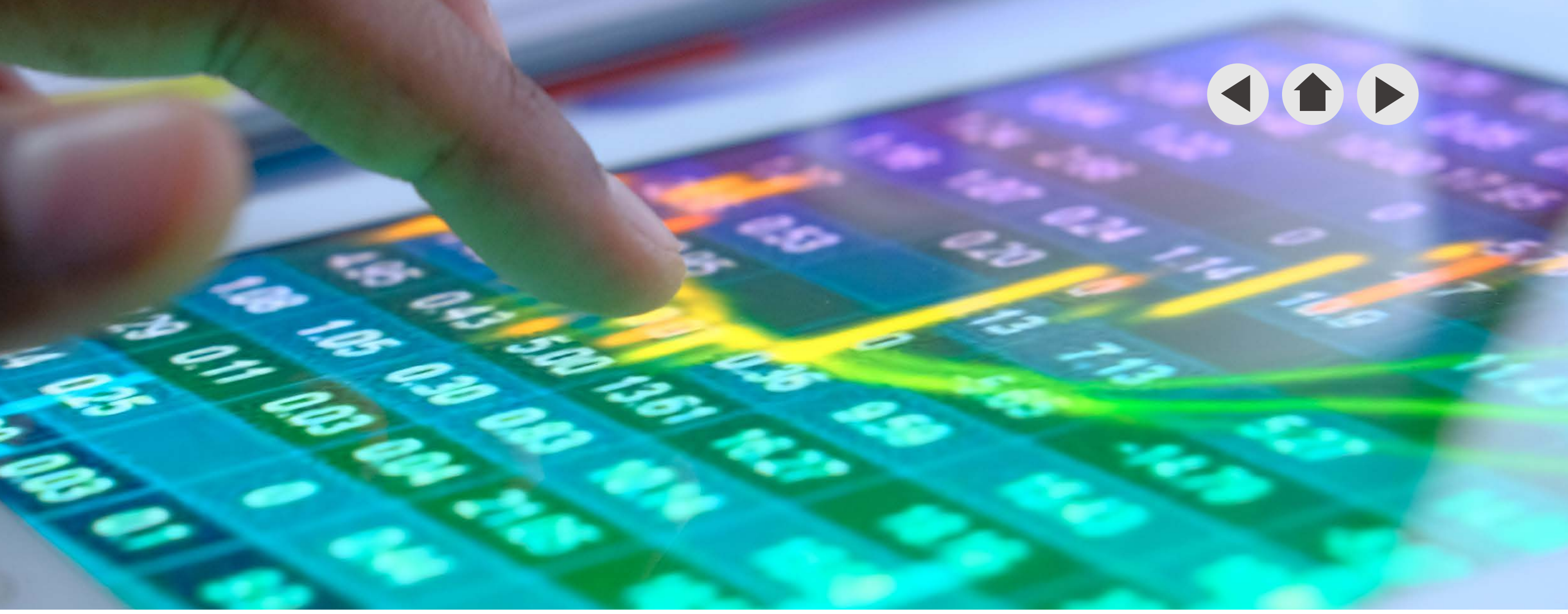
Analysis of Japan's private equity market and recommendations for Japanese companies - 2021

pwc

www.pwc.com/jp

Contents



Introduction

On 11 March 2020, the World Health Organization (WHO) declared the COVID-19 outbreak a pandemic, and the world faced an unprecedented crisis. As the severity of the pandemic increased, it immeasurably impacted the global economy. Remote work became more widespread, restrictions were placed on the movement of people and goods, consumer behaviour changed, supply chains were ruptured, monetary easing was implemented in numerous countries—change of an unprecedented magnitude took place across a wide range of activities. The pandemic, it could be said, also exposed fundamental flaws in global systems and vulnerabilities in corporate business models, raising the question of how we should shape the world of the future.

For business owners and executives in Japan, the situation has also given greater urgency to the need to accelerate reforms. Even before the pandemic, companies were involved in sustainability programs to address environmental and social problems, build governance systems for further globalisation and utilise digital technologies to carry out reforms, as well as other progressive initiatives. In particular, PwC's 24th Annual Global CEO Survey highlights the acceleration of digital transformation as a natural by-product of the pandemic, and the speed and quality of decision-making as a characteristic of pandemic response. The Tokyo Stock Exchange plans to change its market segments in April 2022, and this, too, is likely to raise the bar higher for investors and market reforms.

Against this backdrop, it is only natural that private equity is further increasing its presence in Japan since it creates corporate value by expediting and deepening reforms. Going private can be a powerful solution for many of the aforementioned problems, and private equity can also be prescribed effectively to stimulate the non-core businesses of large companies when investing additional resources is not feasible, or to deal with the problem of business succession when a business has no successor. Private equity is growing at a remarkable pace globally, and is steadily building a track record as a catalyst for growth and change in Japan as well. We expect to see growth in both the scale and number of private equity deals going forward.

Due to strong interest, we have decided to also publish this report in English for the first time this year. Reaffirming this high level of interest in private equity activity in Japan, we attempted to compile this year's report from a new perspective that takes the post-COVID landscape into account. We hope the report will heighten your interest in private equity and help deepen your understanding of it.

Hideo Nagura
Private Equity Leader,
PwC Japan Group
Partner,
PwC Advisory LLC

Trends in investment by private equity funds

First, we will provide a review of trends in private equity (PE) fund investment in Japan. In 2020, the amount of PE investment (based on publicly released figures) grew substantially from the previous year, and has been steadily increasing. Factor in the number of deals, and the investment amount per deal has also been increasing.

The biggest deal in FY2019 was the acquisition by MBK Partners of Godiva's business in Japan for 110.6 billion yen. In 2020, by contrast, there were three deals in the 150 billion yen range: the acquisition by the Blackstone Group of Takeda Consumer Healthcare Company, first and foremost, as well as a management buyout of NICHIIGAKKAN by Bain Capital and the purchase of shares in Seiyu by KKR and Rakuten.

The Blackstone Group's acquisition of Takeda Commercial Healthcare Company (TCHC) for 242.0 billion yen was the fourth largest purchase by a PE fund since 2010.[1] It was the group's second healthcare deal after the AYUMI Pharmaceutical deal in 2018. Christophe Weber, CEO of Takeda Pharmaceutical, stated in a press release that consumer healthcare businesses were not a priority area in Takeda's strategy, that sales from these businesses in Japan accounted for no more than around 2% of Takeda's total sales, and that this share had been falling in recent years. He also said that it would take a great deal of investment to grow TCHC, but because of Takeda's focus on highly innovative drug discovery in five key business areas, it would be difficult to justify putting a higher priority on investing in consumer healthcare businesses. Further, he explained that to maximise the high potential of TCHC and steadily fulfil the company's mission of '...[continuing] to contribute to the extension of healthy life expectancy by delivering "excellent products and timely, accurate information" to [their] customers who want to "live healthy"' going forward, they decided it would be best to turn over the business to a partner that Takeda could trust and that understood the healthcare business model and would be able to strategically invest in the growth of the company's brand, business, organisation and personnel.[2]

The Blackstone Group intends to leverage its global network to accelerate the success of TCHC.

In addition to the TCHC deal, which was a carve-out deal, a very large business succession deal also took place in FY2020, with a total acquisition price of 173.5 billion yen. This was the NICHIIGAKKAN management buyout by Bain Capital. According to the tender offer notice,[3] the death of former chairman Akihiko Terada in September 2019 prompted the company to shift from its traditional top-down structure to a new group-based style of management with all directors involved. At this time, the company decided that the best option for raising corporate value was to build a new management structure, increase operational flexibility and maximise business support from Bain Capital. Along with NICHIIGAKKAN, Bain Capital has also executed another successful succession deal in the form of a management buyout (MBO) of the drug store chain operator Kirindo Holdings from the company's founder.

1. Based on data on M&A by investment firms since 2010 from Recof M&A Database
2. Takeda Pharmaceutical Co., Ltd., 'Takeda to Divest its Japan Consumer Health Care Business Unit to Blackstone for JPY 242.0 Billion', 24 August 2020. https://www.takeda.com/newsroom/newsreleases/2020/takeda-to-divest-its-japan-consumer-health-care-business-unit-to-blackstone-for-jpy-242.0-billion/
3. NICHIIGAKKAN Co., Ltd. 'BCJ-44 Public Tender Notice', 11 May 2020. https://toushi.kankei.me/d/S100IJUD

Another major deal also took place in 2020 in which private equity served as the catalyst for promoting digitalisation. KKR and Rakuten acquired 65% and 20% shares in Seiyu respectively and are working to accelerate the company's digital transformation. In a press release, Hiro Hirano, co-head of private equity for KKR Asia Pacific and chief executive officer of KKR Japan, said, 'We will focus on working closely with Seiyu's management team and associates and leveraging the expertise of Rakuten and Walmart to enhance the customer experience, meet the customer's ever-changing needs, and make shopping more accessible through digitalisation. This investment is a true milestone for KKR in Japan and reinforces our commitment to the market as well as our continuing efforts to champion the long-term success of local businesses.'[4]

The major deals conducted in FY2020, therefore, included both carve-out investment deals—deals involving the sale of a core business or subsidiary of a major company—and business succession deals connected with the advancing age of the business owner, which is a major issue in Japan. The same year also witnessed some activity in listing markets by activist shareholders, with the Murakami Fund as the most prominent example. This leads us to believe that there will be even more opportunities in the future to utilise PE funds to increase corporate value.

Figure 1: Monetary amounts of domestic investments involving PE funds (by industry)

Source: Created by PwC from databases provided by Dealogic.
Note that the amount of information disclosed in relation to investment amounts is limited.
This figure does not include investments of an undisclosed amount.

4. Rakuten, Inc., 'KKR and Rakuten to acquire stakes in Seiyu from Walmart', 16 November 2020 https://global.rakuten.com/corp/news/press/2020/1106_01.html

Figure 2: Major domestic investment deals involving PE funds

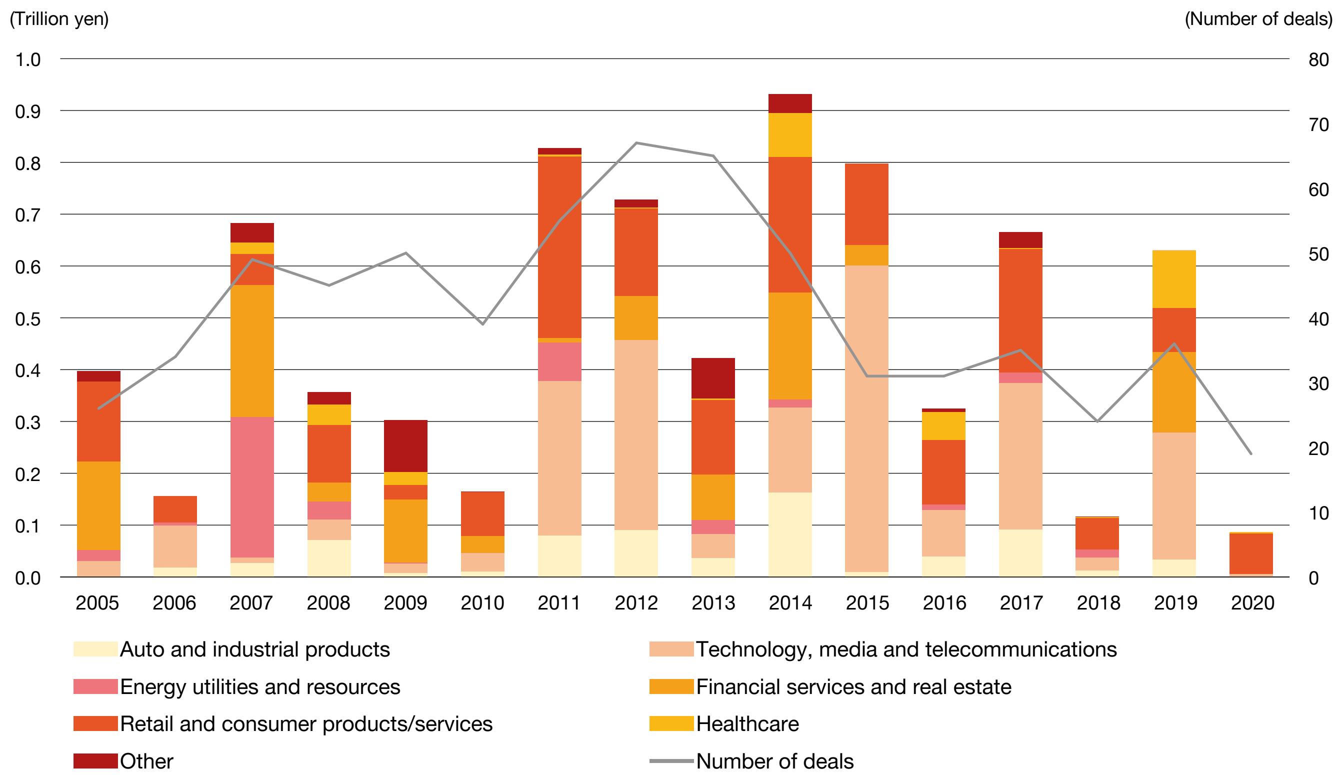
Date of announcement	Acquired company/ business	Industry of acquired company	Acquiring company	Selling company	Amount (billion yen)
Dec. 2020	Q'SAI	Food and beverage	Advantage Partners	Coca-Cola Bottlers Japan Holdings	42
Nov. 2020	Isetan Mitsukoshi Real Estate	Real estate/ property	Blackstone Group	Isetan Mitsukoshi Holdings	approx. 30
Nov. 2020	Seiyu	Retail	KKR, Rakuten	Walmart	172.5
Sep. 2020	Kirindo Holdings	Retail	Bain Capital		39.6
Aug. 2020	Takeda Consumer Healthcare Company	Healthcare	Blackstone Group	Takeda Pharmaceutical	242
Aug. 2020	SOFTBRAIN	Computers and electronics	Ant Capital Partners	Scala Inc. (50.23%)	25.6
May 2020	NICHIIGAKKAN	Healthcare	Bain Capital	Meiwa Co., Ltd. (24.76%)	173.5
May 2020	Asanoya	Retail	Nippon Mirai Capital		n/a
Mar. 2020	T-Garden	Consumer products	INTEGRAL		n/a
Mar. 2020	Akita Kyoei Kanko	Dining and lodging	Fortress Investment		n/a
Feb. 2020	Sogo Medical Holdings	Retail	Polaris Capital Group		94.2
Jan. 2020	Chat Noir	Dining and lodging	Longreach Group		n/a
Jan. 2020	Graniph	Textiles	Marunouchi Capital		n/a
Jan. 2020	Mamezou Holdings	Computers and electronics	INTEGRAL	Information Creative (0.63%)	34.4
Jan. 2020	Showa Aircraft Industry	Auto	Bain Capital	Mitsui E&S Holdings, Foster Electric	73.7

Source: Created by PwC from databases provided by Dealogic.

In this section, we will go over recent trends in exits in Japan by PE funds. Compared to 2019, exits have decreased, both in terms of the number of deals and in terms of monetary amounts. This decline may have been caused in part by the impact of the pandemic and the uncertain outlook of some portfolio companies that serve general consumers, such as restaurants. In FY2019, there were two exit deals with sales prices of over 100.0 billion yen, but in FY2020 the largest deal was KKR's sale of AlphaTheta for 65.0 billion yen. KKR had acquired an 85.05% share in the company (formerly Pioneer DJ) in March 2015, and in March 2020 all shares were sold to Noritsu Koki, including the 15.95% stake owned by Pioneer.

In the press release, Noritsu Koki describes AlphaTheta as a company with global operations that develops products enjoyed by a broad range of customer segments through the use of reliable technologies and advanced and nuanced innovation in the field of music, which has universal value to people. It also states that AlphaTheta is committed to the challenge of world-class innovation and to valuing its customers' opinions, which is consistent with Noritsu Koki's own approach as a company The press release also conveys Noritsu Koki's belief that companies with world-renowned technologies like AlphaTheta will be increasingly valuable in Japanese society moving forward, and that by acquiring an ownership stake, Noritsu Koki would be able to further promote AlphaTheta's development with the aim of enhancing the global presence of the Noritsu Group.[5] With future of DJ equipment sales uncertain because of COVID-19, KKR succeeded in exiting the business after seven years of ownership. Sales from the business were 21,621 million yen[6] when it was transferred to KKR in the fiscal year ending in March 2014, and had risen to 25,338 million yen[5] by December 2019, showing considerable growth under KKR's watch.

Figure 3: Trends in exit deals by PE funds involving Japanese companies



Source: Created by PwC from databases provided by Dealogic.
Note that the amount of information disclosed in relation to investment amounts is limited.
This figure does not include investments of an undisclosed amount.

5. Noritsu Koki Co., Ltd., 'Notice of Acquisition of Shares of AlphaTheta Corporation (formerly Pioneer DJ Corporation) Associated with Transfer of Special Subsidiary', 2 March 2020.
6. Pioneer, 'Pioneer and KKR agree to Pioneer DJ share purchase', 16 September 2014.

The Carlyle Group invested in Meisui Bijin Factory Co., Ltd. (formerly the GGC Group) in March 2016. Meisui Bijin Factory is the company that owns Meisui Bijin, the No. 1 selling bean sprout brand in Japan. In March 2020, Meisui Bijin Factory agreed to transfer full ownership to Shinmei Holdings Ltd., whose core business is rice wholesaling. In the press release, the Carlyle Group stated: 'Carlyle invested in Meisui Bijin Factory in March 2016 through Carlyle Japan Partners III, L.P., an investment fund advised by Carlyle Japan L.L.C. Carlyle has since helped the company drive a strategic transformation that has built the foundations for long-term sustainable growth. Carlyle leveraged its deep sector expertise and operational capabilities to develop a new management structure within Meisui Bijin Factory; start a new factory to establish and scale-up Meisui Bijin Factory's pre-cut vegetable business; strengthen the company's leading market position in bean sprouts through bolstering marketing and sales capabilities; and to rebuild Meisui Bijin Factory's missions and vision. Carlyle will now be transitioning full ownership to Shinmei where significant business synergies exist to support Meisui Bijin Factory's next phase of growth'.

Yusuke Watanabe, managing director of Carlyle Japan, said, 'We have been delighted to partner with Meisui Bijin Factory over the past four years, and feel great pride on the transformation and resulting value creation that we have collectively achieved within the business. We believe Meisui Bijin Factory's new partnership with Shinmei will help the company to further build on its position as the leading bean sprouts and pre-cut vegetables business in Japan.'[7]

Both press releases—those regarding KKR's sale of AlphaTheta and the Carlyle Group's sale of Meisui Bijin Factory—were dated 2 March 2020, which was just in time, one might say, in light of the timing of the COVID-19 pandemic. There have been no exit deals of this scale since April 2020. Buyer companies are aware that COVID-19 has made the outlook for many companies uncertain, and this has no doubt impacted the selling environment for PE funds.

Figure 4: Major exit deals by PE funds involving Japanese companies

Date of announcement	Acquired company	Industry of acquired company	Acquiring company	Selling company	Amount (billion yen)
Dec. 2020	Qit	Auto/trucks	Advantage Partners	CLSA Capital Partners	n/a
Nov. 2020	APRESIA Systems	Computers and electronics	Orix	Nippon Mirai Capital	n/a
Oct. 2020	Total Maintenance Japan	Construction/ building	Daiwa Motor Transportation, Daiwa Bussan	Endeavour United	n/a
Sep. 2020	BUNKASHA	Publishing	Beaglee	Nippon Sangyo Suishin Kiko	5.3
Aug. 2020	Japan Elderly Care Service	Healthcare	Solasto	ACA	2.3
Jul. 2020	Japan Popcorn Shops	Food and beverage	MIDAS CAPITAL	Advantage Partners	n/a
Mar. 2020	AlphaTheta	Consumer products	Noritsu Koki	KKR, Pioneer	65.0
Mar. 2020	Meisui Bijin Factory	Agriculture	Shinmei Holdings	Carlyle Group	n/a
Feb. 2020	Potato Kaitsuka	Food and beverage	Calbee	Japan Growth Investments Alliance	13.8

Source: Created by PwC from databases provided by Dealogic.

7. Carlyle Japan LLC, 'The Carlyle Group Enters into Definitive Agreement to Sell Meisui Bijin Factory to Shinmei Holdings Co., Ltd.', 2 March 2020.

Trends in fundraising by private equity funds

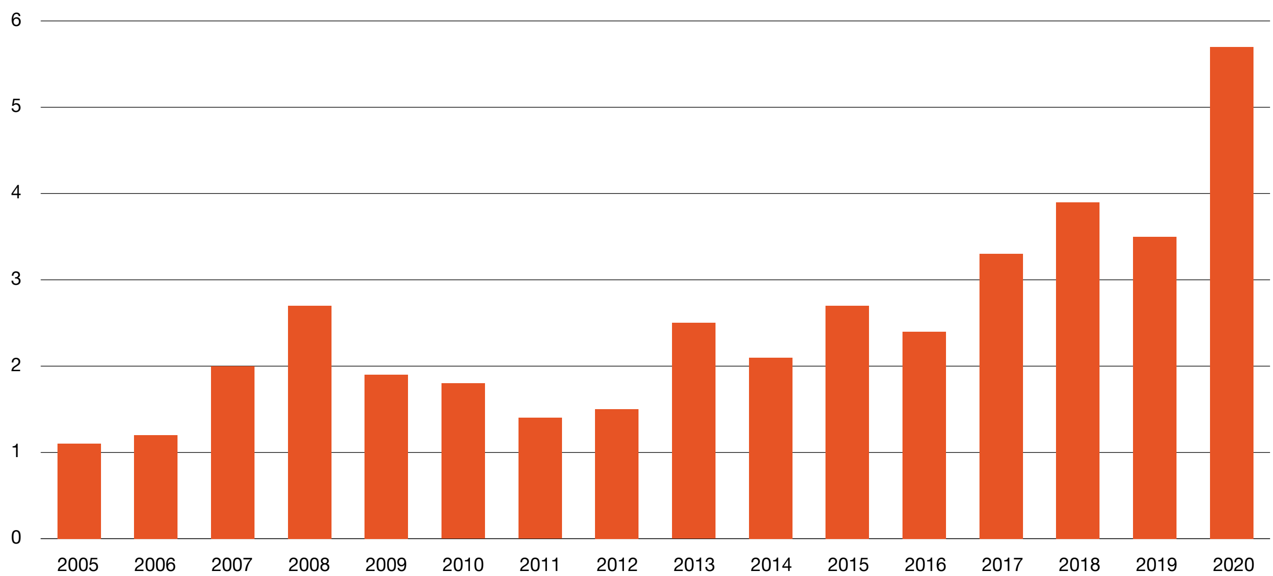
Fundraising by PE funds specialising in Japan reached a new record high in 2020, due in part to excess liquidity around the globe. As shown in Figure 6 (created by PwC based on data provided by Refinitiv), funds raised by PE funds in Japan exceeded 800.0 billion yen. Against a backdrop of low interest rates, capital is flowing into PE funds where high returns can be expected. And, as we explained previously, deals are getting bigger. It is possible that the current store of dry powder (funds that have been committed but not yet allocated) will be used at an accelerating rate.

The Carlyle Group in particular is focused on Japan. It raised 258.0 billion yen for its fourth Japanese buyout fund, Carlyle Japan Partners IV, more than double the amount raised for its Japanese Buyout Fund III.[8]

In addition, the Polaris Capital Group's Polaris Fund V raised 150.0 billion yen, the highest amount of all its funds thus far[9] and double the amount of Polaris Fund IV, which raised 75.0 billion yen.[10]

Similarly, the INTEGRAL Group's Integral Fund VI raised 123.8 billion yen, an almost 70% increase over the 73.0 billion yen raised by Integral Fund III.[11] Comparing all PE funds focused on Japan, the largest is the Carlyle Group's Japanese Buyout Fund IV, followed by the Polaris Capital Group's Polaris Fund V and the INTEGRAL Group's Integral Fund VI. It is noteworthy that of the funds that closed in FY2020, the top three in terms of size were Japan-focused funds. In addition to the three funds mentioned above, Advantage Partners Fund VI successfully raised 85.0 billion yen,[12] and MBK Partners, which actively invests in Japan, raised 6.5 billion US dollars for its Fund V.[13]

Figure 5: Trends in dry powder of PE funds with an interest in Japan (in trillion yen)



Source: Created by PwC from data provided by Preqin.

8. Carlyle Japan LLC, 'The Carlyle Group Raises JPY 258 Billion for Fourth Japanese Buyout Fund', 25 March 2020.
9. Polaris Capital Group, 'Completion of Fundraising for Polaris Private Equity Fund V', 1 December 2020.
10. Polaris Capital Group, 'Completion of Fundraising for Polaris Private Equity Fund IV, L.P.', 27 April 2017
11. Integral, 'Final Closing of Integral Fund IV', December 4, 2020.
12. Advantage Partners, 'Advantage Partners Raises \85 Billion for Latest Japanese Buyout Fund', 27 April 2020.
13. MBK Partners, 'MBK Closes Asia's 3rd Biggest Buyout Fund at $6.5 Billion', 21 May 2020.

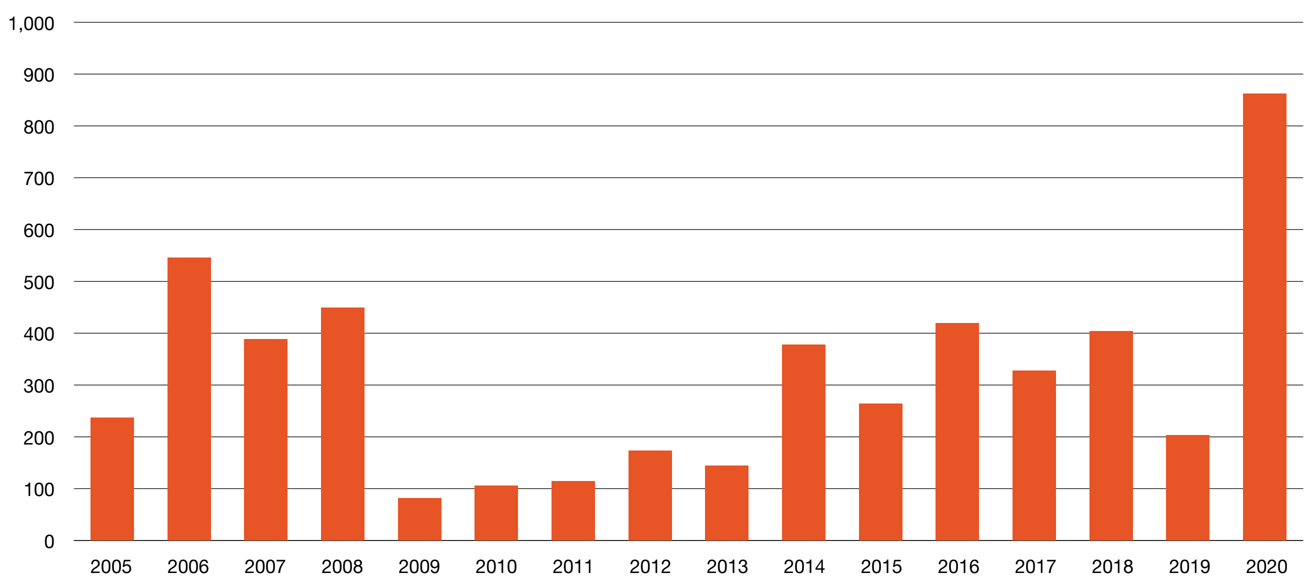
Several public funds were also established in 2020. The Japan Investment Corporation (JIC), a semi-governmental fund established to create a positive cycle for risk capital in support of next-generation industries in Japan, created its Fund No. 1 in September 2020. JIC's press release discusses the background behind the fund's establishment: 'While there are numerous private equity funds that focus on Japanese companies, the supply of risk capital towards enhancing industrial competitiveness in Japan remains limited from the medium- to long-term and industry policy perspective. In this context, investments in both 'emerging sectors' that lead to the creation of new industries, and 'maturing sectors' for large-scale business consolidation are essential across all industries. However, investments in 'emerging sectors' in Japan face high psychological barriers, which stem from the need to secure large amounts of capital and to enter a different industry. Investments in 'maturing sectors' face risk and financing related hurdles that are associated with large-scale acquisitions. In order to resolve these structural issues, a supply of large-scale, medium- to long-term risk capital that complements investments from private companies and financial institutions is indispensable'. The fund's size was set to 200.0 billion yen because 'engaging in large-scale industry reorganization to strengthen international competitiveness is expected to result in larger deal sizes'.[14]

In addition, the Tokyo Metropolitan Government established a fund of funds for business succession M&A, committing 6.0 billion yen to be combined with private-sector funds in support of small and medium-sized enterprises (SMEs).[15]

Further, the Development Bank of Japan, Nihon M&A Center, Career Incubation and others established Search Fund Japan, Inc., a new type of fund management company with the aim of solving problems such as a lack of successors for SMEs in Japan.[16] Search Fund is a mechanism whereby individuals called 'searchers' acquire SMEs through M&A, become executives of those companies, and lead them to renewed growth. Overseas, this is helping to expand the pool of young executives.

According to the research firm Preqin, Japan's PE market is relatively small compared to similar markets in the US and Europe, despite the size and maturity of Japan's economy.[17]

Figure 6: Trends in fundraising by PE funds in Japan (in billion yen)



Source: Created by PwC from data provided by Refinitiv.

14. Japan Investment Corporation, 'JIC establishes JIC Capital Co., Ltd.', 9 September 2020.
15. Bureau of Industrial and Labor Affairs, Tokyo Metropolitan Government, 'Establishment of FY2020 New Business Succession M&A Fund of Funds (FoF)', 1 December 2020.
16. Development Bank of Japan, 'Establishment of New Fund Management Company for Solving the Issue of Business Succession', 9 October 2020.
17. Preqin, 'PEVC in Japan's Transitioning Economy', November 2020.

Figure 7: Major fundraising efforts by PE funds in Japan (2020)

Date	Fund	Company	Main targets	Fund size (billion yen)
Feb. 2021	Fund VI	T Capital Partners	Middle market and SME business succession, subsidiary and business division divestiture associated with major company reorganisation, etc.	81.094
Dec. 2020	Polaris Fund V	Polaris Capital Group	Carve-outs, business succession, going private	49.75
Dec. 2020	Integral Fund IV	INTEGRAL	Business succession, business turnarounds, MBOs, spin-offs from large corporations, etc.	123.8
Nov. 2020	J-GIA Fund II	Japan Growth Investments Alliance	Focused on middle market and SMEs with latent growth potential	38
Sep. 2020	Unison Capital Partners V, LPS	Unison Capital	Medium-sized companies involved mainly in healthcare, consumer-related sectors and B2B services	80
Sep. 2020	JIC PE Fund No. 1 Investment LPS	Japan Investment Corporation	Buyout investment and growth investment in domestic and foreign companies	200
Apr. 2020	Advantage Partners Fund VI	Advantage Partners	Business succession, carve-outs from corporate groups, going private, MBOs and other buyout investments targeting mainly middle market companies	85
Mar. 2020	Buyout Fund IV	Carlyle Group	Investment opportunities in middle market companies and major investment deals in 1) Japanese consumer goods, retail and healthcare, 2) manufacturing and general industry, 3) technology, media and communications, etc.	258

Source: Created by PwC based on the respective companies' websites and press releases.

- T Capital Partners, 'T Capital Partners Closes Maiden Independent Fund at the Hard Cap', 1 February 2021
- Polaris Capital Group, 'Completion of Fundraising for Polaris Private Equity Fund V', 1 December 2020
- INTEGRAL, 'Final Close of Integral Fund IV', 4 December 2020
- Japan Growth Investments Alliance, 'Notice of Closing of J-GIA II Series Fund', 5 November 2020
- Unison Capital, 'First Closing of Unison Capital Partners V, LPS', 30 September 2020
- Japan Investment Corporation, 'JIC establishes JIC Capital Co., Ltd.', 9 September 2020
- Advantage Partners, 'Advantage Partners Raises \85 Billion for Latest Japanese Buyout Fund', 27 April 2020
- The Carlyle Group, 'The Carlyle Group Raises JPY 258 Billion for Fourth Japanese Buyout Fund', 25 March 2020

1. Business succession

With many business owners in Japan advancing in age, business succession is a clear issue related to the sustainability of a company's growth and development. The impact of COVID-19 on business management, including as it relates to the speed of reform and promoting digital transformation, is likely to further accelerate succession in family businesses.

Teikoku Databank analysed the ages of company presidents nationwide in 2020. According to their analysis, the average age of presidents rose from 59.7 in 2019 to 60.1 in 2020, a record high and the first time the average age has exceeded 60 since the survey started in 1990.[18] Teikoku Databank also surveyed company attitudes toward business succession. The survey found that 8.9% of companies were 'more strongly interested' in business succession because of COVID-19.[19] The percentage of companies without a successor fell slightly from 65.2% the previous year to 65.1%, but two in three business owners still have no successor.[20]

This shows that succession is becoming a more pressing problem, and in such an environment, PE funds can serve as an important receptacle for companies facing succession issues.

FY2020 saw the aforementioned Bain Capital deals for NICHIIGAKKAN and Kirindo Holdings, as well as the Polaris Capital Group management buyout of Sogo Medical and Nippon Mirai Capital's investment in Asanoya. NICHIIGAKKAN, Kirindo Holdings and Sogo Medical were public companies, but in all three cases the founder reinvested after they went private, and the same management team remained in place. In the press release for Sogo Medical, Polaris Capital Group said, 'Polaris will extend strong support to Sogo Medical to achieve its stable growth in the dispensing pharmacy business as well as remarkable growth in the medical support business through M&A, etc., with a view to establishing a highly resilient management base and business structure responding to the impact of changes in the system, by leveraging Polaris' knowledge gained from the past experiences investing in a number of healthcare companies and multi-store companies…. To this end, under a new stakeholder and governance system without being constrained by existing bonds, the company aims to boldly transform its business structure by promoting a reallocation of management resources and an evolution of the business model for growth as a comprehensive healthcare company.'[21] Response to COVID-19 has clarified the digital transformation of Japanese medical care as a major issue. We expect that the involvement of private equity can help to further accelerate this transformation.

Japan is known for its long-lived companies. According to a Teikoku Databank survey, 1,176 companies celebrated their 100th anniversaries in 2020,[22] and, according to Nikkei BP Consulting, Inc.'s Shunenjigyo-Lab, Japan has more companies that are 100 years old or older than any other country, making up 41.3% of the global total.[23] At the same, PwC's global Family Business Survey 2021 revealed that family businesses in Japan, which were the focus of the Japan survey, tend to place a low priority on sustainability, and that the percentage of family businesses in Japan engaged at least one initiative related to sustainability and local communities is well below the global average.

In 2013, the Principles for Responsible Investment (PRI) published a global ESG reporting framework for private equity, and the Polaris Capital Group formally agreed to the principles in May 2016. On its website, the group says, 'We Polaris understand that we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios.' They go on to say, 'We also recognize that applying [the six Principles of Responsible Investment] may better align investors with broader objectives of society.'[24] Furthermore, Blackstone, a major investment fund, has set a target of reducing the carbon emissions of its new acquisitions by 15%[25].

Along with the conventional issues faced by family businesses, the importance of ESG initiatives is also increasing. We expect that private equity will be a source of support for these reforms.

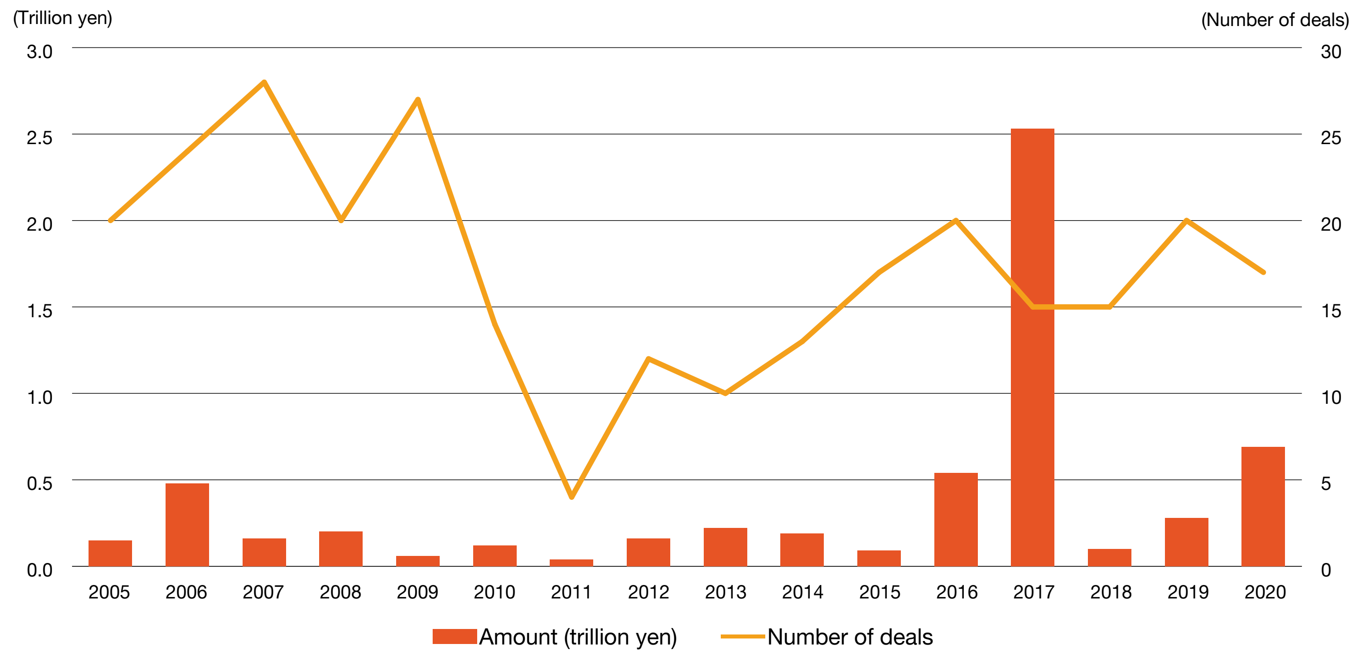
18. Teikoku Databank, 'Nationwide Company President Age Analysis (2020)', 5 February 2021.
19. Teikoku Databank, 'Survey of Corporate Attitudes towards Business Succession (2020)', 14 September 2020.
20. Teikoku Databank, 'Nationwide Survey of Trends in Company Successor Absence Rates (2020)', 30 November 2020.
21. Polaris Capital Group, 'Tender Offer for the Shares of SOGO MEDICAL HOLDINGS CO., LTD.', 5 February 2020.
22. Teikoku Databank, 'Companies with Anniversaries in 2020: 157,507 Companies Nationwide', 20 November 2019. https://www.tdb.co.jp/report/watching/press/pdf/p191106.pdf
23. Nikkei BP Consulting Anniversary Business Lab, 'Global Ranking of Longstanding Companies: Japan Ranks No. 1 in 100- and 200-Year-Old Companies', 18 March 2020. https://consult.nikkeibp.co.jp/shunenjigyo-labo/survey_data/I1-03/
24. Polaris Capital Group, 'Our commitment to ESG', https://www.polaris-cg.com/us/features/esg.html
25. PwC, 'Can private equity save the world?', 18 January 2021. https://www.pwc.com/gx/en/issues/reinventing-the-future/take-on-tomorrow/private-equity-esg-investing.html

2. Carve-outs

Carve-out deals—deals in which a non-core subsidiary or business is carved out for investment—decreased slightly in terms of the number of deals, from 20 in 2019 to 17 in 2020, as the M&A market stagnated because of COVID-19. However, the monetary amounts of these deals increased nearly twofold (Figure 8). There were several major deals in 2020. TCHC, which as we mentioned previously was a consolidated subsidiary of Takeda Pharmaceutical, was sold to the Blackstone Group for around 240.0 billion yen; Seiyu, which was a subsidiary of Walmart, was sold to KKR and Rakuten for around 170.0 billion yen; and Showa Aircraft Industry, previously a consolidated subsidiary of Mitsui E&S Holdings (Mitsui E&S), was sold to Bain Capital for approximately 85.0 billion yen.

In the press release regarding the Showa Aircraft Industry deal, Ryoichi Oka, president and CEO of Mitsui E&S, said that the company had sold various assets as part of its business restructuring plan to reinforce its financial and earnings structure. He also explains that the ability to utilise the global network and management expertise of Bain Capital will allow Showa Aircraft Industry to further accelerate growth and raise corporate value by acquiring customers and developing sales channels in overseas markets, expanding its product line-up, enhancing profitability, and increasing operating efficiency in its export equipment and real estate leasing businesses.[26] Bain Capital explains that the carve-out deal was a part of Mitsui E&S's business restructuring, and that Showa Aircraft Industry expects to grow as a result of leveraging the broad network and expertise of Bain Capital. In its press release, Bain Capital also explains that it intends to make the ample expertise it has accumulated available to Showa Aircraft Industry, as well as provide support, including support for M&A, and promote policies for maximising the latent value of the business.[27]

Figure 8: Carve-outs involving PE funds - Investment amounts and numbers of deals



Source: Created by PwC from databases provided by Dealogic.
Note that the amount of information disclosed in relation to investment amounts is limited.
This figure does not include investments of an undisclosed amount.

26. Mitsui E&S, 'Notice of Tender Offer Agreement for Subsidiary Shares', 23 January 2020.
27. Bain Capital, 'Notice of Tender Offer for Common Shares of Showa Aircraft Industry (Securities Code 7404) by BCPE Planet Cayman, L.P.', 23 January 2020.

Looking back over the past few years, awareness of profitability and capital efficiency among public companies has increased as a result of corporate governance reforms. However, less progress seems to have been made in business restructuring (Figure 9).[28]

The reasons are generally endemic to Japanese companies: Individual business divisions have a lot of power, and mechanisms for portfolio management across businesses are lacking. Companies tend to emphasise performance indicators linked to size, such as sales and profit. And many of them still maintain a membership-type style of employment that assumes employees will work for the same company for their entire career.

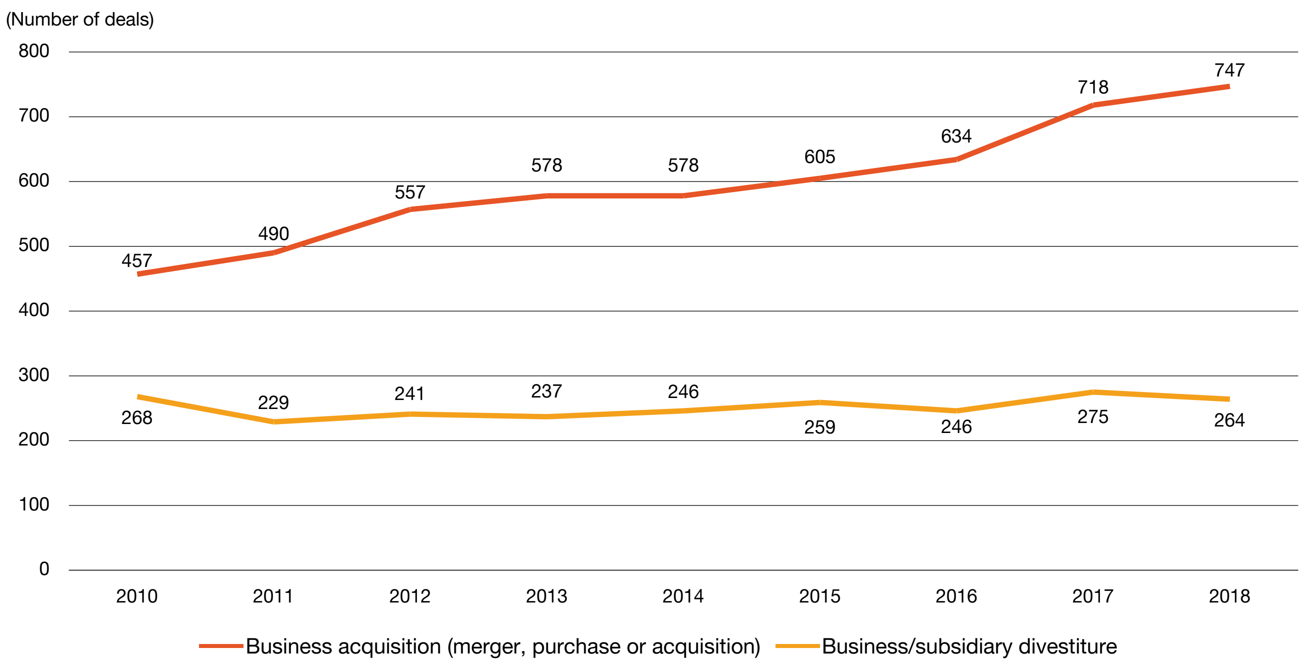
However, with the COVID-19 pandemic, companies are being semi-forced to shift from quantity to quality, and they are beginning to shuffle their business portfolios. This portfolio shuffling is especially common among manufacturing conglomerates because they have assets and it is relatively easy for them to clarify the profitability of each business.

PE funds are also focused on this trend. In an interview with Bloomberg, Kazuhiro Yamada, managing director of Carlyle Japan, indicates that, as Japanese companies rework their strategies in light of the pandemic, he thinks there will be more carve-out deals involving major companies, and that the Carlyle Group intends to capitalise on this opportunity.[29]

In an interview with Jiji Press, Hiro Hirano, CEO of KKR Japan, says that for the time being KKR hopes to invest a total of 300 to 700 billion yen in one or two deals per year. With the business environment changing rapidly due to COVID-19, he indicates KKR's ambition for large-scale acquisitions, pointing to the possibility that conglomerates with diversified management will consider selling subsidiaries and business divisions and that even bigger deals may emerge.[30]

KKR established a new Asia fund of 1.65 trillion yen in April 2021 and intends to invest about a third of it in Japan.

Figure 9: Trends in business restructuring at public companies



Source: Ministry of Economy, Trade and Industry, 'Practical Guidelines for Business Transformations – Toward Changes to Business Portfolios and Organizations', 31 July 2020

28. According to the Ministry of Economy, Trade and Industry's 'Practical Guidelines for Business Transformations' (2020), many companies take a more negative view of 'carving out' businesses than of M&A, and they have not necessarily restructured their business portfolios adequately.
29. Bloomberg, 'Carlyle to Seek Major Company Deals in Japan; Interested in Large-Scale Investment in \100.0 Billion Range', 1 June 2020.
30. Jiji.com, 'KKR of U.S. Planning to Invest \700.0 Billion in Japan Annually; Sights Set on COVID-19 Corporate Restructuring and Reform', 8 September 2020.

The Ministry of Economy, Trade and Industry released its ‘Practical Guidelines for Business Transformations’ in July 2020 to encourage appropriate decisions on revising business portfolios in response to recent changes in the business environment.[31] These guidelines are to help companies practice corporate governance in a manner that contributes to sustaining corporate growth and increasing medium- to long-term corporate value, and are intended to supplement the Corporate Governance Code. They include practical measures for the smooth execution of business restructuring and related carve-outs. Specifically, the guidelines recommend comparing ROIC and capital costs for each business segment and reconsidering optimum business portfolios; having the board of directors supervise business portfolio management; disclosing information to investors, including return on capital for each business segment; and engaging in constructive discussion on business portfolios. Focusing on business transformation, these guidelines state the importance of corporate governance functioning through three layers, (1) executive officers, (2) the board of directors and independent directors, and (3) investors. The Corporate Governance Code requires that targets be set for profitability, capital efficiency and other indictors based on an accurate grasp of capital costs and that business portfolios be revised to achieve them, but management decisions on business restructuring and related carve-outs are no easy matter. These new guidelines present this process in specific terms, and so are expected to promote restructuring in a way that helps to raise corporate value.

In addition, as we discussed at the beginning of this report, the Tokyo Stock Exchange will apply new market segments from April 2022, with the anticipation that this will make the market highly appealing on an international level. As a result, companies listed on the Prime market will need to make efforts to further enhance their governance.

PE funds have also signalled their expectations for this strengthening of corporate governance. In an interview with Diamond, Masashi Suekane, managing director at Bain Capital, expressed his belief that in the future, as reforms to corporate governance progress, portfolio reshuffling is also likely to pick up.[32]

As interest in sustainability and ESG investment rises, Japanese companies will need to allocate more management resources to achieve sustainable growth in line with their own missions and medium- to long-term visions. When a company determines that a certain business no longer fits its portfolio, leveraging the strengths of a PE fund is one possible option. PE funds can provide sufficient management resources, operational expertise and a broad-ranging network to transform the business into a growth business, and then pass the business along to the best owner[33]. Going forward, we expect carve-outs to become more commonplace in the Japanese market as a means of portfolio restructuring, and to provide a catalyst for re-growing the Japanese economy.

31. Ministry of Economy, Trade and Industry, '“Practical Guidelines for Business Transformations - Toward Changes to Business Portfolios and Organizations -” Formulated', 31 July 2020. https://www.meti.go.jp/english/press/2020/0731_004.html
32. Diamond Online, ‘What’s Next After the \2 Trillion Toshiba Semiconductor Deal? Bain Discusses the “Next Chance”’, 30 July 2020. https://diamond.jp/articles/-/243789
33. ‘Best owner’ refers to a management entity that can be expected to maximise the corporate value of the business over the medium to long term.

Conclusion

2020 will go down in history as the year of the COVID-19 pandemic, but it was also a year for reconsidering the ideal state of Japan, of companies and of working styles. For companies to achieve sustainable growth even after COVID-19, they will no doubt need to make changes to solve the problems and issues that were brought to light by the pandemic. PE funds have the ability and experience to make these changes quickly to create value during a limited investment period. Speed is of the essence for Japanese companies looking to make reforms to prepare for a post-pandemic world, which means using PE funds is likely to be an even more prominent option for corporate management. We therefore expect that more Japanese companies will utilise PE funds as part of their efforts to create economic and social value.

Contacts

PwC Japan Group
www.pwc.com/jp/en/contact.html

Hideo Nagura
Partner
PwC Advisory LLC

Satoshi Matsunaga
Partner
PwC Tax Japan

Keisuke Ohnishi
Partner
Strategy Consulting (Strategy&)
PwC Consulting LLC

Kanehito Imai
Senior Manager
Markets
PwC Japan LLC

Yusuke Aiba
Partner
PwC Consulting LLC

Kei Sonoda
Partner
Strategy Consulting (Strategy&)
PwC Consulting LLC

Ryo Shimakata
Partner
PricewaterhouseCoopers Aarata LLC

www.pwc.com/jp

A PDF of this report is available here. www.pwc.com/jp/en/japan-knowledge/thoughtleadership.html
Published: September 2021 Control No: I202107-02