

Transcript of a conference call held on 22 November 2017

Announcer: Ladies and gentlemen, welcome to the conference devoted to the financial results of the CD PROJEKT Capital Group for the third quarter of 2017. The conference will be hosted by Mr. Adam Kiciński, CEO of CD PROJEKT S.A. and Mr. Piotr Nielubowicz, Vice President and CFO of CD PROJEKT S.A. Their presentation will be followed by a Q&A session. I will now turn it over to the speakers.

AK: Good morning, this is Adam Kiciński [**PN:** and Piotr Nielubowicz]. The presentation we are going to discuss is available on our website at cdprojekt.com. It can be accessed by clicking the Q3 2017 results link in the corresponding tab; this is the first white rectangle on the left-hand side; middle link – it's easy to find. Piotr will discuss Q3 financial results in the main part of the presentation but before he begins, I would like to announce that we have reached another milestone – The Witcher 3 and its expansion packs (see second slide) have generated 1 billion PLN in gross revenues, that is pre-tax revenues. As you can see, the return on investment on quality games can be truly amazing and that's why we are hard at work on our future releases, believing that we have not yet said our last word. Of course, we continue to successfully market The Witcher 3. Over to you, Piotr – with slide 3.

PN: At our previous conference we expressed satisfaction with our H1 results. While revenues were 20% lower and net profit 12% lower than during the comparative period, we all knew that the comparative period coincided with the release of Blood and Wine – a major expansion pack for The Witcher 3.

Moving on to our second slide – we compare our semiannual results with Q3 results, both in 2016 and 2017.

On slide 4, our current comparative period for third-quarter result also represents an ambitious challenge. A year ago, at the end of August, we released The Witcher 3 Game of the Year Edition. This was our main product, driving sales in the subsequent, fourth quarter. This year, in Q3 2017 we continued selling previously published games while also working on balance changes and improvements for GWENT. As you know, GWENT has been in the open beta testing phase since May, but it already generates revenues for the Group. Consolidated sales revenues of the CD PROJEKT Capital Group in the third quarter amounted to nearly 85 million PLN, which is only 16% less than during the corresponding period in 2016. The net profit for the third quarter was nearly 36 million PLN – essentially identical to our net profit in Q3 2016, which, as I already remarked, covered the launch of The Witcher 3: Game of the Year Edition.

Cumulative results for the first three quarters of the year are presented on the next slide (no. 5).

Owing to strong sales in the third quarter, cumulative sales revenues for the period between January and September of the current year were nearly 340 million PLN, 283 million of which represents our gross sales profit. The net profit after taxes over the first three quarters of the year was 154 million PLN, which corresponds to 45% profitability of sales.

Analyzing the net profitability of our activities – for each of the presented periods in 2017 this ratio improved in comparison with the corresponding periods in 2016, which was, after all, a good year for the company.

The profitability and financial result of the Group was influenced, first and foremost, by the CD PROJEKT RED segment, whose results are presented on the next slide (no. 6).

In the scope of the CD PROJEKT RED segment, third-quarter results were primarily driven by strong sales of The Witcher 3 – along with its expansion packs – as well as by revenues generated by GWENT. CD PROJEKT RED revenues in the July-September period were 58 million PLN. Following deduction of COGS, the sales margin was 55 million PLN.

In comparison with Q3 2016 – which, as already remarked, saw the release of The Witcher 3: Game of the Year Edition – we reported significantly lower selling costs. This is due to two reasons: intentional reduction of GWENT promotional expenses during the third quarter, and recognition of a refund of to-date marketing costs incurred by one of the Company's foreign partners, reducing our selling costs in the current profit and loss account.

General and administrative expenses at CD PROJEKT RED remained essentially unchanged in comparison with the previous year.

The reported higher value of financial revenues was mostly due to a dividend received from the subsidiary company last year. This dividend is subject to consolidation eliminations.

Altogether, during the third quarter of the year, CD PROJEKT RED earned nearly 33.8 million PLN in net profit. Following deduction of all applicable costs and income tax, the net profitability of CD PROJEKT RED was 58%.

Let's move on to the next slide (no. 7), which presents our other segment – GOG.com.

The third quarter of 2017 saw the strongest sales of any third quarter in GOG.com's history. Sales revenues were 33 million PLN, which is over 40% more than during the corresponding period in 2016. For the second quarter in a row the most important product for GOG.com was GWENT. The participation of GOG Poland in the GWENT development consortium also resulted in somewhat improved sales profitability. GOG's aggregate sales profit for the July-September period was 11.3 million PLN, nearly 50% more than during Q3 2016.

Increased sales in the GOG.com segment resulted in increased selling costs and administrative expenses; nevertheless, their growth was outpaced by increases in sales profits. Altogether, the profitability of GOG's operating activities was over three times greater than during Q3 2016, while the net profit – nearly 2 million PLN – represents a nearly fourfold improvement over the comparative period. In summary, this was a good quarter for GOG.com.

Of particular note are the longer-term results posted by the CD PROJEKT Group, which I would like to present on the next slide.

Here, we compare three trailing twelve-month periods, each ending on 30 September – that's as if our fiscal year ended three months before the end of the calendar year.

The first bar represents the net profit of the CD PROJEKT Group for the period which coincided with the release of The Witcher 3 – this was, of course, the best period in our to-date history.

The second bar represents the following 12 months, which saw several smaller, but notable events: release of Hearts of Stone, in Q4 2015, release of Blood and Wine in Q2 2016 and release of The Witcher 3: Game of the Year Edition in Q3 2016.

The final bar corresponds to a period which began after the final release event associated with The Witcher 3 and its expansion packs, i.e. on 1 October 2016, and ended on 30 September 2017. While no new expansions or bundles of The Witcher 3 were released during this time, we did introduce another new product: GWENT. This game remains in its beta testing phase, yet it already generates noticeable revenues. Coupled with continuing sales of our other products, these revenues mean that the recent 12-month period was essentially equal in terms of profits to the preceding period – which saw a number of major releases.

GWENT naturally benefits from the recognizability and popularity of The Witcher brand, but I also believe that our current GWENT-related marketing events bolster sales of The Witcher 3 and previous instalments in the series. This enables us to exploit synergies which affect our activities, promotional expenses and products, both existing and future – which, in turn, helps stabilize the Group's result in between releases.

Moving on to the next slide which presents the CD PROJEKT Group asset and liability balance.

Regarding fixed assets, the greatest increase is in expenditures on R&D projects. As you know, our two major ongoing projects are Cyberpunk and GWENT. Altogether, the balance of R&D expenses increased by 19.6 million PLN during Q3 2017.

In the scope of working assets, a major change occurred with regard to trade receivables, which decreased by 45 million PLN. This is mostly due to collection of second-quarter sales receivables. A similar reduction in sales receivables was also observed in Q3 2016.

The single greatest change in our asset balance is associated with cash and bank deposits. Over the third quarter this figure increased by over 55 million PLN. I will discuss this in more detail during my presentation of cash flows.

Moving on to the Group's liabilities – the greatest change is in equity, which increased by 38 million PLN, primarily due to current-period profits.

The second most important change was a reduction – by 7.5 million PLN – in other liabilities. This resulted from discounting the advance payment previously received from one of our business partners in association with their expected share in GWENT marketing expenses, and also from an overall reduction in the Group's VAT, PIT and social security liabilities.

Other classes of liabilities did not undergo major changes.

The next slide (no. 10) presents our cash flow balance.

In the past quarter we generated high cash flows from operating activities. With a net profit of 35.7 million PLN, the Group's operating activities produced over 74 million PLN in cash flows – over twice as much as the net result for the reporting period. The most significant changes were associated with the previously presented reduction in receivables.

Regarding investment activities, the major contributions to the reported figure are the result of our active cash allocation policy. Over the third quarter the aggregate value of bank deposits held to maturity was 226.6 million PLN, while newly created bank deposits were worth 90 million more, for a total of 316.6 million PLN.

Development work, i.e. investments which represent the “core” of our activities, consumed 18.2 million PLN during the third quarter, i.e. almost half again as much as during the corresponding period in 2016. To reiterate a statement which appears in nearly all of our result presentations – we continue to recruit additional staff, each quarter brings an expansion in our office space and we also pursue game development activities on a broader scale than ever before. The reported increase in development expenses attests to the continuous upscaling of our production capabilities.

The total negative balance of cash flows from investment activities in Q3 2017 was 108 million PLN, of which 90 million corresponds to the surplus of newly created bank deposits over mature deposits – which, naturally, should be regarded as good news.

No significant financial activities occurred during the reporting period.

To wrap up the presentation of cash flows – during the recent quarter the Group’s available cash assets decreased by 35 million PLN, with a corresponding 90 million PLN increase in bank deposits. Consequently, the aggregate value of cash on hand and bank deposits held by the Group increased by 55 million PLN – that is over 20 million more than our net profit, and nearly 7.5 million more than the corresponding Q3 2016 figure.

The next slide summarizes cumulative cash flows for the first three quarters of the current year.

At the beginning of 2017 we held 597 million PLN in cash and bank deposits. Throughout the first three quarters we spent nearly 52 million on development work. In the second quarter we paid out a dividend in the amount of 101 million PLN. All other activities during this period generated 193 million PLN in positive cash flows. Notably, the Group’s net profit for this period was 154 million PLN.

In summary – while continuing to invest in future games and having paid out over 100 million in a dividend, we continued to generate positive cash flows from operating activities and were able to wrap up the third quarter with 638 million PLN in cash and bank assets.

This concludes my financial presentation – we will now take questions from the audience.

Announcer: Ladies and gentlemen, we will now begin the Q&A session. To ask a question, please dial 01 on your phone keypad.

The first question comes from Mr. Albert Rokicki **(AR)**.

AR: Good morning, Albert Rokicki, longerm.pl. I would like to congratulate you on your fairly stable results in the third quarter. It is interesting to note the influx of cash – in my humble opinion this is the most important information – that you already hold over 638 million PLN. I would therefore like to ask if you intend to pay out a dividend for the current year. That’s my first question. The second question – could you give us the approximate development budget of Cyberpunk?

AK: Hello and thank you. Regarding dividends, we have not yet discussed this, so I cannot reply at this stage. When deciding on our previous dividend we were careful to remark that we were not instituting a

dividend policy. Accordingly, no decisions or targeted discussions have been conducted regarding future dividends. Referring to your second question, the only information we have disclosed and can now confirm is that the Cyberpunk budget will exceed that of The Witcher 3, given the increased business expectations associated with this project. I would like to take a minute to clarify the confusion which has recently arisen – by greater business expectations we mean the expected sales volume, first and foremost, since we believe that we can deliver a game that will sell better than The Witcher 3, and will also represent an overall improvement over that release.

Announcer: Thank you. The next question comes from Mr. Paweł Góraj (**PG**), Reuters.

PG: Hello, this is Paweł Góraj from Reuters. I wish to ask – following up to the question related to the Cyberpunk production budget – is anything known regarding the game's release date? Or could you perhaps provide more information regarding the total development costs of Cyberpunk?

AK: We do not disclose project budgets. The release date has not yet been announced and we will not announce it today. Unfortunately, I cannot answer either question.

PG: I understand. In that case, what development expenditures do you foresee in the coming quarter and the coming year?

PN: As a rule, we do not publish forecasts related to future results. We do, however, work to further expand our production capabilities and staff, and this is evident by comparing the results for the third quarter with Q3 2016 figures – note the continuous increase in development expenditures.

PG: Thank you.

Announcer: The next question comes from Mr. Paweł Strugalski (**PS**), Rockbridge TFI.

PS: Greetings. Two questions from me: the first concerns current employment offers associated with Cyberpunk. Some online portals report approximately 50 unfilled positions. I wish to inquire about the intended team size for this project – previously it had been reported that approximately 300 people would be involved, so are the 50 offers meant to replace departing staff, or is that a straight increase in team size, as mentioned in your strategy document? The second question concerns GWENT and potential milestones, mostly in China. Will the end of the closed beta phase there coincide with the global launch of the game, or will these events occur separately?

AK: Regarding job offers – the ratio of open positions to overall team size has remained fairly stable over the recent years. We continue to grow and recruit new staff. As it is not easy to attract outstanding talent, we consider it good practice to always remain on the lookout for potential valuable employees. The Cyberpunk team is mostly complete, and development is ongoing – I wish to disavow the rumors that key positions remain unfilled. However, as remarked before, we post a significant number of job offers to enable dynamic growth of our studio. Given our financial and organizational capabilities, we pursue organic growth. This is our primary mode of expansion – hence the large-scale recruitment drive.

PS: OK. To clarify – what is the expected target team size for Cyberpunk? Is it 300 or will it grow to 350 in the run-up to the release?

AK: Not counting the testing team, which expands before release, and other employees who become involved immediately prior to release, the core staff is expected to comprise approximately 300 individuals.

With regard to the second question, i.e. our release schedule in China – this is an entirely separate schedule. Whether the hard launch will be correlated with the Chinese edition, we do not yet know. It may happen, but not with certainty. While the game remains largely the same, our Chinese agenda follows a different set of milestones.

PS: Thank you; that's clear. One last follow-up question: is the Chinese open beta expected to last as long as the open beta in other countries, or could it be shorter given your previous preparations?

AK: The schedule may be different and may involve entirely different stages. In western countries we're currently in open beta – or public beta, as we like to call it, to indicate that it is actually a somewhat earlier phase than the traditional open beta – although this is not to say that we intend to progress to the open beta as a separate stage. In China, the stages will be different to reflect the specific nature of that market.

PS: Thank you for the answers.

Announcer: The next question will be asked by Mr. Jakub Tuczyński, Generali (**JT**).

JT: Greetings. I would like to ask you to comment on the recent allegations by the Youtuber YongYea who claims that key staff members are leaving because their vision does not agree with that of Mr. Adam Badowski, who they cannot come to terms with, and also that there are problems with the game engine – that it does not efficiently handle tall structures and so on. Finally, I wish to ask about your Q3 revenues from sales of The Witcher 3.

AK: As concerns the YouTube allegations, we prefer not to comment, particularly on the second video. Regarding the current situation at the studio – we'll let the facts speak for themselves. While it may still take some time, we will eventually show our work and allow you to judge the results. Concerning the engine, I can only reiterate what I have already said during the interview: the engine does exist, it will undergo further refinement, possibly up until the game's release, and that is natural and expected. In short – the engine exists, and supports the current version of the game. I will leave the final question to Piotr.

PN: We do not present such a fine-grained division of sales revenues; however, The Witcher 3 remains the most important contributor to our sales, both in the current quarter and throughout the year. The game is marketed as the Game of the Year Edition as well as, in some areas, a standalone release.

JT: Thank you for the reply.

Announcer: The next question will be asked by Ms. Gabriela Burdach, Wood & co. (**GB**)

GB: [inaudible] Apologies. I wish to ask about the reduction in selling costs in CD PROJEKT RED segment in Q3 2017.

PN: Costs were lower in the third quarter compared to reference periods, for two reasons. First, we intentionally downscaled GWENT promotional expenses during this period. Second, we discounted part of the promotional costs based on an agreement with one of our foreign partners. That partner

refunded some of our promotional costs, and this was presented as a decrease in selling costs – hence the reported lower figure.

GB: Thank you.

Announcer: The next question will be asked by Mr. Piotr Łopaciuk, PKO Securities (**PŁ**).

PŁ: Greetings. I want to ask about your plans to migrate GWENT to a new version of your technology. Could you elaborate?

AK: Yes, we meant parts of the technology stack which are developed specifically for the game. While Unity remains the core engine, certain gameplay features supporting card management are based on our proprietary technology, which is currently being upgraded. This will – in fact, it already does – permit us to expand GWENT with new features planned for the coming year.

PU: Thank you.

Announcer: The next question is from Mr. Albert Rokicki, longterm.pl.

AR: Hello, me again. If I may, I wish to ask about R&D expenses. In Q3 this figure was 18 million. Will these remain at the same level during the coming quarters, or – as the team focuses specifically on Cyberpunk – are they expected to increase?

PN: These expenses represent the sum of several components. First, of course, they comprise compensation of staff members participating in each project. As we recruit additional employees, compensation increases. Second, some costs are associated with specific development stages; for example – as is the case with GWENT right now – localization costs, not directly related to the size of the team. These go to our external collaborators, such as recording studios or actors. Finally, some costs ramp up at the end of the production cycle – for instance, testing costs. As a result, R&D costs are not uniform; they fluctuate depending on our growth and also the development stage of our leading projects during each quarter.

AR: I see. Could you tell us approximately how much GWENT has cost you up until now?

PN: We have not disclosed per-project development costs, and this is intentional. Possibly, as was the case with The Witcher 3, these costs will be summarized and presented at the moment of release; for now, however, GWENT remains a work in progress.

Announcer: The next question will be asked by Mr. Łukasz Kucharski, Polish Press Agency (**ŁK**)

ŁK: Greetings; Łukasz Kowalski speaking. I am interested in GWENT revenues – could you comment on these revenues in the third quarter? You seem to have already revealed part of the picture while presenting CD PROJEKT RED results.

PN: I'm sorry but, as already stated, we have long ago decided not to present each project separately when discussing sales. We will therefore not provide specific data related to GWENT.

Announcer: The next question will be asked by Mr. Jakub Rafał, IPOPEMA (**JR**). Mr. Rafał, the line is open (**JR**).

JR: Another very good result, congratulations. I wish to ask about GWENT – how are you doing in China, what stage are you at, and also could you comment on the current state of the Chinese market?

AK: In China we're in closed beta, which started in late August. I can comment as follows – we're doing well. I mean – that's understandable; Chinese players received a far more advanced product than western players, so their first experience with the game was better in terms of quality. Still, it is too early to speculate about long-term results. While still in closed beta, both ourselves and our Chinese partner are satisfied and optimistic about the future. We intend to continue investing in the Chinese market, insofar as it makes sense for us; we are expanding our Chinese office and will keep supporting GWENT in China in the future – our to-date experience is positive.

Announcer: As there are no further questions, I will once again turn to the presenters.

AK: Thank you very much for participating in this call. Our next results conference will be a live one, as is traditional for annual presentations. So, again, see you either in person or online.

PN: Thank you as well.

Announcer: Thank you for participating. You may now disconnect.