FY2022 Q1 Earnings Announcement
Analyst and Investor Briefing Q&A (Summary)

Date: July 29, 2022 (Fri)

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 first quarter ended June 30, 2022, 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: [G&NS segment] Has slow adoption of the PS5 impacted your software sales or user engagement?

A1: We believe hardware adoption definitely increases user engagement. The data clearly shows that engagement is high among PS5 users, so we would expect to see benefits from the faster adoption of PS5. PS5 sales look poised for robust growth in the second half of this fiscal year, and major third-party and first-party game releases are slated for the second quarter and beyond, so we hope to increase engagement and create momentum.

Q2: [I&SS segment] What are your views on the makeup of your inventory of image sensors for mobile products and the associated risks?

A2: Our policy in the case of image sensors for mobile products is to stockpile strategic inventory based on our demand forecast and production capacity, so our forecast assumes that inventory will be higher than in FY2021. At present, our inventory is above the level that we had anticipated because first-quarter shipments undershot our expectations. However, in light of our prospects for sales growth, we think that our inventory remains within a sensible range. With the start of sales growth in the second quarter, our inventory is expected to gradually decline and normalize. That said, we will be stockpiling some strategic inventory in preparation for FY2023 demand, so we do not think that our inventory level will be much different toward the end of FY2022 than it is now. Much of our FY2022 inventory is in the form of general-purpose products, so our risk basically remains limited.

In order to address the risk of future changes in demand, we will continue to monitor the market situation and respond accordingly, including by adjusting the timing of FY2023 production capacity additions as warranted.

Questioner 2

Q1: [Consolidated] Why is the downward revision to your operating cash flow forecast larger than the downward revision to your operating income forecast?

A1: Our negative operating cash flow in the first quarter was mainly attributable to deterioration in our working capital and to foreign currency translation adjustments following the sharp depreciation in the yen. Of the 230-billion-yen downward revision to our operating cash flow outlook, 50 billion yen is due to the downward revision to our G&NS operating income forecast. Secondly, we expect an increase in working capital, primarily reflecting higher inventory in the I&SS segment. In the I&SS segment, we expect accounts receivable to grow and inventory to rise in the fourth quarter as sales grow from the second quarter on. However, we see this as only a hiccup in our working capital as we believe that our cash flow will recover from FY2023 on the back of our sales efforts. In addition, the impact of foreign currency translation adjustment that we expect is substantial as it reflects the extent to which the yen has depreciated. Aside from these factors, we have assumed a higher level of tax payments and greater television production costs in the Pictures segment versus our May forecast. Foreign exchange rates are having a negative impact on operating cash flow, but the impact is offset on the balance sheet by currency translation adjustments for cash balances held in currencies other than the yen. From a capital allocation standpoint, while the operating cash flow looks negative, one can consider it evened out by cash balances on the balance sheet.

Q2: [I&SS segment] Your full-year operating income forecast assumes that the positive impact of foreign exchange rates will be cancelled out by lower sales of image sensors for industrial equipment and security cameras. Why do you expect that to happen? Also, what are your expectations in terms of capacity and utilization of image sensors?

A2: Our reasoning is based on the risk of a macroeconomic slowdown, including in China, and we have updated our forecast in reflection of our somewhat cautious view on how this may lead to a decline in industrial applications. Starting this quarter, image sensor production capacity and wafer input figures are available in our supplemental information document. We expect our monthly capacity to be 114,000 wafers at the end of the second quarter, and we anticipate a monthly average input of 124,000 wafers for the second quarter.

Questioner 3

Q1: [Consolidated] Following the change of demand in this quarter, what do you intend to change and what do you intend to leave the same operationally? What are the risks to achieving your full-year forecasts? Could you share the quantitative details of any risk buffers you may have incorporated into your forecasts?

A1: One thing we will not change is the investment required for generating growth in the mid- to long-term. While we may adjust the level of investments that we make, we do not intend on changing our stance on investing. We will primarily change how we spend and how we control our inventory. In terms of spending, we are starting to act more conservatively when it comes to recruiting and filling vacant positions at our overseas entertainment subsidiaries, for example. We are also starting to tackle risks on the operational side of each business, including revisiting marketing spending and sales costs, among other items. Each segment is looking very carefully at their respective inventory situations. There is no concern in terms of inventory in the G&NS segment as hardware is currently in short supply. The main reasons behind increased inventories in the ET&S and I&SS segments are threefold. First is the currency situation, whereby the yen's depreciation is making inventory appear inflated. Secondly, supply shortages have persisted for so long that we have intentionally increased our strategic inventories in response. The third reason is product inventory. From an inventory control perspective, it is more the component side where inventories are high, so we are working on returning this to normal levels.
Regarding I&SS segment inventory, we may decide to adjust or delay the timing of FY2023 production capacity increases should risks emerge in high-end smartphones sales.
At present, we do not believe an economic slowdown will have a substantial impact on the game business in the year-end holiday season. We believe that the reopening of the economy will have a greater negative impact on software sales than any slowdown, but we should be able to confirm this to some extent by looking at sales trends when major titles are launched in the second quarter and thereafter.

Questioner 4

Q1: [Music/Pictures segments] How did your first-quarter performance compare to your expectations?

A1: Motion Pictures did extremely well in the first quarter, largely due to home entertainment contributions from FY2021 releases such as *Spider-Man* and *Uncharted*. Television Productions also benefitted from the delivery of numerous drama series. We did not change our full-year forecast because earnings in the second quarter and beyond will be adversely impacted by the postponement to FY2023 of the release of *Spider-Man: Across the Spider-Verse*, which is a major title.

The Music segment performed to our expectations. The streaming market continues to demonstrate solid growth, and Sony's market share and profitability are strong.

Q2: [G&NS segment] You increased your estimate of expenses associated with acquisitions from 44 billion yen to 57 billion yen, but what are your expectations for FY2023 and beyond? Can you provide us with an update on the Bungie business?

A2: We expect expenses associated with acquisitions to be roughly 20% higher in FY2023 than in FY2022. The impact of the Bungie business on both our total sales and operating income is not material.

Questioner 5

Q1: [Consolidated] I believe your first-quarter results were better than you had anticipated in many respects, but what about your overall performance? And how great a part did foreign exchange rates play in that? You only lowered your full-year operating income forecast for the G&NS segment, but how do you feel about that? Do you see any conservatism in your forecast, for example?

A1: Compared to our forecast as of May, we estimate that foreign exchange rates have provided our operating income line with a boost of nearly 30 billion yen. Our forecast as of May also took into account the impact of the Shanghai lockdown and geopolitical risk associated with events occurring at that point in time. In contrast, it did not give due consideration to the potential for a slowdown in the global economy, including in China. We have updated our forecast to reflect such environmental changes. It is quite difficult at present to describe the extent to which we expect the positive impact of foreign exchange rates to be offset by risks under our updated forecasts. This is not only because the answer differs from business to business, but also because asking how much demand is likely to decline is akin to asking how profound the potential economic slowdown is likely to be or how long it is likely to last. The forecasts that we have presented reflect our synthesis of the information available to us at this time. While you may not believe that our latest forecasts necessarily reflect all of the positive impact that we have received from foreign exchange rates, I believe that I have said all we should at present given that we have only completed the first quarter of the fiscal year.

Questioner 6

Q1: [G&NS segment] You said that you were adversely affected by both external factors and company-specific factors in the first quarter. Do you expect to benefit from any company-specific factors in subsequent quarters? Do you have any updates on your platform expansion or live game service?

A1: In terms of positives for the second quarter onward, I would note that we are no longer dealing with most of the component supply constraints that were affecting the production of our PS5 hardware. The Shanghai lockdown is also over. In contrast, logistics lead times have not returned to pre-pandemic levels. We also expect to benefit when major first-party and third-party game titles are released in the second quarter and beyond.

In terms of our platform expansion, we were able to roll out our new PS Plus service as planned at the end of June, and the migration to the new service is also going well. While we will need to see a bit more data to assess the potential impact on total earnings, we do not think that the service has gotten off to a poor start by any means.
