

FY2023 Q4 Earnings Conference Call (February 8th, 2024)

Q&A Summary

【Q】 Could you tell us a bit more detail of the imbalance issue related to *Dungeon&Fighter* in China? How long does it take to be fully fixed?

【A】 Junghun Lee (Director)

In December, an unanticipated imbalance between supply and demand of in-game gold led to decreases in paying users and ARPPU, and negatively impacted our Q4 results and Q1 outlook. Maintaining an in-game economy is complex and is closely associated with quality, content volume, and the cycle between updates. Despite these challenges, we have a track record of successfully overcoming them.

Looking at the full year 2023, our performance was strong, achieving growth compared to the previous year. In 2024, we will not only double the amount of new content added in 2023 but also accelerate the update process. This will include the renewal of the existing characters, the introduction of new characters, a renovation of the existing item system, collaboration with popular IP, plus more raids and other high-end content. We expect the imbalance issue to be resolved over the course of the next few quarters and are confident that users will respond positively to our aggressive updates.

【A】 Shiro Uemura (Chief Financial Officer)

As we have previously said, China *Dungeon&Fighter* steadily recovered from Q1 to Q3 in 2023. In order to ensure that players can enjoy the game in Q1 2024, which is the most important quarter for our business, we encouraged players to spend gold, an in-game currency, to address the oversupply of gold in Q4. As we took these measures, revenue trended within our expectations until late December, but unexpected factors at the end of the year made it difficult to rebalance the gold supply. Under these circumstances, we began selling Lunar New Year packaged-items that contained gold on January 11th. However, the oversupply of gold diminished the incentive to purchase the packaged-items, which led to lower-than-expected performance of its sales. Given this situation, we will execute our measures so that we can expect recovery in the game over the next few quarters.

【Q】 Regarding *THE FINALS*, the traffic on Steam is facing a meaningful decline. Could you please tell us how management is assessing this, and how you are going to get this back on a rising trend?

【A】 **Owen Mahoney (Chief Executive Officer)**

The performance of *THE FINALS* is in line with our expectations two months after launch. Despite launching during a competitive quarter, *THE FINALS* broke into the top five most popular games on Steam with 10 million installs, surpassing internal expectations for booking and KPIs. We've consistently informed investors that our strategy is to start the deep Virtual World slowly and build engagement and revenue over months and quarters. The initial focus was on engaging gamers and influencers through targeted marketing and word of mouth, with the anticipation of ramping up marketing later. The game's rapid success is higher than the expected, and Embark Studios is actively incorporating player feedback and developing new content. Season two release is anticipated in March, and we are very excited about its potential. Overall, we believe that *THE FINALS* will become the fourth pillar for our IP.

【Q】 Regarding China *Dungeon&Fighter Mobile*, could you please let us know more details about the launch timing, marketing plan, and your forecast?

【A】 **Shiro Uemura (Chief Financial Officer)**

The game has been fully developed, and we are brushing up the content now. Our team is working closely with Tencent for the launch and building a robust marketing plan. Also, by monitoring the beta test results and pre-registrations, we will build our forecast. I hope to share more details about the launch timing and the revenue scale as soon as possible.

【Q】 Regarding the Korea *MapleStory*, could you please tell us more details about discontinuing sales of a major probability-based item?

【A】 **Shiro Uemura (Chief Financial Officer)**

After the Korean Fair Trade Commission imposed sanctions to Nexon, this news negatively impacted the *MapleStory* community. To sustain player retention, we provided rewards, and then discontinued sales of a major probability-based item and transitioned to a business model that offers the same experience, paid for with in-game currency rather than a cash transaction. We anticipate this transition will have a short-term negative impact on revenue but believe it will result in a long-term improvement in player satisfaction and engagement.

【Q】 Regarding the release timeline of China *Dungeon&Fighter Mobile*, is there any link to how PC *Dungeon&Fighter* will recover its performance?

【A】 **Shiro Uemura (Chief Financial Officer)**

For *Dungeon&Fighter Mobile*, our goal is to expand the presence and the user base of the *Dungeon&Fighter* franchise. As the target users for PC and mobile are different, there is no direct impact on the launch timing. We are preparing for the mobile version launch as planned.

【Q】 Regarding *THE FINALS*, could you tell us whether the Q4 result met the guidance? Also, please tell us the current revenue trend and the breakdown by region?

【A】 **Shiro Uemura (Chief Financial Officer)**

The bookings exceeded far above the guidance, however, GAAP-based revenue was lower than expected due to the recognition of deferred revenue.

【A】 **Owen Mahoney (Chief Executive Officer)**

Roughly a third of our players comes from North America, Europe, and Asia each. The surprising success in Asia is particularly gratifying, given that the game is developed by a western studio.

While the game came out so strong in its beginning and looked like it had the characteristics if almost like a mobile title, our approach has always been to start slowly and build up over time, by responding to and incorporating player feedback. In the coming months and quarters, we plan to roll out a series of content updates backed by strong global marketing. Our small and targeted team are able to update the game at an incredibly fast pace. We are essentially running a marathon in the live games business, but thanks to our proprietary technology, we are running at a sprint pace. The confidence expressed by the executive team, including myself and Junghun, is based on the fact that we have been progressing exactly as planned. We look forward to achieving continued success.

【Q】 Could you please explain more about the 44.4-billion-yen impairment loss on equity method investments recorded in Q4? Also, are there any other assets that could be subject to impairment?

【A】 **Shiro Uemura (Chief Financial Officer)**

The impairment loss on the equity method company recorded in Q4 relates to our investment in AGBO. However, this does not mean that we are worried about AGBO's business. AGBO faced difficult circumstances last year, including an entertainment industry strike, and there was a gap between our original investment expectations and the actual business results. Based on a conservative assessment, we took the impairment loss for accounting purposes, but we still have high expectations for AGBO's business going forward and hope to achieve growth in our IP through our collaboration with AGBO.

Regarding other assets that are subject to impairment loss, there are assets related to Embark Studios, but its first game was off to a good start, and we are preparing the second and third titles, so we are not considering a risk of impairment at this time.

【A】 **Owen Mahoney (Chief Executive Officer)**

As Uemura-san said, we remain extremely excited about our future with AGBO as it has an unparalleled track record of making massive hits out of IP. We look forward to updating you about our relationship with AGBO and what we are working on soon.

【Q】 For *THE FINALS*, what kind of sales are deferred and how long will it be deferred? Also, which KPIs drove the more-than-expected bookings?

【A】 **Shiro Uemura (Chief Financial Officer)**

For consumables, their revenues are recognized immediately. On the other hand, for items that continue to be in effect over a long period of time, we defer a portion of the bookings. In Q4, we had to defer a relatively large amount, however, this is just an accounting treatment.

Bookings exceeded our expectations as all KPIs were above our target.

【Q】 I understand Embark Studios has no experience in live operations and Nexon Korea is providing extensive support. Could you please provide more color on this?

【A】 Junghun Lee (Director)

We aim to build *THE FINALS* as a major pillar for the company and are placing a big emphasis on East-West collaboration, which entails Nexon supporting Embark's new releases with its world-class live operations capabilities. We also believe that we have successfully captured the western market with *THE FINALS*, and our team in Korea will continue to support Embark in maintaining this game for a long time through its live operations capabilities. Before and after the release of *THE FINALS*, the live operations team has provided extensive support through security updates, in-game balance management, player matching, and recommendations on planning of content updates, all of which help keep the game moving in the right direction.

【Q】 You recorded additional expenses related to the revision of a retention incentive plan. Are there any changes in your view on HR costs in 2024?

【A】 Shiro Uemura (Chief Financial Officer)

From the end of 2022 to the end of 2023, there has been an increase of about 1,000 people. Breaking down this increase, roughly half of the personnel were assigned to the existing title business, while the remaining half were assigned to the business related to the new pipeline. We need human resources to steadily grow our existing titles, and I believe that it is precisely because we have invested in human resources that we were able to secure record annual revenue and operating income in 2023. Although there may be times in which we enhance welfare benefits just as we did for the retention incentive plan, we remain committed to formulating a HR plan that will encourage revenue growth.
