

Risk factors

Specified below are some of the business- and industry-related risk factors that could have consequences for NetEnt's future development. The risk factors are not arranged in order of importance or potential financial impact on the Company's revenues, profit or financial position. For financial risk factors that affect the Company's business, see Note 26.

POLITICAL DECISIONS

NetEnt is a supplier of digitally distributed gaming systems for casino games online. The business is highly dependent on the legal landscape for this type of game, primarily in the EU since the majority of the Company's customers are based in Europe.

NetEnt is legally based in the EU, which provides the Company with constitutional protection for business activities that follow from national law, EU law, and the overarching WTO system. Nonetheless, the operations are dependent on the legal and political conditions that apply to customers, i.e. the gaming operators. Developments in terms of the protection provided by EU law which customers have against national protectionist monopoly systems are of particular importance.

The market for basically all types of gaming services is regulated by national legislation that determines how gaming operations may be conducted. The European Court has dealt with national gaming regulations in a variety of rulings. Currently, EU law allows its Member States relative freedom of choice in the regulation of gaming. However, the regulations must meet the requirements of EU law regarding proportionality and nondiscrimination. They must meet the fundamental requirements regarding consistency and a systematic approach. For example, national regulation may not exclude private foreign entities on public health grounds if the government allows comprehensive promotion of public gaming companies at the same time. Those who argue against gaming monopolies express that gaming monopolies cannot be justified for health or safety reasons when they are operated for profit.

In recent years, the European Court and national courts have issued important rulings that affect the entertainment gaming market. Some rulings have contributed to opening up markets to private operators, while other decisions have been more protectionist. In 2009, the European Court gave Member States greater scope to preserve protectionist monopoly systems. Through a series of rulings in 2010, the European Court confirmed the principle that companies that are legally established in the EU have the right to also offer and provide online

gaming. Any limitations imposed by a Member State must be consistent, systematic, and harmonized. National restrictions must always be proportional in relation to the purpose that motivates the restriction.

It is notable that the gaming market has not been subject to specific harmonization measures in the EU. No legal instruments in the form of directives, regulations or decisions have been adopted by political EU institutions.

Deregulation and reregulation of national gaming laws are taking place in many European countries with, for example, Denmark and Spain having recently regulated online gaming. The development of national licensing systems has partly been prompted by recent case law in the European Court, which has provided Member States with slightly more freedom to implement limitations on offering cross-border gaming services. EU Member States have been given greater possibilities of securing tax revenues provided the licensing systems create sound competitive conditions and are formally open for all operators who meet certain criteria.

NetEnt has a "class 4 license" in Malta that covers delivery and technical operation of casino games for gaming operators licensed in Malta. Malta is a member of the EU, and is thus governed by EU law. Malta is one of the few countries in the EU that has opted to allow the gaming sector to be exposed to competition through a national licensing system. NetEnt also has a category 2 license in Alderney and licenses in Gibraltar, Belgium, the UK and Spain.

Political decisions and court rulings in the EU with the purpose of making it difficult for private gaming operators on national markets, primarily in Sweden, Malta, Italy, the UK and Norway outside the EU, could have severely negative consequences for NetEnt's customers and the Company's operations. A liberalization of the gaming market in these markets could likewise have a positive impact on the Company's customers, and thus on NetEnt.

In the current situation, it is difficult to predict how the legal landscape in the EU will develop, and thus affect the commercial conditions for gaming operators, and ultimately game developers such as NetEnt. Therefore, it must be pointed out in particular that, because of the current legal developments in the various Member States, in combination with emerging practice in EU law, NetEnt is operating in a relatively unpredictable legal environment, at least in terms of the EU market, and there is hence a risk (which is difficult to quantify) of NetEnt's operations being negatively affected by legal developments in the future.

OPERATIONS THAT REQUIRE A LICENSE AND OTHER LEGAL ASPECTS

Following a decision by the Malta Gaming Authority (MGA), NetEnt's subsidiary NetEnt Malta Ltd holds a "class 4 license", which means that the Company can offer gaming systems to its customers under the license, and that its products are MGA-approved. It is of great importance to NetEnt's business that the license is maintained and extended.

The license is issued with a five-year term and was extended in 2015. NetEnt also has a category 2 license in Alderney which enables the Company to offer its casino solution to gaming operators that are licensed by the gaming authority in Alderney. This license is valid until further notice and retaining it is of great importance to the Company. The gaming authority in Alderney, AGCC, performs regular inspections of NetEnt's business. If AGCC were to find that NetEnt no longer fulfills the license requirements, the authority can revoke the license. In Gibraltar, NetEnt has what is known as a Remote Gambling Licence, which is extended each year. In 2015 NetEnt obtained local gaming licenses from the gaming authorities of the UK and Spain. NetEnt already held a license in Belgium and certifications in Denmark, Italy and Estonia. It is of great importance to NetEnt's operations that the aforementioned licenses and certifications are retained.

Certain EU Member States – including Sweden – have bans on promoting lotteries organized from another country. "Promotion" is considered a broad concept, and can thus encompass a number of different activities. That NetEnt's business, namely delivering software and providing hosting for gaming operators from another country where the business is licensed and legal, could be considered "promotion" seems less probable. However, the extent of the concept of "promotion" in this respect is unclear.

Gaming authorities in different countries can also adopt a restrictive approach in relation to other markets to which licensed gaming operators and gaming system providers make games available, for example, if the authorities believe that a country is not applying adequate measures to prevent money laundering or terrorist financing.

The factors described above illustrate how NetEnt operates in an unpredictable legal environment.

OPERATIONAL DISRUPTION

NetEnt is responsible for the operation of licensed customer systems through its operation centers in Malta, Gibraltar, Alderney, Costa Rica and Denmark. Like all online services, the system can sometimes suffer from operational disruptions. These can occur for many different reasons, and may be either within or beyond NetEnt's control. In the event of operational disruption, the Company's product is entirely or partially unavailable to the end user, which affects the gaming operator's revenues and thus license revenues for NetEnt. Any operational disruption or technical problem with the Company's servers could therefore result in lost revenues, loss of confidence in the Company, and possible claims for damages. The Company is constantly working to minimize the risk of operational disruption by, for instance, ensuring high technical security in the system.

GAMBLING ADDICTION

Despite the fact that NetEnt does not conduct any gaming operator activities with direct contact with players, people suffering from gambling addictions could sue companies in the NetEnt Group in their capacity of game and system supplier. Even if such claims appear to be unfounded, and would likely be rejected by a court, they could involve considerable expenses and loss of confidence in NetEnt, which could ultimately lead to reduced revenues.

DEPENDENCE ON KEY PERSONNEL AND SKILLED EMPLOYEES

NetEnt's success depends on its ability to hire and retain expert, talented employees in all functions in the regions where NetEnt conducts business, for example commercial experience, understanding of operator and player preferences, game development and technology. The business is also dependent on certain key people at management level. Because of the high rate of market change, the loss of experienced personnel within business-critical areas could temporarily have a negative impact on the Company's profit and financial performance. NetEnt works actively to recruit dedicated and loyal staff through continuing education, corporate culture and opportunities for advancement within the organization.

DEPENDENCE ON LARGE CUSTOMERS

The loss of some of the Company's customers could have a negative impact on NetEnt's revenues and profit. As the number of customers increases, dependence on individual large customers gradually decreases. See Note 4 on page 80.

COMPETITION

The Company competes with a number of entities with much greater financial and operational resources than NetEnt. The market is highly attractive, and new competitors may enter the market. However, the barriers to becoming established on the game development market are high. If NetEnt cannot successfully respond to such competition, this could negatively affect the Company's profit and financial position. The Company's ambition is to maintain and develop its position on the market as a world-leading supplier of digitally distributed gaming systems, and to be a respected market participant. By continuing to focus on developing high quality games with great entertainment value, in combination with a powerful administration tool and related services, NetEnt hopes to be able to retain existing customers and attract new ones.

INTELLECTUAL PROPERTY RIGHTS

NetEnt's most important intellectual property rights mainly consist of the copyrights for the software and the games developed by the Company, and related materials that are under constant development in the Group. Therefore, it is crucial that the assets developed in the Group remain NetEnt's property. Through contracts with employees and subcontractors, it is ensured that the copyright for developed products accrues to NetEnt. Furthermore, the Group continuously protects its intellectual property rights through, for instance, registering patterns protection and trademarks. There is no guarantee that NetEnt's rights will not infringe on those of competitors, or that NetEnt's rights will not be breached or contested by competitors. The prospect cannot be ruled out either of legal action being taken against NetEnt by competitors for alleged infringement on competitors' rights, both in Europe and North America. If this happened, there would be a risk of the Company suffering substantial liability for damages, which would have a negative impact on the Company's conditions for conducting its business. Lawsuits often involve varying degrees of expenses for the Company in the form of fees for legal advice, even if the legal action does not ultimately lead to a court case. In addition, NetEnt is dependent on specific know-how and the prospect cannot be ruled out of competitors developing equivalent expertise or of NetEnt failing to efficiently protect its know-how.

PRODUCT FAULTS AND SECURITY

There is no guarantee that NetEnt's games cannot contain technical faults that could be exploited by players and lead to a poorer gaming outcome, and consequently lower license revenues in NetEnt's games, or cause legal expenses linked to the Company's responsibility for the products working as prescribed by product descriptions and certifications. The existence of technical faults could also eventually harm confidence in the Company's products. Moreover, the prospect cannot be ruled out either of NetEnt's customers or the Company being subjected to hacking or similar types of cybercrime. NetEnt applies industry practice in systems and processes in order to maintain a high level of IT security. The Company continually monitors game transactions in its systems so that it may detect any irregularities and swiftly take action. IT security and operation are an important area in which the Company constantly invests resources to develop and adapt protection to technological developments.

EXCHANGE RATE FLUCTUATIONS

The Group's profit and financial position are affected by exchange rate fluctuations, since the majority of revenues are invoiced in EUR while costs largely occur in SEK. NetEnt's current policy is not to hedge changes in exchange rates. An appreciation of the SEK vs. the EUR negatively affects the Company's profit. The fulfillment of NetEnt's financial goals may be affected by future changes in exchange rates. The Group's consolidated profit, equity, assets and liabilities are also affected by exchange rate fluctuations when the profit of foreign subsidiaries is translated into SEK for the Group's consolidated financial reporting.

THE STATE OF THE ECONOMY

In the past, NetEnt's revenues have not been negatively affected by a weaker economy. However, the online gaming industry is affected to a certain extent by the general state of the economy. A recession can lead to a reduction in the disposable income of consumers and consequently in demand for digital entertainment, including online casino games. It cannot be ruled out that NetEnt's revenues and profit could be negatively affected in any such future recession. However, this risk is mitigated by the fact that NetEnt's products are distributed to a large number of markets that do not follow the same business cycle.

TAX STATUS

The Group's tax expense is affected by which of the countries where the Group conducts operations is the one in which profit is generated, and the tax rules of each country. Comprehensive assessments are required to establish the income tax provision. There are many transactions and calculations for which the final tax is uncertain at the time when the transactions and calculations are conducted. NetEnt has, alongside external experts, assessed how tax regulations affect the operations in order to ensure an accurate tax status. This also applies to indirect taxes. NetEnt reports and pays to the tax authorities the amount of tax that NetEnt and hired external experts consider correct. However, these figures may prove to be inadequate in the event of the tax authorities applying a different interpretation of the tax rules than that performed by NetEnt and which it believes is correct.

After a tax audit of NetEnt AB (publ) concerning financial years 2007–2010, the Swedish Tax Agency decided to impose additional taxes on the Company in the amount of approximately SEK 92.1 million. In its decision, the Swedish Tax Agency stated that the internal pricing used by the Group between the Sweden-based Parent Company and the Malta-based operations was not justified. NetEnt contested the Swedish Tax Agency's ruling, and in March 2016 the Administrative Court of Appeal approved NetEnt's appeal and reversed the earlier ruling of the Administrative Court and the Swedish Tax Agency's review decision in the case. NetEnt will receive SEK 1.8 million in compensation for legal expenses, but otherwise the ruling has no impact on the Group's reported earnings or financial position.