

## **NetDragon (0777.HK) 2024 Interim Earnings Presentation**

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### **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 very soon and it will also be livestreamed on the Roadshow China, Futu and Tiger platforms. Presentation Powerpoint is currently available under the Webcast - News and Event tab on NetDragon's IR website. If investors on the webcast wish to raise questions, please feel free to enter your questions in the text box. Management will answer your questions during the Q&A section.

Good morning. Thank you for joining us for NetDragon Websoft Holdings Limited today for our 2024 Interim Results Presentation.

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 Vice President.

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

### **Simon:**

Thank you. Good morning. No, that's not what I was expecting. Sorry to get you working on a Friday I guess. But anyway it's good to be here. Actually I'm gonna take you through some so-called highlights. It's an eventful year for us. It's actually some challenges, some headwinds, but nonetheless, there's a lot of opportunity ahead of us. So from a company standpoint, from a management standpoint and for the board, we're as optimistic and enthusiastic as before. But we need to hunker down and work at some of the issues. So I'm gonna go through that, some of that, today.

Now before I do that, I need to remind everybody that the education company, Mynd.ai, is a separately listed company on the New York Stock Exchange under very different governance. Even though we own a big chunk of the company, we have a separate board running it. It is listed on the US. It is actually under the governance of the New York Stock Exchange rules. So I can only talk about it with directional comments. I cannot go into the detail because I'm the non-executive Chairman of the company. In anticipation of that, actually we're gonna arrange a separate Capital Day for everybody to call in and ask the management team very specific questions about what are the challenges, what are the opportunities going forward, okay?

With that, some of you, or most of you, are very familiar with the agenda. So I'm not gonna say anything. Just hit some of the highlights, I'm not gonna go into detail.

For gaming, the good news is actually we are growing. Actually we have some short-term challenges which Lin Chen will talk about. We have a lot of them addressed already. Some of them, like forex, like exchange issue, is something that we cannot do. And then don't forget the worldwide economy is actually under some, interesting, I would say, transformation from that standpoint. But I guess the good news is actually there's a new game called Wukong that came out. That's kind of shot in the arm, not only for China but also for around the world. I happened to be on the Board of Directors of a Swedish gaming company. So a lot of people are talking about it. They are very enthusiastic about the gaming business going forward.

Okay, on the Mynd side, exactly like I said before, we see some headwinds. For example, inflation is actually hitting the US. As you may or may not know, US is our largest market in education. So we're dealing with that. And we are also seeing economic downturn in Europe. I mean you've been reading the news with the war in Ukraine and with Russia and all that stuff. But the good news is actually we are growing in places like Germany. So I can tell a little bit more into the detail later on.

The other good news is that we're working on improving a lot of our metrics, for example, like our costs, our margin, everything. Ben's gonna highlight it at a very high level. Again, the upcoming Capital Day for Mynd.ai will go into much more detail.

Last but not least for education, I think with the invention of AI, with challenges, with inflation and everything. And schools around the world or school districts around the world are looking for opportunities to, number one, enhance the productivity of the teachers and maybe also for the students that allow us to create services that we can help them out. SaaS is actually going to be a term that you can be hearing a lot going forward. Actually we also coined a term called CaaS, which is actually Classroom as a Service, because

it's of what we have. I can assure you we have a lot of activities going on to address that issue, but unfortunately, a lot of them are work in progress. I cannot disclose a lot of the activities that we are doing. We are very confident about moving from a pure hardware play into, really, a hardware and services play. Our biggest asset in education with Mynd.ai is our 1.5 million classrooms around the world and we keep adding to it every year.

So with that, I'm gonna tear. So I tear it up. I think Ben's gonna spend a couple of minutes to go through the financials and then followed by Lin Chen. I will come back and talk a little bit more about Mynd.ai and then we'll give you a view of what we think in the next... it's actually not 6 months and even though this is interim, for the next few months and how does it lead up to 2025. And then we open up for Q&A, okay? Thank you.

**Ben:**

Thank you, Simon. Good morning. I'm gonna go through a couple of slides of financials. As Simon mentioned, the first half is full of challenges and also opportunities. And specifically, I think we're seeing some challenges on the topline, on the revenue side. But I think we've been doing a lot to manage sort of the bottom line. So I think we've done a lot in terms of cost savings and also investment income, which really mitigate a lot of the decrease in revenue.

If I look at this overall P/L here, we're seeing a stable gaming and application services revenue, while Mynd.ai experienced a decrease in revenue. I'm gonna go into that in the next slide with a little bit more details.

But the good news, the positive news is that we're seeing an increase in the gross margin percentage from 62% to 66.6%. So we're seeing increasing gross profit margin. And also on the overhead side, we implemented a lot of cost-saving measures to improve our operational efficiencies. So I think you can see for sales and marketing expenses, we're seeing a 20% decrease YoY in sales and marketing, as we really tried to optimize our sales force and also tried to use our resources more efficiently.

And then if you look at admin expenses, it decreased a little bit, sort of a smaller number, 3.3%. But if you exclude the Singapore learning center operations that we acquired last year, that reduction in admin expense is actually about 11% YoY. And by the way, the Singapore operation is a positive EBITDA business. So just to put that on record.

And then in terms of R&D, obviously we continued to invest in R&D because, you know, we have to

continue to put resources to develop new offerings in terms of gaming and also in education.

Then on the bottom line, as I mentioned, driven by sort of cost efficiencies and also partially by investment income, we're actually seeing a positive growth in EBITDA by 12.9% and also non-GAAP EBITDA as well, actually a larger 33% increase in EBITDA. And as well as profit before taxation, also a 21% increase in profit before taxation. And if you look at the net profit attributable to owners of the company. That's sort of the Bloomberg number, right? So it's a decrease of 20% to 400 million (RMB). But I want to point out that there's actually a one-time deferred tax provision of roughly about 40 million USD, which we have to record in the first half. And what that is, is really a provision on the deferred tax asset that we have to record on the books of Mynd.ai. The reason for recording that is because it's according to accounting principles, you have to record it just in case, you know, Mynd.ai does not have enough income to offset the tax loss carried forward. Because that's what that is. That's tax loss carried forward. That actually can be carried forward for 7 years. So unless we can't be profitable in the next 4-7 years, otherwise we actually can reverse that provision in the future years. So I think that's really a one-time non-cash, non-operating item that you guys should take note of. And if you exclude that item, our net profit actually increased by 24%.

Actually, if I look forward a little bit, right? So if I look forward at the net profit figure for the full year (excluding the one-time deferred tax provision), I think what we're looking at is actually a number that's actually very much in line with many of the sellside estimates and also the Bloomberg consensus. So I think I hope you guys can take note of that. We're confident of the full year bottom line performance.

Then on the balance sheet, I'll just highlight the cash balance. We want to include liquid investments, as cash and liquid investments is a more proper metric, because we do invest in very liquid investments. For example, we invested in some Ethereum (ETH), as some of you guys would know. And we're actually sitting on a pretty profitable position right now on that. If you look at our cash and liquid investments balance, as of the end of the first half, it actually increased by 11% compared to the end of last year.

Okay, so this is the segmental financial highlights. First of all, the top line. Going through the gaming and application service segment first. If you look at the gaming, it's a stable performance, a little bit of slight 0.8% negative growth. And I would attribute that to a couple of reasons. One is that's something that Lin Chen is gonna highlight. We had a little bit of short-term issues on the overseas gaming side, and that led to a material decrease in our overseas gaming.

The second thing is the overall gaming spending, I think if you look at the industry gaming spending, looking at the research report, like the Gamma sector report, first half is roughly about 2% growth for the

entire domestic gaming industry, right? If you take out the mini games, it's actually a reduction of 2.8%. So I think it's a very stable performance for us in light of the market. We did not launch any new games in the first half. So that's also part of what we have to consider. Yeah, I'll let Lin Chen go more into that.

Then the gross margin decreased a little bit. I think that's mainly a mixed issue. Because gaming is a slightly lower percentage of the whole segment's revenue. So that led to a little bit of a lower gross margin. But if you look at the gaming gross margin per se, then it's actually pretty stable.

And then on the SG&A side, it's pretty much in sync with what I just highlighted in the last slide. We decreased our sales and marketing, we decreased our admin expenses. A lot of that is driven by cost efficiencies and cost rationalization. What we did in the first half was actually we did a headcount review and we actually rationalized some of the headcounts, and in the meantime, also upskilled our resources and our people.

And then on the Mynd.ai side, we're seeing a 23.5% decrease in our revenue. And I think there are a couple of factors. So first is we're still seeing a lot of normalization of the demand of the hardware sector after the very large Covid funding that we saw in the past. And I think that's one factor. And the other factor is really inflation also playing a role in that as well, because inflation really affected teacher salaries, affected some of the recurring overhead of the schools. And that squeezed the budget a little bit for some of our customers and that affected our hardware revenue.

But I think the good news is that we're not really focused on hardware, right? Yes, we are focused on hardware because that's our bread and butter from a revenue standpoint. But we're more really moving into the software and service-based model, right? So that's what Simon mentioned. This is something that we're really gonna dive into that when Mynd.ai has its own Capital Market Day.

Then for gross margin, it increased by 4.3 ppts. I think that's again cost savings, efficiencies... We experienced a decrease in the components cost, right? A lot of work on that. And also we had decrease in the freight cost. We also moved a part of our contract manufacturing into Mexico to reduce some of the other costs. And also we reduced our warranty expense as well, as that's also part of the cost of goods. And that's because our failure rate actually is lower, which is good, right? So that's why we saw an increase in the gross margin percentage.

And then on the SG&A side, sales and marketing decreased by 26% as we optimized our sales team while we continued to deepen the reach of our customer base, right? So we're not reducing our sales force to

get a lower revenue. We're really rationalizing our sales force to get better revenue in the future. And for admin expenses, you'll notice that there is a 37.9% increase, which sounds a lot, right? But again, remember we acquired this Singapore learning center business last year and that business actually contributed a lot of sort of admin expense, right? It's a positively EBITDA business but contributed a lot of admin expense. So if you look at that line item individually, you see a very large increase. If you exclude that Singapore operation item, sorry, the Singapore entity, the admin expenses only increased by 11%. Hopefully that gives you guys a clear picture of the segmental financials and that's it for my part. I pass the stage to Lin Chen.

**Lin Chen (Translation):**

Okay. Thanks, Ben.

Good morning everyone. It's a pleasure to walk you through NetDragon's gaming sector performance in 24H1.

First, we believe the fundamentals of our gaming business remained very strong overall in 24H1. In the post-COVID period, we continued to invest in our IPs, our user base and in refining our operations. Gaming revenue maintained very good stability, providing a sound foundation for our future growth.

Beyond revenue, we focus on the influence of our IPs, the number of active users, as well as the effectiveness of our marketing strategies. I will detail the achievements we made in these aspects in H1 over the next few slides.

In terms of PC and mobile game sectors, the domestic PC game market showed a positive trend. Our flagship IPs, i.e. *Eudemons*, *Conquer*, and *Heroes Evolved* saw revenue growth YoY on the PC platform. The domestic PC game market has a very stable user base with strong spending habits. This is a positive factor for us, both in terms of our user base and the overall MMO ecosystem. However, as Ben noted earlier, there were some short-term factors that caused revenue fluctuations YoY on the overseas gaming side.

On the mobile game front, in 23H1, we launched new mobile games. We have maintained strong, stable long-term operations for our existing mobile games. With several new mobile games in the pipeline to be launched in the next phase, we believe our mobile game revenue will be back on the growth track.

Next, I'll talk about our gaming business in both domestic and overseas markets.

In general, our revenue in the domestic market remained relatively stable. Growth in the PC sector was in line with our expectations, partially offsetting the revenue fluctuations experienced on the mobile front. In the mobile sector, we capitalized on traffic acquisition opportunities, such as the traffic brought by some mini-games, to optimize our channels and expand our customer base, so as to achieve HoH growth in 24H2.

Overseas revenue, as Ben mentioned, was impacted by some short-term factors, including bot issues with *Eudemons Online*. These factors caused short-term disruptions to our overall game ecosystem and earnings. The bot issues have been preliminarily addressed by 24H1. We believe we can put the game back on the normal growth track in 24H2.

As for the *Conquer IP*, we faced unexpected challenges with temporary electricity shortages, which, along with forex factors, affected our revenue. Now the electricity shortage issue has been largely resolved. We hope to address these issues and resume a growth trend in 24H2.

Next, I'd like to talk about where we've done well in our user fundamentals.

First, in the MMO PC game ecosystem, online user metrics are fundamental to revenue and long-term operations. Our continued investments in our IPs and refined operations, as well as our growth strategies, have produced positive results backed by user metrics.

In terms of user acquisition, the Simplified Chinese version of *Eudemons* is now available not only on PC but also as a cross-platform version, which has significantly enhanced our user reach and stickiness. The number of active users on the cross-platform version shows that this dual-platform approach effectively reaches users and translates into user activity. We have also placed great emphasis on user growth in this aspect during 24H1.

For long-term operating games, we continuously optimize user onboarding by lowering the entry barrier. In 24H1, we made significant adjustments to the new player onboarding process. This has resulted in effective user growth, as shown in the user metrics.

Although we reduced spending on user acquisition, we have reached users more effectively through live streaming and other methods.

In terms of long-term operations, in 24H1 we increased the frequency of content updates and diversified

the contents of our games.

In 24H1, we worked on various aspects, including lowered entry barrier for new players, the Year Eudemon - Dragon, and crossover with other IPs, to consistently deliver higher-quality content to our users.

The release of high-quality content has accelerated content-driven revenue growth and steadily increased the number of active users. This has laid a strong foundation for the long-term operation and user activity of the *Eudemons* IP. In terms of our content-driven revenue strategy, as mentioned previously, the spending habits and engagement patterns of domestic users have changed remarkably. We will continue to shift toward cultural and content-driven spending.

In 24H1, the shifts in user habits have actually met or even exceeded our expectations. A prime example of our content-driven revenue strategy is the sales of the Year Eudemon. This year, sales from the Year Eudemon- Dragon surpassed 100 million, marking our first nine-digit revenue item and representing a 45% increase YoY.

Content-driven revenue has become our key focus since we noticed the growing trend of content-driven spending last year. The Year Eudemon-Dragon sales has validated our insights into the market as well as users' spending behavior.

We've also upgraded content and gameplay with a cultural approach, which has attracted more users. These upgrades achieved better user activity and revenue than similar content and gameplay upgrades released previously. Looking ahead, this trend is clearly set to continue. Thus, starting in 24H2, we will actively prioritize our R&D resources in these areas to further drive revenue growth.

Just now, Simon mentioned *Black Myth: Wukong*. In fact, we began incorporating traditional Chinese elements across the board last year, including music, art, and skill design, to upgrade the content comprehensively. I believe *Black Myth: Wukong* is more than just an isolated phenomenon. It serves as a remarkable bridge that allows domestic game players to experience and connect with traditional Chinese culture through in-game characters. As content creators in gaming, we craft in-game characters, especially by reinterpreting historical IPs, to effectively convey the cultural messages we wish to share. Players have received this approach very positively. For example, the Eudemon Mulan we introduced in July is a creative take on a historical figure, which makes the *Eudemons* IP more enriched.

Apart from the fantasy aspect, we also brought in the “Jiuzhou Continent” (new gaming contents with



Chinese cultural backgrounds). From the overall Eudemons universe to the characters and in-game purchases, we provide users with an immersive gaming experience, which helps to enhance our entire ecosystem and spending structure.

What we just discussed was about the *Eudemons* IP. Let me also briefly talk about the *Conquer* IP. First, we experienced some temporary impacts overseas. The primary issue has been electricity shortages, which have directly reduced the amount of time players can spend on the game. We hope that with electricity supply restored in 24H2, we can get back on a normal growth track. In fact, when denominated in Egyptian pounds, the decline in user spending is only 1.3%.

However, we see an improvement in the percentage of paying users, which also reflects our potential for long-term retention. Moreover, the number of casual users engaging in gameplay beyond the "cultivation" element of our MMO gameplay system is continuously growing.

This leads us to our new game, *Code - Alpha*, which is based on casual gameplay. We conducted some preliminary tests in 24H1 and the results have been very positive. We plan to develop it into a standalone mobile game to reach a broader audience and market. We have already seen promising results in the testing phase. It will help us introduce this gameplay and content to more markets and users.

Next, our *Heroes Evolved* IP. This IP regained positive growth in 24H1, particularly on the PC platform, where there was a very noticeable growth trend.

From many core metrics, including user activity, number of games played, percentage of paying users, user engagement, and user spending confidence of MOBA games, we are seeing a U-shaped reversal trend rather than seasonal fluctuations. We hope that the *Heroes Evolved* IP will maintain this trend in 24H2. The current trend aligns very well with our expectations. This will also drive our efforts to reach and convert younger users. This creates a mutually reinforcing and complementary relationship between our MMO and MOBA products.

Now that we've covered the fundamentals of our existing games, I'd like to talk about some of the progress we've made with our new game pipeline in 24H1. After 1-2 years of continued R&D investment, most of our new games successfully completed the mass production stage in 24H1. After we confirmed the gameplay prototypes, mass production has also progressed smoothly. The majority of these games have been user tested and received positive feedback.

Starting with the *Eudemons* IP, we have *Eudemons Remake Version* in the relatively strong PC market. This version is a remake aimed at re-engaging past users. The *New Eudemons PC* is expected to launch next year, targeting both our IP users and non-IP users. It is a higher-quality, high-definition version aimed at breaking through our existing user base. Both versions are currently performing as expected in terms of mass production and testing results. *Eudemons Pocket Version 2* is also under development and testing, with plans for future release.

Next, the *Conquer* IP, which primarily focuses on casual gameplay. As mentioned earlier, our casual game *Code - Alpha* has entered small-scale testing. It has slightly exceeded our expectations with its current external testing and spending data. The release of this game in 24H2 is confirmed. It will contribute to our revenue growth in 24H2.

Next, under *Heroes Evolved* IP, we have the overseas version *Code - Nirvana*, which will undergo upgrades for more globalized content, enhancing our presence in the global MOBA market. In addition, *Heroes Evolved 2.0* with upgraded gameplay will further strengthen the long-term competitiveness of our games.

Next, in the ACGN sector, the overseas version of *Under Oath* underwent testing in 24H1. I will cover this in more detail in the upcoming slides. In addition to our existing IPs, we have games under new IPs in the pipeline, including *Miracland Saga (Code - Dragon)*, *Nebula Rangers (Code - Ge Cao)*, and *Huan Kong Cheng Zhan Ge*. All of these games underwent external testing in 24H1.

Next, I'd like to highlight three key new games.

The first is *Eudemons Remake Version*. As the remake of a classic IP, it has a very clear business model. We've dedicated the former *Eudemons* dev team and core R&D resources to this project to have significant upgrades in game design and art design. Feedback from our IP users indicates strong approval of this approach. The mass production is progressing smoothly, and we expect to launch the game around Q1 next year after we receive Ban Hao this year. This game provides pretty high certainty. We hope it will reignite interest among past users and drive at least a 10% revenue growth for the IP line.

*Nebula Rangers* is another key game in our pipeline. It's our first mobile game powered by Unreal Engine (UE). The concept of the game, featuring a roguelike, top-down shooter, has proven to be very popular during our testing on TapTap. It has received positive feedback on both TapTap and Apple for its satisfying shooting and hack-and-slash experience powered by new technology. We plan to invest more resources

into this game to develop a long-term product, rather than one focused on short-term monetization. The gameplay is already well-established, and we will be adding more commercial and long-term “cultivation” content. We aim to launch it next year and hope it will attract a large user base and operate sustainably.

Last but not least, I'd like to talk about *Under Oath* in the ACGN genre. Its overseas version is different from the domestic version. As part of our localization efforts, we've made extensive upgrades to the game's art design, storyline, and voice acting. These upgrades have been well received by Japanese users, according to initial test data. This is a crucial step in upgrading content for a global audience. In terms of our globalization strategy, appealing to local users with localized content and managing long-term overseas operations are key tasks for our R&D teams. The test data for this game has already met our expectations. We plan to launch it in 25H1. It will also play a strategic role in our content strategy in Japan and Korea.

Overall, we achieved solid fundamentals in our existing games in 24H1. Although there were some short-term fluctuations, we are confident that we have a positive outlook for 24H2.

In terms of our strategy and investment in the user base and market, we will continue to focus on our key IPs and seize opportunities such as AIGC and what I just mentioned. We will continue our efforts to maximize the potential of these areas.

Regarding our new game pipeline, we will utilize the insights gained from the current test data to launch our new products in the next 6-9 months, aiming for further growth. We are confident that NetDragon's gaming business will achieve even better results in the next phase. Thank you.

**Simon:**

Thank you, Lin Chen. What I'm going to do is actually go through Mynd.ai very quickly at high level. I think I'm not gonna go into detail because Ben talked quite a bit about some of the numbers, but directionally, I'll tell you where we're going.

We have some challenges in terms of the revenue, but the good news is actually a lot of metrics are up, actually we have another slide on it. So what we are doing is actually optimizing everything and also being prepared for the future.

So this is actually our advantage, I said, but the biggest one is our 1.5 million classrooms around the world we are adding to it not as the same pace. But I think one thing I'd like to mention very quickly is that actually

we have a new product coming out towards the end of the year. I can't go into detail, but that's actually very very exciting and actually very suited for where we are today and also go into the future in terms of services, in terms of embracing AI. Again, some of the metrics, gross margin up, we are managing the sales and marketing expenses, and EBITDA, and all the good stuff.

But it's just like a life in a company we need to manage this, whether we are growing, or we are facing headwinds. So just try to sum it up, we do have some challenges, some headwinds, but we believe this is actually a tremendous market for us going forward. The fact that we have AI coming in with services people start to embrace and they would take us also outside the classroom and possibly into people's homes for learning. To sum it up, I think it's much better for us to have the management team of Mynd.ai to talk to all of you. We decided to do a Capital Day for Mynd.ai later on in the year. I'm sure you'll be hearing about it.

Okay, very quickly on the outlook. Actually Lin Chen talked about the gaming already. So we are excited because there's actually I think, unfortunately, it's not our game, Wukong, but actually that gives you a view of where the market is going. I think one of the things we talk about and we've been doing it for a long time, and we did not highlight it well enough on gaming, is actually a global south, in which the Middle East is actually part of it. The fact that we've been in the Middle East for a while, and if you look at a lot of the activities, especially in Saudi Arabia. That whole area is gonna be an opportunity for us now, not only for gaming, but also over to education. We're doing a lot of work.

A couple comments on how we're addressing going forward in the education market. So We're doing it the same way which is actually organically we grow. Organically means we're gonna create our own product and do that, we can also do it inorganically which is actually we'll find some other way whether we partner or maybe do some acquisitions. That's the direction. That's the strategy.

I'm not saying we will do some tomorrow but that's what we're gonna be doing. So with that just got to finish for the year, we are cautiously optimistic about both businesses, but we have to be cautious and recognize there are some economic challenges for the US, and also for Europe, and also certainly for this part of the world. So we are very cautious about how we approach the market to make sure we do all the right things for the business, both in the short term and also in the long term.

With that. So why don't we open it up? So what do we do?

**Moderator:**

Thank you, Dr. Leung and management.

Now it's time for our Q&A section. If you have questions, please raise your hands. Our colleagues will pass the microphone to you. Before your questions, please also tell us your name and the firm you're representing. For investors on the webcast, if you wish to raise questions, please feel free to enter your questions in the text box. We will read it out for you.

Next, let's welcome our first question on the floor. Please.

**Li Chenghao, CICC (Translation):**

Good morning, management. I'm Li Chenghao, Analyst at CICC.

My questions are about your gaming business. I've noticed that you reduced your overall sales and marketing expenses in 24H1. Looking ahead, beyond genres like MMO and MOBA where you are traditionally strong, you are expanding into shooter games and ACGN games. Since your experience with user acquisition and traffic in these new genres may not be as extensive as in MMO or MOBA, so I'd like to better understand how developing and launching these new genres may affect your sales and marketing expenses and overall revenue and profitability? Thank you.

**Simon (Translation):**

Over to you, Lin Chen.

**Lin Chen (Translation):**

You mentioned a few points. First, regarding the decrease in our sales and marketing expenses. For the MMO genre, since our user base is highly stable, we won't rely on user acquisition for user growth. Instead, we might use strategies like releasing expansion packs to re-engage past users. Even though our sales and marketing expenses have decreased, our number of new users has actually improved. This indicates that in operating our IPs, creating better content to attract past users back to our games and lowering the re-entry barriers is more effective than user acquisition. This helps us expand the overall user base and aligns with what we discussed earlier that good content is the best way to draw users in.

For your second question, regarding our strategy for new overseas markets and growth outside the MMO genre, our approach in ACGN and top-down shooter genres will certainly be different from that for MMO. User acquisition will be necessary, but the entry barrier will become lower and lower, and companies will have their user acquisition best practices. We believe we already have some know-how in user acquisition from our past overseas efforts. Through user acquisition and content marketing, we are confident in

achieving strong user growth results. In key areas where we have advantages, we may also consider engaging external agencies, so that we can focus on long-term operations. In regions where other companies or agencies have a competitive edge, we may collaborate with them in those marginal regions to optimize user growth.

**Simon (Translation):**

Actually, I see this as a positive thing. By doing so, we get to adjust our expenses. I think that's a very healthy approach.

**Moderator:**

Thanks for the question.

We would like to welcome our next question. The gentleman over there, please.

**Wang Yida, Guoyuan International (Translation):**

Okay. Thank you, management. I'm Wang Yida from Guoyuan International.

My question is about your financials. I've noticed that while your cash has increased significantly, your loans have also risen, now amounting to over a billion (RMB). Could you explain this situation? What are the purposes of the loans and what are your plans for managing this in the future? Thank you.

**Ben (Translation):**

Got it. Good question. A significant portion of the loan increase you've noticed is due to what we call "arbitrage". For example, we have some loans in China and at the same time hold some deposits, which allows us to make a small profit. If you exclude this, our loans would theoretically have decreased. Before we completed the Mynd.ai acquisition, or the GEHI acquisition, we had a convertible bond (CB). After the acquisition was completed, the CB was significantly reduced. Now our CB is much lower than before. So the increase you're referring to is mainly due to the arbitrage I just mentioned.

**Wang Yida, Guoyuan International:**

Short-term?

**Ben:**

Yes, short-term.

**Simon (Translation):**

Yes. We take a comprehensive view rather than focusing on individual items in isolation. With our strong cash position, we need to consider how to optimize our profits. I think this is one aspect of our financial management. For instance, we've invested in some cryptocurrencies, like ETH, although we won't disclose our most recent trading activities. We've also invested in some funds, which have yielded very healthy returns. We are quite pleased with that.

Of course, we need to be careful with how we manage our cash. We take a comprehensive approach to managing our cash rather than focusing on one area only. This means not only investing in our businesses but also finding ways to optimize returns on idle cash.

**Moderator (Translation):**

Thank you. Let's now welcome the next question. The lady over there, please.

**Rachel Guo, Nomura Securities (Translation):**

Good morning, management. I'm Rachel from Nomura.

I have a couple of questions regarding the gaming business.

First, I'd like to understand the reasons behind the decline in mobile game revenue in 24H1. Could management please elaborate on the reasons?

Second, given the challenging macroeconomic environment right now, have you observed any changes in the spending behavior of players, particularly for PC games? We've seen an increase in new users, but revenue growth has been disproportional. I'd like to better understand how the number of paying users has changed, and whether there have been any changes in the spending behavior of heavy and casual players. Thank you.

**Lin Chen (Translation):**

Okay. You just raised several questions.

The first question is about the mobile game segment. There are two main factors at play here. The first one is the product launch schedule. In 23H1, we launched a new game, *Eudemons Mobile 2*, while in 24H1 there were no new games launched. The fluctuations in mobile game revenue were tied to our product release schedule.

Our existing mobile games have been relatively stable, although there have been some fluctuations. As I mentioned earlier in my slides, this is related to our channel optimization efforts. We're now aiming for a longer lifecycle for our mobile games, so we've been managing user acquisition channels more closely. If a certain channel is not producing a good return on investment, we will make proactive adjustments. While this caused some short-term impacts on our ecosystem, we've seen the ecosystem recover over the past few months. The fluctuations in mobile game revenue are also a result of our proactive approach to optimizing our user acquisition methods and cost-effectiveness.

Your second question is about the discrepancy between user growth and user spending in our PC games. There are two factors at play. First, attracting users to the game is just the first step in the monetization process. It takes a process from re-engagement of users to spending. From a long-term perspective, we don't want to "harvest" users right after they return, like users come back to the game attracted by high-quality content, and then immediately get monetized for our short-term profit. Instead, we would like to take a phased approach.

In the initial phase, our focus is on bringing users back, getting them to enjoy our content and stay. When they become regular players of the game, we gradually introduce opportunities for spending. I believe the return of users is a positive sign, and the next step is to take a measured approach to maintaining user activity and encouraging spending.

Third, our proactive strategy in understanding user behavior and market trends has proven to be effective. This is very important for us. For example, we introduced culturally-driven content, and as a result, we've seen a noticeable increase in user spending habits. In fact, we believe this growth trend hasn't fully materialized yet. While this year's macroeconomic conditions have made people more cautious about non-essential spending, there is also a growing willingness to pay for unique, high-quality content. This shift is promising as it aligns with the strategies we've been implementing, and we plan to further invest in this area in 24H2.

Regarding the PC game market, *Black Myth: Wukong* has probably brought us very encouraging news, since several of our upcoming games have improved in visual quality significantly. We were initially concerned about whether PC game players would embrace this and whether their existing hardware could handle our upgraded products. However, this news alleviates those concerns because it shows that hardware won't be a barrier to our enhanced visuals. From that perspective, it's actually very positive for us. Thank you.



**Moderator (Translation):**

Any other questions from Rachel?

**Simon (Translation):**

No. What about the webcast side?

**Moderator (Translation):**

Let me see if there are any other questions from the audience. The gentleman over there, please.

**Eric (Translation):**

Good morning, management. I'm Eric.

My question concerns long-term shareholder returns. NetDragon's dividend yield has remained relatively stable, with 40 cents (HKD) per share paid out in both H1 and H2. Is there a possibility of increasing the dividend payout? For example, could the payout ratio be raised, or are there any plans for share buybacks, etc.?

**Simon (Translation):**

We'll see how it goes. What you just talked about is how to optimize shareholder return. We will definitely look at that. But there's not much we could disclose now.

We already had buybacks, both in last year and the year before last year.

**Ben (Translation):**

Yes, we had buybacks in the last three years and also paid out two special dividends.

**Simon (Translation):**

The special dividends are more direct, investors can get the income immediately, right?

**Ben (Translation):**

I think if you look at historical data, since I've been with NetDragon for quite some time, our dividend payouts have actually grown over the years. We have a track record here.

**Eric (Translation):**

Okay. Thank you.

**Moderator (Translation):**

Thank you. Next, we'll take a question from the webcast, and then we'll return to the audience here.

The questions are from Alex at Essence International.

R&D expenses in gaming were relatively high in 24H1. Will you continue to increase your R&D staff? How do you plan to control expenses going forward? Thank you.

**Lin Chen (Translation):**

Regarding R&D in 24H1, the main reason was that our major PC games entered the mass production phase. As you all know, compared to mobile game development, PC games require a larger scale of investment. There was a slight increase in staff due to the smooth progress of mass production. However, the number of R&D staff is likely to decline in 24H2. This is mainly due to two reasons. First, I didn't go into full detail about AIGC adoption just now. At the previous results presentation, I mentioned that our AIGC adoption has been steadily improving. In 24H1, we achieved better HR efficiency, which means AIGC penetration and adoption continued to improve. In this way, while we increase headcount by 5%, we can see a 10% increase in output. This is something we are very pleased with.

In 24H2, we will continue to adopt AIGC and further optimize our cost structure through outsourcing. The trend in 24H2 is already quite stable, and we even hope to accelerate AIGC adoption to further reduce costs. In the long term, I believe AIGC will be very effective in improving the efficiency of game development. Therefore, in the long run, we expect to produce more and better products with a slightly smaller R&D workforce.

**Simon (Translation):**

Let me add to that. This is a very good question. When we talk about AI, I mentioned AI in education just now. Actually, AI is benefiting our entire company in two areas.

On one hand, AI enhances our products, such as our SaaS offerings. On the other hand, AI is helping us improve our internal operations and efficiency. This doesn't only apply to the gaming business but also to back-office management throughout the company. We're increasingly using AI in these areas as well.

So sometimes when you see our expenses decrease, it doesn't mean our efficiency is going down. It's actually the opposite - expenses decrease while efficiency improves. This is because AI has really become more and more helpful for us.

**Moderator (Translation):**

Thank you, Simon. Thank you, Lin Chen.

The next question is also from the webcast, from Zhao Maiqi from CPIC Asset Management.

What is your market share on the hardware side of your education business? What are the trends there? When do we expect to see a rebound in growth? Also, any staffing plans for the education business? Do you have any plans to hire more people in the future?

**Simon (Translation):**

In general, the challenges or headwinds that we're facing right now are not specific to our company, but to the market as a whole, particularly in the US, where we're the largest player. So the impact on us is more visible. However, our market share remains stable and we are still the leader.

To provide more context, we've done internal analyses and found that while our number of orders or contracts hasn't significantly changed compared to the previous year, the average value per contract has decreased. This is due to budget constraints in US schools or school districts, which are being eroded by inflation.

Another factor is the US elections. Many states are uncertain about the future, so they are being more conservative, which leads to challenges for us. However, our market share remains basically the same.

But when will the situation improve? Traditionally, revenue in Q1 and Q2 tends to be lower, especially in the US education sector, where purchases usually occur in Q2 and Q3. That's when we would see an upward trend. Looking ahead to 24H2, we anticipate some challenges, particularly in the US, due to the upcoming elections, which won't take place until November. That said, we believe the market is likely to rebound in 2025.

However, we don't think we have to wait for the market to recover. We need to be proactive. This is why we're exploring both short-term and long-term initiatives to see what we can do.

However, I can't go into detail now, mainly because Mynd.ai is an independent company listed on the NYSE and many of their plans have not yet been approved by their board. We will share more when the time comes.

If you want a clearer picture, please stay tuned for the Capital Market Day, where we'll provide more details. One thing I can say is that our future growth will definitely come from our services, from SaaS and CaaS. These will be the most important segments.

**Moderator:**

Thank you, Simon. Let's return to the floor.

If there are no further questions from the floor, we will move on to take questions from the webcast.

The next question is also about the gaming business. Question by Mr. D Teo from Wattenhill Advisors.

Thanks for the presentation today. Regarding the gaming business segment, please elaborate on how does NetDragon balance the need to attract and retain the best employees such as developers and testers, etc., to ensure timely and consistent quality of games and upgrades. For example, meeting KPI yet also keeping the salary competitive and not overpaying for talent.

**Simon:**

That's a very long question. How much time do we have? I think we need to spend the rest of the day to tackle it. Are you taking the question?

**Lin Chen (Translation):**

I'll answer in Chinese.

**Simon (Translation):**

Chinese, okay.

**Lin Chen (Translation):**

The gaming industry is talent-intensive. Game development can be divided into two parts: creative and production. In production, we aim for high quality and stability. Users expect consistently high-standard content throughout their gaming experience. They don't want a game that starts strong but deteriorates over time. Thus, the focus in game production is on high quality, efficiency, and output. These are the foundations of our expectations for the production teams. We continuously improve our processes and methods to ensure that both art design and content remain at a high level of efficiency and quality. This is how we manage and develop our production teams. Of course, the ultimate goal is to reach the standard of triple-A games.

Then, our core design team. There are two points to note. First, we aim to ignite their passion by identifying what they love. When employees work in areas they are passionate about and good at, they tend to be more energized and creative. This is the first point. Second, game development integrates art, programming, design, and even historical knowledge. Therefore, we place a high value on cross-departmental collaboration. Having a creative team that works closely together is crucial to unleashing their creativity and enthusiasm. This is the most important thing for our creative team.

In terms of compensation, as a listed company, we offer competitive pay as well as short-term and long-term incentives to motivate our employees. We believe an elite creative team is central to embodying video games as "the ninth form of art."

**Simon:**

Let me do this. So I'm gonna talk about it in general, like I said, I have to apologize to the gentleman. Is it a gentleman who asked the question? So I think what we do exactly would summarize what are Lin Chen has said and then we'll send it to him.

But in general, it's like a dynamic process. We don't have one set of rules addressing everything. So what he's saying is that actually we're gonna be looking for different people for different parts of our businesses. We want people to be creative, which is a core group, but we also need a lot of foot soldiers to help us to kind of implement what we want to do.

I think the salary part is actually quite simple. We need to be market competitive, right? So it's actually we're gonna have a mix of people in terms of skill set. And also we want to give them a meaningful job so they can be satisfied with what they're doing.

I want to bring AI back in here. I think that's part of the whole strategy. With AI, we can have AI do a lot of the less interesting job or repetitive job of everybody, and allow people to focus on being more creative, being more entrepreneurial. So that's the overall direction. Again, not just for gaming, but for other businesses, too.

**Moderator:**

Thank you, Simon. Thank you, Lin Chen. Any questions from our floor?

Okay, this concludes the presentation today. We wish you have a very good day today. Thank you very much.