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M&A

*Global interview panel
led by Alan Klein*

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Ryuji Sakai and Kayo Takigawa

M&A IN JAPAN

Ryuji Sakai and Kayo Takigawa are partners at Nagashima Ohno & Tsunematsu, primarily handling corporate M&A matters. They represent various clients in and outside Japan, including both business and finance companies.

What trends are you seeing in overall activity levels for mergers and acquisitions in your country during the past year or so?

Ryuji Sakai & Kayo Takigawa: In brief, the overall trend in levels of M&A activity has not drastically changed in the past year. That is, the number of transactions is still increasing. However, it seems that, in 2016, such increase has become slow and the number of outbound transactions (ie, Japanese companies making investments in target companies in foreign jurisdictions) is decreasing.

In Japan, M&A activity hit rock bottom in 2011, the year of the Great East Japan Earthquake. After December 2012, when the Liberal Democratic Party of Japan regained control of the government, M&A transactions started to increase. The



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aggregate volume of M&A transactions in 2015 exceeded that before the global financial crisis. Further, during the past two or three years, we saw a rise in outbound transactions, including several massive outbound cases, such as the acquisitions of Beam by Suntory, HCC Holdings by Tokio Marine, the acquisition of Dell’s IT services business by NTT Data, the acquisition of beer brands from AB InBev by Asahi and ARM Holdings by Softbank. However, as mentioned, this trend appears to have slowed of late. It may be noteworthy that the number of outbound transactions, especially in China and South East Asia, has become less active compared with the past few years. This may be because of, among other reasons, the rise in employment costs and the uncertainty of China’s economy. There have also been movements of withdrawal by foreign companies doing business in Japan. The acquisition of the retail business of Citibank in Japan by Sumitomo Mitsui Trust Bank or the acquisition by Idemitsu of shares in Showa-Shell Sekiyu held by Royal Dutch Shell are examples of this movement.

Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?

RS & KT: The food and beverage and pharmaceutical and healthcare industries are continuously the focus of active mergers and acquisitions, and we predict that this trend will

continue. The financial industry also seems to have become active especially in outbound transactions, along with, more recently, the software and information technology industry.

The underlying reason for the activity levels in each industry varies. In the food and beverage industry and the financial industry, it appears that companies are in strong need of developing outbound transactions because of the saturation of the domestic market, coupled with a widely expected sharp decrease in the Japanese population in the future. As a result, key players in these industries are actively seeking to expand their business outside Japan through outbound transactions, as demonstrated by the acquisitions of Beam by Suntory, of beer brands from AB InBev by Asahi and of HCC Holdings by Tokio Marine.

We understand that it is a global trend, not a trend particular to Japan, that pharmaceutical companies have recently been very active in mergers and acquisitions. Because of the large amount of R&D costs for sustaining and expanding their businesses, pharmaceutical companies need to seek economies of scale, which may be a strong motivation for M&A deal activity. In addition, the expected increase of the ageing population in Japan and the increasing sensitivity to health and medication problems seem to offer an attractive platform for pharmaceutical and healthcare businesses, while there are many small or medium-sized companies remaining in Japan in this sector. These factors could bolster both inbound and domestic transactions in the pharmaceutical and healthcare industry in Japan.

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Also, it may be worth noting that, in 2016, the monetary volume of M&A in the electricity industry is increasing. The reasons for this increase may be attributable Toshiba’s restructuring attempt as a result of its accounting fraud scandal, and also the acquisition of Sharp by Foxconn Technology.

The size of M&A transactions in the above industries has varied greatly and we do not see any particular pattern in terms of deal size. However, given the underlying incentives for M&A transactions in these industries, it would not be surprising if many large-scale transactions come to light in the future.

What were the recent keynote deals? What made them so significant?

RS & KT: Considering its size, the acquisition of ARM Holdings by Softbank may be called a keynote deal.

In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your country primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

RS & KT: Generally speaking, Japanese shareholders seem to have a strong preference for cash deals, and consideration used in most of the acquisitions in Japan is cash. However, in the case of merger transactions, it is common to offer as consideration the shares of the acquiring company to the shareholders of the target company.

We rarely see any significant acquisition where the shares of foreign acquirers are offered to the shareholders of a Japanese target company (with a possible exception of Citi Group Inc’s acquisition of Nikko Cordial Group several years ago).

How has the legal and regulatory landscape for mergers and acquisitions changed during the past few years in your country?

RS & KT: The most significant change was the amendment to the Antimonopoly Act in 2010, which introduced a pre-notification system for share acquisition. Accordingly, for any share acquisition with a size exceeding the applicable threshold, a notification must be filed with the Japan Fair Trade Commission at least 30 days before the closing. Previously, pre-notification was required only for a merger, business transfer or demerger. The amendment was in line with the global trend. However, it should be noted that this pre-notification will be required in two instances: where the stake in the target company exceeds 20 per cent; and where it exceeds 50 per cent.

Also, an amendment to the corporate law became effective in May 2015, which includes one major change to the procedure for a share acquisition. That is, under the amended corporate law, when a seller company is to sell the shares of its material subsidiary, such sale should be approved by a super majority shareholders’ resolution (ie, at least two-thirds of the votes at a general meeting of shareholders). This requirement is applicable where the book value of shares to be sold exceeds one-fifth of total assets of the seller company, and, as a result of such sale, the target company will not be a subsidiary of the seller company. The impact of this amendment could be significant, since there has been no such requirement for shareholders’ resolution in the case of a share acquisition.

In addition, there is increasing sensitivity to gun-jumping issues between the parties to M&A deals. Exchange of information in the context of M&A transactions would not normally give rise to issues of non-compliance under the Antimonopoly Act. However, it has now been recognised in practice in the case of M&A transactions between global businesses that gun-jumping issues under foreign competition law must be duly taken into account, unlike the situation in prior years where a party could plead ignorance. As a result, this issue has come to significantly affect the information exchange process in the due diligence phase for M&A transactions that have a global aspect.

Describe recent developments in the commercial landscape. Are buyers from outside your country common?

RS & KT: Although, presently, inbound transactions do not seem very active, foreign buyers have become an integral part of M&A practice in Japan. There was a high proportion of buyers from outside Japan in the 1990s when many financially troubled Japanese businesses, including banks, were rescued by foreign buyers, some of which were not well received. Recently, there have not been many inbound transactions



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compared with this surge in the 1990s, but generally there is no longer any discernible bias against buyers from outside Japan in friendly, negotiated deals, and, in this sense, it would be fair to say that foreign buyers are common in Japan.

Are shareholder activists part of the corporate scene? How have they influenced M&A?

RS & KT: Shareholder activists, as well as some attempts at hostile takeovers, experienced something of a boom in Japan in the early 2000s. However, we have not seen much of either since the global financial crisis. One of the reasons may be that some of the key players in shareholder activism and hostile takeovers were involved in scandals and convicted of security fraud. During the era when they were active, a large number of Japanese listed companies introduced a Japanese version of anti-takeover plans (ie, the announcement of possible dilutive issuances of stock acquisition rights). While many of these companies have since abolished the plans because continuation would have been opposed by proxy advisers, such as the Institutional Shareholder Services and many foreign institutional investors, in line with the trend in the US, a significant number of those plans still remain in effect (the statistics of the Tokyo Stock Exchange indicate that approximately 14.6 per cent of the Japanese listed companies adopted such plans in July 2014). It should be noted that Japanese culture is somewhat biased against hostile takeover attempts. For example, it appears to be a general policy of Japanese banks not to provide financial support to hostile takeovers, which seems to have

set a high hurdle to be cleared by acquirers in hostile takeover transactions.

Take us through the typical stages of a transaction in your jurisdiction.

RS & KT: The ways to start a transaction vary, but we understand that, in many cases, contact is initiated through the financial advisers to the parties. However, occasionally, initial contact is made at the top management level.

There is nothing particularly unique about the transaction process in Japan. That is, if both parties are interested in moving forward, a non-disclosure agreement is typically executed first and the due diligence process starts. In many cases, a non-binding or binding memorandum of understanding (MOU) is also executed before the start of the due diligence or after the completion of the preliminary due diligence. In large-scale transactions, an MOU is often executed at an early stage so that full-scale due diligence may be conducted with the participation of a large number of team members. With very few exceptions, only after the completion of the due diligence, which may or may not be comprehensive depending on the particulars of the transaction in question, the parties enter into a definitive agreement. Owing to fiduciary duty concerns, generally, due diligence is viewed in Japan as a ‘must’ for significant transactions. There have recently been many transactions where the buyer is selected through a bidding process, in which case it is sometimes difficult to conduct comprehensive due diligence or heavily negotiate the deal terms.

THE INSIDE TRACK

What factors make mergers and acquisitions practice in your jurisdiction unique?

In Japan, aside from legal theory, it is often unclear as to whose interest is represented by the management of the target company. Almost always, the welfare of the employees is a very important issue. In addition, the possible reaction of governmental authorities and other peers in the relevant industry, not to mention that of suppliers and customers, could be a concern. These factors tend to affect, and sometimes skew, the outcome of the transaction. This may be a matter of cultural differences but there frequently seems to be more substance to it. The Corporate Governance Code has now been introduced by the stock exchanges in Japan at the initiative of the Japanese government with a view to improving the governance of Japanese listed companies. This reform may possibly change the behaviour of the management of Japanese listed companies but it is premature to comment on the impact it may have on M&A transactions.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

A client should certainly consider the availability of resources and in-depth experience for dealing with complicated Japanese law issues; the skill and experience for communication in English, both oral and written; and the capability of efficiently and carefully preparing necessary documentation.

What is the most interesting or unusual matter you have recently worked on, and why?

A client once came to us after 5pm on a Friday and requested that we work on a sizeable M&A transaction, indicating that a certain document needed to be signed the following Monday. We thought that the document would be an NDA or, though unlikely, a simple MOU. It turned out, however, that the client meant the definitive agreement for the deal. The next 48 hours was sheer chaos, but through a great deal of concerted effort, the document was signed as scheduled. This was unprecedented and is likely never to be repeated.

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Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your country?

RS & KT: With respect to legal matters, generally speaking, while there have been some major changes in corporate law and other relevant laws that have been fundamental to mergers and acquisitions over the past several years, we do not expect any further substantial changes in the near future.

As for commercial matters, unless there is any drastic improvement in the Japanese economy, we do not anticipate any significantly favourable changes taking place in the near future. However, we may need to carefully observe how the Chinese economy fares. Unlike the crisis in Europe, a downturn in the Chinese economy would impact Japan.

What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active? Do you foresee any particular geopolitical or macroeconomic developments that will affect deal sizes and activity?

RS & KT: We do not think there will be any drastic change in the next year or so and the active sectors are likely to remain as they are. However, it seems that the retail industry may also become more active in M&A deals, the reason for which, similar to the food and beverage industry, is that the shrinking Japanese population will require retail companies to be more consolidated in the domestic market and expand their business outside Japan.

The state of China's economy will significantly affect geopolitical developments in Japan, including M&A activity. While the country did not experience a harsh impact at the time of the Greek government-debt crisis, we are unable to predict with certainty how business in Japan will be affected by Brexit.

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