KEYNOTE INTERVIEW

The time is right to invest in Asia's leading destination

After years of steady growth, Japan's private equity market presents unrivalled opportunities, say NSSK's Jun Tsusaka and Kaz Tokuyama

Momentum continues to build in the Japanese private equity market, boosted by strong returns and regulatory reforms. Since it was formed in 2014, NSSK has established a reputation as one of the leading players in Japan's burgeoning mid-market. We caught up with Jun Tsusaka, NSSK's CEO, and Kaz Tokuyama, senior partner, to find out why Japan has become such a go-to destination for private equity investors worldwide.

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Q Why are investors targeting the private equity industry in Japan?

Jun Tsusaka: The answer is simple: Japan generated the highest absolute returns on a realised basis between 2010 and 2024 versus the US, Europe and China, according to Bain & Company's *2024 Japan Report*. With almost a one times higher multiple on invested capital returned on a local currency basis (and 0.8 times higher than the US on a US dollar basis for top quartile firms such as NSSK), the numbers speak for themselves.

That is why leading consultants and gatekeepers have been encouraging large asset owners to increase and build exposure to Japan buyouts. It is why the 'smart money' has quietly shifted capital allocations to Japan, making it the leading destination for PE investments in Asia.

Q Is this growth sustainable or are we looking at a one-off opportunity?

JT: We believe the past decade has built a foundation for long-term sustainable growth for our industry, similar to the conditions of the late 1980s and 1990s in the US and European buyout markets.

Japan has several factors that help underpin the PE market: a stable political and regulatory environment; a judicial system based on transparent

Western standards; and a solid economy, to name but a few.

These characteristics – along with a growing M&A market (second in transaction numbers after the US last year), a stock market that has been one of the best performing in the world over the past decade, a stable and educated labour force (thanks to women engagement), capital availability at low-interest costs, low inflation and attractive assets – make it an enviable destination for investment. What's not to like?

Kaz Tokuyama: Over the last decade, much of the persistent thinking that has surrounded the Japanese macroeconomic and investment landscape has been proven wrong. Between 2012 to 2024, Japan's gross domestic product grew by over $700 billion, which is growth of roughly the size of the economies of Singapore or Norway.

Adding to its resilience is the fact that Japan's economy is not solely dependent on the global market, with 56 percent of GDP represented by domestic consumption. Moreover, Japan has one of the best-performing stock markets over the past decade, marking a 3.7 times increase equal to $4 trillion in value developed. What's more, despite historically low interest rates, inflation has remained around 2.5 percent.

The big question is whether the conditions that fostered the strong return performance over the past decade still exist. We predict that the key economic metrics outlined above will persist, maintaining Japanese PE's growth trajectory.

Q What other factors are driving the growth of private equity in Japan?

JT: Growth for private equity requires an increase in the number of investment opportunities. This is where Japan is differentiated from other markets similar to the US. We saw a material increase in the supply of potential deals due to two key driving factors. First, an ageing population is accelerating the sale of private companies with no family heirs. Second, the effects of governmental and regulatory reforms designed to increase market efficiency are kicking in, as evidenced by public companies beginning to systematically pursue strategic alternatives to drive stakeholder value (encouraged by engagement and activist investors).

This has led to going-private transactions and sales of non-core assets. With the large supply of companies becoming available for investment, Japan is one of the few developed markets in the world where you can honestly say that we don't have "too much money chasing too few deals". In fact, there's probably too many deals and not enough professionals that can execute on the opportunity. In this regard, it is unlike anywhere else in the world.

Furthermore, to ensure returns are generated even in turbulent markets, the opportunity to improve operations exists, so it is about building operational capability to squeeze out additional alpha. And the serial roll-up playbook is well suited for Japan, with many small-cap businesses available for sale, and will be an emerging practice to generate sustainable top-quartile returns for investors.

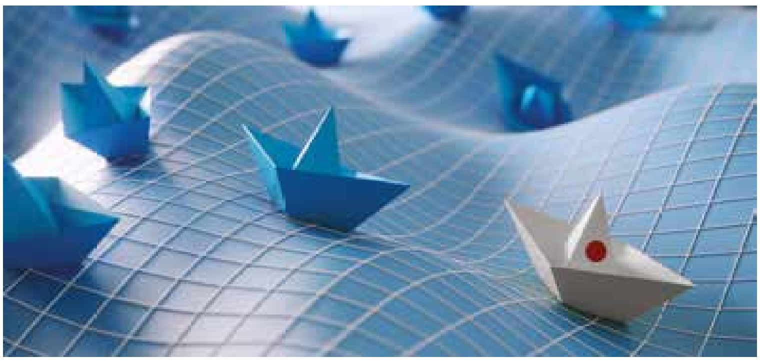
KT: To be successful in private equity you need a delicate balance of many

Q Contradictory to global trends, both investment activity and exits have been increasing in Japan. How do you explain this?

KT: It is interesting to see how Japan has evolved along a different path from other developed markets over the past five years. The US and European markets showed a slowdown in deal activity on both the investment side and exits due to several factors, including high interest rates, uncertainty in the public markets and geopolitical conflict.

During this time, Japan hit record deal levels in terms of volume and value, while exits continued to be robust. This is not only due to the availability of capital at low interest rates, but also driven by corporate reforms where companies that use to pride themselves on having large cash stockpiles are seeking acquisition opportunities at the behest of their institutional investors.

JT: Global investors have always valued cash returns. DPI is more important than ever and Japan has always been a solid performer in this regard. You put money in, you know you will get it back and more. And this is due to the long list of buyers for businesses fuelled further by shareholder pressure to utilise idle cash.



different ingredients. Japan is at the point where there are a multitude of factors converging to make the environment attractive. It starts with the macro economy. Then it needs the financial institutions to provide capital at reasonable and sustainable levels. You also need a regulatory and tax framework that is friendly to investors, as well as political stability. All of these factors need to be in place to take you to the next level and we have those now in Japan.

Most importantly, to invest you need something to invest in. And the supply of companies available for sale has increased materially, in terms of quantity, quality and deal sizes.

JT: What is driving this trend? Japan is the fourth-largest economy in the world, made up of 3.8 million companies in the private sector alone. More than 60 percent of these companies do not have a successor, according to the Japanese Ministry of Economy, Trade and Industry. Historically in Japan, if there was no successor, more often than not the business would close or be sold in a fire sale to a related party.

But this mindset is changing. Business owners are more aware of the opportunities that acquisition presents, including job continuity for employees and the perpetuation of a family's legacy. It is no longer viewed as a loss or failure. So you are seeing a large supply of companies becoming available for investment for private equity firms, which are now viewed as a culturally acceptable solution to the succession issue.

Q What other market trends are emerging?

JT: Like all markets in the world, Japan has made a commitment to acquire generative artificial intelligence capability and firms are scrambling to incorporate AI into their business processes. At NSSK, we have a trademarked value creation toolkit known as the NSSK Value-up Program (NVP®). With this proven and uniquely powerful operational improvement engine, we can introduce generative AI modules across our functional business processes, which cut across a number of industries. These tools are being developed in close cooperation with technology partners like Microsoft Japan. We plan to roll out these modules in 2025 and our NVP® team mantra is "one times more for returns".

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>
> **JUN TSUSAKA**

Q How does this value creation work in practice?

JT: It comes back to our fundamental philosophy of turning good companies into great companies. When we are looking to invest in a company, our definition of 'good' encompasses a lot of factors. Firstly, the company needs to have stable revenues backed by a fundamentally sound business model.

The second definition is a business that's generating solid cashflow. If a company is generating a good cashflow over time, it can sustain global shocks such as a pandemic or a geopolitical crisis. You need to go back 10 years or even 15 years to see how resilient and robust these businesses are.

The third criteria is that you need good management to drive and evolve good business models and execute with tenacity. Are they making the right decisions for offence and defence? Are they doing the best for the company and its employees? How do they react in a crisis? These people will become our partners, so we need to know how they perform.

We always look forward to what our options will be when we are ready to exit the company, whether that be through an IPO or sale. Do we have a lot of options? Will this company garner interest from other companies or the stock market, even if conditions are poor? Are they in a sector that has significant tailwinds for investment for growth, either by being in regulatory favour or in a geopolitical growth category? This is not conducted on a theoretical basis; this is the value programme in action. Our dedicated exit team drives the DPI generation process of our value creation programme.

When you look across markets, historically, the early years of most private equity markets saw funds driving returns through the 'buy low, sell high' approach. This strategy can work in periods of growth or limited competition.

But it is unsustainable in the long term. When you look at our investment results, 75 percent of our returns are derived from revenue, earnings growth and debt paydown. This is being driven by NVP®, our proven value creation programme, which will be critical to drive leading global returns over the next decade. ■