

FY2015 Q3 Japanese Earnings Conference Call (Nov 13th, 2015)

Summary of Q&As

【Q】 Is it correct to assume that the year-over-year decrease in amortization expense of JPY 2.2 billion in Q4 2015 associated with completion of *Dungeon&Fighter* IP amortization will continue until Q3 2016?

【A】 The amortization related to *Dungeon&Fighter* IP was completed in August 2015, therefore, the year-over-year decrease in amortization expense will continue to have impact until August 2016. On monthly basis, we expect the amortization expense to decrease by JPY 0.7 billion.

【Q】 Q4 outlook shows a significant increase in marketing costs. On which titles do you plan to primarily spend marketing costs? Should we expect marketing costs to further increase from Q4 2015 level in 2016 given that you have more titles to launch?

【A】 In Q4, we plan to spend marketing costs primarily on *HIT* (highly expected mobile game), *Fantasy War Tactics*, other new PC / mobile games, TV commercial for *DomiNations*, and existing games including *FIFA Online 3* in time for winter vacation. As for 2016, we expect to spend a decent amount of marketing costs in relation to multiple launches of new titles.

【Q】 Q4 marketing costs are expected to be around JPY 5 billion, an increase of JPY 1.5 billion year-over-year. Should we think this level of marketing costs is not so high given that there are multiple new title launches?

【A】 We intend to invest a decent amount of marketing costs for the highly expected titles with due consideration of cost-effectiveness. The appropriate level of marketing costs will differ depending on situation, however, we do not think JPY 5 billion to be at a high level.

【Q】 The timing of launch for *Dungeon&Fighter* mobile seems to be delayed from the original plan of 2015 launch to 2016. Would you be able to share more specific timeline of its launch? Is it likely to be launched in the early part of 2016 in time for Lunar New Year or likely to be later part of 2016?

【A】 *Dungeon&Fighter* mobile is a mobile title based on an extremely popular IP, which not only Nexon but Tencent has high expectation on. We are currently in the phase of testing / brushing up the game, however, the initial plan of 2015 launch is unlikely to happen. We do not intend to make compromise on its quality, and therefore we would like to make sure that the game is finely tuned. We cannot define the specific timing of launch at this point, however, we intend not to take such a long time until the launch.

【Q】 Net cash position has amounted to approximately JPY 300 billion after NCSOFT share disposition. Can you share us the priority of cash usage?

【A】 The priority of cash usage has not changed because of NCSOFT share disposition and our primary usage of cash remains to be focused on M&A / investments to support future business growth. At the same time, we also place importance on shareholder return, therefore, would like to take a good balance between the two. Our recent investments happen to be limited to minority investments, however, we consider that a strong cash position enables us to be prepared for potential investment opportunities and gives us a competitive advantage over others.

【Q】 Q3 tier 1 content updates for *Dungeon&Fighter* in China seem to have gone well, resulting in an increase of MAUs. What do you think about the possibility of potential upside / maintaining the same level of MAUs as Q3 going forward? In addition, with a view to launching *Dungeon&Fighter* mobile, can you share us your view on potential cannibalization / synergetic effect between PC and mobile version?

【A】 We introduced two tier 1 content updates in Q3 (July Summer update and September National Day update). Between the two, the September National Day update was particularly well received with strong package sales. However, not only the September National Day update but also revenue performance throughout September was strong even before the introduction of National Day update. *Dungeon&Fighter* has been trending very stably and in Q3, both MAUs and paying users increased quarter-over-quarter. As for FY2015 full-year revenues for *Dungeon&Fighter*, we expect low teens % year-over-year increase on an as-reported basis, which is slightly stronger than what we expected at the beginning. Going forward, we continue to focus on longevity and stability of the title as we have been, and under such basic stance, we intend to encourage the title to grow as appropriate.

【Q】 As for Korea in Q4, you anticipate low single digit % to high single digit % increase year-over-year. What is the breakdown of PC online and mobile revenues based on this outlook? How should we think about Q4 *FIFA Online 3 M* and *DomiNations*, which performed very well in Q3?

【A】 We expect a modest increase year-over-year for Q4 Korea revenues. As for PC online games, we expect to see a year-over-year decrease primarily due to decrease in *FIFA Online 3*, which benefited from FIFA World Cup in Q4 2014. On the other hand, we expect to see a year-over-year increase for mobile games due to contribution from new titles including *DomiNations*.

【Q】 You have been engaging in strategic partnerships with game developers in North America. Recently there are new flows around potential acquisition of mobile studios by publisher etc. In such circumstance, can you share us your view on the industry realignment especially in North America? Related to this, are there any changes to your investment / partnership strategy?

【A】 Our policy and our approach to M&A does not change a bit because of what other companies are doing. We have noticed that there is a lot of deal-making recently in the U.S. of course, and our belief is that we need to be tying up with companies that are consistent with our approach to game development. And, we are going to continue to do that at prices that we consider prudent and with teams we believe strongly in that we feel we can grow over time. We have made numerous investments in game companies that we feel we can add a lot of value to, and whose IPs and games we can bring to the world-wide audience, combining what we know about online game play. We will continue to look vigorously for those types of relationships, invest in them when we have the opportunity, and do M&A when the opportunity for profitable investment presents itself. That is completely consistent with our policy all along, and that won't change.

【Q】 Q4 outlook for PC online revenues with quarter-over-quarter decrease was quite surprising as Q3 performance was very strong. Can you share the latest situation of how PC online games are trending against Q4 outlook?

【A】 The quarter-over-quarter decrease in PC online revenues is primarily due to *Dungeon&Fighter* in China. The situation in 2014 and 2015 is quite different. In 2014, Q4 was exceptionally strong against seasonality, which we usually see a seasonal negative rebound in Q4 in comparison with seasonally strong Q3. Whereas in 2015, we expect to see a usual negative rebound from seasonally strong Q3. However, when we look at full-year revenues for *Dungeon&Fighter* in China, we expect to see low teens % year-over-year increase on an as-reported basis, which explains that the quarter-over-quarter decrease in Q4 is simply attributable to seasonality. As for *FIFA Online 3*, we expect to see decrease year-over-year in Q4 as last Q4, the game gained positive effect from FIFA World Cup. In addition, we are scheduled to introduce a large-scale content update (Engine Update) in Q4, so we are more focused on strengthening the user traffics rather than growing revenues. All things considered, we think outlook for Q4 PC online revenues is reasonable.

【Q】 *MapleStory2* had a good start, but seems the momentum has slowed down. Please share us the challenges you are facing / strategy on *MapleStory2* or the overall PC online business going forward?

【A】 While *MapleStory2* dropped in ranking recently, the IP itself is very popular in countries including Korea, Japan and North America. We do not necessarily expect PC online games to generate revenues immediately after the launch but rather, they should gradually establish their user base so that they can contribute to revenues over the long-term. What we recognize from user feedback is that while *MapleStory2* is an extremely high quality game, because of its flexibility in the game play, some light users find it difficult to play with. On the other hand, hardcore users seem to want more of RPG elements incorporated in the game. We would like to reflect such feedback to the game through content updates in our continuous effort to improve *MapleStory2*.

【Q】 What do you think about your investment in NCSOFT after disposition of the shares?

【A】 We were unable to generate business synergy with NCSOFT as originally planned at the initial time of the investment due to some of the differences in the way of thinking and corporate culture. We would like to make a good use of what we learned from this experience as we consider to make investments going forward.

【Q】 How much upside should we expect from *Dungeon&Fighter* in China for Q4?

【A】 We are focused on longevity and stability of the game. In order to achieve those, we consider a well-balanced operation and updates are necessary. As for Q4, we would like to focus on maintaining solid user base rather than monetization in order to prepare for next year. Accordingly, we do not think our Q4 forecast to be conservative, but reasonable.

【Q】 You expect Japan business to decrease by 30⁺% year-over-year. Did you expect such a trend at the beginning of this year? The purpose of asking this question is to have an understanding of possibility of impairment loss related to gloops' goodwill.

【A】 At the beginning of the year, we expected certain decrease in browser revenues, the amount of which turned out to be slightly larger than we initially expected. Although we passed the impairment test in Q3. The potential impairment loss in Q4 and onward is dependent on the performance of new browser title *LAPLACE LINK*, as well as the other existing titles. We will continue to make the best efforts to stabilize the revenue trend of existing titles and in addition, try to generate growth from the new titles.

【Q】 You said that the gain from disposal of NCSOFT shares would not be recognized on consolidated basis. How should we think about the accounting treatment of the tax expense associated with the gain?

【A】 Although the gain is not recognized in our consolidated financial statements, it is recognized on the standalone financial statements. Therefore, corporate tax rate, for instance in Japan of about 40%, is applied to JPY6.4 billion gain associated with gains recognized by Nexon Japan corporate entity through this transaction. Having said that, on consolidated basis, tax expense will not be recognized as the gains do not have an impact on the Income Statement as profit / loss but recognized as other comprehensive income.