

I thank our shareholders for the opportunity to present our annual report for fiscal 2006, ended March 31, 2007.

In fiscal 2006, on a consolidated basis, net sales expanded 31.3%, to ¥163,472 million. Operating income surged 67.5%, to ¥25,916 million, and recurring income similarly rose 68.8%, to ¥26,241 million. Net income, on the other hand, declined 32.0%, to ¥11,619 million. As a result, the recurring income margin was 16.1%, and return on equity (ROE) came to 9.3%.

The Company's dividend policy is to maintain an optimal balance between performance-linked payouts and stable returns to shareholders. In line with this policy, we have set dividends to be ¥35 per share for fiscal 2006, resulting in a consolidated payout ratio of 33.3%.

We enjoyed strong operating performance during the year. Our targets, however, are higher still, while our business environment is becoming increasingly challenging. We are tightening our belts and rallying our forces for another vigorous push forward.

Transition Period Continues in Fiscal 2006

In fiscal 2006, the video game industry remained in a period of major transition. Our challenge in this period of time would be to transform ourselves to be capable in the new business environment, while maintaining sales and profits.

Robust performance of SQUARE ENIX unit

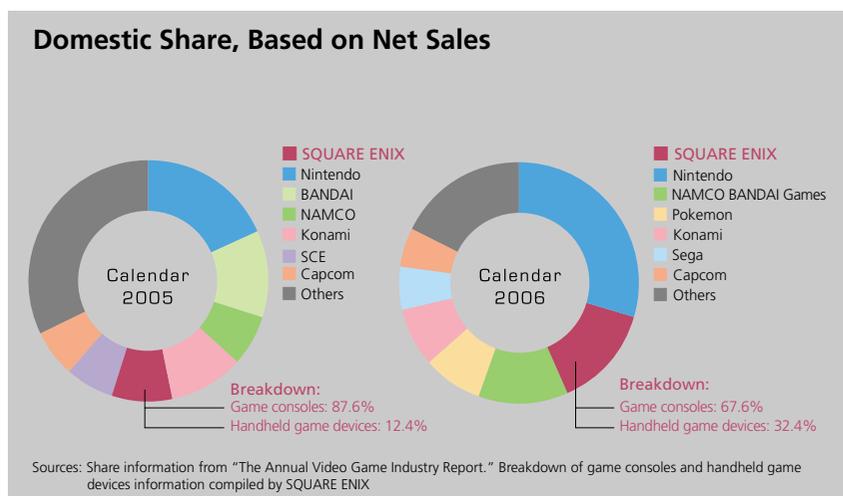
We have acquired Taito in fiscal 2005, but we run its business separate from Square Enix. Thus, I'd like to review our businesses separately.

An effective combination of the present and future has driven our success in the Games (Offline) segment of Square Enix. As for current-generation software titles, major titles such as "FINAL FANTASY XII" and "KINGDOM HEARTS II" for the PlayStation 2 (PS2), both launched in Japan in the previous fiscal year, were released in Europe and North America and contributed substantially to earnings and profits.

"SQUARE ENIX Corners," the dedicated shelf spaces for Square Enix titles, were deployed in over 900 retail stores throughout Japan, which have boosted our sales capitalizing our strong brand in an extremely competitive sales environment. The system particularly contributed to increase the sales of catalogue titles as well as new ones.

We have built a sound business foundation in Europe and North America. In Europe, we began publishing our titles ourselves in fiscal 2006. This move boosted not only the sales of the two new titles mentioned above, but also

[Figure 1]



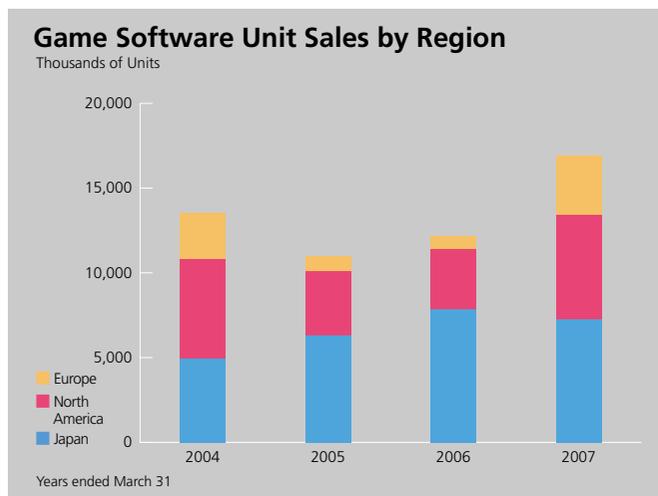
those of catalogue titles due to our improved ability to fulfill repeat orders. As a result, we succeeded in fully capturing market opportunities in game software for current-generation game consoles.

For next-generation game consoles, it became important to select appropriate region, customer segment and timing based on careful analysis, as opposed to the winning strategy for the current generation of selecting and concentrating on the winning game console.

Next-generation game consoles take networked environments as a given, and offer attractive high-definition (HD) graphics capability as their selling point. The flip side, of course, is that these consoles cannot be enjoyed in full unless they are networked and viewed with HD displays. Handheld game devices, on the other hand, are self-sufficient and have no particular environment requirements. Consequently, we expected that the next generation handheld game devices would penetrate the market ahead of the next generation consoles in fiscal 2006 and fiscal 2007, and adjusted development resources accordingly.

Examples of our success with this approach in Japan include sales of the totally remade "FINAL FANTASY III", which sold 990,000 copies in Japan and 460,000 copies in North America; and "Dragon Quest Monsters: Joker", which sold 1.41 million copies in Japan. Both titles were developed for Nintendo Co., Ltd.'s new handheld game device, NINTENDO DS, and played a major role in our success. Our decision to utilize Nintendo Wi-Fi connection in "Dragon Quest Monsters: Joker" proved to be extremely popular, with over 5.6 million cumulative online accesses, proving new market potential.

[Figure 2]



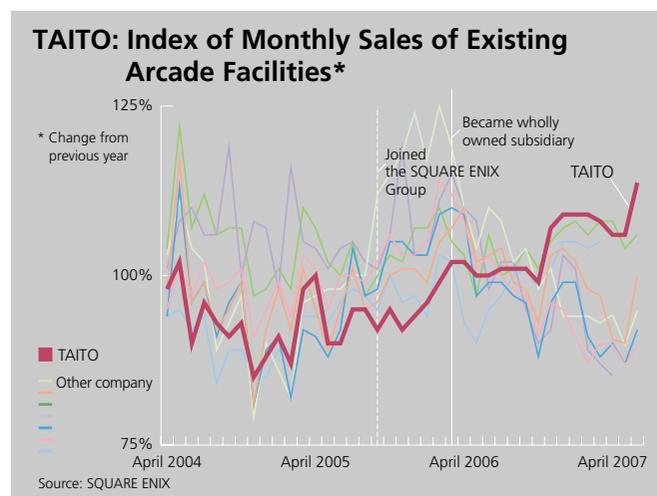
This strategy is for the transition period, of course, and we have no intention of relying solely on handheld game devices in the future. In fact, over the next few years we aim to put our resources in research and development of cutting edge technologies in the next generation consoles and personal computer (PC). We will also work on improving our development pipelines to achieve more efficient and flexible game development. For that purpose, we created the Research and Development Division as a permanent organization in fiscal 2006, in a departure from our previous project-based R&D activities.

In the Games (Online) segment, we are continuing to raise the bar on profits each year. In fiscal 2006, we maintained a profit margin of 49.5%, which is extremely high. A high dependency on "FINAL FANTASY XI" is one of our weaknesses in this business, but in fiscal 2006 we set the stage to move on to the next generation of games.

In the Mobile Phone Content business, we cleared our profit target and posted a new record, but our overseas expansion fell short of expectations. It is becoming apparent that the mobile phone markets in overseas develop very differently from Japanese one. We need to calibrate our strategy accordingly.

In the Publication segment, we achieved the highest levels of sales and profits that we have seen since the days of the former ENIX. Rather than relying on a single hit product, we acquired the ability to generate a constant stream of hits, and our strategy of taking our content across diverse media including, periodicals, anime titles and comic books, is proving to be effective.

[Figure 3]





Creative & Innovative

TAITO unit Poised at the Starting Line

Now, I present the progress we made in TAITO, which became fully consolidated in fiscal 2006. From the strategic point of view, integrating TAITO, which develops and sells arcade machines and operates arcade facility, into the Group is significant in two ways.

First, our new portfolio of businesses increases our touch points with customers, rounding out our strategies in this respect. Various entertainment media are beginning to cross-penetrate. In such a business environment, we need to increase our touch points with customers to understand and respond to various demands of customers. Square Enix had far to go in the virtual space, addition of Taito will enhance our ability to use physical locations and to create the entertainment that appeals to 5 senses nurtured through arcade game development.

The second significance is financial one. Games (Offline) and Games (Online) become increasingly capital intensive and require longer time of investment. TAITO, on the other hand,

runs a flow-based business, require less capital and generate stable flow of cash. The financial risk profiles of these two businesses are polar opposites, a balance that I believe will allow us to develop our business more aggressively.

TAITO's performance to date, however, had not been strong enough for it to function as a supporting pillar of the Group. We positioned fiscal 2006 as a time of restructuring, preparing TAITO to make a fresh start in fiscal 2007. What we needed to do was simple. We had to reallocate resources optimally. The key was to take actions in the fastest manner.

First, we moved out of unprofitable businesses, closed down arcade facilities that were losing money, and made personnel cutbacks. In addition to businesses that were obviously generating losses, we also shut down businesses where the use of capital is not efficient. We completed this process in fiscal 2006.

The next step was to allocate additional resources and invigorate businesses that were delivering borderline performances.

As the first step, we needed to revitalize arcade facility operation. This business gener-

ates revenue through investment in three areas: real estate, arcade machines and people. In the past, being overly obsessed with arcade facility location resulted in disadvantageous real estate agreements that sapped funds for arcade investment. Consistent renewal of arcade machines on arcade floors was allowed to fall behind for lack of funds. Arcade revenue and profit suffered as a result, leaving too little money for proper personnel investment. The cycle was vicious.

Our basic approach was to reverse this cycle by making appropriate and audacious investments to reenergize personnel and renovate arcade machines, then make clear that we will only accept real estate with terms reasonable to us. The amount of funds we actually invest will be at the same level as before, but this structural reform should erase the chronic deficits. Taking a determinedly proactive approach should also boost employee morale and positively impact sales. As Figure 3 shows, these efforts have already begun to bear fruit.

After the completion of revitalizing the arcade facility operation business, we plan to move on the next step of

strengthening the arcade machine business.

On the separate note, TAITO also has mobile phone content and console game businesses, but with different characteristics and business direction than those of SQUARE ENIX. For this reason, we have made the conscious decision to run these businesses independently from SQUARE ENIX. We believe that this path represents a better approach toward synergy.

Note: When converting TAITO to a subsidiary, all its businesses, including the amortization of goodwill, were consolidated into the amusement business.

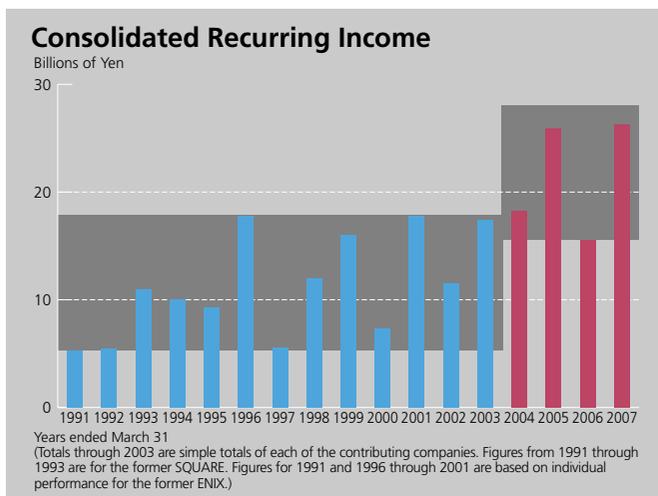
Aiming for ¥50 Billion in Recurring Income

We aim to become a leading global content provider and community management company. Put it in numbers, our current goal is to achieve recurring income of ¥50 billion.

Four years have passed since the merger between ENIX and SQUARE. Despite a number of twists and turns along the way, I think you will agree after looking at Figure 4 that the combined recurring income range has been clearly improved from the time that the two companies were separate.

Now that we have developed the core structure that can generate consistent ¥25±5 billion in recurring income consistently, our next step is to achieve ¥50 billion in a single fiscal year. Next, we will put in place the corporate structures to deliver ¥50±10 billion on a regular basis; ¥35±5 billion from SQUARE ENIX (excluding the amusement business) and ¥10±5 billion from TAITO (the amusement business). We will judiciously apply the funds we have at hand to propel ourselves along this path.

[Figure 4]



What is happening in the industry and what is our plan?

Video games came out in amusement centers more than 30 years ago, and the breakthrough of the Space Invaders game of TAITO in Japan gave the infant industry a strong momentum. Console games arrived a few years later, and in no time a wave of popularity that started in Japan had propagated throughout the world. Nowadays, no corner of the world is unaware of video games. Moving into the 2000s, different multi-functional platforms, such as mobile phones and personal digital assistants (PDAs), developed the capability to accommodate games. In line with the growing range of platforms for playing games, the game-player segment itself grew more diverse.

At the same time, the cross-penetration with other entertainment media, such as movies based on games and games based on movies, added depth to the video game market. In a short period of time the video game industry has grown to be the well recognized industry in the world.

Incumbent game software companies are no longer the only participants in the video game industry, but I wonder how many people in the industry truly recognize this fact. Game software companies used to operate within the closed ecosystems created by game console providers. Now we need to excel not only in the ability of developing creative content, but also in the ability of business development.

There are immense opportunities before us.

At the same time, we face competitive pressures like we have never before experienced.

[Figure 5]



I think PC-based casual game market in U.S. -consisting of people who play games occasionally and informally-is typical example of such threats. It has unexpectedly swelled into a market worth several billion dollars in a few years.

The shift in game media from masked read-only memory and optical discs to networks is transforming marketing and distribution. Even though the industry may accept the logic of this metamorphosis, concrete plans to counter it are few and far between. Many of the leading game companies lagged behind the smaller competitors to realize the huge potential of the PC-based casual game in U.S, whereby housewives and other people who had never before played games suddenly became aficionados.

We are seeing a dramatic increase in opportunity for companies in other industries to enter the video game industry with totally different business models. As a result, there is no future for those of us who have staked our futures on the game business unless we are willing to break free of tradition and make conscious decisions to changes our strategies.

At present, our basic policy is to be diverse.

As customers themselves have diversified, as has their interaction with content, content and services naturally should also become more varied. By this, I mean not to seek the middle ground or to become more decentralized. Rather, I mean that we must identify a few groups of customers that each share tastes and preferences, understand each group deeply, and deliver a number of selected content and services that truly cater to each of specific customer group. We should seek to have diverse customer groups as possible.

Moreover, our business model must be flexible. As our

vision of the future for the ecosystem, or the huge industry system including games remains unfortunately unclear, it is vital to have a host of strategic options, which enables us to conform to any environmental changes responsively.

SQUARE ENIX Group aspires to evoke emotions

In closing, I would like to describe our long-term objectives. We want to build a company that evokes specific emotions or memories among everyone who hears the name SQUARE ENIX. Earlier, I mentioned that we aimed to be the world's leading content provider and community management company. I mean the same thing here.

Next, I would like to refer to our essential business domains and priority areas to realize this vision. I admit it is somewhat abstract, but I believe it is important to mention here.

It is often said that the value in the computer industry has changed from the realm of hardware to software, and is now moving from software to services. The concept of "communities (relations)" in our business may correspond to the "services" in the computer industry.

To clarify this argument, it is useful to break down software into code and data. Code is the "engine" that drives data, "content." Game is unique software in which data plays more important role than in business software.

We shall focus on creating the content, data, and derive our revenue and earnings from the communities.

Immediate task for us is to ride out the transition period and emerge in our new identity. We are putting our full efforts into generating results that will meet the expectations of our stakeholders. As we take on these new challenges, we look forward to your continued support.

July 2007



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

[Figure 6]

