

**[Press Release]**

## **SM Ushers in the SM 3.0 Period through the Introduction of Multi Production Center/Label System**

- Deploy production/key functions within 5+1 production centers, strengthening independent processes
- Develop a Multi Label system including in-house/independent/acquired labels, and establish a subsidiary specialized in music publishing
- Debut three new groups and one virtual artist in 2023."

(Seoul, February 3, 2023) SM Entertainment (hereinafter referred to as SM)'s co-CEOs, Sung Su Lee and Young Jun Tak, announced "SM 3.0: IP Strategy - Multi 'Production Center/Label' System" through the official SM YouTube channel and website today, signaling a new leap into the fan and shareholder-centric period of SM 3.0.

In this announcement, SM explained the direction of SM 3.0 and hinted at the announcement of four growth strategies, introducing the first one in detail, the production strategy.

SM became a pioneer in the K-pop genre with the success of H.O.T.'s debut in 1996 under the leadership of the founder, producer Soo-man Lee. From the establishment of SM until 2010, SM gave birth to major artists such as BoA, TVXQ!, Super Junior, Girls' Generation, and SHINee, which they called the period of 'SM 1.0'. From 2010 to 2022, Soo-man Lee continued to contribute to SM as the overall producer through his contract with the company, giving birth to EXO, Red Velvet, NCT, aespa, and various artists with producing capabilities within the company, which they referred to as the period of 'SM 2.0'. From this year, 2023, SM defined the new period as 'SM 3.0'

The 'SM 3.0' is composed of four key strategies on IP, Business, Global, and Investment which will become SM's growth driver for the future. SM 3.0 is about creation of high-quality intellectual property (IP), which is the essence of SM's entertainment business, business monetization through the IP, expansion of the IP in the global market beyond South Korea, and investment in new businesses such as global music publishing, label acquisition, fandom economy, and metaverse based on the financial performance derived from the monetized IP.

For this, SM announced the introduction of a Multi 'Production/Label' system to create essential new Mega IP for SM 3.0, which will be pursued through the establishment of multi production centers, multi labels, and a subsidiary specialized in music publishing.

The Multi 'Production Center/Label' system of SM 3.0 will maintain the know-how on IP production and management accumulated from the existing system while expanding production capacity and delegating the decision-making authority to each unit leader through independent artist management to accelerate the speed of IP production and advance the SM standard.

Hence, SM will deploy their artists to 5+1 production centers. The five production centers will perform as key functions of production for each artist and respect their independent decision-making and creative autonomy, unveiling more robust IP creativity. The one 'Virtual Artist/IP Production Center' will continuously achieve a leading position in the future entertainment industry represented by metaverse through producing and managing virtual artists like Naevis.

These production centers will also grow into 'internal labels' providing autonomy and growth opportunities to the artists who have originality in music or business by supporting their independence of label. In addition, together with investment in 'acquiring labels', internal labels can evolve into 'independent labels' after a transitional period and expand SM's music spectrum, strengthening their influence in the music market.

In addition, to manage the Multi Production Center/Label harmoniously, SM will build a large music pool through establishing a 100% owned subsidiary specialized in music publishing. SM aims to develop this subsidiary into a new profitable music publishing company by contracting with composers and songwriters from around the world and other global music publishing companies.

Regarding the business effects of introducing the Multi Production Center/Label system through the transformation to SM 3.0, SM CFO Cheol-hyuk Jang stated that "by securing a stable release pipeline for artists and albums, in 2023, three new groups and a virtual artist debut project will be led by the co-CEOs, Sung-su Lee and Young-jun Tak, and Inside Director, Jun-young Pak. We plan to release more than forty albums, an increased by more than 30% from 31 albums last year. We expect sales of 18 million copies, a 30% increase from to the 14 million copies sold in 2022". This statement by the CFO shows SM's determination to achieve financial business performance in the future.

Lastly, co-CEOs, Sung-su Lee and Young-jun Tak, mentioned Soo-man Lee's statement last September on the termination of his producing agreement, where he stated, "Since the line-up of SM artists for concerts and activities in the global market was now fully ready and the production system built over 25 years was being well managed, as a major shareholder, I humbly accept the request of minority shareholders on my retirement. I hope the SM management can set up a new strategy for the next 50 years and take a new leap forward as a global entertainment company." The co-representatives expressed their gratitude to the founder Soo Man Lee, saying "To uphold Soo-man Lee's aspirations, we will open the period of 'SM 3.0'. Although the executive producer agreement has been terminated, we would like to express our sincere gratitude to Soo-Man Lee, who will continue to support our company as a shareholder." They concluded their speech stating "We will give you separate presentations about the IP monetization, including music and IP license, and the global business and investments in February and March. We will continue to inform our fans and shareholders about our current status, plans and goals through various IR channels."

**[Full Text]**

Good Afternoon, I'm Sung Su Lee, Co-CEO of SM ENTERTAINMENT.

Greetings, I'm Young Jun Tak, Co-CEO/COO of SM ENTERTAINMENT.

As you may already have been informed, SM is at the crossroads of significant change. Recently, we have received a lot of inquiries from our fans and shareholders, on where and how SM ENTERTAINMENT as a corporate limited is going in the future, and various opinions and advices.

As a co-CEO of this company, we have discussed a lot with our employees and board of directors. And, over the next three sessions including today, we'd like to introduce and explain how we planned the future of SM and what it will mean to our fans and shareholders.

Before I start with the future of SM, I'd like to briefly tell you about the path that SM has taken so far. SM ENTERTAINMENT was founded by Producer Soo-Man Lee in 1995.

In the following year, 1996, with the successful debut of H.O.T., SM became a pioneer in the K-POP genre, in deed as well as in name. From the establishment of SM until 2010, we call this period of establishing K-POP culture and leading the growth of the Korean entertainment industry, the period of 'SM 1.0'. During this period, the founder and producer Soo-Man Lee had produced great artists, such as H.O.T., BoA, TVXQ, Super Junior, Girl's Generation, SHINee, etc. This is the time when K-POP began to spread to the world and took its place as a unique culture representing South Korea.

The period of 'SM 2.0' lasted 10 years after the period of 'SM 1.0' until 2020. By transitioning to professional management system Producer Soo-Man Lee had made a great contribution to SM as an executive producer under a production agreement with the company. During this period, EXO, Red Velvet, NCT and aespa made their debut. With this experience, many employees in the company achieved producing abilities and they became an asset of our company.

From this year, SM wishes to leap forward to the period of 'SM 3.0'. We have been accumulating IPs that are highly likely to succeed and training competent talents, and now, based on this, we will expand the Korean, Asian and global fandom and respond to changes in the market.

The 'SM 3.0' is composed of the four key growth strategies on IP, Business, Global and Investment which will become SM's growth driver for the future. The first strategy is to produce high quality IP which is the essence of SM's entertainment business. The second one is business monetization through the IP. Third is expansion of the IP in the global market beyond South Korea. And the fourth key strategy is the investment in new businesses, such as label acquisition and metaverse based on financial result monetized through the IP. Today, we will present the details and purpose of each strategy in order. First, I'll introduce the new IP strategy, the Multi 'Production Center/(Multi) Label' system.

SM has successfully created a lot of Mega IPs with the executive Producer Soo-Man Lee and in-house production staffs. However, as the IPs keep being accumulated and business field has continuously expanded, we realized that there is a limit in the existing system to meet the needs of the fans and market for IP production and management. To overcome this limit and produce new Mega IPs, the "SM 3.0 Period" will introduce the Multi 'Production Center/(Multi) Label' system as a new production system.

We have four main purposes through this. First, as the name "Multi Production Center/Label" suggests, we will distribute and systematize the production capabilities SM has accumulated over the

years to multiple production centers and labels, to competitively ensure the sustainability of business.

Secondly, each production center will exclusively manage allocated artists, separately operate production/core functions, and make independent decisions. By this, we will present much stronger IP creation capabilities in a timely manner.

Third, we will ensure the creative autonomy of each production center and expand its music coverage through establishment, management, and acquisition of independent internal/external labels, while reflecting various musical tastes that SM has not covered so far.

Lastly, we will match the responsibilities and authorities based on the artists' life-stage and manage resources customized to each Stage. At the same time, we will make a good basis for long-term co-existence of the artists and the company by establishing a reward structure based on the performances.

As such, the Multi 'Production Center/Label' system will produce the artists that fans wanted to see and serve as a base to maximize business performances for shareholders and our company.

The three key changes in Multi 'Production Center/Label' system are:

First, multi production center; Second, multi label; and Third, establishment of subsidiaries specialized in music publishing. Multi Production Center and Multi Label are models in which multiple parties have decision-making authorities and responsibilities on IP production. The reason why we are using the word 'Multi' is because we are confident on numerous talents in each field who have contributed to the success of Mega IPs over the past 20 years in SM ENTERTAINMENT's system. Further, a subsidiary specialized in music publishing means internalizing of a competitive network of songwriter/lyricist/publisher which has been built so far.

Next, I will introduce the details of each management model.

During the SM 1.0 and SM 2.0, we had a sole executive producer system and produced SM artist IP under the direction of the executive producer, Soo-Man Lee, while the production and core functions were concentrated in one place. In this period, we used an external publishing company for music sourcing.

The Multi 'Production Center/Label' system of SM 3.0 will expand the production capacity and accelerate the speed of IP production by delegating the decision-making authority to each unit leader through independent artist management and advance the SM Standard while maintaining the know-how on IP production and management accumulated from the existing system.

Above all, we will deploy our artists to five production centers that will independently perform key functions, such as production and artist management. Further, the newly added 'Virtual Artist/IP Production Center' will focus on the production and management of virtual human avatars, such as Naevis. With this system, we aim to continuously achieve a leading position by preemptively responding to the future entertainment industry trends including metaverse.

Second, in SM 3.0, we plan to establish and manage new internal labels and external labels. The 'Internal Label' will provide autonomy and growth opportunity to the artists who have originality in music or business by supporting the independence of the label. Also, we will expand the music coverage of SM by investing in promising external artists or labels.

Third, as we believe that the competitiveness of the music industry starts from building a global music pool, we have established relationships with domestic/international music publishers and agencies of

songwriters and lyricists, and we have also made the largest network of the same in the domestic entertainment industry.

To manage the Multi Production Center and Label harmoniously, we have to build a large music pool in advance. Therefore, we are planning to establish a subsidiary specialized in music publishing, which is wholly owned by SM, to internalize such capabilities.

To sum up, under SM 3.0,

- 1) high quality music will be provided to the Multi Production Center and Label by a publishing-specialized subsidiary.
- 2) Then the Multi Production Center will create mega IPs
- 3) and the music coverage will be expanded via continuous label expansion.
- 4) In the process, new music sources will be provided to the publishing subsidiary. Through this system, we will make a virtuous circle.

Now, I'm going to give you the details of the operational structure of the Multi Production Center. Each production center will independently perform major production and core functions. Each center will be managed by two directors, a producing director and a management director, and each center will be responsible for the performance and make its own decisions. However, for the sake of efficiency, shared production-supporting functions, such as casting and training, will be carried out commonly at all centers as before. With respect to the Multi Production Center, we are aware of some concerns that the role of maintaining the SM Standard might disappear, which was previously the role of the executive producer.

To solve this issue, we will establish a more advanced SM Standard maintenance system by operating a separate music selection committee, the 'A&R Committee', under the Multi Production Center.

The 'A&R Committee' will consist of the A&R manager of each production center and specialists under the A&R Headquarter. This Committee will maintain the SM Standard leveraging the collective intelligence of music specialists.

Sung Su Lee will be the A&R Executive, the head of A&R Committee, and he will combine various perspectives of the Committee members.

Further, we will newly establish the 'IP Committee' separately from the production center for consultations on IP management from debut to maturity per life stage. The main agenda of the IP Committee will be the concept planning for new artists, which is a stage before artists are assigned to a specific production center, or label independence of mature artists. The Committee will consist of the leaders of each production center, the CFO and a consulting group of external experts.

We sincerely promise that we will produce and manage IP based on a deep understanding of the fan and the market, not just few employees of our company.

In addition, even after debut and initial growth of an artist IP, SM will introduce a multi label system in which each IP reaches its peak throughout the life cycle and sustainable profitability of mature IP is guaranteed.

Labels will be mainly divided into 'Internal Label' of SM ENTERTAINMENT and 'External Label'. 'Internal Label' will experience independent business and verify business feasibility within the company, before being spun out. And they will get the performance-based compensation depending on the profit

earned by each artist. Also, the internal labels will be organized for SM artists and related employees who have their own outstanding music style and yet to be prepared to run business independently. This type of label may be established for the genre SM ENTERTAINMENT wants to focus on in the future. 'External Label' is a separate entity consisted of artists and employees who are capable of independent creation and business activity. Thus, this Label will earn a separate profit and perform every function of IP production, monetization and management independently.

We will support the artists who have outstanding music talent and deep understanding of the entertainment industry and those who are capable of independent management by establishing a joint venture. This support will not be limited to SM artists and be expanded to external artists, by acquiring or establishing new labels.

The representatives of the newly organized labels will have the full decision-making rights. We will maximize business performance by aligning authorities with responsibilities, reflecting each organization's performance fully to the compensation structure through management of P&L per artist.

The transfer of artists between production centers and labels will be decided by the IP Committee of SM ENTERTAINMENT and the artist together. SM artists will grow in the Multi Production Center, build the base for becoming independent in the Internal Label and then conduct creative and business activities freely in the independent label.

This way, we expect to maximize profit by sustainable creative activities. Additionally, we will give opportunities for SM employees to become a shareholder of the independent label, and allow the core talents to stay in SM for a long term to develop their individual capabilities.

Meanwhile, an intermediate holding label, which will be established as a 100% subsidiary of SM ENTERTAINMENT, will hold shares in the labels.

Especially, acquisition of labels with various genres that SM has not focused on, such as R&B, Hip-Hop, Ballad, OST, will expand SM's music spectrum with external artists of outstanding musical talent and enhance our influence in the music market.

After adoption of the Multi Production Center/Label system, we will need more supplies of high-quality music. Thus, SM ENTERTAINMENT will establish a 100% owned subsidiary specialized in music publishing and further strengthen our A&R network, where we used to be the most competitive.

For your information, music publishing means a business entrusted with music copyright management from songwriters/lyricists, which collects and distributes royalties created from musical copyrights, and at the same time, promotes the use of copyrighted works on music labels, movies, TV programs, advertisements, games, etc.

SM ENTERTAINMENT has been leading the K-Pop music for nearly 30 years by operating a high-quality music production program, such as SM Songwriting Camp, making a network of more than 3000 songwriters, lyricists and publishers around the world. SM's publishing-specialized subsidiary will discover songwriters/lyricists around the world based on the SM ENTERTAINMENT's network and sign publishing and management agreements with them.

We believe this will create a virtuous cycle that will strengthen the A&R network competitiveness of SM ENTERTAINMENT, the parent company. Based on the largest network we have, we will enter into agreements with songwriters, lyricists and global music publishing companies, and establish an

outstanding, global top-tier publishing-specialized entity, and make the publishing business a new source of income for SM ENTERTAINMENT.

Hi, this is Chul Hyuk Jang, CFO of SM ENTERTAINMENT, and I'll explain what kind of business indicators the Multi 'Production Center/Label' system will be based on and our target.

The purpose of the Multi Production Center/Label system is to secure a stable release pipeline for artists and albums, which can be a source of profit.

Considering internal estimates and peer comparisons, we plan to debut more than two teams a year and present high-quality IP in the SM 3.0 system, compared to the average of one team debuting every 3.5 years in the previous SM 2.0 system.

Also, under the new system, we will increase the album release frequency for each artist as well as artist debuts, potentially producing more than forty albums a year.

To address the concerns about potential delay of IP debuts and album releases from fans and shareholders, we will lower the delay rate from about 25% to less than 5%. As soon as the artist management plan is fixed, we will disclose the schedule of IP debuts, album releases and concerts every quarter in a predictable way. In 2023, we are expecting to debut three new groups and one solo artist.

The three new group projects will be led by the co-representatives of SM ENTERTAINMENT. And the solo artist will be a virtual artist, which illustrates the direction of metaverse business that SM is pursuing.

Regarding album releases, we plan to release more than forty albums, an increased by more than 30% from 31 albums last year. We expect sales of 18 million copies, a 30% increase from the 14 million copies sold in 2022. We will announce the concrete forecast of sales and operating profit later at the strategy announcement session.

So we have given you an introduction of the Multi Production Center/Label system, which is the first step towards the SM 3.0 system. IP creation is the foundation of the business, but how well we monetize it is also very important. Thus, we will give you separate presentations about the IP monetization, including music and IP license, and the global business and investments in February and March. We will continue to inform our fans and shareholders about our current status, plans and goals through various IR channels.

SM ENTERTAINMENT was founded by Producer Soo-Man Lee, in 1995, and now it has a history of nearly 30 years. Last September, Soo-Man Lee made an announcement about the termination of the producing agreement and expressed his belief that the talented successors would manage the business very well without much difficulty since the line-up of SM artists for concerts and activities in the global market was now fully ready and the production system built over 25 years was being well managed. He also said that as a major shareholder, he humbly accepted the request of minority shareholders on his retirement. He hoped us to set up a new strategy for the next 50 years and take a new leap forward as a global entertainment company. To uphold his aspirations, we will open the period of 'SM 3.0'.

Our goal in SM 3.0 is to become a global entertainment company focused on fans and shareholders. Starting with today's presentation on the Multi Production Center/Label in SM 3.0, we

promise to lead the communication with our fans and shareholders.

SM could come this far thanks to the efforts of many people. The founder and executive producer Soo-Man Lee, whose life was SM itself, Jin-young Hyun and director Young-jin Yoo, who have dedicated the most shining moments of their lives, all of our artists from H.O.T. to aespa and trainees preparing for debut, and all SM employees who are dedicating the biggest part of their lives to the company even at this very moment with sincere love for the company. All of these people have created SM and that is what SM is about today.

We know that the biggest driving force for SM's growth so far has been the fans who love our artists and music and the shareholders who have trust in our company. We sincerely apologize for this late response to your inquiries about the SM's future and strategic direction, and we promise that we will do our best to continuously update you on our direction in the SM 3.0 era.

Lastly, although the executive producer agreement has been terminated, we would like to express our sincere gratitude to Soo-Man Lee, who will continue to support our company as a shareholder.