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Letter To Our Fellow Shareholders

Dear Shareholders,

First, let us express our sincere gratitude for the support you have given us throughout 2001, which was a challenging year for the Internet sector worldwide. Our company also faced particular hurdles during the year, such as senior management changes, the restatement of our financial statements for the year 2000, and the temporary suspension of trading of our American Depositary Shares on the Nasdaq National Market. Despite these hurdles, our operations have continued their rapid growth, and the NetEase Web sites remain one of the most popular online destinations for Internet users in China.

With the dedicated work of our staff, we had numerous meaningful achievements during last year. For example, the NetEase Web sites have experienced consistent growth in the number of registered users and average daily pageviews. At the end of last year, the NetEase Web sites had 43.2 million registered users, an increase of 213% from the beginning of the year, and average daily pageviews increased 149% to 174.4 million. We also expanded the range of products and services we offer to enrich the user experience when visiting the NetEase Web sites. We will continue to strive to improve the content and service offering on the NetEase Web sites in order to ensure that our strong market position can be maintained.

Notwithstanding the healthy growth in the popularity of the NetEase Web sites, we reported a decline in total revenue for last year, due mainly to a decrease in advertising revenue, but mitigated in part by an increase in other revenues. The decrease in advertising revenue resulted primarily from the general slowdown and intense competition in the online advertising market, as well as the turnover in our management and staff. However, with a somewhat improved climate in the online advertising market and the enhancement of our management team, we have seen a recovery in our advertising sales activities recently, which we hope will continue for the remainder of 2002. Toward this goal, we will continue to bring innovative marketing solutions to our advertising clients.

In addition to online advertising, a key pillar of our strategy has been to explore ways to monetize the enormous user base of the NetEase Web sites. We have experienced initial success in this strategy by launching a series of new fee-based premium services during last year, such as wireless services (including Short Messaging Services), paid Web hosting services, fee-based premium e-mail (for both corporate and individual users), online games and other services. We believe that such services have been well-received by our users, in particular the wireless services. As a result of this strategy of broadening our revenue sources, we were able to achieve a substantial increase in our revenue derived from e-commerce and other services last year.

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We believe that the Internet industry in China has reached a point where users have started to understand the benefits of fee-based value-added services, and we are committed to capturing more revenue opportunities in this area. In addition to continuously refining and improving our existing services, we plan to further identify new market opportunities and thereby develop new value-added services to suit our users' interests and needs. In particular, wireless services and online games have been two areas of focus.

In connection with our introduction of a new online game, "Westward Journey Online," at the end of last year, we have introduced a prepaid debit point card which we expect will facilitate the usability and growth of all of our fee-based services. Traditionally, making online payments in China has been problematic for a variety of reasons, which has inhibited the use of paid services. To address this problem, we launched the "NetEase point card" which users can buy for cash at local stores and other locations in China. The points contained in this card can then be used to pay for the use of various online services offered on the NetEase Web sites, such as playing time for online games. We believe that advances such as this which enable users to more easily access and enjoy our many services are key to our future growth.

Although the path to profitability is challenging and often unpredictable, we believe we are on the right track. We look forward to that exciting challenge, and we thank you once again for your past and future support of our company.

Sincerely,
Ted Sun
Acting Chief Executive Officer

Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words "expect", "anticipate", "intend", "believe", or similar language. All forward-looking statements included in this Annual Report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We caution you that our businesses and financial performance are subject to substantial risks and uncertainties.

Overview

NetEase is a leading Internet technology company in China. Our innovative online communities and personalized premium services, which allow registered users to interact with other community members, have established a large and stable user base for the NetEase Web sites which are operated by our affiliate. As of March 31, 2002, we had more than 50 million registered users, and our average daily page views exceeded 200 million.

In 2001, we continued to develop our various fee-based premium services and online entertainment services, including wireless services , premium e-mail services for both corporate and individual users, online games and other subscription-type products. We believe that we will continue to rely on advertising revenues as one of our primary revenue sources for the foreseeable future, but we anticipate that the revenues generated by these fee-based premium services and online entertainment services will also constitute a significant portion of our future revenues.

We have incurred significant net losses and have had negative cash flows since our inception. As of December 31, 2001, our accumulated deficit was RMB454.1 million (US$54.9 million). We anticipate incurring net losses for the foreseeable future. These losses have been funded principally with proceeds from the issuance of our American Depositary Shares at our initial public offering, which was completed in July 2000.

Our critical accounting policies regarding our recognition of revenues are discussed under the heading "Revenues" below.

Our corporate structure

NetEase.com, Inc. was incorporated in the Cayman Islands on July 6, 1999 as an Internet technology company in China. As of December 31, 2001, we had three directly wholly owned subsidiaries, NetEase Information Technology (Beijing) Co., Ltd., or NetEase Beijing, NetEase Information Technology (Shanghai) Co., Ltd., or NetEase Shanghai, and NetEase (U.S.) Inc., or NetEase US. NetEase Beijing and NetEase US were established before 2000, and NetEase Shanghai was established on May 14, 2000.

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Beijing NetEase Interactive Network Technology Co., Ltd., or NetEase INT, was established on November 28, 2000 by our company and NetEase Beijing, which owned 80% and 20%, respectively, of the equity interest in NetEase INT. NetEase INT remained dormant since its establishment. On March 4, 2002, an approval was obtained from the relevant Chinese authorities for its dissolution.

As the exclusive Internet technology provider to Guangzhou NetEase Computer System Co. Ltd., or 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 related services.

Guangzhou NetEase is a limited liability company organized under the laws of China and is controlled and owned by our principal shareholder. 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, Beijing Guangyitong Advertising Co., Ltd., or Guangyitong Advertising, is licensed by the Chinese authorities to operate an advertising business and engages in Internet-related advertising design, production and dissemination.

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. Our services to Guangzhou NetEase and Guangyitong Advertising constitute the majority of our operations.

Revenues

Our total revenues decreased from RMB33.0 million in 2000 to RMB28.3 million (US$3.4 million) in 2001. We generate our revenues from advertising services, e-commerce and other services and software licensing and related integration projects. In mid-1998, we changed our business model from a software developer to an Internet technology company. In July 1999, we began to offer e-commerce platforms and to provide online auction services in China through Guangzhou NetEase.

Other than revenues from our related parties, Guangzhou NetEase and Guangyitong Advertising, no customer individually accounted for greater than 10% of our total revenues for 2000 and 2001. This compares with two customers to whom we provided Internet advertising services that individually represented greater than 10% of our total revenues for 1999.

Revenues from barter transactions primarily relate to advertising and decreased in 2000 and 2001 as a result of the development of our business. As our business grew and our cash resources improved, we were able to enter into more cash transactions and became less reliant on barter transactions in providing or receiving services. Prior to January 20, 2000, barter transactions were recorded at the estimated fair market value of the services received or estimated fair market value of the services provided, whichever was more readily determinable. Effective from January 20, 2000, we adopted the consensus reached in Emerging Issue Task Force, or EITF 99-17, to account for barter transactions. According to EITF 99-17, revenue and expense should be recognized at fair value from an advertising barter transaction only if the fair value of the advertising surrendered in the transaction is determinable based on the entity's own historical practice of receiving cash, marketable securities, or other consideration that is readily convertible to a known amount of cash for similar advertising from buyers unrelated to the counterparty in the barter transaction. In 2000 and 2001, the recognized revenues and expenses derived from barter transactions were RMB0.7 million (US$0.1 million) for each of those years. We also engaged in some advertising barter transactions in 2000 and 2001 for which the fair value is not determinable within the limits of EITF 99-17, and therefore no revenues or expenses derived from these barter transactions were recognized. These transactions primarily involved exchanges of advertising services rendered by us for advertising, promotional benefits and information content provided by the counterparties.

Advertising services revenues

We currently derive our advertising services revenues from 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. Prior to 2000, we also received advertising services revenue from fees we received from advertisers on the NetEase Web sites.

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, a 3% cultural development fee and certain surcharges that apply to these revenues. We recognize advertising services revenues from Guangyitong Advertising at the same time that Guangyitong Advertising recognizes its advertising revenues.

Guangyitong Advertising derives its advertising fees principally from short-term advertising contracts. Revenues from advertising contracts are generally recognized ratably over the period in which the advertisement is displayed and collection of the resulting receivables is probable. Guangyitong Advertising's 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. These types of advertising contracts are known as CPM contracts. As a result, to the extent that minimum guaranteed impressions are not met within the contractual time period, Guangyitong Advertising defers recognition of the corresponding revenues until the remaining guaranteed impression levels are achieved. We anticipate that the proportion of revenue generated from CPM contracts to total advertising revenue will decrease in the near future as we have been more focused recently on entering into advertising contracts which fees are based on the actual time period that the advertisements appear on the NetEase Web sites rather than based on guaranteed minimum impressions.

E-commerce and other services revenues

We currently derive all our e-commerce and other services revenues from fees earned pursuant to a series of agreements with Guangzhou NetEase under which we provide Internet portal and e-commerce technologies and advertising services to Guangzhou NetEase in exchange for a service fee. Since December 1999, we have recognized e-commerce and other services revenues that we earn through this arrangement as the services are rendered and the services revenues are earned under the e-commerce and other services agreements. The service fee that we charge includes substantially all of the e-commerce and other services revenues recognized by Guangzhou NetEase, net of a 5.5% business tax and certain surcharges that apply to these revenues. Prior to 2001, we derived our e-commerce related services revenues from third parties as well as from Guangzhou NetEase. We recognize services revenues from Guangzhou NetEase at the same time that Guangzhou NetEase recognizes its e-commerce and other services revenues.

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Guangzhou NetEase earns its e-commerce related services revenues from the NetEase Web sites' online shopping mall, online auctions, referral fees from e-commerce companies, and e-commerce solutions.

Guangzhou NetEase launched our online shopping mall platform in July 2000. As of March 31, 2002, this online shopping mall had 33 "online stores" operated by merchant tenants. From the fourth quarter of 2001, all of the online stores paid Guangzhou NetEase fixed service fees, which Guangzhou NetEase recognized ratably over the period of the leases of the e-commerce platforms. Prior to that, a small portion of the online stores paid Guangzhou NetEase commissions based on that merchant's revenues and we also received referral fees from online shopping mall partners of the NetEase Web sites. Each online shopping mall partner paid Guangzhou NetEase a commission, based on revenues which it earns from these referrals.

Prior to October 2000, Guangzhou NetEase earned revenues from services to online auction sellers, whether businesses or consumers, which Guangzhou NetEase recognized ratably over the period of the lease of our e-commerce platform. In October 2000, we established a co-branded online trading and auction channel in partnership with EachNet, China's largest auction site. We earn both fixed upfront fees and referral fees from EachNet. EachNet has informed us that it considers our contract regarding our co-branded Web site arrangements has been terminated in 2002, and to date, we have been unable to resolve this issue or to enter into a new agreement. However, our co-branded Web site remains in operation. We cannot predict whether our business arrangements with EachNet will remain in effect or be modified or terminated in the future, and accordingly, we can provide no assurance that we will receive any further revenue in connection with our co-branded Web site.

Guangzhou NetEase generates revenues from referral fees paid by e-commerce partners of the NetEase Web sites, based on click-through rates or user referral rates.

Guangzhou NetEase's e-commerce solutions services have been changed from platform testing and software solutions services to online shopping mall, auction and news publishing conducted through the Internet. These revenues are recognized upon completion of the respective total contract and acceptance by the customer.

As mentioned previously, we continued to develop our various fee-based premium services and online entertainment services in 2001, which include wireless services, premium e-mail services for both corporate and individual users, online games and other subscription-type services. Some of these services have commenced to generate revenues for Guangzhou NetEase in 2001.

In 2001, Guangzhou NetEase received wireless services revenues from its customers via two China mobile phone companies, which charged Guangzhou NetEase services fees. Guangzhou NetEase recognizes its share of revenues and services fees when services are provided based on confirmations from these mobile phone companies and, in some instances, on our management's estimates after consultation with the mobile phone company. The amount recognized is then adjusted, if necessary, to actual cash receipts we receive. For the other fee-based premium services, Guangzhou NetEase received most of the revenues directly from its customers. Revenues from such fee-based premium services were recorded on a net basis ratably over the period when services are provided. We anticipate that revenues from wireless services and premium e-mail services will continue to grow in 2002 as income levels and familiarity with new technologies continue to grow in China.

Software licensing and related integration projects revenues

Prior to 2000, software licensing and related integration projects revenues consisted of fees received from licensing, services and post-contract customer support. We ceased our software licensing and related integration projects business in 1999. Our revenues in 2000 and 2001 consisted only of the recognition of deferred revenue which was brought forward for post-contract customer support.

We generally provide our customers with post-contract support, for one year or less, on our software products. Such support is generally hot-line support and may involve unspecified upgrades or enhancements. For post-contract support services that are for a period of one year or less, we recognize revenues 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
- the collectibility is probable.

We occasionally 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. Although we continue to perform occasional projects in this area for customers upon request, we expect this category of revenues to remain immaterial to our business.

Cost of Revenues

Advertising, e-commerce and other services costs

Advertising, e-commerce and other services costs represent those direct costs for operating the NetEase Web sites, which consist primarily of server custody and bandwidth fees, content fees, staff costs, depreciation and amortization of computers and software, and other direct costs.

NetEase Beijing, NetEase Shanghai and Guangzhou NetEase lease bandwidth from China Telecom affiliates. NetEase Beijing and Guangzhou NetEase have network servers co-located in facilities owned by China Telecom's affiliates, for which they pay custody fees to China Telecom. We pay 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 e-commerce and editorial professionals.

We depreciate our computer equipment, software and other assets (other than leasehold improvement) on a straight-line basis over their estimated useful lives, which range from one to five years.

Software licensing and related integration projects costs

We did not incur any costs relating to software licensing and related integration projects in both 2000 and 2001 after the cessation of the business in 1999.

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Operating Expenses

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

Selling, general and administrative expenses

Selling, general and administrative expenses consist primarily of marketing and advertising; salary and welfare expenses and share compensation costs; office rental; recruiting expenses; and travel expenses. 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.

Research and development expenses

Research and development expenses consist principally of compensation for our research and development professionals.

Share Compensation Costs

In December 1999, we adopted a stock incentive plan, called the 1999 Stock Incentive Plan, for our employees, senior management and advisory board. In 2000, we replaced the 1999 Stock Incentive Plan with a new stock option plan, called the 2000 Stock Incentive Plan. The 2000 Stock Incentive Plan was subsequently amended and restated in May 2001. During 2000 and 2001, we granted options to our employees, directors, consultants, a member of our advisory board and certain members of our senior management under the 2000 Stock Incentive Plan. The vesting period for these options generally ranges from two years to four years. In addition, certain of the options granted were cancelled as a result of the resignation of these personnel.

In connection with the above option grants, the net balance of the deferred compensation costs was approximately RMB2.0 million (US$0.2 million) as of December 31, 2001, which is to be amortized and charged to expense starting from the grant date and through the end of the vesting periods of the underlying options.

For 2001, we recorded share compensation costs of approximately RMB2.4 million (US$0.3 million). These costs have been allocated to (i) advertising, e-commerce and other services 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. We expect that share compensation costs in 2002 may increase as a result of the possible recruitment of additional management personnel and the granting of new share options to these personnel and other members of our staff.

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 subsidiaries. Chinese companies are generally subject to a 30% national enterprise income tax, or EIT, and a 3% local income tax. Our subsidiary, NetEase Beijing, received the relevant approval to be recognized as a "New and High Technology Enterprise". According to the approval granted by the Haidian State Tax Bureau in November 2000, NetEase Beijing is entitled to a reduced EIT rate of 15% commencing from the year 2000. In addition, the approval also granted NetEase Beijing with a full exemption from EIT from 2000 to 2002, a 50% reduction in EIT from 2003 to 2005, and a full exemption from the local tax from 2000 onwards.

NetEase Shanghai is subject to EIT at the rate of 30% plus a local tax of 3%. For the years ended December 31, 1999, 2000 and 2001.

Guangzhou NetEase is a Chinese domestic enterprise and is generally subject to a 33% EIT. However, 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 is subject to different EIT rates depending on the nature of its taxable revenues.

If the activities of NetEase.com, Inc. 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 our company that is not connected to a permanent establishment in China would be subject to a 10% withholding tax on gross receipt from profit, interest, rentals, royalties and other income earned in China. Dividends from NetEase Beijing to our company are exempt from Chinese withholding tax.

We are generally subject to a business tax of 5% on our service revenues. Prior to the cessation of our software licensing and related integration projects business in 1999, we earned revenues from the sale of computer hardware purchased on behalf of customers. Such revenues were generally subject to a 17% value added tax, which was offset by value added taxes paid on purchases.

NetEase Beijing had tax loss carryforwards of approximately RMB162.4 million (US$19.6 million) as of December 31, 2001 for EIT purposes. Approximately RMB6.6 million (US$0.8 million), RMB75.3 million (US$9.1 million) and RMB80.5 million (US$9.7 million) of such losses will expire in 2004, 2005 and 2006, respectively. NetEase Shanghai had tax loss carryforwards of approximately RMB44.8 million (US$5.4 million) as of December 31, 2001 for EIT purposes. Approximately RMB23.5 million (US$2.8 million) and RMB21.3 million (US$2.6 million) of such losses will expire in 2005 and 2006, respectively. 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 and NetEase Shanghai will be able to utilize net operating loss carryforwards before their expiration.

In addition, the preferential EIT tax treatments that NetEase Beijing obtained may be subject to review by higher authorities. If these preferential tax treatments were not available to NetEase Beijing, it would be subject to EIT at 30% plus a local tax of 3% and the exemption and reduction described above would not apply. In that case, the tax impact of the loss carryforwards and the valuation allowance as of December 31, 2001 would have been higher by approximately RMB29.2 million.

Material Commitments

As of December 31, 2001, we had lease commitments for office rentals of RMB6.9 million (US$0.8 million), RMB1.9 million (US$0.2 million) and RMB1.3 million (US$0.2 million) payable in 2002, 2003 and 2004 respectively. In additional, we had lease commitments for server custody fee of RMB11.3 million (US$1.4 million) payable in 2002.

Outstanding Litigation and Contingent Liabilities

Beginning in October 2001, four substantially identical purported class action complaints alleging violations of the federal securities laws were filed in the United States District Court for the Southern District of New York naming our company, certain of our current and former officers and directors, and the underwriters of our initial public offering as defendants. To date, the complaints have not been consolidated into a single action. The above lawsuits seek certification as a class action to represent those persons who purchased our American Depositary Shares during the period from July 3, 2000 to August 31, 2001. In general, the complaints allege, among other things, that (i) our initial public offering violated the U.S. securities laws because the financial statements accompanying the offering's registration statement misstated our revenue; and (ii) we committed securities fraud by materially misstating our revenue in our 2000 financial statements.

At the present time, we cannot estimate what damages, if any, may be payable in connection with this litigation. The ultimate resolution of this matter may have a material adverse impact on the results of operations in the period in which it is resolved.

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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:

	For the year ended December 31,					
	1999		2000		2001	
	RMB	%	RMB	%	RMB	%
Revenues:						
Advertising services (including revenues of RMB818,075, RMB30,067,477 and RMB 14,163,952 (US$ 1,711,325) from related parties in 1999, 2000 and 2001, respectively)	10,796,074	64.4	30,067,477	91.2	14,163,952	50.0
E-commerce and other services (including revenues of nil, RMB1,094,859 and RMB14,103,151 (US$1,703,978) from a related party in 1999, 2000 and 2001, respectively)	2,459,101	14.6	2,455,834	7.4	14,103,151	49.9
Software licensing and related integration projects	3,515,831	21.0	450,350	1.4	33,218	0.1
Total revenues	16,771,006	100.0	32,973,661	100.0	28,300,321	100.0
Sales and value-added taxes	(1,150,169)	(6.9)	(2,476,444)	(7.5)	(2,274,784)	(8.0)
Net revenues	15,620,837	93.1	30,497,217	92.5	26,025,537	92.0
Cost of revenues:						
Advertising, e-commerce and other services (including cost reimbursements to a related party of RMB1,974,834, RMB2,098,127 and RMB796,454 (US$96,230) in 1999, 2000 and 2001, respectively)	(5,540,600)	(33.0)	(38,738,335)	(117.4)	(60,058,488)	(212.3)
Software licensing and related integration projects	(258,819)	(1.5)	–	–	–	–
Share compensation cost*	(6,296,816)	(37.6)	(1,171,084)	(3.6)	–	–
Total cost of revenues	(12,096,235)	(72.1)	(39,909,419)	(121.0)	(60,058,488)	(212.3)
Gross profit (loss on revenues)	3,524,602	21.0	(9,412,202)	(28.5)	(34,032,951)	(120.3)
Operating expenses:						
Selling, general and administrative expenses (including cost reimbursements to a related party of RMB466,259, RMB3,124,247 and RMB1,884,823 (US$227,729) in 1999, 2000 and 2001, respectively)	(16,709,221)	(99.6)	(162,922,561)	(494.1)	(181,560,624)	(641.5)
Asset impairment loss	–	–	–	–	(2,766,543)	(9.8)
Research and development expenses	(964,855)	(5.8)	(9,525,436)	(28.9)	(11,169,454)	(39.5)
Share compensation cost*	(39,116,583)	(233.2)	(12,668,476)	(38.4)	(2,357,758)	(8.3)
Total operating expenses	(56,790,659)	(338.6)	(185,116,473)	(561.4)	(197,854,379)	(699.1)
Operating loss	(53,266,057)	(317.6)	(194,528,675)	(589.9)	(231,887,330)	(819.4)
Other income (expenses):						
Sales of 163.net usage rights	1,500,000	8.9	–	–	–	–
Investment impairment loss	–	–	–	–	(8,924,381)	(31.5)
Interest income	357,160	2.1	27,858,710	84.5	17,571,187	62.1
Interest expense	–	–	(2,589,735)	(7.9)	(9,882,874)	(35.0)
Other, net	(494,018)	(2.9)	(9,099)	–	(40,516)	(0.1)
Loss before tax	(51,902,915)	(309.5)	(169,268,799)	(513.3)	(233,163,914)	(823.9)
Provision for income tax	(71,338)	(0.4)	–	–	–	–
Net loss	(51,974,253)	(309.9)	(169,268,799)	(513.3)	(233,163,914)	(823.9)
* Share compensation cost						
Cost of revenues – advertising, e-commerce and other services	(6,296,816)	(37.6)	(1,171,084)	(3.6)	–	–
Selling, general and administrative expenses	(34,346,268)	(204.8)	(7,437,230)	(22.6)	(204,423)	(0.7)
Research and development expenses	(4,770,315)	(28.4)	(5,231,246)	(15.8)	(2,153,335)	(7.6)
	(45,413,399)	(270.8)	(13,839,560)	(42.0)	(2,357,758)	(8.3)

Year Ended December 31, 2001 compared to Year Ended December 31, 2000

In 2001, revenues from advertising services, e-commerce and other services and software licensing and related integration projects constituted 50.0%, 49.9% and 0.1%, respectively, of our total revenues. This compares with 91.2%, 7.4% and 1.4%, respectively, of our total revenues in 2000. Our advertising services revenues decreased significantly during 2001 primarily due to the softening of the Internet advertising market in China which led to a decrease in the demand for advertising on the NetEase Web sites, and the intense market competition which affected the general pricing in the Internet advertising market in China. Conversely, revenues from our e-commerce and other services increased significantly during 2001 mainly as a result of the fixed upfront fees and referral fees that we earned from EachNet in connection with the operation of our co-branded trading and auction Web site and the other revenues generated from fee-based services including wireless services, e-mail services and other premium services. Finally, in 2001 our software licensing and related integration projects revenue further decreased as we had previously ceased this line of business but continued to earn fees for post-contract customer support. We expect that advertising and e-commerce and other services will continue to constitute the primary sources of our future revenues.

Revenues

Total revenues decreased by 14.2% to RMB28.3 million (US$3.4 million) in 2001 from RMB33.0 million in 2000. Advertising services revenues decreased by 52.9% to RMB14.2 million (US$1.7 million) in 2001 from RMB30.1 million in 2000, primarily as a result of the softening of the Internet advertising market in China which led to a decrease in demand for advertising on the NetEase Web sites, and the intense market competition which affected the general pricing in the Internet advertising market in China. Average revenue per advertiser decreased from approximately RMB96,000 (US$11,600) in the first quarter to RMB46,000 (US$5,500) in the fourth quarter of 2001. The number of contracted advertisers using the NetEase Web sites decreased from 231 in 2000 to 174 in 2001, with revenues from our top ten advertisers comprising 40.3% of our total advertising services revenues in 2001 as compared to 34.4% in 2000. Despite the recent weakness in the market, we expect that the online advertising market in China will grow as Internet usage in China increases and as more companies accept the Internet as an effective advertising medium.

Revenues from e-commerce and other services increased by 474.3% to RMB14.1 million (US$1.7 million) in 2001 from RMB2.5 million in 2000, mainly as a result of the amortization of the upfront service fee recognized in 2001 of RMB1.0 million (US$0.1 million) and quarterly referral fees of approximately RMB3.3 million (US$0.4 million) that we earned from EachNet. As mentioned previously, EachNet has informed us that it considers our contract regarding our co-branded trading and auction Web site has been terminated in 2002, and while we are in the process of negotiating with EachNet, it is possible that our current business arrangements could be modified or terminated, which in either case could have a material adverse effect on our e-commerce revenues in future periods. In addition, the increase in total revenues from fee-based services in 2001, predominantly from wireless services and to a lesser extent from premium e-mail and other services, totaled RMB6.7 million (US$0.8 million).

We ceased our software licensing and related integration projects business in 1999. Our revenues in 2000 and 2001 consist only of the recognition of deferred revenue which was brought forward for post-contract customer support and totaled RMB33,000 (US$4,000) in 2001, compared to RMB450,000 in 2000. In 2002, we provided certain corporate solution services to a customer in connection with the purchase of servers and computer equipment, development of software and custody and maintenance of servers. We cannot predict whether we will continue to earn revenues from similar transactions in the foreseeable future, but we expect that we will provide these or other similar services to customers upon request.

Cost of revenues

Our cost of revenues increased by 50.5% to RMB60.1 million (US$7.3 million) in 2001 from RMB39.9 million in 2000, primarily due to the overall expansion of our business, including in particular the increase in Internet connection costs, such as server related and bandwidth costs to support the large increase in traffic on the NetEase Web sites, offset in part by a decrease in staff costs. The average daily page views on the NetEase Web sites in December 2001 was approximately 174 million as compared to approximately 70 million in December 2000. As a result, our loss on revenues increased to RMB34.0 million (US$4.1 million) in 2001 from RMB9.4 million in 2000.

Staff costs consisted primarily of compensation expenses for our e-commerce and editorial professionals and comprised 15.2% of our total cost of revenues in 2001, compared with 20.8% in 2000. The decrease was mainly due to the reduction in the number of employees during 2001. We expect that staff costs as a percentage of our total cost of revenues will remain stable in the near term.

Depreciation and amortization of computers and software comprised 22.6% of our total cost of revenues in 2001, compared with 17.2% in 2000. The increase was mainly due to the increase in the number of servers during 2001. As we have spent or plan to spend approximately RMB14.7 million (US$1.8 million) towards the purchase of additional servers and switches in 2002, we expect our depreciation expenses to increase in 2002.

Operating expenses

Total operating expenses increased by 6.9% to RMB197.9 million (US$23.9 million) in 2001 from RMB185.1 million in 2000. Operating expenses as a percentage of total revenues increased from 561.4% in 2000 to 699.1% in 2001. The increase in 2001 was mainly due to the substantial fees charged by third parties as discussed in the next paragraph.

Selling, general and administrative expenses increased by 6.7% to RMB181.8 million (US$22.0 million) in 2001 from RMB170.4 million in 2000, primarily due to certain expenses of more than RMB50 million (US$6.0 million) for legal and professional fees and consultancy fees in 2001.

Asset impairment loss represents a provision for impairment loss on the software costs and other assets directly relating to the development of an online game of RMB2.8 million (US$0.3 million). The impairment loss relating to the online game assets was estimated on the basis of the difference between the carrying value of the assets as of December 31, 2001 and the present value of the future cash flows which are likely to be generated from the operation of the online game.

Research and development expenses decreased by 9.7% to RMB13.3 million (US$1.6 million) in 2001 from RMB14.8 million in 2000, primarily due to a decrease in share compensation costs as a result of the resignation of certain management staff in our technical department during 2001.

Other income (expenses)

Other income and expenses in 2001 mainly consisted of the one time non-recurring provisions for the impairment of our investments in a convertible note issued by Ladynow.com Corporation Limited, a corporation in which we invested, and convertible preference shares issued by EachNet of RMB2.1 million (US$0.3 million) and RMB6.9 million (US$0.8 million), respectively, and net interest income of RMB7.7 million (US$0.9 million). The provision for the Ladynow convertible note was necessitated by Ladynow's cessation of operations in 2001. In turn, the EachNet shares were sold back to EachNet in March 2002, and the impairment charge for our investment in EachNet in 2001 represents the difference between our original cost of investment and the consideration paid for the repurchase. The decrease in the net interest income in 2001 as compared with 2000 was due to the decrease in our cash balance and the reduction of interest rates during 2001.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Revenues

Total revenues increased by 96.6% to RMB33.0 million (US$4.0 million) in 2000 from RMB16.8 million in 1999. Advertising services revenues increased by 178.5% to RMB30.1 million (US$3.6 million) in 2000 from RMB10.8 million in 1999, primarily as a result of expanded Internet advertising operations and an increase in advertising activity on the NetEase Web sites. Furthermore, average revenue per advertiser increased from RMB60,000 (US$7,000) in the first quarter of 2000 to RMB140,000 (US$17,000) in the fourth quarter of 2000. The number of contracted advertisers increased from 110 in 1999 to 231 in 2000, with revenues from our top ten advertisers comprising 34.4% of our total advertising services revenues in 2000.

Revenues from e-commerce and other services decreased by less than 1% to RMB2.5 million (US$0.3 million) in 2000 compared to 1999, primarily as a result of slower than anticipated growth of our e-commerce activities, despite the establishment of a number of e-commerce partnerships with other companies. Revenues from the NetEase Web sites' online shopping mall, online auction platform, referral fees from e-commerce companies, and e-commerce solutions were 25.9%, 43.5%, 11.9% and 18.7%, respectively, of total e-commerce related services revenues in 2000.

We ceased our software licensing and related integration projects business in 2000 but continued to earn revenues on post-contract services provided in 2000 from the recognition of deferred revenue which was brought forward for integration projects which we worked on in 1999. Accordingly, our revenues from software licensing and related integration projects decreased from RMB3.5 million in 1999 to RMB0.5 million (US$54,000) in 2000.

Cost of revenues

Our cost of revenues increased by 229.9% to RMB39.9 million (US$4.8 million) in 2000 from RMB12.1 million in 1999, primarily due to the overall expansion of our business. Our server custody and bandwidth fees increased with the growth of our business in 2000. We increased our staff from 137 employees at December 31, 1999 to 288 employees at December 31, 2000. As a result, we incurred loss on revenues of RMB9.4 million (US$1.1 million) in 2000, as compared with a gross profit of RMB3.5 million in 1999.

Staff costs consisted primarily of compensation expenses for our e-commerce and editorial professionals and comprised 20.8% of our total cost of revenues in 2000, compared with 14.1% in 1999.

Depreciation and amortization of computers and software comprised 17.2% of our total cost of revenues in 2000, compared with 8.0% in 1999.

Power to the People

Operating expenses

Operating expenses increased by 226.0% to RMB185.1 million in 2000 (US$22.4 million) from RMB56.8 million in 1999, primarily due to the overall expansion of our business. Operating expenses as a percentage of total revenues increased from 338.6% to 561.4% primarily as a result of the fact that our operating expenses grew at a faster rate than our revenues from advertising and also as a result of the slight decline in revenues from our e-commerce services in 2000 despite our significant investment in such services.

Selling, general and administrative expenses increased by 233.7% to RMB170.4 million (US$20.6 million) in 2000 from RMB51.1 million in 1999, primarily due to significant personnel increases in 2000. Selling, general and administrative expenses also increased as a result of increased sales and marketing and advertising expenditures, including our "Power to the People" advertising campaign. Our "Power to the People" advertising campaign commenced in the third quarter of 2000. We spent RMB34.6 million (US$4.1 million) on this advertising campaign in the third and fourth quarters of 2000 and saw our user base increase by over 50% in three months. In addition, in 2000, we reimbursed Guangzhou NetEase a total of RMB5.2 million (US$0.6 million) for the costs of operating the NetEase Web sites, compared to RMB2.4 million in 1999.

Research and development expenses increased by 157.3% to RMB14.8 million (US$1.8 million) in 2000 from RMB5.7 million in 1999, primarily due to staff costs of RMB6.9 million (US$0.8 million).

Other income (expenses)

Other income, net of other expenses, increased from RMB1.4 million in 1999 to RMB25.3 million (US$3.1 million) in 2000, which amount consisted primarily of net interest income. In 1999, other income, net of other expenses, consisted of interest income of RMB0.4 million, proceeds from the disposal of the 163.net usage right of RMB1.5 million, and a write-off due to the failure of one of our servers and the accrued tax penalties of RMB0.5 million. The increase in net interest income in 2000 was due to the increase in cash balance arising from the net cash proceeds from our initial public offering in 2000.

Quarterly results of operations data

The following table sets forth selected unaudited quarterly consolidated statement of operations data for each of the four fiscal quarters for the year ended December 31, 2001 in Renminbi. Our management believes this data has been prepared substantially on the same basis as the consolidated audited financial ez·tements, 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 for the year ended December 31, 2001 in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report.

	Quarter Ended			
	March 31, 2001	June 30, 2001	September 30, 2001	December 31, 2001
	(Unaudited) RMB	(Unaudited) RMB	(Unaudited) RMB	(Unaudited) RMB
Revenues:				
Advertising services	3,444,338	3,458,315	4,191,949	3,069,350
E-commerce and other services	1,554,986	2,025,123	3,017,458	7,505,584
Software licensing and related integration projects	33,218	–	–	–
Total revenues	5,032,542	5,483,438	7,209,407	10,574,934
Sales and value-added taxes	(686,027)	(529,796)	(433,963)	(624,998)
Net revenues	4,346,515	4,953,642	6,775,444	9,949,936
Cost of revenues:				
Advertising, e-commerce and other services	(13,435,463)	(16,888,961)	(15,444,570)	(14,289,494)
Total cost of revenues	(13,435,463)	(16,888,961)	(15,444,570)	(14,289,494)
Loss on revenues	(9,088,948)	(11,935,319)	(8,669,126)	(4,339,558)
Operating expenses:				
Selling, general and administrative expenses	(45,526,863)	(61,063,073)	(45,465,590)	(29,505,098)
Asset impairment loss	–	–	–	(2,766,543)
Research and development expenses	(2,891,847)	(2,553,281)	(2,659,269)	(3,065,057)
Share compensation cost	(3,184,177)	2,669,412	(1,058,507)	(784,486)
Total operating expenses	(51,602,887)	(60,946,942)	(49,183,366)	(36,121,184)
Operating loss	(60,691,835)	(72,882,261)	(57,852,492)	(40,460,742)
Other income (expenses):				
Investments impairment loss	(2,069,475)	–	(6,854,906)	–
Interest income	7,882,834	4,168,617	3,812,026	1,707,710
Interest expense	(2,458,847)	(2,319,348)	(2,605,658)	(2,499,021)
Other, net	(802)	4,950	–	(44,664)
Loss before tax	(57,338,125)	(71,028,042)	(63,501,030)	(41,296,717)
Provision for income tax	–	–	–	–
Net loss	(57,338,125)	(71,028,042)	(63,501,030)	(41,296,717)

Power to the People

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;
- our ability to develop new fee-based premium services;
- the receptiveness by users to such fee-based premium services;
- 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;
- general economic conditions in China; and
- the outcome of the litigation described above.

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.

Operating activities

Cash used in operating activities was RMB185.7 million (US$22.4 million) in 2001 and RMB124.7 million and RMB15.7 million in 2000 and 1999, respectively. In 2001, cash used in operating activities consisted primarily of our operating loss and decrease in accrued liabilities and amount due to related parties, offset in part by an increase in accounts payable, salary and welfare payable, and decrease in prepayments and other current assets. In 2000, cash used in operating activities consisted primarily of our operating loss and increases in prepayments and other current assets and due from related parties, offset in part by increases in accounts payable, salary and welfare payable and other accrued liabilities. In 1999, cash used in operating activities consisted primarily of our operating loss and increases in accounts receivable and prepayments and other current assets, offset in part by increases in accounts payable, salary and welfare payable, taxes payable and other accrued liabilities.

Investing activities

Cash used in investing activities was RMB67.3 million (US$8.1 million) in 2001, RMB53.0 million in 2000 and RMB9.3 million in 1999. In 2001, cash used in investing activities mainly consisted of the placing of term deposits which had a maturity of more than three months and the purchase of fixed assets, which accounted for 67.7% and 31.4%, respectively, of total cash used in investing activities. In 2000, cash used in investing activities consisted primarily of the purchase of fixed assets and investment in convertible preference shares, which accounted for 64.1% and 31.2%, respectively, of total cash used in investing activities. Our investment in convertible preference shares coincided with our entering into an agreement to operate our co-branded trading and auction Web site with EachNet, a private Internet based auction company. These shares were subsequently sold in March 2002 back to EachNet for an aggregate net loss of approximately RMB6.9 million (US$0.8 million). In 1999, cash used in investing activities was all used to acquire property, equipment and software.

Financing activities

Cash used in financing activities was RMB22.3 million (US$2.7 million) in 2001. Cash provided by financing activities was RMB904.9 million and RMB142.6 million in 2000 and 1999, respectively. Substantially all of our cash is kept in US dollars. In 2001, the cash used in financing activities mainly consisted of the repayment of bank loans of RMB152.4 million (US$18.4 million) which was offset in part by proceeds from other bank loans totaling RMB123.8 million (US$15.0 million) and the receipt in 2001 of additional net proceeds received from our issuance of Series B preference shares in March 2000 of RMB6.3 million (US$0.8 million). In 2000, the increase in cash provided by financing activities was primarily due to the net proceeds from our issuance of Series B preference shares in March 2000 of RMB283.5 million and our initial public offering in July 2000 of RMB508.7 million and proceeds from bank loans totaling RMB112.6 million. We borrow Renminbi for our working capital purposes.

We had no material commitments for capital expenditures as of December 31, 2001. Up to March, 31 2002, we spent approximately RMB3.3 million (US$0.4 million) for servers and computer equipment, and as our business grows, we plan to spend an additional approximately RMB11.4 million (US$1.4 million) in 2002 towards purchases of additional servers and switches in order to accommodate the expected increase in traffic on the NetEase Web sites.

Our net losses have been funded by our cash resources (in particular the proceeds from our initial public offering in July 2000) and to a lesser extent from cash generated from revenue growth. Although we have been striving to enhance our revenues and stabilize or decrease our operating expenses, we cannot be certain these efforts will be succcessful in future periods which could accelerate the depletion of our cash resources. In particular, as noted previously, our selling, general and administrative expenses have remained relatively high due primarily to legal, professional and consultancy fees, while our revenues from advertising services have decreased in conjunction with the weakening of the online advertising market in China. Nonetheless, given the size of our net losses in recent periods in comparison to our existing cash resources and revenues, we believe that such cash and revenues will be sufficient for us to meet our obligations for the foreseeable future.

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. We will seek to continually improve and enhance our existing products and services to respond to rapidly evolving competitive and technological conditions. For the years 1999, 2000 and 2001, we spent RMB5.7 million, RMB14.8 million and RMB13.3 million (US$1.6 million), respectively, on company-sponsored research and development activities.

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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 our American Depositary Shares, or 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 our ADSs are traded in U.S. dollars. In addition, 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. Furthermore, we have pledged deposits totaling US$10.9 million as security for our Renminbi-denominated bank loans. These deposits are exposed to foreign currency exchange risks. We have not engaged in any hedging activities. Therefore, we may experience economic loss as a result of any foreign currency exchange rate fluctuations.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations" and No. 142 "Goodwill and Other Intangible Assets". SFAS No. 141 applies to business combinations initiated after June 30, 2001. SFAS No. 141 requires that business combinations must be accounted for using only the purchase method of accounting, as opposed to the pooling method. SFAS No. 142 addresses financial accounting for acquired goodwill and other intangible assets and how such assets should be accounted for in financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. We do not believe that the adoption of SFAS No. 141 and No. 142 will have a significant impact on our financial statements.

In October 2001, the FASB also issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses financial accounting and reporting for the recognition and measurement of SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 31, 2001. We do not believe that the adoption of SFAS No. 144 will have a significant impact on our financial statements.

Trend Information

Other than as disclosed elsewhere in the annual report, we are not aware of any trends, uncertainties, demands, commitments or events from the period of inception to December 31, 2001 that are reasonably likely to have a material effect on our net revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

Exchange Rate

The conversion of Renminbi into U.S. dollars in this report is based on the noon buying rate of US$1=RMB8.2766 on December 31, 2001 in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York.

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, 2000 and 2001 and the related consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for the years ended December 31, 1999, 2000 and 2001 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, 2000 and 2001 and the results of its operations and its cash flows for the years ended December 31, 1999, 2000 and 2001 in conformity with generally accepted accounting principles in the United States of America.

Without qualifying our opinion, we draw attention to Note 17 to the consolidated financial statements which indicates that the Company and certain of its current and former officers and directors are defendants of four substantially identical purported class action complaints alleging violations of the federal securities laws and committing securities fraud in the United States District Court for the Southern District of New York. At the present time, the Company cannot estimate what damages, if any, may be payable in connection with this litigation. The ultimate resolution of this matter may have a material adverse impact on the results of operations in the period in which it is resolved.

Arthur Andersen • Hua Qiang

Arthur Andersen • Hua Qiang
Beijing, People's Republic of China
April 2, 2002

Power to the People

NETEASE.COM, INC.

CONSOLIDATED BALANCE SHEETS

	Note	December 31, 2000	December 31, 2001	December 31, 2001
		RMB	RMB	US$
Assets				
Current assets:				
Cash		708,561,012	479,608,534	57,947,531
Restricted cash	4	136,052,705	90,308,448	10,911,298
Temporary cash investments	2	–	45,521,300	5,500,000
Accounts receivable, net of allowance of doubtful accounts of RMB1,241,715 and nil at December 31, 2000 and 2001, respectively		684,888	–	–
Prepayments and other current assets	5	14,825,533	9,136,362	1,103,878
Due from related parties, net of allowance of doubtful accounts of RMB342,737 and RMB7,447,775 (US$899,859) at December 31, 2000 and 2001, respectively	6	5,869,195	2,290,204	276,708
Total current assets		865,993,333	626,864,848	75,739,415
Non-current rental deposit		1,682,710	1,087,487	131,393
Investment in convertible note	7	827,810	–	–
Investment in convertible preference shares	8	16,556,199	9,701,293	1,172,135
Property, equipment and software, net	9	35,362,091	36,356,088	4,392,636
Deferred asset		673,407	783,352	94,647
Total assets		921,095,550	674,793,068	81,530,226
Liabilities & Shareholders' Equity				
Current liabilities:				
Short-term bank loans	10	112,600,000	84,000,000	10,149,095
Accounts payable		7,562,448	13,116,442	1,584,762
Salary and welfare payable	11	6,732,037	9,936,211	1,200,518
Taxes payable	12	1,007,104	1,772,931	214,210
Deferred revenue		558,739	–	–
Accrued liabilities	13	18,781,557	10,937,950	1,321,552
Due to related parties	6	1,313,229	–	–
Total current liabilities		148,555,114	119,763,534	14,470,137
Commitments and contingencies	17			
Shareholders' equity:				
Ordinary shares, US$0.0001 par value: 1,000,000,000,000 shares authorized, 3,010,555,600 shares issued and outstanding as of December 31, 2000, and 3,024,175,192 shares issued and outstanding as of December 31, 2001	15	2,492,350	2,503,626	302,495
Additional paid-in capital	15	1,076,505,358	1,044,889,829	126,246,264
Less: Subscriptions receivable	14	(47,829,909)	(35,100,568)	(4,240,940)
Deferred compensation	16	(37,306,585)	(3,344,574)	(404,100)
Translation adjustments		(348,586)	217,327	26,257
Accumulated deficit		(220,972,192)	(454,136,106)	(54,869,887)
Total shareholders' equity		772,540,436	555,029,534	67,060,089
Total liabilities & shareholders' equity		921,095,550	674,793,068	81,530,226

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

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	Note	1999	2000	2001	2001
		For the year ended December 31,			
		RMB	RMB	RMB	US$
Revenues:					
Advertising services (including revenues of RMB818,075, RMB30,067,477 and RMB14,163,952 (US$1,711,325) from related parties in 1999, 2000 and 2001, respectively)	6	10,796,074	30,067,477	14,163,952	1,711,325
E-commerce and other services (including revenues of nil, RMB1,094,859 and RMB14,103,151 (US$1,703,978) from a related party in 1999, 2000 and 2001, respectively)	6	2,459,101	2,455,834	14,103,151	1,703,978
Software licensing and related integration projects		3,515,831	450,350	33,218	4,013
		16,771,006	32,973,661	28,300,321	3,419,316
Sales and value-added taxes		(1,150,169)	(2,476,444)	(2,274,784)	(274,845)
Net revenues		15,620,837	30,497,217	26,025,537	3,144,471
Cost of revenues:					
Advertising, e-commerce and other services (including cost reimbursements to a related party of RMB1,974,834, RMB2,098,127 and RMB796,454 (US$96,230) in 1999, 2000 and 2001, respectively)	6	(5,540,600)	(38,738,335)	(60,058,488)	(7,256,420)
Software licensing and related integration projects		(258,819)	–	–	–
Share compensation cost*		(6,296,816)	(1,171,084)	–	–
Total cost of revenues		(12,096,235)	(39,909,419)	(60,058,488)	(7,256,420)
Gross profit (loss on revenues)		3,524,602	(9,412,202)	(34,032,951)	(4,111,949)
Operating expenses:					
Selling, general and administrative expenses (including cost reimbursements to a related party of RMB466,259, RMB3,124,247 and RMB1,884,823 (US$227,729) in 1999, 2000 and 2001, respectively)	6	(16,709,221)	(162,922,561)	(181,560,624)	(21,936,619)
Asset impairment loss		–	–	(2,766,543)	(334,261)
Research and development expenses		(964,855)	(9,525,436)	(11,169,454)	(1,349,522)
Share compensation cost*		(39,116,583)	(12,668,476)	(2,357,758)	(284,870)
Total operating expenses		(56,790,659)	(185,116,473)	(197,854,379)	(23,905,272)
Operating loss		(53,266,057)	(194,528,675)	(231,887,330)	(28,017,221)
Other income (expenses):					
Sales of 163.net usage rights		1,500,000	–	–	–
Investments impairment loss		–	–	(8,924,381)	(1,078,266)
Interest income		357,160	27,858,710	17,571,187	2,122,996
Interest expense		–	(2,589,735)	(9,882,874)	(1,194,074)
Other, net		(494,018)	(9,099)	(40,516)	(4,896)
Loss before tax		(51,902,915)	(169,268,799)	(233,163,914)	(28,171,461)
Provision for income tax	12	(71,338)	–	–	–
Net loss		(51,974,253)	(169,268,799)	(233,163,914)	(28,171,461)
Other comprehensive income (loss)					
Currency translation adjustments		–	(348,586)	565,913	68,375
Comprehensive loss		(51,974,253)	(169,617,385)	(232,598,001)	(28,103,086)
Net loss per share, basic and diluted		(0.03)	(0.07)	(0.08)	(0.01)
Net loss per ADS, basic and diluted		(2.73)	(6.78)	(7.74)	(0.93)
Weighted average number of ordinary shares outstanding		1,900,430,600	2,497,467,200	3,013,419,400	3,013,419,400
Weighted average number of ADS outstanding		19,004,306	24,974,672	30,134,194	30,134,194

	1999	2000	2001	2001
* Share compensation cost (see Note 16)				
Cost of revenues - advertising, e-commerce and other services	(6,296,816)	(1,171,084)	–	–
Selling, general and administrative expenses	(34,346,268)	(7,437,230)	(204,423)	(24,699)
Research and development expenses	(4,770,315)	(5,231,246)	(2,153,335)	(260,171)
	(45,413,399)	(13,839,560)	(2,357,758)	(284,870)

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

Power to the People

NETEASE.COM, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Convertible preference shares		Ordinary shares		Additional	Subscriptions	Deferred	Statutory	Retained earnings (Accumulated	Translation	Total shareholders'
	Share	Amount	Share	Amount	paid-in capital	receivable	compensation	reserves	deficit)	adjustments	equity
		RMB		RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB
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 shares issued to principal owner as part of reorganization	–	–	1,868,817,200	1,547,138	(1,547,138)	–	–	–	–	–	–
Ordinary shares issued for cash at US$0.05 per share	–	–	4,500,000	3,725	1,859,004	–	–	–	–	–	1,862,729
Series A preference shares issued for cash at US$5.00 per share	3,000,000	248,367	–	–	123,934,635	–	–	–	–	–	124,183,002
Share compensation cost	–	–	–	–	57,156,581	–	(11,743,182)	–	–	–	45,413,399
Balance as of December 31, 1999	3,000,000	248,367	2,004,500,000	1,659,447	197,604,001	–	(11,743,182)	–	(51,703,393)	–	136,065,240
Series B preference shares issued for cash at US$15.62 per share	2,560,556	211,976	–	–	330,940,024	(41,390,508)	–	–	–	–	289,761,492
Cost of issuance of Series B preference shares	–	–	–	–	(6,246,516)	–	–	–	–	–	(6,246,516)
Ordinary shares issued for cash at US$0.155 per share in initial public offering	–	–	450,000,000	372,560	577,094,666	(6,439,401)	–	–	–	–	571,027,825
Cost of initial public offering	–	–	–	–	(62,289,780)	–	–	–	–	–	(62,289,780)
Automatic conversion of Series A preference shares to ordinary shares	(3,000,000)	(248,367)	300,000,000	248,367	–	–	–	–	–	–	–
Automatic conversion of Series B preference shares to ordinary shares	(2,560,556)	(211,976)	256,055,600	211,976	–	–	–	–	–	–	–
Share compensation cost	–	–	–	–	39,402,963	–	(25,563,403)	–	–	–	13,839,560
Net loss	–	–	–	–	–	–	–	–	(169,268,799)	–	(169,268,799)
Translation adjustments	–	–	–	–	–	–	–	–	–	(348,586)	(348,586)
Balance as of December 31, 2000	–	–	3,010,555,600	2,492,350	1,076,505,358	(47,829,909)	(37,306,585)	–	(220,972,192)	(348,586)	772,540,436
Collection of subscriptions receivable for Series B preference shares issued in 2000	–	–	–	–	–	6,289,940	–	–	–	–	6,289,940
Ordinary shares issued to a senior official of the Company as compensation (see Note 15)	–	–	11,250,000	9,315	1,334,529	–	(739,265)	–	–	–	604,579
Ordinary shares issued for services to be provided by certain employees (see Note 15)	–	–	2,369,592	1,961	799,160	–	(555,914)	–	–	–	245,207
Share compensation cost	–	–	–	–	(33,749,218)	–	35,257,190	–	–	–	1,507,972
Provision for uncollectable subscriptions receivable	–	–	–	–	–	6,439,401	–	–	–	–	6,439,401
Net loss	–	–	–	–	–	–	–	–	(233,163,914)	–	(233,163,914)
Translation adjustments	–	–	–	–	–	–	–	–	–	565,913	565,913
Balance as of December 31, 2001	–	–	3,024,175,192	2,503,626	1,044,889,829	(35,100,568)	(3,344,574)	–	(454,136,106)	217,327	555,029,534

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

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended			
	1999	2000	2001	2001
	RMB	RMB	RMB	US$
Cash flows from operating activities:				
Net loss	(51,974,253)	(169,268,799)	(233,163,914)	(28,171,461)
Adjustments for:				
Depreciation	975,429	8,117,140	17,334,794	2,094,434
Share compensation cost	45,413,399	13,839,560	2,357,758	284,870
Provision for doubtful debts	–	1,584,452	7,105,038	858,449
Write down of investment in convertible note	–	–	2,069,475	250,039
Write down of investment in convertible preference shares	–	–	6,854,906	828,227
Write down of property, equipment and software	–	–	2,766,543	334,261
Provision for uncollectable subscriptions receivable	–	–	6,439,401	778,025
(Increase) decrease in accounts receivable	(5,985,311)	4,706,696	684,888	82,750
(Increase) decrease in prepayments and other current assets	(8,411,872)	(6,056,428)	5,689,171	687,381
Increase in due from related parties	(1,005,245)	(5,194,687)	(3,526,047)	(426,026)
Increase in deferred asset	–	(673,407)	(109,945)	(13,284)
Increase in accounts payable	771,932	6,420,224	5,553,994	671,048
Increase (decrease) in deferred revenue	634,069	(1,035,112)	(558,739)	(67,508)
Increase in salary and welfare payable	1,840,718	4,862,634	3,204,174	387,136
Increase (decrease) in taxes payable	1,216,417	(410,760)	765,827	92,529
Increase (decrease) in accrued liabilities	695,293	18,083,907	(7,843,607)	(947,684)
Increase (decrease) in due to related parties	141,950	371,279	(1,313,229)	(158,668)
Net cash used in operating activities	(15,687,474)	(124,653,301)	(185,689,512)	(22,435,482)
Cash flows from investing activities:				
Increase in temporary cash investments	–	–	(45,521,300)	(5,500,000)
Purchase of property, equipment and software	(9,312,383)	(33,970,794)	(21,095,334)	(2,548,792)
Increase in investment in convertible note	–	(827,810)	(1,241,665)	(150,021)
Increase in investment in convertible preference shares	–	(16,556,199)	–	–
(Increase) decrease in non-current deposit	–	(1,682,710)	595,223	71,916
Net cash used in investing activities	(9,312,383)	(53,037,513)	(67,263,076)	(8,126,897)
Cash flows from financing activities:				
Proceeds from short-term bank loans	–	112,600,000	123,800,000	14,957,832
Re-payment of short-term bank loans	–	–	(152,400,000)	(18,413,358)
Proceeds from issuance of ordinary shares, net of RMB62,289,780 issuance costs and RMB6,439,401 subscriptions receivable in 2000	18,417,413	508,738,045	–	–
Proceeds from issuance of Series A and Series B preference shares, net of issuance costs of RMB6,246,516 and RMB41,390,508 subscriptions receivable in 2000	124,183,002	283,514,976	–	–
Collection of subscriptions receivable for Series B preference shares issued in 2000	–	–	6,289,940	759,967
Net cash provided by financing activities	142,600,415	904,853,021	(22,310,060)	(2,695,559)
Effect of exchange rate changes on cash	–	(348,586)	565,913	68,375
Net increase (decrease) in cash	117,600,558	726,813,621	(274,696,735)	(33,189,563)
Less: (Increase) decrease in restricted cash	–	(136,052,705)	45,744,257	5,526,939
Cash, beginning of year	199,538	117,800,096	708,561,012	85,610,155
Cash, end of year	117,800,096	708,561,012	479,608,534	57,947,531

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)

	For the year ended			
	1999	2000	2001	2001
	RMB	RMB	RMB	US$
Supplemental disclosures of cash flow information:				
Cash paid during the year for income taxes	11,557	–	–	–
Cash paid during the year for interest	–	1,159,275	8,726,640	1,054,375
Supplemental schedule of non-cash investing and financing activities:				
Compensation costs, arising from transfer of ordinary shares and issuance of stock options in the Company to the employees and some non-employees of the Company (see Notes 15 and 16)	45,413,399	13,839,560	2,357,758	284,870

The accompanying notes an integral part of these financial statements.

NETEASE.COM, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts expressed in renminbi ("RMB"), unless otherwise stated)

1. Organization and Nature of Operations

The Group

The accompanying consolidated financial statements include the financial statements of NetEase.com, Inc. (the “Company”) and its controlled entities which consist of NetEase Information Technology (Beijing) Co., Ltd. (“NetEase Beijing”), NetEase Information Technology (Shanghai) Co., Ltd. (“NetEase Shanghai”), NetEase (U.S.) Inc. (“NetEase US”), and Beijing NetEase Interactive Network Technology Co., Ltd. (“NetEase INT”). 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, 2001, the Company had three directly wholly owned subsidiaries, NetEase Beijing, NetEase Shanghai and NetEase US. NetEase Shanghai was established by the Company on May 14, 2000. NetEase INT was established on November 28, 2000 by the Company and NetEase Beijing, which owned 80% and 20% respectively of the equity interest in NetEase INT. On March 4, 2002, an approval was obtained from the relevant Chinese authorities for its dissolution.

The Group is principally engaged in developing and providing Internet-related advertising, e-commerce and other services, and software licensing services, etc. The Group's businesses were previously conducted by Guangzhou NetEase Computer System Co., Ltd. (“Guangzhou NetEase”), a limited liability company established in the People’s Republic of China (“China”), which is controlled by 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.

Power to the People

1. Organization and Nature of Operations (cont'd)

The Group (cont'd)

The Group conducts its business within one industry segment – the business of developing and providing Internet-related advertising, e-commerce and other, and software licensing 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.

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, 2001, the Group had an accumulated deficit of approximately RMB454.1 million and has continued to incur losses subsequent to that date. Management believes that the Group's existing cash resources and cash generated from revenue growth will be sufficient for it to meet its obligations through at least December 31, 2002.

Agreements with Guangzhou NetEase

The Group entered into a series of agreements with Guangzhou NetEase effective January 1, 2000. Under these agreements, the Group provides its Internet portal and e-commerce technologies and advertising services to Guangzhou NetEase, and Guangzhou NetEase operates the NetEase Web sites. 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

1. Organization and Nature of Operations (cont'd)

Agreements with Guangzhou NetEase (cont'd)

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 are accounted for and disclosed as related party transactions.

Agreements with Guangyitong Advertising Co., Ltd. ("Guangyitong Advertising")

NetEase Beijing also entered into a series of agreements with Guangyitong Advertising and the ultimate owners of Guangyitong Advertising effective January 1, 2000. 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 is 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 are not 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 are accounted for and disclosed as related party transactions.

Power to the People

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 from those estimates.

The principal differences between US GAAP 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;
- recognition of compensation cost arising from grants of stock options to the Company's employees, directors, consultants and advisory board members;
- 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.

Advertising services

The Group currently derives its advertising services revenues principally from the fees earned from services provided to Guangyitong Advertising, a related party (see Note 6). Prior to December 1999, the Group also derived advertising services revenues from fees from advertisers on the NetEase Web sites.

2. Principal Accounting Policies (cont'd)

Advertising services (cont'd)

The agreements entered into between NetEase Beijing and Guangyitong Advertising (see Note 1) allow NetEase Beijing to unilaterally adjust the amount of fees NetEase Beijing is entitled to from the technical consulting and related services provided to Guangyitong Advertising such that all of the advertising revenues recognized by Guangyitong Advertising based on the recognition policy described below, less the operating expenses incurred by Guangyitong Advertising, will fully accrue to NetEase Beijing. Therefore, the Group recognizes advertising services revenues from Guangyitong Advertising as the service revenues are earned based on the related service agreement (see Note 1) at the same time as Guangyitong Advertising recognizes its advertising revenues.

Guangyitong Advertising derives its advertising fees principally from short-term advertising contracts. Revenues from advertising contracts are generally recognized ratably over the period in which the advertisement is displayed and only if collection of the resulting receivables is probable. Guangyitong Advertising'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, Guangyitong Advertising defers recognition of the corresponding revenues until the remaining guaranteed impression levels are achieved.

Revenues from barter transactions primarily relate to advertising. Prior to January 20,2000, barter transactions were recorded at the estimated fair market value of the service received or estimated fair market value of the advertisement provided, whichever is more readily determinable.

Effective from January 20,2000, Guangyitong Advertising has adopted the consensus reached in Emerging Issue Task Force ("EITF") 99-17 to account for barter transactions. According to EITF99-17, revenue and expense should be recognized at fair value from a barter transaction involving advertising services provided by the Group only if the fair value of the advertising services surrendered in the transaction is determinable based on the entity's own historical practice of receiving cash, marketable securities, or other consideration that is readily convertible to a known amount of cash for similar advertising from buyers unrelated to the counterparty in the barter transaction. During the years ended December 31, 2000 and 2001, the recognized revenues and expenses derived from barter transactions were approximately RMB0.7 million for each of the years. During the years ended December 31, 2000 and 2001, Guangyitong Advertising also engaged in certain advertising barter transactions for which the fair value is not determinable within the limits of EITF 99-17 and therefore no revenues or expenses derived from these barter transactions were recognized. These transactions primarily involved exchanges of advertising services rendered by Guangyitong Advertising for advertising, promotional benefits, information content, consulting services, and software provided by the counterparties.

Power to the People

2. Principal Accounting Policies (cont'd)

E-commerce and other services

The Group currently derives all its e-commerce and other services revenues from fees earned from services provided to Guangzhou NetEase, a related party (see Note 6). The Company derives e-commerce and other services revenues from technical services provided to Guangzhou NetEase which operates the NetEase Web sites for transactions conducted through the Internet. The agreements entered into between NetEase Beijing and Guangzhou NetEase (see Note 1) allow NetEase Beijing to unilaterally adjust the amount of fees NetEase Beijing is entitled to from the technical services provided to Guangzhou NetEase such that all of the e-commerce and other services revenues recognized by Guangzhou NetEase based on the recognition policy described below will fully accrue to NetEase Beijing.

The transactions conducted by Guangzhou NetEase for which the Group provides technical services to Guangzhou NetEase primarily include short messaging, on-line shopping mall, auctions and revenue sharing from co-branded Web sites, etc. Guangzhou NetEase recognizes its share of the revenues from these transactions when the services are provided.

The Group entered into a strategic co-operation agreement with a private auction company pursuant to which the Group and the private auction company established a co-branded auction Web site on the NetEase Web sites. According to the agreement, the Group is entitled to (i) a non-refundable upfront fee and (ii) quarterly referral fees which are based on the number of click-throughs to the co-branded site with a minimum fee level on a quarterly basis. The agreement is for a term of two years commencing from the date of launch of the co-branded Web site on September 10, 2000. The private auction company informed the Group that it considers that the strategic co-operation agreement has been terminated in 2002. However, the Group has been unable to resolve this issue or to enter into a new agreement with the private auction company and the co-branded Web site still remains in operation. Pursuant to the agreements between the Company and Guangzhou NetEase (see Note 1), Guangzhou NetEase operates the co-branded Web site under the strategic co-operation agreement. Guangzhou NetEase recognizes revenues from the non-refundable upfront fee on the straight-line basis over the service period and recognizes the referral fees as services are provided and as the fees are earned.

The Group recognizes services revenues from Guangzhou NetEase at the same time as Guangzhou NetEase recognizes its e-commerce and other services revenues.

Services provided to third parties during 1999 and 2000 include various short-term service contracts for construction of Web sites and market surveys, etc. Revenue is recognized upon completion of the respective total contract and acceptance by the customer.

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.

2. Principal Accounting Policies (cont'd)

Software and related integration projects (cont'd)

In accordance with AICPA Statement of Position ("SOP") 97-2, revenues from software licensing and related integration projects under which the Group provides 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.

Deferred revenue

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

Cost of revenues

Costs of advertising, e-commerce and other services consist primarily of staff costs of those departments directly involved in providing advertising and e-commerce and other services, depreciation and amortization of computers and software, server custody fees, bandwidth and other direct costs of providing these services. These costs 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 SOP 98-1 and costs incurred prior to the application development stage are 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, 2000 and 2001 are amounts denominated in United States dollars totaling US$81.5 million and US$56.3 million respectively (equivalent to approximately RMB675.0 million and RMB466.0 million respectively).

Temporary cash investments

Temporary cash investments represent time deposits placed with banks or other financial institutions with original maturities over three months. Included in temporary cash investments as of December 31, 2001 are accounts denominated in United States dollars totaling approximately US$5.5 million (equivalent to approximately RMB45.5 million).

Financial instruments

Financial instruments of the Group primarily consist of temporary cash investments, accounts receivable, due from and due to related parties, investment in convertible note, investment in convertible preference shares, short-term bank loans and accounts payable. As of the balance sheet dates, their estimated fair value approximated their carrying value.

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2. Principal Accounting Policies (cont'd)

Property, equipment and software

Property, equipment and software are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line basis over the following estimated useful lives, taking into account any estimated residual value:

•	Furniture and office equipment	5 years
•	Computers	3 years
•	Software	1-3 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 SOP 98-1, under which direct costs incurred to develop the software during the application development stage and to obtain computer software from third parties that can provide future benefits are capitalized. As of December 31, 2001, the capitalized costs of internally developed computer software are approximately RMB5.1 million.

Impairment of long-lived assets

The Company evaluates the recoverability of long-lived assets in accordance with SFAS No.121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". SFAS No. 121 requires recognition of impairment of long-lived assets in the event the net book value of such assets exceeds the future undiscounted cash flows attributable to such assets.

Advertising expenses

The Company recognizes advertising expenses in accordance with AICPA SOP 93-7 "Reporting on Advertising Costs". As such, the Company expenses the costs of producing advertisements at the time production occurs, and expenses the cost of communicating advertising in the period in which the advertising space or airtime is used. Advertising expenses totaled approximately RMB6.9 million, RMB61.6 million and RMB14.7 million, during the years ended December 31, 1999, 2000 and 2001, respectively.

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 = RMB8.2766 on December 31, 2001 in The City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at that rate on December 31, 2001, or at any other certain rate.

2. Principal Accounting Policies (cont'd)

Stock options

In accordance with the provisions of Statement of Financial Accounting Standards No. 123 ("SFAS 123") "Accounting for Stock-Based Compensation", the Group has selected 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 of 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 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 loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is calculated by dividing net 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 323,695,000, 50,164,600 and 66,845,749 for the years ended December 31, 1999, 2000, and 2001, respectively.

Net loss per ADS has been computed by multiplying the net loss per share by 100, which is the number of shares represented by each ADS.

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2. Principal Accounting Policies (cont'd)

Statutory reserves

In accordance with the Regulations on Enterprises with Foreign Investment of China and their articles of association, NetEase Beijing, NetEase Shanghai, NetEase INT, being foreign invested enterprises established in China, are 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 their PRC Statutory Accounts. NetEase Beijing and NetEase Shanghai, being wholly foreign owned enterprises, are required to allocate at least 10% of their after-tax profit to the general reserve. NetEase Beijing and NetEase Shanghai may stop allocations to the general reserve if such reserve has reached 50% of their respective 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, NetEase Shanghai and NetEase INT, respectively. 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 and NetEase Shanghai have been in a loss position according to their 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.

Reclassifications

Certain reclassifications have been made in prior years' financial statements to conform to classification used in the current year.

Recent accounting pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations" and No. 142 "Goodwill and Other Intangible Assets". SFAS No. 141 applies to business combinations initiated after June 30, 2001. SFAS No. 141 requires business combinations to be accounted for using one method, the purchase method. SFAS No. 142 addresses financial accounting for acquired goodwill and other intangible assets and how such assets should be accounted for in financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. The Group does not believe that the adoption of SFAS No. 141 and No. 142 will have a significant impact on its financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets, " (SFAS144), which addresses financial accounting and reporting for the recognition and measurement of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 31, 2001. The Group does not believe the adoption of SFAS144 will have a significant impact on its financial statements.

3. Concentrations

Major customers

Revenues from customers (other than those from related parties described in Note 6 below) that individually represent greater than 10% of the total revenues for the years ended December 31, 1999, 2000 and 2001 are as follows:

Customers	For the year ended December 31, 1999	2000	2001
Top Result Promotion Ltd.	2,369,363	–	–
Big Save Ltd.	2,075,000	–	–

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 the 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, e-commerce and other services to businesses primarily in China. The Group generally does not require collateral for its accounts receivable.

4. Restricted Cash

Restricted cash represents USD denominated deposits in the amounts of US$0.1 million (2000: US$0.1 million) pledged as security money for renting office space and USD denominated deposits totaling US$10.8 million (2000: US$16.3 million) pledged with banks for the Group's RMB denominated short-term bank loans (see Note 10).

5. Prepayments and Other Current Assets

	December 31, 2000	December 31, 2001
Prepayments	7,502,856	2,692,651
Interest receivable	3,211,690	2,854,722
Employee advances	1,088,479	100,535
Low-value consumables	611,396	1,712,813
Other	2,411,112	1,775,641
Total	14,825,533	9,136,362

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6. Related Party Transactions

During the years ended December 31, 1999, 2000 and 2001 the Group derived approximately RMB0.5 million, nil and RMB0.3 million, respectively, of advertising fees from shareholders of the Company.

During the years ended December 31, 1999, 2000 and 2001, the Group derived approximately RMB0.3 million, RMB30.1 million and RMB14.2 million, respectively, of advertising services revenues from Guangyitong Advertising, a related company that is controlled by the principal shareholder of the Company, for advertising-related technical consulting services performed.

During the years ended December 31, 1999, 2000 and 2001, the Group derived approximately nil, RMB1.1 million and RMB14.1 million, respectively, of e-commerce and other services revenues from Guangzhou NetEase, a related company that is controlled by the principal shareholder of the Company.

During the years ended December 31, 1999, 2000 and 2001, the Group reimbursed Guangzhou NetEase a total of approximately RMB2.4 million, RMB5.2 million and RMB2.7 million, respectively, for the costs of operating the NetEase Web sites.

As of the balance sheet dates, due from related parties represents amounts receivable from Guangyitong Advertising and Guanzhou NetEase for services performed and temporary advances to officers of the Group. The balances with related parties were unsecured, interest-free and repayable on demand. As of December 31, 2000 and 2001, the amounts due from related parties included amounts denominated in United States dollars of US$0.2 million and US$0.5 million respectively (equivalent to approximately RMB1.9 million and RMB3.9 million respectively). All other related party balances are denominated in RMB.

7. Investment in Convertible Note

Investment in convertible note as of December 31, 2000 represented an advance made to a private company operating as a provider of women focused content on the Internet and was stated at cost. The investment was fully written off to the statement of operations during the year ended December 31, 2001 as a result of the closure of the private company.

8. Investment in Convertible Preference Shares

	December 31, 2000	December 31, 2001
Investment, at cost	16,556,199	16,556,199
Less: Investment impairment loss	–	(6,854,906)
Net book value	16,556,199	9,701,293

8. Investment in Convertible Preference Shares (cont'd)

Investment in convertible preference shares represents an investment in 705,816 preference shares in a private Internet based auction company at US$2.8336 per share.

According to a board resolution dated March 14, 2002 and an agreement entered into between the Company and the private auction company dated March 18, 2002, the private auction company repurchased from the Company all of the 705,816 preference shares the Company acquired at a consideration of approximately US$1.2 million which is equivalent to approximately RMB9.7 million (see Note 18).

Therefore, the investment has been written down to its net realizable value as of December 31, 2001.

9. Property, Equipment and Software

	December 31, 2000	December 31, 2001
Computers	28,470,949	43,937,710
Furniture and office equipment	1,941,495	2,262,944
Software	9,663,528	12,899,639
Leasehold improvements	3,772,709	3,782,693
Vehicles	705,514	–
	44,554,195	62,882,986
Less: Accumulated depreciation	(9,192,104)	(26,526,898)
Net book value	35,362,091	36,356,088

As a result of the periodic review of the carrying value of property, equipment and software, the Company recorded an impairment loss for software of RMB2.8 million during the year ended December 31, 2001. Fair value was determined for the software, primarily based on the present value of estimated expected future cash flows to be generated from the software.

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10. Short-term Bank Loans

Lender	Period	Annual interest rate	Outstanding principal as of December 31, 2001
China Merchants Bank - loan A	March 2001 to March 2002	5.85%	24,000,000
China Merchants Bank - loan B	April 2001 to April 2002	5.85%	32,000,000
China Merchants Bank - loan C	May 2001 to May 2002	5.85%	28,000,000
			84,000,000

As of December 31, 2001, the above loans A and C totaling RMB52 million are secured by bank deposits of US$6.5 million, and the loan B of RMB32 million is secured by a bank deposit of US$4.3 million.

These short-term bank loans were drawn for working capital purposes.

11. 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 RMB1.4 million, RMB6.2 million and RMB9.6 million for the years ended December 31, 1999, 2000, and 2001, 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 years ended December 31, 1999, 2000 and 2001 amounted to approximately RMB0.2 million, RMB3.6 million and RMB6.3 million, respectively. The Chinese government is responsible for the medical benefits and ultimate pension liability to these employees.

12. 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.

12. Taxation (cont'd)

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, has been recognized as a "New and High Technology Enterprise". According to an approval granted by the Haidian State Tax Bureau in November 2000, NetEase Beijing is entitled to a reduced EIT rate of 15% commencing from the year 2000. In addition, the approval also granted NetEase Beijing with a full exemption from EIT from 2001 to 2002, a 50% reduction in EIT from 2003 to 2005, and a full exemption from the local tax from 2000 onwards.

NetEase Shanghai is subject to EIT at the rate of 30% plus a local tax of 3%.

Domestic Enterprises

Guangzhou NetEase is a Chinese domestic enterprise and is generally subject to EIT at a rate of 33%. However, 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 is subject to different EIT rates depending on the nature of its taxable revenues.

A reconciliation of the differences between the statutory tax rate and the effective tax rate for EIT is as follows:

	For the year ended December 31,		
	1999	2000	2001
EIT statutory rate	(33.0%)	(33.0%)	(33.0%)
Non-deductible share compensation costs	13.1%	2.7%	0.3%
Effect of tax rate applicable to small-sized domestic enterprises	(0.2%)	–	–
Effect of lower tax rate applicable to hi-tech enterprises	18.3%	6.7%	6.2%
Valuation allowance for deferred tax assets	1.9%	12.6%	8.2%
Permanent differences (primarily the expenses incurred by the Company which are not deductible for EIT purposes)			
– Professional fees	–	1.9%	8.5%
–Salaries of the Company's senior officers	–	1.9%	3.1%
–Other	–	7.2%	6.7%
Effective EIT rate	0.1%	–	–

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12. Taxation (cont'd)

Domestic Enterprises (cont'd)

As of December 31, 2000, and 2001, 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:

	December 31, 2000	December 31, 2001
Loss carryforwards (primarily for NetEase Beijing and NetEase Shanghai relating to EIT applicable to foreign invested enterprises)	20,026,267	39,147,456
Valuation allowance	(20,026,267)	(39,147,456)
Net deferred tax assets	–	–

Subject to the approval of the relevant tax authorities, NetEase Beijing had loss carryforwards of approximately RMB162.4 million as of December 31, 2001 for EIT purposes. Approximately RMB6.6 million, RMB75.3 million and RMB80.5 million of these loss carryforwards will expire in 2004, 2005 and 2006, respectively. NetEase Shanghai had loss carryforwards of approximately RMB44.8 million as of December 31, 2001 for EIT purposes. Approximately RMB23.5 million and RMB21.3 million of these loss carryforwards will expire in 2005 and 2006, respectively. A valuation allowance has been provided due to the uncertainty surrounding the realizability of such assets. There is no assurance that NetEase Beijing and NetEase Shanghai will be able to utilize the loss carryforwards before their expiration.

In addition, the preferential EIT treatments that NetEase Beijing obtained may be subject to review by higher authorities. If these preferential tax treatments were not available to NetEase Beijing, NetEase Beijing would be subject to EIT at 30% plus a local tax of 3% and the exemption and reduction described above would not apply. In that case, the tax impact of the loss carryforwards and the valuation allowance as of December 31, 2001 would have been higher by approximately RMB29.2 million (2000: RMB14.7 million).

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 their 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 10% withholding tax on gross receipts from profit, interest, rentals, royalties and other income sourced in China.

Dividends from NetEase Beijing and NetEase Shanghai to the Company are exempt from Chinese withholding tax.

12. Taxation (cont'd)

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

Taxes payable

	December 31, 2000	December 31, 2001
BT	823,831	1,313,896
Other	183,273	459,035
Total	1,007,104	1,772,931

13. Accrued Liabilities

	December 31, 2000	December 31, 2001
Accrued advertising expenses	15,085,096	978,027
Accrued information fee	1,043,000	1,787,468
Accrued professional fees	1,122,461	3,854,513
Other	1,531,000	4,317,942
Total	18,781,557	10,937,950

14. Subscriptions Receivable

Subscriptions receivable represents the amount receivable from a shareholder for subscription for the Company's series B preference shares (see Note 15) and advances to certain shareholders for subscription for the Company's ordinary shares in 2000. At December 31, 2001, an allowance for doubtful subscriptions receivable in the amount of approximately RMB6.4 million was provided as the Company believes that this amount is not collectible.

15. Capital Structure

Ordinary shares

The holders of ordinary shares in the Company are entitled to one vote per share and to receive ratably such dividends, if any, as may be declared by the board of directors of the Company. In the event of liquidation, the holders of ordinary shares are entitled to share ratably in all assets remaining after payment of liabilities. The ordinary shares have no preemptive, conversion, or other subscription rights.

15. Capital Structure (cont'd)

Ordinary shares (cont'd)

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 of his 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 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 of his 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 is to be amortized over the related vesting periods.

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 recorded compensation costs of approximately RMB2.5 million in 2000.

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.

In June 2000, the Company sold 4,500,000 ADS, representing 450,000,000 ordinary shares, in an underwritten initial public offering for net proceeds of approximately US$64.9 million, before offering expenses. Simultaneously with the closing of the public offering, all 3,000,000 shares of Series A preference shares and 2,560,556 shares of Series B preference shares were converted to ordinary shares on a basis of 100 ordinary shares for one preference share (see below).

On March 23, 2001, the Company entered into an agreement whereby the Company acquired certain software for online games, computers and the related intellectual property rights for cash consideration of US$0.2 million from a private technology company. In addition, the Company agreed to issue 7,742,168 ordinary shares in the Company to the founders of the private technology company by installments on a quarterly basis starting from June 23, 2001 through March 23, 2003 for the service to be provided by such individuals as employees of the Company over such period. The total estimated fair value of these shares of approximately RMB0.8 million valued at US$0.0125 per share at the date of agreement is recognized as deferred compensation, which is to be amortized over the related vesting period.

According to an agreement dated September 11, 2001 between the Company and a senior officer of the Company, the Company shall provide cash payments to the officer for him to acquire 25,000,000 ordinary shares in the Company at a subscription price of US$0.006492 per share, representing the fair value of each share at the date of the agreement, by quarterly installments over a period of 18 months. Deferred compensation cost of approximately RMB1.3 million is recognized, which is to be amortized over the related vesting period of 18 months.

15. Capital Structure (cont'd)

Convertible preference shares

Series A preference shares

The Series A preference shares were convertible on a basis of 100 ordinary shares for one preference share. These preference shares were automatically converted upon closing of the public offering of the ordinary shares in the Company in 2000.

The Series A preference shares carried 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 had to 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.

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 a total consideration of approximately US$40 million, of which US$35 million was paid up in cash and US$5 million was 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 Series B preference shares had the same conversion features as the Series A preference shares. The Series B preference shares had an aggregate liquidation preference equal to the total consideration for which they were issued. They carried the same preferences as those of Series A preference shares on dividend payment but had 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 provided 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.

The effect of the issuance of Series B preference shares together with the strategic co-operation agreement with the same shareholder is similar to an issuance of shares to the shareholder for cash consideration of US$40 million (with US$35 million receivable immediately and US$5 million receivable over a period of three years from March 2000) and having a barter transaction for advertising between the Company and the shareholder. The accounting for these two transactions in the financial statements reflects this effect.

16. Stock Option Plans

1999 Stock Option Plan

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 Option Plan"). The Company has reserved 345,675,000 ordinary shares for issuance under the plan.

Power to the People

16. Stock Option Plans (cont'd)

1999 Stock Option Plan (cont'd)

Employees

During the year ended December 31, 1999, the Company granted options to the Company's employees to acquire a total of 3,735,000 ordinary shares at an exercise price of US$0.070 per share. Options for the employees vest upon completion of the first full year of service by the respective employees from the date they first joined the Group and expire at the end of the fifth year of their respective service periods.

Of these grants to employees, options to acquire 740,000 and 1,560,000 ordinary shares were cancelled in 2000 and 2001, respectively, as a result of the resignation of certain employees. Accordingly, option to acquire 1,435,000 ordinary shares remained outstanding as of December 31, 2001.

Senior management

During the year ended December 31, 1999, the Company granted options to members of the Company's senior management to acquire a total of 115,225,000 ordinary shares at an exercise price of US$0.065 per share. 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 would 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.

Of these grants to senior management, options to acquire 46,858,200 and 52,235,300 ordinary shares were cancelled in 2000 and 2001, respectively, as a result of the resignation of certain members of the Company's senior management. Accordingly, options to acquire 16,131,500 ordinary shares remained outstanding as of December 31, 2001.

Advisory board

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. 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 RMB0.9 million was recognized at the date of grant as deferred compensation which was to be amortized over the related vesting period. The estimated fair value of the options granted to advisory board member was 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.

Of these grants to the advisory board members, options to acquire 400,000 and 1,600,000 ordinary shares were cancelled in 2000 and 2001, respectively, as a result of the resignation of the advisory board members. Accordingly, options to acquire 1,000,000 ordinary shares remained outstanding as of December 31, 2001.

16. Stock Option Plans (cont'd)

2000 Stock Option Plan

According to a resolution of the board of directors of the Company in 2000, the 1999 Stock Option Plan was replaced by the 2000 Stock Option Plan.

According to a resolution of the board of directors of the Company in 2001, the 2000 stock option plan was amended and restated. Under the amended plan, the number of ordinary shares available for issuance was increased from 223,715,000 under the prior plan to 323,715,000. The amended plan also included a mechanism for the automatic increase in the number of ordinary shares available for future issuance. This mechanism, which is known as "Evergreen Provision", provided for a periodic increase so that the number of ordinary shares available under the plan would automatically increase by three percent (3%) each year up to a maximum at any given time of 17.5% of the Company's total outstanding ordinary shares, on a fully-diluted basis. These increases would occur on June 1 of 2001 and January 1 of each year thereafter. The "Evergreen Provision" has been suspended pursuant to a resolution of the board of directors dated March 25, 2002.

Employees

During the year ended December 31, 2000, the Company granted options to acquire a total of 64,720,000 ordinary shares to the Company's employees at an exercise price ranging from US$0.063 to US$0.156 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.

Out of the options granted to employees in 2000, options to acquire 21,755,000 and 17,350,000 ordinary shares were cancelled in 2000 and 2001, respectively, as a result of the resignation of certain employees. Options to acquire 25,615,000 ordinary shares remained outstanding as at December 31, 2001.

During the year ended December 31, 2001, the Company granted options to acquire a total of 24,059,000 ordinary shares to the Company's employees at an exercise price of approximately US$0.022 per share. These Options will vest over a period of four years beginning with the completion of one full year from the date of grant.

Out of the options granted to employees in 2001, options to acquire 9,366,000 ordinary shares were cancelled in 2001 as a result of the resignation of certain employees. Options to acquire 14,693,000 ordinary shares remained outstanding as at December 31, 2001.

Senior management

During the year ended December 31, 2000, the Company granted options to acquire a total of 163,424,300 ordinary shares to certain new members of the Company's senior management at exercise prices ranging from US$0.043 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. The compensation costs were calculated based upon the estimated fair value of the Company's ordinary shares ranging from US$0.03 per share to US$0.156 per share during the period from February to December 2000.

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16. Stock Option Plans (cont'd)

2000 Stock Option Plan (cont'd)

Senior management (cont'd)

Out of the options granted to senior management in 2000, options to acquire 33,600,000 and 92,218,800 ordinary shares were cancelled in 2000 and 2001, respectively, as a result of the resignation of certain members of the Company's senior management. Options to acquire 37,605,500 ordinary shares remained outstanding as at December 31, 2001.

During the year ended December 31, 2001, the Company also granted options to acquire a total of 92,225,000 ordinary shares to certain members of the Company's senior management at exercise prices ranging from US$0.006 to US$0.155 per share.

Out of the options granted to senior management in 2001, options to acquire 54,175,000 ordinary shares were cancelled in 2001 as a result of the resignation of certain members of the Company's senior management. Options to acquire 38,050,000 ordinary shares remained outstanding as at December 31, 2001.

Director and consultants

During the year ended December 31, 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 850,000 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 RMB1.5 million. The estimated fair value of the options granted to the director and the consultants was 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.

Of these grants to the directors and the consultants, options to acquire 1,200,000 and 700,000 ordinary shares, respectively, remained outstanding as at December 31, 2001. Options to acquire 150,000 ordinary shares granted to one consultant were cancelled in 2000 as a result of the resignation of that consultant.

16. Stock Option Plans (cont'd)

2000 Stock Option Plan (cont'd)

Advisory board

In June 2000, the Company granted options to acquire a total of 1,500,000 ordinary shares to a member of the Company's advisory board at an exercise price of US$0.155 per share. These options vest over a two year period commencing from the date of grant. Deferred compensation costs related to these option grants was approximately RMB1.8 million, 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$0.155 per ordinary share; expected dividend yield of 0% for all periods; expected life of five years; and expected volatility of 155%. In addition, in August 2000, the Company granted options to acquire a total of 2,000,000 ordinary shares to the same advisory board member at an exercise price of US$0.05 per share to replace the 1,500,000 shares of option granted in June 2000. The terms of the new grants were the same as those of the grants made in June 2000. In this connection, the options to acquire 1,500,000 ordinary shares granted in June 2000 were modified and therefore the modification was subject to an additional compensation cost of approximately RMB0.04 million. Deferred compensation cost related to the remaining newly issued 500,000 share options was approximately RMB0.2 million, 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$0.05 per ordinary share; expected dividend yield of 0% for all periods; expected life of five years; and expected volatility of 155%.

All the above options were cancelled in 2000 and 2001 (3,250,000 in 2000 and 250,000 in 2001, respectively) as a result of the resignation of the advisory board member.

In connection with all the above option grants to the employees, senior management, directors, consultants, and advisory board members in 2000, the Company recorded deferred share compensation costs of approximately RMB48.5 million in 2000 and nil in 2001, which were to be amortized and charged to expense starting from the grant date and through the end of the vesting periods of the underlying options.

In 2001, approximately RMB1.5 million (2000: RMB13.8 million) of the deferred compensation costs were amortized to expense and approximately RMB33.6 million (2000: RMB9.8 million) of the deferred compensation costs were reversed against the additional paid in capital as a result of the resignation of employees, senior management, directors and advisory board members.

The fair value of the options granted to non-employees of the Company, including advisory board members, consultants, and directors, was re-measured as at December 31, 2001 according to EITF96-18. The re-measurement resulted in a decrease in the deferred compensation costs of approximately RMB0.1 million. The balance of the deferred compensation costs as at December 31, 2001 amounted to approximately RMB2 million. The service contracts entered into between the Company and those non-employees generally do not subject the service provider to a significant penalty if the provider does not complete the contracted service and there are no other significant disincentives for non-performance. Therefore these arrangements do not constitute a performance commitment. The following assumptions were used in the re-measurement: risk-free interest rate of 3.14%; estimated fair value of US$0.01 per ordinary share; expected dividend yield of 0% for all periods; expected life of two to five years; and expected volatility of 121.82%. According to EITF96-18, variable accounting will be applied until the relating performance is completed.

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16. Stock Option Plans (cont'd)

2000 Stock Option Plan (cont'd)

Information relating to stock options outstanding is as follows:

	For the year ended December 31,					
	1999		2000		2001	
	Options outstanding	Weighted average exercise price	Options outstanding	Weighted average exercise price	Options outstanding	Weighted average exercise price
		US$		US$		US$
Outstanding at beginning of period	–	–	121,960,000	0.065	248,901,100	0.091
Granted	121,960,000	0.065	233,694,300	0.105	116,284,000	0.017
Cancelled	–	–	(106,753,200)	0.091	(228,755,100)	0.064
Outstanding at period end	121,960,000	0.065	248,901,100	0.091	136,430,000	0.074

As of December 31, 2001, options to purchase 66,845,749 ordinary shares were exercisable. Under the stock option plans, options to purchase 399,561,668 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 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, 2001 were as follows:

	Options outstanding at December 31, 2001			Options exercisable at December 31, 2001	
Exercise Price	Number outstanding	Weighted average remaining contractual life (Years)	Weighted average exercise price (US$)	Number exercisable	Weighted average exercise price (US$)
US$0.006	20,000,000	9.92	0.006	11,667,111	0.006
US$0.016	15,050,000	9.17	0.016	8,777,160	0.016
US$0.022	16,693,000	5.08	0.022	–	0.022
US$0.050	8,000,000	8.67	0.050	4,665,600	0.050
US$0.065	17,131,500	0.33	0.065	17,131,500	0.065
US$0.070 - US$0.075	3,435,000	3.75	0.073	1,935,000	0.071
US$0.100	20,195,000	4.17	0.100	5,672,250	0.100
US$0.155 - US$0.156	35,925,500	7.25	0.156	16,997,128	0.156
	136,430,000	6.26	0.074	66,845,749	0.074

16. Stock Option Plans (cont'd)

2000 Stock Option Plan (cont'd)

For the purposes of SFAS 123 pro forma disclosures, 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 method with the following assumptions:

	For the year ended December 31,		
	1999	2000	2001
Risk free interest rate	2.97% – 3.30%	2.50% – 3.30%	2.97% – 3.30%
Weighted average estimated fair value (US$)	0.06	0.128	0.085
Expected life (in years)	5 – 10	5 – 10	5 – 10
Expected dividend yield	0%	0%	0%
Volatility	0%	142% – 155%	122% – 155%

Had the compensation costs for the plans been determined based on the estimated fair value of the options at the grant dates for awards under the plan, the Group's net loss and net loss per ordinary share on a pro forma basis for the years ended December 31, 1999, 2000 and 2001 would have been as follows:

	For the year ended December 31,		
	1999	2000	2001
Net loss:			
As reported	(51,974,253)	(169,268,799)	(233,163,914)
Pro forma	(52,965,737)	(169,891,681)	(241,221,654)
Basic and diluted net loss per ordinary share:			
As reported	(0.03)	(0.07)	(0.08)
Pro forma	(0.03)	(0.07)	(0.08)

17. Commitments and Contingencies

Commitments

As of December 31, 2001, future minimum lease commitments were as follows:

	Office rental	Server custody fee	Total
2002	6,948,066	11,298,200	18,246,266
2003	1,939,816	–	1,939,816
2004	1,290,441	–	1,290,441
Total	10,178,323	11,298,200	21,476,523

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17. Commitments and Contingencies (cont'd)

Commitments (cont'd)

In the years ended December 31, 1999, 2000 and 2001, the Company incurred rental expenses in the amounts of approximately RMB0.4 million, RMB6.9 million and RMB8.8 million, respectively.

Insurance coverage

As of December 31, 2001, the Group had insurance on its property, equipment and software of approximately RMB22 million.

Litigation

Beginning in October 2001, four substantially identical purported class action complaints alleging violations of the federal securities laws were filed in the United States District Court for the Southern District of New York naming the Company, certain of its current and former officers and directors, and the underwriters of the Company's initial public offering as defendants. To date, the complaints have not been consolidated into a single action. The above lawsuits seek certification as a class action to represent those persons who purchased the Company's ADS during the period from July 3, 2000 to August 31, 2001. In general, the complaints allege, among other things, that (i) the Company's initial public offering violated the securities laws because the financial statements accompanying the offering's registration statement misstated the Company's revenue; and (ii) the Company committed securities fraud by materially misstating the Company's revenue in its 2000 financial statements. At the present time, the Company cannot estimate what damages, if any, may be payable in connection with this litigation. The ultimate resolution of this matter may have a material adverse impact on the results of operations in the period in which it is resolved.

18. Subsequent Events

Sale of an investment in convertible preference shares

According to a board resolution dated March 14, 2002 and agreement entered into between the Company and a private auction company dated March 18, 2002 (see Note 8), the private auction company repurchased from the Company all of the 705,816 preference shares the Company acquired in 2000 at a consideration of US$1.2 million which is equivalent to RMB9.7 million.

New shares issued

According to a board resolution dated January 23, 2002, the Company agreed to make certain stock purchase payments in cash to two newly hired members of senior management of the Company in order to enable them to purchase a total of 12,322,868 ordinary shares in the Company. The total estimated fair value of those shares of RMB0.7 million (valued at US$0.006492 per share) at the date of the agreement is recognized as deferred compensation which is to be amortized over the related vesting period.

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