FY2019 Q2 Earnings Announcement
Analyst and Investor Briefing Q&A (Summary)

Date: October 30, 2019 (Wed)

IMPORTANT: PLEASE READ THE FOLLOWING STATEMENT

For your reference, below please find an English translation of the question and answer session at the analyst and investor briefing for the financial results for the second quarter ended September 30, 2019, which was conducted in Japanese (except for questions asked in English).

This transcript has been edited for the sake of clarity. Footnotes have been included to correct any inaccurate statements.

As a result, there are some differences between the English translation of the transcript below and the simultaneous English interpretation provided at the actual question and answer session. A recording of the simultaneous English interpretation can be found on the Sony Investor Relations website at https://www.sony.net/SonyInfo/IR/.

Questioner No.1

Q1: I have two questions. The first regards the I&SS segment, where you raised your sales guidance by 50 billion yen and your profit guidance by 55 billion yen. Could you elaborate on the basis for that? In particular, you achieved very good numbers in Q1, but does the guidance hike simply reflect the overshoot in Q2, given the lack of visibility on 2H, or have you also changed your views on 2H to some extent? I would appreciate any comments you have in that context.

A1: Thank you. I will elaborate, then, on the basis for the upward revisions to our sales and operating income guidance for the I&SS segment. Firstly, the 50-billion-yen hike to our sales guidance is a direct reflection of the fact that the adoption of multi-lens camera formats and larger die sizes has been greater than what we had anticipated. The hike also includes stronger expectations for 2H than what we had at the beginning of the fiscal year. In terms of the contribution from volumes versus prices, I would note that the adoption of larger sensors has improved our product mix, leading us to believe that we are better placed to maintain our average selling prices than what we had thought at the beginning of the fiscal year, so we have also reflected that to some extent. As regards sales volumes, as I mentioned earlier, inquiries from customers regarding 2H remain strong, but at present our outlook is slightly cautious. That said, we have increased our outlook versus what it was at the beginning of the fiscal year.

The hike to our operating income guidance naturally owes in part to our expectations for stronger sensor sales, but it also owes in part to improvement in our manufacturing operations. Specifically, that includes our profit line being helped by expense cuts and a higher inventory at the end of the fiscal year. We also again think that 2H is looking like it will be stronger than what we had expected at the beginning of the fiscal year. In addition, a significant portion of our business through roughly the end of Q3 has basically been finalized, so almost the only outstanding question is what prices will look like in Q4. At present, our interest has actually shifted more to the question of what demand is going to look like in fiscal year 2020.

Q2: My second question concerns games. You mentioned the significant impact of postponing the release of a major first-party title. Does that suggest that to some extent you intend to take a more flexible approach to your launch schedule for first-party titles in 2H due to strategic considerations related to the launch of PS5?

A2: The postponement of that game's launch is not due to strategic considerations. We had announced that it was coming out in February, but after careful consideration, the studio did not feel that it met their quality standards and that it would take a little more time. As such, they asked us to reschedule the launch for May, and that is the decision we have arrived at for now. What is more important for us is to exercise solid management over our development timelines, so with this as our first step, we intend to undertake solid launch schedule management going forward.

Questioner No.2

Q1: My first question concerns your strategy for IP in the Pictures segment. Your negotiations with Disney over Spider-Man were the subject of discussion in the papers. I realize you are limited in what you can say regarding specific matters, but could you share your latest thinking on your IP strategy for video content? In particular, we are seeing a proliferation in streaming services, including Disney's new service. I would appreciate it if you could share your thoughts on the way forward in that context.

A1: Thank you for your question on our IP strategy for the Pictures segment. It is true that a variety of platforms are stepping up their streaming offerings at present. We see such a competitive landscape as reflective of increased demand for content and therefore view it as extremely positive. We are frequently approached by parties who are interested in us providing content, but with a lot of different platforms looking for high-quality exclusive content, hiring creators and other people who produce such content is also increasingly challenging. Against that backdrop, we intend to continue to strengthen our IP portfolio and to step up our engagement with creators so that we will be able to make our presence felt as an independent studio.

Q2: My second question involves anime, where you discussed the merging of the distribution platforms. My understanding is that in the anime space, it has been the success of FGO that has had a major impact on your earnings. As such, I would first like to ask how your anime business would have performed over the past several years if you exclude the contribution of FGO. In addition, you did not touch on synergies between anime and games today, but I believe those are also significant, so I would also appreciate it if you have anything to add in that context.

A2: You are correct in saying that FGO is our strongest anime offering at present. We intend to continue to develop FGO, but at the same time Aniplex is already working on future offerings where it is building the IP from the ground up. There are several of them that are looking very promising, so we do not believe that our anime properties need to be based on games. We also mentioned animated TV series earlier, so our current view is that we want to engage in that sort of multifaceted merchandising.

Questioner No.3

Q1: I also have two questions. Could you first comment on what profits are likely to look like as you transition between game platforms? I am especially interested in what difference you expect between FY2019 and FY2020. You have postponed *The Last of Us Part II* until FY2020, and you have announced the discontinuation of PlayStation Vue, which has been a loss generator. These moves should be positives for FY2020. At the same time, though, I believe that you will incur various costs associated with the launch of PS5. I would appreciate some further commentary on the balance between these opposing factors, as well as on your thoughts regarding PS4 monetization in FY2020.

A1: Thank you. We believe there is significant interest in what profits will look like as we transition between game platforms. That will hinge largely on how much we decide to sell the PS5 for. As part of our mid-range plan discussions, we are at this very moment performing a multifaceted analysis of our bill-of-material costs, the pricing the market will be willing to accept, and the sort of market penetration that is likely to result for the platform. As such, I cannot comment further at present. That said, we also will be mindful of what that will mean for profit levels and continue to engage with our investors and other capital markets stakeholders as we consider this question. You next asked about our view on PS4 monetization in FY2020. Subscriber numbers for PS Plus and PS Now in our Network Services business are solid, and to the extent possible, we would like to see that customer base transition to PS5. We believe that the larger that base is the better able we are to mitigate our profit volatility, so we intend to continue to work on that.

Q2: My second question also involves the sustainability of profits. Your materials do not mention the box-office success of *Spider-Man: Far From Home* among the reasons for the revision to your outlook for the Pictures segment. You instead cite the Media Networks business, cost cutting, and factors in other businesses. The 70 billion yen in profits you are looking for in FY2019 is somewhat high compared to the past several years. Do you see that as a sustainable level, or would it be better for us to assume that the high level of profits is something you are capable of achieving in years when your pipeline is strong?

A2: The level of profits we anticipate in the Pictures segment in FY2019 does owe in part to the restructuring we have undertaken at the Media Networks business. However, we are making steady progress on improving our profitability, and I also believe that we are on track to achieving the 7% operating margin that we said we are working toward at our IR Day. We will need to work on improving the lineup in the Motion Pictures business over multiple fiscal years, and we will continue that effort while also looking for additional savings opportunities in our cost structure so that we will be able to maintain that margin. It is true that *Spider-Man: Far From Home* was a major hit, but its performance did not deviate significantly from our expectations at the beginning of the fiscal year, and we have actually cut our sales outlook for the segment. As I mentioned, however, that cut owes to changes to our release schedule and to the underperformance of a few of our releases. At any rate, I personally feel that the landscape is such that we have considerably better visibility on profits from the Pictures segment than what we had a few years ago, and we hope to continue to provide you with an outlook for stability.

Questioner No.4

Q1: I have questions regarding both games and the I&SS segment. A moment ago you provided additional commentary on the factors impacting the profit line for games. I believe that included weaker sales outside of the first-party space. Could you speak to how much of that involves free-to-play games and also to the impact you expect that to have in 2H versus 1H and also in FY2020?

A1: Could we show the step chart for games? Thank you. I believe your question concerns the reference here to third-party game software. We have not provided actual numbers for this, but I believe you can get a rough idea. The drop in volume here was exceeded by the decline in the free-to-play space. That means that other titles are offsetting that. In some cases, that involves titles from our existing partners, so in that sense, we do not see having more offerings of a free-to-play nature or more titles with in-game transactions as such a bad thing.

As regards the impact in 2H and FY2020, we have cut our guidance for 2H to reflect the slowdown in 1H. When we devised our outlook at the beginning of the fiscal year, we included some spikes and upside owing to seasonality based on historical trends. However, such spikes did not actually materialize in the end, so our downwardly revised outlook anticipates a fairly flat performance. As such, we do not think we will see much deviation from our revised 2H guidance, but in this case, I believe some degree of uncertainty will remain. That said, we can tell that when one title slows down, customers are moving to other titles, so we are hoping that that will help mitigate volatility to some extent.

Q2: For my second question, I would like to confirm a point about the numbers for image sensors. You had said that you would spend 700 billion yen in capex during the course of the current mid-range plan. Could you please comment on whether there has been any change to that and also whether there has been any change in the split between outsourcing and in-house production for the 138K.

A2: We had said that we were planning 700 billion yen in capex over the three years between FY2018 and FY2020. However, in order to meet current demand, we may have to pull forward a bit of the spending we had anticipated engaging in under our next mid-range plan. As such, our spending may increase by a few tens of billions. That will depend in part on factors such as when the equipment is actually delivered, so I cannot say anything definitive—I would just like to mention it as a possibility.

As regards the split between in-house production and outsourcing for the 138K, there is no change in the outsourced volume, so that means the percentage of in-house production will rise.

Questioner No.5

Q1: I also have two questions, one concerning games and one concerning image sensors. Firstly, I am looking at your supplemental information on games and am hoping you can clarify your views on the landscape. You have game software sales down by around 14 million versus last year, which I believe owes in part to *Spider-Man*, but I believe that would account for about five or six million, which makes me concerned that your tie ratio is down considerably. Is it fair to view this as something temporary, or if you feel that conditions have changed in some way of late, could you share that with us? Also, are you seeing a sharp drop for a subset of the free-to-play titles, or is it a major decline that is more wide spread than that?

A1: I will first speak to the YoY decline in software sales. We had many extremely strong titles such as *Spider-Man* and *God of War* last year, so I do believe that makes for a significant difference. For that reason, we do not see this as indicative of shrinkage in the overall software market, as you proposed in your question. To your second point on third-party free-to-play games, the decline is completely localized. It is not something spread over multiple titles.

Q2: My second question concerns the capacity expansion in the I&SS segment that you discussed earlier. What sort of applications do you believe are going to grow more in 2021 and beyond than you had previously expected? Is it smartphones, automotives, IoT, or things like edge AI that you are engaged in now? Also, depending on that, do you have greater certainty about achieving the goal you referenced earlier of increasing ROIC from 20% to 25%, or do you see it as a quite difficult target to reach?

A2: In terms of our view on expanding capacity in the I&SS segment, in the span between 2020 and 2021, we basically expect smartphones to remain strong. This is because of very robust demand from our image sensor customers owing to the strong drive toward adoption of multi-lens camera formats and larger die sizes. As such, if your question is whether other applications will come to represent a very large, visible part of our overall sales figures, I think that smartphones are going to remain much larger.

Questioner No.6

Q1: My first question concerns the I&SS segment and my second question involves capital allocation. As you always do, could you tell me about capacity and input in the I&SS segment in terms both of Q2 results and your Q3 outlook? You commented a bit earlier on your view regarding 2H, but how has your view on inventory levels in 4Q changed given your expectations for running at full capacity? Page six of the supplemental information makes reference to inventory, but could you share your assumption in terms of number of days or absolute units versus last year and how that has fed into your earnings outlook? My impression is that the 2Q overshoot in I&SS profits or the increase in full-year guidance was quite large, so what I want to ask for my first question is what assumptions underlie the current outlook.

A1:

As of the end of Q2, capacity stood at 108,000/month, so 108K. This represents a slight increase versus our previous assumption of 105K. At present, we expect that figure to reach 117K by the end of Q3. Our plan is to gradually add capacity over a three-month period. In terms of input, we ran basically at full capacity in Q2, as we had expected. We look to run basically at full capacity in Q3 as well.

In terms of inventory, we used the expression “strategic inventory,” and converting the production volume we anticipate for 2H into wafers, we plan to have a strategic inventory of around 50,000 wafers. Frankly speaking, given how strong 2H demand is at present, it is difficult to predict whether we will be able to build up that much inventory.

Q2: My second question concerns your slide on capital allocation. I appreciate that you are discussing it in terms both of divestitures and investments. The materials indicate that 190 billion yen in divestitures and 150 billion yen in investment have already taken place. However, you have maintained your free cash flow figure this time. Does the figure you have provided reflect the divestitures and spending that have already taken place, or does the figure to some extent include a few 2H transactions that you already have visibility on?

A2: Our basic philosophy is that since we are unable to share plans regarding divestitures, we essentially only disclose completed transactions. In the case of strategic investments, we also include transactions where the deal itself has been signed but the execution has yet to take place. That is essentially how we disclose the information.

Questioner No.7

Q1: I have one question involving the mobile business. The business was in the black in Q2, and you have raised your full-year forecast by approximately 10 billion yen. However, given that volumes look poised to fall, what do you think of the probability of being in the black in FY2020? Also, I think that 3.5 million would basically equate to the domestic market and just a bit more. Why are you making better progress on cutting costs than you anticipated, and what is your outlook going forward? Also, could you please provide us with an update on your business strategy?

A1: I believe the split between 1H and 2H is a bit confusing, so let me first provide a bit of color on that. The 1H figure includes upside from one-off factors, meaning that those factors boosted profits. By contrast, one-off costs are negative for 2H. If we exclude such one-offs, we think 2H sales will rise by 23 billion yen versus 1H and operating income will fall by 8 billion yen*. That level would therefore be what we are currently capable of in real terms. That puts us ahead of where we had thought we would be when we put together our structural reform forecast at the beginning of the fiscal year. As such, I believe we will be able to achieve a lower breakeven point than what we had originally anticipated. In conclusion, our current view is that we are amply capable of achieving profitability in FY2020 as we have promised.

I think your question on volumes was whether we would be able to achieve profitability with just the domestic market and a bit more. My current view is that profitability is well within reach at that level. As regards your question about potential upside, I think that trying to pursue short-term upside in the smartphone space would be difficult given the considerable company risk, so I believe that the direction of our strategy is to focus on making ourselves leaner and then establishing our own positioning.

*Sales and operating income without one-off are not measures in accordance with U.S. GAAP. However, Sony believes that this disclosure may be useful information to investors.

Questioner No.8

Q1: I have one question. A qualitative description is fine, but could you tell me about YoY profit change for products other than smartphones in the Electronics Products & Solutions segment, namely TVs, audio & video products, and video cameras?

A1: I will give you a qualitative assessment of the overall direction for non-smartphone products in the EP&S segment. Both sales and profits are down for TVs. Am I correct in understanding that your question is in reference to Q2? The Audio & Video business saw growth in both sales and profits, while the Digital Imaging business saw sales rise but profits fall. Lastly, both sales and profits are down for Professional Solutions. To add some color to that, I would note that our TVs were hit by a decline in sales volume and adverse forex impact. In the Audio & Video business, sales of truly wireless earbuds are extremely brisk, which made a considerable contribution to sales growth. The Digital Imaging business was hit by adverse forex impact, but it also got a boost from the release of new products, which is why its sales grew. The Professional Solutions business was unfortunately hit both by adverse forex impact and by poorer market conditions in China, making things quite challenging for our projectors and camcorders.

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