

# [ Kibe-log ]

Director  
Representative Executive Officer  
President and CEO  
Kibe Kazunari

#14

## The Idea Behind Valuation

Dear Stakeholders, I am Kazunari Kibe, President and CEO of INFRONEER Holdings Inc.

Thank you so much for reading the "Kibe-log".

The Japan Sports Council (JSC) adopted the concession method of selling the right to operate the facility of JAPAN NATIONAL STADIUM over a 30-year period to private companies as a private-sector commercialization project in order to efficiently operate and increase revenue from JAPAN NATIONAL STADIUM, which was used as the main venue for the 2021 Tokyo Olympics.

And recently, "JAPAN NATIONAL STADIUM x Social Well-being Group", a consortium of companies led by NTT DOCOMO, INC., was awarded preferred negotiation rights as the operator of JAPAN NATIONAL STADIUM. MAEDA CORPORATION of the INFRONEER Group is also a major member of this consortium.

Going forward, the consortium will proceed to sign an implementation agreement to begin operations in April 2025.

## Amount proposed in JAPAN NATIONAL STADIUM Concession

In fact, amount our group proposed for the right to operate the concession has become a bit of a hot topic. The price for the 30-year operating rights we proposed was 52.8 billion yen, including consumption tax. It was a proposal to pay 1.76 billion yen per year for the operation of JAPAN NATIONAL STADIUM for 30 years. Some people have asked, "Isn't this amount too high?".

Indeed, even after the government sold the right to operate JAPAN NATIONAL STADIUM, its policy was to cover the operating costs with public funds, up to 1 billion yen per year. In other words, it is a loss-making facility for which the government must be responsible at public expense.

In contrast, our proposal was to pay a little over 1.7 billion yen per year. I do not know the detailed bid amounts for each bidder, but I believe that the total amount of our proposal was more than 30 billion yen higher than the second largest participant's proposal, calculating backward from the published evaluation amounts.

A similar comment was raised in the acquisition of Japan Wind Development Co., Ltd., which was announced in December 2023. The acquisition price of Japan Wind Development Co., Ltd. was 203.1 billion yen, almost half of INFRONEER's market capitalization at the time. The EBITDA multiple, which is the business value divided by EBITDA\*, was also 98 times, which must surely seem expensive considering the common M&A practice.

\*EBITDA: Operating income plus depreciation and amortization. It is an indicator of earning power in the core business. Since it is not affected by interest rates, corporate tax rates, depreciation methods, etc., it is suitable for comparing the performance of global companies.

Questions about these two deals were also raised at the shareholders' general meeting in June.

However, as we reported in the last issue of [Kibe-log #13](#), I honestly feel that the acquisition price of Japan Wind Development Co., Ltd. was not only relatively high, but quite inexpensive. In the case of the right to operate JAPAN NATIONAL STADIUM, I can confidently say that the bid price of 52.8 billion yen is reasonable. This is not something to be bullish about.

So why is there such a discrepancy in perception of acquisition price or bid amount? I feel that it is due to differences in how we perceive future valuations.

## Current profits are not equal to future profits.

The method commonly used to calculate the value of a company or business is called the Discounted Cash Flow (DCF) method. This method is to calculate how much profit the business will make in the future, and then consider future uncertainties and risks as a discount rate to determine the current value.

However, unless we can expect major innovation in that business, the future value will be calculated based on the current business model and profits. It could be said that it is simply stretching past and present

profits into the future. Those who are skeptical about the acquisition of Japan Wind Development Co., Ltd. or the right to operate JAPAN NATIONAL STADIUM are probably evaluating them from this perspective.

On the contrary, we think of present value not in terms of profits from the past to the present, but in terms of profits that can be expected in the future. If we believe that those future profits will be significantly above the trend of the past, then the present value of the business will also increase because there will be a substantial increase in future profits.

As for the acquisition of Japan Wind Development Co., Ltd., its current annual operating profit is only about 1.5 billion yen against the acquisition price of 200 billion yen. If that operating profit level continues, it will take more than 100 years to recoup the investment.

However, as mentioned in the last issue of Kibe-log, Japan Wind Development Co., Ltd. owns development projects with a total potential capacity of 3,800 MW (megawatts). Japan Wind Development Co., Ltd. does not currently have that many assets because it has sold the power plants it developed to funds and other entities. However, in 7 to 8 years when the current projects take shape, many profitable assets will become visible. When that happens, operating income must be far more than 1.5 billion yen.

The same is true for the right to operate JAPAN NATIONAL STADIUM.

JAPAN NATIONAL STADIUM is currently operating in the red as the government has tried to cover operating costs up to 1 billion yen annually. If we assume that the current deficit will continue, we cannot justify the evaluation of paying a price of 1.76 billion yen per year.

However, although it is difficult to notice when you are in Japan, from a global perspective, the arena management business is expanding quite rapidly. What is supporting this rapid expansion is not traditional ticket sales, but sales through VIP rooms, naming rights, food & beverage, merchandise, and content distribution.

The current JAPAN NATIONAL STADIUM is in the red, but it is a legacy of the Tokyo Olympics, and if it can be replaced by a global standard stadium, the top line should grow significantly. That said, if Taylor Swift were to hold a concert at JAPAN NATIONAL STADIUM, food, beverage and merchandise sales would soar.

To this end, we will increase the number of VIP rooms from only 15 at present to 75. We will also enhance the content with soccer and rugby games and concerts inviting overseas artists.

Of course, we will sell naming rights as well. If we can implement such world-class arena management, the top line will undoubtedly grow. Without that confidence, we could not offer an operating price of 52.8

billion yen.

## "Future Value" and "Present Cost"

Ultimately, I believe that this gap in perception arises from the difference between placing the value of a business in terms of future earnings or current costs.

There is a very interesting episode regarding this "future value" and "present cost". It is a story about the Beatles' music rights that appears in a book by Yasuhiro Tanaka. <sup>[1]</sup>

Shortly before Paul McCartney and John Lennon made their debut in the United States, they signed a contract. The contract stated that the rights to the songs would be transferred to a company. As a result, the copyrights to the songs involving the two men were held by a company called Northern Songs.

Paul said he regretted it for the rest of his life, but in 1981 an opportunity arose to buy back his rights. If he paid 20 million pounds (about 4.1 billion yen at today's exchange rate), he could have the company's shares.

Since John had already passed away, Paul contacted his agent Yoko Ono, but the acquisition did not progress smoothly because Yoko was reluctant to pay the 10 million pounds that had been split 50-50 with Paul. For Yoko, it was her (Lennon's) own music, so she must have wondered why she had to pay 10 million British Pounds for it.

In the meantime, a so-called "little brother" of the Beatles, Michael Jackson, bought a share of the company for \$53 million (about 8 billion yen at the current rate), much more than the 20 million pounds.

Michael must have decided that \$53 million was reasonable, considering the future return that the Beatles' music would earn. As pointed out in the book, Yoko was more concerned about the cost she was paying, whereas Michael was more concerned about the future return he could get.

Of course, it is not easy to objectively show future returns. That is why most people have been focusing on visible costs.

However, a public corporation is an entity that will generate added value into the future, and the business, which is the source of added value, changes day by day. Naturally, profits do not grow at a constant rate from the past, but rather grow discontinuously as new sources of value are discovered (and vice versa). In

order to create such opportunities, we, as managers, gather a variety of information, formulate hypotheses, and envision the future of our business.

## The "Yoko-like" thinking behind “The Compact Culture” [2]

The question of whether to view the value of a business backward from the future or as an extension of the past is a very serious question.

The driving force of Japan's recovery from the postwar burnt-out cities was a sense of excitement about the future. The desire of each one of us to create a better life and a better future than the present has motivated us, and as a result, Japan has joined the ranks of developed countries. Japanese companies are also taking the world by storm with their technological advantages.

During the past 30 years of the Heisei era, however, Japan has become a country with very little growth. Although Japanese companies continue to receive high praise for their technological strength, they are not necessarily able to thrive in the global market.

Of course, there are multiple factors that led to low growth, such as the bad loan problems after the burst of the bubble economy and the decline in the working-age population due to the aging of the society. However, it seems to me that the current situation has been caused by a "Yoko-like" thinking that focuses only on risks and costs and takes valuations as an extension of the past.

In a book by sociologist Masachi Osawa [3], he states:

“I think what defines intelligence is first and foremost these surprises and questions, rather than comprehension. It is not the intellect that quickly comes to ‘I get it!’ but on the contrary it is the ability to say, ‘I don't get it! How could that be?’ Intelligence is defined by the ability to stop and wonder.”

Today, the importance of reaching the right answer in the shortest possible way is emphasized. With that value system, it would be more certain to look at the current cost rather than thinking about the future, which may or may not be realized. However, if we continue to maintain the status quo, the status quo will only deteriorate. The only way to create the future is through an exercise in repetition, where we stop to wonder, then envision a solution, and then put into action.

As a manager, I want to envision a better future for INFRONEER. Consequently, I want to realize a better society. Going forward, I will continue to envision the future.

[References]

[1] Tanaka, Yasuhiro (September 27, 2018)

“World History of Accounting: Italy, England, the United States – A Tale of 500 Years”

Nikkei BPM

[2] Lee, O-young (January 1, 1991)

“The Compact Culture – The Japanese Tradition of “Smaller is Better”

KODANSHA Ltd.

Book excerpts: The Japanese national character is obsessed with details and seeks beauty, but it is difficult to see the whole picture and to take on new challenges.

Today, we live in a time of rapid change and uncertainty. It will be necessary to reaffirm the characteristics of the Japanese people and break through their closed nature.

[3] Osawa, Masachi (May 18, 2011)

“Society is Constantly Dreaming”

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