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PRESENTATION

Operator

Good day, everyone, and welcome to today's Nexon First Quarter Earnings Results Q&A Conference Call. Today's call is being recorded. At this time I would like to turn the call over to your moderator, Gregory Melchior. Please go ahead, sir.

Gregory Melchior - Nexon Co Ltd - IR

Hello, everyone, and welcome to Nexon's First Quarter 2013 financial results Q&A conference call. With me today are Seungwoo Choi, CEO and President of Nexon, and Owen Mahoney, CFO.

Before we get started, I'd like to remind you that today's call will contain forward-looking statements, including statements about our results of operations and financial condition such as revenues attributable to our key titles, growth prospects, including with respect to the online games industry, our ability to compete effectively, adapt to new technologies, and address new technical challenges or use of intellectual property, and other statements that are not historical facts. These statements represent our predictions and expectations as to future events, which we believe are reasonable based on our 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 release. We assume no obligation to revise or update any forward-looking statements.

Our financial results for the first quarter, as well as our quarterly letter to shareholders from Seungwoo and Owen, are available on the Company's investor relations website. A replay of this Q&A session will be available on the website following this call.

I'd now like to turn the call over to Seungwoo and Owen for a brief introduction. And then we will begin the Q&A.

Seungwoo Choi - Nexon Co Ltd - President, CEO

Thank you, Greg. And thank you all for joining us today. Before we take your questions I would like to make a few comments on our first quarter results and the business environment. Then I'll hand things over to Owen for some more details.

Similar to last year, we are off to a solid start for 2013. First quarter revenues were JPY44.4 billion. Operating income was JPY20.7 billion, and net income was JPY15.2 billion. We realized strong growth with revenues up 46%, operating income up 24% and net income up 17%, compared to the first quarter of last year.



We achieved strong growth in China and Korea during the first quarter of 2012. We are very pleased to have achieved results exceeding our performance from the previous year.

The first quarter revenues, operating income and net income all exceeded the outlook we provided last quarter. This was primarily due to strong performance in the PC online business in China and Korea, the full contribution of Gloops and inBlue, which we acquired last year, and the weaker Japanese yen.

In our PC online business, successful major updates for Dungeon & Fighter and Counter-Strike Online in China made significant revenue contributions. We continued to see solid user metrics for Dungeon & Fighter, and it remains one of the top titles in China.

In Korea our main titles, Sudden Attack and Dungeon & Fighter, continued to deliver solid performance, and FIFA Online 3, launched in January, is off to a good start in terms of both user metrics and revenues. In our mobile business revenues significantly increase year-over-year due to the full contribution of Gloops and inBlue.

Finally, the yen is weaker, which provides a strong tailwind for a company like Nexon with a high percentage of overseas revenues. Starting in the first quarter our consolidated financial results are prepared in accordance with IFRS. We did this mainly as an effort to provide our investors with globally comparable financial information. We hope that this change will prove beneficial to investors when evaluating our performance.

In closing, a few comments about our overall business environment. Today the gaming industry is rapidly moving from offline to online. That's not new. What's new is that the free play business model is no longer limited to PC online, but it's becoming the industry standard across a variety of platforms.

At the same time, an increasing number of devices -- PCs, tablets, smartphones -- are being used not just for communication, but also as gaming platforms. Over the next few years as these devices continue to evolve we see these platforms converging into a single device.

As devices become more powerful and communication speed increases, Internet connectivity will increase, resulting in easier access to games, an extremely beneficial environment for Nexon. In this world we believe that the most important thing is not going to be the device or platform, but providing users around the world with games that they can enjoy for a long time, which has always set Nexon apart.

With that, I would like to ask Owen to provide some more additional detail on our first quarter results and outlook.

Owen Mahoney - Nexon Co Ltd - CFO

Thank you, Seungwoo. Our first quarter revenues were JPY44.4 billion, an increase of 46% versus a year ago. Revenues exceeded the high end of our outlook, as China performed better than expected as a result of our tier one content updates released for Dungeon & Fighter and Counter-Strike Online against a tough comp in Q1 of 2012.

Korea also performed well against a very tough comp, supported by the launch of FIFA Online 3. Revenues were further boosted by the weaker Japanese yen.

Operating income was JPY20.7 billion in the quarter, an increase of 24% year-over-year. As expected, our operating income margin decreased from the 55% we reported in Q1 2012, a year ago. However, at 47% this quarter it was above our outlook due to better than expected revenues in China.

The operating margin was impacted by three factors; first, the addition of new lower margin mobile revenues; second, development and support costs related to new title launches in the pipeline; and, third, higher royalty payments from the launch of FIFA Online 3. We provide a more detailed look at each of these components in our shareholder letter and our investor presentation, which can be found on our investor relations website.



Our net income was JPY15.2 billion, a 17% increase year-over-year, also above our outlook. Starting in this quarter we're now presenting our consolidated financials in accordance with IFRS. We made the switch from Japanese GAAP mainly to provide our investors with globally comparable financial information, as many other Japanese companies do. We hope that you'll find this helpful in evaluating our performance.

One major change is that under IFRS goodwill is not amortized. In addition, the accounting of investment in securities, including our investments in NCsoft is marked to market on a quarterly basis with the difference between market and book value, after tax effects, now recognized as other comprehensive income. We provide more detail on IFRS on pages 9 and 10 of our investor presentation on our IR website.

Looking at customer metrics, total MAUs were JPY71.5 million, a decrease of JPY11.3 million year-over-year. However, as expected MAUs increased quarter-over-quarter by JPY3.2 million. The year-over-year decline was largely attributable to a decline in less active users of our smaller games in China, as well as a decline in our users in some of our games in Korea.

The decline in MAU was largely offset by an increase in pay rates and ARPPUs. Our pay rate was 11.5% this quarter, up from 10.9% in the prior year. And ARPPUs were up due to strong content updates and the weakening Japanese yen.

Turning to our outlook for the second quarter. We expect PC revenues in the range of JPY27.2 billion to JPY28.4 billion. We expect a weaker Japanese yen to contribute to year-over-year growth.

In China we expect modest growth and are encouraged that user engagement remains robust following the solid tier one content updates we released in the first quarter for Dungeon & Fighter and Counter-Strike Online.

In Korea we also expect to see year-over-year growth in the second quarter, driven by new title launches and the growth of key existing titles. FIFA Online 3 is off to a good start and we expect Dungeon & Fighter and Sudden Attack to remain strong.

For the mobile business we expect revenues in the range of JPY6.8 billion to JPY7.5 billion. We plan to launch several new titles while also focusing on growing existing titles such as Three Kingdoms Guild Battle, which continues to grow almost one year after launch.

We're also leveraging the talent and mobile expertise of Gloops and inBlue to expand into international markets. In Q2 we're launching Dragon Girls in Korea for Kakao and Guardian Break in North America, both as native applications, further expanding our growth opportunities. For more information on these titles, please refer to page 20 of our investor presentation.

In the second quarter we expect operating margins of 33% to 34%. Over the coming quarters we still expect the range to trend towards 30% to 35%. The expected year-over-year decline in operating margins for the second quarter is largely the result of the following factors.

First, in the PC business we have several significant launches of new titles, which we didn't have a year ago. We expect marketing, development and support costs related to these titles to rise prior to launch.

Second, the mobile business adds significant revenue and operating income, but at lower operating margins. This is an ongoing change in our revenue mix. As reminder, mobile carries lower operating income margins of 20% to 25% compared to our traditional PC business margins of 40% to 45%, largely due to the platform fees incurred in the mobile business.

Third, we expect higher marketing expenses in the second quarter to promote several of our key mobile games such as Three Kingdoms Guild Battle and Crystal Crusade. Our mobile games are primarily immersive and hardcore games, and because they are played for a long time, our return on marketing dollars is typically higher than for casual games.

Finally, revenue growth tied to our licensing contracts, principally FIFA Online 3, is expected to increase royalty and marketing costs as a percentage of revenue. With that we would be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. Today's question-and-answer session will be conducted electronically. (Operator Instructions). And there are no questions at this time, Mr. Meltzer.

Owen Mahoney - Nexon Co Ltd - CFO

All right. Well, it sounds like there are no questions. We thank everybody for your time and we look forward to talking to you again next quarter. And if you have questions in the meantime please feel free to call us. Oh it looks like we have one question.

Operator

We do have one question from Ben Lu with Seligman and Associates.

Ben Lu - Seligman and Associates - Analyst

Hi, Owen. Thanks for taking my question, just got under the wire. Well congrats on a great quarter. I wanted to just get a little bit more color on the Q2 guidance. It does seem like you're guiding for a pretty big sequential decline in revenues, maybe if you can just go through how much of that is driven by seasonality, and on an offset on a sequential basis how much of that is driven by the yen. I understand on a year-over-year basis you guys are benefiting.

And, secondly, if you can give an update in terms of where you guys see Dungeon & Fighter and Counter-Strike Online going through the rest of the year in terms of year-over-year momentum, do you think they can continue to show year-over-year growth through the rest of the year, or do you think those titles are a little bit long in the tooth? Thank you.

Owen Mahoney - Nexon Co Ltd - CFO

Okay, Ben. Thanks for your questions. So I'll try to take them in sequence. First of all, actually just talking about the yen or jumping for a second to the yen, our assumptions for the yen/dollar and yen/won rate are encapsulated in the page in our investor presentation. So I would encourage you to feel free to look at page 17.

For the quarter we're assuming \$92.42 Japanese yen to US dollar. And for the Korean won it's JPY8.53 per KRW100 Korean won. So that information is on the investor presentation. Feel free to look at that for the details.

And then relative to our games, recall that we have pretty heavy seasonality in our business, with Q1 and Q3 being the higher quarters, and Q2 and Q4 being the lower quarters. So as an operating team we really look at the year-over-year performance versus the quarter-over-quarter performance. It's very much like in a for a US retailer where you'd have a Christmas quarter followed by the quarter after that. You don't spend as much time thinking about the sequential as you do in our business as you do the year-over-year.

Having said that, if you recall last year at this time we had -- it was more heavily weighted in Q1 than normal. This year what we've continued to feel this quarter as we did last quarter was that the year is going to be characterized by more balance; that is more balance between Q1 and the rest of the quarters, and more balance between Korea and China.

Getting into the details a little bit about the games, I'd say we, as we said, we over-performed in China from our expectations. We were very happy with how things went, including on a local currency basis. And Dungeon & Fighter continues to show a great deal of strength and over-performed even over this incredible comp.



Going forward, it feels like it continues to have strength. We do have planned a major content update in Q3, although Q3's content update we haven't put outlook for a Q3 and Q4, but we think that the Q3 update is more focused on user engagement over monetization.

Overall though we feel good about our guidance and our outlook for next quarter for Q2. And we feel good about the investments we're making. So that probably encompasses most of I think what you're asking.

Ben Lu - *Seligman and Associates - Analyst*

Okay, great. And if I can ask a follow-on, is the cost of geographies, Korea sales were still down about 1% year-over-year on a constant currency basis, so maybe just talk a little bit about that. And also and I noticed that Europe and North America continues to be quite weak, so I was hoping to get some color on when you expect those two regions to turn around.

Owen Mahoney - *Nexon Co Ltd - CFO*

Sure. So I'll talk about Korea first. So we're feeling -- again we're -- we were up against a very, very tough comp last year. As you'll recall last year at this time we were -- our business was up 34% in Korea. And so this comp was a real tough one. Having said that, again we think that there's going to be more balance between around the quarters in Korea.

Going in product by product I'd say we're watching Maple Story very closely. We've got a tier one content update going on in Q2 for MapleStory. It's had a rougher road in the last couple quarters than it did previously and so we're watching that closely.

On the other hand, some of our other products are performing very, very well. Sudden Attack is now the number two game in PC cafe in Korea. And it looks like FIFA Online 3 is now the number three game in PC cafe. It's had an incredible start. So both those titles plus several of our other titles are doing very, very well.

Switching to North America and Europe, we -- switching to North America and Europe we're -- we are working very hard on a couple fronts. One that we've talked about before is operational improvements that happen sort of under the hood in both those regions, so better execution.

And then also we're focused on strong IP. And we just picked up Counter-Strike Online and we'll, are starting to publish that in Turkey. And we see more opportunities for IP publishing in those markets. However, having said that, it's too early to really to talk about those. We'll have to prove and perform before we're going to see the kind of growth that we think that we think is a market opportunity there. We continue to feel that those are markets that are well worth our investment.

Ben Lu - *Seligman and Associates - Analyst*

Okay, great. Thanks, Owen.

Owen Mahoney - *Nexon Co Ltd - CFO*

Yes.

Operator

And we'll take our next question from [Han Jun Kim] with Deutsche Bank.



Han Jun Kim - *Deutsche Bank - Analyst*

Great. Thank you very much, just one quick question from my end, first one, and obviously congratulations on a great quarter. At the same time China ARPPU and paying user ratio seems to be fairly high. Is that an indication that any other games that are actually monetizing at a higher rate, or is this basically the highest that we've seen sort of historically in China?

And then, secondly, it seems like Tencent is working on a few new titles going to the second half of the year, in particular sort of thinking about Blade & Soul from NCsoft, how to you look at the demographic differentiation between your Dungeon & Fighter and then perhaps that game? Thank you.

Owen Mahoney - *Nexon Co Ltd - CFO*

Okay. So let me talk about the second question first. Thanks for your question. So our sense is that it's probably too early to tell about Blade & Soul. We obviously think a lot of the studio that created it since we're their largest investor of NCsoft. And so our feeling is hopeful about that.

Relative to what Blade & Soul is though, it's a harder core game than many of our games. Our games are usually designed to address a much broader market. So we're focused on continuing to deliver against a customer set that is more broadly based than the hardest of the hard core. So that's an important thing to keep in mind when you talk about the games there.

Going back to pay rates and ARPPUs, we don't benchmark formally pay rates and ARPPUs about for our titles against other games. There's a lot of information is not disclosed as widely as ours are.

Overall our -- we -- our content updates for Dungeon & Fighter and Counter-Strike Online performed well in the first quarter. And when you're in -- when you provide an engaging user experience and a lot of new content that brings people into the game, and then they've got a lot of compelling items to buy to enhance their experience, that 10% or 11%, in this case 11.5%, tends to -- the pay rate goes up and they are -- and people who are buying items tend to want to buy more items. So we think that's the driver there.

And of course on the other hand we watch it very closely to make sure that we're not over monetizing. So we're -- that balance is very important to us.

Han Jun Kim - *Deutsche Bank - Analyst*

Great. Thank you.

Owen Mahoney - *Nexon Co Ltd - CFO*

Thank you.

Operator

And we will take our next question from Masaru Sugiyama with Goldman Sachs.

Masaru Sugiyama - *Goldman Sachs - Analyst*

Hi. Thanks for taking my question. I have two questions. I see that you're ramping up from the HR expenses. Could you tell us where you're investing in to developers? Are you investing on the PC Online game developers, or are they browser games or native app developers? Thank you.

And my second question is on the Gloops going overseas. I see that you are expanding your title from the Kakao and native apps. Could you remind us what is happening with the partnership with DeNA? I -- we understand that you have a partnership with them for overseas development as well. That's my second question. So thank you.

Owen Mahoney - Nexon Co Ltd - CFO

Okay, thanks. I'll take your questions in order. First of all, relative to HR expenses the general thing that's going on there is we're launching, as you know, this year a lot of new products. It's the heaviest launch year that we've had in some time.

We launched FIFA Online and we launched 2K Baseball and Warface. And then we've got Dota 2 and CSO 2 coming up in the second half of the year. So when you launch new games you've got costs associated. And of course you have marketing costs to launch the games, but of course you have everything from tech support to -- or customer support to game, live game developers and operations people.

So that as a percentage of your revenue scales up prior to launch because you have to make those investments before the revenues really come in. So that affects your HR costs as a percentage of revenue.

We're also of course scaling up. There's nothing beyond that that's really particularly out of whack, or it's all within line of what we've done in the past.

Relative to your -- oh excuse me, one other question about the first, or one other point about the first question, the investments that we're doing in new games are both on PC and they are on mobile as well. We've got a very active pipeline, not just on the PC side, but on the mobile side, as you mention. And they are both browser games and native applications.

And two games as we mentioned in our opening remarks that we launched are native applications. So today the market is still in Japan 80% browser. That's by revenue in the total Japanese market, but we expect that the native applications market will continue to expand rapidly. So we're investing in that area as well.

Relative to your second question on Gloops, there's no change, no significant change at all or no change of any kind with our relationship with DeNA. That relationship is going, we would classify as very well. We're very happy with them as a partner. So we continue to support that relationship as do they.

Masaru Sugiyama - Goldman Sachs - Analyst

Can I ask one follow-up question?

Owen Mahoney - Nexon Co Ltd - CFO

Sure.

Masaru Sugiyama - Goldman Sachs - Analyst

So in the end what does your engineer portfolio look like? So how many people do you have in total and how many are into PC games, how many into unity-based games or browser games?



Owen Mahoney - Nexon Co Ltd - CFO

So we have about on the PC side we have about 1,800 developers total. 500 of those developers are focused on new games. And 1,300 of those developers are focused on live games. So the people who are focusing on live games that's things like content updates, and new items to buy, new maps to play, new characters and so on. On the mobile side we have an additional 500 developers, a little over 500 developers in the mobile side.

Masaru Sugiyama - Goldman Sachs - Analyst

And most of these are basically browsers in Japan, Gloops. Is that correct?

Owen Mahoney - Nexon Co Ltd - CFO

Well as I said, it's the combination of browser and native applications. And again by context on the browser side it's in Japan it's about 80% of the total revenues generated in the Japanese mobile game market is in browser games. So we're obviously following the revenue there, but that -- but the native applications market is expanding rapidly, so we're investing in both. And as I said, two games, the two games that we just launched are both native applications.

Masaru Sugiyama - Goldman Sachs - Analyst

Thank you.

Owen Mahoney - Nexon Co Ltd - CFO

Thank you.

Operator

And there are no further questions today at this time. I'd like to turn the conference back over to you for any additional or closing remarks.

Owen Mahoney - Nexon Co Ltd - CFO

And we thank everybody and we look forward to seeing you next quarter. And feel free to contact us if you have any follow-up questions.

Operator

Thank you. That concludes today's conference. Thank you for your participation and you may now disconnect.



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