

review

SEGA SAMMY'S
**COMPETITIVE
EDGE**

EXCLUSIVE

**The Entertainment Industry,
It's a Whole New Ballgame**

POINT OF VIEW

**Straight Talk from
the Chairman**





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





No Way!

If you aggressively take on a challenge, you can do what others say is impossible.

That's what we do at the SEGA SAMMY Group.

And if we fail, we use the experience to lead to even greater success.

A work environment that rewards people for tackling difficult challenges.

Outstanding people who are eager to learn from their failures and build on their successes.

These are the SEGA SAMMY Group's strengths.



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exclusive
It's a Whole New Ballgame



Japan's entertainment companies are scrambling to deal with massive changes in their industry. What's behind these developments? And how are companies responding?

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Dreams and Excitement

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

In only a year and a half from the 2004 management integration of SEGA and Sammy to the end of the year under review, we made substantial progress. The SEGA SAMMY Group has implemented reorganization measures targeting enhanced management efficiency and a stronger operational foundation. At the same time, to expand our operations in growth fields, we have invested aggressively, including making acquisitions.

We have captured and retained the dominant number one share of the pachislot machine market. This success is based on unrivaled development capabilities that have enabled Sammy to launch highly regarded machines, such as *ALADDIN II Evolution*. In the pachinko machine business, meanwhile, by bolstering our development capabilities, we have enhanced the quality of our products and obtained more machine approvals, thereby increasing unit sales and expanding our market share. In October 2005, we entered a capital and business tie-up with GINZA Co., Ltd., a developer, manufacturer, and marketer of pachislot and pachinko machines, in order to extend our successful multi-brand strategy from pachislot machines to pachinko machines. Through this tie-up, we will develop new pachinko and pachislot machines, enhance distribution networks, and obtain additional machine approvals.

In the Amusement Machine Sales Business, high-value-added products that leverage SEGA's advanced product development capabilities, such as *StarHorse2 NEW GENERATION*, are storming the market. We are taking steps to secure our foundation for further growth, such as establishing a production and distribution system that can respond smoothly to the demand generated by these hit titles.

In Amusement Center Operations, we are making steady progress in developing new markets. In children's card games, for example, *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress up and Dance!* are showing dramatic growth in both number of installed units and number of cards sold. Additionally, we have begun to expand our amusement center operations from Japan to North America and Asia.

In the Consumer Business, due to rigorous control of schedules and quality following the implementation of reorganization measures



**WE ARE ESTABLISHING
A FOUNDATION
FOR SUCCESS IN
THE ENTERTAINMENT
INDUSTRY**



in development, as well as to the contributions made by listed subsidiaries SEGA TOYS, LTD., Sammy NetWorks Co., Ltd., and TMS ENTERTAINMENT, LTD., we have recorded a substantial improvement in profitability. TMS ENTERTAINMENT, which has been consolidated from the second half of the fiscal year ended March 31, 2006, is engaged in animation planning and production. As our subsidiary, the company has substantially enhanced the Group's animation-related business.

In these ways, we are establishing a foundation for success in the entertainment industry, which has moved onto a new competitive stage. With this strong foundation, we will strive not only in Japan but also overseas and work to achieve our medium-term management objectives – ¥1 trillion in sales and ¥200 billion in ordinary income.

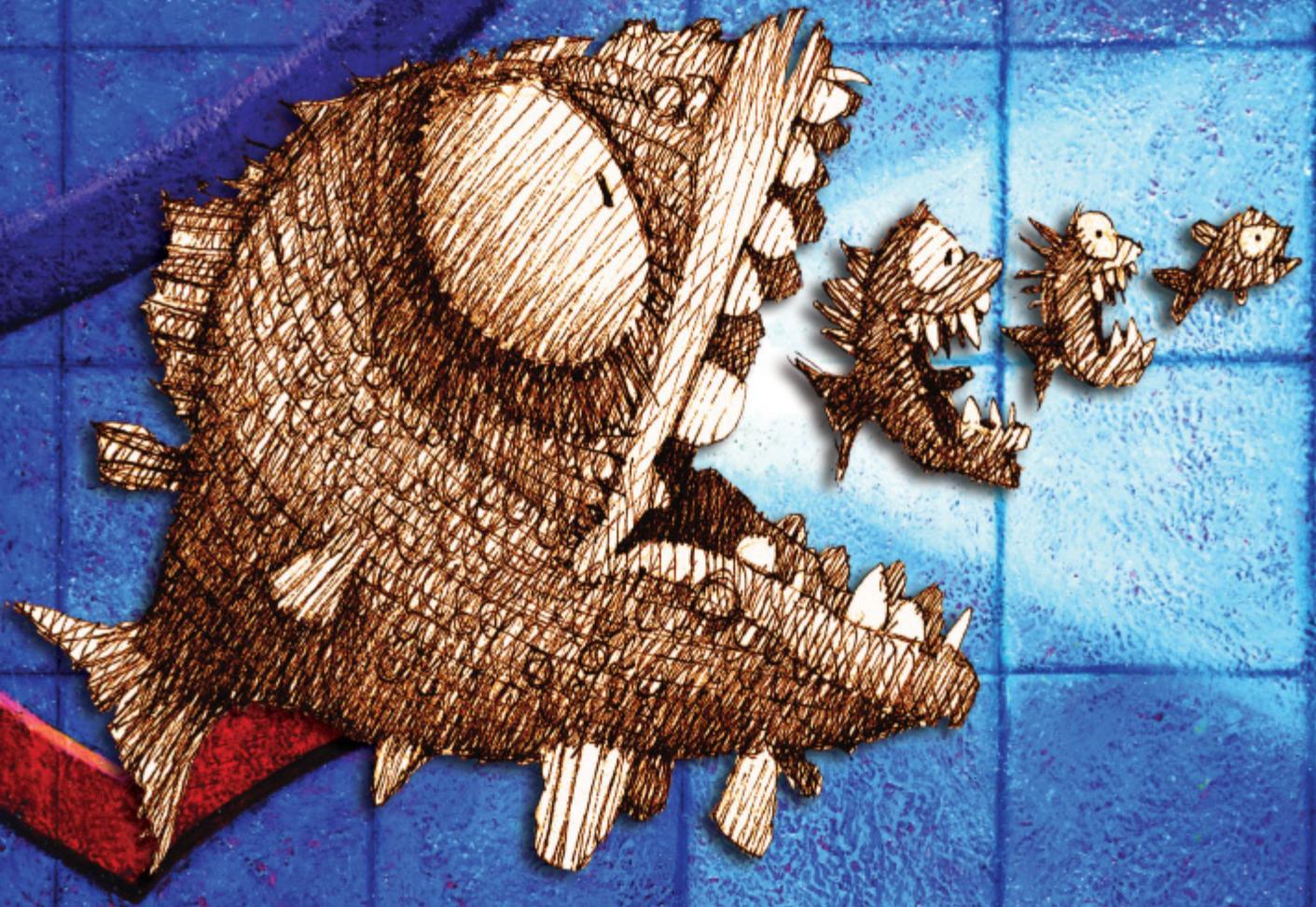
Rather than simply pursuing scale and profits, as a good corporate citizen that makes an ongoing contribution to society, we strictly observe laws, regulations and social norms, and strive to build good relationships with all stakeholders, thereby realizing sound management and fulfilling our

social responsibilities. We believe that such endeavors are indispensable for raising our corporate value, and in accordance with this approach, we have formulated the Group CSR Charter and enhanced our internal control system. At the same time, we have formulated our management philosophy – “By providing entertainment filled with dreams and excitement to people throughout the world, we will strive to enrich our society and culture.” As a group that grows together with all of its stakeholders, the SEGA SAMMY Group will strive to record continued development in global markets, and I would like to ask for your continued support in the years ahead.

July 2006

Hajime Satomi
Chairman and CEO

REVIEW
EXCLUSIVE



IT'S A WHOLE NEW BALLGAME

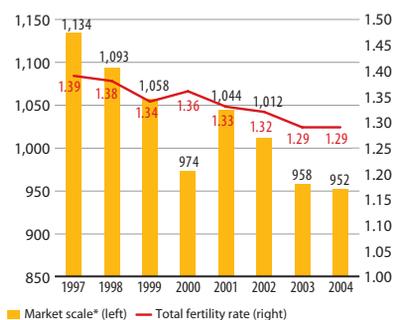
Driven by dramatic change in the game sector's operating environment, Japan's entertainment industry is undergoing a process of sweeping reorganization. With trends toward fewer children per family, an aging population, and higher development costs looming in the background, the accelerating move toward mergers in the industry is tearing down the traditional industry borders. Who will emerge as number one in the comprehensive entertainment industry?

BACKGROUND OF THE INDUSTRY'S REORGANIZATION

Japan's entertainment industry is undergoing a surge of reorganization that is bringing down the barriers that have long separated the traditional industry sectors – game software, toys, and pachinko and pachislot machines. That reorganization was triggered by changes in the market environment stemming from the trend toward fewer children per family, which has had a tremendous impact, especially on the toy sector, including home game consoles and game software. The scale of the market for toys, which peaked at about ¥1,130 billion¹ in fiscal 1997, had contracted to about ¥950 billion¹ by fiscal 2004, keeping pace with declines in the total fertility rate.

Scale of Toy Market* and Total Fertility Rate

(Billions of yen)



* Domestic shipments (including home game consoles and game software)
Sources: Total fertility rate, Ministry of Health, Labour and Welfare population statistics; Market scale, Yano Research Institute Ltd.

The rising cost of developing game software has also fueled industry reorganization. Over the past several years, the scale of the domestic game software market has been stagnant at about ¥300 billion, while development expenses have been growing in tandem with the increasingly advanced specifications of game consoles. In this setting, the advent of next-generation game consoles has been a powerful force for change. These consoles will not only display images at substantially higher resolutions than previously possible; they will completely change the idea of what game consoles are capable of. On the other hand, game producers have to deal with the urgent task of controlling and diversifying the risk of burgeoning development costs. A key feature of the next-generation game consoles will be enhanced ability to access the Internet, and the establishment of entirely new profit models is expected to take on

growing importance for game producers.

Moreover, while the market for packaged game software is sluggish, enhanced IT infrastructure is supporting the extension of game platforms beyond traditional formats to include mobile phones and online PCs, and this field is increasingly being recognized as a growth market.

The pachinko and pachislot market, which boasts a scale of about ¥30 trillion a year, is also seeing waves of change in the operating environment. In accordance with the revision of the regulations pertaining to the Entertainment Establishments Control Law of Japan², entertainment value will increasingly be a requirement for pachinko and pachislot machines. As a result, the ability to develop differentiated machines will become even more important, and the financial resources needed to bolster development capabilities will be indispensable. Also, as it faces a decline in the number of players, the entire industry will need to work together and take steps to increase the number of players, such as introducing machines which are less reliant on payout.

In the face of these dramatic structural changes in the entertainment industry, the strategies of the many companies fighting to survive have certain points in common. One is to offset rising development costs by enhancing content value through the use of synergies. This strategy entails diversifying profit opportunities by developing the same content in

multiple channels, such as game software, amusement machines, animations, content for mobile platforms, toys, and online games. Another common point is to strengthen operations in expanding overseas markets. These common strategies are propelling mergers that transcend traditional industry borders, and in this setting a new concept is taking shape – a comprehensive entertainment industry.

1. Yano Research Institute Ltd.

2. A change in the model testing rules of the Security Electronics and Communications Technology Association, which are mandatory for manufacturers of pachinko and pachislot machines.

FULL-FLEDGED COMPETITION FOR CORPORATE SURVIVAL

Full-scale industry reorganization dates back to about 2003. Aiming to develop “comprehensive” offerings, companies have sought out mergers with partners that could offer complementary business portfolios. However, clear differences are emerging in the areas that will be the keys to the “one content, multiple use” strategy – a business portfolio that extends across a wide range of fields and strong capabilities in each of those fields. Other conditions for survival include killer content, rapid decision making, management strength, financial strength, and the ability to create synergies. Only companies with all of these capabilities will be in the running to emerge as the leader of Japan's entertainment industry and, in turn, to stake out positions of leadership in the widely anticipated global industry reorganization.



**You?
The Winner?**



1

2

3

That's right.

In fact, we are the market leader in a wide range of entertainment fields.

And with a rock-solid profit foundation that enables us
to invest heavily in growth markets,
we're ready to extend our winning streak far into the future.

The SEGA SAMMY Group continues to forge ahead in a wide range of entertainment fields. One of the key driving forces of that progress is the outstanding workforce, which the Group considers to be its most important resource. Why is the Group's workforce so strong? And what is the Group aiming to achieve in the years ahead?



Hiroshi Uemura

Developer of *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress Up and Dance!*

SEGA SAMMY'S Competitive Edge? It's



PROFILE

Hiroshi Uemura

R&D Creative Officer
Family Entertainment R&D Department
Amusement R&D Division
SEGA CORPORATION

After joining SEGA in 1989, was assigned to the Future R&D Division. For about 10 years, worked on the development of large attractions for *Tokyo Joypolis*. Subsequently developed new businesses for SEGA, such as children's games utilizing touch-sensitive displays. Currently working on production of children's card games, such as *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress Up and Dance!*, in the Family Entertainment R&D Department.

AN IDEAL KIND OF ENTERTAINMENT.

Asano: Recently, children can be seen having a great time playing *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress Up and Dance!* at shopping centers everywhere. Why did they become such big hits?

Uemura: *The King of Beetles "MUSHIKING"* uses the theme of beetles from the natural world. Fathers remember being interested in beetles when they were young. For example, they can tell their children about how they raised beetles when they were kids¹. In the same way, with *LOVE AND BERRY Dress Up and Dance!*, mothers don't just participate in their children's play; they really communicate with their children on the shared interest in fashion. The key point is that families can truly enjoy a common topic.

Asano: Adults and children may experience the game in different ways, but they enjoy playing the same game in the same environment, and they can have a great time talking about the game while

eating dinner. From the point of view of an entertainment provider, that's the ideal situation.

TO SUCCEED, YOU HAVE TO BE MARKET-ORIENTED.

Uemura: As a developer of two card games, I can say that I really want these games to continue to be available so that the kids who have bought cards can keep on using them for years. In my mind, just pursuing quick sales, just selling cards and then saying "You're on your own," is sort of like double-crossing the kids. In implementing our character strategy, what's most important is to continue on in a way that earns the trust of the market. That's why, rather than launching another round of similar products for the same age groups that enjoy *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress Up and Dance!*, I want to create new products for new age groups – for age groups that don't have their own products. To expand our customer age range, we have to constantly keep track of what's going on in the market.

1. Raising beetles as pets is a common Japanese children's hobby.

A portrait of Yoshii Asano, a man with glasses and a white shirt, smiling. A large green arrow graphic points towards him from the left.

Yoshii Asano

The Man behind Sammy's Marketing Strategy

All About the People

Asano: That's bringing the market into the development process. Sammy has done a good job of implementing that approach. Based on our development philosophy – Sammy... the wellspring of new ideas – we have worked to maintain an accurate grasp on market needs as we continually launch market-leading products. But sometimes, some of the new products that we propose are not accepted by the market. When that happens, development and marketing work together, repeatedly implementing the PDCA cycle in product development and examining what needs to be improved and what elements should be used in the next versions. We are really implementing the vision of our chairman, Hajime Satomi, who always says “aggressively take on a range of challenges, and if you fail, use that as a platform for future success.” Even young employees are aggressively taking on a lot of responsibility. That approach, in the end, is how we create innovative products and make our customers happy, and it raises the

motivation of our employees. It's the source of Sammy's strength.

Uemura: Since the management integration, SEGA's development and marketing departments have been working together more closely, such as having weekly interdepartmental meetings.

Entertainment helps people to dream and to “recharge their batteries,” but, unlike food, clothing, and shelter, we can live without entertainment, so it is absolutely essential for entertainment companies to create products based on inspiration drawn directly from the market. I used to develop attractions for theme parks, and I always tried to take the customer's point of view. We asked ourselves what we had to do so that all of our customers could enjoy themselves, whether they were good at games or not. That same approach produced *The King of Beetles* “MUSHIKING” and *LOVE AND BERRY Dress Up and Dance!*. In our business, we can't sell products that aren't inspired by market needs.



PROFILE

Yoshii Asano

Department Manager
Marketing Planning Department
Marketing Headquarters
Sammy Corporation

Since joining Sammy in 1993, has worked in marketing for the company, which, along with development, is known as one of Sammy's strengths. Currently utilizing more than 10 years of marketing experience in the Marketing Planning Department, the pivotal department for Sammy's marketing strategy. In accordance with a market-oriented philosophy, is working on the formulation of marketing plans and the provision of wide-ranging sales promotion support, with the goal of making customers and employees happy.

An Ideal Kind of Entertainment – Children’s Card Games

The King of Beetles “MUSHIKING”



TV animation *The King of Beetles “MUSHIKING”*
The Legend of the People of the Forest.
© MUSHIKING Project /TV TOKYO



The King of Beetles “MUSHIKING”
Battle Venture
© SEGA 2003



THE MANAGEMENT INTEGRATION HAS OPENED UP BROAD NEW POSSIBILITIES.

Asano: Currently, we face a problem in the pachinko and pachislot market, where the number of players is declining. One of the reasons is that, as pachinko and pachislot became more complicated to play, the market lost casual players who just wanted some simple entertainment. So at Sammy, we are asking ourselves how we can bring back those casual players that have left the market, and how we can attract new players. To do that, we are advancing our market-oriented approach beyond the existing markets. Casual players want entertainment value and cutting-edge graphics, and since the management integration we can take advantage of SEGA’s strengths, such as technical development capabilities. That’s a huge plus for Sammy.

LOVE AND BERRY Dress Up and Dance!



LB Style Square



LOVE AND BERRY
Dress Up and Dance! goods



Uemura: The management integration also has tremendous benefits for SEGA. A good example is the penetration of Sammy’s market-oriented approach. And with clear direction from senior management, morale has improved, which has been a big gain too. From the viewpoint of a developer, if we don’t know where the company is headed, it’s hard to focus our efforts. Several months prior to the management integration, I had the opportunity to meet with our chairman, Hajime Satomi, and I was deeply impressed with his vision, how it is transparent, fair, and easy to understand. He met with about 200 SEGA employees, and I think that, at the very least, all of us managers were highly motivated to start the “new SEGA” under the leadership of the chief executive.

Asano: It is easy to understand the vision of “becoming number one in the entertainment industry.” And it’s a huge plus to know where we’re headed, and that our direction won’t change. Right now, Sammy’s operations are limited to Japan, but our chairman, Hajime Satomi, has repeatedly said that we should become “a global company in games too.” I have always thought that, to grow further in the entertainment world, we can’t limit ourselves to pachislot and pachinko machines. So that approach really made sense to me. In a single step, the management integration with SEGA made that happen.

Uemura: Through the management integration, everyone at SEGA has started to recognize how we can use the strengths of the Group as a whole. Throughout SEGA, we are thinking about how to advance the character strategy. For example, how can we extend the strong characters in *The King of Beetles “MUSHIKING”* and *LOVE AND BERRY Dress Up and Dance!* through all of the Group’s channels, including SEGA TOYS, TMS ENTERTAINMENT, and Sammy? This is a vitally important strategy for sustaining the popularity of our games. By doubling or tripling the value of a single piece of intellectual property, we can substantially boost the Group’s sales. As a manufacturer too, this is something that is really worth doing.

Asano: Last year, Sammy celebrated its 30th anniversary with the *ALADDIN World Premiere*. The attendees weren’t limited to pachinko hall operators and the media. In a first for the industry, pachislot fans were also invited, and they had a great time. The debut of our *ALADDIN II Evolution* pachislot machine is a good example of our ability to conduct wide-ranging, multifaceted development. Based on the pachislot machine, we extended our development activities to simulation game software, toys, amusement center prizes, and content for mobile platforms.

Uemura: You mentioned simulation game software, and in fact, in the fiscal year ended March 2005, SEGA’s best-selling game software in the domestic

market was the simulation game software product *JISSEN PACHISLOT HISSHOU-HOU! Hokuto No Ken* based on the hit Sammy brand pachislot machine. This software demonstrated how, if you provide products that the market wants, they will definitely sell. For SEGA as a whole, this renewed our appreciation of the importance of the market-oriented approach, a benefit of the management integration.

Asano: Frankly, prior to the management integration, at Sammy we were only thinking about what we needed to do to increase our unit sales of pachislot and pachinko machines. Now however, with a single machine, we have started to think about what the Group as a whole can do with it. For example, in total pachinko hall services, a new field of business, we are supplying pachinko halls with prizes based on *The King of Beetles* “MUSHIKING” and *LOVE AND BERRY Dress Up and Dance!*. This is more than just using popular intellectual property in goods for sale. Through the provision of those goods, we are also working to increase player numbers and, in the end, to provide support for pachinko hall marketing. With total pachinko hall services, our options and ability to influence the market have been greatly expanded. And looking ahead, I think it would be great if we could develop a wide span of these types of links throughout the Group.

LINKING HOMES AND AMUSEMENT CENTERS, PARENTS AND CHILDREN. THIS IS AN IMPORTANT PART OF THE GROUP'S STRATEGY.

Uemura: Creating synergies from the customer's point of view means that, for example, when customers are enjoying a pachislot simulation game, they might decide to visit an actual pachinko hall on the weekend. Or when they are playing with a toy, they might think that it would be fun to go to an amusement center. Motivating customers in that way is a huge synergy. We're looking for more than just the revenue and profit from a single business. Our business can link entertainment in the home with fun outside, such as in amusement centers and pachinko halls. That's a very important part of the Group's strategy.

Asano: That's right. There was some concern that if we made pachislot simulation software that could be enjoyed in the home, customers who enjoyed it would no longer go to pachinko halls. But actually, that hasn't happened; customers are not satisfied with just the game. By playing the game, they improve their skills, and that makes them want to play in an actual pachinko hall.

Uemura: And with market-oriented development, what's important is the change of generations. If you just focus on your current customers, you end up getting stuck in a rut. Until a few years ago,

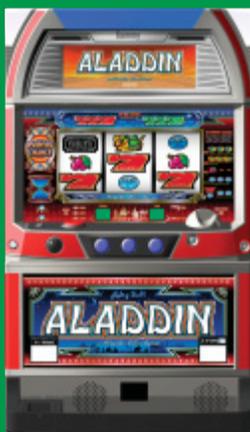
that's where we were in amusement center operations. They were thought of as places only for serious players. That's why we were so pleased when *The King of Beetles* “MUSHKING” and *LOVE AND BERRY Dress Up and Dance!* began to draw fathers and mothers to amusement centers to play with their kids. That's great! Children have memories of enjoying these games with their fathers and mothers. And then when they grow up, they'll bring their own kids to amusement centers. I think we always need to consider the next generation in our business.

WHERE IS THE SEGA SAMMY GROUP HEADED?

Asano: At the end of March, it was a year and a half since the management integration of SEGA and Sammy. We are already seeing synergies in a lot of places, but I think there are still a lot of fields where we can cooperate even more.

Uemura: That's right. By concentrating the comprehensive strengths of SEGA and Sammy, and providing entertainment that can be enjoyed by everyone, adults and children alike, we will be able to create huge synergies.

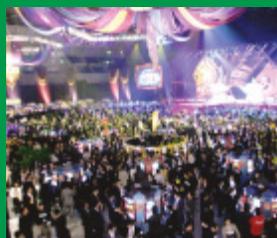
Asano: I think everyone at the Group wants to extend our operations around the world and make steady progress toward the realization of our vision of becoming the number one entertainment company in the world. **X**



ALADDIN II Evolution.
Sammy brand pachislot machine
© Sammy

A Showcase of the Group's Comprehensive Strengths

**The Sammy 30th Anniversary
ALADDIN World Premiere**



In commemoration of its 30th anniversary and the launch of the new-format version of its flagship ALADDIN pachislot machine, Sammy held the ALADDIN World Premiere at the Yokohama Arena. The event provided a powerful demonstration of the Group's comprehensive strengths.

© Sammy

HIGH*LIGHTS

Record-High Revenue and Profit

In the Group's second fiscal year, ended March 31, 2006, the range of initiatives that the Group has implemented produced results, and each business segment recorded a strong performance. As a result, the Group recorded its best results since the management integration, not only by revenue but also by every measure of profit.

Achievement of Profitability in Consumer Business

Following the success of a range of initiatives, such as the restructuring of our development organization, the sale of overseas subsidiaries, and the acquisition of overseas development studios with promising intellectual property, the Consumer Business achieved profitability in just a year and a half.

Stock Split and Higher Dividends

In light of its favorable results, on November 18, 2005, the Company implemented a 2-for-1 stock split. In addition to a ¥50 per share interim dividend, the Company paid a year-end dividend of ¥30 per share, an increase of ¥10 per share, calculated on a pre-split basis. In this way, we took steps to aggressively provide a return to shareholders.

Capital and Business Tie-up with GINZA



Sammy agreed on a capital and business tie-up with GINZA Co., Ltd., in the field of pachislot and pachinko machines. We have begun the development of the GINZA brand, reinforcing our pachislot operations and taking a major step toward the expansion of our market share for pachinko machines.

TMS ENTERTAINMENT Becomes Subsidiary



On October 7, 2005, TMS ENTERTAINMENT, LTD., which had previously been an equity-method affiliate, became a subsidiary after we acquired more than 50% of its stock. By bringing animation-related capabilities into the Group, we will be able to create more powerful synergies among the various facets of the Group's content.

Nationwide Rollout of LB Style Square

The official shops for *LOVE AND BERRY Dress Up and Dance!*



With extensive lineups of original goods, LB Style Square shops propose coordinated offerings to help girls become "fashionable young women."

LOVE AND BERRY Dress Up and Dance!, a children's card game, has received overwhelming support from girls since it was launched. In March 2006, SEGA began rolling out LB Style Square, the official shops for the game, in department stores throughout Japan. These shops offer lineups of original items, such as apparel, stationery, and sundries, that incorporate the characters of *LOVE AND BERRY Dress Up and Dance!*. The objective of the shops is to provide places where girls, who have begun to take an interest in fashion, and their mothers can enjoy time together. In the future, these shops will be rolled out not only in department stores but also in shopping centers around the country. In the fiscal year ending March 2007, we plan to open 100 shops.



© SEGA

1234 **NUMBERS** 5678

Consolidated Financial Highlights

SEGA SAMMY HOLDINGS INC. AND ITS CONSOLIDATED SUBSIDIARIES

For the years ended March 31

	Millions of yen unless stated otherwise			Thousands of U.S. dollars ¹
	2006	2005	2006/2005	2006
Net sales	¥553,241	¥515,668	7.3%	\$4,709,637
Pachislot and Pachinko Machine Business	265,632	280,109	-5.2%	2,261,275
Amusement Machine Sales Business	71,513	63,305	13.0%	608,777
Amusement Center Operations	106,246	83,194	27.7%	904,452
Consumer Business	90,353	65,341	38.3%	769,158
Others	19,497	23,719	-17.8%	165,975
Selling, general and administrative expenses	109,868	106,469	3.2%	935,287
Operating income (loss)	119,144	105,090	13.4%	1,014,250
Pachislot and Pachinko Machine Business	99,848	103,931	-3.9%	849,987
Amusement Machine Sales Business	12,177	7,424	64.0%	103,661
Amusement Center Operations	9,244	5,472	68.9%	78,692
Consumer Business	1,977	(8,810)	-	16,830
Others	(1,713)	(541)	-	(14,583)
EBITDA ²	140,999	122,764	14.9%	1,200,298
Income before income taxes and minority interests	111,924	89,482	25.1%	952,787
Net income	66,222	50,574	30.9%	563,735
Capital expenditures	37,650	32,468	16.0%	320,507
Depreciation and amortization	21,855	17,674	23.7%	186,048
Total assets	522,914	438,991	19.1%	4,451,468
Total shareholders' equity	¥316,680	¥258,954	22.3%	\$2,695,837
Number of shares outstanding ³ (shares)	283,229,476	140,551,522		
	Yen			
Per share data				
Net income	¥ 261.06	¥ 205.27 ⁴	27.2%	\$ 2.22
Diluted net income	260.35	200.48 ⁴	29.9%	2.22
Shareholders' equity	1,254.14	1,033.96 ⁴	21.3%	10.68
Cash dividends	80.00 ⁶	60.00	33.3%	0.68
	%			
Gross profit margin	41.4	41.0		
SG&A/Net sales	19.9	20.6		
Operating margin	21.5	20.4		
Net margin	12.0	9.8		
ROE ⁵	23.0	19.5		
ROA ⁵	13.8	11.5		
Shareholders' equity ratio	60.6	59.0		

1. Yen amounts have been translated into U.S. dollars solely for convenience at the rate of ¥117.47 = US\$1, the approximate exchange rate at March 31, 2006.

2. EBITDA = operating income + depreciation and amortization

3. On November 18, 2005, the Company implemented a 2-for-1 stock split.

4. Per share information calculated as if the November 18, 2005, stock split had been implemented at the beginning of the fiscal year ended March 31, 2005.

5. ROE and ROA for the fiscal year ended March 2005 are calculated using total shareholders' equity and total assets at the end of the fiscal year.

6. Sum of pre-split first-half dividend of ¥50 per share and post-split year-end dividend of ¥30 per share.

**A Year and a Half since
the Management Integration**

BROADER, STRONGER, SOARING HIGHER

“We will become the world’s number one comprehensive entertainment company.”

The SEGA SAMMY Group is taking on the challenge of achieving an ambitious vision, and the achievement of profitability in the Consumer Business is proof that the initiatives the Group has implemented since the management integration are steadily producing results.

Full-fledged competition in the entertainment industry is spilling over into entirely new areas.

The SEGA SAMMY Group will use its business portfolio, the strongest in the industry, to create synergies and stake out a solid position in a new competitive environment.



Hajime Satomi
Chairman and CEO

A COMPREHENSIVE ENTERTAINMENT COMPANY

Q: By the end of the fiscal year under review, it had been about a year and a half since the management integration. Is the SEGA SAMMY Group becoming the type of corporate group that you envisioned?

A: The initiatives that we have implemented since the management integration are steadily bearing fruit, as seen in the achievement of profitability in the Consumer Business. Turning around that business, which had struggled in recent years, was our most important challenge following the management integration. The initiatives that we implemented to take on that challenge, including restructuring on a global scale, are too numerous to mention. But the fact that those initiatives have paid off, making the Consumer Business profitable in only a year and a half, has reinforced my confidence in the Group's new start and in the measures that we have implemented. Plus we are seeing steady improvement in our profit structure, with a better balance between the Pachislot and Pachinko Machine Business and other businesses, as well as tangible gains from the management integration in all of our other fields of business. Over the past year and a half, we have made huge strides toward the establishment of a solid foundation for growth as a comprehensive entertainment company.

The initiatives that we have implemented are steadily producing results, but at this point we are only about 50% to 60% of the way to achieving our goal, and we have considerable challenges ahead.

On the other hand, from the perspective of establishing a commanding presence in all of our fields of business, there are still many operational areas that we need to reinforce and many fields that present

major challenges. In that sense, at this point we are only about 50% to 60% of the way to achieving our goal, and we have considerable challenges ahead.

Q: Would you discuss the 40% to 50% of the Company's objectives that still lie ahead?

A: In the Pachislot and Pachinko Machine Business, Sammy's exceptionally powerful development capabilities have enabled us to secure a dominant top share of the pachislot machine market. Our market share already exceeds 30%, so it is unlikely that this market alone will provide substantial growth for our Pachislot and Pachinko Machine Business over the medium to long term. That's why we are aiming to garner a leading share of the pachinko machine market as well. At this point, however, we still only have about 7% of the pachinko machine market, so we still have a long way to go. And our total pachinko hall services, where we provide peripheral equipment, hall design services, and prizes, have not yet reached the point where they can make a contribution to our profits.

In the Amusement Machine Sales Business, the high-value-added products that are SEGA's specialty are storming the domestic market. This is a considerable achievement, but we have not been able to demonstrate world-leading product strengths in overseas markets. Even though our sales in this field are among the highest of any company in the world, the majority of those sales come from the domestic market, and we need to bring our overseas results up to the level of our domestic performance.

In Amusement Center Operations, our challenge is to improve profitability. In our children's card game business, *The King of Beetles* "MUSHIKING" and *LOVE AND BERRY Dress Up and Dance!* are highly profitable, but overall the level of profitability in our Amusement Center Operations must improve, and we need to consistently achieve an operating margin of at least 10%.

Looking at our listed subsidiaries, TMS ENTERTAINMENT, which handles the

Group's animation business, must enhance its 3D animation technology, which will be a strategically important field in the years ahead. SEGA TOYS is generating a strong level of profits in a difficult toy market, but with sales of about ¥14.0 billion, it faces many challenges in this highly competitive market. Accordingly, SEGA TOYS must increase the scale of its operations. In the same way, in content for mobile phones and online games, our operational scale is still too small.

The SEGA SAMMY Group is generating operating income of more than ¥100.0 billion a year. But we face a number of challenges, including those I have mentioned here. To realize our vision of becoming the world's number one comprehensive entertainment company, we must successfully take on all of these challenges. That's why we won't let up even for a minute as we continue working to make the Group stronger.

Q: Currently, companies in the entertainment industry are increasingly turning to mergers as a means of corporate survival. In a competitive environment that transcends the traditional industry borders, what are the SEGA SAMMY Group's competitive advantages?

A: The entertainment industry has seen the emergence of an intensely competitive environment, where survival requires not just technical and financial strength but also abundant content and the ability to use that content effectively, and many companies are using mergers to enhance their comprehensive strengths. We have established strong competitive advantages in a number of areas.

First, our operations, which extend to a wide range of entertainment fields, support the Group much like large "wings." Management integrations between companies that have substantial overlap in their operational fields can produce synergies in the area of cost reductions; that is, they can achieve increased efficiency in back-office operations. However, substantial synergies cannot be expected in sales and profits, which are the key factors in a company's survival in this environment.

The management integration of SEGA and Sammy, however, was entirely different. We had minimal overlap in our operations, and through the integration, we created a powerful business portfolio –

machine business, where our market presence is steadily increasing, provide a strong, stable financial foundation that enables the Group to invest aggressively in growth fields.



The Group's greatest strength is the ability to create major synergies throughout its wide-ranging fields of business.

the broadest in the industry – that has enabled us to generate vast synergies. We were able to achieve this right away, enabling us to make strategic advances ahead of our competitors. This is one of our key competitive advantages.

Next, a strong financial position is needed, not only for the development of game software for next-generation game consoles, but also to support rapid advances into growth fields. In this area, we are far ahead of any other company, and the reason is our Pachislot and Pachinko Machine Business. Our pachislot machine business, where we have a commanding top share, and our pachinko

The Pachislot and Pachinko Machine Business also foster synergies in cost competitiveness. In comparison with pachislot and pachinko machines, where annual production is in the neighborhood of one million units, our unit production of amusement machines is relatively low, and if our Amusement Machine Sales Business sourced its own parts, the procurement prices would certainly be high. But by sharing parts between these businesses and implementing joint procurement activities, we can benefit from substantial cost synergies.

Q: Would you explain why you hold the position of CEO at SEGA and Sammy as well as at SEGA SAMMY HOLDINGS?

A: While the management integration served to diversify our sources of revenue, that in itself does not provide a sufficient level of synergies. Strong leadership is needed to promote the integration of managerial resources as well as cooperation among business units. Each Group company will remain independent, but I have been given the responsibility for Group-wide management and coordination among the SEGA SAMMY Group companies. This system will foster a clear, rapid decision-making process, helping all Group companies to work together toward their common goal of fostering synergies. This system is another key point that differentiates the Group from its competitors.

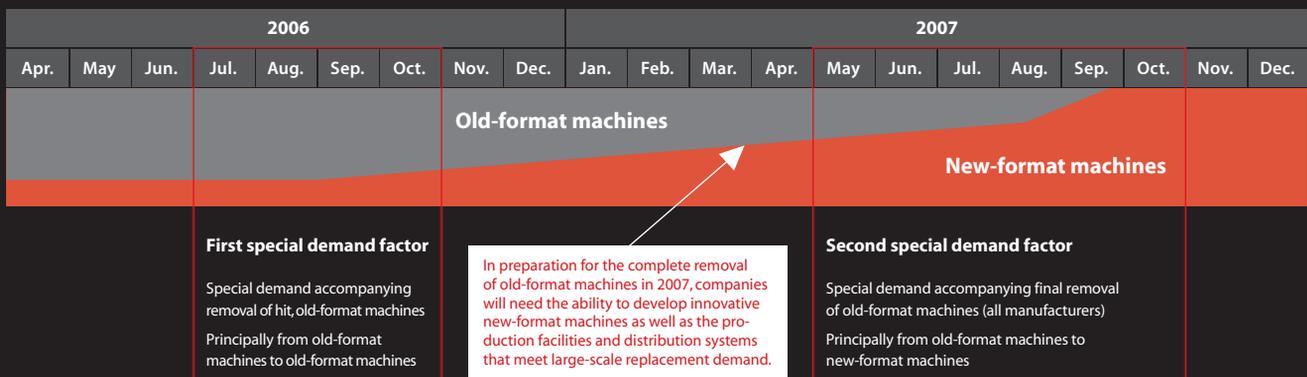
PACHISLOT AND PACHINKO MACHINE BUSINESS

Q: Two years have passed since the regulatory revision in July 2004, and machines designed for the new regulations have revitalized the pachinko machine market. But can pachislot machines maintain their popularity?

A: In comparison with the previous regulations, under the new regulations, certain restrictions on pachislot machines have been added at the development stage. We expected that some time

DEMAND FORECAST FOR THE PACHISLOT MACHINE MARKET

Old-format machines can only be installed for three years after they are approved. As a result, in 2006 and 2007, there will be two factors driving especially strong demand – the expiration of the installation period for hit, old-format machines and the complete replacement of old-format machines with new-format machines accompanying the regulatory revision.



would be required for the market to accept new pachislot machines, but the new-format pachislot machines that we have developed and sold have garnered a certain degree of market support and provide an indication of the direction that new-format machines will take. However, as long as old-format machines are distributed and installed, it will be difficult to achieve full-scale market acceptance of new-format machines. Accordingly, in the fiscal year ending March 2007, our strategy is to steadily achieve our planned unit sales by effectively launching major old-format Sammy machines for which approvals have already been obtained. At the same time, we will strive to develop strategic, new-format pachislot machines. Old-format machines can be installed for three years from the date they are approved, meaning that all of those machines must be replaced with new-format machines from summer to fall 2007. Because more than one million machines will have to be replaced, new-format machines will decide the success of all pachislot machine manufacturers. In this setting, the company that will get the most market support is the company with three key strengths – dominant development capabilities, product strengths, and the production capacity to smoothly meet the high level of demand that will be concentrated in a short period

All pachislot machine manufacturers will have to compete on the basis of new-format machines, and we will win that game.

of time. That company is Sammy. In the market for old-format pachislot machines, Sammy was a pioneer in the development of new genres and made the largest contribution to the expansion of the market.

In the period following the regulatory revision, there will be no change in our corporate declaration – “always proactive, always pioneering.” These strengths will be a key point of differentiation between the Group and its competitors.

Q: Prior to the regulatory revision, there were many pachislot and pachinko machine models characterized by their high payouts, and some observers have commented that this may have driven casual players away from the market.

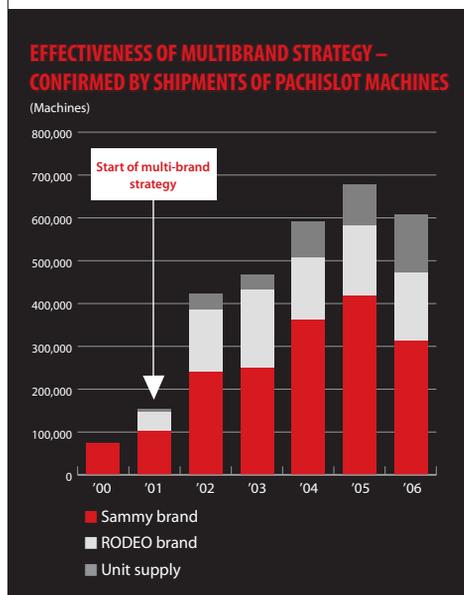
A: I have stated that reducing this element of pachislot and pachinko machines and increasing the entertainment value will be very important in developing a base of new fans, and that these measures are, in fact, indispensable for the sustained growth of the industry. We must broaden the possibilities of machine development so that, in the future, more users can enjoy the entertainment value rather than the payout element. Sammy is highly regarded for the proposal and supply of new types of machines based on that idea, especially in the pachinko machine market. These new type machines, which can be enjoyed for longer periods of time for a smaller amount of money, have not previously been available in the market, and as a result we have secured a solid market position in this category.

Q: In the pachinko machine business, the Company has set a challenging goal for unit sales in the fiscal year ending March 2007. Will the Company be able to achieve that goal in a highly competitive market environment?

A: Our goal for pachinko machine unit sales in the current fiscal year may seem quite high. But over the past several years, Sammy has significantly bolstered its development capabilities in this area, and we are confident that a range of future initiatives will enable us to increase our share even further. Our multi-brand strategy is one of those initiatives.

Sammy has a commanding share of the pachislot machine market. The driving force behind that success has been the multi-brand strategy, which covers our

own Sammy brand products, RODEO brand products offered by our subsidiary RODEO, and the supply of units to partner companies. The development of multiple brands has enabled us to formulate product strategies by brand, to take advantage of diverse distribution routes, and to obtain additional approvals. As a result, the strategy has made a major contribution to increasing unit sales. In the



pachinko machine business, we had only been developing the Sammy brand, and to secure a leading market share, we needed to implement a multi-brand strategy. Our capital and business tie-up with GINZA will make it possible for Sammy to implement a multi-brand strategy in pachinko machines. The GINZA brand will not only be used for pachinko machines, however, but will also be positioned as a new brand in pachislot machines. In this way, we will work to expand the overall share of our Pachislot and Pachinko Machine Business.

To further enhance the market’s evaluation of our products, our biggest challenge is to reinforce our development capabilities. In addition to improving our development capabilities for the implementation of the multi-brand strategy, we will also aggressively take on the challenge of developing entirely new types of pachislot and pachinko machines that invigorate their markets.

Q: What progress is the Company making in total pachinko hall services, a new field of business?

A: Total pachinko hall services are not limited to the supply of pachislot and pachinko machines. They entail the provision of a total range of products and services, including peripheral equipment, prizes, and hall design. Our goals are to provide comprehensive services to pachinko halls

Our goals are to provide comprehensive services to pachinko halls and to broaden our profit opportunities.

and to broaden our profit opportunities through the provision of these services. In August 2005, we made H-I System Corporation, a company that makes hall computers and prize POS systems, a subsidiary. By doing so, we bolstered our lineup of companies engaged in total pachinko hall services, including Shuko Electronics, which provides pachinko hall peripheral equipment; Sammy Design, which provides total



support for store development and planning, centered on pachinko hall design; and NISSHO INTER LIFE, which handles design and construction. We will need to further improve the quality of our solutions in each field in order to clearly differentiate ourselves from our competitors.

AMUSEMENT MACHINE SALES BUSINESS

Q: In the Amusement Machine Sales Business, the Company has a dominant competitive edge in the domestic market. What's next?

A: In the domestic market, we will not be content with our current position. Rather, we will continue working to strengthen our operations. In the past, in the Amusement Machine Sales Business, we provided major hit products on a cycle of once every few years, and that cycle caused fluctuations in sales and profits. In the future, through the introduction of a new business model, whereby a fee is charged to the operator based on content usage for certain products, we will work to create recurring profit opportunities and realize more stable growth.

Also, to achieve growth over the medium to long term, we must succeed in overseas markets. Many overseas markets are still relatively unsaturated, so they have exceptionally high growth potential for us. In addition to Asian markets, which we believe have the highest potential in the world, we have also positioned other regions as target markets, specifically, North America and Western Europe. Our approach will be for SEGA, on its own, to expand the scale of these markets. A key point will be the delivery of

By using the world-leading product strengths of SEGA in overseas markets with high potential, the possibilities will be limitless.

products and services that match the characteristics of each market. That's why we will bolster our local development and sales capabilities as we strengthen our ability to promote our operations in overseas markets.

AMUSEMENT CENTER OPERATIONS

Q: In Amusement Center Operations, the Company is moving ahead with the development of large-scale facilities. However, some investors, when considering the lower level of ROI from these operations, question if they should be continued.

A: To achieve stable growth over the long term, we are paying careful attention to maintaining an optimal balance in the Group's business portfolio. We can expect high levels of return in the pachislot and pachinko machine and consumer businesses, but these businesses are heavily dependent on hit products. On the other hand, our Amusement Center Operations generate a more modest level of profitability, but the profits are exceptionally stable. By achieving a balance between this type of business, with relatively low profit-fluctuation risk, and higher-risk, higher-return businesses, it will be possible for us to follow a stable course of growth. Moreover, I think that in entertainment, seeking out the opinions of customers is vitally important. The fact that the Group's amusement centers are in direct daily contact with customers has enabled us to create such highly competitive products as *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress Up and Dance!*. As a comprehensive entertainment company, our Amusement Center Operations provide us with powerful synergies for all of our businesses.

Of course, we are not satisfied with the level of profitability generated from this business. We will continue to implement thorough improvement measures, such as scrap-and-build initiatives.

CONSUMER BUSINESS

Q: Would you discuss the reasons behind the resurgence of the Consumer Business?

A: Our efforts to strengthen the development system for game software, the main business field in the Consumer Business segment, extend back to before the management integration. Seven development subsidiaries, which had been established through a corporate separa-

tion, were merged back into SEGA prior to the management integration with the objective of increasing efficiency. Following the management integration, under the newly established R&D Headquarters, development teams were temporarily organized by category, such as driving games and sports games, and multiple streams were introduced in the development pipeline. These organizational reforms served to increase the specialization and speed of our development activities. Subsequently, to achieve a more accurate grasp of end-user needs, we vertically integrated the development function and the sales/marketing function, and instituted rigorous profit management on a project basis. And in addition to implementing these initiatives, we acquired leading development companies overseas, such as The Creative Assembly Limited, SPORTS INTERACTIVE Ltd., and SECRET LEVEL Inc., which have successful titles and advanced development and technical capabilities. In this way, we are taking aggressive steps to strengthen our regional development system. The achievement of profitability in the Consumer Business in the fiscal year under review is an indication of the success of these initiatives.

The achievement of profitability in the Consumer Business in the fiscal year under review is an indication of the success of our reformative efforts.

Q: In the game software market, the launch of new game consoles is a major turning point. What is SEGA's strategy in that regard?

A: In May 2006, at the Electronic Entertainment Expo 2006 held in Los Angeles, California, game console companies displayed their next-generation game consoles. Because there is a wide range of variation in product concepts and software

development expenses are expected to increase overall, the over-reliance toward development of game software for a single game console will entail considerable risk.

To diversify development risk, SEGA has followed a multi-platform strategy, providing a balanced lineup of game software for a variety of game consoles.

Maintaining a careful eye toward profitability and rigorously managing risk, we will carefully build an optimal product portfolio.

In developing game software for new game consoles, we will basically continue to follow this strategy, but we will combine "sales regions" and "game genres" with "platforms" to create the optimal product portfolio. We will allocate our development resources in accordance with a careful examination of how we can minimize risks and maximize returns by developing specific genres of software which meet the consumer tastes in specific regions and platforms. Maintaining a careful eye toward profitability, we will implement rigorous risk and cost management in line with the product portfolio strategy I just described. In this way, we will carefully build a development strategy.

Q: Japanese companies are facing growing demands to raise their dividend payout ratios. Would you discuss the Company's approach to dividend payments?

A: I understand the concerns of investors about dividends. We consider shareholder return to be our most important management issue, and in accordance with our results, we have provided measures such as implementing stock splits and raising dividends. In the future, we will maintain this approach.

On the other hand, raising corporate value through efforts such as meeting

medium-term management objectives – ¥1 trillion in net sales and ¥200 billion in ordinary income – is also an important means of providing a return. And to do that, we need to invest aggressively in growth fields and implement M&A activities in areas where the Group's development capabilities are insufficient.



I would like to achieve an overall balance between providing a direct return to shareholders, such as through dividends, and providing returns in other ways, such as long-term growth in corporate value achieved through aggressive investment of resources and the retention of earnings in consideration of future operational scale.

Q: In closing, do you have a message for shareholders and investors?

A: The entertainment industry is changing rapidly and an entirely new, intensely competitive environment is emerging. The industry is undergoing further reorganization. In this setting, the SEGA SAMMY Group moved quickly and established strong "wings" in the form of its broad business portfolio, the strongest in the industry. In the future, we will use those "wings" to aggressively leverage synergies and target success not only in Japan but also overseas.

We will become the world's number one comprehensive entertainment company.

In closing, I would like to thank our shareholders and investors for their continued support for the SEGA SAMMY Group. **X**



Not for the SEGA SAMMY Group.
With a broad and powerful portfolio,
we're ready to launch a new wave of entertainment products.
One after another. After another.

That's enough? Not by a long shot.



**That's
Enough!!**

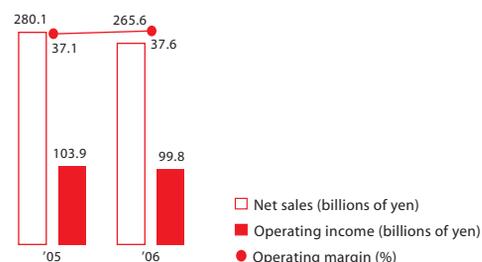
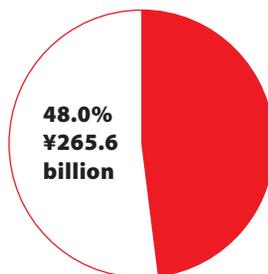
SEGMENTS AT*A*GLANCE

Segment

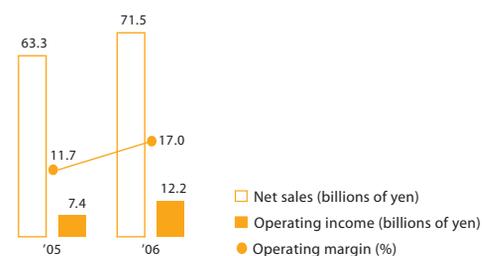
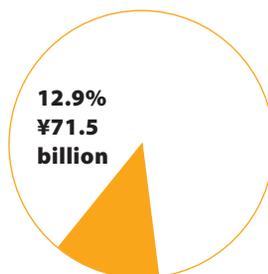
Contribution to Net Sales

Overview of Results

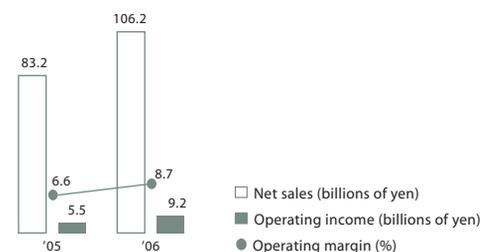
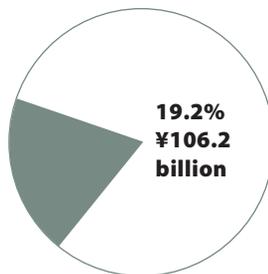
Pachislot and Pachinko Machine Business



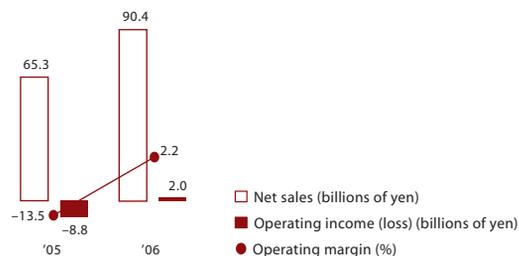
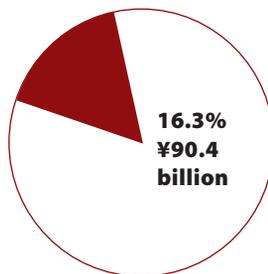
Amusement Machine Sales Business



Amusement Center Operations



Consumer Business



Market Environment

- In July 2004, the regulations pertaining to the Entertainment Establishments Control Law of Japan were revised. In the pachislot machine market, manufacturers are actively developing new-format machines and working to obtain approvals. However, demand for old-format pachislot machines is expected to remain high for the time being. In the pachinko machine market, the regulatory revision has increased the degree of flexibility in machine development, and manufacturers are launching many new machines with enhanced entertainment value.

- The domestic amusement machine sales market contracted temporarily, but against a background of trends toward large amusement centers and entertainment complexes, the launch of network-enabled game machines and large-scale game machines that are differentiated from home game consoles drove progress in the market, which is currently on a course of recovery.

- In Japan, amusement centers are becoming larger and more diversified. Amusement centers in shopping centers with customer-drawing ability are taking hold as community spaces targeting families. The adoption of large-scale machines that are clearly differentiated from home game consoles and can only be enjoyed in amusement centers, such as network-enabled games and children's card games, is driving a market recovery.

- In packaged game software, in preparation for the full-scale adoption of next-generation game consoles, competition in development is heating up around the world. On the other hand, to absorb rising development costs, there is a strong trend toward multifaceted development into other entertainment fields, triggering mergers among companies in the industry.

Accompanying the development of infrastructure, global market expansion in online games is anticipated.

Content for mobile platforms is expanding strongly in the domestic market, with support from the increasingly advanced capabilities of mobile phones. On a global scale, however,

While the number of pachinko halls is declining, the total number of installed pachislot and pachinko machines is rising slightly due to the trend toward larger halls. The number of installed pachislot machines is increasing while the number of installed pachinko machines and players are decreasing. The industry needs to revitalize the market and draw new players to the halls.

the adoption of new handsets and the increasingly advanced capabilities of handsets are expected to drive market growth.

In toys, with a trend toward fewer children per family, the overall market is contracting, but toys targeting a wider range of age groups and exceeding the traditional framework of toy products, as well as educational toys, are considered to be growth fields.

In animation, the field of 3-D graphics is expected to record strong growth.

Market Presence and Strengths

- We maintain a commanding position in the pachislot machine market, with a 33.6% market share in unit sales for the fiscal year ended March 31, 2006. In pachinko machines, we are making good progress toward becoming a market leader, with a 7.1% market share in the fiscal year under review. Our key strength is our overwhelming R&D capability, which we are using to propose new, market-leading machines with enhanced entertainment value.

- In the field of high-value-added products, such as network-enabled game machines, we boast advanced product strengths supported by unrivaled development capabilities. Another strength is our product portfolio, which includes a lineup of existing products that are popular with a wide range of customers, from adults to children.

- We lead the industry with the development of large-scale centers and of centers with full lineups that appeal to a wide range of customer age groups and diverse needs. By merging amusement-center-related subsidiaries into SEGA, we enhanced our business development capabilities and bolstered our overseas operations. Moreover, we took the initiative in children's card games, with such offerings as *The King of Beetles "MUSHIKING"* and *LOVE AND BERRY Dress Up and Dance!*, and currently we are maintaining a substantial lead over competitors.

- In the domestic market, we are a leader in packaged game software. Due to stronger development capabilities and profitability stemming from reorganization measures, both before and after the management integration, and to aggressive acquisition of prominent overseas development studios, our global presence is increasing rapidly.

In content for mobile platforms, toys, and animations, we are still a small company by sales, but we have built a distinctive position in the industry with unique products and services. A key strength is our ability to leverage our broad, strong portfolio and implement multifaceted development of individual pieces of content to diversify development costs and risks while expanding profit sources and increasing content value.

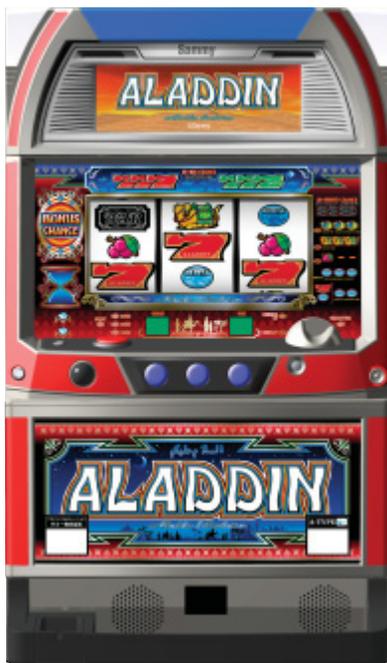
BUSINESS SEGMENTS



* An overview of segment results in the year under review is provided in the Management's Discussion & Analysis section on pages 44 to 48.

Pachislot and Pachinko Machines

We have the top share of the pachislot machine market and are closing in on the leaders in the pachinko machine market. We will strive to take advantage of the dramatic changes in the operating environment to establish rock-solid positions in each of these fields of business, which are powerful profit drivers.



ALADDIN II Evolution pachislot machine © Sammy

MARKET ENVIRONMENT – INTENSIFIED COMPETITION IN DEVELOPMENT OF NEW-FORMAT MACHINES ACCOMPANYING REGULATORY REVISION

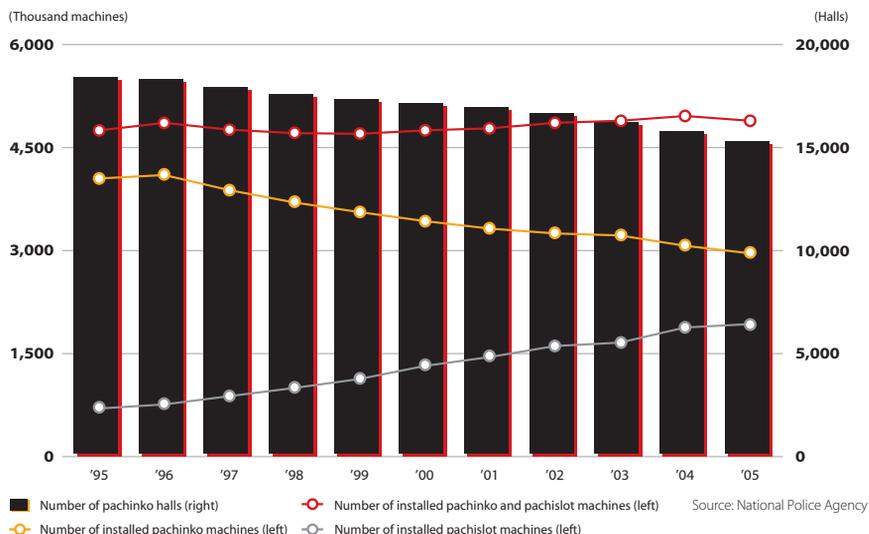
The revision of the regulations pertaining to the Entertainment Establishments Control Law of Japan¹ that was implemented in July 2004 has fostered a shift in emphasis in pachislot machine development from the gambling element to the entertainment value. Companies are actively developing new-format machines and working to obtain approvals for them. However, demand for old-format machines for which approvals were obtained prior to the regulatory revision is expected to remain strong through the first half of the fiscal year ending March 2007. Old-format machines can only be installed for three years from the point when they are approved. The reserves of old-format machines that have been approved will steadily be used up, and the market will gradually shift

toward new-format machines. The installation of old-format machines will come to an end from summer to fall 2007, and as a result, in the fiscal year ending March 2008, large-scale replacement demand is expected as old-format machines are completely replaced with new-format machines.

In pachinko machines, machine classifications² were abolished due to the regulatory revision and the degree of flexibility in machine development has increased. Companies have launched multiple machines with wide-ranging entertainment characteristics, which fostered replacement demand from pachinko halls. However, the market has not seen the penetration of machines that can resolve the industry's key challenges – enabling customers to play for a long time for a small amount of money and bringing casual players back to the market. Industry-wide initiatives are needed to resolve these issues.

Pachinko and Pachislot Machine Market Trends

The number of pachinko halls is declining, but the total number of installed machines is holding steady due to the trend toward larger halls.



The number of pachinko halls is declining each year, but the opening of large-scale halls, principally by major chains, has led to a small increase in the total number of installed pachislot and pachinko machines in recent years. Pachislot machine installations are increasing, while pachinko machine installations continue to decrease. Moreover, the total number of pachislot and pachinko players is declining, and a key challenge for the industry is securing a broader player base.

1. A change in the model testing rules of the Security Electronics and Communications Technology Association, which are mandatory for manufacturers of pachinko and pachislot machines.
2. Previously, specifications were determined and models were tested in accordance with three categories of pachinko machines.

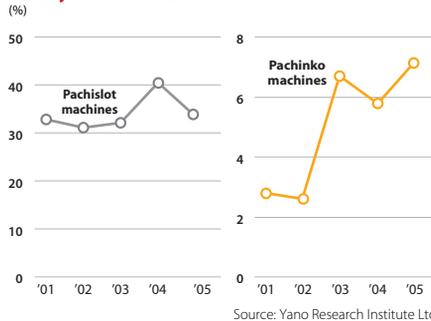
■ MARKET POSITION AND STRENGTHS – INDUSTRY-LEADING PRODUCT DEVELOPMENT CAPABILITIES

Since garnering the top share of the pachislot machine market – 32.8% – in 2001, we have consistently maintained a market share above 30%. We have established a rock-solid position as the market leader, with market shares of 40.4% in 2004 and 33.6% in 2005. In pachinko machines, our market share was below 3% until 2002. Since then, we have steadily been closing the gap with the market leaders, and the Sammy brand is also establishing a foothold in the pachinko machine market.

In accordance with our development philosophy – “Sammy... the wellspring of new ideas” – our key strength in pachislot and pachinko machines is the development capabilities that we have drawn on to be the first to launch machines with

innovative functions, entertainment value, and graphics. Following the management integration, we have further enhanced this strength by sharing development resources with other segments in the Group. Other key strengths include the robust production facilities and distribution system needed to respond accurately to orders that will be concentrated during a short period of time and to prevent lost sales opportunities, as well as a nationwide sales network. Another competitive advantage is our ability to reduce costs through procurement efficiencies driven by high unit sales of pachislot and pachinko machines and by standardizing parts within the Group.

Sammy's Market Share



■ BUSINESS DEVELOPMENT – ONGOING GROWTH IN PACHISLOT AND PACHINKO MACHINES

In the pachislot machine business, we will strive to increase the number of new regulation machine approvals while principally relying on sales of major old-format machines for which approval has already been obtained. Through further strengthening of our development system, we will

work to develop differentiated new-format machines and to obtain additional approvals. Moreover, we will strategically time the market introduction of those products to take advantage of demand trends, thereby steadily meeting the anticipated full-fledged replacement demand for new-format machines. In these ways, we will reinforce our top market share.



One of the industry's largest production bases – Kawagoe Factory

In the pachinko machine business, we will strive to enter the top ranks in terms of market share by achieving our sales target, which calls for substantial growth over the previous year. To achieve the planned level of sales, we will (1) steadily supply hit titles by bolstering our development lines and increasing the number of approvals obtained, and (2) implement a multi-brand strategy with the Sammy and GINZA brands, following the capital and business tie-up with GINZA Co., Ltd., which develops, manufactures, and sells pachinko and pachislot machines.

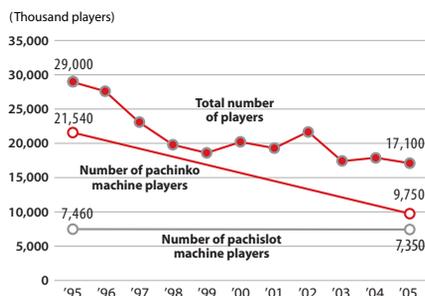
In addition, we will advance cost cuts through the reuse of parts for pachislot and pachinko machines. And we will also work to revitalize the pachislot and pachinko industry by providing easy-to-enjoy products that attract potential players.

In total pachinko hall services, which include peripheral equipment, prizes, and hall design, we are working to further enhance our system for comprehensively meeting a wide range of pachinko hall needs. In August 2005, for example, we made H-I System Corporation, which makes hall computers and prize POS systems, a subsidiary. We will continue working to bolster these services to the point where they contribute to our results as soon as possible.

PLAYER TRENDS

Number of Pachinko and Pachislot Players

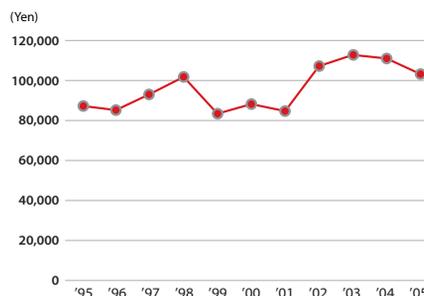
The number of pachinko machine players is declining, while the number of pachislot machine players is basically flat.



Sources: Yano Research Institute Ltd., White Paper on the Leisure Industry 2005; Sammy, Renaissance Project Research

Average Annual Spending per Player

Average annual spending is increasing, indicating a growing number of frequent players.





Amusement Machine Sales

In high-value-added products, we have unrivaled development capabilities and a powerful product portfolio. With these strengths, we are building our presence in markets around the world.

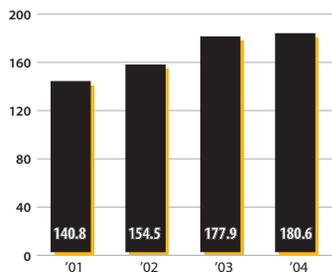


StarHorse2 NEW GENERATION
Large-scale medal game machine
© SEGA

AMUSEMENT MACHINES MARKET SCALE

Amusement Machine Sales

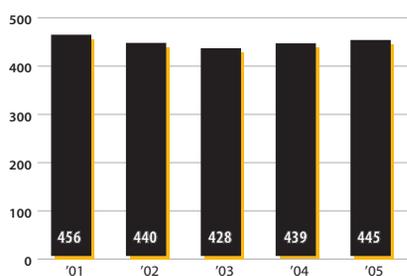
(Billions of yen)



Sources: JAMMA, AOU, and NSA
Sales figure for 2005 is not disclosed by survey organizations.

Number of Installed Game Machines

(Thousand units)



Source: National Police Agency

■ MARKET ENVIRONMENT – A CLEAR RECOVERY TREND

Accompanying the spread of home game consoles, the domestic amusement machine market had declined. In recent years, however, the market has recovered due to the rapid adoption of machines that are clearly differentiated from home game consoles. These include network-enabled game machines and large, so-called satellite game machines utilizing card systems.

■ MARKET POSITION AND STRENGTHS – COMMANDING STRENGTHS IN HIGH-VALUE-ADDED PRODUCTS

We are one of the top-ranked companies in the domestic industry in terms of sales. In particular, we have unrivaled strengths in high-value-added products, such as network-enabled game machines and trading card games. The development capabilities that support those product strengths are the Company's most important competitive advantage in this field. In addition, the management integration of SEGA and Sammy created a broad product lineup that extends from high-value-added products to products for children and families. This lineup gives us the ability to attract customers from a wide range of ages and groups, which has become another competitive edge for the Company.



Sangokushi Taisen 2
Network-enabled card action game machine
© SEGA

■ **BUSINESS DEVELOPMENT –
ACCELERATE EXPANSION IN JAPAN
AND OVERSEAS**

In the domestic market, we will work to further enhance our product strengths by bolstering our development system and to shorten our product supply cycle for major hit products, which is generally two to three years in the amusement machine sales sector. In these ways, we will strive to continually introduce new hit models into the market. With SEGA's strength – a full product lineup – we will work to attract a wide range of customers. Furthermore, we will take steps to reduce revenue and profit

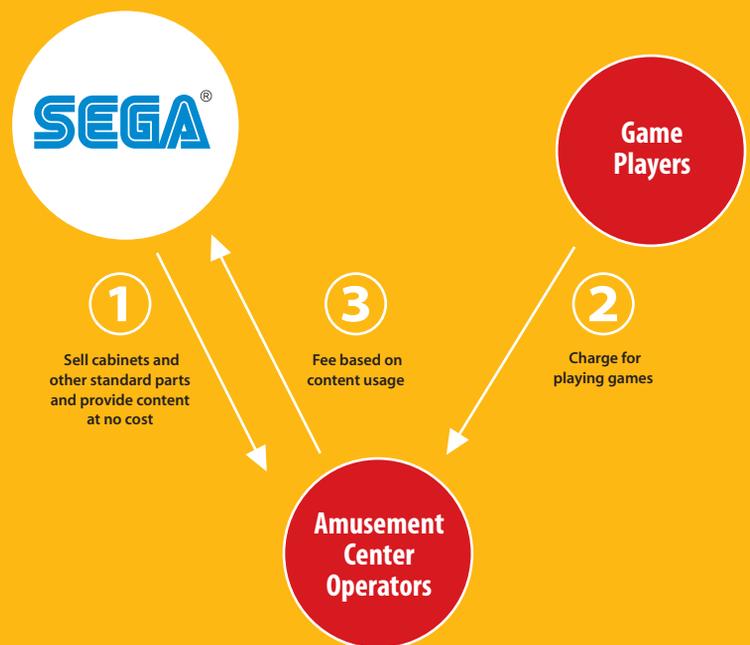
fluctuation risk stemming from dependence on hit titles. To that end, through the introduction of ALL.Net P-ras, a new usage-based business model where payment is based on content usage, we will work to increase the market value of content and thereby to generate steady increases in revenues and profits.

In addition to strengthening development and diversifying services, we will further reinforce production and distribution systems in order to meet large-scale demand and reduce lost sales opportunities. At the same time, we will strive to lower production costs.

A key challenge for this segment is to increase the percentage of sales contributed by overseas operations through aggressive business development in overseas markets. Rather than simply taking hit products from the domestic market and launching them overseas, an important part of our strategy for overseas markets is to supply products that are designed to meet the substantially differing needs of each region. Accordingly, we will bolster marketing through cooperation with Amusement Center Operations and establish regional development systems.

ALL. Net P-ras

Under this business model we sell cabinets and other standard parts and then provide motherboards and software at no cost. We track content use through our network, and receive payment based on that use. This model enables operators of amusement centers to introduce machines with a small initial investment, so machine adoption is expected to be higher than under the conventional sales-based model. Moreover, under the new business model, the SEGA SAMMY Group's business will extend beyond the sale of the machines. By maintaining the market value of content, we can generate continued profits, and as a result we expect the new model to lead to steady gains in revenues and profit for the Amusement Machine Sales Business.





Amusement Center Operations



Tokyo Joypolis

MARKET ENVIRONMENT – TREND TOWARD LARGER, MORE-COMPLEX FACILITIES

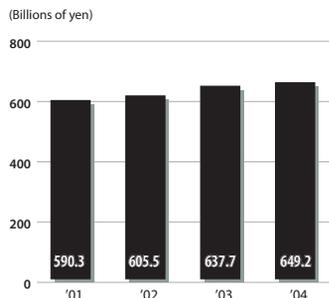
Like the amusement machine sales market, the amusement center market was adversely affected by the spread of home game consoles. Nonetheless, due to the emergence of innovative, large-scale amusement machines that can only be played in amusement centers, the sector has entered a recovery phase. Store formats are becoming larger and more complex, while amusement centers located in shopping centers that have the ability to draw customers are gaining a foothold as community spaces for families. In addition, the spread of machines for children’s card games is driving the emergence of a new market structure.

MARKET POSITION AND STRENGTHS – EXPANSION LED BY CHILDREN’S CARD GAMES

Diverse amusement center development activities, which extend to centers that are larger in scale, located in the suburbs, and multifaceted, are a distinctive characteristic of the Amusement Center Operations. We have established a position of industry leadership with a full lineup of products that meet the needs of a wide span of ages and customer groups. Moreover, by planning and developing new amusement center formats to facilitate the proposal of a new style of entertainment and by entering untapped market sectors, we are leading the way in revitalizing the markets. In the field of children’s card games, two key games – *The King of Beetles* “MUSHIKING” for kindergarten and elementary school boys and *LOVE AND BERRY Dress Up and Dance!*, for kindergarten and elementary school

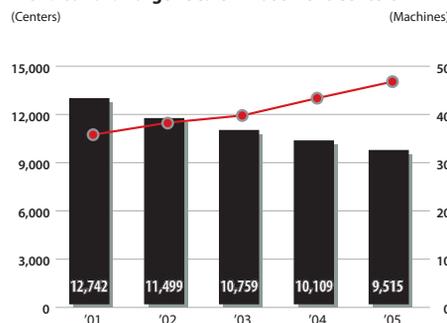
We will open up new markets around the world by drawing on the innovation and development capabilities that were demonstrated by the creation of a new genre of children’s card games and the business development capabilities that were reinforced by the management integration.

Amusement Center Operations Market Scale (Retail Sales)



Source: JAMMA, AOU, and NSA
Sales figure for 2005 is not disclosed by survey organizations.

Trend toward Larger-Scale Amusement Centers



■ Number of game centers (left)
● Installed machines per center (right)
Source: National Police Agency

girls – have far surpassed the competition in both number of installed machines and card sales. These games have become a stable source of profits for the Group.

■ BUSINESS DEVELOPMENT –

SEGA WILL DEVELOP OVERSEAS MARKETS

In Japan, SEGA will work to invigorate amusement centers and raise profitability by employing scrap-and-build initiatives for centers and implementing efficient operations. Moreover, in opening new centers, we will increasingly focus on enter-

tainment complexes with high customer-drawing ability. In children’s card games, we will work to record steady revenues and profits by taking steps to maintain the popularity of existing products, such as *The King of Beetles “MUSHIKING,” LOVE AND BERRY Dress Up and Dance!*, and *Dinosaur King*. These steps will include sponsoring game tournaments around the country, periodically upgrading software, and using the content in entertainment software, toys, and animations. We will also focus on further market development by stepping

up our focus on the introduction of new products and business development in overseas markets.

In overseas markets, centered on Asia and North America, our approach will entail SEGA creating markets on its own, opening model centers and assisting local operators. Through enhanced cooperation with the Amusement Machine Sales Business, we will work to accurately meet needs in each market.

Steady, Ongoing Growth in Children’s Card Games

SEGA lends machines to operators of amusement centers at no cost, and those operators purchase cards for the machines from SEGA. This business model and low space requirements have proved advantageous not only in securing installations in amusement centers but also in the development of new markets, such as shopping centers and convenience stores.

(An interview with the developer of *The King of Beetles “MUSHIKING”* and *LOVE AND BERRY Dress Up and Dance!* appears on pages 10 to 13)



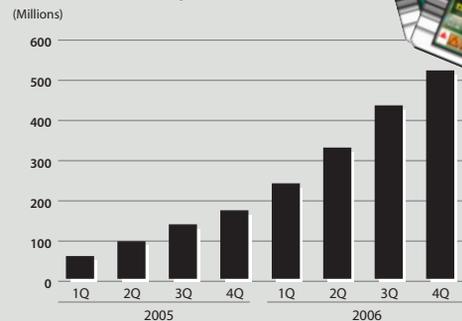
Dinosaur King

The King of Beetles “MUSHIKING”

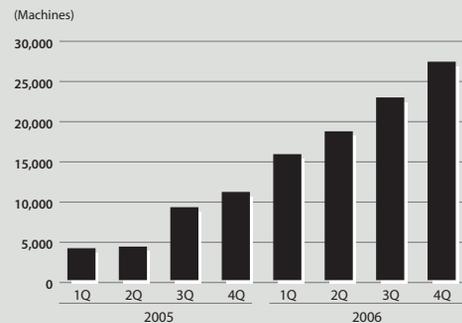
© SEGA



Cumulative Card Shipments*



Total Machine Installed Base*



* Total for *The King of Beetles “MUSHIKING,” LOVE AND BERRY Dress Up and Dance!*, and *Dinosaur King*

How to Play *The King of Beetles “MUSHIKING”*

1. Insert a ¥100 coin.
2. The machine randomly issues a *Beetle Card* or a *Skill Card*.
3. Select *Story mode* or *Competition mode*.
4. Scan any *Beetle Card* and up to three *Skill Cards*.
(If you select *Competition mode*, then make an additional selection: play the computer or play another person).
5. Play paper-scissors-rock; the winner’s beetle attacks the other player’s beetle.
6. The first to drain the strength of the opposing beetle is the winner.



Consumer Business

We will achieve growth in all of our fields of business by bolstering our development process on a global scale, strengthening our listed subsidiaries, and drawing on Group synergies.



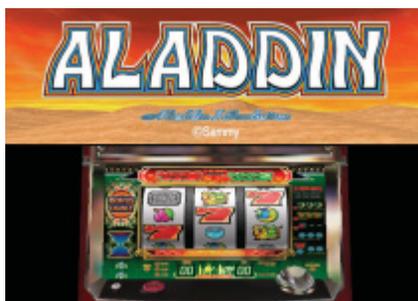
© SEGA

MARKET ENVIRONMENT – NEW GAME CONSOLES PUT COMPANIES TO THE TEST

Against a background of changes in the operating environment – a declining birthrate, an aging population, and the advent of next-generation game consoles – companies in the home videogame software and toy sectors are completing large-scale mergers.

In the domestic market for home videogame software, conditions are challenging. In this setting, new game software for mobile game consoles that target a wide range of players is recording growing

popularity. Overseas, growth is projected to remain strong, centered on Europe and North America.



JISSEN PACHISLOT HISSHOUHOU! ALADDIN II Evolution
© Sammy Published by SEGA

growth, centered on Asia. In content for mobile phones, steady gains in phone capabilities have supported stable growth in the domestic market, while the spread of handsets and the enhancement of their capabilities are expected to lead to overseas growth in the future. Conditions in the traditional toy market are expected to remain difficult as a result of the trends toward a declining birthrate and an aging population, and in this setting companies need to take steps to differentiate themselves from their competitors, such as providing products targeting a wide range of age groups. In the animation field, meanwhile, we anticipate solid progress against a background of strong demand in overseas markets.

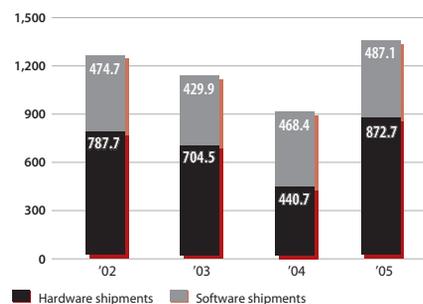
MARKET POSITION AND STRENGTHS – USING THE GROUP'S STRENGTHS AS AN EDGE IN DEVELOPMENT

In home videogame software, the restructuring measures that we implemented after the management integration have resulted in higher unit sales and substantial gains in profitability, both in Japan and overseas.

The adoption of next-generation game consoles is expected to activate and expand game software markets. On the other hand, for game software companies, the increasingly advanced specifications of game consoles are expected to result in higher R&D costs. In the future, we are likely to see growing gaps among game software companies in terms of development capabilities and financial strength.

In online game markets, progress in infrastructure is expected to drive high

Home Videogame Software Market Scale
(Billions of yen)



Source: 2006 CESA Games White Paper, Home Game Shipments

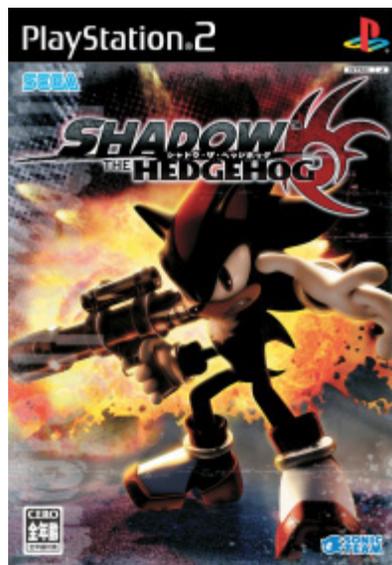
Our market presence has made especially rapid gains overseas due to aggressive acquisitions of development studios with promising intellectual property. In online games, we are currently at the stage of advance investment in development, but we have positioned these operations as a growth field, and we are working to bolster them accordingly. In content for mobile phones, we are establishing a unique market position. For example, *Sammy 777 Town*, a pachislot and pachinko game web site that effectively utilizes the Group's intellectual property, has 1.5 million members. In toys, we have a medium-sized market position by sales, but our new products that appeal to all ages, genders, and nationalities and our products that utilize Group content have been received well by the market. In animations, we made TMS ENTERTAINMENT, LTD., which has provided many highly regarded products, our subsidiary, enabling us to enter the top ranks in the animation field.

As demonstrated by its results in driving growth in home videogame software markets around the world, SEGA is an industry leader in graphics, technology, and content development capabilities. The SEGA brand is well known in overseas markets, and we believe that SEGA is in an excellent position for continued overseas development.



i dog © SEGATOYS 2005

In the future, differences in financial strength will give rise to substantial differentials in development capabilities among companies competing in the Consumer Business segment's operational fields. The Group has multiple businesses that are



SHADOW THE HEDGEHOG © SEGA

stable sources of revenues and profits, such as the Pachislot and Pachinko Machine Business, and we are confident that we have the resources needed to succeed in development competition. Moreover, by sharing development resources throughout the Group, we can diversify the risk of rising development costs. The ability to generate these types of synergies in the area of revenues and profits is another key strength of the Group.

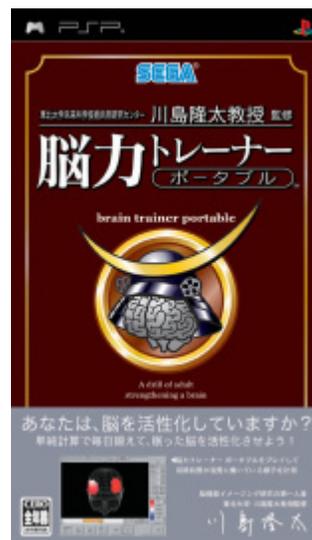
■ BUSINESS DEVELOPMENT –
SYNERGISTIC GROWTH IN ALL OPERATIONS

In home videogame software, we are approaching the transition to next-generation game consoles as an opportunity to expand our market share, and accordingly we will work to further bolster our development capabilities. In particular, in overseas markets, which are more than twice the size of the domestic market, we will enhance our local development systems through aggressive acquisition of studios with competitive titles and brands and advanced development capabilities. In addition, we will follow a multi-platform

strategy, combining “sales regions” and “game genres” to create the optimal product portfolio.

We have positioned online games as a growth field, and we plan to develop these operations into a key source of revenues and profits over the medium to long term. The first step in this process will be the establishment of a strong operational foundation through advance investment in development. We will especially devote resources to the establishment of a solid foothold as rapidly as possible in growth markets in Asia, where we will aggressively enter tie-ups with local companies. In content for mobile phones, we will bolster existing content as well as provide new content and services and enhance overseas business development, thereby establishing a new revenue and profit foundation. In toys, we will work to create new markets through the development of products that transcend traditional concepts, and in animations, we will extend popular products and create new offerings.

In addition to these initiatives, through close cooperation throughout the Group, we will advance the concept of “multiple uses for single content,” and achieve synergistic growth in all of our operations.



Brain Trainer Portable © SEGA, 2005

Brain Trainer™ is a registered trademark of SEGA TOYS. Development, production: SEGA; Planning, development cooperation: SEGA TOYS; Editorial supervision: Professor Ryuta Kawashima, New Industry Creation Hatchery Center, Tohoku University

CORPORATE GOVERNANCE

The SEGA SAMMY Group regards corporate governance as the key foundation for its corporate activities and considers its proper implementation to be essential for sustained growth in corporate value.

■ BASIC STANCE ON CORPORATE GOVERNANCE

The SEGA SAMMY Group regards corporate governance as the key foundation for its corporate activities. The fundamental principles of the Group's corporate governance policy are to enhance efficiency, secure a sound corporate organization, and enhance transparency. This policy is followed in addressing such important management issues as selecting candidates for directorships, deciding compensation for directors, implementing management oversight, and determining compensation for corporate auditors.

ENHANCING EFFICIENCY

The Group will maximize corporate value by establishing expeditious, appropriate decision-making processes and by increasing the efficiency of corporate management. We intend to return the benefits gained from those efforts to our shareholders and other stakeholders.

SECURING A SOUND CORPORATE ORGANIZATION

Amid volatile business conditions, the Group will facilitate the maximization of corporate value by undertaking risk management based on a full awareness of the

range of risks that the Group faces. At the same time, we intend to ensure the soundness of our corporate organization through the reinforcement of compliance systems focused on strict adherence to social norms as well as laws and statutory regulations.

ENHANCING TRANSPARENCY

In light of the growing importance of disclosure among listed companies, the Group will increase management transparency by fulfilling its responsibility to explain corporate actions to shareholders and other stakeholders and by realizing greater disclosure through energetic, comprehensive investor relations (IR) activities.

■ CORPORATE GOVERNANCE ORGANIZATION

The Group has adopted a corporate auditor system in consideration of its desire to enable directors to make quick and optimum management decisions using their bountiful knowledge and experience of industry, market trends, products, merchandise, and services. At the same time, we have strengthened our executive officer and internal control systems, reinforcing our corporate governance organization from the aspects of business execution and organizational oversight. One of our

measures to strengthen corporate governance has been to establish the Advisory Committee, with the goal of improving our efforts to secure the soundness and enhance the transparency of management. Comprised by a group of prominent people from outside the Group, the Advisory Committee contributes to that process by offering management advice and recommendations from a broad perspective. Furthermore, we are pursuing the fulfillment of our corporate social responsibility (CSR) to establish a good relationship with our stakeholders based on the following perspectives.

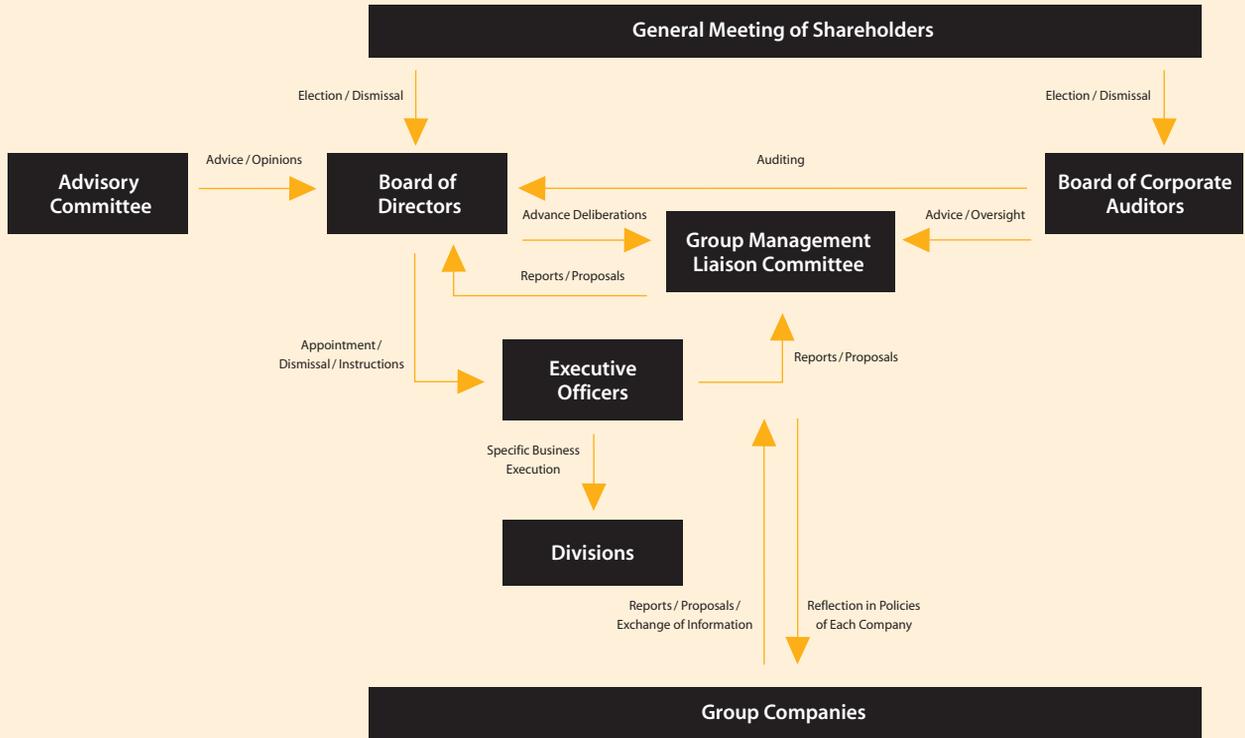
First, as a Group, we approach our CSR activities from the viewpoint of achieving sustained growth in corporate value and contributing to the sustained development of society.

Second, to meet the wide-ranging demands of corporate citizens by society, the Company has established the CSR Management Committee, with the Company's representative director acting as chairman. The committee's members comprise management of the Company, SEGA CORPORATION, and Sammy Corporation. To support the specific actions of that committee, the Company has also set up the CSR Promotion Department.

Third, to accurately deal with a broad range of stakeholders on a Groupwide basis, we are voluntarily and proactively developing CSR activity programs. We have instituted the Group Management Philosophy, the Group CSR Charter, and the Group Code of Conduct to provide the foundation for our CSR activities. We also are revising and creating various types of in-house rules and manuals to govern individual business activities.

Corporate Governance System

CORPORATE GOVERNANCE SYSTEM – CHART 1



CORPORATE GOVERNANCE SYSTEM – CHART 2



■ PROGRESS WITH IMPLEMENTING CORPORATE GOVERNANCE MEASURES

1. BOARD OF DIRECTORS

Comprising six directors as of March 31, 2006, the Board of Directors convenes once a month and additionally as required and manages the Company responsively. Further, the Board of Directors and other bodies of the Company undertake decision making and reporting for certain significant management issues of Group companies.

2. BOARD OF CORPORATE AUDITORS

The Board of Corporate Auditors, consisting of four corporate auditors as of March 31, 2006, meets once a month and additionally as required to deliberate various company issues and thoroughly analyze specific issues.

3. ADVISORY COMMITTEE

A management advisory arm, the Advisory Committee provides management advice and recommendations from the point of view of improving the soundness and transparency of management. Comprising five prominent people from outside the Group, the committee meets monthly.

4. GROUP MANAGEMENT LIAISON COMMITTEE

Meeting once a month, the Group Management Liaison Committee comprises directors and corporate auditors from the Company, SEGA and Sammy. Its purpose is to form a consensus by the Group on various issues based on the sharing of information and thorough debate.

5. GROUP AUDIT COMMITTEE

Chaired by the Company's representative director, the Group Audit Committee comprises directors, corporate auditors, and corporate division heads from the Company, SEGA, and Sammy. The committee convenes approximately once every three months and receives reports on the progress and results of the Audit Office's audits of management divisions.

6. HOLDINGS AUDIT LIAISON COMMITTEE

The Holdings Audit Liaison Committee consists of standing corporate auditors, directors, and corporate division heads from the Company, SEGA, and Sammy as well as representatives of the Company's independent auditor KPMG Azsa & Co. At monthly meetings, committee members exchange opinions from their respective standpoints and seek to enhance accounting compliance.

7. GROUP AUDIT LIAISON COMMITTEE

The Group Audit Liaison Committee comprises standing corporate auditors from Group companies. They convene as required to share information on such timely issues for the Group as revisions in laws and to build close working relationships among the standing corporate auditors.

8. AUDITORS AND AUDIT OFFICE LIAISON COMMITTEE

The Auditors and Audit Office Liaison Committee consists of standing corporate auditors from the Company, SEGA and Sammy as well as members of the Company's Audit Office. The committee meets every month with the purpose of ensuring the soundness of management by sharing information.

9. CSR MANAGEMENT COMMITTEE

The CSR Management Committee decides CSR promotional policies for the Group, establishes and provides instruction for specific CSR promotional measures, and checks on the status of and provides guidance for the CSR promotional measures of each of the Group companies. Comprising the presidents, the corporate division and secretariat heads, and corporate auditors of the Company, SEGA, and Sammy, the committee meets once every three months and is chaired by the representative director of the Company. In addition, the CSR committees of the Company, SEGA, and Sammy meet individually each month to pursue the specific measures decided by the CSR Management Committee and to oversee progress within each company.

■ POSITIONING AND ROLE OF INDIVIDUAL COMMITTEES

The Advisory Committee acts as an advisory arm to the Board of Directors, providing management advice and recommendations, while the Group Management Liaison Committee acts as a detailed investigative arm in screening business proposals before they are submitted to the Board of Directors. The Group Management Liaison Committee also contributes to collaboration by the Company, SEGA, and Sammy in business operations.

The Holdings Audit Liaison, Group Audit Liaison, and Auditors and Audit Office Liaison committees also contribute to collaboration among the Group companies. The three committees, each of which has a different membership composition, are information sharing and opinion exchange bodies regarding management oversight.

Conversely, the Group Audit Committee is an important advisory committee that acts as a liaison between the management oversight and business execution bodies. The primary function of the Group Audit Committee is to report on audits and give recommendations on compliance to these two types of bodies.

The task of the CSR Management Committee is to firmly implant the spirit of the Group CSR Charter in the corporate culture of the entire Group by deciding various Groupwide CSR measures and managing their implementation.

The Company established the Audit Office as its internal audit department to ensure that business is carried out in accordance with laws and its Article of Incorporation, thereby achieving proper conduct of business. Comprising 10 employees, the Audit Office implements internal audits of all Group companies. In addition, the Company receives the advice of KPMG Azsa & Co., which has served as its independent auditor since the Company's establishment on October 1, 2004, not only on fiscal year-end audits but also on accounting treatment and other issues during the fiscal year.

■ BASIC STANCE ON INTERNAL CONTROL SYSTEM

The Group regards the establishment of an internal control system as an essential aspect of pursuing its fundamental principles of raising efficiency, securing a sound corporate organization, and enhancing transparency. We believe that an internal control system is an organized and systematic method of dealing with risk. Such a system is realized through business effectiveness and efficiency and through the establishment of a management organization that can secure the reliability of financial reporting and a corporate culture with a high awareness of compliance that can ensure the propriety of our business. The Company has taken steps to reaffirm that its management organization accords with the Corporation Law and the revisions of the Securities and Exchange Law and to establish an appropriate corporate culture. In addition to instituting the Group CSR Charter to provide guiding principles for business decisions and the Group Code of Conduct to provide guiding principles for business execution, we also require all directors and management-level employees to submit letters of confirmation and pledges regarding compliance and to execute their job responsibilities fairly and appropriately. For directors, in particular, we have established regulations regarding their service and ethics as directors. These rules aim to make them aware of their responsibility for the management of the Company that has been entrusted to them by resolution at the General Shareholders' Meeting, and focus on the points they need to adhere to in the pursuit of their responsibilities as directors. Furthermore, to empower the Group with a self-cleansing function and to prevent or minimize the occurrence of incidents due to legal violations or inappropriate conduct, we have established hotlines inside and outside the Company for reporting such matters. Moreover, to achieve independent monitoring, we established the Audit Office to act as our internal control department in carrying out internal audits of the companies of the Group.

PROGRESS WITH ESTABLISHING INTERNAL CONTROL SYSTEM

Sammy Corporation, one of the Group's core operating companies, began to construct an internal control system based on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework in the second quarter of 2005. Following this step, the Company launched efforts to put in place a Group internal control system. Using the work done by Sammy as a reference, the Company is proceeding with the establishment of a Group internal control system capable of achieving the reliability in financial reporting that will be required by the revised Securities and Exchange Law (Japan's version of the Sarbanes-Oxley Law) when it is enforced.

PROGRESS WITH ESTABLISHING A RISK MANAGEMENT SYSTEM

We believe that the core framework for risk management is formed by a corporate culture in which an awareness of compliance is firmly rooted. Therefore, we are reinforcing internal monitoring activities, such as compliance education and self-inspection systems, at Group companies in accordance with their circumstances. Each of the companies of the Group implements various risk management measures to address business risk. In addition, the Company is collecting and sharing information as required to achieve risk management on a Groupwide basis.

PROGRESS WITH ESTABLISHING AN INFORMATION CONTROL SYSTEM

The Company has determined Rules for Handling and Managing Confidential Corporate Information. Based on these rules, the Company assigns different levels of security to information and handles and manages the information accordingly. The Company encourages all employees to appropriately manage and use internal computer system terminals and networks, requiring them to sign pledges to that effect when joining the Company.

■ STANCE ON HOSTILE TAKEOVERS

The Company believes that endeavoring to raise business and corporate efficiency, secure a sound corporate organization, enhance transparency, and meet the expectations of stakeholders will lead to the maximization of corporate value and greater market capitalization.

■ PROGRESS WITH BUSINESS INFORMATION DISCLOSURE (IR ACTIVITIES)

The Group recognizes that fairness and timeliness are the most important factors in disclosing business information to shareholders and investors. One of the ways in which we practice fairness in providing information is to broadcast our information meetings on financial performance for securities analysts and institutional investors in conjunction with announcements of interim or fiscal year-end financial results over the Internet. In addition, we proactively seek direct communications with investors by participating in seminars and conferences at home and abroad.

For our individual shareholders and investors, we participate in various types of individual investor information meetings. Among the measures taken to encourage a deeper understanding of our corporate activities by individual investors is an IR web site specifically designed for individual investors that offers a wide range of useful information.

The SEGA SAMMY Group intends to draw on the opinions of shareholders and investors gathered through its IR activities to further heighten the transparency of its corporate governance system.

CSR * CSR * CSR

Corporate Social Responsibility

The SEGA SAMMY Group considers the fulfillment of its corporate social responsibility (CSR) to be a top priority management issue. Accordingly, in April 2005, the Company formed the CSR Promotion Department. In June 2005, the Company established the CSR Promotion Committee, for which the CSR Department acts as a secretariat. Under the SEGA SAMMY Group CSR Charter, established to provide guiding principles for business operations, the Group pursues CSR activities on an inter-company basis. Through these activities, the Group aims to achieve sustained growth in corporate value and to contribute to the sustained development of society.

■ SEGA SAMMY GROUP CSR CHARTER

WITH CUSTOMERS

We will bear in mind the current needs and interests of our customers in our effort to provide entertainment filled with dreams and excitement.

WITH PARTNERS

We will maintain fair and impartial relationships with our suppliers and work together as partners in providing entertainment filled with dreams and excitement.

WITH SHAREHOLDERS AND INVESTORS

We will view our business with a global perspective in our efforts to ensure sustained growth and to maximize corporate value.

Further, we will enhance management transparency and meet the expectations of our shareholders and society through fair and timely disclosure and appropriate returns in profits.

WITH EMPLOYEES

Our employees bring to us creativity and a spirit of challenge. They are our most cherished assets and the fuel to our growth.

We will cultivate a corporate culture that allows them to fully exploit their talents and enables us to grow together with our employees.

WITH SOCIETY

As corporate citizens, we will contribute to society not only by prospering in business but also by proactively supporting both the development of cultural activities, including the arts and sport, and the preservation of the global environment.

■ INSTILLING AWARENESS THROUGHOUT THE GROUP

The SEGA SAMMY Group believes that it is important for each employee of the Group to recognize the importance of CSR activities as their own personal issue and to act voluntarily and proactively. To that end, the Group considers, plans, and implements actions to spread CSR awareness in line with the level of understanding of employees. A specific example of such an action is the CSR message that the representative director of the Company relays to employees. By consistently conveying the significance of corporate social responsibility to employees, its importance becomes firmly embedded in their consciousness. At Group companies, the presidents deliver the same message to their employees, resulting in a collective effort by Group management to achieve a common awareness among employees. Among other efforts, we have created a handbook on basic CSR knowledge that contains concrete examples and is distributed to all employees. We also have placed posters in all our domestic offices emphasizing the importance of our relationship with stakeholders. We further utilize various media and communications tools to provide constant reminders of the importance of corporate social responsibility. For example, we have collected CSR-related information on our intranet, making it accessible by employees, and we continually feature CSR items in our in-house communications.



CSR poster (left) and SEGA SAMMY Group CSR Handbook distributed to employees (right)

SOCIAL CONTRIBUTION ACTIVITIES

The SEGA SAMMY Group is strongly aware of its position as a member of the global society and seeks to be a responsible corporate citizen. By basing our corporate social responsibility efforts on the motto "by providing entertainment filled with dreams and excitement to people throughout the world, we will strive to enrich our society and culture," we endeavor to meet

society's level of expectations in terms of ethics and contribution to the public good.

Through ongoing social contribution activities by the entire SEGA SAMMY Group, such as the support of sporting and arts activities, we aim to build a relationship of trust with society and to contribute to realizing a more prosperous society and to "creating culture."

SPONSORSHIP AND SUPPORT OF SPORTING ACTIVITIES

The unpredictability of the outcome of sports events has given rise to much drama, which in turn has provided dreams and excitement for spectators and players alike.

At times, sport can represent an ultimate goal; at times it is simply a part of our daily life – for reasons of health or amusement. In any case, sport has an irreplaceable role in our lives, contributing to the formation of our characters depending on how we incorporate it into our interests in life.

As an entertainment Group, the SEGA SAMMY Group sees sport as an important method of communicating its management philosophy of "providing entertainment filled with dreams and excitement to people throughout the world." We sponsor various sporting activities not only through our business activities but also through the activities of our sports clubs, such as our baseball and track teams.

The Group is committed to further contributing to the development of sports culture.



The SEGA SAMMY Cup Golf Tournament – the ultimate golf entertainment presented by the SEGA SAMMY Group



The Boys' Baseball Course, part of our sports promotion program



The SEGA SAMMY track team participated in the Nagoya International Women's Marathon



The Group is a special sponsor of Nagashima JAPAN Dream Project 2006, a communication event that enables children from across Japan to spend time with the members of the Nagashima JAPAN baseball team

SPONSORSHIP AND SUPPORT OF THE ARTS

Art that has been passed down through history, works of art that reflect their periods, and theatrical arts that hold their audiences captive with detailed plots – the arts are truly "entertainment" and indispensable to the realization of a prosperous society and the "creation of culture."

Toward the realization of its management philosophy, the SEGA SAMMY Group carries out a variety of activities to support the development of the arts. The Group also conducts activities to introduce traditional Japanese culture, outstanding art from abroad, and new cultures to the public.



Tokyo JAZZ 2005, the fourth year of Japan's biggest jazz event



Highland Fling, directed and choreographed by Matthew Bourne, renowned as a wizard of the ballet world

NATURAL DISASTER RELIEF ACTIVITIES

From the perspective of a global society, the SEGA SAMMY Group undertakes a variety of relief and support activities not only in Japan but around the world. These activities include support for disabled people and social contribution activities through sporting events and other activities in addition to aid and donations in times of disaster. For example, the Group made donations to assist the victims of the major hurricane Katrina that devastated parts of the southern United States in August 2005.

DIRECTORS, CORPORATE AUDITORS, AND EXECUTIVE OFFICERS

(As of July 1, 2006)

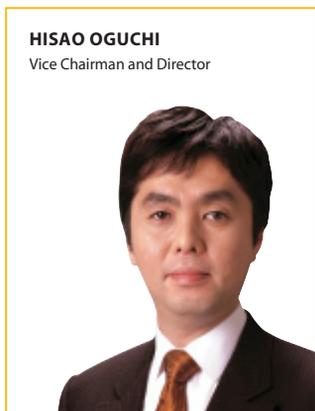
HAJIME SATOMI

Chairman, President and
Representative Director



HISAO OGUCHI

Vice Chairman and Director



KEISHI NAKAYAMA

Executive Vice President and Director



STANDING CORPORATE AUDITOR

Kazutada Ieda

CORPORATE AUDITORS

Akio Kioi

Ryoichi Arai

Toshio Hirakawa

EXECUTIVE OFFICERS

Akira Sugano

Koichi Fukazawa

Michael Masakimi Hotta

Tetsushi Ikeda

Yuichi Amari

TADASHI ISHIDA

Senior Managing Director



TORU KATAMOTO

Director



HIDEKI OKAMURA

Director



YASUO TAZOE

Director





FINANCIAL SECTION

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MARKET DATA

NUMBER OF PACHINKO HALLS

	2001	2002	2003	2004	2005
Number of pachinko halls with pachinko machines installed	15,691	15,255	14,695	13,844	12,913
Number of pachinko halls with pachislot machines installed	1,110	1,249	1,381	1,773	2,252
Total	16,801	16,504	16,076	15,617	15,165

Source: National Police Agency.

Number of pachinko halls with pachinko machines installed includes facilities that combine installations of pachinko machines, pachislot machines, arrange-ball machines, and other machines.

NUMBERS OF PACHISLOT MACHINES AND PACHINKO MACHINES INSTALLED / MARKET SIZE

		2001	2002	2003	2004	2005
Pachislot machines	Machine sales (units)	1,290,719	1,501,894	1,842,392	1,675,049	1,804,292
	Machines installed (units)	1,459,233	1,606,123	1,660,839	1,887,239	1,936,476
	Market size (millions of yen)	351,344	396,566	526,354	524,882	543,049
Pachinko machines	Machine sales (units)	3,230,489	3,174,079	3,686,677	4,012,901	4,047,427
	Machines installed (units)	3,326,583	3,252,241	3,227,239	3,077,537	2,960,939
	Market size (millions of yen)	569,129	561,506	672,055	786,413	867,209

Sources: National Police Agency (machines installed) and Yano Research Institute Ltd. (machine sales and market size)

SHARE OF ANNUAL PACHISLOT MACHINE SALES

Rank	2001		2002		2003		2004		2005	
	Manufacturer	Share								
1	Sammy	32.8%	Sammy	31.1%	Sammy	32.1%	Sammy	40.4%	Sammy	33.6%
2	Yamasa	17.8%	Yamasa	20.0%	Olympia	18.5%	Olympia	16.4%	Daito Giken	13.1%
3	Aruze	16.2%	Aruze	19.7%	Aruze	13.6%	Yamasa	9.0%	Olympia	10.4%
4	Olympia	8.5%	Olympia	11.7%	Yamasa	11.9%	Daito Giken	7.9%	Yamasa	8.3%
5	Pioneer	5.0%	Pioneer	3.7%	Daito Giken	4.9%	Aruze	4.6%	SANKYO	6.2%

Source: Yano Research Institute Ltd.

SHARE OF ANNUAL PACHINKO MACHINE SALES

Rank	2001		2002		2003		2004		2005	
	Manufacturer	Share								
1	Sanyo Bussan	18.9%	Sanyo Bussan	16.4%	Sanyo Bussan	25.2%	Sanyo Bussan	22.9%	Sanyo Bussan	24.7%
2	SANKYO	17.2%	SANKYO	14.8%	SANKYO	16.4%	SANKYO	21.2%	SANKYO	18.3%
3	Heiwa	10.8%	Heiwa	10.0%	Daiichi Shokai	9.5%	Heiwa	8.7%	Kyoraku Sangyo	9.6%
4	Daiichi Shokai	10.3%	Kyoraku Sangyo	8.1%	Heiwa	7.1%	Daiichi Shokai	7.7%	Newgin	7.9%
5	Kyoraku Sangyo	7.6%	Daiichi Shokai	7.9%	Sammy	6.7%	Newgin	6.9%	Sammy	7.1%
	Sammy	2.8%	Sammy	2.6%			Sammy	5.8%		

Source: Yano Research Institute Ltd.

AMUSEMENT MACHINES AND AMUSEMENT CENTER OPERATIONS MARKET SIZE

Billions of yen

	2001	2002	2003	2004
Net sales of amusement machines	140.8	154.5	177.9	180.6
Net sales from amusement center operations	590.3	605.5	637.7	649.2

Sources: JAMMA, AOU, and NSA. Sales figures for 2005 are not disclosed by survey organizations.

HOME VIDEOGAME SOFTWARE MARKET SIZE

Billions of yen

	2002	2003	2004	2005
Hardware shipments	787.7	704.5	440.7	872.7
Software shipments	474.7	429.9	468.4	487.1

Source: 2006 CESA Games White Paper, Home Game Shipments

MOBILE PHONE CONTENT MARKET SIZE

Billions of yen

	2000 (estimated)	2001 (estimated)	2002 (estimated)	2003 (estimated)	2004 (estimated)	2005 (estimated)
Mobile phone content	44.8	119.6	175.8	205.7	233.0	266.5
Visual content	6.5	17.1	26.6	27.4	31.4	58.9
Music content	13.4	73.6	95.8	112.9	136.8	161.0
Game content	2.6	9.0	20.1	27.0	41.2	58.9
Textual content	22.3	41.5	52.1	54.2	56.3	61.9

Source: Based on Digital Content White Paper 2006

DOMESTIC TOY MARKET SIZE (INCLUDING HOME GAME CONSOLES AND GAME SOFTWARE)

Billions of yen

	1999	2000	2001	2002	2003	2004
Domestic shipments	1,057.6	973.9	1,044.3	1,012.0	958.0	952.0
Domestic retail sales	1,477.4	1,319.0	1,372.3	1,299.1	1,224.3	1,214.9

Source: Yano Research Institute Ltd.

DOMESTIC VISUAL CONTENT MARKET SIZE

Billions of yen

	2000 (estimated)	2001 (estimated)	2002 (estimated)	2003 (estimated)	2004 (estimated)	2005 (estimated)
Packaged visual content	214.1	286.3	356.6	448.3	543.5	708.8
Network visual content	0.0	1.0	3.9	14.7	17.3	29.2

Source: Based on Digital Content White Paper 2006

MANAGEMENT'S DISCUSSION & ANALYSIS

Results of Operations in the Fiscal Year Ended March 31, 2006

OVERVIEW

In the fiscal year under review, the Group recorded a favorable performance in each business segment, achieving the highest level of sales and profits since the management integration. The initiatives that we have implemented to bolster our profit structure had marked results, with the Consumer Business becoming profitable in just a year and a half since the management integration. By reorganizing our operations and acquiring promising companies, we reinforced our growth foundation. In the year under review, these initiatives included the following:

Concentrating operations to increase efficiency

- On April 1, 2005, SEGA absorbed the Group's overlapping operations, such as Sammy's amusement machine sales and home videogame software businesses, through a corporate separation. This step was taken to allow Sammy to focus its resources on the Pachislot and Pachinko Machine Business and peripheral equipment.
- On April 1, 2005, to integrate the functions of Amusement Center Operations that were dispersed throughout the Group and to more closely coordinate the Amusement Machine Sales Business and Amusement Center Operations, SEGA AMUSEMENT CO., LTD., and Sammy Amusement Service Co., Ltd., were merged into SEGA.

- On September 1, 2005, to rationalize and raise the efficiency of commercial amusement machine development, manufacturing, and sales in North America, SEGA AMUSEMENTS U.S.A., Inc., and Sammy U.S.A. Corporation were merged.

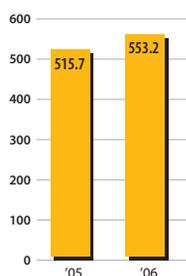
Strengthening operational foundation in growth fields and new fields

- On August 2, 2005, to meet diverse customer needs by providing total pachinko hall services and expand sales opportunities, Sammy acquired shares of H-I System Corporation, which specializes in hall computers and prize POS systems, and made it a consolidated subsidiary.
- To strengthen its imaging business, the Company accumulated shares of equity-method affiliate TMS ENTERTAINMENT, LTD., and it was made a consolidated subsidiary on October 7, 2005.
- On October 26, 2005, Sammy made GINZA Co., Ltd., a consolidated subsidiary to reinforce the development of multiple brands in the Pachislot and Pachinko Machine Business.

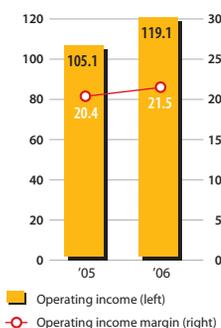
NET SALES

In the fiscal year ended March 31, 2006, net sales rose 7.3%, to ¥553.2 billion. Strong contributions were made by the Amusement Machine Sales Business, which recorded favorable shipments of large-scale, high-value-added products;

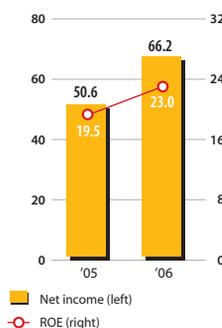
Net Sales
(Billions of yen)



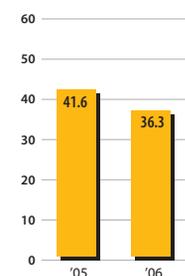
**Operating Income/
Operating Margin**
(Billions of yen) (%)



Net Income/ROE
(Billions of yen) (%)



R&D Expenses
(Billions of yen)



Amusement Center Operations, which registered higher sales at existing centers and favorable performances in children's card games; and the Consumer Business, which benefited from the results of development system reorganization measures and aggressive acquisitions overseas.

■ OPERATING INCOME

In addition to favorable performances in each business segment, the Pachislot and Pachinko Machine Business reduced the cost of sales through active reuse of parts. Additionally, sales commissions, which are included in SG&A expenses, declined due to an increase in the percentage of direct sales. These improvements offset higher advertising and promotion expenses, and operating income rose 13.4%, to ¥119.1 billion. The operating margin improved 1.1 percentage points, to 21.5%.

The top three contributions to the increase in operating income were made by the Consumer Business, the Amusement Machine Sales Business, and Amusement Center Operations. The largest single contribution was from the Consumer Business, which became profitable in the year under review, recording an improvement of ¥10.8 billion from the previous fiscal year's operating loss of ¥8.8 billion. Next, in the Amusement Machine Sales Business, which registered growth in sales of high-value-added products, operating income increased ¥4.8 billion. Third, in Amusement Center Operations, which increased the efficiency of centers and registered favorable performances in

children's card games, operating income increased ¥3.8 billion.

■ OTHER INCOME (EXPENSES)

Net other expenses were ¥7.2 billion, compared with net other expenses of ¥15.6 billion in the previous fiscal year. Major items were impairment losses of ¥7.2 billion, principally for certain amusement centers, while loss on business reorganization, stemming from reorganization measures implemented after the management integration, declined to ¥0.3 billion, from ¥2.9 billion in the previous fiscal year, and loss on redemption of bonds, which was ¥10.6 billion in the previous year, was not recorded in the year under review.

■ NET INCOME

Income before income taxes and minority interests increased 25.1%, to ¥111.9 billion, and net income was up 30.9%, to ¥66.2 billion. The net margin improved 2.2 percentage points, to 12.0%, and ROE increased to 23.0%, from 19.5% in the previous year.

■ OVERVIEW BY SEGMENT

Pachislot and Pachinko Machine Business

In the pachislot machine business, Sammy recorded strong sales of major old-format machines, including *ALADDIN II Evolution*, a Sammy brand pachislot machine based on the ALADDIN character that has become synonymous with Sammy, and *Ore No Sora*, a RODEO brand pachislot machine. Sammy also actively developed and supplied new-format pachislot

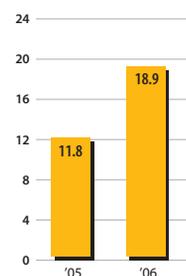
machines. As a result, pachislot machine sales totaled 607 thousand units. Sales declined by 70 thousand units from the previous fiscal year, when the Sammy brand *Hokuto No Ken* pachislot machine became the biggest hit in the history of the industry. Nonetheless, with our continued strengths in development, we maintained our top market share.

In the pachinko machine business, we provided a stable supply of hit products, such as *CR-Hokuto No Ken*, which has become Sammy's all-time top-selling pachinko machine. We are beginning to see results from the initiatives that we have implemented to bolster our development capabilities, and our sales increased by 56 thousand units from the previous fiscal year, to 289 thousand.

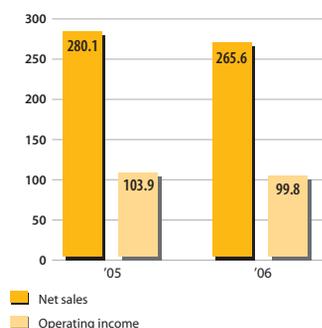
In the year under review, we entered a capital and business tie-up with GINZA Co., Ltd., which develops, manufactures, and sells pachislot and pachinko machines. The purpose of this tie-up was to further strengthen our pachislot machine business and to bolster our multi-brand strategy in the pachinko machine business. In addition, we strengthened our total pachinko hall services when we made H-I System Corporation, a company that specializes in hall computers and prize POS systems, a subsidiary.

Net sales in the Pachislot and Pachinko Machine Business declined 5.2%, to ¥265.6 billion, and operating income was down 3.9%, to ¥99.8 billion. The operating margin improved from 37.1% in the previous fiscal year to 37.6% in the fiscal

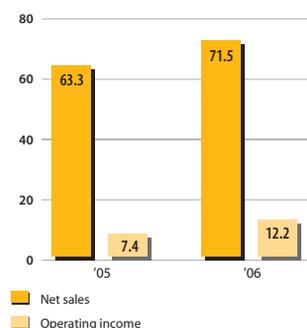
Advertising and Promotion Expenses
(Billions of yen)



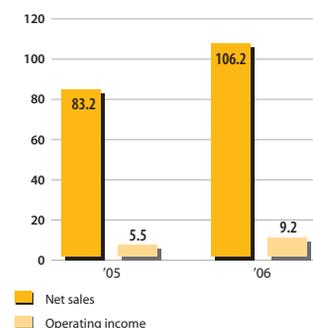
Pachislot and Pachinko Machine Business – Net Sales and Operating Income
(Billions of yen)



Amusement Machine Sales Business – Net Sales and Operating Income
(Billions of yen)



Amusement Center Operations – Net Sales and Operating Income
(Billions of yen)



Best-Selling Pachislot and Pachinko Machine Models

Pachislot Machines 2005			2006		
Brand	Model Name	Unit Sales	Brand	Model Name	Unit Sales
Sammy	<i>Hokuto No Ken</i>	356,820	Sammy	<i>ALADDIN II Evolution</i>	148,979
RODEO	<i>Onimusha 3</i>	69,341	RODEO	<i>Ore No Sora</i>	100,497
Sammy	<i>Popeye</i>	60,191	Sammy	<i>Ultraman Club ST</i>	77,378
RODEO	<i>Umematsu Paradise</i>	36,590	Sammy	<i>Pachislot Umimonogatari</i>	63,924
RODEO	<i>Gamera High Grade Vision</i>	31,121	RODEO	<i>Onimusha 3</i>	51,097
Unit Supply		94,700	Unit Supply		135,118

Pachinko Machines 2005		2006	
Model Name	Unit Sales	Model Name	Unit Sales
<i>CR-Hakushon Daimao 2</i>	60,089	<i>CR-Hokuto No Ken</i>	178,579
<i>CR-Popeye</i>	41,579	<i>CR-ChoroQ</i>	30,066
<i>CR-Ore No Sora</i>	30,245	<i>CR-Sakigake Otokojuku</i>	29,309
<i>CR-Rinda No Dounimotomaranai</i>	25,887	<i>CR-ChoroQ Turbo</i>	27,929
<i>CR-Mermaid Zabun</i>	20,204	<i>CR-Azumi</i>	9,745

year under review, following a decline in sales commissions paid to sales agents due to an increase in the percentage of direct sales and lower cost of sales due to the reuse of parts.

Amusement Machine Sales Business

Demand for prize games and other existing products experienced a cyclical downturn, but we recorded strong sales of high-value-added products – SEGA’s strength – such as *Sangokushi Taisen*, a network-enabled card action game machine, and *StarHorse2 NEW GENERATION*, a large-scale medal game machine. In addition, sales of certain OEM products were solid.

As a result, the segment recorded substantial increases in sales and profits, with net sales rising 13.0%, to ¥71.5 billion, and operating income up 64.0%, to ¥12.2 billion. The segment’s profitability rose

substantially, with the operating margin increasing to 17.0%, from 11.7% in the previous fiscal year. Major reasons for this strong performance included a reduction in lost sales opportunities due to stronger production and distribution systems and enhanced cooperation with Amusement Center Operations.

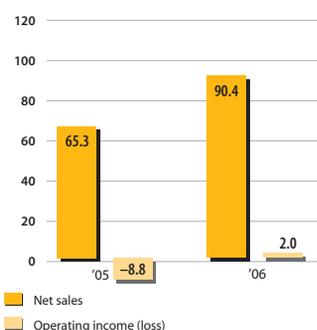
Amusement Center Operations

Due to the revitalization of centers through scrap-and-build initiatives and the adoption of highly popular amusement machines, sales at existing amusement centers rose 3.3%. Moreover, *The King of Beetles “MUSHIKING”* and *LOVE AND BERRY Dress Up and Dance!* recorded solid growth in both installed machines and number of cards sold. As a result, the segment’s net sales were up 27.7%, to ¥106.2 billion.

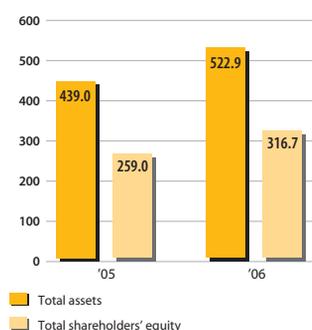
In addition to the gain in sales, the initiatives that we took to increase the efficiency of amusement center operations by concentrating the Group’s amusement center related businesses in SEGA also contributed to an increase in operating income, which was up 68.9%, to ¥9.2 billion. The operating margin also recorded solid improvement, increasing from 6.6% in the previous year to 8.7% in the year under review.

In the year under review we opened 14 new amusement centers and closed 52 existing amusement centers. The total number of centers at the end of the period stood at 462, a decrease of 15 from the previous fiscal-year end. The total number of centers as of the end of the March 2006 fiscal year includes facilities operated by TMS entertainment, which was made a subsidiary during the period.

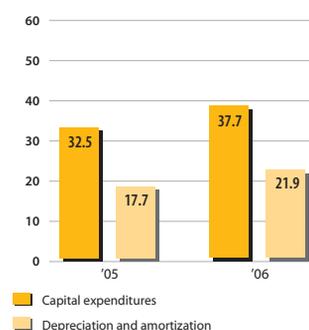
Consumer Business – Net Sales and Operating Income (Loss)
(Billions of yen)



Total Assets/ Total Shareholders' Equity
(Billions of yen)



Capital Expenditures/ Depreciation and Amortization
(Billions of yen)



Consumer Business

In packaged game software, the main business in this segment, we have taken a number of steps since the management integration. In Japan, we have implemented reorganization measures targeting rigorous control of development schedules and quality and clarifying profit-and-loss responsibility. Overseas, we have aggressively acquired promising development companies to bolster our local development capabilities.

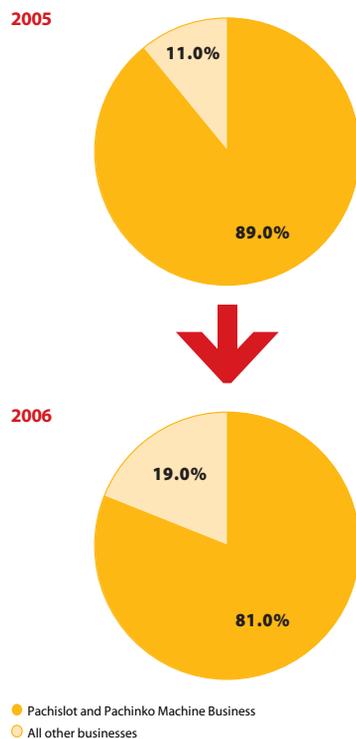
In the year under review, these initiatives produced clear results in the form of higher revenues and reduced costs. The segment's net sales were up 38.3%, to ¥90.4 billion, and the segment turned profitable, recording operating income of ¥2.0 billion, compared with an operating loss of ¥8.8 billion in the previous fiscal year. Unit sales of packaged game software reached 16.4 million units, an increase of 4.6 million units from the previous fiscal year. Unit sales recorded especially strong growth in Europe and North America. This growth was attributable to solid sales of our mainstay *Sonic* series products and to the rapid emergence of the benefits of our aggressive acquisitions. For example, sales of titles developed by The Creative Assembly Limited, which we acquired, exceeded 1 million units.

Favorable performances were recorded in the fields of toys, content for mobile phones, and animations. In particular, toy operations generated higher sales and profits, as our lineup of products targeting a wide range of age groups was well received in a challenging market environment.

Others

This segment comprises the planning, design, construction, and management of commercial facilities and commercial karaoke sales. In the year under review, net sales were down 17.8%, to ¥19.5 billion, and an operating loss of ¥1.7 billion was recorded, compared with a loss of ¥0.5 billion in the previous fiscal year.

Improved Profit Structure* – Operating Income



* Contribution to total operating income by each segment recording operating income.

Financial Position and Liquidity

FINANCIAL POSITION

Total assets at the end of the fiscal year were ¥522.9 billion, up ¥83.9 billion from the end of the previous fiscal year. This increase was primarily attributable to higher notes and accounts receivable accompanying favorable sales through the end of the fiscal year and to an increase in the number of consolidated subsidiaries, including TMS ENTERTAINMENT.

Total current liabilities were ¥137.4 billion, an increase of ¥27.1 billion. This increase was primarily attributable to higher notes and accounts payable and income taxes payable. As a result, although the current ratio was 2.4 times, compared with 2.6 times at the end of the previous fiscal year, it nonetheless remained at a high level. Total long-term liabilities were down ¥11.7 billion, to ¥49.6 billion, due primarily to a decline in long-term debt.

Shareholders' equity was ¥316.7 billion, an increase of ¥57.7 billion. Dividends paid were ¥13.8 billion, while net income was ¥66.2 billion. As a result, retained earnings at year-end were up ¥60.0 billion.

The shareholders' equity ratio was up 1.6 percentage points, to 60.6%. Shareholders' equity per share was ¥1,254.14, compared with ¥2,067.91 a year earlier.*

* On November 18, 2005, the Company implemented a 2-for-1 stock split.

Sales of Major Game Software

2005			2006		
Platform	Title	Unit Sales (Thousands)	Platform	Title	Unit Sales (Thousands)
PS2/Xbox/GC	<i>Sonic Heroes</i>	1,570	PS2/Xbox/GC	<i>SHADOW THE HEDGEHOG</i>	1,590
PS2	<i>JISSEN PACHISLOT HISSHOUHOU! Hokuto No Ken</i>	1,160	PS2/Xbox/GC	<i>Sonic Riders</i>	930
GC	<i>Sonic Mega Collection</i>	860	GBA/NDS	<i>The King of Beetles "MUSHIKING,"</i> <i>The Road to the Greatest Champion</i>	890
PS2/Xbox	<i>Sonic Mega Collection Plus</i>	1,000	PS2/Xbox/GC	<i>Spartan: Total Warrior</i>	640
PC	<i>Football Manager</i>	570	PC	<i>Football Manager 2006</i>	630

■ CAPITAL EXPENDITURES

In the year under review, capital expenditures totaled ¥37.7 billion, compared with ¥32.5 billion in the previous fiscal year. Major investment items included ¥6.7 billion for the acquisition of a site for a new factory for use by Sammy in Kawagoe City, Saitama Prefecture, and ¥24.6 billion in investment in amusement centers operated by SEGA.

■ CASH FLOWS

Net cash provided by operating activities was ¥83.2 billion. Income before income taxes and minority interests was ¥111.9 billion, and payment of income taxes was ¥45.8 billion.

Net cash used in investing activities was ¥54.7 billion. Payment for purchase of property, plant and equipment was ¥26.3 billion, and payment for investment in partnerships was ¥24.7 billion.

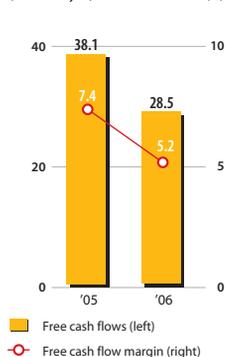
Net cash used in financing activities was ¥21.2 billion. Cash dividends paid totaled ¥13.8 billion, and repayment of long-term debt was ¥9.8 billion.

As a result, cash and cash equivalents at end of year totaled ¥160.1 billion, an increase of ¥8.8 billion from the previous fiscal year-end.

■ INTRODUCTION OF CASH MANAGEMENT SYSTEM

In November 2005, SEGA SAMMY HOLDINGS, Sammy, and SEGA introduced a cash management system to integrate and increase the efficiency of the

Free Cash Flows* / Free Cash Flow Margin
(Billions of yen) (%)



* Free cash flows = cash flows from operating activities + cash flows from investing activities

Group's fund-raising and asset management. The Group also concluded a ¥50.0 billion commitment line contract to bolster the functionality of the cash management system and enhance liquidity over the medium to long term. Taking into account the Group's future overseas business development, the commitment line contract is provided by a total of nine banks, including not only the six domestic banks with which we currently have transaction relationships but also three overseas banks.

■ RESULTS OF OPERATIONS OF LISTED SUBSIDIARIES

SEGA TOYS, LTD.

In the run up to Christmas and the New Year, which is the peak period for the toy market, the home planetarium system *Home Star* became a hit product that sold well in large numbers of stores and over the Internet and ended up selling out in many locations. In addition, the company generated SEGA SAMMY Group synergies and recorded favorable performances with products drawing on *The King of Beetles "MUSHIKING,"* such as *RC Battle and Battle Venture*.

As a result, in the fiscal year under review SEGA TOYS recorded net sales of ¥14.4 billion, an increase of 40.2%; operating income of ¥1.1 billion, up 77.0%; and net income of ¥0.6 billion, an increase of 45.5%.

TMS ENTERTAINMENT, LTD.

In animations, TMS ENTERTAINMENT worked to enhance its animation content, targeting future revenues and profits, and took steps to establish a foundation for revenues and profits through comprehensive operational development with licensing-related and content-related areas. Moreover, in amusement centers, the special strengths of the TMS ENTERTAINMENT group were fully utilized.

As a result, TMS ENTERTAINMENT recorded a record high level of net sales, which were up 18.2%, to ¥16.2 billion. Due to higher costs in animations and amusement, operating income was down

15.8%, to ¥1.7 billion, and net income was down 12.3%, to ¥1.3 billion.

Sammy NetWorks Co., Ltd.

With markets for some of Sammy NetWorks' core businesses, such as ring tones, contracting, the company worked to expand and maintain its existing businesses, such as pachinko and pachislot games for mobile phones and ring tones. In addition, the company took aggressive steps to develop content distribution services for platforms other than mobile phones, such as PCs, and to develop these services into a new pillar of its operations.

As a result, Sammy NetWorks recorded net sales of ¥8.3 billion, operating income of ¥2.2 billion, and net income of ¥1.3 billion. The year under review was the first year in which Sammy NetWorks prepared consolidated financial statements.

NISSHO INTER LIFE CO., LTD.*

NISSHO INTER LIFE worked to expand revenue and profit, implementing three organizational reforms targeting higher profitability and securing an increase in orders in the entertainment field, drawing on SEGA SAMMY Group synergies. In the second half of the fiscal year, there was a delay in the adoption of policies and strategies and in framework improvement within the construction business. As a result, the company's efforts to reduce costs stalled and the gross profit margin for the full fiscal year did not improve.

For the fiscal year, NISSHO INTER LIFE recorded net sales of ¥16.2 billion, an operating loss of ¥0.4 billion, and a net loss of ¥0.4 billion.

* At the NISSHO INTER LIFE Ordinary General Meeting of Shareholders held on August 19, 2004, the company's articles of incorporation were amended and the fiscal year-end was changed from May 20 to March 20. As a result, the fiscal year prior to the year under review covered the 10-month period from May 21, 2004, to March 20, 2005. Accordingly, for the fiscal year under review, comparisons with the previous fiscal year have not been made.

OPERATIONAL RISKS

Risks that could affect the performance or operations of the SEGA SAMMY Group are given below. Further, the following is not a comprehensive list of the operational risks faced by the Group. However, based on an awareness of the following risks, the Group implements measures to prevent the occurrence of incidents arising from those risks and to respond to such incidents in the event of their occurrence. In addition, forward-looking statements in the following text are the judgments of the Group as of March 31, 2006.

Statutory Regulations Affecting the Pachislot and Pachinko Machine Business

Among the Group's mainstay operations, the Pachislot and Pachinko Machine Business account for a significant portion of net sales and income. In particular, this segment generates the greater part of the Group's total operating income. Further, the segment's sales are substantially influenced by user preferences. As a result, the segment tends to rely on the sales of specific machine models. In addition, products sold must conform to the technical specifications stipulated by National Public Safety Commission rules (regulations for the verification of licenses, formats, and other aspects of pachislot and pachinko machines), which are based on the amended Entertainment Establishments Control Law of Japan enacted on February 13, 1985.

Also, in July 2004 revisions were enacted to regulations pertaining to the Entertainment Establishments Control Law that mainly curb the payout characteristics and prevent the improper use of pachislot and pachinko machines.

Such regulatory revisions, the progress of new-machine development, the requirements of format examinations and official licenses, product malfunctions,

user preferences, and the sales trends of competitors' products could have a significant impact on the Group's performance or operations.

Shortness of Product Life Cycles

Due to the short time required for the production of pachislot and pachinko machines, the Group usually produces machines in response to order trends. Because the marketing period is generally short, product shipments are concentrated in the initial period after product launches. Accordingly, the Group procures certain raw materials in advance. However, the Group may not be able to procure sufficient raw materials for production in response to large order volumes in the initial period after product launches.

Comparatively, the time required for the production of amusement machines is long. Consequently, the Group produces those machines based on demand estimates. However, demand for products could change due to shifts in user preferences.

Home videogame software is susceptible to changes in seasonal demand, which focuses on such periods as the run up to Christmas and the New Year. If the Group is unable to supply new products during such selling periods, surplus inventory could result.

To mitigate risks associated with such inventories, the Group takes measures that include the use of common components, the shortening of lead times for components procurement, and the strengthening of inventory asset management. However, losses stemming from the disposal of inventory assets could result due to sales results that fall short of projections.

Entry into Overseas Markets

The Group conducts operations in overseas markets, including markets in North America, Europe, and Asia. The Group

plans to increase sales in overseas markets centered on the Amusement Machine Sales Business, Amusement Center Operations, and the Consumer Business. As a result, fluctuation in foreign currency exchange rates could affect the Group's performance or operations. Further, the Group could be affected by a deterioration in the international geopolitical situation related to such factors as overseas wars, conflicts, and terrorist incidents.

Adoption of Asset-Impairment Accounting

In the fiscal year ending March of 2006, the company adopted asset-impairment accounting. Depending on shifts in business conditions and future cash flows, the Company may be unable to recoup the value of certain investments and would be required to record a loss. If such a case were to occur, it could have a material adverse effect on the Company's operating results.

Management of Personal Information

The Group holds personal information relating to the users of its products and services due to such activities as the operation of membership-based web sites. In light of the enactment of the Act for Protection of Computer Processed Personal Data Held by Administrative Organs, the Group is strengthening the rigor of its personal information management. However, in the unlikely event of a leakage of personal information or the misuse of such personal information, the resulting loss of trust or lawsuits filed against the Group could affect its performance or operations.

Lawsuits

The Group implements measures to minimize the risk of having claims for damages and other lawsuits filed against the Group by strengthening its compliance systems and by exercising sufficient care to avoid the infringement of the intellectual property of third parties. However, lawsuits could be filed against the Group claiming that products manufactured and sold by the Group infringe upon rights.

Consolidated Balance Sheets

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
As of March 31, 2006 and 2005

ASSETS	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current assets:			
Cash and cash equivalents	¥160,094	¥151,253	\$1,362,850
Time deposits (Note 4)	926	1,024	7,883
Trade receivables:			
Notes and accounts receivable (Notes 4 and 7)	96,728	76,922	823,427
Allowance for doubtful accounts	(1,494)	(1,892)	(12,718)
Marketable securities	2,999	–	25,530
Inventories (Note 3)	32,200	32,002	274,113
Income taxes refundable (Note 10)	15,656	–	133,277
Deferred income taxes (Note 10)	6,277	6,024	53,435
Other current assets	17,945	17,129	152,761
Total current assets	331,331	282,462	2,820,558
Property, plant and equipment:			
Land (Note 4)	20,699	22,258	176,207
Buildings and structures (Note 4)	57,171	48,469	486,686
Amusement machines and facilities	57,411	43,375	488,729
Construction in progress	1,840	1,220	15,664
Others	28,205	23,358	240,103
	165,326	138,680	1,407,389
Accumulated depreciation	(82,672)	(65,492)	(703,771)
	82,654	73,188	703,618
Investments and other assets:			
Investments in unconsolidated subsidiaries and affiliated companies	4,150	9,371	35,328
Investments in securities (Notes 11 and 12)	55,890	34,419	475,781
Goodwill	11,267	3,405	95,914
Lease deposits	18,073	19,118	153,852
Deferred income taxes (Note 10)	804	500	6,844
Others	27,207	26,073	231,608
Allowance for doubtful accounts	(8,462)	(9,545)	(72,035)
	108,929	83,341	927,292
	¥522,914	¥438,991	\$4,451,468

See accompanying notes.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current liabilities:			
Short-term bank loans and current portion of long-term debt (Note 4)	¥ 10,395	¥ 13,301	\$ 88,491
Notes and accounts payable – trade (Note 4)	62,133	57,140	528,927
Income taxes payable (Note 10)	29,222	12,508	248,761
Accrued employees' bonuses	1,871	1,722	15,927
Other current liabilities (Note 4)	33,732	25,597	287,154
Total current liabilities	137,353	110,268	1,169,260
Long-term liabilities:			
Long-term debt (Note 4)	29,218	42,229	248,727
Retirement benefits for employees (Note 6)	7,491	6,037	63,769
Retirement benefits for directors and corporate auditors	1,277	1,162	10,871
Deferred income taxes (Note 10)	4,488	5,400	38,206
Other non-current liabilities	7,095	6,437	60,399
Total long-term liabilities	49,569	61,265	421,972
Minority interests	19,312	8,504	164,399
Contingent liabilities (Note 7)			
Shareholders' equity (Note 8):			
Common stock	29,953	27,291	254,984
Authorized – 400,000,000 shares in 2005 and 800,000,000 shares in 2006			
Issued – 140,551,522 shares in 2005 and 283,229,476 shares in 2006			
Capital surplus	171,071	176,302	1,456,295
Retained earnings	193,721	133,761	1,649,110
Revaluation reserve for land (Note 9)	(7,506)	(6,542)	(63,897)
Net unrealized holding gains on securities	11,757	10,793	100,085
Foreign currency translation adjustments	(8,767)	(9,425)	(74,631)
Treasury stock, at cost	390,229	332,180	3,321,946
	(73,549)	(73,226)	(626,109)
Total shareholders' equity	316,680	258,954	2,695,837
	¥522,914	¥438,991	\$4,451,468

Consolidated Statements of Income

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Net sales	¥553,241	¥515,668	\$4,709,637
Cost of sales	324,229	304,109	2,760,100
Gross profit	229,012	211,559	1,949,537
Selling, general and administrative expenses (Note 13)	109,868	106,469	935,287
Operating income	119,144	105,090	1,014,250
Other income (expenses):			
Interest and dividend income	1,101	760	9,373
Interest expenses	(634)	(803)	(5,397)
Equity in (losses) earnings of affiliated companies	(230)	25	(1,958)
Gain on investments in partnership	1,066	1,189	9,075
Loss on sale of property, plant and equipment – net	(169)	(448)	(1,439)
Loss on disposal of property, plant and equipment	(818)	(908)	(6,963)
Loss on revaluation of investment securities	(854)	(1,040)	(7,270)
Gain on change in equity of consolidated subsidiaries	1,066	2,252	9,075
Gain on sale of operations (Note 14)	27	743	229
Impairment losses (Note 16)	(7,195)	(325)	(61,250)
Loss on business reorganization (Note 15)	(318)	(2,945)	(2,707)
Loss on redemption of bonds	–	(10,606)	–
Other – net	(262)	(3,502)	(2,231)
	(7,220)	(15,608)	(61,463)
Income before income taxes and minority interests	111,924	89,482	952,787
Income taxes (Note 10):			
Current	46,796	32,437	398,366
Deferred	(3,018)	5,652	(25,692)
	43,778	38,089	372,674
Income before minority interests	68,146	51,393	580,113
Minority interests	1,924	819	16,378
Net income	¥ 66,222	¥ 50,574	\$ 563,735

	Yen		U.S. dollars
	2006	2005	2006
Per share of common stock (Note 21):			
Net income	¥261.06	¥410.53	\$2.22
Diluted net income	260.35	400.95	2.22
Cash dividends applicable to the year	80.00	60.00	0.68

See accompanying notes.

Consolidated Statements of Shareholders' Equity

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Common stock:			
Beginning balance	¥ 27,291	¥ 10,000	\$ 232,323
Increase in capital stock	2,662	17,291	22,661
Ending balance	¥ 29,953	¥ 27,291	\$ 254,984
Capital surplus:			
Beginning balance	¥ 176,302	¥ 154,340	\$ 1,500,826
Increase			
Increase in capital stock	2,660	17,286	22,644
Gain on sale of treasury stock	7	3	60
Increase in capital stock by wholly owned subsidiary before share transfer	–	2,847	–
Gain on sale of treasury stock by wholly owned subsidiary before share transfer	–	1,826	–
Total	2,667	21,962	22,704
Decrease			
Cash dividends	7,498	–	63,830
Bonuses to directors and corporate auditors	180	–	1,532
Transfer of capital surplus to retained earnings	220	–	1,873
Total	7,898	–	67,235
Ending balance	¥ 171,071	¥ 176,302	\$ 1,456,295
Retained earnings:			
Beginning balance	¥ 133,761	¥ 101,838	\$ 1,138,682
Increase			
Net income	66,222	50,574	563,735
Reversal of land revaluation difference	2	277	17
Increase resulting from increase in consolidated subsidiaries and affiliates under the equity method	194	1,911	1,651
Transfer of capital surplus to retained earnings	220	–	1,873
Total	66,638	52,762	567,276
Decrease			
Cash dividends	6,278	7,433	53,443
Bonuses to directors and corporate auditors	373	525	3,175
Loss on sale of treasury stock by wholly owned subsidiary before share transfer	–	2,525	–
Decrease in treasury stock by wholly owned subsidiary before share transfer	–	10,356	–
Decrease resulting from decrease in consolidated subsidiaries and affiliates under the equity method	27	–	230
Total	6,678	20,839	56,848
Ending balance	¥ 193,721	¥ 133,761	\$ 1,649,110
Revaluation reserve for land:			
Beginning balance	¥ (6,542)	¥ (6,265)	\$ (55,691)
Reversal of land revaluation difference	(964)	(277)	(8,206)
Ending balance	¥ (7,506)	¥ (6,542)	\$ (63,897)
Net unrealized gains on securities:			
Beginning balance	¥ 10,793	¥ 11,841	\$ 91,879
Unrealized holding gains on securities	964	(1,048)	8,206
Ending balance	¥ 11,757	¥ 10,793	\$ 100,085
Foreign currency translation adjustments:			
Beginning balance	¥ (9,425)	¥ (8,793)	\$ (80,233)
Decrease (increase) in foreign currency translation adjustments	658	(632)	5,602
Ending balance	¥ (8,767)	¥ (9,425)	\$ (74,631)
Treasury stocks:			
Beginning balance	¥ (73,226)	¥ (49,165)	\$ (623,359)
Increase			
Transfer of SEGA CORPORATION stock owned by Sammy Corporation to treasury stock	–	(45,521)	–
Acquisition of treasury stock by wholly owned subsidiary before share transfer	–	(257)	–
Acquisition of treasury stock	(378)	(488)	(3,218)
Total	(378)	(46,266)	(3,218)
Decrease			
Sale of treasury stock by wholly owned subsidiary before share transfer	–	11,809	–
Decrease in treasury stock by wholly owned subsidiary before share transfer	–	10,356	–
Sale of treasury stock	55	40	468
Total	55	22,205	468
Ending balance	¥ (73,549)	¥ (73,226)	\$ (626,109)

See accompanying notes.

Consolidated Statements of Cash Flows

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Cash flows from operating activities:			
Income before income taxes and minority interests	¥111,924	¥ 89,482	\$ 952,787
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:			
Depreciation and amortization	21,855	17,674	186,048
Interest and dividend income	(1,101)	(760)	(9,373)
Amortization of goodwill	1,782	720	15,170
Interest expenses	634	803	5,397
Loss on sale and disposal of property, plant and equipment – net	846	1,355	7,202
Gain on change in equity of subsidiaries – net	(779)	(2,252)	(6,631)
Impairment losses	7,195	325	61,250
Loss on sale and revaluation of investment securities	470	1,413	4,001
Gain on investments in partnership – net	(889)	(1,066)	(7,568)
Loss on business reorganization	318	2,945	2,707
Loss on redemption of bonds	–	10,606	–
Equity in losses (earnings) of affiliates	230	(25)	1,958
(Decrease) Increase in allowance for doubtful accounts	(1,016)	596	(8,649)
Increase in accrued employees' bonuses	333	30	2,835
Increase in retirement benefits for employees	1,128	367	9,602
Increase in retirement benefits for directors and corporate auditors	9	64	77
Others – net	(1,299)	(2,025)	(11,058)
Net changes in assets and liabilities:			
(Increase) Decrease in notes and accounts receivable	(14,806)	34,138	(126,041)
Decrease (Increase) in inventories	1,690	(3,948)	14,387
Increase (Decrease) in notes and accounts payable – trade	1,237	(12,091)	10,530
Amount of transfer of equipment by amusement center operations business	(11,817)	(4,982)	(100,596)
Decrease in other assets	3,042	174	25,896
Increase (Decrease) in other liabilities	2,366	(3,973)	20,141
Sub-total	123,352	129,570	1,050,072
Receipts of interest and dividend income	1,315	718	11,194
Payment of interest expenses	(672)	(735)	(5,721)
Payment of income taxes	(45,767)	(51,791)	(389,606)
Refund of deposit for lawsuit	5,000	–	42,565
Net cash provided by operating activities	83,228	77,762	708,504
Cash flows from investing activities:			
Payment for purchase of property, plant and equipment	(26,332)	(24,416)	(224,159)
Proceeds from sales of property, plant and equipment	345	1,046	2,937
Payment for purchase of securities	(3,498)	–	(29,778)
Payment for purchase of investment securities	(2,242)	(2,897)	(19,086)
Proceeds from sales of investment securities	1,253	180	10,667
Payment for investment in partnerships	(24,711)	(2,061)	(210,360)
Proceeds from distribution of investment in partnerships	8,818	697	75,066
Proceeds from (Payment for) acquisition of consolidated subsidiaries – net	6,001	(2,678)	51,085
(Proceeds from) Payment for sales of consolidated subsidiaries – net	(240)	160	(2,043)
Payment for acquisition of affiliated companies	(6,803)	(2,235)	(57,913)
Decrease (Increase) in loan receivables – net	1,137	(1,790)	9,679
Payment for acquisition of operations	(2,850)	–	(24,262)
Decrease (Increase) in time deposits – net	367	(3,500)	3,124
Increase in other investments – net	(5,951)	(2,124)	(50,659)
Net cash used in investing activities	(54,706)	(39,618)	(465,702)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	3,106	1,708	26,441
Repayment of long-term debt	(9,778)	(7,781)	(83,238)
Decrease in short-term bank loans	(557)	(2,540)	(4,742)
Payment for redemption of bonds	(3,239)	(21,265)	(27,573)
Cash dividends paid by wholly owned subsidiary before the stock transfer	–	(7,433)	–
Cash dividends paid	(13,776)	–	(117,272)
Payment for purchase of treasury stock	(378)	(445)	(3,218)
Proceeds from exercise of stock acquisition rights of wholly owned subsidiary before the stock transfer	–	7,262	–
Others – net	3,469	4,791	29,530
Net cash used in financing activities	(21,153)	(25,703)	(180,072)
Effect of exchange rate changes on cash and cash equivalents	686	54	5,841
Net change in cash and cash equivalents	8,055	12,495	68,571
Cash and cash equivalents at beginning of year	151,253	138,758	1,287,588
Net increase in cash and cash equivalents due to consolidation scope change	463	–	3,941
Net increase in cash and cash equivalents due to merger	323	–	2,750
Cash and cash equivalents at end of year	¥160,094	¥151,253	\$1,362,850

See accompanying notes.

Notes to Consolidated Financial Statements

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Years ended March 31, 2006 and 2005

NOTE 1

Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of SEGA SAMMY HOLDINGS INC. (the “Company”) and its consolidated subsidiaries have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan (“Japanese GAAP”), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries of domicile. The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of consolidated statements of shareholders’ equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

In preparing the accompanying consolidated financial statements, certain reclassifications have been made in order to present them in a form which is more familiar to readers outside Japan. Certain reclassifications have been made to the 2005 consolidated financial statements to conform to the classifications used in 2006.

These changes had no impact on previously reported results of operations or shareholder’s equity.

The translation of the Japanese yen amounts into U.S. dollars is included solely for the convenience of readers outside Japan, using the prevailing exchange rate at March 31, 2006, which was ¥117.47 to U.S.\$1. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

NOTE 2

Summary of Significant Accounting Policies

(a) Business combination

On October 1, 2004, the Pooling of Interest Method was applied for the business combination of SEGA CORPORATION and Sammy Corporation, both of whose shares were transferred to establish the Company. The consolidated statements of income, shareholder’s equity and cash flows were prepared as if the combination was completed effective April 1, 2004.

(b) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its significant subsidiaries, which are controlled through substantial ownership of majority voting rights or existence of certain conditions. All significant inter-company balances, transactions and unrealized profits have been eliminated. The number of the consolidated subsidiaries was 72 and 61 in 2006 and 2005, respectively.

(c) Equity method

Investments in affiliated companies over which the Company has the ability to exercise significant influence over operation and financial policies of investors are accounted for using the equity method. The number of companies accounted for under the equity method was 8 and 6 in 2006 and 2005, respectively.

(d) Consolidated statements of cash flows

In preparing the consolidated statements of cash flows, cash on hand, readily available deposits and short-term highly liquid investments with maturities of not exceeding three months at the time of purchase are considered to be cash and cash equivalents.

(e) Allowance for doubtful accounts

The allowance for doubtful accounts is provided at an amount sufficient to cover probable losses on collection by estimating individually uncollectible amounts and applying a percentage based on collection experience to the remaining accounts.

(f) Investment securities

The Company and its consolidated subsidiaries examine the intent of holding each security and classify those securities as (a) securities held for trading purposes (hereafter, “trading securities”), (b) debt securities intended to be held to maturity (hereafter, “held-to-maturity debt securities”), (c) equity securities issued by subsidiaries and affiliated companies and (d) all other securities that are not classified in any of the above categories (hereafter, “available-for-sale securities”).

Held-to-maturity debt securities are stated at amortized cost. Available-for-sale securities with available fair market values are stated at fair market value. Unrealized gains and unrealized losses on these securities are reported, net of applicable income taxes, as a separate component of shareholders’ equity. Realized gains and losses on sale of such securities are computed using moving-average cost. Available-for-sale securities with no available fair market values are stated at moving-average cost.

Equity securities issued by subsidiaries and affiliated companies, which are not consolidated or accounted for using the equity method, are stated at moving-average cost.

The Company and its consolidated subsidiaries did not have trading securities in the years ended March 2006 and 2005 and held-to-maturity debt securities in the year ended March 31, 2005.

(g) Inventories

Inventories are stated at cost determined by the weighted-average method.

(h) Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost. Depreciation is computed primarily using the declining-balance method at rates based on estimated useful lives of respective assets. In addition, buildings acquired after March 31, 1998 are depreciated using the straight-line method.

(i) Amortization of intangible assets

Intangible assets are amortized using the straight-line method, and software used by the Company and its consolidated subsidiaries is amortized using the straight-line method over the estimated useful lives of five years.

(j) Goodwill

The Company and its subsidiaries classified the cost in excess of fair market value of net assets of companies acquired in purchase transactions as goodwill. The Company and its subsidiaries compute amortization of goodwill by the straight-line method at rates based on the estimated useful lives, except for goodwill that is amortized over five years because its useful life is uncertain.

The Company regularly reviews the carrying amount of goodwill for re-evaluation whenever events or circumstances indicate that the carrying amounts may not be recoverable. Insignificant amounts of such intangible assets are charged to income when incurred.

Goodwill that is on the balance sheet of certain foreign subsidiaries has not been amortized. Impairment loss is recognized if necessary according to generally accepted accounting standards of the United States of America.

(k) Impairment of fixed assets

Effective April 1, 2005, the Company and its consolidated domestic subsidiaries adopted the new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003). As a result of this change, income before income taxes and minority interests for the year ended March 31, 2006 decreased by ¥7,195 million (\$61,250 thousand) compared with what would have been recorded under the previous accounting policy.

(l) Accounting for certain lease transactions

Finance leases that do not transfer the ownership to lessees are not capitalized and are accounted for in the same manner as operating leases.

(m) Allowance for employees' bonuses

The Company and its consolidated subsidiaries provide allowance for employees' bonuses based on estimated amounts to be paid in the subsequent period.

Bonuses to directors and corporate auditors, which were subject to approval at the shareholders' meeting, are accounted for as an appropriation of retained earnings.

(n) Retirement benefits for employees

The Company and its consolidated subsidiaries provide two types of post-employment benefit plans, unfunded lump-sum payment plans and funded pension plans, under which all eligible employees are entitled to benefits based on the level of wages and salaries at the time of retirement or termination, length of service and certain other factors.

The Company and its consolidated subsidiaries provide allowance for employees' severance and retirement benefits based on the estimated amounts of projected benefit obligation and the fair value of the plan assets.

The estimated amount of all retirement benefits to be paid at the future retirement date is allocated equally to each service year using the estimated number of total service years. Actuarial gains and losses are charged to income in the succeeding period except for SEGA CORPORATION and three other subsidiaries that recognize actual gains and losses as expenses using the straight-line method over ten years commencing from the succeeding period.

Prior service cost is charged to income when incurred except for SEGA CORPORATION and three other subsidiaries that recognize prior service costs as expenses using the straight-line method over ten years.

(o) Retirement benefits for directors and corporate auditors

Retirement benefits for the directors and corporate auditors are provided based on an accrual basis in accordance with the internal rules of the Company and its subsidiaries.

(p) Income taxes

Income taxes comprise corporation, enterprise and inhabitants taxes.

The Company and its consolidated subsidiaries recognize deferred taxes for tax effects of temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting purposes.

(q) Derivative financial instruments

Derivative financial instruments are stated at fair value and changes in their fair values are recognized as gains or losses unless derivative financial instruments are used for hedging purposes.

For derivative financial instruments that are used as hedges and meet certain hedging criteria, recognition of gains or losses resulting from changes in fair value of derivative financial instruments is deferred until the related losses or gains on the hedged items are recognized in earnings.

Also, if interest rate swap contracts are used for hedging purposes and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed.

(r) Per share data

Net income per share is computed by dividing income available to common stockholders by the weighted-average number of common stock outstanding during the period. Income available to common stockholders is computed by deducting bonuses to directors and corporate auditors from net income. Diluted net income per share is similar to net income per share except that the weight-average number of common stock outstanding is increased by the number of additional common stock that would have been outstanding if the potential common stocks had been issued.

Cash dividends per share in the consolidated statements of income represent actual amounts applicable to the year.

(s) Foreign currency transactions

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end exchange rate.

NOTE 3

Inventories

Inventories as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Merchandise	¥ 3,448	¥ 3,761	\$ 29,352
Finished products	8,548	6,210	72,768
Raw materials	16,517	17,793	140,606
Work in process	2,082	3,542	17,724
Supplies	1,605	696	13,663
	¥32,200	¥32,002	\$274,113

NOTE 4

Short-Term Bank Loans, Current Portion of Long-Term Debt and Long-Term Debt

Short-term bank loans outstanding are generally represented, with interest at rates ranging from 0.80% to 2.76% and 1.38% to 4.61% as of March 31, 2006 and 2005, respectively.

Long-term debt consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Bonds:			
0.28% debenture due in 2006	¥ –	¥ 200	\$ –
0.41% debenture due in 2007	75	–	638
0.40% debenture due in 2007	–	70	–
0.44%–1.99% debenture due in 2008	15,335	–	130,544
0.41% debenture due in 2008	–	18,943	–
1.30% debenture due in 2009	71	–	604
0.20%–0.61% debenture due in 2009	–	5,176	–
0.41%–1.47% debenture due in 2010	10,140	–	86,321
0.41% debenture due in 2010	–	10,000	–
Long-term loans, principally due from banks with interest at 0.90% to 2.98% and 1.35% to 8.76% as of March 31, 2006 and 2005:			
Secured	272	779	2,315
Unsecured	11,114	17,091	94,612
	37,007	52,259	315,034
Less: current portion	(7,789)	(10,030)	(66,307)
	¥29,218	¥ 42,229	\$248,727

On October 29, 2004, the Company issued ¥39,900 million of zero coupon convertible bonds (convertible bond-type bonds with stock acquisition rights) due in 2009. The stock acquisition rights are exercisable on or after November 1, 2004 up to, and including, February 17, 2009 at a conversion price of ¥3,828 per share.

At March 31, 2006 and 2005, balance of convertible bonds with stock acquisition rights were ¥1 million (\$9 thousand) and ¥5,323 million, respectively.

The aggregate annual maturities of long-term debt at March 31, 2006 were as follows:

	Millions of yen	Thousands of U.S. dollars
Years ending March 31,		
2007	¥12,555	\$106,878
2008	6,054	51,537
2009	173	1,473
2010	10,204	86,865
2011 and thereafter	232	1,974

A summary of assets pledged as collateral for short-term loans, long-term debt, accounts payable–trade and other current liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Time deposits	¥ 25	¥ 20	\$ 213
Notes receivable	468	1,479	3,984
Land 535	964	4,554	
Buildings	349	331	2,971
	¥1,377	¥2,794	\$11,722

NOTE 5

Stock Option Plan

- (a) At the annual meeting of shareholders held on June 24, 2005, the Company's employees and subsidiaries' employees were granted options in the amount of 2,600,000 shares to purchase a maximum of 200 common shares of the Company, per individual. At March 31, 2006, a total of 2,486,800 shares are outstanding. The option exercise price is ¥3,470 per share. The option is exercisable between July 31, 2007 and July 30, 2009.
- (b) At the annual meeting of shareholders held on June 20, 2006, the Company's directors were granted options in the amount of not more than 43,000 shares in total. The option exercise price is decided by a resolution of the Board of Directors. The option is exercisable between July 31, 2008 and July 30, 2010.
- (c) At the annual meeting of shareholders held on June 20, 2006, the Company's employees and subsidiaries' directors and employees were granted options in the amount of not more than 2,770,000 shares in total. The subscription price per share of the right will be determined at 1.05 of average market quotation of the shares of the Company at the month that proceeds the month in which the subscription right is granted. The option is exercisable for a period of two years starting two years after the granted.

NOTE 6

Retirement Benefits for Employees

The liabilities and expenses for severance and retirement benefits are determined based on the amounts obtained by actuarial calculations.

The liabilities for severance and retirement benefits included in the liability section of the consolidated balance sheets as of March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation	¥ 19,980	¥16,977	\$170,086
Unrecognized actuarial differences	(2,490)	(4,127)	(21,198)
Unrecognized prior service cost	454	545	3,865
Prepaid pension cost	–	28	–
Less fair value of pension assets	(10,453)	(7,386)	(88,984)
Liability for severance and retirement benefits	¥ 7,491	¥ 6,037	\$ 63,769

Included in the consolidated statements of income for the years ended March 31, 2006 and 2005, severance and retirement benefit expenses comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service costs–benefits earned during the year	¥2,095	¥1,343	\$17,834
Interest cost on projected benefit obligation	340	271	2,894
Expected return on plan assets	(177)	(4)	(1,507)
Amortization of actuarial difference	554	380	4,716
Amortization of prior service cost	(91)	(91)	(775)
Additional interim benefit	–	763	–
Other	175	54	1,491
Severance and retirement benefit expenses	¥2,896	¥2,716	\$24,653
		2006	2005
Discount rate		2.0~2.5%	2.0~2.5%
Rate of expected return on plan assets		1.0~2.5%	0.0~1.0%

NOTE 7

Contingent Liabilities

The subsidiaries of the Company had contingent liabilities as of March 31, 2006 and 2005 as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Electronic Approval System Council	¥ 98	¥130	\$ 834
Dimps K.K.	400	–	3,405
SEGA GAME WORKS, LLC.	–	192	–

Also, the Company and its subsidiaries had ¥11 million of endorsed notes and ¥1,674 million of notes securitized as of March 31, 2005.

NOTE 8

Shareholders' Equity

Under the Japanese laws and regulations, the entire amount of payment for new shares is required to be designated as common stock, although, generally, a company may, by a resolution of the Board of Directors, designate an amount not exceeding one-half of the price of the new shares as additional paid-in capital, which is included in capital surplus.

Japanese Company Law (“the Law”) became effective on May 1, 2006, and, at the same time, the Japanese Commercial Code was repealed (“the Code”).

Under the Code, companies were required to set aside an amount equal to at least 10% of cash dividends and other cash appropriations as legal earnings reserve until the total of legal earnings reserve and additional paid-in capital equaled 25% of common stock. Under the Law, in cases when dividends are paid, an amount equal to 10% of the dividends or the excess of 25% of common stock over the total of additional paid-in capital and legal earnings reserve, whichever is the smaller, must be set aside as additional paid-in capital or legal earnings reserve. Under the Code, additional paid-in capital and legal earnings reserve were available for

distribution by the resolution of the shareholder's meeting as long as the total amount of legal earnings reserve and additional paid-in capital remained equal to or exceeded 25% of common stock. Under the Law, even when the total amount of additional paid-in capital and legal earnings reserve is less than 25% of common stock, additional paid-in capital and legal earnings reserve may be available for dividends if there are sufficient distributable surplus. Under the Code, legal earnings reserve and additional paid-in capital could be used to eliminate or reduce a deficit by a resolution of the shareholders' meeting or may be capitalized by a resolution of the Board of Directors. Under the Law, both of those appropriations require a resolution of the shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Japanese laws and regulations.

At the annual shareholders' meeting held on June 20, 2006, the shareholders resolved cash dividends and directors' and corporate auditors' bonuses amounting to ¥7,559 million (\$64,348 thousand) and ¥200 million (\$1,703 thousand), respectively. Such appropriations have not been accrued in the consolidated financial statements as of March 31, 2006. Such appropriations will be recognized in the period when they are resolved.

NOTE 9

Revaluation Reserve for Land

SEGA CORPORATION, which is a consolidated subsidiary, revalued land for its business in accordance with the Land Revaluation Law. The Company recorded the entire difference between the carrying amount and revalued amount as revaluation reserve for land as a separate component of shareholder's equity.

Revaluation of land was performed by making a reasonable adjustment on the land based on the market value estimated in accordance with relevant provisions of the Land Revaluation Law.

Date of Revaluation: March 31, 2002

The market value of the land as of March 31, 2006 and 2005 was less than the book value by ¥381 million (\$3,243 thousand) and ¥655 million, respectively.

NOTE 10

Income Taxes

The Company and its subsidiaries are subject to a number of taxes based on income, which, in the aggregate, indicate statutory rates in Japan of approximately 40.7% for the years ended March 31, 2006 and 2005.

The following table summarizes the significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes for the year ended March 31, 2005:

	2005
Statutory tax rate	40.7%
Valuation allowance	3.2
Gain on change in equity of a subsidiary	(1.6)
Others	0.3
Effective tax rate	42.6%

The difference between the statutory tax rate and the effective tax rate for financial statement purposes for the year ended March 31, 2006 is not shown because it is not significant.

The Company's and its subsidiaries' significant components of deferred tax assets and liabilities as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Allowance for doubtful accounts	¥ 3,262	¥ 5,593	\$ 27,769
Loss on devaluation of inventories	2,556	3,176	21,759
Expensed tangible assets not deductible for tax purposes	643	1,067	5,474
Enterprise taxes accrued	2,366	-	20,141
Retirement benefits for employees	3,042	1,357	25,896
Depreciation expense	7,895	7,827	67,209
Loss on devaluation of investments	2,849	37,051	24,253
Impairment losses	2,979	132	25,360
Tax loss carry forward	17,503	35,550	149,000
Others	12,592	14,625	107,192
Sub total	55,687	106,378	474,053
Valuation allowance	(43,272)	(97,795)	(368,366)
Total	12,415	8,583	105,687
Deferred tax liabilities:			
Net unrealized holding gains on securities	7,651	7,241	65,132
Others	2,171	218	18,482
Total	9,822	7,459	83,614
Net deferred tax assets	¥ 2,593	¥ 1,124	\$ 22,073

NOTE 11

Market Value Information of Securities

Balance sheet amounts, fair values and valuation gains or losses of held-to-maturity debt securities with available fair values as of March 31, 2006 were as follows:

	Millions of yen		
	Balance sheet amount	Fair value	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Bonds	¥499	¥499	¥ 0
Securities whose market value is equal to or lower than the balance sheet amount:			
Bonds	500	500	(0)

	Thousands of U.S. dollars		
	Balance sheet amount	Fair value	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Bonds	\$4,248	\$4,248	\$0
Securities whose market value is equal to or lower than the balance sheet amount:			
Bonds	4,256	4,256	(0)

Acquisition costs, balance sheet amounts and valuation gains or losses of available-for-sale securities with available fair values as of March 31, 2006 were as follows:

	Millions of yen		
	Acquisition cost	Balance sheet amount	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Stocks	¥1,581	¥15,166	¥13,585
Bonds and debentures	2,001	2,034	33
Securities whose market value is equal to or lower than the balance sheet amount:			
Stocks	1,293	661	(632)
Bonds and debentures	2,922	2,792	(130)

	Thousands of U.S. dollars		
	Acquisition cost	Balance sheet amount	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Stocks	\$13,458	\$129,105	\$115,647
Bonds and debentures	17,034	17,315	281
Securities whose market value is equal to or lower than the balance sheet amount:			
Stocks	11,007	5,627	(5,380)
Bonds and debentures	24,875	23,768	(1,107)

Available-for-sale securities sold in the year ended March 31, 2006 amounted to ¥1,253 million (\$10,667 thousand) and the related gains and losses amounted to ¥400 million (\$3,405 thousand) and ¥16 million (\$136 thousand).

Acquisition costs, balance sheet amounts and valuation gains or losses of available-for-sale securities with available fair values as of March 31, 2005 were as follows:

	Acquisition cost	Millions of yen Balance sheet amount	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Stocks	¥1,386	¥17,454	¥16,068
Bonds and debentures	2,306	2,391	85
Securities whose market value is equal to or lower than the balance sheet amount:			
Stocks	942	608	(334)

Available-for-sale securities sold in the year ended March 31, 2005 amounted to ¥128 million and the related gains amounted to ¥49 million.

NOTE 12

Loan Receivable in Securities

Loan receivable in securities of ¥1,397 million (\$11,892 thousand) and ¥943 million were included in investments in securities as of March 31, 2006 and 2005, respectively.

NOTE 13

Research and Development Expenses

Expenses relating to research and development activities have been charged to income as incurred and amounted to ¥36,338 million (\$309,339 thousand) and ¥41,590 million for the years ended March 31, 2006 and 2005, respectively.

NOTE 14

Gain on Sale of Operations

Gain on sale of operations is derived from sale of operations in RTzen Inc., which was a former consolidated subsidiary for the year ended March 31, 2006, and from sale of investment in Visual Concepts Entertainment, Inc. in relation to SEGA CORPORATION's software restructuring strategy in the United States for the year ended March 31, 2005.

NOTE 15

Loss on Business Reorganization

Loss on business reorganization was recognized in the business reorganization between Sammy Corporation and SEGA CORPORATION for the years ended March 31, 2006 and 2005.

NOTE 16

Impairment Losses

Impairment losses for the year ended March 31, 2006 consisted of the following:

Use	Location	Type	Impairment Loss	
			Millions of yen	Thousands of U.S. dollars
Amusement centers	Chuo-ku, Osaka	Land	¥4,576	\$38,955
		Buildings and structures	1,880	16,004
		Other tangible fixed assets	208	1,771
		Other intangible fixed assets	43	366
	Tokushima-shi, Tokushima	Buildings and structures	100	851
	Takatsuki-shi, Osaka	Buildings and structures	2	17
Assets for lease	Sakaiminato-shi, Tottori; Bunkyo-ku, Tokyo; and three other locations	Land	119	1,013
		Buildings and structures	37	315
Idle assets	Karuizawa-cho, Nagano; and five other locations	Land	42	358
		Other tangible fixed assets	188	1,600
	Kawagoe-shi, Saitama			
Total			¥7,195	\$61,250

For each business segment, the Company classifies assets or asset groups based on whether their cash flows can be estimated independently. The book values of assets or asset groups whose market values have declined significantly or that are projected to consistently generate negative cash flows are reduced to their recoverable value. The amount of this reduction is deemed an impairment loss and is recorded under other expenses in the financial statements. The recoverable values of amusement facilities (Tokushima-shi, Tokushima and Takatsuki-shi, Osaka) and assets for lease are assessed using their values in use, which are the

present value of projected cash flows generated by these assets using the discount rate between 2.2% and 6.0%. The recoverable values of amusement facilities (Chuo-ku, Osaka) and idle assets are calculated using the fair value less cost to sell based on the real estate appraisal value or the assessed value of fixed assets for property tax purposes.

The loss on devaluation of fixed assets for the year ended March 31, 2005 resulted from the decision at the board meeting to sell certain land and a building in Osaka.

NOTE 17

Information for Certain Leases

A summary of assumed amounts of acquisition cost, accumulated depreciation and net book value for the years ended March 31, 2006 and 2005 with respect to the finance leases accounted for in the same manner as operating leases was as follows:

March 31, 2006

	Millions of yen		
	Acquisition cost	Accumulated depreciation	Net book value
Structures	¥ 309	¥ 102	¥ 207
Amusement machines	1,797	936	861
Tools, furniture and fixtures	3,425	1,602	1,823
Machinery and equipment	32	5	27
Software	631	240	391
Others	46	9	37
Total	¥6,240	¥2,894	¥3,346

March 31, 2006

	Thousands of U.S. dollars		
	Acquisition cost	Accumulated depreciation	Net book value
Structures	\$ 2,630	\$ 868	\$ 1,762
Amusement machines	15,298	7,968	7,330
Tools, furniture and fixtures	29,156	13,638	15,518
Machinery and equipment	272	43	229
Software	5,372	2,043	3,329
Others	392	76	316
Total	\$53,120	\$24,636	\$28,484

March 31, 2005

	Millions of yen		
	Acquisition cost	Accumulated depreciation	Net book value
Tools, furniture and fixtures	¥2,626	¥1,121	¥1,505
Machinery and equipment	275	166	109
Software	200	123	77
Others	56	6	50
Total	¥3,157	¥1,416	¥1,741

Future lease payments under the finance leases that were accounted for in the same manner as operating leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2006	2006
Due within one year	¥1,450	¥ 709		\$12,344
Due after one year	2,002	1,052		17,042
Total	¥3,452	\$1,761	\$29,386	

A summary of assumed amounts of lease payments, depreciation and interest for the years ended March 31, 2006 and 2005 with respect to the finance leases accounted for in the same manner as operating leases was as follows:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2006	2006
Lease payments	¥1,478	¥843		\$12,582
Depreciation	1,460	812		12,429
Interest expense	85	32		724

NOTE 18

Derivative Transactions

To avoid adverse effects of fluctuation of the market risk associated with financial activities and fluctuation in exchange rates, the Company and its consolidated subsidiaries use interest rate swap contracts and foreign exchange contracts. The Company and its subsidiaries use derivative financial instruments only for hedging purposes and do not use them for speculative trading purposes.

The interest rate swap contracts and foreign exchange contracts are executed with creditworthy financial institutions, and the Company and its subsidiaries believe the risk of default by counterparties is currently low.

Based on the regulation approved by the board meeting, the accounting and finance department manages derivative transactions after internal authorizations.

Market values of derivative transactions as of March 31, 2006 were as follows (except the derivative transaction hedged):

	Millions of yen			Thousands of U.S. dollars		
	Contract value	Fair value	Unrealized (losses)	Contract value	Fair value	Unrealized (losses)
Forward exchange contracts:						
Buying U.S. dollars	¥304	¥297	¥(7)	\$2,588	\$2,528	\$(60)

Market values of derivative transactions as of March 31, 2005 were as follows (except the derivative transaction hedged):

	Contract value	Millions of yen	
		Fair value	Unrealized (losses)
Forward exchange contracts:			
Buying U.S. dollars	¥584	¥514	¥(70)

NOTE 19

Segment Information

A. Industry segment information

Industry segment information for the year ended March 31, 2006 is as follows:

	Millions of yen							
	Pachislot Pachinko	Amusement machine sales	Amusement center operations	Consumer business	Others	Total	Corporate and elimination	Consolidated
Net sales:								
(1) Outside customers	¥265,632	¥71,513	¥106,246	¥90,353	¥19,497	¥553,241	¥ -	¥553,241
(2) Inter-segment	1,182	5,757	12	376	1,334	8,661	(8,661)	-
Total	266,814	77,270	106,258	90,729	20,831	561,902	(8,661)	553,241
Cost of sales and operating expense	166,966	65,093	97,014	88,752	22,544	440,369	(6,272)	434,097
Operating income	¥ 99,848	¥12,177	¥ 9,244	¥ 1,977	¥ (1,713)	¥121,533	¥ (2,389)	¥119,144
Total assets	¥121,843	¥41,777	¥ 91,099	¥89,599	¥13,425	¥357,743	¥165,171	¥522,914
Depreciation and amortization	¥ 2,482	¥ 1,505	¥ 17,148	¥ 2,411	¥ 717	¥ 24,263	¥ (2,408)	¥ 21,855
Impairment losses	¥ 329	¥ -	¥ 6,808	¥ -	¥ 55	¥ 7,192	¥ 3	¥ 7,195
Capital expenditures	¥ 6,944	¥ 1,467	¥ 24,577	¥ 3,502	¥ 929	¥ 37,419	¥ 231	¥ 37,650

Thousands of U.S. dollars

	Pachislot Pachinko	Amusement machine sales	Amusement center operations	Consumer business	Others	Total	Corporate and elimination	Consolidated
Net sales:								
(1) Outside customers	\$2,261,275	\$608,777	\$904,452	\$769,158	\$165,975	\$4,709,637	\$ –	\$4,709,637
(2) Inter-segment	10,062	49,008	102	3,201	11,356	73,729	(73,729)	–
Total	2,271,337	657,785	904,554	772,359	177,331	4,783,366	(73,729)	4,709,637
Cost of sales and operating expense	1,421,350	554,124	825,862	755,529	191,914	3,748,779	(53,392)	3,695,387
Operating income	\$ 849,987	\$103,661	\$ 78,692	\$ 16,830	\$ (14,583)	\$1,034,587	\$ (20,337)	\$1,014,250
Total assets	\$1,037,227	\$355,640	\$775,509	\$762,739	\$114,283	\$3,045,398	\$1,406,070	\$4,451,468
Depreciation and amortization	\$ 21,129	\$ 12,812	\$145,978	\$ 20,524	\$ 6,104	\$ 206,547	\$ (20,499)	\$ 186,048
Impairment losses	\$ 2,801	\$ –	\$ 57,955	\$ –	\$ 468	\$ 61,224	\$ 26	\$ 61,250
Capital expenditures	\$ 59,113	\$ 12,488	\$209,219	\$ 29,813	\$ 7,908	\$ 318,541	\$ 1,966	\$ 320,507

Notes: 1. The Company has five operating segments based on its management control structure and the nature of products and markets.

2. Main products and line of business by segment:

- (1) Pachislot Pachinko Development, manufacture and sale of pachinko and pachislot machines and design parlors
- (2) Amusement machine sales Development, manufacture and sale of game machines used in amusement arcades
- (3) Amusement center operations Development, operation, rent and maintenance of amusement centers
- (4) Consumer business Development and sales of home video game software; development, manufacture, and sales of toys; planning and production of entertainment contents for cellular phones, etc; planning, production and sale of animated movies
- (5) Others Planning, design, management and construction of commercial establishments, etc.

3. General corporate expenses of ¥4,915 million (\$41,840 thousand), which mainly consist of expenses incurred by the Company's administrative department, are included in "Corporate and elimination."

4. Corporate assets of ¥170,929 million (\$1,455,086 thousand), which mainly consist of cash and cash equivalents of SEGA CORPORATION and Sammy Corporation and the Company's assets, are included in "Corporate and elimination."

Industry segment information for the year ended March 31, 2005 was as follows:

Millions of yen

	Pachislot Pachinko	Amusement machine sales	Amusement center operations	Consumer business	Others	Total	Corporate and elimination	Consolidated
Net sales:								
(1) Outside customers	¥280,109	¥63,305	¥83,194	¥65,341	¥23,719	¥515,668	¥ –	¥515,668
(2) Inter-segment	33	16,535	126	115	747	17,556	(17,556)	–
Total	280,142	79,840	83,320	65,456	24,466	533,224	(17,556)	515,668
Cost of sales and operating expense	176,211	72,416	77,848	74,266	25,007	425,748	(15,170)	410,578
Operating income	¥103,931	¥ 7,424	¥ 5,472	¥ (8,810)	¥ (541)	¥107,476	¥ (2,386)	¥105,090
Total assets	¥114,064	¥35,191	¥74,989	¥54,493	¥19,627	¥298,364	¥140,627	¥438,991
Depreciation and amortization	¥ 2,389	¥ 857	¥11,937	¥ 2,121	¥ 346	¥ 17,650	¥ 24	¥ 17,674
Capital expenditures	¥ 2,843	¥ 1,227	¥24,886	¥ 2,223	¥ 638	¥ 31,817	¥ 651	¥ 32,468

Notes: 1. The Company has five operating segments based on its management control structure and the nature of products and markets.

2. Main products and line of business by segment:

- (1) Pachislot Pachinko Development, manufacture and sale of pachinko and pachislot machines and design parlors
- (2) Amusement machine sales Development, manufacture and sale of game machines used in amusement arcades
- (3) Amusement center operations Development, operation, rent and maintenance of amusement centers
- (4) Consumer business Development and sales of home video game software; development, manufacture, and sales of toys; planning and production of entertainment contents for cellular phones, etc.
- (5) Others Planning, design, management and construction of commercial establishments, etc.

3. General corporate expenses of ¥2,182 million, which mainly consist of expenses incurred by the Company's administrative department, are included in "Corporate and elimination."

4. Corporate assets of ¥144,739 million, which mainly consist of cash and cash equivalents of SEGA CORPORATION and Sammy Corporation and the Company's assets, are included in "Corporate and elimination."

B. Geographical segment information

Geographical segment information was not presented as the sales and assets of consolidated domestic subsidiaries for the years ended March 31, 2006 and 2005 exceed 90% of consolidated net sales and assets.

C. Overseas sales

Overseas sales were not presented as the overseas sales of the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 were less than 10% of consolidated net sales.

NOTE 20

Related-Party Transactions

Material transactions of the Company with related individuals or companies for the year ended March 31, 2006 are as follows:

		Millions of yen			
		Transactions	End of period account balance		
Name of related individual and company	Position and principal business	Description of the Company's transaction	2006	Account	2006
Hajime Satomi	Chairman and CEO of the Company	Lease of business jet	¥349	–	¥ –
FSC Co., Ltd.	Nonlife insurance agent	Payment of insurance and outsourcing fees	22	Prepaid expense	6

		Thousands of U.S. dollars			
		Transactions	End of period account balance		
Name of related individual and company	Position and principal business	Description of the Company's transaction	2006	Account	2006
Hajime Satomi	Chairman and CEO of the Company	Lease of business jet	\$2,971	–	\$ –
FSC Co., Ltd.	Nonlife insurance agent	Payment of insurance and outsourcing fees	187	Prepaid expense	51

- Notes: 1. Hajime Satomi, chairman and CEO of the Company, directly holds 53% shares of FSC Co., Ltd.
 2. The Company paid a lease fee to ITC-Aerospace, Inc. which operated the business jet owned by Hajime Satomi, chairman and CEO of the Company.
 3. The terms and conditions of the above transactions are on an arm's-length basis. The above amounts exclude consumption taxes, but consumption taxes are included in the end of period account balance.

NOTE 21

Per Share Data

Per share data are as follows:

	Yen		U.S. dollars
	2006	2005	2006
Per share data:			
Equity per share	¥1,254.14	¥2,067.91	\$10.68
Net income per share	261.06	410.53	2.22
Net income per share (diluted)	260.35	400.95	2.22

On November 18, 2005, the Company conducted a for stock split. Per share data would have been as follows if the stock split had been performed at the beginning of previous period.

	Yen
Per share data:	
Equity per share	¥1,033.96
Net income per share	205.27
Net income per share (diluted)	200.48

NOTE 22

Subsequent Event

To reinforce the competitiveness of the Company's consumer business in the North American and European markets, subsidiary SEGA HOLDINGS EUROPE LTD. acquired all issued shares of SPORTS INTERACTIVE Ltd. on April 3, 2006. Likewise, on the same day, SEGA HOLDINGS U.S.A., INC., another member of the Sega Sammy Group, acquired all issued shares of SECRET LEVEL, Inc. As a result, both SPORTS INTERACTIVE and SECRET LEVEL became subsidiaries of the Company.

Overview of the New Subsidiaries

(a) SPORTS INTERACTIVE Ltd.

- Trade name: SPORTS INTERACTIVE Ltd.
- Main business: Development of consumer games
- Capital: £859.82
- Transferors of shares:
Oliver Collyer, 37,500 shares; Evertonia Trust, 37,500 shares; and 10,982 shares from 16 other shareholders
- Total number of shares acquired (price):
85,982 shares (£28.5 million)
- Equity after acquisition: 100%

(b) SECRET LEVEL Inc.

- Trade name: SECRET LEVEL, Inc.
- Main business: Development of consumer games and game engines
- Capital: U.S.\$1,470
- Transferors of shares:
Jeremy Gordon, 360,000 shares; Otavio Good, 305,000 shares; and 805,000 shares from 10 other shareholders
- Total number of shares acquired (price):
1,470,000 shares (U.S.\$15 million)
- Equity after acquisition: 100%

Independent Auditors' Report

To the Shareholders and Board of Directors of
SEGA SAMMY HOLDINGS INC.

We have audited the accompanying consolidated balance sheets of SEGA SAMMY HOLDINGS INC. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SEGA SAMMY HOLDINGS INC. and subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

As discussed in Note 2 to the consolidated financial statements, effective April 1, 2005, SEGA SAMMY HOLDINGS INC. and consolidated domestic subsidiaries adopted the new accounting standards for impairment of fixed assets.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
June 20, 2006

THE SEGA SAMMY GROUP

(As of March 31, 2006)

SEGA SAMMY HOLDINGS INC.

Head Office:	Shiodome Sumitomo Building, 1-9-2 Higashi Shimbashi, Minato-ku, Tokyo 105-0021, Japan
Established:	October 1, 2004
Paid-in Capital:	¥29.9 billion
Number of Employees:	96 (non-consolidated) 6,416 (consolidated)

SUBSIDIARIES AND AFFILIATES

Company Name	Paid-in Capital	Voting Rights	Business Lines
Sammy Corporation	¥18,221 million	100.0%	Development, production, and sales of pachislot and pachinko machines
SEGA CORPORATION	¥60,000 million	100.0%	Development, production, and sales of amusement machines; operation of amusement centers; development and sales of game software
RODEO Co., Ltd.	¥100 million	65.0%*	Development, production, and sales of pachislot machines
Shuko Electronics Co., Ltd.	¥179 million	99.9%*	Development, production, and sales of peripheral equipment for pachislot and pachinko machines
Sammy Design Co., Ltd.	¥40 million	100.0%*	Planning, design, and construction of pachinko halls
SI ELECTRONICS, LTD.	¥244 million	88.1%*	Development and sales of system-on-chips for LCD displays
H-I System Corporation	¥10 million	100.0%*	Development, production, and sales of peripheral equipment for pachislot and pachinko machines
GINZA Co., Ltd.	¥10 million	49.0%*	Development, production, and sales of pachislot and pachinko machines
SEGA LOGISTICS SERVICE LTD.	¥200 million	100.0%*	Operations for maintenance services, transportation, and storage
SEGA Amusements U.S.A., Inc.	\$4 million	100.0%*	Importing, production, and sales of amusement machines
SEGA Amusements Europe Ltd.	£22 million	100.0%*	Importing, production, and sales of amusement machines
Sammy NetWorks Co., Ltd.	¥2,286 million	56.3%	Planning and production of music-related content offered through mobile phones and the Internet
SEGA TOYS, LTD.	¥1,713 million	52.6%	Planning, development, and sales of toys
TMS ENTERTAINMENT, LTD.	¥8,816 million	53.1%*	Planning, production and sales of animated movies
SEGA of America, Inc.	\$42 million	100.0%*	Development of game software
SEGA Enterprises, Inc. (U.S.A.)	\$110 million	100.0%*	Management of subsidiaries and management of game software development
SEGA Europe Ltd.	£321 million	100.0%*	Sales of game software
NISSHO INTER LIFE CO., LTD.	¥5,018 million	51.4%	Planning, design, management, and construction of displays and commercial facilities
SEGA SAMMY ASSET MANAGEMENT INC.	¥100 million	100.0%	Prior surveying and consultation for real estate and loans
SEGA MUSIC NETWORKS CO., LTD.	¥400 million	100.0%*	Sales of karaoke machines

* Percentage of voting rights held includes rights of indirectly owned shares.

CAUTIONARY STATEMENT WITH RESPECT TO FORWARD-LOOKING STATEMENTS

Statements in this annual report regarding the plans, estimates, beliefs, management strategies, perceptions, and other aspects of SEGA SAMMY HOLDINGS INC. ("the Company") and its SEGA SAMMY Group Companies ("the Group"), including SEGA CORPORATION and Sammy Corporation, are forward-looking statements based on the information currently available to the Company. Forward-looking statements include, but are not limited to, those statements using words such as "believe," "expect," "plans," "strategy," "prospects," "forecast," "estimate," "project," "anticipate," "aim," "may," and "might," and words of similar meaning in connection with a discussion of future operations, financial performance, events or conditions. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. These statements are based on management's assumptions and beliefs in light of the information currently available to management.

The Company cautions you that a number of important risks and uncertainties could cause actual results to differ materially from those discussed in the forward-looking statements, and therefore you should not place undue reliance on them. You also should not assume that the Company has any obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. The Company disclaims any such obligation.

Actual results may vary significantly from the Company's forecasts due to various factors. Factors that could influence actual results include, but are not limited to, economic conditions, especially trends in consumer spending, as well as currency exchange rate fluctuations, changes in laws and government systems, pressure from competitors' pricing and product strategies, declines in the marketability of the Group's existing and new products, disruptions to production, violations of the Group's intellectual property rights, rapid advances in technology, and unfavorable verdicts in major litigation.

[This annual report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.]

i'll be back!!!



Have your wishes come true.



© Sammy

“What wouldst thou with me? I am the Slave of the Ring, and will obey thee in all things.”

The innovation of the new pachislot game.

Innovation always comes from Sammy. The ideas we've come up with ever since the company was founded are now entering a new stage. Armed with fresh ideas and development capacity, the energy possessed by each and every one of us is going to serve as the engine that powers our dreams and enables us to undertake new challenges.

ALADDIN