OUTLOOK 07: Bankers Prepare For Resurgent Japan M&A Boom
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TOKYO (Dow Jones)--Bankers and lawyers are getting ready for a busy M&A schedule in 2007 that is likely to be driven by corporate Japan's need to restructure, its hunger for foreign acquisitions and a push by foreign firms to take advantage of opportunities in the world's second-biggest economy.

Growth in Japan-related mergers and acquisitions slowed in 2006, with the number of announced deals rising just 1.9% on year to 2,495 in the first 11 months after soaring 23% in 2005 and 28% the year earlier, according to Recof Corp., a Japanese firm that tracks M&A activity.

But deal making in Japan broke fresh ground in 2006, when the first-ever hostile takeover bid by one Japanese blue-chip company for another shattered taboos and signaled Japan is poised to pursue aggressive M&As in years ahead.

And M&A professionals say deal making will gather steam again in 2007. Banks, law firms, and even small M&A boutiques are expanding to cash in on the growing demand for advice.

"Japan now is very reminiscent of New York in the 1980s," said Scott Jones, an M&A lawyer at U.S. law firm Jones Day, which has been growing rapidly in Japan.

Analysts point to several factors that will underpin the deal activity. Many companies are burdened with weak businesses, and more seek to expand overseas in the face of limited prospects for expansion in Japan.

Japan is also a fertile hunting ground for foreigners. Relaxed rules on share-swap mergers involving foreign firms from next year will make it easier for foreigners acquire Japanese firms - many of which are tiny compared to global peers. Big companies are loaded with potential for spin-offs and management buy-outs, while many smaller cash-rich but undervalued firms present opportunities for investment funds.

"We expect to see M&A activity pretty much across the board," said Arthur Ozeki, head of M&A at UBS Securities in Japan. "We're hiring very aggressively, and we'll be hiring very aggressively into 2007."

Restructuring will drive deals next year, continuing a process that has transformed the face of virtually every industry in Japan over the last decade or so.

That's good news for investors. As Japan's banking industry shrank from 12 banks to three banking groups, the steel industry from five makers to two major groups and the shipping industry from six major firms to three, earnings improved as excessive competition was eliminated, says Nikko Citigroup.

Opportunities for consolidation abound, everywhere from consumer finance, which is reeling from a government crackdown on lending at high interest rates, to big electronics makers, which are plagued by hyper-competition in many product areas.

"Even a product like rice makers has eight major companies... competing for market share," Nikko Citigroup strategists Aiko Tojo and Tsutomu Fujita wrote in a report. "We have not noticed such excessive competition in any other country."

Companies also appear ready to get tough, as a hostile bid by Oji Paper Co. - backed by Nomura Securities - for Hokuetsu Paper Mills Ltd. showed in July. About 60% of major companies take a favorable view of hostile bids, a survey by the Japan Center for Economic Research and Nikkei Financial Daily showed.

"I think for a while there's going to be a lot of different experimentation around hostile deals," said Kenneth Siegel, an M&A lawyer at Morrison Foerster who heads the U.S. law firm's Tokyo office, which is expanding to take capture growing business.

Breaking Through The Wall

Corporate Japan, with stronger balance sheets, flush with cash and in need of larger markets, is showing renewed desire to venture overseas for acquisitions.

Toshiba Corp.'s $4.16 billion acquisition of Westinghouse in October marked a bid to make nuclear power a pillar of its growth. Nippon Sheet Glass Co.'s purchase of Pilkington Plc, which transformed it into the world's largest maker of sheet glass, showed that Japanese firms aren't hesitant to acquire bigger rivals.

"There's a strong sense of confidence in Japanese management to grow the business rather than just try to maintain the status quo," said UBS' Ozeki, who advised the Japanese company.

"In the words of the chairman of one company I met with: 'We want to break through the wall,'" Ozeki said. "Companies like this are intrigued by the Nippon Sheet Glass transaction.... Japanese companies now have wish lists."

Japan will also present many opportunities for foreign companies and investors. The government is set to permit triangular mergers from May, enabling Japanese subsidiaries of foreign firms to use shares in their parents as currency when they buy Japanese targets. That has sparked calls from Japan's biggest business lobby, Nippon Keidanren, to water down the planned change. But the government appears set on trying to spur more investment into Japan to help the nation raise its productivity.

Japan's steel industry has been gripped with fear since Mittal Steel Co. made a takeover bid for rival Arcelor in January, prompting Nippon Steel Corp. to tighten its ties with South Korea's Posco. Others also appear vulnerable: Japanese retail giant Aeon Co. has just 9.3% the market capitalization of Wal-Mart Stores Inc. Ajinomoto Co. is 5.7% the size of Nestle SA.

"There are foreign companies that can't grow on their own in Japan and need to make an acquisition," said Nobuo Sayama, a partner at M&A advisory boutique GCA Co., which went public earlier this year.

Foreign private equity firms, which have cut few major deals in Japan despite blockbuster acquisitions in almost every other major market in the world, are also building up their presence in Japan. For example, Carlyle Group LP, which entered Japan in 2001, said in July it raised Y215.6 billion for a second buyout fund. Kohlberg Kravis Roberts & Co. set up its first permanent presence in Tokyo in April.

"What they're doing is trying to originate their own deals, which is the mid-size (management buy-out) or (leveraged buy-out). Or, they're going to try to go to a Hitachi and just say 'I'm going to buy your whole company because I've got $40 billion and here's a check. Whom should I write it out to?'" said M&A lawyer Siegel.

Investment funds are also likely to step up activity in Japan. Steel Partners, a U.S. fund that jolted the business establishment three years ago with hostile bids for two small firms, made a comeback in October with a hostile bid for a noodle maker.

"There are many companies with inefficient management and low stock prices, so there are lots of opportunities," said GCA's Sayama. "As long as there are companies like that around, there will be funds like Steel Partners."

Faced with such threats, many companies have been buying back shares, hiking dividends or trying to communicate more effectively with their shareholders in an effort to increase their market capitalization.

Others have been putting in place defense schemes, such as poison pills. 15 Japanese firms adopted poison pills in 2005, and the tally for 2006 is likely to top 140, said Marc Goldstein, representative director at **Institutional Shareholder Services** in Tokyo.

But bankers said such defenses won't stem the rising tide of M&As, friendly or otherwise. "Japan's M&A market is still immature, and I think it will keep growing for years," said GCA's Sayama.

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