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## CORPORATE PARTICIPANTS

**Gregory Melchior** *Nexon Co. Ltd. - Manager - IR*

**Seungwoo Choi** *Nexon Co. Ltd. - President, CEO*

**Owen Mahoney** *Nexon Co. Ltd. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Dan Kong** *Deutsche Bank - Analyst*

**An Sulu** *OCAM - Analyst*

## PRESENTATION

### Operator

Good day, everyone, and welcome to today's Nexon Second Quarter 2013 Financial 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.

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**Gregory Melchior** - *Nexon Co. Ltd. - Manager - IR*

Hello, everyone, and welcome. With me today are Seungwoo Choi, CEO and president of Nexon, and Owen Mahoney, CFO.

As we have done in the past, Seungwoo and Owen will each make some opening remarks. After that, they will answer questions that have been submitted by email followed by any questions that you all may have live on the call.

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 conditions, 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 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 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 release. We assume no obligation to revise or update any forward-looking statements.

Our financial results for the second 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.

Also please note that net income refers to net income attributable to owners of the parent as stated in Nexon's consolidated financial results.

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

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**Seungwoo Choi** - *Nexon Co. Ltd. - President, CEO*

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



First, our revenues were JPY81.0 billion and operating income was JPY34.1 billion. We realized strong growth with revenues up 52% and operating income up 22% compared to the first half of last year. We exceeded our guidance for the third consecutive quarter driven by strong performance of new and existing titles.

Also, the yen continued to weaken providing an additional boost for a campaign like Nexon with high percentage of overseas revenues.

This quarter we announced a semi-annual dividend of JPY5 per share. We maintain a large cash position and generate strong cash flow, which allows us to reward shareholders, drive organic growth and take advantage of strategic opportunities.

Finally, just after the second quarter closed, we announced strategic investments in two best-in-class US-based developers. We continued to pursue our strategy of growing our business in the west by working with developers of some of the best content that appeals to Western player case.

In closing, I would like to make a few comments about the general business environment and how it's strategically well-positioned to take advantage of current industry trends.

The games market is undergoing a massive change and the free-to-play business model is getting more attention than ever, particularly as devices on which people play games continue to converge. We feel that Nexon's ability to deliver compelling new content, operational know-how, broad global presence and strategic agility has never been stronger and that we're all aligned with the changing market.

First, we can deliver compelling content on both PC and mobile, both through exceptional internal development capabilities and collaboration with world-class developers. We have a strong M&A track record and are always on the lookout for new opportunities to grow our business.

Second, operational know-how is a result of more than a decade of experience developing and managing games. As the pioneers of free-to-play, we have an unmatched understanding of how to monetize gain for long user lifetimes.

Third, with games and service in over 100 countries worldwide, we truly have a global presence. We have a broad base of revenues with China, Japan and Korea now our top markets.

Finally, a strong financial position provides us with strategic flexibility. This enables our experienced shareholder-oriented management team to move aggressively when new opportunities arise. I believe that the unique combination of these capabilities enables Nexon to be a global entertainment leader regardless of platform, and I'm very excited about our prospects.

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

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**Owen Mahoney** - Nexon Co. Ltd. - CFO

Thank you, Seungwoo. Our second quarter revenues were JPY36.6 billion, an increase of 60% versus a year ago. Revenues exceeded the high end of our outlook and the strong performance by new and existing titles.

China and Korea both performed better than expected with Korea returning to year-over-year growth trajectory. In China, Dungeon & Fighter performed very well and continues to show strong user engagement. FIFA Online 3 continue the game popularity in Korea becoming a major revenue contributor in just the second quarter since its launch. We also continue to benefit from the weakening Japanese yen.

Operating income was JPY13.4 billion in the quarter, an increase of 21% year-over-year. Our operating margin of 37% exceeded our expectations.

On a year-over-year basis, operating margin declined as anticipated due to three factors. First was increased marketing investment primarily for mobile games that have good retention characteristics. Second was a change in the revenue mix as the mobile business represents a larger portion of our overall business than a year ago. And third, an increase in royalty costs associated with third party I.P. such as FIFA Online 3.

We provide more detailed look at each of these components in our shareholder letter and investor presentation, both of which can be found on the Investor Relations section of our website.

Net income was JPY11.4 billion, a 54% increase year-over-year, which was also above our outlook.

Now moving to user metrics, total MAUs were JPY71 million, a year-over-year decrease of JPY6.4 million. This decline was primarily the result of a decrease in users playing our more casual games in China.

It's important to keep in mind that this change does not significantly impact our revenues as casual users have shorter retention periods intend to monetize less than immersive gamers.

The quarter-over-quarter decline in MAUs was in line with historical seasonality far along the summer holiday season in Q1. Importantly, Dungeon & Fighter China MAUs were up slightly quarter-over-quarter due to successful summer content updates.

Our pay rate was essentially flat year-over-year from 10.3% last year to 10.2% this year. ARPU was up year-over-year on both an as reported basis and a constant currency basis thanks to successful content updates.

Continuing with our outlook for the third quarter, we expect PC revenues in the range of JPY30.6 billion to JPY32.7 billion. We expect double-digit PC growth in China and Korea driven by content updates in Q3 and from newer titles such as FIFA Online 3. We expect PC growth to be lower than the other regions. We also expect weaker Japanese yen to contribute to year-over-year growth.

In China, we expect growth to come from Tier 1 content updates for Dungeon & Fighter focused on user engagement and summer promotions for Counterstrike Online.

In Korea, we think newer titles such as FIFA Online 3 will drive strong year-over-year performance. We anticipate that existing titles such as Sudden Attack and Dungeon & Fighter will also perform well.

For our mobile business, we expect revenues in the range of JPY6.6 billion to JPY7.2 billion. We plan to launch both native and browser apps from gloops during Q3 including Dragon Eclipse, the first title that jointly developed by gloops and DeNA. We anticipate existing title such as Three Kingdoms Guild Battle in Japan and Fantasy Runners for Kakao in Korea to continue to perform well.

In the third quarter, we expect operating income to be in the range of JPY12.2 billion to JPY14.5 billion, representing an operating margin of 33% to 37%.

Similar to Q2, this year-over-year decline in margin is primarily due to a change in the revenue mix, an increase in royalty cost associated with third party license IP such as FIFA Online 3 and an increase in development and support cost for new title launches. The quarter-over-quarter margin decline is due to an increase in royalty payments associated with strong performance in FIFA Online 3 in Korea.

With that, we'd like to move to Q&A. Greg?

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## QUESTIONS AND ANSWERS

**Gregory Melchior** - Nexon Co. Ltd. - Manager - IR

Thank you, Owen. Now we'd like to go to the submitted questions. The first question is, what is the main factor behind the top and bottom of the Q3 guidance range?

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**Owen Mahoney** - Nexon Co. Ltd. - CFO

Okay. Just so to level-set everybody, on our -- this is Owen -- our investor presentation, which is available on our website, describes in some detail our business outlook. On page 22, we have the P&L outlook for Q3 of 2013 and a comparison of Q3 of 2012.

The main difference between the low and the high, the low for revenue we put it JPY37.153 and the high at JPY39.816 billion. The difference there is really the potential variability that we see in China.

And I think as most people who have been calling us for a while now, China is a very dynamic market. Dungeon & Fighter has continued to perform strongly in that market. We're very happy with the results of Q2 and we see strength going forward. But there is a decent amount of variability in there, so that's the main item that is driving the difference between the top and the bottom of the range. Next question please.

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**Gregory Melchior** - Nexon Co. Ltd. - Manager - IR

Okay. Thank you, Owen. The next question is, what is your mobile outlook for Korea and China?

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**Owen Mahoney** - Nexon Co. Ltd. - CFO

Well, Okay, this is Owen again. When we look at outlook, we typically don't break it up by region. I will say in both Korea and China, they are very early markets for us. We have been satisfied by two data points that we've received early on. First one in China, we launched KartRider Rush Plus and have already garnered 10 million downloads in China now.

That, as much as anything, says that the China market is a very, very large potential. And if you have a decent hit or a good hit, then it results in a lot of downloads.

Of course, monetization rates or ARPUs are much lower in China. So we'll see how that works out in terms of monetization. But China is very, very early on for us. We plan to be working very hard to be successful in China on the mobile side. But we expect little in the course of the next quarter or the next couple of quarters. In Korea, we've also had an early success Fantasy Runners just for Kakao just launched. In its first week, it generated over 1 million downloads.

And just to give you a sense of perspective, 1 million downloads is a very large number in a country that has 45 million or so total citizens in the whole country. So we're very satisfied with that performance. So far, it is continuing to be at or near the top rankings on Kakao and elsewhere, so that's off to a very good start. Again, we'll see how that monetizes going forward.

I'd say both Korea and China, it's early days. But as you can tell from those two early successes, we're very serious about being able to build out our mobile business not just in Japan, but in Korea and China as well. Next question please.

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**Gregory Melchior** - Nexon Co. Ltd. - Manager - IR

Okay. The next question is, how sustainable is Dungeon & Fighter? And do you expect it to continue to grow in China?

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**Seungwoo Choi** - Nexon Co. Ltd. - President, CEO

Okay. This is Seungwoo. Actually we've had this question for a long time, at least for two years, even for IPO. And I think this question is probably associated with issues like increase of competition or introduction of new titles into China market.

However, we believe that we need to have Dungeon & Fighter be sustainable or continue to grow in China because as long as we maintain a good partnership with Tencent, continue to provide good updates that will keep the players happy.



I think one important thing to remember is that the China market is still growing with lower penetration of broadband and lower penetration of PC China market is still growing no matter what. While we see a lot of new trends coming from the mobile side, the PC market is still robust.

And as I said, as long as we continue to provide good contents to the players, Dungeon & Fighter will continue to grow. And we have proven that over the past few years.

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**Gregory Melchior** - Nexon Co. Ltd. - Manager - IR

Okay. Thank you. And the final question we have is, you seem to have focused on larger M&A last year and smaller M&A this year so far. What is your future M&A strategy?

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**Seungwoo Choi** - Nexon Co. Ltd. - President, CEO

Okay, this is Seungwoo again. Actually, it's not about the size itself. It happened that we had bigger M&As last year and small ones this year, but we don't really think about size, it's more about how to acquire good contents in different territories or how to have an efficient entry into new markets or new platforms.

So it happened that we focused more on enforcing our development side last year where this year we see more of the territory expansion especially North America. So whether it's about acquiring a strong development team or whether it's about going on to a new platform or even new territories whenever we see an opportunity, we'll proactively and aggressively seek M&A. So it's not that we had a strategy of doing smaller M&As this year.

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**Gregory Melchior** - Nexon Co. Ltd. - Manager - IR

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

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**Operator**

Thank you. Today's Question and Answer session will be conducted electronically. (Operator Instructions). We will take our first question from [Dan Kong] with Deutsche Bank.

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**Dan Kong** - Deutsche Bank - Analyst

Hi. I just have one question. Could you just give us a quick update on DOTA 2 because it started service in Korea, well, it is a limited open beta service, but could you give us some data points on it?

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**Owen Mahoney** - Nexon Co. Ltd. - CFO

All right, sure. Thanks for your question.

The quick update on DOTA 2 is we plan to be launching it in Q4. We're already ramping up marketing in Q3 and preparation, of course, customer support and live game operations teams. We tend to ramp up a major title like that several quarters out. That process is already very much started right now.

In terms of how we feel about it, going back a couple of quarters, if you recall, before we enter this year, so going back to November, December timeframe, when we looked out into F.Y. '13, we said we've got a lot of new products coming out in F.Y. '13, but two really stand out. The first is FIFA Online 3, which we've just been talking about. The second big one is DOTA 2.

And we are as excited about DOTA 2 as we were back then and probably much more so because we've got more data about how it's been performing. And in the west, their beta has gone very, very successfully in English-speaking markets in North America and Europe. So the team has generated a great deal of buzz around English-speaking markets.

And then, of course, that's spilled over so there's a lot of anticipation in the Korean and Japanese market about this title, particularly in Korea. We've been playing it and it's very exciting to us.

So that's feeling good. Of course, it will depend on how -- what really matters is what Korean consumers believe about how the game is. But so far, all the data points make us very excited about it. And I'd say we're probably as excited about this title over the long-term at this stage a few months out or a little more and a quarter out as we were about FIFA Online and around the same stage.

Now, the difference between DOTA 2 and FIFA is that we expect the ramp in DOTA to be slower, more like a normal game because it has already existed in the market but is a very, very well constructed game by one of the great developers in the West, Valve, and the partnership is excellent there. So all around, we're feeling good about it.

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**Dan Kong** - Deutsche Bank - Analyst

Okay. Thanks.

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**Owen Mahoney** - Nexon Co. Ltd. - CFO

Thank you.

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**Operator**

We'll take our next question from [An Sulu] with [OCAM].

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**An Sulu** - OCAM - Analyst

Hi. Can you share with us what percentage of China revenue is from [launching on fiber] for the past quarter end. You mentioned that -- in giving the outlook you mentioned that the trend of revenue will be going double-digit. Can you be more specific in terms of your expectation on Dungeon & Fighter specifically in China?

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**Owen Mahoney** - Nexon Co. Ltd. - CFO

Sure. Thanks for your question. We don't break out our revenue by game. But as a general rule, the combination of Dungeon & Fighter and Maple Story is a little over 50%.

Going forward, what I can tell you is that Dungeon & Fighter has continued to show great robustness and have a great deal of longevity. The KPIs are good and it's reflected in the revenues. So we're happy with how that game is going and we expect at least for the foreseeable future that it's going to continue to be strong for us. So it will continue to be an important component of our revenue base.

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**Operator**

(Operator Instructions).

**Owen Mahoney** - Nexon Co. Ltd. - CFO

All right. Well, thank you very much for dialing into our call. Certainly contact us anytime if you have follow-up questions, and all the materials are, of course, available on our Investor Relations website. We look forward to talking with you next quarter. Thank you very much.

**Seungwoo Choi** - Nexon Co. Ltd. - President, CEO

Thank you.

**Operator**

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

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