

GRAVITY Co., Ltd.
Form 20-F
April 27, 2012
Table of Contents

As filed with the Securities and Exchange Commission on April 27, 2012

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

p **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2011

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 depositary 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 depositary 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

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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:

U.S. GAAP International Financial Reporting Standards as issued 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 |
| ITEM 3.A. <u>Selected Financial Data</u> | 6 |
| ITEM 3.B. <u>Capitalization and Indebtedness</u> | 8 |
| ITEM 3.C. <u>Reasons for the Offer and Use of Proceeds</u> | 8 |
| ITEM 3.D. <u>Risk Factors</u> | 8 |
| <u>ITEM 4. INFORMATION ON THE COMPANY</u> | 27 |
| ITEM 4.A. <u>History and Development of the Company</u> | 27 |
| ITEM 4.B. <u>Business Overview</u> | 28 |
| ITEM 4.C. <u>Organizational Structure</u> | 67 |
| ITEM 4.D. <u>Property, Plants and Equipment</u> | 67 |
| <u>ITEM 4A. UNRESOLVED STAFF COMMENTS</u> | 68 |
| <u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u> | 68 |
| ITEM 5.A. <u>Operating Results</u> | 68 |
| ITEM 5.B. <u>Liquidity and Capital Resources</u> | 84 |
| ITEM 5.C. <u>Research and Development, Patents and Licenses, Etc.</u> | 85 |
| ITEM 5.D. <u>Trend Information</u> | 86 |
| ITEM 5.E. <u>Off-Balance Sheet Arrangements</u> | 86 |
| ITEM 5.F. <u>Tabular Disclosure of Contractual Obligations</u> | 86 |
| ITEM 5.G. <u>Safe Harbor</u> | 87 |
| <u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u> | 88 |
| ITEM 6.A. <u>Directors and Senior Management</u> | 88 |
| ITEM 6.B. <u>Compensation</u> | 90 |
| ITEM 6.C. <u>Board Practices</u> | 90 |
| ITEM 6.D. <u>Employees</u> | 93 |
| ITEM 6.E. <u>Share Ownership</u> | 94 |
| <u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u> | 95 |
| ITEM 7.A. <u>Major Shareholders</u> | 95 |
| ITEM 7.B. <u>Related Party Transactions</u> | 97 |
| ITEM 7.C. <u>Interests of Experts and Counsel</u> | 101 |
| <u>ITEM 8. FINANCIAL INFORMATION</u> | 101 |
| ITEM 8.A. <u>Consolidated Statements and Other Financial Information</u> | 101 |
| ITEM 8.B. <u>Significant Changes</u> | 103 |
| <u>ITEM 9. THE OFFER AND LISTING</u> | 103 |
| ITEM 9.A. <u>Offer and Listing Details</u> | 103 |
| ITEM 9.B. <u>Plan of Distribution</u> | 104 |
| ITEM 9.C. <u>Markets</u> | 104 |
| ITEM 9.D. <u>Selling Shareholders</u> | 104 |
| ITEM 9.E. <u>Dilution</u> | 104 |
| ITEM 9.F. <u>Expenses of the Issue</u> | 104 |

Table of Contents

| | |
|---|-----|
| <u>ITEM 10. ADDITIONAL INFORMATION</u> | 104 |
| ITEM 10.A. <u>Share Capital</u> | 104 |
| ITEM 10.B. <u>Memorandum and Articles of Incorporation</u> | 105 |
| ITEM 10.C. <u>Material Contracts</u> | 110 |
| ITEM 10.D. <u>Exchange Controls</u> | 111 |
| ITEM 10.E. <u>Taxation</u> | 113 |
| ITEM 10.F. <u>Dividends and Paying Agents</u> | 124 |
| ITEM 10.G. <u>Statement by Experts</u> | 124 |
| ITEM 10.H. <u>Documents on Display</u> | 124 |
| ITEM 10.I. <u>Subsidiary Information</u> | 124 |
| <u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u> | 124 |
| <u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u> | 125 |
| ITEM 12.A. <u>Debt Securities</u> | 125 |
| ITEM 12.B. <u>Warrants and Rights</u> | 125 |
| ITEM 12.C. <u>Other Securities</u> | 125 |
| ITEM 12.D. <u>American Depositary Shares</u> | 125 |
| PART II | 127 |
| <u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u> | 127 |
| <u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u> | 127 |
| <u>ITEM 15. CONTROLS AND PROCEDURES</u> | 127 |
| <u>ITEM 16. RESERVED</u> | 128 |
| <u>ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT</u> | 128 |
| <u>ITEM 16B. CODE OF ETHICS</u> | 128 |
| <u>ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u> | 128 |
| <u>ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES</u> | 128 |
| <u>ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u> | 128 |
| <u>ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT</u> | 128 |
| <u>ITEM 16G. CORPORATE GOVERNANCE</u> | 128 |
| <u>ITEM 16H. MINE SAFETY DISCLOSURE</u> | 128 |
| PART III | 129 |
| <u>ITEM 17. FINANCIAL STATEMENTS</u> | 129 |
| <u>ITEM 18. FINANCIAL STATEMENTS</u> | 129 |
| <u>ITEM 19. EXHIBITS</u> | 129 |

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;

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 is 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. dollar, or Dollar are to the currency of the United States of America;

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

EUR or Euro are to the currency of the Eurozone consisting of Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain;

Chinese Yuan is 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 is 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 December 30, 2011, which was Won 1,158.50 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, 2011 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, plan, planning, planned, predict, p variations of these words, similar expressions, or that certain events, actions or results will, may, might, should, would or could occur, be 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;

Table of Contents

our ability to attract new customers and retain existing customers;

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

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 and economic conditions 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 our consolidated financial statements and the related notes included elsewhere in this annual report. The selected financial data as of December 31, 2010 and 2011 and for the years ended December 31, 2009, 2010 and 2011 are derived from our consolidated financial statements and the related notes thereto 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.

| | 2007 | As of and for the Years Ended December 31, | | | | 2011 | 2011(1) |
|--|--|--|---------------|---------------|---------------|---------------|---------|
| | | 2008 | 2009 | 2010 | | (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 | (Won) 9,405 | (Won) 12,576 | (Won) 12,674 | (Won) 9,908 | (Won) 11,556 | US\$ 9,975 | |
| Online games royalties and license fees | 24,698 | 30,110 | 34,037 | 32,132 | 35,552 | 30,688 | |
| Mobile games | 4,063 | 6,882 | 7,882 | 9,188 | 9,293 | 8,022 | |
| Character merchandising, animation and other revenue | 2,063 | 3,602 | 2,810 | 1,134 | 1,076 | 928 | |
| Total revenues | 40,229 | 53,170 | 57,403 | 52,362 | 57,477 | 49,613 | |
| Cost of revenues | 19,479 | 27,772 | 21,170 | 20,873 | 24,243 | 20,926 | |
| Gross profit | 20,750 | 25,398 | 36,233 | 31,489 | 33,234 | 28,687 | |
| Operating expenses: | | | | | | | |
| Selling, general and administrative | 28,159 | 23,489 | 21,651 | 20,422 | 22,759 | 19,645 | |
| Research and development | 5,761 | 2,145 | 1,799 | 4,652 | 4,136 | 3,570 | |
| Impairment losses on investments | 8,619 | | | | | | |
| Impairment losses on intangible assets | 871 | | 280 | 475 | 3,697 | 3,191 | |
| Gain on loss of control in a subsidiary | | | | | (548) | (473) | |
| Settlement cost of litigation | | | 1,649 | | 29 | 25 | |
| Operating income (loss) | (22,660) | (236) | 10,854 | 5,940 | 3,161 | 2,729 | |
| Other income, net | 3,441 | 6,030 | 2,108 | 2,322 | 1,876 | 1,619 | |
| Income (loss) before income tax expenses (benefit) and equity loss on investments | (19,219) | 5,794 | 12,962 | 8,262 | 5,037 | 4,348 | |
| Income tax expenses (benefit) | 2,916 | 3,379 | 4,544 | 4,207 | (7,962) | (6,873) | |

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| | | | | | | |
|---|----------|---------|---------|-------|--------|--------|
| Income (loss) before equity loss on investments | (22,135) | 2,415 | 8,418 | 4,055 | 12,999 | 11,221 |
| Equity loss on investments, net | (1,026) | (5,119) | (1,424) | (345) | (242) | (209) |

Table of Contents

| | As of and for the Years Ended December 31, | | | | | | | | | | | |
|--|---|--|---------------|--|--------------|--|--------------|--|--------------|--|------------------------|--|
| | 2007 | | 2008 | | 2009 | | 2010 | | 2011 | | 2011(1) (Unaudited) | |
| | (In millions of Won and thousands of US\$, except share and per share data, operating data and percentage) | | | | | | | | | | | |
| Net income (loss) | (23,161) | | (2,704) | | 6,994 | | 3,710 | | 12,757 | | 11,012 | |
| LESS: Net income (loss) attributable to the non-controlling interest | 40 | | 69 | | 77 | | (20) | | (2,171) | | (1,874) | |
| Net income (loss) attributable to parent company | (Won) (23,201) | | (Won) (2,773) | | (Won) 6,917 | | (Won) 3,730 | | (Won) 14,928 | | US\$ 12,886 | |
| Earnings (loss) per share: | | | | | | | | | | | | |
| Basic and diluted per share | (Won) (3,339) | | (Won) (399) | | (Won) 995 | | (Won) 537 | | (Won) 2,148 | | US\$ 1.85 | |
| Basic and diluted per ADS(2) | (835) | | (100) | | 249 | | 134 | | 537 | | 0.46 | |
| Weighted average number of shares outstanding (basic and diluted) | 6,948,900 | | 6,948,900 | | 6,948,900 | | 6,948,900 | | 6,948,900 | | 6,948,900 | |
| Balance sheet data | | | | | | | | | | | | |
| Cash and cash equivalents | (Won) 53,588 | | (Won) 53,168 | | (Won) 51,333 | | (Won) 44,122 | | (Won) 42,430 | | US\$ 36,625 | |
| Total current assets | 72,667 | | 72,550 | | 82,899 | | 76,343 | | 71,833 | | 62,005 | |
| Property and equipment, net | 7,195 | | 5,226 | | 2,837 | | 2,672 | | 2,731 | | 2,357 | |
| Total assets | 96,921 | | 95,935 | | 102,438 | | 125,490 | | 132,878 | | 114,699 | |
| Total current liabilities | 10,106 | | 8,397 | | 8,248 | | 14,065 | | 12,062 | | 10,411 | |
| Total liabilities | 21,377 | | 19,327 | | 18,828 | | 27,078 | | 22,219 | | 19,179 | |
| Total parent company shareholders equity | 75,476 | | 76,471 | | 83,396 | | 87,416 | | 101,834 | | 87,903 | |
| Non-controlling interest | 68 | | 137 | | 214 | | 10,996 | | 8,825 | | 7,617 | |
| Total equity | 75,544 | | 76,608 | | 83,610 | | 98,412 | | 110,659 | | 95,520 | |
| Selected operating data and financial ratios (unaudited) | | | | | | | | | | | | |
| Gross profit margin(3) | 51.6% | | 47.8% | | 63.1% | | 60.1% | | 57.8% | | 57.8% | |
| Operating profit margin(4) | (56.3)% | | (0.4)% | | 18.9% | | 11.3% | | 5.5% | | 5.5% | |
| Net profit margin(5) | (57.7)% | | (5.2)% | | 12.0% | | 7.1% | | 26.0% | | 26.0% | |

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.
- (2) Each ADS represents one-fourth of a share of common stock.
- (3) Gross profit margin for each period is calculated by dividing gross profit by total net revenues for each period.
- (4) Operating profit margin for each period is calculated by dividing operating income by total net revenues for each period.

- (5) Net profit margin for each period is calculated by dividing net income (loss) attributable to parent company 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 2007 through 2011 and for each month during the previous six months through April 20, 2012 expressed in Won per U.S. dollar.

| Period | At End of Period | Average Rate(1) | High | Low |
|--------------------------------|---------------------------------|----------------------------|-------------|------------|
| 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 |
| 2010 | 1,130.6 | 1,158.7 | 1,253.2 | 1,104.0 |
| 2011 | 1,158.5 | 1,105.2 | 1,197.5 | 1,049.2 |
| October | 1,112.1 | 1,150.7 | 1,197.5 | 1,102.5 |
| November | 1,140.1 | 1,133.5 | 1,162.0 | 1,110.6 |
| December | 1,158.5 | 1,148.1 | 1,175.5 | 1,124.5 |
| 2012 | | | | |
| January | 1,125.7 | 1,140.3 | 1,160.0 | 1,120.1 |
| February | 1,117.1 | 1,122.7 | 1,128.9 | 1,115.7 |
| March | 1,131.4 | 1,126.2 | 1,139.8 | 1,116.0 |
| April (through April 20, 2012) | 1,138.1 | 1,134.8 | 1,143.4 | 1,122.4 |

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 a significant portion of our revenues.

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A significant portion of our revenues has been and is currently derived from a single online game product, Ragnarok Online, which was commercially introduced in August 2002 and is currently commercially offered in 79 countries and markets. We derived Won 37,963 million (US\$32,769 thousand) in revenues from Ragnarok Online in 2011 and Won 37,573 million (US\$32,432 thousand) in revenues from Ragnarok Online in 2010, representing approximately 66.0% and 71.8% of our total revenues in 2011 and 2010, respectively.

Ragnarok Online has been in the market for ten 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 in order to retain our existing users and attract new users. In addition to Ragnarok Online, we currently offer eight other massively multiplayer online role playing games, or MMORPGs, Ragnarok Online II, Requiem, Emil Chronicle Online, Dragonica, which is also known as Dragon Saga in the United States and Canada, R.O.S.E. Online, Canaan, Kun Woong Online and Finding Neverland Online. We also offer a casual third person shooter, H.A.V.E. Online, which is also known as Toy Wars in Japan, a simulation role playing game, Ragnarok Online Guild Masters, and two social network games, Fashion Star and Jeweled Planet. We are currently developing a new MMORPG with a tentative title of East Road. We have entered into a license agreement to publish Weapons of the Gods, an MMORPG, in Korea with Shanghai Nineyou Interactive Community and Media Co., Ltd. and its two affiliated Chinese game developers and publishers, Shanghai Nineshine Information Technology Co., Ltd. and HitNorth International Limited. We have entered into a license agreement with RoC Works Co., Ltd., a Korean game developer, to publish Maestia, an MMORPG, in the United States and Canada.

None of our other online games to date have proven to be as commercially successful as Ragnarok Online. We stopped offering Eternal Destiny, a Web browser-based casual MMORPG, in November 2011 as the game did not gain popularity. In addition, we have experienced significant delays in and cost overruns related to the launch of many of our online games. For example, while Ragnarok Online II was commercially launched in March 2012, the launch of the game had been significantly delayed in the past 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. We have entered into license and distribution agreements for Ragnarok Online II with six licensees in nine countries, including Thailand, Japan, the Philippines, Singapore, Malaysia, Vietnam, China, Indonesia and Brazil. The total value of our license and distribution agreements for Ragnarok Online II in nine countries is US\$43,390 thousand as of December 31, 2011. The failure of Ragnarok Online II to gain popularity or market acceptance could result in financial losses, including termination or amendments of license agreements, which could damage our reputation and have a material adverse effect on our business, prospects, financial condition and results of operations.

No assurance can be given that the recently 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 improvement to our 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 are 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 and India for Ragnarok Online, and the United States and Canada for Dragonica, which is also known as Dragon Saga in such markets, as well as the global market other than Russia and 14 other countries and Taiwan, Hong Kong and Macau for Requiem, 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 59.9% of our total revenues in 2011 and 60.9% of our total revenues in 2010. In particular, we are heavily dependent on one licensee for a significant portion of our revenues. In 2011, 49.8% 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 or terminate our licensing agreements or not renew expired license agreements.

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. Hyun Chul Park, Mr. Yoshinori Kitamura, Mr. Kazuki Morishita and Mr. Kazuya Sakai currently serve as General Manager, Director and Executive General Manager, President and Chief Executive Officer, and Chief Financial Officer, Director and Investor Relations 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 Corporation, or NCsoft, of Korea and Tencent, Inc., or Tencent, of China. We also compete with online casual game and game portal companies such as NHN Corporation, or NHN, Nexon Korea Corporation, or Nexon, CJ E&M Corporation, or CJ E&M, and Neowiz Games Corporation, or Neowiz Games, all from Korea. In addition, we may face stronger competition from companies that produce package games, such as Activision Blizzard Inc., or Activision Blizzard, Electronic Arts Inc., or Electronic Arts, Konami Corporation, or Konami, and Sega Corporation, or Sega, 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 in 2007 FIFA Online 2, a sports online game based on its best-selling package sports game franchise FIFA series, and the game is currently serviced in Korea and some Southeast Asian countries. Konami and NHN are co-developing Winning Eleven Online, an online sports game based on Konami's Winning Eleven franchise, and Sports Interactive Limited, a subsidiary of Sega, and KT Hitel Co., Ltd., a Korean online game publisher, are co-developing Football Manager Online, the online version of Sega's Football Manager. 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 offering widely popular games. In

Table of Contents

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 with larger, better 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, or acquisitions of other companies related to development or service of 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. We account for our partnership interest under equity method of accounting and recorded our partnership interest as an equity loss equal to Won 1,026 million, Won 5,119 million, Won 1,424 million, Won 358 million and Won 38 million in 2007, 2008, 2009, 2010 and 2011, respectively. On December 31, 2010, the term of the partnership expired and the partnership is currently undergoing liquidation process. In June 2010, we acquired from Terabit Telecom Ltd., a Russia-based online game company, a 25% of equity interest in Ingamba LLC, or Ingamba, a joint venture company established in April 2010 for online game service in Russia. We recorded Won 13 million as equity income of Ingamba in 2010 but Won 134 million as equity loss of Ingamba in 2011. In October 2010, we acquired an aggregate of 50.83% of the total shares of Barunson Interactive Corporation, subsequently named Gravity Games Corporation, or Gravity Games, an online game developer in Korea. For details of impairment loss from Gravity Games, see ITEM 3.D. RISK FACTORS RISKS RELATING TO OUR BUSINESS We could suffer losses due to asset impairment charges. Gravity EU SASU, our former wholly-owned subsidiary in France, was converted into a joint venture company in which we have a 25% equity interest, Gravity EU SAS, with Media-Participations Paris SA as the joint venture partner, in July 2011. We recorded Won 70 million as equity loss of Gravity EU SAS in 2011.

If our partners or our investments in such joint ventures and partnerships or companies acquired by us are unable to manage their investments, develop promising online games or market or operate commercially successful online games, such joint ventures and partnerships or acquired companies 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.

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.

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

Table of Contents

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 use 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, real-time monitoring against possible intrusion and saving all logs, preventing any unauthorized access to servers, and using firewalls, server virtualization technology, which allows one physical server to be divided into multiple virtual services, each of which functions individually as a complete and independent server 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 negatively impact 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 publicly or privately sell the game money for their personal financial benefit. Although we have internal security procedures in place designed to prevent electronic embezzlement and have not had any incident of electronic embezzlement since early 2006, 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 negatively impact 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 accumulate 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 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 in timely 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 preliminary written accusation to the Tokyo Metropolitan Police Department in October 2009 and filed criminal charges against an illegal server operator of Ragnarok Online in April 2011 in cooperation with GungHo, our licensee in Japan, and the matter is currently under investigation by the Tokyo Metropolitan Police Department. In December 2007 and June 2008, Gravity Interactive, Inc., our wholly owned subsidiary in the United States which manages Ragnarok Online game operations in the United States, petitioned the Federal Bureau of Investigation for remission or mitigation of forfeiture of the property of two illegal servers.

Table of Contents

operators of Ragnarok Online, which property was deemed proceeds of copyright infringement violations by the illegal server operators, and US\$154,674.73 was returned to Gravity Interactive, Inc. in April 2011. We may incur considerable costs in the future in order to remedy software piracy of our server 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. For example, in November 2010, Gravity Interactive, Inc., which manages Dragonica game operations under the name Dragon Saga in the United States and Canada, THQ*ICE LLC, the former game distributor of Dragonica in the United States and Canada, and THQ Inc., the former joint venture partner of THQ*ICE LLC, were accused of trademark infringement. The owner of the registered trademark of Dragonica in the United States filed a lawsuit with the United States District Court for the Southern District of Florida seeking damages and any profits and gains to the defendants through the alleged trademark infringement and the lawsuit was settled in March 2012. 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 and service companies.

Table of Contents

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.

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 2011 report issued by the Korea Creative Content Agency, an industry, non-profit organization that promotes the export 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 and 2009 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. There has been a significant decrease in the number of Internet cafés in operation in 2010 and the number of Internet cafés, and as a result the total number of PCs at Internet cafés, are expected to gradually decrease in the long term as small-scale Internet cafés lacking price competitiveness close down operations. Furthermore, as a result of a rapid increase in the use of smartphones and other mobile devices, with which people access the Internet in a more convenient manner, the number of Internet cafés is expected to continue to decrease. 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 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 South America, may be limited as the penetration rates for PCs 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.

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. Outbreak of widespread public health problems

Table of Contents

such as swine flu, avian influenza, or severe acute respiratory syndrome, or SARS, in China or in other countries may prevent our customers from accessing Internet cafés and may adversely affect our prospects, business and operating results.

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.

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.

Section 3(b)(1) of the Investment Company Act of 1940, or the 40 Act, provides that a company is not an investment company and, therefore, 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 (a Non-Investment Business). There are several bases on which a company can rely in determining that it is a Non-Investment Business.

Under one set of criteria, the factors to be considered in determining that a company is a Non-Investment Business are: (i) the history of the company; (ii) the manner in which the company represents itself to the investing public; (iii) the activities of its officers and directors; (iv) the nature of its current assets; and (v) the sources of its current income. Based on those factors, we believe that we are engaged primarily and directly in the business of providing online game services, and consequently, that we are a Non-Investment Business, and not an investment company as that term is defined under the 40 Act.

However, the determination as to whether a company satisfies the foregoing criteria is fact sensitive and subjective. Accordingly, it is possible that our determination could be challenged by the U.S. Securities and Exchange Commission (SEC), particularly if at any time we own 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. Nonetheless, if this were to become the case, we could be required to take actions to reduce our ownership of investment securities to comply with this standard, such as shifting a portion of our short-term investment portfolio into low-yielding bank deposits. If necessary, such actions would likely reduce the amount of interest or other income that we could otherwise generate from our investments. In addition, we might 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 business strategy.

Alternatively, we could consider other actions, including applying to the SEC for an exemptive order pursuant to Section 3(b)(2) of the 40 Act, declaring that we are a company that is primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities, without regard to the composition of our assets at any particular time. However, there can be no assurance that we would receive an exemptive order and the process to obtain such an exemptive order could be long and expensive.

The 40 Act contains numerous, complex requirements with respect to the organization and operations of investment companies, including restrictions on their capital structure, operations, and transactions with affiliates, as well as restrictions on the composition of the board of directors and other matters which would be incompatible with our business. Also, 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 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.

Table of Contents

Our status as a passive foreign investment company (PFIC) in 2011 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 a PFIC for U.S. federal income tax purposes since our initial public offering. In particular, due to the deterioration of the trading price of our ADSs, we believe that we were a PFIC in 2008 through 2011, and there is a significant risk that we will continue to be a PFIC in 2012. 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 MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS PFICs.

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 are subject to Section 404 of the Sarbanes-Oxley Act of 2002, 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.

Although we have determined that we do not have a material weakness in our internal control over financial reporting for the year ended December 31, 2011, we may in the future determine that we have a material weakness in our internal control over financial reporting. If we fail to maintain an effective system of internal control over financial reporting, we may be unable to accurately report our financial results in a timely manner or prevent errors or fraud. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to loss of investor confidence in the reliability of our consolidated financial statements and could result in investigations or sanctions by the SEC, the NASDAQ, or other regulatory authorities or in stockholder litigation. Any of these factors could ultimately harm our business and could adversely impact the market price of our ADSs. See ITEM 15. CONTROLS AND PROCEDURES.

Rapid technological developments and changes in market environment may limit our ability to recover game development 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 or licensing costs and the recognition of impairment loss for such costs may materially and adversely affect our financial condition and results of operations. For example, we had Won 475 million impairment loss on intangible assets for capitalized research and development cost of Canaan in 2010. In 2011, we recognized an impairment loss on intangible assets for capitalized research and development cost of Won 799 million for Eternal Destiny.

We could suffer losses due to asset impairment charges.

We held a total of Won 15,209 million in acquired intangible assets and Won 7,477 million in goodwill at December 31, 2011. See Note 11 to our consolidated financial statements included in this annual report. We test goodwill and indefinite-lived intangible assets at least annually for impairment, and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of these assets below their carrying amount. Such an event would include unfavorable variances from established business plans, significant changes in forecasted results or volatility inherent to external markets and industries, which are periodically reviewed by management. If such an adverse event occurred and had the effect of changing one of the critical assumptions or estimates related to the fair value of our intangible assets or goodwill, an impairment charge could result. For example, during 2009, as a result of an overall decline in the fair value of the business reporting units in

Table of Contents

our business in Russia, we recorded a goodwill impairment charge of Won 241 million to write off the entire outstanding balance of goodwill in such reporting units. During 2011, we recorded impairment loss on goodwill of Won 514 million primarily due to the overall decline in the fair value of Gravity Games, and recognized an impairment loss of Won 2,384 million since the carrying amount of Dragonica before recognition of impairment loss exceeded its fair value. There can be no assurance that future reviews of our goodwill and other intangible assets will not result in impairment charges. Although it does not affect cash flow, an impairment charge does have the effect of decreasing our earnings, assets and shareholders' equity.

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 countries 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, defamation, pricing, advertising, taxation, promotions, financial market regulation, consumer protection, content regulation, quality of products and services, and intellectual property ownership and infringement that may directly or indirectly impact our activities. The impact of such laws and regulations on our business and results of operations is difficult to predict as many such laws and regulations are constantly changing. However, as we might unintentionally violate such laws or such laws may be modified and new laws may be enacted in the future, any such developments, or developments stemming from enactment or modification of other laws, could increase the costs of regulatory compliance, force changes in business practices or otherwise have a material adverse effect on our business, financial condition and results of operations. Further, if the cost of regulatory compliance increases for our licensees as a result of regulatory changes, our licensees may seek to reduce royalties and license fees payable to us, which may materially and adversely affect our business, results of operations and financial condition.

Korea

Article 9(4) of the National Health Promotion Act was amended on June 7, 2011, which included changes such as the expansion of the scope of public facilities which are required to be designated as entirely non-smoking areas while, at the same time, permitting the establishment of separate smoking sections in order to protect smokers' rights. Such public facilities include (i) business places offering games to adolescents, (ii) business places offering ordinary games, (iii) business places offering Internet computer games and (iv) business places offering combined distributed games as defined under the Act on Promotion of the Game Industry, and the amendment will be effective from June 8, 2013 with respect to such business places. The amendment may cause significant changes in the operation of Internet cafés, which currently operate both smoking and non-smoking sections. The number of Internet cafés in Korea is already gradually decreasing and the enactment of the proposed amendment may further reduce the number of Internet cafés operated by small business owners and have a material adverse effect on our business, financial condition and results of operations. See ITEM 3.D. RISK FACTORS RISKS RELATING TO OUR BUSINESS Slow growth or contractions in the Internet café industry in Korea may affect our ability to target a core group of users. See also ITEM 4.B.

BUSINESS OVERVIEW LAWS AND REGULATIONS Korea for detailed discussion regarding Korean laws that affect our operations.

Under the Act on Promotion of the Game Industry, (i) business places offering adolescent games refers to business places which install and provide to the public games which are rated and classified as appropriate for use by all ages, (ii) business places offering ordinary games refers to business places which install and provide to the public, in addition to games which are rated and classified as appropriate for use by all ages, games which are rated and classified as prohibited to be used by minors, (iii) business places offering Internet computer game facilities refers to business places which have the necessary equipment such as computers to enable the public to play games

Table of Contents

or access other information materials on the Internet and (iv) business places offering combined distributed games refers to business places which provide games or Internet game facilities under the Act on Promotion of the Game Industry as well as other businesses in the same location.

China

The Chinese government, through various regulatory authorities, heavily regulates the Internet sector, which includes the online game industry. In addition, there are uncertainties in the interpretation and application of existing Chinese laws, regulations and policies regarding the activities of Internet companies and businesses in China. Any violations of current and future laws and regulations could materially and adversely affect our and our Chinese licensee's business, financial condition and results of operations. See ITEM 4.B. BUSINESS OVERVIEW LAWS AND REGULATIONS China for detailed discussion regarding Chinese laws that affect our operations.

Taiwan

In Taiwan, the game industry and online game companies are subject to various laws and regulations on different aspects, including, among others, consumer protection, rating system for protection of children and juveniles, Internet cafés, intellectual property and privacy protection.

Currently there is no national law specifically regulating the operation of Internet cafés in Taiwan. However, several municipalities and counties of Taiwan, such as Taipei City, New Taipei City, Taoyuan County, Tainan City, Nantou County, Lienchiang County and Kinmen County, have promulgated ordinances imposing restrictions on Internet cafés. In order to have Internet cafés regulated under a national legislation rather than by different municipalities and counties ordinances, the ROC Ministry of Economic Affairs as well as some legislators propose to regulate all Internet cafés located in Taiwan under a national legislation to be enacted. It is unclear, however, whether or when the above proposals will be passed by the Legislative Yuan and what restrictions will be imposed on Internet cafés. If the future laws and regulations have an impact on the Internet cafés, the growth of the Internet cafés industry in Taiwan may be affected and adversely affect our business, financial condition and result of operations. See ITEM 4.B. BUSINESS OVERVIEW LAWS AND REGULATIONS Taiwan for detailed discussion regarding Taiwanese laws that affect our operations.

Thailand

Although there is no specific law or regulation that directly governs the online game industry in Thailand, new legislation was passed in June 2008 to impose certain restrictions to control operators of game shops (i.e., places where people can play games, including Internet cafés that provide game services) and limit access to game shops by users under 18 years of age. These restrictions include limitations on the business days and hours, location and building structure of game shops as well as the daily playing time of games and curfew hours for users under 18 years of age. According to the Ministerial Regulation of Ministry of Culture Re: Permission and Operation of Video Shops B.E. 2552 (September 24, 2009), users under 15 years of age can enter game shops and Internet cafés between 2:00 p.m. and 8:00 p.m. on Monday to Friday; and between 10:00 a.m. and 8:00 p.m. on public holidays or during school term breaks prescribed by the competent registrar. For users aged from 15 years to 18 years, the access times are limited to between 2:00 p.m. and 10:00 p.m. on Monday to Friday; and between 10:00 a.m. and 10:00 p.m. on public holidays or during school term breaks as prescribed by the competent registrar. See ITEM 4.B. BUSINESS OVERVIEW LAWS AND REGULATIONS Thailand for detailed discussion regarding Thai laws that affect our operations.

United States and Japan

See ITEM 4.B. BUSINESS OVERVIEW LAWS AND REGULATIONS for detailed discussion regarding U.S. and Japanese laws that may materially impacted our operations.

Table of Contents

Our online games may be subject to governmental restrictions or ratings systems, which could delay or prohibit the release of new games or reduce the existing and potential scope of our user base.

Legislation is periodically introduced in many of the countries in which our games are distributed to establish a system for protecting consumers from the influence of graphic violence and sexually explicit materials contained in various types of games. For instance, Korean law requires online game companies to obtain ratings classifications and implement procedures to restrict access of online games to certain age groups. Similar mandatory ratings systems and other regulations affecting the content and distribution of our games have been adopted or are under review in Taiwan, China, the United States and other markets for our online games. In the future, we may be required to modify our game content or features or alter our marketing strategies to comply with new governmental regulations or ratings assigned to our current or future games, which could delay or prohibit the release of new games or upgrades and reduce the existing and potential scope of our user base. Moreover, uncertainties regarding governmental restrictions or ratings systems applicable to our business could give rise to market confusion, thereby materially and adversely affecting our business, financial condition and results of operations.

Restrictions and controls on currency exchange in Korea and in certain countries in which our games are distributed may limit our ability to effectively utilize revenues generated in Won to fund our business activities outside Korea or expenditures denominated in foreign currencies, and may limit our ability to receive and remit revenues effectively.

The existing and any future restrictions on currency exchange in Korea, including Korean exchange control regulations, may restrict our ability to convert Won into foreign currencies under certain emergency circumstances, such as natural calamities, wars, conflicts of arms or grave and sudden changes in domestic or foreign economic circumstances, difficulties in Korea's international balance of payments and international finance and obstacles in carrying out currency policies, exchange rate policies and other Korean macroeconomic policies. Such restrictions may limit our ability to effectively utilize revenues generated in Won to fund our business activities outside Korea or expenditures denominated in foreign currencies.

In addition, the governments in certain markets in which our games are distributed, including Thailand, Taiwan and China, impose controls on the convertibility of local currency into foreign currencies and, in some cases, the remittance of currency outside their countries. Under current foreign exchange control regulations of certain markets, shortages in the availability of foreign currency may restrict the ability of our overseas licensees to pay license fees and royalties, most of which are paid in U.S. dollars, to us. Restrictions on our ability to receive license fees, royalties and other payments from our licensees would adversely affect our financial condition and liquidity.

Adverse changes in the withholding tax rates in the countries from which we receive license fees and royalties could adversely affect our net income.

We may be subject to income tax withholding in countries where we derive revenues. Such withholding is made by our overseas licensees at the current withholding rates in such countries. To the extent Korea has a tax treaty with any such country, the withholding rate prescribed by such tax treaty will apply. Under the Corporation Tax Law of Korea, we are entitled to and recognize a capped tax credit computed based on the amount of income taxes withheld overseas when filing our income tax return in Korea. Accordingly, the amount of taxes withheld overseas may be offset against taxes payable in Korea.

The tax rates on royalties pursuant to tax treaties that Korea entered into have not changed recently. Any adverse changes in tax treaties between Korea and the countries from which we receive license fees and royalties, such as with the rate of withholding tax in the countries in which our games are distributed or in Korean tax law enabling us to recognize tax credits for taxes withheld overseas, could adversely affect our net income.

Table of Contents

RISKS RELATING TO OUR MARKET ENVIRONMENT

Our businesses may be adversely affected by developments affecting the economies of the countries in which our games are distributed.

Our future performance will depend in large part on the economic growth of our principal markets. Our top geographic markets in terms of revenues were Japan, Korea, the United States and Canada, Taiwan and Hong Kong/ Macau, and Europe, representing 51.3%, 18.2%, 10.2%, 6.2% and 3.6%, respectively, of our total revenues in 2011. Accordingly, our business, prospects, financial condition and results of operations are subject to the economic, political, legal and regulatory conditions and developments in these countries. Adverse economic developments in such markets may have an adverse effect on the number of our subscribers and our revenues and have a material adverse effect on our results of operations.

Deterioration in global economic conditions in the recent global downturn and the debt crisis in Europe has weakened the economies of the countries in which our games are distributed. Many countries for the foreseeable future may continue to experience economic slowdowns and recessionary pressures, including difficulty in securing credit in the global financial markets and decreased consumer confidence and discretionary spending. While the recent global economic developments did not yet have a material adverse effect on us, continuing deterioration or delayed recovery in global economic conditions could materially and adversely affect our business, financial condition and results of operations.

Fluctuations in exchange rates could result in foreign currency exchange losses.

In most of the countries in which our games are distributed, the revenues generated by our overseas subsidiaries or licensees are denominated in local currencies, which include the U.S. dollar, the Japanese Yen, the Euro, the NT dollar, the Thai Baht and the Chinese Yuan. In 2011, approximately 81.8% of our revenues were denominated in foreign currencies, primarily in the U.S. dollar and the Japanese Yen. As the revenues denominated in local currencies, other than the U.S. dollar, the Japanese Yen and the Euro, are converted into the U.S. dollar for remittance of monthly royalty payments to us, any depreciation of the local currencies against the U.S. dollar will result in reduced license fees and monthly royalty payments in U.S. dollar terms and may materially and adversely affect our financial condition and results of operations.

While we receive monthly royalty revenues from our overseas licensees in foreign currencies, substantially all of our costs are denominated in Won. Our financial statements are also prepared and presented in Won. We receive monthly royalty payments from our overseas licensees based on a percentage of revenues confirmed and recorded at the end of each month applying the foreign exchange rate applicable on such date. Appreciation of the Won against the Japanese Yen or other foreign currencies will result in foreign currency losses that may materially and adversely affect our financial condition and results of operations. See ITEM 5.A. OPERATING RESULTS OVERVIEW Foreign currency effects.

As of December 31, 2011, we have not entered into any outstanding foreign currency forward exchange contract. We may enter into hedging transactions in the future to mitigate our exposure to foreign currency exchange risks, but we may not be able to do so in a timely or cost-effective manner, or at all.

Increased tensions with North Korea could adversely affect us and the price of our ADSs.

Relations between Korea and North Korea have been tense throughout Korea's modern history. The level of tension between the two Koreas has fluctuated and may increase abruptly as a result of current and future events. In recent years, there have been heightened security concerns stemming from North Korea's nuclear weapons and long-range missile programs and increased uncertainty regarding North Korea's actions, particularly in light of the recent leadership change, and possible responses from the international community. There can be no assurance that the level of tension on the Korean peninsula will not escalate in the future. Any further increase in tension, which may occur, for example, if North Korea experiences a leadership or economic crisis, high-level contacts break down, or military hostilities occur, could adversely affect our business, prospects, financial condition and results of operations and could lead to a decline in the market value of our ADSs.

Table of Contents***Disruptions in Taiwan's political environment could seriously harm our business and operations in Taiwan.***

In 2011 and 2010, we derived 6.1% and 5.2%, respectively, of our total revenues from our licensees in Taiwan. The Chinese government asserts that it has sovereignty over Taiwan as well as mainland China and does not recognize the legitimacy of the government of Taiwan. The Chinese government has indicated that it may use military force to gain control over Taiwan if Taiwan declares independence or a foreign power interferes in Taiwan's internal affairs. In response, the Taiwanese government promulgated the Referendum Law on December 31, 2003, last amended on June 17, 2009, allowing referenda on a range of issues to be proposed and voted upon. The law allows a referendum on key constitutional issues in the event that Taiwan faces a military attack from a foreign power and its sovereignty is threatened.

In March 2008, the Taiwanese people elected President Ma Ying-jeou, who has supported the cultivation of better relations with mainland China. For instance, in July 2008, Taiwan lifted the ban on Chinese persons visiting Taiwan with certain limitations. In December 2008, Taiwan re-established regular direct transportation links with mainland China that had been shut since 1949, including regularly scheduled commercial flights and shipping and mail. Further, the Taiwanese government has partially unbound the restrictions on the investment in Taiwan by Chinese companies and persons and several new regulations in connection therewith have been passed. For the purpose of furthering financial cooperation, Taiwan has entered into a memorandum of understanding regarding cross-strait financial supervision with mainland China on November 16, 2009, which became effective on January 16, 2010. Also, after several months of negotiation, the Taiwanese and Chinese governments entered into the Economic Cooperation Framework Agreement for enjoying custom benefits on June 29, 2010, which became effective on September 12, 2010. President Ma Ying-jeou was re-elected in January 2012, and the people on both sides of the Taiwan Straits generally believe he will continue to cultivate better relations with mainland China. Although recent trends may be beneficial to Taiwan's economy, the history between Taiwan and mainland China has been marked with uncertainties. Deteriorations in the relationship between Taiwan and China and other factors affecting Taiwan's political environment may materially and adversely affect our Taiwanese licensee's business and our results of operations.

RISKS RELATING TO OUR AMERICAN DEPOSITARY SHARES***The public shareholders of our ADSs may have more difficulty protecting their interests than they would as shareholders of a U.S. corporation.***

Our corporate affairs are governed by our articles of incorporation and by the laws and regulations governing Korean corporations. The rights and responsibilities of our shareholders and members of our Board of Directors under Korean law may be different from those that apply to shareholders and directors of a U.S. corporation. For example, minority shareholder rights afforded under Korean law often require the minority shareholder to meet minimum shareholding requirements in order to exercise certain rights. Under applicable Korean law, of the total issued and outstanding shares, a shareholder must own at least (i) one percent to bring a shareholders' derivative lawsuit (or to demand that a director cease certain activity or conduct if there are concerns that a director may cause irrevocable damage to the company by acting in violation of applicable laws and regulations or the articles of incorporation), (ii) three percent to demand convocation of an extraordinary meeting of shareholders, demand removal of directors or inspect the books and related documents of a company, or to propose the agenda for a general meeting of shareholders, (iii) ten percent to apply to the court for dissolution if there is gross improper management or a deadlock in corporate affairs likely to result in a significant and irreparable harm to the company or to apply to the court for a reorganization in the case of an insolvency and (iv) twenty percent to block a small-scale share exchange or a small merger that may be approved only by a board resolution. In addition, while the facts and circumstances of each case will differ, the duty of care required of a director under Korean law may not be the same as the fiduciary duty of a director of a U.S. corporation. Although the business judgment rule concept exists in Korea, there is insufficient case law or precedent to provide guidance to the management and shareholders as to how it should be applied or interpreted. Holders of our ADSs may have more difficulty protecting their interests against actions of our management, members of our Board of Directors or controlling shareholders than they would as shareholders of a U.S. corporation.

Table of Contents

Any dividends paid on our common shares will be in Won and fluctuations in the exchange rate between the Won and the U.S. dollar may affect the amount received by you.

If and when we declare cash dividends, the dividends will be paid to the depository for the ADSs in Won and then converted by the depository into U.S. dollars pursuant to the deposit agreement that governs the rights and obligations of the holders of ADSs. Fluctuations in the exchange rate between the Won and the U.S. dollar will affect, among other things, the U.S. dollar amounts you will receive from the depository as dividends. Holders of ADSs may not receive dividends if the depository does not believe it is reasonable or practicable to do so. In addition, the depository may collect certain fees and expenses, at the sole discretion of the depository, by billing the holders of ADSs for such charges or by deducting such charges from one or more cash dividends or other cash distributions from us to be distributed to the holders of ADSs.

Your ability to deposit or withdraw common shares underlying the ADSs into and from the depository facility may be limited, which may adversely affect the value of your investment.

Under the terms of our deposit agreement, holders of our common shares may deposit such shares with the depository's custodian in Korea and obtain ADSs, and holders of our ADSs may surrender the ADSs to the depository and receive our common shares. However, to the extent that a deposit of common shares exceeds the difference between:

the aggregate number of common shares we have consented to be deposited for the issuance of ADSs (including deposits in connection with offerings of ADSs and stock dividends or other distributions relating to ADSs); and

the number of common shares on deposit with the custodian for the benefit of the depository at the time of such proposed deposit, such common shares will not be accepted for deposit unless (i) our consent with respect to such deposit has been obtained or (ii) such consent is no longer required under Korean laws and regulations or under the terms of the deposit agreement.

Under the terms of the deposit agreement, no consent is required if the common shares are obtained through a dividend, free distribution, rights offering or reclassification of such shares. Under the terms of the deposit agreement, we have consented to any deposit to the extent that, after the deposit, the aggregate number of deposited common shares does not exceed 3,552,229 common shares or any greater number of common shares we determine from time to time (i.e., as a result of a subsequent offering, stock dividend or rights offer), unless the deposit is prohibited by applicable laws or violates our articles of incorporation; provided, however, that in the case of any subsequent offer by us or our affiliates, the limit on the number of common shares on deposit shall not apply to such offer and the number of common shares issued, delivered or sold pursuant to the offer (including common shares in the form of ADSs) shall be eligible for deposit under the deposit agreement, except to the extent such deposit is prohibited by applicable laws or violates our articles of incorporation or, in the case of any subsequent offer by us or our affiliates, we determine with the depository to limit the number of common shares so offered that would be eligible for deposit under the deposit agreement in order to maintain liquidity of the shares in Korea as may be requested by the relevant Korean authorities. We might not consent to the deposit of any additional common shares. As a result, if a holder surrenders ADSs and withdraws common shares, the holder may not be able to subsequently deposit the common shares to obtain ADSs.

You may not be able to exercise preemptive rights or participate in rights offerings and as a result, you may experience dilution in your ownership percentage in us.

The Korean Commercial Code and our articles of incorporation require us to offer shareholders the right to subscribe for new common shares in proportion to their existing ownership percentages whenever new common shares are issued, except under certain circumstances as provided in our articles of incorporation. See ITEM 10.B. ARTICLES OF INCORPORATION Preemptive rights and issuance of additional shares.

Such exceptions include offering of new shares:

through a general public offering;

Table of Contents

to the members of the employee stock ownership association;

upon exercise of a stock option;

in the form of depositary receipts;

to induce foreign direct investment necessary for business in accordance with the Foreign Investment Promotion Act of Korea;

for the purpose of raising funds on an emergency basis;

to certain companies under joint venture arrangements; or

by a public offering or underwritten by underwriters for the purpose of listing such shares on any stock exchange.

Accordingly, if we issue new shares to non-shareholders based on such exceptions, existing holders of ADSs will be diluted. If none of the above exemptions is available under Korean law, we may be required to grant subscription rights when issuing additional common shares. However, under U.S. law, we would not be able to make those rights available in the United States unless we register the securities to which the rights relate or an exemption from the registration requirements of the Securities Act is available. Under the deposit agreement governing the ADSs, if we offer rights to subscribe for additional common shares, the depositary under the deposit agreement, after consultation with us, may make such rights available to you or dispose of such rights on behalf of you and make the net proceeds available to you or, if the depositary is unable to take such actions, it may allow the rights to lapse with no consideration to be received by you. The depositary is generally not required to make available any rights under any circumstances. We are under no obligation to file a registration statement under the Securities Act to enable you to exercise preemptive rights in respect of the common shares underlying the ADSs, and we cannot assure you that any registration statement would be filed or that an exemption from the registration requirement under the Securities Act would be available. Accordingly, you may not be entitled to exercise preemptive rights and may thereby suffer dilution of your interests in the Company.

You will not be treated as our shareholder and you will not have shareholder rights such as the voting rights applicable to a holder of common shares.

As an ADS holder, we are not obligated to and we will not treat you as one of our shareholders and therefore, you will not have the rights of a shareholder. Korean law and our articles of incorporation govern the rights applicable to our shareholder. The depositary will be treated as the shareholder of the common shares underlying your ADSs. As a holder of ADSs, you will have ADS holder rights, which is governed by deposit agreement among us, the depositary and you, as an ADS holder. Upon receipt of the necessary voting materials, you may instruct the depositary to vote the number of shares your ADSs represent. The depositary will notify you of shareholders' meetings and arrange to deliver our voting materials to you only when we deliver them to the depositary with sufficient time under the terms of the deposit agreement. If there is a delay or loss of the proxy materials, we cannot ensure that you will receive voting materials or otherwise learn of an upcoming shareholders' meeting to ensure that you may instruct the depositary to vote your shares. In addition, the depositary and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions.

You would not be able to exercise dissent and appraisal rights unless you have withdrawn the underlying common shares from the depositary facility and become a holder of our common stock.

In some limited circumstances, including the transfer of the whole or any significant part of our business, our acquisition of a part of the business of any other company having a material effect on our business, or our merger or consolidation with another company, dissenting shareholders have the right to require us to purchase their shares under Korean law. However, if you hold our ADSs, you will not be able to exercise such dissent and appraisal rights unless you have withdrawn the underlying common shares from the depositary facility and become our direct shareholder prior to the record date for the shareholders' meeting at which the relevant transaction is to be approved.

Table of Contents

We may amend the deposit agreement and the American Depositary Receipts without your consent for any reason and, if you disagree, your option will be limited to selling the ADSs or withdrawing the underlying securities.

We may agree with the depository to amend the deposit agreement and the ADRs without your consent for any reason. If an amendment adds or increases fees or charges, except for taxes and other governmental charges or expenses of the depository, for registration fees, facsimile costs, delivery charges or similar items, or prejudices a substantial right of ADS holders, it will not become effective for outstanding ADRs until 30 days after the depository notifies ADS holders of the amendment. At the time an amendment becomes effective, you are considered, by continuing to hold your ADSs, to agree to the amendment and to be bound by the ADRs and the deposit agreement as amended. If you do not agree with an amendment to the deposit agreement or the ADRs, your option is limited to selling the ADSs or withdrawing the underlying securities. No assurance can be given that the sale of ADSs would be made at a price satisfactory to you in such circumstances. In addition, the common shares underlying the ADSs are not listed on any stock exchange in Korea. Your ability to sell the underlying common shares following withdrawal and the liquidity of the common shares may be limited.

You may be subject to Korean withholding tax.

Under Korean tax law, if you are a U.S. investor, you may be subject to Korean withholding taxes on capital gains and dividends in respect of the ADSs unless an exemption or a reduction under the income tax treaty between the United States and Korea is available. Under the Korea-United States tax treaty, capital gains realized by holders that are residents of the United States eligible for treaty benefits will not be subject to Korean taxation upon the disposition of the ADSs. However, under the Korea-United States tax treaty, the following holders are not eligible for such tax treaty benefits: (i) in case the holder is a United States corporation, if by reason of any special measures, the tax imposed on such holder by the United States with respect to such capital gains is substantially less than the tax generally imposed by the United States on corporate profits, and 25% or more of the holder's capital is held of record or is otherwise determined, after consultation between competent authorities of the United States and Korea, to be owned directly or indirectly by one or more persons who are not individual residents of the United States and (ii) in case the holder is an individual, if such holder maintains a fixed base in Korea for a period or periods aggregating 183 days or more during the taxable year and the holder's ADSs or common shares giving rise to capital gains are effectively connected with such fixed base or such holder is present in Korea for a period or periods of 183 days or more during the taxable year.

You may have difficulty bringing an original action or enforcing any judgment obtained outside Korea against us and our directors and officers who are not U.S. persons.

We are organized under the laws of Korea, and most of our directors and officers reside outside of the United States. While we have a wholly-owned subsidiary in the United States, most of our assets and the assets of such persons are located outside of the United States. As a result, it may not be possible for you to effect service of process within the United States upon these persons or to enforce against them or us court judgments obtained in the United States that are predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any state of the United States. There is doubt as to the enforceability in Korea, either in original actions or in actions for enforcement of judgments of United States courts, of civil liabilities predicated on the federal securities laws of the United States or the securities laws of any state of the United States.

The transfer, sale or availability for sale of substantial amounts of our ADSs could adversely affect their market price.

GungHo beneficially owns 59.3% of our common shares. If GungHo decides to sell or transfer substantial amounts of our common shares into the form of ADSs in the public market or if there is a perception of their intent to sell, the market price of our ADSs could be materially and adversely affected and could materially impair our future ability to raise capital through offerings of our ADSs.

Table of Contents

ITEM 4. INFORMATION ON THE COMPANY

ITEM 4.A. HISTORY AND DEVELOPMENT OF THE COMPANY

We were incorporated as a company with limited liability under Korean law on April 4, 2000 under the legal name of Gravity Co., Ltd. Following our initial public offering of 8,000,000 ADSs, each representing one-fourth of one share of our common stock, par value Won 500 per share on February 8, 2005, our ADSs were listed on the NASDAQ Stock Market as the NASDAQ Global Market, formerly the NASDAQ National Market, under the symbol GRVY. We list below some of the recent developments relating to our organizational structure:

In March 2003, we established Gravity Interactive, LLC, our wholly-owned subsidiary in the United States. The name of Gravity Interactive, LLC was changed on January 1, 2006 to Gravity Interactive, Inc., or Gravity Interactive.

In January 2004, we acquired 50% of the voting shares of Gravity Entertainment Corporation, or Gravity Entertainment, formerly RO Production Co., Ltd., our subsidiary in Japan. In October 2004, we obtained from GungHo, which was then the other 50% shareholder of RO Production Co., Ltd., their ownership interest in RO Production Co., Ltd., which made Gravity Entertainment our wholly-owned subsidiary. RO Production Co., Ltd. changed its corporate name to Gravity Entertainment on February 5, 2005.

In November and December of 2005, we acquired an aggregate of 96.11% of the total shares of NeoCyon, Inc., or NeoCyon, which provides mobile multimedia services in Korea.

In August 2006, we founded Gravity EU SASU, a wholly-owned subsidiary based in France, which was converted into a joint venture company in which we have a 25% equity interest, Gravity EU SAS, with Media-Participations Paris SA as the joint venture partner, in July 2011.

In September 2006, we acquired 100% of the voting shares of Gravity CIS, Inc. formerly Mados, Inc., from Cybermedia International, Inc., a former subsidiary of NeoCyon. On November 21, 2007, the name of Gravity CIS, Inc. was changed to Gravity CIS Co., Ltd., or Gravity CIS.

In May 2007, we established Gravity Middle East & Africa FZ-LLC, or Gravity Middle East & Africa, a wholly-owned subsidiary in Dubai. Gravity Middle East & Africa has been in the process of liquidation since September 2008.

In October 2007, we founded Gravity RUS Co., Ltd., or Gravity RUS, a Russia-based subsidiary, and acquired 99.99% of the voting shares, and transferred 100% of the voting shares of Gravity CIS to Gravity RUS in December 2007.

In October 2007, we formed L5 Games Inc., or L5 Games, a game development studio in the United States which is a wholly-owned subsidiary of Gravity Interactive. L5 Games went into liquidation proceedings in the United States in August 2008 and the liquidation was completed in May 2010.

On April 1, 2008, GungHo acquired shares of our common stock, after which it became our largest shareholder, beneficially owning approximately 52.4% of our common shares. GungHo subsequently purchased our ADSs and beneficially owns approximately 59.3% of our common shares as of March 31, 2012.

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In June 2010, we acquired from Terabit Telecom Ltd., a Russia-based online game company, a 25% of equity interest in Ingamba LLC, or Ingamba, a joint venture company established in April 2010 for online game service in Russia, and Terabit Telecom sold its 75% of equity interest in Ingamba to Stylonos Technologies Ltd., a Russia-based online game company, in December 2010.

In October 2010, we acquired an aggregate of 50.83% of the total shares of Barunson Interactive Corporation, or Barunson Interactive, an online game developer in Korea. Barunson Interactive changed its corporate name to Gravity Games Corporation, or Gravity Games, on March 28, 2011.

Our registered office is located at Nuritkum Square Business Tower 15F, 1605 Sangam-Dong, Mapo-Gu, Seoul 121-795, Korea. Our telephone number is (822) 2132-7000. Our main Web site is at <http://www.gravity.co.kr>.

Table of Contents

**ITEM 4.B. BUSINESS OVERVIEW
OVERVIEW**

We are a leading developer and publisher of online games in Japan, Taiwan, Brazil, the Philippines, Singapore, Malaysia and Thailand based on the number of peak concurrent users, or PCU, as compiled from various statistical data available from public sources in such countries. We are based in Korea and we currently offer thirteen online games worldwide and have one online game in development and one online game developed or being developed by third parties for which we have entered into license agreements. Our principal product, Ragnarok Online, is commercially offered in Korea and 78 other countries and markets. Ragnarok Online II is currently commercially offered in Korea. Requiem is commercially offered globally. Emil Chronicle Online is commercially offered in Hong Kong, Taiwan, Indonesia and China. R.O.S.E. Online is commercially offered in the United States, Canada, Mexico and 40 other countries. Dragonica is commercially offered in the United States, Canada and 53 other countries. H.A.V.E. Online and Ragnarok Online Guild Masters are commercially offered in Japan. Canaan, Kun Woong Online, Finding Neverland Online and Jeweled Planet are commercially offered in Korea. Fashion Star is commercially offered worldwide on Facebook. We also offer a number of mobile games and license the merchandizing rights of character-related products based on our online games. We intend to diversify our online game offering by developing online games in-house as well as publishing additional online games developed by third parties. We are also expanding our business by providing our games on multiplatform devices, such as Nintendo DS, Xbox Live Arcade, PlayStation Portable or PSP, and PlayStation Vita or PS Vita.

In Korea, we directly manage all aspects of operations of our games, such as marketing, operation, billing and customer service. For certain countries and markets, our subsidiaries directly manage such game operations. Gravity Interactive, our wholly-owned subsidiary in the United States, is responsible for all aspects of Ragnarok Online game operations in the United States, Canada, Australia, New Zealand and India, for all aspects of Requiem game operations globally except for Russia and 14 other countries and Taiwan, Hong Kong and Macau, for all aspects of R.O.S.E. Online game operations in the United States, Canada, Mexico and 40 European countries, and for all aspects of Dragonica, which is also known as Dragon Saga, in the United States and Canada. In the countries where we and our wholly-owned subsidiary, Gravity Interactive, manage game operations, our game revenues are recorded as subscription revenues.

In the rest of the countries in which our games are offered, our overseas licensees are responsible for all aspects of game operations in their respective markets in close cooperation with us. Our license agreements have an initial term of two or three years and are subject to renewal once the initial term expires. We rely on the initial and renewal license fees and the ongoing royalties from our overseas licensees for a significant portion of our revenues. The ongoing royalties are based on a percentage of revenues generated by our overseas licensees from the subscriptions to our games or the micro-transaction system in their respective markets.

Table of Contents

The following table sets forth a summary of our consolidated statements of operations showing revenues from our online games (by type of revenue and geographic market), mobile games, and character merchandising and other revenue as a percentage of total net revenues for the periods indicated.

| | Year Ended December 31, | | | | | | | |
|---|--|--------|--------------|--------|--------------|--------|-------------|--|
| | 2009 | | 2010 | | 2011 | | 2011(1) | |
| | (In millions of Won and thousands of US\$, except percentages) | | | | | | | |
| Online game revenues(2): | | | | | | | | |
| Subscriptions: | | | | | | | | |
| Korea | (Won) 4,951 | 8.6% | (Won) 3,829 | 7.3% | (Won) 4,740 | 8.2% | US\$ 4,092 | |
| United States/Canada(3) | 5,785 | 10.1 | 4,664 | 8.9 | 5,832 | 10.2 | 5,034 | |
| Others | 1,938 | 3.4 | 1,415 | 2.7 | 984 | 1.7 | 849 | |
| Subtotal | 12,674 | 22.1 | 9,908 | 18.9 | 11,556 | 20.1 | 9,975 | |
| Royalties and license fees: | | | | | | | | |
| Japan | 28,089 | 48.9 | 24,761 | 47.3 | 23,854 | 41.5 | 20,590 | |
| Taiwan/Hong Kong/Macau | 1,827 | 3.2 | 2,864 | 5.5 | 3,561 | 6.2 | 3,074 | |
| Others(3) | 4,121 | 7.2 | 4,507 | 8.6 | 8,137 | 14.1 | 7,024 | |
| Subtotal | 34,037 | 59.3 | 32,132 | 61.4 | 35,552 | 61.8 | 30,688 | |
| Mobile game revenues | 7,882 | 13.7 | 9,188 | 17.5 | 9,293 | 16.2 | 8,022 | |
| Character merchandising and other revenue | 2,810 | 4.9 | 1,134 | 2.2 | 1,076 | 1.9 | 928 | |
| Total net revenue | (Won) 57,403 | 100.0% | (Won) 52,362 | 100.0% | (Won) 57,477 | 100.0% | US\$ 49,613 | |

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.
- (2) Online game revenues include revenues from Ragnarok Online, R.O.S.E. Online, Requiem, Emil Chronicle Online, Dragonica, Pororo Game, Canaan, H.A.V.E. Online, Eternal Destiny, Kun Woong Online, Pucca Racing, Time N Tales, our social network games and from online game channeling service through GnJoy, our online game portal site. The revenues from Dragonica in 2010 only include revenues arising after October 21, 2010 when we acquired Barunson Interactive, currently Gravity Games, the developer of Dragonica. Pororo Game, Canaan, H.A.V.E. Online, Eternal Destiny and Kun Woong Online were commercially launched in September 2009, October 2010, March 2011, August 2011 and November 2011, respectively. We commercially launched our two social network games, Fashion Star and Jeweled Planet in January 2011 and March 2011, respectively, and we launched our online game channeling service in August 2011. We discontinued offering Time N Tales, Pucca Racing and Eternal Destiny in March 2009, June 2010 and November 2011, respectively.
- (3) Subscription revenues in the United States and Canada, as shown on this table, also include subscription and other types of game revenues generated in other countries managed by Gravity Interactive. The license agreement for Ragnarok Online with Gravity Interactive was amended in January 2008 to include Australia and New Zealand as countries serviced by Gravity Interactive, and in September 2009 to include India as a country serviced by Gravity Interactive. Revenues generated in India prior to the respective amendment to the license agreement were shown as Online game revenues-Royalties and license fees-Others. The license agreement for Requiem with Gravity

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Interactive was amended in December 2009 to include the United Kingdom and 38 other European countries, and further amended in June 2011 to include Mexico and 23 other Central and South American countries as countries serviced by Gravity Interactive. The license agreement for Requiem with Gravity Interactive was further amended in October 2011 to grant Gravity Interactive the worldwide distribution right of Requiem except for the existing licensed territories in which we have already granted licenses for Requiem game service to other local licenses.

Table of Contents**OUR PRODUCTS**

We currently have five product lines: MMORPGs, other online games, social network games, mobile games, and game-related products and services, including animation and character-based merchandise. Revenues from our principal product, Ragnarok Online, accounted for 66.0% of our total revenues in 2011, compared with 71.8% of our total revenues in 2010. We are seeking to diversify our revenue sources by offering additional MMORPGs, casual online games, social network games and other products and services, including mobile games.

Massively multiplayer online role playing games (MMORPGs)

MMORPG is a genre of computer role playing games in which a large number of players interact with one another within a virtual game world.

The following table summarizes the MMORPGs that we currently offer and currently in development, and those games licensed from third party developers.

| Title | Description | Game Source | Date of Commercial Launch/Testing(2) |
|-----------------------------|---|---|---|
| Ragnarok Online | Action adventure with 150 levels of skill upgrades, which features two-dimensional characters in three-dimensional backgrounds(1) | Developed in-house | Launched in August 2002 |
| Ragnarok Online II | Three-dimensional sequel to Ragnarok Online | Developed in-house | Launched in March 2012 |
| Requiem | Three-dimensional action adventure | Developed in-house | Launched in October 2007 |
| Emil Chronicle Online | Three-dimensional action adventure | Licensed from third party developer | Launched in August 2007 |
| Dragonica (Dragon Saga)(3) | Three-dimensional action adventure | Originally licensed from third party developer and currently owned by us(4) | Launched in February 2009(5) |
| R.O.S.E. Online | Three-dimensional action adventure with seven independent storylines | Originally licensed from third party developer; currently owned by us(6) | Launched in January 2005 |
| Canaan | Web browser-based casual | Licensed from third party developer | Launched in October 2010 |
| Kun Woong Online | Two-dimensional action adventure | Licensed from third party developer | Launched in November 2011 |
| Finding Neverland Online | Three-dimensional casual action adventure | Licensed from third party developer | Launched in January 2012 |
| Maestia | Three-dimensional action adventure | Licensed from third party developer | Currently expected to launch in the third quarter of 2012 |
| East Road (tentative title) | Three-dimensional action adventure | Being developed in-house(7) | Not determined |

Table of Contents*Notes:*

- (1) A game with such features is generally referred to in the industry as a 2.5 dimensional game.
- (2) The actual date of commercial launch of games in each country is dependent on a variety of factors, including technical viability and durability, availability of in-house development capability, market conditions, beta testing results and availability of licensing partners in various jurisdictions, among others.
- (3) Dragonica is commercially offered in the United States and Canada under the name Dragon Saga. We also intend to offer Dragonica in Korea under the name Dragon Saga.
- (4) We acquired an aggregate of 50.83% equity interest in Gravity Games, formerly known as Barunson Interactive, which developed Dragonica, on October 21, 2010.
- (5) Dragonica was initially launched in China in February 2009 followed by 54 other countries and markets under license agreements between Gravity Games and local publishers before our acquisition of Gravity Games.
- (6) We acquired an aggregate of 88.15% equity interest in TriggerSoft, which developed R.O.S.E. Online in April and May 2005. TriggerSoft was liquidated in October 2007.
- (7) East Road is being developed by Gravity Games.

Ragnarok Online

Ragnarok Online is commercially offered in Korea and 78 other countries and markets since its commercial launch in August 2002. Ragnarok Online represented 66.0% of our total revenues or Won 37,963 million (US\$32,769 thousand) in 2011, compared with 71.8% of our total revenues or Won 37,574 million in 2010. See ITEM 4.B. BUSINESS OVERVIEW OUR MARKETS Overseas markets.

The following are revenues generated by Ragnarok Online for the periods indicated:

| Revenue Type | Country | 2009 | Year Ended December 31, | | | 2011(1) |
|--|-------------------------|-------------|-------------------------|-------------|------------|---------|
| | | | 2010 | 2011 | | |
| (In millions of Won and thousands of US\$) | | | | | | |
| Online game-subscription revenue | Korea | (Won) 4,156 | (Won) 3,412 | (Won) 4,542 | US\$ 3,921 | |
| | United States/Canada(2) | 3,794 | 3,003 | 3,479 | 3,003 | |
| | Others(3)(4) | 1,046 | 944 | 950 | 820 | |
| | Subtotal | 8,996 | 7,359 | 8,971 | 7,744 | |
| Online game-royalties and license fees | Japan | 28,089 | 24,637 | 22,320 | 19,266 | |
| | Taiwan/Hong Kong/Macau | 1,452 | 2,167 | 2,769 | 2,390 | |
| | Brazil | 1,057 | 1,079 | 1,162 | 1,003 | |

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| | | | | |
|-------------------------|--------------|--------------|--------------|-------------|
| Philippines | 707 | 689 | 889 | 767 |
| Thailand | 819 | 719 | 865 | 747 |
| Indonesia | 362 | 214 | 208 | 180 |
| Middle East/Africa | 7 | 123 | 209 | 180 |
| Europe(4) | 408 | 152 | 201 | 174 |
| China | 336 | 373 | 166 | 143 |
| Singapore/Malaysia | 57 | 40 | 114 | 98 |
| Russia/CIS countries(3) | | 22 | 89 | 77 |
| Subtotal | 33,294 | 30,215 | 28,992 | 25,025 |
| Total | (Won) 42,290 | (Won) 37,574 | (Won) 37,963 | US\$ 32,769 |

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.

Table of Contents

- (2) Includes subscription and other types of game revenues generated in Australia, New Zealand and India managed by Gravity Interactive. Such revenues from other countries constitute a minor portion of the revenues recorded as subscription revenues from the United States and Canada.
- (3) Gravity CIS, our wholly-owned subsidiary in Russia, was responsible for all aspects of Ragnarok Online and Requiem game operations in Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan only through June 15, 2010. After we entered into a license agreement with Ingamba on June 16, 2010 to distribute Ragnarok Online, Ragnarok Online is serviced in the 15 countries by Ingamba. The revenues generated in the 15 countries until June 15, 2010 were shown as Online game-subscription revenue-Others and those after June 16, 2010 were shown as Online game-royalties and license fees-Russia/CIS countries.
- (4) Burda:ic GmbH was responsible for all aspects of Ragnarok Online game operations in Germany, Austria, Switzerland, Italy and Turkey through October 14, 2010 and Gravity EU SASU, our former wholly-owned subsidiary in France, was responsible for all aspects of Ragnarok Online game operations in France and Belgium through June 30, 2011. Our license agreement for Ragnarok Online with Gravity EU SASU was amended in June 2008 to include the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark and Spain as service countries and further amended on October 15, 2010 to include Germany, Austria, Switzerland, Italy, Turkey where Ragnarok Online game services had previously been offered by Burda:ic and 13 other European countries. On June 30, 2011, we reduced our ownership interest in Gravity EU SASU (now Gravity EU SAS) to 25% by entering into a joint venture arrangement with Media-Participations Paris SA. Upon these changes, (i) the revenues generated in Germany and four other European countries through October 14, 2010 were shown as Online game-royalties and license fees-Europe, those generated from October 15, 2010 to June 30, 2011 were shown as Online game-subscription revenue-Others and those generated on or after July 1, 2011 were shown as Online game-royalties and license fees-Europe; (ii) the revenues generated in France and Belgium through June 30, 2010 were shown as Online game-subscription revenue-Others and those generated on or after July 1, 2011 were shown as Online game-royalties and license fees-Europe; (iii) the revenues generated in the United Kingdom and 20 others European countries from October 15, 2010 when Ragnarok Online was commercially launched in these countries to June 30, 2011 were shown as Online game-subscription revenue-Others and those generated on or after July 1, 2011 were shown as Online game-royalties and license fees-Europe.

The table below provides for the periods indicated, the peak concurrent users and average concurrent users of Ragnarok Online since the first quarter of 2009, in each of our principal markets for Ragnarok Online.

| | | 1Q 09 | 2Q 09 | 3Q 09 | 4Q 09 | 1Q 10 | 2Q 10 | 3Q 10 | 4Q 10 | 1Q 11 | 2Q 11 | 3Q 11 | 4Q 11 | 1Q 12 |
|-------------------------------|---------------|--------|--------|--------|--------|--------|--------|--------|---------|---------|---------|--------|--------|--------|
| Japan | PCU(1) | 58,171 | 57,387 | 54,671 | 59,800 | 52,585 | 48,113 | 61,322 | 55,089 | 43,869 | 44,155 | 47,387 | 48,085 | 38,984 |
| | ACU(2) | 24,554 | 23,038 | 21,331 | 21,817 | 20,232 | 18,547 | 22,631 | 20,905 | 17,983 | 17,909 | 18,157 | 17,203 | 15,654 |
| Korea | PCU | 6,127 | 6,975 | 7,610 | 6,949 | 6,502 | 4,427 | 5,001 | 15,232 | 16,064 | 11,026 | 10,848 | 37,810 | 7,628 |
| | ACU | 3,211 | 2,641 | 3,525 | 3,319 | 3,091 | 2,367 | 1,939 | 4,487 | 6,403 | 3,620 | 3,233 | 3,940 | 2,814 |
| USA/Canada | PCU | 4,908 | 5,093 | 5,634 | 5,128 | 4,933 | 5,476 | 5,307 | 5,502 | 4,692 | 6,635 | 6,811 | 9,201 | 5,180 |
| | ACU | 3,181 | 3,300 | 3,758 | 3,332 | 3,298 | 4,124 | 3,681 | 3,338 | 3,176 | 4,189 | 5,127 | 3,996 | 4,026 |
| Taiwan & Hong Kong | PCU | 27,686 | 27,616 | 37,066 | 27,803 | 29,089 | 30,542 | 32,409 | 120,781 | 119,473 | 109,695 | 88,816 | 84,587 | 89,035 |
| | ACU | 20,351 | 20,678 | 23,599 | 19,274 | 22,437 | 25,087 | 25,522 | 71,580 | 90,670 | 82,966 | 71,207 | 69,560 | 73,345 |

Notes:

- (1) PCU, or peak concurrent users, represents the highest number of users of Ragnarok Online during the specified time period as recorded on the servers for the various countries.
- (2) ACU, or average concurrent users, represents the average number of concurrent users of Ragnarok Online during the specified time period as recorded on the servers for the various countries.

- (3) We believe that the number of users as measured by PCU or ACU (i) is reflective of our active user base and (ii) is correlated to revenues as revenues from an online game depend on the number of users as well as time spent playing the game. However, PCU and ACU are non-financial variables and the data presented has not been audited or reviewed. Other companies may determine PCU or ACU differently than we do.

Table of Contents

We obtained an exclusive license from Mr. Myoung-Jin Lee to use the storyline and characters from his cartoon titled Ragnarok for the development of Ragnarok Online including for animation and character merchandising. We paid Mr. Lee an initial license fee of Won 40 million and are required to pay royalties based on a percentage of adjusted revenues (net of value-added taxes and certain other expenses) or net income generated from the use of the Ragnarok brand through January 2033.

Ragnarok Online is an action adventure-based MMORPG that combines cartoon-like characters, community-oriented themes and combat features in a virtual world within which thousands of players can interact with one another. By combining the highly interactive and community-oriented themes and features, such as marriages and organization of guilds, we believe we are able to create user loyalty from our users who favor games that provide social interaction in a virtual setting.

Other key features of Ragnarok Online include the following:

players may assume an ongoing role, or alter-ego, of a particular game character, each with different strengths and weaknesses. In Ragnarok Online, the user starts as a novice and undergoes training in a specialized mapped game zone to become familiar with the game features. Once that stage is completed, the user can choose from six basic characters, each with a distinct combination of different traits;

as each game character advances in challenge levels, the character can enter into a greater range of mapped game zones and develop into a more sophisticated game character in terms of game attributes and special powers;

Ragnarok Online characters may visually express the users' mood and emotions by using emotive icons that appear within a bubble above the characters' heads. We believe that this feature significantly expands the interface for user interaction and elevates the level of social reality of the game;

game features may be traded or sold within the game, and game characters may simulate real-life experiences such as marriage, group fights and joining a guild. In addition, players may communicate with each other through in-game chatting or instant messaging;

special events are held from time to time to stimulate community formations. For example, we periodically host fortress raids whereby players are encouraged to organize themselves into a team to compete against other teams to capture a fortress within a set time; and

the game has no preordained ending and is designed to continuously evolve in terms of plots, mapped game zones and character attributes through enhancements from time to time.

We believe that the personal computer, or PC, configurations required to run Ragnarok Online are lower than or similar to many other competing MMORPGs, which we believe has facilitated our successful entry into and expansion of Ragnarok Online in many of the developed and developing countries in which Ragnarok Online is distributed. Also, we believe the community based features, such as marriages and organization of guilds, builds user loyalty from our users who favor games that provide social interaction in a virtual setting. We believe that our decision to balance three-dimensional graphics and game functions with prevailing technological standards with a combination of two-dimensional characters, which requires lower PC configurations than three-dimensional MMORPG has helped to increase the popularity of Ragnarok Online, in particular in certain jurisdictions which does not have access to the more technological updated PC technology as a result of cost and other limitations. The recommended minimum PC configuration for Ragnarok Online is Pentium III 1.6 GHz, 256 MB RAM and 32 MB graphics card. Ragnarok Online can be accessed through a dial-up modem as well as broadband Internet.

Ragnarok Online II

Ragnarok Online II, a three-dimensional MMORPG, is a sequel to Ragnarok Online with enhanced character and community features. Ragnarok Online II includes pastel-type graphics, advanced character customization and detailed monsters and non-player characters. Ragnarok Online II also adopts Mr. Myoung-Jin Lee's original drawings from his comic book Ragnarok and music from Kanno Yoko, a well-respected composer in the animation industry. We commercially launched Ragnarok Online II in Korea in March 2012. We have entered into license and

Table of Contents

distribution agreements for Ragnarok Online II with six licensees in nine countries, including Thailand, Japan, the Philippines, Singapore, Malaysia, Vietnam, China, Indonesia and Brazil. The total value of the license and distribution agreements for Ragnarok Online II is US\$43,390 thousand as of December 31, 2011. See ITEM 3.D. **RISK FACTORS** **RISKS RELATING TO OUR BUSINESS** 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.

Requiem

Unlike Ragnarok Online and Ragnarok Online II, which do not emphasize violent themes, we designed Requiem to showcase user-to-user combat. Requiem provides players with a variety of combat systems, which allow them to accumulate experience and reward points to be used when they buy special items designed for combats.

We commercially launched Requiem in Korea in October 2007, in the United States, Canada, Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan in June 2008, in Switzerland, Norway, Denmark, Ireland, Spain, Sweden, the United Kingdom, Iceland, Finland, France, Germany, Greece, Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Albania, Andorra, Bosnia and Herzegovina, Liechtenstein, Monaco, Montenegro, San Marino, Serbia, Vatican City State, Croatia, Former Yugoslav Republic of Macedonia and Turkey in December 2009, in Taiwan, Hong Kong and Macau in May 2010 and Mexico, Guatemala, El Salvador, Nicaragua, Panama, Honduras, Belize, Cuba, Jamaica, Haiti, Dominica, Costa Rica, Puerto Rico, Ecuador, Colombia, Peru, Venezuela, Guyana, Suriname, French Guiana, Chile, Bolivia, Paraguay and Argentina in June 2011. We entered into global service agreements with AsiaSoft Corporation Public Co., Ltd. in December 2009 for markets in Thailand, Vietnam, Singapore and Malaysia, with PT. Lyto Datarindo Fortuna in February 2010 for Indonesian market and with Digital Media International Inc. in June 2010 for the Philippine market pursuant to which we offer Requiem directly to the local markets to generate subscription revenues and pay service fees to AsiaSoft Corporation Public Co., Ltd., PT. Lyto Datarindo Fortuna and Digital Media International Inc. for services related to marketing and billing, among others. We commercially launched Requiem in Thailand, Vietnam, Singapore and Malaysia in March 2010, Indonesia in April 2010 and the Philippines in August 2010 and ceased offering commercial service through these consignees in these markets in July 2011. Requiem is currently commercially offered globally through an amendment to the license agreement with Gravity Interactive in October 2011, which allows Gravity Interactive to distribute the game worldwide except for the existing licensed territories in which we have already granted licenses for Requiem game service to local licensees.

Requiem represented 2.9% of our total revenues or Won 1,660 million (US\$1,432 thousand) in 2011, compared with 4.2% of our total revenues or Won 2,182 million in 2010.

Table of Contents

The following are revenues generated by Requiem for the periods indicated:

| Revenue Type | Country | 2009 | Year Ended December 31, | | | 2011(1) |
|--|-------------------------|-------------|-------------------------|-------------|------------|---------|
| | | | 2010 | 2011 | 2011(1) | |
| (In millions of Won and thousands of US\$) | | | | | | |
| Online game-subscription revenue | Korea | (Won) 559 | (Won) 303 | (Won) 121 | US\$ 104 | |
| | United States/Canada(2) | 1,387 | 981 | 1,162 | 1,003 | |
| | Russia/CIS countries(3) | 892 | 368 | | | |
| | Others | | 103 | 34 | 29 | |
| | Subtotal | 2,838 | 1,755 | 1,317 | 1,136 | |
| Online game-royalties and license fees | Russia/CIS countries(3) | | 72 | 187 | 161 | |
| | Taiwan/Hong Kong/Macau | | 355 | 156 | 135 | |
| | Subtotal | | 427 | 343 | 296 | |
| | Total | (Won) 2,838 | (Won) 2,182 | (Won) 1,660 | US\$ 1,432 | |

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.
- (2) Includes subscription and other types of game revenues generated in other countries serviced by Gravity Interactive. Such revenues from other countries constitute a minor portion of the revenues recorded as subscription revenues from the United States and Canada.
- (3) Gravity CIS, our wholly-owned subsidiary in Russia, was responsible for all aspects of Requiem game operations in Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan only through June 15, 2010. After we entered into a license agreement with Ingamba on June 16, 2010 to distribute Requiem, Requiem is serviced in the 15 countries by Ingamba. The revenues generated in the 15 countries through June 15, 2010 were shown as Online game-subscription revenue-Russia/CIS countries and those generated on or after June 16, 2010 were shown as Online game-royalties and license fees-Russia/CIS countries.

Emil Chronicle Online

We commercially launched Emil Chronicle Online in Korea, Thailand, Hong Kong, Taiwan, Indonesia, Singapore/Malaysia and China in August 2007, September 2007, June 2008, August 2008, September 2009, October 2009 and October 2011, respectively and ceased offering commercial service in Singapore and Malaysia in September 2010, in Korea in November 2010, and in Thailand in September 2011. Emil Chronicle Online is the first online game developed by GungHo, the publisher of Ragnarok Online in Japan, which is our controlling and majority shareholder. Emil Chronicle Online is an animation style game based on the chronicles of three races: Emils, Titanians and Dominions, that offers various characters and avatars for players to enjoy. We entered into a software licensing agreement with GungHo in December 2005 for the right to publish and distribute Emil Chronicle Online worldwide, except for in Japan, which was renewed in August 2011. In February 2009, we entered into a license and distribution agreement with PT. Wave Wahana Wisesa for distribution of Emil Chronicle Online in

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Indonesia. We entered into license and distribution agreements for Emil Chronicle Online in Taiwan and Hong Kong with GameCyber Technology Ltd. in August 2007, which was renewed in June 2011. We entered into a license and distribution agreement in Thailand with Onenet in September 2010, which expired in September 2011. We entered into a license distribution agreement with Access Bright Limited to distribute Emil Chronicle Online in China in June 2010. In February 2012, we entered into a license agreement for Emil Chronicle Online with Gravity Interactive to distribute a Web-browser based version of the game worldwide except for Japan through certain designated Web sites. The amount of revenues from Emil Chronicle Online in 2011 represented less than 1% of our total revenues and that in 2010 represented 1.3% of our total revenues or Won 671 million.

Table of Contents***Dragonica (Dragon Saga)***

Dragonica is a three-dimensional side-scrolling MMORPG, which is offered in the United States and Canada under the name Dragon Saga. Dragonica was developed by Gravity Games, our 50.83%-owned subsidiary. Dragonica is currently commercially offered in China, Taiwan, Hong Kong, Macau, Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Romania, Slovakia, Slovenia, Sweden, Switzerland, Norway, the United Kingdom, Singapore, Malaysia, Australia, New Zealand, Thailand, Indonesia, Vietnam, Laos, Cambodia, Russia, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, Japan, the United States and Canada. Gravity Games entered into a license agreement for Dragonica in Brazil with Gamemaxx Ltda. in October 2011. We entered into an agreement with Gravity Games to publish Dragonica in Korea in December 2011 and conducted closed beta testing under the name Dragon Saga in April 2012. The amount of revenues from Dragonica represented 8.2% of our total revenues or Won 4,715 million (US\$4,070 thousand) in 2011 and that in 2010 represented 1.6% of our total revenues or Won 823 million.

R.O.S.E. Online

R.O.S.E. Online is commercially offered in the United States, Canada, Mexico, Switzerland, Norway, Denmark, Ireland, Spain, Sweden, the United Kingdom, Iceland, Finland, France, Germany, Greece, Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Albania, Andorra, Bosnia and Herzegovina, Liechtenstein, Moldova, Monaco, Montenegro, San Marino, Serbia, Vatican City State, Croatia, Former Yugoslav Republic of Macedonia and Turkey since its commercial launch in January 2005. R.O.S.E. Online represented 1.2% of our total revenues or Won 704 million (US\$608 thousand) in 2011, compared with 1.2% of our total revenues or Won 604 million in 2010.

Canaan

Canaan is a Web browser-based casual MMORPG, which is played on a Web browser and which does not require any client-side software to be installed. In January 2010, we entered into a license agreement with Xpec Entertainment Inc., a Taiwanese game developer, to publish Canaan in Korea. We commercially launched Canaan in Korea in October 2010. The amount of revenues from Canaan in 2011 and 2010 represented less than 1% of our total revenues in 2011 and 2010.

Kun Woong Online

Kun Woong Online is a two-dimensional MMORPG. In January 2011, we entered into a license agreement with Shanghai Jiayou Network Technology Co., Ltd., a Chinese game developer, and SL Media & Games Co., Ltd. a Korean game publisher, to publish Kun Woong Online in Korea. We commercially launched Kun Woong Online in Korea in November 2011. Kun Woong Online represented less than 1% of our total revenues in 2011.

Finding Neverland Online

Finding Neverland Online is a three-dimensional casual MMORPG. In February 2011, we entered into a license agreement with X-Legend Entertainment Co., Ltd., a Taiwanese game developer, to publish Finding Neverland Online in Korea. We commercially launched Finding Neverland Online in Korea in January 2012.

Maestia

Maestia is a three-dimensional MMORPG. In March 2012, we entered into a license agreement with RoC Works Co., Ltd., a Korean game developer, to publish Maestia in the United States and Canada. While we currently expect to launch the game in the third quarter of 2012, no assurance can be given that we can meet this anticipated launch date.

East Road (tentative title)

East Road is a three-dimensional MMORPG, which is being developed by Gravity Games, our 50.83%-owned subsidiary. We entered into an agreement with Gravity Games in June 2011 to publish East Road in Korea and Japan.

Table of Contents***Eternal Destiny***

Eternal Destiny is a Web browser-based casual MMORPG. In January 2010, we entered into a license agreement with Xpec Entertainment Inc. to publish Chaos Land, the original name of Eternal Destiny, in North America excluding the Canadian province of Quebec, which was amended in December 2010 to change the title of the game to Eternal Destiny for service in North America. We entered into a license and distribution agreement with Gravity Interactive in January 2011 to distribute Eternal Destiny in North America excluding the Canadian province of Quebec. We commercially launched Eternal Destiny in North America excluding the Canadian province of Quebec in August 2011 and ceased offering commercial service in November 2011. Eternal Destiny represented less than 1% of our total revenues in 2011.

Other online games

Apart from MMORPGs, we are currently offering commercially one third person shooter game and one tactical role playing game. A third person shooter is a three-dimensional action game emphasizing challenge of aiming and shooting in which a player can see his avatar on screen in a third-person view. A tactical role playing game is a game incorporating elements of strategy games and role playing games and it lays emphasis on battle strategy without requiring users to explore the game world unlike traditional role playing games.

H.A.V.E. Online (Toy Wars)

H.A.V.E. Online is a casual third person shooter game developed by SK i-media Co., Ltd., currently NQ Games Co., Ltd., an online game developer based in Korea. In April 2010, we entered into a publishing agreement with SK i-media Co., Ltd. to publish H.A.V.E. Online in Korea and Japan. We entered into a license and distribution agreement with GungHo in August 2010 to distribute H.A.V.E. Online in Japan. We commercially launched H.A.V.E. Online in Japan under the name Toy Wars in March 2011 and conducted open beta testing of H.A.V.E. Online in Korea from May 2011 to August 2011. H.A.V.E. Online represented 1.9% of our total revenues or Won 1,106 million (US\$955 thousand) in 2011.

Ragnarok Online Guild Masters

Ragnarok Online Guild Masters is a Web browser-based tactical role playing game based on Ragnarok Online, which is played on a Web browser and which does not require any client-side software to be installed. We entered into an agreement with NeoCyon in March 2011 to develop and distribute Ragnarok Online Guild Masters worldwide. NeoCyon entered into a consignment agreement with GungHo in April 2011 to develop a Japanese version of the game and a license agreement with GungHo in May 2011 to distribute the game in the Japanese market. We commercially launched Ragnarok Online Guild Masters in Japan in October 2011.

Social network games

Social network games are simple games that are played on social networking Web sites or on mobile phones. Players typically access social network games through their social network accounts. When players connect to a game, it allows them to invite online friends to join in or facilitate competitions with potentially millions of other players. Currently, we commercially offer two social network games, Fashion Star and Jeweled Planet. We commercially launched Fashion Star on Cyworld, a social network site, in Korea in January 2011 and T World, a mobile application store, in July 2011, Facebook in June 2011 and Apple's App Store in November 2011. Jeweled Planet was commercially launched on Cyworld in March 2011 and T World in July 2011. The amount of revenues from social network games in 2011 represented less than 1% of our total revenues in 2011.

Mobile games

As compared to MMORPGs, mobile games, which are played using mobile phones and other mobile devices, have shorter game playtime and less complex user-game interaction. We believe that mobile games, due to such characteristics, provide less-experienced users with a means to become familiar with both game playing and the game culture without making a substantial commitment in time and resources. As a result, we believe that mobile games allow us to target a broader audience of users, help us to expand the online game culture beyond Internet cafés and users' homes and act as an effective marketing tool to attract new users to our MMORPGs. We develop and distribute our mobile games through our subsidiary in Korea, NeoCyon, Inc.

Table of Contents

We have released Ragnarok Online Mobile Story and Ragnarok Violet, both of which are based on Ragnarok Online, in the smartphone game market. Ragnarok Online Mobile Story, which was originally launched in Japan in March 2010, was released on Google Android in Japan in December 2010. Ragnarok Violet, which was originally launched in Korea and Japan in March 2008 and November 2009, respectively, was released in Apple's App Store in Japan in April 2011 and in Korea and the United States in August 2011. We have also released some other mobile arcade games for Apple's App Store, Google Android as well as feature phones.

The following are revenues generated from our mobile business for the periods indicated:

| Country | Year Ended December 31, | | | | 2011(1) |
|---------|--|-------------|-------------|--------|------------|
| | 2009 | 2010 | 2011 | | |
| | (In millions of Won and thousands of US\$, except percentages) | | | | |
| Korea | (Won) 4,931 | (Won) 5,274 | (Won) 4,550 | 49.0% | US\$ 3,927 |
| Japan | 2,951 | 3,913 | 4,710 | 50.7 | 4,066 |
| Others | | 1 | 33 | 0.3 | 29 |
| Total | (Won) 7,882 | (Won) 9,188 | (Won) 9,293 | 100.0% | US\$ 8,022 |

Note:

(1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.

Game-related products and services***Game character merchandising***

In order to optimize the commercial opportunities presented by the popularity of Ragnarok Online and its characters, we and our licensees have been marketing dolls, stationery, food and other character-based merchandise, as well as game manuals, monthly magazines and other publications, based on the game. We currently have arrangements with a Korean vendor and GungHo to license Ragnarok Online's game characters in Korea and Japan. In Japan, we have been conducting game character merchandising by selling game packages, which package our online game software in DVD format for PC users, in connection with game distribution. We intend to expand our character marketing for our new games as they are launched.

The amount of revenues from game character merchandising represented less than 1% of our total revenues in both 2011 and 2010.

Multiplatform and Internet protocol television games

In December 2006, we entered into a licensing agreement with GungHo to develop and distribute Ragnarok DS, a Nintendo DS version of Ragnarok Online. Ragnarok DS was released in Japan, Korea and the United States and Canada in December 2008, June 2009 and February 2010, respectively. We also entered into agreements with GungHo for development and distribution of Ragnarok: The Princess of Light and Darkness, a tactical role playing game for PSP based on Ragnarok Online, in September 2010 and the game was released in Japan in October 2011. In addition, Ragnarok Odyssey, an action game on PS Vita platform, based on Ragnarok Online, which was developed under a co-development agreement entered into with GungHo in December 2010, was released in Japan in February 2012.

We are also expanding our business by providing our online games on Internet protocol television, or IPTV. In September 2008, we entered into a licensing agreement with Iconix Entertainment Co., Ltd., or Iconix Entertainment, to develop and publish Pororo Game, an IPTV game based on Iconix Entertainment's 3D TV animation series Pororo: The Little Penguin. We commercially launched Pororo Game in September 2009.

The amount of revenues from multiplatform device and IPTV represented 1.1% of our total revenues or Won 648 million (US\$559 thousand) in 2011, compared with less than 1% of our total revenues in 2010.

Table of Contents**Animation**

Gravity Entertainment, our Japanese subsidiary, entered into an agreement with G&G Entertainment Inc. and three other Japanese media and entertainment companies for the production and distribution of 26 half-hour episode animation series based on the storyline and characters of Ragnarok Online. The series was produced by Gravity Entertainment and broadcast on television in nine countries from 2004 through 2007. The animation series of Ragnarok Online has been sold in DVD and VOD (video on demand) formats in North America since March 2006 and it has also been distributed in Europe. Our revenues from our animation business were negligible and represented less than 1% of our total revenues in both 2011 and 2010.

OUR MARKETS

Japan, Korea, the United States and Canada, Taiwan and Hong Kong/Macau, and Europe were our biggest geographic markets in 2011 in terms of revenue. Each of these markets is serviced either by us or a distribution company. We directly manage game operations in Korea. Gravity Interactive, our wholly-owned subsidiary, manages game operations in the United States and Canada, and Requiem and R.O.S.E. Online game operations in Europe. GungHo Online Entertainment, Inc. is our licensee for Ragnarok Online, H.A.V.E. Online and Ragnarok Online Guild Masters in Japan. Nexon Co., Ltd. is our licensee for Dragonica in Japan. Game Flier International Corporation is our licensee for Ragnarok Online, Requiem and Dragonica in Taiwan, Hong Kong and Macau. GameCyber Technology Ltd. is our licensee for Emil Chronicle Online in Taiwan and Hong Kong. Gravity EU SAS is our licensee for Ragnarok Online and Gala Network Europe Ltd. is our licensee for Dragonica in Europe.

The following table sets forth a summary of our consolidated statement of operations showing revenues by geographic area for the periods indicated and the percentage represented by such revenues for year ended December 31, 2011.

| Countries | Year Ended December 31, | | | | |
|-------------------------|--|---------------------|---------------------|---------------|--------------------|
| | 2009 | 2010 | 2011 | 2011(1) | |
| | (In millions of Won and thousands of US\$, except percentages) | | | | |
| Japan | (Won) 31,991 | (Won) 29,186 | (Won) 29,513 | 51.3% | US\$ 25,476 |
| Korea | 11,544 | 9,737 | 10,458 | 18.2 | 9,027 |
| United States/Canada(2) | 5,800 | 4,759 | 5,879 | 10.2 | 5,074 |
| Taiwan/Hong Kong/Macau | 1,887 | 2,926 | 3,590 | 6.2 | 3,099 |
| Europe | 1,054 | 1,084 | 2,058 | 3.6 | 1,776 |
| Others | 5,127 | 4,670 | 5,979 | 10.5 | 5,161 |
| Total | (Won) 57,403 | (Won) 52,362 | (Won) 57,477 | 100.0% | US\$ 49,613 |

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.
- (2) Revenues in the United States and Canada, as shown on this table, also include subscription and other types of game revenues generated in other countries managed by Gravity Interactive. Such revenues from other countries constitute a minor portion of the revenues recorded as subscription revenues from the United States and Canada.

Korea

In Korea, we commercially launched and began to charge subscribers for Ragnarok Online in August 2002, Requiem in October 2007, Canaan in October 2010, Kun Woong Online in November 2011, Finding Neverland Online in January 2012 and Ragnarok Online II in March 2012. Our game subscribers in Korea consist of individual PC account subscribers and Internet café subscribers. Individual PC account subscribers are

individuals who log on to our game servers from places other than Internet cafés, such as from home or work, whereas Internet café subscribers are commercial businesses operating Internet café outlets equipped with multiple PCs that provide

Table of Contents

broadband Internet access to their customers who typically prefer to play the most up-to-date versions of online games. Most Internet cafés charge their customers PC usage and Internet access fees that generally range from Won 700 to Won 1,000 per hour and subscribe to various online games. Over 8,200 and 7,800 Internet cafés offered our games in Korea according to our internal data as of December 31, 2011 and 2010, respectively. In order to offer our games, an Internet café typically purchases minimum game hours from us. The subscription collected from Internet cafés accounted for 9.7% and 10.8% of our subscription revenues in Korea in 2011 and 2010, respectively.

Overseas markets

Ragnarok Online is commercially offered in the following 78 overseas countries and markets: Japan, Taiwan, Hong Kong, Macau, the United States, Canada, Australia, New Zealand, India, Singapore, Malaysia, Thailand, the Philippines, Indonesia, Brazil, Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, the United Arab Emirates, Saudi Arabia, Jordan, Kuwait, Syria, Bahrain, Qatar, Palestine, Oman, Lebanon, Libya, Sudan, Mauritania, Iraq, Yemen, Iran, Egypt, Algeria, Morocco, Tunisia, France, Belgium, the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark, Spain, Austria, Bulgaria, Cyprus, Czech Republic, Germany, Greece, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Switzerland and Turkey. Ragnarok Online is distributed through local game operators and distributors, except for the countries in which our subsidiaries directly publish Ragnarok Online such as Gravity Interactive in the United States, Canada, Australia, New Zealand and India.

The following table lists the overseas countries in which Ragnarok Online is commercially offered through our licensees, the names of the licensees, the dates of the license agreements, and the commercial launch date and expiry date of the license agreements.

| Country | Licensee | Date of License Agreement | Date of Commercial Launch | Date of Expiry |
|-----------------------------|---|----------------------------------|----------------------------------|-----------------------|
| Japan | GungHo Online Entertainment, Inc. | July 2002 | December 2002 | September 2012 |
| Taiwan/Hong Kong/Macau | Game Flier International Corporation(1) | May 2002 | October 2002 | October 2013 |
| Thailand | AsiaSoft Corporation Public Co., Ltd. | June 2002 | March 2003 | March 2013 |
| Singapore/Malaysia | Game Flier (Malaysia) Sdn. Bhd.(2) | May 2003 | April 2004 | October 2013 |
| Philippines | Level Up! Inc. | March 2003 | September 2003 | August 2012 |
| Indonesia | PT. Lyto Datarindo Fortuna | April 2004 | November 2003 | February 2013 |
| Brazil | Level Up! Interactive S.A. | August 2004 | February 2005 | March 2013 |
| Middle East and Africa(3) | Tahadi Games Ltd. | January 2009 | December 2009 | December 2012 |
| Russia and CIS countries(4) | Ingamba LLC(5) | June 2010 | March 2007 | June 2013 |
| Europe(6) | Gravity EU SAS(7) | June 2011 | April 2004(8) | June 2014 |

Notes:

- (1) Game Flier International Corporation is a subsidiary of Soft-World International Corporation.
- (2) Game Flier (Malaysia) Sdn. Bhd. is a wholly-owned subsidiary of Game Flier International Corporation.
- (3) Represents MMORPG operations in the United Arab Emirates, Saudi Arabia, Jordan, Kuwait, Syria, Bahrain, Qatar, Palestine, Oman, Lebanon, Libya, Sudan, Mauritania, Iraq, Yemen, Iran, Egypt, Algeria, Morocco and Tunisia. A single operator services in 20 countries under one license agreement.
- (4) Represents MMORPG operations in Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. A single operator services in 15 countries under one license agreement.

- (5) We own a 25% of equity interest in Ingamba, a joint venture company for online game service in Russia.

- (6) Represents MMORPG operations in France, Belgium, the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark, Spain, Austria, Bulgaria, Cyprus, Czech Republic, Germany, Greece, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Switzerland and Turkey.

- (7) We own a 25% of equity interest in Gravity EU SAS, a joint venture company for online game service in Europe.

- (8) Ragnarok Online was initially launched in Germany, Austria, Switzerland, Italy and Turkey with a different licensee in April 2004.

Table of Contents

Requiem is currently commercially offered worldwide. Emil Chronicle Online is currently commercially offered in Hong Kong, Taiwan, Indonesia and China. Dragonica is currently commercially offered in the United States, Canada, and 53 countries and markets. R.O.S.E. Online is currently commercially offered in the United States, Canada, Mexico and 40 other countries. H.A.V.E. Online and Ragnarok Online Guild Masters are currently commercially offered in Japan. See ITEM 4.B. BUSINESS OVERVIEW OUR PRODUCTS.

Our licensees pay us:

an initial license fee for initial set-up costs, technical support and advisory services that we provide until commercial launch; and

ongoing royalty payments based on a percentage of revenues generated from subscription of the game they service in the respective overseas markets.

In addition, if the license agreement is renewed, we typically negotiate a renewal license fee. The license agreements may be terminated in the event of bankruptcy or a material breach by either party, including by us if the licensee fails to pay royalty fees in a timely manner.

PRICING STRUCTURE AND PAYMENT SYSTEM

Our overseas licensees generally develop, after consultation with us, a retail pricing structure for the users of the game they service in their respective markets. Pricing structures are determined primarily based on the cost of publishing and operating the game, the playing and payment patterns of the users, the pricing of competing games in a given market and the purchase power parity of consumers in that market. Since the launch of Ragnarok Online in August 2002, we have tracked and accumulated user data generated from our user base, which provide us with an extensive database to analyze user patterns and establish pricing for other markets. The pricing for Ragnarok Online has remained generally stable in each of our markets since the respective dates of Ragnarok Online's commercial launch in those markets.

In December 2006, we started to apply a micro-transaction system (or sale of virtual in-game items model) as an additional business model, by providing virtual item shops in the games where players can purchase a wide array of items to customize, personalize and enhance their characters and game playing experiences. The micro-transaction model has been introduced in all the countries and markets where Ragnarok Online is serviced. In addition, since January 2007, we have opened free-to-play servers, which only apply the micro-transaction model, in all the countries and markets where Ragnarok Online is serviced except Japan to encourage the players to download and play Ragnarok Online without paying subscription fees or buying playing time and to purchase in-game items pursuant to our micro-transaction model. In Russia and CIS countries, Korea, the United States, Canada, Australia, New Zealand, India, the United Arab Emirates, Saudi Arabia, Jordan, Kuwait, Syria, Bahrain, Qatar, Palestine, Oman, Lebanon, Libya, Sudan, Mauritania, Iraq, Yemen, Iran, Egypt, Algeria, Morocco, Tunisia, France, Belgium, the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark, Spain, Austria, Bulgaria, Cyprus, Czech Republic, Germany, Greece, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Switzerland and Turkey, we offer Ragnarok Online services with the micro-transaction model only. The amount of revenue generated from micro-transactions as a percentage of revenue per month from each country varies monthly. For example, in 2011, the approximate percentage of revenue derived from micro-transactions accounted for 23.3% of total royalty revenues for Japan, 88.0% of total revenues for the United States and Canada, where we ceased to apply the subscription-based fee model in April 2011, and 91.9% of total royalty revenues for Taiwan, Hong Kong and Macau.

Since September 2007, we have been offering premium services as an additional revenue model, where players are offered certain additional features such as the faster accumulation of experience points or higher rates of item drop for additional fees, in Russia and CIS countries, Indonesia, France and 27 other European countries and markets, the Philippines, the United States, Canada, Australia, New Zealand, India and Brazil. The pricing for Ragnarok Online in Korea and in Japan, the United States and Canada, Taiwan, and Hong Kong and Macau, our principal overseas markets, are set forth below.

Table of Contents**Korea**

Individual PC account users in Korea can choose from a number of alternative payment options, including charges made through mobile or fixed telephone service provider payment systems, prepaid cards, gift certificates, online credit card payments and bank transfers to gain access to or purchase game items of Ragnarok Online. Internet café subscribers make payments through credit card or bank transfers. We pay a commission in the range of 1.4% to 15% to third parties to process payments. These third parties bear the delinquency risk associated with payments from users.

Subscription-based fee model

The subscription-based fee model is currently applied only to Internet cafés and not individual PC users in Korea. The following table sets forth our published pricing plans for Internet cafés in Korea for Ragnarok Online access as of December 31, 2011.

| Hours(1) | Flat Fee per PC (Won) |
|-----------------|----------------------------------|
| 300 hours | 69,300 |
| 600 hours | 138,600 |
| 1,000 hours | 231,000 |
| 2,000 hours | 462,000 |

Note:

(1) Actual hours may vary depending on additional bonus hours we offer in proportion to hours purchased by the subscriber.

Micro-transaction model

We have applied a micro-transaction model in Korea since April 2007. Game users buy RO Cash, the currency of the money used in Ragnarok Online which enable them to buy game items. The price range of each of the game items is between Won 250 and Won 20,000. There are certain game items which users can buy only at Internet cafés.

Japan

GungHo, our licensee in Japan, determines the pricing plan for Ragnarok Online in Japan. A majority of users in Japan typically pay to gain access to or purchase game items of Ragnarok Online with prepaid cards, such as the WebMoney, among others, which can be purchased at convenience stores or retail game outlets, or online. In addition, credit cards are also a popular payment method. Mobile payment, which was introduced in April 2008, is increasingly popular although it cannot be used for the payment of subscription-based fees and can be used only for payment for micro-transaction.

Subscription-based fee model

Our licensee in Japan offers only one rate for Ragnarok Online and charges JPY1,500 per 30 days of unlimited use.

Table of Contents***Micro-transaction model***

We have applied a micro-transaction model in Japan since December 2006. Game users buy GungHo Shop Points which enable them to buy game items or directly buy game items from the mobile item shop. The range of the game items is between JPY50 and JPY1,500. The following table sets forth our licensee's published basic pricing for GungHo Shop Points in Japan as of December 31, 2011.

| Points | Retail Price(1) |
|----------------|------------------------|
| 10,000 points | JPY 1,000 |
| 21,000 points | 2,000 |
| 32,500 points | 3,000 |
| 55,000 points | 5,000 |
| 112,000 points | 10,000 |

Note:

- 1) For your reference only, as of December 30, 2011, the noon buying rate of the Japanese Yens to U.S. dollars quoted by the Federal Reserve Bank of New York was JPY76.98 to US\$1.00.

The United States and Canada

Gravity Interactive, our wholly-owned subsidiary in the United States, determines the pricing plan for Ragnarok Online in the United States and Canada. Users pay through credit cards, wire and/or bank transfers, or mobile payment or online payment systems such as PayPal. Gravity Interactive ceased to apply the subscription-based fee model in April 2011.

Micro-transaction model

We have applied a micro-transaction model in the United States and Canada since June 2007. Game users buy points which enable them to buy game items in the price range between US\$0.05 and US\$15. The following table sets forth our licensee's published basic pricing for points of Ragnarok Online in the United States and Canada as of December 31, 2011:

| Points | Retail Price |
|---------------|---------------------|
| 1,100 points | US\$ 10.00 |
| 1,650 points | 15.00 |
| 2,875 points | 25.00 |
| 4,600 points | 40.00 |
| 6,000 points | 50.00 |
| 9,000 points | 75.00 |
| 12,000 points | 100.00 |

VIP Service fee model

Although Ragnarok Online is offered based on micro-transaction model in the United States and Canada, the VIP Service fee model, a premium service model, was introduced in April 2011 to provide users with enhanced game play as an option. The following table sets forth Gravity Interactive's published basic pricing for VIP Service for Ragnarok Online in the United States and Canada as of December 31, 2011:

| Days | Retail Price |
|-------------|---------------------|
| 30 days | US\$ 7.00 |
| 90 days | 19.00 |
| 180 days | 33.50 |

Table of Contents**Taiwan, Hong Kong and Macau**

Game Flier International Corporation, our licensee in Taiwan, Hong Kong and Macau, determines the pricing plan for Ragnarok Online in Taiwan, Hong Kong and Macau. In Taiwan, Hong Kong and Macau, most users purchase prepaid debit point cards to gain access to or purchase game items of Ragnarok Online. The prepaid cards can be purchased online, by mobile or landline phones, or at convenience stores, Internet cafés and at other locations. Our licensee in Taiwan, Hong Kong and Macau, Game Flier International Corporation, offers the My Card, on which customers can charge GF Points or days which can be used for any games our licensee publishes. Users of Ragnarok Online in Taiwan, Hong Kong and Macau can convert the GF Points on the My Cards to Ragnarok Points.

The following table sets forth our licensee's published basic pricing for the My Card in Taiwan as of December 31, 2011:

| Points(1) or Days | Retail Price(2) |
|--------------------------|------------------------|
| 150 points | NT\$ 150 |
| 350 points or 30 days | 350 |
| 400 points | 400 |
| 450 points | 450 |
| 500 points | 500 |
| 1,000 points | 1,000 |

The following table sets forth our licensee's published basic pricing for the My Card in Hong Kong as of December 31, 2011:

| Points(1) or Days | Retail Price(3) |
|--------------------------|------------------------|
| 50 points | HK\$ 14 |
| 150 points | 40 |
| 300 points | 80 |
| 350 points or 30 days | 93 |
| 400 points | 106 |
| 450 points | 120 |
| 1,000 points | 265 |
| 1,150 points | 305 |
| 2,000 points | 530 |

Notes:

- (1) Each time a user logs onto Ragnarok Online, 20 points are deducted. After a user's playtime exceeds 12 hours, additional 20 points are deducted for every 12 hours of use. Users of NT\$350 or HK\$93 My Card may choose between 350 points and 30 days.
- (2) For your reference only, as of December 30, 2011, the noon buying rate of NT dollars to U.S. dollars quoted by the Federal Reserve Bank of New York was NT\$30.27 to US\$1.00.
- (3) For your reference only, as of December 30, 2011, the noon buying rate of Hong Kong dollars to U.S. dollars quoted by the Federal Reserve Bank of New York was HK\$7.7663 to US\$1.00.

Micro-transaction model

We have applied a micro-transaction model in Taiwan and Hong Kong since December 2006. Game users buy game items with Ragnarok Points. The price range of each of the game items is between NT\$1 and NT\$899 for paid servers and between NT\$1 and NT\$999 for free-to-play servers. Users in Hong Kong and Macau also buy items, the prices of which are based on NT dollars.

Table of Contents

GAME DEVELOPMENT AND PUBLISHING

We expect the online game industry to be characterized by increasing demand for sophisticated or original games with the most up-to-date technologies and/or innovative game design. In response, we intend to expand our game offerings by continuing to develop in-house additional high quality games with the latest technologies and/or innovative game design and by publishing such new games developed by us or licensed or acquired from renowned third party developers.

To prepare for the commercial launch of a new game, we conduct closed beta testing for the game to fix technical problems, which is followed by a period of open beta testing in which we allow registered users to play the game free of charge. During these testing periods, users provide us with feedback and our technical team seeks to address any technical problems and programming flaws that may compromise a stable and consistent game playing environment. Closed beta testing usually takes six to twelve months for MMORPGs but may take significantly more time if material problems are detected. Open beta testing of MMORPGs usually takes one to three months before commercial launch. We generally commence our other marketing activities for the game during the open beta testing stage. For overseas markets, we also localize the language and content of our games to tailor the game to local cultural preferences.

In-house game development

Our game development department is divided into three categories of development teams: one is dedicated to MMORPGs, another is dedicated to casual online games and social network games in operation or under development, and the third is dedicated to mobile games. As of December 31, 2011, we employed a total of 165 game developers. We developed Ragnarok Online, Ragnarok Online II, Requiem, Pucca Racing and some social network games and mobile games in-house. In order to remain competitive, we are focusing our in-house game development efforts on enhancing the game experience and on developing new games, which include MMORPGs incorporating the latest technologies (including software improving the communication and interaction between players), and casual online games, social network games and mobile games, which are popular among younger users and female users. We currently have one MMORPG with a tentative title of East Road, under in-house development.

Publishing

We also seek opportunities to publish games developed by third parties if we determine such games have potential to become a commercial success. Our publishing and licensing processes include the following:

Preliminary screening. Our preliminary screening process for a game usually includes preliminary review and testing of the game and discussions with the game developer on technological and operational aspects.

In-depth examination, analysis and commercial negotiation. Once a game passes the preliminary screening, we thoroughly review and test the game, conduct a cost analysis, develop operational and financial projections and formulate a preliminary game operating plan. We then begin commercial negotiations with the developer.

Game rating and regulatory registration and approval. Once a license agreement to publish and distribute a game is signed, we submit an application to the Game Rating Board to obtain a game rating. This process generally takes approximately 15 days. We also typically register our intellectual property rights in Korea under our license agreements, such as copyright and trademark, with the relevant Korean government agency. Our overseas subsidiaries or licensees follow similar procedures in their respective markets where the games we license are commercially offered.

Testing and marketing. Once the required registration and approvals are obtained, we conduct closed beta testing and open beta testing of the new game and assist the licensor with the development of the game.

Our publishing department takes lead in conducting preliminary screenings to select games for potential distribution and commercial negotiations process. The games initially screened by our publishing department are additionally evaluated or tested by other teams, such as the marketing team and quality management team, for a second

Table of Contents

opinion. Once a license agreement is finalized, we generally create a specific team for the selected game within the marketing department to work with and guide the licensor through the beta testing and marketing process for a successful launch of the game.

MARKETING

We employ a variety of traditional and online marketing programs and promotional activities, including in-game events, in-game marketing and offline events. Due to the close-knit nature of the online game community, we believe that word-of-mouth is an important medium for the promotion of our games.

In Korea, four independent promotional agents currently promote our online games to Internet cafés pursuant to agency agreements. Under these agreements, each promotional agent is granted non-exclusive promotion rights within a specified geographical area. The agent is generally paid a monthly base commission between 10% and 30% of revenues received from Internet cafés in the allocated area. The commission percentage varies according to the amount of revenues.

We conduct a variety of marketing programs and online and offline events to target potential subscribers accessing the Internet from home. Our main marketing efforts include advertising on Web site portals and in online game magazines, conducting online promotional events, participating in trade shows and entering into promotional alliances with Internet service providers. We spent Won 3,121 million (US\$2,694 thousand) on advertising and promotions in 2011, compared with Won 1,853 million in 2010.

We frequently organize in-game events, such as fortress raids for our users, which we believe encourages the development of virtual communities among our users and increases user interest in our games. We also host from time to time in-game tournaments in which users can compete against each other either as a team or individually. In addition, we use in-game events to introduce users to new features of our games. We organized 13 in-game events for Ragnarok Online users in 2011, compared with 15 such in-game events in 2010. In October 2011, we hosted in Korea the Ragnarok World Championship, an offline competition event with approximately 130 active participants, comprised of our game users and representatives from 11 teams representing 40 countries and approximately 30 representatives of our 10 licensees. The event was visited by approximately 1,000 visitors. The event included Ragnarok Game Marketing Forum, where we and our licensees shared development plans, marketing strategies and success cases, and numerous programs for users.

In most of our overseas markets, marketing activities are principally conducted by our overseas subsidiaries or licensees and typically consist of advertising on Web site game portals and online game magazines and through television commercials, as well as hosting online and offline promotional events. The licensees are responsible for the costs associated with such advertising and promotional activities. For example, GungHo, our licensee in Japan, hosted the GungHo Festival in June 2011, which included the Ragnarok Online Japan Championship, game conference and costume-play stage and other programs for users, and the event was attended by approximately 5,000 visitors. In addition, the Ragnarok World Championship was broadcast live on the Web by GungHo and it set a record of 188,000 views, supported by some offline events in Japan conducted by GungHo. In addition, GungHo sells DVD and memorial package of Ragnarok Online software to commemorate the Ragnarok Online Japan Championship every year. Level Up! Inc., our licensee in the Philippines, also hosts annual marketing events, namely Level Up! Live, which gathers 20,000 gamers each year since 2006. PT. Lyto Datarindo Fortuna, our licensee in Indonesia, also annually hosts Lyto Festival, which includes the Ragnarok Online Indonesia Championship. AsiaSoft Corporation Public Co., Ltd., our licensee in Thailand, also hosts the AsiaSoft All Star Battle, which includes the Ragnarok Online Thailand Championship and other promotional events since 2009 and it was attended by approximately 15,000 visitors in 2011. Level Up! Interactive S.A., our licensee in Brazil, organized City Invasion, an offline event through which Ragnarok Online game software in DVD format is distributed in some remote towns in Brazil in March 2011. In addition, from time to time our overseas subsidiaries and licensees also market our games through sponsoring promotional events jointly with other local game publishers or participating in expositions or other events for online games in order to reach a broader local audience. For example, in October 2011, Gravity EU SAS, our licensee in France, took part in the Electronic Sports World Cup, an annual competition of video games, which was held during Paris Games Week, the biggest video game event in France, where champion and vice-champion teams of the Ragnarok Online Europe Championship were invited to play Ragnarok Online

Table of Contents

on stage. The matches were broadcast live on the Web and watched by approximately 10,000 viewers. Level Up! Interactive participated in representative online game events in Brazil, such as Game World, Brasil Game Show and Anime Friend, which includes the Ragnarok Online Brazil Championship, in 2011.

Our licensees are selected in part on the basis of their marketing capabilities, including the size and scope of their distribution networks. In regions where we have a limited network or presence such as the Middle East and Central Asia, we believe that conducting marketing through our licensees is more effective and cost-efficient than direct marketing by us in light of the established brand recognition and marketing networks of our licensees and their comparative advantage in identifying and taking advantage of the cultural and other local preferences of overseas users. However, in more strategic markets where we anticipate considerable growth such as the United States, we also believe that it is important to enhance our own direct publishing network for online game services.

GAME SUPPORT AND CUSTOMER SERVICE

We are committed to providing superior customer service to our users directly and through our licensees. As of December 31, 2011, 19 employees were game masters, or persons who are in charge of testing, updating and providing server maintenance for online games, as well as dealing with customer complaints, 44 employees were members of our domestic customer service team and 49 employees were members of our overseas customer support team. With the diversification of our game offering and in order to better serve our users, we expect to continue to expand the size of our customer service team.

In Korea, we provide customer service for our online games through bulletin boards of the Web sites of our online games, call centers, email and facsimile and at our walk-in customer service center. Our bulletin boards of the Web sites of our online games allow our customers to post questions to, and receive responses from, other users and our support staff. In our overseas markets, our licensees administer customer service through varying combinations of bulletin boards of the Web sites of our online games, call centers, email and facsimile, with assistance from time to time from our overseas customer support staff.

In addition to providing customer service to our users, our customer service staff also collect user comments with respect to our games and generate daily and weekly reports for our management and operations that summarize important issues raised by users as well as how such issues have been addressed.

NETWORK AND TECHNOLOGY INFRASTRUCTURE

We have designed and assembled a game server network and information management system in Korea to allow centralized game management on a global basis. Our system network is designed to speedily accommodate a growing subscriber base and demand for faster game performance. Our game server architecture runs multiple servers on a parallel basis to readily accommodate increased user traffic through deployment of connection to servers, which permits us to route users in the same country to servers with less user traffic. Each of these servers is linked to our information systems network to ensure rapid implementation of game upgrades and to facilitate game monitoring and supervision.

We maintain our server hardware in a single climate-controlled facility at KT Mokdong Internet Computing Center in Mok-1Dong, Yangcheon-Gu, Seoul, Korea and our other system hardware in our offices in Seoul. As of December 31, 2011, our server network for our game operations in Korea consisted of a total of 758 servers, which include 576 physical servers and 182 servers run on 44 physical servers through server virtualization technology we have adopted since July 2011, which allows one physical server to be divided into multiple virtual servers, each of which functions individually as a complete and independent server.

In overseas markets, our overseas subsidiaries or licensees own or lease the servers necessary to establish the server network for the online games and we assist them with the initial assembly and installation of operating game servers and optimization of their systems network for game operations in their respective markets. While the overseas system architectures are modeled on our system architecture in Korea, they are also tailored to meet the specific needs of each market. When we install and initialize a game in an overseas market, we generally dispatch network engineers and database technicians from Korea to assist with assembly and operation of the system network and game servers. Following installation, we typically station two to five of our technicians and customer

Table of Contents

support staff in that market to assist with on-site game operation and technical support. Our overseas subsidiaries and licensees are responsible for providing database and other game information backup.

Our game management software can program the game content to include localized features such as virtual map zones specific to each market. These features can be updated at the host country level in order to encourage development of a communal spirit among the users from the same country.

COMPETITION

We compete primarily with other MMORPG developers and distributors in each of our markets. In addition, we compete against providers of games on various platforms, such as console games, handheld games, arcade games and mobile games. We compete primarily on the basis of the quality of the online game experience offered by us to our users, which depends on a number of factors, including our ability to do the following:

hire and retain creative personnel to develop games that appeal to our users;

maintain an online game platform that is stable and is not prone to server shutdowns, connection problems or other technical difficulties;

provide timely and responsive customer service; and

establish payment systems that are secure and efficient.

Competition in Korea

The online game market in Korea is comprised of massively multiplayer online game market, casual online game market and portal-based online game market. As many of our competitors have significantly greater financial, marketing and game development resources than we have, we face intense competition in the online game industry. We expect competition will continue to be strong as the number of domestic massively multiplayer online game developers in Korea increases in the future and the online game industry begins to consolidate into a small number of leading MMORPG companies due to the high cost of game development, marketing and distribution networks, which is likely to drive unsuccessful MMORPG providers to go out of business or be acquired by other successful game providers.

Currently, the leading providers of massively multiplayer online games in Korea, based on the number of peak concurrent users, are NCsoft, CJ E&M, Neowiz Games and Activision Blizzard according to data available from various public sources. NCsoft released Aion in November 2008, which is the most popular MMORPG in Korea as of March 31, 2012, based on various statistical data available from public sources. NCsoft's Lineage, which was released in 1998, and Lineage II, a sequel to the original Lineage in 2003, gained dominant popularity and have maintained both a large number of players and a loyal user base in Korea. CJ E&M commercially launched Sudden Attack in 2006, which is the most popular massively multiplayer online first person shooter game in Korea. Neowiz Games released Special Force, a massively multiplayer online first person shooter game, in 2004 and FIFA Online 2, a soccer game which was co-developed with Electronic Arts in 2007. The leading companies in the market for casual online games include Nexon Korea, which offers Maple Story and Dungeon Fighter Online, and co-publishes Sudden Attack in Korea. The leading providers of portal-based online games in Korea are NHN, operating under the brand portal of Hangame, CJ E&M, operating under the brand portal of NetMarble, and Neowiz Games, operating under the brand portal of Pmang.

Competition in overseas markets

In each of the overseas markets in which Ragnarok Online is distributed, we face strong competitive pressures. For example, Japan's large game market is primarily driven by console games although online games are gaining popularity among Japanese game users. Consequently, many Japanese console game developers, such as Square Enix Holdings Co., Ltd., or Square Enix, Capcom Entertainment, Inc., or Capcom, and Koei Tecmo Holdings Co., Ltd., or Koei Tecmo, have expanded their businesses to online game development with their well-known brands and advanced overall game development systems, which have resulted in more intense competition in the Japanese online game market. For example, Square Enix developed and released some of its Final Fantasy series as online

Table of Contents

games and Capcom developed and released Monster Hunter Frontier Online, an action online game based on its best-selling package game Monster Hunter Frontier. Koei Tecmo also developed and released online games based on its best-selling package games such as Nobunaga's Ambition Online, Uncharted Waters Online, Dynasty Warriors Online and Sangokushi Online. Taiwan's online game industry has demonstrated significant growth in recent years with the market dominated by games developed in China and Korea. Our principal competitors in Taiwan include Activision Blizzard, NCsoft and Nexon Korea. Thailand is also a fast growing online game market in Asia, where we believe that Ragnarok Online is the dominant online game based on the number of peak concurrent users, as reported by local game magazines and our licensee's reports. There are many online game developers and distributors in China such as Tencent, which publishes Dungeon Fighter Online and Cross Fire, and Shanda Games Limited, whose principal product is Mir II. Recently, social network games, such as Cityville, one of the most popular games on Facebook from Zynga Inc., are gaining global popularity as users play such games with other users through popular social network sites. In addition, action real-time strategy games, such as League of Legends developed by Riot Games, Inc., are increasingly gaining popularity worldwide.

Competition from other game platforms

We also compete against PC and console-based game developers that produce popular package games, such as Electronic Arts, Nintendo Co., Ltd., or Nintendo, Activision Blizzard and Sony Computer Entertainment, Inc., or Sony Computer Entertainment, and game console manufacturers such as Microsoft, Sony Computer Entertainment and Nintendo, all of which also have their own console game development studios. In November 2002, Microsoft started an online game service for its Xbox Live consoles. Microsoft launched an enhanced version of its console platform in November 2005 with the Xbox360 and the latest version of Xbox Live offers more games that are aimed at the casual player and foster cooperation. In November 2010, Microsoft released Kinect, a motion-sensing device, which plugs into the Xbox360 and allows people to play games without the conventional controller. Sony Computer Entertainment started distributing its PlayStation 2 game consoles equipped with a network adapter to enable online gaming in May 2002 and launched an enhanced version of its console platform in November 2006 with PlayStation 3, which provides services for online games followed by PlayStation Move, a motion-sensing game controller for PlayStation 3 in September 2010. Nintendo launched its Wii console platform in November 2006, which accesses the Internet and lets users compete online against others. A number of PC-based game developers are also introducing online features to their PC-packaged games, such as team plays or users-to-users combat features. Moreover, handheld game consoles are also popular among game users. In November 2004, Nintendo launched Nintendo DS and has made modest changes, adding bigger screens or a slimmer model to the DS. The latest version of DS, 3DS, which allows users to play three-dimensional games without special glasses, was released in February 2011. Sony Computer Entertainment's PS Vita, which was released in December 2011, allows users to play games downloaded from Sony Computer Entertainment's online marketplace.

In addition, games for smartphones, such as Apple's iPhone and Android-based smartphones, and tablet computers, such as Apple's iPad or Android-based Samsung's Galaxy Tab, are surging in popularity and competing with portable devices made solely for playing games. Apple and Android device users can access a number of videogames available for download at Apple's App Store or Google's Android Market, respectively.

Competition in the game market is expected to remain intense as established game companies with significant financial resources seek to enter the industry. For a discussion of risks relating to competition, see ITEM 3.D. **RISK FACTORS – RISKS RELATING TO OUR BUSINESS** We operate in a highly competitive industry and compete against many large companies.

INSURANCE

We maintain medical and accident insurance for our employees to the extent required under Korean law, and we also maintain fire and general commercial insurance with respect to our facilities. We do not have any business liability or disruption insurance coverage for our operations in Korea. We maintain a directors' and officers' liability insurance policy covering certain potential liabilities of our directors and officers. See ITEM 3.D. **RISK FACTORS – RISKS RELATING TO OUR BUSINESS** We have limited business insurance coverage and any business interruption could have a material adverse effect on our business.

Table of Contents**INTELLECTUAL PROPERTY**

Our intellectual property is an essential element of our business. We rely on intellectual property such as copyrights, trademarks and trade secrets, as well as non-competition, confidentiality and license agreements with our employees, suppliers, licensees, business partners and others to protect our intellectual property rights. Our employees are generally required to sign agreements acknowledging that all inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf are our property, and assigning to us any ownership rights that they may claim in those works. With respect to copyrights and computer program rights created by our employees within their employment scope and which are made public bearing our name, we are not required to pay any additional compensation to our employees.

In developing Ragnarok Online, we obtained an exclusive license from Mr. Myoung-Jin Lee to use the storyline and characters from his cartoon titled Ragnarok for the production of online games, animation and character merchandising. See ITEM 4.B. BUSINESS OVERVIEW OUR PRODUCTS Massively multiplayer online role playing games (MMORPGs) Ragnarok Online.

We are the registered owner of eight registered software copyrights to seven games: Ragnarok Online, Ragnarok Online II, R.O.S.E. Online, Requiem, Arcturus, Pucca Racing and W Baseball, each of which has been registered with the Korea Copyright Commission. We no longer commercially offer Arcturus, a PC-based, stand-alone game, nor Pucca Racing, and have decided to cease commercialization of W Baseball. As of December 31, 2011, we owned over 61 registered domain names, including our official Web site and domain names registered in connection with each of the games we offer. We had 905 registered discrete trademarks at patent and trademark offices in 46 countries as of December 31, 2011. We had three design patents, two analogous design patents, which are variations of two of the design patents, registered with the Korea Intellectual Property Office, registered copyrights covering 11 game characters, five online game business model patents and four patents pending with the Korea Intellectual Property Office, in each case as of December 31, 2011.

SEASONALITY

Usage of our online games has typically increased slightly around the New Year's holiday and other holidays, in particular during winter and summer school holidays.

LAWS AND REGULATIONS

We are subject to many laws and regulations in the different countries in which we operate. See ITEM 3.D. RISK FACTORS RISKS RELATING TO OUR REGULATORY ENVIRONMENT. A general overview of the material laws and regulations that apply to our business is provided below for the countries from which we derive a significant portion of our revenues.

Korea

The Korean game industry and online game companies operating in Korea are subject to the following laws and regulations:

The Act on Promotion of the Game Industry

In January 2007, the National Assembly amended the Act on Promotion of the Game Industry, or the Promotion Act, which became effective on April 20, 2007. Under the amended Article 21 of the Promotion Act, online games are classified into four categories: suitable for users of all ages, suitable for users 12 years of age or older, suitable for users 15 years of age or older and suitable for users 18 years of age or older. The 15 years of age or older category was added between the 12 years of age and 18 years of age categories to increase ratings flexibility. Fashion Star and Jeweled Planet have been classified as suitable for users of all ages. Ragnarok Online, Canaan, Ragnarok Online II and Finding Neverland Online have been classified as suitable for users 12 years of age or older. Kun Woong Online has been classified as suitable for users 18 years of age or older.

The amendment to the Promotion Act includes for the first time the definition of the term speculative game. A speculative game refers to a game that permits betting and offers monetary loss or profit that is determined by

Table of Contents

chance. Elements that may cause a game to be considered a speculative game include the existence of game money used as a means for betting or purchasing game items (items used within the game for progression in the game) that become the subject of exchange with respect to the game money. The Supreme Court decision No. 2007-4702 rendered on October 26, 2007 provided that the determination of whether a business is speculative or not requires a comprehensive consideration of the following factors: the purpose of use, the method and appearance of use, whether money or gifts exchangeable with money are distributed as a result of using the business, the degree and scale thereof, and whether gifts are actually exchanged into cash. Although the new rules and Supreme Court decision are intended to provide more clarity for the determination of whether a game is deemed speculative or not, because our games involve transactions with game items, we may have to expend much effort to ensure that we are in compliance with the new rules.

A game provider has to report any modification in the content of a game to the Game Rating Board, which may require the game to be reclassified depending on the scope of the modification. If the Game Rating Board determines that the game is speculative, it can refuse to classify such game, in which case the game will be prohibited. According to Article 1(2) of the Enforcement Decree of the Promotion Act newly established on May 16, 2007, any games in which money or items of value are collected from a multiple number of persons and profits or losses are allocated based on winnings or losses determined by chance fall under speculative games. According to Article 16(2) of the Enforcement Decree of the Promotion Act newly established at the same time, so long as certain guidelines are followed, a provision of a gift equivalent to a customer price of Won 5,000 or less, with respect to games that are classified as suitable for users of all ages, is not deemed to be an act that encourages gambling.

Under the Promotion Act, as partially amended on December 21, 2007, the Minister of Culture, Sports and Tourism may order information and communication service providers to refuse, stop, or restrict the offering of games if such games are unrated, contents are different from those submitted for rating, were denied rating as speculative games, or were manufactured or distributed by a person not registered for operation of manufacturing or distributing games for profit-making. Game Rating Board undertakes examination of the information and communications service providers and provides recommendation of correction to the providers as necessary. The information and communications service providers are required to implement the corrective measures recommended within 7 days and report the results thereof to the chairman of the Game Rating Board or the Minister of Culture, Sports and Tourism.

The Game Rating Board published the Yearbook for Classification of Game Ratings in September 2008, June 2009 and July 2011 in order to provide information on industry trends. The Yearbooks include data on ratings and classifications of various games released in Korea and the results of the examination of the information and communications service providers during year 2007, 2008 and 2010. The Game Rating Board published the Yearbook to improve fairness and transparency in inspecting games and to provide industry participants with guidelines on ratings inspection as well as basic information on the development of the game industry.

Prior to a partial amendment on January 1, 2010, the Promotion Act provided that governmental support for the Game Rating Board would be provided until December 31, 2009 and the task of rating games would thereafter be privatized. However, based on the determination of the government that the required social conditions for such privatization are not yet established, the Promotion Act, as partially amended on January 1, 2010, promoted the sustained rating of games and operation of supplementary administrative tasks by extending the date for the provision of governmental support until December 31, 2011.

On April 12, 2010, for the purpose of preventing gaming addiction among adults and teenagers and to promote a constructive gaming culture, the Ministry of Culture, Sports and Tourism introduced the Measures for the Prevention and Alleviation of Excessive Gaming, which includes the following: (i) expanded applicability of the exhaustion system (a program in which the rate at which items are acquired in a game decreases as a person plays the game longer, where this system is closely related to the game scenario), (ii) selective shutdown system for games played by teenagers (a system in which a teenager's access to games can be selectively managed between midnight and 8:00 a.m. with the consent of a parent), (iii) establishment of a fund for the prevention of excessive gaming, and (iv) regulation of Web sites that deal in cash transaction of in-game items.

Recently in the global online and mobile game industry, there has been growth in the open markets in which small content developers and individual content producers directly supply their programs to consumers. However,

Table of Contents

under the then-current law, games could be distributed only after being rated by the Game Rating Board, and this impeded the development of the open market in Korea. In addition, some games, especially those that permit betting, caused social problems as speculative operating methods illegal automatic playing programs which allow players to cheat and acquire game money or game items were being developed. However, the then-existing laws did not provide sufficient grounds to regulate such situations.

In response, on April 5, 2011, the Act on Promotion of the Game Industry was amended. The amendment provides that all games that cannot receive prior rating by the Game Rating Board due to special circumstances in their production and distribution channels should be subject to the distributors' own rating. The Act also provides grounds for sanctioning speculative operating methods and the undermining of fair gaming through illegal programs, among others. The amendment went into effect on July 6, 2011. In addition, consistent with a recent decision by the Constitutional Court on dual punishment, the amendment also includes a revised provision which stipulates that if an employer fulfills her duty of care as a manager and supervisor of her employees, she can be exempt from punishment.

The main content of the Act on Promotion of the Game Industry as amended on April 5, 2011 and the amendment to the Enforcement Decree of the same Act are as follows:

(1) Games which are inappropriate for prior rating by the Game Rating Board due to special circumstances in their production and distribution channels, excepting games unsuitable for minors, may be rated by distributors or others involved in the distribution channel at their discretion according to the standards predetermined upon consultation with the Game Rating Board. According to Article 11-4 of the Amendment to the Enforcement Decree of the Act on Promotion of the Game Industry, games should fulfill all the following requirements in order to be considered being inappropriate for prior rating by the Game Rating Board : (i) they must be provided through basic communications services by persons who are authorized to engage in the basic communications business under the Telecommunications Business Act, (ii) they must be provided through electronic commerce intermediaries such as online open markets and (iii) they must be provided using wireless telecommunications terminals which use mobile telecommunications terminals or the same kind of operating programs as those run on mobile telecommunications terminals.

(2) Game-related companies are prohibited from encouraging speculation by using operating methods, devices or machines closely related to the realization of game contents, and any person violating this provision is subject to corrective recommendation or corrective order imposed by the Minister of Culture, Sports, and Tourism.

(3) The act of distributing or manufacturing for distribution computer programs, devices or machines not provided or approved by game-related enterprises for the purpose of interrupting the normal operation of games is prohibited, and any person violating the foregoing is subject to imprisonment for no more than one year or penalty not exceeding Won 10 million.

(4) In order to realize the principle of responsibility in the dual punishment provision, if an employer fulfills her duty of care as a manager and supervisor with respect to her employees, the employer may be exempt from punishment (proviso in Article 47 of the Promotion Act).

The Promotion Act was further amended on July 21, 2011 and went into effect on January 22, 2012. The amendment was intended to create sound gaming culture by clearly defining the responsibilities of the game industry and the government and to encourage public awareness of prevention of excessive gaming.

The key content of the amendment are as follows:

(1) A game-related enterprise is required to obtain parental consent when a minor joins a game site as a member and to take measures to prevent excessive use of games by imposing a time limit on minors' game usage time. The Minister of Culture, Sports and Tourism may request game-related enterprises to submit or report data relating to such preventive measures and, after an examination thereof, order the relevant game-related enterprises to correct the preventive measures if they are deemed to be insufficient.

(2) The government shall provide support for educating the public on the appropriate use of games and the Minister of Culture, Sports and Tourism may request the Minister of Education, Science and Technology to cooperate with such efforts by providing education on the appropriate use of games in the curriculum of elementary and middle schools.

Table of Contents

The Enforcement Decree of the Act on Promotion of the Game Industry was also amended on January 20, 2012 and became effective on January 22, 2012. The amendment aims to provide measures to implement the Promotion Act, including determining the scope of games subject to the measures to prevent excessive use of games and the methods and procedures of such measures and development of methods and procedures to evaluate the appropriateness of the scope of games subject to the nighttime service limitation.

The key content of the amendment are as follows:

- (1) The scope of amendment excludes games which are not likely to cause over-immersion and addiction to games, including those made and distributed for the purpose of use and display at game tournaments or fairs and games which are provided by small and medium sized companies (in order to protect small and medium sized companies in the online game industry).
- (2) The amendment provides for methods and procedures to prevent excessive use of games such as requiring game-related enterprises to provide the representation of its legal representative that when a minor joins as a member, the enterprise has obtained the necessary parental consents and that it has posted warnings to prevent game users from excessively using games and has display the elapsed time for users.
- (3) The amendment is expected to make the evaluation of the appropriateness of the scope of games subject to the nighttime service limitation with respect to minors under the age of 16 be performed transparently and reasonably by preparing methods and procedures for such evaluation.

The Telecommunications Business Act

Under the Telecommunications Business Act, a person who intends to run a value-added telecommunications business must report to the Korea Communications Commission, or KCC, which has the authority to accept and monitor such reports. We are classified as a value-added telecommunications service provider such that we are required to prepare and submit statistical reports regarding, among others, the current status of facilities, subscription records and current status of users to the KCC upon its request. The KCC is responsible for compiling information and formulating telecommunications policies under this Telecommunications Business Act. In addition, we are required to report any transfer, takeover, suspension or closing of our business activities to the KCC, which may cancel our registration or order us to suspend our business for a period of up to one year if we fail to comply with its rules and regulations.

According to Article 21 of the Telecommunications Business Act, however, any person who intends to operate a value-added telecommunications business using small-scale telecommunications facilities is exempted from the obligation to report to the KCC. Before this Article was amended on May 11, 2007, small scale value-added telecommunications business operators had difficulty entering the market because only key telecommunications business operators, such as telephone and Internet service providers, could be exempted from such obligations. The amendment has relieved burdens associated with entering the value-added telecommunications business industry and facilitate its growth, which has intensified competition among online game service business operators.

The Act on Consumer Protection for Transactions through Electronic Commerce

Under this Act, we are required to take necessary measures to maintain the security of consumer information related to our electronic settlement services. We are also required to notify consumers when electronic payments are made and to indemnify consumers for damages resulting from misappropriation of consumer information by third parties. We believe that we have instituted appropriate safety measures to protect consumers against data misappropriation. To date, we have not experienced material disputes or claims in this area.

This Act was partially amended on March 22, 2010, and the amendment became effective on the same day. The amendment allows a company to avoid liability under the Act if it has exercised proper care in the management or supervision of its employees.

Table of Contents

The Act on Promotion of Information and Communications Network Utilization and Information Protection, or Information Protection Act

Under the Information Protection Act, we are permitted to gather personal information relating to our subscribers within the scope of their consent. We are, however, generally prohibited from using personal information or providing it to third parties beyond the purposes disclosed in our subscriber agreements. Disclosure of personal information without consent from a subscriber is permitted only if it is necessary for the settlement of information and communication service charges or is expressly permitted by this or any other statute.

We are required to indemnify users for damages occurring as a result of our violation of the foregoing restrictions, unless we can prove the absence of willful misconduct or negligence on our part. We believe that we have instituted appropriate measures and are in compliance with all material restrictions regarding internal mishandling of personal information.

Penalty surcharges are imposed on any telecommunications enterprises violating the regulation on the protection of personal information to recover any unfair profits gained by such enterprises, and some conducts, such as collection of personal information of users without their consent, are the subject of criminal punishment. Any telecommunications enterprises violating its obligation to protect personal information by collecting, using, disclosing such information without consent, and not complying with protective measures, may be imposed with surcharges not exceeding 1% of the sales relevant to the conduct of violation in consideration of the details, degree, period, the number of times, and the scale of gained profits.

The Information Protection Act was partially amended on March 17, 2010, and the amendment became effective on the same day. The amendment allows a company to avoid liability under the Act if it has exercised proper care in the management or supervision of its employees. The amendment sets forth rules for (i) designating institutions providing identity authentication services and for discontinuing and closing authentication services in order to safely and efficiently authenticate identities, (ii) suspending identity authentication services or canceling designation as an identity authentication institution in the event that an institution obtains designation through false or other deceptive methods, (iii) separating the process of obtaining consent to share personal information and the process of obtaining consent to consignment of transaction from the process of signing-up for membership, and (iv) notification requirements by telecommunications billing service providers, instead of the previous practice of referring to a Presidential Decree.

The Personal Information Protection Act

The Personal Information Protection Act was enacted on March 29, 2011 and went into effect on September 30, 2011. The scope of the Personal Information Protection Act covers anyone dealing with personal information in the private and public sectors.

If a person's personal information is collected or used, or provided to a third person, such person's consent should be obtained, and if personal information is no longer necessary upon achievement of the purpose of the collection and use of personal information, such information should be immediately destroyed.

Any transaction requiring identifiers granted by law for identification purposes, such as the resident registration number, is generally prohibited, and exceptions are recognized on a restrictive basis only if consent is obtained or if required by law. In addition, any person dealing with personal information as determined pursuant to the Presidential Decree, for instance, such as signing up for a Web site, should provide methods other than using the resident registration number.

In the event of a personal information leak, the processor of personal information should promptly notify the affected person after discovering such incident. If the volume of the leak of personal information exceeds a certain number, the processor of personal information should report the incident to the authorities and take necessary measures to minimize damages.

In addition, the same legislation grants to each individual the right to request perusal, the right to request correction or deletion, and the right to request suspension of process with respect to one's personal information, and also provides the methods to exercise such rights.

Table of Contents

To promote prompt and fair settlement of disputes concerning personal information, the same legislation also provides that a Personal Information Dispute Settlement Board, or PIDSB, should be established and the PIDSB's decision, if accepted by the disputing parties, should have the same legal effect as settlement by trial. In consideration of the fact that most identity theft cases are large in scale and small in the amount of monetary damages, the legislation adopts a collective dispute settlement system. A class action system for personal information has been adopted, but in order to prevent frivolous class action suits, litigants are required to go through the collective dispute settlement system prior to bringing a class action and cases are limited to those seeking suspension or injunctive relief.

The Korean Civil Code and the Act on the Establishment and Management of the Korea Communications Commission

Pursuant to the Korean Civil Code, contracts entered into with persons under 20 years of age without parental consent may be invalidated. Under the Act on the Establishment and Management of the Korea Communications Commission, the KCC was established to oversee services relating to broadcasting and communications and also to deliberate and resolve matters concerning the protection of users' information and communications. As a result, telecommunication service contracts and online game user agreements are required to specifically set forth procedures for rescinding service contracts, which may be entered into by persons under 20 years of age without parental consent.

In November 2003, the KCC issued an order addressed to 15 major online game companies in Korea, including us, to regulate certain business practices relating to the settlement of service charges involving persons under 20 years of age. The KCC raised concerns about the ability of persons under 20 years of age to subscribe to online game services without parental consent by settling charges payable to online game companies through settlement systems operated by fixed-line or broadband service providers. The order required online game companies to implement more specific and effective procedures to ensure, where relevant, that parental consent has been specifically obtained.

Although only a small number of our current subscribers are using the settlement options mentioned in the KCC order, we are enhancing our age verification and parental consent procedures for players using the relevant settlement options. We do not expect compliance with the KCC order to be burdensome.

Copyright Act and Computer Programs Protection Act, or Copyright Act

The Copyright Act, which was amended on April 22, 2009, was established by combining the Copyright Act on the protection of general works and the Computer Programs Protection Act on the protection of computer program works in order to maintain the consistency of copyright protection policies and seek an efficient administration thereof. In addition, the Korea Copyright Commission was established by combining the existing Copyright Commission and the Korea Software Copyright Committee, thereby improving the protection of copyrights and the efficiency in its operation. The amended Copyright Act also includes essential elements of the Computer Programs Protection Act which was abolished on July 23, 2009 and, in connection with computer program works, restrictions on software copyrights, decompilation of computer programs, and the establishment of the exclusive right to issue computer programs as a special case apart from other kinds of works.

Among the amendments to the Copyrights Acts on June 30, 2011, the key content regarding the online game development and services are as follows:

- (1) The amendment extends the period of copyright protection from 50 years to 70 years after the death of copyright holders in order to implement the agreements in the Korea-EU Free Trade Agreement.
- (2) The amendment categorizes online service providers into four types: simple conduit, caching, hosting and information searching. A simple conduit conducts acts of transmitting, designating routes or providing connections for the transmission of copyrighted materials without correcting contents, or acts of storing copyrighted materials automatically, intermediately and temporarily in the process of transmission for a period reasonably necessary for transmission thereof. Caching is an act of automatically, intermediately and temporarily storing copyrighted materials transmitted at the request of service users for the purpose of allowing subsequent users to efficiently access or receive them. Hosting is an act of storing copyrighted materials in the computers of online service providers at the

Table of Contents

request of copiers or transmitters. Finally, information searching is an act of enabling users to become aware of or connect to the location of copyrighted materials on the information and communications networks through information search tools.

(3) The amendment clarifies the requirements for indemnification with respect to each of the foregoing types.

(i) *Simple conduit*. Indemnification is possible in any of the following events: (a) The online service provider has yet to begin transmitting copyrighted materials; (b) the online service provider has yet to choose copyrighted materials or their receivers; (c) the online service provider adopts a policy to terminate the accounts of owners who repeatedly infringe on copyrights or any other rights protected under the Copyright Act and reasonably implements such a policy; or (d) when a right holder uses standard technical measures to identify and protect works, an online service provider accepts and does not intervene such use.

(ii) *Caching*. Indemnification is possible in any of the following events: (a) all of the indemnification requirements with respect to a simple conduit are met; (b) the online service provider does not modify copyrighted materials; (c) if there are any terms and conditions of access to provided copyrighted materials, the online service provider permits only the users who have complied with such terms and conditions to access such copyrighted materials that are temporarily stored works; or (d) the online service provider observes any rules of circulation of the copyrighted materials which are specified by the copiers or senders under the data communications rules for computers or communications that are generally accepted in the relevant industry.

(iii) *Hosting*. Indemnification is possible in any of the following events (a) all of the indemnification requirements with respect to a simple conduit are met; (b) when an online service provider has the authority and power to control infringement, it does not directly obtain any monetary gains from such infringement; (c) when an online service provider becomes aware of actual infringement, or the fact or the circumstances of obvious infringement due to any requests to suspend copy and/or transmission, it immediately stops the relevant copyrighted materials from being copied or transmitted; or (d) the online service provider appoints and publicly announces the party to which a request to suspend copy and/or transmission is to be made.

(iv) *Information searching*. Indemnification is possible in any of the following events: (a) the online service provider has yet to commence the transmission of copyrighted materials; or the indemnification requirements (b), (c) and (d) of the above subparagraph (iii) are met.

The Copyright Act was further amended on December 2, 2011 and went into effect on March 15, 2012, when the Korea-US Free Trade Agreement took effect, in order to promote the protection of rights of copyright holders and fair use of copyrighted materials by amending the relevant provisions necessary for implementing the Korea-US Free Trade Agreement, such as recognition of temporary storage as copying, introduction of a system of fair use of copyrighted materials, prohibition of acts of infringement on the rights of copyright holders including the distribution of forged labels, and the introduction of statutory damages in accordance with the agreements in the Korea-US Free Trade Agreement and to improve and supplement other issues discovered during the operation of the current system. In connection with the amendment to the Copyright Act, the Enforcement Decree and the Enforcement Rules of the Copyright Act were also amended on December 2, 2011 in accordance with the content of the Act.

The key content of the amendment to the Copyright Act on December 2, 2011 regarding online game development and services are as follows:

(1) In order to protect the rights of copyright holders in a digital environment, the amendment specifies that temporary storage falls under the scope of copying but allows temporary storage to be extent it is deemed necessary for smooth and efficient information processing.

(2) An online service provider will be deemed not liable for copyright infringement: (i) if the online service provider has adopted and reasonably implemented a policy of terminating the account of a person who infringed copyrights or (ii) if the online service provider has accepted and not interfered with a right holder's use of standard technical measures for identifying and protecting copyrighted materials.

Table of Contents

Juvenile Protection Act

The Juvenile Protection Act, as amended on February 29, 2008, prescribes the establishment of the Juvenile Protection Commission under the authority of the Minister of the Ministry of Health and Welfare in Korea, formerly known as the Ministry for Health, Welfare and Family Affairs, or the MIHWAF, which has the authority to designate the types of media harmful to juveniles. Under the Juvenile Protection Act, any person who intends to sell, lend or distribute media materials harmful to minors or provides them for viewing or utilization is required to confirm the age of the intended user, and shall not sell, rent or distribute such materials, or provide them for viewing or utilization, to minors. A person in violation may be punished by imprisonment for a maximum of three years or by a fine not exceeding Won 20 million.

On March 4, 2009, the MIHWAF issued a public notice announcing that Web sites for trading items are considered harmful mass media to minors based on the findings of Juvenile Protection Commission that such Web sites for trading online game items are likely to encourage gambling and speculation and negatively influence juveniles. In the public notice, the MIHWAF prohibited any person under the age of 19 from visiting Web sites for trading online game items, effective from March 19, 2009.

A Web site for trading items is a Web site which offers the services of brokerage or agency for trading of tangible or intangible things gained from online games as prescribed in the Promotion Act. A Web site for trading items needs to specify on its Web site that access is not allowed for minors, and any person visiting such Web sites is required to go through the adult certification process. Any Web site operator found to be operating such Web sites in breach of the requirements under the public notice is subject to a maximum of 3 years of imprisonment or a maximum fine of Won 20 million. On June 3, 2009, Item Bay Co., Ltd., one of the leading Web sites in Korea for trading online game items, initiated an administrative proceeding against the MIHWAF seeking cancellation of the MIHWAF's public notice. Item Bay Co., Ltd. argued that game items are purchased by users at their own discretion depending on their necessity, and remote from speculative activity. Therefore, Web sites for trading online game items do not fall under media harmful to minors.

While we offer virtual in-game items for sale to our users on the game Web sites that we operate in Korea, we do not broker the trade of such game items or any other tangible or intangible acquisitions obtained by using online games among our users, and currently do not fall under the category of Web site for trading items. In Korea, however, minors account for a significant percentage of online game users. As they are now prohibited from trading items on Web sites, including virtual in-game items, such prohibition may materially and adversely affect the online game industry in general, which may well have a material adverse affect on our business, financial condition and results of operation.

The Juvenile Protection Act was partially amended on May 19, 2011 and went into effect on November 20, 2011. Under the amendment, online game providers may not provide online games to minors under the age of 16 late at night (specifically, from midnight until 6:00 a.m.) and any provider violating the provision is subject to imprisonment for no more than 2 years and a penalty not exceeding 10 million Won.

Furthermore, the amendment provides that the Minister of Gender Equality and Family, or the MOGEF, in consultation with the Minister of Culture, Sports, and Tourism, should revisit the guidelines every two years to evaluate the appropriateness of the scope of games subject to the late-night restriction and to take measures for improvement, and, with respect to minors suffering from online game addiction, the MOGEF may also provide services for prevention, consultation, treatment and rehabilitation.

The Juvenile Protection Act was further amended on September 15, 2011 and goes into effect on September 16, 2012. The key content of the amendment are as follows:

- (1) The amendment expands the category of businesses which minors are prohibited from entering, or are prohibited from hiring minors, to include those business which provide combined distributed games and business places which provide Internet game facilities;
- (2) The amendment requires protective measures equivalent to packaging;
- (3) The amendment requires a person who intends to sell, rent, distribute or provide any media harmful to minors to check the ages and IDs of his or her counterparties;

Table of Contents

(4) The amendment prescribes that if a person distributes any media harmful to minors through the information and communications network, the Minister of Gender Equality and Family may publicly post the identity of such person and the content of the violation; and

(5) The amendment requires parental consent when a minor under age 16 joins an Internet game as a member and requires the information on the minor's use of games to be reported to the guardians.

Taiwan

The Taiwanese game industry and online game companies operating in Taiwan are subject to the following material laws and regulations:

Consumer protection

As a result of increasing disputes between online game companies and consumers in Taiwan, on February 17, 2006 and as last amended on December 7, 2010, the ROC Ministry of Economic Affairs promulgated a model consumer contract that online game companies are encouraged to adopt and on December 13, 2007 and as last amended on December 2, 2010, the ROC Ministry of Economic Affairs promulgated certain standard provisions that must be included in a consumer contract (the Mandatory Provisions) that online game companies must adopt, which include, among others, customers' right to request a full refund of packaged or downloaded software without cause within seven days from their purchase, to rescind the contract without cause and ask for the unused fees within seven days after the start of the game, to claim for damages suffered from the game program or computer system defect, to terminate the contract without cause at anytime and claim for the unused fees after deduction of necessary costs, as well as obligation of online game company to remark the rating of games in accordance with the Regulations for the Rating of Computer Software. In general, the above model contract and Mandatory Provisions impose more responsibilities and liabilities on the online game companies. Moreover, any article set forth in a consumer contract which is in violation of the Mandatory Provisions shall be null and void. In addition, according to the drafted amendment to Consumer Protection Law proposed by the Executive Yuan, if violating the Mandatory Provisions, except for otherwise provided in any laws or regulations, the enterprise shall correct such violation within the time limit given by the competent authority as well as may be subject to consecutive fines until such violation is corrected. However, it is uncertain whether or when the above draft amendment will be passed by the Legislative Yuan.

Regulations of Internet content and game software

Pursuant to the Children and Juvenile Welfare and Right Protection Act as amended on November 30, 2011, it is illegal to transmit or provide children under 18 years of age with, among other things, computer software, Internet, electronic signals, DVDs and compact discs that contain content which propagates violence, obscenity or similar material that may undermine the mental and physical health of a minor. Any person or entity violating this Act may be subject to a fine and/or the enterprise may be forced to cease to operate for up to one year. In addition, according to this Act, the Regulations for the Rating of Internet Content, and the Regulations for the Rating of Computer Software, Internet content and computer software shall not violate any mandatory law and certain internet content and computer software shall be classified as restricted and therefore shall not be viewed by children and juveniles under the age of 18, which may include, among others:

Depiction of homicide or other criminal offenses;

Plot involving terror, bloodshed, cruelty, or perversion, which is presented in an intense manner; or

Depiction of sexual acts or sexual obscenity, through action, image, language, text, dialogue or sound, yet which does not embarrass or disgust adults in general.

In addition, the Regulations for the Rating of Internet Content suggest that the Internet content that is not rated as restricted is better to be viewed by children under the guidance of the parents, guardians or others taking care of them. The Regulations for the Rating of Computer Software further stipulate that certain computer software not rated as restricted may not be reviewed by children or juveniles under certain age or may only be viewed by them under the guidance or company of the parent, teacher or adult relative depending on the rating of such computer software pursuant to such regulation. The rating of internet content and computer software shall be labeled in accordance with the above regulations, respectively.

Table of Contents

Requiem is rated restricted class and all aforementioned rules with regard to restricted class are applied.

Internet café regulation

Currently, there is no mandatory national legislation specifically covering the operation of Internet cafés. However, several municipalities and counties such as Taipei City, New Taipei City, Taoyuan County, Tainan City, Nantou County, Lienchiang County and Kinmen County have promulgated specific ordinances imposing restrictions on Internet cafés, which relate to the location, building structure, facilities, business hours, age limit of customers and the classification of Internet content.

In order to have Internet cafés regulated under a national legislation rather than by different municipalities and counties ordinances the ROC Ministry of Economic Affairs several years ago proposed draft Statutes of Information-Entertainment Industry legislation that, if implemented, would regulate all Internet cafés located in the ROC. It is unclear, however, whether or when the above proposal will be passed by the Legislative Yuan. In addition, pursuant to the Public Order Maintenance Act, Internet cafés may be subject to a fine and/or a business suspension or shut-down if minors are found at Internet cafés during late hours.

Privacy protection

The ROC government has promulgated the Computer-Processed Personal Data Protection Act to regulate the collection processing, usage and transmission of computer-processed personal data. Generally, an Internet content provider, or ICP, will not be subject to this Act if it does not collect or process the personal data through the computer as its main business activity. However, an ICP may become liable for the loss of any data so collected. On May 26, 2010, the amendments to the Computer-Processed Personal Data Protection Act have been passed by the Legislative Yuan and the name of such Act has been changed to Personal Information Protection Act; however, certain amended articles are not yet effective and the effective date of such articles will be further determined by the Executive Yuan. There can be no assurance when the Executive Yuan will determine the effective date of such provision. Once those articles become effective, an Internet content provider, or ICP, may be subject to this Act as long as it, among others, collects, processes, uses and/or transmits personal data. If an Internet content provider, or ICP, violates the provisions of the Act once it applies to such Act, it will be subject to fine, criminal liability, if applicable, and shall be liable for the losses suffered by the person whose information has been unlawfully collected, processed, used or misappropriated by such Internet content provider.

Intellectual property

Under the Copyright Act, the domestic online games software is to be classified as copyrightable works in the category of computer program, and, therefore, is to be protected in Taiwan without requiring further registration with ROC governmental agency. For foreign works, including foreign computer programs, according to the Copyright Act, if the works of persons of ROC are protected by copyright law in such foreign country by treaty, agreements or others, the works of persons of such foreign country shall also be protected by the Copyright Act. The works of persons of WTO member countries can now also be protected under the Copyright Act.

Japan

Japan does not currently have any national government regulations targeted specifically at the online game industry. Some regulations that are relevant to or that may affect the online game industry are described below.

Protection of personal information

Businesses in Japan are subject to certain statutory requirements with respect to personal information acquired during the ordinary course of business. Pursuant to these statutory requirements, businesses must set up appropriate procedures to protect personal information from use for any purpose other than the intended purpose.

Regulations on sound upbringing of minors

In Japan, Internet and game software content is generally regulated at the local, rather than the national, level. Many local governments have ordinances regarding the sound upbringing of minors, which empower competent

Table of Contents

authorities to designate game software as detrimental to the sound upbringing of minors and prohibit the sale or distribution to minors of such designated game software. In addition, the Computer Entertainment Rating Organization, or CERO, a nonprofit organization, offers rating services for home-use games, including online games. Game developers may request a rating for their game software from CERO, which will then review such software and assign one of the following five ratings: suitable for users of all ages, suitable for users 12 years old or older, suitable for users 15 years old or older, suitable for users 17 years old or older, and suitable only for users 18 years old or older. Ratings are based on, among other factors, the degree of sex, violence and anti-social expression in the game software content. Once a rating is assigned, the relevant game software must prominently display such rating.

Thailand

There is no specific law or regulation that directly governs online games, online game companies or the online game industry in Thailand. The online game industry in Thailand operates under a legal regime that generally regulates vendors of Internet cafés and game shops (places where people go to play video games) rather than online game operators. Several of the governmental agencies in Thailand work in cooperation with one another in regulating the industry. The Thai government, principally through the Ministry of Information and Communication Technology, or ICT Ministry, with the cooperation of the Ministry of Culture, has been making efforts to regulate the fast-growing Internet business, in particular the online game industry. The Thai government has, since 2004, proposed measures that would affect the online game industry, including restrictions on the playing time of game users under 18 years of age to three hours per day, prohibition of gambling, lottery or game item trading via online games and mandatory Internet café registration. The Ministry of Commerce in Thailand is also responsible for regulating online businesses by requiring registration.

In June 2008, the Thai Government passed the Films and Videos Act of 2008 to replace the Control of Business Relating to Tape Cassette and Television Material Act. The new legislation imposes measures to control the operators of game shops (including Internet cafés that provide game services) and limit access to game shops by users under 18 years of age. These measures include restrictions on the business days and hours, location and building structure of game shops as well as the daily playing time of games and curfew hours for users under 18 years of age to enter game shops and Internet cafés. According to the Ministerial Regulation of Ministry of Culture Re: Permission and Operation of Video Shops B.E. 2552 (dated September 24, 2009), users under 15 years of age can enter game shops and Internet cafés between 2:00 p.m. and 8:00 p.m. from Monday to Friday, and between 10:00 a.m. and 8:00 p.m. on public holidays or during an educational term break prescribed by the competent registrar. For users aged from 15 years to 18 years, the access times are limited to between 2:00 p.m. and 10:00 p.m. from Monday to Friday, and between 10:00 a.m. and 10:00 p.m. on public holidays or during an educational term break as prescribed by the competent registrar.

The Films and Videos Act is applicable only to game shop operators that use video materials (including, but not limited to, video tapes, video compact discs or digital video discs). Video under this Act is defined as materials that record pictures, or pictures and sound, that can be shown continuously as motion pictures in the forms of games, plays, karaoke with pictures, or other characteristics as prescribed in the ministerial regulations. Currently, there is no ratings system for online games. According to publicly available information, the Ministry of Culture is considering proposing a draft amendment to the Films and Videos Act to provide a ratings system for the film and video materials under this Act, which may or may not include online games. Due to a lack of precedent and uncertainties in the interpretation of this new legislation by the Thai authorities, the online game operators may or may not be subject to this Act. Despite such uncertainties, the control of game shop operators by this Act may have an impact on the online game industry.

Registration of Internet cafés and online game operators

There is no legislation that specifically regulates online game operators, Internet cafés or online game shops. The Ministry of Commerce in Thailand, however, requires that online game operators offering online games over Web sites or Internet portals register for e-business registration and also requires Internet cafés and online game shops to register under the Commercial Registration Act. Under the Films and Videos Act, game operators are also required to obtain an operating license from the Ministry of Culture. In addition, the ICT Ministerial Notification,

Table of Contents

enacted under the new Computer Related Crime Act, obliges Internet service providers (Internet cafés and online game shops) to keep traffic data for not less than 90 days after such data is entered into a computer system. The traffic data items are: (i) the user's identifying data, (ii) time of use and (iii) the computer IP address.

Regulation of business days and hours, and location and building structure of Internet cafés and game shops

In June 2008, the Control of Business Relating to Tape Cassette and Television Material Act was repealed and replaced by the Films and Videos Act. Under the Films and Videos Act, the business days and hours (especially service hours for users under 18 years of age), location and building structure of game shops are restricted. According to the Ministerial Regulation of Ministry of Culture Re: Permission and Operation of Video Shops B.E. 2552 (dated September 24, 2009), users under 15 years of age can enter game shops and Internet cafés between 2:00 p.m. and 8:00 p.m. from Monday to Friday, and between 10:00 a.m. and 8:00 p.m. on public holidays or during an educational term break prescribed by the competent registrar. For users aged from 15 years to 18 years, the access times are limited to between 2:00 p.m. and 10:00 p.m. from Monday to Friday, and between 10:00 a.m. and 10:00 p.m. on public holidays or during an educational term break as prescribed by the competent registrar.

Restriction on access by children

The Child Protection Act prohibits any person from forcing, threatening, inducing, advocating, causing or permitting children to misbehave or engage in misconduct. In order to implement the protective measures under the Child Protection Act, the Ministry of Culture will also prescribe ministerial regulations under the Films and Videos Act to limit access to Internet cafés and game shops by users under 18 years of age. In addition, the ICT Minister requests online game operators to close access to its game server after curfew hours. Users over 18 years of age, however, are permitted password protected access to certain online game servers even after curfew hours by obtaining a password available at the post office. The ICT Minister has also implemented the Goodnet project, which recommends that members of the computer and Internet service provider community cooperate in restricting their business hours to prevent children under the age of 18 from entering their place of business after curfew hours. Similarly, the Office of the National Culture Commission, in cooperation with the Thai Health Promotion Foundation, has established the White Game Shops for Juveniles project which encourages offline and online game shop operators to operate their businesses in strict compliance with the relevant laws and regulations.

Intellectual property

Under the Copyright Act, online games are classified as copyrightable work in the category of computer program or software, and, therefore, automatically protected in Thailand without requiring further registration with or notification to any governmental agency. Despite the lack of mandatory registration or notification requirements, it is recommended that copyright owners of online games notify the Department of Intellectual Property, the Ministry of Commerce of their online games to ensure that their names officially and publicly appear in the listing of copyrighted computer software. The copyright owner has the exclusive right to copy, modify and publish its copyrighted work.

China

The online game industry in China operates under a legal regime that consists of the State Council, which is the highest authority of the executive branch of the PRC central government, and various ministries and agencies under its leadership. These ministries and agencies include, among others:

the Ministry of Industry and Information Technology;

the Ministry of Culture;

the General Administration of Press and Publication;

the National Copyright Administration;

the Ministry of Public Security; and

the Bureau of State Secrecy.

Table of Contents

The State Council and these ministries and agencies have issued a series of rules that regulate a number of different substantive areas of our business, which are discussed below.

Licenses

Online game companies are required to obtain licenses from a variety of PRC regulatory authorities. As an ICP business, online game companies are required to hold a value-added telecommunications business operation license, or ICP license, issued by the Ministry of Industry and Information Technology or its local offices, and for ICP operators which provide ICP services in multiple provinces, autonomous regions and centrally administered municipalities, it is required that they obtain an inter-regional ICP license. Any ICP license holder that engages in the supply and servicing of Internet cultural products, which include online games, must obtain an additional Internet culture business operation license from the provincial counterparts of the Ministry of Culture. The General Administration of Press and Publication and the Ministry of Industry and Information Technology jointly impose an approval requirement for any entity that intends to engage in Internet publishing, defined as any act by an Internet information service provider to select, edit and process content or programs and to make such content or programs publicly available on the Internet and, further, an online game operator is required to obtain an online game related Internet publishing permit from the General Administration of Press and Publication.

In addition, under a notice published by it in September 2009, the General Administration of Press and Publication prohibits foreign investors from making investment in online game operation business through joint ventures or wholly owned subsidiaries in China, or from controlling the online game operation business through contractual arrangements. This notice may impact the landscape of the online game industry in China, because a lot of online game operators in China are controlled by non-PRC incorporated entities through contractual arrangements.

Regulation of Internet content

The PRC government has promulgated measures relating to Internet content through a number of ministries and agencies, including the Ministry of Industry and Information Technology, the Ministry of Culture and the General Administration of Press and Publication. These measures specifically prohibit Internet activities, including the operation and promotion of online games that result in the publication of any content which is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise State security or secrets. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its Web sites.

Regulation of information security

Internet content in China is also regulated and restricted from a State security standpoint. The National People's Congress, China's national legislative body, has enacted a law that may subject a person to criminal punishment in China for any effort to, among other things: (i) gain improper entry into a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak State secrets; (iv) spread false commercial information or (v) infringe intellectual property rights.

The Ministry of Public Security has promulgated measures that prohibit use of the Internet in ways which, among other things, result in a leakage of State secrets or a spread of socially destabilizing content. The Ministry of Public Security has supervision and inspection rights in this regard. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its Web sites.

Import regulation

Licensing online games from abroad and importing them into China is regulated in several ways. Any license agreement with a foreign licensor that involves import of technologies, including online game software into China, is required to be registered with the Ministry of Commerce. Without that registration, a licensee cannot remit license fees out of China to any foreign game licensor. In addition, the Ministry of Culture requires the licensee to submit for its content review and approval any online games to be imported, and after obtaining the approval from the Ministry of Culture, if there is any upgrade or any material change to the content of the imported online games

Table of Contents

during the operation, the licensee shall submit the new version of imported online games to the Ministry of Culture for content review. According to the Tentative Measures Concerning Online Games Administration promulgated by the Ministry of Culture on June 3, 2010, if the operator of an imported online game changed, the new operator needs to re-apply for a new content review. If a licensee imports and/or operates games without the required approval, the Ministry of Culture may impose penalties, including revoking the Internet culture business operations license required for the operation of online games in China. Furthermore, the National Copyright Administration requires the licensee to register copyright license agreements relating to imported software. Without the National Copyright Administration registration, a licensee is not allowed to publish or reproduce the imported game software in China. Several notices published by the General Administration of Press and Publication in 2009, individually or jointly with other authorities, emphasize that all imported online games licensed by offshore copyright owners may not be published in China without obtaining the approval of the General Administration of Press and Publication, and any new version, expansion packs or innovation of content of such approved online games shall be submitted to the General Administration of Press and Publication for re-approval. Failure to comply with such requirements may lead to certain penalties, including cease of operation by the General Administration of Press and Publication, or shutting down the Web site.

Intellectual property rights

The National People's Congress, the State Council and the National Copyright Administration have promulgated various laws, regulations and rules relating to protection of software in China. Under these laws, regulations and rules, software owners, licensees and transferees may register their rights in software with the National Copyright Administration or its local branches and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process and registered software rights may receive better protection.

Internet café and online game regulation

Internet cafés are required to obtain a license from the Ministry of Culture and the State Administration for Industry and Commerce, and are subject to requirements and regulations with respect to minimum registered capital, location, size, number of computers, age limit of customers and business hours. The PRC government has published a series of rules in recent years to intensify its regulation of Internet cafés. In February 2007, 14 PRC governmental agencies, including the Ministry of Industry and Information Technology, the General Administration of Press and Publication and Ministry of Public Security jointly promulgated a notice about strengthening regulations over Internet cafés and online games. According to the notice, no new Internet café should be approved in 2007 and the regulation of existing cafés should be strengthened. In April 2007, eight PRC governmental agencies, including the Ministry of Education, the Ministry of Industry and Information Technology, the General Administration of Press and Publication and the Ministry of Public Security jointly promulgated a notice regarding the implementation of online game anti-addiction systems to protect the physical and psychological health of minors. According to the notice, online game operators are required to develop and implement anti-addiction systems to all online games from July 16, 2007, and the corresponding identity authentication schemes of the anti-addiction systems shall be put into operation at the same time. Otherwise, the online games may not be approved by or filed with the relevant authorities or may not carry out open beta testing for operational purposes. In mid-2008 and March 2009, the Ministry of Culture and other ministries and agencies, individually or jointly, issued several notices which provide various ways to strengthen the regulation of Internet cafés, including investigating and punishing the Internet cafés which accept minors, cracking down on Internet cafés operating without sufficient and valid licenses, limiting the total number of Internet cafés, screening unlawful games and Web sites, and improving the coordination of regulation over Internet cafés and online games. A notice published by the Ministry of Culture in March 2010 imposes significantly severe punishment on Internet cafés admitting minors, according to which, the Internet culture business operation license of an Internet café will be revoked, if it engages in certain activities, including admitting three or more minors at one time, or admitting minors not within permitted business hours, or having incurred malignant events due to admitting minors, or admitting less than two minors for more than twice within one year. Since March 1, 2011, the Ministry of Culture and seven other authorities jointly launched a parent guardianship project for purposes of protecting minors from addiction to online games. Under the parent guardianship project rules, online game operators shall impose restrictions on and take other various measures with respect to the

Table of Contents

online game accounts held by minors based on the requirements from and communications with the parents, including restrictions on the length or periods of time during which the minors may play online games or, in certain cases, a complete prohibition. The online game operators are required to establish responsive and effective measures and make quarterly reports to local culture administrative authorities. In July 2011, eight PRC governmental agencies, including the Ministry of Education, the Ministry of Industry and Information Technology, the General Administration of Press and Publication and the Ministry of Public Security, reinforced the anti-addiction system adopted under the April 2007 rules referenced above by implementing a regulation requiring strengthening of identity authentication schemes, which requires all online game operators to verify the identity of game players to protect minors from addiction to on-line games.

Privacy protection

PRC law does not prohibit Internet content providers from collecting and analyzing personal information from their users. PRC law prohibits Internet content providers from disclosing to any third parties any information transmitted by users through their networks unless otherwise permitted by law. If an Internet content provider violates these regulations, the Ministry of Industry and Information Technology or its local bureaus may impose penalties and the Internet content provider may be liable for damages caused to its users.

Regulation on information reporting

On April 13, 2009, the Ministry of Industry and Information Technology promulgated the Implementation Measures for Internet Network Security Information Reporting, or the Implementation Measures, pursuant to which ICP operators with inter-regional operations shall set up information monitor mechanism and information report mechanism, and shall report the required event information and early warning information to the competent tele-communications authorities and/or National Computer Network Emergency Response Technical Team/Coordination Center of China in accordance with the Implementation Measures.

While we believe that our licensees are in compliance with the applicable laws and regulations governing the online game industry in China, we cannot assure you that operation of our games in China will not be found to be in violation of any current or future Chinese laws and regulations. Failure by our overseas licensees to comply with laws and regulations in China, including obtaining and maintaining the requisite government licenses and permits, may have a material adverse effect on our business, financial condition and results of operations. See ITEM 3.D. **RISK FACTORS** **RISKS RELATING TO OUR BUSINESS** 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.

United States

Game Ratings and Attempts to Regulate Access to Children

Most video game software publishers comply with the standardized rating system established by the Entertainment Software Rating Board, or ESRB, a non-profit, self-regulatory body established in 1994 by the Entertainment Software Association, or ESA. ESRB rates video games submitted by video game publishers; the ratings include both a symbol for age appropriateness (e.g., E for Everyone or M for Mature) and a content descriptor (e.g., Blood and Gore or Intense Violence). The ESRB specifically excludes any online interactions from the rating, as the ESRB is unable to review content, such as chat, text, audio and video generated by other users in an online environment.

ESRB has rated our games as follows: Requiem is rated Mature, Ragnarok Online is rated Teen, and R.O.S.E. Online and Dragon Saga are rated Everyone 10+.

By submitting a game to the ESRB and using an ESRB rating, a video game publisher must agree to adhere to advertising and packaging guidelines for the rated game, such as using appropriate advertising content and not targeting any advertisement for a game rated Teen, Mature or Adults only to consumers for whom the product is

Table of Contents

not rated as appropriate. The Advertising Review Board has been granted the oversight and enforcement authority for compliance with the advertising guidelines. The ESRB ratings must be displayed on both the front and back of game packaging in compliance with the ESRB requirements. The ESRB may sanction game producers for failing to label their product properly. Although submitting a game to the ESRB is voluntary, many retailers will not sell games without an ESRB rating.

The United States Federal Trade Commission, or FTC, has also taken action with respect to improper ratings pursuant to its broad authority to prohibit fraudulent, deceptive, or unfair business practices. For example, in response to allegations that two videogame publishers failed to disclose hidden nudity and sexually-themed content to the ESRB during the ratings process, the FTC issued a consent order compelling the videogame publishers not to, expressly or implicitly, misrepresent the ratings or content descriptors of their videogames and to maintain a system that ensures that all of the content in their video games is considered and reviewed in preparing submissions to the ESRB. The FTC has also posted an online form on its Web site for the public to file complaints regarding video game ratings that do not accurately reflect of the content of the game.

A number of bills have been introduced in Congress to specifically regulate the sale of video games with violent content to minors, but currently no such federal laws are in force. Several States, as well as several cities, have enacted or are considering laws that would regulate game industry content and marketing, including the rental or sale of games with violent content by or to minors.

For example, the State of Maryland has enacted a law that regulates the sale of video games with explicit sexual content to minors. The Maryland law has not been challenged in court, remains in force, and is supported by the ESA. Other States have enacted laws that require the posting of signs providing information about ESRB ratings. To date, laws that regulate the sale of video games based on content, when challenged, have been declared unconstitutional. Most prominently, the United States Supreme Court ruled in 2011 that a California law that imposed fines on retailers that sell certain violent video games to minors violated the First Amendment of the U.S. Constitution. The Court held that video games represent a form of protected expression under the First Amendment, and that California's statute, no matter how well intentioned, lacked adequate justification for the regulation of such speech.

Irrespective of any laws or industry guidelines, U.S. retailers have become more reluctant to sell M rated video games to minors. The FTC issues periodic marketing reports and in its most recent report to Congress in 2009, the FTC reported that 20% of underage undercover shoppers were able to purchase M rated video games. An undercover survey in 2010-11, however, showed a statistically significant improvement with only 13% of underage shoppers being able to purchase M rated games. Consumer advocacy groups have also opposed sales of interactive entertainment software containing graphic violence, profanity or sexually explicit material by engaging in public demonstrations and media campaigns.

Online Collection of Information from Children

The Children's Online Privacy Protection Act of 1998, or COPPA, prohibits any Web site operator from collecting, maintaining or using personal information (including first and last name, home address, email address, telephone number, Social Security number, or other information that permits the physical or online contacting of a specific individual) of children under 13 years of age, unless the Web site operator obtains verifiable parental consent.

A Web site that knowingly collects information from children under 13 years old, or that in whole or in part is directed to children under 13 years old, must obtain verifiable parental consent before collecting personal information from any child. The Web site operator must also post a clear online privacy policy that provides notice of what information is collected from children, how the information is used, and a list of third parties with whom the operator may share or sell the child's information; parents must be given the choice to determine whether the child's information can be shared with third parties, and must also be provided access to the child's information and the opportunity to delete any such information collected. Moreover, the operator must establish and maintain reasonable procedures to protect the confidentiality, security and integrity of any personal information collected from children under 13 years of age. COPPA also prohibits conditioning a child's participation in a game on the child disclosing more personal information than is reasonably necessary to participate in such activity.

Table of Contents

COPPA authorizes the FTC and the State Attorneys General to bring actions against Web site operators to enforce the statute.

In 2011, the FTC released the results of a study showing that many mobile application providers do not clearly disclose the ways in which they collect and share children's information. The FTC suggests that the providers of mobile applications in the kids app ecosystem do more to disclose key information to parents about the types of information they collect from children, and the ways in which that information is shared with third parties.

Protection of Personal Information

Most States have some form of specific legislation regarding the protection of personal information collected, processed, maintained or used in electronic form, as well as specific notification procedures in the event that such information is accessed by unauthorized individuals. Under these laws, among other things, businesses are required to implement and maintain reasonable security measures designed to protect the computerized personal information of its customers or users from unauthorized access, disclosure or use. These measures may require the encryption of sensitive data, such as credit card numbers, social security numbers, bank security access codes, etc. In the event that a business suffers a security breach, these laws generally require the business to provide notice of such breach to each individual user affected by the breach. In addition, if such personal information is accessed by unauthorized individuals as a result of the business' failure to use reasonable measures to protect the information, the business may be liable to those customers for any misuse of such personal information and may be liable for statutory fines or penalties, as well as civil and even potential criminal prosecution by government authorities.

Privacy Policy Requirements

The FTC and many States require an operator of a Web site to develop, maintain and post on its Web site a privacy policy that informs its customers and users of the categories of personal information that are collected by the operator, how that personal information is used and shared with third parties and how users may change or update such information and opt out of its collection and use. While most States have generally not imposed statutory fines or penalties on an operator for failing to comply with its privacy policy, an operator may be directly liable to its customer or users if it fails to comply with its posted privacy policy if such noncompliance harms the users. The FTC, however, has initiated numerous investigations and imposed significant civil penalties in several cases involving alleged failures by companies to comply with the representations made in their online privacy policies and/or adequately disclose the companies' actual practices in such policies. In 2011, for instance, Google entered into a settlement agreement with the FTC in which Google agreed to be subject to twenty years of privacy audits and to revise its privacy practices in response to FTC charges that Google used deceptive tactics and violated its own privacy policy when it launched its social network, Google Buzz, in 2010. The Google settlement comes amidst increasing pressure from the FTC on online service providers to conspicuously and accurately disclose their user data collection and disclosure practices. This is especially true in the mobile context, where new technologies have presented novel consumer privacy questions. Specifically, the collection and use of mobile geolocation and device identifier data have come under increased FTC scrutiny in the past year.

Liability Arising from User Speech and Conduct

Section 230 of the Communications Decency Act of 1996, or CDA, provides limited protection to interactive computer services, such as an online game service, from liability for publishing information posted or provided by others, such as the users of an online game service. The CDA can, for example, help protect an online game service provider from liability as a publisher that could otherwise arise from a user making defamatory statements on the service about another user. The protections of the CDA, however, do not immunize interactive computer services from criminal liability under United States Federal law (e.g., obscenity or child pornography), for infringement of intellectual property law, or any state laws that are not inconsistent with the CDA.

Some commentators consider Section 230 of the CDA controversial and have called for it to be amended by Congress because a number of courts have interpreted it as granting broad tort immunity. One recent case rejected immunity by holding that claims involving a person's personal information is a violation of such person's publicity rights, which the court held were intellectual property rights outside of the scope of immunity. Another court

Table of Contents

recently held that an interactive computer service was not immune from federal Fair Housing Act violations because the interactive computer service provided tools such as pull down menus that assisted the users in creating the content that violated the Fair Housing Act.

Congress or the courts could continue to narrow the application of Section 230 of the CDA, in which case online game service operators, such as the Company, could face increased potential liability for certain speech or conduct by the users on their online game service.

ITEM 4.C. ORGANIZATIONAL STRUCTURE

The following is our organizational structure as of March 31, 2012:

Note:

(1) Gravity Middle East & Africa FZ-LLC went into liquidation proceedings in the United Arab Emirates in September 2008.

ITEM 4.D. PROPERTY, PLANTS AND EQUIPMENT

As of December 31, 2011, our property and equipment mainly consisted of (i) game engines, (ii) network servers, (iii) PCs and (iv) software purchased externally. As of December 31, 2011, the net book value of our property and equipment was Won 2,731 million (US\$2,357 thousand). Because our main business is to develop and distribute online game services, we do not own any factories.

Korea

Our principal executive and administrative offices are located at Nuritkum Square Business Tower 15F, 1605 Sangam-Dong, Mapo-Gu, Seoul 121-795, Korea. We currently occupy 110,551 square feet of office space, which we lease from Korea Software Industry Promotion Agency, pursuant to a lease that will expire on December 31, 2012 and which is renewable for one additional year. The annual lease payment amounts to Won 1,926 million (US\$1,662 thousand). The offices of NeoCyon, our 96.11% owned subsidiary, are located at Nuritkum Square R&D Tower 14F, 1605 Sangam-Dong, Mapo-Gu, Seoul 121-795, Korea. NeoCyon currently occupies 6,049 square feet of office space, subleased from us. The annual lease payment amounts to Won 106 million (US\$91 thousand). The offices of Gravity Games, our 50.83% owned subsidiary, are located at Nuritkum Square R&D Tower 14F, 1605 Sangam-Dong, Mapo-Gu, Seoul 121-795, Korea. Gravity Games currently occupies 6,066 square feet of office

Table of Contents

space, subleased from us. The annual lease payment amounts to Won 122 million (US\$105 thousand). We believe that the existing facilities of Gravity, NeoCyon and Gravity Games are adequate for our current requirements and that additional space can be obtained on commercially reasonable terms to meet our future requirements.

United States

The offices of Gravity Interactive, our wholly-owned subsidiary in the United States, are located at 13160 Mindanao Way, Marina Del Rey, California 90292. Gravity Interactive currently occupies 7,102 square feet of office space, leased from a third party. The annual lease payment amounts to US\$416 thousand. We believe that the existing facilities of Gravity Interactive are adequate for their current requirements and that additional space can be obtained on commercially reasonable terms to meet their future requirements.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion together with our consolidated financial statements and the related notes which appear elsewhere in this annual report. The following discussion is based on our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. Our historic performance may not be indicative of our future results of operations and capital requirements and resources.

ITEM 5.A. OPERATING RESULTS OVERVIEW

We are a leading developer and distributor of online games in Japan, Taiwan, Brazil, the Philippines, Singapore, Malaysia and Thailand based on the number of peak concurrent users. Our headquarter is in Korea and we are incorporated under the laws of Korea. From our inception in April 2000 to the commercialization of our first online game, Ragnarok Online, in August 2002, our operating activities were limited primarily to developing Ragnarok Online. Our revenues have been and continue to be driven primarily by our first game, Ragnarok Online. Our future growth and profitability will be determined by our ability to enhance the features on our existing games and introduce new games with characters, features and functions that gain market acceptance and following.

In 2010, our revenues decreased by 8.8% to Won 52,362 million from Won 57,403 million in 2009. In 2011, our revenues increased by 9.8% to Won 57,477 million (US\$49,613 thousand) from Won 52,362 million in 2010. We recorded a net income of Won 14,928 million (US\$12,886 thousand) in 2011 as compared to a net income of Won 3,730 million in 2010 and a net income of Won 6,917 million in 2009. Our gross profit margin decreased to 57.8% in 2011 from 60.1% in 2010 and 63.1% in 2009. Our operating margin decreased to 5.5% in 2011 from 11.3% in 2010 and 18.9% in 2009. The decrease in revenues in 2010 was primarily due to decreased royalties and license fees of Ragnarok Online in Japan and decreased subscription revenues of Ragnarok Online in Korea, the United States and Canada, mainly attributable to Ragnarok Online having reached maturity in such markets. The decrease in subscription revenues of Requiem in Korea, the United States and Canada also contributed to the decrease in overall revenues. The increase in revenues in 2011 was mainly due to (i) the revenues from Dragonica resulting from our acquisition of Gravity Games Corporation, the developer of Dragonica, in October 2010; (ii) the increased revenues from Ragnarok Online in Korea, Taiwan, Hong Kong and Macau, and the United States and Canada; and (iii) the revenues from H.A.V.E. Online, which was commercially launched in March 2011 in the Japanese market. Our cost of revenues for 2011 increased as compared to 2010 primarily due to increase in salaries and commission paid. Our operating expenses for 2011 increased as compared to 2010 mostly due to impairment loss on intangible assets, professional service fees and commission paid, and advertising expenses. Our revenue trend will continue to be materially affected in the future by popularity of online games introduced by our competitors.

Our corporate income tax rate in 2011 was 24.2%.

Table of Contents

Revenues

We derive, and expect to continue to generate, most of our revenues from online game subscription revenue generated in the countries where our games are offered by us and royalties and license fees paid by our licensees in our overseas markets. Our revenues can be classified into the following four categories:

online games subscription revenue;

online games royalties and license fees;

mobile games; and

character merchandising, animation and other revenue.

Online games subscription revenue

Subscription revenues are from micro-transaction, except in Korea, where we also generate subscription fees from Internet cafés. All subscription fees are prepaid. Prepaid online game subscription fees are deferred and recognized as revenue on a monthly basis in proportion to the number of days lapsed or based on actual hours used. Micro-transaction fees are deferred when in-game items are purchased by users and recognized as revenue when the purchased in-game items are used in the games.

Online games royalties and license fees

We license the right to market and distribute our games in various countries for a license fee and receive monthly royalties based on an agreed percentage of the licensees' revenues from our games.

The initial license fees are deferred and recognized ratably as revenue over the license period, which generally does not exceed three years. If license agreements are renewed upon expiration of their terms, we generally receive renewal license fees, which are deferred and recognized ratably over the new license period. The guaranteed minimum royalty payments are deferred and recognized as the relevant royalty is earned. For a table setting forth details of each license agreement, see ITEM 4.B. BUSINESS OVERVIEW OUR MARKETS Overseas markets.

We also receive royalty revenues from our licensees based on an agreed percentage of each of the licensees' revenues from our games. Royalty revenues are recognized on a monthly basis after the licensee confirms its revenues based on the licensee's sales from our games during the month. Our licensees' sales consist of revenues from subscription fees and micro-transaction, except in Russia and CIS countries, the United Arab Emirates and 19 other countries in the Middle East and Northern Africa, and France and 27 other countries in Europe where our game services are only offered with the micro-transaction model. We generally are advised by each of our licensees as to the amount of royalties earned by us from such licensee within 15 to 25 days following the end of each month and we generally receive payments of the royalties within 20 to 30 days following the end of each month.

Mobile games revenue

Mobile games are played using mobile phones and other mobile devices. Mobile game revenues are derived from contract prices and a proportion of the per-download fees that users pay. Contract prices are recognized when the products or services have been delivered or rendered and the customers can begin use in accordance with the contractual terms, and per-download fees are recognized on a monthly basis as they are earned.

Character merchandising, animation and other revenue

We license the right to commercialize or distribute our game characters or animation to third-party licensees in exchange for contract prices. These contract prices are recognized when the products or services have been delivered or rendered and the customers can begin their use in

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accordance with the contractual terms. In addition, we receive royalty payment based on a specified percentage of the licensees' sales.

We also generate revenues from multiplatform game business and sell goods related to mobile phones, such as ornamental accessories and USB data cable.

Table of Contents

The following table sets forth a breakdown of revenues by type of revenue and the percentage of total revenue for the periods indicated.

| Revenue Type | Year Ended December 31, | | | | | |
|--|--------------------------------------|--------|--------------|--------|--------------|--------|
| | 2009 | | 2010 | | 2011 | |
| | (In millions of Won and percentages) | | | | | |
| Online games-subscription revenue | (Won) 12,674 | 22.1% | (Won) 9,908 | 18.9% | (Won) 11,556 | 20.1% |
| Online games-royalties and license fees | 34,037 | 59.3 | 32,132 | 61.4 | 35,552 | 61.8 |
| Mobile games | 7,882 | 13.7 | 9,188 | 17.5 | 9,293 | 16.2 |
| Character merchandising, animation and other revenue | 2,810 | 4.9 | 1,134 | 2.2 | 1,076 | 1.9 |
| Total | (Won) 57,403 | 100.0% | (Won) 52,362 | 100.0% | (Won) 57,477 | 100.0% |

Cost of revenues

Our cost of revenues consists principally of the following:

operational expenses, server depreciation expenses, server maintenance costs and related personnel costs and amortization of development-related costs as described in ITEM 5.A. OPERATING RESULTS CRITICAL ACCOUNTING POLICIES Capitalized software development costs ; and

royalty payments to Mr. Myoung-Jin Lee, for the right to use the storyline and characters from his Ragnarok cartoon series used in our game Ragnarok Online. We paid Mr. Lee an initial license fee of Won 40 million and are required to pay royalties based on 1.0% or 1.5% of adjusted revenues (net of value-added taxes and certain other expenses) or 2.5%, 5% or 10% of net income generated from the use of the Ragnarok brand, depending on the type of revenues received from the operation or licensing of Ragnarok Online.

The cost of revenues from the payments to Mr. Myoung-Jin Lee was Won 446 million for 2010 and Won 453 million (US\$391 thousand) for 2011. This agreement expires in January 2033.

Selling, general and administrative expenses

Selling, general and administrative expenses consist of sales commissions paid to independent promotional agents that distribute our online games to our Internet café subscribers in Korea, commissions paid to payment settlement providers, administrative expenses and related personnel expenses of executive and administrative staff, and marketing and promotional expenses and related personnel expenses.

Research and development expenses

Research and development expenses consist primarily of payroll and other overhead expenses which are all expensed as incurred until technological feasibility of a game is reached. Once technological feasibility of a game is reached, these costs are capitalized and, once commercial operation commences, amortized as cost of revenues. See ITEM 5.A. OPERATING RESULTS CRITICAL ACCOUNTING POLICIES Capitalized software development costs.

Interest expense

We recorded interest expense of Won 58 million (US\$50 thousand) in 2011 as compared to Won 32 million in 2010 and Won 41 million in 2009.

Foreign currency effects

In 2011, 81.8% of our revenues were denominated in foreign currencies, primarily in the U.S. dollar and the Japanese Yen.

Table of Contents

In most of the countries in which our games are distributed, the revenues generated by our overseas subsidiaries and licensees are denominated in local currencies, which include the Japanese Yen, the Euro, the NT dollar, the Thai Baht and the Chinese Yuan. The revenues from those countries, other than the United States, Japan and European countries, are converted into the U.S. dollar for remittance of monthly royalty payments to us. Depreciation of these local currencies against the U.S. dollar will result in reduced monthly royalty payments in the U.S. dollar terms, thereby having a negative impact on our net income.

Although we receive our monthly royalty revenues from our overseas licensees in foreign currencies, primarily in the U.S. dollar and the Japanese Yen, in the case of the United States and Japan, and other local currencies, such as the Euro, the NT dollar, the Thai Baht and the Chinese Yuan in our other principal markets, substantially all of our costs are denominated in Won. We receive monthly royalty payments from our overseas licensees based on an agreed percentage of revenues confirmed and recorded at the end of each month applying the foreign exchange rate applicable on such date. We generally receive these royalty payments 20 to 30 days after the end of each month unless delayed due to extraordinary circumstances. Appreciation or depreciation of the Won against these foreign currencies during this period will result in foreign currency losses or gains and affect our net income.

As of December 31, 2011, 2010 and 2009, we had no foreign currency forward contracts outstanding. See ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Income tax expenses

Income tax benefit was Won 7,962 million (US\$6,873 thousand) in 2011, as compared to income tax expenses of Won 4,207 million in 2010 and Won 4,544 million in 2009.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, contingent liabilities, and revenue and expenses during the reporting period. We evaluate our estimates on an ongoing basis based on historical experience and other assumptions we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The policies discussed below are considered by our management to be critical because they are not only important to the portrayal of our financial condition and results of operations but also because application and interpretation of these policies require both judgment and estimates of matters that are inherently uncertain and unknown. As a result, actual results may differ materially from our estimates.

Revenue recognition

We derive, and expect to continue to generate, most of our revenues from online game subscription revenue generated in the countries where our games are offered by us and royalties and license fees paid by our licensees in overseas markets. Our revenues can be classified into the following four categories: (i) online games subscription revenue; (ii) online games royalties and license fees; (iii) mobile games; and (iv) character merchandising, animation and other revenue. For details, see ITEM 5.A. OPERATING RESULTS OVERVIEW Revenues.

We recognize revenue in accordance with U.S. GAAP, as set forth in Accounting Standard Codification, or ASC 605, *Revenue Recognition* and other related pronouncements.

Allowances for doubtful accounts

We maintain allowances for doubtful accounts receivable for estimated losses that result from the inability of our customers to make the required payments. We base our allowances on the likelihood of recoverability of accounts receivable based on past experience and current collection trends. We record allowances for doubtful accounts based on historical payment patterns of our customers and increase our allowances as the length of time such receivables become past due increases.

Table of Contents

Subsequent to June 2003, pursuant to agreements with various payment processing service providers, the providers are responsible for remitting to us the full subscription revenues generated in Korea after deducting their fixed service fees and charges of approximately 1.4% to 15%. In addition, we do not assume any collection risk since payment processing service providers now bear the risk of loss and delinquencies.

Capitalized software development costs

We account for capitalized software development costs in accordance with ASC 985, *Costs of Software to be Sold, Leased, or Marketed*. Software development costs incurred prior to the establishment of technological feasibility are expensed when incurred and treated as research and development expenses. Once the game has reached technological feasibility, all subsequent software development costs for that product are capitalized until it is available for general release to customers. Technological feasibility is evaluated on a product-by-product basis, but generally occurs once the online game has a proven ability to operate on a multi-player level for a large number of users. After the game is available for general release to customers, the capitalized product development costs are amortized and expensed over the game's estimated useful life. We continually evaluate the reasonableness of the economic life of the capitalized software development costs based on the average life cycle of the games whenever each new game is commercially launched or acquired. Further, when the fair value of an intangible asset is measured by income to be derived from such intangible asset, we consider amortizing such intangible asset following a schedule of when the expected benefits will be consumed or otherwise used up. This expense is recorded as a component of cost of revenues.

We evaluate the recoverability of capitalized software development costs on a product-by-product basis. Capitalized costs for those products whose further development or sale is terminated are expensed in the period at which cancellation of the development or sale of such products occurs. In addition, a charge to operating expenses is recorded when management's forecast for a particular game indicates that unamortized capitalized costs exceed the net realizable value of that asset.

Significant management judgment is required to assess the timing of technological feasibility as well as the ongoing recoverability of capitalized costs.

Impairment of goodwill and other intangible assets

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired in a business combination. As of December 31, 2011, the carrying value of goodwill for each reporting unit, NeoCyon and Gravity Games, are Won 1,210 million (US\$1,044 thousand) and Won 6,267 million (US\$5,410 thousand), respectively.

Goodwill is accounted for under ASC 350, *Intangibles - Goodwill and Other*, which requires that goodwill and indefinite-lived intangible assets no longer be amortized, but instead be tested at least annually for impairment, and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of these assets below their carrying amount.

Such an event would include unfavorable variances from established business plans, significant changes in forecasted results or volatility inherent to external markets and industries, which are periodically reviewed by management. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized immediately in an amount equal to that excess. The goodwill impairment test is carried out at the reporting unit, which is either an operating division or a subdivision, for which stand-alone financial information is available to the management personnel of such division or subdivision for evaluating operating results.

We performed our annual impairment test for goodwill at all of our reporting units using data as of December 31, 2011. In performing the valuations, we used cash flows, which reflected management's forecasts and discount rates which reflect the risks associated with the current market. Prior to performing the two-step

Table of Contents

impairment test for goodwill, we performed a qualitative assessment for the reporting unit of NeoCyon and Gravity Games. Given that the result of prior year impairment analysis indicated that the fair value of the business reporting unit of NeoCyon was significantly greater than its carrying value and the fact that there were no adverse events or circumstances identified which would affect the fair value of the reporting unit of NeoCyon, we concluded not to perform the two-step impairment test for NeoCyon as it is more likely than not that a reporting unit of NeoCyon's fair value is greater than its carrying amount.

Assets and liabilities that make up the reporting unit of NeoCyon has not changed significantly since the 2010 impairment test. The fair value determination completed in 2010 for the reporting unit resulted in amounts that exceeded the carrying amount by a substantial margin. The likelihood that a current fair value determination would be less than the carrying amount of the reporting unit is remote based on analysis of events that have occurred since the fair value assessment was completed in 2010.

In performing the annual impairment test for goodwill for Gravity Games, the fair value of the business reporting unit of Gravity Games was determined to be lower than its book value. Therefore, during the fiscal year ended December 31, 2011, we recorded impairment losses of Won 514 million (US\$444 thousand) in reporting unit of Gravity Games due to the overall decline in the fair value of the reporting unit and uncertainty in the future. The fair value of the reporting unit was estimated principally using the expected present value of the future cash flows.

Product technology, presented as an acquired intangible asset in balance sheets, represents that related to Dragonica which was recognized as a result of a business combination with Gravity Games in 2010. As of December 31, 2011, the carrying value of product technology is Won 6,706 million (US\$5,789 thousand).

Product technology is accounted for under ASC 350, *Intangibles – Goodwill and Other*, which requires that intangible assets subject to amortization shall be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset or asset group may not be recoverable in accordance with ASC 360, *Property, Plant and Equipment*. An impairment loss shall be recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. The carrying value is considered unrecoverable if it exceeds the sum of the undiscounted cash flows anticipated from the use and eventual disposition of the asset. Impairment loss is measured as the amount by which the carrying value of an asset exceeds its fair value.

As the significant decrease in revenue of Dragonica was noted in 2011, which was a trigger event for long-lived assets impairment analysis as of December 31, 2011, we performed the impairment test on Dragonica. As the carrying amount of Dragonica exceeded the sum of the estimated undiscounted future cash flows from the use, Dragonica was considered unrecoverable. Therefore, we recognized an impairment loss of Won 2,384 million since the carrying amount before recognition of impairment loss exceeded its fair value.

The assessment of impairments under ASC 350 and ASC 360 requires significant judgment and requires estimates to assess fair values. We believe that the estimates of future cash flows and fair value used in the impairment tests of goodwill and product technology are reasonable; however, in the future, changes in estimates resulting in lower than currently anticipated cash flows and fair value due to unforeseen changes in business assumptions could negatively affect the valuations, which may result in us recognizing impairment charges for goodwill and other intangible assets in the future. In order to evaluate the sensitivity of the fair value calculations on the impairment analysis performed for the fiscal year ended December 31, 2011, we applied a hypothetical five percent decrease to the fair value of each reporting unit. We believe that plus or minus five percentage difference in cash flow projections or discount rate used would not result in a failure of step one of the goodwill impairment test for the reporting unit of NeoCyon. In addition, the table below shows the sensitivity analysis on the product loss in 2011. The sensitivity has been measured using a hypothetical one percent increase or decrease in revenue growth or discount rate.

| | % Point change | Increase/decrease in fair value | |
|--|----------------|---------------------------------|---------------------------|
| | | Dragonica | Goodwill of Gravity Games |
| (In millions of Won except for percentage point) | | | |
| Discount rate | +/-1% | (115)/121 | (788)/940 |
| Revenue growth | +/-1% | 107/(108) | 238/(231) |

Table of Contents

Impairment of Investments

Our investments are comprised of equity securities accounted for under both the cost and equity methods of accounting. If it has been determined that an investment has sustained an other-than-temporary decline in its value, the investment is written down to its fair value by taking a charge to earnings. We regularly evaluate our investments to identify other-than-temporary impairments of individual securities. We consider the following factors in determining whether an other-than-temporary decline in value has occurred: the length of time and extent to which the market value of the security has been less than its original cost, the financial condition, operating results, business plans, milestones and estimated future cash flows of the investee, and other specific factors affecting the market value.

Fair value measurement on financial instruments

From 2009 to 2010, we invested Won 5,000 million each year in the Equity-Linked Securities fund, or ELS fund, which is comprised of bonds, marketable equity securities and trust funds as of December 31, 2010. These investments are classified as short-term available for sale investments on the balance sheet. The fair value of bonds is derived based on quoted prices in active markets, the fair value of marketable securities is derived based on quoted prices in active exchange markets, and the fair value of the trust funds is derived based on quoted prices in markets that are not active or other inputs that are observable. The trust fund portion of these investments contains an embedded derivative. We have determined it is not practical to bifurcate the embedded derivative and account for separately. In accordance with ASC 825, we have elected the fair value option to account for these investments and have assessed the fair value of the instruments as a whole. In 2011, we sold ELS fund, which was invested in 2010 and public bonds, which were non-current available-for-sale securities.

Income taxes

We account for income taxes under the provisions of ASC 740, *Income Taxes*. Under ASC 740, income taxes are accounted for under the asset and liability method.

Management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and the extent to which deferred tax assets can be realized. A valuation allowance is provided for deferred tax assets to the extent that it is more likely than not that such deferred tax assets will not be realized. Realization of future tax benefits related to the deferred tax assets is dependent on many factors, including our ability to generate taxable income within the period during which the temporary differences reverse, the outlook for the economic environment in which the business operates, and the overall future industry outlook. As of December 31, 2011, we have concluded that the portions of the deferred tax assets of Gravity and all of the deferred tax assets of NeoCyon and Gravity Games are realizable based upon the level of historical and projected net taxable income.

Deferred income taxes as of December 31, 2011 were calculated based on the rate of 22% for fiscal years 2012 and thereafter for the amounts expected to be realized during the relevant fiscal year due to the amendment to the corporate income tax law in Korea.

Recent accounting pronouncements

In October 2009, the Financial Accounting Standards Board, or FASB, issued FASB Accounting Standards Update, or ASU, 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The amendments of this update replaces the term *fair value* in the revenue allocation guidance with *selling price* to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. In conjunction with the FASB's deliberations on ASU 2009-13, the FASB considered whether similar changes should be made to the guidance in ASC 985, Software. The FASB considered whether alternatives for determining *fair value* or *selling price* should also apply to arrangements that have deliverables that are within the scope of ASC 985. The FASB observed that multiple deliverable arrangements in the software industry differ from multiple deliverable arrangements in other industries. As such, the higher threshold of VSOE for purposes of separating software deliverables was retained as was the use of the residual method, where appropriate. Instead, the FASB

Table of Contents

issued ASU 2009-14, *Software (Topic 985) – Certain Revenue Arrangements That Include Software Elements*, which modified the scope of ASC 985 to exclude tangible products and certain software components of tangible products from its scope. The ASUs are effective for the revenue arrangements entered into or materially modified in fiscal year beginning on or after June 15, 2010. The Company adopted these amendments effective in the first quarter of 2011, and the adoption did not impact the Company's financial condition and results of operations as ASC 985 is still applicable for the Company.

In December 2010, the FASB issued ASU 2010-28, *when to perform step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts (a consensus of the FASB Emerging Issues Task Force)*. The ASU modifies step 1 of the goodwill impairment test under ASC 350, *Intangibles – Goodwill and Other*, for reporting units with zero or negative carrying amounts to require an entity to perform step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists and whether an interim goodwill impairment test between annual test dates is necessary, an entity should consider whether there are adverse qualitative factors, including the examples provided in ASC paragraph 350-20-35-30, in determining whether an interim goodwill impairment test between annual test dates is necessary. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, for a public entity. The Company adopted the amendments effective, and the adoption did not impact the Company's financial condition and results of operations.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* to provide largely identical guidance about fair value measurement and disclosure requirements. This standard does not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under IFRS. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. A public entity is required to apply the ASU prospectively for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted for a public entity. In the period of adoption, a reporting entity will be required to disclose a change, if any, in valuation technique and related inputs that result from applying the ASU and to quantify the total effect, if practicable. The Company is currently assessing the potential impact of the guidance.

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment*, to help entities perform their goodwill impairment test in a cost-effective manner. This ASU allows entities the option to perform a qualitative assessment to determine whether it is more likely than not that a reporting unit's fair value is less than its carrying amount prior to performing the two-step impairment test. An entity has the option to either perform a qualitative assessment or by-pass the qualitative assessment and proceed directly to Step 1 of the two-step goodwill impairment test for each of its reporting units. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 with early adoption permitted. The Company has early adopted this ASU and the adoption of ASU 2011-08 had no material impact on the Company's consolidated financial statements.

In June and December 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, and ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. The amended guidance requires an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The current option to report other comprehensive income and its components in the statement of stockholders' equity will be eliminated. Although the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under existing guidance. An entity should apply the ASU retrospectively. For a public entity, these ASUs are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. These ASUs will change our financial statement presentation of comprehensive income but will not impact our net income, financial position, or cash flows.

Table of Contents**RESULTS OF OPERATIONS: 2011 COMPARED TO 2010**

The following table summarizes our results of operations for the periods indicated.

| | 2010 | Year Ended December 31, 2011 | | 2011(1) | % Change |
|---|--------------------|---------------------------------|--------------------|--|-----------------|
| | | | | (Unaudited) | |
| | | | | (In millions of Won and thousands of US\$ except for percentages) | |
| Revenues: | | | | | |
| Online games subscription revenue | (Won) 9,908 | (Won) 11,556 | US\$ 9,975 | | 16.6% |
| Online games royalties and license fees | 32,132 | 35,552 | 30,688 | | 10.6 |
| Mobile games | 9,188 | 9,293 | 8,022 | | 1.1 |
| Character merchandising, animation and other revenue | 1,134 | 1,076 | 928 | | (5.1) |
| Total net revenue | 52,362 | 57,477 | 49,613 | | 9.8 |
| Cost of revenue | 20,873 | 24,243 | 20,926 | | 16.1 |
| Gross profit | 31,489 | 33,234 | 28,687 | | 5.5 |
| Gross profit margin(2) | 60.1% | 57.8% | 57.8% | | |
| Operating expenses: | | | | | |
| Selling, general and administrative | 20,422 | 22,759 | 19,645 | | 11.4 |
| Research and development | 4,652 | 4,136 | 3,570 | | (11.1) |
| Impairment losses on intangible assets | 475 | 3,697 | 3,191 | | 678.3 |
| Gain on loss of control in a subsidiary | | (548) | (473) | | N/M |
| Settlement cost of litigation | | 29 | 25 | | N/M |
| Total operating expenses | 25,549 | 30,073 | 25,958 | | 17.7 |
| Operating income | 5,940 | 3,161 | 2,729 | | (46.8) |
| Operating profit margin(3) | 11.3% | 5.5% | 5.5% | | |
| Other income (expenses): | | | | | |
| Interest income | 1,946 | 1,844 | 1,592 | | (5.2) |
| Interest expense | (32) | (58) | (50) | | 81.3 |
| Foreign currency income, net | 96 | 180 | 155 | | 87.5 |
| Others, net | 312 | (90) | (78) | | N/M |
| Total net other income | 2,322 | 1,876 | 1,619 | | (19.2) |
| Income before income tax expenses (benefit) and equity loss on investments | 8,262 | 5,037 | 4,348 | | (39.0) |
| Income tax expenses (benefit) | 4,207 | (7,962) | (6,873) | | N/M |
| Income before equity loss on investments | 4,055 | 12,999 | 11,221 | | 220.6 |
| Equity loss on investments, net(4) | (345) | (242) | (209) | | (29.9) |
| Net income | 3,710 | 12,757 | 11,012 | | 243.9 |
| LESS: Net loss attributable to the non-controlling interest(5) | (20) | (2,171) | (1,874) | | 10,755.0 |
| Net income attributable to parent company | (Won) 3,730 | (Won) 14,928 | US\$ 12,886 | | 300.2% |

N/M = not meaningful

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.

Table of Contents

- (2) Gross profit margin for each period is calculated by dividing gross profit by total net revenue for each period.
- (3) Operating profit margin for each period is calculated by dividing operating income by total net revenue for each period.
- (4) Represents the losses from our 16.39% equity investment in Online Game Revolution Fund No. 1, our 25% equity investment in Ingamba and our 25% equity investment in Gravity EU SAS. These investments were accounted for using the equity method of accounting.
- (5) Represents the non-controlling interest in NeoCyon, a 96.11% held subsidiary acquired in December 2005 and Gravity Games, formerly Barunson Interactive, a 50.83% held subsidiary acquired in October 2010.

Revenues

Our total revenues increased by 9.8% to Won 57,477 million (US\$49,613 thousand) in 2011 from Won 52,362 million in 2010, primarily due to:

a 16.6% increase in subscription revenue to Won 11,556 million (US\$9,975 thousand) in 2011 from Won 9,908 million in 2010. This 16.6% increase resulted primarily from (i) 23.8% increase in the revenues in Korea to Won 4,740 million (US\$4,091 thousand) in 2011 from Won 3,829 million in 2010 resulting from increased revenues from Ragnarok Online due to our ceasing subscription-based fee model and offering the game with free-to-play servers in November 2010, which only apply micro-transaction model encouraging our users in Korea to play the game without paying subscription fees or buying playing time and to purchase in-game items and (ii) a 25.0% increase in the revenues from Ragnarok Online, Dragon Saga, Requiem and R.O.S.E. Online in the United States and Canada to Won 5,832 million (US\$5,034 thousand) in 2011 from Won 4,664 million in 2010 due mostly to our ceasing subscription-based fee model of Ragnarok Online and offering the game with free-to-play servers in April 2011 and revenues from Dragon Saga, which was commercially launched in October 2010; and

a 10.6% increase in royalties and license fees to Won 35,552 million (US\$30,688 thousand) in 2011 from Won 32,132 million in 2010, which primarily resulted from increased revenues from Dragonica to Won 4,231 million (US\$3,652 thousand) in 2011 from Won 747 million in 2010 resulting from our acquisition of Gravity Games, the developer of Dragonica, in October 2010 and Won 1,106 million (US\$955 thousand) of revenues from H.A.V.E. Online, which was commercially launched in Japan in March 2011. Such increase was partially offset by a 9.4% decrease in the revenues to Won 22,320 (US\$19,266 thousand) in 2011 from Won 24,637 million in 2010 from Ragnarok Online in Japan, due mainly to the fact that Ragnarok Online has reached maturity in the Japanese market and the Japanese users with high loyalty to the game are aging.

Cost of revenues

Our cost of revenues increased by 16.1% to Won 24,243 million (US\$20,926 thousand) in 2011 from Won 20,873 million in 2010, primarily due to:

a 21.1% increase in salaries to Won 11,003 million (US\$9,498 thousand) in 2011 from Won 9,088 million in 2010 primarily resulting from increase in salaries for NeoCyon and Gravity Games. The increase in salaries for NeoCyon of Won 1,050 million (US\$906 thousand) was primarily as a result of the number of staff in service division increasing constantly over the current period. The salaries for Gravity Games in 2010 only reflected the period after our acquisition in October 2010 whereas in 2011 such salaries were reflected for the full year; and

a 40.3% increase in commission paid to Won 3,612 million (US\$3,118 thousand) in 2011 from Won 2,574 million in 2010 mainly attributable to royalty payment for H.A.V.E. Online as a result of its commercial launch in March 2011.

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Such increases in cost of revenues were partially offset by a 17.2% decrease in outsourcing fees for NeoCyon to Won 1,937 million (US\$1,672 thousand) in 2011 from Won 2,339 million in 2010 due to decreased outsourcing fees related to games embedded in mobile phones as well as an increase in in-house game development.

Table of Contents

Gross profit and gross profit margin

As a result of the foregoing, our gross profit increased by 5.5% to Won 33,234 million (US\$28,687 thousand) in 2011 from Won 31,489 million in 2010. Our gross profit margin decreased to 57.8% in 2011 from 60.1% in 2010. The decrease in gross profit margin in 2011 compared with 2010 was primarily due to (i) NeoCyon's expanding business resulting in hiring more employees which caused an increase in the related costs; and (ii) the fact that the lower gross profit margin of Gravity Games was reflected only for the period after the acquisition in October 2010 whereas in 2011 it was reflected for the full year.

Operating expenses

Selling, general and administrative expenses. Our selling, general and administrative expenses increased by 11.4% to Won 22,759 million (US\$19,645 thousand) in 2011 from Won 20,422 million in 2010, primarily due to:

a 52.5% increase in professional service fees and commission paid to Won 4,429 million (US\$3,823 thousand) in 2011 from Won 2,904 million in 2010 primarily resulting from (i) fees and expenses incurred in connection with advisory service for tax and legal consulting service; (ii) certain portion of the license fees for Weapons of the Gods we paid being treated as expenses due to the low likelihood of commercial service of the game; and (iii) increase in payment of gateway fees of Gravity Interactive due to increase in its revenues; and

a 68.4% increase in advertising expenses to Won 3,121 million (US\$2,694 thousand) in 2011 from Won 1,853 million in 2010, which mainly consist of marketing expenses for closed and open beta testing of Kun Woong Online and closed beta testing of Ragnarok Online II, and expenses related to the Ragnarok World Championship held in October 2011.

Such increases in selling, general and administrative expenses were partially offset by a 59.7% decrease in taxes and dues expenses to Won 373 million (US\$322 thousand) in 2011 from Won 925 million in 2010 primarily resulting from a tax examination with respect to transfer pricing adjustments between the actual transaction price and the estimated arm's length price, which did not occur in 2011.

Research and development expenses. Our research and development expenses decreased by 11.1% to Won 4,136 million (US\$3,570 thousand) in 2011 from Won 4,652 million in 2010, due to development expenses for a console game based on one of our online games in 2010, which decreased significantly in 2011. Such decrease in research and development expenses were offset by increased development expenses related to East Road and mobile games.

Impairment loss on intangible assets. We had Won 3,697 million (US\$3,191 thousand) impairment loss on intangible assets in 2011 for capitalized research and development cost of Eternal Destiny, and intangible assets and goodwill of Dragonica.

Operating income and operating profit margin

As a result of the cumulative effects of the reasons stated above, we recorded an operating income of Won 3,161 million (US\$2,729 thousand) in 2011 compared to an operating income of Won 5,940 million in 2010 and our operating profit margin recorded at 5.5% in 2011.

Net other income

Our net other income decreased 19.2% to Won 1,876 million (US\$1,619 thousand) in 2011 from Won 2,322 million in 2010 primarily due to a gain of Won 335 million in 2010 on disposition of available-for-sale securities, which did not occur in 2011.

Income tax expenses

We recorded an income tax benefit of Won 7,962 million (US\$6,873 thousand) in 2011, as compared to an income tax expense of Won 4,207 million in 2010, mostly due to the partial release of deferred tax assets of Gravity. Up to 2010, we had recognized full valuation allowance for the deferred tax assets of Gravity; however, from 2011,

Table of Contents

we concluded that Won 7,937 million (US\$6,850 thousand) or 42% of the deferred tax assets from tax credit carry forwards and Won 2,182 million (US\$1,883 thousand) of net deferred tax assets from the other temporary differences are realizable.

Equity loss on investments

In 2010, equity loss on investments represents the net loss incurred from a 16.39% partnership interest in Online Game Revolution Fund No. 1 and the equity income of Ingamba LLC, in which we invested Russian Ruble 13 million, which represents 25% of Ingamba's total capital. The Company cannot significantly influence the partnership's operation and financial policies under the partnership agreement. However, we account for the investment under the equity method of accounting in accordance with ASC 323, *Investment - Equity Method and Joint Ventures*, which requires the use of the equity method unless the investors' interest is so minor that the limited partner may have virtually no influence over partnership operating and financial policies. The investment in Ingamba is accounted for as an equity method investment. We recorded Won 358 million as equity loss of the partnership of Online Game Revolution Fund No. 1 and Won 13 million as equity income of Ingamba in 2010.

In 2011, equity loss on investments represents the losses from the equity loss of Ingamba and Gravity EU SAS, and the loss incurred from a 16.39% partnership interest Online Game Revolution No. 1. In July 2011, Gravity EU SASU increased its capital stock and as a result of our participation in such capital increase together with Media-Participations Paris SA, Gravity EU SASU was converted into a joint venture company, Gravity SAS, in which our ownership is 25%. Therefore Gravity EU SAS was accounted for by using an equity method since August 2011. We recorded Won 134 million (US\$116 thousand), Won 70 million (US\$60 thousand) and Won 38 million (US\$33 thousand) and as equity loss of Ingamba and Gravity EU SAS, and the partnership of Online Game Revolution Fund No. 1, in 2011, respectively.

On December 31, 2010, the term of the partnership of Online Game Revolution Fund No. 1 expired and it is under liquidation during 2011 and 2012. The partnership had invested in eight games since its operation. We expect that the partnership will be able to sell certain games before the consummation of the liquidation, the remaining disposable assets including cash and receivables will be distributed to each investor of the partnership upon dissolution. We have estimated that the Company's share of such liquidation proceeds will be at least equal to the Company's carrying value of its investments in Online Game Revolution Fund No. 1 at December 31, 2011.

Non-controlling interest

Non-controlling interest represents the net income from NeoCyon, our 96.11%-held subsidiary and Gravity Games, formerly known as Barunson Interactive, our 50.83%-held subsidiary, attributable to third-party minority interest holders. We acquired 96.11% and 50.83% of the voting equity of NeoCyon and Gravity Games in 2005 and 2010, respectively.

Net income attributable to parent company

As a result of foregoing, we recorded a net income attributable to parent company of Won 14,928 million (US\$12,886 thousand) in 2011 compared to a net income attributable to parent company of Won 3,730 million in 2010.

Table of Contents**RESULTS OF OPERATIONS: 2010 COMPARED TO 2009**

The following table summarizes our results of operations for the periods indicated.

| | 2009 | Year Ended December 31, | | % Change |
|--|--------------------|---|-------------------|----------------|
| | | 2010 | 2010(1) | |
| | | (Unaudited) | | |
| | | (In millions of Won and thousands of US\$ except for percentages) | | |
| Revenues: | | | | |
| Online games subscription revenue | (Won) 12,674 | (Won) 9,908 | US\$ 9,030 | (21.8)% |
| Online games royalties and license fees | 34,037 | 32,132 | 29,284 | (5.6) |
| Mobile games | 7,882 | 9,188 | 8,374 | 16.6 |
| Character merchandising, animation and other revenue | 2,810 | 1,134 | 1,034 | (59.6) |
| Total net revenue | 57,403 | 52,362 | 47,722 | (8.8) |
| Cost of revenue | 21,170 | 20,873 | 19,023 | (1.4) |
| Gross profit | 36,233 | 31,489 | 28,699 | (13.1) |
| Gross profit margin(2) | 63.1% | 60.1% | 60.1% | |
| Operating expenses: | | | | |
| Selling, general and administrative | 21,651 | 20,422 | 18,612 | (5.7) |
| Research and development | 1,799 | 4,652 | 4,240 | 158.6 |
| Impairment losses on intangible assets | 280 | 475 | 433 | 69.6 |
| Settlement cost of litigation | 1,649 | | | N/M |
| Total operating expenses | 25,379 | 25,549 | 23,285 | 0.7 |
| Operating income | 10,854 | 5,940 | 5,414 | (45.3) |
| Operating profit margin(3) | 18.9% | 11.3% | 11.3% | |
| Other income (expenses): | | | | |
| Interest income | 2,395 | 1,946 | 1,774 | (18.7) |
| Interest expense | (41) | (32) | (29) | (22.0) |
| Foreign currency income (losses), net | (225) | 96 | 87 | N/M |
| Others, net | (21) | 312 | 283 | N/M |
| Total net other income | 2,108 | 2,322 | 2,115 | 10.2 |
| Income before income tax expenses and equity loss on investments | 12,962 | 8,262 | 7,529 | (36.3) |
| Income tax expenses | 4,544 | 4,207 | 3,835 | (7.4) |
| Income before equity loss on investments | 8,418 | 4,055 | 3,694 | (51.8) |
| Equity loss on investments, net(4) | (1,424) | (345) | (314) | (75.8) |
| Net income | 6,994 | 3,710 | 3,380 | (47.0) |
| LESS: Net income (loss) attributable to the non-controlling interest(5) | 77 | (20) | (18) | N/M |
| Net income attributable to parent company | (Won) 6,917 | (Won) 3,730 | US\$ 3,398 | (46.1)% |

N/M = not meaningful

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,097.25 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2011.

Table of Contents

- (2) Gross profit margin for each period is calculated by dividing gross profit by total net revenue for each period.
- (3) Operating profit margin for each period is calculated by dividing operating income by total net revenue for each period.
- (4) Represents the losses from our 16.39% equity investment in Online Game Revolution Fund No. 1 and the income from our 25% equity investment in Ingamba. These investments were accounted for using the equity method of accounting.
- (5) Represents the non-controlling interest in NeoCyon, a 96.11% held subsidiary acquired in December 2005 and Gravity Games, formerly Barunson Interactive, a 50.83% held subsidiary acquired in October 2010.

Revenues

Our total revenues decreased by 8.8% to Won 52,362 million (US\$47,722 thousand) in 2010 from Won 57,403 million in 2009, primarily due to:

a 21.8% decrease in subscription revenue to Won 9,908 million (US\$9,030 thousand) in 2010 from Won 12,674 million in 2009. This 21.8% decrease resulted primarily from the 22.7% decrease in the revenues in Korea to Won 3,829 million (US\$3,490 thousand) in 2010 from Won 4,951 million in 2009 resulting from decreased revenues from Ragnarok Online, Requiem and Emil Chronicle Online and the 19.4% decrease in the revenues from Ragnarok Online and Requiem in the United States and Canada to Won 4,664 million (US\$4,251 thousand) in 2010 from Won 5,785 million in 2009 due mostly to the fact that Ragnarok Online has reached maturity in the markets;

a 5.6% decrease in royalties and license fees to Won 32,132 million (US\$29,284 thousand) in 2010 from Won 34,037 million in 2009, which primarily resulted from decreased revenues from Ragnarok Online in the Japanese market and the strengthening of the Korean Won by approximately 2.6% against the Japanese Yen from 2009 to 2010, though such decrease was partially offset by a 49.2% increase in the revenues from Ragnarok Online in Taiwan, Hong Kong and Macau driven by the introduction of a renewed version of the game in September 2010 in the region. Royalties and license fees from Ragnarok Online decreased to Won 30,215 million (US\$ 27,536 thousand) in 2010 from Won 33,294 million in 2009 due mostly to the fact that Ragnarok Online has reached maturity in most of our principal markets; and

a 59.6% decrease in character merchandising, animation and other revenue to Won 1,134 million (US\$1,034 thousand) in 2010 from Won 2,810 million in 2009, which resulted primarily from a 69.2% decrease in sales of goods to Won 473 million (US\$431 thousand) in 2010 from Won 1,535 million in 2009 and from a 42.9% decrease in character merchandising revenue to Won 524 million (US\$477 thousand) in 2010 from Won 917 million in 2009.

Such decreases in revenues were partially offset by a 16.6% increase in mobile game revenue to Won 9,188 million (US\$8,374 thousand) in 2010 from Won 7,882 million in 2009. This 16.6% increase resulted primarily from revenues of NeoCyon, mainly due to the increase in sales of games embedded in mobile phones and royalty revenues from mobile games based on Ragnarok Online in the Japanese market.

Cost of revenues

Our cost of revenues decreased by 1.4% to Won 20,873 million (US\$19,023 thousand) in 2010 from Won 21,170 million in 2009, primarily due to:

a 22.4% decrease in amortization on intangible assets to Won 2,048 million (US\$1,866 thousand) in 2010 from Won 2,639 million in 2009 primarily resulting from development costs of Emil Chronicle Online and Requiem being fully amortized in July 2010 and September 2010, respectively. Amortization expense of development costs recorded was Won 1,549 million (US\$1,412 thousand) in

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2010 and Won 2,595 million in 2009; and

a 68.6% decrease in cost of goods sold by NeoCyon to Won 286 million (US\$261 thousand) in 2010 from Won 912 million in 2009. NeoCyon sells goods related to cell phones and decrease in sales of goods in 2010 led to decrease in cost of goods sold.

Table of Contents

Such decreases in cost of revenues were partially offset by:

an 8.8% increase in salaries to Won 9,088 million (US\$8,283 thousand) in 2010 from Won 8,353 million in 2009 primarily resulting from increase in salaries for the headquarters and NeoCyon; and

a 70.0% increase in outsourcing fees for the headquarters and NeoCyon to Won 2,339 million (US\$2,132 thousand) in 2010 from Won 1,376 million in 2009.

Gross profit and gross profit margin

As a result of the foregoing, our gross profit decreased by 13.1% to Won 31,489 million (US\$28,699 thousand) in 2010 from Won 36,233 million in 2009. Our gross profit margin decreased to 60.1% in 2010 from 63.1% in 2009.

Operating expenses

Selling, general and administrative expenses. Our selling, general and administrative expenses decreased by 5.7% to Won 20,422 million (US\$18,612 thousand) in 2010 from Won 21,651 million in 2009, primarily due to:

a 32.5% decrease in commission paid to Won 2,904 million (US\$2,647 thousand) in 2010 from Won 4,300 million in 2009 primarily resulting from recognition of a loss on the guarantee payment made for the development of Ice Age Online in 2009 due to the termination of our license agreement with 20th Century Fox Licensing & Merchandising, which did not occur in 2010; and

a 24.3% decrease in rent expenses to Won 1,522 million (US\$1,387 thousand) in 2010 from Won 2,010 million in 2009, which was mainly due to lower rent expense of office of Gravity Interactive in 2010 in connection with its relocation in October 2009.

Such decreases in selling, general and administrative expenses were offset by:

a 63.0% increase in advertising expenses to Won 1,853 million (US\$1,689 thousand) in 2010 from Won 1,137 million in 2009, which mainly consisted of advertising expenses for Ragnarok Online in Japan, closed and open beta testing of Canaan in August 2010 and in September 2010, and closed beta testing of H.A.V.E Online and War of Gods in November 2010; and

a 181.2% increase in taxes and dues expenses to Won 925 million (US\$843 thousand) in 2010 from Won 329 million in 2009 primarily resulting from a tax examination with respect to transfer pricing adjustments between the actual transaction price and the estimated arm's length price.

Research and development expenses. Our research and development expenses increased by 158.6% to Won 4,652 million (US\$4,240 thousand) in 2010 from Won 1,799 million in 2009, due to development of a console game based on one of our online games, a game for Microsoft's Xbox Live Arcade and social network games, such as Fashion Star. The increase also partly resulted from research and development expenses of Gravity Games, formerly Barunson Interactive, in which controlling financial interest was acquired by the Company on October 21, 2010.

Impairment loss on intangible assets. We had Won 475 million (US\$433 thousand) impairment loss on intangible assets in 2010 for capitalized research and development cost of Canaan.

Settlement cost of litigation. Our settlement cost of litigation decreased to nil in 2010 from Won 1,649 million in 2009. See ITEM 8.A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION - LEGAL PROCEEDINGS.

Operating income and operating profit margin

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As a result of the cumulative effects of the reasons stated above, we recorded an operating income of Won 5,940 million (US\$5,414 thousand) in 2010 compared to an operating income of Won 10,854 million in 2009 and our operating profit margin recorded at 11.3% in 2010.

Table of Contents**Net other income**

Our net other income increased 10.2% to Won 2,322 million (US\$2,115 thousand) in 2010 from Won 2,108 million in 2009 primarily due to a gain of Won 335 million (US\$305 thousand) in 2010 on disposition of available-for-sale securities.

Income tax expenses

We recorded an income tax expense of Won 4,207 million (US\$3,835 thousand) in 2010, as compared to an income tax expense of Won 4,544 million in 2009. The decrease of income tax expense is mainly due to the decrease of foreign withholding tax for overseas royalties and license fees. In assessing the realizability of deferred tax assets, we considered whether it was more likely than not that some portion or all of the deferred tax assets would not be realized. However, it is possible that these income tax expenses could be treated as income tax benefit if any taxable income becomes realizable in the future. For the year ended December 31, 2010, we recorded a full valuation allowance on net deferred tax assets of Gravity and its subsidiaries except NeoCyon and Gravity Games, as we determined that it was more likely than not that such net deferred tax assets would not be realizable in the near future.

Equity loss on investments

In 2009, equity loss on investments represents the 16.39% of the net loss incurred from a 16.39% partnership interest in Online Game Revolution Fund No. 1. The Company cannot significantly influence the partnership's operation and financial policies under the partnership agreement. However, the Company accounts for the investment under the equity method of accounting in accordance with ASC 323, *Investment Equity Method and Joint Ventures*, which requires the use of the equity method unless the investors' interest is so minor that the limited partner may have virtually no influence over partnership operating and financial policies. The Company recorded Won 1,424 million as equity loss of the partnership in 2009. In 2010, equity loss on investments represents the 16.39% of the net loss incurred from a 16.39% partnership interest in Online Games Revolution Fund No. 1 and the equity income of Ingamba LLC, in which we invested Russian Ruble 13 million, which represents 25% of Ingamba's total capital, in June 2010 in order to distribute our games in Russia. The investment in Ingamba was accounted for as an equity method investment. The Company recorded Won 358 million (US\$ 326 thousand) as equity loss of the partnership of Online Game Revolution Fund No. 1 and Won 13 million (US\$ 12 thousand) as equity income of Ingamba in 2010. On December 31, 2010, the term of the partnership of Online Game Revolution No. 1 expired and it is under liquidation during 2011. The partnership had invested in eight games since its operation. The Company is expecting that the partnership will be able to sell certain games before the consummation of the liquidation, the remaining disposable assets including cash and receivables will be distributed to each investor of the partnership upon dissolution. The Company has estimated that the Company's share of such liquidation proceeds will be at least equal to the Company's carrying value of its investment in the Fund at December 31, 2010.

Non-controlling interest

Non-controlling interest represents the net income from NeoCyon, our 96.11%-held subsidiary and Gravity Games, formerly known as Barunson Interactive, our 50.83%-held subsidiary, attributable to third-party minority interest holders. We acquired 96.11% and 50.83% of the voting equity of NeoCyon and Gravity Games in 2005 and 2010, respectively.

Net income attributable to parent company

As a result of foregoing, we recorded a net income attributable to parent company of Won 3,730 million (US\$3,398 thousand) in 2010 compared to a net income attributable to parent company of Won 6,917 million in 2009.

Table of Contents**ITEM 5.B. LIQUIDITY AND CAPITAL RESOURCES****Liquidity**

The following table sets forth the summary of our cash flows for the periods indicated:

| | 2009 | Year Ended December 31, | | 2011(1) (Unaudited) |
|--|--|-------------------------|--------------|------------------------|
| | | 2010 | 2011 | |
| | (In millions of Won and thousands of US\$) | | | |
| Cash and cash equivalents at beginning of period | (Won) 53,168 | (Won) 51,333 | (Won) 44,122 | US\$ 38,085 |
| Net cash provided by operating activities | 15,861 | 8,388 | 1,179 | 1,016 |
| Net cash used in investing activities | (17,550) | (15,873) | (2,793) | (2,410) |
| Net cash provided by (used in) financing activities | (55) | 275 | (168) | (145) |
| Effect of exchange rate changes on cash and cash equivalents | (91) | (1) | 90 | 79 |
| Net decrease in cash and cash equivalents | (1,835) | (7,211) | (1,692) | (1,460) |
| Cash and cash equivalents at end of period | (Won) 51,333 | (Won) 44,122 | (Won) 42,430 | US\$ 36,625 |

Note:

(1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,158.50 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on December 30, 2011.

Prior to the commercial launch of Ragnarok Online in August 2002, our principal sources of liquidity were cash from equity financing and incurrence of debt, including the debt we incurred from YNK Korea. Following the commercial launch of Ragnarok Online, our principal sources of liquidity have been cash flows from our operating activities and equity financing and, to a lesser extent, short-term borrowings. Net cash used in investing activities has consisted primarily of investments in acquisition of interests in companies which develop online games or which provide related products and services. However, our net property and equipment increased from Won 2,672 million as of December 31, 2010 to Won 2,731 million (US\$2,357 thousand) as of December 31, 2011 mainly due to the purchase of property and equipment amounting to Won 1,566 million (US\$1,351 thousand). This increase is partially offset by depreciation of property and equipment totaling Won 1,651 million (US\$1,425 thousand).

Our cash investment policy emphasizes liquidity and preservation of principal over other portfolio considerations. We deposit our cash in demand deposits, short-term financial instruments, which primarily consist of time deposits with maturity of one year or less, and money market funds with a rolling maturity of 90 days or less. Our short-term financial instruments decreased from Won 16,000 million as of December 31, 2009 to Won 12,500 million as of December 31, 2010 and increased to Won 15,000 million (US\$12,948 thousand) as of December 31, 2011. The decrease in our short-term financial instruments in 2010 primarily resulted from use of proceeds from such financial instruments in connection with working capital requirements and other expenses and the increase in our short-term financial instruments in 2011 resulted from increase in income from our business.

The Company generates cash primarily through royalties and license fees, and subscription fees from our online games in various countries as described in ITEM 5.A. OPERATING RESULTS OVERVIEW Revenues. The level of popularity of our games in the market place is a key factor in how much cash we can generate. Most of our cash disbursements relate to internal costs such as salaries and other overhead costs for game servicing, other selling, general and administrative activities, and R&D activities.

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Cash flows from operating activities. The decrease in net cash provided by our operating activities in 2011 as compared to 2010 reflected an adjustment of (i) Won 5,987 million (US\$5,168 thousand) in other assets mostly consisting of a deposit in the court amounting to Won 4,140 million made in November 2011 with regards to the

Table of Contents

litigation filed by a former executive claiming our unauthorized withdrawal of funds from a subsidiary; (ii) Won 2,494 million (US\$2,153 thousand) in deferred revenue; and (iii) Won 1,366 million (US\$1,179 thousand) in accounts payable. This decrease was partially offset by Won 3,697 million (US\$3,191 thousand) for impairment losses on intangible assets. The decrease in net cash provided by our operating activities from 2009 to 2010 was primarily the result of decrease in net income from 2009 to 2010. Our decrease in net cash provided by our operating activities in 2010 as compared to 2009 reflected an adjustment of (i) Won 814 million in accrued expenses; and (ii) Won 498 million in deferred revenue. This decrease was partially offset by Won 3,708 million for depreciation and amortization and change in account receivables of Won 1,213 million.

Cash flows from investing activities. Net cash used in investing activities in 2011 was decreased as compared to 2010 because there was no business acquisition and purchase of available-for-sale investments in 2011, which incurred cash outflow of Won 11,277 million and Won 5,000 million in 2010, respectively. Our decrease in net cash used in investing activities in 2010 as compared to 2009 reflected Won 3,500 million for decrease in short-term financial instruments. This cash flow was partially offset by (i) Won 5,092 million for purchase of intangible assets; and (ii) Won 11,277 million for business acquisition of Gravity Games.

Cash flows from financing activities. The increase in net cash used in our financing activities in 2011 as compared to 2010 reflected repayments of borrowings of Won 168 million (US\$145 thousand). Our increase in net cash provided by financing activities in 2010 as compared to 2009 reflected proceeds from borrowings of Won 418 million. This increase was offset by repayments of borrowings of Won 143 million.

Capital resources

As our overseas operations are conducted primarily through our subsidiaries and our overseas licensees, our ability to finance our operations and any debt that we or our subsidiaries may incur depends, in part, on the payment of royalties and other fees by our overseas licensees and, to a lesser extent, the flow of dividends from our subsidiaries.

As of December 31, 2011, our primary source of liquidity was Won 42,430 million (US\$36,625 thousand) of cash and cash equivalents. We believe that our available cash and cash equivalents and net cash provided by operating activities will be sufficient to meet our capital needs through at least the first quarter of 2013. However, we cannot assure you that our business or operations will not change in a manner that would consume available capital resources more rapidly than anticipated. We may require additional cash resources due to changed business conditions or other future developments, including any significant investments or acquisitions. If these sources are insufficient to satisfy our cash requirements, we may seek to sell additional securities either in the form of equity or debt. In the past, we raised cash resources through the issuance of common shares. The sale of additional equity securities or convertible debt securities could result in additional dilution to our shareholders. In addition, we may seek to incur indebtedness through the issuance of debt securities or by obtaining a credit facility. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financial covenants that would restrict operations.

As of December 31, 2011, Gravity Interactive, our subsidiary in the United States, has issued an irrevocable letter of credit in the amount of US\$250,000 to its landlord in relation to its lease agreement, with no amount drawn. A short-term investment valued at US\$250,000 was provided to a bank as collateral for this letter of credit.

We expect to have capital expenditure requirements for the ongoing expansion into other markets, including expenditures for expanding and upgrading our existing server equipment continuously, for developing new games internally, for acquiring and publishing third party games, or for investing in enhancing our technological, marketing, distributing and servicing capabilities. We believe that our internal cash flow from operations, together with our proceeds from our initial public offering in February 2005 will be sufficient to satisfy our working capital requirements through at least the first quarter of 2013, including our new game development expenditures.

ITEM 5.C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC

To remain competitive, we have continued to focus on our research and development efforts. Our research and development efforts and plans consist of the following:

Strategy and planning overall game design and review of technical feasibility, market feasibility and the game development process;

Table of Contents

Graphics designing game characters and game environments, with the objective of optimizing the overall gaming experience;

Server programming server design and development, handling interconnections, validation, security, character data and game process coordination and facilitating online communication among players; and

Client programming enhancing the visual and sound experience and movement simulation of game characters.

Our research and development expenditures were Won 1,799 million, Won 4,652 million and Won 4,136 million (US\$3,570 thousand) in 2009, 2010 and 2011, respectively. Our research and development expenses increased significantly in 2010 as investments in new games increased in 2010. Our research and development expenses decreased as development expenses for a console game based on one of our online games in 2010 decreased significantly in 2011.

See ITEM 4.B. BUSINESS OVERVIEW GAME DEVELOPMENT AND PUBLISHING for our research and development and ITEM 4.B. BUSINESS OVERVIEW INTELLECTUAL PROPERTY for our intellectual property.

ITEM 5.D. TREND INFORMATION

Trends, uncertainties and events which could have a material impact on our sales, operating revenues and liquidity and capital resources are discussed above in ITEM 5.A. OPERATING RESULTS and ITEM 5.B. LIQUIDITY AND CAPITAL RESOURCES.

ITEM 5.E. OFF-BALANCE SHEET ARRANGEMENTS

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditure or capital resources that are material to investors.

ITEM 5.F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table sets forth a summary of our contractual cash obligations due by period as of December 31, 2011.

| | Total | Payments Due by Period | | | |
|-----------------------------|--------------------|------------------------|------------------|--------------|----------------------|
| | | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
| | | (In millions of Won) | | | |
| Capital lease obligations | (Won) 384 | (Won) 232 | (Won) 152 | (Won) | (Won) |
| Operating lease obligations | 2,674 | 2,674 | | | |
| Purchase obligations | 1,452 | 1,452 | | | |
| Accrued severance benefits | 916 | | | | |
| Total | (Won) 5,426 | (Won) 4,358 | (Won) 152 | (Won) | (Won) |

Long-term debt obligations. We have financed our operations primarily through incurrence of debt from financial institutions, cash flows from operations as well as equity investments by our founder and current shareholders. As such, there are currently no long-term debt obligations.

Capital lease obligations. In December 2007, Gravity Interactive entered into a capital lease agreement with respect to the open beta testing server for the commercial distribution of Requiem, with a total lease payment of US\$270,666, over a period of two years. In 2008, this capital lease agreement was amended, thereby decreasing the total lease payment by US\$139,760 to US\$130,906. We also entered into additional capital lease agreements to utilize more assets including servers during the year, which increased the total capital lease payment by US\$123,195,

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US\$326,440 and US\$92,610 in 2009, 2010 and in 2011, respectively. In 2008, we made principal and interest payments of US\$79,811 and US\$26,082, respectively. In 2009, we made principal and interest payments of US\$152,656 and US\$32,616, respectively. In 2010, we made principal and interest payments of US\$123,978 and US\$27,879, respectively. In 2011, we made principal and interest payments of US\$151,370 and US\$52,425, respectively.

Table of Contents

Operating lease obligations. With respect to our operating lease obligations, the lease payments due by December 31, 2012 are Won 2,213 million and Won 461 million for our principal offices in Seoul, offices for our subsidiary in the United States. The lease terms expire in December 2012 and November 2012 for our principal offices in Seoul, offices for our subsidiary in the United States, respectively. The renewal terms in all of the leases are subject to market conditions.

Purchase Obligations. In September 2010, we entered into an agreement with Shanghai Nineyou Interactive Community and Media Co., Ltd., and its two affiliates, Shanghai Nineshine Information Technology Co., Ltd. and HitNorth International Limited, to publish Weapons of the Gods, a game being developed by HitNorth International Limited. As of December 31, 2011, the game is under development, and we treated certain portion of the license fee we paid as expenses due to the low likelihood of successfully commencing commercial service of the game. We are to pay the remaining license fee in installments based on the progress of development of the game. In February 2011, we entered into an agreement with X-Legend Entertainment Co., Ltd. to publish Finding Neverland Online. As of December 31, 2011, the game is under localization and preparation for beta testing, and we have booked certain portion of the license fee we paid as advance payment. We are to pay the remaining license fee in installments based on the progress of development of the game. In December 2011, we entered into an agreement to publish a Web browser-based game. As of December 31, 2011, the game is under preparation for development, and we have booked certain portion of the license fee we paid as advance payment. We are to pay the remaining license fee in installments based on the progress of development of the game.

Uncertain tax position. The Company assessed uncertain tax positions and measured unrecognized tax benefits for open tax years in accordance with ASC 740, *Income Taxes*. The Company's policy is that it recognizes interest expenses and penalties related to income tax matters as a component of income tax expense. Accordingly, the company assesses its income tax positions and records tax benefits for all years subject to examinations based upon the evaluation of the facts, circumstances and information available at that reporting date. For those tax positions for which it is more likely than not that a tax benefit will be sustained, the company records the amount that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. If the company does not believe that it is more likely than not that a tax benefit will be sustained, no tax benefit is recognized. Based on the approach above, the company assessed the uncertain tax positions and did not record any unrecognized tax benefits as the company believes that it is more likely than not that there will not be any unrecognized tax benefits.

Accrued severance benefits. Employees and executive officers with one year or more of service are entitled to receive a lump-sum payment upon termination of their employment with us based on the length of service and their rate of pay at the time of termination. The annual severance benefits expense charged to operations is calculated based upon the net change in the accrued severance benefits payable at the balance sheet date based on the guidance of ASC 715, *Compensation-Retirement Benefits*. As severance benefits have no specific maturities, they are not allocated to the table that sets forth a summary of our contractual cash obligations due by period as of December 31, 2011.

Other Commitments and Liabilities

For a description of our commercial commitments and contingent liabilities, see Note 13 to our consolidated financial statements included in this annual report. For a description of our legal proceedings, see ITEM 8.A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION LEGAL PROCEEDINGS.

ITEM 5.G. SAFE HARBOR

See FORWARD-LOOKING STATEMENTS.

Table of Contents**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****ITEM 6.A. DIRECTORS AND SENIOR MANAGEMENT**

The following table sets forth certain information relating to our directors and executive officers as of March 31, 2012. The business address of all of our directors and executive officers is our registered office at Nuritkum Square Business Tower 15F, 1605 Sangam-Dong, Mapo-Gu, Seoul 121-795, Korea.

| Name | Age | Position |
|--------------------|------------|--|
| Hyun Chul Park | 39 | Chief Executive Officer |
| Yoshinori Kitamura | 44 | Chairman of the Board of Directors and Chief Operating Officer |
| Heung Gon Kim | 46 | Chief Financial Officer |
| Kazuki Morishita | 38 | Executive Director |
| Kazuya Sakai | 47 | Executive Director |
| Jong Gyu Hwang | 42 | Independent Director |
| Doo Hyun Ryu | 51 | Independent Director |
| Jung Yoo | 51 | Independent Director |

Hyun Chul Park has served as our Chief Executive Officer since March 2011 and was an officer of our corporate management office from May 2009 to March 2011. Mr. Park has also been a Director of Gravity Games, formerly Barunson Interactive, since October 2010. He has been a Director and Chief Operating Officer of NeoCyon since December 2009 and April 2012, respectively, and was Chief Strategy Officer of NeoCyon from October 2010 to March 2012. He has been general manager of International Business Division at GungHo Online Entertainment, Inc. since September 2007. He worked as a general manager of Content Producing Department of SEGA Networks (China) Co., Ltd. from July 2005 to September 2007 and a manager of Asia Division at SEGA Corporation from April 2004 to July 2005. He was a manager of Overseas Marketing Team at ActozSoft Co., Ltd. from October 2002 to March 2004 and at Siementech Co., Ltd. from October 2001 to October 2002. He worked at Engineer Team of Toyota Vista Tokyo Co., Ltd. from April 1998 to July 2001. Mr. Park obtained an associate degree in Automotive Engineering from Tokyo College of Technology, currently, Tokyo College of Automotive Technology.

Yoshinori Kitamura has served as our Executive Director since March 2008, Chief Operating Officer since June 2008 and Chairman of the Board of Directors since April 2011. Mr. Kitamura has also been a Director and Chief Executive Officer of NeoCyon since October 2008 and since October 2009, respectively, and a Director of Gravity Games, formerly Barunson Interactive, since October 2010 and a Director of Gravity EU SAS since July 2011. He has been Chief Executive Officer of Gravity Entertainment and Gravity Interactive since March 2008 and July 2008, respectively. Mr. Kitamura has also been a Director and Executive General Manager of International Business Division at GungHo Online Entertainment, Inc. since March 2006 and June 2007, respectively, and was an Executive General Manager of the Marketing Division at GungHo Online Entertainment, Inc. from February 2003 to June 2007. He worked as a Director of GungHo Online Entertainment Korea, Inc. and GungHo Works, Inc. from March 2007 to October 2008 and from March 2008 to June 2008, respectively. Mr. Kitamura was a Director of L5 Games Inc. from July 2008 to its liquidation in August 2008. Mr. Kitamura also worked at NC Japan K.K. as marketing manager from January 2002 to January 2003 and ICC Corporation as business development manager from September 1999 to December 2001. Mr. Kitamura holds a bachelor's degree in English Language and Literature from Bunkyo University.

Heung Gon Kim has served as our Chief Financial Officer since September 2008. Mr. Kim has also been Chief Financial Officer and a Director of Gravity Interactive since June 2009 and March 2011, respectively. Mr. Kim has been a Director of Gravity Games, formerly Barunson Interactive, since October 2010 and a Director of Gravity Entertainment since March 2011. He has been a Director and Chief Financial Officer of NeoCyon since March 2011 and May 2011, respectively. Mr. Kim was a general manager of our financial management division and accounting & treasury department from March 2007 to September 2008 and from September 2006 to March 2007, respectively. He also worked as a manager of our accounting team from April 2004 to September 2006. Mr. Kim worked at Modottel, Inc. as accounting team manager from June 2002 to April 2004. Mr. Kim holds a bachelor's degree in Accounting from Chungang University.

Table of Contents

Kazuki Morishita has served as our Executive Director since March 2008. Mr. Morishita has also been the President and Chief Executive Officer of GungHo Online Entertainment, Inc. since January 2004 and was Chief Operating Officer of GungHo Online Entertainment, Inc. from August 2002 to January 2004. In addition, he has been a director of Acquire Corp. since October 2011 and he was a director of Game Arts Co., Ltd. from December 2005 to March 2008 and has been the President of Game Arts Co., Ltd. since March 2008. Mr. Morishita was the Chairman of GungHo Works, Inc. from October 2007 to December 2009 and a Director of GungHo Online Entertainment Korea, Inc. from March 2007 to October 2008. He also was a general manager of the E-service department at OnSale, Inc. from May 2001 to August 2002. Mr. Morishita served as Director of Kickers Network, Inc. from December 2000 to April 2001 and as Director of Dolphin Net, Inc. from March to November in 2000. Mr. Morishita worked as chief of the system sales department at Softcreate Co., Ltd. from July 1996 to February 2000. Mr. Morishita graduated from High School affiliated with Chiba University of Commerce.

Kazuya Sakai has served as our Executive Director since March 2009. Mr. Sakai has also served as Chief Financial Officer, Director and Investor Relations Officer of GungHo Online Entertainment, Inc. since April 2004, March 2005 and July 2011, respectively. He has also been the auditor of Acquire Corp. since October 2011 and was a Director of Gravity Entertainment from March 2008 to March 2011. Mr. Sakai was Chief Executive Officer of Capri, Inc. from October 2008 to December 2009. Mr. Sakai was a Director of GungHo Works, Inc. from October 2007 to December 2009. Mr. Sakai was a Director of GungHo Online Entertainment Korea, Inc. from March 2007 to October 2008 and Chief Executive Officer in October 2008 to its liquidation in October 2008. He was Chief Executive Officer of GungHo Asset Management, Inc. from January 2007 to October 2008. Mr. Sakai served as a general manager of Administration Division, Director and Chief Executive Officer of Expression Tools, Inc. from January 1993 to March 1996, from April 1996 to April 2000, and from April 2000 to November 2003, respectively. He worked at The Kyushu Sogo Bank, Ltd., currently, The Shinwa Bank, Ltd., from April 1987 to December 1992. Mr. Sakai graduated from Kyushu Sangyo University with a bachelor's degree in Commerce.

Jong Gyu Hwang has served as our Independent Director since June 2009. Mr. Hwang has served as a Director and Chief Operating Officer at Mungyung Monorail, a wholly-owned subsidiary of Korea Monorail, since 2007. He has also served as Compliance Auditor at E-Frontier, Inc. since 2000 and as Auditor at Korea Urban Railway Association since 2009. Mr. Hwang served as a Director of Korea Monorail from 2006 to 2007 and worked as an attorney at Attorney General's Office in Massachusetts in the United States in 2005. He was also an investigation officer of Special Investigation Department at Seoul Central District Prosecutors' Office of the Ministry of Justice of Korea from 1995 to 2000 and worked at the Korean Residents Union in Japan from 1994 to 1995. Mr. Hwang received an LL.B. degree from Tokyo University and an M.P.A. degree from Kennedy School of Government at Harvard University. Mr. Hwang also received an LL.M. degree from Boston University School of Law. Mr. Hwang is a member of the New York State Bar Association.

Doo Hyun Ryu has served as our Independent Director since March 2011. Mr. Ryu has been a Partner, and the head of International Legal and Business Affairs Team since May 2001 and a branch manager of the Vietnam Office of Logos Law, LLC since May 2010. He has served as an arbitrator of the Korean Commercial Arbitration Board since June 2011. He has also been a member of Legal Services Development Committee of the Korean Bar Association since March 2005. Mr. Ryu was a head of Management & Legal Department at Hyundai Card Co., Ltd. and Hyundai Capital Services, Inc. from May 2008 to April 2010 and a member of Information Department Committee at Hyundai Motor Group from June 2008 to April 2010. He worked as Compliance Officer of Financial Department of the Federation of Korean Industries from June 2008 to April 2010 and a member of the Special Committee for Revision of Credit-Specialized Financial Business Act at the Financial Services Commission of Korea from October 2008 to January 2010. Mr. Ryu was an Independent Director of Interactivy, Inc. from April 2007 to May 2008. He was a member of Korea IT International Cooperation Agency from August 2006 to May 2008 and a member of Readers Committee of the Korea JoongAng Daily from October 1999 to October 2000. Mr. Ryu is a member of the Korea Bar Association. Mr. Ryu obtained an LL.B. degree from Seoul National University. Mr. Ryu also completed an Advanced Economists Program at the graduate school of Economics of Yonsei University.

Jung Yoo has served as our Independent Director since March 2011. Mr. Yoo has been Representative Partner of Samhasa GP since June 2007 and a member of the Board of Trustees of Euidang Foundation since August 2007. He was an Advisor of TCAD International, Inc. from March 2008 to March 2010 and an Independent Director of

Table of Contents

NHN Japan Corporation from September 2004 to April 2006. Mr. Yoo was a Managing Director of PCCW Japan Ltd., which changed to Jaleco Ltd. in January 2004, from June 2000 to March 2007. He was a Partner of Pacific Cyber-Venture Co., Ltd. from June 2000 to August 2002 and a Director of Techno-Venture Co., Ltd. from June 2000 to August 2002. Mr. Yoo worked at Credit Suisse Trust and Banking Co., Ltd. from August 1998 to March 2000, Bain & Company Japan, Inc. from August 1996 to May 1998 and SK Securities Co., Ltd. from September 1991 to November 1994. Mr. Yoo received a B.A. degree in East Asian Languages and Cultures from University of Southern California, an M.A. degree in Management History from Waseda University and an MBA degree from INSEAD.

ITEM 6.B. COMPENSATION

We have not extended any loans or credit to any of our directors or executive officers, and we have not provided guarantees for borrowings by any of these persons. For the year ended December 31, 2011, the aggregate amount of compensation paid by us to all directors and executive officers was Won 1,349 million (US\$1,164 thousand). At our general meeting of shareholders held on March 27, 2012, our shareholders approved an aggregate amount of up to Won 1,400 million (US\$1,208 thousand) as compensation for our directors for 2012.

Under the Labor Standard Act and the Employee Retirement Benefit Security Act, we are required to pay a severance amount to eligible employees, who voluntarily or involuntarily terminate their employment with us, including through retirement. The severance amount for our officers equals the monthly salary at the time of his or her departure, multiplied by the number of continuous years of service. There is no severance benefit for our directors.

We maintain a directors and officers liability insurance policy covering certain potential liabilities of our directors and officers.

**ITEM 6.C. BOARD PRACTICES
CORPORATE GOVERNANCE PRACTICES**

Our ADSs are listed on the NASDAQ stock market and we are subject to the NASDAQ listing requirements applicable to foreign private issuers. NASDAQ's corporate governance practice rules provide that a foreign private issuer may elect to follow its home country practices in lieu of the requirements under NASDAQ Marketplace Rule 5600 Series, subject to certain exceptions and to the extent such practices are not prohibited by home country law. The home country practices that we follow in lieu of NASDAQ Marketplace Rule 5600 Series are described below, including certain new rules that we have been following since the amendment to the Korean Commercial Code went into effect on April 15, 2012:

Under Korean law, we are not required to have a board of directors which must be composed of a majority of independent directors. Our Board of Directors is currently composed of a total of 7 directors, three of whom are independent directors.

Under Korean law, we are not required to have the director nomination committee and compensation committee composed solely of independent directors. However, we established a director nomination committee and a compensation committee in accordance with our articles of incorporation. Our director nomination committee and compensation committee are currently each composed of two non-independent directors and one independent director.

Under Korean law, independent directors are not required to have regularly scheduled meetings at which only independent directors are present. However, our audit committee, which is composed solely of three independent directors, generally holds meetings once a month whenever there are matters related to financial results of the Company, related party transactions or others.

In lieu of the requirement that shareholder approval be obtained prior to an issuance of securities in connection with (i) the acquisition of the stock or assets of another corporation; (ii) equity-based compensation of officers, directors, employees or consultants; (iii) a change of control; and (iv) private placements, as specified in NASDAQ Marketplace Rule 5635, we require a resolution to be adopted at the

general meeting of

Table of Contents

shareholders when necessary under Korean law, including, for example, if an issuance of securities is related to the acquisition of all or a part of the business of another corporation which significantly affects the business of the Company.

In lieu of the requirement that copies of an annual report be delivered to shareholders within a reasonable time following the filing of the annual report with the SEC, our business report prepared under Korean law, and financial statements prepared in accordance with Korean GAAP, are made available to shareholders one week before the day of the annual general meeting of shareholders and presented to shareholders at the ordinary general meeting of shareholders. Moreover, such documents as well as our annual report on Form 20-F, once available, may be viewed at our principal or branch office by any of our shareholders making such a request and are also delivered to any shareholder making a request for delivery. Under Korean law, we are not required to prepare quarterly or interim reports. We furnish our quarterly financial statements prepared in accordance with U.S. GAAP on Form 6-K with the SEC.

Under Korean law, we are not required to solicit proxies nor provide proxy statements in connection with any general meeting of shareholders. For shareholders holding only our common shares, we do not solicit proxies from nor provide proxy statements to such shareholders. For holders of our ADSs, our depository, The Bank of New York Mellon, provides proxy statements to, and solicits proxies from, such holders, which proxies will be voted by the Korea Securities Depository on behalf of the holders at the general meeting of shareholders.

Under Korean law, the following categories of individuals or entities are required to make a disclosure to our board of directors and receive the approval of two-thirds or more of the incumbent directors before entering into a transaction with us:

- (i) A director or major shareholder (a shareholder who owns 10% or more of the outstanding voting shares or has influence over major management decisions such as the appointment and removal of directors or auditors);
- (ii) A spouse, direct ancestor or direct descendant of a director or a major shareholder;
- (iii) A direct ancestor or direct descendant of a spouse of a director or a major shareholder;
- (iv) An entity, of which 50% or more of the voting power, individually or in the aggregate, is held by one or more individuals described in (i) through (iii), or any subsidiary of such entity; or
- (v) An entity, of which 50% or more of the voting power, in the aggregate, is held by the combination of one or more individuals described in (i) through (iii) and the entity described in (iv).

Under Korean law, a director may not usurp a business opportunity for its own or third-party's benefit, except upon the approval of two-thirds or more of the incumbent directors.

Under Korean law, the resolution for the removal of members of the audit committee shall be adopted at a meeting of the Board of Directors by approval of two-thirds or more of the incumbent directors.

Under Korean law and our amended articles of incorporation, if a director intentionally or negligently performs an act in violation of the applicable laws and regulations or the articles of incorporation or neglects his or her duties, such director shall be liable for damages to the company. However, unless a director causes damage to the company by willful misconduct or gross negligence, his or her liability will be limited by an applicable exemption of, in the case of a non-independent director, any liability which exceeds six times his

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compensation (including bonuses and benefits from exercise of stock options) for the past one year from the date on which the director caused such damage, and, in the case of an independent director, any liability which exceeds three times his compensation (including bonuses and benefits from exercise of stock options) for the past one year from the date on which the director caused such damage.

Under Korean law and our amended articles of incorporation, the audit committee may, if necessary, demand that the chairman of the Board of Directors convene a meeting of the Board of Directors, and if the chairman fails to convene a meeting without delay, the audit committee may directly convene a meeting of the Board of Directors.

Table of Contents

Under Korean law and our amended articles of incorporation, the general meeting of shareholders shall, in principle, have the authority to provide final approval of our financial statements and dividends. However, our Board of Directors may choose to have final approval of our financial statements and dividends if (i) an external auditor gives an unqualified opinion to the financial statements and (ii) all members of the audit committee unanimously agree.

BOARD OF DIRECTORS

Our Board of Directors has the ultimate responsibility for the administration of our affairs. Our articles of incorporation, as currently in effect, provide for a Board of Directors comprised of not less than three directors and also provide for an audit committee, a compensation committee and a director nomination committee. We currently have 7 members serving as members of our Board of Directors. The directors are elected at a shareholders meeting by a majority vote of the shareholders present or represented, which majority is not less than one-fourth of all issued and outstanding shares with voting rights, so long as not less than one third of all issued and outstanding shares with voting rights are present at the shareholders meeting.

Each of our directors is elected for a term of one year, which may be extended until the close of the annual general meeting of shareholders convened in respect to the last fiscal year of such director's term. However, directors may serve any number of consecutive terms and may be removed from office at any time by a special resolution adopted at a general meeting of shareholders.

The Board of Directors elects one or more representative directors from its members. A representative director is authorized to represent and act on behalf of such company and has the authority to bind such company. A company may have (i) one sole representative director, (ii) two or more co-representative directors or (iii) two or more joint representative directors. The powers and authorities of a sole representative director and any co-representative directors are exactly the same while the only distinction for joint representative directors is that they must act jointly (i.e., all of the joint representative directors must act together in order to bind the company while co-representative directors may act independently). Currently our Board of Directors has elected Hyun Chul Park as our Representative Director. Under the Korean Commercial Code and our articles of incorporation, any director with special interest in an agenda of a board meeting may not exercise his voting rights in such board meeting.

Our Board of Directors has determined that Messrs. Doo Hyun Ryu, Jung Yoo and Jong Gyu Hwang are independent directors within the meaning of NASDAQ Marketplace Rule 5605(a)(2).

COMMITTEES OF THE BOARD OF DIRECTORS

Under our articles of incorporation, we currently have three committees that serve under our Board of Directors:

the audit committee;

the director nomination committee; and

the compensation committee.

Audit committee

Our audit committee was established in December 2004. The audit committee currently consists of the following directors: Doo Hyun Ryu, Jung Yoo and Jong Gyu Hwang. All of the members are independent directors within the meaning of NASDAQ Marketplace Rule 5605(a)(2) and meet the criteria for independence as set forth in Rule 10A-3(b)(1) of the Exchange Act. All of our independent directors are financially literate and have accounting or related financial management expertise. Our Board of Directors has determined that Jong Gyu Hwang is an audit committee financial expert, as such term is defined by the regulations of the SEC issued pursuant to Section 407 of the Sarbanes-Oxley Act. The audit committee is responsible for examining internal transactions and potential conflicts of interest and reviewing accounting and other relevant matters. Under the Korean Commercial Code, if a company establishes an audit committee, such company is not permitted to have a statutory auditor. The committee is currently chaired by Doo Hyun Ryu.

Table of Contents**Director nomination committee**

The director nomination committee consists of the following three directors, Kazuya Sakai, Kazuki Morishita and Doo Hyun Ryu. One of the three members is independent director within the meaning of NASDAQ Marketplace Rule 5605(a)(2). This committee is responsible for recommending and nominating candidates for our director positions. The committee is currently chaired by Kazuya Sakai.

Compensation committee

The compensation committee consists of the following three directors, Kazuki Morishita, Kazuya Sakai and Jong Gyu Hwang. One of the three members is independent director within the meaning of NASDAQ Marketplace Rule 5605(a)(2). This committee is responsible for reviewing and approving the management's evaluation and compensation programs. The committee is currently chaired by Kazuki Morishita.

ITEM 6.D. EMPLOYEES

As of December 31, 2011, we, not including our subsidiaries, had 357 full-time employees, of whom 356 were located in Korea and one was stationed overseas, either working with our subsidiaries or supporting our overseas licensees. The total number of employees remained stable in 2011. The following table sets forth the number of our employees by department as of the dates indicated.

| | 2009 | December 31, 2010 | 2011 |
|------------------------------|------|----------------------|------|
| Senior management | 11 | 13 | 11 |
| Finance | 19 | 18 | 14 |
| Marketing | 56 | 50 | 68 |
| Game development and support | 278 | 280 | 264 |
| Total | 364 | 361 | 357 |

As of December 31, 2011, we had 18 temporary employees consisting of one contract-based employee and 17 outsourced employees.

We do not have a labor union and none of our employees are covered by collective bargaining agreements. We have a labor-management council for such employees as required under the Act on the Promotion of Workers' Participation and Cooperation in Korea. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes or work stoppages.

In addition, as of December 31, 2011, our subsidiaries had the number of employees as set forth in the following table.

| | 2009 | December 31, 2010 | 2011 |
|-------------------------------------|-------|----------------------|--------|
| Gravity Interactive, Inc.(1). | 34 | 30 | 33{3} |
| Gravity Entertainment Corporation | | | |
| Gravity CIS, Inc.(1) | 13{2} | 1 | |
| Gravity Middle East & Africa FZ-LLC | | | |
| NeoCyon, Inc.(1) | 45 | 69{2} | 119{3} |
| Gravity Games Corporation(1)(2) | N/A | 68 | 85{4} |
| Total | 92 | 168 | 237 |

Notes:

- (1) The number in { } is the number of employees (who are included in the total number) seconded from us.

- (2) We acquired an aggregate of 50.83% equity interest in Gravity Games Corporation, formerly known as Barunson Interactive Corporation, in October 2010.

Table of Contents

Gravity Entertainment and Gravity CIS do not have any employees because it has no significant operations. Gravity RUS is a holding company and does not have any employees. Gravity Middle East & Africa went into liquidation proceedings in the United Arab Emirates in September 2008. None of the employees of Gravity Interactive, NeoCyon or Gravity Games are represented by a labor union or covered by a collective bargaining agreement.

We have entered into a standard annual employment contract with most of our officers, managers and employees. These contracts include a covenant that prohibits the officer, manager or employee from engaging in any activities that compete with our business during, and for six months after, the period of their employment with our company.

Under the Labor Standard Act and the Employee Retirement Benefit Security Act, employees with more than one year of service with us are entitled to receive a lump sum payment upon voluntary or involuntary termination of their employment. The amount of the benefit equals the employee's monthly salary, calculated by averaging the employee's daily salary for the three months prior to the date of the employee's departure, multiplied by the number of continuous years of employment. As of December 31, 2011, we provided Won 916 million (US\$791 thousand) to 217 employees as severance payment, being 100% of our severance liability as of such date.

Pursuant to the Korean National Pension Law, we are required to pay 4.5% of each employee's standard monthly income to the National Pension Corporation. Our employees are also required to pay 4.5% of their standard monthly income to the National Pension Corporation each month. Our employees are entitled to receive an annuity in the event they lose, in whole or in part, their wage earning capability. The total amount of contributions we made to the National Pension Corporation in 2009, 2010 and 2011 was Won 960 million, Won 973 million and Won 1,046 million (US\$903 thousand), respectively.

ITEM 6.E. SHARE OWNERSHIP

None of our current directors or officers beneficially owns our common shares.

Stock option plan

Under our articles of incorporation, we may grant options for the purchase of our shares to certain qualified directors, officers and employees. Set forth below are the details of our stock option plan as currently contained in our articles of incorporation.

Stock options may be granted to our officers and employees who have contributed or are qualified to contribute to our establishment, management and technical innovation. Notwithstanding the foregoing, no stock options may be granted to any person who is (i) our largest shareholder, (ii) a holder of 10% or more of our shares outstanding, (iii) certain specially related persons of the person set forth in (i) and (ii) above, or (iv) a shareholder who would own 10% or more of our shares upon exercise of options granted under the stock option plan. Provided, however that, those who fall under the specially related persons upon becoming one of the officers of the concerned company (includes part-time officers of the affiliated company) shall be excluded from item (iii) above.

Stock options may be granted by a special resolution of our shareholders with the aggregate number of shares issuable not to exceed 10% of the total number of our then issued and outstanding common shares.

Upon exercise of stock options, we deliver our common shares or pay in cash the difference between the market price of our shares and the option exercise price.

The number of officers and employees subject to grant of stock options shall not exceed 90% of the currently employed officers and employees, and the stock option granted to an officer or an employee shall not exceed 10% of the total issued and outstanding stocks.

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Stock options granted under the stock option plan, in case new shares are issued, have a minimum exercise price equal to the higher of (i) the market price of our shares calculated pursuant to the method under the

Table of Contents

Inheritance and Gift Tax Law and (ii) the par value of our shares, and in other cases, has a minimum exercise price equal to or higher than the market price of our shares calculated pursuant to the method under the Inheritance and Gift Tax Law.

Stock options may be exercisable by a person who is granted a stock option and has served for the Company for two or more years from the date of the resolution set forth above; provided, that stock options may be exercised by, or on behalf of, a person that dies, retires or resigns due to any cause not attributable to himself/herself before the two years from the date of the resolution set forth above.

Stock options can vest after two years from the stock option grant date and can be exercised up to five years from the vesting date.

Stock options may be cancelled by a resolution of our Board of Directors if (i) the officer or employee who holds the option voluntarily retires after being granted stock options, (ii) the officer or employee who holds the option causes material damage to us by willful misconduct or negligence, (iii) we are unable to deliver our shares or pay the prescribed amount due to bankruptcy or dissolution, or (iv) the occurrence of any cause for cancellation of stock options specified in the stock option agreement.

Each stock option confers the right on the grantee to purchase one share of our common stock at the exercise price. On December 24, 2004, our shareholders approved the implementation of our employee stock option plan and the granting of stock options under this plan to our directors, officers and employees. All the stock options granted on December 24, 2004 have expired. There are no stock options exercisable as of December 31, 2011.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**ITEM 7.A. MAJOR SHAREHOLDERS**

The following table sets forth information known to us with respect to the beneficial ownership of our common shares as of March 31, 2012, by each person known to us to own beneficially 5% or more of our common shares based on 6,948,900 of our common shares outstanding. None of our common shares entitles the holder to any preferential voting rights. Beneficial ownership is determined in accordance with the Exchange Act and the rules and regulations promulgated thereunder, and includes the power to direct the voting or the disposition of the securities or to receive the economic benefit of the ownership of the securities.

| Name | Number of Shares Beneficially Owned | Percentage Beneficially Owned |
|--------------------------------------|--|-------------------------------------|
| GungHo Online Entertainment, Inc.(1) | 4,121,739 | 59.3% |

Note:

- (1) On August 30, 2005, Jung Ryool Kim, our former controlling shareholder and Chairman, sold all of our shares that he and his family members owned to EZER Inc., or EZER, a Japanese company, pursuant to a stock purchase agreement by and among Jung Ryool Kim, Ji Young Kim, Young Joon Kim and Ji Yoon Kim, and EZER dated August 30, 2005. Pursuant to the share sale transaction, EZER became our largest shareholder. EZER, which was 100% owned by our former Chairman and Chief Executive Officer, Il Young Ryu, was the operator of an investment fund established pursuant to a contractual relationship known in Japan as a tokumei kumiai (TK Relationship) with Techno Groove, Inc., a Japanese company and wholly-owned subsidiary of Asian Groove, Inc., or Asian Groove, a Japanese company. The TK Relationship, which is governed by the Commercial Code of Japan, is used in Japan as a means of making and managing investments, and under the investment fund agreement for the TK Relationship (the TK Agreement), EZER acted as the operator of a fund,

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established in Japan under the name of Asian Star Fund, using the capital contribution made by Techno Groove as an investor in the fund.

Asian Star Fund was established for the sole purpose of investing in our shares.

According to Schedule 13/D filed by Techno Groove, among others, their investment in the Asian Star Fund was financed through a loan from Son Asset Management, LLC, formerly known as Son Asset Management Inc., or SAM, a Japanese company, in the amount of JPY40 billion. In exchange, Asian Groove, the parent

Table of Contents

company of Techno Groove, pledged all of its shares of GungHo Entertainment Online, Inc. in custody with Techno Groove, which in turn pledged these shares to SAM.

Under the terms of the TK Agreement, EZER, as the operator of Asian Star Fund, had sole rights with respect to ownership and voting rights of common shares of companies invested in by Asian Star Fund. Asian Star Fund's sole investment was in our shares. Techno Groove had no voting or investment power with respect to the securities held by Asian Star Fund. The term of the TK Agreement was for one year, subject to automatic one-year renewals, unless terminated by either party upon three months prior notice. Upon such termination, the assets of Asian Star Fund must be distributed to Techno Groove by EZER.

On October 31, 2006, Techno Groove was merged into Asian Groove and on December 26, 2006, EZER acquired 3,640,619 shares of our common stock from Asian Star Fund for JPY9,921,679,586. Asian Star Fund was automatically dissolved based on the TK Agreement on December 26, 2006 because all of the shares were transferred outside of the fund.

The acquisition of our common stock by EZER under the TK Agreement was financed by the issuance by EZER to SAM of EZER Series One Corporate Bond in the principal amount of JPY9,930,000,000 (the EZER Series One Corporate Bond).

On October 19, 2007, EZER entered into an accord and satisfaction agreement (the Accord and Satisfaction Agreement) with SAM, whereby, EZER agreed to transfer to SAM 3,640,619 shares of our common stock in partial satisfaction of EZER's obligations under the EZER Series One Corporate Bond held by SAM, in an amount of JPY5,869,244,308 on the later to occur of (i) November 20, 2007, and (ii) the date the Korean Fair Trade Commission approved the transfer of such shares (the Closing Date) based upon the NASDAQ Official Closing Price of our common stock on the day prior to the Closing Date.

On November 19, 2007, the Korean Fair Trade Commission approved the transfer of our common stock pursuant to the Accord and Satisfaction Agreement. As a result, on November 20, 2007, EZER no longer held any of our shares.

On February 13, 2008, Heartis Inc., or Heartis, a corporation organized under the laws of Japan, executed a stock purchase and sale agreement (the Purchase Agreement) with SAM pursuant to which SAM agreed to transfer 3,640,619 shares of our common stock to Heartis. On February 29, 2008, Heartis paid to SAM JPY4,036,298,947, an amount equal to the 3,640,619 shares multiplied by the NASDAQ Official Closing Price of ADSs representing shares of our common stock on February 13, 2008 (US\$2.56), multiplied by four ADSs (representing one share of our common stock), and further multiplied by the JPY/US\$ telegraphic transfer middle rate on February 14, 2008, reported by Mizuho Corporate Bank, Ltd. (JPY108.27 per US\$1.00), in exchange for delivery of our common stock. On the same date, 3,640,619 shares of our common stock were transferred to Heartis pursuant to the Purchase Agreement.

In order to finance the transaction contemplated by the Purchase Agreement, Heartis executed a loan agreement (the Loan Agreement) with SAM on February 22, 2008. Under the Loan Agreement, on February 29, 2008 SAM loaned to Heartis JPY4,030,000,000, the principal of which Heartis shall repay no later than February 28, 2010. Heartis shall pay to SAM interest at a rate of 14.5% per annum. As collateral for the loan, Heartis agreed in the Loan Agreement to pledge to SAM 24,308 shares of common stock of GungHo which shares were acquired by Heartis through a third party allotment on April 1, 2008 under a share subscription agreement (the Share Subscription Agreement) between Heartis and GungHo on February 14, 2008. Heartis provided the remainder of the consideration specified by the Purchase Agreement out of its working capital.

GungHo is 18.53% held by Heartis and 14.50% by Asian Groove. Taizo Son, the Chairman of GungHo, controls Heartis through his 100% ownership of the issued share capital of Inter Operations, which owns 100% of the issued share capital of Heartis. Taizo Son also controls Asian Groove by directly owning 33.3% of the issued share capital of Asian Groove and indirectly owning, through his ownership of Inter Operations, a further 33.3% of Asian Groove. Taizo Son also controls Key Light, Inc. which owns 0.87% of GungHo and directly owns 0.33% of GungHo. Thus, Taizo Son directly and indirectly owns or controls 34.24% of the issued share capital of GungHo.

On February 14, 2008, GungHo executed the Share Subscription Agreement with Heartis pursuant to which, on April 1, 2008, Heartis was to transfer 3,640,619 shares of our common stock to GungHo as a contribution in

Table of Contents

kind for 24,308 newly issued shares of common stock of GungHo. The number of shares issued by GungHo was determined based on an aggregate valuation of the shares of JPY4,035,128,000.

On April 1, 2008, the Share Subscription Agreement between Heartis and GungHo was consummated. As a result, the legal title to 3,640,619 shares of our common stock that Heartis held until such time was transferred to GungHo.

On June 23, 2008, GungHo and LaGrange Capital Partners, L.P., or LaGrange, entered into a Stock Purchase Agreement (the "LaGrange Stock Purchase Agreement"), whereby GungHo purchased 1,378,166 ADSs representing 344,541.50 shares of our common stock held by LaGrange for an aggregate purchase price of US\$2,067,249. The purchase price was paid out of GungHo's own funds. The LaGrange Stock Purchase Agreement was consummated on June 23, 2008.

On June 23, 2008, GungHo and LaGrange Capital Partners Offshore Fund, Ltd., or LaGrange Offshore, entered into a Stock Purchase Agreement (the "LaGrange Offshore Stock Purchase Agreement"), whereby GungHo purchased 424,051 ADSs representing 106,012.75 shares of our common stock held by LaGrange Offshore for an aggregate purchase price of US\$636,076.50. The purchase price was paid out of GungHo's own funds. The LaGrange Offshore Stock Purchase Agreement was consummated on June 23, 2008.

On June 24, 2008, GungHo and Raffles Associates, L.P., or Raffles, entered into a Stock Purchase Agreement (the "Raffles Stock Purchase Agreement"), whereby GungHo purchased 122,261 ADSs representing 30,565.25 shares of our common stock held by Raffles for an aggregate purchase price of US\$183,391.50. The purchase price was paid out of GungHo's own funds. The Raffles Stock Purchase Agreement was consummated on June 24, 2008.

We have in the ordinary course of business, entered into various contracts with GungHo. See ITEM 4.B. BUSINESS OVERVIEW OUR PRODUCTS, ITEM 4.B. BUSINESS OVERVIEW OUR MARKETS Overseas markets and ITEM 7.B. RELATED PARTY TRANSACTIONS Relationship with GungHo Online Entertainment, Inc.

To the best of our knowledge, as of December 31, 2011, approximately 47.1% of our common shares were held in the United States (in the form of ADSs). Also to the best of our knowledge, we had approximately 1,763 beneficial holders of our shares (in the form of ADSs) in the United States as of December 31, 2011.

ITEM 7.B. RELATED PARTY TRANSACTIONS**Relationship with GungHo Online Entertainment, Inc.**

On April 1, 2008, GungHo acquired 3,640,619 shares of our common stock, which was approximately 52.4% of our total shares. On June 23, 2008 and June 24, 2008, GungHo acquired our ADSs representing 450,554.25 and 30,565.25 shares of the Company, respectively. As of March 31, 2012, GungHo beneficially owns approximately 4,121,739 shares of the Company's common stock, constituting approximately 59.3% of the total issued and outstanding common shares.

In July 2002, we entered into an agreement with GungHo, formerly known as OnSale, Inc., for the service and distribution of Ragnarok Online in Japan, which was renewed in 2004, 2006 and 2009. We also entered into a software licensing agreement with GungHo in December 2005 for the right to publish and distribute Emil Chronicle Online worldwide, except for Japan, which was renewed in 2006, 2010 and 2011. We entered into a license and distribution agreement for Ragnarok Online II with GungHo in September 2006. In January 2010, we entered into an agreement with Game Arts Co., Ltd., a 97.74% owned subsidiary of GungHo, to develop Ragnarok Odyssey, an action game on PS Vita platform based on Ragnarok Online. The agreement was terminated upon mutual agreement in December 2010 and we subsequently entered into a co-development agreement with GungHo for the game, which was amended in March 2011 and November 2011. In April 2010, we entered into a licensing agreement with GungHo to develop and distribute a game for Microsoft's Xbox Live Arcade. We entered into a license and distribution agreement with GungHo to distribute H.A.V.E. Online, which is currently serviced under the name Toy Wars, in Japan in August 2010. We also entered into agreements with GungHo for development and distribution of Ragnarok: The Princess of Light and Darkness, a tactical role playing game for PSP based on Ragnarok Online, in September 2010, which was amended in November 2010. We entered into a development agreement and a license and distribution agreement of a Web browser-based game in Japan with GungHo in March 2012 and in April 2012, respectively.

Table of Contents

Mr. Hyun Chul Park, our Chief Executive Officer, Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, Mr. Kazuki Morishita, our Executive Director and Mr. Kazuya Sakai, our Executive Director, have been General Manager, Director and Executive General Manager, President and Chief Executive Officer, and Chief Financial Officer, Director and Investor Relations Officer of GungHo, respectively.

Relationship with SoftBank Corporation

Softbank BB Corp., or Softbank BB, a corporation organized under the laws of Japan, and subsidiary of SoftBank Corporation, or SoftBank, a corporation organized under the laws of Japan, owns 33.7% of the issued share capital of GungHo. Masayoshi Son is the Chairman, Chief Executive Officer and controlling shareholder of SoftBank and Softbank BB, and is also brother to Taizo Son, who directly and indirectly owns or controls 34.24% of the issued share capital of GungHo.

In December 2005, we entered into a limited partnership agreement with Movida Investment Inc., which was merged into Entertainment Farm Inc. in February 2007, SoftBank, GungHo and seven other companies to invest in Online Game Revolution Fund No. 1, a fund with a total proposed investment size of JPY10 billion, with the objective of investing in companies which develop online games in Japan. Entertainment Farm Inc., a Japanese company, operated the fund as the general partner. As a limited partner, we did not have a significant influence over the fund's investment decisions. The fund had a term of five years from the effective date, which was January 1, 2006. As of December 31, 2010, the expiration date, the Company, SoftBank and GungHo had interests of 16.39%, 49.18% and 8.20%, respectively, in the fund. We agreed to contribute a total of JPY1,000 million, which represented 10% of the total capital commitment in the fund by the limited partners at the time of the agreement, and which then represented 16.39% of the fund due to the withdrawal of some limited partners in the fund. The Company invested JPY250 million (Won 2,114 million) until 2006, and made additional investments amounting to JPY642 million (Won 6,054 million) in 2008 and JPY18 million (Won 229 million) in 2009. As of the date of the expiration of the fund, we had invested a total of JPY910 million, which represented 91% of our total capital commitment. On December 28, 2007 and January 7, 2008, the fund entered into a purchase agreement and a service agreement with GungHo to purchase online game of Grandia Online under development by GungHo for JPY2,600 million (Won 23,089 million), and for GungHo to continue providing development, marketing, operation and maintenance services after commercialization for revenue sharing from the game. On July 11, 2008, the fund also entered into a partnership agreement with GungHo Works, Inc., a then subsidiary of GungHo, and paid GungHo Works, Inc. JPY124 million (Won 1,220 million) to share profits from its online game Hero's Saga Laevatein. On December 31, 2010, the term of the partnership expired and is currently undergoing liquidation process.

Relationship with Gravity Interactive, Inc.

In April 2003, we entered into an agreement with Gravity Interactive, formerly known as Gravity Interactive, LLC, for the service and distribution of Ragnarok Online in the United States and Canada pursuant to which Gravity Interactive agreed to remit dividends to us based on a percentage of earnings. After Gravity Interactive changed their form to an incorporated company in January 2006, we entered into an agreement with Gravity Interactive for the service and distribution of Ragnarok Online in the United States and Canada pursuant to which Gravity Interactive agreed to remit royalties to us instead of dividends, which was amended in January 2008 to include Australia and New Zealand as service countries and renewed in January 2009. The agreement was amended in September 2009 to include India as a service country and in October 2009 to change the term of royalty payment remittance from monthly to quarterly basis. The agreement was renewed in January 2011.

Also, we entered into an agreement with Gravity Interactive for the service and distribution of R.O.S.E. Online in the United States, Canada and Mexico in January 2006 and all the right of R.O.S.E. Online for the United States, Canada and Mexico were transferred to Gravity Interactive in June 2007. In February 2010, we entered a game transfer agreement with Gravity Interactive and transferred all the rights of R.O.S.E. Online for the United Kingdom and 39 other European countries. We entered into an agreement with Gravity Interactive for the service and distribution of Requiem in the United States and Canada in February 2008, which was amended in December 2009 to include the United Kingdom and 39 other European countries as service countries, which was further amended in March 2010 to exclude Moldova, where Requiem was already commercially offered by Gravity CIS and to change the term of royalty payment remittance from monthly to quarterly basis. Our license and distribution agreement for

Table of Contents

Requiem with Gravity Interactive was amended in June 2011 to include Mexico and 23 other Central and South American countries as service countries and further amended in October 2011 to include Korean as service language and to distribute Requiem worldwide except for the existing licensed territories in which we have already granted licenses for Requiem game service to local licensees. In September 2010, we entered into a license and distribution agreement with Gravity Interactive, which was amended in April 2011, to distribute Dragonica in the United States and Canada. We entered into a license and distribution agreement with Gravity Interactive to distribute Eternal Destiny in North America excluding the Canadian province Quebec in January 2011. In February 2012, we entered into a license agreement with Gravity Interactive to distribute a Web-browser based version of Emil Chronicle Online, worldwide except for Japan, through certain designated Web sites. Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, Mr. Heung Gon Kim, our Chief Financial Officer, and Mr. Chang Ki Kim, our Chief Strategy Officer, have been Chief Executive Officer, Director and Chief Financial Officer, and Director of Gravity Interactive, respectively.

Relationship with Gravity Entertainment Corporation and the Animation Production Committee

From March to June 2004, we provided a series of loans in the aggregate amount of JPY 35 million, at an annual interest rate of 9%, to Gravity Entertainment, formerly RO Production Co., Ltd., our then 50%-owned subsidiary in Japan, for the production and marketing of Ragnarok the Animation and for working capital purposes. These loans have been fully repaid as of December 2004. In October 2004, we purchased from GungHo, which at the time owned the remaining 50% interest in Gravity Entertainment, their ownership interest in Gravity Entertainment for a purchase price of zero, making us the 100% shareholder of Gravity Entertainment.

Under a consortium agreement which became effective in April 2004 between Gravity Entertainment and other parties to the Animation Production Committee, a Japanese joint venture for the production and marketing of Ragnarok the Animation, Gravity Entertainment was obligated to contribute JPY 117 million plus a 5% tax, amounting to JPY 123 million, to the joint venture. As a shareholder of Gravity Entertainment, we funded this contribution amount in full in the form of additional capital injection.

On October 1, 2004, we granted a license for Ragnarok Online to the joint venture in order for the joint venture to produce Ragnarok the Animation. Pursuant to an arrangement between Gravity Entertainment and the joint venture, Gravity Entertainment is required to remit 70% of the revenues from its animation business to the joint venture. As of December 31, 2011, the amount due and payable to the joint venture by Gravity Entertainment amounted to JPY 18 million.

Pursuant to an export and copyright authorization agreement between Gravity Entertainment and the Company, effective in April 2004, we have the exclusive license to sell Ragnarok the Animation to countries in Southeast Asia, which include Vietnam, Laos, Cambodia, Thailand, Malaysia, Singapore, Indonesia, the Philippines, Taiwan, China and Hong Kong. Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, has been Chief Executive Officer and Mr. Heung Gon Kim, our Chief Financial Officer, has been Director of Gravity Entertainment.

Relationship with NeoCyon, Inc.

We acquired 96.11% of the outstanding common stocks of NeoCyon for an aggregate purchase price of Won 7,716 million in cash pursuant to a series of share purchase transactions which took place in November and December 2005. In September 2006, we entered into an agreement regarding mobile publishing with NeoCyon under which they have been remitting royalties to us, and which was amended in December 2006, January 2007, May 2007 and February 2009, and renewed in September 2010. In February 2008, we entered into a subletting agreement with NeoCyon to sublease 3,914 square feet of office space to NeoCyon. We entered into an amendment to the subletting agreement in April 2012 to sublease additional 2,135 square feet of office space to NeoCyon. We entered into an agreement with NeoCyon in March 2011 to develop and distribute Ragnarok Online Guild Masters worldwide. Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, Mr. Hyun Chul Park, our Chief Executive Officer, and Mr. Heung Gon Kim, our Chief Financial Officer, have been Chief Executive Officer, Director and Chief Operating Officer, and Director and Chief Financial Officer of NeoCyon, respectively.

Table of Contents**Relationship with Gravity CIS Co., Ltd.**

In September 2006, we acquired 100% of the voting shares of Gravity CIS Co., Ltd., formerly known as Gravity CIS, Inc., formerly Mados, Inc., from Cybermedia International, Inc., a former subsidiary of NeoCyon, Inc. Gravity CIS changed to a limited liability company in November 2007. We provided a loan in the amount of US\$1.5 million to Gravity CIS on February 28, 2006 and made an additional loan in the amount of US\$0.5 million on February 10, 2007 at an annual interest rate of 4.9% payable monthly in arrears, which was extended on February 11, 2010. As of March 31, 2012, the total outstanding loan amounts to Gravity CIS were US\$0.5 million. In October 2006, an agreement with NeoCyon for the service and distribution of Ragnarok Online in Russia, which was entered into in December 2004, was transferred to Gravity CIS, which was amended to change the term of royalty payment remittance from monthly to quarterly basis in April 2007. In March 2009, an amendment was made to include Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan as service countries. In December 2007, we entered into an agreement with Gravity CIS for the service and distribution of Requiem in Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan, which was amended to change the term of royalty payment remittance from a monthly basis to a quarterly basis in July 2008. In June 2010, we entered into termination agreements with Gravity CIS for the service of Ragnarok Online and Requiem in Russia and the 14 other countries. Mr. Chang Ki Kim, our Chief Strategy Officer, has been the Chief Executive Officer of Gravity CIS.

Relationship with Gravity RUS Co., Ltd.

In October 2007, we founded Gravity RUS and acquired 99.99% of the voting shares. We transferred 100% of the voting shares of Gravity CIS to Gravity RUS in December 2007.

Relationship with Gravity EU SASU and Gravity EU SAS

In August 2006, we founded Gravity EU SASU, a wholly owned Europe-based subsidiary. In October 2006, an agreement with Mados, Inc., a former subsidiary of Cybermedia International, Inc., a former subsidiary of NeoCyon, for the service and distribution of Ragnarok Online in France and Belgium, which was entered into in August 2005, was transferred to Gravity EU SASU. In June 2008, an amendment was made to include the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark and Spain as service countries, which was renewed in June 2010 and further amended in October 2010 to include Germany and 17 other European countries as service countries. We made a loan in the amount of EUR188,650 to Gravity EU SASU on August 29, 2008 and made additional loans in the amount of EUR100,000 on January 29, 2009, in the amount of EUR100,000 on September 9, 2009, in the amount of EUR50,000 on February 18, 2010, in the amount of EUR 30,000 on June 3, 2010, in the amount of EUR30,000 on July 2, 2010, in the amount EUR30,000 on July 29, 2010 and in the amount EUR80,000 on January 17, 2011 at an annual interest rate of 4.8% payable monthly in arrears. In June 2011, we entered into an agreement with Gravity EU SASU to write off the loan of EUR 468,650 and accrued interest, and Gravity EU SASU repaid EUR 140,000 to us in October 2011, resulting in the existing loan amount due from Gravity EU SASU being decreased to nil.

In July 2011, Gravity EU SASU was converted into a joint venture company in which we have a 25% equity interest, Gravity EU SAS, with Media-Participations Paris SA as the joint venture partner. We entered into an agreement with Gravity SAS for the service and distribution of Ragnarok Online in France and 27 other European countries where Gravity EU SASU had offered commercial service of Ragnarok Online and the distribution agreement with Gravity EU SASU was terminated. In November 2011, an amendment was made to exclude Estonia, where Ragnarok Online was already commercially offered by Ingamba. Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, and Mr. Chang Ki Kim, our Chief Strategy Officer, have been directors of Gravity EU SAS.

Relationship with Gravity Games Corporation

In October 2010, we acquired an aggregate of 50.83% of the total shares of Barunson Interactive, of which corporate name was changed to Gravity Games Corporation on March 28, 2011. We entered into an agreement to publish Dragonica in the United States and Canada with Gravity Games in August 2010. In April 2011, we entered into a subletting agreement with Gravity Games to sublease 6,066 square feet of office space to Gravity Games. We

Table of Contents

entered into agreements with Gravity Games in June 2011 to publish East Road in Korea and Japan and in December 2011 to publish Dragonica in Korea. Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, Mr. Hyun Chul Park, our Chief Executive Officer, Mr. Heung Gon Kim, our Chief Financial Officer, and Mr. Chang Ki Kim, our Chief Strategy Officer, have been directors of Gravity Games.

Relationship with Ingamba LLC

In June 2010, we invested Russian Ruble 13 million, which represents 25% of Ingamba's total capital, in order to distribute our games in Russia. In June 2010, we entered into agreements with Ingamba for the service and distribution of Ragnarok Online and Requiem in Russia, Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

ITEM 7.C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

ITEM 8.A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION FINANCIAL STATEMENTS

All relevant financial statements are included in ITEM 18. FINANCIAL STATEMENTS.

LEGAL PROCEEDINGS

Class action complaints

In May 2005, a number of class action complaints were filed against the Company and other defendants for alleged violation of the United States federal securities law in the United States District Court for the Southern District of New York (the Court) in connection with the initial public offering of the Company's ADSs in February 2005. The actions were consolidated by an order of the Court entered on December 12, 2005 as In Re Gravity Co., Ltd. Securities Litigation, No. 1:05-CV-4804-LAP to be prosecuted on behalf of a class of those who purchased ADSs between February 7, 2005 and November 10, 2005. On July 10, 2006, the lead plaintiff filed a Consolidated Amended Complaint (the CAC) which identified the Company and certain of its former individual directors and officers as defendants, and claims that the Company's registration statement on Form F-1 and the prospectus which constitutes a part of the registration statement used in connection with its initial public offering contained material misstatements and omissions. On October 17, 2006, the Company and certain other defendants filed motions to dismiss the CAC. Pursuant to a mediation session held in New York on April 25, 2007, the Company, one other defendant and the plaintiffs agreed in principle to settle the class action litigation for US\$10 million. The Company's share of the settlement was US\$5 million. In July 2007, the parties filed a stipulation with the Court requesting that the Court approve the proposed settlement. In November 2007, the federal judge presiding over the consolidated class action approved settlement of the class action and made the determination that the costs of administering the settlement, including the plaintiffs' attorneys' fees of 20.56% of the settlement amount and related expenses, be paid out of the settlement fund before distributions were made to class members. No plaintiffs filed an appeal during the 30-day appeal period which expired on December 21, 2007, and settlement amounts were disbursed to class members shortly thereafter. Upon completion of this settlement, the Company, its former directors and officers as well as other third parties were released from liability for the claims asserted in the class action litigation.

Other litigation matters

In May 2006, YNK Korea Inc., formerly known as Sunny YNK Inc., our former investor for Ragnarok Online, filed a lawsuit against us claiming that we failed to distribute the earnings from a certain amount of net sales due to the embezzlement of royalty revenue committed by our former chairman and from license fees from overseas licensees. The claim of the lawsuit amounted to Won 1,895 million and in December 2007, we paid

Table of Contents

Won 623 million to YNK Korea Inc. upon the first trial decision in November 2007. The case was transferred to the Seoul High Court in January 2008 and the Court rendered a decision in December 2009 that YNK Korea Inc. was not entitled to Won 35 million of the Won 623 million paid by us in 2007 and ordered YNK Korea Inc. to pay to us Won 35 million and interest accrued on such amount. No party filed an appeal during the appeal period and the litigation was completed.

In October 2006, Softstar Entertainment Inc., our former licensee in Taiwan, Hong Kong and Macau for R.O.S.E. Online, filed a lawsuit against us insisting that the game program for the open beta testing of the game in Taiwan which was provided by us was different from the program used for the closed beta testing and was materially deficient, thereby causing them to incur a loss in their business. The license agreement with Softstar Entertainment Inc., which was entered into in February 2005, was terminated by the plaintiff in December 2005 and the open beta testing of the game was terminated in March 2006. We counterclaimed in October 2007 against Softstar for breach of the license agreement as Softstar Entertainment Inc. unilaterally postponed and eventually cancelled the commercial launch of the game in Taiwan though the parties mutually agreed to commercially launch the game on August 2, 2005. In December 2009, we and Softstar Entertainment Inc. reached a settlement in the lawsuit pending in the High Court of the Republic of Singapore. In December 2009, we paid US\$2,000 thousand to Softstar Entertainment Inc., which we had agreed to pay in the settlement deed, and recognized the loss of Won 1,649 million, which is the difference between the settlement and the existing deferral revenue balance. As a part of the settlement, we and Softstar mutually agreed to terminate all the claims and counterclaims against each other. The parties also have agreed not to bring any further actions against each other regarding the matter.

In April 2010, a former executive of our Company filed a lawsuit with the Seoul Central District Court seeking payment of compensation which he claims he is entitled to under a certain employment agreement with the Company. The case was dismissed and the plaintiff filed an appeal with the Seoul High Court in May 2011 and the court ruled partially in favor of the plaintiff and both of the parties brought final appeals with the Supreme Court of Korea in December 2011. The final appeals by both parties were dismissed and the Seoul High Court's decision was finally confirmed in April 2012.

In May 2010, the former executive filed another lawsuit with the Seoul Western District Court claiming employment termination without cause. The case was dismissed and the plaintiff filed an appeal with the Seoul High Court in April 2011.

In August 2010, the former executive, on behalf of one of our subsidiaries, filed another lawsuit with the Seoul Southern District Court claiming the Company's unauthorized withdrawal of funds from the subsidiary. The case was decided in favor of the plaintiff and we filed an appeal with the Seoul High Court in November 2011.

In June 2011, the former executive filed a lawsuit with the Seoul Central District Court claiming nullity of dismissal and seeking remuneration due regarding the remainder of his term.

As of the date hereof, we are not involved in any lawsuit that will have a material adverse effect on our business.

Tax matters

In 2011, we were subject to a tax examination by the National Tax Service of Korea for fiscal years 2006 through 2009. As a result of the tax examination, we recognized Won 133 million of income tax expense for penalties and Won 608 million of withholding taxes for transfer pricing adjustments that arose from the difference between the actual transaction price and the estimated arm's length price. The Won 133 million of penalties was recorded as a component of income tax provision, and the Won 608 million of withholding taxes due was recorded as a component of selling, general and administrative expenses for the year ended December 31, 2010. The National Tax Service of Korea is a Korean government agency responsible for tax collection and tax law enforcement.

DIVIDEND POLICY

Since our inception, we have not declared or paid any dividends on our common shares. Any decision to pay dividends in the future will be subject to a number of factors, including cash requirements for future capital expenditures and investments, and other factors our Board of Directors may deem relevant. We have no intention to pay dividends in the near future. Consequently, we cannot give any assurance that any dividends may be declared and paid in the future.

Table of Contents

Holders of outstanding common shares on a dividend record date will be entitled, subject to applicable withholding taxes, to the full dividend declared without regard to the date of issuance of the common shares or any subsequent transfer of the common shares. Payment of annual dividends in respect of a particular year, if any, will be made in the following year after approval by our shareholders at the annual general meeting of shareholders or, if (i) an external auditor gives an unqualified opinion to the financial statement and (ii) all members of the audit committee unanimously agree, after approval by the Board of Directors, and payment of interim dividends, if any, will be made in the same year after approval by our Board of Directors, in each case, subject to certain provisions of our articles of incorporation and the Korean Commercial Code. All dividends may be paid in cash, by shares or by other properties (in-kind). See ITEM 10.B. ARTICLES OF INCORPORATION Dividends.

Subject to the terms of the deposit agreement for the ADSs, you will be entitled to receive dividends on common shares represented by ADSs to the same extent as the holders of common shares, less the fees and expenses payable under the deposit agreement in respect of, and any Korean tax applicable to, such dividends. See ITEM 10.E. TAXATION KOREAN TAXATION. The depositary will generally convert the Won it receives into U.S. dollars and distribute the U.S. dollar amounts to you. For a description of the U.S. federal income tax consequences of dividends paid to our shareholders, see ITEM 10.E. TAXATION MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS.

ITEM 8.B. SIGNIFICANT CHANGES

Not applicable.

ITEM 9. THE OFFER AND LISTING

ITEM 9.A. OFFER AND LISTING DETAILS

Common Stock

Our common shares are not listed on any stock exchange or organized trading market, including in Korea. There is no public market for our common shares, although a small number of our common shares are traded in off-market transactions involving private sales primarily in Korea.

American Depositary Shares

Following our initial public offering on February 8, 2005, the ADSs have been issued by The Bank of New York Mellon, formerly known as The Bank of New York, as depositary and are listed on the NASDAQ Stock Market s the NASDAQ Global Market, formerly the NASDAQ National Market, under the symbol GRVY. Each ADS represents one-fourth of one share of our common stock. As of March 31, 2012, 13,095,692 ADSs representing 3,273,923 shares of our common stock were outstanding.

Table of Contents

The table below provides the high and low trading prices for our ADSs on the NASDAQ Global Market for the periods shown.

| Period | Price | |
|--------------------------------|-----------|------|
| | High | Low |
| | (In US\$) | |
| 2007 | 7.25 | 2.75 |
| 2008 | 3.50 | 0.36 |
| 2009 | 2.63 | 0.50 |
| 2010 | 2.25 | 1.35 |
| First Quarter | 2.10 | 1.56 |
| Second Quarter | 2.25 | 1.44 |
| Third Quarter | 1.62 | 1.35 |
| Fourth Quarter | 1.89 | 1.37 |
| 2011 | 2.19 | 1.13 |
| First Quarter | 2.19 | 1.64 |
| Second Quarter | 2.11 | 1.49 |
| Third Quarter | 1.81 | 1.16 |
| Fourth Quarter | 1.50 | 1.13 |
| October | 1.34 | 1.14 |
| November | 1.50 | 1.13 |
| December | 1.50 | 1.18 |
| 2012 (through April 20, 2012) | 3.47 | 1.39 |
| First Quarter | 3.47 | 1.39 |
| January | 1.79 | 1.39 |
| February | 3.15 | 1.79 |
| March | 3.47 | 2.19 |
| April (through April 20, 2012) | 2.75 | 2.05 |

ITEM 9.B. PLAN OF DISTRIBUTION

Not applicable.

ITEM 9.C. MARKETS

See ITEM 9.A. OFFERING AND LISTING DETAILS.

ITEM 9.D. SELLING SHAREHOLDERS

Not applicable.

ITEM 9.E. DILUTION

Not applicable.

ITEM 9.F. EXPENSES OF THE ISSUE

Not applicable.

ITEM 10. *ADDITIONAL INFORMATION*

ITEM 10.A. *SHARE CAPITAL*

Not applicable.

Table of Contents

ITEM 10.B. MEMORANDUM AND ARTICLES OF INCORPORATION

The section below provides summary information relating to the material terms of our capital stock and our articles of incorporation. It also includes a brief summary of certain provisions of the Korean Commercial Code and related Korean law, all as currently in effect.

General

Our total authorized share capital is 40,000,000 shares, which consists of common shares and convertible preferred dividend shares without voting right (hereinafter referred to as preferred share) each with a par value of Won 500 per share. Under our articles of incorporation, holders of preferred shares are entitled to dividends of not less than 1% and up to 15% of the par value of such shares, the exact rate to be determined by our Board of Directors at the time of issuance, provided that the holders of preferred shares shall be entitled to receive dividends at a rate not lower than that determined for holders of common shares. Under our articles of incorporation, we may not issue any class of shares which are redeemable.

Under our articles of incorporation, we are authorized to issue preferred shares up to 2,000,000 shares.

As of the date hereof, 6,948,900 common shares were issued and outstanding. We have not issued any equity securities other than common shares. All of the issued and outstanding shares are fully paid and non-assessable and are in registered form. Pursuant to our articles of incorporation, we may issue additional common shares without further shareholder approval. The unissued shares remain authorized until an amendment to our articles of incorporation changes the status of the authorized shares to unauthorized shares.

Dividends

We may pay dividends to our shareholders in proportion to the number of shares owned by each shareholder. The common shares represented by the ADSs have the same dividend rights as our other common shares.

In general, we may declare dividends at the annual general meeting of shareholders which is held within three months after the end of each fiscal year. However, in some cases, we may also declare dividends at a meeting of the Board of Directors, if (i) the external auditor gives an unqualified opinion on the financial statements and (ii) all members of the audit committee unanimously agree. We may pay the annual dividend shortly after the annual general meeting of shareholders declaring such dividends. We may distribute the annual dividend in cash, in shares or in other form of valuable property (in-kind). The amendment to the Korean Commercial Code which went into effect on April 15, 2012 allows dividends to be paid by other properties (in-kind). Accordingly, we also revised our articles of incorporation to allow dividends to be paid by other properties (in-kind) than cash or shares from April 15, 2012. However, a dividend in shares must be distributed at par value, and dividends in shares may not exceed one-half of the annual dividends.

Under the Korean Commercial Code, we may pay an annual dividend only out of the excess of our net assets, on a non-consolidated basis, over the sum of (i) our stated capital, (ii) the total amount of our capital surplus reserve and earned surplus reserve accumulated up to the end of the relevant dividend period, (iii) the earned surplus reserve to be set aside for the annual dividend and (iv) unrealized gains (the amount of net assets stated on the balance sheet increased as a result of an evaluation of the assets and liabilities in accordance with GAAP).

We may not pay an annual dividend unless we have set aside as earned surplus reserve an amount equal to at least 10% of the cash portion of the annual dividend, or unless we have an accumulated earned surplus reserve of not less than one-half of our stated capital. We may not use our legal reserves to pay cash dividends but may transfer amounts from our legal reserves to capital stock or use our legal reserves to reduce an accumulated deficit. If our legal reserves exceed 1.5 times our stated capital, the excess legal reserves may be reduced by a majority vote of the shareholders.

In addition to annual dividends, under the Korean Commercial Code and our articles of incorporation, we may pay interim dividends once during each fiscal year in case we earn more retained earnings as of the end of the first half of such year than the retained earnings not disposed of at the time of the general shareholder meeting with respect to the immediately preceding fiscal year. The decision to pay interim dividends shall be made by a resolution of the Board of Directors and is not subject to shareholder approval. Any interim dividends must be paid to

Table of Contents

the shareholders of record as of June 30 of the relevant fiscal year. Although the former Korean Commercial Code allowed interim dividends to be paid in cash only, the amendment to the Korean Commercial Code, which went into effect on April 15, 2012, permits interim dividends to be paid not only in cash but also in shares or in other valuable properties, and our articles of incorporation were amended accordingly to reflect such change.

The total amount of interim dividends payable in a fiscal year shall not be more than the net assets on the balance sheet of the immediately preceding fiscal year, after deducting (i) our capital in the immediately preceding fiscal year, (ii) the aggregate amount of our capital reserves and earned surplus reserves accumulated up to the immediately preceding fiscal year, (iii) the amount relating to the immediately preceding fiscal term which is confirmed at the annual general meeting of shareholders to be distributed as profit or paid, (iv) the amount of voluntary reserves accumulated up to the immediately preceding fiscal year for special purposes pursuant to our articles of incorporation or a resolution by our shareholders, (v) the amount of earned surplus reserves that should be set aside for the current fiscal year following the interim dividend payment and (vi) unrealized gains (the amount of net assets stated on the balance sheet increased as a result of an evaluation of the assets and liabilities in accordance with GAAP). Furthermore, the rate of interim dividends for non-voting preferred shares must be the same as that for our common shares.

We have no obligation to pay any dividend unclaimed for five years from the dividend payment date.

Distribution of free shares

In addition to paying dividends in shares out of our retained or current earnings, we may also distribute to our shareholders an amount transferred from our capital surplus or earned surplus reserve to our stated capital in the form of bonus shares issued free of charge, or free shares. We must distribute such free shares to all our shareholders in proportion to their existing shareholdings. Since our inception, we have not distributed any free shares. We currently have no intention to make such distribution in the near future.

Preemptive rights and issuance of additional shares

We may issue authorized but unissued shares from time to time, unless otherwise provided for in the Korean Commercial Code, on such terms as our Board of Directors may determine. We must offer new shares on uniform terms to all shareholders who have preemptive rights and are listed on our shareholders' register as of the relevant record date.

We may issue new shares pursuant to a board resolution to persons other than existing shareholders, who in these circumstances will not have preemptive rights, if the new shares are issued:

through a general public offering, pursuant to a resolution of the Board of Directors, of no more than 50% of the total number of issued and outstanding shares;

to the members of the employee stock ownership association;

upon exercise of a stock option in accordance with our articles of incorporation;

in the form of depositary receipts of no more than 50% of the total number of issued and outstanding shares;

to induce foreign direct investment necessary for business in accordance with the Foreign Investment Promotion Act of no more than 50% of the total number of issued and outstanding shares;

to the extent not exceeding 50% of the total number of issued and outstanding shares, to domestic or overseas financial institutions, corporations or individuals for the purpose of raising funds on an emergency basis;

to certain companies under a joint venture arrangement with us; or

in a public offering or underwritten by underwriters for the purpose of listing such shares on any stock exchange, to the extent not exceeding 50% of the total number of issued and outstanding shares, provided that, if new shares are allocated to persons other than existing shareholders, the company is required to provide notice of shareholders or make a public notice at least two weeks prior to the payment date of the subscription amount for such new shares.

Table of Contents

We must give public notice of preemptive rights regarding new shares and their transferability at least two weeks before the relevant record date. We will notify the shareholders who are entitled to subscribe for newly issued shares of the deadline for subscription at least two weeks prior to such deadline. If a shareholder fails to subscribe by the deadline, the shareholder's preemptive rights lapse. Our Board of Directors may determine how to distribute fractional shares or shares for which preemptive rights have not been exercised.

In the case of ADS holders, the depository will be treated as the shareholder entitled to preemptive rights.

General meeting of shareholders

We hold the annual general meeting of shareholders within three months after the end of each fiscal year. Subject to a board resolution or court approval, we may hold an extraordinary general meeting of shareholders:

as necessary;

at the request of shareholders holding an aggregate of 3% or more of our outstanding shares; or

at the request of our audit committee.

We must give shareholders written notice or electronic document setting out the date, place and agenda of the meeting at least two weeks prior to the general meeting of shareholders. The agenda of the general meeting of shareholders is determined at the meeting of the Board of Directors. In addition, a shareholder holding an aggregate of 3% or more of the outstanding shares may propose an agenda for the general meeting of shareholders. Such proposal should be made in writing at least six weeks prior to the meeting. The Board of Directors may decline such proposal if it is in violation of the relevant laws and regulations or our articles of incorporation. Shareholders not on the shareholders register as of the record date are not entitled to receive notice of the general meeting of shareholders or attend or vote at the meeting. Holders of preferred shares, unless enfranchised, are not entitled to receive notice of or vote at the general meeting of shareholders. Beginning on April 15, 2012, when the amendment to the Korean Commercial Code went into effect, if a general meeting of shareholders is proposed by a shareholder or shareholders holding an aggregate of not less than 3% of the outstanding shares, the court may approve such general meeting and may also appoint the chairman of such shareholders' meeting upon request by the requesting parties or at its own discretion.

Beginning on April 15, 2012, when the amendment to the Korean Commercial Code went into effect, a shareholder holding an aggregate of 1% or more of the outstanding shares may, prior to the shareholders' meeting, request the court to appoint an inspector to examine the appropriateness of the meeting notice process and voting method.

Our shareholders' meetings are held in Seoul, Korea or other adjacent areas as deemed necessary.

The chairman of the shareholders' meeting shall be appointed by the Board of Directors, and if the person determined by the Board of Directors cannot serve as chairman, the representative director shall serve as chairman. If the representative director cannot serve as chairman, then the vice president, senior executive director or executive director shall serve as chairman, in that order.

Voting rights

Holders of our common shares are entitled to one vote for each common share. However, common shares held by us (i.e., treasury shares) or by any corporate entity in which we have, directly or indirectly, greater than a 10% interest, do not have voting rights. Unless the articles of incorporation explicitly state otherwise, the Korean Commercial Code permits cumulative voting pursuant to which each common share entitles the holder thereof to multiple voting rights equal to the number of directors to be elected at such time. A holder of common shares may exercise all voting rights with respect to his or her shares cumulatively to elect one director. However, our shareholders have decided not to adopt cumulative voting.

Our shareholders may adopt resolutions at a general meeting by an affirmative majority vote of the voting shares present or represented at the meeting, where the affirmative votes also represent at least one-third of our total voting shares then issued and outstanding. However, under the Korean Commercial Code and our articles of

Table of Contents

incorporation, the following matters require approval by the holders of at least two-thirds of the voting shares present or represented at the meeting, where the affirmative votes also represent at least one-third of our total voting shares then issued and outstanding:

amending our articles of incorporation;

removing a director;

effecting a capital reduction (except any reduction in capital to make up for deficits);

effecting any dissolution, merger or consolidation with respect to us;

transferring all or any significant part of our business;

acquiring all of the business of any other company or a part of the business of any other company having a material effect on our business (the material effect qualifier is applied to the acquisition of both the whole and partial business of any other company since the amendment to the Korean Commercial Code went into effect on April 15, 2012);

issuing new shares at a price below the par value; or

any other matters for which such resolution is required under relevant laws and regulations.

In general, holders of preferred shares (other than enfranchised non-voting preferred shares) are not entitled to vote on any resolution or receive notice of any general meeting of shareholders. However, in the case of amendments to our articles of incorporation, any merger or consolidation, capital reductions or in some other cases that affect the rights or interests of the preferred shares, approval of the holders of such class of shares is required. We must obtain the approval, by a resolution, of holders of at least two-thirds of the preferred shares present or represented at a class meeting of the holders of such class of shares, where the affirmative votes also represent at least one-third of the total issued and outstanding shares of such class. In addition, if we are unable to pay dividends on preferred shares as provided in our articles of incorporation, the holders of preferred shares will become enfranchised and will be entitled to exercise voting rights until the dividends are paid. The holders of enfranchised preferred shares have the same rights as holders of voting shares to request, receive notice of, attend and vote at a general meeting of shareholders.

Shareholders may exercise their voting rights by proxy. Under our articles of incorporation, the person exercising the proxy does not have to be a shareholder. A person with a proxy must present a document evidencing its power of attorney in order to exercise voting rights.

Holders of ADSs will exercise their voting rights through the ADS depository. Subject to the provisions of the deposit agreement, holders of ADSs will be entitled to instruct the depository how to vote the common shares underlying their ADSs.

Rights of dissenting shareholders

In some limited circumstances, including the transfer of all or any part of our business having a material effect on our business and our merger or consolidation with another company, dissenting shareholders have the right to require us to purchase their shares. To exercise this right, shareholders must submit to us a written notice of their intention to dissent before the applicable general meeting of shareholders. Within 20 days after the relevant resolution is passed, the dissenting shareholders must request us in writing to purchase their shares. We are obligated to purchase the shares of dissenting shareholders within two months after receiving such request. The purchase price for the shares is required to be determined through negotiations between the dissenting shareholders and us. If an agreement is not attained within 30 days since the receipt of the request, we or the shareholder requesting the purchase of shares may request the court to determine the purchase price. Holders of ADSs will

not be able to exercise dissenters' rights unless they withdraw the underlying common shares and become our direct shareholders.

Register of shareholders and record dates

Our transfer agent, Hana Bank, maintains the register of our shareholders at its office in Seoul, Korea. It registers transfers of shares on the register of shareholders upon presentation of the share certificates.

Table of Contents

The record date for annual dividends is December 31 of each year. For the purpose of determining shareholders entitled to annual dividends, the register of shareholders will be closed for the period from January 1 to January 31 of each year. Further, for the purpose of determining the shareholders entitled to some other rights pertaining to the shares, we may, on at least two weeks' public notice, set a record date and/or close the register of shareholders for not more than three months. The trading of shares and the delivery of share certificates may continue while the register of shareholders is closed.

Annual report

At least one week before the annual general meeting of shareholders, we must make our annual business report, auditor's report and audited consolidated financial statements available for inspection at our principal office and at all of our branch offices. In addition, copies of such reports, financial statements and any resolutions adopted at the general meeting of shareholders will be available to our shareholders. Under the Korean Commercial Code, we are required to prepare consolidated financial statements. In addition, the balance sheet, income and loss statement, statement of change in capital or statement of appropriation of retained earnings (or statement of disposition of deficit) are required to be approved at our shareholders' meeting. However, since the amendment to the Korean Commercial Code went into effect on April 15, 2012, and pursuant to our articles of incorporation which were subsequently revised, the Board of Directors, instead of the shareholders' meeting, may approve the balance sheet, income and loss statement, statement of change in capital or statement of appropriation of retained earnings (or statement of disposition of deficit) if (i) an external auditor gives an unqualified opinion to the financial statements and (ii) all members of the audit committee unanimously agree.

Transfer of shares

Except for the procedural requirements which obligate a non-citizen or non-resident of Korea to file a report to the relevant government authority of Korea at the time of acquisition or transfer of the Company's shares, there is no restriction on transfer or sale of our shares applicable to our shareholders or holders of ADSs under our articles of incorporation and the relevant laws.

Under the Korean Commercial Code, the transfer of shares is effected by delivery of share certificates. However, to assert shareholders' rights against us, the transferee must have his name and address registered on our register of shareholders. For this purpose, a shareholder is required to file his name, address and seal with our transfer agent. A non-Korean shareholder may file a specimen signature in place of a seal, unless he is a citizen of a country with a sealing system similar to that of Korea. In addition, a non-resident shareholder must appoint an agent authorized to receive notices on his or her behalf in Korea and file a mailing address in Korea. The above requirement does not apply to the holders of ADSs.

Under current Korean regulations, the Korean Securities Depository, foreign exchange banks, investment traders, investment brokers, collective investment business entities, internationally recognized foreign custodians and the Korea Securities Depository may act as agents and provide related services for foreign shareholders. Certain foreign exchange controls and securities regulations apply to the transfer of shares by non-residents or non-Koreans. See ITEM 10.D. EXCHANGE CONTROLS.

Our transfer agent, Hana Bank, maintains the register of our shareholders at its office located at 43-2 Yoido-Dong, Youngdeungpo-Gu, Seoul, Korea. It registers transfers of shares of the register of shareholders on presentation of the share certificates.

Acquisition of our shares

After April 15, 2012, when the amendment to the Korean Commercial Code went into effect, within the limitation of distributable profits, we may acquire our own common shares with the prior approval of the general meeting of shareholders (or by a resolution of the Board of Directors) (i) by purchasing them at the stock exchange or (ii) acquiring them after providing notice or making a public notice to all shareholders of the acquisition of treasury stocks, or by way of a tender offer prescribed by the Financial Investment and Capital Market Act of Korea. We may not otherwise acquire our own common shares except in limited circumstances, such as in the case of a merger of our company or an acquisition by us of all of another company's business, or in the case when a shareholder exercises his or her stock option.

Table of Contents

Under the Korean Commercial Code and our articles of incorporation, our Board of Directors can determine the method by which we dispose of any common shares owned by us. Except in limited circumstances, corporate entities in which we own a 50% or greater equity interest may not acquire our common shares.

Except for the procedural requirements which obligate a non-citizen or non-resident of Korea to file a report to the relevant government authority of Korea at the time of acquisition or transfer of the Company's shares, there exists no provision which limits the rights to own our shares or exercise voting rights on our shares due to their status as a non-resident or non-Korean under our articles of incorporation and the applicable Korean laws.

Liquidation rights

In the event of our liquidation, after payment of all debts, liquidation expenses and taxes, our remaining assets will be distributed among shareholders in proportion to their shareholdings.

Other provisions

Under our articles of incorporation, there exists no provision (i) which may delay or prevent a change in control of us and that is triggered in the event of a merger, acquisition or corporate restructuring, (ii) which requires disclosure of ownership above a certain threshold or (iii) that governs the change in capital that is more stringent than required by the applicable laws in Korea.

We may issue bonds by a resolution of the Board of Directors. Our articles of incorporation permit the issuance of convertible bonds and bonds with warrant, but none have been issued. Whereas the former Korean Commercial Code provided that (i) a corporation may not issue bonds in the amount in excess of four times its net worth stated in the latest balance sheet and (ii) a corporation may not offer new bonds for subscription if bonds previously offered for subscription have not been paid in full by investors, both of these provisions have been deleted in the amendment which went into effect on April 15, 2012.

ITEM 10.C. MATERIAL CONTRACTS

Since the filing of our annual report on Form 20-F on June 29, 2011, we have not entered into any material contracts other than in the ordinary course of business and other than those described below or otherwise as described in ITEM 4. *INFORMATION ON THE COMPANY* or elsewhere in this annual report.

Third Amendment to the Exclusive Requiem Online License and Distribution Agreement dated June 16, 2011 between Gravity Interactive, Inc. and Registrant

Under this amendment, the term of Exclusive Requiem Online License and Distribution Agreement was extended for one year to June 15, 2012. The amendment also expanded the service countries to include Mexico, Guatemala, El Salvador, Nicaragua, Panama, Honduras, Belize, Cuba, Jamaica, Haiti, Dominica, Costa Rica, Puerto Rico, Ecuador, Colombia, Peru, Venezuela, Guyana, Suriname, French Guiana, Chile, Bolivia, Paraguay and Argentina.

Third Amendment to the Ragnarok Online Software License Agreement dated October 9, 2011 between Game Flier (Malaysia) Sdn. Bhd. and Registrant

Under this amendment with our licensee in Singapore and Malaysia, the term of the Ragnarok Online Software License Agreement was extended for two years to October 8, 2013. The amendment increased royalty payment from 33% to 35% of the licensee's service sales amount from Ragnarok Online and also included English and Chinese as service languages in addition to Malay.

Fourth Amendment to Ragnarok Online Exclusive Game License Agreement dated October 22, 2011 between Game Flier International Corporation and Registrant

Under this amendment with our licensee in Taiwan, Hong Kong and Macau, the term of the Ragnarok Online Exclusive Game License Agreement was extended for two years to October 21, 2013. The amendment also increased royalty payment from 33% to 35% of the licensee's service sales amount from Ragnarok Online.

Table of Contents

Fourth Amendment to the Exclusive Requiem Online License and Distribution Agreement dated October 26, 2011 between Gravity Interactive, Inc. and Registrant

Under this amendment, Korean was included as service language in addition to English. The amendment also expanded the serviced territory to all the world except for the licensed territories in which Registrant had already granted licenses regarding the service of Requiem game to third parties before the effective date of this amendment; provided that, without further agreement between the licensee and Registrant, the serviced territory shall further include licensed territories with third parties after the expiration or termination of such licenses.

Second Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated March 5, 2012 between AsiaSoft Corporation Public Co., Ltd. and Registrant

Under this amendment with our licensee in Thailand, the term of Exclusive Ragnarok Online License and Distribution Agreement was extended for one year to March 4, 2013.

ITEM 10.D. EXCHANGE CONTROLS

General

The Foreign Exchange Transaction Law and the Presidential Decree and regulations under such Law and Decree, or the Foreign Exchange Transaction Laws, regulate investment in Korean securities by non-residents and issuance of securities outside Korea by Korean companies. Under the Foreign Exchange Transaction Laws, if non-residents wish to acquire Korean securities, a report must be filed with the President of Korea Exchange Bank or the President of Bank of Korea except for certain cases provided, however that, under the Financial Investment Services and Capital Markets Act, foreigners cannot acquire equity securities issued by public corporations in excess of a fixed limit, and under the Foreign Investment Promotion Law, foreigners are either not allowed or restricted in making an investment in certain industries.

Under the Foreign Exchange Transaction Laws, (i) if the Korean government deems that it is inevitable due to the outbreak of natural calamities, wars, conflict of arms or grave and sudden changes in domestic or foreign economic circumstances or other situations equivalent thereto, the Ministry of Strategy and Finance, or the MOSF, may temporarily suspend payment, receipt or the whole or part of transactions to which the Foreign Exchange Transaction Laws apply, or impose an obligation to safe-keep, deposit or sell means of payment in or to certain Korean governmental agencies or financial institutions; and (ii) if the Korean government deems that the international balance of payments and international finance are confronted or are likely to be confronted with serious difficulty or the movement of capital between Korea and abroad brings or is likely to bring on serious obstacles in carrying out currency policies, exchange rate policies and other macroeconomic policies, the MOSF may take measures to require any person who intends to perform capital transactions to obtain permission or to require any person who performs capital transactions to deposit part of the means of payment acquired in such transactions in certain Korean governmental agencies or financial institutions, in each case subject to certain limitations thereunder.

Filing with the Korean government in connection with the issuance of American Depositary Shares

In order for us to issue common shares represented by ADSs in an amount exceeding US\$30 million, we are required to file a prior report of the issuance with the MOSF through the designated foreign exchange bank. No further Korean governmental approval is necessary for the initial offering and issuance of the ADSs.

Under current Korean law and regulations, the depositary is required to obtain our prior consent for the number of common shares to be deposited in any given proposed deposit which exceeds the difference between (i) the aggregate number of common shares deposited by us for the issuance of ADSs (including deposits in connection with the initial and all subsequent offerings of ADSs and stock dividends or other distributions related to these ADSs), and (ii) the number of common shares on deposit with the depositary at the time of such proposed deposit. We have agreed to consent to any deposit so long as the deposit would not violate our articles of incorporation or applicable Korean law, and the total number of our common shares on deposit with the depositary would not exceed the sum of the aggregate number of common shares and any number of additional shares for which the Depositary has received our written consent.

Table of Contents

Furthermore, prior to making an investment of 10% or more of the outstanding voting shares of a Korean company, foreign investors are generally required under the Foreign Investment Promotion Law to submit a report to the Chairman of the Korea Trade-Investment Promotion Agency, or KOTRA, (including the head of the Trade Center, branch office and/or office designated by the Chairman of KOTRA) or the President of the Foreign Exchange Bank (including the head of the branch office designated by the President of the Foreign Exchange Bank). Subsequent sales of such shares by foreign investors will also require a prior report to the Chairman of KOTRA or the President of the Foreign Exchange Bank.

Certificates of the shares must be kept in custody with an eligible custodian

Under Korean law, certificates evidencing shares of Korean companies must be kept in custody with an eligible custodian in Korea, which certificates may in turn be required to be deposited with the Korea Securities Depository, or KSD, if they are designated as being eligible for deposit with the KSD. Only the KSD, foreign exchange banks, investment trader, investment broker, collective investment business entity and internationally recognized foreign custodians are eligible to act as a custodian of shares for a foreign investor. However, a foreign investor may be exempted from complying with the requirement to have the certificates deposited with the KSD with the approval of the Governor of the Financial Supervisory Service in circumstances where such compliance is made impracticable, including cases where such compliance would contravene the laws of the home country of such foreign investor.

A foreign investor may appoint one or more standing proxies from among the KSD, foreign exchange banks, investment trader, investment broker, collective investment business entity and internationally recognized foreign custodians, and cannot have any other apart from those standing proxies to represent or act on behalf of them in order to exercise rights of acquired shares, or other matters connected thereto. However, a foreign investor may be exempted from complying with these standing proxy rules with the approval of the Governor of the Financial Supervisory Service in circumstances where such compliance is made impracticable, including cases where such compliance would contravene the laws of the home country of such foreign investor.

Restrictions on American Depositary Shares and shares

Once the report to the MOSF is filed in connection with the issuance of ADSs, no further Korean governmental approval is necessary for the sale and purchase of ADSs in the secondary market outside Korea or for the withdrawal of shares underlying ADSs and the delivery inside Korea of shares in connection with such withdrawal. In addition, persons who have acquired shares as a result of the withdrawal of shares underlying the ADSs may exercise their preemptive rights for new shares, participate in free distributions and receive dividends on shares without any further governmental approval.

A foreign investor may receive dividends on the shares and remit the proceeds of the sale of the shares through a foreign currency account and a Won account exclusively for stock investments by the foreign investor which are opened at a foreign exchange bank designated by the foreign investor without being subject to any procedural restrictions under the Foreign Exchange Transaction Laws. No approval is required for remittance into Korea and deposit of foreign currency funds in the foreign currency account. Foreign currency funds may be transferred from the foreign currency account at the time required to place a deposit for, or settle the purchase price of, a stock purchase transaction to a Won account opened at a foreign exchange bank. Funds in the foreign currency account may be remitted abroad without any governmental approval.

Dividends on shares are paid in Won. No Korean governmental approval is required for foreign investors to receive dividends on, or the Won proceeds of the sale of, any such shares to be paid, received and retained in Korea. Dividends paid on, and the Won proceeds of the sale of, any such shares held by a non-resident of Korea must be deposited in his Won account. Funds in the investor's Won account may be transferred to his foreign currency account or withdrawn for local living expenses up to certain limitations. Funds in the investor's Won account may also be used for future investment in shares or for payment of the subscription price of new shares obtained through the exercise of preemptive right.

Investment brokers and investment traders are allowed to open foreign currency accounts with foreign exchange banks exclusively for accommodating foreign investors' securities investments in Korea. Through such

Table of Contents

accounts, these investment brokers or investment traders may enter into foreign exchange transactions on a limited basis, such as the conversion of foreign currency funds and Won funds, either as a counterparty to or on behalf of foreign investors, without such investors having to open their own Won and foreign currency accounts with foreign exchange banks.

Amendments to the Foreign Exchange Transaction Law and the related Presidential Decree went into effect on July 31, 2011 and January 6, 2012, respectively. However, nothing in the amendment is applicable to us or our foreign exchange control.

ITEM 10.E. TAXATION
KOREAN TAXATION

The following is a discussion of material Korean tax consequences to owners of our ADSs and common shares that are non-resident individuals or non-Korean corporations without a permanent establishment in Korea to which the relevant income is attributable. A non-resident individual according to Korean tax laws means an individual who does not have an address or a place of residence in Korea for longer than a period of one year. A non-Korean corporation is a corporation whose headquarters and main office is located overseas and does not have a permanent establishment in Korea. The statements regarding Korean tax laws set forth below are based on the laws in force and as interpreted by the Korean taxation authorities as of the date hereof. This discussion is not exhaustive of all possible tax considerations which may apply to a particular investor, and prospective investors are advised to satisfy themselves as to the overall tax consequences of the acquisition, ownership and disposition of our common shares, including specifically the tax consequences under Korean law, the laws of the jurisdiction of which they are resident, and any tax treaty between Korea and their country of residence, by consulting their own tax advisors.

Dividends on the shares or American Depositary Shares

Under Korean tax laws, the domestic source dividend income of non-resident individuals and non-Korean corporations means any profits or surpluses that are distributed by domestic companies. Therefore, dividends that are distributed to non-Korean corporations and non-resident individuals who own common shares of domestic companies are considered to be domestic source dividend income. The dividends provided to the holder of ADSs are also included in the domestic source dividend income as it is no different from dividends that are paid to a holder of common shares in the domestic companies.

With respect to the taxation of domestic source dividend income of a non-resident individual and non-Korean corporation, if there is no tax treaty entered into between Korea and the country of tax residence of the non-resident individual or non-Korean corporation or if the country of tax residence is a tax haven designated by the Commissioner of the National Tax Service of Korea (currently, only Labuan, Malaysia) and has not acquired prior approval of the Commissioner, we will deduct Korean withholding tax from dividends paid to such non-resident individual or non-Korean corporation (whether in cash or in shares) at a rate of 22.0% (including local income tax). Due to an amendment to the Local Tax Act, the term "resident surtax" is changed to "local income tax" effective January 1, 2011. If you are a resident of a country that has entered into a tax treaty with Korea, you may qualify for an exemption or a reduced rate of Korean withholding tax according to the tax treaty. In this connection, if the party with whom the income has been provided exists as a paper company in order to receive the benefits of the tax treaty and there exists a separate beneficiary owner who is the real owner of the income (hereinafter referred to as the "Beneficiary Owner") that is provided with income from dividends, tax will be withheld at source by applying the tax rate determined in the tax treaty entered into between Korea and the country of tax residence of the Beneficiary Owner. If the country of tax residence of the Beneficiary Owner and Korea has not entered into a tax treaty or in the case that such country is Labuan, Malaysia, tax will be withheld at source at a tax rate of 22.0% according to the Korean Corporate Tax Act.

Generally, in order to obtain a reduced rate of withholding tax pursuant to an applicable tax treaty, you must submit to us, prior to the dividend payment date, together with the request form to apply for the reduced rate, such evidence of tax residence as the Korean tax authorities may require in order to establish your entitlement to the

Table of Contents

benefits of the applicable tax treaty. If you hold ADSs, evidence of tax residence may be submitted to us through the depository. See ITEM 10.E. TAXATION KOREAN TAXATION Tax treaties below for a discussion on treaty benefits.

In order for the beneficiary of dividends that is a corporation or an individual in Labuan to be qualified for a limited tax rate, the beneficiary must obtain an approval before such dividends are paid by submitting legal evidentiary documents that verify the country of tax residence of the beneficiary to the Commissioner of the National Tax Service of Korea along with a request for prior approval of tax withholding or the beneficiary may submit a request for correction to the responsible director of the tax office within three years of withholding tax at source.

Taxation of capital gains

Under Korean tax laws, capital gains from securities are triggered when a non-resident individual or a non-Korean corporation transfers his or its securities. Securities subject to taxation include shares and depositary receipts issued based on such shares and equity interests and all securities issued by domestic corporations. (However, in the case of bonds, the interests that are accrued during the holding period are taxable as interest income, and therefore, capital gains treatment is not triggered.)

In regards to capital gains tax originating from Korea, if there is no tax treaty entered into between Korea and the country of tax residence of the non-resident individual or non-Korean corporation or if the country of tax residence is a tax haven designated by the Commissioner of the National Tax Service of Korea (currently, only Labuan, Malaysia) and has not acquired prior approval of the Commissioner, capital gains earned by such non-resident individual or non-Korean corporation upon the transfer of our common shares or ADSs are subject to Korean withholding tax at the lower of (i) 11% (including local income tax) of the gross proceeds realized and (ii) 22.0% (including local income tax) of the net realized gains (subject to the production of satisfactory evidence of the acquisition costs and the transaction costs). However, in most cases where a tax treaty is entered into between Korea and the country of tax residence of the non-resident individual or non-Korean corporation, such non-resident individual or non-Korean corporation is exempt from Korean income taxation under the applicable Korean tax treaty with his or its country of tax residence. In this regard, if the party to whom the capital gains from securities are provided exists as a paper company in order to receive benefits of a tax treaty and there exists a separate Beneficiary Owner that is provided with income from dividends, tax will be withheld at source by applying the tax rate determined in the tax treaty entered into between Korea and the country of tax residence of the Beneficiary Owner. If the country of tax residence of the Beneficiary Owner and Korea has not entered into a tax treaty or in the case that such country is Labuan, Malaysia, tax will be withheld at source at a tax rate (11% of transfer price or 22.0% of capital gains, whichever is less) according to the Korean Corporate Tax Act. See ITEM 10.E. TAXATION KOREAN TAXATION Tax treaties below for a discussion on treaty benefits. Even if you do not qualify for any exemption under a tax treaty, you will not be subject to the foregoing withholding tax on capital gains if you qualify for the relevant Korean domestic tax law exemptions discussed in the following paragraphs.

Aside from the benefits provided in the tax treaties, Korean tax law provides provisions on tax exemptions in regards to capital gains from securities when certain requirements are met. With respect to our common shares, you will not be subject to Korean income taxation on capital gains realized upon the transfer of such common shares, (i) if our common shares are listed on either the Market Division of the Korea Exchange or the KOSDAQ Division of the Korea Exchange, (ii) if shares are transferred through stock market, (iii) if you have no permanent establishment in Korea and (iv) if you did not own or have not owned (together with any shares owned by any entity which you have a certain special relationship with and possibly including the shares represented by the ADSs) 25% or more of our total issued and outstanding shares at any time during the calendar year in which the sale occurs and during the five calendar years prior to the calendar year in which the sale occurs.

With respect to the ADSs, if the ADSs are considered shares and equity interests for the purpose of calculation of capital gains from securities held by non-Korean corporations and non-resident individuals, the capital gains that are realized, regardless of whether a permanent establishment of business exists and regardless of who the transferee is, would be considered as domestic source income. However, if the ADSs are considered securities other than shares and equity interests, the capital gains are considered to be domestic source income in the following cases: (i) if the transferor is a non-Korean corporation with a place of business in Korea or (ii) if the transferor is a non-Korean corporation without a place of business in Korea but the transferee is a domestic corporation, resident

Table of Contents

individual, or the place of business of a resident or non-Korean corporation. In other words, the income accrued through a transfer of securities, which exclude shares and equity interests, between non-resident individuals without a domestic place of business is not subject to taxation.

Before the recent revisions to the law, the regulations regarding the calculation of capital gains were unclear; it was unclear if the ADSs should be considered separately from the underlying shares or if the ADSs should be considered to be part of the underlying shares. The Corporate Tax Act and Income Tax Act as revised in 2007 provides that with respect to the non-Korean corporation's capital gains from securities originating from domestic sources, the depositary receipts issued based on the equity interests should be included in the scope of the equity interests. Therefore, for cases in which a non-Korean corporation transfers the ADSs issued by a domestic corporation and the capital gains are realized, such capital gains are treated the same as capital gains from shares and equity interests and are subject to tax withholding in principle under the Korean tax laws.

However, for cases in which the capital gains from such ADSs meet the following requirements, tax on the capital gains is exempted under the Restriction of Special Taxation Act in addition to the exemption afforded under income tax treaties: (i) the ADSs issued overseas by the domestic corporation must be transferred by a non-resident individual and non-Korean corporation overseas and (ii) the ADSs do not fall under the case in which prior to a corporation issuing the depositary receipts, the shareholder of the same corporation maintains its shares without converting into the depositary receipts even after the corporation has issued depositary receipts, and such shareholder transfers its shares by converting its shares into the depositary receipts at the time of transfer.

If you are subject to tax on capital gains with respect to the sale of ADSs, or of our common shares which you acquired as a result of a withdrawal, the purchaser or, in the case of the sale of common shares on the Korea Exchange or through a licensed securities company in Korea, the licensed securities company, is required to withhold Korean tax from the sales price in an amount at the lower of (i) 11% (including local income tax) of the gross realization proceeds and (ii) 22.0% (including local income tax) of the net realized gains (subject to the production of satisfactory evidence of acquisition costs and the transaction costs for the common shares or the ADSs) and to make payment of these amounts to the Korean tax authority, unless you establish your entitlement to an exemption under an applicable tax treaty or domestic tax law.

Generally, to obtain the benefit of an exemption from tax pursuant to a tax treaty, you must submit to the purchaser or the securities company, or through the ADS depositary, as the case may be, prior to or at the time of payment, such evidence of your tax residence as the Korean tax authorities may require in support of your claim for treaty benefits. However, in order for the beneficiary of capital gains from securities who is a corporation or an individual in Labuan to be qualified for a limited tax rate, the beneficiary must obtain an approval before such capital gains from securities is realized by submitting legal evidentiary documents that verify the country of tax residence of the beneficiary to the Commissioner of the National Tax Service of Korea along with a request for prior approval of tax withholding or the beneficiary may submit a request for correction to the responsible director of the tax office within three years of withholding tax at source. See ITEM 10.E. TAXATION KOREAN TAXATION Tax treaties for additional explanation on claiming treaty benefits.

Tax treaties

Korea has entered into a number of income tax treaties with other countries (including the United States), which would reduce or exempt Korean withholding tax on dividends on, and capital gains on transfer of, our common shares or ADSs. For example, under the Korea-United States income tax treaty, reduced rates of Korean withholding tax of 16.5% or 11.0% (respectively, including local income tax, depending on your shareholding ratio) on dividends and an exemption from Korean withholding tax on capital gains are available to residents of the United States that are beneficial owners of the relevant dividend income or capital gains. However, under Article 17 (Investment or Holding Companies) of the Korea-United States income tax treaty, such reduced rates and exemption do not apply if (i) you are a United States corporation, (ii) by reason of any special measures, the tax imposed on you by the United States with respect to such dividends or capital gains is substantially less than the tax generally imposed by the United States on corporate profits, and (iii) 25% or more of your capital is held of record or is otherwise determined, after consultation between competent authorities of the United States and Korea, to be owned directly or indirectly by one or more persons who are not individual residents of the United States. Also, under Article 16 (Capital Gains) of the Korea-United States income tax treaty, the exemption on capital gains does not

Table of Contents

apply if you are an individual, and (a) you maintain a fixed base in Korea for a period or periods aggregating 183 days or more during the taxable year and your ADSs or common shares giving rise to capital gains are effectively connected with such fixed base or (b) you are present in Korea for a period or periods of 183 days or more during the taxable year.

On the other hand, the International Tax Adjustment Law provides that in regards to taxable income, gains, asset, act or transaction, when the holder and Beneficiary Owner is not the same, the Beneficiary Owner is considered to be the taxpayer who is subject to the applicable tax treaty. If one engages in activities to receive benefits of a tax treaty through having international transactions with a third party indirectly or conducts transactions with more than two parties, such activity is considered to be a direct transaction or a single transaction for which the tax treaty applies. Thus, if a non-Korean company or a non-resident individual establishes a paper company in a certain country for the purpose of receiving benefits of a tax treaty and tries to unreasonably receive dividends and capital gains from securities pursuant to a tax treaty between a certain country and Korea, the tax treaty that is entered into between the country of the residence of the Beneficiary Owner and Korea shall be applied.

You should inquire for yourself whether you are entitled to the benefit of an income tax treaty with Korea. It is the responsibility of the party claiming the benefits of an income tax treaty in respect of dividend payments or capital gains to submit to us, the purchaser or the securities company, as applicable, a certificate as to its tax residence. In the absence of sufficient proof, we, the purchaser or the securities company, as applicable, must withhold tax at the normal rates. Further, effective from July 1, 2002, in order for you to obtain the benefit of a tax exemption on certain Korean source income (e.g., dividends and capital gains) under an applicable tax treaty, Korean tax law requires you (or your agent) to submit the application for tax exemption along with a certificate of your tax residency issued by a competent authority of your country of tax residence. Such application should be submitted to the relevant district tax office by the ninth day of the month following the date of the first payment of such income.

Furthermore, with the amendments of Article 2-2 of the International Tax Adjustment Law, Article 98-5 of the Corporate Tax Law and Article 156-4 of the Personal Income Tax Law, Korea adopted the New Anti-Treaty Shopping Rules (New Rules), which took effect on July 1, 2006. According to the New Rules, even if a tax treaty provides for either an exemption from or reduction of the applicable income tax, the company or person paying dividends, interest, royalty or consideration for share purchase to an offshore entity established in a tax haven jurisdiction designated by the MOSF, must initially withhold the applicable tax on such income under the applicable tax law. In such case, by submitting documents that verify the country of tax residence of the Beneficiary Owner within three years from deduction of withholding tax to the public office for tax in Korea in order to request for correction, the difference between the amount of tax to which the tax rate of exemption and restriction in the tax treaty that the Beneficiary Owner qualifies for and the amount of tax that was withheld initially shall be refunded. If, however, the National Tax Service of Korea has granted prior approval upon application for an exemption or reduction of tax pursuant to a relevant tax treaty, the withholding requirement under the New Rules will not apply. So far, the MOSF has designated only one district, Labuan in Malaysia, as a tax haven jurisdiction under the New Rules as of June 30, 2006.

Inheritance tax and gift tax

Korean inheritance tax is imposed upon (i) all assets (wherever located) of the deceased if he or she was domiciled in Korea at the time of his or her death and (ii) all property located in Korea which passes on death (irrespective of the domicile of the deceased). Gift tax is imposed in similar circumstances to the above (based on the donee's place of domicile in the case of (i) above). The taxes are imposed if the value of the relevant property is above a limit and vary from 10% to 50% at sliding scale rate according to the value of the relevant property and the identity of the parties involved. The inheritance tax rate in Korea was evaluated to be considerably higher than the rates in other OECD member nations. As a result, on October 1, 2008, the Korean government submitted a legislative bill to the National Assembly proposing a reduction in the inheritance tax from the current rate, which ranges from 10% to 50%, to a rate ranging from 6% to 33%; however, due to opposition from numerous members of the National Assembly, the bill is still pending in the National Assembly.

Under the Korean inheritance and gift tax laws, shares issued by Korean corporations are deemed located in Korea irrespective of where the share certificates are physically located or by whom they are owned. If the tax

Table of Contents

authority's interpretation of treating depositary receipts as the underlying share certificates under the 2004 tax ruling applies in the context of inheritance and gift taxes as well, you may be treated as the owner of the common shares underlying the ADSs.

At present, Korea has not entered into any tax treaty relating to inheritance or gift taxes.

Securities transaction tax

The Securities Transaction Tax Act provides that a securities transaction tax shall be imposed on the transfer of share certificate or shares. Pursuant to an October 27, 2010 amendment to the Securities Transaction Tax Act, the scope of taxable share certificates has been expanded to include, with respect to share certificates transferred on or after January 1, 2011, rights arising from the acquisition of shares or shares prior to the issuance of share certificates, preemptive rights, subscription securities issued by corporations established under special laws and depositary receipts pursuant to the Financial Investment Services and Capital Markets Act. However, with respect to the transfer of share certificates listed in overseas securities markets that are similar to the Korean securities market, such as the New York Stock Exchange or NASDAQ, or the transfer of share certificates to an underwriter in order to list such share certificates on foreign stock exchanges, such transfer is not subject to the securities transaction tax. The said Act provides that the types of share certificates that are subject to the securities transaction tax is a share certificate issued by a domestic corporation established according to the Commercial Act or a special act, or the share certificate or depositary receipts which are issued by a non-Korean corporation that are listed or registered in the securities market. Therefore, if you transfer common shares in a Korean corporation and the common shares are not listed in the securities market overseas, you will be subject to a securities transaction tax at the rate of 0.5%.

With respect to transfers of ADSs, whether or not ADSs issued by a domestic corporation falls within the scope of taxable share certificates under the Securities Transaction Tax Act can be determined by looking at the applicable depositary receipts. In the past, the Security Transaction Tax Act did not specify whether depositary receipts are share certificates taxable under the Securities Transaction Tax Act which caused a split between Korean tax authorities, who concluded that, as the substance of a depositary receipt is similar to that of a share certificate, the depositary receipt is actually a share certificate and therefore taxable, and the court, which held that depositary receipts should not be considered taxable as a share certificate because they are legally different from share certificates. However, such disputes have been settled since the October 27, 2010 amendment to the Securities Transaction Tax Act, which specifically includes depositary receipts transferred on or after January 1, 2011 within the scope of share certificates taxable under said Act.

In principle, the securities transaction tax, if applicable, must be paid by the transferor of the shares or the rights to subscribe to such shares. When the transfer is effected through a securities settlement company, such settlement company is generally required to withhold and pay the tax to the tax authorities. When such transfer is made through a securities company only, such securities company is required to withhold and pay the tax. Where the transfer is effected by a non-resident without a permanent establishment in Korea, other than through a securities settlement company or a securities company, the transferee is required to withhold and pay the securities transaction tax.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following summary describes material U.S. federal income tax consequences of the purchase, ownership or disposition of our ADSs and common shares as of the date hereof. The discussion set forth below is applicable to U.S. Holders (as defined below) (i) who are residents of the United States for purposes of the current Korea-United States income tax treaty, (ii) whose ADSs or common shares are not, for purposes of the treaty, effectively connected with a permanent establishment in Korea and (iii) who otherwise qualify for the full benefits of the treaty. Except where noted, it deals only with our ADSs and common shares held as capital assets and does not deal with special situations, such as those of:

financial institutions;

regulated investment companies;

tax-exempt organizations;

Table of Contents

grantor trusts;

certain former citizens or residents of the United States;

insurance companies;

dealers or traders in securities or currencies;

persons liable for alternative minimum tax;

persons (including traders in securities) using a mark-to-market method of accounting;

persons that have a functional currency other than the U.S. dollar;

persons that own (or are deemed to own) 10% or more (by voting power) of our common shares;

persons who hold our common shares or ADSs as a hedge or as part of a straddle with another position, constructive sale, conversion transaction or other integrated transaction; or

entities that are treated as partnerships for U.S. federal income tax purposes.

This discussion is based on the Internal Revenue Code of 1986, as amended (the Code), Treasury regulations promulgated thereunder, administrative and judicial interpretations thereof, the Convention Between the United States of America and the Republic of Korea for the Avoidance of Double Taxation, as amended (the Tax Convention), all as in effect on the date hereof and all of which are subject to change, possibly with retroactive effect, or to different interpretation. This discussion is for general information only and does not address all of the tax considerations that may be relevant to specific U.S. Holders in light of their particular circumstances or to U.S. Holders subject to special treatment under U.S. federal income tax law. This discussion does not address any U.S. state or local or non-U.S. tax considerations or any U.S. federal estate, gift or alternative minimum tax considerations. The discussion below is based, in part, upon representations made by the depositary to us and assumes that the deposit agreement, and all related agreements, will be performed in accordance with their terms.

Persons considering the purchase, ownership or disposition of our ADSs or common shares should consult their own tax advisor concerning U.S. federal income tax consequences in light of their particular situation as well as any other tax consequences arising under the laws of any taxing jurisdiction. In particular, while we do not believe we were a PFIC in 2007, due to deterioration of the trading price of our ADSs and our holding of a significant amount of cash, short-term investments, and other passive assets, it is likely we were a PFIC in 2008 through 2011, and there is a significant risk that we will continue to be one in 2012. See discussion under ITEM 10.E. TAXATION MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS PFICs.

As used herein, the term U.S. Holder means a beneficial holder of our ADS or common share that is for U.S. federal income tax purposes:

an individual citizen or resident of the United States;

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a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia;

an estate the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust that:

is subject to the primary supervision of a court within the United States and the control of one or more United States persons as described in section 7701(a)(30) of the Code; or

has a valid election in effect under applicable U.S. Treasury regulations to be treated as a United States domestic trust.

If a partnership holds our ADSs or common shares, the tax treatment of a partner will generally depend upon the status and the activities of the partner and the partnership. If you are a partner of a partnership holding our ADSs or common shares, you should consult your tax advisor.

Table of Contents

American Depositary Shares

If you hold our ADSs, for U.S. federal income tax purposes, you generally will be treated as the owner of the underlying common shares that are represented by such ADSs. Accordingly, upon the exchange of ADSs for a U.S. Holder's proportionate interest in our common shares represented by such ADSs, (i) no gain or loss will be recognized to such U.S. Holder, (ii) such U.S. Holder's tax basis in such common shares will be the same as its tax basis in such ADSs, and (iii) the holding period in such common shares will include the holding period in such ADSs.

PFICs

In general, we will be a PFIC for U.S. federal income tax purposes for any taxable year in which:

at least 75% of our gross income is passive income; or

on average at least 50% of the value (determined on a quarterly basis) of our assets is attributable to assets that produce or are held for the production of passive income.

For this purpose, passive income generally includes dividends, interest, royalties, rents (other than rents and royalties derived in the active conduct of a trade or business and not derived from a related person). If we own, directly or indirectly, at least 25% by value of the stock of another corporation, we will be treated, for purposes of the PFIC tests, as owning our proportionate share of the other corporation's assets and receiving our proportionate share of the other corporation's income.

The determination of whether we are a PFIC is made annually at the end of each taxable year and is dependent upon a number of factors, some of which are uncertain or beyond our control, including the value of our assets, ADSs and common shares and the amount and type of our income. 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, and may be in subsequent years, a PFIC. In particular, while we do not believe we were a PFIC in 2007, due to deterioration of the trading price of our ADSs and our holding of a significant amount of cash, short-term investments, and other passive assets, it is likely we were a PFIC in 2008 through 2011, and there is a significant risk that we will continue to be a PFIC in 2012. 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 as discussed below. Once we are a PFIC for any portion of the period that you hold our ADSs or common shares, all of our subsequent distributions, and any subsequent dispositions by you of such ADSs or common shares, are subject to the excess distribution rules discussed below, even after we cease to be a PFIC.

Alternatively, the PFIC rules described below could be avoided if an election to treat us as a "qualified electing fund" under section 1295 of the Code were available. This option is not available to you because we do not intend to comply with the requirements necessary to permit you to make this election.

You are urged to consult your own tax advisor 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.

Taxation of dividends

The amount of any dividend paid in Won will equal the United States dollar value of the Won received calculated by reference to the exchange rate in effect on the date the dividend is received by you, in the case of our common shares, or by the Depositary, in the case of our ADSs, regardless of whether the Won are converted into United States dollars. If the Won received as a dividend are not converted into United States dollars on the date of receipt, you will have a basis in the Won equal to their United States dollar value on the date of receipt. Any gain or loss realized on a subsequent conversion or other disposition of the Won generally will be treated as U.S. source ordinary income or loss.

If you hold our ADSs or common shares while we are a PFIC

If we are a PFIC for any taxable year during which you hold our ADSs or common shares, you will be subject to special tax rules with respect to any "excess distribution" received with respect to our ADSs or common shares.

Table of Contents

Distributions received in a taxable year that are greater than 125% of the average annual distributions received during the shorter of the three preceding taxable years or your holding period for our ADSs or common shares will be treated as excess distributions. Under these special tax rules:

the excess distribution or gain will be allocated ratably over your holding period for our ADSs or common shares;

the amount allocated to the current taxable year, and any taxable year prior to the first taxable year in which we were a PFIC, will be treated as ordinary income; and

the amount allocated to each other year will be subject to tax at the highest tax rate in effect for that year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

In addition, if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year, non-corporate U.S. Holders will not be eligible for reduced rates of taxation on any dividends received from us prior to January 1, 2013. If we are a PFIC, you will be required to file Internal Revenue Service (IRS) Form 8621 for each taxable year in which, among other circumstances, you receive a distribution with respect to our ADSs or common shares. See ITEM 10.E. TAXATION MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

Information Reporting Regarding PFICs and Specified Foreign Financial Assets below for additional information concerning PFIC reporting requirements. We do not intend to provide more definitive information on whether we are PFIC.

In certain circumstances, in lieu of being subject to the excess distribution rules discussed above, a shareholder may make an election to include gain on the stock of a PFIC as ordinary income under a mark-to-market method provided that such stock is regularly traded on a qualified exchange. Very generally, a class of stock is considered regularly traded for any calendar year during which such class of stock is traded, other than in de minimis quantities, on at least 15 days during each calendar quarter. Under current law, the mark-to-market election may be available for holders of our ADSs because our ADSs will be listed on NASDAQ which constitutes a qualified exchange as designated in the Code, although there can be no assurance that our ADSs will be regularly traded for purposes of the mark-to-market election. The mark-to-market election may not be available for holders of our common shares.

If you make an effective mark-to-market election, you will include in each year as ordinary income the excess of the fair market value of our ADSs or common shares at the end of the year over your adjusted tax basis in our ADSs or common shares. You will be entitled to deduct, as an ordinary loss each year the excess of your adjusted tax basis in our ADSs or common shares over their fair market value at the end of the year, but only to the extent of the net amount previously included in income as a result of the mark-to-market election. For taxable years beginning after December 31, 2012, U.S. Holders that are individuals, estates or trusts and whose income exceeds certain thresholds generally will be subject to a 3.8% Medicare contribution tax on unearned income, including, among other things, dividends on, and capital gains from the sale or other taxable disposition of, our ADS or common shares, subject to certain limitations and exceptions, though there is uncertainty as to how this will affect you if you elect to mark the ADSs or common shares to market. You should consult your own tax advisor regarding the effect, if any, of such tax on gain recognized from marking the ADSs and common shares to market.

Your adjusted tax basis in our ADSs or common shares will be increased by the amount of any income inclusion and decreased by the amount of any deductions under the mark-to-market rules. If you make a mark-to-market election it will be effective for the taxable year for which the election is made and all subsequent taxable years unless our ADSs or common shares are no longer regularly traded on a qualified exchange or the IRS consents to the revocation of the election. You are urged to consult your tax advisor about the availability of the mark-to-market election, and whether making the election would be advisable in your particular circumstances.

There are a special set of foreign tax credit rules that apply to taxation under the excess distribution regime. These rules are complex and you are urged to consult your tax advisor regarding their application.

If we are never a PFIC while you hold our ADSs or common shares

If we are never a PFIC while you have held our ADSs or common shares, the gross amount of distributions on our ADSs or common shares (including amounts withheld to reflect Korean withholding taxes) will be taxable as

Table of Contents

dividends, to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Such income (including withheld taxes) will be includable in your gross income as ordinary income on the day actually or constructively received by you, in the case of our common shares, or by the depository, in the case of our ADSs. Such dividends will not be eligible for the dividends received deduction allowed to corporations under the Code. With respect to non-corporate U.S. Holders, certain dividends received from a qualified foreign corporation in taxable years beginning before January 1, 2013 may be subject to reduced rates of taxation. A qualified foreign corporation includes a foreign corporation (other than a PFIC) that is eligible for the benefits of a comprehensive income tax treaty with the United States that the United States Treasury Department determines to be satisfactory for these purposes and which includes an exchange of information provision. The United States Treasury Department has determined that the current Tax Convention meets these requirements. A foreign corporation (other than a PFIC) is also treated as a qualified foreign corporation with respect to dividends paid by that corporation on shares (or ADSs backed by such shares) that are readily tradable on an established securities market in the United States. Our common shares generally will not be considered readily tradable for these purposes. Under the United States Treasury Department guidance our ADSs, which are currently listed on NASDAQ, will be considered readily tradable on an established securities market in the United States. There can be no assurance that our ADSs will be considered readily tradable on an established securities market in later years. Non-corporate holders that do not meet a minimum holding period requirement during which they are not protected from the risk of loss or that elect to treat the dividend income as investment income pursuant to section 163(d)(4) of the Code will not be eligible for the reduced rates of taxation regardless of our status as a qualified foreign corporation. In addition, the rate reduction will not apply to dividends if the recipient of a dividend is obligated to make related payments with respect to positions in substantially similar or related property. This disallowance applies even if the minimum holding period has been met.

Subject to certain conditions and limitations, Korean withholding taxes on dividends may be treated as foreign taxes eligible for credit against your U.S. federal income tax liability. Instead of claiming a credit, you may, at your election, deduct such otherwise creditable Korean taxes in computing your taxable income, subject to generally applicable limitations under U.S. federal income tax law. For purposes of calculating the foreign tax credit, dividends paid on our ADSs or common shares generally will be treated as income from sources outside the United States and generally will constitute passive category income. Further, in certain circumstances, if you:

have held our ADSs or common shares for less than a specified minimum period during which you are not protected from risk of loss;
or

are obligated to make payments related to the dividends,
you will not be allowed a foreign tax credit for foreign taxes imposed on dividends paid on our ADSs or common shares. The rules governing the foreign tax credit are complex. You are urged to consult your tax advisor regarding the availability of the foreign tax credit under your particular circumstances.

To the extent that the gross amount of any distribution on our ADSs or common shares exceeds our current and accumulated earnings and profits, the excess (including the amount of any Korean taxes withheld from the excess) will first be treated as a non-taxable return of (and will reduce, but not below zero) your tax basis in the ADSs or common shares to the extent thereof. Any remaining portion of the distribution will be treated as capital gain (which will be either long-term or short-term capital gain depending upon whether you have held the ADSs or common shares for more than one year). Consequently, such distributions in excess of our current and accumulated earnings and profits generally would not give rise to foreign source income and you would not be able to use the foreign tax credit arising from any Korean withholding tax imposed on such distribution unless such credit can be applied (subject to applicable limitations) against U.S. federal income tax due on other foreign source income in the appropriate category for foreign tax credit purposes. However, we cannot guarantee that any calculation we make of our earnings for U.S. financial statement purposes will fully comply with the calculation of our earnings and profits for U.S. federal income tax principles. Therefore, you should expect that a distribution will be treated as a dividend even if that distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above. Further, distributions of our ADSs, common shares or preemptive rights to subscribe for our common shares that are received as part of a pro rata distribution to all of our common shareholders generally will not be subject to U.S. federal income tax. Consequently such distributions will not give rise to foreign source

Table of Contents

income, and you will not be able to use the foreign tax credit arising from any Korean withholding tax imposed on such distributions unless such credit can be applied (subject to applicable limitations) against U.S. federal income tax due on other income derived from foreign sources.

Taxation of capital gains***If you hold our ADSs or common shares while we are a PFIC***

If we are a PFIC for any taxable year during which you hold our ADSs or common shares, you will be subject to the special tax rules discussed above governing excess distributions received with respect to our ADSs or common shares. An excess distribution can arise from gain realized on the sale or other disposition (including a pledge) of our ADSs or common shares. The entire gain on disposition of PFIC stock is treated as an excess distribution. Generally, otherwise applicable nonrecognition provisions of the Code are not applicable to transfers of stock in a PFIC, and otherwise unrecognized gain will be recognized and treated as an excess distribution. See ITEM 10.E. TAXATION MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS Taxation of dividends *If you hold our ADSs or common shares while we are a PFIC* above for additional information concerning the taxation of excess distributions.

Generally, U.S. Holders are unable to utilize foreign taxes paid or deemed paid to offset the taxes arising from an excess distribution by reason of gains recognized on disposition of PFIC stock. If we are a PFIC, you will be required to file IRS Form 8621 for each taxable year in which, among other circumstances, you recognize gain from a sale or other disposition of our ADSs or common shares. See ITEM 10.E. TAXATION MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS Information Reporting Regarding PFICs and Specified Foreign Financial Assets below for additional information concerning PFIC reporting requirements.

As discussed above, in certain circumstances a shareholder may make an election to include gain on the stock of a PFIC as ordinary income under a mark-to-market method. If you make an effective mark-to-market election, any gain or (subject to the foregoing limitation) loss from a sale or other disposition of our ADSs or common shares generally will be ordinary rather than capital. You are urged to consult your tax advisor about the availability of the mark-to-market election, and whether making the election would be advisable in your particular circumstances.

If we are never a PFIC while you hold our ADSs or common shares

If we are never a PFIC while you have held our ADSs or common shares, you generally will recognize capital gain or loss for U.S. federal income tax purposes upon the sale, exchange, or other disposition of our ADSs or common shares in an amount equal to the difference, if any, between the amount realized on the sale, exchange, or other disposition (without reduction for any Korean or other non-U.S. tax withheld from such disposition) and your adjusted tax basis in the ADSs or common shares. Your adjusted tax basis in an ADS or common share generally will be its United States dollar cost. The United States dollar cost of a common share purchased with foreign currency generally will be the United States dollar value of the purchase price paid on the date of the purchase or, if the common shares are traded on an established securities market and the investor is a cash-basis or electing accrual basis taxpayer, the settlement date. Such capital gain or loss will be long-term capital gain (taxable at a reduced rate for non-corporate U.S. Holders, including individuals) or loss if, on the date of sale, exchange, or other disposition, the ADSs or common shares were held by you for more than one year. The deductibility of capital losses is subject to limitations. Capital gain or loss from the sale, exchange, or other disposition will generally be sourced within the United States for U.S. foreign tax credit purposes. Any such loss, however, could be resourced to the extent of dividends treated as received with respect to such ADSs or common shares within the preceding 24-month period. Consequently, you may not be able to use the foreign tax credit arising from any Korean tax imposed on the sale, exchange, other disposition of an ADS or common share unless such credit can be applied (subject to applicable limitations) against tax due on other income treated as derived from foreign sources. Any Korean securities transaction tax imposed on the sale or other disposition of our common shares or ADSs or common shares will not be treated as a creditable foreign tax for U.S. federal income tax purposes, although you may be entitled to deduct such tax, subject to applicable limitations under the Code.

Under the Tax Convention, a U.S. resident is generally exempt from Korean taxation on gains from the sale, exchange or other disposition of our ADSs or common shares subject to certain exceptions. You are urged to consult your tax advisor regarding possible application of the Tax Convention.

Table of Contents**Information Reporting Regarding PFICs and Specified Foreign Financial Assets**

Under the Hiring Incentives to Restore Employment Act (the Act), each U.S. Holder who is a shareholder of a PFIC is required to file an annual report containing such information as the IRS may require, unless otherwise provided by the IRS. This requirement is in addition to the annual reporting requirements for a U.S. Holder of an interest in a PFIC that has made a QEF election. The IRS is developing further guidance (including a revised IRS Form 8621) regarding the PFIC reporting obligations under the Act. The IRS has announced that, until it releases the revised IRS Form 8621, the obligation of PFIC shareholders who would otherwise be required to attach IRS Form 8621 to their tax returns is suspended. PFIC shareholders will have to attach those forms for the suspended tax year to their next tax return that has to be filed with IRS. If the IRS Form 8621 for the suspended tax year is not attached to the next year's tax return, the limitation period for the suspended tax year will not run and penalties may apply.

The Act and temporary and proposed regulations generally require individual U.S. Holders (specified individuals) and specified domestic entities with an interest in any specified foreign financial asset to file an annual report on IRS Form 8938 with information relating to the asset, including the maximum value thereof, for any taxable year in which the aggregate value of all such assets is greater than US\$50,000 on the last day of the taxable year or US\$75,000 at any time during the taxable year. Certain individuals are permitted to have an interest in a higher aggregate value of such assets before being required to file a report. The proposed regulations relating to specified domestic entities apply to taxable years beginning after December 31, 2011. Under the proposed regulations, specified domestic entities are domestic entities that are formed or used for the purposes of holding, directly or indirectly, specified foreign financial assets. Generally, specified domestic entities are certain closely held corporations and partnerships that meet passive income or passive asset tests and, with certain exceptions, domestic trusts that have a specified individual as a current beneficiary and exceed the reporting threshold. Specified foreign financial assets include any depository or custodial account held at a foreign financial institution; any debt or equity interest in a foreign financial institution if such interest is not regularly traded on an established securities market; and, if not held at a financial institution, (1) any stock or security issued by a non-U.S. person, (2) any financial instrument or contract held for investment where the issuer or counterparty is a non-U.S. person, and (3) any interest in an entity which is a non-U.S. person. Specified foreign financial assets would include the ADSs and common shares, unless you hold them in an account maintained by a U.S. financial institution.

Depending on the aggregate value of your investment in specified foreign financial assets, you may be obligated to file an IRS Form 8938 under this provision if you are an individual U.S. Holder. Specified domestic entities are not required to file Form 8938 until the proposed regulations are final. Penalties apply to any failure to file IRS Form 8938. Additionally, in the event a U.S. Holder (either a specified individual or specified domestic entity) does not file such form, the statute of limitations on the assessment and collection of U.S. federal income taxes of such U.S. Holder for the related tax year may not close before the date which is three years after the date such information is filed. You should consult your own tax advisor as to the possible application to you of this information reporting requirement and related statute of limitations tolling provision.

If you are a U.S. Holder, you are urged to consult with your own tax advisor regarding the application of the PFIC and specified foreign financial assets information reporting requirements and related statute of limitations tolling provisions with respect to the ADSs or our common shares.

Reportable transactions

Under United States Treasury regulations, U.S. Holders that participate in reportable transactions (as defined in the regulations) must attach to their federal income tax returns a disclosure statement on Form 8886. You should consult your own tax advisor as to the possible obligation to file Form 8886 with respect to the sale, exchange or other disposition of any Won received as a dividend from our ADSs or common shares, or as proceeds from the sale of our ADSs or common shares.

Information reporting and backup withholding

In general, information reporting will apply to dividends (including distributions of interest on shareholders' equity) in respect of our ADSs or common shares and the proceeds from the sale, exchange, or redemption of our

Table of Contents

ADSs or common shares that are paid to you within the United States (and in certain cases, outside the United States), unless you are an exempt recipient, such as a corporation. A backup withholding tax may apply to such payments if you fail to provide a taxpayer identification number or certification of exempt status, or fail to report in full dividend and interest income. Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability, provided the required information is furnished to the IRS.

ITEM 10.F. DIVIDENDS AND PAYING AGENTS

Not applicable.

ITEM 10.G. STATEMENT BY EXPERTS

Not applicable.

ITEM 10.H. DOCUMENTS ON DISPLAY

We have filed this annual report on Form 20-F, including exhibits, with the SEC. As allowed by the SEC, in ITEM 19 of this annual report, we incorporate by reference certain information we filed with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this annual report. You may inspect and copy this annual report, including exhibits, and documents that are incorporated by reference in this annual report at the Public Reference Room maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Any filings we make electronically will be available to the public over the Internet at the Web site of the SEC at <http://www.sec.gov>.

ITEM 10.I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of our business, we are subject to market risk associated with currency movements on non-Won denominated assets and liabilities and license and royalty revenues and interest rate movements.

Foreign currency risk

We conduct our business primarily in Won, which is also our functional and reporting currency. However, we have exposure to some foreign currency exchange-rate fluctuations on cash flows from our overseas licensees. The primary foreign currencies to which we are exposed are the U.S. dollar, the Japanese Yen, and the NT dollar. Fluctuations in these exchange rates may affect our revenues from license fees and royalties and result in exchange losses and increased costs in Won terms.

As of December 31, 2011, we had Japanese Yen denominated accounts receivable of Won 2,778 million, which represented 42.5% of our total consolidated accounts receivable balance, and U.S. dollar denominated accounts receivable of Won 1,098 million, which represented 16.8% of our total consolidated accounts receivable balance. We also had Japanese Yen denominated accounts payable of Won 682 million, which represented 12.3% of our total consolidated accounts payable balance, and U.S. dollar denominated accounts payable of Won 398 million, which represented 7.2% of our total consolidated accounts payable balance. As these balances all have short maturities, exposure to foreign currency fluctuations on these balances is not significant. For example, a hypothetical 10% appreciation of the Won against the Japanese Yen and the U.S. dollar, in the aggregate, would reduce our cash flows by Won 280 million.

In 2011, Won 47,018 million of our revenue was derived from currencies other than the Won: primarily the Japanese Yen, Won 29,036 million; the U.S. dollar, Won 9,950 million; the NT dollar, Won 2,731 million and the Euro, Won 2,057 million. A hypothetical 10% depreciation in the

exchange rates of these foreign currencies against the Won in 2011 would have reduced our revenue by Won 4,377 million.

Table of Contents

Since 2005, we have begun entering into derivatives arrangements to hedge against the risk of foreign currency fluctuation. As of March 31, 2012, we had no foreign currency forward contracts outstanding. We may in the future continue to enter into hedging transactions in an effort to reduce our exposure to foreign currency exchange risks, but we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by Korean exchange control regulations that restrict our ability to convert the Won into U.S. dollar, Japanese Yen or Euro under certain emergency circumstances.

Interest rate risk

Our exposure to risk for changes in interest rates relates primarily to our investments in short-term financial instruments and other investments. Investments in both fixed rate and floating rate interest earning instruments carry some interest rate risk. The fair value of fixed rate securities may fall due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. We do not believe that we are subject to any material market risk exposure on our short-term financial instruments, as they are readily convertible to cash and have short maturities.

Credit risk

As our cash and cash equivalents and short-term financial instruments are placed with several local financial institutions, of which approximately 30% are held at one financial institution, we face a potential credit risk that the financial institutions may become insolvent and be unable to repay our principal and interest in a timely manner. While the management believes such financial institutions are of a high credit quality, it is difficult for us to predict the financial condition of the Korean banking sector and the financial institutions that manage our cash holdings. We may be materially and adversely affected by any widespread failure in the Korean banking sector caused by economic downturn and the volatile financial markets in the future.

The above discussion and the estimated amounts generated from the sensitivity analyses referred to above include forward-looking statements, which assume for analytical purposes that certain market conditions may occur. Accordingly, such forward-looking statements should not be considered projections by us of future events or losses.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**ITEM 12.A. DEBT SECURITIES**

Not applicable.

ITEM 12.B. WARRANTS AND RIGHTS

Not applicable.

ITEM 12.C. OTHER SECURITIES

Not applicable.

ITEM 12.D. AMERICAN DEPOSITARY SHARES**Fees and Charges Our ADS holders May Have to Pay**

The Bank of New York Mellon, the depository of our ADS program, collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depository collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depository may collect its annual fee for depository services by deductions from cash distributions or by directly billing investors or by

charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

Table of Contents

Persons depositing or withdrawing shares must pay

\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

\$.02 (or less) per ADS

A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs

\$.02 (or less) per ADSs per calendar year

Registration or transfer fees

Expenses of the depositary

Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depositary or its agents for servicing the deposited securities

Fees and Other Payments Made by the Depositary to Us

The Bank of New York Mellon, as depositary, has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS program. The depositary has agreed to reimburse the Company for its continuing annual stock exchange listing fees. The depositary has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse the Company annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depositary will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depositary collects from investors.

From January 1, 2011 to December 31, 2011, the Company received from the depositary US\$43,503.16 for legal fees, after deducting the applicable withholding tax from the total amount payable by the depositary of US\$48,000 and the depositary waived fees for the standard costs associated with the administration of the ADR estimated to total US\$47,137.19.

From January 1, 2012 to the date of this Annual Report, the Company received no reimbursement from the depositary.

For

Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property

Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates

Any cash distribution to ADS registered holders

Distribution of securities distributed to holders of deposited securities which are distributed by the depositary to ADS registered holders

Depositary services

Transfer and registration of shares on our share register to or from the name of the depositary or its agent when you deposit or withdraw shares

Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)

Converting foreign currency to U.S. dollars

As necessary

As necessary

Table of Contents

PART II

ITEM 13. *DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES*

Not applicable.

ITEM 14. *MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS*

Not applicable.

ITEM 15. *CONTROLS AND PROCEDURES*

Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of December 31, 2011. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2011. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP.

Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records, that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2011, based upon criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and concluded that we maintained effective internal control over financial reporting as of December 31, 2011.

Attestation Report of the Registered Public Accounting Firm

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting, as we are a non-accelerated filer exempted from section 404(b) of the Sarbanes-Oxley Act.

Changes in Internal Control over Financial Reporting

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There has been no change in our internal control over financial reporting that occurred during the year ended December 31, 2011 that has materially affected or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**ITEM 16. RESERVED****ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our Board of Directors has determined that Mr. Jong Gyu Hwang, our outside director is an audit committee financial expert, as such term is defined by the regulations of the SEC issued pursuant to Section 407 of the Sarbanes-Oxley Act. Mr. Hwang is an independent director as such term is defined in Rule 10A-3 of the Exchange Act for purpose of the listing standards of the NASDAQ Stock Market that are applicable.

ITEM 16B. CODE OF ETHICS

Pursuant to the requirements of the Sarbanes-Oxley Act, we have previously adopted a Code of Ethics applicable to all our employees, including our Chief Executive Officer, Chief Financial Officer and all other directors and executive officers. We have adopted an amended Code of Ethics, applicable to all our directors and officers and employees, which was filed as Exhibit 11.1 to our annual report for the year ended December 31, 2005. The amendment was made to more clearly set forth the principles underlying the Code of Ethics in order to assist our directors, officers and employees in connection with their adherence to the guideline for ethical behavior described in the Code of Ethics.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees billed for each of the years ended December 31, 2010 and 2011 for professional services rendered by our principal accountants Samil PricewaterhouseCoopers, the Korean member firm of PricewaterhouseCoopers, depending on the various types of services and a brief description of the nature of such services.

| Type of Service | Aggregate Fees Billed During the Year Ended December 31, 2010 2011 | | Nature of Services |
|--------------------|--|------------|---|
| | (In millions of Won) | | |
| Audit Fees | 625 | 646 | Audit service for the Company and its subsidiaries. |
| Audit-Related Fees | 10 | | Due diligence support. |
| Tax Fees | | | |
| All Other Fees | | | |
| Total | 635 | 646 | |

The policy of our audit committee is to pre-approve all engagements of principal accountants and all audit and non-audit services to be provided by the principal accountants, other than as permitted under applicable laws and regulations.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

See ITEM 6.C. BOARD PRACTICES.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

Table of Contents**PART III****ITEM 17. FINANCIAL STATEMENTS**

We have responded to ITEM 18 in lieu of responding to this item.

ITEM 18. FINANCIAL STATEMENTS

Reference is made to ITEM 19. *EXHIBITS* for a list of all financial statements and related notes filed as part of this annual report.

ITEM 19. EXHIBITS

(a) *Financial Statements filed as part of this annual report*

The following financial statements and related notes, together with the reports of an independent registered public accounting firm thereon, are filed as part of this annual report:

| | Page |
|--|-------------|
| <u>Index to Financial Statements</u> | F-1 |
| <u>Report of Independent Registered Public Accounting Firm</u> | F-2 |
| <u>Consolidated Balance Sheets as of December 31, 2010 and 2011</u> | F-3 |
| <u>Consolidated Statements of Operations for the years ended December 31, 2009, 2010 and 2011</u> | F-4 |
| <u>Consolidated Statements of Changes in Equity for the years ended December 31, 2009, 2010 and 2011</u> | F-5 |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2010 and 2011</u> | F-6 |
| <u>Notes to Consolidated Financial Statements</u> | F-7 |
| (b) <i>Exhibits filed as part of this annual report</i> | |

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| 1.1 | Articles of Incorporation, amended as of March 27, 2012 (English translation) |
| 2.1* | Form of Stock Certificate of Registrant's common stock, par value Won 500 per share |
| 2.1** | Form of Deposit Agreement among Registrant, The Bank of New York Mellon, formerly known as The Bank of New York, as depositary, and all holders and beneficial owners of American Depositary Shares evidenced by American Depositary Receipts, including the form of American depositary receipt** |
| 4.1* | Agreement on the Development of Ragnarok Online, dated June 26, 2000, between Myoung-Jin Lee and Registrant (translation in English) |
| 4.2* | Agreement on the Exclusive License of Copyright Regarding Ragnarok Game Services, dated June 26, 2000, between Myoung-Jin Lee and Registrant (translation in English) |
| 4.3* | Cooperation Agreement on Ragnarok Game Services, dated May 31, 2002, between Myoung-Jin Lee and Registrant (translation in English) |
| 4.4* | Agreement on Factual Matters, dated November 19, 2002, between Myoung-Jin Lee and Registrant (translation in English) |
| 4.5* | Agreement on Ragnarok Game Services and Related Matters, dated January 22, 2003, between Myoung-Jin Lee and Registrant (translation in English) |
| 4.6* | Agreement, dated June 3, 2003, between Myoung-Jin Lee and Registrant (translation in English) |

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- 4.7* Agreement, dated October 27, 2004, between Myoung-Jin Lee and Registrant (translation in English)
- 4.8* Investment Agreement, dated February 19, 2002, between Sunny YNK Inc. and Registrant (translation in English)

Table of Contents

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| 4.9* | Agreement, dated February 21, 2002, between Sunny YNK Inc. and Registrant (translation in English) |
| 4.10 | Share Purchase Agreement, dated May 3, 2005, between Mr. Moon Kyu Kim and Registrant (translation in English) |
| 4.11* | Ragnarok License and Distribution Agreement, dated July 24, 2002, between GungHo Online Entertainment, Inc. (formerly ONSALE Japan K.K.) (licensee in Japan) and Registrant |
| 4.12* | Amendment to Ragnarok License and Distribution Agreement, dated September 23, 2004, between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant |
| 4.13* | Ragnarok Exclusive License and Distribution Agreement, dated May 20, 2002, between Soft-World International Corporation (licensee in Taiwan and Hong Kong) and Registrant |
| 4.14* | Fourth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated October 19, 2004, between Soft-World International Corporation (licensee in Taiwan and Hong Kong) and Registrant |
| 4.15* | Exclusive Ragnarok License and Distribution Agreement, dated October 21, 2002, among Soft-World International Corporation, Value Central Corporation (licensee in China) and Registrant |
| 4.16 | Fourth Amendment to the Exclusive Ragnarok License and Distribution Agreement, dated May 18, 2005, among Soft-World International Corporation, Value Central Corporation (licensee in China) and Registrant |
| 4.17* | Ragnarok License and Distribution Agreement, dated June 13, 2002, between Asiasoft International Co., Ltd. (licensee in Thailand) and Registrant |
| 4.18* | Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated October 27, 2004, between Asiasoft International Co., Ltd. (licensee in Thailand) and Registrant |
| 4.19* | Exclusive Ragnarok License and Distribution Agreement, dated May 12, 2003, among Soft-World International Corporation, Value Central Corporation (licensee in Malaysia and Singapore) and Registrant |
| 4.20* | Exclusive Ragnarok License and Distribution Agreement, dated March 25, 2003, between Level Up! Inc. (licensee in the Philippines) and Registrant |
| 4.21 | Third Amendment to the Exclusive Ragnarok License and Distribution Agreement, dated February 18, 2005, between Level Up! Inc. (licensee in the Philippines) and Registrant |
| 4.22* | Exclusive Ragnarok License and Distribution Agreement, dated April 2, 2004, between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Registrant |
| 4.23* | Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated October 29, 2004, between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Registrant |
| 4.24* | Exclusive Ragnarok Online License and Distribution Agreement, dated November 26, 2003, between Burda Holding International GmbH (licensee in Germany, Austria, Switzerland, Italy and Turkey) and Registrant |
| 4.25* | Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated December 2, 2003, between Burda Holding International GmbH (licensee in Germany, Austria, Switzerland, Italy and Turkey) and Registrant |
| 4.26* | Second Amendment to the Exclusive Ragnarok License and Distribution Agreement, dated November 18, 2004, between Burda Holding International GmbH (licensee in Germany, Austria, Switzerland, Italy and Turkey) and Registrant |
| 4.27 | Exclusive Ragnarok License and Distribution Agreement, dated July 16, 2004, between Ongamenet PTY Ltd. (licensee in Australia and New Zealand) and Registrant |

Table of Contents

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| 4.28 | Exclusive Ragnarok License and Distribution Agreement, dated August 15, 2004, between Level Up! Interactive SA (licensee in Brazil) and Registrant |
| 4.29* | Exclusive Ragnarok Software License Agreement, dated May 24, 2004, between Level Up Network India Pvt. Ltd. (licensee in India) and Registrant |
| 4.30* | Lease Agreement, dated August 1, 2004, between Jung Ryool Kim and Registrant (translation in English) |
| 4.31* | Equipment Sales Agreement, dated December 1, 2003, between Gravity Interactive, LLC and Registrant |
| 4.32* | Service and Distribution of Earnings and Profit Agreement, dated April 1, 2003, between Gravity Interactive, LLC and Registrant |
| 4.33* | Loan Agreement, dated January 1, 2004, between Gravity Entertainment Corporation, formerly RO Production Ltd., and Registrant (translation in English) |
| 4.34* | Share (syusshi-mochiban) Assignment Agreement, dated October 25, 2004, between GungHo Online Entertainment, Inc. and Registrant |
| 4.35* | Joint Project Agreement for TV Animation Ragnarok, dated October 1, 2004, among Gravity Entertainment Corporation, formerly RO Production Ltd., GDH Co., Ltd., TV Tokyo Medianet Co., Ltd., Amuse Soft Entertainment Co., Ltd. and GNG Entertainment Inc (translation in English) |
| 4.36* | Ragnarok Sales Agency Agreement, dated April 10, 2002, between Sunny YNK Inc. and Registrant (translation in English) |
| 4.37 | Lease Agreement, dated October 19, 2005, between Meritz Fire & Marine Insurance Co., Ltd. and Registrant |
| 4.38 | Real Estate Sale Agreement, dated May 22, 2006, between Yahoh Communication Ltd. and Registrant |
| 4.39 | Global Publishing Agreement, dated November 7, 2005, between Ndoors Corporation and Registrant |
| 4.40 | Global Publishing Agreement, dated November 15, 2005, between Sonnori Co., Ltd. and Registrant |
| 4.41 | Fourth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated April 20, 2005 between Level Up! Inc. (licensee in Brazil) and Registrant |
| 4.42 | Fifth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated March 22, 2006 between Level Up! Inc. (licensee in the Philippines) and Registrant |
| 4.43 | Exclusive Ragnarok Online Software License Agreement dated April 9, 2006 between Game Flier (Malaysia) Sdn. Bhd. (licensee in Malaysia and Singapore) and Registrant |
| 4.44 | 3rd Amendment to the Exclusive Ragnarok License and Distribution Agreement dated April 15, 2006 between Burda Holding International GmbH (licensee in Germany, Austria, Switzerland, Italy and Turkey) and Registrant |
| 4.45 | 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2006 between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant |
| 4.46 | Agreement on Changes of the Global Publishing Contract dated October 9, 2006 between Ndoors Corporation (developer of Time N Tales) and Registrant |
| 4.47 | Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated October 22, 2006 between Soft-World International Corporation (licensee in Taiwan) and Registrant |
| 4.48 | Agreement on Changes of the Lease Contract dated January 8, 2007 between Meritz Fire & Marine Insurance Co., Ltd. and Registrant |

Table of Contents

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| 4.49 | Exclusive Emil Chronicle Online License and Distribution Agreement dated August 1, 2007, between GameCyber Technology Ltd. (licensee in Taiwan and Hong Kong) and Registrant |
| 4.50 | First Amendment to the Ragnarok Online Software Agreement dated October 9, 2007, between Game Flier (Malaysia) Sdn. Bhd. (licensee in Singapore and Malaysia) and Registrant |
| 4.51 | Exclusive Ragnarok Online 2 License and Distribution Agreement dated October 15, 2007, between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Registrant |
| 4.52 | Amendment to the exclusive Ragnarok Online License and Distribution Agreement dated October 22, 2007, between Soft-World International Corporation (licensee in Taiwan and Hong Kong) and Registrant |
| 4.53 | Exclusive Requiem Online License and Distribution Agreement dated December 1, 2007, between Gravity CIS, Inc. and Registrant |
| 4.54 | Lease Agreement dated January 1, 2008, between Korea SW Industry Promotion Agency and Registrant |
| 4.55 | Second Amendment to the ExclusiveRagnarok Online License and Distribution Agreement dated January 1, 2008, between Gravity Interactive, Inc. and Gravity Co., Ltd. |
| 4.56 | Exclusive Ragnarok Online 2 Authorization to Use and Distribute Software Agreement dated January 21, 2008, between Level Up! Interactive S.A. (licensee in Brazil) and Registrant |
| 4.57 | First Amendment to the exclusive Emil Chronicle Online License and Distribution Agreement dated January 23, 2008, between GameCyber Technology Ltd. (licensee in Taiwan and Hong Kong) and Registrant |
| 4.58 | Exclusive Pucca Racing License and Distribution Agreement dated January 23, 2008, among Ini3 Digital Co., Ltd. (licensee in Thailand), Vooz Co., Ltd. (character licensor) and Registrant |
| 4.59 | Exclusive Requiem Online License and Distribution Agreement dated February 21, 2008, between Gravity Interactive, Inc. and Registrant |
| 4.60 | Sixth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated February 27, 2008, between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Registrant |
| 4.61 | Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated March 4, 2008 between AsiaSoft Corporation Public Co., Ltd. (licensee in Thailand) and Registrant |
| 4.62 | Fourth Amendment to the Exclusive Ragnarok License and Distribution Agreement dated April 30, 2008, between Burda:ic GmbH (licensee in Germany, Austria, Switzerland, Italy and Turkey) and Registrant |
| 4.63 | Assignment of Agreement dated May 30, 2008, among Level Up! Network India Pvt. Ltd., Level Up! International Holdings Pte. Ltd. (licensees in India) and Registrant |
| 4.64 | First Amendment to the Exclusive Ragnarok Software License Agreement dated June 1, 2008, between Gravity EU SASU and Registrant |
| 4.65 | Exclusive Ragnarok Online License and Distribution Agreement dated July 2, 2008, between AsiaSoft Corporation Public Co., Ltd. (licensee in Vietnam) and Registrant |
| 4.66 | First Amendment to the Exclusive Emil Chronicle Online License and Distribution Agreement dated July 4, 2008, between Infocomm Asia Holdings Pte. Ltd. and Registrant |
| 4.67 | Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated September 1, 2008, between Shengqu Information Technology (Shanghai) Co., Ltd. (licensee in China) and Registrant |
| 4.68 | Exclusive Ragnarok Online License and Distribution Agreement dated September 1, 2008, between Level Up! Inc. (licensee in the Philippines) and Registrant |

Table of Contents

| | |
|------|---|
| 4.69 | Exclusive Emil Chronicle Online License and Distribution Agreement dated December 8, 2008, between Run Up Game Distribution and Development Sdn. Bhd. (licensee in Singapore and Malaysia) and Registrant |
| 4.70 | Third Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated January 1, 2009, between Gravity Interactive, Inc., and Registrant |
| 4.71 | Exclusive Ragnarok Online License and Distribution Agreement dated January 21, 2009, between Tahadi Games Ltd. (licensee in UAE and 19 other countries) and Registrant |
| 4.72 | Exclusive Emil Chronicle Online License and Distribution Agreement dated February 26, 2009, between PT. Wave Wahana Wisesa (licensee in Indonesia) and Registrant |
| 4.73 | Exclusive Ragnarok Authorization and Distribution Agreement dated March 2, 2009, between Level Up! Interactive S.A (licensee in Brazil) and Registrant |
| 4.74 | Seventh Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated March 7, 2009, between Gravity CIS, Inc. and Registrant |
| 4.75 | Form of employment agreement with director and senior management. |
| 4.76 | Fourth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated September 1, 2009 between Gravity Interactive, Inc. and Registrant |
| 4.77 | Amendment to the 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2009 between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant |
| 4.78 | Fifth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated October 1, 2009 between Gravity Interactive, Inc. and Registrant |
| 4.79 | Second Amendment to the Ragnarok Online Software License Agreement dated October 9, 2009 between Game Flier (Malaysia) Sdn. Bhd. (licensee in Singapore and Malaysia) and Registrant |
| 4.80 | Ragnarok Online Exclusive Game License Agreement dated October 22, 2009 between Game Flier International Corporation (licensee in Taiwan, Hong Kong and Macau) and Registrant |
| 4.81 | First Amendment to Exclusive Requiem Online License and Distribution Agreement dated December 1, 2009 between Gravity Interactive, Inc. and Registrant |
| 4.82 | Global Service Agreement dated December 1, 2009 between AsiaSoft Corporation Public Co., Ltd., (consignee in Thailand, Singapore, Vietnam and Malaysia) and Registrant |
| 4.83 | Fifth Amendment to the Exclusive Ragnarok License and Distribution Agreement dated February 1, 2010 between Burda:ic GmbH (licensee in Germany, Austria, Switzerland, Italy and Turkey) and Registrant |
| 4.84 | Global Service Agreement dated February 2, 2010 between PT. Lyto Datarindo Fortuna (consignee in Indonesia) and Registrant |
| 4.85 | Ragnarok Online Game License Agreement dated February 27, 2010 between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Registrant |
| 4.86 | Second Amendment to the Exclusive Requiem Online License and Distribution Agreement dated March 1, 2010 between Gravity Interactive, Inc. and Registrant |
| 4.87 | Exclusive Requiem Online License and Distribution Agreement dated March 2, 2010 between Game Flier International Corporation (licensee in Taiwan, Hong Kong and Macau) and Registrant |
| 4.88 | Exclusive Ragnarok Online License and Distribution Agreement dated March 5, 2010 between AsiaSoft Corporation Public Co., Ltd., (licensee in Thailand) and Registrant |
| 4.89 | First Amendment to Exclusive Ragnarok Online 2 Authorization to Use and Distribute Software Agreement dated June 2, 2010 between Level Up! Interactive S.A. (licensee in Brazil) and Registrant |

Table of Contents

| | |
|------|---|
| 4.90 | First Amendment to Exclusive Ragnarok License and Distribution Agreement dated August 31, 2010 between Level Up! Inc. (licensee in the Philippines) and Registrant |
| 4.91 | Amendment to the Exclusive Ragnarok Online Software License Agreement dated September 1, 2010 between Shengqu Information Technology (Shanghai) Co., Ltd. (licensee in China) and Registrant |
| 4.92 | Third Amendment to Exclusive Ragnarok Software License Agreement dated October 16, 2010 between Gravity EU SASU and Registrant |
| 4.93 | Sixth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated January 1, 2011 between Gravity Interactive, Inc. and Registrant |
| 4.94 | First Amendment to the Exclusive Ragnarok Authorization and Distribution Agreement dated January 17, 2011 between Level Up! Interactive S.A. and Registrant |
| 4.95 | Third Amendment to the Exclusive Requiem Online License and Distribution Agreement dated June 16, 2011 between Gravity Interactive, Inc. and Registrant |
| 4.96 | Third Amendment to the Ragnarok Online Software License Agreement dated October 9, 2011 between Game Flier (Malaysia) Sdn. Bhd. (licensee in Singapore and Malaysia) and Registrant |
| 4.97 | Fourth Amendment to Ragnarok Online Exclusive Game License Agreement dated October 22, 2011 between Game Flier International Corporation (licensee in Taiwan, Hong Kong and Macau) and Registrant |
| 4.98 | Fourth Amendment to the Exclusive Requiem Online License and Distribution Agreement dated October 26, 2011 between Gravity Interactive, Inc. and Registrant |
| 4.99 | Second Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated March 5, 2012 between AsiaSoft Corporation Public Co., Ltd. (licensee in Thailand) and Registrant |
| 8.1 | List of Registrant s subsidiaries |
| 11.1 | Registrant s Code of Ethics (amended) |
| 12.1 | CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 12.2 | CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 13.1 | CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 13.2 | CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Incorporated by reference to Registrant s Registration Statement on Form F-1 (File No. 333-122159)

** Incorporated by reference to Registrant s Registration Statement on Form F-6 (File No. 333-122160)

Previously filed as exhibits to our annual report on Form 20-F filed on June 30, 2005. (File No. 000-51138)

Previously filed as exhibits to our annual report on Form 20-F filed on June 30, 2006. (File No. 000-51138)

Previously filed as exhibits to our annual report on Form 20-F filed on June 29, 2007. (File No. 000-51138)

- Previously filed as exhibits to our annual report on Form 20-F filed on June 27, 2008. (File No. 000-51138)

- Previously filed as exhibits to our annual report on Form 20-F filed on June 30, 2009. (File No. 000-51138)

- Previously filed as exhibits to our annual report on Form 20-F filed on June 1, 2010. (File No. 000-51138)

Previously filed as exhibits to our annual report on Form 20-F filed on June 29, 2011. (File No. 000-51138)

Table of Contents

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

GRAVITY CO., LTD.

By: /s/ Heung Gon Kim
Name: Heung Gon Kim
Title: Chief Financial Officer

Date: April 27, 2012

Table of Contents

INDEX TO FINANCIAL STATEMENTS

| | Page |
|--|-------------|
| <u>Index to Financial Statements</u> | F-1 |
| <u>Report of Independent Registered Public Accounting Firm</u> | F-2 |
| <u>Consolidated Balance Sheets as of December 31, 2010 and 2011</u> | F-3 |
| <u>Consolidated Statements of Operations for the years ended December 31, 2009, 2010 and 2011</u> | F-4 |
| <u>Consolidated Statements of Changes in Equity for the years ended December 31, 2009, 2010 and 2011</u> | F-5 |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2010 and 2011</u> | F-6 |
| <u>Notes to Consolidated Financial Statements</u> | F-7 |

F-1

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and the Shareholders of

Gravity Co., Ltd.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in equity and of cash flows present fairly, in all material respects, the financial position of Gravity Co., Ltd. and its subsidiaries (the Company), at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ Samil PricewaterhouseCoopers
Samil PricewaterhouseCoopers

Seoul, KOREA

April 27, 2012

F-2

Table of Contents**GRAVITY CO., LTD.****CONSOLIDATED BALANCE SHEETS****December 31, 2010 and 2011**

| | 2010 | 2011 | 2011 (Note 3) (Unaudited) |
|---|--|----------------------|---------------------------------|
| | (In millions of Korean Won and in thousands of US dollars except share and per share data) | | |
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | (Won) 44,122 | (Won) 42,430 | \$ 36,625 |
| Short-term financial instruments | 12,500 | 15,000 | 12,948 |
| Short-term available-for-sale investments | 5,000 | | |
| Accounts receivable, net (including related party balances of (Won)2,947 and (Won)3,257, respectively) | 8,242 | 6,436 | 5,555 |
| Current portion of deferred income tax assets | 857 | 3,062 | 2,643 |
| Other current assets (including related party balances of (Won)179 and (Won)275, respectively) | 5,622 | 4,905 | 4,234 |
| Total current assets | 76,343 | 71,833 | 62,005 |
| Property and equipment, net | 2,672 | 2,731 | 2,357 |
| Leasehold and other deposits | 1,711 | 5,924 | 5,114 |
| Capitalized software development cost (including related party balances of (Won)0 and (Won)279, respectively) | 13,700 | 18,936 | 16,345 |
| Other intangible assets | 20,140 | 15,750 | 13,595 |
| Goodwill | 7,991 | 7,477 | 6,454 |
| Equity method investments | 1,336 | 1,444 | 1,247 |
| Deferred income tax assets | | 8,308 | 7,171 |
| Other non-current assets (including related party balances of (Won)23 and (Won)43, respectively) | 1,597 | 475 | 411 |
| Total assets | (Won) 125,490 | (Won) 132,878 | \$ 114,699 |
| LIABILITIES AND EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable (including related party balances of (Won)1,147 and (Won)950, respectively) | (Won) 6,641 | (Won) 5,552 | \$ 4,792 |
| Deferred revenue (including related party balances of (Won)650 and (Won)554, respectively) | 5,611 | 4,663 | 4,025 |
| Other current liabilities | 1,813 | 1,847 | 1,594 |
| Total current liabilities | 14,065 | 12,062 | 10,411 |
| Long-term deferred revenue (including related party balances of (Won)5,406 and (Won)4,869, respectively) | 8,993 | 7,457 | 6,437 |
| Accrued severance benefits | 1,031 | 916 | 791 |
| Deferred income tax liabilities | 2,600 | 1,517 | 1,309 |
| Other non-current liabilities | 389 | 267 | 231 |

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| | | | |
|--|---------------|---------------|------------|
| Total liabilities | 27,078 | 22,219 | 19,179 |
| Commitments and contingencies | | | |
| Parent Company Shareholders' equity: | | | |
| Preferred shares, (Won)500 par value, 2,000,000 shares authorized, and no shares issued and outstanding at December 31, 2010 and 2011 | | | |
| Common shares, (Won)500 par value, 38,000,000 shares authorized, and 6,948,900 shares issued and outstanding at December 31, 2010 and 2011 | 3,474 | 3,474 | 2,999 |
| Additional paid-in capital | 75,395 | 75,395 | 65,080 |
| Retained earnings | 4,995 | 19,923 | 17,197 |
| Accumulated other comprehensive income | 3,552 | 3,042 | 2,627 |
| Total parent company shareholders' equity | 87,416 | 101,834 | 87,903 |
| Non-controlling interest | 10,996 | 8,825 | 7,617 |
| Total equity | 98,412 | 110,659 | 95,520 |
| Total liabilities and equity | (Won) 125,490 | (Won) 132,878 | \$ 114,699 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**GRAVITY CO., LTD.****CONSOLIDATED STATEMENTS OF OPERATIONS****Years Ended December 31, 2009, 2010 and 2011**

| | 2009 | 2010 | 2011 | 2011 (Note 3) (Unaudited) |
|---|---|---------------|----------------|---------------------------------|
| | (In millions of Korean Won and in thousands of US dollars except per share data) | | | |
| Revenue | | | | |
| Online games-subscription revenue | (Won) 12,674 | (Won) 9,908 | (Won) 11,556 | \$ 9,975 |
| Online games-royalties and license fees (including related party revenue of (Won)28,089, (Won)24,636 and (Won)23,890, respectively) | 34,037 | 32,132 | 35,552 | 30,688 |
| Mobile games (including related party revenue of (Won)2,951, (Won)3,917 and (Won)4,604, respectively) | 7,882 | 9,188 | 9,293 | 8,022 |
| Character merchandising, animation and other revenue (including related party revenue of (Won)947, (Won)512 and (Won)616, respectively) | 2,810 | 1,134 | 1,076 | 928 |
| Total net revenue | 57,403 | 52,362 | 57,477 | 49,613 |
| Cost of revenue (including related party cost of (Won)188, (Won)259 and (Won)953, respectively) | 21,170 | 20,873 | 24,243 | 20,926 |
| Gross profit | 36,233 | 31,489 | 33,234 | 28,687 |
| Selling, general and administrative (including related party expenses of (Won)482, (Won)3,923 and (Won)588, respectively) | 21,651 | 20,422 | 22,759 | 19,645 |
| Research and development (including related party expenses of (Won)0, (Won)0 and (Won)317, respectively) | 1,799 | 4,652 | 4,136 | 3,570 |
| Impairment loss on intangible assets | 280 | 475 | 3,697 | 3,191 |
| Gain on loss of control in a subsidiary | | | (548) | (473) |
| Settlement cost of litigation | 1,649 | | 29 | 25 |
| Operating income | 10,854 | 5,940 | 3,161 | 2,729 |
| Other income (expenses) | | | | |
| Interest income | 2,395 | 1,946 | 1,844 | 1,592 |
| Interest expense | (41) | (32) | (58) | (50) |
| Foreign currency income (loss), net | (225) | 96 | 180 | 155 |
| Others, net | (21) | 312 | (90) | (78) |
| Income before income tax expenses (benefit) and equity loss on investments | 12,962 | 8,262 | 5,037 | 4,348 |
| Income tax expenses (benefit) | 4,544 | 4,207 | (7,962) | (6,873) |
| Income before equity loss on investments | 8,418 | 4,055 | 12,999 | 11,221 |
| Equity loss on investments, net | (1,424) | (345) | (242) | (209) |
| Net income | 6,994 | 3,710 | 12,757 | 11,012 |

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| | | | | | | | | |
|--|-------|-----------|-------|-----------|-------|-----------|----|-----------|
| Less: Net income (loss) attributable to the non-controlling interest | | 77 | | (20) | | (2,171) | | (1,874) |
| Net income attributable to parent company | (Won) | 6,917 | (Won) | 3,730 | (Won) | 14,928 | \$ | 12,886 |
| Earnings per share basic and diluted: | | | | | | | | |
| Net income attributable to parent company common shareholders | (Won) | 995 | (Won) | 537 | (Won) | 2,148 | \$ | 1.85 |
| Weighted average number of shares | | | | | | | | |
| Basic outstanding and diluted | | 6,948,900 | | 6,948,900 | | 6,948,900 | | 6,948,900 |

The accompanying notes are an integral part of these consolidated financial statements.

F-4

Table of Contents

GRAVITY CO., LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Years Ended December 31, 2009, 2010 and 2011

| | No. of Common Shares | Common Shares | Additional Paid-in Capital <small>(In millions of Korean Won, except number of shares)</small> | Retained Earnings (Accumulated Deficit) | Accumulated Other Comprehensive Income (Loss) | Non-Controlling Interest in Subsidiary | Total |
|---|----------------------------|------------------|---|--|---|--|---------------|
| Balance at January 1, 2009 | 6,948,900 | (Won) 3,474 | (Won) 75,247 | (Won) (5,652) | (Won) 3,402 | (Won) 137 | (Won) 76,608 |
| Amortization of deferred stock compensation | | | 148 | | | | 148 |
| Comprehensive loss | | | | | | | |
| Foreign currency translation adjustments, net of tax | | | | | (140) | | (140) |
| Net income | | | | 6,917 | | 77 | 6,994 |
| Total comprehensive income | | | | | | | 6,854 |
| Balance at December 31, 2009 | 6,948,900 | 3,474 | 75,395 | 1,265 | 3,262 | 214 | 83,610 |
| Increase of non-controlling interest from acquisition of a new subsidiary | | | | | | 10,802 | 10,802 |
| Comprehensive income | | | | | | | |
| Foreign currency translation adjustments, net of tax | | | | | 290 | | 290 |
| Net income (loss) | | | | 3,730 | | (20) | 3,710 |
| Total comprehensive income | | | | | | | 4,000 |
| Balance at December 31, 2010 | 6,948,900 | 3,474 | 75,395 | 4,995 | 3,552 | 10,996 | 98,412 |
| Comprehensive loss | | | | | | | |
| Foreign currency translation adjustments, net of tax | | | | | (510) | | (510) |
| Net income (loss) | | | | 14,928 | | (2,171) | 12,757 |
| Total comprehensive income | | | | | | | 12,247 |
| Balance at December 31, 2011 | 6,948,900 | (Won) 3,474 | (Won) 75,395 | (Won) 19,923 | (Won) 3,042 | (Won) 8,825 | (Won) 110,659 |

(Note 3) Unaudited

(In thousands of US dollars, except number of shares)

| | | | | | | | |
|--|-----------|----------|-----------|----------|----------|----------|-----------|
| Balance at December 31, 2010 | 6,948,900 | \$ 2,999 | \$ 65,080 | \$ 4,311 | \$ 3,065 | \$ 9,491 | \$ 84,946 |
| Comprehensive loss | | | | | | | |
| Foreign currency translation adjustments, net of tax | | | | | (438) | | (438) |

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| | | | | | | | | | | | | | |
|-------------------------------------|-----------|----|-------|--------|--------|---------|--------|--------|---------------|----|-------|----|--------|
| Net income (loss) | | | | 12,886 | | (1,874) | | 11,012 | | | | | |
| Total comprehensive income | | | | | | | | | 10,574 | | | | |
| Balance at December 31, 2011 | 6,948,900 | \$ | 2,999 | \$ | 65,080 | \$ | 17,197 | \$ | 2,627 | \$ | 7,617 | \$ | 95,520 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**GRAVITY CO., LTD.****CONSOLIDATED STATEMENTS OF CASH FLOWS****Years Ended December 31, 2009, 2010 and 2011**

| | 2009 | 2010 | 2011 | 2011 (Note 3) (Unaudited) |
|--|---|-------------|---------------|---------------------------------|
| | (In millions of Korean Won and in thousands of US dollars) | | | |
| Cash flows from operating activities | | | | |
| Net income | (Won) 6,994 | (Won) 3,710 | (Won) 12,757 | \$ 11,012 |
| Adjustments to reconcile net income to net cash provided by operating activities | | | | |
| Depreciation and amortization | 5,627 | 3,708 | 4,088 | 3,528 |
| Allowance for accounts receivable and other receivables | 186 | 426 | 1,021 | 881 |
| Impairment loss on intangible assets | 280 | 475 | 3,697 | 3,191 |
| Provision for accrued severance benefits | 436 | 234 | 586 | 506 |
| Stock compensation expense | 148 | | | |
| Equity loss on investments, net | 1,424 | 345 | 242 | 209 |
| Gain on disposition of available-for-sale investments | | (335) | | |
| Loss (gain) on foreign currency transactions | 59 | 400 | (70) | (61) |
| Loss on disposition of property and equipment | 3 | 108 | | |
| Gain on loss of control in a subsidiary | | | (548) | (473) |
| Others | (36) | 110 | (33) | (29) |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | 265 | 1,213 | 1,437 | 1,240 |
| Other assets | 971 | (170) | (5,987) | (5,168) |
| Accounts payable | (602) | (437) | (1,366) | (1,179) |
| Accrued expenses | (165) | (814) | 447 | 386 |
| Deferred revenue | 1,440 | (498) | (2,494) | (2,153) |
| Income tax payable | (503) | 368 | (364) | (314) |
| Deferred income taxes | 86 | (263) | (11,715) | (10,112) |
| Payment of severance benefits | (832) | (91) | (648) | (559) |
| Other liabilities | 80 | (101) | 129 | 111 |
| Net cash provided by operating activities | (Won) 15,861 | (Won) 8,388 | (Won) 1,179 | \$ 1,016 |
| Cash flows from investing activities | | | | |
| Decrease (increase) in short-term financial instruments | (Won) (8,743) | (Won) 3,500 | (Won) (2,223) | \$ (1,919) |
| Purchase of available-for-sale investments | (5,000) | (5,000) | | |
| Proceeds from disposal of available-for-sale investments | | 5,308 | 5,021 | 4,334 |
| Increase in short-term loans receivables | | (1,249) | | |
| Purchase of equity method investments | (229) | (495) | | |
| Purchase of property and equipment | (627) | (1,449) | (1,566) | (1,351) |
| Proceeds from disposal of property and equipment | 11 | 45 | 2 | 2 |
| Increase in capitalized software development costs | (2,746) | (5,092) | (4,745) | (4,096) |
| Cash paid for acquisition, net of cash acquired | | (11,277) | | |
| Reduction in cash balances upon deconsolidation of a subsidiary | | | (515) | (445) |
| Payment of leasehold deposits | (21) | (74) | | |
| Proceeds from leasehold deposits | 4 | 31 | | |
| Disposal of other non-current assets | | | 955 | 824 |
| Others, net | (199) | (121) | 278 | 241 |
| Net cash used in investing activities | (17,550) | (15,873) | (2,793) | (2,410) |
| Cash flows from financing activities | | | | |
| Proceeds from borrowings | 140 | 418 | | |

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| | | | | |
|--|--------------|--------------|--------------|-----------|
| Repayment of borrowings | (195) | (143) | (168) | (145) |
| Net cash provided by (used in) financing activities | (55) | 275 | (168) | (145) |
| Effect of exchange rate changes on cash and cash equivalents | (91) | (1) | 90 | 79 |
| Net decrease in cash and cash equivalents | (1,835) | (7,211) | (1,692) | (1,460) |
| Cash and cash equivalents | | | | |
| Beginning of the year | 53,168 | 51,333 | 44,122 | 38,085 |
| End of the year | (Won) 51,333 | (Won) 44,122 | (Won) 42,430 | \$ 36,625 |

The accompanying notes are an integral part of these consolidated financial statements.

F-6

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. Description of Business**

Gravity Co., Ltd. (Gravity) was incorporated on April 4, 2000 to engage in developing and distributing online games and other related businesses principally in the Republic of Korea and other countries in Asia, North and South America and Europe. Gravity's principal product, Ragnarok Online, a multi-player online role playing game was commercially launched in August 2002.

Gravity has seven subsidiaries. NeoCyon, Inc. and Gravity Games Corp. (formerly Barunson Interactive Corp.) operate in the Republic of Korea, while the others, including Gravity Interactive, Inc., operate in other countries.

Gravity EU SAS was excluded from the consolidation as of December 31, 2011 since the Company lost control over it (See Note 8).

On April 1, 2008, GungHo Online Entertainment, Inc. became a majority shareholder by acquiring 52.39% of the voting shares from Heartis, Inc., the former majority shareholder, and acquired additional 6.92% voting shares on June 23 and June 24, 2008. As of December 31, 2011, GungHo Online Entertainment, Inc. has majority ownership and voting rights over the Company.

The Company conducts its business within one industry segment the business of developing and distributing online game, software and other related services.

2. Significant Accounting Policies*Basis of presentation*

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). Significant accounting policies followed by the Company in the preparation of the accompanying consolidated financial statements are summarized below.

Principles of consolidation

The accompanying consolidated financial statements include the accounts of Gravity and the following subsidiaries (collectively referred to as the Company). All significant intercompany balances and transactions have been eliminated in the consolidation.

| Subsidiary | Year of Establishment | Year of Obtaining Control | Percentage Ownership (%) |
|---|------------------------------|----------------------------------|---------------------------------|
| Gravity Interactive, Inc.(*1) | 2003 | 2003 | 100.00 |
| Gravity Entertainment Corp. | 2003 | 2004 | 100.00 |
| NeoCyon, Inc. | 2000 | 2005 | 96.11 |
| Gravity CIS Co., Ltd.(*2) | 2005 | 2005 | 100.00 |
| Gravity RUS Co., Ltd.(*2) | 2007 | 2007 | 99.99 |
| Gravity Middle East & Africa FZ-LLC(*3) | 2007 | 2007 | 100.00 |
| Gravity Games Corp.(*4) | 2003 | 2010 | 50.83 |

(*1) In October 2007, Gravity Interactive, Inc. founded L5 Games Inc., as a wholly owned US-based subsidiary. L5 Games Inc. was liquidated in May 2010.

(*2) In October 2007, the Company founded Gravity RUS Co., Ltd., a Russia-based subsidiary, and acquired 99.99% of the voting shares, and then transferred 100% of the voting shares of Gravity CIS Co., Ltd. to Gravity RUS Co., Ltd. in December 2007.

Table of Contents

GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(*3) In May 2007, the Company founded Gravity Middle East & Africa FZ-LLC, a wholly owned United Arab Emirates-based subsidiary. Gravity Middle East & Africa FZ-LLC is in the process of liquidation as of December 31, 2011.

(*4) In October 2010, the Company acquired 50.83% ownership of Barunson Interactive Corp. Based on the shareholders' meeting held on March 28, 2011, Barunson Interactive Corp. changed its name to Gravity Games Corp.

Investments in entities where the Company holds more than 20% but less than 50% ownership or over which the Company has significant management influence are accounted for using the equity method of accounting and the Company's share of the investee's operations is included in equity method investments. The Company follows the equity method of accounting for investment in its joint venture Animation Production Committee, Ingamba LLC. and Gravity EU SAS (Note 8).

Investments in limited partnerships are accounted for using the equity method in accordance with Accounting Standard Codification (ASC) 323, *Investment - Equity Method and Joint Ventures*, which requires the use of the equity method unless the investor's interest is so minor that the limited partner may have virtually no influence over partnership operating and financial policies. The Company follows the equity method of accounting for investment in Online Game Revolution Fund No. 1.

The Company recorded its initial investments at cost and records its pro rata share of the earnings or losses in the results of operations of the equity method investees.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include useful lives, salvage values and recovery of property, plant and equipment; recoverability of goodwill and intangible assets; valuation allowances for receivables, inventories and realization of deferred income tax assets, and fair values of derivatives. Actual results could differ materially from the estimates and assumptions used.

Risks and uncertainties

Industry and revenue

The industry in which the Company operates is subject to a number of industry-specific risks, including, but not limited to, rapidly changing technologies; significant numbers of new competitive entrants; dependence on key individuals; competition from similar products from larger companies; change in customer preferences; the need for the continued successful development, marketing, and selling of its products and services; and the need for positive cash flows from operations. The Company depends on one key product, Ragnarok Online, for most of its revenues.

During the years ended December 31, 2009, 2010 and 2011, the Company generated 84%, 85% and 83% of its revenues from countries in Asia, respectively.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of December 31, 2009, 2010, and 2011, GungHo Online Entertainment, Inc. is the only licensee whose related accounts receivable and total revenue exceeds 10% of the Company's total accounts receivable and total revenue, and the shares are as follows (Note 19):

| Country | Licensee | 2009 | | 2010 | | 2011 | |
|---------|-----------------------------------|---------------------|----------|---------------------|----------|---------------------|----------|
| | | Accounts Receivable | Revenues | Accounts Receivable | Revenues | Accounts Receivable | Revenues |
| Japan | GungHo Online Entertainment, Inc. | 40% | 56% | 35% | 56% | 45% | 50% |

Concentrations of credit risk

Cash and cash equivalents and short-term financial instruments are potentially subject to concentration of credit risk. Cash and cash equivalents and short-term financial instruments are placed with several financial institutions, of which approximately 30% of such amounts are held at one financial institution.

Revenue recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, the product or the service has been delivered or rendered, the price is fixed or determinable, and collection of the resulting receivable is reasonably assured.

The Company derives most of its revenues from online game subscription fees mainly from Ragnarok Online paid by users in Korea, the United States and Canada, France and Belgium, and royalties and license fees paid by our licensees in our overseas markets.

Online games subscription revenue

All subscription fees for the online games are prepaid, which are recorded as deferred revenue and recognized as revenue on a monthly basis in proportion to the number of days lapsed or based on actual hours used. These subscriptions are typically short-term in nature, require no additional upgrades and minor customer support.

Online games royalties and license fees

The Company licenses the right to sell and distribute its games in exchange for an initial prepaid license fee and guaranteed minimum royalty payments. The prepaid license fee revenues are recorded as deferred revenue and recognized ratably over the license period. If license agreements are renewed upon expiration of their terms, renewal license fees are deferred and recognized ratably over the new license period.

The Company generally provides its licensees with minimal post-contract customer support on its software products, consisting of technical supports and occasional unspecified upgrades, or enhancements during the contract term. The estimated costs of providing such support are insignificant and sufficient vendor-specific evidence does not exist to allocate the revenue from software and related integration projects to the separate elements of such projects, therefore all license revenue is recognized ratably over the life of the contract.

The guaranteed minimum royalty payments are recorded as deferred revenue and recognized as the royalties are earned. In addition, the Company receives a royalty payment based on a specified percentage of the licensees' sales, including game item revenues. These royalties that exceed the guaranteed minimum royalty are recognized on a monthly basis, as the related revenues are earned by the licensees.

Table of Contents

GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Mobile game revenue

Mobile games are played using mobile phones and other mobile devices. Mobile game revenues are derived from mobile game development services and a percentage of the per-download fees that users pay. Mobile game development services are recognized when the products or services have been delivered or rendered, and per-download fees are recognized on a monthly basis as they are earned.

Character merchandising, animation and other revenue

The Company licenses the right to commercialize or distribute our game characters or animation to third-party licensees in exchange for contract prices. These contract prices are recognized when the products or services have been delivered or rendered and the customers can begin their use in accordance with the contractual terms. In addition, the Company receives royalty payment based on a specified percentage of the licensees sales.

The Company also sells goods related to mobile phones, such as accessories and USB data cable, which is recorded in other revenue. The company records these sales of goods when delivery has occurred and collectability of the fixed or determinable sales price is reasonably assured.

Cash and cash equivalents

Cash equivalents consist of time deposits with a maturity of three months or less at the time of purchase.

Short-term financial instruments

Short-term financial instruments primarily include time deposits placed with financial institutions which have an original maturity greater than three months but less than one year.

Short-term and long-term available-for-sale investments

On January 1, 2009, the Company adopted ASC 825, *Financial Instruments*. The Company has elected the fair value option for two of its investments in short-term available-for-sale securities that were acquired during the year ended December 31, 2009. Under the fair value option, unrealized gains and losses related to this investment are reflected in the consolidated statements of operations for the years ended December 31, 2009 and 2010. The adoption of ASC 825 did not impact retained earnings as of January 1, 2009.

The Company's remaining investments in long-term available-for-sale securities are accounted for as available-for-sale securities pursuant to ASC 320, *Investments - Debt and Equity Securities*. The long-term available-for-sale securities are reported on the consolidated balance sheets within other non-current assets at the estimated fair market values with any changes in the estimated fair market values being recorded as a component of accumulated other comprehensive income, net of tax.

Allowance for doubtful accounts

The Company maintains allowances for doubtful accounts receivable based upon the following information: an aging analysis of its accounts receivable balances, historical bad debt rates, repayment patterns and creditworthiness of its customers, and industry trend analysis.

The payment processing service providers are responsible for remitting to the Company the full subscription revenues generated in Korea after deducting their fixed service fees and charges, which range from approximately 1.4% to 15% and risk of loss or delinquencies are borne by such payment processing service providers.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Property and equipment***

Property and equipment are stated at cost, less accumulated depreciation. Depreciation for property and equipment is computed using the straight-line method over the following estimated useful lives:

| | |
|------------------------|---------|
| Computer and equipment | 4 years |
| Furniture and fixtures | 4 years |
| Software | 3 years |
| Vehicles | 4 years |

Leasehold improvements are depreciated on a straight-line basis over the estimated useful life of the assets or the lease term, whichever is shorter.

Routine maintenance and repairs are charged to expense as incurred. Expenditures which enhance the value or extend the useful lives of the related assets are capitalized.

Accounting for the impairment of long-lived assets

Definite-lived tangible and intangible assets are amortized over their estimated useful life according to the nature and characteristics of each asset. The Company continually evaluates the reasonableness of the useful lives of these assets.

The Company reviews property, plant and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that carrying value may not be recoverable in accordance with ASC 360, *Property, Plant, and Equipment*. When the aggregate of future cash flows (undiscounted and without interest charges) is less than the carrying value of the asset, an impairment loss is recognized based on the fair value of the asset.

Intangible assets***Capitalized software development costs online game development costs***

The Company capitalizes certain software development costs relating to online games that will be distributed through subscriptions or licenses. The Company accounts for software development costs in accordance with ASC 985, *Costs of Software to be Sold, Leased, or Marketed*. Software development costs incurred prior to the establishment of technological feasibility are expensed when incurred and are included in research and development expense. Once a software product has reached technological feasibility, then all subsequent software development costs for that product are capitalized until the product is commercially launched. Technological feasibility is evaluated on a product-by-product basis, but typically occurs when the online game has a proven ability to operate in a massively multi-player format. Technological feasibility of a product encompasses both technical design documentation and game design documentation.

The Company amortizes capitalized software development costs relating to online games and records as a component of cost of revenues the greater of the amount computed using the ratio of current gross revenues for an online game to the total of current and anticipated future gross revenues for that game or the straight-line method amount over the remaining estimated economic life of the game. Amortization starts when an online game is available for general release to public users. The Company continually evaluates the reasonableness of the economic life of the capitalized software development costs based on the average life cycle of the games whenever each new game is commercially launched or acquired.

Table of Contents

GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Capitalized software development costs for online game net of accumulated amortization at December 31, 2010 and 2011 were (Won)13,700 million and (Won)18,744 million, respectively. Amortization expense for the years ended December 31, 2009, 2010 and 2011 was (Won)2,595 million, (Won)1,549 million and (Won)25 million, respectively.

The Company evaluates the recoverability of capitalized software development costs on a product-by-product basis. The recoverability of capitalized software development costs is evaluated based on the expected performance of the specific products to which the costs relate. Criteria used to evaluate expected product performance include: historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based. Capitalized costs for those products that are cancelled are expensed in the period of cancellation. In addition, impairment loss shall be recorded when management's forecast for a particular game indicates that unamortized capitalized costs exceed the net realizable value of that asset. Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established, as well as in the ongoing assessment of the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional development costs to be incurred. If revised forecasted or actual product sales are less than and/or revised forecasted or actual costs are greater than the original forecasted amounts utilized in the initial recoverability analysis, the actual impairment charge may be larger than originally estimated in any given period.

For the year ended December 31, 2009, the Company recognized an impairment loss on capitalized software development cost of (Won)39 million within impairment loss on intangible assets in the consolidated statements of operations. There were no impairment losses on capitalized software development cost recognized in 2010 and 2011.

Capitalized software development costs - website and internal use software development costs

The Company accounts for website and internal use software development costs in accordance with ASC 340, *Internal Use Software*. For website and internally used software development costs, the Company expenses all costs that are incurred in connection with the planning and implementation phases of development and costs that are associated with repair or maintenance of the existing websites and software. Costs incurred in the development phase are capitalized and amortized over the estimated product life.

Capitalized software development costs for website and internal use software at December 31, 2011 was (Won)192 million.

Research and development costs

Research and development costs consist primarily of payroll, depreciation expense and other overhead expenses which are all expensed as incurred until technological feasibility is reached.

Goodwill

Goodwill is accounted for under ASC 350, *Intangibles - Goodwill and Other*, which requires that goodwill and indefinite-lived intangible assets no longer be amortized, but instead be tested at least annually for impairment, and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of these assets below their carrying amount. Such an event would include unfavorable variances from established business plans, significant changes in forecasted results or volatility inherent to external markets and industries, which are periodically reviewed by the Company's management.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Specifically, qualitative factors are assessed to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the relevant events and circumstances are assessed. If, after assessing the totality of events or circumstances, it is determined that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then a two-step process of the goodwill impairment test are not performed. If it is determined that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the first step of the two-step goodwill impairment test is performed. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized immediately in an amount equal to that excess. The goodwill impairment test is carried out at the reporting unit, which is either an operating division or a subdivision, for which stand-alone financial information is available to the management personnel of such division or subdivision for evaluating operating results.

Acquired in-process research and development technology

Acquired IPR&D assets are considered indefinite-lived intangible assets and are not subject to amortization. An IPR&D asset must be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the IPR&D asset with its carrying amount. If the carrying amount of the IPR&D asset exceeds its fair value, an impairment loss must be recognized in an amount equal to that excess. After an impairment loss is recognized, the adjusted carrying amount of the IPR&D asset will be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited. The initial determination and subsequent evaluation for impairment of the IPR&D asset requires management to make significant judgments and estimates. Once an IPR&D project has been completed, the useful life of the IPR&D asset is determined and amortized accordingly. If an IPR&D project has been abandoned, it is immediately expensed.

Advertising

The Company expenses advertising costs as incurred. Advertising expense was approximately (Won)1,137 million, (Won)1,853 million and (Won)3,121 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Accrued severance benefits and pension plan

Employees and directors with one year or more of service are entitled to receive a lump-sum payment upon termination of their employment with the Company based on the length of service and rate of pay at the time of termination. Accrued severance benefits are estimated assuming all eligible employees were to terminate their employment at the balance sheet date in compliance with relevant laws in Korea. The annual severance benefits expense charged to operations is calculated based upon the net change in the accrued severance benefits payable at the balance sheet date based on the guidance of ASC 715, *Compensation-Retirement Benefits*.

Gravity and NeoCyon introduced a defined contribution pension plan in 2005 and 2011, respectively, and provide an individual account for each participant. A plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net pension cost for a period shall be the contribution called for in that period.

Table of Contents

GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Foreign currency translation

The Korean parent company and its subsidiaries use their local currencies as their functional currencies. The financial statements of the subsidiaries in functional currencies other than the Korean Won are translated into the Korean Won in accordance with ASC 830, *Foreign Currency Matters*. All assets and liabilities of the foreign subsidiaries are translated into the Korean Won at the exchange rate in effect at the end of the period, and capital accounts are determined to be of a permanent nature and are therefore translated using historical exchange rates. Revenues and expenses are translated at average exchange rates during the period. The effects of foreign currency translation adjustments are reflected in the cumulative translation adjustment account, reported as a separate component of comprehensive income in shareholders' equity.

Foreign currency transactions

Net gains and losses resulting from foreign exchange transactions are included in foreign currency income (losses) in the consolidated statements of operations.

Income taxes

The Company accounts for income taxes under the provisions of ASC 740, *Income Taxes*. Under ASC 740, income taxes are accounted for under the asset and liability method. Deferred income taxes are determined based upon differences between the financial reporting and tax bases of assets and liabilities at currently enacted statutory tax rates for the years in which the differences are expected to reverse.

A valuation allowance is provided on deferred income tax assets to the extent that it is more likely than not that such deferred income tax assets will not be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred income tax assets and liabilities.

The Company follows ASC 740, *Income Taxes*, which prescribes a recognition threshold and measurement attribute for tax positions taken or expected to be taken in a tax return. This standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this standard is a two-step process. In the first step, recognition, the Company determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step addresses measurement of a tax position that meets the more-likely-than-not criteria. The tax position is measured at the largest amount of benefit that has a likelihood of greater than 50 percent of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in (a) an increase in a liability for income taxes payable or a reduction of an income tax refund receivable, (b) a reduction in a deferred income tax asset or an increase in a deferred income tax liability or (c) both (a) and (b).

Fair value of financial instruments

The Company's carrying amounts of cash and cash equivalents, short-term financial instruments, accounts receivable, accounts payable and accrued liabilities approximate fair value due to the short maturity of these instruments.

The Company adopted ASC 820, *Fair Value Measurements and Disclosures*, in two steps; effective January 1, 2008, the Company adopted it for all financial instruments and non-financial instruments accounted

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

for at fair value on a recurring basis and effective January 1, 2009, for all non-financial instruments accounted for at fair value on a non-recurring basis. This guidance establishes a new framework for measuring fair value and expands related disclosures (Note 9).

Accounting for stock-based compensation

The Company accounts for stock-based compensation under ASC 718.

The Company uses a Black-Scholes model to determine the fair value of equity-based awards at the date of grant. Compensation cost for stock option grants are measured at the grant date based on the fair value of the award and recognized over the service period, which is usually the vesting period. As stock-based compensation expense recognized in the consolidated statements of operations for each period is based on awards ultimately expected to vest, it is reduced for estimated forfeitures. The Company estimates forfeitures at the time of grant and revises, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Earning (loss) per share

Basic earning (loss) per share is computed by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding for all periods. Diluted earning (loss) per share is computed by dividing net earning (loss) by the weighted average number of common shares outstanding, increased by common stock equivalents. Common stock equivalents are calculated using the treasury stock method and represent incremental shares issuable upon exercise of the Company's outstanding stock options. However, potential common shares are not included in the denominator of the diluted earning (loss) per share calculation when inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded.

Recent accounting pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Update (ASU) 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The amendments of this update replaces the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. In conjunction with the FASB's deliberations on ASU 2009-13, the FASB considered whether similar changes should be made to the guidance in ASC 985, Software. The FASB considered whether alternatives for determining fair value or selling price should also apply to arrangements that have deliverables that are within the scope of ASC 985. The FASB observed that multiple deliverable arrangements in the software industry differ from multiple deliverable arrangements in other industries. As such, the higher threshold of VSOE for purposes of separating software deliverables was retained as was the use of the residual method, where appropriate. Instead, the FASB issued ASU 2009-14, Software (Topic 985) Certain Revenue Arrangements That Include Software Elements, which modified the scope of ASC 985 to exclude tangible products and certain software components of tangible products from its scope. The ASUs are effective for the revenue arrangements entered into or materially modified in fiscal year beginning on or after June 15, 2010. The Company adopted these amendments effective in the first quarter of 2011, and the adoption did not impact the Company's financial condition and results of operations as ASC 985 is still applicable for the Company.

In December 2010, the FASB issued ASU 2010-28, *when to perform step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts (a consensus of the FASB Emerging Issues Task Force)*. The ASU modifies step 1 of the goodwill impairment test under ASC 350, *Intangibles - Goodwill and*

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Other, for reporting units with zero or negative carrying amounts to require an entity to perform step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists and whether an interim goodwill impairment test between annual test dates is necessary, an entity should consider whether there are adverse qualitative factors, including the examples provided in ASC paragraph 350-20-35-30, in determining whether an interim goodwill impairment test between annual test dates is necessary. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, for a public entity. The Company adopted the amendments, and the adoption did not impact the Company's financial condition and results of operations.

In May 2011, FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* to provide largely identical guidance about fair value measurement and disclosure requirements. This standard does not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under IFRS. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. A public entity is required to apply the ASU prospectively for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted for a public entity. In the period of adoption, a reporting entity will be required to disclose a change, if any, in valuation technique and related inputs that result from applying the ASU and to quantify the total effect, if practicable. The Company is currently assessing the potential impact of the guidance.

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment*, to help entities perform their goodwill impairment test in a cost-effective manner. This ASU allows entities the option to perform a qualitative assessment to determine whether it is more likely than not that a reporting unit's fair value is less than its carrying amount prior to performing the two-step impairment test. An entity has the option to either perform a qualitative assessment or by-pass the qualitative assessment and proceed directly to Step 1 of the two-step goodwill impairment test for each of its reporting units. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 with early adoption permitted. The Company has early adopted this ASU and the adoption of ASU 2011-08 had no material impact on the Company's consolidated financial statements.

In June and December 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, and ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. The amended guidance requires an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The current option to report other comprehensive income and its components in the statement of stockholders' equity will be eliminated. Although the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under existing guidance. An entity should apply the ASU retrospectively. For a public entity, these ASUs are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. These ASUs will change our financial statement presentation of comprehensive income but will not impact our net income, financial position, or cash flows.

3. Convenience Translation into United States Dollar Amounts

The Company reports its consolidated financial statements in the Korean Won. The United States dollar (US dollar) amounts disclosed in the accompanying consolidated financial statements are presented solely for the convenience of the reader, and have been converted at the rate of 1,158.5 Korean Won to one US dollar, which is the noon buying rate of the U.S. Federal Reserve Bank of New York in effect on December 30, 2011.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Such translations should not be construed as representations that the Korean Won amounts represent, have been, or could be, converted into, US dollars at that or any other rate. The US dollar amounts are unaudited and are not presented in accordance with generally accepted accounting principles generally accepted either in the Republic of Korea or the United States of America.

4. Restricted Assets

As of December 31, 2011, one of the Company's subsidiaries, Gravity Interactive, Inc. has issued an irrevocable letter of credit in the amount of \$250,000 to its landlord in relation to an office lease agreement with no amounts drawn on this letter of credit as of December 31, 2011. In comparison to the amount of \$500,000 of the previous year, it has been reduced by \$250,000 because of the agreement with its landlord, which was made and entered on March 22, 2011. Additionally a bank deposit amounting to \$250,000 was provided to a bank as collateral for this letter of credit. The Company records this restricted short-term investment as other non-current assets.

5. Allowance for Accounts Receivable

Changes in the allowance for accounts receivable for the years ended December 31, 2009, 2010 and 2011 are as follows:

| | 2009 | 2010 | 2011 |
|--------------------------------|-----------------------------|---------|---------|
| | (In millions of Korean Won) | | |
| Balance at beginning of year | (Won) 67 | (Won) 2 | (Won) 5 |
| Provision for allowances | | 5 | 21 |
| Reversal of previous provision | (65) | | |
| Write-offs | | (2) | (18) |
| Balance at end of year | (Won) 2 | (Won) 5 | (Won) 8 |

6. Available-for-sale Investments

The cost, gross unrealized gains and fair value of available-for-sale securities as of December 31, 2010 and 2011 are as follows:

| | Cost or Carrying Value | Gross Unrealized Losses | Fair Value |
|--|------------------------------|-------------------------------|---------------|
| | (In millions of Korean Won) | | |
| As of December 31, 2010 | | | |
| Current portion of available-for-sale: | | | |
| ELS fund (accounted for at fair value under ASC 825) | (Won) 5,000 | (Won) | (Won) 5,000 |
| Non-current portion of available-for-sale: | | | |
| Public bond | 21 | 1 | 20 |
| | (Won) 5,021 | (Won) 1 | (Won) 5,020 |
| As of December 31, 2011 | | | |
| Current portion of available-for-sale: | (Won) | (Won) | (Won) |
| Non-current portion of available-for-sale: | (Won) | (Won) | (Won) |

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

From 2009 to 2010, the Company invested (Won)5,000 million each year in the Equity-Linked Securities fund (ELS fund), which is comprised of bonds, marketable equity securities and trust funds as of December 31, 2010. These investments are classified as short-term available for sale investments on the balance sheet. The fair value of bonds is derived based on quoted prices in active markets, the fair value of marketable securities is derived based on quoted prices in active exchange markets, and the fair value of the trust funds is derived based on quoted prices in markets that are not active or other inputs that are observable. The trust fund portion of these investments contains an embedded derivative. The Company has determined it is not practical to bifurcate the embedded derivative and account for separately. In accordance with ASC 825 the Company has elected the fair value option to account for these investments and has assessed the fair value of the instruments as a whole. In 2011, the Company sold ELS fund, which was invested in 2010 and public bonds, which were non-current available-for-sale securities.

7. Acquisition of the investment in Gravity Games Corp.

In October 2010, the Company acquired an aggregate of 50.83% of the voting common shares of Gravity Games Corp. (formerly, Barunson Interactive Corp.) for a purchase price of (Won)11,688 million in cash. Gravity Games Corp. is a developer of Dragonica, a multi-player online role playing game in Korea.

The acquisition was accounted for as a purchase. The purchase price was allocated to the assets acquired and liabilities assumed based on their respective fair values. Gravity Games Corp. s results of operations are included in the Company s consolidated financial statements from the date of acquisition. The excess amount of the purchase price over the fair market value of the net assets acquired is accounted for as goodwill. The Company believes the resulting amount of goodwill reflects its expectations of the synergistic benefits of being able to leverage Gravity Games Corp. s multi-player online role playing game service with the Company s own services to provide a wide variety game titles to the Company s global network user base. The goodwill is not deductible for income tax purposes.

Acquisition-related costs of (Won)25 million have been recognized and included with as selling, general and administrative expenses.

The estimated fair value of assets acquired and liabilities assumed on the acquisition date were:

| | 2010 | |
|--|------------------------------------|---------------|
| | (In millions of Korean Won) | |
| Consideration cash | (Won) | 11,688 |
| Current assets | (Won) | 2,150 |
| Non-current assets | | |
| Property and equipment | | 357 |
| Game product technology | | 11,856 |
| In-process research and development technology | | 8,503 |
| Other non-current assets | | 106 |
| Current liabilities | | (460) |
| Non-current liabilities | | (4,064) |
| Deferred income tax liabilities | | (2,739) |
| Total indentified net assets | | 15,709 |
| Non-controlling interest | | (10,802) |
| Goodwill | | 6,781 |
| | (Won) | 11,688 |

Table of Contents

GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The fair value of current assets acquired includes accounts receivable from its customers and loan receivable with a fair value of (Won)1,094 million. The gross amount due under the contract is (Won)1,182 million, of which (Won)88 million is expected to be uncollectible.

Acquired in-process research and development (IPR&D) technology relates to the East Road project and has not been completed at the acquisition date. IPR&D assets are initially recognized at fair value and have indefinite useful lives until the successful completion or abandonment of the associated research and development efforts. Accordingly, during the development period, these assets will not be amortized into the results of operations. Instead, these assets will be subject to periodic impairment testing. Upon successful completion of the development process for the IPR&D project, the determination of the useful life of the asset will be made. At that point in time, the asset would then be considered as having a finite-life and the Company would begin to amortize the asset into earnings.

The excess earnings method was applied as a valuation method that establishes the estimated fair value of the intangible assets based on a stream of future economic benefits, such as net cash flows, discounted to their present value. This calculation is highly sensitive to both the estimated future cash flows from the game product technology and IPR&D project and the discount rate assumed in these calculations. These components are discussed below:

Estimated future cash flows

The key variables that the Company must estimate to determine future cash flows include assumptions for future revenue and costs, and other economic or market-related factors. Significant management judgment is involved in estimating these variables, and they include inherent uncertainties since they are forecasting future events.

Discount rate

The Company employs a Weighted Average Cost of Capital (WACC) approach to determine the Company's discount rate for the valuation on the intangible assets. The Company's WACC calculation includes factors such as the risk free rate of return, cost of debt and expected equity premiums. The factors in this calculation are largely external to the Company, and therefore are beyond the Company's control.

The Company measured the fair value of the non-controlling interest based on the fair value of the enterprise on a per-share basis (49.2%). There was no quoted market price available since the acquired company was a non-public company. Therefore, an income approach (discounted cash flow model) was primarily used to estimate the enterprise value and public company market multiple were also considered.

The following unaudited pro forma information presents the revenue and net income of the combined entity for the years ended December 31, 2009 and 2010 as if the acquisition of Barunson had been completed on January 1, 2009 with adjustments to give effect to pro forma events that are directly attributable to the acquisition. The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings which may result from acquisitions of the investment in Barunson. Accordingly, these unaudited pro forma results are presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the combined company that would have been achieved had the acquisition occurred at the beginning of the comparable prior annual reporting period presented, nor are they intended to represent or be indicative of future results of operations.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The unaudited pro forma revenue and net income are as follows:

| | 2009 | 2010 |
|----------------------------|--|--------------|
| | (In millions of Korean Won except per share data) | |
| Revenue | (Won) 60,689 | (Won) 57,930 |
| Net Income | 5,093 | 3,446 |
| | | |
| Basic earnings per share | 733 | 496 |
| | | |
| Diluted earnings per share | 733 | 496 |

The amounts of revenue and net loss of Barunson included in the Company's consolidated statements of operations from the acquisition date to December 31, 2010 are (Won)748 million and (Won)211 million, respectively.

8. Equity Method Investment

The Company's equity method investment balance is comprised of the following at December 31 :

| | 2010 | 2011 |
|-----------------------------------|------------------------------------|-------------|
| | (In millions of Korean Won) | |
| Animation Production Committee | (Won) | (Won) |
| Online Game Revolution Fund No. 1 | 838 | 838 |
| Gravity EU SAS | | 254 |
| Ingamba LLC | 498 | 352 |
| | | |
| Total equity method investments | (Won) 1,336 | (Won) 1,444 |

The Company's equity income (loss) on investments is comprised of the following for the years ended December 31 :

| | 2009 | 2010 | 2011 |
|-----------------------------------|------------------------------------|-------------|-------------|
| | (In millions of Korean Won) | | |
| Animation Production Committee | (Won) | (Won) | (Won) |
| Online Game Revolution Fund No. 1 | (1,424) | (358) | (38) |
| Gravity EU SAS | | | (70) |
| Ingamba LLC | | 13 | (134) |
| | | | |
| Total equity loss on investments | (Won) (1,424) | (Won) (345) | (Won) (242) |

Animation Production Committee

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In April 2004, the Company's subsidiary, Gravity Entertainment Corp., invested ¥123 million ((Won)1,358 million) for a 30% interest in Animation Production Committee, a joint venture, which was incorporated in Japan to produce an animation of Ragnarok. The investment was accounted for under the equity method of accounting. In 2006, the Company discontinued applying equity method as the investment was reduced to zero. The Company does not have contractual obligation to fund the further losses of joint venture.

Online Game Revolution Fund No. 1

In 2005, the Company entered into a limited liability partnership agreement to invest the committed amount of ¥1,000 million ((Won)8,713 million) in Online Game Revolution Fund No. 1, a limited liability partnership (the

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Partnership). In 2005, 2006, 2008 and 2009, the Company invested ¥100 million ((Won)869 million), ¥150 million ((Won)1,245 million), ¥642 million ((Won)6,054 million) and ¥18 million ((Won)229 million), respectively. As of December 31, 2011, the Company, SoftBank Corp. and GungHo Online Entertainment, Inc. (GungHo) have interests of 16.39%, 49.18% and 8.20%, respectively, in Online Game Revolution Fund No. 1. The Company has 16.39% interest in the Partnership as a limited partner, and cannot significantly influence over the Partnership's operation and financial policies per the limited liability partnership agreement. However, the Company accounts for the investment under equity method of accounting in accordance with ASC 323, *Investment- Equity Method and Joint Ventures*, which requires the use of the equity method unless the investors' interest is so minor that the limited partner may have virtually no influence over the Partnership's operating and financial policies. The Company recorded as equity loss of the Partnership amounting to (Won)1,424 million, (Won)358 million and (Won)38 million in 2009, 2010 and 2011, respectively.

Summarized financial information of the Partnership at December 31, 2010 and 2011 is as follows:

Balance Sheets

| | 2010 | 2011 |
|---|-----------------------------|--------------|
| | (In millions of Korean Won) | |
| Current assets | (Won) 4,296 | (Won) 4,646 |
| Noncurrent assets | 1,863 | 1,980 |
| Total Assets | 6,159 | 6,626 |
| Current liabilities | 28 | 429 |
| Noncurrent liabilities | 1,018 | 1,082 |
| Shareholders' equity | 5,113 | 5,115 |
| Percentage of ownership in equity investees | 16.39% | 16.39% |
| Investment in equity investees at cost plus equity undistributed earnings since acquisition | (Won) 838 | (Won) 838 |

Statements of operations

| | 2009 | 2010 | 2011 |
|---|-----------------------------|--------------|------------|
| | (In millions of Korean Won) | | |
| Revenues | (Won) 1,795 | (Won) 2,180 | (Won) |
| Cost and expense | 10,483 | 9,856 | 300 |
| Operating loss | 8,688 | 7,676 | 300 |
| Other income, net | | 5,492 | |
| Loss before income taxes | 8,688 | 2,184 | 300 |
| Income tax expense | | | |
| Net Loss | 8,688 | 2,184 | 300 |
| Percentage of ownership in equity investees | 16.39% | 16.39% | 16.39% |

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| | | | |
|---|-------------|-----------|----------|
| Equity in net loss of equity method investees | 1,424 | 358 | 49 |
| Income tax effect | | | (11) |
| Equity in net loss of equity method investees, net of tax | (Won) 1,424 | (Won) 358 | (Won) 38 |

F-21

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

This Partnership is operated in Japan and the objective of the Partnership is to invest in business relating to online games for the benefit of all the partners. The Partnership had invested in eight games since its operation.

On December 31, 2010, the term of the Partnership expired and it is under liquidation. The liquidation process was not consummated due to the delay in selling certain games that the Partnership had invested. The Company is expecting that the Partnership will be able to distribute the remaining disposable assets including cash of (Won)4,544 million and receivables from selling the games upon dissolution. The Partnership did not have any debt outstanding at December 31, 2011. Therefore, the Company has estimated that the Company's share of such liquidation proceeds will be at least equal to the Company's carrying value of its investment in the Partnership at December 31, 2011.

Ingamba LLC

In June 2010, the Company invested Russian Ruble 13 million ((Won)502 million), which represents 25% of Ingamba LLC's total capital, in order to distribute the Company's games in Russia. The investment in Ingamba LLC was accounted for as an equity method investment. The Company recorded as equity gain on investments amounting to (Won)13 million in 2010 and equity loss on investments amounting to (Won)134 million in 2011.

Gravity EU SAS

In 2011, Gravity EU SASU issued new shares to new investors and the Company and then transformed into a joint venture named Gravity EU SAS. Due to a dilution of the Company's interest in Gravity EU SAS, the Company's ownership of the investee decreased from 100% to 25%. Gravity EU SAS was excluded from the consolidation as of December 31, 2011 since the Company lost control over it. Upon deconsolidation, the Company recorded its retained interest in Gravity EU SAS at fair value at the date of deconsolidation. As a result, a gain on loss of control in a subsidiary of (Won)548 million was recognized in the consolidated statements of operations. And the entire accumulated other comprehensive income balance that relates to EU SASU was recognized as a part of the gain. Gravity EU SAS was accounted for by using an equity method since August 2011 and equity loss on investments amounting to (Won)70 million was recognized in 2011.

9. Fair value of financial instruments

The Company adopted ASC 820, *Fair Value Measurements and Disclosures* effective January 1, 2009, for all financial assets and liabilities as required. This statement defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining fair value, the Company considers the principal or most advantageous market in which the Company would transact, and the Company considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions and risk of non-performance.

The Company's financial instruments are measured and recorded at fair value, except for cost method investments. The Company's non-financial assets, such as goodwill, intangible assets, and property, plant and equipment, are measured at fair value when there is an indicator of impairment and recorded at fair value only when an impairment charge is recognized.

As discussed in Note 2, the Company adopted ASC 825, which permits entities to choose to measure financial instruments and certain other items at fair value and consequently report unrealized gains and losses on these items in earnings. ASC 825 was effective for the Company's fiscal year beginning January 1, 2009. The Company has elected the fair value option to measure its short-term available-for-sale investments.

Table of Contents

GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The estimated fair value of financial assets is determined by the Company, using available market information and valuation methodologies considered to be appropriate. However, considerable judgment is required in interpreting market data to develop the estimates of fair value.

The following methods and assumptions were used to estimate the fair value of each class of significant financial assets and financial liabilities:

(i) Cash and cash equivalents, short-term financial instruments, accounts receivable and accounts payable

The carrying amount approximates fair value because of the short maturities of these balances.

(ii) Short-term available-for-sale investments with an embedded derivatives features

The Company's short-term available for sale securities are the investment in Equity-Linked Securities fund (ELS fund) which represents equity interests in a fund that is comprised of bonds and trust funds as of December 31, 2010. The fair value of bonds is derived based on quoted prices in active markets, and the fair value of trust funds is derived based on quoted prices in markets that are not active or other inputs that are observable. The trust fund portion of this investment contains an embedded derivative. The Company has determined that it is not practical to bifurcate the embedded derivative and account for separately as the host contract and embedded derivative are closely related. Pursuant to ASC 825, the Company has elected the fair value option to account for this investment. Accordingly, the entire change in estimated fair value in the beneficiary certificates is included in the consolidated statements of operations.

(iii) Long-term available-for-sale investments

The fair value of market traded investments such as listed company's stocks, public bonds and other marketable securities are based on quoted market prices for those investments.

The Company's financial assets and liabilities are valued utilizing the market approach to measure fair value. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The standard describes a fair value hierarchy based on three levels of inputs that may be used to measure fair value which are the following:

Level 1 Quoted prices in active exchange markets involving identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs for the asset or liability, either directly or indirectly, and management assessments and inputs using a binomial lattice model as the valuation technique.

Additionally, the Company considers both counterparty credit risk and its creditworthiness in determining fair value. The Company attempts to mitigate credit risk to third parties by actively monitoring the creditworthiness of counterparties and its exposure to credit risk by selecting major financial institutions with healthy financial position as counterparties.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the Company's financial assets measured at fair value on a recurring basis in accordance with ASC 820 and ASC 825 at December 31, 2010 :

| December 31, 2010 | Quoted Market Price in Active Market (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|--|---|--|--|--------------|
| | (In millions of Korean Won) | | | |
| Short term available for sale investments | (Won) | (Won) 5,000 | (Won) | (Won) 5,000 |
| Long term available for sale investments (other non-current assets) | 20 | | | 20 |
| Total available for sale investments | (Won) 20 | (Won) 5,000 | (Won) | (Won) 5,020 |

In 2010, there was no transfer of financial instruments between different categories of fair value.

As of December 31, 2011, there is no financial instruments measured at their fair value in accordance with ASC 820 and ASC 825.

10. Property and Equipment, Net

Property and equipment as of December 31, 2010 and 2011 consist of the following:

| | 2010 | 2011 |
|--------------------------------|------------------------------------|--------------|
| | (In millions of Korean Won) | |
| Computer and equipment | (Won) 11,608 | (Won) 12,026 |
| Furniture and fixtures | 1,717 | 1,859 |
| Vehicles | 92 | 93 |
| Capital lease assets | 837 | 938 |
| Leasehold improvements | 763 | 771 |
| Software externally-purchased | 9,534 | 9,647 |
| | 24,551 | 25,334 |
| Less: accumulated depreciation | (21,879) | (22,603) |
| | (Won) 2,672 | (Won) 2,731 |

Depreciation expenses for the years ended December 31, 2009, 2010 and 2011 were (Won)2,924 million, (Won)1,856 million and (Won)1,651 million, respectively.

No impairment loss was recorded for the years ended December 31, 2009, 2010 and 2011.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. Goodwill and other intangible assets**

Capitalized software development cost and other intangible assets as of December 31, 2010 and 2011 consist of the following:

| | At December 31, 2010 | | | At December 31, 2011 | | | Net Carrying Amount |
|---------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Accumulated Impairment | |
| | (In millions of Korean Won) | | | | | | |
| Capitalized software development cost | (Won) 21,446 | (Won) (7,746) | (Won) 13,700 | (Won) 26,707 | (Won) (7,771) | (Won) | (Won) 18,936 |
| Acquired intangible assets | | | | | | | |
| Product technology | 18,382 | (6,921) | 11,461 | 18,382 | (9,292) | (2,384) | 6,706 |
| IPR&D technology | 8,503 | | 8,503 | 8,503 | | | 8,503 |
| Trademarks | 450 | (281) | 169 | 503 | (323) | | 180 |
| Others | 176 | (169) | 7 | 1,522 | (362) | (799) | 361 |
| Total | (Won) 48,957 | (Won) (15,117) | (Won) 33,840 | (Won) 55,617 | (Won) (17,748) | (Won) (3,183) | (Won) 34,686 |

The company capitalized (Won)4,243 million and (Won)5,261 amount of R&D costs in accordance with ASC 985, *Costs of Software to be Sold, Leased, or Marketed* in 2010 and 2011.

All of the Company's intangible assets other than goodwill and IPR&D are subject to amortization. No significant residual value is estimated for the intangible assets. Aggregate amortization expense for intangible assets for the years ended December 31, 2009, 2010 and 2011 was (Won)2,703 million, (Won)2,099 million and (Won)2,631 million, respectively.

The Company recognized an impairment loss of (Won)2,384 million and (Won)799 million for product technology (Dragonica), and other intangible assets (Eternal destiny) in 2011, respectively. The gross carrying amounts of Dragonica and Eternal destiny were (Won)11,856 million and (Won)846 million, respectively.

As of December 31, 2011, the carrying values of Dragonica and Eternal destiny are (Won)6,706 million and (Won)0 million, respectively.

Despite the Company's various efforts, a significant decrease in revenue of Dragonica was noted in fourth quarter of 2011, which was a trigger event for the impairment analysis of Dragonica. In addition, the Company commercially launched Eternal Destiny in August 2011. However, the game did not gain popularity in market and the Company ceased offering commercial service in November 2011, which was a trigger event for the impairment of Eternal Destiny.

As the carrying amount of Dragonica and Eternal destiny exceeds the sum of their respective estimated undiscounted future cash flows from the use, Dragonica and Eternal destiny were considered impaired. And the Company recognized an impairment loss of (Won)2,384 million and (Won)799 million, respectively, since the carrying amount before the recognition of impairment loss exceeds their fair values.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Changes in goodwill balances for the years ended December 31, 2010 and 2011 are as follows:

| | 2010 | 2011 |
|---|------------------------------------|-------------|
| | (In millions of Korean Won) | |
| Balance at beginning of the year | | |
| Goodwill | (Won) 1,451 | (Won) 8,232 |
| Accumulated impairment losses | (241) | (241) |
| | 1,210 | 7,991 |
| Impairment losses | | (514) |
| Acquisition in the business combination | 6,781 | |
| Balance at end of the year | | |
| Goodwill | 8,232 | 8,232 |
| Accumulated impairment losses | (241) | (755) |
| | (Won) 7,991 | (Won) 7,477 |

As described in Note 2, the Company performed annual impairment test for goodwill at each reporting unit, NeoCyon, Inc. and Gravity Games Corp. using data as of December 31, 2011. Prior to performing the two-step impairment test for goodwill, the Company performed a qualitative assessment for the reporting unit of NeoCyon and Gravity Games and concluded not to perform the two-step impairment test for NeoCyon as it is more likely than not that a reporting unit of NeoCyon's fair value is greater than its carrying amount. In performing the impairment analysis for goodwill and IPR&D technology (East Road), which have indefinite useful lives, the Company used income approach to determine the fair value of the reporting unit and IPR&D technology. The fair value was determined based on the present value of estimated future cash flows, discounted at a risk-adjusted rate. The Company used internal forecasts to estimate future cash flows and included an estimate of long-term future growth rates based on most recent views of the long-term outlook for each business. The Company derived the discount rates by applying the capital asset pricing model.

As of December 31, 2011, the fair value of East Road is estimated to exceed its carrying amount, therefore the impairment test does not result in any impairment charge for East Road. However, in performing the annual impairment test for goodwill for Gravity Games Corp., the fair value of the business reporting unit for Gravity Games Corp. was determined to be lower than the book value of the business reporting unit for Gravity Games Corp. Therefore, in 2011, the Company recorded impairment loss of (Won)514 million in the reporting unit of Gravity Games Corp., which is primarily a result of a decline in projected future revenues as compared to the projections of revenue used for the initial recognition of the goodwill at the acquisition date in 2010.

During the fiscal year ended December 31, 2009, the Company recorded impairment losses of (Won)241 million in reporting units in the Russian business due to the overall decline in the fair value of the reporting units and uncertainty in the future. The impairment losses of (Won)241 million represented the entire outstanding balance of goodwill in the reporting unit before the impairment losses.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Expected amortization expense related to current net carrying amount of intangible assets is as follows:

| | (In millions of Korean Won) | |
|---------------------|-----------------------------|--------|
| 2012 | (Won) | 5,142 |
| 2013 | | 5,803 |
| 2014 | | 5,631 |
| 2015 | | 5,218 |
| 2016 and thereafter | | 4,389 |
| | (Won) | 26,183 |

IPR&D asset will be amortized once the project is completed and the asset is placed in service. However, it was excluded from the expected amortization schedule due to uncertainty as to when it will be placed in service.

12. Accrued Severance Benefits

Changes in accrued severance benefits for the years ended December 31, 2009, 2010 and 2011 are as follows:

| | 2009 | 2010 | 2011 |
|------------------------------------|-----------------------------|-------------|-------------|
| | (In millions of Korean Won) | | |
| Balance at beginning of year | (Won) 926 | (Won) 478 | (Won) 1,031 |
| Acquisition of Gravity Games Corp. | | 427 | |
| Provisions for severance benefits | 436 | 234 | 586 |
| Severance payments | (832) | (91) | (648) |
| Terminated but not paid | (52) | (17) | (53) |
| Balance at end of year | (Won) 478 | (Won) 1,031 | (Won) 916 |

In 2005, Gravity introduced a defined contribution pension plan (Pension Plan) in accordance with the Employee Benefit Security Act of Korea and entered into a nonparticipating defined contribution insurance contract with a life insurance company. Gravity's contribution to the Pension Plan was (Won)1,027 million, (Won)1,075 million and (Won)1,085 million in 2009, 2010 and 2011, respectively. In 2011, NeoCyon, Inc. also introduced a Pension Plan and the amount of cost recognized for the Pension Plan was (Won)97 million. For the contributions already paid, Gravity and NeoCyon will have no legal or constructive obligation to pay further amounts and therefore no severance benefits were accrued. As of December 31, 2011, no subsidiaries other than NeoCyon, Inc. introduced a Pension Plan and severance benefits were accrued.

13. Commitments and Contingencies**Commitments**

As of December 31, 2011, the Company has outstanding licensing agreements of Ragnarok Online with 10 companies internationally. Based on the agreements with the licensees, the Company receives certain amount (24% to 40%) of each licensee's revenues as royalty.

The Company has contracts for the exclusive right of Ragnarok Online II game distribution and sales with GungHo Online Entertainment, Inc. (GungHo) in Japan, AsiaSoft Corporation Public Co., Ltd. in Thailand, Shanghai The 9 Information Technology Ltd., in China, Level up! Inc. in Philippines, AsiaSoft Online Pte. Ltd., in Singapore and Malaysia, AsiaSoft Corporation Public Co., Ltd. in Vietnam, PT. Lyto Datarindo

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F-27

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Indonesia and Level up! Interactive S.A. in Brazil. The contract periods of these license agreements range from two to four years after commercialization in each geographical location.

In June 2010, the Company entered into an agreement for Requiem in Russia and 14 other countries with Ingamba LLC. In March 2010, the Company entered into an agreement for Requiem in Taiwan, Hong Kong and Macau with GameFlier International Corporation.

The Company entered into a software licensing agreement with GungHo in December 2005 for the right to publish and distribute Emil Chronicle Online (ECO) worldwide, except for Japan, which was renewed in 2006, 2010 and 2011. In August 2007, the Company entered into an agreement with GameCyber Technology Ltd. to distribute ECO in Taiwan and Hong Kong, which was renewed in June 2011. In February 2009, the Company entered into an agreement with PT. Wave Wahana Wisesa for distribution of ECO in Indonesia. The Company entered into a license and distribution agreement with Access Bright Limited to distribute ECO in China in June 2010.

As of December 31, 2011, the Company has outstanding licensing agreements of Dragonica with seven companies internationally. Based on the agreements with the licensees, the Company receives certain amount (21% to 40%) of each licensee s revenues as royalty.

As of December 31, 2011, the license fee the Company has committed to pay upon the commercial launches of the licensed games was (Won)1,452 million.

In December 2007, Gravity Interactive, Inc. entered into a capital lease agreement with respect to the open beta testing server for the commercial distribution of Requiem with a total lease payment of \$271 thousand over a two-year-period. In 2008, this capital lease agreement was amended, thereby decreasing the total lease payment by \$140 thousand to \$131 thousand. The Company also entered into additional capital lease agreements to utilize more assets including servers in 2009, which increased the total capital lease payment by \$123 thousand. In 2008, the Company made principal and interest payments of \$80 thousand and \$26 thousand, respectively. In 2009, the Company made principal and interest payments of \$153 thousand and \$33 thousand, respectively. The Company also entered into additional capital lease agreements to utilize more assets including servers and equipment in 2010, which increased the total capital lease payment by \$326 thousand. Therefore, the Company made principal and interest payments of \$124 thousand and \$28 thousand in 2010, respectively. In 2011, the Company entered into additional capital lease payment agreements which increased the total capital lease payment by \$93 thousand. Therefore, the Company made principal and interest payments of \$151 thousand and \$52 thousand in 2011, respectively.

Future minimum lease payments for the leases as of December 31, 2011, are as follows:

| | 2012 | | 2013 | |
|---------------|-----------|----------|-----------|----------|
| | Principal | Interest | Principal | Interest |
| Capital lease | \$ 172 | \$ 30 | \$ 124 | \$ 7 |

(In thousands of US dollars)

In addition to the capital lease above, the Company leases certain properties. The Company s operating leases consist of various property leases expiring in 2012. Rental expenses incurred under these operating leases were approximately (Won)3,759 million, (Won)2,823 million and (Won)2,949 million for the years ended December 31, 2009, 2010 and 2011, respectively. The Company entered into a lease agreement with Korea Software Industry Promotion Agency in 2008 and recorded a guarantee deposit of (Won)1,371 million as of December 31, 2011.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Future minimum rental payments for the leases as of December 31, 2011, are as follows:

| | 2012 |
|-------------------|------------------------------------|
| | (In millions of Korean Won) |
| Operating lease | 2,674 |
| <i>Litigation</i> | |

In May 2006, a former investor of Ragnarok Online filed a lawsuit in Korean Court against the Company with related claim amount of (Won)1,344 million claiming that the Company failed to distribute the earnings from certain amount of net sales due to the embezzlement of royalty revenue committed by a former chairman of the Company and from license fees from overseas licensees from 2002 to 2005. In 2009, the Company won the lawsuit in Korean Court filed by the former investor of Ragnarok Online to claim additional distribution of earnings.

In October 2006, Softstar Entertainment, Inc., the Company's former licensee in Taiwan, Hong Kong and Macau for R.O.S.E. Online, filed a lawsuit in Singapore against the Company insisting that the Company caused it to incur a loss in their business by providing them with a materially deficient program. The Company entered into a settlement agreement with Softstar Entertainment, Inc. regarding a compensation lawsuit Softstar Entertainment, Inc. filed in 2009. As a result, the Company paid \$2 million to Softstar Entertainment, Inc. and recognized the loss of (Won)1,649 million, which is the difference between the settlement and the existing deferred revenue balance under prior year's statements of operations.

In June 2009, a director and manager of Gravity Middle East & Africa FZ-LLC (ME&A), the subsidiary in United Arab Emirates, asserted to the Company a claim for his salary for the past twenty months, which amounts to (Won)229 million (AED 721,022). The Company did not record any accrual from the claim at this time as the Company believes that they had not entered into a valid contract with this director which required the payment of salary. While there is no significant progress on this claim in 2011, the Company is unable to predict the ultimate outcome of this claim.

In April 2009, the Company repatriated (Won)1,820 million (\$1.4 million) from ME&A, which comprised most of remaining net assets of ME&A. ME&A had been in process of liquidation since September 2008. In August 2010, the director and manager of ME&A, as a representative of ME&A, filed a lawsuit against the Company and some of its directors and officers on the subject of them being accused of the repatriation of ME&A claiming an aggregate of (Won)1,628 million (AED 5 million and related interests plus litigation costs). In November 2011, the case was decided in favor of the plaintiff and the Company filed an appeal with the Seoul High Court and paid deposit in court amounting to (Won)4,140 million to proceed with the appeals against the dismissal of the case regarding the repatriation of capital funds from ME&A. No amount was accrued because the above case would not result in a loss of the Company.

In April 2010, the Company was charged by a former executive of the Company seeking payment of compensation amounting to (Won)1,201 million under a certain employment agreement. The case was dismissed and the plaintiff filed appeal against the dismissals of the lawsuits with the Seoul High Court in May 2011 and the court ruled partially in favor of the plaintiff. The plaintiff and the Company brought final appeals with the Supreme Court of Korea in December 2011 and the both appeals were finally dismissed by the Supreme Court of Korea in April 2012. In May 2010, the former executive filed another lawsuit claiming, amounting to (Won)50 million, employment termination without cause. The case was dismissed and the plaintiff filed an appeal with the Seoul High Court in April 2011. In June 2011, the former executive filed another lawsuit against the Company claiming nullity of dismissal and seeking remuneration, amounting to (Won)110 million, due regarding the remainder

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

of his term. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss with respect to the above matters although the Company is unable to predict the ultimate outcome. The Company did not record a liability as of December 31, 2011.

In June 2010, NeoCyon proposed a lawsuit amounting to (Won)1,294 million and related interests against former CEO of NeoCyon, the defendant, of whom was accused of being given unauthorized surplus of compensations in retirement and retirement bonus funds from NeoCyon. The former CEO of NeoCyon filed suit against NeoCyon while noting that he should be paid an additional amount of (Won)81 million and related interests in retirement and retirement bonus funds. As of December 2011, the court proceedings of the two lawsuit cases are in progress and the Company is unable to predict the ultimate outcome of the above matters.

In November 2010, Gravity Interactive, Inc., THQ Inc. and others were accused of a trademark infringement by the trademark owner of Dragonica, Victor Garcia, and was filed a lawsuit at the United States District Court for the Southern District of Florida. The plaintiff filed a claim on all gains for the Company, losses for the plaintiff and other compensations occurring through the trademark infringement. In February 2011, Gravity Interactive, Inc. sent a written defense to the United States District Court for the Southern District of Florida, noting that there was no trademark infringement of Dragonica. In February 2012, the Company reached a settlement with Victor Garcia on condition that the trademark would not be used in commerce anywhere within the U.S.A. and the settlement was closed in March 2012.

14. Shareholders Equity

As of December 31, 2011, Gravity is authorized to issue a total of 40 million shares with a par value of (Won)500 per share, in registered form, consisting of common shares and non-voting preferred shares. Of this authorized amount, Gravity is authorized to issue up to 2 million non-voting preferred shares. Under the articles of incorporation, holders of non-voting preferred shares are entitled to receive dividends of not less than 1% and up to 15% of the par value of such shares, the exact rate to be determined by Gravity's Board of Directors at the time of issuance, provided that the holders of preferred shares are entitled to receive dividend at a rate not lower than that determined for holders of common shares. Gravity does not have any non-voting preferred shares outstanding.

As of December 31, 2011, the Company had a total of 6,948,900 common shares issued and outstanding. All of the issued and outstanding shares are fully paid and are registered.

15. Stock Purchase Option Plan

A summary of option activity under the Option Plan as of December 31, 2011, and changes during the years then ended is as follows:

| | Number of Stock Options | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Life |
|---|-------------------------------|---|---|
| Stock options outstanding as of January 1, 2009 | 31,095 | (Won) 45,431 | |
| Options expired | 13,526 | 45,431 | |
| Options forfeited | 4,044 | 45,431 | |
| December 31, 2009 | 13,525 | (Won) 45,431 | |
| Options expired | 13,525 | 45,431 | |

December 31, 2010

(Won)

F-30

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2010, 13,525 out of 271,000 stock options granted to officers and employees on December 24, 2004 expired (the accumulated number of stock options which expired until 2009 was 59,742) and none of stock options were cancelled due to the retirement of the officers and employees (the accumulated number of stock options which were cancelled until 2009 were 197,733).

The total compensation expense relating to the grant of stock options is recognized over the five year vesting period using the ASC 718, Compensation-Stock Compensation, graded attribution model. The Company recognized (Won)148 million in stock compensation expense for the years ended December 31, 2009. Stock compensation expenses are included in selling, general and administrative expenses, research and development expenses, and cost of revenue in the consolidated statements of operations.

As there is no stock option outstanding as of December 31, 2011, no compensation cost has been recognized for the year ended December 31, 2011.

16. Earning Per Share

The components of basic and diluted earning per share are as follows:

| | 2009 | 2010 | 2011 |
|--|-----------------------------|-------------|--------------|
| | (In millions of Korean Won, | | |
| | except per share data) | | |
| Net income available for common shareholders (A) | (Won) 6,917 | (Won) 3,730 | (Won) 14,928 |
| Weighted average outstanding shares of common shares (B) | 6,948,900 | 6,948,900 | 6,948,900 |
| Earnings per share Basic and diluted (A/B) | (Won) 995 | (Won) 537 | (Won) 2,148 |

The 13,525 stock options outstanding as of December 31, 2009 are excluded from the Company's calculation of earnings per share as their effect is anti-dilutive.

17. Income Taxes

Income tax expenses (benefit) for the years ended December 31, 2009, 2010 and 2011 consist of the following:

| | 2009 | 2010 | 2011 |
|-----------------------------------|-----------------------------|--------------|-------------|
| | (In millions of Korean Won) | | |
| Income (loss) before income taxes | | | |
| Domestic | (Won) 15,044 | (Won) 10,395 | (Won) 4,878 |
| Foreign | (2,082) | (2,133) | 159 |
| | 12,962 | 8,262 | 5,037 |
| Current income taxes | | | |
| Domestic | 4,477 | 4,458 | 3,694 |
| Foreign | (19) | 12 | 70 |

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| | | | |
|------------------------------------|-------------|-------------|---------------|
| | 4,458 | 4,470 | 3,764 |
| Deferred income taxes | | | |
| Domestic | 86 | (263) | (11,726) |
| Foreign | | | |
| | 86 | (263) | (11,726) |
| Total income tax expenses(benefit) | (Won) 4,544 | (Won) 4,207 | (Won) (7,962) |

F-31

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Income taxes recognized directly in other comprehensive income for the year ended December 31, 2011 is (Won)130 million.

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities as of December 31, 2010 and 2011 are as follows:

| | 2010 | 2011 |
|--|-----------------------------|---------------|
| | (In millions of Korean Won) | |
| Deferred tax assets | | |
| Accrued expense | (Won) 73 | (Won) 181 |
| Allowance for doubtful | 360 | 421 |
| Investments in subsidiaries and equity method investees | | 1,897 |
| Depreciation and amortization | 321 | 204 |
| Deferred revenue | 1,124 | 663 |
| Provisions for severance benefits | 196 | 100 |
| Unrealized foreign exchange losses | 102 | |
| Net operation loss carryforwards in subsidiaries | 5,095 | 3,887 |
| Foreign tax credit carryforwards | 19,356 | 17,224 |
| Tax credit carryforwards for research and human resource development | 3,490 | 2,434 |
| Others | 203 | 164 |
| Total deferred tax assets | 30,320 | 27,175 |
| Less: Valuation allowance | (28,643) | (14,531) |
| | (Won) 1,677 | (Won) 12,644 |
| Deferred tax liabilities | | |
| Accrued income | (Won) 54 | (Won) 78 |
| Depreciation and amortization | 220 | 232 |
| Investments in subsidiaries and equity method investees | | 426 |
| Intangible assets | 3,137 | 2009 |
| Unrealized foreign exchange gains | 2 | 9 |
| Others | 7 | 37 |
| Total deferred tax liabilities | 3,420 | 2,791 |
| Net deferred tax assets (liabilities) | (Won) (1,743) | (Won) 9,853 |
| Reported as | | |
| Current portion of deferred income tax assets | (Won) 857 | (Won) 3,062 |
| Non-current deferred income tax assets | | (Won) 8,308 |
| Non-current deferred income tax liabilities | (Won) 2,600 | (Won) 1,517 |

Deferred income tax assets are recognized only to the extent that realization of the related tax benefit is more likely than not. Realization of the future tax benefits related to the deferred income tax assets is dependent on many factors, including the Company's ability to generate taxable income within the period during which the temporary differences reverse, the outlook for the economic environment in which the Company operates, and the overall future industry outlook.

In assessing the realizability of deferred income tax assets, management considered whether it was more likely than not that some portion or all of the deferred income tax assets would not be realized. Especially, significant portion of the tax credit carryforwards is expected to expire if the Company does not generate sufficient taxable income in Korea. The ultimate realization of deferred income tax asset is dependent upon the

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

generation of future taxable income during the periods in which those temporary differences became deductible. Management considered the scheduled reversal of deferred tax liabilities, uncertainty in the future taxable income, the tax structure of the Company and tax planning strategies in making this assessment. For the years ended December 31, 2009 and 2010, full valuation allowance was provided for Gravity and certain subsidiaries. However, in 2011, based upon the level of historical taxable income and the future taxable income under the Company's business plan over the periods in which the deferred tax assets were deductible, management believed it was more likely than not that (Won)7,937 million or 42% of the deferred tax assets from tax credit carry forwards is realizable for Gravity.

As of December 31, 2011, Gravity Co., Ltd. in Korea had temporary differences of (Won)2,726 million, foreign tax credit carryforwards and tax credit carryforwards for research and human resource development etc. of (Won)16,480 million and (Won)2,386 million, respectively, which expire from 2012 to 2016. Based on the Company's historical and projected net and taxable income, the Company determined that it would be able to realize all of the temporary differences and (Won)7,937 million or 42% of tax credits carryforwards, and recognized a valuation allowance of (Won)10,929 million on the amount of available tax credit carryforwards at an effective rate expected to be incurred to Gravity. Gravity as a controlling company did not recognize the deferred tax assets from outside basis difference amounting to (Won)2,443 million on investment in subsidiaries since Gravity has no plan or intention to dispose those entities in the foreseeable future. The deferred tax liabilities from outside basis difference amounting to (Won)114 million on investment in subsidiary was also not recognized since Gravity is able to control the timing of the reversal and it is probable that the difference will not reverse in the foreseeable future.

As of December 31, 2011, Gravity Entertainment Corp., the Company's 100% owned subsidiary in Japan, had temporary differences of (Won)110 million and available loss carryforwards of (Won)1,232 million which expire from 2012 to 2018. Based on this subsidiary's historical and projected net and taxable income, the Company determined that it would not be able to realize these temporary differences and loss carryforwards, and recognized a valuation allowance of (Won)628 million on the full amount of the temporary differences and available loss carryforwards at an effective rate expected to be incurred in Japan.

As of December 31, 2011, Gravity RUS Co., Ltd. and Gravity CIS Co., Ltd., the Company's 100% owned subsidiaries in Russia, had available loss carryforwards of (Won)2,098 million which expire from 2015 to 2021. Based on these subsidiaries' historical and projected net and taxable income, the Company determined that it would not be able to realize these loss carryforwards, and recognized a valuation allowance of (Won)420 million on the full amount of the available loss carryforwards at an effective rate expected to be incurred in Russia.

As of December 31, 2011, Gravity Interactive, Inc., the Company's 100% owned subsidiary in US, had available loss carryforwards of (Won)6,409 million for federal tax and (Won)6,867 million for state tax, respectively, which expire from 2027 to 2031. Based on this subsidiary's historical and projected net and taxable income, the Company determined that it would not be able to realize these loss carryforwards, and recognized a valuation allowance of (Won)2,554 million on the full amount of the available loss carryforwards at an effective rate expected to be incurred in U.S.

Statutory tax rate applicable to the Company is 24.2% for the years ended December 31, 2009, 2010 and 2011. In accordance with the revised Corporate Income Tax Law, statutory tax rate applicable to the Company is 24.2% until 2011 and 22% thereafter. Deferred taxes are measured using the enacted tax rate expected to apply, which is 22% for the Company.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A reconciliation of income tax expense (benefit) at the Korean statutory income tax rate to actual income tax expense (benefit) is as follows:

| | 2009 | 2010 | 2011 |
|---|-----------------------------|--------------------|----------------------|
| | (In millions of Korean Won) | | |
| Tax expense at Korean statutory tax rate (2009, 2010, 2011: 24.2%) | (Won) 3,137 | (Won) 1,999 | (Won) 1,219 |
| Income tax exemption | | (67) | (5) |
| Foreign tax credit | (427) | (414) | (393) |
| Tax credit carryforwards for research and human resource development | 365 | (585) | (356) |
| Foreign tax differential | (254) | (234) | 39 |
| Income not assessable for tax purpose | (2) | | |
| Expense not deductible for tax purpose | 135 | 233 | 672 |
| Change in statutory tax rate | (261) | (14) | |
| Change in valuation allowances | 454 | (1,551) | (14,112) |
| Loss of control in a subsidiary | | | 1,364 |
| Effect of change in foreign currency exchange rate | 199 | 124 | (52) |
| Expiration of unused foreign tax credit and unused net operating loss carryforwards | 1,240 | 4,430 | 3,635 |
| Income tax penalties | | 133 | |
| Others | (42) | 154 | 27 |
| Total income tax expense(benefit) | (Won) 4,544 | (Won) 4,207 | (Won) (7,962) |

The Company assessed uncertain tax positions and measured unrecognized tax benefits for open tax years in accordance with ASC 740, *Income Taxes*. The Company's policy is that it recognizes interest expenses and penalties related to income tax matters as a component of income tax expense. Accordingly, the company assesses its income tax positions and records tax benefits for all years subject to examinations based upon the evaluation of the facts, circumstances and information available at that reporting date. For those tax positions for which it is more likely than not that a tax benefit will be sustained, the company records the amount that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. If the company does not believe that it is more likely than not that a tax benefit will be sustained, no tax benefit is recognized.

Based on the approach above, the company assessed the uncertain tax positions and did not record any unrecognized tax benefits as the company believes that it is more likely than not that there will not be any unrecognized tax benefits.

In 2011, Gravity was subject to a tax examination by the National Tax Service of Korea for fiscal years 2006 through 2009. As a result of the tax examination, the Company recognized (Won)133 million of income tax expense for penalties and (Won)608 million of withholding taxes for transfer pricing adjustments that arose from the difference between the actual transaction price and the estimated arm's length price. The (Won)133 million of penalties was recorded as a component of the income tax provision, and the (Won)608 million of withholding taxes due was recorded as a component of selling, general and administrative expenses for the year ended December 31, 2010. The National Tax Service of Korea is a Korean government agency responsible for tax collection and tax law enforcement.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Allowances for deferred income tax assets for the three years ended December 31, 2009, 2010 and 2011 are as follows:

| | Balance at Beginning of Year | Decrease (In millions of Korean Won) | Increase | Balance at End of Year |
|---------------------|------------------------------------|---|-----------|---------------------------|
| 2009 | | | | |
| Valuation allowance | (Won) 29,740 | (Won) | (Won) 454 | (Won) 30,194 |
| 2010 | | | | |
| Valuation allowance | 30,194 | 1,551 | | 28,643 |
| 2011 | | | | |
| Valuation allowance | 28,643 | 14,112 | | 14,531 |

18. Operations by Geographic Area

Geographic information for the years ended December 31, 2009, 2010 and 2011 is based on the location of the distribution entity. Revenues by geographic region are as follows:

| | 2009 | 2010 | 2011 |
|----------------------|-----------------------------|--------------|--------------|
| | (In millions of Korean Won) | | |
| Korea | (Won) 11,544 | (Won) 9,737 | (Won) 10,458 |
| Japan | 31,991 | 29,186 | 29,513 |
| Taiwan and Hong Kong | 1,887 | 2,926 | 3,590 |
| United States | 5,800 | 4,759 | 5,879 |
| Russia | 1,298 | 647 | 487 |
| Brazil | 1,096 | 1,114 | 1,189 |
| Thailand | 1,150 | 936 | 1,245 |
| Europe | 1,054 | 1,084 | 2,058 |
| Other | 1,583 | 1,973 | 3,058 |
| | (Won) 57,403 | (Won) 52,362 | (Won) 57,477 |

Approximately 82% and 18% of the Company's property, plant and equipment are located in Korea and the United States, respectively as of December 31, 2011.

19. Related Party Transactions

During the years ended December 31, 2009, 2010 and 2011, there were related party transactions with a shareholder and an equity investee as follows:

| | 2009 | 2010 | 2011 |
|--------------------------------|-----------------------------|--------------|--------------|
| | (In millions of Korean Won) | | |
| Sales to related parties | (Won) 31,987 | (Won) 29,065 | (Won) 29,110 |
| Purchases from related parties | 670 | 4,182 | 2,139 |

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| | | | |
|----------------------------------|-------|-------|-------|
| Amounts due from related parties | 2,473 | 3,149 | 3,573 |
| Amounts due to related parties | 6,608 | 7,412 | 6,373 |

On April 1, 2008, GungHo Online Entertainment, Inc. became a majority shareholder by acquiring 52.39% of the voting shares from Heartis, Inc., the former majority shareholder, and acquired additional 6.92% voting shares on June 23 and June 24, 2008. The transactions with GungHo and the related balances during 2009, 2010 and 2011 were included in related party transactions above.

F-35

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****20. Variable Interest Entity**

A Variable Interest Entity (VIE) is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of a controlling financial interest. A VIE is consolidated by its primary beneficiary. The primary beneficiary has both the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE.

In evaluating whether the Company have the power to direct, as defined in the standard, the Company considers the purpose for which the VIE was created, the importance of each of the activities in which it is engaged and the Company's decision-making role, if any, in those activities that significantly determine the entity's economic performance as compared to other economic interest holders. This evaluation requires consideration of all facts and circumstances relevant to decision-making that affects the entity's future performance and the exercise of professional judgment in deciding which decision-making rights are most important.

In determining whether the Company has the right to receive benefits or the obligation to absorb losses that could potentially be significant to the VIE, the Company evaluates all of economic interests in the entity, regardless of form (debt, equity, management and servicing fees, and other contractual arrangements). This evaluation considers all relevant factors of the entity's design, including: the entity's capital structure, contractual rights to earnings (losses), subordination of our interests relative to those of other investors, contingent payments, as well as other contractual arrangements that have potential to be economically significant. The evaluation of each of these factors in reaching a conclusion about the potential significance of the Company's economic interests is a matter that requires the exercise of professional judgment.

In November 2009, the Company entered into an agreement with Naru Entertainment (Naru) to acquire publishing right of the game in development by Naru, which was considered a VIE of which the Company was not the primary beneficiary, and which was not consolidated as of December 31, 2009 and 2010.

In 2010, the Company and Naru entered into a loan agreement and terminated the publishing agreement from 2009. Under this arrangement, the Company provided loans to Naru in the amount of (Won)1,300 million and recorded it as short-term loans receivable.

In 2009, the Company entered into an agreement with Naru Entertainment Corp. (Naru) to acquire publishing right of the game in process of being developed by Naru in Korea for (Won)1,500 million has accounted for the prepayment of (Won)400 million as other current assets. Per the agreement, the Company retains right to claim refund on the amounts paid if the development game is delayed or failed, and the Company also has the option to acquire new shares of Naru after the commercial launch of the game.

In 2010, the Company and Naru entered into a (Won)1,300 million loan agreement and terminated the publishing agreement. In 2011, the Company amended the loan agreement with Naru so that (Won)300 million of the loan should be paid by Naru in 2012 from a funding provided by the third party, and the rest of the loan, amounting to (Won)1,000 million, and its accrued interest at 8% annually will be paid by revenue sharing payments in the future. The Company provided bad debt reserve of (Won)1,000 million.

Further, in 2011, the Company amended the loan agreement with Naru so that (Won)300 million of the loan should be paid by Naru in 2012 from the funding provided by a third party, and the rest of the loan, amounting to (Won)1,000 million, and its accrued interest at 8% annually will be paid by revenue sharing payments in the future.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

With the termination of the publishing agreement and the funding from a third party, Gravity's involvement over Naru was significantly diminished. As such, the Company has concluded that none of its unconsolidated investments fall within the scope of ASC 810.

As of December 31, 2011, short-term and long-term loans receivable due from Naru were (Won)300 million and (Won)1,000 million, respectively. The Company provided bad debt reserve of (Won)1,000 million.

Based on 2011 unaudited financial statement of Naru, the total assets and liabilities of Naru at December 31, 2011 were (Won)2,648 million and (Won)3,155 million, respectively.

As of January 1, 2010 and subsequently, the Company has evaluated if any of its unconsolidated investments fall within the scope of the amended ASC 810. The Company has concluded that none of its unconsolidated investments fall within the scope of ASC 810.

21. Comprehensive Income

Comprehensive income for the years ended December 31, 2009, 2010 and 2011 are as follows:

| | 2009 | 2010 | 2011 |
|--|-----------------------------|-------------|---------------|
| | (In millions of Korean Won) | | |
| Net income | (Won) 6,994 | (Won) 3,710 | (Won) 12,757 |
| Other comprehensive income | | | |
| Effect of foreign currency translation adjustments, net of tax | (140) | 290 | (510) |
| Comprehensive income | (Won) 6,854 | (Won) 4,000 | (Won) 12,247 |
| Controlling interest | (Won) 6,777 | (Won) 4,020 | (Won) 14,418 |
| Non controlling interest | (Won) 77 | (Won) (20) | (Won) (2,171) |

22. Supplemental Cash Flow Information and Non-Cash Activities

| | 2009 | 2010 | 2011 |
|--|-----------------------------|-------------|-------------|
| | (In millions of Korean Won) | | |
| Supplemental cash flow information | | | |
| Cash paid during the year for income taxes | (Won) 4,439 | (Won) 3,752 | (Won) 3,832 |
| Interest paid | 41 | 32 | 58 |
| Supplemental non-cash activities | | | |
| Reclassification of long-term deferred revenue to deferred revenue | (Won) 1,643 | (Won) 1,749 | (Won) 3,978 |
| Offset of long-term deferred revenue and accounts payable | 876 | 1,161 | |
| Reclassification of prepayment to intangible assets | 86 | 92 | 1,392 |