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Gear heads

By targeting Japan's amateur car enthusiast community Worldtool created a new distribution channel for automotive tools in the country. CLSA Capital Partners has helped take the company's model overseas

BY THE EARLY 1990S JAPAN'S CAR manufacturers were on top of the world. Over the previous three decades the country had grown from an afterthought in the global automotive market to the undisputed leader, even extending its lead over the US players from 1980 to 1990. Yet as homegrown giants such as Nissan, Subaru and Honda captured the world's attention, some of their domestic consumers were feeling neglected.

"There was a significant number of amateur users, who enjoyed car maintenance or remodeling their own cars. But these people had limited access to professional tools, because the major distribution channel was wholesale," says Yasunori Maeda, a director at CLSA Capital Partners' (CLSA CP) Sunrise Capital. "They could only purchase these tools via mail order or specialty shops with a limited product range."

Worldtool, a car parts retailer founded by Japanese entrepreneur Tsutomu Nakajima in 1995, has aimed to make itself the primary resource for this overlooked market and provide the car enthusiast community with the resources it needs. The company's unique business model, which combines elements borrowed from American outsourced manufacturing and clothing retail, proved so successful over its first 20 years of operation that CLSA CP agreed to acquire a controlling stake in 2015.

Since the investment, the GP has sought to justify Nakajima's decision to partner with it by enhancing Worldtool's existing strengths while looking to the next stage of its growth. With new markets opening up and CLSA CP laying the groundwork for an IPO, both the firm and the founder feel that the last three years have proven their faith in each other.

Chance meeting

CLSA CP was no stranger to the automotive market when it first encountered Nakajima and Worldtool. The private equity firm had entered the space nearly two years earlier when it acquired used-car auction site operator BCN from Chubu Motor Sales in the first transaction for its Sunrise Capital II vehicle. This acquisition would lead CLSA directly to Worldtool, for the two were not only potential business partners but also neighbors. In fact, Worldtool's headquarters are only a 15-minute drive from those of BCN in Saitama prefecture in northern Tokyo.

It was during a client meeting for BCN that Worldtool and CLSA CP's representatives, including Maeda, first met face to face. The firm had unknowingly come upon Worldtool at the right moment, as Nakajima for some time had been actively seeking private equity investors to secure the future of the company he had run for the past 20 years.

"Upon our first meeting with Mr. Nakajima, after discussing the potential business alliance between BCN and Worldtool, he shared his thoughts about the future of the company and its ownership," says Maeda. "He knew that BCN was under the ownership of a private equity fund, and he was very interested in how Sunrise Capital provides support to its portfolio companies."

Nakajima had approached 16 PE firms, including CLSA CP, but quickly narrowed the list to eight serious contenders. His main concern was to find a buyer that would play an active role in Worldtool's development and build on its success as a pioneer in Japan's automotive services sector. CLSA CP was open to the idea, especially once it had learned more about how the company had essentially created a new segment all on its own. It agreed to take a 55% stake in a deal that valued the business at JPY10 billion ($82.8 million).

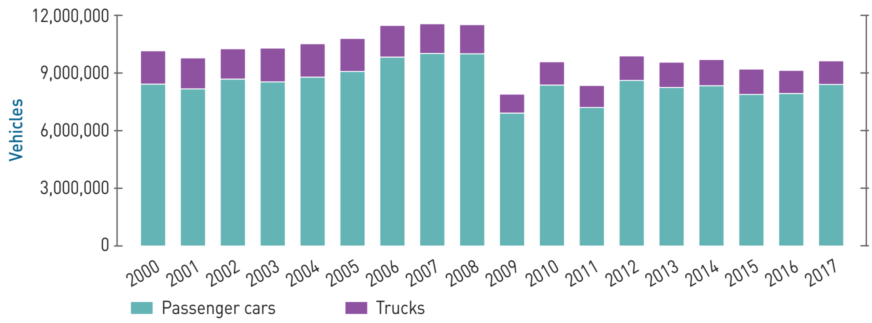
Prior to the founding of Worldtool, high-quality automotive tools for Japanese cars were only made by the manufacturers themselves and distributed to dealers and service centers by wholesalers. As these resellers targeted large enterprises, independent mechanics, small maintenance garage operators and hobbyists had few official channels to get full sets of tools at reasonable prices.

Nakajima, at the time a salaryman in Tokyo, knew that there was an opportunity in these customers and set out to find his way into the market. An arrival from overseas would lay the groundwork for Worldtool's eventual business model. "I had always wanted to be independent and run my own business, so I became a franchisee for a company called Snap-on Tools, one of the most famous tool manufacturers in the US," Nakajima says. "Once I learned how they imported their products from Asia, I thought I could sell a similar quality of tools at a much lower price."

Working as a franchisee for Snap-on proved to be an apprenticeship of sorts for Nakajima, who met with a wide range of clients to learn where they saw the biggest gaps in Japan's automotive tools market. He found that while Snap-on's retail model was promising, consumers were frustrated by the parent company's focus on the US market, which meant that most of its products were calibrated for American vehicles and thus were not marketed in Japan.

Nakajima also believed Snap-on was leaving money on the table by failing to bring its outsourced product lines to Japan, instead selling pricey American-made equipment in the country. Though he was aware of his countrymen's prejudices against Asian-manufactured goods,

Japanese automobile production



Source: Japan Automobile Manufacturers Association he also knew there was potential for overcoming such bias in other markets.

"Back in the late 1980s and early 1990s, Japanese people thought that tools manufactured in China and Taiwan were useless. But these tools were already widely used in the US, and I knew they could be sold in Japan too," recalls Nakajima. "We imported many kinds of tools from Asia that nobody else in Japan was selling, and that's why the business has been so successful."

Retail comparisons

With this insight, Worldtool was launched in 1995 with the Astro Products lineup primarily comprising auto maintenance tools but also including LED lights, solar panels and electric generators, all manufactured in China and Taiwan. The company's stores operate under the same name, giving the company a unified brand identity like apparel retailers Uniqlo and Gap. In fact, CLSA CP refers to this model as SPA (specialty store retailer of private label apparel), a term borrowed from the clothing industry.

Nakajima's ability to grow a business segment from scratch impressed CLSA CP, as did the firm's analysis of the overall industry opportunity. While data from the Japan Automobile Manufacturers Association indicated that by 2015 domestic auto manufacturers had recovered from the shock of the global financial crisis, the industry showed no sign of returning to its pre-crash heights. Even 2012, the best year following the crisis, beat only one of the 15 years before it in terms of total vehicles produced.

With consumer appetite for new cars slowing, CLSA CP concluded that car owners were likely to hold on to their existing vehicles for longer. This meant that demand for vehicle-appropriate tools should increase in turn, particularly among owners of older car models for which dealers would be ending support soon. Nakajima had put Worldtool in a position to capitalize on this momentum, but the private equity firm also saw areas where it could contribute, most immediately in operational improvements – one of the aspects of its management of BCN that had initially impressed Nakajima.

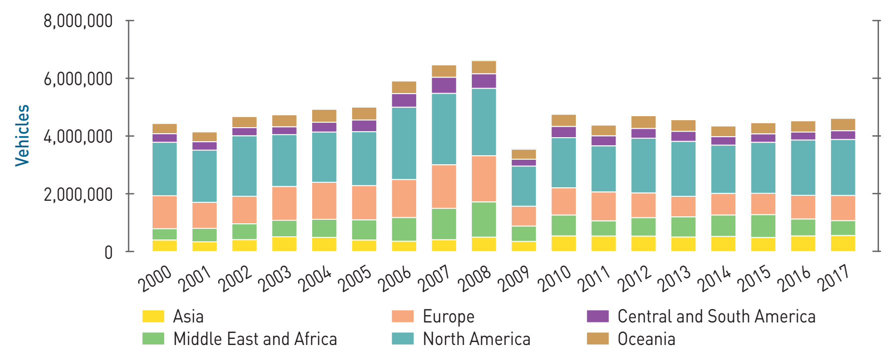
"The company had 120 direct stores when we invested, but the way they operated the store network was the same way as they had five years old when they had only 20-30 stores. Their growth was so fast that they hadn't really changed their operating model," says Maeda. "So, we tried to cultivate a mindset of examining the numbers, looking at facts, and adapting based on those facts and numbers."

A longer-term goal for Nakajima and the new owners was to deepen the penetration of the business into new markets, particularly emerging Asia. While the region has historically been a relatively minor market for Japanese car manufacturers, representing around 12% of total exports last year, it has also been highly stable compared to other jurisdictions, with overall sales remaining steady around 500,000 vehicles per year since 2010.

In addition, CLSA CP sees the Asian demand as concentrated in Southeast Asian countries, which unlike China and South Korea lack highly developed domestic auto industries. This means that mechanics in these countries must provide maintenance services for many Japanese cars, and are likely to have even more difficulty than their Japanese peers in sourcing the appropriate high-quality tools at a reasonable price.

Nakajima agreed with CLSA CP's assessment of the overseas opportunity, but with the company's resources mainly oriented toward domestic expansion he had been unable to formulate a strategy for reaching foreign markets. Bringing in new owners with greater resources and overseas experience would reinforce Worldtool's deep knowledge of the automotive tools market.

Japan automobile exports



Source: Japan Automobile Manufacturers Association

"There was a lack of knowledge in the company on how to expand the business overseas, so Sunrise supported that initiative," Nakajima says. "After Sunrise invested, we spent several months developing the business in Thailand. The only thing the company itself had to do was open the shop – all the technical issues were taken care of by Sunrise."

Thailand was selected as the location for Worldtool's first Southeast Asia branch due to several factors. For one, market research indicated that 80% of the vehicles currently running in the country were made in Japan, so the company would not need to modify its products to bring them to the new market. Thailand's consumers were also considered to favor Japanese products in general, and to be willing to take a chance on a new Japanese brand.

So far the Thailand initiative has played out well: within three months of its opening in 2016, the first Astro Products store in Bangkok had reported a profit. The company plans to open additional locations in the country over the next few years, with other Southeast Asian markets to follow.

A matter of succession

Nakajima sees overseas expansion as a major step for Worldtool that demonstrates the company's ability to continue to grow under new ownership. This is welcome news for the founder, who had hoped to take the business public when he turned 50 and retire from management, but worried about the prospects for leadership after he left.

"There was no clear successor within the company, so he could not really retire, but at the same time he didn't know how much further he could grow the company by himself," says Masamune Konakamura, a senior associate at Sunrise Capital. "When he discussed the matter with commercial banks, the banks recommended using a PE fund to address this issue."

Once Nakajima made his plans clear at their first meeting, CLSA CP was more than willing to help him reach his twin goals of retiring from the company while also positioning it to expand under public ownership. Worldtool has maintained its leadership position in the automotive tool retail sector under private equity ownership, growing from 120 to 160 stores while also adding new distribution channels such as e-commerce. As a result, the founder is optimistic about the future.

"Before the deal was closed I was concerned about whether my employees and the team from CLSA CP could work together smoothly. But in the end, there was no problem and the relationship was very healthy, so my worries were gone after closing," says Nakajima.