

NetDragon (0777.HK) 2022 Interim Results Conference Call and Webcast

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NetDragon's Management Team

Dr. Simon Leung, Group Vice Chairman and Executive Director

Mr. Ben Yam, Group CFO

Mr. Vin Riera, CEO of Promethean

Mr. Lin Chen, Group Senior Vice President

Moderator:

Dear friends. Good morning. Thank you for joining us in NetDragon Websoft Holdings Limited 2022 interim results presentation.

Our presentation PPT will be broadcasted on the live-streaming platform. The PPT is also available for download in on our company website at www.nd.com.cn in the Investor Relations Earnings Call and Webcast.

Before the start of our presentation, please allow me to introduce the management who are joining us today.

Dr. Simon Leung, Group Vice Chairman and Executive Director.

Mr. Ben Yam, Group CFO.

Mr. Lin Chen, Group Senior VP.

Mr. Vin Riera, CEO of Promethean.

Now let's pass our time to Dr. Simon Leung to host the presentation today.

Simon Leung:

Okay, good morning, good afternoon to some of you. Hello everyone. We had the same cast of character about six months ago. We're here talking to you about our business again. So let me first, very quickly give you a highlight of what happened in the past six months, and then we'll go into some financials. Vin and Lin Chen will talk about their own businesses. I'm going to come back and talk about two areas. One is on the metaverse. I was on CNBC earlier this morning, a lot of conversations around the metaverse. I'm happy to take some questions and I certainly will talk a little bit more about it and especially our AI CEO Tang Yu is actually getting quite a bit of attention. So, and then I'll talk briefly about our business for the second half of the year. So very quickly, actually if you look at our results, it actually is good result, I mean, is actually revenue growth, profit growth. But we need to kind of look underneath the blanket a little bit if you will. So it's still very encouraging, but we do have some challenges that we need to manage. Nothing very specific to our company, it's more about

the macroeconomic situation. Let me touch on each of the different businesses and then I'll have the rest of the team going into the details. I could not ask for more on the education business, and that's why Vin has this big smile on his face. So 71% growth year over year, which is something very impressive. I mean, this business has been growing in double digits for the last six years, but (a growth of) 71% is actually very impressive. Gaming, we declined a little bit just like we are in line with the challenges that everybody is facing. Not only companies in China, but around the world, actually is the macro economic headwind, again we'll talk a little bit about it. For the last six months we did do a lot around the metaverse, including building the platform, investing, launch a game. So we will talk in more detail later on. Last but not least is actually our continual commitment to return equity back into our shareholders. So, Ben will talk very specifically about what we are doing is actually, we're going to do another special interim dividend on top of our interim dividend. So, with that, I'm going to turn it over to our CFO, Ben, and he's going to take you through the details of the numbers.

Ben Yam:

Okay. Thank you, Simon. Okay. I'm going to first go over our financial performance for the first half, and then I'll give you all an update on the implementation of our capital return measures. Right. So let's dive into the financial statement. Okay. First of all, top line growth overall was 26%, which was actually one of the highest top line growth we've seen in recent years. As Simon mentioned, our education business delivered record growth in the first half. And that growth is actually a 71% year over year on the back of a fast growing market and also strong execution that led to expansion of our market share.

And on the gaming side, our revenue decreased by 3.9%, which is largely a result of the macro impact in China. And Lin Chen is going to talk about that and break it all down for you. And now on the expense side, you can see that all of the SG&A items all went down, as a percentage of the revenue as we continued to manage our cost effectively. In terms of the bottom line, our net profit increased by over 30% year over year. And then on the non-GAAP basis, which we feel is a much better reflection of our true operating performance, you can see that all of the line items are increasing in double digits, including EBITDA, operating profit as well as net profit. Okay.

So, let's talk about the segmental financial statements. Okay. First on the education business, to go along with our strong top line growth, we also saw over 40% increase in gross profit. You can see that there's a little bit of decrease in the gross margin and Vin is actually going to talk about that later on. And then in terms of the core segmental loss, you can see that we actually reduced substantially to 36 million (RMB) in the first half as a result of operating leverage, as we continued to implement very effective cost control measures. And now on the gaming side, very quick, we continue to invest in R&D to grow our pipeline, and also to enhance our existing games, as R&D expense increased by 9.5%. And in terms of the other line items in OPEX, you can see that we continue to look for opportunities to streamline our operations and as a result you can see that we can see a reduction in selling and marketing as well as the administrative expenses. And then overall in terms of the bottom line, our core segmental profit for gaming maintained at over 1 billion (RMB) in the first half.

Okay. The next section is going to be on the capital return measures. Okay. So first of all, as we have noted in previous earnings calls, we are committed to providing capital returns to our shareholders through a combination

of share buyback and also dividends. So up to now, we have completed 38 million US dollars of share buyback since we announced the 300 million US dollars share buyback program about one year ago. And this year in January, we actually paused our share buyback in order to comply with the listing rules because we cannot do any buyback if we process material insider information. So to fulfill our commitment in lieu of the buyback, which we were not able to perform for the most part of the first half, we have declared a special dividend of 50 cents (HKD) per share on top of kind of a regular interim dividend of 40 cents (HKD). We also want to highlight that we continue to maintain a very strong net cash balance of 4 billion Hong Kong dollars which will enable us to continue to invest and also capitalize on future strategic opportunities.

Okay. And the final slide of this session is a chart where we just want to highlight our track record of kind of giving back to our shareholders through a combination of share buyback, recurring dividends, and also special dividends. As you can see, through the past few years, we continued to consistently increase our cash return to shareholders through all the three measures. And especially in the last couple of years, we have really stepped up our efforts as we already declared special dividends twice within this year and going forward, we're going to continue to deliver on our capital return commitment. So with that, I will pass the stage to Vin to talk about our education business, Vin.

Vin Riera:

Great. Thanks Ben. My name is Vin Riera, I'm the CEO of Promethean and I will talk about the education business. Next slide please.

First half of the year was very strong for our business. We looked at three main metrics. We looked at our overall revenue growth, our volume growth and where we are from a market share perspective. From revenue growth perspective, it was great. First half on a half of half basis, we are up by 42.1% on a year on year basis, we're up by 74.3%. Volume growth was very strong as well; we grew faster than the market. If you look at the market growth in the first half of the year, it was 23.9%. We grew 47.3%. On a year over year basis, we increased from 71.5% to 82.3%. It's important to note that in the first half of the year, we did not have any large tenders, any country tenders. So that's the growth that we're seeing on a global basis throughout all the major markets. And then from a market share perspective, in the second half of 2021, we finished a 21.9% market share; in the first half of 2022, we finished at 26% market share. Next slide, please.

I talked a lot about the importance of being number one globally. It's important for our brand. It's important for our product focus to make sure that we're delivering products that our customers want, and our partners want to sell. And what I'm very pleased is that we remained number one in our top five markets. We're number one in the US. We're number one in the UK, Germany, France and Italy. What's important to point out on the slide is in each one of these regions, they had different mix of products. They had different funding streams, they had different resellers and distributors that we worked with. These really speak to our global presence and our excellence in understanding what's needed in the classrooms around the world. Next slide.

We're continually looking at execution. We did see our ASP dropped 4.5% from the first half on a half on half basis, that ASP reduction comes from two areas. The first was that we reduced some costs. We reduced the price on AP7 to do a sell down before our launch of AP9. I'm going to talk about the launch very shortly. And

then we also had some depreciation of the Euro versus the dollar. The material costs on a per panel basis continued to decrease, component pricing continues to declining. We were able to take advantage of that. We saw 1.6% decrease on a half on half basis, and then freight cost really peaked out in Q3 of 2021. We've seen a consistent decrease there. And we also managed that extremely closely metric that we look at weekly and monthly and we're down 16.7% on a half on half basis. I'm pleased to report that our gross margin excluding tariff is up 1.3 ppts, so it goes from 28.6% in the second half of 2021 to 29.9% in the first half of 2022. Next slide.

All right. I'm thrilled to announce the release of our V9 ActivPanel. This is our first new product that we've launched in the market in the last three years. I'm even more pleased to talk about how successful V7 was and how we maintained and took market share with a product that was in the market for three years, it speaks to how we build our products and how we look at the future state and what we need today, but also what we need in the future. There's five elements that were critically important in this release. It's connectivity, longevity, adaptability, simplicity, and security. I'm going to talk a little bit about each of these to give you a sense of what the focus was. So the first major improvement is in connectivity. Our customers expect all their devices to operate well together and intuitively when directly connected or networked together. Our ActiveSync innovation addresses this need by allowing a more seamless integration between ActivPanel 9 and a connected device like a teacher laptop or OPS. This allows content to be more easily shared between devices. With ActivPanel 9, we've also upgraded the network, Bluetooth and charging capabilities to be best in class. Our customers need longevity, as technologies in the hardware and software space continue to advance, schools need the confidence that their investments are going to continue to support their evolving instructional methods to accommodate the future paradigm shift. ActivPanel 9 has upgraded hardware. It has expandable storage and ActiveSync that allow us to solve for future needs. Of course they expect adaptability, one of the lessons from the pandemic is that schools are preparing for a wide range of scenarios where students and teachers may or may not be in the classroom. Teaching technologies must be adaptable to delivering engaging lessons wherever they may occur in ActivPanel 9 now includes a screen recording tool, making recording, and sharing the lessons easier for teachers.

We always focus on simplicity. Technology in the classroom should be inviting to use. It should be simple to get started and easy to manage. Straightforward operation for teachers and IT managers are important to instilling confidence, satisfaction and successful outcomes. The ActivPanel 9 enhances our Element series unified menu by aligning more customization of menus, roaming cloud profiles, bringing teachers customized experience to any ActivPanel 9 and multiple ways to quickly log in to a panel and take advantage of the custom startup. And then finally, and potentially the most important is security. Security is absolutely paramount. This is a protection of personal and sensitive information with the implementation of industry best practices for hardware and software design. First of all, the ActivPanel 9 is a trusted platform module, which brings industry standard hardware based security to the active panel. We've also improved security of ActivPanel 9 by having multiple ways for a teacher to log into the panel with a profile by giving teachers and admins more control over the locking and unlocking of an ActivPanel 9. And by cleaning up any data left in the system after the session is complete. So I'm thrilled that this product is in market. It's in all of our regions today and we're shipping and installing it as we speak. Next slide, please.

When we take a look at growth, of course, we're going to continue to focus on taking market share on a global

basis, but there are also other things that we're looking at. And I want to make sure that I'm sharing those with you. The first is that we're always looking for partnerships that we feel are going to strongly differentiate us in the market and give our users a better experience. We announced the partnership last year with Radix, they're leading device management software that helps IT administrators keep track of how those panels were installed and used. And I'm very pleased to report that in June, we started exclusively distributing Merlyn Mind, which is a classroom based AI tool to simplify teachers user experience. From a building standpoint, we're always looking at new products that we can build, not only in hardware, but also in software. We see multiple applications that we're investing in. They're going to enhance the user experience and bring recurring revenue streams into the business. And then from an acquisition standpoint, there's a short list of businesses that we're working very closely with as we speak, they're all SaaS based and they're all in closely adjacent markets to front classroom displays that will again enhance the user experience, and create a seamless teaching experience for students and teachers. Next slide please.

And then the final update that I want to give everybody is that we've put a tremendous amount of focus on Edmodo in the first half of the year, we've made a decision that we're going to close down the B2C platform this September, and the closure of the B2C platform is going to result in savings of approximately 20 million US dollars. What we are going to do is to continue to focus and monetize the global country rollout opportunities. We've talked in the past about lots of opportunities at the country level, and we feel very confident that we're going to be able to bring the Edmodo World platform into those opportunities. This is consistent with what we've been talking about from the long term blended learning strategy. And, we will continue to focus on building pipeline with countries where we do countrywide rollouts that include all of our products and services. And with that, I will hand it over to Lin Chen.

Lin Chen: (Translated from Mandarin)

Thanks, Vin.

Hello everyone, I'm Lin Chen.

I'm pleased to present you our gaming results for the first half of 2022. We focus on driving long-term growth, especially in the MMO and MOBA genres, as both are longer term growth drivers as you all know. In the first half of 2022, our gaming revenue declined due to the impact of the economy and Covid. Looking at the other KPIs, we can see positive signs. First of all, overseas revenue grew by 8.5% YoY. It's crucial for MMO and MOBA games to have a stable active user base and paying accounts.

We're pleased to see that these KPIs were stable and maintained at robust numbers in the first half of 2022.

On the next page, let's take a look at the revenue structure. First, PC games suffered a slightly greater impact, especially for the higher-paying accounts, which spent slightly less due to the economic impact. However, we're confident that their spending will recover as the economy bounces back. Our mobile gaming revenue achieved growth in a sluggish market, and the contribution from mobile revenue was increasing, which currently accounted for 16% of total gaming revenue. We believe that there is still a large room for expansion in the future.

On the next page, we have made an overall update on our flagship IP, Eudemons. With our view of all titles under the Eudemons IP as one offering, we hope to run it as a long-term IP and focus on its long-term development. We will continue to invest in and develop not only the specific titles, but also the IP overall. From

the figures, we can see that the revenue from PC games suffered a bigger hit, but we also see mobile revenue growth on the back of the content updates. KPIs of MAU, APA and user base are relatively healthier, which are highly related to the traits of the MMO genre. In the MMO genre, we care more about maintaining our user engagement and a positive ecosystem, and user spendings are closely related to this. We also pay particular attention to user stickiness, so we've implemented multiple measures on user engagement, user stickiness, and community healthiness in the first half of 2022, and these measures have paid off.

Next page. MMO products are content-intensive. We have been developing the content this year in three areas. The first one is the high-quality expansion packs. We focused on the "family" expansion pack in the first half of 2022 to maintain active communities and user stickiness, and to establish a positive ecosystem. We had a strong performance in those area, which drove up the number of active users and returning users in the first half of the year. The second is to cultivate paying accounts. We've adhered to the "Guofeng" and "Guochao" (Chinese culture related contents) for our content updates, which have been particularly popular among paying users with relatively lower spendings, and boosted our APA. Our charity collaborations with the South China Tiger and some other "Guochao" crossover have also delivered good results, allowing our IP to gain more popularity. In August this year, we premiered a Eudemons musical (stage play) to expand the IP user base. For the second half of 2022, in addition to more content updates and brand crossovers, we'll also release the "Awakening of Professions" expansion pack, which will have a stimulating effect on revenue and active users. We expect Eudemons in the second half of the year to be jam-packed with even more exciting content.

Next page. Eudemons is a flagship IP, so we will keep enhancing its product line. First of all, this is Eudemons Mobile II. We've been polishing up this game through the collaboration with Season Entertainment (Kingsoft). We have launched several rounds of testing for the game since Q2 this year, including paid testing. From test data so far, Eudemon IP users welcome and recognize our original contents with the classic Eudemons flair. We will continue to fine-tune the details before release. We expect to beta launch the game in Q4 this year, 2022.

Okay, next page. Content and art quality are very important for MMO games. So for the PC games pipeline, we intend to develop a remake version of Eudemons PC. Highlights of this remake version include the upgrades on the engine and artwork, while we will also retain some features in classic modes. This game is expected to be released next year.

Okay, next page. We mentioned earlier that we'll also expand the overseas market. And this will be done from two fronts. One is the pipeline, and the second one is operation expansion with country strategy. Let's talk about the pipeline first. We'll be testing out different categories. Under Oath is an important attempt for us in the ACGN card game category. We've already signed an agreement with a renowned 3A publisher for its release. One of the important reasons for choosing such a publisher is to establish a more in-depth cooperation with them on long term product iterations and life cycles, in order to ensure a longer lifespan for our games. For Conquer, the IP has seen a huge revenue surge this year, especially in overseas market, which accounted for 67% of revenue. We'll carry over our successful experience in Egypt to other countries, and we expect a significant growth in other countries other than Egypt this year as well. Overseas development of the PC, mobile, and cross-platform versions of the game will be a main focus for us.

For the Heroes Evolved IP, we believe that the MOBA category still has potential for growth overseas. We'll relaunch the Lite version of the game with the overseas users, market traits and device models in mind. We've received recognition in the Vietnam market for this new version and will launch it in more countries. Finally, we have our Neopets Match-3 game. From the test data in the first half of 2022, we have seen some good results. The game is well received by IP and non-IP users. We expect to launch this game in the second half of 2022. On the whole, we expect to step up investments in overseas R&D and marketing. This should drive a sustained growth in overseas revenue.

Next page. We have boosted R&D investments, as Ben has mentioned earlier, from two standpoints in particular. First, we'll continue to release sequels and new products for our stronger MMO titles, especially under the Eudemons IP. Eudemons Mobile II will be launched in Q4 2022, while Eudemons PC remake version is scheduled for release in 2023. Eudemons Pocket 2.0 will be launched in the first half of 2024, and a new Eudemons PC game will be launched in the second half of 2024.

That's for our flagship MMOs. Besides, we're also looking into developing MMO+ and other genres. As each company has their own specialized genre with accumulated experience and strengths they can leverage on, with that we're focusing more on "MMO+".

In the Match-3 category, we added some MMO elements to the core Match-3 gameplay. The launch of Neopets Match-3 in the second half of 2022 will also mark our first "MMO+" test run. For Code- Xianxia and Code-DPS, both are innovations based on MMO and idle card game, two of our most capable genres, in which our accumulated experiences in the MMO category can be put into use. We'll also be launching Under Oath in Japan. These are some of our new offerings with specific launch timeframe, while we still have some under development products without a fixed date of release. These include our attempts at blockchain games as well as games that utilize Metaverse, VR, and AR technology, which will open up more possibilities to us during development.

Development of new games is one of our main focuses. Overall, we will continue to focus on our strengths in the MMO and MOBA categories. For new genres, we will leverage our competencies in those categories to tap into the opportunities for gradually expanding into overseas market, developing new products, and innovating by integrating different genres. Looking ahead, we will be launching new products in the second half of 2022 and next year to maintain stable growth in the gaming segment. That's all for my report. Thank you all. Let's turn it over to Simon.

Simon Leung:

Thank you Lin Chen, so what I am going to do is to talk about our efforts in metaverse. And then I'll move on to talk about the outlook. Before I go into a little bit of the details, we, as a company, are embracing metaverse in more ways than one, we even have a virtual CEO as one of our experiments into the metaverse because we do believe if we don't embrace it as an entire company, we won't be successful. So what we are doing is that we believe in the trend, we believe in blockchain, decentralization and crypto. A lot of people will ask that what

happened with the recent kind of fluctuations of the market. We see that as a long term, our play is actually quite healthy, and the market adjustment is actually good for our long term growth. With that, I'm going to go into a little bit of the details. What we are doing right now is actually we are developing a platform that allows us to get into metaverse. So, building an ecosystem is something that we believe we can do and we will do, in terms of applications, we're going to be focusing on education, and also gaming slash entertainment. Those are the areas that we will be focusing on. So let me talk about each of them and the success, so that you know the reason behind it. We have our new virtual CEO AI base. This is a radical approach, but we do believe it speaks very loudly of our commitment to this area. I was on CNBC earlier. I talked about how we approached it and they said, oh, it is not a gimmick. I said certainly it's not. So hopefully in the near future, she will be here talking to you instead of me. So, which is actually beneficial to all of you. She's going to take an active role in how we manage the company, how we kind of streamline and make the process more efficient and allow us to take some of the current resources and focus in other areas. So it is something highly proficiently and the company are very excited about. Next one, I want to talk about Neopets. Before I go into talk about the Web3 game, I want to go back to the top level. We are very excited about the different development in the Neopets franchise. Lin Chen talked about the Match-3 game, which is a casual game. When we look at all the stats, it's very exciting. We have a very active user base in our classic games. We are also experimenting a world builder. And last Friday, we did an alpha launch on our Web3 game. The response is actually very good. Of course it's a very controlled release of our alpha launch. But nonetheless, the feedback was actually very positive. So, we are excited and we'll continue to commit to the current roadmap that you're seeing. We are looking forward to the success of the first play-and-earn game, but not play-to-earn game, which is very important. We are working on a lot of partnerships that will make the game even richer than ever before. So I do look forward to those announcements at the right time. The next one is actually that we are working on our platform. We do believe things like AR, MR and XR are actually going to be an integral part of metaverse going forward. So we decided to invest in this company called ROKID. We are going to invest 40 million US dollars into this company. They're focusing on producing AR-enabled glasses that work either with our game, our entertainment or our education. Along the line of investment, we also have a strategic partnership with them. We're going to be co-developing our applications in the education metaverse first. We believe it's going to be an integral part and we'll contribute to the success of our education metaverse going forward.

Okay. Let me move on to the outlook. Before I talk about the outlook, I want to mention a couple things. Actually one thing, Ben did talk about our focus on capital return to our shareholders. He did talk about the buyback of close to 40 million (USD) and then our special dividend of 50 cents (HKD). But I want to remind you that we also did a special dividend before, let me see, more than 1 dollar (HKD), I think it's around a hundred million (USD). So we, if you guys do the math, we have returned close to 200 million (USD) back to our shareholders, which is actually followed our commitment that we had announced earlier. In terms of the outlook, we look at the rest of the year; our education is going to be enjoying a record year. Again, I have to reiterate in 2022, but more exciting is that Vin alleged to is some of our partnership, not only just with Radix, but also with Merlyn Mind, which is actually incorporating AI and voice technology into our classroom technology. We are going to be continuing looking at M&A opportunities in that area, which allows us to expand our market share in the classrooms, and more importantly, to build up our SaaS monetization opportunities. We'll continue to be very careful with our costs, actually not only in China, but everywhere else. We're going to focus on streamlining our

costs in anticipation of some of the headwinds coming our way. Last but not least, our gaming franchise. Even though there's some headwinds, we believe that we can get over it just like any other times before, so like Lin Chen said we're going to be focusing on delivering our new games, including the games overseas, which is actually quite exciting, that would kind of reduce our risk and then kind of expand our opportunities. With that, I am going to stop, and call back to the moderator. Thank you.

Moderator:

Thank you, Dr. Leung and thank you management for the presentation today. Now it's time for our Q&A session. You're welcome to raise questions in two ways. First, if you would like to raise questions through the teleconferencing system, you may press star one on your phone keypad and our operator will put you through. Second, if you would like to raise questions via our webcast platform, please click the question mark on the screen and type your question in the Q&A box.

First, we would like to welcome our first question. It's a question for Vin. It's a very impressive result. We have two questions for Vin. First, I noticed a very strong overall market demand in 1H22. Can you talk about the drivers behind the strong demand given overall soft macro environment and do you expect a strong demand to last? And the second question is when do you expect B2G business to contribute significant revenue and what will be the impact on the margin profile? Thank you.

Vin Riera:

Sure. So let's talk about the first question, which is what were the drivers for demand? One of the things that we saw as a result of COVID was that schools put a tremendous amount of technology in the hands of teachers and students. And as they took time off from school and then went back to the classroom, they realized that the classroom technology was not at the same level as the technology that teachers were now using and the students were now using, and we saw significant funding streams globally to improve that front of class based technology. So part of the demand that was driven was the sheer amount of Ed-tech products that were bought during 2020 and 2021, and then retrofitting classrooms to be able to work with that new technology, and having strong funding sources associated with that.

The second part of that question is this something that's going to last? I think one of the biggest trends that we've seen in the last 12 to 18 months is that the need for an interactive flat panel that has the, computing power and speed and capacity to interact with teacher devices and student devices is pretty important. So I think what we're going to see is we're going to see customers that might have been late to transition to interactive flat panels from interactive whiteboards, making that transition. I also think with the launch of V9, we're going to see the demand and interest in people with version one or version two interactive flat panels upgrading to a significantly improved user experience. That's much more secure and just will work much more effectively with teacher and student devices in the classroom. So I think that's going to continue. As far as other forms of revenue, I wasn't sure if you said B2G or B2C, the primary focus right now is classroom education based technology with Promethean. We did talk about some of the partnerships that we had in place. And I also talked very briefly about some acquisitions that we're looking at. And in both those instances, there's the ability to work with and monetize products outside of the classroom. And then it's worth noting that relative to Edmodo, Edmodo

world is something that we're bringing into countries and we're selling into MOE. There's an opportunity to expand out.

Simon Leung:

Well. Okay, if I may, I'll jump in and make a couple of comments too. So, I think we do see a strong demand going forward because actually there are a lot of old technologies that is prime for replacement, we're still lot of greenfield. The good news is that we are a global player. So we can look at other countries for growth in revenue. Now, whether we can grow by another 71% is that we certainly will take on that challenge, but at the end of the day, is that we will see strong growth with us going forward.

Ben Yam:

And I think the other question is the impact on the margin, right? From the country rollout. I think we can answer this question on two fronts, right. Because for the country projects, we have the hardware and then we have the software. On the hardware side, I think the margin could be a little bit lower compared to our run rate business, but as you can all know the scale of hardware revenue for the country projects is actually a lot higher. And then in terms of the software, we're also actually working on kind of generating software revenue from our country projects and the software revenue comes with a lot higher margin. So I think we're talking about we're aiming for significant benefit to our bottom line from our B2G projects.

Moderator:

Thank you very much. Our next question.

(Translated from Mandarin)

Our next question is from CICC.

There are three questions about the education segment.

First, we have seen a reduction in R&D investment in the education sector. What are the main reasons for this?

What is our outlook for the future?

Second, how is the progress of the education business in China?

Third, can you share with us the details about the direction and plans for M&A in the education sector?

Simon Leung: (Translated from Mandarin)

I will answer the third question.

Perhaps I can't share with you the details now, but as I have said, we have many different partnerships, and we are constantly looking for this opportunity. I'm sure I can share with you some news in detail in the near future. Your first and second questions are actually correlated. There have been some headwinds in the Chinese education sector, as well as some changes in regulations. Although such regulation doesn't affect us much, we should still make some adjustments and focus on our actions. So we are looking at this matter from a strategic viewpoint. At the same time, we decided to cut some of our longer-term investments, so that our R&D in China can be reduced a bit. Ben and I have also talked about the cost cutting. However, our R&D actually increased in Promethean and other sectors again on the back of the considerable growth.

Moderator:

(Translated from Mandarin)

The next question comes from CITIC Securities.

What is the main reason for the decline in the gross margin of the education business in the first half of 2022?

Simon Leung: (Translated from Mandarin)

Ben, do you want to answer that one?

Ben Yam: (Translated from Mandarin)

Vin has explained the gross margin, but I can give more details on that. I think there are several aspects. The first one is the issue of foreign currency, i.e. the exchange rates. Actually, we recorded a great amount of revenue from Europe. Both the exchange rates of Euro and British Pound have fallen heavily YoY and HoH in the first half of 2022. For HoH performance, it has dropped by nearly 10%, and our cost of goods sold and purchases are mostly denominated in USD. In this case, our ASP has a relatively large impact on the RMB term or USD term, which affected about a couple points of gross margin. Also, Vin has mentioned our new product launch at the end of June, which is ActivPanel 9. As it is a new product, so we have to sell down inventory of the old products. We actually didn't reduce the price much, yet we were not that aggressive towards ASP. This would be another reason. There was also another factor. We had built a larger inventory at the end of last year, as last year we already anticipated we were going to have a big first half, so we had to make sure that we had sufficient stock, and that stock was purchased at last year's material price.

Simon Leung: (Translated from Mandarin)

The inventory is our intended strategy. If we have stock, we can make delivery immediately. Leveraging our financial strength can help us increase our market share. As Promethean is what I call a "machine", so in all aspects, not only the products, but also the distribution has leveraged our financial strength to gain market share. That's going to continue onwards.

Moderator:

(Translated from Mandarin)

The next question is the call from GF Securities. Operator please dial in the call.

Let's welcome Yang Lin Lin from GF Securities to ask questions. Thank you.

Question: (Translated from Mandarin)

Good morning, management.

I would like to ask three questions. The first one is about the education segment. The revenue growth in education in the first half of 2022 was particularly strong. Losses have also narrowed down significantly. I would like to ask if it is foreseeable to achieve break-even in the education segment this year. Will it happen in the second half of 2022, or what is the timeline? And what is the outlook on the revenue and profit of the education business? Second, we have seen a significant increase in dividends over the last two years. Is this a short term measure to maintain the share price or market capitalization, or is it a longer term plan? The third question is about the gaming segment. What is your view on the performance of new games in the second half of 2022

due to the overall external environment in the first half of 2022, including the factor of the license approval?

Simon Leung: (Translated from Mandarin)

Actually, we've covered these questions earlier, perhaps not in great detail. Let's invite Lin Chen to talk about the gaming business' performance in the second half of the year and next year, then I'll answer the questions about the education segment.

Lin Chen: (Translated from Mandarin)

For gaming, we expect the performance in the second half of 2022 to be better than the first half. The first reason is that we did not launch any new games in the first half of the year, and we will have Eudemons Mobile II launched in the second half, which will bring us incremental revenue. Secondly, the data we have so far show that our ecology and consumption figures are still stable and will be slightly better than the first half of the year. Ben can add a few words regarding this, because in terms of financial expectations, we still expect growth in the second half of the year compared to the first half.

Simon Leung: (Translated from Mandarin)

I'll answer the other questions. The first one is the question about dividends, which both Ben and I have mentioned. A year ago, we announced a USD 300 million buyback in three years, which is a way to return our capital. But as Ben said, we have already made a buyback of close to USD 40 million. However, because of the regulations of HKEx, we have to stop this action, so we declared the special dividend. This is not to cope with the problem of share price, though it can certainly benefit the share price, but the most important thing is that we have to fulfil our commitment to the shareholders. If we don't do buy backs we will distribute dividends. Back to the education aspect, we expect to achieve break-even next year. We had a very good growth in the first half of the year, which was about a 71% YoY growth, but it is unlikely for us to maintain the same growth in the second half. We will still have an impressive growth, but it will not be as high as such. So we expect to have a break-even next year.

Moderator:

(Translated from Mandarin)

Okay, thanks.

Operator please dial in the call from Ping An Securities.

Hello, you are now on speaker phone. Please ask your question.

Question: (Translated from Mandarin)

Thank you, management. I am Yi Yongjian from Ping An Securities. I have a few questions. The first one is about education. According to my personal observation on several fields, such a strong growth that we have achieved, including the spectacular growth in the previous quarters, was mainly due to the release of North American Education Information Technology Fund. If the Fund hadn't been launched, essentially the growth would not have been so rapid. As for the continued launch of the Fund, I know you have a relatively larger influence in the North American market, so what is your forecast for this market this year and next year? I

remember that the fund started in the middle of last year. Will it be able to sustain into next year or beyond? That's the first question.

Second, I have also observed that you have changed the supply chain partner for this part of your products in June and July. Will this have any impact on the quality of the products? This is the second question.

The third one is about the profitability. As far as I know, Promethean is one of the top suppliers of interactive displays around the world. Theoretically, its brand bargaining power is relatively strong, but I think its profitability is a bit out of my expectation, as I believe that electronic products with strong brands have a relatively strong profitability. I'd like to know what the reasons were for the losses in the previous quarters in terms of profitability. Was it from the channels being built, or due to other reasons?

Simon Leung: (Translated from Mandarin)

Sorry, I can't hear the second and third questions.

Moderator:

(Translated from Mandarin)

It isn't very clear, can you ask again slowly?

I'm sorry.

Simon Leung: (Translated from Mandarin)

I can't hear the second and third questions.

Question: (Translated from Mandarin)

Can you hear me clearly now?

Sorry, maybe I spoke too fast.

Simon Leung: (Translated from Mandarin)

It's better now.

Question: (Translated from Mandarin)

My second question is that I noticed there are some changes on the supply chain for education products. Will this have any impact on the products?

The third one is about the profitability of your education business. Promethean is one of the top brands in the world with a pretty strong brand bargaining power in my opinion, so why hasn't it been profitable yet? What are the main costs invested? These are my three questions. Thank you.

Simon Leung: (Translated from Mandarin)

I will answer the third question first. There are several segments in the education business, and since Promethean accounts for a larger share of the revenue, we focus more on Promethean. Our education business

includes the China market, which is separate from Promethean and suffering loss. We also have other small businesses. Perhaps when you look at Promethean alone there is no reason for it to make a loss, but we actually have some expenses in the domestic market, which Ben can explain further if needed.

In response to the second question, changing manufacturers is not a new thing for us. After we acquired Promethean several years ago, we have changed several manufacturers. As we have a very strong supply chain team and R&D team, we have made a lot of consideration for changing manufacturers, and have discussed and conducted testing with the teams. So far, we don't see any problems at all. Of course, there must be some small issues, but we aren't worried because it is not related to the change of manufacturers. We also don't rule out any chance to cooperate with other manufacturers for our new businesses.

For your first question, perhaps you are more attentive. Considering the US market, as Vin has just said, our global presence was also the top in the UK, Germany, France and Italy, apart from the US market. Let's first start with the edtech funding in the US, which should continue for another two years. The replacement cycle has also started. So our growth isn't just from the US government funding, but most of the growth is actually from organic growth. Besides, we are a global company, so we can gain market share in other fields and places, such as the German market, which can also boost our growth. In terms of product lines, we are currently focusing on high-end products, and we are also considering to develop cost effective products. We have also introduced AI into the different segments to boost our revenue growth as well as SaaS. We see a lot of opportunities for growth, both geographically and in replacement, as well as in new users and monetization.

Ben Yam: (Translated from Mandarin)

Let me add a few words to the third question. From the hardware point of view alone, our profitability is substantial, but our goal isn't to be a hardware manufacturer, but to be a blended learning market leader, so we have invested quite a lot in areas including software and SaaS, and in different tools or content. From this perspective, if you look at our bottom line, you will see that we are running at a loss. But in terms of hardware operations, we are leading the industry.

Moderator:

(Translated from Mandarin)

Ok, thank you

Next question is from the analyst of BOCOM. Her first question is about the education business, which we have already covered. For the second question, what is Mr. Lin's view on the gaming business in the second half of the year in terms of the new launches and the performance of Eudemons IP? Thank you

Simon Leung: (Translated from Mandarin)

Lin Chen has already mentioned that for the second half of the year earlier. Do you want him to repeat himself?

Moderator:

(Translated from Mandarin)

Maybe he can provide a bit of additional information, thanks.

Simon Leung: (Translated from Mandarin)

Please answer then.

Lin Chen: (Translated from Mandarin)

Let me talk a little bit more about it

Simon Leung: (Translated from Mandarin)

It's the same question, maybe you can talk about something else. I'm just kidding.

Lin Chen: (Translated from Mandarin)

First of all, regarding the market, we have mentioned the regulatory issue, which I believe the regulation has become increasingly clear in terms of both license approval and the contents. With the more clarified rules, gaming studios are able to better identify their focus on the genres. From the market perspective, we believe that we will see more positive results in the second half of the year than in the first half. In terms of gaming, we have mentioned there are two aspects concerned. One is the new games, and the other is the existing games. For existing games, we may look at the whole product line of Eudemons. The launches are not limited to the second half of this year. In addition to the launch of the Eudemons Mobile II in the second half of this year, we also have a remake version to be launched in the second half of 2023 and two more potential new products for Eudemons in 2024, which are sequels to the Eudemons IP. Of course, there are some integration and creative efforts in the sense of pan-entertainment which we didn't talk much about earlier. We are also putting efforts in stage play, motion comics, and other IP-related products. Eudemons as a whole is not just a game, but a comprehensive IP including many cultural products. As I said before, I do expect the revenue and market situation to improve in the second half of the year.

Simon Leung: (Translated from Mandarin)

Thank you, Lin Chen.

Moderator:

(Translated from Mandarin)

Thank you, Lin Chen. The next question comes from the analyst of BOCI

The analyst of BOCI would like to know our overall development strategy and thoughts on the metaverse. Please share more information on it.

Simon Leung: (Translated from Mandarin)

I've already talked about it thoroughly. Here are a few points. We believe the metaverse is a new direction, so we will make a holistic investment in it. As mentioned earlier, we will build an eco-system, which will cover gaming, entertainment and education services. We have also made some investment including VC and other funds, to improve our understanding of the market. As this is a brand new concept, everyone is still getting familiar with

it. That's all we can say for now. In addition, regarding the general direction of Neopets, we are extremely excited about the prospect of Neopets Web 3.0. We may have to discuss in detail with you some other time.

Moderator:

Okay. Thank you. Our next question comes from Integrated Asset Management. So the question is, as we disclose on our announcement that Promethean enter into US based exclusive distribution agreement with the leading education AI technology company, Merlyn Mind, as our first step to leverage our sales network to expand beyond hardware sales into SaaS solution. Can you please explain more about the SaaS business model that we are planning at the moment? Thank you.

Simon Leung:

Okay. First of all, Merlyn not Marylyn, don't mix it up. Okay. So, Vin, go ahead.

Vin Riera:

Sure. So one of the unique parts of the Merlyn offering is that it's an enhanced user experience based on AI software. And it's used with classroom technology, it creates a seamless environment for a teacher. And what it allows us to do is to create a much more exciting classroom experience for a teacher. It's the same purchaser through the IT administrator with the same funding source, and is specific to software. There is a piece of hardware that you buy, but there's a recurrent revenue stream associated with it that gives the users this enhanced experience. So this is our first partnership in classroom use case SaaS business. And we're super excited about it. We've launched it here in the US. And at the end of June, we've already started to get traction in business pipeline.

Simon Leung:

I want to make a comment. This one is actually not the only opportunity that Vin and his team are looking at. So at the right time, hopefully in the near future, we will share with you more news in that area, which is actually something that the team has been doing is really strengthening up our capability within the classroom. And we, at the same time, maintain our market share position and also expand our SaaS offering.

Moderator:

Thank you very much. Due to time constraint, we would like to welcome our last question.

(Translated from Mandarin)

Ok, thank you

The last question comes from EverBright's analyst. First of all, he would like to congratulate the company on the decent performance in the first half of the year. He would like to ask that as Match-3 games are extremely popular in Europe and the US, do we have any plans or thoughts on expansion in Europe and the United States? Thank you

Simon Leung: (Translated from Mandarin)

Perhaps Lin Chen could further elaborate more on this.
Please give a few words about the Match-3 game of Neopets

Lin Chen: (Translated from Mandarin)

Let me explain. There are in fact many niche sectors in the Match-3 genre. We have mentioned the “Match-3 + MMO” element, of which Gardenscapes is a very successful example in the market. It is very popular in Europe and the US. In China, MMO is a major category, while Match-3 and casual games are the major categories in other countries, so this also determines our strategy for casual games. We believe that Match-3 is a category with long term development, and our strategy is to pursue this opportunity with a long-term view. That’s why the output of Match-3 game content suits us better. As mentioned, Neopets is our first Match-3 game, which has gained recognition from our users in terms of the core sensation and gaming experience including the Match-3 gameplay and the packaging of the Neopets IP. The beta test data in the first half of the year has also boosted our confidence, so we believe its launch and test in the second half of the year will both achieve decent results. It is in fact one of our priority segments. Due to time constraints, I can only give you such a brief explanation.

Simon Leung: (Translated from Mandarin)

I’ll talk a bit about the Neopets IP. Perhaps not everyone is familiar with the game Neopets. It is called “尼奧宠物” in Chinese, which is a game with a long-standing history and a 150 million user base. We now have 1 million MAU. Earlier Lin Chen has mentioned some metrics, and we are very excited about the test data in the first half of the year. We are preparing for the launch in the US market in Q4, and I’m looking forward to sharing with you some good news when we announce our results in the second half of the year.

Moderator:

Thank you very much. This successfully concludes our presentation today. Once again, I would like to thank you all for joining us. If you would like to communicate with the management further, please contact us for one-on-one meeting. Thank you. And we wish you all have a great day.