



# Discussion Points

# Overview of the SEGA SAMMY Group

The SEGA SAMMY Group is a comprehensive entertainment corporate group created through the management integration of SEGA CORPORATION (currently SEGA Games Co., Ltd.) and Sammy Corporation, which have produced many industry-first and world-first products.



Since its establishment in 1975, Sammy has lived up to its "Always Proactive, Always Pioneering" founding principle by creating pachislot and pachinko machines with industry-leading gameplay.



Our mission is *continuing to create moving experiences* for customers worldwide. With this in mind, we will roll out entertainment across a broad spectrum of areas.

**Date of Establishment: October 1, 2004**  
**Capital: ¥29.9 billion**  
**Total Shares Issued and Outstanding: 266,229,476**  
**Number of Shareholders: 90,768**  
**Number of Employees: 7,606 (consolidated)**  
**(as of March 31, 2016)**

## The Group Management Philosophy

By providing entertainment filled with dreams and excitement to people throughout the world, we will strive to enrich our society and culture.



Pachislot CODE GEASS  
 Lelouch of the Rebellion R2  
 ©SUNRISE/PROJECT GEASS  
 Character Design  
 ©2006 CLAMP-ST  
 ©SUNRISE/PROJECT GEASS  
 Character Design  
 ©2006-2008 CLAMP-ST  
 ©BANDAI NAMCO  
 Entertainment Inc. ©Sammy



Pachinko CR Hokuto No Ken 6  
 Tenshou Hyakuretsu  
 ©Buronson & Tetsuo Hara/  
 NSP 1983, ©NSP 2007  
 Approved No.YTK-805 ©Sammy



maimai PINK  
 ©SEGA

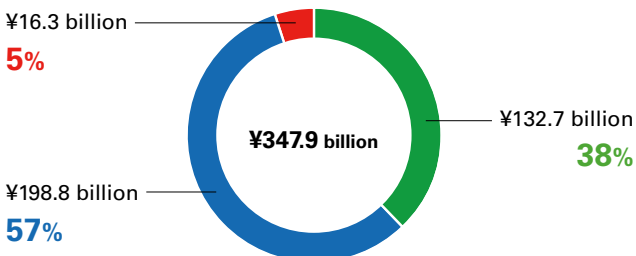


Sonic the Hedgehog  
 ©SEGA

## The Group's Structure

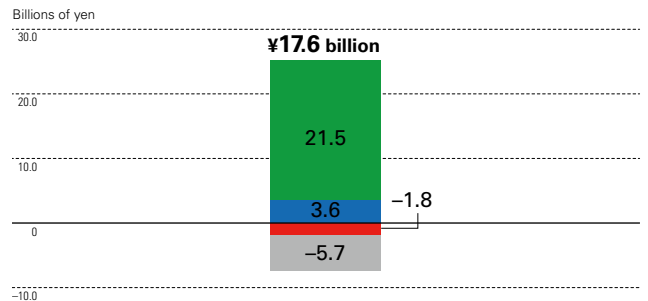
The SEGA SAMMY Group offers a wide spectrum of entertainment. Its Pachislot and Pachinko Machine Business segment is centered on Sammy Corporation. Meanwhile, the SEGA Group's digital game business is the core of the Entertainment Contents Business segment, which develops packaged game software and amusement machines, operates amusement centers, produces animation, and sells toys. Further, the Resort Business segment develops and manages hotels, theme parks, and integrated resorts.

### Net Sales Breakdown (Fiscal 2016)



■ Pachislot and Pachinko Machine Business ■ Entertainment Contents Business ■ Resort Business

### Operating Income (Fiscal 2016)



■ Pachislot and Pachinko Machine Business ■ Entertainment Contents Business ■ Resort Business ■ Corporate and eliminations

# Learning about Our Products and Services

By taking maximum advantage of the abundant intellectual properties at its disposal across an extensive range of entertainment fields, the SEGA SAMMY Group will continue providing *moving experiences*.

## Pachislot and Pachinko Machine Business



**Pachislot**  
**Hokuto No Ken Tomo**  
©Buronson&Tetsuo Hara/  
NSP1983  
©NSP2007,Approved  
No.YFC-128  
©Sammy



**Pachinko CR**  
**Shin Hokuto Muso**  
©Buronson & Tetsuo Hara/  
NSP 1983 Approved No.KOJ-111  
©2010-2013  
KOEI TECMO GAMES CO., LTD.  
©Sammy

## Resort Business



**Phoenix Seagaia Resort**  
©PHOENIX RESORT CO., LTD.



**TOKYO JOYPOLIS**  
©SEGA

## Entertainment Contents Business



**Persona5**  
©ATLUS ©SEGA  
All rights reserved.



**StarHorse3 Season V**  
**EXCEED THE LIMIT**  
©SEGA



**PHANTASY STAR ONLINE 2**  
©SEGA



**Anpanman Uncle Jam's Bakery**  
©Takashi Yanase/Froebel-kan,TMS,NTV



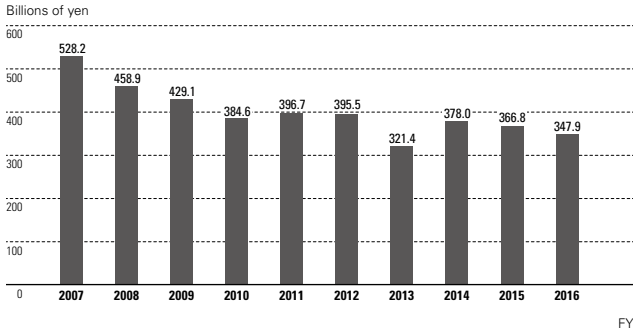
**Detective Conan**  
**The Darkest Nightmare**  
© 2016 GOSHO AOYAMA / DETECTIVE CONAN COMMITTEE  
All Rights Reserved



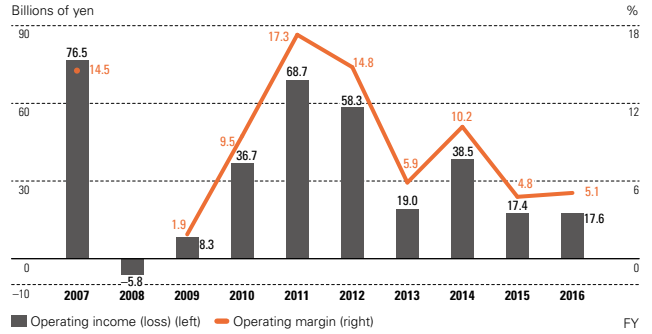
**Puyopuyo!! Quest**  
©SEGA

# Overview of Key Numbers

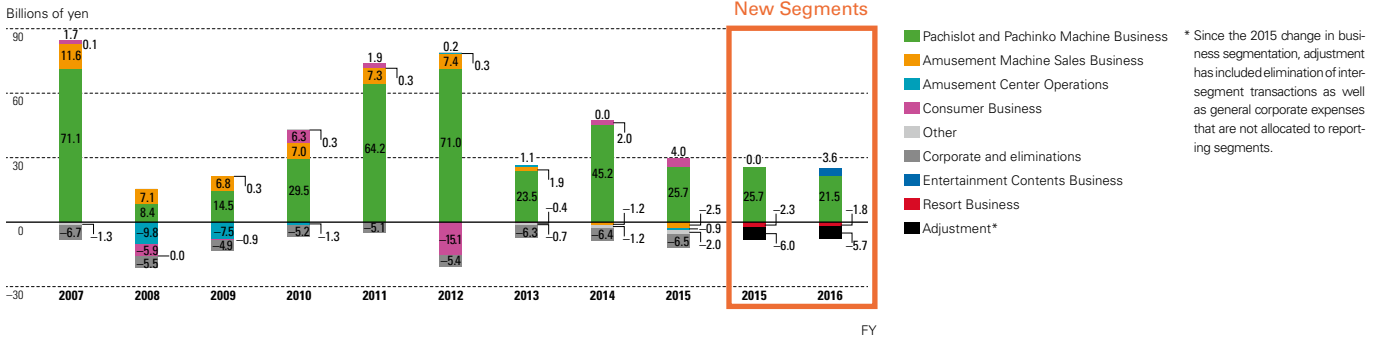
## Net Sales



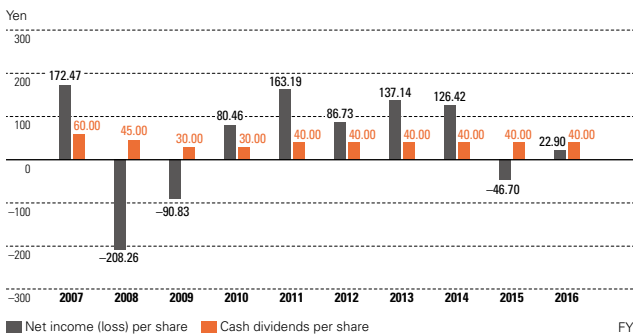
## Operating Income (Loss) / Operating Margin



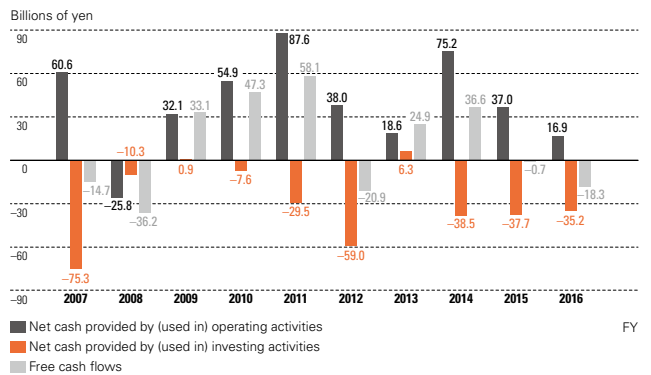
## Operating Income (Loss) by Segment



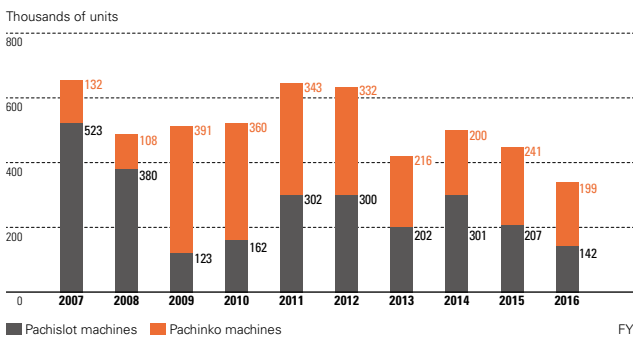
## Net Income (Loss) per Share / Cash Dividends per Share



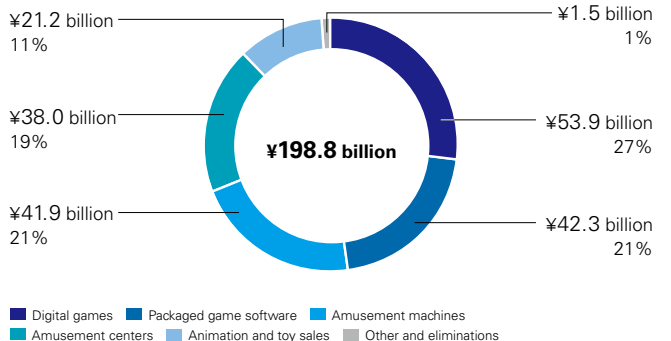
## Cash Flows



## Pachislot and Pachinko Machine Unit Sales

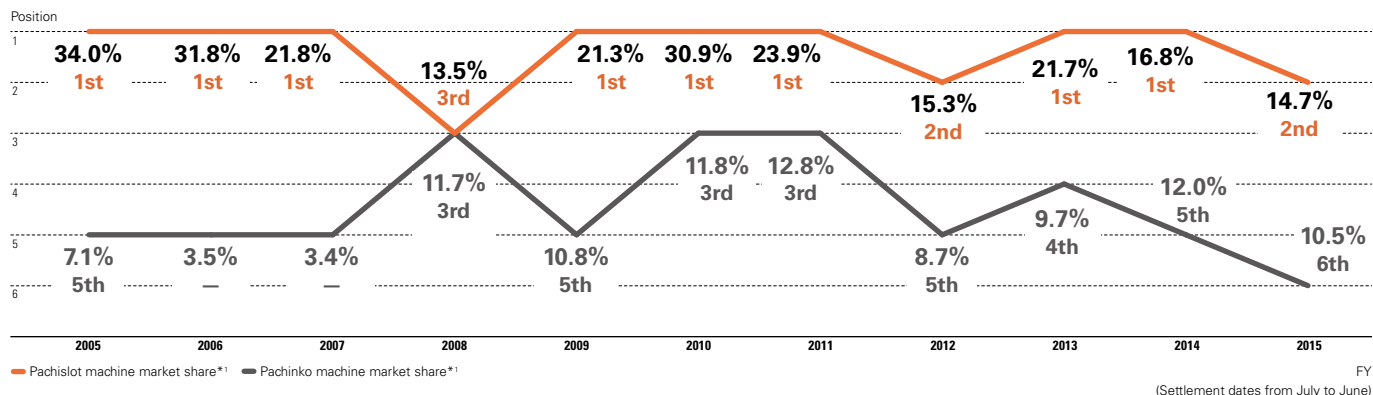


## Breakdown of Net Sales of the Entertainment Contents Business (Fiscal 2016)



## Peer Group Comparison Data

### SEGA SAMMY Group's Positions in the Pachinko and Pachislot Machine Market



	Billions of yen
<b>Net Sales*2</b>	
BANDAI NAMCO	575.5
Nintendo	504.4
<b>SEGA SAMMY</b>	<b>347.9</b>
CyberAgent	254.3
KONAMI	249.9
Heiwa	214.9
SQUARE ENIX	214.1
mixi	208.7
GungHo Online Entertainment	154.3
SANKYO	137.1
ROUND ONE	83.5
CAPCOM	77.0
COLOPL	72.3

	%
<b>ROE*2</b>	
mixi	69.7
COLOPL	52.6
GungHo Online Entertainment	39.9
CyberAgent	24.4
Heiwa	15.6
SQUARE ENIX	12.3
BANDAI NAMCO	11.2
CAPCOM	10.6
KONAMI*4	4.9
SANKYO	2.9
<b>SEGA SAMMY</b>	<b>1.8</b>
Nintendo	1.4
ROUND ONE	0.9

	Billions of yen
<b>Amusement Center Operation Sales*2</b>	
ROUND ONE	83.5
AEON Fantasy	58.8
BANDAI NAMCO	58.6
SQUARE ENIX*6	41.1
<b>SEGA SAMMY</b>	<b>38.0</b>
ADORES*7	14.7
CAPCOM	9.0
KOEI TECMO	1.2

	Billions of yen
<b>Operating Income*2</b>	
mixi	95.0
GungHo Online Entertainment	72.4
BANDAI NAMCO	49.6
Heiwa	38.9
Nintendo	32.8
CyberAgent	32.7
COLOPL	32.3
SQUARE ENIX	26.0
KONAMI	24.6
SANKYO	18.8
<b>SEGA SAMMY</b>	<b>17.6</b>
CAPCOM	12.0
ROUND ONE	6.3

	%
<b>ROA*2,3</b>	
GungHo Online Entertainment	40.2
mixi	37.0
COLOPL	32.8
CyberAgent	11.3
SQUARE ENIX	8.5
BANDAI NAMCO	7.7
CAPCOM	6.9
Heiwa	6.2
KONAMI*4	3.2
SANKYO	2.5
Nintendo	1.3
<b>SEGA SAMMY</b>	<b>1.0</b>
ROUND ONE	0.4

	Millions of units
<b>Unit Sales of Home Video Game Software (Global)*2</b>	
BANDAI NAMCO	26.68
SQUARE ENIX	22.78
CAPCOM	15.00
<b>SEGA SAMMY</b>	<b>9.22</b>
KOEI TECMO	5.57

	%
<b>Operating Margin*2</b>	
GungHo Online Entertainment	46.9
mixi	45.5
COLOPL	44.6
Heiwa	18.1
CAPCOM	15.6
SANKYO	13.7
CyberAgent	12.9
SQUARE ENIX	12.2
KONAMI	9.9
BANDAI NAMCO	8.6
ROUND ONE	7.6
Nintendo	6.5
<b>SEGA SAMMY</b>	<b>5.1</b>

	Billions of yen
<b>Market Capitalization*5</b>	
Nintendo	2,266.7
BANDAI NAMCO	544.7
KONAMI	477.8
SANKYO	375.4
SQUARE ENIX	371.7
mixi	352.3
GungHo Online Entertainment	335.3
CyberAgent	330.6
<b>SEGA SAMMY</b>	<b>326.6</b>
COLOPL	300.1
Heiwa	232.8
CAPCOM	185.9
ROUND ONE	60.6

	Billions of yen
<b>Net Sales of Amusement Machines*2</b>	
BANDAI NAMCO	57.9
<b>SEGA SAMMY</b>	<b>41.9</b>
CAPCOM	13.3

Note: The above is intended to give an idea of the Group's position in the industry and only covers companies for which information can be obtained from published documents, such as listed companies. As there are unlisted companies that do not disclose information, this is not a completely accurate industry ranking.

\*1 Source: Yano Research Institute Ltd.

\*2 Respective companies' settlement data. Source: Respective companies' published documents

\*3 ROA = Profit attributable to owners of parent ÷ Total assets

\*4 IFRS: ROE = Net income to equity attributable to owners of parent ratio; ROA = Net income attributable to owners of parent ÷ Total assets

\*5 Source: Calculated by the Company based on the closing prices at respective stock exchanges on March 31, 2016.

\*6 "Amusement" including amusement centers and amusement machines

\*7 General Entertainment Business

# Analyzing SWOT

## Pachislot and Pachinko Machine Business

### STRENGTHS

- Product appeal underpinned by strong development capabilities
- Intellectual properties promising high utilization
- Large share in the pachislot machine market
- Significant production capacity

### OPPORTUNITIES

- Scope for growth in pachinko machine market
- Capturing of demand from casual players due to regulatory change

### WEAKNESSES

- Variability of earnings
- Business development limited to Japan
- Inefficiency of business activities (development of products with excessively high quality, multibrand strategy)

### THREATS

- Declining player numbers
- Financial position of pachinko hall operators
- Increase in component costs

## Entertainment Contents Business

### STRENGTHS

- One of the industry's largest development teams, comprising approximately 2,000 personnel (the SEGA Group)
- Industry-leading portfolio depth (digital games)
- Marketing support tool *Noah Pass* (digital games)
- Accumulation of numerous major intellectual properties (packaged game software, digital games, amusement machines, animation, and toys)
- Recovery trend in earning power (packaged game software, digital games, amusement machines, amusement centers, animation, and toys)
- Product lineup catering to a broad range of player groups (amusement machines)
- One of industry's highest levels of operational efficiency (amusement centers)

### OPPORTUNITIES

- Trend toward high-end game apps as smartphones become more advanced (digital games)
- Rapid spread of smartphones in Southeast Asia (digital games)
- Spread of new-generation home video game consoles (packaged game software)
- Broadening market for families' three generations and new facilities including restaurants (amusement machines and amusement centers)
- Increase in interest in Japanese culture overseas due to government's "Cool Japan" policy (packaged game software, digital games, animation, toys)
- Revision of Act on Control and Improvement of Amusement Business, etc. (amusement centers)

### WEAKNESSES

- Absence of major hit titles (digital games)
- Low profit margins and capital turnover ratio (amusement centers)

### THREATS

- Intensification of competition in Japan's digital game market
- Challenging financial positions of amusement center operators (amusement machines)
- Diversification of entertainment (packaged game software, amusement machines, amusement centers)
- Decline in player numbers due to lower birthrate (packaged game software, amusement machines, amusement centers)
- Increase in consumption tax (amusement machines, amusement centers)

## Resort Business

### STRENGTHS

- Robust financial base that can support large-scale investment
- Lead in accumulation of know-how related to integrated resorts
- Expertise in creating entertainment spaces and exploitable content
- Early entry into South Korea's integrated resort market

### OPPORTUNITIES

- Increase in overseas visitors to Japan
- Tokyo 2020 Olympic and Paralympic Games
- Moves toward realization of integrated resorts in Japan

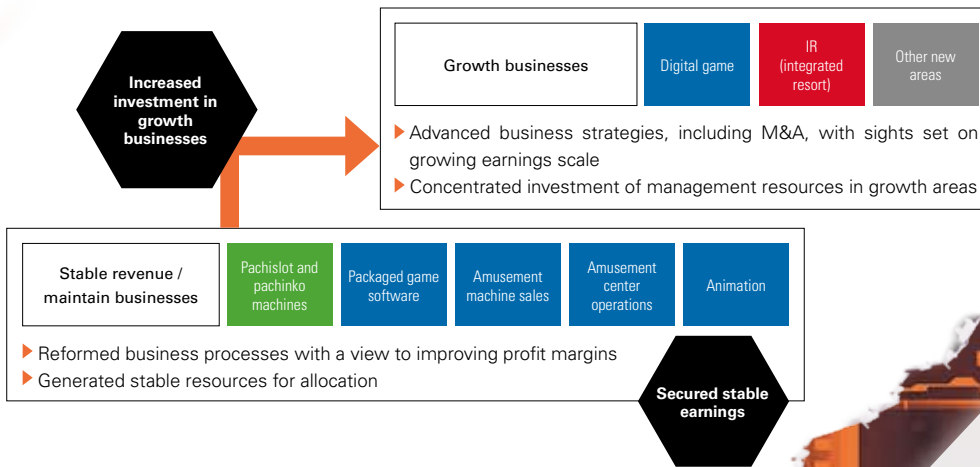
### WEAKNESSES

- Continuing recognition of operating loss because at prior investment stage

### THREATS

- Uncertainty of realization of integrated resorts in Japan
- Intensification of competition within Asia related to integrated resorts

# Evaluating Strategies



## Positioning of each business and management strategy

The three business segments will implement measures with a view to realizing earnings scale or profit margin in accordance with their respective portfolio positions.

## Important Management Benchmarks for Fiscal 2020

Operating Margin **15%**  
ROA\* **5%**

### Pachislot and Pachinko Machine Business

<b>Basic Strategy</b> <b>Generate stable revenue</b>	<b>Segment Target</b> <b>Operating margin of 30%</b> (fiscal 2020)
<b>Main Measures</b>	
<ol style="list-style-type: none"> <li>1. Strengthen collaboration with industry peers</li> <li>2. Revise multibrand strategy</li> <li>3. Select titles carefully</li> <li>4. Promote reuse</li> </ol>	

### Entertainment Contents Business

<b>Basic Strategy</b> <b>Grow mainly through the digital game area</b>	<b>Segment Target</b> <b>Operating income of ¥20 billion</b> (fiscal 2020)
<b>Main Measures</b>	
<ol style="list-style-type: none"> <li>1. Secure stable earnings by heighten the profit margins of amusement machines and home video games</li> <li>2. Invest proactively in digital games for emerging markets overseas</li> <li>3. Move casino machines into the black as soon as possible</li> </ol>	

**Emphasis on Profit Margin**      Make improvement of profit margin first priority

**Enhancement of Capital Efficiency**      Heighten capital turnover ratio  
Optimize management resource allocation

### Resort Business

<b>Basic Strategy</b> <b>Become third pillar</b>	<b>Segment Target</b> <b>Participate in the integrated resort business</b>
<b>Main Measures</b>	
<ol style="list-style-type: none"> <li>1. Implement advance investment aimed at participation in the integrated resort business in Japan</li> <li>2. Accumulate know-how through development and management of integrated resorts overseas</li> <li>3. Enhance the brand value of <i>Phoenix Seagaia Resort</i></li> </ol>	

### New Businesses

**Basic Strategy**  
**Fourth pillar**

**Conditions for Participation in New Businesses**

The Group will participate in new business areas if they enable it to create synergies by leveraging the management resources it has as a comprehensive entertainment corporate group. Mergers and acquisitions are an important option. However, we will only implement mergers and acquisitions if rigorous analysis of the potential corporate value of target companies indicates that we can heighten the value of their businesses.

Fiscal 2016

Operating Margin **5.1%**  
ROA\* **1.0%**

\* ROA = Profit attributable to owners of parent ÷ Total assets

# Examining the Governance System

## Corporate Governance System at a Glance (As of June 30, 2016)

<b>Format</b>	Audit and Supervisory Board member system	<b>Individual disclosure of directors' compensation</b>	Disclosure only for directors with total compensation of ¥100 million or more
<b>Reason for adoption of format</b>	Based on the view that this system enables directors to make prompt, optimal management decisions amid volatile business conditions based on their wealth of expertise and experience regarding the industry, market trends, products, merchandise, and services	<b>Audit and Supervisory Board members</b>	4
<b>Directors</b>	8	<b>Of whom, outside Audit and Supervisory Board members</b>	2
<b>Of whom, outside directors</b>	3	<b>Independent directors</b>	5 (3 outside directors, 2 outside Audit and Supervisory Board members)
<b>Voluntary committees</b>	Independent Advisory Committee	<b>Independent auditor</b>	KPMG AZSA LLC
<b>Term of directors</b>	1 year	<b>Term of auditing contracts</b>	Renewed annually
<b>Incentives granted to directors</b>	Introduction of stock option system	<b>Adoption of executive officer system</b>	Yes

## Compensation of Directors

Compensation of directors and Audit and Supervisory Board members for fiscal 2016 is as follows.

Position	Directors / Audit and Supervisory Board members	Total compensation (¥ million)	Total compensation by type (¥ million)			
			Basic compensation	Bonus	Stock options	
Directors	Internal	8	503	380	123	—
	Outside	2	32	32	—	—
Audit and Supervisory Board members	Internal	—	—	—	—	—
	Outside	2	26	26	—	—

The compensation paid to directors who received ¥100 million or more in consolidated compensation for fiscal 2016 is as follows.

Name	Position	Total consolidated compensation, etc. (¥ million)	Company	Total consolidated compensation by type (¥ million)		
				Basic compensation	Bonus	Stock options
Hajime Satomi	Director	448	The Company	248	50	—
			Sammy	—	150	—

## Outside Directors



**Yuji Iwanaga\***  
Outside Director

1981 Registered with The Japan Federation of Bar Associations  
 1984 Partner of Lillick McHose and Charles Law Office (now Pilsbury Winthrop Shaw Pittman LLP) (current position)  
 Registered with the State Bar of California  
 2003 Outside Director of Manufacturers Bank  
 2005 Outside Director of JMS North America Corporation (current position)  
 2006 Outside Director of TAIYO YUDEN Co., Ltd.  
 2007 Outside Director of the Company (current position)



**Takeshi Natsuno\***  
Outside Director

2005 Executive Officer and Managing Director of Multimedia Services Department of NTT DoCoMo, Inc.  
 2008 Outside Director of the Company (current position)  
 Director of PIA CORPORATION (current position)  
 Outside Director of transcosmos inc. (current position)  
 Director of DWANGO Co., Ltd. (current position)  
 Director of NTT Resonant Inc. (current position)  
 Guest Professor, Graduate School of Media and Governance of Keio University (current position)  
 2009 Outside Director of DLE Inc. (current position)  
 Outside Director of GREE, Inc. (current position)  
 2010 Outside Director of U-NEXT, Inc. (current position)  
 2014 Director, Member of the Board of KADOKAWA DWANGO CORPORATION (current position)  
 2016 Outside Director of Oracle Corporation Japan (current position)



**Kohei Katsukawa\***  
Outside Director

1974 Joined Sumitomo Bank (now Sumitomo Mitsui Banking Corporation)  
 2001 Executive Officer, Head of Osaka Corporate Banking Division II of the above  
 2005 Managing Executive Officer, Deputy Head of Wholesale Banking Unit (in charge of East Japan) of the above  
 2007 Executive Vice President and Representative Director of NIF SMBC Ventures Co., Ltd. (now SMBC Venture Capital Co., Ltd.)  
 2010 President and Representative Director of SMBC Venture Capital Co., Ltd.  
 2014 President and Representative Director of GINSEN Co., Ltd.  
 2016 Outside Director of the Company (current position)

\* Qualified outside director as provided in Paragraph 2, Clause 15 of the Companies Act of Japan.



# Assessing the Creation of Shareholder Value

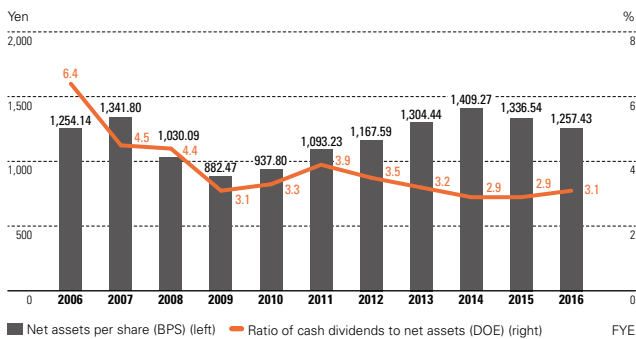
## Returning Profits to Shareholders—Policy, Results, and Outlook

While directly returning profits to shareholders through stable cash dividends, we will retain the option of acquiring treasury stock in response to share price levels. Meanwhile, we will increase shareholder value continuously while taking care to balance strategic investment to win out against competitors in growth areas and internal reserves needed for a future integrated resort business.

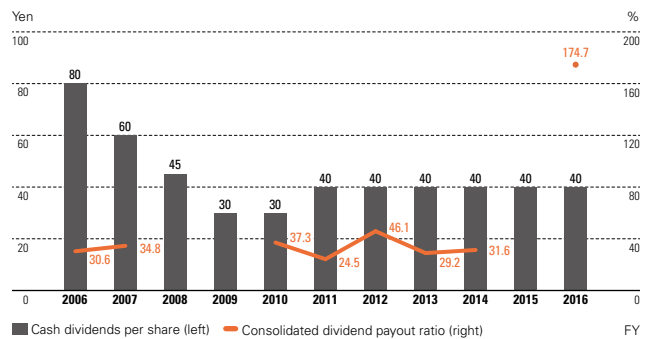
For fiscal 2016, we paid cash dividends of ¥40.00 per share. As a result, the ratio of cash dividends to net assets was 3.1%.

For fiscal 2017, ending March 31, 2017, we plan to pay interim cash dividends of ¥20.00 per share and year-end cash dividends of ¥20.00 per share, giving full-year cash dividends of ¥40.00 per share.

Net Assets per Share (BPS) / Ratio of Cash Dividends to Net Assets (DOE)



Cash Dividends per Share / Consolidated Dividend Payout Ratio

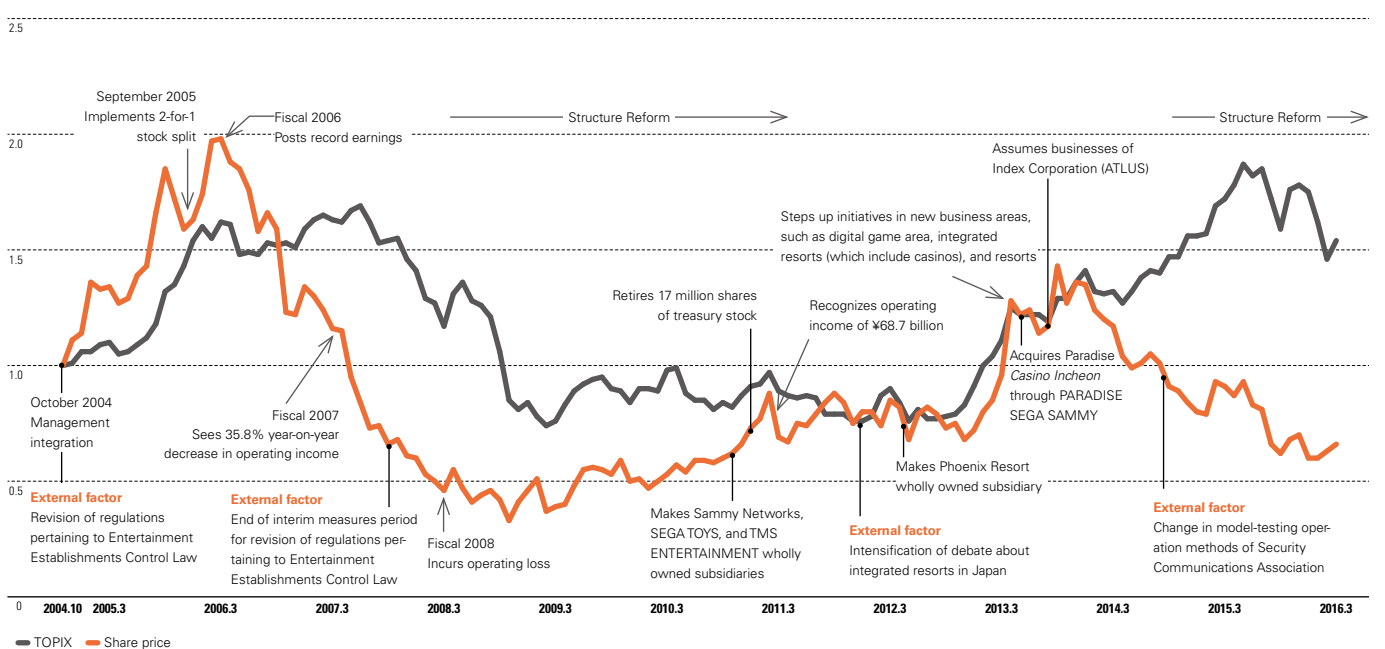


\* Consolidated dividend payout ratio not applicable because the Group recorded a net loss in fiscal 2008, fiscal 2009, and fiscal 2015.

## Acquisition of Shares of Treasury Stock

Fiscal Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Acquisition	—	—	—	—	—	—	14 million shares	5 million shares	10 million shares	—	10 million shares	—

## Comparison of Share Price and Tokyo Stock Price Index (TOPIX)



# Basic Information about the Pachinko and Pachislot Machine Market (Reference)

## Size of Pachinko and Pachislot Markets

Pachinko machines trace their origins to bagatelle boards, imported to Japan in the 1920s. Pachinko is a game in which players manipulate a handle in order to mechanically shoot steel pachinko balls with diameters of about 11mm onto a vertically positioned board studded with numerous pins. When the balls fall into certain devices or the jackpot mouth, additional pachinko balls are won. The main difference between pinball and pachinko is that in a pachinko machine the board is nearly vertical.

Meanwhile, the roots of pachislot are said to be slot machines brought from the United States after the end of the Second World War. The 1960s saw the emergence of slot machines requiring a certain level of playing skill because they incorporated buttons that allowed players to stop the reels spinning. These machines spread to pachinko halls throughout Japan.

As one of Japan's flagship leisure industries, pachinko and pachislot claims a major share of the country's leisure market. Comprising the ball and token rental fees that the pachinko halls charge, this market accounts for roughly 32.1% of the leisure market, revenues of ¥23.2 trillion,\*<sup>1</sup> and 10.7 million players.\*<sup>1</sup> In the pachinko and pachislot machine manufacturing industry, machine sales are worth approximately ¥982.7 billion.\*<sup>2</sup>

\*<sup>1</sup> 2015. Source: *White Paper on Leisure Industry 2016*, Japan Productivity Center

\*<sup>2</sup> Fiscal 2015 (settlement dates from July to June). Source: Yano Research Institute Ltd.

## Regulatory Environment

Before launching a machine, manufacturers are required to navigate an approval process in accordance with the Entertainment Establishments Control Law. First, they must file an application for prototype testing with the Security Communications Association and acquire certification that elements such as materials, functions, and gameplay are in conformance with the law. Next, the machines are verified by the Public Safety Commission in each prefecture. Only then can they be supplied to pachinko halls. Before commencing operations, the pachinko hall operators must acquire approval from district police stations.

The Entertainment Establishments Control Law and the internal regulations of industry bodies have been revised frequently with a view to the sound development of the industry. Each revision has affected the pachinko and pachislot machine market.

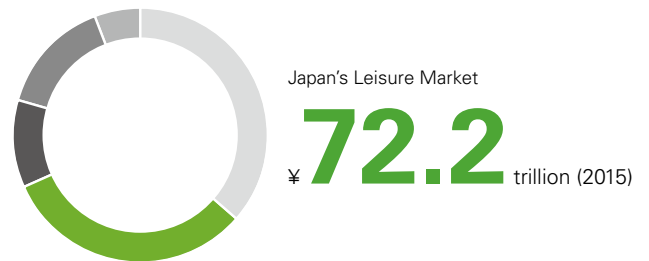


Pachinko CR Shin-Juoh 2  
©Sammy



Pachislot Nisemonogatari  
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## Shares of Pachinko and Pachislot in Japan's Leisure Market

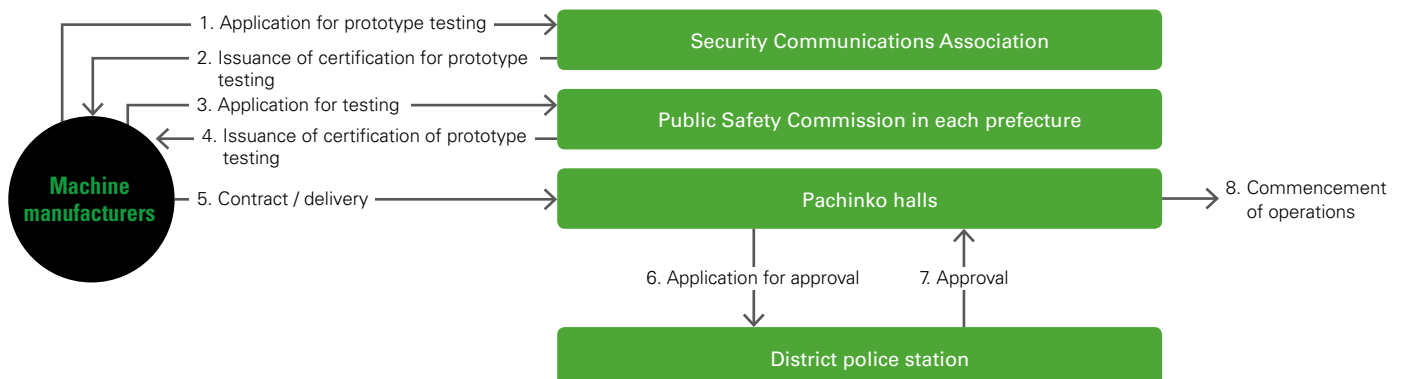


	%	Trillions of yen
Games / Publicly operated sports / Eating and drinking	36.4	26.3
Pachinko and pachislot* <sup>3</sup>	32.1	23.2
Hobbies	11.2	8.1
Tourism	14.7	10.5
Sports	5.5	4.0

Source: *White Paper on Leisure Industry 2016*, Japan Productivity Center

\*<sup>3</sup> Total amounts of hall ball and token rentals

## Approval Process for Pachinko and Pachislot Machines



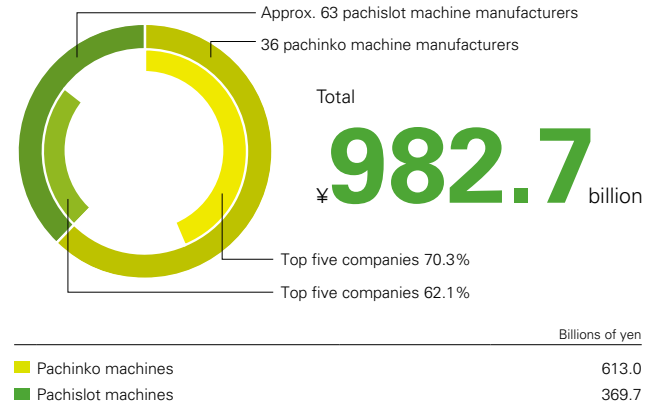
### Strengthening Oligopoly among Leading Titles and Companies

In the pachinko machine market, pachinko machines are sold by 36\*4 companies. In the pachislot machine market, pachislot machines are sold by approximately 63\*5 companies. Pachinko hall operators have been facing challenging business conditions due to the decline in the player population since the enforcement of a revision of regulations pertaining to the Entertainment Establishments Control Law (the regulatory revision) in 2004. As a result, a pronounced bias has emerged in market demand toward titles and manufacturers that promise reliable returns on investment. Partly reflecting the heightened difficulty of development as regulations continue to become stricter, recent years have seen the emergence of an increasingly well-defined oligopoly comprising titles and brands with solid utilization time track records and companies with robust development capabilities and abundant funds for investment.

\*4 Source: Yano Research Institute Ltd.

\*5 Due to the large number of organizations and companies, the current number of pachislot machine manufacturers is the Group's estimate.

### Pachinko and Pachislot Machine Market Scale



Source: The number of pachislot machine manufacturers is the Group's estimate. Market shares are from Yano Research Institute Ltd. (Unit sales basis, fiscal 2016 (settlement dates from July to June))

## Guide

# Keywords in the Pachinko and Pachislot Machine Market

### Pachinko Machine Boards and Frames

The frame is the cabinet part of a pachinko machine. It physically controls the shooting and paying out of pachinko balls. Meanwhile, the board comprises LCDs, "Yakumono," and numerous pins. The board incorporates electronic components, such as boards and sensors that control gameplay, including images and win chances presented by LCDs, and payouts. Because frames can be used continuously for certain periods, pachinko hall operators can introduce new pachinko machines by purchasing boards and simply attaching them to frames already installed at pachinko halls. The price of a pachinko board is less than that of an entire machine (a frame and board), which enables pachinko hall operators to lighten their investment burden. For manufacturers, sales of pachinko boards provide higher margins than sales of entire machines. Furthermore, under this sales model, the installation of a frame promises to generate continuous demand.

Frame



Boards



Pachinko CR Shin Hokuto Muso  
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NSP 1983 Approved No.KOJ-111  
©2010-2013  
KOEI TECMO GAMES CO., LTD.  
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New pachinko machines can be introduced by simply attaching boards to frames



Pachinko CR GAOGAOKING 2  
©Sammy

### Key Indicators for Analysis of Conditions in the Pachinko and Pachislot Machine Markets

$$\text{Annual turnover} = \frac{\text{Annual pachinko and pachislot machine unit sales}}{\text{Pachinko and pachislot machine installations}}$$

Shows the number of times pachinko hall operators replace machines during one year and their capital investment appetite.

Extra capital investment capacity **Increasing** ↑

Annual Turnover

Extra capital investment capacity **Decreasing** ↓

Down

Utilization rate = The number of hours per business day that pachinko or pachislot machines are utilized

Shows players' interest in pachinko and pachislot machines.

# Market Conditions for Each Business

## Pachinko and Pachislot Machine Market

### Long-Term Downward Trend in the Player Population

The number of players peaked in 1995 and began trending downward due to casual players leaving the market because an increasing number of machines featured more complicated gameplay or strong gambling elements. As a result, the pachinko and pachislot machine market\*1 entered a period of long-term decline.

Focused on controlling excessive gambling elements, the regulatory revision of July 2004 narrowed the scope of pachislot machines' gameplay. After the interim measures period\*2 ended in fall 2007, pachinko hall operators proceeded to replace pachislot machines with those compliant with the new regulations. As a result, the departure from the market of players, particularly pachislot core players, accelerated due to the major change in gameplay.

From 2010, the decrease in the pachinko and pachislot player population accelerated even further. In particular, the decline in interest in pachinko and pachislot among young adults has been marked. In the period from 2009 to 2015, this group shrank significantly, with the percentage of men under 20 playing pachinko and pachislot falling from 11.4% to 1.7% and the percentage of men in their 20s playing pachinko and pachislot falling from 24.5% to 6.8%. A likely cause of this trend was the diversification of pastimes that coincided with this period and which resulted from the expansion of the market for game apps for smart devices. A further cause of the trend was the further departure of casual players from the pachinko market due to the increasing installation of

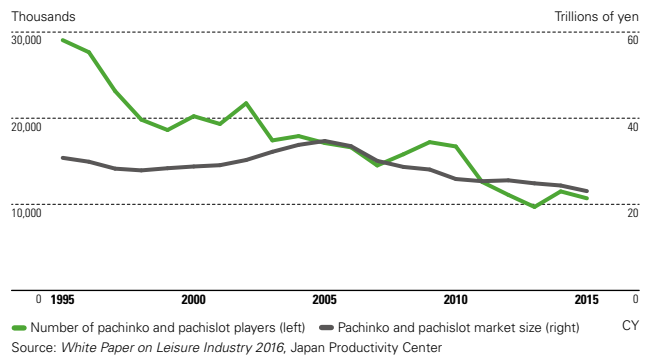
pachinko machines with a strong gambling element. Such machines were known as "Max-type" and promised an early return on investment.

As the player population decreased, the decline in player numbers and the deterioration in pachinko hall operators' financial positions became more pronounced, affecting the pachinko and pachislot machine market significantly.

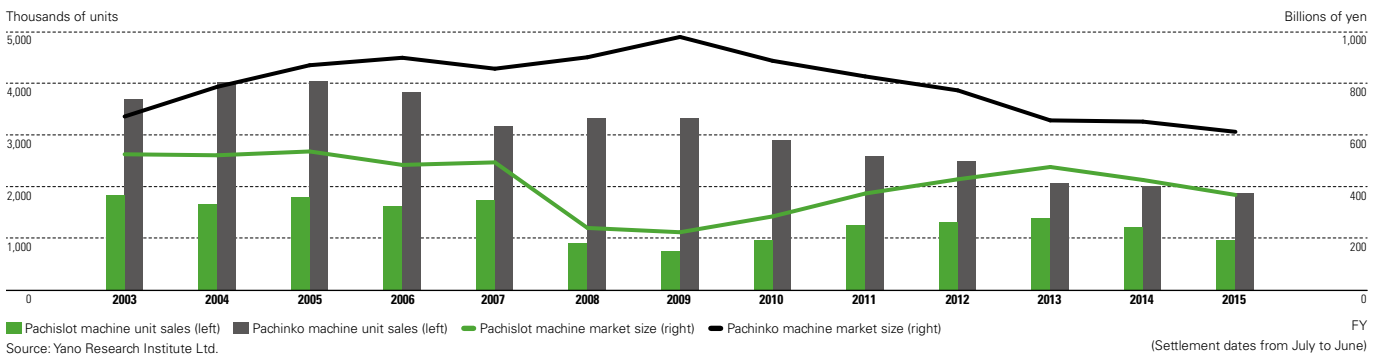
\*1 The total of pachinko hall operators' ball rental fees and token rental fees

\*2 Aiming to mitigate a sudden change of conditions and investment burden of pachinko hall operators, the regulatory revision of July 2004 included a three-year interim measures period for replacing old machines with new-format machines.

### Pachinko and Pachislot—Player Numbers and Market Size



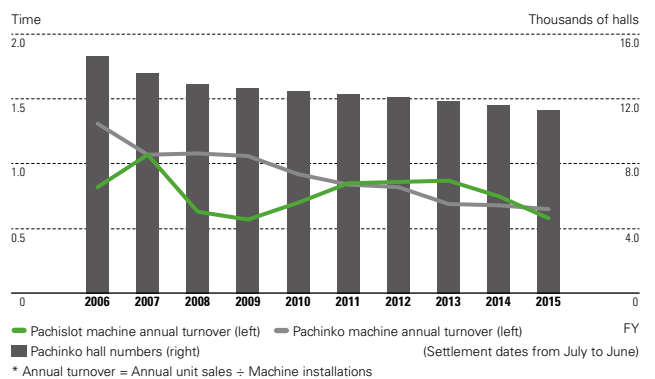
### Pachinko and Pachislot Machines—Unit Sales and Market Size



### Shakeout of Pachinko Hall Operators and Polarization among Pachinko and Pachislot Machine Manufacturers

The number of pachinko halls is on a long-term downward trend. From the perspective of pachinko hall operators, while the continuing decline in the player population is undermining their capacity to invest, prices for machines are rising. Consequently, as the declining annual turnover\*3 in the graph on the right shows, pachinko hall operators are replacing machines less often. This is directly linked to the contraction of the pachinko and pachislot machine market. Seeking reliable returns on the limited investments they can make, pachinko hall operators have been introducing machines that promise favorable utilization times.\*4 This has polarized the market further into two groups: leading manufacturers—who have competitive intellectual properties as well as robust financial bases to support development capabilities—and other manufacturers (Please see page 10).

### Annual Turnover and Pachinko Hall Numbers



\*3 Annual turnover = Annual pachinko and pachislot machine unit sales + Pachinko and pachislot machine installations

\*4 The number of hours per business day that pachinko or pachislot machines are utilized

### Need for Initiatives to Break the Negative Cycle

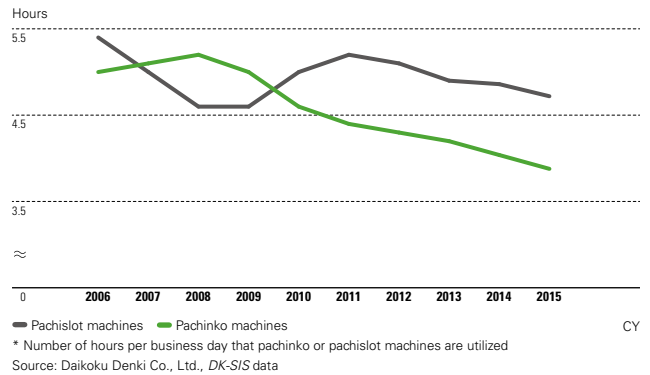
In an effort to broaden the player base, manufacturers developed and pachinko hall operators introduced pachinko machines with weaker gambling elements. Although lowering ball rental fees increased utilization times, it led to a decline in sales per machine for pachinko hall operators. As a result, the business results of pachinko hall operators worsened, further reducing their capital investment appetite and thereby delaying the revitalization of pachinko halls. Furthermore, poor business results encouraged pachinko hall operators to seek rapid returns on investments by introducing machine models with stronger gambling elements. However, this led to even more casual players leaving the market and to frequent players becoming the main player group. The resulting emergence of addiction as a problem among frequent players has spurred the strengthening of regulations. To break this negative cycle, the industry needs to make a concerted effort to revitalize the industry.

### Mold-Breaking Cooperation in the Industry

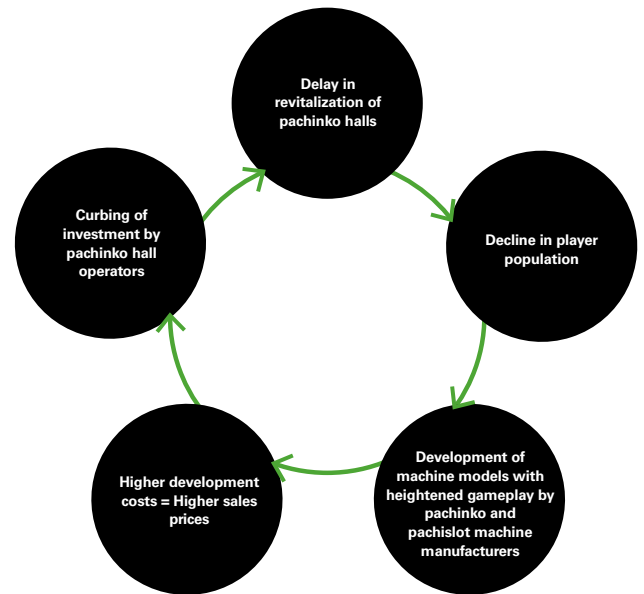
Pachinko and pachislot machine manufacturers and pachinko hall operators have been stepping up efforts to increase the soundness of the industry by resolving its problems, such as addiction and improperly modified pachinko and pachislot machines, both of which have caused a decline in the player population. Pachinko and pachislot machine manufacturers have been making industry-wide efforts to introduce a series of voluntary regulations aimed at curbing functions that encourage excessive gambling. The extremely significant change in conditions is having a short-term impact on pachinko and pachislot machine manufacturers. Major changes in gameplay designed to resolve the problem of addiction have forced manufacturers to change development schedules. Further, although some new-format machines compliant with the new regulations are achieving high utilization rates, there is concern that the change in gameplay could unsettle the market over the short term. In fact, pachinko hall operators are approaching the introduction of new-format machines circumspectly, and the pachinko and pachislot machine market is expected to flag over the short-to-medium term.

Aiming to overcome such impacts and extend the player base to revitalize the industry over the long term, industry competitors are forming partnerships that would have been unthinkable previously. These partnerships are focused on establishing industry-wide platforms that will increase cost efficiency through the joint purchasing of components and the use of common components. Also, collaboration among competitors promises to create new gameplay.

### Utilization Time\*



### Negative Cycle of the Pachinko and Pachislot Machine Market



### Pachislot Machine Market Trends

	FY2015 (Result)	FY2016 (Result)	FY2017 (Forecast)
Market unit sales (thousands of units)	1,230	960	900
Market units installed (thousands of units)	1,640	1,670	1,610

### Pachinko Machine Market Trends

	FY2015 (Result)	FY2016 (Result)	FY2017 (Forecast)
Market unit sales (thousands of units)	2,010	1,880	1,770
Market units installed (thousands of units)	2,950	2,910	2,810

Sources: National Police Agency and Yano Research Institute Ltd. (Data for which definitive values have not been formally issued and figures for fiscal 2016 and fiscal 2017 are estimates and forecasts of the Group.)

## Market Conditions for Each Business

# Game Content Market

### Asia Driving Growth of the Game Content Market

In 2015, sales in the global game content market,\*<sup>1</sup> comprising packaged game software and online game content, rose 23.1% year on year, to approximately ¥8,266.7 billion.\*<sup>2</sup> In Asia (Japan, China, and South Korea), the game content market grew 57.9%, centered on mobile game apps, and drove growth in the global market. Digital downloads (digital downloads to mobile devices, PCs, and home video game consoles) are increasing worldwide. In 2015, they grew 34.4% to account for 84.0% of the market as a whole. This growth is in marked contrast to packaged game software, which shrank 15.0% year on year.

### Growth of Mobile Game Apps Softening in Japan

In 2015, the Japan's home video game market (the value of the game software market, including store sales, download sales, and Free-to-Play (F2P)) decreased 12.1% year on year, to ¥230.1 billion.\*<sup>2</sup> The trend toward online distribution has become clear, with store sales down 15.7%\*<sup>2</sup> and download sales and F2P up 11.0%.\*<sup>2</sup> Meanwhile, online game content rose 26.7% year on year, to ¥998.9 billion,\*<sup>2</sup> which is more than four times larger than the Japan's home video game market. Mobile game apps (games for smart devices) account for the majority of online game content sales. The significant presence of mobile game apps is a unique feature of Japan's market that is not evident in other countries or regions.

In the past three years, Japan's mobile game app market has approximately doubled to become the largest market of its kind in the world. Currently, however, growth is softening in Japan's mobile game app market. Also, the tendency for popularity to focus on titles at the top of the rankings is strengthening, and the introduction of devices with upgraded performance is spurring the release of higher-end apps. As a result, developing and marketing costs are rising, which is creating an increasingly conspicuous oligopoly among leading companies with powerful intellectual properties and solid financial bases.

### China and ASEAN Region Growing Markedly among Overseas Markets

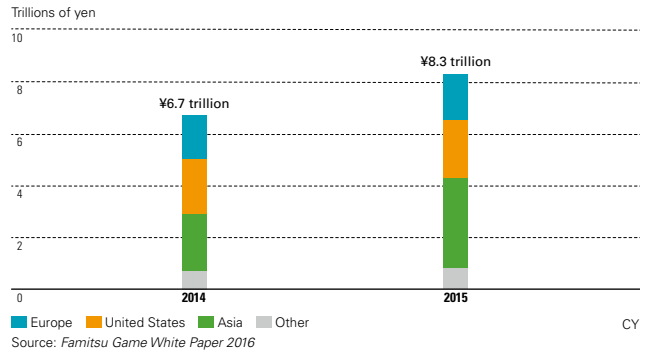
North America's game content market grew 5.6%\*<sup>2</sup> year on year, mainly reflecting digital sales of home video game software, while growth in mobile game apps produced a 5.7%\*<sup>2</sup> year-on-year increase in Europe's game content market. The enduring popularity of home video games and PC online games differentiates the North American and European markets from Japan's market. As the transition from old-generation to new-generation home video game consoles proceeds steadily, popularity continues to concentrate on titles that are released by major publishers and belong to well-known series.

China's game content market grew 22.9%\*<sup>2</sup> year on year. This market is seeing remarkable growth in mobile game apps, sales of which were up 87.2%\*<sup>2</sup> year on year in 2015. Further expansion is expected in step with the upgrading of network capabilities.

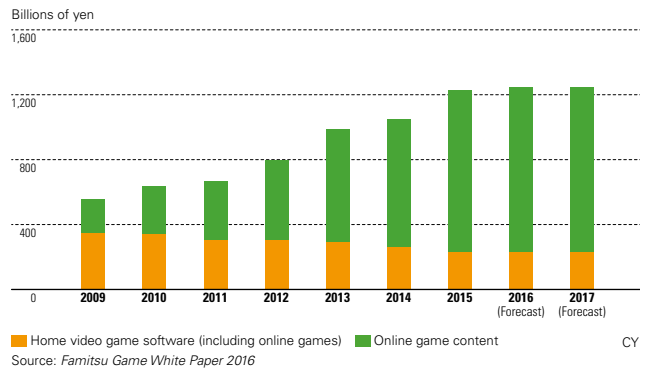
Also, the ASEAN region has emerged as a new growth market. The game industry promises to grow particularly vigorously in Indonesia due to its large working-age population, high smartphone penetration, and government measures to promote industry.

\*<sup>1</sup> Total for mobile game apps, PC online games, and home video game software downloads  
 \*<sup>2</sup> Source: Famitsu Game White Paper 2016

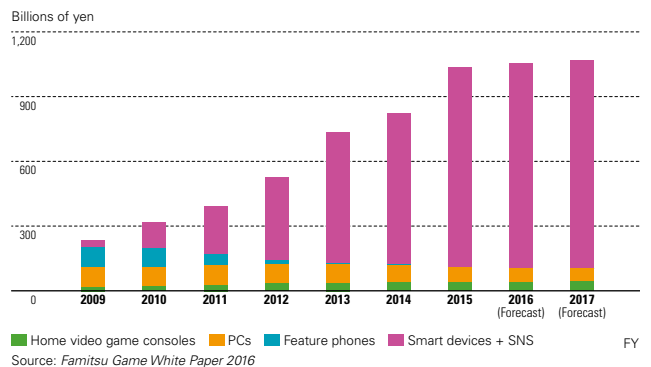
### Estimated Value of Global Game Content Market



### Value of Japan's Home Video Game and Online Game Content Markets



### Value of Japan's Market for Game Content with Network Connectivity



### Virtual Reality, Augmented Reality, and E-Sports Emerging as New Trends

In the game content market, innovations in virtual reality technology are creating a new trend. In tandem with the launches of virtual reality devices, companies are releasing a steady stream of compatible content. By offering players new experiences, this development promises to invigorate the home video game software market. Also, a mobile game app that uses augmented reality technology and location information has become a massive worldwide hit. In this way, the integration of the real and virtual is evolving a new game content market in the Internet of Things (IoT) era.

Further, e-sports is attracting attention as a new growth market. The e-sports approach to gaming, which focuses on highly competitive game content, is rapidly gaining popularity overseas, and tournaments are being held in large venues.



Hatsune Miku: VR Future Live  
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## Amusement Market (Amusement Machines / Amusement Center Operations)

### Tough Conditions Continuing Due to Increase in Consumption Tax

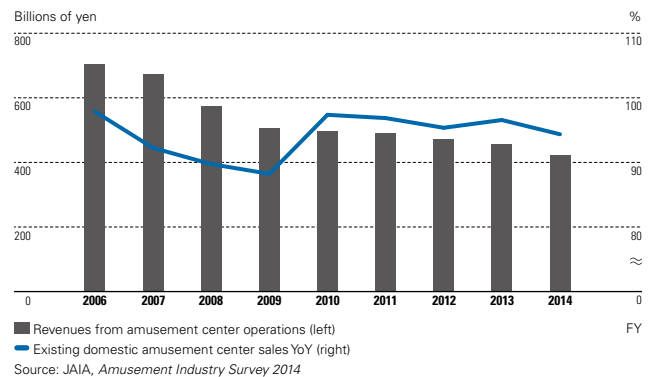
As leisure activities diversify due to the spread of smartphones and other factors, the amusement center operations market has been contracting. During the eight years between the years ended March 2008 and March 2015, it shrank approximately 40%. In the year ended March 2015, the market contracted a significant 7.5%\*<sup>3</sup> year on year as a result of a consumption tax increase in April 2014. Existing amusement centers' sales have been declining year on year since the year ended March 2008 and decreased 5.7%\*<sup>3</sup> year on year in the year ended March 2015. Similarly, the amusement machine market has continued to contract. In the year ended March 2015, the total value of the amusement machine markets in Japan and overseas was 8.0%\*<sup>3</sup> less than in the previous fiscal year.

Aiming to invigorate the amusement market, amusement center operators and amusement machine manufacturers have been taking a range of initiatives. Amusement machine manufacturers are introducing a range of different business models. For example, they are introducing revenue-sharing business models that help invigorate amusement centers by enabling the introduction of new products through a format that reduces the initial investment burden for amusement center operators. Further, the amusement industry is taking measures to attract customer groups that do not tend to visit amusement centers. Also, growing numbers of amusement centers are introducing electronic money with a view to facilitating adjustments reflecting consumption tax increases, enabling flexible pricing based on play demand, and increasing player convenience.

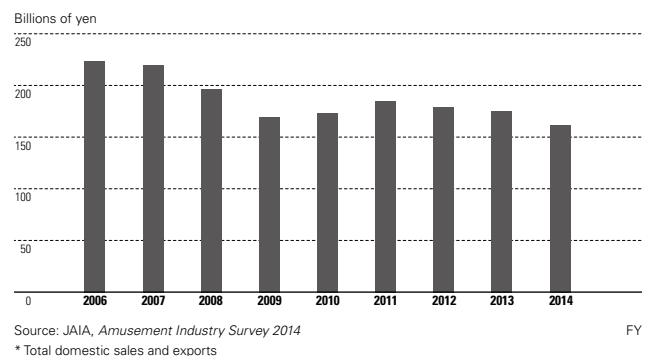
Currently, there are signs that the amusement market is moving away from its long-term contraction trend thanks to a tailwind resulting from the abovementioned concerted industry efforts, the emergence of hit titles that have succeeded in earning endorsement from a broad group of players, and the June 2016 enforcement of a revision of the Act on Control and Improvement of Amusement Business, etc., which mainly eases age restrictions on admission to amusement centers.

\*<sup>3</sup> Source: JAIA, Amusement Industry Survey 2014

### Revenues from Amusement Center Operations / Existing Domestic Amusement Center Sales YoY



### Amusement Machine Sales\*





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