KEYNOTE INTERVIEW

Japan's 'contrarian' on flying solo



The Japanese private equity unit of Hong Kong's CLSA Capital Partners is honing its own distinctive approach for the post-pandemic environment, as managing director Ryoichiro Minagawa and directors Shota Kuwaki and Yasunori Maeda explain

Sunrise Capital, the Japanese private equity unit of Hong Kong's CLSA Capital Partners, is something of a contrarian. While many firms in Japan's private equity market are competing for businesses that have proved resilient – or even thrived – during the pandemic, Sunrise is instead eyeing those who may need a helping hand. It is well-positioned to do so, having closed Sunrise Capital IV on its $450 million hard-cap in September 2020.

Private Equity International caught up with managing director Ryoichiro Minagawa and directors Shota Kuwaki and Yasunori Maeda to discuss how this capital will be deployed and why the firm wants to beat its own path.

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Q Last year was marked by the close of your fourth fund. How did you find the process?

Shota Kuwaki: What was completely different is everything was virtual. In the past it was really normal to have LPs physically visit and conduct onsite due diligence, which was not the case last year. It was much easier to deepen relationships with our existing LPs, but for completely new LP relationships it was quite difficult for them to get comfortable and cross the finish line. That definitely seemed a little bit more challenging than usual years.

Q Sunrise Capital is in the process of spinning out from CLSA. What prompted that decision?

SK: One of the points historically highlighted by LPs from being part of CLSA is our being a captive fund, so it was quite important that we expanded the management effort to a broader group of individuals at the firm.

Historically our firm has been managed solely by our president, Megumi Kiyozuka, but we have now transitioned from a single person management platform to a more collaborative management effort. We have formed a four-person partner group, which includes Megumi Kiyozuka, Ryoichiro Minagawa, Yasunori Maeda and myself. Each of us is essentially running a function within the platform and going forward the four of us will make more consensus-based decisions on how to manage the firm.

Q How active were you last year, and how did you find compelling opportunities?

Ryoichiro Minagawa: We were very proactive in trying to originate deals and completed four new investments in 2020 as a result.

Yasunori Maeda: Even before covid-19, our approach has been more focused on actionability rather than thematic sectors. We reviewed each business one by one and confirmed whether they are stable or resilient even under this environment, or whether we could take a certain contrarian approach to make a specific investment attractive.

All the four investments completed last year were brought to us before covid-19 and we obtained exclusivity before the pandemic, so we were able to avoid competition. After the lockdown we managed to adjust the valuations for the deals significantly affected by covid-19 by sharing our expectations on mid-term performance of the business and controlling the expectations of the seller.

> *"We were very proactive in trying to originate deals and completed four new investments in 2020"*
>
> **RYOICHIRO MINAGAWA**

Q Do you anticipate any challenges associated with take privates?

RM: We do not perceive too many challenges. However, normally a take private would include a takeover bid. If that is the case and the price is too low, there is a chance that third-party investors can outbid you and it fails. There have been instances recently that happened to other GP sponsors. Typically, a takeover bid would be an MBO alongside company management, so it is not optimal to raise prices either for ourselves or the management. The risk of this is that if the price is too low, somebody may come in and take it away from you.

Two of our investments from last year – both of which are B2B IT services – were not affected by covid-19. One business, Assist Inc, which provides an online matching service between consumers and house service venders, such as those for air conditioners, or waste disposal. This business is benefitting from the covid-19 environment where people are staying home for a longer time.

Another is fitness gym operator Worldplus. We invested in that business in August and took a certain contrarian approach because during the covid-19 lockdown period, gyms were blamed as a major source of infection spread. It lost 15-20 percent of its members during that period and financial performance was affected. We reviewed the long-term demand and aspects of the sector and decided to invest with a more conservative valuation and capital structure. The potential deals we are looking at this year include certain businesses that are temporarily negatively affected by covid-19 and still struggling – an area where not many sponsors are looking. We have to be pretty cautious and move quickly in order to capture these types of contrarian benefits. We will need to be actively pursuing the contrarian approach over the next 12 months and after that the vaccine will be spread over the world and investment activity will be back to normal.

Q You're gearing up to pursue public-to-private transactions. Why?

RM: This is driven by regulatory changes which are expected to happen in 2022. The Tokyo Stock Exchange consists of a first section, a second section and Mothers. The problem is there are actually too many companies listed on section one, so they're recategorising these listing statuses and the top section will be called Prime.

There are a couple of criteria to make it to Prime: one is market cap and number two is liquidity. Thirdly, it has been a while since Japan has said it will focus on corporate governance and there were really no concrete actions being taken in the past. In order to improve the quality of the Tokyo Stock Exchange, the government is now really inclined to focus on corporate governance. The bar is actually quite high, so there will be many companies that will not be able to meet these criteria.

Companies that are not converted to the prestigious Prime section will not be able to maintain their current credibility, so there is less meaning for them to maintain their listed status. For these types of companies, what they would typically consider is going private so they do not have to deal with all the burdens of listing requirements.

Historically, we have not completed a public to private transaction, though given this regulatory change there are actually a lot of opportunities coming this way. We think this is a potential opportunity, so from our end we also proactively approach companies that could be in this category as well.

Q Japan has attracted a lot of capital in recent years. What implications does this have for the market?

RM: Many other GPs – our competitors – have raised much larger funds, so there is an abundance of dry powder and quite frankly speaking, we believe there is too much dry powder. There is a large sum of money chasing opportunities which is basically the biggest driver behind the increasing competition in the market.

Naturally there is a trend towards businesses that have not really been affected by covid-19 or are benefitting from covid-19, and these types of businesses everybody likes, so it attracts a bigger crowd. With the abundance of dry powder we believe these types of businesses will continue to be quite competitive going forward.

Auctions are typically not the type of competition that we are very good at. For auctions, valuations will continue to be very high so trying to source deals through those types of situations will be difficult. What we are trying to do is generate deals in exclusive or near-exclusive situations. It is crucial in these cases to be able to present concrete examples of similar businesses where we have been successful in the past. We have experience of this at a portfolio company named Rise Consulting Group, which was a completely proprietary situation because the founder owner was actually a former executive of one of our past portfolio companies.

"With covid-19 kicking in and causing distressed situations, the crown jewels of these conglomerates are also being divested"

SHOTA KUWAKI

Q Carve-out opportunities have been at the heart of this push. How has covid-19 impacted dealflow?

SK: There were already carve-outs happening from conglomerates, though most of the time these non-core assets were not necessarily attractive businesses. With covid-19 kicking in and causing distressed situations, the crown jewels of these conglomerates are also being divested as a rising trend.

RM: Shareholder capital has become a little bit slimmer due to recent underperformance and so by selling a crown jewel they can bring a lot of cash to the balance. Many of these opportunities are popping up and, given that everybody wants to buy these crown jewels, it is becoming a lot more competitive.

In many of these situations, the parent company would like to pursue a rather quick process to divest the subsidiary, so not everybody is able to keep up. If you are able to get in and meet the schedule and be able to deliver based on their timeframe, then occasionally you are able to avoid competition in those situations. ■

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YASUNORI MAEDA