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Japan Outbound M&A: 2019 Update

Welcome

We are delighted to introduce our Japanese Outbound M&A Update for 2019, our biannual publication in which we review the sector and geographic trends, as well as drivers of and challenges in, outbound M&A from Japan.

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Highlights*

1 Japanese M&A remains **predominantly an outbound M&A story** – outbound (USD98.8 billion, 334 deals) v inbound (USD12.4 billion, 37 deals). Outbound **deal volume increased** (from 311 to 334 deals) but value dropped significantly (USD171.8 billion to USD98.8 billion) – without the 2018 Takeda Pharmaceutical-Shire acquisition (USD79.7 billion) though deal value was slightly up.

2 Japan outbound M&A **remained resilient despite global cross border M&A declining** 7% on geopolitical uncertainties and increasing regulatory oversight – in particular in Europe and the Asia-Pacific region M&A was down by over 20% in value. Japanese companies outspent China for the second year in a row to be the biggest dealmakers in Asia in 2019.

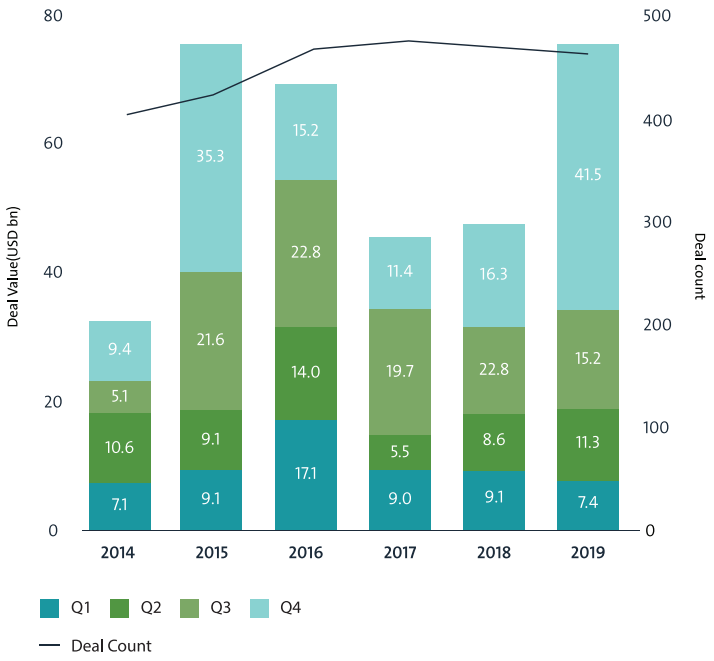
3 The US remained the top destination for outbound M&A, with Australia also remaining one of the top jurisdictions. The **US and Australia accounted for over 60% by deal value**. By deal volume, the UK and Germany remained the top destinations in Europe and for the Asia-Pacific region, India made the top of the list followed by Australia.

4 **Technology, Industrial & Chemicals, Real Estate, Healthcare and Financial Services** were the top sectors in 2019. An **increased focus on sustainability** as more Japanese corporates adopt sustainability development goals (SDGs), is driving increased investment in renewables, battery storage and electric vehicles.

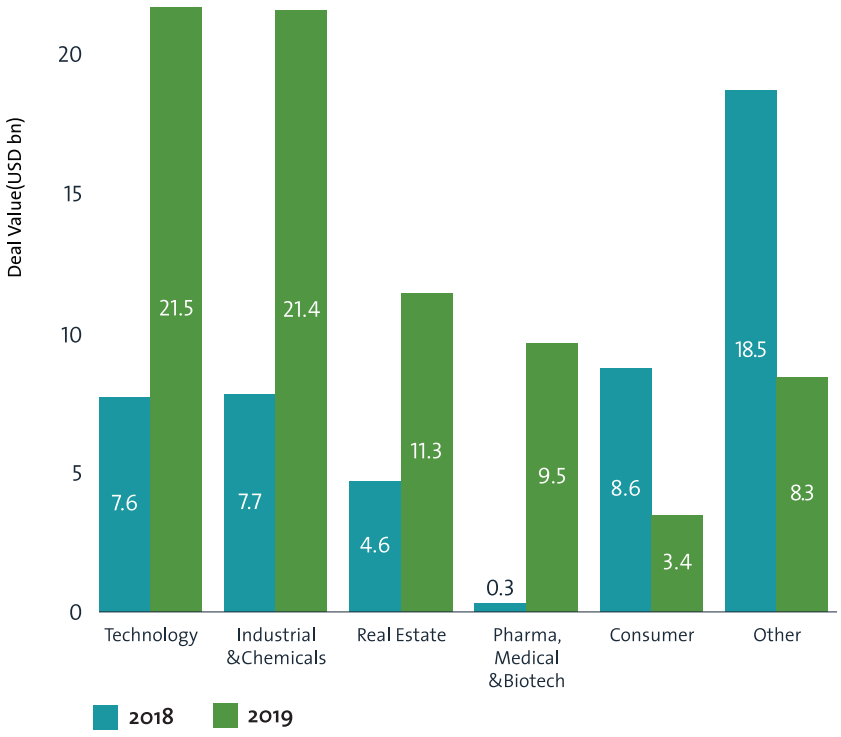
5 **Various domestic and global factors continue to support outbound M&A** – a shrinking domestic market, access to funds, asset recycling, technology disruption and increased Japanese government support.

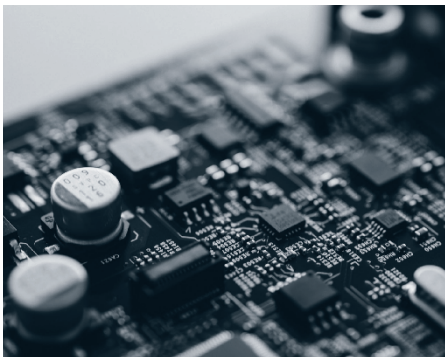
* Based on *Mergermarket* 2018 and 2019 data.

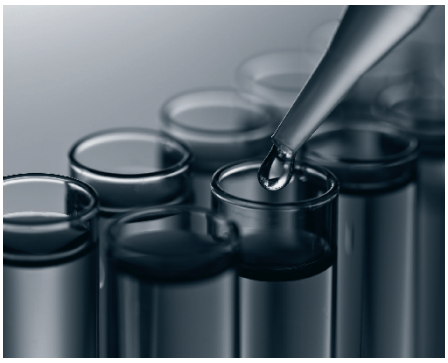
Japan Outbound M&A Trends 2014- 2019
(*Mergermarket* Global 2019 p37)



Japan Outbound M&A Sector Trends – 2018 v 2019
(*Mergermarket* Global 2019 p37)







Sector trends

The **top target sectors** were Technology, Industrial & Chemicals, Real Estate, Healthcare and Financial Services with Consumer remaining strong but declining (*Mergermarkets*, 2019).

Technology

The most active sector. Technology investments are impacting all sectors, with digital transformation a key strategic goal for most Japanese businesses – not just for growth but also for survival.

Industrial & Chemicals

The traditional industry & chemicals investment trend remains strong.

Real Estate

After many years of restraint after the 'Bubble Era', offshore real estate M&A has increased significantly driven by a need for developers to diversify their portfolios overseas to gain returns and investors diversifying outside bonds and stocks to alternative asset classes including real estate.

Healthcare

One of the key growing trends for outbound M&A, including strategic acquisitions to acquire IP, gain scale and invest in further R&D.

Financial services

With low domestic interest rates and a shrinking domestic population, Japanese banks, insurers and asset managers are looking offshore for growth and digital innovation.

Renewable energy

Sustainability is having an increasing impact on Japanese corporates' strategies, driving divestments in thermal coal and coal fired power plants and increasing acquisitions in renewable power, battery storage, electric vehicle infrastructure, digital grid technologies, including their associated tech metals e.g. lithium.

*Based on *Mergermarket* 2019 data.

Geographical trends

The top target geography was the USA. Australia also remained one of the top jurisdictions for Japanese outbound M&A, with the UK and Germany the top two jurisdictions in Europe and India and Australia in the Asia-Pacific region.

1 The USA

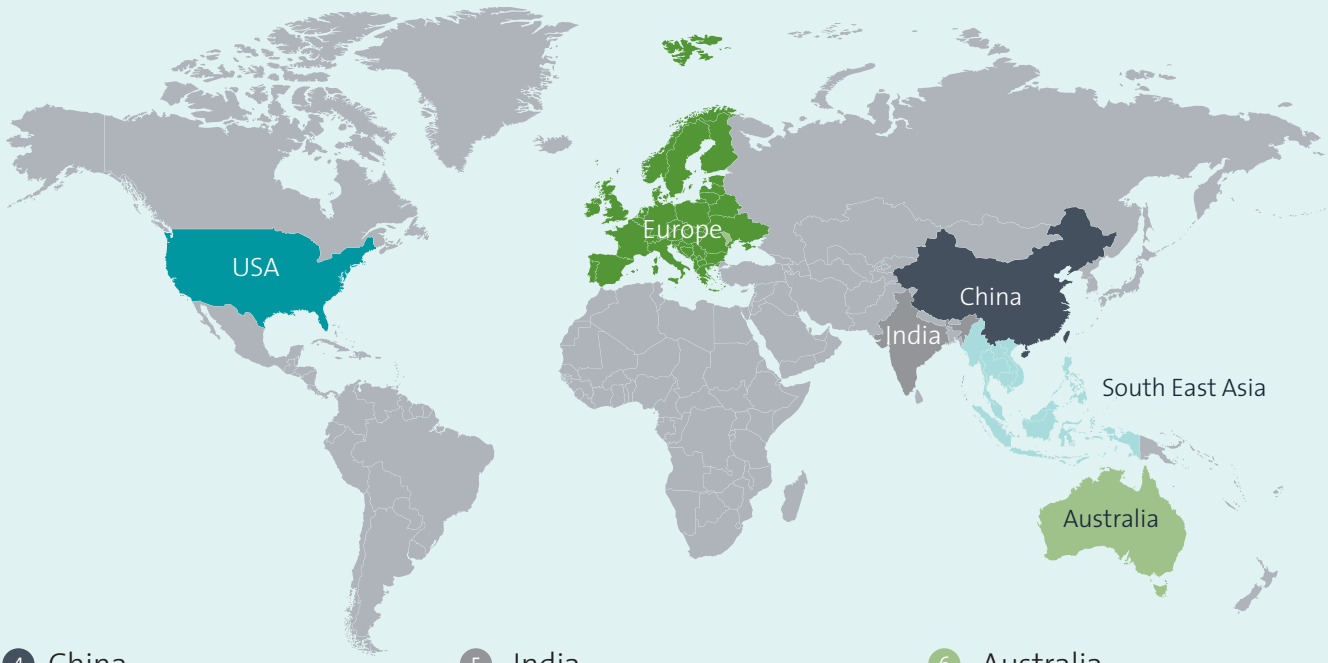
The United States remains the most targeted country for Japanese companies by deal volume. The US and Australia accounted for over 60% of the outbound deal value. The US is in particular popular for technology and mega deal transactions.

2 Europe

Within Europe, the UK and Germany remain the most popular destinations, with an increasing trend towards Germany given its industrial and technology strengths and Brexit uncertainties in the UK. For European M&A in general, inbound activity decreased nearly 30% due to economic concerns and Brexit, with European outbound M&A increasing nearly 30%.

3 South East Asia

Singapore remained one of the top destinations – reflecting both interest directly into Singapore but also the trend of using Singapore as a holding company structure for multi-jurisdictional South East Asian businesses. Vietnam and Thailand were next popular destinations by volume with Indonesia, Malaysia and Myanmar also showing strong interest.



4 China

Whilst increasing wages in China have made some Japanese companies diversify, or relocate, their manufacturing to South East Asia, China remains a strategic outbound M&A interest given its large consumer base. US trade tensions and the Hong Kong protests saw the China/Hong Kong M&A market share drop 30% and increased focus within the region on Singapore, including for deal structuring with the option of an exit on the Singapore stock exchange (given political risk concerns in Hong Kong).

5 India

India was the highest by deal volume in Asia, after a prolonged period of subdued Japanese investment. This significant increase was influenced by regulatory reforms and consolidation across various industries.

6 Australia

Australia remains a significant destination for Japanese outbound M&A, with increasing diversity in sectors and complexity of deals, including public M&A. In particular, this year saw Asahi's takeover of Carlton United Breweries for USD11.3 billion.

*Based on *Mergermarket* 2019 data.

Drivers

There is a mix of domestic and global factors supporting Japan's outbound M&A:

1 Shrinking domestic market

With an ageing population and a declining birth rate, Japanese corporates are continuing to look offshore for growth opportunities in particular in younger and faster growing economies.

2 Significant cash reserves and cheap debt

Japanese companies have an enormous war chest of cash, more than USD890 billion, as well as a strengthening and safe haven currency (at its highest buying power since 2016, Bloomberg). In addition to the cash reserves, Japanese corporates enjoy access to relatively inexpensive financing, with the Bank of Japan maintaining interest rates slightly below zero. Japan will not enjoy this advantage for long as more economies move to low interest rate environments.

3 Portfolio management

Many Japanese companies are reassessing the composition of their portfolios, with more focus on growth areas and the divestment of non-core or underperforming assets or assets at risk of disruption. As a result Japanese corporates are not only buyers offshore, but also sellers. With this increased expertise, and confidence, some Japanese companies are engaging in larger and more complex M&A transactions.

4 Technology disruption

Japanese companies are revisiting their traditional investment models for their sustainability in a digital world – with new consumption patterns, new platforms/ecosystems and new business models resetting the competitive landscape. This is creating divestment, investment and commercial collaboration opportunities.

5 Japanese government support

Japanese government policies are also encouraging outbound M&A. Corporate governance changes under Abenomics, and the risk of shareholder activism, have increased focus on shareholder returns and growth. This has led Japanese companies to more disciplined capital allocation, divesting non-core assets and making more productive purchases offshore. The Japanese government is also supporting outbound M&A through co-equity investments e.g. JBIC, DBJ, JICA.

Challenges

There are also various challenges that Japanese corporates need to address with outbound M&A, whilst some of these will in fact create opportunities for some:

1 Political uncertainties

The China-US trade tensions, growing protectionism and Brexit's impact on the EU, are destabilising global market access and supply chains, causing uncertainties for outbound M&A but also some opportunities for Japanese corporates.

2 PMI

Increasing focus on post-merger integration and the need to prepare during due diligence and deal negotiations for Day 1 post-completion, including the keys to achieving synergies and value from an acquisition – operational integration and cultural alignment.

3 New sources of private capital

As well as traditional private-equity buyers, there is increased pressure for assets from venture capital, corporate venture capital funds, sovereign wealth funds, megafunds and family offices. In particular dedicated utility and infrastructure funds have enormous funds to invest. This will also provide investment opportunities for Japanese corporates e.g. as an investor in those private equity funds - an alternative revenue source in a challenging trading environment.

4 Deal speed

Deal speed remains a challenge for Japanese corporates, in particular in auction processes. We are seeing some corporates take steps to address this by (i) modifying their ringi process e.g. additional meetings and/or different approval structures for digital and venture capital M&A, (ii) building up their internal M&A expertise through dedicated M&A teams and/or hiring in-house M&A experts (lawyers, investment bankers etc.), and (iii) setting up separate entities (e.g. investment funds) which are more agile in their decision-making and can move transactions at a speed that their investing companies could not.

5 Increasing regulatory oversight

Increasing regulatory oversight globally, including enhanced foreign investment regulations, new merger control regimes and increased anti-trust and ABC enforcement, is impacting deal certainty and timing – although the national security measures taken by most governments are focused on Chinese investment, in particular in critical infrastructure and technology, enhancing Japanese corporates competitiveness against their Chinese counterparts.

Future Trends – 2020 the Year Ahead

In Japan, the economic and strategic rationale for outbound M&A, as set out above, **will remain strong**.

We expect to see a continued focus on robust valuations, in-house M&A deal expertise and on PMI preparedness, as well as an increased focus on the use of technology in deal execution e.g. AI in due diligence reviews, for cost and time efficiencies.

Increased regulatory oversight and political uncertainty are likely to be the biggest potential risks to deal making in the short term, however, this may also create M&A opportunities as noted above. Understanding how to position cross-border deals with regulators and other stakeholders will be essential. The increasing technology disruption and political uncertainties will also make Japanese executives review their portfolios more frequently, leading to more divestments and acquisitions.

As identified in almost every Japanese company's mid-term management plan, technology will remain a key focus for growth – and in some cases survival - and M&A will remain a powerful tool to accelerate that. These assets though are popular, including amongst new sources of private capital, so competition will be high.

Japanese corporates will continue to face increased competition from new sources of private capital, some of which will also provide new investment opportunities for Japanese corporates.

Sustainability is a key focus of Japanese corporates in 2020, the Olympics year, and this will drive more investment in clean energy, green infrastructure and smart cities.

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