KEYNOTE INTERVIEW

Why we decided to go it alone

Koji Sasaki, president and managing partner of T Capital Partners, maps the road ahead for the firm now that it has separated from Tokio Marine Insurance Group

The management buyout of Tokio Marine Capital by a group of five senior partners marked something of a milestone in the evolution of the Japanese private equity market where spin-outs are few and far between. Established in 1991 and one of the oldest private equity firms in Japan, the GP, which was a captive entity of blue-chip Tokio Marine Insurance Group, formally agreed to the separation in August last year. It was a bold step for the buyout team, which has since rebranded as T Capital Partners.

Koji Sasaki, president and managing partner, who now owns the business along with Eisuke Shigemura and three other investment partners, describes how it happened and what it means for the firm, its investors and its businesses.

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Q Talk us through the decision to separate.

We had been talking about changing our capital structure for a while. In the midst of a stagnant market after the Lehman shock in 2011, we raised our fourth fund with only ¥23 billion ($210 million; €190 million), and it became clear that we needed to diversify our investor base because banks on which we had heavily relied had been impacted by the Volcker Rule which restricted their commitments to PE funds. Although we successfully raised the next fifth fund in 2016, at ¥52 billion, we had concerns for the future and started serious talks with our shareholder about a management buyout. We realised this was our final chance.

Twenty years ago, around the time we launched the first fund under the Tokio Marine brand, there were very few established independent private equity firms in Japan and being a captive was very useful for both fundraising and deal sourcing because, back then, we had no track record or performance metrics and the Tokio Marine brand was very familiar to investors.

The company had a 150-year history and was one of the largest institutional investors in Japan. It's a respected name. Now the PE market has grown and domestic investors have come to make investment decisions based on the firm's performance and team, not the brand. And we have a good track record – we've never made a loss.

Also, for some time now, we've wanted to diversify our investor base to include international investors. Japanese banks and pensions are important but overseas investors are important too. Although international LPs were impressed by our track record, they were hesitant to commit because of our captive status. We shared carried interest with our shareholder, which international LPs thought should go only to the team. It presented a governance issue as they felt that we, the GP, served two masters – our shareholders and our LPs – and that could create a conflict of interest they felt put them at risk. The management buyout eliminates this issue.

Q What difference has the separation made to your investment approach?

No difference. Although we were legally under the umbrella of Tokio Marine Group, they were a very passive shareholder because they also understood the negative implication of captive funds. Therefore, we used the parent's brand but we have been successfully operating quite independently of the parent for 21 years, building own team members, sourcing our own deals and driving growth at portfolio companies by establishing our own investment philosophy, 'to make good companies better through mutual trust'. Our goal is to retain that culture, supported by our history and track record. These are important assets that determine how our LPs and portfolio companies see us. We will continue our established investment philosophy and approach of being true partners with our portfolio companies. It's in our DNA.

Q You took a big step. How has the buyout been received?

First, our team members were really enthusiastic about the decision because we were no longer regarded as being captive. Neutrality is one of the important benefits of the MBO. In the past, the association of our parent company with Mitsubishi Group gave us positive effects but sometimes had negative implications when we did business with companies outside the Group. That barrier has been lifted.

Second, while I was a little about concerned about the response from portfolio company management, this was soon dispelled post announcement. I found that they weren't concerned about the change because they had taken the decision to invest with us as a partner after extensive communication with us at pre-acquisition. It wasn't because of our parent.

Last, for all our stakeholders, our LPs, current and past, are the most important people to consider. We have lots of Japanese banks and pensions invested in our funds, all of which we met with individually to explain our decision. Some of them might have raised concerns and some invested because of Tokio Marine's name. However, nearly all of the LPs gave us warm appreciation. They understood our successful track record was produced by the team.

Q How do you go about sourcing deals?

That is changing. Two decades ago,

Q How important are environmental, social and governance factors in your decision to invest?

In Japan, the concept of ESG is widely recognised these days, especially among businesses. We signed up to the Principles for Responsible Investment in 2013. For us it was a natural step. ESG accords with our investment philosophy to identify good companies that we can make better or the best, so we had no hesitation. Being a PRI signatory sends a clear signal to our investee companies. By being socially responsible our companies have a role in building a sustainable society. For us to invest, the company already needs to operate at a good level of ESG. During deal sourcing, when we talk with companies, we apply an ESG checklist. Some companies we see at the due diligence stage are quite excellent, while others fall short on some of our ESG criteria. In these cases we will seek to address these internal issues once we've invested by communicating our concerns to the board and through meetings with top management.

sourcing was very difficult. Private equity as an industry did not exist. Big conglomerates and founder-owners were reluctant to talk to private equity managers. In those days, we took advantage of our parent company's name to facilitate access to bigger businesses and family-owned companies. That was our starting point.

Over time, private equity has gradually become widely recognised among not only the big companies but also families. We no longer need to talk about our former parent company. We can rely on our 21-year investment track record. Banks, security houses and boutiques that can connect us to prospective companies know us now. That is a significant change, particularly in relation to sourcing investments in family-owned business, which is an area where the presence of boutiques has grown rapidly.

Q Has your investment philosophy changed?

No. Our number one criteria is to invest in small to medium-sized companies with sound cashflows and sustainable earnings. "Sound" means that even if the company generates strong cashflow, it needs to meet our environmental, social and governance criteria and management needs to be of good character. If the company is linked to anti-social issues or poor corporate governance, or employees are badly treated, then we would not invest. The personality and sincerity of management determines the quality of our communication. Trust is a fundamental value for us and with that, whatever happens, we can work together. This is our definition of soundness.

Everyone wants strong cashflow, but stability is also important to us – will current cashflow levels be sustainable in the future? This, and the soundness of cashflow, are elements we investigate during due diligence. Then we can discuss with management about the future upside scenario or actions to be taken after the investment. This is the approach we took in the past and we continue to take in the future.

Q Do you target particular sectors?

We do not limit ourselves to specific industries, but we do have some that we really like. Manufacturing with strong niche products is one. Healthcare is an industry where we have an edge. Bushu Pharmaceuticals was a successful example of a carve-out transaction and we continue being very active in the sector.

> *"Although international LPs were impressed by our track record, they were hesitant to commit because of our captive status"*

Retail and distribution is also an interesting industry. For example, we invested in Miki Shoko Company, which is a children's apparel brand for aspiring parents. Though Japan's birth rate has been decreasing, purchasing power per baby for high brand gifts has been increasing. Thanks to this, Miki has grown even in the deflationary economy. The third is service industries, like outsourcing, or B2B services. Asahi House Industry Company is one example. It leases temporary portable toilets to well-diversified construction sites and events and maintains steady cashflows. We will continue to focus on industries where market demand doesn't fluctuate.

Q Of your investments, what proportion were succession deals and what were carve-outs?

We have completed 26 buyouts. Today, about 70 percent of our investment portfolio is comprised of family businesses and 30 percent are carve-outs. This was quite different in the past; it was the other way around. For carve-outs, there are a limited number of big companies making decisions to divest and growth in the volume of these opportunities has been slow. For now, family businesses succession transactions drive dealflow. Japan's aging population is one of the key reasons behind this.

In the family business succession category there are two types of sellers: an aging owner with no successor who wishes to cash out, and second, founders who have passed on the business to a successor. In the latter case, the successor retains a stake, or, more commonly, sells the business to us and reinvests through the leveraged buyout. These second generation owners look at their peers to see what other businesses are doing and they want to grow, modernise and run the business in a more sophisticated way than their parents. Private equity can be a solution for them. And they are researching and comparing different GPs.

Q How do you approach these family-owned businesses?

Word of mouth among family owned companies really delivers truth. We like to talk to the founder or second generation owner and negotiate exclusively to come to a deal. He likes us; we like him. It's about having a successful track record and whether, as personalities, you can work together in the future.

Money is important but non-monetary considerations are key to selecting each other. This route makes executing a transaction easier and facilitates a cheaper entry multiple. Corporate carve outs are price-driven – the highest bidder wins the deal. We are currently inclined toward succession deals. That said, we have done carve-outs and if an opportunity pops up, we can quickly pick up contact with those companies again. ■