



Japan Buyout Monthly

September - December 2012

New LDP Government

The lower house election held on December 16th brought a landslide victory to Liberal Democratic Party (LDP) - New Komeito coalition. The LDP had been in power for most part of the last 50 years until it lost to the Democratic Party of Japan (DPJ) in the 2009 election. The outcome is generally seen as the result of voters' denial to the incumbent DPJ government rather than a positive endorsement of LDP led by Shinzo Abe. Abe succeeded Koizumi as the prime minister in 2006 but resigned in 2007. But the fact that the coalition now has a two-thirds supermajority in the lower house gives the incoming government enough votes to force its agenda through Diet without the help of the DPJ-controlled upper house.

While the new LDP government could bring significant changes in some key issues, such as discussions on possible Constitutional reforms and constitutional interpretation of "collective self-defence" in the medium term, the urgent policy agenda remains the same. And most are in the economic front. In fact, economic policy of DPJ and that of LDP have been gradually converging in the past year, with the exception of the nuclear power policy. The difference lie more in "How to do ?" than "What to do ?". Japanese voters apparently bet on the LDP's "execution" ability with its 50 year's ruling experience.

DPJ failed to keep many of the promises it made to voters 3 years ago. Its clumsy foreign policy damaged Japan's relationship with the US, which, many believe, lead to the heightened tension with its neighbors. The territorial issues have had a very profound impact on voters' behavior.

The below is my observation of the new LDP government policy in comparison to that of the DPJ government.

Monetary Policy

LDP President Abe has already applied strong pressure on Japan's central bank to adopt far bolder quantitative easing, which has helped weaken the JPY currency. The BOJ has decided to boost its asset-purchasing program by JPY 10 trillion (USD 117 billion) and to begin discussions toward adopting a 2% inflation target. The stock market rallied and the JPY currency weakened by more than 10%.

Fiscal Policy

The LDP government said it will compile an emergency stimulus package by mid-January (which it did) and submit a sizable supplementary budget by the end of January. If such measures heavily rely on public works, the traditional approach adopted by LDP government, which brought today's huge government debts, they could encounter strong objection from a number of opposition parties.

Consumption Tax

Prior to the election, the LDP - New Komeito coalition had in principle agreed with the then DPJ government to increase the consumption tax rate from 5% to 8% in 2013 and subsequently to 10%. While the agreement provides that the increase is subject to the prevailing economic condition and some LDP members may wish to use the provision as the excuse to delay the increase, it would be reasonable to assume that the increase will be effected as planned.

Tohoku Reconstruction

The need for more efficient execution of various reconstruction programs is evident. Poor and slow execution of the reconstruction programs was one of the major causes for the DPJ defeat.

Nuclear Power Policy

This is the area the LDP and the DPJ differ most. The new LDP government is unlikely to declare a non-nuclear policy in the near future. Last week Abe has suggested that he could abandon the DPJ government's policy of not allowing utilities to build new nuclear reactors.

Trans-Pacific Partnership (TPP)

Prior to the election, the DPJ Government expressed its intention to participate in the discussions on TPP free-trade agreements. Having its major electoral base among farmers, the LDP took an opaque stance on this matter. However, after the blowout win at the election, the LDP and New Komeito adopted a coalition pact that leaves room for the new government to participate in the TPP talks.

The most possible source of instability in the new coalition government is that the LDP and New Komeito differ in some of the key policy agenda, namely on constitutional discussions and nuclear power policy. On these subjects, New Komeito shares more with the DPJ, while the LDP has more in common with another significant opposition party, the Japan Restoration Party led by ex-Tokyo governor Ishihara and Osaka mayor Hashimoto.

Softbank Acquisitions

On October 1, **Softbank** (9984), Japan's 3rd largest mobile phone operator, announced that it would acquire 100% of **eAccess** (9427), an ISP and seller of portable routers for PCs and tablets, through a share swap. Valuing eAccess as much as USD 2.3 billion, Softbank was paying as much as 3.5 x the company's market value. While eAccess was in talks with the No.2 mobile phone operator **KDDI** (9433), Softbank was apparently unaware of this, presumably focusing on their USD 20 billion **Sprint Nextel** acquisition in the US (announced on October 15). Softbank offered an extraordinary 250% premium to beat competitors as they were latecomers to this opportunity.

Nonetheless, some analysts said that buying eAccess at 3.5 times was not too expensive for Softbank, which badly needs additional frequency band to offer tethering services to its iPhone 5 users. KDDI was rapidly increasing iPhone 5 users after it had introduced tethering services. But something must be out of line to say buying a company at 3.5 time of its prevailing market value is not expensive. "Synergy" is often cited as justification for a higher price. But if frequency bandwidth was not a government-controlled commodity, even Softbank would not have paid this much. In fact, eAccess was almost bound to face a serious problem. Its main portable router business could have been made redundant if the top 3 mobile carriers started to offer tethering services as part of their standard mobile phone package. Given the situation, there is no surprise that the major shareholders of eAccess badly wanted to sell their holdings. **Goldman** has been the major shareholder of eAccess for over 10 years. It still owns approx. 30% of the company. **Blackstone** owns about 6% after it invested JPY 17 billion along side with Goldman in June 2010 - only 9 months after Carlyle-backed Wilcom went under being unable to secure financing for necessary capex to stay in business.

Some people have raised questions for potential conflict of interest. Goldman, the largest shareholder of eAccess, advised eAccess in its negotiation with Softbank. Simultaneously Goldman was advising Softbank in its Sprint Nextel acquisition. Additionally, a Goldman professional is on the Softbank board. Softbank's decision to snatch eAccess was apparently very hastily made in a matter of a week. It is unlikely that a robust due diligence was conducted before making the extraordinary offer.

Clearly the losers are Softbank shareholders. With the announcement of 2 large M&As in 2 weeks, Softbank shares tanked by as much as 30% and Softbank shareholders aggregately lost USD 13 billion in total. (*)

Investors must learn the consequences of investing into a company with an extremely ambitious management and relatively weak corporate governance. They should also be reminded that price distortion could be very large in the case of companies in regulated industries. As we all know, many "defensive" stocks belong to sectors with a higher degree of government control and by investing in stocks, listed or private, in such sectors as pharmaceuticals, utilities, healthcare services, telecommunication services, infrastructure

and clean energy, an investor is trading stable cash flows for possible regulation-related event risk.

(*) Softbank share regained a half of its loss by the end of October and more in November with the general strengthening of the equity market. But the share swap ratio for the Softbank / eAccess merger had already been reset at a level 20% below the original swap ratio when the Softbank share plunged.

New Deals

(August)

Dogan Investments acquired a 27.6% stake in **Nichiryu Nagase**, a supplier of gardening products based in Kyushu, from **Eco Trading**, a pet food wholesaler. This is the 5th investments of Kyushu Bridge Fund managed by Dogan. The sales of Nichiryu Nagase in 2011 were JPY 34 billion (USD 425 million).

(September)

Carlyle Japan acquired 100% of the outstanding shares of **Walbro Engine Management**, a global small engine parts manufacturer based in Tucson, Arizona, from **Sun Capital Partners**. Terms of the transaction were not disclosed. Equity for the investment comes from Carlyle Japan Partners II. Walbro has sales, R&D, and production capabilities in Japan and the United States, and also has manufacturing facilities in Thailand, China and Mexico.

Next Capital acquired additional 11.5% stake in **Fuji Medical Instruments** through its second fund. Next invested in the massage chair manufacturer in 2007 from its first fund and its co-investment vehicle. As the maturity of the co-investment vehicle became due, the co-investor agreed to sell its holdings to Next. According to the Next, Fuji's EBITDA increased from JPY 700 million in 2009 to JPY 1.45 billion in 2012, while its outstanding debt declined from JPY 7.3 billion to JPY 4.1 billion.

Unison Capital has acquired a 40% stake in **Dexerials Corporation**, which consists of Sony Chemical & Information Device Corporation and other Sony chemical products businesses. Development Bank of Japan holds the remaining 60% stake. The sale brought JPY 57.2 billion (USD 715 million) cash to Sony. Dexerials seeks to expand its sales in adhesive and optical materials in the smartphone and tablet PC markets and aims to grow its sales from JPY 56.8 billion to JPY 100 billion in the next 5 years.

(October)

Carlyle Japan will sponsor the MBO of **Diversey G.K.** acquiring shares from its US parent **Sealed Air Corporation** for reportedly JPY 30 billion (USD 375 million). Diversey Japan is one of the major providers of cleaning, sanitation and hygiene products and solutions to institutional customers with annual sales of JPY 26 billion (USD 325million).

NEC Capital Solutions acquired 99% of **Marinepolis Holdings**, which manages a conveyor belt sushi chain, for JPY 1 billion (USD 12 million).

The PIPES fund, managed by **Advantage Partners**, increased its investment in JASDAQ listed **CCS Inc.** from 25.5% to 42.11% on November 21. The total purchased stands at JPY 360 million (USD 4.5 million). The purchase price was at about a 5.5% discount from the closing price averaged over the last 3 months. CCS's sales were JPY 5.3 billion (USD 62 million). The Advantage PIPES fund took in about JPY 1 billion (USD 12 million) of preferred CSS stock in July, 2011.

(November)

CITIC Capital announced on November 7 that its second Japan fund would acquire 100% of the issued shares in **Polymatech** in December. Polymatech, a polymer parts manufacturer for electronic equipment with production plants in Japan, China,

Malaysia and Indonesia, has selected CITIC Capital as the sponsor for its civil rehabilitation proceedings approved in August.

(December)

Advantage Partners, through its special purpose company, acquired Sanyo's digital camera business. All the stock of **Sanyo's DI Solutions** and their Indonesian factory affiliate will be acquired on March 31, 2013. Sanyo once had a share exceeding 30% of the world's total by providing cameras to large manufacturers such as Olympus and Nikon on an OEM basis, but with a shrinking digital camera market and an uphill struggle with fleeing OEM customers fleeing after it became a Panasonic subsidiary, recent sales figures have fallen to less than half their peak of USD 2.7 billion in March, 2004. Panasonic has a strong camera business and companies like Olympus did not want to rely on their competitor's sub for OEM orders.

Post Investment Activities

(September)

Alconix, a non-ferrous and rare metal trading company invested in by **Mizuho Capital Partners**, increased its holdings of **Nichifu-Hangji Co.** from 15% to 35% of the outstanding shares. Nichifu-Hangji provides non-ferrous metal products to Japanese auto and electrical makers operating in China.

(October)

Covalent Materials, backed by **Carlyle Japan** and **Unison Capital**, has avoided defaulting on its JPY 53.3 billion (USD 666 million) outstanding debt due February 2014 after agreeing to buy back up to JPY 21 billion at a 24% discount and paying the rest with up to 4 year maturity extensions. The interest rate was increased from 2.87% pa to 4.25% pa and the redemption amounts will increase by JPY 1.25 over JPY 100 loan notional every 6 months. Carlyle and Unison bought ex-Toshiba Ceramics, now Covalent, in 2006. Carlyle held a 47.2 per cent stake in Covalent and Unison a 47.5 per cent stake at the end of March 2012. Blackstone Advisory Partners advised the bondholder group.

<http://japanesepenews.blogspot.jp/2012/10/carlyle-unison-owned-covalent-avoids.html>

Yamaha Living Tech, 85.1% owned by **Japan Industrial Partners**, assigned 5% of its stock to **Denso** as part of a tie-up agreement on October 31. According to a new report, Denso acquired the shares from Japan Industrial Partners and Yamaha Living Tech.

(November)

Non-ferrous metal trading company **Alconix**, a portfolio company of **Mizuho Capital Partners**, acquired 4 subsidiaries of **Univertical Companies** (US), coating material sales and production companies, at the end of December for JPY 6.5 billion (USD 76 million). Univertical has operations in 19 countries including the US and China.

(December)

According to a December 20 news report, **MBK Partners** was in the final stage of proceeding to buy **Komeda**, an **Advantage Partners** invested café chain.

According to a December 30 news report, **Taiwan Chinatrust Commercial Bank** told **Credit Agricole**, **Shinsei Bank** and **Lonestar**, the major shareholders of **Tokyo Star Bank**, about its JPY 50 billion (USD 588 million) buy-out intention of Tokyo Star Bank.

Exits

(September)

Nippon Mirai Capital sold its entire holdings of **Seiko Tone**, a construction company with a specialty in foundation work and earth bracing, to **Hirose Co.**, a client of Seiko Tone that engages in construction and leasing of heavy temporary materials. Nippon Mirai invested in Seiko Tone in 2009 as the reorganization sponsor.

iSigma Capital announced on September 28 the sale of all the stocks in its iSigma #1 Fund investment in **Kotobuki Seisakusyo** to **Pharmarise Holdings** (2796) for JPY 1.62 billion (USD 19 million). With this 100% ownership of Kotobuki Seisakusyo, Pharmarise is looking to move into the business of scanning and storing of medical materials such as x-ray film and paper records. Kotobuki Seisakusyo's 2012 sales were JPY 815 million (USD 9.5 million). iSigma invested in Kotobuki Seisakusyo in December 2009.

Exits already reported in July-September Letter

- Colowide Co. (7616) acquired Advantage Partners' investment in Rex Holding Co.
- J-Star sold Iki Iki k.K. to a subsidiary of Noritsu Koki.
- Nippon Mirai Capital sold Gourmet PIA Network Co. to Jorudan Co.
- DRC Capital divested its equity interest in Yumeshin Holdings (2362).

(October)

Goldman Sachs and **Blackstone** will be exiting from their investments in **eAccess** (9427) as the result of the acquisition by **Softbank** (9984), Japan's third-largest mobile phone carrier. Softbank plans to make eAccess a wholly owned subsidiary through a stock swap where eAccess shares are valued JPY 185 billion (USD 2.3 billion) or at 3.5 x of its actual market value of JPY 52 billion (USD 650 million) before the announcement. Softbank will use eAccess' available bandwidth to cope with sharply rising data traffic. Combined sales at Softbank and eAccess are expected to total about JPY 3.6 trillion (USD 46 billion), which will make Softbank the second-largest mobile carrier in Japan. Goldman has been the major shareholder of the eAccess since its establishment and Blackstone Capital Partners V funds invested JPY 16 billion (USD 200 million) in eMobile in June 2010. Currently Goldman owns 29.86% and Blackstone owns 6.08% of the outstanding shares of eAccess. With Softbank's generous bid, their investment loss was substantially reduced. eAccess was previously invested by Carlyle, Morgan Stanley, Temasek, Mizuho Capital Partners (mezzanine) and other private equity investors.

Daiwa Securities SMBC Principal Investments (DPI) sold its investment of 49.7% of the issued shares in the music video software store chain **Shinseido** (7415) and its JPY 1 billion (USD 12 million) loan claims to **Wonder Corporation** (3344). DPI sponsored a privately-negotiated civil rehabilitation process of Shinseido in 2008, but sales declined and debt exceeded assets in FY 2012.

J-Star sold all of its shares (79.3% of the total) of **Apo Plus Station**, a CSO for drug makers, to **Qol Co.** (2034) on October 31. The total stock sale including a 20.7% equity interest held by the management was JPY 3.1 billion (USD 36 million). Apo Plus' 2012 sales were JPY 5.25 billion (USD 62 million) and recurring profit was JPY 153 million (USD 1.8 million). Qol, a large pharmacy chain that has over 300 pharmacies, is looking to expand its medical related staffing service. J-Star invested in Apo Plus in September 2010.

(November)

None

(December)

On December 14, **Carlyle Group** re-listed **Chimney Co.** on the 2nd section of the Tokyo Stock Exchange. Chimney, a portfolio company of Carlyle Japan 2 Fund, operates Japanese style bar franchises and food services. Carlyle, through the listing, sold 53% of the total number of issued shares it holds. Proceeds of the sale were estimated to be about JPY 10 billion (USD 117 million). When Chimney de-listed in November 2009, Carlyle acquired 87.56% of the stock for JPY 19.4 billion (USD 2228

million), of which JPY 8.6 billion (USD 101 million) was finance by bank loans.

CAS Capital managed fund #5 sold its holdings in **SAINTSTAFF** to **Misawa Homes Co.** on December 21. **SAINTSTAFF**, a staffing company specializing in child care, welfare, nursing care and medical care, also operates elderly homes.

Carlyle Group announced on December 25 that it would sell all of its holdings in **Qualicaps Co. to Mitsubishi Chemical Holdings** (4188). Qualicaps, the largest provider of pharmaceutical capsules in Japan with over 20% of the world's share, is priced at JPY 55.8 billion (USD 656 million) which includes interest-bearing debt. Qualicaps sales were estimated at JPY 19 billion (USD 230million) in 2012, of which 2/3 were sold abroad. Carlyle bought Qualcaps from Shionogi & Co (4507) in 2005 and sales and EBITDA reportedly increased by more than 50% and 120% respectively under Carlyle.

Private Equity Related News

(September)

Yasuda Corporate Investments, a venture and buyout investor, divested its holdings of **T.C Factory**, an application and data base developer, to **Sockets**, a media contents provider.

Goodman Japan established the Goodman Japan Development Partnership as a 50/50 venture between Goodman and the **Abu Dhabi Investment Council**. A combined US\$500 million of equity has been allocated to the partnership. With the use of leverage, the partnership will invest in excess of US\$1 billion targeting at logistics development opportunities in Japan. Additionally, Goodman Japan Core Fund had its first close at USD 100 million with the commitments from 3 global investors.

Reed Capital Management, a 100% subsidiary of **Ant Capital**, invested JPY 150 million to SNS operator **Sumally** through its 2 VC funds.

Mizuho Capital Co. (VC) and 4 other private investors invested JPY 228 million to **Terra Motors**, a Japanese maker of electric bikes and mobility scooters, which is expanding into the Philippine market.

The Innovation Network Corporation of Japan (INCJ) invested JPY 300 million in **Celebrex**, a venture firm that focuses on the development and production of core parts for high-resolution displays.

Uniden (6815), a telecommunication equipment manufacturer, established a corporate venture fund with JPY 3 billion (USD 35 million) to invest in the developers of gaming and smart phone applications.

The Resolution and Collection Corporation of Japan (RCC) bought JPY 10 billion (USD 117 million) in preferred shares issued by **Tohoku Bank** (8349), a major regional bank in 3.11 tsunami-hit Tohoku area, to support the bank's financing in regional reconstruction.

Dogan Investments has established Kyushu Entrepreneur Club Investment LP to invest in venture firms in Kyushu area. 4 regional banks and The Organization for Small & Medium Enterprises and Regional Innovation, JAPAN committed a total of JPY 1. 1 billion (USD 13 million).

SBI Holdings announced that it has sold all of its stock in its subsidiary SBI Capital Solutions and at the same time transferred SBI Group's LP interests in SBI Mezzanine #2 and #3 Funds, 73.2% and 100% respectively, to an undisclosed party.

Longreach Group established Longreach Capital Partners 2 with total commitments of USD 400 million as of 30 September 2012. The fund will focus on Japan and North Asia and its investors include institutions and endowments in Japan, US, Europe and Asia.

(October)

The Innovation Network Corporation of Japan invested JPY 2.5 billion (USD 30 million) in a US venture company, **Transphorm, Inc.** Transphorm is a leading developer of GaN, a next generation power chip.

The Resolution and Collection Corporation (RCC) underwrote JPY 30 billion (USD 352 million) of preferred stocks issued by **Jimoto Holdings**, which was established by the merger of Kirayaka Bank and Sendai Bank on October 1.

Diamond Realty Management, a subsidiary of Mitsubishi Corp. (8058), launched an unlisted REIT with JPY 31.7 billion (USD 372 million). The fund targets commercial and logistics facilities and aims to increase its AUM to reach JPY 250 billion (USD 3 billion) five years from now.

The **Government** announced a plan to set up a public-private fund to aid the development of innovative drugs targeting cancer, diabetes and other diseases that are difficult to treat. Legislation to allow the public **National Institute of Biomedical Innovation** to raise long-term investment funds will be submitted to the Diet in 2013. The Innovation Network Corporation of Japan, financial institutions, pharmaceutical companies and venture capital firms are expected to contribute, with the fundraising target set at JPY 30-40 billion (USD 350-470 million) by fiscal 2014.

Nomura Holdings (8604) plans to launch an infrastructure fund focused on India in 2013. Nomura reportedly aims to raise USD 500 million for the fund from Japanese and Indian investors. The fund will invest in companies operating power grids, highways, airports and other infrastructure.

KKR opened its Singapore office as the regional hub for Southeast Asia. The opening establishes KKR's seventh office in Asia Pacific. KKR has invested more than USD 1 billion in SEA.

NTT Docomo (9437) has established another corporate venture fund with JPY 10 billion (USD 117 million) The "Docomo Innovation Fund" invests in domestic venture firms in the area of internet, healthcare, finance and media.

Social game provider **GREE, Inc.** (3632) acquired all the stock in social game developer **Pokelabo, Inc.** for JPY 13.9 billion (USD 163 million) on October 30. Pokelabo's main shareholders are Doll Capital Management, Sega Corporation and 3 Japanese VC funds.

(November)

JAFCO through its Super V3 Investment Partnership acquired a 50% stake of **Shibaura Group Holdings**, a Kyushu-based housing equipment company which also operates 3 mega solar project, for JPY 501 million (USD 6 million).

Aozora Bank (8304) announced the establishment of Aozora Chiiki Saisei, which will operate business recovery funds to be formed in regions around Japan. The regional revitalization funds will purchase loans to SMEs from regional financial institutions. Aozora has received a number of inquiries from regional banks with regard to "exit strategy" in light of the scheduled expiration of the Act Concerning Temporary Measures to Facilitate Financing to SMEs next March. Aozora aims to set up 5 funds in 5 prefectures with the total capital of JPY 5-10 billion (USD 58-117 million).

Shizuoka Bank (8355) will establish a JPY 4 billion (USD 47 million) fund to support SMEs in Shizuoka region with commitments from itself and other local financial institutions. Shizuoka Capital has managed 3 funds so far.

Mizuho Financial Group (8411) plans to set up a special purpose fund to help build mega-solar farms on idle plots of land owned by companies throughout Japan. The fund will provide JPY 50 billion (USD 590 million) in investments and loans per year, for a total of JPY 200 billion (USD 2.3 billion) over four years, for the development of about 15 mega-solar farm projects.

The Government Pension Investment Fund (GPIF) has commissioned **Brightrust PE Japan, Atsumi & Sakai Law Office, Capital Dynamics** and **T&D Asset Management** to conduct research on alternative investment schemes for the Fund. This is based on a public tender procedure announced last August. The assets to be researched include private equity, infrastructure and real estate.

Nomura Holdings agreed to sell **Annington Homes** held by its UK subsidiary Nomura

International to **Terra Firma** for GBP 3.2 billion with GBP 2.2 billion debt. According to a press report, Nomura Holdings will obtain several hundred million dollars in profit on the sale.

East Japan Disaster Reconstruction Support Organization inaugurated by the Japanese government in February, 2012 to assist in the reconstruction of the business affected by the Great East Japan Disaster will underwrite JPY 4 billion (USD 47 million) preferred shares to be issued by shipbuilder **Yamanishi** based in Ishinomaki in December. This is the largest injection of capital by this organization.

(December)

On 10 December, **the Innovation Network Corporation of Japan (INCJ)** announced that INCJ and the consortium of 8 leading Japanese companies will acquire 75% of **Renesas Electronics Corp.** (6723) for JPY 150 billion (USD 1.76 billion). INCJ will acquire 69.2% of all outstanding shares, while the consortium of **Toyota Motor Corp.** (7203), **Nissan Motor Co.** (7201), **Denso Corp.** (6902), **Keihin Corp.** (7251), **Panasonic Corp.** (6752), **Canon Inc.** (7751), **Nikon Corp.** (7731) and **Yasukawa Electric Corp.** (6506) will own 5.8% in total.

Kyushu Venture Partners will create a JPY 5 billion (USD 58 million) fund in the first half of 2013 that will invest into venture and small to medium sized businesses aiming to penetrate Asia.

Risa Partners has been actively partnering with regional banks looking at the expiration of the Act Concerning Temporary Measures to Facilitate Financing to SMEs in March 2013. After September, 2012, **Joyo Bank, Iyo Bank, Minato Bank, Okinawa Bank, Awa Bank, The Okinawa Kaiho Bank**, 8 banks from Shiga Prefecture, 8 banks from Miyazaki Prefecture, **Aomori Bank / Michinoku Bank** and 7 banks from Niigata Prefecture, signed an agreement on a corporate turnaround fund. Furthermore, it announced the establishment of Setouchi Economic Zone Ship Partners Fund (JPY 1 billion) and Tokyo SME Assistance Fund (JPY 2.5 billion) in December. The latter fund is invested by the **Organization for Small & Medium Sized Enterprises and Regional Innovation** and 11 Tokyo regional financial institutions.

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