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NEXON Co., Ltd. (3659.JP)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Yuki Hayakawa
Head of Corporate PR and Corporate Branding, NEXON Co., Ltd.

Ladies and gentlemen, thank you very much for joining us today. This is the Briefing Session of the Financial Result of NEXON Japan. Today's session is streamed live using the Internet including the current day. Please keep that in your mind.

I'd like to introduce myself. My name is Hayakawa from Corporate PR Team. Let me introduce the participants from NEXON. From the left, our President and CEO, Owen Mahoney; next to him is CFO, Shiro Uemura; next, we have Manager of Corporate Development Section, Shumpei Kumagai; last but not least, we have Maiko Ara, Global IR Team Leader.

Let me explain the procedure of today's briefing session. First of all, our President, Mr. Mahoney will present and talk about the game industry trend and our strategy. We have interpretation services available. So, please use the receiver in front of you.

Next, we have Uemura, CFO, to talk about the fiscal 2016 results, Q4 results as well as Q1 guidance of 2017. The presentation will be in Japanese. And then, we take questions. The presentation will last for about 30 minutes and Q&A is for about 30 minutes.

Today's briefing will be made open or available through our homepage. Let me make sure that you have all the documents. First, our presentation material for today [indiscernible] (02:13) or summary of the consolidated results and the five press releases we have distributed, those seven different presentations. If you are missing anything, please let us know.

Thank you very much. We'd like to now start the presentation. Mr. Mahoney?

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Owen Mahoney

President and Chief Executive Officer, NEXON Co., Ltd.

Thank you very much for joining us today – or for joining us on this wintry, snowy afternoon on your Friday.

Before we get into the results, I'd like to remind you that we're going to be taking a new approach to our semiannual investor briefings. Today, and going forward, our earnings briefings will be webcast live with simultaneous translations in Japanese and English. We will not be hosting a separate conference call in English. Our IR team will be available after the briefing to answer questions from those investors who don't have a chance to participate in the Q&A session.

Uemura-san will run you through the Q4 results and Q1 guidance, both of which we're very excited to share with you. Here, I'd like to talk for a few minutes about our company's strategy and where we sit in the video games and entertainment industry.

Although, NEXON is over 20-years-old, we just celebrated the fifth anniversary of our IPO. So now seems like a good time to reflect on the progress we've made over the last five years. From the time of the IPO, we've been asked frequently about how we think about our progress and about our future. And along the way, we've noticed several points around which our view of NEXON and of the games industry overall has differed pretty significantly from other people. So, I'm going to run through those now.

Number one, scale of the Asian games market and the value of NEXON intellectual property. We've attracted a large base of institutional investors from the U.S. and Europe, which we think reflects their recognition of the value of our intellectual property and our leadership in Asia. That being said, we think the potential of NEXON's intellectual property and the market opportunity of NEXON in Asia remains largely underappreciated.

First, some quick stats. The Asian entertainment and media market finished 2016 at about $544 billion in revenue; as compared to $668 billion in the United States and $441 billion in Europe. And the Asian market is growing nearly twice as fast as those other two markets according to PricewaterhouseCoopers. According to news and research, within the entertainment sector in Asia, games is a massive segment at $47 billion. This is bigger than games in the West at $46 billion. And the Asian games market is growing at 11% per year as compared to North America at 4% and Europe at 5%.

This affinity towards games in places like China, Korea, Southeast Asia is not new. For over 20 years, games on a variety of platforms have been at or near the center of the entertainment experience, on par with movies and music. So clearly, Asia is now on par with the U.S. and Europe in terms of market size in the entertainment industry.

But within entertainment, games, more than music or films, is where the center of gravity is and where the higher growth rate is. As in the West, those companies that have established intellectual property franchises have an enormous advantage. Fortunately, NEXON is in exactly that position.

Our largest franchise, Dungeon&Fighter has achieved live to-date gross revenues of $8.7 billion. For context, that's bigger than both Star Wars franchise worldwide box office, as well as the James Bond franchise worldwide box office, so they're very big.

Number two, longevity. I mentioned above that it's been five years since our IPO. During the IPO, the number one question was, when do your two biggest games, Dungeon&Fighter and MapleStory declined? It was a natural

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question, reflecting the pattern most people saw in popular online or social games at that time, of a rapid rise followed by a rapid fall. And both Dungeon&Fighter and MapleStory have been in existence and prospering for over six years by that time.

I'm happy to report today, five years later, that Nexon's flagship games are strong or stronger than they were five years ago.

MapleStory in Korea ended 2016 with an increase of 18% compared to 2011. Dungeon&Fighter did even better than that. From 2011 to 2016 it doubled its global revenue. So, these franchises are showing themselves to be incredibly robust over a period of many years. And there are more examples. One newer example is DomiNations, our history-themed game for mobile devices developed in the U.S. by our studio Big Huge Games.

In Western markets, where the game is almost two years old, DomiNations closed its revenue in 2016 larger than it was in 2015, and profitability improved. Importantly, it achieved this growth based not on advertising spend. We spent less in advertising in Q4 2016 than in Q4 2015, but on our unique approach to making a game grow over time through live game development and operations.

So, why the disconnect? Over our history, many analysts understandably looked at Nexon and said, your games are old and they will wither. Their world view was old equals soon to die. We said that our core competency was making online games thrive over long periods of time. They saw old, we saw robust community. Their question was, how do you replace that, which is old? Our question was, how do we make more annuities like these? From the lens of Software-as-a-Service, our approach enables us to retain players over a long time, which means longer lifetime values against [ph] a giving (10:11) customer acquisition cost.

Unlike casual games that require constant reacquisition of customers that have very short lifetimes, our marketing cost can remain relatively modest. Making a game thrive over years is one of the most powerful ideas in the game's industry today, and it is extraordinarily hard to do. Building, thriving online game communities is Nexon's most unique and important capability. There are a myriad of components to this, from in-game events and developing new content to smart analytics and personalization. There are very few companies in the world that do it well, and we are among that group, if not, at the very top of it. And this core competency leads to enormous stability that can feed other parts of our business, especially new games development.

Okay. Number 3, Nexon's pipeline. Thanks to the work our game development teams have done over the last two-and-a-half years, Nexon stands at the front edge of a wave of new game launches. Games like LawBreakers, Durango, After the End and TANGO 5. But beyond the large number of games that we are launching is our approach to development.

Nexon developers believe firmly that to succeed in the entertainment industry and especially to have a chance of creating new game franchises, we must focus our efforts on building experiences that are not just highly engaging, but also highly unique. Indeed, every sustainably successful game in our industry from Mario to Minecraft to Dungeon&Fighter have been both highly engaging that is fun, and highly unique, different from what was available before.

Creating such games requires a quality that is sadly lacking in much of our industry today, an ability and a willingness to experiment. Every lasting hit in our industry that we can think of has resulted from such playful experimentation, backed by strong creative and engineering capability. We think this is analogous to TV entertainment in the U.S. in the 1970s and 1980s compared to now.

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If you recall, previously, it seemed the airways were full of least common denominator sitcoms, cop shows and dramas, engineered primarily to appeal to the largest demographic. Today, we see a renaissance in television in the U.S. market, thanks to producers, directors, writers and other creative professionals, who are willing to experiment and break new ground.

The central insight these creatives understand is that getting a good financial result requires capable people taking creative risks. In the creative industry, you cannot win by playing not to lose. You can only win by playing to win.

Fortunately, in the games industry, Nexon has a long history of experimentation in creating new games and new business models.

Our first was over 20 years ago, with Kingdom Of The Winds, which was the first graphical massively multiplayer online game. In the early-2000s, we created the first free-to-play game, making QuizQuiz free and then adding in virtual goods to enhance the player's experience. Fortunately, our experiments have paid off more often than they haven't. So, we have significant cash flow from our existing games each year to fuel development of unique new games. So, we're very excited about our pipeline, and while it's difficult for us to point to any one game and say, this will be a hit, we believe our approach creates enormous valuable optionality in the future growth, on top of the robustness of our existing game communities.

So to summarize, we believe Nexon has three powerful advantages that insulate us from many of the uncertainties in the games industry. First, a deep understanding on the markets and enormous opportunities in Asia. Second, powerful franchises that perform as annuities, growing engagement over years and even decades. Third, stability and resources from sustained hits to make the created [ph] bets than (15:15) enable a strong pipeline in new games.

Okay. Lastly, I will turn to our pipeline for 2017. As you may know, last November, we exhibited 35 titles, most of which were new at G-STAR, the biggest game exhibition in Korea. As the exhibition previewed, 2017 will be an extremely busy year for us with numerous titles launching around the world.

Today, I'd like to preview a few of the titles we are really excited about and provide some updates on some recently launched games that are already off to a strong start. The first is our mobile game HIT. As you know, HIT is our blockbuster mobile action RPG, we launched in Korea in November 2015 and globally, excluding Japan and China in July 2016. In early December 2016, we launched the Japanese service of HIT. While it's still early, the game is performing well and we backed the launched with TV advertising in Japan in December and in January. And now we will show you the trailer, if you haven't seen it already.

[Video Presentation] (16:36-17:53)

Okay. Next is Dungeon&Fighter: Spirit. A mobile side scrolling action RPG based on one of our biggest PC franchises. Following the original characters in the PC online game, the game features additional skills exclusive to mobile as well as graphics that have been enhanced from 2D to 3D.

Dungeon&Fighter: Spirit launched first in Korea on January 12, and we're now preparing to launch the service in other regions including Japan. So, let's play the trailer.

[Video presentation] (18:28-19:06)

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Okay. Next is Titanfall Online, the PC online game in development based on Respawn and EA's – Electronic Arts' popular first-person shooter console game Titanfall. We conducted the first closed beta test in December, which included popular content from the original console version, as well as new modes such as team deathmatch. The game will be available in Asia and we'll keep you updated on the launch timing. Let's play the trailer.

[Video presentation] (19:40-20:45)

I am very excited about that game. And finally, we're excited to show you Dark Avenger 3, the mobile RPG game. It's the third game in the popular action RPG, Dark Avenger series. The first two titles in the series were major successes, together exceeding 35 million downloads worldwide. We're excited about the console quality graphics along with the real-time battle mode and raids.

Korean service will start in the first half of 2017 followed by other regions. So, let's play the trailer, please.

[Video presentation] (21:24-22:35)

As you can tell from the graphics there, the power of mobile platforms has increased substantially over the last couple of years. And we think that that plays to NEXON's strength in providing deep, rich experiences over long periods of time. So, we're very excited about that franchise and many others like it.

With that, I'll turn it over to Uemura-san, who will discuss the Q4 results and the Q1 outlook. Thank you very much.

Unverified Participant

Thank you very much, Mr. Uemura, our CFO, please.

Shiro Uemura

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

Now, let's move on to FY 2016 results. FY 2016 revenues were ¥183.1 billion, down 4% year-over-year on an as reported basis, impacted by significant FX headwinds as the Japanese yen appreciated against the Korean won and Chinese yuan.

On a constant currency basis, full year revenues were up nicely by 17% year-over-year. Adjusted for the first quarter impairment loss of ¥22.6 billion on gloops' goodwill, FY 2016 operating income would have been ¥63.2 billion, up 1% year-over-year on an as reported basis and up 27% year-over-year on a constant currency basis. Including the impairment loss, FY 2016 operating income was ¥40.6 billion, down 35% year-over-year on an as reported basis and down 11% year-over-year on a constant currency basis.

Adjusted for the impairment loss, FY 2016 net income would have been ¥42.7 billion, down 23% year-over-year on an as reported basis and flat year-over-year on a constant currency basis. Including the impairment loss, FY 2016 net income was ¥20.1 billion, down 63% year-over-year on an as reported basis and down 44% year-over-year on a constant currency basis.

Continue on to the Q4 results. For additional details, please see the Q4, 2016 investor presentation included in the handouts. Revenues were ¥43.3 billion, down 6% year-over-year on an as reported basis and up 7% year-over-year on a constant currency basis. These results exceeded our outlook.

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Operating income was ¥7.3 billion and net income was ¥11.2 billion. Fourth quarter revenues exceeded our outlook, primarily due to the strong performances of Dungeon&Fighter in China, FIFA Online 3, and FIFA Online 3 M in Korea, HIT in Taiwan and Thailand, as well as the favorable effect from depreciation of the Japanese yen, against the Korean won and Chinese yuan during the quarter.

Operating income was below our outlook due to the impairment loss, primarily on prepaid royalties related to publishing titles. Excluding the impact of the impairment loss of approximately ¥3.7 billion, operating income would have been ¥11 billion exceeding our outlook. Net income exceeded our outlook primarily due to the FX gain of ¥20.6 billion on our U.S. dollar-denominated cash deposits and accounts receivable due to the depreciation of the Korean won and Japanese yen against the U.S. dollar, partially offset by a ¥14.6 billion deferred tax expense, additionally recorded for undistributed profits of overseas subsidiaries.

Active users for Dungeon&Fighter in China remained high throughout the quarter, driven by solid performance of the National Day update, which continued from the end of the third quarter to November 2017, in addition to a well-received Winter update, which was introduced in December. These updates drove stronger than expected in-game sales of items throughout December including [ph] avatars (27:13). Fourth quarter MAUs and paying users increased both year-over-year and quarter-over-quarter since we conducted the National Day update in the third quarter of 2016. A few days later, we saw a more favorable effect in the fourth quarter of 2016 compared to the prior year. In addition, the well-received Winter update also [ph] gained (27:36) a positive impact on the number of MAUs and paying users.

In Korea, FIFA Online 3 and FIFA Online 3 M performed especially well in November and December, driven by newly added licenses for [ph] soccer (27:51) players in November, as well as successful operation and productive promotions.

Revenues from longstanding hits MapleStory and Dungeon&Fighter, both have been in service for over a decade, have increased year-over-year. MapleStory, in particular, grew significantly year-over-year, driven by continued favorable effects from major update last quarter, which has been extremely well-received.

Now, turning to our Q1 2017 outlook. For the first quarter of 2017, we expect revenues in the range of ¥62.4 billion to ¥67.1 billion, representing a 9% to 17% increase year-over-year on an as reported basis. On a constant currency basis, we expect revenues in the range of ¥62 billion to ¥66.6 billion, representing an 8% to 16% increase year-over-year. We expect operating income to be in the range of ¥30.3 billion to ¥34.8 billion. We expect net income to be in the range of ¥27.1 billion to ¥30.8 billion.

By region, in China for the first quarter revenues, we expect a 30% to 40% increase year-over-year on an as reported basis and on a constant currency basis. And for our key PC online game, Dungeon&Fighter, we conducted a large-scale content update in January 2017 in time for the Lunar New Year, and the game is off to an extremely strong start.

The numbers of active users and paying users from January up to the present have both remained high in comparison to the same period last year, and we expect this trend to continue throughout the first quarter. Therefore, we expect our revenues to grow year-over-year even in comparison with last years and the same period with solid performance.

As you can see, we expect China to see strong growth in Q1 year-on-year, driven by exceptionally strong performance of the Lunar New Year update, which is the most important update of the year. While we do not

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provide a full year outlook, when you think about our China business from Q2 and onwards, please keep in mind that our policy for the game operation remains unchanged meaning that we will continue to focus on our game stability.

As for large scale updates scheduled for Dungeon&Fighter in 2017, there are no big changes. And we expect to conduct at the pace of about one or two updates per quarter. Impact of each update [ph] on the (30:29) quarterly performance can vary somewhat depending on the timing and introduction schedule. Please keep in mind that as a result of the differences in the timing, the year-on-year growth rate could change. The National Day update, which is highly important from the financial perspective among the major updates is likely to come a few days earlier in 2017 compared to 2016. However, the schedule is subject to change. So, please keep in mind that this is our outlook as of today.

In Korea for the first quarter revenue, we expect a high-teens to low-teens decrease year-on-year on as reported basis and on the constant currency basis. We expect year-on-year increase from titles including Dungeon&Fighter, MapleStory, as well as the contribution from the mobile games such Dungeon&Fighter: Spirit, which launched its service in January and Sangokushi Sousouden Online and MapleStory M, both of which were launched in October last year. However, we expect these to be more than offset by year-on-year decrease in revenues from titles including Sudden Attack and HIT.

In Japan, for Q1 revenue, we expect a high single-digit to high-teens percentage increase year-on-year on as reported basis. While we expect mobile browser game revenues to decrease year-on-year, we expect revenues to increase year-on-year, primarily due to the strong performance of HIT, which launched in December last year and contributions from Tree of Savior and HIDE AND FIRE, both of which launched in September last year.

In North America, in Q1 revenue, we expect 20% to high-teens percent decrease year-on-year on as reported basis and on a constant currency basis. Europe and others for the first quarter revenue, we expect a low single-digit decrease to low-teens increase year-on-year on as reported basis and on constant currency basis.

In the first quarter, we expect operating income to be in the range of ¥30.3 billion to ¥34.8 billion, which is 8 times to 9 times what it was during the same period last year. We expect the increase of 8% to 24% year-on-year when excluding the impact of one-time impairment loss of ¥22.6 billion on gloops' goodwill and impairment loss on prepaid royalties and game IP of ¥1.8 billion, which we recognized in the first quarter of 2016.

We expect increased revenues, primarily driven by strong performance of the China business with high margin, as well as lower variable cost. This includes lower royalty cost for DomiNations in relation to the acquisition on Big Huge Games, as well as lower platform fees and payment gateway fees in relation to decreased mobile browser games revenue in Japan and Sudden

Attack in Korea. We expect these to be partially offset by year-on-year increase in HR costs due to the head count increase, primarily in Korea and greater marketing cost related to the launch of new titles.

Lastly, I'd like to give you an update on the year-end dividend. For 2016, the retained earnings of the Nexon Japan corporate entity did not support the year-end dividend. Specifically, we recorded a net loss of ¥44.4 billion, primarily due to the ¥23.5 billion write-down on gloops' stocks and ¥12.9 billion bad debt expense on loans to subsidiaries we recorded in Q1 and Q4 respectively.

As a result, Nexon Japan corporate entities retained earnings, which is our source for funding the dividend, turned negative at minus ¥41.3 billion. We are scheduled to resume the dividend for the mid-year in 2017.

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In the meantime, the board of directors approved the policy to initiate a new share repurchase program of ¥10 billion in one year period from February 13 this year. Details of the share repurchase program will be announced upon the board resolution.

Going forward, we will continue to focus on creating shareholder value by growing the business, as well as returning capital to shareholders through dividends and share buybacks.

Now, we are happy to take your questions.

QUESTION AND ANSWER SECTION

A

Thank you very much. We would like to open the floor for Q&A. Other than in this room, we have people on a conference call. So firstly, we will solicit the questions from the floor. We will fetch you a microphone. So, if you have any questions, please raise your hand and upon posing a question, please mention your name and affiliation. Also, if you have multiple questions, please ask one question at a time. Thank you very much for your understanding. Are there any questions? Second row from the front, a gentlemen raising his hand.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

Thank you very much. I'm Yoneshima of Credit Suisse Securities. I have three questions, so one at a time. Firstly, about China, [ph] about (36:45) PC Dungeon&Fighter. You explained that active users and paying users are growing year-on-year and that is the situation in Q4 and you are trending well in Q1 as well. In terms of [ph] RPU (36:59), can you tell me what is the paying rate per user?

Another question, and Mr. Uemura, you mentioned that you are not sure about the trend of Q2. But in terms of the past two years, I understand that the situation is favorable for Dungeon&Fighter, i.e., you are advancing the level of Dungeon&Fighter. I know that this momentum will not continue forevermore, but in terms of paying users and MAU are increasing. So, as compared to two or three years ago, I believe that the situation is getting better. But do you think that the level has advanced from the long-term perspective? Can you comment on that first?

A

Thank you very much for your question. Regarding Dungeon&Fighter in China, looking at the major KPIs, we were able to record a very healthy robust figures. About ARPPU, Y-o-Y, it is increasing. But Q-on-Q, we see a slight decrease. Why? It is seasonality mostly. Q4-wise, we saw inexpensive items and that trended very well. And that contributed to the sales. But unit price went down. Therefore, ARPPU went down, but then the number of the users increased. Therefore, MAU went up.

So, we are in a positive environment. We do have a very stable user base. And in Q1, up until quite recently, the Lunar New Year's update was very well-received. And also related package sales trended very well as well. So year-on-year, we are seeing a dramatic growth. And that is the situation that we are seeing in Q1.

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Regarding Q2 and Q3, we cannot read the crystal ball. So, I want to talk in a qualitative manner. User base is very robust. So, if we operate a game in the right manner, I believe that we will do better than the previous year. But Q1 is the time in which we have the Lunar New Year impact, so if you expect 30% to 40% growth in Q2 and Q3 that might be quite difficult, but I believe that we should be on par, at least with the previous year. Thank you very much.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

Second question about the shareholder's return. [ph] At this term (40:07), your retained earnings is in the negative, but as far as FY 2017 is concerned I believe that maybe [ph] more have some plan to (40:20) have the right balance sheet, so that you can have the dividend payout and also you have the plan to have the share buyback of ¥10 billion. And so, are you going to come up with a profit from the subsidiary company, so that your balance sheet will be more stable? What are the measures you have on mind to provide dividend payout again?

A

Regarding the dividend, it boils down to the result of the individual entity. So, Nexon Japan should increase its revenue. But having said that, the strength of the group depends on the subsidiary companies as well. So, there will be dividend from the subsidiaries and we will be able to record that as a profit and we plan to provide dividend again.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

Third question. About 3D mobile Dungeon&Fighter and I know that you will start operating it and things might change, but what is the initial impact? And how about China's 2D Dungeon&Fighter? And I think it is included in your full-year plan, so is it determined that you're going to launch that this year or you are coordinating the mater still? So, you have 2D in the plan, but it's not definitive. So, can you tell me the schedule of 2D mobile Dungeon&Fighter?

A

Firstly, 3D Dungeon&Fighter. It is a very popular IP, so we have high expectations toward it. Korean competition is getting tougher. So, we are in a challenging situation. But, of course, in Korea, we will come up with different counter measures and we will try to bring that game to other region as well. So, all-in-all, we will be able to record revenue.

Talking about 2D Dungeon&Fighter, same story. It is a very popular IP in China, and we will collaborate with Tencent, so that we will continue developing it. So, there is nothing to update today, but please note that we will continue putting our full-fledged effort. Thank you very much.

A

Thank you. Now, we move on to the next question. The lady in the first row.

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Q

Thank you for the presentations. [ph] Yagura (43:24) from Nomura Securities. I also have three questions. First, [ph] in our (43:30) Japanese market, your impressions. The revenues have been declining for a long time, and with this quarter, it's now Q-on-Q positive and the market is big. So, if maybe if you can grow, this is going to be a big growth.

Now Japanese market probably is saturating a bit and as for the competitive edge, I have a high expectation from Nexon with the iPhone 8, the screen will be bigger. So, your mobile quality is high, but the capacity is quite high as well, and the iPhone 8 would be higher capacity. So, the mobile game is moving toward the richer experiences. So, your strategy and also the reaction so far. That's my first question. If you can comment on those points.

A

Yes. Thank you very much for your question. In Japanese market, our impression, as you said, the mobile games in Japan is becoming higher quality. Now people are accepting that higher quality games. So, what we want to achieve, I think it matches with what is accepted. So, I think I said this before, but Japanese strategy is first of all to focus on the good operation and high-quality operation.

And then Nexon Group, through the network of the Nexon Group, try to bring high-quality and interesting titles to Japan, that has been the strategy. So, I think that finally [ph] that we're starting (45:30) to working HIDE AND FIRE and HIT last year is doing well. But Japanese market is also a very tough market. We recognize that. So, publishing, we need to keep doing it steadily.

And those launched existing titles, we'd like to make sure that there is a longevity there. So, we are not – we do not believe that we are satisfied. We are continuing to utilize the [ph] group networks (46:12) to bring the good titles to Japan and do the good operation. So, it's a basic thing, but those are the important things. Also, suitable titles in Japan is necessary. So, we need to enhance our development for that. So, that's something that we are doing right now.

A

[indiscernible] (46:35). The Japanese market – our observation is that the Japanese market is one of the most demanding in the world, as you referenced. But when you talk about saturation, I think you have to ask what kind of saturation you're talking about. If it's saturation of a lot of the same types of products, very similar products, then that leads to an obvious strategy and the strategy is to put out games that are differentiated from what already exist in the market. And that's, in fact, exactly what we're doing.

And as I said in my prepared remarks, we have existing games that around the world have been extremely stable and we can use the cash flows that come from that to make a lot of different experiments, [ph] creative bets (47:28) and experiments. And then, we can bring those differentiated experiments into the Japanese market. But it's been our observation that we've seen a few number of breakout hits in the Japanese market in the last couple of years and those tend to have been – games that have been heavily differentiated from what else is out there. So, that's what our strategy is about. It takes some courage to do that. But it's easier to have courage when you can afford to take a lot of different kinds of creative risks. So, that's what our strategy is about.

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Q

[Foreign Language] (48:05). Thank you very much. Second question is about the partnership strategy. Once again, I'd like to ask this question. I'm sure that your way of thinking has not changed, but console games in Japan, Square Enix and other company you work with.

So, the biggest company is more focused on the mobile game and I think they're going for the global market and the long lasting title is something that they want to go for. So, that's going to be something very interesting rather than going forward [indiscernible] (48:54). So, if [ph] you cannot (48:55) talk about specific companies, but maybe you can work with some potential partners in Japan or global. And what would be the qualities that you look for as a partner? What kind of companies do you want to work with? So, if you can talk about your potential partners.

A

Well, as you know we announced the relationship about a year-and-a-half, almost two years ago with Square Enix for Final Fantasy XI for mobile. And we're hard at work developing that game right now and our partnership with them. So, that's specifically about Square Enix. We have a long, personal and intercompany relationship with them and a great deal of respect for the developers over there, as well as their management team.

Your question was about what kinds of partners we look for. I'd say that, again, the main thing because we're in the creative world is we look for other people who look at games as an art form and think about it as a way to create a differentiated truly deep experience that can last a very long time. And if our partner thinks about a game that way, then we're very interested in working together with them. And so, that's what we look for. We think there's certainly a opportunity to do that.

Sadly, as a percentage, there's not many companies like that anywhere in the world, at least, in the last few years. So, around the world this is not specific to Japan, but around the world probably about 90% of the companies that we talked to, small or large are trying to do something that's pretty similar to a game that's already out there. And we tend to shy away from companies like that. We would like to try to take more, to experiment more, and to try new and different things. So, we look for people who are willing to do that with us. It takes money and courage and a certain orientation in terms of game development to be able to do that. But that's overall what we look for, and that's true not just in Japan, but around the world. Fortunately, Japan has a long, long history of creating great intellectual property, great games. So we hope to do more partnering with some of those great developers that are in Japan.

Q

Thank you very much. Last question, it's kind of a detailed question. But impairment loss in the future, the way I was thinking of it. This time, you have booked a impairment loss. I think the IP impairment that's brought forward and I think that the amount is larger than usual. So, I'd like to know the details? And also it's a minor thing probably, but maybe reducing this. Is that something that you are going to do? Or do you think that with a certain creativity [ph] decides of (52:07) impairment loss is something that you expect? So, if you can comment on that.

A

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Our way of thinking about the impairment loss, for example goodwill impairment loss, unlike that other impairment losses, for example I talked about example of the prepaid royalties, ¥3.7 billion. They're not a big amount if you look at each one of them. So, as some of it at the end of the year, the impairment loss was booked. So, more specifically, the projects or game developments during the game developments, there are some losses that we recorded. So in that sense, we the game company, I think it's a kind of a fate and it cannot be helped. So, what about the amount, and that's up to what progress that you have made in the projects and so forth, but more or less I think, this type of impairment loss is something that we expect. But having said that, the goodwill, the major ones, in our BS, balance sheet, I think we cleaned up major concerns. So, major impairment loss is not something that we expect. Thank you very much.

A

Thank you very much. It is about time to get questions from the caller. So, this will be the final question from the floor. Any question? The person sitting by the window, please.

Q

I am [ph] Mochizuki (54:15), Wall Street Journal. I have a question about a particular IP. You have Kemono Friends, and Kemono Friends is becoming very popular on TV and the service has ended and I want to know what is your impression. And you have ended the service, but can you tell me the backdrop of why you stopped the service? And socially, it is becoming very, very popular, so do you have any intention to relaunch the service?

A

Thank you very much for your question. Regarding Kemono Friends, I know that it is quite popular these days. Last year, we handled this title, but the situation has changed since then. We have to think about the timing. We operate different games, and we look at daily KPIs and think about the future plan. Therefore, back then, we did not think that the environment was such that we can continue the service. But if we had launched the service now, maybe that might have been a totally different story, but it's our past. Regarding Kemono Friends IP, whether we're going to come up with a new game or not, nothing is decided yet.

A

So, did he answer your question? Thank you. I understand that there are more questions in the room, but we will like to accept the question from the conference call.

Operator: The next question is Han-Joon Kim from Deutsche Bank. Please go ahead.

Han-Joon Kim
Analyst, Deutsche Bank AG (Hong Kong)

Q

Great. Thank you very much for the opportunity to ask questions. I have three. Maybe I'll go by them one by one. Just the first one, I think this is the first time you guys have officially stated in the presentation that D&F 2D will actually get launched this year. So just wanted to confirm the fact and that we are committed to it this year. And if so, if you had a perspective on when that might be? That'll be good. That's my first question.

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A

Thank you very much for the question. Let me clarify, in our presentation about the launch. We did not say it was a launch, it's in the pipeline, so 2017 and onwards, that's what we said. So, maybe there is a misunderstanding, but we did not say that it will be launched in 2017, but we are currently preparing for it.

Han-Joon Kim
Analyst, Deutsche Bank AG (Hong Kong)

Q

Okay. I can understand. My second question has to do with your overall thoughts on what's happening in Korea, Lineage 2: Revolution has taken the market by storm. My personal sense is I don't really get the sense that it's hugely differentiated, and still it seems to have done fantastically well in terms of monetization in the market. So, I guess I just want to get the management's thought on why you think that game was so different from what we are making in Korea, and why they can do a much bigger scale, than I guess what we've been able to achieve? So, I guess the learnings from what Lineage 2: Revolution [ph] doing (58:14) in Korea would be? My second question.

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

A

Hi. Han-Joon. It's Owen. A couple of observations, although I would just profess it by saying that we're probably not the best people to talk in detail about Lineage Revolution. Our observations are really from the outside. Obviously talking to Netmarble's is probably a better place to go into details on that.

I think that the thing that Lineage Revolution has done well is, first of all, they've executed very, very well on a very, very popular and well made intellectual property and brought it to mobile. So, [ph] they've done (58:54) a great job on that and it's obviously monetized very well. So, there seems to have been some concentration on that. So, early returns are very good.

And our view is that to have a sustained hit over time takes two things, the game has to be really good and it has to be different from what's come before. And that games in general, the more similar they are to other games, the more that they – that you take something that's not a commodity and turn it into a commodity. Our observation about Lineage Revolutions is, it's based off of a very differentiated, very popular, very good IP and the execution on it was excellent and we think that's great.

I would make a second overall observation though. As you know, from following us for several years, the Korean market is exceedingly intense competition, and this is far from the first time that we have faced intense competition in the Korean market. But we think overall, that better games and better competition leads to a stronger overall games industry. And we wish that there were more and better games in every market around the world because that would drive more people into games as an entertainment form.

And games exist – the competition for any individual games doesn't just come from other games in the games market, but other forms of entertainment including social media, including television and movies, and so on. So, more good games in the industry, we think overall and over time helps us more than it hurts us. So, what would be the second observation. Thanks.

Han-Joon Kim
Analyst, Deutsche Bank AG (Hong Kong)

Q

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Great. I appreciate that. So, that leads me to my third and final question. And please feel free to point out errors in my observation. But just from looking at the gross rankings to get likes of D&F 3D, [ph] I'm struck off (01:00:55) really strongly on the charts, and then it has slipped down. So, just some thought around – do mobile games perhaps have shorter longevity or was there a particular element with our games had somehow seem to have, I guess, very good initial launch and then slow their pace over the course of the next few months or so, and don't sustain that level of initial success? So, thoughts on why our games are doing that. Is that a function of just mobile longevity or a function of the games that we've made today?

A

Well, first of all I'd say two things. Number one, it is very misleading if you track only the gross rankings charts. I think this is a problem that a lot of people who observe our industry having – it's an easy mistake to make because you track what's available, not track what's not available. And what's not available is what the profits are from those games. So, a lot of the games that you see – some of the games that you see on the top 50 or the top 20 of the gross rankings are there because the games by themselves have high retention rates because the games have been put together very well. Other games are on the top 50 gross rankings because they are throwing enormous amounts of money in the marketing. But after all the marketing is paid for, you don't have a lot of money left over for profit. Other games are there because they are working very hard to monetize as quickly as they possibly can. This is true in any market.

What we look at even more than near term gross rankings is long-term returns for a game. That's what generates profits. And profits enable you to invest in more games. And so, I'll give you an example of this. When we first launched DomiNations it ranked very – in the U.S., it ranked very high in the gross ranking charts. But what we were really watching was over time how good the longevity is on the game. And as I said in my prepared remarks, we've been very satisfied with how the longevity is. And we're watching that over time because anything that happens in the first couple of months, for the first couple of quarters after a launch is going to be vastly overweighed if it turns into a long-lasting game. This is how Dungeon&Fighter's business was built and MapleStory's business.

If you ask anybody around Nexon, we probably couldn't tell you what happened in the first couple of quarters after the launch of those games. And what we really care about is that the game lasts for a long time. To put it in financial terms, just think of the DCF. If you've got a long lifetime for a game, the DCF is going to be a lot better. So, that's the way we look at it.

Han-Joon Kim
Analyst, Deutsche Bank AG (Hong Kong)

Q

Thank you very much.

A

Thank you.

A

[Foreign Language] (01:03:58) Thank you. [Foreign Language] (01:04:04) Thank you very much. There is another question.

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Operator: The next question is Thomas Kwon from Daiwa Securities. Please go ahead.

Thomas Kwon
Analyst, Daiwa Securities Capital Markets Korea Co., Ltd.

Q

Thanks for the opportunities. I have just one question. My question is about the Dungeon&Fighter, the mobile 3D. The game launch for China market has been delayed, and it still looks uncertain in, [ph] tiding-wise, given the (01:04:34) rapidly changing gamers' demand and tougher competition landscape. At this point, could you share to us what were just the key reasons for this delay? And is there any issues from the developers technically or from the publishers statistically? Any comments from your side, especially from how management [indiscernible] (01:04:59), that will be appreciated. That's my questions. Thanks.

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

A

Sure. This is Owen. Thank you very much for your question. I think anytime we are talking about our largest intellectual property franchise in our largest market, there's going to be a lot of eyes on the game. We don't have an update for when the title is launching, nor do we have a huge update in terms of the development and how that development is progressing. We and our partners on this game, Tencent, have felt that it's important to get the experience on mobile right. And also that there's enough content that goes with the launch of the game and [ph] that when (01:05:38) we have a very strong [ph] ramp (01:05:40) for when it does launch.

So, we continue to work hard on the development and work hard in preparation for a launch, but we don't have an update at this time. There's no problem in particular. Just a desire to put the care into the game, so that it's successful over the long term in the market. Sorry. I can't give you more specifics at this time.

Thomas Kwon
Analyst, Daiwa Securities Capital Markets Korea Co., Ltd.

Q

Can I ask you just a follow-up question?

A

Of course.

Thomas Kwon
Analyst, Daiwa Securities Capital Markets Korea Co., Ltd.

Q

Sure. So, the company launched Dungeon&Fighter's 3D Spirit, I don't know [indiscernible] (01:06:21) be happy with this initial [ph] progress that (01:06:23) we create now on the market? Is there any negative or is there positive [ph] adverse that your 3D (01:06:30) version for China market?

A

I'm sorry. If you could repeat your question. I didn't really understand.

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Thomas Kwon
Analyst, Daiwa Securities Capital Markets Korea Co., Ltd.

Q

Yeah. So 3D Dungeon&Fighter mobile version is already launched in the Korean market. So, is there any impact for [ph] this 2D gaming (01:06:52) launch timing versus market?

A

Your question is, is there an impact on Dungeon&Fighter 2D from the launch of Dungeon&Fighter 3D?

Thomas Kwon
Analyst, Daiwa Securities Capital Markets Korea Co., Ltd.

Q

Yeah. Initial feedback versus initial – the performance in the Korean market.

A

No. There is not an impact on D&F 2D from the launch of D&F 3D.

Thomas Kwon
Analyst, Daiwa Securities Capital Markets Korea Co., Ltd.

Q

Okay. Thank you.

A

Thank you.

Unverified Participant

Thank you very much. This concludes our Q&A session. We would like to end Nexon's 2016 presentation. And please put the receiver on the desk. In order to enhance our IR activities, please fill in the survey form. Once again, thank you very much for participating in this presentation despite your very busy schedule.

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