

SEGA SAMMY HOLDINGS
INTEGRATED REPORT 2019

Challenges

&

Initiatives

Since fiscal year ended March 2018 (fiscal year 2018), the SEGA SAMMY Group has been advancing measures in accordance with the Road to 2020 medium-term management strategy. In fiscal year ended March 2019 (fiscal year 2019), the second year of the strategy, the Group recorded results below initial targets for the second consecutive fiscal year. As for fiscal year ending March 2020 (fiscal year 2020), the strategy's final fiscal year, we do not expect to reach performance targets, which were an operating income margin of at least 15% and ROA of at least 5%.

The aim of *INTEGRATED REPORT 2019* is to explain to stakeholders the challenges that emerged while pursuing Road to 2020 and the initiatives we are taking in response.

Rapidly and unwaveringly, we will implement *initiatives* to overcome *challenges* identified in light of feedback from shareholders, investors, and other stakeholders.

Cultural Inheritance

Innovative DNA

This was the birthplace of milestone innovations.

The headquarters of SEGA shortly after its foundation



Company credo: "Creation is Life"

SEGA

A Host of World and Industry Firsts

In 1960, we brought to market the first made-in-Japan jukebox, *SEGA 1000*. The product name was based on an abbreviation of the company's name at the time: Service Games Japan. Moreover, this is the origin of the company name "SEGA."

In 1966, the periscope game *Periscope* became a worldwide hit. In the 1970s, the company capitalized on the video game boom to increase its standing as a manufacturer of amusement machines.

The SEGA brand became synonymous with innovation by marketing a series of world-first and industry-first products. For example, from the 1980s onward, we launched the motion-controlled game cabinet *Hang On* and a 3D computer graphics (CG) fighting game, *Virtua Fighter*. Also, we debuted the *Print Club* amusement machine for printing stickers, known in Japan as "*purikura*" and a favorite amusement machine genre to this day. In the 2000s, we released a kids' card game.

Consistently Innovative

After entering the home video game console market in the 1980s, SEGA remained an innovator. Representative examples of this innovativeness include the first domestically produced handheld game terminal with a color liquid crystal display (LCD) and *Dreamcast*, which was launched in 1998 as the industry's first home video game console including a communications modem as a standard feature and offering the players the option of using the internet to enjoy games. This became SEGA's last hardware offering as the company withdrew from the home video game console area in 2001. However, the intellectual properties (IP) of the home video game console era, such as *PHANTASY STAR ONLINE*, are valuable management resources that underpin SEGA's current businesses.

Leveraging the innovative DNA expressed by its "Creation is Life" company credo, SEGA has consistently opened up new horizons in entertainment. We will continue passing this DNA on to future generations.



SEGA 1000
©SEGA



UFO CATCHER
©SEGA



Print Club
©SEGA



Dreamcast
©SEGA

The history of the "Always Proactive, Always Pioneering" company began in the room of a small apartment.

Sammy's predecessor, Satomi Corporation



Company credo: "Always Proactive, Always Pioneering"

Sammy

A Corporate Culture That Accepts Failure

Sammy's history goes back to 1965, when current Chairman and Group CEO (Representative Director) Hajime Satomi changed the name of a family-run tofu store to "Satomi" and began selling amusement machines. In 1975, the amusement machine manufacturing and marketing divisions of Satomi Corporation were split off to establish Sammy Industry Co., Ltd. The new company then experienced a series of successes and failures that culminated in the creation of highly original products through the manufacturing and sales of Arrange Ball and earnest entry into the development of amusement machine. The experiences of this era are both the source of a corporate culture that accepts failure if it results from taking on ambitious initiatives as well as the source of the "Always Proactive, Always Pioneering" company credo.

"Always Proactive, Always Pioneering"— The Driver of Sustaining Growth

Sammy entered the pachislot machine market in 1982. To compensate for its comparative lack of brand power, the company competed with major manufacturers by developing products with features that were unprecedented in the industry. The company's strategy bore fruit with the launch of the single-bonus hitter pachislot machine, *ALADDIN*. In 1995, we entered the pachinko machine market and remained at the forefront of the latest developments. For example, we used external IP and incorporated LCD visual effects, features that have now become standard in the industry. A combination of groundbreaking gameplay, tie-in with popular animation, and unique LCD visual effects ensured that pachislot machine *Pachislot Hokuto No Ken* met with a tremendous acclaim in 2003. The title became a hit for the ages by shipping more than 620,000 units, a single-title sales record that is still unbeaten. Our corporate culture—which maintains an uncompromising, proactive mindset and rigorously pursues quality—is part of our DNA. We will cherish this culture as the force that drives and sustains our growth.



ALADDIN

©Sammy



Pachislot Hokuto No Ken

©Buronson & Tetsuo Hara
©Sammy



Pachinko CR Hokuto No Ken

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Unceasing Self-Reform

From Management Integration to the Present Day

Since its management integration in October 2004, the SEGA SAMMY Group has been implementing reform measures continuously.

Main Business Developments

2004
- Established SEGA SAMMY HOLDINGS INC.

2005
- Acquired all of the outstanding shares of The Creative Assembly Ltd. to make it a wholly owned subsidiary

2006
- Acquired all of the outstanding shares of SPORTS INTERACTIVE Ltd. to make it a wholly owned subsidiary

2009
- Established MARZA ANIMATION PLANET INC. (engaged in production of animation, 3D CG, and other visual content)

2010
- Made Sammy Networks Co., Ltd., SEGA TOYS CO., LTD., and TMS ENTERTAINMENT, LTD., wholly owned subsidiaries

2012
- Made PHOENIX RESORT CO., LTD., a wholly owned subsidiary (domestic resort business)
- Established a joint venture with the PARADISE GROUP of South Korea (PARADISE SEGASAMMY Co., Ltd.)
- Established a smartphone games business as a separate company

2013
- Acquired ATLUS. CO., LTD. (Index Corporation's game business, etc.)
- Established SEGA SAMMY CREATION INC. (development, manufacture, and sale of casino machines)

2017
- Acquired gaming machine manufacture and sales license in the U.S. State of Nevada (SEGA SAMMY CREATION INC., Sega Sammy Creation USA, INC.)
- Opened *PARADISE CITY*, South Korea's first integrated resort



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2018
- Relocated head office to Osaki (consolidated 20 companies and about 6,500 employees into the Osaki area in Tokyo)



Main Hit Titles after Management Integration

2005
- Launched the first title in the *Sangokushi Taisen* series of network-enabled trading card games
- Launched the first title in the *Ryu ga Gotoku* series for home video game consoles



Sangokushi Taisen
©SEGA



Ryu ga Gotoku
©SEGA

2008
- Launched *Pachinko CR Hokuto No Ken* series, which set a record for sales of Sammy pachinko machines



Pachinko CR Hokuto No Ken
©1983 Buronson & Tetsuo Hara
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©Sammy

2009
- Launched *Pachislot Psalms of Planets Eureka Seven*

2012
- Launched *PHANTASY STAR ONLINE 2*, an online role-playing game (RPG) for PCs



PHANTASY STAR ONLINE 2
©SEGA

2013
- Launched *Puyopuyo!! Quest* and *CHAIN CHRONICLE* for smartphone
- Launched *Hokuto No Ken Chapter of Resurrection* and *Pachislot Bakemonogatari*

2016
- Launched *Persona5* for home video game consoles
- Launched *Total War™: WARHAMMER* for PC



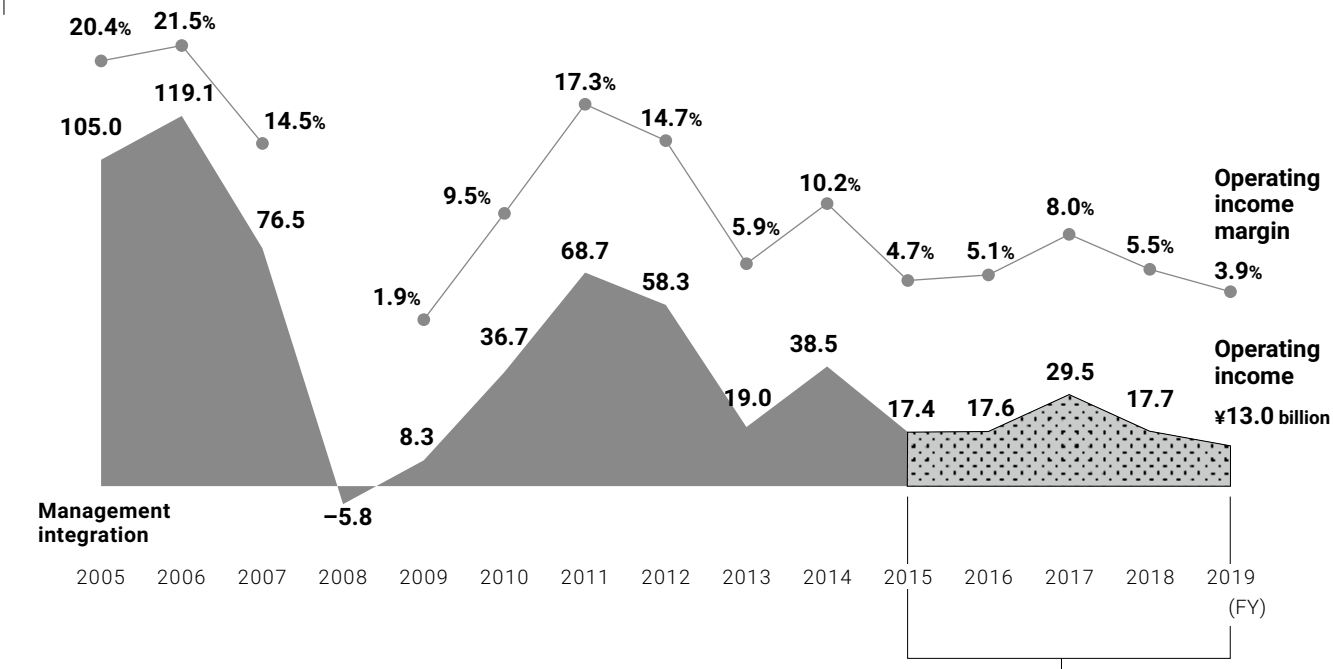
Persona5
©ATLUS ©SEGA
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2017
- Launched *Sonic Mania* for home video game consoles



Sonic Mania
©SEGA

Operating Income (Losses) since Management Integration



Measures in Recent Years

2015 Cost Structure Reform

Reduced fixed expenses by ¥6.0 billion

Clarified core businesses
- Reorganized into three business segments

Pachislot and Pachinko Machines
Entertainment Contents
Resort

Restructured unprofitable and underperforming businesses drastically
- Withdrew from unprofitable businesses
- Offered voluntary early retirement and took other measures

Laid foundations for strengthening business portfolio management
- Split up businesses into separate companies
- Accelerated decision making

Optimized personnel deployment
- Reallocated personnel
- Focused resources on core businesses

2016 Business Structure Reform

Revised business portfolio

Growth businesses

Digital Games
IR (Integrated Resort)
Other New Areas

- Invested in growth businesses
- Grew sales

Core Businesses

Pachislot and Pachinko Machines
Packaged Games
Amusement Machine Sales
Amusement Center Operations
Animation

- Reformed profit structure
- Expanded fan base

Improved Business Efficiency

Pachislot and Pachinko Machines
- Consolidated and streamlined development and production resources

Entertainment Contents
- Disposed of non-core businesses

2017 Implementation Phase

Implemented various initiatives

Pachislot and Pachinko Machines

ZEEG

- Established joint venture ZEEG Co. Ltd. with Universal Entertainment Corporation

Packaged Games
- Acquired PC game developer (Amplitude Studios SAS)

Amusement Center Operations
- Sold asset (Shinsaibashi, Osaka)

Resort
- Transferred business (*JOYPOLIS*)
- Discontinued development of complex facility (Busan, South Korea)

2018– Toward Growth Phase

Implemented various initiatives

FY2020 SEGA SAMMY Group Mission Pyramid

Mission (Raison d'être): "Continuing to create moving experiences" —Making life more colorful—

Value (Mindset / DNA): "Creation is Life" × "Always Proactive, Always Pioneering"

Vision (Ideal self): Be a Game Changer

Goal (Specific target): FY2020 Target : Operating income margin 15% / ROA 5%

Pachislot and Pachinko Machines
Sammy...the wellspring of new ideas as an innovator in the industry

Entertainment Contents
Be a Game Changer

Resort
Be an Experiential Innovator

Group Strategy—Road to 2020

Progress

The Pachislot and Pachinko Machines and the Entertainment Contents businesses have progressed less than initially expected. As a result, we downwardly revised our initial targets in fiscal year 2018 and fiscal year 2019.

Fiscal Year 2018 Initial Targets and Results

Net sales	¥380.0 billion	→	¥323.6 billion
Operating income	¥20.0 billion	→	¥17.7 billion

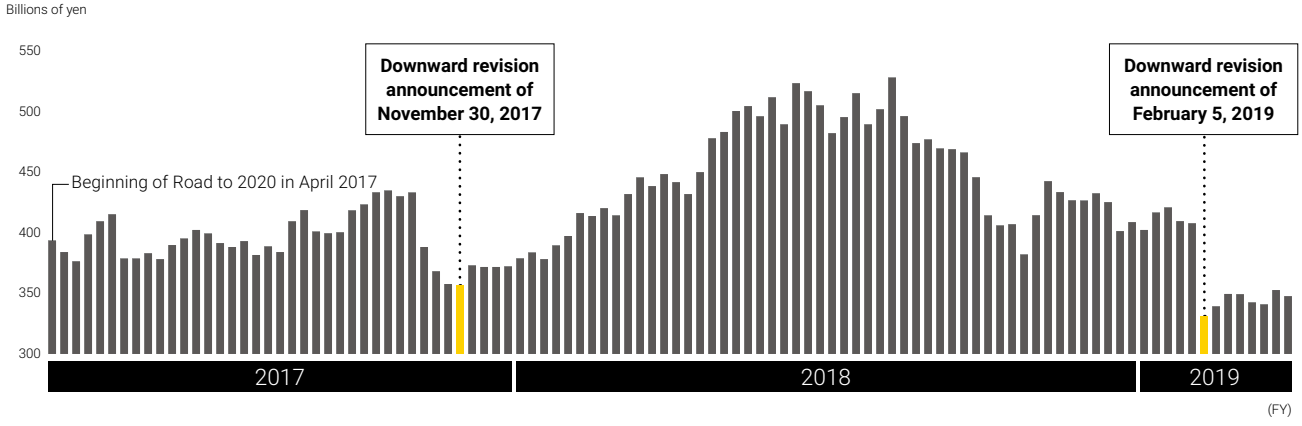
Reasons for shortfall The Pachislot and Pachinko Machines Business delayed the launch of titles due to regulatory revision. The Digital Games area marketed fewer new titles than we planned.

Fiscal Year 2019 Initial Targets and Results

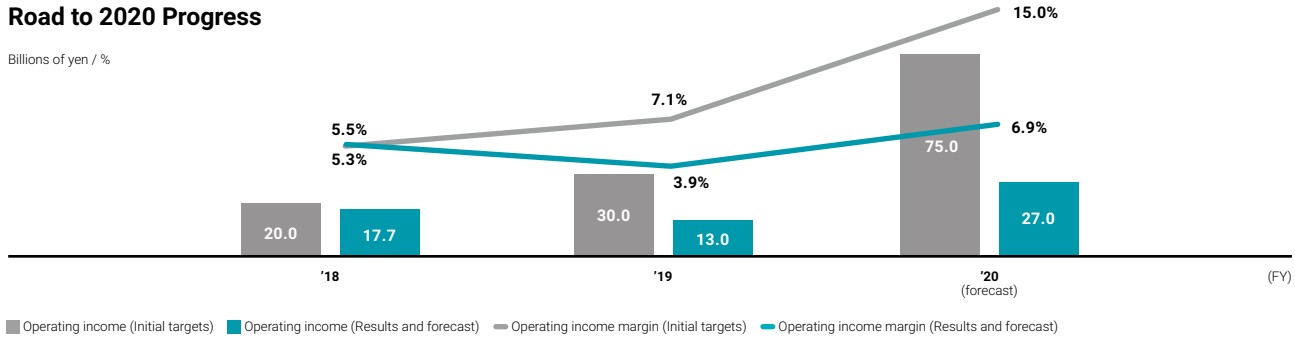
Net sales	¥390.0 billion	→	¥331.6 billion
Operating income	¥21.0 billion	→	¥13.0 billion

Reasons for shortfall Regulatory revision affected the Pachislot and Pachinko Machines Business, and there were insufficient hit titles in the Digital Games area of the Entertainment Contents Business.

Market Capitalization during the Period of Road to 2020



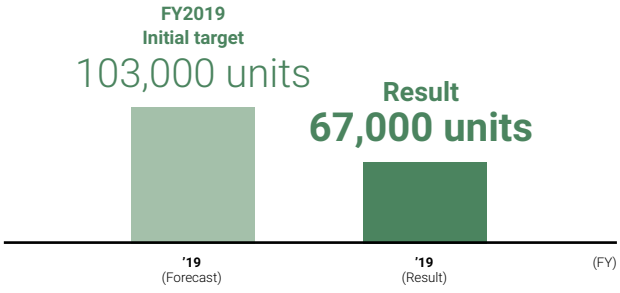
Road to 2020 Progress



Challenges & Initiatives

Pachislot and Pachinko Machines Business

Pachislot Machine Unit Sales



Challenges

Low Approval Rates

As a result of regulatory revision in February 2018, approval rates in prototype testing have become conspicuously lower. This caused the Group's pachislot machine unit sales to fall significantly short of the initial target.

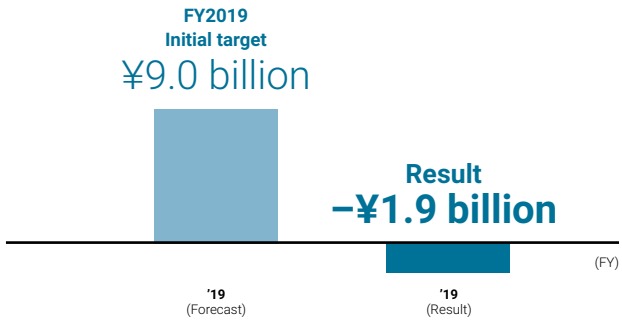
Initiatives

For details, please see P.43.

- Improve approval rates by applying for multiple specifications for both pachislot and pachinko machines
- Develop pachislot machines reflecting market trends (machines with the number of obtainable medals per game set at a higher range, machines with payouts that reflect players' skill, effective use of major existing IP)

Entertainment Contents Business

Digital Games Area Operating Income (Loss)



Challenges

External Factors

- Top-ranking titles remain unchanged
- Increase of existing IP-based titles
- Intensified competition in domestic market

Internal Factors

- Existing titles stagnating
- Lack of hit titles
- New titles delayed or canceled during development

In the Digital Games area, stagnation of existing titles went more rapidly than expected. In addition, amid intensified competition of the market we were unable to create hit titles to replace mainstay titles.

Initiatives

For details, please see P.51.

- Improve profitability by optimizing the number of titles under development and operation
- Invest resources in focusing areas such as overseas packaged games
- Proceed with shift of outsourced work on existing titles to insourcing.

Our Color Pallete

Created through the management integration of Sammy and SEGA, the SEGA SAMMY Group is a comprehensive entertainment corporate group that provides entertainment across a wide range of fields. These fields include pachislot and pachinko machines, game contents for digital games, packaged games, and other games, amusement machine sales, amusement center operations, animation and toys, and resorts.

Pachislot and Pachinko Machines Business

The mainstays of this business are industry-leading pachislot machines and a lineup of pachinko machines that we are making ever-more competitive. Boasting one of the industry's largest development systems, we will develop appealing new pachislot and pachinko machines that invigorate the industry and realize our "*Always Proactive, Always Pioneering*" company credo.



Pachislot DISC UP
©Sammy
5th version: White panels



Pachinko CR Shin Hokuto Muso Chapter 2
©Buronson & Tetsuo Hara/NSP 1983, Approved No. KOK-115
© 2010-2013 Koei Tecmo Games Co., Ltd.
©Sammy

Entertainment Contents Business

This business segment has businesses in a broad spectrum of fields, such as digital games and packaged games as well as amusement machine sales, amusement center operations, and animation and toys.



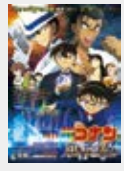
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Ryu ga Gotoku ONLINE
©SEGA



Ikebukuro GiGO
©SEGA ENTERTAINMENT Co., Ltd.



Detective Conan: The Fist of Blue Sapphire
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Team Sonic Racing
©SEGA

Resort Business

The Resort Business operates an integrated resort and a resort complex. We are taking a variety of measures with a view to accumulating know-how, heightening our profile, and ultimately participating in the integrated resort (IR) business in Japan. For example, we are assigning personnel to South Korea's first integrated resort, *PARADISE CITY*, operated through an associate accounted for by the equity method. We also operate *Phoenix Seagaia Resort*, one of Japan's premier resort complexes.



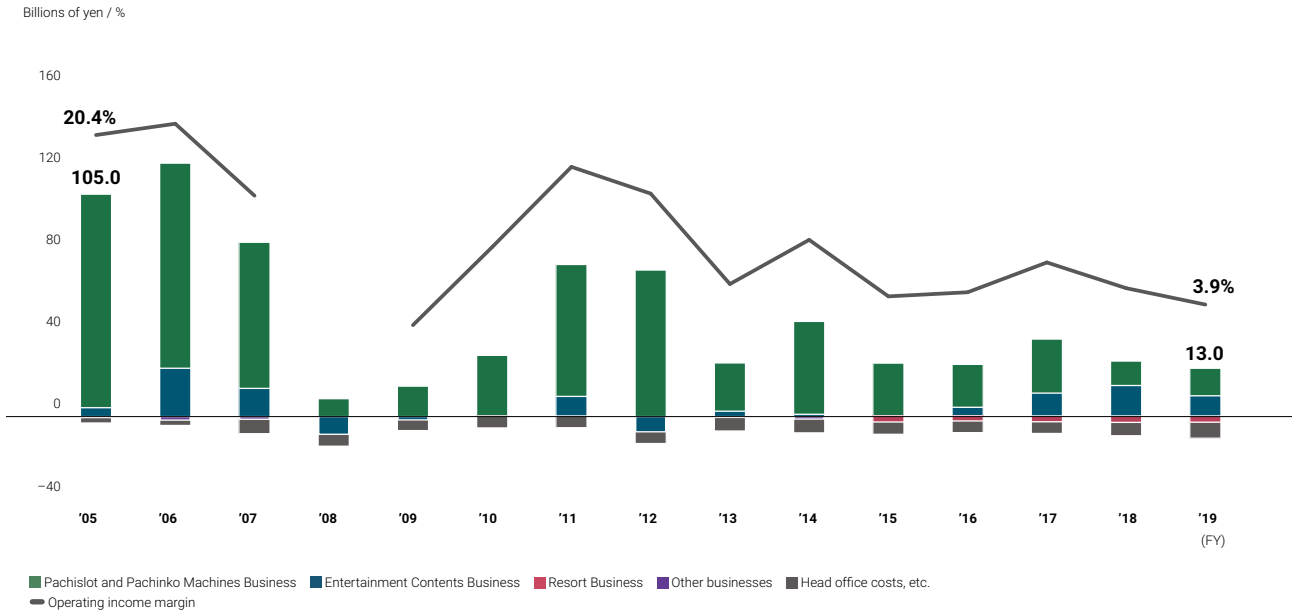
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©Phoenix Resort

Operating Income (Losses) by Segment since Management Integration*

Once the mainstay of operating income, the Pachislot and Pachinko Machines Business has been flagging due to regulatory revision. In the Entertainment Contents Business, where we have put effort to enhance, meanwhile, operating income has grown over the past three fiscal years.



* In fiscal year 2015, the Company changed its business segmentation. For fiscal year 2014 and before, the figures of the Entertainment Contents Business have been calculated by aggregating the results of the consumer business, the amusement machine sales business, and the amusement center operations business.

Key Performance Indicators for each Business Segment

Pachislot and Pachinko Machines Business

Market share of pachislot machines*	Market share of pachinko machines*
2017	2017
14.1%	9.9%
↓	↓
2018	2018
14.8%	11.6%

Entertainment Contents Business

Digital Games area	Packaged Games area	Amusement Center Operations area
FY2018	FY2018	FY2018
¥38.5 billion (Annual sales)	9.2 million units (Repeat sales)	101.9 % (Year-on-year sales at existing amusement centers)
↓	↓	↓
FY2019	FY2019	FY2019
¥40.8 billion	19.35 million units	104.0%

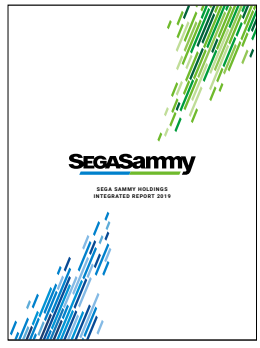
Source: Yano Research Institute Ltd.

* Estimates of Yano Research Institute Ltd. based on settlement dates from July to June

HOW TO READ

Composition of *SEGA SAMMY HOLDINGS INTEGRATED REPORT 2019*

To sustainably enhance its corporate value, the SEGA SAMMY Group needs to continue providing society with value through core entertainment businesses. We define the essence of entertainment as continuing to surpass customers' expectations. In other words, the Group should concentrate on continuing to provide greater-than-expected value. Our *continuing to create moving experiences* mission encapsulates this imperative.



This integrated report focuses on a "*moving experience creation cycle*," which will ensure that the formulation of *moving experiences* drives sustained enhancement of corporate value. Based on an integrated approach, the report tells a story of continuous corporate value creation and comprises the following components.

1. **Target *moving experience creation cycle***
2. **Internal and external challenges that have to be overcome to create virtuous cycles and a road map for tackling challenges**
3. **Initiatives aimed at strengthening our products and services, customers, and financial foundations**
4. **Environmental, social, and governance (ESG) initiatives aimed at maintaining virtuous cycles (society, human resources, and organizational capital)**



For the convenience of stakeholders when engaged in dialogues with us, we have issued *DISCUSSION POINTS 2019*, which summarizes particularly important points. Further, we disclose comprehensive ESG information in the "Social Responsibility" section of our website, accessible via the URL below.



https://www.segasammy.co.jp/english/pr/commu/



DISCUSSION POINTS 2019

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***Moving Experience* Creation Story**



Products and Services / Customers



Financial Foundations



Society

Cautionary Statement with Respect to Forward-Looking Statements

Statements in this integrated report regarding the plans, estimates, beliefs, management strategies, perceptions, and other aspects of SEGA SAMMY HOLDINGS INC. ("the Company") and SEGA SAMMY Group Companies ("the Group"), including SEGA CORPORATION and Sammy Corporation, are forward-looking statements based on the information currently available to the Company. Forward-looking statements include, but are not limited to, those statements using words such as "believe," "expect," "plans," "strategy," "prospects," "forecast," "estimate," "project," "anticipate," "aim," "may," and "might," and words of similar meaning in connection with a discussion of future operations, financial performance, events, or conditions. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. These statements are based on management's assumptions and beliefs in light of the information currently available to management. The Company cautions you that a number of important risks and uncertainties could cause actual results to differ materially from those discussed in the forward-looking statements, and therefore you should not place undue reliance on them. You also should not assume that the Company has any obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. The Company disclaims any such obligation. Actual results may vary significantly from the Company's forecasts due to various factors. Factors that could influence actual results include, but are not limited to, economic conditions, especially trends in consumer spending, as well as currency exchange rate fluctuations, changes in laws and government systems, pressure from competitors' pricing and product strategies, declines in the marketability of the Group's existing and new products, disruptions to production, violations of the Group's intellectual property rights, rapid advances in technology, and unfavorable verdicts in major litigation. [This INTEGRATED REPORT includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.]

Cautionary Statement for Investors and Shareholders with Respect to Nevada Gaming Statutes and Regulations

SEGA SAMMY HOLDINGS INC. ("the Company") is registered with the Nevada Commission as a publicly traded corporation and has been found suitable to directly or indirectly own the stock of SEGA SAMMY CREATION INC., and Sega Sammy Creation USA, Inc., both of which are subsidiaries that have been licensed as manufacturers and distributors of gaming devices in Nevada. Pursuant to Nevada law, the Company's shareholders are subject to the rules and regulations of the Nevada Gaming Authorities. A detailed explanation of Nevada gaming statutes and regulations can be found on the Company's corporate website:
https://www.segasammy.co.jp/english/ir/stock/regulation/

A Message from the CEO

To increase sustainable corporate value, we will unify as a Group and work with strong determination.



Hajime Satomi

Chairman and Group CEO
(Representative Director)
SEGA SAMMY HOLDINGS INC.

G E

Strong Determination

It is time to take a serious look at the issues at hand.

My involvement in the amusement machine sales business began in 1965, in the midst of Japan's economic development and at a time when people were en route to achieving wealth. I was still a student when I crossed paths with the gaming industry, which was in its infancy then, and I joined the amusement machine sales industry with the belief that, without a doubt, the industry would see major growth. In 1978, however, I experienced many setbacks, including being forced into bankruptcy after suppliers failed to pay their bills. Looking back, I think that even negative situations like this one helped me overcome several obstacles along the way, particularly because I had the support of so many people and the passion to move forward.

Since entering the pachislot and pachinko machines development and manufacturing business in the 1980s, I have always maintained this same passion for craftsmanship. Hit pachislot and pachinko titles like *ALADDIN*, *Beast King*, and *Hokuto No Ken* were major launching points for Sammy's growth. As I myself tested and exhaustively molded these titles into something that I absolutely knew would sell, I don't attribute our success to mere coincidence, but instead to "inevitability driven by passion."

Fiscal year 2019 marked the second consecutive year where we were unable to meet the initial targets for the fiscal year. Each director and employee of the Group needs to take a look within themselves and ask whether they have the passion to create *moving experiences*, and thereby win the support of our customers.

Working toward the Group's Sustainable Long-Term Development

We are making steady preparations to enter into the integrated resorts (IR) business in Japan.

One cornerstone of "Road to 2020," which covers the period from fiscal year ended March 2018 to fiscal year ending March 2020, is generating stable profits while improving income margins within our designated core businesses. At the same time, the Company has rolled out a policy to use the cash generated by our core businesses for preferential investment in growth businesses. Within that policy, the Resort Business is the one we are cultivating from a long-term perspective. We are utilizing the know-how built up from our direct involvement, from development to operations, in *PARADISE CITY*, a joint venture with the South Korea-based PARADISE GROUP and South Korea's first integrated resort, to realize part of the Group's long-term growth scenario—the introduction of Japan's first integrated resort, anticipated around 2025. The facilities had been developed as first-phase, secondary project of *PARADISE CITY* opened in September 2018 under this scenario, and we also leveraged our knowledge of amusement center operations toward opening an indoor theme park there in March 2019. We are actively promoting measures to attract Japanese customers to these facilities and are producing steady results in this regard. I have a real sense that these efforts serve not only to aid operation of our facilities but to also help us in our future activities.

Looking ahead, we see the Japanese IR business as an ace-in-the-hole for Japan (and its domestic economy) toward becoming a tourism nation. The enactment of the Act on Development of Specified Complex Tourist Facilities Areas has laid the path for relevant government ordinances and ministry ordinances to be established, after which the selection process for operators and potential sites can begin.

In addition to casino operations, I would also like to see us develop and expand into a wide range of other business areas. To this end, we are undertaking multifaceted and proactive preparations that include cultivating human resources, conducting business investigations and analyses, strengthening governance and compliance system, promoting gambling addiction countermeasures, and implementing financial benefits. I am convinced that if we realize the entry into integrated resorts in Japan, they will become a major source of income and serve as a future pillar of the Group, and with this exciting prospect, I feel the utmost passion.

Working to Overcome Our Issues and Realize Our Ideal Corporate Image

I will address each and every person.

As we task ourselves with reaching this future goal, it is imperative that we devote our full strength toward overcoming the issues at our feet. In keeping with Sammy's company credo, "*Always Proactive, Always Pioneering*," we have always brought forth the winds of change in the industry. As the embodiment of Sega's company credo, "*Creation is Life,*" we have carved innovation into the tablets of history. I would like to return now to my original point. I will take the same passion that has driven me and convey it to all Group directors and employees to awaken the spirit of innovation that is embedded in the DNA of both companies. Through these efforts, I believe that the Sega Sammy Group will tackle the issues facing it with sincere passion, and cultivate the "breakthrough power" to overcome them one after the other, and in doing so, increase corporate value sustainably and in the truest sense of the word.

As we embark on these endeavors, we ask for the continued support of our shareholders, investors, and all other stakeholders.

August 2019



Chairman and Group CEO (Representative Director)
SEGA SAMMY HOLDINGS INC.

A Message from the COO

Taking a long-term perspective, we will tackle issues sincerely and enhance corporate value.



Haruki Satomi

President and Group COO
(Representative Director)
SEGA SAMMY HOLDINGS INC.

G E

Remain Valued and Needed by Society

We will continue implementing sound, far-sighted measures.

In May 2019, the World Health Organization (WHO) officially decided to classify "gaming disorder" as a mental disease. The disorder is a severe addiction to online games and other video games that seriously affects the daily life and health of an individual. Addiction is also recognized as an issue in the pachinko and pachislot machine industry. Nonetheless, my confidence in the power of entertainment to give people vitality in their day-to-day lives remains unchanged.

In addressing addiction and entertainment's other negative effects on society, we must be sincere and tackle issues head on. At the same time, I believe that if we continue to make positive contributions in the form of *moving experiences* that outweigh negative aspects, in other words if we keep creating value surpassing customers' expectations, we can realize the goal of "*making life more colorful,*" the subtitle of our mission. In short, if we fulfill our mission society will continue to value and need us.

The aforementioned philosophy enhances corporate value continuously by avoiding behavior that meets with society's disapproval while implementing sound, far-sighted measures in pursuit of long-term profit, even if this means taking a round-about route. To ensure that we progress steadily in accordance this philosophy, we have to realize the true value of our innovative DNA, expressed in the "*Always Proactive, Always Pioneering*" and "*Creation is Life*" company credos of Sammy and SEGA. This ambition to realize long-term, sustained development of the Group is epitomized by initiatives in the IR business.

Realize the Group's Target Profile

As a Japanese company, we will advance measures with a sense of responsibility and readiness.

For more than 10 years, the SEGA SAMMY Group has been advancing initiatives focused on the IR business in Japan. We began by acquiring the shares of PHOENIX RESORT CO., LTD., which operates one of Japan's premier resort complexes. Aiming to accumulate know-how in the development and operation of casino facilities as early as possible, the Group established PARADISE SEGASAMMY Co., Ltd., dispatched employees to the company, engaged in the operation of an existing casino facility, and began developing *PARADISE CITY*. In 2017, we opened *PARADISE CITY* as South Korea's first full-fledged integrated resort, and with the 2018 opening of phase 1–2, it became a true integrated resort that includes not only a casino and hotels but also a shopping mall, a spa, entertainment facilities, and other attractions. Since it opened, *PARADISE CITY* has received strong endorsement from numerous guests. We have assigned nearly 60 Japanese personnel to the integrated resort as of the end of March 2019. In the near future, we plan to increase this to a 100. Thus, I believe that we are ahead of other Japanese companies with respect to preparations for launching a commercial IR business in Japan.

The Group has announced its intention to participate in all aspects of IR operations in Japan, including casino operations. I would like to emphasize that as the only Japanese company with competence on a par with that of world-famous casino operators, we are advancing measures with a sense of responsibility and readiness. Our acquisition of licenses for the manufacture and sale of gaming machines in the U.S. State of Nevada in 2017 is testament to this readiness. In gaining recognition of its integrity, the Group not only provided financial and tax information but also disclosed all the assets of officers subject to investigation. Also, we are proactively developing gambling addiction countermeasures. In contrast to the majority of companies, which take an after-the-fact approach focused on recovery from addiction, the Group and Kyoto University are jointly conducting the world's first

A Message from the COO

industry–academia research themed on addiction prevention.

Regarding the steps to be followed toward the opening of integrated resorts in Japan, first local governments will issue requests for proposals. We expect once operators have been selected, areas for the establishment of integrated resorts will be approved. To make sure that we convert opportunities into new businesses, we will further enhance the factors that differentiate us, which we have identified through value chain analysis of more than 118 key components.

To ensure the success of these initiatives, which are based on our long-term vision, there is a short-term task that we must tackle—improving the profitability of existing businesses.

The Progress of Road to 2020

Taking issues seriously, we will implement countermeasures.

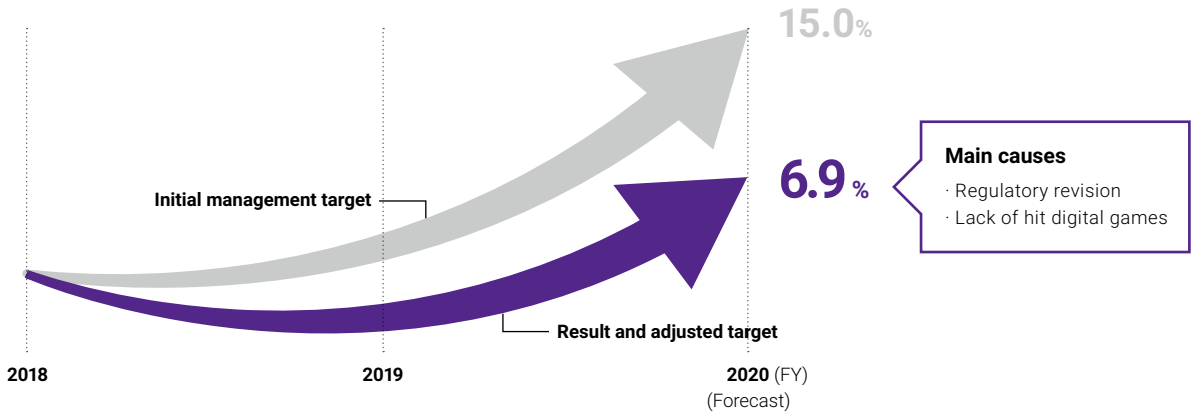
The Group's long-term vision positions integrated resorts as a third pillar. Aiming to achieve this vision, in May 2017 we announced Road to 2020, which maps out our direction through fiscal year 2020. In fiscal year 2019, and the strategy's second year, net sales increased 2% year on year, while operating income declined 26% year on year. For the second consecutive fiscal year, we did not reach initial targets. Much to our regret, we have announced the forecast for fiscal year 2020, the strategy's final year, that do not meet the management targets of at least 15% for the operating income margin and at least 5% for ROA.

One cause was greater-than-expected changes in the business conditions of the Pachislot and Pachinko Machines Business. In February 2018, regulatory revision was enforced. In the pachinko and pachislot machine market, "approval rates" in prototype testing, which is conducted based on regulations, have a major impact on the unit sales of pachinko and pachislot machine manufacturers because only machines compliant with regulations can be marketed. In fiscal year 2019, the overall market saw low approval rates and it significantly affected both the number of titles brought to market and unit sales.

Another major factor was our lack of hit titles in the Digital Games area. As well as experiencing fiercer competition in the Japanese market, we were unable to create hit titles to replace our current mainstay titles. Moreover, the consequent lengthening of the operation periods of such mainstay titles as *PHANTASY STAR ONLINE 2* is causing decline in comparison with their peak performances. In fiscal year 2019, the Digital Games area recorded an operating loss due to a combination of delays in launching new titles and development suspensions.

On the other hand, some of our initiatives produced solid benefits.

Operating Income Margin



Current Outcomes of Road to 2020

In the Pachislot and Pachinko Machines Business, measures to improve income are steadily bearing fruit.

Initially, the Pachislot and Pachinko Machines Business set out a road map that called for a dramatic rise in the operating income margin to at least 30% in fiscal 2020 through an increase in the benefits of reuse and improvements in the efficiency of development. The regulatory revision that I mentioned undermined the premises of this target. Nonetheless, we did make steady progress in improving the business segment's profit margin.

One of our priority strategies for improving the profit margin is to increase the benefits of reuse and promote the commonalization of components. Under this strategy, we greatly increased reusable components and in fiscal year 2019 reached our initial target for the number of such components. As for the commonalization of components, we have already surpassed our initial numerical targets for both pachinko and pachislot machines. Also, cost reductions are proceeding as planned thanks to the use of cost indicators to strengthen management, the revision of development schedules, and the transferring of outsourced work to insource. Regarding the establishment of an industry platform, in fiscal 2019 ZEEG Co. Ltd.—the Group's joint venture with Universal Entertainment Corporation—began joint parts purchasing and introduced common machine cabinets in accordance with plans. Although the need to respond rapidly to regulatory revision means that our efforts to improve development efficiency did not reach the initial targets, measures aimed at improving the profit margin are advancing steadily.

Main Measures of Road to 2020 (Pachislot and Pachinko Machines Business)

- **Increasing of reuse benefits**
- **Promotion of commonalization of components**
- **Cost reduction**
- **Establishment of an industry platform**
- **Improvement of development efficiency**
- **Reduction of common fixed expenses, etc.**

For details on priority measures, please see P.43.

Through such cost improvement measures, we were able to improve the operating income margin despite challenging business conditions. I believe that we have prepared the ground for a dramatic increase in income once we have overcome the uncertain environment that the current shift to new regulations has created.

In the Entertainment Contents Business, with the exception of the Digital Games area, profitability improved. The Packaged Games area saw a significant improvement in profitability in fiscal year 2019, with the operating income margin increasing 3.6 percentage points year on year, to 15.0%. The main driver of this improvement was sales growth overseas. The ratings of review websites tend to have a marked influence on the packaged games market, and our Metacritic ranking is trending upward overall. Thus, the enhanced quality of our offerings is earning favorable evaluations. Further, our measures to step up sales through the STEAM distribution platform for PC games are lengthening sales opportunities, thereby contributing significantly to increases in repeat sales and improvement in profitability. Studios that we previously acquired in North America and Europe, such as The Creative Assembly Limited. are underpinning the Group's revenues.

Further, in the amusement center operations area, existing domestic amusement centers achieved year-on-year sales growth for the fifth consecutive fiscal year. This performance reflects the tailwind provided by the 2016 revision of the Act on Control and Improvement of Amusement Business, etc., as well as the steadily emerging benefits of expanded areas for prize game machines and strengthened operations. We take pride in the fact that comparisons with peers in the amusement center operations area show the high level of our operational capabilities. In the amusement machine sales area, we are successfully expanding our customer base by introducing popular external IP, such as *KanColle Arcade* and *Fate/Grand Order Arcade*. Similarly, effective structural reform of the animation and toys area, which used to have extremely unstable business results, has firmly entrenched a structure that generates income stably.

A Message from the COO

Tasks in Fiscal Year 2020

We must develop pachislot and pachinko machines that increase approval ratio and gain player endorsement.

In fiscal year ending March 2020, the final year of Road to 2020, we are targeting higher net sales and operating income year on year.

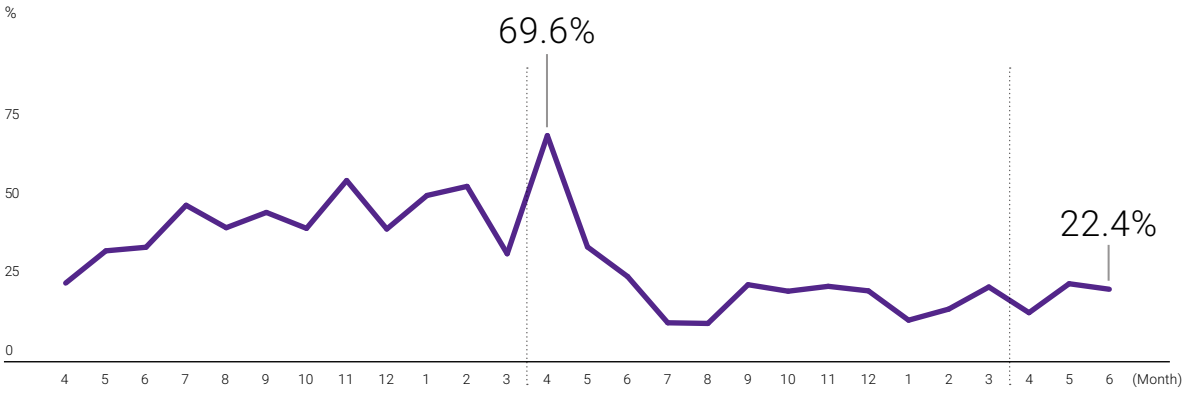
One key to the achievement of this target is the unit sales of the Pachislot and Pachinko Machines Business. Replacement demand for machines conforming to the new regulation is expected to increase as the machines conforming to previous regulation that are currently installed steadily approach their deadlines for removal. In particular, we are setting our sights on capturing concentrated demand in the third quarter, when approximately 182,000 pachislot machines conforming to the previous regulation (No. 5 models) will reach their removal deadlines. Marketing major titles to coincide with this period will be critical. If we grow unit sales as planned, we expect that the benefits of the profitability improvement measures taken to date will enable us to increase the operating income margin from 13.0% to 24.0%, a significant year-on-year improvement.

These strategies are premised on improvement in our approval ratio. Given the particularly low approval ratio for pachislot machines conforming to the new regulation (No. 6 models), the uncertainty of the short-term situation cannot be denied. Through the applications for testing that it has submitted, the Group is acquiring knowledge on testing. Going forward, we intend to heighten our approval ratio by applying for multiple specifications and other measures.

Although it restricts gambling elements, the latest regulatory revision enables the development of pachinko machines with a high jackpot continuous ratio and other specifications that the Group is particularly well qualified to realize. As for pachislot machines, changes in voluntary regulations introduced at the same time as the regulatory revision have substantially broadened the scope for gameplay.

It has become possible to develop pachislot machines that can be enjoyed in around two hours. As a result, in terms of time required, we can now compete on an equal footing with rival forms of entertainment, such as karaoke and movies. I believe that this change gives us scope for expanding our player base. Unfortunately, the Group has yet to create a hit title. However, the market is seeing the emergence of pachislot machines with very high levels of utilization. For this reason, we expect No. 6 model machines to earn solid support among players going forward. Since its launch in June 2018, Sammy's *Pachislot DISC UP* No. 5.9 model machine has become a hit, remaining near the top of pachinko halls' utilization ratio rankings and shipping more than 30,000 units. We feel this pachislot machine has garnered endorsement because to a great extent players' skill levels determine gameplay outcomes. Thus, *Pachislot DISC UP*, which has been able to realize the potential of pachislot machines by providing players with new experiential value, has been a touchstone for us.

Pachislot Machine Approval Ratio



Source: Security Electronics and Communications Technology Association

Uncompromising Creation

We have to set our pride aside and rigorously improve product quality.

I feel that a lack of hit titles is a Groupwide issue. Given that we have still not brought to market the hit titles hoped for, we need to improve product quality rigorously and thereby gain player support.

In the Pachislot and Pachinko Machines Business, while seeking a higher approval rate we will also follow a management philosophy that gives priority to long-term income and implements sound, far-sighted measures. Until we can produce titles that players endorse, we will forge ahead with these measures unwaveringly. We must face the fact that the No. 6 model machines we marketed in fiscal year 2019 met with a less than ideal reception. In the era of No. 5 model machines, after a process of trial and error, we rolled out the hit pachislot machine *Pachislot Psalms of Planets Eureka Seven*.
In the same way, by rigorously improving product quality, we try to meet the expectations of players and pachinko halls and drive market revitalization.

Similarly, in the Digital Games area we have been unable to create hit titles due to complacency in relation to product quality. As the number of titles under development and in operation increases, our preparations are not thoroughgoing enough with respect to determining the best genre and other aspects of marketing for each title or with regard to establishing operation systems that make players want to continue playing over the long term. In these respects, then, our commitment to product quality is insufficient, particularly in the initial phase of development. Further, the Packaged Games area has issues. Our system for heightening profitability by giving each development project responsibility for income has taken root. In addition, digital downloads are providing a tailwind for growth. In comparison with industry peers in Japan and overseas, however, we cannot say we are producing world-class hit titles. Due to insufficiently focused market analysis at the planning stage, we are squandering industry-leading technological capabilities on genres with weak marketability. As a consequence, I feel that we are not taking full advantage of our potential. Admittedly, the SEGA brand is known worldwide. But rather than brand power, this is nothing more than the legacy of past hit titles. We need to set aside pride in our brand and cultivate a sense of crisis because if we do not create new hit titles we will be forgotten by the coming generation.



A Message from the COO

Strategies in the Entertainment Contents Business

We will concentrate resources on areas of strength.

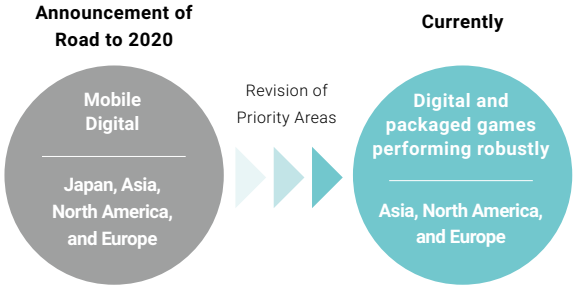
We have dramatically revamped our organization and strategies to overcome issues related to competitiveness in product creation.

When we announced Road to 2020, one of our basic strategies was to focus investment on mobile games in Japan, which was a particularly promising growth area among the Digital Games area. However, given the current intensification of competition that is accompanying softer growth, beginning from fiscal year 2020 we will switch to a portfolio strategy that concentrates resources on areas where we can exploit our advantages. Aiming to create titles that are global hits, we will shift the focus of management resources to packaged games and downloadable PC games—which are continuing to grow robustly centered on North America, Europe, and Asia—and strengthen collaborations with studios in respective countries. Meanwhile, we will continue bolstering and improving the profitability of mobile games because the market for these games in Japan, which has been the focus of our efforts, is far larger than the packaged games market.

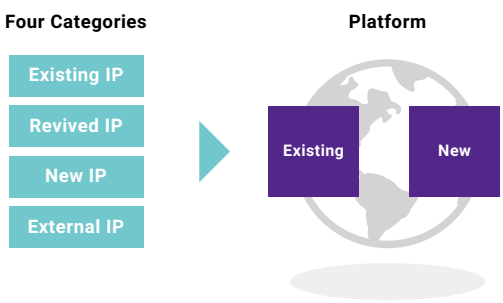
The reorganization that we implemented in January 2019 was part of this strategy. We integrated organizations that, with a view to rapid business development in each area, had been separated based on devices and classified according to such areas as "Digital Games" and "Packaged Games." While encouraging the sharing of personnel and expertise in management of development, we will step up IP-oriented rollouts. We will apportion responsibility to each manager based not on titles, as we have been doing, but on IP. As a result, these managers will put effort on maximizing the value of IP from broad viewpoints encompassing the whole world and all platforms. In step with this reorganization, we have also introduced a new management accounting system that is conducive to Groupwide optimization.

Under this new organization, we will steadily invest in such existing IP as *Sonic the Hedgehog*; revived IP, including *Sakura Wars*; external IP that have generated significant income in recent years, with *Fate/Grand Order* being a representative example; and the creation of new IP. In anticipation of the beginning of 5G services, various companies have stated an intention to enter the cloud games area. We view reaching this new market as a way of increasing our business opportunities.

Revision of Priority Areas



IP Strategy



Toward Stronger, More Efficient Group Management

We will approach business management based on the same viewpoint as that of shareholders.

The Group is also implementing reorganization aimed at strengthening and increasing the efficiency of its business management to ensure the steady advancement of strategies. Our consolidation of Group companies' head office functions in 2018 was part of this reorganization.

We consolidated accounting, personal administration, finance, general affairs, IT solutions, and other management functions that had belonged to the holding company or to

specific operating companies, thereby increasing the efficiency of decision-making processes and eliminating overlapping functions. We have also integrated functions for licensing in and out, which will give our IP strategies further support. Also, we have newly established the Resort Business Division, which manages existing resorts cohesively.

Further, we will strengthen corporate governance. We have bolstered the governance of the Group by consolidating internal audit and control functions at the holding company. At the same time, we have implemented an overall revision of the system for the compensation of directors with the aim of ensuring transparency and heightening incentives in relation to corporate value enhancement. As well as increasing the transparency of fixed compensation, the new system ensures that performance-linked compensation is strictly based on valuations of results. This system, together with the introduction of a stock compensation plan with restriction of transfer, will give senior management the same viewpoint as that of shareholders as it advances measures to enhance corporate value.

To Realize Both Social and Economic Value

The Group will convert society's expectations into opportunities.

Although we have been delayed in reaching the management targets set out in Road to 2020, we still view them as targets that we must meet eventually. At present, we are conducting analysis with a view to preparing our next medium-term management plan. At this juncture, one point that has become clear is that we not only have to be even more aware of economic value but also of social value.

The Group is steadily moving forward with efforts to reduce any adverse impact its businesses have on society. For example, we are conducting supply chain management in accordance with such principles as the elimination of child labor and forced labor and rigorous management of products containing potentially hazardous chemicals. Reuse initiatives in the Pachislot and Pachinko Machines Business exemplify the Group's efforts to simultaneously realize social and economic value. Meanwhile, the responsibilities of entertainment corporate groups are becoming onerous due to such factors as the international recognition of "gaming disorder" as an addiction. In ensuring that society continues to value and need us, I believe there may be occasions when we have to sacrifice short-term income. Turning to opportunities, however, we can help cope will the emergence of a super-aging society and other social issues through our mainstay businesses. In our efforts to sustain growth going forward, we will view society's expectations in relation to such areas as the United Nation's Sustainable Development Goals (SDGs) as growth opportunities and include concrete measures in our plans accordingly.

The SEGA SAMMY Group aims to continue implementing sound, far-sighted measures and providing *moving experiences* to society. To these ends, each employee will take issues seriously and tackle them with a sense of urgency.

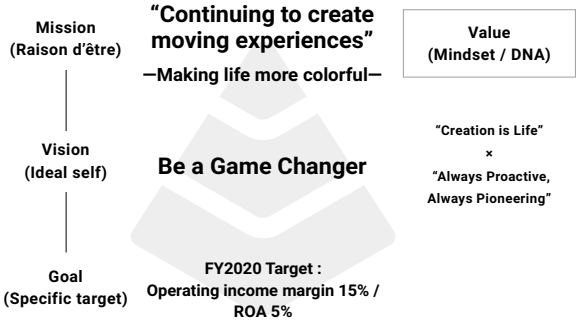
As we move forward, we would like to ask our stakeholders for their continued support.

August 2019



President and Group COO (Representative Director)
SEGA SAMMY HOLDINGS INC.

FY2020 SEGA SAMMY Group Mission Pyramid ···

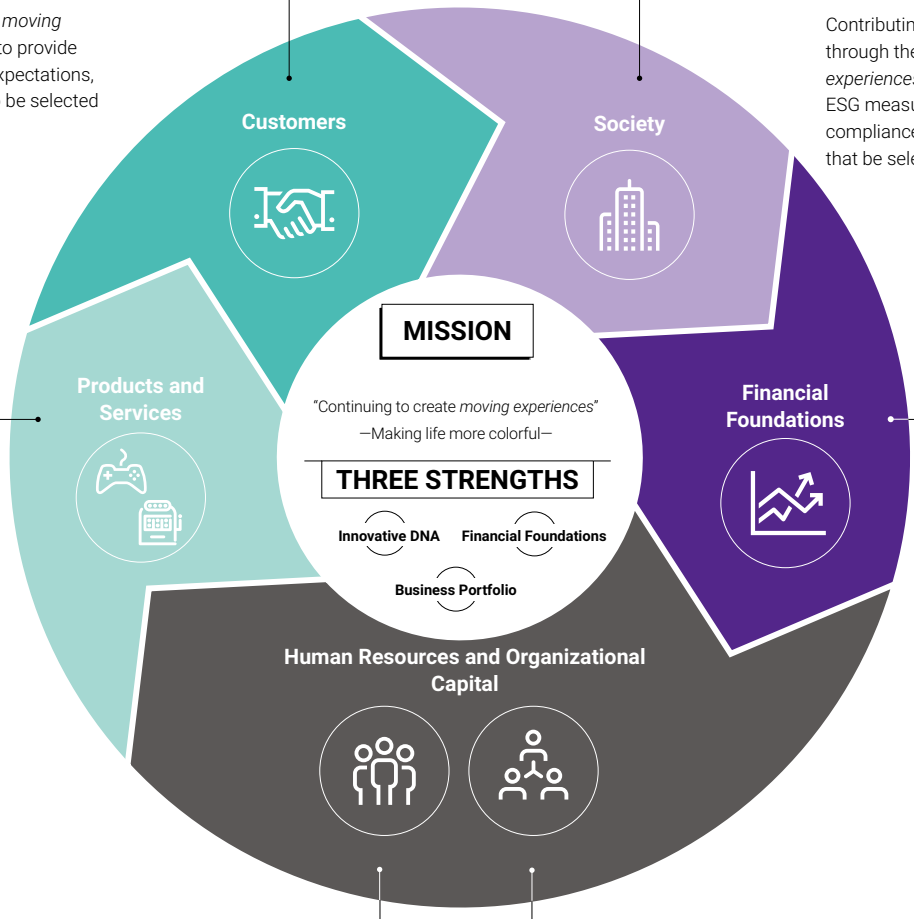




Moving Experience Creation Cycle

The SEGA SAMMY Group recognizes various issues that need to be resolved in order to realize a strong cycle of "*Moving Experience Creation Process*" that contributes to society and increases corporate value by continuing to create "*Moving Experiences*" that exceed customer expectations, rather than "Products" and "Services."

"*Moving Experience Creation Cycle*" We Aim to Realize



Ideal form

By continuously providing *moving experiences*, we continue to provide value that exceeds their expectations, so that we will continue to be selected as a company.

Ideal form

Contributing to an affluent lifestyle through the creation of a *moving experiences* and promoting SDGs and ESG measures, including thorough compliance, will make us a company that be selected by society.

Ideal form

The Group continues to create products and services that provide *moving experiences* to customers in a unified manner.

Ideal form

A robust structure that enables the creation of stable and highly efficient cash flows through a strong cycle, achieving a high total return ratio, and making sufficient investments in organizational capital and human resources.

Ideal form

Achieve stable recruitment and development of diverse human resources that will serve as sources of innovation for the sustainable creation of *moving experiences*.

Ideal form

Build an organization that shares values and enables the Group and external partners to make mutual use of management resources to continuously realize Creating *moving experiences*. As a result, we establish a SEGASAMMY brand that is a testament to the support of customers and society, and realize a virtuous cycle in which people, partners, and customers come together.

A cycle in which "Visible Assets (Financial Foundations, Products and Services)" and "Invisible Assets ("Human Resources and Organizational Capital, Customers, and Society")" are raised synergistically.

Challenges for Realizing a Strong Cycle

Challenges P.39–

We have not been able to continuously provide *moving experiences* at a level that will ensure we will continue to be selected by customers.

Challenges

Creating *moving experiences* utilizing our comprehensive strengths is insufficient. The SDGs and ESG measures have just begun.

P.64–

Challenges

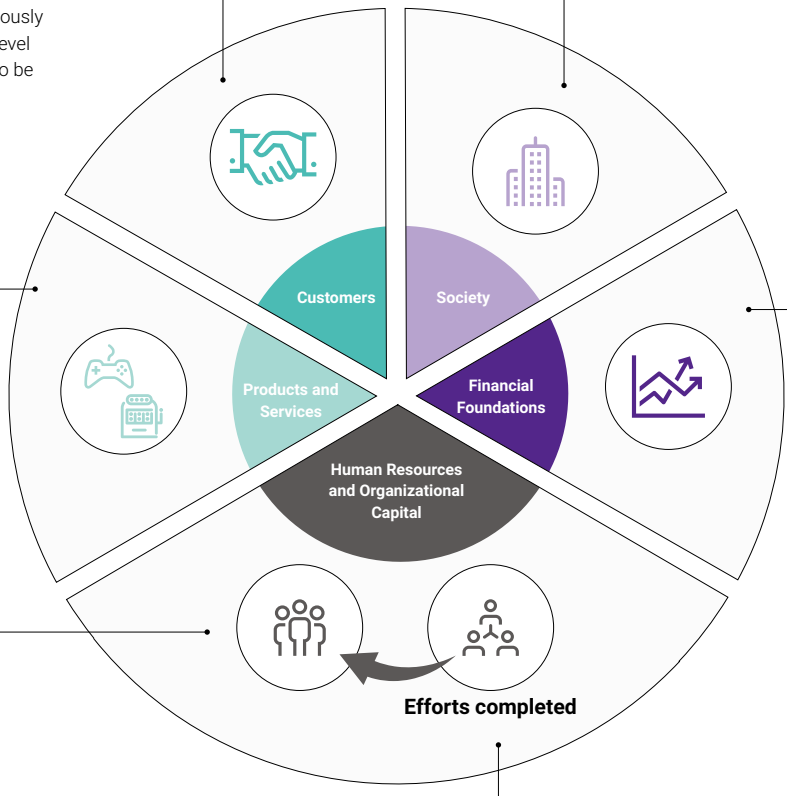
Products and services that generate *moving experiences* have not been able to provide due to some factors, such as continuous low approval rates of proto-type testing for new regulation (No. 6 model) machines and a shortage of hit titles for digital games.

P.39–

Challenges

Earnings are unstable due to insufficient cycles.

P.36–38, P.87–95



Challenges

- Although diverse ways of working are practiced based on the concept of work-style reforms it has not yet become widespread enough.
- We are promoting the sharing of values across the entire Group, but there is insufficient interaction and connection within the Group.

P.66–67

Major Initiatives

- Renewed SEGA SAMMY Group brand logo
- Relocation of head office and consolidation of head office functions
- Integration of administrative and licensing functions
- Establishment of Resort Business Headquarters
- Consolidation of Group auditing and internal control functions
- Reorganization of Entertainment Contents Business

Target Virtuous Cycles of Three Strengths

The SEGA SAMMY Group aims to achieve sustainable Creating *Moving Experiences* by unlocking the potential of its three strengths of "Innovative DNA," "Financial Foundations" and "Business Portfolio" and creating a cycle in which these strengths are synergistically enhanced.

CREATION

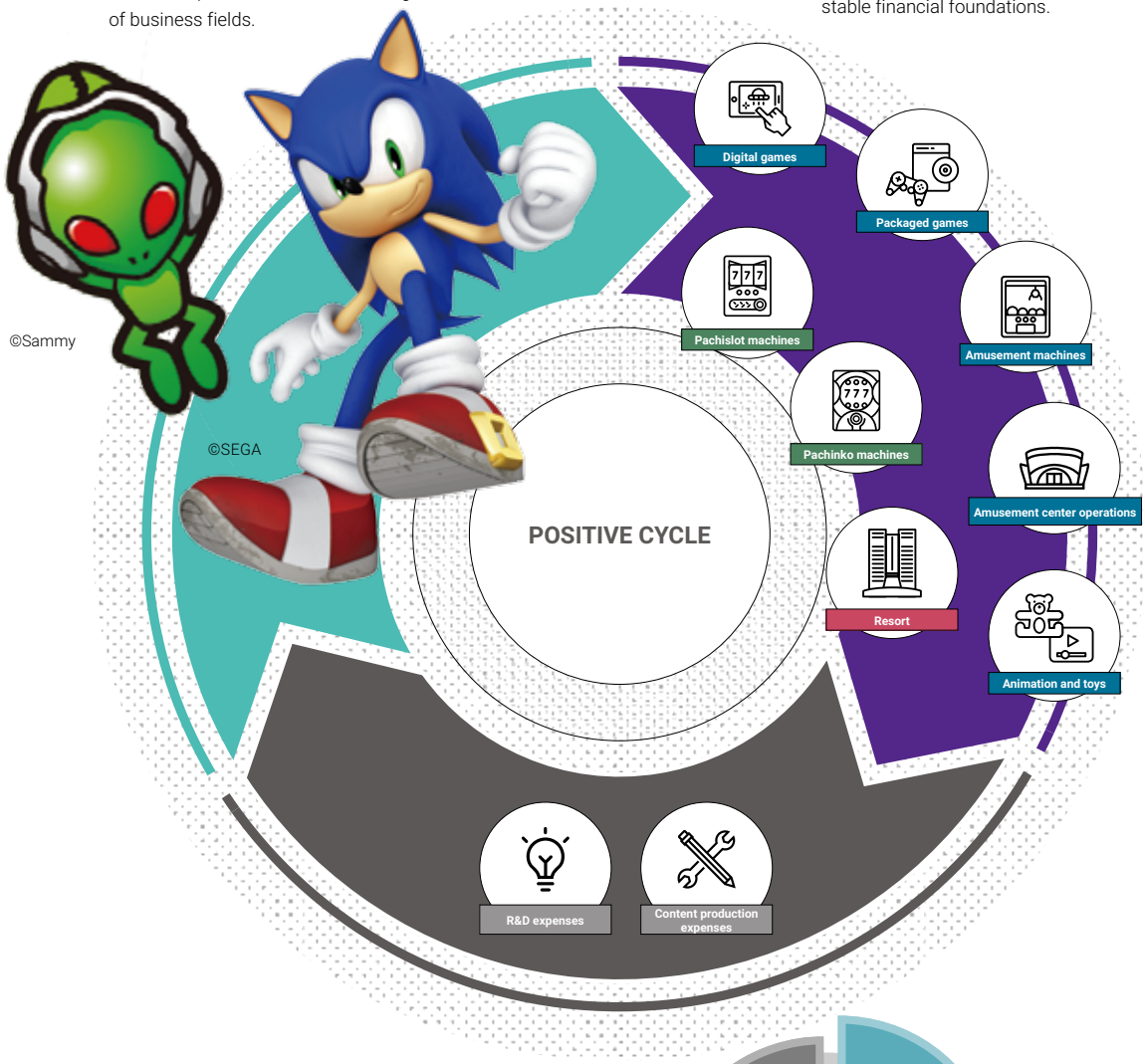
Innovative DNA

By making full use of "Innovative DNA," we aim to strengthen our business portfolio by providing *moving experiences* with unrivaled competitiveness in a wide range of business fields.

DIVERSITY

Business Portfolio

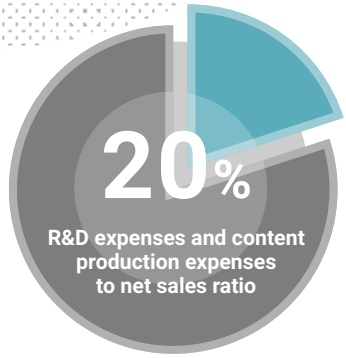
By diversifying the risk of business environmental changes, we will continue to generate stable earnings and maintain stable financial foundations.



FINANCIAL BASE

Financial Foundations

Stable investment in growth areas based on a strong financial base.
This will lead to the strengthening of the "Innovative DNA."





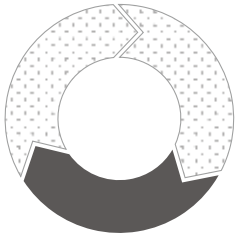
Innovative DNA

The SEGA SAMMY Group was formed as a result of the management integration of SEGA, which pursued innovation that did not exist anywhere else in the world based on the Company Credo "*Creation is Life*," and Sammy, which consistently challenged uncharted area in the industry based on the Company Credo "*Always Proactive, Always Pioneering.*" We will continue to create sustainable *moving experiences* by exploiting the creativity potential that each company has fostered and creating new "Innovative DNA" through the fusion of these strengths.



Business Portfolio

The SEGA SAMMY Group is building a well-balanced business portfolio that spans a wide range of entertainment areas through management integration. We believe that this is the foundation for sustainable corporate value expansion which supporting stable earnings even in an environment that "playing options" for users are increasing and competition for capturing users occurs in the entertainment sector, and improving asset efficiency by effectively utilizing a single IP in multiple businesses.

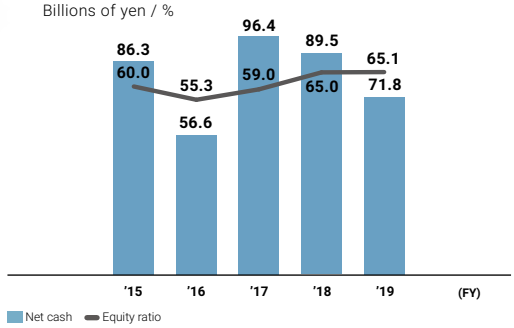


Financial Foundations

Many of our Group's businesses are so-called "hit business" in which continued development investment is required to create a hit, and the presence or absence of a hit has a major impact on profits. Financial stability and the ability to generate cash, primarily in the Pachislot and Pachinko Machines Business, support stable investment in development and enable long-term investment in Resort and other businesses.

The strong financial foundations of the Group, which enable stable investment in development, will be a competitive advantage.

Equity Ratio / Net Cash



	'15	'16	'17	'18	'19
Debt to equity ratio (times)	0.35	0.45	0.34	0.28	0.25

* Net cash = Cash and deposits (cash and cash deposits + cash equivalents) −borrowings

* D/E ratio = Interest bearing debt / equity capital rounded up to the second decimal place

Road Map for Corporate Value Enhancement

The Group is steadily implementing various measures to continuously exceed the expectations of its customers, society and shareholders on a long-term basis.

Exceed Customer Expectations

Mission (Raison d'être)

"Continuing to create moving experiences"
— Making life more colorful —

Value (Mindset / DNA)

"Creation is Life" × "Always Proactive, Always Pioneering"

Vision (Ideal self)

Be a Game Changer

Goal (Specific target)

FY2020 Target : Operating income margin 15% / ROA 5%

Pachislot and Pachinko Machines Business

Sammy...the wellspring of new ideas as an innovator in the industry

P.40

Entertainment Contents Business

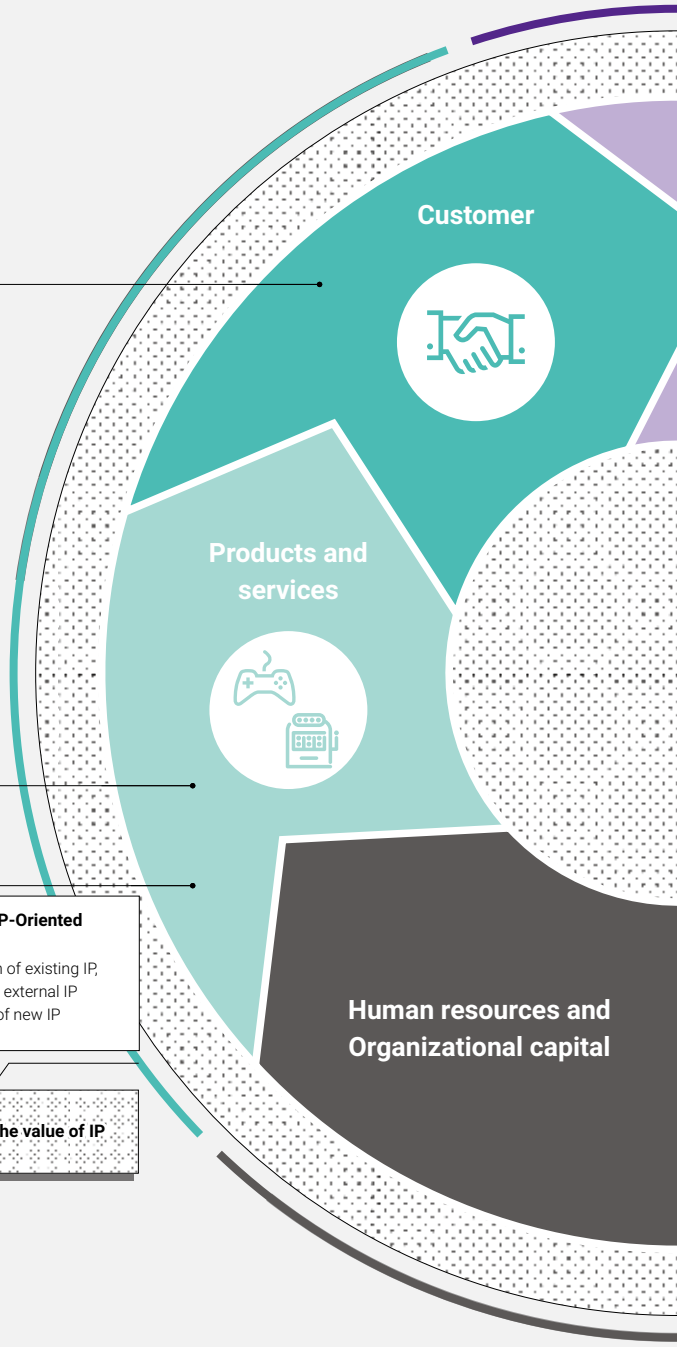
Be a Game Changer

P.48

Resort Business

Be an Experiential Innovator

P.56



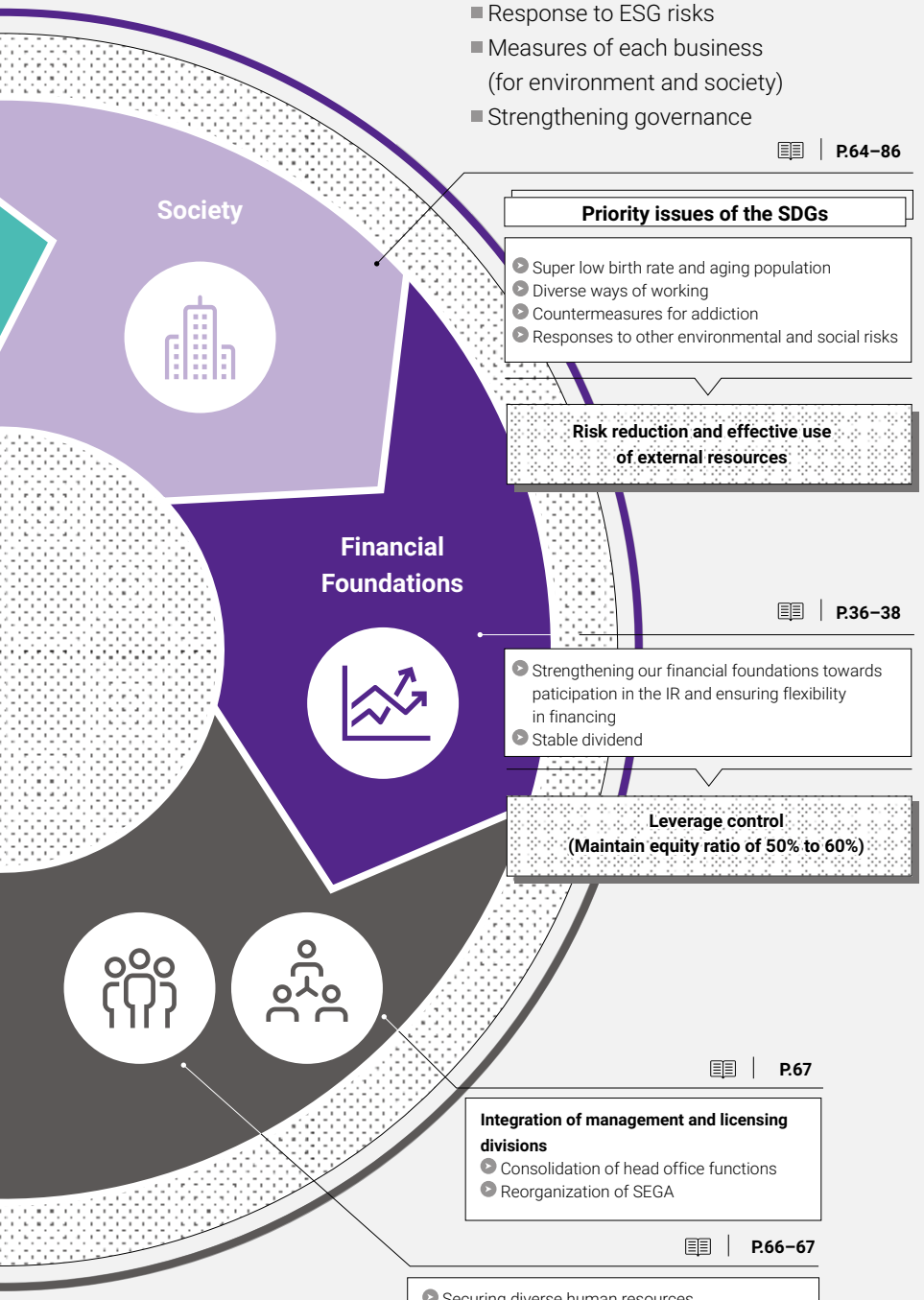
P.35, P.48–55

Promotion of IP-Oriented Strategy
- Full utilization of existing IP, revival IP, and external IP
- Introduction of new IP

Maximizing the value of IP

Reduction of Capital Costs and Simultaneous Creation of Social and Economic Values

- Response to ESG risks
- Measures of each business (for environment and society)
- Strengthening governance



P.64–86

Priority issues of the SDGs

- Super low birth rate and aging population
- Diverse ways of working
- Countermeasures for addiction
- Responses to other environmental and social risks

Risk reduction and effective use of external resources

P.36–38

- Strengthening our financial foundations towards paticipation in the IR and ensuring flexibility in financing
- Stable dividend

Leverage control (Maintain equity ratio of 50% to 60%)

P.67

Integration of management and licensing divisions

- Consolidation of head office functions
- Reorganization of SEGA

P.66–67

- Securing diverse human resources
- Shifting human resources to strategic areas
- Work-style reforms
- Human resource development (Operation of SEGA SAMMY College)

Improving personnel productivity and enhancing innovation capabilities

Surpass Shareholders' Expectations

Sustainably Enhance Corporate Value

Improving capital efficiency

Enhancing productivity and sustainability of non-financial capital

Surpass Society's Expectations

Exceed the expectations of all stakeholders

ESG Risks and Countermeasures in the Value Chain

Recognizing that the various ESG risks faced by different face-to-face markets and business models confront different types of risk, our group has taken steps to address these risks and has identified key themes for contributing to the SDGs.

PACHISLOT AND PACHINKO MACHINES

Pachislot and Pachinko Machines Business

1 3 P.40



Regulatory revision

G

Before they can be sold, pachislot and pachinko machines must receive approval through prototype testing, which determines whether machines are compliant with the Entertainment Establishments Control Law and other statutory laws and regulations. Therefore, regulatory revision can significantly affect the marketability and unit sales of pachislot and pachinko machines.

Response

We are taking steps to increase efficiency with the aim of accelerating development so that we can swiftly respond to regulatory revision. Further, we are developing machine models with diverse gameplay that a wide range of customers can enjoy casually.

Environmental burden of raw materials and the processing of recovered and surplus components

E

Sammy's manufacturing processes could give rise to surplus electrical components and other components. We use natural resources, such as wood, and materials that could place a burden on the environment, such as adhesives. Also, processing pachinko and pachislot machines at the end of their service lives is an important responsibility.

Response

We are committed to the "3Rs" (Reduce, reuse and recycle) throughout all our business processes. At the design and development stages, we are working to standardize parts and share parts between pachislot and pachinko machines, and we reuse machines removed from pachinko halls. We are promoting the use of water-based adhesives with less environmental impact.

Deterioration of image due to improper modifications or playing techniques

S

There is concern that the use of improperly modified pachinko and pachislot machines in commercial operations or improper playing techniques could harm the image of pachinko and pachislot, ultimately leading to the contraction of the pachinko and pachislot machine market.

Response

We coordinate with industry associations in a voluntary drive to collect pachinko and pachislot machines that have been improperly modified. In addition, we have established an office tasked with preventing illegal acts, which gathers market information and contributes to the manufacture of pachinko and pachislot machines that are highly resistant to improper modification. We also take measures to urge caution in relation to strategy guides that are unfounded.

ENTERTAINMENT CONTENTS

Entertainment Contents Business

1 3 P.48

Digital Games area



Excessive use by minors

S

In the digital games market, social problems associated with minors who incur excessive fees when playing games based on the Gacha system, which encourages gambling aspects, are not infrequent. Content vendors are required to take countermeasures for this issue.

Response

For certain titles, we have applied age authentication to set upper limits on monthly fees. Also, we have established and implemented in-house guidelines to avoid the use of vague terms that can give players overly high expectations and to prevent the charging of excessive fees.

Customer support

S

Unlike packaged games, digital games maintain contact between the provider and consumers. Therefore, the provision of ongoing support is necessary. Any shortcomings in such support could harm brands.

Response

Normally, we respond to customer inquiries through a player support helpdesk. If needed, however, we establish dedicated helpdesks.

Game addiction

S

The World Health Organization (WHO) has recognized gaming disorder as a mental disease.

Response

Research has begun by external experts with a fair, neutral, professional background, led by game organizations such as CESA, JOGA, MCF, and JeSU.

ESG Risks

E Environmental Risks　S Social Risks　G Governance Risks

Key Themes for Contribution to SDGs

1 Super low birth rate and aging population　2 Diverse ways of working　3 Countermeasures for addiction

P.66

Amusement Machine Sales area

Planning and development — Manufacturing — Sales — Operation

In-house Outsourcing

Compliance in relation to procurement

E S G

The amusement machine sales area has a fabless business model. If we used our advantageous position to conduct unfair business transactions or failed to comply with the applicable laws in relation to labor practices, we could become subject to legal sanctions. Furthermore, failure to conform to the worldwide strengthening of environmental regulations could lead to the rejection of our products.

Response

We strive to build fair and equitable relationships with our suppliers based on the Supply Chain Procurement Guidebook and the Group Code of Conduct. In the amusement machine sales area, which has a large number of suppliers, we have established a separate AM Material Procurement Policy to ensure fair transactions. In addition, based on the Standards for Chemical Substances in Sega machines and Products all suppliers are requested to establish and operate a chemical substance management system and are monitored.

Amusement Center Operations area

Planning and development — Procurement — Operation

In-house Outsourcing

Guidance and development of young people

S

As an operator of amusement centers, we have a social responsibility to take measures in relation to minors that comply with laws prohibiting smoking, restricting access to venues, restricting entry to amusement centers including restaurants that serve alcohol, and prohibiting alcohol consumption.

Response

We educate employees based on an operational manual that clarifies how to respond appropriately with regard to restricting minors' access to venues and prohibiting smoking. We strictly prohibit the consumption of alcohol and smoking by minors in our amusement centers.

RESORT

Resort Business

IR (Integrated resort)

Planning — Development

3 P.56

Management of IR facilities with casinos (Overseas)

Management of resort complexes without casinos (Japan)

In-house Outsourcing

Compliance violations

G

Any litigation filed against us or any penalties incurred from regulatory authorities for violations of laws or ordinances may have an impact on our brand image and possibly affect our participation in domestic integrated resort operations.

Response

Under the Group Compliance Liaison Committee, we are working to build a corporate structure that fosters the development of sound corporate management in observance of laws, ordinances, and societal norms.

Measures against addiction

S

Lack of responsiveness to social demands for measures against gambling addiction could invite public backlash and jeopardize business continuity.

Response

Through industry–academia joint research with Kyoto University we are working to develop systematic measures against gambling addiction.

Mega Trends: Opportunities and Risks

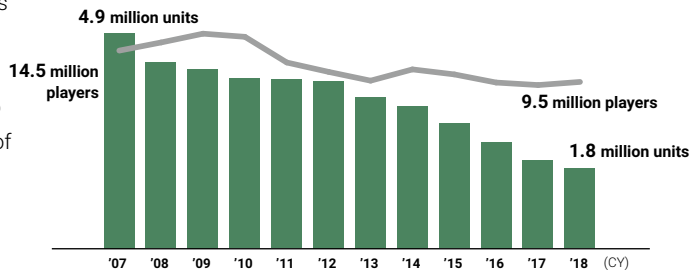
Because we conduct business activities in fields with different industrial characteristics, the business environment varies. Based on a medium- to long-term perspective, we are continuously working to expand our corporate value.

Mega Trends

Pachislot and Pachinko Machines Business

As a result of the gradual strengthening of regulations, the number of game players continues to decline and the number of units sold continues to decline. After the recent revisions of regulations that took effect in February 2018, environment are expected to broaden the base of users with divergence of playability, but the introduction of machines that meet the new has been delayed. To revitalize the market, game machines that attract a wide range of users are required to be introduced.

Pachinko and Pachislot Machine Unit Sales and Number of Pachinko and Pachislot Players



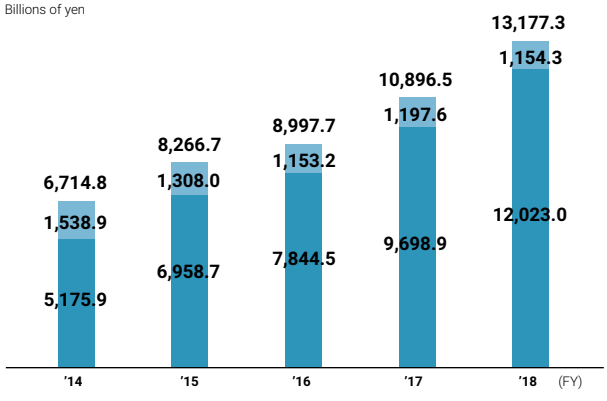
Source: Yano Research Institute Ltd.
Source: *White Paper on Leisure Industry*, Japan Productivity Center

Entertainment Contents Business

The digitally distributed games market is trending toward expansion due to increasing online distribution.

Further, Japan's mobile games market is seeing fiercer competition and increased domination by certain titles. As for the amusement center market, partial regulatory relaxation has produced a clear recovery trend.

Market Size of Packaged Game and Digital Distribution Game



Source: *Famitsu Game White Paper 2019*

*1 Total of income from digital distribution of mobile games, PC online games, and home video games
*2 Including income from packaged home video games and packaged PC games

Resort Business

In July 2018, as the Integrated Resort Development Bill, which includes casinos, was enacted, and moves toward the establishment of integrated resort, which the government regards as the trump card for "a tourism-oriented country" are gaining momentum.

Candidate locations and operators will be selected in the future.



Anticipated Opportunities and Risks	Responses

Opportunities

Possibility of expanding user base

As the scope of development has expanded due to changes in voluntary regulations, machines conforming to the new regulation may expand the user base.

Expansion of replacement demand

With the introduction of machines conforming to the new regulation, it is necessary to gradually remove machines conforming to the previous regulation according to the installation deadline, and the replacement demand is expected to increase.

Risks

Decline in the number of players

The decline in the number of players will reduce the capital investment capacity of halls and affect the number of machines sold.

Risk of approval status

The approval rate, which has remained at a low level due to the recent revision of regulations, may have a significant impact on sales.

- Promotion of reuse
- Building an industry platform
- Improvement of development efficiency
- BtoC strategy
- Application for multiple specifications
- Development of pachislot and pachinko machines in accordance with market trends

P.40

Opportunities

Expansion of the packaged games market

The packaged game market is expanding, supported by growth in the European, North America, and Asian markets.

Growth potential of the overseas online games market

The expansion of diverse game distribution platforms has great potential, particularly in overseas markets.

Risks

Intensifying competition in the domestic digital games market

The risk of not being able to realize the expected return on investment is increasing as a result of intensified competition due to a slowdown in growth of market and the fixation of top titles. (Digital Games area)

Packaged Games

- Expansion of development studios
- Expansion of overseas publishing business
- Development of next-generation titles
- Maximize IP asset value

Digital Games

- Maintenance of earnings through long-term operation of existing titles
- Optimization of the number of titles under development and operation in the Digital Games area
- Reconsidering focus area

P.48

Opportunity

Commercialization of a domestic IR business

If integrated resort is realized in Japan in the future and our group's entry into the market is realized, there is a strong possibility that this business will become a major revenue source.

Risks

Risk of entering into domestic IR business

Delays in legislation related to integrated resorts will have a major impact on our group's long-term scenario.There is also a risk that investment may not be recovered unless the Company is selected as a business entity.

Risks associated with response to addiction issues

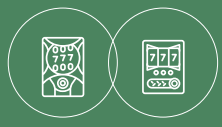
Neglecting to respond adequately to addiction issues and other social issues could expose the Group to social criticism or render sustained development of the industry impossible.

- Acquisition of know-how for the success of IR business
- Improving the profitability of Phoenix Resort
- Countermeasures to addiction

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Business Models of the Main Business Segments

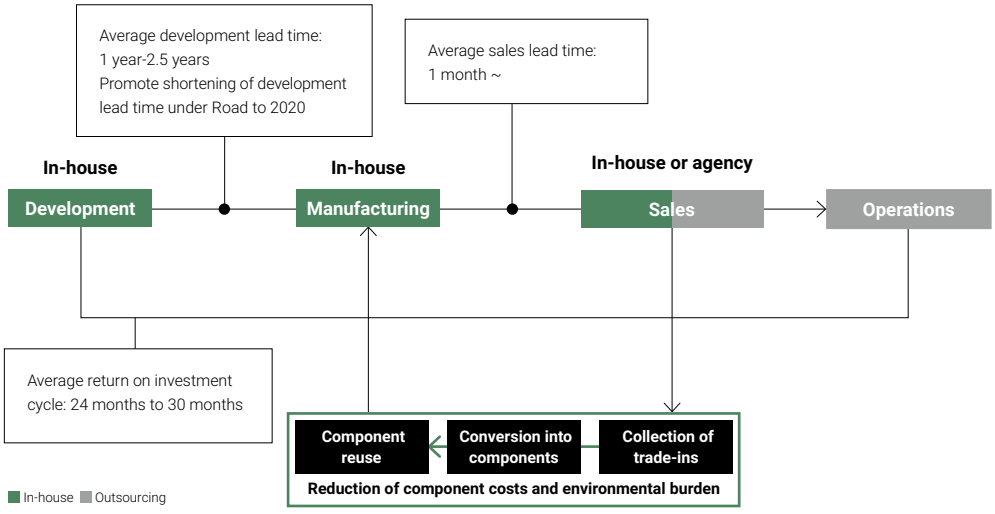
The SEGA SAMMY Group advances business activities across an expansive area in the entertainment sector, and its business models in each field are markedly different. Therefore, we tirelessly adapt our business models to better reflect changes in operating environments.



Pachislot and Pachinko Machines Business

Features of this business are the susceptibility of product cycles and profit margins to new machine installations and utilization rates at pachinko halls as well as the high percentage of costs for which electronic components account. We are taking measures to realize efficient development while reusing more components to increase cost effectiveness.

Value Chain of the Pachislot and Pachinko Machines Business

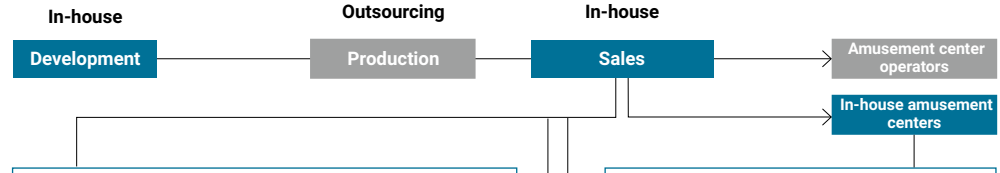




Amusement Machine Sales Area Amusement Center Operations Area

In the amusement machine sales area, we have a fabless business model. We focus on planning, design, and development and contract manufacturing to partner companies. Also, we are diversifying sales models to stimulate the market. In the amusement center operations area, our business model is based on capital investment.

Supply Chain of the Amusement Machine Sales Area and Amusement Center Operations Area



Sell out

This is a traditional business model in which revenues are recorded as products are sold.

Revenue-sharing business model

In the revenue-sharing business model, we provide low-priced machine cabinets and free contents to amusement center operators, sharing revenues from the utilization of the amusement machines with them. The aim of this business model is to stimulate the market and secure a source of continuous earnings. Increased adoption of this business model makes short-term revenue growth appear to have softened.

In-house Outsourcing

Introduction of electronic money

We are introducing electronic money to enable flexible adjustment of pricing, increase customer convenience through the realization of cashless payment, and heighten the efficiency of amusement center operations.

CVT kits

Amusement center operators use CVT kits to introduce the latest game contents or replace the boards and exteriors of existing machines. CVT kits help lessen the investment burden of amusement center operators by enabling them to upgrade games without purchasing new machine cabinets.

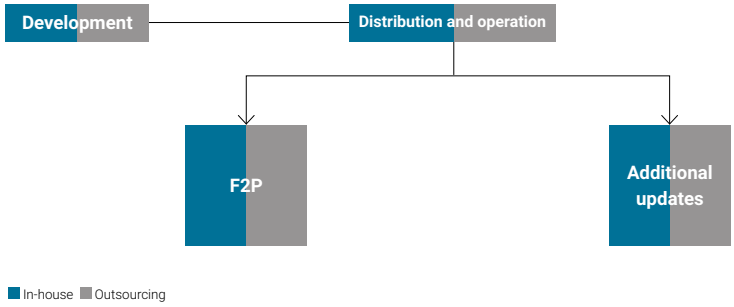


Digital Games Area
Packaged Games Area

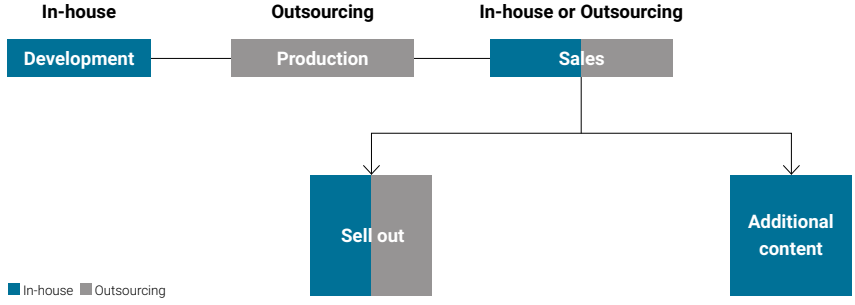
In the digital games area, F2P* is the most common business model. This model entails continuously investing in apps after their release to extend their lifetimes while recovering initial investments (development and advertising costs). In the packaged games area, as well as selling standard packaged games through stores, we are strengthening online compatibility such as download sales and distribution of additional contents, which is resulting in the increasing emergence of long-term sales patterns.

* Free-to-Play

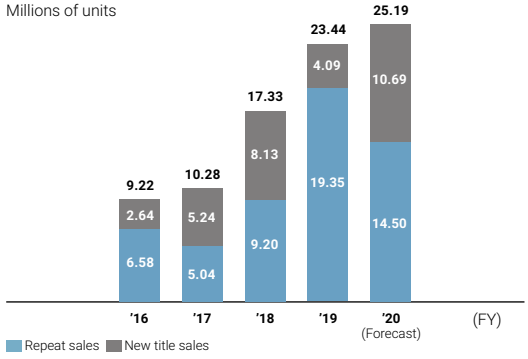
Business Model of Digital Games Area



Business Model of Packaged Games Area



Number of Packaged Games Sales
Millions of units



Increasing Repeat Sales

Digital distribution of packaged games is trending upward. The lengthening of sales is progressing due to the expansion of game distribution platforms for PCs such as STEAM. As with digital games, the diversification of revenues has also progressed, such as additional contents after release. In recent years, a rise in repeat sales has been contributing to the basic levels of unit sales and improving profitability.

IP Strategy

EXISTING IP

Total War™ Series

Themed on the Three Kingdom Saga legends, *Total War™: THREE KINGDOMS*, which is the latest installation of *Total War™*, a highly popular IP in North America and Europe as a PC game, is earning endorsement in China and other Asian countries. In the first week after release, download sales surpassed 1 million units.



©SEGA.
Developed by The Creative Assembly, Ltd.

TOTAL WAR

IP Enhancements for Existing IP
Sonic Series

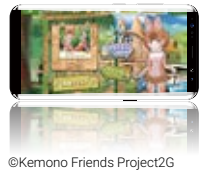
While continuing development of games, we plan to release a live action–computer graphics Hollywood movie in spring 2020 aimed at raising the profile of Sonic among the young generation.



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ジャッジアイズ 死神の遺言

©SEGA

NEW IP

EXTERNAL IP

Four IP* Strategies

Our group classifies its IPs assets into four categories: existing IP, new IP, revived IP, and external IP, and is strengthening its global deployment across multiple devices such as mobile, PC, and console. We will expand profit opportunities and maximize IP value through the full utilization of IPs to achieve sustainable growth in corporate value.

Grow existing IP

Create new IP

Utilize external IP

Leverage revived IP

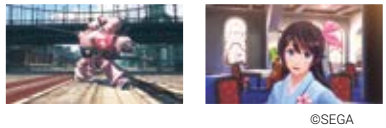
Judgment

The *Ryu ga Gotoku* Studio has taken on the challenge of creating an IP in a new genre. We are also marketing this title overseas.

Kemono Friends

(Digital Games and Amusement Machine Sales areas)
For amusement machines and smartphones, the Group launched game titles featuring an external IP that has gained popularity as an animation series for television.

新サクラ大戦



©SEGA

New Sakura Wars

We launched the first *Sakura Wars* title in 1996, rolling out the popular IP not only through subsequent iterations of the game but also through various media. We have unveiled a completely new title for the first time since the release of the previous title 14 years ago in 2005.

MEGA DRIVE メガドライブ ミニ



©SEGA

Mega Drive Mini

We will release *Mega Drive Mini*, a miniaturized game terminal that reproduces the *Mega Drive* home video game console released in 1988 and which includes 42 video games. Overseas, we have launched *Sega Genesis Mini*, which reproduces the version marketed in North America.

REVIVED IP

* IP: Intellectual property

IP Portfolio

Pachislot and Pachinko Machines | Digital Games | Packaged Games | Amusement Machine Sales | Toys, etc.

Examples of acquired IP

IP title	First appearance year	Multifaceted rollout	Total editions	Cumulative unit sales / downloads
***Megami Tensei* series**	1992	–	30	Approx. **17.4** million (Units / DL*3) (packaged and digital total)
***Persona* series**	1996	–	16	Approx. **10.2** million (Units / DL) (packaged and digital total)
***Total War*™ series**	2000	– – –	–	More than **27.6** million (Units / DL)
***Football Manager* series**	2004	– – –	–	More than **20.0** million (Units / DL)

Examples of IP developed in-house

IP title	First appearance year	Multifaceted rollout	Total editions	Cumulative unit sales / downloads
***Sonic the Hedgehog* series**	1991		–	Approx. **920** million (Units / DL*3) (packaged and digital total)
***Puyo Puyo* series**	1991*1		–	Approx. **29.0** million (Units / DL*3/ ID) (packaged and digital, AM-registered ID total (total for registrations after IP acquisition)
***New Sakura Wars* series**	1996	–	–	Approx. **3.8** million units (packaged and digital total)
***Ryu ga Gotoku* series**	2005	–	101	Approx. **12.0** million (Units / DL) (packaged total)
***ALADDIN* series**	1989	–	14	Approx. **570** thousand units (pachislot and pachinko machines and amusement machines total)
***Beast King* series**	2001	–	17	Approx. **500** thousand units (pachislot and pachinko machines and amusement machines total)
***PHANTASY STAR* series**	1987	– –	–	Approx. **5.50** million users*2 (cumulative total for registered IDs)
***CHAIN CHRONICLE* series**	2013	– –	3	Approx. **19.0** million (Units / DL*3) (packaged and digital total)

*1 SEGA CORPORATION acquired the rights in 1998. Figures for cumulative unit sales are the totals for titles that SEGA sold after acquiring the rights.
*2 Total for *PHANTASY STAR ONLINE 2*
*3 Including downloads of free-to-play titles

Examples of IP licensed from third parties

IP title	First appearance year	Multifaceted rollout	Total editions	Cumulative unit sales / downloads
***SEGA feat. HATSUNE MIKU Project* series**	2009	–	61	Approx. **6.1** million (Units / DL) (packaged and digital total)
***Hokuto No Ken* series**	2002		32	Approx. **2.88** million units (pachislot and pachinko machines total)
***SOUTEN-NO-KEN* series**	2009	–	12	Approx. **470** thousand units (pachislot and pachinko machines total)

A Message from the CFO



We will create a management strategy geared toward clear realization of our long-term vision, driven by strong financial backing.

Koichi Fukazawa
Executive Vice President and Group CFO
(Director of the Board)
SEGA SAMMY HOLDINGS INC.

To Achieve Our Long-Term Vision

We recognize the pressing need to strengthen our existing businesses.

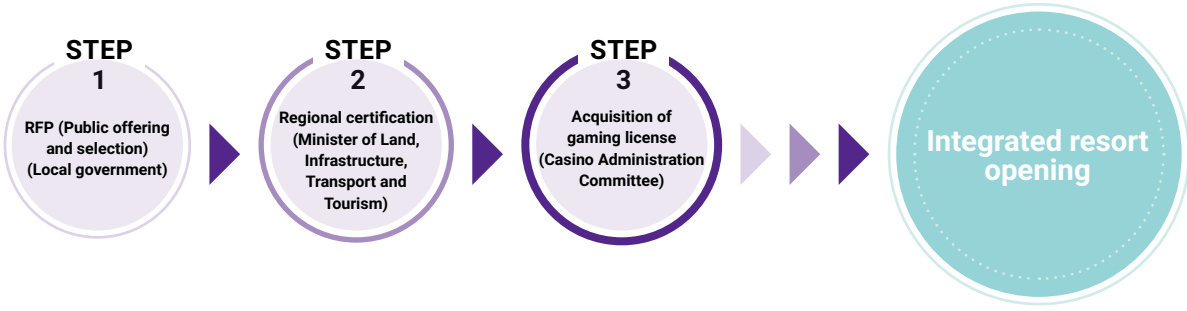
Looking back on the two-year period since the start of the Road to 2020 medium-term business strategy, the Pachislot and Pachinko Machines Business declined due to the effect of an external factor, namely, regulatory revision in February 2018. Further, performance remained sluggish in the digital games area, which the Group had identified as a driver of its growth and invested in accordingly. As a result, we missed our originally announced performance targets for two consecutive fiscal years. As for our forecast for fiscal year 2020, the final fiscal year of Road to 2020, we have already announced a forecast that falls short of initial targets.

As our existing businesses grapple with this situation, we find ourselves getting closer and closer to our entry into the IR business in Japan, positioned as a pillar of future growth, and thus a major event for the Group. To make a successful entry we need to clear three hurdles: first, we need to be selected at a local government's request for proposal (RFP); second, we need to work with that local government to acquire regional

G E

certification; and third, we need to acquire a gaming license from the Casino Administration Committee. In actuality, it may take six to seven years before we can open an integrated resort, but to ensure that all the steps required go as planned, that we are able to make a proper entry into the domestic IR business, and that we can achieve our long-term vision, I believe we need to build the profit structure of our existing businesses into something larger and stronger.

Process for Opening an Integrated Resort



Keeping Aware of Return on Investments

We will enhance the earning power of our businesses.

In fiscal year 2019, net cash decreased ¥17.7 billion year on year, to ¥71.8 billion, mainly due to relocation expenses associated with consolidation of head office functions. To date, the Group has put a high priority on maintaining and expanding its net cash position. This has been a necessary move, made to ensure that we have the financial base to be able to assume any business or financial model required as the only domestic company trying to stand the equivalent position with worldwide casino operators that have announced their entry into the domestic IR business.

However, as I have mentioned earlier, while we will be looking at things in terms of entering the domestic IR business moving forward, there is a need to shift toward increasing earning power, not only in new businesses but in existing business areas as well. It is therefore necessary to be strongly conscious of capital cost further when strengthening existing businesses and investing in new businesses. Considering our portfolio, which is formed by various businesses with different characteristics and financial situations, if we take utilization of return on invested capital (ROIC) and other performance indicators into account, while also incorporating management indicators such as cash conversion cycles into the activities of each respective business, we will be able to at once maintain control over an appropriately sized balance sheet for our existing businesses as well as making it possible to actively and effectively pursue forward-looking investments. I believe that this will in turn lead to an improved return on equity (ROE).

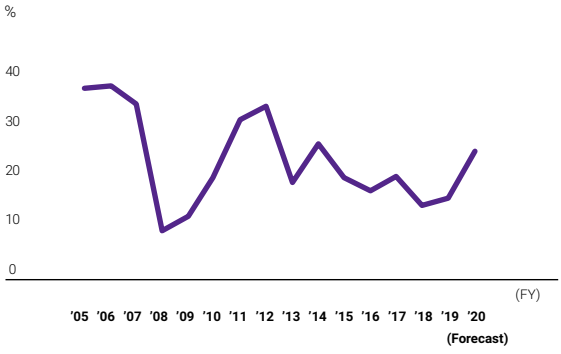
To strengthen the earning power of our existing businesses, we revised our management strategy for fiscal year 2020. In the Entertainment Contents Business, we will optimize the number of titles under development and operation in the digital games area. We plan to increase earning power by investing in areas where we expect to see market growth and also areas where we have strength in such that North American

A Message from the CFO

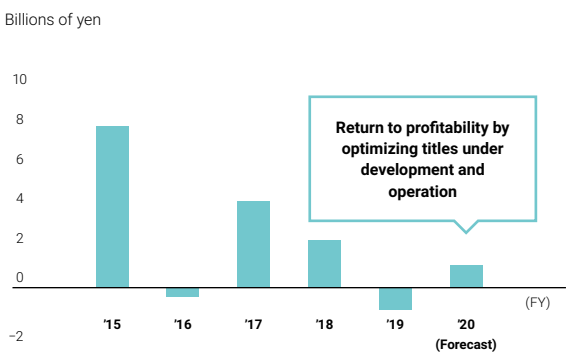
and European packaged games and PC games.

While regulatory revisions have changed the market conditions of the Pachislot and Pachinko Machines Business, we plan to expand revenue by obtaining the approval of machines that conform to the new regulation and releasing machines that can gain support from users while also leveraging the measures that we have implemented to improve profits to date.

Pachislot and Pachinko Machines Business: Operating Income Margin



Digital Games Area: Operating Income (Losses)

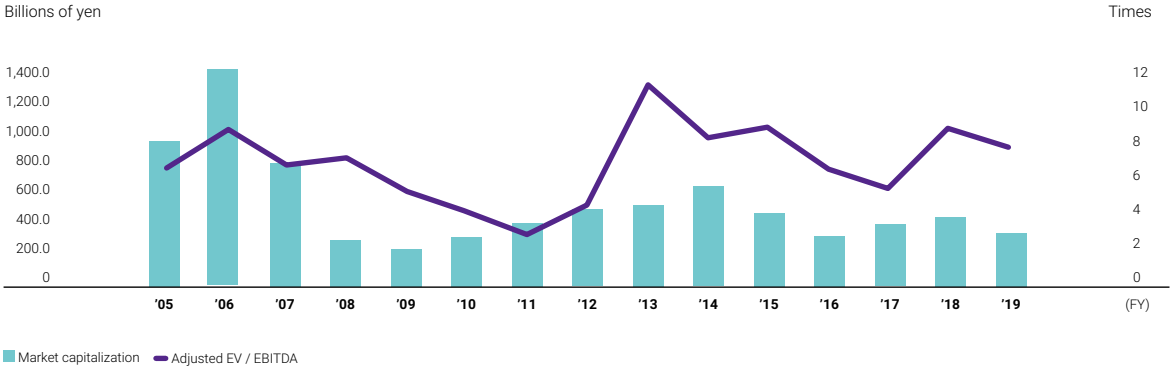


Maintaining a Strong Sense of Caution

We are analyzing the past 15 years from a financial perspective to identify Company issues.

It has been 15 years since the management integration in October 2004. Over this 15-year period, market capitalization has fallen one quarter, a fact which I feel is my responsibility as CFO. We are currently running a financial analysis of the last 15 years, looking at various measures we have implemented in that time, including measures to improve profitability in existing businesses, post-merger integration (PMI), and entries into new businesses. As we move forward, I maintain a strong sense of caution and awareness of the issues facing us. At the same time, I intend to fulfill my obligation to keep improving the corporate value of the Group by driving its growth strategy on one side of the coin, and its financial strategy on the other.

Market Capitalization and Adjusted EV / EBITDA



* Calculated as of the end of March in respective years