

FY2022 Q2 Earnings Conference Call (August 9th, 2022)

Q&A Summary

【Q】 Could you share the reason for the increase in ARPPU year-over-year in Q2? Regarding China *Dungeon&Fighter*, I understand that Labor Day update conducted in April was well-received, but your strategy was to control the increase in ARPPU. Have you seen increases in ARPPU of *FIFA ONLINE4*¹ and other titles in Korea? Or was there an impact from foreign exchange rate?

【A】 Shiro Uemura (Chief Financial Officer)

The KPIs we disclose are the consolidated KPIs of our PC titles. The year-over-year increase in ARPPU was driven by China *Dungeon&Fighter*, PC titles in Korea, and the impact from the foreign exchange rate.

【Q】 Q2 results and Q3 outlook for the China business look weak, but could you tell us the current situation and outlook of China *Dungeon&Fighter*? Also, were you impacted by the lockdown in China?

【A】 Shiro Uemura (Chief Financial Officer)

As I explained in the previous quarter, we believe that China *Dungeon&Fighter* has bottomed out in Q1. We have been operating the game with a mid- to long-term perspective rather than focusing on short-term gains in order to maintain a firm recovery trend. In Q1 and Q2, we were able to increase revenues year-over-year, which means we believe that we have been able to operate the game steadily. As for Q3, we expect a year-on-year decline given the challenging comparison with last year's Q3 when the China business grew 33% year-over-year on a constant currency basis. However, we believe that we have been able to put the game back on a solid recovery trajectory. In terms of the lockdown in China, there was almost no impact on our business.

¹ Official titles are EA SPORTS™ FIFA ONLINE 4 (PC) and EA SPORTS™ FIFA ONLINE 4 M (mobile).

【Q】 HR costs² continue to increase. What is the major reason for the increase? Is this due to the impact of foreign exchange rates or due to the increased cost in talent acquisition?

【A】 Shiro Uemura (Chief Financial Officer)

The increase in HR costs is partly due to foreign exchange rates, but mainly due to bonuses for contributions to great performances and new hiring. In addition to providing sufficient bonuses in line with topline growth, we are also acquiring great talent steadily. We view these investments in human resources as an upfront investment to develop high-quality new games and to maintain and improve the quality of our existing titles. Therefore, while HR costs are increasing, we do not view this as a burden to our business as we think it will later lead to topline growth.

【Q】 Could you share the reason for the delay of *ARC Raiders*? *ARC Raiders* was originally going to be the first title from Embark Studios. Is there any other reason than the difference in progress speed that *Project Discovery* will be released before *ARC Raiders*?

【A】 Owen Mahoney (Chief Executive Officer)

Discovery is progressing faster than we expected, and we do not want the two Embark titles to be released right on top of each other.

Bringing a Virtual World to the market is very different from traditional games and we know from experience what works. As we get ready for launch, we test among progressively larger groups of people, and from the results, we decide what is needed for the game to succeed over years and decades.

In the case of *ARC Raiders*, we like where the game is today—its base, art, backstory, and content—but we wanted to add a major new mode for the longevity of the game.

We made the same decision with *Dungeon&Fighter Mobile* and it worked out great once we launched it. Our live operations team is thrilled with the retention rates the games has had since launch, so we think it is the right approach if you want to have a business that lasts.

I would also like to reiterate that we are enormously thrilled with both games—*Project Discovery*, which we are planning to launch first now, and *ARC Raiders*.

² HR costs include HR cost (COGS), HR cost (SG&A) and R&D (SG&A)

【Q】 Could you explain the reasons behind the strength of *FIFA ONLINE 4*? Do you think there is a positive impact from the World Cup at the end of this year?

【A】 Shiro Uemura (Chief Financial Officer)

*FIFA ONLINE 4*³ and *FIFA ONLINE 4 M*⁴ are doing very well, driven by great daily operation and content update, as well as successful marketing and events.

While the excitement of the World Cup at the end of the year may have a part, we think the success has more to do with the combination of marketing activities and events.

【Q】 Can you give some background as to why the share repurchase policy by November 2023 was completed earlier and the new buyback program was put in place? In the hypothetical case that NXC ends up selling a part of Nexon shares in the market, would the company be willing to use the buyback program to absorb any potential supply of the shares?

【A】 Owen Mahoney (Chief Executive Officer)

We cannot make any comments on what may or may not happen by one of our shareholders. We are feeling very confident about our future. We like our pipeline, our live game operations, and our business model. With this as a backdrop, we thought the share repurchase would be a great way for shareholder return and to invest in our future. We thought it would be a good time to complete the reminder of the share repurchase program announced in November 2020 and to start another program.

【Q】 Regarding your Q3 outlook, could you provide us with a breakdown of PC and mobile revenues in Korea?

【A】 Shiro Uemura (Chief Financial Officer)

We do not provide the breakdown of PC and mobile for each region for the next quarter's outlook. We appreciate your understanding.

【Q】 Regarding your postponement of *ARC Raiders* to 2023, if you have more details on your new schedule, could you share it with us?

【A】 Shiro Uemura (Chief Financial Officer)

We will add a new Player vs. Player mode to *ARC Raiders*. Our policy for launching new games is to launch them when we are truly satisfied with what we have. We believe that we will be able to enhance the longevity and make the game even more likely to succeed. We will announce a more specific schedule as soon as we are ready.

³ Official title is EA SPORTS™ FIFA ONLINE 4 (PC).

⁴ Official title is EA SPORTS™ FIFA ONLINE 4 M (mobile).

【Q】 Do you have any updates on China *Dungeon&Fighter Mobile*?

【A】 Shiro Uemura (Chief Financial Officer)

This is no particular update on China *Dungeon&Fighter Mobile* at this time.

【Q】 My understanding is that *ARC Raiders* is TPS while *Project Discovery* is FPS, and that the market potential for the two genres is very different. How do you see the market potential for these two markets? Also, what are your revenue expectations for these two titles?

【A】 Owen Mahoney (Chief Executive Officer)

As you said, we have announced *ARC Raiders* to be TPS and *Project Discovery* to be FPS. We do know that the FPS genre is massive, but we would really have to bring something special to the table if we are going to win in this genre. In other words, we have to do something differentiated in different look and approach.

The Embark team is one of the most creative and bankable teams in the West. We think that the work they do in the FPS genre is phenomenal, and the FPS genre is really where they started. We feel the project that the team is working on is very differentiated and incredibly fun.

But it's difficult to answer your question directly, because what happens over and over in the games business is that, when you do true innovation, you find that the market is much bigger than that of existing rigid genres. Therefore, market sizing before product launches, collecting users' feedback and retention numbers becomes a very challenging task.

What we believe is that both games will address a large market and our objective is to make them incredibly fun over many years.

【Q】 You wanted to avoid launching the two AAA titles, *Project Discovery* and *ARC Raiders*, at the same time, but what do you think is the minimum time interval that is needed between the two launches?

【A】 Owen Mahoney (Chief Executive Officer)

The short answer to your question is, not in the same quarter. The slightly longer answer is, I would like to remind you that these are not packaged good games. These are Virtual Worlds. We would have to think long and hard to conduct testing, to set up servers, to have a lot of player communication, and to do marketing. We want to make sure that all those things are handled smoothly and well, so at a bare minimum, we do not want them in the same quarter.

【Q】 You said launching a Virtual World requires a long time for various preparations such as testing, communication with users, and marketing. I also heard that *Project Discovery* is now scheduled for the launch around the end of the year. Have you done sufficient beta tests and user communication? Also, is there any possibility that after the test is conducted, the launch may be postponed due to the need to add new features?

【A】 Owen Mahoney (Chief Executive Officer)

We have been very happy with the rapid progress of *Project Discovery*. Beyond that, we do not have any additional details to share at the moment.

【Q】 Since *Project Discovery* is to be launched sooner than your initial expectation, has your confidence in the game changed over the last three months?

【A】 Owen Mahoney (Chief Executive Officer)

What I can tell you is that *Project Discovery* is a game that I am really looking forward to playing. When we show the world what we are working on, I think the world will be as excited as I am.

I think there will be a lot of other people like me, and that is usually a pretty good guide for what works well financially in the videogames business.

【Q】 Regarding China, could you elaborate on the reasons why you had lower-than-expected results in Q2? I understand this was due to your focus on user engagement, but did you see unexpected changes in something such as KPIs during the quarter, which led to a change in the operation?

【A】 Shiro Uemura (Chief Financial Officer)

Our view that China *Dungeon&Fighter* bottomed out in Q1 and has been on recovery track remains unchanged. However, the duration of the positive impact from the measures we have been taking tended to be shorter than we had initially expected. For example, right after we conducted the Level Cap Release, we saw improvements in the KPIs, but the impact did not last as long as expected. Therefore, we are currently operating the game in an even more meticulous manner by monitoring daily KPIs and user trends. However, even under these circumstances, we have been showing solid year-over-year growth and continue to believe that we are on the way to recovery.

We will continue to operate the game in Q3, not from a short-term perspective, but from a mid- to long-term perspective, so that we can realize further solid recovery.

[Q] An increasing number of Japanese game developers are announcing that they are strengthening their PC game business. Given this, I believe that the competition in the PC online game market, in which you have a competitive advantage, will intensify. How do you plan to position yourself in the market and conduct business in this environment?

[A] Owen Mahoney (Chief Executive Officer)

Firstly, I would like to point out that we are a very different company than a lot of game companies. We use the word "Virtual World" to describe what we have been creating. For over 25 years, we have made deeply immersive experiences and simulated virtual environments with thousands of other players in the same game world at the same time. This is very different from the type of single player experiences that you oftentimes see in more traditional games.

Secondly, I am happy that more game developers, particularly Japanese ones, are focusing on the PC business because that means there would be more content for PC. The PC business has always been underserved in Japan in our view, whereas it has been very popular for many years in places like Korea, China, and the United States. Our observation is that the Japanese market tends to consider PC as an office automation tool or a content creation device rather than a content consumption device, so we think it is terrific that more companies and more consumers will see it as a content consumption device.

Thirdly, it is important to put whatever is happening in PC in the context of mobile. iPhone X or up or equivalent Android device is an extremely powerful workstation that we can deliver a very deep immersive Virtual World.

By our estimates, there are roughly 300 to 400 million game playable PCs operating in the world today. According to a publicly available information, there are roughly 3 to 4 billion iPhone X or up are being operated today. So that's a total addressable market expansion of 10x, and we think it's important to deliver our unique Virtual Worlds on all those devices, PCs, consoles, and mobile devices.

Finally, I would like to discuss a very common analytical fallacy that you have seen in the videogames business. It's common to focus on competition in the market and increase of market share partly because we get a lot of people who come from consumer package goods business. But it is an analytical fallacy, because, in our view and in our experience, we are not suffering in the games business from an excessive competition, but we are suffering from a scarcity of great new ideas and creativity. Our view is that if we do something special especially in online Virtual Worlds, we end up with a vast market that grows over time. It dwarfs any near-term issues or potential competition.
