

**NEXON Co., Ltd.**

**Q4 2018 Earnings Prepared Remarks**

**Feb 12, 2019**

**Owen Mahoney, Representative Director, President and Chief Executive Officer, NEXON Co., Ltd.**

Thank you all for joining Nexon's FY2018 4th quarter earnings presentation today.

Thank you also to those of you who are joining us remotely through live broadcast.

Before we get into full-year and 4th quarter results, I'd like to offer a few comments regarding the recent media reports about NXC Corporation. The news reports are that NXC, which currently owns a stake of approximately 47% in Nexon, has been considering selling itself, and with it, its stake in Nexon. For those of you who are not familiar with NXC Corporation, NXC is a separate entity from Nexon, and the majority of its ownership is held by our founder and his family.

As you probably saw on the release we posted to our IR website on January 4th, while it may be true that NXC or its shareholders are considering various options for a transaction, nothing has been decided at this point.

It would be inappropriate for Nexon to comment on what actions NXC might take. However, whatever may or may not happen as a result of this, the entire Nexon management team and I remain completely dedicated to creating the biggest and best game company in the world, by building great online games and bringing them to a massive audience of gamers around the world.

It's also worth reiterating that our founder has not been involved in the day-to-day operations of Nexon for many years. Thus, any decisions he may take are independent of the Nexon management team.

If there is any major change or news to report, we will certainly update you.

Now getting into our FY 2018 results.

We're extremely happy to report record-high annual results for the full year of 2018. Revenue, operating income, and net income were all up year-over-year with record full-year results for both PC and mobile business.

We had a lot of amazing news in the 4<sup>th</sup> quarter and throughout the year. Let me take a moment to recap these briefly.

Our PC business grew year-over-year driven by the strong performances of our key titles in China and Korea, despite the headwind of the *FIFA* service transition impact in Korea throughout 2018.

On the mobile side, Pixelberry, which joined our group in November 2017, integrated very well, and its key title *Choices* contributed a lot to our mobile revenue growth, especially in North America.

The global services of *MapleStory M* and *Darkness Rises* began in mid-2018, did really well internationally, and also contributed to the growth of our mobile business.

In 2018, *Dungeon&Fighter* celebrated its 10<sup>th</sup> anniversary in China. And, in its 10<sup>th</sup> year, we delivered another year with double-digit growth, on top of the high comps of the year before. This makes it THREE consecutive years of China *Dungeon&Fighter* recording double-digit year-over-year growth in local currency terms.

Most recently, we introduced the Lunar New Year update to *Dungeon&Fighter* in China on January 21<sup>st</sup>. We also released its maximum cap to level 95 from 90 on the same day. Uemura-san will share the details on these with you shortly.

It was also an exceptional year for *MapleStory*. In Korea, it celebrated its big 15<sup>th</sup> year anniversary in April along with a lot of exciting off-line events. This was followed by an incredibly successful large-scale update during summer, resulting in its full-year revenue growing by 67% year-over-year.

*MapleStory* not only did well on PC: thanks to the great work of our live operations team, the mobile version also showed outstanding performance, growing 81% year-over-year Korea alone.

This growth further accelerated with the launch of its international service in over 140 countries around the world in 2H 2018. With its global results combined, *MapleStory M* grew its revenue over 6x year-over-year.

Another achievement in 2018 was the successful service transition of *FIFA* in Korea from *FIFA Online 3* to the upgraded *FIFA ONLINE 4*. It was the biggest transition we've ever had, but the live operations teams along with our partners at EA managed it extremely well. Both PC and mobile versions are on track, and we're very satisfied with how *FIFA ONLINE 4* is ramping up.

And, last but certainly not least, we made a major announcement of a strategic partnership with Embark Studios. The Embark team is extremely accomplished group of developers based in Stockholm, Sweden. The founders are responsible for starting and growing some of the biggest game franchises in the West, as well as key technologies underlying some of the biggest console and PC games. Nexon purchased a minority investment in their studio, along with rights to publish titles they produce. Given the demonstrated quality, consistency, and creativity of this team, we think our investment will produce great returns for us in coming years.

As we mentioned last quarter, Patrick Söderlund – the CEO of Embark Studios – has been nominated to serve on Nexon's Board of Directors, which will be voted on at the shareholder meeting next month. Patrick is one of the most respected and accomplished development heads in the Western games industry, and we think his counsel on our board of directors will be invaluable as we expand our development capacity, especially in the West.

So, to sum up, our existing games remain extremely stable, and our approach is to leverage the incredible opportunity they provide to create more opportunity for growth in the future.

So let's now talk about some upcoming products.

First, I'd like to talk about the mobile extension of one of our other large franchises, *Mabinogi*. The PC version of *Mabinogi* was first launched in 2004, and it has quietly built up a very large fan base. Since mobile devices now support fully synchronous networked gameplay on a massive scale just like a high-end PC, we can now bring a deeply immersive massively multiplayer game like *Mabinogi* to these devices. This wasn't possible even a few years ago, as the platform wasn't able to handle it. We had hands-on demos of the game at the recent G-STAR show in Korea and it received the best reviews among all the games we showed. By its nature it appeals to a broad audience, both male and female. There is nothing like it on mobile, and the IP is wholly-owned by Nexon. Let's look at some gameplay.

As you have heard us say before, *DnF* appears to be one of the top 2 or 3 largest franchises in LTD revenue in the entire games industry. It is also the several billion dollars bigger in LTD revenue than the largest movie franchise box office of all time, which is *Star Wars*.

So given the scale of this franchise we get a lot of questions from investors about the mobile version of the product. In November, we showed off the most recent version of *DnF* Mobile at the annual *DnF* fan festival in China. As we get closer to the launch of the game we are able to talk about *DnF* Mobile more openly, so for the first time in an investor presentation, let's take a look at actual gameplay footage.

We have not yet announced a date, but what we can tell you is that development is very far along. Last month we and our partner Tencent conducted a closed beta test in China – both Nexon and Tencent have become increasingly confident about the game meeting the quality bar we have set for it, as we keep working closely on its development.

While keeping the core identity of *DnF*, the mobile version will also have new scenarios and optimized content to deliver its style of action gameplay on mobile devices. We've also decided to bring the game to Korea.

We will keep you updated in future earnings calls.

But that's not all we're doing with the *DnF* IP. We are also developing a 3D action RPG that is based on the *DnF* universe. The game will use the Unreal 4 game engine and is targeting the PC platform for now. While we have not yet announced an expected launch date, and do not expect it to launch in 2019, we are excited about the gameplay in our early internal tests, and think that, like *DnF* mobile, it will open up the *DnF* universe to new types of players.

Let's take a look at some gameplay footage.

Finally, let's talk about how we are evolving our game development and investment strategy. Our teams are making breakthrough innovations to develop exciting new content for our pipeline. When you see these new titles, you will likely notice a few themes.

The first theme is that more than ever before, our teams are focused on wholly-owned Nexon IP. Over the last 25 years Nexon has created some of the largest, the most beloved franchises in the games industry, including wholly-owned IP such as *Dungeon&Fighter*. We see a huge opportunity in updating and extending those franchises to new markets which now have better access to powerful game platforms.

The second theme is how we leverage major technological change. Let me highlight just two that we think are highly disruptive:

First, mobile platforms are now fully capable of delivering a deep, immersive world with thousands of players in the same game world at the same time. This is about to get even better because Google, Microsoft, and now Amazon have each announced plans to spend massively to deliver cloud-based game streaming services to any device. The distinctions between mobile and PC development is disappearing. Your mobile device is your PC. For a developer like Nexon which makes massively multiplayer games, these developments mean that our target market is many times bigger than it was in the days of PC-only online games.

The second way we will leverage technology is about AI. AI will revolutionize online games.

- AI enables us to manage our live services in a much more sophisticated and replicable manner, which will translate to greater retention for our user base. We have been investing heavily in AI for 2 years and are already seeing material benefits in the performance of our games.
- Beyond creating a better experience for our players, we think AI will significantly lower the cost of game development, through procedural generation of content, which is being pioneered at Embark Studios.
- In terms of gameplay, AI will power self-learning automated agents. In an online game world, you'll be playing not just with other human players, but bots who have learned to play the game by playing it thousands of times. You won't be able to tell the difference between a bot and a human. This is going to revolutionize online virtual worlds.

Game platforms and AI are only 2 categories of major technology developments that spell great news for any games company that is willing to innovate. There are many others – and that is great news for both players and our investors.

This is a time of great technological disruption – maybe the biggest since the advent of the Internet in the mid-90's – and like the dawn of the internet, there is great opportunity for companies willing and able to innovate.

Nexon's development strategy of balancing powerful franchise annuities with innovation on new IP means we have a uniquely stable financial base to support innovation in an otherwise chaotic industry. Today Nexon generates about \$1 bil in EBITDA a year. We also have about \$4 bil of cash in the bank. We spend about 7% of our annual revenues on building and launching new games. And while we've spent only a very small portion of our cash position on M&A and equity investments, our cash flow and cash balance give us great flexibility for when the right innovative ideas and teams come along.

Our management team believes that taking creative risks on innovation is the key to growth over the long term. But what many people in the games industry forget is that creative success requires a willingness to take risks, and the financial stability to recover when some of those risks fail. In developing new IP, you have to recognize that only 1 or 2 out of ten games projects will be a hit.

Innovation and creative risks are the hardest, most -often criticized decisions a management team can take on. But in the long term it's essential to growth and the only way to avoid stagnation and failure. The companies not willing to risk failure are going to be left behind.

To avoid stagnation and to grow our company, Nexon is encouraging its creative teams to push themselves, to take creative risks and to innovate.

That's why we are boldly developing new IP and why we invest in creative teams like Pixelberry and Embark.

I'll now hand it over to Uemura-san to discuss the 2018 fourth quarter and our guidance for 2019 Q1.  
Thank you.

**Shiro Uemura, *Representative Director and Chief Financial Officer, NEXON Co., Ltd.***

Now, let's move on to FY 2018 results.

FY 2018 revenues were 253.7 Bn yen, up 8% year-over-year on an as-reported basis.

On a constant currency basis, full-year revenues were up by 7% year-over-year.

FY 2018 operating income was 98.4 Bn yen, up 9% year-over-year on an as-reported basis and up 7% year-over-year on a constant currency basis.

FY 2018 net income was 107.7 Bn yen, up 90% year-over-year on an as-reported basis, and up 86% year-over-year on a constant currency basis.

Continuing on to the Q4 results.

For additional details, please see the Q4 2018 Investor Presentation included in the handouts.

Revenues were 46.1 Bn yen, down 13% year-over-year on an as-reported basis, and down 10% year-over-year on a constant currency basis – in the range of our outlook.

By platform, revenues from PC online games were in the range of our outlook.

While revenues from mobile games were below our expectations primarily due to lower-than-expected contributions from the new mobile games in Japan, as well as mobile games in Korea, the total revenues of Nexon group were in the range of the outlook.

Operating income was 3.9 Bn yen, and net income was 6.5 Bn yen, both of which were below our outlook due to the ¥3.0 Bn impairment loss primarily on NAT Games' game IP and goodwill.

Adjusted for the impairment loss, operating income and net income would have been 6.9 Bn yen and 9.5 Bn yen respectively – both in the range of the outlook.

Our China business in the 4<sup>th</sup> quarter proceeded as planned, and the revenues were in the range of our outlook. Revenues were down year-over-year as the comps were very good last year in Q4 driven by strong performances of *Dungeon&Fighter* as well as *MapleStory 2*.

In the 4<sup>th</sup> quarter, China *Dungeon&Fighter* had no major updates except for the National Day update continued from the 3<sup>rd</sup> quarter, which includes limited-time-offer dungeons as well as avatar package sales. Revenue, ARPPU, MAUs, and paying users for *Dungeon&Fighter* all decreased quarter-over-quarter due to typical seasonality.

Revenue, ARPPU, and MAUs decreased year-over-year, while paying users remained flat.

MAUs decreased year-over-year primarily due to the bot sanctions, and therefore did not impact the game itself.

*Dungeon&Fighter's* revenue for the full-year 2018, 1<sup>st</sup> half, and 2<sup>nd</sup> half all grew year-over-year on local currency basis.

In Korea, PC revenues were in the range of our outlook, while mobile revenues were below our outlook due to lower-than-expected contributions from titles including *OVERHIT* and *Kaiser*. As a result, revenues from Korea were around the low end of our outlook.

PC revenues were roughly flat year-over-year. While *MapleStory* increased year-over-year, this was offset by decreases in *Dungeon&Fighter* and *FIFA ONLINE 4*, which was comparison with last Q4 before it received service transition impact.

Mobile revenues decreased year-over-year due to declines in the titles launched in the second half of 2017, including *AxE* and *OVERHIT*.

PC revenues were roughly flat, while mobile game revenues decreased year-over-year, resulting in a year-over-year decrease in our Korea business for the 4<sup>th</sup> quarter.

For *FIFA ONLINE 4* in the 4<sup>th</sup> quarter, we focused on bolstering user engagement, such as increasing user traffic via in-game events, and we delivered the good results that we hoped for.

MAUs has reached the level of *FIFA Online 3* in 2017, which was its 5<sup>th</sup> year of service.

*FIFA ONLINE 4*'s revenue in the 4<sup>th</sup> quarter was down slightly year-over-year, however, through the gradual release of contents and players, we plan to grow the sequel bigger than its predecessor *FIFA Online 3*.

Revenues from our Japan business in the 4<sup>th</sup> quarter were below our outlook, primarily due to lower-than-expected contribution from *FAITH*, a new mobile game released in Japan during the 4<sup>th</sup> quarter.

Meanwhile, revenues increased year-over-year, driven by contributions from *Dynasty Warriors: Unleashed*, which launched in the 3<sup>rd</sup> quarter, as well as *FAITH*. These were partially offset by the year-over-year decline in mobile browser games, *HIT* and *HIDE AND FIRE*, all of which have been in service for multiyear.

Revenues from North America in the 4<sup>th</sup> quarter were below our outlook, primarily due to lower-than-expected performances of PC online games including *MapleStory* and *MapleStory 2*.

Revenues were up year-over-year, driven by contributions from Pixelberry Studios, which we started to consolidate in November 2017, as well as contributions from *MapleStory M*, which began service in the 3<sup>rd</sup> quarter, and *Darkness Rises*, which launched in the 2<sup>nd</sup> quarter.

Revenues from the EU and Others in the 4<sup>th</sup> quarter were in the range of our outlook.

Revenues were up year-over-year, driven by contributions from *MapleStory M*, *Darkness Rises*, and Pixelberry Studios, as in the case of North America.

In November, we started the service of *Moonlight Blade*, the publishing PC online game developed by Tencent, in Taiwan, Hong Kong, and Macau and it also contributed to the Q4 results.

Now turning to our Q1 2019 outlook.

In Q1 2019, we expect the Chinese Yuan and Korean Won – major currencies in our business – to depreciate against the Japanese yen and negatively impact the as-reported basis performances in China and Korea.

For the 1<sup>st</sup> quarter of 2019, we expect revenues in the range of 79.7 to 87.4 Bn yen, representing a 12% to 3% decrease year-over-year on an as-reported basis and an 8% decrease to 1% increase year-over-year on a constant currency basis.

By region, we expect revenues to increase year-over-year in Japan, Europe, and Others, decrease in China and Korea, and slightly decrease or increase in North America.



We expect our operating income to be in the range of 40.7 to 47.4 Bn yen, representing a 26% to 13% decrease year-over-year on an as-reported basis and a 20% to 7% decrease year-over-year on a constant currency basis.

We expect the net income to be in the range of 37.9 to 43.7 Bn yen, representing a 19% to 6% decrease year-over-year on an as-reported basis and a 13% decrease to flat year-over-year on a constant currency basis.

In China, we expect revenues to decrease year-over-year, as we expect our key PC online game *Dungeon&Fighter* to decrease year-over-year.

On January 21<sup>st</sup>, we conducted the Lunar New Year update for *Dungeon&Fighter*, which will have the greatest impact to Q1 financial performance. As in the past years, the Lunar New Year update consists of limited-time-offer dungeon and avatar package sales. We also introduced the Level Cap release on the same day.

In 2018, the Lunar New Year package sales marked record-high sales since the service began in China. While this year's Lunar New Year update also has been going well, and MAUs are stable, based on its performance to date, we expect the number of paying users will not reach the high bar set in 2018, resulting in a year-over-year decrease in its sales.

*Dungeon&Fighter* recorded double-digit year-over-year growth for three consecutive years from 2016 to 2018 in local currency terms. While we expect its Q1 revenues to decrease year-over-year, both the Lunar New Year update and Level Cap release have been received very well by the users and are on track.

The cadence of the online game business is over years, and our policy is to operate our games stably over the long term. Therefore, we view the year-over-year revenue fluctuations as one of the typical characteristics of the online game business.

For *Dungeon&Fighter*, we will continue to prioritize operating the game stably in accordance with our policy by keeping the current steady in-game condition.

As for the large-scale content update schedule in 2019, there are no major changes from FY2018. We expect to conduct these at a pace of one to two times a quarter.

Details are available in the Investor Presentation.

In Korea, we expect revenues to decrease year-over-year, due to the headwind of FX conversion rate with the Korean Won depreciating against the Japanese Yen. On a constant currency basis, we expect revenues to be roughly flat year-over-year.

We expect PC revenues in Korea to increase year-over-year, driven by the key titles including *FIFA ONLINE 4* and *MapleStory*.

On the other hand, we expect mobile revenues in Korea to decrease year-over-year. While we expect contributions from *Spiritwish*, which launched in January 2019, as well as an increase in *FIFA ONLINE 4M*, we expect these to be more than offset primarily by decreases in *OVERHIT* and *AxE*, as well as in *Durango*, which launched in Q1 2018.

In Japan, we expect revenues to increase year-over-year, driven by contributions from *FAITH* and *Dynasty Warriors: Unleashed*, as well as *Dark Avenger Cross*, which is scheduled to launch on February 13.

In North America, we expect revenues to slightly decrease or increase year-over-year. While we expect to benefit from *MapleStory M*, *Darkness Rises*, and *AxE* global service, which is scheduled to launch in February, we expect these to be offset by decreases in *Choices* and *Dominations*.

In Europe and Other regions, we expect revenues to increase year-over-year, primarily driven by contributions from *MapleStory M*, *Moonlight Blade*, *Darkness Rises*, and *AxE* global service.

In the 1<sup>st</sup> quarter of 2019, we expect the operating income to be in the range of 40.7 to 47.4 Bn yen, representing a year-over-year decrease of 26% to 13% on an as-reported basis and a year-over-year decrease of 20% to 7% on a constant currency basis.

Negative factors compared with 2018 Q1 on operating income are:

First, decreased revenues primarily from the high-margin China business.

Second, increased HR costs, primarily due to an increase in headcount in relation to mobile business expansion as well as consolidation of NAT Games in Q2 2018.

Lastly, increased outsourcing costs and cloud service costs in relation to mobile business expansion.

Due to these factors, we expect the Q1 operating income to decrease year-over-year.