SORTINO M&A GROUP

Toshiba's $14 billion takeover by JIP

TECHNOLOGY

TOSHIBA

JIP
JAPAN INDUSTRIAL PARTNERS, INC.

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Deal Introduction

DETAILS ABOUT THE DEAL

Acquirer: Japan Industrial Partners PE Firm led + Conglomerate of 20 Japanese Investors

Known investors: Orix – Financial Services, Chubu – Utility, Rohm – Chipmaker, Sumitomo Mitsui Financial Group – Major Japanese Bank providing loan commitments for buyout.

Target: Toshiba Corporation

Type of offer: Cash offer of 4620 Yen ($32.44) per share for all outstanding shares.

JIP initially acquired 78.65% of Toshiba shares, giving them the majority to fully acquire company and squeeze out minority investors.

Type of takeover deal: Private Equity Buyout – de-listing of all publicly listed shares from Tokyo Stock Exchange.

Deal Financing: JIP is backed by $10.6 billion in Bank Loans. Troubled and prolonged financing due to post buyout restructuring plans among banks and investment partners. Also, the equity portion took long to finalize due to JIP having difficulty in managing agreements within the consortium.

Financial Advisors to JIP: Crosspoint Advisors

Legal Advisors to JIP: David Polk & Wardwell, TMI Associates
Financial Advisors to Toshiba: Nomura, UBS, Mizuho, JP Morgan Securities

DETAILS ABOUT THE DEAL CONTINUED

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Financial Advisors to Toshiba: Nomura, UBS, Mizuho, JP Morgan Securities

Legal Advisors to Toshiba: Morrison & Foerster

Premium: Accepted at 10% on 23/3/23 in JPY terms but heavily fluctuating in USD terms.

On the specified date, Toshiba's board agreed to the buyout proposal but refrained from advising shareholders to sell their shares, citing the offer's inadequacy. The proposal had been reduced from an initial 5,500 Yen per share. Despite uncertainties around activist investors' acceptance of this reduced offer, it presented them an opportunity to exit their increasingly underwhelming Toshiba investments. Ultimately, the investors opted for this path, accepting the lower offer.
The offer was lowered due to the following reasons:

1. Decline in Semiconductor, HDD Business Value and Kioxia Corporation Value leading to drop in Enterprise value and share value.
2. Significant downward revisions in operating income (24% decrease) and EBITDA forecasts (8.5% decrease). Increase in predicted net interest-bearing debt upward to 180 billion from 100 billion yen.
3. Due to revised corporate value assessment, there was a reduction in Loan amounts: Financial institutions revised their assessments of Toshiba's corporate value, leading to a reduction in financing. Specifically, there was a decrease of 200 billion yen in senior loans and approximately 100 billion yen in subordinated loans.
4. As JIP had lower loan funding from institutions, they increased the amount of equity funding but still needed to lower the acquisition price to reflect the diminished corporate value.

DEAL RATIONALE: STABILIZE OF OPERATIONS AND GOVERNANCE AFTER A TURBULENT PERIOD.

Establishment and Management of a stable management structure to create stable shareholder base that supports new growth of the company, improving corporate value of company.

Alignment with domestic interests, following years of tensions with overseas activist investors.

Activist investors included:

- Effissimo Capital Management (owned 9.9%)
- Farallon Capital Management (6%)
- 3D Investment Partners (4.9%)
- Elliot Management (5%)

Reasons for tension and undermined investor confidence:

- Bad shareholder transparency.
- Governance scandals (accounting issues).
- Management issues.
- Misalignment with shareholder interests due to strategic and management decisions.
- Underperformance across the board but especially present in Nuclear Power Business.
- Collusion with Japanese Government to prevent foreign investors from gaining more influence during a shareholder meeting – direct affront to shareholder rights and transparency.

Industry Overview

As Toshiba is a conglomerate, the industry overview has been separated into three key industries:

Technology

Toshiba's presence in the technology sector is marked by a diverse portfolio covering electronics, semiconductors, quantum technology, HDDs, small signal and power devices, and microcomputers. The company's 2022 annual report underscored its commitment to digital evolution, digital transformation, and quantum transformation which wholly aligns with industry trends.

Taking a look at certain product groups, semiconductors are a key industry within the technology umbrella as it is projected to become a trillion-dollar industry by 2030 (McKinsey, 2023), and makes complete sense due its importance in the manufacturing of other technologies, e.g. modern cars utilise over 3,000 semiconductor chips per vehicle. The semiconductor industry did however, take a hit in 2021 as supply shortages resulted in bottlenecks across industries, causing significant delays and stalling growth.

Other key industries include quantum computing, where the global market is expected to reach $1.6 billion by 2026, exhibiting a remarkable compound annual growth rate of 33.2% from 2021 to 2026. The consumer electronics industry has exhibited strong growth as well, boasting an average annual growth rate of 14.9% between 2017 and 2023. What’s more surprising is that 2020 data revealed COVID 19 had a positive impact on industry growth despite the pandemic causing economic distress and deterioration. This 26.2% increase in revenues came as consumers began to invest heavily in home office setups as there was a shift to remote working.

Energy

Toshiba also operates in the energy sector providing both renewable and non renewable sources of energy.

Over the past two years, the global energy landscape has undergone significant shifts due to the war in Ukraine and subsequent energy crises, reshaping the building blocks to how we view energy security, affordability, industrial competitiveness as well as energy sustainability. McKinsey projects a substantial increase in total energy investments, expecting them to surge from $1.5 trillion USD in 2021 to $2-$3.2 trillion by 2040. Notably, commitments like the IRA, the CHIPS Act, and the IIJA position renewable over non-renewable energy, with PWC research highlighting that solar and wind energy will stand at the forefront of this renewable energy shift (PWC Insights, 2023). This also aligns with the global call for action, as highlighted in COP27, urging governments to revisit and strengthen their 2030 targets.

Infrastructure

Toshiba's operations within the infrastructure sector spans a wide range including buildings, railways, water supply, sewage systems, and telecommunications.

The infrastructure industry, from a global industry perspective, confronts challenges due to the pollution it causes. According to McKinsey estimates, construction is directly or indirectly responsible for 40 percent of global CO2 emissions from fuel combustion and 25 percent of greenhouse gas emissions overall. However, considering Toshiba is a Japanese company, and Japan’s infrastructure is in need of serious development as more than 730,000 bridges, 11,000 tunnels, 10,000 water gates, 470,000 metres of sewage pipe, and 5,000 harbour quays are 50 years or older, the demand for Toshiba’s infrastructure operations will no doubt persist.

Acquirer Overview

JIP
JAPAN INDUSTRIAL PARTNERS, INC.

Japan Industrial Partners (JIP) is a Tokyo-based investment firm specialising in corporate carve-outs. Founded in 2002, JIP focuses on optimising Japanese conglomerates by acquiring and restructuring their non-core units. With a history of significant acquisitions, including from Sony and Olympus, JIP is known for its hands-on, cost-conscious approach under its Wharton-educated former banker leadership. The firm primarily targets the manufacturing, food, distribution, and service sectors in its investment strategy.

PRICE SHARE

The plummet in stock price value came in March 2023 as Toshiba's board accepted JIP's 2 trillion yen tender offer at 4,620 yen a share, versus its last closing price of 4,213 yen.

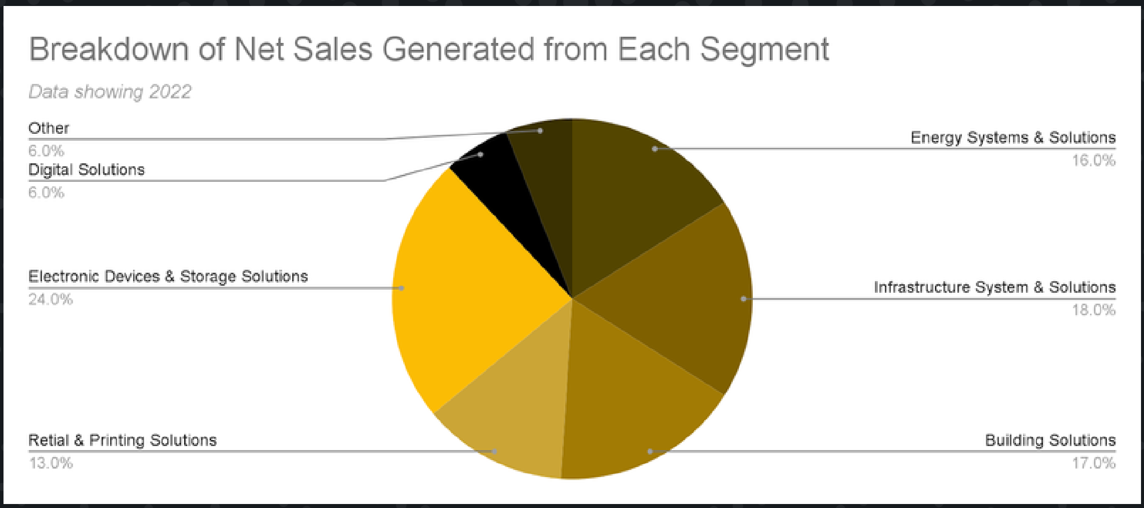
Target Overview

TOSHIBA

Toshiba Corporation is a multinational conglomerate headquartered in Minato, Tokyo, Japan. It operates across various industries including electronics, infrastructure, energy, and IT solutions. The company's origins date back to 1875 as Shibaura Seisaku-sho, which merged with Tokyo Denki in 1939, and was renamed Toshiba Corporation in 1978. In 2022, Toshiba employed 116,224 people highlighting the sheer magnitude of its scale and operations.

BUSINESS MODEL

Toshiba generates revenue from a multitude of areas and the pie chart highlights how this may be broken down by segment:

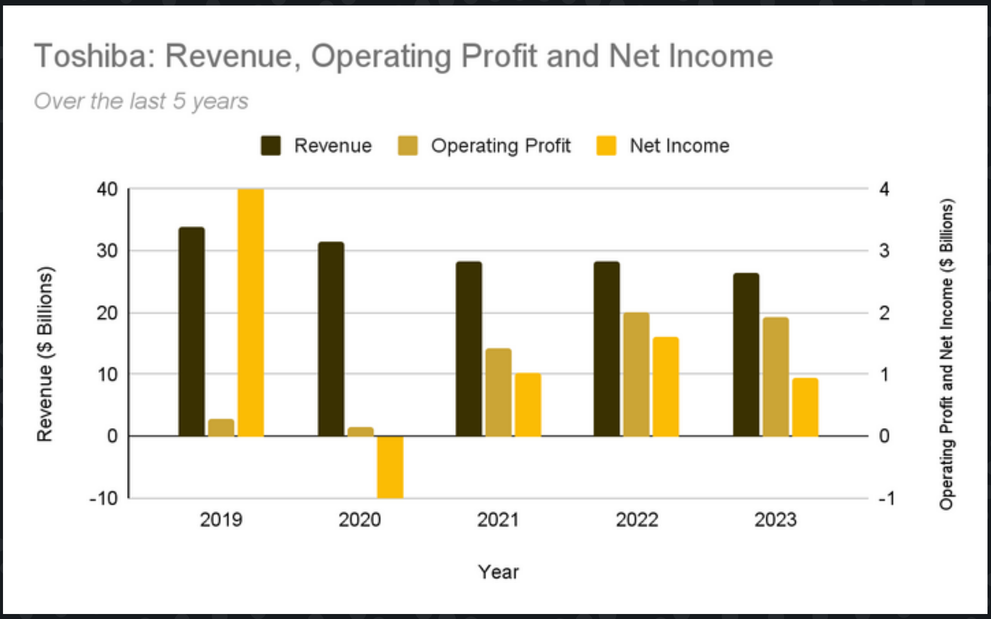


Source: Official Toshiba Annual Report 2022

KEY FINANCIALS

Market Cap $1,923 billion
Total revenue: $26.32 billion
Net Income $0.94 billion
EBIT: $1.92 billion
EBITDA: $2.63 billion
Asset Turnover 1.00

P.E Ratio 10.27
Debt to Equity Ratio 0.63
ROE 9.35%
Pre Tax Profit Margin 5.36%
Net Profit Margin 3.59%
Current ratio 1.51
EPS $1.09



Source: Macro Trends

We see revenues gradually declining in the last 5 years from $33.89 billion to $26.32 billion, which highlights a concerning trend in the company's financial performance and raises questions about its ability to sustain growth. The decline in revenue is likely linked to the company’s series of scandals consisting of accounting malpractices, failed nuclear business attempts, lack of innovation and tarnished company reputation.

KEY FINANCIALS CONTINUED

This may seem surprising as operating profits saw an upward trend: increasing from $282 million to $1.92 billion, however, this can be attributed to the company's cost structure and ability to introduce cost efficiency measures. For example the ability to refinance debt at lower interest rates was achieved as the onset of the COVID-19 pandemic in 2020 triggered a global economic downturn, resulting in a significant reduction in interest rates. More recently, developments in AI likely facilitated enhanced operational efficacy, as AI can help automate processes and reduce expensive labour costs.

Net income saw a negative figure in 2020, which can be explained due to the pandemic as well since consumer demand contracted significantly in this period. Lockdown restrictions meant people were forced to stay at home leading to widespread job loss, income uncertainty and fear. This prompted consumers to reduce their expenditure and prioritise essential spending only and saving. Consequently, Toshiba, like the majority of companies, saw a negative net income and also explains why the fall in revenues across 5 years has a more exaggerated drop in 2020.

ESG PRACTISES

Toshiba's ESG practices focus on addressing climate change and promoting sustainability across its operations. The company aims for carbon neutrality by targeting greenhouse gas emissions reduction in its manufacturing processes, product usage, and procurement. It works closely with suppliers to ensure a comprehensive approach to environmental responsibility. Figures outlined in their 2022 Annual Report reflect success in such commitments as the company reported a substantial 69.3% decrease in GHG emissions from its power supply-related products and services in 2021 compared to 2019 as well as a 8 million CO2 unit reduction in GHG emissions contributed by products and services associated with the renewable energy supply.

Valuation Analysis

COMPARABLE COMPANY ANALYSIS

Buyout Share Price			$4,620.00
FY2023 FCF			100,008
FY2023 EBITDA			210,120
Implied Market Cap (P/FCF)			2,020,815
No. of Shares			433
Implied Share Price (P/FCF)		**¥**	**4,667.22**
	Premium		**-1.0%**
Implied Enteprise Value (EV/EBITDA)			1,745,014
Net Debt			893
Implied Equity Value			1,744,121
No. of Shares			433
Implied Share Price (EV/EBITDA)		**¥**	**4,028.18**
	Premium		**12.8%**

Please click on the table to access the full model

Given that Toshiba's valuation on a P/FCF basis implies a share price of ¥4,667.22, the offered buyout price of ¥4,620.00 by JIP showcases a 1.0% discount, indicating a potential undervaluation against market expectations of future cash flows. Conversely, the EV/EBITDA metric implies a share price of ¥4,028.18, with JIP's offer representing a 12.8% premium. This indicates that JIP is strategically positioning for the future, anticipating that Toshiba's operational efficiency and profitability will improve significantly following the buyout. JIP may be considering the potential for cost synergies, restructuring benefits, or strategic realignments that could enhance Toshiba's value post-acquisition, therefore justifying the premium paid over the current EV/EBITDA valuation.

DISCOUNTED CASH FLOW ANALYSIS

Implied Share Price Calculation	
Sum of PV of FCF	264
Growth Rate	3.0%
WACC	5.5%
Terminal Value	2,513
PV of Terminal Value	1,919
Enterprise Value	2,184
(+) Cash	327
(-) Debt	893
Equity Value	1,617
Diluted Shares Outstanding (M)	432,980,000
Implied Share Price	**¥3,734.70**
Premium paid	**23%**

Please click on the table to access the full model

Based on a DCF model incorporating a 5.5% Weighted Average Cost of Capital and a 3.0% terminal growth rate, we have derived an implied share price for Toshiba of ¥3,734.70. This figure represents a 23% premium to the proposed buyout price by JIP, which is ¥4,620.00 per share.

Sensitivity Table						
		Growth Rate				
	¥3,734.70	2.0%	2.5%	**3.0%**	3.5%	4.0%
WACC	4.5%	¥4,010.98	¥5,212.83	¥7,215.91	¥11,222.07	¥23,240.55
	5.0%	¥3,128.68	¥3,914.76	¥5,093.88	¥7,059.07	¥10,989.47
	5.5%	¥2,452.71	¥2,988.38	**¥3,734.70**	¥4,846.32	¥6,678.39
	6.0%	¥2,026.08	¥2,431.53	¥2,972.12	¥3,728.95	¥4,864.20
	6.5%	¥1,658.66	¥1,968.13	¥2,366.01	¥2,896.53	¥3,639.25

Deal Analysis

STRENGTHS

- Toshiba will have a stable shareholder base that will promote its long-term strategy focused on high-margin digital services.
- JIP has previous experience in corporate carve out, buyouts and spin offs from big Japanese conglomerates, which will most likely help the handling of this acquisition.

OPPORTUNITIES

- The buyout is expected to save Toshiba from the troubled financial history it has had since accounting irregularities surfaced in 2015.
- The acquisition will diversify JIP's current investment portfolio, with the company currently activating in the telecom, auto or healthcare industries.

WEAKNESSES

- Some of Toshiba's shareholders have considered the acquisition price unsatisfactory, albeit the company argued that there was no potential higher bid.
- JIP might face a potential reputational strain for acquiring a company with such a troubled financial history, as well as by maintaining the current CEO.

THREATS

- Japan was the only Asian market with growth in M&A activity in the past year, which is likely to result in increased local competition.
- This represents JIP's biggest and most complex acquisition so far, as well as one that is critical to national security as Toshiba activates in businesses including batteries, chips, nuclear power and defence.

GLOSSARY

Enterprise Value: EV is the entire value of a firm equal to its equity value, plus net debt, plus any minority interest. It is the value of the firm's operating activities.

Terminal Growth Rate: Assumption of the rate that a company is expected to grow forever.

WACC: Cost of capital used to represent a firm's after-tax costs from all resources.

Premium: increased amount paid per share in comparison to the share price at the time of the M&A transaction.

EBITDA: A measure of a company's operating performance, representing earnings before interest, taxes, depreciation, and amortization.

Market Cap: The total market value of a company's outstanding shares of stock, calculated by multiplying the current stock price by the total number of outstanding shares.

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