The Program on Alternative Investments, under the aegis of the Center on Japanese Economy and Business and in cooperation with the student-run Japan Business Association and Private Equity Club of Columbia Business School, hosted its fifth seminar on February 5, 2003. The event featured Mr. Timothy Collins, CEO, Ripplewood Holdings, LLC, and was moderated by Dr. Mark Mason, Director of the Program. Mr. Collins’ presentation focused on Ripplewood’s experiences as a major private equity player in both the United States and Japan, including his firm’s acquisition of the former Long-Term Credit Bank of Japan, now Shinsei, as well as Ripplewood’s broader set of transactions of various size and industry. Following are excerpts from Mr. Collins’ presentation together with selections from the subsequent question and answer period.

The Program on Alternative Investments analyzes several major alternative asset classes—including private equity, hedge funds, distressed investments, and commercial real estate—in Japan and elsewhere in East Asia. The Program meets its substantive goals through a combination of research projects and seminar presentations, the latter led by leading practitioners in each alternative asset classes. Throughout the year, the Program also conducts cutting-edge research on these topics under the direction of Dr. Mason and with the assistance of highly qualified research assistants. For a schedule of upcoming seminar presentations, consult the Center’s web site at http://www.gsb.columbia.edu/japan. Dr. Mason can be contacted at mm412@columbia.edu.

Co-sponsors: HVB Group; Takata Corporation
Ripplewood was established in 1995 to pursue industry-focused investments that are a hybrid between traditional corporate and private equity approaches. Since 1995, we have invested $2.1 billion of equity, half in the United States and half in Japan. This includes over $800 million (including co-investment) in 8 platform companies in the U.S., including 40 total acquisitions; $1.2 billion of equity invested to acquire The Long-Term Credit Bank (LTCB) of Japan; and $120 million invested in four platform companies in Japan through RHJ Industrial Partners. We have the same amount to invest over the next 2-3 years. Ripplewood is really defined by its industrial partnership strategy, which is conceptually simple. We target industries we believe offer exceptional potential for value creation, and we back world-class executives. For example, in Automotive retailing, we support Thomas Gibson, President of Subaru of America; in automotive parts, Richard Donnelly, CEO of GM Europe; in Chemicals, John Georges, Chairman of the Board and CEO of International Paper; and in branded services, Harsha Agadi, President of Little Ceasars Enterprises.

The two defining elements of our strategy are choosing the right industries and choosing the right people to search for, acquire, and subsequently enhance businesses in attractive industries.

Our investment approach is to focus on a small number of opportunities with very low downside risk, without sacrificing the potential for extraordinary returns. This is very easy to describe, but extremely difficult to execute. We have developed a systematic approach to accomplishing this goal. First, we undertake a very rigorous analysis of the underlying elements in the industry. Second, we look at operational improvements, and always have a crisp plan in mind at the operational level. Third, given our discipline about values, our philosophy is that we are prepared to buy a business based on what it is worth, but the majority of the upside from the changes in the strategic nature of the business or the operational improvements are really the ways we enhance our returns. In retrospect, our returns have been relatively attractive.

Ultimately, our goal has less to do with our financial returns than it is to create industry leaders in the segments in which we invest where those enterprises can create sustainable competitive advantage. Our philosophy has always been that if we create value in the underlying business, the financial results will take care of themselves. Sometimes, focusing on the financial results is a mirage as many learned in the 90’s and the hangover that followed. We have created from scratch a $4.5 billion automotive retail business (Asbury Automotive), which is the 4th largest retailer in the U.S.; Shinsei Bank, acquired with assets in excess of $100 billion; WRC Media, which is the largest supplementary educational publisher that reaches over 10 million students, teachers and parents; and Proxim, which is the leader in the wireless modem and wireless networking arena.

Ripplewood has a team in New York and a team in Tokyo. In each case we leverage our deal expertise with deep industry knowledge of our industrial partners. Ripplewood has been...
exploring opportunities in Japan since 1996. We have had the benefit of a very close relationship with Mitsubishi Corporation, which has been a significant investor in Ripplewood funds. The Chairman sits on Ripplewood’s Board of Directors, Mitsubishi professionals work full-time at Ripplewood, and Mitsubishi provides access to deal flow, global distribution and expertise for portfolio companies.

In 1997-98, we undertook a project with a leading global consulting firm on private equity opportunities in Japan. This was a hallmark of our early strategy, and it really laid the groundwork for our understanding of the situation with the LTCB. We have also received extraordinary support from Japanese and other governmental leaders.

Japan is the second largest economy in the world. It was clear to us from the beginning that Japan has the benefit of many first-of-class products and processes, and Japan is in dire need of both risk capital and catalytic management. Japan is and was the most over leveraged economy in the world. The access to cheap money during the bubble period led to high relative levels of capital expenditures, which, in turn, led to very low capacity utilization and low levels of profitability. The low returns are a function of high SG&A costs and low levels of asset utilization.

Despite these conditions, Japan remains a leader in many industries in terms of process and product technology. We believe Japan will restructure successfully to return to significantly higher levels of profitability. Already we are witnessing a dramatic change in the rules of business in Japan, including increased acceptance (albeit sporadic) of foreign ownership, accounting consolidation, deregulation of industries, accounting for pensions, significant increases in M&A activity, stock options, holding companies, and capital injections in the banking system. There has also been a recognition of the extraordinary magnitude of the non-performing loan problem and its impact on the overall economy. I think this recognition is the beginning of a hopeful time for Japan.

After our initial studies, we formed the largest private equity fund in Japan, originally called RHJ Industrial Partners. It was designed to duplicate what we did in the U.S. We had a very focused strategy, reflecting the needs of the Japanese market. Investors included leading Japanese and global institutions. Very importantly, about 40 percent of the capital came from large blue chip Japanese institutions. We focus on investments with an enterprise value of $250 million to $2 billion, which include basic industry, manufacturing, hotels, distribution, financials and services. We only invest where we can add considerable strategic value. We have made five investments to date and have, today, a strong pipeline of new investment opportunities, which we are studying carefully.

Among Ripplewood’s investments in Japan are Denon and Marantz, which are now combined in D&M Holdings; Nippon Columbia, renamed Columbia Music Entertainment, The Shinsei Bank, the Phoenix Resort, and Niles Parts, one of the leaders in automotive sensors and switches.

Ripplewood took effective control of Columbia Music Entertainment in October 2001—the seller, Hitachi, retained a minority stake. Its focus was historically on traditional Japanese music. It had a very muddled strategy and management focus and resources were spread across both the Denon hardware business and the music entertainment business. They also had a variety of non-core activities, including music retail, information systems, real estate, a dramatically underutilized CD pressing business, and they made successive records of losses for the last 11 years. After we bought the company, we spun off Denon, retained its listing on...
the Tokyo Stock Exchange, and we rebuilt from the ground up the artists and repertoire activity with an increasing focus on Japanese pop and rock. We underwent a complete restructuring of the organization, installed new financial, marketing and public relations functions, re-branded the company as a global and contemporary leader in the music entertainment business, strengthened the balance sheet, cleaned up the negative net worth and positioned the company for profit and growth.

Ripplewood acquired Denon Ltd. in October 2001 and merged the company with Nihon Marantz in May 2002, creating a new publicly-traded company called D&M Holdings. Prior to this acquisition, the company lacked strategic leadership, vision or direction, there was no defined product marketing or branding strategy, little investment in expanding product range or in new technologies, the distribution channel was in disarray, there was low morale among the engineers and other employees, and a lack of communication within the organization. Our goal was to transform this business from a stodgy, old music business with a declining customer base into a diversified, global music powerhouse. We are currently mid-stream with that. After we bought the company, we installed a new chairman, a world-class board and merged Denon with Marantz, another high-end branded consumer electronics company. Both companies are really benefiting from the merger in terms of integration of sales, marketing, R&D, manufacturing and purchasing efforts. Denon and Marantz were beneficiaries of a very talented executive named Merle Gilmore, who was the number two person at Motorola before joining Ripplewood.

Ripplewood invested in Niles Parts Co. in April 2001, a family-controlled automotive component manufacturer. The investment represented the first private equity investment in a manufacturing company in Japan. This was a really troubled company with unsuccessful investments in non-automotive businesses, there were no cost control or reporting systems in place, there was low morale among employees, and the company was largely dependent on Nissan in terms of sales (60 percent). They had great products and processes, but very bad business systems. We had two industrial partners with this deal, both of whom were largely responsible for making Niles very profitable.

Ripplewood acquired the Phoenix resort as part of a civil habilitation process in September 2001. Future capital investments were contemplated for the development of the property into a world-class destination resort. The Resort is a very beautiful facility that was over built in every way without any thought to marketing. We are now in the process of upgrading some of the attractions and meshing what the market wants with what we are providing in the way of amusement, entertainment, retail, and facilities. The Resort is a much longer-term turnaround because it needs to rebuild its place in the market. This may very well turn out to be the best investment that we have made in Japan in terms of return on investment.

The story of the Long-Term Credit Bank is breathtaking. The
Bank had an enormous group of talented people and good customers. We were able to recruit Masamoto Yashiro, who has done a remarkable job of installing good basic business and organizational practices and information systems. Shinsei has been growing very rapidly. It is the 5th largest Japanese bank with the strongest capital ratio. The Bank has become a diversified provider of capital, advice, and other financial services and products that add value to retail and corporate customers.

Japan is becoming an attractive environment for investment for at least three reasons. First, macroeconomic forces continue to drive change. Second, the government is recognizing the importance of new forms of capital and foreign investment. Third, Shinsei Bank is an indicator—for Ripplewood and others—that Japanese business is ready to change. However, change will not take place overnight. Many Japanese institutions are not yet familiar with private equity investing, and a significant effort will be required to restructure business organizations. At Ripplewood, we believe, most importantly, that a strategy that focuses on the underlying industry structure and corporate strategy rather than financial engineering has the greatest potential to prevail. We intend to stick to that strategy. We are strong believers in a very simple strategy and organizational structure. Ripplewood is structured around industry lines, supporting great talented executives. We think there is enormous potential for value creation, particularly in Japan.

**Question and Answer:**

**Q:** What has been your experience with labor issues in Japan?

**Collins:** I was a member of the United Auto Workers when I was young, so I am sympathetic to organized labor. We have found that having an organized work force can be very positive. Then you have someone that can speak for the best interests of the most people. So far, we have had support and cooperation along with some painful discussions. The leaders of the labor union have been incredibly constructive.

**Q:** How do you finance an industrial buyout in Japan relative to a buyout in the U.S.?

**Collins:** We do not have any simple rules of thumb. In Japan, many of the businesses can tolerate more leverage because the interest rates are so low. They are able to pay. It really is situation specific. We want to have enough leverage so that we can safely and securely amplify our equity returns, but not too much leverage that it impedes the ability of the management to manage the company or invest in the business for growth. In Japan, we used debt to buy the Phoenix Resort and Denon while in other cases we provided equity to deleverage.

**Q:** Are your investment time horizons in Japan any longer than ones in the U.S. and how will you exit these investments?

**Collins:** The way we make decisions about our portfolio is very simple, and it does not really matter where it is. We buy the business and make every decision as if we are going to own it forever. One of our simple criticisms about the way many people have applied the private equity trade in the U.S. is that they become overly precise about exit strategies. There are many new casualties of that methodology and a weak economy that a bad stock market start to illuminate. We run each business as if we will always own it, but the day after we close, we are also open to ways to maximize the investment and the returns to our investors. In Japan, given the nature of the business that we are investing in, like the Phoenix Resort, the time horizon to put it in shape and get a significant portion of the strategic value is probably a little bit longer than some of the businesses in the U.S. However, there is no simple rule of thumb.
Q: Has the Japanese government presented any impediments for you?

Collins: The Japanese government, just like the U.S. government, is not monolithic. Party politics are complicated, politics within the parties are complicated, and politics across and within ministries are complicated. In the main, we have had reasonable support from the Japanese government and, in some cases, extraordinary support.

Q: Do you think there is any public resentment in Japan against foreign investors and takeovers?

Collins: First, with respect to Shinsei, there will always be jealousy with respect to someone who has made a very attractive deal. There will also be a problem when other institutions are suffering but, for a variety of reasons, our institution is strong and healthy and not in jeopardy. So that creates friction whether it is in Japan or Tibet—it's human nature. Secondly, it was not that long ago when foreign investment in the U.S. was a new thing, and there were people angry over Mitsubishi buying Rockefeller Center. So I do not think there is much unique in the fears or phobias among the Japanese public. We took over this bank and weeks later, for, frankly, no fault of our own, one of the biggest retailers in the country went bankrupt and we were blamed for it. I would say that the negative sentiment is really dying down. The more time that passes the more the Japanese press and public observe that we are behaving responsibly and making a huge commitment to the country by reviving these businesses that otherwise would have disappeared.

Q: What, if any, surprises did you have with the Shinsei deal?

Collins: There were two pretty obvious ones. One, we were pretty surprised that Sogo’s accountants pulled the plug on them weeks after we took over this portfolio. We thought we had a little more time to get our arms around the situation than we were allotted. I think we were surprised by the magnitude of the problems in many of the underlying portfolio companies, how over-leveraged these businesses really were, and how under-reserved the other banks in the market were, for companies that were that massively over-leveraged. Other than that, we expected it to be pretty tough sledding, because we thought that the business model was pretty broken. We also did not expect to be brought before the Diet.

Q: Has your pioneering work in Japan brought you to the point where you are going to be able to deploy significantly greater amounts of capital in the years ahead?

Collins: Maybe the best thing we have done over the last three or four years in the U.S. is being really careful about the capital we have invested. Every dollar that we have not invested is worth two today, so we have $1 billion to invest here today, and we have probably invested about $1 billion here over the past 5 or 6 years. We are glad that we invested slowly and carefully. We are delighted with the potential returns of our portfolio in Japan, and we are exceedingly happy with the deals that are in the pipeline. We think that we are going to make a lot of money in Japan. There comes a point when there are other things than
making money, and it has been fascinating and fun. We hope to ultimately make a contribution to the recovery of the Japanese economy. If we are successful, others will imitate us. But I think we are pretty happy that we did what we did in Japan and the returns, both on the portfolio and on the stuff that we will invest in over the next 3 years, will be truly extraordinary. We are glad we did not invest a lot of money in telecomm or internet, or just basic business that were trading at 2 or 3 times what they were worth. I think there will be extraordinary values in the U.S. over the next 2 or 3 years, so we would expect to invest in the US now, and at a much greater clip.

Q: What do you look at in terms of mitigating risk?

Collins: Buying a business for what it is worth as is, where it is, as it is currently situated in the industry and currently being operated is our basic tenet. We look for the upside through strategic and operational improvement. Also buying a business with a very clear view about the potential for dramatic upside, both in changes in the industry and changes in the strategic position within the industry. That really gives you a cushion, and it is one element of risk mitigation. The other one is really having a depth of knowledge of the industry. If you look back, the two things that have cost people a great deal of money in making investments have been a fundamental misunderstanding of the demand drivers and growth in demand for products and services. Or a fundamental misunderstanding of the nature of competitive advantage and the ability to translate competitive advantage into stable and attractive returns on capital. Therefore, having a deep industry knowledge developed over a long period of time, a robust industry thesis and a talented executive from that industry is the best immunization against major mistakes in industry evaluation.
リール・ウッドとは
リール・ウッドはコーポレートエクイティおよびプライベートエクイティ両方取り扱う投資会社として1995年に設立された。設立後の投資総額321億ドルのうち、半分は米国内で、残り半分を日本で投資を行った。リール・ウッドの特徴としては業界がクリアーアクティブ・戦略である。数多くの投資経験がありました。リール・ウッドの戦略は、業界を理解し、投資に最適な業界と案件に対した「正しい」人材を選ぶことに尽力している。我々はアプローチは、領域を超えた投資家を育てる。長期的に見えてくると、リール・ウッドの成長は明らかである。リール・ウッドは世界の投資家として、投資家と協力関係を築き上げている。リール・ウッドの成長は、業界を理解し、投資に最適な業界と案件に対した「正しい」人材を選ぶことに尽力している。我々はアプローチは、領域を超えた投資家を育てる。長期的に見えてくると、リール・ウッドの成長は明らかである。リール・ウッドは世界の投資家として、投資家と協力関係を築き上げている。