Japan Corporate Credit Spotlight

Fragile Stability Faces Three Threats

Oct. 21, 2021

This report does not constitute a rating action.

PRIMARY CREDIT ANALYST

Makiko Yoshimura
Tokyo
+81-3-4550-8368
makiko.yoshimura@spglobal.com

SECONDARY CONTACTS

Katsuyuki Nakai
Tokyo
+81-3-4550-8748
katsuyuki.nakai@spglobal.com

Hiroyuki Nishikawa
Tokyo
+81-3-4550-8751
hiroyuki.nishikawa@spglobal.com

Hiroki Shibata
Tokyo
+81-3-4550-8437
hiroki.shibata@spglobal.com

Please see full contact list at the end of this report.

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Overview

Key Takeaways

- The credit quality of Japan's corporate sector stopped deteriorating in fiscal 2020 and will stabilize thanks to cost reductions and a global economic recovery.
- We focus on three factors that could worsen credit quality: the pandemic, supply chains, and aggressive growth investments.
- ESG factors will have more influence on credit quality.

As the world's major economies emerge from the COVID-19 pandemic, the credit quality of Japan's corporate sector is stabilizing on the back of efforts to reduce costs. Three risks threaten the gentle recovery: a resurgence of the pandemic, supply chain issues, and an increasing need to invest for growth.

These were the findings in our fifth annual analysis of Japan's corporate sector. We looked at the credit outlooks of about 90 Japanese corporations we consider representative of the sector and the 19 industries in which they operate.

We forecast credit quality will stabilize over the next one to two years, backed by global recovery from the effects of the COVID-19 pandemic and companies' efforts to reduce costs. The number of downgrades we have taken has decreased since the beginning of 2021. Negative bias in outlooks on our ratings (referring to the percentage of ratings with negative outlooks minus the percentage with positive outlooks) has waned substantially from a year earlier. We view eight of the 19 industries analyzed as having negative or slightly negative outlooks on credit quality, down from 14 last year.

We see a resurgence of COVID-19 as one of three hurdles to stable creditworthiness in the next year or two. A prolonged pandemic could further weaken earnings bases of industries such as railways and airlines, for which recovery is not yet in sight. Supply chain issues are another obstacle that could delay a full-fledged recovery in financial performance. Such challenges include a sharp rise in ocean freight rates, higher resource prices, and a global shortage of semiconductors. Furthermore, even in industries where performance is improving, financial soundness could deteriorate due to substantially increased capital expenditures in pursuit of growth and large mergers and acquisitions (M&A). We forecast the outstanding debt of corporations studied will increase moderately in the next one to two years.

Environmental, social, and governance (ESG) factors will likely become focus points and have an increasing impact on Japanese corporations' credit quality, in our view. With interest in ESG factors increasing rapidly among market participants, many corporations have started implementing specific measures to address such issues and setting relevant targets. We incorporate ESG factors into our credit analysis through assessment of the industries in which the corporations we rate operate, their competitive position, profitability, management and governance, and ability to repay debt through cash flow. We have recently published criteria clarifying the impact of ESG factors on credit quality: "General Criteria: Environmental, Social, And Governance Principles In Credit Ratings," published Oct. 10, 2021.

Credit Quality Will Likely Stop Deteriorating And Stabilize

Downgrades have declined substantially in 2021

We anticipate the creditworthiness of corporations studied will stop deteriorating in 2021 after three years of decline. This is evident in a decreasing number of downgrades on our part. Japanese corporations' creditworthiness began deteriorating in 2018 and worsened considerably in 2020 amid the pandemic. We lowered our ratings on 20 of the roughly 80 Japanese corporations we rate by one notch on average in 2020 (see chart 1). Between Jan. 1 and Sept. 30, 2021, we downgraded six corporations. In addition, we upgraded three. We made no upgrades in 2020.

The creditworthiness of corporations we rate is generally resilient to more severe external conditions, in our view. Even after lowering ratings on many such entities in 2020, over 90% of rated Japanese corporations still had investment grade ratings ('BBB-' or higher). In contrast, about 40% of overseas corporations we rate have speculative grade ratings ('BB+' or lower). Moreover, we expect Japanese corporations to maintain strong funding capabilities despite increasing uncertainty in financial markets in China. We take this view because many of these companies can secure sufficient short-term liquidity thanks to close relationships with financial institutions. Also, they have stable access to domestic and overseas financial markets.

Negative bias decreased considerably

As of Sept. 30, 2021, nearly 80% of the outlooks on long-term issuer credit ratings on Japanese corporations we rate were stable. The proportion was 60% on Dec. 31, 2020. Corporate credit quality has stabilized since the beginning of 2021 as performance has bottomed out. Negative bias in rating outlooks has fallen to 20% from 38% on Dec. 31, 2020. Of the 19 industries we studied, 11 have stable outlooks, up from five in 2020.

However, credit stability varies by industry. The proportion of companies with negative outlooks remains high in the sectors hit hardest by the pandemic, such as railways and retail, or by supply chain issues, such as automobiles and components (see chart 2).

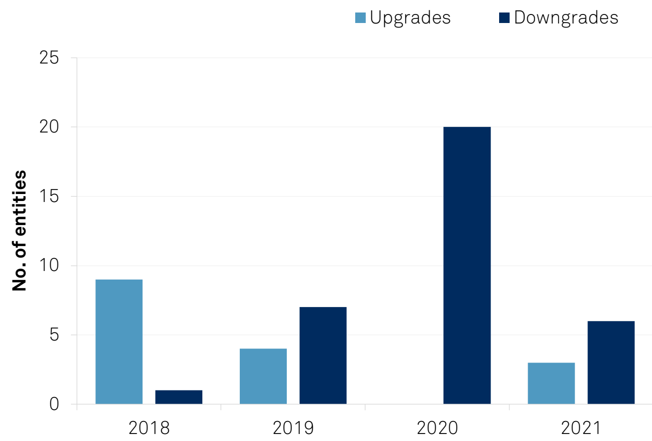
Furthermore, negative bias in rating outlooks on Japanese corporations is higher than in outlooks on global peers (overall negative bias on global corporations is 9%; for Japanese corporations it is 20%). We believe the bias is higher in Japan because of the following factors:

- Tepid GDP growth and a weak post-COVID recovery in Japan;
- Japanese companies' weak resilience to external changes in terms of earnings performance, stemming from long-standing low profitability;
- Vulnerability to supply chain disruption; and
- Increasing financial burdens as severe competition forces companies to invest for growth.

Chart 1

Number Of Downgrades Fell Significantly In 2021

Rating actions on Japanese corporate entities

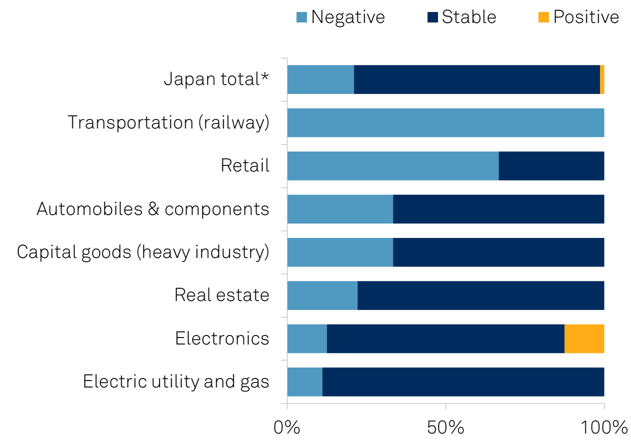


As of Sept. 30, 2021. Source: S&P Global Ratings.

Chart 2

Negative Outlooks Also Materially Decreased

Breakdown of outlooks on Japanese corporate entities



*Rated corporate entities. As of Sept. 30, 2021. Source: S&P Global Ratings.

Performance Will Recover Faster Than We Assumed

Key financial ratios will likely recover beyond last year's assumptions

We forecast that as the global economy recovers in fiscal 2021 the performance of corporations studied will recover faster than we assumed in last year's report, "Japan Corporate Credit Spotlight: A Rough Road To Recovery," published Oct. 22, 2020 (see chart 3).

We assume the following in our base-case scenario:

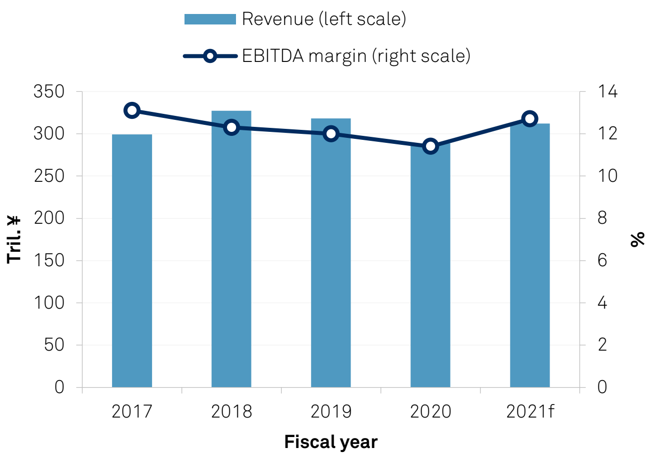
- Corporations' EBITDA will increase in fiscal 2021, exceeding the level of fiscal 2019, thanks to cost reductions and restructuring, and will continue to increase steadily in fiscal 2022;
- Free operating cash flow (FOCF) will continue to increase; and
- As of the end of fiscal 2021, outstanding debt will decrease from the end of fiscal 2020 but exceed that at the end of fiscal 2019, because of continued high growth investments, and will further increase from fiscal 2022.

Based on these assumptions, we estimate that the aggregate debt-to-EBITDA ratio of the corporations studied will improve to about 3.1x by the end of fiscal 2021--a similar level to fiscal 2019--from 3.6x at the end of fiscal 2020 (see chart 4). Improved financial indicators could work as a buffer when risk factors emerge.

Chart 3

Revenue And EBITDA Margins Bottomed In Fiscal 2020

Revenue and EBITDA margin of companies studied

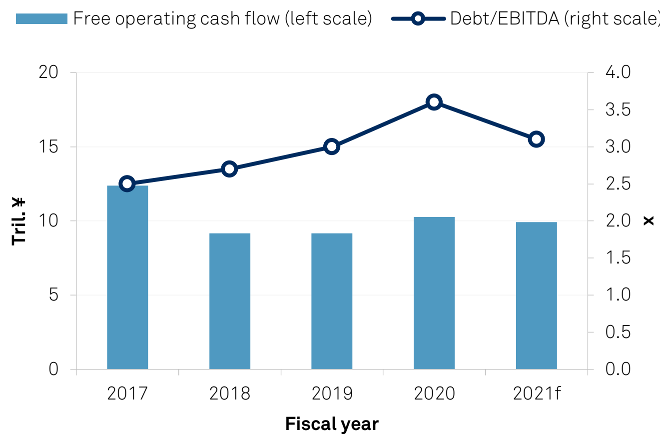


f--Forecast. Source: S&P Global Ratings, based on company materials.

Chart 4

Debt To EBITDA Turned Around

Free operating cash flow and debt to EBITDA of companies studied



f--Forecast. Source: S&P Global Ratings, based on company materials.

Pandemic-hit industries will recover only moderately

The likelihood of performance in the railway industry recovering swiftly is low, in our view, due to passenger demand remaining weak (see chart 5). Similarly, the earnings of airlines in this study are likely to remain under strong pressure, reflecting a slow recovery in passenger numbers on domestic and international routes. Furthermore, the prolonged impact of COVID-19 has revealed structural issues in the retail industry, such as changes in stores' trading areas (where their expected customer base lives) and an increase in online shopping. Business in those categories hit hardest, such as department stores, may not see earnings bounce back.

Conversely, the telecommunications and health care industries will likely suffer limited impact from the pandemic because of their resilience to economic downturns. In addition, we anticipate the following industries will likely recover more quickly than we assumed last year:

- IT services and e-commerce, where the transition to digitalization and online services has accelerated;
- Highly cyclical sectors that have quickly benefited as economic activities recover, including advertising, materials (building materials and glass, and steel), and electronics (excluding office equipment); and
- Industries that have benefited from higher crude oil and resource prices, including oil refining and mining, and general trading and investment companies.

Financial performance in the electric utility and gas industries will likely come under pressure because of liberalization of retail markets and higher raw material prices, in our view. However, the pressure will likely be within a range that companies can absorb with their credit quality, in our view.

Supply chain issues may last until 2022

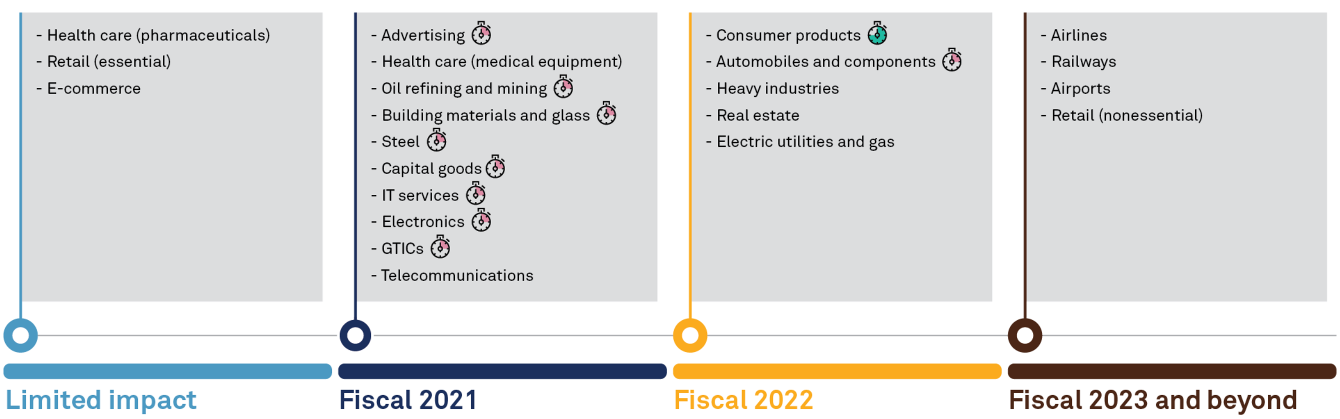
We believe problems with supply chains will likely hamper corporations' recoveries in the next year or two through higher costs and diminished manufacturing activity. Ocean freight rates are at their highest in 13 years with demand rising sharply as the world emerges from the pandemic. The industry could remain that way until 2022. Rising prices for crude oil, natural gas, and resources could be a positive factor for related industries, including oil refining and mining and general trading and investment. However, it threatens to increase costs for purchasers. Furthermore, many manufacturers, including automakers, may suffer opportunity losses stemming from a decline in production capacity utilization and volume. Factors that could trigger this include further lockdowns across Asia, power shortages in China, and the global semiconductor shortage.

Uncertainty in China's real estate sector poses little risk for now

We see a limited risk of instability in and an uncertain outlook for the real estate sector and financial markets in China hurting the performance and creditworthiness of Japanese corporations in this study. Overseas sales of many of these companies are spread throughout the U.S. and Asia. There is also likely to be continued, albeit moderate, movement away from dependency on China in supply chains, which started amid trade conflict between the U.S. and China around 2017. Real estate companies in this study generate only marginal profit from business in the country. Moreover, rated Japanese companies in particular retain sufficient short-term liquidity, backed by close relationships with domestic financial institutions. They also maintain stable access to financial markets. Consequently, we see no material issues in their future funding.

Chart 5

When Will Performance Recover To Fiscal 2019 Levels?



Sectors set to recover faster than we assumed in 2020. Sectors set to recover slower. Source: S&P Global Ratings.

Amid Increasing Growth Investment, Financial Discipline Is Key

We consider large strategic investments for growth a primary risk factor in our assessment of Japanese corporations' credit quality. We believe the companies studied are highly likely to substantially increase capital expenditures and make sizable investments and acquisitions in the next one to two years. They are also highly likely to invest considerably to enhance business competitiveness in the medium to long term.

In our opinion, maintaining competitiveness globally will require considerable growth investments for many Japanese corporations. Many need to drive technological innovation, expand businesses, and enter new markets. Even amid the pandemic in fiscal 2020, aggregate capital expenditures of the companies studied decreased only 6% from fiscal 2019. The corporations made some investments in fiscal 2020, but the volume has increased greatly since the beginning of fiscal 2021 (see table 1).

As the level of spending rises, we believe balancing investment and financial soundness will determine credit quality to a great extent. We hold this view because investments that carry a heavy financial burden may affect ratings. Despite rising spending, investments have triggered few downgrades. This is because companies now place much greater emphasis on mitigating related financial burdens. Measures to do so include divesting assets and businesses, increasing capital, issuing hybrid securities with equity-like characteristics, and reviewing shareholder returns.

Table 1

Rating Impact Of Major Growth Investments

		Rating action		
Final rating action date	Company	Previous*	New	Acquisition details
March 2021	Tokyo Gas Co. Ltd.	AA-/Stable/A-1+	AA-/Negative/A-1+	Plan and partial execution of significantly larger capital expenditures and growth investments than in the past
May 2021	Seven & i Holdings Co. Ltd.	AA-/Stable/--	A/Negative/--	Acquisition of U.S.-based convenience store and gas station chain Speedway LLC for $21 billion
July 2021	Renesas Electronics Corp.	BBB-/Negative/A-3	BBB-/Stable/A-3	Acquisition of U.K.-based Dialog Semiconductor PLC. for about ¥640 billion, with equity issuance of ¥223 billion
July 2021	Hitachi Ltd.	A/Stable/A-1	A/Negative/A-1	Acquisition of U.S.-based IT services company GlobalLogic Inc. for $9.6 billion
July 2021	Rakuten Group Inc.	BBB-/Negative/--	BB+/Negative/--	Significant capital expenditures for mobile business amounting to ¥750 billion in 2021-2022
September 2021	Panasonic Corp.	Ratings unaffected		Acquisition of additional shares to take complete ownership of U.S.-based IT service provider Blue Yonder Holding Inc. for about $7.1 billion

*Ratings and outlook before growth investment. Source: S&P Global Ratings.

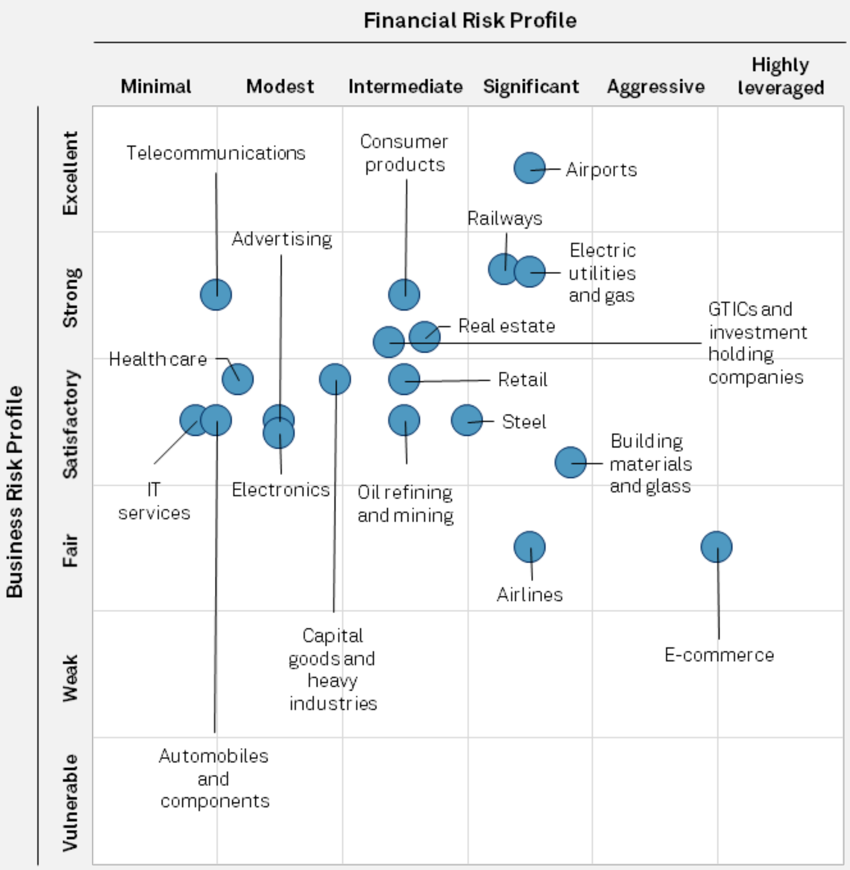
Financial Risk Profiles Deteriorated And Improved In Roughly Even Numbers

Across the 19 industries studied, three suffered deterioration in the average assessment of their financial risk profiles in fiscal 2020. The pandemic hit railways and retail (non-daily goods) hard, while deregulation and heavy investment characterize electric utilities and gas (see chart 6). Outlooks for railways and retail (non-daily goods) are slightly negative because performance is only likely to recover from fiscal 2023. We revised down the financial risk profile of seven companies we do not rate, mainly in those industries above. Of the 90 companies studied, 35 are unrated.

In contrast, the average financial risk profile of the health care, steel, and IT services industries improved in fiscal 2020 thanks to enhanced profitability and debt repayment. The pandemic had little impact on health care and IT services. In all three industries, many companies reduced debt materially by disposing of assets.

Chart 6

Distribution Of Business Risk Profiles And Financial Risk Profiles Across 19 Sectors



Source: S&P Global Ratings.

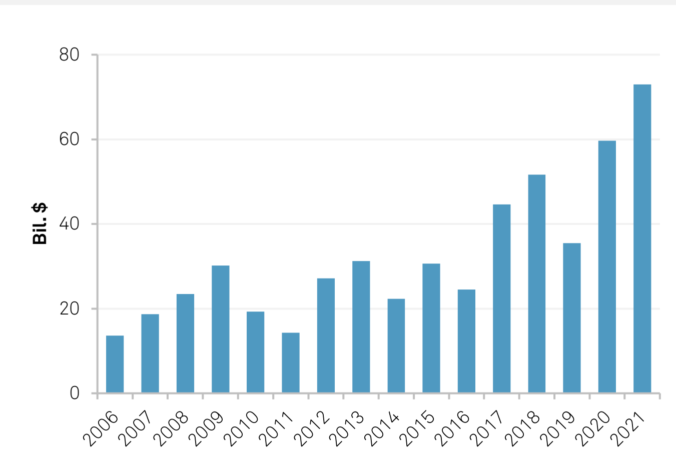
Funding Sources Have Been Diversified With Issuance Of Foreign And Hybrid Bonds

We believe the ability to raise foreign currency-denominated funds quickly and stably has become important for Japanese corporations as they aggressively expand businesses and acquire companies overseas. As of Sept. 30, 2021, the amount of foreign bonds that rated Japanese corporations issued in 2021 had already exceeded last year's total, which was a record high (see chart 7). With companies shifting focus toward growth investments, many are striving to mitigate the financial burden by issuing hybrid securities. The issuance amount of such securities will likely remain high because of robust demand for funds to refinance outstanding hybrid securities on their first callable date (see chart 8).

Chart 7

Foreign Currency Bonds At Record High

Issuance of foreign currency bonds by rated Japanese corporations

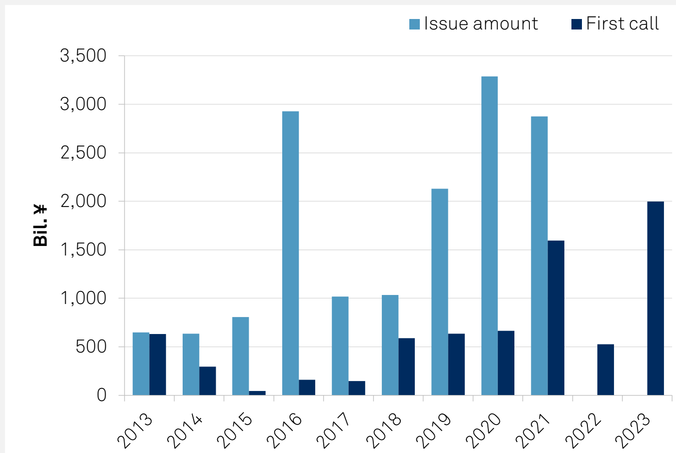


2021--Year to September. Source: S&P Global Ratings.

Chart 8

Expected High Level Of Hybrid Securities Issuance

Issuance of hybrid securities by Japanese corporations



Source: S&P Global Ratings.

Impact Of ESG Factors On Credit Quality Will Increase In Importance

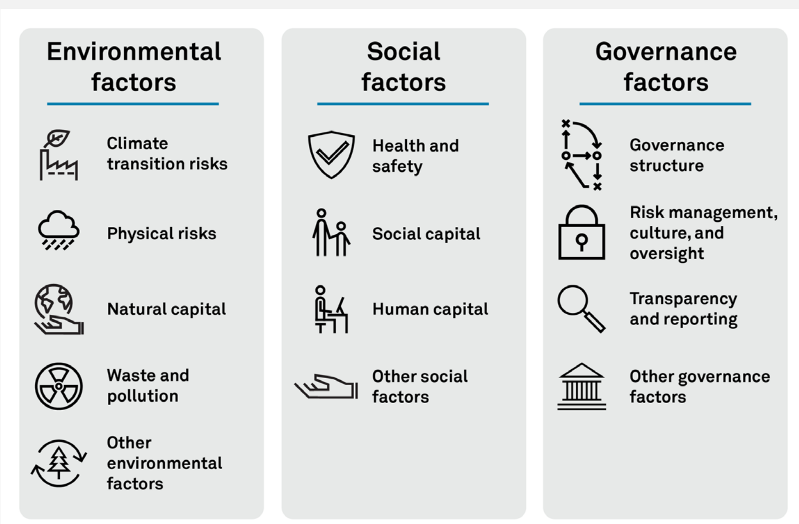
We forecast ESG factors will likely have a more wide-ranging impact on the credit quality of Japan's corporations. Major countries, including Japan, have expressed an intention to be carbon neutral by 2050 and have drawn up specific plans and tightened environmental regulations. Japanese corporations have also started to develop technologies and build infrastructure to move toward a carbon-free society as rapidly as possible. Some industries are being urged to transform business models and structure. For example, automakers are developing electrification technology and utility and gas companies are expanding use of renewable energy.

The COVID-19 pandemic seriously affected companies' production and sales activities from a health and safety perspective. Addressing changes in consumer behavior is a critical challenge in the consumer products and retail industries, in our view. In addition, we consider governance to be an important factor. Japanese corporations are required to provide the market with clearer explanations regarding their capacity to manage risks such as cyber security and governance structure.

In addition, Japan's major financial institutions and leading insurance companies have expressed their intention to freeze new lending to businesses in fields that do not meet generally established ESG standards. An example of this is the avoidance of the construction of new coal-fired power plants. If such trends gather pace, increasing numbers of companies will be compelled to change or prune business development that does not meet ESG standards, in our view.

ESG factors have varying degrees of impact on Japanese corporations' business bases and financial soundness. We incorporate the impact into our ratings through assessments of the industries in which rated corporations operate, their competitive position, profitability, management and governance, and ability to repay debt through cash flow. In October 2021, we clarified the impact of ESG factors as rating criteria. Furthermore, we intend to provide additional disclosure and transparency by applying ESG Credit Indicators to publicly rated entities. From mid-November to December 2021, we plan to publish these indicators for individual companies in the corporate and infrastructure, banking, and insurance sectors. ESG Credit Indicators provide additional disclosure by reflecting our opinion of how material the influence of ESG factors is on the various analytical components in our rating analysis through an alphanumerical 1-5 scale.

Examples of ESG Credit Factors



ESG--Environmental, social, and governance. Source: S&P Global Ratings.

Consumer Products
Outlook - Stable

Responses to changing consumer behavior will dictate credit quality

Primary Credit Analyst
Ryohei Yoshida

Secondary Credit Analyst
Katsuyuki Nakai

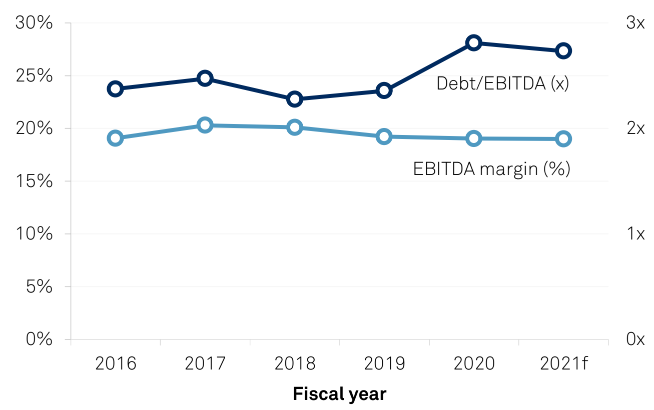
Key Assumptions

- Consumer behavior will continue to evolve after pandemic-induced changes; credit quality will rely increasingly on response capability.
- Average EBITDA margin of food and beverage companies will recover to pre-pandemic levels in fiscal 2022 but lag overseas peers'.
- Debt reduction will continue as companies prioritize improving finances that worsened with pre-pandemic growth investments.
- Large M&A overseas are unlikely in the next two years amid focus on coping with shifts in consumer behavior in existing markets.

Credit Trends And Risks

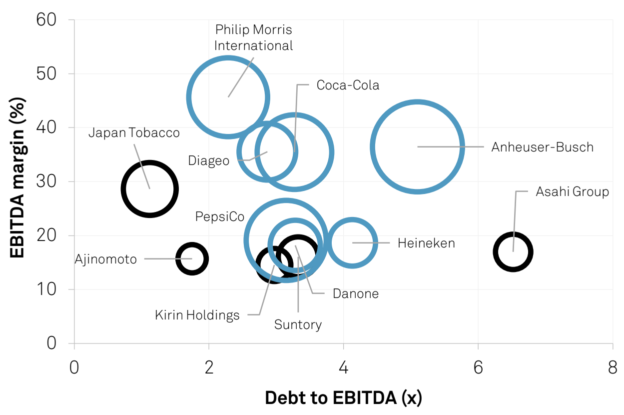
- Stable creditworthiness thanks to solid cash flows relative to other industries and conservative financial management.
- Pandemic-induced constraints on consumer behavior eroding the profitability of existing sales channels and brands.
- Slower response than global peers to changing behavior when investing in product development, brands, and sales channels.
- Swings in commodity prices pushing up raw material costs and squeezing margins.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Consumer products	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Asahi Group Holdings Ltd.	Not rated	Strong	Aggressive	-	-
Kirin Holdings Co. Ltd.	Not rated	Strong	Intermediate	-	-
Ajinomoto Co. Inc.	A+	Strong	Modest	a	+1
Japan Tobacco Inc.	A+	Strong	Minimal	aa-	-1
Suntory Holdings Ltd.	BBB	Strong	Significant	bbb	-
Overseas peers					
Philip Morris International Inc.	A	Strong	Intermediate	a-	+1
PepsiCo Inc.	A+	Excellent	Intermediate	a+	-
Heineken N.V.	BBB+	Strong	Significant	bbb	+1
Danone	BBB+	Strong	Significant	bbb	+1
Anheuser-Busch InBev S.A./N.V.	BBB+	Excellent	Aggressive	bbb	+1
Diageo PLC	A-	Excellent	Significant	a-	-
Coca-Cola Co. (The)	A+	Excellent	Intermediate	a+	-

Retail
Outlook - Negative

Credit quality hinges on efficiency of growth investment

Primary Credit Analyst
Ryohei Yoshida

Secondary Credit Analyst
Makiko Yoshimura

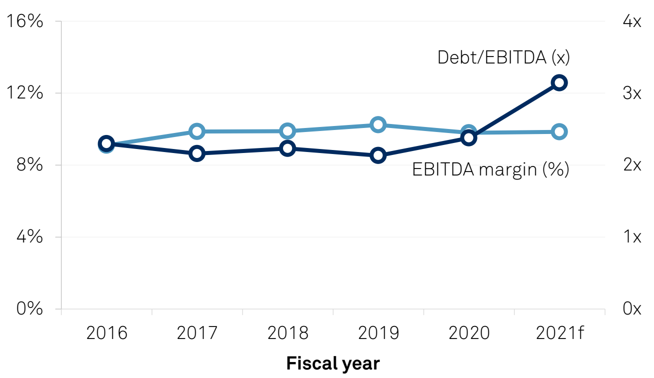
Key Assumptions

- Changes in consumer behavior due to COVID-19 that fueled growth of e-commerce and shifted the popularity of retail areas will remain embedded as effects of the pandemic endure.
- Sustained improvement in consumer sentiment is unlikely until the pandemic recedes.
- Performance within the sector will remain heavily tied to business formats, main product lines, and store locations.
- Total EBITDA will exceed fiscal 2019 levels thanks to aggressive growth investments, although performance will remain varied.

Credit Trends And Risks

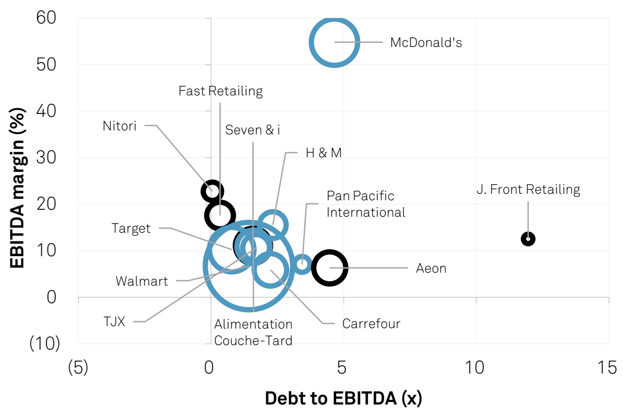
- Persistent pressure on credit quality due to the pandemic and increased debt after growth investments.
- Risk of declines in the profitability of existing store networks as they fall outside consumers' new areas of activity.
- Risk of falling behind peers in adjusting merchandising, product development, and revamps of sales spaces in response to changing consumer behavior.
- Risk of declines in operational and investment efficiency due to failure to adequately analyze consumption patterns using digital technology.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Retail	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
J. Front Retailing Co. Ltd.	Not rated	Fair	Aggressive	-	-
Seven & i Holdings Co. Ltd.	A	Excellent	Intermediate	a	-
Pan Pacific International Holdings Corp.	Not rated	Satisfactory	Significant	-	-
Aeon Co. Ltd.	BBB	Strong	Significant	bbb	-
Nitori Holdings Co. Ltd.	Not rated	Satisfactory	Minimal	-	-
Fast Retailing Co. Ltd.	A	Satisfactory	Minimal	a	-
Overseas peers					
Carrefour SA	BBB	Strong	Intermediate	bbb+	-1
The TJX Companies Inc.	A	Strong	Modest	a	-
Walmart Inc.	AA	Excellent	Modest	aa	-
Target Corp.	A	Strong	Modest	a	-
H & M Hennes & Mauritz AB	BBB	Satisfactory	Modest	bbb+	-1
McDonald's Corp.	BBB+	Strong	Significant	bbb	1
Alimentation Couche-Tard Inc.	BBB	Satisfactory	Modest	bbb+	-1

Advertising
Outlook - Stable

Digital media demand and better finances to support creditworthiness

Primary Credit Analyst
Kei Ishikawa

Secondary Credit Analyst
Makiko Yoshimura

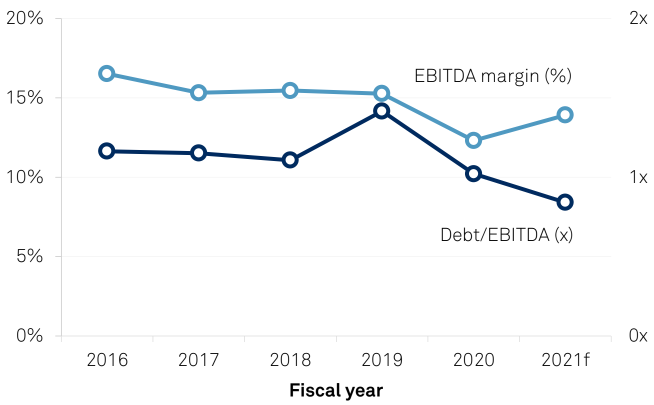
Key Assumptions

- Advertising revenue, which is highly susceptible to economic trends, will recover quicker than GDP in Japan and overseas thanks to an improving economy and contributions from internet advertising.
- Focus area of digital media will grow substantially owing to cost advantages and demand for marketing data.
- Performance will diverge because of differences in business portfolios and digitalization strategies.
- The average debt-to-EBITDA ratio will improve from the end of fiscal 2020 in the absence of large acquisitions or shareholder returns.

Credit Trends And Risks

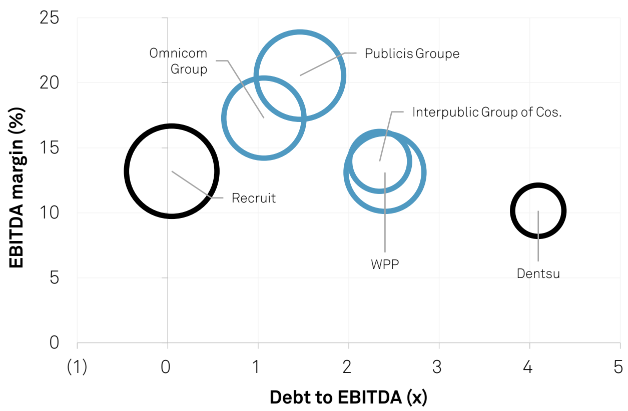
- Profitability recovering this fiscal year and then stabilizing at pre-pandemic levels thanks to restructuring and enhanced portfolios.
- Cash flow metrics remaining commensurate with creditworthiness as performance recovers under disciplined financial management.
- Risk of performance suffering amid pricing pressure and intensifying competition with global peers.
- Risk of financial burdens increasing substantially due to restructuring and large acquisitions.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Advertising	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Dentsu Inc.	Not rated	Satisfactory	Intermediate	-	-
Recruit Holdings Co. Ltd.	A	Satisfactory	Minimal	a	-
Overseas peers					
WPP PLC	BBB	Satisfactory	Intermediate	bbb	-
Omnicom Group Inc.	BBB+	Satisfactory	Modest	bbb+	-
Publicis Groupe S.A.	BBB	Satisfactory	Modest	bbb+	-1
Interpublic Group of Cos. Inc.	BBB	Satisfactory	Intermediate	bbb	-

Health Care
Outlook - Stable

Improving finances support creditworthiness

Primary Credit Analyst
Asa Watanabe

Secondary Credit Analyst
Makiko Yoshimura

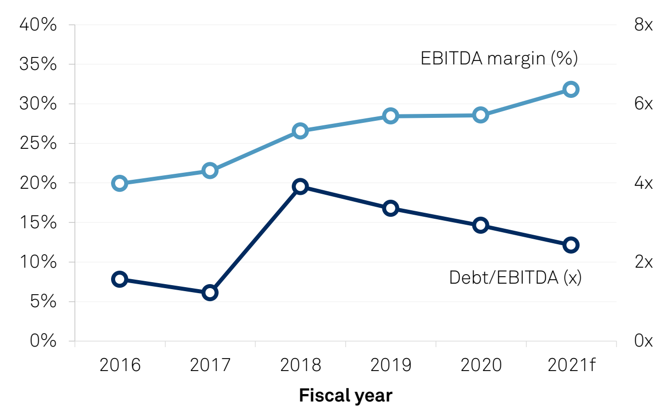
Key Assumptions

- Aggregate EBITDA of companies studied in 2021 will exceed the 2019 level thanks to economic recovery in North America, the sector's largest market.
- Increasing M&A will weaken financial indicators.
- Profitability of pharmaceutical companies will suffer amid continuing pressure on drug prices globally.
- Profitability will generally remain lower than global peers' due to weaker competitiveness and smaller markets for main products.

Credit Trends And Risks

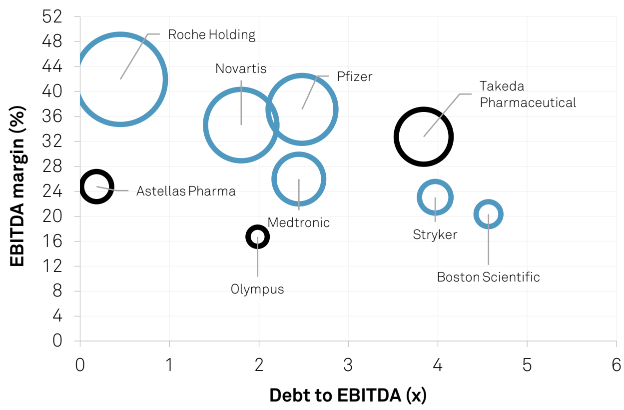
- Stable EBITDA margins at most companies studied thanks to economic recovery following the pandemic.
- Progress in debt reduction improving debt to EBITDA.
- Risk of persistent sluggishness in profitability amid pressure on drug prices globally and increasing research and development expenses.
- Risk of finances deteriorating again due to more aggressive acquisitions in pursuit of earnings growth amid intensifying competition.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Health care	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Takeda Pharmaceutical Co. Ltd.	BBB+	Strong	Intermediate	bbb+	-
Astellas Pharma Inc.	Not rated	-	-	-	-
Olympus Corp.	BBB+	Satisfactory	Minimal	a-	-1
Overseas peers					
Roche Holding AG	AA	Excellent	Minimal	aa+	-1
Pfizer Inc.	A+	Excellent	Intermediate	a	+1
Novartis AG	AA-	Excellent	Modest	aa	-1
Boston Scientific Corp.	BBB	Strong	Significant	bbb	-
Medtronic PLC	A	Strong	Intermediate	a-	+1
Stryker Corp.	A-	Strong	Intermediate	bbb+	+1

E-Commerce
Outlook - Negative

Growth investments to outweigh steady market expansion

Primary Credit Analyst
Makiko Yoshimura

Secondary Credit Analyst
Kei Ishikawa

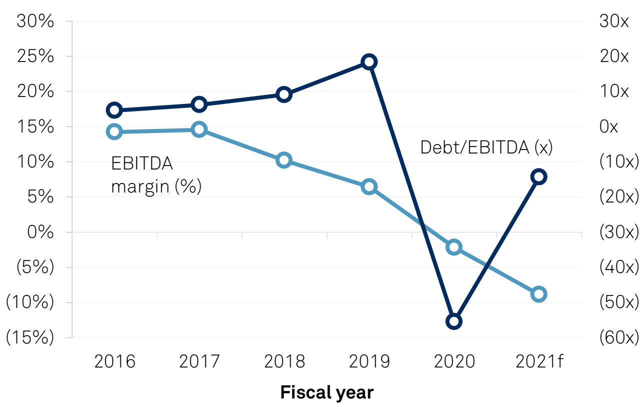
Key Assumptions

- Japan's business-to-customer market will grow by mid-single digits in the next year or two as demand shifts toward online shopping after a slump in travel services produced a flat 2020.
- The companies studied will maintain strong positions in the domestic market as their main services--online shopping and flea markets--benefit from competitive platforms and name recognition.
- The companies will continue to invest heavily to strengthen non-e-commerce, financial services, and overseas businesses.
- EBITDA will be negative for the companies in the next one to two years due to heavy investment burdens.

Credit Trends And Risks

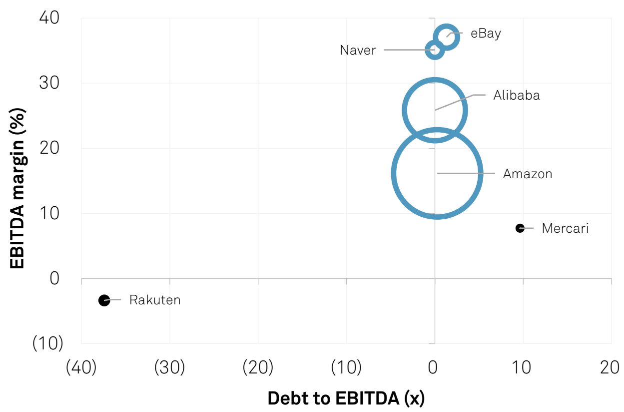
- Financial burdens continuing to weigh on credit quality as companies invest for growth mainly with debt.
- Overseas peers maintaining higher credit quality by using strong cash flows to cover investments, keeping finances sound.
- Risk of competition intensifying as direct sales sites permeate, retailers shift to e-commerce, and new services emerge.
- Risk of key financial ratios worsening further as revenues from robust e-commerce businesses fail to sufficiently cover growth investments in other operations.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents absolute value of EBITDA. Figures for fiscal 2020; figure for Rakuten is negative. Source: S&P Global Ratings.

E-commerce	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Mercari Inc.	Not rated	Weak	Highly leveraged	-	-
Rakuten Group Inc.	BB+	Satisfactory	Aggressive	bb	+1
Overseas peers					
Alibaba Group Holding Ltd.	A+	Strong	Minimal	aa-	-1
Amazon.com Inc.	AA	Excellent	Minimal	aa+	-1
Naver Corp.	A-	Satisfactory	Minimal	a-	-
eBay Inc.	BBB+	Satisfactory	Modest	bbb+	-

Oil Refining And Mining Outlook - Stable

Stable oil prices and duopoly in Japan underpin credit quality

Primary Credit Analyst
Hiroyuki Nishikawa

Secondary Credit Analyst
Katsuyuki Nakai

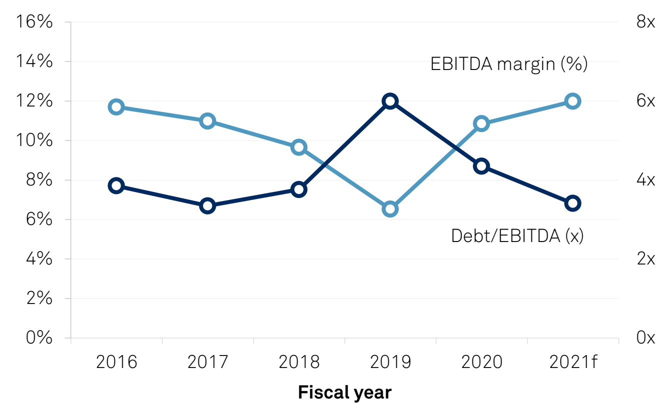
Key Assumptions

- Brent crude prices will be steady at $75 per barrel in 2021 and $65 per barrel in 2022; the average was $43 per barrel in 2020.
- Domestic fuel oil demand will rise 2%-3% in 2021 along with economic growth but slip 1%-2% in 2022 as energy efficiency improves.
- Oil exploration and production operations will generate steady profit thanks to stable prices and recovering demand.
- Favorable petroleum product margins will endure in Japan, where a duopoly controls 80% of the market for fuel oil sales.
- Total free cash flows after shareholder returns will remain positive in the next one to two years as profits recover.

Credit Trends And Risks

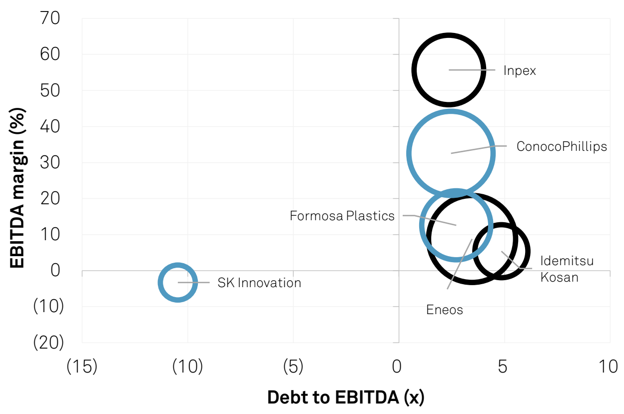
- Credit quality remaining stable owing to relatively high crude oil prices, steady domestic competition, and financial discipline.
- Risk of heavy losses in exploration and production operations or crude oil inventories as a deteriorating supply/demand balance pushes down crude oil prices.
- Risk of a prolonged pandemic significantly slowing recovery in demand for fuel oils such as gasoline and jet fuel.
- Risk of a high burden of investment in nonoil operations and renewable energy to adjust portfolios amid decarbonization.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents absolute value of EBITDA. Figures for fiscal 2020; figure for SK Innovation is negative. Source: Capital IQ and S&P Global Ratings.

Oil refining and mining	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Inpex Corp.	A-	Satisfactory	Intermediate	bbb	+2
Idemitsu Kosan Co. Ltd.	Not rated	-	-	-	-
Eneos Holdings Inc.	Not rated	-	-	-	-
Overseas peers					
SK Innovation Co. Ltd.	BBB-	Satisfactory	Significant	bbb-	-
Formosa Plastics Corp.	BBB+	Satisfactory	Intermediate	bbb	+1
ConocoPhillips	A-	Strong	Intermediate	a-	-

Building Materials And Glass Outlook - Stable

Credit quality hinges on financial strength as earnings recover

Primary Credit Analyst
Kei Ishikawa

Secondary Credit Analyst
Asa Watanabe

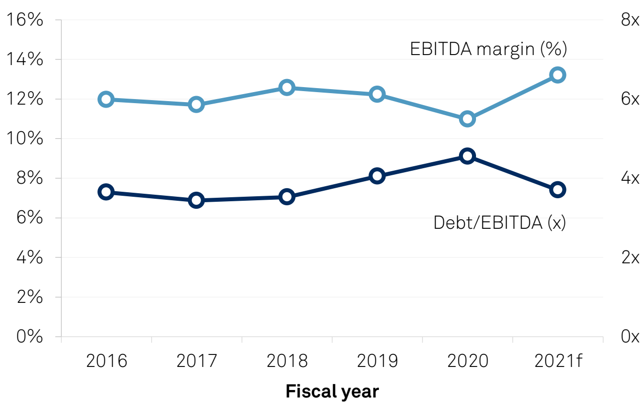
Key Assumptions

- Demand for remodeling will be strong in the global construction sector.
- Demand will pick up thanks to a recovery in the automotive market, followed by other main end markets--photovoltaics, electronics, and chemicals--as the overall economy improves.
- Strengthening growth areas and restructuring will help the average EBITDA margin in fiscal 2021 recover to pre-pandemic levels.
- Key cash flow ratios will continue recovering as improving profits boost cash flows, offsetting high capital investment burdens.

Credit Trends And Risks

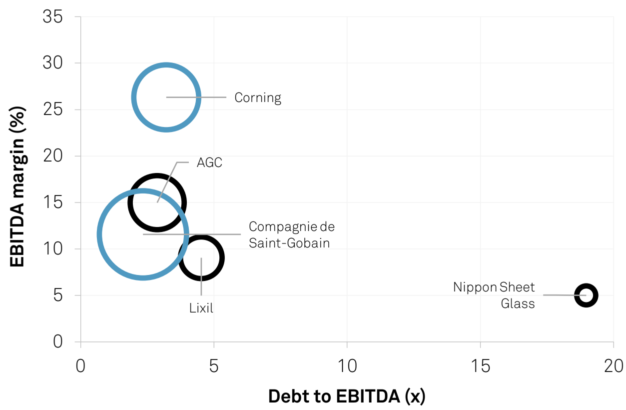
- Stable credit quality as relatively firm demand for main products helps performance gradually improve.
- Continuing gap in credit quality with overseas peers because of differing levels of financial strength, product mix, and diversification.
- Risk of slow recovery in performance and cash flow ratios due to rising raw materials prices and worsening supply/demand balances for main products.
- Risk of key financial ratios deteriorating because of aggressive investment strategies that could include M&A.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Building materials and glass	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
AGC Inc.	A-	Satisfactory	Modest	bbb+	+1
Nippon Sheet Glass Co. Ltd.	Not rated	Fair	Highly leveraged	-	-
Lixil Corp.	Not rated	Satisfactory	Aggressive	-	-
Overseas peers					
Compagnie de Saint-Gobain	BBB	Strong	Significant	bbb	-
Corning Inc.	BBB+	Satisfactory	Modest	bbb+	-

Steel
Outlook - Stable

Investment burden remains heavy despite improving profits

Primary Credit Analyst
Kei Ishikawa

Secondary Credit Analyst
Makiko Yoshimura

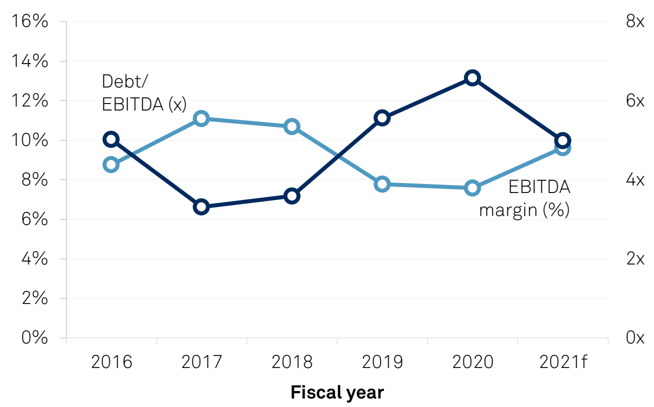
Key Assumptions

- Profits will increase despite rising iron ore prices, thanks to recovering demand for steel products and production volumes.
- The average EBITDA margin will be about 15% in fiscal 2021, exceeding the recent high of fiscal 2018.
- Debts will remain high as recovering cash flows are spent on capital and business investments to maintain competitiveness.
- Profitability will remain lower than global peers' as investments keep Japanese companies' debts relatively high.

Credit Trends And Risks

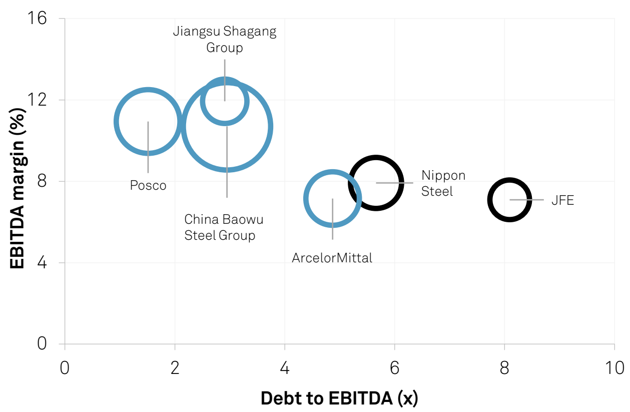
- Continuing heavy investment burdens but disciplined financial management and asset sales underpinning creditworthiness.
- Creditworthiness withstanding heavy investments on environmental issues.
- Risk of decreasing profit due to high volatility in domestic and global steel markets and material prices.
- Intensifying competition with overseas manufacturers further eroding Japanese companies' earnings bases.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Steel	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Nippon Steel Corp.	BBB	Satisfactory	Intermediate	bbb	-
JFE Holdings Inc.	Not rated	Satisfactory	Significant	-	-
Overseas peers					
Posco	BBB+	Strong	Intermediate	bbb+	-
China Baowu Steel Group Corp. Ltd.	A-	Satisfactory	Intermediate	bbb	+2
Jiangsu Shagang Group Co. Ltd.	BBB-	Satisfactory	Intermediate	bbb-	-
ArcelorMittal	BBB-	Satisfactory	Significant	bb+	+1

Capital Goods And Heavy Industries Outlook - Slightly Negative

Slow recovery and acquisitions to weigh on credit quality

Primary Credit Analyst
Makiko Yoshimura

Secondary Credit Analyst
Shinichi Endo

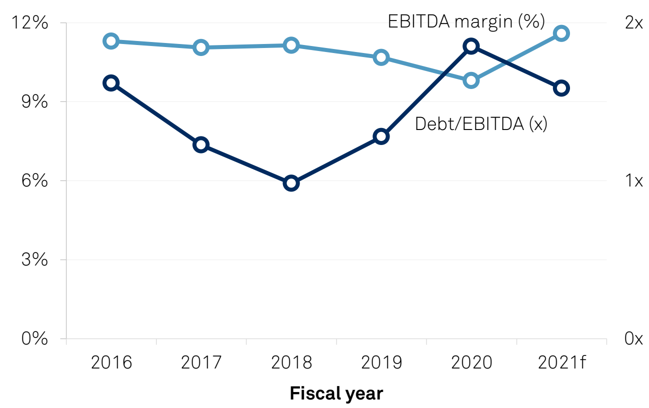
Key Assumptions

- The pace at which companies recover will diverge, reflecting their respective main end markets.
- Capital goods companies will continue recovering, driven by demand in the auto, semiconductor, and construction sectors.
- Heavy industries companies will recover slowly amid a sluggish aircraft market and fewer orders from the coal power industry.
- Earnings will recover in fiscal 2021, but a recurrence of aggressive investments will dent improvement in debt to EBITDA in fiscal 2021 and thereafter.

Credit Trends And Risks

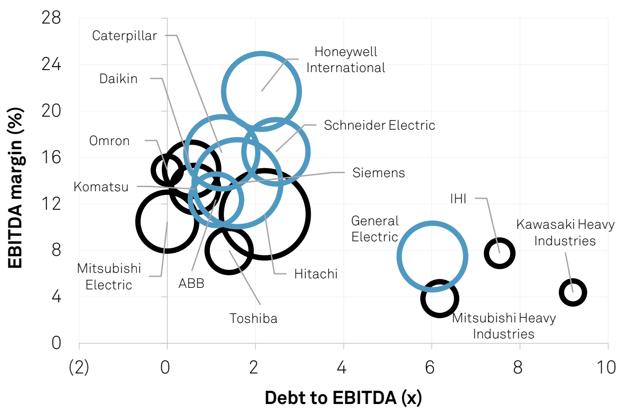
- Pressure on credit quality amid a sluggish recovery in heavy industries and increased investments and shareholder returns.
- Stable credit quality at overseas capital goods companies with ability to cushion investments due to stronger recovery prospects.
- Risk of a slow recovery in profitability due to falling demand in end markets caused by the pandemic or rising shipping and raw material prices.
- Risk of increased R&D spending on decarbonization, aggressive investments, or shareholder returns further hurting finances.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Capital goods and heavy industries	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Komatsu Ltd.	A	Strong	Modest	a	-
Daikin Industries Ltd.	Not rated	Strong	Modest	-	-
Hitachi Ltd.	A	Strong	Modest	a	-
Toshiba Corp.	BB+	Fair	Intermediate	bb+	-
Mitsubishi Electric Corp.	A+	Strong	Modest	a	+1
Omron Corp.	A	Satisfactory	Minimal	a	-
Mitsubishi Heavy Industries Ltd.	BBB+	Satisfactory	Intermediate	bbb	+1
Kawasaki Heavy Industries Ltd.	Not rated	Satisfactory	Significant	-	-
IHI Corp.	Not rated	Satisfactory	Intermediate	-	-
Overseas peers					
Schneider Electric S.E.	A-	Strong	Intermediate	a-	-
Caterpillar Inc.	A	Strong	Modest	a+	-1
Honeywell International Inc.	A	Strong	Modest	a+	-1
General Electric Co.	BBB+	Strong	Significant	bbb	+1
ABB Ltd.	A-	Strong	Intermediate	bbb+	+1
Siemens AG	A+	Strong	Modest	a+	-

IT Services
Outlook - Stable

Strong demand and finances support creditworthiness

Primary Credit Analyst
Shinichi Endo

Secondary Credit Analyst
Makiko Yoshimura

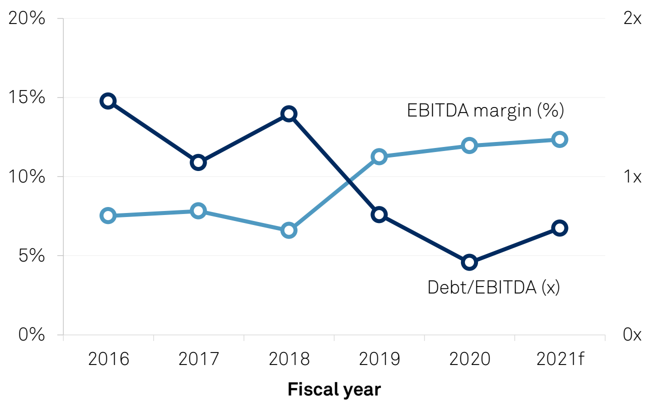
Key Assumptions

- Global information technology (IT) services investment in 2021 will increase about 9% as demand for digitalization rises.
- IT investment in Japan likely to grow only 2%-3% because a focus on conventional system integration has led to limited domestic demand for digitalization.
- Restructuring will push up the average EBITDA margin to about 12% in fiscal 2021, its highest level in the past five years.
- Earnings growth and profitability are likely to continue to lag those of competitive overseas peers.

Credit Trends And Risks

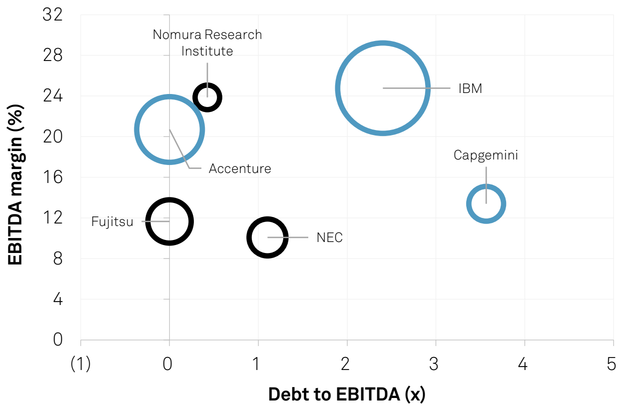
- Stable profit thanks to robust demand.
- Strong cash flow and finances supporting creditworthiness despite increased investments and shareholder returns.
- Lagging response to digitalization leading to lost opportunities for profit.
- Significant M&A in pursuit of growth and sizable shareholder returns hurting financial standing.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

IT services	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Nomura Research Institute Ltd.	A	Satisfactory	Minimal	a	-
NEC Corp.	BBB	Satisfactory	Modest	bbb+	-1
Fujitsu Ltd.	A-	Satisfactory	Minimal	a-	-
Overseas peers					
International Business Machines Corp.	A-	Strong	Intermediate	bbb+	+1
Accenture PLC	AA-	Strong	Minimal	aa-	-
Capgemini SE	BBB	Satisfactory	Intermediate	bbb	-

Electronics
Outlook - Stable

Robust demand and sound finances support creditworthiness

Primary Credit Analyst
Makiko Yoshimura

Secondary Credit Analyst
Kei Ishikawa

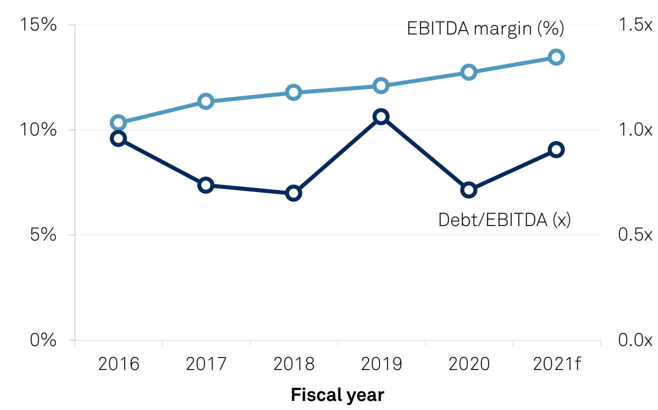
Key Assumptions

- Global IT spending in 2021 will outpace global GDP growth of 5.9%, rising 9.4% amid economic recovery and digitalization demand.
- Semiconductor demand will remain very strong, with PC and smartphone businesses benefiting from widespread remote work.
- Aggregate EBITDA of 10 companies studied will grow nearly 15% in fiscal 2021, backed by the robust demand.
- Debt to EBITDA will remain sound in the next one to two years (about 1.0x) despite continued investments and acquisitions to boost competitiveness.

Credit Trends And Risks

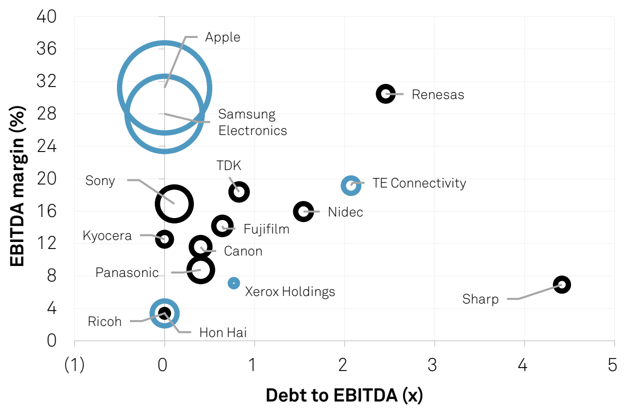
- Stable creditworthiness in the next two years supported by robust demand and sound finances, while companies invest aggressively.
- Competitiveness gap with some top overseas peers unlikely to shrink, as they have improved market positions even during the pandemic.
- Risk of U.S.-China tensions impacting supply chains and demand.
- Risk of continued large investments and generous shareholder returns undermining conservative financial management.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Electronics	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Fujifilm Holdings Corp.	AA-	Strong	Minimal	aa-	-
Nidec Corp.	Not rated	Satisfactory	Modest	-	-
Renesas Electronics Corp.	BBB-	Satisfactory	Intermediate	bbb-	-
Panasonic Corp.	A-	Satisfactory	Modest	bbb+	+1
Sharp Corp.	BB-	Weak	Aggressive	b+	+1
Sony Group Corp.	A-	Satisfactory	Modest	bbb+	+1
TDK Corp.	A-	Satisfactory	Modest	bbb+	+1
Kyocera Corp.	Not rated	Satisfactory	Minimal	-	-
Canon Inc.	A	Satisfactory	Minimal	a	-
Ricoh Co. Ltd.	BBB+	Satisfactory	Minimal	a-	-1
Overseas peers					
Xerox Holdings Corp.	BB	Fair	Minimal	bbb-	-2
TE Connectivity Ltd.	A-	Satisfactory	Modest	bbb+	+1
Apple Inc.	AA+	Strong	Minimal	aa	+1
Hon Hai Precision Industry Co. Ltd.	A-	Strong	Modest	a	-1
Samsung Electronics Co. Ltd.	AA-	Strong	Minimal	aa-	-

Automobiles And Components Outlook - Slightly Negative

Business recovery and sound finances to underpin creditworthiness

Primary Credit Analyst
Katsuyuki Nakai

Secondary Credit Analyst
Asa Watanabe

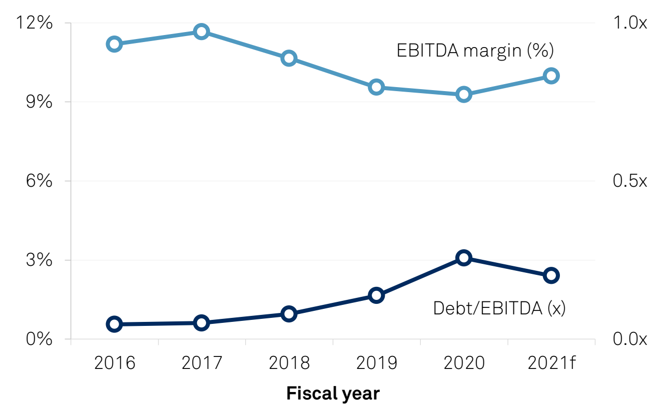
Key Assumptions

- Global auto unit sales will rise 2%-4% in 2021 and continue growing 4%-6% in 2022.
- Heavy investment will continue in next-generation technologies, such as electrification and autonomous driving.
- Recovering demand will raise the average EBITDA margin to near 9% in fiscal 2021, from 7.1% in fiscal 2020 and 8.9% in fiscal 2019.
- Companies will generate stable free operating cash flow by managing financial burdens for strategic investments.

Credit Trends And Risks

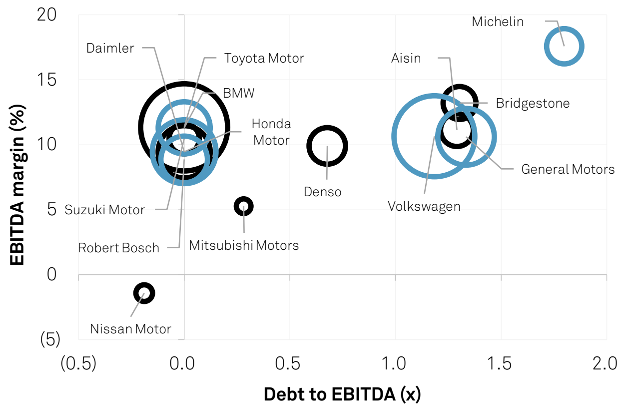
- New model rollouts and cost cuts strengthening businesses and gradually relieving pressure on credit quality in the coming one to two years despite the semiconductor shortage and higher raw material prices.
- Credit quality continuing to draw support from sounder finances than those of major overseas peers.
- Risk of a recurring pandemic, prolonged semiconductor shortage, or soaring raw material prices hurting performance again.
- Risk of more aggressive investments, higher shareholder returns, or a deterioration in captive financing eroding financial soundness.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents absolute value of EBITDA. Figures for fiscal 2020; figure for Nissan Motor is negative. Source: S&P Global Ratings.

Automobiles and components	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Bridgestone Corp.	A	Strong	Modest	a	-
Denso Corp.	A+	Strong	Minimal	aa-	-1
Nissan Motor Co. Ltd.	BBB-	Fair	Modest	bbb-	-
Toyota Motor Corp.	A+	Strong	Minimal	aa-	-1
Mitsubishi Motors Corp.	BB	Weak	Modest	bb+	-1
Aisin Corp.	A	Satisfactory	Minimal	a	-
Honda Motor Co. Ltd.	A-	Satisfactory	Minimal	a	-1
Suzuki Motor Corp.	Not rated	Satisfactory	Modest	-	-
Overseas peers					
Compagnie Generale des Etablissements Michelin S.C.A.	A-	Strong	Intermediate	bbb+	+1
Robert Bosch GmbH	A	Satisfactory	Minimal	a	-
General Motors Co.	BBB	Satisfactory	Intermediate	bbb	-
Ford Motor Co.	BB+	Satisfactory	Significant	bb+	-
Daimler AG	A-	Satisfactory	Minimal	a	-1
Volkswagen AG	BBB+	Satisfactory	Modest	bbb+	-
BMW AG	A	Satisfactory	Minimal	a	-

General Trading And Investment Companies; Investment Holding Companies Outlook – Stable

Creditworthiness to improve with recovery and higher material prices

Primary Credit Analyst
Hiroyuki Nishikawa

Secondary Credit Analyst
Asa Watanabe
Katsuyuki Nakai

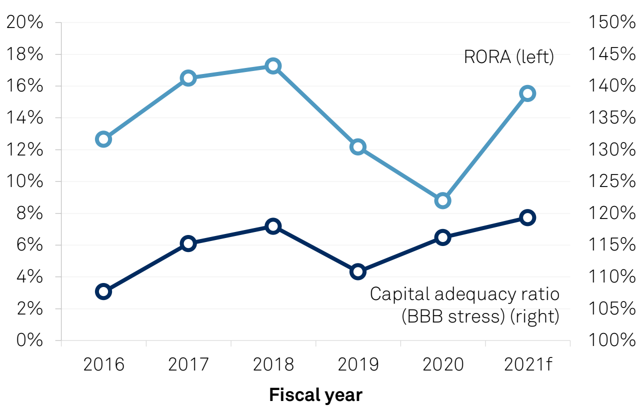
Key Assumptions

- Global economic recovery and higher material prices will boost performance of general trading and investment companies (GTICs).
- GTICs' return on risk-weighted assets (RORA) will recover in fiscal 2021 to midway between 10% and 20%, the fiscal 2018 level, from under 10% in fiscal 2020.
- GTICs' average capital adequacy under our 'BBB' stress scenario will improve to about 120%, exceeding the record high of fiscal 2018, thanks to rising net profit and focus on financial soundness.
- Investment holding company (IHC) performance and finances will be susceptible to stock prices and asset creditworthiness.

Credit Trends And Risks

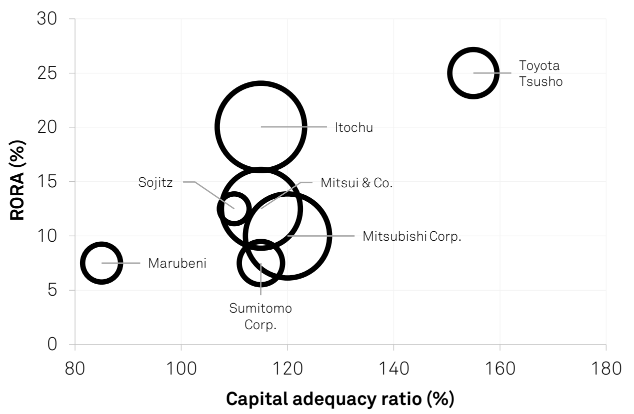
- GTICs' creditworthiness continuing to improve moderately, and creditworthiness of IHC remaining stable.
- Risk of profits falling amid a resurgence in COVID-19 or a decline in demand or prices for crude oil and materials.
- Risk of weakening or delayed improvement in financial soundness, due to growth investments or shareholder returns.

Key Figures



f--Forecast. Source: S&P Global Ratings based on company materials.

Peer Comparison



Bubble size represents net profit. Figures are average over most recent three years. RORA--Return on risk-weighted assets. Source: S&P Global Ratings.

General trading and investment companies; investment holding companies	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
General trading and investment companies					
Sojitz Corp.	BBB-	Satisfactory	Intermediate	bbb	-1
Itochu Corp.	A	Strong	Modest	a	-
Marubeni Corp.	BBB	Strong	Significant	bbb	-
Toyota Tsusho Corp.	A	Satisfactory	Modest	bbb+	+2
Mitsui & Co. Ltd.	A	Strong	Intermediate	a-	+1
Sumitomo Corp.	BBB+	Strong	Intermediate	bbb+	-
Mitsubishi Corp.	A	Strong	Modest	a	-
Investment holding companies					
SoftBank Group Corp.	BB+	Satisfactory	Significant	bb+	-
Overseas peers					
Temasek Holdings (Private) Limited	AAA	Excellent	Minimal	aaa	-
Investor AB	AA-	Excellent	Modest	aa	-1

Real Estate
Outlook - Slightly Negative

Asset classes remain key

Primary Credit Analyst
Ryohei Yoshida

Secondary Credit Analyst
Makiko Yoshimura

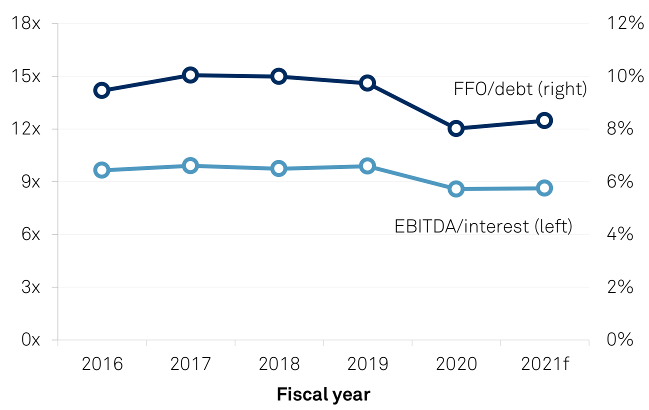
Key Assumptions

- Market sentiment will continue to vary according to asset class while COVID-19 persists.
- Retail, hotel, and office properties continue to suffer, while logistics facilities and residential properties remain sound.
- Central Tokyo's office vacancy ratio will worsen to 6.5-7% in 2021 and 7.5-8% in 2022 but remain less volatile than other major global cities'.
- Despite a weaker market, leasing businesses of the six companies studied will perform solidly, supported by competitive portfolios.
- Median FFO to debt will improve to about 7% in fiscal 2022, up from about 6% in fiscal 2021.

Credit Trends And Risks

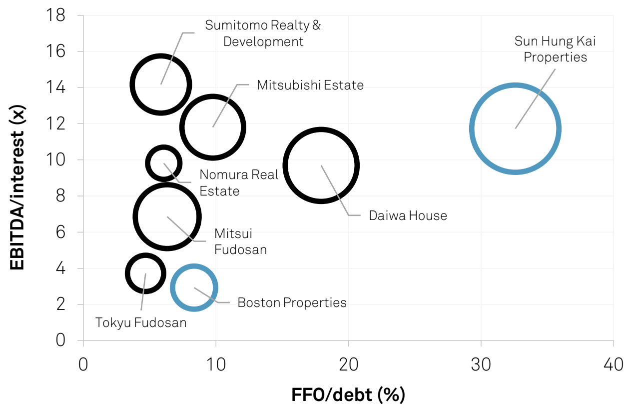
- Creditworthiness remaining under pressure due to the financial burden of aggressive investments and shareholder returns.
- Risk of a structural downturn in commercial demand as remote work and online retail become common amid a prolonged pandemic.
- Risk of delayed recovery in the leasing market for retail and hotel properties due to travel restrictions and changing consumer behavior.
- Risk of delayed recovery in property investment as, for example, reduced interest from overseas weakens the real estate market.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Real estate	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Daiwa House Industry Co. Ltd.	Not rated	Strong	Significant	-	-
Nomura Real Estate Holdings Inc.	Not rated	Satisfactory	Significant	-	-
Tokyu Fudosan Holdings Corp.	Not rated	Satisfactory	Aggressive	-	-
Mitsui Fudosan Co. Ltd.	A	Strong	Modest	a+	-1
Mitsubishi Estate Co. Ltd.	A+	Strong	Modest	a+	-
Sumitomo Realty & Development Co. Ltd.	Not rated	Strong	Modest	-	-
Overseas peers					
Sun Hung Kai Properties Ltd.	A+	Excellent	Intermediate	a	+1
Boston Properties Inc.	BBB+	Strong	Intermediate	a-	-1

Railways
Outlook - Slightly Negative

Slow passenger return and heavy investment weigh on credit quality

Primary Credit Analyst
Shinichi Endo

Secondary Credit Analyst
Katsuyuki Nakai

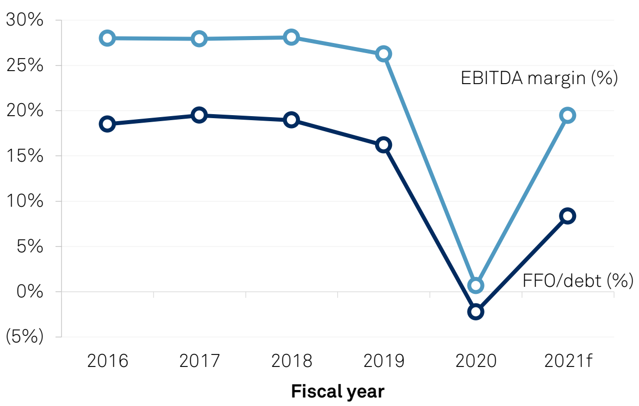
Key Assumptions

- Rail passenger traffic in Japan in fiscal 2021 will total 70%-80% of the pre-pandemic level of fiscal 2019 and will rise to only 80%-90% in fiscal 2022.
- The average EBITDA margin of the five companies studied will recover to midway between 20% and 30% in the next two years--just 90% of pre-pandemic levels.
- The three private companies studied are resilient to falling demand because nonrailway operations account for a large portion of their business and they are less reliant on volatile long-distance passenger transportation.
- The average ratio of funds from operations to debt of the five companies will recover to about 11% in the next two years, still 70% of pre-pandemic levels.
- Japan's railway companies will not receive financial support from the government, in contrast to certain major operators in Europe.

Credit Trends And Risks

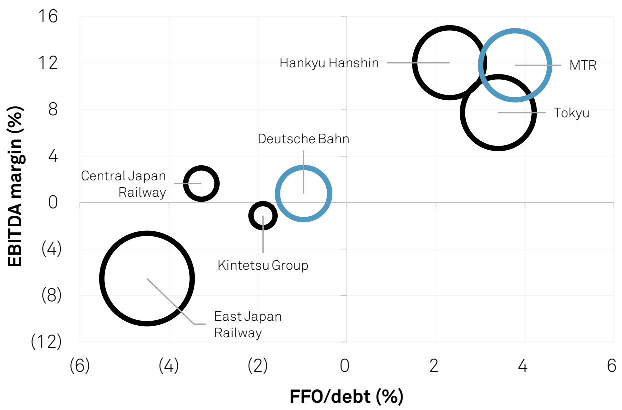
- Maintenance of strong business in respective operating areas despite pressure on transportation revenue in the next two years or so.
- Sluggish passenger demand and a heavy investment burden continuing to weigh on financial soundness metrics.
- Risk of a prolonged pandemic keeping demand weak, slowing recovery in passenger numbers and demand for leisure and hotels.
- Risk of financial soundness suffering amid increased investments, for instance in real estate and retail properties, and higher shareholder returns.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents absolute value of EBITDA. Figures for fiscal 2020; figures for East Japan Railway and Kintetsu Group are negative. Source: S&P Global Ratings.

Railways	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Tokyu Corp.	Not rated	Strong	Significant	-	-
East Japan Railway Co.	A+	Excellent	Intermediate	a+	-
Central Japan Railway Co.	A+	Excellent	Intermediate	a+	-
Kintetsu Group Holdings Co. Ltd.	Not rated	Satisfactory	Aggressive	-	-
Hankyu Hanshin Holdings Inc.	Not rated	Strong	Significant	-	-
Overseas peers					
Deutsche Bahn AG	AA-	Strong	Significant	bbb	+5
MTR Corp. Ltd.	AA+	Excellent	Intermediate	a	+4

Airlines
Outlook - Negative

Worst over but credit quality remains under pressure

Primary Credit Analyst
Katsuyuki Nakai

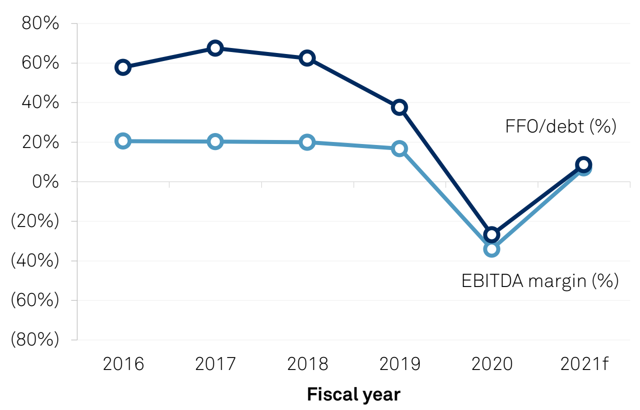
Key Assumptions

- Global air passenger traffic in 2021 will total 40%-60% of 2019's, rising to only 70%-80% in 2022.
- The average EBITDA margin will turn positive to about 6%-8% in fiscal 2021, still well under the pre-pandemic level of 18%-20%.
- Total debt of the two carriers studied will grow to ¥1.8 trillion-¥1.9 trillion in fiscal 2021 from about ¥1.2 trillion the previous year.
- Financial ratios will remain weak but near-term liquidity will be free of major issues thanks to close relationships with creditor banks.
- U.S. carriers' performances will recover before those of most other airlines as passenger demand recovers on domestic routes.

Credit Trends And Risks

- Earnings remaining under heavy pressure as, in contrast to robust cargo transportation, recovery in passenger transportation is slow on domestic and international routes.
- Increasing reliance on debt at the two domestic companies because free cash flow is likely to remain negative even as they continue to carefully manage fixed costs and capital investments.
- Risk of a prolonged pandemic slowing recovery in demand in profitable long-distance routes and business travel.
- Risk of free cash flow falling deeper into negative territory or pressure growing on liquidity.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison

Bubble size represents absolute value of EBITDA. Figures for fiscal 2020; figures for all companies are negative. Source: S&P Global Ratings.

Airlines	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Japan Airlines Co. Ltd.	Not rated	Fair	Intermediate	-	-
ANA Holdings Inc.	Not rated	Fair	Aggressive	-	-
Overseas peers					
Delta Air Lines Inc.	BB	Satisfactory	Aggressive	bb	-
British Airways PLC	BB	Fair	Aggressive	bb-	+1
Deutsche Lufthansa AG	BB-	Satisfactory	Highly leveraged	b+	+1

Telecommunications
Outlook - Stable

Stable finances to keep credit quality steady as competition intensifies

Primary Credit Analyst
Shinichi Endo

Secondary Credit Analyst
Makiko Yoshimura

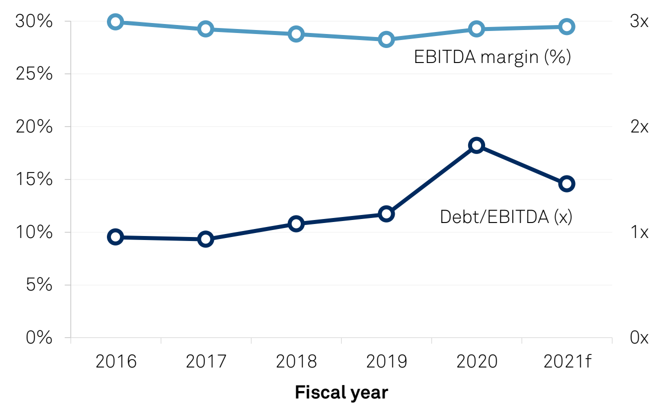
Key Assumptions

- Mobile telecom subscriptions in Japan will grow just over 2% annually with the expansion of 5G wireless networks.
- Demand for fiber optics for households and communication networks for corporations will continue rising sharply due to increasing remote work amid the pandemic.
- Average EBITDA will be about 30% for the next two years as cost cuts ease the impact of competition in mobile communications.
- Debt to EBITDA will be just below 2x for the next two years as companies cover 5G investments and shareholder returns with ample cash flows.

Credit Trends And Risks

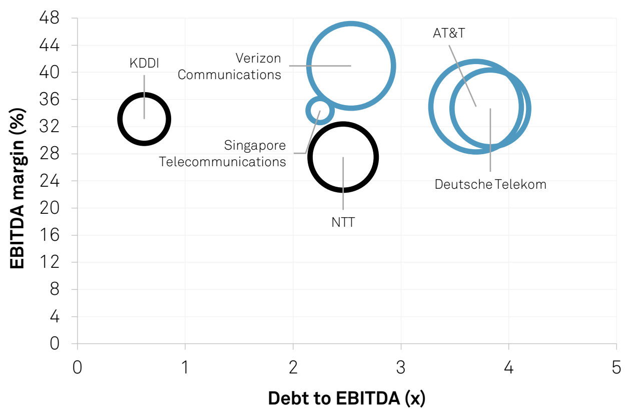
- Disciplined financial management and stable finances underpinning credit quality even as competition weighs on profitability.
- Despite a stable outlook, credit quality in the U.S. and Europe coming under pressure from intense competition for customers and a slow recovery in finances, which have suffered after 5G investments and spectrum auctions.
- Risk of growing pressure on profitability as the Japanese government spurs price competition.
- Risk of finances worsening owing to aggressive 5G investments and shareholder returns that exceed our assumptions.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2019 for Singapore Telecommunications; fiscal 2020 for other companies. Source: S&P Global Ratings.

Telecommunications	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Nippon Telegraph and Telephone Corp.	A	Strong	Modest	a+	-1
KDDI Corp.	Not rated	Strong	Minimal	-	-
Overseas peers					
Verizon Communications Inc.	BBB+	Strong	Intermediate	a-	-1
Deutsche Telekom AG	BBB	Strong	Significant	bbb	-
Singapore Telecommunications Ltd.	A	Strong	Intermediate	bbb+	+2
AT&T Inc.	BBB	Strong	Significant	bbb	-

Electric Utilities And Gas Outlook - Stable

Steady cash flows and government support underpin credit quality

Primary Credit Analyst
Hiroyuki Nishikawa

Secondary Credit Analyst
Katsuyuki Nakai

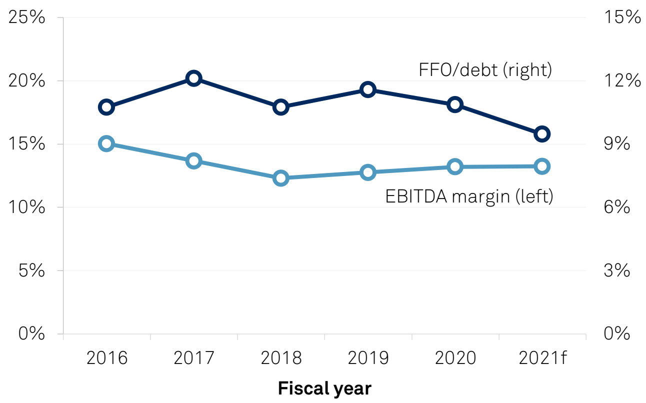
Key Assumptions

- Domestic demand for electricity and gas will recover gradually following the pandemic.
- Competition in retail markets will remain intense, but companies will continue to benefit from dominance in home markets, a stable regulatory framework for networks, and favorable pricing.
- Debt will continue to grow due to maintenance of facilities and investment in renewable energy and overseas businesses.
- Stable cash flows will limit declining financial soundness, with average funds from operations to debt dropping to about 10% in fiscals 2021 and 2022 from about 11% in fiscal 2020.

Credit Trends And Risks

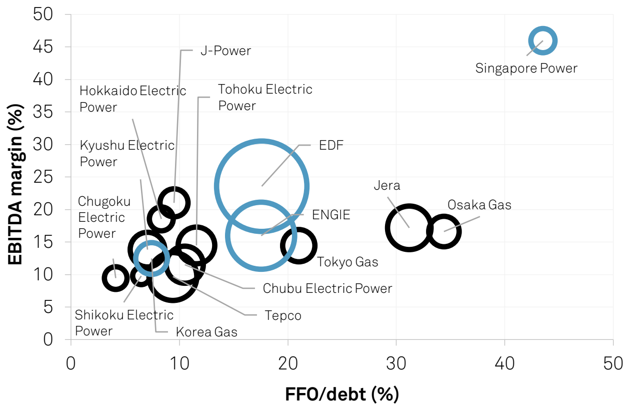
- Credit quality remaining stable thanks to steady cash flows; electricity providers likely benefiting from government support if needed.
- Risk of expanding renewable energy and overseas businesses increasing investment burdens and earnings volatility.
- Risk of profits and cash flows suffering from decarbonization-related changes and retail deregulation while the restart of nuclear plants in Japan remains uncertain.

Key Figures



f--Forecast. Source: S&P Global Ratings, based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures for fiscal 2020. Source: S&P Global Ratings.

Electric utilities and gas	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Tokyo Electric Power Company Holdings Inc. (Tepco)	BB+	Satisfactory	Highly leveraged	b+	+3
Chubu Electric Power Co. Inc.	Not rated	Strong	Significant	-	-
Chugoku Electric Power Co. Inc.	BBB+	Strong	Aggressive	bb+	+3
Tohoku Electric Power Co. Inc.	Not rated	Strong	Significant	-	-
Shikoku Electric Power Co. Inc.	A-	Strong	Significant	bbb	+2
Kyushu Electric Power Co. Inc.	Not rated	Strong	Aggressive	-	-
Hokkaido Electric Power Co. Inc.	Not rated	Strong	Aggressive	-	-
Electric Power Development Co. Ltd. (J-Power)	A	Excellent	Significant	a-	+1
Tokyo Gas Co. Ltd.	AA-	Excellent	Modest	aa	-1
Osaka Gas Co. Ltd.	AA-	Excellent	Modest	aa	-1
Jera Co. Inc.	A-	Strong	Intermediate	a-	-
Overseas peers					
Electricite de France S.A.	BBB+	Satisfactory	Significant	bbb-	+2
ENGIE SA	BBB+	Strong	Significant	bbb	+1
Korea Gas Corp.	AA	Excellent	Aggressive	bbb	+6
Singapore Power Ltd.	AA+	Excellent	Modest	aa	+1

Airports
Outlook - Negative

Sluggish traffic causes slower credit recovery than for railways

Primary Credit Analyst
Asa Watanabe

Secondary Credit Analyst
Katsuyuki Nakai

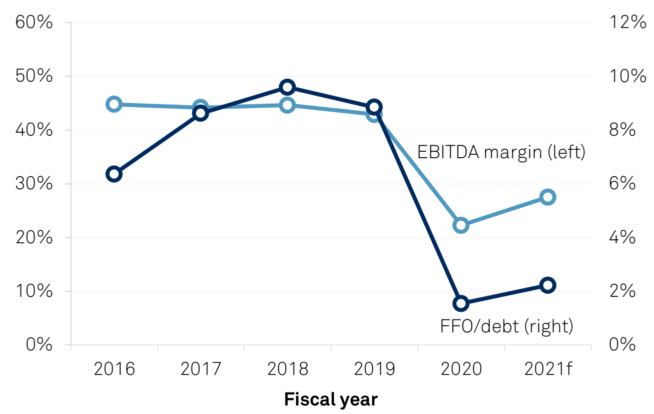
Key Assumptions

- Travel demand on international routes will take two to three years to recover to 2019 levels.
- Globally, performance of some airports focused on domestic routes will recover.
- Profitability will remain under heavier pressure for the Japanese airports studied than for overseas peers because of greater reliance on retail business, which hinges on passenger traffic.
- Total free cash flow of the two companies will remain deeply negative due to fixed-cost burdens and difficulty cutting investments.
- The likelihood of government support remains high, given the record of capital increases and financial support.

Credit Trends And Risks

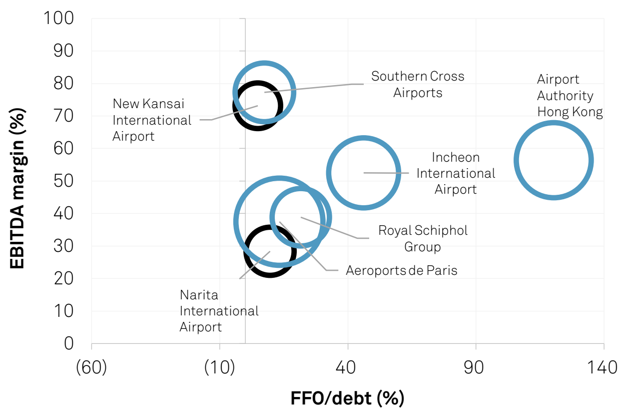
- A prolonged slump in international passenger traffic continuing to pressure credit quality more than in other sectors.
- Total EBITDA recovering in fiscal 2022 to only about half that of fiscal 2019.
- Average ratio of funds from operations to debt of 3%-5% in fiscal 2022, compared with about 9% in fiscal 2019.
- Risk of a resurgence of the pandemic extending government restrictions on inbound travel and movement.

Key Figures



f--Forecast. Source: S&P Global Ratings based on company materials.

Peer Comparison



Bubble size represents EBITDA. Figures are based on average sales, EBITDA, FFO, and debt over most recent three years. Source: S&P Global Ratings.

Airports	Long-term issuer credit rating	Business risk profile	Financial risk profile	Anchor	Modifiers or group/govt.
Narita International Airport Corp.	Not rated	Excellent	Aggressive	-	-
New Kansai International Airport Co. Ltd.	Not rated	Excellent	Aggressive	-	-
Overseas peers					
Aeroports de Paris	A	Excellent	Significant	a-	+1
Airport Authority Hong Kong	AA+	Excellent	Aggressive	bbb	+7
Incheon International Airport Corp.	AA	Excellent	Aggressive	bbb	+6
Royal Schiphol Group N.V.	A	Excellent	Aggressive	bbb	+3
Southern Cross Airports Corp. Holdings Ltd.	BBB+	Excellent	Aggressive	bbb	+1

Related Research

- Japan Corporate Credit Spotlight: A Rough Road To Recovery, Oct. 22, 2020
- Japan Corporate Credit Spotlight: Advertising; Electronics; IT Services; E-Commerce; Telecom And Investment Holding Companies, Oct. 22, 2020
- Japan Corporate Credit Spotlight: Capital Goods And Heavy Industries; Automobiles And Components; Shipping; Airlines, Oct. 22, 2020
- Japan Corporate Credit Spotlight: Pulp And Paper; Chemicals; Glass; Steel; Nonferrous Metals, Oct. 22, 2020
- Japan Corporate Credit Spotlight: Consumer Products; Retail; Health Care; Oil Refining And Mining; General Trading And Investment Companies, Oct. 22, 2020
- Japan Corporate Credit Spotlight: General Contractors; Real Estate; Electric Utilities And Gas; Railways; Airports, Oct. 22, 2020
- Japan’s Surging Corporate Hybrid Issuance: Lessons From EMEA, March 5, 2020
- ESG Credit Indicator Definitions And Application, Oct. 13, 2021

Contacts

PRIMARY CONTACTS

Hiroki Shibata
Senior Director, Analytical Manager
+ 81-03-4550-8437
hiroki.shibata@spglobal.com

Katsuyuki Nakai
Director
+ 81-03-4550-8748
katsuyuki.nakai@spglobal.com

Makiko Yoshimura
Director
+ 81-03-4550-8368
makiko.yoshimura@spglobal.com

Hiroyuki Nishikawa
Director
+ 81-03-4550-8751
hiroyuki.nishikawa@spglobal.com

Ryohei Yoshida
Associate Director
+ 81-03-4550-8660
ryohei.yoshida@spglobal.com

Asa Watanabe
Associate
+ 81-03-4550-8771
asa.watanabe@spglobal.com

Kei Ishikawa
Associate
+ 81-03-4550-8769
kei.ishikawa@spglobal.com

Shinichi Endo
Associate
+ 81-03-4550-8773
shinichi.endo@spglobal.com

EDITOR

Daniel Mendelssohn
Tokyo

DIGITAL DESIGNER

Halie Mennen
Melbourne