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Japan Buyouts Go Native as Locals Lead Private-Equity Revival

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By Tomoko Yamazaki and Komaki Ito

Dec. 30 (Bloomberg) -- A decade ago, global private-equity firms like J.C. Flowers & Co. LLC brought buyouts to Japan, challenging longstanding relationships between corporate executives and their bankers with billion-dollar takeovers.

Today, the Western funds are more focused on chasing deals in faster-growing Asian countries, leaving the Japanese market dominated by local firms targeting investments in small and mid- sized companies. There have been 26 buyouts worth $1.4 billion in Japan this year, compared with 12 deals worth $3.5 billion in 2009, according to London-based research firm Preqin Ltd.

The success of local firms is paving the way to grow the private-equity market in Japan, where it took KKR & Co. four years to do its first buyout this year since entering the nation. Local funds including Ant Capital Partners Co. and Tokio Marine Capital Co. are raising money for fresh funds targeting small and mid-sized companies.

“The sweet spot for Japan’s private-equity market lies in the mid-to-small sectors,” said Joji Takeuchi, chief executive officer of Brightrust PE Japan Co., a Tokyo-based private-equity investment advisory firm. “The mega deals that took place around 2000 gave the wrong perception to overseas funds that Japan is a place for large-scale deals. Such investment opportunities are very rare.”

Buyout deals in Japan had gross internal rate of return of 46 percent on a weighted-average basis in the past decade, according to analysis of 95 out of 192 exits done by Brightrust. That compares with an estimated global average of 20 percent to 30 percent, according to Preqin.

‘Taking the Lead’

“Japan’s PE market may not look too attractive on the surface, but if you look at the middle market and smaller funds, they are making good investments,” said Kazushige Kobayashi, managing director in Tokyo of Capital Dynamics, a Swiss private equity firm with about $20 billion in assets. “Japanese funds are taking the lead, incorporating what’s been developed overseas.”

There’s been just nine $1 billion-plus buyouts out of 233 deals involving Japanese targets that were announced since 1998, according to data compiled by Bloomberg.

While private equity has been an established source of capital in Europe and the U.S. for over 30 years, the industry is only about a decade old in Japan, where companies have preferred financing from banks over investment funds.

The J.C. Flowers and Ripplewood Holdings LLC led buyout of now Tokyo-based Shinsei Bank Ltd. for 121 billion yen ($1.5 billion) in 2000 marked one of the earliest private-equity deals in the nation. Washington-based Carlyle Group and New York-based Blackstone Group LP followed by opening offices in the nation.

KKR Deal

New York-based KKR, which opened its office in Japan in April 2006, agreed in June to buy Usen Corp.’s human resource unit, Intelligence Ltd., for 32.5 billion yen. That was the biggest private-equity transaction in the country this year.

Shusaku Minoda, chief executive officer of KKR’s Japan unit, said global funds such as his have been busy with smaller deals elsewhere in Asia, where economic growth is quicker.

“If you want to do small investments, just compare the opportunities in India, China, Southeast Asia, U.S., Europe and Japan -- betting small in China and India makes more sense,” Minoda said.

Japan’s economic growth will slow to 1.5 percent in 2011, the International Monetary Fund forecasts. China will expand 9.6 percent next year and India will grow 8.4 percent, the Washington-based IMF said.

‘Committed to Japan’

Private-equity managers in Asia have been able to flip companies and profit from exits without the kind of extensive restructuring more common in developed countries. The average premium for private-equity deals announced in 2010 in the Asia- Pacific region rose to 30 percent from 13 percent in 2009, according to data compiled by Bloomberg.

To increase KKR’s activity in Japan, Minoda is looking beyond the traditional buyout strategy -- taking over a company by pooling money from investors and financing purchases with debt with the intention of selling the firm later for a profit - - to help fund companies’ overseas expansions. KKR’s Japan unit aims to invest in at least one to two deals a year, including partnerships investments, he said.

“The biggest obstacle in this country is that people have a huge skepticism about the funds,” Minoda said. “I want to establish a good franchise and brand of KKR in Japan -- we continue committing to Japan as KKR."

Ant Capital

Ant Capital, backed by Norinchukin Bank and Mitsubishi Corp., plans to raise about 15 billion yen by the end of March for its Ant Catalyzer No. 4 fund, which will invest in about 10 companies and targets an internal rate of return of about 30 percent, according to Chief Executive Officer Kazunori Ozaki. The firm is targeting smaller companies that have growth potential yet face difficulties with costs or finding successors as managers reach retirement, Ozaki said.

The firm's recent investments include Honma Golf Co., a Japanese golf product maker, which Ant Capital sold to Marlion Holdings Ltd., a company jointly financed by Chinese investors. Another investment was in Tri-Wall K.K., which makes packaging materials for industrial exports.

Tokio Marine Capital, the private-equity arm of Tokio Marine Holdings Inc., plans to raise as much as 50 billion yen for a new buyout fund focused on Japan's mid-sized companies. Its first and second funds produced internal rates of returns of about 25 percent, according to the firm.

The new fund will target "niche, top players" in their respective markets because it makes it easier to find buyers when the time comes to exit the investments, according to President Hideaki Fukazawa.

Pitching Globally

Next Capital Partners Co., led by Hisao Tateishi, a former managing director at Industrial Revitalization Corp. of Japan, is also focusing on Japan's mid-sized firms. The fund, which began in 2005, made its first exit selling Kasco Co., a Japanese golf goods maker, to Mamiya-OP Co., a fishing tackle and gold equipment maker, in November, returning about 40 percent.

Ant Capital's Ozaki, a former banker at GE Capital in Japan, said it is easier for local firms to pursue smaller deals that may not make sense for a global fund.

"It's difficult for the global funds to pitch their smaller investment ideas at their global investment committee meetings, because then you have to argue what makes the Japan deals more attractive than those you can find in places like China or India," he said. "I can understand their struggle."

In Japan, plagued by two decades of sluggish growth and deflation, the government is keen to help private-equity funds provide capital to the country's small-to-midsized firms.

Government Support

The Organization for Small & Medium Enterprises and Regional Innovation, JAPAN, a government agency under Japan's Ministry of Economy, Trade and Industry, has invested 126.9 billion yen since 1998 into the nation's private-equity funds, according to the agency. The ministry this year relaxed requirements for the agency to invest in the funds, including the minimum amount that the funds would have to have invested in small-to-midsized firms, to expand its capacity for providing funds to buyout firms.

The agency has been investing about 11 billion yen in Japanese private-equity firms each year for the past decade and plans to invest about the same amount in coming years, said Toru Ochiai, manager at the fund planning division of the agency.

Smaller, more nimble deals are able to succeed in Japan where larger rivals, which seek billion-dollar deals, have struggled, said Mark Chiba, former chief executive officer of UBS AG's Japanese brokerage unit and co-founder of The Longreach Group Ltd., a Hong Kong- and Tokyo-based buyout firm.

'World-Class Opportunity'

Longreach this year offered to pay as much as 17.9 billion yen in July for Sanyo Electric Logistics Co., an Osaka prefecture-based logistics solution provider, marking the second-biggest deal in 2010 in Japan after KKR's. It has raised $750 million for its first fund that started in 2004 and finished investing this year.

The firm aims to raise another $750 million for its second fund in the first half of next year to make about eight investments focused in Japan, Chiba said. Longreach aims to close two investments in 2011 as it starts deploying capital from the second fund. It aims to triple invested capital consistently through a traditional buyout strategy, Chiba said.

"You had some foreign players coming in to Japan, in the context of deploying huge global funds, and so needing billion dollar-deals, and being unable to find them and getting frustrated," Chiba said. "You have to be sized and configured for the actual opportunity, and if you are, Japan offers a world-class, traditional alpha-driven private equity opportunity."

--Editors: Malcolm Scott, Andreea Papuc.

To contact the reporters on this story: Tomoko Yamazaki in Tokyo at tyamazaki@bloomberg.net; Komaki Ito in Tokyo at kito@bloomberg.net

To contact the editor responsible for this story: Andreea Papuc at apapuc1@bloomberg.net.