

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES
EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the fiscal year ended December 31, 2000

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission file number: 333-11724

NETEASE.COM, INC.

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

15th Floor, North Tower, Beijing Kerry Centre, No.1 Guang Hua Road
Chao Yang District, Beijing, People's Republic of China

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

NONE

Securities registered or to be registered pursuant to Section 12(g) of the Act.

Name of each exchange and Title of each class on which registered :
American Depositary Shares, each representing 100 ordinary shares, par value US\$0.0001 per share,
Nasdaq National Market

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

NONE

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 3,010,555,600 ordinary shares, par value US\$0.0001 per share.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow:

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INTRODUCTION

This annual report on Form 20-F for the fiscal year ended December 31, 2000 constitutes our initial annual report on Form 20-F as filed with the United States Securities and Exchange Commission. This annual report on Form 20-F includes our audited consolidated financial statements as of December 31, 1999 and 2000, and for the years ended December 31, 1998, 1999 and 2000.

We completed the initial public offering of 4,500,000 American Depositary Shares, each representing 100 of our ordinary shares, par value US\$0.0001 per share, on July 6, 2000. On June 30, 2000, we listed our American Depositary Shares on the Nasdaq National Market, or Nasdaq, under the symbol "NTES." Because we did not file this Form 20-F with the U.S. Securities and Exchange Commission by its due date, we have received a standard notice of delisting from the Nasdaq Stock Market and, consequently, our trading symbol has been "NTESE" since July 23, 2001. See Items 3.D "Risk Factors" and 4.B. "Information on the Company—Business Overview—Recent Developments" below.

Forward-Looking Information

This annual report on Form 20-F contains statements of a forward-looking nature. These statements are made under the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as "will," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates" and similar statements. The accuracy of these statements may be impacted by a number of business risks and uncertainties that could cause actual results to differ materially from those projected or anticipated, including risks related to: the possibility that the Audit Committee's investigation which is described later in this Form 20-F did not uncover all relevant facts and therefore our 2000 financial statements have not been restated to the extent appropriate; the possibility that the problems which led to the restatement of the 2000 financial statements could arise again or new problems could arise which could impact our financial reporting; the outcome of our appeal of Nasdaq's decision to delist our American Depositary Shares; the availability of alternative trading markets for our American Depositary Shares or ordinary shares, including the over-the-counter bulletin board, if our shares are delisted from the Nasdaq National Market; our ability to develop and implement operational and financial systems to manage our operations; our ability to obtain additional financing, governmental uncertainties, general competition and price pressures in the marketplace, our ability to control costs and expenses, the risk that the number of Chinese users of the Internet will not grow; the risk that security and confidentiality concerns may impede broad use of the Internet and e-commerce services; and other risks outlined in this annual report. NetEase does not undertake any obligation to update this forward-looking information, except as required under applicable law.

PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

Item 2. Offer Statistics and Expected Timetable

Not Applicable.

Item 3. Key Information

A. Selected Financial Data

The following table presents the selected restated consolidated financial information for our business. You should read the following information in conjunction with Item 5 “Operating and Financial Review and Prospects” below. The following data have been derived from our audited restated consolidated financial statements, which were prepared in accordance with United States generally accepted accounting principles, or U.S. GAAP, and should be read in conjunction with those statements, which are included in this annual report beginning on page F-1.

	<u>From June 24, 1997</u> <u>(inception) to</u> <u>December 31,</u>	<u>For the Year Ended December 31,</u>			
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2000</u>
	RMB	RMB	RMB	RMB	US\$
				(as restated)	(as restated)
Statement of Operations Data:					
Revenues:					
Advertising services	—	172,850	10,796,074	30,067,477	3,632,478
Software licensing and related integration projects	100,000	2,942,582	3,515,831	450,350	54,407
E-commerce related services			<u>2,459,101</u>		
	<u>—</u>	<u>—</u>		<u>2,455,834</u>	<u>296,691</u>
Total revenues	100,000	3,115,432	16,771,006	32,973,661	3,983,576
Sales and value-added taxes		<u>(230,749)</u>	<u>(1,150,169)</u>		
	<u>(6,600)</u>			<u>(2,476,444)</u>	<u>(299,181)</u>
Net revenues	<u>93,400</u>	<u>2,884,683</u>	<u>15,620,837</u>	<u>30,497,217</u>	<u>3,684,395</u>
Cost of revenues:					
Advertising and e-commerce related services ...	(13,614)	(242,657)	(11,837,416)	(39,909,419)	(4,821,492)
Software licensing and related integration projects		<u>(946,351)</u>	<u>(258,819)</u>		
	<u>(55,000)</u>			=	=
Total cost of revenues	<u>(68,614)</u>	<u>(1,189,188)</u>	<u>(12,096,235)</u>	<u>(39,909,419)</u>	<u>(4,821,492)</u>
Gross profit (Loss on revenues)	<u>24,786</u>	<u>1,695,495</u>	<u>3,524,602</u>	<u>(9,412,202)</u>	<u>(1,137,097)</u>
Operating expenses:					
Selling, general and administrative	(22,844)	(311,957)	(51,055,489)	(170,359,791)	(20,581,317)
Research and development		<u>(951,000)</u>	<u>(5,735,170)</u>		
	<u>(8,000)</u>			<u>(14,756,682)</u>	<u>(1,782,768)</u>
Total operating expenses	<u>(30,844)</u>	<u>(1,262,957)</u>	<u>(56,790,659)</u>	<u>(185,116,473)</u>	<u>(22,364,085)</u>
Operating profit (loss)	(6,058)	432,538	(53,266,057)	(194,528,675)	(23,501,182)
Other income (expenses):					

Sale of 163.net usage right.....	—	—	1,500,000	-	-
Interest income	289	5,719	357,160	27,858,710	3,365,635
Interest expense	—	—	—	(2,589,735)	(312,868)
Other, net		<u>(71,056)</u>	<u>(494,018)</u>		
	<u>(289)</u>			<u>(9,099)</u>	<u>(1,099)</u>
Income (loss) before tax	(6,058)	367,201	(51,902,915)	(169,268,799)	(20,449,514)
Provision for income tax		<u>(34,464)</u>			
	<u>(1,000)</u>		<u>(71,338)</u>	=	=
Net income (loss)	<u>(7,058)</u>	<u>332,737</u>	<u>(51,974,253)</u>	<u>(169,268,799)</u>	<u>(20,449,514)</u>

	<u>From June 24,</u>		<u>For the Year Ended December</u>		
	<u>1997</u>		<u>31,</u>		
	<u>(inception) to</u>				
	<u>December 31,</u>				
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2000</u>
	<u>RMB</u>	<u>RMB</u>	<u>RMB</u>	<u>RMB</u>	<u>US\$</u>
				<u>(as restated)</u>	<u>(as restated)</u>
Net income (loss) per share, basic and diluted.....	(0.01)	0.01	(0.03)	(0.07)	(0.01)
Net income (loss) per ADS, basic and diluted.....	(0.01)	0.02	(2.73)	(6.78)	(0.82)
Weighted average number of shares outstanding.....	1,868,817,200	1,868,817,200	1,900,430,600	2,497,467,200	2,497,467,200
Weighted average number of ADSs outstanding.....	18,688,172	18,688,172	19,004,306	24,974,672	24,974,672
Other Financial Data:					
Capital expenditures	(187,770)	(1,083,248)	(9,312,383)	(33,970,794)	(4,104,042)
Net cash provided by (used in):					
Operating activities	(261,823)	1,232,379	(15,687,474)	(124,653,301)	(15,059,474)
Investing activities.....	(187,770)	(1,083,248)	(9,312,383)	(53,037,513)	(6,407,509)
Financing activities	500,000	—	142,600,415	904,853,021	109,316,091

	<u>As of December 31,</u>			
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2000</u>
	<u>RMB</u>	<u>RMB</u>	<u>RMB</u>	<u>US\$</u>
			<u>(as restated)</u>	<u>(as restated)</u>
Balance Sheet Data:				
Cash	199,538	117,800,096	708,561,012	85,601,881
Working capital (deficit)	(345,804)	126,556,803	717,438,219	86,674,343
Property, equipment and software, net.....	1,171,483	9,508,437	35,362,091	4,272,125
Total assets	2,388,242	143,728,182	921,095,550	111,278,363
Total current liabilities	1,562,563	7,662,942	148,555,114	17,947,073
Total shareholders' equity.....	825,679	136,065,240	772,540,436	93,331,290

Exchange Rate Information

We have published our financial statements in Renminbi, or RMB. Our business is currently conducted in and from China in Renminbi. In this annual report, all references to Renminbi and RMB are to the legal currency of China and all references to U.S. dollars, dollars, \$ and US\$ are to the legal currency of the United States. The conversion of Renminbi into U.S. dollars in this annual report is based on the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York. For your convenience, this annual report contains translations of some Renminbi or U.S. dollar amounts for 2000 at US\$1.00: RMB8.2774, which was the prevailing rate on December 29, 2000, the last trading day in 2000. The prevailing rate at August 24, 2001 was US\$1.00: RMB8.2773. We make no representation that any Renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rates stated below, or at all. The Chinese government imposes control over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade. The exchange rate from U.S. dollar to Renminbi has fluctuated between a range of US\$1.00: RMB8.2770 and US\$1.00: RMB8.5000 over the past five years.

The following table sets forth the average buying rate for Renminbi expressed as per one U.S. dollar for the years 1996, 1997, 1998, 1999, and 2000.

Year	Renminbi Average⁽¹⁾
1996	8.3387
1997	8.3166
1998	8.2969
1999	8.2785
2000	8.2784

(1) Determined by averaging the rates on the last business day of each month during the relevant period.

The following table sets forth the high and low exchange rates for Renminbi expressed as per one U.S. dollar during the past six months.

Month Ended	Renminbi Average	
	High	Low
February 28, 2001	8.2783	8.2763
March 31, 2001	8.2784	8.2768
April 30, 2001	8.2776	8.2767
May 31, 2001	8.2785	8.2709
June 30, 2001	8.2779	8.2767
July 31, 2001	8.2773	8.2767

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

D. Risk Factors

Risks Related to Our Company

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

Our business was established in June 1997 as an Internet software developer. In mid-1998, our business focus changed to an Internet technology provider, and we commenced developing the NetEase Web sites. In July 1999, we commenced our e-commerce services, and in September 1999, we restructured our operations to place our Internet portal operations in Guangzhou NetEase Computer System Co., Ltd., or Guangzhou NetEase. In April 2001, we announced our plan to build an online game business. Because we have a limited operating history, when you evaluate our business and prospects you must consider the risks and difficulties frequently encountered by companies in the early stages of development, particularly companies in the new and rapidly evolving Internet service markets.

Our recent change of business focus from developing Web-based software products to developing and providing technological services to the NetEase Web sites and providing e-commerce services also makes it difficult to evaluate our future prospects. Revenues from our software licensing and related integration projects business exceeded revenues from our advertising and e-commerce related services until September 1999. We cannot assure you that we will be able to increase or maintain our revenues from online advertising and e-commerce services.

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

We incurred significant losses in 2000 and 1999 and had only minimal profit in 1998. We expect to continue to incur significant losses in the foreseeable future. As of December 31, 2000, we had an accumulated deficit of approximately US\$26.7 million. In recent quarters, our expenses have grown faster than our revenues. Accordingly, it is possible that our operating losses may increase and we may not achieve profitability in the foreseeable future or ever.

We face possible delisting from the Nasdaq National Market which could result in a limited public market for our American Depositary Shares.

We have received a standard notice of delisting by the Nasdaq Stock Market because we did not file this Form 20-F by its due date, as required under Nasdaq's marketplace rules. Nasdaq has scheduled a hearing on August 31, 2001 to address this failure to comply with such marketplace rules. We are fully cooperating with Nasdaq in this matter.

In addition, there are several other requirements for continued listing of our American Depositary Shares on the Nasdaq National Market, including, without limitation, maintaining:

- a market value of publicly held shares of US\$5 million;
- at least US\$10 million in stockholders' equity; and
- a minimum closing bid price for our American Depositary Shares of at least US\$1 per share.

As of August 27, 2001, the closing bid price of our American Depositary Shares was US\$0.701 and the market value of our publicly held shares was approximately US\$4.2 million. Even if the Nasdaq hearing panel decides not to delist our American Depositary Shares on August 31, 2001, our shares may be subject to a subsequent delisting action by Nasdaq thereafter if the value of our publicly held shares is less than US\$5 million and the minimum closing bid price of our American Depositary Shares remains below US\$1 per share. If Nasdaq, in its discretion, decides to delist our American Depositary Shares, we would have the right to appeal that decision. However, there can be no assurances that such an appeal would be successful.

If our American Depositary Shares are delisted, then we may apply for listing on the Nasdaq SmallCap Market, subject to Nasdaq's approval. However, there can be no assurance that we will be able to meet the listing requirements for this market. If not, our American Depositary Shares may trade only in the secondary markets in the so-called "pink sheets" or Nasdaq's "OTC Bulletin Board." Delisting from the Nasdaq National Market could adversely affect the liquidity and price of our common stock and it could have a long-term adverse impact on our ability to raise capital in the future.

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

Our rapid growth has placed and continues to place a significant strain on our resources. In one particular instance in our brief history, we have not been able to manage our growth effectively. Specifically, in the second quarter of 2001, our Board of Directors through its Audit Committee initiated an investigation into whether the terms of certain contracts between our company and third party advertisers had been appropriately reflected in our financial statements. The Audit Committee subsequently determined by the end of the investigation that the terms and execution status of certain advertising contracts between our company and third party advertisers and the nature of certain barter transactions were such that revenue could not be recognized in fiscal year 2000. Thus, actual total revenues were RMB33.0 million (US\$4.0 million) for the year ended December 31, 2000, which is RMB35.9 million (US\$4.3 million) or 52.2% less than had previously been reported by us. For a discussion of the investigation, see Item 4.A. "Business—Recent Developments—Internal Investigation."

We are in the process of taking a number of steps to strengthen our controls and procedures to minimize the recurrence of this problem. We are also working to bolster our management team to ensure that the controls and procedures are implemented in a consistent, effective manner. However, the effectiveness of these improved controls and procedures will not be ultimately known until we have had an opportunity to establish a history with them. We note that the improved controls and procedures were only partially in place during the second and third quarter of 2001, and, therefore, we are experiencing some of the same problems in preparing the financial statements for the first quarter of 2001 that we experienced in preparing the year 2000 financial statements. We may experience similar problems in preparing the financial statements for the second quarter of 2001 as well. Further, to date, we have not made any significant additions to our management team since the Audit Committee's investigation commenced, and, as noted below, we cannot be certain that we will be able to employ and retain suitable senior managers to oversee the implementation of our controls and procedures in the future.

If we make any mistakes in operating our business, our operating results may fluctuate and cause the price of our ADSs to decline. The number of our employees has grown from 137 at December 31, 1999 to 325 at July 31, 2001. As noted in the following subsection, we intend to hire several new senior and middle level managers and we also plan to pursue existing and potential market opportunities. This growth will place a significant demand on our management and our operational resources. If we cannot manage growth effectively, our business may suffer.

The success of our business is dependent on our ability to retain our existing key employees and to add and retain new senior officers to our management, which, at present, is significantly understaffed.

We depend on the services of our existing key employees. Our success will largely depend on our ability to retain these key employees and to attract and retain qualified senior and middle level managers to our management team which has a number of vacancies at the moment. Our Chief Financial Officer, Helen Haiwen He, resigned on January 31, 2001, and our Chief Executive Officer, King F. Lai, and Chief Operating Officer, Susan Chen, resigned on June 11, 2001. To date, no permanent replacements have been appointed to these positions, and as a result, significant demands have been made of our remaining management to cover these gaps in management. We also depend on our ability to attract and retain highly skilled technical, editorial, marketing and customer service personnel in the future.

We cannot assure you that we will be able to attract or retain such personnel or that recently hired personnel or any personnel we hire in the future will successfully integrate into our organization or ultimately contribute positively to our business. The loss of any of our key employees would significantly harm our business. We do not maintain key person life insurance on any of our employees.

We may not be able to accurately or comprehensively track the delivery of advertisements through the NetEase Web sites, which may make us less attractive to our present and potential advertisers.

We depend on third party proprietary and licensed advertisement serving technology to deliver advertisements to the NetEase Web sites. Advertisement serving technology allows us to measure the demographics of our user base and the delivery of advertisements on the NetEase Web sites. This technology is still developing. It is important to advertisers that we accurately measure the demographics of the user base of the NetEase Web sites and the delivery of advertisements through the NetEase Web sites, but the system we are currently using is limited to tracking banner advertisements. We are currently developing software in-house to implement additional systems designed to track other types of advertisements we offer to our advertising customers, such as text links, logo displays and pop-up advertisements. We may not be able to implement these systems successfully. Companies may choose not to advertise on the NetEase Web sites or may pay less for advertising if our advertisement serving system is not perceived to be reliable.

Also, the Audit Committee of our Board of Directors, in the course of the investigation referenced above, discovered that the inability of the advertisement serving system we are currently using to track all types of advertisements had in certain instances facilitated the conduct that led to the restatement of our fiscal year 2000 financial statements. If our ongoing efforts to improve our management and internal controls and procedures, including the software we are developing in-house, are not effective in preventing a recurrence of this problem, the tracking gaps in our advertising serving system could again be used to cause an improper recognition of revenue in future periods.

We believe we were a passive foreign investment company for the 2000 taxable year and expect to be treated as a passive foreign investment company for the 2001 taxable year, which will result in adverse U.S. tax consequences to U.S. investors.

Based upon the nature of our income and assets, we believe we were a passive foreign investment company for U.S. federal income tax purposes for the 2000 taxable year and expect to be treated as a passive foreign investment company for the 2001 taxable year. The determination of whether or not we are a passive foreign investment company is made on an annual basis and depends on the composition of our income and assets, including goodwill, from time to time. The calculation of goodwill is based, in part, on the then market value of our American Depositary Shares, which is subject to change. In addition, we have made a number of assumptions regarding the calculation of goodwill and the allocation of goodwill among active and passive assets. While we believe our approach is reasonable, the relevant authorities in this area are unclear, so we cannot assure you that our belief that we were a passive foreign investment company for the 2000 taxable year and our expectation that we will be treated as a passive foreign investment company for the 2001 taxable year are accurate. If we were a passive foreign investment company for the 2000 taxable year, then U.S. investors who owned our shares during the 2000 taxable year generally will be subject to increased U.S. tax liabilities and reporting requirements for the 2000 taxable year and all succeeding years, regardless of whether we continue to meet the income or asset test for passive foreign investment company status, although shareholder elections may apply in certain circumstances. The same adverse U.S. tax consequences will apply to our U.S. investors who acquire our shares during the 2001 taxable year if our expectation that we will be treated as a passive foreign investment company for the 2001 taxable year is accurate. Even if we were not a passive foreign investment company for the 2000 taxable year and are not treated as a passive foreign investment company for the 2001 taxable year, we cannot assure you that we will not become a passive foreign investment company for any future taxable year. See Item 10.E. "Taxation—United States Federal Income Taxation—U.S. Holders—Passive Foreign Investment Company."

Our revenues fluctuate significantly and may adversely impact the trading price of our American Depositary Shares or any other securities which become publicly traded.

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

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

We derived approximately 64.4% and 91.2% of our revenues from advertising services in 1999 and 2000, respectively. Seasonal variation in the level of advertising expenditures by online advertisers will also cause fluctuations in our revenues and operating results. In China, advertising expenditures have historically been significantly lower during the first calendar quarter of the year due to the Chinese New Year holiday and the traditional close of advertisers' annual budgets. If our revenues decrease or expenses increase during these periods, we may not be able to offset our expenses with sufficient revenues.

Accordingly, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance. It is possible that future fluctuation may cause our results of operations to be below the expectations of market analysts and investors. This could cause the trading price of our American Depositary Shares or any other securities of ours which may become publicly traded to decline.

If Guangzhou NetEase, Guangyitong Advertising or Guangyitong Advertising's ultimate shareholders violate our contractual arrangements with them, our business could be disrupted, our reputation may be harmed and we may have to resort to litigation to enforce our rights which may be time consuming and expensive.

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

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

Guangyitong Advertising or Guangyitong Advertising's ultimate shareholders violate our agreements with them, we may have to resort to litigation to enforce our rights. This litigation could result in the disruption of our business, diversion of our resources and the incurrence of substantial costs.

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

Our current relationship with Guangzhou NetEase, Guangyitong Advertising and Guangyitong Advertising's ultimate shareholders is based on a number of contracts. The terms of these agreements are often statements of general intent and do not detail the rights and obligations of the parties. Some of these contracts provide that the parties will enter into further agreements on the details of the services to be provided. Others contain price and payment terms that are subject to monthly adjustment. These provisions may be subject to differing interpretations, particularly on the details of the services to be provided and on price and payment terms. It may be difficult for us to obtain remedies or damages from Guangzhou NetEase, Guangyitong Advertising or Guangyitong Advertising's ultimate shareholders for breaching our agreements. In addition, we have very limited experience in implementing these agreements. Because we rely significantly on Guangzhou NetEase and Guangyitong Advertising for our business, the realization of any of these risks may disrupt our operations or cause degradation in the quality and service provided on, or a temporary or permanent shutdown of, the NetEase Web sites.

Increased government regulation of the information industry in China may result in the Chinese government requiring us to obtain additional licenses or other governmental approvals to conduct our business which, if unattainable, may restrict our operations.

The telecommunications industry, including Internet content provision (known as ICP) services, is highly regulated by the Chinese government, the main relevant government authority being the Ministry of Information Industry or MII. The Chinese government generally prohibits foreign investors from taking any equity ownership in or operating any telecommunications business. ICP services are classified as telecommunications value added services and therefore fall within the scope of this prohibition. We believe that this prohibition to be lifted after China's entry into the World Trade Organization, or the WTO. Pursuant to the bilateral WTO accession agreements entered into between China and other countries including the U.S., foreign investors may hold in aggregate no more than 50% of the total equity ownership in any telecommunications business in China.

To operate the NetEase Web sites in compliance with all the relevant ICP-related Chinese regulations, Guangzhou NetEase has successfully obtained an ICP license issued by the Guangdong Provincial Telecommunications Bureau, or Guangdong Bureau, dated as of December 14, 2000. On February 15, 2001, the News Office of the Beijing Municipal People's Government approved Guangzhou NetEase's application in respect of its news displaying services on the NetEase Web sites. On July 31, 2001, Guangzhou NetEase obtained approval from the Guangdong Bureau for our bulletin board services. Although the Guangdong Bureau granted approval to provide bulletin board services in specialized categories without providing any guidance on the term "specialized categories", we believe that such approval is sufficient to cover our existing online bulletin board services. As for special approvals for other online services relating to publishing, education, health care, medicine and medical devices which are required by statute, since the relevant application procedures are either relatively new or have not yet been formulated, Guangzhou NetEase is still in the process of preparing the respective applications and will submit such applications in due course.

We rely exclusively on our contractual arrangements with Guangzhou NetEase and its approval to operate as an Internet content provider for our business operations. We believe that our present

operations are structured to comply with Chinese law. However, many Chinese regulations are subject to extensive interpretive powers of governmental agencies and commissions. We cannot be certain that the Chinese government will not take action to prohibit or restrict our business activities. We are uncertain as to whether the Chinese government will reclassify our business as a media or retail company, due to our acceptance of Internet advertising fees and e-commerce related services fees as sources of revenues, or as a result of our current corporate structure. Such reclassification could subject us to penalties or fines or significant restrictions on our business. We may fail to obtain some or all the licenses, permits or clearances we may need in the future. In addition, we may have difficulties enforcing our rights under our agreements with Guangzhou NetEase and Guangyitong Advertising if either of these parties breaches any of our agreements with them because we do not have approval from appropriate Chinese authorities to provide Internet content services or Internet advertising services. Future changes in Chinese government policies affecting the provision of information services, including the provision of online services, Internet access, e-commerce services and online advertising, may impose additional regulatory requirements on us or our service providers or otherwise harm our business.

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

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

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

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

Any such action would have a material adverse effect on our business, financial condition and results of operations and on the holders of our ordinary shares and American Depositary Shares.

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

Our business plan has not yet turned a profit. The market for our technology and services is new and rapidly developing. Our business plan depends upon increased revenues generated from online advertising and e-commerce related services on the NetEase Web sites. Online advertising and e-commerce in China are unproven businesses. Many of our current and potential advertisers have limited experience with the Internet as an advertising medium. They have not traditionally devoted a significant portion of their advertising expenditures to Web-based advertising. They may not find the Internet effective for promoting their products and services relative to traditional print and broadcast

media. Likewise, many of our current and potential merchant customers have limited experience with the Internet and online sales, distribution and fulfillment processes. They have not traditionally sold their products over the Internet. To be successful, we must develop and market products and services that either have achieved or are likely to achieve broad market acceptance by Internet users, online advertisers and e-commerce vendors in China.

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

We started as an Internet software developer and in mid-1998 changed our business focus to Internet technology. Within the last three years, we expanded our Internet advertising operations and began to provide e-commerce services such as online shopping mall and auction services as well as online entertainment services such as massively multi-player online role-playing games and short messaging services for mobile telephones in China. As a result of these changes in our business, you should not rely on our historical results of operations and financial condition as an indicator of future results. For more information, see Item 5. “Operating and Financial Review and Prospects.”

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

It is difficult to predict which Internet advertising pricing model, if any, will emerge as the industry standard. This makes it difficult to project our future online advertising rates and revenues. Our advertising services revenues could be materially and adversely affected if we are unable to adapt to new forms of Internet advertising or if we fail to adopt the most profitable form.

We are developing new services in addition to our Internet advertising services, which may not be as successful as we anticipate or generate significant revenues.

In addition to our Internet advertising services, we have been developing other services which we believe could lead to new sources of revenue for our company, including online entertainment services such as massively multi-player online role-playing games and short messaging services for mobile telephones. For a discussion of these and other services, please refer to Item 4.B. “Information on the Company—Business Overview—Our Products and Services.” We have, however, only limited experience in offering these services and cannot be certain that all or even any of them will be popular with China’s Internet users. In addition, our revenue from these non-advertising services has been relatively small to date, and these services, as well as any other services we introduce in the future, may fail to generate significant revenues, which would have a material adverse effect on our business, financial condition and results of operations.

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

Our operations are currently dependent upon our commercial relationships with Guangzhou NetEase and Guangyitong Advertising, and we derive most of our revenues from these companies. A portion of our revenues under our contracts with these companies are based upon arbitrary amounts that have been agreed upon in advance. If these companies are unwilling or unable to perform the agreements which we have entered into with them, we may not be able to conduct our operations in the manner in which we currently plan. Most of these agreements have a term of one year, and they may not be renewed in future years. In addition, Guangzhou NetEase and Guangyitong Advertising may seek to renew these agreements on terms that are disadvantageous to us. Although we have entered into a series of agreements that provide us with substantial ability to control these companies, we may not succeed in

enforcing our rights under them. If we are unable to renew these agreements on favorable terms, or to enter into similar agreements with other parties, our business may not expand, and our operating expenses may increase.

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

Our majority shareholder, William Lei Ding, is also the controlling shareholder of Guangzhou NetEase and Guangyitong Advertising. As a result, Mr. Ding may be able to cause these agreements to be amended in a manner that will be adverse to our company, or may be able to cause these agreements not to be renewed, even if their renewal would be beneficial for us. Prior to our initial public offering of American Depositary Shares, a number of these agreements were amended. Although we have entered into an agreement that prevents the amendment of these agreements without the approval of the members of our Board other than Mr. Ding, we can provide no assurances that these agreements will not be amended in the future to contain terms that might differ from the terms that are currently in place. These differences may be adverse to our interests.

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

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

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

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

Computer hacking could damage our systems and reputation.

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

Our decision to reduce our marketing and branding efforts may result in a decrease in visitor traffic to the NetEase Web sites.

In the last several months, we have reduced the financial and other resources we devote to our marketing and branding efforts in order to control costs. This has led to a reduction in our monthly expenditures and fixed costs. While we believe that our reduction of marketing expenses to date will lead to a decrease in total expenditures for fiscal year 2001, such reduction may also result in a decrease in visitor traffic to the NetEase Web sites and a decrease in revenues generated from the NetEase Web sites.

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

We rely primarily on China Telecom and its affiliates to provide us with bandwidth and server custody service for Internet users to access the NetEase Web sites. If China Telecom or its affiliates fail to provide these services, we may not be able to find a reliable and cost-effective substitute provider on a timely basis or at all. If this happens, our business could be materially curtailed.

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

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

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

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

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

We may face liability for defamation, negligence, copyright, patent or trademark infringement and other claims based on the nature and content of the materials that are published on the NetEase Web sites. We are currently defending a number of defamation claims against NetEase Beijing. We believe that the amounts claimed in these actions, in the aggregate, are not material to our business. However, these amounts may be increased for a variety of reasons as the claims progress, and we and our affiliates could be subject to additional defamation claims which, singly or in the aggregate, could have a material

adverse effect on our business and results of operations, if successful. We also could be subject to claims based upon content that is accessible on the NetEase Web sites such as content and materials posted by users on message boards, online communities, voting systems, email or chat rooms that are offered on the NetEase Web sites. By providing technology for hypertext links to third-party Web sites, we may be held liable for copyright or trademark violations by those third party sites. Third parties could assert claims against us for losses incurred in reliance on any erroneous information distributed by us. For example, we post credit evaluations of our users based upon information provided to us by users of our auction services. Such credit evaluation postings could be subject to claims that such information is inaccurate or defamatory. Moreover, users of the NetEase Web-based e-mail services could seek damages from us for:

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

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

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

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

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

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

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

We collect demographic data, such as geographic location, income level and occupation, from our registered users in order to better understand users and their needs. We provide this data to online advertisers, on an anonymous aggregate basis, without disclosing personal details such as name and home

address, to enable them to target specific demographic groups. If privacy concerns or regulatory restrictions prevent us from collecting this information or from selling demographically targeted advertising, the NetEase Web sites may be less attractive to advertisers.

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

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

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

China's trademark law adopts a "first-to-file" system for obtaining trademark rights. As a result, the first applicant to file an application for registration of a mark will preempt all other applicants. Prior use of an unregistered mark is generally irrelevant except for "well known" marks. Guangzhou NetEase has filed with China's Trademark Office trademark applications for numerous trademarks incorporating the words "NetEase" and "Yeah" in English and for marks for "NetEase" as written in Chinese in traditional and simplified Chinese characters. Guangzhou NetEase has successfully registered most of its trademarks with the Trademark Office and has applications pending for the remainder of its trademarks. It has agreed to transfer to us all of its already registered trademarks and, upon any registration being granted for pending applications, those newly registered trademarks. The transfer of Guangzhou NetEase's already registered trademarks has not yet been effected with the appropriate governmental authorities in China although we intend to make the necessary filings for this purpose. In addition, we have also filed trademark applications in China, Hong Kong and the United States for numerous marks incorporating the words "NetEase" in English and for marks for "NetEase" and other words as written in Chinese in traditional and simplified Chinese characters. We may not be able to successfully defend or claim any legal rights in those "NetEase" related trademarks that Guangzhou NetEase has registered but not yet transferred to us, and those trademarks for which we have made application but for which the Trademark Office has not issued a registration certificate. See Item 4.B. "Information on the Company—Business Overview—Intellectual Property and Proprietary Rights."

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

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

From time to time, we may have to resort to litigation to enforce our intellectual property rights, which could result in substantial costs and diversion of our resources. In addition, third parties may initiate litigation against us for alleged infringement of their proprietary rights. In the event of a successful claim of infringement and our failure or inability to develop non-infringing technology or license the infringed or similar technology on a timely basis, our business could suffer. Moreover, even if we are able to license the infringed or similar technology, license fees that we pay to licensors could be

substantial or uneconomical.

Past discussions regarding a possible acquisition of our stock or assets with third parties have not been successful, and future acquisition opportunities that are advantageous to us and our shareholders may not arise in the future or, if they do, we may not be able to take advantage of them.

In the past year, we have had confidential discussions with several parties concerning a possible acquisition of our stock or assets. These discussions did not result in any agreements and were terminated. Although we have no current plans to engage in acquisition discussions with any other parties, we are continuously reviewing our strategic alternatives and may wish to seek an acquisition in the future. However, due to a number of factors, including, without limitation, our history of losses, our possible delisting from the Nasdaq National Market and our recent internal control problems, we may not be able to negotiate acquisition terms which are advantageous to us and our shareholders. Even if we are able to reach an agreement with a third party regarding an acquisition, we may be unable to fulfill one or more the conditions to the closing of such transaction, such as, for example, our continued listing on the Nasdaq National Market. Our inability to take advantage of acquisition opportunities as they arise could have a material adverse effect on the price of our American Depositary Shares.

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

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

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

We are a holding company with no significant assets other than our equity interests in NetEase Information Technology (Beijing) Co., Ltd., or NetEase Beijing, our wholly owned subsidiary formed in 1999. As a result, our primary internal source of funds is dividend payments from NetEase Beijing. If NetEase Beijing incurs debt on its own behalf in the future, the instruments governing the debt may restrict NetEase Beijing's ability to pay dividends or make other distributions to us, which in turn would limit our ability to pay dividends on our shares and ADSs. Under current Chinese tax regulations, dividends paid to us are not subject to Chinese income tax. In addition, Chinese legal restrictions permit payment of dividends only out of net income as determined in accordance with Chinese accounting standards and regulations. Under Chinese law, NetEase Beijing is also required to set aside a portion of its net income each year to fund certain reserve funds. These reserves are not distributable as cash dividends.

Risks Related to Doing Business in China

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

The growth of the Chinese economy has been uneven across geographic regions and economic sectors. Such growth has also slowed significantly in several recent periods. There can be no assurance that growth of the Chinese economy will be steady or that any slow down will not have a negative effect

on our business. The Chinese economy has recently experienced deflation, which may reoccur in the foreseeable future. The Chinese economy overall affects our profitability as expenditures for advertisements and e-commerce services may decrease due to slowing domestic demand.

Government regulation of the Internet may become more burdensome.

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

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

The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In the late 1970s, the Chinese government began to promulgate a comprehensive system of laws and regulations governing economic matters. The overall effect of legislation enacted over the past 20 years has significantly enhanced the protections afforded to foreign invested enterprises in China. However, these laws, regulations and legal requirements are relatively recent and are evolving rapidly, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to foreign investors, including you.

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

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

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

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

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

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

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

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

Risks Related to the Internet Industry in China

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

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

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

- consumer dependence on traditional means of commerce;
- inexperience with the Internet as an advertising medium or sales and distribution channel;
- competition from other forms of media such as broadcast and print;
- inadequate development of the necessary infrastructure to facilitate e-commerce;
- recent decrease in the rate of growth of Internet users;

- concerns about security, reliability, cost, ease of deployment, administration and quality of service associated with conducting business over the Internet; and
- inexperience with credit card usage or with other means of electronic payment.

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

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

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

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

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

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

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

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

Our growth is limited by the relatively high cost to Chinese consumers of obtaining the hardware, software and communications links necessary to connect to the Internet in China. If the costs required to access the Internet do not significantly decrease, most of China's population will not be able to afford to

use our services. The failure of a significant number of additional Chinese consumers to obtain affordable access to the Internet would make it difficult to grow our business.

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

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

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

Because many of our existing competitors as well as a number of potential competitors have longer operating histories in the Internet market, greater name and brand recognition, better connections with the Chinese government, larger customer bases and databases and significantly greater financial, technical and marketing resources than we have, we cannot assure you that we will be able to compete successfully against our current or future competitors. Any increased competition could reduce page views, make it difficult for us to attract and retain users, reduce or eliminate our market share, lower our profit margins and reduce our advertising revenues.

Item 4. Information on the Company

A. History and Development of the Company

NetEase.com, Inc. was incorporated in the Cayman Islands on July 6, 1999 and it operates under the Cayman Islands Companies Law (2001 Second Revision). Its principal place of business is 15th Floor, North Tower, Beijing Kerry Centre, No.1 Guang Hua Road, Chao Yang District, Beijing, People's Republic of China, and its telephone number is (86-10) 6561-8811. Its agent for service of process in the United States is CT Corporation System, 111 Eighth Avenue, New York, New York 10011.

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 shopping mall and auction services in China through Guangzhou NetEase, a related party. We now provide online auction services only through a co-branded Web site with EachNet, the leading online auction provider in China.

In July 2000, we completed the initial public offering of our American Depositary Shares, representing our ordinary shares, and listed those securities on the Nasdaq National Market.

Our principal capital expenditures for 2000 consisted of computers and servers as well as software for a total of RMB34.0 million (US\$4.1 million). Our principal capital expenditures for 1999 also consisted of computers and servers for a total of RMB9.3 million (US\$1.1 million). Our principal capital expenditures for 1998 consisted of computers for a total of RMB1.1 million (US\$0.13 million).

As our business grows, we have spent approximately RMB15.0 million (US\$1.8 million) as of July 31, 2001, principally for purchases of additional servers, switches and software in order to accommodate the expected increase in traffic on the NetEase Web sites. Our capital expenditure plans for the remainder of 2001 have not yet been fixed. Capital expenditures in 2001 have been, and are expected to continue to be, funded through operating cash flows and through our existing capital resources.

Recent Developments

Internal Investigation. On May 8, 2001, we announced that our Board of Directors discovered potential issues regarding the terms of certain advertising contracts between us and third party advertisers. Based on information available at that time, we believed that these issues would only affect the company's financial statements for the quarter ended March 31, 2001. As a result of this discovery, our Audit Committee of our Board of Directors, with the assistance of our outside counsel and independent auditors, immediately began an intensive investigation. On June 11, 2001, we announced that our Audit Committee had expanded the scope of its investigation to include a review of our financial statements for the year ended December 31, 2000.

Our restated total revenues for 2000 were RMB33.0 million (US\$4.0 million), resulting in a net loss of RMB169.3 million (US\$20.4 million) or RMB6.78 (US\$0.82) per American Depositary Share. We had originally reported total revenues for 2000 of RMB68.9 million (US\$8.3 million), with a net loss of RMB142.8 million (US\$17.3 million) or RMB5.72 (US\$0.69) per American Depositary Share. Our total operating expenses for 2000 were reduced by RMB7.2 million (US\$0.9 million) as a result of the restatement. The adjustments also decreased our previously reported total assets by RMB72.8 million (US\$8.8 million). The restatement of revenue was necessitated by the Audit Committee's finding that the terms and execution status of certain advertising contracts between our company and third party advertisers and the nature of certain barter transactions were such that revenue could not be recognized in fiscal year 2000. For a more comprehensive discussion of the restatement of our audited financial statements for the fiscal year ended December 31, 2000, please see Item 5. "Operating and Financial Review and Prospects" and our consolidated financial statements and related notes beginning on page F-1 of this annual report.

Potential Delisting from Nasdaq National Market. The internal investigation referenced in the preceding subsection caused us to delay the filing of this Form 20-F until after the time permitted by the SEC's rules. As noted in Item 3.D. "Risk Factors" above, we have received a standard notice of delisting by the Nasdaq Stock Market because we did not file this Form 20-F by its due date, as required under Nasdaq's marketplace rules. Nasdaq has scheduled a hearing on August 31, 2001 to address this failure to comply with such marketplace rules. We are fully cooperating with Nasdaq in this matter. Even if the Nasdaq hearing panel decides not to delist our American Depositary Shares on August 31, 2001, we may be subject to another delisting action after that date for other violations of the Nasdaq marketplace rules, in particular the requirement that the value of our publicly traded shares be at least US\$5 million and the price of our American Depositary Shares be at least one dollar per share. If Nasdaq, in its discretion, decides to delist our American Depositary Shares, we would have the right to appeal that decision, however, there can be no assurances that such an appeal would be successful. If our American Depositary Shares are delisted, then we may apply for listing on the Nasdaq SmallCap Market, subject to Nasdaq's approval. However, there can be no assurance that we will be able to meet

the listing requirements for this market. If not, our American Depositary Shares may trade only in the secondary markets in the so-called “pink sheets” or Nasdaq’s “OTC Bulletin Board.”

Management Changes. On January 31, 2001, Helen Haiwen He resigned as our Chief Financial Officer and was replaced on an interim basis by Geoffrey Jie Wei. Ms. He remained a member of our Board of Directors until her resignation on August 28, 2001. Subsequently, on June 11, 2001, King F. Lai and Susan Chen resigned as our Chief Executive Officer and Chief Operating Officer, respectively. Mr. Lai also resigned from our Board of Directors. William Lei Ding, our founder, Chairman of the Board, Chief Architect and majority shareholder, has assumed the duties of acting Chief Executive Officer and acting Chief Operating Officer.

Amended Stock Incentive Plan On May 25, 2001, our shareholders approved the NetEase.com, Inc. Amended and Restated 2000 Stock Incentive Plan, or the Amended Plan. The Amended Plan replaced the 2000 Stock Incentive Plan, under which a total of 223,715,000 of our ordinary shares were reserved for issuance. Under the Amended Plan, the number of ordinary shares reserved for issuance was increased to 323,715,000.

Acquisition Talks On June 19, 2001, we confirmed that we had been having confidential discussions with several parties concerning a possible acquisition of the stock or assets of our company but that these discussions had not resulted in any agreements and had been terminated. We have no current plans to engage in acquisition discussions with any other parties but will continue to review the strategic alternatives available to us.

Online Game Business and Corporate Solutions Services. In April 2001, we announced our plan to commence and develop our online game business. This business is described more fully below under Item 4.B. “Business Overview—Our Products and Services—The NetEase Web Sites—Our Community—Online Games.” In August 2001, we established a Corporate Solutions Services department targeted at providing Internet products, services and solutions to Chinese enterprises and government entities. This business is described more fully below under Item 4.B. “Business Overview—Our Products and Services—Corporate Solutions Services.”

B. Business Overview

We are an Internet technology company supporting a leading interactive online community in China. The NetEase Web sites provide Internet users with Chinese language online services centered around three core inter-related services — content, community and e-commerce. Guangzhou NetEase, which has received approval from the Telecommunications Office of Guangzhou City to engage in the Internet content provider business, operates and maintains the NetEase Web sites pursuant to contractual arrangements with us. The NetEase Web sites now reach over half of China’s Internet population and monthly average daily page views for the month ended July 31, 2001 exceeded 128 million.

We believe we are well positioned to capitalize on the rapid growth anticipated in the Internet market in China. The NetEase content channels offer users an extensive range of local, regional and international Chinese language content, Web-based communication services and sophisticated search capabilities and provide a destination for Chinese Internet users to identify and access resources, services, content and information on the Internet. As of July 31, 2001, the NetEase Web sites had approximately:

- 27.18 million registered users;
- 1.14 million personal home pages;
- 115,500 personal forums; and
- a peak of 55,500 simultaneous chat room participants.

Registered community members can personalize their online experience by publishing their own content and interacting with other users that have similar interests. Under the NetEase (網易) and 163.com brands, we provide various free services, including Chinese language-based e-mail, online chat rooms and discussion forums. Through our co-branded Web site with EachNet, we also provide an auction platform where users can purchase a variety of products and services. We have established a U.S. subsidiary, NetEase.com (U.S.), which operates a computer software development business in California as 163 NetEase.com, Inc.

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

We believe we were the first China-based Internet company to offer e-commerce auction services in China. We started an online auction site which we discontinued in October 2000 to establish a co-branded online trading and auction channel in partnership with EachNet, China's leading online auction provider.

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

Our Opportunity

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

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

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

- in-depth and focused local content as well as a variety of media channels covering a wide variety of regional and international topics;
- fee-based services such as online games and Web hosting;
- China-based online community forums where Internet users in China can communicate and exchange ideas on a wide variety of topics; and

- reliable, easy to use, sophisticated Internet applications and tools in the Chinese language, including e-mail, online chat, full text search capabilities and instant messaging.

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

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

Online Advertising in China. The Internet is a relatively new medium for advertisers in China. Online advertisers have included international and domestic companies covering information technology, telecommunication, financial services, fast moving consuming goods and other traditional industries. We believe that most online advertisers consist of information technology and mobile phone companies. We believe we are one of the largest Internet companies in China that has developed the systems necessary to support large-scale online advertising.

Our Solution

We offer a comprehensive suite of Internet technologies, services and solutions to Internet users in China. We believe that by offering an integrated platform of online content, community and e-commerce related services, we are well positioned to capitalize on the growth of the Internet industry in China. Our technology and services are developed in China specifically for Internet users in China. Our integrated platform of applications, technology and services is available to Internet users through the NetEase Web sites free of charge. Key advantages of our solution include:

- *Pioneer in Developing Technology and Solutions for China's Internet Market.* We have been developing Internet technology and solutions since our inception in June 1997. We believe we are well positioned to develop and adapt the latest Internet applications, services and technologies for the Chinese language. Our technologies and services are supported by a responsive and scalable technology architecture. We believe our products and services are among the most reliable and easy to use for Chinese speakers. All of our platforms were designed to include user-friendly interfaces and easy to understand instructions. We believe we were the first Internet company in China to offer:
 - a dual language free e-mail service;
 - a Chinese language search engine;

- an interactive community platform which allows registered community members to post articles and messages, chat and send instant messages;
 - personal homepages created and maintained by our users;
 - online auction platforms;
 - a plug-in to customize the look and feel of Web browsers;
 - online newsletters in the Chinese language;
 - Chinese language online greeting cards; and
 - an online personal digital assistant.
- *Extensive Content on the NetEase Web sites with Focus on Internet Users in China.* Unlike other Internet companies whose markets include China, we are highly focused on Internet users in China and to a lesser extent, Chinese expatriate Internet users located abroad. Most of our employees are Chinese nationals. Their cultural and linguistic insights enable us to tailor our services to the needs of Internet users in China. Because of our specific market focus, we believe we are better able to attract Internet users in China than other Internet companies with a broader geographic focus. We currently offer a content distribution and management system that supports the publication of 18 separate content channels featuring a variety of local, regional and international content. We also offer Web site hosting and as of July 31, 2001 hosted more than 1.14 million personal homepages created and maintained by Internet users in China. In addition, in April 2001, we announced our plan to build an online game business.
 - *Focus on Community and Personalization.* Our applications, services and technologies have a strong focus on facilitating communication between Internet users in China. We believe the NetEase online community was one of the first in China and as of July 31, 2001 included over 115,500 forums. We believe that the NetEase online community is the largest in China. As of July 31, 2001, the NetEase Web sites had over 27.18 million registered users. The NetEase community platform also allows members to chat, send instant messages to other registered community members and vote in surveys.
 - *Attractive Platform for E-commerce and Online Advertising.* We believe our expanding number of users provide online advertisers and merchants with an attractive platform for advertising and e-commerce. We offer vendors a platform to sell their products online to users in China. In addition, we offer both online advertisers and merchants targeted audiences through the NetEase online communities and content channels. As Internet usage in China accelerates and the market for Internet services develops, we believe that we are strategically well-positioned to deliver value to online advertisers and merchants targeting the Chinese market. We are also able to leverage our technology and experience in order to provide Internet solutions to corporate clients.

Our Business Strategy

Our goal is to make the NetEase Web sites the leading online network in China and to transform our users into customers of our wide range of services. Key strategies for achieving our goal are to:

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

- strategic alliances;
- proactive public relations, which includes frequent communications with our users, our customers and Chinese governmental agencies; and
- traditional and online advertising campaigns.

Continue to Develop User-Friendly Internet Applications, Services and Technologies for the Chinese Market. We intend to continue our focus on developing user-friendly technologies for the Internet industry in China. We will adapt and modify existing technologies for Chinese language-based Internet applications as well as develop our own proprietary Chinese language Internet applications. We plan to continue to enhance our platforms with user-friendly interfaces and with easy to understand user instructions. To increase the number of our users, we intend to work with various providers to develop broadband offerings and will continue to explore opportunities to offer wireless application protocol technologies. To attract customers for our corporate solutions services business, we intend to package our technologies to provide a suite of Web-based applications and services. We employed 136 technology professionals as of July 31, 2001.

Enrich, Expand and Personalize NetEase Content. The NetEase Web sites contain content from approximately 115 local and international content providers, including *Xinhua News Agency, Chinanews.com, 21dnn.com, China Computer World, China Economic Times, China Sports Newspaper, China Youth Daily, Reuters* and *Channel [V]*. To expand our channel offerings, we intend to work with vertical portal developers and to purchase or license existing content from traditional media providers. We intend to continue to expand our content alliances to allow the NetEase Web sites to offer content that will be more tailored for and relevant to our users' daily lives. We believe this will:

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

Expand the Number of Our Registered Users and Registered Community Members. We believe that a Web site must reach a critical mass of users before it is capable of generating significant online advertising and e-commerce revenues. Therefore, we strive to keep the NetEase Web sites in their position as one of the top three Web sites in China in order to achieve our goal of converting our registered users into paying customers. To expand the number of registered community members, we plan to enhance the quality of our community services and introduce new applications, services and technology for our online community that will make the Internet in China an increasingly important medium for exchanging ideas. In addition to our existing communities, we plan to develop technology to

support a user-friendly business community on the Internet. We offer a package of Internet applications, services and technologies to corporate enterprises and government entities in China, including e-mail, Web hosting and other interactive community services to promote our brand name among corporate clients and to increase the number of our registered community members. We plan to leverage our technology and Web-based products to increase the NetEase community.

Expand Our E-commerce Services. We believe that a growing number of consumers in China will look to the Internet as an alternative source of commerce in the future. We believe we were the first company to offer online auction platforms in China. Our online auction business is now operated through our co-branded Web site with EachNet. We have also established an online shopping mall with 33,000 items offered for sale by 56 merchants as of July 31, 2001. We will leverage upon this experience and our registered users and registered community members to actively develop and pursue e-commerce opportunities. We intend to expand our online commerce applications, services and technologies, or our e-commerce platform, and to use our user profile information to market products to specific demographic groups. We also plan to leverage our registered user database to develop direct marketing opportunities.

Expand the Base of Online Advertisers on Our Network. Online advertisers on the NetEase Web sites consist primarily of merchants from the information technology and telecommunications industries as well as an increasing number of advertisers from “traditional” industries such as consumer products and media. We intend to broaden this base of online advertisers and to continue to attract premier online advertisers through promoting our brand name and improving our demographic profiling technology to identify users that we believe will be attractive to online advertisers. We believe that as the online advertising industry in China develops, demographically targeted advertising will command higher prices from online advertisers compared to non-targeted advertising. We will continue to promote the Internet as an alternative method for advertisers to reach end users. In addition, we intend to use third party advertising networks to increase the NetEase online advertiser base. We intend to improve our ability to collect and correlate information regarding our users and their habits, interests and related items to the extent permitted by law. By developing user profiles and user behavior analyses, we intend to increase targetability and identify users attractive to online advertisers.

Establish and Extend Strategic Alliances and Acquisitions. To increase traffic on the NetEase Web sites, further penetrate the Internet market and extend our brand recognition, we will continue to seek potential strategic alliances with prominent Internet companies, leading online content providers, e-commerce service companies, traditional media companies and technology companies. We also intend to seek acquisition and joint venture opportunities that complement our operations. We intend to continue to build partnerships with those who can offer content, distribution, technology, cross-promotional opportunities or revenue sources. We believe that, with the strategic alliances with leaders in the media, communications, e-commerce and infrastructure industries that we have established, the NetEase Web sites will be able to maintain their leading position in China.

Our Products and Services

The NetEase Web Sites

The NetEase Web sites offer Chinese Internet users a network of Chinese language-based online content channels, community products, e-commerce services and other Web-based applications and services to enhance their Internet experience. The NetEase Web sites offer content channels, a full text Chinese language search engine, a Web directory, e-mail, an online personal digital assistant, short messaging service, Web hosting and community tools. We also provide e-commerce platforms that allow

vendors to sell or auction their products online through a co-branded Web site with EachNet. Our content, community and e-commerce platforms are all designed with user friendly interfaces and easy to understand instructions.

Our Members

The NetEase Web sites have registered and unregistered users. Any user may visit the NetEase Web sites without registering. Only registered users can use our personalized services such as our e-mail system and online personal digital assistant, and participate in e-commerce services. The NetEase users provide us with valuable demographic and preference information that will allow us to target audiences with relevant online advertising.

Online registration is available at all times and is easy to use. In October 2000, we introduced the “single sign-on system” so that users are no longer required to log on to each specific service as they travel throughout the NetEase Web sites. This system represents a higher level of service and added convenience to users who only need to log on once in order to enjoy the use of all services available on the NetEase Web sites. With the entry of a user name and password, our users can enjoy seamless access to our community, chat rooms, shopping mall, online personal digital assistant and e-mail services.

As of July 31, 2001, the NetEase Web sites had 27.18 million registered users. In addition to an increase in membership resulting from our successful “Power to the People” marketing campaign (see “Sales and Marketing—Marketing” below), we launched wap.163.com in March 2000, which created the most comprehensive Internet content offering available on a wireless platform. We also commenced distributing our content to subscribers of the “Turbo163” broadband satellite service offered by ChinaCast.

Our Content

The NetEase Web sites’ homepage provides a destination for Chinese Internet users to identify and access resources, services, content and information on the Internet. The NetEase Web sites aggregate, organize and deliver information to meet the needs of Internet users in China. Our media channels provide users with an efficient and easy way to explore and utilize a wealth of information and content organized around a variety of topics. Our content distribution platform enables the NetEase Web sites to offer in-depth local content as well as a variety of locally relevant regional and international content. Our content distribution technology aggregates content from approximately 115 content partners.

We believe that our broad and value-added content increases the number of visits and the amount of time our users spend on the NetEase Web sites. We adopt a significant amount of user-generated content from the personal community forums and personal homepages on the NetEase Web sites. We believe that this user-generated content is highly effective in maintaining user interest and ensuring repeat visits to the NetEase Web sites.

We do not produce our own content for the NetEase Web sites. The NetEase Web sites currently include 18 media channels in the following categories:

- news
- jobs and careers
- science
- sports
- culture
- education
- games
- women’s issues
- travel

- finance
- film and television
- mobile phone
- real estate
- music
- Guangdong Local
- health care
- lifestyle
- Shanghai Local

We provide a comprehensive suite of integrated tools to augment each channel. We continue to work with vertical portal developers and to purchase or license existing content from traditional media providers.

Through the NetEase Web sites, our users can subscribe to 45 electronic magazines, which are delivered to subscribers by e-mail. These electronic magazines are published by media channel editors and include the following topics:

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

As of July 31, 2001, we had over 2.8 million subscribers and over 14.6 million subscriptions to our electronic magazines.

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

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

Web Page Hosting. We offer registered users, free of charge, up to 100 megabytes of computer storage for Web pages created and maintained by our users, or personal homepages. We also offer tools to assist users in building their homepages. The NetEase personal homepages create a Web-based community for Internet users to express themselves, to share ideas, interests and expertise, and to publish personal content accessible by other users with common interests. As of July 31, 2001, we had 1.14 million personal homepages. While we believe most of the NetEase personal homepages are of interest to a small circle of friends and families, there is a core group of users who create homepages with content having broader appeal. Traffic comes from both inside our network of Web sites and from non-registered users visiting from outside. Non-registered users typically find registered users' personal homepages through search engines. In March 2001, we introduced a fee-based premium Web page hosting service. Individual users are now able to choose from service packages available at different rates to improve the overall quality of their personal homepages. This premium service provides a more reliable platform as well as improved customer service while maintaining the content of the personal homepages. Users of our premium Web page hosting service also benefit from greater storage space, a more secure and faster server, and 24-hour customer support.

Our Community

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

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

- *E-mail.* Our technology and services provide registered users with a free Web-based e-mail service which supports both the Chinese and English languages. Registered users can access e-mail through post office protocol 3 servers, which allow users to receive e-mail on their own e-mail applications without opening their Web browser.
- *Online Community.* We offer NetEase registered community members over 1,500 forums where they can post messages and articles for viewing by other registered community members and other users. Community members may also create their own forums in addition to those we offer. We hosted over 115,500 such personal community forums as of July 31, 2001. The NetEase online communities are hosted by volunteers, who are chosen by us based on their contributions to the communities. The NetEase community volunteers monitor our community forums and select appropriate articles for posting. In addition, they monitor the personal homepages hosted by the NetEase Web sites.
- *Instant Messaging.* We offer NetEase registered users a platform to notify their online friends and other users with similar interests when they are online, allowing NetEase registered users to participate in real-time dialogues.
- *Chat.* Our chat services allow NetEase registered users to interact in real-time group or one-on-one discussions. Unlike hyper text markup language, or HTML, our Java-based chat technology allows users to participate in chats without downloading chat software. The NetEase chat rooms are arranged around topics of interest including, among others, relationships and dating, campus life and technology. Registered users can also create their own personal chat rooms.

- *Easebar.* We developed Easebar, a free browser toolbar that provides Internet users with quick access to their favorite destinations and allows users to customize the look and feel of their Web browsers. Easebar remains on a user's screen and provides quick access to specific areas of the Web. Users can customize Easebar by adding buttons and changing their sequence to fit their needs. Users can store their bookmarks on Easebar with the Easebar bookmarks button and access them from any computer.
- *Voting System.* We conduct numerous polls on various social, cultural and other topics to provide our registered users with the opportunity to express their views and also to learn about the opinions of other Internet users.
- *Electronic Greeting Cards.* We believe that we were the first Internet company to offer Chinese Internet users online greeting cards in Chinese. Our greeting cards have different designs for various occasions, including New Year's Day, Chinese New Year, Christmas, birthdays, Valentine's Day, and other celebrations. We make new designs available on a regular basis. A user may send an electronic card without registering with us.
- *iPDA.* In May 2001, we launched Internet Personal Digital Assistant (iPDA), our online personal digital assistant services. The package includes a calendar, address book, and bookmark, as well as services for sending invitations and communicating with schoolmates and alumni. These personalized services are intended to help our members to use Internet-based tools to manage their work and daily lives more easily. We believe that we are the first to introduce such a package in China. We believe that the launch of iPDA will help to convert casual users to loyal users of the NetEase Web sites. The iPDA products are integrated with our short messaging service, or SMS, which we believe will result in an increase of our SMS revenue. In addition, we believe that the iPDA products are also valuable for corporations on their intranet. We will also offer the iPDA products to attract more professional people to our user base.

In addition to our Web page hosting services described above, we also offer these additional fee-based services:

- *SMS.* In conjunction with China Mobile, in January 2001, we launched the short messaging service (SMS) to allow users to send and receive messages from the Internet. We charge a fee for messages sent and received on the NetEase Web sites, and these fees are then added onto the user's China Mobile bill and subsequently paid to us by China Mobile. This new service has experienced strong growth since its launch. During the first quarter of 2001, more than 134,000 users sent 1.1 million short messages, and we began recording revenue from this service in the second quarter of 2001. We expect the usage of this service to increase as the popularity of SMS increases. As part of our strategic partnership agreement with China Unicom to jointly explore business opportunities relating to wireless application protocol, or WAP, applications, users of China Unicom's mobile phone services will also have access to our SMS service.
- *Online Games.* In 2001, we began offering massively multi-player online role-playing games on the NetEase Web sites. As part of this initiative, we acquired technology assets from Guangzhou Tianxia Technology Co. Ltd., a China-based game software developer which we believe was the first company to introduce a domestically developed massively multi-player online role-playing game to the China market. We are developing a massively

multi-player online role-playing game based on Guangzhou Tianxia's technology and plan to launch this game in October 2001. We have also entered into a partnership agreement with Waei International, a Taiwan-based provider of massively multi-player online role-playing games, to promote and distribute one of its most popular games in China on the NetEase Web sites on a per usage basis, with revenues earned from Waei International's game shared between Waei International and us. Our partnership agreement with Waei International is described more fully below under "Strategic Alliances—E-Commerce Solutions."

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

In September 2000, we selected Google to power our search engine. With Google's search technology on the NetEase Web sites, Internet users can now search among 30 million Chinese-language Web pages and the 1.2 billion Web pages available on the World Wide Web. Google provides one of the most advanced Chinese language-specific and global Web search engines.

Our E-commerce Services

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

In July 2000, we introduced the NetEase online shopping mall which provides an e-commerce solution platform for small and medium enterprises. With China's growing economy, the mall offers a unique way for private enterprises to reach out to our educated and affluent users by using our technology platform. As of July 31, 2001, the mall hosted 56 individual storefronts selling over 33,000 different products. Individual storefronts are easy to set up and merchants are provided with online payment solutions, real-time order tracking and comprehensive online reports. We have partnered with leading financial institutions and companies to facilitate online settlements. These partnerships are described more fully below under "Strategic Alliances—E-Commerce Solutions."

In October 2000, we also established a co-branded online trading and auction channel in partnership with EachNet, China's leading online auction provider. This partnership is described more fully below under "Strategic Alliances—EachNet."

Our e-commerce solutions services also include Web site construction and news publishing conducted through the Internet.

Corporate Solutions Services

In August 2001, we established a Corporate Solutions Services department targeted at providing Internet products, services and solutions to Chinese enterprises and government entities. We will provide customized solutions to these corporate customers. We offer a package of Internet applications, services and technologies for a corporate customer's own community, including e-mail, Web site development,

Web page hosting, office automation, systems integration, e-commerce platforms and other interactive community services. We plan to leverage our existing technology and Web-based products to capture a portion of the developing corporate solutions services market in China.

Strategic Alliances

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

The News Corporation

In connection with the issuance of our Series B preference shares, we entered into an agreement with News Digital Ventures, an affiliate of The News Corporation Limited, which provides for cooperation between us and The News Corporation. As part of the consideration for the issuance of our Series B preference shares, The News Corporation and its affiliates will provide us with on-air advertising and promotional inventory with a value of US\$5 million on The News Corporation's media properties, including Channel [V], ESPN Star Sports, Phoenix TV and STAR TV. We have agreed to use at least US\$1 million of the inventory within one year, and at least US\$2 million in each of the next two years. As of March 31, 2001, we have used or have contracted to use in the remainder of 2001 the entire US\$1 million of inventory specified above. In addition, The News Corporation and its affiliates will spend US\$5 million on on-line advertising on the NetEase Web sites during this time, including US\$1 million within one year and US\$2 million in each of the next two years. 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. If The News Corporation and its affiliates are collectively the largest committed buyer of advertising on the NetEase Web sites, they will be entitled to purchase this advertising on terms that are no less favorable than those that are applicable to any other non-affiliated buyer. We and The News Corporation will also cross-license Internet tools and technologies on terms to be mutually agreed upon, and will share customer information generated by either party using the cross-licensed tools and technology. The News Corporation will have a right of first refusal to provide Chinese language content to the NetEase Web sites in the areas of popular music, sports and movies and general entertainment. The News Corporation will offer us the opportunity to participate in cross-promotional and marketing activities, including creating special co-branded marketing and promotional events. Our obligations and The News Corporation's obligations to purchase advertising and promotional inventory from one another, and the arrangements relating to the cross-license of Internet tools and technologies, remain subject to the negotiation of definitive agreements.

EachNet

We have entered into a strategic alliance with the leading online auction provider in China, EachNet. As in other countries, online auctions are rapidly gaining popularity in China, providing a new avenue by which users can buy and sell items of interest to a large and diverse geographic population. In October 2000, NetEase and EachNet launched a co-branded Web site, providing the NetEase Web sites' large pool of users access to the largest collection of auction listings in China. Together, we share advertising and transaction revenues generated from this co-branded site and are jointly offering application technology services to Chinese businesses seeking e-commerce solutions.

Content Partnerships and Alliances

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

We have content distribution relationships with approximately 115 international and domestic Chinese language content providers including *Xinhua News Agency*, *Chinanews.com*, *21dnn.com*, *China Computer World*, *China Economic Times*, *China Sports Newspaper*, *China Youth Daily*, *Reuters* and *Channel [V]*. We minimize the amount of content creation undertaken in house by working with both traditional and online content partners around the world. Under partnership agreements, content partners display their content free of charge or in exchange for a share of revenue, a licensing fee, access to original content generated on the NetEase Web sites or a combination of these arrangements.

E-Commerce Solutions

We provide links to, and promote, the Web sites of several third party e-commerce providers. Referral-based revenues from these providers constituted a major portion of our e-commerce revenues in 2000. For example, in December 2000, we entered into a partnership with People's University of China to become its exclusive online referral agent. By promoting student enrollment and online education on the NetEase Web sites, we receive a percentage of the registration and tuition fees received from each student who registers on the university's Web site.

We also work with 56 online merchants that sell a variety of products and services on our online shopping mall. Merchants operating in our online shopping mall pay rent to us for their storefronts and in some cases have revenue sharing arrangements with us.

In August 2000, we entered into a strategic partnership agreement with CITIC Industrial Bank, a commercial bank in China. Together with CITIC Industrial Bank, we plan to cooperate to promote online banking, online payment, bank credit cards and corporate financial services in China. We have also partnered with several domestic companies to facilitate e-commerce transactions, including China Merchants Bank and China Information Highway Corporation. In April 2001, we entered into a partnership agreement with HiTRUST to offer a complete e-commerce payment system for our users. With this partnership, our users are able to conduct secure e-commerce transactions on our e-commerce platform using MasterCard's advanced payment solutions and HiTRUST's secure authentication services and powered by Acer's high technology hardware. Through these partnerships, we can provide secure and reliable online payment solutions.

With regard to our new online game business, we entered into an agreement with Taiwan-based Waei International in April 2001. We promote and distribute Waei's most popular massively multi-player online role-playing game in China. Waei is responsible for technical support and customer service, while we administer the newly created interactive gaming communities. We share with Waei International usage-based revenues generated by this co-branded game service.

Wireless Application Protocol

We believe that we were the first to launch a wireless application protocol, or WAP, portal in March 2000 and in November 2000 we launched a WAP-enabled e-mail service. NetEase users are now able to access their NetEase e-mail accounts from anywhere in China through their mobile phones.

In addition, we participated in China Mobile's Monternet (Mobile Internet) program, an initiative to provide an open platform on which participating partners have wide access to China Mobile's infrastructure, billing system, WAP platform and short-message platform. In January 2001, Guangzhou NetEase signed on as a partner in this program and since that time it has launched WAP and short-message services to China Mobile users. This six-month partnership agreement was renewed and is scheduled to expire on September 20, 2001, unless we mutually agree to renew it.

In April 2000 we entered into a one-year strategic partnership agreement with China Unicom to jointly explore business opportunities relating to WAP applications and to customize and optimize NetEase's content for China Unicom's WAP mobile phone services. China Unicom is a leading wireless operator in China and we intend to renew this agreement by the third quarter of 2001.

Broadband Partners

To build upon our technological breakthroughs, in June 2000 we formed a strategic partnership with ChinaCast, a broadband Internet access provider in China, to allow subscribers of ChinaCast's Turbo163 broadband satellite service to access the NetEase Web sites via a high-speed satellite downlink. We believe that we were the first Internet company with a broadband satellite link in China.

In August 2000, Guangzhou NetEase entered into a binding letter of intent with Great Wall Broadband Network Service to promote the development of broadband cable networks in residential communities across China as well as to co-develop broadband content, value-added services and applications.

In addition, in November 2000, we entered into a two-year partnership agreement with China Information Broadcast Network Co. Ltd., a subsidiary of China's State Administration of Radio, Film and Television (SARFT). The partnership intends to establish a co-branded broadband Web site and to develop broadband applications and services on the SARFT network.

Sales and Marketing

Sales Organization

We believe the growing number of Internet users in China represents an attractive demographic target for advertisers because it represents an affluent, educated and technically sophisticated market. To capitalize on this advertising opportunity, we established an advertising sales force in May 1999

Guangyitong Advertising sells banner advertisements on the NetEase Web sites, including animated and interactive banner advertisements, button advertisements, sponsorships, text links as well as advertising on our electronic newsletters. In addition, we have been appointed by Guangzhou NetEase to solicit advertising customers for the NetEase Web sites outside of China. Together with Guangyitong Advertising, we had 26 advertising sales professionals located in Beijing, Shanghai and Guangzhou as of July 31, 2001. In addition, online advertising on the NetEase Web sites is also sold through online advertising sales networks and advertising agencies. We believe that our focus on widely-used services that are designed to appeal to a broad base of Internet users attracts a variety of blue chip advertisers,

ranging from technology products to consumer brands. We intend to continue to attract online advertisers by promoting the NetEase brand name to potential advertisers.

Marketing

We employ a variety of traditional and online marketing programs and promotional activities to build our brand as part of our overall marketing strategy. In 2000, we placed advertisements on high-profile third-party Web sites as well as on the NetEase Web sites and held promotional activities such as new product or service launches and special sports and holiday events.

In the third quarter of 2000, we launched a new advertising campaign, the theme of which was 'Power to the People', a slogan that reflected our belief that the Internet empowers its users through meaningful information sharing. The response to this campaign was very positive. We believe that this campaign contributed to the approximately 50% growth of our user base from September 2000 to December 2000. Media Magazine, a regional publication based in Hong Kong, gave the campaign a Certificate of Excellence in the prestigious China Ad Campaign of the Year award in December 2000.

In an effort to control our costs, we have reduced the financial and other resources devoted to our marketing and branding efforts in 2001. However, we continue to build brand awareness through strategic alliances, proactive public relations, and traditional and online advertising.

Research and Development

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

We have utilized and will continue to utilize the products and services of third parties to enhance our platform of technologies and services to provide competitive and diverse Internet services to our users. We also have utilized and will continue to utilize third-party advertisement serving technologies. In addition, we plan to continue to expand our technologies, products and services and registered user base through diverse online community products and services developed internally. For instance, our product Easebar is a Web-browser plug-in that enables registered users to customize the look and feel of their Web browser. We use the Java programming language in developing our technologies which enables interactive content publishing across the Internet as compared to HTML which is more useful for static content publishing. Java is a dynamic development tool with the capability to synchronize and execute multi-process applications in a cross-platform form. We will seek to continually improve and enhance our existing products and services to respond to rapidly evolving competitive and technological conditions.

Infrastructure and Technology

Our infrastructure and technology have been designed for reliability, scalability and flexibility and are administered by our technical staff. The NetEase Web sites are made available primarily through network servers co-located in the facilities of China Telecom's Beijing, Shanghai and Guangzhou affiliates, and Internet data centers co-located in the facilities of 21Vianet. As of July 31, 2001, there were 435 such co-located servers, operating with Web server software from Apache and Netscape. We also maintain Internet data centers co-located in the facilities of 21Vianet. We lease dedicated lines with 500 megabits per second capacity from China Telecom's Beijing affiliate as well as shared lines from China Telecom's Shanghai affiliate and Guangzhou affiliate and from 21Vianet.

Our hardware platform includes Sun Microsystems Enterprise servers, Dell servers, Compaq servers, Network Appliance and IFT storage servers, local brand PCs, Foundry routers, and 3Com and Cisco switches. Our operating system is mainly UNIX-based and includes free BSD, Red Hat Linux and Solaris technology. To provide load balancing and to further reduce user's access time, NetEase uses IBM Network Dispatch products.

We license and optimize StoryServer from Vignette Corporation to provide efficient and responsive management of the content on www.163.com, the main homepage of the NetEase Web sites. We also license NetGravity's advertisement serving technology to provide internal advertising inventory management. In January 2001, we commenced using DoubleClick's DART (Dynamic Advertising Reporting and Tracking) technology to serve our online advertising customers.

Our online mall is supported by Oracle's database systems and implemented in Java. In January 2001, we commenced using Viewpoint Corp.'s media technology which allows us to create 3D product representations that visitors to our online mall can twist and turn and manipulate in virtual replication of the real-world shopping experience.

Our Web directory is based on an open architecture system with over 5,000 volunteer editors. We use Oracle's database systems to manage our registered user database and e-commerce platforms. NetEase has established a comprehensive behavior tracking system to record user behavior patterns and plans to set up a data-mining system to analyze the information. We also deploy a single sign-on system that allows users to access all services within the NetEase Web sites. We intend to continue to use a combination of internally developed software products as well as third party products to enhance our Internet media services in the future.

Competition

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

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

In a report issued in December 2000, NetValue, an Internet market research company, listed the NetEase Web sites as the second most recommended among all Web sites in China. According to this survey report, the top ten Web sites most recommended by Internet users in China were:

- www.sina.com.cn;
- the NetEase Web sites;
- www.sohu.com;
- www.chinaren.com;
- www.tencent.com;

- www.163.net;
- www.21cn.com;
- www.263.net;
- www.fm365.com; and
- www.msn.com.

In the future, we expect to face increased competition from new Internet media companies that choose to target general, special interest and/or demographic markets (such as vertical portals). We are also affected by competition from licensees of our e-mail software. We may encounter indirect competition from providers of Web-based software and other Internet related products. We also compete with traditional forms of media for advertising-related revenue. We may encounter competition from companies offering massively multi-player online role-playing games that choose to target the China market. We also compete with domestic and multi-national Internet solutions providers. There can be no assurance that we will be able to compete successfully against our current or future competitors or that competition will not have a material adverse effect on our business, results of operations and financial condition.

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

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

Governmental Regulations

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

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

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

- formulating and enforcing telecommunications industry policy, standards and regulations;
- granting licenses to provide telecommunications and Internet access services;
- formulating tariff and service charge policies for telecommunications and Internet access services;
- supervising operations of telecommunications and Internet access service providers;
- maintaining fair and orderly market competition among operators; and
- managing the day-to-day administration of the national telecommunications sector.

In September 2000, China's State Council promulgated the Telecommunications Regulations, or the Telecom Regulations. The Telecom Regulations categorize all telecommunications businesses in China as either infrastructure telecommunications businesses or value-added telecommunications businesses, with ICP services and email services classified as value-added telecommunications businesses. According to the Telecom Regulations, the commercial operations of such services are subject to an operating license. The Telecom Regulations also set forth extensive guidelines with respect to different aspects of telecommunications operations in China.

In addition to the regulations promulgated by the central Chinese government, some local governments have also promulgated local rules applicable to Internet companies operating within their respective jurisdictions. In Beijing, where our head office is located, the Beijing Municipal Administrative Bureau of Industry and Commerce, or the Beijing AIC, has promulgated a number of Internet-related rules. In September 2000, the Beijing AIC invalidated a previously issued circular and adopted a new set of rules providing for a registration and filing process for commercial Web sites operating in Beijing. Recently, the Beijing AIC also implemented the Online Advertising Tentative Administrative Measures requiring all ICPs providing online advertising services to obtain an advertising operating license. In addition, the Beijing AIC also issued a circular requiring BBS services providers to obtain approval from the Beijing AIC. Since these local rules or circulars promulgated by the Beijing AIC do not explicitly require a non-Beijing registered Internet company or a non-ICP company to comply with these rules or circulars, we believe that these local rules do not apply to Guangzhou NetEase and NetEase Beijing.

Regulation of Internet Content Services

The telecommunications industry, including Internet content provision (ICP) services, is highly regulated by the Chinese government, the main relevant government authority being the Ministry of Information Industry or MII.

The Chinese government generally prohibits foreign investors from taking any equity ownership in or operating any telecommunications business. We believe that this prohibition to be lifted after China's entry into the WTO. However, at present, pursuant to the bilateral WTO accession agreements

entered into between China and other countries including the U.S., foreign investors may hold in aggregate no more than 50% of the total equity ownership in any telecommunications business in China. Currently, the NetEase Web sites are operated by our affiliated company, Guangzhou NetEase Computer System Co., Ltd., or Guangzhou NetEase.

Subsequent to the State Council's promulgation of the Telecom Regulations in September 2000, MII formulated and implemented a number of Internet-related regulations, including but not limited to the Internet Information Service Administrative Measures, or the ICP Measures, the Internet Electronic Bulletin Board Service Administrative Measures, or the BBS Measures, and the Tentative Administrative Measures Concerning Internet Portals Carrying on the News Displaying Business, or the Internet News Measures. The ICP Measures require that commercial ICP operators must obtain an ICP license from the appropriate telecommunications authorities in order to carry on any commercial ICP operations within China. In addition, the ICP Measures also provide that ICP operators which operate in sensitive and strategic sectors, including news, publishing, education, health care, medicine and medical devices, must obtain additional approvals from the relevant authorities in charge of those sectors as well. The BBS Measures provide that any ICP operator engaged in providing online bulletin board services is subject to a special approval and filing process with the relevant government telecommunications authorities. The Internet News Measures require that any ICP operator engaging in any news displaying services must obtain approval for those services from the appropriate government news department.

To operate the NetEase Web sites in compliance with all the relevant ICP-related Chinese regulations, Guangzhou NetEase has successfully obtained an ICP license issued by the Guangdong Provincial Telecommunications Bureau dated as of December 14, 2000. On February 15, 2001, the News Office of the Beijing Municipal People's Government approved Guangzhou NetEase's application in respect of its news displaying services on the NetEase Web sites. On July 31, 2001, Guangzhou NetEase obtained approval from the Guangdong Bureau for our bulletin board services. Although the Guangdong Bureau granted approval to provide bulletin board services in specialized categories without providing any guidance on the term "specialized categories", we believe that such approval is sufficient to cover our existing online bulletin board services. As for special approvals for other online services relating to publishing, education, health care, medicine and medical devices, since the relevant application procedures are either relatively new or have not been formulated, Guangzhou NetEase is still in the process of preparing the respective applications and will submit such applications in due course.

Under the relevant regulations, ICP operators are prohibited from posting or displaying any content that:

- opposes the fundamental principles determined in China's Constitution;
- compromises state security, divulges state secrets, subverts state power or damages national unity;
- harms the dignity or interests of the state;
- incites ethnic hatred or racial discrimination or damages inter-ethnic unity;
- sabotages China's religious policy or propagates heretical teachings or feudal superstitions;
- disseminates rumors, disturbs social order or disrupts social stability;

- propagates obscenity, pornography, gambling, violence, murder or fear or incites the commission of crimes;
- insults or slanders a third party or infringes upon the lawful rights and interests of a third party; or
- includes other content prohibited by laws or administrative regulations.

Failure to comply with this content censorship requirement may result in the revocation of ICP licenses and the closing down of the concerned Web sites. To ensure compliance with this regulatory requirement, Guangzhou NetEase has taken all reasonable steps to avoid displaying any of the prohibited content on the NetEase Web sites.

Regulation of Advertisements: Publications

The State Administration of Industry and Commerce, or the SAIC, is the government agency responsible for regulating advertising activities in China. While there are no nation-wide uniform laws or regulations in China specifically governing online advertising businesses, certain local government authorities, such as the Beijing Municipal Administration of Industry and Commerce, have issued a number of regulations governing online advertising businesses. The SAIC has not expressly asserted or issued any regulatory documents stating that the Internet is considered an advertising medium under its rules, nor has the SAIC extended its jurisdiction to online advertisements. However, we cannot predict what stance the SAIC or any other Chinese governmental agencies may adopt in the future.

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

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

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

The State News and Publication Bureau, or SNPB, is the government agency responsible for regulating publishing activities in China. There are currently no laws or regulations in China specifically governing the online publication industry. The SNPB has not yet expressly asserted, or issued any regulatory documents stating, that the Internet is considered an electronic publication media under its rules, nor has the SNPB extended its jurisdiction to online publications. However, we cannot predict what stance the SNPB or any other Chinese governmental agencies may adopt in the future. If the SNPB were to extend its jurisdiction to encompass publications on the Internet, we may be regarded by the SNPB as an “Electronic Publisher” as defined in the Chinese Administrative Rules on Electronic Publications, and

we would need to apply to the SNPB for approval so as to be authorized to conduct our electronic publication business in accordance with the Administrative Rules on Electronic Publication and the Detailed Implementing Rules thereof. We cannot assure you that such application would be approved by the SNPB. Failure to obtain such approval may result in penalties including:

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

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

Regulation of E-Commerce

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

Foreign Exchange Controls

Our Chinese subsidiaries are subject to various foreign exchange controls which are discussed in Item 10 in this Form 20-F.

Intellectual Property and Proprietary Rights

We rely primarily on a combination of copyright laws and contractual restrictions to establish and protect our intellectual property rights. We require our employees to enter into agreements requiring them to keep confidential all information relating to our customers, methods, business and trade secrets during and after their employment with us. Our employees are required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes, whether or not patentable or copyrightable, made by them during their employment are our property. They also sign all necessary documents to substantiate our sole and exclusive right to those works and to transfer any ownership that they may claim in those works to us.

While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. Infringement or misappropriation of our intellectual property could materially harm our business. We own the intellectual property (other than the content) relating to the NetEase Web sites and the technology that enables on-line community, personalization and e-commerce services on those sites. We license content from various freelance providers and other content providers.

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

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

China's trademark law adopts a "first-to-file" system for obtaining trademark rights. As a result, the first applicant to file an application for registration of a mark will preempt all other applicants. Prior use of an unregistered mark is generally irrelevant except for "well known" marks. Guangzhou NetEase has filed with China's Trademark Office trademark applications for numerous trademarks incorporating the words "NetEase" and "Yeah" in English and for marks for "NetEase" as written in Chinese in traditional and simplified Chinese characters. As of July 31, 2001, Guangzhou NetEase has successfully registered most of its trademarks with the Trademark Office and has applications pending for the remainder of its trademarks. It has agreed to transfer to us all of its already registered trademarks and, upon any registration being granted for pending applications, those newly registered trademarks. The transfer of Guangzhou NetEase's already registered trademarks has not yet been effected with the appropriate governmental authorities in China although we intend to make the necessary filings for this purpose. In addition, we have also filed trademark applications in China, Hong Kong and the United States for numerous marks incorporating the words "NetEase" in English and for marks for "NetEase" and other words as written in Chinese in traditional and simplified Chinese characters. Therefore, we may not be able to successfully defend or claim any legal rights in those "NetEase" related trademarks that Guangzhou NetEase has registered but not yet transferred to us, and those trademarks for which we have made application but for which the Trademark Office has not issued a registration certificate.

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

Legal Proceedings

We are not currently a party to any material litigation and are not aware of any pending or threatened litigation that, if adversely decided, would have a material negative effect on us.

C. Organizational Structure

The following table sets out the details of our subsidiaries:

<u>Name</u>	<u>Country of Incorporation</u>	<u>Ownership Interest</u>
NetEase Information Technology (Beijing) Co., Ltd.	China	100%
NetEase Information Technology (Shanghai) Co., Ltd.	China	100%
NetEase (U.S.) Inc.	U.S.	100%
Beijing NetEase Interactive Network Technology Co., Ltd.	China	80%

The other 20% of the equity interest in Beijing NetEase Interactive Network Technology Co., Ltd. is held by our wholly owned subsidiary, NetEase Information Technology (Beijing) Co., Ltd.

D. Property, Plant and Equipment

Our principal executive offices are currently located at 15th Floor, North Tower, Beijing Kerry Centre, No.1 Guang Hua Road, Chao Yang District, Beijing, People's Republic of China. We lease our principal executive offices at an annual rent of approximately US\$0.5 million (RMB3.85 million), including management fees, for 2,212 square meters under a lease that expires in February 2003. We also occupy 756 square meters under a lease in Shanghai that expires in December 2002. Guangzhou NetEase occupies a total of 1,120 square meters under leases that expire in May 2002 and November 2001 respectively. Our offices in the United States are located at 39899 Balentine Drive, Suite 230, Newark, California 94569. Our Newark offices occupy 359 square meters under a lease that expires in October 2005. We believe that we will be able to obtain adequate facilities, principally through the leasing of appropriate properties, to accommodate our future expansion plans.

We lease dedicated lines with a total capacity of approximately 500 megabits per second from Beijing Telecom Bureau under a contract expiring in November 2001. In addition, we lease shared lines from 21Vianet and China Telecom's Shanghai affiliate and Guangzhou affiliate under contracts expiring in February 2002, December 2001, and January 2002, respectively. Our bandwidth fees were approximately US\$2.4 million for the year ended December 31, 2000 and approximately US\$0.7 million for the first quarter of 2001.

Item 5. Operating and Financial Review and Prospects

The following discussion of our financial condition and results of operations is based upon and should be read in conjunction with our consolidated financial statements and their related notes included in this annual report on Form 20-F. 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. In evaluating our business, you should carefully consider the information provided under the caption "Risk Factors" in this annual report on Form 20-F. We caution you that our businesses and financial performance are subject to substantial risks and uncertainties.

Restatement of Consolidated Financial Statements

As publicly announced on May 8, 2001 and June 11, 2001, our Board of Directors discovered potential issues within the company's departments regarding the terms of certain advertising contracts. Upon this discovery, the Audit Committee of our Board of Directors, with the assistance of our outside counsel and independent auditors, immediately began an intensive investigation which has just been completed. As a result of the findings of the Audit Committee investigation, we have restated our financial results for the fiscal year 2000. The restatement of revenue was necessitated by the Audit Committee's finding that the terms and execution status of certain advertising contracts between our company and third party advertisers and the nature of certain barter transactions were such that revenue could not be recognized in fiscal year 2000. See Item 4.A. "Information on the Company—Recent Developments."

Our restated consolidated financial statements for the fiscal year 2000 contain adjustments that fall into the following three categories, all of which were identified in the course of the Audit Committee's investigation:

The first category of adjustments arises from advertising contracts for which our Audit Committee could not identify sufficient reliable evidence to support the fair value of the services which had been provided by us prior to December 31, 2000 or, alternately, for which there had been no services provided by us in fiscal year 2000. Accordingly, no revenue could be recognized under these contracts for fiscal year 2000. The findings of the Audit Committee's investigation indicate that, with respect to fiscal year 2000, US\$1.1 million in revenue was improperly recorded for this reason. At present, we cannot ascertain what portion, if any, of this amount can be recognized in future periods.

The second category of adjustments was necessitated by our recognition of certain revenue from barter transactions for which revenue could not be recognized because they did not meet the criteria for recognition set out in Accounting Principles Board Opinion 29 and EITF 99-17 (as defined in "—Revenues" below). This category amounted to a total of US\$2.0 million in revenue which should not have been recorded in fiscal year 2000, and we do not expect that we will recognize this revenue in future periods.

The third category of adjustments concerns certain transactions which lacked economic substance, which resulted in US\$1.2 million of revenue being eliminated from our statements of operations for fiscal year 2000.

For further information regarding the restatement, see Note 16 of the Notes to the Consolidated Financial Statements which begin on page F-1 of this annual report.

Our restated net revenues for 2000 totaled RMB30.5 million (US\$3.7 million), resulting in a net loss of RMB169.3 million (US\$20.4 million) or RMB6.78 (US\$0.82) per American Depositary Share. We had originally reported net revenues for 2000 of RMB65.1 million (US\$7.9 million), with a net loss of RMB142.8 million (US\$17.3 million) or RMB5.72 (US\$0.69) per American Depositary Share. Our total operating expenses for 2000 were reduced by RMB7.2 million (US\$0.9 million) as a result of the restatement. The adjustments also decreased our previously reported total assets by RMB72.8 million (US\$8.8 million). Our management believes that it has made all the adjustments considered necessary as a result of the Audit Committee's investigation. Management further believes that our consolidated financial statements for the year ended December 31, 2000, as restated, include all adjustments necessary for a fair presentation of our financial position and results of operations for such period.

Overview

NetEase.com, Inc. was incorporated in the Cayman Islands on July 6, 1999 as an Internet technology company in China. As of December 31, 2000, the Company 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. NetEase Shanghai was established in China on May 14, 2000. Beijing NetEase Interactive Network Technology Co., Ltd., or NetEase INT, was established in China on November 28, 2000. We hold 80% and NetEase Beijing holds 20% of the equity interest in NetEase INT. NetEase INT has obtained a permit from the relevant Chinese authorities to engage in the online advertising business on its own Web sites, of which there are currently none.

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 grew from RMB16.8 million in 1999 to RMB33.0 million (US\$4.0 million) in 2000. We generate our revenues from advertising services, e-commerce related 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 shopping mall and auction services in China through Guangzhou NetEase. Our online auction services are now offered through our co-branded Web site with EachNet.

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. This compares with two customers to whom we provided Internet advertising services that individually represented greater than 10% of our total revenues for 1999.

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 99-17, 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, recognized revenues derived from barter transactions in accordance with EITF 99-17 were RMB0.7 million (US\$79,000). We also engaged in some advertising barter transactions in 2000 for which the fair value is not determinable within the limits of EITF 99-17, and therefore the revenues and expenses derived from these barter transactions were not recognized. These transactions primarily involved exchanges of advertising services rendered by us for advertising, promotional benefits, information content, consulting services and software provided by the counterparties.

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

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

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

E-commerce related services revenues. We earn e-commerce related services revenues from the NetEase Web sites' online shopping mall, our co-branded online auction Web site with EachNet, referral fees from e-commerce companies, and e-commerce solutions. We derive our e-commerce related services revenues from Guangzhou NetEase as well as from third parties.

We launched our online shopping mall platform in July 2000. As of July 31, 2001, this online shopping mall had 56 "online stores" operated by merchant tenants. Approximately 80% of these merchant tenants pay us a fixed service fee which we recognize ratably over the period of the lease of our e-commerce platform. Approximately 20% of these merchant tenants pay us a commission, based on that merchant tenant's revenues. Also included in revenues from the NetEase Web sites' online shopping mall are referral fees from online shopping mall partners of the NetEase Web sites. Each online shopping mall partner pays us a commission, based on revenues which it earns from these referrals.

Prior to October 2000, we earned revenues from services to online auction sellers, whether businesses or consumers, which we 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 earned a one-time fixed fee upon the signing of our strategic cooperation agreement with EachNet. In addition, we earn referral fees from EachNet, up to a fixed maximum fee in each quarter.

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

Our e-commerce solutions services have expanded from platform testing and software solutions services to also include Web site construction and news publishing conducted through the Internet. These revenues are recognized upon completion of the respective total contract and acceptance by the customer.

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 consist only of pre-paid 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.

Cost of Revenues

Advertising and e-commerce related services costs. Advertising and e-commerce related services costs consist primarily of server custody and bandwidth fees, cost of content, 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 for our bandwidth lease payments and server custody fees on a monthly basis. In addition, as a result of our arrangements with Guangzhou NetEase, we also pay for Guangzhou NetEase's bandwidth lease payments and server custody fees on a monthly basis. These costs are recognized in full as incurred.

Staff costs consist primarily of compensation expenses for our e-commerce and editorial professionals. Our staff costs have risen as our business has expanded and we have hired more personnel.

We depreciate our assets other than leasehold improvements on a straight-line basis over their estimated useful lives, which range from three to five years.

Software licensing and related integration projects costs. We no longer have any material costs relating to software licensing and related integration projects.

Operating Expenses

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

Selling, general and administrative expenses Selling, general and administrative expenses consist primarily of marketing and advertising; 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. Research and development consists principally of compensation for our research and development professionals.

Share Compensation Costs

In 2000, we replaced the 1999 Stock Incentive Plan with the 2000 Stock Incentive Plan. The 2000 Stock Incentive Plan was subsequently amended and restated on May 25, 2001. During 2000, we granted options to our employees, one director, two consultants, a member of our advisory board and certain new members of our senior management. The vesting period for these options generally ranges from two years to four years. In connection with these option grants, we recorded deferred share compensation costs of approximately RMB48.5 million (US\$5.9 million) which are 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 2000, we recorded share compensation costs of approximately RMB13.8 million (US\$1.7 million). These costs have been allocated to (i) advertising and e-commerce related service costs, (ii) selling, general and administrative expenses and (iii) research and development expenses, depending on the functions for which these personnel and employees are responsible.

Income Taxes

Under the current laws of the Cayman Islands, we are not subject to tax on income or capital gain. However, our revenues are primarily derived from our Chinese 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. Our subsidiary, NetEase Shanghai, is subject to EIT at the rate of 30% plus a local tax of 3%.

If the activities of NetEase.com constitute a permanent establishment in China, the income it earns in China would also be subject to a 30% EIT and 3% local income tax. Income of NetEase.com that is not connected to a permanent establishment in China would be subject to a 10% withholding tax on gross receipt from profit, interest, rentals, royalties and other income earned in China. Dividends from NetEase Beijing to NetEase.com are exempt from Chinese withholding tax.

We are generally subject to a business tax of 5% on our service revenues. Prior to ceasing our software licensing and related integration projects business in 2000, 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. Guangzhou NetEase is a Chinese domestic enterprise and is generally subject to a 33% EIT.

NetEase Beijing had tax net operating loss carryforwards of approximately RMB81.9 million (US\$9.9 million) as of December 31, 2000 for EIT purposes. Approximately RMB6.6 million (US\$0.8 million) of these carryforwards will expire in 2004 and another approximately RMB75.3 million (US\$9.1 million) will expire in 2005. NetEase Shanghai had tax net operating loss carryforwards of approximately RMB23.5 million (US\$2.8 million) as of December 31, 2000 for EIT purposes. These carryforwards will expire in 2005. 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.

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:

	Year Ended December 31,					
	1998		1999		2000	
	RMB	%	RMB	%	RMB (as restated)	%
Revenues:						
Advertising services	172,850	5.5	10,796,074	64.4	30,067,477	91.2
Software licensing and related integration projects	2,942,582	94.5	3,515,831	21.0	450,350	1.4
E-commerce related services	—	—	2,459,101	14.6	2,455,834	7.4
Total revenues	3,115,432	100.0	16,771,006	100.0	32,973,661	100.0
Sales and value-added taxes	(230,749)	(7.4)	(1,150,169)	(6.9)	(2,476,444)	(7.5)
Net revenues	2,884,683	92.6	15,620,837	93.1	30,497,217	92.5
Cost of revenues:						
Advertising and e-commerce related services (including share compensation costs of RMB6,296,816 in 1999 and RMB1,171,084 (US\$141,479) in 2000, and cost reimbursements to a related party of RMB1,974,834 in 1999 and RMB2,098,127 (US\$253,476) in 2000)	(242,657)	(7.8)	(11,837,416)	(70.6)	(39,909,419)	(121.0)
Software licensing and related integration projects	(96,531)	(30.4)	(258,819)	(1.5)	—	—
Total cost of revenues	(1,189,188)	(38.2)	(12,096,235)	(72.1)	(39,909,419)	(121.0)
Gross profit(Loss on revenues)	1,695,495	54.4	3,524,602	21.0	(9,412,202)	(28.5)

Operating expenses:						
Selling, general and administrative expenses (including share compensation costs of RMB34,346,268 in 1999 and RMB7,437,230 (US\$898,498) in 2000, and cost reimbursements to a related party of RMB466,259 in 1999 and RMB3,124,247 (US\$377,443) in 2000)	(311,957)	(10.0)	(51,055,489)	(304.4)	(170,359,791)	(516.6)
Research and development (including share compensation costs of RMB4,770,315 in 1999 and RMB5,231,246 (US\$631,991) in 2000)	(951,000)	(30.5)	(5,735,170)	(34.2)	(14,756,682)	(44.8)
Total operating expenses	(1,262,957)	(40.5)	(56,790,659)	(338.6)	(185,116,473)	(561.4)
Operating profit (loss)	432,538	13.9	(53,266,057)	(317.6)	(194,528,675)	(589.9)
Other income (expenses):						
Sale of 163.net usage rights	—	—	1,500,000	8.9	—	—
Interest income, net	5,719	0.2	357,160	2.1	25,268,975	76.6
Other, net	(71,056)	(2.3)	(494,018)	(2.9)	(9,099)	0.0
Income (loss) before tax	367,201	11.8	(51,902,915)	(309.5)	(169,268,799)	(513.3)
Provision for income tax	(34,464)	(1.1)	(71,338)	(0.4)	—	—
Net income (loss)	332,737	10.7	(51,974,253)	(309.9)	(169,268,799)	(513.3)

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

In 2000, revenues from advertising services, e-commerce related services and software licensing and related integration projects constituted 91.2%, 7.4% and 1.4%, respectively, of our total revenues. This compares with 64.4%, 14.6% and 21.0%, respectively, of our total revenues in 1999. Our advertising services revenues increased significantly during 2000 primarily as a result of an increase in advertising activity on the NetEase Web sites. Conversely, revenues from our software licensing and related integration projects decreased as we ceased this line of business but continued to earn fees for post-contract customer support. We introduced our e-commerce related services in the third quarter of 1999, and our revenues from these services declined by less than 1% in 2000. We expect that advertising services will constitute the primary sources of our future revenues.

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 approximately RMB60,000 (US\$7,000) in the first quarter of 2000 to approximately 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. We expect that the online advertising market in China will continue to grow as Internet usage in China increases and as more companies accept the Internet as an effective advertising medium.

Revenues from e-commerce related 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, our 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 pre-paid 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, and we expect these revenues to continue to decrease in the future.

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, our gross profit (loss) decreased to RMB(9.4) million (US\$(1.1) million) in 2000, compared with a gross profit of RMB3.5 million (US\$0.4 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. We expect that staff costs as a percentage of our total cost of revenues will remain the same in the near term.

Depreciation and amortization of computers and software comprised 17.2% of our total cost of revenues in 2000, compared with 8.0% in 1999. We expect that our planned significant capital expenditures, which are intended to expand and enhance our infrastructure, will continue to increase our depreciation expenses in the near term.

Operating expenses. Operating expenses increased by 226.0% to RMB185.1 million (US\$22.4 million) in 2000 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 (expenses) in 2000 consisted primarily of interest income of RMB27.9 million (US\$3.4 million) and interest expense of RMB2.6 million (US\$0.3 million).

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

Revenues Total revenues increased by 438.3% to RMB16.8 million (US\$2.0 million) in 1999 from RMB3.1 million in 1998. Software licensing and related integration projects accounted for RMB573,000 (US\$69,000) of this increase, primarily due to revenues recognized from increased sales of software licenses in the last half of 1998 and in early 1999, prior to our ceasing software license sales in April 1999. Advertising services accounted for RMB10.6 million (US\$1.3 million) of the increase in total revenues. The growth in advertising services revenues resulted primarily from expanded Internet advertising operations following our establishment of a marketing department in mid-1999 and an increase in advertising activity on the NetEase Web sites. The growth also reflects a full year of advertising services revenues as compared to only one quarter in 1998. E-commerce related services accounted for RMB2.5 million (US\$297,000) of the increase in total revenues. The growth in e-commerce related services revenues reflects our introduction of these services in July 1999.

Cost of revenues. Our cost of revenues increased by 917.2% to RMB12.1 million (US\$1.5 million) in 1999 from RMB1.2 million in 1998, primarily due to the overall expansion of our business, increased staff costs, share compensation costs and increased server custody fees and depreciation as a result of our newly acquired servers. We increased our staff from 10 employees at December 31, 1998 to 137 employees at December 31, 1999. Gross profit as a percentage of total revenues decreased from 54.4% in 1998 to 21.0% in 1999.

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

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

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

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

Liquidity and Capital Resources

Our capital requirements relate primarily to financing:

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

Cash used in operating activities was RMB124.7 million (US\$15.1 million) in 2000 and RMB15.7 million in 1999. In 1998, cash provided by operating activities was RMB1.2 million. In 2000, cash used in operating activities consisted primarily of our operating loss and increases in 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, offset in part by increases in accounts payable, salary and welfare payable, taxes payable and other accrued liabilities. In 1998, the net cash provided by operating activities consisted primarily of our operating profit, increases in accounts payable, salary and welfare payable, taxes payable and other accrued liabilities and an increase in deferred revenue, offset in part by increases in accounts receivable, and other current assets.

Cash used in investing activities was RMB53.0 million (US\$6.4 million) in 2000, RMB9.3 million in 1999 and RMB1.1 million in 1998. 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 operating activities. Our investment in convertible preference shares resulted from our joint venture with EachNet, a private Internet based auction company. In 1999 and 1998, cash used in investing activities was all used to acquire property, plant and equipment.

Cash provided by financing activities was RMB904.9 million (US\$109.3 million) in 2000, RMB142.6 million in 1999 and zero in 1998. Substantially all of our cash is kept in U.S. dollars. The increase in cash provided by financing activities is primarily due to the net proceeds from our issuance of Series B preference shares in March 2000 of RMB283.5 million (US\$34.3 million) and our initial public offering in June 2000 of RMB508.7 million (US\$61.5 million) and proceeds from bank loans totaling RMB112.6 million (US\$13.6 million). Our bank loans are Renminbi-denominated loans with one-year maturity and interest rate of 5.85% per annum. We borrow Renminbi for our working capital purposes.

We had no material commitments for capital expenditures as of December 31, 2000. We have spent approximately RMB15.0 million (US\$1.8 million) as of July 31, 2001, principally for purchases of additional servers, switches and software in order to accommodate the expected increase in traffic on the NetEase Web sites. Our capital expenditure plans for the remainder of 2001 have not yet been fixed. We believe that our existing cash resources, the capital inflows from planned additional financing and cash generated from revenue growth will be sufficient for us to meet our obligations through at least December 31, 2001.

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 1998, 1999 and 2000, we spent RMB1.0 million, RMB5.7 million and RMB14.8 million, respectively, on company-sponsored research and development activities.

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. A substantial portion of 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\$16.3 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 June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, or SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." This statement requires companies to record all derivatives on the balance sheet as assets or liabilities measured at fair value. Gains and losses resulting from changes in fair market values of those derivative instruments would be accounted for depending on the use of the instrument and whether it qualifies for hedge accounting. SFAS 133 will be effective for our company's year ending December 31, 2001. In June 2000, the Financial Accounting Standards Board issued SFAS No. 138, "Accounting for Derivatives Instruments and Hedging Activities, An Amendment of FASB Statement No. 133." SFAS No. 138 amends the accounting and reporting standards for certain derivatives and hedging activities such as net settlement contracts, foreign currency transactions and intercompany derivatives. We do not expect that the implementation of SFAS 133 will have a significant impact on our financial position, results of operations or cash flows.

Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events from the period of inception to December 31, 2000 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 condition.

Our monthly expenditures and fixed costs have decreased in the first six months of 2001. This decrease was due to the continuing decrease in bandwidth costs and hardware costs and the resignations of some senior managers during this period. In addition, to control costs, we have reduced the financial and other resources devoted to our marketing and branding efforts. We cannot be certain that this trend of decreasing expenses will continue or even remain at this level in future periods, particularly if we successfully expand our management team as discussed in Item 3.D “Risk Factors.”

Item 6. Directors, Senior Management and Employees

A. Directors and Senior Management

The names of our directors, as well as our other executive officers, their ages as of July 31, 2001 and the principal positions with NetEase.com held by them are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
William Lei Ding (1)	29	Director; Chairman of the Board, acting Chief Executive Officer, acting Chief Operating Officer and Chief Architect
Helen Haiwen He (2)	32	Director
Ted Sun (3)	33	Director
Mary Nee (4)	39	Director
Kathy Xin Xu (4)	34	Director
Michael Sui Bau Tong (4)	30	Director
Lawrence Joseph Smith	45	Director
Geoffrey Jie Wei (5)	33	Interim Chief Financial Officer
Jack L. Xu	33	Chief Technology Officer

- (1) Mr. Ding assumed the positions of acting Chief Executive Officer and acting Chief Operating Officer on June 11, 2001.
- (2) Ms. He resigned from the position of Chief Financial Officer on January 31, 2001. We retained Ms. He as one of our strategic advisors for three months ending April 30, 2001. Ms. He resigned as a director on August 28, 2001.
- (3) Mr. Sun has also served as a consultant to our company since July 2001.
- (4) Member of the Compensation Committee and the Audit Committee.
- (5) Mr. Wei assumed the position of interim Chief Financial Officer on January 31, 2001.

The foregoing directors will hold office until the next annual general meeting of shareholders and until such director’s successor is elected and duly qualified, or until such director’s earlier death, bankruptcy, insanity, resignation or removal. There are no family relationships among any of the directors or executive officers of our company.

King F. Lai resigned from the positions of director and Chief Executive Officer on June 11, 2001 and Susan Chen resigned as Chief Operating Officer on June 11, 2001. William Lei Ding, our founder, Chairman of the Board, Chief Architect and majority shareholder, has assumed the positions of acting Chief Executive Officer and acting Chief Operating Officer.

The News Corporation Limited has the right to nominate one director to our board, and upon nomination, certain of our shareholders holding a majority of our outstanding shares are obliged to vote

their shares in favor of such nominated director. See Item 7.B. “Related Party Transactions” in this annual report. Lawrence Smith was nominated and elected to our board in this manner.

Biographical Information

William Lei Ding, our founder, has served as director and Chairman of the Board since July 1999, as our Chief Architect since March 2001 and as our acting Chief Executive Officer and acting Chief Operating Officer since June 11, 2001. From July 1999 to March 2001, Mr. Ding served as Co-Chief Technology Officer, and from July 1999 to April 1, 2000, he also served as our interim Chief Executive Officer. Mr. Ding established Guangzhou NetEase, our affiliate, in May 1997. Prior to establishing Guangzhou NetEase, Mr. Ding spent one year at Guangzhou Feijie Co. as a systems analyst, from June 1996 to April 1997, one year at Sybase (China) as a project manager, from May 1995 to May 1996, and two years at China Telecom Ningbo Branch as a technical engineer, from July 1993 to May 1995. Mr. Ding holds a Bachelor of Science degree in Communication Technology from the University of Electronic Science and Technology of China.

Helen Haiwen He has served as our director from August 1999 until August 28, 2001. She served as our Chief Financial Officer from August 1999 to January 31, 2001 and as one of our strategic advisors from February 1, 2001 to April 30, 2001. Prior to joining NetEase, Ms. He spent five years as an investment banker at Bear, Stearns & Co. Inc. focusing on the Greater China market and the Asian technology industry, including the Internet sector. Ms. He holds a Master of Science in Computer Science from the University of Arizona and a Bachelor of Science degree in Computer Science from Tianjin University. Ms. He is also a Chartered Financial Analyst.

Ted Sun has served as our director since December 1999 and as a consultant to our company since July 2001. From July 2000 to the present, Mr. Sun has served as the Chief Financial Officer of Infoserve Technology Corporation. Mr. Sun held various positions, ultimately serving as a Managing Director, with Bear Stearns Asia Limited from November 1996 to May 2000. Prior to November 1996, Mr. Sun was an assistant director with Peregrine Capital Limited. Mr. Sun holds a Bachelor of Science degree in Economics from the Wharton School of Business, University of Pennsylvania.

Mary Nee has served as our director since February 2001 when she was appointed by our board to replace Xiang-Dong Yang who resigned at that same time. From June 2000 to the present, Ms. Nee has served as chief financial officer in the principal investment area of Goldman Sachs (Asia) L.L.C. Prior to June 2000, Ms. Nee worked in sales within the fixed income area of Goldman Sachs (Asia) L.L.C. She is also a director of Yue Yuen Industrial (Holdings) Limited and Hung Hing Printing Group Limited. Ms. Nee holds a Bachelor of Science degree in electrical engineering from the Columbia School of Engineering and Applied Sciences and a Masters of Business Administration from the Columbia Business School.

Kathy Xin Xu has served as our director since December 1999. Since 1998, Ms. Xu has been a Partner of Baring Private Equity Partners (Hong Kong) Ltd., an Asian venture capital firm specializing in information technology. At Baring, Ms. Xu has led the firm’s investments in several successful companies, including Vanda System, Comtech, and Netstar. Prior to working with Baring, she served as an investment manager for Peregrine Direct Investments Limited from March 1995 to January 1998 and was a senior accountant for Price Waterhouse from January 1992 to January 1995, both in Hong Kong. Ms. Xu holds a Bachelor of Arts degree in English literature from Nanjing University. She is qualified in the UK as a Certified Chartered Accountant.

Michael Sui Bau Tong has served as our director since December 1999. Since December 2000, Mr. Tong has been a director of techpacific Venture Capital Limited, a Hong Kong-based venture capital

firm, and from July 1999 to December 2000, he served as a manager in charge of venture capital investment for Softbank China Venture Investments Limited, where he evaluated and monitored Softbank China Venture's investments. Previously, he served as a manager in charge of venture capital investment for Nomura China Venture Investments Limited from 1996 to 1999 and served as an executive officer for Jardine Fleming Securities Company Limited from 1995 to 1996. Mr. Tong holds a Bachelor of Business Administration degree in Accounting from the University of Wisconsin.

Lawrence Joseph Smith has served as our director since October 2000. In January 1998, Mr. Smith was appointed Director, Business Development (later to become Chief Representative) of the Beijing Representative Office of News Corporation Limited with responsibility for new business development and coordination of the activities of The News Corporation Limited and its affiliates in China. In September 2000, he was also appointed Executive Vice President (China) of STAR TV Hong Kong with responsibility for STAR TV's China-related business. Prior to January 1998, he was responsible for business development and government relations in China for News Corporation and a



number of its operating subsidiaries. Mr. Smith holds a Bachelor of Science degree in statistics and mathematics from Melbourne University.

Geoffrey Jie Wei joined our company as Vice President and Chief Accountant in February 2000 and became our interim Chief Financial Officer on January 31, 2001, following Helen Haiwen He's resignation from that position. From August 1994 to his appointment to our company, he was a manager in the Audit Department at PricewaterhouseCoopers in its Beijing office. Mr. Wei graduated from the Beijing Polytechnic University with two Bachelor of Science degrees, one in Automatic Control and another in Business Administration.

Jack L. Xu joined our company as Co-Chief Technology Officer in May 2000 and became Chief Technology Officer in March 2001. Mr. Xu served as director of technology at Excite@Home Corporation from July 1999 to May 2000. Before joining Excite@Home, Mr. Xu served as Senior Scientist and Senior Engineering Manager with Excite Incorporated from November 1996 to June 1999. Prior joining Excite Incorporated, he worked as a senior researcher at the University of California at Berkeley. Mr. Xu was a Ph.D. candidate in Information Management and Systems at the University of California at Berkeley. He holds both a Bachelor of Arts and a Master of Science degree in Information Science from Zhongshan University.

B. Compensation

We did not pay any cash compensation to our non-executive directors in 2000. For the year ended December 31, 2000, options to acquire an aggregate of 58,812,500 ordinary shares were granted to our directors as a group.

All of our directors have entered into indemnification agreements in which we agree to indemnify, to the fullest extent allowed by Cayman Islands law, our charter documents or other applicable law, those directors from any liability or expenses, unless the liability or expense arises from the director's own willful negligence or willful default. The indemnification agreements also specify the procedures to be followed with respect to indemnification.

Directors' and Officers' Liability Insurance

We have obtained directors' and officers' liability insurance on behalf of our directors and officers who are residents of the United States.

Executive Officer Compensation

The following table sets forth certain information concerning compensation paid during 2000 to our executive officers:

<u>Name and Principal Position</u>	<u>Fiscal Year</u>	<u>Annual Compensation</u>		<u>Long-Term Compensation</u>	<u>All Other Compensation</u>
		<u>Salary</u>	<u>Bonus</u>	<u>Securities Underlying Options (#)</u>	
		<u>(\$)</u>	<u>\$(1)</u>		<u>(\$)</u>
King F. Lai (2) Chief Executive Officer	2000	262,254	162,000	57,612,500	37,746 (3)
William Lei Ding (4) Chairman of the Board, acting Chief Executive Officer, acting Chief Operating Officer and Chief Architect	2000	85,000	—	—	14,444
Helen Haiwen He (5) Chief Financial Officer	2000	85,000	85,000	—	12,083 (6)
Jack L. Xu (7) Chief Technology Officer	2000	119,736	30,000	33,605,500	12,300 (8)
Susan Chen (9) Chief Operating Officer	2000	119,916	30,000	28,806,300	15,500 (10)

(1) Includes bonus amounts in the year earned, rather than in the year in which such bonus amount was paid or is to be paid.

(2) Mr. Lai served as our Chief Executive Officer from April 1, 2000 to June 11, 2001.

(3) Includes a US\$20,151 housing and auto allowance, plus US\$17,595 in tuition for a family

- member of Mr. Lai.
- (4) Mr. Ding served as our interim Chief Executive Officer from July 1999 to April 1, 2000. Since that time, he has served as our Chairman. He was also our Co-Chief Technology Officer until March 2001, at which time he became our Chief Architect. On June 11, 2001, Mr. Ding also assumed the positions of acting Chief Executive Officer and acting Chief Operating Officer.
 - (5) Ms. He served as our Chief Financial Officer from August 1999 to January 31, 2001 but remained as a director until August 28, 2001. Mr. Geoffrey Jie Wei has been serving as our interim Chief Financial Officer since Ms. He's resignation.
 - (6) Represents payment for Ms. He's unused vacation time in 2000.
 - (7) Mr. Xu joined our company as Co-Chief Technology Officer in May 2000.
 - (8) Represents a housing allowance paid by our company on behalf of Mr. Xu.
 - (9) Ms. Chen served as our Chief Operating Officer from June 2000 to June 11, 2001.
 - (10) This amount was paid to Ms. Chen as a housing allowance.

Employment Agreements

We have entered into employment agreements with William Lei Ding, Jack Xu and Geoffrey Jie Wei and non-competition agreements with Jack Xu, Geoffrey Jie Wei, King F. Lai and Susan Chen, as described below. We have also entered into settlement agreements with King F. Lai and Susan Chen to confirm the termination of their employment upon their resignation as Chief Executive Officer and Chief Operating Officer, respectively, on June 11, 2001. Helen Haiwen He's employment contract with our company terminated upon her resignation as our Chief Financial Officer on January 31, 2001. Commencing on February 1, 2001, Ms. He served as one of our strategic advisors pursuant to a three-month consulting agreement with our company. This consulting agreement terminated on April 30, 2001 and was not renewed.

William Lei Ding. In August 1999, we entered into an employment agreement with Mr. Ding which provides for an initial annual salary of US\$85,000, plus a discretionary bonus, if any. This salary is subject to board review at least once a year. Mr. Ding is also entitled to a housing allowance in an amount to be agreed upon by Mr. Ding and our company on an annual basis. Under this employment agreement, Mr. Ding is obligated to keep all proprietary information regarding our company confidential, except in limited circumstances. He is further precluded during his employment with us from carrying on or being employed by any business in China which is in competition with us or, directly or indirectly, solicit away from our company any of our existing or prospective clients or customers.

Jack L. Xu. In March 2000, we entered into an employment agreement with Mr. Xu which provides for an initial annual salary of US\$185,000 per year, plus a US\$20,000 signing bonus. He is also entitled to receive a housing allowance of up to US\$1,500 per month for a residence in Beijing. In addition, Mr. Xu was granted options to purchase 25,605,500 of our ordinary shares at an exercise price of US\$0.1562 per share under this agreement. These options vest over a period of three years at the rate of 33% on the first anniversary of his employment agreement and 2.78% on each of the following 24 months. If we terminate Mr. Xu's employment without cause at any time, the shares that would have been vested within the next six months after termination will automatically vest at the time of termination. Furthermore, if there is a change of control transaction involving our company, the vesting of Mr. Xu's options will accelerate so that all unvested options will become vested immediately prior to the completion of that transaction. In addition, if we terminate Mr. Xu without cause, we must pay him a lump sum severance equal to three month's salary.

We also entered into a non-competition agreement with Mr. Xu which obligates Mr. Xu to keep all proprietary information regarding our company confidential, except in limited circumstances. This agreement also prohibits Mr. Xu from obtaining an ownership interest in (unless the total investment

represents less than 5% of the total equity of the competitor), or employment with, any of our competitors during his employment with us and for one year thereafter. During that same period, he may not solicit or encourage any of our officers or employees to terminate their employment with us, except when done in the course of his job with our company.

Geoffrey Jie Wei. In February 2000, we entered into an employment agreement with Mr. Wei which provides for an initial salary of RMB37,500 per month. This salary is subject to a board review once a year. Either we or Mr. Wei may terminate the agreement by giving one month notice to the other party.

Mr. Wei also entered into a non-competition agreement with substantially the same terms as Mr. Xu's non-competition agreement.

King F. Lai On June 11, 2001, we entered into a settlement agreement and general release with Mr. Lai relating to the termination of his employment. As a result of this settlement agreement, Mr. Lai's options to acquire our shares were terminated as of June 11, 2001.

The non-competition agreement between our company and Mr. Lai remains in effect. This agreement obligates Mr. Lai to keep all proprietary information regarding our company confidential, except in limited circumstances. This agreement also prohibits Mr. Lai from obtaining an ownership interest in (unless the total investment represents less than 5% of the total equity of the competitor), or employment with, any of our competitors until June 10, 2002, which is one year after the termination of his employment. Furthermore, until June 10, 2002, he may not solicit or encourage any of our officers or employees to terminate their employment with us.

Susan Chen. On June 11, 2001, we entered into a settlement agreement and general release with Ms. Chen relating to the termination of her employment. As a result of this settlement agreement, Ms. Chen's options to acquire our shares were terminated as of June 11, 2001. Ms. Chen also entered into a non-competition agreement with substantially the same terms as Mr. Lai's non-competition agreement and it also remains in effect.

Option Grants in Last Fiscal Year

The following table sets forth information regarding stock options granted to our executive officers during 2000:

Individual Grants						
<u>Name</u>	<u>Number of Securities Underlying Options Granted</u>	% of Total	<u>Exercise Price per Share (2)</u>	<u>Expiration Date</u>	Potential Realizable Value at Assumed Annual Rate of Stock Price Appreciation for <u>Option Term (3)</u>	
		<u>Options Granted to Employees in Fiscal Year (1)</u>			<u>5%</u>	<u>10%</u>
King F. Lai (4)	57,612,500	24.65%	US\$0.08	March 3, 2010	US\$2,897,909	US\$7,345,594
William Lei Ding	—	—	—	—	—	—
Helen Haiwen He	—	—	—	—	—	—
Jack L. Xu (5)	25,605,500	10.96%	US\$0.1562	March 24, 2010	US\$2,514,460	US\$6,373,209
	8,000,000	3.42%	US\$0.05	March 24, 2010	US\$251,200	US\$637,600
Susan Chen (6)	28,806,300	12.33%	US\$0.10	June 25, 2010	US\$1,811,613	US\$4,590,982
Geoffrey Jie Wei (7)	2,000,000	0.86%	US\$0.10	February 1, 2006	US\$68,000	US\$154,400

- (1) Based on a total of 233,694,300 options granted to employees of NetEase in 2000, including our named executive officers.
- (2) The exercise price per share of options granted represented the fair market value of the underlying shares of ordinary shares on the date the options were granted.
- (3) The potential realizable value is calculated based upon the term of the option at its time of grant. It is calculated assuming that the stock price on the date of grant appreciates at the indicated annual rate, compounded annually for the entire term of the option, and that the option is exercised and sold on the last day of its term for the appreciated stock price.
- (4) All of Mr. Lai's vested and unvested options were cancelled pursuant to his settlement agreement with us.
- (5) One-third of Mr. Xu's options vested on March 24, 2001. The remaining options shall vest in equal monthly installments of 2.78% for the two year period following March 24, 2001. The vesting of these options may also accelerate in certain circumstances.
- (6) All of Ms. Chen's vested and unvested options were cancelled pursuant to her settlement agreement with us.
- (7) One-fifth of Mr. Wei's options vested on February 1, 2001 with the same amount vesting on February 1, 2002. Thereafter, 30% of the options will vest on each of February 1, 2003 and 2004. The vesting of these options may also accelerate in certain circumstances. Mr. Wei has served as our Vice President and Chief Accountant and was appointed as our interim Chief Financial Officer on January 31, 2001. Mr. Wei was not an executive officer of NetEase in 2000.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

The following table sets forth certain information with respect to stock options exercised by our executive officers during 2000. In addition, the table sets forth the number of shares covered by stock options as of December 31, 2000, and the value of "in-the-money" stock options, which represents the

difference between the exercise price of a stock option and the market price of the shares subject to such option on December 31, 2000.

<u>Name</u>	<u>Shares Acquired on Exercise</u>	<u>Value Realized (\$)(1)</u>	<u>Number of Securities Underlying Unexercised Options at December 31, 2000 (#)</u>		<u>Value of Unexercised In-the-Money Options at December 31, 2000 (\$)(2)</u>	
			<u>Exercisable</u>	<u>Unexercisable</u>	<u>Exercisable</u>	<u>Unexercisable</u>
King F. Lai (3)	—	—	—	57,612,500	—	—
William Lei Ding	—	—	—	—	—	—
Helen Haiwen He(4)	—	—	24,197,250	10,370,250	—	—
Jack L. Xu	—	—	—	33,605,500	—	—
Susan Chen (5)	—	—	—	28,806,300	—	—
Geoffrey Jie Wei (6)	—	—	—	2,000,000	—	—

- (1) The value realized upon the exercise of stock options represents the positive spread between the exercise price of stock options and the fair market of the shares subject to such options on the exercise date. However, during 2000, no options were exercised by the Named Executive Officers so no value was realized by any of those officers.
- (2) No unexercised options of the Named Executive Officers were in-the-money as of December 31, 2000.
- (3) As a result of his settlement agreement with us, all of Mr. Lai's stock options were cancelled as of June 11, 2001.
- (4) As a result of her resignation as Chief Financial Officer on January 31, 2001, all of Ms. He's stock options expired on July 31, 2001.
- (5) As a result of her settlement agreement with us, all of Ms. Chen's stock options were cancelled as of June 11, 2001.
- (6) Mr. Wei has served as our Vice President and Chief Accountant and was appointed as our interim Chief Financial Officer on January 31, 2001. Mr. Wei was not an executive officer of NetEase in 2000.

Amended and Restated 2000 Stock Incentive Plan

General

Our shareholders approved the NetEase.com, Inc. Amended and Restated 2000 Stock Incentive Plan, or the Amended Plan, at our annual general meeting held on May 25, 2001. The Amended Plan replaced the 2000 Stock Incentive Plan, or the Prior Plan, in its entirety. Under the Prior Plan, a total of 223,715,000 of our ordinary shares were reserved for issuance. The Amended Plan increased the number of ordinary shares reserved for issuance to 323,715,000.

The purpose of the Amended Plan is to attract and retain the best available personnel, to provide additional incentive to employees, directors and consultants and to promote the success of our business. Our board of directors believes that our company's long term success is dependent upon our ability to attract and retain superior individuals who, by virtue of their ability and qualifications, make important contributions to our business. The Amended Plan provides for the granting of incentive awards of our ordinary shares, options to purchase our ordinary shares and any other securities the value of which is derived from the value of our ordinary shares.

Grantees under the Amended Plan will not receive any account status reports. The Amended Plan is not subject to the U.S. Employee Retirement Income Security Act of 1974, as amended, nor is the Amended Plan a “qualified plan” within the meaning of Section 401(a) of the Code.

The Amended Plan continues to be administered by our board, and our board has designated its Compensation Committee to exercise its authority thereunder.

The Amended Plan provides that in the event of certain corporate transactions, including specified types of reorganizations and acquisition transactions, each outstanding award granted under the Amended Plan shall automatically become fully vested and exercisable and be released from any restrictions in transfer (other than transfer restrictions applicable to the award) and repurchase or forfeiture rights, immediately prior to the specified effective date of such corporate transaction, unless the award is assumed by the successor company or its parent company in connection with the corporate transaction. Upon consummation of such corporate transactions, each outstanding award shall be terminated unless the award is assumed by the successor company or its parent company in connection with the applicable corporate transaction. The Compensation Committee will determine whether an award was assumed in the manner contemplated by the Amended Plan.

Under the Amended Plan, awards can be issued to employees, directors or consultants of the company or our subsidiaries, although ISOs may only be issued to our employees or the employees of our subsidiaries.

Awards under the Amended Plan are evidenced by an award agreement which contains, among other things, provisions concerning exercisability and forfeiture upon termination of employment or consulting arrangement (by reason of death, disability, retirement or otherwise) as have been determined by our board. In addition, the award agreement also specifies whether the option constitutes an ISO or a non-incentive stock option, referred to as NQSOs, and may, but need not, include a provision whereby a grantee may at any time during his or her employment with us exercise any part or all of the award prior to full vesting of the award.

An option may be exercised by delivering written notice of such exercise to us. The option price to exercise the option for our ordinary shares must be paid at the time of exercise in full in cash or in check under the Amended Plan, or, in whole ordinary shares with a fair market value at least equal to the option price (or in another appropriate manner approved by us, such as in a combination of cash and whole ordinary shares or by cashless exercise of options through a broker-dealer).

Under the Amended Plan, the exercise price for the options is specified in the award agreement for those options. In any event, the exercise price of ISOs cannot be less than the fair market value of our ordinary shares on the date of grant. However, in the case of an ISO granted to a grantee, who, at the time the ISO was granted, owned stock possessing more than 10% of the combined voting power of all classes of our share capital, the option price may not be less than 110% of the fair market value of our ordinary shares on the date of grant of such ISO. To the extent that the aggregate fair market value of shares subject to options granted as ISOs under the Amended Plan which become exercisable for the first time by a recipient during any calendar year exceeds US\$100,000, then options represented by ordinary shares in excess of the US\$100,000 limitation shall be treated as NQSOs.

NQSOs granted pursuant to the Amended Plan can have an exercise price of no less than 85% of the fair market value of our ordinary shares on the date of grant.

In the event of any extraordinary dividend, share dividend, recapitalization, share split, rights issuance, or combination or exchange of such shares, or other similar transactions, our board may

equitably adjust the option price of our outstanding options so as to reflect such event.

The term of all ISOs and NQSOs will be stated in the applicable award agreement. The term of an ISO granted to a person, who, at the time the ISO was granted, owned stock possessing more than 10% of the combined voting power of all classes of our share capital, may not be more than five (5) years from the date of the grant of the award. As of March 31, 2001, all outstanding awards granted under the Prior Plan have a term of not more than 10 years from the date such options were awarded.

Under the Amended Plan, if the employment, director or consultant relationship of a grantee with us terminates for cause, the grantee's right to exercise the option will expire upon the termination of such relationship. If the employment, director or consultant relationship of a grantee with us terminates without cause, all options then exercisable may be exercised within six months of the date of such termination or such shorter period as may be specified in the award agreement. Any ISO granted under the Amended Plan, if not exercised within the time period provided by law for the exercise of ISOs following the termination of a grantee's employment with us, shall automatically convert to a NQSO thereafter. If the termination of a grantee's employment, director or consultant relationship with us is (i) by reason of death or (ii) by reason of disability, all options then exercisable may be exercised by such grantee, such grantee's estate or by a person who acquired the right of exercise of such options by bequest or inheritance or otherwise by reason of death or disability of such grantee, at any time within a period not less than 12 months (but in no event later than the expiration date of the options) after the date of such termination.

Under the Amended Plan, our board may at any time terminate, suspend, or amend the Amended Plan in any respect, except that no termination, suspension or amendment will be effective without shareholder approval if such approval is required to comply with any law, regulation or stock exchange rule and no such change may adversely affect any award previously granted without the written consent of the recipient. The Amended Plan will expire in February 2010.

C. Board Practices

Committees of the Board of Directors

During the year 2000, our board met in person or passed resolutions by unanimous written consent thirteen times. No director attended fewer than 75% of all the meetings of our board and its committees on which he or she served after becoming a member of our board.

Our board has two committees: the Audit Committee and the Compensation Committee. Our board does not have a nominating committee or a committee performing the functions of a nominating committee.

In 2000, the Audit Committee, which met once in that year, consisted of Xiang-Dong Yang, Kathy Xin Xu and Michael Sui Bau Tong. In February 26, 2001, Xiang-Dong Yang resigned from our board, at which time the board appointed Mary Nee to our board and the Audit Committee (as well as the Compensation Committee) in order to fill this vacancy. Each member of our Audit Committee satisfies the "independence" requirements of the NASD listing standards. The Audit Committee reports to our board regarding the appointment of our independent public accountants, the scope and results of our annual audits, compliance with our accounting and financial policies and management's procedures and policies relative to the adequacy of our internal accounting controls. On May 12, 2000, our board adopted an Audit Committee Charter in accordance with the NASD listing standards.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee, which met twice in 2000, has the same members as the Audit Committee (with Ms. Nee replacing Mr. Yang upon his resignation from the board). The Compensation Committee's functions are to review and make recommendations to our board regarding our compensation policies and all forms of compensation to be provided to our executive officers and directors. In addition, the Compensation Committee reviews bonus and stock compensation arrangements for all of our other employees. No interlocking relationships currently exist or have existed between our board of directors or Compensation Committee and the board of directors or Compensation Committee of any other company.

D. Employees

At December 31, we had 10, 137, 288 employees for the years 1998, 1999 and 2000, respectively. As of July 31, 2001, we had 325 employees, including 88 in media, 136 in technology, 26 in sales, 8 in marketing, 13 in business development, 6 in e-commerce, 10 in customer service, 16 in accounting, 2 in corporate finance, 2 in investor relations, 10 in administration, and 8 in human resources. None of our employees are represented by a labor union.

E. Share Ownership

The following table sets forth certain information known to us with respect to the beneficial ownership as of July 31, 2001 by:

- all persons who are beneficial owners of five percent or more of our ordinary shares,
- each director and nominee,
- our named executive officers, and
- all current directors and executive officers as a group.

As of July 31, 2001, 3,010,776,162 shares of our ordinary shares were outstanding. The amounts and percentages of ordinary shares beneficially owned are reported on the basis of regulations of the Securities and Exchange Commission, or the Commission, governing the determination of beneficial ownership of securities. Under the rules of the Commission, a person is deemed to be a "beneficial owner" of a security if that person has or shares "voting power," which includes the power to vote or to direct the voting of such security, or "investment power," which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. Under these rules, more than one person may be deemed a beneficial owner of securities as to which such person has no economic interest.

Name	Number of Shares Beneficially Owned	
	Number	Percentage
5% Stockholders		
Shining Globe International Limited/William Lei Ding (1)	1,748,419,900	58.1%
15th Floor, North Tower, Beijing Kerry Centre, No. 1 Guang Hua Road Chao Yang District, Beijing 100020, P.R.C.		
Best Alliance Profits Limited (2)	256,055,600	8.5%
c/o The News Corporation Limited 1211 Avenue of the Americas		

New York, NY 10036

Named Executive Officers and Directors (3)

Dawn Technology Limited/Helen Haiwen He (4).....	44,090,000	1.5%
Jack L. Xu (5).....	24,318,019	*
Mary Nee (6).....	—	*
Ted Sun (7).....	960,000	*
Kathy Xin Xu	1,923,000	*
Michael Sui Bau Tong	700,000	*
Lawrence Joseph Smith	—	*
Geoffrey Jie Wei (8).....	400,000	*
All directors and executive officers as a group (11 persons) (9)	2,076,866,519	62.5%

* Less than 1%

- (1) Shining Globe International Limited is 100% owned by William Lei Ding, our founder, Chairman of the Board, acting Chief Executive Officer, acting Chief Operating Officer, Chief Architect and majority shareholder.
- (2) Best Alliance Profits Limited is controlled by The News Corporation Limited.
- (3) The address of our Named Executive Officers and directors is c/o NetEase.com, Inc., 15th Floor, North Tower, Beijing Kerry Centre, No. 1 Guang Hua Road, Chao Yang District, Beijing, People's Republic of China.
- (4) Dawn Technology Limited is 100% owned by Helen Haiwen He, one of our directors until her resignation on August 28, 2001.
- (5) Represents shares subject to stock options currently exercisable or exercisable within 60 days of July 31, 2001. Of this amount, Mr. Xu may acquire (a) 7,521,990 of our ordinary shares at an exercise price of \$0.015625 per share until that option's expiration on March 8, 2011, (b) 3,998,400 of our ordinary shares at an exercise price of \$0.05 per share until that option's expiration on August 16, 2010, and (c) 12,797,629 of our ordinary shares at an exercise price of \$0.1562 per share until that option's expiration on March 24, 2010.
- (6) The Goldman Sachs Group, Inc., which is affiliated with Ms. Nee's employer, directly owns 100,000,000 of our ordinary shares.
- (7) Represents shares subject to stock options currently exercisable or exercisable within 60 days of July 31, 2001. These options may be exercised at a per share price of \$0.10 until their expiration on February 1, 2005.
- (8) Represents shares subject to stock options currently exercisable or exercisable within 60 days of July 31, 2001. These options may be exercised at a per share price of \$0.10 until their expiration on February 1, 2006.
- (9) Shares owned by all of our directors and executive officers as a group includes shares beneficially owned by William Lei Ding. This amount also includes 25,678,019 shares subject to stock options currently exercisable or exercisable within 60 days of July 31, 2001.

Item 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

Please refer to Item 6. "Directors, Senior Management and Employees—Share Ownership."

B. Related Party Transactions

Our business was founded in June 1997. In July 1999, we established a new holding company,

NetEase.com, Inc., in the Cayman Islands. In September 1999, we restructured our operations in order to comply with increasing regulation of the Internet industry in China. As part of this restructuring, substantially all of Guangzhou NetEase Computer System Co., Ltd.'s, or Guangzhou NetEase, fixed and intangible assets and existing Internet applications, services and technologies were acquired by NetEase Information Technology (Beijing) Co., Ltd., or NetEase Beijing, a wholly owned subsidiary of NetEase formed in August 1999. Guangzhou NetEase, which is 80% owned by our founder, Chairman of the Board, acting Chief Executive Officer, acting Chief Operating Officer, Chief Architect and majority shareholder, William Lei Ding, has received approval from the Guangzhou telecommunications administrative authorities to provide Internet content services, and its 80% owned subsidiary, Beijing Guangyitong Advertising Co., Ltd., or Guangyitong Advertising, holds a license to operate an advertising business.

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

- *Domain Name License Agreement between NetEase and Guangzhou NetEase.* NetEase granted Guangzhou NetEase the right to use the domain names "netease.com," "163.com," "126.com," "yeah.net" and "nease.net" on the NetEase Web sites in China for license fees of RMB10,000 per year. NetEase may waive this fee in the future. By a Supplemental Agreement entered into between the parties in May 2000, the term of this agreement has been extended from one year to five years.
- *Copyright License Agreement between NetEase Beijing and Guangzhou NetEase.* NetEase Beijing granted Guangzhou NetEase the right to use NetEase Beijing's Web page layout in China for a royalty of RMB10,000 per year. NetEase Beijing may waive this fee in the future.
- *Trademark License Agreement between NetEase Beijing and Guangzhou NetEase.* NetEase Beijing granted Guangzhou NetEase a license to use NetEase Beijing's registered trademarks on the NetEase Web sites in China for license fees of RMB10,000 per year.

NetEase Beijing may waive this fee in the future.

- *Exclusive Technical Services Master Agreement between NetEase Beijing and Guangzhou NetEase.* NetEase Beijing provides Guangzhou NetEase with technical services for the operation of the NetEase Web sites, including:
 - server maintenance;
 - server application software development;
 - Internet application software development;
 - training; and
 - e-commerce related services.

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

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

- *Exclusive Consulting and Services Agreement between NetEase Beijing and Guangyitong Advertising.* NetEase Beijing provides Guangyitong Advertising with technical consulting and related services for all advertisements published on the NetEase Web sites. Guangyitong Advertising submits designs of advertisements to be published on the NetEase Web sites, and NetEase Beijing completes the related technical work and delivers the completed advertisements to Guangyitong Advertising. Guangyitong Advertising pays fees to NetEase Beijing based on the actual operating circumstances of the parties, which consist of substantially all of Guangyitong Advertising's advertising revenue, net of the related business tax and cultural development fee. NetEase Beijing may unilaterally adjust such fees. NetEase Beijing will be Guangyitong Advertising's exclusive provider of these services. The initial term of this agreement will be 10 years.
- *Exclusive Advertising Agency Agreement between NetEase and Guangzhou NetEase.* Guangzhou NetEase appointed NetEase as its advertising agent to solicit advertising customers on behalf of Guangzhou NetEase in markets outside of China. NetEase pays Guangzhou NetEase 10% of the total advertising revenue under this agreement per month.
- *Online Advertising Agreement between Guangzhou NetEase and Guangyitong Advertising, as amended by a Supplemental Agreement entered into in May 2000.* Guangzhou NetEase sells all of the banner space on the NetEase Web sites to Guangyitong Advertising and publishes the advertisements provided by Guangyitong Advertising on the banner space purchased by Guangyitong Advertising. Guangyitong Advertising pays Guangzhou NetEase RMB 10,000 per year. Guangzhou NetEase may waive this fee in the future. The initial term of this agreement will be 10 years.
- *Trademark Transfer Agreement between Guangzhou NetEase and NetEase Beijing.* Guangzhou NetEase has agreed to transfer its registered trademarks to NetEase Beijing.

- *Supplemental Agreement between NetEase Beijing and Guangzhou NetEase.* NetEase Beijing may not grant the license to use its domain name, copyright and trademark to any third party without Guangzhou NetEase's consent and may not provide technical service to any third party.
- *Operating Agreement among NetEase Beijing, Guangyitong and the ultimate shareholders of Guangyitong Advertising.* To ensure the successful performance of the various agreements between the parties, Guangyitong Advertising and its ultimate shareholders have agreed that they will not enter into any transaction, or fail to take any action, that would substantially affect the assets, liabilities, equity or operations of Guangyitong Advertising without the prior written consent of NetEase Beijing.

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

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

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

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

- *Shareholder Voting Rights Trust Agreement among William Lei Ding, Bo Ding and NetEase Beijing.* Bo Ding irrevocably appoints NetEase Beijing to represent him to exercise all the voting rights to which he is entitled as a shareholder of Guangyitong Advertising and William Lei Ding and Bo Ding agree to cause Guangzhou NetEase to irrevocably appoint NetEase Beijing to represent Guangzhou NetEase to exercise all the voting rights to which Guangzhou NetEase is entitled as a shareholder of Guangyitong Advertising.
- *Termination Agreements between NetEase Beijing and Guangzhou NetEase.* NetEase Beijing and Guangzhou NetEase terminated previously existing contracts related to NetEase Beijing's rights with respect to the operation of Guangzhou NetEase, the lease of equipment from NetEase Beijing to Guangzhou NetEase and the sublease of leased lines from NetEase Beijing to Guangzhou NetEase. Under the Termination Agreements, NetEase Beijing agrees to provide without charge to Guangzhou NetEase equipment related to the operation of Internet information services.
- *Agreement between NetEase Beijing and Guangzhou NetEase.* NetEase Beijing agrees to pay the operating costs of Guangzhou NetEase.
- *Letter of Agreement.* Each of William Lei Ding and Bo Ding have agreed that any

amendments to be made to the Exclusive Consulting and Services Agreement, the Shareholder Voting Rights Trust Agreement, and the Operating Agreement described above, as well as all other agreements to which Guangzhou NetEase, Guangyitong Advertising and/or William Lei Ding and Bo Ding are parties, shall be subject to the approval by the vote of a majority of our board, excluding the vote of William Lei Ding. Messrs. Ding have also agreed that, if any amendments to the above mentioned agreements require a vote of the shareholders of NetEase, Guangzhou NetEase or Guangyitong Advertising, as applicable, both of them will vote in their capacity as direct or indirect shareholders of these companies to act based upon the instructions of our board.

Voting Arrangement. The News Corporation Limited has the right to nominate one director to our board of directors. Upon nomination, certain of our shareholders holding a majority of our outstanding shares, including our largest shareholder, Shining Globe, have agreed to vote their shares in favor of the appointment of The News Corporation's nominated director. The News Corporation's right to nominate one director and certain of our shareholders', including Shining Globe's, agreement to vote their shares in favor of the director nominated by The News Corporation, will be in effect for so long as The News Corporation owns more than 4.25% of our total issued and outstanding share capital. On October 3, 2000, The News Corporation exercised this right and Lawrence Joseph Smith was nominated and elected to our board.

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

Strategic Alliance with The News Corporation. In March 2000, we issued 2,560,556 of our Series B preference shares to Best Alliance Profits Limited, a company controlled by The News Corporation Limited, in exchange for US\$35 million in cash together with on-air advertising and promotional services. In connection with this issuance, we entered into an agreement with News Digital Ventures, an affiliate of The News Corporation Limited, which provides for cooperation between us and The News Corporation. As part of the consideration for the issuance of our Series B preference shares, The News Corporation and its affiliates will provide us with on-air advertising and promotional inventory with a value of US\$5 million on The News Corporation's media properties, including Channel [V], ESPN Star Sports, Phoenix TV and STAR TV. We have agreed to use at least US\$1 million of the inventory within one year, and at least US\$2 million in each of the next two years. As of March 31, 2001, we have used or have contracted to use in the remainder of 2001 the entire US\$1 million of inventory specified above. In addition, The News Corporation and its affiliates will spend US\$5 million on on-line advertising on the NetEase Web sites during this time, including US\$1 million within one year and US\$2 million in each of the next two years. If News Corporation and its affiliates are collectively the largest committed buyer of advertising on the NetEase Web sites, they will be entitled to purchase this advertising on terms that are no less favorable than those that are applicable to any other non-affiliated buyer. 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.

We and The News Corporation will also cross-license Internet tools and technologies on terms to be mutually agreed upon, and will share customer information generated by either party using the

cross-licensed tools and technology. The News Corporation will have a right of first refusal to provide Chinese language content to the NetEase Web sites in the areas of popular music, sports and movies and general entertainment. The News Corporation will offer us the opportunity to participate in cross-promotional and marketing activities, including creating special co-branded marketing and promotional events. Our obligations and The News Corporation's obligations to purchase advertising and promotional inventory from one another, and the arrangements relating to the cross-license of Internet tools and technologies, remain subject to the negotiation of definitive agreements.

Share Transfers to Certain Senior Management Personnel and Key Employees. In 1999, Shining Globe International Limited, which is 100% owned by William Lei Ding, our founder, Chairman of the Board, acting Chief Executive Officer, acting Chief Operating Officer, Chief Architect and majority shareholder, agreed to transfer an aggregate of 109,694,200 ordinary shares to certain senior management personnel and key employees. These share transfers were effected in January 2000. The share transfer commitments were made to provide incentives to senior management personnel and key employees to join our company. The fair market value of these shares as of the date of such agreement (RMB45.4 million or US\$5.5 million) was charged to our earnings in 1999 as share compensation costs in accordance with U.S. GAAP, with a corresponding increase in additional paid-in capital. Furthermore, in March 2000 and January 2001, William Lei Ding transferred 1,945,200 and 8,757,100 shares, respectively, to certain employees.

In addition, Shining Globe has agreed to transfer a total of 9,218,000 ordinary shares for services to be rendered by one of those individuals over the next two years, commencing January 1, 2002. The total estimated fair value of these shares, valued at US\$0.05 per share at the date of grant, is recognized as deferred compensation, which will be amortized over the related vesting periods.

Except for the voting arrangements described above, our major shareholders do not have different voting rights than any of our other shareholders.

Loans and Advances We have entered into loan agreements with five of our employees and other related parties, the proceeds of which loans were used to purchase our ADSs. The loans bear an interest rate of five percent and are due one year from the date of disbursement of loan proceeds. As of July 31, 2001, the amounts disbursed to these five employees were approximately US\$1.0 million in the aggregate. These loans are currently in default by their terms. In addition, we have made certain advances totaling approximately US\$268,000 to William Lei Ding, our founder, Chairman of the Board, acting Chief Executive Officer, acting Chief Operating Officer, Chief Architect and majority shareholder. To date, these advances have not been repaid.

C. Interests of Experts and Counsel

Not applicable.

Item 8. Financial Information

A. Consolidated Statements and Other Financial Information

See Item 18. "Financial Statements" for our audited consolidated financial statements filed as part of this annual report.

Legal Proceedings

We are not a party to any material legal proceedings, nor are there any material legal proceedings pending with respect to any of our properties. We also are not aware of any legal proceedings contemplated by any governmental authorities involving either us or our property. None of our directors, officers or affiliates is an adverse party in any legal proceedings involving NetEase its subsidiaries, or has an interest in any such proceeding which is adverse to NetEase or its subsidiaries.

Dividend Policy

We have never declared or paid any cash dividends on our ordinary shares. We do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain future earnings, if any, to finance operations and the expansion of our business. Any future determination to pay cash dividends will be at the discretion of the board of directors and will be dependent upon our financial condition, operating results, capital requirements and such other factors as the board of directors deems relevant.

B. Significant Changes

We have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

Item 9. The Offer and Listing

Not applicable except for Item 9.A.4. and Item 9.C.

American Depositary Shares, or ADSs, each representing 100 of our ordinary shares, have been listed on the Nasdaq National Market since June 30, 2000. From that date until July 23, 2001, our ADSs have traded under the symbol "NTES." Due to the delay in filing this Form 20-F for 2000, our ADSs have traded on the Nasdaq National Market under the symbol "NTESE" since July 23, 2001.

For the year ended December 31, 2000 (June 30, 2000 through December 31, 2000), the high and low price of our ADSs on Nasdaq has ranged from \$17.25 to \$2.75.

The following table provides the high and low prices for our ADSs on the Nasdaq National Market for (1) each quarter since we completed our initial public offering and (2) each of the most recent six months.

	Sales Price	
	High	Low
Quarterly highs and lows		
Third Quarter 2000	\$15.125	\$4.75
Fourth Quarter 2000	\$6.00	\$2.75
First Quarter 2001	\$3.28125	\$1.00
Monthly highs and lows		
February 2001	2.3125	1.75
March 2001	2.00	1.00
April 2001	1.95	1.12
May 2001	2.00	1.20
June 2001	2.45	1.16
July 2001	1.55	0.51

Item 10. Additional Information

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Our restated memorandum and articles of association are incorporated by reference as noted in Item 19. The following presents a description of the terms and provisions of our restated memorandum and articles of association.

General

We were incorporated in the Cayman Islands on July 6, 1999 and operate under the Cayman Islands Companies Law (2001 Second Revision), or the Companies Law. Our corporate objectives and purpose are unrestricted.

Directors

A director may vote in respect of any contract or transaction in which he is interested provided however that the nature of the interest of any director in any such contract or transaction shall be disclosed by him at or prior to its consideration and any vote on that matter. A general notice or disclosure to the directors or otherwise contained in the minutes of a meeting or a written resolution of the directors or any committee thereof that a director is a shareholder of any specified firm or company and is to be regarded as interested in any transaction with such firm or company shall be sufficient disclosure and after such general notice it shall not be necessary to give special notice relating to any particular transaction.

The directors may determine remuneration to be paid to the directors. The directors may exercise all the powers of our company to borrow money and to mortgage or charge its undertaking, property and uncalled capital or any part thereof, to issue debentures, debenture stock and other securities whenever money is borrowed or as security for any of our debts, liabilities, or obligations or those of any third party.

There are no membership qualifications for directors. Further, there are no share ownership qualifications for directors unless so fixed by us in a general meeting.

Rights, Preferences and Restrictions of Ordinary Shares

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

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

Voting Rights. Each ordinary share is entitled to one vote on all matters upon which the ordinary shares are entitled to vote, including the election of directors. See Item 7.B. “Related Party Transactions—Strategic Alliance with The News Corporation” regarding The News Corporation Limited’s right to nominate a director to our board of directors and the agreement of certain of our shareholders to vote in favor of the election of such director. Voting at any meeting of shareholders is

by show of hands unless a poll is demanded. A poll may be demanded by the Chairman or any other shareholder present in person or by proxy. A quorum required for a meeting of shareholders consists of at least two shareholders present or by proxy.

Any ordinary resolution to be made by the shareholders requires the affirmative vote of a simple majority of the votes attaching to the ordinary shares cast in a general meeting, while a special resolution requires the affirmative vote of no less than two-thirds of the votes cast attaching to the ordinary shares. A special resolution is required for matters such as a change of name. Holders of the ordinary shares may by ordinary resolution, among other things, elect directors, appoint auditors, and make changes in the amount of our authorized share capital.

Liquidation On a return of capital on winding up or otherwise (other than on conversion, redemption or purchase of shares) assets available for distribution among the holders of ordinary shares shall be distributed among the holders of the ordinary shares pro rata. If the assets available for distribution are insufficient to repay all of the paid-up capital, the assets will be distributed so that the losses are borne by our shareholders proportionately.

Calls on Shares and Forfeiture of Shares. Our board of directors may from time to time make calls upon shareholders for any amounts unpaid on their shares in a notice served to such shareholders at least 14 days prior to the specified time and place of payment. The shares that have been called upon and remain unpaid are subject to forfeiture.

Redemption of Shares. We may issue shares on the terms that they are, or at our option or at the option of the holders are, subject to redemption on such terms and in such manner as we may determine by special resolution.

Variations of Rights of Shares

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

General Meetings of Shareholders

The directors may whenever they think fit, and they shall on the requisition of our shareholders holding at the date of the deposit of the requisition not less than one-tenth of our paid-up capital as at the date of the deposit carries the right of voting at general meetings of the Company, proceed to convene a general meeting of the Company. If the directors do not within 21 days from the date of the deposit of the requisition duly proceed to convene a general meeting, the requisitionists, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene a general meeting, but any meeting so convened shall not be held after the expiration of three months after the expiration of such 21 days. Advanced notice of at least five days is required for the convening of the annual general meeting and other shareholders meetings.

Limitations on the Right to Own Shares

There are no limitations on the right to own our shares.

Limitations on Transfer of Shares

There are no provisions in our restated memorandum or articles of association that would have an effect of delaying, deferring or preventing a change in control and that would operate only with respect to a merger, acquisition or corporate restructuring.

Disclosure of Shareholder Ownership

There are no provisions our restated memorandum or articles of association governing the ownership threshold above which shareholder ownership must be disclosed.

Changes in Capital

We may from time to time by ordinary resolution increase the share capital by such sum, to be divided into shares of such amount, as the resolution shall prescribe. The new shares shall be subject to the same provisions with reference to the payment of calls, lien, transfer, transmission, forfeiture and otherwise as the shares in the original share capital. We may by ordinary resolution:

- (a) consolidate and divide all or any of our share capital into shares of larger amount than our existing shares;
- (b) sub-divide our existing shares, or any of them into shares of smaller amount than is fixed by our restated memorandum of association, subject nevertheless to the provisions of Section 12 of the Companies Law;
- (c) cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person.

We may by special resolution reduce our share capital and any capital redemption reserve fund in any manner authorized by law.

Differences in Corporate Law

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

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

- the statutory provisions as to majority vote have been complied with;
- the shareholders have been fairly represented at the meeting in question;

- the arrangement is such as a businessman would reasonably approve; and
- the arrangement is not one that would more properly be sanctioned under some other provision of the Companies Law.

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

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

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

- a company is acting or proposing to act illegally or ultra vires;
- the act complained of, although not ultra vires, could be effected only if authorized by more than a simple majority vote;
- the individual rights of the plaintiff shareholder have been infringed or are about to be infringed; or
- those who control the company are perpetrating a “fraud on the minority.”

Indemnification. Cayman Islands law does not (other than as set forth hereafter) limit the extent to which a company’s organizational documents may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. Our Articles of Association provide for indemnification of officers and directors for losses, damages, costs and expenses incurred in their capacities as such, except through their own willful neglect or default.

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

C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in Item 4. “Information on the Company” or elsewhere in this Form 20-F.

D. Exchange Controls

China's government imposes control over the convertibility of Renminbi into foreign currencies. Under the current unified floating exchange rate system, the People's Bank of China publishes a daily exchange rate for Renminbi, or the PBOC Exchange Rate, based on the previous day's dealings in the inter-bank foreign exchange market. Financial institutions authorized to deal in foreign currency may enter into foreign exchange transactions at exchange rates within an authorized range above or below the PBOC Exchange Rate according to market conditions.

Pursuant to the Foreign Exchange Control Regulations issued by the State Council on April 1, 1996 and the Administration of Settlement, Sale and Payment of Foreign Exchange Regulations which came into effect on July 1, 1996 regarding foreign exchange control, or the Regulations, conversion of Renminbi into foreign exchange by foreign investment enterprises for current account items, including the distribution of dividends and profits to foreign investors of joint ventures, is permissible. Foreign investment enterprises are permitted to remit foreign exchange from their foreign exchange bank account in China on the basis of, inter alia, the terms of the relevant joint venture contracts and the board resolutions declaring the distribution of the dividend and payment of profits. Conversion of Renminbi into foreign currencies and remittance of foreign currencies for capital account items, including direct investment, loans, security investment, is still subject to the approval of the State Administration of Foreign Exchange, or SAFE, in each such transaction. On January 14, 1997, the State Council amended the Foreign Exchange Control Regulations and added, among other things, an important provision, as Article 5 provides that the State shall not impose restrictions on recurring international payments and transfers.

Under the Regulations, foreign investment enterprises are required to open and maintain separate foreign exchange accounts for different types of foreign exchange transactions, and the permitted scope of receipts and expenditures for such accounts is limited to the type of foreign exchange transactions designated for such accounts. In addition, foreign investment enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business upon the production of valid commercial documents and, in the case of capital account item transactions, document approval from the SAFE.

Currently, foreign investment enterprises are required to apply to SAFE for "foreign exchange registration certificates for foreign investment enterprises." With such foreign exchange registration certificates (which are granted to foreign investment enterprises, upon fulfilling specified conditions and which are subject to review and renewal by SAFE on an annual basis) or with the foreign exchange sales notices from the SAFE (which are obtained on a transaction-by-transaction basis), foreign-invested enterprises may enter into foreign exchange transactions at banks authorized to conduct foreign exchange business to obtain foreign exchange for their needs.

E. Taxation

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

Cayman Islands Taxation

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

United States Federal Income Taxation

The following discussion is a summary of the material United States federal income tax considerations that may be relevant to the purchase, ownership or sale of our shares or ADSs (collectively referred to in this section as the “shares”). This discussion is based on the Internal Revenue Code of 1986, as amended, or the Code, U.S. Treasury regulations promulgated under the Code and published administrative rulings and pronouncements and judicial decisions, all as of the date hereof. We cannot assure you that future legislation, administrative rulings or court decisions will not modify the conclusions set forth in this summary, possibly with retroactive effect. Except as specifically set forth herein, this discussion deals only with investors that hold our shares as capital assets within the meaning of Section 1221 of the Code and that have the U.S. dollar as their functional currency, and does not address tax considerations applicable to holders that may be subject to special tax rules, such as:

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

This discussion is of a general nature only and beneficial owners of the shares are urged to consult their tax advisors about the United States federal, state, local and foreign tax consequences to them of the purchase, ownership and sale of the shares.

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

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

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

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

The Cayman Islands, where we are incorporated, is not a party to any double tax treaty with the United States.

U.S. Holders

Taxation of Dividends and Other Distributions on the Shares

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

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

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

foreign tax credit for foreign taxes imposed on dividends paid on the shares.

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

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

Taxation of Disposition of Shares

Subject to the Passive Foreign Investment Company Rules discussed below, which will likely apply to you, you will recognize taxable gain or loss on any sale or exchange of a share equal to the difference between the amount realized (in U.S. dollars) for the share and your tax basis (in U.S. dollars) in the share. The gain or loss will be capital gain or loss. If you are an individual who has held the share for more than one year, you will be eligible for reduced rates of taxation (generally 20%). You may deduct any loss resulting from the sale or exchange of a share only against other capital gains. If you are an individual, up to US\$3,000 of capital loss in excess of your capital gains may be deducted against ordinary income. Excess losses may be carried forward. Any gain or loss that you recognize will generally be treated as United States source income or loss, except that losses will be treated as foreign source losses to the extent you received dividends that were includible in the financial services income basket during the 24-month period prior to the sale.

Passive Foreign Investment Company

We believe we were a passive foreign investment company for United States federal income tax purposes for the taxable year ended December 31, 2000, and expect to be treated as a passive foreign investment company for the 2001 taxable year. If we were a passive foreign investment company for the 2000 taxable year, U.S. Holders who owned shares during the 2000 taxable year generally will be subject to increased U.S. tax liabilities and reporting requirements for the 2000 taxable year and all succeeding years, regardless of whether we continue to meet the income or asset test for passive foreign investment company status, although shareholder elections may apply in certain circumstances. The same adverse U.S. tax consequences will apply to U.S. Holders who acquire the shares during the 2001 taxable year if our expectation that we will be a passive foreign investment company for the 2001 taxable year is accurate. U.S. Holders should consult their own tax advisors regarding our status as a passive foreign investment company and the consequences of an investment in a passive foreign investment company.

A company is considered a passive foreign investment company for any taxable year if either

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

We will be treated as owning our proportionate share of the assets and earning our proportionate

share of the income of any other corporation in which we own, directly or indirectly, more than 25% (by value) of the stock.

In determining that we may have been a passive foreign investment company for the 2000 taxable year and that we may be treated as a passive foreign investment company for the 2001 taxable year, we are relying on our actual and projected acquisition and capital expenditure plans for the past year, current year and future years. In addition, these determinations are based on our valuations of our assets, including goodwill. In calculating goodwill, we have valued our total assets based on our total market value determined using the lowest selling price of the shares for the relevant year and have made a number of assumptions regarding the amount of this value allocable to goodwill. We believe our valuation approach is reasonable. However, it is possible that the Internal Revenue Service will challenge the valuation of our goodwill, which may result in it becoming even more likely that we would be classified as a passive foreign investment company for the 2000 and 2001 taxable years as well as for subsequent years. In addition, if our actual acquisitions and capital expenditures do not match our projections, the likelihood that we are or will be classified as a passive foreign investment company may also increase.

We must make a separate determination each year as to whether we are a passive foreign investment company. As a result, our passive foreign investment company status may change.

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

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

The tax liability for amounts allocated to years prior to the year of disposition or “excess distribution” cannot be offset by any net operating losses, and gains (but not losses) realized on the sale of the shares cannot be treated as capital, even if you hold the shares as capital assets. If we are a passive foreign investment company, you may avoid taxation under the rules described above by making a “qualified electing fund” election to include your share of our income on a current basis, or a “deemed sale” election once we no longer qualify as a passive foreign investment company. However, you may make a qualified electing fund election only if we agree to furnish you annually with certain tax information, and we do not presently intend to prepare or provide such information.

Alternatively, a U.S. Holder of “marketable stock” in a passive foreign investment company may make a mark-to-market election for stock of a passive foreign investment company to elect out of the tax treatment discussed three paragraphs above. If you make a mark-to-market election for the shares, you

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

The mark-to-market election is available only for stock which is regularly traded on a national securities exchange that is registered with the Securities and Exchange Commission or on Nasdaq, or an exchange or market that the U.S. Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. The mark-to-market election would be available to you if we are or were to become a passive foreign investment company unless our ADSs are delisted from the Nasdaq National Market and do not subsequently become regularly traded on the Nasdaq SmallCap Market or other qualified exchange or market. We have received a standard notice of delisting by the Nasdaq Stock Market because we did not file this Form 20-F by its due date, as required under Nasdaq's marketplace rules.

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

Non-U.S. Holders

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

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

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

Information Reporting and Backup Withholding

In general, information reporting requirements will apply to dividends in respect of the shares or the proceeds received on the sale, exchange or redemption of shares paid within the U.S. (and in certain cases, outside the United States) to U.S. Holders other than certain exempt recipients, such as corporations, and a 31% backup withholding tax may apply to such amounts if the U.S. Holder fails to provide an accurate taxpayer identification number or to report interest and dividends required to be shown on its U.S. federal income tax returns. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as credit against the U.S. Holder's U.S. federal income tax liability

provided that the appropriate returns are filed.

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

Enforcement of Civil Liabilities

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

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

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

- (1) the Cayman Islands has a less developed body of securities laws as compared to the United States and provides significantly less protection to investors; and
- (2) Cayman Islands companies may not have standing to sue before the federal courts of the United States.

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

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

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

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

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

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

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

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We have previously filed with the Commission our registration statement on Form F-1 and prospectus under the Securities Act of 1933, as amended, with respect to our ADSs.

We are subject to the periodic reporting and other informational requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the Securities and Exchange Commission. Specifically, we are required to file annually a Form 20-F no later than six months after the close of each fiscal year, which is December 31. Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the Securities and Exchange Commission at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the regional offices of the Securities and Exchange Commission located at Seven World Trade Center, New York, New York 10048 and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. The public may obtain information regarding the Washington, D.C. Public Reference Room by calling the Commission at 1-800-SEC-0330. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

Our financial statements have been prepared in accordance with U.S. GAAP.

We will furnish our shareholders with annual reports, which will include a review of operations and annual audited consolidated financial statements prepared in conformity with U.S. GAAP.

I. Subsidiary Information

Not applicable.

Item 11. Quantitative and Qualitative Disclosures About Market Risk

Please refer to Item 5. “Operating and Financial Review and Prospects—Quantitative and Qualitative Disclosures About Market Risk.”

Item 12. Description of Securities Other than Equity Securities

Not Applicable.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

Not Applicable.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

Use of Proceeds

The following “Use of Proceeds” information relates to the registration statement on Form F-1 (File No. 333-11724) (the “Registration Statement”) for our initial public offering of 4,500,000 American Depositary Shares, each representing 100 of our ordinary shares, for an aggregate offering price of US\$69.75 million. Our Registration Statement was declared effective by the Commission on June 29, 2000.

We received net proceeds of approximately US\$64.9 million from our initial public offering (taking into account underwriting discounts of US\$4.88 million, but not taking into account transaction expenses of approximately US\$2.7 million). None of the transaction expenses included payments to directors or officers of our company, persons owning 10% or more of our equity securities or our affiliates.

From the effective date of the Registration Statement to July 6, 2000, we did not use any of the proceeds from our initial public offering. Since July 6, 2000, we have used the net proceeds from our initial public offering to satisfy past indebtedness and reduce our accounts payable and to fund expenses primarily for marketing, employee compensation, and capital expenditures.

Merrill Lynch Far East Limited, Merrill Lynch & Co. and Deutsche Banc Alex. Brown were the underwriters for our initial public offering.

Item 15. [Reserved]

Item 16. [Reserved]

PART III

Item 17. Financial Statements

The following consolidated financial statements for NetEase.com, Inc. and its subsidiaries are included at the end of this annual report.

Item 18. Financial Statements

The Company has elected to provide financial statements pursuant to Item 17.

Item 19. Exhibits

<u>Exhibit Number</u>	<u>Document</u>
1.1	Amended and Restated Memorandum of Association of NetEase.com, Inc. (incorporated by reference to Exhibit 3.1 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
1.2	Amended and Restated Articles of Association of NetEase.com, Inc. (incorporated by reference to Exhibit 3.2 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
2.1	Specimen American Depositary Receipt of NetEase.com, Inc. (incorporated by reference to Exhibit 4.1 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
2.2	Specimen Stock Certificate of NetEase.com, Inc. (incorporated by reference to Exhibit 4.2 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
3.1	Shareholder Voting Rights Trust Agreement dated May 12, 2000 among William Lei Ding, Bo Ding and NetEase Information Technology (Beijing) Co., Ltd. (incorporated by reference to Exhibit 10.40 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
4.1	1999 Stock Incentive Plan and Form of Stock Option Agreement (incorporated by reference to Exhibit 10.1 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
4.2	Amended and Restated 2000 Stock Incentive Plan and Form of Stock Option Agreement (including standard and non-standard form)
4.3	Employment Agreement dated August 13, 1999 between NetEase.com, Inc. and William Lei Ding (incorporated by reference to Exhibit 10.2 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
4.4	Employment Agreement dated February 1, 2000 between NetEase.com, Inc. and Geoffrey Jie Wei
4.5	Employment Agreement dated March 24, 2000 between NetEase.com, Inc. and Jack Xu
4.6	Asset Purchase Agreement dated September 1, 1999 between Guangzhou NetEase Computer System Co., Ltd. and NetEase Information Technology (Beijing) Co., Ltd. (incorporated by reference to Exhibit 10.4 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)

- 4.7 Supplemental Agreement to Asset Purchase Agreement dated as of September 24, 1999 between Guangzhou NetEase Computer System Co., Ltd. and NetEase Information Technology (Beijing) Co., Ltd. (incorporated by reference to Exhibit 10.5 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
- 4.8 Operating Agreement dated February 3, 2000 among NetEase Information Technology (Beijing) Co., Ltd., Guangzhou NetEase Computer System Co., Ltd., William Lei Ding and Bo Ding (incorporated by reference to Exhibit 10.6 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.9 Domain Name License Agreement dated February 3, 2000 between NetEase.com, Inc. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.7 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
- 4.10 Copyright License Agreement dated February 3, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.8 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
- 4.11 Trademark License Agreement dated February 3, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.9 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
- 4.12 Supplemental Agreement (to Copyright License Agreement, Domain Name License Agreement and Exclusive Technical Services Master Agreement) dated April 27, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.10 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.13 Exclusive Technical Services Master Agreement dated February 3, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.11 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
- 4.14 Notice of Renewal dated April 2, 2001 relating to the Copyright License Agreement, the Trademark License Agreement and the Exclusive Technical Services Master Agreement, each dated February 3, 2000 and made between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd.
- 4.15 Exclusive Consulting and Services Agreement dated February 3, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Beijing Guangyitong Advertising Co., Ltd. (incorporated by reference to Exhibit 10.12 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
- 4.16 Notice of Renewal dated April 2, 2001 relating to the Exclusive Consulting and Services Agreement dated February 3, 2000 and made between NetEase Information Technology

- (Beijing) Co., Ltd. and Beijing Guangyitong Advertising Co., Ltd.
- 4.17 Exclusive Advertising Agency Agreement dated February 3, 2000 between Guangzhou NetEase Computer System Co., Ltd. and NetEase.com, Inc. (incorporated by reference to Exhibit 10.13 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
 - 4.18 Notice of Renewal dated April 2, 2001 relating to the Exclusive Advertising Agency Agreement dated February 3, 2000 between Guangzhou NetEase Computer System Co., Ltd. and NetEase.com, Inc.
 - 4.19 Trademark Transfer Agreement dated March 29, 2000 between Guangzhou NetEase Computer System Co., Ltd. and NetEase Information Technology (Beijing) Co., Ltd. (incorporated by reference to Exhibit 10.14 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
 - 4.20 Online Advertising Agreement dated February 15, 2000 between Guangzhou NetEase Computer System Co., Ltd. and Beijing Guangyitong Advertising Co., Ltd. (incorporated by reference to Exhibit 10.15 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
 - 4.21 Notice of Renewal dated April 2, 2001 relating to the Online Advertising Agreement dated February 15, 2000 and made between Guangzhou NetEase Computer System Co., Ltd. and Beijing Guangyitong Advertising Co., Ltd.
 - 4.22 Amended and Restated Investors' Rights Agreement, dated March 28, 2000 among NetEase.com, Inc., Baring Asia Private Equity Investments XI Limited, The Goldman Sachs Group, Inc., Softbank China Venture Investments No. 1 Limited, Best Alliance Profits Limited and Shining Globe International Limited (incorporated by reference to Exhibit 10.16 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
 - 4.23 Tenancy Agreement (Beijing Kerry Centre I) effective December 3, 1999 between NetEase Information Technology (Beijing) Co., Ltd. and Beijing Jia Ao Real Estate Development Co., Ltd. (incorporated by reference to Exhibit 10.17 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
 - 4.24 Tenancy Agreement (Beijing Kerry Centre II) effective December 3, 1999 between NetEase Information Technology (Beijing) Co., Ltd. and Beijing Jia Ao Real Estate Development Co., Ltd. (incorporated by reference to Exhibit 10.18 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
 - 4.25 Strategic Cooperation Agreement dated March 23, 2000 between NetEase.com, Inc. and News Digital Ventures (incorporated by reference to Exhibit 10.23 from the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on March 27, 2000)
 - 4.26 Amendment No. 1 dated June 22, 2000 to the Strategic Cooperation Agreement between NetEase.com, Inc. and News Digital Ventures
 - 4.27 Amendment No. 2 dated September 1, 2000 to the Strategic Cooperation Agreement between NetEase.com, Inc. and News Digital Ventures

- 4.28 Supplemental Agreement dated May 10, 2000 (amending the Domain Name License Agreement) between NetEase.com, Inc. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.37 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.29 Agreement dated May 11, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.41 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.35 Operating Agreement dated May 10, 2000 among NetEase Information Technology (Beijing) Co., Ltd., Beijing Guangyitong Advertising Co., Ltd., Bo Ding and William Lei Ding (incorporated by reference to Exhibit 10.42 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.36 Termination Agreement (terminating the Operation Agreement dated February 3, 2000) dated April 27, 2000 among NetEase Information Technology (Beijing) Co., Ltd., Guangzhou NetEase Computer System Co., Ltd., William Lei Ding and Bo Ding (incorporated by reference to Exhibit 10.43 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.37 Termination Agreement (terminating the Equipment Lease Agreement) dated April 27, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.44 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.38 Termination Agreement (terminating the Leased Line Sublease Agreement) dated April 27, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.45 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.39 Supplemental Agreement dated May 12, 2000 between Guangzhou NetEase Computer System Co., Ltd. and Beijing Guangyitong Advertising Co., Ltd. (incorporated by reference to Exhibit 10.47 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.40 Supplemental Agreement dated May 15, 2000 (supplementing the Domain Name License Agreement) between NetEase.com, Inc. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to Exhibit 10.48 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.41 Letter of Agreement, dated June 6, 2000, among William Lei Ding, Bo Ding and NetEase.com, Inc. (incorporated by reference to Exhibit 10.49 from Amendment No. 2 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on June 15, 2000)
- 4.42 Supplemental Agreement dated June 15, 2000, between Beijing Guangyitong Advertising Co., Ltd. and Guangzhou NetEase Computer System Co., Ltd. (incorporated by reference to

- Exhibit 10.50 from Amendment No. 2 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on June 15, 2000)
- 4.43 Supplemental Agreement dated June 15, 2000, between NetEase Information Technology (Beijing) Co., Ltd. and Beijing Guangyitong Advertising Co., Ltd. (incorporated by reference to Exhibit 10.51 from Amendment No. 2 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on June 15, 2000)
- 4.44 Odigo Real-time Communications Software Agreement dated April 19, 2000 between NetEase.com, Inc. and Odigo Inc. (incorporated by reference to Exhibit 10.39 from Amendment No. 1 to the company's Registration Statement on Form F-1 (file no. 333-11724) filed with the Securities and Exchange Commission on May 15, 2000)
- 4.45 Binding Letter of Intent dated August 29, 2000 between Guangzhou NetEase Computer System Co., Ltd. and Great Wall Broadband Network Service Cooperation
- 4.46 Cooperation Agreement dated November 22, 2000 between NetEase Information Technology (Beijing) Co., Ltd. and Eastern Xingye Internet Education Service Co. Ltd.
- 4.47 Server Hosting Services Agreement dated January 3, 2001 among NetEase Information Technology (Beijing) Co., Ltd., Beijing Tongyi Network System Co., Ltd. and Century Internet Data Center Co., Ltd. (21Vianet) and its Supplemental Agreement dated July 10, 2001
- 4.48 Website Hosting Service Agreement dated January 9, 2001 between Guangzhou NetEase Computer System Co., Ltd. and HiChina Web Solutions (Beijing) Limited and its Supplemental Agreement dated March 1, 2001.
- 4.49 Cooperative Agreements dated February 26, 2001 and March 16, 2001 between NetEase Information Technology (Beijing) Co., Ltd. and Beijing Waei Associated Software Development Co., Ltd.
- 4.50 Asset Transfer Agreement dated March 23, 2001 between NetEase Information Technology (Beijing) Co., Ltd. and Guangzhou Tianxia Technology Co. Ltd. and its shareholders
- 4.51 Agreement effective June 1, 2001 between Beijing Telecommunications Bureau and NetEase Information Technology (Beijing) Co., Ltd.
- 4.52 Agreement dated June 11, 2001 between Guangzhou NetEase Computer System Co., Ltd. and Beijing Mobile Communication Corporation
- 4.53 Trademark Assignment Agreement dated August 17, 2001 between Guangzhou NetEase Computer System Co., Ltd. and NetEase Information Technology (Beijing) Co., Ltd and its Supplemental Agreement dated August 27, 2001
- 4.54 Friendly Cooperation Agreement dated August 20, 2001 between Guangzhou NetEase Computer System Co., Ltd. and ChinaCast Co., Ltd.
- 4.55 Strategic Cooperation Agreement dated September 10, 2000 between NetEase.com, Inc. and Eachnet, Limited
- 8.1 Subsidiaries of NetEase.com, Inc.
- 10.1 Consent of Arthur Andersen • Hua Qiang, Independent Public Accountants
- 10.2 Consent of Maples and Calder Asia

10.3 Consent of Commerce & Finance Law Office

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

NETEASE.COM, INC.

By: /s/ William Lei Ding

William Lei Ding
Acting Chief Executive Officer

NETEASE.COM, INC.

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Report of Independent Public Accountants

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

We have audited the accompanying consolidated balance sheets of NetEase.com, Inc. (a Cayman Islands corporation) as of December 31, 1999 and 2000 (2000 restated – see Note 16) and the related consolidated statements of operations, shareholders' equity and cash flows for the years ended December 31, 1998, 1999 and 2000 (2000 restated – see Note 16) 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, 1999 and 2000 and the results of its operations and its cash flows for the years ended December 31, 1998, 1999 and 2000 in conformity with generally accepted accounting principles in the United States of America.

Beijing, People's Republic of China
February 14, 2001 (except with respect to the matters discussed in Notes 14 and 16, as to which the date is August 28, 2001)

NETEASE.COM, INC.
CONSOLIDATED BALANCE SHEETS

	Note	December 31, 1999	December 31, 2000	December 31, 2000
		RMB	As restated, see Note 16 RMB	As restated, see Note 16 US\$ (Note 2)
Assets				
Current assets:				
Cash		117,800,096	708,561,012	85,601,881
Restricted cash	4	-	136,052,705	16,436,647
Accounts receivable, net of allowance of doubtful accounts of nil and RMB1,241,715 (US\$150,013) at December 31, 1999 and 2000, respectively		6,633,299	684,888	82,742
Prepayments		5,822,014	3,369,211	407,037
Other current assets	5	2,947,091	11,456,322	1,384,046
Due from related parties, net of allowance of doubtful accounts of nil and RM342,737 (US\$41,406) at December 31, 1999 and 2000, respectively	6			
		<u>1,017,245</u>	<u>5,869,195</u>	<u>709,063</u>
Total current assets		134,219,745	865,993,333	104,621,416
Non-current rental deposit		-	1,682,710	203,290
Investment in convertible note	7	-	827,810	100,008
Investment in convertible preference shares	8	-	16,556,199	2,000,169
Property, equipment and software, net	9	9,508,437	35,362,091	4,272,125
Deferred asset		-	673,407	81,355
		<u>143,728,182</u>	<u>921,095,550</u>	<u>111,278,363</u>
Liabilities & Shareholders' Equity				
Current liabilities:				
Short-term bank loans	10	-	112,600,000	13,603,305
Accounts payable		1,142,224	7,562,448	913,626
Salary and welfare payable	11	1,869,403	6,732,037	813,303
Taxes payable	12	1,417,864	1,007,104	121,669
Deferred revenue		1,593,851	558,739	67,502
Accrued liabilities	13	697,650	18,781,557	2,269,016
Due to related parties	6	941,950	1,313,229	158,652
		<u>7,662,942</u>	<u>148,555,114</u>	<u>17,947,073</u>
Total current liabilities				
Commitments and contingencies	17			
Shareholders' equity:				
Series A convertible preference shares US\$0.01 par value: 3,000,000 shares authorized, issued and outstanding as of December 31, 1999 (aggregate preference on liquidation of US\$15 million)	14	248,367	-	-
Ordinary shares, US\$0.0001 par value: 1,000,000,000,000 shares authorized, 2,004,500,000 shares issued and outstanding as of December 31, 1999, and 3,010,555,600 shares issued and outstanding as of December 31, 2000	14	1,659,447	2,492,350	301,103
Additional paid-in capital	14	197,604,001	1,076,505,358	130,053,562
Less: Subscription receivable		-	(47,829,909)	(5,778,374)
Deferred compensation	15	(11,743,182)	(37,306,585)	(4,507,041)
Translation adjustments		-	(348,586)	(42,113)
Accumulated deficit		(51,703,393)	(220,972,192)	(26,695,847)
		<u>136,065,240</u>	<u>772,540,436</u>	<u>93,331,290</u>
Total shareholders' equity				
Total liabilities & shareholders' equity		<u>143,728,182</u>	<u>921,095,550</u>	<u>111,278,363</u>

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

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Note	For the year ended December 31,			
		1998	1999	2000	2000
		RMB	RMB	As restated, see Note 16 RMB	As restated, see Note 16 US\$ (Note 2)
Revenues:					
Advertising services (including revenues of RMB818,075 and RMB30,067,477 (US\$3,632,478) from related parties in 1999 and 2000, respectively)					
Software licensing and related integration projects	6	172,850	10,796,074	30,067,477	3,632,478
E-commerce related services (including revenues of RMB1,094,859 (US\$132,271) from a related party in 2000)		2,942,582	3,515,831	450,350	54,407
	6	-	2,459,101	2,455,834	296,691
		3,115,432	16,771,006	32,973,661	3,983,576
Sales and value-added taxes		(230,749)	(1,150,169)	(2,476,444)	(299,181)
Net revenues		2,884,683	15,620,837	30,497,217	3,684,395
Cost of revenues:					
Advertising and e-commerce related services (including share compensation costs of RMB6,296,816 in 1999 and RMB1,171,084 (US\$141,479) in 2000, and cost reimbursements to a related party of RMB1,974,834 in 1999 and RMB2,098,127 (US\$253,476) in 2000)		(242,657)	(11,837,416)	(39,909,419)	(4,821,492)
Software licensing and related integration projects		(946,531)	(258,819)	-	-
Total cost of revenues		(1,189,188)	(12,096,235)	(39,909,419)	(4,821,492)
Gross profit (loss on revenues)		1,695,495	3,524,602	(9,412,202)	(1,137,097)
Operating expenses:					
Selling, general and administrative expenses (including share compensation costs of RMB34,346,268 in 1999 and RMB7,437,230 (US\$898,498) in 2000, and cost reimbursements to a related party of RMB466,259 in 1999 and RMB3,124,247 (US\$377,443) in 2000)		(311,957)	(51,055,489)	(170,359,791)	(20,581,317)
Research and development (including share compensation costs of RMB4,770,315 in 1999 and RMB5,231,246 (US\$631,991) in 2000)		(951,000)	(5,735,170)	(14,756,682)	(1,782,768)
Total operating expenses		(1,262,957)	(56,790,659)	(185,116,473)	(22,364,085)
Operating profit (loss)		432,538	(53,266,057)	(194,528,675)	(23,501,182)
Other income (expenses):					
Sales of 163.net usage rights		-	1,500,000	-	-
Interest income		5,719	357,160	27,858,710	3,365,635
Interest expense		-	-	(2,589,735)	(312,868)
Other, net		(71,056)	(494,018)	(9,099)	(1,099)
Income (loss) before tax		367,201	(51,902,915)	(169,268,799)	(20,449,514)
Provision for income tax	12	(34,464)	(71,338)	-	-
Net income (loss)		332,737	(51,974,253)	(169,268,799)	(20,449,514)
Other comprehensive loss					
Currency translation adjustments		-	-	(348,586)	(42,113)
Comprehensive income (loss)		332,737	(51,974,253)	(169,617,385)	(20,491,627)
Net income (loss) per share, basic and diluted		0.01	(0.03)	(0.07)	(0.01)
Net income (loss) per ADS, basic and diluted		0.02	(2.73)	(6.78)	(0.82)
Weighted average number of ordinary shares outstanding		1,868,817,200	1,900,430,600	2,497,467,200	2,497,467,200
Weighted average number of ADS outstanding		18,688,172	19,004,306	24,974,672	24,974,672

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

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Convertible preference shares		Ordinary shares		Additional paid-in capital	Subscription receivable	Deferred compensation	Statutory reserves	Retained earnings (Accumulated deficit)	Translation adjustments	Total shareholders' equity
	Share	Amount RMB	Share	Amount RMB							
Balance as of December 31, 1997	-	-	-	-	500,000	-	-	-	(7,058)	-	492,942
Net income	-	-	-	-	-	-	-	-	32,737 ³	-	332,737
Appropriations to statutory reserves	-	-	-	-	-	-	-	54,819	(54,819)	-	-
Balance as of December 31, 1998	-	-	-	-	500,000	-	-	54,819	70,860 ²	-	825,679
Reorganization adjustment	-	-	-	-	(745,181)	-	-	(54,819)	-	-	(800,000)
Net loss	-	-	-	-	-	-	-	-	(51,974,253)	-	(51,974,253)
Ordinary share issued for cash at US\$0.015 per share	-	-	66,666,700	55,183	8,222,386	-	-	-	-	-	8,277,569
Ordinary share issued for cash at US\$0.0155 per share	-	-	64,516,100	53,401	8,223,714	-	-	-	-	-	8,277,115
Ordinary share issued to principal owner as part of reorganization	-	-	1,868,817,200	1,547,138	(1,547,138)	-	-	-	-	-	-
Ordinary share issued for cash at US\$0.05 per share	-	-	4,500,000	3,725	1,859,004	-	-	-	-	-	1,862,729
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 (as restated, see Note 16)	-	-	-	-	-	-	-	-	(169,268,799)	-	(169,268,799)
Translation adjustments	-	-	-	-	-	-	-	-	-	(348,586)	(348,586)
Balance as of December 31, 2000 (as restated, see Note 16)	-	-	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

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

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended			
	1998	1999	2000	2000
	RMB	RMB	As restated, See Note 16 RMB	As restated, See Note 16 US\$ (Note 2)
Cash flows from operating activities:				
Net income (loss)	332,737	(51,974,253)	(169,268,799)	(20,449,514)
Adjustments for:				
Depreciation	89,980	975,429	8,117,140	980,639
Share compensation cost	-	45,413,399	13,839,560	1,671,969
Provision for doubtful debts	-	-	1,584,452	191,419
(Increase) decrease in accounts receivable	(638,988)	(5,985,311)	4,706,696	568,620
(Increase) decrease in prepayments	-	(5,822,014)	2,452,803	296,325
(Increase) in other current assets	(37,233)	(2,589,858)	(8,509,231)	(1,028,006)
(Increase) in due from related parties	(12,000)	(1,005,245)	(5,194,687)	(627,575)
(Increase) in deferred assets	-	-	(673,407)	(81,355)
Increase in accounts payable	243,340	771,932	6,420,224	775,634
Increase (decrease) in deferred revenue	959,782	634,069	(1,035,112)	(125,053)
Increase in salary and welfare payable	27,158	1,840,718	4,862,634	587,459
Increase (decrease) in taxes payable	194,303	1,216,417	(410,760)	(49,624)
Increase in accrued liabilities	73,300	695,293	18,083,907	2,184,733
Increase in due to related parties	-	141,950	371,279	44,855
Net cash provided by (used in) operating activities	1,232,379	(15,687,474)	(124,653,301)	(15,059,474)
Cash flows from investing activities:				
Purchase of property, equipment and software	(1,083,248)	(9,312,383)	(33,970,794)	(4,104,042)
(Increase) in investment in convertible note	-	-	(827,810)	(100,008)
(Increase) in investment in convertible preference shares	-	-	(16,556,199)	(2,000,169)
(Increase) in non-current deposit	-	-	(1,682,710)	(203,290)
Net cash used in investing activities	(1,083,248)	(9,312,383)	(53,037,513)	(6,407,509)
Cash flows from financing activities:				
Proceeds from short-term bank loans	-	-	112,600,000	13,603,305
Proceeds from issuance of ordinary shares, net of RMB62,289,780 issuance costs and RMB6,439,401 subscription receivables in 2000 (1999 – nil)	-	18,417,413	508,738,045	61,461,092
Proceeds from issuance of Series A and Series B preference shares, net of issuance costs of RMB 6,246,516 and RMB41,390,508 subscription receivable in 2000 (1999 – nil)	-	124,183,002	283,514,976	34,251,694
Net cash provided by financing activities	-	142,600,415	904,853,021	109,316,091
Effect of exchange rate changes on cash	-	-	(348,586)	(42,113)
Net increase in cash	149,131	117,600,558	726,813,621	87,806,995
Less: Increase in restricted cash	-	-	(136,052,705)	(16,436,647)
Cash, beginning of year	50,407	199,538	117,800,096	14,231,533
Cash, end of year	199,538	117,800,096	708,561,012	85,601,881

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

NETEASE.COM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT'D)

	For the year ended			
	1998	1999	2000	2000
	RMB	RMB	As restated, See Note 16 RMB	As restated, See Note 16 US\$ (Note 2)
Supplemental disclosures of cash flow information:				
Cash paid during the year for income taxes	8,158	11,557	-	-
Cash paid during the year for interest	-	-	1,159,275	140,053
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 senior management personnel and some non-employees of the Company (Notes 14 and 15)	-	45,413,399	13,839,560	1,671,968

The accompanying notes are 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, 2000, 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 own 80% and 20% respectively of the equity interest in NetEase INT.

The Group is principally engaged in developing and providing Internet-related advertising, e-commerce related 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”), and controlled and owned by the same individual who is the principal shareholder of the Company.

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

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

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

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

The Group has a limited operating history and has not generated significant revenues. As a result, the Group is subject to risks associated with early-stage companies in new and rapidly evolving markets. As of December 31, 2000, the Group had an accumulated deficit of approximately RMB221 million and has continued to incur losses subsequent to that date. Management believes that the Group's existing cash resources, the capital inflows from planned additional financing and cash generated from revenue growth will be sufficient for it to meet its obligations through at least December 31, 2001.

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.

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

Agreements with Guangzhou NetEase (cont'd)

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

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

- 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.

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").

2. Principal Accounting Policies (Cont'd)

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.

Restatement of consolidated financial statements

On June 11, 2001, the Company announced that the Audit Committee of the Board of Directors was initiating an investigation into the accuracy of the Company's financial statements for the year ended December 31, 2000. The Audit Committee investigation has since been completed and, as a result of its findings, the Company has restated its previously issued consolidated financial statements for the year ended December 31, 2000. All information presented in the consolidated financial statements and related notes includes all such restatements. (See Note 16).

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 derives its advertising services revenues principally from fees received from advertisers on the NetEase Web sites operated by Guangzhou NetEase and the fees earned from services provided to Guangyitong Advertising, a related party (see Note 6).

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

2. Principal Accounting Policies (Cont'd)

Starting from December 1999, the Group also derives advertising services revenues from advertising-related technical consulting services provided to Guangyitong Advertising, a related party. The Group recognizes advertising services revenues from Guangyitong Advertising as services are rendered and the service revenues are earned based on the related service agreement (see Note 6).

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. For the years ended December 31, 1998 and 1999, revenues derived from barter transactions were nil and approximately RMB3.4 million respectively. Of the barter revenue for the year ended December 31, 1999, approximately RMB2.4 million arose from the exchange of the Group's Internet advertising space for advertisements of an outdoor advertising media company, from which the Group also purchased advertisements for cash (see Note 3). Accordingly, measurable and reliable fair value for such transactions has been obtained from comparable cash purchases.

Effective from January 20, 2000, the Company 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 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. During the year ended December 31, 2000, the recognized revenues and expenses derived from barter transactions were approximately RMB654,000. During the year ended December 31, 2000, the Company also engaged in some advertising barter transactions for which the fair value is not determinable within the limits of EITF 99-17 and therefore the revenues and expenses derived from these barter transactions were not recognized. These transactions primarily involved exchanges of advertising services rendered by the Group for advertising, promotional benefits, information content, consulting services, and software provided by the counterparties.

Software and related integration projects

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

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

- persuasive evidence of an arrangement;
- delivery has occurred and services have been performed;

2. Principal Accounting Policies (Cont'd)

- 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.

E-commerce related services

The Group derives its e-commerce related services revenues from services provided to third parties and from fees earned from services provided to Guangzhou NetEase, a related party (see Note 6).

Services provided to third parties 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.

Starting from July 2000, the Company also derived e-commerce related services revenues from technical services provided to Guangzhou NetEase which operates the NetEase Web sites for transactions conducted through the Internet. Those transactions conducted by Guangzhou NetEase for which the Group provides technical services to Guangzhou NetEase include on-line shopping mall, auctions and revenue sharing from co-branded Web sites. Services revenues from Guangzhou NetEase are recognized as services are provided.

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

Cost of advertising and e-commerce related services

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

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

Cash

Cash represents cash on hand and demand deposits placed with banks or other financial institutions. Included in the cash balance as of December 31, 1999 and 2000 are amounts denominated in United States dollars totaling US\$14.1 million and US\$81.5 million respectively (equivalent to approximately RMB116.8 million and RMB675 million respectively).

2. Principal Accounting Policies (Cont'd)

Financial instruments

Financial instruments of the Group primarily consist of 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.

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.....	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, 2000, the capitalizable costs of internally developed computer software are not significant.

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. Based on its most recent analysis, the Company believes that there was no impairment of its property, equipment and software, and its deferred asset as of December 31, 2000.

Subscription receivable

Subscription receivable represents the amount receivable from a shareholder from the issuance of Series B preference shares in March 2000 (see Note 14), and advances to certain shareholders for subscription for the Company's ordinary shares. The advances to certain shareholders are offset against equity as such ordinary shares are pledged by those shareholders as security for repayment of the advances.

2. Principal Accounting Policies (Cont'd)

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 RMB1,000, RMB6,896,828, and RMB61,628,934, during the years ended December 31, 1998, 1999 and 2000, 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 = RMB8.2774 on December 31, 2000 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, 2000, or at any other certain rate.

Stock options

The Group has adopted the provisions of Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation." In accordance with the provisions of SFAS 123, the Group has 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 for a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of, the deferred tax asset will not be realized.

2. Principal Accounting Policies (Cont'd)

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

In accordance with Statement of Financial Accounting Standards No. 128, "Computation of Earnings Per Share," basic EPS is computed by dividing net income (loss) attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of the ordinary shares issuable upon the conversion of the convertible preference shares (using the if-converted method) and ordinary shares issuable upon the exercise of outstanding stock options (using the treasury stock method). Ordinary equivalent shares in the diluted EPS computation are excluded in net loss periods as their effect would be anti-dilutive. The number of these ordinary equivalent shares excluded from the diluted EPS computation amounted to nil, 323,695,000, and 50,164,600 for the years ended December 31, 1998, 1999, and 2000, respectively.

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

The weighted average number of ordinary shares outstanding for the year ended December 31, 1998, for the purposes of EPS calculations, represents the number of ordinary shares issued to the principal owner of Guangzhou NetEase, which conducted the Group's businesses prior to the September 1999 Reorganization.

Statutory reserves

In accordance with the Regulations on Enterprises with Foreign Investment of China and their articles of association, NetEase Beijing and NetEase Shanghai, being wholly foreign owned 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 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 and NetEase Shanghai, 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.

2. Principal Accounting Policies (Cont'd)

Recent accounting pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities". This statement requires companies to record all derivatives on the balance sheet as assets or liabilities measured at fair value. Gains and losses resulting from changes in fair market values of those derivative instruments would be accounted for depending on the use of the instrument and whether it qualifies for hedge accounting. SFAS 133 will be effective for the Group's year ending December 31, 2001. In June 2000, the Financial Accounting Standards Board issued SFAS No. 138, "Accounting for Derivatives Instruments and Hedging Activities, An Amendment of FASB Statement No. 133". SFAS No. 138 amends the accounting and reporting standards for certain derivatives and hedging activities such as net settlement contracts, foreign currency transactions and intercompany derivatives. The Group does not expect that the implementation of SFAS 133 will have a significant impact on its financial position, results of operations or cash flows.

3. Concentrations

Major customers

Revenues from customers (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, 1998, 1999 and 2000 are as follows:

Customers	For the year ended December 31,		
	1998	1999	2000
Guangzhou Feihua Telecom Co., Ltd.	398,729	-	-
Jinhua Postal Bureau	390,000	-	-
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, software licensing 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 deposit in the amounts of US\$135,257 pledged as security money for renting office space and USD denominated deposits totaling US\$16.3 million pledged with the banks in China for the Group's RMB denominated short-term bank loans (see Note 10).

5. Other Current Assets

	December 31, 1999	December 31, 2000
Temporary deposits for rented premises	1,722,460	-
Interest receivable	383,828	3,211,690
Prepaid information fee	-	1,032,430
Prepaid advertising	-	1,390,057
Advances	369,406	1,088,479
Others	471,397	4,733,666
	<u>2,947,091</u>	<u>11,456,322</u>

6. Related Party Transactions

During the years ended December 31, 1998, 1999 and 2000, the Group had advertising fees from shareholders of the Company amounting to approximately nil, RMB539,000 and nil, respectively.

During the years ended December 31, 1998, 1999 and 2000, the Group derived approximately nil, RMB279,000 and RMB30.1 million, respectively, of advertising services revenues from Guangyitong Advertising, a related company that is 80% owned by the principal shareholder of the Group for advertising-related technical consulting services performed.

During the years ended December 31, 1998, 1999 and 2000, the Group reimbursed Guangzhou NetEase a total of approximately nil, RMB2.4 million and RMB5.2 million, respectively, for the costs of operating the NetEase Web sites.

During the years ended December 31, 1998, 1999 and 2000, the Group derived approximately nil, nil, and RMB1.1 million, respectively, of e-commerce related services revenues from Guangzhou NetEase.

As of the balance sheet dates, due from related parties represents amounts receivable from Guangyitong Advertising for services performed and temporary advances to officers of the Group. Due to related parties primarily represents amounts payable to Guangzhou NetEase and its owners. The balances with related parties were unsecured, interest-free and repayable on demand. As of December 31, 1999 and 2000, the amounts due from related parties included an amount denominated in United States dollars of US\$50,000 and US\$230,755 respectively (equivalent to approximately RMB415,000 and RMB1.9 million respectively). All other related party balances are denominated in RMB.

7. Investment in Convertible Note

Investment in convertible note represents an advance made to a private company operating as a provider of women focused content on the Internet and is stated at cost. The convertible note bears interest at 8% per annum, and will mature on May 24, 2001. The total of the principal amount and the accrued interest thereon can be applied in satisfying the consideration payable upon acquiring the ordinary shares in the private company at option of the Company before May 24, 2001 upon an acquisition by the Company of 50% or more of the equity ownership of the private company. Subsequent to December 31, 2000, the Board of Directors of the Company resolved to acquire all the outstanding capital stock of the private company at a total consideration up to US\$600,000 (see Note 18).

8. Investment in Convertible Preference Shares

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 and is stated at cost. These preference shares are convertible on an one-for-one basis into ordinary shares in the investee upon closing of a public offering of the ordinary shares in the private company, representing a 1.93 % interest in the ordinary share capital of the investee upon conversion of all of its outstanding convertible preference shares. The preference shares carry certain preferences on dividend payment and return of capital in case of a winding up of the private company.

The Company also entered into a strategic co-operation agreement with the private auction company pursuant to which the Company and the private auction company established a co-branded auction web site on the NetEase Web sites. According to the agreement, the Company is entitled to a non-refundable upfront fee and revenues generated from the co-branded web site which is based on the number of click-throughs and an advertising revenue sharing scheme. The agreement is for a term of two years commencing from the date of launch of the co-branded web site.

9. Property, Equipment and Software

	December 31, 1999	December 31, 2000
Computers and servers	8,327,804	28,470,949
Furniture and office equipment	433,125	1,941,495
Software	854,972	9,663,528
Leasehold improvements	967,500	3,772,709
Vehicle	-	705,514
	<u>10,583,401</u>	<u>44,554,195</u>
Less: Accumulated depreciation	<u>(1,074,964)</u>	<u>(9,192,104)</u>
Net book value	<u>9,508,437</u>	<u>35,362,091</u>

10. Short-term Bank Loans

Lender	Period	Annual interest rate	Outstanding principal as of December 31, 2000
Construction Bank of China - loan A	March 2000 to March 2001	5.85%	4,950,000
Construction Bank of China - loan B	April 2000 to April 2001	5.85%	4,950,000
Construction Bank of China - loan C	April 2000 to April 2001	5.85%	10,000,000
Construction Bank of China - loan D	May 2000 to April 2001	5.85%	10,000,000
Construction Bank of China - loan E	June 2000 to April 2001	5.85%	13,000,000
Construction Bank of China - loan F	September 2000 to September 2001	5.85%	9,900,000
Construction Bank of China - loan G	August 2000 to August 2001	5.85%	9,900,000
Construction Bank of China - loan H	October 2000 to October 2001	5.85%	9,900,000
China Merchants Bank - loan A	November 2000 to November 2001	5.85%	20,000,000
China Merchants Bank - loan B	December 2000 to November 2001	5.85%	20,000,000
			<u>112,600,000</u>

As of December 31, 2000, the loans A and B from Construction Bank of China of RMB4.95 million each are secured by a bank deposit of US\$1.2 million. The loans C, D and E from Construction Bank of China of RMB10 million, RMB10 million and RMB13 million are secured by a bank deposit of US\$4 million as of December 31, 2000. The loans F, G and H from Construction Bank of China of RMB9.9 million each are secured by a bank deposit of US\$3.6 million. The loans A and B from China Merchants Bank of RMB20 million each are secured by bank deposits of US\$7.5 million as of December 31, 2000.

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 RMB27,000, RMB1.4 million and RMB6.2 million for the years ended December 31, 1998, 1999, and 2000, 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, 1998, 1999 and 2000 amounted to approximately nil, RMB 194,000 and RMB3.6 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.

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 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%.

Domestic Enterprises

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

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,		
	1998	1999	2000
EIT statutory rate	33.0%	(33.0%)	(33.0%)
Non-deductible share compensation costs	-	13.1%	2.7%
Effect of tax rate applicable to small-sized domestic enterprises	(23.6%)	(0.2%)	-
Effect of lower tax rate applicable to hi-tech enterprises	-	18.3%	6.7%
Valuation allowance for deferred tax assets	-	1.9%	12.6%
Permanent differences	-	-	11.0%
Effective EIT rate	<u>9.4%</u>	<u>0.1%</u>	<u>-</u>

12. Taxation (Cont'd)

As of December 31, 1999, and 2000, 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, 1999	December 31, 2000
Net operating loss carryforwards (primarily in NetEase Beijing and NetEase Shanghai relating to EIT applicable to foreign invested enterprises)	984,128	20,026,267
Valuation allowance	(984,128)	(20,026,267)
Net deferred tax assets	<u>-</u>	<u>-</u>

NetEase Beijing had net operating loss carryforwards of approximately RMB81.9 million as of December 31, 2000 for EIT purposes. Approximately RMB6.6 million of these loss carryforwards will expire in 2004 and another approximately RMB75.3 million will expire in 2005. NetEase Shanghai had net operating loss carryforwards of approximately RMB23.5 million as of December 31, 2000 for EIT purposes. These carryforwards will expire in 2005. 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.

Foreign Enterprises

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

Income of the Company and NetEase US that is not connected to a permanent establishment in the PRC would be subject to a 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.

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, the Group is subject to a cultural development fee at 3% on its Internet advertising fees.

12. Taxation (Cont'd)

Value added taxes ("VAT")

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

Taxes payable

	December 31, 1999	December 31, 2000
VAT	374,232	-
BT	529,662	823,831
Income taxes	87,086	-
Culture construction fee	76,591	-
Others	350,293	183,273
	<u>1,417,864</u>	<u>1,007,104</u>

13. Accrued Liabilities

	December 31, 1999	December 31, 2000
Accrued advertising expenses	-	15,085,096
Other	697,650	3,696,461
Total	<u>697,650</u>	<u>18,781,557</u>

14. Capital Structure

Ordinary shares

The holders of ordinary shares in the Company are entitled to one vote per share. Subject to certain preferences attributable to the outstanding preference shares (see below), the holders of ordinary shares are entitled to receive ratably such dividends, if any, as may be declared by the board of directors of the Company. In the event of liquidation, the holders of ordinary shares are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred shareholders. The ordinary shares have no preemptive, conversion, or other subscription rights.

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

14. Capital Structure (Cont'd)

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 incurred share 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).

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 must be obtained for any acquisition, merger, reorganization, substantial disposal of assets, alteration of capital amounts, disposal of interest in any subsidiary or associate company, and liquidation or winding-up of the Company.

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.

14. Capital Structure (Cont'd)

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 restated financial statements reflects this effect.

15. 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 a total of 345,675,000 ordinary shares for issuance under the plan.

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

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

The Company also granted options to acquire a total of 3,000,000 ordinary shares to its advisory board members. Twenty percent of these options vest on the date of appointment, which was the end of 1999, and 10% will vest each quarter over the next two years thereafter. The exercise price is US\$0.065 per share. The total estimated fair value of the options granted to the advisory board members of approximately 867,000 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.

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.

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

15. Stock Option Plans (Cont'd)

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.

In addition, 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 RMB1,500,000. 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.

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 RMB1,776,000, 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 RMB40,000. Deferred compensation cost related to the remaining newly issued 500,000 share options was approximately RMB191,000, 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%.

During the year ended December 31, 2000, the Company also 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.

In connection with the above option grants the Company recorded deferred share compensation costs of approximately RMB48.5 million 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.

15. Stock Option Plans (Cont'd)

The fair value of the options granted to non-employees of the Company, including advisory board members, consultants, and directors were re-measured as of December 31, 2000 according to EITF96-18, under which variable accounting needs to be applied in the interim periods. 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 2.5% or 3.26%; estimated fair value of US\$0.03 per ordinary share; expected dividend yield of 0% for all periods; expected life of two to five years; and expected volatility of 142%. According to EITF96-18, variable accounting will be applied until the relating performance is completed.

Information relating to stock options outstanding is as follows:

	For the year ended December 31,			
	1999		2000	
	Options outstanding	Weighted average exercise price US\$	Options outstanding	Weighted average exercise price US\$
Outstanding at beginning of period	-	-	121,960,000	0.065
Granted	121,960,000	0.065	233,694,300	0.105
Canceled	-	-	(106,753,200)	0.091
Outstanding at period end	<u>121,960,000</u>	<u>0.065</u>	<u>248,901,100</u>	<u>0.091</u>

As of December 31, 2000, options to purchase 50,164,600 ordinary shares were exercisable. Under the stock option plans, options to purchase 96,773,900 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, 2000, were as follows:

Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Number Vested
US\$0.043 – US\$0.043	1,500,000	4.92	-
US\$0.05 – US\$0.05	8,250,000	9.42	250,000
US\$0.063 – US\$0.065	71,766,800	7.25	45,969,600
US\$0.07 – US\$0.08	62,607,500	9.08	2,995,000
US\$0.10 – US\$0.10	65,921,300	4.33	950,000
US\$0.155 – US\$0.156	38,855,500	7.58	-
	<u>248,901,100</u>	<u>7.00</u>	<u>50,164,600</u>

15. Stock Option Plans (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,		
	1998	1999	2000
Risk free interest rate	-	2.97% - 3.30%	2.50% - 3.30%
Estimated fair value (US\$)	-	0.05 – 0.07	0.03 – 0.156
Expected life (in years)	-	5 – 10	5 – 10
Expected dividend yield	-	0%	0%
Volatility	-	0%	142% - 155%

Had the compensation costs for the plan been determined based on the estimated fair value of the options at the grant dates for awards under the plan, the Group's net income (loss) and net income (loss) per ordinary share on a pro forma basis for the years ended December 31, 1998, 1999 and 2000 would have been as follows:

	For the year ended December 31,		
	1998	1999	2000
Net income (loss):			
As reported	332,737	(51,974,253)	(169,268,799)
Pro forma	332,737	(52,965,737)	(169,891,681)
Basic and diluted net income (loss) per ordinary share:			
As reported	0.01	(0.03)	(0.07)
Pro forma	0.01	(0.03)	(0.07)

16. Restatement

Subsequent to the issuance of the Company's consolidated financial statements for the year ended December 31, 2000, the Company became aware of potential issues regarding the reporting of its revenues for the year ended December 31, 2000. The Audit Committee of the Board of Directors then commenced an internal investigation into the accuracy of its financial statements for the year ended December 31, 2000. As a result of the investigation, it was determined that revenues for various advertising and E-commerce related services transactions were improperly recognized in 2000.

With respect to advertising services revenues, it was determined that the revenues from a number of advertising contracts were improperly recognized in 2000 because:

- the performance of certain advertising contracts had not been completed by the end of December 31, 2000;
- certain advertising contracts were found to be subject to significant extensions of performance periods that went beyond December 31, 2000;
- certain advertising contracts were found to be barter transactions with related expense or asset purchase contracts. The revenues from these revenue contracts could not be recognized as they did not meet the criteria for recognition set out in APB Opinion 29 and EITF 99-17; and
- certain other advertising contracts were found to lack economic substance or there was no reasonable assurance that the customers would pay the contract amount. It was determined that the revenue recognition criteria – services have been rendered and collectibility is reasonably assured, were not met.

With respect to E-commerce related services revenues, it was determined that the revenues from a number of E-commerce arrangements were inappropriately recognized in 2000 because they were actually barter transactions and the fair value of these contracts could not be reliably determined.

In connection with the restatement of advertising and e-commerce services revenues, the related assets, liabilities, and expenses are also restated.

16. Restatement (Cont'd)

The effect of the restatements discussed above, on the consolidated balance sheet and the consolidated statement of operations as of and for the year ended December 31, 2000, is shown in the following tables:

Consolidated Statement of Operations For the year ended December 31, 2000			
	As previously reported	Restatements	As restated
	RMB	RMB	RMB
Revenues:			
Advertising services	60,023,320	(29,955,843)	30,067,477
Software licensing and related integration projects	450,350	-	450,350
E-commerce related services	8,447,834	(5,992,000)	2,455,834
Total revenues	68,921,504	(35,947,843)	32,973,661
Sales and value-added taxes	(3,789,394)	1,312,950	(2,476,444)
Net revenues	65,132,110	(34,634,893)	30,497,217
Cost of revenues:			
Advertising and e-commerce related services	(40,871,514)	962,095	(39,909,419)
Software licensing and related integration projects	-	-	-
Total cost of revenues	(40,871,514)	962,095	(39,909,419)
Gross profit (loss on revenues)	24,260,596	(33,672,798)	(9,412,202)
Operating expenses:			
Selling, general and administrative expenses	(179,657,915)	9,298,124	(170,359,791)
Research and development	(12,678,904)	(2,077,778)	(14,756,682)
Total operating expenses	(192,336,819)	7,220,346	(185,116,473)
Operating profit (loss)	(168,076,223)	(26,452,452)	(194,528,675)
Other income (expenses):			
Sale of 163.net usage right	-	-	-
Interest income	27,858,710	-	27,858,710
Interest expense	(2,589,735)	-	(2,589,735)
Other, net	(9,099)	-	(9,099)
Profit (loss) before tax	(142,816,347)	(26,452,452)	(169,268,799)
Provision for income tax	-	-	-
Net income (loss)	(142,816,347)	(26,452,452)	(169,268,799)
Other comprehensive loss			
Currency translation adjustments	(348,586)	-	(348,586)
Comprehensive loss	(143,164,933)	(26,452,452)	(169,617,385)
Net income (loss) per share, basic and diluted	(0.06)	(0.01)	(0.07)
Net income (loss) per ADS, basic and diluted	(5.72)	(1.06)	(6.78)
Weighted average number of ordinary shares outstanding	2,497,467,200	-	2,497,467,200
Weighted average number of ADSs outstanding	24,974,672	-	24,974,672

16. Restatement (Cont'd)

Consolidated Balance Sheet As of December 31, 2000

	As previously reported	Restatements	As restated
	RMB	RMB	RMB
Assets			
Current assets:			
Cash	708,561,012	-	708,561,012
Restricted cash	136,052,705	-	136,052,705
Accounts receivable, net	1,084,888	(400,000)	684,888
Prepayments	3,369,211	-	3,369,211
Other current assets	29,732,955	(18,276,633)	11,456,322
Due from related parties, net	30,494,178	(24,624,983)	5,869,195
Total current assets	909,294,949	(43,301,616)	865,993,333
Non-current rental deposit	1,682,710	-	1,682,710
Investment in convertible note	827,810	-	827,810
Investment in convertible preference shares	16,556,199	-	16,556,199
Property, equipment and software, net	44,205,640	(8,843,549)	35,362,091
Deferred asset	21,368,657	(20,695,250)	673,407
Total assets	<u>993,935,965</u>	<u>(72,840,415)</u>	<u>921,095,550</u>
Liabilities & Shareholders' Equity			
Current liabilities:			
Short-term bank loans	112,600,000	-	112,600,000
Accounts payable	9,996,953	(2,434,505)	7,562,448
Salary and welfare payable	6,732,037	-	6,732,037
Taxes payable	2,320,054	(1,312,950)	1,007,104
Deferred revenue	1,808,739	(1,250,000)	558,739
Accrued liabilities	18,781,557	-	18,781,557
Due to related parties	1,313,229	-	1,313,229
Total current liabilities	<u>153,552,569</u>	<u>(4,997,455)</u>	<u>148,555,114</u>
Shareholders' equity:			
Series A convertible preference shares US\$0.01 par value: 3,000,000 shares authorized, issued and outstanding as of December 31, 1999 (aggregate preference on liquidation of US\$15 million)	-	-	-
Ordinary shares, US\$0.0001 par value: 1,000,000,000,000 shares authorized, 2,004,500,000 shares issued and outstanding as of December 31, 1999, and 3,010,555,600 shares issued and outstanding as of December 31, 2000	2,492,350	-	2,492,350
Additional paid-in capital	1,076,505,358	-	1,076,505,358
Less: Subscription receivable	(6,439,401)	(41,390,508)	(47,829,909)
Deferred compensation	(37,306,585)	-	(37,306,585)
Translation adjustments	(348,586)	-	(348,586)
Accumulated deficit	(194,519,740)	(26,452,452)	(220,972,192)
Total shareholders' equity	<u>840,383,396</u>	<u>(67,842,960)</u>	<u>772,540,436</u>
Total liabilities & shareholders' equity	<u>993,935,965</u>	<u>(72,840,415)</u>	<u>921,095,550</u>

17. Commitments and Contingencies

Commitments

As of December 31, 2000, future minimum lease commitments were as follows:

	<u>Office rental</u>	<u>Server custody fee</u>	<u>Total</u>
2001	4,574,065	16,694,704	21,268,769
2002	4,009,659	45,135	4,054,794
2003	385,530	-	385,530
Total	<u>8,969,254</u>	<u>16,739,839</u>	<u>25,709,093</u>

Insurance coverage

As of December 31, 2000, the Group had insurance on its property, equipment and software of approximately RMB7.1 million.

18. Subsequent Events

Acquisition

On January 20, 2001, the Board of Directors of the Company resolved to purchase all of the outstanding capital stock of a private company operating as a provider of women focused content on the Internet, up to a total consideration of US\$600,000.

New options granted

In January 2001, the Company granted options to acquire a total of 26,559,000 ordinary shares to the Company's employees and certain members of the Company's senior management at exercise price of US\$0.022 per share. These options generally vest over a period of three to four years beginning with the completion of one full year from either the date of employment or the date of offer of employment.

Information relating to stock options outstanding subsequent to December 31, 2000 is as follows:

	<u>Shares</u>	<u>Average exercise price US\$</u>
Balance, December 31, 2000	248,901,100	0.091
Options granted	26,559,000	0.022
Options cancelled	(11,259,950)	(0.073)
Balance, February 14, 2001	<u>264,200,150</u>	<u>0.085</u>