

GRAVITY Co., Ltd.
Form 20-F
June 01, 2010

Table of Contents

As filed with the Securities and Exchange Commission on June 1, 2010

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 20-F

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
 - or**
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2009
 - or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
 - or**
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number: 000-51138

GRAVITY CO., LTD.

(Exact name of registrant as specified in its charter)

N/A

(Translation of registrant's name into English)

The Republic of Korea

(Jurisdiction of incorporation or organization)

**Nuritkum Square Business Tower 15F, 1605 Sangam-Dong, Mapo-Gu,
Seoul 121-795, Korea**

(Address of principal executive offices)

**Heung Gon Kim
Chief Financial Officer**

Nuritkum Square Business Tower 15F, 1605 Sangam-Dong, Mapo-Gu, Seoul 121-795, Korea

Telephone: 82-2-2132-7000

Fax: 82-2-2132-7070

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, par value Won 500 per share* American depository shares, each representing one-fourth of a share of common stock	The NASDAQ Global Market

* Not for trading, but only in connection with the listing of American depository shares on the NASDAQ Global Market pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: Shares, par value Won 500: 6,948,900

Indicated by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

Edgar Filing: GRAVITY Co., Ltd. - Form 20-F

U.S. GAAP International Financial Reporting Standards as used by the International Accounting Standards Board Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow: Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Table of Contents**TABLE OF CONTENTS**

PART I	6
<u>ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>	6
<u>ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE</u>	6
<u>ITEM 3. KEY INFORMATION</u>	6
<u>ITEM 3.A. Selected Financial Data</u>	6
<u>ITEM 3.B. Capitalization and Indebtedness</u>	8
<u>ITEM 3.C. Reasons for the Offer and Use of Proceeds</u>	8
<u>ITEM 3.D. Risk Factors</u>	8
<u>ITEM 4. INFORMATION ON THE COMPANY</u>	27
<u>ITEM 4.A. History and Development of the Company</u>	27
<u>ITEM 4.B. Business Overview</u>	28
<u>ITEM 4.C. Organizational Structure</u>	64
<u>ITEM 4.D. Property, Plants and Equipment</u>	65
<u>ITEM 4A. UNRESOLVED STAFF COMMENTS</u>	65
<u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	65
<u>ITEM 5.A. Operating Results</u>	66
<u>ITEM 5.B. Liquidity and Capital Resources</u>	81
<u>ITEM 5.C. Research and Development, Patents and Licenses, etc.</u>	83
<u>ITEM 5.D. Trend Information</u>	83
<u>ITEM 5.E. Off-Balance Sheet Arrangements</u>	83
<u>ITEM 5.F. Contractual Obligations</u>	83
<u>ITEM 5.G. safe harbor</u>	85
<u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	85
<u>ITEM 6.A. Directors and Senior Management</u>	85
<u>ITEM 6.B. Compensation</u>	87
<u>ITEM 6.C. Board Practices</u>	87
<u>ITEM 6.D. Employees</u>	89
<u>ITEM 6.E. Share Ownership</u>	90
<u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	92
<u>ITEM 7.A. Major Shareholders</u>	92
<u>ITEM 7.B. Related Party Transactions</u>	94
<u>ITEM 7.C. Interests of Experts and Counsel</u>	97
<u>ITEM 8. FINANCIAL INFORMATION</u>	97
<u>ITEM 8.A. Consolidated Statements and Other Financial Information</u>	97
<u>ITEM 8.B. Significant Changes</u>	99
<u>ITEM 9. THE OFFER AND LISTING</u>	99
<u>ITEM 9.A. Offer and Listing Details</u>	99
<u>ITEM 9.B. Plan of Distribution</u>	100
<u>ITEM 9.C. Markets</u>	100
<u>ITEM 9.D. Selling Shareholders</u>	100
<u>ITEM 9.E. Dilution</u>	100
<u>ITEM 9.F. Expenses of the Issue</u>	101

Table of Contents

<u>ITEM 10. ADDITIONAL INFORMATION</u>	101
<u>ITEM 10.A. Share Capital</u>	101
<u>ITEM 10.B. Articles of Incorporation</u>	101
<u>ITEM 10.C. Material Contracts</u>	105
<u>ITEM 10.D. Exchange Controls</u>	108
<u>ITEM 10.E. Taxation</u>	109
<u>ITEM 10.F. Dividends and Paying Agents</u>	120
<u>ITEM 10.G. Statement by Experts</u>	120
<u>ITEM 10.H. Documents on Display</u>	120
<u>ITEM 10.I. Subsidiary Information</u>	120
<u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	121
<u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	122
<u>PART II</u>	123
<u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	123
<u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	123
<u>ITEM 15. CONTROLS AND PROCEDURES</u>	123
<u>ITEM 16. RESERVED</u>	125
<u>ITEM 16.A. Audit Committee Financial Expert</u>	125
<u>ITEM 16.B. Code of Ethics</u>	125
<u>ITEM 16.C. Principal Accountant Fees and Services</u>	125
<u>ITEM 16.D. Exemptions from the Listing Standards for Audit Committees</u>	126
<u>ITEM 16.E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	126
<u>ITEM 16.F. Change in Registrant's Certifying Accountant</u>	126
<u>ITEM 16.G. Corporate Governance</u>	126
<u>PART III</u>	126
<u>ITEM 17. FINANCIAL STATEMENTS</u>	126
<u>ITEM 18. FINANCIAL STATEMENTS</u>	126
<u>ITEM 19. EXHIBITS</u>	127
<u>EX-4.76</u>	
<u>EX-4.77</u>	
<u>EX-4.78</u>	
<u>EX-4.79</u>	
<u>EX-4.80</u>	
<u>EX-4.81</u>	
<u>EX-4.82</u>	
<u>EX-4.83</u>	
<u>EX-4.84</u>	
<u>EX-4.85</u>	
<u>EX-4.86</u>	
<u>EX-4.87</u>	
<u>EX-4.88</u>	
<u>EX-8.1</u>	
<u>EX-12.1</u>	
<u>EX-12.2</u>	
<u>EX-12.3</u>	
<u>EX-13.1</u>	
<u>EX-13.2</u>	
<u>EX-13.3</u>	

Table of Contents

CERTAIN DEFINED TERMS

Unless the context otherwise requires, references in this annual report on Form 20-F, or annual report to:

ADRs are to the American depositary receipts that evidence our ADSs;

ADSs are to our American depositary shares, each of which represents one-fourth of a share of our common stock;

Government is to the government of The Republic of Korea;

Gravity, the Company, we, us, our, or our company are to Gravity Co., Ltd. and except as otherwise indicated or required by context, our subsidiaries;

Korea or the Republic are to The Republic of Korea;

China or the PRC are to the People's Republic of China (excluding Taiwan, Hong Kong and Macau);

Taiwan or the ROC are to Taiwan, the Republic of China;

US\$, U.S. dollars, US dollars, or Dollars are to the currency of the United States of America;

Won, Korean Won, or W, are to the currency of The Republic of Korea;

Chinese Yuan or CNY are to the currency of China;

Japanese Yen or JPY are to the currency of Japan;

NT dollar or NT\$ are to the currency of Taiwan;

Hong Kong dollar or HK\$ are to the currency of Hong Kong; and

Thai Baht or THB are to the currency of Thailand.

For your convenience, this annual report contains translations of certain Won amounts into U.S. dollars at the noon buying rate as quoted by the Federal Reserve Bank of New York for Won in effect on March 31, 2010, which was Won 1,131.2 to US\$1.00. No assurance is given that any Won or dollar amounts could have been, or could be converted into dollars or Won as the case may be at such rate, or any other rate, or at all.

Discrepancies in tables between totals and sums of the amounts listed are due to rounding.

FORWARD-LOOKING STATEMENTS

This annual report for the year ended December 31, 2009 contains forward-looking statements, as defined in Section 27A of the U.S. Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended, or the Exchange Act. The forward-looking statements are based on our current expectations, assumptions, estimates and projections about us and our industry, and are subject to various risks and uncertainties. Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as anticipate, believe, considering, depends, estimate, expect, intend,

planning, planned, predict, project, continue and variations of these words, similar expressions, or that certain events or actions or results will, may, might, should, would or could occur, be taken or be achieved.

Forward-looking statements include, but are not limited to, the following:

future prices of and demand for our products;

future earnings and cash flow;

estimated development and commercial launch schedule of our games in development;

our ability to attract new customers and retain existing customers;

the expected growth of the Korean and worldwide online gaming industry;

Table of Contents

the effect that economic, political or social conditions in Korea have on the revenue generated from our online game product and our results of operations;

the effect that the current global financial crisis and global economic recession will or may have on our business prospects, financial condition and results of operations; and

our future business development and prospects, results of operations and financial condition.

We caution you not to place undue reliance on any forward-looking statement each of which involves risks and uncertainties. Although we believe that the assumptions on which our forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions could be incorrect. All forward-looking statements are based on our management's current expectation, assumptions, estimates and projections of future events and are subject to a number of factors that could cause actual results to differ materially from those described in the forward-looking statements. Risks and uncertainties associated with our business include, but are not limited to, risks related to changes in the regulatory environment; technology changes; potential litigation and governmental actions; changes in the competitive environment; changes in customer preference and popular culture and trends, including the online gaming culture; political changes; recent global economic events including, but not limited to, the significant downturn in the global economic and financial markets and the tightening of the global credit markets, changes in business and economic conditions, fluctuations in foreign exchange rates, fluctuations in prices of our products, decreasing consumer confidence and slowing of economic growth generally, and other risks and uncertainties that are more fully described under the heading "Risk Factors" in this annual report, and elsewhere in this annual report. In light of these and other uncertainties, you should not conclude that we will necessarily achieve any plans and objectives or projected financial results referred to in any of the forward-looking statements. We undertake no obligation to update or revise any forward-looking statement to reflect future events or circumstances.

Table of Contents**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**ITEM 3.A. SELECTED FINANCIAL DATA**

You should read the selected financial data below in conjunction with the financial statements and the related notes included elsewhere in this annual report. The selected financial data as of and for the years ended December 31, 2007, 2008 and 2009 are derived from our audited financial statements and related notes thereto are included elsewhere in this annual report. Our historical results do not necessarily indicate results expected for any future periods. Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP.

	As of and for the Years Ended December 31,					
	2005	2006	2007	2008	2009	2009(1)
	(Unaudited)					
	(In millions of Won and thousands of US\$, except share and per share data, operating data and percentage)					
Statements of operations						
Revenues:						
Online games subscription revenue	₩ 11,249	₩ 8,420	₩ 9,405	₩ 12,576	₩ 12,674	US\$ 11,204
Online games royalties and license fees	37,375	26,123	24,698	30,110	34,037	30,090
Mobile games	1,664	3,840	4,063	6,882	7,882	6,968
Character merchandising, animation and other revenue	3,096	2,580	2,063	3,602	2,810	2,484
Total revenues	53,384	40,963	40,229	53,170	57,403	50,746
Cost of revenues	16,038	17,746	19,479	27,772	21,170	18,715
Gross profit	37,346	23,217	20,750	25,398	36,233	32,031
Operating expenses:						
Selling, general and administrative	30,795	27,555	28,159	23,489	21,651	19,140
Research and development	9,219	9,239	5,761	2,145	1,799	1,590
			8,619			

Impairment losses on investments						
Impairment losses on intangible assets			871		280	248
Litigation charges	4,648					
Proceeds from a former chairman due to fraud	(4,947)					
Gain in disposal of assets held for sale	(1,081)					
Settlement cost of litigation					1,649	1,458
Operating income (loss)	(2,668)	(12,197)	(22,660)	(236)	10,854	9,595
Other income (expense), net	(787)	2,265	3,441	6,030	2,108	1,863
Income (loss) before income tax expenses and equity in loss of related joint venture and partnership	(3,455)	(9,932)	(19,219)	5,794	12,962	11,458
Income tax expenses (benefit)	(817)	12,069	2,916	3,379	4,544	4,017
Income (loss) before equity in loss of related joint venture and partnership	(2,638)	(22,001)	(22,135)	2,415	8,418	7,441
Equity in loss of related joint venture and partnership	394	1,106	1,026	5,119	1,424	1,259

Table of Contents

	As of and for the Years Ended December 31,							
	2005	2006	2007	2008	2009	2009(1)		
	(In millions of Won and thousands of US\$, except share and per share data, operating data and percentage)						(Unaudited)	
Income (loss) before cumulative effect of change in accounting principle	(3,032)	(23,107)	(23,161)	(2,704)	6,994	6,182		
Cumulative effect of change in accounting principle, net of tax		849						
Net income (loss)	(3,032)	(22,258)	(23,161)	(2,704)	6,994	6,182		
LESS: Net income (loss) attributable to the non-controlling interest	(2)	7	40	69	77	68		
Net income (loss) attributable to Parent Company	₩ (3,030)	₩ (22,265)	₩ (23,201)	₩ (2,773)	₩ 6,917	US\$ 6,114		
Earnings (loss) per share:								
Income (loss) before cumulative effect of change in accounting principle	₩ (445)	₩ (3,326)	₩ (3,339)	₩ (399)	₩ 995	US\$ 0.88		
Cumulative effect of change in accounting principle(2)		122						
Basic and diluted per share	₩ (445)	₩ (3,204)	₩ (3,339)	₩ (399)	₩ 995	US\$ 0.88		
Basic and diluted per share(3)	(111)	(801)	(835)	(100)	249	0.22		
Weighted average number of shares outstanding (basic and diluted)	6,803,147	6,948,900	6,948,900	6,948,900	6,948,900	6,948,900		
Balance sheet data:								
Cash and cash equivalents	₩ 25,874	₩ 35,314	₩ 53,588	₩ 53,168	₩ 51,333	US\$ 45,379		
Total current assets	109,428	88,203	72,667	72,550	82,899	73,284		
Property and equipment, net	11,863	8,472	7,195	5,226	2,837	2,508		
Total assets	144,857	122,561	96,921	95,935	102,438	90,557		
Total current liabilities	19,448	16,192	10,106	8,397	8,248	7,291		
Total liabilities	24,073	24,419	21,377	19,327	18,828	16,644		
	120,762	98,113	75,476	76,471	83,396	73,724		

total parent company						
shareholders equity						
non-controlling interest	22	29	68	137	214	189
total equity	120,784	98,142	75,544	76,608	83,610	73,913
Selected operating data						
and financial ratios						
(unaudited):						
gross profit margin(4)	70.0%	56.7%	51.6%	47.8%	63.1%	63.1%
operating profit margin(5)	(5.0)	(29.8)	(56.3)	(0.4)	18.9	18.9
net profit margin(6)	(5.7)	(54.4)	(57.7)	(5.2)	12.0	12.0

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.
- (2) Accounting Standard Codification (ASC) 718, *Compensation-Stock Compensation* (formerly referenced as the Financial Accounting Standards Board's (FASB) Statements of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*) was adopted in 2006.
- (3) Each ADS represents one-fourth of a share of common stock.
- (4) Gross profit margin for each period is calculated by dividing gross profit by total net revenues for each period.
- (5) Operating profit margin for each period is calculated by dividing operating income (loss) by total net revenues for each period.
- (6) Net profit margin for each period is calculated by dividing net income (loss) by total net revenues for each period.

Table of Contents**Exchange Rate Information**

The following table sets forth information concerning the noon buying rate for the years 2005 through 2009 and for each month during the previous six months through May 14, 2010, expressed in Won per US dollar.

Period	At End of Period	Average Rate(1)	High	Low
2005	₩ 1,010.0	₩ 1,023.2	₩ 1,059.8	₩ 997.0
2006	930.0	950.1	1,002.9	913.7
2007	935.8	928.0	950.2	903.2
2008	1,262.0	1,105.8	1,507.9	935.2
2009	1,163.7	1,270.0	1,570.1	1,149.0
November	1,164.4	1,162.8	1,188.1	1,152.0
December	1,163.7	1,163.3	1,185.4	1,149.0
2010				
January	1,158.7	1,138.2	1,163.1	1,120.0
February	1,159.0	1,155.7	1,170.0	1,144.0
March	1,131.2	1,136.1	1,153.0	1,128.0
April	1,108.0	1,115.5	1,126.3	1,104.0
May (through May 21, 2010)	1,193.0	1,144.2	1,193.5	1,115.0

Source: Federal Reserve Bank of New York.

Note:

- (1) The average rates for the annual periods were calculated based on the average noon buying rate on the last day of each month during the period. The average rates for the monthly periods were calculated based on the average noon buying rate of each day of the month.

ITEM 3.B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

ITEM 3.C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

ITEM 3.D. RISK FACTORS**RISKS RELATING TO OUR BUSINESS**

We currently depend on one online game product, Ragnarok Online, for most of our revenues.

Most of our revenues have been and are currently derived from a single online game product, Ragnarok Online, which was commercially introduced in August 2002 and currently commercially offered in 59 countries and markets. We

derived Won 42,290 million (US\$37,385 thousand) in revenues from Ragnarok Online in 2009 and Won 38,949 million in revenues from Ragnarok Online in 2008, representing approximately 73.7% and 73.3% of our total revenues in 2009 and 2008, respectively.

Ragnarok Online has been in the market for nearly eight years and has reached maturity in most of our principal markets. The life cycle of an online game generally lasts from four to seven years and reaches its peak popularity within the first two years of its introduction after which usage gradually stabilizes and begins to decrease over time. The number of users of Ragnarok Online worldwide reached its peak in the first quarter of 2005 and has continued to decline since such time. Our failure to maintain, improve, update or enhance Ragnarok Online in a timely manner or successfully introduce it in attractive new markets is likely to lead to a continual decline in Ragnarok Online's user base and subscription revenues and royalties. This will likely lead to a decline in our overall revenues, which would materially and adversely affect our business, financial condition and results of operations.

Table of Contents

If we are unable to consistently and timely develop, acquire, license, launch, market or operate commercially successful online games in addition to Ragnarok Online, our business, financial condition and results of operations may be materially and adversely affected.

In order to grow our revenues and net income, we must develop, acquire, license, launch, market or operate commercially successful online games in addition to Ragnarok Online that will retain our existing users and attract new users. In addition to Ragnarok Online, we currently offer three other massively multiplayer online role playing games, or MMORPGs, Requiem, Emil Chronicle Online and R.O.S.E. Online, and one casual online game, Pucca Racing. We are currently conducting open beta testing of an MMORPG sequel to Ragnarok Online, Ragnarok Online II. We recently entered into license agreements to publish an MMORPG, tentatively named, Estar, which is being developed by Naru Entertainment Co., Ltd., a Korean company, and a web browser-based casual MMORPG called Canaan, which was developed by Xpec Entertainment Inc., a Taiwanese company, and is currently being localized and prepared for beta testing.

None of our other online games to date have proven to be as commercially successful as Ragnarok Online. We stopped offering Time N Tales, an MMORPG, in March 2009 as the game did not prove to be popular. We discontinued developing a massively multiplayer online game, Ice Age Online, for which we had licensed the right to use the theme, characters and storyline from 20th Century Fox Licensing & Merchandising, the trademark licensor. We stopped development around the end of 2009, as there were disagreements between us and the trademark licensor over the general concept of the game and the trademark licensor sent to us a written notice of termination of the license agreement in November 2009.

None of the games we currently offer are as successful as Ragnarok Online. In addition, we have experienced significant delays in and cost overruns related to the launch of many of our online games. For example, although we have been conducting open beta testing of Ragnarok Online II since May 2007 and had indicated our plan to release Ragnarok Online II at various times over the past few years, the launch of this game has been significantly delayed on a number of occasions for a variety of reasons, including as a result of technical difficulties and corrective actions taken in response to market feedback during the testing and development phase. While no assurance can be given that we will be able to meet our current anticipated launch date, we currently intend to launch Ragnarok Online II in the fourth quarter of 2010. Due to the continued delay in the launch of Ragnarok Online II, certain licensees of Ragnarok Online II have delayed remitting royalty payments otherwise payable for Ragnarok Online. Any continued delay in the launch schedule of Ragnarok Online II could result in financial losses, including termination of certain license agreements, which could damage our reputation and have a material adverse effect on our business, prospects, financial condition and results of operation.

In addition, no assurance can be given that when launched, Ragnarok Online II will gain market acceptance and popularity and be profitable for us. The success of Ragnarok Online II will be subject to many factors, including the quality, uniqueness and playability of the game and the launch by our competitors of other games that may gain more market acceptance than Ragnarok Online II. See ITEM 3.D. RISK FACTORS RISKS RELATING TO OUR BUSINESS As we introduce new games, we face the risk that a significant number of users of our existing games may migrate to our new games without any net gains in the overall user base or overall improvement to our total revenues.

As we introduce new games, we face the risk that a significant number of users of our existing games may migrate to our new games without any net gains in the overall user base or overall total revenues.

We expect that as we introduce new games, a certain number of our existing users will migrate from our existing games to the new games. If the net gains in new users is significantly lower than our expectations, then our revenue growth and profitability is likely to be materially and adversely affected.

In particular, there is a high degree of uncertainty about the potential impact of the commercial launch of Ragnarok Online II on the user base of Ragnarok Online. While we believe that the game environment and the overall game experience of Ragnarok Online II will be meaningfully different from those of Ragnarok Online, we cannot assure you that the overall user base will grow and that the net migration away from Ragnarok Online will not be significant and detrimental to our total revenues and as a result our net income.

Table of Contents

We depend on our overseas licensees for a substantial portion of our revenues and rely on them to distribute, market and operate our games, and comply with applicable laws and government regulations.

In markets other than Korea, the United States, Canada, Australia, New Zealand, India, Russia, CIS countries, France and Belgium for Ragnarok Online; Korea, the United States, Canada, Russia, CIS countries and certain European countries for Requiem; the United States, Canada, Mexico and certain European countries for R.O.S.E. Online and Korea for Pucca Racing, in which we or our subsidiaries directly publish our games, we license our games to overseas operators or distributors for license fees and royalty payments based on a percentage of revenues generated from our games in such markets. Overseas license fees and royalty payments represented 79.9% of our total revenues in 2009 and 73.7% of our total revenue in 2008. In particular, we are heavily dependent on one licensee for a significant portion of our revenues. In 2009, 55.7% of our total revenues was derived from GungHo Online Entertainment, Inc., or GungHo, our licensee in Japan, which is also our majority shareholder. Deterioration in our relationships with licensees or material changes in the terms of our licenses with such licensees will likely have a material adverse effect on our business, prospects, financial condition and results of operations. In addition, as we are heavily dependent on certain licensees, deterioration or any adverse developments in the operations, including changes in senior management, of our overseas licensees may materially and adversely affect our business, financial condition and results of operations.

Further, our overseas licensees generally have the exclusive right to distribute our games in their respective markets for a term of two or three years and may also operate or publish other online games developed or offered by our competitors, while we may not be able to easily terminate the license agreements as the agreements do not specify particular financial or performance criteria that need to be met by our licensees. If our overseas licensees devote greater time and resources to marketing their proprietary games or those of our competitors, we may not be able to terminate our license agreements or enter into a new license agreement with a different licensee and our revenues and net profit would be adversely impacted. Also a failure to satisfy our obligation to provide technical and other consulting services to the licensees under the license agreement may negatively affect user satisfaction and loyalty and hinder our licensees' efforts to increase market share, which may lead the licensees to focus their attention on our competitors' games or request modifications to our licensing agreements, including our licensees terminating or not re-newing their relationship with us.

Our overseas licensees are responsible for remitting royalty payments to us based on a percentage of sales from our games after deducting certain expenses. Some licensees may be allowed to deduct certain expenses before calculating royalty payments depending on the terms of the applicable contract. Failure by our licensees to maintain a stable and efficient billing, recording, distribution and payment collection network in these markets may result in inaccurate recording of sales or insufficient collection of payments from these markets and may materially and adversely affect our financial condition and results of operations. Certain of our licensees in the past have failed to accurately report amounts due to us and have diverted certain payables to one of our former chairmen, in contravention of our license agreements. When the illicit payments were discovered, we audited the database of our licensees in Japan, Taiwan, Thailand, the Philippines and China to assess the amount embezzled by the former chairman. Although we have audit rights, pursuant to our license agreements, to ensure that proper payment amounts are being recorded and remitted, such activities can be disruptive and time consuming and as a result we do not exercise such rights on a regular basis. Although we have taken a number of steps to improve our internal controls and compliance procedures to prevent inaccurate reporting and illicit diversion of payments, we cannot ensure that such incidents will not occur again. Any future occurrence of such incidents may materially and adversely affect our business, financial condition and results of operations.

Furthermore, our overseas licensees are responsible for complying with local laws, including obtaining and maintaining the requisite government licenses and permits. Failure by our overseas licensees to do so may result in, among others, a suspension of service of our games in such market which may result in user complaints and decrease

in use of our game which would likely have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

GungHo, the publisher of our games in Japan, our largest market in terms of revenues, is our majority shareholder, which gives them control of our board of directors.

Since April 1, 2008, GungHo has been our largest shareholder and beneficially owns, as of the date hereof, 59.3% of our common shares. As a result, GungHo is able to exert significant control over all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions, including acquisitions, divestitures, strategic relationships and other matters, and may also exert significant control over decisions related to the status of our American depositary shares being eligible for quotation and trading on the NASDAQ Global market. In addition, as GungHo is also an online game developer, there may be conflicts of interest. For instance, GungHo may lead our management with strategies and efforts which benefit itself and its shareholders to the detriment of our other shareholders. GungHo may also compete directly or indirectly against us for users and customers or increased market share for its games. Furthermore, four of our registered Executive Directors, Mr. Toshiro Ohno, Mr. Kazuki Morishita, Mr. Yoshinori Kitamura and Mr. Kazuya Sakai currently serve as Executive Officer, President and Chief Executive Officer, Director and Executive General Manager, Director and Chief Financial Officer, respectively, of GungHo, and there may be conflicts of interest in the decisions made by our Board of Directors and senior management. See ITEM 7.B. RELATED PARTY TRANSACTIONS Relationship with GungHo Online Entertainment, Inc.

We operate in a highly competitive industry and compete against many large companies.

Increased competition in the online game industry in our markets from existing and potential competitors could make it difficult for us to retain existing users and attract new users, and could reduce the number of hours users spend playing our current or future games or cause us and our licensees to reduce the fees charged to play our current or future games. In some of the countries in which our games are distributed, such as Korea, Japan and Taiwan, growth of the market for online games has continued to slow while competition remains strong. If we are unable to compete effectively in our principal markets, our business, financial condition and results of operations could be materially and adversely affected. Many companies worldwide are dedicated to developing and/or operating online games and compete across various markets and regions. We expect more companies to enter the online game industry and a wider range of online games to be introduced in our current and future markets. Our competitors in the MMORPG industry vary in size from small companies to very large companies with dominant market share such as NCsoft of Korea and Shanda of China. We also compete with online casual game and game portal companies such as NHN, Nexon, CJ Internet and Neowiz Games, all from Korea. In addition, we may face stronger competition from companies that produce package games, such as Activision Blizzard, Electronic Arts, Nintendo and Sony Computer Entertainment, some of which have already successfully entered the online gaming market and many of which have announced their intention to expand their game services and offerings over the Internet. For example, World of Warcraft, Activision Blizzard's online game, was released in 2004 and has been one of the most popular games in the world. Electronic Arts co-developed with Neowiz Games and launched FIFA Online 2, a sports online game based on its best-selling package sports game franchise FIFA series, in Korea in 2007 and beta testing is conducted in China and South East Asian countries. Many of our competitors have significantly greater financial, marketing and game development resources than we have. As a result, we may not be able to devote adequate resources to develop, acquire or license new games, undertake extensive marketing campaigns, adopt aggressive pricing policies or adequately compensate our game developers or third-party game developers to the same degree as many of our competitors.

As the online game industry in many of our markets is rapidly evolving, our current or future competitors may more effectively adapt to the changing competitive landscape and market conditions and compete more successfully than us. In particular, online game products are becoming more similar to each other, thus becoming commoditized and undifferentiated. In this environment, larger companies with relative economies of scale have a clear advantage over smaller companies like ours, as they are able to develop games in a more cost efficient manner, diversify their risks with a broader category of games and genres and increase their chances of having widely popular games. In addition,

any of our competitors may offer products and services that have significant performance, price, creativity or other advantages over those offered by us. These products and services may weaken the market strength of our brand name and achieve greater market acceptance than ours. In addition, any of our current or future competitors may be acquired by, receive investments from or enter into strategic relationships

Table of Contents

with larger, more well established and better-financed companies and therefore may be able to obtain significantly greater financial, marketing and game licensing and development resources than we can. See ITEM 4.B. BUSINESS OVERVIEW COMPETITION.

Our investments in joint ventures or partnerships related to development of new online games may not be successful.

Since 2004 we have made investments in joint ventures and entered into partnership arrangements with third parties to invest in online games. In many cases, as we do not have significant investment or other control over such entities, the success of such joint ventures and partnership arrangements is heavily dependent on third parties and their investment decisions. In December 2005, we entered into a limited liability partnership agreement to invest an aggregate amount of JPY1,000 million in Online Game Revolution Fund No. 1, a limited liability partnership which purpose was to invest in online games. In 2005, 2006, 2008 and 2009, we made contributions of JPY100 million, JPY150 million, JPY642 million and JPY18 million, respectively, to the partnership. While as of December 31, 2009, we have a 16.39% interest in the partnership as a limited partner, we cannot significantly influence the partnership's operation and financial or investment policies. We account for our partnership interest under equity method of accounting. We recorded our partnership interest as an equity loss equal to Won 1,026 million, Won 5,119 million Won 1,424 million in 2007, 2008 and 2009, respectively. We also invested US\$9 million in May 2006 for the purchase of Series D preferred shares of Perpetual Entertainment, Inc., a game development company, which subsequently went into liquidation and we recognized the total investment amount of Won 8,619 million as impairment losses on investments in 2007.

If our partners or our investments in such joint ventures and partnerships are unable to manage their investments and develop promising online games, such joint ventures and partnerships will be unable to attain their investment objectives, which may materially and adversely affect the value of our investments and commitments and will likely have a material adverse affect on our business, financial condition and results of operation.

We have experienced frequent turnover among our senior management team and key employees in the past. Some of our senior managers and key employees have limited experience in our industry, which could materially and negatively affect our business prospects.

Some members of senior management members and other key employees have worked with us and in our industry for a relatively short period of time. Their unfamiliarity with many aspects of our business operations may adversely affect our business, prospects, financial condition and results of operation. Despite our efforts to stabilize the composition of our senior management, we cannot provide any assurance that we will be successful. Our business prospects must be considered in light of the risks and difficulties we have encountered in the recruiting and retaining qualified senior management. Our inability to successfully address these risks and difficulties could materially harm our business prospects, financial condition and results of operations.

If we fail to hire and retain skilled and experienced game developers or other key personnel to design and develop new online games and additional game features, we may be unable to achieve our business objectives.

In order to meet our business objectives and maintain our competitiveness, we need to attract and retain qualified employees, including skilled and experienced online game developers. We compete to attract and retain key personnel with other companies in the online game industry as well as in the broader entertainment, media and Internet industries, many of which offer superior compensation arrangements and career opportunities. In addition, our ability to train and integrate new employees into our operations may not meet the changing demands of our business. We cannot assure you that we will be able to attract and retain qualified game developers or other key personnel, and successfully train and integrate them to achieve our business objectives, which could materially harm our business

prospects. For example, during the development of Ragnarok Online II, certain key online game developers left, which negatively affected our ability to launch Ragnarok Online II in a timely fashion.

Table of Contents

Undetected programming errors or flaws in our games could harm our reputation or decrease market acceptance of our games, which would materially and adversely affect our business prospects, reputation, financial condition and results of operations.

Our current and future games may contain programming errors or flaws, which may become apparent only after their release. In addition, our online games are developed using programs and engines developed by and licensed from third party vendors, which may include programming errors or flaws over which we have little or no control. If our users have negative experiences with our games related to or caused by undetected programming errors or flaws, they may be less inclined to continue subscriptions for our games or recommend our games to other potential users.

While we have not experienced any material disruptions to our business from such errors or flaws in our games or in the programs and engines that we use to develop our games, these risks are inherent to our industry and, if realized, could severely harm our reputation, cause our users to cease playing our games, divert our resources or delay market acceptance of our games, any of which could materially and adversely affect our business, financial condition and results of operations.

Unexpected network interruptions, security breaches or computer virus attacks could harm our business and reputation.

Failure to maintain satisfactory performance, reliability, security and availability of our network infrastructure, whether maintained by us or by our licensees, may cause significant harm to our reputation and negatively impact our ability to attract and maintain users. Major risks relating to our network infrastructure include:

any breakdowns or system failures, including from fire, flood, earthquake, typhoon or other natural disasters, power loss or telecommunications failure, resulting in a sustained shutdown of all or a material portion of our servers;

any disruption or failure in the national or international backbone telecommunications network, which would prevent users in certain countries in which our games are distributed from logging onto or playing our games for which the game servers are located in other countries; and

any security breach caused by hacking, loss or corruption of data or malfunctions of software, hardware or other computer equipment, and the inadvertent transmission of computer viruses.

Hacking involves efforts to gain unauthorized access to information or systems or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment. Hackers, if successful, could misappropriate proprietary information or cause disruptions in our service. We may have to spend significant capital and human resources to fix any damage to our system. In addition, we cannot ensure that any measures we take against computer hacking will be effective. A well-publicized computer security breach could significantly damage our reputation and materially and adversely affect our business.

We have been subject to denial of service attacks that have caused portions of our network to be inaccessible for limited periods of time but did not cause material losses or damages. Although we take a number of measures to ensure that our systems are secure and unaffected by security breaches, including ensuring that our servers are hosted at physically secure sites, limiting access to server ports, and using firewalls, passwords, and encryption technology, we cannot ensure that the measures we have implemented will be effective against all hacking efforts.

In addition, computer viruses may cause delays or other service interruptions on our systems and expose us to a material risk of loss or litigation and possible liability. We may be required to expend significant capital and other

resources to protect our Web sites against the threat of such computer viruses and to alleviate any problems resulting from such viruses. Moreover, if a computer virus affecting our system is highly publicized, our reputation could be materially damaged and our visitor traffic may decrease.

Any of the foregoing factors could reduce our users' satisfaction, harm our business and reputation and have a material adverse effect on our financial condition and results of operations.

Table of Contents

Electronic embezzlement could lessen the popularity of our online games and adversely affect our reputation and our results of operations.

Despite security measures, some of our employees or licensees employees with high-level security access to our network, or other employees who hack into or otherwise gain unauthorized access to certain sectors of our network, may succeed in breaching internal security systems and engage in electronic embezzlement by creating or diverting game money used in our online games and engaging in a public or private sale of the game money for their personal financial benefit. For example, from October 2005 to March 2006, a Ragnarok Online game master at GungHo hacked into his superior's account which enabled the game master to create game money. The game master sold game money for cash in an aggregate of JPY58 million, which caused price inflation in the game and disrupted the balance of game play among the different players in Japan. GungHo dismissed the game master and implemented disciplinary action for high level executives. Although we have internal security procedures in place designed to prevent electronic embezzlement and have not had any recent incident of electronic embezzlement, we cannot assure you that we or our overseas licensees will be successful in preventing all electronic embezzlement. We have taken a number of procedures to prevent electronic embezzlement, including installing security programs designed to prevent counterfeiting and modification of program files, but cannot assure you such procedures will be sufficient to prevent new methods to engage in electronic embezzlement. Incidents of electronic embezzlement may negatively impact the reputation of our games, which may materially and adversely affect our business, financial condition and results of operations.

Cheating by users of online games could lessen the popularity of our online games and adversely affect our reputation and our results of operations.

We have experienced numerous incidents where users were able to modify the published rules of our online games. Although these users did not gain unauthorized access to our systems, they were able to modify the rules of our online games during game play in a manner that allowed them to cheat and disadvantage our other online game users, for example, by utilizing auto-run programs that enabled the games to be continuously and automatically played without user participation, which allowed the users to accrue in-game points quickly, causing many other players to stop using the game and shortening the game's lifecycle. Such unauthorized manipulation of our games may negatively impact the image and users' perception of our games and damage our reputation. Although we have taken a number of steps to deter our users from cheating when playing our online games, including spot checks, monitoring of game play by game masters to check for suspicious activity, we cannot assure you that we or our licensees will be successful or timely in taking the corrective steps necessary to prevent users from modifying the terms of our online games.

Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

Our intellectual property such as copyrights, service marks, trademarks and trade secrets are critical to our business. Unauthorized use of the intellectual property used in our business, whether owned by us or licensed to us, may materially and adversely affect our business and reputation. We rely on trademark and copyright law, trade secret protection and confidentiality agreements with our employees, customers, business partners and others to protect our intellectual property rights. Despite certain precautions taken by us, it may be possible for third parties to obtain and use our intellectual property without authorization.

Since the commercialization of Ragnarok Online in August 2002, we have discovered that the server-end software of Ragnarok Online has been consistently and unlawfully released in most of the countries and markets in which Ragnarok Online is offered. This enables unauthorized parties to set up local server networks to operate Ragnarok Online, which may result in the diversion of a significant number of paying users. We designate certain employees to be responsible for detecting such illegal servers. In Korea, we report offenders to the relevant enforcement authority

for possible prosecution relating to crimes on the Internet. In markets outside of Korea, we cooperate with and rely on our licensees to seek enforcement actions against operators of illegal servers. For example, in Japan, we submitted a written accusation to the Tokyo Metropolitan Police Department in October 2009, in cooperation with GungHo, our licensee in Japan, charging a server operator of illegally operating a Ragnarok Online server, and the matter is currently under investigation by the Tokyo Metropolitan Police

Table of Contents

Department. We may incur considerable costs in the future in order to remedy software piracy of our sever software and to enforce our rights against the operators of unauthorized server networks.

The validity, enforceability, enforcement mechanisms and scope of protection of intellectual property in Internet-related industries are uncertain and evolving. In particular, the laws and enforcement regimes of Korea, Japan, Taiwan, Thailand, China and certain other countries in which our games are distributed are uncertain or may not protect intellectual property rights to the same extent as do the laws and enforcement procedures of the United States. Moreover, litigation may be necessary in the future to enforce our intellectual property rights. Such litigation could result in substantial costs and diversion of our resources, disruption of our business, and have a material adverse effect on our business, prospects, financial condition and results of operations.

We may be subject to claims with respect to the infringement of intellectual property rights of others, which could result in substantial costs and diversion of our financial and management resources.

We cannot be certain that our online games do not or will not infringe upon patents, copyrights or other intellectual property rights held by third parties. We may become subject to legal proceedings and claims from time to time relating to the intellectual property of others. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, and we may be required to pay penalties, fines and pay for unauthorized use of such intellectual property and we may need to incur additional license fees or be forced to develop alternative technology or obtain other licenses. We may incur substantial expenses in defending against these third party infringement claims, regardless of their merit. In addition, certain of our employees were recruited from other online game developers, including current and potential competitors. To the extent these employees have been and are involved in the development of our games that are similar to the games they helped develop at their former employers, we may become subject to claims that we or such employees have improperly used or disclosed trade secrets or other proprietary information. Although we are not aware of any pending or threatened claims of this type, if any such claims were to arise in the future, litigation or other dispute resolution procedures might be necessary to retain our ability to offer our current and future games, which could result in substantial costs and diversion of our financial and management resources.

Successful infringement or licensing claims against us may result in substantial monetary damages, which may materially disrupt our business operations and have a material adverse effect on our reputation, business, financial condition and results of operations.

We may not be able to successfully implement our growth and profit improvement strategies.

We are pursuing a number of growth and profit improvement strategies, including the following:

distributing games developed in-house;

publishing games acquired from or developed by third parties through licensing arrangements;

offering our games in countries where we currently have little or no presence;

optimizing our marketing and research and development expenditures;

cross-selling our popular online games through other lines of businesses, such as mobile games, console games, animation and character merchandising; and

pursuing joint ventures with game development companies.

We cannot assure you that we will be successful in implementing any of these strategies. Certain of our strategies relate to new services or products, such as game business related to internet protocol television, for which there are no established markets, or in which we lack experience and expertise. If we are unable to successfully implement our growth and profit improvement strategies, our revenues, profitability and competitiveness may be materially and adversely affected.

Table of Contents

We have limited business insurance coverage and any business interruption could have a material adverse effect on our business.

While we carry insurance coverage against certain risks, such as fire, flood and earthquake, in respect of our principal assets, including offices and equipment, as well as directors and officers liability insurance, we do not separately maintain casualty and liability insurance against litigation, risks or disruptions related to our business. The occurrence of any natural disaster, fire, power loss, telecommunications failure, break-ins, sabotage, computer viruses, intentional acts of Internet vandalism, human error or other similar events may damage our facilities or network servers and disrupt the operation of our business. As we do not carry sufficient natural disaster or business interruption insurance to compensate us for all types or amounts of loss that could arise, any damage or disruption from such events might result in our incurring substantial costs and the diversion of our resources, and have a material adverse effect on our business, financial condition and results of operation. See ITEM 4.B. BUSINESS OVERVIEW INSURANCE.

Slow growth or contractions in the Internet café industry in Korea may affect our ability to target a core group of users.

According to the 2009 report issued by the Korea Creative Content Agency, an industry, non-profit organization that promotes exporting of Korean culture, the growth of the Internet café industry started to stabilize from 2000 although the total number of personal computers, or PCs, in Internet cafés continues to increase steadily. The number of Internet cafés slightly increased in 2008 after a short period of decrease in 2007 due to certain legal developments such as the Enforcement Decree of the Building Act, which placed limitations on the space for Internet cafés, the School Health Act, which prohibited the entry of certain facilities into the school environment clean-up zone and the Mandatory Registration of Businesses Supplying Games which was enforced by the government to regulate speculative gambling places. While we believe that there was no significant change in the number of Internet cafés in operation in 2009, as the Korean government enforces its regulations to tighten control over businesses that provide Internet and computer game facilities, the number of Internet cafés and as a result the total number of PCs at Internet cafés is expected to gradually decrease in the long term. Internet cafés have traditionally been the largest consumer and served as a medium of the game industry in Korea and any future reduction in the number of Internet cafés may shrink the size of the overall game market in Korea and adversely affect our ability to target a core group of potential users who prefer playing online games, in particular, MMORPGs, at Internet cafés.

The high cost to access the Internet access in certain markets may impede our entry into new markets.

Our growth potential in many of the markets in which our games are currently distributed or which we intend to enter, such as Southeast Asia and CIS countries, may be limited as the penetration rates for personal computers in such markets are relatively low and the cost of Internet access relative to the per capita income is higher when compared to some of our principal markets such as Korea and Japan. If we are unable to successfully enter and develop new markets for our games, our growth and profit improvement strategies, our revenues, profitability and competitiveness may be materially and adversely affected.

Occurrence of widespread public health problems could adversely affect our business and results of operations.

During 2003, some online game operators in China experienced declining growth of their online game revenues which they believe resulted from the closure of Internet cafés in Beijing and elsewhere to prevent the spread of SARS, or severe acute respiratory syndrome. In April 2009, a new strain of influenza A virus subtype H1N1, commonly referred to as swine flu, was first discovered in Mexico and quickly spread to other parts of the world. A renewed outbreak of SARS or another widespread public health problem, such as swine flu or avian influenza, in China or in other countries may prevent our customers from accessing Internet cafés and may adversely affect our prospects, business and operating results.

Table of Contents

A worldwide health crisis from any known or unknown causes and the response and the reaction from the health authorities of each country may impact our operations in a number of ways, including, among other things:

quarantines or closures of some of our offices which would severely disrupt our operations;

the sickness or death of our officers and key employees; and

closure of Internet cafés and other public areas where people access the Internet.

Any of the foregoing events or other unforeseen consequences of public health problems could adversely affect our business, financial condition and results of operations.

Some of our minority shareholders were very active in making demands in the past and requests on our management and our management may be required to expend substantial time, effort and resources to respond to such demands and requests.

Certain of our minority shareholders in and outside of Korea have made various demands on our management, including with respect to our corporate governance practices. For example, certain of our minority shareholders formed a committee in March 2006 named the Gravity Committee for the Fair Treatment of Minority Shareholders, or the Minority Shareholders Committee, which is still in existence as of the date of this report. The committee has since made a number of requests, including a request to inspect our financial documents and review decisions made by our management concerning transactions entered into with certain parties, and to pursue legal action if the committee views such transactions to have been entered into improperly. In the future, our management may be required to expend substantial time, effort and resources to respond to such requests from our minority shareholders, including the Minority Shareholders Committee, which may negatively impact the ability of our management to address business challenges and operational requirements facing us, and adversely affect our business, financial condition and results of operations.

We may be required to take significant actions that are contrary to our business objectives in order to avoid being deemed an investment company as defined under the Investment Company Act of 1940, as amended.

Generally, the Investment Company Act of 1940, or the 40 Act, provides that a company is not an investment company and is not required to register under the 40 Act as an investment company if the company is primarily engaged, directly or through a wholly-owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting or trading in securities. We believe that we are engaged primarily and directly in the businesses of providing online game services, and consequently, that we are not an investment company as that term is defined under the 40 Act. At the same time, the determination of whether we are primarily engaged in a non-investment business may depend partly upon the composition of our assets. In particular, under certain circumstances we could become subject to registration as an investment company if we owned investment securities (as defined in the 40 Act) having a value in excess of 40% of our total assets (exclusive of cash items and U.S. government securities). We do not currently own investment securities in excess of this threshold (for this purpose, we treat a bank deposit that may be withdrawn earlier than on its maturity date upon demand without penalty against the principal amount of the deposit as a cash item rather than as a security). In the future, we nonetheless could be required to take actions to avoid the requirement to register as an investment company, such as shifting a significant portion of our short-term investment portfolio into low-yielding bank deposits or other short-term securities which are not considered to be securities due to their liquidity and certain other characteristics. These types of investments may reduce the amount of interest on other income that we could otherwise generate from our investment activities. In addition, we may need to acquire additional income or loss generating assets that we might not otherwise have acquired or forego opportunities to acquire minority interests in companies that could be important to our strategy.

The 40 Act also contains regulations with respect to investment companies, including restrictions on their capital structure, operations, transactions with affiliates and other matters which would be incompatible with our operations. If we were to be deemed an investment company in the future, we would effectively be precluded from making public offerings of securities in the United States. In addition to disciplinary actions, such as SEC

Table of Contents

enforcement actions seeking monetary damages, we could also be subject to administrative or legal proceedings and any contracts to which we are a party that violate the 40 Act or the rules thereunder might be rendered unenforceable or subject to rescission.

Our status as a passive foreign investment company (PFIC) in 2009 and potentially other years could result in adverse U.S. tax consequences for you.

In light of the nature of our business activities and our holding of a significant amount of cash, short-term investments, and other passive assets after our initial public offering, we may have been since our initial public offering a PFIC for U.S. federal income tax purposes. In particular, due to the deterioration of the trading price of our ADSs, we believe that we were a PFIC in 2008 and 2009, and there is a significant risk that we will continue to be a PFIC in 2010. If we are a PFIC for any taxable year during which you hold our ADSs or common shares, you could be subject to adverse U.S. federal income tax consequences. You are urged to consult your tax advisors concerning the U.S. federal income tax consequences of holding our ADSs or common shares if we are considered a PFIC in any taxable year. See ITEM 10.E. TAXATION U.S. FEDERAL INCOME TAX CONSIDERATIONS Passive foreign investment companies.

In the current year and in prior years, we have identified material weaknesses in our internal controls over financial reporting. If we fail to achieve and maintain an effective system of internal controls over financial reporting, we may be unable to accurately report our financial results or do so on a timely basis or reduce our ability to prevent or detect fraud, and investor confidence and the market price of our ADSs may be adversely affected.

We have identified material weaknesses in our internal control over financial reporting in current year and prior years. Most recently, in connection with the audit of our financial statements prepared under U.S. GAAP for the year ended December 31, 2009, we have identified a material weakness (as defined under both the U.S. Securities and Exchange Commission, or SEC, Management's Report on Internal Control Over Financial Reporting, and Standards of the Public Company Accounting Oversight Board (United States)) in our system of internal control over financial reporting. In addition, our management assessed the effectiveness of our internal controls over financial reporting and disclosure controls and procedures as of December 31, 2009 pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act, and related SEC rules, respectively and concluded that our internal control over financial reporting and disclosure controls and procedures were not effective as of December 31, 2009. Management has identified the following material weakness in our internal control over financial reporting as of December 31, 2009:

Lack of monitoring controls over significant transactions at a subsidiary level. We did not design or operate effective monitoring controls over significant transactions at a subsidiary level. Specifically, the internal control over the accuracy and completeness of the severance benefits and approval of the related benefit distribution to a former director at the subsidiary level was not effective.

This material weakness could result in a misstatement of the aforementioned accounts and disclosures that would result in a material misstatement to our consolidated financial statements that would not be prevented or detected. After considering this material weakness, among other matters, our Chief Executive Officer and Chief Financial Officer have also concluded, most recently as of December 31, 2009, that our disclosure controls and procedures were not effective to provide reasonable assurance that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required. Furthermore, we are subject to the Sarbanes-Oxley Act, which requires us to, among other things, maintain an effective system of internal controls over financial reporting, and requires our management to provide a certification on the effectiveness of our internal controls on an annual basis. Additionally, our independent registered public accounting firm must provide an audit opinion on the effectiveness of our internal control over financial reporting.

If we fail to design and maintain an effective system of internal controls over financial reporting, we may be unable to accurately report our financial results in a timely manner or prevent errors or fraud, and investor

Table of Contents

confidence and the market price of our ADSs may be adversely affected. See ITEM 15. *CONTROLS AND PROCEDURES* for additional discussion concerning our material weakness and changes in internal control.

Rapid technological developments and changes in market environment may limit our ability to recover game development, acquisition or licensing costs and adversely affect our financial condition and results of operations due to impairment loss.

The online game industry is subject to rapid technological developments and changes in market environment, which could render our online games under development and commercialized games obsolete or unattractive to users. Any resulting failure to recover capitalized development, acquisition or licensing costs and the recognition of impairment loss for such costs may materially and adversely affect our financial condition and results of operations.

RISKS RELATING TO OUR REGULATORY ENVIRONMENT

Our online operations and businesses are subject to regulation in certain of the countries in which our games are distributed, such as Korea, China, Taiwan, Japan and Thailand, the changes of which are difficult to predict, and the uncertainties in interpretation and enforcement of rules in such counties may limit the protections available to us.

The regulatory and legal regimes in many of the countries in which our games are distributed have yet to establish a sophisticated set of laws, rules or regulations designed to regulate the online game industry. However, in many of our principal markets, such as Korea, China, Taiwan and Thailand, legislators and regulators have implemented or indicated their intention to implement laws and regulations with respect to issues such as user privacy, defamat