

Letter to Shareholders

FY 2019

To our shareholders,

PREFACE

Prior to starting this year's shareholder letter, I want to acknowledge the rapid rise of COVID-19, which has impacted each of the regions in which Nexon does business. Our first thought is to all of our employees, partners, and customers around the world who have been affected by this terrible virus. As I write this letter, we have not seen discernable impact on our business. Several weeks ago we instituted various measures – such as travel bans and work-from home policies – to protect our employees. Much about the virus is still unknown. We will continue to be proactive to protect our employees and our business through this difficult time.

INTRO

Nexon had challenges and much change in 2019. We made several significant changes to our strategy: we stopped supporting low-margin games and significantly reduced our pipeline of new titles.

We refocused those resources towards our core strengths, as part of a broad strategy of making fewer, but bigger games that offer long-term profitability and sustained fun for our players. Implementing these changes was a challenging process for the management team and especially for our employees around the world, but we expect these steps to strengthen our company significantly.

As a result of both the performance of our biggest game and paring down our product lineup, our revenue was down in several regions, but we finished the year strongly, especially in Korea:

- **China** was down 16% year-over-year. After several consecutive years of growth at massive scale, *Dungeon&Fighter*, our largest franchise, had a difficult second half. The updates we introduced mid-year were not well-received by players, and our revenue and KPIs fell significantly. This is a situation we are familiar with and have handled many times. One of Nexon's core strengths is in sustaining and growing large franchises over time, and this experience gives us confidence we can return *Dungeon&Fighter* to more solid footing in China.
- **Japan** was flat year-over-year. We pared back our offerings to a smaller number of products while we retool our business.
- **North America, Europe and Others**¹ combined were flat year-over-year. As in Japan, we reduced our title count.
- **Korea** was up 22% year-over-year, and was particularly strong in the second half of the year. *MapleStory* (up 39% constant currency²) and *MapleStory M* (up 65% constant currency²) were especially strong. *FIFA*³ ended the year with its highest revenue ever. *V4*, our newest MMORPG franchise, had a gratifyingly strong start, despite the heavy competition in Korea for that genre.

While streamlining our organization and product offerings is a long-term strategy, the early data suggests it is working. What's more, we believe the momentum we're seeing from these improvements will accelerate in 2020. I will spend most of the rest of this letter describing our approach.

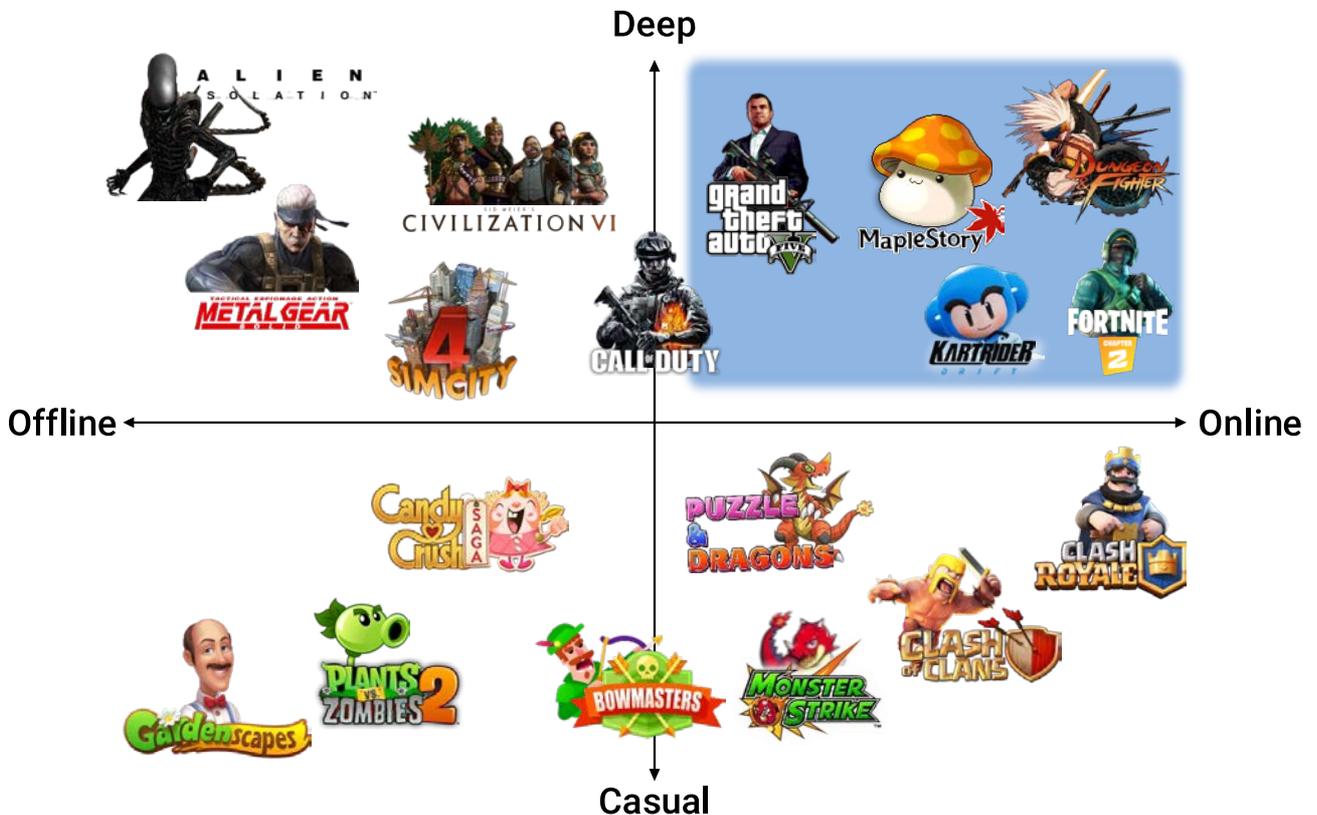
¹ "Europe and Others" includes Europe as well as other Asian countries and South American countries

² Constant currency is a non-GAAP measure used to show performance unaffected by fluctuations in foreign currency exchange rates. Constant currency basis amounts are calculated using the average foreign currency exchange rates for the comparable period in the prior year and applied to the current period.

³ Official titles are *EA SPORTS™ FIFA ONLINE 4 (PC)* and *EA SPORTS™ FIFA ONLINE 4M (mobile)*.

CONTEXT AND MAP

To understand Nexon's strategy, some context and history is helpful. One way to classify the global videogames industry in four quadrants^{4,5}, shown here.



The global games industry has evolved significantly over the last 25 years, driven by successive waves of enabling technology that each drove massive growth.

Much of the industry started in the upper left quadrant. That's the realm of deep offline single-player games, primarily on early PC's and consoles. There are many great games in this quadrant, but Nexon has never really focused on it.

Then the Internet opened the right-hand side of the graph in the mid-nineties, when Nexon and some other companies in Korea and then China invented online games and later free-to-play games. The first graphic MMORPG was Nexon's *Kingdom of the Winds* in 1996; the first free-to-play game was Nexon's *QuizQuiz*, in 2001.

⁴ The letters, graphics, symbols, logos and other marks, and illustrations, characters and other works, which are shown in this material are trademarks, registered trademarks, copyrighted works or other legally protected materials owned by respective right holders.

⁵ The categorization of the games is based on our own view. It may not necessarily reflect the common views in the market.

Subsequently, about 12 years ago, the rapid ascent of Facebook and smartphones unlocked the lower half of the graphic – the realm of casual games. These technology advances brought many new customers to the industry and brought the games industry out from a fairly niche audience to an industry that is now far larger than linear entertainment (movies, TV, streaming put together).

Nexon's core strength is in the upper right-hand quadrant: deeply immersive online games. We sometimes call them virtual worlds, because a player of this type of games has an immersive experience, connected with thousands of other live players at the same time. And even though they may look simple on the surface, the depth of the world, variety of challenges, intricacy of game systems, and massive numbers of players make them as entertaining and engaging as experiences in the "real" world.

The upper right quadrant of deep online games is where Nexon started, and where our hearts have always been. And this core competency is both highly unique and hard to replicate. In the entire global games business there are only a handful of companies who have done it consistently and who can do it well.

For years, deep virtual worlds were mostly exclusive to the PC platform. That changed in 2017 with the launch of iPhone X and equivalent mobile devices, phones so powerful as to deliver graphics and networking power indistinguishable from high-end desktop PCs – in your pocket. Cloud services from Google and several others are likely to accelerate this trend.

From a business perspective, this represents massive opportunity for Nexon. Because high-end games can now be played by billions of devices (rather than mere hundreds of millions), the Total Addressable Market of our efforts expands by a factor of 10x.

FOCUS

With this context in mind, it is easier to understand Nexon's decision to streamline our game offerings. In mid-year, as the results of several product launches became available, the executive team took a close look at our portfolio. Several games were of high quality but were not able to retain their user base in a crowded market.

A few simply did not meet our standards for quality and originality. And by launching so many games, our publishing and marketing teams were stretched thin.

As a result we decided to simplify our business, around four simple principles:

1. **Deep multiplayer games:** Concentrate our teams on fewer, but bigger, fully online multiplayer games and virtual worlds.
2. **Multiplatform:** Enabling our virtual worlds to be played across multiple hardware platforms: PC, console and mobile.
3. **Nexon IP:** Leveraging our substantial IP portfolio to generate long-lasting games with significant recurring revenue.
4. **New IP and Tech:** As appropriate, placing bets on new IP that we think are really special. Our acquisition of Embark was an example of this.

Focus also means saying "no" to many things that are not part of our core. In Japan, we sold our subsidiary Gloops, a talented group of people but not part of our key pillars. We also said goodbye to a number of game development projects in our Korean studios, as well as several live games. In almost all cases we redeployed the development teams to projects that are closer to our core strength.

These were difficult decisions. But by saying "no" to the things that are not part of our core and eliminating what we don't do well, we can bring fierce determination to the few projects that we say yes to. We believe these will result in better games, a more robust business, and strong returns for our shareholders.

As I will explain below, we think our performance in Q4 in Korea is an early indication of the impact of this focus; and we expect the benefits to accumulate and grow over time as our strategy plays out in more markets.

A reflection of this strategy are the two significant investments we made in 2019. First, we bought Embark Studios, based in Stockholm, Sweden. We are pleased with their progress so far on their first game and are looking forward to sharing more about the game later in 2020. Second, we invested in Wonder Holdings, based in Seoul, led by Min Hur,

the highly respected studio leader and entrepreneur who previously founded our subsidiary Neople in 2001, where he led the development of our biggest franchise *Dungeon&Fighter*. Both Patrick Söderlund and Min Hur are world-class creative leaders and great additions to the Nexon family. Both investments strongly reflect the focus on deeply immersive online games (the upper right-hand quadrant in the graphic above).

IP POWER AND SCALE

A powerful component of Nexon's continuing success – and one that is frequently misunderstood by outsiders – is the scale and resiliency of our portfolio of franchises. Nexon's IP bench ranks among the biggest and best performing in the world.



One example is *MapleStory*, a 16-year strong franchise, which has amassed more than 180 million registered players worldwide. It is deeply woven into the Korean culture: player registrations are equal to 45% of the total number of people in Korea. Its revenue scale is massive: *MapleStory* PC and mobile revenue combined is about equal to the global box office of the movie franchise *Frozen*⁶, which is one of Disney's biggest. In terms of total players, Life-to-Date user registrations of *MapleStory* PC are larger than Life-to-Date unit sales of one of the greatest game franchises ever, the *Final Fantasy* series on PC plus console⁷. So, *MapleStory* is in excellent company.

⁶ Life-to-date global box office revenues as of February 13th, 2020 sourced from BoxOfficeMojo.com

⁷ Life-to-date unit sales and download number of *Final Fantasy* franchise as of the end of December 2019 sourced from CESA Games White Paper and company research



KartRider is another example of a game not well-known in Japan or the West, but with massive scale. We first introduced this fully online multiplayer racing game in 2004. More than half of the Korean population and over 45% of the Taiwanese population has played this game. Life-to-date, registered users of *KartRider* total more than 380 million people worldwide. For a sense of scale, more than 100 million more people have played *KartRider* than have played *Mario Kart*⁸ on all platforms – clearly the gold standard of the genre and one of the greatest franchises of the industry. We have enormous respect for Nintendo and the craftsmanship they have put into the *Mario Kart* franchise. While the free-to-play business model is quite different, we think that the reach of both of these franchises highlights the scale and potential of compelling interactive entertainment properties. The fact that hundreds of millions of people have experienced the IP's game world for many hours creates a large and receptive audience for new versions or extensions for that IP. So, reach of the IP really does matter if you can make use of it.

And that's exactly what we're doing. In 2020, we plan to release an all new *KartRider*. Unlike the previous version, which was only on PC, the new version will be on multiple platforms, all over the world. We think this is a massive opportunity for Nexon and our shareholders as we bring a beloved franchise to a global audience of players.

⁸ Life-to-date unit sales and download number of *Mario Kart* franchise as of the end of December 2019 sourced from Nintendo website, CESA Games White Paper, and App Annie



And of course, *Dungeon&Fighter* is our largest franchise and the one we get asked about the most. For those who don't live in China and Korea, it is very easy to miss *Dungeon&Fighter's* massive scale. We launched *Dungeon&Fighter* on PC in 2005, and since then the global registered user base tops 700 million. By comparison, this is more than 2x *Fortnite*⁹ across all its platforms in 2019. Life-to-date, *Dungeon&Fighter* has grossed well over \$10 billion – that's several billion dollars more than the life-to-date receipts for both the *Star Wars* and *Harry Potter* series, and roughly double the revenue of the entire *Avengers* series¹⁰. And remember *Dungeon&Fighter* is still only on PC, and the PC installed base of players represents a small fraction of total game players. You can see why we are so excited to bring this franchise to mobile platforms, which have an installed base of, by our estimates, at least 10 times that of PC, and growing very quickly.

The enormous scale and growing strength of these and other franchises has led to consistent and growing cash-flow, which we can use to further invest in our business.

⁹ Life-to-date registered users of *Fortnite* in 2019 sourced from Statista and App Annie

¹⁰ Life-to-date global box office revenues as of February 13th, 2020 sourced from BoxOfficeMojo.com

3 BIG BEATS

And we are investing in our future. Nexon's development teams are working incredibly hard on the four themes I mentioned earlier. We have several new products in the works to launch in the near term. I'll briefly mention three here.

The first big beat is *Dungeon&Fighter 2D Mobile*, which brings one of the world's biggest game franchises to the world's biggest game platform, in the world's largest game market. The development team has been working hard to make sure that this fully-online multiplayer action game will work well across the China mobile internet, and the results from the recent beta test in China have been positive. This will be a big launch for us in 2020, so we are focused on getting it right.

Next is *KartRider: Drift* – the next generation *KartRider*, the PC franchise that has been played by more than half of the Korean population. Three things to know about this new version of the *KartRider* franchise:

1. When it launches it will not just be on PC, but consoles and other platforms as well.
2. It's built from the bottom-up to be fully online. That means it has a lot of features online game players love and have not seen in either casual or hard-core racing games.
3. It's free to play

No other game has this set of features. We recently completed our first round of closed beta testing and we ramp up to launch later in 2020.

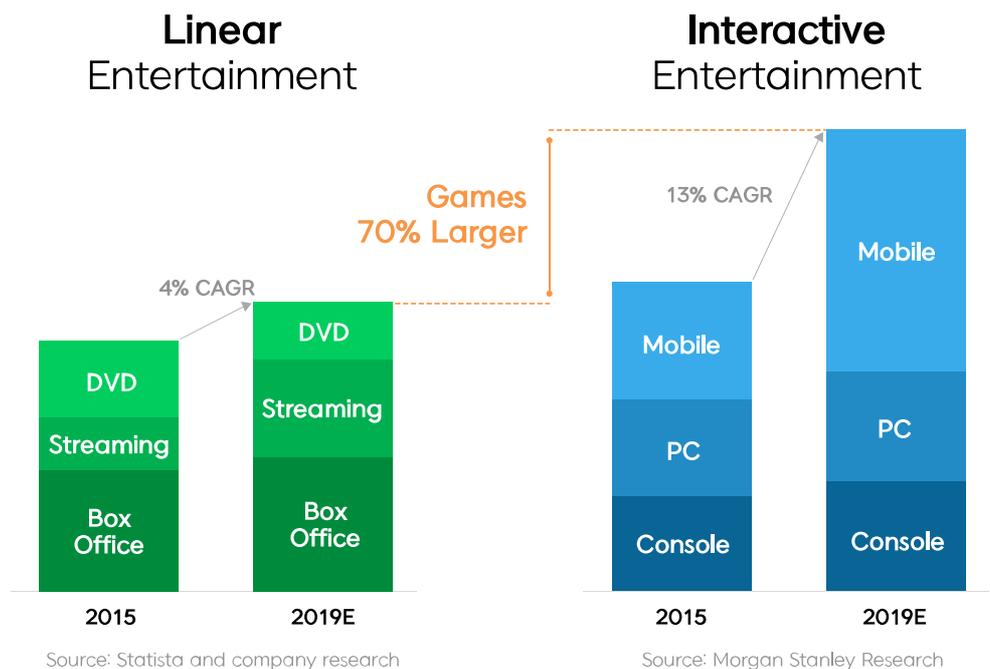
Later this year we will be talking a lot more about the new game from Embark. It's a multiplayer co-op action game, and we think it is really exciting. Embark's team is extraordinary from both a creative as well as a technology perspective. We think what they are working on will change online games in the West.

GROWTH AND CHANGE AHEAD

Unlike other sectors of the entertainment industry like linear entertainment or music, in the games business each new wave of platform technology innovation unlocks massive new growth. At Nexon we are doubling down on our core strength of development and operations of deeply immersive online games because we think that’s where the best opportunity is in the future, and where we bring the most to the table.

Nexon has a great foundation that consists of a world-class portfolio of franchises that are as big or bigger than the best movie and game franchises in the world. While these game franchise revenues can fluctuate during their long-life cycle, our extensive experience has shown again and again that franchise revenues can continue to grow over decades, despite near-term fluctuations. This is a key point to understand about our business and that of companies like us.

The broader media and tech industry has woken up to the video games industry; it seems everyone wants in. Several media and technology companies are spending billions each to get into the games business. Several have announced cloud services in an effort to be the “Netflix of Gaming”. All this activity makes sense – today the games industry is significantly larger than linear entertainment or music. It is much more profitable, and it is growing at roughly 3x the rate¹¹.



¹¹ Source: Morgan Stanley Research Estimates, Statista, and company research

The winning company or business model in any industry is usually the one that holds and can make use of a scarce resource. What is scarce in the games industry? It's not a platform for game delivery – several great companies are in that business and more are on the way.

What is scarce is great development talent to build unique online games that can last and grow for years. Few game companies in the world have done that, and it remains a specialized skill set – one that Nexon has been refining for over two decades.

Nexon's business is stronger than ever. Our IP is among the very largest in the entire entertainment industry. Our teams are the most experienced in deep online games – the next big frontier in the entertainment industry. And our balance sheet – with over \$5 billion in cash and cash-flow generation of \$1 billion per year – provides us with enormous strategic flexibility to further augment our growth.

Nexon is extremely well positioned to take advantage of the largest trends in the industry and we are moving fast to seize the opportunity.



A handwritten signature in black ink, appearing to read 'O. Mahoney'.

Owen Mahoney, CEO and President

Tokyo, Japan
March 24, 2020