

## NTT buys in Docomo: a bullish sign of change

### Summary

- The deal is a win for Japanese governance reform
- It has commercial and strategic logic
- The consolidation wave could gather strength

### Disclaimer

Peter Tasker is a strategist for Arcus. The views and opinions expressed in this document are those of the author's alone and do not reflect the opinion of Arcus Investment Limited ("AIL"), Arcus Investment Asia Limited ("AIAL") or Arcus Research Limited, Japan Branch ("ARL") collectively referred to as "Arcus" or the "Arcus Group."

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Docomo (9437), Japan's largest mobile carrier, was spun off from parent company NTT (9432) in 1998. Now, twenty-two years later, it is returning to the mothership. NTT has offered to buy in the one third of Docomo shares that it does not own at a 40% premium to the prevailing price.

NTT has a reasonably strong balance sheet for a telco but has chosen not to use any of its cash and equivalents or long-term investments to fund the deal, nor is it using equity. Instead, it will borrow the entire Yen 4.2 trillion (USD 42 billion) from a syndicate of Japanese banks, who were no doubt grateful for the new lending opportunity.

Our first thoughts are that the deal is a ringing endorsement of the corporate governance reforms that gathered steam during the Abenomics era (2012-20). In recent years, NTT, once notorious for conservatism and a lack of concern for investors' interest, has become one of the most reliable returners of capital to shareholders via dividends and buybacks. Now, it is buying in Docomo at a more than generous premium that has taken the stock price back to levels not seen since the aftermath of the dotcom bubble. As NTT was the controlling shareholder, it could easily have got away with a lower offer.

At the same time, NTT is tackling the issue of "parent-and-child" (main company and subsidiary) double listings, which are increasingly frowned upon by the Tokyo Stock Exchange and corporate governance advocates. In stark contrast, Softbank Group (9984) spun off its mobile arm as a 63% owned listed subsidiary in December 2018.

The business logic behind the Docomo deal has not been made clear, but we can see two aspects – one tactically defensive, the other strategically aggressive. The first concerns the Japanese government's determination to secure lower prices, in some shape or form, for users of mobile services. It is well known that current Prime Minister Yoshihide Suga was instrumental in offering a fourth mobile licence to Rakuten (4755) on the basis that it would offer a cheaper, no-frills service. In the event (unlikely, in our view) of a full-scale price war, Docomo would be better protected as a division of NTT rather than a standalone player.

The strategic aspect is more interesting. Here, NTT is looking a decade down the line at the coming of automated driving, 6G networks and massive demand for new telecom infrastructure, potentially in a world in which Huawei and other Chinese high-tech players are locked out. Earlier this year, NTT took a 5% stake in NEC (6701), formerly a member of the "NTT family" of supplier companies in pre-privatisation days. The inference is that NTT sees NEC as a long-term partner in the development of telecoms infrastructure and protocols, and that Docomo will be the natural "customer" for the roll-out of new services.

Such developments are a long way in the future. For now, investors should be cheered by the largest of the twenty-odd spin-off / spin-on corporate actions that have taken place in the Japanese market this year. Japanese managements are thinking harder than ever before about what businesses they need to be in. The NTT deal could be the harbinger of a boom in consolidating / restructuring major companies in other sectors, sharpening focus and raising profitability.