

FY2021 Q3 Earnings Conference Call (November 9th, 2021)

Q&A Summary

[Q] After about two years of decline, China *Dungeon&Fighter* seems to be recovering driven by the content update under the new director. Do you think the recovery trend look clearer compared to six months ago?

[A] **Shiro Uemura (Chief Financial Officer)**

After struggling for two years, we are very pleased to see that China *Dungeon&Fighter* exceeded our expectations and grew year-over-year in Q3. The initiatives under the predecessor were handed over to the team under new leadership, and they have made further improvements successfully. More specifically, the team under the new leader held a user meeting and announced improvement plans that would reduce the burden placed on users in the game. By reducing the burden to raise characters, users started to own multiple characters. This led to higher sales of packages during the National Day update. We believe we improved the situation significantly as we earn solid revenue while reducing the burden on users.

I will also explain the reason for the year-over-year revenue decrease in Q4 despite the strong Q3 performance. We positioned Q4 2021 as a preparation period for 2022, especially for Q1. While good momentum continues, we strategically focus on building our user base. If we properly operate the game in Q4, we believe we will see good results in 2022. The recovery trend is becoming clearer, and we have high expectations for the next year.

Owen Mahoney (Chief Executive Officer)

China *Dungeon&Fighter* is a franchise that we remain enormously excited about, and we have good plans for 2022 that would solidify the base. We remain and are getting more bullish all the time in the franchise.

[Q] Metaverse and play-to-earn model are getting huge attention in the market recently. I read Owen's Medium post about Virtual World, which was very impressive. Given the openness you have shown with crypto assets, are these things the company would be willing to explore in the future?

[A] Owen Mahoney (Chief Executive Officer)

I published a Medium post about Virtual World recently right when everybody started talking about Metaverse. You can find it linked to it at the top of our IR website.

We are enormously excited about the talk on the Metaverse and NFTs and what is going on. Since the inception of the company in the mid-90's, we have felt that all of us will be spending a large part of our day in a deeply immersive Virtual World. This has been the whole concept of the company since the very beginning.

As we have said in recent quarters, we think that mobile will make this concept explode and everybody on the planet will have a high-end workstation in their pockets soon. There are already 3 billion iPhone 10s or higher or equivalent Android devices. Thus, this makes the idea of spending a long time in an immersive world not only a topic for a small number of users but also for a very large and rapidly growing number of users.

Also, it is important to remember that we are the first company to put virtual items and virtual currencies into an interactive entertainment experience. The first Virtual World we created was *The Kingdom of the Winds*, and the first use of virtual currencies in an interactive entertainment experience was *QuizQuiz*. So, we are very familiar with the topic and very excited by the new technology that is available to us particularly around NFTs, which we think will create a lot of new opportunities for us.

I think the problem with the whole discussion of the Metaverse, though, is that nobody seems to have a specific idea of what exactly we are supposed to be building, and nobody agrees on it. If you ask 10 different people what their definition of metaverse is, they will tell you 10 different answers. It seems that many of the other companies that are talking a lot about the metaverse, if not almost all of them, are throwing a lot of money and a lot of technology at a not-very deeply conceived idea of what it is that they are building.

So, we do not even use the term Metaverse. Instead, we use Virtual World and make sure that we are very specific with what we are building. In conclusion, my short answer to your question is, we are very excited, but we feel the need to be very specific

【Q】 While the quarterly MAU and pay rate for the overall PC business continued to decline, it seems that they showed an increase in Q3. What do you think about the sustainability of this trend? Also, while MAU remains lower than in the past, the pay rate increased. Do you think this is a healthy trend?

【A】 Shiro Uemura (Chief Financial Officer)

MAU has been gradually stabilizing driven by our efforts. But popular titles inevitably have bot accounts. So, MAU have decreased as we eliminated them.

Also, we see the increase in the pay rate as a positive trend. The increase can be a sign that we are able to retain core users and increase customer loyalty.

【Q】 Regarding *MapleStory*, it seems you will refrain from monetization for a while to regain users' trust, but which KPI do you look at to see whether you can restart monetization?

【A】 Shiro Uemura (Chief Financial Officer)

In Q3, *MapleStory* had favorable results. As I have mentioned before, there is no problem with the game itself. But a lack of communication led users to leave the game. We conducted various initiatives to regain users' trust, which included the disclosure of all the probabilities of the paid probability-based items.

In Q3, we achieved great results driven by Miracle Time Event in August and Chuseok¹ sales promotion in September. At the same time, *MapleStory's* Net Promoter Score has been improved. We think that we are going in the right direction to rebuild users' trust.

Therefore, we believe that the addition of good content and sales of good items will naturally generate revenue. We are not planning to take any strong monetization measures. The game itself is in good condition, so we can improve the sales performance as we regain the users' trust.

¹ Also known as Korean Thanksgiving

【Q】 Can you elaborate more on the idea of a creative platform developed by Embark?

【A】 Owen Mahoney (Chief Executive Officer)

The creative platform allows all of us — not just professional game makers — to craft interactive entertainment experiences to be played, remixed, and shared with other players. This has been the dream for many people for some time, and there is a lot of interesting work being done on this right now. But if we are going to develop deeply immersive Virtual Worlds, we have to address this challenge. The existing tools are very impressive, but we think we can go further in allowing everybody to be able to create highly interactive online entertainment experiences.

I will leave more details to a future discussion that is about launch of the product.

To achieve this vision, we have to think differently than people who have already been thinking about it. One of the things that help us a lot is the significant investment in technology that Embark made upfront.

The technology will not only be used in the first game codenamed Pioneer and in the second game codenamed Discovery. It can be used in the third project, a creative platform, to help everybody make games.

【Q】 Has Embark's upfront investment been capitalized and scheduled to be amortized when games are released? Or did you already recognize it as an expense? Are there any future risks for impairment loss or write-downs on the investments made so far?

【A】 Shiro Uemura (Chief Financial Officer)

At the time of the acquisition of Embark, goodwill of less than 30 billion yen was booked.

On the other hand, what they are currently developing are expensed as incurred.

[Q] Regarding Korea *Mobile Dungeon&Fighter*, is this the same game as the one planned to be released in China? Also, can you give us more background regarding your decision to launch in Korea first?

[A] **Shiro Uemura (Chief Financial Officer)**

Mobile Dungeon&Fighter that we are going to launch in Korea is the same one that we are planning to launch in China. As you know, *Dungeon&Fighter* is a very popular franchise in Korea. So, as we are ready to launch the game in Korea, we announced that we will launch in Q1 2022 accordingly.

Regarding *Mobile Dungeon&Fighter* in China, we have no updates on the release timing.

[Q] Please tell us the scale of Embark Studios' Pioneer and Discovery. Is the studio getting their feet wet in developing the games, or are they diving in fully to be major releases?

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

These are significant projects that we are extraordinarily excited about. We will talk about the first game codenamed Pioneer more in December.

By way of quick background, Embark is about 2.5 years old and is a new studio, but it is not a new development team. The founder of Embark was previously the Head of Development at Electronic Arts from 2014 to 2018. He is an extraordinarily accomplished developer who turned highly differentiated games into massive franchises. The biggest of them is the *Battlefield* franchise.

When I was at Electronic Arts running corporate development, I purchased DICE Studio and got to know Patrick Söderlund and his team very well. After Patrick left Electronic Arts, we partnered with them and finally purchased Embark. The studio has assembled 250 spectacularly talented creative, and capable developers. We are very excited about them.

【Q】 What are the reasons behind the 2.8% year-over-year decrease in accumulated revenues for the nine months ended September 30, 2021?

【A】 Shiro Uemura (Chief Financial Officer)

The major reasons for the year-over-year decrease are Korea *MapleStory*'s setbacks from the beginning of this year and the continued decline in China *Dungeon&Fighter*. While the growth of other titles has partially offset the soft performances of these titles and the two franchises have shown a sign of recovery in Q3, the accumulated revenues decreased year-over-year due to the challenging comparison with last year when we achieved significant growth.

【Q】 You recorded a revaluation gain of 1.7 billion yen due to changes in the market price of crypto assets, but what was the reason for the revaluation? Also, please tell us the amount of loss recorded in Q2 2021.

【A】 Shiro Uemura (Chief Financial Officer)

We recognized a revaluation loss of 4.5 billion yen in Q2 2021 while booked a reversal of loss on revaluation of 1.7 billion yen in Q3, reflecting the market value as of the end of September.

We hold bitcoin as one of the currencies with a medium to long term perspective. So, we are not so concerned about short-term volatility.
