
From: Ryan, Jim [REDACTED]
To: GDM Leadership
Sent: 2/23/2022 12:06:58 AM
Subject: FW: Jim Ryan and Fidelity Meeting
Attachments: 2022.2.22 Jim Ryan x Fidelity Meeting.docx

Notes on the investor meeting held yesterday.

This was especially interesting (and in fact especially difficult) given the vastly divergent levels of industry knowledge in those attending.

[REDACTED]

Jim

From: Miura, Makiko <[REDACTED]>
Sent: 22 February 2022 20:32
To: Yoshida, Kenichiro (SGC) <[REDACTED]>; Totoki, Hiroki (SGC) <[REDACTED]>; Ryan, Jim <[REDACTED]>; Matsuoka, Naomi (SGC) <[REDACTED]>; Saito, Yoshinori (SGC) <[REDACTED]>; Clark, Jennifer <[REDACTED]>; Auby, Karen <[REDACTED]>; Tao, Lin (SIE) <[REDACTED]>; Hayakawa, Sadahiko (SGC) <[REDACTED]>; Kondo, Teruya (SGC) <[REDACTED]>
Cc: GH/mailling-list/ir <[REDACTED]>; Hill, Justin <[REDACTED]>; Koizumi, Mai <[REDACTED]>
Subject: Jim Ryan and Fidelity Meeting

Dear All,

Today Jim had a meeting with analysts / portfolio managers at Fidelity. Please see the meeting memo attached.

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Makiko Miura (三浦真希子) | Head of Investor Relations Europe | Sony Global Treasury Services | +44(0) 7393 467554 | [REDACTED]

Jim Ryan x Fidelity Meeting 2/22

Attendees from Fidelity:

| | |
|------------------|------------------|
| Michael Reznikas | Steve Dufour |
| Andrew Sergeant | William Danoff |
| Matthew Drukker | Cameron Maddox |
| Jed Weiss | John Dance |
| Faris Rahman | Mark Schmehl |
| Alex Zavratsky | Nicole Abernethy |
| Sonu Kal | Bill Bower |
| Adam Kramer | |

Opening remarks from Jim Ryan

Q: You mentioned that you'll be launching 10 new games, and your goal is to double your first party revenue stream within four years. So, out of these 10 games, how much will come from your existing titles?

A: It's a mixture. I'm not going to go beyond anything that's already been announced, but it would be fair to say that when you look at our IP portfolio and when you think about the biggest names in there, having those games break out from the constraints of the console model is a very significant prospect for us. You can assume that a significant portion of our existing AAA IP will find its way into a live service game. We have partnerships under development with people who we've already worked with and with some new partners, who will bring new IP to PlayStation and there's even one or two things that are completely new that are coming from the ground up. But I think it's the first category that really excites us because those games leverage something that we already know resonates massively with the gaming community. It's an untapped opportunity for us. And if we do it right, the potential upside for SIE will be enormous.

Q: In order to double your first party game revenue, how many of the 10 new games need to be big hits?

A: It would be naive for us to assume that all 10 will be massive successes so that is not a necessary condition for us to double first party revenues. That is certainly not what we're assuming. Clearly, the distinction between a hit and not a hit is not a binary one. And don't forget that as we do this, we will continue to publish the games that have served us so well over the years. These first person, graphically beautiful narrative rich games will continue to be the bedrock of our first party publishing business.

Q: What would be the ideal mix for your first party games going forward? How much will be live games vs traditional first person narrative-driven games?

A: We will continue to make first person games like we always have, and we expect those to have slightly greater sales and profitability, reflecting our confidence in the long-term installed base of PS5, as well as the fact that those games will make their way to PC. So, we think that the pie from those games will grow, but that growth will be incremental in nature. We think the live service games will build on that foundation and take us to another level.

Q: Bungie has 1,000 employees and 20-30 years of history making games. You're counting on a big contribution from them to help you with these 10 games and help you to allocate capital effectively as well as avoid making mistakes. Is that the strategy?

A: Yes, it is. I've been talking a lot over the past couple of years with our publishing partners, many of whom are slightly farther down the road than we are in terms of live service publishing. What they all have in common is that they've made a lot of mistakes on that road. And I think one of the benefits of being a fast follower in this space is that if we're intelligent and thoughtful, we can learn from those mistakes. But these partners can be viewed as our competitors and there's a limit to what they will share. Having a premier live service publisher within the group who is extremely keen to collaborate with Sony massively increases our ability to learn and our ability to avoid the mistakes that others have made.

Q: Sony has a nice royalty business and your first party business was originally designed to differentiate your platform. I believe what you're describing is a bigger push into first party publishing but not on an exclusive basis. Was the decision to pivot the business model in this way based on a view that the royalty business may be less sustainable at some point in the future? Or do you think that first party publishing with live services is incremental or even a better business model than the past model of royalty take rates?

A: We hope that our investment in first party development and first party publishing is going to generate terms that are wholly incremental to the historic way that we run our business. I think the most likely scenario is that will be the case. However, business models in the online space are subject to scrutiny right now. And they're subject to competitive pressures. Therefore, one of the reasons why we are investing massively in first party development and publishing is to provide us with a hedge against pressure on the historic business model. Right now, we don't see that pressure. But that's not to say that pressure might not manifest itself at some point down the road. Having a business model where you own elements from the top to the bottom increases your ability to be self-determinant. And when you get it right, particularly in this live services area, the financial upside is absolutely spectacular.

Q: The operating margins in the gaming segment have been in the low teens. Activision's operating margins are in the 30s. Would you expect the profitability on a margin basis to go up or down?

A: On the margin basis, it would go up if the games are successful.

Q: You've made it very clear that there's going to be more acquisitions to come. What is an ideal acquisition target and what are you hoping it will help you achieve?

A: I think an ideal acquisition target has to help us deliver on our strategies in a way that we're not capable of doing on our own. And when I look at our portfolio of studios and our publishing capabilities, we need help in the areas in which we're not strong at present. We aspire to grow our community, grow engagement with our games, grow the number of people who are playing those games, grow the

amount of time people are spending on those games, move across to PC and mobile, and grow the number of people playing with each other. It's in these spaces, where we don't have expertise and presence, we need to build expertise. These are some of the reasons behind the acquisition of Bungie. We have publicly stated ambitions in the area of mobile. That's part of game development that we've not been present in any meaningful extent. So, you can assume that we have an interest in acquiring development knowledge and management expertise there.

Q: Did you look at Activision as a target? Was it too big to buy?

A: We know Activision extremely well. They are probably one of our principal partners. In terms of deployment of Sony's capital, when you look at 69 billion dollars for Activision compared to 3.6 billion dollars for Bungie, we believe that Bungie can give us way more than a 69 billion acquisition of Activision. And that's before considering the relative value of that particular transaction.

Q: PlayStation is very important to Activision. In the next decade, is Microsoft going to turn off their supply of games to you?

A: I honestly believe that that will not happen. We continue to talk with Activision. I talk with Phil Spencer at Microsoft. We're having good conversations. They obviously have significant regulatory hurdles that they must navigate to get this transaction cleared. And ongoing availability of Activision games on competitive platforms is going to be central for them to be successful in that mission.

Q: Is there an angle where Microsoft could do a windowing strategy where their content comes to Xbox first?

A: Clearly those options are open to Microsoft. They have paid a huge amount of money for this acquisition. But as I answered in the previous question, we feel extremely confident that *Call of Duty* and other Activision games will continue to be published on our platform. Actually these days, we see ourselves in a lot more partnerships like the one we have with Microsoft.

Q: Given the rapid change in competition in gaming, are there some potential M&A opportunities that are larger in size that you would consider? There are some unique software assets not focused on gaming such as Unity, Roblox and Epic for example. Are those targets you might consider going forward?

A: I go back to the comment that I made earlier that a necessary condition for us to consider when making any acquisition is whether it helps us advance our basic strategy of growing our first party publishing business across multiple formats in a way that we have not in the past. And if a potential acquisition ticks those boxes, it goes on the list.

Q: You as well as Sony's senior management have made it clear that you expect strong operating income growth in the PS5 cycle. Has that expectation changed due to your M&A activity, which includes several years of amortization and added retention costs? Do you still believe in strong growth this cycle?

A: We absolutely continue to believe in a structurally healthier cycle than we have ever had. What we hoped for when we developed the PS5, and what we are actually seeing, is a series of new platform features and great games where people are spending more time on the PS5 than they did on the PS4. That uplift is definitely sustaining and turning itself into meaningful engagement and meaningful financial spend. Our acquisitions are clearly significant in terms of cashflow outlay, and while there are strategic components to the rationale, each obviously has to stand on its own feet in terms of financial return. Bungie is no exception. Each acquisition has been accretive to the financial model of PS5. I have never been more bullish about PS5, and I continue to be more bullish with each day that passes.

Q: Due to component shortage, you had to lower your console unit forecast for this year. Do you think that by next holiday season things will improve materially? Are you keeping your 23 million units expectation for FY22 or is that now a stretch?

A: Going from 11.5 million to 23 million is certainly non-trivial in terms of supply chain, but we absolutely see a path towards that number. To be honest, it's still too early to say how that number will look, but, in any scenario, unit sales will be significantly above what we are this current fiscal year.

Q: Despite the fact that you sold less consoles than expected this year, your profitability has been pretty good. You have been able to leverage the PS4 and keep selling which is encouraging.

A: Yes, profitability is at an all-time high. First, the amount of time people are spending on the PS5 is massive. Second, the level of engagement on PS4 is significant. Third, the demand for PS5 is such that we don't need to promote it at all. I don't think there is a single PS5 being promoted anywhere in the world. We are now closing on 20 million units sold and we are completely out of stock. There are big markets in Europe, the Middle East and Russia where we haven't gotten started yet, so the business is structurally strong right now. We don't expect this to change. We will see PS4 engagement waning as the years pass, but it's still an extraordinary balance.

Q: How should we think about take rates going forward? If Microsoft gets aggressive on take rates, what is the right response for Sony? What can you do to offset the hit on your profitability and to maintain current market share?

A: We will do what we are doing right now, which is to become less reliant on 3P games and 3P royalties, and to make more 1P games. If we double our share of 1P games, which are more profitable than the 3P royalty stream, it will bring down our reliance on 3P games. That is the single biggest thing, and one of the main reasons why we are embarking on M&A. I would like to point out that we are also growing our existing studios, increasing capabilities and their ability to output in various areas including live services. I feel like this part deserves a lot more attention than it currently gets. Large M&A gets all the headlines, but there is a lot going on, and growing your studios organically successfully is a smart thing to do.

Q: In 5-to-10-year time, what would be the ideal 1P operating income mix compared with your current 15%? 80% of Nintendo's profit comes from 1P, so they don't get much 3P participation as a result. On the other hand, you are able to attract all the best developers in the world due to having an open platform. What is the right balance?

A: It's not a zero-sum game. Growing the size of the overall pie is the most important point. We will do that by selling more PS5s than we ever have in the past, multiplied by making sure that the users spend more time on each of them. Having done that, we want to grow beyond 15%. Doubling market share should be possible. In a growing pie, the consequence of doubling market share is that we would overachieve our ambition of doubling our 1P business. The number of games we have slated is way beyond what we have had in the past. The competitiveness of our 1P games is increasing, Metacritic scores are going up, and the performance of each title is increasing. The part that we are missing is in live services. With live services, the historical way of measuring market share, with number of games sold, becomes difficult. We will be looking at other metrics such as revenue and engagement.

Q: If Microsoft cuts their take rate, will you have to match them immediately, or can you take your time?

A: I don't think we have to cut at all. The take rate is just one variable that a publisher uses to assess the overall attractiveness of the PlayStation platform. PlayStation has historically led the console market in terms of the number of consoles sold, which creates a large fertile ground that the publishers view as attractive. The amount of time spent is another variable. These items drive the top line of businesses, so the take rate is just one of many variables. I do not at all accept that just because someone makes a move, we would automatically need to follow.

Q: The Game Pass business model appears to have some challenges, and Microsoft appears to be losing a lot of money on it. Because the AAA publishers spend \$100 mil or more on developing titles, they are happy to sell it for \$70 on PS5.

The subscription model is more challenging for them. Given that environment, will Microsoft need to provide minimum revenue guarantees if they want those titles on Game Pass? Or do they need to go out and buy more assets like Activision to put on their platform? Are those the two options for Microsoft when trying to gain critical mass and support from the AAA publishers for Game Pass?

A: I can say with a very high degree of certainty that Microsoft has tried the first path and it did not work at all. That has driven them to make the large acquisition. I talked to all the publishers, and they unanimously do not like Game Pass because it is value destructive, not only on an individual title-basis, but also on an industry level. The recent number of subscribers that Microsoft announced on January was 25 million. I am sure everyone has their own views on this, but I personally was expecting a larger number given all the money they have spent. We have close to 50 mil PS Plus subscribers. We believe we have a meaningful subscription service.

Q: What is Sony's metaverse strategy? How big of a role will VR2 play there? Is it for gaming only, or will it be for something broader in terms of applications and markets?

A: We're approaching metaverse conversations through 2 lenses. First is as a platform holder. We had something called PlayStation Home for the PS3 and that was a very early manifestation of a platform metaverse. It was probably 10-15 years ahead of its time. The second is from the studio perspective. We have a couple of projects underway that are very exciting for us, in terms of creating some sort of game-type metaverse which can possibly have collaboration with other parts of Sony. Sony's entertainment assets have huge potential in the metaverse area. As for VR2, we see it as having a role down the road, more in the mid-term.

Q: Why isn't Roblox on the PlayStation?

A: Historically because of the large number of children that play on the PlayStation, we have been very careful with regards to opening them up to anything that

could potentially exploit them. Over the last couple of years however, we have reviewed those policies and relaxed a little on this. We have been conservative for too long, and now we are currently engaging with people at Roblox. We hope that the situation will change.

Q: Netflix upended the industry in TV and movie content. They want to give free content at no extra charge. I am curious how you think about Netflix's emerging presence in the gaming space. Is Netflix something you have to think about as a potential competitor?

A: Just given the nature of Netflix, it is important to watch them carefully. Some of what they're doing, such as leveraging their IP portfolio with game-type applications is quite smart. I contrast that with what the other huge tech companies tried to do and failed. Building a gaming platform is very difficult, but, I think in the long-term, what they're doing is interesting. We need to be careful with them. The business of making games is an extremely expensive one, and at some point, if they're serious about it, and if they aspire to accumulate critical mass, I think that they will have to change their business model. The current model will be challenging.