Business up-date meeting: Entertainment and BRICs

Date: November 19, 2010 [Fri]
Place: Sony Corporation Headquarters

On Friday the 19th of November 2010 Sony Corporation held an Entertainment and BRICs up-date meeting for Analysts at their Tokyo Headquarters.

Entertainment
BRICs

Entertainment

The Entertainment session consisted of updates on both Sony Pictures Entertainment and the Network Entertainment businesses.

Presenters:

Michael Lynton

Chairman & Chief Executive Officer, Sony Pictures Entertainment

Robert S. Wiesenthal

Group Executive, Sony Corporation

Executive Vice President and Chief Financial Officer, Sony Corporation of America

Executive Vice President and Chief Strategy Officer, Sony Entertainment Inc.

Sony Pictures Entertainment, presented by Michael Lynton

The key subjects discussed during Mr. Lynton's presentation included the diversity of the company's business model-with motion picture, television production and television networks, the demand trends impacting the consumption of entertainment created by the company and the advantages that Sony Pictures Entertainment ("SPE") enjoys as being part of Sony Corporation.

Mr. Lynton first discussed the Motion Picture business, highlighting its continued success over nine consecutive years with over $1 billion in North American box office receipts. In the near-term SPE has a number of significant motion picture releases from both its Columbia Pictures and Screen Gems labels which include *The Tourist* (with Angelina Jolie and Johnny Depp), *The Green Hornet* in 3D (with Seth Rogan and Cameron Diaz), *Just Go With It* (with Adam Sandler and Jennifer Aniston) and Burlesque (with Cher and Christina Aguilera). In addition, there are a number of "event" films in the pipeline from existing franchises already in place (*Spider-Man, Men in Black 3, Resident Evil 5 and Underworld 4*) and a new franchise, *The Girl with the Dragon Tattoo*.

Mr. Lynton also discussed trends in 3D films at the box office and he noted that the proportion of box office receipts from 3D has been consistently high in international markets. In the U.S., young male-oriented films have generated the highest percentage of box office receipts from 3D.

In the Television Production business, Mr. Lynton noted the company's large global footprint with continued investment in international production and networks. In the U.S., Sony Pictures Television has 25 series on the air across 13 broadcast and cable networks this season. Of particular note, *The Dr. Oz Show* was recently renewed for three years and it has been sold in 100 territories worldwide, including local language production in China, Russia and the Middle East.

In the Television Networks business, the company currently serves over 435 million households in over 140 countries with 122 feeds and in 22 languages.

Discussing the home entertainment business, Mr. Lynton noted that consumption patterns are changing, most notably a shift from purchase of DVDs to rentals and video on demand. This has been mitigated to some degree by purchases of Blu-ray Disc™ content. Higher margin digital and video on demand transactions are accelerating and they, along with the potential for new distribution windows, represent growth opportunities for the company.

Mr. Lynton also discussed the breadth of 3D initiatives across SPE from theatrical, home entertainment and digital production to television network and the company's unique 3D Technology Center. SPE currently has five 3D movies in production, it has produced stereoscopic 3D effects for more movies than any other motion picture studio and it released the first 3D movie available at retail (*Cloudy with a Chance of Meatballs*), which was also offered as a bundle with Sony 3D televisions.

In reviewing the benefits which accrue to SPE as a result of its ownership by Sony Corporation, several key points were noted. First, with the integration of content and hardware, Sony can differentiate its consumer electronics from the competition while at the same time, provide a distribution opportunity for SPE content. Second, Mr. Lynton also noted recent collaboration across Sony businesses which included SPE films delivered digitally to Sony devices, SPE content cross-promoted with Sony hardware, hardware product placement in films and the synergies created by the availability of 3D content and 3d devices. Last, SPE also provides its content on various Sony services and will work to place 3D films on the new 3D network.

Media Consumption Trends and Opportunities for Networked Entertainment Solutions, presented by Robert Wiesenthal

Three key subjects were addressed by Mr. Wiesenthal in his presentation-the shift from ownership of entertainment content to rental and from bundled content to disaggregated content; new business models emerging due to proliferation of new access methods and the availability of cloud storage; and continued vulnerability of content to piracy. More specifically, in the film and television businesses, there is a shift from the ownership of DVDs towards rental, digital delivery and video on demand. With that consumers are choosing to "unbundle" content typically delivered by cable and satellite providers and alternatively select individual programs via other delivery mechanisms, particularly over the internet. Similarly, in the music business, albums have been disaggregated to single tracks and there is also a shift from ownership of CDs to single track purchases or subscription access models.

As a result of these shifting dynamics, the economic model of entertainment is changing which creates significantly lower revenues per transaction (i.e. purchasing a single music track instead of a CD). This is offset to some degree by increased transaction demand as consumers have become more comfortable with the newer delivery mechanisms and they have more devices upon which they can enjoy content.

Mr. Wiesenthal noted that these new delivery mechanisms promote legitimate consumption and reduce incentives for piracy. While some threats still exist, new security measures such as digital forensic watermarking of movies and encrypted transfers for digital films to theaters help to mitigate those risks.

Most importantly, Mr. Wiesenthal demonstrated that, for the first time, the company has the hardware functionality and service offerings to generate revenue from its home electronics consumer beyond the point of purchase. For example, in the past a consumer would purchase a Sony television and the company's profits were restricted to that single hardware sale. In the future, with digital delivery of content to that television via the internet, the company has the opportunity to benefit from higher margin and higher frequency transactions in addition to the hardware sale.

When discussing Sony's competitive advantages in this opportunity, Mr. Wiesenthal noted several. First, most of our devices such as IP enabled televisions, Blu-ray Disc™ players, PlayStation®3 ("PS3") and PSP® (PlayStation®Portable) are already network enabled and have access to our content networks. As such, the consumer does not need to add yet another device in their living room to enjoy digital content. Second, Sony devices are optimized for Sony content services. By comparison, other content distributors have to try and have a good consumer experience across multiple vendors devices. Furthermore, because Sony is uniquely positioned with both content (films, television, music, music videos, video games) and consumer electronic devices, it can differentiate its devices from the competition and provide additional incentives for the consumer to choose Sony over a competitor.

As a result of these unique competitive advantages, Sony has the opportunity to augment its somewhat less frequent and lower-margin consumer electronic sales with higher-frequency, higher-margin content sales while, at the same time, delivering a superior consumer experience.

In discussing the potential opportunity, Mr. Wiesenthal noted that the company already has 59 million connected user accounts on its PlayStation Network service alone. By comparison, the largest cable or satellite company has approximately 23 million subscribers. As Sony's consumer devices become network enabled and access to its services is rolled out across international regions, there is the potential for hundreds of millions of Sony devices to access the company's content services.

The company intends to aggressively market and encourage consumers to take advantage of the IPTV capabilities of their Wi-Fi connected Blu-ray Disc players, PS3 hardware and connected TVs. In addition, the company is actively working with its content companies to provide unique consumer experiences and preferential windows of content viewing for Sony customers.

BRICs

Sony held a BRICs up-date session with a focus on India and China.

Kiyoshi Shikano

Global Sales & Marketing Officer

Corporate Executive SVP, Sony Corporation

Masaru Tamagawa

Managing Director, Sony India

Haruyasu Nagata

President, Sony China

BRICs Overview presented by Kiyoshi Shikano

Global GDP is expected to grow by 3.5% year-on-year through the fiscal year ending March 31, 2014, and it is said that BRICs countries are expected to make up more than 20% of global GDP in three years. Sony will continue to view these BRICs countries as one of the business areas with future potential. The consumer electronics market in BRICs countries is expected to grow by 18% year-on-year and we expect our growth to be greater than that of the market.

Sony's strategy in developing countries will be handled in the following ways. First, in terms of our customer approach, we are focusing on expanding our business in the middle income class, in addition to reinforcing business with our existing high-income class consumers. We will retain our strong brand image and deliver Sony's unique high value-added products and services among these customers.

Next I will discuss our product strategy. Entry models have long been a necessary part of product line up and this is one area where we will actively continue our efforts. We will look closely at the specific tastes and likes of consumers in different countries and introduce models that match these consumer preferences in each region.

With regards to our sales channel strategy, the four BRICs countries have very different sales structures. It is important for to continue developing our dedicated Sony stores and establish an appropriate balance between mass retailers and other sales channels on a country by country basis. In BRICs countries where Sony has a higher brand image than in other countries, we will focus on further strengthening our brand image by making our products appealing mainly through offering a rich user experience at our Sony stores.

Lastly, I would like to mention our regional sales strategies. Even among the four BRICs countries, each of the countries has different characteristics such as different sales peak season trends. Additionally, even within one given country, people have very different tastes in different states and areas. In April of 2010 we reorganized what were 46 regional sales companies worldwide and those of the BRICs countries-China, India, Russia, and Brazil-were reorganized to report directly to Sony global headquarters. We carried out this reorganization in order to put increased efforts, together with local staff, in developing region-specific strategies which fit with local needs ranging from those of the capital cities to those of provincial regions, which Sony views as being areas of future growth.

Furthermore, in our developing countries business, we consider people to be our most valuable asset and we will continue to focus on the recruitment and training of local staff, leveraging their local talent and knowledge on a global level.

Sony India presented by Masaru Tamagawa

The Indian market, which was showing very strong annual growth for a number of years before the Lehman shock, has since seen a slight slow down in growth. However, Sony's sales in India have continuously shown growth stronger than that of the market. This year in particular, our Indian business has seen market share increases in a number of growing product categories.

In terms of key electronic products, Sony has obtained a high market share in value terms in the LCD TV category, retaining the No.1 share position since May, 2010 (based on the most recent data available from September 2010). For digital cameras, Sony has the No.1 share position on both a value and a volume basis (based on the most recent data available from July 2010). As for PCs, Sony's market share was suffering due to our limited model line-up in the volume zone models; however, our share grew to No. 3 position in the April-June period of 2010.

Sony classifies India into three categories; eight metropolitan cities, 40 second tier cities, and 400 third tier cities. Our 19 sales branches cover 450 Indian cities in total. In addition, Sony believes that post purchase customer service is a very important factor of our business and we have a network of 250 service centers located throughout India. We also have 30 warehouses located all over the country to effectively manage our supply chain as inter-state sales result in higher taxes and the transportation over a long distance is challenging given the status of the current infrastructure, including the roads.

Now, let me touch upon customer segmentation in India. So far, Sony's main target has been the high income class, which consists of about 40 million individuals. Going forward we will also accelerate our efforts toward the middle income class, which has a large population and is expected to continue to experience significant growth.

As for differentiation from our competitors, Sony India is different in that we prioritize sell-through control, effectively utilizing POS and other data sources while many other companies tend to focus more on their monthly sell-in target. In addition, we tightly control our inventory, which leads to the smooth transition of product models in the market place.

Regarding our sales channel strategy, we have about 250 franchised Sony Centers in India. The percentage of sales derived from dedicated Sony stores is stable at around 30% of all sales. Recently, however, sales from national chain stores and regional chain stores is growing. The mix of such store channels varies significantly by region and it is important to consider suitable sales channel strategies for each region. We are also looking to increase the number of sub-dealers we use going forward.

Lastly, I would like to mention the value of the Sony brand and group-wide cooperation. Sony has a very strong brand image in India. We work closely with other companies in the Sony Group in general and Sony India distributes all PlayStation® products in the Indian market. We also had a tie-up campaign promotion with Sony Pictures Entertainment, utilizing its first Bollywood production film in 2007. Such cooperative initiatives contribute to the high brand image of Sony in the Indian market.

Sony China presented by Haruyasu Nagata

First of all, I would like to explain about some of the changes that we are expecting to see occur in the next three years within the Chinese business environment.

Integration of broadcasting, communication and the internet is the current direction adopted by the Chinese government. As this integration advances, there will be increased opportunities for consumers to enjoy our content and we expect this to have a positive influence on the sale of Sony's electronic products. In addition, the content production and distribution functions will be separated from broadcasting stations, which may result in an increase in the sale of Sony's broadcast and professional-use products.

In addition, in the Chinese market there is an increased awareness of environmental issues. A recycling law has been passed and products are rated based on their energy efficiency. Based on the steps taken by a given corporation to comply with these matters, costs are likely to rise. Furthermore, there are unique technical standards and specifications in China, which the Chinese government has been actively promoting. Sony seeks to participate in the development of these Chinese technical standards and specifications, so as to avoid a delay in product development due to a lack of access to relevant information.

In terms of the labor environment, we are expecting to see changes in the overall employment system as a result of such things as the increasing strength of labor unions, proposed changes to the level of protection offered under the temporary employment law, increases in wages, and labor shortages.

We consider the best way in which to improve customer satisfaction is to improve their understanding of Sony's products. In order to achieve this we have utilized Post Purchase Marketing (PPM), during which we held a number of seminars for customers who purchased our products. Moving forward we plan to continue to utilize this approach. If we refer to our brand shops as the "hardware", then this approach could be called the "software." Based on these two approaches we expect Sony's brand value to increase further and our fan base to grow.

Demand for products has shifted to the inland regions and we expect our number of operating sites to increase by three times that of 2009. Additionally, in provincial areas where the Sony brand is not well understood, we use the global brand logo "SONY" and we also add Chinese characters which sound out "Sony" in an attempt to lift brand awareness. We also plan to expand our brand shop network significantly in these areas. In China, there are customers with a strong preference for product quality, design, and form. We are increasing the number of global Sony products we sell in China, "World to China". In addition, we have also begun to introduce a number of products successful in China into similar global markets, "China to World"

Now I would like to mention how our main products are performing in the Chinese market. Demand for flat TVs has been slowing, and Sony's overall LCD TV performance during Chinese "spike-peaks" (Lunar New Year, National Day, and Labor Day) have become key to overall LCD TV sales performance. So far this year, things have been going well for us. A big change which has occurred in the last two years is smoother inventory control attributable to improvements in Sony's operations. As a result, we were able to turn over TV inventory on a three week cycle in the fiscal year ended March 31, 2010.

In the digital camera market we are currently battling for the top share spot and we maintain only three weeks of inventory on hand at any one time. With regard to PCs we are one of the leading players in the third tier group and we are maintaining an appropriate inventory turn over level of two weeks.

In China Sony's brand awareness is very high. In particular this is as a result of the recent aforementioned approaches which have resulted in the level of Sony's brand awareness improving significantly in the last two years.