

NEXON Co., Ltd.

Q2 2018 Earnings Prepared Remarks

Aug 9, 2018

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

Thank you everyone for your time today.

I thought I'd start with some context.

One of the most misunderstood aspects of online games is that they can grow and generate revenues and profitability for years – even decades. Many industry analysts are stuck in a model that over-values brand new games, even though most new games have a short life cycle. While short life cycles may be true for most of the industry, it is important for investors to understand how well-managed online games can be sustained for years – generating predictable revenue and profitability. This requires investors to recognize a different model – one that does not rely primarily on hype and high costs associated with developing and marketing new games. Instead, the truly valuable model is one of sustained revenue, profitability and player base thanks to skillfully managed live services. Games that continue to last and grow are the most valuable assets in the games business – by far.

Since the industry doesn't often recognize this truth, the focus of most of the games industry is about new games, and little value is put on the long-lasting, annuity-like, cash flows of a well-managed live game. At Nexon we think about our biggest online games operating on a model that is much like a theme park – like Disneyland. The rides, restaurants, and other amusements are periodically updated, but the overall experience known as Disneyland continues to last for decades.

Disneyland doesn't invest in a completely new facility every year built right next to the existing park. And yet it seems that many games analysts believe that this type of strategy would be a good one for online games.

Back in 2011 during Nexon's IPO, the number one question that Nexon received during the roadshow was: "When do *MapleStory* and *Dungeon&Fighter* start declining?". Certainly nobody thought at that time that these two games would continue to grow 7 years later in 2018, but that is exactly what they have done. And they've been getting stronger over the years, not weaker.

So with that as context, I'd like to talk about some of our key existing games.

Q2 was a truly outstanding quarter for one of our most enduring franchises: *MapleStory*. Following successful 15th anniversary events and summer content update, this 15-year franchises grew an incredible 61% year over year in Korea. Let me repeat that: our 15-year old game franchise grew revenue by 61%.

Another of Nexon's franchises, *Dungeon&Fighter* is showing consistent growth in China with year over year growth in the second quarter despite a VERY high bar set in 2017. *Dungeon&Fighter's* strengthening position was certainly visible in the anniversary celebrations we saw in China. I'll talk about that more shortly.

The consistent growth of these titles over many years represents a larger story: the growth of Nexon's owned intellectual property into the ranks of the most valuable IP in the world. The financial metrics tell a very good story about massive life-to-date revenue, growth in CCU's, and the massive yearly cash-flow. But observers often miss the influence of Nexon's IP because it is not tangible to them. Our customers live in different countries than our biggest investors and analysts, and it's therefore difficult to grasp how truly important our IP is to those customers. So, we thought we'd take a minute to give you a sense of what these IPs mean to people who play them every day.

Let's go back to *MapleStory* – a 15-year franchise which, as I said earlier in the most recent quarter grew 61% year over year in Korea.

Growing *MapleStory* starts with holding our base – Korean players who have been playing for many years and cascading their love of the game to new generations. To date, over one-third of the entire Korean population have played *MapleStory*. Millions grew up with *MapleStory*, and millions more people play it for the first time every year.

In addition to frequent content updates that refresh the game for existing players, we have skillfully localized *MapleStory* for large audiences in new markets like Japan and China.

In the top row are a couple of pictures from our 15th anniversary art balloon event in April. The iconic *MapleStory* characters are a fan favorite whenever we do live fan events. In the bottom row, you see an off-line event we held in Taipei last year. Over 1,500 users gathered wearing red hoodies and formed a giant red human maple leaf, which is part of the game's logo. Their efforts got them a Guinness World Record for "the largest human maple leaf", beating the previous record held by Canada. As you can imagine, our friends in Canada did not take this too kindly since after all the Maple Leaf is part of their flag, so they managed to recapture their record...for now.

And, of course, everyone in this room knows *Dungeon&Fighter* is a monster IP that keeps growing, especially in China. Today, *Dungeon&Fighter* has generated well over \$10 billion-US in life-to-date gross revenues worldwide. To put that in context, *Dungeon&Fighter* is a couple of billions bigger than life-to-date Star Wars box office.

So those are the numbers. In that context, you can see why our 10th anniversary events in China help grow awareness and player engagement. Here are some pictures.

We had a variety of outdoor location-based marketing events and on the upper right you can see the hundreds of fans that were enjoying the light show on the side of the buildings in that area. On the lower right is a picture from the 10th anniversary celebration event held in June, when thousands of fans gathered to celebrate the anniversary.

Also around this time, CCTV, which is China's predominant state TV broadcaster, ran a special on *Dungeon&Fighter* as one of the most successful intellectual properties in China, supporting the development of the nation's IPs in cultural programs and games industry. It's exceptionally rare for IPs to be covered by the state TV broadcaster, which underscores how massive *Dungeon&Fighter* is in the country.

Supporting our fans is an enormously dedicated and talented live game development and operations team around the world, who lead the industry in growing our biggest franchises over time. And as you can see in pictures and in the numbers, their talent and work really pays off.

Another of our blockbuster live games is *FIFA Online 3*, which is currently transitioning it's audience to *FIFA Online 4*. Transitions in online games are always tricky, but the stakes were especially high on this one since it's our largest transition to-date. I'm very glad to report the live game teams did a great job, working closely with our partners at EA. The new PC service launched in May, and the mobile game launched at the end of July. Our initial focus has been on core users and our next step is to transition casual users. We think it is proceeding well.

So, our teams have been working very hard to enable these huge franchises to grow consistently, over the long term. And thanks to their talent and efforts we have an enormously stable base of revenues from which to invest in new projects and to expand our franchises geographically.

I hope the biggest takeaway from this presentation is to understand the core idea of games that last for decades. This longevity is both possible and is exceedingly valuable. We think it is the most important idea in the video games industry. It is widely misunderstood. Longevity measured in decades is also highly unique in the games industry – only a few companies have done it for any length of time.

So with that as backdrop, now let's talk about new titles.

The stable annuity-like revenues from our massive existing franchises gives Nexon a stream of capital that enables us to invest in creative risks without compromising the financial stability of the company. So let's look at a few of these.

The first of these is the Japan launch of *OVERHIT*. We launched the game in late May and within a month and a half it has exceeded 1.5 million downloads. The development team spent a lot of time localizing and culturalizing the game specifically for the Japanese market, so it ended up quite different from the Korean version. It appears to be off to a great start so we'll be watching it closely in the coming months.

Next is *Darkness Rises*. In June, we released *Darkness Rises* in 140 countries around the world, and it's been off to a great start, especially in Asia, as well as in the West. Like *OVERHIT* in Japan, we worked very hard to localize and culturalize the art and gameplay from the original Korean versions and that seems to have paid off so far. The game has been downloaded over 10 million times worldwide in six weeks.

And finally, *MapleStory M*. The game first launched in Korea in 2016 and has been showing steady growth and strong retention over the last several quarters. Two weeks ago we launched the game in over 140 countries outside Korea, and it exceeded 3 million downloads in just a week. Given the retention numbers we're seeing in Korea and the very successful launch in other countries two weeks ago, we think this has great potential over the long term.

As you have heard us say over and over, what we really target is longevity – long-term engagement by our customers results in long-term value for shareholders. So we've been experimenting with new titles, new styles of gameplay, new ways of launching and new regions...and when we see retention numbers we want, we double-down our efforts. Our massive cash flows from our existing business enable us to invest to build tomorrow's business.

We have many more games slated for launch around the world, including the Western service of *MapleStory2*, the *OVERHIT* global service, and the *Dynasty Warriors: Unleashed* Japan service, for which we opened the pre-registration today.

To summarize, Nexon is a uniquely stable company in the somewhat chaotic and hit driven games industry. We have learned to build and sustain global blockbuster games for years and even decades. We avoid the boom-bust model that cripples many other publishers and instead use the margins from our perennial blockbusters to invest in new titles that could break through to become hits.

With that, I'll turn it over to Uemura-san to discuss the 2nd quarter results and 3rd quarter outlook.

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

Now, let's move on to the Q2 results.

Revenues were 47.8 Bn yen, up 2 % year over year on an as-reported basis, and down 2 % year over year on a constant currency basis – in the range of our outlook.

The operating income was 16.0 Bn yen, and the net income was 32.2 Bn yen, both of which exceeded our expectations.

Revenues from Korea in the 2nd quarter were down slightly year over year. This was primarily due to the service transition from *FIFA Online 3* to *FIFA Online 4*, which had a negative impact on both PC and mobile business.

Revenues from Japan and Other regions – included in Europe and Others – decreased, while revenues from China and North America increased year over year. As a result, our group revenues were roughly flat year over year, as expected.

In comparison with our outlook, revenues from PC online games exceeded our expectations, driven by the strong performance of *MapleStory* in Korea, thanks to the successful 15th Anniversary promotions and Summer Update.

Meanwhile, revenues from mobile games were below our expectations due to lower-than-expected contributions from *KAISER*, which launched in Korea during the 2nd quarter, and the *OVERHIT* service in Korea.

Net, while PC revenues exceeded our outlook, this was offset by lower-than-expected mobile revenues. As a result, total revenues were within the range of our outlook.

Operating income exceeded our outlook. While we recorded 0.8 billion yen impairment loss primarily on prepaid royalties, we recorded other income as well as incurred lower-than-planned costs.

We acquired an additional 30% of equities of NAT Games and consolidated them beginning at the end of Q2. In reference to this, we reevaluated the equities we held before the additional acquisition of the market price. As a result, we recored a 2.7 Bn yen gain on the step acquisition under other income.

I will explain the details of the expected impact on our financials related to the NAT Games consolidation later.

Costs were lower than planed mainly due to lower variable costs, including platform fees and royalties, due to lower-than-expected revenues from mobile business and *KAISER*, a published title, as well as lower-than-planned marketing costs.

The net income exceeded our outlook due to a 15.5 Bn yen FX gain on our U.S. dollar-denominated cash deposits and account receivables related to the depreciation of the Korean Won against the U.S. dollar during the 2nd quarter.

Revenues from our China business in the 2nd quarter were at the high end of our outlook.

For *Dungeon&Fighter*, we introduced the Labor Day Update in April and the 10th Anniversary Update in June, both of which were well-received by users.

This year's Labor Day Update went very well, similar to that of the last year's, which gave us a strong result. Moreover, the user community showed excitement toward the large-scale promotions and offline events for the 10th Anniversary. We conducted many in-game events and introduced the largest content update in time for the anniversary, all of which were well-received. In the 2nd quarter, we focused on providing our players with enjoyable content to enhance their engagement, and achieved good results, as we had hoped.

Revenues, ARPPU, and MAUs decreased quarter over quarter due to typical seasonality. On the other hand, paying users increased quarter over quarter. This was driven by small item sales in time for seasonal events, including April Fools' Day, which were very popular. ARPPU and MAUs decreased, while paying users increased year over year. Revenues increased year over year driven by increased paying users.

Revenues from Korea in the 2nd quarter were within the range of our outlook.

PC revenues were down slightly year over year. We launched *FIFA Online 4* in late May and since the beginning of May, we have stopped introducing content updates and in-game sales for *FIFA Online 3*. In Q2, revenues decreased year over year since we focused on supporting users' smooth transition from *FIFA Online 3* to *FIFA Online 4*.

Meanwhile, *MapleStory* grew significantly year over year driven by the successful 15th Anniversary events and Summer Update. The strong year-over-year growth of *MapleStory* was offset by a decline in *FIFA Online 3*. As a result, PC revenues in Korea were down slightly year over year.

Mobile game revenues were roughly flat year over year. Similar to the PC online service, *FIFA Online 3 M* decreased year over year. However, we benefited from games launched in the second half of 2017, including *OVERHIT* and *AxE*, as well as *KAISER* which launched in June. As a result, mobile revenues were roughly flat year over year.

Overall, revenues from our Korea business decreased slightly year over year.

Revenues from Japan in the 2nd quarter decreased year over year.

While we benefited from the *OVERHIT* launch in late May, this was more than offset by the decrease from *HIT* and mobile browser games. As a result, revenues from the Japan business decreased year over year.

Revenues from our North America business in Q2 increased significantly year over year, primarily driven by contributions from Pixelberry Studios, which we started to consolidate in Q4 2017.

Revenues from Europe and Others in the 2nd quarter decreased year over year.

Revenues from Europe increased year over year driven by contributions from Pixelberry Studios, similar to North America. However, revenues from other regions decreased due to the deceleration of *Dynasty Warriors: Unleashed*. As a result, revenues from Europe and Others decreased year over year.

As mentioned earlier, we started to consolidate NAT Games beginning at the end of Q2.

NAT Games is the developer of *HIT* and *OVERHIT* and has excellent development capabilities. We entered into a strategic partnership with them and made them an equity method affiliate in April 2016. To strengthen collaboration and the relationship, as well as reinforce Nexon group's development capabilities, we additionally acquired approximately 30% of outstanding shares of NAT Games and made them a consolidated subsidiary in late June.

In relation to the consolidation, we booked 10.6 Bn yen in goodwill and 21.2 Bn yen in intangible assets at the end of Q2.

NAT Games generates most of its revenues from royalty income paid by Nexon. The expected impact on our quarterly consolidated financials related to the acquisition is around 0.7 Bn yen in amortization costs on intangible assets beginning in Q3.

Now turning to our Q3 2018 outlook.

For the 3rd quarter of 2018, we expect revenues in the range of 60.9 to 65.9 Bn yen, representing a 1 % to 9 % increase year over year on an as-reported basis and flat to an 8 % increase year over year on a constant currency basis.

We expect the Nexon group revenues to be up 1% to 9% year over year. While we expect revenues to increase year over year in North America, Europe and Others, and roughly flat in China, we expect these to be partially offset by revenue decreases in Korea and Japan.

We expect our operating income to be in the range of 21.0 to 25.2 Bn yen.

We expect the net income to be in the range of 20.5 to 24.0 Bn yen.

In China, we conducted the Summer Update of our key PC online game *Dungeon&Fighter* on July 5. We are also scheduled to introduce the National Day Update in September. MAUs in July increased and paying users were roughly flat compared with the same period last year, while ARPPU decreased year over year. Reflecting factors including the most recent situation, we expect *Dungeon&Fighter* revenues for the 3rd quarter to be roughly flat year over year. We expect *MapleStory2* to decrease year over year. Overall, we expect revenues from our China business to be roughly flat year over year.

For the PC online business in Korea, we expect *FIFA* revenues to decrease year over year, as we launched *FIFA Online 4* in May and the game is still at the beginning of the service. We launched its mobile version, *FIFA Online 4 M*, on July 26 and closed the services for *FIFA Online 3* and *FIFA Online 3 M* on August 2nd. On the other hand, given the strength of *MapleStory* driven by the Summer Update continuing from the 2nd quarter, as well as *Dungeon&Fighter*, which is expected to perform well, driven by the Level Cap Update released on August 9th, we expect revenues of these titles to increase year over year. We expect the increase in revenues from *MapleStory* and *Dungeon&Fighter* to exceed the decline in *FIFA*'s revenues, resulting in PC online revenues in Korea increasing year over year.

Looking at the mobile business in Korea, we expect *OVERHIT*, which launched in Q4 last year, and *KAISER*, which launched in this year's 2nd quarter, to contribute to revenues. However, similar to PC, we expect revenues from *FIFA* mobile to decrease year over year, as well as those from *Dark Avenger 3* and *AxE*, both of which launched in Q3 last year, resulting in mobile revenues in Korea decreasing year over year. Overall, we expect the decrease in mobile revenues to be bigger than the increase in PC revenues, resulting in the revenues of our Korea business decreasing year over year.

In Japan, we expect revenues to decrease year over year, primarily due to the deceleration of mobile browser games, *HIT*, and *HIDE AND FIRE*, while we expect contributions from *OVERHIT*, which was launched in the 2nd quarter, and *GIGANT SHOCK*, which was launched in late July.

In North America, we expect revenues to increase year over year, driven by contributions from Pixelberry Studios' *Choices*, as well as from *Darkness Rises*, which was launched in late June, and *MapleStory M*, which was launched in late July.

In Europe and Other regions, we expect revenues to increase year over year, driven by contributions from *Choices*, *Darkness Rises* and *MapleStory M*, similar to North America.

In the 3rd quarter of 2018, we expect the operating income to be in the range of 21.0 to 25.2 Bn yen, representing a year-over-year decrease of 8% to increase of 11%.

Favorable factors compared with 2017 Q3 on operating income are:

First, an increase in revenues, primarily driven by our North America, Europe and Others business.

Second, in Q3 2017, we recorded an impairment loss of 3.6 Bn yen, which will not be repeated in 2018.

Negative factors compared with 2017 Q3 on operating income are:

First, increased HR costs, primarily due to higher stock option expenses and an increased headcount.

Second, increased marketing costs associated with promotions for new titles, including *Darkness Rises*, the *OVERHIT* Japan service, and the *MapleStory M* global service, as well as promotions for *Choices* and Korea *MapleStory*.

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