

FY2022 Q3 Earnings Conference Call (November 9th, 2022)

Q&A Summary

【Q】 There has been a lot of concerns about the Chinese game industry overall due to the weak trends we have been seeing lately. China *Dungeon&Fighter* doesn't seem to reflect those weak trends as you are expecting year-on-year increase in revenue in Q4. Did you see any changes in gamers' consumption patterns or behaviors, which would impact the growth trajectory of the game?

【A】 Shiro Uemura (Chief Financial Officer)

Although China *Dungeon&Fighter* isn't doing great, we believe this is due to the in-game situation and not due to changes in the Chinese market nor user trends. We believe that PC online games can theoretically be enjoyed forever through careful operation and high-quality updates. China *Dungeon&Fighter* is a very important title for us, and we believe that by continuing to carefully and stably operate the game, we can maintain its current level and return it to the growth trajectory in the long term.

【Q】 If the beta test for *THE FINALS* is in Q1 2023, would it be fair to assume that the game's commercial launch would be Q2 and beyond? Also, would that imply that *ARC Raiders*' launch would most likely be in the second half of 2023?

【A】 Owen Mahoney (Chief Executive Officer)

Regarding *THE FINALS*, we expect its public beta to be in Q1, and have not made any announcements beyond that. However, just to be clear, it will not be an early test; rather, it will be a high-polish public beta and development continues to move very quickly.

As for *ARC Raiders*, we have not made any updates, but I would not assume that the launch timing of *THE FINALS* would impact the launch timing of *ARC Raiders* since they are operated as separate and distinct projects.

【Q】 Your games tend to start and monetize slowly, therefore require some time to recoup upfront costs. Therefore, is there a possibility that the period of recouping costs will be longer than expected?

【A】 Shiro Uemura (Chief Financial Officer)

Mobile games' revenues generally ramp up right after launch, and it is important to stabilize the game after some users have left the game. For PC and console games, of course it is important to attract the large number of players at the beginning of launch, however, even if we are not initially able to attract the expected number of players, through marketing, daily operation, and content updates, we are able to grow the game over a long period of time. Since we make advanced investments in marketing while taking ROI into consideration, if we are able to service the game as we plan, the period of recouping the costs will not be majorly different from the expectations.

【Q】 Please give us what caused to expect marketing expenses to be approximately 10 billion yen in Q4?

【A】 Shiro Uemura (Chief Financial Officer)

Regarding the marketing expenses of 10 billion yen in our Q4 guidance, we plan to allocate it to further grow our existing titles that are performing well, such as *FIFA ONLINE 4*¹ and Korea *MapleStory*, and to also further grow our titles that have been just launched, such as *HIT2* and *Dungeon&Fighter Mobile*.

Furthermore, since we will participate in G-STAR, the largest game show in Korea, for the first time in four years, we are going to spend marketing expenses for branding and promotions.

¹ Official titles are EA SPORTS™ FIFA ONLINE 4 (PC) and EA SPORTS™ FIFA ONLINE 4 M (mobile).

[Q] What are your thoughts on the mid to long-term profitability of your business, and how do you view costs?

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

We view costs as upfront investments and manage them by looking at their ROI. Since we spend on HR costs² and marketing expenses to grow our revenues, the ratio of HR costs to revenue for full year 2022 is expected to be close to last year's level, and marketing expenses are expected to be within 8-10%, which generally was the ratio for the past five years. We believe we will be able to control our margin by continuing to manage costs while also increasing revenue.

However, the profitability of our business depends on the situation of each titles. While China *Dungeon&Fighter* is highly profitable, the profitability of our overall business declines when the game is not doing well. The profitability of Korea *MapleStory*, which is both developed and published by Nexon, is relatively high, while the profitability of *FIFA ONLINE 4*³ is relatively low since we are just the publisher of the title.

I want to highlight that whatever cost we spend would contribute to growing the topline.

[Q] Could you elaborate on the feedback at the alpha test for *THE FINALS* and on what makes the game unique?

[A] **Owen Mahoney (Chief Executive Officer)**

The alpha test for *THE FINALS* went better than expected.

First, the tech worked great—keep in mind that we've got brand new technology that nobody has ever done before, which is called server-side destruction. So, what is server-side destruction? I'll give you an example to better illustrate it. Let's say you and I are playing in the same game world, and I'm up with my crew hiding on the second floor of a building, while you and your crew have a whole bunch of explosives. You can blow up the ceiling of the first floor, and we'd fall down from the second floor onto the first floor. Then, you can attack us all. The technology that I'm describing enables something fun, but what it really enables is emergent gameplay, which allows wholly new and unexpected ways to play the game. This can only be done with realistic physics, not pre-rendered physics.

Second, the customer feedback was fantastic. They told us that for all the reasons I just mentioned, we're in a unique category.

What we learned in the alpha test was:

² HR costs include HR cost (COGS), HR cost (SG&A) and R&D (SG&A),

³ Official titles are EA SPORTS™ FIFA ONLINE 4 (PC) and EA SPORTS™ FIFA ONLINE 4 M (mobile).

First, people enjoyed the game very much and burned through the content at a very fast pace. And we even learned a lot more about what emergent gameplay opportunities from server-side destruction are, so we want to double down on this.

Second, we need to get the play balance right between the different classes and weapons, especially in a world of emergent gameplay from destruction.

Third, we want to add additional meta game to ensure high retention.

Those are the three things that we took away from the alpha.

The things that I just described are feasible, and there is no major creative unknown or major technical issue that we have remaining.

People who have played the game want us to launch the game as soon as possible for sure, but we know from experience that getting the content plan and balance right would determine whether the game would be a short-term success or a long-term franchise.

Furthermore, the impact from the launch timing of *THE FINALS* in Q4 and 2022 is minimal. Our core business of live games is growing nicely, and we have the luxury to make the right creative decision for the good of the product.

[Q] Could you give us an idea on what kind of profitability assumptions we should have for new titles coming out in 2023?

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

The profitability of a new game depends on the genre. We refer to similar titles that we released in the past and calculate the expected initial revenue by taking into account feedback we received from alpha and beta tests and by looking at the game's retention rate. We then determine how much marketing and promotion needs to be done to generate the expected revenue, and make upfront investments based on that.

Owen Mahoney (Chief Executive Officer)

Essentially, the way we look at the world is, console equals mobile equals PC. There is a common belief that mobile games have bad margins, especially after changes made to IDFA. However, we don't approach mobile games in the traditional way. Our mobile business is different in that we make online Virtual Worlds designed for years and decades of gameplay, not casual games. This means our business is about high retention of players and high lifetime value. We do this by bringing our Virtual Worlds, which started on PC, to an audience that's 10 times as big, thanks to the addition of mobile and console.

Our mobile business grew 40% year-to-date and the retention and the profit margin are what we hope to see. So, although this is a non-traditional approach, we think it's showing great signs of success and that it's going to get better over time.

[Q] Is Nexon looking to develop immersive games for others who have strong intellectual property (IP)? Do you believe you have the capacity to do so, or are you already developing games for others that you have not announced yet?

[A] Owen Mahoney (Chief Executive Officer)

The fundamental answer to your question is, we really like our own IP. Part of our focus strategy is to focus on our own IP, and the good news is that we have some of the biggest IP in the entire world. *Dungeon&Fighter*, for example, has generated well over \$20 billion in life-to-date revenue and it's got 850 million players around the world. *MapleStory* has been played by over 180 million people worldwide, and in terms of life-to-date franchise revenue, it is bigger than one of Disney's biggest, the *Frozen*⁴ franchise⁵. Our IP are some of the biggest in the entire entertainment industry and all the benefits accrue to us when we build these games up and run them well.

We have, from time to time, decided to work with or explored the idea of working with some external partners who we thought were really interesting and had great IP, and were willing to work with us in a way that made sense for both parties—this meant a reasonable sharing of upside for both sides, and a very long-term focus since Virtual Worlds are designed to run for decades.

We made an announcement last year about our partnership with Games Workshop for the *Warhammer Age of Sigmar*⁴ franchise, but we haven't talked much about it although we continue to develop that. However, this is an unusual and special case for us since we are very focused on our own enormous IP.

It's our view that one of the rarest commodities in the world right now is the ability to make a game last and grow for decades on end. That's very special indeed, and we want to be very judicious and focused on how we leverage our specialized capabilities.

⁴ All other product names mentioned here are trademarks or registered trademarks of their respective companies.

⁵ Life-to-date global box office revenues as of November 8th, 2022, sourced from BoxOfficeMojo.com.