

» A Message to Our Shareholders



Thank you for your continued support of the Square Enix Group. In the fiscal year ended March 2018, our consolidated net sales declined slightly on a year-on-year basis to ¥250.3 billion, but we set new records for operating income, ordinary income, and net income. I am pleased to take this opportunity to describe conditions in each of our business segments and our plans for the way forward.

Business Segment Overview

Digital Entertainment

In the fiscal year ended March 2018, the Digital Entertainment Business Segment posted net sales of ¥191.4 billion and operating income of ¥43.4 billion, representing a decline in sales but rise in profits on a year-on-year basis.

In the **HD (High-Definition) Games sub-segment**, we launched "DRAGON QUEST XI: Echoes of an Elusive Age," the latest installment in the DRAGON QUEST series, in July 2017. We undertook the ambitious task of offering the title on both the PlayStation 4 and the Nintendo 3DS. The title has proven extremely popular with players on both platforms, becoming a major hit with combined sales in excess of three million units. With the launch of Western versions of the title slated for September 2018, we plan to grow the DRAGON QUEST brand globally in the fiscal year ending March 2019.

Meanwhile, in the FINAL FANTASY franchise, we launched "FINAL FANTASY XII THE ZODIAC AGE," a remaster of "FINAL FANTASY XII" for which we have completely updated the graphics and incorporated new elements. The title has met with a great reception from players the world over. Remasters are important because they enable us to bring franchise titles presented with the latest look and feel to customers who have never played earlier titles in a series, thus imbuing our game franchises with renewed vitality. We also believe that even players who have experienced the original will find new surprises and excitement in playing recreations brought to life with the latest technologies. As such, we intend to remain proactive in offering remastered titles.

We are also very happy with the major success we enjoyed with "NieR:Automata" in the fiscal year ended March 2018. The title had been launched in the fourth quarter of the fiscal year ended March 2017 but continued to see solid sales volume growth throughout the fiscal year ended March 2018, resulting in the development of a substantial franchise. Traditionally, consumer games have generated the majority of their lifetime sales in the first few months after their launches, but "NieR:Automata" actually saw significant growth after the initial few months post-launch, making it a revolutionary title from our perspective. Despite being a single-player title, the game has generated nearly 60% of its sales via digital downloads, which is an unusually high number. The fact that it continues to sell well even at present

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highlights its status as a title emblematic of the shift from the physical to the digital. The game was the second installment in the NieR series, coming seven years after the original. New players also loved it, and we feel that we have succeeded at establishing a new franchise for our Group.



FINAL FANTASY XII: THE ZODIAC AGE

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DRAGON QUEST XI: Echoes of an Elusive Age

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NieR:Automata

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Developed by PlatinumGames Inc.

In the **MMO (Massively Multiplayer Online game) sub-segment**, we launched expansion packs for both “FINAL FANTASY XIV” and “DRAGON QUEST X” for the first time in two years in an endeavor to maintain and expand our paying subscriber base. Continuously adding new content is key to maintaining paying subscribers for online games, which tend to show marked attrition with the passage of time. The release of the expansion pack proved especially effective for “FINAL FANTASY XIV,” which, in defiance of the aforementioned tendency, achieved the highest paying subscriber count since its launch. The game itself has also garnered extremely positive feedback, and we saw the year as one in which it demonstrated its presence as a global MMORPG. Having been on the market for more than five years, both titles are long runners, but by rolling out new content on an ongoing basis, we will endeavor to create an even more robust service.



FINAL FANTASY XIV

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DRAGON QUEST X ONLINE

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Net sales in our **Games for Smart Devices/PC Browsers sub-segment** came in slightly under the ¥100 billion mark, and the titles we released in the latter half of the fiscal year ended March 2018 delivered lackluster performances on the whole. As such, we saw the year as one that left us many issues to tackle. While maintaining and bolstering the percentage of our titles that prove successful is always a key challenge, we regret that many of the new titles released in the last fiscal year delivered very disappointing results. Common wisdom has it that Japan's gaming market has matured, making it difficult to generate new hits. Meanwhile, we view the new trend of Chinese and Korean developers

and publishers creating hit titles to be one worthy of note. Our intention is always to pursue new and creative gaming experiences, and in the fiscal year ending March 2019, we will return to this basic philosophy, revisit our development and operation organizations, and strive to create new hit titles.



Amusement

The release of fewer new game machine titles resulted in sales declining to ¥41.7 billion and operating income falling to ¥2.4 billion in the fiscal year ended March 2018. However, arcade operations were stable, and we were proactive in undertaking new initiatives, as exemplified by our renovation of the Mizonokuchi location of the Taito Station arcade outlets and our opening of the MEGARAGE arcade bar. With the number of brick-and-mortar stores continuing to decline, many prime retail properties that we traditionally would not have had access to are coming onto the market. We intend to capitalize on this opportunity and be proactive in opening new arcades to bolster our earnings.

In the portion of the business dealing in amusement machine sales, we launched a newly reincarnated version of “DENSHA DE GO!!,” a train simulator game machine, as that title marked its twentieth anniversary. “DENSHA DE GO!!” is a key piece of IP (intellectual property) not only for TAITO CORPORATION but also for our Group. While the latest version has faced various challenges, it has been positively received by core fans, and we are currently exploring how we might go about further spreading its popularity. We hope you will look forward to what we have in store. In the fiscal year ending March 2019, we have launched a brand-new title, “Starwing Paradox.” Players have very high expectations for the title given the sheer size of the machine and the physical gaming experience it provides. The greatest appeal of arcade gaming is the realism it offers that cannot be gained from gaming at home. As such, we continue to see our arcades as a key piece of our Group’s gaming portfolio and intend to continue to take on new challenges in the Amusement Business Segment.



DENSHA DE GO!!

(Arcade version)

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JR東日本商品化許諾済



MEGARAGE at the Taito Station arcade in Mizonokuchi

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Publication

The Publication Business Segment posted net sales of ¥11 billion and operating income of ¥2.4 billion in the fiscal year ended March 2018. The shift to digital is pronounced in the Publication Business Segment, where we have come to generate more than 20% of our sales digitally. We look for that figure to increase further, and to accelerate the trend, we launched our MANGA UP! and GANGAN pixiv services in the fiscal year ended March 2017. By offering smartphone applications, we hope to create an environment that gives a broader base of readers easy access to manga and thereby tap new demand. The DAU (daily active users) figures for these smartphone applications have reached a sizeable level, and we are looking at them to develop into media that will underpin our Publications Business Segment.

Additionally, in a new effort to bring manga to life using VR (virtual reality) technology, we have been working on an initiative we call "Project Hikari." In May 2018, the project at last resulted in the launch of a product, "Tales of Wedding Rings VR," a pilot endeavor that enables users to enter the world of manga via VR technology. Through initiatives such as this, we will continue to pursue new ways to depict the world of manga, thus adding further breadth to our Group's content lineup.

Merchandising

The Merchandising Business Segment generated net sales of ¥7.5 billion and operating income of ¥1.8 billion. Earnings were helped by the variety of events we organized to commemorate the 30th anniversaries of our Group's two major franchises, namely DRAGON QUEST in 2016 and FINAL FANTASY in 2017. Profits declined year on year due to increased advertising spending, but we are hopeful that these commemorative events have further strengthened our brand and will contribute to the development of the franchises.

Moreover, following the opening of our first SQUARE ENIX CAFE in the fiscal year ended March 2017, we added locations in Osaka and Shanghai in the fiscal year ended March 2018. The cafes, which serve as a messaging platform for our content, have proven popular with customers. While we have no plans for additional openings at the moment, we see such brick-and-mortar locations as an effective shaper of our brand and are upbeat on future possibilities in this area.

Key Business Development Initiatives

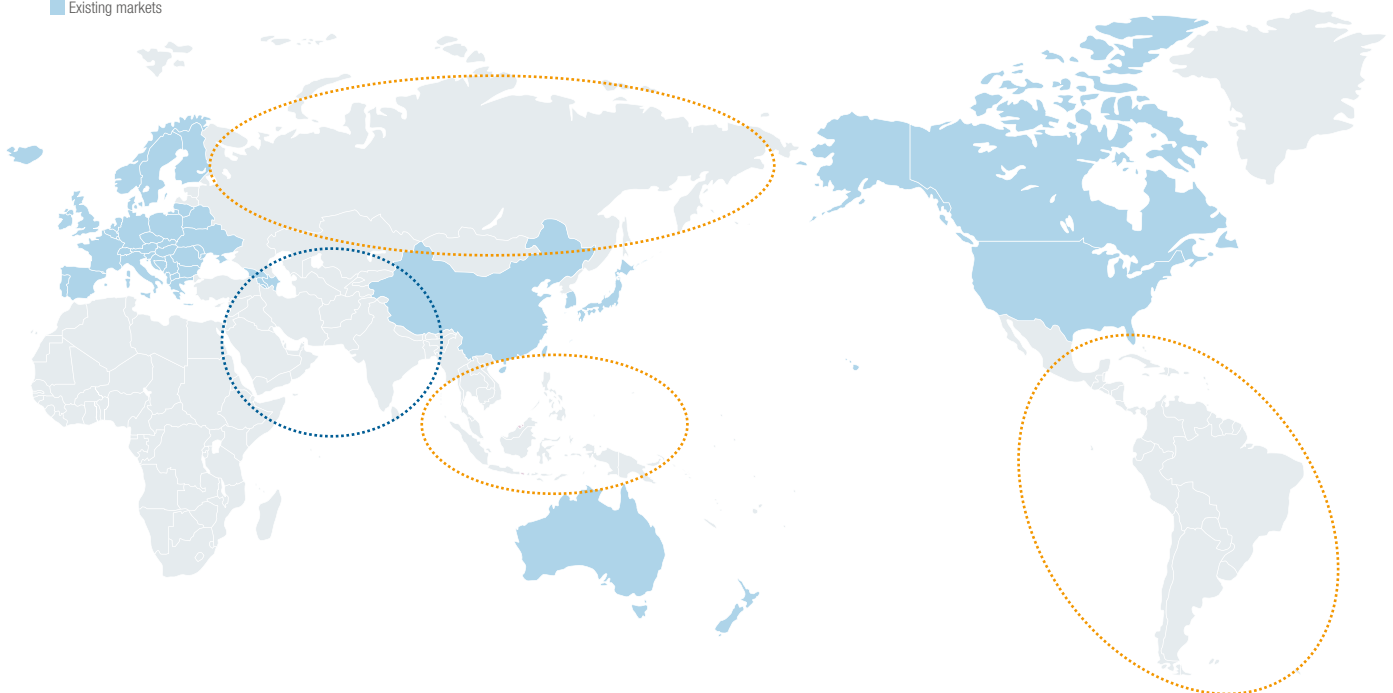
For our Group to continue to deliver growth, we remain engaged in the following initiatives: 1) Digital Sales Enhancement; 2) Multiplatform Utilization; 3) Geographic Expansion; and 4) Game as a Service, Game as Media.

Geographic Expansion

In the context of Geographic Expansion, we have highlighted the Middle East, Southeast Asia, Latin America, and India as key strategic regions. Amongst these regions, we especially intend to position India as a region for focused investment starting this fiscal year. India's telecommunications infrastructure has developed in recent years, and advances in fintech have given rise to more payment methods. As such, we believe the market is reaching the point that it can at last support the development of a robust gaming business. For this reason, we will be ramping up our investment in India. The Middle East is also very promising. We see it as an extremely attractive market when viewed broadly as the Arabic-speaking world rather than looking at it country by country. We intend to invest in the region not only via the localization and culturalization of our games, but also by supporting local developers or otherwise seeking opportunities to discover new talent.

Overseas Expansion of the Digital Entertainment Business Segment

- Priority markets
- Target markets
- Existing markets



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Game as a Service, Game as Media

E-sports are a major topic of discussion in Japan of late. The focus tends to be on their business potential as a draw for spectators; however, rather than focusing exclusively on that side of e-sports, we hope instead to build excitement around them via initiatives designed to support the player community that makes them a viable spectator event to begin with. The concept of “Game as a Service” became the subject of significant debate in the fiscal year ended March 2018 due to its association with the loot box controversy. We see “Game as a Service” as a type of game design capable of enhancing the user’s entertainment experience and as a key concept in shaping the way e-sports and other gaming will look in the future. Similarly, we believe “Game as Media” is best considered in the context of the overall trend of games evolving into services. The world we find ourselves in demands that we think of new business models that recognize the media value of games by establishing streaming and viewing as ways of enjoying games in addition to actual game play.



Digital Sales Enhancement/e-commerce

We have implemented our digital sales enhancement initiatives against a backdrop of customers increasingly purchasing full games—especially HD games—via digital download rather than in boxes. These initiatives have included enhancing and renovating our sales site to make for a smoother purchasing experience for our customers. As a result, the fiscal year ended March 2018 saw download sales of our catalog titles grow, which led to a sharp increase in the portion of our HD game sales that we generate digitally to more than 40%. The trend toward greater digital shopping is irreversible, so we will now need to go beyond simply renovating our sales site to creating the capability to provide our customers with tailored recommendations based on their preferences and game-play style. We must admit that our Group is behind in terms of such

initiatives, but we will ramp up our system development and other relevant efforts to make up for lost time.

We will in fact take things a step further by not only bolstering the digital sales of our games, but also establishing an e-commerce strategy as the fifth pillar of our growth initiatives to better leverage our Group’s IP portfolio. To date, we have recognized sales of IP-derived figures and other merchandise produced either by ourselves or via licensing arrangements under our Merchandising Business Segment and positioned such offerings as a way of supplementing the original IP. However, of late we have noted that consumers increasingly want not simply to enjoy games and manga in isolation but in a more wholistic way that includes merchandise based upon such contents. They have begun not only to want to play games but also to have a deeper appreciation for the universe of the game and the characters that inhabit

it. Social networks have made it possible for players to share their playing experiences and reviews with many other players, thus creating global communities. In those communities, fans enjoy games, manga, and other content as though they are all part of a single universe, irrespective of whether they are engaging with the original IP or derivative products. For this reason, we believe that we should no longer limit our Merchandising Business Segment to a supplementary role vis-à-vis the original IP but to redefine it as “e-commerce,” applying a broad interpretation to the term and including in it the digital sales of our games, manga, and other products. We further believe that we should strive to grow such business, thereby giving additional depth to our earnings base and enabling investment in the development of more new content. We intend to pursue e-commerce as a new thematic initiative starting in the fiscal year ending March 2019.

Multiplatform Utilization

In the context of Multiplatform Utilization, we note that game streaming was a hot topic at E3 this year. Game streaming is finally becoming a reality just as the current generation of game consoles are approaching the end of their lifecycles and the next-generation consoles are beginning to be discussed. The telecommunications landscape looks poised for dramatic change over the next few years with the roll-out of 5G or the fifth-generation mobile network, and we expect the gaming industry to face a major paradigm shift spurred by the advent of client-agnostic gaming services. This may fundamentally change the look of the gaming industry, not only in terms of how it designs its games but also even in terms of its business models. To respond to these changes, our Group will strengthen its R&D and sales functions to lay the groundwork for further expanding our businesses. New technologies such as AI (artificial intelligence), blockchain, and XR (a catchall term covering VR, or virtual reality; AR, or augmented reality; and MR, or mixed reality) may give rise to new platforms. We will invest aggressively in such new technologies with an eye to the post-smartphone world. As we have already announced, we have set aside US\$25 million to invest via a venture capital fund. Through such investment, we will develop content businesses befitting the times in which we live.

We look forward to your continued support.



Yosuke Matsuda

President and Representative Director