SONY

SONY – 'MAKE BELIEVE'.
Sony Corporation (SNE, Market Capitalisation JP¥ 9.38T)[1] is a giant technology conglomerate, specialising in electronics and entertainment possessing a long history of revolutionary products that have made Sony a global household name. A relentless pursuit of innovation has driven the company forward, resulting in their products achieving an emotional connection to the consumer. Sony is in a transition period to break the public perception of being an old, slow consumer electronics company.

Sony reports through diversified business segments which can be grouped into:

Media & Entertainment – earns revenue through sales of hardware, software and network services attributable to PlayStation.
Sony Music - The music division earns revenue through streaming, concerts, licence agreements, and mobile-game development.
Sony Pictures - Box-office sales and revenues affiliated with movie franchises e.g. Spiderman.
Technology – B2B & B2C sales of technology developed by Sony. Product examples: televisions, headphones, semiconductors, mobile phones, cameras, and medical imaging devices for operating rooms.
Financial Services – provides life insurance and other insurance types primarily using a consulting-based sales technique. Sony bank is an internet bank that focuses on asset management and lending.

"Sony seeks to deliver products, content, and services that resonate with people and affect a positive impact on society, based on its Purpose to 'fill the world with emotion, through the power of creativity and technology.'"
Kenichiro Yoshida – 7 January 2020

Sony was founded in 1946 by Masaru Ibuka whose vision was to do what has never been done before and "establish an ideal factory that stresses a spirit of freedom and open-mindedness that will, through technology, contribute to Japanese culture." Sony has been leading the charge of technological change since going public in 1955, innovating with the consumer in the forefront of their design process, exemplified by revolutionary products such as the Walkman (1979), the first commercialised CD player (1983), the Camcorder (1983), and PlayStation (1995). The past 20 years have been turbulent, following the dot-com bubble bursting in 2000, the GFC in 2008, and reporting a loss of ~US$5.8B in 2012[2], Sony has not had an easy run. Re-establishing itself with investors and consumers has been a top priority, which we believe they are partway through the process of via a renewed corporate strategy and pursuit of high-quality products and services.

Sony 20 Year Share Price History (JP¥)

Source: Refinitv Eikon

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MORE THAN JUST ELECTRONICS.

Sony is a reawakening conglomerate that has historically been plagued by slow decisions to capitalise on new opportunities; the result was a loss of market share from 2000-2010 to industry disruptors Apple (AAPL.O) and Samsung (005930.KS). To combat this, Sony has focused efforts on restructuring the business segments experiencing significant economic tailwinds. By streamlining employees into their most productive position within the business, acquiring faster-growing gaming/music businesses, e.g. Insomniac Games (developer of Ratchet & Clank) and investing heavily in the products/services with a prosperous long-term outlook, Sony has seized significant market share in the Music, Semiconductors and Gaming industries.

Source: Refinitiv Eikon

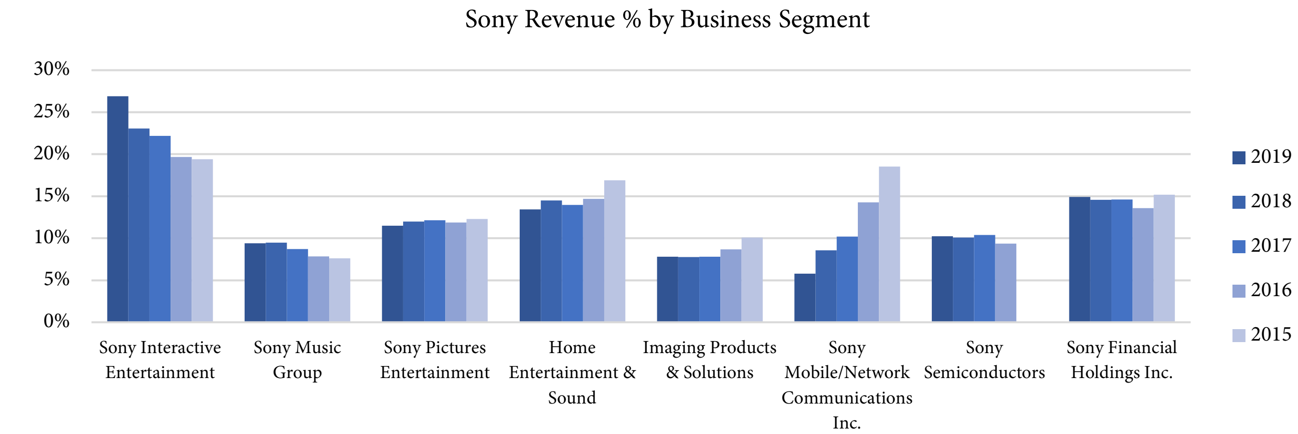
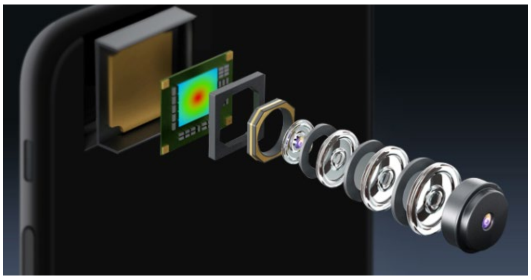
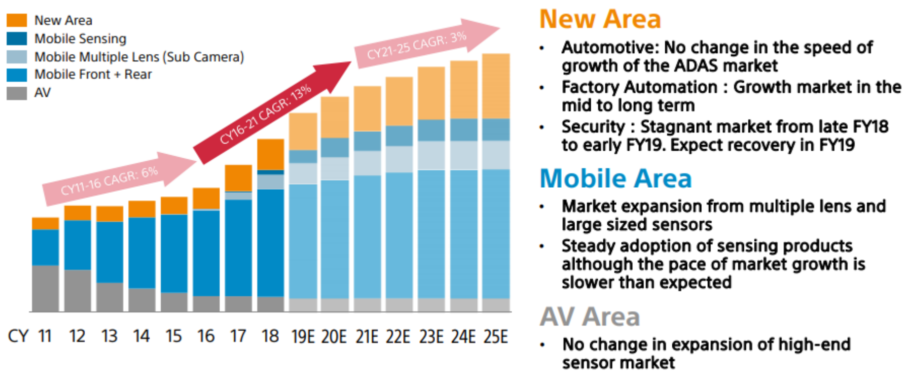


IMAGE SENSORS EXPERIENCING DEMAND OUTSTRIPPING SUPPLY.

Sony's sensors are selling faster than they can be produced; we do not view this as a negative. Sony has a 51% market share[3] of the sensor industry, attributable to its product excellence. The image sensor market is rapidly growing mainly due to major mobile phone giants (Apple, Samsung and Huawei) using camera quality as an incentive to sway consumers into upgrading or brand switching. The market is expected to grow from US$ 17.2B in 2019 to US$ 27B by 2023 (CAGR of +9.44%). Sony intends to capture 60% of the market by 2025 with continued R&D, and more than doubling their CAPEX spend to ~JY¥ 700B in the three-year period ending March 2021. We believe this segment provides long-term opportunities given the economic tailwinds in the image sensor market.



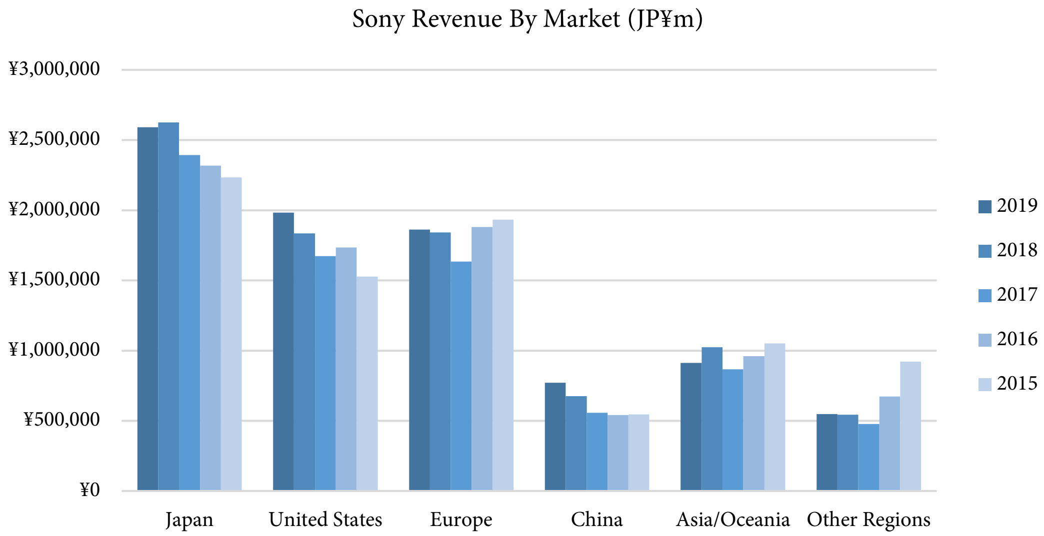


Source: Sony

"Judging by the way things are going, even after all that investment in expanding capacity, it might still not be enough," Shimizu said in an interview at the Tokyo headquarters. "We are having to apologise to customers because we just can't make enough."
Bloomberg, 24 December 2019

SONY IS A HOUSEHOLD NAME, EVERYWHERE.

Sony's first major international venture was in 1960 when they entered the US market with the world's first direct-view portable B&W TV (TV8-301). Since then, the company has had an ongoing increase in global sales, from 2015-2019 the company experienced revenue increasing at a CAGR of +3.02% in Japan, +5.34% in the USA, and +7.10% in China. The Sony brand has become an established player in significant global markets, earning most of its revenue in Japan, the USA and Europe. With unwavering loyalty to their signature gaming console (PlayStation), we expect Sony will continue to thrive in global markets following the release of the PS5 in November 2020.



Source: Refinitiv Eikon

A GAMING REVOLUTION.

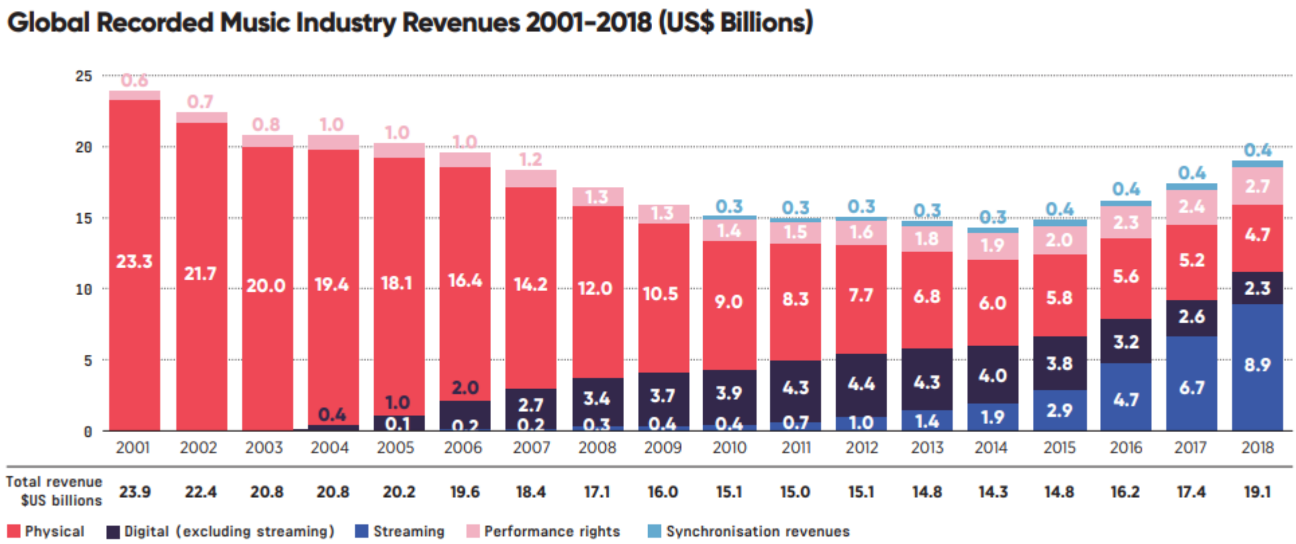
Sony released the original PlayStation in 1994 and have announced intentions to launch PlayStation 5 in November 2020. Sony are world leaders in console gaming innovation with the PlayStation line selling over 529 million total units to date[4]. Key drivers for long-term growth in the gaming market are monthly active users (MAU) and average revenue per paying user (APPU). Sony currently has over 100 million PlayStation 4 MAUs[5], which we expect to experience reduced short-term growth as customers anticipate the release of PlayStation 5. To maintain customer loyalty and boost APPU, Sony launched PS Plus in 2010, a paid subscription service used by over 36 million customers as at May 2019[6]. For a monthly fee of NZ$ 7.50 subscribers gain access to the "Instant Game Collection," a monthly rotation of 'free' games. The service generates a predictable revenue stream with an average lifetime spend exceeding $700 per PS Plus subscription. PlayStation 4 engagement is unprecedented; if Sony can execute a seamless transition to the PlayStation 5 by offering cross-generational play, these loyal customers will remain thanks to Sony's revolutionary cloud-based system negating the need for physical titles.

STREAMERS AND FREE-TO-PLAY GAMES DRIVE SALES.

PlayStation Now (~700K subscribers)[7] is a monthly subscription offered by Sony for US$ 9.99 per month which allows users to stream their gameplay live. The significance of the proliferation in online streaming cannot be ignored. In Sony's 2019 Annual Report, Game & Network Services revenue increased by +20.36% from 2018, largely due to continued global obsession with free-to-play game Fortnite. As Fortnite grew in popularity with streamers and gamers, a partial migration of mobile users to console occurred while console incumbents became similarly captivated by the game that took over the free-to-play world. Gamers want to try before they buy and free-to-play games, which represent 82% of digital gaming revenue[8], offer no up-front commitment and is instead supported by monthly subscriptions and in-game add-ons to improve the users' experience. This change in consumer behaviour represents an opportunity for Sony as free-to-play games on average generate a significantly higher revenue than paid games games[9].

STREAMING HAS REVITALISED THE MUSIC INDUSTRY.

Sony owns the music industry's largest publishing company and the second-largest recording company achieved by maintaining an artist skillset that is difficult to replicate; Sony's artists include Beyoncé, Mariah Carey, Shakira, Michael Jackson and Frank Sinatra. When the iPod was released in 2001 the shockwaves were felt globally; consumers were finally offered an alternative to having to purchase entire albums to listen to one song they wanted to hear. Physical music sales declined as pirated songs became ubiquitous; the industry was dying a slow death. Spotify's introduction to the market was partially funded by Sony who retains a 2.35% ownership in the music streaming giant who saw an opportunity give consumers what they wanted and have them pay for it again. Spotify disrupted the fundamentals of accessing music. The paid streaming service allowed artists to once again monetise their music and consumers were granted access to over 50 million tracks, a win-win. As a content owner, Sony is entitled to a significant portion of Spotify's revenue which we believe will be sustained over the long-term as Global Recorded Music Industry Revenues have increased at a CAGR of +36.18% from 2014-2018.



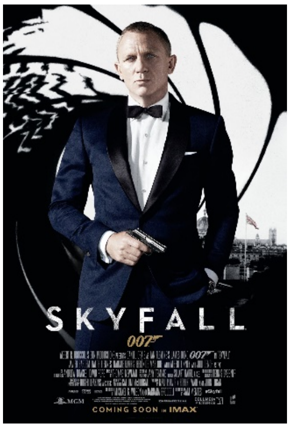
Source: IFPI Global Music Report 2019

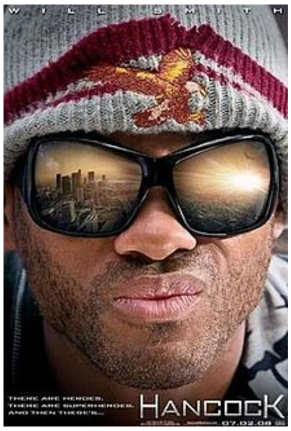
"This is an exciting time of growth for the music industry and we've increased our investment in talent and the creative process. We're partnering with our artists to continue advancing innovative and unique opportunities to connect with audiences in more corners of the world than ever before."

Rob Stringer, CEO Sony Music Entertainment

BOX OFFICE REVENUES INCREASING GLOBALLY.

Despite streaming platforms Netflix, Amazon and Disney+ becoming household names there are no signs of consumers neglecting the box-office, in 2019 worldwide Box Office generated record revenue of US$ 42.5B. Disney/Fox continues to dominate with a 51.45% market share in 2019; Sony came in fifth with at 11.71% grossing US$3.351B[10]. Sony has a 30-year history in the industry with titles including *Skyfall, Casino Royale, Jumanji: Welcome to the Jungle, Spider-Man,* and *Men in Black.* In 2019 *Spider-Man: Far from Home* global box office grossed US$1.132B taking the collective franchise to a total grossing of US$6.3B. Sony are showing no signs of slowing down box office releases. With a highly valuable library (Sony recently sold *Seinfeld* to Netflix for US$ 500M) we project this segment to perform adequately in the coming years if they can find a way to navigate the resurgence of vertical integration in the industry. Netflix, Amazon and Disney are leveraging their massive subscriber bases to limit the number of global players[11]; if Sony can continue to realise the value in their portfolio by selling in-demand titles to companies like Netflix, then they are poised to benefit from the disruption to the movie industry. However, a more likely outcome is a sale of the entire studio/production business which would be attractive to multiple parties including ViacomCBS (another holding in the Elevation Capital Global Shares Fund).





"I was working at the store on the Sony studios in Culver City, and I was literally holding a shirt when they came in and told me I'd got the part! It just shows dreams do come true."

—Derek Luke - 2019

VALUATION.
Sony's valuation can be estimated utilising what is commonly referred to as a sum-of-the-parts (SOTP) valuation methodology.

Gaming & Networks – Consoles typically have a 5-year cycle, using the 5-year average EBITDA of comparable companies, we estimate a 13x EBITDA multiple for this business segment which is lower than comparable companies (ATVI, TTWO, UBI) that have higher historical margins[12].
Sony Music – The primary competition for Sony is Vivendi, the world's largest recording company which recently sold a 10% stake in UGM to Tecent at an EV/EBITDA multiple of 30x. There are very few publishing and recording companies for sale and even fewer with the market power of Sony, who is one of the top three players in the world. For this reason, we estimate a conservative EBITDA multiple of 17x factoring in earnings growth and market share for this business segment[13].
Pictures – Sony Media results have been underwhelming due to increased competition from streaming services Netflix, Amazon and Disney+. Disney recently acquired Fox at 18-19x EBITDA while AT&T paid 13x EBITDA for Time Warner (a historical investment of the Elevation Capital Global Shares Fund). Conservatively, we estimate Sony Pictures value at 10x EBITDA based on their reduced market share and declining box-office revenue[14].
Electronics – Electronics is a saturated industry with several major players. While it's difficult to identify direct competition, the market for TV's, headphones, speakers and similar products is a battleground with no clear winner in sight. We conservatively place a multiple of 5x EBITDA representing a reluctance to place huge value in the segment that has collectively declined at a CAGR of -6.49% from 2015-2019[15].
Semiconductors – Sony has been aggressively investing in its production capacity since branching off from the Electronics segment in 2016. Similar semiconductor companies in the USA[16] trade at an average EV/EBITDA multiple of 15x as at 26 February 2020[16], we place an EV/EBITDA multiple of 8x on their semiconductor segment with expectations of it to rise as they refine their production process to meet demand[17].

As at 4 March 2020 Sony is trading at a TTM EV/EBITDA multiple of 6.41x (US$ 62.52 per share) which is a discount of -58.27% to our estimated SOTP valuation of ~11x EV/EBITDA (US$ 107.29 per share).

CONCLUSION.
Sony has been an innovator for decades and has diversified its business into industries that not only have significant barriers to entry but are also experiencing strong economic tailwinds. By consolidating its already profitable business segments and investing heavily in the sectors projected to experience long-term growth, the company has increased its operating profit at a CAGR of +29.68% since 2016[18]. With a proactive growth strategy and continued innovation, we believe that Sony offers a sound long-term investment supported by the success of the PlayStation 4 and the November 2020 release of the PlayStation 5, the booming semiconductor market and revitalised music segment. Sony is currently trading below intrinsic value largely due to misplaced sentiments that the company is still primarily the same as it was in 2012, in our view Sony is only just reawakening with many levers to pull for value creation to unfold.

Any data not referenced was sourced from Sony annual reports.
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[8] Yanev, V. (2019) *Video Game Demographics – Who Plays Games in 2020.* Techjury.
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[11] G.research. Sony Corporation, Creative Environment, Technology and Value. 24 October 2019.
[12] See note 11.
[13] See note 11.
[14] See note 1.
[15] See note 11.
[16] ON.O, TXN.OQ, MXIM.OQ, SMTC.OQ, VSH.N, IFXGn.DE, DIOD.OQ, POWI.OQ
[17] See note 1.
[17] See note 11.
[18] See note 1.

This summary report was written in March 2020.