

BLOOMBERG:

Private Equity Sees Opportunity in Getting Naked With Strangers

Japan's traditional hot baths are among the world's oldest businesses — and they're attracting big new money.

By

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For Japan's growing flood of foreign tourists, one of the top internet search terms is "onsen," the traditional hot springs where travelers have soaked since the days of the samurai. Now some of the world's oldest businesses are attracting big new money.

Private equity funds like SoftBank-owned Fortress Investment Group LLC and Hong Kong-based Odyssey Capital Group are spending billions to tap into the appeal of traditional inns amid a tourism boom that's ramping up ahead of next year's Tokyo Olympics. The big funds are moving in as centuries-old spas, many of them still family-run, struggle to find successors in an aging country where small towns and villages are losing young people.

Odyssey, along with two other investors, last year purchased its first Japanese onsen, an inn with 28 tatami-floored guest rooms near the Sea of Japan called Kagetsu, or "flowering moon." Christopher Aiello, managing director of Odyssey's Japan real estate business, says the firm plans to spend \$500 million in the next three years buying about 20 more traditional Japanese hotels, which are known as ryokan.



An outdoor bath at Shosenkaku Kagetsu.

Photographer: Shiho Fukada/Bloomberg

“The Japanese hospitality sector has tremendous opportunities for investment,” Aiello said in an interview. “Many of these ryokan are very undervalued after experiencing so much recession and mismanagement, but a lot of them are located in beautiful natural settings.”

At Kagetsu, the founder’s granddaughter, Tomoko Tomii, greets her guests at the inn’s stone-paved entrance, dressed in a delicate pale-pink garment like a kimono. The 40-year-old says the family decided to sell to the Odyssey group last year because debts had piled up and they needed money to update rooms and design an English-language website.

“We had no choice but to look for a sponsor,” she said. “We appreciate that our buyer is stabilizing the business, but not kicking us out.”



Tomoko Tomii

Photographer: Shiho Fukada/Bloomberg

Odyssey and its partners sent two professional managers to help streamline operations, but agreed to let Tomii and the family's 30 employees stay on after the sale. That was important because concern for the welfare of employees deters many small business owners from selling, even when they've fallen into desperate straights. Japanese proprietors, in particular, have a reputation for being "allergic" to selling.

Japanese hot springs have become hot investment targets for other big businesses, too. Yokohama-based Breezbay Hotel Co. is looking to acquire 100 lodges and onsen inns over five years, according to its chief executive officer, Noritada Tsuda.

Bain Capital LP has been buying onsen since 2015, when it purchased a chain of 29 Japanese spas and resorts, including one on an artificial island in Tokyo Bay. Last month, the Boston-based private equity firm opened a new ocean-view property in the rural prefecture of Mie, bringing the number of its Japanese hospitality assets to 36, with plans for more.



Solaniwa Onsen in Osaka is owned by New York-based fund Fortress. Clockwise from top: Visitors take photographs in front of the onsen's imitation shrine, a resting room with tatami flooring, employees arrange padded kimono jackets.

Photographer: Buddhika Weerasinghe/Bloomberg

Fortress, the New York-based fund purchased in 2017 for \$3.3 billion by Masayoshi Son's SoftBank Group Corp., is also in the game. In February, the firm opened a downtown Osaka spa the size of two city blocks where day trippers can soak in tubs on the edge of a traditional Japanese garden, with a hotel-and-mall complex next door and a 51-story tower rising above. It's a novel experiment that transplants the onsen experience into the heart of one of Japan's grittiest neon metropolises.

Thomas Pulley, chief investment officer for global real estate at Fortress, is a self-described Japanophile who says he traveled to the country five times during the construction of the resort to handpick its cherry trees and the earthenware baths used in its private, open-air rooms. The tubs cost about \$20,000 each.



A private bath inside a guest room at Shosenkaku Kagetsu.

Photographer: Shiho Fukada/Bloomberg

For a modern touch, the spa also has a comic-book lounge where bathers can peruse a library of 15,000 manga.

“Onsen is truly unique in Japan,” said Pulley, who ran Credit Suisse Group AG’s private equity business in Tokyo during the 2000s. “There’s hopefully great demand for this type of urban onsen resort.”

Fortress already owns more than 90 Japanese spas and hotels, but plans to spend the equivalent of \$3.6 billion on more. Pulley said SoftBank’s backing has given Fortress extra credibility and opened doors to more deals in Japan.



A Shosenkaku Kagetsu employee prepares futons for guests.

Photographer: Shiho Fukada/Bloomberg

Both Bain and Fortress are raising cash by selling their properties to publicly-traded real estate investment trusts they sponsor. Shares in Bain's REIT have risen about 10% this year, while Fortress' Invincible Investment Corp. has gained more than 20%. The benchmark Nikkei 225 Stock Average is up less than 6%.

Japan has almost 13,000 traditional onsen inns, where bathers go unclothed in big communal baths heated by geothermal energy that's bubbled up to the surface.



Tourists ride a cable car in Yuzawa.

Photographer: Shiho Fukada/Bloomberg

Many of these old hotels are at the end of remote mountain roads or in small seaside towns and, after decades of economic recession, financial distress is common. The most venerable of them, an inn that has run continuously since it was opened in 704, filed for bankruptcy this year.

More than half are at risk of simply closing down because they lack someone to take over from their aging owners, according to a 2017 report published by the trade ministry.

Solving the succession problem is why Tokyo-based human resources firm BizReach Inc. in March launched an online match-making platform to try to pair owners of traditional ryokan with potential buyers.

“Owners are still a little resistant to selling,” said CEO Soichiro Minami. “But we think people will gradually open up.”



A Shosenkaku Kagetsu employee waves off guests.

Photographer: Shiho Fukada/Bloomberg

For the Tomii family, the decision to sell to the Odyssey group came after the realization that the actual work of running the hotel — pampering guests and preparing elaborate meals — was leaving no time for figuring out how to make money at the business.

“We were too busy with the day-to-day,” Tomii said, “to even think about the future.”