KKR vs. Bain Capital - Competing TOBs for FUJISOFT

Blakemore & Mitsuki Analyzes Legal Issues Related to KKR's and Bain Capital's Competing TOBs for FUJISOFT[1]

September 12, 2024

I. Fundamental Issues Related to Valuation of Business Value

1 Main Discussion

The case is characterized by the fact that FUJISOFT INCORPORATED ("**FUJISOFT**") has huge tangible fixed assets (real properties) amounting to 100,642 million yen on a consolidated basis (book basis) (see the consolidated balance sheet on the next and succeeding pages[2]).

Since FUJISOFT has real properties with a book value of about five times its annual income before income taxes of 20.439 billion yen[3], it appears clear that selling the real properties and using the sale proceeds for capital expenditures would help the company increase the value of its business.

With respect to the Valuation Report (SMBC Nikko Securities), "The financial projections assumed in the DCF analysis are based on the Business Plan prepared by the Company and do not include fiscal years in which significant increases or decreases in earnings or free cash flow are expected," the Opinion Report states.

With respect to the Valuation Report (JPMorgan Securities), too, "The financial projections assumed in the DCF analysis are based on the Business Plan prepared by the Company and do not include fiscal years in which significant increases or decreases in earnings or free cash flow are expected," the Opinion Report states.

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[1] A document entitled "KKR vs. Bain Capital/Time Series Table" (the "**Time Series Table**") is attached hereto as Appendix A. Whenever terms defined in the Time Series Table, the Tender Offer Registration Statement (dated September 5, 2024) relating to the tender offer by FK Corporation for FUJISOFT (defined below), and the Opinion Report (dated September 5, 2024) relating to such tender offer (the "**Opinion Report**") are used herein, such terms shall have the meanings ascribed to them in such documents unless otherwise defined herein.

[2] Based on FUJISOFT's Semiannual Report (August 9, 2024).

[3] Based on FUJISOFT's Annual Securities Report (March 27, 2024).

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1 [Interim Consolidated Financial Statements

(1) [Interim Consolidated Balance Sheet

(Millions of yen)

	Previous consolidated fiscal year (December 31, 2023)	Current interim consolidated accounting period (June 30, 2024)
Assets		
Current assets		
Cash on hand and in banks	35,324	40,777
Notes, accounts receivable and contract assets	※1 62,696	※1 62,941
Marketable securities	8,100	1,700
Goods	1,350	988
Work in progress	4,478	3,982
Raw materials and supplies	91	88
Other	11,214	11,773
Allowance for doubtful accounts	△102	△99
Total current assets	123,153	122,153
Fixed assets		
Property, plant and equipment		
Buildings and structures	64,846	76,638
Accumulated depreciation	△33,138	△32,596
Buildings and structures, net	31,707	44,042
Lot	55,322	50,966
Construction in progress	14,273	2,416
Other	13,175	13,665
Accumulated depreciation	△10,315	△10,448
Other, net	2,859	3,217
Total property, plant and equipment	104,163	100,642
Intangible fixed assets		

Goodwill	272	240
Software	5,242	5,050
Other	30	30
Total intangible fixed assets	5,544	5,320
Investments and other assets		
Investments in securities	8,986	10,791
Assets related to retirement benefits	7,400	7,862
Deferred tax assets	3,904	2,997
Deferred tax assets on land revaluation	64	-
Other	4,459	4,231
Allowance for doubtful accounts	△81	△87
Total investments and other assets	24,734	25,795
Total fixed assets	134,443	131,757
Total assets	257,596	253,911

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Based on the aforementioned assumptions, a significant increase in income and free cash flow is expected in a fiscal year in which a large amount of prime real properties is sold, but such a fiscal year would not be included in the DCF analysis.

Specifically, if FUJISOFT sold all of its real properties in the fiscal year 2025, obtained a large amount of cash, and then distributed the cash to its shareholders (the Offeror) in the fiscal year 2026 as a dividend for the fiscal year 2025, the large amount of cash obtained in the fiscal year 2025 would constitute a "significant increase in profit and free cash flow," and thus the fiscal year 2025 would not be included in the DCF analysis. However, this would mean that the Offeror would monopolize the unrealized profits of FUJISOFT's real properties and the minority shareholders would not be able to share in the distribution of such profits (since the financial statements for the fiscal year 2026 will not record the large amount of unrealized profits (cash) and no capital investment was made, the assets related to the capital investment will not be recorded either). Since a premium will be paid in this TOB, a part of the unrealized profits of FUJISOFT's real properties will be deemed to be distributed to minority shareholders, but under the circumstances where the amount of unrealized gains on real properties was not disclosed, the ratios of such unrealized gains to be distributed between the Offeror and the minority shareholders were not disclosed. Therefore, the board of directors of FUJISOFT should either request the tender offerer to disclose the above, or should disclose it by itself and explain to the shareholders for what reason it recommends that they tender their shares at the tender offer price indicated by the tender offerer.

Therefore, the Share Valuation Report (by SMBC Nikko Securities) and the Share Valuation Report (by JPMorgan Securities), which were prepared by adopting the method described above of not including in the DCF analysis the fiscal years in which a significant increase in profit and free cash flow is expected, would result in a significantly lower valuation per share of FUJISOFT, which raises the question of whether the valuation per share of FUJISOFT is not reasonable. Similarly, one may raise the question of whether the Fairness Opinion, which was prepared in reliance on the Share Price Valuation Report (JPMorgan Securities), is not reasonable.

2 Addendum No. 1 (3DPI's position)

In response to the above argument 1, it is expected that a counterargument may be made that this may also apply to 3DPI. In other words, there is an argument that 3DPI had KKR make a TOB in order to own the unrealized profits of FUJISOFT's real properties, but if this argument is correct, if 3DPI sells FUJISOFT shares at the tender offer price offered by the tender offeror, which is the same price as the minority shareholders, 3DPI would not have overlooked the fact that the tender offer price should be deemed to be low, and would have arranged for the tender offer price to reflect the unrealized gains on the real properties.

In response to this, 3DPI has indeed committed to subscribe to KKR's TOB pursuant to the 3DIP Tender Agreement with the Offeror, but by applying the purchase price to the purchase price of the Offeror's preferred shares, it is possible to argue that by becoming a preferred shareholder of the Offeror, 3DPI will be able to receive a share of the unrealized profits of FUJISOFT's real properties by being the Offeror's preferred shareholder.

In order to dispel such argument unfavorable to 3DPI, it should be clearly stated in the disclosure documents relating to KKR's TOB that there is no such arrangement between 3DPI and the Offeror as described above.

If such an arrangement has been made between 3DPI and the Offeror, the details of such arrangement should be clearly stated in the disclosure documents relating to KKR's TOB. Otherwise, minority shareholders will not be able to determine whether or not they can accept the tender offer price offered by the Offeror.

3 Addendum No. 2 (Majority of Minority)

Considering the situations in 1 and 2 above, we think that MOM should be included as a requirement for TOB to reduce the possibility of being claimed by minority shareholders later.

However, even if MOM is included, there may be some minority shareholders who, without knowing anything about the unrealized gains on the real properties and knowing that the Offeror monopolized them after the completion of the TOB and the subsequent squeeze-out, will file some complaints with the Offeror, the Board of Directors of FUJISOFT, which issued the recommended opinion for applying for the TOB, and the Special Committee. Therefore, we believe that more appropriate disclosure should be made regarding the amount of unrealized gains on real properties and the distribution ratios of such gains to be distributed between the Offeror and the minority shareholders.

II. Isn't it true that FUJISOFT agreed to the TOB by KKR without coming to a conclusion as to whether going private is the best way to improve FUJISOFT's business value?

The 3DIP Process is a process under the leadership of the 3DIP to solicit potential investors for measures to enhance corporate value through the privatization of FUJISOFT shares. In other words, in the 3DIP Process, going private of FUJISOFT shares is a given precondition for increasing corporate value.

As a matter of course, consideration should be given as to whether going private is necessary to enhance the value of the business.

In the case of FUJISOFT, which has a large number of prime real properties, the best way to increase its business value is to sell such properties and promptly invest the proceeds in capital expenditures related to its core businesses (system construction, cloud computing, and control software development), which are expected to grow significantly.

For this reason, there may be no necessity to take FUJISOFT shares private at all. Going private would be disadvantageous to minority shareholders because it would allow the tender offeror to monopolize the proceeds of the huge real property transaction in the form of dividends.

Because of this consideration, the FUJISOFT Information Provision Process appears to have been defined as a process aimed at providing information regarding the enhancement of corporate value to which multiple candidates were invited. In other words, going private of FUJISOFT shares is not a given precondition in the FUJISOFT Information Provision Process.

And the matters for consultation by the Special Committee were determined to be the following:

(a) Comparison of the proposals of the three candidates who were granted preferential negotiating rights in the 3DIP Process, including KKR; and

(b) If it is determined that the corporate value enhancement measures presented by the three candidates for the go private proposal are more desirable than the corporate value enhancement measures developed by FUJISOFT, to make a recommendation or recommendations to the board of directors of FUJISOFT as to whether the go private proposal should be approved by the board of directors of FUJISOFT.

FUJISOFT did not consider the proposals of the above four companies (including Bain Capital) because "FUJISOFT had received information from the four companies in the FUJISOFT Information Provision Process, but such information was only information concerning measures to enhance corporate value and was not a takeover proposal for FUJISOFT," therefore, FUJISOFT did not make the proposals of the above four companies (including Bain Capital) matters for consultation by the Special Committee.

This means that, based on the given premise of going private, the company will select the proposal that best contributes to the improvement of FUJISOFT's corporate value from among the three candidate companies that were granted preferential negotiating rights in the 3DIP Process, including KKR. Although in (b) above, it is said that "If it is determined that … are more desirable than the corporate value enhancement measures developed by FUJISOFT," since, as described above, the proposals of the 4 companies who provided information in the FUJISOFT Information Provision Process were not subject to consideration by the Special Committee, the best proposal from the three candidates who were granted preferential negotiating rights in the DIP Process will remain as a candidate. In (b) above, the phrase "whether the go private proposal should be approved by the board of directors of FUJISOFT" is used, but the "go private proposal" here only means the best proposal among those of the three candidates (including KKR) who were granted 3 DIP Process Preferential Negotiating Rights. In other words, the decision was made to have multiple proposals submitted and decide on the superiority of each proposal based on the premise of going private, without considering whether or not going private is necessary to enhance corporate value.

In fact, if you look at the statements in the rightmost column of the timeline table for June 28, 2024, August 4, 2024, and August 7, 2024, the first column of each row, that is in fact the case. The Special Committee has not made a determination as to whether the company needs to go private in order to enhance its corporate value.

We believe that this is as Bain Capital points out in its "Notice of Bain Capital's Submission of Proposal for Tender Offer for FUJISOFT INCORPORATED (Securities Code: 9749)" (dated September 3, 2024).

In the first place, the board of directors of FUJISOFT may be held responsible for failing in its duty of care to FUJISOFT for entrusting the Special Committee with matters that are not reasonable as described above.

III. The Board of Directors' failure to make Bain Capital's proposal included in the matters for consultation by the Special Committee.

The fact that the Special Committee was not entrusted with the question of whether going private is the best way to enhance FUJISOFT's business value is discussed in II.

above.

This section discusses Bain Capital's proposed acquisition of FUJISOFT for ¥8,006 per share, which the Board of Directors did not make included in the natters for consultation by the Special Committee.

Bain Capital claims that it proposed to FUJISOFT in early August 2023 or later that the acquisition price per share of FUJISOFT stock would be 8,006 yen if FUJISOFT shares were taken private in the transaction.

If this were true (and it must be proven to be true), then the Board's failure, on September 13, 2023, to include consideration of (and comparison of) Bain Capital's takeover offer in the matters for consultation by the Special Committee would be a breach of its duty of care.

In addition, if Bain Capital's allegation is true, FUJISOFT's assertion that "FUJISOFT had received information from the four companies in the FUJISOFT Information Provision Process, but such information was only information concerning measures to enhance corporate value and was not a takeover proposal for FUJISOFT" (see the third column from the left in the "September 15, 2023" row of the Time Series Table) would be deemed a false statement, and, in such case, FUJISOFT could be held liable for violating the FIEA, because the assertion is a false statement.

In its August 4 Opinion, the Special Committee states that the July 26, 2024 Bain Capital Proposal is a non-legally binding proposal as one of the main reasons why there is no need to change the June 28 Opinion, but it is questionable why the Special Committee did not request Bain Capital to make a legally binding takeover offer in order to raise the acquisition price.

IV. Future Development

FK's tender offer period for TOB: September 5, 2024 to October 21, 2024

Bain Capital is asserting that "If the fact that Bain Capital made a legally binding offer at a tender offer price higher than the FK Tender Offer Price is publicly announced before the FK Tender Offer is completed, it would be an economically rational course of action for ordinary shareholders to refrain from applying for the FK Tender Offer, and the FK Tender Offer is likely to fail to meet the minimum limit of the FK Tender Offer. We believe that there is a strong likelihood that the FK Tender Offer will fail to meet the minimum limit."

We think that Bain Capital will probably make a legally binding offer at a tender offer price above the tender offer price of the FK tender offer (the "**Legally Binding Bain Capital Offer**") by October 21, 2024.

However, the tender offer is subject to the precondition that FUJISOFT's Board of Directors expresses, by its resolution, an affirmative opinion and recommends that the shares be tendered.

At this time, since 3DPI and KKR are cooperating, it is unclear whether the Special Committee, which includes two members from 3DPI's side, will express an affirmative opinion on the Legally Binding Bain Capital Proposal and issue a recommendation to tender. In response to Brother Industries' legally binding takeover offer with a tender offer price that was higher than the tender offer price of the Taiyo side, Roland DG's Board of Directors adopted a position to have an opinion in favor of the takeover bid of the Taiyo side, but to become neutral on the application for the TOB of the Taiyo side.

If the Board of Directors of FUJISOFT (and this Special Committee) determines, similarly to Roland DG's board of directors, adopts a position to have an opinion in favor of the takeover bid of KKR, but to be neutral on the application for the TOB of KKR, Bain Capital may decide not to conduct the tender offer on the grounds that the above preconditions are not fulfilled.

In that case, we wonder if a claim for damages could be filed by a general shareholder on the grounds that FUJISOFT's Board of Directors (and the Special Committee) did not fulfill its duty of care as a director (a member of the Special Committee) with regard to the fact that it did not express an opinion in favor of the Legally Binding Bain Capital Proposal with a higher TOB price and did not issue a recommendation for subscription.

The FUJISOFT Board of Directors (and the Special Committee) would be compelled to carefully consider how it is reasonable to respond to such risks.

V. Overall Summary

In order to maximize the value of FUJISOFT's business, the company should promptly sell all of its real property holdings and use the proceeds to invest in its core business (system construction, cloud computing, and control software development) without delay. No one will be able to argue with this.

The problem, we suspect, is that the board of directors of FUJISOFT, which should realize this, has been weakened and is no longer able to suppress the demands of outside forces (3DPI, etc.) to realize their private interests.

Originally, decision to sell the real properties and use the proceeds for capital investment should have been made much earlier. It is the fact that 3DPI has exerted its efforts to be the driving force behind the contemplated decision to sell the real properties.

While we recognize their achievements, if 3DPI intends to distribute the unrealized gains on the real properties among a small number of people to the exclusion of minority shareholders, this would clearly harm the interests of minority shareholders. We believe that going private is unnecessary in order to maximize the business value of FUJISOFT. It is sufficient to have a person with a sense of mission to maximize the business value of FUJISOFT manage the company and use the profit from the sale of real estate for capital investment, and there is no need to take FUJISOFT private.

If a competent management team is assembled and the proceeds from the sale of the real properties can be used for capital investment, the share price should rise sufficiently. At that stage, not only 3DPI but also any minority shareholders who wish to do so can simply sell their shares in FUJISOFT.

Whether the winner of the TOB will be KKR or Bain Capital, it should aim to maximize FUJISOFT's business value (and share price) by setting the ownership ratio of the tender offeror below 65%, arranging to avoid delisting, and then using the proceeds from the sale of real properties for capital investment.

If going private is implemented (despite the fact that it is not necessary), minority shareholders who were forced to sell their shares could seek relief from the court by claiming that even if FUJISOFT purchased such shares at the same price as the public offering price, such price is not a fair price, and seeking a higher payment. This is because, since (i) the Share Valuation Report (by SMBC Nikko Securities), the Share Valuation Report (by JP Morgan Securities), and the Fairness Opinion (which relies on the Share Valuation Report (by JP Morgan Securities)) all state that "The financial projections assumed in the DCF analysis are based on the Business Plan prepared by the Company and do not include fiscal years in which significant increases or decreases in earnings or free cash flow are expected," and (ii) accordingly, the financial forecast does not include any fiscal years in which significant increases or decreases in earnings or free cash flow are expected (although FUJISOFT expects a significant increase in income and free cash in the fiscal year in which it sells a large amount of prime real properties), minority shareholders would believe that the KKR-side public offering price[4] is significantly or substantially lower than fair value (i.e., a price that reflects the fact that FUJISOFT expects a significant increase in income and free cash flow in the fiscal year in which it sells a large amount of prime real properties estate).

However, the KKR (or Bain Capital) side and 3DPI[5] may be willing to take such a risk and force FUJISOFT to go private (squeeze out the remaining minority shareholders) in order to maximize their profits.

In that case, we suspect that the remaining minority shareholders may file a lawsuit for damages against the directors of Fujisoft who forced the company to go private (squeeze out the remaining minority shareholders) (even though 2/3 of the shareholders approved the move).

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4 The Bain Capital side's tender offer price probably would, given the history to date, be the one which (i) is also based on the assumption that FUJISOFT will go private, and (ii) adopts the reasoning that "The financial projections assumed in the DCF analysis are based on the Business Plan prepared by the Company and do not include fiscal years in which significant increases or decreases in earnings or free cash flow are expected."

5 3DPI has committed to tender to KKR's TOB pursuant to the 3DIP Tender Agreement with the Offeror, and may apply the purchase price to the purchase price of the Offeror's preferred shares, thereby becoming a preferred shareholder of the Offeror and thereby receiving a share of the unrealized profits of FUJISOFT's real properties.

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