Japanese Beer Wars

In a market known for measured and deliberate and more often than not friendly M&A, the merger between Kirin and Suntory is an interesting transaction. The Kirin Suntory deal is by no means hostile but it is a merger of rivals. The merger if consummated will create the fifth largest food and beverage company in the world. There are several remarkable features of the deal.

The Japanese beer industry is an oligopoly, making the potential merger a remarkable one, breaking a long standing status quo.

Given the size of Suntory, the deal looks more like a merger of very substantial equals rather than a takeover. Working out who will run the combined entity will be an interesting exercise in speculation.

Japan’s Fair Trade Commission will have to approve the deal. Given that the merger is between the number 2 and 3 by market share (out of 4 players), this might present some issues, were it not for the fact that the Fair Trade Commission is pretty powerless.

The two companies employ a total of 59000 employees. Cost savings through layoffs will be politically unpalatable in the middle of a recession when unemployment is already high.

Kirin has been in acquisition mode and in the midst of buying Lion Nathan, a not insignificant cash deal valued at 4.8 billion AUD. Lion Nathan itself is quite highly geared strong debt service ratios notwithstanding. It has 2 pieces of debt maturing 2010 and 2013, of 285 m and 404 m AUD respectively. Kirin itself is less highly geared and has a more distributed term structure. In any case Kirin will have to lever its balance sheet a good 15% to acquire Lion Nathan. Quite what the terms of the Kirin Suntory deal will be will impact the credit quality of the combined entity.

The deal has as usual been telegraphed in the market well ahead of an announcement. No one likes surprises in Japan. Suntory is unlisted, however, Kirin’s share price has traded up on yet undisclosed deal terms.

For risk arbitrageurs, the fact that Suntory is unlisted doesn’t really help a lot, nor the fact that deal terms are yet undisclosed. Hedge ratios in the equity are near impossible to determine. Both Suntory and Kirin have debt in issue which can be used to express a risk arb view although given the track record of credit expressions of risk arb in 2008, it is doubtful if any arbs would be trying that for some time. Also, the Suntory debt is not traded very much and would be hard to source and dispose of in case of deal break.

There may, however, be a capital structure trade. Kirin will most certainly have to gear its balance sheet to digest its latest and potential acquisitions. Kirin’s bonds have traded sharply up in the past month, particularly its 03/2018 and its 03/2020 issues.

That Kirin’s share price has jumped on the news seems to suggest that despite the absence of precise deal terms, this is a bona fide merger as opposed to a takeover, with the balance of power in Suntory’s hands. Its hard to tell given the opacity of the Suntory end of the deal. If Kirin is the defacto target, the deal may be positive for its share price.

A long equity short debt trade might be the way to profit from this transaction.