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Japan: Trends & Developments

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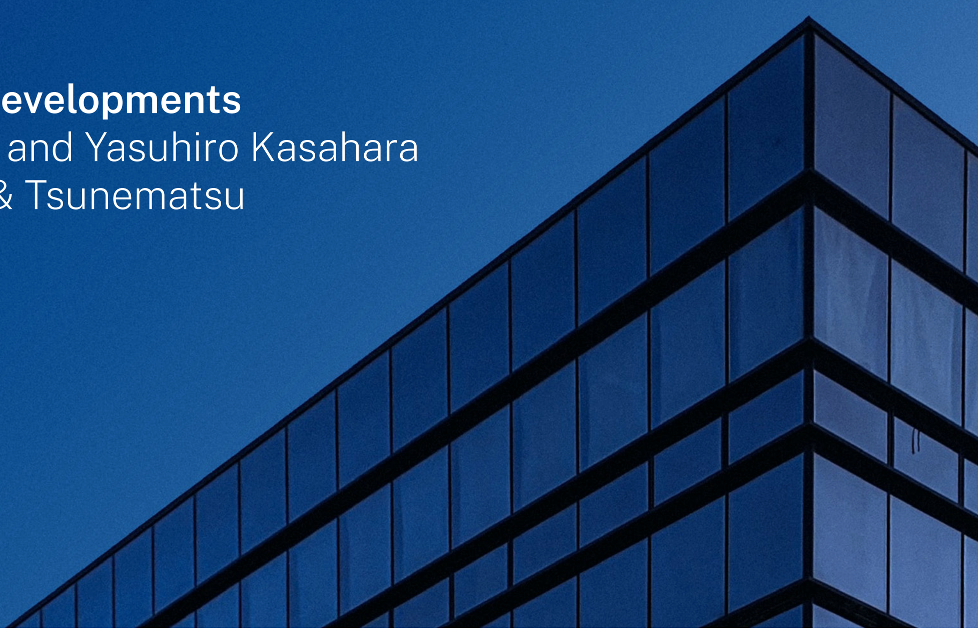

Trends and Developments

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Investment Deal Trends

The private equity market in Japan continued to be very active in 2022. 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 2022. 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 2022 include the following:

- the acquisition of Accordia Golf from MBK Partners by Fortress Investment Group in January 2022 for approximately JPY400 billion;
- the acquisition of Yayoi Co., Ltd. by KKR in March 2022 for approximately JPY240 billion;
- the acquisition of Huis Ten Bosch by PAG in September 2022 for approximately JPY100 billion;
- the acquisition of Shinoken Group Co., Ltd. by Integral Corporation in October 2022 for approximately JPY49 billion (going-private);
- the acquisition of Hitachi Transport System by KKR in December 2022 for approximately JPY600 billion (going-private); and
- the acquisition of Uzabase Inc. by Carlyle in December 2022 for approximately JPY54 billion (going-private).

It is notable that there were around 20 going-private deals by private equity funds in 2022, which is almost the same level as in 2021. 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 continued to be very high in 2022, with around 20 deals. This is a similar number to 2021. 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 companies to another, it is reported that there were around 16 deals in 2022, which is the highest number of such deals in the last five years. This is probably because an IPO exit was very difficult in 2022 (there was only one IPO exit in 2022), which resulted in the increase of exits by sale to another private equity firm.

Looking forward from 2022

While the economy was gradually slowing down in 2022, M&A activities in Japan continued to be very active. This trend is expected to continue in 2023.

Increases in resource prices and the global economic downturn are also affecting Japanese companies and the number of court restructurings and out-of-court restructurings is increasing. It is likely that there will be more distressed M&A deals in 2023.

Exit Trends

It is reported that the number of exit deals in 2022 was slightly above the average in the last five years (approximately 40 to 50 exit deals per year) but decreased compared to 2021, which saw the highest number of exit deals in recent years. As in 2021, the IPO market in Japan has become dormant (with only one IPO in 2022). Partly because the IPO market was dormant, the secondary market was very active (with around 16 deals in 2022, which is the highest number of deals in the last five years). It is expected that the IPO market may recover in 2023.

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 ministries and wait for the 30-day processing period (which may be extended to up to five months in very exceptional cases) to elapse before performing the proposed act.

Private equity firms doing deals in Japan should carefully examine whether a company in which they contemplate investing in 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 and Guidelines for Corporate Takeover

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 that companies, which are undergoing an M&A transaction, are establishing 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 in acquisitions of companies by their controlling shareholders but also in other public transactions involving squeeze-outs that are not directly covered by the these guidelines.

In addition, on 31 August 2023, METI published the Guidelines for Corporate Takeovers. The purpose of these new guidelines will be to present principles and best practices that should be shared among the economy to develop fair rules regarding M&A transactions. The guidelines may encourage more M&A activity targeting listed companies in Japan as they require, among other things, the board of directors of target companies to give sincere consideration to a bona fide offer.

Hostile Takeovers

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

Although there has not been any transaction recently where a private equity fund attempted to acquire a target company against the wishes of the target company's management, the 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 measures 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 (such cases also included 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.

On the other hand, activists sometime drove M&A deals by advocating for going-private transactions or divesture of assets or companies to enhance shareholder value.

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