

Shareholder's activism, M&A in Japan already back in business?

Buyout funds day is closing by.

Merger and acquisitions are back on the agenda in Japanese market. Offshore & onshore shareholder activist, buy-out and private equity funds are raising profile.

One of the core reasons I have constantly insisted on the fact that a value strategy is a winning strategy in Japan is the still untapped potential to increase shareholders value for the Japanese universe.

In the aftermath of Murakami's mauling I thought that shareholder activism would adopt low profile for the very short term but that period may already be over.

I noticed with interest an article quoted in the 'scramble' section of Nikkei Financial Daily 11th of July 2006: Steel Partners Japanese chief representative Kuroda Kenji had given his resignation by June end. It is also reported that his explanation for such a move was that US Steel Partners requests were too aggressive and straightforward for Japanese way of doing business. As Kuroda has now left, Steel Partners direct instructions will come from US based CIO and are sure to hit the market sooner than later in a more aggressive tone. The Nikkei Financial Daily report that a previous example was the Korean market. Steel Partners teamed with the famous US activist C. Icahn to launch a full assault on Korean tobacco giant KT&G and they succeeded to secure external seat at the shareholders meeting. It looks like the market is still expecting other moves by the Icahn Steel Partnership team considering the frontier between shareholder's activism and pure buy-out (LBO) funds became less than clear.

For very large LBO funds the article mentions the example of London based Permira which has a buying power of close to 1 trillion 500 billion Yen (10 billion euros). The Permira Japanese local representative stresses that from an economic cycle point of view Japanese market looks attractive.

US Carlyle also recently set up a new 200 billion Yen fund specially targeted at Japan.

One of the reasons mentioned behind the lack of M&A funds related activity in Japan is the fact that Japanese companies would traditionally use standard banking facilities to finance acquisitions. With the end of ZIRP and the 'normalization' of Japanese economy European and US investment banks have started to promote the use of M&A funds in Japan to ease the financial burden of companies financing acquisitions.

This said buyout funds will still need the facilities of Japanese banking system to proceed as it has already been the case in US or Europe. Not surprising that foreign M&A funds are looking toward Japanese market with envy.

The 30th of June World second largest buyout fund, US Bains capital announced they were setting up a Tokyo office. Sugimoto Yuji from RHJ International (ex Ripplewood) has been appointed managing director from July. Recently World number four US Texas Pacific Group has done the same.

To summarize the world largest buyout funds are coming onshore to Japan in droves.

This is why I am a strong believer in using fundamental Merger and acquisition related ratios. But that is not enough, the little plus is inside market know-how (by know-how, I mean deep knowledge of the market) without which it would prove difficult to build a highly geared portfolio.

Now what to buy?

Although I believed, like Kimura San, new growth markets had already bottomed the 15th of July another margin settlement led wave of selling has capped the rebound.

On the leading stocks front it is a different story 3rd quarter current earnings are strong. Large industry core companies are mostly revising up for the April June quarter earnings. (6752) Matsushita is an interesting example, April June earnings were above expectations thanks to TFT flat screen sales. This said consolidated ROE is still low at 5 %. In an interview to the Nikkei the 25th of July Matsushita new CEO (appointed by June end) said that he was targeting a 10 % consolidated ROE by 2010. To reach that target Otsubo Fumio intend to increase global sales, cut costs and *explore new business fields*, for this last option external growth strategy is in sight. I feel this sound very positive and a leap forward for Matsushita group. Market sources strongly believe that Matsushita need totally new business model to reach such an ambitious goal.

More generally speaking when it comes to selecting target companies for purchase the key point remain to find a good balance between short term and long term benefit potential. 80 % of a company's value stems from long term earnings potential. Those are the lessons learned from the fall of Japan largest activist fund.