Overview of the Nittaku Group

Established in 1965 as a real estate developer. As a result of diversification, the company is now operating real estate development, rental buildings, pachinko parlors, and game centers under the motto of “Urban leisure and service industries” which is based on profits from commercial real estate located in urban areas. The company’s name “Nittaku” reflects the company’s founding spirit of “Reinventing ourselves daily and opening the way for the future.”

Haruki Satomi
President and Group COO (Representative Director)
SEGA SAMMY HOLDINGS INC.

Takuro Nishimura
President and Chief Executive Officer
Nittaku Holdings Co., Ltd.

Special Topic 1

Make pachislot and pachinko machines “a familiar pastime”

As the number of pachislot and pachinko users continues to decline due to the revision of regulations and diversification of entertainment, the pachislot and pachinko industry is required to make concerted efforts to return to “a familiar pastime.”

Takuro Nishimura, President and CEO of Nittaku Holdings Co., Ltd., and Haruki Satomi, Group COO, President of our company, discussed the future of the industry.
To make pachislot and pachinko an enjoyable and familiar entertainment regardless of past

Pachinko developed amid the chaos of the postwar era, and during the period of rapid economic growth, it became a familiar form of entertainment.

In fact, the feature of gambling element came later, and it has been established for a long time. In order to control excessive gambling elements, regulations have been revised many times.

This is an industry with a very special history. On every new regulations revision, the pachislot and pachinko manufacturers created new game characteristics within the scope of the rules and contributed to maintaining the vitality of the pachislot and pachinko industry.

I first met with President Nishimura about 15 years ago, and over those 15 years, the market environment has changed drastically due to the revision of regulations. The current situation is that the industry has yet to reach a consensus on whether to restrict “gambling elements” and aim for familiar entertainment, or to pursue high levels of gambling elements within the bounds of regulations.

At its peak in the early 1990s, more than 20 years ago, pachislot and pachinko machines were said to have about 30 million users. However, the number has now fallen to less than about 10 million. In the past, entertainment had limited options, such as movies, travel, and pachinko parlors, but now there is a wide variety of entertainment and the current situation is to compete for disposable time among them. If we want to be a mass entertainer, it’s not easy given the shrinking market and the number of competitors. There are such dilemmas, but as the phrase “gameplay” indicates, we believe that the true essence of pachinko and pachislot is to provide “Play,” and so we should not go beyond that.

That’s right. Humans have a natural desire to seek “more,” so it seems that their gambling element has gradually increased, and it has naturally become excessive, not intentionally. To be honest with you, there was a time when the industry as a whole wanted a gaming machine with a high level of gambling element, but I think it was undoubtedly the bubble economy. Instead of dreaming about a return to the past, I think we should move to a “familiar pastime,” where we can enjoy ourselves casually while facing reality squarely and gaining the understanding of our customers.
Development of easy-to-play pachislot and pachinko machines and changes in the market environment

Over the past 15 years, there have been constant headwinds in the pachislot and pachinko industry. However, we believe that the revision of regulations in February 2018 and changes in the internal regulations of industry groups since then will provide an opportunity to revitalize the market. With the revision of the internal rules, we can make a machine that can be played in a short time while the gambling element is suppressed.

I am hoping that we will be able to create demand again, for example, to stop by on the way home from work to play.

That's right. In fact, we have seen the emergence of new pachislot machines based on the new regulation (No. 6 model machines) that utilization is extremely well, and we feel the expectations of our customers. As a matter of fact, the overall ratio of utilization in pachinko halls has been improving over the past year. In addition to this trend, pachinko halls will continue to introduce machines conforming to the new regulation that are currently being developed by pachislot and pachinko machine manufacturers. We expect that the outlook for the next one to two years will be bright.

The future of the pachislot and pachinko industry

While there are expectations for the future of new regulation machines, I also hope that “three major reasons why you don’t want to go to pachinko” may be resolved from a long-term perspective.

One is “tobacco.” Smoking rates in pachinko halls are extremely high, and this is one of the reasons why people avoid playing pachinko. In April 2020, the revised Health Promotion Law went into full effect and as a general rule, smoking is prohibited inside restaurants and other facilities. If all pachinko halls had separate smoking rooms and smoking was prohibited at the seats, there would be a possibility that non-smokers would visit the pachinko halls.

The second is the sound. The noise of pachinko balls which are from pachinko balls and medals paid out and sound effects of machines themselves are major causes of annoyance. Some users even play with earplugs. To address this issue, the industry is currently developing pachinko machines with digital payouts and medal-less pachislot machines as well as directional speakers that can be heard only by players. If they are put into practical use in the future and become widespread, we will be able to resolve the problem of sound.

The third is that “it has become difficult to have drawn a jackpot experience.” In the current gameplay environment, even if the amount of money you spend is large, you may not be able to draw a jackpot even once. If that happens, it will be difficult for people to think “Let’s come again tomorrow.” As a manufacturer, we want to develop machines that are easy to draw a jackpot and that are supported by users, while restraining the overall gambling element, which could be machines with payout ratios at a high range in some cases so that users can experience more “drawing a jackpot.”

On the other hand, if we can create a structure in which pachinko halls can secure profits by handling fees such as exchange rates, it will be a better environment for not only pachinko halls and users but for manufacturers as well.

Other entertainment such as movies, bowling, and karaoke cost around ¥1,000 per hour. If you look at the average expenses of pachislot and pachinko users, it’s pretty close, but there’s a big difference between winners and losers.

We believe that if everyone can approach that price, it will become a more casual game, bringing back dormant users, and increasing the frequency of visits by existing users.
I think it’s really good if things go that way.

On the pachinko hall side, we are also working on the installation of smoking areas and other measures to address the tobacco problem, which is one of the points President Satomi mentioned. I think we will soon be able to resolve this issue. As for the noise, with the cooperation of pachislot and pachinko machine manufacturers, we can expect to see the resolution of this in the future as well. We believe the third, “providing drawing a jackpot experience” can be realized by expanding the use of new regulation machines, enhancement of the regulations, and strengthening operations at pachinko halls.

We would like to support the pachislot and pachinko machine manufacturers who are making efforts to invigorate the market by developing new game machines with our “service.” I think pachinko halls are more difficult to serve customers than any other industries. If you serve delicious food at a restaurant, customers will come again. However, not all customers can have a good experience at a pachinko hall. We can’t continue our business for a long time unless the customers who lost while playing come to our hall again. From that point of view, we are especially trying to improve our service and customer service skills, which will invariably help in making our customers feel like visiting again.

Although the number of pachinko and pachislot players and the number of pachinko halls still remains on a declining trend, we believe that the industry environment will gradually stabilize as the number of pachinko halls reaches an appropriate level for the number of players and the spread of new regulation machines with reduced gambling element.”

**Regarding the addiction problem**

In order to develop the industry in a sustainable manner, it is necessary to face the issue of seeking “countermeasures for addiction.” First of all, I think the important thing is not to put it vaguely in the word “addiction” but to grasp how many people are really having trouble in their daily lives. Without that process, you don’t know how much money or people to invest. The next step is how to support these people, but the important thing is how to prevent addiction before it happens.

It is a very important theme that supports the sustainability of the industry, so we will actively participate in the industry’s efforts.

We have introduced “Self-Declaration and Family Declaration Programs”* to reduce the number of times customers are allowed to enter the store beyond the limit set by the customers. In addition, we put up posters to remind customers that “Pachislot and pachinko is a game we should enjoy moderately.” Hall employees are required to attend “Secure Pachinko and Pachislot Advisor”* seminars. But whether we can say these efforts will help prevent addiction, the reality is not that easy. I think pachinko halls and pachislot and pachinko machine manufacturers should work together to solve essential problems. I hope that President Satomi and the SEGA SAMMY Group will continue to take the lead in these efforts and in reviving the industry as familiar entertainment.

*1 Self-Declaration Programs: A program that can be used when a player wishes to restrict his/her play by his/her own declaration. (Select three items: Amount of money used, number of games played, and game time. When the specified standard is reached, store staff prompts the player to stop playing.)
*2 Family Declaration Program: A program under which the entry of a player may be restricted by the declaration of the family of the pachislot and pachinko player.
*3 Secure Pachinko and Pachislot Advisor: Personnel in charge of providing appropriate guidance and advice on issues related to gambling addiction at pachinko halls

The SEGA SAMMY Group’s raison d’être is to “Continue to create moving experiences.” We believe that the pachislot and pachinko industry is capable of providing numerous moving experiences. Failure to make efforts to be recognized as a “necessary presence in society” will jeopardize the future of the industry as a whole.

I will take the various problems facing the pachislot and pachinko industry seriously, and at the same time, I will work with all the players in this industry to advance our efforts as “a familiar pastime.”
CREATED AROUND THE WORLD, DELIVERED TO THE WORLD

In the Entertainment Contents Business, we have established development studios and publishing bases in countries around the world with which we maintain flexible relationships, allowing us to build a system that is capable of IP development from a global perspective. Looking closer, we have made efforts to utilize our IPs with a long history while generating new IP. Additionally, we have also made strides toward increasing our lineup by taking advantage of the diverse development capabilities of game studios around the world and through M&A. We are leveraging both the special traits of each studio and the characteristics of each IP to the maximum degree to develop contents for the growing global market and thereby increase earnings.

Investing toward Bearing Fruit in the Long Term

Since 2005, the Entertainment Contents Business has continued to expand its IP pipeline, which we have accomplished through the M&A of excellent IP and highly capable development studios around the world. These ongoing investments, made from a long-term perspective, are showing steady results, with each IP beginning to bolster profits. Our product lineup of high-quality titles created in development studios around the world contributed to earnings, and fiscal year 2019 marked the fourth consecutive year of operating income growth in the Packaged Games area.

<table>
<thead>
<tr>
<th>IP Expansion Timeline</th>
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<tbody>
<tr>
<td>The Creative Assembly</td>
</tr>
<tr>
<td>(U.K.)</td>
</tr>
<tr>
<td>Sports Interactive</td>
</tr>
<tr>
<td>(U.K.)</td>
</tr>
<tr>
<td>Relic Entertainment</td>
</tr>
<tr>
<td>(Canada)</td>
</tr>
<tr>
<td>Demiurge Studios</td>
</tr>
<tr>
<td>(U.S.A.)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Studio</th>
<th>Major IP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>The Creative Assembly, Ltd.</td>
<td>Total War: ROME II</td>
</tr>
<tr>
<td>2006</td>
<td>Sports Interactive Ltd.</td>
<td>Football Manager 2019</td>
</tr>
<tr>
<td>2013</td>
<td>Relic Entertainment</td>
<td>Company of Heroes, Dawn of War series</td>
</tr>
<tr>
<td>2015</td>
<td>Demiurge Studios</td>
<td>Endless Space series and other</td>
</tr>
<tr>
<td></td>
<td>Creative Assembly Sofia</td>
<td>Total War Saga: Troy</td>
</tr>
<tr>
<td></td>
<td>Amplitude Studios</td>
<td>Marvel Puzzle Quest and SEGA Heroes</td>
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</table>

Other Studios and Their Characteristics

- Relic Entertainment
- Amplitude Studios
- Demiurge Studios
- Creative Assembly Sofia

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<th>Major IP</th>
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<tr>
<td>Relic Entertainment</td>
<td>Company of Heroes, Dawn of War series</td>
<td>This studio, based in Vancouver, Canada has produced several high-quality games with movie-like graphics and highly strategic gameplay.</td>
</tr>
<tr>
<td>Amplitude Studios</td>
<td>Endless Space series</td>
<td>Based in Paris, France, this studio is notable for developing turn-based strategy games, particularly in the 4X genre*, where it has received rave reviews.</td>
</tr>
<tr>
<td>Demiurge Studios</td>
<td>Marvel Puzzle Quest, SEGA Heroes</td>
<td>This studio, which operates out of Cambridge, Massachusetts, U.S.A., primarily develops and operates mobile games.</td>
</tr>
<tr>
<td>Creative Assembly Sofia</td>
<td>Total War Saga: Troy</td>
<td>Creative Assembly Sofia is a satellite studio of U.K.-based the Creative Assembly, Ltd. based in Bulgaria and mainly works on development of the Total War™ series.</td>
</tr>
</tbody>
</table>

* Games with play focused around four “X”s: Explore, expand, exploit, and exterminate.

Basic Policy Related to M&A

To expand its business, SEGA Games Co., Ltd., which primarily handles packaged and digital games, needs to expand its lineup, which requires it to develop IP for a variety of regions across multiple platforms. M&A is an effective method we have utilized to this end.

Since 2005, we have pursued acquisitions of overseas studios primarily that develop strategy games of various themes that exude a unique quality distinctive presence in the market. In recent years SEGA Games has established teams dedicated to gathering information and maintaining a growing number of dialogues on outside development studios at all times, and all over the world. M&A candidates are selected based on three major criteria, with a system in place to execute a decision in prompt fashion.

1. The candidate possesses IP with potential for future growth and franchising
2. The candidate demonstrates high competitiveness in a particular area
3. The candidate has a compatible corporate culture that can generate strong synergies

Post M&A, we provide publishing support in cooperation with our publishing bases around the world including support for marketing, sales, licensing, and other business development. In addition, we utilize the specific characteristics of each IP for development into a wide range of areas and platforms. These actions serve to increase the value of the IP itself and support each IP so that it may grow into a pillar of profit. In addition, we also support development studios according to their own individual characteristics to help them establish a better development environment.
Our global sales strategy is aimed at reliably providing contents to the growing global market.

In the Entertainment Contents Business, we have leveraged M&A of development studios to create a system that enables us to develop contents in locations around the world. To ensure that we can reliably deliver these titles worldwide, we are also establishing publishing bases in each region and are working to expand our scope of operation by strengthening internationally the ties between the publishing bases and the development studios. With downloading becoming a more popular method to get contents, it is now possible to deliver games to areas where sales were once difficult for our distribution network; therefore, we are also working to strengthen our download delivery capabilities.

By adopting these strategies and expanding our operating areas, recent years have brought strong results in the packaged segment and sales of older games has also increased. Emerging markets still have room for expansion, and we will further promote our global sales strategy.

Global Market Conditions

The global game market has grown in size by 13.1 trillion in keeping with the expansion of the Chinese market. With the emergence of new platforms and the advancing communication environment, the user base has expanded, and we expect to maintain a high growth rate and expand further in the future.

Global Game Contents Market Size

<table>
<thead>
<tr>
<th>Year</th>
<th>Market Size (Billions of yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>6,714.8</td>
</tr>
<tr>
<td>2015</td>
<td>8,264.7</td>
</tr>
<tr>
<td>2016</td>
<td>8,997.7</td>
</tr>
<tr>
<td>2017</td>
<td>10,896.4</td>
</tr>
<tr>
<td>2018</td>
<td>13,177.4</td>
</tr>
</tbody>
</table>

Source: Famitsu Game White Paper 2019
We will concentrate resources in areas where we can leverage the strengths of our global manufacturing and sales systems to provide moving experiences to the world

In fiscal 2019, we faced a hard struggle in the mobile-focused Digital Games area. The fact that several titles were late to enter the market and were unable to produce hits amid stagnating market conditions and fierce competition is a major cause for concern. At the same time, the Packaged Games area showed strong results and improved performance for PC games produced by European and North American development studios.

Looking at our showing for the fiscal year 2019, we can see that Japan’s mobile market is hitting a standstill. As a result, we are reviewing titles that are under development and in operation and adjusting our scale of involvement. We are also planning to improve profitability by establishing a development management system. On the other hand, we can also expect continued market growth in overseas packaged games and PC digital games. We are planning to devote more resources to the already thriving market in Europe and North America, as well as the expanding market in Asia and are working toward global development.

SEGA Games’ manufacturing and sales system, which comprises both overseas development studios producing unique titles as well as publishing bases, is highly distinct, even compared to other Japanese game companies. The system functions effectively because instead of simply establishing multiple bases overseas, the management teams at each base receive a certain degree of authority which they can demonstrate with the head office in Japan through the latter’s connections with development studios and publishers in each region.

Original members of a development studio prior to M&A are allowed to demonstrate leadership and develop contents that utilize the studio’s specific qualities. Our publishers employ management teams with extensive industry experience who construct sales plans tailored to the characteristics of a title and based on market trends in their territory. In order to make the best use of this unique manufacturing and sales system and maintain flexible ties between bases, overall courses of action are shared between the head office in Japan and regional teams while management policies are communicated to the management teams at each base at regular intervals.

In fiscal 2020, we are planning on putting this manufacturing and sales system to work. In May 2019, U.K.-based studio the Creative Assembly Limited released Total War™: THREE KINGDOMS, the latest in the Total War™ series, a bona fide hit that has amassed large numbers of supporters in Asia. In September 2019, we conducted a simultaneous release in Japan, North America, and Asia of the SEGA Mega Drive™ Mini (SEGA Genesis Mini in North America), a palm-sized revival of the home video console SEGA Mega Drive, originally launched in 1988. U.K.-based Two Point Studios is developing a console version of Two Point Hospital, originally launched for PC, set for release. Going forward, we will continue to deepen ties between bases, increase the value of individual IP, and develop IP titles for a wide range of devices, regions, and platforms, and make them a valuable part of our future results.
WITH RESPONSIBILITY AS A JAPANESE COMPANY

Looking toward participation in the IR business in Japan, we are advancing preparations steadily with our sights set on certainly being selected as an operator.

Accumulating IR Know-How Overseas

We have been sending personnel to casino facilities in South Korea since forming an alliance with South Korean casino operator the PARADISE GROUP in 2012. After opening South Korea’s largest IR, PARADISE CITY, we began assigning even more personnel. In areas ranging from dealer duties through to business management, these personnel are accumulating expertise in the operation of IR, which include casinos.

For this reason, we are confident that we have built a decisive lead over other Japanese companies with respect to fostering the Japanese personnel who will be needed when IR are allowed to open in Japan.

Acquiring Expertise of Operating Resort Facilities at One of Japan’s Premier Resort Complexes

In 2012, the Group was joined by PHOENIX RESORT CO., LTD., the operator of a large resort complex in Miyazaki named Phoenix Seagaia Resort. The resort boasts several accommodation facilities—including a high-end resort hotel that is part of the prestigious international Sheraton hotel chain—and a world-class convention center with a maximum capacity of 5,000 people. At the resort complex, we are developing professional skills that will be useful for operating IR. For example, we are formulating measures to tap into MICE* demand.

* MICE is a business tourism format. The acronym stands for Meetings, including training and seminars tour; Incentives, referring to employee-reward tourism; Conferences or Conventions, such as academic conferences and international meetings; and Exhibitions or Events.

Personnel Sent to PARADISE CITY

<table>
<thead>
<tr>
<th>Year</th>
<th>Working on site</th>
<th>Working at head office</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>71</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>84</td>
<td>0</td>
</tr>
</tbody>
</table>

Aiming to increase to around 100 personnel

2012

May 2012
Established PARADISE SEGASAMMY Co., Ltd., as a joint venture with the PARADISE GROUP

March 2012
Acquired all shares of PHOENIX RESORT CO., LTD.

April 2014
Began sending employees to PARADISE SEGASAMMY Co., Ltd.
Conducting Value Chain Analysis
Covering More than 118 Elements

Beginning IR operations requires not only preparations for the operation of facilities and casinos but also for a host of ancillary operations, such as cash management and rigorous security. With this in mind, we have conducted an analysis and identified more than 118 elements that comprise our IR business. More specifically, we have identified elements for which we utilize our resources to provide differentiated services, elements that are required as standard in IRs, and elements that are the external resources of partners or associates are necessary. In light of this analysis, we are proceeding with multifaceted preparations.

Conducting Joint Research on Gambling Addiction

When operating IR in Japan, gambling addiction countermeasures will be essential. With a view to identifying the precursors of dangerous levels of gambling, we are conducting joint research on gambling addiction and prevention with Kyoto University.

We hope that this research helps clarify the onset mechanism of gambling addiction, and we will use the findings to take preventive measures in Japan for the onset, progression, and recurrence of gambling addiction.

Capable of Various Elements

Aquisition of Licence for Casino Machines from Nevada State and Distribution of Them

In December 2017, the Group’s wholly owned subsidiary SEGA SAMMY CREATION INC., and its wholly owned subsidiary, Sega Sammy Creation USA, INC., acquired Nevada state gaming machine manufacture and distribution licenses. Normally, the acquisition of this license takes about two years. However, we were awarded the licenses in the unusually short period of just one year. Meeting the world’s most rigorous licensing standards and eligibility criteria clearly demonstrates the Group’s eligibility to engage in the IR business in Japan.

Participation in the IR Business in Japan

2014
November 2014
Began building PARADISE CITY, South Korea’s first IR

2017
December 2017
Launched research on addiction countermeasures with Kyoto University

2019
December 2017
Acquired Nevada state gaming machine manufacture and distribution license

2019
April 2017
Opened PARADISE CITY

Verification of More Than 118 Elements

Before opening

- Business plan
- Floor plan design
- Task planning
- Personnel planning
- Systems design
- Etc.

After opening

- Attracting customers
- Settlement
- Entry
- General administration
- Provision of games
- Etc.