

FY2023 Q1 Earnings Conference Call (May 11th, 2023)

Q&A Summary

【Q】 *KartRider: Drift* was below expectations in Q1. How are you going to address this?

【A】 Owen Mahoney (Chief Executive Officer)

KartRider: Drift didn't start as strong as we hoped.

However, we have very clear feedback from our fans, and we have an incredibly talented group of people working on this issue right now. We are doing a consistent cadence of updates that addresses the feedback that we received. We are also focused on the user experience—it's been our experience that when we focus on the user experience rather than on the near-term revenue, the Virtual World ends up building a very strong base of players over time. Furthermore, we're incredibly dedicated to the *KartRider* franchise, which is loved by millions of people, and we're very focused on bringing it to an even larger audience around the world.

【Q】 Could you provide more details on the development status of *THE FINALS*? What steps are remaining for the game to be launched?

【A】 Owen Mahoney (Chief Executive Officer)

We conducted a beta test in March and over 2 million people signed up. We had no major network issues in the client or the server side, which is a big deal given all the tech that's involved in the game. Also, the game resonated well with the audience—we received a lot of feedback that the game is fun.

As with any beta test, though, we identified areas of improvement for the game to be successful in a commercial state.

First, we saw some performance problems. We found out there were some areas that need optimizing, especially around movement and player control. We also had some issues on performance in lower spec machines. Furthermore, there were some issues in the way some players played together, especially in light of the destruction physics that we introduced into the game, and we came to the conclusion that we need more ways for players to play the game and enter into the game.

These areas to improve are very clear. So, we have a clear roadmap of what we need for the game to be successful when it is commercially launched.

In the short-term, our objective is to build up a very strong user experience for our players so that we can build a community and a Virtual World that lasts for many years.

[Q] Could you elaborate on your future vision, key initiatives, or key hurdles you have for the company's expansion in the Western region?

[A] Owen Mahoney (Chief Executive Officer)

We did a major reorganization in 2019, in which we narrowed our focus on fewer, bigger, and better products. Rather than doing many different smaller projects, offline games, or more casual games, we decided to focus on what we do best, which are deeply immersive Virtual Worlds. Since it's been a few years since this reorganization, we'll be seeing those hand-picked products come out steadily in the coming months.

Regarding game development, we acquired Embark Studios in Stockholm, Sweden. Our view is that the studio is made up of a premier group of developers in the West; the founder of Embark Studios used to run studios very successfully at Electronic Arts until 2018, and him and most of his team members come from the studio that created the *Battlefield*¹ franchise. The team has been doing incredible work that we're excited to show to the world in the near future, starting with *THE FINALS*. Our objective is to combine Embark's expertise, which is its capability in AAA Western online game development, with what we know best—making an online Virtual World last and grow forever—which we have been doing for more than two decades.

Furthermore, marketing is changing at a very rapid rate in the West, especially in the video games business, that is, how you reach customers and what is the best way to break through. In light of this, we are forming a world-class marketing team in the West.

Finally, our view is that Nexon's live game operations capability is among the very best in the world. We have established our capability based on our abundant experiences, augmented more recently by the advanced technology that we have put together. We have a team consisting of our most capable live game operators, which is working to bring that technology and live operations know-how so that everybody at Nexon around the world is as strong as our live game operations team in Korea. We think this is very important in the coming years as we bring high-quality Virtual Worlds around the globe.

¹ All other product names mentioned here are trademarks or registered trademarks of their respective companies.

[Q] In Q1, marketing and HR costs² were lower-than-planned, but are they deferred to Q2?

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

Regarding marketing expenses, due to *KartRider: Drift*'s slower-than-expected start, we decided to hold off on marketing for this game until the issues are resolved, which resulted in lower-than-expected marketing expenses in Q1.

As for HR cost, we think that part of it may be deferred to Q2 because in Q1, hiring was lower-than-planned and there were changes in overtime expenses and incentive compensations compared to plan.

This depends on how our business progresses going forward, but given that we made a large upfront investment in talent last year, we do not expect the ratio of HR costs to revenue and the year-on-year increase rate of HR cost to be as high as last year.

[Q] China *Dungeon&Fighter* was very strong in Q1, but do you think that you over-monetized and there may be blowback from the strong success in Q1 into Q2?

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

Regarding China *Dungeon&Fighter*, we conducted a number of initiatives over the past few years to stabilize the game. Amidst the increase in user engagement driven by the initiatives continued from Q4, the Lunar New Year update was well-received and the Chinese business grew 39% year-on-year on a constant currency basis³ in Q1.

On the other hand, we expect Q2 to be roughly flat year-on-year, but this is due to the difference in levels of comparison. Our China business grew 5% year-on-year on a constant currency basis last year in Q1, whereas it grew 39% in Q1 this year. In terms of last year's Q2, it grew 25% on a constant currency basis, so we are trying to stabilize this year's Q2 at roughly the same level compared to last year. We are making steady progress in stabilizing China *Dungeon&Fighter* and have no particular concerns regarding how the game's KPI is trending; users also continue to enjoy the game. Therefore, we believe that this year's Q1 and Q2 are making a steady and natural progression.

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

³ Constant currency is a non-GAAP measure used to show performance unaffected by fluctuations in foreign currency exchange rates. Constant-currency basis amounts are calculated using the average foreign currency exchange rates for the comparable period in the prior year and applied to the current period. As an example, we calculate royalty revenues from China *Dungeon&Fighter* by applying the same CNY/USD, USD/KRW and KRW/JPY exchange rates from last year's same fiscal quarter.

[Q] Regarding *KartRider: Drift*, why didn't you find the issues in the beta test that have come up post-launch? Why were the issues not fixed before the launch?

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

The key pieces of feedback that we picked up in the commercial launch were around two factors.

The first factor was around challenges that people had with the user interface. It's important to remember that the game launched on five platforms at the same time—two on mobile (iOS and Android), two on console (PlayStation 4 and Xbox One⁴), and one on PC. It is a global one-build where gamers are playing around the world. So, we have a much wider group of people playing all at the same time than we had during the beta test, which means we picked up more user interface-related issues at the launch.

The second factor was around the amount of content. As you know, the original *KartRider* on PC had been around for nearly two decades, and *KartRider Rush+* has already been around for a few years. Our fans who are familiar with the franchise expected even more content than was provided at launch, comparing the content volume with the previous versions of the *KartRider* games.

I would also like to refer back to how we manage Virtual Worlds that last for a very long time. We find over and over again that when we put out a new content plan, sometimes it works better than expected, and sometimes it works worse than expected. *KartRider: Drift* is a case where it didn't work out as well as we hoped. However, the way we manage that is by listening very carefully to the feedback that the community is giving, and then entering into a relentless cadence of content updates. This has worked with us again and again over the decades. We are very dedicated to the *KartRider* franchise and this is the approach that we are taking.

Lastly, even if the launch of a new game is a slower-than-expected start, it does not signify the end of our work when we have a great gameplay experience at the core—it's actually just the beginning. Our process of building up the franchise will continue for years. This has worked very well for us in growing our Virtual Worlds and making them last, and this is the approach we are taking for this franchise going forward.

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