

FY2019 Q4 Earnings Presentation (Feb 13, 2020)

Q&A Summary

【Q】 I got the impression that China *Dungeon&Fighter's* new key update scheduled in March is targeted toward core users. However, looking at the KPIs, it seems that there is an outflow of casual users. What kind of impact are you aiming at through the March update and what is the current attribute of the users?

【A】 Shiro Uemura (Chief Financial Officer)

We observed some of the light users leaving the game. The major objective of the March update is to regain the light users. The March update includes the level cap release and the third awakening, which we think will attract not only the core users but also the light users. Third awakening allows players to gain new skills for their characters and motivates users to further play the game. It has been 7 years since we introduced the previous awakening in 2013. By introducing the level cap release as well as the third awakening, we plan to drastically change the current situation, revitalize the game and hope to see the return of light users.

【Q】 You said that you would narrow down new games. What would be the number of titles that you will be launching in 2020? What would be the financial impact as a result of this? Would you be able to reduce impairment loss, HR cost and marketing cost, which would allow you to attain more profitability?

【A】 Shiro Uemura (Chief Financial Officer)

We have decided to focus on fewer but bigger titles that are close to our value and expertise. That is fully-online multiplayer games. It is difficult to give a specific number of titles for 2020 because our pipeline review is not a one-off event, but is an on-going process and will also be constantly reviewed in the future.

In terms of the impact of this strategy on our cost structure, we believe there is a potential for us to enjoy less marketing cost. Previously we tried various type of games therefore, increased the marketing costs. Going forward, we will be launching fewer titles that are very promising.

Owen Mahoney (Chief Executive Officer)

Just to add what Uemura-san said a little bit. First of all, pipeline changes that we have made are really about focusing our efforts. That's the key thing. It's not a cost-savings exercise so much as it is reallocating those resources from games where we have less expertise or less capability or we think the market is more of a red ocean, and focus on that upper right-hand quadrant that we talked about where we bring a lot to the table, particularly online – deep, immersive online games.

Point number two is there are areas where we can save costs and also have much more efficiencies. We have started to talk about some of these, but as a slightly different topic. I recently gave a presentation about the cost of AAA game development. It has been rising very substantially over time. And by spending a little bit of time and effort into the game development tools and technologies you use, we can actually save a lot of costs in the game development process. Game development can be done much more inexpensively than it has been in the past.

Especially through our team at Embark, they have been able to make some tools and technologies that we think are going to allow us to develop AAA-quality content at a much less expensive price, which also means that we can do more rapid new game development and more rapid development of follow-on content after game launches.

[Q] You showed the four quadrants on page 3 of the presentation material. I believe the new game from Embark Studios will fall into the upper right. And if I may try to decompose the upper right in more granularity, I believe it can further be broke into two groups – core games that are more akin to movies and games that are easy to start playing, but hard to play. I believe the game which Embark Studios is making seems to fall under the former while your strength is in the latter. So, whether it is good or bad, there seems to be a discrepancy between your current strength and what you plan to realize through Embark Studios. Can you tell me whether my analysis on the four quadrants correct and the positioning of your current games as well as the Embark's game?

[A] **Owen Mahoney (Chief Executive Officer)**

First of all, the game that Embark Studios is working on is definitely in the upper right-hand quadrant. However, I think that the idea of a game that is hard to learn and hard to master and a game that is easy to learn and hard to master is a bit of a false dichotomy. You can have a very sophisticated game that actually is easy to learn and hard to master.

Fortnite is a good example of this. I learned to pick it up very quickly, but I do not play it anywhere near the level of my kids. Another example would be *MapleStory*, which looks very friendly and open in the beginning, but it's a very deep RPG. *Civilization* in the offline world is also easy to learn, very hard to master game.

A great way to build a good business is to have a game that is easy to pick up, that is intuitive to learn, but then you can go very deep on over time over many years. So, in that respect, what Embark is working, what Embark thinks about, what we think about, when we think about this game, is kind of like *MapleStory*, easy to pick up, easy to learn, friendly and open to players, but something that you will want to play for a very long time. That is what we are going for and we think more games should be like that.

【Q】 Regarding your comment that you expect revenue growth to be tough for the next few quarters for *Dungeon&Fighter* in China, I was under the impression that the key update in March was the event that could bring about a return to revenue growth. So, is there something that you saw in the fourth quarter, the Lunar New Year update or read through from performance in Korea that has made you reassess the return to growth?

【A】 Shiro Uemura (Chief Financial Officer)

There is no change in our view. So far, we are in line with our plan. The primary target of the March update is to get back the churned users. And we hope to get revenues back on track in a few quarters ahead.

【Q】 There has been talks that the coronavirus is keeping people at home in China and that might have a positive impact on gaming activity. Can you give us some comments on whether you have any insights on whether that is actually happening in China? And if it is, how would you assess the impact on both the PC and mobile games businesses?

【A】 Owen Mahoney (Chief Executive Officer)

When we were talking about the coronavirus, we should just preface and start by emphasizing that our first concern is for the health and safety of our customers, our partners and our employees in China. And it is our strong feeling that this should make sure to pay attention to the authorities and stay safe. So, that's first and our overwhelming concern frankly at this point.

Having said that, we do not offer precise breakdown, but think that the large majority of our players access the game from PCs in their home. However, we have not seen any noteworthy changes in our player engagement at this point as of today. We are watching it very closely and will continue to monitor.

【Q】 Regarding *Dungeon&Fighter 2D Mobile*, it has been about a month and a half since pre-registration has started. Given that pre-registration usually lasts about two to three months, can you share a little bit more details on when you expect the game to be launched? And depending on certain conditions, could the game potentially be delayed to further quarters or launch within the first half of 2020 is something that we should realistically be expecting?

【A】 Shiro Uemura (Chief Financial Officer)

There is no change to our plan to launch *Dungeon&Fighter 2D Mobile* in 1H 2020. Our Q1 guidance does not include the contribution from *Dungeon&Fighter 2D Mobile*, which naturally means that the launch is expected to be in Q2.

【Q】 Regarding shareholder return policy, you mentioned that you returned about a third of your annual free cash flow to shareholders in 2019. Should we take this as a benchmark in management and the board of directors' thought process going forward?

【A】 Shiro Uemura (Chief Financial Officer)

We mentioned that 2019 represents an allocation that is good for our shareholders with a good balance of shareholder return and investments. However, this does not mean that capital allocation in 2019 would be the benchmark for the future years. We have made the plan to reinstate a shareholder dividend and will try to pay dividend stably in 2020 and onwards. As for share buyback, we will be flexibly conducting share buybacks in an agile matter.

[Q] You had a few iterations of *KartRider* released onto mobile over time. And I understand although this one is different and being a multi-platform release. Can you walk us through some of your post-model analysis of why some of your other mobile iterations for *KartRider* have not been as commercially successful and how this one might be different?

[A] **Owen Mahoney (Chief Executive Officer)**

We have not yet announced all the platforms that *KartRider: Drift* will be on. What we have announced is that it will be on PC and several other platforms. So, that is where it stands as of now, but you will see us make more announcements about the title later. There have been other iterations of *KartRider* in the past, but keep in mind that it has been pretty heavily focused on one platform. And our general direction for *KartRider: Drift* is multi-platform cross-play across several regions, very easy to learn and has a very deep gameplay. And so, our development teams are working very hard on that and we will be making more marketing announcements about that in the future. But the key thing is that it is a key title and a key franchise for us. And so, we are certainly putting time, attention and resources towards it.

[Q] You were talking about selective distribution of key titles. I'm trying to understand if the launches of games like *V4* or *Counterside* or more of residual games that you have in the pipeline that you might as well just get them out and that you really would not have these type of titles going forward? Or will you continue to have those, but just reallocate a little bit more resource into some of our core franchise IP?

[A] **Owen Mahoney (Chief Executive Officer)**

We have been working very hard on the idea of focusing our new game development efforts around fewer franchises that are very close to what we are all about – deeply immersive online games. So that focus is extremely important to us and to our development teams. That is the area that we pioneered. We invented much of that industry. It is the area where we bring the most to the table where we have our greatest expertise. And we think as we look at the performance, for example, on *MapleStory* in page 5 of the presentation, really reflects that very well and where our heart is. So, with that in mind, we are transitioning to a much greater focus and our development teams have worked very hard to transition our focus. There are still some games that we have had in the pipeline that we think are very strong but are not as much deep in that upper-right hand quadrant that we talked about. But this is a transition that we are doing over time. It would not happen on a dime, but has been happening quite rapidly within our organization.
