Skadden

Skadden, Arps, Slate, Meagher & Flom LLP
& Affiliates

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Kenton J. King
Palo Alto
650.470.4530
kenton.king@skadden.com

Michael J. Mies
Palo Alto
650.470.3130
michael.mies@skadden.com

Hiroshi Sarumida
New York
212.735.2321
hiroshi.sarumida@skadden.com

* * *

525 University Avenue, Palo Alto, California 94301
Telephone: 650.470.4500

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

The Resurgence of Japanese Outbound M&A

The Nikkei has skyrocketed more than 50 percent over the last six months. Goldman Sachs has issued a report predicting a further 20 percent gain in the index before year-end. Japanese companies were the third-most active group of acquirers in the world in 2012, behind only the U.S. and virtually tied with Canada for second place.

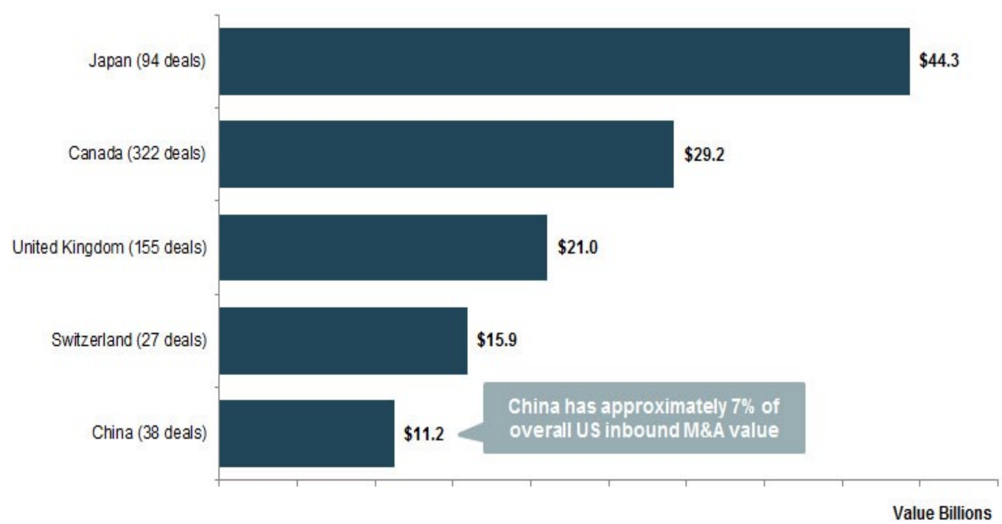
This ferment of activity is taking place largely under the radar — as global attention is far more focused on the potential economic effects accompanying China's emergence on the world stage.

What are the drivers of this uptick in Japanese outbound M&A activity? Is it sustainable? What are the challenges for the Japanese economy and its private sector? What are some practical tips for bridging the inevitable cultural gaps associated with Japanese company dealmaking? The following discusses what is happening in Japan to magnify its participation in the global M&A marketplace and what the future may hold.

Trending Upward: A Look at Record Japanese Activity[1]

From the vantage point of the U.S. M&A market, Japan was the top inbound acquirer of U.S. targets in 2012, with more than one-quarter of the market share of deal value. By contrast, China represented about 7 percent of deal value and was only the fifth-most active acquirer of U.S. companies last year. While Japan's 2012 figure certainly was impacted by the $20.1 billion Softbank/Sprint megadeal announced in October, the country's participation in the U.S. M&A market has been trending steadily upward since 2009. Viewed over a longer period of time, Japanese outbound M&A activity is at an all-time high, far surpassing the late 1980s when Japanese investors were buying Rockefeller Center, Pebble Beach, Columbia Pictures and other high-profile assets worldwide. In fact, the deal value of outbound Japanese M&A in 2012 was more than three times that of 1990, considered the peak year of that era. Yet this resurgence of deal flow has not been a center of focus in the news media today, reflecting our view that Japanese companies appear to be welcome buyers in today's environment.

Top US Inbound Acquirors in 2012



1 Statistics in this section are sourced from Thomson ONE Analytics.

Macroeconomic Drivers

The inexorable effect of population demographics. Not only is the Japanese population declining in absolute numbers, but it also is aging significantly — both trends are stark among the world's top economies and are expected to continue. Japanese corporate managers are aware of this and recognize that the pursuit of top-line revenue growth must take place outside of Japan.

The dramatic increase in value of the Japanese yen since 2008. While it has depreciated against the U.S. dollar since Prime Minister Shinzō Abe made unusually forceful comments on monetary policy shortly before taking office in late 2012, the yen remains at historically high levels. Whether the recent currency depreciation will dampen the appetite of Japanese companies for outbound M&A remains to be seen. The conventional wisdom being purveyed on the streets of Tokyo is that, somewhat perversely, the yen's depreciation may help Japanese companies better compete, providing the needed confidence to fuel continued outbound M&A activity. Projected higher revenues from foreign operations on their yen-denominated income statements (*i.e.*, resulting from a weaker currency) would add to this confidence. Such added confidence, coupled with their need to grow in overseas markets, would outweigh the effects of making outbound acquisitions with more costly foreign currencies.

Key Challenges and Open Questions

In addition to the yen's potential impact on M&A activity, there are a number of key challenges and open questions:

Will the post of prime minister continue to be a revolving door?

There have been seven prime ministers in the six-and-one-half years since Prime Minister Junichiro Koizumi left office in September 2006. Prime Minister Abe has been greeted with significant enthusiasm, but can it be sustained? This summer's upper-house elections will be a key initial test for the new prime minister. Regardless of the outcome, we believe the election will not undercut the fundamental drive for Japanese companies to expand their global operations due to growth limitations in Japan's domestic market.

Will "Abenomics" lead to an end of deflation and put Japan back on a path of economic growth?

Japan has experienced 15 years of falling wages and nearly 15 years of deflation. Purchasing power has been falling faster than prices: Average earnings in Japan have decreased 12.2 percent since the 1997 fiscal year, while a core measure of consumer prices — excluding food and energy — has fallen 6.8 percent. Japan needs a stronger domestic economy to support its growth ambitions. It starts with addressing these issues. The quantitative easing recently announced by the Bank of Japan has been dramatic and well-received by the Japanese financial markets. The question remains whether a pure financial engineering approach, without other effective structural reforms in the economy, can jump-start the Japanese economy, and whether Prime Minister Abe will be able to implement his fiscal and growth policy goals, in addition to his monetary policy agenda.

An additional source of uncertainty is the potential impact of regional tensions on prospects for economic growth — both in terms of territorial disputes and developments in North Korea. In the most recent fiscal year, the U.S. surpassed China as Japan's most significant export market. This is partially as a result of the slowing growth rate of the Chinese economy — but undoubtedly attributable to increased tension in the China-Japan relationship.

Can Japanese companies become global players through outbound acquisitions?

While there certainly are global Japanese companies and, at some level, many already are world players, there is a profound lack of confidence among many Japanese corporate managers that they truly can operate smoothly and effectively in international settings and direct heterogeneous management teams across borders capably. Language and cultural differences continue to represent profound gaps that are difficult to overcome. This presents challenges for Japanese companies seeking inorganic growth through cross-border M&A. Japanese acquirers tend to retain the management teams and employees of target companies, and a critical challenge for those that engage in cross-border M&A and seek to become global is achieving effective communications and integration.

Can Japan achieve a more open and dynamic business environment?

This issue is more about opportunities for M&A within Japan, particularly deals driven by private equity funds. From a structural standpoint, Japan should be ripe territory for private equity fund-sponsored acquisitions. Many large Japanese companies have orphaned businesses and need to focus on core strategic areas and rationalize their operations. Yet Japanese companies traditionally have been reluctant asset sellers, and do not have built-in, entrepreneurial management teams to run spun-off businesses that can partner with private equity funds. A shift in perspective and culture in this area, as evidenced in some recent business combinations and carve-out transactions in Japan, would have far-reaching effects on opportunities for M&A within the country.

Tips for Bridging Cultural Gaps With a Japanese Company in the Deal Process

Conventional wisdom is that the Japanese cultural need for obtaining consensus may ensure the certainty of closing a transaction, but can be a significant roadblock to timely dealmaking and conflicts with today's fast-paced, continuously changing deal environment. However, having a good understanding of the cultural and business aspects of a potential transaction with Japanese buyers can help ensure a smooth process. For example, the sell-side team should be ready for:

- extensive due diligence with many highly detailed questions and requests;
- a strong reluctance to price in risk, generally resulting in extensive representations and indemnification requests;
- a transaction team with a need to communicate with the higher-level decision makers in Japan, creating time lags in the dealmaking process, in particular due to time differences; and
- differing expectations as to corporate governance and process matters (*e.g.*, the relationship between a U.S. target's CEO and his or her board of directors).

Despite these challenges, there are some very good reasons to include a Japanese buyer in any sales process. First and foremost, Japanese buyers have a history of offering competitive and fully priced deals, possibly even more so under "Abenomics," which has eased financing issues. Additionally, once consensus has been achieved, Japanese companies are incentivized to move quickly and are highly committed to sign and close over just about any adverse situation.

Given global trends and the larger macroeconomic drivers of Japanese M&A activity, any company thinking about a strategic transaction would be well-advised to consider companies located in Japan as well as part of the universe of potential counterparties. Notwithstanding some challenges, with some attention to the issues and experience in handling them, dealmaking can get done and result in transactions that are beneficial to all stakeholders.