

Transcript of conference call held on 12 May 2016

Jerzy Kosiński: Ladies and gentlemen, my name is Jerzy Kosiński. Welcome to the the CD PROJEKT Q1 2016 results teleconference. I would first like to introduce our guests: President of the Board, Mr. Adam Kiciński, and Vice President of the Board for Financial Affairs, Mr. Piotr Nielubowicz. The conference will open with a presentation by the Management Board and conclude with a Q&A session. I now give the floor to the Management Board.

Adam Kiciński: Good morning, this is Adam Kiciński.

Piotr Nielubowicz: Good morning from Piotr Nielubowicz.

AK: Today's presentation will consist of approximately 10 slides. Together with Piotr we will focus on financial results and I will also mention our upcoming release. The entire presentation should last around 15 -20 minutes, following which – as mentioned before – we will proceed with a Q&A session.

PN: Hello again. We will begin with a discussion of our results. The first slide presents the results of the Group in the first quarter of the current year. Much like with annual results, we decided to not limit ourselves to a comparison with the first quarter of 2015 – which preceded the release [of The Witcher 3] – but instead compare the current results with four past quarters, including two quarters immediately following the release of The Witcher 2 in 2011 and 2012. This should hopefully give you a more complete picture of our standing.

Regarding revenues, the Group reported nearly 87 million PLN, which is approximately 3.4 times more than the average revenues for the four past years. Note that in the past years our revenues also included the “videogame and motion picture distribution in Poland” activity segment which is no longer part of the Group. In the scope of current-quarter sales revenues attributable to our key activity segments, i.e. videogame development carried out by CD PROJEKT RED and digital videogame distribution carried out by GOG.com, the increase in revenues compared to our previous four-year average was fivefold. This increase translated into respectable gross sales revenues – nearly 70 million PLN, which is eight times more than our four-year average. Such an increase in the sales volume and margins required a commensurate increase in operating expenses – these also increased, but only by 3.7 times compared to the four-year average. Regarding costs, most of them were selling costs – 16.8 million, of which slightly over 5 million represents digital distribution (GOG.com), while more than 11 million – nearly 12 million, in fact – represents videogame development. These costs are also associated with activities which will bear fruit in the second quarter of the current year, including the run-up to the release of the upcoming expansion pack: Blood and Wine. Our income from operating activities – 38.5 million PLN – benefitted from the positive balance of financial revenues and expenses; especially interest on cash assets held by the Group. Pre-tax income was 40 million PLN, with 32.5 million PLN in net profit. Accordingly, the Group's net profitability in the first quarter of 2016 was 37% - this represents the ratio between after-tax profit and revenues.

Moving on to our second slide, it presents the results of the GOG.com segment, previously called the digital distribution segment. Q1 profits were slightly greater than the corresponding profits in the first quarter of the previous year. This increase is rather limited as the current quarter saw no major releases or other spectacular events which would drive up customer activity – such as the release of The Witcher 3 in Q2 2015 or new language versions rolled out progressively throughout the past year. Even so, the current quarter was strategically important for GOG.com, since late in 2015 GOG.com – together with CD PROJEKT RED – began preparations for the release of a new game in a format we have not previously explored, and in January GOG.com set up a dedicated

team for that purpose. The results of this activity are not yet visible but the team is hard at work, which of course called for record-breaking recruitment expenses – also in conjunction with continuing development of GOG Galaxy. Let's not forget that GOG.com continued to develop additional language versions and support for additional currencies – rolled out several days ago, in May 2016. In summary, GOG.com posted a quarter million PLN in Q1 net profit. This is slightly less than in the first quarter of the previous year but note that in recent years the first quarter has never been particularly important nor provided a major contribution to the results for any given year.

In the videogame development segment, called CD PROJEKT RED in our current financial statement – see the next slide – highlights include over 68 million PLN in sales revenues, which represents a tenfold increase over the corresponding period in 2015, and an exceptionally high gross sales margin – 63.5 million PLN. This margin is generally due to the fact that most of our sales revenues are attributable to The Witcher 3 and, as announced at our annual conference, at the end of 2015 our reported inventories still included a bit over 1.5 million PLN in The Witcher 3 development expenses. All of these expenses have been discounted by the end of the current quarter. Accordingly, most ongoing sales of The Witcher 3 are recognized as pure revenues, with no significant offsetting costs. From now on further sales of The Witcher 3 will not incur expenses associated with procurement of products and services sold, reflecting past development efforts. Regarding selling costs, nearly 12 million PLN, as already mentioned in the scope of the Group's activities, are chiefly associated with events scheduled for Q2 2016. This second quarter will be particularly intensive – it will include, among others, the release of the Blood and Wine expansion pack. General administrative expenses and other operating expenses comprise employee compensation and provisions for future compensation dependent on our financial result. This result was – again – particularly strong in the current quarter, with 42.9 million PLN in gross revenues and 34 million PLN in net profit, for a 50% net profitability and a very respectable result.

The next slide presents the Group's assets. No important changes occurred with regard to fixed assets. The slight observed decrease is due to partial dissolution of deferred income tax assets. In the scope of working assets, the most interesting item is inventories. The aggregate value of our inventories at the end of March was 48 million PLN, most of which – 42 million PLN – is attributable to half-finished products and production in progress, and corresponds to to-date expenses associated with development of new games, the most important of which are, of course, the upcoming Blood and Wine expansion pack and Cyberpunk 2077. Regarding finished products recognized as inventories, their aggregate value was just over 3.5 million PLN. This figure comprises the development expenses of the first expansion pack – Heart of Stone. Much like with Blood and Wine, these costs will be discounted in proportion to the sales of the Expansion Pass and Blood and Wine, set to begin on 31 May.

Current income tax receivables and other receivables should be analyzed together. Owing to our activity profile, most of our receivables are licensing royalties which call for withholding tax to be levied upon our foreign partners. This tax is then reported to us – we collect the appropriate declarations – following which we can recognize any withholding tax paid in our name by our foreign partners, and aggregate it with our domestic liabilities due to tax authorities. Up until the receipt of such declarations – or certificates – the corresponding receivables are reported as “other receivables”, but once the declarations are collected, they are reclassified as “current income tax receivables”, which is why the former figure is lower and the latter figure has increased as of March 2016. Regarding other working assets, no important changes have occurred. The observed reduction is mostly due to a reduction in GOG.com's prepaid expenses, i.e. royalties payable by GOG.com under distribution agreements. And now for the most interesting item on balance sheet – cash assets. For the first time we have crossed the 400 million PLN threshold, with 434.8 million PLN at the end of March. This is 41 million more than at the end of December 2015.

Moving on – the next slide presents the Group's liabilities. Equity, of course, increase due to profit in the current period and also, to a much lesser extent – i.e. by 903 thousand PLN – due to payments obtained by the Company in association with issue of stock under the last year's incentive program. No major changes occurred in the scope of the Group's long-term liabilities. The observed reduction is due to partial dissolution of deferred income tax provisions. Regarding short-term liabilities, trade liabilities remained relatively unchanged since the end of the previous year, and are closely linked to the scale of the Group's ongoing activities. Of note is the “other liabilities” item, which mostly aggregates advance licensing royalties received in connection with our future releases – at the end of March this mostly comprised preorders of expansion content which will be recognized as revenues following the release of Blood and Wine on 31 May. At that point the aggregate amount of 59 million PLN will be transferred to the revenues portion of the videogame development segment and duly reported in CD PROJEKT's financial statement. Regarding other short-term liabilities, the reported reduction is due to partial dissolution of provisions for compensation dependent on the Group's financial result – those provisions which were subject to settlements based on our annual results, occurring in the first quarter – as well as due to a reduction in income tax liabilities following recognition of the previously mentioned receivables, and current-year income tax offsets.

The next slide illustrates our cash flows. As I already mentioned while discussing changes in cash assets, this was a very solid quarter. The Group generated over 41 million PLN in positive cash flows, the vast majority of which – over 40 million – was from operating activities. No major outflows were reported in the scope of investment or financial activities, with a positive balance of cash flows across the board. Altogether, at the end of March the Group held nearly 435 million PLN in cash assets.

That's all from me. Back to you, Adam.

AK: I would like to say a few words about our upcoming release – the Blood and Wine expansion pack. Several days ago we announced that Blood and Wine would be released on the last day of May. The next slide presents the content of the limited collector's edition. Only the PC and PlayStation 4 releases will be offered as box sets – though, of course, all three releases can be purchased as digital downloads. Similarly to the previous expansion, the box set will cost more than the digital edition – it's priced at \$30 or €30. In terms of physical content it will be similar to Hearts of Stone.

The next slide shows what I already mentioned – that is that Blood and Wine will be offered for Xbox One, PlayStation 4 and the PC as a digital edition – which, of course, is our main distribution channel for this release.

Moving on with the fourth and final slide of my presentation – regarding the content of Blood and Wine – it adds a whole new area to the game world, which is a difference compared to Hearts of Stone. The previous expansion made use of existing areas, while Blood and Wine introduces an additional, major area, similar in size to one of three major sections of the base game. The expansion pack should provide more than 30 hours of gameplay, with more than 90 quests, 40 points of interest, over 30 new weapon types, over 20 new monster classes and 14,000 lines of dialogue. Compare this with Hearts of Stone, which featured approximately 6,000 lines of dialogue – in terms of conversations Blood and Wine is more than 2.5 the size of Hearts of Stone. The release date announcement effectively ended our “information embargo” and we began showcasing the new expansion pack to journalists representing key markets. Initial reactions are extremely favorable; everyone is very excited. This is, after all, the final installment in The Witcher trilogy; there will be no more expansion packs and we did our very best to ensure that gamers form fond memories of The Witcher. Blood and Wine is one of the most richly featured and coolest expansion

packs ever published – so, by all means, read the reviews and buy the game!

This concludes my presentation. We will now take questions from the audience.

PA: Ladies and gentlemen – we are now opening the Q&A session. To ask a question, please dial '01' on your phone keyboard.

The first question comes from Mr. Paweł Szukalski from ING Securities.

PSz: Good morning, I would like to congratulate you on your strong result. I am curious if you could elaborate on the structure of your inventories. Could you provide a breakdown into expansion pack development costs or tell us if this 15 million increase includes some development expenses associated with the unannounced release?

PN: Let me answer this. We do not provide a detailed breakdown of expenses with regard to projects. Regarding your other question – yes, it does include some of these expenses.

PSz: OK, thank you. I'd like to follow up with a second question related to what was presented at your previous conference, namely distribution provisions. How much of the 36 million PLN previously allocated to Q1 is now reported as revenues – approximately what part – I understand that distributors now offer discounts which use up some of those provisions – so how much of the announced 36 million in provisions is presented on the current-period balance sheet?

PN: The answer to this question is seemingly simple, but touches upon a more complex issue. We can assume that all provisions allocated to the current quarter are accounted for – so the report recognizes +36 million in provisions – however some of that figure was consumed on discounts or returns in Q1. Additionally, due to activities planned in Q2 and Q3 which have been agreed upon with distributors we also decided that some of those provisions would be recreated so that distributors are able to conduct the promotional activities which we expect them to carry out in the coming weeks or months. Regarding the balance of all these operations, at the end of March the reported aggregate value of provisions associated with licensing agreements with our distributors was approximately 17 million PLN.

PSz: Thank you very much.

PA: The next question will be asked by Mr. Tomasz Rodak, BOŚ Brokerage House.

TR: Good morning and congratulations on your result. Allow me to follow up on the previous discussion. Of the 17 million in provisions, how much will be dissolved – and in which quarter? That's one question – and also, do you expect reviews of Blood and Wine to appear on the release date or will there be a delay before reviews are out? Regarding the second quarter of 2016, do you intend to fully discount the development costs of both expansion packs by the end of the second quarter? And my final question – is No Man's Sky the game previously announced in your strategy as the first triple-A release from an external developer to be published by GOG.com?

PN: The first question concerned provisions and when they would be dissolved, right? As a rule, they would be dissolved in the second or third quarter, however they are partly associated with marketing activities agreed upon with our partners and distributors, including the release of Blood and Wine, and additional events scheduled for the summer holidays and early fall. So yes, they will eventually be dissolved, but they have been created for the purposes of these specific activities, which will result in their being consumed in large part.

AK: Allow me to field the second question – it is natural for reviews to appear before the release date. On the release day gamers are expected to have already been informed about the game. We are not going to provide specific dates but, as with every one of our to-date releases, reviews will be available before the release.

PN: The third question concerned our plans for disclosure of expansion packs' development costs in the second quarter, as a rule – yes, we plan to do so, as a one-time action; however note that we are yet to select the licensed auditor for the current year and our semiannual financial results are subject to review, so the decision on how to accurately present these expenses will be made in cooperation with the auditor. As of today we intend to disclose these expenses as Q2 costs.

AK: And no, No Man's Sky is not the triple-A release mentioned at our strategy conference where we discussed plans for the coming six-year period.

PA: The next question will be asked by Mr. Maciej Borkowski, PKO Brokerage House.

MB: Good morning; I want to ask about GamesCom and E3 – do you plan to showcase Cyberpunk 2077 at these fairs?

AK: No, we do not plan to present Cyberpunk at either event.

MB: Thank you, and I wish you success in marketing your expansion pack for The Witcher.

AK: Thanks!

PA: Ladies and gentlemen, I would like to remind you that in order to ask a question you need to dial '01' on your phone keyboard.

To ask a question, dial '01'.

Ladies and gentlemen, as there are no further questions, I would like to once again yield the floor to our speakers.

AK: Ladies and gentlemen, thank you for participating in our first-ever teleconference. We will try to summarize each future quarter in this way. The current plan is for annual and – possibly – semiannual results to be discussed at a live meeting, with Q1 and Q3 results presented at a teleconference. This, of course, is subject to events occurring in future quarters and we will adjust this general plans as the needs dictate. Thank you once again and see you IRL!

PN: Thank you as well.