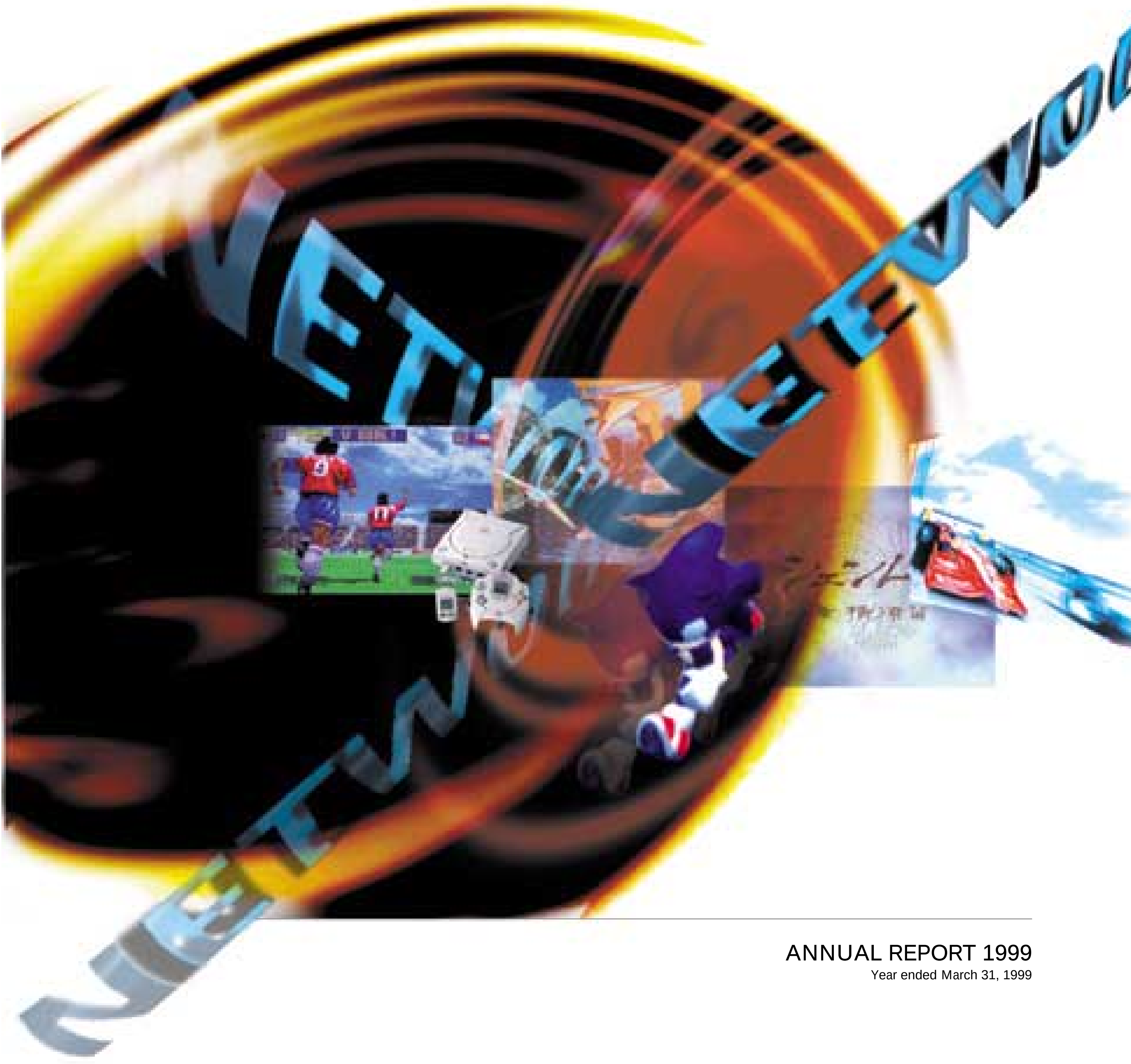
SEGA ENTERPRISES, LTD.



ANNUAL REPORT 1999

Year ended March 31, 1999

NON-CONSOLIDATED FINANCIAL HIGHLIGHTS

SEGA Enterprises, Ltd.
Years ended March 31, 1997, 1998, and 1999

			Millions of yen	Thousands of U.S. dollars
	1997	1998	**1999**	**1999**
For the year:				
Net sales:				
Consumer products	¥164,395	¥ 74,375	**¥ 68,434**	**$ 567,681**
Amusement center operations	88,191	90,958	**87,943**	**729,515**
Amusement machine sales	98,241	101,890	**56,203**	**466,221**
Royalties on game software	9,103	4,252	**1,966**	**16,309**
Total	¥359,930	¥271,475	**¥214,546**	**$1,779,726**
Cost of sales	¥285,146	¥216,596	**¥170,594**	**$1,415,130**
Gross profit	74,784	54,879	**43,952**	**364,596**
Selling, general and administrative expenses	43,555	41,172	**41,871**	**347,333**
Operating income	31,229	13,707	**2,081**	**17,263**
Net (loss) income	5,572	(43,300)	**(33,383)**	**(276,922)**
Depreciation and amortization	22,914	21,831	**23,336**	**193,579**
At year-end:				
Total assets	387,279	346,538	**417,763**	**3,465,475**
Total shareholders' equity	179,293	132,036	**100,636**	**834,808**
Financial ratios:				
Return on average assets	1.3%	—%	**—%**	**—%**
Return on average equity	3.1	—	**—**	**—**
Payout ratio	68.6	—	**—**	**—**

			Yen	U.S. dollars
	1997	1998	**1999**	**1999**
Net (loss) income per share—basic	¥55.4	¥(430.3)	**¥(331.1)**	**$(2.75)**
Net income per share—diluted	48.5	—	**—**	**—**
Cash dividends per share	38.0	38.0	**39.0**	**0.32**
Number of employees	3,872	3,982	**3,974**	

Notes: 1. U.S. dollar amounts are translated from yen, for convenience only, at the rate of ¥120.55=US$1, the exchange rate prevailing at March 31, 1999.
2. Net (loss) income per share figures have been computed using the weighted average number of shares outstanding during each period.

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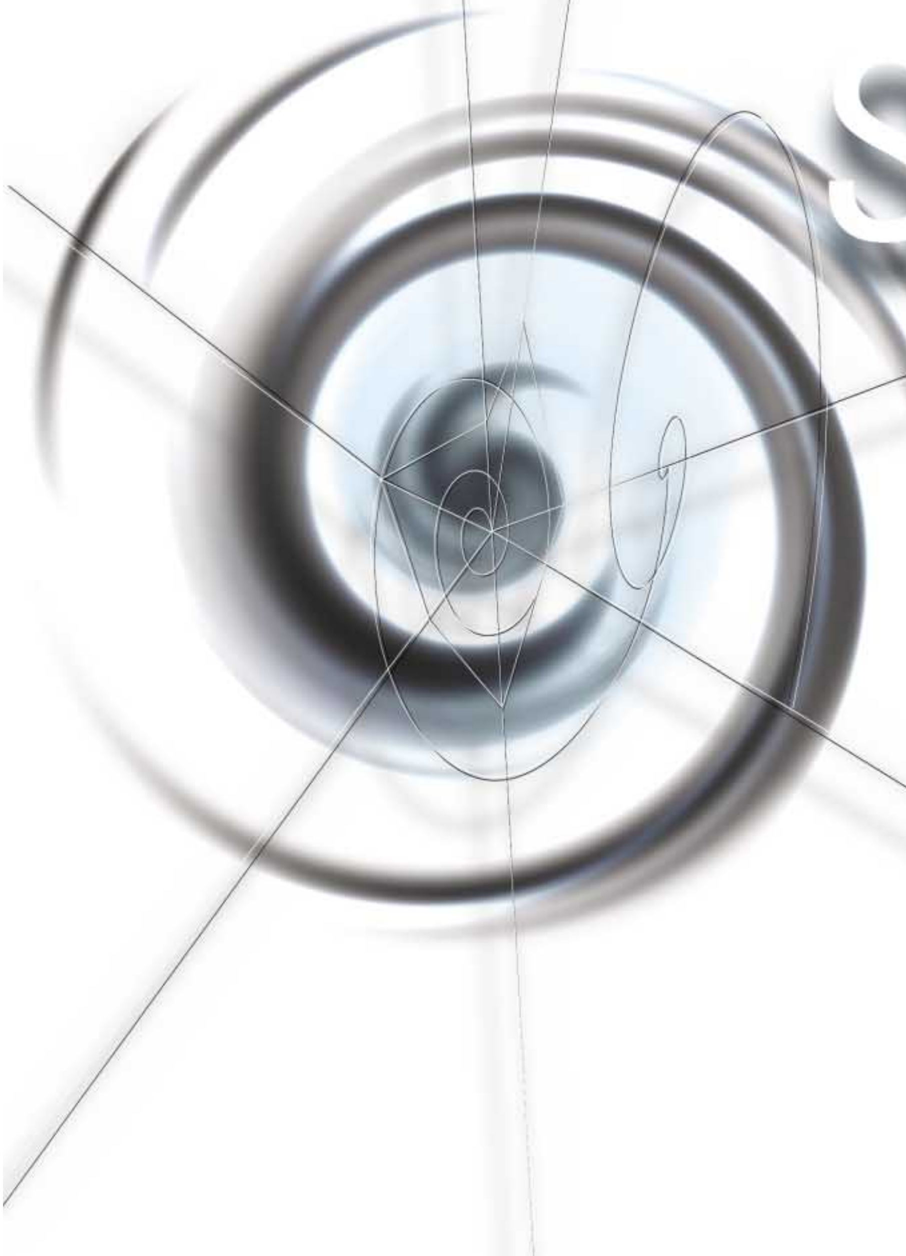
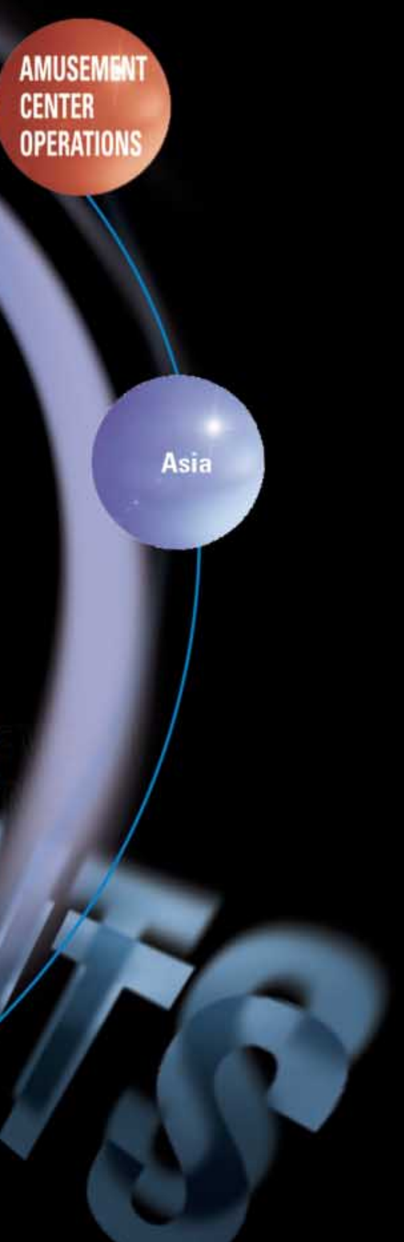
Spiral



SEGA Enterprises, Ltd., founded in 1951 and incorporated in 1960, is a world leader in interactive digital entertainment, engaged in the comprehensive businesses of consumer products, amusement center operations, and amusement machines. To launch the products, technologies, and interactive entertainment of tomorrow, we are centering our creative energies on interactive content and amusement theme parks (ATPs).


Spiral
Europe
America
SEGA™
Dreamcast™
Japan
AMUSEMENT MACHINE

The CSK Group, utilizing its comprehensive strength, strives to create an imaginative business world.



The CSK Group's research and development encompasses both the business and entertainment sectors covering a range of technologies from microchips to satellite communications. The CSK Group, comprising more than 90 corporations worldwide, conducts its operations with a level of creativity and originality that is unparalleled in the world's information technology industry. CSK is leading the growth of systems development, systems integration, outsourcing, and networks. Group companies handle such areas as telemarketing, education and publishing, prepaid card business, and visual data processing and are leaders in the information and communications industry. In the fields of entertainment and consumer electronics, SEGA and ASCII Corp., with its abundant information content and knowledge, as well as CSK Electronics Corporation, our PC and peripherals sales company, are enjoying growth through their individual efforts. Each Group member's strength contributes to the synergy that enhances the overall creative energy of the entire Group.

Isao Okawa
Representative Director and Chairman

It is my firm conviction that the 21st century will become the century of the network society and the Internet society. As readers are no doubt aware, the number of Internet users is currently experiencing dramatic worldwide growth, and forecasts predict that the number of users will exceed one billion by 2005.

According to projections by the U.S. research company Forrester Research, the number of households connected to the Internet at the end of 1999 will have increased 16.5%, to 38.8 million, compared with one year earlier. The Interactive Digital Software Association (IDSA) predicts that computer game users will increasingly enter the Internet society, attracted by the potential for taking part in multi-player games, and that by 2002, 26.8 million Internet users will be playing on-line computer games.

According to the Internet Association of Japan, the number of Japanese Internet users exceeded 10 million in February 1998 and is forecast to reach 45 million in 2010. The number of radio listeners worldwide took 38 years to reach 50 million, and the number of television viewers worldwide took 13 years to reach the same figure. In comparison with these technological advances, the Internet has been adopted with a speed and range unheard of in human experience, and it is my belief that it will continue to contribute to society in numerous ways.

Stock price trends often provide an insight into future developments, and the phenomenal recent growth of Internet and electronic commerce (E-commerce) related stocks tends to support the scenario of a world changing radically as a result of the influence of these two technologies.

In the next stage in E-commerce related development, software and digital content will take center stage as what is likely to be an era of Internet-based services, electronic services, commences. I believe that SEGA Enterprises, Ltd., and the CSK Group, with their command of the software and digital content fields that brings them to the heart of the electronic services business, are very favorably positioned to respond to this development by offering customers high-value-added services.

Specifically, the coming era for computer games will be one where such cyberspace applications as voice-chat and video-chat will create a global gaming community that enables gamers to communicate and enjoy playing games together with other computer game enthusiasts from across the globe. I believe that the expansion of the Internet infrastructure based “Global Live Community” will begin to intensify in the coming period.

One of the key points in this new era of electronic services in the computer game industry will be how to use cyberspace to create an efficient gaming environment.

SEGA is committed to bringing the potential of cyberspace to game users by creating an array of network-based multiplayer games as well as cameras and microphones for use with Dreamcast. At the same time, we will work on the creation of proprietary networks principally centering on Dreamcast.

SEGA Soft Networks, Inc., a U.S. company established by SEGA and CSK Corp., which has engaged in four years of field-leading investment in network game and electronic services systems, provides Heat Net, a proprietary PC-based on-line game service.

Our next aim is the worldwide launch of Dreamcast Network, a Dreamcast-based network system that will allow simultaneous access by 200,000 users and make it possible for people from every corner of the globe to communicate in various ways, play games together, and converse with each other.

When playing games on the system, additional voice and 3-D moving image functions increase the depth and range of games and how they are played. This development creates a whole new genre of inexpensive computer games, precipitating a radical shift in gamers’ perceptions of game playing and engendering a form of communication beyond even the scope of video telephones.

Dreamcast literally creates a dream-type world, characterized by interactive communication in which the player takes the leading role.

I am confident that Dreamcast will not simply function as video game equipment but will become a leading network tool serving the needs of business and the individual in the 21st century.

In this context, the pioneering business partnerships that we have concluded with AT&T Corp. in the United States as well as British Telecom plc and ICL plc in Europe will play a crucial role in the next stage of our business development and give us high expectations for the future of SEGA.

August 1999

Isao Okawa

Isao Okawa
Representative Director and Chairman

EVOLUTION

Aspiration

Shoichiro Irimajiri

Representative Director and President

BUSINESS RESULTS

Despite the fact that fiscal 1999, ended March 31, 1999, was an extremely difficult year for Sega, with the stepping up of its consumer businesses as typified by the domestic launch of Dreamcast the year also represents what was in many respects a new start for the Company.

However, the severe operating environment of the previous fiscal year continued and, in fact, deteriorated in fiscal 1999 with the result that non-consolidated net sales dropped ¥56.9 billion, or 21.0%, to ¥214.5 billion, and operating income declined 84.8%, to ¥2.1 billion. In addition, special losses of ¥33.9 billion were recorded, resulting in a net loss of ¥33.4 billion.

Consolidated net sales fell 19.7%, to ¥266.2 billion. Operating income, however, amounted to ¥2.1 billion, compared with an operating loss of ¥2.1 billion for the previous fiscal year.

Looking at consolidated results by business segment, total sales from amusement center operations were down ¥1.4 billion, or 1.5%, to ¥93.1 billion, amusement machine sales declined ¥34.6 billion, or 27.9%, to ¥89.4 billion, and consumer product sales dropped ¥29.8 billion, or 26.0%, to ¥84.7 billion.

The Company increased cash dividends applicable to the period ¥1, to ¥39, representing the Dreamcast anniversary ¥1 dividend increase included in the interim dividend already paid.

ANALYSIS

The deep recession affecting the Japanese economy became still more protracted and severe in the period under review. Employment prospects and personal incomes deteriorated, causing consumer spending to slump; companies pared back capital investment as demand weakened; and anxiety concerning the financial sector continued as did the economic crisis affecting Asian economies.

In the amusement industry, although certain products which struck a chord with young people's sensibilities managed to attain hit status, generally speaking the recession-induced downturn in consumer spending further depressed the market, and consequently demand remained stagnant.

In this difficult operating environment, SEGA, using the basic components from Dreamcast, brought to market a variety of new amusement machine products utilizing its low-cost and high-capability new computer graphics (CG) system board, NAOMI. In the consumer products business, the Company commenced domestic sales of its key product, Dreamcast, a 128-bit home video game console.

However, amusement center operators, hit hard by the decline in personal consumption, reduced orders for new machines, and the amusement machine business suffered as a result. The consumer products business also felt the negative effects of an insufficient supply of hardware to meet the initial market fervor that greeted the launch of Dreamcast and the lack of the timely release of software killer titles. Both amusement machine and consumer products sales declined as a consequence.

Nevertheless, SEGA implemented aggressive measures during the year to ensure financial soundness and restore profit earning potential. These measures included the disposal of unprofitable overseas amusement center operations; the write-off of amusement machine inventories; the write-off of SegaSaturn components and the depreciation of software development costs for the same product; the diminution of investment in the PC software business; and the charging to the accounts of evaluation losses on investment securities. As a result, SEGA posted special losses of ¥33.9 billion and consolidated special losses of ¥26.0 billion.

In response to these disappointing results, from April 1999 the Company began implementing large-scale structural reforms and streamlining its operations. To revitalize the quality of its management and restore profit earning potential, SEGA found it essential to implement drastic streamlining measures that entailed the rethinking and overhaul of its management structure. As part of this streamlining, levels of management remuneration have been cut, and the number of executive officer posts reduced.

The Company is also in the process of reducing fixed costs 30% as part of its drive to achieve highly efficient, streamlined operations. SEGA's early retirement program facilitated staff reductions of 900 by the end of June 1999, in line with the need to achieve the appropriate staff levels in view of the scale of the Company's operations. With the inclusion of the natural reduction in the number of our employees through standard retirement, we expect to reach our target of a reduction of 1,000 staff by the end of fiscal 2000.

Fixed cost-cutting initiatives are expected to yield annual cost reductions of ¥21 billion, helping to make SEGA a leaner, stronger company.

In addition to the aforementioned measures, initiatives aimed at specific business segments are detailed as follows.

Delight

AMUSEMENT CENTER OPERATIONS

In amusement center operations, with radical changes in the market environment due to the depressed economic conditions during the term, a downward trend was shown in income. However, to maintain the number one position in the industry, we will carry out the following measures.

First, we will close 101 of our amusement centers, concentrating on nonperforming small-scale locations, and cut back on the opening of and investment in the existing type of centers. Overseas, with the exception of certain areas, we will specialize in amusement machine sales.

Second, for the purpose of enhancing ownership awareness, we will consider the adoption of a franchise system of operations.

Third, we will strive for the development of new styles of amusement facilities through alliances with other industries.

Fourth, in line with our conservative expectations for SEGA's future performance, we will abandon the hitherto uniform style of amusement center development and strive to create unique new entertainment spaces through the optimal utilization of SEGA's know-how.

Fifth, we will aggressively invest in R&D for the development of radically innovative facilities that will drive the cutting-edge technologies of vision, sound, and virtual reality.

In the opening of new amusement centers, we have restricted ourselves to locations with high profitability as well as new operations development. At the end of June, we opened Shibuya GIGO, in Tokyo's Shibuya Ward, and in July we opened SEGA Arena Toyohashi, in Aichi Prefecture, and the new, sensational virtual aquarium restaurant, Fish "on" Tips, in Gifu Prefecture.

AMUSEMENT MACHINE SALES

In amusement machine sales, we are bolstering the development of powerful, thrilling games that can only be experienced in arcades, such as F355 Challenge. This game, which uses the NAOMI CG system board, is the first driving simulator to be developed under the supervision of Ferrari S.p.A. Furthermore, we will work to expand software licensees for the NAOMI CG system board, which shares principal components with Dreamcast. At the same time, we will strengthen the synergy between consumer products and amusement machines, made possible through interworking with Dreamcast using its Visual Memory System—a combination memory card and portable game card with a built-in LCD screen.

F355 challenge™, Ferrari®, logos and the F355 Challenge distinctive all associated designs are trademarks of Ferrari Idea S.A.

In addition, we will reinforce our approach to new market segments, such as the women's, children's, and family markets, through new system sales. Examples of these new systems include the Disney Fun Square from SEGA, which comprises entertainment machines geared for children that incorporate Disney characters, and the Virtual Aquarium that utilizes SEGA's cutting-edge computer graphics technology.

CONSUMER PRODUCTS

In consumer products, we will release new software titles that fully utilize Dreamcast's communications features, thereby differentiating our products from other TV game brands. We will respond to the demands of the network society by pursuing network entertainment, with Dreamcast as its core, and thereby enrich the world of amusement and communication.

Concerning our software lineup, major new products will be fully assembled from such powerful licensees as Acclaim, Accolade, Capcom, Take2, THQ, Hasbro Interactive, Mindscape, Namco, Midway, GT Interactive, Interplay, Konami, Micropose, ASC Games, Fox Interactive, Ubi Soft, and also Shenmue, our own line of software whose debut we have been carefully planning. Numerous killer titles, network titles, children's titles, and groundbreaking new cornerstone software titles are planned for continuous release.

At present, more than 500 publishers around the world are developing software for Dreamcast. We are striving for Dreamcast's ever-broader sales expansion through superb quality and cost performance hardware and a wide variety of software titles incorporating the talents of outstanding software creators.

Overseas, we will commence sales of Dreamcast in the United States on September 9, 1999, priced at $199.99, and later in Europe, priced at £199.99. As in Japan, we have made modems standard equipment through which we are pursuing the new entertainment potential of on-line games by adding networking to traditional playing environments.

Additionally, we will streamline our development division through the concentration and consolidation of our software development business and work toward the strengthening and optimization of our home entertainment software and software for amusement center machines.

Fruition

Dreamcast (for the Japanese market)

THE DREAM COMES TRUE WITH SEGA

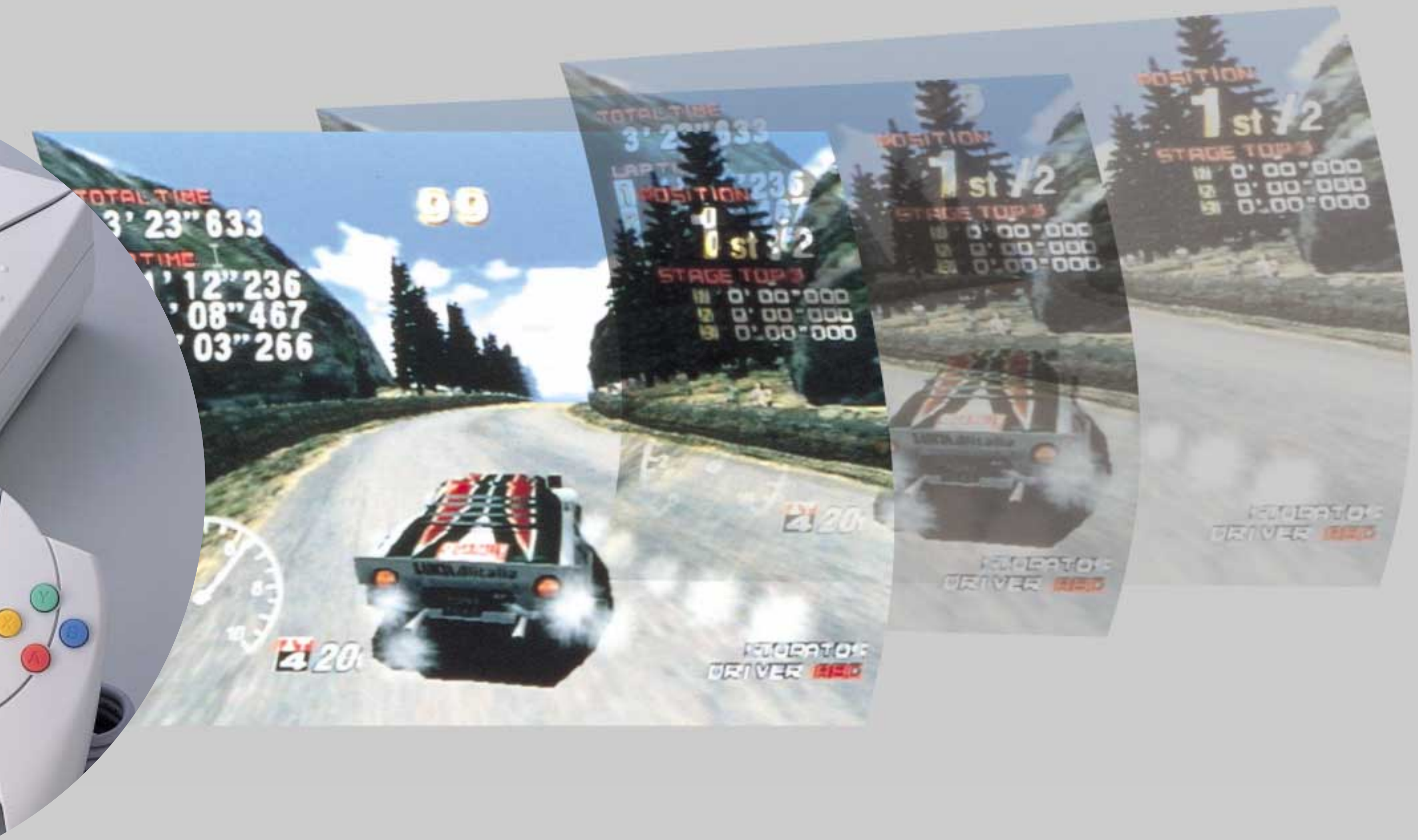
In the six months since Dreamcast's introduction in Japan on November 27, 1998, we achieved sales of one million units. The speed of its market diffusion exceeds all previous records for TV game consoles. In addition, as a second-phase strategy of our domestic Dreamcast operations, on June 24, 1999, we lowered the price of Dreamcast to ¥19,900. The market reaction to this price cut was huge, and we firmly believe that it will further accelerate the spread of Dreamcast.

As for the marketing of Dreamcast overseas, sales are slated to commence in September at highly competitive prices made possible through drastic cost reductions. The sales launch will be accompanied by the simultaneous introduction of an abundant lineup of 16 software titles, which will be further expanded to 40 titles by Christmas 1999. Dreamcast has received rave reviews in the U.S. and European markets, and we are aggressively promoting its business development.

DREAMCAST NETWORK

With the phenomenal evolution of graphic expression capabilities and the explosive spread of Internet environments, from the outset the premise of Dreamcast has been to develop an entirely new game machine. Hence, Dreamcast realizes the fusion of the world of 3-D game graphics with the world of Internet-based networking. Since its introduction in Japan in November, more than 30% of users have accessed the network. These are astounding figures for Japan and are attracting attention from all industries. Furthermore, of our network users more than 50% had never accessed the Internet before.

At SEGA, we are developing our own network service and support, but it is our belief that the popularity of Dreamcast will be the catalyst for the spread of networks all over Japan. Moreover, Dreamcast has attracted the attention of numerous corporations in other industries as a new type of information terminal and is actually being used by Toyota Motor Corp. in all of its nationwide sales locations as a new tool in a variety of applications.



Obviously, SEGA's network business through Dreamcast has the potential to expand instantly. SEGA, together with CSK, has established SEGA Soft Networks in the United States and is promoting the development of on-line games. Presently, SEGA Soft Networks is providing such service across the United States under the name Heat Net. In the future, SEGA will apply Heat Net's service to Dreamcast and with the support of such partners as AT&T, British Telecom, and ICL will develop a worldwide Dreamcast Network.

SEGA recognizes the potential of the network business and has established a new division for this business' aggressive development. With respect to Dreamcast-based Internet services, SEGA and CSK will pool all their resources and proactively invest in the development of network content, communication services, and E-commerce. Through the newly developed Dreamcast Network, we plan to further expand the functions and scope of network services through alliances with AT&T in the United States, British Telecom in Europe, and prominent corporations in Japan. From these three hubs, we will provide real-time, on-line games and a variety of network and electronic services.

In closing, on behalf of the Board of Directors I would like to thank our shareholders for their support and ask for their continued backing as we move into an exciting future.

August 1999

Shoichiro Irimajiri

Shoichiro Irimajiri
Representative Director and President

AMUSEMENT CENTER OPERATIONS

In fiscal 1999, the flat conditions in the amusement center market reflected the ongoing recession in the Japanese economy. Against this backdrop and on the basis of thorough research, SEGA opened two new amusement theme parks (ATPs), the Okayama Joypolis, in Okayama Prefecture, and the Umeda Joypolis, in Osaka.

Moreover, the Company moved to capture a profitable market with the launching of eight new-style amusement complexes, including Club SEGA in Shibuya and SEGA Arena in Hamaotsu. These medium-sized complexes complement the large-scale ATPs.

With 870 domestic sites, SEGA ranks top in the Japanese market for amusement center operations. During the term under review, the Company further improved the management efficiency of these sites and developed multi-entertainment complexes that combine movie theaters, bowling alleys, karaoke rooms, food and beverage stands, and souvenir shops.

However, revenues from our amusement center operations declined due to sluggish overall consumer spending in Japan, the absence of a hit product that would appeal to a wide range of users, and changes in the spending patterns of young people. These factors were exacerbated by the continued poor performance of small-scale centers.

As a result, net sales from amusement center operations edged down ¥3.0 billion, or 3.3%, to ¥87.9 billion.

AMUSEMENT MACHINE SALES

In domestic amusement machine sales, we continued to lead the market with such distinctive products as Virtua Striker 2, a soccer game that harnesses the power of the MODEL 3 CG board, and the battle game Cyber Troopers, Virtual On: Oratorio. Moreover, in the second half of the fiscal period SEGA released several new game machines that use NAOMI, a new CG system board that combines low cost with high performance.

The title list of games incorporating the NAOMI board includes The House of The Dead 2, a horror shooting game; Dynamite Baseball 98; Crazy Taxi, a driving game; and Airline Pilots, a flight simulator.

However, SEGA was late to enter the market for music games, a new genre that is proving extremely popular. In addition, the weak conditions of the Japanese economy were reflected in the flat conditions of the amusement center market. In particular, sales to amusement center operators contracted as their finances became tight due to a precipitous decline in consumer spending after the start of the year. Against the backdrop of this harsh operating environment, SEGA's domestic sales of amusement machines shrank.

Among export products, the Company met market needs with such games as Virtua Striker 2 Version 99, Daytona USA 2 Power Edition—a racing game—and Harley Davidson & LA Riders. In addition, we focused on developing new customer segments by launching new products incorporating the NAOMI board. Despite these measures, the protracted sluggishness of European and U.S. amusement markets together with the negative influence of weak Asian economies led to a decline in export sales.

Domestic sales of amusement machines plunged ¥35.9 billion, or 51.8%, to ¥33.4 billion. However, the difference in sales from the






Dreamcast (for the Japanese market)

previous period is partly due to the spin-off of slot-machine and pachinko businesses and the transfer of karaoke business marketing functions to subsidiaries. These businesses recorded sales of ¥20.1 billion. Exports dropped ¥9.7 billion, or 30.0%, to ¥22.8 billion. Net sales in this segment fell ¥45.7 billion, or 44.8%, to ¥56.2 billion.

CONSUMER PRODUCTS

In the domestic consumer products business, we released the much-awaited Dreamcast, a 128-bit home video game console, in Japan in November 1998.

We also released an impressive array of exciting games to take advantage of the outstanding capabilities of Dreamcast, which incorporates a modem. The software lineup includes the Virtua Fighter 3 team battle; Sonic Adventure, a high-speed, 3-D action game; The House of The Dead 2; and the nonstop adventure game Blue Stinger. In addition, SEGA Rally 2 is a racing game that uses the console's modem to enable networked play.

However, a shortage of semiconductors employed in fabricating Dreamcast, together with a delay in developing software for use with the console, had a negative impact on sales.

As of the end of fiscal 1999, the Company had sold 900,000 Dreamcast game consoles, falling slightly short of initial sales targets. By May 1999, however, the Company had sold more than one million consoles.

The network functionality of Dreamcast is one of its greatest attractions, and 30% of purchasers have taken advantage of the Internet capabilities of the console.

Overseas, we began sales of Dreamcast to Asian markets and focused on promotional activities to boost demand.

Thanks to the aforementioned factors, domestic sales edged up 2.6%, or ¥1.5 billion, to ¥59.4 billion. Overseas sales dropped 45.2%, or ¥7.4 billion, to ¥9.0 billion, as Dreamcast was only marketed in Asia.

We intend to expand sales of Dreamcast to the U.S. market on September 9, 1999, and later to European markets.

	Billions of yen		Millions of U.S. dollars
Sales by division	1998	**1999**	**1999**
Net sales:	¥271.5	**¥214.5**	**$1,779.7**
Consumer products:	74.4	**68.4**	**567.7**
Domestic sales	58.0	**59.4**	**492.9**
Exports	16.4	**9.0**	**74.8**
Amusement center operations	91.0	**87.9**	**729.5**
Amusement machine sales:	101.9	**56.2**	**466.2**
Domestic sales	69.4	**33.4**	**277.1**
Exports	32.5	**22.8**	**189.1**
Royalties on game software	4.2	**2.0**	**16.3**

Note: U.S. dollar amounts are translated from yen, for convenience only, at the rate of ¥120.55=US$1, the exchange rate prevailing at March 31, 1999.

OVERVIEW

During fiscal 1999, ended March 31, 1999, although the Japanese video game industry was buoyed by the success of a number of new products among young consumers, it again had to deal with lackluster consumer spending amid the protracted economic recession. As before, the problems of a market lacking economic vitality persisted.

Under difficult conditions, SEGA undertook two major product launches: NAOMI, a low-cost, high-performance CG system board, and Dreamcast, a 128-bit home video game console. Despite the introduction of NAOMI, Amusement Machine Division revenues declined due to slack consumer spending and operators' diminished appetite for purchasing. Revenues in the Consumer Products Division also fell, reflecting the insufficient supply of hardware and software to meet the initial demand for Dreamcast.

While promoting its new flagship products, the Company advanced with wide-ranging measures to streamline its operations and effect revenue recovery through a healthy corporate structure. These included liquidating unprofitable overseas amusement operations, reducing inventory levels, amortizing SegaSaturn software development expenses, disposing of investments in PC software businesses, and writing off investment securities valuation losses.

As a result of these factors, non-consolidated net sales for the term declined 21.0%, to ¥214.5 billion (US$1,779.7 million). Furthermore, due to the special losses accompanying corporate restructuring, SEGA recorded a net loss of ¥33.4 billion (US$276.9 million)—an improvement on the ¥43.3 billion net loss posted in the previous fiscal year.

In commemoration of the debut of Dreamcast, SEGA paid annual cash dividends per share of ¥39.0 (US$0.32), up ¥1.00 from the previous fiscal year.

NET SALES

SEGA's non-consolidated net sales dropped ¥56.9 billion, or 21.0%, to ¥214.5 billion (US$1,779.7 million). In amusement machine sales, we concentrated our efforts on invigorating the Japanese market by introducing a variety of unique products for CG system boards and releasing NAOMI. However, divisional sales plummeted ¥45.7 billion, or 44.8%, to ¥56.2 billion, and this was the primary cause of the decline in net sales. This was due to the slowdown in the amusement market, associated with the adverse effects from the introduction of music games and the overall economic downturn, and a decline in demand brought on by a sudden and acute drop in personal consumption at the start of the calendar year.

In consumer products, the Company introduced Dreamcast to the Japanese market. Along with the hardware, featuring communications functions in the form of internal modems, we strove for sales of a large assortment of software as well. In exports, we launched sales of Dreamcast in Asia and worked to promote sales through software support. However, the insufficient supply of hardware and software incurred during the start-up adversely affected sales, regrettably resulting in a decline in sales for the division of ¥5.9 billion, or 8.0%, to ¥68.4 billion (US$567.7 million).

In amusement center operations, the Company strove to attract customers by opening ATPs in two locations and opening eight operationally efficient medium-sized complexes. We also improved our support services and enhanced operations and management systems, including the establishment of multi-entertainment complexes that combine amusement facilities with restaurants and retail stores. However, due to the general weakness of personal consumption and such market changes as the diversification of spending among young consumers, sales for the division inched down ¥3.0 billion, or 3.3%, to ¥87.9 billion (US$729.5 million).

Royalties on game software plummeted ¥2.3 billion, or 53.8%, to ¥2.0 billion (US$16.3 million).

Exports represented 15.1% of net sales, down 3.8 percentage points from the previous year. This was mainly due to declines in revenue from products and royalties. Export sales declined ¥18.9 billion, or 36.8%, to ¥32.4 billion (US$268.9 million).

COSTS, EXPENSES, AND EARNINGS

Cost of sales for the term decreased ¥46.0 billion, or 21.2%, to ¥170.6 billion, slightly more than the 21.0% drop in net sales. As a result, the cost of sales ratio declined 0.3 percentage point, to 79.5%. However, due to the large drop in revenue, fixed costs were not completely recovered, resulting in a drop in gross profit of ¥10.9 billion, or 19.9%, to ¥44.0 billion (US$364.6 million).

Although the Company endeavored to keep selling, general and administrative (SG&A) expenses down, advertising costs incurred in the development of Dreamcast and other new products resulted in SG&A expenses expanding ¥0.7 billion, or 1.7%, to ¥41.9 billion (US$347.3 million). Due to this factor and the decline in revenue, SG&A expenses as a percentage of sales rose 4.3 percentage points, to 19.5%. R&D expenses included in SG&A expenses decreased ¥1.4 billion, or 23.5%, to ¥4.7 billion (US$38.9 million). Total R&D expenses decreased ¥2.5 billion, or 9.2%, to ¥24.6 billion (US$204.5 million). This reflects the expenditure incurred during the previous term in the development of NAOMI and Dreamcast. However, as a percentage of net sales, R&D expenses climbed 1.5 percentage points, to 11.5%. This level of expenditure reflects our ongoing drive to create a strong R&D structure and a commitment to become a high-tech application corporation underpinned by proprietary R&D capabilities. As a result of these factors, operating income declined ¥11.6 billion, to ¥2.1 billion (US$17.3 million), and fell 4.0 percentage points as a percentage of net sales, to 1.0%.

Total other expenses, while declining ¥13.6 billion, to ¥35.2 billion (US$292.1 million), still remained high. This was due to the aforementioned efforts to bolster corporate structure and streamline operations as well as several special losses. Principal losses for the term included an ¥11.5 billion (US$95.4 million) loss on the write-down or disposal of inventories (see Note 14), a ¥5.0 billion (US$41.6 million) loss on the dissolution of a subsidiary, a ¥7.1 billion (US$59.2 million) provision for doubtful accounts, and a ¥5.5 billion (US$45.5 million) loss on reserve for guaranteed obligation.

As a result of these factors, the Company recorded a loss before income taxes of ¥33.1 billion (US$274.9 million) and a net loss of ¥33.4 billion (US$276.9 million).

Net loss per share—basic, compared with ¥430.3 in the previous term, amounted to ¥331.1 (US$2.75).

FINANCIAL POSITION

In consideration of its plans for business development in the 21st century, during the term under review SEGA procured net capital of ¥104.1 billion through various methods, including fund-raising.

Emphasizing asset quality, we continued to record suitable provisions for doubtful accounts related to investments in and advances to subsidiaries and affiliates, and also promoted the reduction of inventory levels. As a result, total assets at March 31, 1999, stood at ¥417.8 billion (US$3,465.5 million), up ¥71.2 billion from the previous fiscal year-end.

Total current assets rose ¥55.8 billion, to ¥234.0 billion, and was the principal cause for the increase in total assets. Among current assets, cash and cash equivalents leapt ¥69.5 billion, to ¥127.0 billion, reflecting the growth of marketable securities under temporary management and the procurement of funds for anticipated capital requirements in the next term. In addition, inventories climbed ¥9.6 billion due to the advanced production of certain products undertaken to meet strong future demand. Trade receivables fell ¥6.5 billion as a result of a sharp decline in amusement machine sales at the beginning of 1999.

In property and equipment, the Company invested a total of ¥19.0 billion (US$157.6 million) in amusement machines and facilities. As the amount of capital expenditure was less than the amount of depreciation, total property and equipment fell ¥1.9 billion, to ¥74.9 billion (US$621.1 million).

Despite such factors as the increases in provisions for doubtful accounts related to investments in and advances to subsidiaries and affiliates, total investments and advances increased ¥13.5 billion, to ¥73.3 billion (US$608.2 million), mainly due to increased investments and advances for new business development.

Although contributions of ¥4.4 billion were made due to the construction of new amusement facilities, cancellation of contracts and returns resulted in only a ¥1.8 billion increase in fixed leasehold deposits, to ¥24.2 billion (US$200.5 million).

Total current and long-term liabilities increased ¥102.6 billion, to ¥317.1 billion (US$2,630.7 million). Short- and long-term interest-bearing debt climbed ¥100.8 billion, to ¥245.6 billion (US$2,037.6 million), underpinning the rise in total liabilities. This was the result of a new drive to raise funds for business expansion, primarily through the issue of straight and convertible bonds. Although income tax payable decreased ¥4.0 billion due to the net loss, a ¥5.5 billion (US$45.5 million) loss on reserve for guaranteed obligation and other factors resulted in operating and other liabilities expanding ¥1.8 billion, to ¥71.5 billion (US$593.0 million).

Due to these factors, working capital increased ¥44.3 billion during the term, to ¥133.8 billion (US$1,110.1 million). As a result, the current ratio rose from 2.0 to 2.3. SEGA considers this level of liquidity to be sufficient to maintain smooth operations.

Total shareholders' equity declined ¥31.4 billion, to ¥100.6 billion (US$834.8 million). This primarily reflects a ¥45.0 billion reversal of voluntary reserves. Mainly as a result of this factor and the increase in interest-bearing debt during the year, the equity ratio decreased 14.0 percentage points, to 24.1%. SEGA will make every effort to restore shareholder value through the implementation of business development measures that emphasize corporate financial results. Also, the Company plans to improve its equity ratio through the conversion of ¥191.9 billion in convertible bonds. Furthermore, the ¥32.1 billion (US$266.1 million) accumulated deficit was eliminated by a ¥38.0 billion reversal in voluntary reserves, which was approved at the Annual General Meeting of Shareholders on June 29, 1999.

CASH FLOWS

In fiscal 1999, cash and cash equivalents increased ¥69.5 billion, to ¥127.0 billion (US$1,053.3 million). This jump was mainly due to an increase in the procurement of funds to finance future business development.

Net cash provided by operating activities decreased ¥27.8 billion, to ¥18.4 billion (US$152.7 million). Net cash after adjustments for depreciation, amortization, and other non-cash items totaled ¥22.1 billion, down ¥4.2 billion from the previous fiscal year. Changes in operating assets and liabilities, resulted in a cash outflow of ¥3.7 billion, compared with a cash inflow of ¥19.9 billion in the previous fiscal year. This difference was primarily due to an increase in inventories and a decrease in notes and accounts receivable.

Net cash used in investing activities declined ¥28.1 billion, to ¥49.1 billion (US$407.7 million), mainly due to a ¥27.0 billion decrease in investments in subsidiaries and affiliates, to ¥20.1 billion. In addition, acquisition of property and equipment, at ¥20.6 billion, was down slightly from the previous fiscal year.

Net cash provided by financing activities totaled ¥100.2 billion (US$831.3 million), in contrast with outflows of ¥3.8 billion in the previous term. This mainly reflects the procurement of ¥104.1 billion through convertible bonds and long-term bank loans. This fund-raising activity countered expenditure incurred for bond redemption and the repayment of long-term borrowings.

YEAR 2000 (Y2K) PROBLEM

SEGA has placed highest priority on this matter and is proceeding with Y2K compliance of internal information systems, products, and ATP and head office facilities.

Hardware and software compliance is expected to be completed by September 1999.

We estimate the cost of Y2K compliance at ¥40 million and had appropriated ¥7 million by March 1999.

We do not expect these expenses to have any significant effect on our future business operations or performance.

NON-CONSOLIDATED BALANCE SHEETS

SEGA Enterprises, Ltd.
March 31, 1998 and 1999

	Millions of yen		Thousands of U.S. dollars (Note 3)
ASSETS	1998	**1999**	**1999**
Current Assets:			
Cash and cash equivalents (Note 2 (3)):			
Cash	¥ 34,468	**¥ 94,476**	**$ 783,708**
Time deposits	8,520	**7,020**	**58,233**
Short-term investments (Note 5)	14,503	**25,479**	**211,356**
	57,491	**126,975**	**1,053,297**
Notes and accounts receivable:			
Trade	18,157	**11,701**	**97,064**
Subsidiaries and affiliates	43,946	**28,906**	**239,785**
Other	9,916	**3,211**	**26,636**
	72,019	**43,818**	**363,485**
Less allowance for doubtful accounts	(485)	**(26)**	**(216)**
	71,534	**43,792**	**363,269**
Inventories (Note 4)	36,952	**46,542**	**386,080**
Prepaid expenses	11,201	**14,612**	**121,211**
Other current assets	1,054	**2,087**	**17,312**
Total current assets	178,232	**234,008**	**1,941,169**
Investments and Advances:			
Investments in securities (Note 5)	18,827	**22,023**	**182,688**
Investments in and advances to subsidiaries and affiliates (Note 8)	73,372	**90,685**	**752,260**
Other investments	9,979	**9,440**	**78,308**
	102,178	**122,148**	**1,013,256**
Less allowance for doubtful accounts	(42,387)	**(48,833)**	**(405,085)**
Total investments and advances	59,791	**73,315**	**608,171**
Property and Equipment:			
Amusement machines and facilities	69,072	**70,801**	**587,317**
Buildings and structures	47,872	**50,366**	**417,802**
Machinery and equipment	20,947	**20,752**	**172,144**
	137,891	**141,919**	**1,177,263**
Less accumulated depreciation	(83,813)	**(89,747)**	**(744,479)**
	54,078	**52,172**	**432,784**
Land	22,574	**22,574**	**187,258**
Construction in progress	126	**122**	**1,012**
Total property and equipment	76,778	**74,868**	**621,054**
Fixed Leasehold Deposits (Note 6)	22,373	**24,170**	**200,498**
Deferred Charges and Intangible Assets	9,364	**11,402**	**94,583**
Total assets	¥346,538	**¥417,763**	**$3,465,475**

The accompanying notes are an integral part of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen 1998	Millions of yen 1999	Thousands of U.S. dollars (Note 3) 1999
Current Liabilities:			
Current portion of long-term debt (Note 9)	¥ 19,897	**¥ 29,371**	**$ 243,642**
Notes and accounts payable:			
Trade	50,308	**46,171**	**383,003**
Subsidiaries and affiliates	522	**880**	**7,300**
Other	563	**3,626**	**30,079**
	51,393	**50,677**	**420,382**
Accrued expenses	11,605	**12,619**	**104,679**
Income taxes payable (Note 7)	4,088	**85**	**705**
Reserve for guaranteed obligation	—	**5,485**	**45,500**
Other current liabilities	1,726	**1,944**	**16,125**
Total current liabilities	88,709	**100,181**	**831,033**
Long-Term Liabilities:			
Long-term debt (Note 9)	124,923	**216,265**	**1,793,986**
Accrued employees' retirement benefits (Note 10)	595	**556**	**4,612**
Accrued retirement benefits for directors and corporate auditors (Note 10)	275	**125**	**1,036**
Total long-term liabilities	125,793	**216,946**	**1,799,634**
Commitments and Contingent Liabilities (Note 18)			
Shareholders' Equity:			
Common stock:			
Authorized—200,000,000 shares at March 31, 1998 and 1999			
Issued, par value ¥50 per share—100,633,718 shares and 103,219,703 shares at March 31, 1998 and 1999, respectively	39,154	**42,109**	**349,307**
Additional paid-in capital	38,700	**41,653**	**345,525**
Legal reserve (Note 11)	2,377	**2,770**	**22,978**
Voluntary reserves (Note 11)	90,892	**45,892**	**380,689**
Special tax-purpose reserves (Note 2 (13))	302	**291**	**2,414**
Accumulated deficit (Note 19)	(39,389)	**(32,079)**	**(266,105)**
Total shareholders' equity	132,036	**100,636**	**834,808**
Total liabilities and shareholders' equity	¥346,538	**¥417,763**	**$3,465,475**

NON-CONSOLIDATED STATEMENTS OF OPERATIONS

SEGA Enterprises, Ltd.
For the years ended March 31, 1997, 1998 and 1999

	Millions of yen			Thousands of U.S. dollars (Note 3)
	1997	1998	**1999**	**1999**
Net Sales (Notes 12 and 13)	¥359,930	¥271,475	**¥214,546**	**$1,779,726**
Cost of Sales (Note 12)	285,146	216,596	**170,594**	**1,415,130**
Gross profit	74,784	54,879	**43,952**	**364,596**
Selling, General and Administrative Expenses	43,555	41,172	**41,871**	**347,333**
Operating income	31,229	13,707	**2,081**	**17,263**
Other Income (Expenses) (Note 13):				
Interest and dividend income	1,396	1,313	**1,604**	**13,306**
Interest expense	(675)	(651)	**(879)**	**(7,292)**
Loss on write-down or disposal of inventories (Note 14)	(3,243)	—	**(11,495)**	**(95,355)**
Loss on sale or disposal of property and equipment	(419)	(380)	**(1,085)**	**(9,000)**
Loss on write-down of investments in subsidiaries (Note 8)	(22,944)	—	**—**	**—**
Loss on valuation of investment securities	(722)	(4,295)	**(1,291)**	**(10,709)**
Loss on valuation of investments in subsidiaries and affiliates	—	(739)	**(750)**	**(6,221)**
Loss on valuation of cash trust for investments	—	(3,992)	**(1,330)**	**(11,033)**
Gain on sales of investments in subsidiaries and affiliates	4,416	—	**—**	**—**
Gain on sales of investment securities	1,780	510	**—**	**—**
Loss on sale or disposal of operations in subsidiaries and affiliates	—	(2,780)	**—**	**—**
Loss on dissolution of a subsidiary (Notes 8 and 15)	—	—	**(5,014)**	**(41,593)**
Net (loss) gain on foreign exchange	4,305	1,155	**(529)**	**(4,388)**
Provision for doubtful accounts (Notes 8 and 16)	—	(40,343)	**(7,139)**	**(59,220)**
Loss on reserve for guaranteed obligation (Note 17)	—	—	**(5,485)**	**(45,500)**
Amortization of discounts on bonds	(1,154)	(687)	**(686)**	**(5,691)**
Amortization of bond and note issue expenses	(977)	(263)	**(723)**	**(5,998)**
Other, net	1,265	2,309	**(416)**	**(3,450)**
Total other income (expenses)	(16,972)	(48,843)	**(35,218)**	**(292,144)**
(Loss) income before income taxes	14,257	(35,136)	**(33,137)**	**(274,881)**
Income Taxes (Note 7)	8,685	8,164	**246**	**2,041**
Net (loss) income	¥ 5,572	¥ (43,300)	**¥ (33,383)**	**$ (276,922)**

	Yen			U.S. dollars (Note 3)
	1997	1998	**1999**	**1999**
Per Share (Note 2 (15)):				
Net (loss) income—basic	¥55.4	¥(430.3)	**¥(331.1)**	**$(2.75)**
Net income—diluted*	48.5	—	**—**	**—**
Cash dividends	38.0	38.0	**39.0**	**0.32**
Weighted average number of shares (thousands)	100,633	100,633	**100,833**	

The accompanying notes are an integral part of these statements.

* Diluted net loss per share was not disclosed for the years ended March 31, 1998 and 1999, as net loss per share was calculated for the year after the adjustment for dilution.

NON-CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

SEGA Enterprises, Ltd.
For the years ended March 31, 1997, 1998 and 1999

		Millions of yen					
	Number of shares of common stock	Common stock	Additional paid-in capital	Legal reserve	Voluntary reserves	Special tax-purpose reserves	(Accumulated deficit) Retained earnings
Balance at March 31, 1996	100,633,718	¥39,154	¥38,700	¥1,589	¥88,892	¥324	¥ 8,985
Net income for the year ended March 31, 1997	—	—	—	—	—	—	5,572
Cash dividends	—	—	—	—	—	—	(3,824)
Transfer to legal reserve	—	—	—	392	—	—	(392)
Bonuses to directors and corporate auditors	—	—	—	—	—	—	(99)
Reversal of special tax-purpose reserves (Note 2 (13))	—	—	—	—	—	(11)	11
Transfer to voluntary reserves	—	—	—	—	1,000	—	(1,000)
Balance at March 31, 1997	100,633,718	39,154	38,700	1,981	89,892	313	9,253
Net loss for the year ended March 31, 1998	—	—	—	—	—	—	(43,300)
Cash dividends	—	—	—	—	—	—	(3,824)
Transfer to legal reserve	—	—	—	396	—	—	(396)
Bonuses to directors and corporate auditors	—	—	—	—	—	—	(133)
Reversal of special tax-purpose reserves (Note 2 (13))	—	—	—	—	—	(11)	11
Transfer to voluntary reserves	—	—	—	—	1,000	—	(1,000)
Balance at March 31, 1998	100,633,718	39,154	38,700	2,377	90,892	302	(39,389)
Net loss for the year ended March 31, 1999		**—**	**—**	**—**	**—**	**—**	**(33,383)**
Cash dividends		**—**	**—**	**—**	**—**	**—**	**(3,925)**
Transfer to legal reserve		**—**	**—**	**393**	**—**	**—**	**(393)**
Reversal of special tax-purpose reserves (Note 2 (13))		**—**	**—**	**—**	**—**	**(11)**	**11**
Reversal of voluntary reserves		**—**	**—**	**—**	**(45,000)**	**—**	**45,000**
Proceeds from conversion of convertible bonds	**2,585,985**	**2,955**	**2,953**	**—**	**—**	**—**	**—**
Balance at March 31, 1999	**103,219,703**	**¥42,109**	**¥41,653**	**¥2,770**	**¥45,892**	**¥291**	**¥(32,079)**

	Thousands of U.S. dollars (Note 3)					
	Common stock	Additional paid-in capital	Legal reserve	Voluntary reserves	Special tax-purpose reserves	(Accumulated deficit) Retained earnings
Balance at March 31, 1998	$324,794	$321,029	$19,718	$753,978	$2,505	$(326,744)
Net loss for the year ended March 31, 1999	**—**	**—**	**—**	**—**	**—**	**(276,922)**
Cash dividends	**—**	**—**	**—**	**—**	**—**	**(32,559)**
Transfer to legal reserve	**—**	**—**	**3,260**	**—**	**—**	**(3,260)**
Reversal of special tax-purpose reserves (Note 2 (13))	**—**	**—**	**—**	**—**	**(91)**	**91**
Reversal of voluntary reserves	**—**	**—**	**—**	**(373,289)**	**—**	**373,289**
Proceeds from conversion of convertible bonds	**24,513**	**24,496**	**—**	**—**	**—**	**—**
Balance at March 31, 1999	**$349,307**	**$345,525**	**$22,978**	**$380,689**	**$2,414**	**$(266,105)**

The accompanying notes are an integral part of these statements.

NON-CONSOLIDATED STATEMENTS OF CASH FLOWS

SEGA Enterprises, Ltd.
For the years ended March 31, 1997, 1998 and 1999

	Millions of yen			Thousands of U.S. dollars (Note 3)
	1997	1998	1999	1999
Cash Flows from Operating Activities:				
Net (loss) income	¥ 5,572	¥(43,300)	**¥ (33,383)**	**$ (276,922)**
Adjustments to reconcile net (loss) income to net cash provided by operating activities:				
Depreciation	18,994	19,279	**19,881**	**164,919**
Amortization	3,920	2,552	**3,455**	**28,660**
Loss on write-down or disposal of inventories	3,243	—	**11,495**	**95,355**
Loss on sale or disposal of property and equipment	419	380	**1,085**	**9,000**
Loss on write-down of investments in subsidiaries	22,944	—	**—**	**—**
Loss on valuation of investment securities	722	4,295	**1,291**	**10,709**
Loss on valuation of investments in subsidiaries and affiliates	—	739	**750**	**6,221**
Gain on sales of investments in subsidiaries and affiliates	(4,416)	—	**—**	**—**
Gain on sales of investment securities	(1,780)	(510)	**—**	**—**
Loss on sale or disposal of operations in subsidiaries and affiliates	—	2,780	**—**	**—**
Loss on dissolution of a subsidiary	—	—	**5,014**	**41,593**
Provision for doubtful accounts	—	40,343	**7,139**	**59,220**
Loss on reserve for guaranteed obligation	—	—	**5,485**	**45,500**
Others	651	(281)	**(151)**	**(1,253)**
Changes in assets and liabilities:				
Decrease in notes and accounts receivable	14,042	10,873	**27,741**	**230,120**
(Increase) decrease in inventories	4,836	2,849	**(17,885)**	**(148,362)**
(Increase) decrease in prepaid expenses and other current assets	1,759	(479)	**(7,443)**	**(61,742)**
(Decrease) increase in notes and accounts payable	(33,527)	11,892	**(3,799)**	**(31,514)**
(Decrease) increase in income taxes payable	6,135	(2,045)	**(3,986)**	**(33,065)**
Increase (decrease) in accrued expenses and other current liabilities	1,845	(3,175)	**1,722**	**14,286**
Net cash provided by operating activities	45,359	46,192	**18,411**	**152,725**
Cash Flows from Investing Activities:				
Acquisition of property and equipment	(31,075)	(23,054)	**(20,602)**	**(170,900)**
Proceeds from sale of property and equipment	1,746	1,638	**1,316**	**10,917**
Increase in investments in securities	(7,547)	(1,925)	**(4,506)**	**(37,379)**
(Increase) decrease in investments in subsidiaries and affiliates	3,294	(47,114)	**(20,077)**	**(166,545)**
Increase in other investments	(761)	(2,963)	**(154)**	**(1,277)**
Increase in fixed leasehold deposits	(96)	(350)	**(1,797)**	**(14,907)**
Increase in deferred charges and intangible assets	(1,600)	(3,445)	**(3,323)**	**(27,566)**
Net cash used in investing activities	(36,039)	(77,213)	**(49,143)**	**(407,657)**
Cash Flows from Financing Activities:				
Proceeds from issuance of long-term debt	—	—	**129,830**	**1,076,981**
Repayment of current portion of long-term debt	(30,620)	—	**(19,897)**	**(165,052)**
Repayment of long-term borrowings	—	—	**(5,792)**	**(48,046)**
Cash dividends	(3,824)	(3,824)	**(3,925)**	**(32,559)**
Net cash provided by (used in) financing activities	(34,444)	(3,824)	**100,216**	**831,323**
Changes in Cash and Cash Equivalents	(25,124)	(34,845)	**69,484**	**576,391**
Cash and Cash Equivalents at Beginning of Year	117,460	92,336	**57,491**	**476,906**
Cash and Cash Equivalents at End of Year	¥ 92,336	¥ 57,491	**¥126,975**	**$1,053,297**

The accompanying notes are an integral part of these statements.

NOTES TO THE NON-CONSOLIDATED FINANCIAL STATEMENTS

SEGA Enterprises, Ltd.
For the years ended March 31, 1997, 1998 and 1999

1. BASIS OF PRESENTING THE NON-CONSOLIDATED FINANCIAL STATEMENTS

(1) Accounting Principles

The accompanying non-consolidated financial statements have been prepared from accounts maintained by SEGA Enterprises, Ltd. (the “Company”) in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards.

Certain items presented in the non-consolidated financial statements filed with the Ministry of Finance (the “MOF”) in Japan have been reclassified for the convenience of readers outside Japan. In addition, the non-consolidated statements of cash flows are not required to be filed with the MOF, but have been prepared and included in the non-consolidated financial statements.

The non-consolidated financial statements are not intended to present the non-consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

(2) Significant Shareholders

The Company is an affiliate of CSK Corporation, Japan, which owned 20,148 thousand shares of common stock of the Company at March 31, 1998 and 1999, representing 20.02% and 19.52% of shares outstanding at such dates. In addition, the chairman of the Company, Mr. Isao Okawa, personally owned 2.11% of the issued shares of the Company as of March 31, 1999.

There have been no material transactions and account balances outstanding, other than the shareholdings, between the Company and CSK Corporation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Inventories

Inventories are stated at cost, determined by the moving-average method. When the net realizable value of certain classes of inventories is substantially lower than the carrying value (cost) and such decline of value is considered to be permanent, appropriate write-downs are recorded on such items.

(2) Valuation of Securities

Securities with quoted market values are valued at the lower of cost or market on an individual basis, cost being determined by the moving-average method. Other securities are valued at cost, which is determined by the moving-average method.

(3) Cash and Cash Equivalents

Cash equivalents include time deposits and short-term investments in conformity with generally accepted Japanese accounting practices.

(4) Investments in Subsidiaries and Affiliates

Investments in subsidiaries (majority-owned companies) and affiliates (20% to 50% owned companies) are valued at cost. The equity method of accounting for investments in the common stock of subsidiaries and affiliates has not been followed by the Company in the non-consolidated financial statements under Japanese accounting practices.

(5) Property and Equipment

Depreciation is computed, except for buildings acquired on and after April 1, 1998, by the declining-balance method at rates based on the estimated useful lives of assets, as prescribed by the Japanese income tax laws. The depreciation method of buildings, except for buildings’ improvements and structures, acquired on and after April 1, 1998, was changed from the declining-balance method to the straight-line method in accordance with the 1998 amendments of the Japanese tax laws. The effects of this change were immaterial. The range of useful lives is principally from 3 to 50 years for buildings and structures; from 2 to 20 years for machinery, equipment, furniture and tools; and from 2 to 5 years for amusement machines and facilities.

The estimated useful lives of buildings have been shortened in accordance with the 1998 amendments of Japanese tax laws. The effects of this change were to increase depreciation expense by ¥101 million ($838 thousand) and to decrease gross profit and operating profit by ¥27 million ($224 thousand) and ¥95 million ($788 thousand), respectively, and to increase loss before income taxes by ¥95 million ($788 thousand).

(6) Consumption Tax

Until March 31, 1997, the consumption tax had been imposed at the flat rate of 3% on all domestic consumption of goods and services (with certain exemptions). On April 1, 1997, the rate was increased to 5%.

The consumption tax imposed on the Company’s sales to customers is withheld by the Company at the time of sale and is paid to the national government subsequently. The consumption tax withheld upon sale is not included in the amount of “Net sales” in the accompanying non-consolidated statements of operations but is recorded as a liability, “consumption tax withheld.” The balances of “consumption tax withheld” and “consumption tax paid” (an asset item), which is borne by the Company on the purchases of products, merchandise and services from vendors, are not included in the amounts of costs and expenses but are offset, and the net balance is included in “Other current assets” or “Other current liabilities” of the non-consolidated balance sheets at March 31, 1998 and 1999.

(7) Leases

Finance leases other than those which are deemed to transfer the ownership of the leased assets to lessees are accounted for by the method that is applicable to ordinary operating leases.

(8) Amortization

Amortization of deferred charges and intangible assets is computed by the straight-line method, principally over seven years.

"Bond discount" arising from the issue of the zero-coupon convertible discount bonds (see Note 9), is recorded as a deferred charge and is amortized to expenses on a straight-line basis over the period up to the maturity of the bonds. When the discount bonds are converted into common stock of the Company, appropriate amortization is made in proportion to the balance of converted bonds.

Bond and note issue expenses are deferred and amortized on a straight-line basis over a three-year period.

(9) Foreign Currency Translation

Cash and short-term receivables and payables denominated in foreign currencies are translated into yen at the current exchange rates prevailing at the respective balance sheet dates. Resulting translation gains or losses are included in the determination of net income for the fiscal year.

Long-term receivables denominated in foreign currencies, including investments in overseas subsidiaries, are generally translated at the historical rates prevailing at the transaction dates.

Accounts denominated in foreign currencies which are hedged by forward exchange contracts are translated into yen at the contracted rates of exchange.

(10) Income Taxes

Income taxes are provided for based on the amount required by the tax returns for the fiscal year. No tax effect is recorded for temporary differences in the recognition of certain expenses between tax and financial reporting.

(11) Allowance for Doubtful Accounts

At March 31, 1999, the Company provided for allowance for doubtful accounts that are deemed adequate to cover future losses from delinquency and write-off based on its analyses on the historical collection date, in accordance with the Japanese Tax Law as amended. At March 31, 1998, and prior, the Company maintained allowance for doubtful accounts at 0.8% of total receivables outstanding in accordance with the Japanese Tax Law.

(12) Reserve for Guaranteed Obligation

Estimated future obligations related to certain guarantees are provided based on the financial position of the recipients of these guarantees.

(13) Special Tax-Purpose Reserves

The Company has provided for special tax-purpose reserves which have resulted in the deferral of income tax payments in accordance with the provisions of the Special Taxation Measures Law of Japan. The provisions for and reversals of the special tax-purpose reserves are made through appropriation of retained earnings and are deducted from or added back to the taxable income of the fiscal year to which the appropriation relates.

The reserves of the Company are in respect of the postponement of income tax payments by reason of export sales and deferred capital gains arising from qualified asset replacements.

(14) Appropriation of Retained Earnings

Under the Japanese Commercial Code and the Articles of Incorporation of the Company, the plan for appropriation of retained earnings (including year-end cash dividend payments) proposed by the Board of Directors should be approved by the shareholders' meeting which must be held within three months of the end of each fiscal year. The appropriation of retained earnings reflected in the accompanying non-consolidated financial statements represents the results of such appropriations which are applicable to the immediately preceding fiscal year but were approved by the shareholders' meeting and disposed of during that year. Year-end dividends are paid to shareholders on the shareholders' register at the end of each fiscal year.

(15) Net (Loss) Income and Dividends per Share

Net (loss) income per share of common stock is based upon the weighted average number of shares of common stock outstanding during each fiscal year. Net (loss) income per share is computed to reflect the dilutive effect on net income assuming potential issues of new shares of common stock upon conversion of convertible debt securities and exercise of warrants outstanding with the related reduction of interest expenses.

Cash dividends per share shown for each year in the non-consolidated statements of operations represent dividends declared as applicable to the respective period.

(16) Common Stock and Additional Paid-in Capital

Under the provisions of the Japanese Commercial Code, it is required that at least 50% of the issue price of new shares be transferred to the "Common stock" account, provided 50% of the issue price is greater than the par value of common stock. In accordance with such requirements, 50% of the proceeds from new share issues sold in public offerings at market price is transferred to the "Common stock" account and the remaining 50% is credited to the "Additional paid-in capital" account.

3. UNITED STATES DOLLAR AMOUNTS

The Company maintains its accounting records in yen. The dollar amounts included in the non-consolidated financial statements and notes thereto represent the arithmetical results of translating yen to dollars on the basis of ¥120.55=US$1. 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 ¥120.55=US$1 or at any other rate.

4. INVENTORIES

Inventories as of March 31, 1998 and 1999, consisted of:

	Millions of yen		Thousands of U.S. dollars
	1998	**1999**	**1999**
Merchandise	¥ 3,141	**¥ 3,222**	**$ 26,727**
Products	12,152	**20,498**	**170,037**
Materials	14,427	**13,757**	**114,119**
Work in process	4,901	**6,361**	**52,766**
Supplies	2,331	**2,704**	**22,431**
	¥36,952	**¥46,542**	**$386,080**

5. SHORT-TERM INVESTMENTS AND INVESTMENTS IN SECURITIES

Short-term investments (current portfolio) and investments in securities (non-current portfolio) of the Company at March 31, 1998 and 1999, consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	1998	**1999**	**1999**
Short-term investments:			
Cash trust for investments	¥ 6,007	**¥ 4,678**	**$ 38,805**
Lease-backed notes	4,000	**20,500**	**170,054**
Other securities	4,496	**301**	**2,497**
	¥14,503	**¥25,479**	**$211,356**
Investments in securities:			
Listed corporate shares	¥ 8,209	**¥ 9,124**	**$ 75,687**
Unlisted corporate shares	5,818	**5,432**	**45,060**
Other securities	2,671	**5,338**	**44,280**
	16,698	**19,894**	**165,027**
Shares and convertible bonds issued by CSK Corporation	2,129	**2,129**	**17,661**
	¥18,827	**¥22,023**	**$182,688**

Market value of listed corporate shares (except for CSK Corporation's shares) included in the non-current portfolio as of March 31, 1998 and 1999, is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	**1999**	**1999**
Market value of listed corporate shares in:			
Non-current portfolio	¥8,654	**¥12,095**	**$100,332**

Derivative Financial Instruments

The Company enters into foreign currency forward contracts and foreign currency options to hedge against exposure to foreign currency fluctuations in its export and import transactions. The Company does not hold or issue derivative financial instruments for trading purposes.

All the derivative transactions are controlled by the foreign currency committee which determines the Company's hedging strategy.

The derivative transactions have market risk associated with the volatility of the foreign currency markets. The Company sometimes issues put options in order to enter into zero cost option contracts. Under such contracts, the Company may suffer adverse effects caused by market fluctuations. Therefore, the Company's involvement in options contracts is limited so as not to exceed its demand for foreign currencies.

As of March 31, 1998 and 1999, all of the foreign currency forward contracts were allocated to related accounts receivable and there were no currency option contracts outstanding.

6. FIXED LEASEHOLD DEPOSITS

The Company conducts amusement center operations on property leased from lessors on a long-term cancellable basis.

Japanese lessors require large amounts of leasehold deposits relative to the amount of annual lease rental payments. Such leasehold deposits do not bear interest and are generally returnable only when the lease is terminated. Such leasehold deposits are shown in the non-consolidated balance sheets as "Fixed leasehold deposits."

7. INCOME TAXES

Income taxes in Japan applicable to the Company for the years ended March 31, 1997, 1998 and 1999, consisted of corporate income tax (national), enterprise tax (local) and resident income taxes (local) at the approximate rates indicated below:

	Rates on taxable income		
	1997	1998	**1999**
Standard rates:			
Corporate income tax	37.5%	37.5%	**34.5%**
Enterprise tax	12.6	12.6	**11.6**
Resident income taxes	7.8	7.8	**7.1**
	57.9%	57.9%	**53.2%**
Statutory tax rate in effect to reflect the deductibility of enterprise tax when paid	51.4%	51.4%	**47.7%**

Unlike other income taxes, enterprise tax is deductible for tax purposes when it is paid.

Income tax expenses as shown in the accompanying non-consolidated statements of operations differ from the amounts computed by applying the aforementioned statutory tax rates to (loss) income before income taxes. Such differences arise partly from entertainment expenses, which are not tax deductible. In addition, the differences arise because no tax effects have been recognized on certain temporary differences between financial accounting and tax reporting primarily in relation to accrued enterprise tax not deductible until paid, write-down of inventories not deductible until actually disposed of, reserve for doubtful accounts provided in excess of the limit of deduction established by the tax laws and other factors.

8. INVESTMENTS IN AND ADVANCES TO SUBSIDIARIES AND AFFILIATES

Investments in and advances to subsidiaries and affiliates as of March 31, 1998 and 1999, were as follows:

	Percentage of ownership	Millions of yen		Thousands of U.S. dollars
		1998	1999	1999
Subsidiaries:				
SEGA Europe Ltd.	100.0	¥15,014	**¥15,014**	**$124,546**
SIMS Co., Ltd.	100.0	101	**101**	**838**
SI Electronics Co., Ltd.	100.0	100	**100**	**829**
SEGA Amusements Taiwan Ltd.	75.0	475	**721**	**5,981**
SEGA Singapore Pte. Ltd.	100.0	103	**103**	**854**
SEGA International Finance B.V.	100.0	11	**11**	**91**
Nextech Co., Ltd.	100.0	100	**169**	**1,402**
SEGA Huahan Culture Entertainment Co., Ltd.	80.0	240	**240**	**1,991**
SEGA TOYS, Ltd. (formerly SEGA Yonezawa Co., Ltd.)	100.0	—	**490**	**4,065**
SEGA Enterprises (Australia) Pty. Ltd.				
Investment in capital stock(*1)	86.0	2,014	**—**	**—**
Advances(*4)	—	—	**5,031**	**41,734**
SEGA Enterprises, Inc. (U.S.A.)(*2)	100.0	8,605	**15,798**	**131,049**
Cross Products Ltd.	100.0	257	**257**	**2,132**
SEGA Distribution Australia Pty. Ltd.	100.0	365	**365**	**3,028**
SEGA Food Works Co., Ltd.	51.0	5	**5**	**41**
S.G.S. Co., Ltd.	63.0	65	**126**	**1,045**
OASIS Park Co., Ltd.	63.8	—	**255**	**2,115**
Eighty-one Entertainment Co., Ltd.	61.4	—	**250**	**2,074**
SEGA of America, Inc.				
Advances(*4)	—	40,000	**40,000**	**331,813**
Other	—	120	**11**	**91**
Affiliates:				
Linguaphone Japan Ltd.	24.6	—	**—**	**—**
Light Printing Co., Ltd.	33.4	1,470	**1,470**	**12,194**
SEGA Digital Communication Co., Ltd.	35.0	140	**26**	**216**
SEGA Music Networks Co., Ltd.				
Investment in capital stock	50.0	200	**—**	**—**
Advances	—	1,246	**1,870**	**15,512**
SG MEDIA Co., Ltd.	20.0	60	**60**	**498**
SEGA Soft Networks, Inc.				
Investment in capital stock(*3)	50.0	—	**1,437**	**11,920**
Advances	—	—	**4,930**	**40,896**
SEGA Logistics Service Co., Ltd.	50.0	100	**100**	**830**
Super Merge Corporation Sdn. Bhd.	20.0	437	**—**	**—**
Hyundai Sega Entertainment Co., Ltd.	25.0	173	**173**	**1,435**
SEGA Muse Ltd.	46.9	255	**255**	**2,115**
Lotte SEGA Co., Ltd.	50.0	709	**709**	**5,881**
Amusement World of Vietnam Corporation	30.0	38	**38**	**315**
SEGA Lease Co., Ltd.				
Investment in capital stock	29.0	30	**30**	**249**
Advances	—	838	**476**	**3,949**
Atlus Dream Entertainment Co., Ltd.	—	76	**—**	**—**
Other	—	25	**64**	**531**
		¥73,372	**¥90,685**	**$752,260**

(*1) During the year ended March 31, 1999, the Company wrote off the investment in capital stock of SEGA Enterprises (Australia) Pty. Ltd. in the amount of ¥2,014 million. The loss recognized as a result of the write-off is ¥2,014 million, which is included in "Loss on dissolution of a subsidiary" in the accompanying non-consolidated statements of operations.
(*2) During the year ended March 31, 1999, the Company increased investments in SEGA Enterprises, Inc. (U.S.A.).
(*3) During the year ended March 31, 1999, the Company purchased shares of SEGA Soft Networks, Inc.
(*4) Advances to SEGA of America, Inc. and SEGA Enterprises (Australia) Pty. Ltd. are fully reserved.

9. LONG-TERM DEBT

Long-term debt at March 31, 1998 and 1999, consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
2.00% unsecured notes due 2001	¥ —	¥ 10,000	$ 82,953
2.15% unsecured notes due 2001	—	10,000	82,953
2.27% unsecured notes due 2002	—	5,000	41,477
Zero-coupon convertible discount bonds due 1999	19,897	—	—
0.55% convertible bonds due 2000	94,339	88,452	733,737
Zero-coupon convertible bonds due 1999	29,371	29,371	243,642
Zero-coupon convertible bonds due 2003	—	44,095	365,782
0.40% convertible bonds due 2006	—	29,996	248,826
Unsecured loans, from banks:			
Due 2001 to 2002 with interest ranging from 1.80% to 1.92% per annum	—	27,000	223,973
Other long-term debt	1,213	1,722	14,285
	144,820	245,636	2,037,628
Less portion due within one year	19,897	29,371	243,642
	¥124,923	¥216,265	$1,793,986

The 0.55% convertible bonds due 2000 were issued on June 24, 1994, in the principal amount of ¥100,000 million. The bonds are convertible into shares of common stock of the Company at the current conversion price of ¥7,726.10 per share.

The zero-coupon convertible bonds due 1999 were issued on September 7, 1995, in the principal amount of ¥30,000 million. The bonds are convertible into shares of common stock of the Company at the current conversion price of ¥4,156.60 per share.

The zero-coupon convertible bonds due 2003 were issued on February 17, 1999, in the principal amount of ¥50,000 million. The bonds are convertible into shares of common stock of the Company at the current conversion price of ¥2,285 per share.

The 0.40% convertible bonds due 2006 were issued on February 17, 1999, in the principal amount of ¥30,000 million. The bonds are convertible into shares of common stock of the Company at the current conversion price of ¥2,285 per share.

10. RETIREMENT PLAN AND SEVERANCE INDEMNITIES

The employees of the Company are generally entitled to receive lump-sum payments or pension payments upon retirement under the Company's retirement benefit plan. The amounts of such retirement benefits are determined by reference to the latest rate of pay, length of service and whether the retirement is voluntary or involuntary.

In November 1993, together with the SEGA Group Companies, the Company transferred 100% of the retirement benefits to a separate contributory pension program which was established as a pension trust fund, pursuant to the welfare pension insurance laws in Japan, whereby the pension fund has been substituted for a portion of the government pension program.

As a result, the balance of the "Accrued employees' retirement benefits," which became no longer necessary due to the change, is being amortized to income over a period for which the past service costs of the pension plan are being amortized.

As of March 31, 1999, the past service costs amounted to ¥1,646 million ($13,654 thousand), which are being amortized over 20 years.

With respect to directors and corporate auditors, while the Company has no legal obligation, as is customary practice in Japan, the Company makes lump-sum payments to a director or corporate auditor upon retirement with the approval of a general meeting of the shareholders. The amounts are determined on a basis similar to that used for employees' payments. The Company has provided a reserve for such payments to directors and corporate auditors on an accrual basis.

11. LEGAL RESERVE AND APPROPRIATION OF RETAINED EARNINGS

The Japanese Commercial Code states that an amount equal to at least 10% of cash distributions (cash dividends and bonuses to officers, etc.) paid out of retained earnings should be appropriated to the legal reserve until such reserve equals 25% of the amount of common stock. This reserve may be transferred to common stock by a resolution of the Board of Directors or used to reduce a deficit by a resolution of a shareholders' meeting, but is not available for dividend payments.

The Company's Board of Directors, with subsequent approval by the shareholders, has made annual appropriations of retained earnings for various purposes, the accumulated balance of which is presented as "Voluntary reserves" in the accompanying financial statements. Any disposition of such appropriations shall be at the discretion of the Board of Directors and the shareholders.

12. ANALYSIS OF NET SALES AND COST OF SALES

The breakdown of the Company's net sales and cost of sales for the years ended March 31, 1997, 1998 and 1999, is as follows:

			Millions of yen	Thousands of U.S. dollars
	1997	1998	**1999**	**1999**
Net sales:				
Product sales	¥250,010	¥139,555	**¥105,777**	**$ 877,453**
Merchandise sales	12,626	36,710	**18,860**	**156,449**
	262,636	176,265	**124,637**	**1,033,902**
Revenues from amusement center operations	88,191	90,958	**87,943**	**729,515**
Royalties on game software	9,103	4,252	**1,966**	**16,309**
	¥359,930	¥271,475	**¥214,546**	**$1,779,726**
Cost of sales:				
Cost of products and merchandise sold	¥227,033	¥151,372	**¥103,616**	**$ 859,527**
Cost of amusement center operations	58,113	65,224	**66,978**	**555,603**
	¥285,146	¥216,596	**¥170,594**	**$1,415,130**

13. RELATED PARTY TRANSACTIONS

The Company's significant transactions with related parties for the years ended March 31, 1997, 1998 and 1999, are summarized as follows:

			Millions of yen	Thousands of U.S. dollars
	1997	1998	**1999**	**1999**
Sales to subsidiaries and affiliates (products)	¥147,608	¥82,085	**¥58,743**	**$487,291**
Sales to subsidiaries and affiliates (merchandise)	101	120	**16,571**	**137,462**
Revenues from amusement center operations	54	46	**44**	**365**
Royalty income	900	1,068	**914**	**7,582**
Interest income	51	83	**749**	**6,213**
Gain on sales of investments in subsidiaries and affiliates	4,416	—	**—**	**—**

14. LOSS ON WRITE-DOWN OR DISPOSAL OF INVENTORIES

Loss on write-down or disposal of inventories of ¥11,495 million for the year ended March 31, 1999, represents a valuation loss on hardware and software for consumer products and amusement machine products and a loss of write-off of prepaid development costs for certain software.

15. LOSS ON DISSOLUTION OF A SUBSIDIARY

Loss on dissolution of a subsidiary of ¥5,014 million for the year ended March 31, 1999, represents a valuation loss on the investment in SEGA Enterprises (Australia) Pty. Ltd. and losses on the discontinuation of operations in Australia.

16. PROVISION FOR DOUBTFUL ACCOUNTS

Provision for doubtful accounts for the year ended March 31, 1998, represented the write-down of loans from an affiliated company (SEGA of America, Inc.).

Provision for doubtful accounts for the year ended March 31, 1999, included the write-down of loans from affiliated companies (SEGA Enterprises (Australia) Pty. Ltd. and SEGA Music Networks Co., Ltd.) amounting to ¥6,400 million ($53,090 thousand).

17. LOSS ON RESERVE FOR GUARANTEED OBLIGATION

Loss on the reserve for guaranteed obligation for the year ended March 31, 1999, represented the estimated loss from the guarantee to SEGA of America, Inc.'s bank loan.

18. COMMITMENTS AND CONTINGENT LIABILITIES

Finance lease contracts without ownership transfer as of and for the years ended March 31, 1998 and 1999, are summarized as follows.

Calculated amounts relevant to the acquisition cost, accumulated depreciation and book value of leased properties as of March 31, 1998 and 1999, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Amusement machines:			
Acquisition cost	¥3,164	**¥1,968**	**$16,325**
Accumulated depreciation	(2,031)	**(1,530)**	**(12,692)**
Book value	¥1,133	**¥ 438**	**$ 3,633**
Buildings:			
Acquisition cost	¥3,517	**¥2,542**	**$21,087**
Accumulated depreciation	(1,280)	**(1,033)**	**(8,569)**
Book value	¥2,237	**¥1,509**	**$12,518**
Others:			
Acquisition cost	¥3,691	**¥5,785**	**$47,988**
Accumulated depreciation	(1,758)	**(2,495)**	**(20,697)**
Book value	¥1,933	**¥3,290**	**$27,291**

The amount of outstanding future lease payments for finance leases without ownership transfer due at March 31, 1998 and 1999, which included the portion of interest thereon, is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Future lease payments:			
Within one year	¥2,057	**¥2,085**	**$17,296**
More than one year	3,538	**3,389**	**28,113**
	¥5,595	**¥5,474**	**$45,409**

Lease payment and the calculated amounts relevant to depreciation and interest expense for the leased properties for the years ended March 31, 1998 and 1999, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	1999	1999
Lease payment	¥2,478	**¥2,893**	**$23,998**
Depreciation	2,185	**2,548**	**21,136**
Interest expense	324	**302**	**2,505**

The amount of outstanding future lease payments for non-cancellable operating leases at March 31, 1999, is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Within one year	¥140	$1,161
More than one year	166	1,377
	¥306	$2,538

The Company was contingently liable for obligations of others as of March 31, 1999, as follows:

	Millions of yen	Thousands of U.S. dollars
Guarantee of lease rental obligations for:		
SEGA Enterprises, Inc. (U.S.A.)	¥ 6,030	$ 50,021
SEGA Gameworks, L.L.C.	707	5,865
Cross Products Ltd.	123	1,020
SEGA of America, Inc.	5,473	45,400
Guarantee of obligations to banks for:		
Atlus Dream Entertainment Co., Ltd.	271	2,248
Eighty-one Entertainment Co., Ltd.	205	1,701
SEGA Enterprises, Inc. (U.S.A.)	4,580	37,993
SEGA Europe Ltd.	2,354	19,527
SEGA Amusements Europe Ltd.	2,340	19,411
Premier Loisir France S.A.	468	3,882
TRILOGY Corporation	60	498
TOWA JAPAN CO., LTD.	262	2,173
Other guarantee or commitment for:		
SEGA Amusements Europe Ltd.	9	75
Premier Loisir France S.A.	45	373
SEGA Lease Co., Ltd.	197	1,634
	¥23,124	$191,821

19. SUBSEQUENT EVENTS

Appropriations of Retained Earnings

The appropriations of retained earnings in respect of the year ended March 31, 1999, proposed by the Board of Directors and approved by the General Meeting of Shareholders held on June 29, 1999, are as follows:

	Millions of yen	Thousands of U.S. dollars
Accumulated deficit as of March 31, 1999	¥(32,079)	$(266,105)
Reversal of special tax-purpose reserves	10	83
Reversal of voluntary reserves	38,000	315,222
	5,931	49,200
Appropriations:		
Cash dividends (¥39 per share)	2,374	19,693
Transfer to legal reserve	237	1,967
Total appropriations	2,611	21,660
Retained earnings to be carried forward	¥ 3,320	$ 27,540

Early Retirement Program

In order to reduce costs and improve productivity and asset utilization, the Company offered a voluntary early retirement program to its employees. As a result, 706 employees accepted this program from May 7, 1999, to June 18, 1999. The Company will recognize ¥2,038 million ($16,906 thousand) of special termination costs in the next fiscal year.

20. STOCK OPTION PLAN

(1) At the General Meeting of Shareholders held on June 26, 1998, the shareholders of the Company approved a stock option plan for certain directors and employees. Under the plan, options for 130,000 shares and 305,000 shares of common stock of the Company were granted to 9 directors and 161 employees, respectively, at March 31, 1999. All options are exercisable at an exercise price of ¥2,835 from July 1, 1999, through June 30, 2002. The exercise price will be subject to adjustments if there are stock splits or additional shares issued for less than the ongoing market price.

(2) In addition, at the General Meeting of Shareholders held on June 29, 1999, the shareholders of the Company approved another stock option plan for certain directors and employees. Under the plan, options for 127,000 shares and 317,000 shares of common stock of the Company would be granted to 9 directors and 318 employees, respectively. These new options to be granted will be exercisable at an exercise price of 105% of the average market price for the month immediately preceding the date of grant over a period from July 30, 1999, through June 30, 2002. The exercise price will be subject to adjustments if there are stock splits or additional shares issued for less than the ongoing market price.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON THE NON-CONSOLIDATED FINANCIAL STATEMENTS

To: The Board of Directors of
SEGA Enterprises, Ltd.

We have audited the accompanying non-consolidated balance sheets of SEGA Enterprises, Ltd. as of March 31, 1998 and 1999, and the related non-consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 1999, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the non-consolidated financial statements referred to above present fairly the non-consolidated financial position of SEGA Enterprises, Ltd. at March 31, 1998 and 1999, and the non-consolidated results of its operations and its cash flows for each of the three years in the period ended March 31, 1999, in conformity with accounting principles and practices generally accepted in Japan (see Note 1) consistently applied during the periods.

The amounts expressed in U.S. dollars, provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying non-consolidated financial statements.

Tokyo, Japan
June 29, 1999

Chuo Audit Corporation

Chuo Audit Corporation
Independent Certified Public Accountants

CONSOLIDATED STATEMENTS OF OPERATIONS AND (ACCUMULATED DEFICIT) RETAINED EARNINGS

SEGA Enterprises, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 1998 and 1999

	Millions of yen		Thousands of U.S. dollars (Note 5)
	1998	1999	1999
Net Sales	¥331,605	**¥266,194**	**$2,208,163**
Cost of Sales	270,710	**201,819**	**1,674,152**
Gross profit	60,895	**64,375**	**534,011**
Selling, General and Administrative Expenses	63,043	**62,287**	**516,690**
Operating income (loss)	(2,148)	**2,088**	**17,321**
Other Income (Expenses):			
Interest and dividend income	1,913	**1,313**	**10,892**
Interest expense	(3,719)	**(2,175)**	**(18,042)**
Loss on write-down or disposal of inventories (Note 3)	—	**(11,497)**	**(95,371)**
Loss on sale or disposal of property and equipment	(477)	**(436)**	**(3,617)**
Loss on dissolution of a subsidiary (Note 4)	(638)	**(8,499)**	**(70,502)**
Loss on valuation of investment securities	(6,340)	**(1,436)**	**(11,912)**
Loss on valuation of investments in subsidiaries and affiliates	(321)	**(550)**	**(4,562)**
Loss on valuation of cash trust for investments	(3,993)	**(1,330)**	**(11,033)**
Loss on sale or disposal of operations in subsidiaries and affiliates	(2,780)	**—**	**—**
Gain on sales of investment securities	510	**—**	**—**
Net gain on foreign exchange	1,088	**—**	**—**
Amortization of discounts on bonds	(686)	**(686)**	**(5,691)**
Amortization of bond and note issue expenses	(263)	**(723)**	**(5,998)**
Equity in losses of non-consolidated subsidiaries and affiliates (Note 2 (2))	—	**(6,379)**	**(52,916)**
Provision for doubtful accounts	(346)	**(1,366)**	**(11,331)**
Other, net	1,705	**(974)**	**(8,080)**
Total other income (expenses)	(14,347)	**(34,738)**	**(288,163)**
Loss before income taxes	(16,495)	**(32,650)**	**(270,842)**
Income Taxes:			
Current	5,718	**230**	**1,908**
Deferred (Note 2 (4))	(2,553)	**10,343**	**85,799**
	3,165	**10,573**	**87,707**
	(19,660)	**(43,223)**	**(358,549)**
Minority Interests in Earnings of Consolidated Subsidiaries	339	**342**	**2,837**
Amortization of Excess Investment Costs over Net Assets of Consolidated Subsidiaries Acquired (Note 2 (1))	(11,819)	**—**	**—**
Equity in Losses of Non-Consolidated Subsidiaries and Affiliates (Note 2 (2))	(4,495)	**—**	**—**
Net loss	(35,635)	**(42,881)**	**(355,712)**
(Accumulated Deficit) Retained Earnings:			
Balance at beginning of year	76,669	**41,685**	**345,790**
Transfer from legal reserve	—	**2,378**	**19,726**
(Decrease) increase due to additional consolidation of subsidiaries	21	**(401)**	**(3,326)**
Increase due to equity method of affiliates (net)	—	**47**	**390**
Increase due to tax effects (Note 2 (4))	4,982	**—**	**—**
Cash dividends paid	(3,824)	**(3,925)**	**(32,559)**
Transfer to legal reserve	(395)	**—**	**—**
Bonuses to directors and corporate auditors	(133)	**—**	**—**
Balance at end of year	¥ 41,685	**¥ (3,097)**	**$ (25,691)**

	Yen		U.S. dollars (Note 5)
	1998	1999	1999
Per Share:			
Net loss—basic	¥(354.1)	**¥(425.3)**	**$(3.53)**
Net income—diluted*	—	**—**	**—**
Cash dividends	38.0	**39.0**	**0.32**

The accompanying notes are an integral part of these statements.
* Diluted net loss per share was not disclosed for the years ended March 31, 1998 and 1999, as net loss per share was calculated for the year after the adjustment for dilution.

CONSOLIDATED BALANCE SHEETS

SEGA Enterprises, Ltd. and Consolidated Subsidiaries
March 31, 1998 and 1999

ASSETS	Millions of yen 1998	Millions of yen 1999	Thousands of U.S. dollars (Note 5) 1999
Current Assets:			
Cash	¥ 42,403	**¥100,708**	**$ 835,404**
Time deposits	8,540	**7,020**	**58,233**
Short-term investments	14,503	**25,479**	**211,356**
Notes and accounts receivable:			
Trade	27,807	**25,512**	**211,630**
Non-consolidated subsidiaries and affiliates	26,043	**14,170**	**117,545**
Other	13,603	**4,700**	**38,988**
	67,453	**44,382**	**368,163**
Less allowance for doubtful accounts	(1,918)	**(1,690)**	**(14,019)**
	65,535	**42,692**	**354,144**
Inventories	44,683	**61,580**	**510,825**
Prepaid expenses	12,182	**15,520**	**128,743**
Deferred income taxes—current (Note 2 (4))	8,675	**—**	**—**
Other current assets	1,067	**2,875**	**23,850**
Total current assets	197,588	**255,874**	**2,122,555**
Investments and Advances:			
Investments in securities	22,920	**22,227**	**184,380**
Investments in and advances to non-consolidated subsidiaries and affiliates (Note 2 (2))	11,350	**7,186**	**59,610**
Other investments	3,261	**7,179**	**59,552**
Total investments and advances	37,531	**36,592**	**303,542**
Property and Equipment:			
Amusement machines and facilities	76,352	**74,095**	**614,641**
Buildings and structures	54,401	**53,181**	**441,153**
Machinery and equipment	29,035	**30,931**	**256,582**
	159,788	**158,207**	**1,312,376**
Less accumulated depreciation	(92,783)	**(101,071)**	**(838,415)**
	67,005	**57,136**	**473,961**
Land	22,632	**22,629**	**187,715**
Construction in progress	126	**175**	**1,452**
Total property and equipment	89,763	**79,940**	**663,128**
Fixed Leasehold Deposits	22,618	**24,622**	**204,247**
Deferred Charges and Intangible Assets	9,561	**17,301**	**143,517**
Deferred Tax—Non-Current (Note 2 (4))	2,942	**938**	**7,781**
Excess Investment Costs over Net Assets of Consolidated Subsidiaries Acquired	1,427	**1,786**	**14,815**
Translation Adjustment (Note 2 (3))	7,533	**8,561**	**71,016**
Total assets	¥368,963	**¥425,614**	**$3,530,601**

The accompanying notes are an integral part of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen 1998	Millions of yen 1999	Thousands of U.S. dollars (Note 5) 1999
Current Liabilities:			
Short-term bank loans	¥ 12,655	**¥ 17,154**	**$ 142,298**
Current portion of convertible bonds	19,897	**29,371**	**243,642**
Current portion of long-term debt	746	**6**	**50**
Notes and accounts payable:			
Trade	54,566	**52,957**	**439,295**
Other	2,601	**6,682**	**55,429**
	57,167	**59,639**	**494,724**
Accrued expenses	14,792	**14,317**	**118,764**
Income taxes payable	4,783	**734**	**6,089**
Other current liabilities	8,143	**3,397**	**28,178**
Total current liabilities	118,183	**124,618**	**1,033,745**
Long-Term Liabilities:			
Long-term debt	124,511	**214,668**	**1,780,738**
Accrued employees' retirement benefits	597	**598**	**4,961**
Accrued retirement benefits for directors and corporate auditors	276	**125**	**1,037**
Other	3,066	**4,816**	**39,950**
Total long-term liabilities	128,450	**220,207**	**1,826,686**
Minority Interests in Consolidated Subsidiaries	283	**148**	**1,228**
Commitments and Contingent Liabilities (Note 7)			
Shareholders' Equity:			
Common stock:			
Authorized—200,000,000 shares at March 31, 1998 and 1999			
Issued, par value ¥50 per share—100,633,718 shares and 103,219,703 shares at March 31, 1998 and 1999, respectively	39,154	**42,109**	**349,307**
Additional paid-in capital	38,700	**41,653**	**345,525**
(Accumulated deficit) retained earnings	44,063	**(3,097)**	**(25,691)**
Unrealized (loss) gain on available-for-sale securities	133	**(23)**	**(191)**
Treasury stock	(3)	**(1)**	**(8)**
Total shareholders' equity	122,047	**80,641**	**668,942**
Total liabilities and shareholders' equity	¥368,963	**¥425,614**	**$3,530,601**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SEGA Enterprises, Ltd. and Consolidated Subsidiaries
For the years ended March 31, 1998 and 1999

1. BASIS OF PRESENTING THE CONSOLIDATED FINANCIAL STATEMENTS

(1) Accounting Principles

The accompanying consolidated financial statements have been prepared from the accounts maintained by SEGA Enterprises, Ltd. (the "Company") and its consolidated subsidiaries (collectively, the "Companies") in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards.

Certain items presented in the consolidated financial statements filed with the Ministry of Finance (the "MOF") in Japan have been reclassified for the convenience of readers outside Japan.

The consolidated financial statements are not intended to present the consolidated financial position and results of operations in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

(2) Significant Shareholder

The Company is an affiliate of CSK Corporation, Japan, which owned 20,148 thousand shares of common stock of the Company at March 31, 1998 and 1999, representing 20.02% and 19.52% of shares outstanding at such dates.

There have been no material transactions and account balances outstanding, other than the shareholdings, between the Company and CSK Corporation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Scope and Principles of Consolidation

The Company had 55 subsidiaries (majority-owned companies) and 21 affiliates (20% to 50% owned companies) at March 31, 1999 (55 subsidiaries and 21 affiliates at March 31, 1998). The consolidated financial statements include the accounts of the Company and 38 of its subsidiaries (39 at March 31, 1998), which are listed below.

	Country of incorporation	Equity ownership percentage at March 31, 1999	Fiscal year-end
SEGA Enterprises, Inc. (U.S.A.)	U.S.A.	100.0	March 31
SEGA of America, Inc.(*1)	U.S.A.	100.0	March 31
SEGA Pinball, Inc.(*1)	U.S.A.	100.0	February 28
SEGA Europe Ltd.	U.K.	100.0	February 28
SEGA Operations UK Ltd.(*2)	U.K.	100.0	February 28
SEGA ATP Europe Ltd.(*3)	U.K.	100.0	February 28
SEGA Amusements Europe Ltd.(*2)	U.K.	100.0	February 28
Deith Leisure Praha spol s.r.o.(*4)	Czech Republic	100.0	February 28
Deith Leisure Hungary Kereskedelal KFT(*4)	Hungary	100.0	February 28
Deith Leisure Warszawa Sp.z.o.o.(*4)	Poland	100.0	February 28
Deith Leisure Bulgaria Ltd.(*4)	Bulgaria	100.0	February 28
Deith Ltd.(*4)	U.K.	100.0	February 28
SEGA Amusements France S.A.(*5)	France	100.0	February 28
SEGA Operations France Eurl.(*6)	France	100.0	February 28
Premier Loisir France S.A.(*6)	France	100.0	February 28
WDK Eurl(*7)	France	100.0	February 28
SCI D'AUGNY(*7)	France	100.0	February 28
Premier Loisir Germany GmbH(*7)	Germany	100.0	February 28
SEGA Europe Overseas Ltd.(*2)	U.K.	100.0	February 28
SEGA France S.A.(*8)	France	100.0	February 28
No cleche S.A.(*9)	France	99.0	February 28
SEGA Gesellschaft fur Videospiele GmbH(*8)	Germany	100.0	February 28
SEGA Consumer Products S.A.(*8)	Spain	100.0	February 28
SEGA Amusements Spain S.L.(*10)	Spain	100.0	February 28
New Software Center Company S.L.(*10)	Spain	100.0	February 28
SGE Holding Ltd. (formerly SEGA Gaming Europe Ltd.)(*2)	U.K.	100.0	February 28
JPM International Ltd.(*11)	U.K.	100.0	February 28
ACE Coin Equipment Ltd.(*11)	U.K.	100.0	February 28
Crystal Leisure Ltd.(*11)	U.K.	100.0	February 28
JPM Interactive Ltd.(*11)	U.K.	100.0	February 28
SEGA Singapore Pte. Ltd.	Singapore	100.0	March 31
Cross Products Ltd.	U.K.	100.0	March 31
SEGA Enterprises (Australia) Pty. Ltd.	Australia	86.0	December 31
SEGA Distribution Australia Pty. Ltd.	Australia	100.0	December 31
SEGA Food Works Co., Ltd.	Japan	51.0	March 31
S.G.S. Co., Ltd.	Japan	63.0	March 31
SEGA TOYS, Ltd.	Japan	100.0	March 31
Eighty-one Entertainment Co., Ltd.	Japan	61.4	March 31

(*1) Directly Owned 100% by SEGA Enterprises, Inc. (U.S.A.)
(*2) Directly Owned 100% by SEGA Europe Ltd.
(*3) Directly Owned 100% by SEGA Operations UK Ltd.
(*4) Directly Owned 100% by SEGA Amusements Europe Ltd.
(*5) Directly Owned 100% by Deith Ltd.
(*6) Directly Owned 100% by SEGA Amusements France S.A.
(*7) Directly Owned 100% by Premier Loisir France S.A.
(*8) Directly Owned 100% by SEGA Europe Overseas Ltd.
(*9) Directly Owned 99% by SEGA France S.A.
(*10) Directly Owned 100% by SEGA Consumer Products S.A.
(*11) Directly Owned 100% by SGE Holding Ltd.

In consolidating the accounts of overseas consolidated subsidiaries with fiscal years ending on days other than March 31, necessary adjustments have been made to take account of any significant transactions that took place between the three different year-ends.

The remaining 17 non-consolidated subsidiaries (16 for 1998), whose total assets, net sales and net income in the aggregate are not significant in relation to those of the consolidated financial statements of the Companies, have not been consolidated with the Companies.

For the purpose of preparing the consolidated financial statements, all significant intercompany transactions, account balances and unrealized profits among the Companies have been eliminated.

Investments in consolidated subsidiaries in Europe in excess of the underlying equity in net assets are recognized as an asset and amortized over 15 years.

Investments in other consolidated subsidiaries in excess of the underlying equity in net assets are recognized as an asset and amortized over 5 years.

In accordance with the amendment of the Consolidated Financial Statement Regulation, the amortization of excess investment costs over net assets of consolidated subsidiaries acquired was included in selling, general and administrative expenses, which was formerly presented as a deduction of loss before income taxes. See Note 6 for the effects of this change to segment information.

(2) Investments in Non-Consolidated Subsidiaries and Affiliates

The equity method has been applied to the investments in the 9 non-consolidated affiliates, SEGA Gameworks L.L.C., Seru Distribution GmbH, SEGA Muse Ltd., Sega Soft Networks, Inc., Hyundai Sega Entertainment Co., Ltd., Lotte SEGA Co. Ltd., SGW Holding, Inc., Village Entertainment Equipment Sales and Service Pty. Ltd. and Sega Music Networks Co., Ltd. for the fiscal year ended March 31, 1999.

The other investments in the non-consolidated subsidiaries and affiliates are carried at cost and are not adjusted for equity in losses of such investees for each fiscal year because the effect of applying the equity method is not material.

In accordance with the amendment of the Consolidated Financial Statement Regulation, equity in losses of affiliates and non-consolidated subsidiaries was included in other expenses, which was formerly disclosed as a deduction for loss before income taxes.

(3) Translation of Foreign Currency Denominated Financial Statements

The financial statements of non-consolidated foreign subsidiaries were prepared in their respective local currencies and translated into Japanese yen based on the current exchange rate at the end of the period for the balance sheets and on an average rate for the period on the statements of operations.

(4) Accounting for Income Taxes

During the year ended March 31, 1998, the Company and its consolidated subsidiaries changed the method of accounting for income taxes. In prior years, intraperiod allocation of income taxes had been made only for the portion related to consolidation adjustments, such as eliminations of intercompany profits and certain other items incidental to consolidation and elimination. However, during the year ended March 31, 1998, intraperiod allocation of income taxes was made for all the items related to temporary differences between financial reporting purposes and tax purposes. The change was made in order to achieve the better matching of periodic cost against revenue, because the materiality of temporary differences of the Company and its consolidated subsidiaries has increased.

This change in accounting principles resulted in the following impact on the consolidated financial statements as of and for the year ended March 31, 1998: operating loss was lower by ¥911 million; net loss was lower by ¥4,192 million; and retained earnings were higher by ¥9,175 million, compared with the amounts based on the prior years' accounting principles.

(5) Changes in Accounting Principles

The Company and its domestic subsidiaries changed the depreciation method of buildings, except for buildings' improvements and structures, acquired on and after April 1, 1998, from the declining-balance method to the straight-line method in accordance with the 1998 amendments of Japanese tax laws. The effects of this change were immaterial. In addition, the estimated useful lives of buildings have been shortened in accordance with the 1998 amendments of Japanese tax laws. The effects of this change were to increase depreciation expense by ¥101 million ($838 thousand), to decrease gross profit and operating profit by ¥27 million ($224 thousand) and ¥95 million ($788 thousand), respectively, and to increase loss before income taxes by ¥95 million ($788 thousand). See Note 6 for the effects of these changes to segment information.

(6) Other Accounting Principles and Practices Employed by the Company

Accounting principles and practices employed by the Company in preparing the accompanying consolidated financial statements which have significant effects thereon are explained in Note 2 of the notes to the non-consolidated financial statements. Therefore, the accompanying consolidated financial statements should be read in conjunction with such notes.

In addition, the following accounting policies, which are different from those applied by the Company, have been applied by the consolidated overseas subsidiaries:

(1) Depreciation of property and equipment held by the subsidiaries is computed by the straight-line method.

(2) Inventories held by the subsidiaries are valued at the lower of cost or market, cost being determined by the first-in, first-out cost method.

(3) Valuation losses of inventories are charged to cost of sales.

3. LOSS ON WRITE-DOWN OR DISPOSAL OF INVENTORIES

Loss on write-down or disposal of inventories of ¥11,497 million for the year ended March 31, 1999, represents a valuation loss on hardware and software for consumer products and amusement machine products, and loss of write-off of prepaid development costs for certain software.

4. LOSS ON DISSOLUTION OF A SUBSIDIARY

Loss on dissolution of a subsidiary of ¥8,499 million for the year ended March 31, 1999, represented the loss on discontinuation of operations of SEGA Enterprises (Australia) Pty. Ltd.

5. UNITED STATES DOLLAR AMOUNTS

The Company maintains its accounting records in yen. The dollar amounts included in the consolidated financial statements represent the arithmetical results of translating yen to dollars on the basis of ¥120.55=US$1. 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 ¥120.55=US$1 or at any other rate.

6. SEGMENT INFORMATION

(1) Business Segment Information

The Company and its subsidiaries operate principally in the following business segments: consumer product sales, amusement center operations and amusement machine sales.

Sales of the Companies for the years ended March 31, 1998 and 1999, classified by business segment, are summarized as follows:

	Millions of yen				
	Year ended March 31, 1998				
	Business segments				
	Consumer product sales	Amusement center operations	Amusement machine sales	Eliminations /corporate	Total
Sales to outside customers	¥114,457	¥ 94,521	¥122,627	¥ —	¥331,605
Intersegment sales/transfers	—	—	1,322	(1,322)	—
Total sales	114,457	94,521	123,949	(1,322)	331,605
Cost of sales and operating expenses	138,852	84,271	111,963	(1,333)	333,753
Operating (loss) income	¥ (24,395)	¥ 10,250	¥ 11,986	¥ 11	¥ (2,148)
Assets*	¥ 65,753	¥117,523	¥ 91,979	¥93,708	¥368,963
Depreciation	2,486	19,239	1,564	47	23,336
Capital expenditures	2,731	25,005	2,248	2,100	32,084

* Change in accounting principles of intraperiod income tax allocation—As mentioned in Note 2 (4), “Summary of Significant Accounting Policies,” the Company changed its accounting method regarding income taxes to fully recognize temporary differences of its subsidiaries upon consolidation.

Due to this change, the recorded amount of assets was higher by ¥903 million regarding amusement machine sales.

Recorded assets were higher by ¥3,123 million regarding consumer product sales and by ¥1,850 million regarding amusement center operations, compared with the amounts based on the accounting principles used by the Company in prior years.

The total of recorded assets in all business segments was higher by ¥3,297 million.

	Consumer product sales	Amusement center operations	Amusement machine sales	Eliminations /corporate	Total
	Millions of yen				
	Year ended March 31, 1999				
	Business segments				
Sales to outside customers	**¥ 84,694**	**¥93,128**	**¥88,372**	**¥ —**	**¥266,194**
Intersegment sales/transfers	**—**	**—**	**1,018**	**(1,018)**	**—**
Total sales	**84,694**	**93,128**	**89,390**	**(1,018)**	**266,194**
Cost of sales and operating expenses	**95,174**	**87,922**	**81,866**	**(856)**	**264,106**
Operating income (loss)	**¥(10,480)**	**¥ 5,206**	**¥ 7,524**	**¥ (162)**	**¥ 2,088**
Assets	**¥ 86,506**	**¥94,662**	**¥79,579**	**¥164,867**	**¥425,614**
Depreciation	**2,725**	**21,904**	**1,521**	**(9)**	**26,141**
Capital expenditures	**5,986**	**21,016**	**1,042**	**349**	**28,393**

	Consumer product sales	Amusement center operations	Amusement machine sales	Eliminations /corporate	Total
	Thousands of U.S. dollars				
	Year ended March 31, 1999				
	Business segments				
Sales to outside customers	**$702,563**	**$772,526**	**$733,074**	**$ —**	**$2,208,163**
Intersegment sales/transfers	**—**	**—**	**8,445**	**(8,445)**	**—**
Total sales	**702,563**	**772,526**	**741,519**	**(8,445)**	**2,208,163**
Cost of sales and operating expenses	**789,498**	**729,341**	**679,104**	**(7,101)**	**2,190,842**
Operating income (loss)	**$ (86,935)**	**$ 43,185**	**$ 62,415**	**$ (1,344)**	**$ 17,321**
Assets	**$717,594**	**$785,251**	**$660,133**	**$1,367,623**	**$3,530,601**
Depreciation	**22,605**	**181,701**	**12,617**	**(75)**	**216,848**
Capital expenditures	**49,656**	**174,334**	**8,644**	**2,895**	**235,529**

Due to changes in depreciation and disclosure for the amortization of excess investment costs over net assets of consolidated subsidiaries as mentioned in Note 2 (1) and (5), "Summary of Significant Accounting Policies," the following effects were incurred in each business segment:

Amusement machine sales: Operating income decreased by ¥306 million ($2,538 thousand), assets decreased by ¥14 million ($116 thousand) and depreciation increased by ¥16 million ($133 thousand).

Consumer product sales: Operating loss decreased by ¥46 million ($382 thousand), assets decreased by ¥44 million ($365 thousand) and depreciation increased by ¥46 million ($382 thousand).

Amusement center operations: Operating income decreased by ¥194 million ($1,609 thousand), assets decreased by ¥37 million ($307 thousand) and depreciation increased by ¥38 million ($315 thousand).

(2) Geographical Segment Information

Sales of the Companies for the years ended March 31, 1998 and 1999, classified by geographical segment, are summarized as follows:

	Japan	North America	Europe	Other	Total	Eliminations	Consolidated total
	Millions of yen						
	Year ended March 31, 1998						
Net sales to:							
Outside customers	¥265,728	¥ 25,163	¥38,582	¥2,132	¥331,605	¥ —	¥331,605
Intersegment sales/transfers	25,610	3,213	1,083	—	29,906	(29,906)	—
	291,338	28,376	39,665	2,132	361,511	(29,906)	331,605
Cost of sales and operating expenses	277,936	40,791	40,399	2,988	362,114	(28,361)	333,753
Operating (loss) income	¥ 13,402	¥(12,415)	¥ (734)	¥ (856)	¥ (603)	¥ (1,545)	¥ (2,148)
Assets*	¥270,111	¥ 13,016	¥23,651	¥6,746	¥313,524	¥55,439	¥368,963

* Change in accounting principles of intraperiod income tax allocation—As mentioned in Note 2 (4), "Summary of Significant Accounting Policies," the Company changed its accounting method regarding income taxes to fully recognize temporary differences of its subsidiaries upon consolidation.

Due to this change, the recorded amount of assets within Japan increased by ¥9,175 million, compared with the amount based on the accounting principles used by the Company in prior years.

No other segments were affected by the change in accounting principles of intraperiod income tax allocation.

	Japan	North America	Europe	Other	Total	Eliminations	Consolidated total
	Millions of yen						
	Year ended March 31, 1999						
Net sales to:							
Outside customers	¥209,528	¥21,604	¥33,563	¥ 1,499	¥266,194	¥ —	¥266,194
Intersegment sales/transfers	19,212	3,616	1,245	—	24,073	(24,073)	—
	228,740	25,220	34,808	1,499	290,267	(24,073)	266,194
Cost of sales and operating expenses	226,827	22,083	38,293	2,692	289,895	(25,789)	264,106
Operating income (loss)	¥ 1,913	¥ 3,137	¥ (3,485)	¥(1,193)	¥ 372	¥ 1,716	¥ 2,088
Assets*	¥265,707	¥16,854	¥22,144	¥ 696	¥305,401	¥120,213	¥425,614

	Japan	North America	Europe	Other	Total	Eliminations	Consolidated total
	Thousands of U.S. dollars						
	Year ended March 31, 1999						
Net sales to:							
Outside customers	$1,738,100	$179,212	$278,416	$12,435	$2,208,163	$ —	$2,208,163
Intersegment sales/transfers	159,370	29,996	10,328	—	199,694	(199,694)	—
	1,897,470	209,208	288,744	12,435	2,407,857	(199,694)	2,208,163
Cost of sales and operating expenses	1,881,601	183,185	317,653	22,331	2,404,770	(213,928)	2,190,842
Operating income (loss)	$ 15,869	$ 26,023	$ (28,909)	$ (9,896)	$ 3,087	$ 14,234	$ 17,321
Assets*	$2,204,123	$139,809	$183,691	$ 5,774	$2,533,397	$997,204	$3,530,601

* Due to changes in depreciation and disclosure for amortization of excess investment costs over net assets of consolidated subsidiaries as mentioned in Note 2 (1) and (5), "Summary of Significant Accounting Policies," the following effects were incurred in each business segment:
Japan: Operating income decreased by ¥102 million ($846 thousand) and assets decreased by ¥95 million ($788 thousand).
Europe: Operating loss increased by ¥287 million ($2,381 thousand).
Other: Operating loss increased by ¥156 million ($1,294 thousand).

(3) Overseas Sales Information

Overseas sales of the Company for the years ended March 31, 1998 and 1999, are summarized as follows:

	North America	Europe	Other	Total
	Millions of yen			
	Year ended March 31, 1998			
Overseas sales	¥31,055	¥39,108	¥21,422	¥ 91,585
Consolidated net sales				331,605
Ratio of overseas sales to consolidated sales	9.4%	11.8%	6.4%	27.6%

	North America	Europe	Other	Total
	Millions of yen			
	Year ended March 31, 1999			
Overseas sales	¥24,034	¥33,828	¥13,583	¥ 71,445
Consolidated net sales				266,194
Ratio of overseas sales to consolidated sales	9.0%	12.7%	5.1%	26.8%

	North America	Europe	Other	Total
	Thousands of U.S. dollars			
	Year ended March 31, 1999			
Overseas sales	$199,370	$280,614	$112,675	$ 592,659
Consolidated net sales				2,208,163
Ratio of overseas sales to consolidated sales	9.0%	12.7%	5.1%	26.8%

7. COMMITMENTS AND CONTINGENT LIABILITIES

Lease rental expense on finance lease contracts without ownership transfer during the years ended March 31, 1998 and 1999, is summarized as follows.

Calculated amounts relevant to acquisition cost, accumulated depreciation and book value of leased properties as of March 31, 1999 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	**1999**	**1999**
Amusement machines:			
Acquisition cost	¥—*	**¥1,968**	**$16,325**
Accumulated depreciation	—*	**(1,530)**	**(12,692)**
Book value	¥—*	**¥ 438**	**$ 3,633**
Buildings:			
Acquisition cost	¥—*	**¥2,542**	**$21,087**
Accumulated depreciation	—*	**(1,033)**	**(8,569)**
Book value	¥—*	**¥1,509**	**$12,518**
Other:			
Acquisition cost	¥—*	**¥6,021**	**$49,946**
Accumulated depreciation	—*	**(2,584)**	**(21,435)**
Book value	¥—*	**¥3,437**	**$28,511**

The amount of outstanding future lease payments for finance leases without ownership transfer due at March 31, 1998 and 1999, which included the portion of interest, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	**1999**	**1999**
Future lease payments:			
Within one year	¥2,068	**¥2,157**	**$17,893**
More than one year	3,570	**3,466**	**28,752**
	¥5,638	**¥5,623**	**$46,645**

Lease payments and the calculated amounts relevant to depreciation and interest expense for the leased properties for the years ended March 31, 1998 and 1999, are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1998	**1999**	**1999**
Lease payments	¥2,484	**¥2,960**	**$24,554**
Depreciation	—*	**2,613**	**21,676**
Interest expense	—*	**306**	**2,538**

The amount of outstanding future lease payments for non-cancellable operating leases at March 31, 1999, is summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Future lease payments:		
Within one year	¥ 657	$ 5,450
More than one year	4,318	35,819
	¥4,975	$41,269

* Disclosure of this information was not required by the Consolidated Financial Statement Regulation as of and for the year ended March 31, 1998.

The Company was contingently liable for obligations of others as of March 31, 1999, as follows:

	Millions of yen	Thousands of U.S. dollars
Note endorsed	¥147	$1,219
Guarantee of obligations to banks for:		
Atlus Dream Entertainment Co., Ltd.	271	2,248
TRILOGY Corporation	60	498
TOWA JAPAN CO., LTD.	262	2,173
Other guarantee or commitment for:		
SEGA Lease Co., Ltd.	197	1,634
	¥937	$7,772

8. STOCK OPTION PLAN

(1) At the General Meeting of Shareholders held on June 26, 1998, the shareholders of the Company approved a stock option plan for certain directors and employees. Under the plan, options for 130,000 shares and 305,000 shares of common stock of the Company were granted to 9 directors and 161 employees, respectively, at March 31, 1999. All options are exercisable at an exercise price of ¥2,835 from July 1, 1999, through June 30, 2002. The exercise price will be subject to adjustments if there are stock splits or additional shares issued for less than the ongoing market price.

(2) In addition, at the General Meeting of Shareholders held on June 29, 1999, the shareholders of the Company approved another stock option plan for certain directors and employees. Under the plan, options for 127,000 shares and 317,000 shares of common stock of the Company would be granted to 9 directors and 318 employees, respectively. These new options to be granted will be exercisable at an exercise price of 105% of the average market price for the month immediately preceding the date of grant over a period from July 30, 1999, through June 30, 2002. The exercise price will be subject to adjustments if there are stock splits or additional shares issued for less than the ongoing market price.

9. SUBSEQUENT EVENT

In order to reduce costs and improve productivity and asset utilization, the Company offered a voluntary early retirement program to its employees. As a result, 706 employees accepted this program from May 7, 1999, to June 18, 1999. The Company will recognize ¥2,038 million ($16,906 thousand) of special termination costs in the next fiscal year.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON THE CONSOLIDATED FINANCIAL STATEMENTS

To: The Board of Directors of
SEGA Enterprises, Ltd.

We have audited the accompanying consolidated balance sheets of SEGA Enterprises, Ltd. and its consolidated subsidiaries as of March 31, 1998 and 1999, and the related consolidated statements of operations and (accumulated deficit) retained earnings for the years then ended, all expressed in Japanese yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, except for the change in accounting method for income taxes described in the following paragraph, the consolidated financial statements referred to above present fairly the consolidated financial position of SEGA Enterprises, Ltd. and its consolidated subsidiaries at March 31, 1998 and 1999, and the consolidated results of their operations for the years then ended in conformity with accounting principles and practices generally accepted in Japan (see Note 1) consistently applied during the periods.

As described in Note 2 (4) of the Notes to the Consolidated Financial Statements, SEGA Enterprises, Ltd. and its consolidated subsidiaries, during the year ended March 31, 1998, changed the method of accounting for income taxes. In prior years, intraperiod allocation of income taxes had been made only for the portion related to consolidation adjustments, such as eliminations of intercompany profits and certain other items incidental to consolidation and elimination. However, during the year ended March 31, 1998, intraperiod allocation of income taxes was made for all the items related to temporary differences between financial reporting purposes and tax purposes. The change was made in order to achieve the better matching of periodic cost against revenue, because the materiality of temporary differences of SEGA Enterprises, Ltd. and its consolidated subsidiaries has increased, and, therefore, we concur with the change as appropriate.

As a result of the change, operating loss and net loss for the year ended March 31, 1998, were decreased by ¥911 million and ¥4,192 million, respectively, as compared with the previous method. Also, the effect of the change to the segment information has been described in Note 6 of the Notes to the Consolidated Financial Statements.

The amounts expressed in U.S. dollars, provided solely for the convenience of the reader, have been translated on the basis set forth in Note 5 to the accompanying consolidated financial statements.

June 29, 1999
Tokyo, Japan

Chuo Audit Corporation

Chuo Audit Corporation
Independent Certified Public Accountants

BOARD OF DIRECTORS

(As of June 29, 1999)

Representative Director and Chairman
Isao Okawa

Representative Director and President
Shoichiro Irimajiri

Executive Vice President
Masahiro Aozono

Executive Vice President
Hisashi Suzuki

Executive Vice President
Sadahiko Hirose

Managing Director
Tetsuo Takakura

Director
Yoshiji Fukushima

Director
Yasushi Akimoto

Director
Yukio Sonoyama

SEGA ENTERPRISES, LTD.

Head Office

2-12, Haneda 1-chome, Ohta-ku, Tokyo 144-8531

Tel: (03) 5736-7111

Branch Offices

Sapporo, Kansai, Kyushu

Date of Incorporation

June 3, 1960

Paid-in Capital

¥42,109 million

Number of Employees

3,974

PRINCIPAL SUBSIDIARIES

SEGA of America, Inc.

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

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

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

SEGA Europe Ltd.

266-270 Gunnersbury Avenue,
London W4 5QB, United Kingdom
Tel: 44-208-995-3399

SEGA Operations UK Ltd.

Unit 2, Industrial Estate,
Leigh Close, New Malden,
Surrey KT3 3NL, United Kingdom
Tel: 44-208-336-2256

SEGA Amusements Europe Ltd.

Unit 2, Industrial Estate,
Leigh Close, New Malden,
Surrey KT3 3NL, United Kingdom
Tel: 44-208-336-3342

AMERICAN DEPOSITARY RECEIPTS

Depositary

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

SEGA Enterprises, Ltd.
2-12, Haneda 1-chome, Ohta-ku, Tokyo 144-8531, Japan
Tel: (03) 5736-7111   http://www.sega.co.jp/

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