A Message to Our Shareholders

Thank you for your continued support of the Square Enix Group.

I would first like to express our sincerest condolences to those of you who have lost someone to COVID-19 and to wish the earliest recovery to those of you currently being treated for the virus. In addition, I express our deepest gratitude to the many healthcare professionals on the frontlines of the pandemic and to all the essential workers who are working day and night to maintain our way of life during this crisis.
Sustained growth through more recurring income, content investment

While we saw a slight impact from the sudden spread of COVID-19 infections in the latter half of the fourth quarter, we posted net sales of ¥260.5 billion, operating income of ¥32.7 billion, and profit attributable to owners of parent of ¥21.3 billion in the fiscal year ended March 2020, making for lower sales but higher profits than in the previous fiscal year. Net sales declined versus the previous fiscal year in part because we had initially planned to release “FINAL FANTASY VII REMAKE” in March 2020, but the launch was postponed until April 2020. However, our operating income rose because growth in our MMO (Massively Multiplayer Online game) and Games for Smart Devices/PC Browsers sub-segments expanded our base of recurring income.

I have previously stressed the importance of generating more robust recurring income, and that will remain the case. Developing content is a highly volatile endeavor in that there can be great swings between success and failure. High volatility makes for high risk; but taking risks in order to produce massive hits is what content development is all about. That holds all the more true when you are developing huge HD (High-Definition) games. We in the content business must always take on risk if we are going to create 1 from 0. What enables us to take that risk is the recurring income that grows 1 to 10 and 10 to 100. Sustaining a cycle of recurring income generation makes our earnings more robust and enables us to create a business structure that can support the investments we make into the inherently risky business of content development.

In the fiscal year ended March 2020, our release of expansion packs for “FINAL FANTASY XIV” and “DRAGON QUEST X ONLINE” grew the user base in our MMO sub-segment. We achieved great success with “FINAL FANTASY XIV: Shadowbringers” in particular, as it was met with an excellent response and led to a record high in paying monthly subscribers six years after the launch of “FINAL FANTASY XIV: A Realm Reborn.”
In the Games for Smart Devices/PC Browsers sub-segment, “Romancing SaGa Re:univerSe,” which we launched in December 2018, contributed to profits for the full fiscal year. “DRAGON QUEST WALK” (September 2019 launch) and “WAR OF THE VISIONS: FINAL FANTASY BRAVE EXVIUS” (November 2019 launch) were also both hits that contributed significantly to the expansion of our earnings. These are examples of how we intend to align innovative undertakings with a stronger base of recurring income that fuel them so that we can achieve sustained growth.

The fiscal year ended March 2020 also saw another key achievement in our journey to expand our recurring income base, namely the strong growth of our Publication segment. The segment’s earnings are steadily expanding as it rides the wave of digitization. In particular, our comic application MANGA UP! has established a solid position as our publication platform, achieving steady growth in terms of both DAU (daily active users) and MAU (monthly active users). We also succeeded at building up the Publication segment’s content library, adding such new hit titles as “The Apothecary Diaries” and “Toilet-bound Hanako-kun.”
Creating new amusement services

Meanwhile, in our Amusement segment, arcade operations were relatively strong through the third quarter, but sales dropped in the fourth quarter due to the impact from COVID-19 in March 2020. The Amusement segment and its arcade operations in particular are a source of recurring income that we count on, but given its nature as a business that relies on customers coming to physical locations, it was dealt a direct blow by COVID-19 and has continued to face extremely harsh conditions from April 2020 onward. While Japan’s local governments are no longer asking businesses to shutter, a return to the previous level of sales is still not in sight, and in operating our arcades, we will need to be meticulous in ensuring that we prevent the spread of the coronavirus. For the time being, we will cope by cutting fixed costs to lower our breakeven point and also review any unprofitable locations, but over the longer term, we will pursue innovation in our amusement facilities so that they are in step with a world where we co-exist with the coronavirus. We will move this business forward to create new amusement services in the wake of the coronavirus crisis.
Overcoming the impact of COVID-19

The fiscal year ending March 2021 got off to an inauspicious start, with COVID-19 continuing its global rampage, major cities around the world going into lockdown, and the Japanese government declaring a state of emergency. In anticipation of slowdowns and disruptions to our distribution processes due to the crisis, we elected to produce and ship fewer physical copies of “FINAL FANTASY VII REMAKE,” which we launched in April. As a result, initial shipments undershot our original expectations.

Meanwhile, digital sales grew sharply, making the game our first title for the PlayStation platform to top two million downloads. The shift to digital sales is a major trend in the game industry as a whole, but it has seen a spike in momentum as a result of the coronavirus crisis. We will endeavor to execute a more effective digital sales strategy for the remainder of this fiscal year’s lineup.

COVID-19 also compelled us to endeavor to transition quickly to a work-from-home model for our content development so that we would be able to sustain those efforts. The Group as a whole is currently operating at roughly 70 to 80 percent of previous levels, and we are striving to further develop our working environment so that we will be able to bring that to nearly 100%.

Even after the coronavirus crisis has subsided, we intend to transition to a hybrid working model that offers work-from-home as the default option but also enables employees to come into the office. In so doing, we will strive to create an organizational structure that is capable of coping flexibly with major disasters and infectious disease outbreaks. Meanwhile, we have yet to see sufficient recovery in some of the operations where we rely on external resources, such as voice recording and motion capture. The impact we expect from this is not minimal, but we will coordinate closely with our external partners and collaborators and share a variety of ideas with one another so that we are able to work through these difficulties.

Furthermore, as discussed above, our Amusement segment finds itself in a challenging situation whereby it is losing sales, and recovery is not yet within sight. As such, we are leaving our earnings outlook for the current fiscal year undecided, but will release it promptly once we are able to make reasonable calculations.
Next-generation consoles and the cloud

Turning to the broader industry, this calendar year 2020 will see the release of the next-generation consoles PlayStation 5 and Xbox Series X. This year’s E3 (Electronic Entertainment Expo) was cancelled, but we expect to see a growing stream of news regarding the next-generation consoles between now and the end of the year. We are hoping the excitement reaches fever pitch and will be working hard on corresponding to the next-generation consoles. These will include the development of not only cross-gen (cross-generation) titles that are playable on both current- and next-generation consoles but also of titles that are exclusively for the next-generation consoles. We are currently doing our utmost to ensure that we can bring our customers new gaming experiences that leverage the specs of the next-generation consoles to the max. We will be releasing information on these titles at the appropriate timing and will endeavor to expand our business on the back of the new platforms.

In addition, we will ramp up our efforts for the cloud as we head into a new era. The game platform companies have already shifted their gaze to what lies beyond the next-generation consoles. The next major trend is the cloud. Cloud-based gaming is likely to bring new entrants to the market in addition to the existing platform companies. These newcomers will offer game publishers and developers new opportunities to expand their businesses. Our hope is that healthy competition between platforms will lead to further growth for the gaming industry as a whole.

Game distribution/sales and development in a cloud environment

We can view the cloud-based gaming business from two perspectives: distribution/sales and game development. In terms of distribution/sales, we hope that game streaming will provide new business opportunities. A rapid shift is underway from selling games as packaged products to selling them via digital downloads, but streaming is likely to give rise to the concept of “using” rather than “buying” games. This is the subscription concept. There are a few subscription services out there already, and while none has taken off in a major way yet, we believe that the presence of game subscription services will grow if game streaming advances. When that happens, how extensive a library of games a subscription service can offer will determine its appeal. We believe that our Group’s library of games—especially single-player games—will be extremely attractive in the subscription service context. We will consider what sort of subscription service we would like to offer our games on, leaving ourselves the option of owning our own channel that we operate as a proprietary subscription service, and execute on whatever decision we make.

We also expect subscription services to serve as an effective means of curating our game sales. This would naturally include providing subscribers other players’ recommendations of games that they have never played and getting them to try them out so that we can increase player numbers. We will leverage such opportunities to pursue further earnings expansion.

In terms of game development, it will be critical to develop...
games that are cloud centric and cloud native. We predict that cloud gaming will really take off when it offers new gaming experiences that are only possible in the cloud. It is our hope that new gaming experiences that leverage the power of the cloud rather than relying on client devices like consoles and PCs will serve as a major differentiator. There are substantial hurdles to be overcome involving telecommunications infrastructure and server costs, but technology will eventually resolve these issues. We will focus our R&D efforts on that day.

The evolution to Games as a Service

As gaming transitions more and more to the cloud, we expect that games will evolve into something more service-like in nature. This is the Games as a Service (GaaS) concept. Moreover, as the GaaS concept advances, games are likely to become platforms unto themselves. Games with massive DAUs and MAUs could themselves become huge social networking platforms. Any given player could broadcast information that is not necessarily relevant to the game, and that would instantly reach the many other players, triggering interaction on a massive scale—matching the definition of a social network to a tee. Movements that arose within a few games have created a buzz during the coronavirus crisis as well. The fact that games are connecting people and
serving as new forums for communication that has nothing to do with what their creators had intended is a revolutionary development that should be regarded as an epoch-making event for revealing yet another facet of gaming. The transition of gaming to the cloud and the GaaS model are not necessarily interrelated, but we believe such trends will become more prominent in the cloud era. The total DAUs/MAUs of multiple game services will also be important, but we must strive to develop and operate games with massive DAUs/MAUs. We will endeavor to develop games that enhance user engagement and encourage them to play for a long time.

Applying AI to entertainment

We recently established a new Group company called SQUARE ENIX AI & ARTS Alchemy Co., Ltd. Our objective is to develop new businesses by taking the AI technology and expertise that we have amassed in the gaming business and leveraging them in the broader world of entertainment, with an eye to potentially applying it to other industries as well. The global battle for AI supremacy is pitting numerous firms, ranging from major corporations to start-ups, against one another. Against that backdrop, gaming AI technology has attracted the attention not only of the adjacent entertainment industry but also of other industries. By creating entertainment AI technology expanding beyond the boundary of games, we will work to develop new businesses that are not bound by the traditional confines of gaming or entertainment while also ensuring that our entire Group benefits from the technologies that these efforts produce. Through these initiatives, we hope to contribute to the development of our Group as a whole, and by extension to the gaming and entertainment industries.

Our shareholder return policy for the fiscal year ending March 2021

Lastly, I would like to discuss our shareholder return policy for the fiscal year ending March 2021. In accordance with our initial policy of achieving a consolidated dividend payout ratio of 30%, we raised our dividends in the fiscal year ended March 2020 versus the previous fiscal year, providing a year-end dividend of ¥44 that made for a full-year dividend of ¥54. While our earnings outlook for the fiscal year ending March 2021 remains undecided, we intend to mainly reward shareholders with dividend payments, maintaining our consolidated dividend payout ratio of 30% as we pursue our operations in consideration of the balance between investment and shareholder return. With the launch of the next-generation consoles and the advent of the cloud era on the horizon, we will endeavor to strike the optimal balance between aggressive investment and shareholder return. And we will strive to achieve sustainable growth as we adapt to the new lifestyle co-existing with the coronavirus.

I would appreciate your continued support.

Yosuke Matsuda
President and Representative Director