The Year's Record Profit: Broad-Based Success

In the year under review, sales and profit reached record levels, while nearly all business segments showed increased profit. Furthermore, sales across all geographic segments of Japan, North America and Europe achieved record levels (Figures 2 - 4).

Key Factors to Enter the Next Growth Stage

As I've mentioned, we have been able to manage our current businesses very effectively under a challenging operating environment.

So, are we prepared to enter the next growth stage? I would like to give the following overview from this perspective.

We have identified three key success factors.

1. Globalization
2. Becoming "Network Centric"
3. Strengthening Own-IPs

Since our creation by merger between ENIX and SQUARE, these fundamental themes have not changed.

Globalization

Entertainment in so many forms is destined to spread around the world.

While digital entertainment has been the most recent to enter the market, computer games and network communications have already pervaded virtually every part of the world. Based on this, the whole world has become game companies' target market. The only choice available to individual companies in the industry is where to set up content development and marketing operations to best serve global markets.

For us, we have chosen the path of complete globalization.

Our substantial first step in this process was the acquisition of U.K.-based Eidos. A year on since the acquisition, progress has been extremely smooth as we not only completed the organizational integration but also have begun to collaborate on certain development projects.

As a result, we've been able to strengthen our development and marketing structures in North America and Europe. And while we are still developing in this area, our composition of human resources is now more balanced across regions, forming a solid foundation for global business development (Figures 5 - 6).

When I say that we've built a foundation, I don't mean that we will then simply expand these operations by functional extensions based on the status quo.

In fact, each location has differences in personnel skills and performance as well as costs and trading conditions. This world-wide location framework will provide the basis for the most efficient resource allocation in the globalization of our businesses.

Figure 7 shows the geographical breakdown of sales of game titles achieving over 3 million units during the fiscal year under review.

Figure 2 Net Sales and Recurring Income

Figure 3 Operating Income by Business Segment

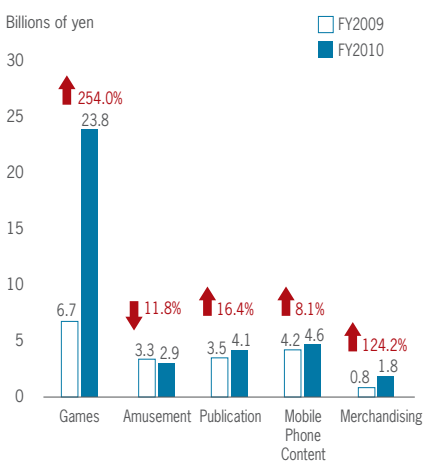
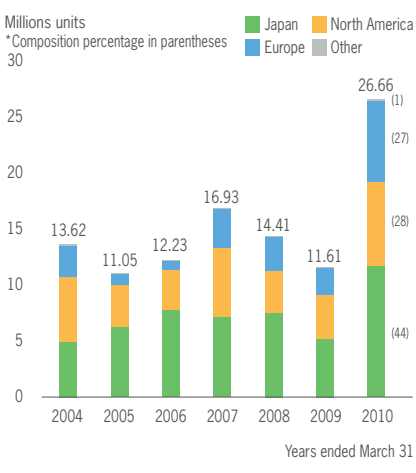


Figure 4 Game Software Sales by Region



In the case of “FINAL FANTASY XIII,” cumulative sales reached 5.55 million units as of March 31, 2010, which were evenly distributed across our geographies of Japan, North America and Europe. Only released in Japan, “DRAGON QUEST IX: Sentinels of the Starry Skies” has reached 4.26 million units. On the other hand, “Batman: Arkham Asylum” had very modest sales in Japan but sold 3.24 million units mostly in North America and Europe.

Our global development is not the release of all titles in all regions, nor is it game development in a certain region for meeting any individual, regional taste.

As we maximize the unique strengths of each title, sales performance may vary depending on regional preference. The globalization we pursue achieves an optimal balance of products across the Group through combinations of such strong titles.

The fiscal year under review, which enjoyed several big title releases, serves as a good example of the direction we are pursuing.

As network environments continue to develop around the world, the international flow of content is speeding up. Now, there are no obstacles other than language.

In marketing segmentation, while culture continues to be a factor, user location has little meaning.

As a result, segmentation by “individual customer preference” is the truly vital issue.

In this way, we have first established a globalization “skeleton” for which we will be adding “nerves” and “muscle” going forward.

In the current fiscal year, it is critical that we further strengthen our organization. Our focus is to establish organic connections across the Group and raise the business execution skills of each internal organization.

In the area of geographic expansion, our biggest work ahead is the development of our business in China, on which we shall place a top priority going forward.

Becoming “Network Centric”

While continuing to show strength in the market and serving as a pillar of our online earnings, eight years have passed since the service launch of our “FINAL FANTASY XI.” The fiscal year ended March 31, 2010 was an interim year. For large scale MMORPGs, the fiscal year ending March 31, 2011 will include our launch of “FINAL FANTASY XIV.”

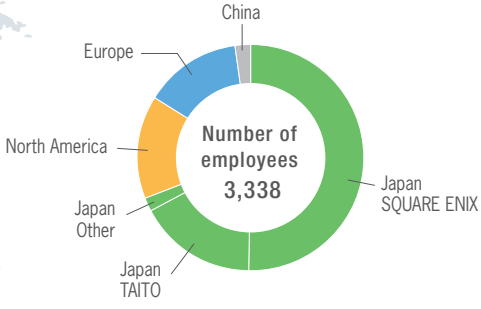
At the same time, we have started to see our new initiatives bear fruit.

In order to successfully position our “SQUARE ENIX MEMBERS” as a net-based customer contact point for the entire Group, we began the full-fledged strengthening of this operation during the fiscal year under review. With over 1.5 million registered members worldwide, we have now reached a good starting point for business development.

Further, at SMILE-LAB Co., Ltd., a wholly-owned subsidiary established in February 2008, we have created a successful

Figure 5 SQUARE ENIX Group Network

Figure 6 Number of Employees by Region



avatar-based casual portal site called “Nicotto Town.” We felt this type of community service is a promising business area and that it would be difficult to generate such ideas from our current employees. Therefore, we created a separate entity independent from the Group in which all company staff came from the outside. Created in September 2008, “Nicotto Town” has successfully issued over 500,000 IDs, allowing SMILE-LAB to already reach profitability in the fiscal year ended March 2010.

In the increasingly important area of downloadable content, we are releasing over 50 downloadable titles for game consoles alone during the fiscal year under review.

We are also placing a priority on games for new devices such as smartphones. This has included, for example, game titles for iPhone/iPod touch like “CHAOS RINGS,” “SPACE INVADERS INFINITY GENE,” and “FINAL FANTASY,” which each reached #1 in sales rankings on the App Store.

Additionally, we are making steady progress in the development of social network games.

However, the true impact of networks is not only on the content layer that I’ve described so far. There will be a structural transformation of business in which the very core of the ecosystem changes.

How will the distribution of the profit generated from the market change under a network centric model?

Put another way, what will happen to profits among the various market participants due to changes in media?

In the prior game media shift from mask ROM to CD, the benefits generated by improvements such as production cost savings and inventory risk reduction were shared by customers and software developers. As a result, profits at platform manufacturers improved and the entire industry grew.

So, what is happening this time? Cost savings resulting from the shift in media from discs to networks are mostly becoming the profits of network operators. Further, the reality is that customers are demanding price reduction in excess of the cost savings.

Without a successful network strategy, software developers will face structural difficulties in making profits.

On the other hand, these challenges are also accompanied by opportunities.

Through the use of a common infrastructure, it is possible for us to become a network operator or even a platform holder.

We plan to transform ourselves into a “community platform operator.”

How will market growth change in a network-centric world?

In comparison with physical media, the pricing of network-based content is clearly falling. This will be a negative factor for industry growth.

However, there will be a far greater positive boost from the wider geographic reach and larger potential customer-base offered by the very nature of networks.

Furthermore, we will be able to create a variety of new business models that were not possible in the packaged software business. In-game item sales are just one of the early examples of what is coming in the future.

This, therefore, represents a business chance for companies

Figure 7 Sales of the Main Titles by Region

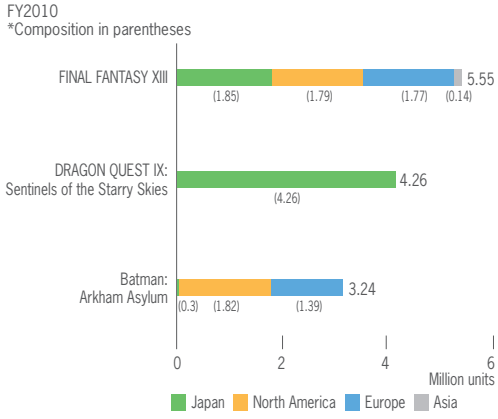
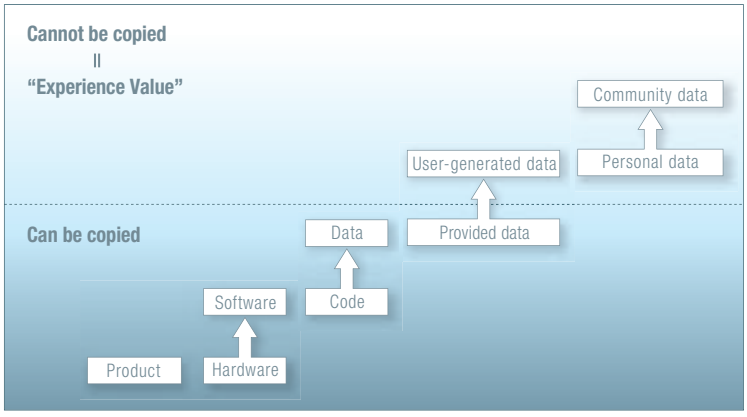


Figure 8 Shifts in Value



that are fast and flexible in business development.

The die is cast. We shall not refuse to face this reality.

By properly reading the trends in networking, we can utilize this torrent of changes to our advantage.

I would next like to discuss the importance of networking from another perspective.

That is, how are customer perceptions of value shifting?

A shift from hardware to software is one theme that has been around for a long time.

However, this represented only the starting point for further shifts in value.

We can learn more about the shift in value by looking at phases of the value shift for software. Within software, value was originally found in code, but later transitioned to data. This value flow can be seen using personal computers as an example. Value first shifted from PCs to application software. However, while application software such as spreadsheets was initially highly valued, commoditization of the application occurred and value shifted to the data used for input to the application.

The value found in data can be broken down further. In games, for example, game-play data (user-generated data) is becoming more important than the enormous amount of data for use in games (provided data). In Asian markets an example of this has been the emergence of games that are often distributed free of charge, creating business models that generate earnings from in-game item sales. Such new business models are examples of the value shift within software. Taking this a step further, the value of individual user data will likely be surpassed by community data.

The latter part of the shift is driven by network infrastructure.

The characteristic of "bit" data that allows perfect copies at no cost has created the destructive power of widespread diffusion.

However, because of this diffusive nature, "bit" data has lost its rarity value. On the other hand, with the emergence of user data and data shared among users, bit data can finally achieve rarity and value.

Earlier, I discussed our Group's transformation into a community platform operator.

By this, I mean that we are shifting from a creator of game data to a manager of individual and community data.

Strengthening Own-IPs

In establishing networks at the core of our business, we shall have a free hand in deploying certain titles into various content and services. While it is impossible to predict what future opportunities might be possible at the time of original title development, the current copyright system gives only IP holders the rights to determine what modifications can be made. As a result, titles based on external IPs face the risk of structural bottlenecks in business development.

This is why we insist on focusing on our own-IPs.

At SQUARE ENIX and TAITO, almost all of our titles are our own-IPs. And with the acquisition of Eidos, we increased our stable of AAA and potential AAA titles including "Tomb Raider," "Hitman" and "Kane & Lynch," to name a few.

We, of course, are also continuing to challenge ourselves in the creation of altogether new titles as well.

These are the three pillars of our growth strategy.

Constant Improvement

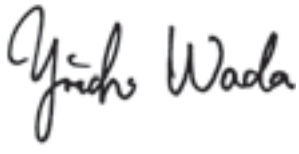
It takes strength to support transformation. In preparation, we took reinforcement measures in the fiscal ended March 2010.

These included a slimming of our content production account and an accelerated amortization of goodwill.

We also conducted a headcount adjustment to strengthen our fundamentals and energize the organization. Our over 350 new graduate and mid-career hires were more than offset by a headcount reduction of over 800, resulting in a net decline of 457 employees.

We achieved record profit in the fiscal year under review.

However, this industry is deep in the middle of a rapidly changing operating environment.

As I have discussed, we are making every effort to become the industry leader in the next evolutionary stage. In these endeavors, I look forward to your continuing loyal support.

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