



SEGA Enterprises, Ltd.

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## **Semiannual Report 2000**

Six months ended September 30, 1999



## **MANAGEMENT'S REVIEW OF OPERATIONS**

*SEGA Enterprises, Ltd.*

### **FIRST-HALF RESULTS**

During the first half of fiscal 2000, ended September 30, 1999, the state of the Japanese economy continued to waver as the stock market decline showed some signs of abating. However, personal spending remained slack, reflecting bleak outlooks for employment and wages as well as for the possibilities for economic stimulation. Although the amusement market was affected significantly by such drastic changes in consumer trends as the enormous boom in the market for mobile telephones, especially among younger consumers, and the increasing popularity of the Internet, mobile e-mail, and portable devices, overall prospects remained grim.

Amid this operating environment, despite SEGA's measures to promote low-cost, high-performance products incorporating the NAOMI system board, Company revenues in this market segment declined during the period under review due to the overall decline in consumption and dwindling investment by amusement center operators. In consumer product sales, although we aggressively promoted Dreamcast with new competitive pricing and powerful software titles, results fell short of initial targets. However, in overseas markets, the September 9, 1999, North American launch of Dreamcast, along with 18 software titles, met with unexpected favor. Results from the launch drastically exceeded initial forecasts. In amusement center operations, revenues declined due to the closing of less-lucrative, small-scale locations—in line with our efficiency-oriented management policies—and a radically changing consumer market, especially among younger consumers.

In response to these conditions, the Company enacted measures to curtail operational expenditure and capital investment, including the reduction of its workforce through an early retirement plan. As a result, a special loss of ¥2.0 billion was recorded.

Also, Dreamcast's networking capabilities, with an internal modem as a standard feature, have become a significant selling

point. As of the end of the period under review, the number of networked users in Japan reached approximately 400,000, representing a huge opportunity for future business expansion. Expanding our network business will require the acquisition of funds to invest in alliances with influential partners, secure medium-term business stability, and cover general business expansion costs. To meet these needs, our network business group was made a separate company through transferring its business to ISAO Corporation (formerly known as IIC Co., Ltd.)—a SEGA affiliate and member of the CSK Group—on September 30, 1999, resulting in the recording of a special income of ¥4.7 billion in gain on sales of discontinued business.

As a result, non-consolidated net sales for the period under review increased 25.2% from the corresponding period of the previous fiscal year, to ¥126.4 billion; income before income taxes plunged, resulting in a loss of ¥19.1 billion; and net income plummeted, resulting in a net loss of ¥19.1 billion.

### **AMUSEMENT MACHINE SALES**

Concentrating its efforts on developing new products using the NAOMI system board, SEGA introduced Ferrari F355 Challenge, the first authentic Ferrari sports car driving simulator. Also, in the new genre of profession games, we expanded sales of Airline Pilots as well as Crazy Taxi and, further, brought to market our new Brave Fire Fighters game, striving to stimulate this lackluster market. Moreover, we breathed new life into the market with the top-notch soccer game Virtua Striker 2 Version 2000 and the overseas model Virtua Striker 2 Version 99. However, due to the decline in the number of amusement facilities and shrinking amusement center operator investments, income for the period under review decreased.

In overseas markets, the Company strove for sales of products suited to each geographical location, but income for the period under review declined due to market stagnation in Europe and North America as well as the economic downturn in Asia.

As a result, net sales for the period under review declined ¥13.0 billion, or 44.6%, to ¥16.2 billion (of this, exports shrank ¥5.2 billion, or 45.2%, to ¥6.7 billion).

### **CONSUMER PRODUCT SALES**

In the Japanese market, SEGA strove for aggressive sales expansion of Dreamcast with new competitive pricing. We successively introduced 42 exciting software titles, including our Let's Make a Pro Baseball Team and Let's Make a J-League Pro Soccer Club as well as Seaman: The Forbidden Pet, from Vivarium Inc., and Soul Calibur, from Namco Ltd.

Overseas, we officially launched sales of Dreamcast in North America on September 9, 1999, with a powerful lineup of 18 software titles, including our own Sonic Adventure, SEGA Sports NFL 2000, The House of the Dead 2, Cart Flag to Flag, and other third-party titles. Approximately 600,000 Dreamcast units were sold by September 30, setting a new record.

As a result, net sales for the period under review increased ¥44.8 billion, or 183.4%, to ¥69.2 billion (of this, exports increased ¥38.7 billion, or 1,092.7%, to ¥42.2 billion).

### **AMUSEMENT CENTER OPERATIONS**

The overall slump in personal spending and the changes in trends among younger consumers wrought by mobile phones and other networking and communications media resulted in immense market

upheaval and continued severe operating conditions. Amid this environment, SEGA strove for operational efficiency and worked hard to meet particular market needs with focused sales efforts. Also, to improve operational efficiency, the Company closed approximately 150 operations, mostly smaller, less-lucrative ones. Regarding newly opened centers, we concentrated on locations with high-profitability potential, opening a modest figure of nine new franchises, including Shibuya GIGO, SEGA Arena Toyohashi, Club SEGA Tachikawa, and SEGA World Kasai. As a result, net sales for the period under review decreased ¥7.2 billion, or 14.5%, to ¥39.4 billion.

## **OUTLOOK**

Although Japan's economy is showing some signs of recovery, with the persistent slump in personal spending and deteriorating employment conditions, we expect the market to remain severe for the foreseeable future. In amusement machine sales and amusement center operations, as the market leader, SEGA will continue to develop new amusement facilities; in consumer products, it will strive to expand sales of Dreamcast in both the Japanese and overseas markets. The favorable reception of Dreamcast in the North American market since its introduction in September 1999 remains strong, and results in the European market, in which Dreamcast was launched in October 1999, continue to exceed initial expectations.

### ***Amusement Machine Operations***

We will intensify our development of true-to-life products that can only be experienced in amusement facilities equipped with NAOMI system boards and products that will serve as client-to-client communication tools. Also, in our efforts to stimulate the market for amusement centers, we will promote sales of our Derby Owners Club, which simulates racehorse breeding.

### ***Consumer Product Sales***

We will make determined efforts to further expand sales and supplies of Dreamcast and compatible software titles in both the Japanese and overseas markets. In light of its favorable reception in North America and Europe, we expect results to greatly exceed initial targets in these markets.

### ***Amusement Center Operations***

In addition to closing less-lucrative, small-scale operations—as was performed in the first half of fiscal 2000—we will continue to strive to meet the needs of each particular market. Furthermore, we will continue to deliver hitherto such unimagined recreational media as Derby Club Owners.

Although we will firmly implement these strategic measures, due to the temporary effects of such advance investments as the development and marketing expenses incurred from the launch of Dreamcast in Europe and North America, we expect year-end non-consolidated net sales for fiscal 2000 of ¥290 billion, a loss before income taxes of ¥10.2 billion, and a net loss of ¥10.9 billion.

January 2000



Shoichiro Irimajiri  
Representative Director and President

## SEMIANNUAL NON-CONSOLIDATED FINANCIAL STATEMENTS

<b>SEMIANNUAL NON-CONSOLIDATED STATEMENTS OF OPERATIONS</b>		Millions of yen		Thousands of U.S. dollars (Note 1)
SEGA Enterprises, Ltd. For the six months ended September 30, 1998 and 1999		1998	1999	1999
<b>Net Sales</b>	¥100,932	<b>¥126,384</b>	<b>\$1,181,714</b>	
<b>Cost of Sales</b>	77,339	<b>118,095</b>	<b>1,104,208</b>	
Gross profit	23,593	<b>8,289</b>	<b>77,506</b>	
<b>Selling, General and Administrative Expenses</b>	18,250	<b>25,969</b>	<b>242,816</b>	
Operating (loss) income	5,343	<b>(17,680)</b>	<b>(165,310)</b>	
<b>Other (Expenses) Income:</b>				
Interest and dividend income	813	<b>627</b>	<b>5,865</b>	
Interest expense	(274)	<b>(864)</b>	<b>(8,083)</b>	
Loss on write-down or disposal of inventories	—	<b>(1,286)</b>	<b>(12,030)</b>	
Loss on disposal of property and equipment	(728)	<b>(379)</b>	<b>(3,541)</b>	
Loss on write-down of investment securities	(3,266)	—	—	
Loss on write-down of investments in subsidiaries and affiliates	(437)	<b>(1,209)</b>	<b>(11,306)</b>	
Gain on sales of investment securities	—	<b>922</b>	<b>8,617</b>	
Gain on sales of discontinued business	—	<b>4,700</b>	<b>43,948</b>	
Reversal of provision for doubtful accounts	241	—	—	
Loss on settlement of litigation	(1,398)	—	—	
Foreign exchange (losses) gains, net	268	<b>(1,678)</b>	<b>(15,687)</b>	
Loss on reserve for guaranteed obligation	—	<b>(462)</b>	<b>(4,318)</b>	
Amortization of discounts on bonds	(343)	—	—	
Amortization of bond and note issue expenses	—	<b>(367)</b>	<b>(3,430)</b>	
Special employee termination costs	—	<b>(2,016)</b>	<b>(18,850)</b>	
Other, net	1,158	<b>616</b>	<b>5,757</b>	
	(3,966)	<b>(1,396)</b>	<b>(13,058)</b>	
(Loss) income before income taxes	1,377	<b>(19,076)</b>	<b>(178,368)</b>	
<b>Income Taxes</b>	164	<b>43</b>	<b>398</b>	
<b>Net (loss) income</b>	¥ 1,213	<b>¥(19,119)</b>	<b>\$ (178,766)</b>	

  

		Yen		U.S. dollars (Note 1)
	1998	1999	1999	
<b>Per Share:</b>				
Net income (loss)	¥12.06	<b>¥(182.92)</b>	<b>\$ (1.71)</b>	

The accompanying notes are an integral part of these statements.

**SEMIANNUAL NON-CONSOLIDATED BALANCE SHEETS**SEGA Enterprises, Ltd.  
September 30, 1998 and 1999

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1998	1999	1999
<b>Assets</b>			
Total current assets	¥150,594	<b>¥220,272</b>	<b>\$2,059,584</b>
Investments and advances	64,500	<b>74,781</b>	<b>699,212</b>
Property and equipment	77,954	<b>73,375</b>	<b>686,068</b>
Fixed leasehold deposits	24,517	<b>22,363</b>	<b>209,098</b>
Deferred charges and intangible assets	9,121	<b>14,660</b>	<b>137,075</b>
	¥326,686	<b>¥405,451</b>	<b>\$3,791,037</b>

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1998	1999	1999
<b>Liabilities and Shareholders' Equity</b>			
Total current liabilities	¥ 88,238	<b>¥192,922</b>	<b>\$1,803,853</b>
Total long-term liabilities	107,514	<b>126,709</b>	<b>1,184,747</b>
Shareholders' equity	130,934	<b>85,820</b>	<b>802,437</b>
	¥326,686	<b>¥405,451</b>	<b>\$3,791,037</b>

The accompanying notes are an integral part of these statements.

**NOTES TO THE SEMIANNUAL NON-CONSOLIDATED FINANCIAL STATEMENTS****1. UNITED STATES DOLLAR AMOUNTS**

The dollar amounts included in the semiannual non-consolidated financial statements represent the arithmetical results of translating yen to dollars on the basis of ¥106.95=US\$1, the approximate effective rate of exchange at September 30, 1999. The inclusion of such dollar amounts

is solely for convenience and is not intended to imply that yen amounts have been or could be converted, realized or settled in dollars at that or any other rate.

**2. ADDITIONAL INFORMATION**

The accompanying semiannual non-consolidated financial statements of the Company should be read in conjunction with the notes to the

non-consolidated financial statements in the annual report for the year ended March 31, 1999.

## NON-CONSOLIDATED FINANCIAL HIGHLIGHTS

SEGA Enterprises, Ltd. For the six months ended September 30, 1998 and 1999	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Net sales	¥100,932	<b>¥126,384</b>	<b>\$1,181,714</b>
Cost of sales	77,339	<b>118,095</b>	<b>1,104,208</b>
Gross profit	23,593	<b>8,289</b>	<b>77,506</b>
Operating (loss) income	5,343	<b>(17,680)</b>	<b>(165,310)</b>
Net (loss) income	1,213	<b>(19,119)</b>	<b>(178,766)</b>
Net (loss) income per share (yen and U.S. dollars)	¥12.06	<b>¥(182.92)</b>	<b>\$(1.71)</b>

Notes: 1. The figures herein are non-consolidated and unaudited.

2. All dollar figures refer to U.S. currency. Yen amounts have been translated into dollars, for convenience only, at ¥106.95=US\$1.

## CORPORATE DATA

SEGA ENTERPRISES, LTD.

### Head Office

2-12, Haneda 1-chome, Ohta-ku,  
Tokyo 144-8531, Japan  
Tel: (03) 5736-7111

URL: <http://www.sega.co.jp>

### Branch Offices

Sapporo, Kansai, Kyushu

### Date of Incorporation

June 3, 1960

### Paid-in Capital

¥45,449 million

### Number of Employees

3,232

### Net Sales

¥126.4 billion (for the six months  
ended September 30, 1999)

## PRINCIPAL SUBSIDIARIES

### **SEGA of America**

#### **Dreamcast, Inc.**

Townsend Center,  
650 Townsend Street,  
Suite 650, San Francisco,  
CA 94103-4908, U.S.A.  
Tel: 1-415-701-6000

### **SEGA Enterprises, Inc. (U.S.A.)**

Townsend Center,  
650 Townsend Street,  
Suite 575, San Francisco,  
CA 94103-4908, U.S.A.  
Tel: 1-415-701-6500

### **SEGA Europe Ltd.**

266-270 Gunnersbury Avenue,  
London W4 5QB, United Kingdom  
Tel: 44-181-995-3399

### **SEGA Operations UK Ltd.**

Unit 2, Industrial Estate,  
Leigh Close, New Malden,  
Surrey KT3 3NL, United Kingdom  
Tel: 44-181-336-2256

### **SEGA Amusements Europe Ltd.**

Unit 2, Industrial Estate,  
Leigh Close, New Malden,  
Surrey KT3 3NL, United Kingdom  
Tel: 44-181-336-1222

## AMERICAN

## DEPOSITARY RECEIPTS

### **Depositary**

Morgan Guaranty Trust  
Company of New York  
60 Wall Street, New York,  
NY 10260, U.S.A.