FY2019 Q1 Earnings Announcement
Analyst and Investor Briefing Q&A (Summary)

Date: July 30, 2019 (Tue)

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 first quarter ended June 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: The Imaging and Sensing Solutions segment reported very high growth in Q1, including over 20% YoY growth in image sensor sales in particular. How much of this growth comes from volume and how much from price, and what are the drivers?

A1: The I&SS segment was indeed strong in Q1 versus the same quarter of the previous fiscal year. Breaking down into volume and price, the average selling price [of image sensors] held up better than we had expected thanks to a more favorable product mix. Inquiries for 48MP 0.8um image sensors were especially strong, in part due to increased sensor size. Volume growth meanwhile came mainly from customers in China. We believe this was driven by increased adoption of multi-lens camera formats across the market, customers' smartphone production shifting more toward flagship models with a higher camera count, and front-loaded procurement aimed at counteracting the impact of US export restrictions.

Q2: Although the Game segment reported a decline in profit for Q1 versus the same quarter of last fiscal year, when first-party software sales were strong, profit still looked reasonably good. How much of the previously stated 30 billion yen increase in development costs related to the next-generation console hit the books in Q1? Could you give us an idea of whether you expect this cost growth to be more weighted to 2H or 1H?

A2: We are relatively positive about our performance in the Game segment for Q1 versus the same quarter of last fiscal year. We had expected software sales to decline given that Q1's first-party title, Days Gone, is a weaker title than the previous Q1's God of War and Detroit. We haven't disclosed the breakdown of development costs between 1H and 2H, but I can say that the costs are trending as planned. We lowered our target for annual hardware sales (as of July, 2019) from 16 million to 15 million units, and sold 3.2 million units in Q1. This is roughly the same volume as in Q1 last fiscal year. We had thought sales could be somewhat weaker than expected in light of competitor trends, but sales so far have been decent. Partially because we have started to convey some information about the next-generation console, we are not being too aggressive in selling the current model, focusing instead on raising the level of penetration while securing a profit. This is why we have slightly lowered our sales outlook but maintained our profit target.

Questioner No.2

Q1: The "Other" segment reported a profit of 400 million yen, but why is it not generating a significant loss? Could you explain the reasons for the YoY improvement? Also, you have maintained your full-year outlook for that segment to lose 106 billion yen. Do you expect any special factor to emerge in Q2 or thereafter which would result in such loss?

A1: We signed a licensing agreement that generated royalty revenue. Taking into consideration of the relationship with the counterparty of the agreement, I will refrain from disclosing the details, but this was a factor in the result. At present, we are not expecting any particular loss-making item that would cancel out the Q1 result, but it is still only Q1 and we would rather maintain the current outlook to the extent possible rather than making several minor alterations.

Q2: I believe investors have suggested you make changes to the business portfolio such as spinning off the semiconductor division or selling the financial services business. I think you may have hinted at an answer to these suggestions within your speech today, but is there anything you would like to explicitly say on this point?

A2: In short, there was no particular response within my speech today. Please assume that I have reiterated our current thinking as regards the business portfolio. It is the basic philosophy of our management and our board members that we should pay sincere and due consideration to suggestions from investors whatever they may be, and we have indeed received suggestions of this kind and are giving them careful thought. I will refrain from commenting further on the matter.

Questioner No.3

Q1: Could you explain your view on fixed costs in the semiconductor business? At the beginning of the year, you mentioned that although sales are expected to increase, so are fixed costs, resulting in little increase in profit, but in Q1, profit appeared to increase solidly in step with higher sales. Could you talk about fixed costs this quarter, including any peculiarities?

A1: We posted a significant 20.4 billion yen increase in operating income, the major contributing factor being an increase in volume. However, a rise in operating gains on the back of changes in inventory was also a factor. Headwinds such as the rise in depreciation costs and R&D expenses you mention were as expected, but the impact of sales growth was enough to outweigh these negatives.

Q2: In the Electronic Products & Solutions segment, the mobile business reported a substantial improvement, but looking at results without the mobile portion, it appears that TV and camera business deteriorated considerably. You have already touched on the TV situation, but could you explain what happened in the segment excluding mobile?

A2: The bottom line did indeed improve in the mobile business in Q1. Excluding mobile, our performance does indicate underperformance of TV, and the general direction is that TVs suffered a YoY decline in Q1 sales and profit. This was primarily due to the impact of a 23% drop in sales volume from 2.6 million units last Q1 to 2.0 million this Q1. This combined with a negative forex impact. Audio & Video sales also declined slightly, but operating income stayed largely the same YoY. Although there was a slight change in the sales mix, headphones were extremely buoyant. Digital imaging saw a decline in sales and profit. Digital camera and consumer camcorder volume declined, albeit modestly, leading to the decline in sales. Operating income was thus affected by lower sales and a mild forex headwind despite an improvement in [product] mix. However, we are planning the launch of strong products in the digital imaging field and believe they have good prospects. Finally, the professional solutions business was impacted by weaker pricing in China and therefore posted lower sales and profit.

Questioner No.4

Q1: I understand production in semiconductors was at full capacity in Q1, but what are utilization levels like in Q2 and what level are you targeting?

A1: In Q1, our production capacity was 100,000 wafers. With input levels of 100,000, we operated at around full capacity. In Q2, capacity is set to increase to 105,000 wafers, which is in-line with our initial plans. We plan to input 105,000 wafers, achieving roughly full utilization.

Q2: In your mid-range plan, investment is set to increase, but recent press reports have mentioned land procurement. Could you give an update on the progress of your mid-range investment plan, including the impact on cash flow?

A2: There are no changes to our previously stated plan to spend around 600 billion yen in capex on existing facilities between FY2018 and FY2020. We have not made any decisions on building new facilities as of yet, but we would like to do so this fiscal year after having confirmed what demand is likely to look like in FY2021 and beyond. Capacity-wise, we have mentioned plans to raise output to around 130,000 wafers by the end of FY2020. Again, this remains unchanged. The target for FY2019 (excluding the Financial segment) is to generate operating cash flow of 760 billion yen, which also remains unchanged, so it is safe to assume we have no plans to make any major changes to the cash flow outlook.

Questioner No.5

Q1: You mentioned in your speech that demand for Free-to-Play (F2P) and other third-party software in the G&NS segment was somewhat weak. Could you give us more details on the current situation and how we should view the risks into the second half?

A1: In Q1, sales of first-party games were more or less as expected and our outlook remains unchanged. Sales of Add-Ons and F2P games were well below our expectations, with sales of F2P in particular declining sharply. This prompted us to reduce our forecast. PlayStation Plus subscriber numbers declined slightly versus the end of March, but this was largely as expected, and the outlook is for modest growth over the full year. We took all these factors into consideration in setting our current forecast. The current 2H outlook does not factor in any major downside risk, and we are not looking for any to arise. We continue to keep a close eye on sales trends and geopolitical risks.

Q2: In relation to Sony Financial Holdings (SFH), you explained that Sony Corporation's management would be taking a more proactive role than in the past. I remember some time ago that efforts were made to generate synergies with the Sony parent company, but they remained elusive. What is your current thinking in this regard and in what way do you believe closer involvement in SFH's management will contribute to profit growth for the [Sony]group as a whole?

A2: I believe there is naturally more that we can do in terms of generating synergies with the parent company and also in terms of enhancing the value of SFH group companies via greater engagement in the management of those companies. I won't go into the details right now, but our intention is to work on increasing value in these businesses through engagement at the board level.

Questioner No.6

Q1: What was the extent of the sales, profit, and inventory impact on semiconductor operations from the earthquake in June? Did it affect Q1 performance?

A1: I assume you are referring to the earthquake in Yamagata. We did not suffer any significant damage to either personnel or property. When the earthquake hit, operations automatically shut down for safety reasons but have since been fully restored. The impact of the stoppage on earnings, including goods-in-process, was negligible.

Q2: My second question is rather nebulous, but on page 4 of your supplemental information document, you show data on sales to customers by geographic region. I understand this does not perfectly reflect customer trends, but if you break it down into hardware and non-hardware fields, have sales trends in the US, Europe and Asia been much different to what you expected back in February or March? Also, as outsiders looking in, are there any trends in particular we should be following closely?

A2: By region, the strongest YoY sales growth has been in the US, coming chiefly from Music and Pictures. China performance has been driven by growth in semiconductor sales. The biggest declines have been in Europe, Asia-Pacific and Other areas. This mainly stemmed from a decline in Electronics Products & Solutions sales. If we view emerging markets as regions other than Japan, the US, and Europe, growth in China was outweighed by declines in Asia-Pacific and other areas, resulting in a Q1 contraction. Emerging market sales totaled 500.2 billion yen in Q1 2019, which is a 28.2 billion yen YoY decrease. This was also the result of currency trends.

Questioner No.7

Q1: Regarding forecast changes in the Game segment, you revised the sales outlook down by 100 billion yen, which I understand is largely because of hardware and free-to-play games, but despite the change in forex assumption and the lower sales outlook, your profit outlook remains unchanged. Has there been any change in outlook on costs or profitability?

A1: We have become more sensitive to changes and are better able to compensate for them operationally. In addition, we are also developing greater organizational flexibility. If we see that demand for hardware is somewhat weak, for example, we can make modifications to the way we are promoting products or make cuts where possible in operating expenses. We are making gradual and solid progress in improving our capabilities in this regard. Therefore, our current profit projection includes a degree of cost cutting.

Q2: In the Pictures segment, you managed to turn to profit this Q1 despite marketing costs associated with the Spider-Man movie on top of increases in film costs and Motion Pictures production costs. Perhaps this has come on the back of the success with Spider-Man and this turnaround was as planned, but have there been any specific changes in the Pictures segment and do you see any further upside on the current profit outlook?

A2: We believe there is more opportunity than risk in this segment. We are only at the Q1 stage and there are promising major title releases to come, so rather than rushing to make changes to our earnings forecasts, we decided to stick with our initial projections at this time. As for changes in profitability, we undertook considerable restructuring in the Media Networks business in FY18 at a cost of over 11 billion yen, which is having a positive impact on this Q1's earnings, and our performance in India has been stronger than expected. On top of this, the number of subscribers to anime distribution services such as those offered by Funimation is on the rise, and the resulting growth is another highly positive factor.

Questioner No.8

Q1: Returning to image sensors, you spoke just now about Chinese smartphone makers, but has your view on image sensor demand for smartphones changed at all since April given the shifting business climate, or are there any factors you expect to change in the future?

A1: We made assumptions at the start of FY19 on how the trend to multi-lens and larger die-sizes would evolve in the Chinese smartphone market, and we had a somewhat cautious view on FY19 demand in general at that time. However, Q1 demand was stronger than expected and that buoyancy looks likely to continue in Q2, too. That said, as we cautioned earlier, some of this demand may be front-loaded, which is why we opted to maintain our existing forecasts. The adoption of multi-lens and larger die-sized cameras in smartphones appears to have progressed at a faster and stronger pace than we imagined, so we expect related demand to remain brisk.

Q2: On macroeconomic matters, if the US imposes level 4 tariffs on China, which Mr Totoki has already mentioned, what impact might they have on your earnings? What is your current thinking?

A2: We have not factored any impact into our current forecasts as the timing and specific conditions are key considerations that are currently unknown, but we would expect a decision to impose level 4 tariffs to impact the hardware business in the G&NS segment, as well as cameras, audio & video equipment and projectors in EP&S. Applying high tariffs to these products would itself have an ultimately detrimental impact on consumption, retail and jobs within the U.S. economy, and as such, our U.S. subsidiary has, together with industry associations and other related organizations, submitted its views in writing to the US government. We are currently discussing various responses to the issue based on the product list in preparation for any decision being taken, including advance deliberations on measures such as changing the location of production for each item, passing the extra cost on to consumers, and whether to continue selling certain products at all. If the decision to apply level 4 tariffs is taken, we want to be ready to swiftly deploy such measures in order to mitigate the extent of any impact, and should this happen within FY19, we aim to contain the negative effect on operating income to below 10 billion yen.

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