

GRAVITY Co., Ltd.
Form 20-F
June 30, 2006

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As filed with the Securities and Exchange Commission on June 30, 2006

**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, 2005

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**

For the transition period from to

**Commission file number: -
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)

**14/ F Meritz Tower, 825-2 Yeoksam-Dong, Gangnam-Gu
Seoul 135-934 Korea**

(Address of principal executive offices)

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*	Nasdaq National Market

American depositary shares, each representing
one-fourth of a share of common stock

* Not for trading, but only in connection with the listing of American depositary shares on the Nasdaq National 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 last full fiscal year covered by this Annual Report: 6,948,900 shares of common stock, par value of Won 500 per share

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 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.

Large Accelerated filer Accelerated filer Non-accelerated-filer

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 to:

China or the PRC are to the People's Republic of China;

Government are to the government of the Republic;

GRAVITY, the Company, we, us, our, or our company are to GRAVITY Co., Ltd. and its subsidiaries.

Japanese Yen or JPY are to the currency of Japan;

Korea or the Republic are to The Republic of Korea;

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

US\$ and U.S. dollars are to the currency of the United States; and

Won or W are to the currency of the Republic of Korea.

For your convenience, this annual report contains translations of certain Won amounts into U.S. dollars at the noon buying rates of the Federal Reserve Bank of New York for Won in effect on December 31, 2005, which was Won 1,010.0 to US\$1.00.

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

FORWARD-LOOKING STATEMENTS

This annual report on Form 20-F for the year ended December 31, 2005 contains forward-looking statements, as defined in Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended (Exchange Act). All statements, other than statements of historical facts, included in this annual report that address activities, events or developments which we expect or anticipate will or may occur in the future are forward-looking statements. The words believe, intend, expect, anticipate, project, estimate, considering, depends, may, could, should or could and similar expressions are also intended to identify forward-looking statements.

These forward-looking statements address, among others, such issues as:

future prices of and demand for our products;

future earnings and cash flow;

expansion and growth of our business and operations; and

our prospective operational and financial information.

These statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in particular circumstances. However, whether actual results and developments will meet our expectations and predictions depends on a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including the risks set forth in Item 3. Key Information Risk Factors and the following:

fluctuations in prices of our products;

potential acquisitions and other business opportunities;

general economic, market and business conditions; and

other risks and factors beyond our control.

Consequently, all of the forward-looking statements made in this annual report are qualified by these cautionary statements. We cannot assure you that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected effect on us or our business or operations.

Table of Contents**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS****1.A. Directors and Senior Management**

Not applicable.

1.B. Advisers

Not applicable.

1.C. Auditors

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**3.A. Selected Financial Data**

The following selected consolidated financial information is derived from our consolidated financial statements as of each of the dates and for each of the periods indicated below. This information should be read in conjunction with our audited consolidated financial statements and the related notes thereto, included in this annual report. Our consolidated financial statements and related notes thereto have been prepared in accordance with accounting principles generally accepted in the United States.

The balance sheet data as of December 31, 2003 and the statement of operations data for the years ended December 31, 2002 and 2003 have been derived from our audited financial statements and related notes thereto not included in this annual report. The balance sheet data as of December 31, 2002 are derived from our unaudited financial statements and related notes thereto, which are not included in this annual report.

As of and for the Years Ended December 31,

	2001	2002	2003	2004	2005	2005(1)
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(Unaudited)

(In millions of Won and thousands of US\$, except share and per share data, operating data and percentages)

Statement of operations:

Revenues:

Online games subscription revenue	W	W 7,310	W 18,560	W 16,253	W 11,249	US\$ 11,138
Online games royalties and license fees		2,330	29,727	45,101	37,375	37,005
Mobile games			43	376	1,664	1,648
Character merchandising, animation and other revenue		167	427	1,185	2,696	3,096
Total revenues		167	10,067	49,515	64,426	53,384
Cost of revenues			1,738	6,958	10,116	16,038
Gross profit		167	8,329	42,557	54,310	37,346

Operating expenses:

Selling, general and administrative	354	4,870	11,360	13,660	30,795	30,490
Research and development	718	815	1,597	2,029	9,219	9,128

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	2001	2002	2003	2004	2005	2005(1)
						(Unaudited)
	(In millions of Won and thousands of US\$, except share and per share data, operating data and percentages)					
Operating income (loss)	(905)	2,644	29,600	38,621	(2,668)	(2,641)
Other expenses, net	(3)	(2,424)	(6,210)	(4,879)	(787)	(780)
Income (loss) before income tax expenses, minority interest, and equity in loss of related joint venture	(908)	220	23,390	33,742	(3,455)	(3,421)
Income tax expenses (benefit)		542	4,250	5,406	(817)	(809)
Income (loss) before minority interest and equity in loss of related joint venture	(908)	(322)	19,140	28,336	(2,638)	(2,612)
Minority interest				(17)	(2)	(2)
Equity in loss of related joint venture				296	394	390
Net income (loss)	W (908)	W (32)	W 19,140	W 28,057	W (3,030)	US\$ (3,000)
Earnings (loss) per share:						
Basic and diluted per share	W (492)	W (96)	W 3,730	W 5,056	W (445)	US\$ (0.44)
					(111)	(0.11)

Basic and diluted per ADS						
Weighted average number of shares outstanding (basic and diluted)	1,846,575	3,355,616	5,130,895	5,548,900	6,803,147	6,803,147
Balance sheet data:	(Unaudited)					
Cash and cash equivalents	W 1,820	W 560	W 5,405	W 16,405	W 25,874	US\$ 25,618
Total current assets	2,383	7,916	17,824	46,868	109,428	108,345
Property and equipment, net	522	2,254	5,417	14,760	11,863	11,746
Total assets	3,055	13,617	36,424	68,644	144,857	143,423
Total current liabilities	1,123	8,251	10,575	12,221	19,448	19,255
Total liabilities	2,912	13,707	13,960	18,209	24,073	23,835
Total shareholders equity	143	(90)	22,464	50,435	120,762	119,566
Selected operating data and financial ratios:						
Gross profit margin(2)	100.0%	82.7%	85.9%	84.3%	70.0%	70.0%
Operating profit margin(3)	N/M	26.3	59.8	59.9	(5.0)	(5.0)
Net profit margin(4)	N/M	(3.2)	38.7	43.5	(5.7)	(5.7)

N/M = not meaningful

Notes:

- (1) For convenience, the Won amounts are expressed in U.S. dollars at the rate of Won 1,010.0 to US\$1.00.
- (2) Gross profit margin for each period is calculated by dividing gross profit by total revenues for each such period.
- (3) Operating profit margin for each period is calculated by dividing operating income (loss) by total revenues for each such period.

- (4) Net profit margin for each period is calculated by dividing net income (loss) by total revenues for each such period.

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Fluctuations in the exchange rate between Won and U.S. dollar may affect the market price of our ADSs. These fluctuations will also affect the U.S. dollar conversion by the depository of any cash dividends paid in Won and the Won proceeds received by the depository from any sale of our common shares represented by our ADSs.

In certain parts of this annual report, we have translated Won amounts into U.S. dollars for convenience purposes only. The noon buying rate is the rate in The City of New York used for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. Unless otherwise stated, all translations from Won to U.S. dollars were made at Won 1,010.0 to US\$1.00, which was the noon buying rate announced on December 31, 2005. The translation is not a representation that the Won or U.S. dollar amounts referred to herein could have been or could be converted into U.S. dollars or Won, as the case may be, at any particular rate, or at all. The table below sets forth, for the periods indicated, information concerning the noon buying rate for Won, expressed in Won per one U.S. dollar.

Year Ended December 31,	At End of Period	Average(1)	High	Low
	(Won per US\$1.00)			
2001	1,313.5	1,292.0	1,369.0	1,234.0
2002	1,186.3	1,250.4	1,332.0	1,160.6
2003	1,192.0	1,192.1	1,262.0	1,146.0
2004	1,035.1	1,139.3	1,195.1	1,035.1
2005	1,010.0	1,023.8	1,059.8	997.0
2006 (through June 29, 2006)	960.4	962.2	1,002.9	927.4
January	958.9	981.8	1,002.9	958.9
February	970.9	969.8	976.3	962.0
March	971.4	974.7	982.0	966.8
April	942.8	952.6	970.4	939.6
May	945.3	940.8	951.5	927.4
June (through June 29, 2006)	960.4	954.4	961.8	942.7

Note:

(1) Annual and monthly averages are calculated using the average of the daily rates during the relevant period.

3.B. Capitalization and Indebtedness

Not applicable.

3.C. Reasons for the Offer and Use of Proceeds

Not applicable.

3.D. Risk Factors**Risks Relating to Our Business**

We currently depend on one product, Ragnarok Online, for substantially all of our revenues.

Substantially all of our revenues have been and are currently derived from a single product, Ragnarok Online, which was commercially introduced in August 2002. In 2005, we derived approximately 88.3% of our revenues from Ragnarok Online. We expect to continue to derive a substantial portion of our revenues from Ragnarok Online. Our failure to maintain, improve, update or enhance Ragnarok Online in a timely manner or successfully enter new markets could reduce Ragnarok Online's user base, decrease its popularity, and reduce our revenues which would materially and adversely affect our business, financial condition and results of

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operations. In addition, we are currently developing Ragnarok Online II, the successor game to Ragnarok Online, as Ragnarok online has been in the market for close to four years and we believe that this game has reached relative maturity in our principal markets. Although we have indicated our plan to introduce Ragnarok Online II at various times in the past, the launch of this successor game has been delayed for various reasons, including technical difficulties. We currently intend to launch Ragnarok Online II by the end of 2006, although no assurance can be given that we will be able to meet our current anticipated launch date for this game. In addition, no assurance can be given that when launched, such game will gain market acceptance and popularity. 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. Our inability to launch Ragnarok Online II and if launched, the lack of popularity or market acceptance of such game, is likely to have a material adverse effect on our business, prospects, reputation, financial condition and results of operations.

If we are unable to consistently 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 maintain our growth and profitability, we must continually develop or publish commercially successful online games in addition to Ragnarok Online that will retain our existing users and attract new users. We have recently acquired a controlling interest in a third party developer that developed R.O.S.E. Online, from whom we used to have an exclusive license to distribute such game. In addition, we have acquired publishing rights for a casual game portal, as well as games licensed from third party online game developers. We are also internally developing two new massively multiplayer online role playing games, Requiem and Ragnarok Online II, a sequel to Ragnarok Online. No assurance can be given that the Requiem, Ragnarok Online II or any of the other games we develop or purchase licensing rights to, will gain popularity with the market or that we will generate sufficient revenues from such games to justify the costs of development and/or payment of licensing fees for such games.

A game's commercial success largely depends on appealing to the tastes and preferences of a critical mass of users as well as the willingness of such users to continue as paying subscribers after the completion of the free open beta testing stage, all of which are difficult to predict prior to a game's development and introduction. Developing games internally requires substantial development costs, including the costs of employing skilled developers and acquiring or developing game engines which enable the creation of products with the latest technological features. In order to succeed, we must acquire, license or develop promising games at an acceptable cost and ensure technical support for the successful operation of such games. The online game publishing market is highly competitive. And in order to successfully distribute and operate a game, we also need a sizable game management and support staff, continued investment in technology and a substantial marketing budget. If we are not able to consistently develop, acquire, license, launch, market or operate commercially successful online games, we may not be able to generate enough revenues to offset our initial development, acquisition, licensing or marketing costs, and our future business, financial condition and results of operations will be materially and adversely affected.

Our limited resources may affect our ability to manage our growth.

Our growth to date has placed, and the anticipated further expansion of our operations will continue to place, a significant strain on our management, systems and resources. In addition to training and managing our employees, we will need to continue to develop and improve our financial and management controls as well as our reporting systems and procedures appropriate for a publicly listed company. We cannot assure you that we will be able to efficiently or effectively manage the growth of our operations, and any failure to do so may limit our future growth and materially and adversely affect our business, financial condition and results of operations.

Table of Contents***We depend on license fees and royalty payments from our overseas licensees for a substantial portion of our revenues.***

In markets other than Korea, the United States and Canada, we license Ragnarok Online to overseas operators or distributors from whom we receive license fees and royalty payments based on a percentage of such operators revenues from Ragnarok Online. Such overseas license fees and royalty payments represented 70.0% of our revenues in 2005. In addition, we are heavily dependent on two licensees for a significant portion of our revenues. In 2005, we derived 31.1% of our total revenues from GungHo Online Entertainment Inc., our licensee in Japan, and 19.8% of our total revenues from Soft-World International Corporation, our licensee in Taiwan. Deterioration in our relationship with our material licensees, or material changes in the terms of our license with such licensees, will likely have a material adverse affect 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 conditions and results of operations. Our reliance on third parties that we do not control exposes us to certain risks that we would not encounter if we were to operate or distribute directly in such markets. If our overseas licensees fail to perform their contractual obligations or suffer from management or other problems in their businesses, our business operations in overseas markets and our ability to collect royalty payments from such markets may be materially and adversely affected. We may not be able to easily terminate our license agreements with our overseas licensees as these agreements do not specify particular financial or performance criteria that need to be met by our licensees. As our overseas licensees generally have the exclusive right to distribute our games in their respective markets generally for a term of two years, we may not be able to enter into a new license agreement in a particular country for the term of the agreement unless it is terminated earlier. Under the license arrangements, our overseas licensees may operate or publish other online games developed or offered by our competitors. Therefore, our overseas licensees may devote greater time and resources to marketing their proprietary games or those of our competitors than to ours. In general, we may not unilaterally terminate our license agreements. Furthermore, as a part of our license agreement with our licensees, we must provide technical and other consulting services to our licensees in order for them to offer Ragnarok Online in their markets. Our inability to provide such technical and other assistance may hinder our licensees' efforts to gain market share in their market and affect users' satisfaction and loyalty as well as impact the number of users in these markets for Ragnarok Online, which may lead to modifications in the terms and conditions of our licensing agreement with our licensees and, in certain circumstances, result in our licensees terminating 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. We generally receive royalties earned by us from such licensee within 20 to 30 days following the end of each month (except Europe and China, where such payments are received up to 60 days after the record date). Online payment systems in China and certain other countries are still in a developmental stage and are not as widely available or used. Payment for online game services in these countries generally take the form of prepaid cards sold in Internet cafés, convenience stores and other distribution channels. Some of our overseas licensees rely heavily on a multilayer distribution and payment network composed of third party distributors for sales to, and collection of payments from, users. 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. In addition, although we have pursuant to our license agreement audit rights to the database of our licensees to ensure that proper payment amounts are being recorded and remitted, such activities can be disruptive and time consuming and we have as a result not always exercised such rights. Certain of our licensees in the past have failed to accurately report amounts due to us and have diverted certain payables to us to our former chairman, in contravention of our license agreements.

Table of Contents***We operate in a highly competitive industry and compete against many large companies.***

Many companies worldwide, including over 100 companies in Korea alone, are dedicated to developing and/or operating online games. 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 massively multiplayer online role playing game industry vary in size from small companies to very large companies with dominant market shares such as NCsoft of Korea and Shanda of China. We also compete with online casual game and game portal companies such as NHN, Nexon and CJ Internet, all from Korea. In addition, we may face stronger competition from console game companies, such as Sony, Microsoft, Electronic Arts, Nintendo and Sega, many of which have announced their intention to expand their game services and offerings over the Internet. For example, Electronic Arts recently announced that it has entered into an agreement to acquire Mythic Entertainment Inc. Upon consummation of the transaction, it is expected to give Electronic Arts, one of the world's leading games publisher by sales, an entry into the market for massively multiplayer online games. 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 or third-party game developers to the same degree as certain of our competitors.

As the online game industry in many of our markets is relatively new and rapidly evolving, our current or future competitors may compete more successfully as the industry matures. In particular, 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 other strategic relationships with larger, longer-established and better-financed companies and therefore obtain significantly greater financial, marketing and game licensing and development resources than we have. Increased competition in the online game industry in our markets 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 and Taiwan, growth of the market for online games has slowed while competition continues to be 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.

We have a limited operating history, which may make it difficult for you to evaluate our business.

We have a limited operating history upon which you can evaluate our business and prospects. Our business was established in April 2000 but Ragnarok Online was commercially introduced in August 2002. Our senior management and employees have worked together at our company for a relatively short period of time, including as a result of frequent changes in senior management to date. In addition, the online game industry, from which we derive substantially all of our revenues, is a relatively new industry. The first massively multiplayer online role playing game in Korea was developed and distributed by one of our competitors in 1996. Since then, only a limited number of companies have successfully commercialized such online games on an international scale. You must consider our business prospects in light of the risks and difficulties we encounter as an early-stage company in a new and rapidly evolving industry. We may not be able to successfully address these risks and difficulties, which could materially harm our business prospects, financial condition and results of operations.

Rapid technological change may adversely affect our future revenues and profitability.

The online game industry is subject to rapid technological change in areas including hardware, software and content programming. We need to anticipate the emergence of new technologies and games, assess their likely market acceptance, and make substantial game development and related investments. In addition, new technologies in online game programming or operations could render our current or future games obsolete or unattractive to our subscribers, thereby limiting our ability to recover game-related development, acquisition

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or licensing costs and potentially materially and adversely affecting our business, financial condition and results of operations.

If we fail to retain and hire skilled and experienced game developers or other key personnel in order 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 in the future, we will need to attract and retain skilled and experienced online game developers and other key personnel. While certain of our current senior employees or staff members are bound by non-competition agreements for six months after termination of employment with us, since our industry is characterized by high demand and intense competition for talent, we may need to offer higher compensation and other benefits in order to retain or replace key employees, and no assurance can be given that should such key employees leave, that we will be able to hire qualified employees to replace them, or on terms that are reasonable. In addition, as we are still a relatively young company and our business has grown rapidly since our establishment, at times our ability to train and integrate new employees into our operations may not meet the growing demands of our business.

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 no control. If our users have a negative experience with our games related to or caused by undetected programming errors or flaws, they may be less inclined to continue or resume subscriptions for our games or recommend our games to other potential users. Undetected programming errors and game defects can also 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.

Any failure to maintain satisfactory performance, reliability, security and availability of our network infrastructure, whether maintained by us or by our overseas licensees, may cause significant harm to our reputation and 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 all 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.

From time to time, we detect users that gain an unfair advantage by modifying Ragnarok Online execution files saved on the users' computers to facilitate the progression of their game characters. Unauthorized character manipulation may negatively impact the image and users' perception of Ragnarok Online and could limit the popularity of the games and damage our reputation.

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

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

We regard our copyrights, service marks, trademarks, trade secrets and other intellectual property as critical to our success. 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. For example, in April 2003, we discovered that the server-end software of Ragnarok Online was unlawfully released in Korea, China and the United States. This enabled unauthorized third parties to set up local server networks to operate Ragnarok Online, which may have resulted in a diversion of a significant number of paying subscribers. Since then, we have designated certain employees to be responsible for detecting these illegal servers and reporting them to the relevant enforcement authority in Korea in charge of crimes on the Internet. In overseas markets, we cooperate with and rely on our overseas licensees to seek enforcement actions against operators of illegal free servers. We may incur considerable costs in the future to remedy software piracy 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 regime of Korea, Japan, Taiwan, Thailand, China and certain other countries in which our games are distributed are uncertain or do not protect intellectual property rights to the same extent as do the laws and enforcement procedures of the United States and other developed countries. 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, and could disrupt our business, as well as 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 in the ordinary course of our business. 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 incur licensing fees or be forced to develop alternative technology or obtain other licenses. In addition, 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 certain of our current or potential competitors. To the extent these employees have been and are involved in the development of our games similar to the development in which they have been involved at their former employers, we may become subject to claims that such employees or we 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 the conduct of our business and have a material adverse effect on our reputation, business, financial condition and results of operations.

The discontinuation of any of the preferential tax treatments currently available to us in Korea could materially and adversely affect our business, financial condition and results of operations.

Under Korean law and regulations, small- and medium-sized venture companies may be entitled to enjoy a preferential tax treatment from the Korean government in the form of a 50% reduction in corporate income tax rates for the year in which it first generates taxable income and the following five years if such company

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satisfies a number of financial and non-financial criteria, including the maintenance of its status as a designated venture company. In 2002, when we first generated taxable income, we qualified for the preferential tax treatment and enjoyed the 50% reduction in corporate income tax rates. In 2005, we also qualified for this preferential treatment and our applicable corporate income tax rate (including resident surtax) was 13.75% after the 50% reduction. A company that engages in data processing or computer related businesses, including us, may qualify as a small-and medium-sized enterprise under the Framework Act on Small- and Medium-Sized Enterprises if, among other things, (i) we hire less than three hundred full-time employees or (ii) our total revenue does not exceed Won 30 billion (US\$30 million). In 2004, we failed to satisfy both of these tests. However, even if a company fails to satisfy both of the preceding requirements, it may continue to enjoy its status as a small- and medium-sized enterprise for the following three years so long as that company neither (x) merges into, nor consolidates with, another company nor (y) becomes an affiliate of certain large enterprises. Accordingly, we believe that we qualify as a small- and medium-sized company through September 2007 as long as we satisfy such conditions. See Item 5.A. Operating Results Overview Income tax expenses. However, if the National Tax Service were to audit us and determine that we were not entitled to such tax benefit, we may be required to pay back-taxes and statutory interest.

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

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

distributing games developed in-house;

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

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

taking advantage of our popular online games to strengthen our other lines of businesses, such as mobile games, animation and character merchandising;

selectively pursuing acquisitions of, investments in, or joint ventures with, game development companies, technologies and personnel that are complementary to our existing business; and

investing our capital in investment funds which target online game industry, with the goal, among others, of increasing our knowledge of, as well as building relationship with, potential third party developers of online games.

In addition, we have formulated a strategic vision to promote our role as a hub for integrating the financial and human resources, technology and distribution networks worldwide to create and publish online games globally. To this end, we will continue to (i) strengthen our efforts to develop online games, (ii) identify and implement opportunities for overseas publishing of our games, (iii) establish strategic alliances with major players in the online game industry in Korea, (iv) enhance brand recognition for our key online games and facilitate cross-selling of other products and (v) promote our mobile games.

We cannot assure you that we will be successful in any of these strategies. Some of these strategies relate to new services or products for which there are no established markets, or in which we lack experience and expertise. If we are unable to successfully implement our growth strategies, our revenues, profitability and competitiveness may be materially and adversely affected. Our growth potential in many of the markets in which Ragnarok Online is currently distributed or which we intend to enter may be limited since the penetration rate for personal computers is relatively low and the cost of Internet access relative to the per capita income is higher in such markets when compared to some of our principal markets such as Korea and Japan. If we decide to pursue acquisitions, investments or joint ventures to achieve growth, the success of such acquisitions, investments or joint ventures will depend on the availability of suitable acquisition and investment candidates at an acceptable cost, our ability to compete effectively to attract and reach agreement with acquisition candidates or joint venture partners on commercially reasonable terms, and the availability of financing to complete such acquisitions, joint ventures or investments. For example, in May 2006, we

entered into a contract to invest US\$9 million in Perpetual Entertainment, Inc. an online game developer based in the

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United States. Also, in December 2005, we completed our acquisition of a controlling interest in NEOCYON, Inc., a mobile Internet solution provider in Korea. In December 2005, we entered into an agreement with Movida Investment Inc., SOFTBANK CORP. and eight other companies to invest in Online Game Revolution Fund No. 1, with total capital commitment in the amount of Japanese Yen 1 billion, which represents 10% of the aggregate size of the fund. As of the date hereof, we have invested Japanese Yen 100 million, which represents 10% of our total capital commitment. We cannot be certain that any particular acquisition, investment or joint venture will produce the intended benefits on a timely basis or at all.

Mr. Il Young Ryu, our chairman, chief executive officer and representative director and also the representative director of EZER Inc., our largest shareholder, has substantial control over us and can delay or prevent a change in corporate control.

As of June 26, 2006, Mr. Il Young Ryu, our chairman, chief executive officer and representative director and also the representative director of EZER Inc., our largest shareholder, beneficially owned, in the aggregate, approximately 52.4% of our outstanding common shares. As a result, Mr. Ryu exerts 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. Mr. Ryu also has the power to prevent or cause a change in control. In addition, 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 corporation incorporated in the United States. 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 corporation incorporated in the United States. Holders of our ADSs may have more difficulty protecting their interests against actions of our management, members of our board of directors or controlling shareholder than they would as shareholders of a corporation incorporated in the United States.

Our business may be adversely affected by developments affecting the Korean economy and other of our principal markets.

We are incorporated and headquartered in Korea, and derived 18.9% of our revenues in 2005 from our operations in Korea. In addition, in 2005, we derived an aggregate of 61.3% of our revenues from Japan, Taiwan and Thailand. Accordingly, our business, financial condition, results of operations and prospects are subject, to a significant extent, to economic, political, legal and regulatory conditions and developments in these countries.

We have limited business insurance coverage in Korea.

The insurance industry in Korea is still at an early stage of development. In particular, Korean insurance companies offer limited business insurance products. As a result, we do not have any business liability or disruption insurance coverage for our operations in Korea. In 2004 and 2005, we derived 21.0% and 18.9% of our total revenues from Korea, respectively. Any business disruption, litigation or natural disaster might result in our incurring substantial costs and the diversion of our resources.

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

According to the 2005 report issued by the Korean Game Development and Promotion Institute, or KGDI, the growth in the number of active Internet cafés in Korea has stabilized since 2000 and the number of such cafés actually declined in 2003, with no significant change to the number of active Internet cafés in 2004 from 2003. We believe that there was no significant change in the number of active Internet cafés in 2005. Intensifying competition for users of online games, as well as more widespread availability of personal computers, or PCs, and broadband Internet access in homes in Korea could trigger further declines in the number of Internet cafés. Future reductions in the number of Internet cafés operating in Korea could adversely affect our ability to target a core group of potential users, who tend to prefer playing online games, in particular, massively multiplayer online role playing games, at Internet cafés.

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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 provides that a company is not an investment company and is not required to register under the Investment Company 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, owning, holding or trading in securities; and

40% or less of the fair market value of the company's assets is represented by investment securities.

We believe that we are engaged primarily and directly in the businesses of providing online game services, that less than 40% of the fair market value of our assets is represented by investment securities and, consequently, that we are not an investment company as that term is defined under the Investment Company Act. However, in the future we may be required to take actions to avoid the requirement to register as an investment company, such as shifting a significant portion of our long- and short-term investment portfolio into low-yielding bank deposits or other short-term securities which are not considered to be investment 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 Investment Company 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, among other things, effectively be precluded from making public offerings in the United States. We could also be subject to administrative or legal proceedings and, among other things, contracts to which we are a party might be rendered unenforceable or subject to rescission.

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 future economic growth of our principal markets. Adverse developments in such markets may have an adverse effect on the number of our subscribers and results of operations, which could have a material adverse effect on our business.

A deterioration in the economies of the countries in which our games are distributed can also occur as a result of deterioration in global economic conditions. The worldwide economy has experienced periods of economic weakness since the beginning of 2001, which has been exacerbated by the terrorist attacks in the United States on September 11, 2001, recent developments in the Middle East, including the war in Iraq and terrorist attacks and threats across the globe and rising oil prices. In addition, if investors perceive that there is a crisis in Asia, such as due to economic difficulties similar to those that Asian economies experienced in the late 1990s, companies and economies in that region may be adversely affected irrespective of their economic soundness.

Any future deterioration in global economic conditions, or a significant adverse change in politics and economies in Asia or a loss of investor confidence in the financial systems of emerging and other markets could have a material adverse effect on our business, financial condition and results of operations.

We may have been in 2005, and may be in subsequent years, a passive foreign investment company, which could result in adverse U.S. tax consequences to 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 in 2005, we may have been in 2005, and

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may be in subsequent years, a passive foreign investment company for U.S. federal income tax purposes. If we are a passive foreign investment company 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 passive foreign investment company in any taxable year. See Item 10.E. Taxation U.S. federal income tax considerations Passive foreign investment companies.

We have identified certain 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 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.

In connection with the audit of our financial statements prepared under U.S. GAAP for the year ended December 31, 2005, we have identified certain material weaknesses (as defined under Standards of the Public Company Accounting Oversight Board (United States)) in our system of internal controls over financial reporting. Specifically, we did not maintain a control environment adequate to encourage the prevention or detection of the override of our controls or intentional misconduct, including the embezzlement of revenues due to us, improper payment for assets not purchased for our benefit, the intentional and inappropriate early recognition of revenue and the preparation of false management reports, accounting records, financial statements and documents together with forged invoices. The absence of effective control environment allowed our former Chairman to take inappropriate actions that resulted in certain transactions not being properly reflected in our consolidated financial statements as of December 31, 2003 and 2004 and for the years ended December 31, 2002, 2003 and 2004. Such intentional misconduct by the former Chairman included the preparation of false accounting records and documents to deceive accounting personnel under his supervision, other members of senior management, our Board of Directors and our independent registered public accountants. Additionally, the lack of an effective control environment allowed our lines of communication among, and our monitoring of, our operations and accounting personnel, including the former Chairman, to be ineffective in preventing or detecting these instances of intentional misconduct. Taken as a whole, our control environment did not adequately emphasize appropriate judgment, skepticism and objectivity, which we believe contributed to the events which necessitated our having to restate our financial statements and us having to file an amendment to our annual report on F-20 for the fiscal year ended December 31, 2004.

This control environment material weakness could result in misstatements of any of our financial statement accounts that are not prevented or detected which could result in a material misstatement to our annual consolidated financial statements. Accordingly, our management has determined that this control deficiency constitutes a material weakness. This material weakness in our control environment contributes to the existence of the certain additional material weaknesses, including, lack of independent oversight and supervision controls, lack of controls over the reported revenues from our overseas licensees, lack of controls over bank accounts, lack of sufficient complement of personnel, lack of controls over the purchase and accounting for fixed assets and lack of controls over the financial close and reporting process.

Our management, in particular, our CEO and CFO along with the Audit Committee, is in the process of addressing the material weaknesses and will seek to put in place a system of internal control over financial reporting which will remediate such material weaknesses as expeditiously as possible. All disclosure controls and procedures, no matter how well designed, however, have inherent limitations including the possibility of human error and the circumvention or overriding of the controls and procedures. 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

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(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.

Furthermore, we are subject to the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act. The Sarbanes-Oxley Act 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 accountants must provide an attestation report on management's assessment of internal controls beginning from the fiscal year ending December 31, 2006. We have not yet fully completed the establishment of a system of internal controls appropriate for our anticipated reporting requirements. No assurance can be given that we will be able to establish such system in a timely manner and even if we do, that our internal controls system will not fail in the future.

If we fail to create 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 confidence and the market price of our ADSs may be adversely affected. See Item 15. Controls and Procedures for additional discussion concerning our material weaknesses.

Risks Relating to Recent Developments at GRAVITY

Our senior management team is required to devote a significant amount of attention to matters arising from events related to the embezzlement of funds by the former Chairman.

Our Chief Executive Officer, our Chief Financial Officer and all members of our Audit Committee and certain senior members of our management have changed from the time of filing of our annual report on Form 20-F for the fiscal year ended December 31, 2004 originally filed on June 30, 2005. Our new directors and senior management team's ability to manage the Company's business has been hindered by their need to spend significant time, effort and resources addressing our internal review of events related to the internal investigation into embezzlement of company funds by Mr. Jung Ryool Kim, our former Chairman, which led to the issuance by the Company of restated financial statements as of December 31, 2003 and 2004 and for the years ended December 31, 2002, 2003 and 2004 and our amending our annual report on Form 20-F for the fiscal year ended December 31, 2004. Our board of directors and our senior management have had to spend considerable amount of time communicating with regulators, auditors, external advisors with respect to the investigation, developing effective corporate governance procedures and designing and implementing effective internal control over financial reporting. In addition, because our directors and senior management are new to the company, and by virtue of their relatively short tenure in their respective positions, these individuals may be required to expend more time and resources to undertake such efforts as they are not as familiar with our business. We cannot assure you that the demands on our senior management and directors to address such matters will not adversely affect our business, prospects, financial condition and results of operations.

Harm from continued regulatory scrutiny and securities litigation

We have received and continue to receive requests and inquiries from the staff of the Securities and Exchange Commission, the officials of Nasdaq, shareholders and others seeking information regarding our financial condition and results of operations, accounting and related internal controls over financial reporting and details related to the Investigation and the Restated Financial Statements. We cannot predict if such inquiries will ultimately lead to formal investigations and enforcement actions by the Securities and Exchange Commission or Nasdaq, or other government agencies or lead to lawsuits filed by our shareholders. If such formal investigations or enforcement actions occur or lawsuits are brought, we may be required to pay material fines, consent to injunctions on future conduct, be subject to other penalties or be required to expend time and resources on defending against such litigation, each of which could have a material adverse effect on our business, financial condition and results of operations.

Furthermore, we are currently subject to a class action lawsuit pending in the United States District Court for the Southern District of New York titled *In Re Gravity Co., Ltd. Securities Litigation* (Consolidated Civ. Act. No. 1:05-CV-4804 (LAP.)). This action combines three separate lawsuits filed in the Southern District in May 2005, which were consolidated by an order of the Court entered on December 12, 2005. The

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plaintiffs seek to represent a class of persons who purchased our ADSs in the open market between February 7, 2005 and May 12, 2005. Each of the complaints alleged violations of the Securities Act of 1933 and the Exchange Act of 1934 against us and the former individual directors and officers. The claims arise out of an initial public offering of our ADSs in the United States beginning February 7, 2005. Plaintiffs allege that, in connection with the public offering of the ADSs, we misstated or omitted material information relating to various aspects of our business, including an alleged decline in sales of our core online product, and material adverse trends affecting our mobile animation business and Chinese operations. Plaintiffs seek, for themselves and the class members, compensatory damages, fees and expenses and other unspecified relief. Following the consolidation of the actions, a Stipulation and Order was entered by the Court in which, among other things, it provided for the filing of a single consolidated amended complaint by the later of February 28, 2006 or 45 days after we announce a restatement of our previously issued financial statements. As of the date of this report, the consolidated amended complaint has not yet been filed or served. We cannot at this time determine what the final conclusion of such litigation will be, including any damages which may need to be paid or any amounts which may be paid in settlement. A judgment against us in such litigation may result in significant damages. Also, any settlement amounts, if we were to agree to settle, may be significant and may have a material adverse affect on our financial condition, results of operations and liquidity.

In addition, certain of our minority shareholders in Korea and outside of Korea have recently made various demands on our management, including with respect to our corporate governance practices. For example, certain of our minority shareholders have formed a committee named The Gravity Committee for the Fair Treatment of Minority Shareholders, or the Minority Shareholders Committee, in March 2006 and have since made a number of requests, including inspection of our financial documents. In particular, the Minority Shareholders Committee has recently issued a press release announcing the intention to 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. 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, in the future, 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 operation.

Risks Relating to Our Regulatory Environment

Our operations are subject to the regulation of the Internet in certain of the countries in which our games are distributed, such as Korea, China, Taiwan, Japan and Thailand, the impact of which is difficult to predict.

The regulatory and legal regimes in nearly all of the countries in which our games are distributed have yet to establish a sophisticated set of laws, rules or regulations designed to regulate, among other things, the social, political and financial risks relating to the online game industry. However, in many of our principal markets, such as Korea, China, Taiwan and Thailand, the legislators and regulators have, either through public announcements or press releases, indicated their intention to implement laws, rules or regulations regulating and restricting this industry, which include laws or regulations relating 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. In some of these countries, distribution of information over the Internet and electronic commerce are currently under legal and regulatory review. Other countries in which our games are distributed or which we intend to enter may adopt similar laws and regulations. The impact of such laws and regulations on our business and results of operations is difficult to predict. 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 and results of operations.

Table of Contents***Our online games may be subject to governmental restrictions or rating systems, which could delay or prohibit the release of new games or reduce the existing and potential range 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 rating classifications and implement procedures to restrict the distribution of online games to certain age groups. Similar mandatory rating systems and other regulations affecting the content and distribution of our games have also 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 games or alter our marketing strategies to comply with new governmental regulations or new ratings assigned to our current or future games that may call for restrictions or modifications to our game content or features, which could delay or prohibit the release of new games or upgrades and reduce the existing and potential range of our user base. Moreover, uncertainties regarding governmental restrictions or rating systems applicable to our business could give rise to market confusion, thereby materially and adversely affecting our business.

The legal systems in some of the countries where our games are distributed have uncertainties which could limit the legal protections available to us.

The laws, regulations and legal requirements in many of the countries in which our games are distributed are constantly changing, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us. We cannot predict the effect of future developments in the legal systems in these countries, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. If the cost of regulatory compliance increases for our licensees as a result of regulatory changes, our licensees may in the future seek to reduce royalties and license fees, which may materially and adversely affect our licensee's business and our results of operations and financial condition.

If our licensee in Taiwan adopts the model consumer contract promulgated by the ROC Ministry of Economic Affairs or the ROC Ministry of Economic Affairs imposes additional regulatory burdens on our licensee in Taiwan, our licensee in Taiwan may require us to reduce the license fee or royalties, or share the cost of regulatory compliance.

In 2004 and 2005, we derived 22.7% and 19.8%, respectively, of our total revenues from our licensee in Taiwan. As a result of increasing disputes between the online game companies and consumers in Taiwan, on February 17, 2006, the ROC Ministry of Economic Affairs of the Executive Yuan (the ROC MOEA) has promulgated a model consumer contract that online game companies are encouraged to adopt. In addition, the ROC MOEA may, within its authority, further consider promulgating certain standard provisions that must be included in a consumer contract that online game companies must use in order to operate in the future when necessary. If our licensee in Taiwan adopts the above model consumer contract or these standard provisions are implemented, the cost of regulatory compliance may significantly increase for our Taiwanese licensee. Our Taiwanese licensee may in the future seek to reduce royalties and license fees, which may materially and adversely affect our licensee's business and our results of operations and financial condition.

Our business may be adversely affected by complexities, uncertainties and changes in law and regulations of China regulating Internet companies and businesses operating in China, including those related to online games.

In 2004 and 2005, we derived 4.4% and 2.2%, respectively, of our total revenues from our licensee in China. The Chinese government, through various regulatory authorities, heavily regulates the Internet sector, which includes the online game industry. These laws and regulations include the following:

restrictions on content on the Internet, including restriction on distribution of online games containing content that purports to propagate obscenity, gambling or violence, instigate crime, undermine public morality or the cultural traditions of China, or compromise state security or secrets;

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license and permit requirements for companies in the Internet industry, including for importing and operating online games, from various regulatory authorities; and

restrictions on and supervision of Internet cafés, including closing of unlicensed Internet cafés and requiring installation of security software to prevent access to subversive sites.

In addition, there are uncertainties in the interpretation and application of existing Chinese laws, regulations and policies regarding the businesses and activities of Internet companies and businesses in China, including those related to our online games. Any violations of the foregoing laws and regulations as well as other laws and regulations to be introduced in the future could materially and adversely affect the business and results of operations of our Chinese licensee and us.

Restrictions on currency exchange in certain of the countries in which our games are distributed may limit our ability to receive and remit revenues effectively.

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

In many of our markets, we rely heavily on our overseas licensees to operate and distribute our games and to comply with applicable laws and government regulations.

We rely on our overseas licensees for substantially all aspects of our overseas operations, including:

holding the required government licenses for the operation and distribution of our games;

publishing, advertising and marketing our games;

establishing the pricing of our games after consultation with us;

owning and operating the server network and other aspects of game management and maintenance;

providing customer service and trouble-shooting;

maintaining network security and providing back-up for game data and software; and

billing and collecting subscription fees from users and remitting royalty payments to us.

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 have a material adverse effect on our business, financial condition and results of operations.

Restrictions on currency exchange in Korea in certain emergency circumstances may limit our ability to utilize effectively revenues generated in Won to fund our business activities outside Korea or expenditures denominated in foreign currencies.

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 an outbreak of natural calamities, wars, conflict 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 macroeconomic policies of Korea. Such restrictions may limit our ability to utilize effectively revenues generated in the Won to fund our business activities outside Korea or expenditures denominated in foreign currencies.

Table of Contents***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 tax credit computed based on the amount of income withheld overseas when filing our income tax return in Korea, up to a limited amount. Accordingly, the amount of taxes withheld overseas may be offset against tax payable in Korea. Adverse changes in tax treaties between Korea and the countries from which we receive license fees and royalties, in 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***Fluctuations in exchange rates could result in foreign currency exchange losses.***

In 2005, approximately 81.1% 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, other than the United States, Japan and Europe, the revenues generated by our licensees in those markets are denominated in local currencies, which include the NT dollar, the Baht and the Renminbi. Depreciation of these 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 our monthly royalty revenues from our overseas licensees in foreign currencies, primarily the U.S. dollar, the Japanese Yen and the Euro, substantially all of our costs are denominated in Won. Our financial statements are also prepared and presented in the 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. We generally receive these royalty payments 20 to 30 days after such record date (except in Europe and China, where such payments are received up to 60 days after the record date). Appreciation of the Won against these foreign currencies during this period will result in foreign currency losses that may materially and adversely affect our financial condition and results of operations.

As of December 31, 2005, there are no outstanding foreign currency forward exchange contracts entered into by us. 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.

Relations between Korea and North Korea have been tense over most of Korea's modern history. 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 and North Korea. The level of tension between Korea and North Korea, as well as between North Korea and the United States, has increased as a result of North Korea's admission in October 2002 to the maintenance of a nuclear weapons program in breach of the peace accord executed in October 1994. In response, the United States, Japan, Korea and the European Union (which became party to the 1994 accord in November 2002) decided to suspend shipments of oil to North Korea called for by the 1994 accord and reiterated their demands for the dismantling of North Korea's nuclear weapons program. Following the suspension of oil shipments, North Korea removed the seals and surveillance equipment from its Yongbyon nuclear power plant and evicted inspectors from the United Nations International Atomic Energy Agency, or IAEA, and has reportedly resumed activity at its Yongbyon power plant. In January 2003, North Korea announced its intention to withdraw from the Nuclear Non-Proliferation Treaty, demanding that the United States sign a non-aggression pact as a condition to North Korea dismantling its nuclear program. In August 2003, representatives of Korea, the United States, North Korea, China, Japan and Russia held multilateral talks in an effort to resolve issues relating to North Korea's nuclear weapons program. While the talks

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concluded without resolution, participants in the August meeting indicated that further negotiations may take place in the future and, in February and June 2004, six-party talks were held in Beijing, China. In June 2004, the third round of the six-party talks resumed in Beijing, which ended with an agreement by the parties to hold further talks by the end of September 2004, which failed to take place as planned due to North Korea's refusal to participate. In February 2005, North Korea announced that it possessed nuclear weapons. In September 2005, North Korea agreed to end its nuclear weapons program, and the six participating nations signed a draft preliminary accord pursuant to which North Korea agreed to dismantle its existing nuclear weapons, abandon efforts to produce new future weapons and readmit international inspectors to its nuclear facilities. In return, the other five nations participating in the talks, China, Japan, Korea, Russia and the United States, expressed willingness to provide North Korea with energy assistance and other economic support. The six parties agreed to hold further talks in November 2005. However, one day after the joint statement was released, North Korea announced that it would not dismantle its nuclear weapons program unless the United States agreed to provide civilian nuclear reactors in return, a demand that the United States rejected. We cannot assure you that future negotiations will result in a final agreement on North Korea's nuclear program, including critical details such as implementation and timing, or that the level of tensions between Korea and North Korea will not escalate. Any further increase in tensions, resulting for example from a break-down in contacts, test of long-range nuclear missiles coupled with continuing nuclear programs by North Korea 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.

The government of China asserts sovereignty over mainland China and Taiwan and does not recognize the legitimacy of the government of Taiwan. The government of China 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. On the other hand, the government of Taiwan promulgated the Referendum Law on December 31, 2003 and as last amended on May 30, 2006 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 comes under military attack from a foreign power and its sovereignty is threatened. In 2004 and 2005, we derived 22.7% and 19.8% of our total revenues from our licensee in Taiwan. 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.

The economic, political and social conditions, as well as government policies in China, could adversely affect our operations in China.

In 2004 and 2005, we derived 4.4% and 2.2% of our total revenues from our licensee in China, respectively. While the Chinese economy has experienced significant growth in the past twenty years, growth has been uneven, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall Chinese economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us or our licensees.

The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. Although the Chinese government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the Chinese government. In addition, the Chinese government continues to play a significant role in regulating industry development by imposing industrial policies. The Chinese government also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies.

Table of Contents**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 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 significant and irreparable injury to the company or to apply to the court for reorganization in the case of an insolvency and (iv) 20 percent to block a small-scale share exchange 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 concept of a business judgment rule 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 in a particular circumstance. Holders of our ADSs may have more difficulty protecting their interests against actions of our management, members of our board of directors or controlling shareholder than they would as shareholders of a U.S. corporation.

Any dividends paid on our common shares will be in the 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 in connection with the deposit agreement. 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

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deposit agreement, we have consented to any deposit to the extent that, after the deposit, the aggregate number of deposited common shares does not exceed 3,552,229 common shares or any greater number of common shares we determine from time to time (i.e., as a result of a subsequent offering, stock dividend or rights offer), unless the deposit is prohibited by applicable laws or violates our articles of incorporation; provided, however, that in the case of any subsequent offer by us or our affiliates, the limit on the number of common shares on deposit shall not apply to such offer and the number of common shares issued, delivered or sold pursuant to the offer (including common shares in the form of ADSs) shall be eligible for deposit under the deposit agreement, except to the extent such deposit is prohibited by applicable laws or violates our articles of incorporation, or, in the case of any subsequent offer by us or our affiliates, we determine with the depository to limit the number of common shares so offered that would be eligible for deposit under the deposit agreement in order to maintain liquidity of the shares in Korea as may be requested by the relevant Korean authorities. We might not consent to the deposit of any additional common shares. As a result, if a holder surrenders ADSs and withdraws common shares, it may not be able to deposit the common shares again to obtain ADSs.

You may not be able to exercise preemptive rights or participate in rights offerings and may experience dilution of your holdings.

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;

as necessary for the inducement of technology, to certain companies under an alliance arrangement with us; or

by a public offering or subscribed for by the underwriters for the purpose of listing on the Korean public stock markets.

Accordingly, if we issue new shares to non-shareholders based on such exception, a holder of our 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 U.S. 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 depository 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.

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Accordingly, you may not be entitled to exercise preemptive rights and may thereby suffer dilution of your interests in us.

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

As an ADS holder, we will not treat you as one of our shareholders and you will not have the rights of a shareholder. Korean law governs shareholder rights. The depositary will be the shareholder of the common shares underlying your ADSs. As a holder of ADSs, you will have ADS holder rights. A deposit agreement among us, the depositary and you, as an ADS holder, sets out ADS holder rights as well as the rights and obligations of the depositary. New York law governs the deposit agreement and the ADSs. 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, we cannot ensure that you will receive voting materials or otherwise learn of an upcoming shareholders' meeting in time 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 our direct shareholders.

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, 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 ADRs 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 American depositary receipts, or 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, as of the date hereof, the common shares underlying the ADSs are not listed on any stock exchange in Korea. Your ability to sell the underlying common shares following withdrawal and the liquidity of the common shares may be limited.

You may be subject to Korean withholding tax.

Under Korean tax law, if you are a U.S. investor, you may be subject to Korean withholding taxes on capital gains and dividends in respect of the ADSs unless an exemption or a reduction under the income tax treaty between the United States and Korea is available. Under the United States-Korea 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 United States-Korea income 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

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with respect to such capital gains is substantially less than the tax generally imposed by the United States on corporate profits, and 25% or more of the holder's capital is held of record or is otherwise determined, after consultation between competent authorities of the United States and Korea, to be owned directly or indirectly by one or more persons who are not individual residents of the United States and (ii) in case the holder is an individual, if such holder maintains a fixed base in Korea for a period or periods aggregating 183 days or more during the taxable year and the holder's ADSs or common shares giving rise to capital gains are effectively connected with such fixed base or such holder is present in Korea for a period or periods of 183 days or more during the taxable year.

You may have difficulty bringing an original action or enforcing any judgment obtained outside Korea against us, our directors and officers or other offering participants, such as underwriters or experts, who are not U.S. persons.

We are organized under the law of Korea, and all of our directors and officers reside in Korea. All or a significant portion 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. We have, however, irrevocably appointed an agent in New York to receive service of process in any proceedings in the State of New York relating to our ADSs. Notwithstanding the foregoing, 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.