

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

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

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

Form 20-F

(Mark One)

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

GRAVITY CO., LTD.

(Exact name of registrant as specified in its charter)

N/A

(Translation of registrant's name into English)

The Republic of Korea

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

**Heung Gon Kim
Chief Financial Officer**

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

Telephone: 82-2-2132-7000

Fax: 82-2-2132-7070

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

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

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

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

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

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

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

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

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

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CERTAIN DEFINED TERMS

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

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

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

Government is to the government of The Republic of Korea;

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

Korea or the Republic are to The Republic of Korea;

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

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

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

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

Chinese Yuan or CNY are to the currency of China;

Japanese Yen or JPY are to the currency of Japan;

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

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

Thai Baht or THB are to the currency of Thailand.

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

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

FORWARD-LOOKING STATEMENTS

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

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

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

future prices of and demand for our products;

future earnings and cash flow;

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

our ability to attract new customers and retain existing customers;

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

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

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

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

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

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

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

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

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

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

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

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

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

Notes:

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

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

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

Source: Federal Reserve Bank of New York.

Note:

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

ITEM 3.B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

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

Not applicable.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

distributing games developed in-house;

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

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

optimizing our marketing and research and development expenditures;

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

pursuing joint ventures with game development companies.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

RISKS RELATING TO OUR REGULATORY ENVIRONMENT

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

A draft amendment to the National Health Promotion Act was submitted to the National Assembly in February 2009. The draft amendment, among others, proposes to designate certain public facilities including Internet cafés as non-smoking areas. If the draft amendment is adopted in the extra session of the National Assembly, it will 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 materially adverse effect on our business, financial condition and results of operation. 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.

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

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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, Taipei County, Taoyuan County, Tainan City, Nantou 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 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 (2009), users under 15 years of age can enter game shops and Internet cafés between 2:00 pm and 8:00 pm on Monday to Friday; and between 10:00 am and 10:00 pm 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 pm and 10:00 pm on Monday to Friday; and between 10:00 am and 10:00 pm 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.

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

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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 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 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 other than with regards to the limited tax rates in Thailand. While this tax rate change is not adverse for us, 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.

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, Hong Kong and Macau, and Russia and CIS countries, representing 55.7%, 20.1%, 10.1%, 3.3% and 2.3%, respectively, of our total revenues in 2009. 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 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

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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 licensees are denominated in local currencies, which include the U.S. dollar, Japanese Yen, Euro, NT dollar, the Thai Baht and Chinese Yuan. In 2009, approximately 79.9% of our revenues were denominated in foreign currencies, primarily in the U.S. dollar and Japanese Yen. As the revenues denominated in local currencies, other than the U.S. dollar, Japanese Yen and 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. While, in 2009, we enjoyed increased royalty revenues due to the strengthening of the Japanese Yen against the Korean Won by approximately 26.4% from 2008 to 2009, 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, 2009, 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 over most of Korea's history and the Demilitarized Zone between the two countries is the most fortified border in the world. In October 2004, the United States and Korea agreed to a phased downsizing of the number of American troops stationed in Korea from 37,500 to 25,000 by the end of 2008, as part of worldwide U.S. troop realignment plans. However, in April 2008, the presidents of the U.S. and Korea reached an agreement to maintain the current U.S. troop level of 28,500, halting the planned withdrawal of 3,500 more U.S. troops.

The level of tension between Korea and North Korea has fluctuated and may increase or change abruptly as a result of current and future events, including ongoing contacts at the highest levels of the governments of Korea, North Korea and the United States. North Korea, Korea, the United States, China, Japan and Russia entered an accord in February 2007, whereby North Korea would begin to disable its nuclear facilities in return for fuel oil and aid. After several months of alleged non-compliance by North Korea and other related disputes among the parties, North Korea shut down its sole functioning nuclear reactor in Yongbyon and allowed the inspection team of the International Atomic Energy Agency to visit North Korea to monitor the shutdown and sealing of the facilities in July 2007. At the six-party talks in Beijing in October 2007, North Korea agreed to disable its nuclear facility at Yongbyon by the end of the year in a process overseen by a U.S.-led international team and to disclose all of its nuclear programs in return for one million tons of heavy fuel oil and lifting of sanctions by the United States. North Korea complied with disabling its nuclear facility at Yongbyon and the United States and other parties initiated delivery of the heavy fuel oil. However, North Korea failed to address an alleged plutonium-based program, uranium-enrichment program and other nuclear proliferation activities in Syria and North Korea missed the December 31, 2007 deadline to disclose the entirety of its nuclear programs.

In April 2008, North Korea and the United States agreed to draft two separate declarations, a public one that would address the plutonium-based program, and another classified one that would include the issues of uranium-enrichment program and proliferation. After breakdowns in negotiations, in September 2008, North Korea announced it was preparing to restore and restart its nuclear facility in Yongbyon. In October 2008, the

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United States agreed to remove North Korea from its list of countries that sponsor terrorism after North Korea agreed to again allow international inspectors access to declared nuclear sites in North Korea and to resume disabling its nuclear facility in Yongbyon. In January 2009, North Korea nullified all political and military agreements with South Korea. In March 2009, in response to two-week long joint military exercises between the United States and South Korea, North Korea placed its military in combat ready mode and stated that it would not guarantee the safety of civilian aircraft that approached its airspace during the duration of the joint military exercises. In April 2009, North Korea launched a long-range rocket over the Pacific Ocean and in May 2009, it announced that it had conducted a second nuclear test and tested short-range missiles. United Nations Security Council unanimously passed a resolution in June 2009 that condemned North Korea for its actions and decided to tighten sanctions against North Korea.

The level of tension between Korea and North Korea has been elevated in recent months as a result of a chain of incidents in the western shore of Korea, near Baengnyeong Island. In November 2009, patrol ships from Korea and North Korea exchanged fire, resulting in casualties for North Korea. Both sides exchanged fire in the same region again in January 2010. Tensions rose higher after the sinking of a Korean naval vessel in March 2010, from an explosion that killed 46 sailors. The Korean government made an official announcement in May 2010 that a North Korean torpedo attack caused the damage. In addition, there recently has been increased uncertainty with respect to the future of North Korea's political leadership and concern regarding its implications for economic and political stability in the region.

We cannot assure you that recent events will not lead to an escalation of tension with North Korea. Any further increase in geopolitical tensions, resulting from testing of long-range nuclear missiles, continuing nuclear programs by North Korea, transition of power in leadership in North Korea, a break-down in existing contacts or an outbreak in military hostilities 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.

Disruptions in Taiwan's political environment could seriously harm our business and operations in Taiwan.

In 2009 and 2008, we derived 3.3% and 4.3%, respectively, of our total revenues from our licensee in Taiwan, Hong Kong and Macau, which was added as a service territory in October 2009. 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 May 27, 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, a new president in Taiwan was elected, President Ma Ying-jeou, who has supported the cultivation of better relations with mainland China. For instance, from July 2008, Taiwan has lifted the ban on Chinese persons visiting in 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, Taiwanese government has partially unwound the restrictions on the investment in Taiwan by Chinese companies and person and several new regulations in connection therewith have been passed. For the purpose to further the finance cooperation, Taiwan has entered into a Memorandum of Understanding regarding cross-strait financial supervision with mainland China on November 16, 2009, which becomes effective on January 16, 2010. Also, Taiwan and China governments are in the progress of negotiating the Economic Cooperation Framework Agreement to be entered into for enjoying the custom benefit. 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.

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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, a shareholder must own at least (i) one percent of the total issued shares to bring a shareholders' derivative lawsuit, (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, (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) 20 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.

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 depositary for the ADSs in Won and then converted by the depositary 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 depositary as dividends. Holders of ADSs may not receive dividends if the depositary does not believe it is reasonable or practicable to do so. In addition, the depositary may collect certain fees and expenses, at the sole discretion of the depositary, 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 depositary 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 depositary's custodian in Korea and obtain ADSs, and holders of our ADSs may surrender the ADSs to the depositary 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 depositary 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

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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;

to the members of the employee stock ownership association;

upon exercise of a stock option;

in the form of depository 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 an alliance arrangement; or

by a public offering or to cause underwriters to underwrite new shares for the purpose of listing them 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 depository 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 depository 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.

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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.

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 depositary 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 depositary, 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 depositary 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 with 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

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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.

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 on the NASDAQ Global Market, formerly the NASDAQ National Market, under the symbol GRVY.

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, 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 April and May 2005, we acquired an aggregate of 88.15% equity interest in TriggerSoft Corporation, or TriggerSoft, which developed our R.O.S.E. Online game. TriggerSoft went into liquidation proceedings in Korea in May 2007 and the liquidation was completed in October 2007. In November and December 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, or Gravity EU, a wholly-owned subsidiary based in France, and 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 U.S., which is a wholly-owned subsidiary of Gravity Interactive. L5 Games has been in the process of liquidation since August 2008. 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

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subsequently purchased our ADSs and beneficially owns approximately 59.3% of our common shares as of March 31, 2010.

Our registered office is located at Nuritkum Square Business Tower 15F, 1605 Sangam-Dong, Mapo-Gu, Seoul, Korea 121-795. Our telephone number is (822) 2132-7000. Our main Web site is at <http://www.gravity.co.kr>. Our address for service of process in the United States is Gravity Interactive, 13160 Mindanao Way, Marina Del Rey, California 90292.

ITEM 4.B. BUSINESS OVERVIEW

OVERVIEW

We are a leading developer and publisher of online games in Japan, Brazil, the Philippines, Indonesia, Singapore, Malaysia, Thailand, Russia and Taiwan 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 five online games worldwide and have one online game in development and two online games 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 58 other countries and markets. Requiem is commercially offered in Korea, the United States, Canada and 62 other countries. Emil Chronicle Online is commercially offered in Korea, Thailand, Hong Kong, Taiwan, Indonesia, Singapore and Malaysia. R.O.S.E. Online is commercially offered in the United States, Canada, Mexico and 40 other countries. Pucca Racing is commercially offered in Korea. 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 internally 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.

In Korea, we directly manage all aspects of game operations, 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 in the United States, Canada and 39 European countries and for all aspects of R.O.S.E. Online game operations in the United States, Canada, Mexico and 40 European countries. Gravity CIS and Gravity EU, our subsidiaries, are responsible for Ragnarok Online game operations in Russia and CIS countries, and in France and Belgium, respectively. In the countries where we and our wholly-owned subsidiaries, Gravity Interactive, Gravity CIS and Gravity EU, manage game operations, our game revenues, including both subscription-based fee revenues and micro-transaction based 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 every year once the initial term expires. We rely on the initial 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 in their respective markets.

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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,										
	2007		2008		2009		2009(1)				
	(In millions of Won and thousands of US\$, except percentages)										
Online game revenues(2):											
Subscriptions:											
Korea	₩	6,238	15.5%	₩	7,463	14.0%	₩	4,951	8.6%	US\$	4,377
United States/Canada(3)		2,608	6.5		3,607	6.8		5,785	10.1		5,114
Others		559	1.4		1,506	2.9		1,938	3.4		1,713
Royalties and license fees:											
Japan		17,849	44.4		23,353	43.9		28,089	48.9		24,831
Taiwan/Hong Kong(4)		2,345	5.8		2,210	4.1		1,827	3.2		1,615
Thailand		1,034	2.6		970	1.8		1,104	1.9		976
Others		3,470	8.6		3,577	6.7		3,017	5.3		2,668
Subtotal		24,698	61.4		30,110	56.5		34,037	59.3		30,090
Mobile game revenues		4,063	10.1		6,882	12.9		7,882	13.7		6,968
Character merchandising and other revenues		2,063	5.1		3,602	6.9		2,810	4.9		2,484
Total revenues	₩	40,229	100.0%	₩	53,170	100.0%	₩	57,403	100.0%	US\$	50,746

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.
- (2) Online game revenues include revenues from Ragnarok Online, R.O.S.E. Online, Requiem, Emil Chronicle Online, Pucca Racing, Time N Tales and from two games offered through STYLIA, our casual online game portal site. We discontinued offering games through STYLIA in September 2008. We discontinued offering Time N Tales in March 2009.
- (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. The license agreement for Requiem with Gravity Interactive was amended in December 2009 to include the United Kingdom and 38 other European countries serviced by Gravity Interactive.

- (4) The license agreement for Ragnarok Online with Game Flier International Corporation, which manages Ragnarok Online service in Taiwan and Hong Kong, was amended in October 2009 to include Macau as a service territory.

OUR PRODUCTS

We currently have four product lines: MMORPGs, casual online games, mobile games, and game-related products and services, including animation and character-based merchandise. Revenues from our principal product, Ragnarok Online, accounted for 73.7% of our total revenues in 2009, compared with 73.3% of our total revenues in 2008. We are seeking to diversify our revenue sources by offering additional MMORPGs, casual online games, and other products and services, including mobile games.

Table of Contents**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
R.O.S.E. Online	Three-dimensional action adventure with seven independent storylines	Originally licensed from third party developer; currently owned by us(3)	Launched in January 2005
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
Ragnarok Online II	Three-dimensional sequel to Ragnarok Online	Being developed in-house by the Company	Open beta testing since May 2007. Currently expected to launch in the fourth quarter of 2010
Estar (tentative title)	Three-dimensional action adventure	Licensed from third party developer	Not determined
Canaan	Web browser-based casual	Licensed from third party developer	Currently expected to launch in the third quarter of 2010

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) 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.

Ragnarok Online

Ragnarok Online is commercially offered in Korea and 58 other countries and markets since its commercial launch in August 2002. We began to commercially offer Ragnarok Online in 20 new countries in 2009, including India and countries in the Middle East and Northern Africa. Ragnarok Online represented 73.7% of our total revenues or Won 42,290 million (US\$37,385 thousand) in 2009, compared with 73.3% of our total revenues or Won 38,949 million in 2008. See ITEM 4.B. BUSINESS OVERVIEW OUR MARKETS Overseas markets.

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

Revenue Type	Country	Year Ended December 31,			
		2007	2008	2009	2009(1)
		(In millions of Won and thousands of US\$)			
Online game-subscription revenue	Korea	₩ 5,143	₩ 5,971	₩ 4,156	US\$ 3,674
	United States/ Canada(2)	2,103	2,693	3,794	3,354
	Others	558	1,198	1,046	924
	Subtotal	7,804	9,862	8,996	7,952
Online game-royalties and license fees	Taiwan/Hong Kong(3)	2,345	1,706	1,452	1,284
	Japan	16,791	23,326	28,089	24,831
	Thailand	981	679	819	724
	Philippines	655	699	707	625
	China	613	472	336	297
	Indonesia	358	322	362	320
	Europe	419	446	408	360
	Singapore/Malaysia	109	63	57	51
	Australia/New Zealand(2)	1			
	Brazil	547	971	1,057	935
	India(2)	152	26		
	Chile	209	186		
	Vietnam	130	191		
	Middle East/Africa			7	6
Subtotal		23,310	29,087	33,294	29,433
Total		₩ 31,114	₩ 38,949	₩ 42,290	US\$ 37,385

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.
- (2) 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. Such revenues from other countries constitute a minor portion of the revenues recorded as subscription revenues from the United States and Canada. 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 such countries prior to the respective amendment to the license agreement were shown as Online game royalties and license fees.

- (3) The license agreement for Ragnarok Online with Game Flier International Corporation, which manages Ragnarok Online service in Taiwan and Hong Kong, was amended in October 2009 to include Macau as a service territory.

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The table below provides for the periods indicated, the peak concurrent users and average concurrent users of Ragnarok Online since the first quarter of 2007, in each of our principal markets for Ragnarok Online.

	Taiwan/Hong Kong		Thailand		Japan		China		Korea		USA/Car
	PCU(1)	ACU(2)	PCU	ACU	PCU	ACU	PCU	ACU	PCU	ACU	PCU
7	78,516	45,993	27,491	19,061	78,053	34,504	14,691	8,516	10,338	5,177	6,538
7	56,663	34,455	19,408	13,673	77,151	35,633	11,986	5,809	8,046	4,721	6,468
7	39,983	28,097	12,931	8,562	66,441	23,975	10,108	5,541	7,997	4,575	4,604
7	34,982	24,935	63,445	38,511	60,788	24,018	7,760	3,936	7,854	4,562	4,638
8	36,429	29,893	63,316	25,942	61,800	24,674	8,609	4,469	6,785	3,219	4,334
8	34,747	26,364	14,996	9,709	57,348	22,908	7,393	3,856	10,146	3,518	4,288
8	40,574	27,097	22,850	12,687	57,515	22,401	6,979	3,273	9,192	4,357	3,700
8	30,128	21,292	30,455	20,707	59,470	24,109	5,342	2,476	6,306	3,052	4,661
9	27,686	20,351	28,761	22,628	58,171	24,554	5,942	2,861	6,127	3,211	4,908
9	27,616	20,678	47,679	36,445	57,387	23,038	5,378	2,571	6,975	2,641	5,093
9	37,066	23,599	47,310	31,636	54,671	21,331	6,351	3,162	7,610	3,525	5,634
9	27,803	19,274	31,883	24,603	59,800	21,817	4,877	2,247	6,949	3,319	5,128
0	29,089	22,437	31,042	24,253	52,585	20,232	5,447	2,529	6,502	3,091	4,933

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 not measures under accounting principles generally accepted in Korea, or Korean GAAP, or U.S. GAAP and should not be construed as an alternative to operating income or another measure of performance determined in accordance with Korean GAAP or U.S. GAAP. Other companies may determine PCU or ACU differently than we do.

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;

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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.

R.O.S.E. Online

R.O.S.E. Online, which was commercially launched in January 2005, represented 1.1% of our total revenues or Won 604 million (US\$534 thousand) in 2009, compared with 1.4% of our total revenues or Won 766 million in 2008.

The following are revenues generated by R.O.S.E. Online for the periods indicated:

Revenue Type	Country	Year Ended December 31,			
		2007	2008	2009	2009(1)
		(In millions of Won and thousands of US\$)			
Online game-subscription revenue	United States/Canada/Mexico	₩ 505	₩ 444	₩ 604	US\$ 534
	Subtotal	505	444	604	534
Online game-royalties and license fees	Japan	1,058	27		
	Indonesia	72			
	Philippines	125			

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China		136			
Vietnam		60			
Taiwan		99			
Subtotal	1,255	322			
Total	₩ 1,760	₩ 766	₩ 604	US\$ 534	

Notes:

(1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.

R.O.S.E. Online, a three-dimensional game, is the first online game developed by a third party that we published pursuant to an exclusive publishing license agreement. R.O.S.E. Online was developed by TriggerSoft

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Corporation, or TriggerSoft, in close coordination with our in-house game development team. In May 2005, we acquired control of TriggerSoft to enhance our ability to update and improve R.O.S.E. Online on a more effective and timely basis and gained ownership of R.O.S.E. Online after liquidation of TriggerSoft in 2007.

In the United States, Canada and Mexico, we have been offering commercial service of R.O.S.E. Online since 2005 and all rights for R.O.S.E. Online in such countries have been transferred to our wholly-owned subsidiary, Gravity Interactive in June 2007. In February 2010, we entered into a game transfer agreement with Gravity Interactive and transferred to it all the rights of R.O.S.E. Online 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, Moldova, Monaco, Montenegro, San Marino, Serbia, Vatican City State, Croatia, Former Yugoslav Republic of Macedonia and Turkey and Gravity Interactive has been offering commercial service of R.O.S.E. Online in these countries since then.

Requiem

Unlike Ragnarok Online, which does 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 and in the United States, Canada, Armenia, Azerbaijan, Belorussia, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan in June 2008. In December 2009, we entered into an amendment to the license and distribution agreement with Gravity Interactive, our licensee for Requiem in the United States and Canada, to include 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 as countries serviced by Gravity Interactive, which was further amended in March 2010 to exclude Moldova, where Requiem is already commercially offered by our wholly-owned subsidiary, Gravity CIS. Requiem has been commercially offered in these countries since December 2009. We entered into global service agreements with AsiaSoft Corporation Public Co., Ltd. in December 2009 for markets in Thailand, Vietnam, Singapore and Malaysia, and with PT. Lyto Datarindo Fortuna in February 2010 for Indonesian 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. and PT. Lyto Datarindo Fortuna for services related to marketing and billing, among others. We commercially offered Requiem in Thailand, Vietnam, Singapore and Malaysia in March 2010 and Indonesia in April 2010. We also entered into a license and distribution agreement for Requiem in Taiwan, Hong Kong and Macau with Game Flier International Corporation in March 2010 and Requiem has been commercially offered in these markets since May 2010.

Requiem represented 4.9% of our total revenues or Won 2,838 million (US\$2,509 thousand) in 2009, compared with 3.3% of our total revenues or Won 1,743 million in 2008.

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

Revenue Type	Country	Year Ended December 31,			
		2007	2008	2009	2009(1)
(In millions of Won and thousands of US\$)					

Online game-subscription revenue	Korea	₩ 644	₩ 964	₩ 559	US\$ 494
	United States/Canada(2)		470	1,387	1,226
	Russia/CIS countries		309	892	789
	Total	₩ 644	₩ 1,743	₩ 2,838	US\$ 2,509

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- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.
- (2) Includes subscription and other types of game revenues generated in other countries serviced by Gravity Interactive, 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. Such revenues from other countries constitute a minor portion of the revenues recorded as subscription revenues from the United States and Canada.

Emil Chronicle Online

We commercially launched Emil Chronicle Online in Korea, Thailand, Hong Kong, Taiwan, Indonesia, Singapore and Malaysia in August 2007, September 2007, June 2008, August 2008, September 2009 and October 2009, respectively. Emil Chronicle Online is the first online game developed by GungHo Online Entertainment, Inc., 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 Japan. In November 2006, we entered into a license and distribution agreement with Infocomm Asia Holdings Pte. Ltd., or Infocomm Asia, to distribute Emil Chronicle Online in Singapore, Malaysia, Brunei, Thailand, the Philippines, Indonesia, Vietnam, Australia and New Zealand. In February 2007, we and Infocomm Asia granted the distribution rights of Emil Chronicle Online in Thailand to Onenet Co., Ltd. In July 2008, we amended the agreement with Infocomm Asia to cancel its rights to distribute Emil Chronicle Online in Singapore, Malaysia, Brunei, the Philippines, Indonesia, Vietnam, Australia and New Zealand. In December 2008, we entered into license and distribution agreements with Run Up Game Distribution and Development Sdn. Bhd. for distribution of Emil Chronicle Online in Singapore and Malaysia and in February 2009 with PT. Wave Wahana Wisesa for distribution in Indonesia. We entered into license and distribution agreements for Emil Chronicle Online in China with a wholly-owned subsidiary of The9 Limited in January 2007, which was terminated in January 2010. We entered into license and distribution agreements for Emil Chronicle Online in Taiwan and Hong Kong with GameCyber Technology Ltd. in August 2007. The amount of revenues from Emil Chronicle Online in 2009 represented 1.4% of our total revenues and that in 2008 represented 1.8% of our total revenues.

Ragnarok Online II

Ragnarok Online II is a sequel to Ragnarok Online and an MMORPG expected to have 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 cartoonist 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 currently have 32 designers, 15 programmers and 13 game planners dedicated to the development of Ragnarok Online II. We have been conducting open beta testing of Ragnarok Online II since May 2007 and continue to upgrade and develop Ragnarok Online II in response to market feedback received during the testing and development phase. We have entered into license and distribution agreements for Ragnarok Online II with six licensees in ten countries, including Thailand, Japan, Taiwan, Philippines, Singapore, Malaysia, Vietnam, China, Indonesia and Brazil beginning from the end of 2006. While we currently expect to launch the game in the fourth

quarter of 2010, no assurance can be given that we can meet this anticipated launch date or, if there is any further delay in the launch date, such delay would not result in termination of any of the existing license agreements for Ragnarok Online II. 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.

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Estar (tentative title)

In November 2009, we entered into a publishing agreement with Naru Entertainment Co., Ltd., an online game developer based in South Korea, to publish Estar game worldwide. Estar is expected to be an MMORPG targeting male game users from their teens through their thirties.

Canaan

In January 2010, we entered into a license agreement with Xpec Entertainment Inc., a Taiwanese game developer, to publish Canaan in Korea. 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. Canaan is currently serviced in Taiwan, China, Hong Kong and Macau. While we currently expect to launch the game in the third quarter of 2010, no assurance can be given that we can meet this anticipated launch date.

Time N Tales

We commercially launched Time N Tales in July 2006 under a publishing agreement entered into with Ndoors Corp., a Korean online game developer, in November 2005. The amount of revenues from Time N Tales in 2009 and 2008 represented less than 1% of our total revenues in 2009 and 2008, respectively. We terminated our agreement with Ndoors Corp in January 2009 and stopped offering Time N Tales in March 2009.

Casual online games

Casual online games can fit in to any genre and have any type of game play. They are targeted at mass audience of casual online gamers and generally distinguished by simple rules and lack of commitment required in contrast to more complex and hardcore MMORPGs. Currently, we commercially offer one casual online game, Pucca Racing.

Pucca Racing

We commercially launched Pucca Racing in Korea and in Thailand in September 2007 and March 2008, respectively and ceased offering commercial service in Thailand in March 2010. Pucca Racing was co-developed by us and Vooz Co., Ltd., which originally designed the Pucca characters. We entered into license and distribution agreements for Pucca Racing in Thailand with Ini 3 Digital Co., Ltd. in January 2008, in Taiwan and Hong Kong with M-etel Co., Ltd. in October 2008, which were terminated in February 2010. The amount of revenues from Pucca Racing in 2009 and 2008 represented less than 1% of our total revenues in each of 2009 and 2008.

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.

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

Country	Year Ended December 31,				2009(1)
	2007	2008	2009		
	(In millions of Won and thousands of US\$, except percentages)				
Korea	₩ 3,673	₩ 4,573	₩ 4,931	62.6%	US\$ 4,360
Japan	390	2,309	2,951	37.4	2,608
Total	₩ 4,063	₩ 6,882	₩ 7,882	100.0%	US\$ 6,968

Note:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.

Game-related products and services***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 in 2009, and Won 255 million in 2008, which represented less than 1% of our total revenues in 2009 and 2008, respectively.

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 and other character-based merchandise, as well as game manuals, monthly magazines and other publications, based on the game. We currently have arrangements with three Korean vendors and two overseas vendors in Japan and Brazil to license Ragnarok Online's animation and game characters in Korea and 11 overseas countries. 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 have also entered into arrangements to license Emil Chronicle Online, Requiem and Ragnarok Online II in Korea.

The total amount of license fees from our contracts with Korean vendors was approximately Won 119 million (US\$105 thousand) in 2009, compared with Won 101 million in 2008, and the total amount of license fees from our contracts with overseas vendors was approximately Won 798 million (US\$706 thousand) in 2009, compared with Won 992 million in 2008. We intend to expand our character marketing for our new games as they are launched.

The following are revenues generated from game character merchandising for the periods indicated:

Country	Year Ended December 31,				2009(1)
	2007	2008	2009		
	(In millions of Won and thousands of US\$, except percentages)				
Korea	₩ 377	₩ 101	₩ 119	13.0%	US\$ 105
Japan	470	975	798	87.0	706
Taiwan/Hong Kong		17			
Total	₩ 847	₩ 1,093	₩ 917	100.0%	US\$ 811

Note:

(1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.

Table of Contents***Multiplatform and Internet protocol television games***

In December 2006, we entered into a licensing agreement with GungHo Online Entertainment, Inc. 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 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. to develop and publish an IPTV game based on Iconix's 3D TV animation series Pororo: The Little Penguin. We commercially launched Pororo Game, an IPTV game in September 2009.

The amount of revenues from multiplatform device and Internet protocol television games in 2009 represented less than 1% of our total revenues in 2009.

OUR MARKETS

Japan, Korea, the United States and Canada, Taiwan and Hong Kong, and Russia and CIS countries were our biggest geographic markets in 2009 in terms of revenue. Each of these markets is serviced either by us or a distribution company. We directly manage game operations in Korea, and our wholly-owned subsidiaries, Gravity Interactive and Gravity CIS manage game operations in other countries including the United States and Canada, and Russia and CIS countries. For Ragnarok Online, GungHo Online Entertainment, Inc. is our licensee for Japan and Game Flier International Corporation is our licensee for Taiwan, Hong Kong and Macau. For Emil Chronicle Online, GameCyber Technology Ltd. is our licensee for Taiwan and Hong Kong.

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, 2009.

Countries	Year Ended December 31,				
	2007	2008	2009		2009(1)
	(In millions of Won and thousands of US\$, except percentages)				
Japan	₩ 18,899	₩ 27,037	₩ 31,991	55.7%	US\$ 28,281
Korea	11,119	14,009	11,544	20.1	10,205
United States/Canada(2)	2,614	3,620	5,800	10.1	5,127
Taiwan/Hong Kong(3)	2,369	2,301	1,887	3.3	1,668
Russia and CIS countries	489	1,078	1,298	2.3	1,148
Others	4,739	5,125	4,883	8.5	4,317
Total	₩ 40,229	₩ 53,170	₩ 57,403	100.0%	US\$ 50,746

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.

- (2) 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. 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. The license agreement for Requiem with Gravity Interactive was amended in December 2009 to include the United Kingdom and 38 other European countries serviced by Gravity Interactive.
- (3) The license agreement for Ragnarok Online with Game Flier International Corporation, which manages Ragnarok Online service in Taiwan and Hong Kong, was amended in October 2009 to include Macau as a service territory.

Table of Contents**Korea**

In Korea, we commercially launched and began to charge subscribers for Ragnarok Online in August 2002, R.O.S.E. Online in January 2005, which service was terminated in April 2007, Love Forty and TV Boyz in June 2006, which services were terminated in September 2008, Time N Tales in July 2006, which service was terminated in March 2009, Emil Chronicle Online in August 2007, Pucca Racing in September 2007 and Requiem in October 2007. 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 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 1,200 per hour and subscribe to various online games. Over 5,600 and 6,400 Internet cafés offered our games in Korea according to our internal data as of December 31, 2009 and 2008, 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 13.6% and 14.6% of our subscription revenues in Korea in 2009 and 2008, respectively.

Overseas markets

Ragnarok Online is commercially offered in the following 58 overseas countries and markets: Japan, China, Taiwan, Hong Kong, Macau, United States, Canada, Australia, New Zealand, India, Singapore, Malaysia, Thailand, the Philippines, Indonesia, Germany, Austria, Switzerland, Italy, Turkey, Brazil, France, Belgium, Vietnam, Armenia, Azerbaijan, Belorussia, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, United Arab Emirates, Jordan, Kuwait, Syria, Bahrain, Qatar, Palestine, Oman, Lebanon, Libya, Sudan, Mauritania, Iraq, Yemen, Iran, Egypt, Algeria, Morocco and Tunisia. 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; Gravity CIS in Russia and CIS countries; and Gravity EU in France and Belgium. In June 2008, we amended our license and distribution agreement with Gravity EU to include the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark and Spain as service territories and currently plan to conduct closed beta testing of Ragnarok Online in these countries.

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(1)
Taiwan/Hong Kong/Macau(2)	Game Flier International Corporation(3)	May 2002	October 2002	October 2011(4)
Thailand	AsiaSoft Corporation Public Co., Ltd.	June 2002	March 2003	March 2012(5)

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China	Shengqu Information Technology (Shanghai) Co., Ltd.(6)	July 2005	May 2003	August 2010
Singapore/Malaysia(7)	Game Flier (Malaysia) Sdn. Bhd.(8)	May 2003	April 2004	October 2011(9)
Philippines	Level Up! Inc.	March 2003	September 2003	August 2010
Indonesia	PT. Lyto Datarindo Fortuna(10)	April 2004	November 2003	February 2012(11)
Europe(12)	Burda:ic GmbH	November 2003	April 2004	October 2010(13)
Brazil	Level Up! Interactive S.A.	August 2004	February 2005	March 2011(14)
Vietnam	AsiaSoft Corporation Public Co., Ltd.	July 2008	April 2007	December 2010
Middle East and Africa(15)	Tahadi Games Ltd.	January 2009	December 2009	December 2012

Notes:

(1) Renewed in September 2009.

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- (2) Governed under a single license agreement covering three markets. Macau was included in the most recent agreement.
- (3) Game Flier International Corporation is a wholly-owned subsidiary of Soft-World International Corporation, former licensee in Taiwan and Hong Kong.
- (4) Renewed in October 2009.
- (5) Renewed in March 2010.
- (6) Shengqu is a wholly-owned subsidiary of Shanda Interactive Entertainment Ltd.
- (7) Governed under a single license agreement covering both markets.
- (8) Game Flier (Malaysia) Sdn. Bhd. is a wholly-owned subsidiary of Soft-World International Corporation.
- (9) Renewed in October 2009.
- (10) Previously with a different licensee.
- (11) Renewed in February 2010.
- (12) Represents MMORPG operations in Germany, Austria, Switzerland, Italy and Turkey. A single operator services these five countries under one license agreement.
- (13) Renewed in April 2010.
- (14) Renewed in March 2009.
- (15) Represents MMORPG operations in 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 19 countries except Saudi Arabia under one license agreement. Although Saudi Arabia is included as service territory in the license agreement with Tahadi Games Ltd., Ragnarok Online is not commercially offered in Saudi Arabia. We are currently in the process of conducting open beta testing of the game and intend to offer commercial service of the game in Saudi Arabia in the near future.

R.O.S.E. Online is currently commercially offered in the United States, Canada, Mexico and 40 other countries. Emil Chronicle Online is currently commercially offered in Thailand, Hong Kong, Taiwan, Indonesia, Singapore and Malaysia. Requiem is commercially offered in the United States, Canada and 62 other countries. 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

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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 applies the micro-transaction model, in all the countries and markets where Ragnarok Online is serviced except Japan, France, Belgium, Germany, Austria, Switzerland, Italy and Turkey 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, Vietnam, United Arab Emirates, Jordan, Kuwait, Syria, Bahrain, Qatar, Palestine, Oman, Lebanon, Libya, Sudan, Mauritania, Iraq, Yemen, Iran, Egypt, Algeria, Morocco and Tunisia, we offer our game services with the micro-transaction model only. We also intend to extend free-to-play servers into other markets. The amount of revenue generated from micro-transactions as a percentage of revenue per month from each country varies monthly. For example, in 2009, the approximate percentage of revenue derived from micro-transactions accounted for 25.8% of total royalty revenues for Japan, 68.1% of total revenues for the United States and Canada, 69.7% of total royalty revenues for Taiwan, Hong Kong and Macau, 76.8% of total royalty revenues for Thailand, 65.8% of total revenues for Russia and CIS countries and 58.8% of total revenues for Korea. The pricing for Ragnarok Online in Korea and our principal overseas markets, Japan, the United States and Canada, Taiwan, Hong Kong and Macau, Thailand and China are set forth below:

Korea

Individual PC subscribers 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. We pay a commission in the range of 1.8% to 15% to third parties to process payments. These third parties bear the delinquency risk associated with payments from subscribers.

Subscription-based fee model

We determine the pricing plan for Ragnarok Online in Korea. We offer separate pricing plans to Internet cafés and individual PC account subscribers. Our subscribers have an option to pay an hourly fee or a flat monthly fee. The following table sets forth our published pricing plans in Korea for Ragnarok Online access as of December 31, 2009.

Subscription Fees		
Individual PC users		
Flat-fee rate	1 month	₩ 19,800
	2 months	37,600
	3 months	53,500
	6 months	101,000
Hourly-fee rate	5 hours	3,300
	20 hours	8,800
	Number of PCs	Flat Fee per PC
Internet cafés(1)		
Hourly-fee rate	300 hours	₩ 69,300
	600 hours	138,600
	1,000 hours	231,000
	2,000 hours	462,000

Note:

- (1) Actual monthly and hourly-rate fees may vary depending on discounts we offer based on volume of use by the subscriber.

Approximately 86.4% of our revenues from Ragnarok Online in Korea in 2009 were derived from subscriptions by individual PC users and the remaining 13.6% was derived from Internet cafés.

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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 200 and 9,800 for paid servers and between Won 250 and 14,700 for free-to-play servers.

Japan

Users in Japan typically pay for access to Ragnarok Online with credit cards or cyber money, which is increasingly becoming a popular payment method in Japan.

Subscription-based fee model

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

Micro-transaction model

We have applied a micro-transaction model in Japan since December 2006. Game users buy points which enable them to buy game items. The range of the game items is between JPY50 and 1,500(1).

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 March 31, 2010, the noon buying rate of Japanese Yens to U.S. dollars quoted by the Federal Reserve Bank of New York was JPY93.4 to US\$1.00.

The United States and Canada

Gravity Interactive, our wholly-owned subsidiary in the United States, permits users to access Ragnarok Online using credit cards, money orders, wire and/or bank transfers and Gravity Game Card, a prepaid card.

Subscription-based fee model

The following table sets forth Gravity Interactive's published basic pricing for Ragnarok Online access in the United States and Canada as of December 31, 2009:

Hours or Month	Retail Price
-----------------------	---------------------

30 hours	US\$ 7.99
1 month	9.99
3 months	26.99
6 months	47.99

The following table sets forth Gravity Interactive's published basic pricing for the Gravity Game Card.

Subscription Plan	Retail Price
14 Day Plan	US\$ 5 Gravity Game Card
45 Day Plan	US\$ 15 Gravity Game Card
90 Day Plan	US\$ 30 Gravity Game Card

Table of Contents***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 through credit cards and wire and/or bank transfers. The range of the game items is between US\$0.15 and 15 for paid servers and between US\$0.2 and 19 for free-to-play servers. 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, 2009.

Points	Retail Price
500 points	US\$ 4.99
1,050 points	9.99
1,650 points	14.99
2,300 points	19.99
5,200 points	39.99
10,400 points	74.99

In addition, the following table sets forth Gravity Interactive's published basic pricing for the Gravity Game Card to be used only for buying points for users of a micro-transaction model.

Points	Retail Price
525 points	US\$ 5 Gravity Game Card
1,650 points	US\$ 15 Gravity Game Card
3,900 points	US\$ 30 Gravity Game Card

Taiwan, Hong Kong and Macau

In Taiwan, Hong Kong and Macau, most users purchase prepaid debit point cards to access Ragnarok Online. The prepaid cards can be purchased online, by mobile phones or at convenience stores, Internet cafés and at other locations. Taiwan has Web sites dedicated to selling prepaid cards for various uses, including online game payments, which is also used by users in Hong Kong to change their prepaid cards and to buy points.

Subscription-based fee model

Our licensee in Taiwan, Hong Kong and Macau, Game Flier International Corporation, generally does not offer a separate subscription plan for Internet café outlets. Our licensee in Taiwan, Hong Kong and Macau currently offers approximately 200 different rates for Ragnarok Online.

The following table sets forth our licensee's published basic pricing for Ragnarok Online access in Taiwan as of December 31, 2009:

Points⁽¹⁾ or Days	Retail Price⁽²⁾
150 points	NT\$ 150
350 points	350

400 points	400
450 points	450
500 points	500
1,000 points	1,000
30 days	350

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The following table sets forth our licensee's published basic pricing for Ragnarok Online access in Hong Kong as of December 31, 2009:

Points(1)	Retail Price(3)
50 points	HK\$ 12
150 points	39
350 points	88
400 points	98
450 points	113
1,000 points	250

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.
- (2) For your reference only, as of March 31, 2010, the noon buying rate of NT dollars to U.S. dollars quoted by the Federal Reserve Bank of New York was NT\$31.73 to US\$1.00.
- (3) For your reference only, as of March 31, 2010, the noon buying rate of Hong Kong dollars (HK\$) to U.S. dollars quoted by the Federal Reserve Bank of New York was HK\$7.7647 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 points which enable them to buy game items. The price range of each of the game items is between NT\$1 and 899 for paid servers and between NT\$1 and 999 for free-to-play servers. Users in Hong Kong and Macau also buy points based on NT dollars.

Thailand

Our licensee in Thailand, Asiasoft Corporation Public Co., Ltd., permits users to access Ragnarok Online through prepaid cards or by mobile and electronic payment. Most of the users use prepaid cards to access Ragnarok Online. Each prepaid card has a specified maximum number of hours or days of use. Users can purchase prepaid cards from automated teller machines, Internet cafés or convenience stores.

Subscription-based fee model

The following table sets forth our licensee's published basic pricing for Ragnarok Online access in Thailand as of December 31, 2009:

Hours or Days	Points	Retail Price(1)
5 hours	2,800	THB 28
10 hours	5,500	55

20 hours	8,900	89
40 hours	15,900	159
15 days	18,900	189
20 days	24,500	245
No limit within 30 days	34,900	349
40 days	45,000	450
No limit within 90 days	88,800	888

Note:

- (1) For your reference only, as of March 31, 2010, the noon buying rate of the Thai Bahts to U.S. dollars quoted by the Federal Reserve Bank of New York was THB32.36 to US\$1.00.

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

We have applied a micro-transaction model in Thailand since February 2007. Game users buy points which enable them to buy game items. The price range of each of the game items is between THB 0.01 and 600.

China

In China, Ragnarok Online can be accessed through prepaid cards. The prepaid card system was introduced to take account of the limited availability of online and credit card payment systems in China. A majority of Ragnarok Online players purchase prepaid debit point cards at Internet cafés or retail game outlets or purchase prepaid online credits by directly paying at Internet cafés, which in turn purchase online credits from our China licensee, Shengqu Information Technology (Shanghai) Co., Ltd., a wholly-owned subsidiary of Shanda Interactive Entertainment Limited. Game users can choose between buying hours or days to play since each prepaid card contains a network access password to access Ragnarok Online from a PC at home or at an Internet café and to buy points which enable them to buy game items. Our licensee in China currently offers two different cards: (i) the Shanda Point Card, of which points and hours or days can be used for any game that our licensee publishes and (ii) the Ragnarok Point Card, of which points and hours or days are for Ragnarok Online only. Each prepaid card can be recharged through the licensee's Web site.

The following table sets forth our licensee's published basic pricing for the Shanda Point Card in China as of December 31, 2009:

Points	Hours or Day	Retail Price(1)
150 points	25 hours	CNY 10
450 points	75 hours	30
No limit within 30 days	30 days	45

The following table sets forth our licensee's published basic pricing for the Ragnarok Point Card as of December 31, 2009.

Points	Hours or Day	Retail Price(1)
60 points	10 hours	CNY 5
150 points	25 hours	10
No limit within 7 days	7 days	15
450 points	75 hours	30
No limit within 30 days	30 days	45

In addition, the following table sets forth our licensee's published basic pricing for the Ragnarok Point Card to be used only for buying points for users of a subscription-based fee model as of December 31, 2009.

Points	Retail Price(1)
500 points	CNY 5
1,000 points	10

3,500 points	35
4,500 points	45
10,000 points	100
30,000 points	300
50,000 points	500
100,000 points	1,000

Note:

- (1) For your reference only, as of March 31, 2010, the noon buying rate of Chinese Yuan to U.S. dollars quoted by the Federal Reserve Bank of New York was CNY6.8258 to US\$1.00.

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Subscription-based fee model

Ragnarok Online access prices were set significantly lower in China than in Korea to take into account the prevailing pricing structure of other online games in the Chinese market as well as relatively low consumer spending levels.

Micro-transaction model

We have applied a micro-transaction model in China since January 2007. Game users buy points which enable them to buy game items. The price range of each of the game items is between CNY 1 and 588 for paid servers and between CNY1 and 888 for free-to-play servers.

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 three to six months for MMORPGs but may take significantly more time if material problems are detected. Open beta testing of MMORPGs usually takes three to six 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 two categories of development teams: one is dedicated to MMORPGs and the other is dedicated to casual online games in operation or under development. As of March 31, 2010, we employed a total of 231 game developers. We developed Ragnarok Online, Requiem and Pucca Racing 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 which are becoming popular among younger users and female users. We currently have one MMORPG, Ragnarok Online II, under in-house development. Ice Age Online, a massively multiplayer online game, was under development until the end of 2009 when we stopped developing the game as there were disagreements over the general concept of the game between the trademark licensor, 20th Century FOX Licensing & Merchandizing, and the Company and we received a written notice of termination of license agreement in November 2009.

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.

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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 business group within the strategy office takes lead in conducting preliminary screenings to select games for potential distribution and commercial negotiations process. The games initially screened by our publishing team are additionally evaluated or tested by other teams, such as the development team and quality management team, for a second 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, five 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 1,137 million (US\$1,005 thousand) on advertising and promotions in 2009, compared with Won 1,483 million in 2008.

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 17 in-game events for Ragnarok Online users in 2009, compared with 20 such in-game events in 2008. In November 2009, we hosted in Yokohama, Japan, with GungHo Online Entertainment, Inc., our licensee in Japan, the Ragnarok World Championship, an offline competition event at which approximately 98 people, comprised of our game users and representatives from 14 teams representing 38 countries and approximately 60 representatives of our 13 licensees, participated in person. The event was visited by approximately 15,000 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 Online Entertainment, Inc., our licensee in Japan, hosts User Symposium annually since 2004, where the invited users of Ragnarok Online share information with the publisher. GungHo also hosts Ragnarok Thank-You Festival, which includes Ragnarok Online Japan Championship, game conference and costume-play stage and other programs for users. Ragnarok Thank-You Festival has been an annual event since 2005 and its 2009 event was attended by approximately 6,000 visitors. Level Up! Inc., our licensee in the Philippines, and PT. Lyto Datarindo Fortuna, our licensee in Indonesia,

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among others, also host similar marketing events, namely, Level Up! Live and Lyto Festival, respectively. AsiaSoft Corporation Public Co., Ltd., our licensee in Thailand, also hosts offline event annually to celebrate anniversaries of Ragnarok Online game service in Thailand since 2004, which includes Ragnarok Online Thailand Championship and other promotional events. In addition, from time to time our licensees also market our games through sponsoring promotional events jointly with other local game publishers in order to reach a broader local audience.

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, 2009, 18 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, 34 employees were members of our domestic customer service team and 51 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 March 31, 2010, our server network for our game operations in Korea and global service of Requiem (in Thailand, Vietnam, Singapore, Malaysia and Indonesia) consisted of a total of 677 servers.

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 initial assembly and installation of operating game servers and optimizing 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 support staff

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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 Corporation, or NCsoft, CJ Internet Corporation, or CJ Internet, Neowiz Games and Activision Blizzard according to data available from various public sources. NCsoft released Aion in November 2008, which became the most popular MMORPG in Korea as of March 31, 2010, based on statistical information from the Korea Creative Content Agency. 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 Internet 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. Neowiz Games has also been developing additional online games with Electronic Arts, its second largest shareholder, who owns approximately 11.5 percent of its common shares. The leading companies in the market for casual online games include Nexon, which is developed for Maple Story and Kart Rider, and YD Online, publisher of the dance game, Audition. The leading providers of portal-based online games in Korea are NHN Corporation, operating under the brand portal of Hangame, CJ Internet, 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

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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 Final Fantasy XI, an online game, as part of its Final Fantasy series and Capcom developed and released Monster Hunter Frontier Online, an action online game based on its best-selling package game Monster Hunter Frontier, in June 2007. Koei 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 Corporation. 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, Inc., which publishes Dungeon Fighter Online and Cross Fire, and Shanda Interactive Entertainment, whose principal product is Mir II.

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, Activision Blizzard and 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 May 2002, Sony Computer Entertainment started distributing its PlayStation 2 game consoles equipped with a network adapter to enable online gaming and 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. Sony Computer Entertainment launched an enhanced version of its console platform in November 2006 with the PlayStation 3, which provide services for online games. Nintendo launched its Wii console platform in November 2006, which access 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. Sony Computer Entertainment's PSP Go was released in October 2009 that allows user to play games downloaded from Sony's online marketplace.

In addition, games for Apple's iPhone and iPod Touch are surging in popularity and competing with portable devices made solely for playing games. The Apple device users can access a number of videogames available for download at its App Store.

Competition in the online 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.

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

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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, Pucca Racing, Requiem, W Baseball and Arcturus, each of which has been registered with the Korea Software Copyright Committee. We no longer commercially offer Arcturus, a PC-based, stand-alone game and have decided to cease commercialization of W Baseball. As of March 31, 2010, we owned over 66 registered domain names, including our official Web site and domain names registered in connection with each of the games we offer. We had 92 registered discrete trademarks at patent and trademark offices in 47 countries as of March 31, 2010. We had three design patents and two analogous design patents, which are variations of the two design patents, registered with the Korea Intellectual Property Office, and registered copyrights covering 11 game characters and three online game business model patents and 8 patents pending with the Korea Intellectual Property Office, in each case as of March 31, 2010.

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 are 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. Pucca Racing has been classified as suitable for users of all ages. Emil Chronicle Online and Ragnarok Online II have been classified as suitable for users 12 years of age or older. Ragnarok Online has been classified as suitable for users 12 years of age or older except for one server where player-versus-player combat is allowed, which has been classified as suitable for users 18 years of age or older. Requiem 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 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

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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 deny any classification, 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 2008 Yearbook for Classification of Game Ratings for the first time in September 2008 and the 2009 Yearbook for Classification of Game Ratings in June 2009 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 and 2008. 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 will be provided until December 31, 2009 and the task of rating games will thereafter be privatized. However, based on the decision 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, and 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 gaming time can be selectively managed between midnight and 8:00 am with the consent of a parent), (iii) establishment of a fund for the prevention of excessive gaming, and (iv) regulation of

internet Web sites that deal in cash transaction of in-game items.

As a result, starting as early as the end of 2010, it is anticipated that the system for the restriction of teenager access to online games during late night hours (midnight to 8:00am) will be implemented based on selective preference, and the exhaustion system which is currently applied to 4 games (none of which are our games) will be

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applied to additional 15 games (none of which are our games) within the year. The provision completely prohibiting the transaction of in-game items, which has been the subject of controversy, has been excluded from this proposal, because it was expected to cause substantial side effects. Instead, the focus has shifted to an approach to reinforce the responsibilities of brokers dealing in transactions involving in-game items through continued monitoring and detection of illegal items.

The Korean government is planning to codify such excessive gaming prevention measures, but since no specific proposals have been created, it is necessary to monitor the future developments.

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 is expected to relieve burdens associated with entering the value-added telecommunications business industry and facilitate its growth, which may result in intensified competition between 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.

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.

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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 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 the Company, 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 abolished Computer Programs Protection Act 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.

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, or MOHW, formerly known as the Ministry for Health, Welfare and Family Affairs, 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 juveniles 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

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or utilization, to juveniles. 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, MIHWAF issued a public notice announcing that Web sites for trading items are considered harmful mass media to juveniles based on the findings of Juvenile Protection Commission that such websites for trading online game items are likely to encourage gambling and speculation and negatively influence juveniles. In the public notice, MIHWAF prohibited any person under the age of 19 from visiting a website 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 juveniles, and any person visiting such Web site is required to go through the adult certification process. Any Web site operator found to be operating such Web site 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 MIHWAF seeking cancellation of 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 juveniles.

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, juveniles account for a significant percentage of online game users. As they are now prohibited from visiting Web sites for trading items, 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 Special Tax Treatment Control Law

From 2002 to 2007, we were entitled to a reduced corporate income tax rate of 13.75%, which is 50% of the statutory tax rate, under the Special Tax Treatment Control Law. This reduced tax rate applies to certain designated small- and medium- sized venture companies operating in Korea for a period of six years from the year such companies generate income after being designated as a venture company. We were entitled to such reduced tax rate for the fiscal year ended December 31, 2007 but we were not entitled to this reduced tax rate since 2008. Our statutory income tax rate in 2009 was 24.2%. Beginning in 2012, we will be subject to a 22% tax rate due to an amendment to the Corporate Tax Law of Korea (following an amendment to the Korean tax law in 2008, the reduced tax rate of 22% was due to become effective starting in 2010, but the effective date was postponed for another 2 years through an amendment to the Corporate Tax Law of Korea at the end of 2009 after the Korean government's financial burden became an issue). See ITEM 5.A. OPERATING RESULTS OVERVIEW.

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, the ROC Ministry of Economic Affairs promulgated a model consumer contract that online game companies are encouraged to adopt and on December 13, 2007, 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, and to terminate the contract without cause at anytime and claim for the unused

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fees after deduction of necessary costs. In general, the above model contract and Mandatory Provisions impose more responsibilities and liabilities on the online game companies. Moreover, deviations from the Mandatory Provisions may cause certain clauses to be invalidated. 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 a fine. However, it is uncertainty that 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 Act, 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.

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, Taipei County, Taoyuan County, Tainan City, Nantou 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. Also, according to recent news reports, some legislators proposed to have Internet cafés regulated under the now existing national legislation, Electronic Game Arcade Business Regulation Act. It is unclear, however, whether or when the above proposals 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

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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.

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 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

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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(2009), users under 15 years of age can enter game shops and Internet cafés between 2:00 pm and 8:00 pm on Monday to Friday; and between 10:00 am and 10:00 pm 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 pm and 10:00 pm on Monday to Friday; and between 10:00 am and 10:00 pm 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, 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(2009), users under 15 years of age can enter game shops and Internet cafés between 2:00 pm and 8:00 pm on Monday to Friday; and between 10:00 am and 10:00 pm 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 pm and 10:00 pm on Monday to Friday; and between 10:00 am and 10:00 pm 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

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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.

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 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. Furthermore, the Ministry of Industry and Information Technology has promulgated rules requiring ICP license holders that provide online bulletin board services to register with, or obtain an approval from, the relevant telecommunications authorities.

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.

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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 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.

In addition, the PRC government has issued several regulations concerning the installation of filter software to filter out unhealthy content from the Internet. On April 1, 2009, the Ministry of Education, the Ministry of Industry and Information Technology and other ministries and agencies promulgated a notice requiring that by the end of May 2009, all computer terminals connected with the Internet at all elementary and secondary schools shall be able to include and operate the Green Dam-Youth Escort, a software aimed at filtering out unhealthy content in text and graphics from the Internet, which, according to the official Web site of the software, may be used to control the time on Internet, prohibit access to computer games, and filtering out unhealthy Web sites. The Ministry of Industry and Information Technology further expands the scope of usage of this filter software by issuing a notice on May 19, 2009 requiring that effective as of July 1, 2009, all computers manufactured and sold in China shall have the latest available version of Green Dam-Youth Escort preinstalled when they leave the factories and all imported computers shall have the latest available version of Green Dam-Youth Escort preinstalled before being sold in China. The Green Dam Youth Escort should be preinstalled on the hard drive of the computer or in the form of a CD accompanying the computer and should also be included in the backup partition and system restore CD. However, the implementation of this requirement of preinstallation of Green Dam-Youth Escort was postponed according to remarks at the press conference by the Ministry of Industry and Information Technology on June 30, 2009.

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 during the operation, the licensee shall submit the new version of imported online games to the Ministry of Culture for 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

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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 severer 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.

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

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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 is 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 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.

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 and remains in force. Some other States have enacted laws that require the posting of signs providing information about ESRB ratings. However, to date, such laws, when challenged, have been declared unconstitutional. A federal court recently declared unconstitutional a California law

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that imposes fines on retailers that sell or rent certain violent video games to minors, but in April 2010, the United States Supreme Court agreed to hear California's appeal of the ruling during the Court's Fall 2010 session.

If the United States Supreme Court were to overturn the decision to invalidate the California law regarding sales of M-rated games, or if any groups (including international, national and local political and regulatory bodies) were to otherwise target M-rated titles, sales practices regarding such titles could be affected and/or producers could be required to alter the content of such video games.

Irrespective of any laws or industry guidelines, retailers have become more reluctant to sell M-rated video games to minors. The FTC issues periodic reports with respect to the marketing of M-rated games to minors, and in its most recent report (2009) the FTC reported that only 20% of the underage undercover shoppers were able to purchase M-rated video 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.

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

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

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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.

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 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, 2010:

Note:

- (1) L5 Games Inc. and Gravity Middle East & Africa FZ-LLC went into liquidation proceedings in the United States and United Arab Emirates in August 2008 and September 2008, respectively.

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ITEM 4.D. PROPERTY, PLANTS AND EQUIPMENT

As of December 31, 2009, our property and equipment mainly consisted of (i) game engines, (ii) network servers and (iii) personal computers. As of December 31, 2009, the net book value of our property and equipment was Won 2,837 million (US\$2,508 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 1,969 million (US\$1,740 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 3,914 square feet of office space, subleased from us. The annual lease payment amounts to Won 66 million (US\$58 thousand). We believe that the existing facilities of Gravity and NeoCyon 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\$429 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.

France

The offices of Gravity EU, our wholly-owned subsidiary in France, are located at Tour Areva 30th Floor, 1 Place Jean Miller 92084 Paris La Defense Cedex. Gravity EU currently occupies 312 square feet of office space, leased from a third party. The annual lease payment amounts to EUR44 thousand (US\$59 thousand). For convenience only, the Euro amounts are expressed in U.S. dollars at the rate of EUR0.74 to US\$1.00, the noon buying rate of EMU (European Monetary Union) Euros to U.S. dollars as quoted by the Federal Reserve Bank of New York as of March 31, 2010. We believe that the existing facilities of Gravity EU are adequate for its current requirements and that additional space can be obtained on commercially reasonable terms to meet its future requirements.

Russia

The offices of Gravity CIS, our wholly-owned subsidiary in Russia, are located at 125040, Str. Nizhnyaya build. 14, str.1, Moscow. Gravity CIS currently occupies 1,812 square feet of office space, leased from a third party. The annual lease payment amounts to Russian Ruble 4,615 thousand (US\$157 thousand). For convenience only, the Russian Rubles amounts are expressed in U.S. dollars at the rate of Russian Ruble 29.36 to US\$1.00, the rate of Russian Rubles to U.S. dollars as quoted by the Russian Central Bank as of March 31, 2010. We believe that the existing facilities of Gravity CIS are adequate for its current requirements and that additional space can be obtained on commercially reasonable terms to meet its 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 report. The following discussion is based on our consolidated financial

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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, Brazil, the Philippines, Indonesia, Singapore, Malaysia, Thailand, Russia and Taiwan 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.

Since Ragnarok Online's initial commercial launch in August 2002, we have experienced significant growth in revenues and net income until 2004, followed by a substantial decrease in revenues and net income in 2005 and 2006. In 2008, our revenues increased by 32.2% to Won 53,170 compared to 2007 and net loss decreased to Won 2,773 million from net loss of Won 23,201 million in 2007. In 2009, our revenues increased by 8.0% to Won 57,403 million (US\$50,746 thousand) from Won 53,170 million in 2008. We recorded a net income of Won 6,917 million (US\$6,114 thousand) in 2009 as compared to a net loss of Won 2,773 million in 2008. Our gross profit margin increased to 63.1% in 2009 from 47.8% in 2008 and 51.6% in 2007, and our operating margin increased to 18.9% in 2009 from negative 0.4% in 2008 and negative 56.3% in 2007. We attribute our revenue growth until 2004 largely to our early entry into additional markets since Ragnarok Online's commercial launch and the continuing popularity of Ragnarok Online among users in the existing markets. Once a game is launched and the initial development and marketing costs have been expensed, relatively low marginal costs are incurred to expand into additional markets directly or through licensing arrangements. The decrease in revenues between 2005 and 2008 was primarily due to the continuing decline in royalties from Ragnarok Online because we believe that it had begun to reach relative maturity in our principal markets. The increase in revenues in 2009 was mainly due to the currency gains from the depreciation of the Won against foreign currencies, mainly the Japanese Yen, and the increase in revenues from Ragnarok Online and Requiem in the United States and Canada. Our cost of revenues for 2009 decreased as compared to 2008 primarily due to the decrease in salaries, amortization on intangible assets, commission paid and cost of good sold. Our revenue trend will be materially affected in the future by the popularity of online games introduced by our competitors.

In January 2005, we commercially launched R.O.S.E. Online, an MMORPG. In August 2007, we commercially launched Emil Chronicle Online, an MMORPG, followed by Pucca Racing, a casual online role playing game, in September 2007 and Requiem, an MMORPG, in October 2007. Revenues were Won 604 million (US\$534 thousand) for R.O.S.E. Online, Won 814 million (US\$719 thousand) for Emil Chronicle Online, Won 120 million (US\$106 thousand) for Pucca Racing and Won 2,838 million (US\$2,509 thousand) for Requiem in 2009 and Won 766 million, Won 957 million, Won 106 million and Won 1,743 million in 2008, respectively.

Our corporate income tax rate in 2009 was 24.2%. From 2002 to 2007, our corporate income tax was 13.75% as we were entitled to a 50% reduction in our corporate income tax rate as we were designated as a small-and medium-sized venture company. We lost such designation in 2008. See ITEM 4.B. BUSINESS OVERVIEW LAWS AND REGULATIONS Korea *The Special Tax Treatment Control Law.*

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;

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mobile games; and

character merchandising, animation and other revenue.

Online games subscription revenue

Subscription revenues include revenues from subscription fees and micro-transaction, except in Russia and CIS countries where our game services are only offered with the micro-transaction model. 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 two years. If license agreements are renewed upon expiration of their terms, renewal license fees 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. In addition, if the license agreements are renewed upon the expiration of their terms, we generally receive renewal license fees, which are deferred and recognized ratably over the new license period.

We also receive royalty revenues from our licensees based on an agreed percentage of each of the licensee's 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 also consist of revenues from subscription fees and micro-transaction, except in Vietnam, United Arab Emirates and 18 other countries in the Middle East and Northern Africa 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. We generally receive payments of the royalties within 20 to 30 days following the end of each month, except in Europe and China where such payments are received up to 45 days and 60 days after the end of each month, respectively.

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 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.

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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,					
	2007		2008		2009	
	(In millions of Korean Won and percentages)					
Online games-subscription revenue	₩ 9,405	23.4%	₩ 12,576	23.7%	₩ 12,674	22.1%
Online games-royalties and license fees	24,698	61.4	30,110	56.6	34,037	59.3
Mobile games	4,063	10.1	6,882	12.9	7,882	13.7
Character merchandising, animation and other revenue	2,063	5.1	3,602	6.8	2,810	4.9
Total	₩ 40,229	100.0%	₩ 53,170	100.0%	₩ 57,403	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 520 million for 2008 and Won 497 million (US\$439 thousand) for 2009. 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 41 million (US\$36 thousand) in 2009 as compared to Won 31 million in 2008 and Won 92 million in 2007.

Foreign currency effects

In 2009, 79.9% of our revenues were denominated in foreign currencies, primarily in the U.S. dollar and the Japanese Yen. In most of the countries in which our games are distributed, the revenues generated by our 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

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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 U.S. 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 (except in Europe and China, where such payment could be received up to 45 days and 60 days after the end of each month, respectively) 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, 2009, 2008 and 2007, we had no foreign currency forward contracts outstanding. See ITEM 11. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.*

Income tax expenses

Income tax expenses were Won 4,544 million (US\$4,017 thousand) in 2009, as compared to Won 3,379 million in 2008 and Won 2,916 million in 2007.

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 (ASC) 605, *Revenue Recognition* (formerly referenced as SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*, Statement of Position 97-2, *Software 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 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.

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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 8% 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* (formerly referenced as the FASB's SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise 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, which is deemed to be three years. 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 cost of revenues 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 our acquisition of NeoCyon. As of December 31, 2009, goodwill reflected on our balance sheet was Won 1,210 million (US\$1,070 thousand).

Goodwill is accounted for under ASC 350, *Goodwill and Other* (formerly referenced as the FASB's SFAS No. 142, *Goodwill and Other Intangible Assets*), 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 reporting unit for goodwill impairment test is determined based on each legal entity, which is the component level.

We performed our annual impairment test for goodwill at all of our reporting units using data as of December 31, 2009. 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. Based on the results of our testing, the fair value of the business reporting unit for NeoCyon, Inc. exceeded its book value, and therefore, the second step of the impairment test (in which fair value of the reporting unit's assets and liabilities are measured) was not required to be performed. However, in performing the annual impairment test for goodwill for Gravity CIS Co., Ltd., the fair

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value of the business reporting unit for the Russian subsidiary was determined to be lower than the book value of the business reporting unit. Therefore, during the fiscal year ended December 31, 2009, the Company recorded impairment losses of Won 241 million (US\$231 thousand) 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 fair values of the reporting units were estimated principally using the expected present value of future cash flows.

The assessment of impairments under ASC 350 requires significant judgment and requires estimates to assess fair values. A percentage difference in cash flow projections or discount rate used would not likely result in an impairment write-down. We believe that plus or minus five percentage difference in cash flow projections or discount rate used would not result in additional significant impairment loss.

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. We have evaluated our investment in Online Game Revolution Fund No. 1, a limited liability partnership, or the Revolution Fund, and Perpetual Entertainment Inc. The Company's investment in Perpetual Entertainment was recorded as an impairment loss due to the liquidation of Perpetual Entertainment on October 10, 2007. The impairment loss reflected in our statements of operations was Won 8,619 million. Significant management judgment is involved in evaluating whether there is an impairment. Any changes in assumptions could significantly affect the valuation and timing of recognition of impairment losses.

Fair value measurement on financial instruments

We adopted ASC 825, *Financial Instruments* (formerly referenced as the FASB's SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*). We have elected the fair value option for two of our 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 year ended December 31, 2009.

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, 2009. 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. We have 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, we have 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 statement of operations.

Income taxes

We account for income taxes under the provisions of ASC 740, *Income Taxes* (formerly referenced as the FASB's SFAS No. 109, *Accounting for 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, 2009, we

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have concluded that net deferred tax assets of Gravity and its subsidiaries except NeoCyon will not be realized in the near future based on our historical and projected net and taxable income.

We enjoyed in 2007 a reduced tax rate of 13.75%, which is 50% of the statutory tax rate and applied to certain designated venture companies. However, the Company is no longer entitled to such tax benefits since 2008. Accordingly, deferred income taxes as of December 31, 2009 were calculated based on the rate of 24.2% for fiscal years 2010 and 2011 and 22% thereafter for the amounts expected to be realized during the relevant fiscal year. Due to the amendment to the corporate income tax law, the rate of 24.2% will be applied for the fiscal years from 2009 through 2011 and 22% for the fiscal year 2012 and thereafter. See ITEM 5.A. OPERATING RESULTS OVERVIEW

Recent accounting pronouncements

In January 2010, the FASB issued Accounting Standards Update 2010-06 (ASU 2010-06), which amends the disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, as of January 1, 2010. ASU 2010-06 requires new disclosures for any transfers of fair value into and out of Level 1 and 2 fair value measurements and separate presentation of purchases, sales, issuances and settlements within the reconciliation of Level 3 unobservable inputs. The Company previously adopted ASC 820 on January 1, 2008 and January 1, 2009 for financial assets and liabilities and for nonfinancial assets and liabilities, respectively. ASU 2010-06 is effective for annual and interim periods beginning after December 15, 2009, except for the Level 3 reconciliation which is effective for annual and interim periods beginning after December 15, 2010. The adoption of ASU 2010-06 as of January 1, 2010 did not have a material effect on the Company's financial condition or results of operations. The Company does not expect the adoption of ASU 2010-06 in relation to the Level 3 reconciliation to have a material impact on the Company's financial condition or results of operations.

In September 2009, the Emerging Issues Task Force (the EITF) reached final consensus under ASU No. 2009-13 on the issue related to revenue arrangements with multiple deliverables. This issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration should be measured and allocated to the separate units of accounting. This issue is effective for the Company's revenue arrangements entered into or materially modified on or after January 1, 2011. The Company will evaluate the impact of this issue on the Company's financial statements when reviewing its new or materially modified revenue arrangements with multiple deliverables when it becomes applicable.

In June 2009, the FASB issued a statement which improves financial reporting by enterprises involved with variable interest entities. This statement requires companies to perform an analysis to determine whether the company's variable interest or interests give it a controlling financial interest in a variable interest entity. This statement will be effective as of the beginning of the annual reporting period that begins after November 15, 2009. The Company will evaluate the impact of this statement on the Company's financial statements when reviewing any new variable interest entities or transactions when it becomes applicable.

In June 2009, the FASB issued a statement which improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets as well as the effects of a transfer on its financial position, financial performance, and cash flows and a transferor's continuing involvement, if any, in transferred financial assets. The statement requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The statement will be effective as of the beginning of annual reporting period that begins after November 15, 2009. The Company believes the adoption of this pronouncement will not have a material impact on the Company's financial statements as the Company does not currently transfer its financial assets.

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

	2008	Year Ended December 31, 2009		2009(1) (Unaudited)	% Change
	(In millions of Won and thousands of US\$ except for percentages)				
Revenues:					
Online games subscription revenue	₩ 12,576	₩ 12,674	US\$ 11,204		0.8%
Online games royalties and license fees	30,110	34,037	30,090		13.0
Mobile games	6,882	7,882	6,968		14.5
Character merchandising, animation and other revenue	3,602	2,810	2,484		(22.0)
Total net revenue	53,170	57,403	50,746		8.0
Cost of revenue	27,772	21,170	18,715		(23.8)
Gross profit	25,398	36,233	32,031		42.7
Gross profit margin(2)	47.8%	63.1%	63.1%		
Operating expenses:					
Selling, general and administrative	23,489	21,651	19,140		(7.8)
Research and development	2,145	1,799	1,590		(16.1)
Impairment losses on intangible assets		280	248		N/M
Settlement cost of litigation		1,649	1,458		N/M
Total operating expenses	25,634	25,379	22,436		(1.0)
Operating income (loss)	(236)	10,854	9,595		4,699.2
Operating profit margin(3)	(0.4)%	18.9%	18.9%		
Other income (expenses):					
Interest income	2,857	2,395	2,117		(16.2)
Interest expense	(31)	(41)	(36)		32.3
Foreign currency income (losses), net	3,235	(225)	(199)		(107.0)
Others, net	(31)	(21)	(19)		(32.3)
Total net other income	6,030	2,108	1,863		(65.0)
Income before income tax expenses and equity loss of joint venture and partnership	5,794	12,962	11,458		123.7
Income tax expenses	3,379	4,544	4,017		34.5
Income before equity in loss of related joint venture and partnership	2,415	8,418	7,441		248.6
Equity loss of joint venture and partnership(4)	5,119	1,424	1,259		(72.2)
Net income (loss)	(2,704)	6,994	6,182		(358.7)
	69	77	68		11.6

LESS: Net income attributable to the
non-controlling interest(5)

Net income (loss) attributable to parent company	₩ (2,773)	₩ 6,917	US\$ 6,114	(349.4)%
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N/M = not meaningful

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Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.
- (2) Gross profit margin for each period is calculated by dividing gross profit by total net revenues for each period.
- (3) Operating profit margin for each period is calculated by dividing operating income (loss) by total net revenues for each period.
- (4) Represents the losses from our 16.39% equity investment in the Revolution Fund. This investment in the Revolution Fund was 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.

Revenues

Our total revenues increased by 8.0% to Won 57,403 million (US\$50,746 thousand) in 2009 from Won 53,170 million in 2008, primarily due to:

a 0.8% increase in subscription revenue to Won 12,674 million (US\$11,204 thousand) in 2009 from Won 12,576 million in 2008. This 0.8% increase resulted primarily from the 60.4% increase in the revenues in the United States and Canada to Won 5,785 million (US\$5,114 thousand) in 2009 from Won 3,607 million in 2008 resulting from the commercial launch of Requiem in June 2008 and the increased revenues from micro-transactions mainly due to sales of certain game items of Ragnarok Online in 2009. Such increase in subscription revenues was partially offset by the 33.7% decrease in the revenues from Ragnarok Online, Requiem, Pucca Racing, Time N Tales and Emil Chronicle Online in Korea to Won 4,951 million (US\$4,377 thousand) in 2009 from Won 7,463 million in 2008;

a 13.0% increase in royalties and license fees to Won 34,037 million (US\$30,090 thousand) in 2009 from Won 30,110 million in 2008, which primarily resulted from the weakening of the Korean Won by approximately 26.4% against the Japanese Yen from 2008 to 2009. Royalties and license fees from Ragnarok Online increased to Won 33,294 million (US\$29,432 thousand) in 2009 from Won 29,087 million in 2008; and

a 14.5% increase in mobile games revenue to Won 7,882 million (US\$6,968 thousand) in 2009 from Won 6,882 million in 2008. This 14.5% 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.

Such increases in revenues were partially offset by:

a 22.0% decrease in character merchandising, animation and other revenue to Won 2,810 million (US\$2,484 thousand) in 2009 from Won 3,602 million in 2008, which resulted primarily from a 16.1% decrease in character merchandising revenue to Won 917 million (US\$811 thousand) in 2009 from Won 1,093 million in 2008 and from a 19.4% decrease in sales of goods to Won 1,535 million (US\$1,357 thousand) in 2009 from Won 1,905 million in 2008.

Cost of revenues

Our cost of revenues decreased by 23.8% to Won 21,170 million (US\$18,715 thousand) in 2009 from Won 27,772 million in 2008, primarily due to:

a 42.1% decrease in amortization on intangible assets to Won 2,639 million (US\$2,333 thousand) in 2009 from Won 4,561 million in 2008 primarily resulting from fully completed amortization of intangible assets in December 2008, related to acquisition of NeoCyon in December 2005. Amortization expense of development costs recorded was Won 2,595 million (US\$2,294 thousand) in 2009 and Won 2,595 million in 2008;

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a 19.7% decrease in salaries to Won 8,353 million (US\$7,384 thousand) in 2009 from Won 10,403 million in 2008 primarily resulting from decrease in salaries for the headquarters and decrease in salaries for the subsidiaries in the U.S. mainly due to the liquidation proceedings of L5 Games Inc. taking place since August 2008;

a 28.9% decrease in service fees and license fees paid to Won 2,468 million (US\$2,182 thousand) in 2009 from Won 3,469 million in 2008 resulting from (i) a switch to an Internet Data Center charging lower service fee rate, (ii) lower royalty payments to GungHo, the licensor of Emil Chronicle Online as a result of the amendment of the license agreement in January 2009 and (iii) decrease in service fees paid to the provider of content delivery network service as a result of a decrease in the number of downloads by our users of the client-side software of our games; and

a 44.3% decrease in cost of goods sold by NeoCyon to Won 912 million (US\$806 thousand) in 2009 from Won 1,637 million in 2008. NeoCyon sells goods related to cell phones and decrease in sales of goods in 2009 led to decrease in cost of goods sold.

Gross profit and gross profit margin

As a result of the foregoing, our gross profit increased by 42.7% to Won 36,233 million (US\$32,031 thousand) in 2009 from Won 25,398 million in 2008. Our gross profit margin increased to 63.1% in 2009 from 47.8% in 2008.

Operating expenses

Selling, general and administrative expenses. Our selling, general and administrative expenses decreased by 7.8% to Won 21,651 million (US\$19,140 thousand) in 2009 from Won 23,489 million in 2008, primarily due to:

a 29.3% decrease in rent expenses to Won 2,010 million (US\$1,777 thousand) in 2009 from Won 2,845 million in 2008, which was mainly due to (i) higher rent expense in 2008 as rent expenses were incurred in both the old and new office buildings for the period between February 1, 2008 and March 16, 2008 in connection with the relocation of the headquarter office and (ii) rent expenses of Gravity Middle East & Africa FZ-LLC which ceased to exist in 2009 due to liquidation proceedings taking place since September 2008; and

a 32.1% decrease in severance benefit to Won 743 million (US\$657 thousand) in 2009 from Won 1,094 million in 2008, due to changes in benefit policies for the directors of a certain subsidiary in February 2008.

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

a loss of Won 975 million (US\$862 thousand) on guarantee payment made for development of Ice Age Online, due to the low likelihood of recovery as we received a written notice of termination of the license agreement with 20th Century FOX Licensing & Merchandising, the trademark licensor of Ice Age, in November 2009.

Research and development expenses. Our research and development expenses decreased by 16.1% to Won 1,799 million (US\$1,590 thousand) in 2009 from Won 2,145 million in 2008, as certain research and development expenses were capitalized into intangible assets after open beta testing of some of our games and charged into cost of revenues after such games are available for general release to customers.

Impairment loss on intangible assets. We had Won 280 million (US\$248 thousand) impairment loss on intangible assets in 2009, for (i) capitalized research and development cost of Pucca Racing; and (ii) goodwill of

Gravity CIS Co., Ltd., which was acquired in our acquisition of NeoCyon in 2005.

Settlement cost of litigation. We paid US\$2,000 thousand to Softstar Entertainment, Inc. for the settlement of litigation filed in October 2006 related to R.O.S.E. Online service in Taiwan, Hong Kong and Macau, and recognized the loss of Won 1,649 million, which is the difference between the settlement and the existing deferral revenue balance.

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Operating income (loss) and operating profit margin

As a result of the cumulative effects of the reasons stated above, we recorded an operating income of Won 10,854 million (US\$9,595 thousand) in 2009 compared to an operating loss of Won 236 million in 2008 and our operating profit margin recorded at 18.9% in 2009.

Net other income

Our net other income decreased 65.0% to Won 2,108 million (US\$1,863 thousand) in 2009 from Won 6,030 million in 2008 primarily due to:

a 107.0% decrease in foreign currency income to a loss of Won 225 million (US\$199 thousand) in 2009 from a gain of Won 3,235 million in 2008 mainly resulting from the lower rate of depreciation of the Won against the Japanese Yen in 2009 compared to 2008.

Income tax expenses (benefit)

We recorded an income tax expense of Won 4,544 million (US\$4,017 thousand) in 2009, as compared to an income tax expense of Won 3,379 million in 2008. The increase of income tax expense is mainly due to the increase of foreign withholding tax for overseas license and royalty revenue and to the decrease in income tax benefit in the amount of Won 530 million which was no longer available to the Company after 2008, due to the amortization of intangible assets incurred from acquisition of NeoCyon in December 2005 being fully completed in December 2008. In 2009, overseas license and royalty revenue of Gravity headquarters increased by Won 5 billion and accordingly the foreign tax increased by Won 514 million. This increase was also partially due to the loss carry back of Won 195 million from Gravity Interactive in 2008. 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, 2009, we recorded a full valuation allowance on net deferred tax assets of Gravity and its subsidiaries except NeoCyon, 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 of joint venture and partnership

In 2008 and 2009, equity loss of joint venture and partnership represents the 16.39% of the net loss incurred from a 16.39% partnership interest in the Revolution Fund. 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* (formerly referenced as EITF D-46, *Accounting for Limited Partnership Investments*), 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 5,119 million and Won 1,424 million (US\$1,259 thousand) in 2008 and 2009, respectively, as equity loss of the partnership. During 2008, the partnership purchased an online game under development of which technological feasibility had not been established, therefore, the partnership charged the purchase price of the game to expense, which resulted in a significant loss in 2008.

Non-controlling interest

Non-controlling interest represents the net income from NeoCyon, our 96.11%-held subsidiary acquired in December 2005, attributable to third-party minority interest holders. We acquired 96.11% of the voting equity of NeoCyon in 2005.

Net income (loss) attributable to parent company

As a result of foregoing, we recorded a net income attributable to parent company of Won 6,917 million (US\$6,114 thousand) in 2009 compared to a net loss attributable to parent company of Won 2,773 million in 2008.

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

	Year Ended December 31,			%
	2007	2008	2008(1)	Change
	(Unaudited)			
	(In millions of Won and thousands of US\$			
	except for percentages)			
Revenues:				
Online games subscription revenue	₩ 9,405	₩ 12,576	US\$ 9,848	33.7%
Online games royalties and license fees	24,698	30,110	23,579	21.9
Mobile games	4,063	6,882	5,389	69.4
Character merchandising, animation and other revenue	2,063	3,602	2,821	74.6
Total net revenue	40,229	53,170	41,637	32.2
Cost of revenue	19,479	27,772	21,748	42.6
Gross profit	20,750	25,398	19,889	22.4
Gross profit margin(2)	51.6%	47.8%	47.8%	
Operating expenses:				
Selling, general and administrative	28,159	23,489	18,394	(16.6)
Research and development	5,761	2,145	1,680	(62.8)
Impairment losses on investments	8,619			N/M
Impairment losses on intangible assets	871			N/M
Total operating expenses	43,410	25,634	20,074	(40.9)
Operating income (loss)	(22,660)	(236)	(185)	(99.0)
Operating profit margin(3)	(56.3)%	(0.4)%	(0.4)%	
Other income (expenses):				
Interest income	3,041	2,857	2,237	(6.1)
Interest expense	(92)	(31)	(24)	(66.3)
Foreign currency income, net	388	3,235	2,533	733.8
Others, net	104	(31)	(24)	(129.8)
Total net other income	3,441	6,030	4,722	75.2
Income tax expenses	2,916	3,379	2,646	15.9
Income (loss) before equity in loss of related joint venture and partnership	(22,135)	2,415	1,891	(110.9)
Equity loss of joint venture and partnership(4)	1,026	5,119	4,009	398.9
Net income (loss)	(23,161)	(2,704)	(2,117)	(88.3)
	40	69	54	72.5

LESS: Net income attributable to the
non-controlling interest(5)

Net income (loss) attributable to parent company	₩ (23,201)	₩ (2,773)	US\$ (2,172)	(88.0)%
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N/M = not meaningful

Notes:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,277.0 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on April 30, 2009.

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- (2) Gross profit margin for each period is calculated by dividing gross profit by total net revenues for each period.
- (3) Operating profit margin for each period is calculated by dividing operating income (loss) by total net revenues for each period.
- (4) Represents the losses from our 15.15% and 16.39% equity investment in the Revolution Fund in 2007 and 2008, respectively. This investment in the Revolution Fund was 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.

Revenues

Our total revenues increased by 32.2% to Won 53,170 million (US\$41,637 thousand) in 2008 from Won 40,229 million in 2007, primarily due to:

a 33.7% increase in subscription revenue to Won 12,576 million (US\$9,848 thousand) in 2008 from Won 9,405 million in 2007. This 33.7% increase resulted primarily from the 26.4% increase in the revenues from Ragnarok Online to Won 9,862 million (US\$7,723 thousand) in 2008 from Won 7,804 million in 2007 due to (i) the increased revenues from micro-transactions resulting from opening free-to-play servers in Korea in May 2008 and in United States and Canada in September 2008; and (ii) commercialization of Ragnarok Online in Russia in March 2007 and in France and Belgium in June 2007. This increase also partially came from the initial commercial launch of Requiem in the United States, Canada, Russia and CIS countries in June 2008. Subscription revenues of Requiem increased to Won 1,743 million (US\$1,365 thousand) in 2008 from Won 644 million in 2007;

a 21.9% increase in royalties and license fees to Won 30,110 million (US\$23,579 thousand) in 2008 from Won 24,698 million in 2007, which primarily resulted from the weakening of the Korean Won by approximately 36% against the Japanese Yen from 2007 to 2008 and increased revenues in Japan. Royalties and license fees from Ragnarok Online increased to Won 29,087 million (US\$22,778 thousand) in 2008 from Won 23,310 million in 2007;

a 69.4% increase in mobile games revenue to Won 6,882 million (US\$5,389 thousand) in 2008 from Won 4,063 million in 2007. This 69.4% increase resulted primarily from revenues of NeoCyon, primarily due to the commercial launch of new mobile games based on Ragnarok Online in 2008. Mobile revenues of NeoCyon recorded Won 8,258 million (US\$6,466 thousand) in 2008 and Won 4,794 million in 2007; and

a 74.6% increase in character merchandising, animation and other revenue to Won 3,602 million (US\$2,821 thousand) in 2008 from Won 2,063 million in 2007, which resulted primarily from a 29% increase in character revenue to Won 1,093 million (US\$856 thousand) in 2008 from Won 847 million in 2007 and from a 119% increase in sales of goods to Won 1,905 million (US\$1,492 thousand) in 2008 from Won 870 million in 2007.

Cost of revenues

Our cost of revenues increased by 42.6% to Won 27,772 million (US\$21,748 thousand) in 2008 from Won 19,479 million in 2007, primarily due to:

a 43.3% increase in amortization on intangible assets to Won 4,561 million (US\$3,572 thousand) in 2008 from Won 3,182 million in 2007 primarily resulting from the commercial launch of Emil Chronicle Online, Pucca Racing and Requiem in August, September and October 2007, respectively. Amortization expense of development costs recorded was Won 2,595 million (US\$2,032 thousand) in 2008 and Won 1,007 million in 2007; and

a 45.5% increase in salaries to Won 10,403 million (US\$8,147 thousand) in 2008 from Won 7,149 million in 2007 mainly resulting from the commercial launch of Emil Chronicle Online, Pucca Racing and Requiem in August, September and October 2007, respectively and increase in salaries of L5 Games Inc., which was established in October 2007 as such expenses are, subsequent to the commercial launch, incurred as an item in cost of revenues; and

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a 210.6% increase in cost of goods sold by NeoCyon to Won 1,637 million (US\$1,282 thousand) from Won 527 million. NeoCyon sells goods related to cell phones and increase in sales of goods in 2008 led to increase in cost of goods sold.

Gross profit and gross profit margin

As a result of the foregoing, our gross profit increased by 22.4% to Won 25,398 million (US\$19,889 thousand) in 2008 from Won 20,750 million in 2007. Our gross profit margin decreased to 47.8% in 2008 from 51.6% in 2007.

Operating expenses

Selling, general and administrative expenses. Our selling, general and administrative expenses decreased by 16.6% to Won 23,489 million (US\$18,394 thousand) in 2008 from Won 28,159 million in 2007, primarily due to:

a 77.6% decrease in advertising expenses to Won 1,483 million (US\$1,161 thousand) in 2008 from Won 6,623 million in 2007, which mainly consisted of advertising expenses for closed and open beta testing of Ragnarok Online II, Requiem and Pucca Racing, which were Won 1,747 million, Won 504 million and Won 389 million respectively, and commercialization expenses of Requiem, which was Won 645 million, and Won 1,496 million of expenses related to the Gravity Festival held in July 2007, which did not recur in 2008; and

a 15.0% decrease in professional service fees paid to Won 3,934 million (US\$3,081 thousand) in 2008 from Won 4,628 million in 2007, for fees and expenses incurred in connection with legal consulting service and advisory service for accounting and Sarbanes-Oxley compliance.

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

a 88.6% increase in severance benefits to Won 1,094 million (US\$857 thousand) in 2008 from Won 580 million in 2007, due to changes in benefit policies for the directors of a certain subsidiary in February 2008.

a 5.8% increase in salaries to Won 8,234 million (US\$6,448 thousand) in 2008 from Won 7,782 million in 2007, primarily resulting from the payment of retirement bonus by the Company during its restructuring process, and by NeoCyon and Gravity RUS.

Research and development expenses. Our research and development expenses decreased by 62.8% to Won 2,145 million (US\$1,680 thousand) in 2008 from Won 5,761 million in 2007, as the research and development expenses were capitalized into intangible assets after open beta testing of some of our games and charged into cost of revenues after such games are available for general release to customers.

Impairment loss on investments. In 2007, we had Won 8,619 million impairment loss on available-for-sale securities of Perpetual Entertainment, Inc., or Perpetual Entertainment, in which the Company invested in May 2006. Perpetual Entertainment was liquidated in October 2007. There were no such impairment charges recorded in 2008.

Operating income (loss) and operating profit margin

As a result of the cumulative effects of the reasons stated above, we recorded an operating loss of Won 236 million (US\$185 thousand) in 2008 compared to an operating loss of Won 22,660 million in 2007.

Net other income

Our net other income increased 75.2% to Won 6,030 million (US\$4,722 thousand) in 2008 from Won 3,441 million in 2007 primarily due to:

a 733.8% increase in foreign currency income to a gain of Won 3,235 million (US\$2,533 thousand) in 2008 from a gain of Won 388 million in 2007 as a result of favorable exchange rates in 2008, mainly from the depreciation of the Won against the Japanese Yen.

Table of Contents**Income tax expenses (benefit)**

We recorded an income tax expense of Won 3,379 million (US\$2,646 thousand) in 2008, as compared to an income tax expense of Won 2,916 million in 2007. The increase of income tax expense is mainly due to the increase of foreign withholding tax for overseas license and royalty revenue. In 2008, overseas license and royalty revenue of Gravity headquarters increased by Won 7 billion and accordingly the foreign tax increased by Won 618 million. This increase was partially offset by the loss carry back of Won 194 million from Gravity Interactive. 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, 2008, we recorded a full valuation allowance on net deferred tax assets of Gravity and its subsidiaries except NeoCyon, 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 of joint venture and partnership

In 2007, equity loss of joint venture and partnership represents the 15.15% of the net loss incurred from a 15.15% partnership interest in the Revolution Fund. In 2008, equity loss of joint venture and partnership represents the 16.39% of the net loss incurred from a 16.39% partnership interest. As of December 31, 2008, the Company held 16.39% partnership interest in the Revolution Fund due to the withdrawal of a participant. 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* (formerly referenced as EITF D-46, *Accounting for Limited Partnership Investments*), 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 recorded Won 1,026 million and Won 5,119 million (US\$4,009 thousand) in 2007 and 2008, respectively, as equity loss of the partnership. During 2008, the partnership purchased an on-line game under development of which technological feasibility had not been established, therefore, the partnership charged the purchase price of the game to expense, which resulted in a significant loss in 2008.

Non-controlling interest

Non-controlling interest represents the net income from NeoCyon, our 96.11%-held subsidiary acquired in December 2005, attributable to third-party minority interest holders. We acquired 96.11% of the voting equity of NeoCyon in 2005.

Net loss attributable to parent company

As a result of foregoing, we recorded a net loss attributable to parent company of Won 2,773 million (US\$2,172 thousand) in 2008 compared to a net loss attributable to parent company of Won 23,201 million in 2007.

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:

	Year Ended December 31,			
	2007	2008	2009	2009(1)
	(Unaudited)			
	(In millions of Won and thousands of US\$)			
Cash and cash equivalents at beginning of period	₩ 35,314	₩ 53,588	₩ 53,168	US\$ 47,002
Net cash provided by (used in) operating activities	(10,626)	6,952	15,861	14,021
Net cash provided by (used in) investing activities	29,338	(9,028)	(17,550)	(15,514)
Net cash provided by (used in) financing activities	(438)	(82)	(55)	(49)
Effect of exchange rate changes on cash and cash equivalents		1,738	(91)	(81)
Net increase in cash and cash equivalents	18,274	(420)	(1,835)	(1,623)
Cash and cash equivalents at end of period	₩ 53,588	₩ 53,168	₩ 51,333	US\$ 45,379

Note:

- (1) For convenience only, the Won amounts are expressed in U.S. dollars at the rate of Won 1,131.2 to US\$1.00, the noon buying rate as quoted by the Federal Reserve Bank of New York in effect on March 31, 2010.

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. See Note 6 to the notes to our consolidated financial statements included in this annual report. However, our net property and equipment decreased from Won 5,226 million as of December 31, 2008 to Won 2,837 million (US\$2,508 thousand) as of December 31, 2009 mainly due to the depreciation of property and equipment totaling Won 2,924 million (US\$2,585 thousand). This decrease is partially offset by purchase of property and equipment amounting to Won 627 million (US\$554 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 8,715 million as of December 31, 2007, to Won 7,278 million as of

December 31, 2008 and increased to Won 16,000 million (US\$14,144 thousand) as of December 31, 2009. The decrease in our short-term financial instruments in 2008 was primarily as a result of 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 2009 primarily 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.

Cash flows from operating activities. The increase in net cash provided by our operating activities from 2007 to 2008 was primarily the result of decrease in net loss from 2007 to 2008. Our increase in net cash provided by our

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operating activities in 2008 as compared to 2007 reflected an adjustment of (i) Won 8,501 million for depreciation and amortization and (ii) Won 5,119 million in equity loss of related joint venture and partnership. This increase was partially offset by change in account receivable of Won 1,393 million and also change in account payable of Won 2,035 million. The increase in net cash provided by our operating activities from 2008 to 2009 was primarily the result of net income in 2009. Our increase in net cash provided by our operating activities in 2009 as compared to 2008 reflected an adjustment of (i) Won 5,627 million (US\$4,974 thousand) for depreciation and amortization and (ii) Won 1,424 million (US\$1,259 thousand) in equity loss of related joint venture and partnership. This increase was partially offset by payment of severance benefits of Won 832 million (US\$736 thousand) and also change in account payable of Won 602 million (US\$531 thousand).

Cash flows from investing activities. Our decrease in net cash by investing activities in 2008 as compared to 2007 reflected (i) Won 6,054 million for purchase of equity investments and (ii) Won 3,645 million for purchase of intangible assets. This decrease was partially offset by (i) Won 1,769 million for proceeds from leasehold deposits and (ii) Won 1,585 million from maturity of short-term financial instruments. Our decrease in net cash by investing activities in 2009 as compared to 2008 reflected (i) Won 8,743 million (US\$7,729 thousand) for increase in short-term financial instruments, (ii) Won 2,746 million (US\$2,428 thousand) for purchase of intangible assets and (iii) Won 5,000 million (US\$4,420 thousand) for increase in short-term available for sale investments.

Cash flows from financing activities. Our increase in net cash used by financing activities in 2008 as compared to 2007 reflected proceeds from borrowings of Won 212 million. This increase was offset by repayments of borrowings of 294 million. Our increase in net cash used by financing activities in 2009 as compared to 2008 reflected proceeds from borrowings of Won 140 million (US\$124 thousand). This increase was offset by repayments of borrowings of Won 195 million (US\$173 thousand).

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, 2009, our primary source of liquidity was Won 51,333 million (US\$45,379 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 2011. 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 the past, we also raised cash by entering into indebtedness arrangements such as the transaction entered into with YNK Korea. 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, 2009, Gravity Interactive, our subsidiary in the U.S., has issued an irrevocable letter of credit in the amount of US\$500,000 to its landlord in relation to its lease agreement, with no amount drawn. A short-term investment valued at US\$500,000 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 2011, including our new game development expenditures for Ragnarok Online II.

Table of Contents**ITEM 5.C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.**

To remain competitive, we have continued to focus on our research and development efforts. For the past three years, our research and development efforts and plans have consisted of the following:

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

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 5,761 million, Won 2,145 million and Won 1,799 million (US\$1,590 thousand) in 2007, 2008 and 2009, respectively. Our research and development expenses decreased significantly as (i) investments in new games have decreased since 2007: and (ii) certain research and development expenses were capitalized into intangible assets after open beta testing of some of our games and charged into cost of revenues after commercialization.

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. CONTRACTUAL OBLIGATIONS

The following table sets forth a summary of our contractual cash obligations due by period as of December 31, 2009.

	Payments Due by Period				More than 5 Years
	Total	Less than 1 Year	1-3 Years	3-5 Years	
	(In millions of Won)				
Long-term debt obligations	₩	₩	₩	₩	₩

Capital lease obligations	168	115	53
Operating lease obligations	7,575	2,666	4,909
Purchase obligations	1,100	1,100	
Accrued severance benefits	478		

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.

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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. 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.

Operating lease obligations. With respect to our operating lease obligations, the lease payments due by December 31, 2010 are Won 1,762 million, Won 558 million, Won 196 million and Won 33 million for our principal offices in Seoul, offices for our subsidiaries in the United States, Russia and France, respectively. The lease terms expire in December 2012, November 2012, July 2011 and June 2010 for our principal offices in Seoul, offices for our subsidiaries in the United States, Russia and France, respectively. The renewal terms in all of the leases are subject to market conditions.

Purchase Obligations. In December 2005, we entered into an agreement with Movida Investment Inc., which was merged into Entertainment Farm Inc. in February 2007, SoftBank Corporation, GungHo and seven other companies to invest in Online Game Revolution Fund No. 1, a limited partnership, with a total capital commitment in the amount of JPY1,000 million, which represented 10% of the aggregate size of the fund. In 2006, 2007 and 2008, some of the co-participants of Online Game Revolution Fund No. 1 withdrew and our interest in the total fund rose from 10% to 16.39% of the aggregate size of the fund. However, this did not cause our total capital commitment to change. We made payments of JPY100 million, JPY150 million, JPY642 million and JPY18 million in 2005, 2006, 2008 and 2009, respectively. Upon 30 days prior written notice by Entertainment Farm, Inc., the general partner of Online Game Revolution Fund No. 1, we are required to pay the outstanding portion of our pledged contribution. As of December 31, 2009, we did not have an estimate of when Entertainment Farm, Inc. would send such a notice. The remaining JPY90 million due is not included in the contractual cash obligations because we cannot estimate when Entertainment Farm, Inc. will send us a notice to pay the outstanding portion of our contribution. Under the agreement, the investment term is five years from the effective date, which is January 1, 2006. In November 2009, we entered into an agreement with Naru Entertainment Co., Ltd. to publish a game being developed by Naru Entertainment Co., Ltd. for Won 1,500 million. As of December 31, 2009, the game is under development, and we have booked the license fee of Won 400 million as advance payment. We are to pay the remaining Won 1,100 million in installments based on the progress of development of the game. Under the agreement, we have right to claim refund on the amounts paid if the development of the game is delayed or failed.

Uncertain tax position. As a result of the adoption of ASC 740, *Income Taxes* (formerly referenced as FIN 48, *Accounting for Income Tax Uncertainties*), we identified uncertain tax positions and measured unrecognized tax benefits for open tax years and accordingly decreased its loss carryforwards of Won 66 million and Won 40 million in income tax calculation of 2006 and 2007. No interest expenses and penalties were calculated from such unrecognized tax benefits due to significant amounts of loss carryforwards at each year. Even if recognized, all Won 106 million of unrecognized tax benefits would not affect our income tax expense and effective tax rate for 2006 and 2007 as a full valuation allowance was provided for the entity which has taken these uncertain tax positions. In addition, its unrecognized tax benefits recorded as of December 31, 2009 are not predictable as to when to receive. As such, the ASC 740 liability is not included in the table.

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* (formerly referenced as EITF 88-1, *Determination of Vested Benefit Obligation for*

a Defined Benefit Pension Plan).

Other Commitments and Liabilities

For a description of our commercial commitments and contingent liabilities, see note 13 of the Notes to our consolidated financial statements included elsewhere in this annual report. For a description of our legal

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proceedings, See ITEM 8.A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION
LEGAL PROCEEDINGS.

ITEM 5.G. SAFE HARBOR

See FORWARD-LOOKING STATEMENTS.

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, 2010. 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
Toshiro Ohno	50	Chief Executive Officer, President, Chairman of the Board of Directors
Yoon Seok Kang	43	Chief Executive Officer
Yoshinori Kitamura	42	Executive Director and Chief Operating Officer
Heung Gon Kim	44	Chief Financial Officer
Kazuki Morishita	36	Executive Director
Kazuya Sakai	45	Executive Director
Luke Kang	36	Independent Director
Phillip Young Ho Kim	48	Independent Director
Jong Gyu Hwang	40	Independent Director

Toshiro Ohno has served as our Executive Director since March 2009 and has served as our Chief Executive Officer, President and Chairman of the Board of Directors since April 2009. Mr. Ohno has also been a Director of Gravity Interactive, Inc. since June 2009. Mr. Ohno has served as an Executive Officer at GungHo Online Entertainment, Inc. since 2008. Prior to joining GungHo, he served in a variety of capacities at GameOn Co., Ltd, an online game company in Japan, including as an advisor from 2007 to 2008, Chief Executive Officer from 2006 to 2007 and Chief Administrative Officer, Executive Vice President and management planning team leader from 2003 to 2006. Mr. Ohno served as manager at Chunsoft Co., Ltd. from September 2000 to December 2002. Mr. Ohno obtained an LL.B. degree from Meiji University.

Yoon Seok Kang has served as our Executive Director since March 2008 and Chief Executive Officer since June 2008. Mr. Kang has also served as a Director of Gravity Entertainment, Gravity Interactive, and NeoCyon since March 2008, July 2008 and October 2008, respectively. He was Chief Compliance Officer from May 2008 to September 2009, Chairman of our Board of Directors from June 2008 to April 2009 and Chief Operating Officer from June 2008 to August 2008. Mr. Kang was a Director of L5 Games Inc. from July 2008 to August 2008 when L5 games went into liquidation. Mr. Kang served as a Managing Director at Korea Venture Fund from August 2000 to March 2008. Mr. Kang also served as a fund manager at Samsung Venture Investment Corporation from November 1999 to August 2000 and as a manager at Samsung Electronics Co. from 1993 to 1999. Mr. Kang obtained a bachelor's degree from University of Utah and a master's degree in electrical engineering from Polytechnic Institute of New York University. Mr. Kang also completed an executive course at the graduate school of business administration at Stanford University.

Yoshinori Kitamura has served as our Executive Director since March 2008 and has served as Chief Operating Officer since June 2008. 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. 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 of NeoCyon since October 2008 and Chief Executive Officer since October 2009. 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

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L5 Games Inc. from July 2008 to its liquidation in August 2008. Mr. Kitamura worked as an Executive General Manager of the Marketing Division at GungHo Online Entertainment, Inc. from 2003 to 2007. Mr. Kitamura also worked at NC Japan K.K. as marketing manager from 2002 to 2003 and ICC Corporation as business development manager from 1999 to 2003. Mr. Kitamura holds a bachelor's degree in English from Bunkyo University.

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

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. In addition, 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 Chief Operating Officer of GungHo Online Entertainment, Inc. from August 2002 to January 2004, a Director of GungHo Entertainment Korea, Inc. from March 2007 to October 2008 and the Chairman of the Board of Directors of GungHo Works, Inc. from October 2007 to December 2009 when GungHo Works went into liquidation. He also was a general manager of 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 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 and Director of GungHo Online Entertainment, Inc. since April 2004 and March 2005, respectively. He has also been a Director of Gravity Entertainment since March 2008. Mr. Sakai was a Director of GungHo Works, Inc. from October 2007 to its liquidation in December 2009 and has been Representative Liquidator since December 2009. Mr. Sakai was Representative Director of Capri, Inc. from October 2008 to its liquidation in December 2009 and has been Representative Liquidator since December 2009. Mr. Sakai was a Director of GungHo Online Entertainment Korea, Inc. from March 2007 to October 2008, Representative Director in October 2008 and Liquidator from October 2008 to January 2009. He was Representative Director of GungHo Asset Management, Inc. from January 2007 to October 2008 and Representative Liquidator from October 2008 to March 2009. Mr. Sakai served as Director and Representative Director of Expression Tools, Inc. from April 1996 to April 2000, and from April 2000 to November 2003, respectively. He worked at The Kyushu Bank, Ltd., currently, The Shinwa Bank, Ltd., from 1987 to 1992. Mr. Sakai graduated from Kyushu Sangyo University with a bachelor's degree in commerce.

Luke Kang has served as our Independent Director since March 2008. Mr. Kang had served as an Independent Director of Wealthbridge Co., Ltd. from November 2008 to May 2009. He has also served as Senior Vice President and Managing Director of MTV Networks Korea from 2006 to 2008 and worked at MTV Networks Asia Pacific Region headquarters from 2001 to 2006. Mr. Kang has served as a Head of Business Development Manager at Asiacontent.com from March to October in 2000 and worked as a senior consultant at Monitor Group from August 1996 to March 2000. He worked as an editor at the Ministry of Finance & Economy of the Republic of Korea from June 1995 to July 1996. Mr. Kang received a bachelor's degree in history from University of Michigan. Mr. Kang is currently pursuing a master degree in management at Stanford University.

Phillip Young Ho Kim has served as our Independent Director since March 2008. Mr. Kim has also served as Managing Director at IRG Limited, a boutique investment bank based in Hong Kong, since 2000. Mr. Kim served as an Executive Director at Morgan Stanley in Hong Kong from 1998 to 2000. Mr. Kim served as Vice President at Lehman Brothers from 1985 to 1997 and at Crocker National Bank in San Francisco from 1983 to 1984. Mr. Kim

received a bachelor's degree in economics from University of California at Berkeley.

Jong Gyu Hwang was our Independent Director from June 2009 to March 2010 and has served as our Independent Director since March 2010. 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. Mr. Hwang served as a Director of Korea Monorail from 2006 to 2007 and

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worked as an attorney at Attorney General's Office in Massachusetts in the United States in 2005. He was also a Deputy Director at 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.

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, 2009, the aggregate amount of compensation paid by us to all directors and executive officers was Won 1,356 million (US\$1,199 thousand). We also paid Won 60 million (US\$53 thousand) for severance and accrued Won 86 million (US\$76 thousand) to provide for retirement or similar benefits to our executive officers. At our general meeting of shareholders held on March 26, 2010, our shareholders approved an aggregate amount of up to Won 1,400 million (US\$1,238 thousand) as compensation for our directors for 2010.

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 and directors equals the monthly salary at the time of his or her departure, multiplied by the number of continuous years of service.

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:

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

Under Korean law, we are not required to have director nomination committee and compensation committee comprised solely of independent directors. Our director nomination committee and compensation committee are currently each comprised of two independent directors and one non-independent director.

Under Korean law, independent directors are not required to have regularly scheduled meetings at which only independent directors are present. Our audit committee, which is comprised 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 Rule 5635, we require a resolution to be adopted at the general meeting of shareholders when necessary under Korean law, including, for example, if an issuance of securities is related to the acquisition of all of the business of another corporation or the acquisition of a part of the business of another corporation which significantly affects 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,

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and financial statements prepared in accordance with Korean GAAP, are made available to shareholders one (1) week before the day of the 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.

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 8 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 elected before the shareholders' meeting in March 2009 is elected for a term of three years, and each of directors elected at the shareholders' meeting in March 2009 and thereafter is elected for a term of one year, both of 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 terms of Toshiro Ohno and Kazuya Sakai expire on March 31, 2011, and those of Yoon Seok Kang, Kazuki Morishita, Yoshinori Kitamura, Luke Kang and Phillip Young Ho Kim on March 28, 2011. The term of Jong Gyu Hwang expires on March 26, 2011.

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 Toshiro Ohno and Yoon Seok Kang as our Representative Directors. 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. Phillip Young Ho Kim, Luke Kang 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

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the compensation committee.

Audit committee

Our audit committee was established in December 2004. The audit committee currently consists of the following directors: Jong Gyu Hwang, Phillip Young Ho Kim and Luke Kang. 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 Phillip Young Ho Kim 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 Jong Gyu Hwang.

Director nomination committee

The director nomination committee consists of the following three directors, Kazuki Morishita, Luke Kang and Jong Gyu Hwang. Two of the three members are independent directors 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 Kazuki Morishita.

Compensation committee

The compensation committee consists of the following three directors, Kazuya Sakai, Phillip Young Ho Kim and Jong Gyu Hwang. Two of the three members are independent directors 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 Kazuya Sakai.

ITEM 6.D. EMPLOYEES

As of March 31, 2010, we, not including our subsidiaries, had 353 full-time employees, of whom 344 were located in Korea and 9 were stationed overseas, either working with our subsidiaries or supporting our overseas licensees. The total number of employees remained stable in 2009 after a significant decreased in 2008 due to restructuring and discontinuation of development projects. The following table sets forth the number of our employees by department as of the dates indicated.

	December 31,			March 31,
	2007	2008	2009	2010
Senior management	6	10	11	11
Finance	14	14	19	18
Marketing	29	53	56	56
Game development and support	462	286	278	268
Total	511	363	364	353

As of March 31, 2010, we have 1 temporary employee.

We do not have a labor union and none of its 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.

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In addition, as of March 31, 2010, our subsidiaries had the number of employees as set forth in the following table.

	2007	December 31, 2008	2009	March 31, 2010
Gravity Interactive, Inc.(1)	29{3}	34	34	35
L5 Games Inc.(2)	20			
Gravity Entertainment Corporation				
Gravity EU SASU	8	7	6	6
Gravity RUS Co., Ltd.(3)				
Gravity CIS, Inc.(1)	20{3}	20{2}	13{2}	13{2}
Gravity Middle East & Africa FZ-LLC(1)(4)	2{2}			
NeoCyon, Inc.	46	45	45	48
Total	125	106	98	102

Notes:

- (1) The number in { } is the number of employees (who are included in the total number) seconded from us.
- (2) L5 Games was formed in October 2007 and went into liquidation proceedings in the United States in August 2008.
- (3) Gravity RUS was founded in October 2007.
- (4) Gravity Middle East & Africa went into liquidation proceedings in United Arab Emirates in September 2008.

Gravity Entertainment does not have any employees because it has no significant operations. Gravity RUS is a holding company and does not have any employees. None of the employees of Gravity Interactive, Gravity EU, Gravity CIS or NeoCyon 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, 2009, we provided Won 478 million (US\$423 thousand) to 124 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 (from the monthly income that the employer reports within the range between Won 220,000 and Won 3,600,000, an amount of Won 1,000 or less will be disregarded, i.e., rounded off for Won 1,000) annual wages 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 2007, 2008 and 2009 was Won 1,337 million, Won 1,152 million and Won 960 million (US\$849 thousand), respectively.

ITEM 6.E. SHARE OWNERSHIP

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

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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.

Stock option granted under the stock option plan, in case new shares are issued, has a minimum exercise price equal to the higher of (i) the market price of our shares calculated pursuant to the method under the 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 (2) 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 (2) 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 (5) years from the vesting date.

Stock option 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.

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.

Each stock option confers the right on the grantee to purchase one share of our common stock at the exercise price. The exercise price for these stock options is, in the case of some senior employees, Won 55,431 per share, representing the price per share of our common shares (or ADS equivalent) offered to the public in our initial public offering of February 2005, and in the case of all other eligible employees, Won 45,431 per share, representing the price per share offered to the public less Won 10,000 per share. A total of 13,525 stock options were outstanding, representing 0.2% of our total number of shares issued as of December 31, 2009, all of which were issued to a total of 62 eligible employees.

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The table below set forth information on the stock options outstanding as of March 31, 2010 that we had granted to our directors and executive officers listed in ITEM 6.A.

Executive Officers and Directors	Grant Date	Exercise Price	Number of Options Granted	Expiration Date	Number of Exercisable Options
Heung Gon Kim	December 24, 2004	Won 45, 431	250	December 23, 2010	250

Other than Mr. Heung Gon Kim, our Chief Financial Officer, none of our current directors or executive officers as listed in ITEM 6.A. has options to purchase our common shares.

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, 2010, 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, 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 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

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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 19.47% held by Heartis and 14.55% 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 directly owns 0.18% of GungHo. Thus, Taizo Son directly and indirectly owns or controls 34.2% 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 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 JPY4,035,180,549.

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.

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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 MARKETS Overseas markets and ITEM 10.C. MATERIAL CONTRACTS.

To the best of our knowledge, as of December 31, 2009, approximately 45.5% of our common shares were held in the United States (in the form of common shares or ADSs). Also to the best of our knowledge, we had approximately 1,374 beneficial holders of our shares (in the form of ADSs) in the United States as of December 31, 2009.

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, 2010, 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. The trade accounts receivable due from GungHo as of December 31, 2007, December 31, 2008 and December 31, 2009 amount to Won 1,613 million, Won 3,291 million and Won 2,377 million, respectively.

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 amended in 2006 and 2009. In January 2010, we entered into an agreement with Game Arts Co., Ltd., a 64.98% owned subsidiary of GungHo, to develop a console game based on one of our online games.

Mr. Toshiro Ohno, our Chief Executive Officer, President, Chairman of the Board of Directors, Mr. Yoshinori Kitamura, our Executive Director and Chief Operating Officer, Mr. Kazuki Morishita, our Executive Director and Mr. Kazuya Sakai, our Executive Director, have been an Executive Officer, Director and Executive General Manager, President and Chief Executive Officer, and Director and Chief Financial 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 33.8% 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 34.2% 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

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company, operates the fund as the general partner. As a limited partner, we do not have a significant influence over the fund's investment decisions. The fund has a term of five years from the effective date, which is January 1, 2006. As of December 31, 2009, the Company, SoftBank and GungHo had interests of 16.39%, 49.18% and 8.20%, respectively, in the fund. We have 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 currently represents 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 hereof, we have invested a total of JPY910 million, which represents 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 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.

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.

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 is already commercially offered by Gravity CIS and to change the term of royalty payment remittance from monthly to quarterly basis. Mr. Toshiro Ohno, our Chief Executive Officer, President and Chairman of the Board of Directors, and Mr. Yoon Seok Kang, our Chief Executive Officer, are Directors and Mr. Yoshinori Kitamura, our Executive Director and Chief Operating Officer, is Chief Executive Officer of Gravity Interactive.

Relationship with L5 Games Inc.

In October 2007, we formed L5 Games Inc., which is a wholly-owned subsidiary of Gravity Interactive. L5 Games went into liquidation proceedings in August 2008.

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 Japanese Yen 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.

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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 Japanese Yen 117 million plus a 5% tax, amounting to Japanese Yen 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, 2009, the amount due and payable to the joint venture by Gravity Entertainment amounted to Japanese Yen 15 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. Yoon Seok Kang, our Chief Executive Officer, and Mr. Kazuya Sakai, our Executive Director, have been Directors and Mr. Yoshinori Kitamura, our Executive Director and Chief Operating Officer, has been Chief Executive Officer of Gravity Entertainment.

Relationship with TriggerSoft Corporation

We acquired 88.15% of the outstanding common shares of TriggerSoft for an aggregate purchase price of Won 1,627 million in April and May 2005. We made loans in the amount of Won 1,050 million and Won 940 million to TriggerSoft, the developer of R.O.S.E. Online game, at an annual interest rate of 9% payable monthly in arrears in 2005 and 2006, respectively. We made additional loans in the amount of Won 185 million in 2007. TriggerSoft went into liquidation in May 2007 and the liquidation was completed in October 2007. TriggerSoft defaulted on the Company's loans in October 2007. All the rights of R.O.S.E. Online were transferred to us in October 2007.

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. In February 2008, we entered into a subletting agreement with NeoCyon to sublease 3,914 square feet of office space to NeoCyon. Mr. Yoon Seok Kang, our Chief Executive Officer, has been a Director, and Mr. Yoshinori Kitamura, our Executive Director and Chief Operating Officer, has been Chief Executive Officer of NeoCyon.

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 extended a loan in the amount of US\$1.5 million to Gravity CIS on February 28, 2006 and made additional loans 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 2010. As of March 31, 2010, 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, Belorussia, 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 Armenia, Azerbaijan, Belorussia, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan,

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which was amended to change the term of royalty payment remittance from a monthly basis to a quarterly basis in July 2008. Mr. Chang Ki Kim, our general manager, 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

In August 2006, we founded Gravity EU, 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. In June 2008, an amendment was made to include the United Kingdom, Finland, Sweden, Norway, Ireland, Scotland, Denmark and Spain as service countries. We made a loan in the amount of EUR188,650 to Gravity EU 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 and in the amount of EUR50,000 on February 18, 2010 at an annual interest rate of 4.8% payable monthly in arrears. As of March 31, 2010, the total outstanding loan amounts to Gravity EU were EUR438,650. Mr. Chang Ki Kim, our general manager, has been the Chief Executive Officer of Gravity EU.

Relationship with Gravity Middle East & Africa FZ-LLC

In May 2007, we founded Gravity Middle East & Africa, a wholly owned Dubai-based subsidiary. In November 2005, an agreement with Sento Enterprises Limited for the service and distribution of Ragnarok Online in United Arab Emirates, Saudi Arabia, Kuwait, Qatar, Bahrain, Oman, Yemen, Iraq, Syria, Egypt, Iran, Israel, Lebanon and Jordan, which was entered into in May 2005, was amended with the distributor to exclude Iran and Syria. In May 2007, the agreement was transferred to Gravity Middle East & Africa. Gravity Middle East & Africa went into liquidation proceedings in September 2008 and the distribution agreement was terminated.

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

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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 current and 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 Won 623 million to YNK Korea Inc. upon the first trial decision in November 2007. The case was transferred to Seoul High Court in January 2008 and the Court rendered a decision that YNK Korea Inc. repay Won 35 million and interest to us out of Won 623 million, which was paid by us, in December 2009. 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 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 and May 2010, a former executive of our Company filed lawsuits with the Seoul Central District Court and Seoul Western District Court claiming employment termination without cause and seeking payment of compensation which he claims he is entitled to under a certain employment agreement with the Company. The Company intends to vigorously defend this action.

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

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.

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

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be made in the following year after approval by our shareholders at the annual general meeting of shareholders, 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. 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 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, 2010, 12,643,528 ADSs representing 3,160,882 shares of our common stock were outstanding.

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The table below shows the high and low trading prices on the NASDAQ Global Market for the outstanding ADSs since February 8, 2005.

Period	Price	
	High	Low
	(In US\$)	
2005	13.77	5.30
2006	9.88	4.80
2007	7.25	2.75
First Quarter	6.55	5.42
Second Quarter	7.25	5.57
Third Quarter	6.50	3.63
Fourth Quarter	4.31	2.75
2008	3.50	0.36
First Quarter	3.50	1.38
Second Quarter	2.00	1.00
Third Quarter	1.99	0.80
Fourth Quarter	1.14	0.36
2009	2.63	0.50
First Quarter	0.90	0.50
Second Quarter	1.22	0.64
Third Quarter	2.63	1.00
Fourth Quarter	2.08	1.32
October	2.08	1.51
November	1.60	1.36
December	1.72	1.32
2010 (through May 21, 2010)	2.25	1.56
First Quarter	2.10	1.56
January	2.00	1.56
February	2.10	1.83
March	2.05	1.60
April	2.25	1.84
May (through May 21, 2010)	2.05	1.75

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.

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ITEM 9.F. EXPENSES OF THE ISSUE

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

ITEM 10.A. SHARE CAPITAL

Not applicable.

ITEM 10.B. 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 non-voting preferred shares, each with a par value of Won 500 per share. Under our articles of incorporation, holders of non-voting 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 non-voting 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.

We may declare dividends at the annual general meeting of shareholders which is held within three months after the end of each fiscal year. We may pay the annual dividend shortly after the annual general meeting declaring such dividends. We may distribute the annual dividend in cash or in shares. 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 legal reserve accumulated up to the end of the relevant dividend period and (iii) the legal reserve to be set aside for the annual dividend. We may not pay an annual dividend unless we have set aside as legal reserve an amount equal to at least 10% of the cash portion of the annual dividend, or unless we have an accumulated legal 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.

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. Unlike annual dividends, the decision to pay interim dividends can be made by a resolution of the Board of Directors and is not subject to shareholder approval. Any interim dividends must be paid in cash to the shareholders of record as of June 30 of the relevant fiscal year.

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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 legal reserves accumulated up to the immediately preceding fiscal year, (iii) the amount of earnings for dividend payments confirmed at the general meeting of shareholders with respect to the immediately preceding fiscal year, (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 and (v) the amount of legal reserves that should be set aside for the current fiscal year following the interim dividend payment. 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 legal 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 at the times and, unless otherwise provided 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 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 depository receipts of no more than 50% of the total number 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 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 an alliance arrangement with us; or

- by a public offering or to cause the underwriters to underwrite new shares for the purpose of listing them on any stock exchange of no more than 50% of the total number issued and outstanding shares.

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 depositary will be treated as the shareholder entitled to preemptive rights.

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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 law 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 non-voting preferred shares, unless enfranchised, are not entitled to receive notice of or vote at the general meeting of shareholders.

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

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 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;

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;

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

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

In general, holders of non-voting 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 non-voting preferred shares, approval of the holders of such class of shares is

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required. We must obtain the approval, by a resolution, of holders of at least two-thirds of the non-voting 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 non-voting preferred shares as provided in our articles of incorporation, the holders of non-voting preferred shares will become enfranchised and will be entitled to exercise voting rights until the dividends are paid. The holders of enfranchised non-voting 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 significant part of 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 dissenter's 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.

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 non-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.

Transfer of shares

Except for the procedural requirements which obligate a non-citizen or non-residents 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

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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, Korean securities companies and banks, including licensed branches of non-Korean securities companies and banks, investment trust companies, futures trading companies, 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

We may not acquire our own common shares except in limited circumstances, such as reduction of capital and acquisition of our own common shares for the purpose of granting stock options to our officers and employees. Under the Korean Commercial Code, except in the case of a capital reduction (in which case we must retire the common shares immediately), we must resell any common shares acquired by us to a third party (including to a stock option holder who exercised his or her stock option) within a reasonable time. 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-residents 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 only 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.

ITEM 10.C. MATERIAL CONTRACTS

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.

Fourth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated September 1, 2009 between Gravity Interactive, Inc. and Gravity Co., Ltd.

Under this amendment, the serviced countries were expanded to include India.

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Amendment to the 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2009 between GungHo Online Entertainment, Inc. and Gravity Co., Ltd.

Under this amendment with our licensee in Japan, the term of the Ragnarok Online License and Distribution Agreement was extended to September 28, 2012 for a renewal license fee of US\$1,200,000 and a monthly royalty payment of 40% of the licensee's net revenue amount from Ragnarok Online. The licensee also agreed to make a commercially reasonable effort to spend a minimum of JPY200,000,000 for each year after the execution date of the amendment for the advertisement and promotion of Ragnarok Online in Japan. We agreed to reimburse 50% of the marketing expenses paid by the licensee in excess of the minimum required spending of JPY200,000,000 per year and such reimbursement will not exceed JPY120,000,000 in any given year.

Fifth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated October 1, 2009 between Gravity Interactive, Inc. and Gravity Co., Ltd.

Under this amendment, the royalty payment term was changed to a quarterly basis.

Second Amendment to the Ragnarok Online Software License Agreement dated October 9, 2009 between Game Flier (Malaysia) Sdn. Bhd. and Gravity Co., Ltd.

Under this amendment with our licensee in Singapore and Malaysia, the term of the Ragnarok Online Software License Agreement was extended to October 8, 2011. The amendment also increased monthly royalty payment from 30% to 33% of the licensee's service sales amount from Ragnarok Online.

Ragnarok Online Exclusive Game License Agreement dated October 22, 2009 between Game Flier International Corporation and Gravity Co., Ltd.

On October 22, 2009, we entered into an agreement with Game Flier International Corporation, our licensee in Taiwan, Hong Kong and Macau, under which we granted Game Flier International Corporation an exclusive license to distribute Ragnarok Online in Taiwan, Hong Kong and Macau for an initial license fee of US\$150,000 and a monthly royalty payment of 33% of the licensee's service sales amount from Ragnarok Online. The term of the agreement is two years from the execution date of the agreement.

First Amendment to Exclusive Requiem Online License and Distribution Agreement dated December 1, 2009 between Gravity Interactive, Inc. and Gravity Co., Ltd.

Under this amendment, the serviced countries were expanded to include 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. The amendment also increased royalty payments from 25% to 28% of the licensee's service sales amount from Requiem, which was changed to be paid on a quarterly basis.

Global Service Agreement dated December 1, 2009 between AsiaSoft Corporation Public Co., Ltd. and Gravity Co., Ltd.

On December 1, 2009, we entered into an agreement with AsiaSoft Corporation Public Co., Ltd., our consignee in Thailand, under which we consigned marketing, billing, operating and customer service of Requiem in Thailand, Singapore, Vietnam and Malaysia to AsiaSoft Corporation Public Co., Ltd. We agreed to pay 50% of the gross sales

amount from Requiem as compensation and the consignee agreed to pay us the gross sales amount net of their compensation. Under the agreement, the gross sales amount is to be recognized as our sales amount in whole and only the compensation is to be recognized as revenue of the consignee. The term of the agreement is two years from the commercial launch date of Requiem in any of the Thailand, Singapore, Vietnam and Malaysia markets.

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Fifth Amendment to the Exclusive Ragnarok License and Distribution Agreement dated February 1, 2010 between Burda:ic GmbH and Gravity Co., Ltd.

Under this amendment with our licensee in Germany, Austria, Switzerland, Italy and Turkey, the term of the original agreement was extended to October 14, 2010.

Global Service Agreement dated February 2, 2010 between PT. Lyto Datarindo Fortuna and Gravity Co., Ltd.

On February 2, 2010, we entered into an agreement with PT. Lyto Datarindo Fortuna, our consignee in Indonesia, under which we consigned marketing, billing, operating and customer service of Requiem in Indonesia to PT. Lyto Datarindo Fortuna. We agreed to pay 50% of the gross sales amount from Requiem as compensation and the consignee agreed to pay us gross sales amount net of their compensation. Under the agreement, the gross sales amount is to be recognized as our sales amount in whole and only the compensation is to be recognized as revenue of the consignee. The term of the agreement is two years from the commercial launch date of Requiem in Indonesia.

Ragnarok Online Game License Agreement dated February 27, 2010 between PT. Lyto Datarindo Fortuna and Gravity Co., Ltd.

On February 27, 2010, we entered into an agreement with PT. Lyto Datarindo Fortuna, our licensee in Indonesia, under which we granted PT. Lyto Datarindo Fortuna an exclusive right to license the distribution rights for Ragnarok Online in Indonesia for an initial license fee of US\$50,000 and a monthly royalty payment of 32% of the licensee's service sales amount from Ragnarok Online. The licensee agrees to spend a minimum of US\$150,000 for each year after the execution date of the agreement for marketing of Ragnarok Online in Indonesia. The term of the agreement is two years from the execution date of the agreement, subject to renewal for a one-year term and during the one-year additional term, the monthly royalty payment is 34% of the licensee's service sales amount from Ragnarok Online.

Second Amendment to the Exclusive Requiem Online License and Distribution Agreement dated March 1, 2010 between Gravity Interactive, Inc. and Gravity Co., Ltd.

Under this amendment, the serviced countries were changed to exclude Moldova.

Exclusive Requiem Online License and Distribution Agreement dated March 2, 2010 between Game Flier International Corporation and Gravity Co., Ltd.

On March 2, 2010, we entered into an agreement with Game Flier International Corporation, our licensee in Taiwan, Hong Kong and Macau, under which we granted Game Flier International Corporation an exclusive right to license the distribution rights for Requiem in Taiwan, Hong Kong and Macau for an initial license fee of US\$300,000, a minimum guaranteed payment of US\$300,000 and a monthly royalty payment of 20% of the licensee's gross sales amount from Requiem. The term of the agreement is three years from the date of commercial service of Requiem in Taiwan, Hong Kong and Macau.

Exclusive Ragnarok Online License and Distribution Agreement dated March 5, 2010 between AsiaSoft Corporation Public Co., Ltd. and Gravity Co., Ltd.

On March 5, 2010, we entered into an agreement with AsiaSoft Corporation Public Co., Ltd., our licensee in Thailand, under which we granted AsiaSoft Corporation Public Co., Ltd. an exclusive right to license the distribution rights for Ragnarok Online in Thailand for a technical support service maintenance fee of US\$50,000 and a monthly royalty payment of 35% of the licensee's gross sales amount from Ragnarok Online. The licensee agrees to spend a minimum of US\$50,000 for each year after the execution date of the agreement for marketing of Ragnarok Online in Thailand.

The term of the agreement is two years from the execution date of the agreement.

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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.

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,

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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 accounts, these investment brokers or investment traders may enter into foreign exchange transactions on a limited basis, such as 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.

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

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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 National Tax Service in 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 resident surtax). 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, such evidence of tax residence as the Korean tax authorities may require in order to establish your entitlement to the 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 National Tax Service 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 depository 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 National Tax Service in Korea (currently, only Labuan, Malaysia) and has not acquired prior approval of the Commissioner, capital gains earned by such non-resident

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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 resident surtax) of the gross proceeds realized and (ii) 22.0% (including resident surtax) 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 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 depository 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 to a non-resident individual and non-Korean corporation overseas, or (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.

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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 resident surtax) of the gross realization proceeds and (ii) 22.0% (including resident surtax) 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 depository, 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 National Tax Service 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 resident surtax, 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 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

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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 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 (according to the legislative bill submitted by the government to the National Assembly on September 22, 2009, it was proposed to add transfer of ETF (Exchange Traded Fund) as a transaction subject to the securities transaction tax beginning in 2012, in addition to the current taxable transactions including transfer of share certificates and shares; however, the bill is still pending in the National Assembly). However, in the event of the transfer of share certificates listed in overseas securities markets such as the New York Stock Exchange or NASDAQ that is similar to the Korean securities market, 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

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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 under taxable share certificates pursuant to the Securities Transaction Tax Act can be determined by looking at the depositary receipts, in which the ADSs fall under. The depositary receipts constitute share certificates subject to the securities transaction tax according to the 2004 tax ruling; provided that, under the Securities Transaction Tax Law, the transfer of depositary receipts listed on, among others, the New York Stock Exchange or NASDAQ is exempt from the securities transaction tax.

According to tax rulings issued by the Korean tax authorities in 2000 and 2002, foreign stockholders are not subject to securities transaction tax upon the deposit of underlying share and receipt of depositary securities or upon the surrender of depositary securities and withdrawal of the originally deposited underlying share, but there remained uncertainties as to whether holders of ADSs other than initial holders will not be subject to securities transaction tax when they withdraw common shares upon surrendering the ADSs. However, the holding of the 2004 tax ruling referred to above seems to view the ADSs as the underlying shares at least for the purpose of the securities transaction tax and, though not specifically stated, could be read to imply that the securities transaction tax should not apply to deposits of common shares in exchange of ADSs or withdrawals of common shares upon surrender of the ADSs regardless of whether the holder is the initial holder because the transfer of ADSs by the initial holder to a subsequent holder would have already been subject to securities transaction tax under such tax ruling.

However, the administrative court ruling rendered in 2007 provides that even if the nature of depositary receipts is similar to that of share certificates, depositary receipts are not share certificates. Therefore, the transfer of depositary receipts is not subject to securities transaction tax as they are not considered to be share certificates. In other words, because depositary receipts are not taxable share certificates pursuant to the Securities Transaction Tax Act, securities transaction tax is not imposed. Also, with respect to a transfer transaction in which the holder of the ADSs converts them into common shares, since the subject of the transfer is not classified as shares, it is not subject to securities transaction tax from the viewpoint of the transferor.

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.

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;

grantor trusts;

certain former citizens or residents of the United States;

insurance companies;

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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 passive foreign investment company 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 passive foreign investment company in 2008 and 2009, and there is a significant risk that we will continue to be one in 2010. See discussion under ITEM 10.E. TAXATION U.S. FEDERAL INCOME TAX CONSIDERATIONS Passive foreign investment companies.

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;

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.

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

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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.

Passive foreign investment companies

In general, we will be a passive foreign investment company (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 and 2009, and there is a significant risk that we will continue to be a PFIC in 2010. If we are a PFIC for any taxable year during which you hold our ADSs or common shares, you could be subject to adverse U.S. federal income tax consequences 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. Distributions received in a taxable year that are greater than 125% of the average annual distributions received

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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, 2011. If we are a PFIC, you will be required to file Internal Revenue Service Form 8621 for each taxable year in which, among other circumstances, you receive a distribution with respect to our ADSs or common shares.

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.

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 Internal Revenue Service 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 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 depositary, 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, 2011 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

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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 Korea-United States income tax treaty 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 amount of any distribution exceeds our current and accumulated earnings and profits for a taxable year, as determined under U.S. federal income tax principles, the distribution will first be treated as a tax-free return of capital, causing a reduction in the adjusted basis of our ADSs or common shares (thereby increasing the amount of gain, or decreasing the amount of loss, to be recognized by you on a subsequent disposition of our ADSs or common shares), and the balance in excess of adjusted basis will be taxed as capital gain recognized on a sale or exchange. 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. 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 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

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of stock in a PFIC, and otherwise unrecognized gain will be recognized and treated as an excess distribution. See ITEM 10.E. TAXATION 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 Internal Revenue Service 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.

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.

Information Reporting Regarding PFICs and Specified Foreign Financial Assets

Congress recently enacted the Hiring Incentives to Restore Employment Act (the Act). Under 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, which took effect on March 18, 2010, 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.

In Notice 2010-34, the IRS advised that it is developing further guidance regarding the PFIC reporting obligations under the Act and that, in the meantime, U.S. Holders that were not otherwise required to file an annual report prior to March 18, 2010, will not be required to file an annual report as a result of the Act for taxable years beginning before March 18, 2010.

The Act also requires individual U.S. Holders with an interest in a specified foreign financial asset to file a report to the IRS with information relating to the asset and the maximum value thereof during the taxable for any

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year in which the aggregate value of all such assets is greater than \$50,000 (or such higher dollar amount as prescribed by Treasury regulations). 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, (i) any stock or security issued by a non-United States person, (ii) any financial instrument or contract held for investment where the issuer or counterparty is a non-United States person, and (iii) any interest in an entity which is a non-United States person. Depending on the aggregate value of your investment in specified foreign financial assets, you may be obligated to file an annual report under this provision. The requirement to file a report is effective for taxable years beginning after March 18, 2010. Penalties apply to any failure to file a required report.

In the event a U.S. Holder does not file the information reports described above relating to ownership of a PFIC or disclosure of specified foreign financial assets, 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 will not close before such report is filed.

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.

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 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 Internal Revenue Service.

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.

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.

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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, 2009, we had Japanese Yen denominated accounts receivable of Won 2,138 million, which represented 36.17% of our total consolidated accounts receivable balance, and U.S. dollar denominated accounts receivable of Won 963 million, which represented 16.29% of our total consolidated accounts receivable balance. We also had Japanese Yen denominated accounts payable of Won 635 million, which represented 19.81% of our total consolidated accounts payable balance, and U.S. dollar denominated accounts payable of Won 307 million, which represented 9.59% 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 216 million.

In 2009, Won 45,860 million of our revenue was derived from currencies other than the Won: primarily the Japanese Yen, Won 31,991 million; the NT dollar, Won 1,613 million; the Thai Baht, Won 1,150 million; and the U.S. dollar, Won 5,800 million. A hypothetical 10% depreciation in the exchange rates of these foreign currencies against the Won in 2009 would have reduced our revenue by Won 4,055 million.

Since 2005, we have begun entering into derivatives arrangements to hedge against the risk of foreign currency fluctuation. As of March 31, 2010, 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. dollars, Japanese Yen or EMU Euros 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 24% 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

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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

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

Fees and Charges Our ADS holders May Have to Pay

The Bank of New York Mellon, the depositary 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 depositary 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 depositary may collect its annual fee for depositary 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.

Persons depositing or withdrawing shares must pay:	For:
\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	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
\$.02 (or less) per ADS	Any cash distribution to ADS registered holders
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	Distribution of securities distributed to holders of deposited securities which are distributed by the depositary to ADS registered holders
\$.02 (or less) per ADSs per calendar year	Depositary services
Registration or transfer fees	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

Expenses of the depositary

Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)

Converting foreign currency to U.S. dollars

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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 As necessary

Any charges incurred by the depositary or its agents for servicing the deposited securities As necessary

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, 2009 to December 31, 2009, the Company received no reimbursement from the depositary, while the depositary waived fees for the standard costs associated with the administration of the ADR estimated to total US\$46,473.52.

From January 1, 2010 to the date of this Annual Report, the Company received from the depositary US\$34,640.58 for legal fees, after deducting the applicable withholding tax from the total amount payable by the depositary of US\$48,000.

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, 2009. Based on this evaluation and as a result of the material weakness discussed below, our Chief Executive Officer and Chief Financial Officer have

concluded that our disclosure controls and procedures were not effective as of December 31, 2009. 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. Due to the material weakness described below, we performed additional analysis, additional closing procedures, and other post-closing procedures to ensure that our consolidated financial statements were

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prepared in accordance with generally accepted accounting principles. Accordingly, our management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

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 (1) pertain to the maintenance of records, that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (2) 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 (3) 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, 2009, based upon criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented or detected on a timely basis. In connection with our management's evaluation of our internal control over financial reporting described above, our management has identified the following material weakness in our internal control over financial reporting as of December 31, 2009.

Lack of monitoring controls over significant transactions at a subsidiary level.

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

This material weakness could result in a misstatement of the aforementioned accounts and disclosures that would result in a material misstatement to our consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

Because of the material weakness described above, our management has concluded that we did not maintain effective internal control over financial reporting as of December 31, 2009, based on the Internal Control – Integrated Framework issued by the COSO.

Attestation Report of the Registered Public Accounting Firm

The effectiveness of our internal control over financial reporting as of December 31, 2009 has been audited by Samil PricewaterhouseCoopers, an independent registered public accounting firm, as stated in their report which is included in ITEM 19 of this Form 20-F.

Remediation of Material Weakness in Internal Control over Financial Reporting

As of the date of the filing of this annual report, our management, including our Chief Executive Officer and Chief Financial Officer and the Audit Committee, have established a plan of actions to address the material

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weakness in our internal control over financial reporting, including implementing new controls that requires pre-approval from the Chief Financial Officer of Gravity for all significant payments of subsidiaries and the performance of regular monitoring of subsidiaries treasury cycle activities by Gravity's headquarter finance team.

We believe these steps will enable us to remediate the material weakness reported as of December 31, 2009. As part of our 2010 assessment of internal control over financial reporting, our management will conduct sufficient testing and evaluation of the control to be implemented as part of this remediation plan to ascertain that they are designed and operate effectively.

Changes in Internal Control over Financial Reporting

In our consolidated financial statements as of and for the year ended December 31, 2008, our management identified a material weakness in our internal control over financial reporting related to lack of controls over equity method investments. To address this material weakness, our management, in 2009, implemented a number of measures to rectify the material weakness including preparing a review checklist on the financial statements of our equity method investments and performing a regular interview and review process with the management of the entity accounted for under the equity method to understand the investee's accounting policy and to ensure the completeness and accuracy of GAAP conversion process to identify any potential GAAP difference for material transactions.

As of December 31, 2009, our management determined that the remediation measures undertaken to improve our internal control over financial reporting have enabled it to conclude that the material weakness identified in 2008 has been remediated.

Other than remediation of the prior year material weakness described above and the material weakness over monitoring controls over significant transactions at a subsidiary level, there have been no other changes in our internal control over financial reporting during the year ended December 31, 2009 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

In addition, the Company enhanced certain internal controls related to treasury cycle activities at the subsidiary level, and the related controls over approval and internal reporting procedures.

ITEM 16. RESERVED

ITEM 16.A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Mr. Phillip Young Ho Kim, 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. Kim 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 16.B. 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 16.C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees billed for each of the years ended December 31, 2008 and 2009 for professional services rendered by our principal accountants Samil PricewaterhouseCoopers, the Korean

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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, 2008 2009		Nature of Services
	(In millions of Won)		
Audit Fees	495	495	Audit service for the Company and its subsidiaries.
Audit-Related Fees		25	Accounting advisory service.
Tax Fees			
All Other Fees			
Total	495	520	

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 16.D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16.E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

ITEM 16.F. CHANGE IN REGISTRANT S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16.G. CORPORATE GOVERNANCE

See ITEM 6.C. BOARD PRACTICES.

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 schedules filed as part of this annual report.

Table of Contents**ITEM 19. EXHIBITS***(a) Financial Statements filed as part of this annual report*

The following financial statements and related schedules, together with the reports of independent accountants 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, 2008 and 2009</u>	F-4
<u>Consolidated Statements of Operations for the years ended December 31, 2007, 2008 and 2009</u>	F-5
<u>Consolidated Statements of Changes in Equity for the years ended December 31, 2007, 2008 and 2009</u>	F-6
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2008 and 2009</u>	F-8
<u>Notes to Consolidated Financial Statements</u>	F-9

(b) Exhibits filed as part of this annual report

- 1.1^{◇◇} Articles of Incorporation, amended as of June 12, 2009 (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)
- 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)
- 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

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- 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
- 4.28 Exclusive Ragnarok License and Distribution Agreement, dated August 15, 2004, between Level Up! Interactive SA (licensee in Brazil) and Gravity Co., Ltd.
- 4.29* Exclusive Ragnarok Software License Agreement, dated May 24, 2004, between Level Up Network India Pvt. Ltd. (licensee in India) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd. and Meritz Fire & Marine Insurance Co., Ltd.

4.38 Real Estate Sale Agreement, dated May 22, 2006, between Gravity Co., Ltd. and Yahooh Communication Ltd.

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- 4.39 Global Publishing Agreement, dated November 7, 2005, between Gravity Co., Ltd. and Ndoors Corporation.
- 4.40 Global Publishing Agreement, dated November 15, 2005, between Gravity Co., Ltd. and Sonnori Co., Ltd.
- 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 Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4.43 Exclusive Ragnarok Online Software License Agreement dated April 9, 2006 between Game Flier (Malaysia) Sdn. Bhd. (licensee in Malaysia and Singapore) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4.45 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2006 between GungHo Online Entertainment, Inc. (licensee in Japan) and Gravity Co., Ltd.
- 4.46 Agreement on Changes of the Global Publishing Contract dated October 9, 2006 between Ndoors Corporation (developer of Time N Tales) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4.48 Agreement on Changes of the Lease Contract dated January 8, 2007 between Meritz Fire & Marine Insurance Co., Ltd. and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4..51[◇] Exclusive Ragnarok Online 2 License and Distribution Agreement dated October 15, 2007, between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4..53[◇] Exclusive Requiem Online License and Distribution Agreement dated December 1, 2007, between Gravity CIS, Inc. (licensee in Russia and CIS countries) and Gravity Co., Ltd.
- 4..54[◇] Lease Agreement dated January 1, 2008, between Korea SW Industry Promotion Agency and Gravity Co., Ltd.
- 4..55[◇] Second Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated January 1, 2008, between Gravity Interactive, Inc. (licensee in the United States and Canada) 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 Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4..58[◇] Exclusive Pucca Racing License and Distribution Agreement dated January 23, 2008, between Ini3 Digital Co., Ltd. (licensee in Thailand), Vooz Co., Ltd. (character licensor) and Gravity Co., Ltd.
- 4..59[◇] Exclusive Requiem Online License and Distribution Agreement dated February 21, 2008, between Gravity Interactive, Inc. (licensee in the United States and Canada) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.

4.61⁰⁰ Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated March 4, 2008 between AsiaSoft Corporation Public Co., Ltd. (licensee in Thailand) and Gravity Co., Ltd.
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- 4.62⁰⁰ 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 Gravity Co., Ltd.
- 4.63⁰⁰ Assignment of Agreement dated May 30, 2008, among Level Up! Network India Pvt. Ltd., Level Up! International Holdings Pte. Ltd. (licensees in India) and Gravity Co., Ltd.
- 4.64⁰⁰ First Amendment to the Exclusive Ragnarok Software License Agreement dated June 1, 2008, between Gravity EU SASU (licensee in France and 9 other European countries) and Gravity Co., Ltd.
- 4.65⁰⁰ Exclusive Ragnarok Online License and Distribution Agreement dated July 2, 2008, between AsiaSoft Corporation Public Co., Ltd. (licensee in Vietnam) and Gravity Co., Ltd.
- 4.66⁰⁰ First Amendment to the Exclusive Emil Chronicle Online License and Distribution Agreement dated July 4, 2008, between Infocomm Asia Holdings Pte. Ltd. and Gravity Co., Ltd.
- 4.67⁰⁰ 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 Gravity Co., Ltd.
- 4.68⁰⁰ Exclusive Ragnarok Online License and Distribution Agreement dated September 1, 2008, between Level Up! Inc. (licensee in the Philippines) and Gravity Co., Ltd.
- 4.69⁰⁰ 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 Gravity Co., Ltd.
- 4.70⁰⁰ Third Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated January 1, 2009, between Gravity Interactive, Inc., (licensee in the United States, Canada, Australia and New Zealand) and Gravity Co., Ltd.
- 4.71⁰⁰ Exclusive Ragnarok Online License and Distribution Agreement dated January 21, 2009, between Tahadi Games Ltd. (licensee in UAE and 19 other countries) and Gravity Co., Ltd.
- 4.72⁰⁰ Exclusive Emil Chronicle Online License and Distribution Agreement dated February 26, 2009, between PT. Wave Wahana Wisesa (licensee in Indonesia) and Gravity Co., Ltd.
- 4.73⁰⁰ Exclusive Ragnarok Authorization and Distribution Agreement dated March 2, 2009, between Level Up! Interactive S.A (licensee in Brazil) and Gravity Co., Ltd.
- 4.74⁰⁰ Seventh Amendment to the Exclusive Ragnarok Online License and Distribution Agreement, dated March 7, 2009, between Gravity CIS, Inc. (licensee in Russia and CIS countries) and Gravity Co., Ltd.
- 4.75⁰⁰ 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. (licensee in the United States, Canada, Australia, New Zealand and India) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4.78 Fifth Amendment to the Exclusive Ragnarok Online License and Distribution Agreement dated October 1, 2009 between Gravity Interactive, Inc. (licensee in the United States, Canada, Australia, New Zealand and India) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4.81 First Amendment to Exclusive Requiem Online License and Distribution Agreement dated December 1, 2009 between Gravity Interactive, Inc. (licensee in the United States, Canada and 40 European countries) and Gravity Co., Ltd.
- 4.82 Global Service Agreement dated December 1, 2009 between AsiaSoft Corporation Public Co., Ltd., (consignee in Thailand, Singapore, Vietnam and Malaysia) and Gravity Co., Ltd.

- 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 Gravity Co., Ltd.

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- 4.84 Global Service Agreement dated February 2, 2010 between PT. Lyto Datarindo Fortuna (consignee in Indonesia) and Gravity Co., Ltd.
- 4.85 Ragnarok Online Game License Agreement dated February 27, 2010 between PT. Lyto Datarindo Fortuna (licensee in Indonesia) and Gravity Co., Ltd.
- 4.86 Second Amendment to the Exclusive Requiem Online License and Distribution Agreement dated March 1, 2010 between Gravity Interactive, Inc. (licensee in the United States, Canada and 39 European countries) and Gravity Co., Ltd.
- 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 Gravity Co., Ltd.
- 4.88 Exclusive Ragnarok Online License and Distribution Agreement dated March 5, 2010 between AsiaSoft Corporation Public Co., Ltd., (licensee in Thailand) and Gravity Co., Ltd.
- 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 CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 12.3 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 CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 13.3 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)

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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.

Name: Heung Gon Kim

By: /s/ Heung Gon Kim

Title: Chief Financial Officer

Date: June 1, 2010

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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, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, because a material weakness in internal control over financial reporting related to the design and operation of monitoring controls over significant transactions at a subsidiary level existed as of that date. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness referred to above is described in the accompanying Management's Annual Report on Internal Control over Financial Reporting appearing under Item 15. We considered this material weakness in determining the nature, timing, and extent of audit tests applied in our audit of the 2009 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing under Item 15. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for noncontrolling interests in 2009.

A company's 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 generally accepted accounting principles. A company's 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 the assets of the company; (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 receipts and expenditures of the company are being made only in accordance

with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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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.

/s/ Samil PricewaterhouseCoopers
Samil PricewaterhouseCoopers

Seoul, KOREA
June 1, 2010

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Table of Contents**GRAVITY CO., LTD.****CONSOLIDATED BALANCE SHEETS
December 31, 2008 and 2009**

	2008	2009	2009 (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	₩ 53,168	₩ 51,333	\$ 45,379
Short-term financial instruments	7,278	16,000	14,144
Short-term available-for-sale investments (accounted for using fair value option)		4,973	4,396
Accounts receivable, net (including related party balances of ₩3,291 and ₩2,377, respectively)	6,540	5,907	5,222
Current portion of deferred income tax assets		375	332
Other current assets (including related party balances of ₩20 and ₩41, respectively)	5,564	4,311	3,811
Total current assets	72,550	82,899	73,284
Property and equipment, net	5,226	2,837	2,508
Leasehold and other deposits	1,501	1,496	1,322
Intangible assets	12,605	12,455	11,011
Equity method investments	2,420	1,100	972
Deferred revenue tax assets	207		
Other non-current assets (including related party balances of ₩47 and ₩55, respectively)	1,426	1,651	1,460
Total assets	₩ 95,935	₩ 102,438	\$ 90,557
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable (including related party balances of ₩402 and ₩507, respectively)	₩ 3,093	₩ 3,205	\$ 2,833
Deferred revenue (including related party balances of ₩630 and ₩606, respectively)	3,286	3,750	3,315
Current portion of deferred income tax liabilities	18		
Other current liabilities	2,000	1,293	1,143

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Total current liabilities	8,397	8,248	7,291
Long-term deferred income (including related party balances of ₩4,828 and ₩5,495, respectively)	9,839	9,658	8,538
Accrued severance benefits	926	478	423
Deferred income tax liabilities		272	240
Other non-current liabilities (including related party balances of ₩9 in 2008)	165	172	152
Total liabilities	19,327	18,828	16,644
Commitments and contingencies			
Parent Company Shareholders' equity:			
Preferred shares, ₩500 par value, 2,000,000 shares authorized, and no shares issued and outstanding at December 31, 2008 and 2009			
Common shares, ₩500 par value, 38,000,000 shares authorized, and 6,948,900 shares issued and outstanding at December 31, 2008 and 2009	3,474	3,474	3,072
Additional paid-in capital	75,247	75,395	66,650
Retained earnings (accumulated deficit)	(5,652)	1,265	1,118
Accumulated other comprehensive income	3,402	3,262	2,884
Total parent company shareholders' equity	76,471	83,396	73,724
Non-controlling interest	137	214	189
Total equity	76,608	83,610	73,913
Total liabilities and equity	₩ 95,935	₩ 102,438	\$ 90,557

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, 2007, 2008 and 2009

	2007	2008	2009	2009 (Note 3) (Unaudited)
	(In millions of Korean Won and in thousands of US dollars except per share data)			
Revenue				
Online games-subscription revenue	₩ 9,405	₩ 12,576	₩ 12,674	\$ 11,204
Online games-royalties and license fees (including related party revenue of ₩16,773, ₩23,326 and ₩28,089, respectively)	24,698	30,110	34,037	30,090
Mobile games (including related party revenue of ₩390, ₩2,309 and ₩2,951, respectively)	4,063	6,882	7,882	6,968
Character merchandising, animation and other revenue (including related party revenue of ₩597, ₩1,089, and ₩947, respectively)	2,063	3,602	2,810	2,484
Total net revenue	40,229	53,170	57,403	50,746
Cost of revenue (including related party cost of ₩86, ₩483 and ₩188, respectively)	19,479	27,772	21,170	18,715
Gross profit	20,750	25,398	36,233	32,031
Selling, general and administrative (including related party expenses of none, ₩121 and ₩482 respectively)	28,159	23,489	21,651	19,140
Research and development	5,761	2,145	1,799	1,590
Impairment losses on investments	8,619			
Impairment losses on intangible assets	871		280	248
Settlement cost of litigation			1,649	1,458
Operating income (loss)	(22,660)	(236)	10,854	9,595
Other income (expenses)				
Interest income	3,041	2,857	2,395	2,117
Interest expense	(92)	(31)	(41)	(36)
Foreign currency income (losses), net	388	3,235	(225)	(199)
Others, net	104	(31)	(21)	(19)
Income (loss) before income tax expenses and equity loss of joint venture and partnership	(19,219)	5,794	12,962	11,458
Income tax expenses	2,916	3,379	4,544	4,017

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Income (loss) before equity loss of related joint venture and partnership	(22,135)	2,415	8,418	7,441
Equity loss of joint venture and partnership(1)	1,026	5,119	1,424	1,259
Net Income (loss)	(23,161)	(2,704)	6,994	6,182
Less: Net income attributable to the non-controlling interest	40	69	77	68
Net Income (loss) attributable to parent company	₩ (23,201)	₩ (2,773)	₩ 6,917	\$ 6,114
Earnings (loss) per share basic and diluted: Net income attributable to parent company common shareholders	₩ (3,339)	₩ (399)	₩ 995	\$ 0.88
Weighted average number of shares outstanding Basic and diluted	6,948,900	6,948,900	6,948,900	6,948,900

(1) See Note 19 for transactions with related party.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**GRAVITY CO., LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**
Years Ended December 31, 2007, 2008 and 2009

	No. of Common Shares (In millions of Korean Won and in thousands of US dollars, except number of shares)	Common Shares	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Non-Controlling Interest in Subsidiary	Total
Balance at January 1, 2007	6,948,900	₩ 3,474	₩ 74,694	₩ 20,322	₩ (377)	₩ 28	₩ 98,141
Amortization of deferred stock Compensation			432				432
Comprehensive income (loss)							
Cumulative effect of foreign currency translation					132		132
Net loss				(23,201)		40	(23,161)
Total comprehensive loss							(23,029)
Balance at December 31, 2007	6,948,900	3,474	75,126	(2,879)	(245)	68	75,544
Amortization of deferred stock Compensation			121				121
Comprehensive income (loss)							
Cumulative effect of foreign currency translation					3,647		3,647
Net income (loss)				(2,773)		69	(2,704)
Total comprehensive income							943
	6,948,900	3,474	75,247	(5,652)	3,402	137	76,608

**Balance at
December 31,
2008**

Amortization of deferred stock Compensation			148					148
Comprehensive income (loss)								
Cumulative effect of foreign currency translation					(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

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**GRAVITY CO., LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Continued)**

	No. of		Additional	Retained	Accumulated	Non-Controlling		
	Common	Common	Paid-in	Earnings	Other	Interest		
	Shares	Shares	Capital	(Accumulated	Income	in		Total
				Deficit)	(Loss)	Subsidiary		
				(Note 3) Unaudited				
	(In thousands of US dollars, except number of shares)							
Balance at								
December 31, 2008	6,948,900	\$ 3,072	\$ 66,519	\$ (4,996)	\$ 3,007	\$ 121		\$ 67,723
Amortization of deferred stock compensation			131					131
Comprehensive income (loss)								
Cumulative effect of foreign currency translation					(123)			(123)
Net income				6,114		68		6,182
Total comprehensive income								6,059
Balance at								
December 31, 2009	6,948,900	\$ 3,072	\$ 66,650	\$ 1,118	\$ 2,884	\$ 189		\$ 73,913

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, 2007, 2008 and 2009

	2007	2008	2009	2009 (Note 3) (Unaudited)
	(In millions of Korean Won and in thousands of US dollars)			
Cash flows from operating activities				
Net income (loss)	₩ (23,161)	₩ (2,704)	₩ 6,994	\$ 6,182
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Depreciation and amortization	7,481	8,501	5,627	4,974
Allowance for other receivables		7	186	165
Loss on impairment of intangible assets	871		280	248
Loss on impairment of property and equipment		11		
Provision for accrued severance benefits	152	885	436	386
Stock compensation expense	432	121	148	131
Loss on impairment of investment	8,619			
Equity loss of joint venture and partnership	1,026	5,119	1,424	1,259
Loss (gain) on foreign currency transactions	(133)	108	59	52
Loss (gain) on disposition of property and equipment	(7)	84	3	3
Others	72	55	(36)	(33)
Changes in operating assets and liabilities:				
Accounts receivable	(2,556)	(1,393)	265	234
Other assets	(447)	(57)	971	859
Accounts payable	9	(2,035)	(602)	(531)
Deferred revenue	1,966	(849)	1,440	1,273
Income tax payable	255	310	(503)	(444)
Deferred income taxes	(560)	(714)	86	75
Payment of severance benefits	(86)	(616)	(832)	(736)
Accrued litigation liabilities	(4,648)			
Other liabilities	89	119	(85)	(76)
Net cash provided by (used in) operating activities	₩ (10,626)	₩ 6,952	₩ 15,861	\$ 14,021
Cash flows from investing activities				
Decrease (increase) in short-term financial instruments	₩ 36,839	₩ 1,585	₩ (8,743)	\$ (7,729)
Decrease (increase) of available-for-sale and other investments	640		(5,000)	(4,420)
Purchase of equity investments		(6,054)	(229)	(202)
Purchase of property and equipment	(4,243)	(2,217)	(627)	(554)
Proceeds from disposal of property and equipment	1,272	390	11	9

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Purchase of intangible assets	(5,371)	(3,645)	(2,746)	(2,428)
Payment of leasehold deposits	(226)	(614)	(21)	(18)
Proceeds from leasehold deposits	533	1,769	4	4
Others, net	(106)	(242)	(199)	(176)
Net cash provided by (used in) investing activities	29,338	(9,028)	(17,550)	(15,514)
Cash flows from financing activities				
Proceeds from borrowings	257	212	140	124
Repayment of borrowings	(695)	(294)	(195)	(173)
Net cash used in financing activities	(438)	(82)	(55)	(49)
Effect of exchange rate changes on cash and cash equivalents		1,738	(91)	(81)
Net increase (decrease) in cash and cash equivalents	18,274	(420)	(1,835)	(1,623)
Cash and cash equivalents				
Beginning of the year	35,314	53,588	53,168	47,002
End of the year	₩ 53,588	₩ 53,168	₩ 51,333	\$ 45,379

The accompanying notes are an integral part of these consolidated financial statements.

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**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 eight subsidiaries. One is NeoCyon, Inc. for mobile service business operating in the Republic of Korea, while the others, including Gravity Interactive, Inc., operate in other countries.

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, 2009, 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.

New Accounting Standard Adopted in 2009

Effective September 30, 2009, the Financial Accounting Standards Board (FASB) established *The FASB Accounting Standards Codification*TM (ASC) as the source of authoritative accounting to be applied by nongovernmental entities in the preparation of financial statements in conformity with US GAAP. Except for newly issued standards which have not been codified, references to codified literature have been updated to reflect this change.

Effective January 1, 2009, the Company, as required, adopted an amendment of ASC 810, *Consolidation* (formerly referenced as the FASB's SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements*), which requires to make certain changes to the presentation of our financial statements. This amendment requires to classify earnings attributable to noncontrolling interests (previously referred to as minority interest) as part of consolidated net earnings (₩69 million and ₩77 million for 2008 and 2009, respectively) and to include the accumulated amount of noncontrolling interests as part of equity (₩137 million and ₩214 million at December 31, 2008 and 2009, respectively). The net earnings amounts the Company has previously reported are now presented as Net income (loss) attributable to parent company and, as required, earnings per share continues to reflect amounts attributable only to the parent company. Similarly, in the presentation of shareowners' equity, the Company distinguishes between equity amounts attributable to parent company shareholders and amounts attributable to the noncontrolling interest previously classified as minority interest outside of shareowners' equity. In addition to these financial reporting changes, this guidance provides for significant changes in accounting related to noncontrolling interests; specifically, increases and decreases in the controlling financial interest in consolidated subsidiaries will be reported in equity

similar to treasury stock transactions. If a change in ownership of a consolidated subsidiary results in loss of control and deconsolidation, any retained ownership interests are remeasured with the gain or loss reported in net earnings.

Effective January 1, 2009, the Company adopted ASC 825, *Financial Instruments* (formerly referenced as the FASB's SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*).

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****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
L5 Games Inc.(*1)	2007	2007	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 EU SASU	2006	2006	100.00
Gravity RUS Co., Ltd.(*2)	2007	2007	99.99
Gravity Middle East & Africa FZ-LLC(*3)	2007	2007	100.00

(*1) In October 2007, Gravity Interactive, Inc. founded L5 Games Inc., as a wholly owned US-based subsidiary. L5 Games Inc. is in the process of liquidation as of December 31, 2009.

(*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.

(*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, 2009.

Investments in entities where the Company holds more than 20% but less than 50% ownership or over which the Company has significant management control 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 (Note 7).

Investments in limited partnerships are accounted for using the equity method in accordance with ASC 323, *Investment - Equity Method and Joint Ventures* (formerly referenced as Emerging Issues Task Force (EITF) D-46, *Accounting for Limited Partnership Investments*), 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 joint venture and partnership.

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.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****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, 2007, 2008 and 2009, the Company generated 89%, 87% and 84% of its revenues from countries in Asia, respectively. Any further economic downturn or crisis in Asia could have a significant negative impact on the Company.

As of December 31, 2007, 2008, and 2009, 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:

Country	Licensee	2007		2008		2009	
		Accounts Receivable	Revenues	Accounts Receivable	Revenues	Accounts Receivable	Revenues
Japan	GungHo Online Entertainment, Inc.	33%	44%	50%	50%	40%	56%

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 24% of such amounts are held at one financial institution. Management believes these financial institutions are of high credit quality.

Revenue recognition

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, Russia and CIS countries, 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

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GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

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. The Company deposits cash and cash equivalents with high credit quality financial institutions.

Short-term financial instruments

Short-term financial instruments include time deposits, with maturities greater than three months but less than a year at each reporting date.

Short-term and long-term available-for-sale investments

On January 1, 2009, the Company adopted ASC 825 *Financial Instruments* (formerly referenced as the FASB's SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*). 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 year ended December 31, 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* (formerly referenced as the Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*). The long-term available-for-sale securities are reported on the consolidated balance sheets within other non-current assets at their 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. The adoption of ASC 825 did not impact retained earnings as of January 1, 2009. Investments in available-for-sale securities that were previously classified as available-for-sale as of December 31, 2008 continue to be classified as available-for-sale as of December 31, 2009.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Equity securities in non-public companies***

Equity securities in non-public companies are carried at cost as fair value is not readily determinable. If the fair value of a non-public equity investment is estimated to have declined and such decline is judged to be other than temporary, the Company recognizes the impairment of the investment and the carrying value is reduced to its fair value.

Determination of impairment is based on the consideration of such factors as operating results, business plans and estimated future cash flows. Fair value is determined through the use of such methodologies as discounted cash flows, valuation of recent financings and comparable valuations of similar companies. The Company invested \$9 million in acquiring Series D preferred shares of Perpetual Entertainment, Inc in 2006 and then recognized impairment losses in 2007. Perpetual Entertainment, Inc was liquidated in 2008 (See Note 7). As of December 31, 2009, the Company has no equity securities in non public companies.

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 8% to 15% and risk of loss or delinquencies are borne by such payment processing service providers.

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:

Building	40 years
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

Long-lived assets and intangible assets that do not have indefinite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. 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.

Capitalized software 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* (formerly referenced as the FASB's SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*). Software development

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 and records as a component of cost of revenues the greater of the amount computed using the ratio that 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 over the remaining estimated economic life of the game, which is deemed to be three years. Amortization starts when an online game is available for general release to public users.

Capitalized software development costs net of accumulated amortization at December 31, 2008 and 2009 were ₩10,895 million and ₩11,006 million, respectively, which is included in intangible assets of the accompanying consolidated balance sheets. Amortization expense for the years ended December 31, 2007, 2008 and 2009 was ₩1,007 million, ₩2,595 million and ₩2,596 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.

The Company recognized an impairment loss of ₩871 million, zero and ₩39 million in 2007, 2008 and 2009 respectively.

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, *Goodwill and Other* (formerly referenced as the FASB's SFAS No. 142, *Goodwill and Other Intangible Assets*), 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. 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

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 reporting unit for goodwill impairment test is determined based on each legal entity, which is the component level.

Definite-lived other Intangible assets

Definite-lived intangible assets are amortized over their estimated useful life according to the nature and characteristics of each intangible asset. The Company continually evaluates the reasonableness of the useful lives of these assets. Definite-lived intangible assets that are subject to amortization are reviewed for impairment in accordance with ASC 360, *Property, Plant, and Equipment* (formerly referenced as the FASB's SFAS No. 144, *Accounting for the impairment or Disposal of Long-Lived Assets*).

Advertising

The Company expenses advertising costs as incurred. Advertising expense was approximately ₩6,623 million, ₩1,483 million and ₩1,137 million for the years ended December 31, 2007, 2008 and 2009, 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* (formerly referenced as EITF 88-1, *Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*).

The Company introduced a defined contribution pension plan in 2005 and provides 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.

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* (formerly referenced as the FASB's SFAS No. 52, *Foreign Currency Translation*). 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, net of tax, 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.

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GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income taxes

The Company accounts for income taxes under the provisions of ASC 740, *Income Taxes* (formerly referenced as the FASB's SFAS No. 109, *Accounting for Income Taxes*). Under ASC 740, income taxes are accounted for under the asset and liability method. Deferred 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 tax assets to the extent that it is more likely than not that such deferred 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 tax assets and liabilities.

The Company follows ASC 740, *Income Taxes* (formerly referenced as FASB Interpretation (FIN) 48, *Accounting for Income Tax Uncertainties*), which prescribes a recognition threshold and measurement attribute for tax positions taken or expected to be taken in a tax return. This interpretation 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 interpretation 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 tax asset or an increase in a deferred 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 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 8).

Accounting for stock-based compensation

The Company accounts for stock-based compensation under ASC 718, *Compensation-Stock Compensation* (formerly referenced as the FASB's SFAS No. 123(R), *Share-Based Payment*).

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 statement of operations for the year ended December 31, 2009 is based on awards ultimately expected to vest, it has been 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. For the periods prior to 2006, the Company accounted for forfeitures as they occurred under ASC 718 (see Note 15).

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****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 January 2010, the FASB issued Accounting Standards Update 2010-06 (ASU 2010-06), which amends the disclosure requirements of ASC 820, Fair Value Measurements and Disclosures, (ASC 820) as of January 1, 2010. ASU 2010-06 requires new disclosures for any transfers of fair value into and out of Level 1 and 2 fair value measurements and separate presentation of purchases, sales, issuances and settlements within the reconciliation of Level 3 unobservable inputs. The Company previously adopted ASC 820 on January 1, 2008 and January 1, 2009 for financial assets and liabilities and for nonfinancial assets and liabilities, respectively. ASU 2010-06 is effective for annual and interim periods beginning after December 15, 2009, except for the Level 3 reconciliation which is effective for annual and interim periods beginning after December 15, 2010. The adoption of ASU 2010-06 as of January 1, 2010 did not have a material effect on the Company's financial condition or results of operations. The Company does not expect the adoption of ASU 2010-06 in relation to the Level 3 reconciliation to have a material impact on the Company's financial condition or results of operations.

In September 2009, the EITF reached final consensus under ASU No. 2009-13 on the issue related to revenue arrangements with multiple deliverables. This issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration should be measured and allocated to the separate units of accounting. This issue is effective for the Company's revenue arrangements entered into or materially modified on or after January 1, 2011. The Company will evaluate the impact of this issue on the Company's financial statements when reviewing its new or materially modified revenue arrangements with multiple deliverables when it becomes applicable.

In June 2009, the FASB issued a statement which improves financial reporting by enterprises involved with variable interest entities. This statement requires companies to perform an analysis to determine whether the company's variable interest or interests give it a controlling financial interest in a variable interest entity. This statement will be effective as of the beginning of the annual reporting period that begins after November 15, 2009. The Company will evaluate the impact of this statement on the Company's financial statements when it becomes applicable.

In June 2009, the FASB issued a statement which improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets as well as the effects of a transfer on its financial position, financial performance, and cash flows and a transferor's continuing involvement, if any, in transferred financial assets. The statement requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The statement will be effective as

of the beginning of annual reporting period that begins after November 15, 2009. The Company believes the adoption of this pronouncement will not have a material impact on the Company's financial statements as the Company does not currently transfer its financial assets.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****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 1,131.20 Korean Won to one US dollar, which is the noon buying rate of the US Federal Reserve Bank of New York in effect on March 31, 2010. 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 either in Korea or the United States of America.

4. Restricted Assets

As of December 31, 2009, one of the Company's subsidiaries, Gravity Interactive, Inc. has issued an irrevocable letter of credit in the amount of \$500,000 to its landlord in relation to an office lease agreement with no amounts drawn on this letter of credit as of December 31, 2009. Additionally a short-term investment amounting to \$500,000 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, 2007, 2008 and 2009 are as follows:

	2007	2008	2009
	(In millions of Korean Won)		
Balance at beginning of year	₩ 108	₩ 139	₩ 67
Provision for allowances	37	47	
Reversal of previous provision			(65)
Write-offs	(6)	(119)	
Balance at end of year	₩ 139	₩ 67	₩ 2

6. Available-for-sale investments

The cost, gross unrealized gains and fair value of available-for-sale securities as of December 31, 2008 and 2009 are as follows:

Cost or	Gross Unrealized Losses	Fair Value
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**Carrying
Value**

As of December 31, 2008

Public bond	₩	21	₩	1	₩	20
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As of December 31, 2009

Current portion of available-for-sale:

ELS fund (accounted for at fair value under ASC 825)	₩	4,973	₩		₩	4,973
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Non-current portion of available-for-sale:

Public bond		21		1		20
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	₩	4,994	₩	1	₩	4,993
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In 2009, the Company invested ₩5,000 million in equity interests in the Equity-Linked Securities fund (ELS fund), which is comprised of bonds, marketable equity securities and trust funds as of December 31, 2009. These

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 (formerly FAS 159) 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. The change of ₩27 million between the acquisition cost of the equity interests in the ELS fund and its fair value as of December 31, 2009 has been recognized in the other expense on the consolidated statement of operations.

In January 2006, the Company invested ₩21 million in public bond and classified this as long-term available-for-sale investments within other long-term assets on the balance sheet in the amount of ₩20 million based on its estimated fair value. Changes in the estimated fair market value has been recorded as a component of accumulated other comprehensive income, net of tax. There has been no change in the fair value from 2007 through 2009.

7. Equity Method Investment

In April 2004, the Company's subsidiary, Gravity Entertainment Corp., invested ¥123 million (₩1,358 million) for a 30% interest in Animation Production Committee, a joint venture, which was incorporated in Japan to produce 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.

In 2005, the Company entered into a limited liability partnership agreement to invest the committed amount of ¥1,000 million (₩8,713 million) in Online Game Revolution Fund No. 1, a limited liability partnership. In 2005, 2006, 2008 and 2009, the Company invested ¥100 million (₩869 million), ¥150 million (₩1,245 million), ¥642 million (₩6,054 million) and ¥18 million (₩229 million), respectively. As of December 31, 2009, 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* (formerly referenced as EITF D-46, *Accounting for Limited Partnership Investments*), 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 as equity loss of the partnership amounting to ₩1,026 million, ₩5,119 million and ₩1,424 million in 2007, 2008 and 2009, respectively.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's significant investment at December 31, 2008 and 2009 is investment in the partnership and its summarized financial information that is based on information provided by the significant equity investee is as follows:

Balance Sheets

	2008	2009
	(In millions of Korean Won)	
Current assets	₩ 3,201	₩ 3,423
Noncurrent assets	18,407	9,491
Total Assets	21,608	12,914
Current liabilities	34	32
Noncurrent liabilities	6,813	6,172
Shareholders' equity	14,761	6,710
Percentage of ownership in equity investees	16.39%	16.39%
Investment in equity investees at cost plus equity undistributed earnings since acquisition	₩ 2,419	₩ 1,100

Statements of operations

	2007	2008	2009
	(In millions of Korean Won)		
Revenues	₩	₩ 40	₩ 1,795
Cost and expense	6,770	33,420	10,483
Operating loss	6,770	33,380	8,688
Other income (expense), net			
Loss before income taxes	6,770	33,380	8,688
Income tax expense			
Net Loss	6,770	33,380	8,688
Percentage of ownership in equity investees	15.15%	16.39%	16.39%
Equity in net loss of equity method investees	₩ 1,026	₩ 5,119	₩ 1,424

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. During 2008, the partnership purchased an online game under development of which technological feasibility had not been established, therefore, the partnership charged the purchase price of the game to expense, which resulted in a significant loss in 2008. The partnership did not have any debt outstanding at December 31, 2007, 2008 and 2009.

In May 2006, the Company invested \$9 million in acquiring Series D preferred shares of Perpetual Entertainment, Inc. The investment was accounted for using the cost method. Perpetual Entertainment, Inc. has been in the process of liquidation since October 2007 due to its poor financial condition from developing various games. Therefore, the Company determined that the investment amount will not be recoverable and recognized the total related amount of W8,619 million (\$9 million) as impairment losses on investments in the accompanying statement of operations in 2007.

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GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Fair value of financial instruments

The Company adopted ASC 820, *Fair Value Measurements and Disclosures* (formerly referenced as the FASB's SFAS No. 157 *Fair Value Measurements*) effective January 1, 2009, for all financial assets and liabilities as required.

The adoption ASC 820 was not material to the Company's financial position or results of operations.

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.

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, 2009. 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 statement 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.

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The following table summarizes the Company's financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 and ASC 825 as of December 31, 2009:

Assets	Level 1	Level 2	Level 3	Total
	(In millions of Korean Won)			
Short-term available-for-sale investments		4,973		4,973
Long-term available-for-sale investments	20			20

9. Change of subsidiaries***Liquidation of TriggerSoft Corp.***

In May 2007, the liquidation of TriggerSoft Corp. was commenced following the shareholders' resolution and the liquidation process was completed in October 2007. As a result, TriggerSoft Corp. was excluded from consolidation as of December 31, 2007.

Acquisition of NeoCyon, Inc.

In November and December 2005, the Company acquired an aggregate of 96.11% of the voting common share of NeoCyon, Inc. (NeoCyon). The Company determined the fair value of assets acquired and liabilities assumed and performed an allocation of the total price of W 7,716 million to the net assets acquired.

Of the W 6,526 million of acquired intangible assets, W 5,600 million and W 926 million were assigned to the value of content download business and the Ragnarok Online publishing rights in Russia, respectively. The Company recorded amortization expense of W 2,175 million and W 1,929 million for the acquired intangible assets in 2007 and 2008, respectively, using straight-line method and useful life of three years, in cost of revenue. No amortization expense was recorded in 2009, as the acquired intangible asset was fully amortized in December 2008.

In addition, the excess amount of the purchase price over the fair value of the net assets acquired was accounted for as goodwill. Of W 1,451 million of total goodwill, W 1,210 million and W 241 million were assigned to two reporting units NeoCyon, Inc. and a Russian subsidiary, Gravity CIS Co., Ltd., respectively (See Note 11)

10. Property and Equipment, Net

Property and equipment as of December 31, 2008 and 2009 consist of the following:

2008	2009
(In millions of Korean Won)	

Computer and equipment	₩	12,416	₩	12,236
Furniture and fixtures		1,506		1,468
Vehicles		88		83
Capital lease assets		331		436
Leasehold improvements		749		765
Software externally-purchased		8,751		8,899
		23,841		23,887
Less: accumulated depreciation		(18,615)		(21,050)
	₩	5,226	₩	2,837

Depreciation expenses for the years ended December 31, 2007, 2008 and 2009 were ₩4,247 million, ₩3,880 million and ₩2,924 million, respectively.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company recognized an impairment loss of ₩11 million for property and equipment in 2008 and no impairment loss was recorded for the year ended December 31, 2007 and 2009.

11. Goodwill and other intangible asset

Goodwill and other intangible assets as of December 31, 2008 and 2009 consist of the following:

	At December 31, 2008			At December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In millions of Korean Won)					
Capitalized software development cost	₩ 14,496	₩ (3,601)	₩ 10,895	₩ 17,203	₩ (6,197)	₩ 11,006
Acquired intangible asset (See Note 9)	6,526	(6,526)		6,526	(6,526)	
Goodwill (See Note 9)	1,451		1,451	1,210		1,210
Trademarks	331	(168)	163	418	(231)	187
Others	133	(37)	96	133	(81)	52
Total	₩ 22,937	₩ (10,332)	₩ 12,605	₩ 25,490	₩ (13,035)	₩ 12,455

The company capitalized ₩3,815 million and ₩2,746 amount of R&D costs in accordance with ASC 985, *Costs of Software to be Sold, Leased, or Marketed* in 2008 and 2009.

All of the Company's intangible assets other than goodwill 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, 2007, 2008 and 2009 was ₩3,234 million, ₩4,621 million and ₩2,703 million, respectively.

Changes in goodwill balances for the years ended December 31, 2008 and 2009 are as follows:

	2008 (In millions of Korean Won)	2009 (In millions of Korean Won)
Balance at beginning of the year		
Goodwill	₩ 1,451	₩ 1,451
Accumulated impairment losses		
	1,451	1,451

Impairment losses		(241)
Balance at end of the year		
Goodwill	1,451	1,451
Accumulated impairment losses		(241)
	₩ 1,451	₩ 1,210

As described in Note 2, the Company performed annual impairment test for goodwill at each reporting unit, NeoCyon, Inc. and a Russian subsidiary, Gravity CIS Co., Ltd., using data as of December 31, 2009. In performing the valuations, the Company used cash flows that reflected management's forecasts and discount rates that reflect the risks associated with the current market. Based on the results of our testing, the fair value of the business reporting unit for NeoCyon, Inc. exceeded their book values, and therefore, the second step of the impairment test (in which fair value of the reporting unit's assets and liabilities are measured) was not required to be performed. However, in performing the annual impairment test for goodwill for Gravity CIS Co., Ltd., the fair value of the business reporting unit for the Russian subsidiary was determined to be lower than the book value of the business reporting unit. Therefore, during the fiscal year ended December 31, 2009, the Company recorded impairment

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

losses of ₩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 ₩241 million represented the entire outstanding balance of goodwill in the reporting unit before the impairment losses. The fair values of the reporting units were estimated principally using the expected present value of future cash flows. The Company used the income approach to determine the fair value of the reporting unit for purposes of the goodwill impairment analysis. For purposes of the income approach, fair value is determined based on the present value of estimated future cash flows, discounted at an appropriate risk-adjusted rate. The Company use internal forecasts to estimate future cash flows and include 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.

Estimating the fair value of reporting units involves the use of estimates and significant judgments that are based on a number of factors including actual operating results. If current conditions change from those expected, it is reasonably possible that the judgments and estimates described above could change in future periods.

Expected amortization expense related to current net carrying amount of intangible assets is as follows:

	(In millions of Korean Won)	
2010	₩	2,430
2011		3,194
2012		3,169
2013		2,380
2014		72
	₩	11,245

12. Accrued Severance Benefits

Changes in accrued severance benefits for the years ended December 31, 2007, 2008 and 2009 are as follows:

	2007	2008	2009
	(In millions of Korean Won)		
Balance at beginning of year	₩ 649	₩ 715	₩ 926
Provisions for severance benefits	152	885	436
Severance payments	(86)	(616)	(832)
Terminated but not paid		(58)	(52)
Balance at end of year	₩ 715	₩ 926	₩ 478

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. The Company's contribution to the Pension Plan was ~~₩1,421 million~~, ~~₩1,221 million~~ and ~~₩1,027 million~~ in 2007, 2008 and 2009, respectively. As of December 31, 2009, Gravity's subsidiaries had not introduced this Pension Plan.

13. Commitments and Contingencies

Commitments

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 Co., Ltd. in Thailand, Gamania Digital Entertainment Co., Ltd. in Taiwan, Shanghai The 9 Information Technology Ltd., in China, Level up! Inc. in Philippines, AsiaSoft Corporation Public Co., Ltd., in Malaysia, AsiaSoft Corporation Pubic Co., Ltd. in Vietnam,

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

PT. Lyto Datarindo Fortuna in 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 November 2006, the Company entered into an agreement with Infocomm Asia Holding Pte. Ltd, a company located in Singapore to service, use, promote, distribute and market Emil Chronicle Online (ECO) in the following countries: Singapore, Malaysia, Brunei, Thailand, Philippines, Indonesia, Vietnam, Australia and New Zealand. In February 2007, the Company and Infocomm Asia granted the distribution rights of ECO in Thailand to Onenet Co., Ltd. In 2008, the Company amended the agreement with Infocomm Asia to take back Infocomm Asia's distribution rights in countries in which Infocomm Asia had not yet entered into service agreements with sub-licensees. As a result, the Company took back the distribution rights for the remaining 8 countries excluding Thailand. In 2007, the Company entered into an agreement with GameCyber Technology Ltd. in Taiwan and Hong Kong. In 2008, the Company entered into an agreement with Run Up Game Distribution and Development Sdn. Bhd. in Singapore and Malaysia. In February 2009, the Company entered into an agreement with PT. Wave Wahana Wisesa in Indonesia. These agreements grant each licensee exclusive sales and distribution right for three years from the time ECO is locally commercialized.

In 2005, the Company entered into a limited liability partnership agreement to invest the committed amount of ¥1,000 million (~~₩~~8,713 million) in Online Game Revolution Fund No. 1, a limited liability partnership. In 2005, 2006, 2008 and 2009, the Company invested ¥100 million (~~₩~~869 million), ¥150 million (~~₩~~1,245 million), ¥642 million (~~₩~~6,054 million) and ¥18 million (~~₩~~229 million), respectively.

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 \$270,666 over a 2-year-period. In 2008, this capital lease agreement was amended, thereby decreasing the total lease payment by \$139,760 to \$130,906. The Company also entered into additional capital lease agreements to utilize more assets including servers during the year, which increased the total capital lease payment by \$123,195. In 2008, the Company made principal and interest payments of \$79,811 and \$26,082, respectively. In 2009, the Company made principal and interest payments of \$152,656 and \$32,616, respectively.

In 2009, the Company entered into an agreement with Naru Entertainment Corp to acquire publishing right of the game in process of being developed by Naru Entertainment Corp. in Korea for ~~₩~~1,500 million. As of December 31, 2009, the game is in the development process, and the Company has accounted for the prepayment of ~~₩~~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 Entertainment Corp. after the commercial launch of the game.

Future minimum lease payments for the leases as of December 31, 2009, are as follows:

	2010		2011		2012	
	Principal (In US Dollar)	Interest	Principal (In US Dollar)	Interest	Principal (In US Dollar)	Interest
Capital lease	\$ 88,858	\$ 9,498	\$ 26,380	\$ 2,153	\$ 16,262	\$ 382

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 ₩3,919 million, ₩4,579 million and ₩3,759 million for the years ended December 31, 2007, 2008 and 2009, respectively. The Company entered into a lease agreement with Korea Software Industry Promotion Agency in 2008 and recorded a guarantee deposit of ₩1,171 million as of December 31, 2009.

Future minimum rental payments for the leases as of December 31, 2009, are as follows:

	2010	2011	2012
	(In millions of Korean Won)		
Operating lease	₩ 2,666	₩ 2,509	₩ 2,400

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Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Litigation***

In May 2005, the initial purchasers and shareholders of the ADSs filed a number of class action complaints for violation of the United States federal securities law in the United States District Court for the Southern District of New York, which were consolidated by an order of the Court entered on December 12, 2005. The complaints identify the Company and certain of its former individual directors and officers as defendants, and claim 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. On October 17, 2006, the Company and certain other defendants filed a motion to dismiss the claims. However, briefing on the motion was suspended in anticipation of an effort to first mediate the dispute amicably in good faith. 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 \$10 million. The Company's share of the settlement was \$5 million (~~₩4,648 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 to be made to class members. No plaintiff filed an appeal during the 30-day time 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 current and former directors and officers as well as other third parties were released from liability for the claims asserted by the class. Regarding the class action litigation matters described above, the Company made an accrual of \$5 million (~~₩4,648 million~~) in accordance with ASC 450, *Contingencies* (formerly referenced as the FASB's SFAS No. 5) and recognized the same amount as an operating expense in 2006. Subsequently in 2007, the Company paid ~~₩4,619 million~~ to settle this case.

In May 2006, the Company's former investor of Ragnarok Online, filed a lawsuit in Korean Court against the Company with related claim amount of ~~₩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 from 2002 to 2005. In October 2006, 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 them to incur a loss in their business by providing them a materially deficient program.

Two pending litigations as discussed above as of December 31, 2008 were closed in 2009 upon settlement or through court decision. The Company won the lawsuit in Korean Court filed by the Company's former investor of Ragnarok Online to claim additional distribution of earnings, and 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 \$2,000,000 to Softstar Entertainment, Inc. and recognized the loss of ~~₩1,649 million~~, which is the difference between the settlement and the existing deferred revenue balance under current year's income statement.

In April 2009, the Company repatriated \$1.4 million (~~₩1,820 million~~) from Gravity Middle East & Africa FZ-LLC (ME&A), the subsidiary in United Arab Emirates, which comprised most of remaining net assets of ME&A. ME&A had been in process of liquidation since September 2008. In June 2009, a director and manager of the Company's subsidiary in the UAE asserted to the Company a claim for his salary for the past twenty months, which amounts to AED 721,022 (~~₩229 million~~). 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. The

outcome of the claim is uncertain and the ultimate financial impact cannot be estimated at this time.

14. Shareholders Equity

As of December 31, 2009, Gravity is authorized to issue a total of 40 million shares with a par value of ₩500 per share, in registered form, consisting of common shares and non-voting preferred shares. Of this authorized

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Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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, 2009, 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, 2009, 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, 2007	122,670	₩	46,165	
Options granted				
Options exercised				
Options expired	30,668		46,165	
Options forfeited	22,365		45,431	
December 31, 2007	69,637	₩	46,400	
Options granted				
Options exercised				
Options expired	15,548		45,431	
Options forfeited	22,994		48,367	
December 31, 2008	31,095	₩	45,431	
Options granted				
Options exercised				
Options expired	13,526		45,431	
Options forfeited	4,044		45,431	
Stock options outstanding as of December 31, 2009	13,525	₩	45,431	0.98

Vested and expected to vest as of December 31, 2009	13,525	₩	45,431	0.98
Exercisable as of December 31, 2009	13,525	₩	45,431	0.98

During 2009, 13,526 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 2008 was 46,216) and stock options of 4,044 were cancelled due to the retirement of the officers and employees (the accumulated number of stock options which were cancelled until 2008 were 193,689). The number of stock options outstanding as of December 31, 2009 is 13,525.

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* (formerly referenced as FIN 28), graded attribution model. For the years ended December 31, 2007, 2008 and 2009, the Company recognized ₩432 million, ₩120 million and ₩148 million in stock compensation expense for the shares granted.

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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. There is no intrinsic value of options outstanding and exercisable as of December 31, 2009 as the exercise price is higher than the market price. There were no exercised options since granted.

As of December 31, 2009, there was no unrecognized compensation cost related to nonvested stock options. The total fair value of shares vested during the year ended December 31, 2009 is ₩445 million.

The fair value of each option was estimated, at the date of grant and repricing date, using the Black-Scholes option pricing model, with the following weighted average assumptions:

	Grant Date	Repricing Date
Valuation assumptions:		
Expected dividend yield	0%	0%
Risk-free interest rate	3.50%	3.54%
Expected volatility	53%	53%
Expected term	4	3.9
Fair value of stock	₩ 55,431	₩ 55,431

The fair value of the stock at the date of grant was based on the initial public offering price of the Company's American Depositary Shares on the NASDAQ Global Market on February 8, 2005, adjusted for the ratio of common stock to ADSs. The risk-free interest rate was calculated based on the yield to maturity of U.S. T-Bond for each expected term and the expected term was based on the assumption that the options are exercised in equal increments from the vesting date through the cancellation date. The expected volatility was calculated based on historical data of similar companies using BAPNET index (Bloomberg Asia Pacific Internet index) at the date of grant and repricing date due to lack of the Company's own historical data.

The following table summarizes information about stock options outstanding as of December 31, 2009:

Options Outstanding			Options Exercisable	
Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Number of Shares	Weighted Average Remaining Contractual Life (Years)
₩45,431	13,525	0.98	13,525	0.98

16. Earning (Loss) Per Share

The components of basic and diluted earning (loss) per share are as follows:

	2007	2008	2009
	(In millions of Korean Won, except per share data)		
Net income (loss) available for common shareholders(A)	₩ (23,201)	₩ (2,773)	₩ 6,917
Weighted average outstanding shares of common shares(B)	6,948,900	6,948,900	6,948,900
Earnings (Losses) per share Basic and diluted(A/B)	₩ (3,339)	₩ (399)	₩ 995

The 31,095 and 13,525 stock options outstanding as of December 31, 2008 and 2009, respectively, are excluded from the Company's calculation of earnings (losses) per share as their effect is anti-dilutive.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****17. Income Taxes**

Income tax expenses (benefit) for the years ended December 31, 2007, 2008 and 2009 consist of the following:

	2007	2008	2009
	(In millions of Korean Won)		
Income (loss) before income taxes			
Domestic	₩ (17,428)	₩ 13,075	₩ 15,044
Foreign	(1,791)	(7,281)	(2,082)
	(19,219)	5,794	12,962
Current income taxes			
Domestic	3,230	4,274	4,477
Foreign	246	(190)	(19)
	3,476	4,084	4,458
Deferred income taxes			
Domestic	(576)	(656)	86
Foreign	16	(49)	
	(560)	(705)	86
Total income tax expenses	₩ 2,916	₩ 3,379	₩ 4,544

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, 2008 and 2009 are as follows:

	2008	2009
	(In millions of Korean Won)	
Current deferred income tax assets (liabilities)		
Foreign tax credit carryforwards	₩ 1,256	₩ 5,570
Tax credit carryforwards for research and human resource development	386	1,415
Accrued expense	143	111
Accrued income	(59)	(88)
Unrealized foreign exchange losses	52	137
Net operating loss carryforwards in subsidiaries		108

Other	86	1
	1,864	7,254
Less: Valuation allowance	1,882	6,879
	₩ (18)	₩ 375
Non-current deferred income tax assets (liabilities)		
Foreign tax credit carryforwards	₩ 16,172	₩ 14,882
Tax credit carryforwards for research and human resource development	4,515	3,100
Depreciation and amortization	412	291
Provisions for severance benefits	191	65
Accrued expense	63	130
Net operating loss carryforwards in subsidiaries	6,771	4,618
Other	(59)	(43)
	28,065	23,043
Less: Valuation allowance	27,858	23,315
	₩ 207	₩ (272)

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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 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 tax assets, management considered whether it was more likely than not that some portion or all of the deferred tax assets would not be realized. The ultimate realization of deferred tax asset is dependent upon the 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, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and uncertainty in the future taxable income over the periods in which the deferred tax assets were deductible, management believed it was more likely than not that Gravity and certain subsidiaries could not realize the benefits of these deductible differences and recognized full allowances from deferred tax assets.

As of December 31, 2009, Gravity Co., Ltd. had temporary differences of ₩2,700 million, foreign tax credit carryforwards and tax credit carryforwards for research and human resource development etc. of ₩20,557 million and ₩4,515 million, respectively, which expire from 2010 to 2014. Based on the Company's historical and projected net and taxable income, the Company determined that it would not be able to realize these temporary differences and tax credits carryforwards, and recognized a valuation allowance of ₩25,585 million on the full amount of temporary differences and available tax credit carryforwards at an effective rate expected to be incurred to Gravity.

As of December 31, 2009, Gravity Entertainment Corp., the Company's 100% owned subsidiary in Japan, had temporary differences of ₩157 million and available loss carryforwards of ₩1,347 million which expire from 2010 to 2016. 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 ₩632 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, 2009, Gravity RUS Co., Ltd. and Gravity CIS Co., Ltd., the Company's 100% owned subsidiaries in Russia, had available loss carryforwards of ₩2,081 million which expire from 2015 to 2019. 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 ₩416 million on the full amount of the available loss carryforwards at an effective rate expected to be incurred in Russia.

As of December 31, 2009, Gravity EU SASU, the Company's 100% owned subsidiary in France, had available loss carryforwards of ₩3,775 million which do not have the time limit. Based on this subsidiary's history of net and taxable losses and expected projected net and taxable losses, the Company determined that it would not be able to realize these loss carryforwards, and recognized a valuation allowance of ₩1,258 million on the full amount of the available loss carryforwards at an effective rate expected to be incurred in France.

As of December 31, 2009, Gravity Interactive, Inc., the Company's 100% owned subsidiary in US, had available loss carryforwards of ₩5,250 million for federal tax and ₩5,855 million for state tax, respectively, which expire from 2027 to 2029. 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 ₩2,303 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 27.5% and 24.2% for the years ended December 31, 2008 and 2009, respectively. In accordance with the revised Corporate Income Tax Law, statutory tax rate applicable to the Company is 24.2% until 2011 and 22% thereafter.

Table of Contents**GRAVITY CO., LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A reconciliation of income tax expense at the Korean statutory income tax rate to actual income tax expense is as follows:

	2007	2008	2009
	(In millions of Korean Won)		
Tax expense at Korean statutory tax rate (2007, 2008: 27.5%, 2009: 24.2%)	₩ (5,285)	₩ 1,593	₩ 3,137
Income tax exemption	529		
Foreign tax credit	(288)	(366)	(427)
Tax credit carryforwards for research and human resource development	(919)	(1,000)	365
Foreign tax differential	(179)	(481)	(254)
Income not assessable for tax purpose	(681)	(31)	(2)
Expense not deductible for tax purpose	821	181	135
Change in statutory tax rate	(712)	905	(261)
Change in valuation allowances	9,529	3,309	454
Tax loss carryback		(195)	
Effect of change in foreign currency exchange rate	(47)	(546)	199
Expiration of unused foreign tax credit and unused net operating loss carryforwards	252	9	1,240
Others	(104)	1	(42)
Total income tax expense	₩ 2,916	₩ 3,379	₩ 4,544

The Company assessed uncertain tax positions and measured unrecognized tax benefits for open tax years in accordance with ASC 740, *Income Taxes* (formerly referenced as FIN 48, *Accounting for Income Tax Uncertainties*.) and accordingly decreased its loss carryforwards of ₩66 million and ₩40 million in income tax calculation of 2006 and 2007. No interest expenses and penalties were calculated from such unrecognized tax benefits due to significant amounts of loss carryforwards and tax credit carryforwards at each year. Even if recognized, all ₩106 million of unrecognized tax benefits would not affect the Company's income tax expense and effective tax rate for 2006 and 2007 as a full valuation allowance was provided for the entity which has taken these uncertain tax positions. As such, no adjustments were made to retained earnings as of January 1, 2007. The unrecognized tax benefit of ₩106 million has remained unchanged since 2007. The Company's policy is that it recognizes interest expenses and penalties related to income tax matters as a component of income tax expense. The company believes its unrecognized tax benefits recorded as of December 31, 2009 would not be reduced within the next twelve months as a result of the lapse of applicable statutes of limitations.

A reconciliation of total gross unrecognized tax benefits for the year ended December 31, 2009 is as follows (in millions of Korean Won):

Balance at January 1, 2009	₩ 106
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Additions based on tax positions taken during the current year
Gross increase/decrease for tax positions of prior years
Decreases relating to settlements with taxing authorities
Reductions due to lapsing of applicable statute of limitations

Balance at December 31, 2009

₩ 106

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The Company's primary tax jurisdictions are Korea and the United States and open tax years for Gravity, NeoCyon and Gravity Interactive are 4 years, 5 years and 6 years, respectively. The Company has no ongoing tax examinations by tax authorities at this time.

Allowances for deferred tax assets for the three years ended December 31, 2007, 2008 and 2009 are as follows:

	Balance at Beginning of Year	Deduction	Increase	Balance at End of Year
	(In millions of Korean Won)			
2007				
Valuation allowance	₩ 16,902	₩	₩ 9,529	₩ 26,431
2008				
Valuation allowance	26,431		3,309	29,740
2009				
Valuation allowance	29,740		454	30,194

18. Operations by Geographic Area

Geographic information for the years ended December 31, 2007, 2008 and 2009 is based on the location of the distribution entity. Revenues by geographic region are as follows:

	2007	2008	2009
	(In millions of Korean Won)		
Korea	₩ 11,119	₩ 14,009	₩ 11,544
Japan	18,899	27,037	31,991
Taiwan and Hong Kong	2,369	2,301	1,887
United States	2,614	3,620	5,800
Russia	489	1,078	1,298
Brazil	580	1,006	1,096
Thailand	1,054	989	1,150
Other	3,105	3,130	2,637
	₩ 40,229	₩ 53,170	₩ 57,403

Approximately 72% and 18% of the Company's property, plant and equipment are located in Korea and the United States, respectively as of December 31, 2009.

19. Related Party Transactions

During the years ended December 31, 2007, 2008 and 2009, there were related party transactions with a major shareholder and an equity investee as follows:

	2007	2008	2009
	(In millions of Korean Won)		
Sales to related parties	₩ 17,760	₩ 26,724	₩ 31,987
Purchases from related parties	86	604	670
Amounts due from related parties	1,660	3,358	2,473
Amounts due to related parties	6,186	5,869	6,608

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

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on June 23 and June 24, 2008. The transactions with GungHo and the related balances during 2007, 2008 and 2009 were included in related party transactions above.

On November 20, 2007, Son Asset Management, Inc. became a principal shareholder by acquiring 52.39% of the voting shares from EZER, INC., the former majority shareholder. Subsequently on February 13, 2008, Son Asset Management, LLC transferred 52.39% of the voting shares to Heartis Inc., resulting in a change of majority shareholder.

Investment in 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 (~~₩~~8,713 million) in Online Game Revolution Fund No. 1, a limited liability partnership. In 2005, 2006, 2008 and 2009, the Company invested ¥100 million (~~₩~~869 million), ¥150 million (~~₩~~1,245 million), ¥642 million (~~₩~~6,054 million) and ¥18 million (~~₩~~229 million), respectively. As of December 31, 2009, the Company has a 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* (formerly referenced as EITF D-46, *Accounting for Limited Partnership Investments*), 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 as equity loss of the partnership amounting to ~~₩~~1,026 million, ~~₩~~5,119 million and ~~₩~~1,424 million in 2007, 2008 and 2009, respectively.

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 Company invested ¥892 million (~~₩~~8,168 million) until 2008, and made an additional investment amounting to ¥18 million (~~₩~~229 million) in 2009. As of December 31, 2009, 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. On December 28, 2007 and January 7, 2008, the fund entered into purchase agreement and service agreement with GungHo Online Entertainment to purchase online game of GRANDIA ONLINE under development by GungHo for ¥2,600 million (~~₩~~23,089 million), and for GungHo to continue providing development service, promotions, operating service and maintenance service after commercialization for revenue sharing from the game. On July 11, 2008, Online Game Revolution Fund No. 1 also entered into a partnership agreement with GungHo Works, Inc., the subsidiary of GungHo, to share profit from its online game, HERO S SAGA LAEVATEIN, and paid GungHo Works, Inc. ¥124 million (~~₩~~1,220 million).

20. Supplemental Cash Flow Information and Non-Cash Activities

	2007	2008	2009
	(In millions of Korean Won)		
Supplemental cash flow information			
Cash paid during the year for income taxes	₩ 3,539	₩ 3,933	₩ 4,439
Interest paid	92	31	41
Supplemental non-cash activities			

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Reclassification of prepayment to leasehold deposits	₩	₩ 586	₩
Reclassification of leasehold deposits to other account receivable		409	
Reclassification of long-term deferred revenue to deferred revenue		1,570	1,643
Offset of long-term deferred income and accounts payable			876
Reclassification of prepayment to intangible assets			86

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GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

21. Subsequent events

In April and May 2010, a former executive of Gravity filed two lawsuits against the Company with the Seoul Central District Court and Seoul Western District Court claiming employment termination without cause and seeking additional termination compensation. Management of the Company has concluded that the Company does not have any obligation to pay any additional termination compensation to the former executive as the former executive voluntarily resigned and was already paid certain compensation at that time. The Company has not recorded any accrual from this claim as the outcome of the claim is uncertain and the ultimate financial impact cannot be estimated as of the audit report date.

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