

NEXON Co., Ltd.

Q4 2022 Earnings Prepared Remarks

February 9, 2023

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

Thank you Kawai-san, and welcome everyone.

I'd like to start today's call by setting context. Like most companies in our business, at Nexon we regularly do comprehensive reviews of other companies that we might want to buy. Recently we've been challenged to find potential targets that have not expressed serious concerns about the future. Private and public game companies have each been telling us a very similar story, largely around four themes:

- First, the global economy is in bad shape, and that is impacting consumer spending.
- Second, competition – especially from highly-funded AAA games – has been even more fierce than usual.
- Third, the end of COVID and return to work has eliminated the surge in players and play time we saw during the pandemic.
- Fourth, for many companies in the mobile space, the IDFA changes from Apple have destroyed their unit economics, and their hope to generate any material profit.

This all sounds pretty bleak. And certainly the gloom we've been hearing in games is even worse in the broader consumer media and tech space, where even the most respected companies are slashing ad spending and laying off tech workers by the 10s of thousands.

In sharp contrast to that gloomy operating environment, Nexon's performance has never been better, and is getting even stronger. Nexon achieved its best ever revenue year in 2022. We just completed an outstanding Q4, where we grew our topline 36% on a constant currency basis. That brought us to 19% growth for the year on a constant currency basis. And that great performance extends to Q1 of 2023: as Uemura-san will detail for you, our guidance calls for revenue growth of 19% to 28% growth on a constant currency basis. Performance of all of our largest live games has been excellent. And now we're launching a number of major new Virtual Worlds in 2023.

In a moment we will give you details of our performance by franchise and by region.

Before doing so, we think it's worth pausing to underline a key point to help investors. That is: Nexon's business – the business of deeply immersive Virtual Worlds – is so different from other game companies as to constitute a wholly different entertainment industry category altogether. Virtual Worlds is different in almost every way: different in how we operate our business on a day-to-day basis, the kind of people we hire, what metrics we use to gauge our success, what technology investments we make, how we communicate our business performance internally and to outsiders, and perhaps most importantly the mind-set of our management and operating teams.

The sharp contrast of our performance to other companies that we are usually grouped together with presents an opportunity to reconsider and reframe what investors think they know about Virtual Worlds companies like Nexon. In this call Uemura-san and I will endeavor to explain what we mean by this difference, so that you can better analyze our performance and our future.

I'll start by summarizing the highlights of the quarter and the year.

Q4 2022 marked the highest Q4 revenue in Nexon's history, and 2022 marked the highest annual revenue in Nexon's 28-year history. Fourth quarter revenue grew 49 percent year over year, to 81.1Bn JPY and included a year-over-year increase in operating profit of more than 200 percent. For the full-year 2022, Nexon delivered a 29 percent increase in year-over-year revenue to 353.7 Bn JPY and a 13% year-over-year increase in operating profit.

In the full course of 2022 Nexon delivered strong results in key franchises.

FIFA ONLINE 4 delivered record-high annual revenue. We're extremely pleased with the result, especially since we think the core product, the performance of our live game team, and our live ops tech stack backing the game are working so well together. World Cup clearly provided a boost for 2022, although we should note we'll have a tough comp in 2023 for this product as there will be no World Cup.

Meantime, following a drop we experienced back in 2021, *MapleStory* in Korea continued its growth trajectory that began in Q2 of 2022. Both revenue and MAUs increased year-over-year.

Also in Korea, the Mobile version of *Dungeon&Fighter*, which we introduced in March 2022, has continued to perform well. In Q4, the game also won Game of the Year from the Korean Association of Game Industry, known as K-Games. The live operations team celebrated this achievement by lowering monetization in the game. Why would they do this? Because they understand that in a well-run Virtual World, building long-term engagement over years and decades is more important than near term monetization.

In China, after significant preparation work by the live development team, the PC version of *Dungeon&Fighter* showed very strong performance, and overall our business in China grew by 55% year-over-year. Importantly, the game saw a meaningful increase in active users in Q4. The Lunar New Year update released this January is proving to be very popular, and our China business is tracking toward double-digit year-over-year growth in Q1. It's too early to project how this trend will continue across the full year, but we are pleased with the recent results we're seeing in China.

I will pause here to note that the rebound of both *MapleStory* in Korea and *Dungeon&Fighter* in China reflect our experience over and over again: live Virtual Worlds fluctuate up and down in the near term but when managed well can show steady growth over years and decades.

Second, and as important, Nexon has a portfolio of such robust Virtual Worlds, so when one goes down, the others very often make up the difference. This inherent stability to our portfolio enables us to make thoughtful investments in the community of each game over time.

Next, I want to provide an update on new Virtual Worlds in development for release in 2023.

In mid-January, *KartRider: Drift* debuted with an open play test on PC and mobile platforms. The test which we dubbed "Preseason" was conducted with only limited marketing support and was designed to evaluate stability, network code, new features, and gameplay with a large number of consumers in Asia, Europe and the Americas. *KartRider: Drift* is fully-cross platform, meaning players can compete across PC, Console, or Mobile. It is also global, so that players in the US can play against others in Korea or Japan. The game is scheduled to begin official service from March 9 on PC, iOS, Android, Xbox and PlayStation.

KartRider: Drift is an example of how we are approaching Virtual Worlds by focusing on building a robust community over time. While *KartRider* is virtually unknown in Japan and the West, in Korea it's been played by over half the population. The consensus of the community around the world is that *KartRider: Drift* is a lot of fun, but even more, it redefines the genre of Kart Racing. Of course, it starts by being free, and it's also available with full cross-play on 5 different platforms, not just one. But because it's online, players love to express their personality through the deep customization features we've put into the product. So, the Virtual World of *KartRider* is about players' own individuality, not limited to someone else's IP. This sentiment of individuality and self-expression is a powerful aspect of successful Virtual Worlds and one that we will build out much more deeply in the quarters and years ahead.

Speaking of deep customization and self-expression, I'll now turn to *THE FINALS*, from Embark in Sweden. We plan to follow up from the successful closed Alpha last quarter to a much larger, closed beta this quarter as planned. We are very excited with the technology underpinning the game, and most importantly with the gameplay that technology and other innovations enable. Despite these innovations, development has continued to move rapidly. The upcoming beta will enable us to test these features at a scale of hundreds of thousands globally.

Meantime, development for the second game from Embark, *ARC Raiders*, has been proceeding apace.

We are conducting an internal UXR test in March, followed shortly by a closed Alpha with a limited number of outsiders, just as we did with *THE FINALS*.

Our external playtests of both *KartRider: Drift*, and *THE FINALS* are conducted with limited marketing support. At the early stages, our focus is on player engagement and fun, so that we can build a robust community over time. That community of engaged players enables us to build a strong, stable revenue base that we hope to extend and grow over future quarters and years. As a Virtual Worlds company, we've learned from experience how important those early stages are for the long-term success, so we discourage investors from making assumptions about early-stage revenues until these games are launched and established in the market.

In addition to these, several other Virtual Worlds are in later stages of development, including *WARS OF PRASIA*, *VEILED EXPERTS*, *The First Descendant*, *Warhaven*, and *MABINOGI MOBILE*.

To summarize, Nexon delivered record-breaking revenues in Q4 and full-year 2022. Performance of our portfolio of live Virtual Worlds has never been stronger, and our pipeline of upcoming Virtual Worlds has never been more robust.

We think our strong performance reflects both the extraordinary effort by Nexon teams around the world, but also the power of the innovative business model of Virtual Worlds that Nexon has pioneered. We believe the next 12 to 18 months will be very exciting.

With that, I will turn the call over to Uemura-san.

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

Thank you, Owen. Now, I'll review our Q4 and FY 2022 full-year results.

For additional details, please see the Q4 2022 Investor Presentation available on our IR website.

We achieved record breaking fourth quarter revenue of 81.1 Bn yen, up 49% year-over-year on an as-reported basis and up 36% year-over-year on a constant currency basis. Our performance continued to be driven by the growth of multiple major titles, as well as contributions from new titles - *HIT2* and *Dungeon&Fighter Mobile*.

Overall, our topline performance was within the range of our outlook. *Dungeon&Fighter* in China and *FIFA ONLINE 4* exceeded our expectations, while revenues from our mobile business in Korea were lower than planned.

By region, revenues from China, North America and Europe exceeded our outlook while revenues from the Rest of World came in at the high end of our expectations. Revenues from Japan were within the expected range and revenues from Korea were at the low end of our outlook.

Looking at the total company performance by platforms, PC revenues exceeded our outlook while mobile revenues were lower than expected.

Operating income was up 269% year-over-year and within our outlook at 11.0 Bn yen.

Net loss was 7.9 Bn yen, which was below our outlook.

This was mainly due to an FX loss of 25.0 Bn yen related to the appreciation of the Korean Won and Japanese Yen against the U.S. dollar and its corresponding impact on U.S. dollar-denominated cash deposits.

Let's move on to results by region.

Revenues from our Korea business were at the low end of our outlook.

On a year-over-year basis, revenues increased by 62% on an as-reported basis and by 50% on a constant currency basis, coming in at 51.0 Bn yen, representing record-breaking fourth quarter revenues in Korea.

FIFA ONLINE 4's PC and mobile combined revenues exceeded our outlook driven by successful World

Cup-related events and sales promotions.

MAUs, paying users and ARPPU all increased year-over-year. As a result, its revenues grew significantly and marked record-breaking fourth quarter revenues.

MapleStory's MAU and revenue increased year-over-year driven by the well-received Winter update.

Dungeon&Fighter's revenue grew by 65% year-over-year, which exceeded our expectations and achieved record-breaking fourth quarter revenue driven by well-received update.

For *Sudden Attack*, revenue decreased year-over-year due to the challenging comps with last Q4 when it grew 124% year-over-year.

All in, PC revenues in Korea increased by 61% year-over-year.

As for the mobile business, revenues from *HIT2* and *Dungeon&Fighter Mobile* were lower than expected.

HIT2's revenue was below our outlook as the impact from the update introduced during the quarter was lower than expected. We are preparing multiple major updates that we anticipate will help maintain high user engagement in 2023.

For *Dungeon&Fighter Mobile*, the user community was excited about the news that the game was selected as the best game of the year at the Korean Game Awards in November. Given this positive event, we decided to focus on keeping the good momentum, and canceled the planned item sales and instead, offered large-scale rewards to players. As a result, while the revenue was below our outlook, the number of active users increased quarter-over-quarter.

On a year-over-year basis, mobile revenues in Korea increased by 63%. Contributions from *HIT2* and *Dungeon&Fighter Mobile*, as well as growth of *FIFA ONLINE 4 M* and *FIFA MOBILE*, were partially offset by revenue decreases in *Blue Archive*, *V4*, *The Kingdom of the Winds: Yeon* and *KartRider Rush+*.

On a quarter-over-quarter basis, mobile revenues decreased by 15% primarily due to a decrease in *Dungeon&Fighter Mobile's* revenue and a seasonal decrease in *FIFA ONLINE 4 M's* revenue.

Revenues from our China business exceeded our outlook driven by *Dungeon&Fighter's* strong performance. On a year-over-year basis, revenues increased by 55% on an as-reported basis and by 37% on a constant currency basis.

For *Dungeon&Fighter*, revenue exceeded our expectations. Last quarter, we adjusted the game to be more user friendly and saw a recovery in active users after the introduction of the National Day update at the end of September. Amidst this positive trend, we strengthened our communications with players and conducted various events during the quarter, which resulted in further improvement of user engagement and increase in active users.

On a quarter-over-quarter basis, MAUs and paying users increased as a result of these initiatives while ARPPU decreased due to seasonality.

On a year-over-year basis, MAUs, paying users and ARPPU all increased.

Revenues from Japan increased by 14% year-over-year driven by the growth of *Blue Archive* and a contribution from *TalesWeaver: SecondRun* despite revenue decreases from *FIFA MOBILE*, *TRAHA* and *V4*.

Revenues from North America and Europe decreased by 6% year-over-year due to revenue decreases from *Choices* and *Blue Archive* despite the growth in *MapleStory*.

Revenues from the Rest of World increased by 25% year-over-year driven by the growth in *MapleStory M* and contributions from new games.

Next, I'll review our FY 2022 full-year results.

We achieved record breaking revenue in FY2022 driven by the growth in existing games backed by the strength of our live operations and the launch of new games. Group revenues for the full year 2022 were 353.7 Bn yen, up 29% on an as-reported basis and up 19% on a constant currency basis.

FIFA ONLINE 4 significantly grew driven by successful marketing, as well as well-received events and sales promotions. It marked record-breaking full-year revenue for the fourth year in a row.

Dungeon&Fighter and *MapleStory*, which experienced decreases in active users and revenues in 2021, showed signs of recovery in 2022 and increased revenues year-over-year as we strengthened our relationships with players and increased the volume of content and events. As a result, overall PC revenues grew by 24% year-over-year.

As for the mobile business, revenues grew by 41% driven by significant contributions from Korea *Dungeon&Fighter Mobile* and *HIT2*, which launched in March and August 2022, respectively.

Operating income was 103.7 Bn yen, up 13% year-over-year on an as-reported basis and up 2% year-over-year on a constant currency basis as the increase in revenues was larger than the increase in costs.

HR costs increased year-over-year primarily due to recruitment of staff for development of new games as well as bonuses for outstanding financial performances from our games. Marketing expenses also increased primarily due to promotions for new game launches.

While Operating income was up year-over-year, Net income was 100.3 Bn yen, down 13% on an as-reported basis and down 21% on a constant currency basis.

The year-over-year decrease in net income is primarily due to a comparison with last year when tax expense was at the low level due to recording of additional deferred tax assets on overseas subsidiaries. Also, we recorded valuation losses for investment funds, bitcoins and affiliates due to changes in the market environment.

Moving on to our FY2023 first quarter outlook.

In Q1 2023, we expect our three major titles, *Dungeon&Fighter*, *FIFA ONLINE 4*, and *MapleStory* to continue to grow year-over-year. We also expect good contributions from *HIT2* and *KartRider: Drift* which we started preseason in January.

Consequently, we expect record-breaking quarterly revenues in Q1 2023, in the range of 116.7 to 125.6 Bn yen, representing a 28% to 38% increase year-over-year on an as-reported basis and a 19% to 28% increase year-over-year on a constant currency basis.

We expect our Q1 operating income to be in the range of 45.3 to 52.5 Bn yen, representing a 18% to 36% increase year-over-year on an as-reported basis and a 11% to 28% increase year-over-year on a constant currency basis. I'll discuss the details on this shortly.

We expect net income to be in the range of 34.4 to 39.8 Bn yen, representing a 15% to 1% decrease year-over-year on an as-reported basis and a 19% to 6% decrease year-over-year on a constant currency basis.

The year-over-year decrease in net income is due to a 12.7Bn yen FX gain that we recorded a year ago. As you know our guidance does not factor FX gains or losses.

In Korea, we expect growth from our major existing franchises as well as solid contributions from *HIT2* and *KartRider: Drift* which we started pre

season in January.

Consequently, we are looking for revenue in Korea to be in the range of 62.7 to 67.2 Bn yen, representing a 31% to 40% increase year-over-year on an as-reported basis and a 20% to 29% increase year-over-year on a constant currency basis.

As for the PC business, we expect our three major titles, *FIFA ONLINE 4*, *Dungeon&Fighter* and *MapleStory*, to maintain their strong momentum from Q4 2022 and to grow year-over-year.

We also expect an initial contribution from *KartRider: Drift*, as its preseason started on January 12th with the grand launch on March 9th.

Regarding the mobile business, we expect Q1 revenues to increase year-over-year.

We expect contributions from *HIT2* and *KartRider: Drift*. In addition, we expect year-over-year growth in *FIFA MOBILE*. We expect these to be partially offset by year-over-year revenue decreases in older mobile titles.

Turning to China, we expect revenues from our China business to be in the range of 39.3 to 42.4 Bn yen, representing a 32% to 43% increase year-over-year on an as-reported basis and 25% to 35% increase year-over-year on a constant currency basis, driven by the anticipated increase in *Dungeon&Fighter's* revenue.

For *Dungeon&Fighter*, in Q4 2022, we saw a turnaround in the number of active users which increased year-over-year. Under this positive trend, we introduced the Lunar New Year update on January 12th.

We expect revenues to grow year-over-year driven by the excellent start of the Lunar New Year update accompanied by strong sales of the avatar package.

Throughout 2023, we will continue to focus on promoting communication with players to stably operate the game.

In Japan, we expect revenues in the range of 2.7 to 3.0 Bn yen, representing a 3% decrease to 8% increase year-over-year on an as-reported basis and a 8% decrease to 3% increase year-over-year on a constant currency basis. We anticipate contributions from new games and growth in *Blue Archive* to be offset by decreases in older mobile titles.

In North America and Europe, we expect revenues to be in the range of 4.8 to 5.2 Bn yen, representing a 2% to 11% increase year-over-year on an as-reported basis and a 8% decrease to flat year-over-year

on a constant currency basis. We anticipate contributions from new games including *KartRider: Drift* to be offset by decreases from *MapleStory M* and *Choices*.

We expect revenues in the Rest of World in the range of 7.2 to 7.8 Bn yen, representing a 22% to 32% increase year-over-year on an as-reported basis and a 12% to 21% increase year-over-year on a constant currency basis. While we anticipate contributions from new games including *KartRider: Drift*, we expect these to be partially offset by a decrease from *MapleStory*.

In Q1 2023, we expect operating income to be in the range of 45.3 to 52.5 Bn yen, representing a year-over-year increase of 18% to 36% on an as-reported basis and a 11% to 28% increase year-over-year on a constant currency basis.

An increase in revenue is expected, which will contribute to an improvement in year-over-year operating income.

However, compared to Q1 last year, we expect increases in costs due to business growth.

First, we expect increased royalty costs due to revenue increases in FIFA franchises and a contribution from *KartRider: Drift*. Also, we expect increased PG fees due to revenue increases in mobile titles.

Since *KartRider: Drift* is developed by the joint venture, royalties to them will be recognized following the launch.

Second, we expect increased HR costs related to additional headcount for the development and operation of our major games as well as an annual salary hike.

Third, we expect increased marketing expenses primarily associated with promotions for new games such as *KartRider: Drift*.

Lastly, we expect increased other costs under COGS and SG&A in relation to outsourcing costs associated with new game development and cloud service costs due to mobile business growth.

Operating income is expected to increase year-over-year as we anticipate the increases in costs due to business growth to be more than offset by revenue increase.

Overall, in Q4 2022, we saw increases in user engagement and active users in our three major titles driven by our strength in live game operations.

This positive trend continued into Q1 2023 and therefore, we expect revenues from these titles to increase year-over-year.

In addition, the development of new games is progressing well. *KartRider: Drift* started its preseason on January 12th and is scheduled for grand launch on March 9th. We plan to reflect player feedback during the preseason as well as even after the grand launch and to focus on maximizing player experiences through communication.

For Embark Studios' first title, *THE FINALS*, we plan to conduct a beta test in Q1. In addition, we are preparing for the launch of multiple new Virtual Worlds. We believe that Nexon could grow our business in the long term by layering these titles on top of our strong revenue base.

On the other hand, lastly, I would like to make some comments on our short-term outlook.

First, last year, while revenue in the first quarter grew just 3% year-on-year, it grew roughly 30% to 50% from Q2 to Q4, respectively, which means we will face high hurdles for the rest of the year.

Secondly, we focus on long-term growth over short-term financial performance, and we sometimes scale back our short-term monetization strategy to sustain long-term strength in our titles.

Finally, unlike traditional games, we gradually grow our Virtual Worlds following their launch as we nurture the user community and enhance player engagement.

We think it important to consider these three points when considering our business from the second quarter onwards.

Last, I would like to provide an update on the shareholder return.

Based on our 2022 shareholder return plan, we plan to pay year-end dividends of 5 yen per share to shareholders recorded on our shareholder registry as of December 31, 2022.

We will continue to pay the semi-annual dividends of 5 yen per share in 2023.

As of the end of January, we have completed approximately 24.7 Bn yen of our three-year 100Bn yen share repurchase policy that we announced on August 9, 2022. We expect to have completed 50 Bn yen in share repurchases by April 2023.

As for the remaining 50 Bn yen, we plan to complete the rest of the repurchase authorization after

May 2023 and by August 2025 at the latest, by considering several factors including investment opportunities, financial conditions, as well as the market environment.

This concludes my comments.

Back to you Owen.

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

Thanks Uemura-san.

To summarize our thoughts: in the face of a very difficult global economy, Nexon has never been stronger, or its future brighter. We grew 49% year over year in Q4 and we expect to grow 28% to 38% year-over-year in Q1. Nexon teams around the world are clearly firing on all cylinders.

But as happy as we are by our results, we think there's an additional factor at work, that is vital for investors to understand.

The business of Nexon is commonly mis-classified as games, as if making casual games or single-player RPGs is similar to making and marketing online Virtual Worlds. It's not. We operate a different category of the entertainment business altogether. This legacy misclassification is a trap for analysts. But since so many market participants use legacy mental models, there is a significant opportunity for the analyst who uses an updated set of tools.

So what do we mean by the category of Virtual Worlds?

- First, we obsess about time spent in a game, over what a user pays us in an individual month.
- Second, we focus on assembling a community of dedicated players, over near-term monetization. We'd rather miss our quarterly revenue forecast for the game than hurt the community. We have made this decision many times in the past and it has served our shareholders extremely well.
- Third, over a period of years, a successful Virtual World will have ups and downs over the short term, but we will see through those near-term fluctuations to achieve our objective of growing a community of players who are highly engaged.
- Fourth, player lifetime in a Virtual World is indefinite, spanning years and in some cases decades. In our world, a "whale" is not someone who spends a lot of money in the near term, it is someone who is highly engaged and has a large and active network of friends in their chosen Virtual World.
- Finally, a concentrated portfolio of well-run Virtual Worlds may double revenues in the period of a few years without launching a single new game. Very few people understand this.

Why do we take this approach? We see ourselves as investors, not traders. As investors, we look for compounding growth over the long term. Our objective is to make Nexon a strong, resilient business.

So what does this mean for you the analyst or investor? Our view is that it's best to start over, and recognize we're talking about an entirely different industry, one that has similarities to the games business, but is in fact operating from a different set of principles.

One example of where to start over is the game lifecycle fallacy, where a game starts, grows and then dies in a relatively predictable pattern. That pattern does not apply to a well-run Virtual World.

A second useless analytical fallacy is the focus on timing of product launches to predict revenue. Again, this matters a lot in the games business but is of very limited use in Virtual Worlds.

What should you do instead? Here's how we think of Nexon in the coming couple of years:

- Our base of live Virtual Worlds has proven again and again to be very solid. Within any quarter some will be up and some will be down year over year, but we believe our portfolio is anti-fragile, and serves as a stable base of revenue and profit in the coming years.
- On top of that base, we then have 8 major projects in the pipeline over the next 18 months. If one hits we're looking at another year of strong double-digit growth. If 2 hit, we're a whole different company.
- We don't know the exact timing of most of these launches but that doesn't affect your investment decision much because the impact in whatever month they launch will be dwarfed by the performance in following quarters and years.
- Net, we see our business as an asymmetric opportunity: with limited risk to the downside and much opportunity to the upside. We have in fact designed it that way.

We expect you to come to your own conclusion on how to forecast the Nexon business, but it's important for you to see the business through our eyes, so you can make more informed decisions.

Thank you very much for your time. With that, we'd be happy to take your questions.