Japan Buyout Monthly

February 2012

Bridging the Gap

There are 15 Japanese buyout GPs that are in the market raising funds today. There are another 11-12 GPs that we think will start fund raising during this year. There are 3 GPs that have been raising funds on a deal by deal basis. As a result, we could have **nearly 30 Japanese GPs looking for investors' money in the coming year.** However, the fund raising is likely to be tough.

There are multiple reasons for this.

✓ Japanese banks are no longer the reliable cornerstone investors for local funds. Major Japanese banks already dominate the local LBO market and there is no need for them to be a fund LP, especially under the punitive BIS III capital charge.

✓ After the Lehman crisis, the PE budgets at insurance companies were significantly reduced.

✓ Japanese public pensions have yet to start investing in PE. While corporate pensions were emerging as important PE investors, the momentum is now severely disrupted by a totally unrelated incident, a Japanese version of the Madoff scandal. Late last month it was reported that 84 corporate pensions, mostly small industry group pensions, have invested in an allegedly fraudulent hedge fund called AIJ and they could lose as much as USD 2.5 billion.This scandal is attracting a lot of attention and some politicians and regulators are quick to label "alternatives" as unacceptably risky assets.

✓ Most Japanese GPs have little experience in raising funds from foreign LPs and are often slow to adopt international standards on such matters as accounting and GP carry. On the other hand, a handful of larger GPs who raised out-sized funds from overseas investors in mid-2000s disappointed the LPs. They had difficulties in managing their latest large funds as well as their previous USD 500 million funds.

✓ Lastly, Japanese GPs have been competing against Chinese and Indian GPs for investor's Asia allocations, which has been tough.

Despite the difficulty in fund raising, the buyout market continues to offer very attractive investment opportunities. In fact, the environment is much better than 2006/7, when some Japan-focused funds were heavily over-subscribed. The good investing environment is supported by:

✓ Valuations remain cheap. Despite the recent price increase, Topix is still less than half of its peak in 2007 and small-mid cap indexes are at 1/2 to 1/3 of their highs in 2006. A good number of small-mid cap shares are trading at 2-4 times EBITDA offering attractive take private opportunities. A few funds were reportedly paying aggressively in the recent biddings, but we believe this is a temporary and idiosyncratic phenomenon.

✓ There is a large pool of private and public companies that have great products and services but are under-managed.

✓ Succession issues faced by a lot of private companies have become more imminent with the passage of time.

✓ There are a number of SMEs that are keen to expand their business overseas and they welcome GP’s support in this respect. Many Japanese companies - small and large - today make more money abroad than at home, via overseas operations and exports.

✓ Japan has as much as USD 3.5 trillion domestic consumption, which equals to China's. The market is large enough for hundreds of local SMEs to grow.

✓ On top, there will be USD 250 billion spending to support Tohoku rehabilitation, which has started to benefit certain sectors.

How might one bridge the gap between the shortage of funds and the availability of good investments? I believe **co-investments** would be the answer. While a fund LP is always a preferred co-investor, under the current situation, GPs will need to look for other sources of capital. **Japanese GPs should actively look for other GPs and strategic partners - both within Japan and overseas - for co-investments.** There are pros and cons of co-investments. But we do not live in a perfect world. If a transaction is attractive, doing the deal with a known and trusted partner would be much better than missing it. Additionally, leading a co-investment with a highly regarded foreign GP would be a powerful reference point during the fund raising.

Buyout Deals (Up to February 29th)

None

Post Investment Activities

Skylark, an operator of restaurant chains and a portfolio company of Bain Capital, will sell its 52.57% stake in Kozosushi So-Honbu (JASDAQ9973) through a tender offer.

Exits

Longreach has agreed to sell its 95% stake in **Sanyo Electric Logistics** to **Mitsui-Soko** (TSE 9302), who will acquire a 100% stake and warrants for JPY 24.2 billion (USD 298 million). Longreach originally invested in Sanyo Electric Logistics in 2010.

Mizuho Capital Partners has agreed to sell a 57.39% stake in auto parts maker **Faltec** to **TPR** (TSE6463) for JPY 8.1 billion (USD 100 million). Mizuho originally invested in the company in 2003.

RHJI has agreed to sell its 100% stake in **Phoenix Resort**, an operator of Seagaia Resort in Miyazaki Prefecture, to **Sega Sammy** (TSE6460) for JPY 0.4 billion (USD 4.9 million). RHJI originally invested in Phoenix in 2001.

Daiwa PI Partners has sold a 9.29% stake in **Nippon Dry-Chemical** (TSE1909) in the market. Daiwa originally invested in the company in 2008 and led it to an IPO in 2011. Daiwa still maintains a 38.6% stake after the sale.

Phoenix Capital has sold its 9.59% stake in **Seikitokyu Kogyo** (TSE1898), a civil engineering company, in the market. Phoenix originally invested in the company in 2005. Phoenix still maintains a 11.87% stake after the sale.

Japan Private Equity has sold its entire holding stake in **Morinaga Electric**, a maker of lightning protection system, to Nippon Chiko Dogan, a provider of grounding system. Japan Private Equity originally invested in Morinaga in 2007.

Fund News

Polaris Capital plans to launch its third buyout fund this year with target commitment of JPY 30-40 billion.

Financial News

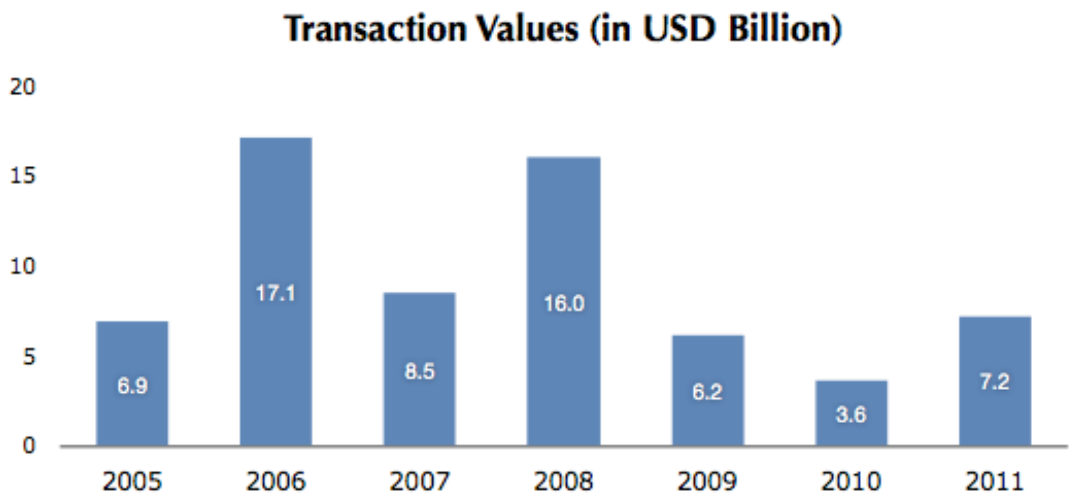
Consolidated net profits of companies listed in JASDAQ and TSE Mothers are expected to soar by 48% for fiscal 2011 according to the Nikkei.

Asian PE Headlines

Pacific Alliance Group invests USD250M in Bicon Pharmaceutical.
India's IDF invests 1.5B Rupees (USD 30M) in agriculture service company Staragi Warehousing and Collateral Management.
L Capital acquires a 5% stake in Indian ethnic wear chain Fabindia.

Japan Buyout Statistics

The transaction values of new deals in 2011 recovered thanks to two large transactions, Skylark and Tsubaki Nakashima.



Market Indices

		Monthly change	
TOPIX	835.96	80.69	+10.7%
Nikkei JASDAQ	1313.45	85.01	+6.9%

This monthly letter is composed by Brightrust PE Japan Co., Ltd. Brightrust is a Tokyo-based independent investment advisory firm. (http://brightrust.jp/) If you have further inquiries regarding the contents of the monthly letter or Japanese buyout market in general, please contact us at mail@brightrust.jp