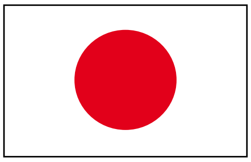
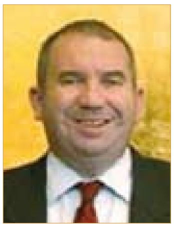


North Asia
Japan

Japanese companies have continued to be involved in the deal activities for business restructuring and expansion. Political change can also generate a range of new investment opportunities especially in the renewable energy sector.



Matthew Wyborn
Corporate Finance Leader
Japan

Current Environment

Japan's economy experienced considerable difficulties during 2009, inspite of its quarter-on-quarter growth in real GDP of 0.7% in the second quarter and 0.3% in the third quarter.

For the first half of 2009, exports from Japan decreased by 42.7% in terms of value, imports as well declined by 38.6%, primarily reflecting lower trade volumes with both US and China. While there has been some recovery in recent months, total export values declined by 36% over the 11 months ended November 2009. Export-orientated companies have been impacted by the appreciation of the Japanese yen against the US dollar from 100 in January 2009 to 92 by year-end, having attained its strongest position in 15 years, a level of 84 in November 2009. The yen remained steady against the Euro, closing the year at a level of 132.

The continued difficult economic circumstances have meant that Japanese companies continue to refrain from investment and in the third quarter, total corporate investment expenditure (excluding software) was down 25.7% year-on-year. The Ministry of Finance commented that many manufacturers have taken drastic cost cutting measures resulting in an overall reduction in expenditure of 40.7%, the most significant decrease since 1955.

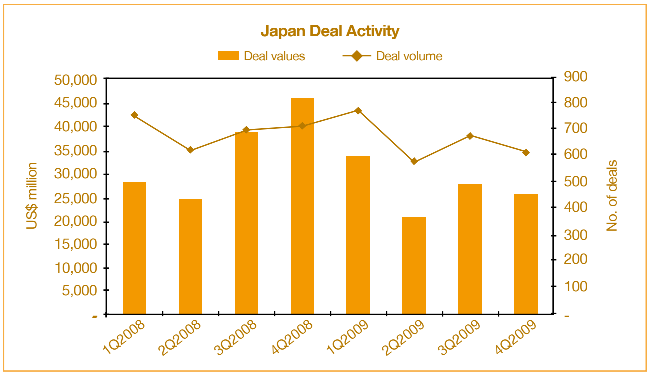
Outbound direct investment in the period from January to September 2009 amounted to US$59.6 billion, a decline of 12.7% over 2008. From a geographical perspective, Japanese investment declined in a number of key regions, including North America (54.1%), Oceania (20.2%) and the European Union (13.5%). By contrast, outbound investment into China and ASEAN rose by 15.6% and 33.1% respectively.

From an inbound perspective, direct investment into Japan decreased by 44.2% during 2009. There has been a significant rise in investment from the European Union (up 80.9%), but inflows have declined from all other regions, including North America (66.3%) and Asia (53.5%).

Japan's stock market performance showed an overall gain during 2009, following a rally in the Nikkei index which reached 10,767 points in August and closed the year at 10,546 points after a slow final quarter. While the overall gains in 2009 indicate that Japan may have passed the worst of financial crisis, uncertainty remains over the economic and monetary policies of the new government led by the Democratic Party of Japan (DPJ).

Within the financial sector, there has been a continued tightening within the lending environment. At year-end, the Bank of Japan's (BOJ) discount rate stood at 0.3%, although it is expected to rise in the near future. Given this, many leading Japanese companies such as Mitsubishi UFJ Financial Holdings, Nomura, Toshiba, Hitachi and All Nippon Airways have obtained additional bond or equity financing in recent months. Total stock financing was JPY3,399 billion for the period January to October 2009, more than double the equivalent for the previous year.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2009.

According to Thomson Reuters, the total announced value of M&A transactions involving Japanese companies in 2009 was US$105.9 billion, a decrease of 22% against the previous year. The overall decline is mainly attributable to a 74% fall in the value of outbound transactions from Japan.

Deal activities in the second half of 2009 reflect three notable characteristics: Firstly, industrial product manufacturers, food companies and pharmaceutics businesses, who have, historically, generally relied on the domestic market for growth, continued to show increasing interest in acquiring overseas competitors in order to increase global sales. The main transactions in this space include:

- The acquisition by Suntory Holdings, which continues to progress on a merger with rival, Kirin, of Orangina, a Paris-based producer and wholesaler of soft drinks with an estimated deal value of US$3.8 billion. Suntory followed this in December with the announcement that they will acquire a South Carolina-based bottler for Pepsi in a US$110 million deal.

- A number of pharma deals including Taisho Pharmaceuticals' purchase of Bristol-Myers Squibb Indonesia, the acquisition of AkaRx, a US biopharmaceutical company, by Eizai, the decision by Hisamitsu Pharmaceuticals to secure US-based Noven Pharmaceuticals and the announcement by Dainippon Sumitomo Pharma to acquire Sepracor.

- On the electronics side, Canon was active and announced two European acquisitions, most notable was the takeover of Dutch printing system developer Océ for US$1.1 billion and also a US$85 million outlay to acquire Optopol Technology, a Polish healthcare equipment supplier.

Secondly, there has been further progress on domestic mergers, which competitors are continuing to explore as a means of increasing market share and as a necessary means of strengthening their businesses and financial bases. Key activities on this front include:

- The announcement by Japanese brewery Sapporo Holdings that it will invest in domestic soft drinks manufacturer, Pokka.

- The merger of Mitsubishi Chemical Holdings with Mitsubishi Rayon in a US$2.4 billion deal which sees the formation of Japan's largest chemical company.

- Progress towards an amalgamation of Shinsei Bank with Aozora Bank under a stock swap transaction valued at US$3.1 billion.

- An agreement by Hitachi and NEC to integrate their semiconductor and mobile phone subsidiaries as a means of pursuing economies of scale and improving their international competitiveness.

Thirdly, the market is seeing a round of equity injections into struggling firms as a means of securing business assets, sales networks, customers, technologies and brands. A number of situations have seen the usage of business recovery frameworks such as the Japanese Association of Turnaround Professionals'Alternative Dispute Resolution (ADR) process. A revised Act on Special Measures for Industrial Revitalization was also enacted in 2009 in order to facilitate business restructuring through official financial support, including tax exemptions or debt guarantees. Recent highlights in the distressed sector include:

- A merger of two of Japan's real estate investment trusts (J-REITs) whereby Advanced Residence Investment Corporation sponsored by trading house, Itochu Corporation, acquired Nippon Residential Investment Corporation, which had previously been owned by bankrupt real estate investor, Pacific Holdings.

- Japan's largest department store operator, Mitsukoshi Isetan Holdings, acquired Iwataya, a regional department store group and utilised the above Act to advance the restructuring process.

- The largest residential construction company, Daiwa House Industry, sponsored Cosmos Initia, a top tier residential developer, in its ADR application.

- A high profile restructuring involving Japan Airlines, which is reportedly considering a range of possible revival measures that may involve the application of bankruptcy laws or ADR. Other alternatives being considered include debt relief via the state-backed Enterprise Turnaround Initiative Corporation of Japan (ETIC) fund, or a capital participation via competing overseas carriers, Delta and American Airlines.

Private Equity

The difficult financial environment has forced certain funds to decelerate their portfolio activities in Japan, although divestments have in turn provided some attractive investment opportunities for strategic buyers.

Portfolio reductions by the activist Steel Partners included divestment of its 7.91% stake in Nihon Tokushu Toryo, a specialty resin paints and coating materials maker to Kansai Paint for JPY421 million and the disposal of its 16.38% stake in New Cosmos Electric, a leading manufacturer of gas detectors and alarms, to Iwatani Corporation for JPY2,025 million

US-based real estate investor, Athos Group, divested its 78.74% stake in MID Urban Development to Kansai Electric Power Company, which is reportedly planning to expand its real estate activities.

Amongst the domestic funds, Unison Capital sold Cosmos Initia to Daiwa House Industry and Advantage Partners sold its minority stake in beverage maker Pokka to Sapporo. These funds, together with MKS Partners, sold Kracie, a sanitary and cosmetics maker (formerly known as Kanebo), to Japan's leading hair dye producer, Hoyu.

In contrast, there has been limited buy side activity in Japan involving fund investment. Notables include the MBOs of restaurants operator, Chimney, backed by Carlyle and that of Universal Studios Japan, backed by a Goldman Sachs fund affiliate. In addition, Bain Capital Partners outbid a number of rivals to secure Bellsystem24, a leading call center services provider, from Nikko Citi.

The latter half of the year also saw some activity from other funds including NTT Investment Partners, SBI Group and NIS Group, as well as some added focus on specific regions and small and medium-sized enterprises.

Outlook

Economists are forecasting that the Japanese economy and corporate earnings will improve in the year ahead, with real GDP growth estimates of between 1.2% and 1.8% for 2010. As the economy gradually recovers, it is anticipated that healthier companies will continue to pursue M&A opportunities, even as more underperformers will be exposed to business restructuring through group reorganisation, MBOs, ADR application schemes or the ETIC initiative.

In the domestic market, sectors such as engineering, regional banking, IT consulting, wholesaling and retail are likely to see pressure towards further consolidation. From a cross border perspective, it is anticipated that a continuation of the strong yen will see further outbound M&A in sectors such as food and beverage, pharmaceuticals, healthcare, chemicals, IT consulting, energy and financial services. Prospects on both the inbound and private equity fronts will remain relatively slim, although restructuring will continue to present some opportunities.

Finally, the year ahead should start to see some clarity around the DPJ policy environment, especially after upper house elections in July 2010. Investors have to date shown caution and it remains difficult to predict what impact the DPJ policies will have on M&A activity. The DPJ has released a "Policy Index" statement containing articles on areas such as the introduction of a carbon tax, an increase in the minimum wage and a possible restructuring of the corporate and financial income tax system.

Of particular interest will be the ability of the DPJ to follow through on its bold pledge to reduce greenhouse gas emissions by 25% from 1990 levels by the year 2020. The DPJ has yet to announce details of its environmental and renewable energy policy but it is anticipated that the pledge can generate a range of new investment opportunities if supported by incentives such as subsidies for renewable power and the introduction of a carbon credit trading market. The Shosha trading houses, energy companies, utilities and major electronics players have all been active in the development of renewable energy capabilities and have been seeking out opportunities to deploy their skills in innovation and partnering as a means of building their expertise and international presence in advance of a stepped change in renewable activities in Japan. This activity can be expected to accelerate in the year ahead. ■