KEYNOTE INTERVIEW

Business succession goes big



An ageing population is driving Japan's business succession market and the targets are only getting larger, say NSSK's Jun Tsusaka, Ryoji Kanamori and Makoto Iwami

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Q To what extent is business succession a key driver of dealflow in today's market?

Jun Tsusaka: At NSSK, we source around 500 transactions per year and more than 400 of them can be characterised as business succession opportunities. There are two primary reasons why this is the case. First, NSSK is uniquely positioned to help revitalise the regional economy through its network with the large number of private businesses that are owned and operated in the regional markets of Japan. Second, the business succession segment of the private equity market has consistently represented more than half of all transactions in Japan in recent years.

We strongly believe that this trend will continue given the country's ageing population. Business owners are getting older and often lack successors. High inheritance tax – which can reach up to 55 percent – is an issue as well. Meanwhile, families are seeking to pass on their ownership to responsible investors who will not only carry the torch but also enhance the company through operational improvements.

Q What changes have you seen in the nature of the business succession investment opportunities that are becoming available?

JT: The evolution of the business succession market in Japan has experienced a step change in terms of the size of the companies involved. Historically, the enterprise value of businesses in this space tended to fall in the $50 million to $100 million range. Today, we are seeing larger and larger private companies being put up for sale. Indeed, in the past 12 months alone NSSK has announced three of the largest succession deals involving a private equity buyer, with a combined value of $2 billion. The largest of these involved Sakura Pharmacy, which we acquired for $1 billion. In fact, we have seen a ten-fold increase in deal size when compared to our last fund.

Q Which sectors or investment themes are proving particularly attractive for you as a firm?

JT: The opportunities are increasing across numerous sectors, and I would say that business succession is arguably sector agnostic. Among the investment themes that we deem to be particularly attractive, however, is the healthcare space – assuming one has experience in managing risk in a regulated industry.

We also favour business-to-business and business-to-consumer companies that are positioned to take advantage of domestic and international growth opportunities due to differentiated products or services, fragmented industries where there are economies of scale to be achieved through consolidation, and other industries that enjoy long-term secular tailwinds such as the ageing population theme. However, it isn't only business succession deals that are interesting in these areas. We also see opportunities with corporate carve-outs, management buyouts, secondary buyouts and special situation deals.

Q A recent business succession deal that NSSK completed involved Project Kyushu. What was the rationale there?

Makoto Iwami: Project Kyushu's signing was completed in March and is valued at close to $750 million. Once again, therefore, this is one of the largest succession deals to ever be completed by a GP. Project Kyushu is a technology-based manufacturer of faucets and filtration components, among other water-related products.

We are partnering with the family – and the matriarch in particular, who is the CEO – to help drive the next stage of growth with an ambitious manufacturing capacity expansion programme and plans to professionalise business processes ranging from sales and marketing to distribution and cost management. Equally importantly, we have secured highly attractive covenant-lite financing from NSSK's regional bank network that will provide the management with maximum flexibility to operate through good times and bad.

Q What are some of the challenges that you typically come across in business succession deals in Japan and how can these be overcome?

JT: I would say that the biggest hurdle we face involves sourcing the opportunity. To get preferential access to these deals requires trust and a reputation that is built over time. Sellers are not only looking to maximise price, but also to create holistic outcomes where they can solve business issues while providing their employees, customers and other stakeholders comfort that the new owners will make things better. This is where a commitment to ESG comes into play. That resonates very strongly with both employees and owners.

A proven commitment to protecting employees, creating safer and more attractive work environments, aligning interests with staff and shareholders, a track record of the GP delivering on promises around governance and transparency and protecting the environment, are all music to sellers' ears. At NSSK, we are proud to showcase how ESG drives better financial, business and community outcomes in our annual ESG report.

Q What are some of the value-creation levers that you typically employ in business succession deals?

Ryoji Kanamori: The value-creation levers that we employ are designed

Q What was the story behind the Sakura Pharmacy deal and what are your plans for that business?

Ryoji Kanamori: Sakura Pharmacy involved a classic case of business succession needs being accelerated by special situation dynamics. The company is the third largest player in a $70 billion market and enjoys $1.5 billion in revenues. It has close to 900 outlets throughout cities in Japan.

Sakura is a strong cashflow-generating business that benefits from the ageing population trend, as well as roll-up and build-out opportunities, and strategic alliances to capture scale benefits and improved efficiencies from best practice implementation across all aspects of its business. We will also be investing in developing next-generation retail models to better serve its customers and communities.

Next level: NSSK acquired Sakura Pharmacy in a $1 billion succession-based deal specifically for each of our investments through our NSSK Value Up Programme, or NVP. We have a dedicated team of professionals with specific operating skills that work with our investment teams to identify value-creation opportunities during the due diligence phase.

The NVP playbook spans everything from redefining mission statements to implementing new key performance indicators; structuring employee ownership programmes and incentivisation alignment; and maximising sales force productivity, manufacturing outcomes and distribution channels, while also making use of artificial intelligence and data analysis tools.

Q How would you describe the exit market available to you today?

MI: People sometimes forget that Japan is the third largest economy in the world after the US and China. Japan has around four million businesses operating in a $5 trillion economy. It also has close to 4,000 publicly traded companies with an aggregate market value of close to $7 trillion. This provides robust exit opportunities through both trade sales and IPOs. In addition, with the increase in foreign private equity firms and an increase in the availability of debt capital, the secondaries market is developing fast. Finally, foreign buyers are becoming more and more aggressive given the stability of Japan's economy, geopolitical considerations and the short-term impact of the depreciation of the yen.

Q Would you say that Japan represents an attractive investment opportunity right now, relative to other parts of the world?

JT: According to private equity advisers and gatekeepers, Japan has produced some of the highest and most consistent returns in the region over the past decade. Certainly, this is consistent with NSSK's experience.

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>
> **JUN TSUSAKA**

The attractiveness of Japan as a destination for private equity capital is based on its resilient nature amid global turmoil. This is due to its large domestic economy; the attractive supply and demand dynamics for deals that favour buyers; a strong and growing business succession market that accounts for more than half of total dealflow; the continued availability of low-cost debt capital; a relatively stable public market and a highly active merger market – the third largest in terms of dealflow; and, finally, laws and regulations based on western practices.

Q How would you describe investor appetite for the region as a result?

JT: We have seen more LPs with historical exposure to China shift their attention to other markets, including Japan, due to geopolitical issues. Furthermore, given the steady returns that Japan has provided, LPs are re-upping at larger amounts. For example, one of our largest investors doubled its commitment from the prior fund. With new GPs also entering the market, the depth and breadth, as well as the sophistication of the market, is increasing, which is a boon for all participants.

Q What do you believe the future holds for Japanese private equity and for succession deals, in particular?

JT: Japanese private equity has entered a golden age. We are at the beginning of what should be a 20-year run, much like the US buyout market in the 1980s. This is reflected in increased dealflow and value; the enhanced sophistication of transactions; the growing acceptance of private equity as a solution for families and businesses; and the solid outcomes that have been produced.

Meanwhile, the business succession market will represent the lion's share of mid-market activity. I believe it will also deliver strong and consistent returns due to deal dynamics that favour proprietary negotiations versus full blown auctions, as well as characteristics that are more growth buyout orientated versus turnarounds. The professionalisation of business processes at private companies has also proven to be a reliable value-creation tool. Lastly, the availability of low-cost and flexible debt capital will be another important driver for attractive risk returns versus other markets. ■

Jun Tsusaka is CEO of Nippon Sangyo Suishin Kiko and chair of the firm's ESG committee; Ryoji Kanamori and Makoto Iwami are directors and co-leaders of the investment team at NSSK