KPMG FAS Newsletter

Driver

Vol. 04 June 2019

| Close-up |

Industry Outlook: Creative Disruptions

kpmg.com/jp/fas

04

KPMG FAS Newsletter

Driver

04

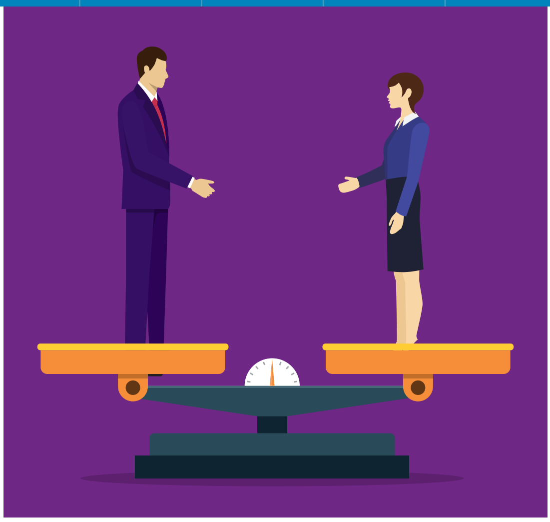
This is an English translation of KPMG FAS Newsletter, Driver Vol. 04, which was originally compiled and published in Japanese. In case of discrepancy between the Japanese and English, the original Japanese version will prevail.

Contents

KPMG FAS Newsletter "Driver"
Vol. 04 June 2019

News & Trends

Hot Issues and Trend Information



Addressing conflicts of interest: METI's revised MBO guidelines

More than ten years have passed since the Ministry of Economy, Trade and Industry (METI) formulated the guidelines for management buyouts (MBOs). The environments around listed companies have changed with the accumulation of various types of M&A transactions executed and the improvement of corporate governance practices. However, a number of challenges, including certain conflicts of interest inherent in some forms of M&A transactions, have yet to be addressed.

METI launched a "fair M&A study group" last fall. It has been deliberating fair M&A practices including revisions to the MBO guidelines, taking into account wide-ranging discussions inside and outside Japan.

It is noteworthy that in addition to the MBO practices, METI intends to address transactions where a parent company makes a listed subsidiary a wholly owned subsidiary, attempting to deliver a summary of issues focusing on conflicts of interest that inherently arise between acquirers and minority shareholders, as well as the information asymmetry involved in such cases.

The simultaneous listing of both a parent company and its subsidiaries is a prominent issue in the Japanese market. The issue summary is expected to help enhance the fairness of M&A practices in Japan for market participants, as it provides more clarity and predictability in dealmaking.

5G: Advent of a new era and new threats

The 5th generation of mobile communication system, 5G, will soon be introduced. 5G will offer not just more stable connection but also a communication speed that is 100-fold faster than the current 4G. The commercialization of super-high-speed communication is bringing about a substantive Internet of Things (IoT) era in which all things are connected to the Internet, from PCs and smartphones, to automobiles and consumer electrical appliances, houses, medical equipment, factory facilities, vending machines, and even toilets. Gartner Inc. expects that the number of IoT devices in use will increase to over 30 billion by 2020.

The commercialization of new technologies always entails risks. Privacy breach could potentially take place through the abuse of IoT sensors. Worse, the development of weapons by cyber criminals using IoT could even be possible. We can readily remember the incidents where services were disabled by the transmission of a large volume of data through contaminated IoT devices to targeted corporate servers. The data volume transmitted was 1TB at that time. The 5G era will not be anything compared to that. If a web service is targeted, there would be no means to escape the attack. Society as a whole must address these new threats.

Upsurge in Japan's ESG investments

The report issued by an international body, the Global Sustainable Investment Alliance (GSIA), in March 2019 shows that in 2018 the total value of ESG investment in five major markets worldwide increased 34% to USD 30.7 trillion in the last two years. ESG investments in Japan reached USD 2.1 trillion in 2018, up 307% for the same period, which puts the country in the third place in terms of ESG-related asset under management behind the US and Europe. This rapid growth can be partly attributed to the government-led development of the infrastructure for ESG investments such as introduction of the "Stewardship Code" in 2014 and "Corporate Governance Code" in 2015 and also partly to the commencement of the management of its pension money in ESG investments by the Japanese GPIF, the world's largest public pension manager. This trend is expected to accelerate further. While companies are required to analyze the non-financial information typically sought by ESG investors, they at the same time need to enhance disclosure by collecting and summarizing useful information inside of their companies.

Record-highs continue in J-REIT Consolication possible in second half

While global capital markets have been destabilized by the prolonged trade conflicts between China and the US, investments in Japan Real Estate Investment Trusts (J-REITs) have remained strong. With J-REITs having been traded so far at a near-record level in 2019, the TSE REIT index temporarily recovered to a 1900 level at the end of March 2019, the first time in three years. There are several reasons behind it. Office rents in the five wards in central Tokyo have risen for 64 consecutive months. The yield gap between J-REITs and 10-year government bonds has maintained a certain width due to a continued ultra-low rate policy by the Bank of Japan.

J-REITs' current strong rent incomes make payout of high dividends possible, leading to higher investment unit prices. Furthermore, J-REITs by leveraging the high unit prices secure additional equity funding to acquire news assets and achieve growth.

However, the cap rate in the current real estate market is at its historically lowest level. Going forward, the acquisition of properties at high prices may be exposed to equity share sale at discounts, potentially resulting in a loss of investor confidence. In order for J-REITs to achieve sustainable growth, consolidation should be a realistic process especially among high-yielding names with unstable income streams.

Industry Outlook: Creative Disruptions

Driven by irreversible waves of commercialization of digital technologies, IT giants, called platformers, continue to grow in the global market. In an era when new technologies are rapidly transforming not only existing products and services but also social systems as a whole, companies are more pressed to clarify their corporate visions and provide what their customers really expect on a timely and multi-channel basis. Focusing on the three industries –consumer & retail, healthcare, and hospitality (integrated resort), "Close-up" articles of this issue discuss the mid- and long-term challenges in those sectors as well as the new models of customer-centric businesses,.

Authors

Keiichi Ohwari
Partner (photo: left)

Representative Director and Partner,
KPMG Healthcare Japan Co., Ltd.
Founded KPMG Healthcare Japan in 2000, Keiichi Ohwari has assisted numerous medical institutions, services providers including caregiving businesses, and strategic and financial investors, in areas such as formation of domestic and overseas business strategies, new business development, M&As, corporate reorganization and restructuring, and fund raising. He has been head of Japan KPMG healthcare practice since 2000.

keiichi.ohwari@jp.kpmg.com

Takashi Kurihara
Partner (photo: middle)

Lead, Hospitality & leisure, KPMG in Japan
Partner, KPMG FAS Co., Ltd.
Since 2000, Takashi Kurihara has been engaged in various projects of M&As, corporate restructuring, and fund raising by tourism/hospitality operators of hotels, golf courses, and other leisure facilities. He has provided a wide range of advisory services from business analysis and assessment of target facilities, to operational restructuring, and development of turnaround plans for troubled companies. He has been a member of KPMG Japan IR Advisory Group since 2016.

takashi.t.kurihara@jp.kpmg.com

Yoshinobu Nakamura
Partner (photo: right)

Lead, Consumer & retail, KPMG in Japan
Partner, KPMG FAS Co., Ltd.
For more than 20 years with KPMG, Yoshinobu Nakamura has been engaged in various projects ranging from M&As, to JV formation, reorganization and restructuring of businesses, overseas market entries/withdrawals and business transformation. He has mainly helped consumer and retail sector clients in their corporate combination, group-wide restructuring, business plan development and new business development. As head of Restructuring, KPMG Japan, he oversees assistance to organizations under voluntary or legal liquidation process, publicly supported institutions as well as troubled companies for their turnaround and consolidation.

yoshinobu.nakamura@jp.kpmg.com

Close-up 1

Surviving the perfect storm

By Yoshinobu Nakamura, Partner

The transformational "perfect storm" concurrently taking place in the context of regions, demographics, and technologies has been rewriting the rules of businesses everywhere. One of the industries most deeply influenced is the consumer and retail sector. Consumers nowadays wish and expect to buy what they want immediately. Their questions have changed from "what to buy" to "how," "when," "where," and "from whom" to buy, and even further "how they rate and share". The level of their demands has been continuously rising. In the era of technologies this article explores the possible directions of transformation in order for companies to meet new, diversifying consumer demands.

Getting started to know your customers

A new class of giant IT companies called platformers and their ecosystems with which they provide large-scale services on the internet have emerged in an era of technology-driven, fast-evolving changes. The platformers have achieved a great deal within a short span of time by deepening their presence and intensifying many ideas, resources, clients and data through alliances with others. Convenient services from the giant platformers that provide everything consumers need on a one-stop-shop basis may discourage them from moving to other providers. Aggressive entries of technology-savvy startups which targeting the millennial and post-millennial generations have also driven the market growth.

The current keyword is "growth". Have a company's corporate culture, strategies, and business model been agile enough to meet current customer demands? Does the digitalization and use of smart technologies really contribute to the company's growth? Companies must authentically understand their customers, come closer to them, and provide them with the best proposals and experiences that match their individual situations. Only the companies that are able to transform themselves through a customer-centric way can achieve high growth and performance.

While the phases of "cognition," "consideration," "conversion (purchase of goods)," and "assessment" in consumption still proceed in the same order, the nature of each has significantly changed on the back of the penetration of the internet, digital innovation, and the online shopping boom. The evolution of a touch point from offline, TV and media advertisement to online, mobile, and social networking service (SNS) has brought about a more complicated purchasing process that proceeds not linearly, but multi-directionally like the branches of a web, with repeated transitions between offline and online activities. The experiences provided to consumers through various customer journeys, and the associated empathy and relationships built up in the process, are more important than ever before.

The "Five My" concept to understand diversified consumers

In the digital world, with its evolving technologies and ever-growing data trail, consumers expect companies to offer customized proposals on what to purchase based on the understanding of individual customers and their purchasing behaviors, and companies are also aiming to realize the system to meet that need. KPMG advocates the "Five My" concept in analyzing consumers: My "Motivation," My "Attention," My "Connection," My "Watch," and My "Wallet." By focusing on the Five My's in analyzing customers' life stages, life events, and the mutual interactions among them, you can piece together images and profiles of current and future individual consumers with a level of detail that cannot be matched by demographic analyses. An understanding of the true factors tied to the diversified behaviors of consumers and the significant tradeoffs in the purchase decisions consumers make may enable you to specifically access consumers with a precision never before attained.

Successful inter-generational surfing:
Millennials and generation Z

When surfing you must decide whether to act fast and ride the next wave or bide your time on the current wave, waiting until it subsides before you change to another. A company can grasp the waves of need that come and go in a consumer's life if it understands the stages of life the consumer passes through – the passage from youth to adulthood, the child-rearing era, the empty-nester period, the golden years of retirement, etc. – and determine the patterns of change that take place stage by stage. Alternatively, a company can conquer the surfing challenge by placing a focus on a specific life stage and catching the wave of the new generation entering that stage. Of course the company must understand that people of the same generation may have very different notions of life events or may time them differently. Established business models are likely to be ill-suited to catching the next waves. Are companies really ready to accept millennials and generation Z as customers?

The millennials born in the 1980s to early 2000s are said to place little weight on driving licenses and car ownership. In previous generations, these attainments were evidence that one has become an adult. For a millennial, the first-time use and possession of a smartphone is a very important life event and the mobile and online spaces are channels for connecting with others. The millennials are more inclined to use car-sharing services, mobility rentals, and on-demand traffic modes. The timing for marriage, first home purchase, and delivery of a first child is now being further deferred, and marriage rate and birth rate have both decreased.

The members of generation Z, born after the year 2000, are familiar with computer games as their parents are used to playing them. Now online gaming enables them to live another ego of their lives through online game avatars in virtual reality. The boom game "Fortnite" has achieved monthly sales of 300 million dollars solely from in-app sales of items. Gamers enjoy Fortnite with friends and use their pocket money to buy skins (changeable costumes covering the whole body). The online space is where they can express their "true selves." For the members of generation Z, who are versatile with media and can freely move among devices and contents while viewing multiple YouTube programs concurrently, tie-in is a "new normal." Moving back and forth between a game and movie, then visiting YouTube, then jumping over to retailing sites selling toys or apparel, is a normal sequence of actions.

What is required is "non-linear transformation"

As information and things become more abundant in society, companies face growing difficulty in having customers select their goods and services. Unless customers can identify the "attractive aspects" of goods and services and understand the "reasons" for obtaining them in empathic ways through sharing with others, the threshold for selection tends to narrow down to the price alone. The points that attract the interests and empathies of customers are diverse and compound, ranging from quality, price, design, function, convenience to the environment, health, and the social activities and philosophy of the companies that provide them. Balance among these points is also key.

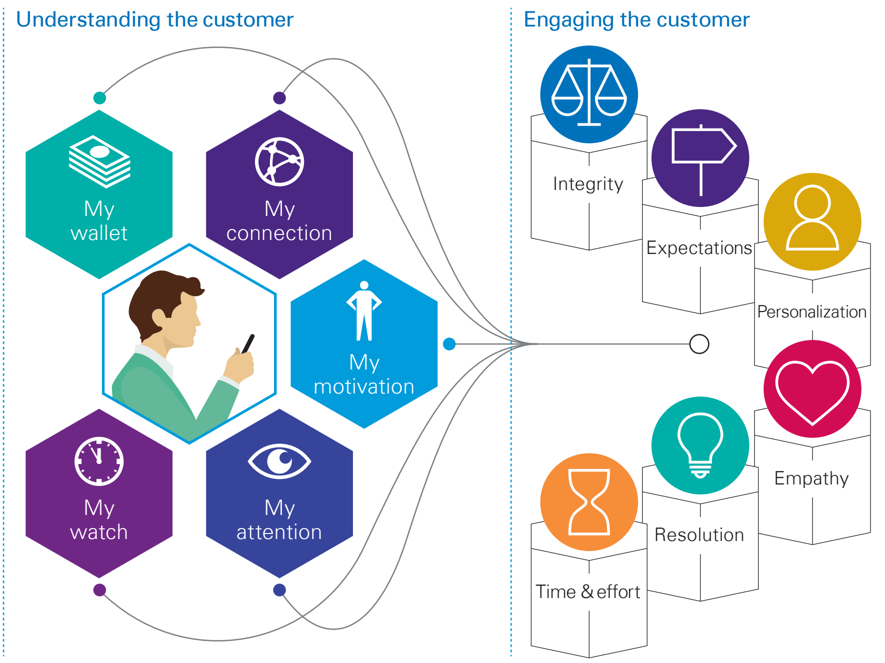
To understand customers, and develop and establish relationships between companies and customers, it will become more important to enhance the branding images and make themselves better known to their customers by having the touch points by themselves, which were formerly delegated to retailers and dealers. Note also that the customer incentive to purchase goods and services may often lie outside of the goods and services themselves. For double-income parents perpetually pressed for time and in need of help, for example, convenience throughout the customer journey is key. If companies can fully make their whole supply chain complete and simple with mobile applications and provide communities online that parents can turn to for support in their constant struggles to meet the demands of parenting and work, companies can attract them as customers and maintain their loyalty.

For whatever sectors, the notion of "Think like a start-up" will be key to addressing the non-linear transformation. First, consider who you would target as customers if you started up a business from scratch. Next, ask yourself how you would use digital environments and technologies, and what business models you would wish to develop. Given their existing resources, their workforces and assets, companies that operate established businesses tend to rule out the range of options open to them too readily by dismissing strategies that they believe would impair the productivity of their current resources. It is the dilemma of innovation, and a typical case is the cannibalization of sales between the offline and online modes.

Companies should compare the natural consequences when they interminably delay the necessary transformation with those when they make the transformation on a whole corporate value basis. Management must act not just with courage and guts, but with a commitment to optimizing corporate value not partially, but holistically.

As diversified customers change, a useful strategy to address it might be

Launch walk-through experiences of customers



Source : KPMG International "Me, My Life, My Wallet Issue 2" issued in April 2019 to adjust the key performance indicators (KPIs). Instead of judging performance by sales at an individual shop, for example, the judgment could be based on sales to an individual customer or a customer's level of satisfaction. With these performance indicators, sales could be realistically valued regardless of whether they take place online or offline.

Companies may find it effective to incubate new business seeds under separate organizations by setting up corporate venture capital, or acquiring businesses all at once through M&A arrangements.

Many of these approaches may require abundant funding and investment periods of a few years. By the time a company clearly perceives disruptions to its existing business, it may be too late to commence these approaches. Any company that does not meet the expectations of its customers will be extinguished. Existing companies now stand at a point of disruption. Therefore they must act now by disrupting existing businesses themselves, and executing non-linear transformational changes.

COLUMN

Retailers operating physical outlets and shops continue to face downward revenue pressure as online shopping takes a growing share of total consumption. Those retailers have to reduce costs by curtailing shop floor areas to secure profit in their existing profit-and-loss structures. If they wish to regain the sales from their online competitors, they will have to either attract more customer visits and consumption offline by providing "attractiveness" that customers can only experience in physical spaces, or claim their own share of online consumptions by launching their own sites or advancing their shops into internet malls. Physical retailers could also enhance productivity and increase sales by successfully integrating their physical shops and outlets into compound facilities with other retailers, residence units or caring facilities, or by converting some or all of their shops and outlets into different categories.

The younger generations find it bothersome to select products from myriad selections arranged on vast shop floors. Instead, they often prefer to complete their shopping in a short period of time by choosing from a proposed selection of products that suit their taste. If companies target them, they should optimize shelves to present the goods and products that serve the customers' appetites in smaller and more efficient spaces, and utilize the remaining areas to provide unique experiences and values that could attract more customer visits, or to install storage or picking points for online sales.

Retailers operating physical shops and outlets encounter various challenges when entering the online space. The costs and logistical burdens they incur in opening retail sites, shipping goods and products, and overcoming the last mile issue can be prohibitive. If these challenges could be resolved through the commercialization of technological innovation, physical shop operators with an established access to certain customer bases would enjoy enhanced competitive advantage. Online facilities managed by physical shop operators could also potentially relieve some of the frustrations customers face in meeting their needs that fall between the online and offline modes. With understanding of their customers using digital facilities, and the convenience gained by establishing one-to-one relationships with customers as "neighbors," physical shop operators may be able to sufficiently regrow their share of the customer's wallet.

Close-up 2

Transformation to 21st century health care:
Four key trends

By Keiichi Ohwari, Partner

All advanced economies now face the three challenges of aging, fiscal restraints, and a dwindling workforce. In 2025, Japan's baby boomers will be over 75 years old. By 2035, their children will be over 65 years old. While the need for medical and nursery care further expands in the coming years, declining birth rate will drastically worsen fiscal conditions and workforce shortages will deepen. Fundamental healthcare reforms will be the only viable course to solve the crisis that Japan is expected to face in the next twenty years. This article explores how the crisis can be turned into an opportunity by discussing the possible direction of healthcare reform from the perspectives of four significant trends.

[Trend ONE] Patient engagement: Enhanced involvement of patients and consumers

The latest survey on patients compiled by the Ministry of Health, Labor and Welfare reveals that as many as half of all patients were treated for one or more of the three lifestyle diseases: diabetes, hyperlipidemia, and high blood pressure. Most patients with these diseases are elderly and are diagnosed and treated by doctors face to face. Against this backdrop, online medical treatment has been added for the first time to Japan's national health insurance treatment scheme in April 2018. The scheme is still in its early development stages with a limited number of users, held back by the rigor of requirements for insurance coverage. The scheme, however, has represented a breakthrough in making virtual medical treatment available domestically. In many developed countries, virtual treatment has already been in a penetration phase with help from strong advocacy efforts. Kaiser Permanente, the largest healthcare system in the US, for example, reports that 50% or more of the medical treatments extended to over 100 million patients have been provided on a virtual basis.

Globally, it is now recognized that the proactive involvement of patients and consumers in their own treatment is significantly effective in lowering medical expenses. Online medical treatment reduces the cost of managing diseases while improving convenience for patients, helping wider involvement. Many diagnostic technologies will be available at home in near future with the development of new wearable devices and sensing technologies as well as the introduction of the 5G, new high-speed communication system.

Insurance companies too have been offering incentives for the insured to promote their own health as part of their efforts to encourage patients to take part proactively in their own health management. Discovery, a South African insurance company, offers discounts in insurance premiums, depending on a level of patient's involvement in various health programs and the achieved outcomes. Discovery, partnering with various companies, provides the insured with health-promoting gadgets such as Fitbits and Apple Watches as well as fitness services. On the bottom line, the company has succeeded in reducing its insurance benefit payouts and expanded its profits.

[Trend TWO] Shift in the care setting:
Care provided at relevant locations

Japan is ranked high in the supply of physical resources such as hospital beds and medical equipment in the hospital sector but low in terms of their productivity. It is also noticeable that human resources such as doctors and medical cases are left dispersed among medical institutions throughout Japan. The nation significantly lags behind other advanced countries on these fronts. Under the current circumstances, the Japanese government is restructuring its regional medical treatment frameworks as well as region-wide comprehensive care systems, and also facilitating the shift from medical treatments at hospitals to treatment at home. It sets 2025 as the target for completion of these restructuring efforts.

Despite the increasing number of aged people in Japan, evolving medical technologies have helped shorten hospital stays and to consistently reduce the occupancy rate of hospital beds. Going forward, many of the beds for patients in the acute stage are to be converted to beds for patients in the recovery stage. Further, the consolidation of hospitals will accelerate, downsizing hospitals themselves. In Japan, work-life balance issues for doctors have been a center of discussion recently. When regulations capping overtime hours take effect in 2024, hospital consolidation will most certainly be triggered. By the 2020s, medical institutions will be futher realigned by their roles in treatments of various diseases such as cancer and circulatory diseases. Along the way, groups of specialist doctors will be aggregated, and high-volume centers aligned by categories of medical treatment will be established.

Elderly people often suffer from multiple diseases concurrently and require an integrated approach in home care. In line with the long-term trend of physician specialization, medical professionals specialized in home treatment and care will inevitably be needed to be cultivated. In 2018, Japan launched the new specialist doctor system that subdivides the roles of specialist doctors into 19 areas of medical treatment. The current functions of family doctors are expected to converge with those of comprehensive treatment specialist doctors, gradually laying the foundations for primary care. The one-man doctor system will also shift to group treatment systems connected by functions.

[Trend THREE] Value-based care:
Maximizing value for patients

The interests of stakeholders in the healthcare industry are often in conflict with each other. Providers such as medical institutions try to increase the number of diagnoses or medical treatments, while suppliers such as pharmaceutical companies aim to increase sales to providers. On the contrary, payers such as governments and insurance companies exercise the best efforts to curtail the medical expenses paid to providers and suppliers.

The notion of value-based care has recently been dominating all over the world. This is to fundamentally convert the norm of value inherent in healthcare by converging the interests of all stakeholders towards the maximization of value for patients. Enhanced value for patients should improve the outcomes of medical treatments and caring, and that will be achieved by optimizing costs associated with those treatments and caring.

The largest driver for promoting value-based care relates to the structural reforms for the payment of medical fees. The reform focuses on the preclusion of overlapping or non-useful medical treatments or caring. In order to provide a patient with integrated care, hospital operators are compelled to practice clinical governance with other operators on a regional basis. Thus, robust organizational integration is encouraged among hospital operators in a scale different from the existing model. This move is very clear in the US, where business models like that of the Integrated Healthcare Network (IHN) have been evolving. Even in Japan, some regions have already started to adopt "Japanese versions of the IHN".

A similar reform has been taking place among payers and suppliers. The most representative reform is the adoption of the Health Technology Assessment (HTA). Government agencies including independent third-party organizations assess the clinical usefulness, safety, and cost-efficacy of medical technologies such as new drugs, and judge the application of health insurance or the fairness of the medical fees. "Kymriah" a new drug for leukemia from Novartis, has recently been approved for coverage under the national insurance system in Japan. The drug costs over JPY30 million. Kymriah is offered for a fixed fee in Japan, while some countries such as the US have adopted an incentive fee structure based on the level of effect. The essence of this incentive fee structure is to transfer the risks associated with the product value from the payers to the suppliers. Suppliers are certain to be held more accountable for the product value.

[Trend FOUR] Innovation of medical technologies:

Shift to one-to-one medical treatment and risk-sharing

A rapid paradigm shift to one-to-one medical treatment has been taking place in the medical treatment community. Rather than applying legacy medical treatments to groups of patients, optimized, one-to-one medical treatments are applied to patients as individuals with the support of advanced technologies such as gene analysis, data analytics, and AI.

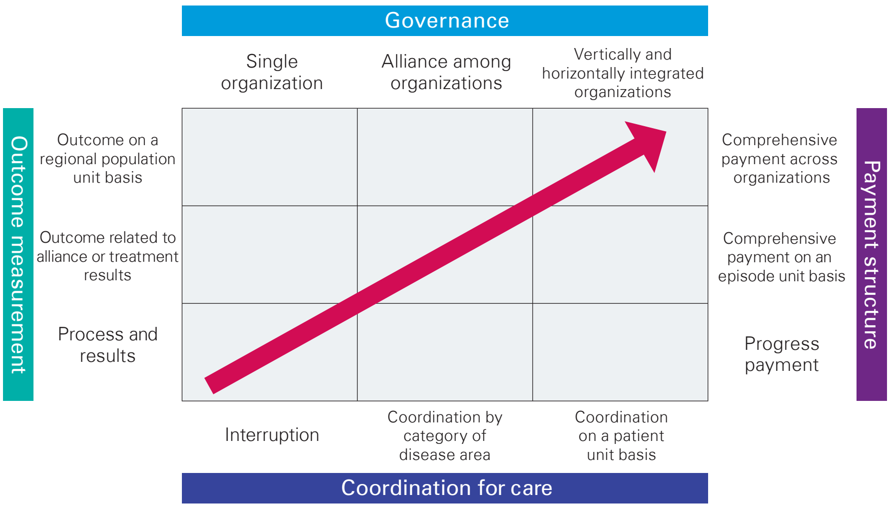
With the evolving innovations of medical technologies, the risk-sharing approaches among stakeholders have been changing. Roche recently acquired Foundation Medicine, a provider of panel testing for cancer-associated genes, and Flatiron, a data analytics specialist that collects and analyzes electronic medical records and other real-world data.

The respective forms of know-how of these companies can be used to support drug discovery and the selection of treatment options at medical institutions. In anticipation of supporting medical institutions, major providers of diagnostic imaging devices such as GE and Siemens have been actively investing in the development of image analysis technologies in interpreting radiographic images. Through moves such as this, functions of pathology and image interpretation conventionally performed by medical institutions are separated and transferred to these equipment suppliers or data analytics specialists.

The changes in the risk-sharing structure can be seen as one of several trends towards the formation of a health ecosystem that facilitates innovation. Going forward, risk-sharing

Direction of healthcare system reform in Japan

Source: KPMG Healthcare Japan



among the players involved in the stages of research and development, commercialization, and clinical implementation, will be steadily optimized. These players include medical institutions, research institutions, suppliers, payers, bio-ventures, IT companies, and financial institutions.

Moving to new stage:
Smartphones, primary care and lean hospitals

The challenges Japan currently faces are not necessarily unique to Japan. These challenges are extreme, however, given the magnitude of problems and the velocity required to solve the problems. We should not underestimate the crisis we are facing.

Even so, the author remains optimistic about the future. We should be able to predict the next stage of healthcare by looking at the four trends described above. In the next two decades, the delivery channel for healthcare will significantly shift from a face-to-face setting to virtual healthcare. Convenience will rise and prices will substantially fall. Second, the role of primary care will extend to the comprehensive health management of people in regions rather than just focusing on health and disease prevention for individuals. This role is likely to be scaled up to encompass other social resources for caregiving and welfare on the regional level. Third, thanks to the broad penetration of digital health, consumers will become more involved in their own treatments and health management, and become healthier. Fourth, medical treatment providers at hospitals and homes will share standardized clinical paths and protocols, giving rise to integrated healthcare systems on a regional level. Fifth, highly specialized medical treatments will be rendered only by specialist hospitals, as digitally enabled institutions will offer smarter, safer, more efficient medical treatments. The current healthcare delivery system, which is still strongly rooted in the 20th century, will enter a new stage of innovation with 21st-century medical treatments and optimized risk-sharing among stakeholders.

Healthcare is the most important social infrastructure integral to the prosperity of a country and its citizens. Stakeholders are encouraged to play more proactive roles than ever to ensure that Japan's healthcare system will be brought to a sustainable stage for the next generations.

Close-up 3

Challenges in making Japan a tourism-oriented country:

Why deregulate Casinos?

By Takashi Kurihara,Partner

Under the Act on Promotion of Development of Specified Complex Tourist Facilities Areas (so-called "Integrated Resort (IR) Promotion Act") passed in the Japanese Diet in 2018, casino operations are legalized, which had been prohibited as gambling under the criminal code in Japan. Casino facilities will be integrally developed and operated within large-scale integrated resort (IR) facilities owned and run by private entities. However, the introduction and promotion of IR does not mean only the lifting of the ban on casinos. It has a very important public policy mission for Japan. The first IR facilities are expected to be open in the mid-2020s. The facilities will be built on a large scale and are reported to require total investments ranging from hundreds of billions to as much as one trillion yen. This article discusses the ambitious measures the Japanese government intends to take following the lifting of the ban on casino operations in Japan.

Final piece integral to the realization of Japan as a tourism-oriented country

The government of Japan has identified the tourism industry as a pillar of its growth strategy and has undertaken various initiatives to meet the demands of overseas visitors coming into the country. Partly through the government's efforts, the number of incoming tourists surpassed 30 million for the first time in 2018, and altogether they consumed goods and services exceeding JPY4.5 trillion in value. Looking ahead, the government has set ambitious targets of 60 million incoming visits and JPY15 trillion in consumption by the year 2030. Japan will be hosting various global events such the Tokyo Olympic Games in 2020 and Osaka International Exhibition in 2025. In order to capture a continuous inflow of foreign tourists even after 2025, the introduction of IR facilities is now expected more than ever.

In its aim to make Japan a tourism-oriented country, what does the government intend to achieve by leveraging vast revenues from casino operations? IR refers to large-scale complex-type resort facilities consisting of casinos and entertainment facilities, in addition to accommodations, convention halls, restaurants and cafes and retailers.

The Marina Bay Sands (MBS), an iconic IR facility in Singapore, can be seen as a benchmark for the Japanese version of IR. The MBS as a world-class landmark has enhanced the image and appeal of Singapore and has grown to become one of the world's major urban resort destinations.

Back in 2005, Singapore was losing its appeal as an international tourism-oriented city state. Lee Hsien Loong, the Singaporean prime minister at that time, decided to promote the development of an IR with a casino as a national policy with the aim of regaining the status as an international tourism-oriented city state. Despite the global financial crisis, the so-called Lehman shock, hit in the late 2000s, the large-scale IR facilities have brought about a significant and continuous increase in the number of overseas visitors and domestic consumption. In addition, as seen in Singapore having grown to a global player in the Meeting, Incentive, Convention, Exhibition (MICE) market, the government-led IR promotion has become one of the most successful examples of the public policies.

As the meaning of IR promotion, the Japanese government refers to the public benefits of making Japan a globally competitive tourist destination that attracts many visitors and encourages them to stay longer. It also insists that the IR facilities can work as tourist hubs to send foreign visitors to different locations throughout the country. Casino operations have thus been permitted on the assumption that the development of large-scale tourism bases will contribute to the goal of promoting tourism across Japan to serve the public good. The area used for casino operations is regulated to be no more than 3% of the total floor area of the vast IR facilities. Focusing solely on the lifting of the ban on casinos provides no insight into the essence of the introduction of the IR model. The economic and social effects of Japan's transformation into an advanced tourism country need to be noted. The Japanese version of IR will be subject to the world's first two-phase regulation models. The first phase of regulation is controlled under a Casino Management Committee. The second is controlled under the Minster of Land, Infrastructure, Transport and Tourism. Importantly, the world's most stringent regulatory oversight will be provided in conjunction with the lifting of the casino ban, including an initiative to use a portion of revenue from IRs to combat gambling addiction in Japan.

Another pillar: Promotion of MICE

There are some core facilities necessary in all IR facilities, dictated in the IR Promotion Act. Japanese IR facilities comprise MICE facilities (exhibition hall and international convention center), attractiveness-enhancing facilities, tourist hub facilities, and accommodations, in addition to casino facilities. The IR facilities are expected to achieve a physical scale and levels of quality never seen before in Japan, and will be developed in a comprehensive and integrated manner. Crucially, the IR facilities should appeal to business travellers as well as family customers, to ensure that the benefits that IR projects generate are maximized. It is expected that the facilities must be unique, leveraging the vitality of the private sector combined with the creativity of each region where they are based. As the ban on gambling being lifted as a special exemption, it is important that IR facilities in Japan are required to maintain a certain level of public interest.

As a result, integral development of highly profitable casinos and other core facilities will lead to the establishment of a businesses model in which casino revenue internally subsidizes vast initial investments. Singapore's extremely high yielding MBS posts an EBITDA margin of over 50% from its entire IR business. The initial investment, reportedly reaching more than JPY500 billion, is said to be recouped in just more than four years. For a large-scale real estate development project like this, the resort has realized an astonishing returns on investment.

The most difficult challenge for operators to address in their investment planning is said to be how "MICE facilities" are to attain a scale and quality consistent with those of other facilities. A casino is fundamentally defined as a business model centered on weekend operations. MICE facilities, which can be operated on weekdays, will help level the operations of entire IR facilities, including accommodations. As MICE can be compatible with casino in this sense, the IR facilities in Singapore as well as in Las Vegas are both accompanied by large-scale MICE facilities to evoke business-related demands.

Development of large-scale MICE facilities alone, has proven to be low in profitability around the world. With the vast initial investment being challenging to recoup, decisions of reinvestment is naturally difficult to make too. Therefore projects of this type are often promoted by central or local governments for the public interest. In Japan, a local government with a low fiscal surplus may find it difficult to develop and operate new large-scale MICE facilities.

On the other hand, the strong economic knock-on effect arising from a MICE event is extremely noteworthy. While the presence of Japan in the global MICE market has been declining, an international convention participant visiting Japan consumes an average of JPY360,000 during the stay, or more than double the JPY160,000 spent by a general tourist. The promotion of MICE is also consistent with the government's policy to increase consumption by foreign visitors.

In addition to the direct consumption activities of participants in a MICE event, new agreements and the creation of new business opportunities associated with business meetings and advertisement activities are also expected. Though annual revenues of the Tokyo Big Site in 2017 was only JPY21.2 billion, the economic effect arising from exhibitions and other events at the venue has been preliminarily estimated to reach JPY750 billion annually.

The operating rate has almost peaked, however, among the landmark facilities in the Greater Tokyo Metropolitan area such as the Tokyo Big Site, the Tokyo International Forum, and Pacifico Yokohama. Opportunity losses have in fact been identified. High-end conference venue with the capacity of 1,000 participants or more are extremely difficult to find in the metropolitan area, and large hotels and attractive leisure facilities have rarely existed around them.

Thus, the Japanese version of IR facilities embodies the intention and desire of the Japanese government to regain its presence in the global MICE market by leveraging the internal subsidy mechanism to inter-relatedly develop highly profitable casino facilities and world-class MICE facilities.

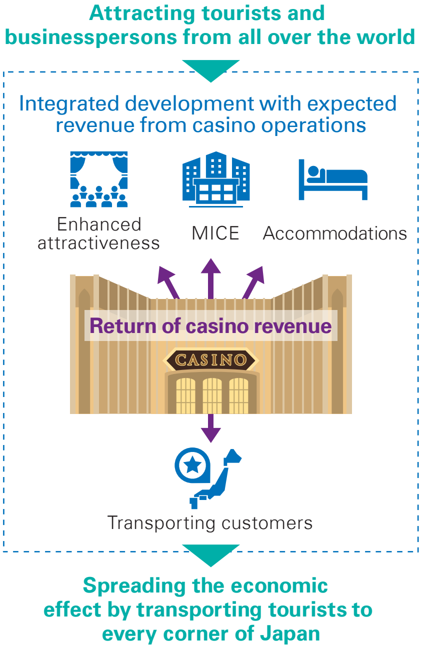
Paradox inherent in the Japanese version of IR

"Tourist hub facilities" can be regarded as core facilities unique to the Japanese version of IR. Overseas IR facilities themselves are the destination, a place where every need is fulfilled and accordingly takes the name "integrated resort." The business model is built around the intention to persuade visitors to stay longer and spend more money and time at one place.

On the contrary, the Japanese version of the IR has been identified as an initiative to disseminate the attractiveness of Japan across the world. Ways and means to send tourists to every corner of Japan have therefore been explored. Those who try to maximize the revenue, however, find a paradox built into the business. This is partly because 60% or more of visitors to Japan currently concentrate their visits along the so-called golden route connecting the three largest metropolitan areas in the country. The government intends to address the structural inequity faced by the areas remote from the golden route, which have been missed out on the benefits of the growing numbers of foreign tourists visiting Japan.

Operators are accordingly expected to commit to sending tourists to areas remote from the golden route by holding tourism expositions that use cutting-edge technologies such as VR to embody unique Japanese traditions, cultures, and arts that tourists have yet to discover. By committing to sending tourists to every corner of Japan, operators are practically obliged to return a part of casino revenues for the public interest.

Image of Public Interest Embodied by IR



Leveraging IR to promote regional economies

The ultimate objective of the IR Promotion Act envisaged by the government is to help promote regional economies and thereby contribute to the improvement of finances of local governments. In practice, Japan's prefectural governments have already started their promotions of IR facilities. Local governments are going to publicly seek their partnering private operators. The race among the pairs of local governments and selected private sector operators for the maximum of three locations for the Japanese IR development projects is already gaining steam and is carefully watched by the Japanese public as a whole.

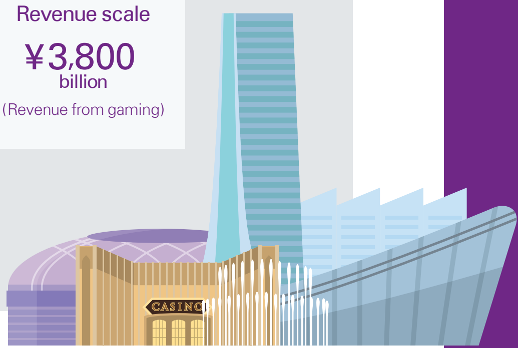
Major regulations imposed by the government on operators could potentially constrain their businesses. Sufficient profitability that justifies the vast amounts invested would therefore be required as a condition precedent in entering into the business. Operators would select prospective areas to operate business, taking into account the government's intentions, particularly with regard to the scale and quality of the core facilities and the creativity unique to the local governments to differentiate their appeals.

Meanwhile, a local government that eventually selects an operator may place extreme emphasis on the operator's ability to procure funds, in addition to the business plans, given the vast investment required for the development and operation of IR facilities. In fact, it can be argued that financial institutions neither the government nor operators, could be holding the key to success in IR leveraged-promotion of the regional economies, as they are the ones to provide an unprecedented scale of finance to the country's first-ever large IR development projects, with a limited forecast on the cash flow.

The world's largest urban IR facility – An IR business model designated by Osaka

Investment scale	Total floor area	Revenue scale
¥930 billion	100 million m²	¥3,800 billion
(Marina Bay Sands invested about ¥500 billion)	(21 times the floor area of Tokyo Dome)	(Revenue from gaming)

- Accommodations: 3,000 rooms
- International convention hall: The largest convention halls accommodating 6,000 participants and 12,000 participants at maximum
- Exhibition floor: 100,000 square meters



*Prepared by KPMG based on the Osaka Government website

Market Check!

EV/EBITDA multiple trends by sector

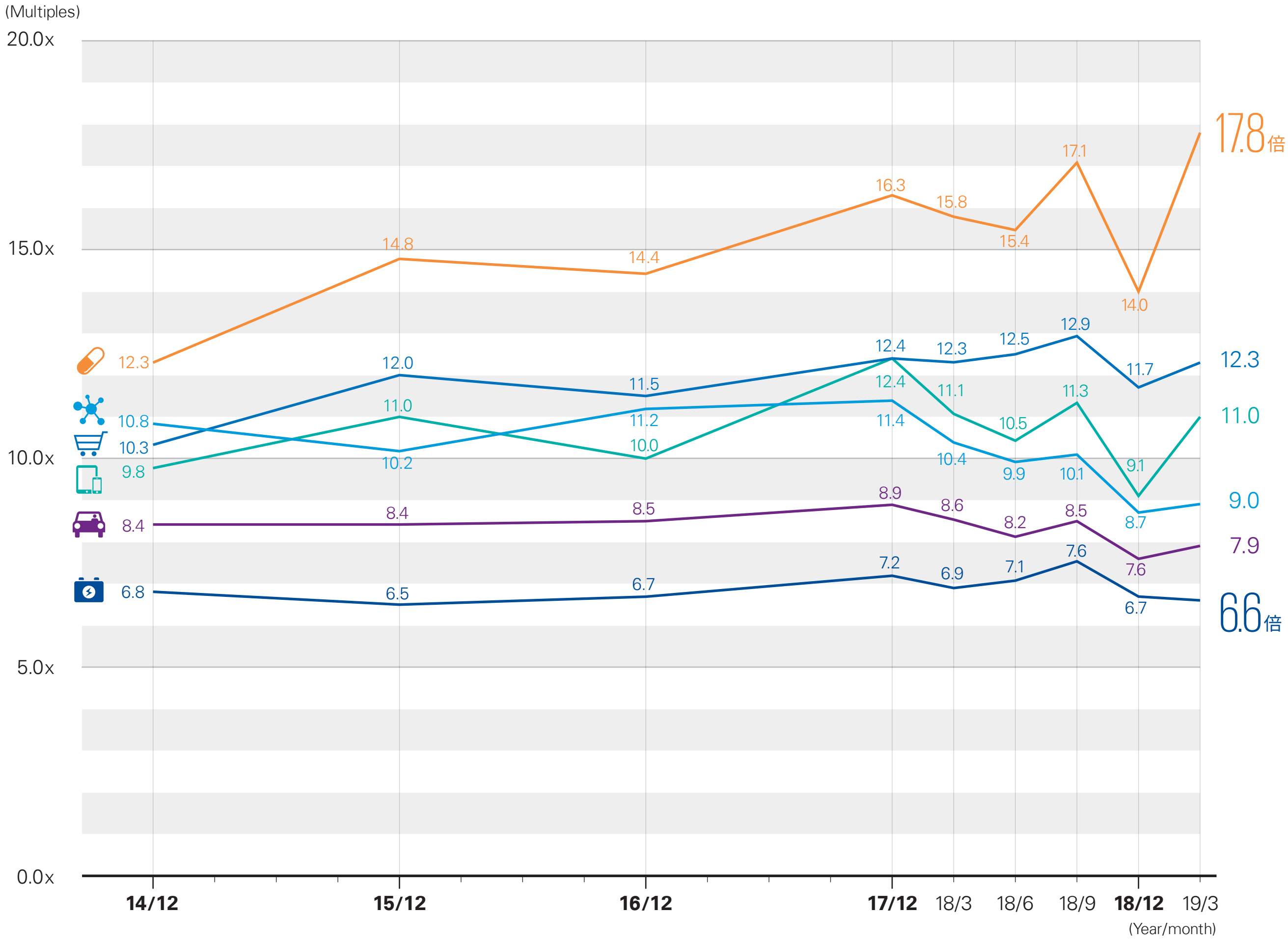
Market multiples trends as an indicator for measuring M&A Markets

Looking at six sectors ranging from hardware centric to software centric, this section provides fixed-point observation data for the market multiples of major markets in Japan, the US, and China.

M&As are defined as an important tool for companies in realizing growth strategies. M&As by Japanese companies both in Japan and overseas continue to increase.

We hope these data will provide you with insight into the M&A transaction trends in the sector to which your company belongs, as well as the recent growing trend of cross-sector M&A transactions.

Changes in EV/EBITDA multiples: Japan



• **Component issues of the six sectors**

Sectors	Industry classification	Representative companies (as of March 2019, top five of market capitalization) Japan
Energy, utilities and communications	Energy-related facilities and services / Oil, gas and consumable fuels / Electrical communications, wireless services, independent power generation business / Electric power, gas, tap water / Comprehensive utilities	Softbank / NTT / NTT Docomo / KDDI / JX TG HD
Materials and capital goods	Chemical, machinery, semi-conductor, aerospace, defense / Metal, mining / Paper products, wood products, containers, packages / Construction, civil works, electrical equipment, architectural materials / Trading companies, distribution, conglomerate automobile parts / Automobiles	Mitsubishi Corporation / NIDEC / Shin-Etsu Chemical / DAIKIN / FANUC
Automobiles and durable consumables	Durable goods	TOYOTA / Sony / Honda / NISSAN / DENSO
Consumer goods and retail	Retail, sales / Beverage / Foods / Tobacco / Home appliances / Personal goods	FAST RETAILING / JT / Kao / Seven & I HD / Shiseido
IT Internet	Internet sales, catalog sales / Interactive media and services / IT services / Software healthcare related	NTT Data / Fujitsu / Rakuten / Yahoo / Nomura Research Institute
Pharmaceuticals and healthcare	Biotechnologies / Pharmaceuticals / Life science tools	Takeda / CHUGAI / DAIICHI SANKYO / Astellas / HOYA
Component number (March 2019)		276

- Energy, communications, utilities
- Materials, consumables
- Automobiles, durable consumables
- Consumables, retail
- IT Internet
- Pharmaceuticals, healthcare

- Japan ———
- USA - - - - - - - -
- China — — — —

EV/EBITDA multiples:

Index indicating the enterprise value (EV) multiples against earnings before income tax and depreciation and amortization (EBITDA)

*In this analysis, we determine EV as the total of market capitalization and interest-bearing liabilities. The EBITDA stated is for the most recent 12-month period.

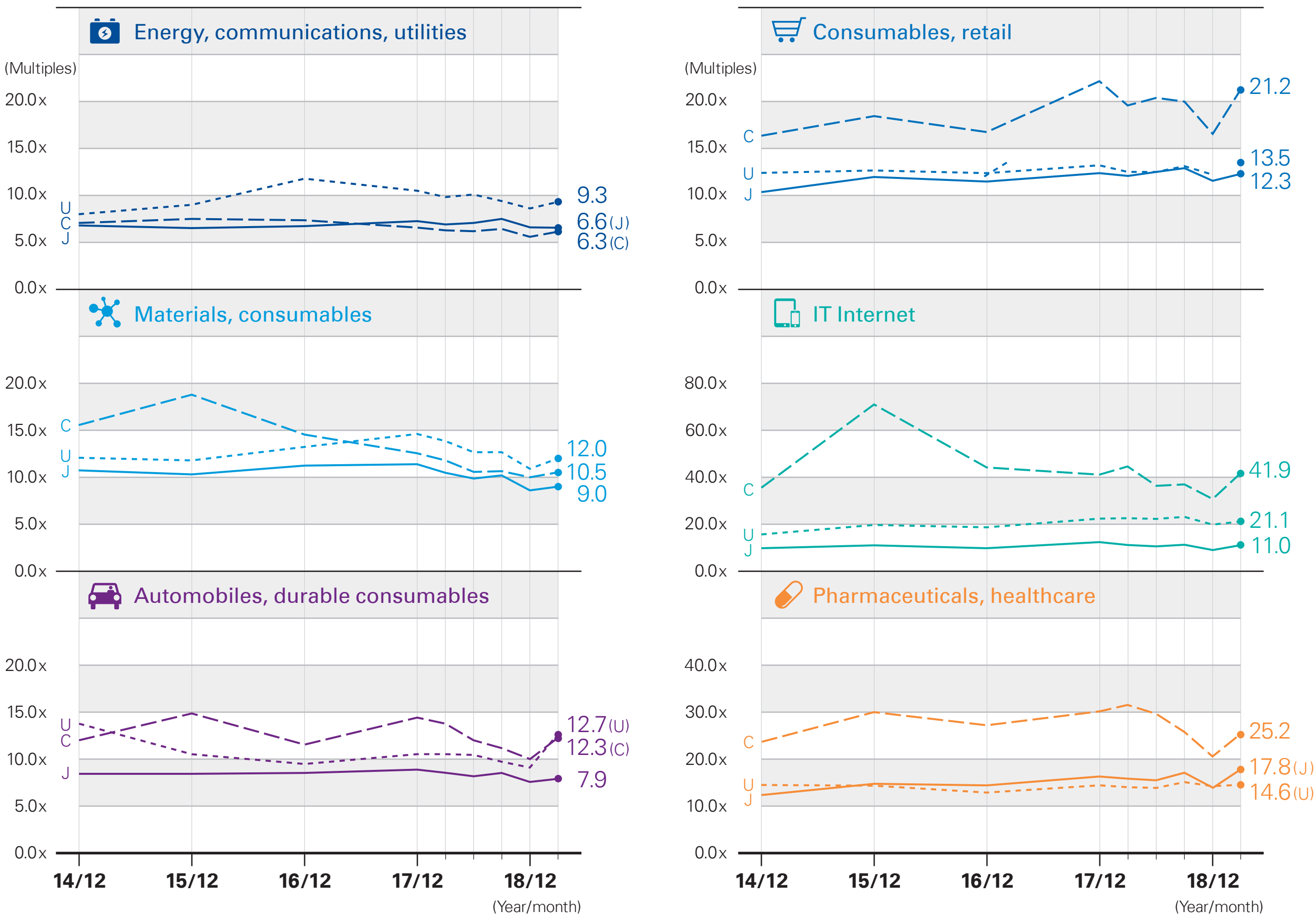
• How to calculate multiples

We classify the component issues of representative stock indexes (JPX Nikkei 400; S&P 500, CSI 300) into the following six sectors defined by KPMG: "energy, utilities and communications," "materials and capital goods," "automobiles and durable consumables," "consumer goods and retail," "IT Internet," "pharmaceuticals and healthcare." Then we illustrate them with charts.

• Sources

Capital IQ / Bloomberg

Country comparisons of changes in EV/EBITDA multiples by sector: Japan / USA / China



	USA	China
	Exxon Mobil / Verizon Communications / Chevron / AT&T / NextEra Energy	PetroChina / China Petroleum & Chemical / China Shenhua Energy / China Yangtze Power / China United Network Communications
	Intel / The Boeing / DowDuPont / 3M / Broadcom	China State Construction Engineering / CRRC / Anhui Conch Cement / China Communications Construction / China Railway Group
	General Motors / Ford Motor / Aptiv / Garmin / Lennar	Midea Group / SAIC Motor / Gree Electric Appliances / BYD / Qingdao Haier
	Walmart / The Procter & Gamble / The Home Depot / The Coca-Cola / PepsiCo	Kweichow Moutai / Wuliangye Yibin / Jiangsu Yanghe Brewery Joint-Stock / Inner Mongolia Yili Industrial Group / Suning.com
	Microsoft / Amazon.com / Alphabet / Facebook / Visa	iFLYTEK / Yonyou Network Technology / Hundsun Technologies / Aisino / Beijing Shiji Information Technology
	Johnson & Johnson / UnitedHealth Group / Pfizer / Merck & Co / Abbott Laboratories	Jiangsu Hengrui Medicine / Yunnan Baiyao Group / Aier Eye Hospital Group / Shanghai Fosun Pharmaceutical (Group) / Guangzhou Baiyunshan Pharmaceutical
	320	178

Publications & Reports

★ Recommended Books

Publication

Practical CVC

From the development of strategies to foundation and investment valuation

This book elaborates on practical approaches required through all phases of CVC operations by comprehensively discussing the flow of processes from establishment and operational management to exit strategies. The reports closely reflect KPMG's experiences with CVS supports while describing the most sophisticated CVC transactions in the US and Japan.

Editor : KPMG FAS Co., Ltd.
Publisher : Chuokeizai-Sha
Publication date : October 5, 2018
No. of pages : 252
Price : ¥2,200

(Available only in Japanese)

★ Recommended Books

Publication

Understanding M&As

This book elaborates on the flow of M&A transactions from the development of a project to due diligence, valuation, the contract, the closing, and project management, while lucidly highlighting key issues in each phase.

Authors : Masahiko Chino, Hikaru Okada
Publisher : Nikkei Publishing
Publication date : June 2018
Price : ¥1,000

(Available only in Japanes)

★ Other recommendations

KPMG FAS Books (Available only in Japanese)

- New "ASEAN Company Map - Second Edition"
  Shoeisha / January 2019
- "Business Rehabilitation and Buyout"
  Chuokeizai-Sha / November 2018
- "Customer Experience Strategy"
  Nikkei Publishing / June 2018
- "ROIC Management – Development of Power to Generate Profit and Strategic Dialogue"
  Nikkei Publishing / November 2017
- "Corporation and Business Rehabilitation Handbook"
  Nikkei Publishing / April 2015
- "Chart – All about Enterprise Value"
  Nippon Jitsugyo Publishing / April 2011

KPMG Research Reports

- New "REACTION Magazine: Chemicals 26th Edition"
  https://home.kpmg/ca/en/home/insights/2018/08/reaction-magazine-26th-edition.html
- New "Me, my life, my wallet, 2nd Edition"
  https://home.kpmg/xx/en/home/campaigns/2018/09/me-my-life-my-wallet.html
- New "Accelerating mobility"
  https://institutes.kpmg.us/manufacturing-institute/articles/2019/accelerating-mobility-optimizing-transit.html
- New "Industry 4.0"
  https://home.kpmg/xx/en/home/campaigns/2018/11/industry-4-0.html
- New "2019 Autonomous Vehicles Readiness Index"
  https://home.kpmg/xx/en/home/insights/2019/02/2019-autonomous-vehicles-readiness-index.html
- "Cyber risks in the maritime industry"
  https://home.kpmg/no/nb/home/campaigns/2018/10/how-to-detect-and-address-cyber-risks-in-the-maritime-industry.html

For details of publications, please see "**www.kpmg.com/jp/publication**". Please order a book directly from the publishing companies.

If you wish to obtain relevant reports, please see "**www.kpmg.com/jp**" or contact "**fasmktg@jp.kpmg.com**".

Contacts

Representative Director & Partner		
	Masahiko Chino	masahiko.chino@jp.kpmg.com
	Hiroyuki Oshida	hiroyuki.oshida@jp.kpmg.com
	Hikaru Okada	hikaru.okada@jp.kpmg.com
Service Line		
Corporate finance	Koichiro Tanaka	koichiro.tanaka@jp.kpmg.com
PMI advisory	Tetsuya Tanaka	tetsuya.nakao@jp.kpmg.com
Restructuring	Yoshinobu Nakamura	yoshinobu.nakamura@jp.kpmg.com
Strategy	Koichi Iguchi	koichi.iguchi@jp.kpmg.com
Deal strategy	Kaoru Mano	kaoru.mano@jp.kpmg.com
Transaction	Osamu Matsushita	osamu.matsushita@jp.kpmg.com
Forensic	Toshifumi Takaoka	toshifumi.takaoka@jp.kpmg.com
Sector		
Automotive	Koichi Iguchi	koichi.iguchi@jp.kpmg.com
Chemicals	Kaoru Mano	kaoru.mano@jp.kpmg.com
Business services	Yuki Minamiya	yuki.minamiya@jp.kpmg.com
Consumer & retail	Yoshinobu Nakamura	yoshinobu.nakamura@jp.kpmg.com
Energy	Tsuneo Miyamoto	tsuneo.miyamoto@jp.kpmg.com
Financial services	Kenichiro Kato	kenichiro.kato@jp.kpmg.com
Industrial manufacturing	Osamu Matsushita	osamu.matsushita@jp.kpmg.com
Life science	Naotomo Akune	naotomo.akune@jp.kpmg.com
Hospitality & leisure	Takashi Kurihara	takashi.t.kurihara@jp.kpmg.com
Real estate & infrastructure	Junya Kato	junya.kato@jp.kpmg.com
Telecom, media & technology	Takeshi Moriya	takeshi.moriya@jp.kpmg.com
Private equity	Paul Ford	paul.ford@jp.kpmg.com
Focus Area		
Corporate venture capital	Jun Okamoto	jun.okamoto@jp.kpmg.com
Business logic & technology	Hisahiro Ito	hisahiro.ito@jp.kpmg.com
Digital transformation	Paul Ford	paul.ford@jp.kpmg.com
Regional revitalization	Kaoru Abe	kaoru.abe@jp.kpmg.com
Overseas business value up	Shinichi Yoshino	shinichiyoshino1@kpmg.com

Information

Next issue:
Expected to be issued in October 2019.

Latest and back numbers are available at "www.kpmg.com/jp/driver".

To subscribe to this newsletter or register a change of location or cancellation, please contact "fasmktg@jp.kpmg.com".

KPMG FAS Newsletter "Driver" Vol. 04

Issue date : June 2019
Issuer : KPMG FAS Co., Ltd.

Tokyo office
Otemachi Financial City North Tower
1-9-5 Otemachi, Chiyoda-ku
Tokyo 100-0004, Japan
TEL : +81-3-3548-5770

Osaka office
Ginsen Bingomachi Building
3-6-5 Kawaramachi, Chuo-ku
Osaka 541-0048, Japan
TEL : +81-6-6222-2330

Nagoya office
Dainagoya Building
3-28-12, Meieki, Nakamura-ku
Nagoya 450-6426, Japan
TEL : +81-52-589-0520

www.kpmg.com/jp/fas

KPMG FAS Co., Ltd.

Otemachi Financial City North Tower
1-9-5 Otemachi, Chiyoda-ku
Tokyo 100-0004, Japan
TEL : +81-3-3548-5770

www.kpmg.com/jp/fas