FY2020 Q2 Earnings Announcement

Analyst and Investor Briefing Q&A (Summary)

Date: October 28, 2020 (Wed)

IMPORTANT: PLEASE READ THE FOLLOWING STATEMENT

For your reference, below please find an English summary of the question and answer session at the analyst and investor briefing for the financial results for the second quarter ended September 30, 2020, which was conducted in Japanese.

This English summary, which is intended to replace the simultaneous translation of the question and answer session previously provided, is not intended to be a direct translation of the question and answer session. As a result, there may be some differences between this English summary and the simultaneous English interpretation provided at the question and answer session.

Questioner 1

Q1: [I&SS segment] As you head toward FY2021, how do you plan to regain market share of image sensors in volume terms? Also, I believe you will need to expand your market share in the custom space thereafter. Unlike in the past, there are going to be customer needs for high pixel counts and miniaturization, but is it fair to assume that you feel capable of handling that?

A1: We think competition will be waged over miniaturization to 0.7 microns, and we will catch up on market share. However, since we are talking about commodity sensors, we believe that the margins will be lower than those on previous products, where our strength was higher picture quality. We will have to allow for that to some extent because we want to capture market share and further expand our customer base. And then, customers will want high pixel counts, so we want to respond to that demand and use FY2021 to lay the groundwork for the business in FY2022.

Q2: [G&NS segment] Your final slide shows a sunny outlook for the games business again in FY2021. Am I correct in understanding that you believe you will be able to offset diminished demand from people staying at home with an increase in momentum from the PS5 cycle starting? Also, is it fair to assume you expect continued strength in FY2021 from add-on content, software sales and network services?

A2: To avoid any confusion, allow me to clarify that the final slide illustrates the business momentum that we expect from now into FY2021 and beyond. It is not meant to represent our earnings forecast for FY2021. The reason we chose the sunshine mark for G&NS's momentum is because the extremely strong demand for PS5, the positive feedback we have received on it, and the strong lineup of software we have slated for it all suggest that we are going to further grow our customer base in FY2021. Over the medium term, we want to offer that larger customer base greater network services and generate more recurring earnings. We feel that the true competition lies not in single-year profits but in how large a universe we can build over the medium term.

Questioner 2

Q1: [Consolidated] Could you go segment by segment and give us a rough idea of how much of the increase in your full-year operating income forecast comes from outperformance in the 2nd Quarter and how much comes from higher expectations for the second half ("2H")?

A1: It may well appear that we are expecting considerable deterioration of operating income in 2H following an excellent first half ("1H"), but there are various temporary factors at play, so let me discuss the situation segment by segment. In the G&NS segment, we expect 2H profit to be impacted by an increase in costs relating to the launch of PS5. We also anticipate a falloff in stay-at-home demand in 2H compared to 1H. In the Music segment, we booked a one-time gain relating to the transfer of a business in 1H. In the Pictures segment, we expect marketing costs for theatrical releases to increase in 2H, and we are not expecting much in the way of revenue from home entertainment or other merchandising in 2H as there were very few theatrical releases in 1H. In the EP&S segment, we expect to book greater restructuring costs than in 1H. In the I&SS segment, we are not forecasting any 2H sales to one of our major Chinese customers following the suspension of shipments to that customer, and we expect a drop in utilization at our production facilities due to inventory adjustments, but this also relates to your second question, so I will elaborate in a moment. In the Financial Services segment, Sony Bank booked valuation gains on assets under management in 1H. In the All Other, Corporate and elimination, we expect a slight rise in costs in 2H versus 1H, relating to new business exploration activities. These factors are included in our forecast, but I feel that you will get a more accurate view of our business momentum and underlying capability by looking at our full-year performance.

Q2: [I&SS segment] Could you tell us about wafer input levels, where you expect to see capacity at the end of FY2020, what you anticipate utilization looking like throughout 2H, and what your inventory target is for the end of FY2020? Am I correct in understanding that the 17.5 billion yen in inventory write-downs was for commodity rather than custom sensors and that you will be able to sell them elsewhere?

A2: We expect photo diode production capacity of 130,000 wafers on average for the three months of the 3rd Quarter, and we believe our input will be roughly 85% of that amount at around 110,000 wafers. At present, the low end of our forecast assumes that we will reduce photo diode production by one more notch in the 4th Quarter, bringing wafer input to just under 70% of our current capacity. That said, this assumes no additional orders whatsoever, so we may be able to increase that a little depending on how orders trend. I cannot give you a specific inventory figure at present because the level of inventory we want to have at the end of FY2020 (including strategic inventory) is something we will ultimately determine once we have a better idea of the likelihood of additional orders in the 4th Quarter and the strength of demand in 1H FY2021. The simulations on which our current outlook is premised do not call for us building strategic inventory (to the level we had anticipated in last August). However, this is something that will be determined by demand, so we intend to be flexible. I believe there is a high probability of us receiving additional orders. Most of the inventory that we wrote down was for a specific customer. Some of it was commodity sensors and some custom, but please assume that custom sensors accounted for the larger portion.

Questioner 3

Q1: [Consolidated] Could you talk us through any examples of segments that have turned the pandemic into an opportunity and noticeably increased their ability to generate profits ahead of FY2021?

A1: What I feel most keenly is how we are managing to keep our businesses running despite limitations such as being unable to commute to work and being forced to operate remotely amidst the pandemic. This owes to enormous efforts on the part of our employees, as well as to some creativity. In addition, despite current circumstances, demand for entertainment remains undiminished. In fact, it has grown stronger, which is very encouraging. I would go so far as to say that we have seen tangible improvements in every segment. In Financial Services segment, too, Sony Life Insurance's Life Planners have long been engaged in face-to-face sales efforts, but since the introduction of remote consulting services, new policy numbers are returning to levels nearly as high as the previous year. I think that this demonstrates that even in a pandemic, we are capable of running our businesses, and there are still opportunities to expand.

Q2: [G&NS segment] Going forward, will the default assumption be that you need to make equity investments in publishers? If there has been any change to your attitude toward acquiring game content, such as being more aggressive than before, please describe that.

A2: We do not think that taking financial stakes will necessarily be a requirement in our relationships with publishers. However, we do see capital tie-ups as one potential strategy if we are talking about forming a deeper engagement with a particular publisher, such as by collaborating in numerous endeavors. In any case, there has been no change whatsoever in our goal of providing as many customers as possible with high-quality content via our platform, so we want to access as much good content as we can.

Questioner 4

Q1: [Pictures segment] In your prepared remarks, you referred to the trend in theatrical releases and subsequent earnings opportunities in regard to profit in the Motion Pictures category, could you tell us more details? If you could speak in more detail on this, it might give us a better idea of how the business can recover heading into FY2021.

A1: Unlike in FY2019, we are having almost no new releases in FY2020, which means that earnings from home entertainment and streaming will decrease in 2H. Although there were very few major titles released in 1H, we do expect to resume releases in 2H, and we will incur marketing costs ahead of that. The success of movies in theaters leads subsequently to earnings from home entertainment, so the profit from home entertainment will be delayed. On top of this, there is uncertainty as to whether a title will be a hit after its theatrical release. However, we are expecting Media Networks and Television Productions to make up for such uncertainty.

Q2: [Consolidated] You increased your operating cash flow forecast and reduced your capex budget, primarily by cutting the budget for I&SS segment. What are your current thoughts on how you will use the additional free cash flow generated?
A2: We increased our FY2020 operating cash flow forecast by 80 billion yen compared with the level we released at our 1st Quarter results. We expect less capital expenditure compared with our previous forecast. Our strategic investment plans remain unchanged. We expect to invest around 300 billion yen in addition to the funds used to acquire the remainder of Sony Financial Holdings, as we discussed when we announced our 1st Quarter results. The 70 billion yen in total investments already made in Bilibili Inc. and Epic Games, as well as the 100-billion-yen share repurchases program announced in FY2020, are included in the 300-billion-yen figure. There are a growing number of M&A opportunities out there, so we aim to make timely strategic investment decisions after undertaking thorough diligence and analysis of the investment opportunities arising across various segments.

Questioner 5
Q1: [I&SS segment] What was your wafer input for photo diode production in the 2nd Quarter?
A1: In the 2nd Quarter, input averaged around 110,000 wafers versus a capacity of 130,000. We reduced production slightly for mobile devices and digital cameras. Input was also impacted by a one-off factor in the 2nd Quarter, namely legally mandated inspections that had to be performed at some of our facilities.

Q2: [EP&S segment] Both sales and profits were up even without Mobile Communications. Could you explain your performance, referencing the former classifications of HE&S [Home Entertainment & Sound] segment and IP&S [Imaging Products & Solutions] segment? Your momentum chart shows the business going from cloudy to partly sunny in FY2021. Could you describe your thinking there?
A2: If we exclude Mobile Communications, the category that was the greatest contributor to sales and profit growth in the 2nd Quarter was televisions, followed by digital cameras. The weather symbols are meant to illustrate the momentum we expect from now into FY2021 and beyond. They are by no means intended to represent our earnings forecast for any fiscal year. The reason we expect momentum improvement is because both sales and profits took substantial hits from the pandemic in the 1st Quarter, and that impact should diminish considerably. While there may be second and

third waves of infections in some regions, we have been learning how to cope and believe momentum will improve given our ability to cope.

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