

FY2020 Q1 Earnings Conference Call (May 13, 2019)

Q&A Summary

【Q】 Q1 Korea revenues grew significantly, especially PC revenues. Was this driven by external factors related to COVID-19 or was the growth purely organic? How you analyze the sustainability of Korea's strong performance?

【A】 Shiro Uemura (Chief Financial Officer)

In regards to what we are finding in South Korea, at the moment, we find it quite fortunate that we have not been seeing a serious impact from COVID-19. Games that people typically play at PC cafes had negative impacts from temporary closure of PC cafés while games that people play from home received slight benefits due to extended vacation. Of course, the situation differs depending on title, however, it is fair to say that overall, we are not finding a large impact. Rather, I would like to emphasize that our existing major titles are enjoying good momentum which continued since last year. These titles delivered great results in Q1, primarily driven by successful content updates during Lunar New Year season. We expect our Korea business to grow year-over-year again in Q2. We think we will be able to sustain the good momentum in Q3 and onward, as long as we can continue to offer high-quality content updates and daily operations.

Owen Mahoney (Chief Executive Officer)

Just a couple of points to underscore to what Uemura-san said. Our strong performance in Korea is not a recent phenomenon. We have been able to build powerful franchises over several decades.

I think another big factor is what we consider or what we are presuming as a long-term secular shift from linear entertainment to online virtual worlds. The games industry is already much bigger in revenue than linear media on a worldwide basis. It is growing at three times the rate, and it is more profitable.

On the demand side, obviously people are playing more games when they cannot travel and cannot go to amusement parks, theaters and cruise ships. But what is interesting is on the supply side. We can make content and run our virtual amusement parks from our home. Also, when we put out an hour of game content, that often or usually translates to multiple hours of content consumption. Whereas if you put an hour of linear entertainment content, it is rare that you will consume it for more than one hour. So, in the games business you have huge leverage in your content production. The health crisis and the work-from-home situation may certainly have brought these issues into sharp focus and they may be accelerating these trends. However, long before the health crisis, these were playing out. And our focus is about virtual worlds for those reasons.

【Q】 Regarding the March update for China *Dungeon&Fighter*, I believe the aim of the update was to attract back the users that have churned last year. How does improved user engagement among existing users relate to getting churned users back? Or, will the mobile launch become the key for regaining users? What would be your strategy going forward?

【A】 Shiro Uemura (Chief Financial Officer)

The aim of the March update was to try to lure users back who had left the game. In fact, our strategy worked out well. However, what was a bit different from our expectations was that there were people who were not able to access the game due to PC café closure. That said, broadly speaking, I would say things went almost in line with expectations.

Since the March update, we have been seeing some improvements in the KPIs. With the reopening of PC cafés, we expect to see further improvement in the user metrics and therefore, expect *Dungeon&Fighter's* Q2 revenue to be roughly flat compared to its strong revenue last year in Q2.

Going forward, we would like to gradually get our users back so that we can be back on the growth trajectory.

[Q] I understand the surrounding environment of game industry is very much changing, triggered by COVID-19. Some titles are getting much more popular while some titles are not seeing that much of changes. I feel that titles that are becoming popular are the ones that appeal well to the mass market. However, Nexon has franchises that have long history like *Dungeon&Fighter*, which may find it more difficult to capture newer type of users. So, would there be any changes in your strategy or necessity to change the order of launches in your pipeline as you try to capture newer users?

[A] Owen Mahoney (Chief Executive Officer)

I think the big secular shift that we see is that more and more people are living their lives online, in a virtual playground rather than just in a physical playground. It is hard to see in the early stages of this happening, but I honestly feel that we are going to look back at this and see this period right now as a turning point. I think that with quality games we will not only find very limited audiences, but also find very broad audiences. In our case we found both.

For example, *MapleStory* has in many respects really reinvigorated itself even though it has been available for quite a long time. A lot of people grew up with that. They would come back to the game and we have also found a whole new generation of players who never played the game before but loved to play it on mobile. As for *Dungeon&Fighter*, a similar type of effect is our expectation. We also think that we can bring games like *KartRider* to a much broader international audience. We also want to bring it to multiple platforms. In other words, it is not just on the few hundred million game playable PCs but on many more game playable devices, primarily on mobile. So, in terms of changing of our development strategy, I would say that the fundamental shift that you have seen us do is to recognize our core strength – deeply immersive online games. We, along with a couple other companies, more or less invented this category. We have experimented a number of other areas, casual, offline games, story-driven games, but really where our heart is, is in deeply immersive games and that is where we are focused on.

And then I would say another big thing that we can do to bring this to a wider audience is we are just very excited about what is happening with our Western strategy with the Embark team. We are very excited to be able to talk to you about that more later in the year.

[Q] I wanted to follow up on the delay of *Dungeon&Fighter* 2D Mobile. I want to contextualize if this was led by a tactical decision or was led by COVID-19? Also, I would like to know how we can preclude the potential for further delays?

[A] Shiro Uemura (Chief Financial Officer)

It is not associated with the impact from COVID-19 nor is a tactical decision. Because we view this as a very important title for us, we are simply fine-tuning the game.

【Q】 Can you just give us a little bit of sense of how we should think about *KartRider Rush+* and *KartRider: Drift*? It seems like you baked their contributions into the second quarter guidance, but I am trying to contextualize how much comfort you have with them that these will be sustained and enduring new franchises, or they might still need to go through a lot more iterations before they become sticky sources of revenue.

【A】 Shiro Uemura (Chief Financial Officer)

We just launched *KartRider Rush+* yesterday and I think we were able to make a very good start. At the moment, we have included the best estimates in our Q2 outlook.

On the other hand, *KartRider: Drift* is the title which is under development, and is a successor game of the original *KartRider* on PC.

s is a very important IP for Nexon, so we are developing the game with enough attention and will be testing the game properly.

【Q】 What percentage of your users are playing in Internet cafés versus playing at home for China *Dungeon&Fighter*?

【A】 Shiro Uemura (Chief Financial Officer)

We initially thought that people who were playing the game from PC cafés would also be able to access the game from their homes. However, we understood that there were a certain number of users who were only able to play the game at PC cafés. We understand that the percentage is fairly small, but there are a certain number of players accessing the game from PC cafés. The consequence of that was that we were not able to realize the comeback of users, especially light users, as much as we had expected.

However, the Lunar New Year as well as the March updates were well received, and especially after the March update, we started to see KPIs improving. And as PC cafés gradually reopen, we believe we will be able to see further improvement going forward.

[Q] *Dungeon&Fighter* 2D mobile is one of the biggest launches for Nexon. Obviously, there is competition but at the same time there have not been too many new games in the last two years, so there is an anticipation and excitement for the game. Can you give us some color as to what else we should be looking on, both positive as well as on the risk side as well?

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

Dungeon&Fighter IP is a very strong IP, especially in China. So, of course, we have lots of expectation as this is a mobile version based on that IP. We are doing final fine-tuning, but as we do not offer guidance for Q3 and onwards, please allow me to refrain from giving you specific financial expectation.

Not only the significant user base on the PC version or the pre-registrations for the mobile version, but Tencent will support its launch with their highest level of game marketing and operational support. It is going to be a very important title for Nexon, Tencent, as well as our stakeholders.

Owen Mahoney (Chief Executive Officer)

I have a couple of comments on top of what Uemura-san said. From a broader perspective just to step back, I think it is important to remember that this is one of the largest entertainment franchises in the world. The feedback that we got from the beta test has been quite positive. But we are really playing for the long term. And so, our team are just very focused on making sure that we have the right amount of content, the right quality of the content and all the technical issues are in great shape.