(BN) Sony’s $100 Billion Lost Decade Supports Loeb Breakup: Real M&A

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By Angus Whitley, Brooke Sutherland and Naoko Fujimura

May 16 (Bloomberg) -- Sony Corp. has a $100 billion reason to consider Daniel Loeb’s breakup proposal.

Loeb, whose Third Point LLC hedge fund just took a $1.1 billion stake in Sony, is pushing the Tokyo-based company to sell as much as 20 percent of its entertainment business and focus on the “considerable and underappreciated value” of its electronics unit. After Loeb’s proposal sparked the biggest rally in Sony shares in more than four years, the $21 billion company still languishes at a cheaper valuation relative to profit than 90 percent of similar-sized consumer electronics makers, according to data compiled by Bloomberg yesterday.

Loeb is approaching Sony after shareholders lost more than $100 billion in market value since 2000. CLSA Asia-Pacific Markets said Sony would be worth 28 percent more in a separation. While estimates from Macquarie Group Ltd.’s Damian Thong fall short of Loeb’s targeted 60 percent stock gain, the analyst said the activist’s claim that spinning off the entertainment unit and boosting its profitability may raise the company’s market value by about 30 percent “seems reasonable.”

“Sony is a chronic underperformer,” Joshua Strauss, Chicago-based co-manager of the Appleseed Fund at Pekin Singer Strauss Asset Management Inc., which oversees about $1 billion, including investments in Japan and Korea, said in a telephone interview. “Should they spin off the entertainment division?
Would it create shareholder value? Probably. When you do that sort of thing, the sum of the parts is greater than the whole.”

Entertainment IPO

Loeb said in a May 14 letter to Sony Chief Executive Officer Kazuo Hirai that the company should sell as much as 20 percent of Sony Entertainment in an initial public offering, giving current Sony shareholders priority in owning the shares and reducing leverage for the electronics business.

“As President and CEO Kazuo Hirai has said repeatedly, the entertainment businesses are important contributors to Sony’s growth and are not for sale,” Sony said in an e-mailed statement May 14.

Independently listed, the entertainment business -- featuring artists including Bruce Springsteen and the top- grossing U.S. film studio -- could improve its margins and boost earnings as much as 50 percent, wrote Loeb, whose firm owns about 64 million Sony shares. Loeb said that could add 625 billion yen ($6.1 billion) to Sony’s market value, or 540 yen per share -- an amount that Thong, a Tokyo-based analyst at Macquarie, said in a phone interview “seems reasonable.”

Sony shares, which rose 10 percent yesterday, gained another 0.5 percent to 2,082 yen in Tokyo today. The stock closed at 1,877 yen on May 14 before Loeb’s letter was disclosed.

Walkman Players

In addition, Loeb said Sony should focus on streamlining its electronics offerings as that unit is poised to return to profitability. Sony makes consumer electronics such as the PlayStation game console and Xperia smartphones.

"The value realization within the entertainment business was always secondary to the turnaround in the electronics business," Thong said in a phone interview. "What this has done is shine a search beam right on a part of the business that should be valued more."

Founded in 1946, Sony was emblematic of Japan's post-World War II rise, inventing the Trinitron cathode-ray tube TV in the 1960s and the Walkman portable music player a decade later. Its market value, which topped $120 billion in 2000, has since plunged as consumers shifted to flat-panel TVs, smartphones and mobile devices made by Samsung Electronics Co. of South Korea and Cupertino, California-based Apple Inc.

Depressed Value

While a weaker yen, box-office successes like "Skyfall" and the sale of its New York headquarters helped return Sony to its first profit in five years, the company's valuation has still lagged behind its historical highs and its peers.

Sony trades at a 5 percent discount to the value of its net assets, compared with an average price-book ratio of about 2.8 for consumer electronics makers with market capitalizations exceeding $1 billion, according to data compiled by Bloomberg.

Sony's enterprise value of 2.2 trillion yen is 4.2 times the average of analysts' estimates for earnings before interest, taxes, depreciation and amortization this year, the data show. The company's peers trade at an average of about 8.9 times.

The value of Sony's entertainment division -- which makes the "Spider-Man" movies through its Culver City, California- based Sony Pictures and also represents music artists including Grammy winner Adele -- isn't being realized in the company's current structure, said Michael Souers, an equity analyst at Standard & Poor's.

Breakup Analysis

"It's totally being weighed down by the struggling consumer electronics unit and the fact that it's had to subsidize that unit," Souers said in a phone interview from New York. A partial spinoff "would make sense for them. And from a managerial perspective, they could focus a little bit more on turning around the electronics business."

A sum-of-the-parts analysis by Christian Dinwoodie, a Tokyo-based analyst at CLSA, values Sony at 2,400 yen a share, 28 percent higher than its price May 14, before Loeb's proposal lifted the stock. Spinning off part of the entertainment business would give Sony an infusion of capital and allow it to transfer some debt to the new entity, Dinwoodie wrote in a May 14 report.

Sony has pursued a similar approach before. It raised 320 billion yen in 2007 when it spun off its financial services unit in an IPO. Sony still owns 60 percent of the banking and insurance business, known as Sony Financial Holdings Inc.

Activist Failures

Still, Loeb's push faces hurdles in a culture that traditionally hasn't been welcoming to overseas activist investors, said Strauss of Pekin Singer Strauss.

In the early 1990s, oilman T. Boone Pickens failed to win a board seat at auto parts dealer Koito Manufacturing Co. Last month, Seibu Holdings Inc. said it won't offer any concessions to New York-based private-equity firm Cerberus Capital Management LP, the hotel and rail operator's biggest investor, in its push for board seats and a bigger stake.

"The Japanese don't care," Strauss said. "They're not beholden to shareholders in that country. Some guy in New York is not going to convince Japanese companies to change their way of doing things."

Loeb's plans for Sony are designed to maximize his own returns at the possible expense of the company's long-term viability, said Amir Anvarzadeh, a Singapore-based manager for Japanese equity sales at BGC Partners Inc. Without the cash flow of the entertainment business, Sony's consumer electronics will struggle, he said.

'Quick Buck'

"In Japan, activist investors have never been successful -
- it's not the type of capitalism that Japan likes," Anvarzadeh said in a phone interview. "This guy doesn't care about Sony.
He just wants to make a quick buck."

Still, Nobuo Sayama, a partner at Tokyo-based private- equity firm Integral Corp., said the return of activist investors to Japan is a positive development.

Loeb's interest "is something Sony or Japan as a whole should welcome," he said in a phone interview. "The industry should be grateful for such proposals from investors at home or abroad."

Sony shareholders have nothing to lose should the company meet Loeb's demands, said Thong, the Macquarie analyst. Even after selling 20 percent of the entertainment business in an IPO, Sony would retain control and bank any profits, he said.

"It's primarily a way of making transparent a part of the business which is relatively untransparent," Thong said.
"Everyone's excited not just in the context of Sony but of corporate activism accelerating change in Japanese firms or the Japanese economy in general. This provides additional reasons to believe that change is in the air."

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