

FY2020 Q4 Earnings Conference Call (February 9th, 2021)

Q&A Summary

【Q】 Q1 outlook of *Dungeon&Fighter* in China looks weak when I compare with the previous quarter. Probably one of the reasons is that some of the PC players who are waiting for the launch of *Mobile Dungeon&Fighter* refrain from purchasing items in the PC version. What do you think would happen to the players after the launch of *Mobile Dungeon&Fighter*?

【A】 Shiro Uemura (Chief Financial Officer)

It is very difficult to give you the precise answer for the question, but I think there is a possibility that the players on the PC version are refraining from purchasing to some extent because they are waiting for the launch of the mobile version.

As for *Dungeon&Fighter* in China, the downtrend which started in the second half of 2019 continued in 2020 as well. But if we look at KPIs in Q4 on a month-on-month basis, we saw active users and paying users continue to be flat from October to December and so it seems KPIs were stable at the low level. Q1 has started under this environment, but compared to the previous Q1 which included the major update such as Level Cap release and Third Awakening, we expect sales to decrease by 30% year-over-year in this Q1.

It is difficult to foresee PC players' behavior after the launch of the mobile version. But we are preparing to generate synergies rather than to have cannibalization so that we can reactivate the PC version.

【Q】 In both Q4 2020 and Q1 2021, the HR costs¹ were or are expected to be around ¥18 billion to ¥20 billion. Do you expect this level of the HR costs¹ to continue for the full year in 2021? Or is it just a temporary increase in Q4 2020 and Q1 2021? Please share us your forecast.

【A】 Shiro Uemura (Chief Financial Officer)

HR costs increase in Q4 2020 and Q1 2021 has different natures. The increase in Q4 was due to incentive bonuses that we offered reflecting the great performance in 2020. On the other hand, the increase in Q1 is mainly due to the introduction of the new compensation program on top of an increase in stock option costs.

For a game company like us, the most important assets are talent. Providing a sufficient compensation and incentive is the long-term investment for sustainable growth. That's why we introduced this new compensation program. We expect the HR costs¹ to stay at the Q1 level in the coming quarters.

¹ HR costs includes HR cost (COGS), HR cost (SG&A) and R&D (SG&A)

【Q】 Regarding a new title from Embark Studios, could you share with us the progress so far and the details of the title to the extent you can?

【A】 Owen Mahoney (Chief Executive Officer)

We are not ready to release the details or the launch date yet, but what I can tell you is that what we have seen to date is very exciting and we believe that the games from Embark are going to have a profound impact on how games are created and how they are played in the future. I have been playing the build internally and I am excited as a gamer. We hope to provide you more details in the coming quarters.

【Q】 I recall that you explained you had a great result from a collaboration with BTS. In a large sense, it is a collaboration within the same entertainment industry, but at the same time, we could also say this is a new type of collaboration between the virtual and real world. So I'm very interested in what this could bring about in the end. Do you think that you were able to capture new users through this collaboration? Also, do you expect to have more this type of new collaboration or new fusion as we look down the road in a mid-to-long term?

【A】 Owen Mahoney (Chief Executive Officer)

The short answer to your question is yes. We do see more opportunities like this. In some ways with BTS, we were lucky. A couple of the members are big fans of *MapleStory*. It was not only impactful, but it was also a lot of fun for us.

I think that this is the type of thing that we are putting a lot of thought to. Because we are focusing on a fewer number of very immersive games that are big intellectual property, we can put time and attention to questions exactly like what you are asking. And we see it not only as an opportunity to broaden the audience, but also to deepen the gameplay experience for our players.

【Q】 When I look at the MAU number, it was 27.4 million in Q4 2019 and it was 17.3 million in Q4 2020. We have seen about a 10 million decline in MAU. Can you give us a sense of how we think about this breakdown?

【A】 Shiro Uemura (Chief Financial Officer)

I can say the decline was mostly due to the *Dungeon&Fighter* in China. One of the reasons is that we have seen the downtrend with *Dungeon&Fighter* in China in the past several quarters. Also, we have conducted strong bot sanctions since Q4 last year.

【Q】 I think one of the common questions that investors would have about declining MAU and higher ARPPU is the concern over monetization. Can you give us a sense of where you feel some of your games are in this respect?

【A】 Owen Mahoney (Chief Executive Officer)

One of the things that we really focus on is being very careful about the exact topic. So, if the premise of your question is that we may be over monetizing in games, we would definitely disagree with that premise of your question.

Also, I would add one other point. Like revenue, player growth tends to occur in a non-linear pattern over an extended period of time. Monetization is a really important metric because it can reflect how much people are engaged in the game and how much time they are spending and enjoying the game. So, it is safe to assume that when a player is investing more in a game, it is because they are enjoying the game and planning to continue.

[Q] Given that we're going into 2021, can we get a color as to how you plan to drive growth in 2021? I am assuming there are games that you feel that you can continue to grow from current levels while you have games like *Dungeon&Fighter* in China which is still in a declining trend. With that, we can get some layers of new titles. I know it is difficult to give very specifics given there are always a lot of moving parts. But can you give some scenario as to how we should think about which platforms or titles that you feel can grow and drive growth for another strong year?

[A] Owen Mahoney (Chief Executive Officer)

I think you have hit on a point which we were trying to make actually in our prepared remarks. That's really the analytical challenge of analyzing a virtual worlds company.

First of all, our base of revenues come from existing virtual worlds. We call them virtual theme parks for a reason because we operate them like theme parks. They happen to be in software, and we deliver them from the cloud, but they work in a lot of ways and they should be analyzed in our view like a physical theme park. That is an important understanding.

So, one way to illustrate this is our business off of just our existing virtual worlds could double within a couple of years, without any new products whatsoever. And if you can really understand that, you can now understand virtual worlds company like us or like other virtual worlds companies. People ask us about catalysts, because we are a games company. Catalysts are something that you think of in the traditional games business. So, we look like a games company but what we really are is a virtual worlds company.

Now, if you want to talk about new games, we have three very big beats coming up that we are very excited about. One is *Mobile Dungeon&Fighter*. One is *KartRider: Drift*. And one is the first game from Embark. We are going to be talking about all three of those in the coming months. Each of those three for their own reason, we're very excited about. As we layer these new virtual worlds and as we expand beyond the PC to mobile and beyond, we really foresee a step change in earning power. That is why we are so excited about the future in 2021 and beyond.

[Q] It seems that Electronic Arts is taking a new approach with its *FIFA* business, including partnering with another company in Japan. So, I was wondering if there are any implications from EA's new approach for your *FIFA* partnership in Korea?

[A] Owen Mahoney (Chief Executive Officer)

No, there's no change at all in our relationship with EA regarding *FIFA*.

【Q】 We are seeing big games like Fortnite and Roblox doing concerts or other events having user-driven content actually within it. Is that something that you were thinking about for your fewer but bigger games in the longer term and that you're going to have user-driven content and events and turn them into a much bigger game or much bigger entertainment platforms? Or will you focus more on a game only?

【A】 Owen Mahoney (Chief Executive Officer)

I think it is an important question and there are two separate and distinct parts of the question. One is in-game events or promotion that goes across events that happen within a game, for example, in the Fortnite case from a Music Star. The second and very different one is user-generated content. I think both are very important.

Taking events for one minute, I would say the key on that is you have to make sure that it is relevant to the game itself in some way if you want it to be sustainable. For gamers who are actually in the game, it has to be relevant to what they're doing as part of the game. That is what a gamer will tell you, who spends a lot of time in that game or that virtual world. So, that is the creative challenge that needs to be addressed before this becomes a big and important thing. I would say this is something that we spend a lot of time thinking about. We also spend a lot of time thinking about user-generated content.

【Q】 On specifically user-generated content, are you developing games with that in mind in the future that users can get involved with the creative process?

【A】 Owen Mahoney (Chief Executive Officer)

We do not have any announcements around that topic.

【Q】 According to press reports, *Final Fantasy XI R* has been canceled. Could you give me a comment around why that was the case after several years of development?

【A】 Owen Mahoney (Chief Executive Officer)

NEXON and Square Enix have made the mutual decision that our work on *Final Fantasy* was not showing the level of creative differentiation that we think our players expect from the *Final Fantasy* franchise. So, rather than releasing a game that did not break new creative ground, we have agreed to halt the project and redeploy our creative teams on the other projects. We think this reflects us taking a very hard look at every project we do and focusing on the things that we believe in, which includes in large part NEXON's own intellectual property, which we think is very powerful. When you go through the creative process, sometimes you can get the core of the fun, and sometimes you are not able to get there.

I would classify our relationship with Square Enix as enormously respectful. I have huge respect for their creative teams. We worked very closely together, but we made the decision to protect the value of their IP and to focus our resources on what we think were higher and better uses.