

Accounting Case Study

Research project:

Please pick a non-US company (Fast Retailing Company from Japan) that interests you and walk me through your company's annual report. You are required to hand in a two-page research report. Specifically, you can write your report using bullet points. It has to be professional looking, however, and needs to be informative.

1. Please locate the most recent annual report for your firm and find two risk factors that are mentioned regarding global operations. Most companies have this early on in their report (item 1 Risk Factors) and will talk about the economic environment in global markets, exchange rate challenges, foreign legal uncertainties, and international taxation. If your firm also files reports in the US, the report will be called 20-F (the equivalent to a 10-K for foreign filers) and you can find it on the sec.gov website. If your firm doesn't file in the US, you can find their report on the company website. You need to be able to discuss the risk factors, e.g. what impact can they have on your firm's operations, how can you minimize their impact, etc.?
2. Next, please find your firm's conference call. Firms will discuss their financial information with investors, and I would like you to look through the conference call to find management's discussion of global issues surrounding their business. Sometimes firms will discuss this on their own, and other times it will be prompted by analysts in the Q&A part of the conference call. You can find conference call transcripts on the Factiva database on the Pepperdine Library site. I posted a video in Session 2 how to access it. If you cannot find it on Factiva, you will most likely find it on the investor relations page of your firm's website. You need to be able to discuss management's statements regarding international business issues. Do you think they are truthful, mentioned all foreign business issues, or did they forget something? Do they mention something that was not in the filings?
3. What is the major accounting policy choice they have to make? Please record a transaction using Debits and Credits of the major accounting policy transaction. ?
4. Does your firm have tables showing the impact of FX, or just a discussion? What do they say about the impact of FX on their business? Has it helped their numbers? What is their functional currency? And what method do they use to translate their international segments into the local report? ?
5. Compute the ratios from the DuPont model and graph your firm's ratios using the chart from the slides in Session 5. ?
6. Taxation issues.

SOLUTION

Business Summary

Sony Corporation is a multinational conglomerate headquartered in Konan, Minato, Tokyo. Its business includes gaming, consumer electronics, entertainment and financial services. It was ranked 105th on the Fortune Global 500 2017. The company is the fifth largest manufacturer of television sets. Its slogan is “Be Moved”. It was founded in 1946 after the end of World War 2.

Risk Factors

The company’s annual report for FY 2016 was the earliest one available. It lists several risks and uncertainties that Sony is likely to face in the future.

One of the key uncertainties that Sony faces is the changing global economic and political environment in Sony’s operating countries and markets, with particular concerns about consumer spending. As a global firm, Sony has to abide by laws and regulations in different countries affecting areas like advertising, data protection, consumer protection, import and export requirements, anti-corruption, anti-competition, environmental protection, occupational health and safety, labor practices and human rights. With the rise in nationalistic sentiments globally, Sony may face trade barriers in its markets. There is a rising focus on privacy, environmental impact of products and corporate social responsibility. Sony must also keep in mind potential consumer boycotts which may happen if they’re associated with advertising on unsavoury media.

Sony’s revenue is highly dependent on the prevailing economic conditions in the major markets of Sony. They may face economic downturns, which is likely to bring down consumer confidence levels and spending levels. Customers may experience credit crunch, cash flow shortages as well. This may result in reduced demand for Sony products leading to lesser sales and therefore lesser revenue.

Another major concern of Sony is its ability to continue to design and develop innovative products and make sure its products find widespread acceptance to ensure profitability. It has invested in large scale investments in R&D to develop such products. Consumer electronics market is highly volatile and very competitive nature. Many products are launched in this space. To continue to stimulate and enhance customer demand for its products and transition to new products and market spaces, Sony must keep innovating and bringing out great products. These products should also find acceptance among the consumers so that they can be produced at a larger scale to recoup the R&D investments and ensure profitability of the company. To increase acceptance, Sony ought to have the ability to plan and execute a successful marketing strategy.

Consumer electronics is also subject to changing consumer preferences and quick technological innovation. Due to relative ease of technological imitation, consumer electronics products are highly subject to standardization leading to price erosion. Sony continues to invest heavily in R&D to keep its market edge. To reduce costs, it concentrates on markets with fantastic growth potential. It may not always be successful in identifying markets with great market potential and risks its revenue.

Earnings Call for FY 2016:

- Sony’s consolidated sales in FY 2016 were down 6% yoy to 7 trillion 603.3 billion yen.
- Consolidated operating income decreased 2% yoy while EBIT decreased 17%

- Sony has consistently recorded loss in Electronics in 4th quarter, they made a operating profit in 6 electronics segments
- Sony expects sales in FY 17 to increase 5% yoy, while net income is expected to be 255 billion yen.
- Sony aims to complete transfer of battery business in FY 2017
- In FY2016, Mobile Communications segment's sales were down 33% yoy. However, their operating income improved 71.6 billion yen to 10.2 billion yen because of the benefit of lower costs, due to restructuring initiatives.
- Sony expects to improve their annual smartphone sales by 1.9 billion due to increase in ME and Europe sales. Sales revenue is expected to increase 8% yoy to 820 billion yen
- In the Game & Network Services segment, sales and operating income increased year-on-year and operating income was 135.6 billion. Network sales increased 35% year-on-year
- In Products & Solutions segment, sales decreased by 15% yoy and operating income saw an decrease of 22.1 billion yen to 47.3 billion yen. In FY 2017, this segment' numbers are expected to increase due to improvement in product mix
- In Home Entertainment & Sound segment, sales decreased 10% year-on-year partially due to the impact of foreign exchange rates while operating income increased 7.9 billion yen to 58.5 billion yen, primarily attributable to an improvement in product mix

DuPont formulae

Revenue = 8105.7 billion yen

Net Profit = 147.8 billion yen

Equity = 1386.8 billion yen

Total Assets = 10915.529 billion yen

Net profit margin = Net profit / Revenue = 0.0182

Asset Turnover = Revenue / Total Assets = 0.7426

Financial Leverage = Total Assets / Equity = 7.871

Critical Accounting Policies and Estimates

Sony prepares its financial statements in accordance with US GAAP rules, which requires management to make estimate and assumptions about assets, liabilities, revenues, expenses etc.

Foreign exchange rate fluctuations

Sony's financial conditions are sensitive to fluctuations in foreign exchange rates as Sony's products are generally sold in countries other than the country where they were developed and/(or)

manufactured. Sales of Sony products are dispersed in yen, US Dollar, Renminbi, Euro and other local currencies etc. When yen, euro and emerging markets currencies weaken significantly against US Dollar, Sony's operating results are adversely affected. Sony hedges most of its net short term incomes from foreign currency exposure. But it can't completely eliminate its exposure. The decrease in operating revenue of Sony in FY 2016 was primarily due to the outsize impact of foreign exchange rates.