

FY2020 Q2 Earnings Conference Call (August 6, 2019)

Q&A Summary

【Q】 In terms of the cooperation with SUPERCAT for *The Kingdom of the Winds: Yeon*, in the past you had good partnerships like this such as with NAT Games and progressively over time managed to consolidate them. Is this something that is possible for SUPERCAT as well in the interest of scale and managing *The Kingdom of the Winds* IP on mobile?

【A】 Owen Mahoney (Chief Executive Officer)

We are not in a position to speculate on what might happen down the future. It is not the right time to do that, and we have no announcements to make of any sort.

【Q】 Any updates on pipeline for 2H 2020 and after including *KartRider: Drift*, *MABINOGI MOBILE*, and Embark Studios' title?

【A】 Owen Mahoney (Chief Executive Officer)

We do not have anything to announce at this time in terms of timing.

What we have told you is that those two games, particularly *KartRider: Drift* and the first title from Embark are our next big beats.

But we have not announced dates for those yet and that is going to be driven entirely by product development and marketing. We will make the appropriate announcement for the time that is best for those launches.

【Q】 Regarding China *Dungeon&Fighter*, if you look at the quarterly revenue before it started to decline last year, quarter-over-quarter growth was observed in Q3 primarily driven by the National Day update. Now, you said you are focusing more on the existing users. Does that mean that the seasonality might change from now on?

【A】 Shiro Uemura (Chief Financial Officer)

Let me summarize China *Dungeon&Fighter*. We saw a very steady growth until 1H 2019, but from the Anniversary update in June and the Summer update in July of 2019, we started to see some decline. This year in March, we had the major update in order to recapture the churned users. However, we could not recapture them as much as what we had expected.

But the content of the update was well-received by the existing users, and so the existing user base is very stable. We think that the strong seasonality should be unchangeably seen in Q1 and Q3.

PC online games have longevity and we can grow them in the long run. So, we think it is important to maintain the current level and put it into the regrowth trajectory again.

【Q】 What kind of scenario did you expect for the start-up of *Mobile Dungeon&Fighter* when you built Q3 outlook? Is this based on the assumption that the monetization goes well from the beginning or gradually goes up? Also, since you have a very big number of pre-registrations, please tell us if you have sufficient content from the beginning.

【A】 Shiro Uemura (Chief Financial Officer)

We have very high expectations on *Mobile Dungeon&Fighter*. however, it has not yet launched and is difficult to talk about what would happen clearly at this moment. But the game experience on mobile is very close to that of the PC version. *Dungeon&Fighter* PC has been played by users for a long time and has grown significantly over time. So, our idea is to do the same with the mobile version like we did for PC version.

Regarding the Q3 outlook, we expect *Dungeon&Fighter* PC to be flat or slightly up on the high-end, and this to be offset by the decrease in *KartRider Rush+*. So, that means that we expect the year-over-year net increase in Q3 China revenue to primarily come from *Mobile Dungeon&Fighter*.

Owen Mahoney (Chief Executive Officer)

I just have one other comment. We have this game under development for some time and one of the things we wanted to be very careful of was to develop a lot of content.

A big part of polishing the game was making sure that we have enough content, which had been a big focus for our team. I wanted to let you know that this was an important component of getting the product ready.

【Q】 *The Kingdom of the Winds: Yeon* came in, at one point, number two grossing game in Korea and its revenue seems to be quite stable. I recall that the original PC version is a very old game and was curious as to whether the players are those played this game on the PC version or we are seeing younger generation of players. Also, could you share your view on the longevity this game could see?

【A】 Shiro Uemura (Chief Financial Officer)

As you mentioned, *The Kingdom of the Winds: Yeon* is trending very well, and the original PC version is quite an old title, which is the very first PC online game Nexon launched. We are very happy with the results we are getting through this game.

Talking about the attributes, needless to say, people who used to play the PC version come back to play the mobile version feeling nostalgic. However, not only that, but we are seeing a broader generation playing *The Kingdom of the Winds: Yeon*. So, we see that broader generation including both past and new users are playing the game.

Regarding the outlook, we believe that this title can be a major contributor to our business, which is reflected in our Q3 guidance. So far, KPIs look very favorable. Of course, I cannot make any comment on the Q4 outlook and onward, but we want to utilize our know-how of operating long-lived PC online games, and we will put our full-fledged effort to enjoy longevity.

【Q】 Can I get a little bit more of background as to the rationale behind the \$1.5 billion investment in global entertainment companies? Is it to replenish some of your IP given that a lot of the games that Nexon had developed in the past has now come out on a mobile or a cross platform version? Does this \$1.5 billion include game companies or only companies that own non-game related IP? Is it going to be a passive investment or more of a mutual partnership?

【A】 Owen Mahoney (Chief Executive Officer)

Let me give you a quick background. We have a very particular view on what is going on in the global media industry right now and where it is heading in the coming years. We have a very strong opinion that we are in the middle of a profound secular shift in our industry and that we are going to look back on the first half of 2020 as a major turning point. We think the world has really changed at least in the entertainment industry. The market for interactive entertainment is already bigger (than that of linear entertainment) and it is changing a lot.

However, when I read the newspapers in the US and Japan, this type of discussion is barely mentioned. The topics typically are about linear entertainment, about movies, music or live sports when you see entertainment coverage.

The question for us is who wins in this new world. We think that we win if we execute well, but we also think there are a lot of good IP out there that can win if the IP owners make that transition to the new world. We think this represents a real opportunity in the next 10 years. So, we think it is a good use to put our cash into this opportunity. It is not part of our M&A strategy. The primary purpose is to get a better return on our cash in a zero-interest rate environment. The Board has approved us to invest in up to \$1.5 billion and we have invested about half of that so far. If the opportunity arises, potentially, we can work with the companies that we invest in to help them make that transition, if they are interested in doing that.

So, to your question whether it is about replenishing our IP, we do not think that way at all. We have some of the very biggest IP in the entire entertainment industry anywhere in the globe. But we also have a view that there are going to be some other great winners in the world that we are all going into. So, that is what it is about.

[Q] Can I confirm that you cited that you already spent 50% of this budget and that means in the near future, you will be disclosing which companies you have invested in?

[A] Owen Mahoney (Chief Executive Officer)

Yes, we are confirming that we spent roughly 50% of the budget. We may or may not announce who those companies are that we have invested in.

[Q] How are you managing the potential risk of cannibalization for *Mobile Dungeon&Fighter*? Are there some metrics you are monitoring such as how many are current active users on PC versus those who are not out of the 60 million pre-registrations?

[A] Owen Mahoney (Chief Executive Officer)

The short answer is that it is extraordinarily hard to tell. But over time, what we have seen is that the franchise tends to grow on both. The much bigger impact that we have seen is synergies between the platforms. That gets reflected across the KPIs, and eventually get reflected in revenue.

As an illustrative example of this, we have shown before the history of *MapleStory* PC and *MapleStory M*. You can see what happened with *MapleStory* on page 40 of the Q2 deck. We launched *MapleStory M* in 2016, and through 2019, the numbers got substantially stronger in *MapleStory* PC, and those numbers have gotten even a lot stronger in the first half of 2020.

So, over the long term, it has been very good for the franchise overall on each of those platforms and that overwhelms whatever cannibalization, which is very hard to tell that may be there. Net, it is hard in the near term to call precise numbers, however, over the long term, our experience has been very positive. And we will just have to see how it works out for *Dungeon&Fighter*.

[Q] Is there some kind of an image you could share in terms of the monetization for *Dungeon&Fighter* on PC versus mobile as well as the take rate?

[A] Owen Mahoney (Chief Executive Officer)

The way to think about *Mobile Dungeon&Fighter* is that it is basically designed to be PC *Dungeon&Fighter* but on a mobile device. That is the way to think about it in terms of everything about the gameplay, monetization, how long we expect or hope that people will play and interact with each other and so on. But there will be two important differences, a small one and a bigger one. The small difference is that there is going to be a platform fee.

The bigger one is we are addressing a much bigger market. By our estimates, there are roughly about 300 million game playable PCs in the world while there are roughly 3 billion game playable mobile devices which are iPhone 10 equivalents or higher. We are dealing with a total addressable market that is much bigger and that dwarfs platform fees in terms of size of impact for us and are very excited about the mobile platform.

So, it is designed to be the PC experience, but from a user's perspective, there is a huge impact as mobile is with you all the time, anywhere you are at.

【Q】 Could you please elaborate on what Tencent is doing to get those pre-registrations for *Mobile Dungeon&Fighter*?

【A】 Shiro Uemura (Chief Financial Officer)

There were many pre-registrations for *Mobile Dungeon&Fighter* even before the full-fledged marketing, which started quite recently. After the launch date announcement, Tencent conducted major marketing activities, including marketing activities on *Mobile Dungeon&Fighter's* official website and showcasing at the Tencent Games Annual Conference as well as China Joy.

【Q】 Is there anything that you can comment on regarding how Tencent is leveraging its platforms to make the most out of *Mobile Dungeon&Fighter*?

【A】 Shiro Uemura (Chief Financial Officer)

Tencent has communication channels such as QQ and WeChat. My understanding is that they are maximizing these channels to conduct marketing activities.