

## To Our Shareholders

I am grateful to our shareholders for the opportunity to present the Company's annual report for the fiscal year ended March 31, 2009.

In the fiscal year under review, on a consolidated basis, net sales decreased 8.0% compared with the previous fiscal year, to ¥135,693 million. Operating income declined 42.9% to ¥12,277 million, and recurring income decreased 40.3% to ¥11,261 million. Net income amounted to ¥6,333 million, a 31.1% decline compared with the previous fiscal year. As a result, the recurring income margin was 8.3%, and return on equity (ROE) stood at 4.3%.

We set dividends applicable to the fiscal year ended March 31, 2009, at ¥30.00 per share, resulting in a consolidated payout ratio of 54.4%.

In light of the very high payout ratio, I would like to provide additional clarification. 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 stated that our benchmark for the payout ratio is approximately 30%. Underpinning this is our belief that the Company should generate sustained growth and we define the key measurement for this as growth in dividends per share. In other words, it is our policy to maintain the payout ratio at around 30%, as the dividend increases step by step.

Although a characteristic of the entertainment industry is that it is impossible to avoid volatility in operating results, I am conscious that such volatility is only tolerable as long as it occurs within the context of steady growth in the Company's core strengths.

Regrettably, the Company's operating results for the fiscal year under review were disappointing. However, this was not a reflection of a loss of core strength and I think that we have been able to lay the groundwork for our next phase of growth. Although the payout ratio is quite high, we judged that a dividend of ¥30.00 is an appropriate amount in these circumstances.

During the period under review, from a medium- to long-term strategic perspective, did we actually make substantive progress toward sustained growth? I would now like to discuss this point in some detail.

### The SQUARE ENIX Group's Growth Strategy

I believe that the entertainment industry's structure, or "ecosystem," is undergoing a major transformation, triggered by the on-going progress of globalization and networking. The SQUARE ENIX Group's growth strategy is based on this perception of the times. Although it is essential to adapt one's tactics flexibly during such a transformative phase, our core strategy remains focused on the following four principal elements.

#### The SQUARE ENIX Group's Growth Strategy

- 1 Enhancing the value of our brands
- 2 Building a global business structure
- 3 Establishing diverse points of contact with our customers
- 4 Reinforcing capabilities in community management

#### 1 Enhancing the value of our brands

The essence of entertainment is the value derived from the entertainment experience. To enhance that value, we believe that it is important to produce our own robust lineup of content and services, and build this lineup into firmly established brands. In other words, the SQUARE ENIX Group's identity is that of a creator—the source of our value is what we create ourselves rather than acting as an intermediary for the creations of others.

By focusing principally on intellectual property (IP) that we own outright, we can promote our own cross-media initiatives with increased flexibility and scalability, without burden of procuring third party rights. This provides a crucial foundation for profit maximization.

In the fiscal year under review, although we successfully reinforced the brand value of our main franchises, only the Publication segment was able to produce significant new IP. We will continue tackling the challenges of enhancing our brand values.

#### 2 Building a global business structure

Through advances in communications technology, interaction among people spread around the globe is accelerating. Customer preferences are spreading beyond national borders. We therefore have to design strategies based on the premise that the market extends world-wide for entertainment industry players, including among others, the digital entertainment sector.

Having said that, we must also acknowledge that until now,

the Group's business foundations have remained—for the most part—within Japan.

A substantial share of our earnings have been dependent on the Japanese market. Although we have several strong franchises appealing to North American and European markets, our business structure has remained as a typical export-driven model, whereby the content we developed in Japan has been exported to overseas markets.

In the fiscal year under review, the major management theme for us has revolved around building a global business structure.

First off, from the fiscal year ended March 31, 2009, we began placing orders for game development with U.S. and European companies. We have forged strategic relationships with such renowned game developers as Gas Powered Games Corp. We have already shown several of these titles at the 2009 E3 (Electronic Entertainment Expo) in Los Angeles.

Additionally, leveraging our significant marketing strength within Japan, we commenced domestic sales of game titles produced by leading game publishers. These include titles from Ubisoft (released exclusively by Square Enix in Japan) and Activision Blizzard.

We expect these moves to contribute to earnings from the second half of 2009.

Regarding our efforts to build a global business structure, we have already taken another decisive step in 2009. I will provide further details on this development later in this report.

#### Gas Powered Games Corp.

Gas Powered Games is currently developing "Supreme Commander 2," which is scheduled for release by the Group in 2010. In June 2009, "Supreme Commander 2" received considerable attention after winning the Best Strategy Game award at E3 2009 in Los Angeles.

#### 3 Establishing diverse points of contact with our customers

Since the content we create is not a commodity with physical value but derives its value from the experience it provides, this content cannot reach our customers without passing through some point of contact. I use "contact points" as a generic term including such communications devices as game consoles, personal computers (PCs), and mobile phones; such media as books, DVDs and broadcasting; and such distribution channels as movie theaters, game arcades, DVD retailers, ISPs and mobile communications carriers.

The revenue model for content has been established in

each contact point. A customer's choice of a certain contact point depends on his/her lifestyle. In other words, even if a customer's content-related tastes do not change, if the customer's lifestyle changes, there is the possibility that we may no longer be able to convert those customer tastes into revenue.

For this reason, we are committed to offering content across a broad array of contact points. No matter which contact point a customer chooses, we have the opportunity to convert tastes into revenue. Furthermore, we can maximize revenue opportunities by providing multiple contact points for the same content. At the same time, the exposure our content receives becomes multilayered and brand value is enhanced.

Until now, the entertainment industry has been divided, according to the point of contact chosen by the customer, into such sectors as movies, music, manga (comics), and games. However, many sectors, including the movie sector, have pursued a multi-window strategy while the digitization of content formats has also contributed to the blurring of boundaries between sectors. This evolution means that the business environment has been transformed into one in which brand development has a far stronger impact on profitability than ever.

Whilst we fully recognize this environmental change, our business segments are purposefully divided according to customer contact point. Our most fundamental value is the centripetal force—or drawing power—of our content. Although this value is not dependent on a particular point of contact, unless each segment succeeds at its own business, we cannot generate synergies between segments. This fundamental rule effectively disciplines the day-to-day business operations.

The Mobile Phone Content segment has performed very robustly, achieving new records for both operating income and operating income margin. However, the most pressing issue we must address is that, so far, this success has been limited to the Japanese market alone. We are committed to accelerating the development of this business in North America and Europe to further bolster the segment's profitability.

The Publication segment has also performed strongly. Each year, some of our new titles achieve hit-product status, leading to extremely favorable results. However, this segment must also address the issue of being a domestic market-only business. In the future, driven by online development, we aim to expand the Publication segment's geographic territories.

The Amusement segment is facing an uphill struggle. Since our acquisition of TAITO CORPORATION four years ago, we have successfully restructured the business and built up operating profitability to around ¥4–5 billion per year. Unfortunately, in the



year under review, we faced the impact of slumping economic conditions. It seems likely that an adverse economic climate will persist for another one or two years, and we believe this industry is in a shakeout phase where the surviving participants will eventually reap rewards. For this reason, we are exerting our utmost efforts now to ensure that we are one of the future winners.

Synergy is emerging between SQUARE ENIX and TAITO. Such successes as “DRAGON QUEST Monster Battle Road” and “LORD OF VERMILLION” are drawing much attention within the amusement industry.

#### **④ Reinforcing capabilities in community management**

Brand value rests not only on the relationship between the customer and us. The brand should become a kind of hub, facilitating communication among customers themselves, and thereby further bolstering value. By running a wide range of communities, from “FINAL FANTASY XI” to “Nicotto Town,” we aim to reinforce our group's community management capabilities.

The four strategies I have outlined above form the core of our growth strategy.

##### **Nicotto Town**

SQUARE ENIX HOLDINGS wholly owned subsidiary SMILE-LAB Co., Ltd., officially launched the Nicotto Town online virtual community in September 2008. In the nine months since its official launch, Nicotto Town has recorded over 240,000 user registration. With site page views now exceeding 200 million per month, Nicotto Town continues to enjoy steady growth.

### Game Entertainment becomes Mainstream

Computer games had their first boom around thirty years ago through the emergence of arcade games. More than twenty years ago, Nintendo’s Family Computer (or NES) game console became a major hit product in Japan, ushering in an era of intense competition in the home game console market. Game consoles spread in popularity to North America in the second half of the 1990s and subsequently to Europe at the beginning of this decade, eventually leading to global market penetration.

During this time, PC-based computer games steadily strengthened their footing in Europe and North America, while online games achieved a breakthrough in popularity in the Asia region from the second half of the 1990s, particularly centered on South Korea and China. Since 2000, as the functionality of mobile phones has advanced, the range of games played on mobile phones has also expanded rapidly.

In terms of demographic spread, although computer games started out mainly as entertainment aimed at children, over the industry’s thirty-year history it has evolved into a popular entertainment genre for adults too.

Games have spread their popularity from almost any perspective one might choose—geographically, across age groups, and to a wide variety of platforms. Games have become a mainstream genre of global entertainment.

The game industry has now grown to become one of the world’s major industries, with continuing growth expected in the future. Consequently, as an industry participant, we must take all possible measures to serve the game market as one of the world’s most sophisticated markets. I believe such efforts will be rewarded.

### Eidos Ltd. joins the SQUARE ENIX Group

Since the reach of the game industry is global, we must also become a truly global business. We need to establish game development studios in multiple locations around the world and transform our sales and marketing organization in each region from a mere outpost agency of Japan-based headquarters to one that has firm roots in the local market.

In April 2009, as our first move aimed at forging more globalized operations, we acquired Eidos Ltd. as a wholly owned subsidiary. The acquisition price was £84.3 million (¥12.1 billion as of the purchase date).

Three main reasons contributed to our decision that Eidos would make a suitable member of the SQUARE ENIX Group.

Firstly, Eidos has proven its extremely high game development capabilities. The company boasts a strong lineup of high-quality content, including such major franchises as “Tomb Raider” (more than 30 million units shipped) and “Hitman” (over 8 million units shipped).

Secondly, among major European and North American game publishers, Eidos is one of the few companies to own nearly all of its titles’ IP outright. From the perspective of our core strategy of establishing a diverse range of customer points of contact, this is particularly significant.

Thirdly, Eidos has a corporate culture that emphasizes the importance of what we in Japan refer to as “monozukuri”—a passion for the art and science of producing high-quality products. This also fits closely with our philosophy. Eidos places importance on the world view articulated through its products. The company’s culture of pursuing the richest game experience possible

### Eidos studios and its major titles

■ Crystal Dynamics	United States	Tomb Raider : Underworld (Published in November 2008) Hitman : Blood Money (Published in May 2006)
■ IO Interactive	Denmark	Kane & Lynch : Dead Men (Published in November 2007) Mini Ninjas (In development, September 2009)
■ Eidos Montréal	Canada	Deus Ex 3 (In development, TBA) Thief 4 (In development, TBA)
■ Beautiful Game Studios	United Kingdom	Championship Manager 10 (In development, September 2009) Just Cause 2 (In development, 2010)
■ Eidos Game Studios*	United Kingdom	Battlestations : Pacific (Published in May 2009)

\*Eidos Game Studios includes the Eidos Hungary Studio (Battlestations: Pacific) and the management of all external studio projects such as Rocksteady Studios (Batman: Arkham Asylum) and Avalanche Studios (Just Cause 2). Eidos owns 25% of Rocksteady Studios.

for its customers has much in common with our own approach.

We anticipate significant opportunities to generate short- and medium-term synergies between SQUARE ENIX and Eidos. Although Eidos develops excellent content, the company's major source of revenue is limited to game software sales. By promoting SQUARE ENIX's unique strength in creating multiple revenue opportunities for content, we will strive to maximize Eidos' earnings potential. In addition, since the entire SQUARE ENIX Group's sales will become more geographically balanced, we believe we can generate substantial scale advantages through our publishing of games. Furthermore, while SQUARE ENIX has built its reputation principally based on its strengths in the role-playing game (RPG) genre and on its capabilities in high-quality graphics, Eidos is known for its strengths in the action and adventure genres. Consequently, we think the two companies can build an ideal complementary relationship. I am sure that by providing opportunities for game creators from both companies to communicate and share their know-how, we can forge a sound base for the creation of superior content.

Another key point is the potential for long-term advantages. Unlike consumer electronics or business software, the "global standard" model is not applicable to the entertainment industry. By this, I mean that a single standard does not dominate all markets. I believe that striking the correct balance between global and local is particularly crucial. Based on this awareness, I think that there are limitations to what can be achieved in overseas business expansion if we simply rely on extending bridgeheads out from Japan. By this, I mean a model whereby Japanese staff members are sent out to overseas locations to establish offices and hire local staff as a means of expanding the business internationally.

Eidos has a history in Europe spanning over twenty years, and was listed on the London Stock Exchange prior to the acquisition by SQUARE ENIX. The experience and track record built up by Eidos now becomes part of the SQUARE ENIX Group, and we anticipate significant benefits from the ideal fusion of these two corporate cultures.

### **Established Framework for Growth**

We can spare no effort as we strive to create the highest quality content. Naturally, until now, we have focused on building a sound framework for growth. We have been making every effort to establish a broad variety of points of contact with our customers and to build a business platform capable of expansion into a global concern.

The beginning of this building process was the merger of

ENIX and SQUARE. Through the birth of SQUARE ENIX, we have been able to construct a solid business foundation comprising of our respective game businesses, characters and derivative products, publication and mobile phone content. Through this we have successfully established a diverse range of customer points of contact.

Later, by acquiring TAITO, we added physical points of contact with our customers through the game arcade-based Amusement business. Now, with the addition of Eidos, we have successfully established the foundations for a truly global enterprise.

The framework we have been aiming for is now largely visible. What remains is the establishment of business bases in China and other parts of Asia, and the shift to an online business platform. Of course, a framework on its own does not make a business. We must build out from what we have established, and, I am acutely conscious of the necessity to follow up with tangible results.

Over thirty years ago, the arcade revolution was triggered by "Space Invaders" (TAITO). Twenty years ago, home game-console software first entered popular consciousness with the arrival of "DRAGON QUEST" (ENIX). Ten years ago, the 3-D graphics that enabled game content to provide the same viewing experience as other video-based content was "FINAL FANTASY" (SQUARE). Also 10 years ago, a milestone in 3-D action adventure was reached with the launch of "Tomb Raider" (Eidos).

The SQUARE ENIX Group has consistently been at the forefront of major breakthroughs in the history of the game industry. Although it may seem somewhat immodest, I believe we have a mission to play a major part in the coming convergence between media and entertainment. Our focus on building a sound growth framework is based on this mission.

Although our business results for the fiscal year under review were less than satisfactory, we are steadfast in our commitment to be a driving force in the media and entertainment industries. In these endeavors, I look forward to your continuing loyal support.

July 2009



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