

January 1, 2023

## A New Year's Letter from the President

I would like to begin by wishing everyone a Happy New Year.

Countries around the world experienced soaring inflation in 2022. The US Fed accelerated the pace of its tapering effort at the outset of the year, and Russia's subsequent invasion of Ukraine resulted in heightened geopolitical risk that drove up resource prices and caused supply chain disruptions. The Fed and other central banks then embarked on a round of rapid policy rate hikes that spurred a substantial rise in long-term interest rates. Stock prices plunged, especially in the tech sector, and IPOs stalled. This chain of events continues to cast a major shadow over global capital markets. The impact on our lives in Japan also mounts with each passing day as the dramatic depreciation of the yen has ballooned prices on imported raw materials, triggering further inflation.

Coming just as we were seeing promising signs of the world moving beyond the three years of the COVID-19 pandemic, these tremendous changes in the macroeconomic environment also pose a variety of risks to the digital entertainment industry. In particular, the semiconductor shortage has constricted hardware supplies, which has had more than a minor impact on the operation of our Group's businesses. Steering our businesses amidst this uncertainty remains challenging. However, we expect these conditions to ameliorate in the early spring, which we hope will provide a tailwind to the achievement of our Group's medium-term business plan, which can be found [here](#).

Based on this understanding of our environment, we ascribed two purposes to the year 2022. The first was to lay the groundwork for our fiscal year running from April 2023 through March 2024, which is the final year of our current medium-term business plan. The second was to implement structural reforms that looked even farther out. For these reasons, we undertook a major overhaul of both our development and publishing organizations, with a focus on our core existing Digital Entertainment business.

On the development side, we sold three studios—Crystal Dynamics, Eidos-Montréal, and Square Enix Montréal—as well as associated IP to Embracer Group in August of last year. The objective of this divestment was to further concentrate our resources as the increasing sophistication and complexity of game development have made such endeavors more costly to pursue. This divestment represents part of the aforementioned structural reforms and was designed to effect

fundamental change in our portfolio of studios.

We will also start to reconfigure our Group's portfolio of titles for the medium to long term. To that end, we will accelerate our efforts to strengthen our internal development capabilities by further expanding our internal talent pool, while also more quickly concentrating our resources on the development of titles that are competitive globally. The remarkable growth in the scale of modern game development has made elevating the skill sets and focusing the efforts of our development teams more important than ever.

Divesting studios and strengthening our internal development capabilities may on the surface appear to be moves that are at odds with one another. However, we must flexibly and constantly revisit our medium/long-term title portfolio and the development studios that create it in light of the environment in which we find ourselves. As such, both of these moves are essential if our Group is to continue to provide entertainment that meets the needs of an evolving world. We will continue to review our development organization and use M&A and other methods to optimize our studio portfolio by both organic and inorganic means, thereby ensuring that we continue to strengthen our internal development capabilities.

On the publishing side, we are moving away from the previous geography- and function-based model under which our Japanese and Western publishing organizations operated independently of one another. Instead, we are creating an end-to-end global publishing organization based on the concept of "One Square Enix." We launched this new structure late last year with close cooperation between our two Chief Publishing Officers (CPOs), a newly created role. We undertook especially thorough changes to the organizational structure of our Western operations, adopting a sales and marketing structure optimized to match the new studio portfolio created by the divestment of our three overseas studios. We are expanding our functions so that we can capture as much of the upside as possible from the digital shift that has been gaining momentum since the outbreak of the pandemic.

By simultaneously strengthening our development and publishing organizations, we will further enhance our Group's presence as a global publisher and achieve new growth for our core existing Digital Entertainment business.

In terms of new business domains, we named three focus investment fields under our medium-term business plan. Among those, we are most focused on blockchain entertainment, to which we have devoted aggressive investment and business development efforts. Looking externally, I think it is fair to say that blockchain gained significant recognition as a field in 2022, as evidenced by

“Web 3.0” becoming a firmly established buzzword among businesspeople. However, the year also saw volatility in the cryptocurrency and NFT (non-fungible token) markets that tracked the dramatic shifts in the macroeconomy described above. The latter half of the year in particular produced a somber string of news stories with blockchain connections, including the scandalous bankruptcy filing of FTX in November.

In the wake of these developments, we hear rumblings from some countries of early moves to regulate such businesses more strictly. In Japan, meanwhile, the drive to encourage such businesses has gained momentum, led by the government. In June 2022, the Japanese cabinet signed off on a plan called the “Priority Policy Program for Realizing a Digital Society,” which includes wording regarding the creation of an environment for promoting the Web 3.0 concept, including the use of NFTs based on blockchain technology. Japan’s Digital Agency also launched a Web 3.0 study group.

New technologies and frameworks lead to innovation, but they also create considerable confusion. Having ridden out such societal tides, some such technologies and frameworks gradually become part of people’s lives, eventually giving rise to new businesses and growth. Following the excitement and exhilaration that surrounded NFTs and the metaverse in 2021, 2022 was a year of great volatility in the blockchain-related space. However, if this proves to have been a step in a process that leads to the creation of rules and a more transparent business environment, it will definitely have been for the good of the growth of blockchain entertainment.

Keeping a steady eye on these environmental changes while considering from a higher-level perspective what Web 3.0 and blockchain entertainment are actually all about presents a different vista than if we focus on them solely in technological or speculative investment terms. As I said in last year’s New Year’s letter, if we consider traditional gaming to have been centralized, then blockchain gaming must operate based on a self-sustaining decentralized model. It is that concept, that philosophy that I see to be key.

That is to say that what sort of new experiences and new excitement our Digital Entertainment business can deliver to our customers through its game development efforts and other endeavors under the self-sustaining, decentralized concept is extremely important.

Multiple blockchain gaming events held overseas recently produced more active discussion than ever before about what makes the games exciting and what their user community looks like. The market was driven more by speculative investors than by gamers though 2021. In other words, the

content that was at the forefront was created based on the premise that blockchain and NFTs should result in monetization. However, in the wake of the aforementioned turbulence in the cryptocurrency industry, there is now a trend to view blockchain technology as a mere means to an end and to discuss what needs to happen to achieve the end of delivering new experiences and excitement to customers. I see this as a very beneficial development for the future growth of the industry.

Our Group has multiple blockchain games based on original IPs under development, some of which we announced last year, and we are undertaking preparations that will enable us to unveil even more titles this year. We are also engaged in global sourcing from an investment perspective and will continue to take stakes in promising businesses whether we find them in Japan or abroad. Blockchain has been an object of exhilaration and a source of turmoil, but with that in the rearview mirror, we hope that blockchain games will transition to a new stage of growth in 2023.

Lastly, I would like to note that 2023 is a milestone year for us in that it marks the 20th anniversary of the merger of Enix and Square. Against a backdrop of dizzying change in our business environment, we have achieved significant growth fueled by the myriad opportunities that arose over the past two decades. Our Group intends to achieve further growth by continuing our self-sustaining evolution and transformation as we remain watchful for the changes that will occur in the next decade and beyond. We will drive our businesses forward with the goal of making 2023 a year of major evolution and transformation.

I wish you all the best for the new year.

Yosuke Matsuda  
President and Representative Director,  
SQUARE ENIX HOLDINGS CO., LTD.