

**NEXON Co., Ltd.**

**Q1 2018 Earnings Conference Call**

**Transcript**

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## **MANAGEMENT DISCUSSION SECTION**

**Operator:** Good day, everyone, and welcome to Nexon's 2018 First Quarter Earnings Conference Call. Today's call is being recorded. At this time, I'd like to turn the call over to Maiko Ara, Head of Investor Relations. Please go ahead, ma'am.

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**Maiko Ara, Head of Investor Relations, NEXON Co., Ltd.**

Hello, everyone and welcome. Thank you for joining us today. With me are Owen Mahoney, President and CEO of Nexon and Shiro Uemura, CFO. Today's call will contain forward-looking statements, including statements about our results of operation and financial condition, such as revenues attributable to our key titles, growth prospect, including with respect to online game industry, our ability to compete effectively, adapt to new technologies, and address new technical challenges, our use of intellectual property, and other statements that are not historical facts.

These statements represent our predictions, projections, and expectations about future events, which we believe are reasonable or based on reasonable assumptions. However, numerous risks and uncertainties could cause actual results to differ materially from those expressed or implied in the forward-looking statements. Information on some of these risks and uncertainties can be found in our earnings-related IR document. We assume no obligation to update or alter any forward-looking

statement.

Please note net income refers to net income attributable to owner of the parent, as stated in Nexon's consolidated financial results. Furthermore, this conference call is intended to provide investors and analysts with financial and operational information about Nexon, not to solicit or recommend any sale or purchase of stock or other securities of Nexon. A recording of this conference call will be available on our Investor Relations website, [www.ir.nexon.co.jp/en/](http://www.ir.nexon.co.jp/en/) following this call. Unauthorized reporting of this conference call is not permitted.

I'd now like to turn the call over to Owen.

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

Thank you, Ara-san, and thank you all very much for joining us today. We had an outstanding start to 2018. Q1 was a record-breaking quarter, and revenues, operating income, and net income all exceeded our expectations. Revenues and operating income both recorded double-digit growth, and operating margin was 60%. Net income more than doubled year-over-year. These excellent results reflected our solid performance from several regions around the world, both PC and mobile.

Last quarter, we said China *Dungeon&Fighter's* Lunar New Year update got off to a very strong start. The momentum continued into latter half of the quarter, performing particularly well throughout the important Lunar New Year season. *Dungeon&Fighter* exceeded even the strong expectations we built into the guidance for Q1.

Our North American business nearly doubled year-over-year, driven by a full-quarter contribution from Pixelberry Studios. We are now a quarter and a half into our integration with Pixelberry and it has been going very well.

We've also had significant year-over-year growth in our Korean mobile business, as a result of games we launched in the second half of 2017 and the first quarter of 2018.

The year is off to a great start for our key titles, some of which are celebrating a service period of over a decade. And these key titles have all shown double-digit growth year-over-year in the first quarter, reflecting the sustained work of our live games teams did to enable stable, long-term growth.

*Dungeon&Fighter* will celebrate its 10th anniversary in China next month, and has marked the highest quarterly revenues since the service began in that region. The year-over-year growth of this title has been extremely robust. This was the 9th quarter in a row that *Dungeon&Fighter* China recorded double-digit year-over-year gross revenue growth in local currency terms.

*MapleStory* in Korea just celebrated its 15th anniversary in April, and its first quarter revenues worldwide grew 11% year-over-year.

*DomiNations* had its 3rd anniversary in April. Its first quarter revenues globally grew 18% year-over-year, and the worldwide life-to-date revenues exceeded \$150 million.

These are excellent results. They once again demonstrate Nexon's core strength in live game operations, and our ability to grow games over time. As we've said in the past, the ability to grow online games over time is one of the most powerful ideas in video games and is unique to only a few companies around the world with proven capability to do it consistently.

The strong results also reflect the latent strength of Nexon's IP. Games like *Dungeon&Fighter* and *MapleStory* are loved by tens of millions of gamers around the world, young and old, who continue to come back year after year. We've built an incredibly robust business based on these simple concepts. Year-after-year, Nexon's ability to implement them has resulted in one of the most sustained and consistent growth trajectories in the video games industry. We think it is still very early innings.

The strength of our existing business has enabled us to invest heavily in developing the enduring hits of tomorrow. To better execute on new game development, we've reorganized our studios in Korea from one large division with many teams, to seven studio hubs. Each studio under the new structure now has more discretion and more responsibility in studio operation, including in personnel and the creation of new projects.

Our objective is to put more the creative decisions in the hands of our most creative people and to better enable our development teams to create their own studio culture. Our other objective is to better foster the development of the next generation of Nexon's creative leadership.

Looking ahead, we have multiple titles launching around the world. In Korea, *EA SPORTS™ FIFA ONLINE 4* will launch later this month before the FIFA World Cup Russia. The mobile version will follow the PC version later in July. We have high confidence in EA's development of this game and we are preparing for some exciting events during the second quarter, including World Cup Mode in late May. Anticipation for this title is very high. Its predecessor, *EA SPORTS™ FIFA Online 3*, has over 13 million life-to-date registered accounts in South Korea, fully one quarter of the total South Korean population.

In the first several quarters after the launch of *EA SPORTS™ FIFA ONLINE 4*, the two series will undergo a transition period, during which our primary focus will be on enabling our players to smoothly move from *EA SPORTS™ FIFA Online 3* to *EA SPORTS™ FIFA ONLINE 4*.

We expect the transition to impact our revenues in the region in the early quarters after launch of *EA SPORTS™ FIFA ONLINE 4*. As in other successful games, we think this investment in live operations in the near-term will result in more sustained growth over the long-term.

In Korea, during the second quarter, we're also launching a new MMORPG, *KAISER*.

For Japan, although revenue was down in Q1, we recently announced our plan to launch 10 mobile titles in 2018. These include *OVERHIT*, *DURANGO: Wild Lands*, and *GIGANT SHOCK*. There will be several more around the world, including the international services of *Durango: Wild Lands*, *Darkness Rises*, and *MapleStory M*.

Nexon's business is extremely robust with strong intellectual property, unparalleled live operations capability to enable our IP to grow in a strong slate of new games. I am more excited than ever about the future of our business.

With that, I'll turn the call over to Uemura-san to discuss the Q1 results and Q2 outlook.

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

Now, let's move on to the Q1 results. For additional details, please see the Q1 2018 Investor Presentation available on our IR website.

We were pleased that revenues exceeded our expectations for the quarter. For Q1, revenues were ¥90.5 billion, up 21% year-over-year on an as-reported basis and up 18% year-over-year on a constant currency basis. Operating income was ¥54.7 billion and net income was ¥46.6 billion, both of which exceeded our expectations.

The first quarter revenue outperformance was primarily driven by the continued strength of *Dungeon&Fighter's* Lunar New Year update in China.

Operating income exceeded our outlook, primarily due to the outperformance of high-margin China business as well as lower-than-planned HR cost due to lower head count increase.

Net income also exceeded our outlook. While we recorded FX loss of ¥2.2 billion primarily on our U.S. dollar-denominated cash deposits related to the depreciation of the U.S. dollar against the Japanese yen during the first quarter, this was more than offset by the operating income outperformance.

Revenues from our China business in the first quarter exceeded our expectations. Again, this was

primarily driven by the strong performance of *Dungeon&Fighter*.

We introduced the Lunar New Year update on February 1. The Lunar New Year update included beast-themed special dungeons, which are only playable for a limited period, as well as avatar package sales, both of which were particularly well received.

The strong performance of the Lunar New Year update continued into mid-February and was particularly strong around the February Lunar New Year season, which helped push revenue above our expectation.

First quarter revenues typically increased sequentially from the fourth quarter due to the Lunar New Year holiday. This was true again this year, with revenues, ARPPU, MAUs, and paying users for *Dungeon&Fighter* in China increasing quarter-over-quarter.

Revenues and ARPPU increased year-over-year mainly due to strong sales of the Lunar New Year avatar package. MAUs decreased year-over-year. This was because we faced very high comps with last year's first quarter. As you might recall, last year's first quarter result was driven by the Level Cap update in addition to the Lunar New Year update. The number of paying users was roughly flat year-over-year.

Revenues from Korea in the first quarter were below our expectations. The as-reported results were negatively impacted by the Japanese yen appreciation against the Korean won during the quarter. Excluding impact of FX fluctuation, the revenues were at the low end of our outlook.

Mobile game revenues grew significantly year-over-year driven by contributions from *OVERHIT* and *AxE*, which were launched in the second half of 2017, as well as *Yulhyulgangho M* and *Durango: Wild Lands*, which were launched this year in the first quarter.

PC online game revenues decreased year-over-year. Revenues from *MapleStory* increased year-over-year primarily driven by successful Lunar New Year promotions. This was more than offset by the significant year-over-year decrease in *Dungeon&Fighter* due to the high comparison with last year's first quarter driven by continued strength from large-scale updates in the second half of 2016 as well as *EA SPORTS™ FIFA Online 3* due to the upcoming service transition to *EA SPORTS™ FIFA ONLINE 4*.

Last November, we announced our plan to launch *EA SPORTS™ FIFA ONLINE 4*, the upgraded version, and the sequel to *EA SPORTS™ FIFA Online 3* and our plan to transition the service from *EA SPORTS™ FIFA Online 3* to *EA SPORTS™ FIFA ONLINE 4*.

And during the preparation period of service transition, users typically hold off on in-game purchases because they have concerns over how they can transfer their in-game assets to the new service. As

expected, first quarter revenues for *EA SPORTS™ FIFA Online 3* decreased significantly year-over-year.

We announced the details of our asset transfer program to users in April, but we expect revenues to remain low for several months compared to regular times, even after the launch of *EA SPORTS™ FIFA ONLINE 4* later in May. This is because we are focusing more on supporting users' smooth transition and on building user base. This process accompanies the service transition; we would like to grow *EA SPORTS™ FIFA ONLINE 4* after providing full transition support for our users.

And the year-over-year increase in revenues from mobile games was more than offset by the revenue decrease from PC online games. As a result, revenues for the Korea business as a whole fell slightly year-over-year.

Revenues from our North America business nearly doubled year-over-year in the first quarter primarily driven by contribution from Pixelberry Studios, which we started to consolidate from the fourth quarter of 2017.

Revenues from Europe and Others in Q1 exceeded our expectations, mainly due to the contribution from Pixelberry Studios. Pixelberry Studios is a development studio located in the United States and its major market is the North America. For the sake of simplicity, in our outlook, we included the entire amount of its revenues in North American region.

This year's Q1 was the first quarter in which we had a full quarter contribution from the Pixelberry Studios, and we classified its revenues by region. Thus, revenues from Europe and Others exceeded our expectations.

The total revenues from Pixelberry Studios were at the high end of our outlook. Q1 was the first quarter we consolidated Pixelberry Studios on a full quarter basis, so we disclosed its revenue composition by region. For details, please see page 10 of the Investor Presentation.

Now, turning to our Q2 2018 outlook. For Q2, we expect revenues in the range of ¥45.1 billion to ¥49.1 billion, representing a 4% decrease to 4% increase year-over-year on as-reported basis and 7% decrease to 1% increase year-over-year on a constant currency basis.

We expect the Nexon Group revenues to slightly decrease or slightly increase year-on-year. While we expect revenues to increase year-on-year in China and North America, we expect these will be offset by revenue decreases in Korea, Japan, Europe and Other regions.

We expect operating income to be in the range of ¥10.5 billion to ¥13.5 billion. We expect the net income

to be in the range of ¥11.2 billion to ¥13.8 billion.

In China, we conducted a large-scale content update of our key PC online game, *Dungeon&Fighter*, on April 26 in time for Labor Day. We are also scheduled to introduce the 10th Anniversary Update in June.

The number of paying users in April increased year-on-year, while ARPPU decreased. Reflecting these factors, we expect *Dungeon&Fighter* revenues to slightly increase year-on-year in Q2.

In Korea, as I explained earlier, we expect significant year-on-year decrease in revenues for *EA SPORTS™ FIFA Online 3* and *EA SPORTS™ FIFA Online 3M* due to service transition. The PC version of *EA SPORTS™ FIFA ONLINE 4* will start in late May and its mobile version will follow in late July. Both *EA SPORTS™ FIFA Online 3* and *EA SPORTS™ FIFA Online 3M* will end their services in August.

For other PC online games, we expect revenues from *Sudden Attack* and *Dungeon&Fighter* to decrease year-over-year. However, we expect mobile revenues to increase year-on-year mainly due to the contributions from *OVERHIT* and *AxE*, which launched in the second half of 2017, and *KAISER*, which will launch in Q2.

Overall, we expect the impact of negative drivers in Korea to offset positive drivers, resulting in revenues to slightly decrease or be flat year-on-year.

In Japan, we expect revenues to decrease year-on-year mainly due to the deceleration of mobile games including *HIT*, *HIDE AND FIRE* and browser games, while we expect contributions from *OVERHIT*, which is set to launch in Q2.

In North America, we expect revenues to increase year-on-year driven by contributions from Pixelberry Studios. In Europe and Other regions, we expect revenues to decrease year-on-year. While we expect year-on-year growth in Europe driven by contributions from Pixelberry Studios, we expect this to be more than offset by decreases in the Other component of Europe and Other regions primarily due to the deceleration of *Dynasty Warriors: Unleashed*.

In Q2 of 2018, we expect the operating income to be in the range of ¥10.5 billion to ¥13.5 billion, representing a year-on-year decrease of 36% to 17%. Favorable factors compared to 2017 Q2 on operating income are: first, an increase in revenues driven by China business and contributions from Pixelberry Studios; second, in Q2 of 2017, we recognized impairment loss of ¥2.2 billion, which will not be repeated in 2018.

Negative factors compared to 2017 Q2 on operating income are: first of all, increased HR costs mainly

due to the higher head count and stock option expense; second, increased marketing costs related to promotions for new games including *EA SPORTS™ FIFA ONLINE 4*, *OVERHIT*, and *KAISER* as well as promotions for *Choices: Stories You Play*.

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 year-on-year operating income decrease.

Now, we'd be happy to take your questions.

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**Maiko Ara, Head of Investor Relations, NEXON Co., Ltd.**

Thank you, Uemura-san. Next, we would like to open up the lines to live Q&A.

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## **QUESTION AND ANSWER SECTION**

**Q - Keiichi Yoneshima, Analyst, Credit Suisse Securities Japan Ltd.**

Thank you very much. I am Yoneshima of Credit Suisse Securities. Can you hear me?

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

Yes. We can hear you.

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**Q - Keiichi Yoneshima, Analyst, Credit Suisse Securities Japan Ltd.**

Thank you. I have three questions altogether. I have two questions on guidance and one question about development. Firstly, guidance. I have a question on cost in Q2. In terms of operating profit, you mentioned about the cost as well and you mentioned that the headcount of cost will increase by ¥3.1 billion and Others will increase by ¥1.7 billion. And looking at the change from Q1 and also as compared to other quarters, the numbers are very large. So is there any one-time factor? And, also, why HR cost as well as Other expenses increased so dramatically?

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

Thank you very much for your question. About the first question, in terms of Q2 outlook, I mentioned that there will be an increase of HR cost by ¥3.1 billion. And we have ordinary HR cost as well as stock option cost. Stock option cost is more than one-third of ¥3.1 billion. And we want to retain the key figures and we believe that this is a cost that we have to bear. And we have been providing stock option as needed, and this is a new stock option that we provided, the expense of which will be recorded almost proportionally over the three years.

So this is not a one-time cost, but rather it is a kind of fixed cost. We have stock options that we have issued in the past and there might be some decrease. But given the current point, I believe that the amount of stock option expense will stay stable.

Regarding Other expenses, we have outsourcing expenses and there is nothing particular to note about. There will be changes from one quarter to another, and I do not think that there will be much fluctuation from one quarter to another.

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**Q - Keiichi Yoneshima, Analyst, Credit Suisse Securities Japan Ltd.**

Thank you very much. I would like to ask you the second question, which is on *EA SPORTS™ FIFA ONLINE 4* transition period. How long do you think it will take for transition? You will have PC in May and mobile in July and in August you will end *EA SPORTS™ FIFA Online 3*. So is it correct to understand that you will complete your transition by Q3 and business will be as usual starting Q4? And we have World Cup and maybe you have not factored in yet, but I believe that you might be able to enjoy more revenue in Q2 because of the World Cup?

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

Regarding *EA SPORTS™ FIFA ONLINE 4*, based on our past World Cup event experiences, the time after World Cup is more important rather than before the World Cup. And during the World Cup, there is momentum and even after the World Cup, momentum stays for some time. And so, months after the World Cup, we were able to record very good figures. So in May, we will launch PC and try to help the transition and have a stable user base and launch mobile in July.

So in terms of Q2, it is a transition period for the users. So I do not think that there will be any major upside or downside. And after Q3, we will look at the situation and try to grow the game.

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**Q - Keiichi Yoneshima, Analyst, Credit Suisse Securities Japan Ltd.**

Thank you very much. My last question, Mr. Owen Mahoney, you mentioned about the development organization change and you have split into different development divisions, and I understand that you can understand more creativity as well as more leadership. But in terms of the management, maybe it might be more desperate because you will have more divisions to work with. So how are you going to manage the teams overall?

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

Thanks for your question. Let me just talk about a couple of different points that gets you to, I guess, an overall feel for how we think things will change compared to what they were. What we felt was that to run a studio as one central organization with a lot of major decisions flowing up to a key studio leadership is one way to do things, but it doesn't scale that well. And as our studios get bigger and bigger and we put out more products and we try a variety of different things that gets more difficult to do.

Another thing about game development is a lot of times the very best ideas come from people who are

closest to users and closest to games and to single game ideas. And so, we want to put more the creative decision-making autonomy in the hands of people who are closest to users. That doesn't mean we hand over everything to the individual game leaders, but it does mean we want them to be closer to, in English, we would say where the rubber hits the road or where the rubber meets the road, in other words, between game developers and closest to customers. So we think that's very important.

So the other thing that has been going on over the last few years is a new generation of leaders that Nexon has been gradually, sort of, coming up. They've gotten older. They've gotten more experience. And we think that this is a great way to put more autonomy in that next generation of leaders. And so, we think it's important to do that.

Now having said that, we will be monitoring very closely from the central studio leadership as we have in the past. But we want to put more decision-making power in the hands of those new leaders that I talked about. So an example is sometimes you want to hire a really key developer. Maybe that person comes from outside the company, and a decision like that would oftentimes have to roll up to the central studio leadership. We think that that's the kind of decision that can be handed more autonomously to the studio leaders, and that will enable faster decision-making, and it will enable them to run the studio in the way that they best see fit. Now, some of them will do great, some of them will be challenged, but we want to watch how that goes and we'll be monitoring it very closely in the coming quarters and years.

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**Q - Keiichi Yoneshima, Analyst, Credit Suisse Securities Japan Ltd.**

Thank you very much. I understood very well.

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**Operator:** Our next question comes from Han-Joon Kim, Deutsche Bank. Please go ahead.

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**Q - Han-Joon Kim, Analyst, Deutsche Bank AG (Hong Kong)**

Great. Thanks very much for the chance to ask questions. My first question is on your *Dungeon&Fighter* PC numbers. So I think in IR presentation, we basically highlighted that MAUs declined, paying users have increased and ARPPU has increased. As we think about the dynamics here, I mean, when do we feel like we hit a level where we want to delve back on the ARPPU and focus a little bit more on the MAU? And is 1Q more of a freak accident on the positive side where we just had a lot of ARPPU and that 2Q is kind of more the normalized level on that? Yeah, I'm just trying to understand the dynamics between MAU, paying ratio and kind of ARPPU, how you look at the first quarter numbers. And is that kind of a very top-ish number and do we want to really delve it back for the longevity of the product?

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

Thank you very much for your question. Well, again let me explain this more in detail. In Q1, the *Dungeon&Fighter* in China MAU is down. Number of the paying user is almost flat and ARPPU has

significantly increased. Concerning those, if I may add further explanation, in 2017, *Dungeon&Fighter* showed a very strong performance and we try to look at the daily operation and also the content update for each event. We have been very focused on that so that we can keep the game very healthy. And at the same time, in Q4 last year, especially without taking the monetization measure, we try to make sure that we maintain the user base. So in Q4, the appetite of the user was very strong to purchase in Q1 this year, which is a high season for us.

And during the Q1, we made sure that we had a good content update and the package sales was realized. And by doing so, MAU is down, but the ARPPU is up. The decline of the MAU, if I may talk further about that, in Q1 last year, there was a Level Cap update. Now, Level Cap update is done only once every several years. This is a special measure. So with that update, the users were activated and many users came in. So it was a wonderful MAU. So in comparison to that level, this year it seems like it has declined, but, in comparison to the regular Q1, this MAU is actually about the same level. So it doesn't mean that it has declined significantly. It just means that the last year's MAU was so high.

Another thing is, where the paying user is flat and MAU is down, the revenue exceeded last year because of the higher ARPPU. Now this higher ARPPU, as I mentioned, under the very good situation in the game, we had a good content update and also avatar packages sold very well. More specifically, already heavy users or core users, instead of just buying one package, they bought multiple packages. And also, light users, light paying users started to buy packages.

So we have a very good in-game environment and we – our measure is quite very effective, that led to the better revenue. So that is our analysis. So we have a very good control and we had a very good performance.

In the presentation, as I said, Q2 more recent trend is that MAU is almost stable and pay user is increasing and ARPPU is about the same as last year's level or slightly down. So Q1 situation or status means that our measures worked very well. In Q2, we tried to make sure that we maintain the user base. So already ARPPU is lower than that of last year. So concerning that there are, of course, seasonalities, high season and low season. So we try to look at the in-game environment. We would take the measures which are necessary. So in that sense, as you said, continuing to see the high ARPPU, low MAU that is not the case. So as a company – and China *Dungeon&Fighter*, we believe it's a very good situation right now.

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**Q - Han-Joon Kim, Analyst, Deutsche Bank AG (Hong Kong)**

Thanks for the response to first question. My second question is in regards to *Durango: Wild Lands*, as far as the Korea launch has gone, from a revenue standpoint, it's done well and then has faded. I'm wondering how the underlying KPIs look from your perspective? And if we can kind of envision this as a

game that can continue to grow over two, three, four-year timeframe? And alongside that I think *Durango: Wild Lands* is going to be launching overseas as well. So should we be assuming a relatively soft launch overseas as well and then progressively growing or kind of how has that thought involved on *Durango: Wild Lands* longevity-wise? Thank you.

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

Hi, Han-Joon. This is Owen. I'll give you some color on *Durango: Wild Lands* and then hopefully that will fill out the picture for you. I'd say a couple of things about it. First of all, when we launched it, frankly it greatly – the interest level in *Durango: Wild Lands* greatly exceeded even our expectations. And our expectations are pretty high given the significant numbers of pre-registrations and just for the general buzz in Korea when we launched it. So that's number one.

That's the good news. The bad news is that significant increase in – oh, I'd say one other thing about that. That level of interest from customer base was also fueled by the great support from Google and Apple that we got. And I think what was driving both of those first two things was *Durango: Wild Lands* is just not like really any other game in the mobile market right now or very, very few mobile games. And I think there's probably a consensus that we could all use something different sometimes because as we've talked about publicly before, much of what launches around the world in mobile seems to be pretty similar to other things that are already out in the market. So *Durango: Wild Lands* represented something completely new and innovative. And I think people are really liking that aspect of it. So that was the great part.

The second thing I'd say though, or second major thing I'd say is it sort of overwhelmed a lot of even our high expectations for it. There was a flood of new users in the opening hours and days of it that created some server problems for us and, therefore, some customer experience problems, which is certainly a problem. Some people will call that in a nice problem to have category, but we think it's just a problem when customers don't experience the game that we've designed. So that was not great.

And then the second thing is that was driven by some technical challenges, because, frankly, *Durango: Wild Lands* is so different, we can't rely on a lot of off-the-shelf technology. We have to develop sometimes new technology for managing provision of land inside the game and so on. And the other aspect of having a lot of users coming all at the same time is the game is designed for sort of a constant supply of new users, and when there's massive numbers of new users coming in all at once in a virtual world that affects actually the game economy in the gameplay and the sociology of the game world, which has really simulated reality experience. So you put all those things together and we were very happy with how things have gone, but then they went down in terms of app store rankings.

So the third major thing, I would say about *Durango: Wild Lands*, however, is that in an open-world

MMORPG, you really don't judge the success of the game from the first one or two months or quarters after launch. Really, you can't really test how the user experience is going to be and work out all the kinks in the system and tell the game has been out for some time and oftentimes that takes several quarters. We know this from PC and we know this from any open-world simulated world.

And so, we think it's very, very early days. We're very supportive of the team and what they're doing. We're going to be bringing it, as we've said in our prepared remarks, we're going to be bringing it around the world and we'll be launching it in a different way than we did in Korea when we bring it to other regions. But we, overall, believe that this is exactly the kind of game that we should do.

And frankly, all the games that we've launched that have done really well over a period of years and also many of the games from other companies that we've noticed that have done very well on a worldwide basis, they oftentimes start as very small or they've had rocky launches. What really matters is not this quarter or next quarter, even the quarter after. What really matters is that we're all talking about this game 5 or 10 years from now. That's what we're designing it for. And we think we are on track to be doing that. So that's what we're focused on now and you'll hear us talk about it more in upcoming quarters. I hope that answers your question.

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**Q - Han-Joon Kim, Analyst, Deutsche Bank AG (Hong Kong)**

It does. It does. Appreciate that. My last question is going back to, I think, a question that somebody else asked as well. But if we take the midpoint of your second quarter guidance for revenue and operating profit, we have virtually zero revenue growth against, about a 26% year-over-year declining operating profit. So pure mathematically, I think we probably need to see some top-line kind of – and on the same margins 20% revenue growth to be able to kind of reach flat operating profit going forward.

I'm cognizant of the fact that in the second quarter, we're in a transition period for some of the games. But how do we think about the dynamics where the cost is growing faster than the revenues and at what point have we invested enough into our business and costs are to stabilize a little bit?

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

Well, about Q2 cost prospect, the HR cost is increasing significantly and one-third of that is stock option-related expenses. And for us, the game company, this is something we need. That is to say that the talent to retain very good talent is very important. So for that, looking at the situation, we will make sure that we would offer stock options, so accumulation of those has been happening. But as I mentioned earlier, this is not just a one-time cost, but this is likely to continue for some time to come, more specifically for three years. But as for the pre-existing stock option that would decline. So there could be some decrease, slight decrease.

Another major factor is the advertising and promotions and for that, the launch of the major titles with the high expectations, we have to really make an investment for the advertising and promotions. So last year's – in comparison to the Q2 last year and advertising and promotion has increased significantly. But this is considered to be the upfront investments.

So in Q2, the operating profit is pushed down by this, but it means that we have to make sure that we have a good title launched, so that in the following terms, we can expect higher revenues. So as for the advertising and promotion, I cannot say that this would happen regularly, but this is something that we need as an investment. So in our profit and loss, the major variable will be advertising and promotion expenses and also HR cost, the level of Q2 is likely to be recorded in coming years.

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**Q - Han-Joon Kim, Analyst, Deutsche Bank AG (Hong Kong)**

Understood. Thank you very much.

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**Operator:** Next question comes from Yamamura, Nomura Securities. Please go ahead.

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**Q - Junko Yamamura, Analyst, Nomura Securities Co., Ltd.**

Hello. Can you hear me?

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

Yes. We can hear you.

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**Q - Junko Yamamura, Analyst, Nomura Securities Co., Ltd.**

Thank you very much for your explanation. You mentioned about the marketing cost as well as HR cost, I want to confirm the following. In Q1, you had factored in some HR cost, but I believe that you were not able to use the entire amount, but in Q2 you have a stock option and you have factored in an increase in HR costs. Say in Korea, maybe might not be Korea, but you want to secure talents and you try, but you were not able to secure the number of people that you wanted and you realize that you had to increase the salary or compensation to attract talented people or am I reading too much between the lines? So I want to know what is happening here. That's my first question.

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

As we have mentioned in Q1, there was a difference between the actual cost and the budget because we were not able to hire as many talent as we have wanted. You mentioned the possibility of having to raise more compensation to secure talents, but that is not the case, because the more titles we have, we will increase the headcount and also looking at the pipeline development situation, we hire people.

And so, regarding the personnel costs and I'm particularly talking about payroll, there is not much of a

difference from one quarter to another. But stock option expense wise, we need to retain the top talents for sure so we provide stock options for them.

And also, for the management, we have stock options as well. So in order to secure and retain and the employees that we have, we provide stock option. So we believe that this is a necessary investment, a necessary expense that we have to bear.

As compared to last year's quarter, you might feel that the number is too high, but during the high season, when the revenue goes up, on a year-over-year basis, up until Q4, there will be the changes as you are seeing right now. But it is indeed true that the number impact the operating income this time around.

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**Q - Junko Yamamura, Analyst, Nomura Securities Co., Ltd.**

Thank you. Let's move on to the second question about the marketing cost. In the quarter, you have many new titles. You used about ¥5 billion and I want to confirm that in Q3, you will be promoting *EA SPORTS™ FIFA ONLINE 4*. And I know that mid- to long-term, you are not making any major changes. But in terms of Q3, do you think that you will increase more marketing expense in order to promote *EA SPORTS™ FIFA ONLINE 4*?

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

Right now, we have factored in our best guidance, so I do not think that there will be any major increase furthermore. We have *EA SPORTS™ FIFA ONLINE 4* launched and also *OVERHIT* is being expected a lot by the users and we have a Korean mobile title with high expectations. So regarding those new IPs, after the launch, we will look at the KPIs to decide how we're going to allocate our marketing cost. So I cannot say definitively whether we're going to not increase or increase the marketing cost. But for now, we believe that the marketing expense that we have disclosed to you right now is the best read that we can make at this point in time.

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**Q - Junko Yamamura, Analyst, Nomura Securities Co., Ltd.**

One final question. So you disclosed pipeline by region. And in terms of the Japanese mobile, you disclosed the plan and you said that you will be launching about 10 mobile titles in Japan and I do not think that all the titles are written on the slide. And can you tell me what will be the pace in which you will be launching mobile titles here in Japan?

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

Yes. We are planning to launch about 10 titles. And of course not all the titles are written on the slide. In terms of the launch timing, we have *OVERHIT* in Q2, and *GIGANT SHOCK* and *DURANGO: Wild Lands* sometime within this year. And once we complete the preparation, we will be launching different titles.

In Japan, we have highly expecting the titles here in Japan and we haven't done that for the past two years. So we have high expectations towards these IPs. And as time passes by, we believe that we will be able to introduce new titles into the market.

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**Q - Junko Yamamura, Analyst, Nomura Securities Co., Ltd.**

Thank you very much. That's all from me.

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**Operator:** Our next question comes from Alicia Yap, Citigroup. Please go ahead. Our next question comes from Alicia Yap, Citigroup. Please go ahead.

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**Q - Alicia Yap, Analyst, Citigroup Global Markets Asia Ltd.**

Hi. Yes. Thank you. So, good afternoon, management. Thanks for taking my questions. I have some follow-up questions regarding your second quarter guidance, especially for the China revenue. I find it a little bit disconnect here. So given that June will have a 10-year anniversary promotion for *Dungeon&Fighter* and also the Labor Day update in April seems to be quite successful, isn't that it should drive a faster growth in the second quarter compared to the first quarter?

And if we look back on the China revenue over the past few quarters in 2017, first quarter 2017 actually has high base and yet you guys just report a very strong Q1 2018. And you have these Labor Day update and anniversary promotion. So can you help us to understand the misconnect here? Thank you.

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

Well, thank you very much for your question. In the case of PC online game, let me explain a bit more. On the daily basis, we would like to make sure we have a good operation for different event. We would like to have a content update. So there are many things that we need to do every quarter. But if we continue to monetize all the time, that is not possible, because the users would get tired and the balance in the game will be lost. So for example, Q1 for us is at the peak season most important for the China *Dungeon&Fighter* and also Q3 the National Holiday. So Q2 and Q4 are the ones that we try to maintain the user base so that we make a preparation for the next major leap.

So Labor Day, 10th anniversary, our 10th anniversary there, of course, we have done it, for example, 8<sup>th</sup> anniversary, 9th anniversary and so forth, but relatively not too expensive avatar sales is something that we do to make sure that we have maintained the users. So as a result of the Labor Day update, we continue to see success, but it doesn't mean that we would take the monetization measure, but we need to really maintain the user base. As we mentioned, ARPPU is a bit lower than that of last year. And paying user is increasing. MAU is stable.

So once again, we would like to – we are working on the fact that we can maintain the user base. So like this Q1 growing all the time or quarterly is not something we do, but we like to maintain the good balance in the game and keep growing. So I hope I'm answering your question. If you have any clarification, please ask further questions.

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

I'll just add one more thing to what Uemura-san said overall. The key thing to remember about how long-lived online game and probably if there's one key word is longevity. So what we play for is to ensure that years from now the game is still operating and healthy and the game environment is growing. And so, that's a key deciding factor to keep in mind when you're interpreting sort of the results in any given quarter in the near term. Thank you.

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**Q - Alicia Yap, Analyst, Citigroup Global Markets Asia Ltd.**

Thanks for that. Can I just have very quick follow-up? I think in some of your previous answer to the previous question, just wanted to make sure I hear it correctly, did you actually say the *Dungeon&Fighter* in China will actually be slightly increased on a year-over-year basis in the second quarter? And then, also, any updates on the mobile *Dungeon&Fighter*? When should we expect that to be launched? Thank you.

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

Yes. We continue to see the healthy status of the *Dungeon&Fighter* in China. The slight increase in Q2 is expected. The paying user is increasing and MAU is stable. So you're right.

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**Q - Alicia Yap, Analyst, Citigroup Global Markets Asia Ltd.**

Hi. And any comment on *Dungeon&Fighter 2D mobile*?

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

Sorry, we have no updates on mobile *Dungeon&Fighter* at this time, but we will be updating when we have news to share with the game community.

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**Q - Alicia Yap, Analyst, Citigroup Global Markets Asia Ltd.**

Great. Thank you.

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

Thank you.

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**Operator:** Our next question comes from Jay Defibaugh, CLSA. Please go ahead.

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**Q - Jay Defibaugh, Analyst, CLSA Securities Japan Co., Ltd.**

Hi. Yes. Thanks for taking my question. Just one for me please, can you comment on the competitive backdrop for *Dungeon&Fighter* PC in China with regard to, for example, the increasing popularity of the Battle Royale genre or if you're seeing any kind of shift from PC to mobile for the market overall? So if you could address that question regarding what you see now and what you would expect in the future. Thanks.

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

Thank you very much for your question. Regarding China's PC online game, *Dungeon&Fighter*, it is one and only and in terms of this genre, it is very rare. There are very popular titles in the market. But since the genre is so different, we are not impacted by those games.

And in terms of Chinese PC market, the situation might be challenging. Some people say that. But regarding China *Dungeon&Fighter*, we are doing very well. So we are so different as compared to other titles. I repeat myself, regarding China *Dungeon&Fighter*, we have no concern whatsoever. And also, we believe that we can enjoy the longevity of the game and we will focus on the operation accordingly.

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

Hi, Jay. This is Owen. I just had a comment on top of what Uemura-san said. As he said, we're not seeing an impact of any sort from Battle Royale types of games in China *Dungeon&Fighter*.

I think stepping back a little bit, what's interesting about this topic is sort of two-fold. We get asked – we have over the years gotten a lot of questions about transition to mobile and does that impact PC. I'd say actually it's been pretty counterintuitive as we've seen how the mobile and PC market has developed. First of all, I think, Battle Royale genre has shown us that at least for now PC is very much alive and well, quite to the contrary of what a lot of people's expectations have been. And this is I think true around the world. So that's been interesting to see.

I think the other thing that's interesting about some of the Battle Royale games it has shown is one thing that we've said over and over again is that mobile is now capable of a very deep and rich experience. I mean, I played – I like to play a lot of other company's games. I played Fortnite last weekend with my 14-year-old and five of his buddies from school and some of them were playing – some of us were playing on PC, including me, some of us were playing on mobile. You couldn't do that a year or two ago. And so, I think this is very, very good for us around the world, because Nexon specializes and focuses on deep, rich, highly immersive games.

And we do that both on PC and mobile, but there's kinds of games that we really like to make haven't really been capable on mobile until now with the advent of the new phones. The GPU and the

networking layer is now quite robust. It's really workstation quality in your pocket. So while we're seeing a lot of robustness on the PC business around the world, not just for ourselves but for other companies, we're also seeing robustness on the mobile side. All that, I think is good news for us over the long-term, so we're very excited.

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**Q - Jay Defibaugh, Analyst, CLSA Securities Japan Co., Ltd.**

Got it. Thanks, guys.

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

Thank you.

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**Operator:** This concludes the question-and-answer session. Ms. Ara, at this time, I like to turn the conference back over to you for any additional or closing remarks.

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**Maiko Ara, Head of Investor Relations, NEXON Co., Ltd.**

Thank you. If there are no further questions, I would like to take this opportunity to thank you for your participation in this call. Please feel free to contact the Nexon IR team at [investors@nexon.co.jp](mailto:investors@nexon.co.jp) should you have any further questions. We appreciate your interest in Nexon and look forward to meeting you whether it is here in Tokyo or in your corner of the world.

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**Operator:** Thank you. That concludes today's conference. Thank you for your participation. You may now disconnect.