TAKING ON THE CHALLENGES

Annual Report 2007

SEGA SAMMY HOLDINGS

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.]

SEGA SAMMY HOLDINGS

ANNUAL REPORT 2007

SEGA SAMMY
HOLDINGS

if you know the enemy

and you know yourself

you need NOT fear

the result of 100 battles

Sun-Tzu

知彼知己
百戰不殆

孫子

TAKING ON THE CHALLENGES

SEGA SAMMY HOLDINGS

ANNUAL REPORT 2007

Consolidated Financial Highlights

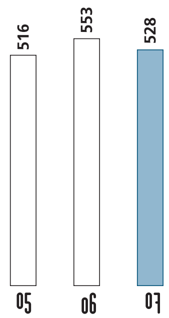
SEGA SAMMY HOLDINGS INC. AND ITS CONSOLIDATED SUBSIDIARIES
Years Ended March 31, 2007, 2006 and 2005

	Millions of yen unless stated otherwise				Thousands of U.S. dollars[1]
	2007	2006	2005	% change	2007
Net sales	¥528,238	¥553,241	¥515,668	–4.5%	$4,474,697
Pachislot and Pachinko Machine Business[2]	211,540	265,632	280,109	–20.4%	1,791,953
Amusement Machine Sales Business[2]	75,455	71,513	63,305	5.5%	639,178
Amusement Center Operations[2]	103,850	106,246	83,194	–2.3%	879,712
Consumer Business[2]	119,593	90,353	65,341	32.4%	1,013,071
Others[2]	17,800	19,497	23,719	–8.7%	150,783
Gross profit	203,079	229,012	211,559	–11.3%	1,720,280
Selling, general and administrative expenses	126,549	109,868	106,469	15.2%	1,071,995
Operating income (loss)	76,530	119,144	105,090	–35.8%	648,285
Pachislot and Pachinko Machine Business	71,102	99,848	103,931	–28.8%	602,304
Amusement Machine Sales Business	11,683	12,177	7,424	–4.1%	98,967
Amusement Center Operations	132	9,244	5,472	–98.6%	1,118
Consumer Business	1,749	1,977	(8,810)	–11.5%	14,816
Others	(1,345)	(1,713)	(541)	—	(11,393)
EBITDA[3]	104,578	140,999	122,764	–25.8%	885,879
Net income	43,456	66,222	50,574	–34.4%	368,115
Capital expenditures	59,272	37,650	32,468	57.4%	502,092
Depreciation and amortization	28,048	21,855	17,674	28.3%	237,594
Research and development expenses	52,107	36,338	41,590	43.4%	441,398
Net cash provided by operating activities	60,623	83,228	77,762	–27.2%	513,537
Net cash used in investing activities	(75,395)	(54,706)	(39,618)	—	(638,670)
Free cash flow[4]	(14,772)	28,522	38,144	—	(125,133)
Total assets	549,940	522,914	438,991	5.2%	4,658,535
Total net assets / shareholders' equity[5]	358,858	316,680	258,954	13.3%	3,039,882
Number of shares outstanding[6] (shares)	283,229,476	283,229,476	140,551,522		
Per share data		Yen			U.S. dollars[1]
Net income	¥ 172.47	¥ 261.06	¥ 205.27[7]	–33.9%	$ 1.46
Diluted net income	172.35	260.35	200.48[7]	–33.8%	1.46
Total net assets / shareholders' equity	1,341.80	1,254.14	1,033.96[7]	7.0%	11.37
Cash dividends	60.00	80.00	60.00[7]	–25.0%	0.51
Key ratios		%			
Gross profit margin	38.4	41.4	41.0		
SG&A ratio	24.0	19.9	20.6		
Operating margin	14.5	21.5	20.4		
ROE[8]	13.3	23.0	19.5		
ROA[8]	8.1	13.8	11.5		
Total net assets ratio	61.5	60.6	59.0		

1. Yen amounts have been translated into U.S. dollars solely for convenience at the rate of ¥118.05 = US$1, the approximate exchange rate at March 31, 2007.
2. Net sales to external customers
3. EBITDA = operating income + depreciation and amortization
4. Free cash flow = net cash provided by operating activities + net cash used in investing activities
5. Following the enactment of the new Japanese Corporate Law in 2006, the Company presents total net assets for the fiscal year ended March 31, 2007, which represents the shareholders' equity figure used in previous years plus minority interests and share subscription rights.
6. On November 18, 2005, the Company implemented a 2-for-1 stock split.
7. All net income per share data has been adjusted for the stock split implemented on November 18th, 2005. Cash dividend per share data has not been adjusted for the stock split implemented on November 18th, 2005.
8. 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.

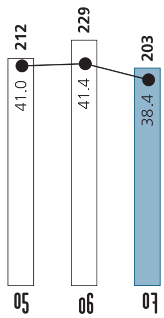
☐ **Net Sales**

Billions of yen



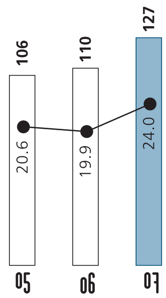
☐ **Gross Profit**
● **Gross Profit Margin**

Billions of yen / %



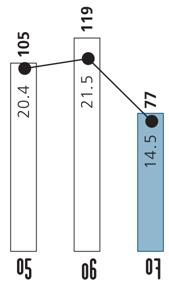
☐ **SG&A**
● **SG&A Ratio**

Billions of yen / %



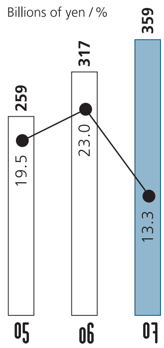
☐ **Operating Income**
● **Operating Margin**

Billions of yen / %



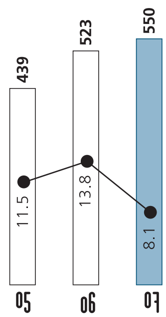
☐ **Total Net Assets/ Shareholders' Equity[1]**
● **ROE**

Billions of yen / %



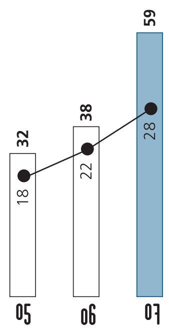
☐ **Total Assets**
● **ROA**

Billions of yen / %



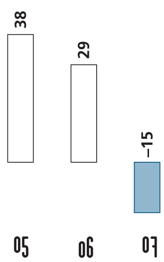
☐ **Capital Expenditures**
● **Depreciation and Amortization**

Billions of yen



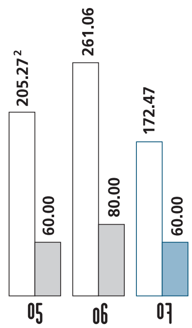
☐ **Free Cash Flow**

Billions of yen



☐ **Net Income per Share**
■ **Cash Dividends per Share**

Yen



1. Following the enactment of the new Japanese Corporate Law in 2006, the Company presents total net assets for the fiscal year ended March 31, 2007, which represents the shareholders' equity figure used in previous years plus minority interests and share subscription rights.
2. All net income per share data has been adjusted for the stock split implemented on November 18th, 2005. Cash dividend per share data has not been adjusted for the stock split implemented on November 18th, 2005.

contents

PART 1
The Market

PART 2
Ourselves

PART 3
Taking on the Challenges

Part 1

The Market

The more extensive a man's knowledge of what has been done, the greater will be his power of knowing what to do.

Benjamin Disraeli

Market Environment

PACHINKO AND PACHISLOT MACHINE MARKET

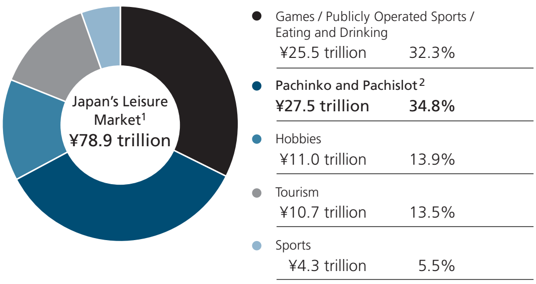
Pachinko and Pachislot Market Scale – Unshakable Position as Popular Entertainment

Pachinko's roots are said to lie in the import of bagatelles from overseas in the 1920s. Pachislot, meanwhile, originated with slot machines introduced from the United States following World War II. Having undergone a unique development process in Japan, these games have formed a huge market that today accounts for more than one-third of Japan's ¥80 trillion a year leisure market.

Trends in the Pachinko and Pachislot Market – Declining Number of Players

Although this giant market recorded a long stretch of unbroken expansion, the growth trend has changed. The number of pachinko and pachislot players peaked in about 1996 and has continued to decline. A key factor behind this downward trend is the loss of players from the mid-1990s due to such factors as increasing complexity in the entertainment aspects of machines and the hall environments. The trend toward higher average annual spending per person is an indication of the trend toward frequent players.

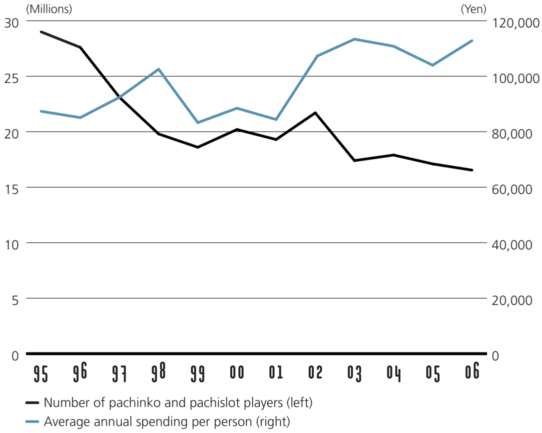
Share of Pachinko and Pachislot in Japan's Leisure Market



Source: *White Paper on Leisure Industry 2007*

1. 2006
2. Total ball and token sales in pachinko and pachislot halls in 2006

Number of Pachinko and Pachislot Players and Average Annual Spending per Person



Source: *White Paper on Leisure Industry 2007*

¥27.5 trillion

Scale of Pachinko and Pachislot Market*

* Total ball and token sales in pachinko and pachislot halls in 2006
Source: *White Paper on Leisure Industry 2007*

– Industry Faces Need to Attract Players

As a result, the scale of the pachinko and pachislot market* peaked when it reached about ¥31 trillion in 1995. To reverse this trend, the industry is working to bring back players and to attract new players.

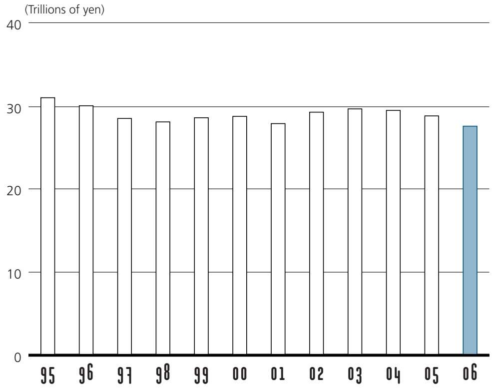
* Total ball and token sales in the pachinko and pachislot industry

– Shakeout Among Small and Medium-Sized Pachinko Halls and Shift Toward Larger Halls

Small and medium-sized pachinko halls, which have only limited resources for advertising and for capital investment in the new machines that are needed to attract players, are facing difficulties surviving in the market, and, hence, the number of pachinko halls continues to decline. Moreover, another important trend is that the larger population of pachislot players has led to growth in the number of halls with only pachislot machines since the late 1990s.

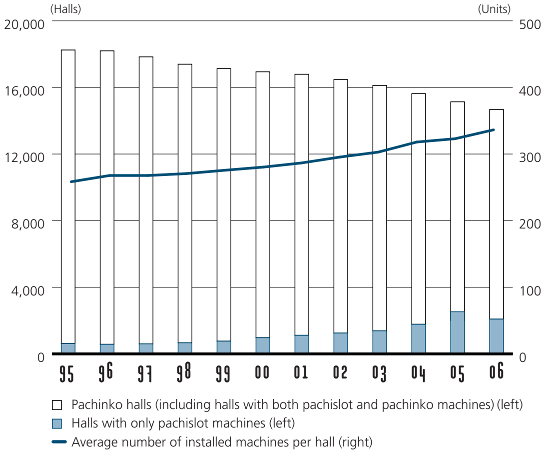
While the number of pachinko halls is declining, the total installment base of pachinko and pachislot machines has been stable, implying an increasing trend in the number of machines per hall. This shift toward larger halls is due in part to the opening of large halls by major chains, which have substantial capital resources.

Pachinko and Pachislot Market Scale



Source: *White Paper on Leisure Industry 2007*

Number of Pachinko and Pachislot Halls and Average Number of Installed Machines per Hall



Source: National Police Agency

Scale and Characteristics of the Pachinko and Pachislot Machine Market
– Market Dominated by Top Companies

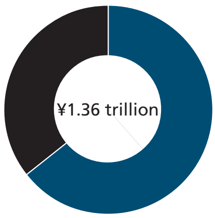
In addition to the ball and token revenues recorded by pachinko and pachislot halls, which total about ¥27.5 trillion, the revenues recorded by pachinko and pachislot machine manufacturers total about ¥1.36 trillion. As of the end of June 2007, there were 27[1] pachinko machine manufacturers and 26[2] pachislot machine manufacturers, with market share concentrated amongst the top companies in each sector. This aspect of the market is primarily attributable to increasingly fierce development competition. To differentiate their products, manufacturers are releasing increasingly advanced machines, and, as a result, the top companies that have advantages in development capabilities and capital resources are becoming stronger.

1. As of the end of June 2007, Nikkouso member companies
2. As of the end of June 2007, Nichidenkyo member companies

– Pachinko and Pachislot Machine Regulatory Environment and the July 2004 Revision of Regulations Pertaining to the Entertainment Establishments Control Law

Manufacturers undergo inspections of their respective new machines by the Security Electronics and Communications Technology Association and by the Public Safety Commission in each prefecture and must receive certification that such elements as materials and functions are in conformance with current regulations. (Please see the flow chart on the following page.) In the past, the approval and authorization regulations have been revised periodically, but companies with top shares have responded flexibly to changes in the market environment.

Pachinko and Pachislot Machine Market Scale*

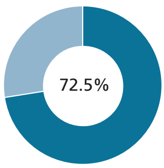


- Pachinko machine market scale* ¥875.0 billion
- Pachislot machine market scale* ¥485.4 billion

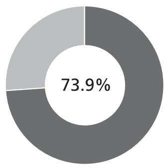
Source: Yano Research Institute Ltd.
* 2006

Market Share of Top Manufacturers*

Pachinko Machines



Pachislot Machines



Top Five Pachinko Machine Manufacturers	
SANYO BUSSAN	23.2%
KYORAKU SANGYO	21.0%
SANKYO	16.6%
Newgin	6.6%
DAIICHI SHOKAI	5.1%

Top Five Pachislot Machine Manufacturers	
Sammy	32.0%
DAITO GIKEN	12.2%
YAMASA	10.6%
OLYMPIA	9.6%
KITA DENSHI	9.5%

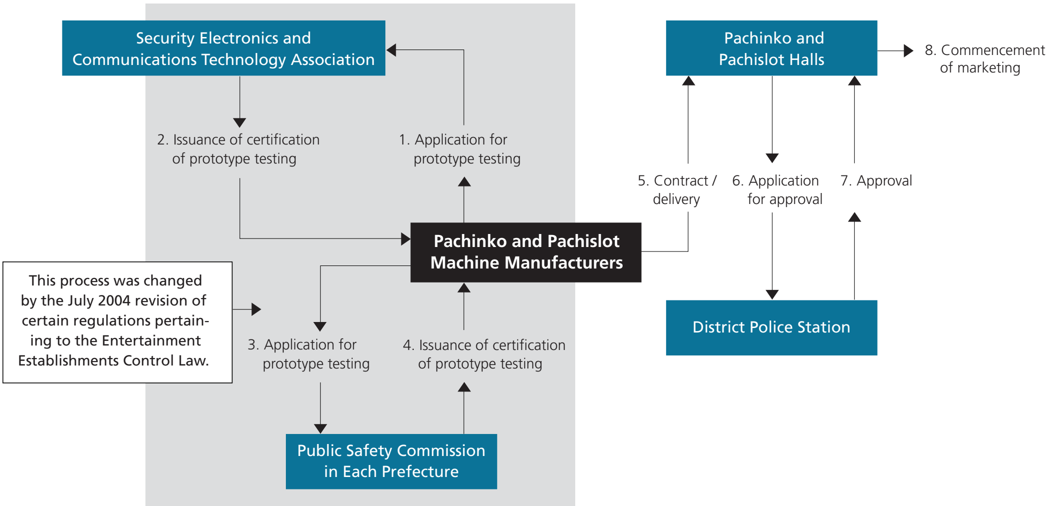
Source: Yano Research Institute Ltd.
*2006

¥1.36 trillion

Scale of Pachinko and Pachislot Machine Market*

* 2006 Source: Yano Research Institute Ltd.

Approval Process for Pachinko and Pachislot Machines



Objective of the Revision of Regulations Pertaining to the Entertainment Establishments Control Law

From the mid-1990s, machines with heavy emphasis on higher volatility accounted for a growing share of the pachinko hall industry business, and the player population became skewed toward frequent players. The objective of the July 2004 revision was the long-term growth of the industry through control of the volatility of the machines and provision of machines popular among a wider range of users.

• Pachinko Machines – Eliminating Machine Classification System and Enhancing Entertainment Value

The barriers separating the three classifications of machines under the previous system were eliminated, and the special features of each type of machine were allowed to be combined, making possible the creation of entirely new types of machines.

• Pachislot Machines – Shifting to a Focus on Entertainment Value

The point of the regulatory revision was to promote a shift of the emphasis in machine development from volatility to entertainment value, hence enabling the machines to cater towards a wider range of users.

Influence of the Regulatory Revision

Pachinko Machine Market – Reinvigorating the Market

Within a short period after the regulatory revision, many pachinko machines with diverse entertainment value were launched. In 2006, unit sales declined (A), but due in part to an increase in unit prices, the market scale continued to expand (B), and the annual turnover*, which indicates the capital investment trend of hall operators, also remained high (C).

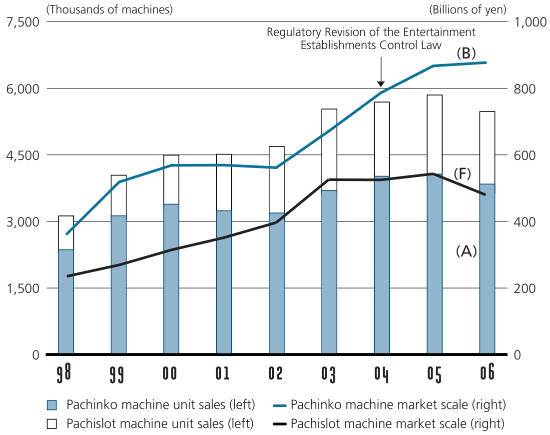
* Annual turnover = annual unit sales / number of installed units

Pachislot Machine Market – Developing Machines That Can Be Enjoyed by a Wide Range of Users Is an Issue for the Entire Industry

In contrast, it required more time for manufacturers of pachislot machines to develop innovative new-format machines, so in 2005 and 2006 the market continued to be dominated by old-format machines. Given the popularity of pachislot, the number of installed pachislot machines increased (D), but in addition to the delay in the adoption of innovative new-format machines, highly popular old-format machines have remained in use. As a result, the annual turnover declined (E), and the scale of the market decreased (F).

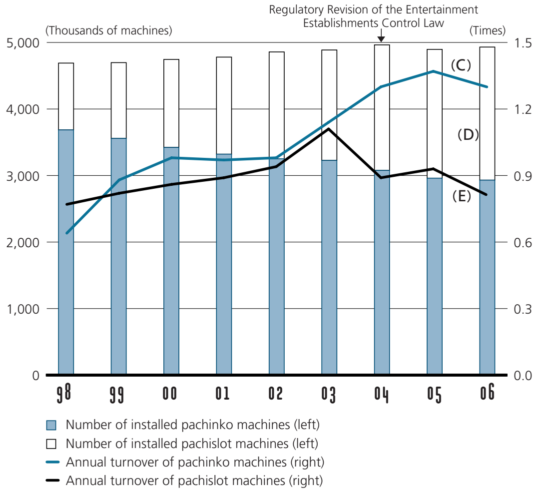
As stipulated by the regulatory revision, the deadline for the replacement of many old-format pachislot machines falls in the first half of the fiscal year ending March 31, 2008. As a result, there has been substantial replacement demand for new-format machines in the first half of the fiscal year ending March 2008. In the future, manufacturers face the challenge of developing machines with high entertainment value and that appeal to a broader range of players.

Unit Sales and Market Scale



Source: Yano Research Institute Ltd.

Number of Installed Machines and Annual Turnover



Source: Yano Research Institute Ltd.

¥199.2 billion

Scale of Amusement Machine Market*

* 2005 Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*

AMUSEMENT MACHINE AND AMUSEMENT CENTER OPERATIONS MARKETS

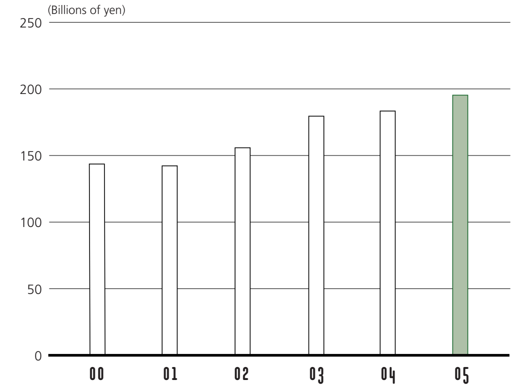
Amusement Machine Market
– Clear Recovery Trend

Against a background of growing popularity of home video games, the amusement machine market experienced a long-term declining trend, a bottom in 2001, and a subsequent recovery period which, through 2005, has continued for four consecutive years, reaching a scale of ¥199.2 billion. While the current period of growth coincides with the overall recovery in the domestic economy, there are a number of industry-specific drivers of growth, such as the emergence of a new family-oriented market through the location of amusement facilities in shopping centers and department stores and the increasing popularity of such large-scale games as medal games that are clearly different from home video games. In particular, network-enabled games, which allow multiple players to participate over networks, are rapidly gaining a strong presence in the market.

Amusement Center Operations Market
– Sluggish Sales at Existing Centers Demonstrate Harsh Competitive Environment

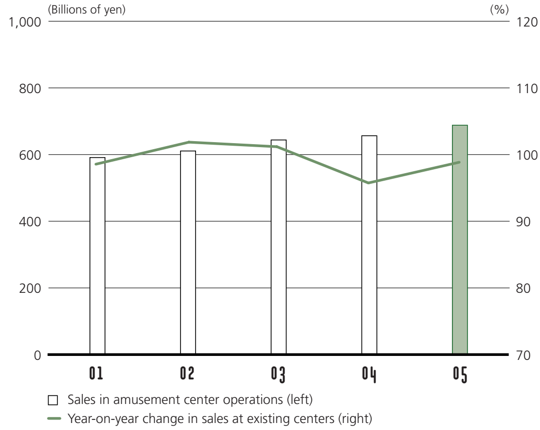
Net sales in amusement center operations turned upward in 2002 and marked the fourth consecutive year of growth in 2005. On the other hand, sales at existing centers declined in 2004 and 2005.

Net Sales of Amusement Machines



Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*

Sales from Amusement Center Operations



Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*

¥682.5 billion

Scale of Amusement Center Operations Market*

* 2005 Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*

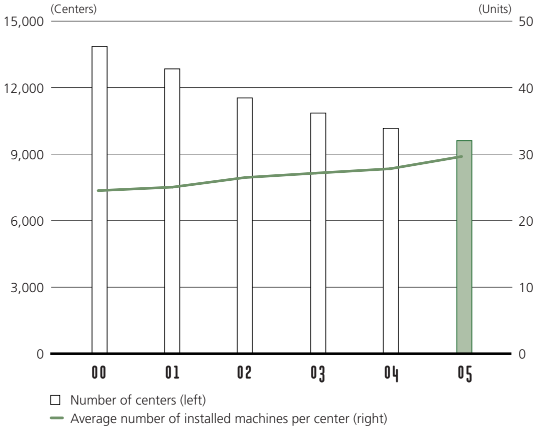
The graph on the right shows the number of centers and the average number of installed machines per center. While the number of centers has declined each year, the number of installed machines per center is increasing. It is clear that the trend is toward larger-scale centers as operators implement scrap-and-build initiatives.

Factors related to the expansion of the amusement machine market include trends toward larger, higher-value-added amusement machines against a background of larger amusement centers.

– Emergence of a New Market and Growth in Family-Oriented Games

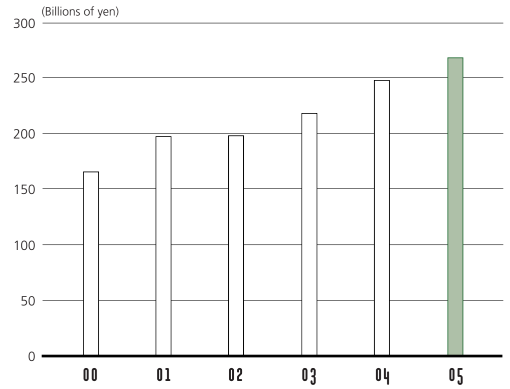
Two key trends have emerged in the amusement center operations market in recent years. The number of large shopping centers has increased as a result of the 2000 revision of the Large-Scale Retail Stores Location Law, and a new family-oriented amusement market has emerged in shopping centers and department stores. In line with this development, there has been a resurgence in family-oriented games, specifically medal and prize games, such as crane games. In recent years, kids card games have also driven growth in the amusement center operations market.

Ongoing Trend Towards Fewer Centers, but Average Scale Increasing



Source: JAMMA, AOU, and NSA, *Amusement Industry Survey*

Sales at Amusement Centers in Shopping Centers and Department Stores



Source: JAMMA, AOU, and NSA, *Amusement Industry Survey*

¥1.72 trillion

Scale of Home Video Game Software Markets in Japan, North America, and Europe*

* 2006 Source: *Famitsu Game White Paper 2007*

HOME VIDEO GAME SOFTWARE MARKETS

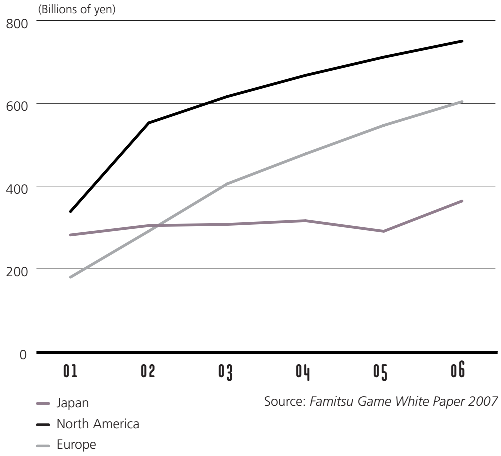
Market Scale
– Continued Rapid Growth in Overseas Markets

Until about 2001, Japan was the largest market for home video game software. Since 2001, however, the scale of the Japanese market has held steady at about ¥300.0 billion, while the North American, European, and other overseas markets have experienced rapid growth since about 2000. For home video game software makers, the ability to garner share in overseas markets has been the key to growth.

Rapid Adoption of Handheld Game Platforms
– Expansion in the Player Base

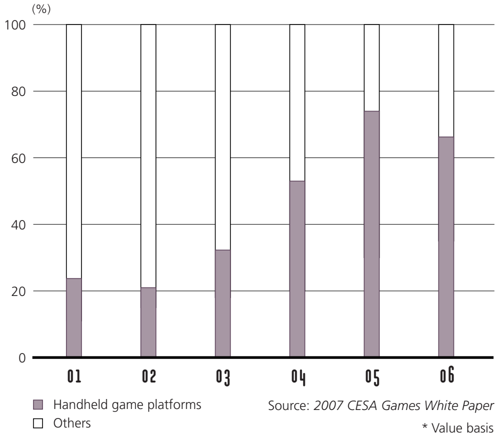
A number of factors have contributed to the sluggish growth in the domestic market, including a decline in the number of users due to the trend toward fewer children per family and the growth of games played on mobile phones or over the Internet. In addition, while the capabilities of platforms have recorded remarkable advances, the industry has lagged in its effort to capture a wider range of users. From 2004, however, handheld game platforms have succeeded in capturing a broad span of users that transcend the previous user boundaries, and these platforms have revitalized the market. Home video game software makers are also aggressively developing and marketing video game software for new users.

Major Home Video Game Software Markets



Source: *Famitsu Game White Paper 2007*

Composition of Handheld Game Platform Market*



Source: *2007 CESA Games White Paper*

* Value basis

Penetration of New Platforms

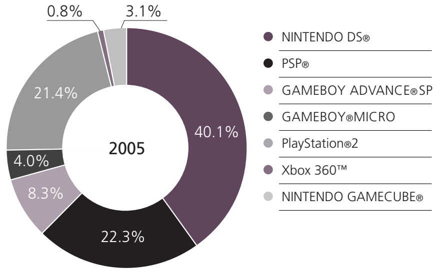
The new-generation platforms, which include the Xbox 360™, launched in winter 2005, and the PLAYSTATION®3 and the Wii®, both launched in winter 2006, have vastly enhanced functions and capabilities relative to their previous-generation counterparts.

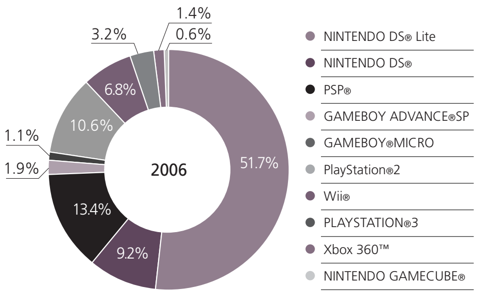
The markets for the previous generation of game platforms expanded in tandem with the lineups of software for those platforms, and the full-scale penetration of those platforms required about three to four years after the platforms were launched. Additionally, ramp ups in platform sales further stimulate software sales, so based on past experience, we are likely to see full-fledged expansion of the market for home video game software for new-generation platforms beginning in the fiscal year ending March 2008.

The cost of developing software for new-generation platforms, which have significantly enhanced functionality, is increasing in comparison with costs for previous-generation platforms, so initiatives to boost revenues and earnings, such as multiplatform development, use of well-known characters and video content, and alliances, have become increasingly important.

In the domestic market in 2006, sales of handheld game platforms remained strong, while the adoption of new consoles continued to register progress. Similar trends were seen in overseas markets. In Japan, North America, and Europe, the preferences of game players are different, so it is necessary to formulate development strategies while carefully tracking the status of platform adoption in each market.

Share of Home Video Game Platforms in Domestic Market





Source: *Famitsu Game White Paper 2007*

Part 2
Ourselves

Our knowledge is the amassed thought and experience of innumerable minds.

Ralph Waldo Emerson

Bird's Eye View of SEGA SAMMY

SEGA SAMMY in the Entertainment Industry

Net Sales[1]

Company	Millions of yen
Nintendo	966,534
SEGA SAMMY	**528,238**
NAMCO BANDAI	459,132
KONAMI	280,279
SANKYO	197,723
SQUARE ENIX	163,472
Heiwa	76,677
CAPCOM	74,542

Market Capitalization[2]

Company	Millions of yen
Nintendo	4,852,163
SEGA SAMMY	**778,881**
SANKYO	505,555
NAMCO BANDAI	479,206
KONAMI	452,200
SQUARE ENIX	337,281
Heiwa	168,522
CAPCOM	105,359

Operating Margin[1]

Company	%
SANKYO	27.8
Nintendo	23.4
SQUARE ENIX	15.9
SEGA SAMMY	**14.5**
CAPCOM	12.9
KONAMI	10.0
NAMCO BANDAI	9.2
Heiwa	4.5

ROE[1]

Company	%
Nintendo	16.8
CAPCOM	13.8
SEGA SAMMY	**13.3**
SANKYO	10.5
KONAMI	9.6
NAMCO BANDAI	9.4
SQUARE ENIX	9.3
Heiwa	1.8

SEGA SAMMY in the Pachinko and Pachislot Machine Industry

Share of Annual Pachislot Machine Sales[3]

Company	%
Sammy	**32.0**
DAITO GIKEN	12.2
YAMASA	10.6
OLYMPIA	9.6
KITA DENSHI	9.5

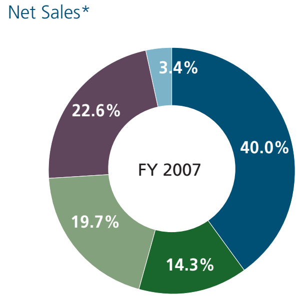
Share of Annual Pachinko Machine Sales[3]

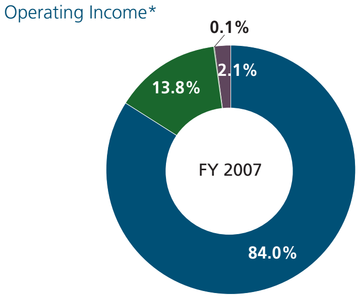
Company	%
SANYO BUSSAN	23.2
KYORAKU SANGYO	21.0
SANKYO	16.6
Newgin	6.6
DAIICHI SHOKAI	5.1
Sammy	**3.5**

Pachislot Machine Production Capacity per Month[3]

Company	Units
Sammy[4]	**200,000**
ARUZE	60,000
SNK PLAYMORE	60,000
OLYMPIA	50,000
YAMASA	40,000
DAITO GIKEN	30,000
ABILIT	25,000
KITA DENSHI	20,000

1. Fiscal year ended March 2007; figures for net sales, operating margin, and ROE are from materials released by each company.
2. As of March 31, 2007
3. 2006, source: Yano Research Institute, Ltd.
4. Total for Sammy, RODEO, and GINZA





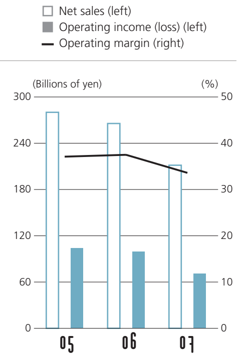
- Pachislot and Pachinko Machine Business
- Amusement Machine Sales Business
- Amusement Center Operations
- Consumer Business
- Others

* Composition of net sales is based on net sales to external customers. Composition of operating income was calculated without including the ¥1.3 billion operating loss recorded in others.

Pachislot and Pachinko Machine Business

Features and Strengths

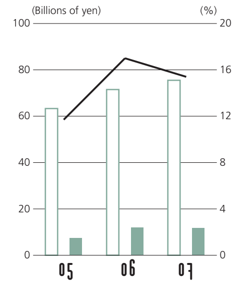
This segment, which comprises the pachinko machine business and the pachislot machine business, is a source of capital that the Group can invest in growth fields. In the pachislot machine business, we continue to maintain the top share of the market. Although the market environment changed substantially in the fiscal year ended March 2007 due to the regulatory revision, we maintained our top market share, at 32.0%. Our development and production capabilities are unrivaled, and in the future we will work to further bolster our pachinko machine business.



Amusement Machine Sales Business

Features and Strengths

This is one of the core businesses of SEGA, which is a major player in the industry. SEGA continues to lead the market with proposals of innovative entertainment and the cultivation of new groups of players. Sales of high-end products, such as network-enabled trading card games, have recorded dramatic growth in recent years, and SEGA has used its overwhelming technical advantages to drive forward in this segment of the market. One of SEGA's key strengths is the full lineup of products that resulted from the management integration, and now SEGA's lineup extends from high-value-added products to offerings for kids and families.

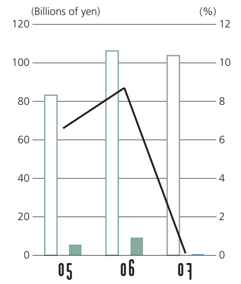


Amusement Center Operations

Features and Strengths

The SEGA SAMMY Group operates 449* amusement centers throughout Japan. By developing diverse types of centers, from urban-style locations to suburban-type facilities, we have attracted a wide range of customers. Together with the Amusement Machine Sales Business, we have enabled the installation and operation of a diverse range of machines. As a result, we can create locations that meet a wide range of market needs, one of our key strengths.

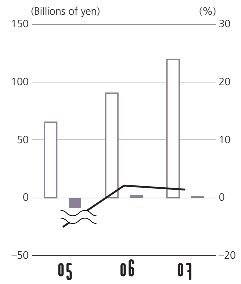
* As of the end of March 2007



Consumer Business

Features and Strengths

SEGA has implemented a multiplatform strategy of providing software for a wide range of platforms in home video game software operations. Following the management integration, we have decisively reformed and improved the efficiency of R&D. As a result, we moved into the black in just two years after the management integration. With overseas markets expected to record substantial growth, one of our major competitive advantages stems from our global R&D structure. In addition, we are also developing content for mobile phones, toys, and animations, principally through our listed subsidiaries.



Challenges to Overcome

We have identified the following challenges in each of our fields of operation, and we are implementing a range of initiatives to address them.

Pachislot and Pachinko Machine Business

1. Strengthen R&D process in pachinko machine business
2. Develop innovative new-format pachislot machines to expand player base
3. As the leader in the pachislot machine market, support industry transition to new-format machines

Amusement Machine Sales Business

1. Expand product lineup by strengthening R&D
2. Clarify strategies for overseas businesses

Amusement Center Operations

1. Improve profitability of amusement center operations
2. Maintain position in kids card game business

Consumer Business

1. Improve profitability in home video game software
2. Strengthen global R&D organization
3. Further nurture businesses of other Group companies

Part 3

TAKING ON THE CHALLENGES

Knowledge is power.

Sir Francis Bacon

With our operating environment undergoing dramatic change, we will address our operating and profit structures to achieve sustained growth for the SEGA SAMMY Group.

Hajime Satomi
Chairman of the Board and Chief Executive Officer

To Our Shareholders and Investors

In fiscal 2007, ended March 2007, the SEGA SAMMY Group recorded lower sales and profits for the first time since the management integration. While we take this particular point in time to pause and reflect, we are also a fluid and dynamic company that is constantly addressing market changes and internal operations and adapting as a market leader.

What does the SEGA SAMMY Group have to do to return to a course of growth?

The first step, of course, is to accurately grasp current conditions and future trends in our markets. Following that, we must objectively review our current position and thoroughly identify the challenges we face. We have every confidence, despite the volatility we are facing recently in some of our operating markets, that our core business segments are solid long term industries and that the measures we are implementing in response to such trends will lead us to further success going forward.

I will outline my specific thoughts and what must be done with respect to these challenges we face.

Results in the Year under Review

Coming to grips with an array of challenges

In fiscal 2007, we recorded lower sales and profits for the first time since the management integration in October 2004. Consolidated net sales were down 4.5%, to ¥528.2 billion, operating income declined 35.8%, to ¥76.5 billion, and net income decreased 34.4%, to ¥43.4 billion.

Our operating environment was marked by dramatic changes. Pachinko hall operators faced increasingly difficult business conditions, and the market for home video game software was affected by the launch of next-generation platforms. We implemented multiple initiatives in response to the challenges, but unfortunately, sales of pachinko machines declined year on year, and Amusement Center Operations recorded weak earnings at existing facilities and sluggish sales of cards for kids card games. We are not satisfied with these results, and we are implementing fundamental reforms to address the challenges that we face.

Challenges and Countermeasures in the Pachinko Machine Business

Product differentiation

In the market for pachinko and pachislot machines, a revision of the regulations pertaining to the Entertainment Establishments Control Law of Japan was implemented in July 2004. As a result of this revision, pachinko halls are obligated to remove all old-regulation machines by their respective deadlines, causing an increase in cap-ex burdens for the halls. In this environment, there has been an obvious trend where the halls are moving towards machines that provide them with the highest probability of recouping their investment, or essentially machines that come from top companies with strong brand power. We recorded solid sales results in pachislot machines, where the Group has the top market share, but in pachinko machines our sales were down substantially year on year. The reason for that decline was our inability to differentiate our offerings from those of the top companies and to launch machines that were well received by the market.

Reevaluating the development process

Given this situation, in the second half of fiscal 2007, we began to substantially reevaluate the pachinko machine development process. Specifically, we will not place undue emphasis on the number of approvals and, instead, we are focused on the development of products that will be certain to capture the interest of players. To achieve this, we are analyzing many factors, such as the game environment, character recognition, and specifications, as well as the evaluation of product quality. We have established multiple evaluation points in the development process. In this way, we have created a framework that enables us to incorporate a wide range of market opinions in our products. Only after products have cleared this development process, and we are convinced that we can meet market needs with a high degree of accuracy, do we apply for prototype testing. Typically, about a year is required to develop and launch a new product, so the machines developed under this new system will begin to be introduced into the market starting in the second half of fiscal 2008. In the future, strengthening our pachinko machine business will remain one of our top management priorities.

Challenges and Countermeasures in the Amusement Center Operations Segment

Increasing profitability and strengthening capabilities in Amusement Center Operations

In Amusement Center Operations, *MUSHIKING The King of Beetles*, a boys card game introduced by SEGA in January 2003, became an unprecedented hit, and subsequently *LOVE AND BERRY Dress up and Dance!*, a girls card game, also became a major hit. With this product lineup, SEGA successfully cultivated a new customer group comprised of children in kindergarten and the early years of elementary school and their families. Subsequently, SEGA continued to lead the kids card game market and recorded strong profitability in these products due to the high utilization rates of its machines. However, from early 2006, competition in the kids card game market intensified, and SEGA's market share declined. In fiscal 2007, the number of cards sold were down year on year. In the future, we hope to maintain share through effective media mix initiatives, including animations, game software for handheld game platforms, and toys, as well as through the introduction of new titles. In fiscal 2008, we have already launched *Marine-Marine Minami Hakofugu To Sangosho No Nakamatachi*, a kids card game based on a tropical fish theme, and *Issho-Ni-WanWan*, a next-generation kids ride that incorporates a card game with an on-board touch panel display.

In Amusement Center Operations, profitability at existing centers was down year on year from the second quarter of fiscal 2007 onward. Currently, we are analyzing the profitability and potential of our domestic amusement centers, which totaled 449 as of the end of March 2007, and, from a variety of perspectives, we are considering countermeasures to raise profitability based on the results of this analysis. We will resolutely implement reforms as we endeavor to build a robust structure that can steadily generate profits.

Outlook for the Pachinko and Pachislot Machine Market

Regulatory revision an opportunity to expand the scope of the market

In pachinko machines, the degree of development flexibility increased due to the July 2004 revision of regulations pertaining to the Entertainment Establishments Control Law. The development and supply of new-format machines with diverse and enhanced entertainment value has made steady progress, and the transition to new-format machines has been smooth. In pachislot machines, the volatility has been limited, and there is a stronger emphasis on the entertainment value that can be enjoyed by a wide range of players. Due to the substantial changes in specifications, it took time to develop and supply machines that were accepted in the market, but from the second half of 2006, highly anticipated machines gradually began to be introduced into the market, and the market overall has begun to move to new-format machines. Previously, the emphasis on volatility had caused some players to leave the market, but I believe that the regulatory revision presents us with the opportunity to bring those players back to the market and to create an environment in which new players can casually participate. Although some people fear that the change in regulations will lead to a decline in the number of players, I believe that it is a significant positive factor that will enable manufacturers to invigorate the industry through development efforts that will attract a wide range of players.

Outlook for the Pachinko and Pachislot Machine Market

As with previous regulatory revisions, the market environment will recover over the medium term

For pachinko and pachislot hall operators, players, and manufacturers, the regulatory revision marks a major change in the environment, and it is expected to require some time for these market participants to adjust. Nonetheless, in the past, the machine market recovered following previous rounds of regulatory revisions, and I am confident that, in this case too, it will ultimately return to a recovery track.

At this point, we need to reinvigorate the market by creating products with new game features that transcend previous boundaries, and to adjust to the preferences of existing players while simultaneously cultivating a broad range of new players. To achieve these goals, we will make wide-ranging use of the Group's innovative strength.

In addition to our efforts in product development, we will provide limited-time special discounts and rental plans, thereby establishing cooperative relationships with pachinko hall operators, who face a growing financial burden in the installation of new-format machines. In these ways, we will work to stabilize the market as rapidly as possible. I believe that this is one of our responsibilities as the leader in the pachislot machine market.

Assuming the Office of President, Representative Director, CEO, and COO of SEGA CORPORATION

Strengthening SEGA's operations as a pillar of earnings

In Sammy's high-margin Pachislot and Pachinko Machine Business, we will reinforce our profit foundation, with a special emphasis on bolstering the pachinko machine business. However, the pachinko and pachislot machine market is limited to Japan, and, for the SEGA SAMMY Group to record sustained growth in the years ahead, we must bolster the earnings power of SEGA's operations – Amusement Machine Sales Business, Amusement Center Operations, and Consumer Business. It is extremely important that we transform these operations into reliable sources of profits in addition to Sammy's Pachislot and Pachinko Machine Business. In accordance with this commitment, we have given priority to measures intended to reform SEGA's operational structure and to fundamentally enhance the profit structure, and, in June 2007, I became SEGA's president, representative director, CEO, and COO. In the future, our priority policies will include strengthening the profit structure in the Consumer Business, fundamentally reevaluating the operational structure in Amusement Center Operations, and clarifying our strategies for each overseas market targeted by the Amusement Machine Sales Business and Amusement Center Operations. Moreover, we will identify the fields in which we can draw on our core competencies in development and focus the allocation of management resources on those fields to increase the rate of sales growth and raise the operating margin and asset efficiency. As the leader of the SEGA SAMMY Group, I am committed to soundly improving SEGA's operations.

Objectives of Capital and Business Tie-ups

Quickly establish enhanced competitiveness in key fields

Viewing our business from a medium to long-term perspective, our fundamental approach is to, in selected areas management considers important but where internal resources are insufficient, quickly establish a strong operational foundation through business alliances and opportunistic M&A transactions with companies that already have established businesses or competitiveness.

In the home video game software market, the domestic market is stagnant but the North American and European markets continue to expand, and the importance of these markets for future development is increasing. In April 2006, we purchased 100% interests in Sports Interactive Ltd. and Secret Level, Inc., in order to fulfill our objectives of expanding our product lineup in these growth markets and acquiring advanced development technologies. In Europe, Sports Interactive has a strong track record with established brands, including the highly popular *Football Manager* series of games for PCs. In North America, meanwhile, Secret Level, Inc., boasts an array of advanced development technologies.

In March 2007, Sammy concluded a basic business and capital agreement with TAIYO ELEC Co., Ltd., which develops, produces, and sells pachinko machines, pachislot machines, and arrange ball machines. Through a third-party placement, Sammy acquired 5.6 million shares of TAIYO ELEC, or 33.4% of voting rights. Our objectives are to cultivate and strengthen our pachinko machine business, making it into a highly profitable business like the pachislot machine business and, at the same time, to reinforce our top share in the pachislot machine business and further strengthen our profit foundation.

In April 2007, we concluded a basic agreement on a comprehensive business alliance with Sanrio Company, Ltd. In entertainment-related fields, characters are an important factor in the ability to leverage synergies among operations. Sanrio has many strong characters developed in-house that are popular around the world, such as *Hello Kitty*, and the company has a wealth of experience in the global licensing business. We expect this tie-up to generate synergies through the combination of the wide-ranging entertainment that the SEGA SAMMY Group provides with Sanrio's characters, new character development capabilities, and live entertainment. These synergies will include improved recognition and popularity of characters and entertainment content and will foster further growth for both companies.

Providing Returns to Shareholders

Achieve appropriate balance between shareholder returns and investment for future growth

The SEGA SAMMY Group considers the return of profits to shareholders to be its top priority, and we will seek to continue to provide an appropriate return in light of our results. For the year under review, our cash dividends applicable to the year were ¥60.00 per share.

On the other hand, for the Group to record ongoing, stable growth, I believe that investment in growth areas and M&A activities and alliances in fields where the Group's in-house development capabilities are currently insufficient will be indispensable. In addition to providing a direct return to shareholders in the form of dividends, we strive to strike a balance based on a comprehensive consideration of investment for long-term growth and the retention of internal reserves needed to sustain future operational scale.

Business Plan for Fiscal 2008

Forecast profits down due to temporary factors

In fiscal 2008, ending March 2008, our plans call for consolidated net sales of ¥670.0 billion, ordinary income of ¥67.0 billion, and net income of ¥35.0 billion. In the Pachislot and Pachinko Machine Business, pachinko hall operators face substantial capital investment burdens due to the revision of regulations, and in response we will offer a range of support – including limited-time special discounts, which extend to October 2007, and rental plans during the replacement period. Furthermore, looking at the outlook for fiscal 2008, we expect that a significant portion of the year's pachislot machine production and shipments will be concentrated in a relatively short period of time, hampering our ability to benefit from cost reduction initiatives due to such factors as limited availability of parts for reuse. These types of temporary factors are the reason that we are forecasting lower profits. Through various initiatives, however, we will work to contribute to the recovery of the market as rapidly as possible and to achieve stable profit generation over the long term. In fiscal 2009, we will not be impacted by the temporary factors mentioned above, and we expect sales and profits to recover.

In fiscal 2008, ending March 2008, we expect substantial changes in our operating environment. We are approaching the current year as one of fundamental reform of our operational and profit structures, and we will rigorously implement the principles of selection and focus to boost Groupwide efficiency. From fiscal 2009, we look to achieve a recovery in sales and profits and begin to generate sustained growth for the Group.

I would like to ask our shareholders and investors for their continued support of the SEGA SAMMY Group.

July 2007

Hajime Satomi

Chairman of the Board and
Chief Executive Officer

BUSINESS SEGMENTS

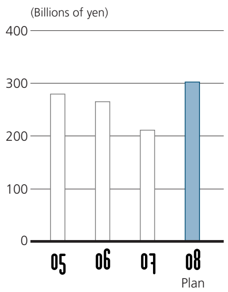
Business Segments

PACHISLOT AND PACHINKO MACHINE BUSINESS

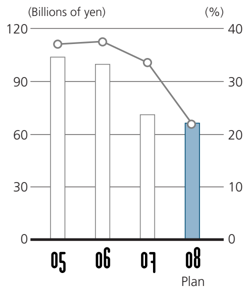
CR-Hokuto No Ken STV pachinko machine
©Burouson • Tetsuo Hara / NSP
A licensed identification of copyright SAA-306,
©Sammy

The Pachislot and Pachinko Machine Business is the foundation of the SEGA SAMMY Group's profit structure. With the environment changing rapidly, we will take steps to reinforce our position of leadership.

□ **Net Sales**



□ **Operating Income**
○ **Operating Margin**



✶ Operational Characteristics and Strengths

The Pachislot and Pachinko Machine Business contributed 40.0% of the Group's consolidated net sales in the fiscal year ended March 2007 and 84.0%[1] of the Group's operating income and is SEGA SAMMY's core segment. Moreover, with an operating margin of more than 30%[2], the segment provides a source of capital that the Group can invest in growth fields.

Sammy entered the pachislot machine market in 1982 and entered the pachinko machine market in 1995. We have contributed to the development of these markets by providing machines with innovative entertainment value. Sammy has maintained the top share of the pachislot machine market since 2001, and in 2006 we reinforced that position, garnering 32.0%[3] of the market. In the pachinko machine market, our market share in 2006 was 3.5%[3].

Our strengths are the development capabilities that enable us to offer innovative gameplay and graphics and industry-leading entertainment value; the industry's largest production facilities, which enable us to respond to concentrated periods of demand; and a system that enables us to employ a multibrand strategy based on three brands, Sammy, RODEO, and GINZA. We have been able to realize Group synergies in our development process by drawing on the Group's technical capabilities and appealing content.

1. Before corporate and elimination
2. Operating margin in the Pachislot and Pachinko Machine Business: fiscal year ended March 2006, 37.6%; fiscal year ended March 2007, 33.6%
3. Source: Yano Research Institute Ltd.

✶ Overview of the Year under Review

In the pachinko machine market as a whole, the sales volume[4] in 2006 was down 5.3% year on year, to 3.83 million units, but due to higher machine prices sales revenue[4] rose 0.8%, to ¥875.0 billion. In the pachislot machine market, the pace of replacement of old-format machines with new-format machines picked up in the second half of 2006, but full-scale replacement began in June and July 2007, as the replacement deadline for the most widely installed old-format machines was reached. As a result, the number of units sold marketwide[4] was down 9.2%, to 1.63 million units, and sales revenue[4] declined 9.7%, to ¥485.4 billion.

In this environment, we maintained our top market share in the pachislot market with sales of 520,000 units. That performance was led by *Hokuto No Ken SE*, an old-format Sammy-brand pachislot machine that recorded sales of 340,000 units. From the second half of the fiscal year under review, we formulated a sales strategy centered on new-format machines. Such products as *Spider-Man 2*, a new-format machine with innovative entertainment value, were well received by the market. In addition, we introduced rental plans to support pachinko hall operators as they make the transition to new-format machines.

On the other hand, we launched 15 new pachinko machines, with disappointing results. As a result, our sales of pachinko machines were limited to 130,000 units. We began to implement a substantial reevaluation of the development process in the pachinko machine business from the second half of the year under review.

Sales in the Pachislot and Pachinko Machine Business totaled ¥211,540 million, down 20.4% year on year. While the rental rate for pachislot machines was lower than expected, sales of pachinko machines were down substantially year on year. As a result, operating income declined 28.8%, to ¥71,102 million. The operating margin decreased 3.9 percentage points from a year earlier, to 33.6%.

4. Source: Yano Research Institute Ltd.

✶ Outlook for the Fiscal Year Ending March 2008

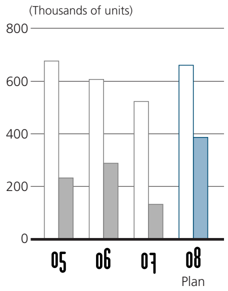
Our key challenges in the pachislot machine business include taking the initiative in reinvigorating the industry as the market leader. Our track record provides strong confirmation of the superiority of our planning and development capabilities, which we will use to provide products that meet the preferences of a wide range of customers. Moreover, we will offer limited-time special discounts and rental plans to support a smooth transition to new-format machines in pachinko halls.

In the pachinko machine business, Sammy will work to launch differentiated, quality focused products that will attract the attention of the marketplace as rapidly as possible. Since September 2006, we have substantially reevaluated our development strategy, and we are moving forward with development activities that accurately incorporate market preferences. The products that have been developed under this new system will be launched in stages from the second half of the fiscal year ending March 2008.

In the fiscal year ending March 2008, we are forecasting increased sales of pachinko machines and sales of ¥303.0 billion in the Pachislot and Pachinko Machine Business, or an increase of 43.3%. On the other hand, due to temporary factors, such as the influence of the limited-time discounts for new-format pachislot machines and limits on our ability to reuse parts due to the concentration of shipments in a short period of time, we are forecasting a decline of 6.8% in operating income, to ¥66.3 billion, resulting in a decrease of 11.8 percentage points in the operating margin, to 21.8%. In the fiscal year ending March 2009, however, the influence of these factors will have waned and we anticipate a recovery in profitability.

Unit Sales

□ Pachislot machines
■ Pachinko machines



Spider-Man 2 pachislot machine

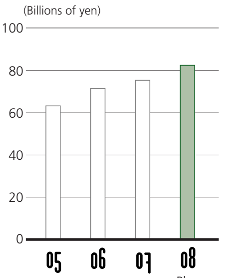
One of the largest pachinko and pachislot machine production bases – Kawagoe Factory

AMUSEMENT MACHINE SALES BUSINESS

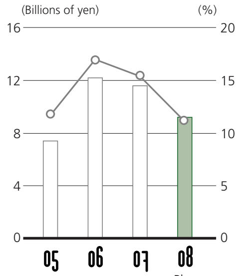
Using advanced, innovative product development capabilities and a diverse product portfolio, SEGA has built a solid position in the amusement machine market.

Sangokushi Taisen 2

□ **Net Sales**



□ **Operating Income**
○ **Operating Margin**



✶ Operational Characteristics and Strengths

The Amusement Machine Sales Business is one of SEGA's core businesses, and SEGA has been a leader in the industry since its establishment in 1960. SEGA has launched groundbreaking games, such as *Hang On*, the first game ever to incorporate force feedback control, and *Virtua Fighter*, a 3D computer graphics fighting game, and we have offered machines that meet latent market needs, such as *UFO Catcher* and *Print Club*. In this way, SEGA has introduced new types of entertainment and attracted new groups of customers, thereby contributing to the development of the industry. The advanced development capabilities that have been the backbone of this track record are demonstrated by SEGA's history of continually merging entertainment and leading-edge technologies, such as successive generations of multipurpose 3D computer graphics boards for arcade machines and the development of *ALL.Net*, the technological foundation for networks that link games and centers.

SEGA has been one of the leading manufacturers in the domestic market, with a dominant position in network-enabled trading card game machines and large-scale satellite game machines. These types of high-value-added products have been complemented with products for children and families, resulting in a full product lineup. The ability to provide internally developed products for a wide range of age groups is one of SEGA's key strengths.

✶ Overview of the Year under Review

Industry-wide sales of arcade amusement machines in Japan[1] increased for the fourth consecutive year, with sales in 2005 up 12.5%, to ¥188.6 billion, year-on-year. However, overseas sales[1] in 2005 declined for the ninth consecutive year, falling 17.5%, to ¥10.6 billion. In Japan, the top-selling products were network-enabled game machines and satellite game machines using card systems.

In this market environment, demand for existing products, such as prize machines, was slack, but favorable sales were recorded by *Sangokushi Taisen 2*, a network-enabled trading card game machine. Moreover, strong sales were registered by new products, such as *Ami-Gyo*, a new type of medal game targeting couples and families, and *Initial D ARCADE STAGE 4*, the newest version of a popular racing game.

As a result, sales in the Amusement Machine Sales Business were up 5.5%, to ¥75,455 million, while operating income was down 4.1%, to ¥11,683 million. The operating margin declined 1.6 percentage points year on year, to 15.4%.

1. Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*

Initial D ARCADE STAGE 4
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✶ Outlook for the Fiscal Year Ending March 2008

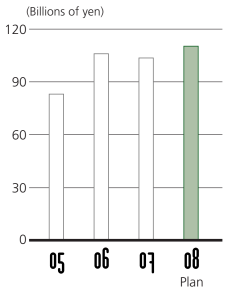
In Japan, we will work to increase revenues and profits by expanding our lineup of the large-scale, high-value-added products that are currently driving growth in the market. We will also work to stabilize revenues and profits by reducing the fluctuations arising from the dependence on hit products. We have already begun to collect and verify basic data as we prepare for the full-scale launch of *ALL.Net P-ras*, a new business model where we charge content usage fees based on the number of times a game is played.

Overseas, we will clarify the countermeasures that we need to implement, with an emphasis on the particular conditions in each major market.

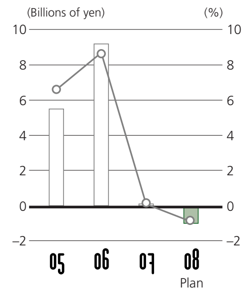
In the fiscal year ending March 2008, we are forecasting sales of ¥82.5 billion in the Amusement Machine Sales Business, an increase of 9.4%, and operating income of ¥9.2 billion, a decline of 20.7%. We expect the operating margin to decrease 4.3 percentage points, to 11.1%, and the overseas sales percentage to increase from 12.9% to 18.2%.

SEGA WORLD DREAM FACTORY

□ **Net Sales**



□ **Operating Income (Loss)**
○ **Operating Margin**



AMUSEMENT CENTER OPERATIONS

SEGA has always proposed new types of amusement centers and has continually taken on the challenge of creating and developing new markets, such as kids card games.

★ Operational Characteristics and Strengths

Amusement Center Operations have been a key source of the revenues that have supported SEGA's growth. SEGA has continually worked to give concrete form to innovative concepts by developing a variety of different facilities, such as *JOYPOLIS, SEGA WORLD*, and *CLUB SEGA*. One of SEGA's key strengths in this area is the ability to offer a full lineup of products – developed through cooperation with the Amusement Machine Sales Business – that can be enjoyed by a wide range of customers, regardless of age. Moreover, as shown by the success of its kids card games, SEGA is working to uncover underserved market needs and propose new types of entertainment, thereby fostering the development of new markets.

✶ Overview of the Year under Review

The scale of the domestic market served by Amusement Center Operations recorded a year-on-year increase of 5.1%[1] in 2005, to ¥682.5 billion, the fourth consecutive year of growth. On the other hand, sales at existing centers were down 1.3%[1], marking the second consecutive year of decline. The number of centers is decreasing, but the average number of machines per center is increasing in the wake of a trend toward larger centers.

In this environment, Amusement Center Operations recorded lower sales at existing centers from the second quarter of the year under review, and sales for the year were down 4.2% from a year earlier. The popularity of kids card games, such as *LOVE AND BERRY Dress up and Dance!* and *MUSHIKING The King of Beetles*, tapered off and competition intensified. As a result, the number of units installed at the end of the year was 29,400, an increase of only 2,400 machines from a year earlier, and the number of cards sold in the year under review was down 37.8%. Additionally, we continued to implement scrap-and-build initiatives. At the end of the year under review, the number of centers was down by 13 from a year earlier, to 449.

As a result, sales in Amusement Center Operations were down 2.3%, to ¥103,850 million, and operating income declined 98.6%, to ¥132 million.

1. Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*

✶ Outlook for the Fiscal Year Ending March 2008

The key challenges in this segment include improving the profitability of existing centers and maintaining our market share in kids card games. With existing centers, we will carefully examine the profitability of each location and use more rigorous standards in implementing the scrap-and-build policy. At the same time, to enhance customer satisfaction we will tailor the range of products and services to match customer preferences at each facility. In these ways, we will strive to improve profitability.

In kids card games, in addition to introducing new products, we will leverage synergies by utilizing the core competencies of other Group operations, such as animations, home video game software, and merchandise, to maintain our current market share.

In the fiscal year ending March 2008, we are forecasting sales of ¥110.5 billion in Amusement Center Operations, an increase of 6.4%, and an operating loss of ¥1.0 billion. Sales at existing centers are expected to rise 2.1%.

G-link Shibuya-Dogenzaka

TOKYO JOYPOLIS

Ryu Ga Gotoku 2

CONSUMER BUSINESS

In home video game software, we are implementing a strategy that takes into account the global market, from development to sales.

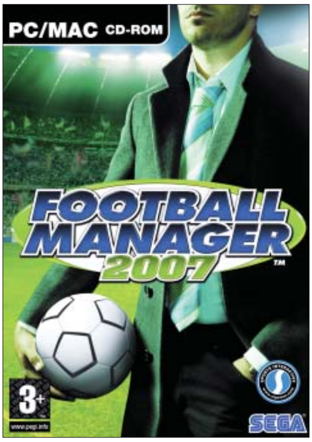
✶ Operational Characteristics and Strengths

Since withdrawing from the market for home video game hardware in 2001, SEGA has specialized in the provision of content and has implemented a multiplatform strategy of providing software for a wide range of platforms. Following the management integration, SEGA bolstered its development foundation through reorganization of its development system and M&A of overseas development studios and it has steadily increased sales of its titles offered in Japan and overseas.

Currently, the factors that determine success as a provider of home video game software are development expertise, which is needed to leverage the characteristics of new-generation platforms; financial strength to support development efforts; and the ability to develop operations in overseas markets.

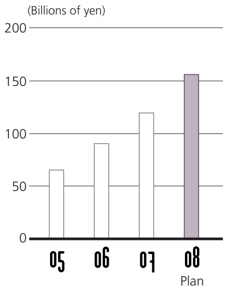
SEGA's track record demonstrates its superior development capabilities, which enable it to offer the highest-quality graphics. Moreover, SEGA has an advantage in the Group's financial strength. In addition, SEGA has a strong overseas development system. Such overseas development studios include Sports Interactive Ltd., the creator of the *Football Manager* series, which is extremely popular in Europe. These assets are a major strength because they enable SEGA to precisely meet needs that differ substantially in each market.

In the market for home video game software, due to such factors as the increasingly advanced features of game platforms, development costs are rising. In this setting, the Group's strengths include the ability to generate synergies through the shared use of promising content among segments, and the distribution of development risk through the sharing of development resources.

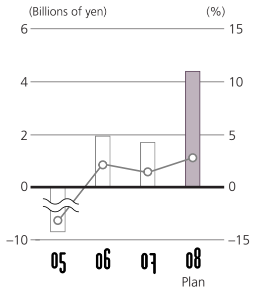


Football Manager 2007

□ **Net Sales**



□ **Operating Income (Loss)**
○ **Operating Margin**



✶ Overview of the Year under Review

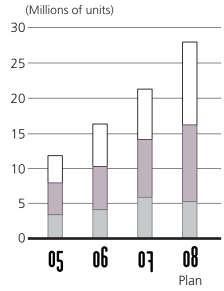
In 2006, total sales in the markets for home video game software in Japan, North America, and Europe rose 10.9%, to ¥1.72 trillion. Contributing to this increase were the gain in the number of players due to the spread of handheld game platforms and the introduction of new game platforms.

In the Consumer Business, sales in Japan were led by *LOVE AND BERRY Dress up and Dance! – DS Collection* for handheld game platforms and by *Ryu ga Gotoku 2* for the PlayStation®2. Sales were up by 1.66 million units, to 5.86 million units. In North America, higher sales were recorded by titles for new-generation platforms, such as *Sonic the Hedgehog*, and sales increased by 2.09 million units, to 8.23 million units. In Europe, increased sales were recorded by such titles as *Football Manager 2007* from Sports Interactive, which became a wholly owned subsidiary in April 2006. Sales rose by 1.12 million units, to 7.18 million units, and sales growth was well balanced by game platform. Overall, sales were up by 4.87 million units, to 21.27 million units.

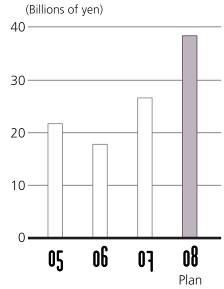
Toy sales were sluggish, but content for mobile phones and animation products recorded solid results.

As a result, sales in the Consumer Business were up 32.3%, to ¥119,593 million. In the year under review, we recorded an increase of ¥8.8 billion in R&D expenditures, to ¥26.6 billion, due to efforts to strengthen our global development system. As a result, operating income was down 11.5%, to ¥1,749 million.

Unit Sales



□ R&D Expenditures



✶ Outlook for the Fiscal Year Ending March 2008

In home video game software, we will further enhance our position in the industry by leveraging the market expansion led by overseas market growth and new-generation platform adoption. In overseas markets, we will continue to focus on strengthening our development system and will strive to provide software that accurately meets needs that differ by region. Moreover, we will increase R&D expenditures to strengthen our competitiveness. From the fiscal year ending March 2009, our investments will begin to bear fruit, and we will strive to increase volume and revenue growth while simultaneously improving profitability.

In the fiscal year ending March 2008, we anticipate sales of ¥156.0 billion in the Consumer Business, an increase of 30.5%, and a gain in operating income of 158.8%, to ¥4.4 billion. R&D expenditures will increase by ¥11.8 billion, to ¥38.4 billion.

LOVE AND BERRY
Dress up and Dance! – DS Collection

Corporate Governance

The SEGA SAMMY Group regards corporate governance as the key foundation for its corporate activities and it is working to maximize its corporate value by strengthening and enhancing this area.

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 the basis for 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 strive to maximize corporate value by establishing expeditious, appropriate decision-making processes and by increasing the efficiency of corporate management. We will work to return the benefits of these efforts to our shareholders and other stakeholders.

Securing a Sound Corporate Organization: To maximize corporate value in volatile business conditions, the Group will identify and manage the range of risks that it faces. At the same time, we will secure a sound corporate organization through the reinforcement of compliance systems focused on strict adherence to social norms as well as laws and regulations.

Enhancing Transparency: In light of the growing importance of disclosure by companies, the Group will increase management transparency by fulfilling its responsibility to explain corporate actions to shareholders and other stakeholders and by realizing enhanced disclosure through proactive investor relations (IR) activities.

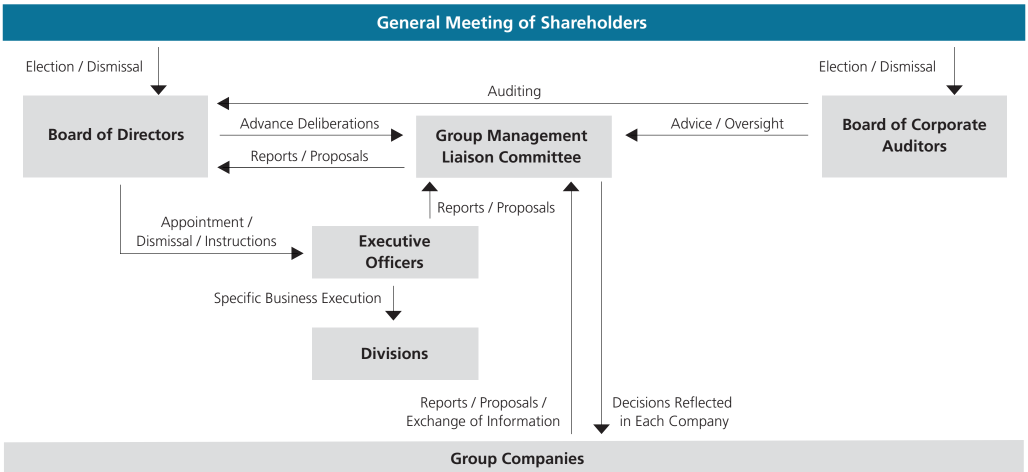
Corporate Governance Organization

The Group has adopted a corporate auditor system in consideration of its objective of enabling directors, who have abundant knowledge and experience of industry, market trends, products, merchandise, and services, to make quick and optimal management decisions in a rapidly changing management environment. At the same time, we have appointed outside directors and strengthened our executive officer and internal control systems, reinforcing our corporate governance organization from the aspects of business execution and organizational oversight.

Directors: Two of the Company's seven directors are outside directors. The outside directors work to enhance efficiency, secure a sound corporate organization, and enhance transparency in accordance with their specialized viewpoints and their combined domestic international legal experience concerning corporate management.

Corporate Auditors: Two of the Company's four corporate auditors are outside corporate auditors. The outside corporate auditors work to enhance efficiency, secure a sound corporate organization, and enhance transparency in the Company's management by conducting audits and providing frank guidance and advice based on their abundant experience and specialized knowledge. In addition, the Company has established the Office of Corporate Auditors, which reports directly to the Board of Corporate Auditors. The staff of the Office of Corporate Auditors assists the corporate auditors in their duties in accordance with guidance and instruction from the corporate auditors.

Corporate Governance System – Chart 1



Status of Measures Implemented by the Corporate Governance Body

Board of Directors: Comprising seven directors as of March 31, 2007, the Board of Directors convenes once a month and additionally as required and implements responsive management. Further, the Board of Directors and other bodies of the Company undertake decision making and reporting for certain significant management issues of Group companies.

Board of Corporate Auditors: The Board of Corporate Auditors, consisting of four corporate auditors as of March 31, 2007, meets once a month and additionally as required to conduct deliberations and thoroughly analyze specific issues.

Group Management Liaison Committee: Meeting once a month, the Group Management Liaison Committee comprises directors, corporate auditors, and corporate officers from the Company and directors from 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.

Group Audit Committee: Chaired by the Company's President and 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 Office of Corporate Auditors' audits of management divisions.

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

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, regulations and to build close working relationships among the standing corporate auditors.

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

CSR Management Committee: The CSR Management Committee decides CSR promotional policies and directions 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, corporate division heads and secretariat heads, and corporate auditors of the Company, SEGA, and Sammy, the committee meets once every three months and is chaired by the President and Representative Director of the Company. In addition, the CSR committees of the Company, SEGA, and Sammy meet periodically to pursue the specific measures decided by the CSR Management Committee and to oversee progress within each company.

Positioning and Roles of Individual Committees

The Group Management Liaison Committee acts as a detailed investigative arm in screening business proposals before they are submitted to the Board of Directors, which makes decisions. 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 Office of Corporate Auditors Liaison committees also contribute to collaboration among 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.

In addition, 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 Office of Corporate Auditors as its internal audit department to ensure appropriate operations are carried out in accordance with laws, regulations and the Articles of Incorporation. The Office of Corporate Auditors has nine employees and implements internal audits of all Group companies. In addition, the Company receives the advice of KPMG AZSA & Co., which has served as its independent auditors 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 Policies for Strengthening Internal Control Systems

In accordance with the Corporate Law, the Company has formulated and is working to implement the following basic policies for strengthening its internal control systems.

(1) System to ensure that directors perform their duties in conformance with laws, regulations, and the Articles of Incorporation

To ensure a thorough understanding that compliance is a prerequisite to all corporate activities, we have formulated the Group CSR Charter and Group Codes of Conduct, which are the foundation of our social responsibility policies for filling our role as a member of society, including the establishment of a compliance system. The President and Representative Director will repeatedly take steps to convey the spirit of these policies to all officers and employees. Furthermore, to ensure appropriate and sound execution of the Company's operations overall, the Board of Directors is striving to establish effective internal control systems and a system to ensure compliance by the Company with laws, regulations, and the Articles of Incorporation from the perspective of further strengthening corporate governance. In addition, the Board of Corporate Auditors is working to find and correct any problems at an early stage by auditing the effectiveness and functions of the internal control systems and verifying them periodically.

(2) System to store and control information on the performance of duties by directors

The President and Representative Director has appointed the Director in charge of the Administration Divisions as the person responsible for the storage and control of information on the performance of duties by directors. In accordance with internal rules, that information is recorded in documents or electronic media and stored and controlled in easily searchable formats that facilitate adequate, accurate inspection by the directors and corporate auditors.

(3) Rules and other systems concerning management of exposures to loss

With regard to risks related to the execution of business by the Company, each relevant division analyzes and identifies individual foreseeable risks and clarifies the risk management system. In addition, the internal audit department audits the status of risk management by each division and each department and periodically reports the results of audits to management decision-making, execution, and oversight bodies.

(4) Systems to ensure efficient performance of duties by directors

To ensure efficient performance of duties by directors, we employ a system of corporate auditors to enable internal officers familiar with the business of the Group to make decisions swiftly and properly. At the same time, in accordance with the regulations of the Board of Directors and other regulations, we have established a system to ensure appropriate and efficient performance of duties by directors through rules on authority and decision making.

(5) Systems to ensure that employees perform their duties in conformance with laws, regulations, and the Articles of Incorporation

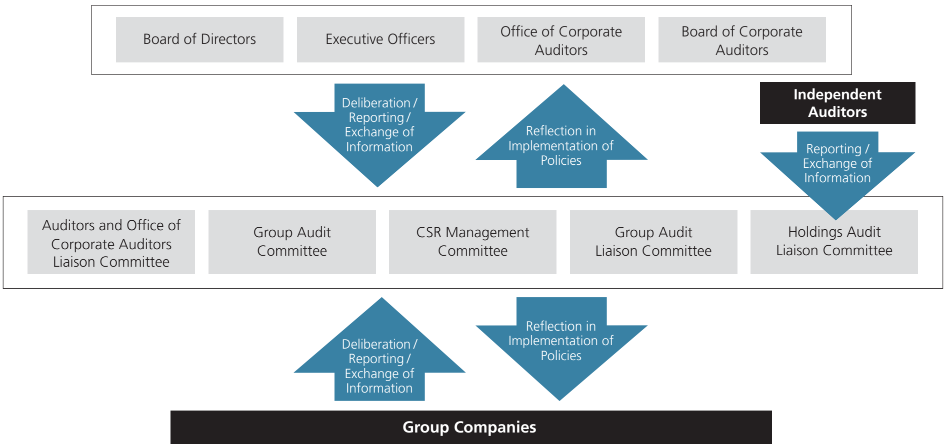
1) We have delegated supervisory functions concerning compliance to the CSR Supervisory Committee, which has general responsibility for the CSR activities of the Company and the Group. We have instituted the Group CSR Charter and Group Codes of Conduct as rules and behavioral standards to ensure that all officers and employees act in compliance with laws, regulations, the Articles of Incorporation, and other internal rules as well as social norms. We endeavor to foster a thorough understanding of and ensure strict compliance with the Group CSR Charter and Group Codes of Conduct.

2) We have established a system to enable employees to make reports if they become aware of any contravention of laws, regulations, the Articles of Incorporation, other internal rules, or social norms. In addition, we have established a system to ensure that responsible personnel report any important cases to the Board of Directors and the Board of Corporate Auditors without delay. Moreover, as a system to protect such whistleblowers and to ensure appropriate handling while maintaining transparency, we have established reporting channels that include not only regular reporting channels but also an internal department in charge of compliance and outside attorneys.

(6) Systems to ensure proper execution of business by the corporate group, including the company and its parent company and subsidiaries

We have established the Group Management Liaison Committee, the Group Audit Liaison Committee, and other committees to discuss various problems involving the Group and matters involving significant risks that should be controlled. At the same time, the Office of Corporate Auditors conducts audits from the perspectives of the Groupwide interest, and we are doing our utmost to share information within the Group and ensure appropriate business execution.

Corporate Governance System – Chart 2



(7) Matters concerning employees appointed by request of the corporate auditors to assist the corporate auditors in the performance of their duties

We have established the Office of Corporate Auditors under the direct control of the Board of Corporate Auditors. Employees assigned to the Office of Corporate Auditors assist the corporate auditors in the performance of their duties in compliance with their directions and orders.

(8) Matters concerning the independence from the directors of the employees described in item (7)

1) Employees assigned to assist the corporate auditors in the performance of their duties are supervised directly by the corporate auditors and are not subject to orders or supervision from the directors.

2) In regard to the employees described above, such matters as appointment, dismissal, transfer, evaluation, disciplinary disposition, and wage revision require prior consent from the Board of Corporate Auditors.

(9) Systems for ensuring directors and employees provide reports to corporate auditors and other systems for ensuring the provision of reports to corporate auditors

1) If directors or employees become aware of any material violation of laws, regulations, or the Articles of Incorporation, of any misconduct with regard to the performance of duties, or of any fact that may cause material damage to the Company, they must report the situation to the Board of Corporate Auditors without delay.

2) Directors and employees must report any decisions that could have a material effect on business or the organization and the results of any internal audits to the Board of Corporate Auditors without delay.

(10) Other systems to ensure effective audits by corporate auditors

1) The representative directors must meet with the corporate auditors periodically to exchange opinions on the administration of the Company, in addition to reports on operations, and must otherwise work to foster mutual communication.

2) The Board of Directors must ensure that corporate auditors attend business execution meetings as needed to ensure appropriate operations.

3) Whenever necessary, the Board of Corporate Auditors must be given opportunities to receive advice on their duties by independently engaging attorneys, certified public accountants, and other third-party advisors.

Stance on Hostile Takeovers

The Company believes that endeavoring to enhance 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 and, consequently, will be the best takeover defense policy.

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 ensure fairness in providing information is to distribute over the Internet the content of interim and fiscal year end financial results meetings, which are held for securities analysts and institutional investors. 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 website specifically designed for individual investors that offers a wide range of useful information.

The SEGA SAMMY Group intends to strengthen two-way communication with its shareholders and investors through these activities to further heighten the transparency of its corporate governance system.

Other Initiatives in Regard to Further Enhancement of Corporate Governance

Representative examples of items to be considered, policies under consideration, and objectives in regard to the future enhancement of corporate governance by the Company and the Group include the implementation of a group internal control system project targeting the establishment of a framework for evaluating and reporting on internal control systems. This framework will be implemented in response to the system for evaluation and auditing standards for internal control for financial reports as stipulated by the Financial Instruments and Exchange Law, which is commonly known as "J-SOX" Rules.

Previously, each company in the Group established its own internal control system. From the fiscal year ended March 2006, Sammy, one of the core companies of the Group, began to design an internal control system based on the so-called COSO framework. Subsequently, the Financial Services Agency framework was released, and Sammy established an internal control system in response to that framework. Currently, the development of that system has progressed to the stage of effectiveness verification.

On the other hand, the Company established the Internal Control Promotion Office in February 2007. As the nucleus of the internal control projects that were under way within the Group, the system developed by the forerunner Sammy will be utilized by other Group companies. In this way, while maintaining each company's independence, as a corporate group, we are working to establish a framework for evaluation and reporting on internal control systems in response to "J-SOX" Rules. We are confident that in the fiscal year ending March 2009, we will be prepared to present the "internal control system report" and the "internal control audit report" required by "J-SOX" Rules.

Corporate Social Responsibility

We have established the following CSR Charter as we regard the fulfillment of corporate social responsibility (CSR) as one of our most important management objectives. As a responsible corporate citizen, we will comply with all relevant laws, regulations and social norms and further deepen the relationship with our stakeholders. Through these efforts, we believe we can provide sound management of our group and fulfill our responsibilities to society. This CSR Charter provides guidelines for our business operations.

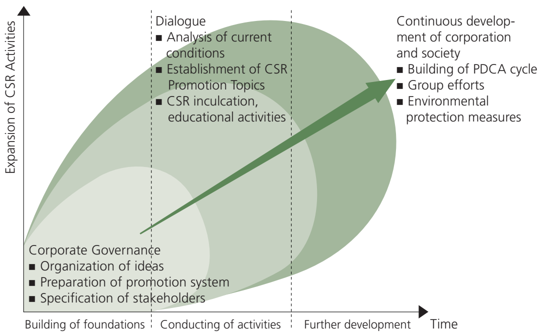
Overview of the SEGA SAMMY Group's Approach to CSR

The SEGA SAMMY GROUP aims "to provide people throughout the world with entertainment brimming with dreams and excitement." In the 21st century, companies consider as important not only the growth of their business but also economic, environmental and social issues such as environmental protection, compliance with the law, active disclosure, the transparency of management, etc.

Overview of Development of CSR System

1. Sound management
2. Further deepen the relationship with our stakeholders
3. The continuous development of the corporation and society

Having clarified the goals to be achieved and the milestones to be reached along the way, we planned, based on that basic thinking, three phases for the creation of an effective CSR system for the entire Group – building of foundations, conducting of activities, and Further development – adjusting the plan as necessary to accommodate each Group company.

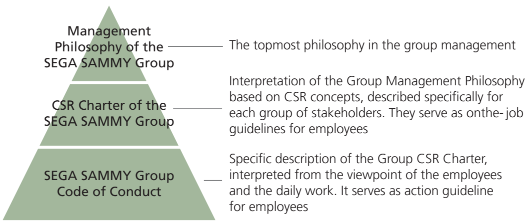


Positioning and Concept of CSR

At the SEGA SAMMY Group we conceive of CSR as follows.

■ It is a general term for the type of corporate conduct that corporations should follow – both as a policy of maximum importance for increasing corporate value and as corporate citizens that will continue to exist in society – in order to needed by society.

■ It is behavior that, by establishing corporate governance that encompasses compliance and risk management and by effectively and actively strengthening relations with stakeholders, aims to realize both the Group's continuous creation of value and the continuous development of society.



Management Philosophy, CSR Charter, Action Guidelines

We aim to incorporate this CSR concept into the Group's management philosophy, conducts, guidelines, and specific activities. To achieve that goal, "Group Management Philosophy," "Group CSR Charter," and "Group Code of Conduct" have been systematically established. In accordance with these three factors, the Group as a whole will reflect the spirit of CSR in its management and conduct corporate activities.

CSR Promotion System

For promoting CSR activities, we have established a CSR Management Committee that decides on the policy and course for promoting the CSR of the Group as a whole; establishes specific measures for promoting CSR activities and gives instructions for carrying them out; checks the state of progress of CSR activities; and generally provides leadership for the entire Group in the area of CSR. Moreover, so that the company, SEGA and Sammy can each devise a CSR activities plan, carry out appropriate promotion measures, and manage its own progress according to the framework and milestones presented in the Group CSR Activities Plan devised by the CSR Management Committee, each company has established its own CSR committee.

Group CSR Promotion Topics

In order give Group CSR activities a sense of unity, Group CSR Promotion Topics – which serve as the standards for CSR activities – have been established separately for each type of stakeholder. Based on the spirit of the Group CSR Charter and the Group Code of Conduct, and taking into account the SEGA SAMMY Group's business interests and social position and referring to the GRI Guidelines and the CSR Initiative, we deduced a total of 35 Group CSR Promotion Topics from the requirements that must be met in order for the Group's corporations to coexist symbiotically with the economy, the environment and society; and then broadly organized them.

RELATIONSHIPS WITH STAKEHOLDERS

With our focus set on our five types of stakeholders – customers, business partners, shareholders & investors, employees, and society – we are constantly working to further build up and strengthen our relations with them.

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.

All of the people who enjoy the services sold and provided by the SEGA SAMMY Group are our customers. In response to their needs, we provide them with entertainment designed to enable them to enjoy themselves to their heart's content.

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.

To explain its basic thinking regarding business, the SEGA SAMMY Group has created a Group Code of Conduct that serves a behavioral guideline for all Group employees and helps to ensure that these employees will raise more awareness about its basic thinking regarding business. So that the Group Code of Conduct can be revised as appropriate, all Group employees are alert to changes in social conditions, and to demands from stakeholders, that might necessitate such revisions.

With Shareholders and Investors

We will view our business with a global perspective in our efforts to ensure sustained growth and to maximize enterprise value. Additionally, we will enhance management transparency and meet the expectations of our shareholders and society through fair and timely disclosure and appropriate returns in profits.

At the company, we conduct explanatory meetings for shareholders and investors in Japan and overseas. We have also established an IR Information Center, to answer the questions of shareholders and investors.

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 which allows them to fully exploit their talents and enables us to grow together with our employees.

We are striving to create workplace environments that enable employees to fully utilize their capabilities. The key themes in these endeavors are "career path," where we work to establish systems for fair appraisals, compensation, and training; "diversity," where we aim to achieve a work-life balance that supports both work and home and to employ a range of people without regard to gender or nationality; and "health and safety," where we take steps to create safe, healthy work environments.

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 arts and sport, and the preservation of the global environment.

In addition to providing entertainment through its core operations, the SEGA SAMMY Group provides ongoing support for a wide range of activities, such as sports and the arts. In regard to the environment, we are aggressively advancing our own environmental measures through such initiatives as thorough observance of related laws and regulations and efficient utilization of energy and resources. Moreover, we are creating a corporate culture that enables all employees to enhance their awareness of social issues.

The SEGA SAMMY BASEBALL CLUB offers clinics to youth players as one sports promotion initiative.

Sammy's pachinko and pachislot showroom was opened to senior citizens in a welfare facility.

Special Olympics Nippon

* The Special Olympics (SO) is an international sports organization that,throughout the year, provides regular sports training to people with intellectual disabilities and holds tournaments where the results of that training can be displayed.

SEGA SAMMY Group provided support for the 4th Special Olympics 2006 Japanese National Summer Games, Kumamoto.

Green Power BIOMASS | Green Power WATER | Green Power WIND

Green Power Certificates
(for biomass, micro-hydro power, wind-generated power)

* Since 2005, SEGA has been annually purchasing 1-million kWh "Green Power Certificates." These certificates are based on the Green Power Certification System of the Japan Natural Energy Company Limited, with which SEGA has concluded a contract for their purchase. By using this clean energy system, SEGA is reducing its environmental impact from energy use. Since April 2007, moreover, SEGA has been participating in the Yokohama City Wind-Power Electrical Generation Project as a project supporter (Y-Green Partner).

The Company issued a CSR report in August 2007. For details of CSR activities, please see the CSR page on the Company's website.
http://www.segasammy.co.jp/english/pr/corp/csr_report.html

Directors, Corporate Auditors, and Executive Officers

As of August 1, 2007

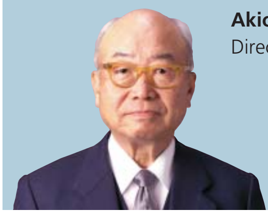
Hajime Satomi
Chairman of the Board and Chief Executive Officer

Keishi Nakayama
Executive Vice President and Representative Director

Hisao Oguchi
Vice Chairman and Director

Tadashi Ishida
Senior Managing Director

Toru Katamoto
Director



Akio Kioi
Director

Yuji Iwanaga
Director

Standing Corporate Auditor

Kazutada Ieda

Corporate Auditors

Toshio Hirakawa

Hisashi Miyazaki

Mineo Enomoto

Senior Executive Officers

Hideo Yoshizawa

Koichi Fukazawa

Executive Officers

Michael Masakimi Hotta

Tetsushi Ikeda

Takatoshi Akiba

FINANCIAL SECTION

contents

Market Data

Number of Pachinko Halls

Halls

	2002	2003	2004	2005	2006
Number of pachinko halls with pachinko machines installed	15,255	14,695	13,844	13,163	12,588
Number of pachinko halls with pachislot machines installed	1,249	1,381	1,773	2,252	2,086
Total	16,504	16,076	15,617	15,165	14,674

Source: National Police Agency
Number of pachinko halls with pachinko machines installed includes halls that combine installations of pachinko machines, pachislot machines, arrange-ball machines, and other machines.

Pachislot Machine and Pachinko Machine Sales, Installed, and Market Scale

		2002	2003	2004	2005	2006
Pachislot machines	Machine sales (units)	1,501,894	1,842,392	1,672,049	1,786,292	1,637,853
	Machines installed (units)	1,606,123	1,660,839	1,887,239	1,936,470	2,003,482
	Market scale (millions of yen)	396,566	526,354	522,582	537,349	485,404
Pachinko machines	Machine sales (units)	3,174,079	3,686,677	4,013,153	4,047,999	3,831,211
	Machines installed (units)	3,252,241	3,227,239	3,077,537	2,960,939	2,932,952
	Market scale (millions of yen)	561,506	672,055	786,535	869,940	875,009

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

Share of Annual Pachislot Machine Sales

	2002		2003		2004		2005		2006	
Rank	Manufacturer	Share	Manufacturer	Share	Manufacturer	Share	Manufacturer	Share	Manufacturer	Share
1	**Sammy**	**31.1%**	**Sammy**	**32.1%**	**Sammy**	**40.5%**	**Sammy**	**34.0%**	**Sammy**	**32.0%**
2	YAMASA	20.0%	OLYMPIA	18.5%	OLYMPIA	16.4%	DAITO GIKEN	13.2%	DAITO GIKEN	12.2%
3	ARUZE	19.7%	ARUZE	13.6%	YAMASA	9.0%	OLYMPIA	10.5%	YAMASA	10.6%
4	OLYMPIA	11.7%	YAMASA	11.9%	DAITO GIKEN	7.9%	YAMASA	8.4%	OLYMPIA	9.6%
5	PIONEER	3.7%	DAITO GIKEN	4.9%	ARUZE	4.7%	SANKYO	6.3%	KITA DENSHI	9.5%

Source: Yano Research Institute Ltd.

Share of Annual Pachinko Machine Sales

	2002		2003		2004		2005		2006	
Rank	Manufacturer	Share	Manufacturer	Share	Manufacturer	Share	Manufacturer	Share	Manufacturer	Share
1	SANYO BUSSAN	16.4%	SANYO BUSSAN	25.2%	SANYO BUSSAN	22.9%	SANYO BUSSAN	24.7%	SANYO BUSSAN	23.2%
2	SANKYO	14.8%	SANKYO	16.4%	SANKYO	21.2%	SANKYO	18.3%	KYORAKU SANGYO	21.0%
3	Heiwa	10.0%	DAIICHI SHOKAI	9.5%	Heiwa	8.7%	KYORAKU SANGYO	9.6%	SANKYO	16.6%
4	KYORAKU SANGYO	8.1%	Heiwa	7.1%	DAIICHI SHOKAI	7.7%	Newgin	7.9%	Newgin	6.6%
5	DAIICHI SHOKAI	7.9%	**Sammy**	**6.7%**	Newgin	6.9%	**Sammy**	**7.1%**	DAIICHI SHOKAI	5.1%
	Sammy	**2.6%**			**Sammy**	**5.8%**			**Sammy**	**3.5%**

Source: Yano Research Institute Ltd.

Amusement Machine and Amusement Center Operations Markets

Millions of yen

	2001	2002	2003	2004	2005
Net sales of amusement machines	140,802	154,528	177,889	180,550	199,227
Net sales from amusement center operations	590,294	605,521	637,744	649,223	682,458
Number of amusement centers	12,742	11,499	10,759	10,109	9,515
Year-on-year comparison of sales at existing amusement centers (%)	99.1	101.5	101.1	96.0	98.7

Source: JAMMA, AOU, and NSA, *Amusement Industry Survey 2006*. Sales figures for 2006 are not disclosed by the survey organizations.

Home Video Game Market Scale

Millions of yen

	2002	2003	2004	2005	2006
Hardware shipments	787,685	704,513	440,702	872,740	958,129
Software shipments	474,721	429,850	468,412	487,110	674,174

Source: *2007 CESA Games White Paper*, Home Video Game Shipments

Mobile Phone Content Market Scale

Billions of yen

	2002 (estimated)	2003 (estimated)	2004 (estimated)	2005 (estimated)	2006 (estimated)
Mobile phone content	248.9	275.8	321.7	396.9	439.2
Visual content	26.6	27.4	31.4	58.9	73.1
Music content	95.8	112.9	136.8	161.0	160.2
Game content	20.1	27.0	41.2	58.9	74.8
Textual content	106.4	108.5	112.3	118.1	131.1

Source: Based on *Digital Content White Paper 2007*

Domestic Toy Market Scale (including home video game consoles and software)

Billions of yen

	2001	2002	2003	2004	2005
Domestic shipments	1,044.3	1,012.0	958.0	952.0	1,034.9
Domestic retail sales	1,372.3	1,299.1	1,224.3	1,214.9	1,306.8

Source: Yano Research Institute Ltd.

Domestic Visual Content Market Scale

Billions of yen

	2000 (estimated)	2001 (estimated)	2002 (estimated)	2003 (estimated)	2004 (estimated)	2005 (estimated)	2006 (estimated)
Packaged visual content	214.1	286.2	326.1	406.2	494.8	606.7	604.2
Network visual content	0.0	1.0	3.9	14.7	17.3	29.2	33.8

Source: Based on *Digital Content White Paper 2007*

Management's Discussion and Analysis

Operating Environment

In 2006, the scale of Japan's leisure market declined 1.6% to about ¥78.9 trillion, from about ¥80 trillion a year earlier. The pachinko and pachislot market, including the sales of pachinko halls and of pachinko and pachislot machine makers and other related businesses, declined to ¥27.5 trillion, from ¥28.7 trillion in the previous year, due in part to a shrinking population of players. The player population decreased to about 16.6 million in 2006, a decline of 500 thousand from 2005. The number of pachinko halls also continues to decline, reaching 14,674 at the end of 2006, compared with 15,165 a year earlier. In recent years, the markets for sales of pachinko and pachislot machines had both been expanding. In 2006, however, while the pachinko machine market increased from about ¥869.9 billion a year earlier to about ¥875.0 billion, the pachislot machine market declined from about ¥537.3 billion to about ¥485.4 billion due to the influence of the July 2004 revision of regulations pertaining to the Entertainment Establishments Control Law.

The scale of the domestic market for amusement machines has continued to increase, with its growth driven by large-scale network-enabled machines.

In the amusement center operations market, there has been a trend toward larger centers opened under scrap-and-build initiatives, and the scale of the market has increased for four years in a row. However, in the year under review, sales at existing centers were down year on year.

In the market for home video game software, the penetration of handheld game platforms and the launch of multiple new platforms have invigorated the market, and in 2006 total sales for the domestic market rose 10.9%, to ¥1.72 trillion.

Overview of Results

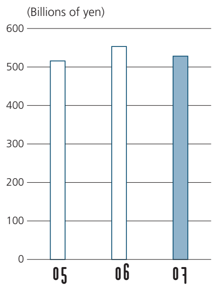
In the fiscal year under review, the SEGA SAMMY Group recorded lower sales and profits. Solid performances were recorded in the Amusement Machine Sales Business and Consumer Business segments, while the Pachislot and Pachinko Machine Business and Amusement Center Operations segments recorded declines in profits year on year.

Results of Operations

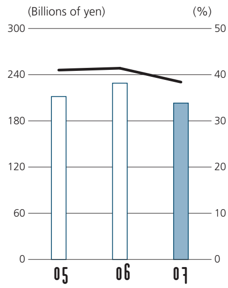
Net Sales: In the fiscal year ended March 31, 2007, net sales declined 4.5%, to ¥528.2 billion. Higher sales were recorded in the Amusement Machine Sales Business and Consumer Business segments, while the mainstay Pachislot and Pachinko Machine Business segment and the Amusement Center Operations segment registered declines. The performance of the Pachislot and Pachinko Machine Business segment had a major influence on our results. This segment, which accounts for about 40% of consolidated net sales, recorded a year-on-year decline in sales of about 20% due to poor market acceptance of our pachinko machines. For more information, please see the following Overview by Segment section.

Operating Income: With weak sales of pachinko machines, our mainstay Pachislot and Pachinko Machine Business segment recorded lower operating income. Lower sales were recorded at existing centers, and the Amusement Center Operations segment also registered a decline in operating income. As a result,

Net Sales

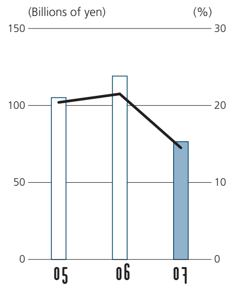


Gross Profit and Gross Profit Margin



□ Gross profit (left)
— Gross profit margin (right)

Operating Income and Operating Margin



□ Operating income (left)
— Operating margin (right)

operating income declined 35.8%, to ¥76.5 billion, and the operating margin was down 7.0 percentage points, to 14.5%. For more information, please see the following Overview by Segment section.

Other Income (Expenses): Net other income was ¥0.9 billion, compared with net other expenses of ¥7.2 billion in the previous year. While the Company recorded the amortization of goodwill of ¥2.3 billion related to subsidiary TMS ENTERTAINMENT, LTD., impairment loss, principally on amusement centers, in the year under review was ¥1.7 billion, down from ¥7.2 billion in the previous year. Gain on investments in partnerships – net was ¥4.2 billion and liquidation dividend from investment was ¥3.2 billion.

Net Income: As a result, income before income taxes and minority interests was down 30.8%, to ¥77.4 billion. Net income was down 34.4% year on year, to ¥43.5 billion. The statutory tax rate was 40.7%, and after the application of tax effect accounting, the tax burden was 42.6%. The net margin was 8.2%, down 3.8 percentage points from the previous year. ROE declined to 13.3%, from 23.0% a year earlier.

Overview by Segment

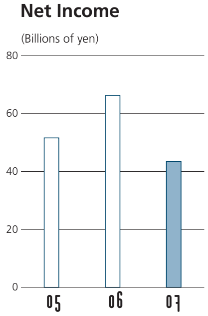
Pachislot and Pachinko Machine Business: In the pachislot machine business, the SEGA SAMMY Group posted total machine sales of 523 thousand units and retained the top share of the market. *Hokuto No Ken SE*, the successor to the hit *Hokuto No Ken* model that was an unprecedented top-selling product in 2005, recorded sales of 340 thousand units. In the second half of the fiscal year, sales of *Spider-Man 2* and other new-format machines were strong. Overall, however, sales in the pachislot machine business were down 8.3%, to ¥173.7 billion. This figure includes sales from rental plans, which were introduced in the year under review but totaled only ¥5.9 billion, which was less than expected.

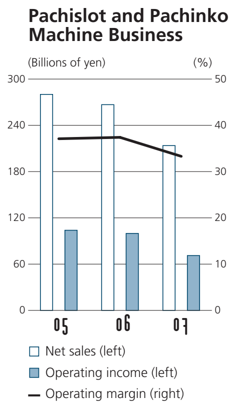
In the pachinko machine business, new product launches included *CR-Hokuto No Ken STV* and *CR-Mangetsu No Yoru Ni Shoten Shitai*, the first product developed under the GINZA brand through the capital and business tie-up between Sammy and GINZA CORPORATION. Nonetheless, these products were not well received by pachinko halls and players, and sales were limited to 132 thousand machines. Sales in the pachinko machine business were down 57.7%, to ¥28.3 billion.

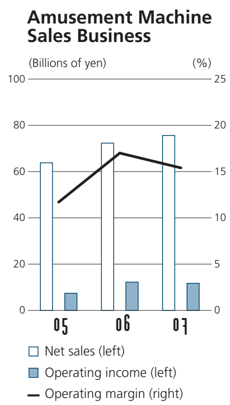
In the pachinko ball, token dispensing machine, and other peripheral businesses, the SEGA SAMMY Group continued working to strengthen its total pachinko hall services.

As a result, sales in this segment were down 20.4%, to ¥211.5 billion, and operating income declined 28.8%, to ¥71.1 billion. The operating margin was down 3.9 percentage points, to 33.6%.

Amusement Machine Sales Business: Sales of existing products, such as prize games, declined, but sales of new products were strong. These new products included *Sangokushi Taisen 2*, a network-enabled trading card game machine launched in the previous fiscal year; *Ami-Gyo*; and *Initial D ARCADE STAGE 4*, the newest version of the popular racing game. In overseas operations, our sales increased, but due







to a shortage of titles released, we did not reach our targets. Also, in the year under review, we began to collect and verify basic data in preparation for the full-scale launch of *ALL.Net P-ras*, a new business model where we charge content usage fees based on the number of times the content is used.

Consequently, sales in this segment were up 5.5%, to ¥75.5 billion, and operating income declined 4.1%, to ¥11.7 billion. The operating margin was down 1.6 percentage points, to 15.4%.

Amusement Center Operations: Sales comparisons at existing amusement centers were negative from the second quarter of the year under review onward, and sales for the year declined 4.2% from a year earlier. In addition, in sales of cards for the kids card game machine business, which includes *LOVE AND BERRY Dress up and Dance!* and *MUSHIKING the King of Beetles*, the boom in popularity tapered off and competition intensified. As a result, the total number of cards sold was down by a large margin. We opened 18 new amusement centers in Japan and closed 31 locations. Consequently, the Group had a total of 449 amusement centers as of March 31, 2007.

As a result, sales in this segment were down 2.3%, to ¥103.9 billion, and operating income declined 98.9%, to ¥0.1 billion. The operating margin was down 8.6 percentage points, to 0.1%.

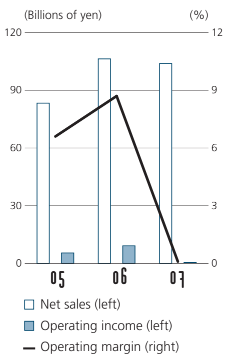
Consumer Business: In the consumer business's mainstay home video game software sales, strong performances in Japan were recorded by *LOVE AND BERRY Dress up and Dance! – DS Collection*, which sold more than one million copies, and *Ryu Ga Gotoku 2*, the latest title in the *Ryu Ga Gotoku* series, which sold over 600 thousand copies. Overseas, sales of titles from overseas development companies – The Creative Assembly Ltd. and Sports Interactive Ltd., acquired through M&A transactions – made solid contributions to the segment's performance. As a result, we recorded home video game software sales of 5,800 thousand units in Japan, 8,230 thousand units in the United States, 7,180 thousand units in Europe, and 60 thousand units in other regions. Total sales were 21.3 million units, an increase of 4.9 million units. Consequently, sales of home video game software were basically in line with plans. In network game operations, sales increased but did not meet our targets due to delays in various services.

Sales of toys were sluggish, but we recorded strong sales of content for mobile phones and animated videos.

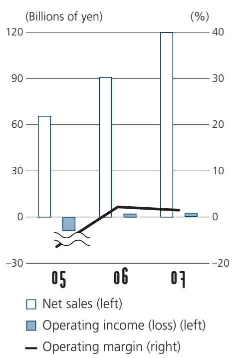
Consequently, sales in this segment were up 32.4%, to ¥119.6 billion, while operating income declined 11.5%, to ¥1.7 billion. The operating margin was down 0.7 percentage points, to 1.5%. R&D expenditures rose 49.4%, to ¥26.6 billion, due to efforts to strengthen our global development capabilities.

Others: This segment comprises the planning, design, management, and construction of commercial facilities and the sales of commercial karaoke systems. Net sales in this segment were down 8.7%, to ¥17.8 billion, and the operating loss was ¥1.3 billion, compared with an operating loss of ¥1.7 billion a year earlier.

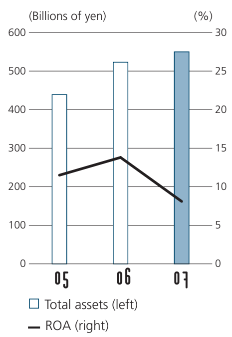
Amusement Center Operations



Consumer Business



Total Assets and ROA



Financial Position and Liquidity

Financial Position: Total assets as of March 31, 2007 were ¥549.9 billion, an increase of ¥27.0 billion from a year earlier. This gain was primarily attributable to increases in property, plant and equipment and assets accompanying new consolidation of subsidiaries.

Current assets were down ¥19.2 billion, to ¥312.2 billion. This decline was principally due to decreases in notes and accounts receivable and marketable securities. Current liabilities were up ¥15.7 billion, to ¥153.0 billion. This gain was primarily the result of increases in short-term bank loans and notes and accounts payable-trade. As a result, the current ratio stood at 2.0 times, lower than 2.4 times at the end of the previous fiscal year, but still at a high level.

Net property, plant and equipment was up ¥29.2 billion, to ¥111.9 billion, due primarily to an increase in land. Total long-term liabilities were down ¥11.5 billion, to ¥38.1 billion, due in part to declines in bonds and long-term debt.

Total net assets were up ¥22.9 billion, to ¥358.9 billion. This gain was principally due to net income of ¥43.5 billion. As a result, the total net assets ratio increased 0.9 percentage points, to 61.5%. Net assets per share were ¥1,341.80.

Capital Expenditures: In the year under review, capital expenditures totaled ¥59.3 billion, a substantial increase from the level of ¥37.7 billion in the previous fiscal year. This rise was primarily attributable to an increase in investment in the Amusement Center Operations segment from ¥24.6 billion in the previous year to ¥40.8 billion in the year under review, including the cost of acquiring land within the MM21 project area located in the Central Ward of the city of Yokohama, in Kanagawa Prefecture, which will be used for development of a multifaceted entertainment related facility.

Cash Flows: Net cash provided by operating activities was ¥60.6 billion, a decrease of ¥22.6 billion from the previous fiscal year. This was primarily attributable to a decline in income before income taxes and minority interests of ¥34.5 billion, which offset an income tax refund for ¥15.8 billion.

Net cash used in investing activities was ¥75.4 billion, an increase of ¥20.7 billion. This gain was the result of an increase in payment for purchase of property, plant and equipment of ¥23.0 billion.

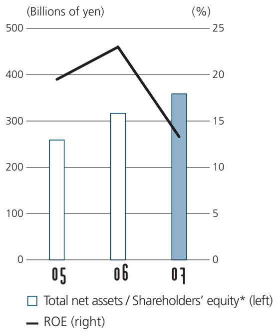
Net cash used in financing activities was down ¥19.4 billion, to ¥1.7 billion. This was principally a result of an increase in short-term bank loans of ¥21.4 billion, which offset a payment for the redemption of bonds of ¥2.0 billion, repayment of long-term debt of ¥5.8 billion, and a cash dividend paid of ¥15.1 billion.

Cash and cash equivalents as of March 31, 2007, were ¥144.9 billion, a decrease of ¥15.2 billion from the previous fiscal year-end.

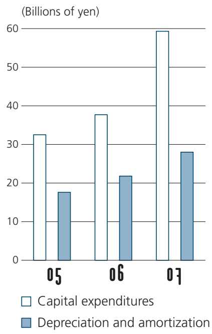
Outlook for the Current Fiscal Year

In the fiscal year ending March 2008, we are forecasting net sales of ¥670.0 billion, an increase of 26.8%; operating income of ¥70.0 billion, a decline of 8.5%; and net income of ¥35.0 billion, down 19.5%. In the Pachislot and Pachinko Machine Business segment, we will work to increase our share

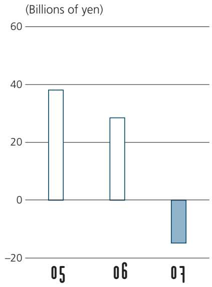
Total Net Assets / Shareholders' Equity* and ROE



Capital Expenditures and Depreciation and Amortization



Free Cash Flow



* Following the enactment of the new Japanese Corporate Law in 2006, the Company presents net assets for the fiscal year ended March 31, 2007, which represents the shareholders' equity figure used in previous years plus minority interests and share subscription rights.

in the pachinko machine market by launching differentiated products under the new development system. In the pachislot machine market, as the company with the highest share, we will work to stabilize the industry as rapidly as possible by providing support to pachinko hall operators for the transition to new-format machines. In the Amusement Machine Sales Business segment, we will work to expand sales and profits by bolstering our product lineup. In the Amusement Center Operations segment, we will strive to improve profitability at existing centers and maintain our current share in the kids card game market. In the Consumer Business segment, we will continue to reinforce our global development system. These forecasts are based on assumed exchange rates of US$=¥110 and €1=¥140.

Results of Operations of Listed Subsidiaries

SEGA TOYS, LTD.: In family entertainment related operations, the company worked to reinforce the position of the home planetarium system *Home Star*. In addition, overseas the *idog* pet substitute toy continued to perform well. In new content business, the long-established *Anpanman* toys and overseas operations performed well, but other toys recorded sluggish sales in Japan, and the company recorded a loss on inventory valuation.

As a result, in the fiscal year under review SEGA TOYS recorded net sales of ¥15.2 billion, operating income of ¥333 million, and net income of ¥114 million.

TMS ENTERTAINMENT, LTD.: In animation, production revenues declined, but licensing revenues recorded a substantial gain, and as a result earnings improved by a large margin. On the other hand, in amusement centers, the opening of new centers contributed to higher sales, but revenues from existing and new centers were sluggish. Earnings declined due to costs associated with the introduction of large-scale game machines and with the opening of larger centers.

Consequently, TMS ENTERTAINMENT recorded a 3.5% decline in net sales, to ¥15.6 billion, a 5.2% decrease in operating income to ¥1.6 billion, and an 8.9% increase in net income to ¥1.4 billion.

Sammy NetWorks Co., Ltd.: 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. In the year under review, new services for PCs included pachislot games and seven pachinko games, and the company added 16 participating partners and 38 varieties of content.

As a result, Sammy NetWorks recorded a 28.5% gain in net sales, to ¥10.6 billion, a 16.4% rise in operating income to ¥2.5 billion, and an 11.7% increase in net income to ¥1.4 billion.

Nissho Inter Life Co., Ltd.: In specialized construction, projects for shopping centers and department stores increased and sales and operating income both recorded strong performances. On the other hand, in general construction, sales declined due to a policy of not accepting less-profitable projects, and competition for orders intensified, and as a result an operating loss was recorded.

Consequently, Nissho Inter Life Co., Ltd. recorded an 8.2% decline in net sales, to ¥14.9 billion; an operating loss of ¥463 million, compared with an operating loss of ¥431 million in the previous fiscal year; and a net loss of ¥446 million, compared with a net loss of ¥385 million in the previous fiscal year.

Operational Risks

Risks that could affect the performance or operations of the SEGA SAMMY Group are given below. Further, these risks are 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, 2007.

Statutory Regulations Affecting the Pachislot and Pachinko Machine Business: Among the Group's mainstay operations, the Pachislot and Pachinko Machine Business accounts 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 volatility 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 video game software is susceptible to changes in seasonal demand, which focuses on such periods as the year-end shopping season. 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 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 ended March 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 websites. 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 certain rights.

Consolidated Balance Sheets

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
As of March 31, 2007 and 2006

	Millions of yen		Thousands of U.S. dollars
ASSETS	2007	2006	2007
Current assets:			
Cash and cash equivalents	¥ 144,869	¥160,094	$1,227,183
Time deposits (Note 4)	2,276	926	19,280
Trade receivables:			
Notes and accounts receivable (Note 4)	83,493	96,728	707,268
Allowance for doubtful accounts	(571)	(1,494)	(4,837)
Marketable securities (Note 11)	497	2,999	4,210
Inventories (Note 3)	40,118	32,200	339,839
Income taxes refundable (Note 10)	5,594	15,656	47,387
Deferred income taxes (Note 10)	6,905	6,277	58,492
Others	28,994	17,945	245,608
Total current assets	312,175	331,331	2,644,430
Property, plant and equipment:			
Land (Notes 4 and 9)	46,029	20,699	389,911
Buildings and structures (Note 4)	59,463	57,171	503,710
Amusement machines and facilities	67,790	57,411	574,248
Construction in progress	1,566	1,840	13,266
Others	38,340	28,205	324,778
	213,188	165,326	1,805,913
Accumulated depreciation	(101,291)	(82,672)	(858,035)
Net property, plant and equipment	111,897	82,654	947,878
Investments and other assets:			
Investments in unconsolidated subsidiaries and affiliated companies	7,664	4,150	64,922
Investments in securities (Notes 11 and 12)	55,808	55,890	472,749
Goodwill (Note 22)	18,524	11,267	156,917
Lease deposits	23,326	18,073	197,594
Deferred income taxes (Note 10)	3,198	804	27,090
Others	25,070	27,207	212,368
Allowance for doubtful accounts	(7,722)	(8,462)	(65,413)
Total investments and other assets	125,868	108,929	1,066,227
	¥ 549,940	¥522,914	$4,658,535

See accompanying notes.

LIABILITIES AND NET ASSETS/SHAREHOLDERS' EQUITY	Millions of yen 2007	2006	Thousands of U.S. dollars 2007
Current liabilities:			
Short-term bank loans and current portion of long-term debt (Note 4)	¥ 37,170	¥ 10,395	$ 314,867
Notes and accounts payable–trade (Note 4)	71,414	62,133	604,947
Income taxes payable (Note 10)	12,059	29,222	102,152
Accrued employees' bonuses	1,731	1,871	14,663
Accrued directors' and corporate auditors' bonuses	490	—	4,151
Allowance for sales return	225	—	1,906
Allowance for game points earned by customers	119	—	1,008
Others (Note 4)	29,813	33,732	252,545
Total current liabilities	153,021	137,353	1,296,239
Long-term liabilities:			
Long-term debt (Note 4)	16,806	29,218	142,363
Retirement benefits for employees (Note 6)	8,429	7,491	71,402
Retirement benefits for directors and corporate auditors	1,294	1,277	10,961
Deferred income taxes (Note 10)	1,881	4,488	15,934
Others	9,651	7,095	81,754
Total long-term liabilities	38,061	49,569	322,414
Minority interests	—	19,312	—
Commitments and contingent liabilities (Note 7)			
Shareholders' equity (Notes 8 and 19):			
Common stock:	—	29,953	—
Authorized–800,000,000 shares			
Issued–283,229,476 shares			
Capital surplus	—	171,071	—
Retained earnings	—	193,721	—
Unrealized gains on securities, net of taxes	—	11,757	—
Land revaluation difference, net of taxes (Note 9)	—	(7,506)	—
Foreign currency translation adjustments	—	(8,767)	—
Treasury stock, at cost	—	(73,549)	—
Total shareholders' equity	—	316,680	—
Net assets (Note 8):			
Shareholders' equity (Note 19):			
Common stock	29,953	—	253,731
Authorized–800,000,000 shares			
Issued–283,229,476 shares			
Capital surplus	171,097	—	1,449,360
Retained earnings	221,172	—	1,873,545
Treasury stock, at cost	(73,656)	—	(623,939)
Total shareholders' equity	348,566	—	2,952,697
Accumulated gains (losses) from revaluation and translation adjustments:			
Unrealized gains on securities, net of taxes	4,779	—	40,483
Unrealized losses on hedging derivatives, net of taxes	(18)	—	(152)
Land revaluation difference, net of taxes (Note 9)	(7,505)	—	(63,574)
Foreign currency translation adjustments	(7,753)	—	(65,675)
Total accumulated losses from revaluation and translation adjustments	(10,497)	—	(88,918)
Share subscription rights (Note 5)	455	—	3,854
Minority interests	20,334	—	172,249
Total net assets	358,858	—	3,039,882
	¥549,940	¥522,914	$4,658,535

Consolidated Statements of Income

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Years Ended March 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007
Net sales	¥528,238	¥553,241	¥515,668	$4,474,697
Cost of sales	325,159	324,229	304,109	2,754,417
Gross profit	203,079	229,012	211,559	1,720,280
Selling, general and administrative expenses (Note 13)	126,549	109,868	106,469	1,071,995
Operating income	76,530	119,144	105,090	648,285
Other income (expenses):				
Interest and dividend income	1,407	1,101	760	11,919
Interest expenses	(625)	(634)	(803)	(5,294)
Equity in earnings (losses) of affiliated companies	12	(230)	25	102
Gain on investments in partnership–net	4,160	889	1,066	35,239
Gain (loss) on sale of property, plant and equipment–net	98	(28)	(447)	831
Loss on disposal of property, plant and equipment	(861)	(818)	(908)	(7,294)
Loss on revaluation of investment securities	(1,052)	(854)	(1,040)	(8,911)
Gain on change in equity of consolidated subsidiaries	5	1,066	2,252	42
Gain on sale of operations (Note 14)	—	27	743	—
Impairment losses (Note 16)	(1,706)	(7,195)	(325)	(14,452)
Loss on business reorganization (Note 15)	—	(318)	(2,945)	—
Loss on redemption of bonds	—	—	(10,606)	—
Liquidation dividend from investment	3,206	—	—	27,158
Amortization of goodwill	(2,335)	—	—	(19,780)
Other–net	(1,422)	(226)	(3,380)	(12,046)
	887	(7,220)	(15,608)	7,514
Income before income taxes and minority interests	77,417	111,924	89,482	655,799
Income taxes (Note 10):				
Current	33,698	46,796	32,437	285,455
Deferred	(1,149)	(3,018)	5,652	(9,732)
	32,549	43,778	38,089	275,723
Income before minority interests	44,868	68,146	51,393	380,076
Minority interests	(1,412)	(1,924)	(819)	(11,961)
Net income	¥ 43,456	¥ 66,222	¥ 50,574	$ 368,115

	Yen			U.S. dollars
Per share of common stock (Note 23):				
Net income	¥172.47	¥261.06	¥410.53	$1.46
Diluted net income	172.35	260.35	400.95	1.46
Cash dividends applicable to the year	60.00	80.00	60.00	0.51

See accompanying notes.

Consolidated Statement of Changes in Net Assets

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Year Ended March 31, 2007

	Millions of yen										
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized gains on securities, net of taxes	Unrealized losses on hedging derivatives, net of taxes	Land revaluation difference, net of taxes	Foreign currency translation adjustments	Share subscription rights	Minority interests	Total
Shareholders' equity at March 31, 2006 as previously reported	¥29,953	¥171,071	¥193,721	¥(73,549)	¥11,757	¥ —	¥(7,506)	¥(8,767)	¥ —	¥ —	¥316,680
Reclassification due to adoption of new accounting standards for presentation of net assets in the balance sheet at April 1, 2006										19,312	19,312
Net assets at April 1, 2006	29,953	171,071	193,721	(73,549)	11,757	—	(7,506)	(8,767)	—	19,312	335,992
Net income			43,456								43,456
Cash dividends paid			(15,118)								(15,118)
Bonuses to directors and corporate auditors			(646)								(646)
Acquisition of treasury stock				(107)							(107)
Sale of treasury stock		26		0							26
Effect from changes of consolidated subsidiaries and affiliates accounted for under the equity method and others			(241)								(241)
Unrealized losses on hedging derivatives, net of taxes						(18)					(18)
Changes in unrealized gains on securities, net of taxes					(6,978)						(6,978)
Changes in revaluation reserve for land, net of taxes							1				1
Changes in foreign currency translation adjustments								1,014			1,014
Changes in share subscription rights									455		455
Changes in minority interests										1,022	1,022
Balance at March 31, 2007	¥29,953	¥171,097	¥221,172	¥(73,656)	¥ 4,779	¥(18)	¥(7,505)	¥(7,753)	¥455	¥20,334	¥358,858

	Thousands of U.S. dollars										
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized gains on securities, net of taxes	Unrealized losses on hedging derivatives, net of taxes	Land revaluation difference, net of taxes	Foreign currency translation adjustments	Share subscription rights	Minority interests	Total
Shareholders' equity at March 31, 2006 as previously reported	$253,731	$1,449,140	$1,641,008	$(623,032)	$99,593	$ —	$(63,583)	$(74,265)	$ —	$ —	$2,682,592
Reclassification due to adoption of new accounting standards for presentation of net assets in the balance sheet at April 1, 2006										163,592	163,592
Net assets at April 1, 2006	253,731	1,449,140	1,641,008	(623,032)	99,593	—	(63,583)	(74,265)	—	163,592	2,846,184
Net income			368,115								368,115
Cash dividends paid			(128,064)								(128,064)
Bonuses to directors and corporate auditors			(5,472)								(5,472)
Acquisition of treasury stock				(907)							(907)
Sale of treasury stock		220		0							220
Effect from changes of consolidated subsidiaries and affiliates accounted for under the equity method and others			(2,042)								(2,042)
Unrealized losses on hedging derivatives, net of taxes						(152)					(152)
Changes in unrealized gains on securities, net of taxes					(59,110)						(59,110)
Changes in revaluation reserve for land, net of taxes							9				9
Changes in foreign currency translation adjustments								8,590			8,590
Changes in share subscription rights									3,854		3,854
Changes in minority interests										8,657	8,657
Balance at March 31, 2007	$253,731	$1,449,360	$1,873,545	$(623,939)	$40,483	$(152)	$(63,574)	$(65,675)	$3,854	$172,249	$3,039,882

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							
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized gains on securities, net of taxes	Land revaluation difference, net of taxes	Foreign currency translation adjustments	Total shareholders' equity
Balance at March 31, 2005	¥27,291	¥176,302	¥133,761	¥(73,226)	¥10,793	¥(6,542)	¥(9,425)	¥258,954
Increase in capital stock	2,662	2,660						5,322
Net income			66,222					66,222
Cash dividends paid		(7,498)	(6,278)					(13,776)
Bonuses to directors and corporate auditors		(180)	(373)					(553)
Transfer of capital surplus to retained earnings		(220)	220					—
Effect from changes of consolidated subsidiaries and affiliates accounted for under the equity method and others			167					167
Acquisition of treasury stock				(378)				(378)
Sale of treasury stock				55				55
Changes in unrealized gains on securities, net of taxes					964			964
Reversal of land revaluation difference			2			(964)		(962)
Gain on sale of treasury stock		7						7
Changes in foreign currency translation adjustments							658	658
Balance at March 31, 2006	¥29,953	¥171,071	¥193,721	¥(73,549)	¥11,757	¥(7,506)	¥(8,767)	¥316,680

	Millions of yen							
	Common stock	Capital surplus	Retained earnings	Treasury stock, at cost	Unrealized gains on securities, net of taxes	Land revaluation difference, net of taxes	Foreign currency translation adjustments	Total shareholders' equity
Balance at March 31, 2004	¥10,000	¥154,340	¥101,838	¥(49,165)	¥11,841	¥(6,265)	¥(8,793)	¥213,796
Increase in capital stock	17,291	17,286						34,577
Increase in capital stock by wholly owned subsidiary before share transfer		2,847						2,847
Decrease in treasury stock by wholly owned subsidiary before share transfer			(10,356)					(10,356)
Gain (loss) on sale of treasury stock by wholly owned subsidiary before share transfer		1,826	(2,525)					(699)
Net income			50,574					50,574
Cash dividends paid			(7,433)					(7,433)
Bonuses to directors and corporate auditors			(525)					(525)
Transfer of capital surplus to retained earnings								—
Effect from changes of consolidated subsidiaries and affiliates accounted for under the equity method and others			1,911					1,911
Acquisition of treasury stock				(488)				(488)
Transfer of SEGA CORPORATION stock owned by Sammy Corporation to treasury stock				(45,521)				(45,521)
Acquisition of treasury stock by wholly owned subsidiary before share transfer				(257)				(257)
Sale of treasury stock				40				40
Sale of treasury stock by wholly owned subsidiary before share transfer				11,809				11,809
Decrease in treasury stock by wholly owned subsidiary before share transfer				10,356				10,356
Changes in unrealized gains on securities, net of taxes					(1,048)			(1,048)
Reversal of land revaluation difference			277			(277)		—
Gain on sale of treasury stock		3						3
Changes in foreign currency translation adjustments							(632)	(632)
Balance at March 31, 2005	¥27,291	¥176,302	¥133,761	¥(73,226)	¥10,793	¥(6,542)	¥(9,425)	¥258,954

See accompanying notes.

Consolidated Statements of Cash Flows

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES

Years Ended March 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007
Cash flows from operating activities:				
Income before income taxes and minority interests	¥ 77,417	¥111,924	¥ 89,482	$ 655,799
Adjustments to reconcile income before income taxes and minority interests to net cash provided by operating activities:				
Depreciation and amortization	28,048	21,855	17,674	237,594
Interest and dividend income	(1,407)	(1,101)	(760)	(11,919)
Amortization of goodwill	4,831	1,782	720	40,923
Interest expenses	625	634	803	5,294
Loss on disposal and sale of property, plant and equipment–net	763	846	1,355	6,463
Loss (gain) on change in equity of subsidiaries–net	36	(779)	(2,252)	305
Impairment losses	1,706	7,195	325	14,452
Loss on sale and revaluation of investment securities–net	933	470	1,413	7,903
Gain on investments in partnership–net	(4,160)	(889)	(1,066)	(35,239)
Loss on business reorganization	—	318	2,945	—
Loss on redemption of bonds	—	—	10,606	—
Liquidation dividend from investment	(3,206)	—	—	(27,158)
Equity in (earnings) losses of affiliates	(12)	230	(25)	(102)
(Decrease) increase in allowance for doubtful accounts	(1,647)	(1,016)	596	(13,952)
(Decrease) increase in accrued employees' bonuses	(142)	333	30	(1,203)
Increase in accrued directors' and corporate auditors' bonuses	490	—	—	4,151
Increase in retirement benefits for employees	935	1,128	367	7,920
Increase in retirement benefits for directors and corporate auditors	17	9	64	144
Increase in allowance for sales return	225	—	—	1,906
Increase in allowance for game points earned by customers	8	—	—	67
Others–net	(759)	(1,299)	(2,025)	(6,429)
Net changes in assets and liabilities:				
Decrease (increase) in notes and accounts receivable	14,321	(14,806)	34,138	121,313
(Increase) decrease in inventories	(7,538)	1,690	(3,948)	(63,854)
Increase (decrease) in notes and accounts payable–trade	8,779	1,237	(12,091)	74,367
Amount of transfer of equipment by amusement center operations business	(8,096)	(11,817)	(4,982)	(68,581)
Amount of transfer of equipment by pachislot and pachinko rental business	(2,275)	—	—	(19,271)
(Increase) decrease in other assets	(1,255)	3,042	174	(10,631)
(Decrease) increase in other liabilities	(8,109)	2,366	(3,973)	(68,691)
Sub-total	100,528	123,352	129,570	851,571
Receipts of interest and dividend income	1,236	1,315	718	10,470
Payment of interest expenses	(309)	(672)	(735)	(2,618)
Payment of income taxes	(56,614)	(46,438)	(52,408)	(479,575)
Refund of income taxes	15,782	671	617	133,689
Refund of deposit for lawsuit	—	5,000	—	—
Net cash provided by operating activities	60,623	83,228	77,762	513,537
Cash flows from investing activities:				
Payment for purchase of property, plant and equipment	(49,345)	(26,332)	(24,416)	(418,001)
Proceeds from sale of property, plant and equipment	1,543	345	1,046	13,071
Payment for purchase of securities	—	(3,498)	—	—
Payment for purchase of investment securities	(33,180)	(2,242)	(2,897)	(281,067)
Proceeds from sale of investment securities	4,343	1,253	180	36,789
Payment for investment in partnerships	(9,803)	(24,711)	(2,061)	(83,041)
Proceeds from distribution of investment in partnerships	24,624	8,818	697	208,590
Proceeds from liquidation dividend from investment	3,431	—	—	29,064
(Payment for) proceeds from acquisition of consolidated subsidiaries–net	(9,213)	6,001	(2,678)	(78,043)
Proceeds from (payment for) sales of consolidated subsidiaries–net	300	(240)	160	2,541
Payment for acquisition of affiliated companies	(4,676)	(6,803)	(2,235)	(39,610)
(Increase) decrease in loan receivable–net	(1,565)	1,137	(1,790)	(13,257)
Payment for acquisition of operations	(1,051)	(2,850)	—	(8,903)
(Increase) decrease in time deposits–net	(1,549)	367	(3,500)	(13,122)
Others–net	746	(5,951)	(2,124)	6,319
Net cash used in investing activities	(75,395)	(54,706)	(39,618)	(638,670)
Cash flows from financing activities:				
Proceeds from issuance of long-term debt	200	3,106	1,708	1,694
Repayment of long-term debt	(5,821)	(9,778)	(7,781)	(49,310)
Increase (decrease) in short-term bank loans	21,371	(557)	(2,540)	181,033
Payment for redemption of bonds	(2,001)	(3,239)	(21,265)	(16,950)
Cash dividends paid by wholly owned subsidiary before the stock transfer	—	—	(7,433)	—
Cash dividends paid	(15,094)	(13,776)	—	(127,861)
Payment for purchase of treasury stock	(107)	(378)	(445)	(906)
Proceeds from exercise of share subscription rights of wholly owned subsidiary before the stock transfer	—	—	7,262	—
Others–net	(261)	3,469	4,791	(2,211)
Net cash used in financing activities	(1,713)	(21,153)	(25,703)	(14,511)
Effect of exchange rate changes on cash and cash equivalents	755	686	54	6,395
Net change in cash and cash equivalents	(15,730)	8,055	12,495	(133,249)
Cash and cash equivalents at beginning of year	160,094	151,253	138,758	1,356,154
Net increase in cash and cash equivalents due to consolidation scope change	505	463	—	4,278
Net increase in cash and cash equivalents due to merger	—	323	—	—
Cash and cash equivalents at end of year	¥144,869	¥160,094	¥151,253	$1,227,183

See accompanying notes.

Notes to Consolidated Financial Statements

SEGA SAMMY HOLDINGS INC. AND CONSOLIDATED SUBSIDIARIES
Years Ended March 31, 2007, 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 from International Financial Reporting Standards.

The accounts of the Company's 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 certain expanded disclosure and the inclusion of the consolidated statements of shareholders' equity for 2006 and 2005) 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. Certain 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.

The consolidated balance sheet as of March 31, 2007, which has been prepared in accordance with the new accounting standards as discussed in Note 2 (u), is presented with the consolidated balance sheet as of March 31, 2006 prepared in accordance with the previous presentation rules.

Also, as discussed in Note 2 (v), the consolidated statement of changes in net assets for the year ended March 31, 2007 has been prepared in accordance with the new accounting standards. The accompanying consolidated statements of shareholders' equity for the years ended March 31, 2006 and 2005 were voluntarily prepared for the purpose of inclusion in the consolidated financial statements although such statements were not required to be filed with the Local Finance Bureau.

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 2006 and 2005 consolidated financial statements to conform to the classifications used in 2007. These changes had no impact on previously reported results of operations or shareholders' 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, 2007, which was ¥118.05 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 combinations

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, shareholders' equity and cash flows were prepared as if the combination was completed effective April 1, 2004.

Effective from April 1, 2006, the Company and its domestic subsidiaries have adopted the new accounting standards for business combinations ("Accounting Standards for Business Combinations" issued by the Business Accounting Deliberation Council on October 31, 2003 and "Accounting Standards for Business Divestitures Statement No. 7" issued by the Accounting Standards Board of Japan on December 27, 2005) and the implementation guidance for the accounting standards for business combinations ("Guide on Accounting Standards for Business Combinations and Accounting Standards for Business Divestitures Guidance No. 10" issued by the Accounting Standards Board of Japan on December 22, 2006). The adoption of these accounting standards had no effect on the statements of income.

(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 consolidated subsidiaries was 87, 72 and 61 in 2007, 2006 and 2005, respectively.

(c) Equity method

Investments in affiliated companies over which the Company has the ability to exercise significant influence over their operation and financial policies are accounted for using the equity method. The number of companies accounted for under the equity method was 9, 8 and 6 in 2007, 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

Allowance for doubtful accounts is provided at an amount sufficient to cover probable losses on collection. It consists of the estimated uncollectible amount with respect to certain identified doubtful receivables and an amount calculated using the actual percentage of the Company's collection losses.

(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 net assets/shareholders' equity. Available-for-sale securities with no available fair market values are stated at moving-average cost. Realized gains and losses on the sale of such securities are computed using 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 net amount of equity included in the Company's financial statements from limited liability investment partnerships and similar investments, regarded as marketable securities under Article 2-2 of the Securities and Exchange Law of Japan, is calculated based on the relevant financial statements for the partnership available as of the reporting date stipulated in the partnership agreement.

The Company and its consolidated subsidiaries did not have trading securities in the years ended March 31, 2007 and 2006.

(g) Inventories

Inventories are stated at cost determined by the gross-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 April 1, 1998 are depreciated using the straight-line method.

(i) Amortization

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 life 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 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 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.

(n) Allowance for directors' and auditors' bonuses

The Company and its domestic subsidiaries provide allowance for directors' and corporate auditors' bonuses based on estimated amounts to be paid in the subsequent period.

Effective April 1, 2006, the Company and its domestic subsidiaries adopted the new accounting standard, "Accounting Standard for Directors' Bonuses" (Statement No. 4 issued by the Accounting Standards Board of Japan on November 29, 2005). As a result, operating income and income before income taxes and minority interests each decreased by ¥490 million ($4,151 thousand).

(o) Allowance for sales return

In order to prepare for losses associated with future returns, an estimated loss amount in conjunction with future returns is provided.

(p) Allowance for game points earned by customers

In order to prepare for expenses associated with the redemption of points earned by customers, an estimated amount related to future redemption has been provided.

(q) 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 cost as expenses using the straight-line method over ten years.

(r) 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.

(s) 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.

(t) 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.

(u) Accounting standard for presentation of net assets in the balance sheet

Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Presentation of Net Assets in the Balance Sheet" (Statement No. 5 issued by the Accounting Standards Board of Japan on December 9, 2005), and the implementation guidance for the accounting standard for presentation of net assets in the balance sheet (the Financial Accounting Standard Implementation Guidance No. 8 issued by the Accounting Standards Board of Japan on December 9, 2005), (collectively, "the New Accounting Standards").

The consolidated balance sheet as of March 31, 2007 prepared in accordance with the New Accounting Standards comprises three sections, which are the assets, liabilities and net assets sections. The consolidated balance sheet as of March 31, 2006 prepared pursuant to the previous presentation rules comprises the assets, liabilities, minority interests and shareholders' equity sections.

Under the New Accounting Standards, the following items are presented differently at March 31, 2007 compared to March 31, 2006. The net assets section includes unrealized losses on hedging derivatives, net of taxes. Under the previous presentation rules, unrealized losses on hedging derivatives were included in the assets or liabilities section without considering the related income tax effects. Share subscription rights and minority interests are included in the net assets section at March 31, 2007. Under the previous presentation rules, companies were required to present share subscription rights and minority interests between the liabilities section and the shareholders' equity section, respectively.

The adoption of the New Accounting Standards had no impact on the consolidated statement of income for the year ended March 31, 2007. Also, if the New

Accounting Standards had not been adopted at March 31, 2007, shareholders' equity amounting to ¥338,087 million ($2,863,931 thousand) would have been presented.

(v) Accounting standard for statement of changes in net assets

Effective from the year ended March 31, 2007, the Company and its consolidated subsidiaries adopted the new accounting standard, "Accounting Standard for Statement of Changes in Net Assets" (Statement No. 6 issued by the Accounting Standards Board of Japan on December 27, 2005), and the implementation guidance for the accounting standard for statement of changes in net assets (the Financial Accounting Standard Implementation Guidance No. 9 issued by the Accounting Standards Board of Japan on December 27, 2005), (collectively, "the Additional New Accounting Standards").

The Company prepared the accompanying consolidated statement of changes in net assets for the year ended March 31, 2007 in accordance with the Additional New Accounting Standards. The accompanying consolidated statements of shareholders' equity for the years ended March 31, 2006 and 2005, which were voluntarily prepared for inclusion in the consolidated financial statements, have not been restated to the new presentation rules of 2007.

(w) Stock option

Effective from the year ended March 31, 2007, the Company and its subsidiaries adopted the new accounting standard, "Accounting Standard for Share-based Payment" (Statement No. 8 issued by the Accounting Standards Board of Japan on December 27, 2005), and the implementation guidance for the accounting standard for share-based payment (the Financial Accounting Standard Implementation Guidance No. 11 issued by the Accounting Standards Board of Japan on May 31, 2006). As a result, operating income and income before income taxes and minority interests each decreased by ¥454 million ($3,846 thousand).

(x) 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. Dividing income available to common stockholders is computed by deducting directors' bonuses from net income for the years ended March 31, 2006 and 2005. Diluted net income per share is similar to net income per share except that the weighted-average number of common stock outstanding is increased by the number of additional common stock that would have been outstanding if the potential common stock had been issued.

Cash dividends per share represent actual amounts applicable to the year.

(y) 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, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Merchandise	¥ 2,727	¥ 3,448	$ 23,100
Finished products	8,870	8,548	75,138
Raw materials	23,068	16,517	195,409
Work in process	3,775	2,082	31,978
Supplies	1,678	1,605	14,214
	¥40,118	¥32,200	$339,839

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 0.88% to 5.02% and 0.80% to 2.76% as of March 31, 2007 and 2006, respectively.

Long-term debt consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Bonds:			
0.41%–0.79% debenture due in 2006	¥ —	¥ 100	$ —
0.41%–1.06% debenture due in 2007	75	1,976	635
0.44%–1.24% debenture due in 2008	13,335	13,335	112,961
1.30% debenture due in 2009	70	70	593
0.41%–1.47% debenture due in 2010	10,140	10,140	85,896
Long-term loans, principally due from banks with interest at 0.90% to 7.29% and 0.90% to 2.98% as of March 31, 2007 and 2006:			
Secured	356	272	3,016
Unsecured	5,693	11,114	48,225
	29,669	37,007	251,326
Less: current portion	(12,863)	(7,789)	(108,963)
	¥ 16,806	¥29,218	$ 142,363

The aggregate annual maturities of long-term debt at March 31, 2007 were as follows:

	Millions of yen	Thousands of U.S. dollars
Years ending March 31,		
2008	¥ 6,166	$52,232
2009	173	1,465
2010	10,232	86,675
2011	67	568
2012 and thereafter	168	1,423

A summary of assets pledged as collateral for short-term loans, long-term debt, accounts payable – trade and other current liabilities at March 31, 2007 and 2006 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Time deposits	¥ 20	¥ 25	$ 169
Notes receivable	279	468	2,363
Land	419	535	3,550
Buildings	67	349	568
	¥785	¥1,377	$6,650

NOTE 5

STOCK OPTION PLAN

The following tables summarize contents of stock options as of March 31, 2007:

Company name	Date of the annual shareholders' meeting	Position and number of grantees	Class and number of stock	Date of issue	Condition of settlement of rights	Period grantees provide service in return for stock options	Period subscription rights are to be exercised
The Company	June 24, 2005	The Company's employees and subsidiaries' employees: 944	Common stock 2,534,000	July 29, 2005	Continue to work from July 29, 2005 to July 30, 2007	From July 29, 2005 to July 30, 2007	From July 31, 2007 to July 30, 2009
The Company	June 20, 2006	The Company's directors: 4	Common stock 43,000	August 14, 2006	Continue to work from August 14, 2006 to August 14, 2008	From August 14, 2006 to August 14, 2008	From August 15, 2008 to July 30, 2010
The Company	June 20, 2006	The Company's employees and subsidiaries' directors and employees: 1,086	Common stock 2,701,500	August 14, 2006	Continue to work from August 14, 2006 to August 14, 2008	From August 14, 2006 to August 14, 2008	From August 15, 2008 to August 13, 2010
The Company	June 20, 2006	The Company's employees and subsidiaries' directors and employees: 1	Common stock 10,000	September 4, 2006	Continue to work from September 4, 2006 to September 4, 2008	From September 4, 2006 to September 4, 2008	From September 5, 2008 to September 4, 2010
NISSHO INTER LIFE Co., LTD.	August 19, 2002	NISSHO INTER LIFE Co., LTD.'s directors: 9 The Company's employees: 3 NISSHO INTER LIFE Co., LTD.'s employees: 133	Common stock 295,900	October 4, 2002	Continue to work from October 4, 2002 to August 20, 2004	From October 4, 2002 to August 20, 2004	From August 21, 2004 to August 20, 2010
NISSHO INTER LIFE Co., LTD.	August 19, 2003	NISSHO INTER LIFE Co., LTD.'s directors: 7 NISSHO INTER LIFE Co., LTD.'s employees: 129	Common stock 299,000	October 1, 2003	Continue to work from October 1, 2003 to August 20, 2005	From October 1, 2003 to August 20, 2005	From August 21, 2005 to August 20, 2008
NISSHO INTER LIFE Co., LTD.	August 19, 2004	NISSHO INTER LIFE Co., LTD.'s directors: 5 NISSHO INTER LIFE Co., LTD.'s employees: 139	Common stock 300,000	October 6, 2004	Continue to work from October 6, 2004 to August 20, 2006	From October 1, 2004 to August 20, 2006	From August 21, 2006 to August 20, 2009
Sammy NetWorks Co., Ltd.	July 30, 2003	Sammy NetWorks Co., Ltd.'s directors: 4 Sammy NetWorks Co., Ltd.'s employees: 25	Common stock 1,596	December 22, 2003	Continue to work through exercise of right	From December 22, 2003 to July 30, 2005	From July 31, 2005 to July 30, 2007
Sammy NetWorks Co., Ltd.	July 30, 2003	Sammy NetWorks Co., Ltd.'s directors: 4	Common stock 960	March 22, 2004	Continue to work through exercise of right	From March 22, 2004 to July 30, 2005	From July 31, 2005 to July 30, 2007

Company name	Date of the annual shareholders' meeting	Position and number of grantees	Class and number of stock	Date of issue	Condition of settlement of rights	Period grantees provide service in return for stock options	Period subscription rights are to be exercised
Sammy NetWorks Co., Ltd.	July 30, 2003	Sammy NetWorks Co., Ltd.'s employees: 4	Common stock 144	May 27, 2004	Continue to work through exercise of right	From May 27, 2004 to July 30, 2005	From July 31, 2005 to July 30, 2007
Sammy NetWorks Co., Ltd.	June 22, 2005	Sammy NetWorks Co., Ltd.'s employees: 12	Common stock 18	August 30, 2005	Continue to work through exercise of right	From August 30, 2005 to July 30, 2007	From July 31, 2007 to July 30, 2012
Sammy NetWorks Co., Ltd.	June 22, 2005	Sammy NetWorks Co., Ltd.'s directors: 5 Sammy NetWorks Co., Ltd.'s corporate auditors: 1 Sammy NetWorks Co., Ltd.'s employees: 77	Common stock 353	April 28, 2006	Continue to work through exercise of right	From April 28, 2006 to July 30, 2007	From July 31, 2007 to July 30, 2012
Media-Trust Co., Ltd.	December 12, 2005	Media-Trust Co., Ltd.'s directors: 5 Media-Trust Co., Ltd.'s corporate auditors: 3 Media-Trust Co., Ltd.'s employees: 44	Common stock 3,050	December 12, 2005	Continue to work through exercise of right	From December 12, 2005 to December 12, 2007	From December 13, 2007 to December 12, 2015
SEGA TOYS CO., LTD.	June 26, 2002	SEGA TOYS CO., LTD.'s directors: 3 SEGA TOYS CO., LTD.'s corporate auditors: 2 SEGA TOYS CO., LTD.'s employees: 32	Common stock 456,000	July 1, 2002	Continue to work through exercise of right	From July 1, 2002 to June 30, 2004	From July 1, 2004 to June 30, 2008
SEGA TOYS CO., LTD.	June 29, 2004	SEGA TOYS CO., LTD.'s directors: 8 SEGA TOYS CO., LTD.'s corporate auditors: 3 SEGA TOYS CO., LTD.'s employees: 105	Common stock 894,600	August 9, 2004	Continue to work through exercise of right	From August 9, 2004 to June 30, 2005	From July 1, 2005 to June 30, 2008
TMS ENTERTAINMENT, LTD.	June 27, 2003	TMS ENTERTAINMENT, LTD.'s directors: 12 TMS ENTERTAINMENT, LTD.'s employees and subsidiaries' directors: 118	Common stock 458,000	August 1, 2003	Continue to work from August 1, 2003 to June 30, 2005	From August 1, 2003 to June 30, 2005	From July 1, 2005 to June 30, 2008
TMS ENTERTAINMENT, LTD.	June 28, 2006	TMS ENTERTAINMENT, LTD.'s directors: 6 TMS ENTERTAINMENT, LTD.'s employees and subsidiaries' directors: 93	Common stock 598,000	August 21, 2006	Continue to work from August 21, 2006 to June 30, 2008	From August 21, 2006 to June 30, 2008	From July 1, 2008 to June 30, 2011

The following tables summarize scale and movement of stock as of March 31, 2007:

Company name	The Company	The Company	The Company	The Company	NISSHO INTER. LIFE Co., LTD.	NISSHO INTER LIFE Co., LTD.	NISSHO INTER LIFE Co., LTD.
Date of the annual shareholders' meeting	June 24, 2005	June 20, 2006	June 20, 2006	June 20, 2006	August 19, 2002	August 19, 2003	August 19, 2004
Not exercisable stock options							
Stock options outstanding at April 1, 2006	2,486,800	—	—	—	—	—	215,500
Stock options granted	—	43,000	2,701,500	10,000	—	—	—
Forfeitures	47,600	—	53,700	—	—	—	29,500
Conversion to exercisable stock options	—	—	—	—	—	—	186,000
Stock options outstanding at March 31, 2007	2,439,200	43,000	2,647,800	10,000	—	—	—
Exercisable stock options							
Stock options outstanding at April 1, 2006	—	—	—	—	144,300	135,000	—
Stock options granted	—	—	—	—	—	—	186,000
Forfeitures	—	—	—	—	—	2,000	—
Conversion to exercisable stock options	—	—	—	—	26,000	27,500	13,500
Stock options outstanding at March 31, 2007	—	—	—	—	118,300	105,500	172,500

Company name	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Media-Trust Co., Ltd.	SEGA TOYS CO., LTD.
Date of the annual shareholders' meeting	July 30, 2003	July 30, 2003	July 30, 2003	June 22, 2005	June 22, 2005	December 12, 2005	June 26, 2002
Not exercisable stock options							
Stock options outstanding at April 1, 2006	—	—	—	18	—	2,840	—
Stock options granted	—	—	—	—	353	—	—
Forfeitures	—	—	—	6	7	10	—
Conversion to exercisable stock options	—	—	—	—	—	—	—
Stock options outstanding at March 31, 2007	—	—	—	12	346	2,830	—
Exercisable stock options							
Stock options outstanding at April 1, 2006	504	696	48	—	—	—	135,000
Stock options granted	—	—	—	—	—	—	—
Forfeitures	324	192	48	—	—	—	66,000
Conversion to exercisable stock options	—	—	—	—	—	—	—
Stock options outstanding at March 31, 2007	180	504	—	—	—	—	69,000

Company name	SEGA TOYS CO., LTD.	TMS ENTERTAINMENT, LTD.	TMS ENTERTAINMENT, LTD.
Date of the annual shareholders' meeting	June 29, 2004	June 27, 2003	June 28, 2006
Not exercisable stock options			
Stock options outstanding at April 1, 2006	—	—	—
Stock options granted	—	—	598,000
Forfeitures	—	—	25,000
Conversion to exercisable stock options	—	—	—
Stock options outstanding at March 31, 2007	—	—	573,000
Exercisable stock options			
Stock options outstanding at April 1, 2006	325,200	152,000	—
Stock options granted	—	—	—
Forfeitures	43,500	—	—
Conversion to exercisable stock options	—	13,000	—
Stock options outstanding at March 31, 2007	281,700	139,000	—

The following tables summarize price information of stock options as of March 31, 2007:

Yen

Company name	The Company	The Company	The Company	The Company	NISSHO INTER LIFE Co., LTD.	NISSHO INTER LIFE Co., LTD.	NISSHO INTER LIFE Co., LTD.
Date of the annual shareholders' meeting	June 24, 2005	June 20, 2006	June 20, 2006	June 20, 2006	August 19, 2002	August 19, 2003	August 19, 2004
Exercise price	¥3,470	¥4,235	¥4,235	¥4,068	¥454	¥341	¥515
Average market price of the stock at the time of exercise	—	—	—	—	—	446	—
Fair value of the stock option at the date of issue	—	510	509	620	—	—	—

Company name	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Media-Trust Co., Ltd.	SEGA TOYS CO., LTD.
Date of the annual shareholders' meeting	July 30, 2003	July 30, 2003	July 30, 2003	June 22, 2005	June 22, 2005	December 12, 2005	June 26, 2002
Exercise price	¥ 70,834	¥ 70,834	¥ 70,834	¥1,700,000	¥1,053,914	¥50,000	¥255
Average market price of the stock at the time of exercise	782,324	784,736	845,250	—	—	—	942
Fair value of the stock option at the date of issue	—	—	—	—	—	—	—

Company name	SEGA TOYS CO., LTD.	TMS ENTERTAINMENT, LTD.	TMS ENTERTAINMENT, LTD.
Date of the annual shareholders' meeting	June 29, 2004	June 27, 2003	June 28, 2006
Exercise price	¥ 288	¥413	¥472
Average market price of the stock at the time of exercise	1,067	—	—
Fair value of the stock option at the date of issue	—	—	126

U.S. dollars

Company name	The Company	The Company	The Company	The Company	NISSHO INTER LIFE Co., LTD.	NISSHO INTER LIFE Co., LTD.	NISSHO INTER LIFE Co., LTD.
Date of the annual shareholders' meeting	June 24, 2005	June 20, 2006	June 20, 2006	June 20, 2006	August 19, 2002	August 19, 2003	August 19, 2004
Exercise price	$29	$36	$36	$34	$4	$3	$4
Average market price of the stock at the time of exercise	—	—	—	—	—	4	—
Fair value of the stock option at the date of issue	—	4	4	5	—	—	—

Company name	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Sammy NetWorks Co., Ltd.	Media-Trust Co., Ltd.	SEGA TOYS CO., LTD.
Date of the annual shareholders' meeting	July 30, 2003	July 30, 2003	July 30, 2003	June 22, 2005	June 22, 2005	December 12, 2005	June 26, 2002
Exercise price	$ 600	$ 600	$ 600	$14,401	$8,928	$424	$2
Average market price of the stock at the time of exercise	6,627	6,647	7,160	—	—	—	8
Fair value of the stock option at the date of issue	—	—	—	—	—	—	—

Company name	SEGA TOYS CO., LTD.	TMS ENTERTAINMENT, LTD.	TMS ENTERTAINMENT, LTD.
Date of the annual shareholders' meeting	June 29, 2004	June 27, 2003	June 28, 2006
Exercise price	$2	$3	$4
Average market price of the stock at the time of exercise	9	—	—
Fair value of the stock option at the date of issue	—	—	1

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 liabilities section of the consolidated balance sheets as of March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Projected benefit obligation	¥ 22,870	¥ 19,980	$ 193,731
Unrecognized actuarial differences	(2,157)	(2,490)	(18,271)
Unrecognized prior service cost	363	454	3,075
Prepaid pension cost	—	—	—
Less fair value of pension assets	(12,647)	(10,453)	(107,133)
Liability for severance and retirement benefits	¥ 8,429	¥ 7,491	$ 71,402

Included in the consolidated statements of income for the years ended March 31, 2007, 2006 and 2005, severance and retirement benefit expenses comprised the following:

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007
Service costs–benefits earned during the year	¥2,203	¥2,095	¥1,343	$18,662
Interest cost on projected benefit obligation	393	340	271	3,329
Expected return on plan assets	(255)	(177)	(4)	(2,160)
Amortization of actuarial difference	407	554	380	3,448
Amortization of prior service cost	(91)	(91)	(91)	(771)
Additional interim benefit	149	—	763	1,262
Other	359	175	54	3,041
Severance and retirement benefit expenses	¥3,165	¥2,896	¥2,716	$26,811

	2007	2006	2005
Discount rate	2.0–2.5%	2.0–2.5%	2.0–2.5%
Rate of expected return on plan assets	1.0–2.5%	1.0–2.5%	0.0–1.0%

NOTE 7

CONTINGENT LIABILITIES

The subsidiaries of the Company have contingent liabilities as of March 31, 2007 and 2006 as follows:

		Millions of yen		Thousands of U.S. dollars
	Description	2007	2006	2007
Electronic Approval System Council	Lease obligation	¥ 66	¥ 98	$ 559
Dimps Corporation	Guarantee due to bank loan	400	400	3,388
Orix Premium Ltd.	Lease obligation	218	—	1,847
Sega (Shanghai) Software Co., Ltd.	Joint and several guarantee due to bank loan	100	—	847
FIELDS CORPORATION	Joint and several guarantee due to joining a union	10	—	85

NOTE 8

NET ASSETS/SHAREHOLDERS' EQUITY

The Japanese Corporate Law ("the Law") became effective on May 1, 2006, replacing the Japanese Commercial Code ("the Code"). The Law is generally applicable to events and transactions occurring after April 30, 2006 and for fiscal years ending after that date.

Under Japanese laws and regulations, the entire amount paid for new shares is required to be designated as common stock. However, 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.

Under the Law, in cases where a dividend distribution of surplus is made, the smaller of an amount equal to 10% of the dividend or the excess, if any, of 25% of common stock over the total of additional paid-in capital and legal earnings reserve must be set aside as additional paid-in capital or legal earnings reserve. Legal earnings reserve is included in retained earnings in the accompanying consolidated balance sheets.

Under the Code, companies were required to set aside an amount equal to at least 10% of the aggregate amount 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 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 could be capitalized by a resolution of the Board of Directors. Under the Law, both of these appropriations generally require a resolution of the shareholders' meeting.

Additional paid-in capital and legal earnings reserve may not be distributed as dividends. Under the Code, however, on condition that the total amount of legal earnings reserve and additional paid-in capital remained equal to or exceeded 25% of common stock, they were available for distribution by resolution of the shareholders' meeting. Under the Law, all additional paid-in capital and all legal earnings reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

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 Japanese laws and regulations.

At the Board of Directors' meeting held on May 16, 2007, the directors approved cash dividends amounting to ¥7,559 million ($64,032 thousand). Such appropriations have not been accrued in the consolidated financial statements as of March 31, 2007. Such appropriations are recognized in the period in which they are approved by the Board of Directors.

NOTE 9

REVALUATION RESERVE FOR LAND

SEGA CORPORATION, which is a consolidated subsidiary of the Company, 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 net assets/shareholders' 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

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, 2007, 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 years ended March 31, 2007 and 2006 is not shown because it is not significant.

The Company and its subsidiaries' significant components of deferred tax assets and liabilities as of March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Deferred tax assets:			
Allowance for doubtful accounts	¥ 4,917	¥ 3,262	$ 41,652
Loss on devaluation of inventories	4,306	2,556	36,476
Accrued employees' bonuses	1,333	1,705	11,292
Retirement benefits for employees	3,419	3,042	28,962
Depreciation expense	12,201	7,895	103,355
Loss on devaluation of investments	3,647	2,849	30,894
Impairment losses	2,929	2,979	24,812
Tax loss carry forward	21,805	17,503	184,710
Others	18,298	13,896	155,001
Total	72,855	55,687	617,154
Valuation allowance	(59,723)	(43,272)	(505,913)
Net deferred tax assets	13,132	12,415	111,241
Deferred tax liabilities:			
Net unrealized holding gains on securities	3,541	7,651	29,996
Others	1,369	2,171	11,597
Total	4,910	9,822	41,593
Recorded deferred tax assets	¥ 8,222	¥ 2,593	$ 69,648

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, 2007 were as follows:

	Millions of yen		
	Balance sheet amount	Fair value	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Bonds	¥497	¥497	¥ 0
Securities whose market value is equal to or lower than the balance sheet amount:			
Bonds	500	499	(1)

	Thousands of U.S. dollars		
	Balance sheet amount	Fair value	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Bonds	$4,210	$4,210	$ 0
Securities whose market value is equal to or lower than the balance sheet amount:			
Bonds	4,235	4,227	(8)

Acquisition costs, balance sheet amounts and valuation gains or losses of available-for-sale securities with available fair values as of March 31, 2007 were as follows:

	Millions of yen		
	Acquisition costs	Balance sheet amount	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Stocks	¥ 1,501	¥ 9,257	¥7,756
Bonds and debentures	2,501	2,531	30
Securities whose market value is equal to or lower than the balance sheet amount:			
Stocks	22,861	22,486	(375)
Bonds and debentures	4,008	3,765	(243)

	Thousands of U.S. dollars		
	Acquisition costs	Balance sheet amount	Valuation gains (losses)
Securities whose market value exceeds the balance sheet amount:			
Stocks	$ 12,715	$ 78,416	$65,701
Bonds and debentures	21,186	21,440	254
Securities whose market value is equal to or lower than the balance sheet amount:			
Stocks	193,655	190,479	(3,176)
Bonds and debentures	33,952	31,893	(2,059)

Available-for-sale securities sold in the year ended March 31, 2007 amounted to ¥4,343 million ($36,789 thousand) and the related gains amounted to ¥122 million ($1,033 thousand).

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)

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 costs	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)

Available-for-sale securities sold in the year ended March 31, 2006 amounted to ¥1,253 million and the related gains and losses amounted to ¥400 million and ¥16 million, respectively.

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 ¥723 million ($6,125 thousand) and ¥1,397 million were included in investment securities as of March 31, 2007 and 2006, respectively.

NOTE 13

RESEARCH AND DEVELOPMENT EXPENSES

Expenses relating to research and development activities have been charged to income as incurred and amounted to ¥52,107 million ($441,398 thousand), ¥36,338 million and ¥41,590 million for the years ended March 31, 2007, 2006 and 2005, respectively.

NOTE 14

GAIN ON SALE OF OPERATIONS

Gain on sale of operations is derived from the sale of operations in RTzen Inc., which was a former consolidated subsidiary for the year ended March 31, 2006, and from the 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 2006 and 2005.

NOTE 16

IMPAIRMENT LOSSES

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 value is calculated using the fair value less cost to sell based on the current market price.

Impairment losses for the year ended March 31, 2007 consisted of the following:

Use	Location	Impairment Loss		
		Type	Millions of yen	Thousands of U.S. dollars
Amusement facilities	Tarumi-ku, Kobe	Buildings and structures	¥ 167	$ 1,415
		Other tangible fixed assets	5	42
	Akashi-shi, Hyogo	Buildings and structures	134	1,135
		Other tangible fixed assets	21	178
		Other intangible fixed assets	1	8
	Funabashi-shi, Chiba	Buildings and structures	116	983
		Other tangible fixed assets	13	110
		Other intangible fixed assets	0	0
	Kita-ku, Osaka	Buildings and structures	112	949
		Other tangible fixed assets	2	17
	Tokushima-shi, Tokushima	Buildings and structures	94	796
		Land	11	93
	Nishi-ku, Hiroshima and seven other locations	Buildings and structures	132	1,118
		Other tangible fixed assets	82	695
Assets for business	Ota-ku, Tokyo and five other locations	Buildings and structures	27	229
		Other tangible fixed assets	202	1,711
		Other intangible fixed assets	486	4,117
		Investment and other assets	29	246
		Lease assets	72	610
Total			¥1,706	$14,452

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

Use	Location	Impairment Loss	
		Type	Millions of yen
Amusement facilities	Chuo-ku, Osaka	Land	¥4,576
		Buildings and structures	1,880
		Other tangible fixed assets	208
		Other intangible fixed assets	43
	Tokushima-shi, Tokushima	Buildings and structures	100
	Takatsuki-shi, Osaka	Buildings and structures	2
Assets for lease	Sakaiminato-shi, Tottori; Bunkyo-ku, Tokyo; and three other locations	Land	119
		Buildings and structures	37
Idle assets	Karuizawa-cho, Nagano and five other locations	Land	42
	Kawagoe-shi, Saitama	Other tangible fixed assets	188
Total			¥7,195

The recoverable values of amusement facilities (Tokushima-shi, Tokushima and Takatsuki-shi, Osaka) and assets for lease are assessed using their value in use, which is 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 from 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, accumulated impairment losses and net book value for the years ended March 31, 2007 and 2006 with respect to the finance leases accounted for in the same manner as operating leases was as follows:

	Millions of yen			
	Acquisition cost	Accumulated depreciation	Accumulated impairment losses	Net book value
March 31, 2007:				
Structures	¥ 280	¥ 88	¥—	¥ 192
Amusement machines	2,087	915	—	1,172
Tools, furniture and fixtures	2,783	1,488	28	1,267
Machinery and equipment	555	260	—	295
Software	823	436	44	343
Total	¥6,528	¥3,187	¥72	¥3,269

	Thousands of U.S. dollars			
	Acquisition cost	Accumulated depreciation	Accumulated impairment losses	Net book value
March 31, 2007:				
Structures	$ 2,372	$ 745	$ —	$ 1,627
Amusement machines	17,679	7,751	—	9,928
Tools, furniture and fixtures	23,575	12,605	237	10,733
Machinery and equipment	4,701	2,202	—	2,499
Software	6,972	3,694	373	2,905
Total	$55,299	$26,997	$610	$27,692

	Millions of yen		
	Acquisition cost	Accumulated depreciation	Net book value
March 31, 2006:			
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

Future lease payments under the finance leases that were accounted for in the same manner as operating leases as of March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Due within one year	¥1,626	¥1,450	$13,774
Due after one year	1,833	2,002	15,527
Total	¥3,459	¥3,452	$29,301
Liability of impairment loss for lease assets	¥ 72	—	$ 610

A summary of assumed amounts of lease payments, depreciation, impairment losses and interest expense for the years ended March 31, 2007, 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
	2007	2006	2005	2007
Lease payments	¥1,970	¥1,478	¥843	$16,688
Depreciation	1,882	1,460	812	15,942
Impairment losses	72	—	—	610
Interest expense	99	85	32	839

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, 2007 were as follows (except the derivative transaction hedged):

	Millions of yen			Thousands of U.S. dollars		
	Contract value	Fair value	Unrealized gains	Contract value	Fair value	Unrealized gains
Forward exchange contracts:						
Buying						
U.S. dollars	¥23	¥24	¥1	$195	$203	$8

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

	Millions of yen		
	Contract value	Fair value	Unrealized losses
Forward exchange contracts:			
Buying			
U.S. dollars	¥304	¥297	¥(7)

NOTE 19

SHAREHOLDERS' EQUITY

Changes in the number of shares issued and outstanding during the years ended March 31, 2007 and 2006 are as follows:

Common stock outstanding

	2007	2006
Balance at beginning of the year	283,229,476	140,551,522
Increase due to exercise of convertible bonds with stock acquisition rights	—	1,489,025
Increase due to stock split	—	141,188,929
Balance at end of the year	283,229,476	283,229,476

Treasury stock outstanding

	2007	2006
Balance at beginning of the year	31,254,693	77,003
Increase due to purchase from subsidiaries	—	20,023,368
Increase due to stock split	—	11,104,383
Increase due to purchase of odd stock	29,441	63,086
Decrease due to sale of odd stock	7,142	13,147
Balance at end of the year	31,276,992	31,254,693

NOTE 20

SEGMENT INFORMATION

A. Industry segment information

Industry segment information for the year ended March 31, 2007 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	¥211,540	¥75,455	¥103,850	¥119,593	¥17,800	¥528,238	¥ —	¥528,238
(2) Inter-segment	2,170	4,165	9	240	1,834	8,418	(8,418)	—
Total	213,710	79,620	103,859	119,833	19,634	536,656	(8,418)	528,238
Cost of sales and operating expense	142,608	67,937	103,727	118,084	20,979	453,335	(1,627)	451,708
Operating income	¥ 71,102	¥11,683	¥ 132	¥ 1,749	¥ (1,345)	¥ 83,321	¥ (6,791)	¥ 76,530
Total assets	¥118,581	¥46,524	¥106,318	¥111,752	¥11,593	¥394,768	¥155,172	¥549,940
Depreciation and amortization	¥ 5,332	¥ 2,403	¥ 18,052	¥ 3,216	¥ 362	¥ 29,365	¥ (1,317)	¥ 28,048
Impairment losses	¥ —	¥ —	¥ 890	¥ 494	¥ 322	¥ 1,706	¥ —	¥ 1,706
Capital expenditures	¥ 8,790	¥ 3,333	¥ 40,754	¥ 5,676	¥ 346	¥ 58,899	¥ 373	¥ 59,272

	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	$1,791,953	$639,178	$879,712	$1,013,071	$150,783	$4,474,697	$ —	$4,474,697
(2) Inter-segment	18,382	35,282	76	2,033	15,536	71,309	(71,309)	—
Total	1,810,335	674,460	879,788	1,015,104	166,319	4,546,006	(71,309)	4,474,697
Cost of sales and operating expense	1,208,031	575,493	878,670	1,000,288	177,712	3,840,194	(13,782)	3,826,412
Operating income	$ 602,304	$ 98,967	$ 1,118	$ 14,816	$ (11,393)	$ 705,812	$ (57,527)	$ 648,285
Total assets	$1,004,498	$394,104	$900,618	$ 946,650	$ 98,204	$3,344,074	$1,314,461	$4,658,535
Depreciation and amortization	$ 45,167	$ 20,356	$152,918	$ 27,243	$ 3,066	$ 248,750	$ (11,156)	$ 237,594
Impairment losses	$ —	$ —	$ 7,539	$ 4,185	$ 2,728	$ 14,452	$ —	$ 14,452
Capital expenditures	$ 74,460	$ 28,234	$345,227	$ 48,081	$ 2,931	$ 498,933	$ 3,159	$ 502,092

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 ¥7,014 million ($59,416 thousand), which mainly consist of expenses incurred by the Company's administrative department, are included in "Corporate and elimination".

4. Corporate assets of ¥157,478 million ($1,333,994 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, 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

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, 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, 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 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	¥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 is not presented as the sales and assets of consolidated domestic subsidiaries for the years ended March 31, 2007, 2006 and 2005 exceeded 90% of consolidated net sales and assets.

C. Overseas sales

Overseas sales for the year ended March 31, 2007 were as follows:

	Millions of yen			
	North America	Europe	Other	Total
Total overseas sales	¥37,035	¥24,781	¥7,561	¥ 69,377
Consolidated net sales				¥528,238
Percentage of overseas sales to consolidated net sales	7.0%	4.7%	1.4%	13.1%

	Thousands of U.S. dollars			
	North America	Europe	Other	Total
Total overseas sales	$313,723	$209,920	$64,049	$ 587,692
Consolidated net sales				$4,474,697
Percentage of overseas sales to consolidated net sales	7.0%	4.7%	1.4%	13.1%

Overseas sales for the years ended March 31, 2006 and 2005 are 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 21

RELATED-PARTY TRANSACTIONS

Material transactions of the Company with related individuals or companies for the year ended March 31, 2007 are as follows:

		Millions of yen			
		Transactions		End of period balance	
Name of related individual and company	Position and principal business	Description of the Company's transaction	2007	Account	2007
Hajime Satomi	Chairman of the Board and Chief Executive Officer	Lease of business jet	¥250	—	¥—
FSC Co., Ltd.	Nonlife insurance agent	Payment of insurance and outsourcing fee	26	Prepaid expense Accrued expense	7 0

		Thousands of U.S. dollars			
		Transactions		End of period balance	
Name of related individual and company	Position and principal business	Description of the Company's transaction	2007	Account	2007
Hajime Satomi	Chairman of the Board and Chief Executive Officer	Lease of business jet	$2,118	—	$—
FSC Co., Ltd.	Nonlife insurance agent	Payment of insurance and outsourcing fee	220	Prepaid expense Accrued expense	59 0

Notes: 1. Hajime Satomi, Chairman of the Board and Chief Executive Officer, directly holds 53% shares of FSC Co., Ltd.
2. 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.

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 balance	
Name of related individual and company	Position and principal business	Description of the Company's transaction	2006	Account	2006
Hajime Satomi	Chairman of the Board and Chief Executive Officer	Lease of business jet	¥349	—	¥—
FSC Co., Ltd.	Nonlife insurance agent	Payment of insurance and outsourcing fee	22	Prepaid expense	6

Notes: 1. The Company paid the lease fee to ITC-Aerospace, Inc. which operated the business jet owned by Hajime Satomi, Chairman of the Board and Chief Executive Officer.
2. Hajime Satomi, Chairman of the Board and Chief Executive Officer, directly holds 53% shares of FSC Co., Ltd.
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 22

BUSINESS COMBINATIONS

Material transactions of business combinations for the year ended March 31, 2007 are as follows:

1. Sports Interactive Ltd.

(1) Summary of business combination, including name of combining company, description of business, purpose of business combination, date of business combination, legal framework of business combination and percentage of voting rights acquired.

(i) Trade name and main business:
Sports Interactive Ltd.
Development of consumer games

(ii) Purpose of business combination:
To reinforce the competitiveness of the Company's consumer business in the European market, Sega Holdings Europe Ltd. acquired all issued shares of Sports Interactive Ltd.

(iii) Date of business combination: April 3, 2006

(iv) Legal framework of business combination: Acquisition of stock

(v) Percentage of voting rights acquired: 100%

(2) Period for which the performance of the new subsidiary is reflected in the consolidated financial statements
From April 4, 2006 to March 31, 2007

(3) Cost of acquisition of business and its details

	Millions of yen	Thousands of U.S. dollars
Cost of acquisition:		
Shares of Sports Interactive Ltd.	¥7,567	$64,100
Direct cost for acquisition:		
Cost of calculating stock price	105	889
Cost of acquisition of business	¥7,672	$64,989

(4) Amount of goodwill, reason and amortization method and period

(i) Amount of goodwill: ¥7,671 million ($64,981 thousand)

(ii) Reason: The fair value of net assets at the time of the business combination fell below the acquisition cost.

(iii) Amortization method and period: Straight-line method over 15 years

(5) Amounts of acquired assets and liabilities recognized at the date of the business combination

	Millions of yen	Thousands of U.S. dollars
Amount of assets:		
Current assets	¥145	$1,228
Fixed assets	5	42
Total	¥150	$1,270
Amount of liabilities:		
Current liabilities	¥149	$1,262
Total	¥149	$1,262

(6) Descriptions of the conditional acquisition cost under the contract of the business combination and accounting methods implemented after the current fiscal year

(i) Details of the conditional acquisition cost under the contract of the business combination

Under the contract of the business combination, the Company pays additional costs based on expected profits and expected sales amounts for 10 years after the business combination. This additional payment is measured as part of the initial cost of the business combination as present discount value.

(ii) Accounting methods implemented after the current fiscal year

When actual payments exceed the additional payments, the excess of the cost is amortized over the remaining period of goodwill.

(7) Effects on the consolidated income statement if the business combination had been completed on April 1, 2006

No material effect on the consolidated statement of income.

2. Secret Level, Inc.

(1) Summary of business combination, including name of combining company, description of business, purpose of business combination, date of business combination, legal framework of business combination and percentage of voting rights acquired

(i) Trade name and main business: Secret Level Inc. Development of consumer games and game engines

(ii) Purpose of business combination: To reinforce the competitiveness of the Company's consumer business in the North American market, Sega Holdings U.S.A., Inc. acquired all issued shares of Secret Level Inc.

(iii) Date of business combination: April 3, 2006

(iv) Legal framework of business combination: Acquisition of stock

(v) Percentage of voting rights acquired: 100%

(2) Period for which the performance of the new subsidiary reflected in the consolidated financial statements

From April 4, 2006 to March 31, 2007

(3) Cost of acquisition of business and its details

	Millions of yen	Thousands of U.S. dollars
Cost of acquisition:		
Shares of Secret Level Ltd.	¥1,772	$15,011
Direct cost for acquisition:		
Cost of calculating stock price	24	203
Cost of acquisition of business	¥1,796	$15,214

(4) Amount of goodwill, reason and amortization method and period

(i) Amount of goodwill: ¥1,243 million ($10,529 thousand)

(ii) Reason: The fair value of net assets at the time of the business combination fell below the acquisition cost.

(iii) Amortization method and period: Not amortized but is tested for impairment annually and when there are indications of impairment.

(5) Amounts of acquired assets and liabilities recognized at the date of the business combination

	Millions of yen	Thousands of U.S. dollars
Amount of assets:		
Current assets	¥265	$2,245
Fixed assets	692	5,862
Total	¥957	$8,107
Amount of liabilities:		
Current liabilities	¥349	$2,956
Long-term liabilities	55	466
Total	¥404	$3,422

(6) Effects on the consolidated income statement if the business combination had been completed on April 1, 2006

No material effect on the consolidated statement of income.

3. Sega Amusement Works, LLC

(1) Summary of business combination, including name of combining company, description of business, purpose of business combination, date of business combination, legal framework of business combination and name of company after business combination

(i) Trade name and main business:
Sunshine Entertainment Holdings, LLC
Management of amusement machines

(ii) Purpose of business combination: To extend the sales opportunities of the Company's amusement business in the North American market

(iii) Date of business combination:
December 1, 2006

(iv) Legal framework of business combination:
Transfer of business

(v) Name of company after business combination:
Sega Amusement Works, LLC

(2) Period for which the performance of the new subsidiary is reflected in the consolidated financial statements

From December 1, 2006 to March 31, 2007

(3) Cost of acquisition of business and its details

	Millions of yen	Thousands of U.S. dollars
Cost of acquisition:		
Shares of Sega Amusement Works, LLC	¥1,417	$12,003
Direct cost for acquisition:		
Cost of calculating stock price	—	—
Cost of acquisition of business	¥1,417	$12,003

(4) Amount of goodwill, reason and amortization method and period

(i) Amount of goodwill: ¥537 million ($4,549 thousand)

(ii) Reason: The fair value at the time of the business combination.

(iii) Amortization method and period: Not amortized but is tested for impairment annually and when there are indications of impairment.

(5) Amounts of acquired assets and liabilities recognized at the date of the business combination

	Millions of yen	Thousands of U.S. dollars
Amount of assets:		
Current assets	¥ 418	$ 3,541
Fixed assets	988	8,369
Total	¥1,406	$11,910
Amount of liabilities:		
Current liabilities	¥ 253	$ 2,143
Long-term liabilities	31	263
Total	¥ 284	$ 2,406

(6) Estimated amounts of effects on the consolidated income statement if the business combination had been completed on April 1, 2006

	Millions of yen	Thousands of U.S. dollars
Sales	¥2,016	$17,078
Operating income	46	390
Net income	21	178

The estimated amounts are calculated based on the monthly average amounts included in the income statement.

NOTE 23

PER SHARE DATA

Per share data are as follows:

	Yen			U.S. dollars
	2007	2006	2005	2007
Per share data:				
Net assets per share	¥1,341.80	¥1,254.14	¥2,067.91	$11.37
Net income per share	172.47	261.06	410.53	1.46
Net income per share (diluted)	172.35	260.35	400.95	1.46

On November 18, 2005, the Company split its common stock into two for one. Per share data would have been as follows if the stock split had been performed at the beginning of the 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

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, 2007 and 2006, and the related consolidated statements of income for each of the three years in the period ended March 31, 2007, the consolidated statement of net assets for the year ended March 31, 2007, the consolidated statements of shareholders' equity for the years ended March 31, 2006 and 2005 and the consolidated statements of cash flows for each of the three years in the period ended March 31, 2007, 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, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2007, in conformity with accounting principles generally accepted in Japan.

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

(1) 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.

(2) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2006, SEGA SAMMY HOLDINGS INC. and consolidated domestic subsidiaries adopted new accounting standards for the presentation of net assets in the balance sheet.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 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, 2007

The SEGA SAMMY Group

As of March 31, 2007

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	134 (non-consolidated) 7,734 (consolidated)

PRINCIPAL SUBSIDIARIES

Company	Capital	Voting Rights (%)
Sammy Corporation	¥18,221 million	100.0%
SEGA CORPORATION	¥60,000 million	100.0%
RODEO Co., Ltd.	¥100 million	65.0%[1]
Shuko Electronics Co., Ltd.[2]	¥179 million	100.0%[1]
Sammy Rental Service Co., Ltd.	¥160 million	100.0%[1]
Sammy Design Co., Ltd.	¥40 million	100.0%[1]
SI ELECTRONICS LTD.	¥244 million	88.1%[1]
H-I System Corporation[2]	¥10 million	100.0%[1]
GINZA CORPORATION	¥10 million	49.0%[1]
Sega Logistics Service Co., Ltd.	¥200 million	100.0%[1]
Sega Amusements U.S.A., Inc.	US$3 million	100.0%[1]
Sega Amusements Europe Ltd.	£22 million	100.0%[1]
Sega Entertainment U.S.A., Inc.	US$0 million	100.0%[1]
Sammy NetWorks Co., Ltd.	¥2,306 million	56.6%
SEGA TOYS, LTD.	¥1,728 million	52.4%
TMS ENTERTAINMENT, LTD.	¥8,816 million	55.5%[1]
Sega of America, Inc.	US$41 million	100.0%[1]
Sega Enterprises, Inc. (U.S.A.)	US$110 million	100.0%[1]
Sega Europe Ltd.	£320 million	100.0%[1]
Sega Publishing Europe Ltd.	£0 million	100.0%[1]
Nissho Inter Life Co., Ltd.	¥5,018 million	51.4%
SEGA SAMMY ASSET MANAGEMENT INC.[3]	¥100 million	100.0%

1. Percentage of voting rights includes rights of indirectly owned shares.
2. On April 1, 2007, Shuko Electronics Co., Ltd., merged with H-I System Corporation, and the resulting entity was renamed Sammy Systems Corporation.
3. On September 1, 2007, the name of SEGA SAMMY ASSET MANAGEMENT INC. was changed to SEGA SAMMY INVESTMENT AND PARTNERS INC.
4. On June 26, 2007, SEGA SAMMY HOLDINGS INC. acquired the shares of TMS ENTERTAINMENT, LTD., held by SEGA SAMMY INVESTMENT AND PARTNERS INC., raising its direct p

Main Business
Development, production, and sales of pachislot and pachinko machines
Development, production, and sales of amusement machines; development and operation of amusement centers; development and sales of home video game software
Development, production, and sales of pachislot machines
Development, production, and sales of peripheral equipment for pachislot and pachinko machines
Rental, leasing, and maintenance of pachislot and pachinko machines
Planning, design, and construction of pachinko halls and offices
Development, production, and sales of LCD displays and application software development environments for LCD displays
Development, production, and sales of peripheral equipment for pachislot and pachinko machines
Development, production, and sales of pachislot and pachinko machines
Distribution, distribution management, design of distribution systems, installation of machines, and provision of maintenance services
Importing, production, and sales of amusement machines
Importing and sales of amusement machines
Operation of amusement centers
Distribution service for music- and game-related content offered through mobile phones and PCs
Development, production, and sales of toys
Planning, production, and distribution of animated movies; planning, development, and operation of amusement centers
Importing and sales of consumer software; sales of game software
Consumer software
Design, development, importing, and sales of consumer software in the U.K.; holding company for European region
Sales of computer games
Planning, design, management, and construction of displays and commercial/cultural facilities
Investment advisory operations; operation and management of investment partnerships

centage of voting rights from 41.1% to 55.5%.

• THE SEGA SAMMY GROUP •

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