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Japan highlights
Global Capital Confidence Barometer

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A note from Vincent Smith, EY Japan Leader, Transaction Advisory Services

While some global executives opt to pause M&A due to regulatory, trade and tariff uncertainty, such as Brexit, – Japanese outbound investment remains a priority

53%

of Japanese respondents cite regulation and political uncertainty as the biggest potential risk to dealmaking in the next 12 months.

82%

expect the global M&A market to improve, and 84% expect their local market to improve.

62%

of Japanese respondents are reviewing their portfolios every six months.

Despite 2018 being on track to become a near-record year for the number of global mergers and acquisitions (M&A), global corporate acquisition appetite is at a four-year low. Deal plans are subdued, in part due to increasing geopolitical concerns. With rising regulatory uncertainty, and ongoing trade and tariff negotiations, 53% of Japanese respondents cite regulation and political uncertainty as the biggest potential risk to dealmaking in the next 12 months. Only 50% are now planning to acquire in the next 12 months – down from 73% six months ago.

However, M&A imperatives and macroeconomic fundamentals remain robust, with 82% of Japanese respondents expecting the global M&A market to improve, and 17% expecting it to remain stable in the next 12 months. Seventy-nine percent of Japanese executives believe global economic growth prospects are improving, with only 2% predicting short-term market stability will decline, and no deterioration in equity valuations.

Geopolitical, trade and tariff uncertainties have finally caused some dealmakers to hit the pause button. Despite stronger-than-anticipated first-half earnings and the undeniable strategic imperative for deals, we can expect this year to finish with weaker M&A than how it started. The good news is that companies will likely take the break in action as an opportunity to focus on integrating the many deals undertaken over the past 12 months. This is likely to be just a pause, not a complete stop. In Japan, the strategic rationale for deals, both domestic and cross-border, remains strong, and the appetite to acquire will likely grow towards the second half of 2019.

The increasing risk of technological disruption, geopolitical uncertainties and ever-changing consumer preferences are prompting executives to review their portfolios more frequently. An increasing number of Japanese executives (62%) are reviewing their portfolios every six months, compared with only 22% six months ago. Just 14% of Japanese companies review their portfolios once a year or less, compared with 73% six months ago.

65%

of Japanese respondents have identified assets to divest.

82%

of Japanese respondents believe that the biggest competition they face for assets will come from private capital.

20%

of Japanese executives are focusingmore on international opportunities.

As a result of portfolio reviews, nearly two-thirds (65%) of Japanese companies have identified assets to divest — due to underperformance or risk of disruption — indicating that other assets are coming to market and future buy-sell churn.

Some divestments could attract private equity (PE) buyers, with 22% of executives citing PE as a major acquirer in the next year. Eighty-two percent believe that the biggest competition they face for assets will come from private capital, including PE and corporate investment funds.

The rise of private capital, including private equity, super funds, sovereign wealth funds and corporate venture capital, has fundamentally reshaped the funding environment and will help refresh M&A activity in the future. Fund managers are allocating more to private capital than ever before in the history of modern capital markets. Many will use private equity as a vehicle to deliver returns, while others will increase direct investment activity.

Despite ongoing global trade and tariff uncertainty, many Japanese companies are still planning cross-border deals, with 20% of executives focusing more on international opportunities, including within the UK, which is the number three destination of M&A choice for executives in Japan. Overall, the top five investment destinations for executives surveyed are Japan, the US, the UK, China and India.

The fundamental drivers for Japanese companies to complete cross-border M&A remain. Furthermore, many companies are looking to M&A to mitigate the potential impact of trade and tariff policies, secure market access and protect supply chains. All of the top M&A destinations of choice are countries embroiled in trade uncertainties, suggesting that those companies planning deals are actively looking to get ahead of potential geopolitical disruption. Uncertainty is giving some executives pause for M&A thought — and that will likely result in a fall from current deal highs in the next 12 months. However, we can expect higher M&A activity into next year. Portfolio reviews today will yield asset sales in due course. Getting ahead of technological disruption and navigating geopolitical shifts will require M&A. With growing competition for assets among private equity and other private capital, those corporate executives who are opting to wait on the sidelines will likely find they are compelled to return to the deal table in 12-18 months' time.

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