based Internet applications.
- Enrich, expand and personalize the content offered on the Netease Web sites to make it more tailored for and relevant to our users' daily lives and to provide our users with a more customized and comprehensive Internet experience.
- Expand the number of our registered users and registered community members by enhancing the quality of our community services and by introducing new applications, services and technology for our interactive online community. In addition to our existing communities, we plan to develop technology to support a business community on the Internet.
- Expand our e-commerce services by expanding our online e-commerce platform, by assisting traditional vendors to establish their e-commerce strategies, and by leveraging our registered users to target products to specific demographic groups.
- Expand our online advertiser base by aggressively extending our brand recognition, by continuing to promote the Internet as an alternative method for advertisers, by offering demographically targeted advertising services to attract online advertisers and by utilizing third party advertising networks and advertising agencies.
- Establish and extend strategic alliances with or acquire prominent Internet companies, e-commerce service companies, traditional media companies and technology companies.

Our History and Recent Developments

Our business was founded in June 1997. Our initial business objective was to develop large-scale distributed software systems for use on the Internet in China. In mid-1998, we changed our business model from a software developer to an Internet technology company. In July 1999, we established a new holding company, Netease.com, Inc., in the Cayman Islands. In September 1999, we restructured our operations in order to comply with increasing regulation of the Internet industry in China. As part of this restructuring, substantially all of Guangzhou Netease's fixed and intangible assets and existing Internet applications, services and technologies were acquired by Netease Information Technology (Beijing) Co., Ltd., or Netease Beijing, a wholly owned subsidiary of Netease.com formed in August 1999. In addition, the rights to use the following uniform resource locators, or URLs, were transferred from Guangzhou Netease to Netease.com:

- www.netease.com;
- www.163.com;
- www.126.com;
- www.yeah.net; and
- www.netease.net.

Under current Chinese regulations and policies, foreign or foreign-invested entities may not own or operate telecommunications businesses in China, which may include the operation of Internet content provision businesses. In addition, the ownership by foreign or foreign-invested entities of advertising businesses in China is subject to government approval. Guangzhou Netease, which is 80% owned by our founder, Chairman of the Board, Co-Chief Technology Officer and majority shareholder, William Lei Ding, has received approval from the Guangzhou telecommunications administrative authorities to provide Internet content services, and its 80% owned subsidiary, Beijing Guangyitong Advertising Co., Ltd., or Guangyitong Advertising, holds a license to operate an advertising business. Because of the restrictions described above, Netease.com is currently not permitted to own an equity interest in Guangzhou Netease and does not have approval to own an equity interest in Guangyitong Advertising. Risks relating to the impact of Chinese law on our operations are described on pages 10, 11, 15 and 17.

We have agreed to acquire the operations of or the equity in Guangzhou Netease or any part thereof when Chinese law permits foreign ownership of an Internet content provider in China. We have also agreed to acquire the operations of or Guangzhou Netease's equity interest in Guangyitong Advertising when Chinese laws regarding foreign ownership of advertising businesses are relaxed. We cannot assure you that Chinese laws will ever permit our ownership of Guangzhou Netease or Guangyitong Advertising or that it will be economically viable to acquire these businesses at that time.

We entered into a series of agreements with Guangzhou Netease and Guangyitong Advertising effective January 1, 2000. Under these agreements, we provide our Internet portal and e-commerce technologies and advertising services to Guangzhou Netease and Guangyitong Advertising, and Guangzhou Netease and Guangyitong Advertising operate the Netease Web sites and the online advertising business, respectively. To ensure that Guangyitong Advertising will not do anything detrimental to our joint endeavors, we have entered into an operating agreement with Guangyitong Advertising and its ultimate shareholders and a proxy agreement with Guangyitong Advertising's ultimate shareholders that allow us to direct the policies and management that guide the ongoing activities of Guangyitong Advertising. Our agreements with Guangzhou Netease and Guangyitong Advertising are described in more detail in the section "Related Party Transactions" on page 66, and several risks relating to these contracts are described on pages 10, 11 and 12.

In March 2000 we issued our Series B preference shares, convertible into 256,055,600 of our ordinary shares, to an affiliate of The News Corporation Limited for US\$35 million in cash and US\$5 million of advertising inventory. We expect to use the cash proceeds of this private placement for marketing, content development, server and bandwidth expenditures, research and development and working capital and general corporate purposes. In connection with this transaction, we entered into an agreement with an affiliate of The News Corporation that provides for cooperation between us and The News Corporation. The agreement also provides for The News Corporation to provide us with US\$5 million of advertising inventory and for The News Corporation to purchase US\$5 million of advertising on the Netease Web sites. For more information regarding this strategic alliance, see “Business—Strategic Alliances—The News Corporation” on page 52.

Our Offices

Our principal executive office is located at 15th Floor, North Tower, Beijing Kerry Centre, No. 1 Guanghai Road, Chaoyang District, Beijing 100020, People’s Republic of China, and our telephone number is (8610) 6561-8811. We also have offices in Guangzhou and Shanghai.

The Offering

American Depositary Shares offered by

Netease.com:

U.S. offering.....	2,250,000 ADSs
International offering	<u>2,250,000 ADSs</u>
Total.....	4,500,000 ADSs

The ADSs..... Each ADS represents 100 ordinary shares, par value US\$0.0001 per share. The ADSs will be evidenced by American Depositary Receipts. To understand the terms of the ADSs, you should carefully read the section in this prospectus entitled “Description of American Depositary Shares.” We also encourage you to read the deposit agreement, which is an exhibit to the registration statement that includes this prospectus.

Ordinary shares outstanding after the offering..... 3,010,555,600 shares

Use of proceeds..... Our net proceeds from this offering without exercise of the over-allotment options will be approximately US\$62.6 million. We intend to use these net proceeds for marketing, content development, server and bandwidth expenditures, research and development and working capital and general corporate purposes.

Risk factors..... See “Risk Factors” and other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in the ADSs.

Nasdaq National Market symbol NTES

The ordinary shares outstanding immediately after this offering exclude the following:

- any ordinary shares represented by the ADSs to be issued pursuant to the underwriters’ over-allotment options;
- 295,148,000 ordinary shares issuable upon the exercise of options outstanding as of June 15, 2000 under our stock incentive plans at a weighted average exercise price of US\$0.091 per share; and
- 50,527,000 ordinary shares reserved as of June 15, 2000 for future issuance under our stock incentive plan.

SUMMARY FINANCIAL DATA

You should read the following information in conjunction with our consolidated financial statements and related notes, "Selected Consolidated Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus. Our financial statements are presented in Chinese renminbi and prepared in accordance with U.S. GAAP as of December 31, 1998 and 1999 and for the period between June 24, 1997 (date of inception) to December 31, 1997 and the years ended December 31, 1998 and 1999. For your convenience, financial statements for the year ended and as of December 31, 1999 also have been translated into U.S. dollars. These financial data reflect our reorganization and have been prepared as if our current corporate structure had been in existence throughout the relevant periods.

The pro forma per share data give effect to the conversion of our outstanding preference shares into ordinary shares that will occur upon the consummation of this offering. For additional information regarding the pro forma data, see "Capitalization" on page 25.

	From June 24, 1997 (inception) to December 31, 1997	For the Year Ended December 31,		
	(RMB)	1998 (RMB)	1999 (RMB)	1999 (US\$)
Statement of Operations Data:				
Revenues.....	100,000	3,115,432	16,771,006	2,025,607
Sales and value-added taxes	(6,600)	(230,749)	(1,150,169)	(138,918)
Net revenues.....	93,400	2,884,683	15,620,837	1,886,689
Cost of revenues.....	(68,614)	(1,189,188)	(12,096,235)	(1,460,986)
Gross profit.....	24,786	1,695,495	3,524,602	425,703
Operating expenses	(30,844)	(1,262,957)	(56,790,659)	(6,859,190)
Operating profit (loss)	(6,058)	432,538	(53,266,057)	(6,433,487)
Other income (expenses).....	—	(65,337)	1,363,142	164,640
Income (loss) before tax	(6,058)	367,201	(51,902,915)	(6,268,847)
Provision for income tax.....	(1,000)	(34,464)	(71,338)	(8,616)
Net income (loss)	(7,058)	332,737	(51,974,253)	(6,277,463)
Net income (loss) per share, basic and diluted.....	(0.01)	0.01	(0.03)	(0.01)
Net income (loss) per ADS, basic and diluted.....	(0.01)	0.02	(2.73)	(0.33)
Weighted average number of shares outstanding	1,868,817,200	1,868,817,200	1,900,430,600	1,900,430,600
Weighted average number of ADSs outstanding	18,688,172	18,688,172	19,004,306	19,004,306
Pro forma net income (loss) per ordinary share, basic and diluted	(0.01)	0.01	(0.02)	(0.01)
Pro forma net income (loss) per ADS, basic and diluted.....	(0.01)	0.02	(2.36)	(0.29)
Pro forma weighted average number of ordinary shares outstanding	1,868,817,200	1,868,817,200	2,200,430,600	2,200,430,600
Pro forma weighted average number of ADSs outstanding.....	18,688,172	18,688,172	22,004,306	22,004,306

	From June 24, 1997 (inception) to December 31, 1997	For the Year Ended December 31,		
		1998	1999	1999
		(RMB)	(RMB)	(US\$)
Other Financial Data:				
Capital expenditures	187,770	1,083,248	9,312,383	1,124,752
Net cash provided by (used in):				
Operating activities	(261,823)	1,232,379	(15,687,474)	(1,894,737)
Investing activities	(187,770)	(1,083,248)	(9,312,383)	(1,124,752)
Financing activities	500,000	—	142,600,415	17,223,313

The following table sets forth our balance sheet data: as of December 31, 1999:

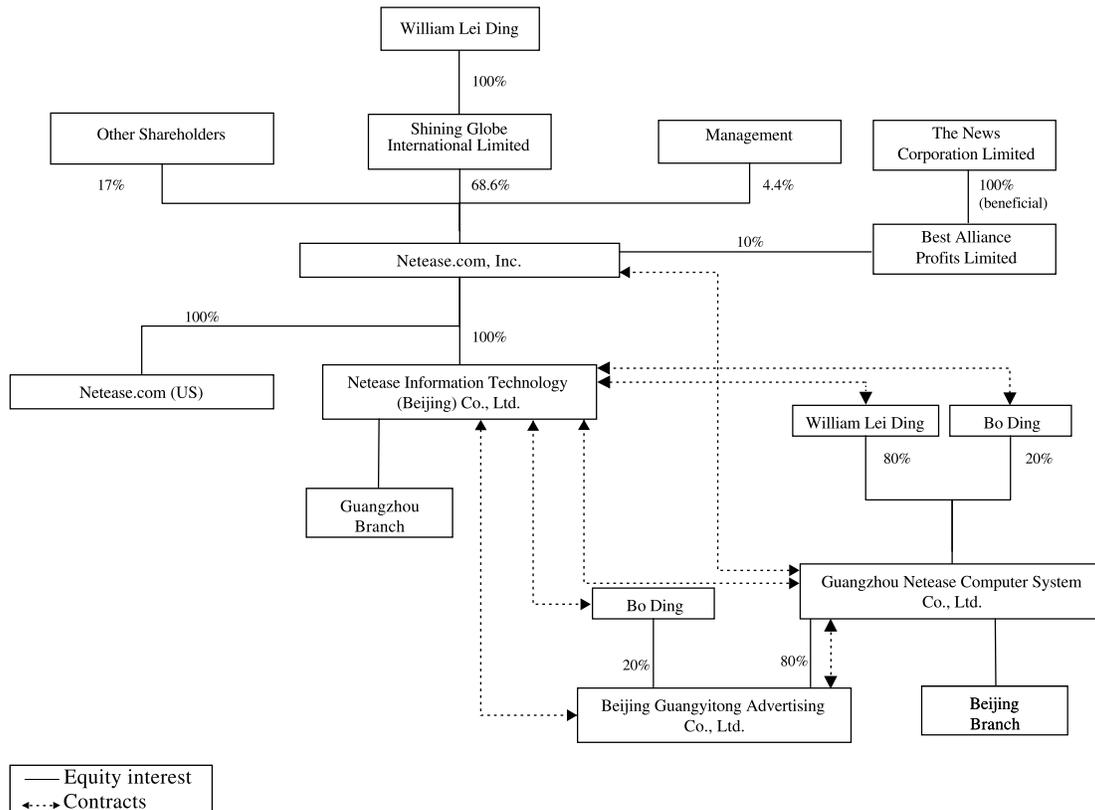
- on an actual basis;
- on a pro forma basis to reflect the issuance and sale of 2,560,556 Series B preference shares in March 2000 and the conversion of our outstanding Series A and Series B preference shares into ordinary shares that will occur upon the consummation of this offering; and
- as adjusted to give effect to the issuance and sale of 4,500,000 ADSs offered hereby at the initial public offering price of US\$15.50 per ADS, after deducting estimated underwriting discounts, commissions and offering expenses.

	As of December 31, 1999					
	Actual		Pro Forma		Pro Forma As Adjusted	
	RMB	US\$	RMB	US\$	RMB	US\$
Balance Sheet Data:						
Cash	117,800,096	14,227,924	407,582,596	49,227,924	926,024,187	111,845,424
Working capital	126,556,803	15,285,562	424,618,803	51,285,562	943,060,394	113,903,062
Property, plant and equipment	9,508,437	1,148,431	9,508,437	1,148,431	9,508,437	1,148,431
Total assets	143,728,182	17,359,524	474,908,182	57,359,524	993,349,773	119,977,024
Total current liabilities	7,662,942	925,531	7,662,942	925,531	7,662,942	925,531
Total shareholders' equity	136,065,240	16,433,993	467,245,240	56,433,993	985,686,831	119,051,493

NETEASE.COM, INC.

Our business was founded by William Lei Ding, our Chairman of the Board and Co-Chief Technology Officer, in June 1997. Mr. Ding owns 100% of our majority shareholder, Shining Globe International Limited, and owns 80% of Guangzhou Netease. In September 1999, we restructured our operations in order to comply with increasing regulation of the Internet industry in China. As part of this restructuring, substantially all of Guangzhou Netease's fixed and intangible assets and existing Internet technologies were acquired by Netease Beijing, our wholly owned subsidiary. The rights to use all of Guangzhou Netease's URLs were transferred to Netease.com. 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 Guangzhou Netease and of Guangyitong Advertising is owned by our employee, Bo Ding, the brother of William Lei Ding.

Under current Chinese regulations, foreign or foreign-invested companies may not own or operate telecommunications businesses in China, which may include the operation of Internet content provision businesses. 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 own an Internet content provision or advertising business. Netease.com has therefore entered into a series of agreements with Guangzhou Netease and Guangyitong Advertising under which we provide our Internet applications, services and technologies and advertising services to Guangzhou Netease and Guangyitong Advertising, and Guangzhou Netease and Guangyitong Advertising operate the Netease Web sites and the online advertising business. For more information on these agreements, see "Related Party Transactions" on page 66. The table below illustrates our corporate structure and the relationship between Netease.com and Guangzhou Netease and their major shareholders.



RISK FACTORS

Investment in our ADSs involves a high degree of risk. You should consider carefully the following information about these risks, together with the other information contained in this prospectus, before you decide whether to buy our ADSs. Any of the following risks could have a material adverse effect on our business, results of operations and financial condition. In any such case, the market price of our ADSs could decline, and you may lose all or part of the money you pay to buy our ADSs.

Risks Related to Our Company

Our business prospects are difficult to evaluate because we commenced our operations in 1997 and changed our business focus in 1998.

Our business was established in June 1997 as an Internet software developer. In mid-1998 our business focus changed to an Internet technology provider and we commenced developing the Netease Web sites. In July 1999, we commenced our e-commerce service and in September 1999 we restructured our operations to place our Internet portal operations in Guangzhou Netease. 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. Our recent change of business focus from developing Web-based software products to developing and providing technological services to the Netease Web sites and providing e-commerce services also makes it difficult to evaluate our future prospects. Revenues from our software licensing and related integration projects business exceeded revenues from our advertising and e-commerce related services until September 1999. We cannot assure you that we will be able to increase or maintain our revenues from online advertising and e-commerce services.

We incurred significant losses in the past and expect losses to continue in the future.

We incurred significant losses in 1999 and had only minimal profit in 1998. We expect to continue to incur significant losses in the foreseeable future. As of March 31, 2000, we had an accumulated deficit of approximately US\$9.2 million. In recent quarters, our expenses have grown faster than our revenues. In addition, we anticipate our spending to increase significantly due to our increased capital expenditures, marketing costs and the cost of additional personnel. Accordingly, it is possible that our operating losses may increase and we may not achieve profitability in the foreseeable future or ever.

Our revenues fluctuate significantly and may adversely impact the trading price of our ADSs.

Our revenues and results of operations have varied significantly in the past and may continue to fluctuate in the future. Many of the factors that cause such fluctuation are outside our control. Steady revenues and results of operations will depend largely on our ability to:

- attract and retain users to the Netease Web sites in the increasingly competitive Internet market in China;
- successfully implement our e-commerce strategies as planned; and
- update and develop our Internet applications, services, technologies and infrastructure.

We derived approximately 64.4% and 93.1% of our revenues from advertising services in 1999 and in the first quarter of 2000, respectively. Seasonal variation in the level of advertising expenditures by online advertisers will also cause fluctuations in our revenues and operating results. In China, advertising expenditures have historically been significantly lower during the first calendar quarter of the year due to the Chinese New Year holiday and the traditional close of advertisers' annual budgets. If our revenues decrease or expenses increase during these periods, we may not be able to offset our expenses with sufficient revenues.

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 fluctuation 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 to decline.

If Guangzhou Netease, Guangyitong Advertising or Guangyitong Advertising's 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.

Because of current Chinese laws and restrictions, Guangzhou Netease operates the Netease Web sites and Guangyitong Advertising, an 80%-owned subsidiary of Guangzhou Netease, operates the online advertising business pursuant to contractual arrangements with us. Guangzhou Netease is 80% owned by our founder, Chairman of the Board, Co-Chief Technology Officer and majority shareholder, William Lei Ding and 20% owned by our employee Bo Ding, William Lei Ding's brother. Bo Ding owns the remaining 20% of Guangyitong Advertising.

The interests of the shareholders of Guangzhou Netease may differ from ours and yours because they own a larger percentage of Guangzhou Netease than of our company. In addition, Guangzhou Netease, as an Internet content provider, and Guangyitong Advertising, as an advertising firm, may be subject to laws and regulations in China that are incompatible with the business strategies or operations of our company. Guangzhou Netease, Guangyitong Advertising or Guangyitong Advertising's ultimate shareholders could violate our agreements with them by, among other things, failing to operate and maintain the Netease Web sites or advertising business in an acceptable manner, failing to remit revenues to us on a timely basis or at all or diverting customers or business opportunities from our company to Guangzhou Netease. A violation of these agreements could disrupt our business and adversely affect our reputation in the market. If Guangzhou Netease, Guangyitong Advertising or Guangyitong Advertising's ultimate shareholders violate our agreements with them, we may have to resort to litigation to enforce our rights. This litigation could result in the disruption of our business, diversion of our resources and the incurrence of substantial costs.

Because our contractual arrangements with Guangzhou Netease, Guangyitong Advertising and Guangyitong Advertising's ultimate shareholders are new and do not detail the parties' rights and obligations, our remedies for a breach of these arrangements are limited.

Our current relationship with Guangzhou Netease, Guangyitong Advertising and Guangyitong Advertising's ultimate shareholders is based on a number of recently executed contracts. 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 Guangzhou Netease, Guangyitong Advertising or Guangyitong Advertising's ultimate shareholders for breaching our agreements. In addition, we have very limited experience in implementing these agreements. Because we rely significantly on Guangzhou Netease and Guangyitong Advertising 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 Web sites.

Increased government regulation of the information industry in China may result in the Chinese government reclassifying our business as a telecommunications, media or retail business which may restrict our operations.

The Chinese government regulates Internet access, distribution of news and other information and provision of commerce and advertising services through strict business licensing requirements and other

governmental regulations. Netease Beijing is licensed to operate as an information technology company and is not licensed to operate as an Internet content provider, retail business or advertising business. Guangzhou Netease obtained approval in January 2000 from the Guangzhou telecommunications administrative authorities to provide Internet content services. We rely exclusively on our contractual arrangements with Guangzhou Netease and its approval to operate as an Internet content provider for our business operations. We believe that our present operations are structured to comply with Chinese law. We have been informed by our Chinese legal counsel that we have obtained all necessary permits, licenses and clearances from governmental agencies in China necessary for operating our business. 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. We are uncertain as to whether the Chinese government will reclassify our business as a media or retail company, due to our acceptance of Internet advertising fees and e-commerce related services fees as sources of revenues, or as a result of our current corporate structure. Such reclassification could subject us to penalties or fines or significant restrictions on our business. We are also uncertain as to whether the Chinese government will reclassify our business as a telecommunications business, potentially resulting in significant restrictions on our business. We may fail to obtain some or all the licenses, permits or clearances we may need in the future. In addition, we may have difficulties enforcing our rights under our agreements with Guangzhou Netease and Guangyitong Advertising if either of these parties breaches any of our agreements with them because we do not have approval from appropriate Chinese authorities to provide Internet content services or Internet advertising services. Future changes in Chinese government policies affecting the provision of information services, including the provision of online services, Internet access, e-commerce services and online advertising, may impose additional regulatory requirements on us or our service providers or otherwise harm our business.

Our business would be materially harmed if the Chinese government were to take any action against us for the content on the Netease Web sites.

The Chinese government has recently enacted regulations governing Internet access and distribution of news and other information over the Internet. In the past, the Chinese government has stopped the distribution of information over the Internet that it believed to be inappropriate. We cannot predict the effect of further developments in the Chinese legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement of laws.

If we are found to be in violation of any existing or future Chinese laws or regulations, the relevant Chinese authorities would have broad discretion in dealing with such a violation, including, without limitation, the following:

- levying fines;
- revoking our business license;
- requiring us to restructure our corporate structure, operations or relationship with Guangzhou Netease or Guangyitong Advertising; and
- requiring us to discontinue any portion or all of our Internet business or our relationship with Guangzhou Netease or Guangyitong Advertising.

Any such action would have a material adverse effect on our business, financial condition and results of operations and on the holders of our ADSs.

Our business plan is based upon an unproven business model that may not be successful.

Our business plan is new and relatively unproven. The market for our technology and services is new and rapidly developing. Our business plan depends upon increased revenues generated from online advertising and e-commerce related services on the Netease Web sites. Online advertising and e-commerce in China are

unproven businesses. Many of our current and potential advertisers have limited experience with the Internet as an advertising medium. They have not traditionally devoted a significant portion of their advertising expenditures to Web-based advertising. They may not find the Internet effective for promoting their products and services relative to traditional print and broadcast media. Likewise, many of our current and potential merchant customers have limited experience with the Internet and online sales, distribution and fulfillment processes. They have not traditionally sold their products over the Internet. To be successful, we must develop and market products and services that either have achieved or are likely to achieve broad market acceptance by Internet users, online advertisers and e-commerce vendors in China.

You should not rely on our historical financial results as an indicator of future results.

We started as an Internet software developer and in mid-1998 changed our business focus to Internet technology. Within the last year, we expanded our Internet advertising operations and began to offer e-commerce platforms and to provide online auction services in China. As a result of these changes in our business, you should not rely on our historical results of operations and financial condition as an indicator of future results. For more information, see “Management’s Discussion and Analysis of Results of Operations and Financial Condition” on page 32.

Because the majority 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 revenues. Our advertising services revenues 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.

We may not be able to conduct our operations without the services provided by Guangzhou Netease and Guangyitong Advertising.

Our operations are currently dependent upon our commercial relationships with Guangzhou Netease and Guangyitong Advertising, and we derive most of our revenues from these companies. A portion of our revenues under our contracts with these companies are based upon arbitrary amounts that have been agreed upon in advance. 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 plan. Most of these agreements have a term of one year, and they may not be renewed in future years. In addition, Guangzhou Netease and Guangyitong Advertising 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.

Guangzhou Netease and Guangyitong Advertising are controlled by our controlling shareholder, who may cause these agreements to be amended in a manner that is adverse to us.

Our majority shareholder, William Lei Ding, is also the controlling shareholder of Guangzhou Netease and Guangyitong Advertising. As a result, Mr. Ding may be able to cause these agreements 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. Prior to this offering, a number of these agreements were recently amended to contain the terms that are described in this prospectus. Although we have entered into an agreement that prevents the amendment of these agreements without the approval of the members of our Board 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.

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

Both the continual accessibility of the Netease Web sites and the performance and reliability of our technical infrastructure are critical to our reputation and the ability of the Netease Web sites to attract and retain users and advertisers. Any system failure or performance inadequacy that causes 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 Web sites' appeal to users and advertisers. As the number of Netease Web pages and traffic increase, we cannot assure you that we will be able to scale our systems proportionately. In addition, any system failures and electrical outages could materially and adversely impact our business.

Computer viruses may cause delays or interruptions on our systems and may reduce visitor traffic and harm our reputation.

Computer viruses may cause delays or other service interruptions on our systems. In addition, the inadvertent transmission of computer viruses could expose us to a material risk of loss or litigation and possible liability. We may be required to expend significant capital and other resources to protect the Netease Web sites against the threat of such computer viruses and to alleviate any problems. Moreover, if a computer virus affecting our system is highly publicized, our reputation could be materially damaged and our visitor traffic may decrease.

Computer hacking could damage our systems and reputation.

Any compromise of security, such as computer hacking, could cause Internet usage to decline. "Hacking" involves efforts to gain unauthorized access to information or systems or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment. Hackers, if successful, could misappropriate proprietary information or cause disruptions in our service. We may have to spend significant capital and human resources to rectify any damage to our system. In addition, we cannot assure you that any measures we take against computer hacking will be effective. A well publicized computer security breach could significantly damage our reputation and materially adversely affect our business.

If our exclusive provider of bandwidth and server custody service fails to provide these services, our business could be materially curtailed.

We rely exclusively on China Telecom and its affiliates to provide us with bandwidth and server custody service for Internet users to access the Netease Web sites. If China Telecom or its affiliates fail to provide these 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.

If our exclusive provider of bandwidth and server custody service increases its prices, our results of operations would suffer.

Netease Beijing and Guangzhou Netease contract exclusively with China Telecom and its affiliates for bandwidth and server custody services. Pursuant to our contractual arrangements with Guangzhou Netease, we pay for bandwidth and server custody service costs incurred by Guangzhou Netease. We have no control over the costs of the bandwidth and server custody service provided by China Telecom and its affiliates. China Telecom or its affiliates may increase the price we pay for these services. If this happens, our operating costs may be higher than we anticipate and our results of operations would suffer.

If third party content providers fail to develop and maintain the content we need, the Netease Web sites could lose viewers and advertisers.

We rely on a number of third parties to create traffic and provide content in order to make the Netease Web sites more attractive to advertisers and consumers. Third parties providing content to the Netease Web

sites include both commercial content providers with which we have contractual relationships and our registered community members who post articles and other content on the Netease Web sites. If these third parties fail to develop and maintain high-quality content, the Netease Web sites could lose viewers and advertisers. Most of our contractual arrangements with third party content providers are not exclusive and are short-term or may be terminated at the convenience of either party. There can be no assurance that our existing relationships with commercial content providers will result in sustained business partnerships, successful service offerings, traffic on the Netease Web sites or revenues for us.

If third party advertisement serving technology fails, our advertising services revenues could decline.

We depend on third party proprietary and licensed advertisement serving technology to deliver advertisements to the Netease Web sites. Advertisement serving technology allows us to measure the demographics of our user base and the delivery of advertisements on the Netease Web sites. This technology is still developing. Advertisers may choose not to advertise on the Netease Web sites or may pay less for advertising if they do not perceive our ability to track and measure the demographics of our users or the delivery of advertisements to be reliable. If such advertisement serving technology becomes unavailable or fails to address our advertising needs properly, our advertising business may be materially and adversely affected and our advertising services revenues could decline.

If we cannot successfully run and manage our business, we will not be able to hire, integrate and retain key personnel.

We depend on the services of our executive officers and key employees. Our success will largely depend on our ability to retain our existing executive officers and key employees and to attract and retain qualified senior and middle level managers, as well as highly skilled technical, editorial, marketing and customer service personnel in the future. Competition for such personnel is intense. We cannot assure you that we will be able to attract or retain such personnel or that recently hired personnel or any personnel we hire in the future will successfully integrate into our organization or ultimately contribute positively to our business. The loss of any of our senior executive officers, or the failure of any of our recently hired executive officers, to integrate into our operations, would significantly harm our business. In particular, our success depends on the continued efforts of William Lei Ding, our Chairman of the Board, Co-Chief Technology Officer and majority shareholder. We do not maintain key person life insurance on any of our employees.

We may be held liable for information displayed on, retrieved from or linked to the Netease Web sites.

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 Web sites. We also could be subject to claims based upon content that is accessible on the Netease Web sites such as content and materials posted by users on message boards, online communities, voting systems, email or chat rooms that are offered on the Netease Web sites. By providing technology for hypertext links to third-party Web sites, 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. For example, we post credit evaluations of our users based upon information provided to us by users of our auction services. Such credit evaluation postings could be subject to claims that such information is inaccurate or defamatory. 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 service.

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

We may be subject to product liability claims because of our e-commerce services.

There is the potential for product liability, warranty, commodity fraud and similar claims against us by users who purchase goods and services through our e-commerce services. We do not carry insurance to cover these kinds of claims.

Information displayed on, retrieved from or linked to the Netease Web sites may subject us to claims of violating Chinese laws.

Violations or perceived violations of Chinese laws arising from information displayed on, retrieved from or linked to the Netease Web sites could result in significant penalties, including a temporary or complete cessation of our business. Recently, Chinese government agencies have announced restrictions on the transmission of “state secrets” through the Internet. “State secrets” has been broadly interpreted by Chinese governmental authorities in the past. We may be liable under these new pronouncements for content and materials posted or transmitted by users on message boards, virtual communities, chat rooms or e-mails. The Ministry of National Security and the Ministry of Public Security have authority to cause any local Internet service provider to block any Web site. These ministries have, in the past, stopped the online distribution of information that they believed to be socially destabilizing or politically improper. If the Chinese government takes any action to limit or eliminate the distribution of information through the Netease Web sites, or to limit or regulate any current or future community functions available to users or otherwise block the Netease Web sites, our business would be significantly harmed.

Privacy concerns may prevent us from selling demographically targeted advertising in the future which could make the Netease Web sites less attractive to advertisers.

We collect personal data from our registered users in order to better understand users and their needs. We intend to provide this data to online advertisers to enable them to target specific demographic groups. If privacy concerns or regulatory restrictions prevent us from collecting this information or from selling demographically targeted advertising, the Netease Web sites may be less attractive to advertisers.

Security and confidentiality concerns may impede our e-commerce services and our growth.

A significant barrier to e-commerce has been public concern over security and privacy of confidential information transmitted over the Internet. If this concern is not adequately addressed, it may inhibit the growth of the Internet as a means of conducting commercial transactions. In addition, China’s regulation of encryption technology is still evolving, and it is possible that such regulations may limit the methods of encryption that we can employ. If a well-publicized breach of Internet security were to occur, general Internet usage could decline, which could reduce traffic to the Netease Web sites and impede our growth.

Until China’s Trademark Office issues actual trademark registration certificates, there may be uncertainty with respect to our legal rights to the “网易” marks.

China’s trademark law adopts a “first-to-file” system for obtaining trademark rights. As a result, the first applicant to file an application for registration of a mark will preempt all other applicants. Prior use of an unregistered mark is generally irrelevant except for “well known” marks.

Guangzhou Netease has filed with China’s Trademark Office trademark applications for marks incorporating the word “Netease” in English and the mark “网易” (“Netease” as written in Chinese) in traditional and simplified Chinese characters. Guangzhou Netease has agreed to transfer these trademarks to us when they are issued. However, until actual registration certificates are issued by the Trademark Office, we may not be able to successfully defend or claim any legal rights in these marks.

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 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 to prevent unauthorized parties from copying or otherwise obtaining and using our technology. Monitoring unauthorized use of our products is difficult and costly, and we cannot be certain that the steps we take will effectively prevent misappropriation of our technology.

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, third parties may initiate litigation against us for alleged infringement of their proprietary rights. In the event of a successful claim of infringement and our failure or inability to develop non-infringing technology or license the infringed or similar technology on a timely basis, our business could suffer. Moreover, even if we are able to license the infringed or similar technology, license fees that we pay to licensors could be substantial or economically unviable.

If we cannot manage our growth effectively, our business may suffer.

Our rapid growth has placed and continues to place a significant strain on our resources. We may not be able to manage our growth effectively. If we make mistakes in operating our business, our operating results may fluctuate and cause the price of our ADSs to decline. The number of our employees has grown from ten at December 31, 1998 to 199 at May 31, 2000. In addition, Guangzhou Netease had 45 employees at May 31, 2000. We plan to continue to hire new employees to expand our operations significantly and to pursue existing and potential market opportunities. This growth will place a significant demand on our management and our operational resources. In order to manage growth effectively, we must implement and improve our operational systems, procedures and controls on a timely basis. If we cannot manage growth effectively, our business may suffer.

If we cannot obtain sufficient funds to meet our capital requirements and to grow our business, we may be forced to delay deployment of services or curtail or cease our operations.

Our capital requirements are difficult to plan in our rapidly changing industry. As our business continues to grow, we expect to have substantial future capital requirements to further develop and improve our existing services and to expand our business. Because we are likely to generate losses for the foreseeable future, we will need significant external financing to fund our operations. Our ability to obtain additional financing depends on a number of factors, such as market conditions and our operating performance. There can be no assurance that we will be able to obtain additional financing in a timely manner and upon acceptable terms, if at all. If we fail to obtain necessary funds upon acceptable terms, we may be forced to delay the deployment of our services or otherwise curtail or cease our operations.

We may become a passive foreign investment company, which could result in adverse U.S. tax consequences to U.S. investors.

Based upon the nature of our income and assets, we may be classified as a passive foreign investment company, or PFIC, by the United States Internal Revenue Service, or IRS, for U.S. federal income tax purposes. Such characterization could result in adverse U.S. tax consequences to you if you are a U.S. investor. For example, if we are a PFIC, our U.S. investors will become subject to increased tax liabilities under U.S. tax laws and regulations and will become subject to burdensome reporting requirements. The determination of whether or not we are a PFIC will be made on an annual basis and will depend 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 if 50% or more of our assets, based on an annual quarterly average, are passive assets, or 75% or more of our annual gross income is derived from passive assets. The calculation of goodwill will be based, in

part, on the then market value of our ADSs, which is subject to change. In addition, the composition of our income and assets will be affected by how we spend the cash we raise in this offering. We cannot assure you that we will not be a PFIC for the current or any future taxable year. See “Taxation—United States Federal Income Taxation—U.S. Holders—Passive Foreign Investment Company” on page 83.

If our subsidiaries are restricted from paying dividends to us, our primary internal source of funds would decrease.

We are a holding company with no significant assets other than our equity interests in Netease Beijing, our wholly owned subsidiary. As a result, our primary internal source of funds is dividend payments from Netease Beijing. If Netease Beijing incurs debt on its own behalf in the future, the instruments governing the debt may restrict Netease Beijing’s ability to pay dividends or make other distributions to us, which in turn would limit our ability to pay dividends on our shares and ADSs. Under current Chinese tax regulations, dividends paid to us are not subject to Chinese income tax. 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, Netease Beijing is also required to set aside a portion of its net income each year to fund certain reserve funds. These reserves are not distributable as cash dividends.

Risks Related to Doing Business in China

Slow-down of the Chinese economy may slow down our growth and profitability.

The growth of the Chinese economy has been uneven across geographic regions and economic sectors. Such growth has been slowing recently. There can be no assurance that growth of the Chinese economy will not continue to decrease or that any slow down will not have a negative effect on our business. The Chinese economy is experiencing deflation, which may continue in the foreseeable future. The Chinese economy overall affects our profitability as expenditures for advertisements and e-commerce services may decrease due to slowing domestic demand.

Government regulation of the Internet may become more burdensome.

Government regulation of the Internet industry is burdensome and may become more burdensome. New regulations could increase our costs of doing business and prevent us from efficiently delivering our products and services over the Internet. These regulations may stop or slow down the expansion of our customer and user base and limit the access to the Netease Web sites. In addition to new laws and regulations, existing laws not currently applicable to the Internet industry may be applied to the Internet.

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 little 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 20 years has significantly enhanced the protections afforded to foreign invested enterprises in China. However, 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, including you.

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 Cooperation and Development, or 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.

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.

Fluctuation in the exchange rate between the U.S. dollar and the renminbi could adversely affect the value of our ADSs and any cash dividend declared on them.

Fluctuations in the currency exchange rate between the U.S. dollar and the renminbi could adversely affect the U.S. dollar value of our ADSs. Because holders of our ADSs may elect to receive cash dividends, if any, in U.S. dollars, fluctuations in the exchange rate could also affect the value of any cash dividend declared in renminbi and paid in U.S. dollars. In addition, because our revenues are primarily denominated in renminbi, our valuation could be materially and adversely impacted by the devaluation of the renminbi if U.S. investors analyze our value based on the U.S. dollar equivalent of our financial condition and results of operations.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

Because almost all of our future revenues may be in the form of renminbi, any future restrictions on currency exchanges may limit our ability to use revenue generated in renminbi to fund our business activities outside China or to make dividend payments in U.S. dollars. Although the Chinese government introduced regulations in 1996 to allow greater convertibility of the renminbi for current account transactions, significant restrictions still remain. We cannot be certain that the Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the renminbi, especially with respect to foreign exchange transactions.

Risks Related to the Internet Industry in China

The Internet market has not been proven as an effective commercial medium in China.

The market for Internet products and services in China has only recently begun to develop. The number of Internet users and the Internet penetration rate in China are, and are expected to continue to be, significantly lower than those in the United States and other developed countries. Since the Internet is an unproven medium for commerce in China, our future operating results from online advertising and e-commerce services will depend substantially upon the increased use and acceptance of the Internet for collection of information, distribution of products and services, delivery of advertisements and facilitation of commerce in China.

The Internet may not become a viable commercial marketplace in China for various reasons in the foreseeable future. More salient impediments to Internet development in China include:

- consumer dependence on traditional means of commerce;
- inexperience with the Internet as an advertising medium or sales and distribution channel;

- competition from other forms of media such as broadcast and print;
- inadequate development of the necessary infrastructure to facilitate e-commerce;
- concerns about security, reliability, cost, ease of deployment, administration and quality of service associated with conducting business over the Internet; and
- inexperience with credit card usage or with other means of electronic payment.

If the Internet is not widely accepted as a medium for advertising and e-commerce in China, our business prospects will be adversely affected.

Underdeveloped telecommunications infrastructure may limit the growth of the Internet market in China.

The telecommunications infrastructure in China is not well developed. Although private sector Internet service providers exist in China, almost all access to the Internet is maintained through ChinaNet, currently owned by China Telecom, under the administrative control and regulatory supervision of China's Ministry of Information Industry. In addition, the government's interconnecting national networks connect to the Internet through a government-owned international gateway. This international gateway is the only channel through which a domestic Chinese user can connect to the international Internet network. We rely on this infrastructure and China Telecom to provide data communications capacity primarily through local telecommunications lines. Although the government has announced plans to develop aggressively the national information infrastructure, we cannot assure you that this infrastructure will be developed. In addition, we will have no access to alternative networks and services, on a timely basis if at all, in the event of any infrastructure disruption or failure. The Internet infrastructure in China may not support the demands associated with continued growth in Internet usage.

The undeveloped online payment systems in China may restrict our ability to develop our e-commerce service business.

Online payment systems in China are in a developmental stage and are not as widely available or acceptable to consumers in China as in the United States and elsewhere. Although major Chinese banks are instituting online payment systems, these systems are still at an early stage. In addition, a limited number of consumers in China have credit cards or debit cards. The lack of adequate online payment systems may limit the number of e-commerce transactions that we can service and may increase the risk of non-payment for transactions effected through our e-commerce platform. If online payment services do not develop, our ability to grow our e-commerce business would be limited.

The limited use of personal computers in China limits our pool of potential customers and restricts the growth of our business.

We believe the market penetration rates of personal computers and online access in China are far lower than such rates worldwide. Alternate methods of obtaining access to the Internet, such as through cable television modems or set-top boxes for televisions, are not widely available in China at present. There can be no assurance that the number or penetration rate of personal computers in China will increase rapidly or at all or that alternate means of accessing the Internet will develop and become widely available in China. If significant numbers of Chinese consumers are unable to access the Internet, our ability to grow our business would be impeded.

The relatively high cost of accessing the Internet in China limits our potential customer base and restricts the growth of our business.

Our growth is limited by the relatively high cost to Chinese consumers of obtaining the hardware, software and communications links necessary to connect to the Internet in China. If the costs required to access

the Internet do not significantly decrease, most of China's population will not be able to afford to use our services. The failure of a significant number of additional Chinese consumers to obtain affordable access to the Internet would make it difficult to grow our business.

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. Barriers to entry are minimal, and current and new competitors can launch new Web sites at a relatively low cost. Many companies offer competitive products or services including Chinese language-based Web search, retrieval and navigation services and extensive Chinese language content, informational and community features and e-mail. In addition, as a consequence of China's attempt to join the World Trade Organization, the Chinese government may lift or reduce restrictions on foreign or foreign-invested enterprises to permit their investment and participation in telecommunications businesses, including Internet businesses, in China.

Currently, our competition comes from Chinese language-based Web search and retrieval companies as well as U.S.-based portal companies. Some of our current and potential competitors are much larger and better capitalized than we are, and currently offer, and could further develop or acquire, content and services that compete with the Netease Web sites. We also face competition from Internet service providers, Web site operators and providers of Web browser software that incorporate search and retrieval features. Any of our present or future competitors may offer products and services that provide significant performance, price, creativity or other advantages over those offered by us and, therefore, achieve greater market acceptance than ours.

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. Any increased competition could reduce page views, make it difficult for us to attract and retain users, reduce or eliminate our market share, lower our profit margins and reduce our advertising revenues.

Risks Related to this Offering

One shareholder will control the outcome of shareholder votes after this offering.

Currently, our founder, Chairman of the Board and Co-Chief Technology Officer, William Lei Ding, beneficially owns approximately 68.7% of our outstanding ordinary shares, and after the offering will beneficially own approximately 58.5% of our outstanding ordinary shares. Accordingly, Mr. Ding will control the outcome of any corporate transaction or other matter submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets. He will also have the power to prevent or cause a change in control.

If an active trading market for our ADSs does not develop, the price of our ADSs may suffer and may decline below the initial offering price.

Prior to the offering, there has been no public market for our ordinary shares or ADSs. The initial price to the public for our ADSs will be determined by negotiations between us and our underwriters and may not be indicative of the price at which ADSs will trade following the completion of the offering. We cannot assure you that an active trading market will develop or be sustained following the completion of the offering, or that the market price of our ADSs will not decline below the initial offering price.

Market fluctuations may adversely affect the market price of our ADSs.

The securities markets have from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our ADSs.

The sale by our existing shareholders of a substantial number of our ADSs in the public market could adversely affect the price of our ADSs.

Immediately after the completion of the offering, we will have 3,010,555,600 ordinary shares outstanding, including 4,500,000 ADSs, representing 450,000,000 ordinary shares, sold in this offering. Our ADSs sold in this offering will be eligible for immediate resale in the public market without restrictions and those held by our existing shareholders may also be sold in the public market in the future pursuant to, and subject to the restrictions contained in, Rule 144 under the Securities Act and applicable lock-up agreements. If any existing shareholder or shareholders sell a substantial amount of ADSs, the prevailing market price for our ADSs could be adversely affected.

You will experience immediate and substantial dilution in the book value of ADSs purchased.

The initial public offering price per ADS is substantially higher than the net tangible book value per ADS prior to the offering. Accordingly, when you buy our ADSs in the offering, at the initial public offering price of US\$15.50 per ADS, you will incur an immediate dilution of US\$11.55 per ADS. See “Dilution” on page 27.

You may face difficulties in protecting your interests, and our ability to protect our rights through the U.S. federal courts may be limited, because we are incorporated under Cayman Islands law.

Our corporate affairs are governed by our memorandum and articles of association and by the Companies Law (1998 Revision) and common law of the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the U.S., and provides significantly less protection to investors. Therefore, our public shareholders may have more difficulties in protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States. In addition, Cayman Islands companies may not have standing to sue before the federal courts of the United States. As a result, our ability to protect our interests if we are harmed in a manner that would otherwise enable us to sue in a United States federal court may be limited.

Your ability to bring an action against us or against our directors and officers, or to enforce a judgment against us or them, will be limited because we are incorporated in the Cayman Islands, because we conduct a substantial portion of our operations in China and because the majority of our directors and officers reside outside of the U.S.

We are incorporated in the Cayman Islands, and we conduct a substantial portion of our operations in China through Netease Beijing. Most of our directors and officers reside outside of the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the Cayman Islands or in China in the event that you believe that your rights have been infringed under the securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the Cayman Islands and of China may render you unable to enforce a judgment against our assets or the assets of our directors and officers. For more information regarding the relevant laws of the Cayman Islands and China, see “Enforcement of Civil Liabilities” on page 29.

We have not determined any specific use for a significant portion of the proceeds from this offering and we may use the proceeds in ways with which you may not agree.

We have not allocated the majority of the net proceeds of this offering to any particular purpose. Rather, our management will have considerable discretion in the application of the net proceeds received by us. You will not have the opportunity, as part of your investment decision, to assess whether the proceeds are being used appropriately. You must rely on the judgment of our management regarding the application of the net proceeds of this offering. The net proceeds may be used for corporate purposes that do not improve our efforts to achieve profitability or increase our stock price. The net proceeds from this offering may be placed in investments that do not produce income or that lose value.

**FORWARD-LOOKING STATEMENTS CONTAINED IN THIS PROSPECTUS
MAY NOT PROVE TO BE ACCURATE**

Many statements made in this prospectus under the captions “Prospectus Summary,” “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Business” and elsewhere are forward-looking statements that reflect our current expectations and views of future events. These forward-looking statements can be identified by words or phrases such as “may,” “will,” “expect,” “anticipate,” “estimate,” “plan,” “believe,” “is/are likely to” or other similar expressions. The forward-looking statements included in this prospectus relate to, among others:

- our goals and strategies;
- our future business development, results of operations and financial condition;
- the expected growth of and expected changes in the Internet industry, in the demand for Internet and Internet-related technologies and services, and in the market place;
- competition in China; and
- Chinese governmental policies regarding the Internet and information industry.

These forward-looking statements involve risks and uncertainties. There are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including those discussed under “Risk Factors.”

This prospectus contains data related to our market and the Internet. These market data include projections that are based on a number of assumptions. These assumptions include, among others, that:

- no significant failure of the Internet will occur;
- the number of people online in China and the total number of hours spent online will increase significantly over the next three to four years;
- the personal computer penetration rate in China will increase significantly over the next three to four years;
- the value of online advertising expenditures spent will increase significantly in China; and
- Internet security and privacy concerns will be adequately addressed.

If any one or more of the foregoing assumptions turns out to be incorrect, actual results may differ from the projections based on these assumptions. We therefore advise that you do not place undue reliance on these forward-looking statements.

The Internet-related markets may not grow at the rates projected by market data, or at all. The failure of these markets to grow at the projected rates may have a material adverse effect on our business and the market price of our ADSs. In addition, the relatively new and rapidly changing nature of the Internet industry subjects any projections or estimates relating to the growth prospects or future condition of the Internet-related markets to significant uncertainties.

The forward-looking statements made in this prospectus relate only to events or information as of the date on which the statements are made in this prospectus. Except as otherwise required by the securities laws of the United States, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

USE OF PROCEEDS

We estimate that the net proceeds from this offering, after deducting underwriting discounts and the estimated offering expenses payable by us and assuming no exercise of the over-allotment options, will be approximately US\$62.6 million, based upon the initial offering price of US\$15.50 per ADS.

The principal purpose of this offering is to increase our working capital. As of the date of this prospectus, we have not allocated any specific portion of the net proceeds to any particular purpose although we intend to use the net proceeds for such purposes as increasing our bandwidth, hiring additional personnel, expanding our marketing operations and capital expenditures such as hardware. We anticipate allocating a portion of the net proceeds as follows:

- US\$15 million to marketing;
- US\$1 million to content development;
- US\$3 million to server and bandwidth expenditures; and
- US\$2 million to research and development.

Accordingly, our management will have significant flexibility in applying the net proceeds of the offering. We may also use a portion of the proceeds to acquire or invest in complementary businesses, products and technologies; however, we currently have no commitments or agreements with respect to any such transaction.

Pending use of the net proceeds, we intend to invest our net proceeds in short-term, interest bearing, U.S. government securities or hold them in short-term bank deposits. These investments may have a material adverse effect on the U.S. federal income tax consequences of your investment in our ADSs. It is possible that we may become a passive foreign investment company for United States federal income tax purposes, which could result in negative tax consequences for you. These consequences are described in more detail in “Risk Factors—Risks Related to Our Company—We may become a passive foreign investment company, which could result in adverse U.S. tax consequences to U.S. investors” and “Taxation—United States Federal Income Taxation—U.S. Holders—Passive Foreign Investment Company.”

DIVIDEND POLICY

We have never declared or paid cash dividends on our ordinary shares. We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends on our ordinary shares, or indirectly on our ADSs, for the foreseeable future. Investors seeking cash dividends should not purchase our ADSs.

Future cash dividends, if any, will be at the discretion of our board of directors and will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors as the board of directors may deem relevant. Any dividend we declare will be paid to the holders of ADSs, subject to the terms of the deposit agreement, to the same extent as holders of our ordinary shares, less the fees and expenses payable under the deposit agreement. Other distributions, if any, will be paid by the depositary to holders of our ADSs in any means it deems legal, fair and practical. Any dividend will be distributed by the depositary, in the form of cash or additional ADSs, to the holders of our ADSs. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars. See “Description of American Depositary Shares” on page 74.

CAPITALIZATION

The following table sets forth, as of December 31, 1999:

- our actual capitalization;
- our capitalization on a pro forma basis to reflect the issuance and sale of 2,560,556 Series B preference shares in March, 2000 and the conversion of our outstanding Series A and Series B preference shares into ordinary shares that will occur upon the consummation of this offering; and
- our capitalization as adjusted to give effect to the issuance and sale of 4,500,000 ADSs offered hereby at the initial public offering price of US\$15.50 per ADS, after deducting underwriting discounts, commissions and estimated offering expenses.

The renminbi amounts of the par value of ordinary shares and Series A and Series B preference shares have been translated using the historical exchange rates prevailing on the dates of contribution. The corresponding U.S. dollar amounts have been translated from the renminbi amounts for convenience purposes based on the exchange rate at December 31, 1999, which is different from the historical exchange rates.

Additional paid-in capital includes an amount of RMB45,413,399 arising from an agreement by our majority shareholder to transfer 109,694,200 ordinary shares beneficially owned by our founder, Chairman of the Board, and Co-Chief Technology Officer, William Lei Ding, to certain senior management personnel and key employees and represents the fair market value of these shares on the date of such agreement. These share transfers were effected in January 2000. Additional paid-in capital also includes an amount of RMB10,876,318 arising from an agreement by our majority shareholder to transfer 26,271,300 ordinary shares beneficially owned by William Lei Ding to certain of these individuals for services to be rendered by them over three years starting from January 1, 2000. These share transfers are to be effected on January 1, 2001, 2002 and 2003 upon completion of each full year of service. The total estimated fair value of these shares valued at US\$0.05 per share at the date of grant is recognized as deferred compensation which will be amortized over the related vesting periods. In addition, additional paid-in capital also includes an amount of RMB866,864 arising from the grant of options to acquire 3,000,000 ordinary shares to our advisory board members for services to be rendered by them over two years starting from the end of 1999.

You should read this table in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes, included elsewhere in this prospectus.

	As of December 31, 1999					
	Actual		Pro Forma		Pro Forma	Pro Forma
	RMB	US\$	RMB	US\$	As Adjusted	As Adjusted
				RMB	US\$	
Cash	117,800,096	14,227,924	407,582,596	49,227,924	926,024,187	111,845,424
Shareholders’ equity:						
Ordinary shares,						
US\$0.0001 par value;						
999,740,000,000 shares						
authorized:						
2,004,500,000 shares						
issued and outstanding						
actual; 2,560,555,600						
shares issued and						
outstanding pro forma;						
3,010,555,600 shares						
issued and outstanding						
pro forma as adjusted	1,659,447	200,429	2,119,790	256,029	2,492,368	301,029
Series A convertible						
preference shares,						
US\$0.01 par value;						
3,000,000 shares						
authorized issued and						
outstanding actual; zero						
shares authorized and						
outstanding pro forma						
and pro forma as						
adjusted	248,367	29,998	—	—	—	—
Series B convertible						
preference shares,						
US\$0.01 par value: zero						
shares authorized, issued						
and outstanding actual,						
pro forma and pro forma						
as adjusted (2,600,000						
shares authorized and						
2,560,556 shares issued						
and outstanding prior to						
conversion).....	—	—	—	—	—	—
Additional paid-in capital	197,604,001	23,866,658	528,572,025	63,841,056	1,046,641,039	126,413,556
Deferred compensation.....	(11,743,182)	(1,418,344)	(11,743,182)	(1,418,344)	(11,743,182)	(1,418,344)
Accumulated deficit.....	(51,703,393)	(6,244,748)	(51,703,393)	(6,244,748)	(51,703,393)	(6,244,748)
Total shareholders’ equity ..	<u>136,065,240</u>	<u>16,433,993</u>	<u>467,245,240</u>	<u>56,433,993</u>	<u>985,686,832</u>	<u>119,051,493</u>
Total capitalization	<u>136,065,240</u>	<u>16,433,993</u>	<u>467,245,240</u>	<u>56,433,993</u>	<u>985,686,832</u>	<u>119,051,493</u>

DILUTION

Our net tangible book value as of December 31, 1999 was approximately US\$56.4 million, or US\$0.022 per ordinary share, and \$2.20 per ADS. Net tangible book value per ordinary share is determined by dividing our net tangible book value by the number of outstanding ordinary shares. Our net tangible book value is determined by subtracting the value of our intangible assets and total liabilities from our total assets. Dilution is determined by subtracting net tangible book value per ordinary share from the assumed public offering price per ordinary share. The number of ordinary shares used to calculate dilution assumes the conversion of our outstanding Series A and Series B preference shares into ordinary shares that will occur upon the consummation of this offering.

Without taking into account any other changes in such net tangible book value after December 31, 1999, other than to give effect to our sale of Series B preference shares, convertible into 256,055,600 ordinary shares, in March 2000 at the equivalent of US\$0.156 per ordinary share, and \$15.62 per ADS, and our sale of the 4,500,000 ADSs offered in this offering, at the initial public offering price of US\$15.50 per ADS and after deduction of underwriting discounts and commissions and estimated offering expenses, our as adjusted net tangible book value at December 31, 1999 would have been US\$119.1 million, US\$0.040 per outstanding ordinary share, including ordinary shares underlying our outstanding ADSs, and \$3.95 per ADS. This represents an immediate increase in net tangible book value of US\$0.018 per ordinary share, or \$1.75 per ADS, to existing shareholders and an immediate dilution in net tangible book value of US\$0.115 per ordinary share, or \$11.55 per ADS, to purchasers of ADSs in this offering. The following table illustrates this per ordinary share dilution, assuming all ADSs are exchanged for ordinary shares:

Initial public offering price per ordinary share	<u>US\$0.155</u>
Pro forma tangible book value per ordinary share at December 31, 1999, assuming conversion of Series A and Series B preference shares	0.022
Increase in net tangible book value per ordinary share attributable to price paid by new investors.....	<u>0.018</u>
Net tangible book value per ordinary share after the offering.....	0.040
Dilution in net tangible book value per ordinary share to new investors in the offering.....	<u>US\$0.115</u>
Dilution in net tangible book value per ADS to new investors in the offering.....	<u>US\$11.55</u>

The following table summarizes on a pro forma basis the differences as of December 31, 1999 between the shareholders at our most recent fiscal year end and the new investors with respect to the number of ordinary shares purchased from us, the total consideration paid and the average price per ordinary share paid.

The total ordinary shares do not include the following:

- 675,000 ADSs (all or a portion of which may be in the form of ordinary shares) issuable pursuant to the exercise of over-allotment options granted to the underwriters;
- options outstanding as of May 11, 2000 to purchase 283,668,000 ordinary shares at a weighted average exercise price of US\$0.088 per ordinary share, issued pursuant to our stock incentive plan; and
- 62,007,000 ordinary shares reserved as of May 11, 2000 for issuance upon the exercise of options that may be granted in the future pursuant to our stock incentive plan.

	Ordinary Shares Purchased		Total Consideration		Average Price Per Ordinary Share Equivalent	Average Price Per ADS Equivalent
	Number	Percent	Amount	Percent		
			(US\$)			
Existing shareholders.....	2,560,555,600	85.1	57,223,000	45.1	0.022	2.23
New investors	450,000,000	14.9	69,750,000	54.9	0.155	15.50
Total	3,010,555,600	100.0	126,973,000	100.0	0.042	4.22

To the extent that any of the outstanding options are exercised, there will be further dilution to new investors.

CONVENTIONS WHICH APPLY TO THIS PROSPECTUS

Unless we indicate otherwise, all information in this prospectus reflects the following:

- no exercise by the underwriters of their over-allotment options to purchase up to 675,000 additional ADSs representing 67,500,000 ordinary shares;
- conversion of all outstanding Series A and Series B preference shares to ordinary shares upon the closing of this offering;
- a 100 for one stock split of our ordinary shares effected in March 2000; and
- no exercise of outstanding employee stock options.

EXCHANGE RATE INFORMATION

Our business is currently conducted in and from China in renminbi. Periodic reports will be made to shareholders and will be expressed in U.S. dollars using the then current exchange rates. In this prospectus, all references to renminbi, yuan and RMB are to the legal currency of China and all references to U.S. dollars, dollars, \$ and US\$ are to the legal currency of the United States. The conversion of renminbi into U.S. dollars in this prospectus is based on the noon buying rate in The City of New York for cable transfers of renminbi as certified for customs purposes by the Federal Reserve Bank of New York. For your convenience, this prospectus contains translations of some renminbi or U.S. dollar amounts for 1999 at US\$1.00: RMB8.2795, which was the prevailing rate on December 31, 1999. The prevailing rate at May 1, 2000 was US\$1.00: RMB8.2799. We make no representation that any renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or renminbi, as the case may be, at any particular rate, the rates stated below, or at all. The Chinese government imposes control over its foreign currency reserves in part through direct regulation of the conversion of renminbi into foreign exchange and through restrictions on foreign trade. The exchange rate from U.S. dollar to renminbi has fluctuated between a range of US\$1.00: RMB8.2770 and US\$1.00: RMB8.5000 over the past five years.

The following table sets forth various information concerning exchange rates between the renminbi and the U.S. dollar for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this prospectus or will use in the preparation of our periodic reports or any other information to be provided to you. The source of these rates is the Federal Reserve Bank of New York. Average exchange rates during the period are calculated by averaging the rates on the last business day of each month during the relevant period.

Exchange Rate: RMB per US\$1.00	For the Year Ended December 31,				
	1995	1996	1997	1998	1999
Exchange rate at end of period.....	8.3374	8.3284	8.3100	8.2789	8.2795
Average exchange rate during period.....	8.3685	8.3395	8.3193	8.2969	8.2785
Highest exchange rate during period.....	8.4584	8.5000	8.3290	8.3180	8.2800
Lowest exchange rate during period	8.3203	8.3267	8.2911	8.2774	8.2770

ENFORCEMENT OF CIVIL LIABILITIES

We are incorporated in the Cayman Islands because of the following benefits found there:

- political and economic stability;
- an effective judicial system;
- a favorable tax system;
- the absence of exchange control or currency restrictions; and
- the availability of professional and support services.

However, certain disadvantages accompany incorporation in the Cayman Islands. These disadvantages include:

(1) the Cayman Islands has a less developed body of securities laws as compared to the United States and provides significantly less protection to investors; and

(2) Cayman Islands companies may not have standing to sue before the federal courts of the United States.

Our constituent documents do not contain provisions requiring that disputes, including those arising under the securities laws of the United States, between us, our officers, directors and shareholders be arbitrated.

A substantial portion of our current operations is conducted in China through Netease Beijing, our wholly-owned Chinese subsidiary. All or most of our assets are located in China. We have appointed CT Corporation System, 111 Eighth Avenue, New York, NY 10011, as our agent upon whom process may be served in any action brought against us under the securities laws of the United States. A majority of our directors and officers are nationals or residents of jurisdictions other than the United States and a substantial portion of their assets are located outside the United States. As a result, it may be difficult for a shareholder to effect service of process within the United States upon these persons, or to enforce against us or them judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States.

Maples and Calder Asia, our counsel as to Cayman Islands law, and Commerce & Finance Law Office, our counsel as to Chinese law, have advised us that there is uncertainty as to whether the courts of the Cayman Islands or China would:

(1) recognize or enforce judgments of United States courts obtained against us or our directors or officers predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States; or

(2) entertain original actions brought in the Cayman Islands or China against us or our directors or officers predicated upon the securities laws of the United States or any state in the United States.

Maples and Calder Asia has further advised us that a final and conclusive judgment in the federal or state courts of the United States under which a sum of money is payable, other than a sum payable in respect of taxes, fines, penalties or similar charges, may be subject to enforcement proceedings as a debt in the courts of the Cayman Islands under the common law doctrine of obligation.

Commerce & Finance Law Office has advised us further that the recognition and enforcement of foreign judgments are provided for under Chinese Civil Procedures Law. Chinese courts may recognize and enforce foreign judgments in accordance with the requirements of Chinese Civil Procedures Law based either on treaties between China and the country where the judgment is made or on reciprocity between jurisdictions.

SELECTED CONSOLIDATED FINANCIAL DATA

The following table presents the selected consolidated financial information for our business. You should read the following information in conjunction with the section of this prospectus entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes beginning on page F-1 of this prospectus, which were prepared in accordance with U.S. GAAP.

The following data have been derived from our audited consolidated financial statements and should be read in conjunction with those statements, which are included in this prospectus beginning on page F-1. The pro forma per share data give effect to the conversion of our outstanding Series A preference shares into ordinary shares that will occur upon the consummation of this offering. The pro forma per share data does not give effect to the issuance of 2,560,556 Series B preference shares of par value US\$0.01 each, which took place after December 31, 1999. For additional information regarding the pro forma data, see “Capitalization” on page 25.

	From June 24, 1997 (inception) to December 31, 1997	For the Year Ended December 31,		
	RMB	1998 RMB	1999 RMB	1999 US\$
Statement of Operations Data:				
Revenues:				
Advertising services (including revenues from related parties).....	—	172,850	10,796,074	1,303,953
Software licensing and related integration projects	100,000	2,942,582	3,515,831	424,643
E-commerce related services	—	—	2,459,101	297,011
Total revenues	100,000	3,115,432	16,771,006	2,025,607
Sales and value-added taxes	(6,600)	(230,749)	(1,150,169)	(138,918)
Net revenues.....	93,400	2,884,683	15,620,837	1,886,689
Cost of revenues:				
Advertising and e-commerce related services	(13,614)	(242,657)	(11,837,416)	(1,429,726)
Software licensing and related integration projects	(55,000)	(946,351)	(258,819)	(31,260)
Total cost of revenues	(68,614)	(1,189,188)	(12,096,235)	(1,460,986)
Gross profit.....	24,786	1,695,495	3,524,602	425,703
Operating expenses:				
Selling, general and administrative.....	(22,844)	(311,957)	(51,055,489)	(6,166,495)
Research and development	(8,000)	(951,000)	(5,735,170)	(692,695)
Total operating expenses.....	(30,844)	(1,262,957)	(56,790,659)	(6,859,190)
Operating profit (loss):	(6,058)	432,538	(53,266,057)	(6,433,487)
Other income (expenses):				
Sale of 163.net usage right	—	—	1,500,000	181,170
Interest income	289	5,719	357,160	43,138
Other, net.....	(289)	(71,056)	(494,018)	(59,668)
Income (loss) before tax	(6,058)	367,201	(51,902,915)	(6,268,847)
Provision for income tax.....	(1,000)	(34,464)	(71,338)	(8,616)
Net income (loss)	(7,058)	332,737	(51,974,253)	(6,277,463)

	From June 24, 1997 (inception) to December 31, 1997	For the Year Ended December 31,		
		1998	1999	1999
	RMB	RMB	RMB	US\$
Net income (loss) per share, basic and diluted.....	(0.01)	0.01	(0.03)	(0.01)
Net income (loss) per ADS, basic and diluted.....	(0.01)	0.02	(2.73)	(0.33)
Weighted average number of shares outstanding	1,868,817,200	1,868,817,200	1,900,430,600	1,900,430,600
Weighted average number of ADSs outstanding	18,688,172	18,688,172	19,004,306	19,004,306
Pro forma net income (loss) per ordinary share, basic and diluted.....	(0.01)	0.01	(0.02)	(0.01)
Pro forma net income (loss) per ADS, basic and diluted	(0.01)	0.02	(2.36)	(0.29)
Pro forma weighted average number of ordinary shares outstanding	1,868,817,200	1,868,817,200	2,200,430,600	2,200,430,600
Pro forma weighted average number of ADSs outstanding	18,688,172	18,688,172	22,004,306	22,004,306
Other Financial Data:				
Capital expenditures.....	187,770	1,083,248	9,312,383	1,124,752
Net cash provided by (used in):				
Operating activities	(261,823)	1,232,379	(15,687,474)	(1,894,737)
Investing activities	(187,770)	(1,083,248)	(9,312,383)	(1,124,752)
Financing activities	500,000	—	142,600,415	17,223,313
As of December 31,				
		1998	1999	
		RMB	RMB	US\$
Balance Sheet Data:				
Cash.....		199,538	117,800,096	14,227,924
Working capital (deficit)		(345,804)	126,556,803	15,285,562
Property, plant and equipment		1,171,483	9,508,437	1,148,431
Total assets		2,388,242	143,728,182	17,359,524
Total current liabilities		1,562,563	7,662,942	925,531
Total shareholders' equity.....		825,679	136,065,240	16,433,993

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included in this prospectus beginning on page F-1. Our consolidated financial statements and the financial data included in this prospectus reflect our reorganization and have been prepared as if our current corporate structure had been in existence throughout the relevant periods. The following discussion and analysis contain forward-looking statements that involve risks and uncertainties. For additional information regarding these risks and uncertainties, please see "Risk Factors" beginning on page 9.

Overview

Netease.com was incorporated in the Cayman Islands on July 6, 1999 as an Internet technology provider. Guangzhou Netease was organized on June 24, 1997 under the laws of China and is wholly owned by Chinese nationals. Our initial business objective was to develop large-scale distributed software systems for use on the Internet in China. In mid-1998, we changed our business model from a software developer to an Internet technology company and commenced developing the Netease Web sites. In September 1999 we restructured our operations. As part of this restructuring, all of Guangzhou Netease's fixed and intangible assets and existing Internet applications, services and technologies were acquired by Netease Beijing, our wholly owned subsidiary. In addition, the rights to use all of Guangzhou Netease's URLs were transferred to Netease.com.

Guangzhou Netease has been approved by the Chinese authorities to operate as an Internet content provider and operates the Netease Web sites. Guangzhou Netease's 80% owned subsidiary, Guangyitong Advertising, is licensed by the Chinese authorities to operate an advertising business and engages in Internet-related advertising design, production and dissemination. As the exclusive Internet technology provider to Guangzhou Netease, we provide a variety of Internet applications, technologies and services to support Guangzhou Netease's operation of the Netease Web sites and our e-commerce services. The technologies we provide to Guangzhou Netease include Chinese language-based online software and related technology, online advertising technology, portal technology and e-commerce technology. Our services to Guangzhou Netease and its subsidiary constitute substantially all of our operations.

We have entered into a series of contractual arrangements with Guangzhou Netease and Guangyitong Advertising with respect to the operation of the Netease Web sites and the provision of advertising services. For more information, see "Related Party Transactions" on page 66 of this prospectus.

Revenues

Our total revenues grew from RMB100,000 in 1997 (from June 24 to December 31) to RMB3.1 million in 1998 and RMB16.8 million (US\$2.0 million) in 1999. We generate our revenues from software licensing and related integration projects, advertising services and e-commerce related services. Because we started as an Internet software developer, software licensing and related integration projects accounted for a majority of our total revenues in 1997 and 1998. In mid-1998, we changed our business focus to Internet technology. The proportion of our total revenues attributable to software licensing and related integration projects decreased from 100% of our revenues in 1997 to 21.0% of our total revenues, or RMB3.5 million (US\$425,000), in 1999. In April 1999, we ceased licensing our software. Conversely, the proportion of our total revenues attributable to advertising services increased from zero in 1997 to 64.4% of our total revenues, or RMB10.8 million (US\$1.3 million), in 1999. Our advertising services revenues increased significantly in the second half of 1999 as a result of our expanded Internet advertising operations following our establishment of an advertising sales department in mid-1999. In July 1999, we began to offer e-commerce platforms and to provide online auction services in China. The total revenues generated by our e-commerce related services constituted 14.6% of our total revenues, or RMB2.5 million (US\$297,000), in 1999. We expect that, going forward, advertising and e-commerce related services will constitute the primary sources of our future revenues.

In 1998, sales of software licenses to Guangzhou Feihua Telecom Co., Ltd. and Jinhua Postal Bureau accounted for 12.8% and 12.5%, respectively, of our total revenues. In 1999, Internet advertising services to Top Result Promotion Ltd. and Bigsave Ltd. accounted for 14.1% and 12.3%, respectively, of our total revenues.

We derived 20.1% of our revenues in 1999 from barter transactions. In exchange for advertisements on the advertising media of our customers, we provide an equal amount in value of advertising to such customers on the Netease Web sites. We record our barter transactions at the estimated fair market value of the services received or estimated fair market value of the services provided, whichever is more readily determinable. In 1999, revenues derived from barter transactions were RMB3.4 million (US\$409,000). Of that amount, RMB2.4 million, or 70.0%, related to advertising services revenue from Top Result Promotion Ltd. As part of our marketing campaign in 1999, we purchased advertisements displayed on outdoor advertising media from Top Result in exchange for advertising space on the Netease Web sites that Top Result sold to its customers. We did not derive any of our revenues in 1997 or 1998 from barter transactions.

Advertising services revenues. We derive our advertising services revenues principally from fees we receive from advertisers on the Netease Web sites and the fees we earn from Guangyitong Advertising for services that we provide in connection with advertisements placed on the Netease Web sites and advertising-related technical consulting services.

Our advertising fees are derived principally from short-term advertising contracts. Revenues from these contracts are recognized ratably over the period in which the advertisement is displayed and collection of the resulting receivables is probable. Our obligations to the advertisers typically also include guarantees of a minimum number of impressions or times that an advertisement appears in pages viewed by users. As a result, to the extent that minimum guaranteed impressions are not met within the contractual time period, we defer recognition of the corresponding revenues until the remaining guaranteed impression levels are achieved.

We have entered into an agreement with Guangyitong Advertising under which we are the exclusive provider of advertising-related technical consulting services to Guangyitong Advertising, and under which we receive a service fee. Since December 1999, we have recognized advertising services revenues that we earn through this arrangement as services are rendered and the service revenues are earned under the agreement. The service fee that we charge includes substantially all of the advertising revenues of Guangyitong Advertising, net of a 5% business tax and a 3% cultural development fee that apply to these revenues.

Software licensing and related integration projects revenues. Software licensing and related integration projects revenues consist of fees received from customers for licenses that permit them to use our e-mail software products for a specified duration or in perpetuity. Substantially all of our software revenues are derived from our internally developed e-mail software products. Our software licensing and related integration projects revenues have historically also included revenues generated from related hardware sales. Our software licensing and related integration projects business includes such services as planning, design, system integration and customization of our proprietary and third party software products. We ceased licensing our software in April 1999.

We generally charge a fixed price for our e-mail software licensing products or a price that is readily determinable on the basis of a signed licensing agreement. We recognize our software licensing revenues upon delivery of our products if we do not have any significant post-delivery obligations. We generally provide our customers with one year of post-contract support on our software products. Such support typically includes hot line and on-call services we provide to our customers to maintain or upgrade the operation of the software products licensed. We occasionally agree to provide post-contract support services that extend beyond one year. In such event, we would recognize revenues for applicable contracts ratably over the terms of those contracts.

E-commerce related services revenues. Our e-commerce related services revenues are derived principally from various service contracts for Web site construction, market surveys, auctions and news publishing conducted through the Internet. Our online auction sellers, whether businesses or consumers, typically pay us an auction commission upon consummation of the sale. The auction commission is based on the selling price of the product sold online and may vary depending upon the product sold. We also sometimes

charge our online auction sellers a fixed one-time registration fee for posting their products on the Netease Web sites. We recognize our e-commerce related services revenues as follows:

- (1) in the case of auction commissions, upon consummation of the online sale;
- (2) in the case of registration fees, ratably over the period in which the product for sale is displayed on the Netease Web sites; and
- (3) in the case of other e-commerce related services revenues, upon completion of the total contract and acceptance by our customers.

Our e-commerce related services business is relatively new and has not constituted a material portion of our total revenues in the past. In the future, due to Chinese restrictions on foreign participation in retail businesses, we will not charge commissions based on sales consummated. We will instead charge a fixed service fee for lease of our e-commerce platform.

Cost of Revenues

Advertising and e-commerce related services costs. Advertising and e-commerce related services costs consist of bandwidth and server custody fees, share compensation costs, staff costs and depreciation.

Netease Beijing and Guangzhou Netease lease bandwidth from China Telecom affiliates. Both Netease Beijing and Guangzhou Netease have network servers co-located in facilities owned by China Telecom's Beijing, Guangzhou and Shanghai affiliates, for which they pay custody fees to China Telecom. We pay for our bandwidth lease payments and server custody fees on a monthly basis. In addition, as a result of our arrangements with Guangzhou Netease, we also pay for Guangzhou Netease's bandwidth lease payments and server custody fees on a monthly basis. These costs are recognized in full as incurred.

Staff costs consist primarily of compensation expenses for our technology and editorial professionals. Our staff costs have risen as our business has expanded and we have hired more personnel. Based on our current estimates of growth in our operations, we expect that the number of our personnel will continue to increase in the near term and that such increases may be significant from time to time.

We depreciate our assets other than leasehold improvements on a straight-line basis over their estimated useful lives, which range from three to five years. We depreciate leasehold improvements, which are included in our operating expenses, on a straight-line basis over the lesser of the relevant lease term or their estimated useful lives. We expect that our planned significant capital expenditures to expand and enhance our infrastructure will substantially increase our depreciation expenses in the near future.

Software licensing and related integration projects costs. Software licensing and related integration projects costs consist principally of staff costs for integration projects and hardware costs. We recognize these costs at the same time as we recognize the related revenues.

Operating Expenses

Operating expenses include selling, general and administrative expenses and research and development.

Selling, general and administrative expenses. Selling, general and administrative expenses consist primarily of marketing and advertising; share compensation costs, salary and welfare expenses; office rental; amortization of leasehold improvements; and travel expenses. As we expand the scope of our operations, we expect selling, general and administrative expenses to continue to increase for the foreseeable future. We intend to continue to hire new sales and marketing personnel and continue to increase our marketing and advertising

expenses to further increase our brand awareness. In addition, since our business is dependent upon Guangzhou Netease, which operates the Netease Web sites, and Guangzhou Netease will not have any significant revenues, we expect that we will need to finance the operating costs of Guangzhou Netease. Accordingly, we will accrue for the staff costs and other general and administrative expenses of Guangzhou Netease as they are incurred and include them in our selling, general and administrative expenses.

Research and development. Research and development consists of compensation for our research and development professionals and in 1998, fees and expenses of external consultants we used to develop our technology platforms and several new products.

Share Compensation Costs

In 1999, Shining Globe International Limited, which is 100% owned by William Lei Ding, our founder, Chairman of the Board and Co-Chief Technology Officer, agreed to transfer an aggregate of 109,694,200 ordinary shares to certain senior management personnel and key employees. These share transfers were effected in January 2000. The share transfer commitments were made to provide incentives to senior management personnel and key employees to join our company. The fair market value of these shares as of the date of such agreement (RMB45.4 million or US\$5.5 million) was charged to our earnings in 1999 as share compensation costs in accordance with U.S. GAAP, with a corresponding increase in additional paid-in capital. In addition, William Lei Ding, has agreed to transfer a total of approximately 26,270,000 ordinary shares to certain of these employees for services to be rendered by them over a period of three years commencing January 1, 2000. The total estimated fair value of these shares, valued at US\$0.05 per share at the date of grant, is recognized as deferred compensation which will be amortized over the related vesting periods. Moreover, in March 2000 William Lei Ding transferred approximately 1,900,000 shares to certain employees, which we expect will result in share compensation costs of approximately RMB2.5 million in 2000.

These costs have been allocated to (i) advertising and e-commerce related service costs, (ii) selling, general and administrative expenses and (iii) research and development expenses depending on the functions for which these personnel and employees are responsible.

Income Taxes

Under the current laws of the Cayman Islands, we are not subject to tax on income or capital gain. However, our revenues are primarily derived from our Chinese subsidiary. Chinese companies are generally subject to a 30% national enterprise income tax, or EIT, and a 3% local income tax. Our subsidiary, Netease Beijing, intends to apply to the relevant tax authorities to be classified as a “high-tech” company. This designation would entitle Netease Beijing to preferential treatment under Chinese tax laws. If Netease Beijing receives the relevant approvals, it would operate free of EIT for the first three years of operations and would be entitled to a 50% tax reduction for the subsequent three years. We cannot be sure, however, that we will obtain approvals from the relevant tax authorities to be entitled to these tax benefits, that we would actually realize these benefits if Chinese tax laws or interpretations change or that we will qualify for these benefits. See Note 9 to our consolidated financial statements.

If the activities of Netease.com constitute a permanent establishment in China, the income it earns in China would also be subject to a 30% EIT and 3% local income tax. Income of Netease.com that is not connected to a permanent establishment in China would be subject to a 20% withholding tax on gross receipt from profit, interest, rentals, royalties and other income earned in China. If such income is earned from sources within the designated special economic zones or other designated areas, the withholding tax is reduced to 10%. Dividends from Netease Beijing to Netease.com are exempt from Chinese withholding tax.

Guangzhou Netease is a Chinese domestic enterprise and is generally subject to a 33% EIT. In 1997 and 1998, Guangzhou Netease was classified as a small-sized taxpayer by the local tax bureau of Guangzhou and was subject to EIT at 1% of the total amount of its revenues and other income.

We are generally subject to a business tax of 5% on our service revenues. We are also subject to an additional cultural development fee of 3% on our advertising revenues, but which does not apply to our advertising services revenues derived from Guangyitong Advertising. Our revenues from integration projects in China are generally subject to a 17% value added tax which is offset by value added taxes paid on purchases. In 1997 and 1998, because Guangzhou Netease was classified as a small-sized taxpayer, its revenues from integration projects were subject to a reduced value added tax of 6% but no offset was allowed.

Netease Beijing had tax net operating loss carryforwards, or NOLs, of RMB6.6 million (US\$797,000) as of December 31, 1999 for EIT purposes. These NOLs will expire in 2004. A valuation allowance has been provided to offset gross deferred tax assets due to the uncertainty surrounding the realizability of such assets. We cannot assure you that Netease Beijing will be able to use all or any of its NOLs before they expire.

Consolidated Results of Operations

The following table sets forth a summary of our audited consolidated statements of operations for the periods indicated both in renminbi and as a percentage of total revenues:

	From June 24 to December 31, 1997		Year Ended December 31,			
			1998		1999	
	RMB	%	RMB	%	RMB	%
Revenues:						
Advertising services	—	—	172,850	5.5	10,796,074	64.4
Software licensing and related integration projects.....	100,000	100.0	2,942,582	94.5	3,515,831	21.0
E-commerce related services.....	—	—	—	—	2,459,101	14.6
Total revenues.....	100,000	100.0	3,115,432	100.0	16,771,006	100.0
Sales and value-added taxes.....	(6,600)	(6.6)	(230,749)	(7.4)	(1,150,169)	(6.9)
Net revenues	93,400	93.4	2,884,683	92.6	15,620,837	93.1
Cost of revenues:						
Advertising and e-commerce related services (including share compensation costs of RMB6,296,816 in 1999)	(13,614)	(13.6)	(242,657)	(7.8)	(11,837,416)	(70.6)
Software licensing and related integration projects.....	(55,000)	(55.0)	(946,531)	(30.4)	(258,819)	(1.5)
Total cost of revenues.....	(68,614)	(68.6)	(1,189,188)	(38.2)	(12,096,235)	(72.1)
Gross profit	24,786	24.8	1,695,495	54.4	3,524,602	21.0
Operating expenses:						
Selling, general and administrative expenses (including share compensation costs of RMB34,346,268 in 1999)	(22,844)	(22.9)	(311,957)	(10.0)	(51,055,489)	(304.4)
Research and development (including share compensation costs of RMB4,770,315 in 1999).....	(8,000)	(8.0)	(951,000)	(30.5)	(5,735,170)	(34.2)
Total operating expenses	(30,844)	(30.9)	(1,262,957)	(40.5)	(56,790,659)	(338.6)
Operating profit (loss)	(6,058)	(6.1)	432,538	13.9	(53,266,057)	(317.6)
Other income (expenses):						
Sale of 163.net usage right.....	—	—	—	—	1,500,000	8.9
Interest income (expenses).....	289	0.3	5,719	0.2	357,160	2.1
Others, net.....	(289)	(0.3)	(71,056)	(2.3)	(494,018)	(2.9)
Income (loss) before tax.....	(6,058)	(6.1)	367,201	11.8	(51,902,915)	(309.5)
Provision for income tax	(1,000)	(1.0)	(34,464)	(1.1)	(71,338)	(0.4)
Net income (loss)	(7,058)	(7.1)	332,737	10.7	(51,974,253)	(309.9)

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998

Revenues. Total revenues increased RMB13.7 million (US\$1.7 million), or 438.3%, to RMB16.8 million (US\$2.0 million) in 1999 from RMB3.1 million in 1998. Software licensing and related integration projects accounted for RMB573,000 (US\$69,000) of this increase, primarily due to revenues recognized from increased sales of software licenses in the last half of 1998 and in early 1999, prior to our ceasing software

license sales in April 1999. Advertising services accounted for RMB10.6 million (US\$1.3 million) of the increase in total revenues. The growth in advertising services revenues resulted primarily from expanded Internet advertising operations following our establishment of a marketing department in mid-1999 and an increase in advertising activity on the Netease Web sites. The growth also reflects a full year of advertising services revenues as compared to only one quarter in 1998. E-commerce related services accounted for RMB2.5 million (US\$297,000) of the increase in total revenues. The growth in e-commerce related services revenues reflects our introduction of these services in July 1999.

Cost of revenues. Our cost of revenues increased RMB10.9 million, or 917.2%, to RMB12.1 million (US\$1.5 million) in 1999 from RMB1.2 million in 1998, primarily due to the overall expansion of our business, increased staff costs, share compensation costs and increased server custody fees and depreciation as a result of our newly acquired servers. We increased our staff from 10 employees at December 31, 1998 to 161 employees at December 31, 1999. Gross profit as a percentage of total revenues decreased from 54.4% in 1998 to 21.0% in 1999.

Operating expenses. Operating expenses increased 4,396.6% to RMB56.8 million (US\$6.9 million) in 1999 from RMB1.3 million in 1998, primarily due to substantial share compensation costs. Operating expenses also increased as a result of the overall expansion of our business, increased sales and marketing and advertising expenditures and increased personnel compensation costs. Operating expenses as a percentage of total revenues increased from 40.5% to 338.6% primarily because of the substantial increases in share compensation costs and selling, general and administrative expenses.

Selling, general and administrative expenses increased 16,263.8% to RMB51.1 million (US\$6.2 million) in 1999 from RMB312,000 in 1998 primarily due to substantial share compensation costs and significant increases in marketing expenses. Selling, general and administrative expenses also increased as a result of significant personnel increases in 1999.

Research and development expenses increased 503.1% to RMB5.7 million (US\$693,000) in 1999 from RMB951,000 in 1998. In 1998, we increased our focus on research and development to develop our technology platforms and several new products and hired external consultants to assist in this development, resulting in higher costs. Because our technology platforms were put in place in 1998, we had less need for research and development in 1999 and did not outsource any of this work. The significant increase in research and development expenses in 1999 was due to the substantial share compensation costs.

Other income (expenses). Other income (expenses) in 1999 consisted primarily of our sale in July 1999 of our right to use the Web site domain name, www.163.net, for RMB1.5 million (US\$181,000), a one-time non-recurring event. Other income (expenses) in 1999 also included interest income. The increase of interest income in 1999 compared to 1998 was primarily due to an increase in cash primarily as a result of equity financings, offset in part by lower interest rates on cash deposits. Others, net, consisted primarily of a write-off due to the failure of one of our servers and accrued tax penalties.

Period from June 24 to December 31, 1997

Our business was established in June 1997 with the objective of developing large-scale distributed software systems for the Internet. In mid-1998, we changed our business objective to developing Internet technologies and services for the Netease Web sites. We therefore do not believe that a comparison between the period from June 24, 1997 to December 31, 1997 and the year ended December 31, 1998 is meaningful. The following discussion summarizes our results of operations for the period from June 24, 1997 (inception) to December 31, 1997.

Revenues. Total revenues for the partial year period were RMB100,000. They consisted entirely of software licensing and related integration projects revenues.

Cost of revenues. Our cost of revenues was RMB69,000 for this partial 1997 period. Software licensing and related integration projects costs accounted for 80.2% of the total cost of revenues.

Operating expenses. Operating expenses were RMB31,000. Operating expenses during this initial startup period as a percentage of total revenues were 30.9%. Selling, general and administrative expenses accounted for 74.1% of our operating expenses during this period.

Quarterly Results of Operations Data

The following table sets forth selected unaudited quarterly consolidated statement of operations data for each of the five fiscal quarters ended March 31, 2000 in renminbi. Our management believes this data has been prepared substantially on the same basis as the consolidated audited financial statements included elsewhere in this prospectus, including all necessary adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of such data. Operating results for any quarter are not necessarily indicative of results for any future quarter. You should read the quarterly data for the four quarters set forth below ended December 31, 1999 in conjunction with our consolidated financial statements and the related notes included elsewhere in this prospectus.

	Quarter Ended				
	March 31, 1999	June 30, 1999	September 30, 1999	December 31, 1999	March 31, 2000
	RMB	RMB	RMB	RMB	RMB
Revenues:					
Advertising services	213,011	600,901	2,385,517	7,596,645	6,613,031
Software licensing and related integration projects	716,824	1,759,653	922,166	117,188	117,188
E-commerce related services	—	—	—	2,459,101	370,850
Total revenues	929,835	2,360,554	3,307,683	10,172,934	7,101,069
Sales and value-added taxes	(65,416)	(192,863)	(320,502)	(571,388)	(635,487)
Net revenues	864,419	2,167,691	2,987,181	9,601,546	6,465,582
Cost of revenues:					
Advertising and e-commerce related services	(191,583)	(288,411)	(1,271,545)	(10,085,877)	(5,926,968)
Software licensing and related integration projects	(139,137)	(116,438)	(3,244)	—	—
Total cost of revenues	(330,720)	(404,849)	(1,274,789)	(10,085,877)	(5,926,968)
Gross profit	533,699	1,762,842	1,712,392	(484,331)	538,614
Operating expenses:					
Selling, general and administrative	(234,573)	(890,180)	(3,692,792)	(46,237,944)	(22,445,315)
Research and development	(12,500)	(12,500)	(183,453)	(5,526,717)	(2,923,322)
Total operating expenses	(247,073)	(902,680)	(3,876,245)	(51,764,661)	(25,368,637)
Operating profit (loss)	286,626	860,162	(2,163,853)	(52,248,992)	(24,830,023)
Other income (expenses):					
Sale of 163.net usage right	—	—	1,500,000	—	—
Interest income (expenses)	1,039	3,398	(31,027)	383,750	896,496
Others, net	(302,074)	(71,965)	(38,919)	(81,060)	—
Income (loss) before tax	(14,409)	791,595	(733,799)	(51,946,302)	(23,933,527)
Provision for income tax	(9,298)	(26,623)	(35,417)	—	—
Net income (loss)	(23,707)	764,972	(769,216)	(51,946,302)	(23,933,527)

Our advertising services revenues increased significantly during 1999 primarily as a result of an increase in advertising activity on the Netease Web sites. Conversely, revenues from our software licensing and related integration projects decreased significantly because we ceased licensing our software in April 1999. We introduced our e-commerce related services in the third quarter of 1999 and began generating revenues from these services in the fourth quarter of 1999. The changes in our cost of revenues and selling, general and administrative expenses during the year reflect these changes in our business.

Other material changes in our quarterly financial data included share compensation costs of RMB45.4 million (US\$5.5 million) incurred in the fourth quarter, a gain of RMB1.5 million (US\$181,000) in the third quarter from our sale of the right to use the domain name www.163.net and interest income of RMB384,000 (US\$46,000) in the fourth quarter earned on cash we received from an equity financing.

In the three months ended March 31, 2000, our advertising services revenue declined from RMB7,596,645 to RMB6,613,031, compared to the previous quarter, primarily as a result of seasonal variations in the Internet advertising business. Our e-commerce related services revenues declined from RMB2,459,101 to RMB370,850. We believe this is a result of seasonal variations, as well as the evolving nature of the e-commerce business in China.

Our cost of revenues decreased from RMB10,085,877 to RMB5,926,968 and our operating expenses decreased from RMB51,764,661 to RMB25,368,637, primarily as a result of lowered share compensation costs. This was partially offset by increases in recruiting, consultant and marketing expenses, as well as expenses associated with our increased headcount and the hiring of senior management personnel.

Our revenues and results of operations have varied significantly in the past and may fluctuate in the future due to a combination of factors, including:

- the ability of the Netease Web sites to attract and retain users;
- demand for advertising on the Internet in general and on the Netease Web sites in particular;
- our ability to successfully implement our e-commerce strategies;
- our ability to update and develop our Internet portal systems and infrastructure;
- technical difficulties that users may experience on the Netease Web sites;
- competition in Internet markets, including our competitors' performance in each of the above aspects;
- growth and acceptance of the Internet in China;
- changes in Chinese governmental regulations; and
- general economic conditions in China.

Liquidity and Capital Resources

Our capital requirements relate primarily to financing:

- (1) our working capital requirements, such as bandwidth and server custody fees, staff costs, sales and marketing expenses and research and development, and
- (2) costs associated with the expansion of our business, such as the purchase of servers.

Cash provided by (used in) operating activities was (RMB15.7 million or US\$1.9 million) in 1999, RMB1.2 million in 1998 and (RMB262,000) in 1997. In 1999, cash used in operating activities consisted primarily of our operating loss and increases in accounts receivable and prepayments, offset in part by increases in accounts payable, salary and welfare payable, taxes payable and other accrued liabilities. In 1998, the net cash provided by operating activities consisted primarily of our operating profit, increases in accounts payable, salary and welfare payable, taxes payable and other accrued liabilities and an increase in deferred revenue, offset in part by increases in accounts receivable, and other current assets. In 1997, the net cash used in operating activities consisted primarily of our operating loss and increases in other current assets and accounts receivable, offset in part by depreciation and increases in accounts payable, salary and welfare payable, taxes payable and other accrued liabilities.

Cash used in investing activities was RMB9.3 million (US\$1.1 million) in 1999, RMB1.1 million in 1998 and RMB188,000 in 1997, all used to acquire property, plant and equipment.

Cash provided by financing activities was RMB142.6 million (US\$17.1 million) in 1999, zero in 1998 and RMB500,000 in 1997. In 1999, we raised an aggregate of RMB18.4 million (US\$2.2 million) in capital through the issuance of ordinary shares and an aggregate of RMB124.2 million (US\$15.0 million) through the issuance of Series A preference shares to The Goldman Sachs Group, Inc., Softbank China Investments No.1 Limited and BAPEF Investments XI Limited in private placements. Cash provided by financing activities in 1997 consisted of a capital contribution of RMB500,000 (US\$60,000) by our majority shareholder.

In March 2000, we issued our Series B preference shares, convertible into 256,055,600 ordinary shares, to Best Alliance Profits Limited, a company controlled by The News Corporation Limited, for RMB289.7 million (US\$35 million) in cash and an amount of advertising and promotional inventory valued at US\$5 million to be provided over three years. The advertising can be placed on News Corporation's majority owned or controlled media properties, including Channel [V], ESPN Star Sports, Phoenix TV and STAR TV. We expect to use the cash proceeds of this private placement for marketing, content development, server and bandwidth expenditures, research and development and working capital and general corporate purposes. In addition, The News Corporation and its affiliates will purchase US\$5 million of advertising on the Netease Web sites over a three year period.

We have financed our working capital and other financing requirements through private placements of our equity securities with strategic investors and careful management of our billing cycle. As of December 31, 1999, almost all of our accounts receivable were within 60 days past due.

As our business continues to expand, we expect that our working capital requirements will grow and we will need to raise additional capital. We expect that our future minimum lease commitments and capital expenditures in 2000 will total approximately RMB12.5 million (US\$1.5 million). We currently anticipate that the net proceeds of this offering, together with available funds and cash flows generated from operations, will be sufficient to meet our anticipated needs for working capital, capital expenditures and business expansion through at least the next 12 months. Thereafter, we may need to raise additional funds. We may need to raise additional funds sooner, however, to fund more rapid expansion, to develop new or enhanced services or products or to respond to competitive pressures. Our future liquidity and capital requirements will depend upon numerous factors, including costs and timing of product development efforts and the success of such efforts, the success of our existing and new technology service offerings and competing technological and market developments.

We plan to raise additional funds, if necessary, through new issuances of our equity securities primarily through private placements to accredited investors or through borrowings from lending institutions. There can be no assurance that additional financing will be available to us on favorable terms when needed, if at all. If adequate funds are not available on acceptable terms, we may be unable to fund and expand our operations, develop or enhance our services, take advantage of future opportunities or respond to competitive pressures. Any such limitation could have a material adverse effect on our business, financial condition and operating results. See "Risk Factors" on page 9.

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 short term money market accounts and certificates of deposit. We have not used derivative financial instruments in our investment portfolio. Interest earning 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 interest income may fall short of expectations due to changes in interest rates.

Foreign Currency Risk. Substantially all our revenues and expenses are denominated in renminbi. We have not had any material foreign exchange gains or losses. Although in general, our exposure to foreign exchange risks should be limited, the value of your investment in our ADSs will be affected by the foreign exchange rate between U.S. dollars and renminbi because the value of our business is effectively denominated in renminbi, while the ADSs will be traded in U.S. dollars. Furthermore, a decline in the value of renminbi could reduce the U.S. dollar equivalent of the value of the earnings from, and our investments in, our subsidiaries and controlled entities in China.

Impact of Year 2000

We believe that all our systems are Year 2000 compliant. Costs incurred to date, and expected future costs, to address and remedy Year 2000 compliance issues have not been, and are not expected to be, material.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Boards issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement requires companies to record all derivatives on the balance sheet as assets or liabilities measured at fair value. Gains and losses resulting from changes in fair market values of those derivative instruments would be accounted for depending on the use of the instrument and whether it qualifies for hedge accounting. SFAS No. 133 will be effective for the fiscal year ending December 31, 2001. We currently do not engage or plan to engage in investing in derivative instruments or hedging activities.

BUSINESS

Overview

We are one of the leading Internet technology companies in China. With our Internet applications, services and technology, we provide Chinese Internet users with Chinese language-based online services centered around three core inter-related services—content, community and e-commerce. Guangzhou Netease, which has received approval from the Telecommunications Office of Guangzhou City to engage in the Internet content provider business, operates and maintains the Netease Web sites pursuant to contractual arrangements with us. In a survey report dated January 2000 by the China Internet Network Information Center, or CNNIC, a non-profit service under the administrative control of the Chinese Academy of Sciences and supervised by the Ministry of Information Industry, the Netease Web sites were ranked as the second most popular in China. Our average daily page views for the seven-day period ended May 31, 2000 exceeded 20 million.

We believe we are well positioned to capitalize on the rapid growth anticipated in the Internet market in China. The Netease content channels offer users an extensive range of local, regional and international Chinese language content, Web-based communication services and sophisticated search capabilities and provide a destination for Chinese Internet users to identify and access resources, services, content and information on the Internet. As of May 31, 2000, the Netease Web sites had approximately:

- 4.9 million registered members;
- 1.2 million registered community members;
- 378,000 personal home pages;
- 29,500 simultaneous chat room participants; and
- 3 million e-mail accounts.

Registered community members can personalize their online experience by publishing their own content and interacting with other users that have similar interests. Under the Netease (网易) and 163.com brands, we provide various free services, including Chinese language-based e-mail, online chat rooms, discussion forums and an auction platform where registered members can purchase a variety of products and services. We have established a U.S. subsidiary, Netease.com (U.S.), which does business in California as 163 Netease.com, Inc.

The Netease Web sites' market position as a leading Internet destination for Chinese Internet users offers online advertisers and e-commerce vendors access to a large and rapidly growing market of Chinese Internet users.

We believe we were the first China-based Internet company to offer e-commerce auction services in China. We host a permanent online auction site that offers a wide range of products in partnership with various brand name retailers.

We believe that demand for our services is growing rapidly as the number of Internet users in China increases. With our strong focus on the Chinese domestic market, we aim to have the Netease Web sites become the leading online service destination for Internet users in China.

Industry Overview

The Global Internet Market. The Internet has grown rapidly since its initial commercialization in the early 1990s. IDC projects that the number of Internet users worldwide will grow from approximately 261.4 million at the end of 1999 to approximately 623.3 million by the end of 2003. The existing proliferation of

Web sites and development of Internet applications and technologies have allowed online advertisers and merchants to target specific demographic and geographic groups and to capture valuable data about their buying patterns and consumer preferences, thereby enhancing the effectiveness of online advertisements and promoting the growth of e-commerce. Forrester Research Inc. estimates that worldwide online advertising spending will increase from approximately US\$3.3 billion in 1999 to approximately US\$33.1 billion by 2004, which would represent approximately 6.8% of traditional advertising expenditures projected for 2003. IDC estimates that worldwide business and consumer e-commerce revenues will grow from US\$130.5 billion in 1999 to US\$1,640 billion in 2003. As Internet advertising and e-commerce markets mature, Forrester Research believes online advertisers and retailers will increasingly spend their marketing budgets on more focused Web sites to reach specific demographic groups.

The Internet Market in China. The markets in China for online advertising and e-commerce are in their early stages of development. China has only recently begun to expand its Internet infrastructure. We believe that the relatively high cost of personal computers and Internet access in China has limited the number of potential Internet users in China. According to the CNNIC January 2000 survey report, the number of Internet users in China grew to 8.9 million at December 31, 1999. The following table illustrates the growth in the number of Chinese Internet users according to data from CNNIC survey reports dated July 1998, January 1999, July 1999 and January 2000:

	<u>July 1998</u>	<u>January 1999</u>	<u>July 1999</u>	<u>January 2000</u>
Internet Users in China	1.2 million	2.1 million	4.0 million	8.9 million

Internet subscription costs have decreased significantly during recent years, allowing increased growth in Internet use in China. The following table illustrates this decrease according to the latest data reported by BDA (China) Ltd. Internet subscription costs are based on ChinaNet subscription costs for 40 hours of Internet access as reported in the third month of each year, including local telephone charges:

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Monthly Internet subscription costs (in RMB)	744	744	444	294	222

The Internet market in China is expected to continue to experience rapid growth over the next few years. For example, according to IDC, the number of Internet users in China is expected to increase to 25.2 million by 2003. We believe that a continued reduction in access costs and personal computer prices in China will further enhance the growth in Internet use in China. The potential for Internet access through television-based and wireless Internet access devices may further accelerate Internet growth. According to Kagan World Media, there were 58.0 million cable television households out of a total 248.4 million television households in China at the end of 1998, which represents a significant potential market for television-based Internet access devices. The January 2000 CNNIC survey report found that as of December 31, 1999 more than 200,000 Chinese Internet users were accessing the Internet through means other than personal computers.

In response to the rapid growth in Internet usage, the Chinese government has significantly increased the amount of bandwidth capacity between China and other countries. The following table sets forth information relating to the growth of international bandwidth capacity in China according to data from CNNIC survey reports dated October 1997, July 1998, January 1999, July 1999 and January 2000.

	<u>October 1997</u>	<u>July 1998</u>	<u>January 1999</u>	<u>July 1999</u>	<u>January 2000</u>
International Capacity of Internet Backbone Providers (in megabits)	25.4	84.6	143.3	241.0	351.0

China's principal commercial Internet backbone transport provider is ChinaNet, currently owned by China Telecom which is under the administrative control and regulatory supervision of China's Ministry of Information Industry. ChinaNet is also the country's largest Internet service provider, commonly referred to as

an ISP. Although China has approximately 200 other ISPs, the vast majority are small and localized. We believe ChinaNet's dominant position in the ISP market is attributable, in part, to its ownership and control of a significant portion of the Chinese Internet backbone.

Urban centers in China represented approximately 30% of China's population or roughly 374.9 million people in 1998, according to the China Statistical Year Book (1999). Despite the fact that China has one of the lowest per capita gross domestic products, or GDPs, in Asia and, we believe, one of the lowest Internet penetration rates in Asia, these urban centers constitute a more affluent population with higher Internet usage relative to their rural counterparts. For example, in 1998, Beijing, Shanghai and Guangdong Province, three of China's largest Internet markets, had an average per capita GDP of US\$2,110, which is almost three times the US\$755 average per capita GDP for the whole of China. As a result, we believe that urban centers in China represent a more attractive market opportunity for us than lesser developed areas of China.

The following table illustrates the demographic profile of Internet users in China surveyed according to data from the CNNIC survey report dated January 2000:

<u>Age</u>	<u>%</u>	<u>Geographic Location of Internet Users</u>	<u>%</u>
Older than 60	0.4	Beijing	21.2
51-60	1.2	Guangdong	12.9
41-50	4.5	Shanghai	11.2
36-40	5.7	Jiangsu	5.9
31-35	10.2	Shandong	5.2
25-30	32.8	Zhejiang	4.5
18-24	42.8	Other locations	39.1
<u>Education Level</u>	<u>%</u>	<u>Internet Access Location</u>	<u>%</u>
Primary School	3.0	Home	50.0
High School	13.0	Office	37.0
Polytechnic School	32.0	Internet Café	11.0
Undergraduate	45.0	Other Locations	2.0
Master	6.0		
Doctor	1.0		
<u>Average Time Online per Week (hours)....</u>	<u>17</u>	<u>Gender</u>	<u>%</u>
		Male	79.0
		Female	21.0

As the Internet becomes more pervasive in China, the opportunities for online advertising and e-commerce are also expected to grow. Forrester Research estimates that online advertising expenditures in China will grow from US\$8.0 million in 1999 to US\$220.0 million by 2003. IDC forecasts e-commerce revenues in China to reach US\$11.7 billion by 2004 from US\$43.0 million in 1999.

Our Opportunity

The Internet market in China is underdeveloped as compared to the United States and other developed countries. We believe that the potential for growth of the Internet industry presents a significant opportunity for companies that target Chinese Internet users. There are few Web sites that offer Chinese Internet users a combination of content, community and e-commerce in the Chinese language. Most of the major Web sites in the Chinese language are targeted at Chinese speaking users throughout the world and are not specifically tailored to Internet users in China.

Internet Technology and Solutions Targeted at China. We believe there are few companies that focus on the provision of Internet technology and solutions to the developing Chinese Internet industry. Internet technologies and solutions created for English speaking Internet users typically cannot be directly integrated into Chinese language-based Internet applications because of the double-byte characters used in the Chinese language. We believe the lack of available Internet technology solutions for the Chinese speaking market has inhibited the growth of the Internet in China.

Online Content and Community for Chinese Users. Despite the rapid growth in Internet users in China we believe there are few Chinese language online portal and community destinations designed exclusively for Chinese Internet users that provide the following services:

- in-depth and focused local content as well as a variety of media channels covering a wide variety of regional and international topics;
- China-based online community forums where Internet users in China can communicate and exchange ideas on a wide variety of topics; and
- reliable, easy to use, sophisticated Internet applications and tools in the Chinese language, including e-mail, online chat, full text search capabilities and instant messaging.

In addition to the Netease Web sites, a number of other Web sites that focus on Chinese speaking Internet users globally are attempting to provide these services. However, we believe that few have successfully addressed the unique needs and interests of Internet users in China. Because these Web sites have broad geographic markets, they do not target a majority of their content or community functions at the market in China. In an attempt to target Internet users in China, some English language portal Web sites have translated portions of their content into the Chinese language. However, these Web sites have generally limited their Chinese translations to selected topical content.

E-commerce in China. E-commerce in China is not as developed as in some other countries. According to the CNNIC January 2000 survey report, as of December 31, 1999, only 7.7% of Internet users in China had used the Internet for e-commerce. We believe there are only a limited number of well established e-commerce sites in China that both attract a large number of users and provide a platform for vendors to sell their products online. We believe that as the Internet becomes more pervasive in China, the opportunities for e-commerce will also expand. We believe the Chinese market offers relatively fewer established retail networks than more developed countries, especially in the non-metropolitan areas. An established e-commerce network will give Internet users in China access to products and information about various products to which they would not otherwise have access. We believe we are well positioned to leverage our technology platform and database of users to capture a significant portion of the increasing e-commerce market.

Online Advertising in China. The Internet is a relatively new medium for advertisers in China. We believe that most online advertisers consist of information technology and mobile phone companies. We believe we are one of the largest Internet companies in China that has developed the systems necessary to support large-scale online advertising.

Our Solution

We offer a comprehensive suite of Internet technologies, services and solutions to Internet users in China. We believe that by offering an integrated platform of online content, community and e-commerce related services, we are well positioned to capitalize on the growth of the Internet industry in China. Our technology and services are developed in China specifically for Internet users in China. Our integrated platform

of applications, technology and services is available to Internet users through the Netease Web sites free of charge. The Netease Web sites were ranked by the CNNIC January 2000 survey report as the second most recommended by Internet users in China. Key advantages of our solution include:

- *Pioneer in Developing Technology and Solutions for China's Internet Market.* We have been developing Internet technology and solutions since our inception in June 1997. We believe we are well positioned to develop and adapt the latest Internet applications, services and technologies for the Chinese language. Our technologies and services are supported by a responsive and scalable technology architecture. We believe our products and services are among the most reliable and easy to use for Chinese speakers. All of our platforms were designed to include user-friendly interfaces and easy to understand instructions. We believe we were the first Internet company in China to offer:
 - a dual language free e-mail service;
 - a Chinese language search engine;
 - an interactive community platform which allows registered community members to post articles and messages, chat and send instant messages;
 - personal homepages created and maintained by our users;
 - online auction platforms;
 - a plug-in to customize the look and feel of Web browsers;
 - online newsletters in the Chinese language; and
 - Chinese language online greeting cards.
- *Extensive Content on the Netease Web sites with Focus on Internet Users in China.* Unlike other Internet companies whose markets include China, we are highly focused on Internet users in China and to a lesser extent, Chinese expatriate Internet users located abroad. Most of our employees are Chinese nationals. Their cultural and linguistic insights enable us to tailor our services to the needs of Internet users in China. Because of our specific market focus, we believe we are better able to attract Internet users in China than other Internet companies with a broader geographic focus. We currently offer a content distribution and management system that supports the publication of 15 separate content channels featuring a variety of local, regional and international content. In addition, we offer free Web site hosting and are currently hosting more than 378,000 personal homepages created and maintained by Internet users in China.
- *Focus on Community and Personalization.* Our applications, services and technologies have a strong focus on facilitating communication between Internet users in China. We believe the Netease online community was one of the first in China and as of May 31, 2000 included over 200 forums. We believe that the Netease online community is the largest in China. As of May 31, 2000, the Netease Web sites had over 1.2 million registered community members. The Netease community posts approximately 20,000 new articles daily. The Netease community platform also allows members to chat, send instant messages to other registered community members and vote in surveys. We believe we were also the first China-based Internet company to launch a personalization service, my.163.com, which allows users to choose their own content and interact with others with similar interests.
- *Attractive Platform for E-commerce and Online Advertising.* We believe our expanding number of users provide online advertisers and merchants with an attractive platform for advertising and e-commerce. Our technology enables vendors and online advertisers to reach Internet users in China who are relatively affluent, educated and technologically savvy. We offer vendors a platform to sell their products online to users in China. In addition, we offer both online advertisers and merchants targeted audiences through the Netease online communities and content

channels. As Internet usage in China accelerates and the market for Internet services develops, we believe that we are strategically well-positioned to deliver value to online advertisers and merchants targeting the Chinese market.

Our Business Strategy

Our goal is to make the Netease Web sites the leading online network in China. Key strategies for achieving our goal are to:

Aggressively Extend Brand Name Recognition. We believe that brand name recognition will be increasingly important in China as more Chinese consumers move online and additional Web sites compete for these users. Our goal is to make our brand name synonymous with the Internet among users in China. We believe that extensive brand name recognition will attract Internet users in China, as well as online advertisers and e-commerce vendors. We intend to continue to build brand awareness through:

- a comprehensive set of marketing campaigns, including special promotional events;
- traditional and online advertising campaign;
- strategic alliances; and
- proactive public relations, which includes frequent communications with our users, our customers and Chinese governmental agencies.

Continue to Develop User-Friendly Internet Applications, Services and Technologies for the Chinese Market. We intend to continue our focus on developing user-friendly technologies for the Internet industry in China. We will adapt and modify existing technologies for Chinese language-based Internet applications as well as develop our own proprietary Chinese language Internet applications. We plan to continue to enhance our platforms with user-friendly interfaces and with easy to understand user instructions. To increase the number of our users, we intend to work with various providers to develop broadband offerings and will continue to explore opportunities to offer wireless application protocol technologies. We employ 40 technology professionals and Guangzhou Netease employs 23 technology professionals.

Enrich, Expand and Personalize Netease Content. The Netease Web sites contain content from over 140 local and international content providers, including *China Computer World*, *China Economic Times*, *China Sports Newspaper*, *China Youth Daily*, *Popular Cinema* and Netvigator. To expand our channel offerings, we intend to work with vertical portal developers and to purchase or license existing content from traditional media providers. We intend to continue to expand our content alliances to allow the Netease Web sites to offer content that will be more tailored for and relevant to our users' daily lives. We believe this will:

- further differentiate the Netease Web sites from competing Web sites and enhance our competitive position;
- provide users with a more customized, comprehensive and satisfying Internet experience; and
- increase the number of visits to the Netease Web sites and the length of time each user stays on those sites.

Expand the Number of Our Registered Users and Registered Community Members. To expand the number of registered community members, we plan to enhance the quality of our community services and introduce new applications, services and technology for our online community that will make the Internet in China an increasingly important medium for exchanging ideas. In addition to our existing communities, we plan to develop technology to support a user-friendly business community on the Internet. We intend to offer a package of Internet applications, services and technologies to small and medium sized companies in China, including e-mail, document hosting, word processing and other interactive community services to promote our brand name among corporate clients and to increase the number of our registered community members. We plan to leverage our technology and Web-based products to increase the Netease community. For instance, we may license our proprietary e-mail services in exchange for access to the licensee's database of members.

Expand Our E-commerce Services. We believe that a growing number of consumers in China will look to the Internet as an alternative source of commerce in the future. We believe we were the first company to offer online auction platforms in China. We will leverage upon this experience and our registered users and registered community members to actively develop and pursue e-commerce opportunities. We intend to assist traditional vendors to establish their e-commerce strategies. We intend to expand our online commerce applications, services and technologies, or our e-commerce platform, and to use our user profile information to market products to specific demographic groups. We also plan to leverage our registered user database to develop direct marketing opportunities.

Expand the Base of Online Advertisers on Our Network. Online advertisers on the Netease Web sites consist primarily of merchants from the information technology and telecommunications industries. We intend to broaden this base of online advertisers and to continue to attract premier online advertisers through aggressively promoting our brand name and improving our demographic profiling technology to identify users that we believe will be attractive to online advertisers. We believe that as the online advertising industry in China develops, demographically targeted advertising will command higher prices from online advertisers compared to non-targeted advertising. We will continue to promote the Internet as an alternative method for advertisers to reach end users. In addition, we intend to use third party advertising networks to increase the Netease online advertiser base.

Establish and Extend Strategic Alliances and Acquisitions. To increase traffic on the Netease Web sites, further penetrate the Internet market and extend our brand recognition, we will continue to seek potential strategic alliances with prominent Internet companies, leading online content providers, e-commerce service companies, traditional media companies and technology companies. We also intend to seek acquisition and joint venture opportunities that complement our operations.

Our Products and Services

The Netease Web sites offer Chinese Internet users a network of Chinese language-based online content channels, community products, e-commerce services and other Web-based applications and services to enhance their Internet experience. The Netease Web sites offer content channels, a full text Chinese language search engine, a directory, e-mail and community tools. We also provide e-commerce platforms that allow vendors to sell or auction their products online. Our content, community and e-commerce platforms are all designed with user friendly interfaces and easy to understand instructions.

Our Members

The Netease Web sites have users, registered users and registered community members. Any user may visit the Netease Web sites without registering. Online registration is available at all times and is fast and easy. The Netease registered users consist of users who have registered for e-mail or domain name registration services and also include registered community members. Only registered community members can post articles in our community forums. Only registered users can use our e-mail system and participate in e-commerce services. The Netease users provide us with valuable demographic and preference information that will allow us to target audiences with relevant online advertising.

Our Content

The Netease homepage provides a destination for Chinese Internet users to identify and access resources, services, content and information on the Internet. The Netease Web sites aggregate, organize and deliver information to meet the needs of Internet users in China. Our media channels provide users with an efficient and easy way to explore and utilize a wealth of information and content organized around a variety of topics. Our content distribution platform enables the Netease Web sites to offer in-depth local content as well as a variety of locally relevant regional and international content. Our content distribution technology aggregates content from over 140 content partners.

We do not produce our own content for the Netease Web sites. The Netease Web sites currently include 15 media channels in the following categories:

- news
- information technology
- entertainment
- sports
- finance
- women's issues
- games
- culture
- science
- leisure
- health care
- education
- jobs and careers
- real estate
- fashion

We are currently in the process of launching new channels that will broaden the content coverage on the Netease Web sites.

Through the Netease Web sites, our users can subscribe to 26 electronic magazines, which are delivered to subscribers by e-mail. These electronic magazines are published by media channel editors and include the following topics:

- information technology
- news
- lifestyle in Beijing
- philosophy
- sports
- music
- health
- literature
- auctions
- finance
- stock investment
- English study
- job search
- stories and anecdotes
- music, book and other reviews
- special reports
- science
- real estate
- relationships
- education
- emotional life
- entertainment
- Netease weekly updates
- stamp collecting

As of May 31, 2000, we had over 960,000 subscribers and over 2.6 million subscriptions to our electronic magazines.

Personalization. We believe we were the first Internet company to offer technology for personalized portals in China. The Netease Web sites offer users a personalized portal service, my.163.com, which allows registered users to choose their own content and to interact with other users with similar interests. My.163.com allows registered users to create a personal profile that directly organizes and delivers information of personal interest, including, among others:

- stock quotes;
- stock portfolio management;
- news;
- weather; and
- sports.

Web Page Hosting. We offer registered users, free of charge, up to 100 megabytes of computer storage for Web pages created and maintained by our users, or personal homepages. We also offer tools to assist users in building their homepages. The Netease personal homepages create a Web-based community for Internet users to express themselves, to share ideas, interests and expertise, and to publish personal content accessible by other users with common interests. While we believe most of the Netease homepages are of interest to a small circle of friends and families, the Netease homepage members include a core group of people who create homepages with content having broader appeal. Traffic comes from both inside our network of Web

sites and from non-registered users visiting from outside. Non-registered users typically find registered users' personal homepages through search engines.

Our Community

With our leading online community technology, the Netease Web sites have established a large online community member base. We launched what we believe to be one of the first online communities in China in December 1998. Users can register with us online to interact with other registered community members. We believe that as users become more involved with our online community, they will return to the Netease Web sites frequently.

Netease users can interact through a variety of community products and services. We offer our products and services free of charge. They include:

- *E-mail.* Our technology and services provide registered users with a free Web-based e-mail service which supports both the Chinese and English languages. Registered users can access e-mail through post office protocol 3 servers, which allow users to receive e-mail on their own e-mail applications without opening their Web browser. We completed the coding of our dual language e-mail system in December 1997. This e-mail system has been licensed to a number of leading unaffiliated Internet companies in China, including 163.net, 263.net, 188.net (China Telecom's local affiliates located in Guangzhou, Beijing, and Zhejiang, respectively), and Chinadotcom.
- *Online Community.* We offer Netease registered community members over 200 forums where they can post messages and articles for viewing by other registered community members and other users. Community members may also create their own forums in addition to those we offer. We host over 13,700 such personal community forums. The Netease online communities are hosted by volunteers, who are chosen by us based on their contributions to the communities. The Netease community volunteers monitor our community forums and select appropriate articles for posting. In addition, they monitor the personal homepages hosted by the Netease Web sites.
- *Instant Messaging.* We offer Netease registered users a platform to notify their online friends and other users with similar interests when they are online, allowing Netease registered users to participate in real-time dialogues.
- *Chat.* Our chat services allow Netease registered users to interact in real-time group or one-on-one discussions. Unlike hyper text markup language, or HTML, our Java-based chat technology allows users to participate in chats without downloading chat software. The Netease chat rooms are arranged around topics of interest including, among others, relationships and dating, campus life and technology. Registered users can also create their own personal chat rooms.
- *Easebar.* We developed Easebar, a free browser toolbar that provides Internet users with quick access to their favorite destinations and allows users to customize the look and feel of their Web browsers. Easebar remains on a user's screen and provides quick access to specific areas of the Web. Users can customize Easebar by adding buttons and changing their sequence to fit their needs. Users can store their bookmarks on Easebar with the Easebar bookmarks button and access them from any computer.
- *Voting System.* We conduct numerous polls on various social, cultural and other topics to provide our registered users with the opportunity to express their views and also to learn about the opinions of other Internet users.
- *Electronic Greeting Cards.* We believe we were the first Internet company to offer Chinese Internet users online greeting cards in Chinese. Our greeting cards have different designs for

various occasions, including New Year's Day, Chinese New Year, Christmas, birthdays, Valentine's Day, and other celebrations. We make new designs available on a regular basis. A user may send an electronic card without registering with us.

We recently entered into an agreement with Odigo, Inc., developers of the Odigo real-time communications software for Internet users. In conjunction with Odigo, we began to offer a free Chinese version of the Odigo software to our users in May 2000. The software offers co-browsing, people search by interest, instant messaging, voice chatting, notes posting and searching for sites. The software also enables our users to see other Odigo members on the same page or site they are visiting and initiate a conversation, if desired.

Our E-commerce Services

We believe e-commerce will become the most rapidly growing sub-sector of China's Internet market, despite the fact that there are a number of obstacles that need to be overcome. These obstacles include a low credit card penetration rate, the lack of secure online payment systems and the lack of reliable and efficient product distribution networks. However, we believe that these obstacles will be overcome in time, and that e-commerce will generate significant revenues in the future. Our e-commerce services focus on well known brand name vendors and products to attract users.

Our e-commerce solutions focus on business-to-consumer e-commerce and on branded vendors such as Sogo, Lufthansa and Kodak. We also offer a consumer-to-consumer e-commerce platform to attract traffic and as a convenience to our users. Users utilizing our consumer-to-consumer platform arrange their own payment terms and fulfillment procedures. We believe we were the first Internet technology company in China to provide online e-commerce auction services. Our auction service was initially launched in July 1999 by auctioning personal computers to consumers in 24 provinces throughout China. We launched the Netease permanent auction site, auctions.163.com, in November 1999. The Netease permanent auction site offers a wide range of products, including:

- computers and peripherals
- telecommunications products
- software and games
- household appliances
- books, audio and video products
- vehicles and accessories
- Internet-related products
- arts and collectibles
- sports and fitness equipment
- real estate (purchase and leasing)
- cosmetics and clothing
- online ticketing
- children's products and toys

We offer an online user services menu which allows registered users to go directly to various sections of the Netease auction site. The Netease Web site also includes a section which features promotional products and automatically lists the latest 20 and the six most popular auction items posted to our auction site. Users register once to open both buying and selling accounts. Our staff monitors each user to ensure that such user's online activities are appropriate. We also provide registered users with a simple and accurate search engine to identify an item on auction. Our search engine not only helps users search for a particular item on auction, but also helps them search for user information by a registered user's reference number, name or e-mail address. Our platform also offers an automatic category watch system. A registered user may record a particular product in which he or she is interested. When a new product is added to the category watch system, an e-mail will automatically be sent to inform the registered user that the product is being put on auction. We also provide a credit evaluation system supported by our registered users. Our staff as well as other registered users may post credit evaluations of other users or merchants on the Netease auction site. As of May 31, 2000, the Netease auction platform had over 68,500 registered users and 38,000 registered products. The Netease auction platform had more than 70,000 average daily page views during the month of May 2000.

We have entered into an agreement with Capital Information Development Co., Ltd. to join its Capital E-commerce City services. These services include:

- verification of the identity of the parties to an e-commerce transaction;
- online payment services, including Visa, Mastercard, American Express, JCB and Diner's Club credit cards, and debit and credit cards issued by the Bank of China and the Industrial and Commercial Bank of China;
- data transaction security services; and
- mediation of disputes.

The time necessary for online payments to clear typically ranges from instantaneous to two working days. Registered users may also pay by check or choose cash-on-delivery.

Vendors using our e-commerce platform are responsible for distribution and fulfillment. However, we have established a non-exclusive alliance with China Express Mail Services Company, or CEMS, allowing businesses that sell goods on our platform to use CEMS at discounted rates to deliver goods to more than 1,900 cities in China. In addition, we have formed a non-exclusive alliance with Daily Express Services which focuses on delivery in Beijing.

We have typically charged sellers an auction commission upon consummation of the sale based on a fixed percentage of the selling price of the product sold. We also sometimes charge our online auction sellers, whether businesses or consumers, a fixed one-time registration fee for posting their products on the Netease Web sites. Going forward, we will charge vendors a fixed fee for use of the Netease e-commerce platform.

We offer an e-commerce customer service support team that staffs toll-free telephone hotlines. In addition, we offer a Web-based call center.

Strategic Alliances

We have entered into strategic alliances and partnerships with companies that complement our products and services in a number of areas.

The News Corporation

In connection with the issuance of our Series B preference shares, we entered into an agreement with News Digital Ventures, an affiliate of The News Corporation Limited, which provides for cooperation between us and The News Corporation. As part of the consideration for the issuance of our Series B preference shares, The News Corporation and its affiliates will provide us with on-air advertising and promotional inventory with a value of US\$5 million on The News Corporation's media properties, including Channel [V], ESPN Star Sports, Phoenix TV and STAR TV. We must use at least US\$1 million of the inventory within one year, and at least US\$2 million in each of the next two years. In addition, The News Corporation and its affiliates will spend US\$5 million on on-line advertising on the Netease Web sites during this time. We and The News Corporation will also cross-license Internet tools and technologies on terms to be mutually agreed upon, and will share customer information generated by either party using the cross-licensed tools and technology. The News Corporation will have a right of first refusal to provide Chinese language content to the Netease Web sites in the areas of popular music, sports and movies and general entertainment. The News Corporation will offer us the opportunity to participate in cross-promotional and marketing activities, including creating special co-branded marketing and promotional events. Our obligations and The News Corporation's obligations to purchase advertising and promotional inventory from one another, and the arrangements relating to the cross-license of Internet tools and technologies, remain subject to the negotiation of definitive agreements.

Content Partnerships and Alliances

Through our content partnerships our users have access to a broad offering of Chinese language content on the Netease Web sites. Our content partners display their content on one or more of the Netease Web sites and media channels free of charge or in exchange for a share of revenue, a licensing fee, access to original content produced by the Netease community or a combination of these arrangements. We distribute this content through our content distribution system to Guangzhou Netease, which determines the appropriate content to publish on the Netease Web sites. Our content alliances are generally non-exclusive.

We have established over 140 local and international content alliances with news agencies, paper media, Web-based services and personal Web sites. Guangzhou Netease recently entered into an agreement with AsiaMD.com Limited to create a co-branded page in our healthcare channel for which AsiaMD.com will be the exclusive content provider.

E-Commerce Solutions

We have entered into a strategic alliance agreement with BEA System (Hong Kong) Co., Ltd., an international on-line solutions supplier, pursuant to which we agreed to use BEA's Weblogic Commerce Server for our e-commerce services. We also agreed to jointly establish an e-commerce research and development center, where the two parties can jointly develop market-oriented e-commerce platforms and integrated systems, and to jointly market and promote each other's products and services. We also committed to purchase no less than US\$2 million of BEA's products and services by March 2002.

Wireless Application Protocol

In order to develop wireless application protocol, or WAP, related services for China's mobile data market, we have entered into non-binding letters of intent with a number of international wireless telecommunications appliance suppliers, including Motorola, Siemens, Ericsson and CMG Telecommunications. These letters of intent state the parties' intention to work closely to develop content and applications for wireless Internet devices and to explore mobile data markets in China. For example, Siemens will provide links to our services on its handsets and Motorola will recognize Netease.com as its first official WAP partner and first official wireless portal partner in China.

Guangzhou Netease recently entered into a memorandum of understanding with China Unicom to jointly explore business opportunities relating to WAP applications. Pursuant to this memorandum of understanding, we will customize and optimize the Netease Internet information content for China Unicom's WAP mobile phone services, and China Unicom will promote our information services to its customers. In addition, China Unicom and we will jointly construct a WAP portal for China Unicom. We have agreed to assist China Unicom to develop Internet applications, such as short message transmission, community broadcasting and other WAP-related applications, for use on China Unicom's wireless networks.

Auction Partners

Guangzhou Netease has entered into separate cooperation agreements with ClubCiti Information Technology (Beijing) Co., Ltd. the operator of the auction Web site www.clubciti.com.cn, and with Jindian Wanwei Technology Co., Ltd., the operator of the auction Web site www.yabuy.com. Guangzhou Netease has also entered into a cooperation agreement with pAsia, Inc., the operator of the auction Web site coolbid.com.cn, and we have entered into a cooperation agreement with Shenzhen eWay Co., the operator of the auction Web site ibid.com.cn. These agreements provide for mutual promotional activities and for the creation of co-branded Web sites. In addition, each of ClubCiti, Jindian Wanwei, pAsia and Shenzhen eWay will pay set-up fees, referral fees for new registered users that join its service through the Netease Web sites, and transaction based fees.

Sales and Marketing

Sales Organization

We believe the growing number of Internet users in China represents an attractive consumer market for online advertisers. To capitalize on this advertising opportunity, we established an advertising sales force in May 1999. Guangyitong Advertising sells banner advertisements on the Netease Web sites, including animated and interactive banner advertisements, button advertisements, sponsorships, text links as well as advertising on our electronic newsletters. In addition, we have been appointed by Guangzhou Netease to solicit advertising customers for the Netease Web sites outside of China. Together with Guangyitong Advertising, we currently have 22 advertising sales professionals located in Beijing and seven in Shanghai. We expect to add additional sales professionals in each of these locations. In addition, online advertising on the Netease Web sites is also sold through online advertising sales networks and advertising agencies.

As of May 31, 2000, some of the online advertisers who have advertised on the Netease Web sites included:

- Bigsave Ltd.
- Civiline International Information Technology Co.
- Nokia
- Great Wall Computer Co. Ltd.
- Intel
- Legend
- Motorola
- IBM
- China Construction Bank
- Alibaba

Marketing

We employ a variety of traditional and online marketing programs and promotional activities to build our brand as part of our overall marketing strategy. In addition, we place advertisements on high-profile third-party Web sites as well as on the Netease Web sites. To increase our brand awareness, we also hold promotional activities such as new product or service launches and special sports and holiday events.

In September 1999, we launched a major marketing campaign in key Internet markets in China, using traditional media such as print, outdoor, television and Internet advertising. Our outdoor advertising consists of posting the Netease Web site addresses on subways, buses and signposts. We have also started a national television campaign. We will launch a number of special events over the next 15 months to extend our brand name recognition in China. We recently conducted our Best Business Plan contest, where, along with sponsors such as Great Wall Computer Co. and Softbank China Venture Investments Limited, we judged the best Internet-based start-up business plan and awarded the top winner a prize of RMB500,000, the same sum with which our company was founded.

Research and Development

We believe that an integral part of our future success will depend on our ability to develop and enhance our products and services. Our product development efforts and strategies consist of incorporating new technologies from third parties as well as continuing to develop our own proprietary technology.

We have utilized and will continue to utilize the products and services of third parties to enhance our platform of technologies and services to provide competitive and diverse Internet services to our users. We also have utilized and will continue to utilize third-party advertisement serving technologies. In addition, we plan to continue to expand our technologies, products and services and registered user base through diverse online community products and services developed internally. For instance, we recently developed and introduced Easebar, a Web-browser plug-in that enables registered users to customize the look and feel of their Web browser. We use the Java programming language in developing our technologies which enables interactive

content publishing across the Internet as compared to HTML which is more useful for static content publishing. Java is a dynamic development tool with the capability to synchronize and execute multi-process applications in a cross-platform form. We will seek to continually improve and enhance our existing products and services to respond to rapidly evolving competitive and technological conditions.

Infrastructure and Technology

Our infrastructure and technology have been designed for reliability, scalability and flexibility and are administered by our technical staff. The Netease Web sites are made available through more than 130 network servers co-located in the facilities of China Telecom's Beijing, Shanghai and Guangzhou affiliates. There are also seven servers dedicated to CerNet.163.com located at leading universities in Beijing. CerNet is China's education and research network and is available to university students and university staff in China. These servers operate with Netscape's Web server software and Guangzhou Netease leases dedicated lines with 200 and 130 megabits per second capacity from China Telecom's Beijing and Guangzhou affiliates, respectively. In addition, Netease Beijing leases dedicated lines with 100 megabits per second capacity from each of China Telecom's Beijing and Shanghai affiliates.

Our hardware platform includes Sun Microsystems Enterprise servers, Dell Power Edge 6300 servers and Network Appliance Storage servers. Our operating system is mainly UNIX-based and includes free BSD and Solaris technology. To provide load balancing and to further reduce user's access time, we use IBM Network Dispatch products.

We have licensed and optimized StoryServer from Vignette Corporation to provide efficient and responsive management of Web content. We license NetGravity's advertisement serving technology to provide internal advertising inventory management and analysis systems to serve our online advertising customers. In addition, we license Web Trend software to track page views on the Netease Web sites.

Our auction platform is supported by a Solaris operating system and Sun Microsystems Enterprise 5000 servers. We license technology from Opensite Technologies, Inc., a U.S.-based floating pricing application system supplier. We have modified Opensite's functionalities by remodeling the user interface and adjusting the system to conform to the online payment format provided by domestic Chinese banks.

We use both Oracle and Sybase database systems to manage our registered user database and e-commerce platforms. We are also planning to set up a comprehensive behavior tracking system to record the behavior patterns of our users.

We intend to continue to use a combination of internally developed software products as well as third party products to enhance our Internet media services in the future.

Competition

A number of companies offer competitive products or services in China, our main operating market. These include Sina, Sohu, 163.net, 263.net, Chinadotcom, 21cn.com and east.net.

We face competition from U.S.-based portals such as Yahoo! and Yahoo! Chinese who have translated some of their content from the English language to the Chinese language. We also face competition from Web sites that operate outside our market and offer content in the English language, which may be attractive to a portion of Chinese Internet users. Further, we face competition from other Web sites that offer online community products. We also face competition from other e-commerce service providers servicing our market including Sina and 8848.net. Some of our existing and potential competitors have significantly greater financial and marketing resources than we do.

The CNNIC January 2000 survey report listed the Netease Web sites as the second most recommended among all Web sites in China. According to this survey report, the top ten Web sites most recommended by Internet users in China were:

1. www.sina.com.cn;
2. the Netease Web sites;
3. www.sohu.com.cn;
4. www.163.net;
5. www.yahoo.com;
6. www.263.net;
7. cn.yahoo.com;
8. www.china.com;
9. www.21cn.com; and
10. www.east.net.cn.

In the future, we expect to face increased competition from new Internet media companies that choose to target general, special interest and/or demographic markets (such as vertical portals). We are also affected by competition from licensees of our e-mail software. We may encounter indirect competition from providers of Web-based software and other Internet related products. We also compete with traditional forms of media for advertising-related revenue. 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.

We believe the principal competitive factors in the Internet market in China are:

- brand recognition;
- user-friendliness;
- focus on Internet users in China;
- development of technology tailored for the Chinese Internet industry;
- comprehensiveness, quality and responsiveness of products and services;
- availability of targeted content;
- personalized experience and online community applications, services and technologies; and
- the ability to attract and retain talent.

Governmental Regulations

The telecommunications industry, including computer information and Internet access services, is highly regulated by the Chinese government. Regulations issued or implemented by the State Council, the Ministry of Information Industry, or the MII, and other relevant government authorities cover virtually every aspect of telecommunications network operation, including entry into the telecommunications industry, the scope of permissible business activities, interconnection and transmission line arrangements, tariff policy and foreign investment.

In March 1998, the National People's Congress approved a government restructuring plan that directed the MII to assume, among other things, the regulatory, administrative and other responsibilities of, and rights previously exercised by, the former Ministry of Posts and Telecommunications.

The MII, under the leadership of the State Council, is responsible for, among other things:

- formulating and enforcing telecommunications industry policy, standards and regulations;
- granting licenses to provide telecommunications and Internet access services;

- formulating tariff and service charge policies for telecommunications and Internet access services;
- supervising operations of telecommunications and Internet access service providers;
- maintaining fair and orderly market competition among operators; and
- managing the day-to-day administration of the national telecommunications sector.

Recently, the Beijing Municipal Administrative Bureau of Industry and Commerce issued a circular adopting a registration and filing process for Internet-related business activities carried out in the Beijing Municipality. Such Internet-related business activities include e-commerce, on-line advertising, Web page design, on-line product promotion, network technical services and information sourcing and provision. Netease Beijing, Guangyitong Advertising and Guangzhou Netease are in the process of registering pursuant to this new regulation.

Regulation of Internet Content Services and Internet Access Services

The Provisional Rules on Administration of International Connection to Computer Information Networks (Amended), promulgated by the State Council on May 20, 1997 and their implementing rules, promulgated by the State Council on March 6, 1998, lay out the basic organizational and administrative structure of China's Internet services networks.

The MII regulates Internet content services and Internet access services in the same manner that it regulates telecommunications services.

Internet content services in China are regulated as telecommunications value added services. Until recently, with several exceptional cases approved by the State Council, the Chinese government generally prohibited foreign investors from taking any equity ownership in or operating any telecommunications business, and classified Internet network services and Internet content services as telecommunications value added services. The recently signed agreement between the governments of the United States and China regarding China's entry into the World Trade Organization allows foreign investors to own 30% of Chinese Internet company, which can be increased to 49% by the year-end of 2000 and to 50% by the year-end of 2001. However, this agreement has not been ratified.

China has also enacted other regulations governing Internet connections and the distribution of information over the Internet. According to the Administrative Measures on China Public Multimedia Telecommunications, Internet content providers are required to be verified by the MII or the provincial Telecommunications Administration Bureau in order to engage in the business of providing Internet content services. Internet content providers must also enter into an interconnection agreement and an undertaking letter for information security with China Telecom or other node service providers.

It has been reported recently that the News and Publication Bureau plans to set up an office for purposes of regulating the Internet content provision business in China.

Regulation of Content

Under the Administrative Measures on Security Protection for International Connections to Computer Information Networks, any use of the Chinese Internet infrastructure which results in a breach of the public security or the provision of socially destabilizing content is a violation of Chinese laws and regulations. A breach of the public security includes the infringement of legal rights and interests of China and Chinese citizens as well as illegal or criminal activities.

Socially destabilizing content includes content that:

- violates China’s Constitution, laws, or administrative regulations;
- incites subversion of the State, harms national unity or damages the reputation of a State organ;
- involves obscenities, pornography, gambling, violence or instigates criminal acts; or
- openly humiliates or libels another party.

If, through the provision of our content and e-commerce products and services to Netease users in China we commit any of the above violations, whether with or without intent, we may be subject to significant liability. Potential sanctions would include being disconnected from China Telecom’s network or blocked in China. Where breaches are severe, criminal proceedings may be initiated against us.

Because of the strict regulations relating to the type of content that may be transmitted through the Chinese Internet infrastructure and our conservative interpretation of such regulations, the content we provide over the Netease network of Web sites is stringently edited and may not be as appealing as other Web sites.

Under the Administrative Measures on Security Protection for International Connection to Computer Information Networks, entities with computer information networks that are connected to the Internet are required to make certain filings with relevant authorities designated by local public security bureaus. Netease Beijing, Guangyitong Advertising and Guangzhou Netease are in the process of making such filings with the relevant authorities.

We also monitor the compliance of the above-mentioned content restrictions on our community forums in the following ways:

- prior to registering with any of the Netease community forums, all users must agree to abide by restrictions on content set forth in our posted legal notice; and
- each user of the Netease community forums is required to provide an e-mail address.

Regulation of Advertisements: Publications

The State Administration of Industry and Commerce, or SAIC, is the government agency responsible for regulating advertising activities in China. There are no laws or regulations in China specifically governing online advertising businesses. The SAIC has not expressly asserted or issued any regulatory documents stating that the Internet is considered an advertising medium under its rules, nor has the SAIC extended its jurisdiction to online advertisements. However, we cannot predict what stance the SAIC or any other Chinese governmental agencies may adopt in the future.

Guangyitong Advertising holds an advertising operating license and operates our online advertising business. If the SAIC were to treat our current technological service to Guangyitong Advertising as an online “Advertisement Publisher” as defined in the Advertising Law in China, we would need to apply to the local SAIC to amend our business license to authorize us to conduct an online advertising business in accordance with the Administrative Regulations on Advertising and the Detailed Implementing Rules thereof. We cannot assure you that such application would be approved by the SAIC. Failure to obtain such approval may result in penalties including:

- being banned from engaging in online advertising activities,
- confiscation of illegal earnings; and
- fines.

On the other hand, if an application were approved by the SAIC and we were deemed to be an online “Advertisement Publisher,” we would be held responsible for examining relevant documents and verifying the content of advertisements we post online.

The State News and Publication Bureau, or SNPB, is the government agency responsible for regulating publishing activities in China. There are currently no laws or regulations in China specifically governing the online publication industry. The SNPB has not yet expressly asserted, or issued any regulatory documents stating, that the Internet is considered an electronic publication media under its rules, nor has the SNPB extended its jurisdiction to online publications. However, we cannot predict what stance the SNPB or any other Chinese governmental agencies may adopt in the future. If the SNPB were to extend its jurisdiction to encompass publications on the Internet, we may be regarded by the SNPB as an “Electronic Publisher” as defined in the Chinese Administrative Rules on Electronic Publications, and we would need to apply to the SNPB for approval so as to be authorized to conduct our electronic publication business in accordance with the Administrative Rules on Electronic Publication and the Detailed Implementing Rules thereof. We cannot assure you that such application would be approved by the SNPB. Failure to obtain such approval may result in penalties including:

- being banned from engaging in online publishing activities,
- confiscation of illegal earnings; and
- fines.

On the other hand, if our application is approved by the SNPB and we are deemed to be an “Electronic Publisher,” we would be held responsible for examining relevant documents and verifying the content of our publications.

Regulation of E-Commerce

At present, there are no specific Chinese laws governing e-commerce or defining e-commerce activities. No Chinese government authority has been designated to regulate e-commerce. There are existing regulations governing retail and auction businesses which require companies to obtain licenses in order to engage in these businesses. However, it is unclear whether these existing regulations will be applied to e-commerce. There is no assurance that the Chinese government will not, in the future, promulgate specific regulations governing e-commerce, designate a government agency to regulate e-commerce activities or apply existing retail and auction regulations to e-commerce activities. Any of these actions could have a material adverse effect on our business.

Intellectual Property and Proprietary Rights

We rely primarily on a combination of copyright laws and contractual restrictions to establish and 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 right to those works and to transfer any ownership that they may claim in those works to us.

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. Infringement or misappropriation of our intellectual property could materially harm our business. We own the intellectual property (other than the content) relating to the Netease Web sites and the technology that enables on-line community, personalization and e-commerce services on those sites. We license content from various freelance providers and other content providers.

We have full legal rights over and have registered the following domain names with Network Solutions, Inc.:

- www.netease.com;
- www.163.com;
- www.yeah.net;
- www.126.com; and
- www.nease.net.

Guangzhou Netease has also applied for registered trademarks for Netease in both Chinese and English with China's Trademark Office. China's trademark law, however, adopts a "first-to-file" system for obtaining trademark rights, whereby the first applicant to file an application for registration of a mark will preempt all other applications. Prior use of an unregistered mark is generally irrelevant except for "well known" marks. China's Trademark Office has issued a registration certificate for one of the English Netease marks to Guangzhou Netease. Guangzhou Netease is in the process of transferring this registered trademark to Netease Beijing. China's Trademark Office has not yet issued a registration certificate for other English Netease marks or the Chinese Netease marks. As a result, until actual registration certificates are issued by the Trademark Office, we may not be able to successfully defend or claim any legal rights in the those English Netease marks or the Chinese Netease marks.

Many parties are actively developing and seeking patent protection for community, e-commerce and related Web technologies. We expect these parties to continue to take steps to protect these technologies, including seeking patent protection. There may be patents issued or pending that are held by others and that cover significant parts of our technology, business methods or services. For example, we are aware that a number of patents have been issued in areas of e-commerce, Web-based information indexing and retrieval, and online direct marketing. Disputes over rights to these technologies are likely to arise in the future. We cannot be certain that our products do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others.

Employees

As of May 31, 2000, we had 199 employees and Guangzhou Netease had 45 employees, including 67 in media, 63 in technology, 27 in sales, 20 in marketing, 12 in business development, 8 in e-commerce, 12 in customer service, 15 in accounting, 2 in finance, 10 in administration and 8 in human resources. We plan to expand our work force within the next 15 months, with our customer service, editorial, marketing, sales, and technology departments expected to have the highest employee growth. None of our employees are represented by a labor union. We consider our relations with our employees to be good.

Facilities

Our Beijing offices currently occupy approximately 2,212 square meters under a lease that expires in February 2003. We also occupy 766 square meters under a lease in Shanghai that expires in December 2002. Guangzhou Netease occupies 113 square meters under a lease that expires in March 2001. We believe that we will be able to obtain adequate facilities, principally through the leasing of appropriate properties, to accommodate our future expansion plans.

Legal Proceedings

We are not currently a party to any material litigation and are not aware of any pending or threatened litigation.

MANAGEMENT

The following table sets forth the name, age and position of each director and executive officer of our company.

<u>Name</u>	<u>Age</u>	<u>Position</u>
King F. Lai	40	Director; Chief Executive Officer
William Lei Ding	28	Director; Chairman of the Board and Co-Chief Technology Officer
Helen Haiwen He	31	Director; Chief Financial Officer
Jack L. Xu	32	Co-Chief Technology Officer
Susan Chen	41	Chief Operating Officer
Ted Sun	32	Director
Xiang-Dong Yang	35	Director
Kathy Xin Xu	33	Director
Michael Sui Bau Tong	29	Director

King F. Lai joined our company as Chief Executive Officer on April 1, 2000. Mr. Lai previously worked for eight years at Saatchi & Saatchi Advertising as their Chief Executive Officer for offices in China and Taiwan. Prior to his employment with Saatchi & Saatchi Advertising, he worked for his own marketing consulting firm, The Marketing Partnership, from 1987 to 1992. Mr. Lai studied English literature for three years at the University of Pennsylvania.

William Lei Ding, our founder, has served as director, Chairman of the Board and Co-Chief Technology Officer since July 1999. Until April 1, 2000, Mr. Ding also served as our interim Chief Executive Officer. Mr. Ding established Guangzhou Netease, our affiliate, in May 1997. Prior to establishing Guangzhou Netease, Mr. Ding spent one year at Guangzhou Feijie Co. as a systems analyst, from June 1996 to April 1997, one year at Sybase (China) as a project manager, from May 1995 to May 1996, and two years at China Telecom Ningbo Branch as a technical engineer, from July 1993 to May 1995. Mr. Ding holds a Bachelor of Science degree in Communication Technology from the University of Electronic Science and Technology of China.

Helen Haiwen He has served as our Chief Financial Officer since August 1999, prior to which she spent five and half years as an investment banker at Bear, Stearns & Co. Inc. focusing on the Greater China market and the Asian technology industry, including the Internet sector. Ms. He holds a Master of Science in Computer Science from the University of Arizona and a Bachelor of Science degree in Computer Science from Tianjin University. Ms. He is also a Chartered Financial Analyst.

Jack L. Xu joined our company as Co-Chief Technology Officer in May 2000. Mr. Xu previously served as the Senior Manager for Search Technology at Excite@Home Corporation, one of the premier search engines on the Web, from June 1999 to May 2000. Prior to working for Excite@Home, he served as Senior Engineering Manager of Excite Incorporated from December 1996 to June 1999. Prior joining Excite Incorporated, he worked as a researcher at University of California at Berkeley in the field of full text search engine technologies. Mr. Xu was a Ph.D. candidate in Information Management and Systems at University of California at Berkeley. He holds a Master of Science degree in Information Science from Zhongshan University and a Bachelor of Arts degree in Information Science from Zhongshan University.

Susan Chen is expected to join our company as Chief Operating Officer in July 2000. Ms. Chen served as Vice President of Marketing of FarEasTone Telecommunications Co. since July 1997. Before joining FarEasTone, Ms. Chen served as a director in various fields of marketing, sales and business development for American Express Taiwan from April 1991 to July 1997. Prior to her employment with American Express Taiwan, she worked with Johnson & Johnson (Taiwan) from February 1982 to April 1991. Ms. Chen holds a Bachelor of Arts degree in Business Administration from Tamkang University.

Ted Sun has served as our director since December 1999. Mr. Sun served as a Managing Director of Bear Stearns Asia Limited from November 1996 to May 2000. Prior to November 1996, Mr. Sun was an assistant director with Peregrine Capital Limited. Mr. Sun holds a Bachelor of Science degree in Economics from the Wharton School of Business, University of Pennsylvania.

Xiang-Dong Yang has served as our director since December 1999. Mr. Yang is also a Managing Director of The Goldman Sachs Group, Inc. and Co-Head of the Goldman Sachs Principal Investment Area in ex-Japan Asia. Mr. Yang holds a Bachelor of Arts degree in economics from Harvard University and Master of Business Administration from Harvard Business School.

Kathy Xin Xu has served as our director since December 1999. Since 1998, Ms. Xu has been a Principal of Baring Private Equity Partners (Hong Kong) Ltd., an Asian venture capital firm specializing in information technology. At Baring, Ms. Xu has led the firm's investments in several successful companies, including Vanda System, Comtech, Netstar and Netease. Prior to working with Baring, she served as an investment manager for Peregrine Direct Investments Limited and was a senior accountant for Price Waterhouse, both in Hong Kong. Ms. Xu holds a Bachelor of Arts degree in English literature from Nanjing University. She is qualified in the UK as a certified public accountant.

Michael Sui Bau Tong has served as our director since December 1999. Mr. Tong is currently a manager in charge of venture capital investment for Softbank China Venture Investments Limited, where he evaluates and monitors Softbank China Venture's investments. Previously, he served as a manager in charge of venture capital investment for Nomura China Venture Investments Limited from 1996 to 1999 and served as an executive officer for Jardine Fleming Securities Company Limited from 1995 to 1996. Mr. Tong holds a Bachelor of Business Administration degree in Accounting from the University of Wisconsin.

Board of Directors and Board Committees

Our board of directors consists of seven members, including four non-executive directors. We expect that all current directors will continue to serve after the offering.

After the closing of this Offering, The News Corporation Limited will have the right to nominate one director to our board of directors. Upon nomination, certain of our shareholders holding a majority of our outstanding shares have agreed to vote their shares in favor of the appointment of the News Corporation's nominated director. See "Related Party Transactions" on page 66.

The audit committee reports to the board regarding the appointment of our independent public accountants, the scope and results of our annual audits, compliance with our accounting and financial policies and management's procedures and policies relative to the adequacy of our internal accounting controls. The audit committee consists of Xiang-Dong Yang, Kathy Xin Xu and Michael Sui Bau Tong.

The compensation committee of the board of directors reviews and makes recommendations to the board regarding our compensation policies and all forms of compensation to be provided to our executive officers and directors. In addition, the compensation committee reviews bonus and stock compensation arrangements for all of our other employees. The current members of the compensation committee are Xiang-Dong Yang, Kathy Xin Xu and Michael Sui Bau Tong. No interlocking relationships currently exist or have existed between our board of directors or compensation committee and the board of directors or compensation committee of any other company.

Duties of Directors

Under Cayman Islands law, our directors have a statutory duty of loyalty to act honestly in good faith with a view to our best interests. Our directors also have a duty to exercise the care, diligence and skills 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 memorandum and articles of association. A shareholder has the right to seek damages if a duty owed by our directors is breached.

Terms of Directors and Officers

All directors hold office until the next annual meeting of shareholders or until their successors have been duly elected and qualified. Officers are elected by and serve at the discretion of the Board of Directors.

Advisory Board

We formed an advisory board in December 1999. The advisory board is composed of the following:

<u>Name</u>	<u>Age</u>	<u>Occupation</u>
William Adamopoulos	37	Managing Director, Forbes Asia
Johnny Chan	40	Chief Executive Officer, Techpacific.com Limited
Duncan Clark	32	Partner, BDA (China) Ltd.
Jonathan Lemberg	40	Managing Partner, Hong Kong Office, Morrison & Foerster LLP
David Williams	31	Partner, Asia Pacific, Draper Fisher Jurvetson, and Advisor to the Emerging Markets Internet Group, Merrill Lynch (Asia Pacific) Limited

We expect that the advisory board will provide consultation and advisory services in connection with our business development, including areas related to strategic partnership, marketing and financing. The initial term of each member of the advisory board is two years. We believe that the particular knowledge and expertise of each member of the advisory board will be an invaluable contribution to our growth and future success.

Compensation of Directors and Executive Officers

For the year ended December 31, 1999, the aggregate cash compensation to our executive officers was approximately US\$63,000. We did not pay any cash compensation to our directors in 1999. For the year ended December 31, 1999, options to acquire an aggregate of 69,135,000 ordinary shares were granted to our directors and executive officers as a group.

Stock Incentive Plans

Our 1999 stock incentive plan was adopted by our board of directors in December 1999 and approved by our shareholders in January 2000. Our 2000 stock incentive plan, which supersedes the 1999 plan, was adopted by our board of directors and our shareholders in February 2000. The purpose of the plans is to attract and retain the best available personnel, to provide additional incentives to our employees, directors and consultants and to promote the success of our business. The plans provide for the granting of incentive stock options within the meaning of Section 422 of the Internal Revenue Code, as amended, nonstatutory stock options and other equity-based rights.

An aggregate of 345,675,000 of our ordinary shares, or approximately 13.5% of our total outstanding shares as of June 15, 2000, are reserved for issuance under the plans. The 13.5% reserved shares are allocated under the plans as follows: 11% to 12% of the shares are reserved for awards to be granted to the Chief Executive Officer, the Co-Chief Technology Officers, the Chief Operating Officer, the Chief Financial Officer, the Senior Vice Presidents in Sales, Marketing and Business Development, the General Manager of our Shanghai subsidiary and the members of our board, and the remaining 2-3% are reserved for awards to other employees and consultants. Options to acquire 295,148,000 ordinary shares were outstanding as of June 15, 2000, 153,553,000 of which were held by our directors and executive officers as a group.

Where the award agreement permits the exercise or purchase of the award for a certain period of time following the recipient's termination of service with us, or the recipient's disability or death, the award will terminate to the extent not exercised or purchased on the last day of the specified period or the last day of the original term of the award, whichever occurs first.

With respect to awards granted to our directors or officers who are also our employees, the plans are administered by our board of directors or a committee designated by our board of directors constituted to permit such awards to be exempt from Section 16(b) of the Securities Exchange Act of 1934, as amended, in accordance with Rule 16b-3 thereunder. With respect to awards granted to other participants, the plans are administered by our board of directors or a committee designated by it. In each case, our board of directors or the committee it designates will determine the provisions, terms and conditions of each award, including, but not limited to, the award vesting schedule, repurchase provisions, rights of first refusal, forfeiture provisions, form of payment upon settlement of the award, payment contingencies and satisfaction of any performance criteria.

The plan administrator will determine the vesting schedule of awards granted under the plan. Typically, options granted under the 1999 plan to employees vest upon the completion of their first full year of service; options granted under the 1999 plan to senior management personnel and under the 2000 plan to employees who have not been granted options under the 1999 plan vest at the rate of 20% on a specified vesting commencement date, 20% upon completion of one full year of service and 30% upon completion of each of the next two years; and options granted under the 1999 plan to members of our advisory board vest 20% on the date of appointment and 10% each quarter over the next two years. Outstanding options held by certain senior management personnel and key employees will vest in full upon William Lei Ding's ceasing to be our majority shareholder. In addition, 50% of the unvested outstanding options held by one of our executive officers will vest in full upon the consummation of this offering. Options granted under the 2000 plan to employees who have been granted options under the 1999 plan vest at the rate of 25% on a specified vesting commencement date, and 37.5% on each of the first and second anniversary of the vesting commencement date.

Incentive stock options are not transferable by the optionee other than by will or the laws of descent or distribution and are exercisable during the lifetime of the optionee only by the optionee. Other awards are transferable by gift to family members or upon a divorce.

The exercise price of incentive stock options must be at least equal to the fair market value of our shares on the date of grant, and the term of the option must not exceed ten years. The purchase price of non-qualified stock options must be at least 85% of the fair market value of our shares on the date of grant. With respect to an employee who owns shares possessing more than 10% of the voting power of all classes of our outstanding capital, the exercise price of any incentive stock option must equal at least 110% of the fair market value of our shares on the date of grant and the term of the option must not exceed five years. The exercise or purchase price of other awards will be such price as determined by the administrator. The consideration to be paid for the shares upon exercise or purchase of an award will be determined by the administrator and may include cash, check, ordinary shares, a promissory note, or the assignment of part of the proceeds from the sale of shares acquired upon exercise or purchase of the award.

If a third party acquires us through the purchase of all or substantially all of our assets, a merger or other business combination, all awards will become fully vested and exercisable immediately prior to such transaction and all unexercised awards will terminate unless, in either case, the awards are assumed by the successor corporation or its parent.

Unless terminated sooner, the 1999 and 2000 plans will terminate automatically in December, 2009 and February, 2010, respectively. Our board has the authority to amend, suspend or terminate the plans subject to shareholder approval of amendments to the extent necessary to comply with applicable law and provided no such action may affect awards previously granted under the plans.

PRINCIPAL SHAREHOLDERS

The following table sets forth information with respect to the beneficial ownership of our ordinary shares, on a fully diluted basis, as of May 31, 2000 assuming the conversion of all Series A and Series B Preference Shares into ordinary shares and as adjusted to reflect the sale of the ADSs offered hereby by:

- (1) each person known to us to own beneficially more than 5% of our ordinary shares; and
- (2) all of our directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting or investment power with respect to the securities. Except as indicated below, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all ordinary shares shown as beneficially owned by them. The number of ordinary shares outstanding used in calculating the percentage for each listed person includes the ordinary shares of underlying options held by such persons that are exercisable within 60 days of May 31, 2000, but excludes ordinary shares underlying options held by any other person. Percentage of beneficial ownership is based on 2,560,555,600 ordinary shares outstanding as of May 31, 2000, and 3,010,555,600 ordinary shares outstanding after completion of this offering, each assuming the conversion of all Series A and Series B Preference Shares into ordinary shares effective upon completion of this offering.

<u>Name and Address</u>	<u>Shares Beneficially Owned Prior to this Offering</u>		<u>Shares Beneficially Owned After this Offering</u>	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Shining Globe International Limited/William Lei Ding	1,764,090,500	68.7	1,764,090,500	58.5
15th Floor, North Tower, Beijing Kerry Centre, No.1 Guanghai Road, Chaoyang District, Beijing 100020 People's Republic of China				
The News Corporation Limited	256,055,600	10.0	256,055,600	8.5
c/o News Digital Ventures 620 Avenue of the Americas New York, NY 10011				
All directors and executive officers as a group of nine persons	1,845,228,000	71.5	1,859,055,000	61.1

Shining Globe International Limited is 100% owned by William Lei Ding, our founder, Chairman of the Board and Co-Chief Technology Officer. Shares owned by Shining Globe include options to acquire 6,913,500 ordinary shares that are exercisable within 60 days of May 31, 2000 and held by Mr. Ding.

Shares owned by all of our directors and executive officers as a group includes shares beneficially owned by William Lei Ding and also includes 23,045,000 shares and options to purchase 4,609,000 shares beneficially owned by an executive officer with respect to which voting and investment power is shared with such officer's spouse. Shares beneficially owned by our directors and executive officers prior to this offering includes additional options to acquire 7,393,500 ordinary shares that are exercisable within 60 days of May 31, 2000. Shares beneficially owned by all of our directors and executive officers after this offering includes options to acquire 32,743,000 ordinary shares that are exercisable within 60 days of May 31, 2000, including options to acquire 13,827,000 ordinary shares that will become exercisable upon completion of this offering.

We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

RELATED PARTY TRANSACTIONS

Netease.com and Netease Beijing entered into a series of agreements with Guangzhou Netease, Guangyitong Advertising and the shareholders of Guangzhou Netease and Guangyitong Advertising under which we provide our Internet and e-commerce applications, services and technologies and advertising services to Guangzhou Netease and Guangyitong Advertising, and Guangzhou Netease and Guangyitong Advertising operate the Netease Web sites and our online advertising business. We do not believe Netease.com and Netease Beijing could have obtained these agreements, taken as a whole, from unrelated third parties. We believe that the terms of each agreement are no less favorable than the terms that we could obtain from disinterested third parties. Guangzhou Netease is one of a limited number of companies in China to have secured approval from the Guangzhou telecommunications administrative authorities to engage in the Internet content provider business. Through our agreements, we have the exclusive right to benefit from this approval. In addition, we have secured significant rights over Guangyitong Advertising and the ultimate shareholders of Guangyitong Advertising and have obtained the commitment of the ultimate shareholders of Guangyitong Advertising to allow it to direct the policies and management of the ongoing activities of Guangyitong Advertising. We believe that the shareholders of Guangzhou Netease and Guangyitong Advertising will not receive material benefits from these agreements except as shareholders of Netease.com. Because of the uncertain and changing legal and regulatory environment in China, most of these agreements have terms of one year, except for the Domain Names License Agreement between Netease.com and Guangzhou Netease which has a term of five years, and the Operating Agreement among Netease Beijing, Guangyitong Advertising and the ultimate shareholders of Guangyitong Advertising which has a term of twenty years. In addition, the Voting Rights Trust Agreement among Netease Beijing and William Lei Ding and Bo Ding, as ultimate shareholders of Guangyitong Advertising has a term of ten years. These agreements are described below.

- *Domain Name License Agreement between Netease.com and Guangzhou Netease.* Netease.com granted Guangzhou Netease the right to use the domain names “netease.com,” “163.com,” “126.com,” “yeah.net” and “nease.net” on the Netease Web sites in China for license fees of RMB10,000 per year. Netease.com may waive this fee in the future. By a Supplemental Agreement entered into between the parties in May 2000, the term of this agreement has been extended from one year to five years.
- *Copyright License Agreement between Netease Beijing and Guangzhou Netease.* 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 in the future.
- *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 Web sites in China for license fees of RMB10,000 per year. Netease Beijing may waive this fee in the future.
- *Exclusive Technical Services Master Agreement between Netease Beijing and Guangzhou Netease.* Netease Beijing provides Guangzhou Netease with technical services for the operation of the Netease Web sites, including
 - server maintenance;
 - server application software development;
 - Internet application software development;
 - training; and
 - e-commerce related services.

Guangzhou Netease pays monthly service fees to Netease Beijing based on the actual operating circumstances of the parties. Netease Beijing may unilaterally adjust such fees. Netease Beijing is Guangzhou Netease’s exclusive provider of these services.

Netease Beijing has the right to transfer and sell its interests in this Exclusive Technical Services Master Agreement or any other agreements between it and Guangzhou Netease.

- *Exclusive Consulting and Services Agreement between Netease Beijing and Guangyitong Advertising.* Netease Beijing provides Guangyitong Advertising with technical consulting and related services for all advertisements published on the Netease Web sites. Guangyitong Advertising submits designs of advertisements to be published on the Netease Web sites, and Netease Beijing completes the related technical work and delivers the completed advertisements to Guangyitong Advertising. Guangyitong Advertising pays fees to Netease Beijing based on the actual operating circumstances of the parties, which consist of substantially all of Guangyitong Advertising's advertising revenue, net of the related business tax and cultural development fee. Netease Beijing may unilaterally adjust such fees. Netease Beijing will be Guangyitong Advertising's exclusive provider of these services. The initial term of this agreement will be 10 years.
- *Exclusive Advertising Agency Agreement between Netease.com and Guangzhou Netease.* Guangzhou Netease appointed Netease.com as its advertising agent to solicit advertising customers on behalf of Guangzhou Netease in markets outside of China. Netease.com pays Guangzhou Netease 10% of the total advertising revenue under this agreement per month.
- *Online Advertising Agreement between Guangzhou Netease and Guangyitong Advertising, as amended by a Supplemental Agreement entered into in May 2000.* Guangzhou Netease sells all of the banner space on the Netease Web sites to Guangyitong Advertising and publishes the advertisements provided by Guangyitong Advertising on the banner space purchased by Guangyitong Advertising. Guangyitong Advertising pays Guangzhou Netease RMB10,000 per year. Guangzhou Netease may waive this fee in the future. The initial term of this agreement will be 10 years.
- *Trademark Transfer Agreement between Guangzhou Netease and Netease Beijing.* Guangzhou Netease has agreed to transfer 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.
- *Operating Agreement among Netease Beijing, Guangyitong and the ultimate shareholders of Guangyitong Advertising.* To ensure the successful performance of the various agreements between the parties, Guangyitong Advertising and its ultimate shareholders have agreed that they will not enter into any transaction, or fail to take any action, that would substantially affect the assets, liabilities, equity or operations of Guangyitong Advertising without the prior written consent of Netease Beijing.

The parties have agreed that upon Netease Beijing's determination and at any time when Netease Beijing is able to obtain approval to invest in and operate all or any part of Guangyitong Advertising, Netease Beijing will acquire all of the assets or equity interests of Guangyitong Advertising, to the extent permitted by Chinese law. The consideration for such acquisitions will be based on the book value of Guangyitong Advertising at the time of acquisition.

Netease Beijing has agreed that it will provide performance guarantees and guarantee loans for working capital purposes to the extent required by Guangyitong Advertising for its operations.

The ultimate shareholders of Guangyitong Advertising have agreed that upon instruction from Netease Beijing, they will appoint or terminate Guangyitong Advertising's board members, General Manager, Chief Financial Officer and other senior officers.

Netease Beijing has the right to transfer and sell its interests in the Operating Agreement or any other agreements between it and Guangyitong Advertising.

- *Shareholder Voting Rights Trust Agreement among William Lei Ding, Bo Ding and Netease Beijing.* Bo Ding irrevocably appoints Netease Beijing to represent him to exercise all the voting rights to which he is entitled as a shareholder of Guangyitong Advertising and William Lei Ding and Bo Ding agree to cause Guangzhou Netease to irrevocably appoint Netease Beijing to represent Guangzhou Netease to exercise all the voting rights to which Guangzhou Netease is entitled as a shareholder of Guangyitong Advertising.
- *Termination Agreements between Netease Beijing and Guangzhou Netease.* Netease Beijing and Guangzhou Netease terminated previously existing contracts related to Netease Beijing's rights with respect to the operation of Guangzhou Netease, the lease of equipment from Netease Beijing to Guangzhou Netease and the sublease of leased lines from Netease Beijing to Guangzhou Netease. Under the Termination Agreements, Netease Beijing agrees to provide without charge to Guangzhou Netease equipment related to the operation of Internet information services.
- *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 Bo Ding have agreed that any amendments to be made to the Exclusive Consulting and Services Agreement, the Shareholder Voting Rights Trust Agreement, and the Operating Agreement described above, as well as all other agreements to which Guangzhou Netease, Guangyitong Advertising and/or William Lei Ding and Bo Ding are parties, shall be subject to the approval by the vote of a majority of our board, excluding the vote of William Lei Ding. Messrs. Ding have also agreed that, if any amendments to the above mentioned agreements require a vote of the shareholders of Netease.com, Guangzhou Netease or Guangyitong Advertising, 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.

Voting Arrangement

After the closing of this offering, The News Corporation Limited will have the right to nominate one director to our board of directors. Upon nomination, certain of our shareholders holding a majority of our outstanding shares, including our largest shareholder, Shining Globe, have agreed to vote their shares in favour of the appointment of The News Corporation's nominated director. The News Corporation's right to nominate one director and certain of our shareholders', including Shining Globe's, agreement to vote their shares in favour of the director nominated by The News Corporation, will be in effect for so long as The News Corporation owns more than 4.25% of our total issued and outstanding share capital.

Co-Sale Rights

Under the term of the investors' rights agreement among The News Corporation, Shining Globe and certain other shareholders, for so long as The News Corporation owns at least 4.25% of our outstanding share capital, it has the right, at its option, to sell its shares if Shining Globe proposes to sell any of its shares, on the same terms and conditions as Shining Globe. To the extent any prospective purchaser of Shining Globe's shares refuses to purchase The News Corporation's shares, Shining Globe may not sell its shares unless Shining Globe purchases The News Corporation's shares.

Strategic Alliance with The News Corporation

In March 2000, we issued 2,560,556 of our Series B preference shares to Best Alliance Profits Limited, a company controlled by The News Corporation Limited, in exchange for US\$35 million in cash together with on-air advertising and promotional services. In connection with this issuance, we entered into an agreement with News Digital Ventures, an affiliate of The News Corporation Limited, which provides for cooperation between us and The News Corporation. As part of the consideration for the issuance of our Series

B preference shares, The News Corporation and its affiliates will provide us with on-air advertising and promotional inventory with a value of US\$5 million on The News Corporation's media properties, including Channel [V], ESPN Star Sports, Phoenix TV and STAR TV. We must use at least US\$1 million of the inventory within one year, and at least US\$2 million in each of the next two years. In addition, The News Corporation and its affiliates will spend US\$5 million on on-line advertising on the Netease Web sites during this time, including US\$1 million within one year and US\$2 million in each of the next two years. If News Corporation and its affiliates are collectively the largest committed buyer of advertising on the Netease Web sites, they will be entitled to purchase this advertising on terms that are no less favorable than those that are applicable to any other non-affiliated buyer.

We and The News Corporation will also cross-license Internet tools and technologies on terms to be mutually agreed upon, and will share customer information generated by either party using the cross-licensed tools and technology. The News Corporation will have a right of first refusal to provide Chinese language content to the Netease Web sites in the areas of popular music, sports and movies and general entertainment. The News Corporation will offer us the opportunity to participate in cross-promotional and marketing activities, including creating special co-branded marketing and promotional events. Our obligations and The News Corporation's obligations to purchase advertising and promotional inventory from one another, and the arrangements relating to the cross-license of Internet tools and technologies, remain subject to the negotiation of definitive agreements.

Share Transfers to Certain Senior Management Personnel and Key Employees

In 1999, Shining Globe International Limited, which is 100% owned by William Lei Ding, our founder, Chairman of the Board and Co-Chief Technology Officer, agreed to transfer an aggregate of 109,694,200 ordinary shares to certain senior management personnel and key employees. These share transfers were effected in January 2000. The share transfer commitments were made to provide incentives to senior management personnel and key employees to join our company. The fair market value of these shares as of the date of such agreement (RMB45.4 million or US\$5.5 million) was charged to our earnings in 1999 as share compensation costs in accordance with U.S. GAAP, with a corresponding increase in additional paid-in capital. In addition, Shining Globe also agreed to transfer a total of 26,271,300 ordinary shares for services to be rendered by some of those individuals over three years, commencing January 1, 2000. The total estimated fair value of these shares, valued at US\$0.05 per share at the date of grant, is recognized as deferred compensation, which will be amortized over the related vesting periods. Furthermore, in March 2000, William Lei Ding transferred approximately 1,900,000 shares to certain employees, which we expect will result in share compensation costs of approximately RMB2.5 million in 2000, and has agreed to transfer a total of approximately 26,300,000 shares to employees over a period of three years commencing January 2001. Depending upon the fair market value of those shares at the time they are transferred, we are likely to incur additional share compensation costs.

DESCRIPTION OF SHARE CAPITAL

As of the date hereof, our authorized share capital consists of: 999,740,000,000 ordinary shares, par value of US\$0.0001 each; 3,000,000 Series A preference shares, par value of US\$0.01 each; and 2,600,000 Series B preference shares, par value US\$0.01 each. As of the date hereof, there are: 2,004,500,000 ordinary shares issued and outstanding; 3,000,000 Series A preference shares issued and outstanding; and 2,560,556 Series B preference shares issued and outstanding. All of our issued and outstanding Series A and Series B preference shares will automatically be converted into ordinary shares on a basis of one hundred ordinary shares to one preference share upon the closing of this offering.

We are a Cayman Islands company and our affairs are governed by our Memorandum and Articles of Association and the Companies Law (1998 Revision) of the Cayman Islands. Upon the closing of this offering, we will adopt an Amended and Restated Memorandum and Articles of Association. The following are summaries of material provisions of our Amended and Restated Memorandum and Articles of Association and the Companies Law insofar as they relate to the material terms of our ordinary shares. We have filed copies of our complete Amended and Restated Memorandum and Articles of Association as exhibits to our registration statement on Form F-1.

Ordinary Shares

General. All of our outstanding ordinary shares are fully paid and nonassessable. Certificates representing the ordinary shares are issued in registered form. Our shareholders who are nonresidents of the Cayman Islands may freely hold and vote their shares.

Dividends. The holders of ordinary shares are entitled to such dividends as may be declared by our board of directors.

Voting Rights. Each ordinary share is entitled to one vote on all matters upon which the ordinary shares are entitled to vote, including the election of directors. See “Related Party Transactions—Voting Arrangement” regarding The News Corporation Limited’s right to nominate a director to our board of directors and the agreement of certain of our shareholders to vote in favor of the election of such director. Voting at any meeting of shareholders is by show of hands unless a poll is demanded. A poll may be demanded by the 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 or by proxy. Shareholders’ meetings are held annually and may be convened by the board of directors on its own initiative or upon a request to the directors by shareholders holding in the aggregate 10% or more of our voting share capital. Advance notice of at least five days is required for the convening of the annual general meeting and other shareholders meetings.

An ordinary resolution to be made by the shareholders requires the affirmative vote of a simple majority of the votes attaching to the ordinary 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 the ordinary shares. A special resolution is required for matters such as a change of name. Holders of the ordinary shares may by ordinary resolution, among other things, elect directors, appoint auditors, and make changes in the amount of our authorized share capital.

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 ordinary shares shall be distributed among the holders of the ordinary shares on a pro rata basis. 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 of directors 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 and place of payment. The shares that have been called upon and remain unpaid are subject to forfeiture.

Redemption of Shares. 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.

Variations of Rights of Shares. All or any of the special rights attached to any class of shares may, subject to the provisions of the Companies Law, be varied either with the consent in writing of the holders of three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a general meeting of the holders of the shares of that class.

Preference Shares

Upon completion of this offering, all outstanding Series A and Series B preference shares will automatically be converted into ordinary shares on the basis of one hundred ordinary shares to one preference share.

Differences in Corporate Law

The Companies Law in the Cayman Islands is modeled after that of the United Kingdom but does not follow recent United Kingdom statutory enactments and differs from laws applicable to United States corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of the Companies Law applicable to Netease.com and the laws applicable to companies incorporated in the United States and their shareholders.

Mergers and Similar Arrangements. Cayman Islands law does not provide for mergers as that expression is understood under United States corporate law. However, there are statutory provisions that facilitate the reconstruction and amalgamation of companies, provided that the arrangement in question is approved by a majority in number of each class of shareholders and creditors with whom the arrangement is to be made, and who must in addition represent three-fourths in value of each such class of shareholders or creditors, as the case may be, that are present and voting either in person or by proxy at a meeting, or meetings convened for that purpose. The convening of the meetings and subsequently the arrangement must be sanctioned by the Grand Court of the Cayman Islands. While a dissenting shareholder would have the right to express to the court the view that the transaction ought not to be approved, the court can be expected to approve the arrangement if it satisfies itself that:

- the statutory provisions as to majority vote have been complied with;
- the shareholders have been fairly represented at the meeting in question;
- the arrangement is such as a businessman would reasonably approve; and
- and the arrangement is not one that would more properly be sanctioned under some other provision of the Companies Law.

When a take-over offer is made and accepted by holders of 90% of the shares within four months, the offerer may, within a two month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the Grand Court of the Cayman Islands but this is unlikely to succeed unless there is evidence of fraud, bad faith or collusion.

If the arrangement and reconstruction is thus approved, the dissenting shareholder would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of United States corporations, providing rights to receive payment in cash for the judicially determined value of the shares.

Shareholders' Suits. Our Cayman Islands counsel is not aware of any reported class action or derivative action having been brought in a Cayman Islands court. In principle, Netease.com itself will normally be the proper plaintiff and a derivative action may not be brought by a minority shareholder. However, based on English authorities, which would in all likelihood be of persuasive authority in the Cayman Islands, exceptions to the foregoing principle apply in circumstances in which:

- a company is acting or proposing to act illegally or ultra vires;
- the act complained of, although not ultra vires, could be effected only if authorized by more than a simple majority vote which has not been obtained; and
- those who control the company are perpetrating a “fraud on the minority.”

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, such as to provide indemnification against civil fraud or the consequences of committing a crime. Our Articles of Association provide for indemnification of officers and directors for losses, damages, costs and expenses incurred in their capacities as such, except through their own willful neglect or default.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers or persons controlling the registrant pursuant to the foregoing provisions, we have been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and therefore is unenforceable.

Registration Rights

Under the terms of our investors’ rights agreements with certain of our shareholders, including Shining Globe and The News Corporation, at any time on or after the date which is six months after the closing of this offering, any holder of outstanding ordinary shares not previously sold to the public or eligible for sale pursuant to Rule 144(k) in any three-month period who is a party to the investors’ rights agreement may, on one occasion only, require us to register for public sale all or any portion of the registrable shares held by the parties to the investors’ rights agreement who request inclusion in the registration. Registrable shares consist of ordinary shares that were issued upon conversion of our Series A and Series B preference shares. We are only required to register such shares if they have an anticipated aggregate public offering price, before underwriting discounts and commissions, of at least US\$2 million.

Further, if we become eligible to file registration statements on Form F-3 under the Securities Act, holders of outstanding registrable shares who are parties to the investor’s rights agreement may require us to register on Form F-3 for public sale all or any portion of the registrable shares held by the parties to the investors’ rights agreement who request inclusion in the registration. We are only required to effect such registration on Form F-3 if all shares to be registered have an aggregate price to the public of at least US\$1 million and if we have not already effected two such registrations within the previous twelve months.

In addition, holders of registrable shares who are parties to the investors’ rights agreements may, on one occasion only per holder, require us to register their ordinary shares when we file any registration statement under the Securities Act other than a registration statement relating to any employee benefit plan or corporate reorganization. This type of registration right is known as a “piggyback” registration right.

The foregoing registration rights are subject to certain conditions and limitations, including:

- the right of the underwriters in any underwritten offering to limit the number of ordinary shares to be registered for public sale by shareholders.
- our right to delay for up to 60 days during any twelve month period the filing of a registration statement if our board of directors determines that the registration would be seriously detrimental to us and our shareholders at that time.

We are generally required to bear all of the expenses of all registrations, except underwriting discounts and commissions. Registration of any of the ordinary shares held by shareholders with registration rights would result in those shares becoming freely tradable without restriction under the Securities Act immediately after the effectiveness of the registration. We have agreed to indemnify the holders of registration rights in connection with demand, Form F-3 and piggyback registrations in certain circumstances. Our obligations under the investors' rights agreements to register ordinary shares terminate three years after the closing of this offering.

Co-Sale Rights

See "Related Party Transactions—Co-Sale Rights" regarding the right of The News Corporation Limited to participate in sales of shares of our ordinary shares by Shining Globe.

Inspection of Books and Records

Holders of our ADSs will have no general right under Cayman Islands law to inspect or obtain copies of our list of shareholders or our corporate records. However, we will provide our shareholders with annual audited financial statements. See "Where You Can Find Additional Information" on page 95.

DESCRIPTION OF AMERICAN DEPOSITARY SHARES

The Bank of New York will act as the depositary bank for the American Depositary Shares. American Depositary Shares are frequently referred to as “ADSs” and represent ownership interests in securities that are on deposit with a depositary bank. ADSs are normally represented by certificates that are commonly known as American Depositary Receipts or “ADRs.” The depositary bank typically appoints a custodian to safekeep the securities on deposit. In this case, the custodian is The Hongkong and Shanghai Banking Corporation Limited, Custody and Clearing, Hong Kong office.

We have appointed The Bank of New York as depositary bank pursuant to a deposit agreement to be entered into by us, The Bank of New York as depositary, registered holders of outstanding ADSs and the owners of a beneficial interest in ADSs evidenced by ADRs.

You should read this summary together with the deposit agreement and the ADR. You can inspect a copy of the deposit agreement at the corporate trust office of the depositary, currently located at 101 Barclay Street, New York, New York 10286, and at the principal offices of the custodian, which will act as agent of depositary, currently located at Basement 1 & 2, 1 Queen’s Road Central, Hong Kong. We have also filed a copy of the deposit agreement as an exhibit to the registration statement that includes this prospectus.

We are providing you with a summary description of the ADSs and your rights as an owner of ADSs. Please remember that summaries by their nature lack the precision of the information summarized and that a holder’s rights and obligations as an owner of ADSs will be determined by the deposit agreement and not by this summary. We urge you to review the deposit agreement in its entirety as well as the form of ADR attached to the deposit agreement.

American Depositary Receipts

The Bank of New York will issue the ADRs. The ownership interest in each share will be represented by one ADR. The shares, or the right to receive shares, will be deposited by us with the custodian. Each ADR will also represent securities, cash or other property deposited with The Bank of New York but not distributed to ADR holders.

You may hold ADRs either directly or indirectly through your broker or other financial institution. If you hold ADRs directly, you are an ADR holder. This description assumes you hold your ADRs directly. If you hold the ADRs indirectly, you must rely on the procedures of your broker or other financial institution to assert the rights of ADR holders described in this section. You should consult with your broker or financial institution to find out what those procedures are.

Because The Bank of New York will actually be the legal owner of the shares, you must rely on it to exercise the rights of a shareholder. The obligations of The Bank of New York are set out in a deposit agreement among us, The Bank of New York and you, as an ADR holder. The deposit agreement and the ADRs are generally governed by New York law. However, our obligations to the holders of ordinary shares will continue to be governed by the laws of the Cayman Islands which may be different from the laws in the United States.

Share Dividends and Other Distributions

The Bank of New York has agreed to pay to you the cash dividends or other distributions it or the custodian receives on shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of shares your ADRs represent.

Cash. The Bank of New York will convert any cash dividend or other cash distribution we pay on the shares into U.S. dollars, if it can do so on a reasonable basis and can transfer the U.S. dollars to the United States. If that is not possible or if any approval from Chinese government is needed and cannot be obtained, the deposit agreement allows The Bank of New York to distribute the renminbi only to those ADR holders to whom it is possible to do so. It will hold the renminbi it cannot convert for the account of the ADR holders who have not been paid. It will not invest the renminbi and it will not be liable for interest.

Before making a distribution, any withholding taxes that must be paid under United States law will be deducted. See “Taxation—United States Federal Income Taxation—U.S. Holders—Taxation of Dividends and other Distributions on the Shares or ADSs” on page 84. The Bank of New York will distribute only whole U.S. dollars and cents and will round fractional cents to the nearest whole cent. *If the exchange rates fluctuate during a time when The Bank of New York cannot convert the renminbi, you may lose some or all of the value of the distribution.*

Shares. The Bank of New York may distribute new ADRs representing any shares we may distribute as a dividend or free distribution, if we furnish it promptly with satisfactory evidence that it is legal to do so. The Bank of New York will only distribute whole ADRs. It will sell shares which would require it to issue a fractional ADR and distribute the net proceeds in the same way as it does with cash. If The Bank of New York does not distribute additional ADRs, each ADR will also represent the new shares.

Rights to Receive Additional Shares. If we offer holders of our ordinary shares any rights to subscribe for additional shares or any other rights, The Bank of New York may make these rights available to you. We must first instruct The Bank of New York to do so and furnish it with satisfactory evidence that it is legal to do so. If we do not furnish this evidence and/or give these instructions, and The Bank of New York decides it is practical to sell the rights, The Bank of New York will sell the rights and distribute the proceeds, in the same way as it does with cash. The Bank of New York may allow rights that are not distributed or sold to lapse. In that case, you will receive no value for them.

If The Bank of New York makes rights available to you, it will exercise the rights and purchase the shares on your behalf. The Bank of New York will then deposit the shares and issue ADRs to you. It will only exercise rights if you pay it the exercise price and any other charges the rights require you to pay.

U.S. securities laws may restrict the sale, deposit, cancellation and transfer of the ADRs issued after exercise of rights. For example, you may not be able to trade the ADRs freely in the United States. In this case, The Bank of New York may issue the ADRs under a separate restricted deposit agreement which will contain the same provisions as the deposit agreement, except for the changes needed to put the restrictions in place.

Other Distributions. The Bank of New York will send to you anything else we distribute on deposited securities by means it thinks are legal, fair and practical. If it cannot make the distribution in that way, The Bank of New York has a choice. It may decide to sell what we distributed and distribute the net proceeds in the same way as it does with cash or it may decide to hold what we distributed, in which case the ADRs will also represent the newly distributed property.

The Bank of New York is not responsible if it decides that it is unlawful or impractical to make a distribution available to any ADR holders. We have no obligation to register ADRs, shares, rights or other securities under the Securities Act. We also have no obligation to take any other action to permit the distribution of ADRs, shares, rights, or anything else to ADR holders. This means that you may not receive the distribution we make on our shares or any value for them if it is illegal or impractical for us to make them available to you.

Deposit, Withdrawal and Cancellation

The Bank of New York will issue ADRs if you or your broker deposit shares or evidence of rights to receive shares with the custodian. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, The Bank of New York will register the appropriate number of ADRs in the names you request and will deliver the ADRs at its office to the persons you request.

You may turn in your ADRs at The Bank of New York's office. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, The Bank of New York will deliver:

- (1) the deliverable portion of the underlying shares to an account designated by you; and
- (2) the deliverable portion of any other deposited securities underlying the ADR at the office of the custodian. Or, at your request, risk and expense, The Bank of New York will deliver the deliverable portion of the deposited securities at its office. The "deliverable portion" of the ADSs will be the maximum number of whole units of shares represented by the ADSs being turned in by you at one time. If you turn in ADSs that do not constitute an integral multiple of 5,000 ADSs, The Bank of New York will deliver to you the deliverable portion of the ADSs and an ADR representing the remaining amount.

Voting Rights

You may instruct The Bank of New York to vote the shares underlying your ADRs but only if we ask The Bank of New York to ask for your instructions. Otherwise, you will not be able to exercise your right to vote unless you withdraw the shares. However, you may not know about the meeting enough in advance to withdraw the shares.

If we ask for your instructions, The Bank of New York will notify you of the upcoming vote and arrange to deliver our voting materials to you. The materials will:

- (1) describe the matters to be voted on; and
- (2) explain how you, on a specified date, may instruct The Bank of New York to vote the shares or other deposited securities underlying your ADRs as you direct. For instructions to be valid, The Bank of New York must receive them on or before the date specified. The Bank of New York will try, in compliance with Chinese law and the provisions of our memorandum and articles of association, to vote or to have its agents vote the shares or other deposited securities as you instruct. The Bank of New York will only vote or attempt to vote as you instruct.

We cannot assure you that you will receive the voting materials in time to ensure that you can instruct The Bank of New York to vote your shares. In addition, The Bank of New York and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that you may not be able to exercise your right to vote and there may be nothing you can do if your shares are not voted as you requested.

Fees and Expenses

<u>ADR holders must pay:</u>	<u>For:</u>
US\$5.00 (or less) per 100 ADSs	Each issuance of an ADR, including as a result of a distribution of shares or rights or other property
	Each cancellation of an ADR, including if the agreement terminates
US\$1.50 (or less) per ADS	Registration of transfer of receipts
US\$0.02 (or less) per ADS	Any cash payment
Registration or Transfer Fees	Transfer and registration of shares on the share register of the Foreign Registrar from your name to the name of The Bank of New York or its agent when you deposit or withdraw shares
Expenses incurred by The Bank of New York	Conversion of PRC renminbi to U.S. dollars Cable, telex and facsimile transmission expenses
Taxes and other governmental charges The Bank of New York or the Custodian have to pay on any ADR or share underlying an ADR, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary

Payment of Taxes

You will be responsible for any taxes or other governmental charges payable on your ADRs or on the deposited securities underlying your ADRs. The Bank of New York may refuse to transfer your ADRs or allow you to withdraw the deposited securities underlying your ADRs until such taxes or other charges are paid. It may apply payments owed to you or sell deposited securities underlying your ADRs to pay any taxes owed and you will remain liable for any deficiency. If it sells deposited securities, it will, if appropriate, reduce the number of ADRs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

Reclassifications, Recapitalizations and Mergers

<u>If we:</u>	<u>Then:</u>
<ul style="list-style-type: none">• Change the nominal or par value of our shares;• Reclassify, split up or consolidate any of the deposited securities;• Distribute securities on the shares that are not distributed to you;• Recapitalize, reorganize, merge, liquidate, sell all or substantially all of our assets; or• Take any similar action	<p>The cash, shares or other securities received by The Bank of New York will become deposited securities. Each ADR will automatically represent its equal share of the new deposited securities.</p> <p>The Bank of New York may, and will if we ask it to, distribute some or all of the cash, shares or other securities it received. It may also issue new ADRs or ask you to surrender your outstanding ADRs in exchange for new ADRs identifying the new deposited securities.</p>

Amendment and Termination

We may agree with The Bank of New York to amend the deposit agreement and the ADRs without your consent for any reason. If the amendment will cause any of the following results, the amendment will become effective 30 days after The Bank of New York notifies you of the amendment:

- adds or increases fees or charges, except for:
 - taxes and other government charges;
 - registration fees;
 - cable, telex or facsimile transmission costs; or
 - delivery costs or other such expenses; or
- prejudices any substantial right of ADR holders.

At the time an amendment becomes effective, you are considered, by continuing to hold your ADR, to agree to the amendment and to be bound by the ADRs and the deposit agreement as amended.

The Bank of New York will terminate the deposit agreement if we ask it to do so. In such case, The Bank of New York must notify you at least 30 days before termination. The Bank of New York may also terminate the deposit agreement if The Bank of New York has told us that it would like to resign and we have not appointed a new depositary bank within 90 days.

After termination, The Bank of New York and its agents will be required to do only the following under the deposit agreement:

- advise you that the deposit agreement is terminated; and
- collect distributions on the deposited securities and deliver the deliverable portion of shares and other deposited securities upon cancellation of ADRs.

One year after termination, The Bank of New York may sell any remaining deposited securities by public or private sale. After that, The Bank of New York will hold the proceeds of the sale, as well as any other cash it is holding under the deposit agreement for the pro rata benefit of the ADR holders that have not surrendered their ADRs or are unable to surrender their ADRs because they represent less than a unit of shares. It will not invest the money and will have no liability for interest. The Bank of New York's only obligations will be an indemnification obligation and an obligation to account for the proceeds of the sale and other cash. After termination, our only obligations will be an indemnification obligation and our obligation to pay specified amounts to The Bank of New York.

Limitations on Obligations and Liability to ADR Holders

The deposit agreement expressly limits our obligations and the obligations of The Bank of New York, and it limits our liability and the liability of The Bank of New York. We and The Bank of New York:

- are only obligated to take the actions specifically provided for in the deposit agreement without negligence or bad faith;
- are not liable if either is prevented or delayed by law or circumstances beyond their control from performing their obligations under the deposit agreement;

- are not liable if either exercises discretion permitted under the deposit agreement;
- have no obligation to become involved in a lawsuit or other proceeding related to the ADRs or the deposit agreement on your behalf of any other party; and
- may rely upon any documents they believe in good faith to be genuine and to have been signed or presented by the proper party.

In the deposit agreement, we and The Bank of New York agree to indemnify each other under designated circumstances.

Requirements for Depositary Actions

Before The Bank of New York will issue or register the transfer of an ADR, make a distribution on an ADR, or process a withdrawal of shares, The Bank of New York may require:

- payment of stock transfer or other taxes or other governmental charges and transfer or registration fees charged by third parties for the transfer of any shares or other deposited securities;
- production of satisfactory proof of the identity and genuineness of any signature or other information it deems necessary; and
- compliance with regulations it may establish, from time to time, consistent with the deposit agreement, including presentation of transfer documents.

The Bank of New York may refuse to deliver, transfer or register transfers of ADRs generally when our books or the books of The Bank of New York are closed, or at any time if The Bank of New York or we think it advisable to do so.

You have the right to cancel your ADRs and withdraw the underlying shares at any time except:

- when temporary delays arise because: (1) The Bank of New York or we have closed its or our transfer books; (2) the transfer of shares is blocked to permit voting at a shareholders' meeting; or (3) we are paying a dividend on the shares;
- when you or other ADR holders seeking to withdraw shares owe money to pay fees, taxes and similar charges; or
- when it is necessary to prohibit withdrawals in order to comply with any laws or governmental regulations that apply to ADRs or to the withdrawal of shares or other deposited securities.

This right of withdrawal may not be limited by any other provision of the deposit agreement.

Pre-Release of ADRs

In compliance with the provisions of the deposit agreement, The Bank of New York may issue ADRs before deposit of the underlying shares. This is called a pre-release of the ADR. The Bank of New York may also deliver shares upon cancellation of pre-released ADRs, even if the ADRs are cancelled before the pre-release transaction has been closed out. A pre-release is closed out as soon as the underlying shares are delivered to The Bank of New York. The Bank of New York may receive ADRs instead of shares to close out a pre-release. The Bank of New York may pre-release ADRs only under the following conditions:

- before or at the time of the pre-release, the person to whom the pre-release is being made must represent to The Bank of New York in writing that it or its customer owns the shares or ADRs to be deposited;

- the pre-release must be fully collateralized with cash or other collateral that The Bank of New York considers appropriate; and
- The Bank of New York must be able to close out the pre-release on not more than five business days' notice.

In addition, The Bank of New York will limit the number of ADRs that may be outstanding at any time as a result of pre-release to 30% of total shares deposited, although The Bank of New York may disregard the limit from time to time, if it thinks it is appropriate to do so.

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this offering, we will have outstanding 4,500,000 ADSs representing approximately 15.0% of our ordinary shares. All of the ADSs sold in this offering and the ordinary shares they represent will be freely transferable by persons other than our “affiliates” without restriction or further registration under the Securities Act. Sales of substantial amounts of our ADSs in the public market could adversely affect prevailing market prices of our ADSs. Prior to this offering, there has been no public market for our ordinary shares or the ADSs, and while application has been made for the ADSs to be quoted on the Nasdaq National Market, we cannot assure you that a regular trading market will develop in the ADSs. We do not expect that a trading market will develop for our ordinary shares not represented by the ADSs.

Lock-Up Agreements

Our directors, executive officers, holders of our preference shares and 5% shareholders have signed lock-up agreements under which they have agreed, subject to some exceptions, not to transfer or dispose of, directly or indirectly, any of our ordinary shares in the form of ADSs or otherwise, or any securities convertible into or exchangeable or exercisable for shares of our ordinary shares, in the form of ADSs or otherwise, for a period of 180 days after the date of this prospectus. These agreements are discussed in “Underwriting—No Sales of Similar Securities” on page 89 of this prospectus. After the expiration of the 180-day period, the ordinary shares or ADSs held by our directors, executive officers, holders of our preference shares or 5% shareholders may be sold subject to the restrictions under Rule 144 under the Securities Act or by means of registered public offerings.

Rule 144

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated), who has beneficially owned our ordinary shares for at least one year is entitled to sell within any three month period a number of shares, in the form of ADSs or otherwise, that does not exceed the greater of the following:

- 1% of the then outstanding number of shares of our ordinary shares, in the form of ADSs or otherwise, which will equal approximately 30.1 million shares immediately after this offering; or
- the average weekly trading volume of our ordinary shares, in the form of ADSs or otherwise, during the four calendar weeks preceding the date on which notice of the sale is filed with the Securities and Exchange Commission.

Sales under Rule 144 must be through unsolicited brokers’ transactions. They are also subject to manner of sale provisions, notice requirements and the availability of current public information about us.

Rule 144(k)

Under Rule 144(k), a person who is not one of our affiliates at any time during the three months preceding a sale, and who has beneficially owned the shares, in the form of ADSs or otherwise, proposed to be sold for at least two years, including the holding period of any prior owner other than an affiliate, is entitled to sell those shares without complying with the manner of sale, public information, volume limitation or notice provisions of Rule 144. Therefore, unless otherwise restricted, “144(k) shares” may be sold at any time.

Rule 701

In general, under Rule 701 of the Securities Act as currently in effect, each of our employees, consultants or advisors who purchases shares, in the form of ADSs or otherwise, from us in connection with a compensatory stock plan or other written agreement is eligible to resell such shares, in the form of ADSs or otherwise, in reliance on Rule 144, but without compliance with some of the restrictions, including the holding period, contained in Rule 144.

Registration Rights

Upon completion of this offering, the holders of 556,055,600 of our ordinary shares or their transferees will be entitled to request that we register their ordinary shares under the Securities Act, following the expiration of the lockup agreements described above. See “Description of Share Capital—Registration Rights” on page 72.

Stock Incentive Plans

At June 15, 2000, options to purchase 295,148,000 of our ordinary shares were issued and outstanding under our stock incentive plans. All of these shares will be eligible for sale in the public market from time to time, subject to vesting provisions, Rule 144 volume limitations applicable to our affiliates and the expiration of lock-up agreements.

We intend to file a registration statement under the Securities Act covering the 345,675,000 ordinary shares reserved for issuance under our stock incentive plans. This registration statement is expected to be filed within 90 days after the date of this prospectus and will automatically become effective upon filing. Following such filing, shares registered under the registration statement will, subject to the lockup agreements, Rule 144 volume limitations applicable to affiliates and the lapsing of our repurchase rights, be available for sale in the open market upon the exercise of vested options 90 days after the effective date of this prospectus.

TAXATION

The following summary of the material Cayman Islands and United States federal income tax consequences of an investment in our ADSs is based upon laws and relevant interpretations thereof in effect as of the date of this prospectus, all of which are subject to change. This summary does not deal with all possible tax consequences relating to an investment in the common stock, such as the tax consequences under state, local and other tax laws. To the extent that the discussion relates to matters of Cayman Islands tax law, it represents the opinion of Maples and Calder Asia, special Cayman Islands counsel to us. To the extent the discussion relates to matters of United States law or legal conclusions and subject to the qualifications herein, it represents the opinion of Morrison & Foerster LLP, our special U.S. counsel.

Cayman Islands Taxation

The Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to Netease.com levied by the Government of the Cayman Islands except for stamp duties which may be applicable on instruments executed in, or after execution brought within the jurisdiction of the Cayman Islands. The Cayman Islands is not party to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

United States Federal Income Taxation

The following is a summary of the principal United States federal income tax consequences under present law of an investment in the shares or ADSs. This summary applies only to investors that hold the shares or ADSs as capital assets and that have the U.S. dollar as their functional currency.

The following discussion does not deal with the tax consequences to any particular investor or to persons in special tax situations such as:

- banks;
- insurance companies;
- broker dealers;
- traders that elect to mark to market;
- tax-exempt entities;
- persons liable for alternative minimum tax;
- persons holding a share or ADS as part of a straddle, hedging, conversion or integrated transaction; or
- holders that actually or constructively own 10% or more of our voting stock.

Prospective purchasers are urged to consult their tax advisors about the United States federal, state and local tax consequences to them of the purchase, ownership and disposition of shares or ADSs.

The discussion below of the United States federal income tax consequences to “U.S. Holders” will apply if you are the beneficial owner of shares or ADSs and you are

- a citizen or resident of the United States;
- a corporation or partnership organized under the laws of the United States, any State or the District of Columbia;

- an estate whose income is subject to United States federal income taxation regardless of its source;
- a trust that is subject to the supervision of a court within the United States and the control of one or more United States persons; or
- a trust that has a valid election in effect under applicable U.S. Treasury regulations to be treated as a United States person.

If you are not described as a U.S. Holder, you will be considered a “Non-U.S. Holder.” Non-U.S. Holders should consult the discussion below regarding the United States federal income tax consequences applicable to Non-U.S. Holders.

U.S. Holders

Taxation of Dividends and Other Distributions on the Shares or ADSs

Subject to the passive foreign investment company rules discussed below, all our distributions to you with respect to the shares or ADSs, other than certain pro rata distributions of our shares or ADSs, will be includible in your gross income as ordinary dividend income when you, in the case of shares, or The Bank of New York, in the case of ADSs, receive the distribution, but only to the extent that the distribution is paid out of our current or accumulated earnings and profits. For this purpose, earnings and profits will be computed under United States federal income tax principles. The dividends will not be eligible for the dividends-received deduction allowed to corporations. To the extent that the amount of the distribution exceeds our current and accumulated earnings and profits, it will be treated first as a tax-free return of your tax basis in your shares or ADSs, and to the extent the amount of the distribution exceeds your tax basis, the excess will be taxed as capital gain.

Dividends paid in renminbi will be included in your income as a U.S. dollar amount based on the exchange rate in effect on the date that you or The Bank of New York receives the dividend, regardless of whether the payment is in fact converted into U.S. dollars. If you do not receive U.S. dollars on the date the dividend is distributed, you will be required to include either gain or loss in income when you later exchange the renminbi for U.S. dollars. The gain or loss will be equal to the difference between the U.S. dollar value of the amount that you include in income when you receive the dividend and the amount that you receive when you actually exchange the renminbi for U.S. dollars. The gain or loss generally will be ordinary income or loss from United States sources. If we distribute to you non-cash property, you will include in income an amount equal to the U.S. dollar equivalent of the fair market value of the property on the date that it is distributed.

Dividends will constitute foreign source income for foreign tax credit limitation purposes. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends distributed by us with respect to the shares or ADSs will be “passive income” or, in the case of certain U.S. Holders, “financial services income.” Special rules apply to individuals whose foreign source income during the taxable year consists entirely of “qualified passive income” and whose creditable foreign taxes paid or accrued during the taxable year do not exceed \$300 (\$600 in the case of a joint return). Further, in particular circumstances, a U.S. Holder that (i) has held the shares or ADSs for less than a specified minimum period during which it is not protected from risk of loss, (ii) is obligated to make payments related to the dividends, or (iii) holds the shares or ADSs in arrangements in which the U.S. Holder’s expected economic profit, after non-U.S. taxes, is insubstantial will not be allowed a foreign tax credit for foreign taxes imposed on dividends paid on the shares or ADSs.

You will not be eligible for a foreign tax credit against your U.S. federal income tax liability for taxes paid by us that are deemed under Chinese law to have been paid by our shareholders.

Distributions to you of shares or ADSs or rights to subscribe for shares or ADSs that are received as part of a pro rata distribution to all our shareholders should not be subject to United States federal income tax. The basis of your new shares or ADSs or rights so received will be determined by allocating your basis in the old shares between the old shares or ADSs and the new shares or ADSs or rights received, based on their relative fair market values on the date of distribution. However, the basis of the rights will be zero if (i) the fair market value of the rights is less than 15% of the fair market value of the old shares or ADSs at the time of distribution or (ii) the rights are not exercised and expire.

Taxation of Disposition of Shares or ADSs

Subject to the Passive Foreign Investment Company Rules discussed below, you will recognize taxable gain or loss on any sale or exchange of a share of ADS equal to the difference between the amount realized (in U.S. dollars) for the share or ADS and your tax basis (in U.S. dollars) in the share or ADS. The gain or loss will be capital gain or loss. If you are an individual who has held the share or ADS for more than one year, you will be eligible for reduced rates of taxation (generally 20%). You may deduct any loss resulting from the sale or exchange of a share or ADS only against other capital gains. If you are an individual, up to US\$3,000 of capital loss in excess of your capital gains may be deducted against ordinary income. Excess losses may be carried forward. Any gain or loss that you recognize will generally be treated as United States source income or loss.

Passive Foreign Investment Company

We believe that we are not a passive foreign investment company for United States federal income tax purposes and do not expect to become a passive foreign investment company in the future. A company is considered a passive foreign investment company for any taxable year if either

- at least 75% of its gross income is passive income, or
- at least 50% of the value of its assets (based on an average of the quarterly values of the assets during a taxable year) is attributable to assets that produce or are held for the production of passive income.

We will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, more than 25% (by value) of the stock.

In determining that we are not a passive foreign investment company, we are relying on our projected acquisition and capital expenditure plans for the current year and for future years. In addition, this determination is based on our current valuation of our assets, including goodwill. In calculating goodwill, we have valued our total assets based on our total market value determined using the lowest selling price of the shares for the past year and have made a number of assumptions regarding the amount of this value allocable to goodwill. We believe our valuation approach is reasonable. However, it is possible that the Internal Revenue Service will challenge the valuation of our goodwill, which may also result in us being classified as a passive foreign investment company. In addition, if our actual acquisitions and capital expenditure do not match our projections, we may become a passive foreign investment company.

We must make a separate determination each year as to whether we are a passive foreign investment company. As a result, our passive foreign investment company status may change. In particular, as we have valued our goodwill based on the market value of our shares or ADSs, a decrease in the price of our shares or ADSs below the lowest trading price of the shares or ADSs for the past year, may result in us becoming a passive foreign investment company.

If we are a passive foreign investment company for any taxable year during which you hold shares or ADSs, you will be subject to special tax rules with respect to any “excess distribution” that you receive and

any gain you realize from a sale or other disposition (including a pledge) of the shares or ADSs, unless you make a “mark-to-market” election as discussed below. Distributions you receive in a taxable year that are greater than 125% of the average annual distributions you received during the shorter of the three preceding taxable years or your holding period for the shares or ADSs will be treated as an excess distribution. Under these special tax rules

- the excess distribution or gain will be allocated ratably over your holding period for the shares or ADSs,
- the amount allocated to the current taxable year, and any taxable year prior to the first taxable year in which we were a passive foreign investment company, will be treated as ordinary income, and
- the amount allocated to each other year will be subject to tax at the highest tax rate in effect for that year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

The tax liability for amounts allocated to years prior to the year of disposition or “excess distribution” cannot be offset by any net operating losses, and gains (but not losses) realized on the sale of the shares or ADSs cannot be treated as capital, even if you hold the shares or ADSs as capital assets.

If we are a passive foreign investment company, you may avoid taxation under the rules described above by making a “qualified electing fund” election to include your share of our income on a current basis, or a “deemed sale” election once we no longer qualify as a passive foreign investment company. However, you may make a qualified electing fund election only if we agree to furnish you annually with certain tax information, and we do not presently intend to prepare or provide such information.

Alternatively, a U.S. Holder of “marketable stock” in a passive foreign investment company may make a mark-to-market election for stock of a passive foreign investment company to elect out of the tax treatment discussed three paragraphs above. If you make a mark-to-market election for the shares or ADSs, you will include in income each year an amount equal to the excess, if any, of the fair market value of the shares or ADSs as of the close of your taxable year over your adjusted basis in such shares or ADSs. You are allowed a deduction for the excess, if any, of the adjusted basis of the shares or ADSs over their fair market value as of the close of the taxable year. However, deductions are allowable only to the extent of any net mark-to-market gains on the stock included in your income for prior taxable years. Amounts included in your income under a mark-to-market election, as well as gain on the actual sale or other disposition of the shares or ADSs, are treated as ordinary income. Ordinary loss treatment also applies to the deductible portion of any mark-to-market loss on the shares or ADSs, as well as to any loss realized on the actual sale or disposition of the shares or ADSs, to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included for such shares or ADSs. Your basis in the shares or ADSs will be adjusted to reflect any such income or loss amounts. The tax rules that apply to distributions by corporations which are not passive foreign investment companies would apply to distributions by us.

The mark-to-market election is available only for stock which is regularly traded on a national securities exchange that is registered with the Commission or on Nasdaq, or an exchange or market that the U.S. Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. We expect that the ADSs will be listed on the Nasdaq National Market and, consequently, the mark-to-market election would be available to you were we to be or become a passive foreign investment company.

If you hold shares or ADSs in any year in which we are a passive foreign investment company, you would be required to file Internal Revenue Service Form 8621 regarding distributions received on the shares or ADSs and any gain realized on the disposition of the shares or ADSs.

Non-U.S. Holders

If you are a Non-U.S. Holder, you generally will not be subject to United States federal income tax on dividends paid by us unless the income is effectively connected with your conduct of a trade or business in the United States.

You generally will not be subject to United States federal income tax on any gain attributable to a sale or other disposition of the shares or ADSs unless such gain is effectively connected with your conduct of a trade or business within the United States or you are a natural person who is present in the United States for 183 days or more and certain other conditions exist.

Dividends and gains that are effectively connected with your conduct of a trade or business in the United States generally will be subject to tax in the same manner as they would be if you were a U.S. Holder. Effectively connected dividends and gains received by a corporate Non-U.S. Holder may also be subject to an additional branch profits tax at a 30% rate or a lower tax treaty rate.

Information Reporting and Backup Withholding

In general, information reporting for U.S. Federal income tax purposes will apply to distributions made on the shares or ADSs paid within the United States to a non-corporate United States person and on sales of the shares or ADSs to or through a United States office of a broker by a non-corporate United States person. Payments made outside the United States will be subject to information reporting in limited circumstances.

In addition, backup withholding of U.S. Federal income tax at a rate of 31% will apply to distributions made on shares or ADSs within the United States to a non-corporate United States person and on sales of shares or ADSs to or through a United States office of a broker by a non-corporate United States person who:

- fails to provide an accurate taxpayer identification number,
- is notified by the Internal Revenue Service that backup withholding will be required, or
- in certain circumstances, fails to comply with applicable certification requirements.

The amount of any backup withholding collected will be allowed as a credit against United States federal income tax liability provided that appropriate returns are filed.

A Non-U.S. Holder generally may eliminate the requirement for information reporting and backup withholding by providing certification of its foreign status to the payor, under penalties of perjury, on IRS Form W-8BEN.

UNDERWRITING

We intend to offer the ADSs in the U.S. and Canada through the U.S. underwriters and elsewhere through the international managers. Merrill Lynch, Pierce, Fenner & Smith Incorporated and Deutsche Bank Securities Inc. are acting as U.S. representatives of the U.S. underwriters named below. Subject to the terms and conditions described in a U.S. purchase agreement among us and the U.S. underwriters, and concurrently with the sale of 2,250,000 ADSs to the international managers, we have agreed to sell to the U.S. underwriters, and the U.S. underwriters severally have agreed to purchase from us, the number of ADSs listed opposite their names below.

<u>U.S. Underwriter</u>	<u>Number of ADSs</u>
Merrill Lynch, Pierce, Fenner & Smith Incorporated	1,345,500
Deutsche Bank Securities Inc.	724,500
Chase Securities Inc.	60,000
Salomon Smith Barney Inc.	60,000
UBS Warburg LLC.....	60,000
Total	<u>2,250,000</u>

We have also entered into an international purchase agreement with the international managers for sale of ADSs outside the U.S. and Canada for whom Merrill Lynch Far East Limited and Deutsche Bank Securities Inc. are acting as lead managers. Subject to the terms and conditions in the international purchase agreement, and concurrently with the sale of 2,250,000 ADSs to the U.S. underwriters pursuant to the U.S. purchase agreement, we have agreed to sell to the international managers, and the international managers severally have agreed to purchase from us, the number of ADSs listed opposite their names below.

<u>International Manager</u>	<u>Number of ADSs</u>
Merrill Lynch Far East Limited	1,462,500
Deutsche Bank Securities Inc.	787,500
Total	<u>2,250,000</u>

The initial public offering price per ADS and the total underwriting discount per ADS are identical under the U.S. purchase agreement and the international purchase agreement. Merrill Lynch Far East Limited is acting as the global coordinator and bookrunner for the offering.

The U.S. underwriters and the international managers have agreed to purchase all of the ADSs sold under the U.S. and international purchase agreements if any of these ADSs are purchased. If an underwriter defaults, the U.S. and international purchase agreements provide that the purchase commitments of the nondefaulting underwriters may be increased or the purchase agreements may be terminated. The closings for the sale of ADSs to be purchased by the U.S. underwriters and the international managers are conditioned on one another.

We have agreed to indemnify the U.S. underwriters and the international managers against certain liabilities, including liabilities under the Securities Act, or to contribute to payments the U.S. underwriters and international managers may be required to make in respect of those liabilities.

The underwriters are offering the ADSs, subject to prior sale, when, as and if issued to and accepted by them, subject to approval of legal matters by their counsel, including the validity of the ADSs, and other conditions contained in the purchase agreements, such as the receipt by the underwriters of officer's certificates and legal opinions. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part.

Commissions and Discounts

The U.S. representatives have advised us that the U.S. underwriters propose initially to offer the ADSs to the public at the initial public offering price on the cover page of this prospectus and to dealers at that price less a concession not in excess of US\$.651 per ADS. The U.S. underwriters may allow, and the dealers may reallocate, a discount not in excess of US\$.10 per ADS to other dealers. After the initial public offering, the public offering price, concession and discount may be changed.

The following table shows the public offering price, underwriting discount and proceeds before expenses to us. The information assumes either no exercise or full exercise by the U.S. underwriters and the international managers of their over-allotment options.

	<u>Per ADS</u>	<u>Without Option</u>	<u>With Option</u>
Public offering price	US\$15.50	US\$69,750,000	US\$80,212,500
Underwriting discount	US\$1.085	US\$4,882,500	US\$5,614,875
Proceeds, before expenses, to us	US\$14.415	US\$64,867,500	US\$74,597,625

The expenses of the offering, not including the underwriting discount, are estimated at US\$2,250,000 and are payable by us.

Over-allotment Options

We have granted options to the U.S. underwriters and the international managers to purchase up to 675,000 additional ADSs at the public offering price less the underwriting discount. The U.S. underwriters and the international managers may exercise these options for 30 days from the date of this prospectus solely to cover any over-allotments. If the U.S. underwriters exercise these options, each will be obligated, subject to conditions contained in the U.S. purchase agreement, to purchase a number of additional ADSs proportionate to that U.S. underwriter's initial amount reflected in the above table.

Intersyndicate Agreement

The U.S. underwriters and the international managers have entered into an intersyndicate agreement that provides for the coordination of their activities. Under the intersyndicate agreement, the U.S. underwriters and the international managers may sell ADSs to each other for purposes of resale at the initial public offering price, less an amount not greater than the selling concession. Under the intersyndicate agreement, the U.S. underwriters and any dealer to whom they sell ADSs will not offer to sell or sell ADSs to non-U.S. or non-Canadian persons or to persons they believe intend to resell to non-U.S. or non-Canadian persons, except in the case of transactions under the intersyndicate agreement. Similarly, the international managers and any dealer to whom they sell ADSs will not offer to sell or sell ADSs to U.S. persons or Canadian persons or to persons they believe intend to resell to U.S. or Canadian persons, except in the case of transactions under the intersyndicate agreement.

No Sales of Similar Securities

We and our executive officers, directors, holders of our preference shares and 5% shareholders have agreed, with exceptions, not to sell or transfer any ADSs and common stock for 180 days after the date of this prospectus without first obtaining the written consent of the global coordinator. Specifically, we and these other individuals and entities have agreed not to directly or indirectly:

- offer, pledge, sell or contract to sell any ordinary shares and ADSs,
- sell any option or contract to purchase any ordinary shares and ADSs,

- purchase any option or contract to sell any ordinary shares and ADSs,
- grant any option, right or warrant for the sale of any ordinary shares and ADSs,
- lend or otherwise dispose of or transfer any ordinary shares and ADSs,
- request or demand that we file a registration statement related to the ordinary shares and ADS, or
- enter into any swap or other agreement that transfers, in whole or in part, the economic consequence of ownership of any ordinary shares and ADSs whether any such swap or transaction is to be settled by delivery of ordinary shares, ADSs or other securities, in cash or otherwise.

This lockup provision applies to ordinary shares, ADSs and to securities convertible into or exchangeable or exercisable for or repayable with ordinary shares or ADSs. It also applies to ordinary shares and ADSs owned now or acquired later by the person executing the agreement or for which the person executing the agreement later acquires the power of disposition. However, this restriction will not limit our ability to:

- issue awards and securities issuable upon the exercise of awards under the plans described under “Management-Stock Option Plans”; and
- file a registration statement on Form S-8 in order to register the shares available under these plans.
- issue ordinary shares, ADSs and other securities in connection with merger, acquisition, strategic alliance or joint venture transactions, provided that until the end of the 180-day lock-up period, such securities shall not be registered under the Securities Act, and the recipients of such securities shall have agreed to the same lockup restrictions.

Reserved ADSs

At our request, the underwriters have reserved, at the initial public offering price, up to 225,000 of our ADSs included in the offering, for sale to employees, consultants, advisors, customers and strategic partners through a directed share program. The number of ADSs available for sale to the general public will be reduced to the extent that these persons purchase such reserved ADSs. There can be no assurance that any of the reserved ADSs will be purchased. Any reserved ADSs that are not orally confirmed for purchase within one day of the pricing of the offering will be offered by the underwriters to the general public on the same terms as the other ADSs offered hereby.

We intend to grant interest bearing loans to certain consultants, advisors, customers and strategic partners to enable them to purchase such reserved ADSs in this offering.

Quotation on the Nasdaq National Market

We expect the ADSs to be approved for quotation on the Nasdaq National Market, subject to notice of issuance, under the symbol “NTES”.

Before this offering, there has been no public market for our ordinary shares or ADSs. The initial public offering price will be determined through negotiations among us, the global coordinator, the U.S. representatives and the lead managers. In addition to prevailing market conditions, the factors to be considered in determining the initial public offering price are:

- the valuation multiples of publicly traded companies that the global coordinator, the U.S. representatives and the lead managers believe to be comparable to us,
- our financial information,
- the history of, and the prospects for, our company and the industry in which we compete,
- an assessment of our management, its past and present operations, and the prospects for, and timing of, our future revenues,

- the present state of our development, and
- the above factors in relation to market values and various valuation measures of other companies engaged in activities similar to ours.

An active trading market for the ADSs may not develop. It is also possible that after the offering the ADSs will not trade in the public market at or above the initial public offering price.

The underwriters do not expect to sell more than 5% of the ADSs in the aggregate to accounts over which they exercise discretionary authority.

Price Stabilization, Short Positions and Penalty Bids

Until the distribution of the ADSs is completed, SEC rules may limit underwriters and selling group members from bidding for and purchasing our ADSs. However, the U.S. representatives may engage in transactions that stabilize the price of the ADSs, such as bids or purchases to peg, fix or maintain that price.

The underwriters may create a short position in the ADSs in connection with the offering, i.e., they could sell more ADSs than are listed on the cover of this prospectus. The U.S. representatives may reduce that short position by purchasing ADSs in the open market. The U.S. representatives may also elect to reduce any short position by exercising all or part of the over-allotment options described above. The underwriters may sell more ADSs than could be covered by exercising all of the over-allotment options, in which case, they would have to cover these sales through open market purchases. Purchases of the ADSs to stabilize its price or to reduce a short position may cause the price of the ADSs to be higher than it might be in the absence of such purchases.

The U.S. representatives may also impose a penalty bid on underwriters and selling group members. This means that if the U.S. representatives purchase ADSs in the open market to reduce the underwriters' short position or to stabilize the price of such ADSs, they may reclaim the amount of the selling concession from the underwriters and selling group members who sold those ADSs. The imposition of a penalty bid may also affect the price of the ADSs in that it discourages resales of those ADSs.

Neither we nor any of the underwriters make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the ADSs. In addition, neither we nor any of the underwriters make any representation that the U.S. representatives or the lead managers will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

Other Relationships

Some of the underwriters and their affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with us. They have received customary fees and commissions for these transactions.

Selling Restrictions

This prospectus does not constitute an offer of, or an invitation by or on behalf of, us or by or on behalf of the underwriters, to subscribe for or purchase, any of the ADSs in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in that jurisdiction. The distribution of this prospectus and the offering of the ADSs in certain jurisdictions may be restricted by law. We and the underwriters require persons into whose possession this prospectus comes to inform themselves about and to observe any such restrictions.

Settlement Cycle

We expect that delivery of the ADSs will be made against payment therefor on or about the date specified in the last paragraph of the cover page of this prospectus, which is the fourth business day in New York following the date of this prospectus. Pursuant to Rule 15c6-1 under the Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in three business days unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the ADSs on the date of this prospectus or the next four succeeding business days will be required, by virtue of the fact that these securities will settle in T+4, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement and should consult their own advisors.

NOTICE TO CANADIAN RESIDENTS

The Offering

The offering in Canada is being made solely in the Province of Ontario.

Resale Restrictions

The distribution of the ADSs in Canada is being made on a private placement basis. Accordingly, any resale of such ADSs must be made in accordance with an exemption from the registration and prospectus requirements of applicable securities laws. Purchasers of the ADSs are advised to seek legal advice prior to any resale of the ADSs.

Representation by Purchasers

Confirmations of the acceptance of offers to purchase the ADSs will be sent to purchasers in Canada who have not withdrawn their offers to purchase prior to the issuance of such confirmations. Each purchaser who receives a purchase confirmation will, by the purchaser's receipt thereof, be deemed to represent to us and the dealer from whom such purchase confirmation is received that such purchaser is entitled under applicable provincial securities laws to purchase such ADSs without the benefit of a prospectus qualified under such securities laws.

Enforcement of Legal Rights

The ADSs being offered are those of a foreign issuer and Ontario purchasers will not receive the contractual right of action prescribed by section 32 of the Regulation under the *Securities Act* (Ontario) (now Ontario Securities Commission Rule 45-501, 21 O.S.C.B. 127). As a result, Ontario purchasers must rely on other remedies that may be available, including common law rights of action for damages or rescission or rights of action under the civil liability provisions of the U.S. federal securities laws.

All of our directors and officers and the experts named herein may be located outside Canada and, as a result, it may not be possible for Canadian purchasers to effect service of process within Canada upon us or such persons. All or a substantial portion of our assets and the assets of such persons may be located outside Canada and, as a result, it may not be possible to satisfy a judgment against us or such persons in Canada or to enforce a judgment obtained in Canadian courts against us or such persons outside Canada.

Section 130.1 of the *Securities Act* (Ontario) provides that where an offering memorandum contains a misrepresentation, a purchaser who purchases a security offered by the offering memorandum during the period of distribution shall be deemed to have relied on the misrepresentation if it was a misrepresentation at the time of purchase and such purchaser shall have a right of action for damages or rescission against the issuer on whose behalf the distribution was made.

Exchange Rates

Certain financial information in the prospectus is disclosed in Chinese renminbi.

The following table sets forth, for the periods indicated, certain information with respect to the rate of exchange for Chinese renminbi expressed in Canadian dollars (“Cdn.\$”).

Cdn.\$ per 1.00 Chinese Renminbi

<u>Year</u>	<u>Average⁽¹⁾</u>	<u>Period End⁽²⁾</u>
1995	0.1643	0.1640
1996	0.1640	0.1652
1997	0.1670	0.1728
1998	0.1792	0.1855
1999	0.1795	0.1753

-
- (1) Represents the average of the noon mid-market rate as reported by Dow Jones & Company, Inc.
(2) Represents the noon mid-market rate as reported by Dow Jones & Company, Inc. on the last trading day of the period.

LEGAL MATTERS

The validity of the ADSs and certain other legal matters will be passed upon for us by Morrison & Foerster LLP, Hong Kong. Certain legal matters in connection with this offering will be passed upon for the underwriters by Brown & Wood, Hong Kong. The validity of the ordinary shares represented by the ADSs offered in this offering will be passed upon for us by Maples and Calder Asia, Hong Kong. Legal matters as to Chinese law will be passed upon for us by Commerce & Finance Law Office, Beijing and for the underwriters by Gong Cheng Law Office, Beijing. Morrison & Foerster LLP may rely upon Maples and Calder Asia with respect to matters governed by Cayman Island's law and upon Commerce & Finance Law Office, Beijing, with respect to matters governed by Chinese law. Brown & Wood may rely upon Gong Cheng Law Office with respect to matters governed by Chinese law. Partners and employees of Morrison & Foerster LLP may purchase up to 36,000 ADSs in this offering. Partners and employees of Commerce & Finance Law Office may purchase up to 6,000 ADSs in this offering.

EXPERTS

Our consolidated financial statements as of December 31, 1998 and 1999 and for the period from June 24, 1997 (inception) to December 31, 1997 and the years ended December 31, 1998 and 1999 included in this prospectus have been audited by Arthur Andersen • Hua Qiang, independent public accountants, as stated in their reports appearing herein, and are included in reliance upon the reports of Arthur Andersen • Hua Qiang given on their authority as experts in accounting and auditing.

The statements included in this prospectus under the caption “Risk Factors—Risks Related to Our Company”; “Risk Factors—Risks Related to Doing Business in China”; Risk Factors—Risks Related to the Internet Industry in China”; “Business—Government Regulation”; “Prospectus Summary—Netease.com, Inc.”; and “Related Party Transactions”, to the extent they constitute matters of Chinese law, have been reviewed and confirmed by Commerce and Finance Law Office, special PRC counsel to the Company, as experts in such matters, and are included herein in reliance upon such review and confirmation.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form F-1, including relevant exhibits and schedules under the Securities Act with respect to the ADS and underlying ordinary shares, to be sold in this offering. This prospectus, which constitutes a part of the registration statement, does not contain all of the information contained in the registration statement. You should read the registration statement and its exhibits and schedules for further information with respect to us and our ADSs.

Immediately upon completion of this offering we will become subject to periodic reporting and other informational requirements of the Exchange Act as applicable to foreign private issuers. Accordingly, we will be required to file reports, including annual reports on Form 20-F, and other information with the SEC. As a foreign private issuer, we are exempt from the rules of the Exchange Act prescribing the furnishing and content of proxy statements to shareholders. The registration statement, reports and other information so filed can be inspected and copied at the public reference facilities maintained by the SEC at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the regional offices of the SEC at Seven World Trade Center, 13th Floor, New York, New York 10048 and 500 West Madison Street, Chicago, Illinois 60661. You can request copies of these documents upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Our SEC filings, including the registration statement and other information may also be inspected at the offices of the Nasdaq National Market, Reports Section, 1735 K Street, N.W., Washington, D.C. 20006.

NETEASE.COM, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholders of
Netease.com, Inc.:

We have audited the accompanying consolidated balance sheets of Netease.com, Inc. (a Cayman Islands corporation) as of December 31, 1998, and 1999 and the related consolidated statements of operations, shareholders' equity and cash flows for the period from July 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999 expressed in Chinese renminbi ("RMB"). These financial statements are the responsibility of Netease.com, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those Standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Netease.com, Inc. as of December 31, 1998 and 1999 and the results of its operations and cash flows for the period from July 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999, in conformity with generally accepted accounting principles in the United States of America.

Arthur Andersen • Hua Qiang

Beijing, People's Republic of China
May 11, 2000 (except with respect to the matter discussed in Note 13(c), as to which the date is June 15, 2000)

NETEASE.COM, INC.
CONSOLIDATED BALANCE SHEETS

		December 31, 1998	December 31, 1999	December 31, 1999	Pro Forma Shareholders' Equity December 31, 1999
	Note	RMB	RMB	US\$ (Note 2)	RMB (Note 10) (Unaudited)
Assets					
Current assets:					
Cash		199,538	117,800,096	14,227,924	
Accounts receivable.....		647,988	6,633,299	801,171	
Prepayments.....	5	—	5,822,014	703,184	
Other current assets	6	357,233	2,947,091	355,950	
Due from related parties.....	4	12,000	1,017,245	122,864	
Total current assets		<u>1,216,759</u>	<u>134,219,745</u>	<u>16,211,093</u>	
Property, plant and equipment, net	7	1,171,483	9,508,437	1,148,431	
Total assets		<u><u>2,388,242</u></u>	<u><u>143,728,182</u></u>	<u><u>17,359,524</u></u>	
Liabilities & Shareholders' Equity					
Current liabilities:					
Accounts payable.....		370,292	1,142,224	137,958	
Salary and welfare payable	8	28,685	1,869,403	225,787	
Taxes payable	9	201,447	1,417,864	171,250	
Deferred revenue		959,782	1,593,851	192,506	
Accrued liabilities.....		2,357	697,650	84,262	
Due to related parties		—	941,950	113,768	
Total current liabilities.....		<u>1,562,563</u>	<u>7,662,942</u>	<u>925,531</u>	
Shareholders' equity:					
Series A convertible preference shares, US\$0.01 par value: 3,000,000 shares authorized, issued and outstanding (aggregate preference on liquidation of US\$15 million)	10	—	248,367	29,998	—
Ordinary shares, US\$0.0001 par value: 1,000,000,000,000 shares authorized, 2,004,500,000 shares issued and outstanding.....	10	—	1,659,447	200,429	1,907,814
Additional paid-in capital.....	10	500,000	197,604,001	23,866,658	197,604,001
Statutory reserve.....		54,819	—	—	—
Deferred compensation.....		—	(11,743,182)	(1,418,344)	(11,743,182)
Retained earnings (accumulated deficit).....		270,860	(51,703,393)	(6,244,748)	(51,703,393)
Total shareholders' equity		<u>825,679</u>	<u>136,065,240</u>	<u>16,433,993</u>	<u>136,065,240</u>
Total liabilities & shareholders' equity		<u><u>2,388,242</u></u>	<u><u>143,728,182</u></u>	<u><u>17,359,524</u></u>	

The accompanying notes are an integral part of these financial statements.

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Note	For the Period from June 24 to December 31, 1997	For the Year Ended December 31, 1998	For the Year Ended December 31, 1999	For the Year Ended December 31, 1999
		RMB	RMB	RMB	US\$
Revenues:					
Advertising services (including revenues of RMB818,075 (US\$98,807) from related parties in 1999)	4	—	172,850	10,796,074	1,303,953
Software licensing and related integration projects ...		100,000	2,942,582	3,515,831	424,643
E-commerce related services		—	—	2,459,101	297,011
Total revenues		100,000	3,115,432	16,771,006	2,025,607
Sales and value-added taxes	9	(6,600)	(230,749)	(1,150,169)	(138,918)
Net revenues.....		93,400	2,884,683	15,620,837	1,886,689
Cost of revenues:					
Advertising and e-commerce related services (including share compensation costs of RMB6,296,816 (US\$760,531) and cost reimbursements to a related party of RMB1,974,834 (US\$238,521) in 1999)		(13,614)	(242,657)	(11,837,416)	(1,429,726)
Software licensing and related integration projects ...		(55,000)	(946,531)	(258,819)	(31,260)
Total cost of revenues		(68,614)	(1,189,188)	(12,096,235)	(1,460,986)
Gross profit.....		24,786	1,695,495	3,524,602	425,703
Operating expenses:					
Selling, general and administrative expenses (including share compensation costs of RMB34,346,268 (US\$4,148,351) and cost reimbursements to a related party of RMB466,259 (US\$56,315) in 1999)		(22,844)	(311,957)	(51,055,489)	(6,166,495)
Research and development (including share compensation costs of RMB4,770,315 (US\$576,159) in 1999)		(8,000)	(951,000)	(5,735,170)	(692,695)
Total operating expenses.....		(30,844)	(1,262,957)	(56,790,659)	(6,859,190)
Operating profit (loss).....		(6,058)	432,538	(53,266,057)	(6,433,487)
Other income (expenses):					
Sale of 163.net usage rights.....		—	—	1,500,000	181,170
Interest income.....		289	5,719	357,160	43,138
Other, net.....		(289)	(71,056)	(494,018)	(59,668)
Income (loss) before tax		(6,058)	367,201	(51,902,915)	(6,268,847)
Provision for income tax.....	9	(1,000)	(34,464)	(71,338)	(8,616)
Net income (loss)		(7,058)	332,737	(51,974,253)	(6,277,463)
Net income (loss) per share, basic and diluted.....		(0.01)	0.01	(0.03)	(0.01)
Net income (loss) per ADS, basic and diluted		(0.01)	0.02	(2.73)	(0.33)
Weighted average number of ordinary shares outstanding...		1,868,817,200	1,868,817,200	1,900,430,600	1,900,430,600
Weighted average number of ADSs outstanding		18,688,172	18,688,172	19,004,306	19,004,306
Pro forma net income (loss) per share, basic and diluted ..		(0.01)	0.01	(0.02)	(0.01)
Pro forma net income (loss) per ADS, basic and diluted...		(0.01)	0.02	(2.36)	(0.29)
Pro forma weighted average number of ordinary shares outstanding		1,868,817,200	1,868,817,200	2,200,430,600	2,200,430,600
Pro forma weighted average number of ADSs outstanding ...		18,688,172	18,688,172	22,004,306	22,004,306

The accompanying notes are an integral part of these financial statements.

NETEASE.COM, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Convertible Preference Shares		Ordinary Shares		Additional Paid-in Capital	Deferred Compensation	Statutory Reserves	Retained Earnings (Accumulated Deficit)	Total Shareholders' Equity
	Shares	Amount	Shares	Amount					
	RMB		RMB		RMB	RMB	RMB	RMB	RMB
Balance as of									
June 24, 1997	—	—	—	—	—	—	—	—	—
Capital contribution....	—	—	—	—	500,000	—	—	—	500,000
Net loss	—	—	—	—	—	—	—	(7,058)	(7,058)
Balance as of									
December 31, 1997	—	—	—	—	500,000	—	—	(7,058)	492,942
Net income	—	—	—	—	—	—	—	332,737	332,737
Appropriations to statutory reserves....	—	—	—	—	—	—	54,819	(54,819)	—
Balance as of									
December 31, 1998	—	—	—	—	500,000	—	54,819	270,860	825,679
Reorganization adjustment	—	—	—	—	(745,181)	—	(54,819)	—	(800,000)
Net loss	—	—	—	—	—	—	—	(51,974,253)	(51,974,253)
Ordinary shares issued for cash at US\$0.015 per share.....	—	—	66,666,700	55,183	8,222,386	—	—	—	8,277,569
Ordinary shares issued for cash at US\$0.0155 per share.....	—	—	64,516,100	53,401	8,223,714	—	—	—	8,277,115
Ordinary share issued to principal owner as part of reorganization (Note 2)	—	—	1,868,817,200	1,547,138	(1,547,138)	—	—	—	—
Ordinary share issued for cash at US\$0.05 per share	—	—	4,500,000	3,725	1,859,004	—	—	—	1,862,729
Convertible preference shares issued for cash at US\$5.00 per share ..	3,000,000	248,367	—	—	123,934,635	—	—	—	124,183,002
Share compensation costs (Note 10)	—	—	—	—	57,156,581	(11,743,182)	—	—	45,413,399
Balance as of									
December 31, 1999	<u>3,000,000</u>	<u>248,367</u>	<u>2,004,500,000</u>	<u>1,659,447</u>	<u>197,604,001</u>	<u>(11,743,182)</u>	<u>—</u>	<u>(51,703,393)</u>	<u>136,065,240</u>

The accompanying notes are an integral part of these financial statements.

NETEASE.COM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Period from June 24, 1997 to December 31, 1997	For the Year Ended December 31, 1998	For the Year Ended December 31, 1999	For the Year Ended December 31, 1999
	RMB	RMB	RMB	US\$
Cash flows from operating activities:				
Net income (loss)	(7,058)	332,737	(51,974,253)	(6,277,463)
Adjustments for:				
Depreciation	9,555	89,980	975,429	117,813
Share compensation costs	—	—	45,413,399	5,485,041
(Increase) in accounts receivable	(9,000)	(638,988)	(5,985,311)	(722,907)
(Increase) in prepayments	—	—	(5,822,014)	(703,184)
(Increase) in other current assets	(320,000)	(37,233)	(2,589,858)	(312,804)
(Increase) in due from related parties	—	(12,000)	(1,005,245)	(121,414)
Increase in accounts payable	55,000	243,340	771,932	93,234
Increase in salary and welfare payable	1,527	27,158	1,840,718	222,323
Increase in deferred revenue	—	959,782	634,069	76,583
Increase in taxes payable	7,144	194,303	1,216,417	146,919
Increase in accrued liabilities	1,009	73,300	695,293	83,978
Increase in due to related parties	—	—	141,950	17,144
Net cash provided by (used in) operating activities	<u>(261,823)</u>	<u>1,232,379</u>	<u>(15,687,474)</u>	<u>(1,894,737)</u>
Cash flows from investing activities:				
Purchases of property, plant and equipment	<u>(187,770)</u>	<u>(1,083,248)</u>	<u>(9,312,383)</u>	<u>(1,124,752)</u>
Cash flows from financing activities:				
Proceeds from capital contribution	500,000	—	—	—
Proceeds from ordinary shares issued	—	—	18,417,413	2,224,460
Proceeds from convertible preference shares issued	—	—	124,183,002	14,998,853
Net cash provided by financing activities	<u>500,000</u>	<u>—</u>	<u>142,600,415</u>	<u>17,223,313</u>
Net increase in cash	50,407	149,131	117,600,558	14,203,824
Cash, beginning of period/year	—	50,407	199,538	24,100
Cash, end of period/year	<u>50,407</u>	<u>199,538</u>	<u>117,800,096</u>	<u>14,227,924</u>
Supplemental disclosures of cash flow information:				
Cash paid during the period/year for income taxes	<u>—</u>	<u>8,158</u>	<u>11,557</u>	<u>1,396</u>
Supplemental schedule of noncash investing and financing activities:				
Compensation costs, arising from transfer of ordinary shares in the Company to senior management personnel (Note 10)	<u>—</u>	<u>—</u>	<u>45,413,399</u>	<u>5,485,041</u>

The accompanying notes are an integral part of these financial statements.

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts expressed in renminbi (“RMB”), unless otherwise stated)

1. Organization and Nature of Operations

The accompanying consolidated financial statements include the financial statements of Netease.com, Inc. (the “Company”) and its controlled entities which consist of Netease Information (Beijing) Co., Ltd. (“Netease Beijing”) and Netease (U.S.) Inc. (“Netease US”). The Company and these controlled entities are hereinafter collectively referred to as the “Group”.

The Company was incorporated in the Cayman Islands on July 6, 1999. As of December 31, 1999, the Company had two wholly owned subsidiaries, Netease Beijing and Netease US. Netease US has not started its operations yet.

The Group is principally engaged in developing and providing Internet-related advertising, software licensing and other services. The Group’s businesses were previously conducted by Guangzhou Netease, a limited liability company established in the People’s Republic of China (“China”), and controlled and owned by the same individual who is the principal shareholder of the Company.

In September and October 1999, ordinary shares in the Company were issued to the principal shareholder of the Company who controlled Guangzhou Netease, and Netease Beijing was formed by the Company. The ordinary shares in the Company were issued in connection with the acquisition by Netease Beijing of all the fixed assets of Guangzhou Netease as of August 31, 1999 at their book value, and all other intangible assets and contract rights not reflected on the balance sheet of Guangzhou Netease as of September 1, 1999, for a total consideration of approximately RMB1.4 million pursuant to an agreement dated September 1, 1999 and a supplemental agreement dated September 24, 1999 (hereinafter referred to as the “September 1999 Reorganization”). As a result of these transactions, Netease Beijing took over the business previously owned by Guangzhou Netease. As the same individual controls the existing Internet-related business of the Group both before and after the September 1999 Reorganization, the September 1999 Reorganization has been accounted for as a reorganization of companies under common control in a manner similar to that in pooling of interest accounting in accordance with AICPA Accounting Interpretations (AIN) 39 of Accounting Principles Board Opinion No. 16—Transfers And Exchanges Between Companies Under Common Control. All the assets acquired by Netease Beijing from Guangzhou Netease have been stated at their historical amounts to Guangzhou Netease.

The Group conducts its business within one industry segment—the business of developing and providing Internet-related advertising, software licensing and e-commerce related services in China. 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; significant numbers of new entrants; dependence on key individuals; competition from similar products from larger companies; customer preferences; the need for the continued successful development, marketing, and selling of its products and services; the need for financing; and the need for positive cash flows from operations.

The Group is currently targeting the Chinese market. The Chinese government regulates Internet access, the distribution of news and other information and the provision of commerce through strict business licensing requirements and other governmental regulations, which include, among the others, those restricting foreign ownership in Chinese companies providing Internet access, information and other online Internet services. Management is of the opinion that the Group’s businesses comply with existing Chinese laws and regulations. However, the interpretation and application of current or proposed requirements and regulations may have an adverse effect on the Group’s business, financial condition and results of operations.

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts expressed in renminbi (“RMB”), unless otherwise stated)

A significant portion of the Group’s business is transacted in RMB, which is not freely convertible into other currencies. Approval of foreign currency payments by the State Administration of Foreign Exchange of China requires a payment application form to be submitted together with suppliers’ invoices, shipping documents, and signed contracts.

The Group has a limited operating history and has not generated significant revenues. As a result, the Group is subject to risks associated with early-stage companies in new and rapidly evolving markets. As of December 31, 1999, the Group had an accumulated deficit of approximately RMB51.7 million and has continued to incur losses subsequent to that date. Management believes that the Group’s existing cash resources, the capital inflows from planned additional financing and cash generated from revenue growth will be sufficient for it to meet its obligations through at least December 31, 2000.

2. Principal Accounting Policies

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its controlled entities. As explained in Note 1 above, the September 1999 Reorganization has been accounted for as a reorganization of companies under common control in a manner similar to that in pooling of interest accounting. All significant transactions and balances between the Company and its controlled entities have been eliminated upon consolidation.

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“US GAAP”). This basis of accounting differs from that used in the statutory accounts of those companies within the Group established in China (“PRC Statutory Accounts”), which are prepared in accordance with accounting principles and the relevant financial regulations applicable to enterprises established in China (“PRC GAAP”).

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 significantly from those estimates.

The principal differences between US and PRC GAAP applicable to the Group include the following:

- recognition of compensation costs arising from transfer of ordinary shares in the Company by the principal shareholder to certain members of senior management;
- adjustment of depreciation expenses on equipment so as to more accurately reflect the useful economic lives of these assets;
- basis for revenue recognition; and
- tax effects related to the above adjustments.

Revenue recognition

The Group has adopted the provisions of the Staff Accounting Bulletin 101, “Revenue Recognition” in its accounting policy on revenue recognition.

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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Advertising services

The Group derives its advertising services revenues principally from fees received from advertisers on the Netease Web sites and the fees earned from services provided to a related party (see Note 4).

Advertising fees are derived principally from short-term advertising contracts. Revenues from advertising contracts are recognized ratably over the period in which the advertisement is displayed and collection of the resulting receivables is probable. The Group’s obligations typically also include guarantees of a minimum number of impressions or times that an advertisement appears in pages viewed by users. To the extent that minimum guaranteed impressions are not met within the contractual time period, the Group defers recognition of the corresponding revenues until the remaining guaranteed impression levels are achieved.

Starting from December 1999, the Group also derives advertising services revenues from advertising-related technical consulting services provided to a related party (see Note 4). The Group recognizes advertising services revenues from the related party as services are rendered and the service revenues are earned based on the related service agreement (see Note 13).

Revenues from barter transactions primarily relate to advertising. Barter transactions are recorded at the estimated fair market value of the service received or estimated fair market value of the advertisement given, whichever is more readily determinable. For the period from June 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999, revenues derived from barter transactions were approximately zero, zero and RMB3.4 million, respectively. Approximately RMB2.4 million of the barter revenues for the year ended December 31, 1999 arose from the exchange of the Group’s Internet advertising space for advertisements of an outdoor advertising media company, from which the Group also purchased advertisements for cash (see Note 3). Accordingly, measurable and reliable fair value for such transactions has been obtained from comparable cash purchases.

Software and related integration projects

Software and related integration projects include the elements of licensing, services, and postcontract customer support (“PCS”). PCS, generally for one year or less and occasionally beyond one year, are generally hotline support in nature and may involve unspecified upgrades or enhancements. These unspecified upgrades or enhancements offered during PCS arrangements historically have been and are expected to continue to be minimal and infrequent. The estimated costs of providing PCS are insignificant. Sufficient vendor-specific objective evidence does not exist to allocate the revenues from software and related integration projects to the separate elements of such projects.

In accordance with AICPA Statement of Position 97-2, revenues from software licensing and related integration projects under which the Group provide PCS for one year or less are recognized when the following criteria are met:

- persuasive evidence of an arrangement;
- delivery has occurred and services have been performed;
- the sales amount is fixed or determinable; and
- collectibility is probable.

Revenues from those projects under which the Group provides PCS that extend beyond one year are recognized ratably over the respective terms of the contracts. Warranty on the hardware in the related integration projects is substantially assumed by the original equipment vendors.

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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E-commerce related services

Revenues from e-commerce related services are derived principally from various short-term service contracts for construction of Web sites, market surveys, auctions, news publishing, etc. for customers conducted through the Internet, as well as registration fees and commissions charged to auction sellers for posting their products on the Web sites operated by the Company’s affiliate, Guangzhou Netease (the “Netease Web Sites”). E-commerce related services are recognized (i) in the case of auction commissions, upon consummation of the online sale, (ii) in the case of registration fees, ratably over the period in which the product for sale is displayed on the Netease Web sites and (iii) in the case of other e-commerce related service revenues, upon completion of the respective total contract and acceptance by the customers.

Deferred revenues represent prepayments by customers for services yet to be completed as of the balance sheet dates.

Cost of advertising and e-commerce related services

Cost of advertising and e-commerce related services consisting primarily of staff costs of those departments directly involved in providing advertising and e-commerce related services, depreciation and amortization of computers and software, server custody fees, bandwidth and other direct costs of providing these services are charged to the statement of operations as incurred.

Material direct costs incurred in the development of platforms for providing these services consist primarily of computer software developed or acquired. They are capitalized and amortized in accordance with AICPA Statement of Position 98-1 and costs incurred prior to the application development stage were expensed as incurred.

Cash

Cash represents cash on hand and demand deposits placed with banks or other financial institutions. Included in the cash balance as of December 31, 1999 are amounts denominated in United States dollars totaling US\$14.1 million (equivalent to approximately RMB116.8 million).

Financial instruments

Financial instruments of the Group primarily consist of accounts receivable and accounts payable. As of the balance sheet dates, their estimated fair value approximated their carrying value.

Property, plant and equipment

Property, plant and equipment 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:

Furniture and office equipment.....	5 years
Computers.....	3 years
Software.....	3 years
Leasehold improvements.....	lesser of the term of the lease or the estimated useful lives of the assets

Costs of computer software developed or obtained for internal use are accounted for in accordance with AICPA Statement of Position 98-1, under which direct costs incurred to develop the software during the

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts expressed in renminbi (“RMB”), unless otherwise stated)

application development stage and to obtain computer software from third parties that can provide future benefits are capitalized. As of December 31, 1999, the capitalizable costs of internally developed computer software are not significant.

Advertising expenses

Advertising expenses are charged to the statement of operations when incurred.

Foreign currency translation

The functional currency of the Group is RMB. Transactions denominated in currencies other than RMB are translated into RMB at the exchange rates quoted by the People’s Bank of China (the “PBOC”) prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into RMB using the applicable exchange rates quoted by the PBOC at the balance sheet dates. The resulting exchange differences are included in the determination of income.

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 = RMB8.2795 on December 31, 1999 in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate on December 31, 1999, or at any other certain rate.

Stock options

The Group has adopted the provisions of Statement of Financial Accounting Standards No. 123 (“SFAS 123”), “Accounting for Stock-Based Compensation.” In accordance with the provisions of SFAS 123, the Group has elected the disclosure only provisions related to employee stock options and follows the provisions of Accounting Principles Board Opinion No. 25 (“APB 25”) in accounting for stock options issued to employees. Under APB 25, compensation expense, if any, is recognized as the difference between the exercise price and the estimated fair value of the ordinary shares on the measurement date, which is typically the date of grant, and is recognized over the service period, which is typically the vesting period.

Income taxes

Deferred income taxes are provided using the balance sheet liability method. Under this method, deferred income taxes are recognized for the tax consequences of significant temporary differences by applying enacted statutory rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. The effect on deferred taxes for a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of, the deferred tax asset will not be realized.

Net income (loss) per share (“EPS”) and per American Depositary Share (“ADS”)

In accordance with Statement of Financial Accounting Standards No. 128, “Computation of Earnings Per Share,” basic EPS is computed by dividing net income (loss) attributable to ordinary shareholders by the

NETEASE.COM, INC.

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weighted average number of ordinary shares outstanding during the period. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of the ordinary shares issuable upon the conversion of the convertible preference shares (using the if-converted method) and ordinary shares issuable upon the exercise of outstanding stock options (using the treasury stock method). Ordinary equivalent shares in the diluted EPS computation are excluded in net loss periods as their effect would be anti-dilutive. The number of these ordinary equivalent shares excluded from the diluted EPS computation amounted to zero, zero and 323,695,000 for the period from June 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999 respectively.

Pro forma basic and diluted EPS is computed based on the weighted average number of ordinary shares outstanding giving effect to the assumed conversion of Series A preference shares outstanding as of December 31, 1999, that will automatically convert upon completion of the Company’s initial public offering (see Note 10 for details) (using the if-converted method from the original issuance date). Pro forma diluted EPS excludes the impact of stock options in the net loss periods as the effect of their inclusion would be antidilutive. The weighted average and pro forma weighted average number of ordinary shares outstanding include the effect of the one-hundred-for-one share split as discussed in Note 13. Net income (loss) per ADS has been computed by multiplying the net income (loss) per share by 100, which is the number of shares represented by each ADS.

The weighted average number of ordinary shares outstanding for the period from June 24, 1997 to December 31, 1997 and for the year ended December 31, 1998, for the purposes of EPS calculations, represent the number of ordinary shares issued to the principal owner of Guangzhou Netease, which conducted the Group’s businesses prior to the September 1999 Reorganization.

Statutory reserves

In accordance with the Regulations on Enterprises with Foreign Investment of China and its articles of association, Netease Beijing, being a wholly foreign owned enterprise established in China, is required to provide for certain statutory reserves namely general reserve, enterprise expansion fund and staff welfare and bonus fund which are appropriated from net profit as reported in its PRC Statutory Accounts. Netease Beijing is required to allocate at least 10% of its after-tax profit to the general reserve. Netease Beijing may stop allocations to the general reserve if such reserve has reached 50% of its registered capital. Appropriations to the enterprise expansion fund and staff welfare and bonus fund are at the discretion of the board of directors of Netease Beijing. These reserves can only be used for specific purposes and are not distributable as cash dividends. Appropriations to the staff welfare and bonus fund will be charged to selling, general and administrative expenses.

Netease Beijing has been in a loss position according to its PRC Statutory Accounts and no appropriations to statutory reserves have been made.

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 common significant influence.

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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Recent accounting pronouncement

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 (“SFAS 133”), “Accounting for Derivative Instruments and Hedging Activities”. This statement requires companies to record all derivatives on the balance sheet as assets or liabilities measured at fair value. Gains and losses resulting from changes in fair market values of those derivative instruments would be accounted for depending on the use of the instrument and whether it qualifies for hedge accounting. SFAS 133 will be effective for the Group’s year ending December 31, 2001. The Group does not expect that the implementation of SFAS 133 will have a significant impact on its financial position, results of operations or cash flows.

3. Concentrations

Major customers

Revenues from customers that individually represent greater than 10% of the total revenues for the period from June 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999 are as follows:

<u>Customers</u>	<u>For the Period from June 24, 1997 to December 31, 1997</u>	<u>For the Year Ended December 31, 1998</u>	<u>For the Year Ended December 31, 1999</u>
Guangzhou Feihua Telecom Co., Ltd.	90,000	398,729	—
Jinhua Postal Bureau	—	390,000	—
Top Result Promotion Ltd.	—	—	2,369,363
Bigsave Ltd.	—	—	2,075,000

All of the revenues from Top Result Promotion Ltd. resulted from barter transactions.

Bandwidth and server custody service provider

The Group relies exclusively on a telecommunications service provider and its affiliates for bandwidth and server custody service.

Dependence on Guangzhou Netease

The Group relies exclusively on Guangzhou Netease, which has approval to operate as an Internet content provider, for the operation of the Netease Web sites.

Credit risk

The Group is principally engaged in developing and providing Internet-related advertising, software licensing and other services to businesses primarily in China. The Group generally does not require collateral for its accounts receivable.

4. Related Party Transactions

During the year ended December 31, 1999, the Group had advertising revenues from shareholders of the Company amounting to approximately RMB539,000.

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During the year ended December 31, 1999, the Group reimbursed Guangzhou Netease a total of approximately RMB2,441,000 for the costs of operating the Netease Web sites.

During the year ended December 31, 1999, the Group derived approximately RMB279,000 of advertising services revenues from Guangyitong Advertising Co., Ltd. (“Guangyitong Advertising”), a related company that is 80% owned by the principal shareholder of the Group for advertising-related technical consulting and services performed.

As of the balance sheet dates, due from related parties represents amounts receivable from shareholders for services performed, temporary advances to officers of the Group, and advances to Guangzhou Netease. Due to related parties represents amounts payable to Guangyitong Advertising. The balances with related parties were unsecured, interest-free and repayable on demand. As of December 31, 1999, the amounts due from related parties included an amount denominated in United States dollars of US\$50,000 (equivalent to approximately RMB415,000). All other related party balances are denominated in RMB.

5. Prepayments

	<u>December 31, 1998</u>	<u>December 31, 1999</u>
Prepaid advertising expenses	—	4,433,441
Prepaid rentals	—	362,617
Prepayment for office equipment purchases	—	288,602
Prepaid legal fees	—	347,971
Others	—	389,383
	<u>—</u>	<u>5,822,014</u>

6. Other Current Assets

	<u>December 31, 1998</u>	<u>December 31, 1999</u>
Temporary deposits for rented premises	—	1,722,460
Interest receivable	—	383,828
Advances	315,000	369,406
Others	42,233	471,397
	<u>357,233</u>	<u>2,947,091</u>

7. Property, Plant and Equipment

	<u>December 31, 1998</u>	<u>December 31, 1999</u>
Computers	1,218,760	8,327,804
Furniture and office equipment	52,258	433,125
Software	—	854,972
Leasehold improvements	—	967,500
	<u>1,271,018</u>	<u>10,583,401</u>
Less: Accumulated depreciation	<u>(99,535)</u>	<u>(1,074,964)</u>
Net book value	<u>1,171,483</u>	<u>9,508,437</u>

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Amounts expressed in renminbi (“RMB”), unless otherwise stated)

8. Employee Benefits

The full-time employees of those companies within the Group which are established in China are entitled to staff welfare benefits including medical care, welfare subsidies, unemployment insurance and pension benefits, etc. These companies are required to accrue for these benefits based on certain percentages of the employees' salaries in accordance with the relevant regulations. The total provision for such employee benefits amounted to approximately RMB2,000, RMB27,000 and RMB1.4 million for the period from June 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999 respectively. These companies are also required to make contributions to the state-sponsored pension and medical plans out of the amounts accrued for medical and pension benefits. These contributions for the period from June 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999 amounted to approximately zero, zero and RMB194,000 respectively. The Chinese government is responsible for the medical benefits and ultimate pension liability to these employees.

9. Taxation

Income taxes

Cayman Islands

Under the current laws of the Cayman Islands, the Company is not subject to tax on income or capital gain. Additionally, upon payments of dividends by the Company to its shareholders, no Cayman Islands withholding tax will be imposed.

People's Republic of China

Foreign Invested Enterprises

In accordance with “Income Tax Law of China for Enterprises with Foreign Investment and Foreign Enterprises,” foreign invested enterprises are generally subject to enterprise income tax (“EIT”) at the rate of 30% plus a local tax of 3%. Netease Beijing, being a foreign invested enterprise and located in the New Technology Industrial Development Experimental Zone in Beijing, is eligible to apply for a reduced EIT rate of 15% if it is recognized as a New and High Technology Enterprise. A New and High Technology Enterprise is also eligible to apply for a full exemption from EIT for the first three years of its operations and a 50% reduction in EIT for the following three years. These tax preferences are subject to the approval of the relevant Chinese tax authorities.

Domestic Enterprises

Guangzhou Netease is a Chinese domestic enterprise and is generally subject to EIT at a rate of 33%. For the period from June 24, 1997 to December 31, 1997 and for the year ended December 31, 1998, Guangzhou Netease was categorized as a small-sized tax payer by the local tax bureau of Guangzhou, China. According to the relevant tax circulars issued by the local tax bureau of Guangzhou, Guangzhou Netease was subject to EIT calculated at 1% of the total amount of its revenues and the gross amounts of other income, which principally accounted for the difference between the provision for income taxes at the statutory rate of 33% and the effective tax rates for those periods.

NETEASE.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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The following is a reconciliation between the EIT statutory rate and the Group’s effective EIT rate:

	For the Period from June 24, 1997 to December 31, 1997	For the Year Ended December 31, 1998	For the Year Ended December 31, 1999
EIT statutory rate	(33.0%)	33.0%	(33.0%)
Non-deductible share compensation costs.....	—	—	13.1%
Effect of tax rate applicable to small-sized domestic enterprises.....	49.5%	(23.6%)	(0.2%)
Effect of lower tax rate applicable to hi-tech enterprises.....	—	—	18.3%
Valuation allowance for deferred tax assets	—	—	1.9%
Effective EIT rate.....	<u>16.5%</u>	<u>9.4%</u>	<u>0.1%</u>

As of December 31, 1999, the tax impact of significant temporary differences between the tax and financial statement bases of assets and liabilities that gave rise to deferred tax assets were principally related to the following:

Net operating loss carryforwards (primarily in Netease Beijing relating to EIT applicable to foreign invested enterprises).....	984,128
Valuation allowance	<u>(984,128)</u>
Net deferred tax assets	<u>—</u>

Netease Beijing had tax net operating loss carryforwards of approximately RMB6.6 million as of December 31, 1999 for EIT purposes. These carryforwards will expire in 2004. A valuation allowance has been provided to offset gross deferred tax assets due to the uncertainty surrounding the realizability of such assets. There can be no assurance that Netease Beijing will be able to utilize net operating loss carryforwards before their expiration.

Foreign Enterprises

In the event that the activities of the Company and Netease US, being foreign enterprises for Chinese tax purposes, constitute a permanent establishment in China, they would be subject to EIT to the extent of income sourced in China. The normal EIT rate is 30% plus a local tax of 3% on the net taxable income.

Income of the Company and Netease US that is not connected to a permanent establishment in the PRC would be subject to a 20% withholding tax on gross receipts from profit, interest, rentals, royalties and other income sourced in China. If such income is earned from sources within the designated special economic zones or other designated areas, the withholding tax is reduced to 10%.

Dividends from Netease Beijing to the Company are exempt from Chinese withholding tax.

Business tax (“BT”)

The Group is subject to BT on the provision of taxable services in China, transfer of intangible assets and the sale of immovable properties in China. The tax rates range from 3% to 20% of the gross receipts,

NETEASE.COM, INC.

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depending on the nature of the revenues. The applicable BT rate for the Group’s revenues is generally 5%. In addition, the Group is subject to a cultural development fee at 3% on its Internet advertising revenues.

Value added taxes (“VAT”)

The Group is subject to VAT at a rate of 17% on revenues from the sale of computer hardware purchased on behalf of customers as part of the integration projects related to software licensing, which is payable after offsetting against the input value added tax paid on purchases. For the period from June 24, 1997 to December 31, 1997 and the year ended December 31, 1998, Guangzhou Netease was categorized as a small-sized taxpayer and therefore was required to pay VAT calculated at 6% on such revenues with no input VAT offset.

Taxes payable

	December 31, 1998	December 31, 1999
VAT	154,294	374,232
BT	(532)	529,662
Income taxes	27,306	87,086
Cultural development fee.....	5,186	76,591
Others.....	15,193	350,293
	<u>201,447</u>	<u>1,417,864</u>

10. Capital Structure

Ordinary shares

The holders of ordinary shares in the Company are entitled to one vote per share. Subject to certain preferences attributable to the outstanding preference shares (see below), the holders of ordinary shares are entitled 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, subject to prior distribution rights of preferred shareholders. The ordinary shares have no preemptive, conversion, or other subscription rights.

In November 1999, in consideration for certain members of the senior management joining the Group, the principal shareholder of the Company committed to transfer a total of 109,694,200 ordinary shares in the Company to such individuals with no vesting period requirement. The estimated fair value of these shares committed to be transferred, valued at US\$0.05 per share at the date of commitment, is recognized as compensation costs immediately. In addition, the principal shareholder of the Company also agreed to transfer a total of 26,271,300 ordinary shares in the Company for services to be rendered by certain of those individuals over three years starting from January 1, 2000. The total estimated fair value of these shares valued at US\$0.05 per share at the date of grant is recognized as deferred compensation which will be amortized over the related vesting periods.

Convertible preference shares

The Series A preference shares are convertible on a basis of 100 ordinary shares for one preference share. These preference shares will be automatically converted upon closing of a public offering of the ordinary shares in the Company prior to December 31, 2000 that meets certain threshold conditions on the amounts of valuation and proceeds, or upon the written consent of holders of these preference shares.

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The Series A preference shares carry certain preferences on dividend payment and return of capital in case of a winding up of the Company. Written consent of the holders of more than 50% of these preference shares must be obtained for any acquisition, merger, reorganization, substantial disposal of assets, alteration of capital amounts, disposal of interest in any subsidiary or associate company, and liquidation or winding-up of the Company.

11. Stock Option Plans

In December 1999, the Company adopted an incentive and non-statutory stock option plan for the Company’s senior management and employees (the “1999 Stock Incentive Plan”). The Company has reserved a total of 345,675,000 ordinary shares for issuance under the plan.

Options for the members of the Company’s senior management become exercisable at the rate of 20% on the vesting commencement date which was September 1, 1999, 20% upon completion of one full year and 30% upon completion of each of the next two full years thereafter. These options will also vest upon the founder of the Group ceasing to be the principal shareholder of the Group. In addition, certain of these options will vest upon closing of a public offering of the ordinary shares in the Company. The options for the members of the Company’s senior management expire on September 1, 2009. The exercise price is US\$0.065 per share.

Options for the employees vest upon completion of the first full year of service by the respective employees from that the date they first joined the Group and expire at the end of the fifth year of their respective service periods. The exercise price of the options for the employees is US\$0.07 per share.

The Company also granted options to acquire a total of 3,000,000 ordinary shares to its advisory board members. Twenty percent of these options vest on the date of appointment, which was the end of 1999, and 10% will vest each quarter over the next two years thereafter. The exercise price is US\$0.065 per share. The total estimated fair value of the options granted to the advisory board members of approximately 867,000 is recognized at the date of grant as deferred compensation which will be amortized over the related vesting period. The estimated fair value of the options granted to advisory board member is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for the grant: risk-free interest rate of 2.97%; estimated fair value of US\$0.050 per ordinary share; expected dividend yield of 0% for all periods; expected life of two years; and expected volatility of 155% for all periods.

Information relating to stock options outstanding is as follows:

	Shares	Weighted Average Exercise Price
Balance, December 31, 1998	—	—
Options granted	121,960,000	US\$0.065
Balance, December 31, 1999	121,960,000	US\$0.065

As of December 31, 1999, options to purchase 23,695,000 ordinary shares were exercisable. Under the stock option plans, options to purchase 223,715,000 ordinary shares were available for future grant. The fair value of ordinary shares on the dates of stock option grants was determined by management based on the recent

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issuance of preference shares, consideration of significant milestones achieved by the Group and other market considerations. Options outstanding and exercisable by price range as of December 31, 1999, were as follows:

<u>Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number Vested</u>
US\$0.065	118,225,000	9.54	23,645,000
US\$0.07	3,735,000	4.47	50,000
	<u>121,960,000</u>	<u>9.38</u>	<u>23,695,000</u>

For the purposes of SFAS 123 pro forma disclosure, the estimated fair value of each senior management or employee option grant is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for the grants: risk-free interest rates of 3.30% and 2.97% for the options for senior management and employees respectively; estimated fair value of US\$0.05 and US\$0.07 for the options granted to senior management personnel and to employees, respectively; expected dividend yield of 0% for all periods; expected lives of ten years and five years for the options for senior management and employees respectively; and expected volatility of 0% for all periods.

Had the compensation costs for the plan been determined based on the estimated fair value of the options at the grant dates for awards under the plan, the Group’s net income (loss) and net income (loss) per ordinary share on a pro forma basis for the period from July 24, 1997 to December 31, 1997, and for the years ended December 31, 1998 and 1999 would have been as follows:

	<u>For the Period from June 24, 1997 to December 31, 1997</u>	<u>For the Year Ended December 31, 1998</u>	<u>For the Year Ended December 31, 1999</u>
Net income (loss):			
As reported.....	(7,058)	332,737	(51,974,253)
Pro forma.....	(7,058)	332,737	(52,965,737)
Basic and diluted net income (loss) per ordinary share:			
As reported.....	(0.01)	0.01	(0.03)
Pro forma.....	(0.01)	0.01	(0.03)

12. Commitments and Contingencies

Commitments

As of December 31, 1999, future minimum lease commitments were as follows:

	<u>Office Rental</u>	<u>Server Custody Fee</u>	<u>Total</u>
2000	1,069,514	6,762,000	7,831,514
2001	983,080	604,000	1,587,080
2002	612,835	—	612,835
2003	43,798	—	43,798
Total	<u>2,709,227</u>	<u>7,366,000</u>	<u>10,075,227</u>

In addition, the Company has total capital commitments amounting to approximately RMB2.4 million.

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Insurance coverage

As of December 31, 1999, the Group did not have insurance on its property, plant and equipment of approximately RMB9.5 million.

Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the Group's ability to conduct normal business operations. Management has been addressing this issue; however, given the nature of this risk, it is not possible to be certain that all aspects of the Year 2000 Issue affecting the Group, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved without adverse impact on the Group's operations.

13. Subsequent Events

(a) Agreements with Guangzhou Netease

On February 3, 2000, to satisfy Chinese regulations, the Company and Netease Beijing entered into a series of agreements with Guangzhou Netease whereby Guangzhou Netease will operate the Netease Web sites with its Internet content company approval and the technologies and other services provided by the Company and Netease Beijing. These services include:

- use of domain names;
- use of copyrighted Web-page layout;
- use of registered trademarks;
- use of equipment; and
- provision of technical and consulting services.

Under these agreements, substantially all of the income received by Guangzhou Netease will be paid to the Company and Netease Beijing. Guangzhou Netease is a related party because it is also controlled by the principal shareholder of the Company. The business of the Group is dependent upon Guangzhou Netease which operates the Netease Web sites. The Group expects that it will need to provide financial support in the form of cost reimbursements to Guangzhou Netease. Until Guangzhou Netease demonstrates that it can support its own operations through its revenues from third party customers, the Group will accrue for the costs and expenses of Guangzhou Netease in excess of its revenues as the costs are incurred by Guangzhou Netease. Under the agreements with Guangzhou Netease, the Group is to receive payments from Guangzhou Netease for the technologies and other services it provides. Such payments will be accounted for as cost reimbursements unless there are corresponding revenues received by Guangzhou Netease from unrelated parties. The effect of the accounting will be that revenues that the Group records related to transactions with Guangzhou Netease will not exceed the revenues that Guangzhou Netease derives from unrelated parties. Also, the Group will record losses arising from the provision of financial support to Guangzhou Netease. Transactions with Guangzhou Netease will be accounted for and disclosed as related party transactions.

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(Amounts expressed in renminbi (“RMB”), unless otherwise stated)

(b) Agreements with Guangyitong Advertising

In May 2000, Netease Beijing entered into a series of agreements with Guangyitong Advertising and the ultimate owners of Guangyitong. These agreements include:

- a ten-year irrevocable proxy given by the ultimate owners of Guangyitong Advertising which allows Netease Beijing to exercise all of the shareholder voting rights of Guangyitong Advertising;
- an operating agreement providing for the following:
 - Guangyitong Advertising will appoint only those individuals nominated by Netease Beijing as its senior management personnel;
 - the major decisions of Guangyitong Advertising have to be approved by Netease Beijing, including those relating to financing; transfer of ownership interests, significant acquisitions, disposals or pledges of assets; and amendment and assignment of contracts;
 - Netease Beijing has a commitment to purchase the assets and business of Guangyitong Advertising at their net book value once it obtains the approval from the Chinese Government to do so under Chinese law; and
 - Netease Beijing will issue guarantees for the benefit of Guangyitong Advertising when considered necessary for Guangyitong Advertising’s operations;
- a ten-year exclusive consulting and technical services agreement providing for the following:
 - Netease Beijing is the exclusive provider of technical consulting and related services to Guangyitong Advertising for all the advertisements which Guangyitong Advertising will receive and publish on the Netease Web sites; and
 - Netease Beijing will charge Guangyitong Advertising a monthly fee for the above services. The service fee may be unilaterally adjusted by Netease Beijing such that Netease Beijing may receive all of the profits and cash flows of Guangyitong Advertising;
- an undertaking by the principal shareholder of the Company and the ultimate owners of Guangyitong Advertising that they will not vote in any shareholders’ or directors’ meetings of the Company on any amendments or supplements to the agreements with Guangyitong Advertising except as directed by the Company’s Board.

Under these agreements, Guangyitong Advertising will be fully dependent on the technical consulting and other services provided by Netease Beijing to operate its online advertising business. Substantially all of the revenues received by Guangyitong Advertising will be paid to Netease Beijing. Guangyitong Advertising is a related party because it is also 80% owned by the principal shareholder of the Company. The financial statements of Guangyitong Advertising will not be consolidated with those of the Group because of the majority equity interest that the principal shareholder of the Company has both in the Company and Guangyitong Advertising. Transactions with Guangyitong Advertising will be accounted for and disclosed as related party transactions.

(c) New options granted

In February and March 2000, the Company granted options to acquire a total of 50,070,000 ordinary shares to the Company’s employees at an exercise price of US\$0.100 per share. From March to May, 2000, the Company granted options to acquire a total of 7,387,000 ordinary shares to other new employees at an exercise

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price of US\$0.156 per share. From May to June 15, 2000, the Company granted options to acquire a total of 3,780,000 ordinary shares to other new employees at an exercise price equal to the initial public offering price of the Company’s ordinary shares. In May 2000, the Company also granted options to acquire a total of 100,000 ordinary shares to a new employee at an exercise price of US\$0.20 per share. Options for those employees who joined the Group in 1999 vest over a period of three years beginning with the completion of the second full year of service by the respective employees. Options for other employees vest over a period of four years beginning with the completion of one full year from the date of grant.

On February 1, 2000, the Company granted options to acquire a total of 1,200,000 ordinary shares to a director and options to acquire a total of 550,000 ordinary shares to two consultants. These options generally vest over a period of two years beginning on February 1, 2000. The exercise price of these options is US\$0.100 per share. Deferred compensation costs related to these option grants to the director and two consultants in 2000 were approximately RMB 1,337,000. The estimated fair value of the options granted to the director and the consultants is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for the grants: risk-free interest rate of 2.97%; estimated fair value of US\$0.10 per ordinary share; expected dividend yield of 0% for all periods; expected life of five years; and expected volatility of 155% for all periods.

From February to June 15, 2000, the Company also granted options to acquire a total of 120,081,000 ordinary shares to certain new members of the Company’s senior management at exercise prices ranging from US\$0.065 to US\$0.156 per share. These options generally vest over a period of three to four years beginning with the completion of one full year from (i) February 1, 2000, (ii) the date of employment or (iii) the date of offer of employment.

In connection with the above option grants the Company expects to record deferred share compensation costs of approximately RMB 33.3 million which will be amortized and charged to expense starting from the grant date and through the end of the vesting periods of the underlying options. The compensation costs were calculated based upon an assumed fair value of the Company’s ordinary shares of US\$0.10 per share on February 1, 2000 and US\$0.156 per share from March to May, 2000.

Information relating to stock options outstanding subsequent to December 31, 1999 is as follows:

	Shares	Average Exercise Price
Balance, December 31, 1999	121,960,000	0.065
Options granted	183,168,000	0.109
Options cancelled	(9,980,000)	0.091
Balance, June 15, 2000	295,148,000	0.091

(d) Series B preference shares

On March 23, 2000, the Company entered into a Series B Preference Shares Purchase Agreement pursuant to which the Company issued 2,560,556 Series B preference shares of US\$0.01 each at an issuance price of US\$15.60 per share for total consideration of approximately US\$40 million, of which US\$35 million is to be paid up in cash and US\$5 million is to be paid up by advertising to be provided by the shareholder of the Series B preference shares and its affiliated companies on their television channels over a period of three years. The Company will account for the advertising inventory as a deferred asset which will be recognized as an expense when the airtime is used in accordance with AICPA Statement of Position 93-7.

NETEASE.COM, INC.

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The Series B preference shares have the same conversion features as the Series A preference shares. The Series B preference shares have an aggregate liquidation preference equal to the total consideration for which they are issued. They carry the same preferences as those of Series A preference shares on dividend payment but have certain preferences over Series A preference shares on return of capital in case of a winding up of the Company.

The Company also entered into a strategic co-operation agreement with the shareholder of its Series B preference shares which provides for, among other things, advertising spending of US\$5 million from the shareholder over the next three years, cross licensing of Internet tools and technologies, licensing of content information, and other co-operative marketing and promotional events on commercial terms to be agreed between the two parties.

(e) Transfer of Additional Ordinary Shares by Principal Shareholders

In addition, in March 2000 the principal shareholder of the Company transferred an additional approximately 1,900,000 ordinary shares to certain employees, for which the Company will incur share compensation costs of approximately RMB 2.5 million in 2000.

(f) Share split

By a resolution of the shareholders of the Company on March 31, 2000, the ordinary shares in the Company were split on a one-hundred-for-one basis. The effects of the share split have been reflected in the financial statements on a retroactive basis for all the periods presented.

Through and including July 24, 2000 (the 25th day after the date of this prospectus), all dealers effecting transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

4,500,000 American Depositary Shares



Netease.com, Inc.

Representing 450,000,000 Ordinary Shares

PROSPECTUS

Merrill Lynch Far East Limited

Merrill Lynch & Co.

Deutsche Banc Alex. Brown

June 29, 2000
