

NEXON Co., Ltd.

Q4 2019 Earnings Prepared Remarks

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

Thank you all for joining Nexon's FY 2019 4th quarter earnings presentation today. Thank you also to those of you who are joining us remotely through the live broadcast.

Before we get to our results, I'd like to spend a minute talking to you about the evolution of the interactive entertainment business, and Nexon's strategy within that landscape. I will then follow up with a brief recap on our performances in Q4 and FY 2019, our plan for growth in 2020, as well as our exciting game pipeline. I will conclude by briefly touching on our approach to shareholder returns.

So let's start by talking about the industry today. We think it's helpful to think of the videogames industry in four quadrants:

- Offline vs online
- Deep game experiences vs casual game experiences

Thinking about the last 25 years of the games business, we started mostly in the upper left quadrant. That's the realm of deep offline single-player games, primarily on consoles and on PC. There are many great games and franchises in that area, but Nexon has never really played in that space.

Then the internet enabled the right-hand side of the graph in the mid-nineties, when Nexon and some other companies in Korea and then China invented online games and free-to-play. Then about 12 years ago Facebook and smartphones really unlocked the lower half of the graphic, and made it a big business. This is the realm of casual games.

Nexon's core strength is in the upper right hand quadrant. That is, deeply immersive online games. We sometimes call them virtual worlds because you have a very immersive experience with thousands of other connected players at the same time. And even though they may look simple on the surface, they are designed to be experienced as almost a second life.

From a business perspective, the key thing to know about this is that in the past, these types of games were only available on the PC platform. Starting about 24 months ago, we have seen the iPhone 10 and equivalent mobile platforms become powerful enough to act like a PC. What that means is that rather than having a total addressable market of a few hundred million gamer PCs, our TAM is now literally several billion people who have full workstation functionality in their pockets. That's an increase of roughly 10x in the Total Addressable Market, and of course, the mobile unit number is rising very rapidly.

This represents massive opportunity for Nexon. Our core competency is the upper right. And it's in the upper right that also has the best growth going forward, and the fewest number of competitors who can make and grow these types of immersive games. Games I'll show you later in this preso are all in the upper right of the quadrant.

So this is where we see opportunity and this is where our focus lies.

With that as a backdrop, I'll briefly review our performances in Q4 and FY 2019, before talking about our future.

Group revenues in Q4 came in ahead of our expectations, driven by the phenomenal strength in the Korea region. Our major franchises, especially *MapleStory* and *FIFA ONLINE 4*, performed exceptionally well, and *V4* is off to a great start. Our Q4 performance in Korea marked our highest Q4 revenue ever.

On an as-reported basis revenues and operating income for the full-year 2019 were down year-over-year due to FX headwinds, while net income was up versus a year ago. On a constant currency basis, full-year 2019 revenues, operating income and net income all grew year-over-year. The growth was again, primarily driven by Korea, demonstrating the strength of our major franchises in that market.

MapleStory in Korea continues to amaze. The game marked another revenue record in 2019, surpassing the previous record set in 2018. On a constant currency basis, Q4 *MapleStory*, on the PC grew 88% year-over-year, and the mobile version of *MapleStory* grew 114%. On a full-year basis, constant- currency revenues grew 39% and 65% respectively. This was on top of an already-strong 2018, where PC and mobile *MapleStory* year-over-year growth was 67% and 81%, respectively. PC and mobile *MapleStory* each recorded double-digit growth for the 6th and 3rd consecutive years, respectively.

As a reminder, *MapleStory* PC originally launched in 2003, and *MapleStoryM* launched in 2016. As you can see from these graphs, they have been incredible performers over time – this is what we mean by Forever Franchises.

FIFA ONLINE 4 also recorded the highest Q4 and full-year revenue, growing significantly year-over-year, surpassing the previous peak of *FIFA ONLINE 3* that we achieved in 2017.

Now on to China *Dungeon&Fighter*. Q4 revenue decreased year-over-year, but came in slightly above our expectation. Full-year revenue also declined year-over-year due to its soft performance in the second half of 2019 when we faced challenges following the June update that did not resonate as well with our players as we had hoped.

During the earnings call last quarter, we said that we expected things to be challenging for a few quarters, and we still expect that to be the case. Over the course of Q4, we conducted multiple in-game events and dropped small-scale updates, in addition to the National Day update which continued from Q3. Most recently, we introduced the Lunar New Year update on January 14th. So far, we have not experienced a notable pick-up and the sales from this year's Lunar New Year update is expected to decline substantially from 2019's strong performance.

We think the next important event for *Dungeon&Fighter* comes later in first half 2020, when we launch the new update that addresses the primary feedback that we have received from our players. In December, our operating team at Neople announced to our players in China that this key update will become available in China in March. The update includes the level cap release and the third awakening which allows players to gain new skills for their characters.

This update went live last month in Korea, and Korea performance has historically been a good indicator of how things will be received in China. The reviews by our players in Korea have been good with better key performance indicators after the introduction of the update.

We have a number of other projects underway for *Dungeon&Fighter* PC, and are very focused on bringing improvements to our player base that will drive further growth.

Now, onto the mobile version of *Dungeon&Fighter*. We've made some great progress since our last call. In December, together with our partner Tencent, we began the 2nd closed beta test for *Dungeon&Fighter* 2D Mobile in China. We are happy with the encouraging results we observed during the test, and went on to start pre-registration for the game later that month. As of today, more than 16 million people have signed up and are waiting for the game's launch in the first half of 2020.

We are extremely excited to deliver the deep immersive multiplayer online world of *Dungeon&Fighter* to many more people in the region on the mobile platform, and we think mobile represents a massive increase in the Total Addressable Market for the game.

Meantime, we launched *V4* in November. It's early, but so far, we're satisfied with its performance, especially given its competition in the Korean market.

At this point I'd like to pause, and place Nexon's key IP in the context of other great media franchises around the world, so you get a sense of scale and future potential. Several of Nexon's franchises have been played by hundreds of millions of players around the world, and generate revenue that is both recurring and growing over time.

First, let's look at *MapleStory*, a 16-year strong franchise, which has amassed more than 180 million registered players worldwide. It's so deeply woven into the culture that player registrations now equal 45 percent of the total number of people in Korea. In terms of revenue, *MapleStory* PC and mobile total is about equal to global box office of the movie franchise *Frozen*, which is one of Disney's biggest. In terms of total players, Life-to-Date user registrations of *MapleStory* PC are larger than Life-to-Date unit sales of one of the greatest game franchise ever, the *Final Fantasy* series on PC and console. So, *MapleStory* is in very good company.

Next is *KartRider* – Nexon's fully-online multiplayer racing game originally introduced in 2004. Now this might not be fully on the radar of the people who follow games closely in Japan and the US, but more than half of the Korean population and over 45% of the Taiwanese population has played this game. Life-to-date, registered users of *KartRider* total more than 380 million people worldwide. For a sense of scale, that is over 100 million more people than *Mario Kart*, which is clearly the gold standard of the genre and one of the great games of the whole industry. We have enormous respect for Nintendo and the craftsmanship they put into *Mario Kart*. And acknowledging that the free-to-play business model is quite different, we think that the reach of these two game IP is very important.

One of the points about entertainment IP is that the fact that you've had many hundreds of millions of people experience the IP's game world for many hours creates a very large and receptive audience to new version or extensions for that IP. So, reach of the IP really does matter if you can make use of it.

And that's exactly what we're doing. In 2020, we will release an all new *KartRider*. Unlike the previous version which was only on PC, the new version will be on multiple platforms, all over the world. We think this is a massive opportunity for Nexon's customers as well its shareholders.

And last but not least is *Dungeon&Fighter*. We launched this fully-online action RPG in 2005, and since then it has garnered a massive fan base that exceeds 700 million registered users globally. By comparison, this is more than 2 times more than *Fortnite* across all platforms in 2019. Life-to-date, *Dungeon&Fighter* has grossed well more than 10 billion US dollars – that is several billion dollars more than the life-to-date receipts for both the *Star Wars* and *Harry Potter* series, and roughly double the revenue of the entire *Avengers* series. And remember *Dungeon&Fighter* is still only on PC, and PC installed base is a small percentage of total game players. You can see why we are so excited to bring this franchise to mobile platforms, which have an installed base of, by our estimates, at least 10 times that of PC, and growing very quickly.

In 2019, Nexon went through a major transition. Our management team spent a lot of time re-setting the strategic pillars of our global business. We believe these will result in better games, a more robust business, and strong returns for our shareholders. The 4 core tenets:

- First, focusing on a portfolio of fewer, but bigger, fully-online multiplayer games and virtual worlds.
- Second, enabling these virtual worlds to be played across multiple hardware platforms: PC, console, and mobile.
- Third, leveraging our substantial IP portfolio to generate long-lasting games with significant recurring revenue.
- Fourth, as appropriate, placing bets on new IP that we think are really special. Our acquisition of Embark is an example of this.

In 2020, you'll start to see us roll out products that are based on these focus themes.

So now I'd like to show you three big beats we have planned for 2020.

First is *Dungeon&Fighter 2D Mobile* – the mobile version of one of the biggest game franchises in the world. I mentioned this before, but our development team has been working hard to make sure that this fully-online multiplayer action game will work well across the China mobile Internet. We recently had a terrific beta. Today I am showing you some of the game scenes from the most recent closed beta test.

Next is *KartRider: Drift* – the next generation *KartRider*, the PC franchise which has been played by more than half of the Korean population. 3 things to know about this new version, *KartRider Drift*:

- When it launches it will not just be PC, but consoles and other platforms as well.
- It's built from the bottom-up to be fully online. That means it has a lot of features online game players love and have not seen in either casual or hard-core racing games.
- It's free to play

No other game has this set of features. We just completed our first round of closed beta testing and we plan to introduce it in 2020 to players around the world on multiple platforms.

And later this year we will be talking a lot more about the new game from Embark. It's a multiplayer coop action game, and we think it is really exciting. Embark's team is truly extraordinary from both a creative and a technology perspective, and we think what they are working on will change online games in the West.

Now, let me put the strategic priorities I talked about earlier as well as our 2020 game pipeline in the context of our drivers of growth and shareholder value going forward.

Nexon has a great foundation that consists of a world-class portfolio of franchises that are as big or bigger than the very best movie and game franchises in the world. While these game franchise revenues can fluctuate during their long life cycle, our extensive experience has shown again and again that franchise revenues can continue to grow over decades, despite near term fluctuations. This is a key point to understand about our business and that of companies like us.

Nexon is well positioned to lead the next wave of online games as platform providers invest heavily into the games business and build a much bigger addressable market for us. I talked about mobile before, but it's also true about advances in console and cloud-based technology from newer entrants such as Google and Amazon. All of these platform providers are spending billions to bring high-end game platforms to consumer mass markets, way beyond previous business which was largely focused on PC. Because of all this we see big opportunities to get our online games and virtual worlds in the hands of at least 10 times as many players as they were previously, and will be aggressive on leaning into these opportunities. The 3 big game beats of 2020 – *Dungeon&Fighter 2D Mobile*, *KartRider: Drift*, and Embark's game – are just the beginning.

Lastly, I'd like to briefly touch on our cash allocation and shareholder return in FY 2019 since we get asked about this a lot and the board and I review it frequently.

In 2019, Nexon group generated operating cash flow of 105.1 billion yen. Our working capital was 10.3 billion yen.

We made equity investments in Embark Studios as well as Wonder Holdings, which totaled 38.4 billion yen. These two companies make games that are firmly in the upper right of the quadrants I talked earlier, meaning they're about deeply immersive online games.

Additionally, we returned 30 billion yen to our shareholders in the form of share buyback. After those expenditures we kept the surplus of 26.4 billion yen.

We will continually re-examine the best use of our cash flow and the flexibility we need to grow Nexon's global business. However, we think that 2019 represents an allocation that is good for our shareholders, with a good balance of shareholder return and investments.

With that, I'll now hand it over to Uemura-san to discuss the Q4 results and Q1 2020 outlook.

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

Now, let's move on to FY 2019 results.

FY 2019 revenues were 248.5 Bn yen, down 2% year-over-year on an as-reported basis.

On a constant currency basis, full-year revenues were up by 4% year-over-year.

FY 2019 operating income was 94.5 Bn yen, down 4% year-over-year on an as-reported basis and up 3% year-over-year on a constant currency basis.

FY 2019 net income was 115.7 Bn yen, up 7% year-over-year on an as-reported basis, and up 16% year-over-year on a constant currency basis.

Continuing on to the Q4 results.

For additional details, please see the Q4 2019 Investor Presentation included in the handouts.

Revenues were 49.2 Bn yen, up 7% year-over-year on an as-reported basis, and up 14% year-over-year on a constant currency basis, which exceeded our outlook primarily driven by the strong performances of *MapleStory* and *FIFA ONLINE 4* in Korea. In addition, revenues from the new mobile MMORPG *V4* which launched in November as well as *Dungeon&Fighter* in China slightly exceeded our expectations.

On a platform basis, both PC and mobile revenues exceeded our outlook.

Operating income was 4.5 Bn yen, which was below our outlook. While Q4 revenues exceeded our outlook, this was more than offset by a 9.2 billion yen impairment loss primarily on assets related to Pixelberry, including goodwill.

Total expenses of other cost items were roughly in line with our expectations.

Net income was 3.3 Bn yen, which was below our outlook.

While we recognized a 11.0 billion yen deferred tax assets related to foreign tax credit at Neople, our consolidated subsidiary, this was more than offset by operating income underperformance and a 11.4 billion yen FX loss primarily on U.S. dollar-denominated cash deposits.

Based on the Korean tax rules, Neople enjoyed a five-year tax exemption period beginning in 2015, when it relocated to Jeju island. During this time, however, Neople paid the withholding taxes on their foreign income, including royalty income related to China *Dungeon&Fighter*.

While withholding taxes are subject to foreign tax credit, these credits had been carried forward since Neople had a tax exemption.

Beginning in 2020, Neople will, again, pay corporate taxes but at half of the Korean statutory rate. However, it will be able to apply its federal foreign tax credits, which it has carried forward over the last 5 years.

Based on an estimated tax amount, we have forecasted the foreign tax credit that can be applied in 2020, and booked an 11.0 billion yen deferred tax asset at the end of 2019.

Revenues from our China business exceeded our outlook as *Dungeon&Fighter's* revenue slightly exceeded our expectation.

As for *Dungeon&Fighter*, we do not expect to experience a notable improvement before we launch the new key update in March. While its Q4 revenue came in above our expectation, it was essentially as planned.

In Q3, we introduced the National Day update, which included limited-time-offer dungeons, as well as avatar package sales, and continued until November 28th.

Following the National Day update, we conducted multiple in-game events and small-scale updates, aiming to recover the user metrics including active users and paying users. As a result of these, Q4 paying users increased slightly on a sequential basis, however, they remained well below the year ago level. As we have not experienced a notable change from Q3, Q4 paying users decreased year-over-year.

Both ARPPU and revenue decreased sequentially due to seasonality. Year-over-year, revenue decreased while ARPPU increased, primarily due to a decrease in light users compared to a year ago.

MAUs decreased both quarter-over-quarter and year-over-year, primarily due to the reduced number of bots since the implementation of a stricter measure to verify player identity was made in October.

Revenues from our Korea business in Q4 exceeded our outlook, primarily driven by stronger-than-expected performances of *MapleStory* and *FIFA ONLINE 4*. New mobile MMORPG *V4* and *MapleStory M* also exceeded our expectations.

As a part of our key themes, we're leveraging our substantial IP portfolio and strengthening our best-in-class live operations capabilities. Accordingly we are placing more resources on *MapleStory*. Q4's performance certainly reflects our efforts.

MapleStory's Q4 revenue exceeded our expectation driven by strong item sales in the latter half of the quarter supported by well-received seasonal in-game events and the Winter update which began in mid-December.

User metrics including MAUs, paying users and ARPPU increased year-over-year. Revenue grew 73% on an as-reported basis or 88% on a constant currency basis, surpassing the previous record Q4 revenue which we achieved in 2018.

Its mobile version, *MapleStory M*, also delivered a strong quarter. Together with PC, it recorded the highest Q4 revenue growing 97% on an as-reported basis or 114% on a constant currency basis year-over-year. We have experienced great synergies between the PC and mobile platforms.

FIFA ONLINE 4's revenues also exceeded our expectations driven by the strong sales in the latter half of the quarter, which was supported by the successful introduction of legendary players, seasonal events and sales promotions.

Q4 user metrics including MAUs, paying users and ARPPU increased year-over-year. Combined PC and mobile revenues grew significantly year-over-year compared with Q4 2018 when its revenue had reached approximately the level of *FIFA ONLINE 3* in Q4 2017, prior to the service transition.

We launched our new mobile MMORPG *V4* on November 7th and it is off to a great start. Despite the intense competition in this genre, as well as the big launch from a competitor during the quarter, *V4* has been extremely stable and its December revenue exceeded our expectation.

As a results of all these, both the PC and mobile business grew year-over-year, resulting in a year-over-year increase in our Korea business.

Revenues from our Japan business in Q4 were slightly below our outlook, primarily due to the lower-than-expected performances of mobile games including *MapleStory M*.

On a year-over-year basis, while we benefitted from *MapleStory M* and *MapleStory 2*, both of which launched in Q2 2019, these were more than offset by decreases in *Dynasty Warriors: Unleashed* and *FAITH*, which launched in 2018, as well as the lower contribution from browser-based mobile games. As a part of our growth strategy to focus on games closer to our value and expertise, we disposed of gloops' browser business, which completed on December 1st. Consequently, their browser revenue contributed a month less in this year's Q4.

While revenues from North America in Q4 decreased year-over-year, the performance was better than we had expected driven by *Choices*.

The year-over-year decline was primarily attributable to *Choices*, as well as *Darkness Rises* and *MapleStory M*, both due to tough comparisons with last Q4 when the services just began in the region.

While revenues from Europe and Others in Q4 decreased year-over-year, the performance was better than we had expected driven by *MapleStory M* and *Spiritwish* global service which launched on October 30th.

Revenues decreased year-over-year. While we benefitted from *Spiritwish* and *AxE*, these were more than offset by deceleration of *MapleStory M* and *Darkness Rises*, both due to tough comparisons with Q4 2018 when the services began in the region, as well as the decrease in *Choices*.

Now turning to our Q1 2020 outlook.

In the quarter, we expect the Chinese Yuan and Korean Won, both major currencies in our business, to depreciate against the Japanese yen and, therefore, to negatively impact the as-reported basis performance of our results.

For Q1 2020, we expect revenues in the range of 74.0 to 80.7 Bn yen, representing a 20% to 13% decrease year-over-year on an as-reported basis and a 18% to 10% decrease year-over-year on a constant currency basis.

While we expect revenue from our Korea business to increase, we anticipate revenues from the other regions outside of Korea to decrease and overall revenues to decrease year-over-year.

We expect our operating income to be in the range of 36.0 to 42.1 Bn yen, representing a 32% to 20% decrease year-over-year on an as-reported basis and a 29% to 17% decrease year-over-year on a constant currency basis. I'll discuss the details of this shortly.

We expect net income to be in the range of 31.7 to 36.6 Bn yen, representing a 41% to 31% decrease year-over-year on an as-reported basis and a 38% to 29% decrease year-over-year on a constant currency basis.

Turning to China, while we expect to benefit from *KartRider Rush Plus*, we anticipate this to be more than offset by the decrease in revenue of our key PC online game, *Dungeon&Fighter*. Overall, we expect revenues from our China business to be in the range of 33.5 to 37.6 Bn yen, representing a 42% to 35% decrease year-over-year on an as-reported basis and a 40% to 32% decrease year-over-year on a constant currency basis.

As for *Dungeon&Fighter*, we introduced the Lunar New Year update on January 14th, which includes limited-time-offer dungeons as well as avatar package sales.

As we explained earlier, we do not expect to experience a notable lift in *Dungeon&Fighter* performance before the key update, which includes the level cap release and many more components, releases in March.

We expect a decline in sales, including sales from the Lunar New Year package sales compared to Q1 2019 when the number of paying users were at a high level and the sales from the Lunar New Year update were strong. Accordingly, we expect *Dungeon&Fighter's* revenue to decrease year-over-year.

In Korea, which has historically been a good indicator of how things will be received in China, the key update including the Level Cap release and the 3rd awakening, which allows players to gain new skills for their characters, went live in January, ahead of the launch in China. We experienced certain improvements in user metrics including returning users and paying users. So far, we're happy about the reviews we have received from our players in the region.

We will share the early results of the outcome of the update in China on our next earnings call.

Turning to our Korea business. For *MapleStory* in Q1, the Winter update continued from December to the end of January. The Winter update, which included the introduction of new classes and jobs as well as avatar package offerings, was well-received by users. Moreover, we had strong sales from the Lunar New Year sales promotion. Accordingly, we expect *MapleStory's* revenue to increase significantly on top of the 69% year-over-year growth we achieved in Q1 2019.

We expect *FIFA ONLINE 4* to grow year-over-year in Q1 as the game continues its positive momentum from Q4 2019. The performance will primarily be driven by the strong sales from the Lunar New Year package offerings.

We expect our mobile revenues in Korea to increase year-over-year. We expect the growth to be driven by *V4, Counterside* – our new mobile title that launched on February 4th, as well as increases in *MapleStory M* and *FIFA ONLINE 4 M*.

We anticipate both PC and mobile revenue to each grow year-over-year. Overall, we anticipate revenues from our Korea business to be in the range of 32.3 to 34.0 Bn yen, representing a 44% to 52% increase year-over-year on an as-reported basis and a 51% to 59% increase year-over-year on a constant currency basis.

In Japan, we expect contributions from *MapleStory M* to be more than offset by decrease in revenues from the browser-based mobile games due to the disposition of GLOOPS' business.

We also expect decreases in *FAITH, Dynasty Warriors: Unleashed* and *OVERHIT*, which all started their services in 2018. As a result, we expect revenues in the range of 1.6 to 1.7 Bn yen, representing a 58% to 55% decrease year-over-year on an as-reported basis and a 57% to 54% decrease year-over-year on a constant currency basis.

In North America, we expect revenues in the range of 2.5 to 2.7 Bn yen, representing a 40% to 35% decrease year-over-year on an as-reported basis or on a constant currency basis, primarily due to decreases in *Choices*, *Darkness Rises* and *AxE*.

In Europe and Other regions, we expect revenues to be in the range of 4.2 to 4.7 Bn yen, representing an 18% to 10% decrease year-over-year on an as-reported basis and a 16% to 8% decrease year-over-year on a constant currency basis. While we expect to benefit from *World of Dragon Nest*, which launched in Southeast Asia on January 8th, we expect this to be more than offset by decreases in *AxE*, *Choices* and *Darkness Rises*.

In Q1 2020, we expect the operating income to be in the range of 36.0 to 42.1 Bn yen, representing a year-over-year decrease of 32% to 20%.

The primary driver for the lower operating income in Q1 2020 is the year-over-year revenue decrease.

Other unfavorable factors include greater HR costs due to an annual salary increase as well as higher variable costs, including PG fees associated with the revenue growth in Korea and royalty costs in relation to the increase in contributions from publishing titles.

Favorable factors compared to Q1 2019 regarding the operating income include:

One, decreased marketing costs. We expect promotion costs for *Choices* to decrease, and marketing costs to decrease compared to Q1 2019 when we launched multiple new games.

Two, a decreased impairment loss of 2.9 Bn yen recorded in Q1 2019, which will not be repeated in Q1 2020.

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

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

First, on the share buyback. Last September, we initiated the share repurchase program of 30 billion yen and conducted share buyback through September 10th, 2019 to January 29th, 2020 up to the full amount. Furthermore, today, the Board of Directors approved the plan to cancel the shares we bought back on February 28th.

Additionally, today, the Board of Directors approved a change to our dividend policy. We had suspended the dividend since the year end of FY2016 to retain the flexibility to continue our growth investments in our global operations. As a result of our reevaluation, we have made the plan to reinstate a shareholder dividend of 2.5 yen per share to shareholders registered on our shareholder register as of December 31st, 2019.

We plan to pay the same dividend per share at the interim and year end of FY 2020.

We will remain disciplined in delivering shareholder value by growing our business globally, as well as returning capital to shareholders through dividends and share buybacks.