

Japan

The economy found the bottom, and Japanese companies with strong balance sheets have started to move outbound again.



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Japan

Current Environment

Real GDP declined by 3.8% in the first quarter of 2009, the third consecutive quarter of negative growth and the worst quarterly rate ever. The overall level of real GDP for 2009 is forecast to decline by around 3.3%. Capital expenditure at corporations has decreased drastically under conditions of worsening profitability, whilst individual consumption and residential investment are both still weakening.

However, the decline in economic conditions appears to be slowing in the second quarter, with both exports and productivity showing some increases as well as signs of growth in public investments.

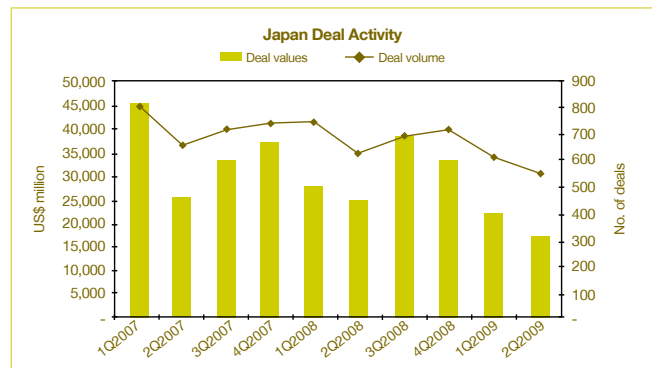
Looking at the financial markets, the overnight call rate remains around 0.1% and other term rates have also held stable. The long-term government bond rate (JGB) and stock market have both moved upwards while the Japanese yen has depreciated slightly against the US dollar. At the end of June, the JGB was trading at around 1.5% with the anticipation of a new issuance for the new fiscal year. The Nikkei Index was trading just below JPY 10,000 with the currency valued in the range JPY96 to 98 per US dollar at the end of June 2009.

With an outlook whereby the long-term government bond coupon rate is forecast to move upwards, we are seeing companies with higher credit ratings starting to issue long-term corporate bonds in order to secure funding at current lower interest rates. A total of JPY6 trillion in new funds has been raised through corporate bond issues in the first half of 2009. As examples, Toyota issued JPY200 billion in five-year bonds at 1.34% and a further JPY130 billion at 1.07%, whilst other corporates raising funds at below the current JGB rate included Denso (JPY100 billion), Panasonic (JPY400 billion), Japan Tobacco (JPY100 billion), NTT (JPY170 billion) and Sony (JPY220 billion).

The period from January to April 2009 saw some JPY3.9 trillion of investment in Outbound Foreign Direct Investment (FDI), although there was JPY6.4 trillion of prior investment withdrawn from overseas during the same period. The largest net decrease in overseas investment was from China (JPY159 billion), followed by the UK (JPY 129 billion), the Netherlands (JPY98 billion) and Australia (JPY95 billion). There was also a net decline of investment of JPY70 billion within the USA, the largest cumulative market for overseas investment by Japanese companies.

Looking to invest in Japan, there was inbound FDI of some JPY1.2 trillion in the first four months of 2009, with JPY891 billion withdrawn by overseas investors during the same period. The largest net contributor of inbound FDI was Germany (JPY18 billion), followed by the USA and the Netherlands (both with JPY17.9 billion) and France (JPY16 billion).

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2009

Data from MARR (The M&A Research Report and Japan's primary source of deal-related information) indicated a total of 1,512 deals (reflecting 972 M&A deals and 540 group reorganisations) for Japan for the period from January to June 2009. Deal values were announced for 564 of these deals, totalling JPY2.22 trillion.

Of the published information, some 86% of total deal volume and 32.4% of estimated deal value related to domestic deals. Outbound deals comprised 8.9% of total volume and 55% of estimated deal value, and inbound deals provided 5.0% of volume and 12.6% of total deal value.



Outbound activity took place predominantly in the financial services, energy and mining, and food and beverage sectors. Financial sector transactions have been triggered primarily by the overall distressed state of the markets, whilst energy and mining activity reflects an uptick in efforts to secure scarce natural resources for energy-challenged Japan. Deals in the food and beverage arena have been motivated by players keen to expand beyond their saturated domestic market. At the time of writing, Kirin and Suntory had just announced discussions around a possible merger which would create a giant global player in the food and beverage sector.

Financial Services

- The largest deal announced during the first half of 2009 was the acquisition of the securities business of Nikko Citi (including Nikko Cordial Securities and Nikko Citigroup Securities) by Sumitomo Mitsui Bank Corporation for JPY573.5 billion. Nikko Securities was one of the big four securities firms in Japan and had previously become a wholly-owned subsidiary of US-based Citigroup in 2008.
- Mitsubishi UFJ Securities (part of the MUFG group) announced its intention to merge with the Japanese operations of Morgan Stanley Securities, and has also increased its equity investment in Kim Eng Holdings of Singapore to over 20%.

Energy & Mining

- Sumitomo Corp acquired 100% of Oranje-Nassau Energie, a crude oil developer based in the Netherlands for a total of JPY80 billion.
- Toshiba, Tokyo Power and JBIC jointly acquired a 19.9% stake in Uranium 1 of Canada for JPY20 billion.

Food & Beverage

- The announcement of discussions between Kirin and Suntory in early July is potentially the standout M&A transaction of the year. Both players have, alongside Asahi Breweries, continued to remain active in exploring international M&A opportunities and their coming together would create the potential for even larger transactions in the international market.
- Kirin Holdings acquired a majority stake in San Miguel Beer of the Philippines for JPY131.6 billion.
- Asahi Breweries acquired a minority stake in Tsingtao Brewery of China from Anheuser-Busch InBev of Belgium for JPY59.3 billion.

In other areas, we would also make mention of the acquisition by PricewaterhouseCoopers Japan of the Japanese business of BearingPoint, a transaction which greatly strengthens our consulting capability in the Japanese market.

In the domestic M&A market, a large number of deals occurred in non-manufacturing sectors such as services, information and software, amusement, real estate and hotels. Two of the largest deals in this sector include the acquisition by Yahoo Japan of 100% of Softbank IDC Solutions for JPY45 billion and Culture Convenience Club's acquisition of 20% of Kakaku Dot Com for JPY18 billion.

Another significant trend in the first half of 2009 in Japan was the delisting of some 38 companies from the Tokyo Stock Exchange (TSE), the highest level since records began back in 1961. Of these, 12 companies were delisted on grounds of financial distress (against a total of 16 companies for the entire year in 2008) whilst a further 14 companies were delisted to eliminate a double listing alongside a parent company. The listing of both parent and subsidiaries has been a subject of public debate in recent years in Japan. A total of 2,364 companies currently remain listed on the TSE.

In the area of private equity, the difficult funding market has seen a number of players seeking to reduce their holdings in Japanese stocks. For example, Steel Partners, one of the most prominent activist funds in Japan which previously held stakes in more than 30 Japanese companies now holds stakes in only 14. In addition, certain international private equity players have elected to exit Japan in early 2009.

Recent months have seen some developments in the impact of activist international private equity shareholders at general shareholders' meetings in Japan. The direct focus on business performance, which historically has not ordinarily been well-received, saw some changes at the recent general shareholders' meeting for Aderans, a major producer of wigs. Steel Partners, a 28% shareholder of Aderans, requested changes in the composition of the board and submitted seven nominees for approval in the shareholders' meeting, which in an unusual move were voted on one-by-one alongside a counterproposal by the current board in conjunction with Unison Capital. All seven nominees submitted by Steel Partners were approved by a majority of shareholders, whilst the three nominees submitted by the current board were rejected.



Outlook

On 16 June 2009, three discussion papers were issued by various bodies:

- The Finance Council of the Financial Service Agency issued a report on “Corporate Governance for Listed Companies”
- The Corporate Value Study Group of the Ministry of Economy, Trade and Industry issued a “Corporate Governance Study Report”
- The Japan Securities Dealers Association issued a discussion paper “Regarding Policies on Finance and Capital Market”

Whilst the reports differ in terms of their emphasis and proposals, all reports focus on ways of achieving better regulation over a range of corporate governance issues including:

- The dual listing of parent and subsidiary companies
- Disclosure of proxy results in a shareholders’ meeting
- Private placement of equity stocks issued to a third party that results in a change of control

Debate on each of these reports will continue, although it is reasonable to expect that additional regulations / rules will be issued in Japan within the current year. As such, we expect to see corporate activity continue to accelerate in response to the anticipated regulatory changes. This will play through with further delisting of subsidiaries and with more disclosure of proxy results within the shareholders’ meeting (which is already mandatory in the UK, and where the European Union is expected to follow) with a move towards making such disclosure obligatory. Currently, only a few companies such as Sony Corporation disclose the detailed proxy results within a shareholders’ meeting, although situations such as the Aderans case can be expected to become more common.

In a move intended to provide support to distressed companies, the Japanese government has enacted a new law to establish oversight of the investment banking branch of the Development Bank of Japan (DBJ), which was privatised in October 2008. The oversight body will scrutinise the financial standing of subject companies and, upon approval of a revitalisation plan, will inject funds into the companies. To date, both Elpida Memory Inc., a semiconductor company and Japan Airlines (JAL) have been granted funds through the DBJ, in the amount of JPY140 billion and JPY100 billion respectively. JAL has continued to suffer financial distress for more than a decade and has previously issued preferred shares on a couple of occasions. Set against this, All Nippon Airways (ANA) recovered from its own financial difficulties relatively quickly through implementation of an innovative management framework built around EVA. On 16 June, the same day the government announced that it would guarantee 80% of loans provided to JAL by DBJ, ANA announced its own plans to raise funding of JPY150 billion through a new equity share issue.

The public debate continues around the appropriateness of providing funding to distressed companies, using the nation’s financial resources, in a manner that may prolong the life of such companies but may cause market inefficiencies. However, we can expect there to be further developments in this area, as well as continued consolidation of domestic players and moves to further the international expansion by Japan’s strongest corporates over the months ahead as the global economic outlook starts to become clearer. ■