FY2024.Q1 Earnings Announcement
Q&A (Summary)

Date: August 7, 2024 (Wed)

IMPORTANT: PLEASE READ THE FOLLOWING STATEMENT

For your reference, below please find an English summary of the question and answer session for the financial results for the first quarter ended June 30, 2024, 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

Q: [G&NS segment] Regarding the structural reform, in particular, you mentioned that you are strengthening schedule management and optimizing development projects for the studio business group. Could you tell us what structural reforms you made during this fiscal year or what you plan to do in the future?

A: We have currently announced the structural reform of Bungie. The purpose of this structural reform is to optimize our cost structure and portfolio. At the same time, we plan to integrate back-office functions with Sony Interactive Entertainment's (SIE) studios to further increase efficiency. Bungie itself intends to focus its resources, including human resource, on the development of "Destiny 2" and the new live-service title "Marathon" in order to focus on developing high-quality, outstanding gaming experiences. We are also reallocating resources by transferring other functions of Bungie and the development of different types of titles to PlayStation Studios and proceeding with optimization. Through the transformation of the organizational structure, we aim to build a better studio framework.

Questioner 2

Q: [Consolidated] Regarding the overall IP strategy, why are you not making a further proposal to acquire Paramount? Additionally, what are your projected fields and scale of entertainment IP acquisitions in the future? What percentage of your total operating income do you think should ideally be derived from IP?

A: The reason we are not making a further proposal to acquire Paramount is that we do not consider the acquisition of Paramount to be a good fit for our strategy at this moment. Regarding the target for the percentage of earnings from IP, it is difficult to say because the entertainment businesses involve IP in some form or another, and IP is at the core of business development and revenue generation. There is no change in our policy of strengthening IP across our entertainment businesses as a whole. In the 5th Mid-Range Plan, we have set a 10% or more compound annual growth rate (CAGR) of consolidated operating income (excluding the Financial Services segment) and cumulative operating income margin of 10% or more as key targets, so we intend to implement various measures to achieve these targets.

Questioner 3

Q: [Pictures segment] The number of paying subscribers to Crunchyroll has surpassed 15 million, do you expect this momentum to continue? What are your thoughts on the current situation and future growth?

A: Anime works, such as "Demon Slayer - Hashira Training Arc," "Kaiju No.8" and "My Hero Academia" are contributing to the increase in the number of paying subscribers. Partnerships with distribution platforms such as Amazon Prime Channels also contributed to it. Theatrical distribution is also performing well. Crunchyroll has a strong position because of its ability to provide high-value services at attractive price levels. In addition, Crunchyroll is also working on discovering high-quality IP overseas and co-producing works with Japanese animation creators. In the future, Crunchyroll intends to focus on global expansion in Europe, Latin America, India, and Southeast Asia, as well as multilingual support. In addition, through further expansion of partnerships, Crunchyroll aims to continue to increase its number of viewers.

Q: [Consolidated] You mentioned that Sony is at a stage where the true value of your Mid-Range Plan policy of enhancing resilience is being tested. What do you think will be most important in enhancing resilience in the face of increasing uncertainty?

A: In the short term, we intend to do what we can in terms of finance, such as controlling inventories and cash flow. What I believe is essential in terms of our core qualities is the diversity of our people. In addition to operating diverse businesses, we can expect synergistic effects from our diverse people' diverse ideas will emerge, we will have the ability to create new products, and we will be able to analyze information from a variety of angles.

Questioner 4

Q: [G&NS segment] To what do you attribute the strong 7% year-on-year growth in monthly active users (MAU)? It looks like you could still be benefitting from the update to the major third-party title in the third quarter of FY2023, but were there any other reasons?

A: While the expansion in our PS5 install base has played a role, MAU growth has been aided by our solid offering of franchise software titles as well. A tailwind from third-party free-to-play titles has also helped.

Q: [Music segment] You say that you are targeting streaming revenue growth in the mid-to-high single digits over the mid- to long-term, but while you were showing double-digit growth through the fourth quarter of FY2023 even excluding currency effects, your growth seemed to slow somewhat to 6% in the first quarter. Have you already reached the pace of growth you are anticipating for the mid- to long-term, or were there some one-time factors at play in the first quarter?

A: Overall streaming service growth remains in line with historic growth trend. One reason that growth appears to have slowed is that the year-on-year comparison is no longer benefitting from the price increases made more than a year ago by multiple digital service providers. In addition, our revenue from ad-supported streaming services is down slightly versus our subscription-based streaming services. That said, on a constant currency basis, we estimate growth in our streaming revenue to be in the 6% range, higher than our dollar-denominated growth estimate of 5%, so we see our overall streaming revenue growth as tracking to our forecast.

Questioner 5

Q: [I&SS segment] Your production capacity and wafer input figures suggest that you are increasing your output of mobile image sensors. Could you speak to what changes you have seen over the last three months, including trends in products for your North American customer base? Also, the market is interested in the risk of competitors joining this space. Could you describe your thinking on your position over the mid- to long-term?

A: Our increased output was to support increased shipments of high-end products. Talk of possible new entrants is nothing new. In an environment where we have competitors, we need to engage in constant analysis of competitors, overcome our weaknesses, and surpass them with our technologies. At least for the period covered by our current Mid-Range Plan, we believe the risk of other companies joining this space is extremely low.

Q: [Financial Services segment] Your first-quarter operating income put you 21% of the way toward your full-year forecast. In addition, the financial markets are in the midst of some major swings. Against that backdrop, you have elected to leave your full-year forecast unchanged. How should we view the upside and downside risks that you face?

A: Our first-quarter progress was low for two reasons. Firstly, interest rates rose, and the yen weakened versus the dollar, leading to an increase in cancellations, primarily on dollar-denominated insurance policies at Sony Life. Secondly, our non-life insurance business was impacted by natural disasters such as hailstorms. One upside factor for our full-year forecast is that our sales result continued to perform well in the first quarter. On the other hand, it bears noting that the life insurance business is not one where good sales translate immediately to profits directly. It is one in which profits are recorded through the period you provide services. In terms of our sales efforts, market conditions played a part in driving cancellations up, but we could potentially see upside from our Lifeplanners and other team members providing customers with relevant information that enables them to make more appropriate decisions. Market conditions can also affect our earnings. Market conditions are quite volatile at the moment, but compared to the end of June, interest rates are down slightly with the curve steepening, share prices are down, and the yen is appreciating. The interest rates have a positive impact on our profits, but the share prices and currency rates are negative, demonstrating how market conditions can have both upside and downside risks. We intend to keep a close eye on market conditions as we manage our profits.

Questioner 6

Q: [Consolidated] In the three months since May, you have repurchased nearly 100 billion yen in shares. It looks like you are going ahead with share repurchases regardless of your share price. You previously positioned share repurchases as a strategic investment, but has that policy changed?

A: Our policy on share repurchases is largely unchanged. We continue to undertake agile share buybacks as a part of our strategic investment plans, taking into account our financial position, earnings, and share price. We emphasize total payout ratio under our 5th Mid-Range Plan and are targeting approximately 40% for FY2026. As such, we are repurchasing shares based on the level of our share price while also executing our policy of enhancing shareholder returns.

Q: [Consolidated] When your consolidated equity ratio excluding Financial Services was in the 30% range, I recall that you aimed to increase it to 40% or more. Lately, your equity ratio has been above 50%, which means you are no longer enjoying the benefits of leverage. What level do you believe your consolidated equity ratio excluding Financial Services should be?

A: Our view on financial discipline remains the same when it comes to our consolidated equity ratio excluding Financial Services. We target a consolidated equity ratio without Financial Services of at least 40% in order to enable competitive and agile financing that allows us to respond to any sort of investment opportunities or changes in market conditions that may arise. This target is also informed by credit rating considerations. Recently, a build-up in profits has led to a rise in our equity ratio, but we intend to manage our balance sheet with a greater mindfulness of capital efficiency, including share buybacks like we just described.

Questioner 7

Q: [G&NS segment] I believe that your revenue from add-on content grew by roughly 20% on a dollar basis. What does that look like if you break it down between first-party and third-party content (major releases and other titles)? Also, you raised your full-year forecast, but after a strong first quarter, what are your assumptions for add-on content in the remaining quarters of the fiscal year?

A: Our first-party titles made a slight contribution to the add-on content revenue growth, but it was mostly due to third-party titles. I cannot comment on individual titles, but we were helped by the biggest title that you likely have in mind, and several other titles are also showing solid growth.

Q: [I&SS segment] Your inventory rose roughly 100 billion yen versus the end of FY2023. I believe your work in progress is up due to seasonality, but where does your inventory of finished products stand? Do you think your quantities of finished products are sufficient, and based on your answer to that question, what is your thinking on utilization of your capacity in the second quarter and beyond?

A: As you noted, seasonality played a significant part. We think our inventory of finished products is reasonable given the scale of our sales. We expect our capacity for mobile image sensors to be almost full in the second quarter and beyond.

Questioner 8

Q: [Consolidated] You spoke about foreign exchange rates and the U.S. economy as examples of recent changes in market conditions that could impact Sony. Could you talk through the fluctuation risks on profits by these factors in each of your segments? From a business model perspective, are there any additional risks you are watchful of given the nature of recent changes in the macro environment?

A: The updates to our earnings forecasts are based on foreign exchange rate assumptions that reflect a weaker yen versus both the U.S. dollar and the euro despite the recent pronounced volatility in foreign exchange markets. Since the beginning of August, assuming that the yen has appreciated 10 yen against the dollar and a corresponding movement in the yen against the euro, our foreign exchange sensitivities would suggest 70-80 billion yen in deterioration in consolidated profitability. We signed some forward contracts before the swing in foreign exchange rates, and also made product price adjustments and cost revisions, so we do not expect that such analysis of foreign exchange sensitivities would directly impact on our earnings. Regarding impacts on each segment, the I&SS segment is the most sensitive to foreign exchange rates, but we have updated our forecast to reflect our latest outlooks for various aspects other than foreign exchange rates of the business. For Music and Pictures segments, every one-yen appreciation versus the U.S. dollar shaves 5 billion yen and every one-yen appreciation versus the euro shaves 6.5 billion yen from our profits. These sensitivity figures represent the effects over the course of a full year and we hedge exposure to the dollar-yen rate, both of which help mitigate the impact. We intend to respond flexibly where necessary, including possibly updating prices to adjust for any impacts, which is an option we have already employed in the ET&S segment.

From a business model perspective, geopolitical risk is the macro factor with the potential to have the greatest impact. We have been affected in the past, particularly in the I&SS segment, by developments in U.S.-China relations, so we need to remain watchful of geopolitical risks.
