

Barbarians at the Fortress Gate: SoftBank Shows its Global Ambitions

SoftBank Group Corp (TYO:9984)—market cap as of 17/02/17: ¥88.84tn (€74.19bn)

Fortress Investment Group LLC (NYSE:FIG)—market cap as of 17/02/17: \$3.08bn

Introduction

On February 14, 2017, the Japanese conglomerate SoftBank Group Corp. announced the acquisition of Fortress Investment Group LLC for \$3.3bn in cash. The deal represents a radical departure from SoftBank's traditional technology and telecommunications holdings, but it is in line with other recent endeavors such as the \$100bn "SoftBank Vision Fund" which is just weeks away from launch.

About SoftBank Group Corp.

SoftBank was established in 1981 by Mr. Son (current Chairman and CEO) as a distributor of packaged software. Since then, the firm has adopted a very aggressive external growth strategy and, as of today, SoftBank Group Corp. is a pure holding company with more than 740 subsidiaries.

The corporation's main segment is "Domestic Telecommunications" which owns, among others, SoftBank Corp. and Wireless City Planning Inc. and which focuses mainly on selling mobile devices and providing telecommunications and mobile communications services in Japan.

SoftBank provides the same telecom services also in the US, through the subsidiary Sprint Corporation. Moreover, the conglomerate holds 43% voting rights in Yahoo Japan Corporation, which operates in the business of internet advertising and e-commerce, and is active in the distribution of software, peripherals, and mobile device accessories.

Overall, SoftBank appears as a very well diversified TMT empire with solid financial results: FY2015 net sales of ¥8.8tn (€74.2bn) and net income of ¥474.1bn (€3.96bn) show respectively a 4-year CAGR of 40.5% and of 14.7%. Total assets have jumped from ¥7.2tn (€60.28bn) in 2012 to ¥20.7tn (€172.9bn) in 2015. This rapid external growth, however, has also compressed margins and increased the leverage of the firm. Operating margin has halved from 21.1% in 2011 to 10.2% in 2015. Net Debt to EBITDA ratio, which as of FY2011 was just 0.5x, is, as of FY2015, 3.8x.

In October 2016, Mr. Son announced the creation of "SoftBank Vision Fund" - a UK-based fund which will invest in large technology companies and may reach \$100bn in AUM. The fund, which is expected to launch in the coming weeks, has received a \$45bn capital commitment from Saudi Arabia sovereign wealth fund, \$25bn from SoftBank itself and smaller contributions from Apple and Oracle, among others.

About Fortress Investment Group LLC

Fortress Investment Group LLC is a global and diversified investment manager. Founded in 1998 with \$400m AUM, Fortress now manages \$70.1bn through Private Equity, Credit and Liquid Funds.

Fortress' flagship product is credit: through several PE funds and Hedge Funds focused on distressed and undervalued assets, the firm manages a combined \$18.3bn in this segment.

The traditional PE business, which makes control-oriented investments in cash-flow generating and asset backed business manages \$13.9bn.

Finally, \$4.5bn are invested by the Liquid Markets Division, which adopts a global macro approach.

The remaining AUM are overseen by the traditional Asset Management Business, named Logan Circle Partners.

Fortress has been the first large Private Equity firm to become publicly traded in the US. Indeed, in 2007, it went public on the NYSE for \$18.50 per share. Pre-deal share price was just \$5.85, and the stock has been trading on similar levels since 2009 – a clear signal of the difficulties that the firm has faced since the financial crisis.

Industry Overview

This deal is one of a series in which an Asian conglomerate buys an overseas investment firm.

On January 17, 2017, HNA Group - a Chinese conglomerate with interests that span in aviation, real estate, logistics and several other industries, announced the acquisition of SkyBridge Capital, a Fund of Hedge Funds firm.

SoftBank's founder Mr. Son, has recently stated that he is planning to create a "Berkshire Hathaway of the tech industry" while HNA Group reported that its acquisitions of financial services firms are steps in "building a global asset management business". Indeed, many Asian companies are sitting on stockpiles of money and have the ambition of becoming financial conglomerates.

When these giant conglomerates scout for investment opportunities, overseas private equity and insurance firms naturally make the list of targets. Buying investment firms like Fortress and SkyBridge offer the Asian buyers a deeper insight in the US markets. This can be extremely valuable, considering that many of these conglomerates own business that operate in several US sectors. Moreover, they can provide access to wealthy investors and synergies with other investment arms owned by the conglomerate.

Deal structure

In the all-cash SoftBank acquisition of Fortress, the acquirer offered \$8.08 per each class-A share of Fortress, which represents a 38.6% premium above market prices at the announcement date of the transaction. Further, each Fortress shareholder may receive up to two quarterly dividends before the closing of the transaction, in an amount that does not exceed Fortress' current level of \$0.09 per share.

All told, SoftBank will now oversee assets under management of \$170bn, making it one of the largest private investors in the world after the Blackstone Group, which manages about \$330 billion.

The top managers at Fortress—Pete Briger, Wes Edens, and Randy Nardone—will continue to lead the business unit and will invest 50% of their after-tax proceeds from the deal in Fortress' products. This may highlight concerns with interest alignment in the combined company.

Under the terms of the deal, Fortress will become an independent subsidiary of SoftBank. Fortress's principals, who control roughly a third of the firm's voting shares, have agreed to vote in favor of the sale, which is expected to close by year's end.

Deal rationale

The purchase of Fortress is part of SoftBank's plan - announced in October - to collaborate with Saudi Arabia and other investors to launch a \$100bn technology fund - SoftBank Vision Fund – which will be headed by Rajeev Misra, a former trader at Fortress, and will likely be the first of several funds.

The Japanese telecommunications giant is essentially buying a completely autonomous investment platform to suit Masayoshi Son's often controversial purchases, without exposing SoftBank. The purchase will yield \$70.1bn assets under management and 1,100 employees.

Several analysts also suggested that the real focus of the acquisition is the investment in Fortress' human capital. If so, Masayoshi Son must have very strong faith in Fortress's expertise as the investment firm did not come cheap, and its employees have always been compensated generously.

Nonetheless, while not cheap (given the 38.6% premium), Fortress can still be considered bought at a discount. Such discount comes as a result of a series of events that affected the private equity firm in the past years. Indeed, the firm's IPO, in February 2007, valued it at \$7.4bn with the company's value quickly surging to \$14bn. About a year and a half later, the financial crisis in 2008 dealt a heavy blow to Fortress whose share price (pre deal) was trading at an 80% discount to the IPO price.

Market reaction

SoftBank's stock initially rose by 1.6% on the day of announcement but started falling in the following days. It is currently trading at ¥8,518 (€68.13, as of 17/02/17), a 0.2% decrease of the price before the announcement. Fortress, on the other hand rose by 6.5% on the day prior the announcement and a further 28.6% on the next day before closing at \$7.99 per share.

Financial Advisors

Softbank was advised by KPMG and JP Morgan, whereas Morgan Stanley and Evercore Partners advised Fortress.