Japanese Deal Recap

Japan's Yen Carry Trade Unravels

The dramatic unravelling of Japan's yen carry trade earlier this summer has continued reverberating through global markets weeks after the initial turmoil. In late July, the Bank of Japan made a pivotal shift in monetary policy, raising the target rate for 10-year government bonds and scaling back bond purchases—moves that signalled the end of a decade-long era of ultra-loose monetary policy. Though modest compared to global standards, these actions were enough to send the yen soaring and disrupt a financial strategy that had long been a cornerstone of global trading: the yen carry trade.

As investors rushed to unwind their positions, the yen appreciated rapidly, climbing from over 161 to 142 against the dollar in days. This abrupt 12% gain wiped out the profitability of many carry trades, triggering a cascade of losses across markets. The fallout wasn't confined to currency markets; equities also saw sharp declines, underscoring the relevance of Japan's policies to global financial flows.

Weeks after the initial shock, the market's attention has shifted to what will happen next. Will the BOJ take further steps to tighten policy, or will it revert to its historically cautious stance? The implications for Japan's economy—and global markets reliant on yen-funded trades—make this a defining moment in Japan's financial stance.

Meanwhile, Japan is contending with the effects of a record-breaking surge in tourism, which has reignited debates about over-tourism and economic equity. The government is considering a controversial two-tier pricing model to charge foreign visitors more than locals, reflecting a broader struggle with confidence and pricing power. Despite an influx of tourists, Japanese households remain cautious, with overseas travel stuck at just 60% of pre-COVID levels, hampered by the yen's prolonged weakness.

This currency vulnerability has exacerbated a negative terms-of-trade crisis for a nation heavily reliant on energy, food, and raw materials imports. While exporters benefit from the weak yen, households bear the burden of higher costs. Their finances are stretched by cost-push inflation rather than the demand-driven version that could spark genuine economic optimism.

Notably, the BOJ's projections now point to rising service prices driven by wage increases, a potential shift toward inflation being increasingly anchored in domestic factors rather than soaring import costs. Marcel Thieliant, chief Asia-Pacific economist at Capital Economics, noted that this new language reflects growing confidence in the sustainability of inflation. Similarly, Stefan Angrick, senior economist at Moody's Analytics, highlighted that the BOJ's growth and inflation forecasts suggest further rate rises remain under consideration.

More data is needed to gauge whether the BOJ's policy shifts will stabilise the yen without derailing growth, but the stakes are clear. As Japan navigates these challenges, its economy remains a study in contrasts—booming tourism alongside fragile household confidence and export strength against import dependency—all underscored by a pivotal moment for its currency and monetary policy.

The Intersection of Japan's Economic Shifts and Its M&A Market

Despite the economic challenges of a rising yen, inflation pressures, and subdued household confidence, Japan's M&A market is thriving. The ongoing corporate restructuring, bolstered by government reforms and increased shareholder activism, has created a favourable environment for deal-making. A weaker yen has also made Japanese assets more attractive to foreign investors. At the same time, reforms by METI and the Tokyo Stock Exchange have strengthened corporate governance and encouraged companies to evaluate takeover proposals with "good faith".

Ample liquidity, with cash reserves on corporate balance sheets and private equity funds, fuels this momentum. Strategic sectors such as energy, technology, and healthcare are seeing increased activity, with Japanese firms leveraging cross-border opportunities while foreign investors capitalise on undervalued assets in Japan. The market is booming, with deal volumes rising 20% in the first half of 2024 compared to 2023. Japan-related M&A accounted for over 20% of Asia's total transactions—the highest share in four years—highlighting its regional significance.

One deal exemplifying this activity is the potential sale of Fujitec [TYO: 6406], a $2.7bn lift maker, to private equity groups. Fujitec, which has seen its valuation soar amid pressure from activist investors like Oasis and Farallon, is exploring options with UBS as its advisor. The company has engaged in discussions with multiple private equity firms, including Sweden's EQT [XSTO: EQT]. Fujitec's appeal lies in its high-margin maintenance contracts and potential for consolidation within the fragmented global elevator industry.

As Japanese firms like Fujitec revamp their strategies and attract foreign capital, the M&A landscape reflects a pivotal shift in how companies position themselves for global competition. This thriving activity demonstrates Japan's ability to leverage corporate and policy-driven reforms to overcome domestic economic pressures.

The 7-Eleven Corporate Battle

The ongoing battle for Seven & i Holdings [TYO: 3382], the Japanese operator of 7-Eleven, has intensified, marking a pivotal moment in Japan's corporate landscape. In September, we wrote about the initial bid by Canadian convenience store giant Alimentation Couche-Tard [TSE: ATD] to acquire Seven & i for $39 billion. While the bid would have been the largest foreign takeover in Japan's history, a special committee swiftly rejected it, citing undervaluation and potential regulatory challenges in the US. Read the article here!

In November, Couche-Tard raised the stakes with a revised offer of nearly $47bn, a 20% increase from its initial bid. This new proposal highlights the Canadian company's determination to consolidate its position as a global leader in the convenience store industry. If successful, the deal would create one of the largest retail chains worldwide, combining Couche-Tard's Circle K network with Seven & i's dominant footprint in Japan, the US, and beyond. However, Seven & i's board remains resistant, focusing instead on convincing investors of its ability to enhance value independently. The company has accelerated plans to divest non-core assets, including Seven Bank and its supermarket business, to streamline operations and reinforce its core convenience store focus.

Adding further complexity, the founding Ito family has entered the fray with a proposal to take Seven & i private. The family has set an ambitious goal to raise over ¥8tn ($52bn) by the end of the fiscal year, leveraging a special purpose company and support from Japan's largest banks and global investment firms such as KKR, Bain Capital, and Apollo Global Management. This move would allow Seven & i to remain under current management while shielding it from shareholder pressure to sell additional assets or accept an external takeover. Some observers speculate that the buyout proposal could also serve as a tactic to force Couche-Tard to increase its bid further.

Whether Seven & i opts for a strategic sale, goes private under the Ito family, or remains independent, the outcome will have far-reaching implications for the global convenience store industry, setting the tone for future cross-border acquisitions in Japan.

Nippon Steel Situation

On December 18, 2023, Nippon Steel [TYO: 5401] announced the acquisition of U.S. Steel [NYSE: X] for an enterprise value of almost $15bn, offering $55 per share, a 40% premium on U.S. Steel's closing price on December 15, 2023. Nippon Steel is Japan's largest steel producer and fourth globally. It operates in four main areas: steelmaking, engineering, chemicals, and system solutions. U.S. Steel, headquartered in Pittsburgh, Pennsylvania, is an American steel producer with facilities in the U.S. and Central Europe. In 2008, it was the eighth-largest steel producer globally, but it ranked 24th in 2024 and third in the U.S. behind Nucor and Cleveland-Cliffs. The acquisition aims to help Nippon Steel counter weak demand in Japan and strengthen its position globally, particularly against competition from China, which produces more than half of the world's steel. The combined company would have an annual crude steel production capacity of 86mn tons, reducing the gap with the world's largest steelmaker, China Baowu Steel Group.

The merger faced strong opposition in the United States, and its completion is still uncertain. Politicians from both parties have criticized the deal, expressing concerns over a 123-year-old American company being bought by a foreign firm. The United Steelworkers (USW) union, headquartered in Pennsylvania, also opposed the acquisition. This further amplified the issue as Pennsylvania is known as one of the main swing states, representing an important voter base for the 2024 presidential election. As soon as the deal became public, USW president David McCall criticized Nippon Steel for not consulting with its leaders during the negotiations, unlike Cleveland-Cliffs, another bidder for U.S. Steel, which had engaged with the union. USW claimed the acquisition violated an agreement requiring U.S. Steel to inform it about any change in control. It also raised national security concerns and pointed out gaps in the commitments Nippon Steel had offered. The firm opposition from the union was followed by political figures.

In January 2024, former President Donald Trump, already the leading Republican candidate at the time, announced he would block the deal if elected. President Biden, who emphasized his pro-union stance, also opposed the deal. However, Nippon Steel hired former U.S. Secretary of State Mike Pompeo as an advisor to lobby for the acquisition and, to address concerns, it pledged to invest $1.4bn in U.S. Steel's facilities and relocate its U.S. headquarters from Houston to Pittsburgh, U.S. Steel's base. It sent Takahiro Mori, its vice chairman and key negotiator, to engage with key counterparty stakeholders and withdrew from a joint venture in China to ease U.S. regulatory concerns.

In March, President Biden described the deal as a threat to national security, in a move that was not well received by the U.S.'s most important ally in the Indo-Pacific, while the USW endorsed him for re-election. The deal, however, received approval from U.S. Steel shareholders and faced little regulatory scrutiny outside the United States, gaining clearance from the EU.

In September, the Committee on Foreign Investment in the United States (CFIUS) extended its national security review of the deal by 90 days. Although it had concluded that the deal posed unmitigated risks, formal recommendations to the President were delayed, possibly due to disagreements from both the State Department and the Pentagon. Additionally, U.S. Steel warned that thousands of jobs could be lost if the acquisition was blocked and Nippon Steel stopped negotiations with USW McCall after an arbitrator ruled in its favour.

By November, Nippon Steel had committed to investing $3bn in U.S. facilities and sent its executives to meet local officials and workers in Pennsylvania and Washington. The Japanese group shifted its focus to communicating directly with regular USW members, with some showing support for the acquisition and others splitting from USW president McCall. Meanwhile, U.S. Steel's shares remained far below Nippon Steel's $55 offer price, closing at

$40.77 on November 29, 2024. Nippon Steel expressed confidence that the deal would close by year-end, with Takahiro Mori linking this to the resolution of the U.S. election, which saw Donald Trump win.

Activist Activity

Japan has been a significant focus for activist investors, second only to the U.S. Elliott Investment Management, a hedge fund with over $60bn in AUM, has actively engaged in Japan's corporate sector, targeting some of the country's largest and most well-known companies.

In 2020, Elliott built a $2.5bn stake in SoftBank [TYO: SFTBY] after its founder, Masayoshi Son, claimed the company was undervalued. Elliott argued that SoftBank's portfolio of assets, including its holdings in Alibaba [NYSE: BABA], Sprint, and Arm [NASDAQ: ARM], was worth significantly more than the company's market valuation. Elliott demanded a $20bn share buyback to help boost the stock price, threatening a more hostile position if the request was not fulfilled. The announcement of this campaign caused SoftBank's stock price to rise by 7%. Other investors, such as Tiger Global, echoed similar concerns about the "SoftBank discount".

In 2021, Elliott turned its attention to Toshiba [TYO:6502], acquiring a stake shortly after an earlier activist campaign led to significant management changes at the company. While Elliott's position remained below the 5% disclosure threshold, its investment signaled confidence in Toshiba's long-term potential. The rationale behind their continued investment in Japan was a desire to expand their Tokyo team as the macroeconomic environment caused suppressed valuations due to the sale of non-core assets by several important Japanese companies.

In 2023, Elliott made a $300m investment in Dai Nippon [TYO: DNPLY], becoming the company's third-largest shareholder. Dai Nippon holds a 70% global market share in smartphone screen production, but Elliott saw opportunities to unlock value through operational and strategic changes. It urged the company to implement a share buyback, sell non-core real estate assets, and divest its minority stakes in other Japanese companies. This campaign reflected Elliott's focus on improving governance and addressing inefficiencies in companies with strong underlying assets.

In February 2024, Elliott targeted Mitsui Fudosan [TYO: MTSFY], Japan's largest property group, building over a year a position that placed it among the company's top five shareholders, with Nomura Asset Management, Vanguard and BlackRock. Elliott called for a $6.8bn (¥1tn) share buyback and the sale of Mitsui Fudosan's $3.6bn stake in Oriental Land, the operator of Tokyo Disneyland. The activist fund highlighted the substantial undervaluation of Mitsui Fudosan, pointing to a 33% discount between its market capitalization and the value of its property holdings. Elliott argued that improving returns on equity through these measures would better align the company's valuation with its assets.

Most recently, Elliott disclosed a 5% stake in Tokyo Gas [TYO: 9531], a major natural gas utility company. The activist fund focused on the company's non-core property portfolio, which includes undeveloped land in Tokyo's Toyosu district, two hotels, and other real estate. Elliott estimated these assets were worth approximately ¥1.5tn ($9.7bn), nearly equivalent to its market capitalization. It called for Tokyo Gas to monetize these holdings and refocus on its core energy business. The company derived nearly 10% of its operating profit from real estate in the last fiscal year, but Elliott emphasized the unrealized gains, equivalent to roughly one-third of the company's market capitalization, that could be achieved by divesting these properties.

Elliott's increased activity in Japan reflects broader trends in the country's corporate governance landscape. Regulatory changes, such as the Japan Exchange Group's "name-and-shame" policy introduced in 2023, have pressured companies to outline plans for boosting corporate value or face public scrutiny. This environment has created opportunities for activist investors to push for reforms, improve valuations, and enhance shareholder returns. Elliott's campaigns demonstrate how these changes have attracted significant global investment interest in Japan.

Fuji Soft Saga

Fuji Soft [TYO: 9749] is a major independent IT solutions vendor with a rich history over 50+ years. Growing from a small business founded in Nozawa Hiroshi in his house, the company filed for its IPO in 1987. Interest in the business is linked to their large $1bn+ real estate portfolio and the presence of crucial investors/stakeholders: 3D Investment Partners and Farallon Capital Management – both played a key role in the battle for control of Toshiba which is a testament to their Japanese experience.

At the start of 2024, Fuji Soft started exploring options with various private equity firms as part of a strategic shift prompted by their top shareholder. Being an iconic Japanese brand, several sponsors expressed interest in the deal with KKR [NYSE: KKR] and Bain Capital [NYSE: BCSF] being the two main players in the takeover battle.

On October 12, 2024, following an initial bid by KKR, Bain Capital swept in with an initial non-binding offer and then subsequently a binding offer that beat the KKR's offer by 7% in hopes of coming out on top. The offer was ¥9,450 a share, valuing the Japanese IT giant at $4bn. This overcame KKR's offer of ¥8,800 in the first round of the planned tender offer. "KKR has a demonstrated track record of collaborating with management teams and employees and unlocking growth for Japanese companies, which contributed to the reasons the board of Fuji Soft has twice recommended and supported our offer," a KKR spokesperson said after the initial offer. However, what's interesting is that Fuji Soft founder Nozawa was a public endorser of Bain Capital calling them a "White Knight" at this stage. However, the board continued to recommend KKR's ¥8,800 offer despite not outright rejecting Bain's offer. This led to the following statement on behalf of the board:

"We believe that Bain Capital's proposal is a sincere proposal and will continue to consider it"

The sell side was aligned on the uniqueness of the circumstance with private equity battles amongst large private equity firms of this scale being rare in Japan. The sell side concerns were focused on how the stakeholder management will look like on behalf of the Fuji Soft board when inclinations were to accept the KKR bid that was lower than the Bain Capital one. KKR's second tender offer rallied the positions of both 3D and Farallon making the control sit at 32.7% and making a de facto blocking position. Following weeks of back and forth and consideration – KKR decided to up and beat the Bain Capital offer edging out the competition with a bid of ¥9,451 (¥1 higher than Bain's offer) thus giving them control of 33% of the company and being the final straw needed to close the deal and give KKR ownership.

Conclusion

Japan's financial landscape is undergoing significant change, marked by the unwinding of the yen carry trade and its ripple effects on global markets. The Bank of Japan's policy shifts signal a potential end to ultra-loose monetary strategies, creating both challenges and opportunities. This has led to a significant increase in Japanese M&A activity particularly in the restructuring and shareholder activism sector with corporate takeovers making headlines across the world for the scale of the ones that have happened in Japan. Sponsors on the other hand have been hard at work, particularly in marquee acquisitions including the battle for Fuji Soft between KKR and Bain Capital. This shows a changing landscape with open mindedness towards foreign capital – quite a stark difference between Japan's traditional family-owned businesses. The economic and financial landscape in Japan is ever changing and between various macroeconomic shifts and policy changes, it begs the question, is this a permanent shift towards a global M&A hub for Japan. We believe that this rally in M&A will continue for the foreseeable future and financial sponsors will be increasingly involved in buyouts across the country.

TAGS: Japan, Private Equity, Activism, Eliott, Macro

