SAN FRANCISCO
Daily Journal
www.dailyjournal.com

MONDAY, JANUARY 27, 2014

What cross-border mega-deals say for Japan M&A

By Jeff Schrepfer and Masayo Nobe

Those born in the Year of the Horse are known to be energetic and active. Japan's cross-border M&A certainly started off the year with a healthy kick, with the Jan. 13 announcement by Suntory Holdings Ltd., maker of whiskey and beer, including Yamazaki and Premium Malt's brands, of its $16 billion deal to acquire Beam Inc., maker of well-known spirits such as Jim Beam and Maker's Mark. Since Bill Murray's famous *Lost in Translation line*, "[f]or relaxing times, make it Suntory time," back in 2003, Suntory has steadily made an international name for itself through consistently producing award-winning whiskies. Now, Suntory has galloped into the spotlight, announcing a deal that puts several iconic American brands under its umbrella and propels Suntory to being the number three premium spirits company in the world. The $16 billion price tag translates into a valuation of 20.5 times EBITDA, well over the multiple paid in other wine and spirits deals.

The Suntory transaction is the second largest acquisition of a U.S. company by a Japanese company, with Softbank's $21.6 billion acquisition of Sprint, announced in late 2012 and completed last summer, being the largest. If you include the $29 billion merger of equals between Tokyo Electron and Applied Materials, announced in September 2013, the Suntory transaction rounds out the top three largest Japan-U.S. M&A deals of all time.

One might wonder whether the fact that all three of these mega-deals were announced in the last 18 months is merely a coincidence, or whether there are larger economic forces at work. Virtually every discussion regarding Japan's economy for the entirety of last year has focused on "Abenomics," referring to a set of economic reforms that Prime Minister Shinzo Abe announced shortly after taking office in December 2012. Is Abenomics working, and has it sent Japanese companies on a shopping spree?

The Three Arrows of Abenomics

The economic reforms proposed by Abe, dubbed the "three arrows," consist of aggressive monetary, fiscal and structural changes aimed at reawakening the "animal spirits" of the Japanese economy. (The three arrows reference comes from a well-known story, likely apocryphal, about a 16th century feudal lord named Mori Motonari who, in an effort to encourage his three sons to work together for the benefit of the Mori clan, first handed each of them each an arrow and asked them to break it, which they did easily. He then handed them three arrows and asked them to break them all at once, which they were unable to do.) The first arrow involves aggressive monetary easing, aimed at bringing the country out of a 20-year deflationary spiral. In connection with this first arrow, Bank of Japan governor Haruhiko Kuroda, a bank outsider who was appointed to the position in April of last year as part of a significant shakeup by Abe, announced an aggressive program to buy back 7.5 trillion bonds per month. The Bank of Japan also adopted an aggressive target of achieving a consumer price inflation rate of 2 percent over a period of two years.

The second arrow involves a 10.3 trillion yen fiscal stimulus package aimed at achieving short-term growth through government spending, primarily aimed at infrastructure and renewable energy projects. The third arrow involves structural reforms aimed at fostering long-term growth and making Japan "the easiest place in the world to do business."

There was, and still is, no shortage of critics and skeptics of Abenomics, and the jury is likely to be out for the foreseeable future. One of the primary reasons is that launching the third arrow is much more challenging than the first two, and thus far it appears to be falling short of its mark. Although plans for the third arrow were announced last summer, some of the more sweeping, radical changes (such as changes in labor laws that would enable companies to fire employees more easily) did not make the list. In addition, permitting the sale of drugs online, which did make the list, was later scaled back, causing one of its key proponents, Rakuten CEO Hiroshi Mikitani, to announce that he was "fed up" and to resign his positions as advisor to Abe and member of the Industrial Competitiveness Council.

But while no one is confident that the third arrow will be the final shot that will awaken Japan's animal spirit, there is no question that the first two arrows have caused quite a stir, even if only temporarily. The yen has weakened dramatically — down more than 20 percent since Abe took office, which has boosted the earnings of Japan's major export-reliant companies. The stock market is also up significantly as the Nikkei closed out 2013 up 57 percent, a six-year high and, according to Thomson Reuters, the largest gain since 1972. For the first half of 2013, Japan recorded an annualized growth rate of 4 percent, far outperforming any other G7 country. As of December, Haruhiko Kuroda announced that the BOJ had achieved almost half of its target inflation rate, with the core inflation rate at 0.9 percent.

The Role of Abenomics in Japanese M&A

So what does this mean for outbound M&A from Japan? It may be that the economy is indeed inching its way out of stagnation, but it is hard to make the argument that Abenomics has contributed to any increase in outbound M&A. For one thing, there simply is no increase to speak of, according to Thomson Reuters, outbound M&A by Japanese companies peaked in 2012, *before* Abenomics was announced, and slowed in 2013, falling from $85.5 billion spent on acquiring U.S. companies in 2012 to $49 billion spent in 2013. If anything, this trend would suggest that the weaker yen has dampened the appetite of Japanese companies to make more expensive overseas acquisitions, even if future earnings would ultimately benefit from the weaker yen upon repatriation.

Second, with respect to the three mega-deals described above, Abenomics could not have played any part in Softbank's decision to acquire Sprint, which was announced two months before Abe was re-elected prime minister. Since then, the yen has weakened and outbound M&A deals from Japan have decreased. Is it the case then that the Tokyo Electron and Suntory transactions occurred not because of, but *despite* Abenomics?

One could argue that for both Suntory and Tokyo Electron, a confluence of necessity and luck was the driving force behind the companies' bold moves. With respect to the Suntory transaction, Beam had been up for grabs since it was divested from the rest of the Fortune Brands conglomerate, and given the rapid consolidation of the industry, if Suntory hadn't moved when it did, it would have likely lost its only major opportunity to enter the U.S. market. In addition, Suntory and Beam had little overlap in their businesses and serve as distributors for each other's products, providing both an existing business relationship to serve as a foundation for discussions and a favorable story from a regulatory/integration standpoint. Similarly, Tokyo Electron and Applied Materials were faced with a shrinking semiconductor industry, and they had different specialties and CEOs who have known each other for over 30 years. Whether Abenomics or "Abegeddon" (as UBS's Alex Friedman would say), these deals likely would have happened anyway as a matter of survival.

The Role of Abenomics Going Forward

This is not to say, however, that Abenomics has nothing to offer for outbound M&A going forward. If Abenomics has helped energize the stock market, then at least there is more capital available for companies that have access to it, and that may have a positive effect on M&A activity. With respect to Suntory, its acquisition of Beam Inc. may have been enabled in part by the successful listing of its food and beverages subsidiary, supplying Suntory with approximately $4 billion of capital. Similarly, Tokyo Electron's stock price followed the Nikkei and climbed from spring to summer of 2013, which may have encouraged it to pursue the all-stock merger with Applied Materials.

However, whether Abenomics will have any sustained, meaningful impact on outbound M&A from Japan is still unclear. The most likely and immediate effect of Abenomics is that a weaker yen will curb the appetite of most Japanese companies, particularly private companies, to make expensive overseas acquisitions. Although the earnings of Japanese companies that rely heavily on exports will enjoy a boost as a result of the weaker yen, this may not translate into an uptick in outbound M&A, because companies may be reluctant to part with their windfall of excess cash; Abe is experiencing resistance from some of Japan's largest exporters, such as Toyota and Sony, to follow the Abenomics program and to raise the wages of Japanese workers. On the other hand, the combination of a weaker yen and the rise in labor costs may make it more attractive for Japanese companies to shift their operations overseas. In any event, after spending the last two decades in stagnation, and given that many parts of Abenomics have yet to be implemented, many companies may be in a wait-and-see mode. And if real economic recovery is what these companies are waiting for, they may be waiting a long time.

For all the hype around Abenomics, there doesn't seem to be much evidence that it has had any positive impact on Japan's cross-border M&A, and whether it ever will remains unclear until a meaningful third arrow of reforms that make a deeper impact on the Japanese economy is launched. The recent mega-deals aren't a product of Abenomics, but rather a result of certain Japanese companies believing that bold moves are necessary for success. If other Japanese companies follow suit, perhaps it is they, and not Abenomics, that will awaken the animal spirit of Japan M&A.

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