

## **Major Questions Asked in Sega Sammy Management Meeting on November 30, 2018**

December 6, 2018

Sega Sammy Holdings Inc.

IR Department, Finance & Accounting Division

### **Part 1: Haruki Satomi, President, Group COO, and Representative Director**

#### **General**

Q: It seems that achieving the medium-term management targets for the fiscal year ending March 2020 will be difficult. Could you tell us about the current status of your progress, the present issues, and what course of action you will take in the future, if any?

A: The biggest problem is we have not produced hit titles for smartphone in the digital games area. In our initial forecast, we expected a new big-name title introduced this fiscal year would contribute to sales throughout the fiscal year ending March 2020, but the release has been delayed. However, the recently released “Ryu ga Gotoku ONLINE” and “IDOLA PHANTASY STAR SAGA” have made good starts. Whether we can aim for further growth in the fiscal year ending March 2020 will depend on whether new titles launched next year do well, so we are reviewing the situation closely.

In the Pachislot and Pachinko Machines Business, the regulations were revised after we announced our medium-term management targets, so we were obliged to adapt to the changes. On the other hand, we have made considerable progress on improving problems that need to be resolved internally in order to achieve our medium-term management target. Mainly, for reuse, we have changed to product designs that make it easier to remove components, and we have also improved costs in our back-office departments. If we receive approval for the titles scheduled for release, we think it will be possible to achieve an operating income margin of 30%.

#### **Pachislot and Pachinko Machines Business**

Q: What is the approval status of Type-6 Pachislot Machines? Do you have any forecasts or impressions regarding passing future tests?

A: In order to release titles during this fiscal year, we would like to have the approval and license by the end of January. Of course, if the utilization of “Pachislot SOUTEN-NO-KEN PONYOU,” which will be released around early January, is high, there is the chance we will receive additional orders and it will then be possible to hold back some titles for subsequent release until next fiscal year. However, if possible, we would like to receive approval and licenses for one or two more titles. For models that have not been approved, we are verifying which elements were not acceptable and hope to make use of the learnings for obtaining approval going forward.

With regard to pachinko, sales of machines adapted to the current voluntary regulations will begin around February of next year. The acceptance status of application is very busy as numbers of applications for these machines have been submitted by various companies, but if we can obtain approval, we would like to release some machines. The number of applications should subside next fiscal year, so we believe that we will be

able to supply some titles.

Q: How will the market environment be affected by the changes in regulations for pachislot and pachinko machines? For example, will there be changes in the gross profits or number of players of pachinko halls?

A: It was indicated in the presentation the frequency of replacing pachislot and pachinko machines is decreasing and the annual turnover rate is declining. To put it another way, we guess pachinko halls are currently saving their investment in machines, and there are halls which want to buy machines if there are good ones available. With the new regulation changes having enabled shorter play times, our mission now is to how we can bring back users by creating a more accessible experience for customers. Our “Pachislot DISC UP” is a machine with which it was difficult for halls to make a gross profit, but sales were favorable since the utilization of the machine is very high and it attracts customers to visit halls. If we can supply machines with short play times and high utilization rates and this model becomes popular, we believe it will be possible to curb the advance of low-stakes pachinko in the future.

### **Entertainment Contents Business**

Q: Your plan assumes the success of your current digital games. While some titles have been partial hits, they do not seem to have sustained success. If you do not produce a major hit, what course of action will you take in terms of cutting costs, overseas rollout, and so forth?

A: At present, hit titles tend mainly to be IP titles. We believe that Sega has neglected this area, so we are changing course and moving forward with initiatives to proactively develop our IP strategy. In our approach to IP development, we are working not only on the challenge of creating new IP assets but also on improving our efficiency, such as actively using third-party IP as well as reducing risks by licensing out our IP to third parties.

Similarly, in China, we are developing our business both by supplying titles and by licensing out IP, and we believe that the use of multiple-platform rollout will increase going forward. We want to adopt this approach in various countries other than Japan, not just China. If we do not engage directly in promotion and publishing and leave it to local companies with rollout expertise, we believe we can earn royalty income with a low degree of risk.

We are already distributing pay-to-play titles in various countries worldwide, and while we are considering distribution from Japan to overseas depending on titles, we want to adopt a different approach to rollout, rather than using the high-risk, high-return approach we have used in the past.

Q: You stated that you will carry out a reorganization based on an IP-centric strategy, but could you tell us the sales level for each of your current IP titles? Also, do you also plan the IP-centric rollout with regard to overseas studios?

A: Our overseas studios are already organized by IP asset, so their approach will not change greatly. The Total War series, to take one example, contributes significantly to our sales, including licensing to third parties. Also, as we announced previously, we are reviewing idle IP titles with the aim of reviving them. If we are able to launch these successfully, we believe we will establish a framework for each IP asset to contribute

effectively to our sales. We intend to disclose further details once we are able to do so.

Q: It has been said in the past that in order to create titles that will be sold well in western markets, a local (western) studio is required. Recently, however, there are examples of Japanese games that have been well received in other countries. Has this changed your attitude with regard to the development of recent titles?

A: The tastes of the market have changed in the past few years. In the past, games could not compete unless they were produced locally for local consumption, but various titles have now begun to sell globally. In Japan, western titles were not popular before, but recently western games such as FPS genre games have been selling quite well. The same is true for smartphone games, with titles by non-Japanese companies becoming hits, so we are seeing the market environment has been gradually changing.

Just as western titles are selling in Japan, Japanese games are starting to sell in other countries. We will therefore make a concerted effort to pursue these markets going forward. In India, the market is changing dramatically, with smartphone use becoming more widespread and smartphone games growing more popular. As long as we focus on overseas markets as well as the domestic market, we believe there is still margin for growth. Since the global game market is growing, we will continue striving to identify new opportunities overseas.

## Part 2: Hajime Satomi, Chairman, Group CEO, and Representative Director

### **General**

Q: Progress toward the medium-term management target doesn't seem to be well. What are your thoughts on current status?

A: Unfortunately, we cannot say we are progressing on track. One significant factor is the regulatory revisions that occurred in the Pachislot and Pachinko Machines Business. However, since Type-6 machines have extended the scope of playability, we believe they will provide us with momentum going into next fiscal year and beyond if the launch of "Pachislot SOUTEN-NO-KEN PONYOU," which is scheduled to begin delivery in early January, will be successful. In the pachinko business as well, the voluntary regulations have been revised. If the changes are accepted by the market, we are confident that our business plan will go well next fiscal year. Should that happen, we have the possibility to achieve an operating income margin of 30% or more, which is the medium-term target for the Pachislot and Pachinko Machines Business.

In the Entertainment Contents Business, in the past many segments posted a loss, but we are now making a profit in almost all areas. In the film area, in addition to the success of "Detective Conan: Zero the Enforcer," we are seeing our 3D film studio moving steadily toward turning to be profitable. The toys area has become profitable as well. However, in the digital games area, which should be our main income generator, we have not been able to produce numbers of hit as we originally expected. The problem is that titles make a promising start but their success is not sustained over the long term. Our goal is to improve in this area going forward through reorganization.

### **Resort Business**

Q: Osaka has been selected to host the World Expo, which should increase the possibility that Osaka to be selected as IR location. How do you see this?

A: With Osaka being selected to host the World Expo, we believe there is a possibility the large-scale IR facilities will be developed in conjunction with the event. However, as has been reported in the press, there are still some issues in terms of infrastructure development. As we are a Kanto-based company, we intend to keep monitoring the situation for now and think carefully about whether we should actively engage in IR development in Osaka.

Q: What about selecting IR business partners and the amount of investment?

A: Assuming we pursue development in the Tokyo metropolitan area, it is possible that it will be a large-scale project, and we do not know how much the total equity share will be, but since we would like to hold the largest equity share in it, we need to ensure we have that level of investment capability.

In terms of the actual investment amount, it depends on the level of internal rate of return that is set based on the presumed income amount, so we intend to evaluate the investment-return balance. We will secure the capital required based on this by building up our net cash as well as considering financing activities such as loans.