Japan Buyout Monthly

May 2012

FX Risk

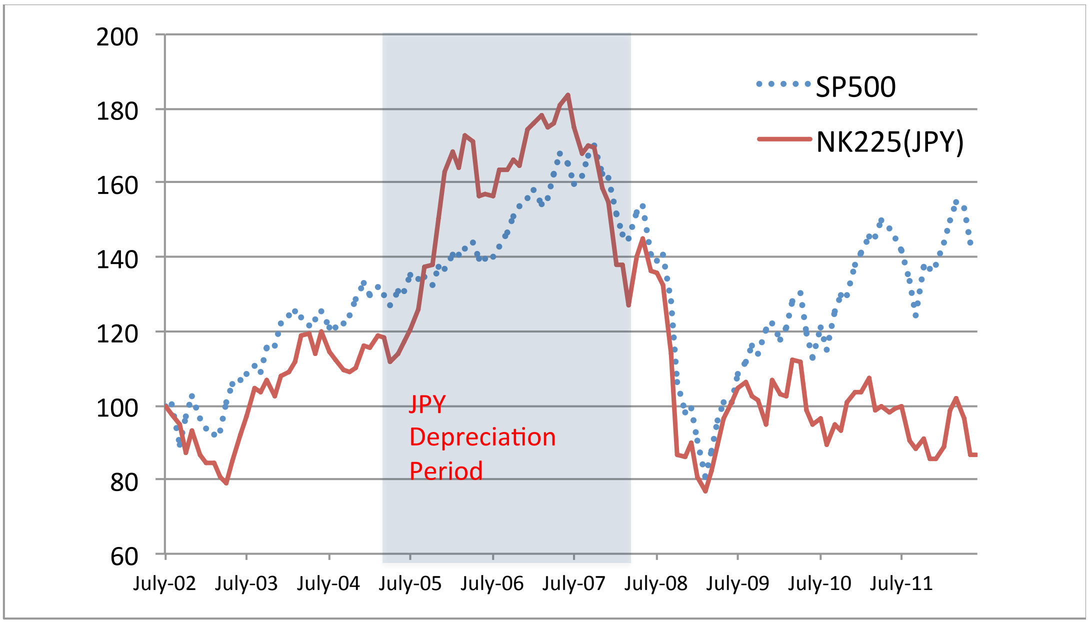
Japanese Yen currency risk is often cited as one of the major reasons for a foreign investor being hesitant to make commitments to Japanese PE funds. The general view held by these investors is that JPY has become too strong in the past few years and it will substantially weaken in the future. Considering the staggered nature of PE cash flows, for a PE fund investor to lose substantial money due to FX, the JPY has to stay strong in the next 5 years (capital call period) and it needs to substantially weaken in the following 5 years. But how likely is this scenario?

Let us look at historical JPY/USD FX rates:

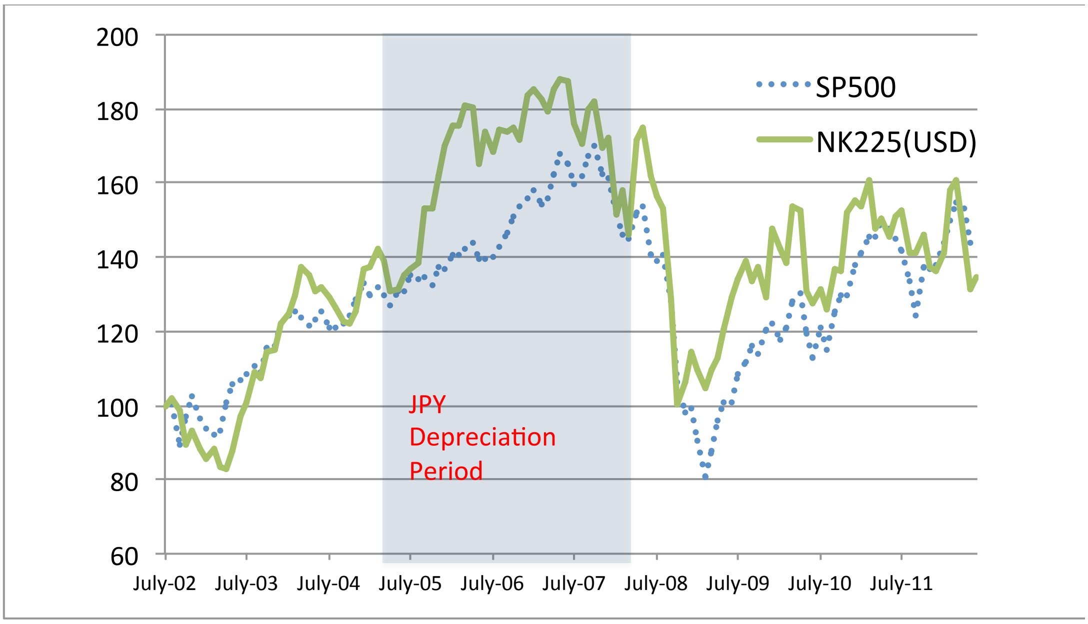
From 1990 to 1995: a 5-year JPY bull period (@160.35 to @79.75)
From 1995 to 1998: a 3-year JPY bear period (@79.75 to @147.64)
From 1998 to 1999: a 1-year JPY bull period (@147.64 to @ 101.25)
From 1999 to 2002: a 2-year JPY bear period (@101.25 to @ 135.20)
From 2002 to 2005: a 3-year JPY bull period (@135.20 to @101.67)
From 2005 to 2007: a 2.5-year JPY bear period (@101.67 to @124.14)
From 2007 to 2012 ?: a 4.5-year JPY bull period (@124.14 to @75.57)

The above shows that the JPY/USD market has typically had 2 to 5-year cycles. Given the current JPY bull period is already 4.5-years old, a start of a JPY bear period in the near future would be a reasonable assumption. In fact it may have already started after hitting the historical high of 75.75 in last October. In that case, we may see a JPY bear period in the next several years, which may be followed by a period of JPY appreciation, which is exactly opposite to the scenario mentioned above. Some investors may, however, say that their concern is not the medium-term fluctuation of JPY, but the very long-term trend of JPY weakening. The long-term JPY bear view may be right. But the FX market will still have several large medium-term corrections, as it has had in the past 20 years. And the medium term swings can be so large that they could have far more impact to investment returns. Buyout deals typically have 3-7 year holding periods.

But there is another important consideration. Japanese stocks tend to be sold when JPY appreciates and bought when JPY depreciates.



The market perception is that the Japanese economy is heavily dependent on exports and therefore corporate earnings are sensitive to FX. In addition, many Japanese companies have increased revenues from overseas through cross border M&As and direct foreign investments. They have a good part of their cash flows and assets (factories, mining rights, etc.) outside Japan and they are denominated in foreign currencies. By investing in Japanese companies, an investor is also acquiring foreign business and assets. It is often the case that real FX exposure in investing in Japanese stocks is less than the face value of the investments. How much less? It depends on the respective company and its business. Small to medium-sized companies tend to have less foreign contents, but not always.



The green line is the Nikkei 225 denominated in USD. The chart tells us that the Nikkei in USD is more correlated to the S&P especially in the current JPY bull cycle. A USD-based investor who invested in the Nikkei 225 on July 1, 2002 has seen the Nikkei outperforming the S&P for the major part of the last 10 years. As far as the last decade is concerned, it may be argued that FX exposure has actually reduced the risks for foreign investors.

Despite all the above, it is a fact that some foreign investors are hesitant to invest in Japanese buyouts due to the currency risk. And this concern is not going away anytime soon. The investors will stick to the view while the JPY remains strong and they may decide to wait a little longer once the JPY starts to weaken. If so, s**hould it be a time for Japanese GPs to offer solutions to this problem for non-Japanese investors?** It is very rare for a PE fund to provide FX overlay. But very few PE firms in other jurisdictions have faced the same needs. Despite the difficulty in estimating future cash flows and the complications associated with measuring the real FX sensitivity, a GP is in the best position to gauge the FX exposure of the fund portfolio companies. Overlay hedging is already quite common among hedge funds and the purpose is to reduce, not eliminate, risks in preparation for major market fluctuations.

Buyout Deals

has agreed to acquire a 62% stake in **Voyage Group**, an operator of e-commerce navigation site, from **Cyber Agent** (TSE4751). Voyage Group reported annual sales of JPY 7.9 billion (USD 101 million) and operating profits of JPY 0.5 billion (USD 6.4 million) for the period ending September 2011.

Nippon Mirai Capital has agreed to sponsor a MBO of e-learning provider **ALC Press** (JASDAQ 2496) through a tender offer. The tender offer price is JPY 27,500 per share, a 33.73% premium over the last 3-month average trading price. The tender offer value is JPY 3.1 billion (USD 39.7 million). ALC reported annual sales of JPY 7.9 billion (USD 101 million) and operating profits of JPY 0.4 billion (USD 5.1 million) for the period ending January 2012.

Unison Capital has agreed to acquire a 100% stake in pharmaceutical company **Showa Yakuhin Kako** from **Tokio Marine Capital, Polaris Capital Group, and PineBridge**.

Milestone Turnaround Management and **ACA** have agreed to invest JPY 1.8 billion (USD 22.8 million) in property company **Samty** (JASDAQ 3244). Milestone and ACA will acquire convertible preferred shares through a private placement. The two funds will effectively hold 22.8% stake in the company. Samty reported annual sales of JPY 16.2 billion (USD 205 million) and net profits of JPY 1.2 billion (USD 15.2 million) for the period ending November 2011.

Japan Industrial Solutions has agreed to invest JPY 3 billion (USD 38 million) in **JOEL** (TSE6951), a maker of electronic microscope, in the form of preferred shares through a private placement. JOEL reported annual sales of JPY 83.1 billion (USD 1.05 billion) and a net loss of JPY 9 billion (USD 114 million) for the period ending March 2012.

J-Star has acquired a 100% stake in pet apparel company **Three Arrows**. The company reported annual sales of JPY 2.3 billion (USD 29.5 million) and net profits of JPY 80 million (USD 1 million) for the period ending July 2011.

TPG and UK real estate company Savills have agreed to acquire a 100% stake in failed condominium developer **Joint Corporation** from its former restructuring sponsor **Reno Corporation**. Joint filed for bankruptcy protection in 2009.

Post Investment Activities

Skylark, an operator of restaurant chains and a portfolio company of **Bain Capital**, plans to offer free electric vehicle chargers at around 900 of its restaurant within five years, according to the Nikkei.

Exits

Tokio Marine Capital, Polaris Capital Group, and PineBridge have agreed sell their 100% stake in Showa Yakuhin Kako to Unison Capital. The three investors originally invested in the company in 2008.

MUL Capital has agreed to sell its 100% stake in **Tarami**, a fruit jelly maker, to **DyDo Drinco** (TSE 2590) for JPY 11 billion (USD 141 million). Tarami reported annual sales of 14.5 billion (USD 186 million) and net profits of JPY 0.52 billion (USD 6.7 million) for the period ending December 2011. MUL originally invested in the company in 2009.

Daiwa Principal Investments has agreed to sell its holding stake in **Meisei Electric** (TSE 6709) to **IHI** (TSE 7013) through a tender offer. Daiwa originally invested in Meisei in 2002.

New Horizon Capital has agreed to sell its holding stake in plumbing fixture maker **Housetec** to electronic appliance retailer **Yamada Denki** (TSE 9831) for reportedly JPY 10 billion (USD 128 million). New Horizon originally invested in Housetec in 2008.

Polaris Capital Group has agreed to sell its 26.2% stake in internet-based travel information service provider **Ekitan** (TSE 3646) to **CSI**. Polaris will remain a minor shareholder with a 25% stake. Polaris originally invested in Ekitan in 2007 and led the company to IPO in 2011.

Fund News

JAIC plans to launch a JPY 5 billion growth capital fund.

Financial News

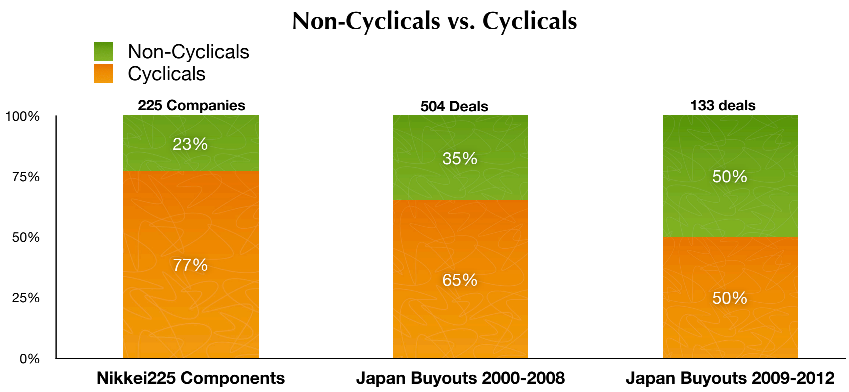
The aggregate pretax profits of 491 companies listed in JASDAQ and TSE Mothers market were up by 13% in the year ended March 2012, achieving a third consecutive year of double-digit increases, according to the Nikkei.

Asian PE Headlines

CKLC Fund invests in Shanghai Nongyi Digital Engineering Technology.
Fortune Venture Capital invests RMB100M in accessory chain Aiyaya.

Japan Buyout Statistics

While the Nikkei 225 stock composition illustrates the manufacturing-centric and hence cyclical nature of the Japanese economy, buyout funds are increasingly focusing on non-cyclical sectors after the Lehman Crisis.



Market Indices

		Monthly change	
TOPIX	719.49		-10.54%
Nikkei JASDAQ	1313.85	-76.51	-5.50%

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