

NEXON Co., Ltd.

Q3 2019 Earnings Prepared Remarks

Nov 7, 2019

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

Thank you all very much for joining us today.

Today I'm going to begin with a brief update on our performance in Q3. I'll follow with a broader outline of the strategic imperatives we've defined to grow Nexon's global business.

My intent today is to show you that while our short-term performance is being challenged, Nexon's management of live games, our recent investments, and the retooling of our new game development projects reflect a larger strategy for robust success and profitability in both Asia and the West.

Group revenues came within our expected range despite the FX headwind during the quarter. Our Korea business showed excellent results, exceeding our expectations driven by strength in our key franchises, including *MapleStory* and *FIFA ONLINE 4*.

On the other hand, the results in China were below our outlook due to lower-than-expected performance of *Dungeon&Fighter*. I will discuss *Dungeon&Fighter* in more detail shortly.

First, *MapleStory*. Q3 was another outstanding quarter for *MapleStory* in Korea. Both PC and mobile set life-time high quarterly revenue in this 16-year-old franchise.

On a constant currency basis, PC revenue grew 8%, which was well above our expectation, and surpassed the previous peak in Q3 of last year. You might recall that in the year ago quarter, *MapleStory* received a massive update for its 15th anniversary and, as a result, grew 129% year-over-year in that quarter. So growing an additional 8% this year, on top of that high hurdle is quite a feat. The driver this year was the successful Summer content update, as well as events and sales for Korea Thanksgiving, all of which were hits with our customers. We're also starting to receive operational benefits from the AI technology developed in our Intelligence Labs unit.

MapleStory M, the mobile version of *MapleStory*, delivered stronger-than-expected results in key territories. In Korea, the game grew 51% year-over-year, surpassing the record quarterly revenue we achieved in Q4 2016 – the quarter in which the service began in the region. *MapleStory M* has grown double-digit or more for its remarkable seventh consecutive quarter in Korea.

Together *MapleStory* PC and *MapleStory* mobile demonstrate two important points about Nexon's live franchises and their future.

First, both games have yet again shown that they can grow to new revenue heights even after periods of decline.

Second, the opportunity for growth and longevity for deeply immersive games is as strong on mobile as it is on PC. This bodes well not just for the future of *MapleStory*, but for upcoming mobile games such as *Dungeon&Fighter*.

It is important to remember that there are now roughly 3 billion smartphones around the world that can play a highly immersive online game, so the massive market expansion combined with proven longevity is a very powerful tailwind for this and other Nexon franchises.

FIFA ONLINE 4 also delivered stronger-than-expected results in the third quarter. The combined PC and mobile revenues increased significantly year-over-year. We have been extremely happy with *FIFA*'s post service transition performance this year.

Now on to China *Dungeon&Fighter*.

As we said during the previous call, we observed weakness in the key performance indicators of *Dungeon&Fighter* beginning in June, as the 11th anniversary update in that month and the July Summer update did not resonate as well with our players as we had planned.

Accordingly, we are aggressively addressing the customer feedback through updates and new content that will extend over multiple quarters. However, we expect that getting revenue back on track will require another two to three quarters.

Over the course of Q3, we introduced the Summer update and the National day update. In addition to these two regular seasonal updates, we also rolled out several in-game events.

The content and avatar design of our National Day offerings received good reviews and increased engagement, as measured by paying users and ARPPU, however sales in August and September were lower than expected.

Addressing this near-term challenge in *Dungeon&Fighter* China is a core priority at Nexon, and the operating team at Neople is working hard to pull forward the timing of the new key update, which addresses the primary feedback we received from players. Our current plan is to deliver a key update by mid 1H 2020. We will provide more clarity on the release date as we get closer to the update being available to our players.

Nexon has extensive experience in listening to players. And when they tell us they don't appreciate something, our live operations team moves quickly to update and improve that element of the game. Over the years, this has happened in several of our franchises, and the changes we make usually result in renewed engagement. We remain confident in the long-term health of *Dungeon&Fighter* – a game enjoyed daily by millions of players. We expect this game will rebound and grow to new heights in players, revenue and, most of all, fun.

With regard to the mobile version of *Dungeon&Fighter*, together with our partner, Tencent, we are now preparing for the second closed beta test in China. Prior to the CBT, we're fine-tuning the game to adjust to the actual internet environment in China, making sure that this fully-online action multiplayer game will work well across China as the game is played by a massive audience.

We expect the full launch will occur within first half of 2020. This is of course subject to the result of the second CBT. We'll keep you posted for any updates.

For both *Dungeon&Fighter* PC and mobile, we're reallocating our resources and bringing more people to each of these teams. This will allow us to accelerate the speed of content development, as well as provide our players with better live services.

Now moving to the progress of our strategic initiatives. Last quarter, we highlighted our strategic focus on our substantial IP portfolio, concentrating our resources on our key franchises and streamlining our operations in the West and Korea to reflect the convergence of game platforms as well as technological developments.

Our management team has spent the last few months running group-wide studio reviews and has made the decision to drop a substantial number of our new game projects.

We are leaning into our strength and placing our resources on games and genres where we excel: fully-online multiplayer games and virtual worlds. Our strength in these categories is evident in the live game operations that we have run in games such as *Dungeon&Fighter* and *MapleStory*, games that have been operating for more than a decade – and are enjoyed by millions on a daily basis.

In upcoming quarters you'll see us launch fewer titles, but which closely adhere to this focus on better, deeper, more fully-online games that are playable across multiple platforms. Our players will see bigger games with deeper support and services. Our developers and live operators will focus on key performance indicators that will lead them to deliver games that entertain and delight our players on a regular basis over an extended period of time; and games that provide strong cash flow and positive returns for our shareholders.

As part of this focus, we announced last month, that we will sell our browser-based mobile games business in Japan. While the mobile sector remains heavily competitive with small margins, the overall game sector in Japan remains vibrant. We see enormous untapped opportunity in the fully online multiplayer market – which is a Nexon strength and a sector with much better margin opportunities.

On the investment side, in September, we made a strategic investment in Wonder Holdings. Wonder Holdings was founded 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*. The company owns two game studios, as well as a successful e-commerce platform. Through this strategic partnership, Nexon will support the game development and live operations of Wonder Holdings game studios, and Min became an external advisor of Nexon's new game development in Korea. He has participated with Nexon's management team in the franchise reviews I discussed earlier.

Turning to the West, as most of you know, we have increased our ownership stake in Embark Studios to 73% over the last several months. Additionally, our plan to fully purchase Embark's remaining shares through Nexon stock over a five-year period was ratified at the extraordinary shareholder meeting held in September.

Since the company's founding last November, Embark has been moving very fast with a mission to create ground-breaking online game experiences for Western audiences.

For marketing and competitive reasons, we have been deliberately cautious about detailing too much about Embark's games at this phase. However, we have shared that their first game will be a cooperative free-to-play multiplayer action game set in a distant future. They are developing this game on Epic's Unreal Engine, augmented with highly unique proprietary technology they have under development. They also have several additional products in the pipeline.

Embark has expanded their team to approximately 80 people, and is looking to add additional headcount by the end of the year, to better enable them to work on multiple projects.

There are several points of synergy between Nexon and Embark that we have been exploiting. First is cross-pollination of knowledge between the development teams. Embark's leadership team has a long history of developing blockbuster franchises across multiple platforms; the Nexon team offers world class live services which allow games to grow for years and decades. Second, Embark's innovative development technology has broad applicability at Nexon's studios. And finally, live game technology developed at Nexon will be integrated into Embark's games.

We have been very gratified at the progress we have made collaborating with Embark and are looking forward to unveiling their first game and additional details about the studio's progress in 2020.

To summarize, Nexon is in the middle of a transition. We are taking proactive steps to address customer feedback on our recent content update in *Dungeon&Fighter*. And at the same time we are making hard choices about our slate of games so that we can focus our attention and resources on opportunities with greater potential returns. This inevitably means we have to say no to certain projects to make it possible to say yes to ideas that hold more promise and that are closer to our core values and expertise. I and the rest of the management team are exceedingly focused on this task. The core economics of our company remain incredibly compelling today while we make this transition.

At its core Nexon is a maker and operator of deeply immersive online virtual worlds. We are one of the world's very best companies at delivering that. And there is a massive shift in games and entertainment to that core.

We will be ready.

With that, I will turn the call over to Uemura-san to discuss the Q3 results and Q4 outlook.

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

Now, let's move on to the Q3 results.

Q3 revenues were 52.4 Bn yen, down 24% year-over-year on an as-reported basis, and down 18% year-over-year on a constant currency basis – within the range of our outlook.

While *MapleStory* and *FIFA ONLINE 4* in Korea exceeded our expectations, China *Dungeon&Fighter's* revenue was below our outlook. FX headwinds, due to the appreciation of the Japanese Yen during the 3rd quarter, also negatively affected our results. Net, group revenues in Q3 were in the range of our outlook.

On a platform basis, both PC and mobile revenues were in the range of our outlook.

Operating income was 24.4 Bn yen and exceeded our outlook.

While we recorded a total 2.2 Bn yen impairment loss primarily on the goodwill of our Korean subsidiary Boolean Games, costs including HR costs and marketing costs were lower than planned, and we recorded higher-than-expected gain on step acquisition related to the purchase of additional shares of Embark Studios and its consolidation.

Net income was 39.8 Bn yen, which exceeded our outlook primarily driven by a 15.4 Bn yen FX gain mainly on our U.S. dollar-denominated cash deposits related to the depreciation of the Korean Won against the U.S. dollar during Q3.

Revenues from our China business were below our outlook.

KartRider Rush Plus, which received a major update on July 2nd, exceeded our expectation driven by continued strength in the latter half of the quarter. Meanwhile, *Dungeon&Fighter's* revenue was below our outlook. As a result, revenues from our China business were below our outlook.

Dungeon&Fighter's revenue underperformance was primarily due to lower-than-expected item sales in the latter half of the quarter, as well as National Day avatar package sales, which started on September 24th.

We are addressing the content issues through updates that will extend over multiple quarters. While we did not expect to experience a substantial improvement in Q3, in addition to the seasonal updates, we conducted several in-game events, aiming to recover the number of active users and paying users that had declined since the 11th Anniversary update in June.

However, we were unable to obtain the benefits we had hoped. Consequently, the number of paying users remained at a lower level compared to our expectation and decreased both year-over-year and quarter-over-quarter.

As we explained last quarter, revenue from the July Summer package sales was soft as the avatar design was not received well by our users.

Subsequent to this, users' purchase appetite did not recover as much as we had expected. Accordingly, revenues from the regular item sales as well as the National Day update were also below our expectations. Consequently, ARPPU remained lower than last year's Q3 throughout the quarter and decreased year-over-year.

However, the content and avatar design of the National Day update received good reviews and positively affected user metrics. I will discuss the Q4 outlook shortly.

ARPPU increased sequentially due to the strong seasonality. However, revenue was below our outlook, and has decreased both quarter-over-quarter and year-over-year.

MAUs decreased slightly both quarter-over-quarter and year-over-year.

Revenues from our Korea business in Q3 exceeded our expectations, primarily driven by stronger-than-expected performances of *MapleStory*, *FIFA ONLINE 4*, as well as *MapleStory M*.

MapleStory's revenue in the latter half of the quarter exceeded our outlook, driven by the successful events and sales promotions which began in late August in time for the Korean Thanksgiving holiday.

MapleStory generated record quarterly revenue and grew year-over-year on a constant currency basis on top of the 129% year-over-year growth we achieved in Q3 2018. This was driven by the strong performances of the Summer update as well as the Korean Thanksgiving holiday events and sales promotions.

FIFA ONLINE 4's revenue exceeded our outlook driven by the strong package sales in August.

KPIs including MAUs, paying users, and ARPPU increased year-over-year. Combined PC and mobile revenues grew significantly compared to Q3 2018, just after the service transition from *FIFA Online 3* to *FIFA ONLINE 4*.

MapleStory M's revenue in the latter half of the quarter exceeded our outlook driven by the successful content update and sales promotions. Its revenue grew 51% year-over-year, and generated record quarterly revenue since the Korea service began in October 2016.

Both PC and mobile business grew year-over-year, primarily driven by these titles, resulting in a year-over-year increase in our Korea business.

Revenues from our Japan business in Q3 were within the range of our outlook.

Revenues decreased year-over-year. While we benefitted from *MapleStory M*, *MapleStory 2*, *FAITH*, and *ArkResona*, which launched on August 14th, these were more than offset by decreases from *OVERHIT* and *Dynasty Warriors: Unleashed*, which launched in 2018, and from browser-based mobile games.

Revenues from North America in Q3 were within the range of our outlook.

Revenues decreased year-over-year, due to the deceleration of *Choices*, as well as *MapleStory M* and *Darkness Rises*, both due to the tough comparisons with last Q3 just after their services began.

Revenues from Europe and Others in Q3 exceeded our outlook primarily driven by the stronger-than-expected performance of *MapleStory M*.

Meanwhile, revenues decreased year-over-year. While we benefitted from the Taiwan's service of *Moonlight Blade*, *AxE* and *OVERHIT*, which all began their services in or after Q4 2018, these were more than offset by the deceleration of *MapleStory M* and *Darkness Rises*, both due to tough comparisons with Q3 2018 just after their services began, and the deceleration of *Choices*.

Now turning to our Q4 2019 outlook.

In the quarter, we expect the Chinese Yuan, Korean Won, and U.S. Dollar – major currencies in our business – to depreciate against the Japanese yen, as was the case in Q3 2019, and, therefore, to negatively impact the as-reported basis performance of our results.

For Q4 2019, we expect revenues in the range of 41.4 to 44.5 Bn yen, representing a 10% to 4% decrease year-over-year on an as-reported basis and a 3% decrease to 4% increase year-over-year on a constant currency basis.

While we expect revenues of our Korea business to increase, we anticipate revenues from the other regions outside of Korea to decrease year-over-year.

We expect our operating income to be in the range of 6.0 to 8.2 Bn yen, representing a 53% to 110% increase year-over-year on an as-reported basis and a 60% to 120% increase year-over-year on a constant currency basis. I'll discuss the details of this shortly.

We expect net income to be in the range of 7.6 to 9.4 Bn yen, representing a 16% to 45% increase year-over-year on an as-reported basis and a 23% to 53% increase year-over-year on a constant currency basis.

In China, while we expect to benefit from *KartRider Rush Plus*, we anticipate this to be more than offset by the decrease in revenue of our key PC online game, *Dungeon&Fighter*. Overall, we expect revenues from our China business to be in the range of 13.9 to 15.3 Bn yen, representing a 22% to 14% decrease year-over-year on an as-reported basis and a 18% to 10% decrease year-over-year on a constant currency basis.

For *Dungeon&Fighter* in Q4, the National Day update, which includes limited-time-offer dungeons as well as avatar package sales, has continued from Q3. In addition, we have conducted small-scale content updates in order to improve the user metrics, including active users and paying users. There will be some more small updates and in-game events throughout the quarter.

Since there has not been any substantial change in the trend since Q3, we expect Q4 paying users and ARPPU to be both lower compared to Q4 2018, resulting in a year-over-year decrease in *Dungeon&Fighter's* revenue.

Meanwhile, the content and the avatar designs of the National Day update received positive reviews. As a result of these, we observed a slight recovery in the number of paying users and ARPPU compared to Q3. Therefore, we expect the percentage of the year-over-year revenue decrease to be smaller than in Q3 2019.

In Korea, *MapleStory* has strong momentum as we enter Q4, and we expect its revenue to further increase in Q4 2019 even compared to last year, when it grew by 34% year-over-year.

We expect our mobile revenues in Korea to increase year-over-year. We expect to benefit primarily from the new MMORPG *V4* launched today, November 7th, and *TRAHA*, which launched in Q2, as well as an increase in *MapleStory M* to more than offset the expected year-over-year declines in *AxE* and *OVERHIT*.

Overall, we anticipate revenues from our Korea business to be in the range of 19.2 to 20.2 Bn yen, representing a 23% to 30% increase year-over-year on an as-reported basis and a 35% to 43% increase year-over-year on a constant currency basis.

In Japan, we expect contributions from *MapleStory M* and *MapleStory 2* to be more than offset by year-over-year decreases in *Dynasty Warriors: Unleashed* and *FAITH*, both of which started their services in 2H 2018. Q4 includes a two-month contribution from our browser-based mobile games. This is for the period prior to the sale of gloops' browser-based mobile business, which will close on December 1st.

As a result, we expect revenues in the range of 2.3 to 2.5 Bn yen, representing a 46% to 43% decrease year-over-year on an as-reported basis and a 44% to 40% decrease year-over-year on a constant currency basis.

In North America, we expect revenues in the range of 2.8 to 3.0 Bn yen, representing a 36% to 30% decrease year-over-year on an as-reported basis and a 33% to 27% decrease year-over-year on a constant currency basis due to decreases in *Choices*, *Darkness Rises* and *MapleStory M*.

In Europe and Other regions, we expect revenues to be in the range of 3.2 to 3.5 Bn yen, representing a 20% to 14% decrease year-over-year on an as-reported basis and a 15% to 8% decrease year-over-year on a constant currency basis. While we expect to benefit from *Spiritwish* global service, which launched on October 30th, we expect this to be more than offset by decreases in *MapleStory M*, *Choices* and *Darkness Rises*.

In Q4 2019, we expect the operating income to be in the range of 6.0 to 8.2 Bn yen, representing a year-over-year increase of 53% to 110%.

The primary driver for the lower operating income in Q4 2019 is the year-over-year revenue decrease.

Favorable factors compared to Q4 2018 regarding the operating income are:

First, decreased marketing costs. While we expect to incur marketing costs for new titles launching in the 4th quarter including *V4*, we expect these to decrease compared to last year in Q4, when we had multiple new launches including *MapleStory 2* in the West and *FAITH's* Japan service.

Second, decreased variable costs. We anticipate decreased royalty costs in relation to the lower contributions from publishing titles including *Dynasty Warriors: Unleashed*, as well as lower PG fees benefiting from stronger yen.

Lastly, a decreased impairment loss of 3.0 Bn yen recorded in Q4 2018, which will not be repeated in 2019.

The high end of the range reflects the fact that we expect the impact of positive drivers to be larger than that of negative drivers, resulting in a year-over-year operating income increase.

Next, I will discuss the investments we made in Q3, as well as the sales of the browser-based mobile business in Q4.

First, on Embark Studios.

In relation to the consolidation of Embark Studios, we have provisionally booked a 23.7 Bn yen goodwill on our balance sheet as of September 2019. The 23.7 Bn yen is expected to be allocated to goodwill and intangible assets after further review.

Moving on to our strategic investment in Wonder Holdings.

In Q3, we entered into a strategic partnership with Wonder Holdings, and acquired 11% of its total shares outstanding for 31.5 Bn yen.

We expect the impact on our quarterly consolidated P&L related to this investment to be immaterial.

Lastly, on the sale of our browser-based mobile game business.

On October 24th, Nexon's Board of Directors approved the sale of our consolidated subsidiary gloops' browser-based mobile game business to Mynet Inc. for 0.5 Bn yen. The transaction is scheduled to close on December 1st. We expect the impact on our consolidated financials from this sale to be very limited.

Finally, I'd like to give you an update on the share repurchase program.

Based on the policy of the share repurchase program we announced on August 8th, on September 9th, the Board of Directors approved to initiate a share repurchase program with the total amount of 30.0 Bn yen. The share repurchase program will take place over the six-month period between September 10th, 2019 and February 7th, 2020.

We have been updating the progress of the program every month, and these are available on our IR website.