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NEXON Co., Ltd. (3659.JP)

Q3 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to Nexon's 2017 Third Quarter Earnings Conference Call. Today's call is being recorded.

At this time, I would like to turn the call over to Maiko Ara, Head of the Corporate Development and IR team. Please go ahead, ma'am.

Maiko Ara
Head of Corporate Development & Investor Relations, NEXON Co., Ltd.

Hello, everyone, and welcome. Thank you for joining us today. With me are Owen Mahoney, President and CEO of Nexon; and Shiro Uemura, CFO. Today's call will contain forward-looking statements, including statements about our results of operation and financial condition, such as revenues attributable to our key titles, growth prospect, including with respect to online game industry, our ability to compete effectively, adapt to new technologies, and address new technical challenges, our use of intellectual property, and other statements that are not historical facts.

These statements represent our predictions, projections, and expectations about future events, which we believe are reasonable or based on reasonable assumptions. However, numerous risks and uncertainties could cause actual results to differ materially from those expressed or implied in the forward-looking statements. Information on some of these risks and uncertainties can be found in our earnings-related IR document. We assume no obligation to update or alter any forward-looking statement.

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I'd now like to turn the call over to Owen.

Owen Mahoney

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

Thank you, Ara-san, and thank you all very much for joining us today. Q3 was a great quarter for Nexon, with revenues, operating income and net income well above our expectations. It was also the biggest Q3

ever. These strong results reflect continued growth in our key existing titles in China and Korea, as well as strong starts in new games both PC and mobile.

Dungeon&Fighter China's outperformance was driven by the strong start of the National Day Update. Our live operations team continued to deliver for our customers with engaging experiences that led to stronger KPIs across the board and underscored Nexon's industry-leading strength in growing online games over many years through live services.

FIFA Online 3 and FIFA Online 3 M in Korea also both had a terrific quarter, driven by successful promotions and strong sales around the Korean Thanksgiving holiday. This is the fifth year for the service of this franchise on PC and the fourth year on mobile, and yet in the third quarter, both have grown significantly year-over-year.

In Korea, we also had a good start to AxE, our new in-house mobile franchise.

We are also excited to see the good results from the limited access and open beta pre-test from MapleStory2 China during the third quarter, which also helped push revenues above our expectations. As many of you know, our publishing partner from MapleStory2 in China is Tencent.

We've worked very hard tuning and localizing the game together with them and we're both excited for the upcoming launch in China. Additionally, we announced the extension of our publishing relationship with EA for FIFA ONLINE 4 in Korea. This marks the fourth partnership with EA following FIFA ONLINE 3 and FIFA ONLINE 3 M, Need for Speed Edge and Titanfall Online.

FIFA ONLINE 3 was the first game NEXON and EA worked on together starting back in 2013, and we've gone on to achieve great success with the game in Korea. So, we're thrilled to work with them on a sequel.

In upcoming quarters, we have a number of significant new launches. These include the official start of MapleStory 2 in China later in the fourth quarter and OVERHIT in Korea, the sequel to our major mobile game HIT later in November. And in 2018, we have much more to come, including Durango on mobile.

Now, I'd like to talk with you about Pixelberry Studios. This is our largest acquisition in several years, so it's worth providing some context on the synergies and our plans for this team. Nexon has maintained a tightly disciplined approach to allocating capital to grow our business. In M&A, we look for companies with

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great management teams, building highly unique game experiences and address large blue ocean market opportunities.

We avoid overpriced companies or genres that are already dominated by one or two wealth resource market leaders and/or too many companies are making very similar games.

We begin with recognition of our strengths and what we can bring to any given acquisition. Nexon builds online games that engage players for years and decades rather than weeks or months. We have a powerful live operations team and back-end infrastructure that continuously improves the player experience, and thereby creates new revenue opportunities.

And as a result, our flagship games like Dungeon&Fighter, MapleStory and DomiNations served as annuities, providing steady capital for us to invest in new ideas. Pixelberry Studios is the leader in interactive fiction on mobile devices. Its flagship title, Choices, presents the player with an interactive story that develops according to decisions the user makes, an interactive dialogue as the story unfolds. It is the top app in this category even though it doesn't rely on celebrity or brand integration.

At face value, Pixelberry Studios may seem like an unorthodox acquisition for Nexon, but we believe the company checks every box and will strongly complement Nexon's innate strengths. Pixelberry Studios generates tens of millions of dollars in revenues per year. It's profitable, it's growing quickly, and we expect it to be accretive to Nexon starting in 2018.

The company targets a massive, highly valuable, and very underserved demographic, women. While hundreds of millions of women use mobile devices, the games market targeting them is highly fragmented and hits that last more than even a few weeks are very elusive. It is still very early innings in this market. Pixelberry Studios was on a lot of potential acquirers' radar screens. They decided to go with Nexon because we have a deeply shared vision for the future of interactive entertainment, as well as multiple ways to grow each other's businesses.

We see several synergies with Pixelberry Studios. First, we see strong synergies in combining Pixelberry Studios' proven development capability and interactive fiction with Nexon's ability to sustain and grow player engagement over several years, leveraging Nexon's live operations capability. Second, we see an opportunity to make Pixelberry Studios games more online, bringing many users together in the same interactive fiction world at the same time. We believe this can further extend the lifetime of each game experience. Third, we see international opportunities for Pixelberry Studios games while also benefiting our reach in mobile in the West.

While some companies view mobile as a platform that supports mostly casual or casino games, we look at it from a core gamer point of view. We believe that deep immersive games should be played by everyone, not just hardcore gamers. And although they are harder to build and maintain, immersive games typically have much longer lifespans than casual games. So, Nexon and Pixelberry Studios are excited about this combination because it opens the opportunity to bring immersive games to much broader audience of women.

While much of the rest of the industry is spending heavily into the most competitive and established segments in the market in the busy third and fourth quarters, we see in Pixelberry Studios a blue ocean opportunity and a highly complementary segment that is both massive and barely noticed by the games industry incumbents. This is a highly deliberate acquisition that we think will create great value for both players and shareholders.

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Summarizing the quarter, Nexon has delivered yet another quarter of very solid growth. We have a great pipeline of new IP and we have just announced a great acquisition. I'm more excited than I have ever been about Nexon's future.

With that, I'll turn the call over to Uemura-san.

Shiro Uemura

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

Now, let's move on to Q3 results. For additional details, please see the Q3 2017 Investor Presentation available on our IR website.

We were pleased that revenues exceeded our outlook for the quarter. For Q3, revenues were ¥60.4 billion, up 36% year-over-year on an as reported basis and up 27% year-over-year on a constant currency basis. Operating income was ¥22.7 billion and net income was ¥19.6 billion, both of which exceeded our outlook.

The third quarter revenue outperformance was primarily due to the strong performance of Dungeon&Fighter in China. The strength of FIFA Online 3 and FIFA Online 3 M in Korea also contributed, as did mobile games AxE, which was launched in Korea in mid-September. In addition, MapleStory2, which started limited access in August and open beta pre-test in September helped push revenue above our outlook.

Operating income also exceeded our outlook. We had higher-than-planned expenses due to impairment losses on prepaid royalties related to LawBreakers and incentive bonus expenses related to strong business performance. However, these higher expenses were more than offset by the revenue outperformance that I described a moment ago, driven by high-margin Dungeon&Fighter and MapleStory2 in China, as well as FIFA Online 3, FIFA Online 3 M, and AxE in Korea. Net income also exceeded our outlook, mainly due to the operating income outperformance, as well as finance income.

Revenues from our China business in the third quarter exceeded our expectations. Again, this was mainly driven by Dungeon&Fighter. We introduced the National Day Update on September 21 and it got off to a strong start. The National Day Update includes navy-themed special dungeons, which are only playable for a limited period of time, as well as avatar package sales which did particularly well.

Third quarter revenues typically increase sequentially from the second quarter due to the summer vacations and update time for the National Day holidays. During the third quarter, ARPPU for Dungeon&Fighter in China increased quarter-over-quarter due to this typical seasonality. Meanwhile, quarter-over-quarter MAUs and paying users were down slightly and flat, respectively. Third quarter MAUs and paying users typically tend to increase quarter-over-quarter seasonally. However, this year, we faced very high comps with the second quarter.

As you may recall, our last quarter's results were driven by a very well-received Labor Day Update and the ninth anniversary update. ARPPUs, MAUs, and paying users are increased year-over-year. In particular, the number of paying users grew significantly. In the third quarter, we also conducted the limited access of MapleStory2 in August and open beta pre-test in September. Although it is still in a test phase, we gradually started monetization and the game is trending well. Again, our Korea business in the third quarter exceeded our outlook due to the strong performance of FIFA Online 3 and the FIFA Online 3 M, as well as the strong start of mobile game AxE, which was launched in Korea in mid-September.

Total PC revenues increased year-over-year, driven by the significant year-over-year growth of FIFA Online 3, which resulted from successful summer vacation promotions and package sales in time for the Korean

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Thanksgiving holiday. This increase was partially offset by the year-over-year decrease in MapleStory due to the comparison with last year's third quarter, which had a large-scale update.

On the mobile side, while we had a large drop on HIT year-over-year, mobile game revenues significantly increased year-over-year, driven by FIFA Online 3 M, as well as Dark Avenger 3 and AxE, both of which were launched during the third quarter.

Our results in North America in the third quarter were below our outlook, mainly due to the sales from LawBreakers being below our expectations. LawBreakers is a unique FPS developed for core users. We

had very high expectations for its launch; however, the timing of its launch turned out to be unfortunate, specifically the blockbuster PC online game PlayerUnknown's Battlegrounds came out right about the same time, making the market environment very tough for first-person shooters in general and for LawBreakers.

Now, turning to our Q4 outlook. For the fourth quarter of 2017, we expect revenues in the range of ¥48.7 billion to ¥52.8 billion, representing 13% to 22% increase year-on-year on a reported basis and 7% to 16% increase year-on-year on a constant currency basis. We expect Nexon Group revenues to increase year-on-year driven by a strong performance in China and Korea, as well as year-on-year increase in North America due to the consolidation of Pixelberry Studios, partially offset by revenue decreases in Japan, Europe and other regions. We expect the operating income to be in the range of ¥12.2 billion to ¥15.4 billion. We expect net income to be in the range of ¥11.3 billion to ¥13.9 billion. In China, no large-scale content updates are planned during Q4 for our key PC online game, Dungeon&Fighter.

In Q4, revenues typically decrease quarter-on-quarter from the seasonally strong Q3. On the other hand, the number of paying users so far in Q4 has remained higher than the same period last year, and the business has been doing positively. Therefore, we expect Dungeon&Fighter revenue to increase year-on-year. In addition, we also expect MapleStory 2 to contribute as a driver for year-on-year growth in China. MapleStory2 will officially launch in Q4 through Tencent.

In Korea, an increase in mobile game revenues is the main driver of year-on-year growth. We expect AxE and Dark Avenger 3, which launched in Q3, as well as OVERHIT, a highly anticipated mobile game scheduled to launch on November 28 to significantly contribute to year-on-year growth. As many of you know, the G-STAR, the largest game exhibition in Korea, will run from November 16 through 19. Nexon will be participating as the main sponsor. We are presenting some of our most exciting titles, including OVERHIT, Moonlight Blade, Battlerite, FIFA Online 4, Need for Speed Edge and Titanfall Online.

In Japan, we expect revenues to decrease year-on-year, primarily due to the deceleration of browser mobile games and PC online games, Tree of Savior. While we do not have major launches in Japan during Q4, we have multiple mobile games slated for launch in 2018.

In North America, we expect revenues to increase year-on-year due to the consolidation of Pixelberry Studios, which will begin in Q4. In Europe and other regions, we expect revenues to decrease year-on-year due to the deterioration of the mobile game HIT in Europe and Asia and decrease in PC online game revenues in Europe.

In Q4, we expect the operating income to be in the range of ¥12.2 billion to ¥15.4 billion, which is an increase of 68% to 112% year-on-year. Favorable factors compared to last year's Q4 on operating

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income are, first, the increase in revenues primarily driven by our high-margin China business and mobile game revenues in Korea. Second, in Q4 last year, we recognized the impairment loss of ¥3.7 billion, which we do not have this year.

These factors will be partially offset by, first, an increase in HR cost due to the head count increases primarily in Korea and an increase in incentive bonuses related to positive business performance; second, an increase in CSR donation; third, an increase in PG fees driven by mobile revenue growth; and lastly, increased marketing cost related to launch promotions for highly anticipated titles such as OVERHIT. So based on these, operating income is expected to increase year-on-year.

Lastly today, we announced a share buyback of up to ¥10 billion. Based on the policy, we announced on February 10 this year, we will conduct a share buyback over the three-month period beginning November 13, 2017. The details of the share buyback program are available on our IR website.

Now, we'll be happy to take your questions.

Maiko Ara
Head of Corporate Development & Investor Relations, NEXON Co., Ltd.

Thank you, Uemura-san. Next, we would like to open up the line to live Q&A.

QUESTION AND ANSWER SECTION

Operator: Today's question-and-answer session will be conducted live over the phone. [Operator Instructions] The first question is Mr. Sugiyama from Goldman Sachs Japan. Please, Mr. Sugiyama.

Masaru Sugiyama
Analyst, Goldman Sachs Japan Co., Ltd.

Q

Thank you very much. I am Sugiyama of Goldman Sachs Japan. I have three questions altogether. First question, you acquired the Pixelberry Studios and I want to know more about the contribution to your PL. So what is the current revenue and what is the schedule of the new titles that will be launched in the future? Do you mind if I go to the second question?

A

I would like you to post one question at a time.

Masaru Sugiyama
Analyst, Goldman Sachs Japan Co., Ltd.

Q

Okay.

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

A

Hi. I would like to answer your question. This is Uemura speaking. Regarding Pixelberry Studios' revenue and profit details, we are not disclosing the details. But as a stand-alone company, it has revenues and sufficient

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profit. And we have to go through the accounting processes through M&A and we haven't gone through the details yet. We agree to go for M&A today. So, in terms of our consolidated P&L impact, we cannot give you the detail today, and I would like to refrain from giving you any numbers. But needless to say, there, our consolidation will be beneficial and have a positive impact on our PL as well as profit.

Masaru Sugiyama
Analyst, Goldman Sachs Japan Co., Ltd.

Q

Now, the next question is in terms of other expenses, do you have impairment loss or any other extraordinary expenses included in other expenses?

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

A

This is Uemura once again. I would like to respond to that question. In Q3, in other expenses, impairment loss is included. And out of the total number, LawBreakers' impairment loss actually account for the majority of that amount. And also, regarding impairment loss for LawBreakers, this is everything, so we will not be accruing any other impairment loss pertaining to LawBreakers in the future.

Masaru Sugiyama
Analyst, Goldman Sachs Japan Co., Ltd.

Q

Third question, from the beginning of 2016, I understand the China Dungeon&Fighter is contributing to the positive growth of your revenues, but as we can see on page 30, you believe that live game is volatile, but it will be flat on all. So, looking at the current situation, do you think your future prospective is changing? Or in terms due to long-term perspective, do you believe that this scenario is as is? So, can you share with us what is your take on the future growth?

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

A

This is Uemura speaking. In terms of the growth strategy image that we have, as you have referred to page 30, this is a very image that we have. The current live games is depicted in green and there are ups and downs. This is PC online business, so there are ups and downs depending on the market environment, but the green portion will increase in volume image wise. So regarding China Dungeon&Fighter, it is growing steadily. And we are conducting very stable operation and taking caution in our day-to-day operation, and that is reflected in the current growth of Dungeon&Fighter in China.

And regarding the existing game titles, we want to enjoy a longevity. So, it is favorable if the green portion increases furthermore, and that is the image that we would like to materialize in the future.

Masaru Sugiyama
Analyst, Goldman Sachs Japan Co., Ltd.

Q

I have a follow-up question. In terms of the paying user increase for Dungeon&Fighter, they are using more active users joining from the rural areas or what do you think is the factor that cause the people to leave the game?

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

A

This is Uemura speaking again. In Q4 of 2015, I think I mentioned this already, and I would like to reiterate what I have mentioned back then. In 2015, for the whole year, we were very happy for the users to stay with us for a

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year and we provided very affordable avatar, and this avatar looks like a snowman. And it really contributed to the growth and that trigger the increase of paying user.

And in 2016, the players learned the joy of being paying users, so the number of paying users grew accordingly. As mentioned by Mr. Sugiyama right now, we have younger people joining us, and we are seeing them immediately becoming paying users. So, MAU is increasing and also paying user is increasing for the players of Dungeon&Fighter. So, we are still in the midst of growth regarding this title.

Masaru Sugiyama
Analyst, Goldman Sachs Japan Co., Ltd.

Q

Thank you very much.

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

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

Q

Great. Good afternoon, guys, and congratulations on a strong [ph] trend (30:08). Just want to – I had a few questions. I was a little bit surprised to hear you guys talk about MapleStory2 in China. I guess my impression has always been that Dungeon&Fighter accounts for kind of 90%-plus of your China revenues, but as you think about MapleStory2, do you actually think this has the potential to kind of be a significant contributor, i.e., more than kind of 10%?

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

A

Hi, Han-Joon. It's Owen. I think it's way too early to tell. We're happy with how things – I think we and Tencent are happy with how things have started, but that's just a start. And as you know, it's only a hit in our view if it's been growing and successful for several years. So, we'll see how it goes from here. We're very happy with how things have started though.

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

Q

Understood, understood. I think MapleStory2 in Korea had a really strong start and then it faded after several months, then I think people just kind of gravitated back to MapleStory1. How is that experience kind of [ph] trained us (31:24) for MapleStory2 in China?

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

A

Great question. We spent an enormous amount of time between the launch of MapleStory 2 in Korea and now really going back to the core, what the game is all about. And if you've ever seen MapleStory 2 or seen any videos of it or played it, you know that there's a lot there. They're sort of the core game experience. And then the game developers really – they put in many, many really interesting game ideas. There is a – you can have a house in the game. You put items in the house. You can have friends over in the house. There's many ways to work together with others to solve these big-boss battles. There's user-generated content. There's all these different creative ideas. And what the team has worked really hard on over the last couple of years since the original Korean launch was to tie those various ideas into the core of the game play and make sure that they're highly relevant to the core of the game play, the leveling experience and how the game is really played. So, we've

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worked very hard and we think that the – that it's very reflective in the game play and in the revised version. That's one of the reasons why we're excited to be launching it around the world.

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

Great. Just a followup on that. I mean, I think we just spoke about Dungeon&Fighter benefiting from young people joining us, join Dungeon&Fighter and immediately contributing. I know it's a fact that MapleStory 2 also is kind of targeting a younger audience within China. So, I guess do you guys kind of see some tailwind where you're seeing a demographic or audience expansion in China related to the young audience or maybe the introduction of more rural audience coming online and then starting to enjoy PC games more? And just maybe if you see any secular backdrop to your China market. I mean, that will be an interesting area to explore.

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

Yeah, it's a great question. I think it's a very, very large market, and there's a lot of different styles of game play, a lot of different taste within the market. I think it's a little tough to answer that question directly. Also, I'd say a lot of games look like they're targeting one style of game play or one demographic on the surface, but they're, in fact, widely liked by a very different demographic. So I think MapleStory1 is a good example of that. We've often said that on the surface it looks like a friendly 2D pixelated side-scrolling game, but under the hood, it's this deep rich MMORPG experience.

And so you see just a very wide variety of players play that game around the world, and it's not unlike how Nintendo games are often perceived. They sort of looked – they look like they're targeting young demographic on the surface, but then you find people of all ages and backgrounds playing the game. So, I think in the China market, it's hard to draw hard lines.

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

Makes sense. Okay, okay. I don't want to hug the queue, but just one last question. So as we get overhead, how do you think AxE manifest? And there's a lot of view that the market [ph] crease (35:06), MMORPG market is a little bit saturated. So do you feel like there's going to be some cannibalization impact or are they kind of run alongside each other a little bit?

Shiro Uemura
Representative Director and Chief Financial Officer, NEXON Co., Ltd.
A

Hi. Yes, Uemura speaking. I'd like to answer your question. Concerning OVERHIT and AxE or HIT, each one of them are different in terms of [ph] genre (35:40) and as for OVERHIT, it's a multi-hero RPG. And originally, HIT is action RPG, and AxE is MMORGP. So, the game [ph] genres (35:58) are different. So, our mobile titles in Korea, whether we will have a cannibalization, we're not so worried about that. But of course, the market is very competitive. So of course, there will be a competition.

AxE, I think, after the launch, we are looking at retention and I think it is up to our expectations. So, good quality content update and daily operation. I think those are very important, so that we can maintain our retention so that this would be the very long-term title.

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

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Understood. Thank you very much.

Operator: The next question is Mr. Yoneshima of Credit Suisse Securities.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

I am Yoneshima from Credit Suisse Securities. Thank you for giving me the chance to ask you a question. I have two questions. But first of all, the question overlies with that of Mr. Sugiyama. Pixelberry's impact is the question. In terms of North American revenues, according to the guidance, there has been an increase of 30% to 60%. And is it correct to understand that mostly the contribution will be from Pixelberry? And what is the acquisition price that you pay for Pixelberry? If you can disclose the number, please do so.

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

A

This is Uemura speaking. Regarding the contribution of Pixelberry to our North American business, year-on-year wise, you see an increase and the majority of that amount will come from Pixelberry. For Pixelberry, it will be accounted for in the middle of the fiscal year. And so, a portion of Pixelberry's revenue will contribute to our revenue.

Regarding the acquisition price, as mentioned before, we signed an agreement today. So, there are still items that we have not finalized. So, based on the accounting practice, we will come to an agreement and reflect the numbers accordingly. Therefore, at this point in time, I cannot give you any figure.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

I have a follow-up question then. Regarding consolidation of Pixelberry, it will happen only from December or are you going to include some portion of November?

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

A

Our policywise, we do not disclose the unconsolidated stand-alone entity's revenue and profit. And if we do, then you can put two and two together to find out what is the number for the stand-alone entity. So, I would like to refrain from answering that question.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

Understood. Thank you. Now, I would like to move on to the second question. EA Sports FIFA Online 4, you have signed the publishing game in and congratulations for that. And within 2018, I believe that you're going to start the service. And you have FIFA Online 3, as well as FIFA Online 3 M already. And do you think there will be some impact of FIFA Online 4? Are you going to run them in parallel or are you going to replace some of the titles?

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

A

This is Uemura speaking again. Regarding FIFA Online 3, as mentioned in our Q2 results, it is trending very favorably and users are really enjoying playing this game. So, based on that situation currently, I do not think that there is any major impact on the title. And I do not think that this momentum will change dramatically. Regarding

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FIFA Online 3 and FIFA Online 4, their positioning, the details have not been announced yet. We moved from FIFA Online 2 to 3. So, similar scenario will most probably be followed. So, I guess it is natural for you to think that there will be a shift from FIFA ONLINE 3. Thank you.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

Last question, and it's a very minor question about Dungeon&Fighter update, and it is on page 16. And in terms of the fourth quarter winter update, last year you did, but this year, it says not applicable. So, I want to know why you decided not to go for winter update.

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

A

Well, regarding Q4, business slows down, generally speaking. And this is the quarter where you do not see any dramatic change. Last Q4 was we had winter update, but this was not major as compared to Lunar New Year or National Day Update. So, this is lightweight update, so to speak.

For our China Dungeon&Fighter, Lunar New Year is the most important season, so we want to be well prepared and have a very solidified user base so that there will be many users to enjoy the game during Lunar New Year. So, Q4 is the period in which business slows down usually. So, we don't have any update. But needless to say, we will have small events and also we'll be conducting small content updates. Therefore, content rise. Please do understand that there is not much of a difference between this Q4 and last Q4.

Keiichi Yoneshima
Analyst, Credit Suisse Securities Japan Ltd.

Q

Thank you.

Operator: Our next question comes from Jay Han from BNP Paribas. Please go ahead.

Jay Han
Analyst, BNP Paribas Securities (Asia) Ltd.

Q

Thanks for taking my questions. I have three questions. First one is, could you share globalization schedule of existing mobile game titles, especially Dark Avenger 3 and AxE?

Second question is, could you share more detail on incentive bonus, how much was the incentive bonus in third quarter? And I think that your 2017 profit will be record high and I presume there would be a more incentive bonus-related cost going forward. So, how much do you think it would impact on our 2018 P&L?

And my last question is DNF PC game. Could you quantify user demographic change of this game title so we have a better sense on young user acquisition? Thank you.

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

A

Yes. This is Uemura speaking. As for your first question, concerning AxE and Dark Avenger 3, right now, we have not yet announced the global launches.

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As for the second question, the incentive bonus. At our company, we have certain target and when the target is achieved, the incentive bonus will be paid. So, naturally, when we have good results like this, the incentive bonus is expected. But when the revenue goes up significantly, there's an incentive bonus. So, it's not just the increase of the cost. So, based upon the increase in revenue, there will be incentive bonus accordingly.

Yes, as to your third question about the Dungeon&Fighter user demographics. The young people are coming in, as I said earlier, but we are not seeing the – I did not want to give you an impression that a lot of young people are coming in. I wanted to say that also young people are coming in and there is a trend that they are becoming paying users. So, we do not see the major change in the user demographics, but we do see some trend of younger users coming in. That's what I meant.

Jay Han
Analyst, BNP Paribas Securities (Asia) Ltd.

Q

Okay. Thank you.

Operator: The next question is Yamamura-san of Nomura Securities. Please.

Junko Yamamura
Analyst, Nomura Securities Co., Ltd.

Q

Thank you very much for your presentation. My name is Yamamura. I have a question pertaining to mobile, there are three. Firstly, about the OVERHIT with

Lineage. When you look at the game type, it started as MMORPG and, based on that, I understand that you are changing the content to make it different from HIT. And so based on the learnings that you have from the previous title, you have come up with OVERHIT, and I want to know what kind of changes you made in the strategy in launching this title? So that's my first question. Moving on to the second question, it is about Durango.

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

A

Yamamura-san, would you please hold so that we can answer your first question? This is Uemura speaking. About the first question, about OVERHIT and HIT. OVERHIT is a multi-hero RPG and HIT is MMORPG and we're using the same name HIT, but genre is different. And as you might remember about HIT, it was ranked number one for sometime in Korea, so this is a very well-known title. And so we use this IP, so we have high expectations toward OVERHIT, and also this is a multi-hero RPG.

We have assortment of heroes. Actually, there are more than 100. So, you collect those heroes, so you can cooperate with other users to proceed with the game. In the Korean market, MMORPG is playing mainstream, but characteristic wise, OVERHIT is quite different. So, we have a high expectation or some extent of expectation toward this title.

Junko Yamamura
Analyst, Nomura Securities Co., Ltd.

Q

Second question is on Durango. You mentioned about the release in 2018, I think. But I was thinking that if time allows, you can actually launch this within this year. Are you trying to work more on it so you need more time or you are thinking how you can monetize on this game? And what kind of paying scheme that you have for Durango? That's my question.

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Shiro Uemura
Representative Director and Chief Financial Officer, NEXON Co., Ltd.
A

This is Uemura speaking again. Now, about Durango, as we have rightfully mentioned, we will be launching it in 2018 instead of 2017. The reason is as follows. We have been talking about Durango for some time and we have a very high expectations toward Durango. Having said that, there are different challenges that we are working on for this game. So, monetization is one of those challenges that we have to overcome. We want to make Durango a success. So aiming at that, we are actually working more on the development, thus the delay in the launch.

Junko Yamamura
Analyst, Nomura Securities Co., Ltd.
Q

Thank you very much

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

Sorry.

Junko Yamamura
Analyst, Nomura Securities Co., Ltd.
Q

And I have a...

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

Sorry, this is Owen. I would just add a couple of things just in background. Just by way of background, and I think we said this before, Durango takes many, many creative risks and is really a groundbreaking title. So, it's very different than a lot of other games. Actually, it's almost wholly unique in the games industry right now, especially on mobile, and it's a big title. It's a fully realized MMORPG world. So, it's going to be very different. So, with that as backdrop, our view is that whatever happens in the near term in terms of timing is, if we're successful with it, it's going to be – whatever happens in the near term is going to be dwarfed by what could happen in one year or two years, or five years or 10 years from now.

We think of these over a very long-term time horizons. So that thinking and that approach goes into the development of a game like Durango that is so different from what's already out there. So, I would just add that as perspective to the comments that Uemura-san made.

Junko Yamamura
Analyst, Nomura Securities Co., Ltd.
Q

Thank you very much. Last question, it's about mobile Korean business. You have AxE and I know that you're putting [indiscernible] (52:49) effort in AxE and Q-on-Q wise, three months contribution will be made. And so, looking at your plan, I thought that it can grow more. Or do you think there are other titles such as FIFA that might impact by each other? So, can you tell me the backdrop of what you have those numbers for AxE?

Shiro Uemura
Representative Director and Chief Financial Officer, NEXON Co., Ltd.
A

This is Uemura speaking. Firstly, we have FIFA Online 3 M in mobile titles. So, in terms of Q3 and Q4, there are seasonality aspects. And so, that is the factor for decrease. And Dark Avenger 3 is decreasing, so that is yet another negative factor. And in terms of FIFA, seasonality is one of the major reasons of this decrease. We have

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new titles such as AxE and OVERHIT, and we hope that it can have a positive contribution and provide some growing momentum to the mobile game business.

Junko Yamamura
Analyst, Nomura Securities Co., Ltd.

Q

Thank you.

Operator: We are getting close to the end of the session, so we are taking one last question from SMBC Nikko Securities. We have Mr. Maeda. Mr. Maeda, please.

Eiji Maeda
Analyst, SMBC Nikko Securities Inc.

Q

Thank you very much. A few questions, if I may. First, Pixelberry acquisition. You mentioned that you have just reached an agreement so you cannot disclose the price, but that's for the hint. Based upon the past acquisitions, is it close to the major acquisitions that you have done so far? Is this something that we can just understand as one of the acquisitions? Could you just give us the hint as to the size of this acquisition?

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

A

This is Owen. We haven't disclosed the size of the acquisition. What we can say is it's smaller than the gloops acquisition that we made several years ago, which was our last large acquisition and – but bigger than the smaller and the very small ones that we've made around Asia in the last couple of years. So, it's pretty significantly bigger than the smaller ones that we made, but it's not as big as gloops, I guess is what we'd say. Beyond that, we have not disclosed anything about the size of the acquisition.

Eiji Maeda
Analyst, SMBC Nikko Securities Inc.

Q

I see. Thank you. Second question. FIFA Online, from two to three transitions, you've mentioned that the same scenario would apply. I just want to clarify in terms of assets, three license fee, is that something that is remaining? And when you transition to four, is it something that you'd might incur sometime in the future as for the license fee?

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

A

Sorry. One minute, please.

Eiji Maeda
Analyst, SMBC Nikko Securities Inc.

Q

This is something about the temporary processing, but I wasn't sure what needs to be processed.

A

Mr. Maeda, could you maybe clarify your question? We could not get the whole question.

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Eiji Maeda
Analyst, SMBC Nikko Securities Inc.

Q

Yes. Concerning FIFA Online 3 to 4, at the time of the transition, you mentioned that transition from 2 to 3 is something that we can apply. So, at the time of transition, the license fee, the asset – remaining asset and at the time of the transition, I think there was some kind of temporary cost or expense incurred at the time of the transition from 2 to 3. So, I'd like to understand what we should expect.

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

A

Yes. This is Uemura speaking. Well, the discussion with the EA or agreement with EA and also the license asset, the current status, I cannot really answer to that question at this moment.

Eiji Maeda
Analyst, SMBC Nikko Securities Inc.

Q

Yes, last question. One point. So this time, you announced a share buyback. You made the resolution and you announced this on the 10th of February so it took you some time. And after that, share price has gone up. So, the number of the shares that you can buy back with ¥10 billion I think it's pure shares. So, in terms of efficiency and timing, maybe you can share with us your policy once again or the way you're thinking?

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

A

Yes. Uemura speaking. On the 10th of February, we made announcement. And as we've said, ¥10 billion buyback for one year. And as for the intention, the return to the shareholder is the concept. Naturally, depending on the share prices, the number of the shares that we can buy back would change. We make sure that we do our work on a daily basis, so that we can improve our corporate value. So, higher share price is something is favorable to us.

In terms of timing for share buyback, there are several requirements that need to be satisfied. For example, we cannot do it when we have an insider information and we would like to make sure that we have a good commitment and we make sure that we deliver. That is the return to the shareholders. So, we believe that now it is possible.

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

A

This is Owen. I would just one more comment to that. I think just by way of context, remember, over the last couple of quarters, our performance has exceeded our guidance a few quarters in a row. So, we have been very positive on our business as we've told you for the last couple of years, but it's exceeded even our expectations. So that's clearly been seen by the outside world as well.

Eiji Maeda
Analyst, SMBC Nikko Securities Inc.

Q

Thank you very much.

Operator: This concludes the question-and-answer session. At this time, I'd like to turn the conference back over to you for any additional or closing remarks.

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Maiko Ara

Head of Corporate Development & Investor Relations, NEXON Co., Ltd.

Thank you. If there are no further questions, I would like to take this opportunity to thank you for your participation in this call. Please feel free to contact the Nexon IR team at investors@nexon.co.jp should you have any further questions. We appreciate your interest in Nexon and look forward to meeting you whether it is here in Tokyo or in your corner of the world.

Operator: Thank you. That concludes today's conference. Thank you for your participation. You may now disconnect.

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