

SEGA™

SEGA Enterprises, Ltd.

Semiannual Report 1999

Six months ended September 30, 1998



FINANCIAL HIGHLIGHTS

SEGA Enterprises, Ltd. For the six months ended September 30, 1997 and 1998	Millions of yen		Thousands of U.S. dollars
	1997	1998	1998
Net sales	¥126,754	¥100,932	\$745,711
Cost of sales	93,872	77,339	571,400
Gross profit	32,882	23,593	174,311
Operating income	14,384	5,343	39,475
Net income	5,035	1,213	8,961
Net income per share (yen and U.S. dollars)	¥50.03	¥12.06	\$0.09

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

2. All dollar figures refer to U.S. currency. Yen amounts have been translated into dollars, for convenience only, at ¥135.35=US\$1.

MANAGEMENT'S REVIEW OF OPERATIONS

SEGA Enterprises, Ltd.

FIRST-HALF RESULTS

During the first half of fiscal 1999, ended September 30, 1998, Japan's severe economic slowdown intensified. Personal spending was slack, reflecting a deteriorating employment and wage outlook. Housing investment and corporate investment, which entered the year at very low levels, dipped further. Other negative factors included public unease regarding the nation's financial system and the ongoing currency crises in other Asian nations.

In the amusement industry, only products that accurately met consumer trends and provided new innovations in the user experience became hits. Amid the economic downturn in Japan and the resulting slump in personal spending, the market as a whole remained stagnant.

In this difficult operating environment, SEGA Enterprises, Ltd., worked to bolster its marketing capability and develop innovative new products. At the same time, we repositioned our amusement centers as "multientertainment" complexes that offer high-quality services. Nevertheless, the Company was unable to escape the grip of the deepening domestic economic downturn and the ongoing Asian currency crises. The Company's business results were also negatively affected by the significant loss on write-down of investment securities due to the stagnant Japanese stock market.

As a result of these factors, non-consolidated net sales dropped 20.4% from the corresponding period of the previous year, to ¥100.9 billion; income before income taxes plunged 88.7%, to ¥1.4 billion; and net income plummeted 75.9%, to ¥1.2 billion.

Amusement Machine Sales

In Japan, sales of arcade video game machines were solid. Examples of successful products included the martial arts game *Virtual On* Oratorio Tangram and the driving game *Daytona USA 2*. In recent years, sales of the *Making Club Series*—*Print Club*, *Name Club*, and *Stamp Club*—exceeded all expectations as such products took hold as a fashion statement among the nation's youth. However, such pop culture phenomena are almost impossible to sustain, and sales generated by the *Making Club Series* peaked and declined during the period under review.

Overseas, the Company marketed such innovative new machines as the above-mentioned *Daytona USA 2* as well as *Harley Davidson & LA Riders*. However, these advances were erased by such negative factors as the Asian currency crises, resulting in an overall drop in revenue.

Consumer Products Sales

In Japan, with the release of Dreamcast—our next-generation digital entertainment machine—scheduled for the second half of fiscal 1999, we centered our sales strategy on software for the 32-bit Sega Saturn. This, along with solid demand from repeat customers, resulted in strong sales.

In overseas markets, we weighted our sales efforts toward software. Nevertheless, stiff competition and stagnant Asian economies combined to hamper sales.

Amusement Center Operations

In July, we opened Okayama Joypolis, our latest "amusement theme park." We also developed new attractions for our existing Joypolis facilities to increase their drawing power. We launched SegaArena Hamaotsu and three other medium-sized amusement centers—a category of center that generally can be run very efficiently. Our large-scale multientertainment complexes—encompassing movie theaters, bowling alleys, karaoke facilities, restaurants, and gift shops—also performed well.

SECOND-HALF OUTLOOK

On November 27, 1998, the Company introduced Dreamcast, a digital entertainment machine developed by SEGA that embodies the world's leading-edge technologies.

Dreamcast offers an unprecedented gaming experience. It incorporates a high-speed modem and allows users to log on through their phone lines immediately after they unpack their machines. Dreamcast users can enjoy games, send E-mail messages, surf the Internet, and play network games against opponents in other locations—all on their TV sets. Moreover, the machine's ultrarealistic 3-D graphics and lifelike sound far surpass those of any other existing game machine.

We released four cutting-edge game titles on the same day as the Dreamcast machine itself, including *Virtua Fighter 3 Team Battle* and *Godzilla Generation*. We are set to release a number of titles in the coming months, including the high-speed 3-D action game *Sonic Adventure*. All in all, Dreamcast has enjoyed a wildly enthusiastic reception in the gaming market.

We will continue with our efforts to breathe new life into the amusement machine market by developing machines with strong drawing power. To this end, we will introduce the newly developed Naomi system, a high-performance, cost-efficient 3-D computer graphics board that has component synergies with the Dreamcast system. We expect that the Naomi system board will be the standard of the amusement industry.

In amusement center operations, SEGA will concentrate on building efficient new amusement centers and developing new attractions for our existing centers. We will develop, to an even greater extent, a customer-oriented business approach by promoting the multientertainment concept and improving the quality of service.

January 1999



Shoichiro Irimajiri
Representative Director and President

SEMIANNUAL NON-CONSOLIDATED FINANCIAL STATEMENTS

SEMIANNUAL NON-CONSOLIDATED STATEMENTS OF INCOME

SEGA Enterprises, Ltd.

For the six months ended September 30, 1997 and 1998

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1997	1998	1998
Net Sales	¥126,754	¥100,932	\$745,711
Cost of Sales	93,872	77,339	571,400
Gross profit	32,882	23,593	174,311
Selling, General and Administrative Expenses	18,498	18,250	134,836
Operating income	14,384	5,343	39,475
Other Income (Expenses):			
Interest and dividend income	624	813	6,007
Interest expense	(356)	(274)	(2,024)
Loss on sales of marketable securities and short-term investments	—	(29)	(214)
Loss on disposal of property and equipment	(158)	(728)	(5,379)
Loss on write-down of investment securities	(1,434)	(3,266)	(24,129)
Loss on write-down of investments in subsidiaries and affiliates	—	(437)	(3,229)
Loss on sales of investment securities	—	(17)	(126)
Reversal of provision for doubtful accounts	—	241	1,780
Loss on settlement of litigation	—	(1,398)	(10,329)
Foreign exchange gains (losses), net	(1,276)	268	1,980
Amortization of discounts on bonds	(343)	(343)	(2,534)
Amortization of bond and note issue expenses	(131)	—	—
Other, net	885	1,204	8,895
	(2,189)	(3,966)	(29,302)
Income before income taxes	12,195	1,377	10,173
Income Taxes	7,160	164	1,212
Net income	¥ 5,035	¥ 1,213	\$ 8,961

	Yen		U.S. dollars (Note 1)
	1997	1998	1998
Per Share:			
Net income	¥50.03	¥12.06	\$0.09

The accompanying notes are an integral part of these statements.

SEMIANNUAL NON-CONSOLIDATED BALANCE SHEETSSEGA Enterprises, Ltd.
September 30, 1997 and 1998

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1997	1998	1998
Assets			
Total current assets	¥220,440	¥150,594	\$1,112,625
Investments and advances	56,507	64,500	476,543
Property and equipment	79,259	77,954	575,944
Fixed leasehold deposits	22,824	24,517	181,138
Deferred charges and other assets	8,841	9,121	67,388
	¥387,871	¥326,686	\$2,413,638

	Millions of yen		Thousands of U.S. dollars (Note 1)
	1997	1998	1998
Liabilities and Shareholders' Equity			
Total current liabilities	¥ 60,277	¥ 88,238	\$ 651,925
Total long-term liabilities	145,714	107,514	794,340
Shareholders' equity	181,880	130,934	967,373
	¥387,871	¥326,686	\$2,413,638

The accompanying notes are an integral part of these statements.

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

The dollar amounts included in the semiannual non-consolidated financial statements represent the arithmetical results of translating yen to dollars on the basis of ¥135.35=US\$1, the approximate effective rate of exchange at September 30, 1998. The inclusion of such dollar amounts

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

2. ADDITIONAL INFORMATION

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

non-consolidated financial statements in the annual report for the year ended March 31, 1998.

CORPORATE DATA

SEGA ENTERPRISES, LTD.

Head Office

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

Branch Offices

Sapporo, Kansai, Kyushu

Date of Incorporation

June 3, 1960

Paid-in Capital

¥39,154 million

Number of Employees

4,156

Net Sales

¥100.9 billion (six months ended September 30, 1998)

PRINCIPAL SUBSIDIARIES

SEGA of America, Inc.

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

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

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SEGA Europe Ltd.

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Tel: 44-181-995-3399

SEGA Operations UK Ltd.

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Surrey KT3 3NL, United Kingdom
Tel: 44-181-336-2256

SEGA Amusements Europe Ltd.

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Surrey KT3 3NL, United Kingdom
Tel: 44-181-336-1222

AMERICAN DEPOSITARY RECEIPTS

Depositary

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