Chambers
AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Private Equity 2022

Definitive global law guides offering comparative analysis from top-ranked lawyers

Japan: Trends & Developments

Shuichi Nishimura and Yasuhiro Kasahara
Nagashima Ohno & Tsunematsu

practiceguides.chambers.com

Trends and Developments

Contributed by:
Shuichi Nishimura and Yasuhiro Kasahara
Nagashima Ohno & Tsunematsu see p.6

Investment Deal Trends

The private equity market in Japan continued to be very active in 2021. While there is no official data on the number or type of transactions conducted by private equity firms, it is reported that a historically high number of private equity deals occurred in 2021. Since around 2015, the increase in private equity deals has mainly been driven by the expanding need to find successors for small to mid-size business owners. Recently, however, private equity deals are showing more diversity, such as carve-out deals, taking-private deals, including MBOs, and secondary buyout deals. This is strong evidence that private equity firms are now recognised in the Japanese market and are expanding their role in Japan.

Notable deals from 2021 include the following:

- the acquisition of Q'SAI CO., LTD. by Advantage Partners in January 2021 for approximately JPY42 billion (carve-out);
- the acquisition of Seiyu Co., Ltd. by KKR in March 2021 for approximately JPY173 billion;
- the acquisition of Alinamin Pharmaceutical Co., Ltd. by The Blackstone Group in March 2021 for approximately JPY242 billion (carve-out);
- the acquisition of Tsukui Holdings Corporation by MBK Partners in March 2021 for approximately JPY56 billion (going-private);
- the acquisition of the personal care business of Shiseido Company, Limited by CVC Capital Partners in July 2021 for approximately JPY160 billion (carve-out);
- the acquisition of Kokusai Kogyo Co., Ltd. by Carlyle in September 2021 for approximately JPY24 billion; and
- the acquisition of AG Energy Co., Ltd. by Carlyle in September 2021 for approximately JPY35 billion.

It is notable that there were at least 20 going-private deals by private equity funds in 2021, which is highest in the last five years. Hostile takeover deals are also increasing, in line with recent trends, which are expected to continue.

The secondary market and public-to-private transactions

The number of public-to-private (P2P) deals increased rapidly in 2021, with more than 20 deals. This trend may be explained by the fact that, starting from April 2022, the Tokyo Stock Exchange (TSE) introduced new market segments that made the requirements for the most prestigious market, called the Prime Market, more stringent, such as requiring companies listed on the Prime Market to maintain a minimum level of market capital (at least JPY10 billion) as well as a sufficient number of tradable shares (at least 35%).

While most of the companies previously categorised in the First Section Market passed such stringent requirements and remained in the most prestigious market (the Prime Market), some public companies may have decided to go private as these more stringent regulations and/or increasing pressures from investors such as institutional investors and activists drove up the cost of being a public company. In the secondary market, in which one private equity firm sold its portfolio company(ies) to another, it is reported that there were around ten deals in 2021, which is almost the same level as in recent years.

Looking forward from 2021

As in most other jurisdictions, COVID-19 did not have any significant long-term negative impact on investments by private equity firms, which were more active in 2021 than in 2020. While at least the same level of investment activity by private equity firms is expected in 2022, the weaker Japanese yen may affect the activities of private equity firms. One possible consequence is that it may become easier for global private equity firms to make investments in Japan by taking advantage of the stronger US dollar (or other major currencies).

Increases in resource prices, partially due to the Russia–Ukraine conflict, are also affecting Japanese companies. This may result in an increase in potential target Japanese companies requiring financial support from private equity firms, including the possibility for distressed M&A deals.

Exit Trends

In recent times, there have been approximately 40 to 50 deals per year in which a private equity fund or investor exits their investment (exit deals), but it is reported that the number of exit deals in 2021 was well above this recent average, being probably the highest in the last five years. In particular, there were more than ten IPO exits, which is likely to be an historical high. However, since the Russia–Ukraine conflict began, the IPO market in Japan has become dormant and it is expected that such difficult conditions will continue in the immediate future, leading to fewer IPO exits in 2022.

Recent Amendments to the Foreign Exchange and Foreign Trade Act

Recent amendments to the Foreign Exchange and Foreign Trade Act (FEFTA) have tightened the rules applicable to foreign direct investments to align Japan with the global trend towards strengthening the regulation of foreign investors.

Under FEFTA, when foreign investors (including foreign-based private equity firms) seek to perform certain acts, such as the acquisition of shares in Japanese companies engaged in designated industries, they must file an advance notification to the relevant Japanese ministry(ies) and wait for the 30-day processing period (which is often shortened to two weeks but may be extended to up to five months in very exceptional cases) to elapse before performing such act.

FEFTA amendment

One FEFTA amendment that came into effect on 1 August 2019 expanded the scope of designated industries by adding certain sectors in the information and communication technology and software development industries. Due to this amendment, the number of transactions requiring a prior notification has significantly increased, including investments into tech start-ups.

A subsequent amendment added certain types of actions that trigger an obligation for foreign-based private equity firms to submit prior notifications to the specified government authority, such as making an affirmative vote to elect a foreign investor (including a foreign-based private equity firm) or its affiliated person as an officer of a Japanese company in the designated industry or proposing the transfer or abolition of the business in a designated industry.

Pre-deal examinations

Private equity firms doing deals in Japan should carefully examine whether a company in which it contemplates investing is engaged in any of the designated industries, bearing in mind that such examination may require some time as the classification of the designated industries is not always clear. As mentioned above, the statutory waiting period is generally 30 days, but in practice there is some uncertainty as to whether allowing 30 days for the processing period is sufficient, and a longer period may be required.

After filing such notification, questions from the authority may be anticipated in the examination process, and the 30-day period may elapse before the examination is completed if the answers are not provided on a timely basis. In some cases, conditions may be attached by the specified ministry in relation to a contemplated foreign investment. In these cases, a revised notification may need to be filed that includes a declaration that the foreign investor will comply with such conditions. In these cases, the 30-day waiting period starts again from the date the revised notification is filed.

Fair M&A Guidelines

The "Fair M&A Guidelines: Enhancing Corporate Value and Securing Shareholders' Interests" issued by the Ministry of Economy, Trade and Industry (METI) have influenced M&A practices. In particular, following the publication of these Guidelines, there is a trend towards companies undergoing an M&A transaction to establish special committees to examine the proposed transaction and for such special committees to become more deeply and actively involved at an earlier stage of MBO transactions. It is becoming common for such special committees to be established not only in MBOs and the acquisition of companies by their controlling shareholders but also in other public transactions involving squeeze-outs that are not directly covered by the Guidelines.

Hostile Takeovers

Hostile acquisitions have long been considered taboo in Japan. However, the number of hostile transactions has risen since 2019, some of which ended successfully for the acquirer.

Although there has not been any recent transaction where a private equity fund attempted to acquire a target company against the wishes of the target company's management, this trend of increasing numbers of hostile takeovers has greatly affected investments by private equity funds.

In response to hostile acquisition bids, some target companies attempted to introduce poison pill type defence measures, the validity of which was disputed before the courts. The courts tend to support the validity of such defence measure if the shareholders' meeting approved the implementation thereof. However, given that poison pills are not a perfect defence measure, the increasing number of activities by activist shareholders could potentially induce other types of investments by private equity funds, such as investments from a "white knight".

Shareholder Activism

The presence of activist shareholders in Japan is growing. They are increasingly making various demands of the listed companies in which they hold shares (including dialogue with management), and often submit proposals and express opposition to company proposals at general shareholders' meetings.

In the context of M&A, there have been several recent cases where activist shareholders intervened in M&A deals for listed companies by announcing their opinion that the purchase price was too low or by buying up the target company shares themselves, resulting in the share price in the market exceeding the tender offer price and the tender offer being unsuccessful (including MBO deals by private equity funds). Therefore, in going-private transactions of listed companies, especially in MBO transactions, it is necessary to fully consider the appropriateness of the price and the possibility of intervention by activist shareholders before proceeding with the transaction.

Nagashima Ohno & Tsunematsu is the first integrated full-service law firm in Japan and one of the foremost providers of international and commercial legal services based in Tokyo. The firm's overseas network includes offices in New York, Singapore, Bangkok, Ho Chi Minh City, Hanoi and Shanghai, associated local law firms in Beijing and collaborative relationships with prominent local law firms in many other jurisdictions. In representing leading domestic and international clients, the firm has successfully structured and negotiated many of the largest and most significant corporate, finance and real estate transactions related to Japan. In addition to its capabilities spanning key commercial areas, the firm is known for handling ground-breaking domestic and cross-border risk management/corporate governance cases and large-scale corporate reorganisations. The firm has over 500 lawyers, who work together in customised teams to provide clients with the expertise and experience specifically required for each client matter.

Authors

Shuichi Nishimura is a partner at Nagashima Ohno & Tsunematsu. His main areas of practice are cross-border and domestic M&A, private equity and general corporate. He has vast experience in complex M&A transactions, serving both private equity firms and corporate clients. He graduated with an LLB from Waseda University in 2004 and with an LLM from the University of Southern California Gould School of Law in 2011. He was an Adjunct Lecturer at Aoyama Gakuin University Graduate School of Law from 2018 to 2022.

Yasuhiro Kasahara is a partner at Nagashima Ohno & Tsunematsu. His main areas of practice are cross-border and domestic M&A, private equity, joint ventures and other corporate transactions. He has extensive experience in North, Central and South American matters. He graduated with an LLB from the University of Tokyo in 2005 and with an LLM from Columbia Law School in 2012. He worked at Nagashima Ohno & Tsunematsu NY LLP from 2012 to 2014, and was a Visiting Associate Professor at the University of Tokyo School of Law from 2019 to 2022.

Nagashima Ohno & Tsunematsu

JP Tower
2-7-2 Marunouchi
Chiyoda-ku
Tokyo 100-7036
Japan

Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
Email: yasuhiro_kasahara@noandt.com
Web: www.noandt.com

NAGASHIMA OHNO & TSUNEMATSU

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com