

## NetDragon (0777.HK) 2023 Interim Results Conference Call and Webcast

10:00 AM, Aug 31, 2023 Hong Kong Time

(10:00 PM, Aug 30, 2023 Eastern Time)

### NetDragon's Management Team

Dr. Simon Leung, Group Vice Chairman and Executive Director

Mr. Ben Yam, Group CFO

Mr. Lin Chen, Group Senior Vice President

### Moderator:

Ladies and gentlemen, our presentation will start soon. Presentation PowerPoint is currently available under the webcast, news, and events tab on NetDragon's IR website, IR.NetDragon.com. If investors on webcasts need to raise questions, please feel free to enter the questions in the text box, management will answer during the Q&A session.

Good morning, sir. I'm Catherine, the MC today. Thank you for joining NetDragon Websoft Holdings Limited for the 2023 interim results presentation today.

First, 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.

Now, please allow me to pass the time to Dr. Simon Leung.

### Simon:

Okay. Thank you. This is Simon. Thank you for joining the call. Good morning, good evening, good afternoon. I have to admit, I'm looking at the picture of the three of us, we look kind of all wearing the same jacket. It looks kind of boring. Maybe we should be wearing T-shirts next time. Anyway, great to be here to share with you on

what happened in the first six months of the year and talk a little bit about the future, and the next six months. Today, I'm going to take you through very quickly on the highlights, and Ben is going to take you through the financials, because I think we should kind of dig into the numbers a little bit, and as usual Lin Chen will be talking about gaming. And because Vin is actually a little bit busy today, so I'm going to take over and talk about education, especially our impending spinoff of the company, and then, of course, we'll touch on the outlook and turn to Q&A. So, let's start. Next page, please. The first six months is kind of like Charles Dickens story, the Tale of Two Cities. Let's go to the more exciting one. For gaming, we were back on growth, that is something very exciting. After COVID, in China, people are spending, which is good, so we grew 8% YoY, 16% HoH, which is very exciting. With all of the investments we have made in the last few years, we will start to see some of the new games coming out, so I'm not going to steal the thunder from Lin Chen, he's going to take you through the details, which is good. For education, it's really a challenging first six months. It's really nothing wrong with mechanics or the operation or the structure of the company. It's really about the market. So, I think two factors. One is after COVID, our largest market, the US, is taking a pause to digest all of the equipment that they have acquired, so, actually, we are seeing a slower first six months of the year. And the good news is actually the money is still there. I think they are taking a pause. The other one, of course, is Europe. Europe has been slow for us for economic reasons. The upshot on this one is actually a couple of things. We still maintain the number one market share outside of China. That means we didn't lose market share, which is good. We have launched a new product that allows us to expand our addressable market, which is a big part of -- I would call it the value part of the market, which is the mid-to-low end. We launched the product. We started to ship in June, so we should be seeing some momentum in the next few months and the years after. Last but not least, actually, we are moving towards making the merger agreement happen. I will talk about it a little bit later on. So, with that, I hope I painted you an overall picture of what we were dealing with over the last six months. A lot of encouraging signs, but some issues I admit we need to work on. With that, I'll turn it over to Ben to take you through the numbers.

**Ben Yam:**

Thank you, Simon. First, I'm going to go through our P&L on a high level, and then I'll dive into the segmental financials. Here, so you can see that our overall revenue had a negative 13% growth in the first half as a result of a decline in our education revenue, which was really in line with the overall market. We believe that is a temporary decline because of the ultra-high growth we had in the past couple of years because of COVID, this is something that Simon will go into when we talk about our education business. Our gaming revenue, on the

other hand, was up 8.1% YoY and we are really happy with this performance as we see our gaming business clearly back in growth trajectory, I will let Lin Chen to go into a lot more details in the next section. On the expense side, we continued to implement disciplined controls on our spending and make sure that we are spending in the areas with the proper return. Our admin expense was actually 22.8% higher YoY, and that is actually because of our expenses related to the spinoff listing transaction for our overseas education business. If you take out this one time effect, our admin expense increased by about 10% (YoY), that would be due to salary increment as well as more traveling this year compared to last year because of the opening up of China from COVID. In terms of the bottom line, our EBITDA went up by 4.3% (YoY), and our operating profit and net profit went down by 6.1% (YoY) and 11.5% (YoY) respectively. However if you add back the one-time nature of the spinoff listing and related expenses, these two line items should be largely flat or have a slight increase on an adjusted basis. Alright. The final point I want to highlight on this slide is that we continue to maintain a strong cash position, with a cash and bank balance of RMB4.2 billion, as well as a net cash balance of approximately RMB3.2 billion, and with our strong cash position, we are also happy that we have announced that we have declared a special dividend of HK\$1.0 per share on top of our regular interim dividend of HK\$0.4 per share.

Okay. Onto the segmental financials. I talked about the revenue in the last slide, here I'm going to talk about the other metrics. First, on the education business, a couple of things to highlight. Our gross margin was 24.4% in the first half, slightly down by 1 ppts YoY, but on a sequential basis, our gross margin actually went up by 3.7 ppts and it's gone up two quarters in the growth because we are benefiting from a higher ASP from our ActivPanel 9 that was launched in the middle of last year. Our core segmental loss on education was higher in the first half at RMB249 million, that was due to lower revenue and also the fact that our business overhead was largely flat on a year over year basis. On the gaming, in terms of our gaming business, it's notable that our gross margin increased by 1 ppts to 96.8% due to more optimized use of our service, that was a result of our cost management measures carried out last year. In terms of our overhead expenses for gaming, R&D expenses increased by 16% due to more headcounts that were recruited last year, and as we have mentioned in the past, these headcounts will benefit us as we get to a better position to produce more quality games in a faster pace. For the selling and marketing and the G&A costs, we continued to be very disciplined in our spending as these two overhead items were largely stable year over year. Alright. That's what I want to highlight in the financial session, and I'll pass the stage to Lin Chen who will walk us through the performance of the gaming business.

**Lin Chen: (Translation)**

Hello, I'm Lin Chen, happy to share more about the gaming sector performance for 23H1.

First, I'd like to highlight that gaming revenue has resumed growth in 23H1, with an overall growth of 8.1% YoY. Our domestic and overseas business have both recorded growth. Domestically, as previously mentioned, there was a drop in spending among medium and large spenders due to the pandemic last year. Spending from these users has recovered along with the macro recovery this year, lifting up domestic revenue growth by 8.9% YoY. Internationally, growth was slightly lower at 4% due to forex impact.

At the same time, we're also seeing a healthier structure of revenue. In terms of user ecosystem and player communities, we've been putting in place anti-hacks measures to clean up unauthentic accounts. This has caused a drop in DAU but the overall ecosystem, user experience and confidence have improved. All of these have boosted our ARPPU and built up confidence for sustainable consumption within our games.

Next page.

As you can see from the data, we have maintained a steady growth momentum with consecutive growth for the past four quarters. Our gaming revenue hit record highs in H1 this year, especially for the Eudemons IP, where we hit a historical high. This signifies that past investments and strategies in the IP have been successful and we are reaping the rewards now.

Apart from the growth for both domestic and overseas markets, our PC and mobile sectors have also seen strong growth at the same time. For the PC side, our revenue grew by 8.3% YoY. On top of the PC version, we have the cross-platform version as well, which allowed us to increase user engagement and attract more users. The cross-platform version spurred the returning of old users and increased the current user stickiness. This has driven our PC users and revenue growth both domestically and in the overseas market.

For the mobile sector, even though the broader industry faced great challenges this year, our optimization of the user community and user acquisition strategy have allowed us to reduce user acquisition cost and spur user growth, thus drive growth in our flagship products, including the DAU growth in *Eudemons Pocket Version*, and a corresponding increase in revenue.

Next page.

We'll next take a look at our business performance by looking into various IPs.

The first one is *Eudemons* IP, where we continued to execute the IP development strategy through content enhancement and product portfolio extension. As we push forward the strategy, the IP's overall revenue reached new records. These records came from several areas. Firstly, we saw very strong growth in *Eudemons* PC,

where there was a 10% YoY increase and 22% HoH increase. This was mainly driven by engaging returning users in the cross-platform versions of the game and converting them into the PC version. This has helped to increase overall activity and APA growth, leading to the healthy development of the user ecosystem as a whole.

For the mobile sector, our user acquisition strategy optimization led to a 9.5% YoY revenue growth. We also continued to launch high-quality expansion packs for the IP and launched *Eudemons Mobile 2* in 1H. These have contributed to the overall healthy development of the *Eudemons* IP in terms of user operation, revenue, and user growth.

Next page.

Let's talk a bit more about the multi-pronged long-term IP strategy. High quality content, user retention, and user re-engagement have always been our focus. In terms of IP production, we've made progress in IP content creation this year. Last year, we mainly focused on pushing out better content through IP crossovers, but this year, we've enhanced our content creation and will produce more original IP content, which solidify user loyalty to the IP. The efficient use of original IP content will also result in better retention and have a good effect on the IP itself. This is an important strategy that we will put in more efforts in the future.

With excellent content, we can engage, attract, and retain users better through new channels like Douyin, livestreaming, and eSports. Our enhanced multi-pronged approach will see to it that the IP continues to achieve healthy growth.

As we can see from the data shown before, our user spending has increased in 1H. It shows that our product strategy should focus on understanding habits and experiences for both existing and new users, and continuing to enhance our successful business model. The "cultivation" is an important element of MMO game and that's why we've never stopped working on honing our eudemons (in-game pets for *Eudemons*) module. We've vastly improved and polished core spending systems including data mechanism, graphics, gaming experiences, gameplay, character design, and lore. This module alone contributes to more than 50% of the overall cultivation-related revenue in a healthy way. Users are thus not only positive about our content but are more willing to trust the system behind the content as well, eventually leading to more spending.

Looking at the overall industry trend, gamers are more and more willing to spend on content, which is not only driven by ACGN related games. This trend can be seen in our games as well. Therefore, we will keep working on improving content depth and game experiences. For example, our year of rabbit eudemon, zodiac eudemon in each Chinese New Year makes up a major part of our revenue. We've spent more time than usual on the lore, character design, and IP integration this year to produce higher quality content. Beyond that, we extend

various strategies to drive in game spending. On the PC end, we have enhanced the spending depth for medium and large spenders, driving revenue growth YoY. On the mobile end, we have taken into consideration the gap in spending habits among small to medium spenders and medium to large spenders. This has driven the increase of the take rate and ARPU. These strategy optimizations have greatly contributed to our growth.

As mentioned earlier, user acquisition is a challenge for all companies in the market this year. We've met the challenge adequately by making progress in producing high-quality content, developing new marketing channels, reducing user acquisition costs, and generating content for returning users.

Next page.

That was for the *Eudemons* IP. Now let's talk about the *Heroes Evolved* IP. In 1H, we continued to leverage the successful business model of IP crossovers by working with the Japanese anime IP, "*Bofuri: I Don't Want to Get Hurt, so I'll Max Out My Defense*", and this greatly boosted our gross billings on both PC and mobile platforms, delivering an 18% YoY growth overall. In the MOBA genre, we have limited competitors so we're focusing on improving the user experience and diving deeper into successful business models so as to maintain a good level of user activity and revenue for the IP. Looking ahead, we will emphasize on certain opportunities in the MOBA genre, such as: eSports tournament being more casual and reaching more players, and the in game combat features being more intensified. *Heroes Evolved Lite* and *Heroes Evolved 2.0* are still in development and are expected to be launched in the next year or two so as to keep us deeply engaged in this genre.

Next page.

As for the *Conquer* IP, revenue fell by 12.3% YoY in 1H, mainly caused by the Egyptian Pound devalued almost 50% against the USD, which affected our revenue denominated in USD. If we look at the Egyptian market alone with constant forex rate, our revenue actually saw a hefty 45% YoY increase.

We've discovered two essential opportunities through the *Conquer* IP. Firstly, revenue growth is driven by the Egyptian and Middle East markets, which allows us to dig deeper into the spending habits of medium to large spenders in these areas. We saw that improving gameplay was what led to growth in their spendings. MMO is a massive market and many MMO players also start playing casual games within the MMO itself, such as casual board games. We were able to grasp the new gameplay attractive to Egyptian players and started a new project based on this: *Code - Alpha*, which will be released in 24H1. This is a new market opportunity that we've managed to excavate from the *Conquer* IP, and as the IP expands its influence in the Egyptian market, we believe this effect will cascade out to other markets as well, resulting in sustained growth internationally in the

*Conquer* line of products.

Next page.

The next main topic is about AIGC. First of all, AIGC has been validated by the market and our peers as an effective method of producing graphical content. The technology has already vastly improved our production efficiency among original graphics, UI, scenes design, etc. For the 2D original graphics alone, our production efficiency has been improved by more than 30%. We foresee it becoming very useful to improving our content quality and efficiency in the future.

In terms of gameplay, we are very positive about the application of AI to smart NPCs. Our flagship products are MMO games, and the core concept behind MMOs is human interaction as well as community and ecosystem building. We see more people using AI tools such as ChatGPT, and this will help us to conceptualize smarter and more interactive NPCs that can contribute to user experience enhancement through faster and smarter iterations of character interaction, social modeling, and ecosystem evolution. That's why we're heavily investing in this technology and will be integrating it into our games in the future.

Next page.

We've already implemented AI gaming companion features to some degree and seen some results, mainly in our MOBA and MMO games. For gaming contents with more combating features and requires more player proficiency, AI can help to lighten the load for casual players, lowering the barriers of entry and level of difficulty. This in turn allows more casual players to embrace more complicated gameplay with combating features. For hardcore players with stronger needs for more combating features, AI gaming companions and AI training will result in better gaming experience for them. We'll continue to deepen our research into these areas in order to create a better user experience that will lead to revenue growth. To sum up, AI is a major focus for the group.

Next page.

Here is our pipeline across major IPs. Our IP strategy is sound and effective. For *Eudemons*, we will be launching a series of new PC and mobile games this year and the next. There is the *Remake Version*, which has been validated by the market as a successful business model and with better win rate, and some other quality enhancement versions to win more new users outside the current "circle" to ensure the overall stability and growth of *Eudemons* IP. In the MOBA genre, as previously mentioned, we're concentrating efforts on moving into *Lite* version and also games with heavier combatting features. For *Conquer*, we're seeing large untapped revenue opportunities in the area of casual gaming. Revenue next year will be driven by integration with MMO+ integration and crossover elements and growth in the overseas market can be expected.

As for our new IPs, we are producing *Under Oath* in close cooperation with our partner and the game is expected to be launched next year. We are also expecting to launch a new idle card game product and an MMO *Code - Dragon* that targets the overseas market next year. These new IPs are expected to promote revenue growth.

Overall, NetDragon has shown strong growth in 23H1 and we will keep this growth trend throughout the second half as well. Our investment in R&D should also produce results in next year and the year after, driving faster gaming revenue growth in the future.

That's all from me. Thank you everyone. I'll hand back to Simon.

**Simon:**

Thanks, Lin Chen.

Before I go into education, I pretend I'm Vin Riera. So, I'll make a couple of comments. One is actually content, which is actually very exciting for gaming. Equally exciting is the area of AI, because you will see the same theme in education from a geographical standpoint, both for education and for gaming, we find the Middle East/West Africa market very exciting going forward. That's going to be a growth engine. So, okay, so let me be Vin Riera for the next few minutes, even though I'm older and probably not as good looking.

Okay. Next page.

This will give you an idea of how the market has been in the last few years and then the forecast for this year. As you can see, the overall market, because a big part is actually the US need to digest what they have purchased and the economy in Europe, so we have seen negative growth in terms of the total units. And if you look at our peers to Promethean, they are seeing exactly the same challenge. I'm not saying that's right, but it is a market situation that we have to echo, but we do have the answer as to how to grow in a down market.

Okay. Next page.

This is just to give you an idea of how we have been growing compared to the industry. We have been outgrowing the industry for the last couple of years by quite a wide margin. That's why, it is expected the decline of our first half, so let me take you through some of those.

Next page.

The good news for us, actually, is if you look at all of the operating metrics, actually, we maintained the number one market share. We have a higher ASP for our new product, AP9. Our gross margin improved YoY. The revenue decline is actually 29% (YoY). That's partly because the market declined, but equally kind of important,



we dramatized the decline because in the first six months of last year, we grew 71% (YoY), so if you take a look at the combination that actually just exaggerates the decline. It's not an excuse, but I just wanted you to understand the numbers.

Okay, next.

I did talk about how we grow in a declining market. This is how we do it, because, for the longest time, we decided to focus on the high-end products, because we wanted to maintain our profitability, margin and everything. Because of where the market is going, we decided last year, not this year, last year to enter this market, which opened up a big market that we have never been able to address before with the AP9. So, this is very exciting. We called it the "value" product. We can use it to enter the low-end segment of the market. We worked on it last year, introduced it early this year, and we started to ship in June. So, you will see it in the coming months and in the years to come.

Next.

Just looking at some of the numbers. So we have a big opportunity with the new product. It's a huge space of old technology that we can go and replace. We have a very big installed base of our product, 1.7 million, so, actually, we can open up our market without kind of the actual market growth. So we are looking at a bigger market that we can address after we started shipping the LX product.

Next.

These are some of the things that we are doing for the next few months, is actually besides launching the product, getting it out, and going out to the market, we are also moving towards getting more SaaS revenue coming in, so we target to roll out our first software subscription by the end of the year. If you'll remember, we acquired a company called Explain Everything, so we'll integrate that into our product, so we are going to launch it in the second half of the year. I think a lot of the things that we are doing, we are really aiming to save time and effort for the teachers, so which is great. By the way, AI is going to do exactly the same. We also are working with AI, just like Lin Chen talked about in the gaming. We are looking at AI in two different areas. One is, actually, we see a lot of use cases to use AI to help teachers to cut down on efforts in the areas of lesson preparation, homework, marking the homework, and also enabling them to teach more effectively in the classroom. So, we are going to put AI into our classroom technology, including our panels. But equally exciting, we are looking at how to do it. We do believe that we need a large language model. Not only that, so we need, probably, an education large language model for each country or locality, because one of the things about education that we worry about is governance, security, all of the local laws and regulations and local culture

and all of that. By the way, local curriculum. So it's not a one-size-fits-all environment, so that creates a lot of good opportunity for us to work with a lot of our customers/countries, because you all know we work with countries like Egypt and Ethiopia and all of that, so we believe that we can work with them and really put the AI technology and large language model technology into countries and districts and all of that. So, this is actually very, very exciting. That's also related to SaaS subscription opportunities. Again, so we are really excited about AI and also from a geographical standpoint about the Middle East.

Next.

So, this is actually something we have been working on very, very hard. Our team in the US has been working day and night to complete this. We are at the very final stage of the process, I would say, so it's going to happen very, very soon. So, as a result, we'll spin off the company or the education company overseas, and then we will list it on the New York Stock Exchange. As a result, we, NetDragon, will retain the ownership of 70% of the company. Now, by the way, we don't have to stay at 70%. I mean, we are happy to go down in the percentage, as long as the valuation keeps going up. So, we are working hard to get there and making sure that the NetDragon shareholder is going to share the growth of this particular company going forward.

Next page.

Just very quickly, why we want to do that, these are the three main reasons to do it. Number one, we want to unlock shareholder value, because the sum of all parts probably will work better in this particular case.

Number two, there will be a separate platform that we can go and raise money, whether from the public or from our strategic investors. So, it's really specifically looking at the education business overseas. The third one is actually we want to look at all of the geopolitical situations, being very open about the China and US relationship, so we believe having an education company with a large market in the US, being listed in the US, is actually strategically, it's actually much better for us, so because we deal with the government, a lot of these regulations much more effectively as a separate company. So, we decided to do it, so this is actually all good for the shareholders.

Okay, next page.

What I'm going to do is actually close the session with the outlook. I think I've talked quite a bit about, and also Lin Chen talked about it also in his presentation, so I'm going to be very brief on this one. So, on gaming, we are on track. Actually, we are going to be doing well. We'll continue to grow our flagship games, plus we are going to work very hard to launch the new games, because, actually, that's how we maintain the growth of gaming. Education, very simple, number one priority is to complete the spinoff. So we are going to enjoy the

valuation of that company. I talked about the LX product. This is how we can grow in a down market, because we expand our addressable market. We talk about evolving to SaaS. Last but not least, with the spinoff, that gives us a chance to really look at our cost base in education with what's left in the company, and also looking at the China market and see how we react to this part of the business. So, this is what we are going to do in the next few months.

So, with that, I'm going to stop. Thank you for your patience. Thank you for listening. So, operator, I think we are going to be ready for Q&A.

**Moderator:**

Thank you, Dr. Leung and management. Now it is time for our Q&A session.

For investor on the phone call, if you wish to raise the question, please press star one and our operator will read your name before the question. For investor on webcast, if you wish to raise the question, please enter your question in the text box, and emcee will read your question later.

We are now coming to the Q&A session.

We welcome questions in English, Mandarin and Cantonese.

The first question is from BOCI, regarding the gaming sector.

Is the AI model used in our gaming model business self-developed or a large model from external partners?  
Did you cooperate with any domestic LLM developer?

Second question, can the management elaborate more on the domestic education business plan? Other than primary and secondary school, do we also have plans in the vocational or higher education sector?

**Simon: (Translation)**

Lin Chen, please answer the question about the gaming and I'll answer the question about education.

**Lin Chen: (Translation)**

Our AI application can be divided into a few dimensions. Firstly, we definitely use existing large models, such

as ChatGPT from overseas and Ernie Bot from Baidu. In terms of large models, technically, we must apply the most mature existing models. Meanwhile, we will also deploy some small models for certain aspects of the gaming business. For example, there are some game-specific data and content from our MMO and MOBA games, so in the MOBA battle, we will reinforce and deepen the learning of the small models based on our own game data. We deploy and apply both large and small models at the same time, while focusing on how to create a better gaming experience.

**Simon: (Translation)**

I believe we can cooperate with many different large models and it's not limited to only one, right?

**Lin Chen: (Translation)**

Yes, we are currently cooperating with a few large models at the same time.

**Simon: (Translation)**

Back to the education sector, we have not talked about the situation in China in detail yet. We are conducting a strategic review but can talk about a few points. In terms of education, I can't see it clearly, because we can't be doing too much sub-sectors simultaneously in China. So now, we focus on one or two sub-sectors to continue. Our resources in China also offer some support to our overseas business, so we must also make plan for how to support our new company abroad (MYND.AI) and see what we can do: such as AI, or higher vocational field as you mentioned. Actually we have been quite successful in the higher vocational field. So we are now still in the planning phase, sorry that we don't have much to disclose.

**Moderator:**

Thank you Simon and Lin Chen. Just a quick reminder, for investors on the phone call, if you wish to raise a question, please press \*1 and operator will read your name before your question.

The next question is from GF Securities, she would like to understand the main reason for the significant revenue decline of the education business in 23H1? What is the revenue outlook for 23H2? Thank you.

**Simon:**

Ben, why don't you take this one?

**Ben: (Translation)**

Sure, no problem. Simon did talk about this in his section, but I can explain more in detail. The main reason for the decline in our education revenue is that it followed the decline of the overall market environment. If you look at our peers, you will find out that everyone has declined, especially in the overseas markets. It is due to the pandemic in the past two or three years, many different countries around the world, such as the United States or different countries in Europe, have set up a lot of government funds to stimulate the procurement of classroom technology. This resulted in a spike in demand than the normal in the past two years, where the growth is higher than normal. We believe that this year is a digestion year. It does not mean that the industry will decline, but it only represents the higher than usual growth in the past two or three years will need to be digested. We expect that the market will continue to grow in the future. In terms of 23H2, we believe that this year is still a year to digest. 23H2 should be better than H1, but (on an annual basis) the overall growth will not be able to recover until next year.

**Simon: (Translation)**

Sorry, Ben, I thought they were asking why the decline in 23H1 is relatively large, I thought you would talk about the figures, so let me add on. Just now Ben mentioned that the whole market is declining and so are we. Another reason for the large decline is that our (YOY) growth in 22H1 was 71%. This figure makes people feel that the decline in 23H1 seems to be huge, because our growth last year was incredible. That's why there was a page earlier talking about the growth in 22H1, the market was declining and that is true, but why it seems like we have declined a lot, that is just a matter of math.

**Moderator:**

Thank you, Simon and Ben. Next question from CICC. What is the company's layout in the blockchain field? Secondly, what is the core value of the panel software? How much price increase is expected from this business

model?

**Simon: (Translation)**

Lin Chen, you can answer our work on Web3 first.

**Lin Chen: (Translation)**

For blockchain, we will not participate in any “exploitation” behavior which is quite common in the industry currently. We are interested in the application of blockchain technology in digital assets, including virtual assets in gaming, especially for our long-term gaming products. For users, the decline of a game or the cease of operation of a game will cause them great damage to their vested digital assets. We are seriously looking into the application of blockchain technology in the gaming assets, including value preservation, value appreciation, and transaction of certain assets. In our pipeline, we have a sci-fi version of *Heroes Evolved* which we have planned to integrate the blockchain technology, to allow our users to better validate and transact their digital assets ingame, such as skins, just like CSGO. This is the direction that we are looking forward to in terms of the long-term operation of digital assets, and we have already begun to apply it.

**Simon: (Translation)**

I must mention that we have two main focuses in Web3, blockchain and cryptocurrency. Just now Lin Chen didn't mention cryptocurrency, but only the blockchain technology. We will also apply blockchain technology in our education sector. This is a special feature of our company: we have many technologies that can be applied in both gaming and education sectors. Just now you asked about the core competitiveness on the panel, maybe we need a longer time, or I'll just briefly talk about it. Our solid competency has been proven that we are the first in the global ex. China market. Our system can be used in the classroom to support learning and teaching. For the past few years, we have always been the top in overseas.

**Moderator:**

Thank you Simon and Mr. Lin. Next question is from an online investor.

Next question comes from Deutsche Bank, Herman. Please go ahead, thank you.

**Herman: (Translation)**

I am from Deutsche Bank. Excuse me for asking the question in Cantonese.

**Simon: (Translation)**

No problem.

**Herman: (Translation)**

I would like to know; how will the development of Generative AI be combined with the education and the gaming sectors of your company to develop new products? Thank you.

**Simon: (Translation)**

I will start with the education aspect, and Lin Chen to recapitulate our work on AI.

We got two significant opportunities on AI, one is the combination of AI with the big screen, meaning the panels in combination with the entire intelligent classroom system. This not only helps relieve teachers of their workload, but also facilitates teacher-student interactions in teaching and learning, as well as assisting teachers in preparing and correcting assignments after school. We are not saying that teachers don't have to work, but we simply aim to help teachers reduce their workload in this regard, so that they can devote more time to their students. This is a great opportunity for us in two ways. The first is the use of AI on our panels to develop our own product features that differentiate us from our competitors' products. Earlier, some of you asked about the core competitiveness (of our panels). In combination with the AI application, this is where our core competitiveness lies, which forms our distinctive product offerings. We have a theory of "winner-take-most", meaning that we can continue to increase our market share even in a down market, so that is very exciting.

Another exciting aspect is the vertical large language model. Instead of competing with Google, OpenAI, Baidu, and Ali Baba, we will build specialized models to be applied in the education sector, which can be applied with much flexibility, including the models to be applied in the gaming sector as mentioned by Lin Chen earlier.

Why do we think this is an opportunity? Letting students, especially on K12 students, to engage with general LLM without knowing what content will be accessed, could bring violations of local rules or regulations alongside many other different problems. Our vertical large language model will set up a guard-rail to handle the cybersecurity governance and the local content regulations, which is in great demand. We are equipped with the integrated capabilities because we are the best at working with large districts, large states, or entire countries for education, such as in Egypt, so we are in a special position.

The last thing I would add is that the application of AI can change the entire world of education. We believe in the idea of "learning at your own pace and customizing your curriculum", and AI can make this happen.

Lin Chen, do you understand Cantonese? He asked about our progress in applying AI to games. You spoke about this earlier. Would you repeat?

**Lin Chen: (Translation)**

I will summarize it again. There are several aspects for AI. The first is to reduce costs and increase efficiency. The profit margin of the gaming sector is certainly very high, and AI is certainly helpful to further reduce costs and increase efficiency, but it may not be the most important thing. There are two key points, one of which is the enhancement of the existing game experience. For example, we can improve the MMO and MOBA game experience by using AI technology, which can further enlarge our existing revenues. The biggest opportunity for us is to create new experiences and new game modes through AI, which I think is a very important "blue ocean" opportunity in the future. As I mentioned earlier, smart NPC can potentially create unprecedented experience through AI technology, which I believe is the most appealing aspect to users. This has been recognized from the demand in the MMO genre. I think how to enhance community interaction with AI is a great opportunity for us.

**Moderator:**

Thank you Simon and Lin Chen. Just a quick reminder, for investors on the phone call, if you wish to raise a question, please press \*1 and operator will read your name before your question.

For the next question, we receive a question regarding the capital returning initiative of the company:

Can the company elaborate on its latest thinking behind its capital return initiative? For example, how much is



it prepared to return to shareholders, based on the current capital structure? Thank you.

**Ben:**

Yeah, sure, so in terms of capital return measures, we have been keeping investors updated in the past couple of years, I think if you remember, a couple of years ago we did announce a measure to do up to USD 300 million of stock buyback. Since then we have been carrying out buybacks periodically. Then last year we were not able to do buyback for the most part, because of the compliance issue, because we were in a quiet period due to the listing of our education business. I think, and then after we announced the listing of education business, we started to resume buyback for a few months. You also noticed that we have also declared a special dividend this time, on top of the interim dividends. I think from a holistic perspective, we want to make sure that we consistently return capital to the shareholders. So, if you look at our announcement or our webcast a couple of years ago, we committed to return a majority of our free cash flow to our shareholders by way of combination of stock buyback and dividends. I think with the dividends that we have declared yesterday, and also a couple of rounds of special dividends that we have declared in the past couple of years, I think we have been kind of living up to that promise.

So, going forward I think we would be maintaining that commitment. But in the meantime, we also have to be cognizant of the market conditions, because as you can see, right now the stock market is not in a very good condition on a broad basis. So is stock buyback the best approach to return to our shareholders? That's what we should continue to think about. But we will calibrate. It doesn't mean that we are not going to do stock buyback, but we are going to calibrate between stock buyback and dividends and overall make sure that we return the right amount of capital to our shareholders.

**Simon:**

Let me put a caveat around that. What we are going to do is that we are going to review our strategy on a regular basis, because we also want to maintain some flexibility in terms of if we intend to do some M&A, we have enough capital in the company to do it. That's why we won't commit to a specific plan on how to do it. But history demonstrates we will do the right thing at the right time.

**Moderator:**

Thank you, Ben and Simon for your detailed response.

The next question comes from an investor at Guotai Junan Securities on the line. Would the operator please connect the call? Thank you.

**Operator:**

Thank you. The next question is from Augus Liang from Guotai Junan Securities. Please state your question. Thank you.

**Augus: (Translation)**

Thank you management. I am Augus from Guotai Junan Securities, and I have a quick question about the education sector. As we see that there were some plan for AI panels before, I would like to ask about the current progress of AI panels, and whether the ASP is expected to increase significantly compared with regular panels? What is the forecast for the shipment volume in our target markets in the future? This is the first question.

The second question is about the gaming sector. We have seen a strong performance in the Eudemons Cross-Platform Version and the Eudemons Mobile this year, indicating a robust vitality of the entire Eudemons IP. I would like to ask about the pacing of the game launch next year related to the Eudemons IP, and which Eudemons IP game is expected to have greater revenue? Thank you.

**Simon: (Translation)**

I will answer the question about the education sector, Lin Chen will answer the rest, because it is more straightforward for the education sector.

First, we will certainly apply AI to our panels. As to whether we can increase the ASP, it depends on our overall product strategy. In fact, the most important aspect is not to increase the ASP, but to create a recurring revenue through SaaS subscription model, so we are not focusing on improving the ASP. The incorporation of AI can definitely contribute to our market share, which will work for sure, but the key indicator of success lies in the SaaS revenue, not in the ASP.

**Lin Chen: (Translation)**

First of all, in terms of the pipeline of the *Eudemons* IP, we will focus on the layout of the entire IP content this year, and will release the IP white paper to present a brand-new and improved universe for the game in 23H2. In terms of the general strategy, the first is to maintain our investment in the content, and the second is the pipeline of new games. As you can see from the pipeline section shown earlier, we will have ongoing PC and mobile game launches in the next year and the year after.

With regard to future forecasts, due to the huge base of the entire *Eudemons* IP, we expect a steady growth of like 20% or 30% in the next year or two, because the base of the entire IP is already very large.

For which product is expected to achieve greater revenue, I believe that the potential success of *Eudemons Remake Version* and the *New Eudemons PC* have been validated by the industry from a business model standpoint. In addition to the *Eudemons* IP, the *Jianxia* IP or some of the Perfect World IPs are able to maintain a solid 10% to 20% of revenue growth for the overall IP product line through the remake version and new updated products. In this regard, the *Eudemons* IP is our cornerstone, and we are able to maintain a solid growth of 10% to 20% per year through new products and content updates. Some of our new games may become a big hit, and we consider them as a complement to our product line. This is how it works in general. Thank you.

**Moderator:**

Thank you Lin Chen and Simon. Due to time constraints, we would like to end the 2023 Interim Result Presentation for NetDragon Websoft Holding.

Once again, I would like to thank you all for joining us. If you would like to further communicate with the Management, please contact NetDragon's Investor Relations Team for meeting arrangements.

Thank you and have a nice day.