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Ben Lu *J. & W. Seligman & Co. - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Nexon's Fourth Quarter Earnings Results Call. After management's remarks to you, we will open the call up for questions.

(Operator Instructions)

With that, I would like to turn the call over to Fumiaki Yamato for introductory remarks. Thank you. Please go ahead.

Fumiaki Yamato - *Nexon - General Manager - Corporate Planning*

Hello, everyone, and welcome to Nexon's Fourth Quarter and the Full Year 2012 Financial Results Q&A conference call. With me today are Seungwoo Choi, CEO and President of Nexon, and Owen Mahoney, CFO.

Before we get started, I like to remind you that today's call will contain forward-looking statements, including statements about our results of operations and the financial conditions, such as revenues attributable to our key titles; growth prospects, including with respect to the online games industry; our ability to compete effectively, adapt to technologies, and address new technical challenges; use of intellectual property, and the other statements that are not historical facts. These statements represent our predictions and expectations as to future events, which we believe are reasonable or based on the 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 release. We assume no obligation to revise or update any forward-looking statements. Our financial results for the fourth quarter, as well as our quarterly letter to shareholders from Seungwoo and Owen, are available on the Company's Investor Relations website at ir.nexon.co.jp. A replay of this Q&A session will be available on the website following this call.

I'd now like to turn the call over to Seungwoo and Owen for a brief introduction, and then we will begin the Q&A.

Seungwoo Choi - *Nexon - CEO, President*

Thank you, Mr. Yamato. Welcome, everyone. Before we take your questions, I'd like to provide a few comments on our fourth quarter and 2012 results and objectives as we head into 2013. As we exit our first full year as a public company, we are pleased to report another year of double-digit revenue and operating income growth.

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Fiscal year 2012 revenues were JPY108.4 billion, an increase of 24% over 2011. Consolidated operating income was JPY47.8 billion, an increase of 25% year-over-year, and we generated JPY42 billion in cash from operations. Our solid cash position and strong cash flow enable us to invest in areas that will continue to build on our position as a global leader in free-to-play games.

2012 was a year of transformation for Nexon. We diversified our business model with the acquisitions of two mobile game developers, inBlue and gloops, positioning us as the leading third-party mobile game developer in the world. Mobile, in fact, now constitutes about a quarter of our total business. Since we acquired these companies, they have both grown and performed above our expectations, and each is set to deliver a strong 2013 lineup, totaling more than 15 games for both domestic and international markets. Our new alliance with DeNA will accelerate our ability to take advantage of the tremendous opportunity within the global mobile games market. DeNA will provide top-tier marketing support for our games to drive user acquisition and retention.

We strengthened our PC online game business during 2012 by adding several strong publishing agreements to our roster, including FIFA Online 3 and Dota 2.

We started 2013 off with the launch of FIFA Online 3 on January 17, and the game appears to be making a strong start. The second half of this year, we will launch Dota 2 in Korea and Japan in partnership with Valve Corporation. The game is displaying strong results in territories it has launched - already at 236,000 MCCUs.

Also, after reviewing the quality of the games in our pipeline, we decided to push the launches of Warface into Q2, and Counter-Strike Online 2 into the second half of this year to help ensure these games get a stronger start.

Throughout 2013, we expect the bulk of the revenue and growth in our PC business will continue to come from Korea and China. We have a robust update schedule planned for 2013, including Tier 1 updates for several of our top titles. This year, our Tier 1 updates will also be spread more evenly between the first quarter and the third quarter than they were in 2012.

Overall, we're very excited about 2013 and beyond. The market for games continues to shift our way towards online, multi-player, and free-to-play. We're especially well positioned to capitalize on these trends on both PC and mobile platforms as we move into 2013.

With that, let me ask Owen to provide some additional detail on our results and outlook.

Owen Mahoney - *Nexon - CFO*

Thanks, Seungwoo. First I'd like to provide a little more detail on our financials for the quarter, and then I'll discuss our outlook. We reported Q4 revenues of JPY30.9 billion, an increase of 39% versus a year ago.

Excluding gloops, revenues in Q4 were JPY24.4 billion, up 10% versus a year ago. Revenues exceeded the high end of our outlook as Korean and China both performed better than we'd expected, and were further boosted by the weakening Japanese yen.

Our gloops business continued to perform well in Q4 with revenues of JPY6.4 billion, primarily driven by Three Kingdoms Guild Battle, which was introduced early last year and is still showing strong momentum 8 months later, atypical of a mobile game. Guardian Break and Biohazard Clan Master also contributed to revenue in Q4.

Operating income was JPY9.7 billion in Q4, an increase of 5% year-over-year, and also ahead of our outlook. Our operating income margin decreased from 42% to 32% year-over-year, primarily due to four factors. First, the addition of significant new mobile revenues, which are at lower margins. Second, our geographical mix shift, as the increase in Japan mobile revenues caused our higher margin China business to decrease as a percentage of the total revenue. Third, higher marketing expenses tied to new product launches. And fourth, amortization expenses from our gloops acquisition.

Our net income for the quarter was well below our outlook, primarily due to write down of our JC Entertainment investment triggered by market valuation, and higher than expected tax expenses due to a new interpretation of a Korean tax regulation by the Korean Tax Authorities.

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Total MAUs in Q4 were 68.3 million, a decline from a year ago, which was driven primarily by two components. 3 million of the MAU decline was from MapleStory Adventures, a Facebook game that we no longer support. In China, Dungeon&Fighter and Counter-Strike Online both experienced declines in MAUs during Q4, possibly related to the increased popularity of Tencent's League of Legends.

Importantly, the decline in MAUs was more than offset by ARPPUs and pay rates, both of which increased year-over-year. ARPPUs were JPY1,683, up from JPY1,350 a year ago, and pay rate was 10.5%, up from 9.9% a year ago.

Turning to our outlook, as many of you know, our business and the environment in which we operate are very dynamic. As a result, in 2012 it was necessary to make several revisions to our annual guidance. In an effort to provide our shareholders with more precise information, starting with our Q1 outlook today, we plan to provide our outlook for the coming quarter, rather than the full year ahead. We will, of course, continue to provide detail on the longer-term trends in the business, as well as updates on our product pipeline through our quarterly shareholder letter, on these Q&A calls, and through other investor communications.

With that, for Q1 we expect to see revenues in the range of JPY28.5 billion to JPY30.3 billion driven by Tier 1 content updates around the Q1 holidays in Asia, and the launch of FIFA Online 3. As Seungwoo noted, this year our Tier 1 updates will be more evenly spread between Q1 and Q3.

As a reminder, we are faced with very tough comps in Q1 in both China and Korea. In China, we expect revenues in Q1 to be roughly flat versus a year ago, supported by Tier 1 updates to Dungeon&Fighter and Counter-Strike Online around the Lunar New Year.

We are currently forecasting MAUs to be modestly down in China in 2013, but we believe the updates for our existing games this year will resonate with our users, and will drive engagement and monetization.

In Korea in Q1, we still expect a modest increase in revenues year-over-year despite the tough comp. During the quarter, our games will mostly be supported through smaller updates, and events around the Lunar new year. We expect growth in Q1 to be driven by FIFA Online 3 and Dungeon&Fighter, and to a lesser extent, Sudden Attack.

Lastly, for North America and Europe, we are expecting minimal growth from both of these regions, as we continue to focus on improving our execution and operations in these territories.

For our mobile business, which includes gloops and inBlue, we expect revenues in the range of JPY7.4 billion to JPY8.1 billion, primarily driven by strong marketing programs on the Mobage platform through our new alliance with DeNA.

We expect to launch more than 15 new games this year, and are forecasting mobile revenues to build throughout the year.

For the first quarter, we expect operating margins to be in the range of 34% to 37%. Over the coming quarters, we expect the range to trend towards 30% to 35%. This decline in operating margins relative to last year's average is the result of shifts in our revenue composition in 2012, attributable to three factors.

First, our mix has shifted from nearly all PC to approximately 25% mobile, and operating margins in the mobile business are about 20% to 25%, inherently lower than our traditional PC margins of 40% to 45%, largely because of platform fees. Second, the major licensing deals we have recently established, principally FIFA Online 3 and Dota 2, have lower margin profiles than internally developed games due to royalty costs, although the returns from an ROI perspective have the potential to be much higher.

Third, our geographic mix is shifting as Japan revenue becomes a larger percentage of total revenue from mobile business, decreasing China's relative percentage. As a reminder, our China revenue generally has higher margins due to our licensing arrangements there. Finally, higher marketing expenses tied to new product launches through the year.

We provide a more detailed look at the contribution of each of these components in our shareholder letter and our investor presentation, which can be found on our IR website.

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With that, we'd like to open up the Q&A session. Some of you have sent us questions, so we'll start by going down that list, and then we'll open it up to live Q&A after that. Let's begin with the first question. Yamato-san, why don't you start with the first question, please.

QUESTIONS AND ANSWERS

Fumiaki Yamato - *Nexon - General Manager - Corporate Planning*

First question is, when do you think Korean revenue will turn positive year-over-year?

Owen Mahoney - *Nexon - CFO*

Okay, this is Owen. We expect a modest increase in revenue, as we said in the letter and the investor presentation. Overall for FY13, we expect to return to growth for Korea, and we think that starts in Q1. Next question, please.

Fumiaki Yamato - *Nexon - General Manager - Corporate Planning*

Second question is, please comment on the dividend. Do you have any updates on dividends?

Owen Mahoney - *Nexon - CFO*

As a management team, we always review the dividend policy on a regular basis, and consider how best to allocate our cash resources. At this point, we have no updates, but we will certainly communicate if and when we do have an update. Next question, please.

Fumiaki Yamato - *Nexon - General Manager - Corporate Planning*

Third question is, you mentioned that you expect operating income to decrease in Q1 2013. Can you give us the analysis behind that by regions? Assuming that China is constant, and the gloops doesn't go negative, I understand that to mean either the business in Korea will decrease dramatically, or marketing costs will increase. Is that correct?

Owen Mahoney - *Nexon - CFO*

I would answer this question as follows. If you think about our operating income in Q1 2012, it came out to JPY17 billion. If you think about a scenario this quarter where our Chinese business is roughly flat, maybe slightly up, slightly down, and gloops adds a little bit, you think about roughly a JPY4 billion difference between last year and this year in operating income. In very rough numbers, the difference is, in terms of additional spend, somewhere between a JPY1.5 billion and JPY2 billion in marketing for the launch of new products.

As we said, we're in a very heavy launch mode over the course of this quarter and the next few quarters, so that adds up to somewhere between JPY1.5 billion and JPY2 billion. We've got amortization of intangibles associated with the gloops acquisition for a little under JPY1 billion. And then because we're launching new products, we're going to have people and servers, and support staff for those new products. So, that's the difference. Next question, please.

Fumiaki Yamato - *Nexon - General Manager - Corporate Planning*

Fourth question, please give us background on decline of MAUs in China.

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Owen Mahoney - *Nexon - CFO*

Sure, so, clarifying the MAU decline, we provide an average for the quarter. In China, October was down year-over-year, but November and December were progressively higher. That means up sequentially, month-over-month. And in January, going into Q1, we've already had an uptick following the launch of Tier 1 updates for Dungeon&Fighter.

But by way of background on a year-over-year basis, 3 million MAUs of the user decline was from our U.S. Facebook business, as we've shifted our focus to mobile social games and off of Facebook. So, that's 3 million of the MAUs.

The rest was largely from China, and the China decline came from our two largest titles, Dungeon&Fighter and Counter-Strike. There are a few things to keep in mind when looking at this number. First of all, typically when you have MAUs decline, the first users to go are non-monetizing users. So, you'll see a progression of ARPPUs and pay rates typically go up. Our MAUs did decline year-over-year, and we think that's a function of content update schedules, as well as potentially, competition.

That is to say, if you're not doing a major Tier 1 content update, you'll tend to lose MAUs, and there won't be a major step-up in terms of revenue. When you do good updates, and they resonate well with an audience, MAUs and revenues tend to respond.

Now, we launched a Q1 update for Dungeon&Fighter in 2013, and the early returns are good, and our guidance for -- outlook for the 2013 Q1 period reflects those returns. And keep in mind, last year all of our China content updates were in Q1, and we had a phenomenal quarter, making this Q1 a tough comp, especially given our updates are spread evenly, or more evenly, between Q1 and Q3.

But finally, and most importantly I'd say, the MAUs by themselves, as we've said before, in isolation are not helpful by themselves. You have to look at pay rates and ARPPUs, and as I mentioned before, both pay rates and ARPPUs were up during the quarter. Overall, of course, we're watching the MAUs very closely. We've obviously been watching them as a hawk in Q1, and as I mentioned, we like what we're seeing in the beginning of Q1. But, we'll continue to watch it closely. Next question, please.

Fumiaki Yamato - *Nexon - General Manager - Corporate Planning*

Fifth question is, please comment on incremental costs you are planning for Q1.

Owen Mahoney - *Nexon - CFO*

Sure, so we talked about this a little bit before, but compared to a year ago, we have additional marketing costs because we are launching major new products. A year ago, we were not launching new products into the market, and as we were in Q4 and then into Q1, and at various points throughout this coming year -- or this year in 2013, we expect to have additional costs, in Q1 especially, related to FIFA.

Additionally, we have amortization expenses related to the gloops acquisition, and we have platform fees related to mobile games.

More questions sent in? No, okay. So, with that we would like to open up to questions that we did not cover, that were not sent in ahead. Operator, could you open up the call for any additional questions?

Operator

Thank you. Ladies and gentlemen, we will now begin the question and answer session. (Operator Instructions). Your first question comes from Ben Lu from Seligman. Please ask your question.

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Ben Lu - *J. & W. Seligman & Co. - Analyst*

Hi, good morning, guys. Good morning, Owen. I know you gave an update on the Korea sales. You guys are targeting year-over-year growth for this year. Can you give an update on what you are expecting for China sales for this year, given that there's a couple of big launches coming out with Blade and Soul, as well as Call of Duty?

Owen Mahoney - *Nexon - CFO*

You mean after Q1?

Ben Lu - *J. & W. Seligman & Co. - Analyst*

For the rest of the year. I think earlier you said that revenues for Korea will increase slightly in Q1, and that for 2013, it will show year-over-year growth. So, I wanted to see if you can comment a little bit about what your outlook for China for the rest of the year.

Owen Mahoney - *Nexon - CFO*

Yes, it's at this point, we're not getting any more specific than that. I'd say if we're talking about competition, the one that we're watching the most closely is League of Legends, right now. We'll see how the others go. But, for now we're really focused on -- that's the extent that we're thinking about competition. But for Q1, it looks like things -- obviously, our viewpoint on this is reflected in our outlook, and we've got a little bit of the beginning of the quarter in data to look at, to inform our opinion on this, and it's feeling like -- it's feeling reasonably good.

Ben Lu - *J. & W. Seligman & Co. - Analyst*

So, you think League of Legends, the impact has peaked in China, so far, and you're not worried about Call of Duty, or Blade and Soul?

Owen Mahoney - *Nexon - CFO*

Well, I'll tell you, it's hard to tell on those other two titles. There hasn't been as much information about Call of Duty. We still feel like they're a little bit away. Blade and Soul, we're expecting to come out, the issue of course with Blade and Soul for now is it's a subscription game. So, we'll see what happens when they come out. It's too early to tell.

Ben Lu - *J. & W. Seligman & Co. - Analyst*

Got it. And then can you give an update really on the Korea side of the business, both on some of the new regulations -- or regulatory proposals that are coming out in Korea under the new administration, and also if you can give an update on NCsoft partnership? I know you guys had highlighted some of that in the Tokyo meeting with some of the engineers, but if you can elaborate a little bit on that that would be great. Thanks.

Owen Mahoney - *Nexon - CFO*

Sure, thanks. So, I'll take the NC question first. We don't have an update at this point relative to the NC relationship. As we talked about before, we have a -- we're working with them for some upcoming products that we put under the NC banner, but we don't have any additional commercial deals to announce related to that.

Relative to the regulatory situation, yes, there was some noise over the course of the last quarter. It seems to have died down a little bit. We'll see where it goes from here. We've got some new leadership in place. So, from there we don't have any more information.

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Ben Lu - *J. & W. Seligman & Co. - Analyst*

One thing on NCsoft, Owen, I think you acquired them for JPY54 billion or JPY55 billion. I think their market value now is noticeably below that. I know you did some write downs this past quarter. Do you have to do anything with NCsoft?

Owen Mahoney - *Nexon - CFO*

At this point, not, but we're watching it very closely, and we describe this in some detail in our letter, and so I would certainly refer you to that. It's possible, which is why we certainly called it out in the shareholder letter.

Ben Lu - *J. & W. Seligman & Co. - Analyst*

Understood. Thank you.

Owen Mahoney - *Nexon - CFO*

Yes, thank you. Next question, please.

Operator

(Operator Instructions). All right, as there are no further questions at this time, I would now like to hand the call back to today's presenters. Please continue. Thank you.

Owen Mahoney - *Nexon - CFO*

Alright. Well, we thank everybody for your time today, and we look forward to seeing some of you coming up, and we look forward to talking to you again next quarter. Thanks very much for your time.

Seungwoo Choi - *Nexon - CEO, President*

Thank you very much.

Operator

Thank you. Ladies and gentlemen that does conclude our conference for today. Thank you for participating. You may all disconnect.

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