

A Message to Our Shareholders



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

Yosuke Matsuda
President and Representative Director

I am pleased to report that the Group set new records for full-year net sales (¥365.2 billion) and all its profit lines (operating income of ¥59.2 billion, ordinary income of ¥70.7 billion, and profit attributable to owners of parent of ¥51 billion) in the fiscal year ended March 2022, which was the first year of the Medium-Term Earnings Targets and Business Strategy that we unveiled in May 2021.

Digital Entertainment

The High-Definition (HD) Games sub-segment struggled, in part due to the challenging year-on-year comparison created by the release of multiple major titles in the fiscal year ended March

2021. However, “OUTRIDERS,” which was released in April 2021, achieved a global player base in excess of 3.5 million in its first month, becoming a new looter shooter entry in our Group’s library of game IP. In addition, “NieR Replicant ver.1.22474487139...” offered a new way to experience the origins of the NieR franchise. Players whose first contact with the NieR series had been the long-selling title “NieR:Automata” thereby gained a richer enjoyment of the NieR universe, and “NieR Replicant ver.1.22474487139...” also captured the interest of new customers, thus bringing renewed vitality to the franchise.

The Massively Multiplayer Online (MMO) game sub-segment released expansion packs for “FINAL FANTASY XIV” and



OUTRIDERS

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NieR Replicant ver.1.22474487139...

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FINAL FANTASY XIV

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DRAGON QUEST X ONLINE

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“DRAGON QUEST X Online.” “FINAL FANTASY XIV: Endwalker” was received with especially great excitement by fans around the world who had been waiting for a sequel. The expansion pack not only boosted “FINAL FANTASY XIV” to the status of the world’s top MMO games in every sense of the word, but also made a massive contribution to our Group’s business. We remain devoted to our engagement with these passionate fans and will continue to strive for even higher heights in our operation of the game.

The Games for Smart Devices/PC Browsers sub-segment underperformed our initial expectations, largely because many of

our existing titles have reached maturity and offered limited upside and because the new titles that we launched in the fiscal year ended March 2022 did not perform to the levels that we had anticipated at the outset. “DRAGON QUEST WALK” and multiple other key titles continue to deliver solid performances, but in order to return the sub-segment to a growth trajectory by generating new hit titles, we are going to start developing an organizational structure that helps enhance our development capabilities, while also working to bolster our profitability, in part by revisiting our lineup of titles.

Amusement

Conditions in the Amusement segment remain uncertain, given the continued impact of COVID-19. However, our arcade operations are showing gradual signs of recovery. Arcade traffic has picked up since the lifting of Japan's state of emergency declaration and some of its other preventative measures. Moreover, the segment's efforts to make its arcades more attractive have proven successful. These have included rolling out new prize offerings based on assessments of visitors' interests. The result of such initiatives has been steady improvement in the momentum of the business as a whole. We expect to see upside for the segment as the pandemic winds down, including from demand generated by foreign visitors returning to Japan. We will ensure that we do not let such opportunities pass us by and work to maintain and accelerate the segment's recovery.

Publication

The Publication segment saw a phase of sharp growth through the fiscal year ended March 2021. Its growth curve is now



My Dress-Up Darling
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moderating as the segment enters a phase of stable growth. Against this backdrop, the fourth quarter of the fiscal year ended March 2022 saw a major hit from “My Dress-Up Darling.” In addition, building on the positive reception of many customers in Japan, the segment began rolling out the “MANGA UP!” app to the wider world with the launch of a global version in July 2022. We will strive for further growth not only by continuing to generate the sort of content that our customers want, but also by focusing on cultivating the market in order to deliver that content to more and more customers.

Merchandising

The Merchandising segment set new records for both net sales and profits by making a marked shift to e-commerce and other digital sales as the pandemic deprived it of some of its traditional sales opportunities by forcing the cancellation or downscaling of in-person events. The crisis created by the pandemic served as an opportunity for it to diversify its sales channels through digital transformation, which is a key theme in the segment. Its success is inspiring not only for the segment itself but also for our other



**FINAL FANTASY® VII REMAKE PLAY ARTS KAI™
ACTION FIGURE TIFA LOCKHART**
FINAL FANTASY® VII REMAKE PLAY ARTS KAI™ ACTION FIGURE TIFA LOCKHART
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CHARACTER DESIGN: TETSUYA NOMURA/ROBERTO FERRARI



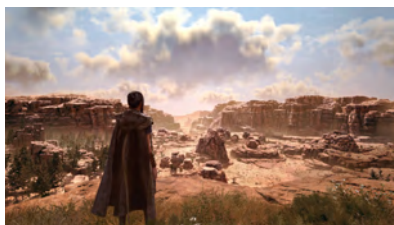
business segments, and we see this success as one of our major achievements over the past several years.

Our outlook

Based on the achievements described above, we see the fiscal year ending March 2023, which is the second year of our Medium-Term Earnings Targets and Business Strategy, as the year to lay the groundwork for the third and final year.

We will not be releasing any HD game titles from our flagship franchises until the fiscal year ending March 2024, but we intend to diversify our title portfolio by releasing mid-sized titles and new IP in the fiscal year ending March 2023.

We find ourselves somewhat treading water in terms of smartphone games partly because, as noted above, our launches during the fiscal year ended March 2022 unfortunately did not include any significant earnings drivers. However, we have already started working on our development structure, and once that



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FINAL FANTASY VII EVER CRISIS
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CHARACTER DESIGN: TETSUYA NOMURA
CHARACTER ILLUSTRATION: LISA FUJISE

begins producing results, we hope that subsequent launches will produce the big hit that will be our next growth driver.

I will next discuss our future business strategy.

Future business strategy

Revamping our studio portfolio

On May 2, 2022, we announced that we would be selling some of our overseas studios and IP to Sweden-based Embracer Group AB. The sale covered the three studios of Crystal Dynamics, Eidos-Montréal, and Square Enix Montréal, as well as related business assets and IP. The objective of the sale was to build stronger business foundations by revamping our portfolio of titles and studios, thereby enabling us to be selective and focused in leveraging our resources, as game development efforts become more sizable and sophisticated.

Achieving major growth in the game industry is difficult now for companies that compete primarily in the Japanese market, given its graying demographics. As such, it is critical for our business that we produce hit titles that speak to the global market, which offers greater scale in terms of both customers and sales volumes. Furthermore, game development efforts are becoming more sizable and sophisticated as the result of technological advancements in the devices on which they are played, such as consoles or smart devices. The investment required to develop game titles is therefore an order of magnitude greater than in the past. In other words, the Japanese market is no longer sufficient for achieving a level of earnings that enables

us to recoup our development investment and generate a profit, and we therefore need to approach our development efforts based on the assumption that we have to succeed in the global market.

Another change is how easily accessible information on games has become for our customers. We find ourselves in a world where social media spreads information instantaneously, enabling customers the world over to simultaneously obtain the same information on games through a variety of different devices and outlets.

For our Group to better focus on developing titles for the global market in this changing environment, we need to concentrate our limited resources on the development of strong and robust titles. We need to enhance our presence in the global market by quickly establishing an organizational structure that enables us to consistently roll out high-quality content produced through selective and focused resource allocation, which requires the revamping of our title and studio portfolio.

Since our acquisition of Eidos in 2009, the three studios included in the recent sale made major tangible and intangible contributions to our Group as our core overseas studios. However, their portfolios were focused on the development of major titles, which presented the risk of a serious cannibalization of our Group's financial resources over the medium to long term. We therefore decided to divest the studios in order to achieve further growth through the optimal allocation of our resources and the creation of a more robust product pipeline. We look forward to seeing Crystal Dynamics, Eidos-Montréal, and Square Enix Montréal further develop through their new partnership with Embracer Group AB.

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The initiative described above represents the first stage of our studio portfolio strategy. For the second stage, we are exploring the question of how to diversify the capital structure of our studios, as detailed below.

Diversifying capital structure of our studios

Our studio portfolio strategy has basically been for the Group to own its studios outright. Our 2005 acquisition of TAITO and 2009 acquisition of Eidos were in keeping with this view. Full ownership meant that since we bore all the development costs, we would stand to receive the entirety of the financial returns. At the same time, however, it also meant that we were exposed to the entirety of the downside risk. In the days before game development efforts reached their present massive scale, this strategy proved very effective because our Group was amply capable of absorbing any volatility on its own, as well as of generating returns that outstripped any risk.

However, as the investment required for development efforts has grown, this strategy has begun to produce side effects of a scale that we cannot ignore. It is now more important than ever that we manage financial volatility and the impact that it has on our accounting because, while development investments fuel our Group's future growth, we must also recognize those investments in the form of our content production account. How to exercise appropriate control over volatility and strike a balance between risk and return when making growth investments are the key questions that we must ask ourselves as we manage our games business going forward, and I believe that the answer lies in a more diversified capital structure of our studios.

By “a more diversified capital structure of our studios,” I refer to not fixating on full ownership and instead making various patterns of the studios' capital structure that enables sharing development risk with partners. Such a strategy would allow us to grow our studio portfolio as a whole while exposing ourselves to less risk. Specifically, we would diversify the capital structure of our studios by not only owning some studios outright, but also by welcoming third parties to take stakes in some of our studios or by our taking stakes in studios outside the Group. In this way, we would create a studio portfolio that spans a continuum from studios that we own outright to those that are equity-method affiliates or less. Under such a strategy, we would also engage in M&A activities, for example, and work to achieve a balance between growth and financial stability.

I will next discuss the blockchain entertainment domain, which is to play a key part in our strategy for future growth.

Blockchain entertainment domain

We have identified AI, the cloud, and blockchain as focus investment areas under our Medium-Term Earnings Targets and Business Strategy. At present, we are positioning the blockchain domain as our most important focus and approaching our investment and business development initiatives accordingly. Leveraging AI and the cloud in game development primarily involves incorporating new technological advancements into the gaming experience. By contrast, the uniqueness of blockchain is not purely technological. It lies more in its philosophical aspects as represented by the concept of decentralization that underlies the blockchain model.



As I stated in my 2022 new year's letter, under the traditional model, game developers have provided gaming experiences that represent a completed product. Players enjoy the gaming experience within the confines controlled by the supplier of the game. It is fair to refer to these as "centralized games."

Blockchain games, on the other hand, involve the participation of players with a variety of motivations. They exercise their own agency in creating and running the world of the game. As such, it is fair to refer to these as "decentralized games." Going forward, we may see the concept of decentralized gaming take off and a proliferation of token economies, which are mechanisms for incentivizing players to take part in decentralized games in various ways. If this leads to the creation of self-sustaining worlds with even greater scalability, I believe that we will see new types of games produced unlike any anyone has ever seen before.

This field is only in its infancy, and we have yet to see any

games providing the type of excitement only possible with blockchain technology. We also acknowledge that some view the very concept of blockchain gaming with suspicion due to what appears to be a bubble in NFT asset sales, the incredible volatility of crypto assets, and the fact that laws, accounting practices, and tax codes are still being established or formalized.

However, I believe that blockchain gaming holds the potential to create new forms of gaming content, and that it represents a new business domain worth our Group addressing alongside traditional games.

Based on this belief, we created a Blockchain Entertainment Business Division in February 2022, marking the meaningful start of our efforts in this field. We have also been ramping up our investments in a variety of both internal and external projects. Rather than limiting ourselves solely to blockchain games, we

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intend to pursue a wide range of new types of entertainment under the banner of “blockchain entertainment.” We are a content company. As such, our mission is to create new excitement of a sort never seen before using new technologies and new ways of thinking. Blockchain technology presents us with the challenge of seeing what sort of new excitement we can create with it. We will remain aggressive in taking on this new field.

This concludes my review of our earnings for the year ended March 2022 and my update on our Medium-Term Earnings Targets and Business Strategy, as well as a discussion of our future business strategy with a focus on our studio portfolio strategy, focus investment areas, and our progress in the blockchain entertainment business in particular.

I will close by discussing the new composition of our board of directors and our shareholder return policy.

Our governance apparatus and shareholder return

As of June 23, 2022, we added three new executive officers to our Board of Directors. With this change to our governance apparatus, we will maintain the supervisory capabilities made

possible by a majority of outside directors, while also creating a board that is more balanced in its composition between execution and supervisory functions, thereby driving greater corporate value. In regards to our shareholder return policy, we will maintain our guideline of a consolidated dividend payout ratio of 30%, while working to return profits in a way that is optimally balanced in terms of both reflecting our financial performance and ensuring the stability of rewards.

The environment in which our Group finds itself is at a more significant inflection point than any preceding it, especially with regard to the digital entertainment industry. We will work to achieve greater growth by further fortifying the foundations of our existing businesses and taking on new business domains. We look forward to your continued support to that end.



Yosuke Matsuda

President and Representative Director