

## Risk Factors

Listed below are the principal business risks of Sharp that may have a significant influence on investors' decisions and countermeasures.

Note that in addition to these, there exist certain other risks that are difficult to foresee.

Each of these risks has the potential to impact the operations, business results, and financial position of Sharp.

All references to possible future developments in the following text were made by Sharp as of March 31, 2020 (or June 30, 2020 as appropriate).

### **(1) Global Market Trends and Overseas Businesses (Risk)**

Sharp conducts its business not only in Japan but also in different regions around the world. Business results and financial position are thus subject to economic and consumer trends, private consumption and corporate capital investment trends associated with the COVID-19 pandemic, competition with other companies, product demand, raw material supply, and price fluctuations in each region, including Japan. The political and economic situation in respective areas, the growing impact of world economic recession, U.S.-China trade friction, etc. may affect Sharp's business results and financial position.

#### **(Countermeasure)**

Business units that control Sharp's overseas subsidiaries collect risk and other information that may impact Sharp's operations, including global market trends, in cooperation with their local offices and make necessary operational decisions. Business results of the overseas subsidiaries and business

units are reported to management regularly, and changes from those in the previous report are analyzed and prescribed necessary measures are taken against risks. Important matters requiring decision making for business execution are elevated to the Executive Management Meeting, a deliberation and decision-making body for important business execution, where deliberation is conducted.

### **(2) Exchange Rate Fluctuations (Risk)**

The proportion of consolidated net sales accounted for by overseas sales was 70.0% in fiscal 2018 and 65.4% in fiscal 2019.

Sharp sells products made overseas in the Japanese market, and also sells products in countries where it does not manufacture the products. Therefore, Sharp's business results may be impacted by exchange rate fluctuations.

#### **(Countermeasure)**

Sharp hedges the risk of exchange rate fluctuations by employing forward exchange contracts and expanding and strengthening optimally located production.

### **(3) Dependence on Certain Businesses, Products, and Clients**

#### **(Risk)**

Sharp's 8K Ecosystem segment accounts for nearly half of Sharp's sales. Accordingly, Sharp's earnings may be impacted negatively by factors including slowing customer demand for related products, falling product prices, or increasing competition

due to the emergence of substitute or competitive products, or the emergence of new competitors.

Sharp's Smart Life and 8K Ecosystem segments have high dependence on a small number of specific clients for the sales of some of their products. Sharp's business results and financial position could be affected if sales to such important clients languish due not to only factors related to Sharp's products but reasons outside of Sharp's control. These include declining demand for the clients' products, changes in product specifications, and changes in the clients' sales strategies.

#### **(Countermeasure)**

Sharp aims to gain superior competitive advantages by accelerating a business model shift achieved by launching new high value-added service solutions; accelerating the global business expansion; and simultaneous entry to the B2C and B2B markets, in addition to maintaining and expanding the existing business segments by expanding the traditional hardware business.

### **(4) Strategic Alliances and Collaborations (Risk)**

Sharp has forged strategic alliances and collaborations with other companies in order to enhance corporate competitiveness, improve profitability, and bolster the development of new technologies and products in various business fields. If, however, any strategic issues with such strategic partners or other business issues arise, or goals change, it may become difficult to maintain such alliances and collaborative ties with these companies, or to generate adequate results. In such cases, Sharp's business

results and financial position may be impacted.

#### **(Countermeasure)**

Sharp believes that importance of strategic alliances and collaborations will grow in the future.

To lead them to success, Sharp thoroughly verifies the business strategic necessity, profitability, and financial appropriateness beforehand at the stage of executing strategic alliances and collaborations, and makes decisions after deliberation at the Executive Management Meeting and the Board of Directors.

After executing them, Sharp monitors the progress of the alliances and collaborations under close cooperation with the relevant business units, and reports to management early if it is determined that the expected results cannot be achieved, to ensure that measures can be taken to minimize the impact they may have on Sharp's business results and financial position.

### **(5) Relations with Parent Company Group (Risk)**

The equity investments from our parent company group (including Hon Hai Precision Industry, subsidiaries, and affiliates) allowed Sharp to pursue operational synergies using the technological, productivity, and cost capabilities of our parent company group. However, we cannot guarantee that operational synergies between Sharp and the parent company group will occur as envisioned.

A change in the parent company group's business strategies or competitive relationship with the parent company group arising in the future may adversely affect Sharp's operations, business

## Risk Factors

results, and financial position.

Decision making of important matters, such as management policy and business development may be biased by the parent company group and maintaining our independence and autonomy may not be possible.

### (Countermeasure)

Sharp conducts business operations by maximizing operational synergies with the parent company group while fully respecting independence and autonomy between both entities and in close cooperation with the parent company group.

Sharp identifies areas where Sharp can create synergy effects with the parent company group, such as its operational efficiency improvement and expansion of its sales and income, and Sharp appropriately verifies the expected synergies in those areas in cooperation with the parent company group in an effort to implement them.

The parent company group engages mainly in outsourced production of electronic equipment, and it manufactures and sells telecommunications equipment, electrical appliances, and general electronics application equipment and components under the Sharp and other brands. Therefore, Sharp believes that there is no competition in the parent company group that may impact Sharp's operations.

Sharp strives to grow, develop, and improve its performance in close cooperation with the parent company group, while fully respecting independence and autonomy between both entities.

Sharp recognizes that working together with the parent company group to increase Sharp's operational efficiency and expand its sales and income will benefit the interests of noncontrolling shareholders.

### (6) Other Factors Affecting Financial Position (Risk)

Sharp raises funds through borrowings from financial institutions such as banks. The debt to total assets ratio is 42.4% as of the end of the current consolidated fiscal year.

Sharp might become subject to restrictions on how it uses its cash flows in order to repay debt, and also face the possibility of an increase in expenses due to rising interest rates.

Sharp has the possibility of increases in fund raising costs as well as limitations on fund raising. This may be because necessary funds cannot be raised at the required time with adequate conditions, including for the refinancing of existing debt. These factors may affect Sharp's business results and financial position.

Sharp has borrowing agreements with multiple financial institutions, and some of the agreements entail financial covenants. If its consolidated net assets fall below the levels specified under such financial covenants, or if Sharp fails to undertake faithful consultations in the event that its consolidated operating profit and profit attributable to owners of parent fall below specified levels, or if its consolidated ordinary income cannot be kept at certain levels, Sharp may forfeit the benefit of time at the lender's request.

Sharp may also forfeit the benefit of time on other borrowings if it violates the relevant financial covenants.

Sharp's dependence on borrowings, credit ratings reduction caused by it, or deterioration of Sharp's financial position may work to its disadvantage with respect to competition with other

companies with robust financial positions, and contract-related issues could also arise between Sharp and its lenders or business partners.

### (Countermeasure)

Sharp's major lending institutions are Mizuho Bank, Ltd. and MUFG Bank, Ltd. As necessary, Sharp consults with both banks about ways to improve its financial position and other matters.

Sharp also shares information about its financial position with other financial institutions with which Sharp has borrowing agreements.

Sharp has a system in place to discuss matters when necessary, keeps good relations with its correspondent financial institutions, and maintains and continues borrowings.

Sharp strives to improve free cash flows by recovering operating cash flows through recovery of its earnings performance and by managing investment cash flows through concentrating on investments focused on efficiency.

Sharp tries to create an environment that allows for fund raising through direct financing instead of indirect financing by early recovering from a bad rating.

### (7) Technological Innovation

#### (Risk)

Rapid technological advancement and proper response to changes in the business areas where Sharp operates improves the competitiveness of Sharp's products and services, whereas insufficient response to the following items may adversely affect the growth and business results.

- Prediction and response to the technological

advancement and rise and fall, and their social significance

- Selection and concentration in R&D, and proper resource allocation
- Technological enhancement for new areas
- Acceleration of R&D in collaboration with external partners

In addition, trade frictions have led to the United States designating certain emerging technologies for export control. This may have an indirect impact on our business due to added constraints in taking said technologies out of the United States or limits on exporting (re-exporting) goods containing more than the allowed ratio of added-value for said technologies from Japan, etc. to third countries.

### (Countermeasure)

Sharp's R&D teams work together as one to go beyond simply the improvement of the technological level and develop the 8K+5G Ecosystem and AIoT World under the collaboration of the three business groups.

Rapidly changing society significantly changes the evaluation of technologies. Therefore, Sharp quickly identifies social issues and senses technological innovations at global exhibitions and on other occasions and promotes R&D keeping in mind suitability for social issues.

In addition, Sharp does not stick to its in-house R&D, but accelerates R&D in active collaboration with external partners to strengthen the technological capability in new areas necessary to continue transformation to the solution business.

Through these initiatives, Sharp reduces risks associated with social changes and technological innovations, and aims to become a brand company

## Risk Factors

that continues to grow sustainably through technological advancement.

In addition to complying with export and import control laws and regulations in the operational activities, Sharp executes control for export and import in conformance with laws and regulations as well as regulatory situation in each country and region in R&D to deal with the tightening of control of emerging technologies involving social platforms for global infrastructure, defense, security, and so on.

### **(8) Intellectual Property Rights (Risk)**

Sharp strives to protect its proprietary technologies by acquiring intellectual property rights in Japan and in other countries, and by concluding contracts with other companies.

However, there is a risk that rights may not be granted, or a third party may demand invalidation of an application, such that Sharp may be unable to obtain sufficient legal protection of its proprietary technologies.

There may also be instances where a third party launches litigation against Sharp, claiming infringement of intellectual property rights. Resolution of such cases may place a significant financial burden on Sharp. Furthermore, if such a third-party claim against Sharp is recognized, Sharp may have to pay a large amount of compensation, and may incur further damage by having to cease using the technology in question.

In addition, intellectual property that Sharp holds may not result in a superior competitive advantage, or Sharp may not be able to make effective use of

such intellectual property, such as when a third party infringes on the intellectual property rights of Sharp.

If any of the above problems related to intellectual property rights were to occur, it could impact Sharp's business results and financial position.

#### **(Countermeasure)**

Under recognition that the intellectual property rights are important assets for a company, Sharp strives to actively create intellectual properties, and tries to acquire strong rights by mainly using Sharp's subsidiary ScienBiziP Japan, its intellectual property rights application and acquisition division.

Before releasing its products, Sharp checks the clearance of intellectual property rights by thoroughly checking the intellectual property rights of third parties, and at the same time, Sharp improves clearance accuracy by standardizing the clearance process. Thus, Sharp implements measures against the risk of infringing on the intellectual property rights of third parties.

Further, Sharp maximizes the use of intellectual property rights in conjunction with the business and R&D strategies, and at the same time, protects its intellectual property rights and fully respects the intellectual property rights of third parties.

In principle, Sharp resolves a dispute concerning an infringement of rights through dialogue, but if its intellectual property rights are not respected by a third party, Sharp does not hesitate to seek a judgment by a third party, such as a court.

### **(9) Product Liability (Risk)**

Many of Sharp's products are for consumer use,

and also incorporate innovative technologies. If defects arise in any of these products, Sharp may incur responsibility as a manufacturer and other obligations.

There is a risk of a large-scale product recall or litigation caused by unforeseen events, which may adversely affect Sharp's brand image or influence its business results and financial position.

#### **(Countermeasure)**

Sharp not only complies with public safety standards in each country to ensure the safety of its products but also improves safety by combining the risk assessment policy with its unique safety criteria.

To ensure safety even if an unexpected problem arises, in particular criteria for inflammable structure, malfunction test, etc. were established, and they are revised when necessary to pursue a higher level of safety, and training is performed for internal stakeholders to ensure that the safety criteria are understood and shared by the design and quality departments.

Sharp has established a system to ensure safety to make sure that an emergency action can be taken quickly and appropriately when a problem arises.

In order to fulfill its responsibility as a manufacturer in case product defects do arise, Sharp has taken out insurance to cover compensations based on product liability.

### **(10) Competition to Secure Skilled Personnel (Risk)**

Failure to secure skilled personnel in the technology and management fields could affect Sharp's business results and financial position.

#### **(Countermeasure)**

Sharp implements the following measures to secure skilled personnel in the technology and management fields.

Sharp actively hires new graduates in order to acquire new talents according to its business policies.

Sharp also actively hires experienced personnel in order to secure core personnel responsible for new businesses.

Sharp created education and training programs that allow all employees to acquire basic and professional knowledge by self-driven learning to develop professional personnel who can fulfill their professional duties.

As a platform where diverse human resources can work with peace of mind, Sharp actively implements initiatives in consideration of the work-life balance of employees, such as creating various programs to strike a balance between work and child upbringing/care/treatment.

### **(11) Influence of COVID-19 (Risk)**

The prolonged and escalating influence of the COVID-19 pandemic may cause personal consumption reduction, supply chain stagnation in Japan and overseas, and stagnation of Sharp's operational activities, adversely affecting Sharp's financial position and business results.

#### **(Countermeasure)**

Sharp closely analyzes the influence of the COVID-19 pandemic on the processes, such as procurement, production, and sales, and rebuilds a supply chain that is more resilient to business risks, and at the

## Risk Factors

same time, implements structural transformation such as further cost and expense reduction to strengthen the corporate structure.

Sharp also accelerates a shift of business model from selling goods as a home appliance manufacturer to a company that provides services and solutions, and enhances and creates products and services suitable for new life styles that prevent the spread of COVID-19 and facilitate economic activities at the same time.

From a financial viewpoint, based on the assumption that the influence of COVID-19 on the production and sales activities will continue for a certain period of time in fiscal 2020, Sharp will conduct stable and efficient business operations while paying sufficient attention to the liquidity and inventory asset levels.

In addition to the risks above, there are various potential risks, including a risk of dealing with a large number of suppliers and clients, capital investment risk, regulatory risk, large-scale natural disaster risk, or climate change risk. There are other potential risks that are not mentioned in this section which may adversely affect Sharp's business results and financial position.

### **(Risk Management System)**

Sharp sees the risk management as "one of the important activities to fulfill our social responsibilities by growing the business sustainably and meeting the expectations of our stakeholders."

Specifically, Sharp has established the Business Risk Management Guidelines as basic rules for the risk management, created a company-wide risk management system in line with the guidelines, and selected risks that have significant impact on

the business as "specific risks" and manages them.

To respond to changes in the business and market environments, Sharp considers adding or changing specific risks every fiscal year for all specific risks, and reviews, scores, and prioritizes the added or changed specific risks.

The functional department that manages company-wide risks works together with the companies and business units in charge of managing their business segments to minimize and mitigate risks and take the necessary measures to prevent them.

In addition, in case a specific risk arises, the department where the incident arises reports it to the internal control department that serves as risk management secretariat as well as management, works together with the relevant departments to respond to the relevant incident, and, when necessary, considers company-wide improvement measures to prevent recurrence.