

**NEXON Co., Ltd.**

**Q3 2018 Earnings Conference Call**

**Prepared Remarks**

**Nov 8, 2018**

**Owen Mahoney, Representative Director, President and Chief Executive Officer, NEXON Co., Ltd.**

Thank you all very much for joining us today.

I'm pleased to report that we had another great quarter, with our business delivering solid results around the world. The results represent record Q3 revenues, operating income, and net income, and we also delivered the highest quarterly mobile revenues in our history.

These excellent results were primarily driven by the continued strength of our biggest franchises across the regions. The credit for the sustained growth in these franchises goes to the outstanding work by our live operations and live development teams around the world. The work by these incredibly talented people is the key to building a sustainably growing, SaaS-like business. We believe Nexon has the best live teams in the world.

Our world-class live teams are one way Nexon is different from the traditional games industry model. The games industry has recently been re-tooling to digital online and recurring revenue models. That's been Nexon's approach since day 1.

Another difference is how we build for the future. In the traditional games approach, most of your revenues comes from games that were recently launched, in the last 1-2 quarters. In an online approach, most of your revenues comes from games you launched well over a year ago.

That difference means in the traditional approach, the key point of analysis was to look for catalysts, which means evaluating the pipeline of new product launches. In the purely online approach it's about growing the game world over many years. This is conceptually similar to a SaaS model, in that the primary objective is about delivering annuity-like returns by continuously adding to and growing out the offering.

This difference of approach is why Nexon has been able to consistently build its business over the long term, rather than being distracted by the noise in the short term. And the growth of those SaaS-like game worlds, along with our pipeline of new games, makes us confident in the future.

Now, let me talk about our progress during the 3<sup>rd</sup> quarter.

We introduced the National Day update to China *Dungeon&Fighter* on September 17, and it's been performing well. Sales from this update during the quarter were very strong, and as a result, *Dungeon&Fighter* exceeded our expectations, showing double-digit growth year-over-year in local currency terms, and record Q3 revenues.

While most people don't know this, *DNF* is now among the very largest game franchises of all time, in terms of life-to-date revenue. More importantly, while there may be fluctuations depending on timing and performance of individual updates to the game, in reviewing the KPIs and activity within the game, we are seeing resilience and growth well into the future.

On to *MapleStory*. It's been a great quarter for the *MapleStory* franchise around the world. Last quarter we said *MapleStory* PC had an incredible 61% year-over-year growth in Korea, following the successful 15th anniversary events and Summer update. The Summer update, which started in Q2, continued its strong performance in Q3, along all key metrics, including MCCUs, ACCUs, MAUs, and paying users. This strong engagement drove *MapleStory* to exceed the very high expectations we built into our guidance, and resulted in it growing 129% from the same period last year. Like *DNF*, *MapleStory* is bigger than it has ever been in 15-year history – this is precisely what we mean when we use the term “forever franchise”.

Meantime, the mobile version of *MapleStory*, which we launched 2 years ago, had another great quarter, growing significantly both QoQ, and YoY. Again thanks to the great work by our live operations and live development teams, the game grew 134% YoY in Korea.

And in July we launched the game outside Korea to the global markets excluding Japan and China. It's off to a solid start.

And last but not least in the world of *MapleStory* IP, we launched *MapleStory2* for PC in the West in October. We made a lot of changes to the game for its launch in the West, specifically to foster high retention, and it's off to a great start. While it's still early, so far we are seeing the kinds of KPIs that we know from experience leads to long-term success. And so far on Twitch and the Reddit forums our players have given high marks to both the development teams in Korea, and the operations team in the US.

These results underscore the strength of Nexon's IP bench. Both *Dungeon&Fighter* and *MapleStory* are getting both stronger in engagement and bigger in revenue than they've ever been.

Now let me shift gears and give you a quick update on *FIFA ONLINE 4*, which we service in Korea in close partnership with the game's developer, Electronic Arts. The transition from *FIFA Online 3* to *FIFA ONLINE 4* has gone very well, and the revenues as well as the key metrics, such as MAUs, and paying users, were all up nicely quarter over quarter.

Again, our focus is on the continued long-term growth of the franchise, and we are happy with the progress.

Looking ahead, we have a rich library of new games we will launch around the world. These include some of our most long-established and beloved IPs, including *Mobinogi*, *Tales Weaver*, *Crazy Arcade BnB*, and *The kingdom of the Winds*. We will be showing several of these at the upcoming G-STAR show in Korea later this month.

Nexon's ability to make immersive virtual worlds that grow over many years is highly unique and incredibly powerful. Longevity – which means players coming back for many months or years – is the most powerful concept in online games on any platform. Although much of the industry is focused on near-term catalysts, product launches, and app store rankings, it is player longevity that builds forever franchises that have enduring benefit for customers, employees, and shareholders.

That leads to the topic of Western game development, and our investment in Embark Studios, which we announced earlier today.

Embark is a new game development studio located in Stockholm, Sweden, headed by Patrick Söderlund. Patrick is one of the most prolific and successful creative leaders in the videogames industry. He was responsible for creating the highly innovative *Battlefield* franchise almost 20 years ago, and then building it into one of the largest and most iconic franchises in the industry.

His most recent position was Chief Design Officer and head of development at Electronic Arts, where he led the renaissance in their game development efforts over the last several years, and oversaw the growth of blockbuster franchises such as *Star Wars*, *Need for Speed Edge*, *Madden NFL*, and *FIFA*.

Nexon is the sole strategic investor in Embark Studios and will serve as the worldwide operator of the new properties developed by the company. Similar to our relationship with EA for *FIFA Online* or *Valve for Counterstrike Online*, Nexon will manage the day-to-day live operations of the game worlds, including customer interaction, in-game events, customer support, user acquisition, and localization.

Additionally, Patrick will be nominated to serve on Nexon's Board of Directors. The nomination is expected to be ratified at the Nexon shareholder meeting in March 2019.

As an executive with years of experience making hit game franchises in the Western market, we think Patrick will bring a unique perspective to Nexon's Board of Directors and will help shape Nexon's vision for years to come, especially for development of games that appeal to a global audience.

And, Nexon's board of directors and I feel it's important and appropriate for the board of a videogame company to have a game developer as one of its members, especially someone as capable as Patrick.

I've asked Patrick to join us on this call to talk briefly about his perspective, but before that I want to briefly talk about what this means for the future of games and of Nexon.

In preview, this agreement represents the marriage of our complimentary skill sets in game development and operations of online games, of expertise in the East and West games markets, and of the highest caliber of people.

In our view, the online games industry is just beginning. It's only been 25 years since Nexon brought the first graphic massively multiplayer online game to the market, *The Kingdom of the Winds*. Over the next 25 years, we expect new technologies like AI, machine learning and even AR to enable vastly different experiences. This is great news for our industry, if the industry chooses to innovate and take creative risks. Despite the incredible advances in technology in just the last few years, our industry has been slow to catch on and leverage the new technologies to bring great game experiences to customers. Yet all the biggest new franchises of our industry, whether from Nexon or other companies, had major innovative leaps at their core.

So the time is now for the next big innovative leap. But to pull off great innovation requires both clear vision and great execution. Embark Studios is just that sort of team.

And now, let me introduce Patrick Söderlund.

**Patrick Söderlund, *Embark Chief Executive Officer (CEO)***

Thanks for the extremely kind words, Owen.

This partnership between Embark Studios and Nexon is built on a deeply aligned vision about the future of interactive entertainment, and about challenging the standard conventions and practices of how to create.

What will interactive experiences look like in a few years? Connected players, big data, speech recognition, cloud compute, advanced AI and more – what new play will open up?

Embark are a group of veteran creators eager to move beyond current play experiences. Committed to a modern development approach, our past pushes us to explore new creative methods.

Very few companies and leaders in our industry dare to see around the next corner, dare to think about the future of interactive entertainment and most importantly try to do something about it. In Owen and Nexon I feel we have the perfect partner to do just that.

Nexon knows how to not just build incredible IP - such as *Dungeon&Fighter* and *MapleStory* - but to design experiences that keep players in these worlds for over a decade. The ability to understand what engages, entertains and brings value to players long term is the most powerful ability for any games company.

Further, Nexon has built THE most effective and powerful game operations, live services and player relationships model, which has become the gold standard utilized by nearly all of the most successful game businesses around the globe, while underestimated still in the West.

And finally, what I have seen of the leadership at Nexon, has been a fearlessly bold vision and frictionless decision-making ability to help create brand new forms of interactive entertainment.

As we embark on this long-term venture with Nexon, and as I hope to take a seat at the table as a board member, I am extremely excited and committed to help realizing our mutual vision for the future of our industry, and to push the limits of what is possible.

I will now turn the call back to Owen.

**Owen Mahoney, *Representative Director, President and Chief Executive Officer, NEXON Co., Ltd.***

To conclude, among all the noise in the industry right now, Nexon's business continues to grow over the long term, and we are methodically investing and building for a very bright future.

We believe other opportunities to invest will arise in the future and we intend to act aggressively when great opportunities appear.

On behalf of our entire management team, we thank our shareholders and our partners, for your support, and especially our thousands of employees around the world for their hard work in making Nexon stronger than ever.

With that, I will turn the call over to Uemura-san to discuss the Q3 results and Q4 outlook.

**Shiro Uemura, *Representative Director and Chief Financial Officer, NEXON Co., Ltd.***

Now, let's move on to the Q3 results.

For additional details, please see the Q3 2018 Investor Presentation available on our IR website.

We're pleased to report that revenues exceeded our expectations for the quarter. Q3 revenues were 69.3 Bn yen, up 15% year over year on an as-reported basis or on a constant currency basis.

The operating income was 23.7 Bn yen, and the net income was 22.3 Bn yen, both of which were in the range of our outlook.

The revenue outperformance was primarily driven by the strong start of *Dungeon&Fighter* China's National Day update as well as the stronger-than-expected result of *MapleStory* in Korea, driven by the successful Summer update.

Despite the revenue outperformance and lower-than-planned costs including HR and marketing costs, these were offset by a ¥7.3 billion impairment loss primarily on NAT Games' goodwill and game IP. Accordingly, operating income was in the range of our outlook.

Net income was in the range of our outlook while we recorded a 1.9 Bn yen FX loss on our U.S. dollar-denominated cash deposits related to the depreciation of the U.S. dollar against the Korean Won during the 3rd quarter.

Revenues from our China business in the 3rd quarter exceeded our expectations, driven by the solid performance of our key title *Dungeon&Fighter*.

For *Dungeon&Fighter*, we introduced the National Day Update on September 17 and it got off to a great start. The stronger-than-expected sales from the avatar package designed for the special dungeons playable for limited period of time helped push revenues above our expectations.

During the 3rd quarter, revenues, ARPPU, and MAUs for *Dungeon&Fighter* all increased quarter over quarter due to the typical seasonality.

Meanwhile, the number of paying users decreased quarter over quarter. This was primarily due to the high comps with the previous quarter with a high base of paying users, driven by small item sales in time for seasonal events.

Revenues, ARPPU, and MAUs increased year over year. Paying users decreased slightly year over year.

Revenues from Korea in the 3rd quarter exceeded our expectations primarily driven by the strong performance of *MapleStory*.

*MapleStory's* revenue grew 129% year over year, driven by the successful Summer Update continued from Q2. MAUs and paying users were also up significantly year over year.

As a result of this, total PC revenues in Korea increased year over year.

Following the launch of the PC service in late May, we launched *FIFA ONLINE 4M* – the mobile service – in late July. Both are going well, and revenues for both have increased significantly on a sequential basis. We are planning to gradually grow *FIFA ONLINE 4* through content updates, the introduction of new players, as well as events. That said, we expect it will take more time before their revenues return to the pre-transition level.

Mobile game revenues in Korea were slightly above our expectations, primarily driven by the strong performance of *MapleStory M*, while revenues were down compared to a year ago.

While we benefited from *OVERHIT* and *KAISER*, as well as the strong performance of *MapleStory M*, these were more than offset by the decrease from *Dark Avenger 3* and *AxE*, both of which launched in the 2nd half of 2017, as well as *FIFA ONLINE 4M* impacted by the service transition.

Revenues from Japan in the 3rd quarter decreased year over year.

While we benefited from *OVERHIT* and the good start of the new mobile game *Dynasty Warriors: Unleashed*, launched on September 20, these were more than offset by the decrease from the mobile browser games, *HIT* and *HIDE AND FIRE*.

Revenues from our North America business in Q3 were up over 2x year over year, primarily driven by contributions from Pixelberry Studios, which we started to consolidate in Q4 2017, *MapleStory M* launched in July, and *Darkness Rises* launched in June.

Revenues from Europe and Others in Q3 were also up over 2x year over year, primarily driven by contributions from *MapleStory M*, *Darkness Rises*, and Pixelberry Studios.

Now turning to our Q4 2018 outlook.

For the 4th quarter of 2018, we expect revenues in the range of 45.9 to 50.0 Bn yen, representing a 13% to 5% decrease year over year on an as-reported basis and 10% to 2% decrease year over year on a constant currency basis.

While we expect revenues to increase year over year in Japan, North America, Europe and Others, we expect these to be more than offset by revenue decreases in China and Korea. Accordingly, we expect the Nexon group revenues to decrease year over year.

We expect our operating income to be in the range of 6.4 to 8.8 Bn yen.

We expect the net income to be in the range of 7.6 to 9.6 Bn yen.

In China, we expect revenues to decrease year over year due to revenue decreases in *Dungeon&Fighter* and *MapleStory2*.

For *Dungeon&Fighter*, aside from the National Day update continuing from the 3rd quarter, including limited-time-offer dungeons as well as avatar package sales, no other large-scale content updates are planned during the 4th quarter.

We expect *Dungeon&Fighter* revenue for the 4th quarter to decrease year over year. The initial sales from the National Day packages were strong in the 3rd quarter, contributing more to the 3rd quarter than we had initially anticipated. Meanwhile, we expect gross revenues of *Dungeon&Fighter* to increase year over year on the local currency basis for the full-year of 2018.

If you recall, last year in Q4, the comps were very good and our China business had a nice 48% year-over-year growth. While we expect this year's Q4 revenues to be down from last year in the same period, we continue to be happy about the health of our business in China.

In Korea, we expect *MapleStory's* revenue to increase, driven by the continued strength from the successful Summer update, while we expect other key PC online games' revenues to decrease, resulting in PC revenues to be roughly flat year over year.



On the other hand, for the mobile business in Korea, we expect revenues to decrease year over year primarily due to decreases in *AxE* and *OVERHIT*, both of which launched in the second half of 2017.

As a result, we expect the revenues of our Korea business to decrease year over year.

In Japan, we expect revenues to increase year over year driven by contributions from *FAITH*, which is set to launch in the 4th quarter, and *Dynasty Warriors: Unleashed*, which launched in the 3rd quarter.

In North America, we launched *MapleStory2* on October 10th, and it has gotten off to a good start. We expect revenues from the North America business to increase year over year, driven by contributions from Pixelberry Studios, which we started to consolidate from the end of November 2017, as well as from *MapleStory2*, *MapleStory M*, and *Darkness Rises*.

In Europe and Other regions, we expect revenues to increase year over year, driven by contributions from Pixelberry Studios, as well as from *MapleStory M*, and *Darkness Rises*.

In the 4th quarter of 2018, we expect the operating income to be in the range of 6.4 to 8.8 Bn yen, representing a year-over-year decrease of 46% to 25%.

Negative factors compared with 2017 Q4 on operating income are:

First, decreased revenues, including the high-margin China business.

Second, increased HR costs, primarily due to increased headcount in relation to mobile business growth as well as consolidation of game studios, such as NAT Games and Pixelberry Studios.

Third, increased marketing costs associated with promotions for new titles including Japan service of *FAITH* and *Dynasty Warriors Unleashed*, and *MapleStory2* global service, as well as promotions for *Choices*.

Lastly, increased platform fees associated with increased mobile revenues and increased costs of cloud services associated with increased number of new mobile launches.

Favorable factor compared with 2017 Q4 on operating income is the decrease in impairment loss of 4.2 Bn yen, which we recorded in 2017 Q4 and will not be repeated in 2018.

The high end of the range reflects the fact that we expect the impact of negative drivers to be larger than that of positive drivers, resulting in a year-over-year operating income decrease.

As you can see on page 15 of our Q3 investor presentation, for the full-year 2018, we expect revenues, operating income, and net income to all grow year over year.

Full-year 2018 group revenues are expected to grow year over year primarily driven by the growth in our China business with strong performance of *Dungeon&Fighter*, as well as the growth in North America, EU and Other regions with contributions from Pixelberry Studios and new mobile games, including *MapleStory M* and *Darkness Rises*.

We expect full-year 2018 operating income to grow year over year primarily driven by the growth in our high-margin China business, as well as strength of our in-house title *MapleStory* in Korea.

While we are guiding and reporting on quarterly basis, the cadence of our business is over years. We remain confident about the prospect of our long-term business.