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HD Cover Story: Rolling back the years

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Japanese banks are back. The world's biggest international creditors have lent to firms ranging from China's Alibaba to Australian miners and are scouting for US and Asian acquisitions By Alison Tudor-Ackroyd.

One of Australia's biggest mining projects received a windfall in March when Japanese financiers put up about dollars 2.7 billion to help complete construction.

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The dollars 10 billion iron ore project called Roy Hill in Western Australia, which is run by Australia's richest person Gina Rinehart, is one of a fast-growing number of construction sites around the world welcoming Japanese capital.

Japan's banks are once again the world's biggest creditors, a position they've not occupied since the late 1980s when they financed such white elephant deals as Mitsubishi Estate's purchase of the Rockefeller Center in New York in 1989.

After many of these trophy purchases turned sour, Japanese banks sank into more than two decades of consolidation and international retrenchment, resisting any financial innovation. Now they are staging a comeback.

Around the world they are putting up long-term capital for projects such as Roy Hill, financing blockbuster takeovers including Suntory's dollars 16 billion acquisition of US whisky maker Beam, and making their own acquisitions at prices European and North American banks can't top.

The world looks set to become even more reliant on Japanese capital in the coming years. As Prime Minister Shinzo Abe's economic stimulus package loses steam the banks are redeploying their record profits and ample yen liquidity into faster-growing economies; dollars 2 trillion worth of deposits in the first quarter of last year.

'Japanese banks hungry for product are increasingly active lenders in Asia, and we're working with them more and more on deals in the region,' said Stephen Williams, head of capital financing across the Asia-Pacific region at HSBC, one of the largest lenders in the world still extending its balance sheet.

Roy Hill backers

Mitsubishi UFJ Financial Group (MUFG), Mizuho Financial Group and Sumitomo Mitsui Financial Group (SMFG). Japanese policy lenders, Japan Bank for International Cooperation (JBIC) and Nippon Export and Investment Insurance, were also prominent financiers of the mining project, which employs about 3,200 people in the state of Western Australia and looks set to become Australia's fourth-largest iron ore producer.

Japanese banks' resurgence is happening just as European and US lenders are licking their wounds in the wake of the global financial crisis of 2007-2008 and the subsequent euro-area debt crisis. It took Roy Hill about three years to gather finance.

Cross-border lending has shrunk globally by dollars 2.3 trillion in the seven quarters to end-December 2013, according to the Bank of International Settlements (BIS), the Basel-headquartered alliance of central bankers. Continental European banks have retrenched most, their data shows.

Japanese banks are taking up the slack, surpassing German banks in 2011 to become the world's largest international lenders. As of end-2013, Japanese banks' outstanding international claims hit dollars 2.531 trillion, up from dollars 1.836 trillion at the end of 2009, according to the BIS. (International claims exclude bank domestic assets in local currencies).

Japanese banks' share of consolidated international claims of all BIS-reporting banks rose to 13% at end-March 2013, up from 8% in early 2007, where it finally bottomed after a long descent from 36% in 1989.

The Japanese banks are becoming the go-to banks for longer-term projects. Japanese banks' distaste of financial innovation in the run-up to the global financial crisis meant their balance sheets were less badly affected, so they were better able to comply with stricter regulations that required bigger capital buffers and seemingly penalized banks locking up capital for long periods. The tenor of the Roy Hill loan door-to-door is 11 years.

In contrast, other Western banks are treating capital as a precious commodity to be spooned out for as little time as possible.

To be sure, the Japanese are not the only banks expanding and loans are not the only source of capital for entrepreneurs to tap. **Chinese** banks are aggressively pursuing lending opportunities overseas. In 2013 alone, **Chinese** bank loan facilities hit dollars 250 **billion**, up 60% from 2012, according to the Institute of International Finance. They are just not on the same scale yet as the Japanese.

In addition, with interest rates so low globally, bond investors are hungry for more yield and, increasingly, taking out the banks.

'The velocity of credit has speeded up. Asian bank loans are being replaced by bond issues faster than ever, so we have to work hard to keep extending new credit and maintain the size of the loan book,' said Russell Julius, head of banking across the Asia-Pacific region at HSBC.

Even so, for the coming years, Japan's megabanks are setting even more ambitious growth targets and scouting for acquisitions in Southeast Asia.

Bank Mutiara (formerly Bank Century), the Indonesian bank now being privatised after being taken over by the state in 2008, has already received bids from Japanese lenders.

SMFG said on May 14 that it would become an Asian-centric institution over the next decade after announcing that its overseas loans rose Yen3 trillion year-on-year to Yen15.2 trillion. But both SMFG and MUFG are also running the slide rule over deposit-taking banks in the US, such as Royal Bank of Scotland's Citizens Bank, a person familiar with the matter told FinanceAsia.

ABENOMICS FIRES UP BANKS

When Abe came to office in December 2012 he set out to reverse Japan's 20 years of economic stagnation and 15 years of deflation using three policy arrows: monetary and fiscal stimulus combined with structural reform.

Japan's central bank has aggressively sought to buy long-term **bonds**, potentially doubling the country's monetary base in the two years from April 2013, in an attempt to hit its 2% inflation target.

However, with real economic growth in Japan averaging just 0.3% in the last five years, its workforce shrinking, and activity restrained by a lack of structural reforms, Japanese banks are sitting on a flood of liquidity from selling government **bonds** while casting around for opportunities to deploy capital.

'There is more money circulating in the system which has led to an expansion in the financial sector's balance sheet,' Ritesh Maheshwari, managing director of financial services at credit ratings agency Standard & Poor's, told FinanceAsia.

Credit analysts like Maheshwari are worried that Japanese lenders are in too big a rush to deploy the capital and will make lower underwriting standards.

SMFG said on May 14 that it is aiming for consolidated profit growth of 15% between fiscal years 2013 and 2017. 'To this end we will invest our resources and take risks necessary for our growth,' SMFG said in a statement.

The three megabanks' overseas loans grew by about 20% between March and December last year, according to banking data provider SNL.

Credit analysts are also mildly concerned the Japanese banks are becoming more reliant on short-term money-market instruments to fund their overseas growth. However, they can always convert their ample yen liquidity and fall back on the BOJ's swap facility, if stressed. In the first three months of 2013 about dollars 2 trillion of domestic yen deposits were used to finance cross-border loans, according to BIS.

Japanese banks also appear to be concentrating risk with a few large corporate clients. An example is the dollars 12.5 **billion** bridge loan made to Suntory by MUFG's main banking unit Bank of Tokyo-Mitsubishi UFJ (BTMU) earlier this year, to finance its **acquisition** of US spirit group Beam.

Bankers in Tokyo said BTMU was struggling to syndicate the jumbo loan as the margins looked unattractive and, as a result, not-for-profit JBIC will take a chunk.

Risky lending, untrammelled money supply and rapid credit growth led to an asset price bubble and its subsequent bursting in 1991. However the banks are now far more disciplined than then and Japan's financial regulator has a tighter grip.

The latest massive extension of credit has not resulted in a significant rise in bad loans so far. Non-performing loans in Japan fell last year 'All the conditions of easy money exist, where investment opportunities are hunted and risk perception goes down,' Maheshwari said. 'Our bank analysts are checking but there has been no reason to change our perception of the asset quality of Japanese banks as yet.'

The megabanks seem to be adopting slightly different strategies as they expand overseas. MUFG has been active in **acquisition** financing while SMFG is focusing more on asset finance.

Earlier this year, BTMU participated in a syndicated revolving credit facility in the HKdollars 10 **billion** (dollars 1.29 **billion**) financing of CLP Holdings' **acquisition** of an additional 30% **stake** in Castle Peak Power and a 51% **stake** in **Hong Kong** Pumped Storage Development (See interview with CLP). CLP supplies electricity to 80% of **Hong Kong**'s population.

SMFG acquired RBS's aircraft financing business for dollars 7.2 **billion** in 2012 and Perella Weinberg Partners' railroad leasing business for dollars 1.1 **billion** in 2013.

HOME TURF

SMFG and Mizuho both reported record net profits in the latest Japanese financial year ended March. MUFG, Japan's biggest lender by assets, reported that its net profit improved by 15.5% compared with the previous year to Yen984.85 **billion**.

The banks were helped by a rise in the value of their **equity** holdings after Abe's monetary stimulus sent the Nikkei 225 index of leading Japanese shares soaring 46% last calendar year as well as by improving credit costs as economic growth edged up. (See earnings chart)

Their results are unlikely to get the same boost in the current fiscal year. The Nikkei 225 has fallen 10% since March on worries the boost from Abenomics is fizzling out.

'Japanese banks are unlikely to sustain their strong profit run this year,' Miki Murakami, director of financial institutions at credit ratings **firm**Fitch Ratings, said. 'This is because recent Abenomics-related gains can be attributed to a spike in optimism rather than fundamental improvements.'

As a result, Japanese banks are looking for riskier but more lucrative opportunities, mostly overseas.

They are also scouring their own back yard for opportunities for bigger fees. Prior to the global financial crisis, Japan's megabanks generally treated private **equity** buyouts with great caution. Now they are chasing such deals and the extra competition is squeezing margins.

Spreads on the financing of leveraged buyouts in Japan, for example, have fallen back to the levels seen before the collapse of Lehman Brothers to around 250bp on senior debt, bankers in Tokyo said.

'After Abenomics kicked off last year, the Japanese banks are being much more aggressive in terms of debt capacity (leverage ratio) as well as pricing. They are looking more at event-driven opportunities,' Yuki Ikuno, head of leveraged capital markets Japan at UBS, told FinanceAsia.

For borrowers, the banks' new appetite for credit opportunities means they can refinance expensive bridge loans quicker and cheaper. Bain's **acquisition** of Skylark was refinanced within months, as was Permira's **purchase** of sushi chain Akindo Sushiro. Refinancing rates are down to 150-175bp.

It used to be unusual to see all three megabanks participate in the same loans, as in the case of Roy Hill, but now they are often clubbing and can take on the vast amount of loans, as in the financing of KKR's acquisition of Panasonic Healthcare. As a result regional banks and trust banks in Japan are struggling to find lending opportunities in the syndicated loan market.

'Because the banks that are capturing more of these deals tend to hold large amounts, there is very little supply coming out into the syndicated loan market,' Ikuno said in an interview in Tokyo.

Syndicated loan volumes in Japan have fallen to dollars 95.1 billion so far this year, down from dollars 118.13 billion in the same period of 2008. In contrast, the number of club loans, which never reach general syndication, over the same five years has risen to 15 with a total value of dollars 2.34 billion from five totaling dollars 1.05 billion.

MONEY PUMP

Japanese banks have been particularly active in the Asia-Pacific region where financing needs are greater than in their own sluggish domestic market.

They have also been following their corporate clients into the region. Japanese investment in Asia hit a record dollars 40.47 billion last year, according to the Japan External Trade Organisation.

Japan's Marubeni is the largest equity investor in Roy Hill behind Rinehart. Rival trading house Itochu sponsored the Sarulla power project in North Sumatra, Indonesia, which could become the largest geothermal power project in the country. BTMU, SMBC and Mizuho Bank participated in the dollars 1.17 billion financing.

The Japanese banks are making their own purchases of overseas financial institutions at eye-popping book multiples, which may mean the deals take longer to pay off, such as SMFG's acquisition of a stake in Indonesia's Bank Tabungan Pensiunan Nasional at 4.5 times price-to-book.

MUFG also sealed its acquisition of a 70% stake in Thailand's Bank of Ayudhya in December for more than dollars 5 billion.

To be sure, there are limits to the valuations Japanese banks are prepared to stomach. Mizuho was looking at acquiring Australian bank ANZ's 39.2% stake in Indonesian lender Panin but the Japanese bank is unwilling to pay ANZ's asking price, according to a person familiar with the matter.

Japanese banks' foreign claims in the Asia-Pacific region expanded to dollars 305.3 billion as of the end of last year from dollars 132.8 billion as of the end of 2008. Its share of foreign claims in Asia-Pacific also grew to 14.8% from 11.8% over the same period, according to BIS. (Foreign claims include international claims as well as local claims in local currencies.)

Their presence has grown swiftest in Vietnam where claims have jumped by 248% since before the global financial crisis, followed by Thailand, up 163%, and Indonesia, up 175%, according to analysis by the Institute of International Finance.

Mizuho was a bookrunner on a dollars 8 billion loan to Chinese e-commerce giant Alibaba and SMFG was a mandated lead arranger on a dollars 6 billion loan to Thai retailer CP All. Both were among last year's most notable large syndicated loan deals.

Roy Hill is paying about 250bp for the part of the loan uncovered by collateral, over the rate at which banks borrow. That is a much fatter spread than currently available on bilateral loans in Japan.

US EXPANSION

Japanese banks are also extending credit in the US but not quite at this pace and for different reasons.

To protect its taxpayers from having to bail out failed banks, as occurred during the global financial crisis, the Federal Reserve wants foreign lenders in the United States to hold extra capital and liquid assets in the country. Under the proposed plan, foreign banks with US assets of dollars 50 billion or more would have to keep a 30-day buffer of very liquid assets.

As a result Japan's megabanks are looking at acquiring deposit-taking lenders in the US, such as Royal Bank of Scotland's Citizens Bank.

Japanese bank boards are by and large still ethnically uniform. However, to reflect its increasingly global nature MUFG's main lending arm, BTMU, made US and Canadian national Randall Chafetz, its Americas corporate and investment banking head, an executive officer in June last year.

Chafetz, the first non-Japanese executive officer in the bank's 400-year-plus history, will **lead** the bank's corporate and investment banking business outside of Japan. 'The appointment of Randy as the first non-Japanese executive within the bank is another example of BTMU's true commitment to be a global leader in the financial services industry,' Takashi Morimura, BTMU's deputy president, said at the time.

Dollars 2.5tn - Japanese banks' outstanding international claims at end 2013

CO alibab : Alibaba.com Corporation | mizfin : Mizuho Financial Group, Inc

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