NEXON Co., Ltd.

Q2 2019 Earnings Prepared Remarks

Aug 8, 2019

Owen Mahoney, ***Representative Director, President and Chief Executive Officer, NEXON Co., Ltd.***
Thank you all very much for joining us today.

Before we get into the 2nd quarter results, I'd like to open by thanking the Nexon employees around the world for their incredible dedication and focus amid the media reports about the potential sale by our founder of his stake in the company. Our teams stayed firmly focused on delivering great experiences for our customers. The solid results in Q2 are certainly evidence of their hard work.

As you know the management team cannot speak for any of our shareholders, but at this point, as the external noise has now settled down, Nexon can focus on its work and is in the middle of an ambitious agenda to transform its business, which I will describe more in a minute.

First, let's recap our Q2 results.
Nexon delivered another great quarter, marking the highest Q2 revenues in our history, and recorded strong double-digit year-over-year growth in key territories. Both PC and mobile business grew year-over-year. Our key franchises such as *Dungeon&Fighter, MapleStory* and *FIFA ONLINE 4* all showed strong performance.

In June, *Dungeon&Fighter* celebrated its 11th anniversary in China. As we discussed last quarter, we expected *Dungeon&Fighter* to face a tough comparison this quarter given that Q2 last year was the best 2nd quarter since the service began in the region. Despite the high bar, Q2 local-currency basis gross revenue came in just slightly lower than that in 2018, and within our expected range.

As you will hear from Uemura-san, we expect that Q3 revenues will be down YoY from Q3 2018. Two important points to remember about *Dungeon&Fighter* when interpreting our results and our guidance:

The first is to reiterate that 2018 was an extraordinary year for growth of *Dungeon&Fighter* China, so the hurdle in 2019 is very high.

Second, through our history we've seen near-term ebbs and flows in the performance of our biggest online franchises, even though the long-term trend remained robustly positive. Certainly this has been the history of *Dungeon&Fighter*. And we have seen the same pattern in other long-lived franchises as well, such as *MapleStory* over its 16 years. *MapleStory* experienced YoY decline at several points in its history, while today it is bigger than ever, and its recent performance has been extraordinary.

KartRider is another example of dramatic year over year revenue growth after a previous period of decline. Properly managed for the long term, this is the nature of major online franchises.

While we are very dedicated to the performance of each content update, our primary focus is on the long-term health of the game. And in that regard we remain very confident. Our team at Neople and our partners at Tencent are hard at work to deliver even greater experiences for our customers.

Dungeon&Fighter is one of the most successful game franchises of all time, anywhere in the world, and we believe its long-term position is solid.

Now, on to *MapleStory,* which continues to amaze. In Q2, Korea *MapleStory* celebrated its 16th anniversary and had another fantastic quarter, growing 15% year-over-year. This was on top of 61% year-over-year growth the year before.

MapleStory M – the mobile version of *MapleStory* – which is in its 3rd service year in Korea, also grew 43% year-over-year. This marks another milestone for both *MapleStory* and *MapleStory M* growing double-digit or more for their 6th consecutive quarter.

We launched the Japan service of *MapleStory M* in April, and its performance so far has exceeded our expectations. And the global service that started in July 2018 has continued to be very steady.

Q2 was also a strong quarter for *FIFA ONLINE 4* in Korea. Combined PC and mobile revenues increased significantly year-over-year, exceeding our expectations. Revenues were even higher than the level of the original *FIFA Online 3* in Q2 2017, just prior to the service transition last year from *FIFA Online 3* to *FIFA ONLINE 4*. The franchise is in great shape.

It was also another great quarter for Nexon's 15-year-old casual racing game *KartRider*, which had a significant resurgence last quarter. The strength continued, and its Q2 revenue in Korea doubled year-over-year.

Speaking of *KartRider,* the mobile version of *KartRider* in China, called *KartRider Rush Plus,* has showed outstanding performance. While the game started small after its launch back in 2013, it has surged in recent weeks due to a major update, which provided a deeper, more PC-like experience. We have been working with a local publisher TianCity since the launch, and TianCity has appointed Tencent as a joint operator for the updated build in order to leverage Tencent's know-how and reach in the Chinese market.

KartRider on PC in China has over 340 million life-to-date registered users, and we're very excited about its potential on mobile, especially after seeing the success of the recent update.

We think this is another great proof point for our thesis that mobile devices can now support much deeper, PC-like experiences, and this creates great opportunity for Nexon. Our development teams will do much more along this thesis in coming quarters.

More broadly, the performance of *MapleStory*, *FIFA*, and *KartRider* in recent quarters demonstrate an idea we have stressed many times: that good live operations can make a game grow over very long time-frames, even though such games may fluctuate in the short term. While this pattern can be difficult to discern in any given quarter, it is extremely important for the long-term success of our business, as it enables us to feed investments into a new generation of growth.

That leads us to the topic of the recent announcement of our acquisition of Embark Studios. Following the strategic investment in November 2018, over the last month we have brought Embark into the Nexon family.

In July we acquired an additional 32.8% of the outstanding shares of the studio, raising total ownership to 66.1%. Three days ago, we announced that we will acquire an additional 6.9% stake as well as have the option to fully purchase the remaining stake in the studio over the next five years.

This additional transaction is expected to be ratified at the Nexon extraordinary shareholder meeting scheduled in late September. Details of the transaction are available on our IR website.

With this combination, Embark's leadership will be the centerpiece of our game development in the West.

Embark is less than a year old, but it is not a new team. They are in fact one of the most successful development teams in the games industry, responsible for building some of the biggest hits on console and PC. This is a major addition to Nexon's global game development capability.

Embark's team has a consistent track record of making hits in the West. Nexon has a consistent track record of making online games grow for many years on end. We think this combination is very powerful. Over the last few months we observed Embark making incredible progress on its games under development over a very short period of time. We also realized the two companies' visions are even more closely aligned, and that the creative synergies are even greater than we originally planned. So we jointly decided to combine the companies sooner rather than later, in order to lean into the creative synergies we had already been experiencing.

The number of people playing fully-online games in the West is exploding. Our purpose is to develop AAA-level games that match Westerners' tastes, and then grow them over many years.

Meantime, on the publishing side, we recently streamlined our Western publishing organization, by integrating the PC, console and mobile businesses into one unit and location. Our belief is that as platforms converge, so should our operational approach to these different platforms, and therefore our teams. Previously, Nexon America was responsible for PC and console publishing and Nexon M was responsible for mobile publishing in the West. We've now merged these functions into a single location at Nexon America.

We made a similar change in our Korean organization and merged our operations team that supports mobile with the team that supports PC.

As in the West, we think that in the near future, deeply multiplayer game experiences – where Nexon focuses -- will not differ much between platforms, whether the platform is mobile, PC, console, or cloud-based. So operationally we need to combine our teams.

I'd like to close by briefly talking about where the industry and Nexon are headed.

The coming 1-3 years will be ones of massive change for the business of online games. The advance of Moore's law has put staggering computing and networking power into the pockets of billions of people around the world. Each of these devices is a portal into a virtual world. This means that the market for deeply immersive online games -- the kinds of games that Nexon specializes in -- is exploding, and is several orders of magnitude bigger than it was even a few years ago, when immersive online games required a PC.

Building and maintaining these games is difficult, but the rewards for doing it well have gotten substantially bigger than even a few years ago.

Meantime, new technologies like AI and cloud computing enable whole new game experiences that couldn't exist before.

We think these developments spell great news for Nexon, so we are working to seize the opportunity.

We are thrilled about our acquisition of Embark, not just for the games they are building and the technology they have developed, but for the talent they bring.
We have been re-tooling operations to reflect the convergence of mobile, PC, and console.

Our development teams are leveraging our substantial IP bench, and will be making more announcements soon about games based on Nexon's key IP.

And we are sharpening our focus and our resources around key franchises that are likely to deliver the highest returns to our shareholders.

We are leaning in heavily to this future, going to where the market is going and leveraging both our substantial capabilities in online games as well as new technology to build experiences that have not existed before.

We look forward to making more announcements about future actions based on these themes in coming quarters.

With that, I will turn the call over to Uemura-san to discuss the Q2 results and Q3 outlook.

Shiro Uemura, ***Representative Director and Chief Financial Officer, NEXON Co., Ltd.***
Now, let's move on to the Q2 results.

Q2 revenues were 53.9 Bn yen, up 13% year-over-year on an as-reported basis and up 20% year-over-year on a constant currency basis – in the range of our outlook.

Revenues from China were below our outlook due to FX headwinds from the appreciation of the Japanese yen during the 2nd quarter. Revenues from Europe and Others were also below our outlook, while, in Japan, revenues were in the range of our outlook, and revenues from Korea and North America business exceeded our expectations. Net, group revenues in Q2 were in the range of our outlook.
Applying our Q2 outlook basis FX rates, revenues came in at the high-end of our outlook.

By platform, both PC and mobile revenues were in the range of our outlook.

Operating income was 13.0 Bn yen.
We recorded a total 3.6 Bn yen impairment loss primarily on right-of-use assets related to the adoption of IFRS 16 Leases, which we baked into our Q2 outlook, as well as on prepaid royalties. Meanwhile, costs were lower-than-planned benefiting from the appreciation of the Japanese yen against the Korean Won during the quarter. As a result, operating income was in the range of our outlook.

Net income was 19.1 Bn yen, which exceeded our outlook due to a 5.9 Bn yen FX gain mainly on our U.S. dollar-denominated cash deposits related to the depreciation of the Korean Won against the U.S. dollar during Q2.

As I explained earlier, revenues from our China business were below our outlook due to the appreciation of the Japanese Yen against the Chinese Yuan during Q2. Applying our Q2 outlook basis FX rates, revenues were in the range of our outlook.

China *Dungeon&Fighter*'s local-currency basis revenues were in the range of our outlook.

As-reported basis revenues decreased year-over-year due to a decrease in *Dungeon&Fighter* revenue as well as an unfavorable FX impact. However, constant-currency revenues were just modestly lower even compared to the high base set in Q2 2018.

For *Dungeon&Fighter* in Q2, we introduced the Labor Day update from April 23rd until June 6th, which was associated with avatar package sales. We also introduced the 11th Anniversary update on June 18th, which included a content update and in-game events.

Revenues and ARPPU decreased quarter-over-quarter due to typical seasonality, while MAUs and paying users increased sequentially.

MAUs increased year-over-year. ARPPU also increased year-over-year driven by higher sales from the Labor Day package sales compared to a year ago.
Meanwhile, paying users decreased year-over-year mainly due to the high comps with last year's Q2 when the number of paying users was high driven by the strength in small item sales for seasonal events.

Paying users decreased while ARPPU increased, resulting in *Dungeon&Fighter*'s local-currency basis revenue decreasing slightly year-over-year.

Revenues from Korea in Q2 exceeded our expectations primarily driven by the stronger-than-expected performances of *FIFA ONLINE 4* and *FIFA ONLINE 4M*. The strength was driven by the successful introduction of players with new ratings, package sales, and promotions.
As a result, both PC and mobile revenues in Korea exceeded our outlook.

FIFA ONLINE 4's PC and mobile combined revenues increased significantly compared to last Q2 when it received an adverse impact from the service transition, and they were even higher than *FIFA Online 3*'s revenues in Q2 2017 before the service transition.

By platform, PC revenues increased year-over-year, driven by increases in *FIFA ONLINE 4*, *MapleStory*, and *KartRider*.

Mobile revenues increased year-over-year. While revenues from *OVERHIT* and *AxE* decreased year-over-year, we benefited from the increase in *FIFA ONLINE 4M* and contributions from *TRAHA*, which began service on April 18th, and *Lyn* launched in Q1.

Revenues for both PC and mobile grew year-over-year, resulting in a year-over-year increase in our Korea business for Q2.

Revenues from our Japan business in Q2 were in the range of our outlook.
Revenues increased year-over-year, driven by contributions from *MapleStory M*, which launched on April 10th, and *MapleStory 2,* which launched on June 5th, as well as *Dynasty Warriors: Unleashed*, *FAITH*, and *DarkAvenger X*, all of which began service in or after 2H 2018. These were partially offset by decreases in *OVERHIT* and mobile browser games.

Revenues from North America in Q2 exceeded our outlook, primarily driven by stronger-than-expected contributions from *OVERHIT*, which launched on May 30th.
While *Choices* decreased year-over-year, revenues were up driven by contributions from *OVERHIT* as well as *Darkness Rises, MapleStory M* and *AxE*, all of which began service in or after Q2 2018.

Revenues from Europe and Others in Q2 were below our outlook due to lower-than-expected contribution from *OVERHIT*.
Revenues increased year-over-year, primarily driven by contributions from *MapleStory M*, Taiwan's service of *Moonlight Blade*, and *AxE*, which all began service in or after Q3 2018, as well as *OVERHIT,* which began service on May 30th as in the case of North America.

Now turning to our Q3 2019 outlook.

In Q3 2019, we expect the Chinese Yuan, Korean Won, and U.S. Dollar – major currencies in our business – to depreciate against the Japanese yen as in the case of Q2 2019 and negatively impact the as-reported basis performances.

For Q3 2019, we expect revenues in the range of 51.6 to 56.0 Bn yen, representing a 26% to 19% decrease year-over-year on an as-reported basis and a 21% to 14% decrease year-over-year on a constant currency basis.

We expect our operating income to be in the range of 20.6 to 24.4 Bn yen, representing a 13% decrease to 3% increase year-over-year on an as-reported basis and a 8% decrease to 9% increase year-over-year on a constant currency basis. I'll discuss the details of this shortly.

We expect the net income to be in the range of 21.8 to 25.0 Bn yen, representing a 2% decrease to 12% increase year-over-year on an as-reported basis and a 3% to 18% increase year-over-year on a constant currency basis.

In China, while we expect to benefit from *KartRider Rush Plus*, which has been performing well since the introduction of a major update on July 2nd, we expect this to be more than offset by the decrease in revenue for our key PC online game, *Dungeon&Fighter*. Overall, we expect revenues from our China business to be in the range of 20.9 to 23.3 Bn yen, representing a 33% to 25% decrease year-over-year on an as-reported basis and a 29% to 21% decrease year-over-year on a constant currency basis.

Since the introduction of the major update, *KartRider Rush Plus* has been jointly operated by TianCity – its publisher in China – and Tencent. While this is our in-house title, its contribution to our financials is limited compared with that of a typical PC online game in China as it is a jointly operated title as well as due to the payment of mobile platform fees.

As for *Dungeon&Fighter*, we introduced the Summer update on July 4. As in every year, we are also scheduled to introduce the National Day update in September.

Benefiting from the positive impact of the successful 10th anniversary update in June, Q3 2018 was off to a strong start, which also led to strong sale of the National Day package sales.

Meanwhile, we were unable to obtain the benefit we had hoped for in the 11th Anniversary in June this year, which was an important update in terms of activating user numbers. In addition, we could not achieve the result we had expected from the Summer update which began in July. As a result, MAUs, paying users, and ARPPU for July this year were all lower than those of July last year.

Reflecting these factors, we expect both paying users and ARPPU to decrease year-over-year as well as sales from the National Day update to be lower than those of Q3 of last year. As a result, we expect *Dungeon&Fighter*'s revenue to decrease year-over-year.

We plan to take some measures to improve the user metrics by leveraging our know-how of online game operations.

KPIs including the revenue of an online game fluctuate depending on the types and nature of content updates and benefits those bring in accordance with its long-term plan designed to last for years.

While we expect Q3 revenues to decrease year-over-year, we will continue to operate the game stably over the long-term – our core online game operation policy.

In Korea, we expect an increase in *FIFA ONLINE 4*'s revenue versus last Q3, when it was negatively impacted by the service transition. On the other hand, we expect revenue from *MapleStory* to decrease due to the extraordinary high comps in last Q3 when it marked the record-high quarterly revenue with a year-over-year growth of 129% driven by the largest content update since the service began in the region.
As a result, we expect PC revenues in Korea to decrease year-over-year.

We expect our mobile revenues in Korea to increase year-over-year. While we expect *KAISER*, *OVERHIT,* and *AxE* to decrease year-over-year, we expect *FIFA ONLINE 4M* to increase year-over-year, as well as benefits from *TRAHA* and *Lyn*.

Overall, we expect the decrease in PC revenues to be larger than the increase in mobile revenues.
As a result, we expect revenues from our Korea business to be in the range of 20.3 to 21.3 Bn yen, representing a 12% to 8% decrease year-over-year on an as-reported basis and a 5% to 1% decrease year-over-year on a constant currency basis.

In Japan, we expect revenues to be in the range of 3.1 to 3.4 Bn yen, representing a 13% to 4% decrease year-over-year on an as-reported basis and a 10% to 2% decrease year-over-year on a constant currency basis. While we expect to benefit from *MapleStory M, MapleStory 2,* and *FAITH* as well as *ArkResona*, which is scheduled to launch on August 14, we expect these to be more than offset by decreases in *OVERHIT, Dynasty Warriors: Unleashed* and mobile browser games.

In North America, we expect *Choices* as well as *MapleStory M* and *Darkness Rises*, both of which just started their services last Q3 to decrease year-over-year. As a result, we expect revenues in North America to be in the range of 3.3 to 3.6 Bn yen, representing a 32% to 26% decrease year-over-year on an as-reported basis and a 29% to 24% decrease year-over-year on a constant currency basis.

In Europe and Other regions, we expect revenues to be in the range of 4.0 to 4.4 Bn yen, representing a 39% to 33% decrease year-over-year on an as-reported basis and a 36% to 29% decrease year-over-year on a constant currency basis. While we expect to benefit from *OVERHIT*, *Moonlight Blade,* and *AxE*, we expect these to be more than offset by the revenue decreases in *Choices* as well as *MapleStory M* and *Darkness Rises*, both of which just started their services last Q3, as in the case of North America.

In Q3 2019, we expect the operating income to be in the range of 20.6 to 24.4 Bn yen, representing a year-over-year decrease of 13% to increase of 3%.

A negative factor compared with Q3 2018 regarding the operating income is the revenue decrease, including the high-margin China business.

Favorable factors compared with Q3 2018 regarding the operating income are:

First, decreased marketing costs, compared with Q3 2018, when we had promotions for new titles including global services of *MapleStory M* and *Darkness Rises*.

Second, decreased variable costs. We expect increased royalty costs in relation to the increased contributions from publishing titles such as *FIFA ONLINE 4* and *TRAHA* while we expect decreased PG fees due to the decrease in our mobile revenues.

Third, increased Other Income. On July 1st, we acquired additional shares of Embark Studios and turned it into a consolidated subsidiary. The amount of gain on the step acquisition under Other Income is currently under examination, however, we have reflected an expected gain of 4.7 Bn yen in our Q3 outlook.

Lastly, a decreased impairment loss of 7.3 Bn yen recorded in Q3 2018, which will not be repeated in 2019.

The high end of the range reflects the fact that we expect the impact of positive drivers to be larger than that of negative drivers, resulting in a year-over-year operating income increase.

Next, I'd like to explain the impact of the consolidation of Embark Studios on our consolidated financial statements.

We expect additional costs of approximately 0.5 Bn yen, including HR costs to our quarterly P&L, as well as a 4.7 Bn yen gain on the step acquisition, as I explained earlier.

We are currently reviewing the amount of goodwill and intangible assets to be booked and are scheduled to disclose these in or after the Q3 earnings. Therefore, we have not included an additional amortization cost related to these in our Q3 guidance.

The impact on our consolidated financial statements in relation to the consolidation of Embark Studios is tentative and subject to change.

Lastly, I would like to give you an update on the shareholder return.

Today, the board of directors approved the policy to initiate a new share repurchase program with the maximum amount of 30 billion yen in a 6-month period beginning on August 9th, 2019.

Details of each specific share repurchase will be announced separately upon board resolution. Please note that this is an announcement on new policy, thus, as of today, nothing specific has been decided as to share repurchase.

We plan to continue to maintain financial flexibility to be able to invest in future growth. We will also continue to place importance on the shareholder return, including share buybacks in addition to creating shareholder value by growing our business.