SQUARE ENIX CO., LTD.
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Printed in Japan

ANNUAL REPORT 2006

SQUARE ENIX CO., LTD.

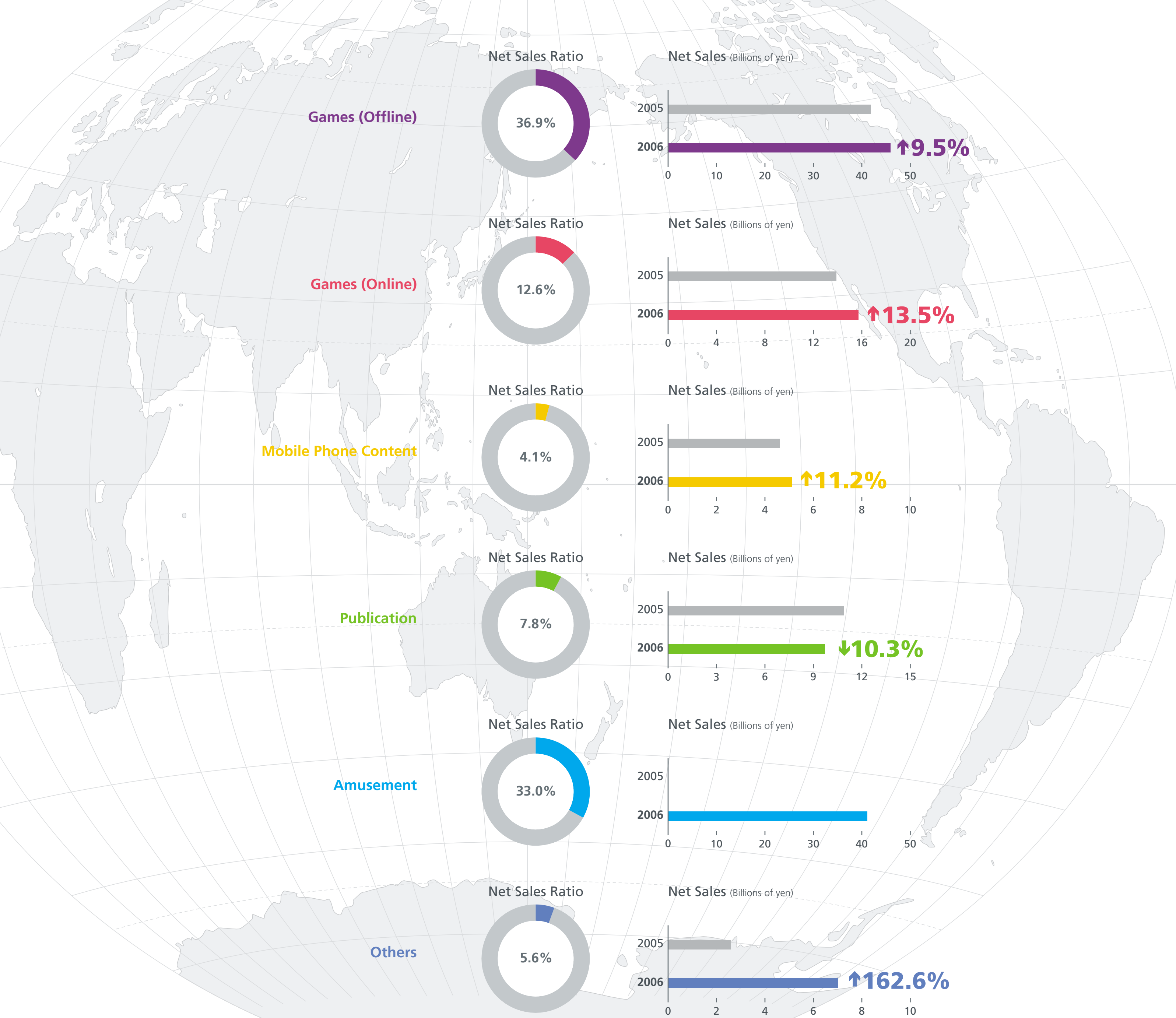
SQUARE ENIX

ANNUAL REPORT 2006

At a Glance

Net Sales by Business Segment

Years Ended March 31



Contents

Disclaimer Regarding Forward-Looking Statements

Statements in this annual report with respect to the current plans, estimates, strategy, and beliefs of SQUARE ENIX CO., LTD., and consolidated subsidiaries [collectively "SQUARE ENIX"] include both historical facts and forward-looking statements concerning the future performance of SQUARE ENIX. Such information is based on management's assumptions and beliefs in light of the information currently available and, therefore, involve risks and uncertainties. Actual results may differ materially from those anticipated in these statements due to the influence of a number of important factors.

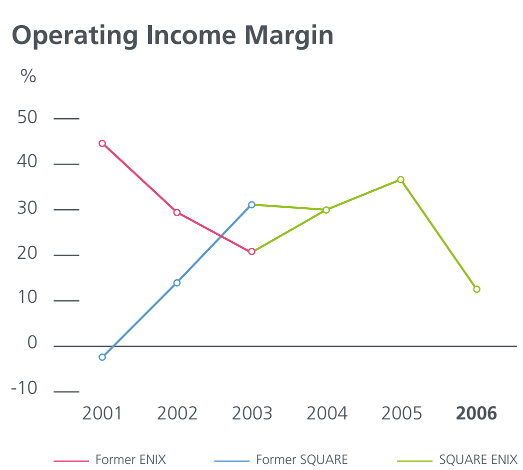
Such factors include but are not limited to: [1] general economic conditions in Japan and foreign countries, in particular levels of consumer spending; [2] fluctuations in exchange rates, in particular the exchange rate of the Japanese yen in relation to the U.S. dollar, the euro and others, which SQUARE ENIX uses extensively in its overseas business; [3] the continuous introduction of new products, and rapid technical innovation in the digital entertainment industry; and [4] SQUARE ENIX's ability to continue developing products and services accepted by consumers in the intensely competitive market, which is heavily influenced by subjective and quickly changing consumer preferences.

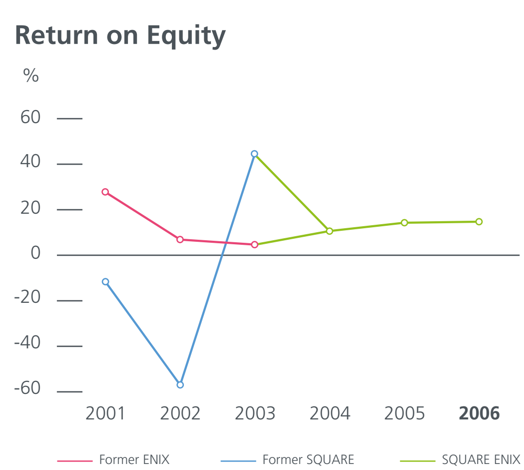
Financial Highlights

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years Ended March 31

	Millions of Yen		Thousands of U.S. Dollars
	2006	2005	**2006**
For the Year			
Net sales	**¥124,473**	¥ 73,864	**$1,059,619**
Operating income	**15,470**	26,438	**131,695**
Net income	**17,076**	14,932	**145,370**
At year-end			
Total assets	**¥213,348**	¥131,695	**$1,816,198**
Total shareholders' equity	**120,993**	108,933	**1,029,997**
	Yen		U.S. Dollars
Per Share of Common Stock			
Net income	**¥ 154.65**	¥ 135.63	**$ 1.31**
Total shareholders' equity	**1,094.50**	988.19	**9.31**
	%		
Key Ratios			
Operating income margin	**12.4%**	35.8%	
Return on equity	**14.9**	14.5	
Shareholders' equity ratio	**56.7**	82.7	

Notes: For the convenience of readers, amounts in U.S. dollars have been translated from yen at the exchange rate prevailing in the Tokyo foreign exchange market as of March 31, 2006 of ¥117.47=US $1.





Notes: 1. Return on equity = Net income / Average shareholders' equity
2. The former ENIX did not prepare consolidated financial statements for the period in FY2000. The former ENIX figures for this period are, therefore, disclosed on a non-consolidated basis.
3. Return on equity for FY2003 has been calculated using the simple addition of the former ENIX and the former SQUARE's shareholders' equity as of the end of the previous period.

Yoichi Wada
President and Representative Director
SQUARE ENIX CO., LTD.

I am pleased to present the SQUARE ENIX annual report for fiscal 2005, ended March 31, 2006, to our shareholders and other stakeholders.

In fiscal 2005, on a consolidated basis, net sales rose 68.5%, to ¥124,473 million, operating income declined 41.4%, to ¥15,470 million, recurring income decreased 39.9%, to ¥15,547 million, and net income climbed 14.3%, to ¥17,076 million.

The operating income margin was 12.4%, and return on equity (ROE) was 14.9% in fiscal 2005.

When we inaugurated SQUARE ENIX, I've laid out the actions to be taken as follows. The first two fiscal years were to be largely devoted to building up strength and stamina. Our primary focus for the third year —the year under review—and fourth year was to modify our physique. In addition to accomplishing structural reforms, we would work toward a significant leap forward through the completion of our new structure in fiscal 2010.

In fiscal 2005, we met the challenges of a changing operating environment and the change of the industry structure by preparing a stronger than ever product lineup. FINAL FANTASY XII and KINGDOM HEARTS II became record-setting game titles in the industry during the fiscal year under review, while the release of the computer-generated imagery (CGI)-animated film *FINAL FANTASY VII: Advent Children* gained considerable attention in both the United States and Japan for its unprecedented success. Although our major products performed as strongly as anticipated, changes in the operating environment were even harsher than initially expected, and therefore other products were unable to mirror our major-product successes. As a result, we were unable to avoid a decline in operating income.

While committed to reassessing the current circumstances and modifying our approach, based on our firmly held philosophies, we will continue to push forward, our resolution firm, until we

Net
Every

achieve our goal of becoming the world's leading company in our chosen sphere.

2005: "Year Zero" for the "Video Game Industry"

In the twenty or so years since its emergence, the video game industry has enjoyed extremely favorable growth. Although it almost goes without saying that this growth was driven by the advent of completely new and revolutionary content, at the same time, another key ingredient has been the industry's unique structure.

In the industry's early phase, video game console manufacturers developed and marketed both game consoles and game software. The source of the growth of the industry was their careful move recognizing the benefit of the network externality. As a result, an enormous base of independent software developers flourished. Each new generation of hardware produced by game console manufacturers spawned a complete ecosystem comprising software development and distribution channels. The ecosystem rapidly grew to become a massive industry.

Simply stated, one could say that this industry developed not as the "video game industry" but as the "game console industry." This setup has fostered a positive climate for risk-taking by game software developers, and in some ways has been a comfortable environment in which to grow.

However, in recent times several of the prerequisite conditions necessary to maintain this ecosystem have begun to crumble. From such physical media as read-only memory (ROM) cartridges and DVDs, the industry is moving toward online networks. This is not only altering the industry's distribution structure but also transforming the business model itself.

Furthermore, changes are occurring in the competitiveness of game consoles. In particular, in terms of graphics capabilities, game consoles that had enjoyed an overwhelming cost performance advantage are now facing a raft of competitive challenges. On the one hand, consumers have been oversupplied with features, while on the other, general-use terminals have achieved a remarkable jump in performance.

Of course, it is not the case that the conventional business model has become generally obsolete. Apple Computer, Inc.'s iPod and Nintendo Co., Ltd.'s NINTENDO DS demonstrate the successful experience of the conventional model. What I am referring to is the fact that it has become difficult for a single game console manufacturer to sustain a market worth several trillion yen. My point here is not to debate the fate of a particular game console maker, but to explain the kind of problems briefly that we must grapple with as a game software producer.

On reflection, if we focus our attention on the content itself, over the past twenty years, millions of people around the world have grown familiar with video games, while the assets we have accumulated are vast. It would be fair to say that video games have already become a recognized genre of entertainment.

If the ecosystem that has existed until now breaks down, the content itself must become self-sustainable. In other words, our basic cognizance of the operating environment is that a "video game industry" in the true sense is beginning to take shape.

As well as being a significant opportunity, this juncture also represents a huge challenge. We must examine at the most fundamental level a whole array of points that—until now—we have not needed to be directly involved with.

work is the Game.
thing plays Games.

Strategic Options Needed

I have provided a brief overview above of the current situation in the video game industry. The changes taking place have implications far beyond the video game industry alone. I would argue that it is natural to view what is happening in the video game industry as part of a much broader industrial revolution sweeping the economy as a whole. In our industry and in many others, a process of trial and error is being repeated, with the consensus on the next generation of business models not yet within reach.

I believe the strategy suited to such a fluid period of transformation should involve management developing a diverse and effective range of tactical options. In particular, what kind of management options should we prepare?

At the heart of the current revolution is a power shift from companies to consumers. There are many very hasty arguments about the meaning of this phenomenon; however, I would propose a reasonable definition along the following lines. The power of consumers was not recognized in the past, but now consumers are getting involved in one end of the supply chain.

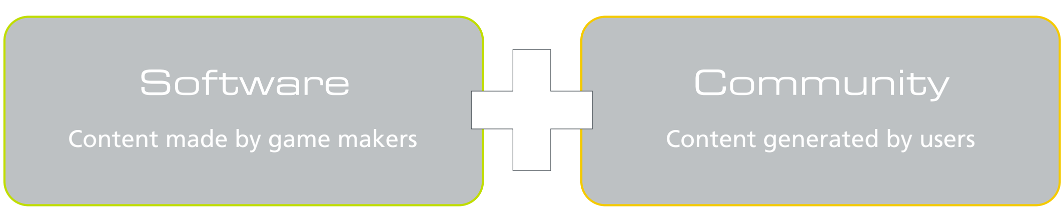
A fundamental policy must be to make this power shift toward consumers an anchor within our menu of strategic options. Simultaneously, we need to ensure that the Company has a sufficient level of maneuverability. For this reason, we decided to raise ¥50 billion in convertible bonds with warrants in November 2005.

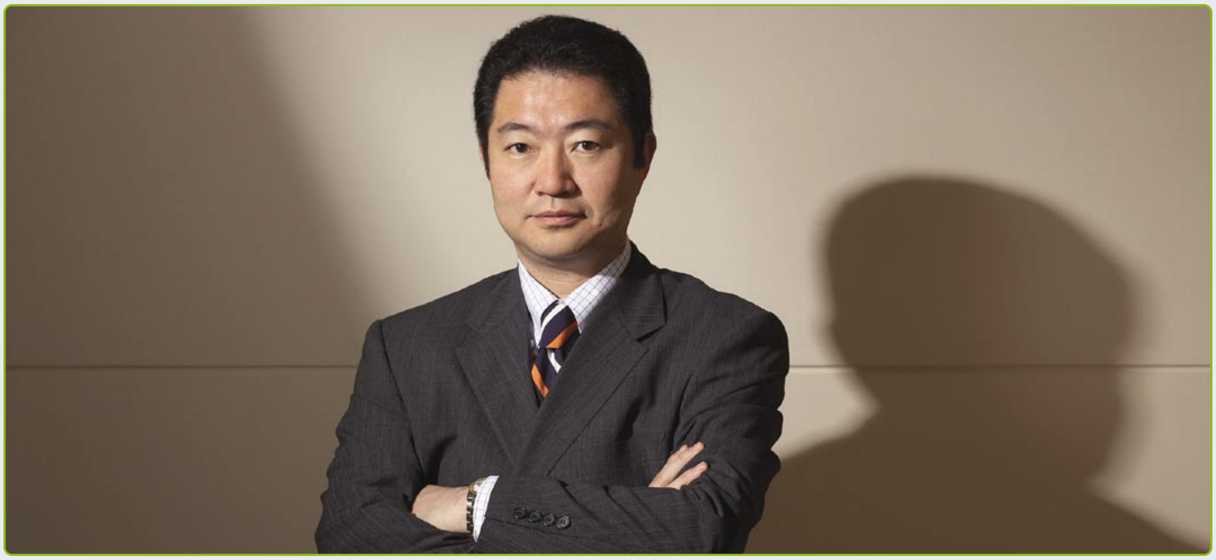
Becoming the World's Leading Community Management Company: Three Key Approaches

Our goal is to become the best community management company providing the best content in the world. When I talk about "community," I do not limit it to just net-based communities, but use it to mean any group of customers that share a common set of tastes and interests. By serving each community organically with the highest quality content and services, we aim to make these communities even stronger.

In the world of entertainment, if the people in the audience are not enjoying themselves, they will refuse to pay the entertainer a dime. To say it another way, the fact that people have paid shows that they have already made quite a significant commitment to what we are offering. Through the development of the network environment and the formation of virtual and real communities, the relationships built up between content and customers, as well as the relationships among customers, will become even stronger.

In a networked society, content providers and customers will develop content together





Our fundamental strategy is to leverage this energy skillfully as the driving force for a business. I believe the real engine for growth will be the vitality of communities formed by customers.

At the kernel of a community is a shared worldview, whether that springs from a common interest in video games, manga or some other pursuit. Communities are thus defined by such attributes as a video game's worldview or a certain taste in design. Conventional methods of grouping customers—such as by age, gender or nationality—are hardly useful.

Seen from the customer's perspective, each person has a multitude of tastes, so each person can belong to several communities without any incompatibility. The important point is to avoid generalization of communities. Regardless of the community size, we should be conscious of the fact that each community is unique and irreplaceable.

However, if we analyze customer lifestyles, we find that there is some level of uniformity across such marketing parameters as age group or occupation, and further, that the type of terminals people use and their media exposure patterns have a close correlation with lifestyle.

Therefore, it becomes important to prepare a diverse array of content and service entry points. To enhance a community's gravitational pull as well as increase profitability, it is necessary to cater to a wide range of lifestyles. One of the reasons we decided to bring TAITO into the SQUARE ENIX Group was the addition of amusement arcades to our existing lineup of customer entry points, which includes video game consoles, personal computers (PCs), mobile phones and magazines.

What specific measures are needed to implement the strategies I have outlined? We have formulated three key approaches.

1. Bolstering the performance of existing communities

To reiterate, customers belonging to a particular community exhibit few common attributes outside of their shared interest in the community. Consequently, their lifestyles tend to be many and varied. By utilizing many types of terminals across a large number of media, it is possible to bolster the contact points with customers belonging to a community. As well as increasing average revenue per user (ARPU), this is also aimed at seeking out potential customers. An example of how we might increase ARPU is releasing a movie in response to customer demand for ways to revisit the emotion they experienced when playing a video game.

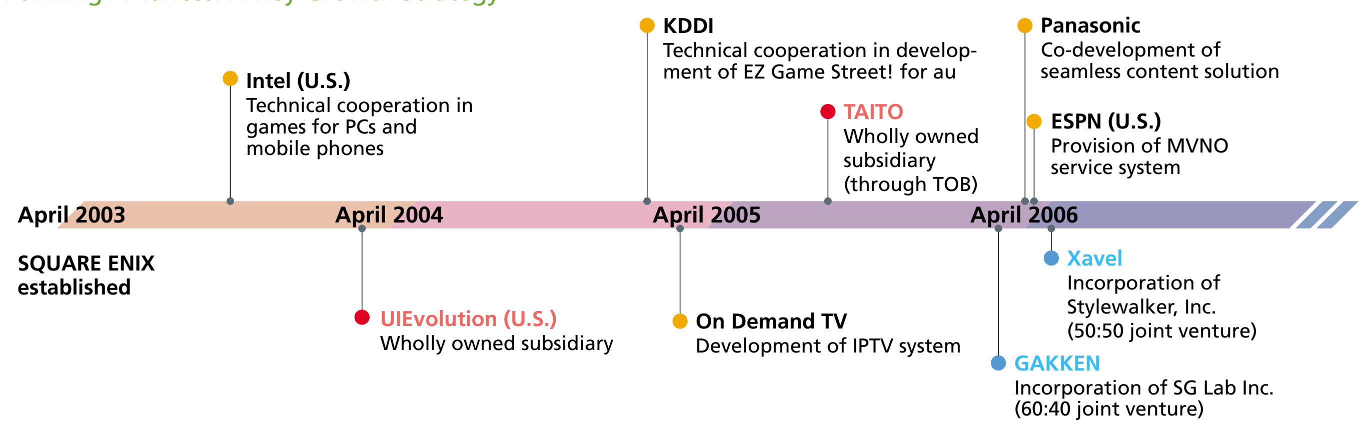
Our definition of potential customers may be a little different than the typical one. Seen from the customer point of view, since the communities to which the customer belongs and their own lifestyle may be unrelated, if there are no content or services catering to their particular lifestyle the opportunities for purchasing behavior are limited. For example, a busy office worker may belong to a particular band's fan club, but he may not have the time to go to their concerts, and is therefore unable to purchase tickets through the club. However, he can buy their CDs, which he can listen to whenever he likes. What we mean by potential customers are those whose tastes or interests match the community's but have not been able to contribute to revenue. A point to be noted is that while trying to grow the community, the introduction of people with unrelated interests should be avoided. If a community's raison d'être is diluted, it is very hard to resurrect.

2. Developing new communities

To expand the business without diluting communities, we need not only to grow existing communities, but also develop new ones. Up to now, we have concentrated on developing our own original content and have produced a number of major hits. In the future, we aim to respond to the expectations of our customers by further refining our creativity. I believe that our diverse creative capabilities across several genres, including game software, publication and animation, will continue to bolster our competitive advantage.

At the same time, in a departure from our past practices we will actively seek to approach outside communities. This may involve providing value added to third parties, who have already developed communities with strong drawing power, and helping invigorate these communities. We are confident that we can nurture such businesses to become new revenue sources. Services provided to EZ Game Street! and On Demand TV are our initial foray into this area. Our joint venture with Xavel, Inc., is also part of this strategy. In both cases, rather than our own brands we will work in the background to enhance our partners' brands.

Forming Alliances: A Key Growth Strategy



From a slightly different perspective, I would also like to discuss our joint venture with GAKKEN Co., Ltd. here. The creative media of video games may not only be harnessed for entertainment, but may also be utilized effectively for a wide range of other purposes, including education, training and welfare. Our joint venture with GAKKEN has the objective of embarking on these other potential applications for video game software. By utilizing the advantage of widespread familiarity with video games, we are aiming to foster a completely new market.

3. Strengthening technology development to build a common platform

Be creative and innovative—that is the essence of our spirit. Having strengths in both artistic and technological fields is the core of our competitive advantages. We will do whatever we can to maintain our world-leading capabilities in the game development. We will also focus on complementary themes.

To cater to the needs of diverse lifestyles, it is necessary to foster capabilities across a wide range of terminals and media. For this reason, it becomes essential to develop middleware to function on a cross-platform basis. We are currently pursuing a joint project with a team at UIEvolution, Inc., a U.S.-based subsidiary we acquired three years ago, which has recently led to a business alliance with Matsushita Electric Industrial Co., Ltd. In addition to video game consoles, PCs and mobile phones, this project also expands development to cover a wide variety of digital consumer electronic devices.

Our Mission and Contribution to Society

Within our business, we have set a number of precedents in the development of the "networked society." This stems from the fact that at present, only online games have realized a completely "virtual society."

If the pioneers in a new field do not properly define key issues and begin a steady process of dealing with them, there is a danger that the foundations laid for the next generation will be undermined. We must bear this mission in mind, and I believe it is our duty to voice our views on these issues to society. By directly offering our wisdom and labors, I wish to make a proactive contribution to society.

My assumption of office as chairman of the Computer Entertainment Suppliers' Association—Japan's video game industry body—from fiscal 2006 is also part of this contribution. Furthermore, for three years from fiscal 2006 we have secured a research base at the University of Tokyo covering intellectual property issues. We hope to utilize this research grouping as the hub for in-depth discussions in this field.

We believe that our business creation will benefit from such efforts to contribute to the development of solid foundations for a prosperous future.

In these endeavors, we look forward to your continued support.

July 2006

Yoichi Wada

Yoichi Wada
President and Representative Director

Review of Operations

The Year in Review

SQUARE ENIX CO., LTD., and its consolidated subsidiaries (collectively, "the Company") have been making determined efforts to strengthen the foundation and profitability of its business segments of Games (Offline), Games (Online), Mobile Phone Content, Publication, AM (Amusement) and Others. The Company has been pursuing fundamental R&D activities to obtain advanced information technologies, which are crucial to promote network-related businesses, and to apply such technologies to our products and services.

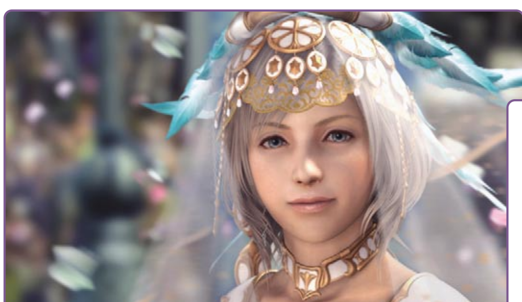
During the fiscal year under review, the Company made TAITO CORPORATION a consolidated subsidiary. TAITO and its consolidated subsidiaries (the "Taito Group") were included in the Company's scope of consolidation from the end of September 2005. For the fiscal year ended March 31, 2006, Taito Group is included in the consolidated balance sheets, and the business results of the Taito Group for the six months ended March 31, 2006 are included in the consolidated statements of income of the Group. Through the addition of the Taito Group, the Group has secured a diverse range of content services, including the amusement center and machine businesses.

Overview by Business Segment

Games (Offline)

The Company plans, develops and distributes games for game consoles (including handheld game machines). The Company also handles localization of games developed and distributed in Japan to distribute in North America through a wholly owned subsidiary, SQUARE ENIX, INC., while distribution in Europe and Asia is handled by leading publishers through license arrangements.

During this fiscal year under review, conditions in the Japanese market were generally harsh; however, such major title releases as "FINAL FANTASY XII" for PlayStation 2 (2,380 thousand units in Japan as of March 31, 2006) and "KINGDOM HEARTS II" (1,150 thousand units in Japan and 1,260 thousand units in North America, ditto) achieved robust sales. Consequently, sales in the Games (Offline) segment totaled ¥45 billion (up 9.5% from the previous fiscal year results), and operating income amounted to ¥9 billion (down 51.2%, ditto).



CHARACTER DESIGN: AKIHIKO YOSHIDA

©Disney Enterprises, Inc.
Developed by SQUARE ENIX

Business Segment Information (Fiscal year ended March 31, 2006)

(Millions of yen)

	Games (Offline)	Games (Online)	Mobile Phone Content	Publication	Amusement	Others	Elimination or corporate	**Consolidated total**
Net sales	45,916	15,720	5,067	9,742	41,069	6,957	–	124,473
Operating income	9,590	5,907	726	2,866	(1,170)	2,007	(4,457)	15,470
Operating income margin	20.9%	37.6%	14.3%	29.4%	(2.8%)	28.8%	–	12.4%

Games (Online)

The Company plans, develops, distributes and operates network-compliant online games. "FINAL FANTASY XI," a massively multi-player online role-playing game (MMORPG), remained steady with 500,000 paying subscribers, and continued to be the focus of the segment's operations during the period under review. In Japan, the Company also released new titles, including "FRONT MISSION Online." Consequently, sales in the Games (Online) segment totaled ¥15 billion (up 13.5% from the previous fiscal year results), and operating income amounted to ¥5 billion (up 18.5%, ditto).

Mobile Phone Content

The Company plans, develops and provides content for mobile phones. During the period under review, the Company continued to provide a wide range of mobile content services, including ring tones, wallpapers, games and portals. Led by such portal services as "DRAGON QUEST" and "FINAL FANTASY," the service lineup leveraged the Company's strength in original content. Consequently, sales in the Mobile Phone Content segment totaled ¥5 billion (up 11.2% from the previous fiscal year results), and operating income amounted to ¥0.7 billion (down 58.2%, ditto).

DRAGON QUEST II

Consolidated Sales by Geographic Segment (Fiscal year ended March 31, 2006)

(Millions of yen)

	Japan	North America	Europe	Asia	Total
Consolidated net sales	104,433	15,635	1,378	3,025	124,473
Percentage of share	83.9%	12.6%	1.1%	2.4%	100.0%

Publication

The Company publishes game-related books including comic magazines, comic books and game strategy books. In the period under review, the Company published monthly magazines “SHONEN GANGAN,” “GANGAN POWERED,” “G FANTASY,” “GANGAN WING” and “YOUNG GANGAN,” as well as comic collections taken from regular monthly magazine serials and various game strategy books. Segment sales were robust, driven by such comic book collections as the major hit “FULLMETAL ALCHEMIST,” which has now surpassed total sales of 20 million copies. Consequently, sales in the Publication segment totaled ¥9 billion (down 10.3% from the previous fiscal year results), and operating income amounted to ¥2 billion (down 16.0%, ditto).

Amusement

This segment includes all the businesses of the Taito Group, which was included in the Company’s scope of consolidation from the end of September 2005. These businesses include the operation of amusement centers and rental of coin-operated game machines business, the products and merchandise business, the content services business and others. Taito Group’s operating results are included in the Company’s consolidated statements of income from October 2005.

During the period under review, the mainstay amusement center operations business focused on developing new amusement facilities, including family amusement centers within multipurpose commercial complexes and large-scale amusement centers that contain such facilities as bowling centers.

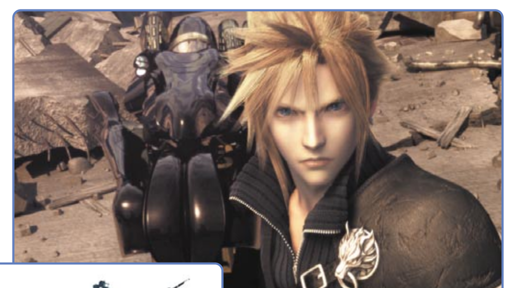
by TAITO

RAKUGAKI-OHKOKU in Utsunomiya
(Utsunomiya, Tochigi Prefecture, Japan)

In the second half of the period, TAITO worked to expand its operations by entering new businesses, including commercial game card machines aimed at children. However, sales at existing amusement centers were sluggish, dropping 4% compared with the corresponding period of the previous fiscal year, and investments swelled in medal game machines and children's game card machines, leading to severe pressure on operating income. As a result, sales in the AM segment amounted to ¥41 billion, and operating loss totaled ¥1 billion.

Others

The Others segment covers the planning, production, distribution and licensing of SQUARE ENIX titles' derivative products, and the operation of a game creator training school. During the period under review, the segment embarked on a new initiative through the release of the CGI-animated film "FINAL FANTASY VII: Advent Children," which is a sequel to the game software "FINAL FANTASY VII" set two years in the future. This work has been widely acclaimed, including being submitted for screenings at the Venice International Film Festival two years running, and continues to record brisk sales. Consequently, sales in the Others segment amounted to ¥6 billion (up 162.6% from the previous fiscal year results), and operating income totaled ¥2 billion (up 156.5%, ditto).



FINAL FANTASY VII
ADVENT CHILDREN

1. Basic Perspectives on Corporate Governance

The Company has adopted a statutory auditors system. To strengthen monitoring functions and further ensure sound management, half of the statutory auditors are from outside. Also, in line with Company standards and guidelines on decision authority, the Board of Directors, which focuses on enterprise-level management decisions, and decision-making committees related to business execution are clearly divided. Through these measures the Company is undertaking efforts to optimize and make more efficient managerial decisions and execution of operations.

2. Implemented Measures

(1) Management and other corporate governance systems regarding decision making, execution and monitoring of business operations

The Company has six directors (one outside) and four statutory auditors (two outside and one standing statutory auditor). The term for directors is one year-the same as in the "Company with Committees" system-and half of the statutory auditors are from outside.

There is also a stand-alone internal audit staff whose responsibilities include communicating with the Board of Auditors and the independent audit firm and performing regular checks and evaluations of the internal management structure, including Group companies-taking into account priorities and risks. The staff then reports and offers advice directly to the president.

The Board of Directors meets at least once a month and enhances mutual checking by vigorous discussions among the directors, including one outside director.

The Board of Auditors also meets at least once a month, and performs account and operation auditing based on audit policies. The auditors also attend the Board of Directors' meetings and audit the directors' exercise of duties.

Regarding the utilization of outside independent professionals, significant legal issues and events are consulted with several outside counsels as needed.

Accounting issues are reviewed by an independent audit firm, ChuoAoyama PricewaterhouseCoopers, under the Commercial Code of Japan and the Securities and Exchange Law.

In this fiscal year, certified public accountants in charge are as follows:

- Certified Public Accountants
  Partner staff: Shigeo Kobayashi, Yasuhisa Yajima
- Supporting staff
  Certified public accountants: 7; Assistants: 4; Others: 2

Remuneration for Directors and Auditors

Remuneration for directors stood at ¥332 million (including ¥6 million for an outside director).

Compensation for auditors came to ¥30 million (including ¥12 million for outside auditors).

Compensation for Independent Audit Firm

The Company has paid compensation of ¥57 million to ChuoAoyama PricewaterhouseCoopers for auditing as defined in the Certified Public Accountants Law Article 2 No. 1.

(2) Personal, financial or business relationships and any conflict of interest between the Company and independent directors/auditors

No items specified.

(3) Basic policy on building an internal control system

On May 8, 2006, the Board of Directors passed a resolution concerning the "basic policy on building an internal control system." Since then, the Company has been maintaining and promoting this policy to reinforce its auditing and supervisory functions. In addition to ensuring that the execution of business operations complies with laws, regulations and the Company's articles of incorporation, this policy also promotes enhanced efficiency in the directors' exercise of duties.

Directors, Auditors and Executive Officers

Board of Directors

President and Representative Director
Yoichi Wada

Executive Vice President and Director
Keiji Honda

Director
Akitoshi Kawazu

Director
Yosuke Matsuda

Director
Yukinobu Chida

Director *1
Makoto Naruke

Corporate Auditors

Standing Auditor
Hiroshi Nakamura

Auditor
Toshio Maekawa

Auditor *2
Tamotsu Iba

Auditor *2
Norikazu Yahagi

*1: Outside Director
*2: Outside Auditor

Corporate Executives/ Executive Producers

Yoichi Wada
Keiji Honda
Akitoshi Kawazu
Yosuke Matsuda
Koichi Ishii
Yoshinori Kitase
Yosuke Saito
Michihiro Sasaki
Koji Taguchi
Hiromichi Tanaka
Tatsuo Tomiyama
Satoshi Nakajima
Ken Narita
Shinji Hashimoto
Masashi Hiramatsu
Yu Miyake
Koji Yamashita

Honorary Chairman

Yasuhiro Fukushima

Contents

SQUARE ENIX CO., LTD., assumes full responsibility of the consolidated financial statements prepared in conformity with accounting principles generally accepted in Japan, which are the English translation of the consolidated financial statements submitted to the Director of the Kanto Finance Bureau in Japan (*yukashoken hokokusho*).

The consolidated financial statements prepared in conformity with accounting principles generally accepted in the United States of America were audited by independent auditors.

Management's Discussion and Analysis of Operating Results and Financial Position (JPNGAAP)

The following is based on the views of SQUARE ENIX CO., LTD. (the Company), management as of June 30, 2006, and has not been audited.

The following management's discussion and analysis also contains forward-looking statements concerning the future performance of the Company. For more information regarding this, please read the disclaimer regarding forward-looking statements at the beginning of this annual report.

1. Significant Accounting Policies and Estimates

The consolidated financial statements of the SQUARE ENIX Group (the Group) are prepared in accordance with generally accepted accounting principles in Japan (JPNGAAP). In preparing the consolidated financial statements, management shall choose and apply accounting policies, and make estimates that affect the disclosure of amounts in assets, liabilities, income and expenses. Management formulated these estimates based on historical performance and other factors. However, actual results may differ materially from these estimates due to uncertainties inherent in the estimates.

Important accounting policies used in the Group's consolidated financial statements are contained in the section titled "Summary of Significant Accounting Policies Used in the Preparation of Consolidated Financial Statements," which is on page 28 of this report. In particular, judgments for the estimates made in the preparation of the consolidated financial statements are affected by accounting policies.

Revenue Recognition

Sales revenue of the Group is recognized when products are ordinarily shipped or services are provided, while royalty revenue is recognized based on the statement from the licensee. In certain cases, the recognition of sales is decided according to contracts with suppliers and type of products.

Provision for Doubtful Accounts

The Group provides a provision for doubtful accounts based on estimated irrecoverable amounts to prepare for bad debt losses on accounts receivable. In the event that the financial condition of a supplier deteriorates and their solvency declines, the Group may provide additional amounts to the provision for doubtful accounts or record bad debts and losses.

Content Production Account

When the Group determines that differences between actual costs and expected future demand for the content production account and actual cash value, based on market conditions, have reached a certain level, the Group will then perform a write-off. If future demand and market conditions are worse than management's forecasts, there is the possibility that further write-offs will then become necessary.

Unrealized Losses on Investments

The Group owns shares in financial institutions, and companies with which it sells or purchases goods. These shareholdings include stock in listed companies subject to price fluctuation risks in the stock market and stock in privately held companies for which share prices are difficult to calculate. In the event that the fair market value of these shares as of the end of this fiscal year ended March 31, 2006 ("fiscal 2005") have declined no less than 50% of their acquisition cost, the entire amount is treated as an impairment.

In the event of a 30% to 50% decline, an amount determined as necessary considering its significance and potential for recovery is treated as an impairment. During fiscal 2005, the Company recorded a loss from revaluation of investment securities amounting to ¥91 million. A worsening in market conditions or unstable performance at the invested company may require the recording of revaluation losses in the event that losses are not reflected in the current book value, or, the book value becomes irrecoverable.

Deferred Tax Assets

The Group records a valuation allowance to provide for amounts thought likely to decrease in deferred tax assets. In evaluating the necessity of valuation allowance, the Company examines future taxable income and possible tax planning for deferred tax assets with a high likelihood of realization. If the Company decides that all or a portion of net deferred tax assets cannot be realized in the future, the Company writes down deferred tax assets during the fiscal year the decision is made. If the Company decides that deferred tax assets in excess of the recorded amount can be realized in the future, the Company recognizes deferred tax assets to the recoverable amount and increases profits by the same amount during the period the decision is made.

2. Analysis of Financial Policy, Capital Resources and Liquidity

The Company internally finances working capital and capital investment, and utilizes the issuance of corporate bonds. The Company has issued yen-denominated zero-coupon warrant bonds with maturity in 2010. As of March 31, 2006, there was no outstanding balance of interest-bearing debt. The shareholders' equity ratio stood at 56.7%. Cash and cash equivalents at end of year totaled ¥75,252 million, a 7.4% decrease compared with a year earlier.

Please refer to the details below for an analysis of cash flows during fiscal 2005 and significant factors affecting those cash flows.

The Group believes that it is possible to procure the funds required for working capital and capital investment in the future to maintain growth based on its sound financial standing and ability to generate cash through operating activities.

3. Analysis of Business Performance in Fiscal 2005 (For the year ended March 31, 2006)

Note: The figures used in this analysis are for reference purposes and are based on TAITO CORPORATION (Taito) being included within the scope of consolidation for the period from October 1, 2005, to March 31, 2006. These figures include goodwill amounting to ¥27,232 million within non-current assets, and payables related to merger totaling ¥66,999 million within current liabilities.

Assets

Total Assets

Years ended March 31 — Millions of yen

2005	**2006**	Change	Reference: Taito
¥131,695	**¥213,348**	¥81,653	¥91,335

Total assets as of March 31, 2006, amounted to ¥213,348 million, an increase of ¥81,653 million compared with the previous fiscal year-end. The major factors contributing to this change are as follows. (Note: Taito non-current assets include goodwill of ¥27,232 million.)

Cash and Deposits

Years ended March 31 — Millions of yen

2005	2006	Change	Reference: Taito
¥81,243	**¥75,257**	¥(5,986)	¥8,953

(1) Net cash provided by operating activities
Income before income taxes totaled ¥8,990 million, and net cash provided by operating activities amounted to ¥9,174 million, a 63.1% decrease compared with the previous fiscal year. Major cash flows included the non-cash adjustment for depreciation and amortization amounting to ¥8,419 million, increase in accounts receivable totaling ¥16,330 million, which are mainly attributable to the release of a major game title near the end of the fiscal year, and decrease in inventories amounting to ¥9,140 million.
(2) Net cash used in investing activities
Net cash used in investing activities totaled ¥60,039 million, compared with net cash provided by investing activities totaling ¥574 million in the previous fiscal year. Major cash flows included payments for the acquisition of Taito stock amounting to ¥53,747 million, and payments for acquiring property and equipment totaling ¥8,258 million.
(3) Net cash provided by financing activities
Net cash provided by financing activities amounted to ¥44,153 million, compared with net cash used in financing activities totaling ¥2,907 million in the previous fiscal year. Major cash flows included proceeds from the issuance of corporate bonds amounting to ¥50,000 million and payments for dividends totaling ¥6,617 million.

Notes and Accounts Receivable

Years ended March 31 — Millions of yen

2005	2006	Change	Reference: Taito
¥7,670	**¥33,215**	¥25,544	¥9,564

The year-end balance of notes and accounts receivable varies greatly depending on the timing of new game title releases. In the fiscal year ended March 31, 2005, there were no million-selling titles released in the fourth quarter. However, in the period under review, "FINAL FANTASY XII" was released in Japan on March 16, 2006, with shipments totaling 2.38 million units as of March 31, 2006. In North America, "KINGDOM HEARTS II" was released on March 28, 2006, with shipments reaching 1.26 million units as of the fiscal year-end. After adding the effect of Taito's inclusion in the scope of consolidation, notes and accounts receivable totaled ¥33,215 million, an increase of ¥25,544 million compared with the previous fiscal year-end.

Content Production Account

Years ended March 31 — Millions of yen

2005	2006	Change	Reference: Taito
¥15,510	**¥7,312**	¥(8,197)	¥—

As a rule, content development costs incurred after the outset of authorized productions through release are capitalized in the content production account. When the title is released, this amount is then recorded as an expense.

The content production account is reevaluated based on the current business environment. In the event that a title development project is canceled as a result of such reevaluation, the Company may write-off capitalized development costs for the canceled title in the content production account as an extraordinary loss. In the fiscal year under review, an extraordinary loss amounting to ¥460 million was posted owing to the write-off of canceled content.

Costs incurred during the pre-production phase—the phase before development is formally approved by a decision-making body—are posted as selling, general and administrative (SG&A) expenses as they are incurred.

As of March 31, 2006, the content production account totaled ¥7,312 million, a decrease of ¥8,197 million compared with the end of the previous fiscal year. This decrease was mainly owing to the domestic release of such major titles as "FINAL FANTASY XII" and "KINGDOM HEARTS II," whose production costs were expensed during the period under review.

Deferred Tax Assets (current and non-current)

Years ended March 31 — Millions of yen

	2005	2006	Change	Reference: Taito
Current	¥3,440	**¥7,877**	¥4,437	¥2,897
Non-current	1,768	**6,523**	4,754	2

In September 2005, the Company acquired 93.7% of the common shares of TAITO CORPORATION via a takeover bid. Subsequently, Taito was merged with SQEX, Inc., a wholly owned subsidiary of the Company, resulting in Taito becoming a wholly owned subsidiary of the Company, as planned.

The temporary tax differences associated with the takeover of Taito are recognized as a tax effect that the Company is expected to benefit from its profitability to recover the difference in the future, and were recorded as a deferred tax asset. Current deferred tax assets as of March 31, 2006, increased ¥4,437 million, to ¥7,877 million, while non-current deferred tax assets increased ¥4,754 million, to ¥6,523 million.

Intangible Assets

Years ended March 31 — Millions of yen

2005	2006	Change	Reference: Taito
¥6,096	**¥25,389**	¥19,293	¥28,156

Intangible assets increased ¥19,293 million, to ¥25,389 million, mainly owing to an increase in goodwill of ¥18,511 million. As of March 31, 2006, goodwill amounted to ¥23,446 million, which is comprised entirely of Taito goodwill. The goodwill of UIEVOLUTION, INC., a U.S. subsidiary of the Company, which had been posted until the previous fiscal year, was fully amortized in the year under review. (Note: Taito includes goodwill totaling ¥27,232 million.)

Rental Deposits

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥2,863	**¥17,361**	¥14,498	¥14,443

Claims in Bankruptcy

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥—	**¥2,240**	¥2,240	¥2,240

Construction Cooperation Fund

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥—	**¥2,158**	¥2,158	¥2,158

Allowance for Doubtful Accounts

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥—	**¥(4,738)**	¥(4,738)	¥(4,738)

Among investments and other assets, rental deposits, claims in bankruptcy and reorganization proceedings, construction cooperation fund and provision for doubtful accounts all increased owing to Taito becoming a consolidated subsidiary. Rental deposits and the construction cooperation fund are mainly related to the lease of game center facilities. Claims in bankruptcy and reorganization proceedings are mainly attributable to a claim against Baltec Co., Ltd., an equity-method affiliate. Provision for doubtful accounts is mainly related to reserves provided for receivables from Baltec and rental deposits for leases of game center facilities.

Liabilities

Total Liabilities

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥22,103	**¥91,234**	¥69,131	¥89,323

Total liabilities as of March 31, 2006, amounted to ¥91,234 million, an increase of ¥69,131 million compared with the previous fiscal year-end. The major factors contributing to this change are as follows. (Note: Taito includes payables related to the merger of ¥66,999 million.)

Notes and Accounts Payable

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥2,241	**¥12,124**	¥9,882	¥8,433

Notes and accounts payable increased ¥9,882 million, to ¥12,124 million, mainly owing to Taito becoming a consolidated subsidiary and the timing of game title releases near the end of the period.

Accrued Expenses

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥1,662	**¥6,413**	¥4,750	¥4,422

Accrued expenses increased ¥4,750 million, to ¥6,413 million, mainly owing to Taito being made a consolidated subsidiary.

Other Accounts Payable

Years ended March 31			Millions of yen
2005	**2006**	Change	Reference: Taito
¥1,190	**¥6,509**	¥5,318	¥67,760

Mainly owing to payables relating to the merger and takeover of Taito, namely outstanding payables to minority interests in Taito, other accounts payable increased ¥5,318 million, to ¥6,509 million. Among Taito's other accounts payable shown above, the amount of payables relating to the merger with SQEX, which was payable to the Company, was offset through consolidation. (Note: Taito includes payables relating to the merger totaling ¥66,999 million.)

Shareholders' Equity

Years ended March 31			Millions of yen
	2005	**2006**	Change
Common stock	¥ 7,433	**¥ 7,803**	¥ 370
Capital surplus reserve	36,673	**37,044**	370
Retained earnings	65,561	**76,022**	10,460
Unrealized gain on revaluation of other investment securities	472	**531**	59
Foreign currency translation adjustment	(807)	**97**	904
Treasury stock	(401)	**(506)**	(104)
Total shareholders' equity	¥108,933	**¥120,993**	¥12,060

As of March 31, 2006, total shareholders' equity amounted to ¥120,993 million, an increase of ¥12,060 million compared to the previous fiscal year-end. The increases in common stock and capital reserve are due to stock options being exercised.

Total shareholders' equity as of March 31, 2006, was not affected by the takeover of Taito—excluding consolidated income effects in the second half of the period—since the Company did not use treasury stock in the takeover transaction. Consequently, compared with the previous fiscal year-end, the ¥10,460 million increase in retained earnings is the main factor contributing to the increase in total shareholders' equity.

Consolidated Statements of Income

Net Sales and Operating Income

Years ended March 31 — Millions of yen

	2005	Composition	**2006**	Composition	Amount change	Percent change
Net sales	¥73,864	100.0%	**¥124,473**	**100.0%**	¥50,608	68.5%
Gross profit	48,161	65.2	**56,367**	**45.2**	42,402	88.0
Reversal of allowance for sales returns	1,569	2.1	**1,316**	**1.1**	(253)	(16.1)
Provision for allowance for sales returns	1,316	1.8	**1,186**	**0.1**	(129)	(9.8)
Net gross profit	48,414	65.5	**56,497**	**45.4**	8,082	16.7
Selling, general and administrative expenses	21,975	29.7	**41,026**	**33.0**	19,051	86.7
Operating income	26,438	35.8	**15,470**	**12.4**	(10,968)	(41.5)

In the Games (Offline) business segment during the fiscal year under review, conditions in the Japanese market remained harsh; however, such major game title releases as "FINAL FANTASY XII" and "Kingdom Hearts II" achieved robust sales, leading to an increase in segment sales compared with the previous fiscal year. In contrast, sales of second-tier titles were sluggish and conditions in the operating environment prompted the Company to reevaluate the content production account on an ongoing basis. Owing to stringent evaluation of these assets, segment operating income declined sharply compared with the previous fiscal year.

In the Games (Online) business segment, flagship game title "FINAL FANTASY XI" continued to perform strongly, leading to higher sales and operating income for the segment.

The Mobile Phone Content business segment achieved an increase in sales. However, owing to a delay in revenue contributions from the segment's overseas operations and initial investments made in the domestic market in the second half of the period, which had yet to be recouped, costs outstripped sales growth, leading to a decrease in segment operating income.

In the Publication business segment, in the absence of such major hits as "FULL METAL ALCHEMIST" and top-selling game strategy books such as those related to "DRAGON QUEST VIII," which were a feature of the previous fiscal year's results, segment sales and operating income declined. In contrast, magazine and comic book sales were firm, providing a stable source of income.

In the Others business segment, during the fiscal year under review the success of the CGI-animated film *FINAL FANTASY VII: Advent Children* led to a substantial increase in segment sales and operating income.

The operating results for Taito, which was included in the scope of consolidation from the end of September 2005, are presented in the Amusement business segment. These results apply to the period from October 1, 2005, to March 31, 2006.

The Amusement business segment was projected to contribute to consolidated operating income; however, the commercial children's card game machine business, which Taito entered in the second half of the period, performed poorly, and both new and existing game center facilities posted sales below the level achieved in the previous fiscal year. As a result, the segment posted an operating loss for the six-month period.

For a breakdown of segment sales and operating income and comparison with the previous fiscal year, please refer to the Review of Operations on pages 8 to 11 of this report. A breakdown of the Amusement segment results (Taito) is as follows.

Results Applicable to the Company's Consolidated Results (Reference)

	Six months ended March 31, 2006 (Millions of yen)			Year ended March 31, 2006 (Millions of yen)		
	Net sales	Operating income	Operating margin	Net sales	Operating income	Operating margin
Game arcade operations	**¥22,179**	**¥ (188)**	**(0.9)%**	¥43,526	¥ 656	1.5%
Coin-operated game machines	**8,178**	**26**	**0.3**	16,092	520	3.2
Content services	**3,856**	**1,161**	**30.1**	7,974	2,384	29.9
Commercial karaoke machines	**2,999**	**43**	**1.4**	6,175	(49)	(0.8)
Other	**3,854**	**(744)**	**(19.3)**	8,782	(1,105)	(12.6)
Eliminations and corporate		**(1,086)**			(2,300)	
Taito consolidated total	**¥41,069**	**¥ (788)**	**(1.9)%**	¥82,551	¥ 106	0.1%
Amortization		**(382)**				
Amusement segment total	**¥41,069**	**¥(1,170)**	**(2.8)%**			

Note: The commercial karaoke machines business was sold to XING Inc. on July 3, 2006. For details regarding this transaction, please refer to Subsequent Events on page 42 of this report.

Non-Operating Income and Expenses

Years ended March 31			Millions of yen
	2005	**2006**	Change
Non-operating income	¥ 542	**¥1,046**	¥ 503
Non-operating expenses	1,080	**968**	(111)

In the fiscal year under review, non-operating income amounted to ¥1,046 million, an increase of ¥503 million compared with the previous fiscal year. Within this figure, the Company recorded a foreign exchange gain totaling ¥508 million, compared with ¥296 million for this item in the previous fiscal year. Other items included increases in interest income and dividends received.

Non-operating expenses amounted to ¥968 million, a decrease of ¥111 million compared with the previous fiscal year. This included a loss on write-off of the content production account totaling ¥460 million, compared with ¥983 million for this item in the previous fiscal year.

Extraordinary Gain and Loss

Years ended March 31			Millions of yen
	2005	**2006**	Change
Extraordinary gain	¥118	**¥1,361**	¥1,243
Extraordinary loss	443	**7,878**	7,435

Extraordinary gain amounted to ¥1,361 million, an increase of ¥1,243 million compared with the previous fiscal year. This was primarily due to a gain on sale of investment securities relating to the sale of shares in Mag Garden Corporation.

Extraordinary loss amounted to ¥7,878 million, an increase of ¥7,435 million compared with the previous fiscal year. This included impairment loss of ¥4,426 million, extraordinary disposal loss on inventories of ¥1,652 million, adjustment loss in connection with advance received in mobile phone business of ¥302 million, loss on liquidation of affiliate of ¥209 million, provision for doubtful accounts of ¥505 million and provision to allowance for store closings of ¥153 million.

Impairment loss was mainly related to UIEVOLUTION goodwill. For details, please refer to the note on page 33 of this report.

Extraordinary disposal loss on inventories, provision for doubtful accounts and provision to allowance for store closings stemmed from the inclusion of Taito in the Company's scope of consolidation. These items were related to the write-offs of inventory such as coin-operated amusement machines, and reserve provisions for closure of unprofitable game center facilities.

Adjustment loss in connection with advance received in mobile phone business resulted from the increase in significance of a user point program run as part of the Mobile Phone Content business. This loss was posted in relation to unused points awarded up to the previous fiscal year.

Loss on liquidation of affiliate related to the establishment of a wholly owned subsidiary in China, SQUARE ENIX (China) CO., LTD., and the accompanying transfer of operations from a formerly existing 60%-owned affiliate, SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD. (SEW). The business transfer led to a loss on liquidation of SEW.

Dividends

For the previous fiscal year, the Company paid an ordinary dividend of ¥30 per share and a commemorative dividend of ¥30 per share, for a total annual dividend of ¥60 per share. For the fiscal year under review, the Company paid a ¥30 per share ordinary dividend only. This was mainly owing to an income increase relating to tax effects, which are expected to materialize in the future but have not produced a cash increase at this stage.

Capital Expenditures and Depreciation

Years ended March 31				Millions of yen
	2005	**2006**	Change	Reference: Taito
Capital expenditures	¥1,814	**¥8,419**	¥6,605	¥6,364
Depreciation	1,523	**9,169**	7,646	6,521

Note: Depreciation does not include amortization of goodwill.

Capital expenditures for the fiscal year ended March 31, 2006, amounted to ¥8,419 million, an increase of ¥6,605 million compared with the previous fiscal year. This was mainly owing to the consolidation of Taito.

Amortization of Goodwill

In March 2004, the Company acquired UIEVOLUTION and made it a wholly owned subsidiary of SQUARE ENIX, INC., a wholly owned subsidiary of the Company. The purpose of this acquisition was to acquire information and telecommunication technologies fundamental to the development of network-related businesses, and bolster the Company's product and service capabilities in this area. As a result of this transaction, the Company posted goodwill amounting to U.S.$507 million. In the previous fiscal period, the Company commenced amortization of this goodwill over five years. However, in the fiscal year under review the Company compared projected future cash flows from this subsidiary with its book value, and decided to post an impairment loss of ¥3,926 million, which is the amount projected at this stage as unrecoverable.

In addition, accompanying the consolidation of Taito during the period under review, the Company recorded goodwill amounting to ¥23,283 million. This amount will be amortized over 20 years commencing from the fiscal year under review.

As a result of the factors outlined above, amortization of goodwill totaled ¥1,827 million.

Overseas Sales

Geographic segment sales are dependent on game title development in Japan. As a result, overseas sales fluctuate depending on the timing of overseas game title releases.

North America

Years ended March 31		Millions of yen
2005	**2006**	Change
¥12,295	**¥15,635**	¥3,340

In North America, the Company's main businesses are Games (Offline), Games (Online) and Mobile Phone Content. In the Games (Offline) business in this region, game titles developed by the Company are sold under license mainly by SQUARE ENIX, INC. In the fiscal year under review, several titles for the PS2 were released, including "Dragon Quest VIII: Journey of the Cursed King" and "Kingdom Hearts II." The Company's online game service PlayOnline—focused on "FINAL FANTASY XI"—performed well, recording membership growth on par with that achieved in Japan. As a result, sales in North America increased ¥3,340 million, to ¥15,635 million.

Europe

Years ended March 31 — Millions of yen

	2005	**2006**	Change
	¥1,298	**¥1,378**	¥80

The Company primarily conducts Games (Offline), Games (Online) and Mobile Phone Content businesses in Europe. In the PAL region, sales of the Company's game content are generally licensed to leading European publishers. However, during the period under review, SQUARE ENIX LTD., a wholly owned subsidiary of the Company in this region, began preparations for game sales under the Company's own brand. The Company also launched online game and mobile phone content services in the European market in the previous fiscal year. As a result, sales in Europe increased ¥80 million, to ¥1,378 million.

Asia

Years ended March 31 — Millions of yen

	2005	**2006**	Change
	¥1,179	**¥3,025**	¥1,846

In Asia, the Company provides primarily Games (Online) and Amusement services. In the Games (Online) business, the Company primarily operates the CROSS GATE online game service for the PC platform in China. In the Amusement business, the Company operates game center facilities in Korea and China. Sales in Asia increased ¥1,846 million compared with the previous fiscal year, to ¥3,025 million.

4. Strategic Outlook, Issues Facing Management and Future Direction

It is management's main task to grow the Company in the medium and long term, maintaining profitability with the creation of advanced, high-quality content.

As the development and popularization of information technology (IT) and network environments are rapidly advancing, new digital entertainment will transform the industry structure in the near future; customer needs for network-compliant entertainment will increase; and multi-functional terminals will enable users easy access to various types of content.

It is the Company's medium- and long-term strategy to respond to such changes and open a new era of digital entertainment.

In the fiscal year ending March 31, 2007, as part of our implementation of a medium-term business strategy, we will focus on expanding our existing offline game franchises and strengthening our network-related businesses. We will also work to restore profitability to the Amusement business.

The Group's targets for the fiscal year ending March 31, 2007, are as follows:

Years ended March 31 — Millions of yen

	2004 Results	2005 Results	2006 Results	2007 Targets
Net sales	¥63,202	¥73,864	¥124,473	¥150,000
Operating income	19,398	26,438	15,470	19,000
Ordinary income	18,248	25,901	15,547	19,000
Net income	10,993	14,932	17,076	11,000

Owing to the consolidation of Taito at the end of September 2005, Taito's operating results are reflected in the Company's consolidated statements of income from October 2005. Following this merger, we have set an operating income ratio of 20% or more and average annual growth in net income per share (EPS) of 10% as our main numerical targets.

5. Dividend Policy

It is one of the Company's most important management policies to return profit to shareholders. We will reserve retained earnings as we take priority over investments for effective purposes for future growth of corporate value, such as the enhancement and expansion of existing business operations, capital investments for new business development and merger and acquisition (M&A) activities. Regarding returning profit to be expended for dividends, and we will maintain continuous and stable dividend payouts.

6. Risk Factors

■ Changes in the Economic Environment

In the event of an exceptionally harsh downturn in the economy, causing consumer expenditure to fall, demand for the Group's products and services in the entertainment field may decline. Such circumstances may lead to an adverse impact on the Group's business performance.

■ Changes in Consumer Preferences in the Digital Content Market and the Group's Ability to Respond to Rapid Progress of Innovative Technology

In such a period of transition as stated in the medium- and long-term strategy and tasks, it is probable such change may affect the Group's business performance if it is unable to deal with the transitions properly and promptly.

■ Changes in Game Platforms and the Company's Response

The Group's core business predominantly involves the sale of software for use on home-use video game consoles. Consequently, the Company's business may be subject to the impact of transition to next-generation console platforms and changes in console manufacturers' strategies. During platform generation transition periods, there is a tendency for consumers to reduce their game software purchases, which may lead to stagnation in the Company's sales growth. Such circumstances may lead to an adverse impact on the Group's business performance.

■ Securing Human Resources to Execute the Group's Growth Strategies Concentrating on Creation of New Content Services and Business Development Overseas

The Group has been making rapid growth in expanding its business operations globally. Delay in developing human resources may adversely affect the Group's business performance.

■ Expansion in the Group's International Business Operations

In the Games (Offline), Games (Online) and Mobile Phone Content business segments, the Group is pursuing expansion of its international business operations. A variety of factors present in the countries and regions in which the Group operates overseas may affect the Group's business performance. Such factors include market trends, political situations, economic climates, law and legal factors, cultural factors, religious factors, customs and other factors.

■ Fluctuation of Exchange Rates

The Group includes consolidated subsidiaries located in North America, Europe and Asia. The risks of foreign exchange loss have been reduced as foreign currency gained by subsidiaries is expended for settlement or reinvestment in each country. However, sales, expenses and assets of the overseas subsidiaries are converted into Japanese yen amounts in the consolidated financial statements. Consequently, the exchange rate may affect the Group's financial results as it fluctuates beyond our forecast.

■ Entertainment Industry Laws

The operation of game centers is subject to government control under the Law for Proper Control of Entertainment and Amusement Business and other related laws and regulations. These laws and regulations include an approval and licensing system for the opening and operation of amusement centers, regulations on business hours (ordinances vary, but operation is generally prohibited from midnight to 10 a.m.), age restrictions (ordinances vary, but the admittance of persons under 16 years old after 6 p.m. and persons under 18 years old after 10 p.m. is generally prohibited), area restrictions on outlet opening, and regulations concerning facility structure, interior, lighting and noise. While complying with the laws, the Group has actively pursued the establishment of new centers. However, if regulations were to change owing to the establishment of new laws or other reasons, the Group's business performance may be affected.

■ Management of Personal Information

In conjunction with the enactment of the Personal Information Protection Law, the Group has bolstered employee training with the aim of increasing awareness about the handling of personal information. The Group has also improved the timeliness of its personal information management systems and identified all personal information obtained by the Group. The Group has undertaken a full range of measures to strengthen its internal control systems, including ongoing improvements to technology controlling access to its customer database and to its data security system, restrictions on personnel permitted to access information and establishment of a system to deal with customer inquiries regarding personal information. To this point, no leakage of personal information has occurred from the Group. The Group intends to maintain its stringent management systems for personal information by reviewing current systems and enhancing employee training. However, if a leak of personal information were to occur from the Group, the Group's business performance may be affected.

■ Accidents and Disasters

The Group periodically carries out accident prevention checks, facility checks and emergency drills to minimize accidents and the impacts of disasters, including terrorist attacks, infectious diseases, food poisoning, fires, electrical blackouts, computer system/server malfunctions, earthquakes, and typhoon and flood damage. However, in the event of accidents or disasters it may not be possible to avoid or alleviate all adverse impacts. If a major earthquake or disaster occurs, which could impede the continuation of business, the Group's business performance may be affected.

■ Litigation

The Group is being managed strictly in compliance with laws and regulations and with full respect for third parties' rights while carrying out its operations. However, in the course of its business activities in Japan and abroad the risk of the Group becoming the defendant of litigation cannot be discounted. If such litigation were to occur, the Group's business performance may be affected.

Consolidated Balance Sheets (JPNGAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
As of March 31

	Millions of yen	
	2006	2005
Assets		
I Current assets		
1. Cash and deposits	**¥ 75,257**	¥ 81,243
2. Notes and accounts receivable	**33,215**	7,670
3. Inventories	**5,489**	1,112
4. Content production account	**7,312**	15,510
5. Deferred tax assets	**7,877**	3,440
6. Other current assets	**3,968**	1,337
Allowance for doubtful accounts	**(868)**	(262)
Total current assets	**132,251**	110,053
II Non-current assets		
1. Property and equipment		
(1) Buildings and structures	**18,694**	3,667
Accumulated depreciation	**11,546**	1,525
	7,148	2,142
(2) Tools and fixtures	**12,481**	9,116
Accumulated depreciation	**8,761**	6,162
	3,719	2,954
(3) Amusement equipment	**58,733**	—
Accumulated depreciation	**45,292**	—
	13,440	—
(4) Other	**26**	16
Accumulated depreciation	**15**	8
	10	7
(5) Land	**5,516**	3,813
(6) Construction in progress	**159**	—
Total property and equipment	**29,995**	8,918
2. Intangible assets		
(1) Goodwill	**23,446**	4,934
(2) Other	**1,942**	1,161
Total intangible assets	**25,389**	6,096
3. Investments and other assets		
(1) Investment securities*1	**1,459**	1,295
(2) Long-term loans	**173**	9
(3) Rental deposits	**17,361**	2,863
(4) Construction cooperation fund	**2,158**	—
(5) Claims in bankruptcy	**2,240**	—
(6) Deferred tax assets	**6,523**	1,768
(7) Other*1	**533**	689
(8) Allowance for doubtful accounts	**(4,738)**	—
Total investments and other assets	**25,712**	6,626
Total non-current assets	**81,097**	21,641
Total assets	**¥213,348**	¥131,695

The accompanying notes are an integral part of these statements.

	2006	Millions of yen 2005
Liabilities		
I Current liabilities		
1. Notes and accounts payable	**¥ 12,124**	¥ 2,241
2. Other accounts payable	**6,509**	1,190
3. Accrued expenses	**6,413**	1,662
4. Accrued corporate taxes	**4,848**	9,994
5. Accrued consumption taxes	**1,245**	1,022
6. Advance payments received	**991**	896
7. Deposits received	**421**	385
8. Reserve for bonuses	**2,648**	1,021
9. Allowance for sales returns	**1,186**	1,316
10. Allowance for store closings	**292**	—
11. Other	**1,159**	1,057
Total current liabilities	**37,840**	20,790
II Non-current liabilities		
1. Corporate bonds	**50,000**	—
2. Allowance for retirement benefits	**3,001**	1,173
3. Allowance for directors' retirement benefits	**189**	55
4. Other	**202**	84
Total non-current liabilities	**53,394**	1,313
Total liabilities	**91,234**	22,103
(Minority interests)		
Minority interests in consolidated subsidiaries	**1,120**	658
(Shareholders' equity)		
I Common stock*2	**7,803**	7,433
II Capital surplus reserve	**37,044**	36,673
III Retained earnings	**76,022**	65,561
IV Unrealized gain on revaluation of other investment securities	**531**	472
V Foreign currency translation adjustment	**97**	(807)
VI Treasury stock*3	**(506)**	(401)
Total shareholders' equity	**120,993**	108,933
Total liabilities, minority interests and shareholders' equity	**¥213,348**	¥131,695

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income (JPNGAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years ended March 31

Millions of yen

		2006	2005
I	Net sales	¥124,473	¥73,864
II	Cost of sales	68,105	25,703
	Gross profit	56,367	48,161
	Reversal of allowance for sales returns	1,316	1,569
	Provision for allowance for sales returns	1,186	1,316
	Net gross profit	56,497	48,414
III	Selling, general and administrative expenses*1	41,026	21,975
	1. Packaging freight charge	1,623	634
	2. Advertising expense	7,458	5,346
	3. Sales promotion expense	1,177	109
	4. Provision for doubtful accounts	101	77
	5. Compensation for directors	498	233
	6. Salary	11,604	4,251
	7. Provision to reserve for bonuses	1,350	418
	8. Net periodic pension costs	251	107
	9. Provision to reserve for directors' retirement benefits	19	121
	10. Welfare expense	1,511	753
	11. Rental expense	1,949	1,033
	12. Commissions paid	3,204	2,667
	13. Depreciation and amortization	1,648	1,141
	14. Other	8,625	5,079
	Operating income	15,470	26,438
IV	Non-operating income	1,046	542
	1. Interest income	139	72
	2. Dividends received	23	4
	3. Foreign exchange gain	508	296
	4. Rental income	63	30
	5. Support fees received	28	—
	6. Facilities installation cooperation fees	79	—
	7. Miscellaneous income	202	138
V	Non-operating expenses	968	1,080
	1. Interest expenses	29	2
	2. Commissions paid	94	—
	3. Loss on disposal of inventories	151	3
	4. Loss on write-off of content development account	460	983
	5. Loss on inventory valuation	190	—
	6. Corporate bond issuance expenses	17	—
	7. Investment loss on equity method	7	—
	8. Miscellaneous loss	18	90
	Recurring income	15,547	25,901
VI	Extraordinary gain	1,361	118
	1. Gain on sale of property and equipment*2	—	0
	2. Gain on sale of investment securities	1,353	106
	3. Reversal of allowance for doubtful accounts	—	11
	4. Other	8	—
VII	Extraordinary loss	7,878	443
	1. Loss on sale of property and equipment*3	19	2
	2. Loss on disposal of property and equipment*4	457	50
	3. Impairment loss*6	4,426	—
	4. Loss on evaluation of investment securities*5	91	80
	5. Loss on sale of investment securities	—	2
	6. Evaluation loss on shares held in affiliates	—	145
	7. Loss on liquidation of affiliates	209	—
	8. Adjustment loss in connection with advance received in mobile business	302	—
	9. Accelerated amortization of goodwill	—	145
	10. Extraordinary loss on inventory write-downs	1,652	—
	11. Provision for doubtful accounts	505	—
	12. Provision to allowance for store closings	153	—
	13. Other	59	16
	Income before income taxes and distribution of loss in partnership (*tokumei-kumiai*)	9,031	25,576
	Distribution of loss in partnership (*tokumei-kumiai*)	40	20
	Income before income taxes	8,990	25,556
	Corporate, resident and enterprise taxes	1,835	11,267
	Refunded income taxes	(912)	—
	Deferred income taxes	(9,039)	(760)
	Minority interest in consolidated subsidiaries	31	116
	Net income	¥17,076	¥14,932

The accompanying notes are an integral part of these statements.

Consolidated Statements of Capital Surplus and Retained Earnings (JPNGAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen	
	2006	2005
(Capital surplus)		
I Capital surplus at beginning of year	**¥36,673**	¥36,393
II Increase in capital surplus	**370**	280
1. Gain on disposal of treasury stock	**0**	1
2. Shares issued through stock options	**370**	278
III Capital surplus at end of year	**37,044**	36,673
(Retained earnings)		
I Retained earnings at beginning of year	**65,561**	53,931
II Increase in retained earnings	**17,076**	14,932
1. Net income	**17,076**	14,932
III Decrease in retained earnings	**6,616**	3,302
1. Dividends	**6,616**	3,301
2. Bonus for directors	**—**	0
IV Retained earnings at end of year	**¥76,022**	¥65,561

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows (JPNGAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen	
	2006	2005
I Cash flows from operating activities		
Income before income taxes	**¥8,990**	¥25,556
Depreciation and amortization	**8,419**	1,814
Impairment loss	**4,426**	—
Increase in allowance for doubtful accounts	**611**	31
Increase (decrease) in reserve for bonuses	**643**	(218)
Decrease in allowance for sales returns	**(155)**	(267)
(Decrease) increase in allowance for retirement benefits	**(1,213)**	195
Increase (decrease) in allowance for directors' retirement benefits	**19**	(54)
Increase in other allowances	**153**	—
Interest and dividends received	**(163)**	(76)
Interest expenses	**29**	2
Gain on sale of investment securities	**(1,353)**	(106)
Loss on sale of investment securities	**—**	2
Losses on investments in securities	**91**	80
Evaluation loss on shares held in affiliates	**—**	145
Loss on disposal of property and equipment	**457**	50
Gain on sales of property and equipment	**—**	(0)
Loss on sales of property and equipment	**19**	2
(Increase) decrease in accounts receivable	**(16,330)**	4,319
Decrease (increase) in inventories	**9,140**	(5,618)
Increase (decrease) in purchase liabilities	**1,797**	(953)
Increase in accrued consumption taxes	**102**	614
Decrease (increase) in other current assets	**57**	(94)
Decrease (increase) in other non-current assets	**358**	(198)
Increase in other current liabilities	**391**	701
Directors' bonuses paid	**—**	(0)
Other	**2,643**	1,632
Subtotal	**19,138**	27,559
Interest and dividends received	**121**	83
Interest paid	**(30)**	(0)
Income taxes paid	**(10,054)**	(2,768)
Net cash provided by operating activities	**9,174**	24,873

The accompanying notes are an integral part of these statements.

	2006	2005
		Millions of yen
II Cash flows from investing activities		
Payments for acquiring property and equipment	**(8,258)**	(1,318)
Payments for acquiring intangible assets	**(340)**	(362)
Proceeds from sales of investment securities	**1,504**	—
Proceeds from redemption of investment securities	**—**	2,000
Payments for acquisition of shares in affiliates	**(53,747)**	(27)
Proceeds from liquidation of shares in affiliates	**—**	34
Proceeds from return of guarantee money paid	**1,160**	104
Payments for provision of guarantee money paid	**(234)**	(101)
Other	**(122)**	245
Net cash (used in) provided by investing activities	**(60,039)**	574
III Cash flows from financing activities		
Proceeds from short-term loans	**40,000**	—
Payment of short-term loans	**(40,000)**	—
Proceeds from issuance of corporate bonds	**50,000**	—
Payments for acquisition of treasury stock	**(104)**	(154)
Payments for dividends	**(6,617)**	(3,300)
Payments for dividends for minority interests	**—**	(2)
Other	**876**	549
Net cash provided by (used in) financing activities	**44,153**	(2,907)
IV Effect of exchange rate changes on cash and cash equivalents	**719**	27
V Net (decrease) increase in cash and cash equivalents	**(5,991)**	22,567
VI Cash and cash equivalents at beginning of year	**81,243**	58,676
VII Cash and cash equivalents at end of year*1	**¥75,252**	¥81,243

The accompanying notes are an integral part of these statements.

Summary of Significant Accounting Policies Used in the Preparation of Consolidated Financial Statements

1. Scope of Consolidation

• FY2004 (April 1, 2004 to March 31, 2005)

(1) Number of consolidated subsidiaries:
11 and one partnership
DIGITAL ENTERTAINMENT ACADEMY CO., LTD.
COMMUNITY ENGINE INC.
THE GAME DESIGNERS STUDIO, INC.
SQUARE ENIX, INC.
SQUARE L.L.C.
SQUARE PICTURES, INC.
SQUARE ENIX LTD.
SQUARE ENIX (China) CO., LTD.
SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD.
COMMUNITY ENGINE NETWORK SOFTWARE (BEIJING) CO., LTD.
UIEVOLUTION, INC.
FF·FILM·PARTNERS (partnership)

SQUARE ENIX (China) CO., LTD., was established in January 2005 and has been included in the Company's scope of consolidation from this fiscal year.

(2) Non-consolidated subsidiaries:
BMF CORPORATION
SOLID CO., LTD.

SPORTS BB CORPORATION was liquidated during this fiscal year.

(Rationale for the exclusion of subsidiary companies from the scope of consolidation)
Non-consolidated subsidiaries conduct operations that are relatively small in scale. The total of non-consolidated subsidiaries' assets, sales, equity in net income (loss), and equity in retained earnings (deficit) are deemed to have an immaterial effect on the Company's financial performance and consolidated financial statements.

• FY2005 (April 1, 2005 to March 31, 2006)

(1) Number of consolidated subsidiaries:
17 and one partnership
DIGITAL ENTERTAINMENT ACADEMY CO., LTD.
COMMUNITY ENGINE INC.
TAITO CORPORATION
SQUARE ENIX, INC.
SQUARE L.L.C.
SQUARE PICTURES, INC.
SQUARE ENIX LTD.
SQUARE ENIX (China) CO., LTD.
SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD.
COMMUNITY ENGINE NETWORK SOFTWARE (BEIJING) CO., LTD.
UIEVOLUTION, INC.
FF·FILM·PARTNERS (partnership)
HUANG LONG CO., LTD.
BEIJING TAIXIN CULTURAL AMUSEMENT CO., LTD.
TAITO KOREA CORPORATION
TAITO ART CORPORATION
EFFORT CO., LTD.
TAITO TECH CO., LTD.

HUANG LONG CO., LTD. was established in August 2005 and has been included in the Company's scope of consolidation from this fiscal year.

In this fiscal year, THE GAME DESIGNERS STUDIO, INC., changed its name to SQEX, INC. Subsequently, on March 31, 2006, SQEX merged with TAITO CORPORATION concurrent with the latter company's acquisition by the Company and on the same day changed its name to TAITO CORPORATION.

Also in this fiscal year, the Company's consolidated financial statements have been prepared on the basis of the Company's assumption of a controlling interest in TAITO CORPORATION, BEIJING TAIXIN CULTURAL AMUSEMENT CO., LTD., TAITO KOREA CORPORATION, TAITO ART CORPORATION, EFFORT CO., LTD. and TAITO TECH CO., LTD., as of September 30, 2005.

SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD., is currently undergoing liquidation procedures.

(2) Non-consolidated subsidiaries:
SOLID CO., LTD.
UIE JAPAN CO., LTD.
ZERO RESEARCH LTD.

UIE JAPAN CO., LTD., and ZERO RESEARCH LTD., were established in this fiscal year.

(Rationale for the exclusion of subsidiary companies from the scope of consolidation)
Same as FY2004

2. Application of the Equity Method of Accounting

• FY2004 (April 1, 2004 to March 31, 2005)

Number of equity-method non-consolidated subsidiaries and affiliates: 0

Principal non-consolidated subsidiaries not accounted for under the equity method (BMF CORPORATION, SOLID CO., LTD., SQUARE U.S.A., INC.) and an affiliated company (KUSANAGI INC.) are excluded from the scope of consolidation as equity-method affiliates, as the Company's equity in net income (loss) and equity in retained earnings (deficit) in these companies are deemed to have an immaterial effect on the Company's consolidated financial statements. In addition, as the Company's investment in MAG GARDEN CORP. is deemed to be temporary, it has been excluded from the scope of consolidation as an equity-method affiliate.

• FY2005 (April 1, 2005 to March 31, 2006)

Number of equity-method affiliates: 3
Baltec Co., Ltd.
Kaaku LTD.
Kaasa Solution GmbH

Principal non-consolidated subsidiaries not accounted for under the equity method (UIE JAPAN CO., LTD., ZERO RESEARCH LTD., and SOLID CO., LTD.) and affiliated companies (BMF CORPORATION and KUSANAGI INC.) are excluded from the scope of consolidation as equity-method affiliates, as the Company's equity in net income (loss) and equity in retained earnings (deficit) in these companies are deemed to have an immaterial effect on the Company's consolidated financial statements. Baltec Co., Ltd., Kaaku LTD., and Kaasa Solution GmbH are consolidated subsidiaries of TAITO CORPORATION acquired during the period.

3. Fiscal Year-End of Consolidated Subsidiaries

• FY2004 (April 1, 2004 to March 31, 2005)

The fiscal year of SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD., COMMUNITY ENGINE NETWORK SOFTWARE (BEIJING) CO., LTD., SQUARE ENIX (China) CO., LTD., SQUARE PICTURES, INC., and FF·FILM PARTNERS (partnership) ends on December 31.

In the preparation of consolidated financial statements, their financial statements for the December 31 fiscal year-end are used. Significant transactions between their fiscal year-end and the consolidated balance date of March 31 are reconciled for consolidation.

• FY2005 (April 1, 2005 to March 31, 2006)

Among the Company's consolidated subsidiaries, the fiscal year of SQUARE ENIX (China) CO., LTD., HUANG LONG CO., LTD., COMMUNITY ENGINE NETWORK SOFTWARE (BEIJING) CO., LTD., BEIJING TAIXIN CULTURAL AMUSEMENT CO., LTD., SQUARE PICTURES, INC., and FF·FILM PARTNERS ends on December 31.

In the preparation of consolidated financial statements, their financial statements for the December 31 fiscal year-end are used. Significant transactions between their fiscal year-end and the consolidated balance sheet date of March 31 are reconciled for consolidation.

For SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD., a provisional settlement of accounts for this fiscal year was used as the basis for the preparation of financial statements.

4. Summary of Significant Accounting Policies

(1) Standards and valuation methods for major assets

• FY2004 (April 1, 2004 to March 31, 2005)

A) Investment securities
Held-to-maturity securities:
Amortized cost method, amortized on a straight-line basis
Other investment securities
Securities for which fair values are available:
Market value, determined by the quoted market price as of the balance sheet date, with unrealized gains and losses reported as a separate component of shareholders' equity at a net-of-tax amount, and the cost of sales determined by the moving-average method
Securities for which fair values are unavailable:
Stated at cost determined by the average method

B) Inventories
Manufactured goods, merchandise:
Stated at cost, determined by the monthly average method
Content production account:
Stated at cost, determined by the identified cost method
Amusement equipment:
———
Unfinished goods:
Stated at cost, determined by the monthly average method
Supplies:
Stated at the last purchase price

• FY2005 (April 1, 2005 to March 31, 2006)

A) Investment securities
Held-to-maturity securities:
———
Other investment securities
Securities for which fair values are available:
Same as FY 2004
Securities for which fair values are unavailable:
Same as FY 2004

B) Inventories
Manufactured goods, merchandise:
Stated at cost, determined by the monthly average method
Certain consolidated subsidiaries, however, determine cost by the moving-average method

Content production account:
Same as FY2004
Amusement equipment:
Stated at cost, determined by the identified cost method
Unfinished goods:
Stated at cost, determined by the monthly average method
Certain consolidated subsidiaries, however, determine cost by the moving-average method
Supplies:
Same as FY2004

(2) Method for depreciation and amortization of major assets:
• FY2004 (April 1, 2004 to March 31, 2005)

A) Property and equipment
Property and equipment of the Company and its domestic consolidated subsidiaries are depreciated using the declining-balance method. However, the straight-line method is applied to buildings (excluding building fixtures) acquired after April 1, 1998. The estimated useful lives of major assets are as follows:

Buildings and structures	3–50 years
Tools and fixtures	3–15 years

B) Intangible assets
In-house software used by the Company and its domestic consolidated subsidiaries is amortized using the straight-line method based on an estimated useful life of five years. For all other intangible fixed assets, trademarks are amortized using the straight-line method based on an estimated useful life of 10 years. Goodwill is amortized using the straight-line method over a period of five years.

• FY2005 (April 1, 2005 to March 31, 2006)

A) Property and equipment
Property and equipment of the Company and its domestic consolidated subsidiaries are depreciated using the declining-balance method. However, the straight-line method is applied to buildings (excluding building fixtures) acquired after April 1, 1998. The estimated useful lives of major assets are as follows:

Buildings and structures	3–65 years
Tools and fixtures	3–15 years
Amusement equipment	3–8 years

B) Intangible assets
Same as FY2004

(3) Accounting for allowances and reserves:
• FY2004 (April 1, 2004 to March 31, 2005)

A) Allowance for doubtful accounts
An allowance for doubtful accounts provides for possible losses arising from default on accounts receivable. The allowance is made up of two components: the estimated credit loss for doubtful receivables based on an individual assessment of each account, and a general reserve calculated based on historical default rates.
B) Reserve for bonuses
A reserve for bonuses provided for payments to employees of the Company and its consolidated subsidiaries at the amount expected to be paid in respect of the calculation period ended on the balance sheet date.
C) Allowance for sales returns
An allowance is provided for losses due to the return of published materials, at an amount calculated based on historic experience, prior to this fiscal year. In addition, an allowance is provided for losses due to the return of game software, at an estimated amount of future losses assessed by each game title.
D) Allowance for store closings
——————
E) Allowance for retirement benefits
An allowance for retirement benefits is provided at the amount incurred during this fiscal year, which is based on the estimated present value of the projected benefit obligation. Unrecognized actuarial differences are fully amortized in the next year in which they arise. Unrecognized prior service cost is amortized over a certain period (one year) within the average remaining service period of the employees. In addition, the Company and its domestic consolidated subsidiaries provide a reserve for retirement benefits equal to 100% of such benefits the Company and its subsidiaries would be required to pay under the lump-sum retirement plan if all eligible employees were to voluntarily terminate their employment at the balance sheet date.
F) Allowance for directors' retirement benefits
An allowance for directors' retirement benefits is provided to adequately cover the costs of directors' retirement benefits, which are accounted for on an accrual basis in accordance with internal policy.

• FY2005 (April 1, 2005 to March 31, 2006)

A) Allowance for doubtful accounts
Same as FY2004
B) Reserve for bonuses
Same as FY2004
C) Allowance for sales returns
An allowance is provided for losses due to the return of published materials, at an amount calculated based on historic experience, prior to this fiscal year. In addition, an

allowance is provided for losses due to the return of game software and other items, at an estimated amount of future losses assessed by each game title.

D) Allowance for store closings
For store closures determined during this fiscal year, an allowance is provided to an amount in line with reasonable estimates of future losses arising from such closures.

E) Allowance for retirement benefits
An allowance for retirement benefits is provided at the amount incurred during this fiscal year, which is based on the estimated present value of the projected benefit obligation. Unrecognized actuarial differences are fully amortized in the next year in which they arise. At certain consolidated subsidiaries, amortization for each period is made over a certain period (five years), using the straight-line method within the average remaining years of service of employees when they are accrued, commencing from the period after they are incurred. Unrecognized prior service cost is amortized over a certain period (one year or five years) within the average remaining service period of the employees. In addition, at certain of the Company's domestic consolidated subsidiaries, a reserve for retirement benefits is provided equal to 100% of such benefits the subsidiaries would be required to pay under the lump-sum retirement plan if all eligible employees were to voluntarily terminate their employment at the balance sheet date.

F) Allowance for directors' retirement benefits
Same as FY2004

(4) Translation of foreign currency transactions and accounts:

• FY2004 (April 1, 2004 to March 31, 2005)

All monetary assets and liabilities of the Company and its domestic consolidated subsidiaries denominated in foreign currencies are translated at the balance sheet date at the year-end rate. The resulting translation gains or losses are charged or credited to income. All monetary assets and liabilities of overseas subsidiaries are translated as of the balance sheet year-end rate, and all income and expense accounts are translated at rates for their respective periods. The resulting translation adjustments are recorded in minority interests in consolidated subsidiaries and shareholders' equity as "Foreign currency translation adjustment."

• FY2005 (April 1, 2005 to March 31, 2006)

Same as FY2004

(5) Accounting for leases:

• FY2004 (April 1, 2004 to March 31, 2005)

Finance leases, other than those for which the ownership of the leased assets are considered to be transferred to the lessees, are accounted for as operating leases.

• FY2005 (April 1, 2005 to March 31, 2006)

Same as FY2004

(6) Accounting for deferred assets:

• FY2004 (April 1, 2004 to March 31, 2005)

Stock issuance expenses
Costs associated with issuance of common shares are expensed as incurred.

A) Corporate bond issuance expenses
―――――

• FY2005 (April 1, 2005 to March 31, 2006)

Stock issuance expenses
Same as FY2004

A) Corporate bond issuance expenses
Costs associated with issuance of corporate bonds are expensed as incurred.

(7) Additional accounting policies used to prepare consolidated financial statements:

• FY2004 (April 1, 2004 to March 31, 2005)

A) Accounting treatment of consumption tax
Income statement items are presented exclusive of consumption tax.

B) Accounting treatment of overseas subsidiaries
The accounts and records of overseas subsidiaries are maintained in conformity with accounting principles and practices generally accepted in their respective countries.

• FY2005 (April 1, 2005 to March 31, 2006)

A) Accounting treatment of consumption tax
Same as FY2004

B) Accounting treatment of overseas subsidiaries
Same as FY2004

5. Valuation of Assets and Liabilities of Consolidated Subsidiaries

• FY2004 (April 1, 2004 to March 31, 2005)

All assets and liabilities of consolidated subsidiaries are revalued on acquisition.

• FY2005 (April 1, 2005 to March 31, 2006)

Same as FY2004

6. Amortization of Goodwill

• FY2004 (April 1, 2004 to March 31, 2005)

Goodwill is amortized over a period of 3–5 years on a straight-line basis.

• FY2005 (April 1, 2005 to March 31, 2006)

Goodwill is amortized over 5 years or 20 years on a straight-line basis.

7. Appropriation of Retained Earnings

• FY2004 (April 1, 2004 to March 31, 2005)

The consolidated statement of capital surplus and retained earnings is prepared based on earnings (deficit) appropriations determined during the fiscal year.

• FY2005 (April 1, 2005 to March 31, 2006)

Same as FY2004

8. Scope of Cash and Cash Equivalents in the Statements of Cash Flows

• FY2004 (April 1, 2004 to March 31, 2005)

Cash and cash equivalents in the consolidated statements of cash flows is comprised of cash on hand, bank deposits which are able to be withdrawn on demand and highly liquid short-term investments with an original maturity of three months or less and with minor risk of significant fluctuations in value.

• FY2005 (April 1, 2005 to March 31, 2006)

Same as FY2004

New Accounting Standards

• FY2004 (April 1, 2004 to March 31, 2005)

———————

• FY2005 (April 1, 2005 to March 31, 2006)

(Accounting standard for impairment of non-current assets)
Effective from this fiscal year, the Company has applied the Accounting Standard for the Impairment of Fixed Assets—(Opinion Concerning Establishment of Accounting Standard for the Impairment of Fixed Assets [Business Accounting Council, August 9, 2002]) and Implementation Guidance for the Accounting Standard for Impairment of Fixed Assets (Financial Accounting Standard Implementation Guidance No. 6 [Accounting Standards Board of Japan, October 31, 2003]). As a result, income before income taxes decreased ¥4,426 million in this fiscal year. The effect of the new accounting standard on segment information has been reflected wherever relevant. The cumulative amount of impairment loss was deducted directly from the book value of each asset in accordance with the amended consolidated accounting policy.

Reclassifications

• FY2004 (April 1, 2004 to March 31, 2005)

(Consolidated Balance Sheets)
"Goodwill," which was included in "Intangible assets" in the previous fiscal year, is presented separately in the current year as the amount became material. In the previous year, "Goodwill" included in "Intangible assets" was ¥6,361 million.

• FY2005 (April 1, 2005 to March 31, 2006)

(Consolidated Balance Sheets)

———————

Notes to Consolidated Balance Sheets

• FY2004 (April 1, 2004 to March 31, 2005)

*1 Investment in non-consolidated subsidiaries and affiliates:

Investment securities	¥151 million
Investments and other assets	¥4 million

*2 Number of shares of common stock outstanding:

Common stock	110,385,543

*3 Number of shares of treasury stock:

Common stock	150,650

4 Contingent liabilities for guarantees:
The Company has issued a revolving guarantee to a maximum limit of U.S.$15 million on behalf of consolidated subsidiary SQUARE ENIX, INC., in favor of SONY COMPUTER ENTERTAINMENT AMERICA INC. As of March 31, 2005, there is no liability outstanding under the guarantee.

• FY2005 (April 1, 2005 to March 31, 2006)

*1 Investment in non-consolidated subsidiaries and affiliates:

Investment securities	¥35 million
Investments and other assets	¥24 million

*2 Number of shares of common stock outstanding:

Common stock	110,729,623

*3 Number of shares of treasury stock:

Common stock	182,139

*4 Contingent liabilities for guarantees:
The Company has issued a revolving guarantee to a maximum limit of U.S.$15 million on behalf of consolidated subsidiary

SQUARE ENIX, INC., in favor of SONY COMPUTER ENTERTAINMENT AMERICA INC. As of March 31, 2006, there is no liability outstanding under this guarantee.

The Company has issued a guarantee on behalf of consolidated subsidiary TAITO CORPORATION covering its bank overdraft agreement (maximum amount: ¥41,000 million). As of March 31, 2006, there is no liability outstanding under this guarantee.

Consolidated subsidiary TAITO CORPORATION has issued guarantees on behalf of its commercial audiovisual products customers covering their leasing fee liabilities to TOKYO LEASING Corporation and KYOCERA Leasing Co., Ltd. These guarantees cover leasing fee liabilities up to ¥60 million.

Notes to Consolidated Statements of Income

• FY2004 (April 1, 2004 to March 31, 2005)

*1 ————

*2 Breakdown of gain on sale of property and equipment:

Tools and fixtures	¥0 million

*3 Breakdown of loss on sale of property and equipment:

Tools and fixtures	¥2 million

*4 Breakdown of loss on disposal of property and equipment:

Tools and fixtures	¥47 million
Software	¥2 million
Total	¥50 million

*5 Loss on investment securities is due to the significant decline in market prices of marketable securities.

*6 ————

• FY2005 (April 1, 2005 to March 31, 2006)

*1 Selling, general and administrative expenses include R&D costs of ¥1,145 million.

*2 Breakdown of gain on sale of property and equipment:

Tools and fixtures	¥— million

*3 Breakdown of loss on sale of property and equipment:

Tools and fixtures	¥19 million

*4 Breakdown of loss on disposal of property and equipment:

Buildings and structures	¥52 million
Tools and fixtures	¥220 million
Amusement equipment	¥159 million
Software	¥22 million
Other	¥3 million
Total	¥457 million

*5 Same as FY2004

*6 Impairment loss

In this fiscal year, the Group posted impairment losses on the following non-current assets.

Millions of yen

Location	Usage	Category	Impairment amount
Nagareyama-shi, Chiba	Idle assets	Land	¥ 42
Tokushima-shi, Tokushima	Idle assets	Land	146
Chiyoda-ku, Tokyo	Idle assets	Telephone subscription rights	9
Republic of Korea (TAITO KOREA CORPORATION)	—	Goodwill	260
The United States of America (UIEVOLUTION, INC.)	—	Goodwill	3,926
Other	—	—	41
Total			¥4,426

Cash in-flows from each business segment of the Group are complementary to each other in terms of similarity in nature of products, merchandise, services and markets. Consequently, all assets for operational purposes are classified in one asset group, and idle assets which are not used for operational purposes are classified individually. In addition, assets related to the Group's headquarters and welfare facilities are classified as common-use assets.

Since the market values for the idle assets listed above has declined severely in relation to their book values, and because it remains uncertain as to whether the Group will be able to utilize these assets in the future, their book values have been impaired to the recoverable amounts. The resulting losses have been posted as an impairment loss totaling ¥198 million.

Furthermore, the recoverable amounts for these assets have been determined according to market prices calculated using real estate appraisals.

¥260 million related to the Republic of Korea (TAITO KOREA CORPORATION) has been posted as an impairment loss. This is the difference between the appraised income potential in excess of acquisition amount for amusement facilities in Korea at the time of acquisition, and the current level of income assessed as recoverable above acquisition amount.

The goodwill impairment totaling ¥3,926 million listed for the United States of America (UIEVOLUTION, INC.) has been posted as an impairment loss. This amount is the appraised difference between future cash in-flows and the current book value.

Notes to Consolidated Statements of Cash Flows

• FY2004 (April 1, 2004 to March 31, 2005)

*1 Reconciliation of cash and cash equivalents on consolidated statements of cash flows to the amounts disclosed in the consolidated balance sheet is as follows:

(As of March 31, 2005)

Cash and deposits	¥81,243 million
Cash and cash equivalents	¥81,243 million

• FY2005 (April 1, 2005 to March 31, 2006)

*1 Reconciliation of cash and cash equivalents on consolidated statements of cash flows to the amounts disclosed in the consolidated balance sheet is as follows:

(As of March 31, 2006)

Cash and deposits	¥75,257 million
Time deposits with maturity periods over three months	(5 million)
Cash and cash equivalents	¥75,252 million

2 Assets and liabilities of key companies that became consolidated subsidiaries following the acquisition of shares.

The following figures represent the assets and liabilities of TAITO CORPORATION and its affiliated companies at the time it became a consolidated subsidiary through a share acquisition, as well as the acquisition cost of shares in TAITO in relation to the net payment for acquiring TAITO CORPORATION and its affiliated companies:

Current assets	¥26,776 million
Non-current assets	41,508 million
Goodwill	15,975 million
Current liabilities	(15,298 million)
Non-current liabilities	(2,641 million)
Minority interests in consolidated subsidiaries	(3,246 million)
Acquisition cost of shares	(63,074 million)
Cash and cash equivalents	(9,930 million)
Net payment for acquisition of shares	53,143 million

Lease Transactions

• FY2004 (April 1, 2004 to March 31, 2005)

Information related to finance leases other than those that transfer ownership to the lessee

1. Acquisition cost, accumulated depreciation and net book value of leased assets:

Millions of yen

	Acquisition cost	Accumulated depreciation	Net book value
Tools and fixtures	¥74	¥49	¥24
Total	¥74	¥49	¥24

Note: The total future lease payment at the end of the year is an insignificant portion of total property and equipment at the end of the year. Accordingly, the total acquisition cost includes the interest portion.

2. Ending balance of future lease payments:

Due within one year	¥14 million
Due after one year	9 million
Total	¥24 million

Note: The total future lease payment at the end of the year is an insignificant portion of total property and equipment at the end of the year. Accordingly, the total future lease payment includes the interest portion.

3. Lease payments and depreciation:

Lease payments	¥16 million
Depreciation expense	¥16 million

4. Method of calculation for depreciation
Depreciation is calculated using the straight-line method over the useful life with no residual value.

• FY2005 (April 1, 2005 to March 31, 2006)

Information related to finance leases other than those that transfer ownership to the lessee

1. Acquisition cost, accumulated depreciation, accumulated impairment loss and net book value of leased assets:

Millions of yen

	Acquisition cost	Accumulated depreciation	Net book value
Buildings and structures	¥1,278	¥ 213	¥1,064
Tools and fixtures	1,802	984	818
Total	¥3,080	¥1,197	¥1,882

Note: Same as FY2004

2. Ending balance of future lease payments:

Due within one year	¥ 493 million
Due after one year	1,389 million
Total	¥1,882 million

Note: Same as FY2004

3. Lease payments, reversal of impairment of leased assets, depreciation, interest and impairment loss:

Lease payments	¥552 million
Depreciation expense	¥552 million

4. Method of calculation for depreciation
Same as FY2004

(Impairment loss)
No impairment loss is recognized for leased assets.

Securities

• FY2004 (April 1, 2004 to March 31, 2005)

1. Held-for-sale securities
Not applicable

2. Held-to-maturity securities with market value
Not applicable

3. Other investment securities with market value:

Millions of yen

	Type	Acquisition cost	Book value	Unrealized gain (loss)
Securities with book value exceeding acquisition cost	(1) Stocks	¥179	¥ 994	¥814
	Subtotal	179	994	814
Securities with acquisition cost exceeding book value	(1) Stocks	¥ 76	¥ 58	¥ (18)
	Subtotal	76	58	(18)
Total		¥256	¥1,052	¥796

Note: Impairment loss on securities is charged to income when the market price at the end of the fiscal year falls less than 50% of the acquisition cost. Impairment loss on securities is charged to income when the market price at the end of the fiscal year falls between 30% and 50% of the acquisition cost after considering factors such as the significance of amount and the possibility of recovery.

4. Securities sold during the fiscal year:
(April 1, 2004 to March 31, 2005)

Millions of yen

Amount of sale	Gain on sale	Loss on sale
¥248	¥106	¥2

5. Investment securities whose fair values are not readily determined as of March 31, 2005:

Millions of yen

	Book value
(1) Other marketable securities	
Unlisted securities (excluding OTC securities)	¥81
Unlisted overseas bonds	—

6. Redemption schedule of other securities with a maturity date on those to be held to maturity
Not applicable

• FY2005 (April 1, 2005 to March 31, 2006)

1. Held-for-sale securities
Not applicable

2. Held-to-maturity securities with market value
Not applicable

3. Other investment securities with market value:

Millions of yen

	Type	Acquisition cost	Book value	Unrealized gain (loss)
Securities with book value exceeding acquisition cost	(1) Stocks	¥174	¥1,128	¥953
	Subtotal	174	1,128	953
Securities with acquisition cost exceeding book value	(1) Stocks	¥210	¥ 197	¥ (12)
	Subtotal	210	197	(12)
Total		¥384	¥1,325	¥941

Note: In the period ended March 31, 2006, the impairment loss associated with the fair market value determination of other investment securities with market value was ¥91 million. Impairment loss on securities is charged to income when the market price at the end of the fiscal year falls less than 50% of the acquisition cost. Impairment loss on securities is charged to income when the market price at the end of the fiscal year falls between 30% and 50% of the acquisition cost after considering factors such as the significance of amount and the possibility of recovery.

In the period ended March 31, 2005, the impairment loss associated with the fair market value determination of other investment securities with market value was ¥80 million.

4. Securities sold during the fiscal year:
(April 1, 2005 to March 31, 2006)

Millions of yen

Amount of sale	Gain on sale	Loss on sale
¥1,504	¥1,353	¥—

5. Investment securities whose fair values are not readily determined as of March 31, 2005 and 2006:

Millions of yen

	Book value
(1) Other marketable securities	
Unlisted securities (excluding OTC securities)	¥132
Unlisted overseas bonds	0

6. Redemption schedule of other securities with a maturity date on those to be held to maturity
Not applicable

Derivative Transactions

• FY2004 (April 1, 2004 to March 31, 2005)

1. Condition of transaction
(1) Type of transaction and purpose
The Company does not engage in derivative transactions in principal, however, the Company enters into foreign exchange forward contracts to reduce the effect of fluctuations in foreign currencies.

(2) Transaction policy
The Company enters into foreign exchange forward contracts to cover anticipated transactions denominated in foreign currencies but does not enter into these contracts for speculation.

(3) Risks
Foreign exchange forward contracts include the market risk of fluctuations in foreign currencies but in our estimation, the risk of nonperformance is considered to be low as the contracts are entered into with prestigious financial institutions.

(4) Risk Management
Contracts are approved by the representative director and executive director in charge, and the Accounting and Financing Division administer the risk management.

2. Market value of transaction
Not applicable

• FY2005 (April 1, 2005 to March 31, 2006)

1. Condition of transaction
(1) Type of transaction and purpose
Same as FY2004

(2) Transaction policy
Same as FY2004

(3) Risks
Same as FY2004

(4) Risk Management
Same as FY2004

2. Market value of transaction
Not applicable

Retirement Benefits

• FY2004 (April 1, 2004 to March 31, 2005)

1. Overview of retirement benefit plan applied
The Company and its domestic consolidated subsidiaries applied a lump-sum retirement payment plan with regard to its retirement benefit obligation.
The projected benefits are allocated to periods of service on a straight-line basis. The Company's domestic consolidated subsidiaries apply the conventional method in the calculation of retirement benefit obligations. In addition, certain of the Company's overseas subsidiaries maintain defined contribution retirement pension plans.

2. Retirement benefit obligation:

	Millions of yen
Retirement benefit obligation	¥ 969
Net unfunded obligation	969
Unrecognized prior service cost	100
Unrecognized actuarial loss	103
Allowance for retirement benefits	¥1,173

3. Retirement benefit expenses:

	Millions of yen
Service cost	¥210
Interest cost	15
Amortization of net actuarial gains and losses	10
Retirement benefit expenses	¥235

4. Assumption used in accounting for retirement benefit obligation:

Periodic allocation method for projected benefits	Straight-line basis
Discount rate	1.652%
Years over which prior service costs are amortized	1 year
Years over which net actuarial gains and losses are amortized	1 year

• FY2005 (April 1, 2005 to March 31, 2006)

1. Overview of retirement benefit plan applied
The Company and its domestic consolidated subsidiaries applied a lump-sum retirement payment plan with regard to its retirement benefit obligation.
The projected benefits are allocated to periods of service on a straight-line basis. The Company's domestic consolidated subsidiaries apply the conventional method in the calculation of retirement benefit obligations. In addition, certain of the Company's overseas subsidiaries maintain defined contribution retirement pension plans.

2. Retirement benefit obligation:

	Millions of yen
Retirement benefit obligation	¥11,249
Fair value of plan assets	10,622
Net unfunded obligation	627
Unrecognized prior service cost	1,895
Unrecognized actuarial loss	479
Allowance for retirement benefits	¥ 3,001

3. Retirement benefit expenses:

	Millions of yen
Service cost	¥ 378
Interest cost	129
Expected return on plan assets	(89)
Amortization of prior service cost	(356)
Amortization of net actuarial gains and losses	(103)
Retirement benefit expenses	¥ (40)

4. Assumption used in accounting for retirement benefit obligation:

Periodic allocation method for projected benefits	Straight-line basis
Discount rate	1.700%–1.837%
Expected rate of return on plan assets	1.700%
Years over which prior service costs are amortized	1–5 years
Years over which net actuarial gains and losses are amortized	1–5 years

Tax Effect Accounting

• FY2004 (April 1, 2004 to March 31, 2005)

1. Significant components of deferred tax assets and liabilities are summarized as follows:

	Millions of yen
Deferred tax assets	
1) Current assets	
Enterprise tax payable	¥ 809
Office tax payable	19
Accrues bonuses, allowance for bonuses to employees	415
Advances paid	310
Accrued expenses	346
Allowance for sales return	442
Non-deductible portion of allowance for doubtful accounts	162
Tax credits	80
Non-deductible portion of allowance for content production account	(190)
Evaluation loss on content	1,140
Other	(97)
Total	3,440
2) Non-current assets	
Non-deductible portion of allowance for retirement benefits	477
Allowance for directors' retirement benefits	31
Non-deductible depreciation expense of property and equipment	562
Tax effect on deficit of subsidiaries	690
Loss on investments in securities	242
Other	87
Offset to deferred tax assets (non-current assets)	(324)
Total	1,768
Net deferred tax assets	5,209
Deferred tax liabilities	
Non-current liabilities	
Net unrealized gains on other investment securities	(324)
Offset to deferred tax assets (non-current assets)	324
Total deferred tax liabilities	—
Balance: Net deferred tax assets (liabilities)	¥5,209

2. Reconciliation of the statutory tax rate and the effective tax rate:

Statutory tax rate	40.70%
Permanent differences excluded from non-taxable expenses	0.17
Permanent differences excluded from gross revenue	(0.01)
Taxation on per capita basis for residents tax	0.04
Special income tax credits	(0.56)
Amortization on consolidation adjustment account	2.43
Difference in tax rate with the parent company	(1.17)
Other	(0.49)
Effective tax rate	41.11%

• FY2005 (April 1, 2005 to March 31, 2006)

1. Significant components of deferred tax assets and liabilities are summarized as follows:

	Millions of yen
Deferred tax assets	
1) Current assets	
Enterprise tax payable	¥ 37
Office tax payable	20
Accrued bonuses, allowance for bonuses to employees	708
Advances paid	128
Accrued expenses	180
Allowance for sales return	358
Non-deductible portion of allowance for doubtful accounts	169
Non-deductible portion of allowance for content production account	(194)
Evaluation loss on content	835
Loss carried forward	4,665
Non-deductible valuation gain on allowance for retirement benefits	1,060
Non-deductible amortization of goodwill	191
Other	(285)
Total	7,877

2) Non-current assets	
Non-deductible portion of allowance for retirement benefits	433
Allowance for directors' retirement benefits	34
Non-deductible depreciation expense of property and equipment	1,191
Loss on investments in securities	339
Non-deductible portion of allowance for doubtful accounts	38
Loss carried forward	12,201
Other	198
Valuation allowance	(7,206)
Offset to deferred tax assets (non-current assets)	(707)
Total	6,523
Net deferred tax assets	14,401
Non-current liabilities	
Net unrealized gains on other investment securities	(364)
Other	(342)
Offset to deferred tax assets (non-current assets)	707
Total deferred tax liabilities	—
Balance: Net deferred tax assets (liabilities)	¥14,401

2. Reconciliation of the statutory tax rate and the effective tax rate

Statutory tax rate	40.70%
Permanent differences excluded from non-taxable expenses	0.72
Permanent differences excluded from gross revenue	(209.88)
Taxation on per capita basis for residents tax	1.05
Special income tax credits	(10.14)
Amortization of and impairment loss on goodwill	22.73
Valuation allowance	78.8
Reclaimed payment	2.94
Tax effect from reorganization of subsidiaries	(9.50)
Loss carried forward	(6.35)
Other	(1.35)
Effective tax rate	(90.28)%

Segment Information

[Consolidated Business Segment Information]

• FY2004 (April 1, 2004 to March 31, 2005)

Millions of yen

	Games (Offline)	Games (Online)	Mobile Phone Content	Publication	Others	Total	Eliminations or unallocated	Consolidated total
I Sales and operating income								
Net sales								
(1) Sales to outside customers	¥41,944	¥13,853	¥4,557	¥10,859	¥2,649	¥ 73,864	¥ —	¥ 73,864
(2) Intersegment sales	—	—	—	—	—	—	—	—
Total	41,944	13,853	4,557	10,859	2,649	73,864	—	73,864
Operating expenses	22,295	8,866	2,818	7,448	1,866	43,295	4,131	47,426
Operating income	¥19,649	¥ 4,986	¥1,738	¥ 3,411	¥ 782	¥ 30,569	¥ (4,131)	¥ 26,438
II Assets, depreciation and capital expenditures								
Assets	¥64,860	¥20,752	¥4,725	¥20,448	¥6,168	¥116,955	¥14,739	¥131,695
Depreciation	693	770	35	19	99	1,618	195	1,814
Capital expenditures	106	725	51	3	17	905	618	1,523

Notes: 1. The classification of business segments is made according to the types of products and services.

2. Major products offered by each business segment:

Segment	Major Products
Games (Offline)	Games
Games (Online)	Online games
Mobile Phone Content	Content for mobile phones
Publication	Magazine comics, serial comics, game-related books
Others	Derivative products such as character merchandise, school for game designers

3. Unallocated operating expenses included in "Eliminations or unallocated" totaled ¥4,131 million. These expenses are mainly related to unallocated administrative departments of the Company.

4. Unallocated assets included in "Eliminations or unallocated" totaled ¥14,739 million. These assets are mainly related to administrative departments of the Company.

• FY2005 (April 1, 2005 to March 31, 2006)

Millions of yen

	Games (Offline)	Games (Online)	Mobile Phone Content	Publication	Amusement	Others	Total	Eliminations or unallocated	Consolidated total
I Sales and operating income									
Net sales									
(1) Sales to outside customers	¥45,916	¥15,720	¥5,067	¥ 9,742	¥41,069	¥6,957	¥124,473	¥ —	¥124,473
(2) Intersegment sales	—	—	—	—	—	—	—	—	—
Total	45,916	15,720	5,067	9,742	41,069	6,957	124,473	—	124,473
Operating expenses	36,326	9,812	4,341	6,875	42,240	4,949	104,545	4,457	109,003
Operating income	¥ 9,590	¥ 5,907	¥ 726	¥ 2,866	¥ (1,170)	¥2,007	¥ 19,927	¥ (4,457)	¥ 15,470
II Assets, depreciation, impairment loss and capital expenditures									
Assets	¥67,658	¥15,421	¥4,056	¥12,348	¥80,897	¥6,912	¥187,293	¥26,055	¥213,348
Depreciation	690	663	47	15	6,364	68	7,850	569	8,419
Impairment loss	1,308	1,308	1,308	—	271	—	4,197	229	4,426
Capital expenditures	1,075	640	89	1	6,521	91	8,420	748	9,169

Notes: 1. The classification of business segments is made according to the types of products and services.

2. Major products offered by each business segment:

Segment	Major Products
Games (Offline)	Games
Games (Online)	Online games
Mobile Phone Content	Content for mobile phones
Publication	Magazine comics, serial comics, game-related books
Amusement	All operations of TAITO CORPORATION, including rental operations, product and merchandise sales, and content services
Others	Derivative products such as character merchandise, school for game designers

3. Unallocated operating expenses included in "Eliminations or unallocated" totaled ¥4,457 million. These expenses are mainly related to administrative departments of the Company.

4. Unallocated assets included in "Eliminations or unallocated" totaled ¥26,055 million. These assets are mainly deferred tax assets.

[Consolidated Geographic Segment Information]

• FY2004 (April 1, 2004 to March 31, 2005)

Millions of yen

	Japan	North America	Europe	Asia	Total	Eliminations or unallocated	Consolidated total
I Sales and operating income							
Net sales							
(1) Sales to outside customers	¥ 60,949	¥11,528	¥ 577	¥ 810	¥ 73,864	¥ —	¥ 73,864
(2) Intersegment sales	3,436	360	312	13	4,123	(4,123)	—
Total	64,386	11,889	889	823	77,988	(4,123)	73,864
Operating expenses	40,425	9,619	858	646	51,550	(4,123)	47,426
Operating income	¥ 23,960	¥ 2,270	¥ 31	¥ 176	¥ 26,438	¥ —	¥ 26,438
II Assets	¥118,306	¥10,694	¥1,010	¥1,683	¥131,695	¥ —	¥131,695

Notes: 1. The classification of geographic segments is made according to geographical distances.
2. Main countries and areas included in each segment are as follows:
(1) North America..............the United States of America
(2) Europe ....United Kingdom
(3) Asia..............................China
3. There are no unallocated operating expenses included in "Eliminations or unallocated."
4. There are no unallocated assets included in "Eliminations or unallocated."

• FY2005 (April 1, 2005 to March 31, 2006)

Millions of yen

	Japan	North America	Europe	Asia	Total	Eliminations or unallocated	Consolidated total
I Sales and operating income							
Net sales							
(1) Sales to outside customers	¥107,354	¥14,670	¥ 413	¥2,035	¥124,473	¥ —	¥124,473
(2) Intersegment sales	4,316	837	364	5	5,523	(5,523)	—
Total	111,670	15,507	778	2,040	129,997	(5,523)	124,473
Operating expenses	99,910	12,109	728	1,778	114,526	(5,523)	109,003
Operating income	¥ 11,760	¥ 3,398	¥ 49	¥ 262	¥ 15,470	¥ —	¥ 15,470
II Assets	¥196,210	¥12,683	¥1,207	¥3,247	¥213,348	¥ —	¥213,348

Notes: 1. The classification of geographic segments is made according to geographical distances.
2. Main countries and areas included in each segment are as follows:
(1) North America..............the United States of America
(2) Europe ....United Kingdom
(3) Asia..............................China, Republic of Korea
3. There are no unallocated operating expenses included in "Eliminations or unallocated."
4. There are no unallocated assets included in "Eliminations or unallocated."

[Consolidated Overseas Sales]

• FY2004 (April 1, 2004 to March 31, 2005)

Millions of yen

	North America	Europe	Asia	Total
I Overseas sales	¥12,295	¥1,298	¥1,179	¥14,772
II Consolidated sales	—	—	—	73,864
III Percentage of overseas sales to consolidated sales	16.6%	1.8%	1.6%	20.0%

Notes: 1. The classification of geographic segments is made according to geographical distances.
2. Main countries and areas included in each segment are as follows:
(1) North America.............the United States of America, Canada
(2) Europe ....United Kingdom, France, Germany, others
(3) Asia.............................China, others
3. Overseas sales represent sales of the Company and its consolidated subsidiaries to countries and areas outside of Japan.

• FY2005 (April 1, 2005 to March 31, 2006)

Millions of yen

	North America	Europe	Asia	Total
I Overseas sales	¥15,635	¥1,378	¥3,025	¥ 20,039
II Consolidated sales	—	—	—	124,473
III Percentage of overseas sales to consolidated sales	12.6%	1.1%	2.4%	16.1%

Notes: 1. The classification of geographic segments is made according to geographical distances.
2. Main countries and areas included in each segment are as follows:
(1) North America.............the United States of America, Canada
(2) Europe ....United Kingdom, France, Germany, others
(3) Asia.............................China, Republic of Korea, Taiwan, others
3. Overseas sales represent sales of the Company and its consolidated subsidiaries to countries and areas outside of Japan.

[Related Party Transactions]

• FY2004 (April 1, 2004 to March 31, 2005)

None

• FY2005 (April 1, 2005 to March 31, 2006)

None

Per Share Information

• FY2004 (April 1, 2004 to March 31, 2005)

Net assets per share (yen)	¥988.19
Net income per share (yen)	135.63
Diluted net income per share (yen)	134.46

• FY2005 (April 1, 2005 to March 31, 2006)

Net assets per share (yen)	¥1,094.50
Net income per share (yen)	154.65
Diluted net income per share (yen)	153.44

Note: The basis for calculating net income per share and diluted net income per share is provided as follows:

• FY2004 (April 1, 2004 to March 31, 2005)

Net income per share	
Net income (millions of yen)	¥ 14,932
Components not pertaining to common shareholders (millions of yen)	—
Components pertaining to common shareholders (millions of yen)	14,932
Average number of shares of common stock outstanding during the fiscal year (thousands of shares)	110,093
Adjustments to net income used to calculate diluted net income per share	
Adjustments to net income (millions of yen)	—
Increase in the number of common shares (thousands of shares)	962
(of which new shares with acquisition rights)	(962)

Number of latent shares with no dilution excluded from the calculation of diluted net income per share:

The issue of stock options was approved at the Company's annual general meeting of shareholders held on June 18, 2002 and June 23, 2003.

• FY2005 (April 1, 2005 to March 31, 2006)

Net income per share:	
Net income (millions of yen)	¥ 17,076
Components not pertaining to common shareholders (millions of yen)	—
Components pertaining to common shareholders (millions of yen)	17,076
Average number of shares of common stock outstanding during the fiscal year (thousands of shares)	110,419
Adjustments to net income used to calculate diluted net income per share:	
Adjustments to net income (millions of yen)	—
Increase in the number of common shares (thousands of shares)	870
(of which new shares with acquisition rights)	(870)

Number of latent shares with no dilution excluded from the calculation of diluted net income per share:

The issue of stock options was approved at the Company's annual general meeting of shareholders held on June 18, 2005, and bonds with warrants issued through a resolution of the Board of Directors on November 9, 2005.

Significant Subsequent Events

• FY2004 (April 1, 2004 to March 31, 2005)

None

• FY2005 (April 1, 2005 to March 31, 2006)

Business transfer of consolidated subsidiary TAITO CORPORATION's commercial karaoke-on-demand business

1. Reasons for the business transfer
   At a meeting of its Board of Directors held on April 27, 2006, TAITO CORPORATION resolved to transfer its commercial karaoke-on-demand business to XING INC. This business was separated as a new company, and all shares of the new company were sold to XING INC.
   Since TAITO CORPORTATION was added as a consolidated subsidiary in September 2005, the Company has considered medium- to long-term growth strategies for the entire Group. One of the conclusions reached through this process was that the sale of TAITO CORPORATION's commercial karaoke-on-demand business to XING INC. would contribute to raising the corporate value of the Group.
2. Name of the partner company to transfer
   XING INC.
3. Detail of the business to transfer

Selling party	TAITO CORPORATION
Main operations	- Operation and rental business - Product and merchandise sales - Content services - Other businesses
Paid-in capital	¥16 million
Shareholding ratio	SQUARE ENIX CO., LTD. 100%
Brands	LAVCA, X2000
Partner company to transfer	XING INC.

Main operations	- Commercial karaoke-on-demand business - Mobile phone content distribution business	
Paid-in capital	¥1,621 million	
Shareholding ratio	Brother Industries LTD. 88%, INTEC LEASING INC. 11%	
Brand	JOYSOUND	

4. Book value of assets and liabilities to be transferred:
   Planned amount of assets to be transferred ¥2,602 million
   Planned amount of liabilities to be transferred ¥708 million
5. Date of transfer July 3, 2006
6. Transfer price ¥4,683 million (planned)

Additional Consolidated Information

[Corporate Bonds Issued]

• FY2004 (April 1, 2004 to March 31, 2005)

Not applicable

• FY2005 (April 1, 2005 to March 31, 2006)

Company	Bond type	Issue date	Outstanding balance at end of FY2004 (Millions of yen)	Outstanding balance at end of FY2005 (Millions of yen)	Coupon (%)	Security	Maturity
SQUARE ENIX CO., LTD.	Five-year yen-denominated bonds with warrants	November 25, 2005 (UK time)	—	50,000	—	None	November 25, 2010 (UK time)
Total			—	50,000			

[Bonds with Warrants Issued]
(As of March 31, 2006)

Issue price	100% of face value
Aggregate issue amount	¥50.0 billion
Warrant applicable to	Common shares
Exercise price (yen)	¥5,100

Period for exercising warrants
November 28, 2005 to November 11, 2010 (local time where funds are deposited)

Share price when issued due to exercising of warrants and amount capitalized (yen)

Issue price:	¥5,100
Amount capitalized:	¥2,550

Conditions for exercise of warrants
Warrants cannot be partially exercised

[Borrowings]
Not applicable

[Other]
Not applicable

Consolidated Balance Sheets (U.S. GAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
As of March 31

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Assets			
Current assets			
Cash and cash equivalents	**¥ 75,252**	¥ 81,244	**$ 640,608**
Accounts and notes receivable, less allowance for doubtful accounts of 869 and 262, respectively	**31,666**	7,409	**269,566**
Inventories	**6,030**	1,113	**51,334**
Software development costs	**7,312**	17,890	**62,249**
Prepaid expenses and others current assets	**3,973**	1,338	**33,823**
Deferred income taxes	**8,435**	3,575	**71,811**
Total current assets	**132,668**	112,569	**1,129,391**
Property and equipment, net	**32,202**	8,918	**274,126**
Intangible assets, net	**93,048**	73,905	**792,103**
Investment securities	**1,459**	1,295	**12,421**
Lease deposits and other	**16,693**	2,863	**142,100**
Other assets	**536**	699	**4,547**
Deferred income taxes	**7,704**	2,115	**65,590**
Total assets	**¥284,310**	¥202,364	**$2,420,278**

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

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Liabilities and Stockholders' Equity			
Current liabilities			
Accounts and notes payable:			
Trade	**¥ 12,124**	¥ 2,242	**$ 103,213**
Other	**6,509**	1,191	**55,410**
Current installments of obligations under capital leases	**493**	—	**4,199**
Advances received	**991**	896	**8,438**
Income taxes payable	**4,849**	9,995	**41,277**
Accrued bonus	**2,649**	1,021	**22,549**
Reserve for sales returns and price protection	**1,187**	1,316	**10,102**
Accrued expenses and other current liabilities	**10,223**	4,459	**87,018**
Deferred income taxes	**1,211**	968	**10,312**
Total current liabilities	**40,236**	22,088	**342,518**
Long-term debt and obligations under capital leases, excluding current installments	**51,390**	—	**437,469**
Accrued pension costs	**3,136**	1,228	**26,692**
Other long-term liabilities	**774**	139	**6,594**
Deferred income taxes	**13,863**	14,203	**118,014**
Total liabilities	**109,399**	37,658	**931,287**
Minority interest in consolidated subsidiaries	**1,120**	658	**9,537**
Commitments and contingencies			
Stockholders' equity			
Common stock:	**7,804**	7,434	**66,432**
No par value. Authorized 440,000,000 shares, issued and outstanding 110,547,484 and 110,234,893 shares, respectively.			
Additional paid-in capital	**111,055**	110,685	**945,396**
Retained earnings	**54,887**	46,801	**467,246**
Accumulated other comprehensive income (loss)	**543**	(479)	**4,619**
Treasury stock, at cost, 182,139 and 150,650 shares, respectively	**(498)**	(393)	**(4,239)**
Total stockholders' equity	**173,791**	164,048	**1,479,454**
Total liabilities and stockholders' equity	**¥284,310**	¥202,364	**$2,420,278**

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

Consolidated Statements of Income (U.S. GAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Net sales	**¥123,416**	¥74,063	¥63,095	**$1,050,614**
Cost of sales	**71,892**	26,632	28,991	**612,004**
Gross profit	**51,524**	47,431	34,104	**438,610**
Impairment charge for goodwill and other intangible assets	**5,521**	—	—	**47,002**
Impairment losses on long-lived assets	**500**	—	—	**4,275**
Selling, general and administrative expenses	**44,241**	23,169	25,495	**376,615**
Income from operations	**1,262**	24,262	8,609	**10,718**
Other income (expenses):				
Interest income	**159**	73	67	**1,357**
Interest expense	**(30)**	(2)	(7)	**(252)**
Write-down of investment securities	**(91)**	(80)	(375)	**(777)**
Foreign currency exchange gains (losses)	**509**	297	(788)	**4,331**
Gain on sale of investment in non consolidated affiliate	**1,353**	—	—	**11,520**
Other (expenses) income, net	**(33)**	(258)	102	**(253)**
Income before income taxes, minority interest and equity in losses of an affiliated company	**3,129**	24,292	7,608	**26,644**
Income taxes:				
Current	**923**	11,267	3,600	**7,857**
Deferred	**(12,534)**	(1,612)	(1,168)	**(106,699)**
	(11,611)	9,655	2,432	**(98,842)**
Income before minority interest and equity in losses of an affiliated company	**14,740**	14,637	5,176	**125,486**
Minority interest in earnings of consolidated subsidiaries	**(31)**	(117)	(61)	**(264)**
Equity in income of an affiliated company	**(7)**	—	(760)	**(63)**
Net income	**¥ 14,702**	¥14,520	¥4,355	**$ 125,159**

Per share data:

	Yen			U.S. dollars
Net income—basic	**¥133.15**	¥131.89	¥39.58	**$1.13**
—diluted	**132.46**	130.74	37.99	**1.13**
Cash dividends	**¥ 30.00**	¥ 60.00	¥30.00	**$0.26**

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

Consolidated Statements of Changes in Stockholders' Equity (U.S. GAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years ended March 31

Millions of yen (except number of shares)

	Common stock						
	Shares	Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock, at cost	Total stockholders' equity
Balance at March 31, 2003	58,741,609	¥6,940	¥ 9,383	¥33,206	¥ 66	¥ (85)	¥ 49,510
Issuance of common stock to effect business combination	51,167,293		100,807				100,807
Dividends declared				(1,978)			(1,978)
Purchase of treasury stock	(88,221)					(211)	(211)
Reassurance of treasury stock	25,398					59	59
Exercise of stock option	184,800	214	214				428
Unrealized gains on available-for-sale securities					296		296
Foreign currency translation adjustments					(999)		(999)
Net income				4,355			4,355
Balance at March 31, 2004	110,030,879	¥7,154	¥110,404	¥35,583	¥(637)	¥(237)	¥152,267
Dividends declared				(3,302)			(3,302)
Purchase of treasury stock	(54,132)					(163)	(163)
Reassurance of treasury stock	3,021		1			7	8
Exercise of stock option	255,125	280	280				560
Unrealized gains on available-for-sale securities					109		109
Foreign currency translation adjustments					49		49
Net income				14,520			14,520
Balance at March 31, 2005	110,234,893	¥7,434	¥110,685	¥46,801	¥(479)	¥(393)	¥164,048
Dividends declared				**(6,616)**			**(6,616)**
Purchase of treasury stock	**(32,764)**					**(108)**	**(108)**
Reissuance of treasury stock	**1,275**					**3**	**3**
Exercise of stock option	**344,080**	**370**	**370**				**740**
Unrealized gains on available-for-sale securities					**59**		**59**
Foreign currency translation adjustments					**963**		**963**
Net income				**14,702**			**14,702**
Balance at March 31, 2006	**110,547,484**	**¥7,804**	**¥111,055**	**¥54,887**	**¥ 543**	**¥(498)**	**¥173,791**
							Thousands of U.S. dollars (except number of shares)
Balance at March 31, 2005	110,234,893	$63,280	$942,239	$398,410	$(4,081)	$(3,345)	$1,396,503
Dividends declared				**(56,323)**			**(56,323)**
Purchase of treasury stock	**(32,764)**					**(924)**	**(924)**
Reissuance of treasury stock	**1,275**		**5**			**30**	**35**
Exercise of stock option	**344,080**	**3,152**	**3,152**				**6,304**
Unrealized gains on available-for-sale securities					**505**		**505**
Foreign currency translation adjustments					**8,195**		**8,195**
Net income				**125,159**			**125,159**
Balance at March 31, 2006	**110,547,484**	**$66,432**	**$945,396**	**$467,246**	**$ 4,619**	**$(4,239)**	**$1,479,454**

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

Consolidated Statements of Cash Flows (U.S. GAAP)

SQUARE ENIX CO., LTD. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Cash flows from operating activities:				
Net income	**¥14,702**	¥14,520	¥ 4,355	**$125,159**
Adjustments to reconcile net income to net cash provided by operating activities:				
Deferred income taxes	**(10,395)**	(1,486)	(673)	**(88,489)**
Depreciation and amortization	**10,093**	4,455	5,406	**85,920**
Amortization and write-off of capitalized software developments costs	**23,916**	7,321	12,723	**203,591**
Write-down of investment securities	**91**	80	375	**777**
Impairment charge for goodwill and other intangible assets	**5,521**	—	—	**47,002**
Impairment losses on long-lived assets	**500**	—	—	**4,275**
Minority interest in earnings of consolidated subsidiaries	**31**	117	61	**264**
Equity in income of an affiliated company	**7**	—	760	**63**
Changes in assets and liabilities, net of effects of acquisitions:				
Accounts and notes receivable	**(15,039)**	4,351	4,849	**(128,021)**
Accrued pension costs	**(1,135)**	193	200	**(9,658)**
Inventories	**402**	(235)	(437)	**3,424**
Software development costs	**(13,340)**	(12,704)	(12,226)	**(113,550)**
Accounts and notes payable	**1,798**	(948)	(507)	**15,306**
Other assets	**(1,052)**	(281)	555	**(8,959)**
Other liabilities	**(7,492)**	9,954	(916)	**(63,779)**
Other	**566**	(462)	(388)	**4,777**
Net cash provided by operating activities	**9,174**	24,875	14,137	**78,102**
Cash flows from investing activities:				
Purchases of property and equipment	**(8,258)**	(1,319)	(2,709)	**(70,303)**
Purchases of intangible assets	**(341)**	(363)	(416)	**(2,899)**
Purchases of investment securities	**—**	—	—	**—**
Proceeds from sale of investment securities	**1,505**	248	—	**12,809**
Purchases of investment in affiliated company	**—**	(27)	—	**—**
Proceeds from sale of investment in affiliated company	**—**	—	423	**—**
Proceeds from maturity of treasury bond	**—**	2,000	—	**—**
Refund of lease deposits	**1,160**	105	407	**9,877**
Payment of lease deposits	**(235)**	(102)	(1,843)	**(2,000)**
Cash acquired in business acquisitions (net of cash used)	**(53,747)**	—	12,095	**(457,541)**
Other	**(123)**	32	292	**(1,045)**
Net cash (used in) provided by investing activities	**(60,039)**	574	8,249	**(511,102)**
Cash flows from financing activities:				
Repayment of short-term borrowings	**—**	—	(1,000)	**—**
Repayment of current portion of long term debt	**—**	(18)	—	**—**
Purchases of treasury stock	**(104)**	(155)	(147)	**(889)**
Dividends paid	**(6,618)**	(3,302)	(2,574)	**(56,336)**
Proceeds from issuance of bond	**50,000**	—	—	**425,640**
Proceeds from exercise of stock option	**740**	560	428	**6,304**
Other	**136**	7	719	**1,154**
Net cash provided by (used in) financing activities	**44,154**	(2,908)	(2,574)	**375,873**
Effect of exchange rate changes on cash and cash equivalents	**719**	28	(984)	**6,122**
Net (decrease) increase in cash and cash equivalents	**(5,992)**	22,569	18,828	**(51,005)**
Cash and cash equivalents at beginning of year	**¥81,244**	¥58,675	¥39,847	**$691,613**
Cash and cash equivalents at end of year	**¥75,252**	¥81,244	¥58,675	**$640,608**

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

1. Business and Organization

SQUARE ENIX CO., LTD. (the "Company"), is a digital entertainment content provider. The Company was formed through the merger of ENIX CORPORATION ("Enix") and SQUARE CO., LTD. ("Square") on April 1, 2003, with being Enix the surviving entity.

The Company's businesses consist of six segments: (i) games, (ii) online games, (iii) mobilephone content, (iv) publication, (v) amusement and (vi) others. (i) *Games:* The Company develops interactive games designed for video game console platforms and PCs, and publishes and distributes such games in Japan, North America, Europe and Asia. (ii) *Online Games:* The Company provides online game services including massively multi-players online RPGs such as "FINAL FANTASY XI" in Japan and North America, and "CROSS GATE" in Asia. (iii) *Mobilephone Content:* The Company's mobilephone content is delivered via third party telecommunication carriers while offering content such as games, wallpaper, and ring tones. (iv) *Publication:* Publishing of RPG strategy guide books, comic books and manga magazines. (v) *Amusement:* The Company operates amusement arcade facilities located in Japan. The Company also manufactures various types of game machine for independent amusement arcade facility operators. (vi) *Others:* The Company produces character goods and toys.

As of March 31, 2006, the Company had seventeen consolidated subsidiaries, one partnership and three non-consolidated subsidiaries. Eight subsidiaries were established in Japan, four in the United States, two in the United Kingdom, five in the People's Republic of China, and one in the Republic of Korea.

SQUARE ENIX, INC., the wholly-owned U.S. subsidiary, publishes video games, provides localization services to the Company translating Japanese content into English, provides online game and mobilephone content services, and markets middle-ware products to electronic device manufacturers.

SQUARE ENIX LTD., the wholly-owned U.K. subsidiary, provides localization services to the Company, translating Japanese content into English, French, Germany, Italy, and Spanish. Marketing and distribution of the translated content in the European market is carried out through outside independent licensees.

SQUARE ENIX (China) LTD, the wholly-owned Chinese subsidiary, provides on-line game services in China, which business was transferred from SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD. ("SEW"), a joint venture company with SOFTSTAR ENTERTAINMENT, INC., a Taiwan based video game publisher. As of March 31, 2006, SEW is in process of a liquidation proceeding in Beijing.

TAITO CORPORATION ("Taito"), the wholly owned Japanese subsidiary, in which the Company acquired its entire stake in September 2005 through March 2006, operates amusement arcade facilities located in Japan. Taito also manufactures various types of arcade game machines for independent amusement arcade operators in Japan.

2. Translation into U.S. Dollars

The accompanying consolidated financial statements are stated in Japanese yen, the functional currency of the country in which the Company is incorporated and principally operates. The U.S. dollar amounts included herein represents a translation using the mid price for telegraphic transfer of U.S. dollars for yen quoted by The Bank of Tokyo–Mitsubishi UFJ, Ltd. as of March 31, 2006 of ¥117.47 to $1 and are included solely for the convenience of the reader. The translation should not be construed as a representation that the yen amounts have been, could have been, or could in the future be converted into U.S. dollars at the above or any other rate.

3. Significant Accounting Policies

Basis of Accounting

The Company and its domestic subsidiaries maintain their books and records in conformity with generally accepted accounting principles and practices in Japan ("JPNGAAP"), and its foreign subsidiaries in conformity with those of the country of their domicile. The consolidated financial statements presented herein have been prepared in a manner and reflect certain adjustments that are necessary to conform to accounting principles generally accepted in the United States of America ("U.S.GAAP").

Principles of Consolidation

The consolidated financial statements include the financial statements of the Company and its material majority owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with the U.S.GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to the recoverability of capitalized software development costs and other intangibles, inventories, realization of deferred income taxes and the adequacy of allowances for returns, price protection and doubtful accounts. Actual amounts could differ from these estimates.

Concentration of Credit Risk

If the financial condition and operations of the Company's customers deteriorate, the risk of collection could increase substantially. As of March 31, 2006 and 2005, the receivable balances from the Company's five largest customers amounted to approximately 22.5% and 60.1% of the Company's net accounts and notes receivable balance, respectively. For the years ended March 31, 2006, 2005 and 2004, the Company's five largest customers accounted for 13.3%, 25.4%, and 21.6% of net sales, respectively. The Company sets the credit limit to each customer and monitors its solvency continuously.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts and notes receivable, accounts and notes payable and accrued expenses and approximate fair value because of their short maturity. Investments in marketable securities are stated at their fair value based on quoted market prices. Investments in non-marketable securities for which there are no quoted market price are stated at cost because reasonable estimates of their fair value could not be made without incurring excessive costs and it was not practicable to estimate their fair value of common stock representing certain closely held companies. The face value of long-term debt approximates its fair value because the debt is with zero coupon and the difference between its face value and the greater of its straight bond value or conversion value constitutes a premium of the embedded conversion right therein provided by the debt holder. The carrying amount of the Company's lines of credit approximates fair value because the interest rates of the lines of credit are based on floating rates identified by reference to market rates.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Inventories

Inventories are stated at the lower of cost or market. The Company periodically evaluates the carrying value of its inventories and makes adjustments as necessary. Cost is determined primarily by the monthly average method for finished goods, merchandise and work in progress, by the specific identification method for amusement equipment and, by the last purchase price method for other supplies.

Software Development Costs

The Company applies Statement of Financial Accounting Standards ("SFAS") No.86, "*Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed*", pursuant to which, the Company capitalizes internal software development cost, as well as content cost, subsequent to establishment of technological feasibility of certain video game software. Capitalized software development costs on the accompanying consolidated balance sheets include the payment to an outside independent contactor as well as costs associated with internal development of the video game products. Software development costs are amortized as a component of "Cost of sales" over the expected life of each video game product, starting from its initial delivery to the market. The Company continually evaluates the recoverability of capitalized software costs and will charge to earnings any amounts that are deemed unrecoverable or for projects that it will abandon.

Property and Equipment

Depreciation of property and equipment is computed on the declining-balance method for the Company and domestic subsidiaries, and the straight-line method for foreign subsidiaries over the estimated useful lives of the assets, ranging from 3 to 65 years for buildings, 3 to 15 years for machinery and equipment, and 3 to 8 years for amusement equipment. The cost of additions and betterments are capitalized, and repairs and maintenance costs are charged to earnings in the periods incurred. When depreciable assets are retired or sold, the cost and related allowances for depreciation are removed from the accounts and the gain or loss is recognized.

Intangible Assets

Intangible assets consist of identifiable intangibles and the remaining excess purchase price paid over identified intangible and tangible net assets of acquired companies (goodwill). The Company applies the provisions of SFAS No. 141, "*Business Combinations*" in its entirety and SFAS No. 141 requires all business combinations be accounted for using the purchase method of accounting and that certain intangible assets acquired in a business combination shall be recognized as assets apart from goodwill. SFAS No. 142, "*Goodwill and Other Intangible Assets*" addresses the recognition and measurement of goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that intangible assets with indefinite lives and goodwill not be amortized but tested for impairment annually.

SFAS No. 142 requires an annual test for impairment of goodwill, and between annual tests if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. In assessing potential impairment of goodwill, the Company determines the implied fair value of each reporting unit using discounted cash flow analysis and compares such values to the respective reporting unit's carrying amount. The Company performs its annual test for indication of goodwill impairment in the fourth quarter of each fiscal year.

Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable. The Company evaluates the recoverability of long-lived assets by measuring the carrying amount of the assets against the estimated undiscounted future cash flows associated with them. At the time such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair values.

Investment Securities

The Company invests in equity securities and bonds, and has classified its investment securities as available-for-sale and held-to-maturity, in accordance with SFAS No. 115 "*Accounting for Certain Investments in Debt and Equity Securities*." Investment securities designated as available-for-sale, whose fair values are readily determinable, are carried at fair value with unrealized gains or losses included as a component of accumulated other comprehensive income, net of applicable taxes. Investment securities that are expected to be held-to-maturity are carried at amortized cost. Individual securities classified as either available-for-sale or held-to-maturity are reduced to net realizable value by a charge to income for other than temporary declines in fair value. Realized gains and losses are determined on the moving average cost method and are reflected in income.

Income Taxes

The Company recognizes deferred taxes using the asset and liability method. Under the asset and liability method, deferred income taxes are recognized for the differences between financial statement and tax bases of assets and liabilities at currently enacted statutory tax rates for the years in which the differences are expected to reverse. The effect on deferred taxes for a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Employee Benefit Plan

The Company and its domestic subsidiaries have defined benefit retirement plans, which are accounted for in accordance with SFAS No. 87 "*Employers' Accounting for Pensions*".

Revenue Recognition

The Company recognizes revenue in accordance with Statement of Position ("SOP") No. 97-2, "*Software Revenue Recognition*", which provides guidance on applying generally accepted accounting principles in recognizing revenue on software transactions and Staff Accounting Bulletin ("SAB") No.101, "*Revenue Recognition in Financial Statements*", as amended by SAB No. 104, "*Revenue Recognition*", which outline the basic criteria that must be met to recognize revenue and provides guidance for presentation of revenue and for disclosure related to revenue recognition policies in financial statements. The Company recognizes revenue when the price is fixed and determinable, when there is persuasive evidence of an arrangement, upon fulfillment of its obligations under any such arrangement and when determination that collection is probable.

Sales Returns and Allowances and Bad Debt Reserves

The Company's software distribution arrangements with customers in Japan do not give customers the right to return products; however, the U.S. subsidiary, at its discretion, may accept product returns for stock balancing or defective products, sometimes negotiates accommodations to customers, including price discounts, credits and product returns, when demand for specific products falls below expectations, and accepts returns and grants price protection in connection with its publishing arrangements. The U.S. subsidiary estimates potential future product returns, price protection and sales incentives related to the current period product revenue. The U.S. subsidiary analyzes historical returns, current sell-through of distributor and retailer inventory of its products, current trends in the software games business segment and the overall economy, changes in customer demand and acceptance of its products and other related factors when evaluating the adequacy of the sales returns and price protection allowances. In addition, the U.S. subsidiary monitors and manages the volume of sales to retailers and distributors and monitors their inventories as substantial overstocking in the distribution channel can result in high returns or the requirement for substantial price protection in subsequent periods. Similarly, significant judgment is required to estimate the allowance for doubtful accounts in any period. The Company and the U.S. subsidiary analyze customer concentrations, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts.

Shipping and Handling Charges

Outbound shipping and handling charges of approximately ¥1,623 million, ¥634 million and ¥545 million for the year ended March 31, 2006, 2005 and 2004, respectively, are included in selling, general and administrative expenses.

Advertising Expenditures

The Company recognizes advertising expense as it is incurred except for cooperative advertising. Cooperative advertising obligations are accrued and amortized at the same time the related revenues are recognized. Total advertising expense was approximately ¥7,458 million, ¥5,346 million and ¥5,119 million for the year ended March 31, 2006, 2005 and 2004, respectively.

Recently Issued Accounting Pronouncements

In November 2004, the Financial Accounting Standards Bord ("FASB") issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43*. This statement clarifies the accounting for idle capacity expense, freight, handling costs, and wasted material and is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company believes the adoption of this statement will not have a material effect on its results of operations, cash flows or financial position.

In December 2004, the FASB issued SFAS No. 123(R), *Share Based Payment*. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods and services. It focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions (employee stock options). The statement requires the measurement of the cost of employee services received in exchange for an award of equity instruments (such as employee stock options) at fair value on the grant date. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (the requisite service period). This statement is effective as of the beginning of the first annual reporting period that begins after December 15, 2005. The Company is adopting transition methods under this standard.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Non-monetary Assets, an amendment of APB 29*. This statement clarifies that all non-monetary transactions that have commercial substance should be recorded at fair value and is effective for the fiscal periods beginning after June 15, 2005. The Company believes the adoption of this statement will not have a material effect on its results of operations, cash flows or financial position.

In June 2005, the EITF Issue No. 05-6, *Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination*. Issue No. 05-6 states that leasehold improvements that are placed in service significantly after the beginning of the lease term should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. The pronouncement is effective for leasehold improvements that are purchased or acquired in reporting periods beginning after June 29, 2005. The Company believes the adoption of this issue has had no material impact on its consolidated financial statements.

In June 2005, the FASB issued FSP No. FAS 150-5. This FSP clarifies that freestanding warrants and other similar instruments on shares that are redeemable (either puttable or mandatorily redeemable) should be accounted for as liabilities under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, regardless of the timing of the redemption feature or price, even though the underlying shares may be classified as equity. This FSP is effective for the first reporting period beginning after June 30, 2005. The Company believes the adoption of this issue has had no material impact on its consolidated financial statements.

Stock-Based Compensation

The Company accounts for its incentive stock option plans using intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "*Accounting for Stock Issued to Employees*" ("APB25"). Under APB25, generally no compensation expenses are recorded when the terms of the award are fixed and the exercise price of the stock option equals or exceeds the fair value of the underlying stock on the date of grant.

In fiscal 2003, the Company adopted the disclosure provisions of SFAS No. 148 "*Accounting for Stock-Based Compensation-Transaction and Disclosure—an Amendment of FASB Statement No. 123*", which provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation.

On April 1, 2003, the Company took over SQUARE's stock option plan as a result of the merger, pursuant to which, the directors, officers and employees of former SQUARE may purchase up to an aggregate of 3,330,895 shares of common stock of the Company. This plan expires in the year of 2009.

In June 2004, the stockholders of the Company approved the Company's Stock Option Plan, pursuant to which, officers, directors, employees of the Company may purchase up to an aggregate of 600,000 shares of common stock. This plan expires in the year of 2009.

In June 2005, the stockholders of the Company approved the Company's Stock Option Plan, pursuant to which, officers, directors, employees of the Company may purchase up to an aggregate of 909,000 shares of common stock. This plan expires in the year of 2010.

As of March 31, 2006, 2005 and 2004, the plans had outstanding stock options totaling 3,418,710, 3,258,775 and 3,262,645 shares of the Company's common stock, respectively.

The following table summarizes the activities in options under the plans:

	Number of shares	Weighted-average exercise price
Options outstanding—March 31, 2004	3,262,645	¥3,001.17
Granted—exercise price equal to fair value	580,000	2,981.00
Granted—exercise less than fair value	—	—
Exercised	255,125	2,186.14
Forfeited	328,745	2,964.57
Options outstanding—March 31, 2005	3,258,775	¥3,065.08
Granted—exercise price equal to fair value	909,000	3,364.96
Granted—exercise less than fair value	—	—
Exercised	344,080	2,152.00
Forfeited	404,985	7,318.47
Options outstanding—March 31, 2006	3,418,710	¥2,732.85

At March 31, 2006, 2005 and 2004, the number of options exercisable was 346,242, 660,595 and 723,397, respectively, and their related weighted average exercise prices were ¥2,732.85, ¥3,065.08 and ¥3,001.17, respectively.

Had compensation cost for the Company's stock option plan been determined based on the fair value at the grant date for awards in 2006, 2005 and 2004, consistent with the provisions of SFAS No.123, the Company's net income and the net income per share would have been reduced to the pro forma amounts indicated below.

	Millions of yen (Except share data) Years ended March 31			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Net income:				
As reported	**¥14,702**	¥14,520	¥4,355	**$125,159**
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	**716**	387	—	**6,096**
Pro forma net income	**¥13,986**	¥14,133	¥4,355	**$119,063**
Earnings per share:				
As reported—Basic	**¥133.15**	¥131.89	¥39.58	**$1.13**
Pro forma—Basic	**126.67**	128.38	—	**1.08**
As reported—Diluted	**¥132.46**	¥130.74	¥37.99	**$1.13**
Pro forma—Diluted	**126.01**	127.26	—	**1.07**

The pro forma disclosures shown are not representative of the effects on net income and the net income per share in future years.

The fair value of the Company's stock options used to compute pro forma net income and the net income per share disclosures is the estimated present value at the grant date using the Black-Scholes option-pricing model. The weighted average fair values of options granted were ¥787.67 and ¥666.56 for the years ended March 31, 2006 and 2005, respectively. The following weighted average assumptions for the years ended March 31, 2006 and 2005 were used to value grants, respectively: expected volatilities of 32.16 and 28.33 percent; risk-free interest rates of 0.524 and 0.715 percent; and expected holding periods of 4.9 and 4.8 years.

Earnings Per Share

Basic earnings per share ("EPS") are computed by dividing the net income (loss) applicable to common stockholders for the year by the weighted-average number of common shares outstanding during the year. Diluted EPS is computed by dividing the net income (loss) applicable to common stockholders for the year by the weighted-average number of common and common stock equivalents, which include common shares issuable upon the exercise of stock options outstanding during the year. Common stock equivalents are excluded from the computation if their effect is antidilutive.

Derivative Instruments

The Company adopted SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," as amended by SFAS No. 138, "*Accounting for Certain Derivative Instruments and Certain Hedging Activities—an amendment of FASB Statement No. 133*," and by SFAS No. 149, "*Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities.*" Under SFAS No. 133, all derivative instruments are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings, unless the derivatives qualify as hedges of future cash flows. For derivatives qualifying as hedges of future cash flows, the effective portion of changes in fair value is recorded in other comprehensive income, then recognized in earnings along with the related effects of the hedged items. Any ineffective portion of hedges is reported in earnings as it occurs.

Derivative instruments to be utilized by the Company are forward exchange contracts and currency options. The Company uses derivatives for hedging purpose only and does not intend to hold or issue derivative financial instruments for trading purposes. No material derivatives were used for the years ended March 31, 2006, 2005 and 2004.

Because the conversion right embedded in convertible debenture is not detachable from the debenture and is not purported to convert the debenture into financial instruments other than the Company's common stock, the Company does not value the embedded conversion right as derivative instrument separable from the debenture for fiscal year of 2006.

Comprehensive Income (Loss)

Comprehensive income (loss) represents change in net assets of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) of the Company includes net income adjusted for the change in foreign currency translation adjustments and the change in net unrealized gains (losses) from investments.

Foreign Currency Translation and Transactions

The functional currency for the Company's foreign operations is the applicable local currency. Accounts of foreign operations are translated into Japanese yen using period-end exchange rates for assets and liabilities at the balance sheet date and average prevailing exchange rates for the period for revenue and expense accounts. Adjustments resulting from translation are included in other comprehensive income (loss). Realized and unrealized transaction gains and losses are included in income in the period in which they occur.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

4. Supplemental Disclosures to Consolidated Statements of Cash Flows

	Millions of yen			Thousands of U.S. dollars
	Years ended March 31			
	2006	2005	2004	**2006**
Cash payment for interest	**¥ 30**	—	¥ 11	**$ 260**
Cash payment for income taxes	**¥10,054**	¥2,768	¥4,797	**$ 85,591**
Cash acquisition of a new subsidiary:				
Fair value of assets, net of cash acquired	**¥67,013**	¥3,507	—	**$570,465**
Liabilities assumed	**(35,371)**	(747)	—	**(301,106)**
Goodwill	**21,502**	3,331	—	**183,046**
Cash paid, net of cash acquired	**¥53,144**	¥6,091	—	**$452,405**

5. Business Combinations

Acquisition of SQUARE

On April 1, 2003, the Company acquired all outstanding shares of SQUARE CO., LTD., a video game developer in Japan, in the form of a statutory merger. The aggregate purchase price, including assumption of liabilities and issuance of 51,167,293 shares of common stock was ¥117,131 million. The value of the Company's common stock issued in connection with this acquisition was based on the market price of the Company's common stock shortly before and after the date such proposed transaction was agreed and announced. The acquisition has been accounted for as a purchase business combination in accordance with SFAS No. 141 and, accordingly, the result of operations and financial position of the acquired business are included in the Company's consolidated financial statement from the dates of acquisition. The balance of the purchase price in excess of the fair value of the assets acquired and the liabilities assumed at the date of acquisition was recorded as goodwill totaling ¥35,624 million, none of which is expected to be deductible for tax purposes. The amount of purchased in-process research and development assets was ¥12,728 million. Of this, ¥4,862 million was charged to cost of sales during the year ended March 31, 2004.

The following table sets forth the components of the purchase price of the SQUARE acquisition:

	Millions of yen
Cost of the acquisition:	
Value of stock issued	¥100,807
Liabilities assumed	16,324
Total	¥117,131
Allocation of purchase price:	
Current assets	¥ 49,973
Non-current assets	8,012
Trademarks (indefinite useful life)	10,300
Licensing agreement (indefinite useful life)	9,710
Existing online game (useful life of 12 years)	12,850
Existing offline games and other (useful life ranging from 1 to 5 years)	3,130
Goodwill	35,624
Net deferred tax liabilities	(12,468)
Total	¥117,131

Acquisition of UIEvolution

On March 24, 2004, the Company acquired all of the outstanding preferred and common stock of UIEvolution, Inc. ("UIEvolution"), a Seattle-based middleware development company for approximately $58 million. This transaction was accounted for as a purchase business combination and included in the Company's operations since the date of acquisition. The balance of the purchase price in excess of the fair value of the assets acquired and the liabilities assumed at the date of acquisition was recorded as goodwill totaling ¥3,331 million, none of which is expected to be deductible for tax purposes. The Company's consolidated results of operations for the year ended March 31, 2004 reflected UIEvolution's operating activities for the period from March 24, 2004 (the date of acquisition) to March 31, 2004.

The following table sets forth the components of the purchase price of the UIEvolution acquisition:

	Millions of yen
Cost of the acquisition:	
Cash, net of cash acquired	¥6,091
Total	¥6,091
Allocation of purchase price:	
Property and equipment	¥ 10
Existing technology (useful life of 5 years)	2,853
Trade name and trade marks (useful life of 5 years)	401
Customer contracts (useful life of 2 years)	243
Goodwill	3,331
Net other liabilities	(747)
Total	¥6,091

Acquisition of TAITO

On September 28, 2005, the Company acquired 93.7% of outstanding shares of stock of Taito by a cash tender offer. Per share price offered to the shareholders of Taito was ¥181,100 each. Following the acquisition of 93.7% stake in Taito, the Company engaged in the minority cash-out transaction in March 2006 in order for Taito to become a wholly owned subsidiary of the Company. In a series of these transactions, the aggregate purchase price, including assumption of liabilities, was ¥87,145 million. The acquisition has been accounted for as a purchase business combination in accordance with SFAS No.141 and, accordingly, the result of operations and financial position of the acquired business are included in the Company's consolidated financial statement from the dates of acquisition. The balance of the purchase price in excess of the fair value of the assets acquired and that of intangible assets acquired at the date of acquisition was recorded as goodwill totaling ¥21,502 million, none of which is expected to be deductible for tax purposes. The Company's consolidated results of operations for the year ended March 31, 2006 reflected Taito's operating activities for the period from September 28, 2005 (the date of acquisition) to March 31, 2006.

The following table sets forth the components of the purchase price of the Taito acquisition:

	Millions of yen	Thousands of U.S. dollars
Cost of the acquisition:		
Cash, net of cash acquired	¥53,144	$452,405
Liabilities assumed	34,001	289,444
Total	¥87,145	$741,849
Allocation of purchase price:		
Current assets	¥16,841	$143,364
Non-current assets	42,994	365,997
Database (indefinite useful life)	1,449	12,335
Trademarks (useful life of 1.5 years)	232	1,975
Business license (useful life of 3.5 years)	2,046	17,417
Copyrights (useful life of 1 year)	2,081	17,715
Goodwill	21,502	183,046
Total	¥87,145	$741,849

Unaudited Pro Forma Information

The unaudited pro forma data below for the years ended March 31, 2006, 2005, and 2004 are presented as if the acquisitions of UIEvolution and Taito had taken place on April 1, 2003. The unaudited pro forma financial information is based on management's estimates and assumptions and does not purport to represent the results that actually would have occurred if the acquisitions had, in fact, been completed on the dates assumed, or which may result in the future.

	Millions of yen (Except share data) Years ended March 31			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Total revenue	**¥164,902**	¥158,623	¥145,386	**$1,403,779**
Income before income taxes	**¥3,763**	¥26,753	¥7,137	**$32,033**
Net income	**¥13,692**	¥16,102	¥4,422	**$116,557**
Net income per share —Basic	**¥124.00**	¥146.26	¥40.19	**$1.055**
Net income per share —Diluted	**¥123.36**	¥144.99	¥38.57	**$1.050**

6. Equity Investment in the Affiliated Company

The Company had an equity interest of 26.54% in DigiCube Co., Ltd., a domestic video game whole-seller devoted to the convenience store market, listed on the Hercules market of Osaka Securities Exchange, and accounted for using the equity method. DigiCube went bankrupt in November 2003, and the Company recognized an impairment loss on its investment in DigiCube in the amount of ¥760 million. The bankruptcy proceeding was closed on April 25th, 2006. Equity method of accounting was no longer applied for the years ended March 31, 2006 and 2005.

7. Inventories

As of March 31, 2006 and 2005, inventories consist of:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Finished goods and merchandise	**¥3,602**	¥ 938	**$30,667**
Work in progress	**1,050**	99	**8,939**
Raw materials	**1,319**	—	**11,227**
Other supplies	**59**	76	**501**
Total	**¥6,030**	¥1,113	**$51,334**

8. Software Development Costs

The following table provides the details of capitalized software development costs:

Years ended March 31	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Beginning balance	**¥17,890**	¥12,507	**$152,290**
Increased during the year	**13,338**	12,704	**113,550**
Amortization	**(23,456)**	(6,338)	**(199,675)**
Written off	**(460)**	(983)	**(3,916)**
Ending balance	**¥ 7,312**	¥17,890	**$ 62,249**

9. Property and Equipment

As of March 31, 2006 and 2005, property and equipment consist of:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Buildings	**¥20,132**	¥ 3,668	**$171,382**
Machinery and equipment	**14,284**	9,117	**121,596**
Amusement machinery and equipment	**58,733**	—	**499,984**
Land	**5,517**	3,814	**46,962**
Other	**441**	15	**3,759**
Total	**¥99,107**	¥16,614	**$843,683**
(Less accumulated depreciation)	**(66,905)**	(7,696)	**(569,557)**
Net book value	**¥32,202**	¥ 8,918	**$274,126**

Depreciation expenses for the year ended March 31, 2006, 2005 and 2004 were ¥8,169 million, ¥1,433 million and ¥1,631 million, respectively.

The Company recognized impairment losses on long-lived assets in total amount of ¥500 million, pursuant to SFAS No. 144, in the year ended March 31, 2006, which were attributable to the reporting units of "Amusement" and "Corporate and elimination" in the amount of ¥271 million and ¥229, respectively. The losses were incurred principally on the acquired business franchise in Korea with respect to "Amusement", due to the difficulty of recovery of carrying amounts with expected future cash flows. The losses attributable to "Corporate and elimination" were incurred on the lands and buildings not currently in use, because their fair market values quoted by the independent appraiser were below their carrying amounts. The Company employed discounted cash flows method to determine the fair value of long-lived assets.

Lease

The Company is obligated under various capital leases for certain buildings and certain machinery and equipment that expire at various dates during the next 5 years. At March 31, 2006 and 2005 the gross amount of plant and equipment and related accumulated amortization recorded under capital leases were as follows:

Years ended March 31	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Buildings	**¥1,278**	¥—	**$10,881**
Machinery and equipment	**1,802**	74	**15,341**
Total	**3,080**	74	**26,222**
(Less accumulated amortization)	**(1,197)**	(49)	**(10,196)**
Net value	**¥1,883**	¥24	**$16,026**

Amortization of assets held under capital leases is included with depreciation expense.

Future minimum capital lease payments as of March 31, 2006 are:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 493	$ 4,199
2008	411	3,499
2009	372	3,166
2010	318	2,704
2011	185	1,577
2012 and thereafter	104	882
Total minimum lease payments	¥1,883	$16,027
Less estimated executory costs	—	—
Net minimum lease payments	1,883	16,027
Less amount representing interest	—	—
Present value of net minimum capital lease payments	1,883	16,027
Less current installments of obligations under capital leases	493	4,199
Obligations under capital leases, excluding current installments	¥1,390	$11,828

10. Intangible Assets

As of March 31, 2006 and 2005, intangible assets consist of:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Software	**¥ 4,450**	¥ 3,109	**$ 37,884**
Patent and trademark	**10,599**	10,789	**90,226**
Online game	**12,850**	12,850	**109,390**
License agreement for related goods	**9,710**	9,953	**82,659**
Existing game	**2,940**	2,940	**25,028**
Existing technologies	**—**	2,854	**—**
Database (indefinite useful life)	**1,449**	—	**12,335**
Business license (useful life of 3.5 years)	**2,046**	—	**17,417**
Copyright (useful life of 1 year)	**2,081**	—	**17,715**
Other intangible assets	**889**	463	**7,564**
(Less: accumulated amortization)	**(11,092)**	(8,008)	**(94,418)**
Net book value	**¥35,922**	¥34,950	**$305,800**
Goodwill	**¥57,126**	¥38,955	**$486,303**
Total	**¥93,048**	¥73,905	**$792,103**

Amortization expenses for the years ended March 31, 2006, 2005 and 2004 were ¥1,924 million, ¥3,021 million and ¥3,775 million, respectively.

Expected annual amortization expenses for the ensuing fiscal years are as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 3,529	$ 30,043
2008	2,139	18,209
2009	1,987	16,915
2010	1,289	10,977
2011	1,140	9,704
2012 and thereafter	4,305	36,643
Total	¥14,389	$122,491

The Company evaluates the recoverability of the carrying value of goodwill under SFAS No. 142. The Company engages an independent appraiser to assist management in its determination of the fair values of goodwill. In its determination of the fair values, the appraiser primarily utilizes a discounted cash flow analysis as well as other valuation approaches including comparison of multiples indicated by the stock price and market capitalization of comparable companies, and asset and liability structure of the acquired subsidiaries. Significant assumptions used in this analysis included 1) expected future revenue growth rates, profit margins and working capital levels of the acquired subsidiaries, 2) a discount rate, and 3) a terminal value multiples. The revenue growth rates, profit margins and working capital levels are based on management's expectation of future results. In evaluating the recoverability of other intangible assets, the Company primarily utilizes a discounted cash flow analysis as well as other applicable valuation approaches, and if applicable, independent valuations.

At the end of fiscal year 2006, the Company determined that the fair values of goodwill and intangible assets associated with the acquisition of UIEvolution were lower than their carrying values. The Company's management reviewed the cash flow projection of UIEvolution to evaluate the value thereof with the discounted cash flow analysis, and concluded that goodwill and intangibles associated with acquisition of UIEvolution were not expected to be recoverable in the foreseeable future. Accordingly, impairment charges for goodwill and intangible assets in the amount of ¥3,331 and ¥2,190, respectively, associated with the reportable unit of "Mobilephone content" were recognized in the year ended March 31, 2006. These impairment losses were attributable to the difficulty of prediction of UIEvolution's value growth due to the rapidly changing business environment surrounding "Mobilephone content" unit.

11. Investment Securities

As of March 31, 2006 and 2005, investment securities consist of:

	Millions of yen			
	2006			
	Cost	Unrealized gain	Unrealized loss	Fair value
Marketable equity securities	**¥503**	**¥827**	**¥(4)**	**¥1,326**
Other equity securities	**133**	**—**	**—**	**133**
Total	**¥636**	**¥827**	**¥(4)**	**¥1,459**

	Thousands of U.S. dollars			
	2006			
	Cost	Unrealized gain	Unrealized loss	Fair value
Marketable equity securities	**$4,280**	**$7,044**	**$(36)**	**$11,288**
Other equity securities	**1,133**	**—**	**—**	**1,133**
Total	**$5,413**	**$7,044**	**$(36)**	**$12,421**

	Millions of yen			
	2005			
	Cost	Unrealized gain	Unrealized loss	Fair value
Marketable equity securities	¥330	¥741	¥(18)	¥1,053
Other equity securities	242	—	—	242
Total	¥572	¥741	¥(18)	¥1,295

12. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities as of March 31, 2006 and 2005 consist of:

Years ended March 31	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Consumption taxes payable	**¥ 1,246**	¥1,022	**$10,606**
Unearned revenue	**1,159**	1,057	**3,586**
Deposit receipt	**421**	385	**9,869**
Accrued paid absence	**691**	329	**5,878**
Accrued expenses and other	**6,706**	1,666	**57,079**
Total	**¥10,223**	¥4,459	**$87,018**

13. Commitments and Contingencies

Certain subsidiaries lease office space under non-cancelable operating leases that expire beginning in 2007. Future minimum rental payments required under non-cancelable terms of more than one year are as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 439	$ 3,734
2008	412	3,510
2009	297	2,524
2010	266	2,262
2011	240	2,039
2012 and thereafter	225	1,916
Total minimum lease payments	¥1,879	$15,985

Rent expense is recognized on a straight-line basis over the lease periods. Rent expense under all operating leases was approximately ¥8,305 million for the year ended March 31, 2006.

The Company is involved in routine litigation in the ordinary course of its business, which in management's opinion, will not have a material adverse effect on the Company's financial condition, cash flows or results of operations.

14. Employee Benefit Plan and Retirement Benefit to Directors and Statutory Auditors

Employee Benefit Plan

The Company has defined benefit plans covering their domestic employees, which are internally funded. The benefits are in the form of lump-sum payment and are based on current basic rate pay applicable to former Enix employees and the highest basic rate pay until present applicable to former Square employees. For the new employees hired by the Company on and after April 1, 2003, the current basic rate pay is applicable to the basis of benefit. Effective April 1, 2005, the Company changed its plan policy, in which the benefit is defined as the accumulation of the product of base-pay and certain point earned in each year of service until termination.

The Company adopted SFAS No. 87 "*Employers' Accounting for Pensions*" for its domestic defined benefit plans effective April 1, 2002. A portion of the transitional obligation was allocated and charged directly to equity on the adoption date.

The Company took over benefit obligation in the amount of $10,479 million from Taito as a result of its acquisition taken place in September 2005. Taito has adopted a defined benefit obligation plan to meet future retirement obligation for its employees, and the plan has been externally funded. As of March 31, 2006, the plan asset has its fair value of $10,623 million.

Certain U.S. and U.K. subsidiaries have defined contribution plans for their employees and the contributions are charged to earnings when incurred. No pension plan is provided for the employees of the Chinese subsidiary.

Net periodic pension cost of the Company and its domestic subsidiaries for the year ended March 31, 2006, 2005 and 2004 consist of the following:

Years ended March 31	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Service cost	**¥356**	¥214	¥227	**$3,028**
Interest cost	**88**	16	8	**749**
Expected return on plan assets	**(145)**	—	—	**(1,230)**
Amortization of actuarial loss	**(7)**	—	—	**(59)**
Amortization of prior service cost	**(101)**	—	—	**(858)**
Amortization of SFAS No. 87 transition obligation	**3**	2	2	**23**
Net periodic pension cost	**¥194**	¥232	¥237	**$1,653**

Reconciliations of beginning and ending balances of the pension benefit obligations and the fair value of the plan assets are as follows:

As of March 31	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Change in benefit obligation:			
Benefit obligation at beginning of year	**¥ 968**	¥ 983	**$ 8,253**
Service cost	**356**	214	**3,028**
Interest cost	**88**	16	**749**
Benefit obligation transferred from acquired company	**10,479**	—	**89,203**
Prior service costs	**—**	(101)	—
Actuarial gain	**(200)**	(104)	**(1,706)**
Benefits paid	**(219)**	(40)	**(1,868)**
Benefit obligation at end of year	**¥11,472**	¥ 968	**$ 97,659**
Change in plan assets:			
Fair value of plan assets at beginning of year	**—**	—	**—**
Plan assets transferred from acquired company	**8,253**	—	**70,260**
Actual return on plan assets	**2,077**	—	**17,677**
Employer contributions	**475**	—	**4,045**
Benefits paid	**(182)**	—	**(1,551)**
Fair value of plan assets at end of year	**10,623**	—	**90,431**
Funded status	**(849)**	(968)	**(7,228)**
Unrecognized actuarial loss (gain)	**(2,306)**	(180)	**(19,625)**
Unrecognized prior service costs	**—**	(101)	**—**
Unrecognized FAS87 transition obligation	**19**	21	**161**
Net amount recognized	**¥ (3,136)**	¥(1,228)	**$(26,692)**
Accumulated benefit obligation at end of year	**¥10,868**	¥845	**$ 92,517**
Actuarial assumption:			
Discount rate	**1.680~ 1.837%**	1.652%	**1.680~ 1.837%**
Assumed rate of increase in compensation level	**3.900~ 4.101%**	4.101%	**3.900~ 4.101%**

The future benefit payments for the plan are expected as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 500	$ 4,257
2008	503	4,280
2009	577	4,913
2010	516	4,392
2011	518	4,409
2012–2016	2,873	24,458

Retirement Benefit to Directors and Statutory Auditors

In order to prepare for the payment of retirement benefit to the Company's directors and statutory auditors in the future, the Company internally funds a retirement allowance. The Board of Directors determined the certain formula for calculation of retirement benefits, pursuant to which, the benefits are calculated based on a certain fixed amount multiplied by the number of years of office and the coefficient predetermined by the Board according to the title of directors. New legislature, the Japanese Corporation Law ("JCL"), was introduced effective May 1st, 2006 as an amendment of former Japanese Commercial Code ("JCC"). The JCL requires the Company to have its shareholders' approval for payment, and the Company accrues retirement allowance according to such formula until the benefits are approved by the shareholders. The balances of ¥189 million and ¥55 million at March 31, 2006 and March 31, 2005, respectively, are presented as "other long-term liabilities" in the consolidated balance sheets. Charges to income for the directors' and corporate auditors' retirement plans were ¥19 million, ¥121 million and ¥6 million in 2006, 2005 and 2004, respectively.

15. Long-Term Debt

Long-term debt as of March 31, 2006 is as follows:

	Millions of yen	Thousands of U.S. dollars
	2006	**2006**
Unsecured Zero Coupon Convertible Debenture, due in November 2010	**¥50,000**	**$425,651**
Total Long-term debt	**¥50,000**	**$425,651**

Yen denominated unsecured zero coupon convertible debenture was privately issued offshore on November 25, 2005 to Daiwa Securities SMBC Europe Limited, a UK corporation.

The debenture indenture has a provision that the conversion price per share shall be adjusted once in a year on the 3rd Friday in every November ("the date of price adjustment") in 2006 and thereafter to the price 6% below the average of volume-weighted average prices of underlying stock of the Company at the Tokyo Stock Exchange ("TSE") for ten consecutive trading days on or before the date of price adjustment. Notwithstanding the foregoing, the conversion price shall not be adjusted below the floor price, which is equal to the closing price of underlying stock of the Company at the TSE as of November 8, 2005, the date one-day before the date when the Company decided the issue. The Company has an option, ("Option"), to move the floor price per share to the market price of underlying stock at the time of the exercise of Option or ¥1,700, whichever is then greater. The Option is exercisable only once throughout the life of debenture. The initial conversion price per share applicable on or before the date of first price adjustment and the floor price per share are ¥5,100 and ¥3,400, respectively. As of the date of issuance of this report, the Company has not exercised the Option.

If underlying stock is traded at the price of 115% of conversion price then applicable for 10 consecutive trading days on the TSE, the Company is able to redeem the debenture in full at par, with the irrevocable 30 days advanced notice to the debt holder commencing from the end of such 10 consecutive trading days, at any time during the period on or after November 25, 2005 until November 24, 2010. The Company is also given the right to redeem the debenture in full at 1.015 of its face value, with the irrevocable 30 days advanced notice to the debt holder prior to the redemption, on or after November 28, 2005 before the exercise of the Option. Once the Option is exercised, the Company is able to redeem the debenture in full at par, with the irrevocable 30 days advanced notice to the debt holder prior to the redemption, after the date 6 months after the date of exercise of the Option until November 24, 2010.

Line of Credit

As of March 31, 2006, the Company had an unused line of credit with a bank in the amount of ¥71,000 million at various rates expiring in 2007. No guarantee is provided for such line-of-credit.

16. Income Taxes

Domestic and foreign income before income taxes are as follows:

Years ended March 31	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Domestic	**¥ 195**	¥21,745	¥4,577	**$ 1,665**
Foreign	**2,934**	2,547	3,031	**24,979**
Total	**¥3,129**	¥24,292	¥7,608	**$26,644**

Income tax expenses are as follows:

Years ended March 31	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Current:	**¥ 923**	¥11,267	¥ 3,600	**$ 7,857**
Domestic	**(638)**	10,350	1,723	**(5,434)**
Foreign	**1,561**	917	1,877	**13,291**
Deferred:	**¥(12,534)**	¥ (1,612)	¥(1,168)	**$(106,699)**
Domestic	**(11,982)**	(1,807)	(1,234)	**(101,999)**
Foreign	**(552)**	195	66	**(4,700)**
Total	**¥(11,611)**	¥ 9,655	¥ 2,432	**$ (98,842)**

The differences between the provision for income taxes and the income taxes computed using Japan statutory tax rate to pretax income as a percentage of pretax income are as follows:

Years ended March 31	**2006**	2005	2004
Statutory tax rate (%)	**40.70%**	40.70%	42.05%
Tax rate difference from foreign consolidated affiliates	**—**	(1.23)	(2.29)
Effect of tax rate change	**—**	(0.86)	(0.22)
Dividend received deduction	**(602.92)**	—	—
Valuation allowance	**175.04**	—	—
Investment tax credit	**(29.14)**	(0.58)	(2.19)
Impairment charge for goodwill and intangible assets	**42.20**	—	—
Reversal of valuation allowance on deferred tax assets	**—**	—	(3.50)
Others	**3.14**	1.72	(1.88)
Income tax expense (%)	**(370.98)%**	39.75%	31.97%

The components of the deferred tax assets and liabilities as of March 31, 2006 and 2005 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Software development costs	**¥ 641**	¥ 951	**$ 5,457**
Accrued paid absence	**281**	134	**2,453**
Accrued pension costs	**1,548**	500	**13,223**
Enterprise tax payable	**38**	810	**323**
Prepaid expenses	**—**	310	**—**
Accrued bonus	**709**	416	**6,035**
Reserve for sales return and price protection	**358**	442	**3,048**
Accrued expense and other	**180**	366	**1,536**
Investment securities	**339**	934	**2,888**
Investment tax credit	**—**	80	**—**
Net operating loss	**16,867**	—	**143,589**
(Less valuation allowance)	**(7,206)**	—	**(61,247)**
Other	**2,384**	747	**20,096**
Gross deferred tax assets	**¥16,139**	¥ 5,690	**$137,401**
Deferred tax liabilities:			
Software development costs	**—**	¥ 968	**—**
Fixed assets	**¥14,650**	13,752	**$124,716**
Valuation gain on investment securities	**365**	324	**3,106**
Other	**59**	127	**504**
Gross deferred tax liabilities	**¥15,074**	¥15,171	**$128,326**
Net deferred tax assets (liabilities)	**¥ 1,065**	¥ (9,481)	**$ 9,075**

On April 1st, 2003, the acquisition of Square took place in the form of a qualified non-taxable merger. Accordingly, the tax attributes to produce future tax deduction in the amount of ¥9,867 million were transferred, without limitation, to the Company. It included pre-merger net operating loss carryforwards (NOLs) and the deductible temporary difference that arose from a past write-off of a depreciable motion picture film in the amount of ¥1,661 million and ¥2,211 million, respectively. Transferred pre-merger NOLs were fully utilized in the year ended March 31, 2004.

Following the acquisition of 93.7% of outstanding shares of Taito ("Old Taito") in September 2005, the Company engaged in the minority cash-out transaction by means of a forward triangular merger so as for Old Taito to become a wholly owned subsidiary of the Company. "SQEX", another wholly owned subsidiary of the Company, was used for a vehicle of merger. Upon consummation of the merger, surviving SQEX was renamed "Taito Corporation ("New Taito")". The merger was taxable for Japanese tax purposes. Accordingly, tax basis of assets of Old Taito transferred to New Taito were stepped up to their respective fair values, and New Taito recognized goodwill in its balance sheet in the amount of ¥26,686 million, which was tax deductible over 5 years on a straight-line basis. New Taito deducted from income an amortization of goodwill, currently in the taxable year of 2006, which resulted in NOL of ¥4,873 million for tax purposes subject to carry-forward of 7 years over next taxable year. Also, in the course of merger, the Company, as one of the Old Taito's shareholders, received from Old Taito the merger consideration in total amount of ¥63,292 million.Whereas the receipt of consideration was eliminated in consolidation for financial reporting purposes and had no effect to the consolidated financial statement of income for the year of 2006, a portion thereof was deemed comprised of the receipt of constructive dividend and the incurrence of capital loss in the same amount of ¥46,364 million for tax purposes. Because constructive dividend is subject to dividend received deduction ("DRD") for tax purposes, DRD offset the income of the Company to the extent of its income before DRD, currently in the taxable year of 2006. The unused portion of DRD resulted in NOL of ¥36,586 million, which was carried forward to next 7 years.

At March 31, 2006, the U.S. subsidiary has NOLs and research and development credits (R&D credits) for federal income tax purposes of approximately $27.75 million and $0.74 million, expiring beginning in 2022 and 2019, respectively. Utilization of NOLs and R&D credits has certain limitations.

At March 31, 2006, the Chinese subsidiaries have NOLs and tax credits for Chinese tax purposes of approximately 13,150 million RMB and 0.223 million RMB, expiring beginning in 2010, respectively. Utilization of NOLs and tax credits has certain limitations.

The total amount of undistributed earnings of foreign subsidiaries for income tax purposes was approximately ¥2,273 million, ¥4,377 million and ¥5,128 million for the years ended March 31, 2006, 2005 and 2004, respectively. It is the Company's intention to reinvest undistributed earnings of its foreign subsidiaries and thereby indefinitely postpone their remittance. Accordingly, no provision has been made for the Japanese income taxes which may become payable if undistributed earnings of foreign subsidiaries were paid as dividends to the Company.

17. Stockholders' Equity

Merger

On April, 2003, the Company issued 51,167,293 shares of common stock in exchange for shares of former Square as a result of the statutory merger. The merger was accounted for using "pooling of interest method of accounting" for JCC purposes, and accordingly, the stockholders' equity of liquidated Square was combined with that of the Company. The Company made cash payments to stockholders of former Square in the total amount of ¥4,153 million in lieu of dividend for the final year of Square ended March 31, 2003.

Dividend

Both the JCC and the JCL require that dividends declared to be paid out of retained earnings of the Company and such retained earnings available for dividend shall be calculated in accordance with the related JCC or JCL requirements and the JPNGAAP.

Comprehensive Income

Accumulated other comprehensive (loss) income as of March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Foreign currency translation adjustments:			
Balance, beginning of year	**¥ (907)**	¥(956)	**$(7,731)**
Aggregate adjustment for the year resulting from translation of foreign currency financial statements	**963**	49	**8,195**
Balance, end of year	**¥ 56**	¥(907)	**$ 464**
Net unrealized gains on available-for-sale securities:			
Balance, beginning of year	**¥ 428**	¥ 319	**$ 3,650**
Net increase	**59**	109	**505**
Balance, end of year	**¥ 487**	¥ 428	**$ 4,155**
Total accumulated other comprehensive income:			
Balance, beginning of year	**¥ (479)**	¥(637)	**$(4,081)**
Adjustments for the year	**1,022**	158	**8,700**
Balance, end of year	**¥ 543**	¥(479)	**$ 4,619**

Tax effects allocated to each component of other comprehensive income (loss) and adjustments are as follows:

			Millions of yen
2006	Pretax amount	Tax benefit (expense)	Net of tax amount
Foreign currency translation adjustments	**¥963**	**¥—**	**¥963**
Net unrealized gain on available-for-sale securities:			
Unrealized gain arising during the year	**145**	**86**	**59**
Less: reclassification for gain included in net income	**—**	**—**	**—**
Net unrealized gain	**¥145**	**¥86**	**¥ 59**

			Thousands of U.S. dollars
2006	Pretax amount	Tax benefit (expense)	Net of tax amount
Foreign currency translation adjustments	**$8,195**	**—**	**$8,195**
Net unrealized gain on available-for-sale securities:			
Unrealized gain arising during the year	**1,242**	**737**	**505**
Less: reclassification for gain included in net income	**—**	**—**	**—**
Net unrealized gain	**$1,242**	**$737**	**$ 505**

			Millions of yen
2005	Pretax amount	Tax benefit (expense)	Net of tax amount
Foreign currency translation adjustments	¥ 49	—	¥ 49
Net unrealized gain on available-for-sale securities:			
Unrealized gain arising during the year	268	¥159	109
Less: reclassification for gain included in net income	—	—	—
Net unrealized gain	¥268	¥159	¥109

			Millions of yen
2004	Pretax amount	Tax benefit (expense)	Net of tax amount
Foreign currency translation adjustments	¥(999)	—	¥(999)
Net unrealized gain (loss) on available-for-sale securities:			
Unrealized gain (loss) arising during the year	539	¥220	319
Less: reclassification for gain (loss) included in net income	(39)	(16)	(23)
Net unrealized gain (loss)	¥ 500	¥204	¥ 296

18. Earnings per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computation is as follows.

	2006	2005	2004	2006
	Millions of yen			Thousands of U.S. dollars
Net income	**¥14,702**	¥14,520	¥4,355	**$125,159**
Diluted net income	**¥14,702**	¥14,520	¥4,355	**$125,159**
Weighted-average common shares outstanding	**110,419,003**	110,093,589	110,030,879	**110,419,003**
Dilutive effect of:				
Stock option	**579,469**	962,777	4,609,207	**579,469**
Diluted common shares outstanding	**110,998,472**	111,056,366	114,640,086	**110,998,472**
Earnings per share:				
Basic	**¥133.15**	¥131.89	¥39.58	**$1.13**
Diluted	**¥132.46**	¥130.74	¥37.99	**$1.13**

19. Segment Information

Operating segment information

The Company has six operating segments; (i) games, (ii) online games, (iii) mobilephone content, (iv) publication, (v) amusement, and (vi) others. Revenue from disc sales for Final Fantasy XI is included in the online games segment. They are defined for which separate financial information is available and regularly reviewed by the Company's chief operating decision maker. The Company's chief operating decision maker utilizes the information on operating income (loss) from each operating segment and allocates resources to each respective segment. Accordingly, these segments constitute "reportable segments" for purposes of SFAS No. 131 "*Disclosures about Segments of an Enterprise and Related Information*". Since the Company is listed on the TSE, the segment information utilized by the Company's chief decision maker is based on the JPNGAAP. The differences between the JPNGAAP and the U.S.GAAP are indicated in the tables below:

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Net sales	**2006**	2005	2004	**2006**
Games	**¥ 45,916**	¥41,945	¥37,988	**$ 390,880**
Online games	**15,720**	13,853	8,924	**133,824**
Mobilephone Content	**5,067**	4,557	2,793	**43,137**
Publication	**9,742**	10,860	9,671	**82,932**
Amusement	**41,070**	—	—	**349,620**
Others	**6,958**	2,650	3,826	**59,226**
Corporate and elimination	**—**	—	—	**—**
Total	**¥124,473**	¥73,865	¥63,202	**$1,059,619**
U.S.GAAP adjustments	**(1,057)**	198	(107)	**(9,005)**
Consolidated	**¥123,416**	¥74,063	¥63,095	**$1,050,614**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Operating expenses	**2006**	2005	2004	**2006**
Games	**¥ 36,326**	¥22,295	¥21,583	**$ 309,240**
Online games	**9,812**	8,867	6,575	**83,531**
Mobilephone Content	**4,341**	2,818	1,633	**36,955**
Publication	**6,875**	7,448	6,491	**58,530**
Amusement	**42,241**	—	—	**359,587**
Others	**4,950**	1,867	2,799	**42,135**
Corporate and elimination	**4,458**	4,131	4,722	**37,946**
Total	**¥109,003**	¥47,426	¥43,803	**$ 927,924**
U.S.GAAP adjustments	**13,151**	2,375	10,683	**111,972**
Consolidated	**¥122,154**	¥49,801	¥54,486	**$1,039,896**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Operating income (loss)	**2006**	2005	2004	**2006**
Games	**¥ 9,590**	¥19,650	¥16,404	**$ 81,640**
Online games	**5,908**	4,986	2,348	**50,293**
Mobilephone Content	**726**	1,739	1,159	**6,182**
Publication	**2,867**	3,412	3,180	**24,402**
Amusement	**(1,171)**	—	—	**(9,967)**
Others	**2,008**	783	1,029	**17,091**
Corporate and elimination	**(4,458)**	(4,131)	(4,722)	**(37,946)**
Total	**¥15,470**	¥26,439	¥19,398	**$131,695**
U.S.GAAP adjustments	**(14,208)**	(2,177)	(10,789)	**(120,977)**
Consolidated	**¥ 1,262**	¥24,262	¥ 8,609	**$ 10,718**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Depreciation and amortization	**2006**	2005	2004	**2006**
Games	**¥ 691**	¥ 694	¥ 870	**$ 5,880**
Online games	**664**	770	742	**5,649**
Mobilephone Content	**47**	36	17	**404**
Publication	**15**	20	12	**129**
Amusement	**6,364**	—	—	**54,181**
Others	**69**	99	94	**587**
Corporate and elimination	**569**	195	239	**4,844**
Total	**¥ 8,419**	¥1,814	¥1,974	**$71,674**
U.S.GAAP adjustments	**1,674**	2,641	3,432	**14,246**
Consolidated	**¥10,093**	¥4,455	¥5,406	**$85,920**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Capital expenditures	**2006**	2005	2004	**2006**
Games	**¥1,076**	¥ 106	¥ 175	**$ 9,159**
Online games	**640**	725	384	**5,450**
Mobilephone Content	**90**	52	12	**763**
Publication	**1**	4	0	**12**
Amusement	**6,522**	—	—	**55,519**
Others	**92**	18	—	**783**
Corporate and elimination	**748**	619	1,976	**6,370**
Total	**¥9,169**	¥1,524	¥2,547	**$78,056**
U.S.GAAP adjustments	**—**	—	—	**—**
Consolidated	**¥9,169**	¥1,524	¥2,547	**$78,056**

As of March 31	Millions of yen			Thousands of U.S. dollars
Assets	**2006**	2005	2004	**2006**
Games	**¥ 67,658**	¥ 64,860	¥ 55,104	**$ 575,960**
Online games	**15,421**	20,753	14,215	**131,278**
Mobilephone Content	**4,057**	4,725	2,583	**34,536**
Publication	**12,349**	20,448	14,225	**105,119**
Amusement	**80,897**	—	—	**688,662**
Others	**6,912**	6,169	5,983	**58,841**
Corporate and elimination	**26,055**	14,740	18,523	**221,803**
Total	**¥213,349**	¥131,695	¥110,633	**$1,816,199**
U.S.GAAP adjustments	**70,961**	70,669	71,415	**604,079**
Consolidated	**¥284,310**	¥202,364	¥182,048	**$2,420,278**

Geographic information

The Company's chief decision maker also regularly reviews segment information by geographic area. Since such information is based on the JPNGAAP, the differences between the JPNGAAP and the U.S.GAAP are indicated in the tables below:

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Sales from external customers	**2006**	2005	2004	**2006**
Japan	**¥107,354**	¥60,949	¥49,354	**$ 913,886**
North America	**14,670**	11,529	12,981	**124,886**
Europe	**414**	577	148	**3,522**
Asia excluding Japan	**2,035**	810	719	**17,325**
Corporate and elimination	**—**	—	—	**—**
Total	**¥124,473**	¥73,865	¥63,202	**$1,059,619**
U.S.GAAP adjustments	**(1,057)**	198	(107)	**(9,005)**
Consolidated	**¥123,416**	¥74,063	¥63,095	**$1,050,614**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Inter segment sales	**2006**	2005	2004	**2006**
Japan	**¥4,317**	¥3,437	¥3,718	**$36,746**
North America	**837**	361	389	**7,127**
Europe	**364**	313	279	**3,101**
Asia excluding Japan	**6**	13	0	**48**
Corporate and elimination	**(5,524)**	(4,124)	(4,386)	**(47,022)**
Total	**—**	—	—	**—**
U.S.GAAP adjustments	**—**	—	—	**—**
Consolidated	**—**	—	—	**—**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Total sales	**2006**	2005	2004	**2006**
Japan	**¥111,671**	¥64,386	¥53,073	**$ 950,632**
North America	**15,507**	11,890	13,371	**132,013**
Europe	**778**	890	428	**6,623**
Asia excluding Japan	**2,041**	823	717	**17,373**
Corporate and elimination	**(5,524)**	(4,124)	(4,387)	**(47,022)**
Total	**¥124,473**	¥73,865	¥63,202	**$1,059,619**
U.S.GAAP adjustments	**(1,057)**	198	(107)	**(9,005)**
Consolidated	**¥123,416**	¥74,063	¥63,095	**$1,050,614**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Operating expenses	**2006**	2005	2004	**2006**
Japan	**¥ 99,911**	¥40,425	¥36,880	**$ 850,521**
North America	**12,109**	9,619	10,178	**103,086**
Europe	**729**	859	336	**6,203**
Asia excluding Japan	**1,778**	646	796	**15,136**
Corporate and elimination	**(5,524)**	(4,123)	(4,387)	**(47,022)**
Total	**¥109,003**	¥47,426	¥43,803	**$ 927,924**
U.S.GAAP adjustments	**13,151**	2,375	10,683	**111,972**
Consolidated	**¥122,154**	¥49,801	¥54,486	**$1,039,896**

For the years ended March 31	Millions of yen			Thousands of U.S. dollars
Operating income	**2006**	2005	2004	**2006**
Japan	**¥11,760**	¥23,961	¥16,192	**$100,111**
North America	**3,398**	2,270	3,192	**28,927**
Europe	**49**	31	91	**420**
Asia excluding Japan	**263**	177	(77)	**2,237**
Corporate and elimination	**—**	—	—	**—**
Total	**¥15,470**	¥26,439	¥19,398	**$131,695**
U.S.GAAP adjustments	**(14,208)**	(2,177)	(10,789)	**(120,977)**
Consolidated	**¥ 1,262**	¥24,262	¥ 8,609	**$ 10,718**

As of March 31	Millions of yen			Thousands of U.S. dollars
Assets	**2006**	2005	2004	**2006**
Japan	**¥196,211**	¥118,307	¥ 96,547	**$1,670,303**
North America	**12,684**	10,694	12,106	**107,974**
Europe	**1,207**	1,010	772	**10,279**
Asia excluding Japan	**3,247**	1,684	1,208	**27,643**
Corporate and elimination	**—**	—	—	**—**
Total	**¥213,349**	¥131,695	¥110,633	**$1,816,199**
U.S.GAAP adjustments	**70,961**	70,669	71,415	**604,079**
Consolidated	**¥284,310**	¥202,364	¥182,048	**$2,420,278**

20. Related Party Transaction

No related party transaction was identified for the years ended March 31,2006, 2005 and 2004.

21. Subsequent Event

Sale of Taito's Commercial Karaoke Business

On April 27, the Company decided to sell off Taito's commercial karaoke business to XING INC., one of the major commercial karaoke operators and a subsidiary of BROTHER INDUSTRIES LTD., in order to restructure overall business of Taito. As of March 31, 2006, book value of assets and liabilities associated with Business were ¥2,602 million and ¥708 million, respectively, and net selling price was agreed upon at ¥4,683 million, subject to adjustment after closing depending on the circumstances. The sale was consummated on July 3, 2006.

Dividend Declared

The annual stockholders' meeting for the year ended March 31, 2006 was held on June 24, 2006 in Tokyo. In the meeting, the year-end cash dividend in total amount of ¥2,210 million was proposed by the management of the Company and approved by the stockholders.

ChuoAoyama PricewaterhouseCoopers

PRICEWATERHOUSECOOPERS

Kasumigaseki Bldg. 32nd Floor
3-2-5, Kasumigaseki, Chiyoda-ku,
Tokyo 100-6088, Japan

Report of Independent Auditors

To the Board of Directors and
Stockholders of Square Enix Co., Ltd.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, changes in stockholders' equity and cash flows present fairly, in all material respects, the financial position of Square Enix Co., Ltd. and its subsidiaries (collectively the "Company") at March 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

ChuoAoyama PricewaterhouseCoopers

August 4, 2006

Corporate Data (As of March 31, 2006)

Company Profile

Headquarters:
Shinjuku Bunka Quint Bldg.
3-22-7 Yoyogi, Shibuya-ku
Tokyo 151-8544, Japan
TEL. +81-3-5333-1555

Established:
September 22, 1975

Common stock:
¥7,803,740,680

Number of employees:
3,050 (Consolidated)
1,428 (SQUARE ENIX)

Note: Number of employees does not include temporary staff.

SQUARE ENIX Group

Company Name Consolidated Subsidiaries	Established	Fiscal Year-End	Common Stock	Percent of Voting Rights	Principal Lines of Business
Japan					
Community Engine Inc.	May 2000	March	¥25 million	64.7%	Network application, development, sale of middleware
DIGITAL ENTERTAINMENT ACADEMY CO., LTD.	October 1991	March	¥72 million	70.8%	School for computer game engineers
TAITO CORPORATION	August 1953	March	¥16 million	100.0%	Management and operation of amusement centers; planning, development, production, sale and rental of coin-operated game machines and coin-operated karaoke machines; planning, development and sale of game software; planning, development and sale of mobile phone content
TAITO ART CORPORATION	November 1966	March	¥35 million	100.0% (100.0%)	Travel agency and insurance agency
EFFORT CO., LTD.	February 1999	March	¥10 million	100.0% (100.0%)	Planning and production of music content
North America					
SQUARE ENIX, INC.	March 1989	March	US$10 million	100.0%	Sale of games, sale and management of online games in North America
UIEVOLUTION, INC.	August 2000	March	US$3 million	100.0% (100.0%)	Development, sale and licensing of network applications and middleware
SQUARE PICTURES, INC.	November 1997	December	US$0.1 million	100.0%	Management of overseas film revenues
Europe					
SQUARE ENIX LTD.	December 1998	March	GB£3 million	100.0%	Sale of games, sale and management of online games in Europe
Asia					
SQUARE ENIX (China) CO., LTD.	January 2005	December	US$12 million	100.0%	Development, sale, and management of online games in Asia
Huang Long Co., Ltd.	August 2005	December	10 million yuan RMB	0.0% [100.0%]	Sale and operation of online games in Asia
SQUARE ENIX WEBSTAR NETWORK TECHNOLOGY (BEIJING) CO., LTD.	December 2001	December	US$4 million	60.0%	Development, sale, and management of online games in Asia
COMMUNITY ENGINE NETWORK SOFTWARE (BEIJING) CO., LTD.	September 2003	December	877 thousand yuan RMB	80.0% (80.0%)	Network application, development, and sale of middleware
BEIJING TAIXIN CULTURAL ENTERTAINMENT CO., LTD.	June 1996	December	16,617 thousand yuan RMB	80.0% (80.0%)	Management of amusement centers and rental of game machines
TAITO KOREA CORPORATION	May 2004	March	3,300 million won	100.0% (100.0%)	Management and operation of amusement centers
Partnership					
FF Film Partners	March 1998	December	—	92.2%	Licensing and management of movies and derivative products

Notes: 1. In the Percentage of Voting Rights column, numbers in parentheses ( ) represent the percentage of indirect holdings and are including in the total percentage of voting rights held by the Company. Numbers in brackets [ ] represent the percentage of holdings of closely related parties of parties of the same interest and are excluded from the total percentage of voting rights held by the Company.

2. On March 31, 2006, TAITO CORPORATION (the former SQEX, Inc., name changed on March 31, 2006) absorbed the former TAITO CORPORATION. To make the de facto surviving company of this merger—the former TAITO CORPORATION—a wholly owned subsidiary of the Company, the former TAITO CORPORATION was absorbed by TAITO CORPORATION (the former SQEX, Inc.) on a pro forma basis. Consequently, the date of establishment is recorded as that of the de facto surviving company, the former TAITO CORPORATION.

Share Information

Number of shares issued:110,729,623

Number of shareholders: 46,084

Principal Shareholders

Rank	Shareholder	Investment in SQUARE ENIX (Thousands of Shares)	(%)
1	Yasuhiro Fukushima	23,626	21.33
2	Masashi Miyamoto	13,422	12.12
3	Fukushima Planning Co., Ltd.	9,763	8.81
4	Sony Computer Entertainment Inc.	9,520	8.59
5	JP Morgan Chase Oppenheimer Funds JASDEC Account (Standing agent: Sumitomo Mitsui Banking Corporation)	3,707	3.34
6	OM04 SSB Client Omnibus (Standing agent: The Bank of Tokyo-Mitsubishi UFJ, Ltd., Custodial Services Department)	3,174	2.86
7	S System Co., Ltd.	2,545	2.29
8	The Master Trust Bank of Japan, Ltd. (Trust Account)	2,196	1.98
9	Japan Trustee Services Bank, Ltd. (Trust Account)	2,142	1.94
10	HSBC Fund Service J2 (Standing agent: The Hong Kong and Shanghai Banking Corporation, Tokyo Branch)	1,685	1.52

Note: The above investment of Japan Trustee Services Bank, Ltd. (Trust Account), includes 114,000 shares held in the name of Japan Trustee Services Bank, Ltd. (Trust Account 4).

Shareholders' Memo

» **Fiscal year:**
April 1 to March 31

» **Annual general meeting of shareholders:**
June

» **Number of shares authorized:**
440,000,000

» **Public notices:**
URL:http://www.aspir.co.jp/koukoku/9684/9684.html (Japanese)

(Public notices will be announced in the *Nihon Keizai Shimbun*, a Japanese-language newspaper, in case an electronic notice is not possible due to an accident or any other unavoidable reasons.)

» **Trading unit:**
100 shares

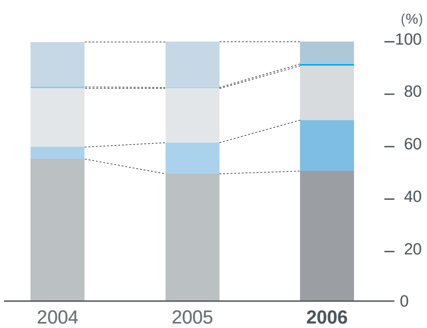
» **Listed on:**
The First Section of the Tokyo Stock Exchange

» **Securities code:**
9684

» **Shareholder registration agent:**
Securities Agency Department
Mitsubishi UFJ Trust and Banking Corporation
7-10-11 Higashi-suna, Koto-ku, Tokyo 137-8081
TEL: +81-3-5683-5111

» **Transfer agent offices:**
Mitsubishi UFJ Trust and Banking Corporation (domestic branches)

Number of Shares Owned (Thousands of shares)



	2004		2005		2006	
Financial Institutions	19,225	(17.46%)	19,475	(17.64%)	9,456	(8,54%)
Securities Companies	486	(0.44%)	374	(0.34%)	822	(0.74%)
Other Companies	25,023	(22.72%)	23,117	(20.94%)	23,178	(20.94%)
Foreign Companies and Individuals	4,914	(4.46%)	13,252	(12.01%)	21,761	(19.65%)
Individuals and Other	60,481	(54.92%)	54,164	(49.07%)	55,510	(50.13%)
Total	110,130	(100.00%)	110,385	(100.00%)	110,729	(100.00%)