

## A Message to Our Shareholders



Yosuke Matsuda  
President and Representative Director

Thank you for your continued support of the Square Enix Group. In the fiscal year ended March 2019, we booked net sales of ¥271 billion, operating income of ¥24.5 billion, and profit attributable to owners of parent of ¥18.4 billion. Net sales rose 8.2% versus the previous year, but operating income was down 35.7% as costs rose as a result of major title launches. In addition, the revisiting of our business strategy for one of our Group companies led us to post an extraordinary loss, which resulted in a 28.5% decline in profit attributable to owners of parent.

## Business Segment Overview

### Digital Entertainment

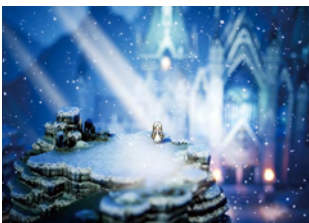
Net sales rose from the previous year to ¥204.5 billion while operating income fell to ¥29 billion at the Digital Entertainment segment in the fiscal year ended March 2019.

The HD (High-Definition) Games sub-segment released “SHADOW OF THE TOMB RAIDER” and “JUST CAUSE 4,” the latest installments in these major franchises from our Western studios. With competition intensifying in the AAA game market, both titles struggled immediately after their launches, resulting in initial sales well below our plans. However, thanks to subsequent sales promotion initiatives, we are in the process of making up for that initial shortfall and intend to continue to add to sales during the course of the fiscal year ending March 2020. Our Japanese studios meanwhile released titles including “KINGDOM HEARTS III,” “LEFT ALIVE,” and “OCTOPATH TRAVELER.” Our customers around the world had especially high expectations for “KINGDOM HEARTS III” as it was the first new installment in that franchise since the release of “KINGDOM HEARTS II” approximately 13 years earlier. The response to the game was excellent, and although we did not release it until our fourth quarter, it contributed significantly to the achievement of the ¥270 billion in sales we had targeted in the

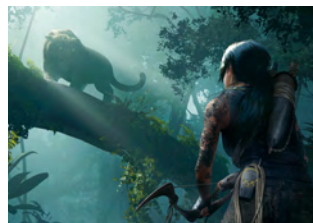
fiscal year ended March 2019. “OCTOPATH TRAVELER” is a brand-new RPG (role-playing game), and its artistic style, gameplay, and plot were well received by RPG fans the world over. The game represents the successful creation of a new piece of IP (intellectual property). The creation of new IP and new franchises is the core business of game and content companies. We need to constantly maintain development investment with the goal of establishing new pieces of IP. “OCTOPATH TRAVELER” is the result of our sustained efforts to create new IP, and we have high expectations for its further growth and development.

Net sales at the MMO (Massively Multiplayer Online game) sub-segment fell as no new expansion packs were launched for either “FINAL FANTASY XIV” or “DRAGON QUEST X,” but we worked to maintain and grow our subscriber base via ongoing operational initiatives. In the fiscal year ending March 2020, we will launch expansion packs for both “FINAL FANTASY XIV” and “DRAGON QUEST X” and work to grow our subscriber base further.

As with the HD Game sub-segment, the Games for Smart Devices/PC Browsers sub-segment struggled considerably in the fiscal year ended March 2019. “Romancing SaGA Re;univerSe,” which was launched in December 2018, got off to a good start, contributing significantly to both sales and profits in the fourth quarter. However,



**OCTOPATH TRAVELER**  
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**SHADOW OF THE TOMB RAIDER**  
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**JUST CAUSE 4**  
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**KINGDOM HEARTS III**  
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we saw weak performances from all of the other new games we launched between the beginning of the fiscal year and the third quarter, resulting in extremely disappointing sales and profit figures for the sub-segment as a whole. We maintain our strategy of launching new titles to offset waning performances by existing titles and thereby growing our overall portfolio, but we deeply regret that we were unable to satisfy our customers with our new titles. It is true that the maturing of the smart device game market in Japan has made for more intense

competition, but new titles that meet with customer approval continue to appear on the scene. We attribute the sluggish performance of this sub-segment in the fiscal year ended March 2019 solely to our inability to provide our customers with new, fun gaming experiences and take this fact to heart. In light of these results, we have undertaken a major overhaul of how our development functions are structured at SQUARE ENIX CO., LTD. We hope that you will look forward to our forthcoming releases.



**FINAL FANTASY XIV**

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**DRAGON QUEST X ONLINE**

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**Romancing SaGa Re;univerSe**

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ILLUSTRATION: TOMOMI KOBAYASHI



**Starwing Paradox**

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## Amusement

Net sales in the Amusement segment rose from the previous year to ¥46.2 billion while operating income fell to ¥1.9 billion in the fiscal year ended March 2019. Major new titles including “Starwing Paradox” contributed to the rise in sales, but this was not enough to offset the amortization of development costs. Meanwhile, arcade operations generated stable earnings throughout the year, and we also added to our arcade count, so we are steadily expanding the business. In the fiscal year ending March 2020, the number of tourists visiting Japan looks likely to grow as the Tokyo Olympic and Paralympic Games approach in July 2020. Meanwhile, we also anticipate the increase in Japan’s consumption tax. As such, the business environment is difficult to read, but by undertaking constant improvements in our arcade operations, we intend to bolster the segment as a whole.

## Publication

The Publication segment saw both net sales and operating income grow in the fiscal year ended March 2019, with net sales reaching ¥14 billion and operating income rising to ¥3.9 billion. The key growth driver is digital sales. Nearly 40% of sales booked in the fiscal year ended March 2019 were digital, and the most recent monthly figure was in excess of 50%. Business is brisk for our MANGA UP! and GANGAN pixiv services, with both enjoying solid growth in their MAU (monthly active users) and DAU (daily active users) numbers. This has contributed significantly to the rise in margins for the segment as a whole. Meanwhile, sales of printed comics are growing in synch with digital sales, so the overall segment is demonstrating well-balanced growth. The drive toward digitization is irreversible, and we look for the digital weighting of our own business to continue to grow. We will create new IP using media well suited to the digital world and continue to grow the segment as a whole.

## Merchandising

Both net sales and operating income fell from the previous year in the Merchandising segment in the fiscal year ended March 2019, with net sales dropping to ¥7.3 billion and operating income declining to ¥900 million. These results are owing to considerable upfront spending on the development of new products, but we will strive for growth in the fiscal year ending March 2020 and beyond as we release new products timed to coincide with the launch of major game titles and add to our product lineup. We do not see this segment as one dealing solely in products derived from and intended to complement our original IP. Today’s customers clearly tend to enjoy content in the context of an entire universe. The products and services we offer in this segment meet the needs of such customers while adding to the richness of our IP portfolio. By proactively working to develop this segment into an e-commerce business, we will make purchasing more convenient for our customers and make our products and services more a part of their lives.

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### Our Medium-term Earnings Targets

We are striving to create a business structure in or after the fiscal year ending March 2021 that will enable us to consistently generate net sales of ¥300 to 400 billion and operating income of ¥40 to 50 billion. In the fiscal year ending March 2020, when we had originally anticipated achieving our medium-term earnings targets, we now look to book net sales of ¥270 billion and operating income of ¥24 billion, a performance on par with that of the fiscal year ended March 2019. Our reasoning is twofold. Firstly, the titles we released in the Games for Smart Devices/PC Browsers sub-segment in the first through third quarters of the fiscal year ended March 2019 performed poorly, making it difficult to achieve the earnings we had originally anticipated. Secondly, we are taking a conservative outlook on additional sales of

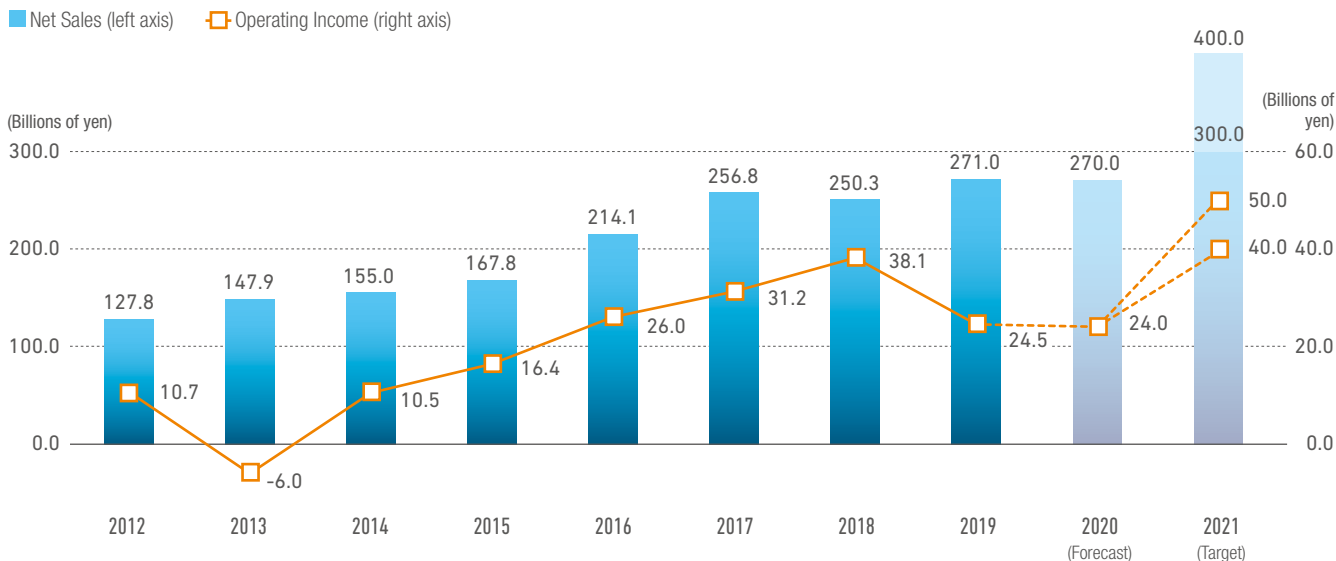
the new HD game titles we launched in the fiscal year ended March 2019. In order to achieve our medium-term earnings targets, we have been working on our strategic challenges of: 1) digital sales enhancement, 2) multiplatform utilization, 3) geographic expansion, 4) Games as a Service/Games as Media, and 5) e-commerce.

To achieve our medium-term earnings targets as soon as possible, we have worked to expand stable recurring earnings while also continuing to invest in new IP. Sales of new HD game titles become a major contributor to profits once their development costs have been fully amortized. Provided we see expansion in our stable recurring earnings, I believe we will be able to achieve our medium-term earnings targets with our current pipeline.

**Mid-term Target**

**Targeting net sales of ¥300–400 billion and operating income of ¥40–50 billion.**

**Looking for Digital Entertainment segment to drive sales and income growth.**



## Future Developments in Our Businesses

### Cloud gaming

Current-generation game consoles are reaching the end of their lifecycles, and the industry is beginning to discuss the next generation. The announcement of cloud gaming services such as Google's Stadia and Microsoft's Project xCloud has also created significant buzz. In addition, the number of new entrants to the gaming industry is growing, with examples including Apple's Apple Arcade and the launch of game development efforts at Netflix. Once the purview of platform companies and publishers, the map of the gaming industry is being redrawn.

Cloud gaming in particular has been cited for some time as a potential driver of sweeping change in the gaming business, but its history has been one of trials and failures. In anticipation of the rollout of 5G (fifth-generation mobile communications networks), IT giants such as Google and Microsoft are entering the space, signaling the potential for cloud gaming finally to get off the ground in a major way. Given the requirements for high volumes of data traffic and large-scale server infrastructure, major telecommunications and cloud server players will definitely see cloud gaming as their next new business opportunity. As such, we expect to see additional new entrants to the market, which makes us even more hopeful that this will finally be the time that cloud gaming takes flight.

Game publishers and developers can view cloud gaming from two perspectives.



The first is to see it as a new distribution channel. Game consoles, PCs, and smart devices have served to put catalog games and new games in the hands of customers, and now cloud streaming will be added to that list. Telecommunications infrastructure and streaming technologies evolve daily, so the time will eventually come when there is little perceivable difference, but given the extent to which gameplay will depend upon the individual user's telecommunications environment, we must take the view that the odds of cloud streaming immediately taking the place of the existing game consoles or PCs are low for now. As such, for the time being, the major expectation that game publishers are likely to have for game streaming services is that

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they serve as a way to access not only the users who already regularly play games on consoles and PCs, but also more casual game fans or those that live in regions where game consoles are not easy to come by. The streaming of gameplay is popular lately, with many game fans around the world enjoying streamed gameplay even if they do not actually play games themselves. If cloud streaming were to create an environment that allowed for a quick and seamless transition to gameplay, the likelihood of such casual fans actually playing games would grow. In addition, there are many game fans in regions where game consoles are either not commonplace or else not sold at all. We have high hopes that cloud streaming could serve as a major means for such fans to access games. Several independent providers of local rather than global services have appeared on the scene. The expansion of geographic coverage in this way is definitely of benefit to game publishers such as ourselves.

The second perspective views cloud gaming not merely as a means for distributing traditional games but also as one for offering gaming experiences not possible elsewhere. A variety of developers are already working on developing such cloud-centric or cloud-native games. Our Group also has concrete plans for incorporating such cloud-centric elements into some of the new game development efforts we are currently undertaking. Offering new gaming experiences unique to the cloud would be a highly marketable way to reach existing console and PC game players, and thus significantly promote the adoption and reputation of cloud gaming.

There remain many challenges to be resolved beyond the technological, including the issue of the telecom charges users will bear, but as outlined above, cloud gaming has major potential. Our Group has already decided to make existing titles including “FINAL FANTASY XV” and “SHADOW OF THE TOMB RAIDER” as well as our forthcoming “Marvel’s Avengers” title available on Google’s Stadia, highlighting our strong hopes for cloud gaming to take off globally.

### Expanding our recurring earnings base

With the next-generation consoles and the launch of cloud gaming services in the offing, the map of the digital content industry is poised to undergo significant change in the next few years. The quality and volume of content that customers demand is also likely to grow even further. In order to keep pace with such trends and consistently provide customers with the ultimate in excitement, we will need to engage in sustained and aggressive investment in content development. The scale of development spending will grow, and investment in the underlying technologies that enable such efforts will gain further importance. Moreover, the earnings and financial foundations that fund such investment will become even more crucial than before. It is our Group’s recurring earnings generated from our rich content portfolio that will create such foundations.



Digitization is extending the lifespan of games, making sales initiatives critical not only at launch but also thereafter. Thanks to digitization, we are also seeing the creation of an environment that enables us to meet the needs of fans of manga content at any time, and that has become a pillar underpinning the growth of our Publication Business Segment. Furthermore, as the ways customers enjoy content diversify, they have come to expect a greater variety of engagement opportunities including film and stage productions that enable them to enjoy their favorite content as an entire universe. We will be launching a dedicated organization within SQUARE ENIX CO., LTD. as of the fiscal year ending March 2020 so that we can best respond to these diverse customer needs. This unwavering commitment to strengthening our customers' engagement and connections with our customers will enable us to generate recurring earnings.

Developing new content requires massive investments and therefore involves risk. Our Group is in the business of providing

content and thus must always take on this risk, create entertaining new content, and deliver it to our customers around the world. In order to be able to take on such risk, we need a solid foundation of recurring earnings. New content creates new recurring earnings, which in turn enables new investment. Creating such a cycle will give rise to sustained growth for our Group, thereby making our corporate philosophy a reality. Further digitization, the arrival of next-generation consoles, and the launch of cloud gaming services will serve as good opportunities for us to strengthen our customers' engagement. We also need to examine the pros and cons of the much-discussed topic of subscription models from the perspective of how they might help us to bolster our customers' engagement and our connections with our customers. By strengthening engagement, we will generate recurring earnings and create business foundations that constantly enable us to take on new challenges and thereby keep pace with a changing world.

## On Shareholder Return

Our annual dividend per share for the fiscal year ended March 2019 was ¥47. Heretofore, we have used a 30% consolidated dividend payout ratio as a yardstick and intend to maintain that policy in the fiscal year ending March 2020. As discussed above, the digital content industry remains in a period of major change, so in addition to the content development efforts we are currently undertaking, we also need to engage in development initiatives to support the next-generation of consoles and for cloud-centric and cloud-native games. As such, we will keep to our strategy of bolstering recurring earnings by prioritizing the funding of the content development that will underlie our growth while also maintaining a level of cash and deposits that will serve as a financial buffer against investment risk. We intend to

continue to reward our shareholders primarily via dividends as we endeavor to strike a balance with our growth investments.

I would like to take this opportunity to ask for your continued support.



Yosuke Matsuda

President and Representative Director