

# Overview of Japanese Credit Market

## ~ Background of Aversion to Credit Risk ~

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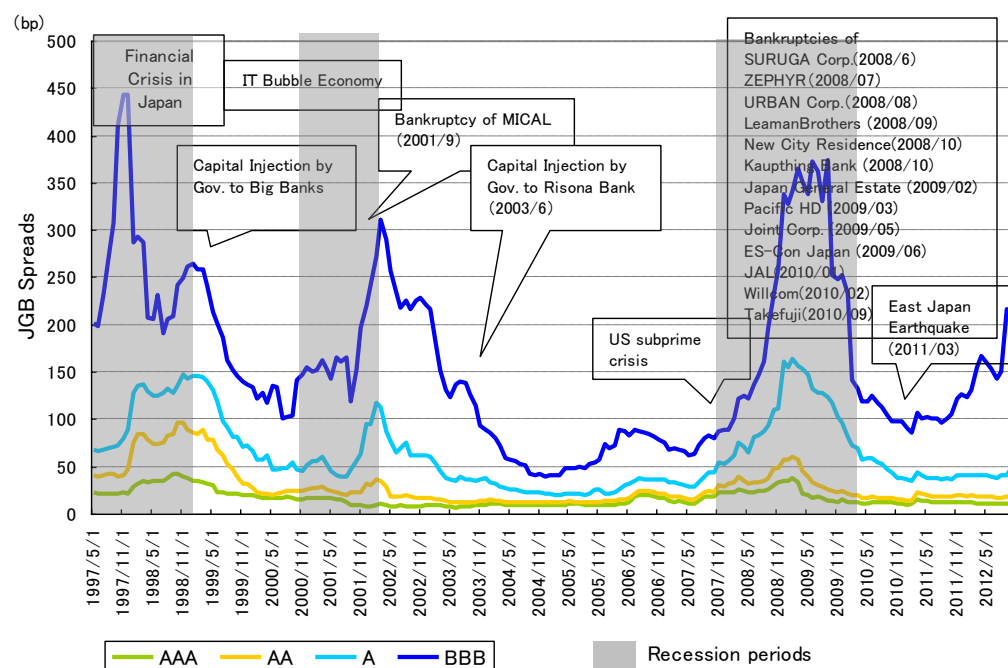
6 December 2012

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**MD & Head of Credit Research**  
**Fixed Income, Currency and Commodities Research Dept.**

# Preface

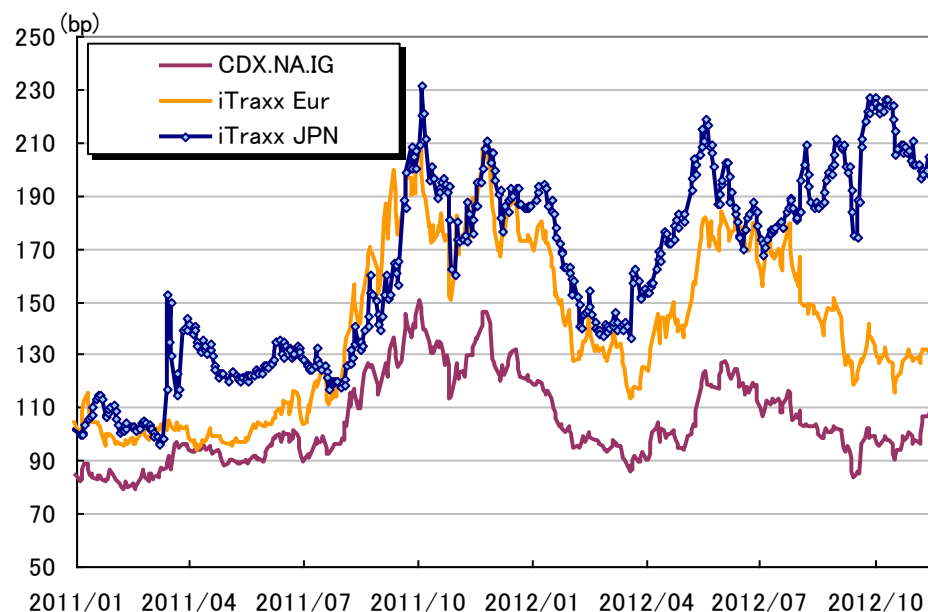
- Domestic credit market tends to post “ultra” two-tier performance
- Decoupling of domestic credit market from European/US credit market

Spreads over JGBs by Rating Category (Ave. with 3-7Y maturities)



Note: Calculations exclude electric utility bonds since March 2011  
Source : Daiwa Securities

CDS Index in Japan, US, and Europe (5Y)



Source : Markit, Daiwa Securities

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# ■ Domestic Credit Market Facing Oversensitivity to Credit Risk

## Background of oversensitivity

1. With low recovery rate, default of corporate bonds no longer rare
2. Faster and bigger tendency in downgrading actions
3. Existence of CDS market which has quick price movement

## On the other hand,

1. Financial market promoting credit investment (monetary easing, decoupling of Japan from Europe/US )
2. Supply/demand conditions are unlikely to loosen (lackluster new issuance of corporate bonds, steady demand)
3. Stable credit fundamentals across the board (conservative corporate financial policy, expectations for improvement in corporate earnings)

It's time to take credit risk base on each firm's credit evaluation

# 1. With Low Recovery Rate, Default of Corporate Bonds No Longer Rare

Default cases of publicly offered corporate bonds and recovery rate by bond type in Japan

Default date	name (industry)	Law	CCB	SB Outstanding (¥ bil.)	Recovery Rates
Dec-98	Japan Land Development (real estate)	Corporate Reorganization Law	yes	50	10% or 6%
Sep-01	MYCAL (retail)	Corporate Reorganization Law	yes	243	30% (in case of retail bond) 10.2% (in case of wholesale bond)
			no	100	depend on holding amount 5% + ¥5M (~up till ¥2billion) 4% + ¥25M (~up till ¥10B) etc.
Jun-08	SURUGA Corporaton (real estate)	Civil Rehabilitaion Law	no	21	¥30M+54.2%min
Jul-08	ZEPHYR (real estate)	Civil Rehabilitaion Law	no	20	14.70%
Aug-08	URBAN Corporation (real estate)	Civil Rehabilitaion Law	no	20	Max15%
Oct-08	New City Residence Investment Corp. (J-REIT)	Civil Rehabilitaion Law	no	17	100%
Feb-09	Japan General Estate Corp. (real estate)	Corporate Reorganization Law	no	10	4.0% (¥0.1B~1B credit) 2.8% (over ¥1B credit)
Mar-09	Pacific Holdings (real estate)	Corporate Reorganization Law	no	37	5.78% (over ¥0.1M credit)
May-09	Joint Corp. (real estate)	Corporate Reorganization Law	no	15	7.13% (over ¥0.5M credit)
Jun-09	ES-CON Japan (real estate)	ADR(Alternative Dispute Resolution)	no	80	15%
Jan-10	Japan Airlines	Corporate Reorganization Law	no	470	12.5%
Feb-10	Willcom (telecom)	Corporate Reorganization Law	no	350	13.3% (over ¥10M credit)
Sep-10	Takefuji (non-bank)	Corporate Reorganization Law	no	926	3.3%+α
Feb-11	Elpida Memory (semiconductor)	Corporate Reorganization Law	no	450	17.4% (not yet finalized)

Note: CCB is a commissioned company for bondholders

■ Domestic corporate bonds:  
Consensus of expected recovery rate is about 10%

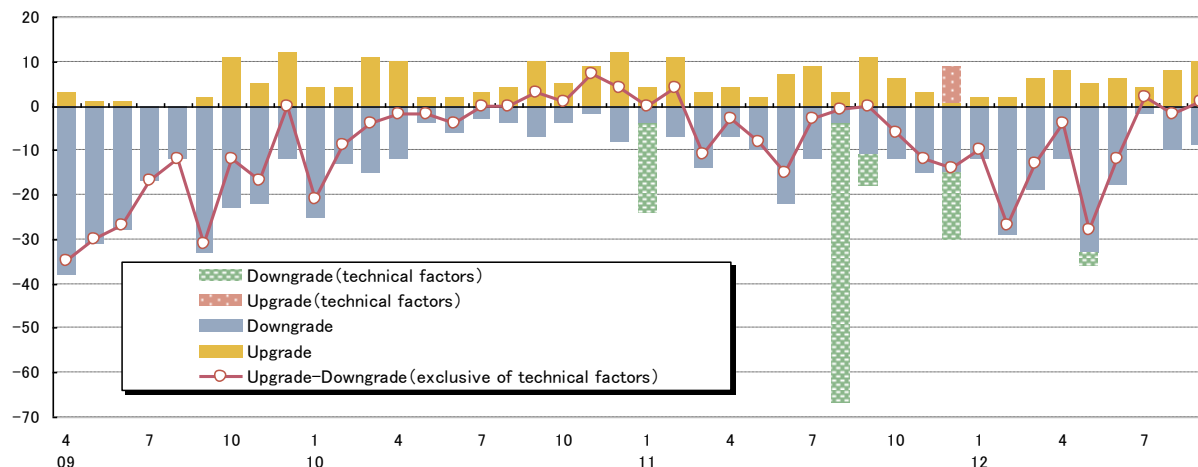
【Reference】  
According to Moody's, worldwide recovery rate of senior unsecured bonds during 1982-2011 averaged at 36.8%.

Source: Moody's Annual Default Study

Source: Various materials; compiled by Daiwa Securities

## 2. Faster and Bigger Tendency in Downgrading Actions

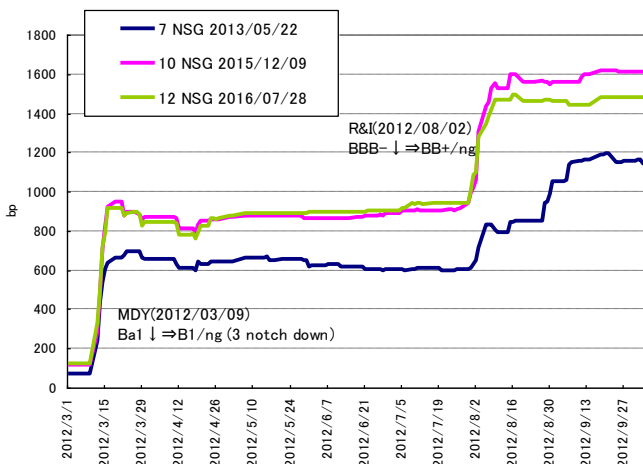
Monthly Trend of Rating Actions



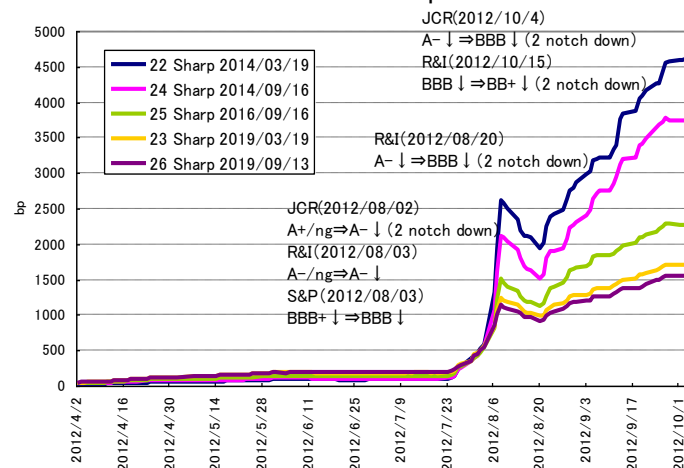
Notes: 1) Downgrades are expressed as negatives. Technical factors: Rating actions triggered by changes in sovereign ratings or by changes in the rating agency's valuation methodology.

Source: Rating agencies; compiled by Daiwa Securities

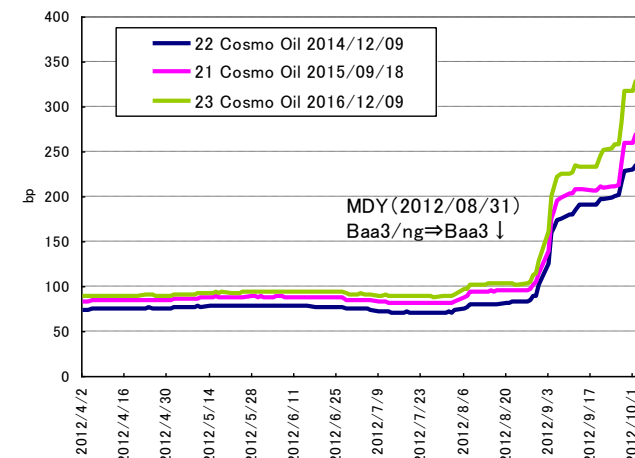
Case 1 : Nippon Sheet Glass



Case 2 : Sharp



Case 3 : Cosmo Oil

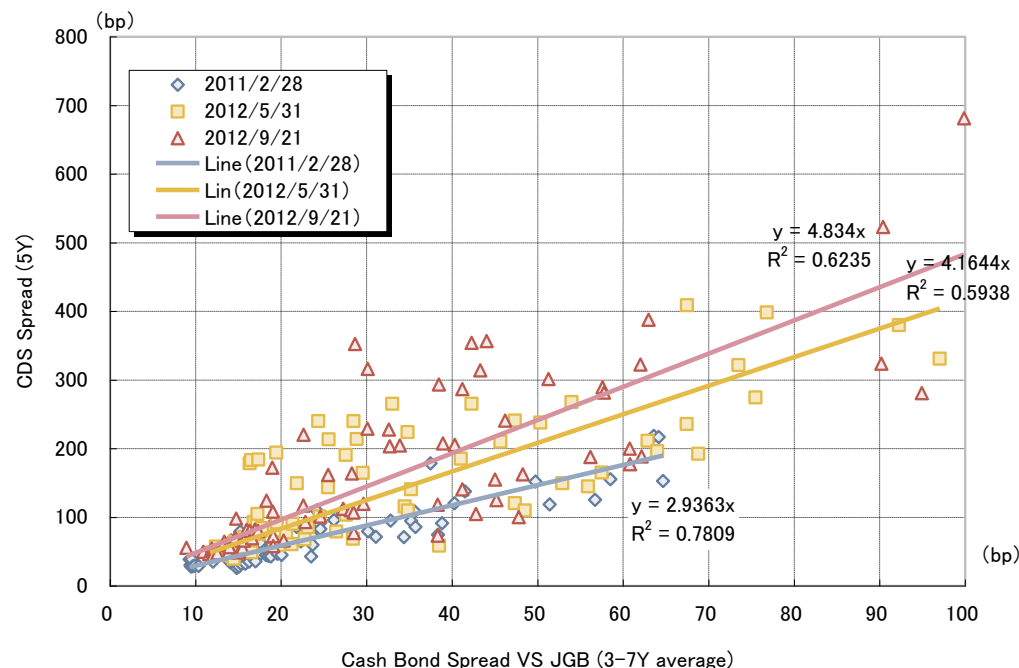


Source : Japan Securities Dealers Association, Daiwa Securities, rating agencies.

### 3. Existence of CDS Market Which Has Quick Price Movement

- CDS spread remains greater than cash bond spread in Japan
- Increase in CDS spread is greater than that in cash bond spread

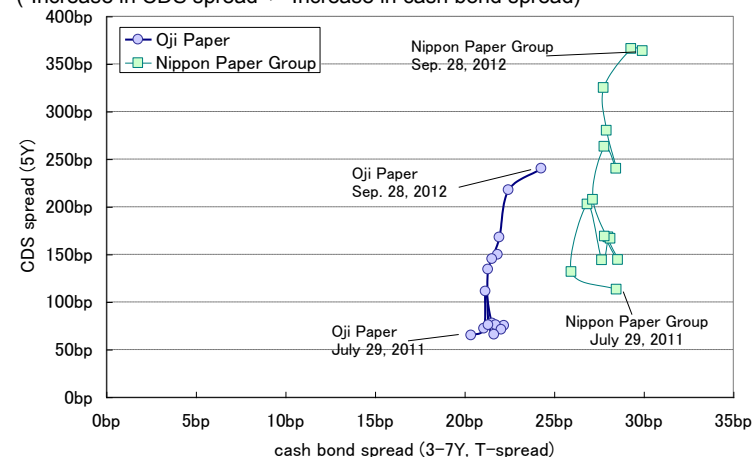
Change in Spread Map for CDS and Cash Bonds



Source : Markit, Japan Securities Dealers Association; compiled by Daiwa Securities

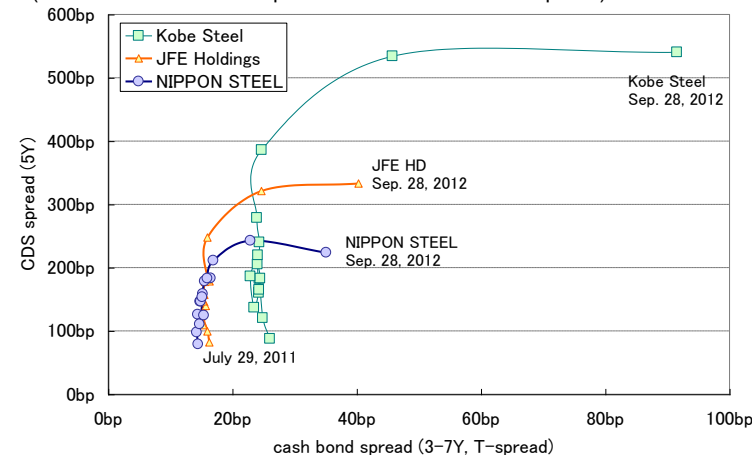
Case 1 : Paper & Pulp Sector

( Increase in CDS spread > Increase in cash bond spread)

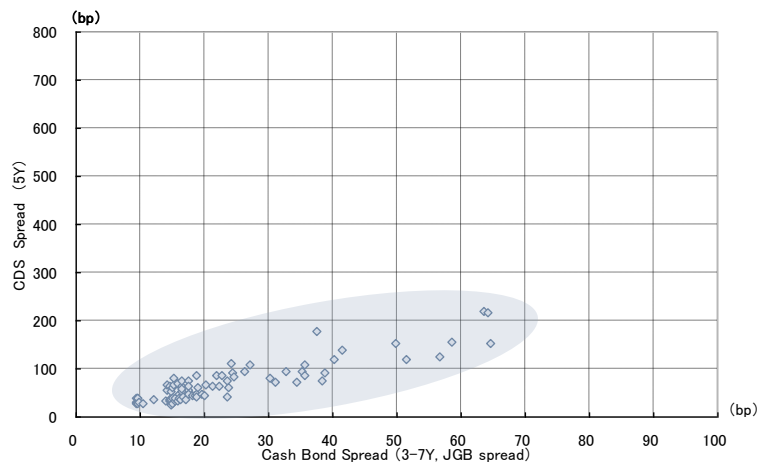


Case 2 : Iron & Steel Sector

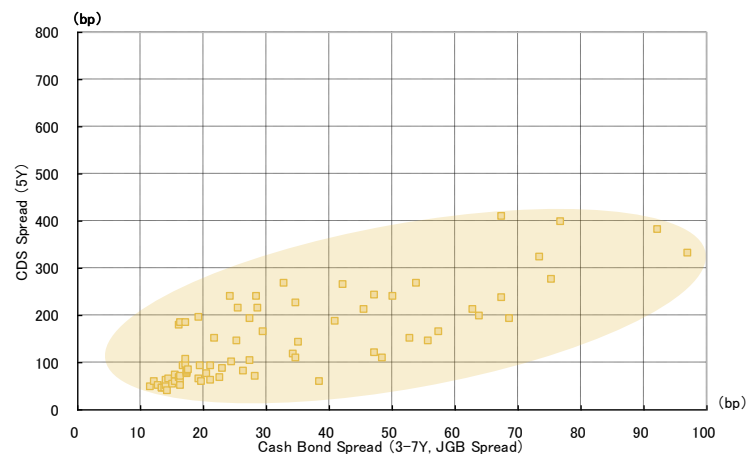
( Increase in cash bond spread followed that in CDS spread)



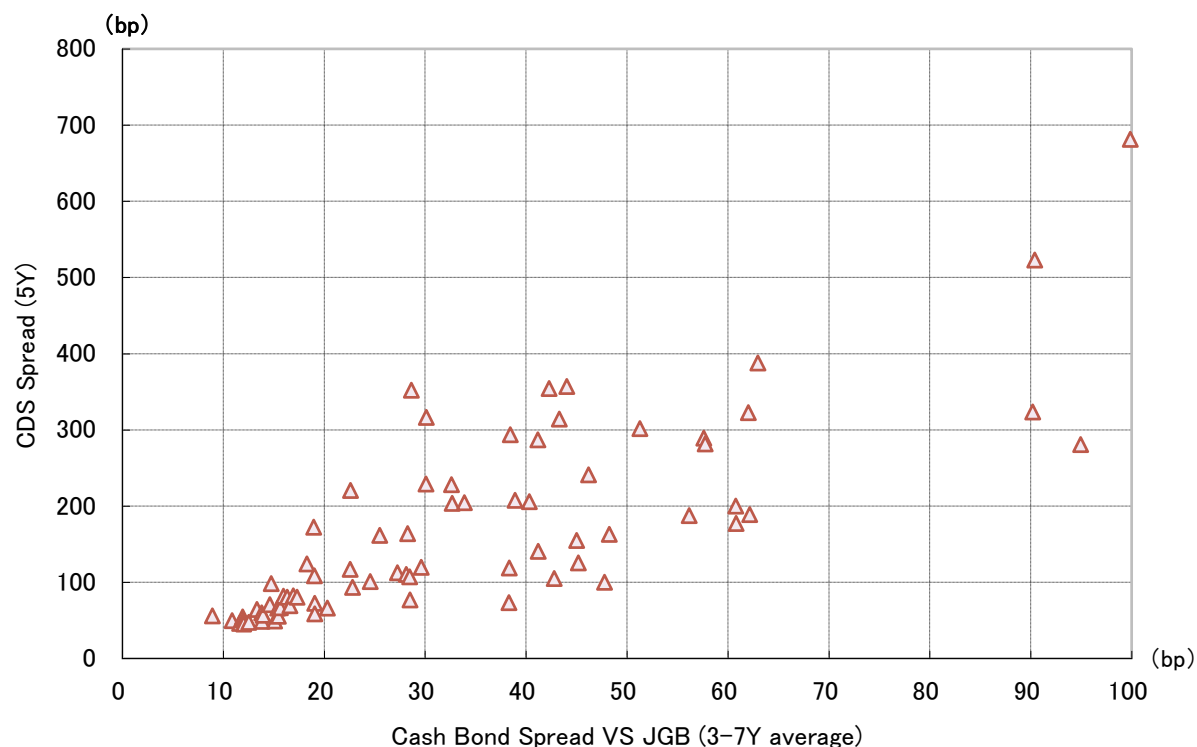
Spread Map for CDS and Cash Bonds (Feb 2011)



Spread Map for CDS and Cash Bonds (May 2011)



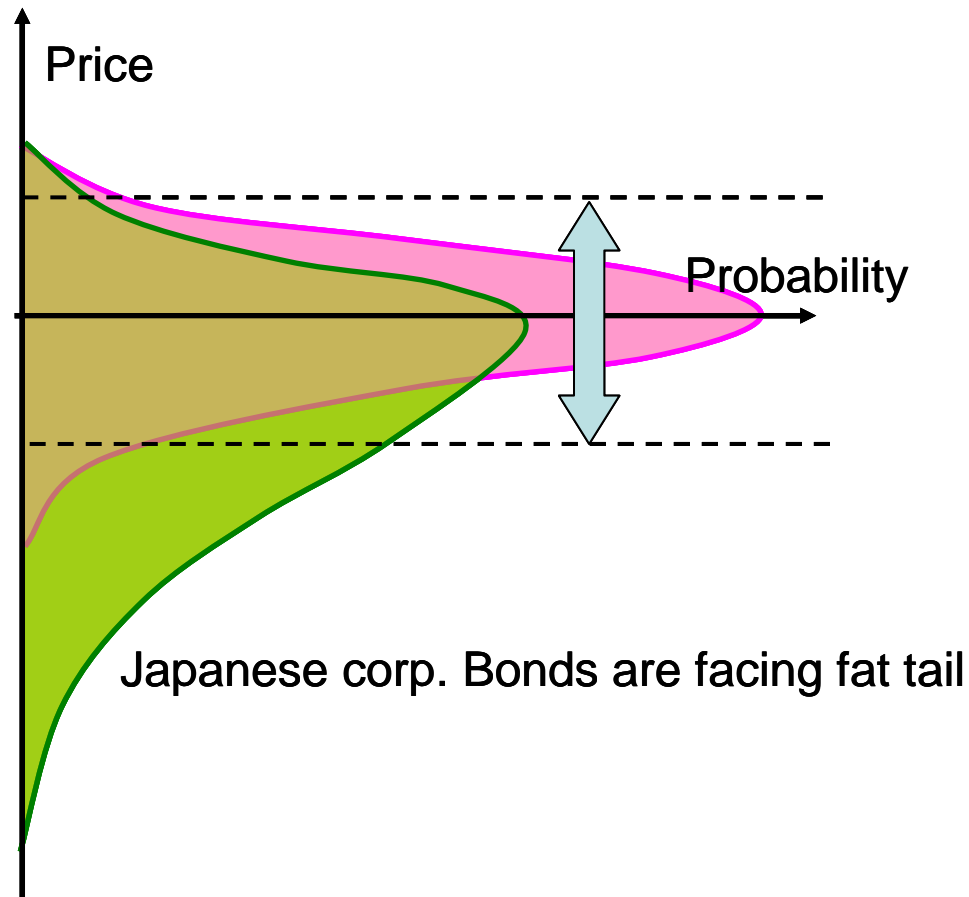
Spread Map for CDS and Cash Bonds (21 Sep 2012)



Source : Japan Securities Dealers Association, Markit; compiled by Daiwa Securities



- Progress in “ultra” two-tier performance in Japanese credit market
- Investors are oversensitive to credit risk



Source: Daiwa Securities



## Coffee Break

### Necessary measures to improve each factor

1. With low recovery rate, default of corporate bonds no longer rare
  - Improvement in the rights of corporate bond holders :  
Watching for outcome of " Study Group to Vitalize the Corporate Bond Market" at Japan Securities Dealers Association (JSDA)
  - Increasing number of activist bondholders : Thought-provoking change in conditions of Covalent Materials bonds
2. Faster and bigger tendency in downgrading actions
  - Rating agencies need to be evaluated : Is it time to reconsider using foreign rating agencies (Moody's, S&P ) ?
3. Existence of CDS market which has quick price movement
  - More utilization of CDS market: Watching for increase in CLN ( CLL ) transactions

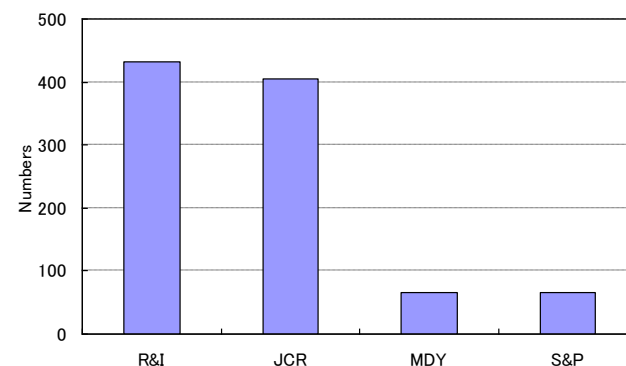
## Concrete measures at JSDA's study group

- **Review of underwriting inspection: Review of practice**
- **Granting of covenants and information disclosure**
  - Preparation and illustration of covenants model example
  - Compilation of cases of information disclosure promotions
- **CCB reform**
  - System should be revised to that corresponding to investor attributes/ level of issuer's credit risk
  - Plan to introduce "Corporate bond manager system" (temporary name)
- **Development of infrastructure for disseminating corporate bond price information:** Publication of transaction prices, improvement of credibility of reference statistical prices (yields) for OTC bond transactions

## Is it time to reconsider using foreign rating agencies (MDY, S&P) ?

- Reason (1) Gap in rating universe of Japanese companies
- Reason (2) Gap in reactions to important events  
(E.g., Gap in actions after release of TEPCO's "Comprehensive Special Business Plan" )

Rating universe of Japanese companies (as of Mar 2012)



Source : Rating agencies; compiled by Daiwa Securities

Early-evening 9 May : Government approved TEPCO's "Comprehensive Special Business Plan"

10 May: Our report "Impact on TEPCO bonds" released in the morning  
R&I/JCR View on TEPCO rating released

11 May: Our report on gap in actions by rating agencies released (14:00)  
S&P View on TEPCO rating released (past 17:00)

6 Jun: MDY Confirmation on TEPCO rating released

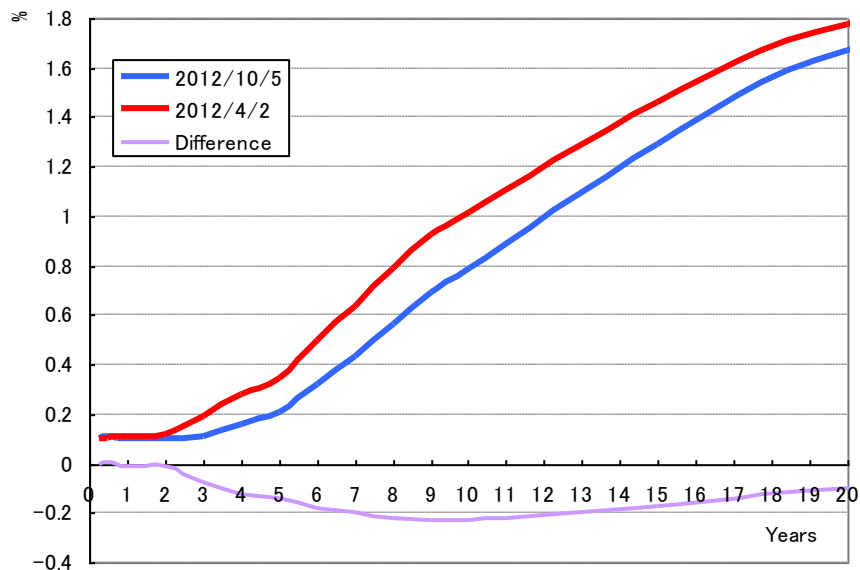
Source: *Measures Toward Vitalization of the Corporate Bond Market* by the Japan Securities Dealers Association

# On the Other Hand

## 1. Financial Market Promoting Credit Investment

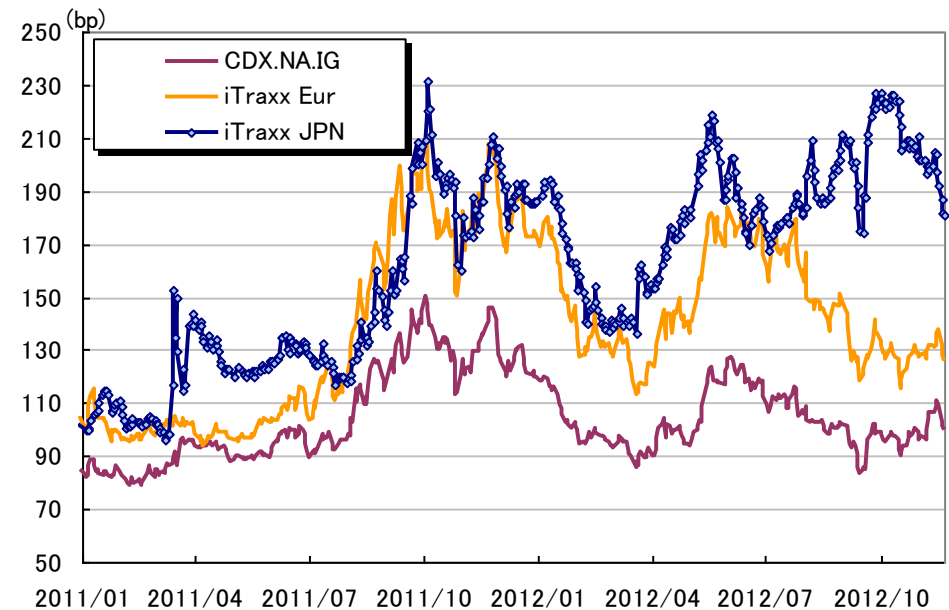
- Interest rates to remain low due to ultra monetary easing
- Inflow of investment funds into credit market in Europe/US (Decoupling of Japan from Europe/US )

Change in Yield Curve in Japan



Source : Daiwa Securities

CDS Index in Japan, US, and Europe (5Y)

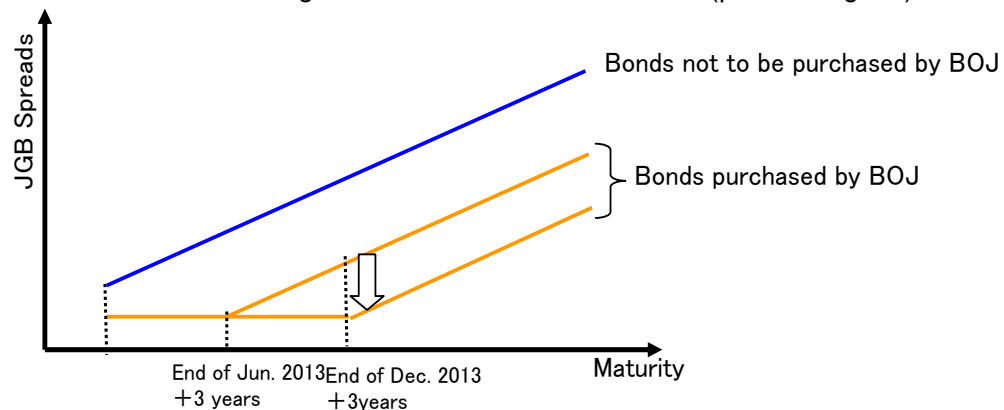


Source : Markit, Daiwa Securities

## Backup Measures by Band of Japan

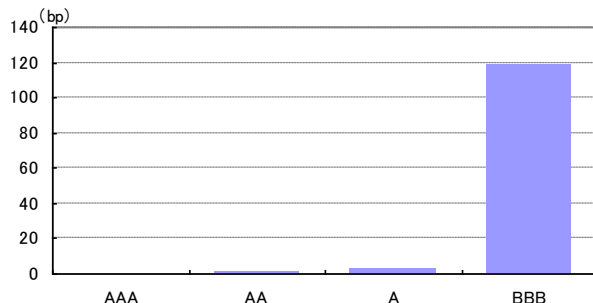
- BOJ's corporate bond purchase measure bolstering credit market
  - But, BOJ's own credit decisions resulting in distortion in resource allocation
- ⇒ Facilitating two-tier performance on the market

Effects of Extending JGB Maturities to be Purchased (pattern diagram)



Source : Daiwa Securities

Change in Spread by Rating ( from end-Dec 2010 to 18 Sep 2012)



Source : Daiwa Securities  
Note: Excluding electric utility bonds

BOJ's Bidding Results for Corporate Bonds

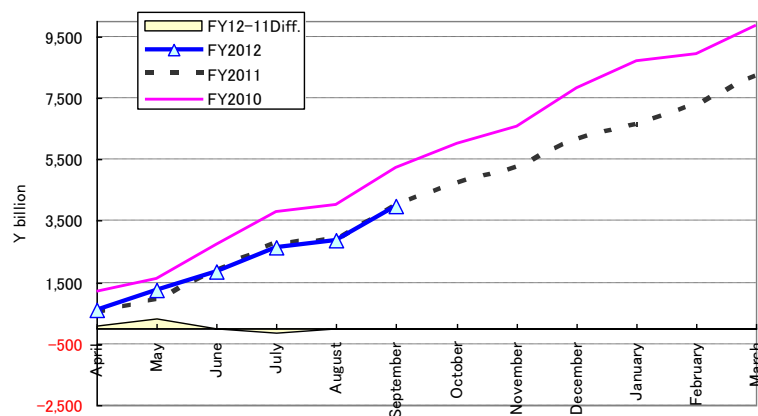
	Auction Date	Auction Amount (Y billion)	Accepted Bid (Y billion)	Competitive Bid (Y billion)	Bid-to-Cover Ratio (times)	Lowest Accepted Yield (%)	Average Accepted Yield (%)
#1	3-Dec-10	100	100	270	2.7	0.151	0.185
#2	3-Feb-11	100	100	294	2.9	0.211	0.238
#3	6-Apr-11	150	138	311	2.1	0.400	1.377
#4	11-May-11	150	150	336	2.2	0.203	0.236
#5	3-Jun-11	150	150	379	2.5	0.204	0.227
#6	6-Jul-11	150	150	328	2.2	0.235	0.266
#7	4-Aug-11	150	150	220	1.5	0.162	0.196
#8	6-Sep-11	150	150	221	1.5	0.134	0.153
#9	6-Oct-11	150	150	214	1.4	0.122	0.143
#10	9-Nov-11	150	144	144	1.0	0.100	0.118
#11	8-Dec-11	200	163	163	0.8	0.100	0.103
#12	13-Jan-12	150	150	180	1.2	0.101	0.111
#13	8-Feb-12	150	150	159	1.1	0.100	0.108
#14	9-Mar-12	200	194	217	1.1	0.100	0.108
#15	6-Apr-12	200	77	77	0.4	0.100	0.103
#16	11-May-12	200	158	597	3.0	0.210	0.302
#17	12-Jun-12	200	199	579	2.9	0.200	0.225
#18	9-Jul-12	200	195	461	2.3	0.200	0.209
#19	3-Aug-12	200	200	340	1.7	0.175	0.202
#20	11-Sep-12	250	250	312	1.2	0.131	0.175
#21	12-Oct-12	200	198	297	1.5	0.120	0.152

Source: Bank of Japan

## 2. Supply/demand Conditions Unlikely to Loosen

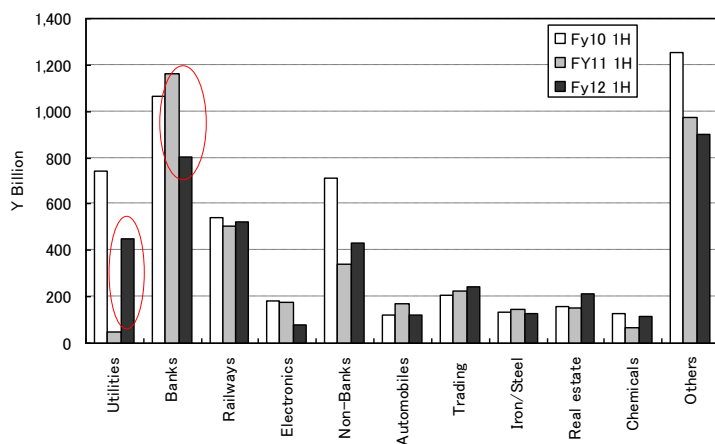
### ■ Lackluster supply of new corporate bonds

Monthly Issuance Amount of Corporate Bonds (Cumulative)



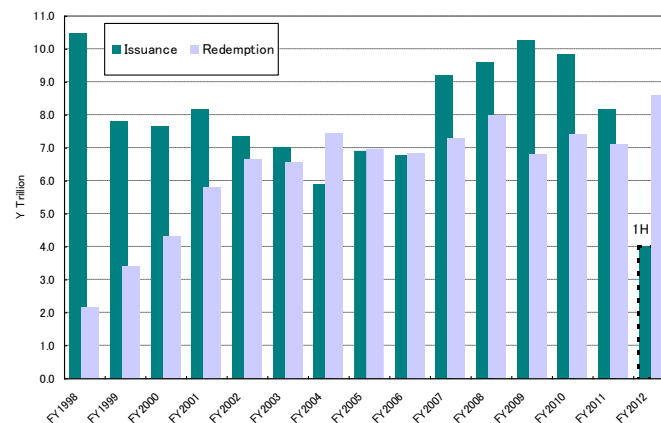
Source : Daiwa Securities

Issuance Amount by Sector



Source : Daiwa Securities

Issuance and Redemption of Corporate Bonds



Source : Daiwa Securities

Issuance Amount of Ordinary Corporate Bonds by Rating Y100 million

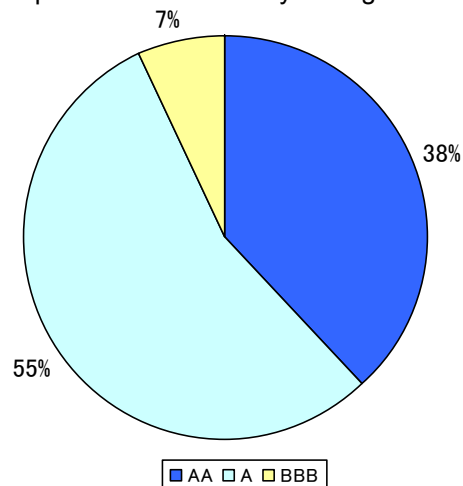
	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	SUM
FY2002	16,680	8,960	9,900	12,630	10,420	3,885	6,530	1,950	1,355	200	72,510
FY2003	9,900	6,970	9,100	5,600	11,640	10,270	9,330	4,250	1,790	850	69,700
FY2004	6,900	5,520	6,100	4,420	11,820	6,900	6,800	3,950	4,550	1,990	58,950
FY2005	7,500	5,820	7,850	6,400	7,900	14,830	4,600	5,530	4,765	2,465	67,660
FY2006	2,100	11,770	7,480	4,200	13,500	11,950	6,905	5,720	1,780	2,140	67,545
FY2007	1,400	20,720	13,130	8,250	21,211	13,180	5,900	4,040	3,283	780	91,894
FY2008	6,800	30,160	10,965	11,479	15,923	16,662	2,230	900	900	0	96,019
FY2009	1,700	16,050	12,110	17,050	21,112	18,990	10,997	2,010	2,583	0	102,602
FY2010	5,950	14,800	15,390	5,448	16,070	21,515	10,978	5,966	2,371	100	98,588
11/4			1,100	300	2,554	1,200					5,154
11/5	1,150	1,000	200	1,100	200	300			350		4,300
11/6	500	300	400	1,150	900	2,550	2,450	300	483		9,033
11/7	200	600	1,200	500	2,300	2,200	1,240	350	540		9,130
11/8					680	200	200				1,080
11/9	950	600	1,380	1,200	1,880	2,650	1,383	500	573		11,116
11/10	800	200	600	900	2,150	1,650	650	600			7,550
11/11	600		700	400	100	2,200	450	230	50		4,730
11/12	300	800	900	1,200	600	3,860	880	500	250		9,290
12/1		1,800	600	450	1,700	900	700	130	300		4,780
12/2		1,800	600	200	900	3,010	230				6,740
12/3		1,900	300	1,200	1,720	2,620	400	290	560		8,990
FY2011	4,500	7,200	7,980	8,600	15,684	23,340	8,583	2,900	3,106	0	81,893
12/4		250	1,300	800	1,900	650	550	200	400		6,050
12/5		1,650	900	600	1,100	1,200	420	550			6,420
12/6		350	500	900	1,081	2,170	350	500	100		5,951
12/7		300	700	1,350	2,380	1,700	1,100	100	100		8,030
12/8		200		700	350	650	350				2,250
12/9		2,200	430	1,800	1,673	3,500	900	460	370		11,333
FY2012	0	5,250	3,830	6,150	8,484	9,870	3,670	1,810	970	0	40,034

Note: Payment basis. Lower rating is adopted for rating assigned by Japanese rating agencies, while higher one is adopted in the case that the rating is assigned only by foreign agencies.

Source : Daiwa Securities

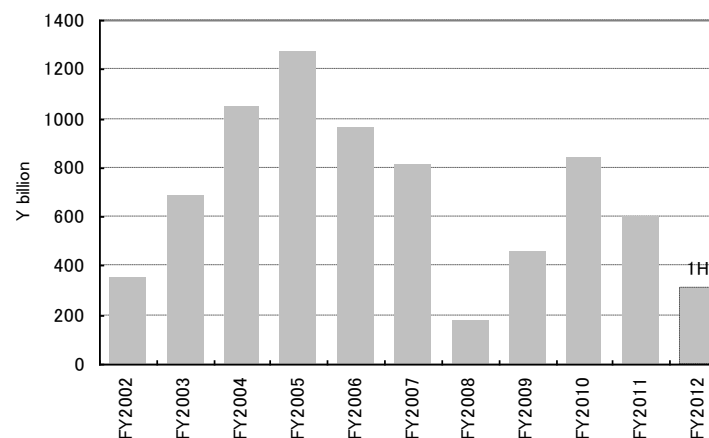
## ■ Newly-issued bonds tend to have high ratings, gradually narrowing spread

Corporate Bond Share by Rating Issued in 1H



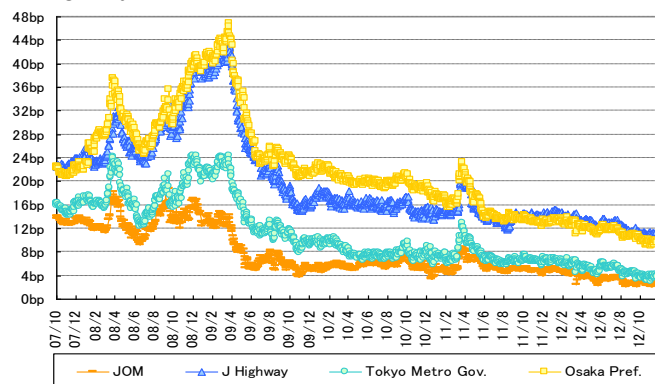
Source : Daiwa Securities

Issuance of Corporate Bonds with BBB Rating



Source : Daiwa Securities

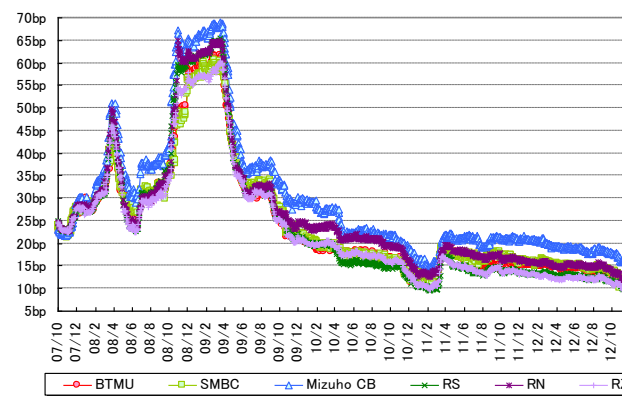
Spreads of Government-guaranteed Bonds Issued by JOM\* and FILP Agency Bonds over JGBs



Source: Japan Securities Dealers Association (Ave: with 9-10Y maturities)

\*Denotes Japan Finance Organization for Municipalities

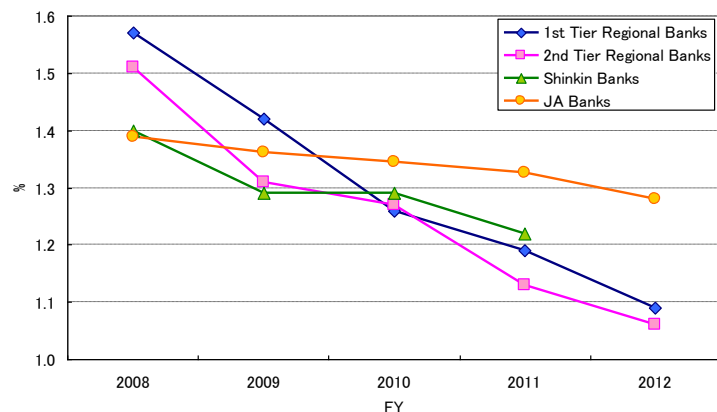
Spreads of Coupon Bank Debentures and Bank Bonds over JGBs



Source: Japan Securities Dealers Association (Ave: with 4-5Y maturities)

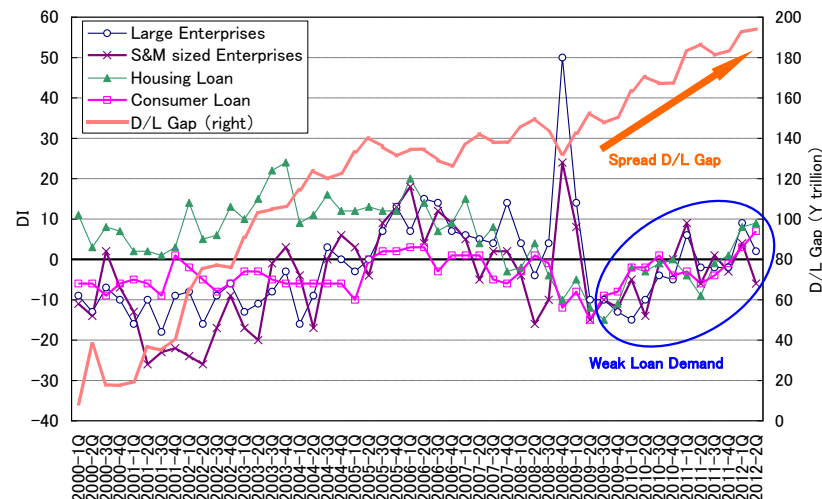
## ■ Demand for credit likely to increase gradually

Yield on securities falling year by year



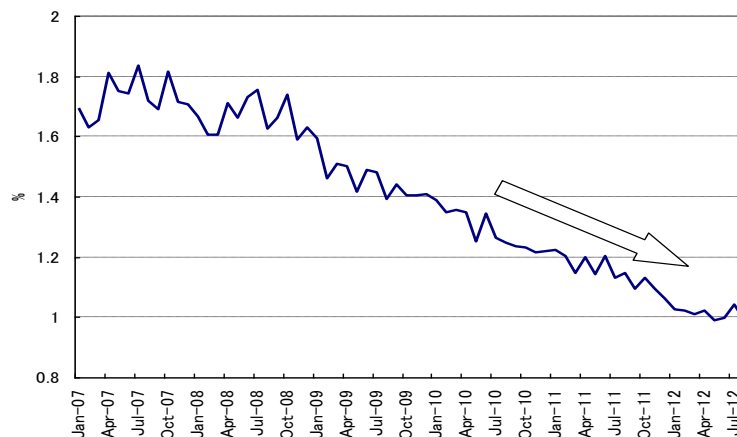
Source: Regional Banks Association of Japan for first regional banks, Second Association of Regional Banks for second regional banks, Shinkin Central Bank Research Institute for Shinkin banks, and disclosure materials for credit federation of agricultural cooperatives.

Deposit-Loan Gap and DI for Demand for Loans



Source: Bank of Japan

New long-term lending rate at domestic banks also falling gradually



Source: Bank of Japan



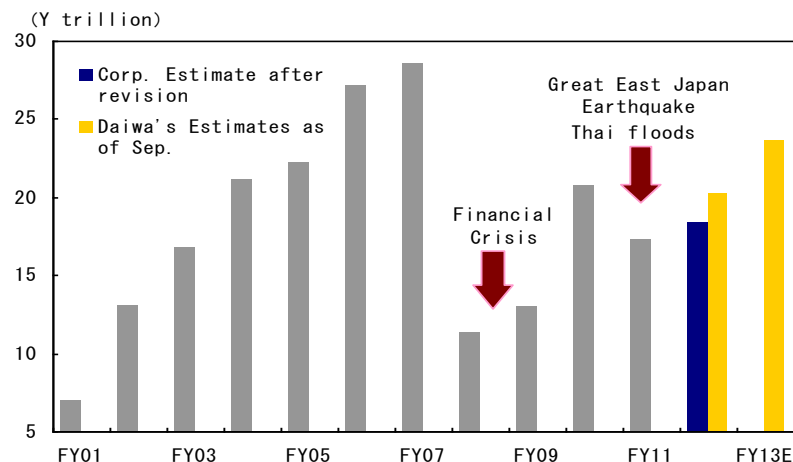
### 3. Stable Credit Fundamentals Across the Board

#### Credit Outlook by Sector

Sector	H2 FY2011	H1 FY2012	H2 FY 2012
Food & beverages	Stable	Stable	Stable
Paper & pulp	Stable	Stable	Slightly negative
Chemicals	Slightly negative	Slightly negative	Slightly negative
Iron/Steel	Slightly negative	Slightly negative	Slightly negative
Electrical machinery	Stable	Polarized	Polarized
Automobiles	Stable	Slightly positive	Slightly positive
Trading Companies	Slightly positive	Slightly positive	Stable
Retail	Stable	Stable	Stable
Consumer finance	Polarized	Polarized	Slightly positive
Credit Card	Stable	Slightly positive	Slightly positive
Leasing	Stable	Stable	Stable
Major banks	Stable	Stable	Stable
Regional banks	Stable	Stable	Stable
Construction	Stable	Stable	Stable
Real estate	Stable	Stable	Stable
REITs	Stable	Stable	Stable
Railways	Stable	Stable	Stable
Air transport	Slightly negative	Stable	Stable
Electric utilities	Slightly negative (excl. TEPCO)	Stable (excl. TEPCO)	Stable (incl. TEPCO)
Gas utilities	Stable	Stable	Stable
Telecom	Stable	Stable	Stable
FILP agencies	Stable	Stable	Stable
Municipals	Stable	Stable	Stable

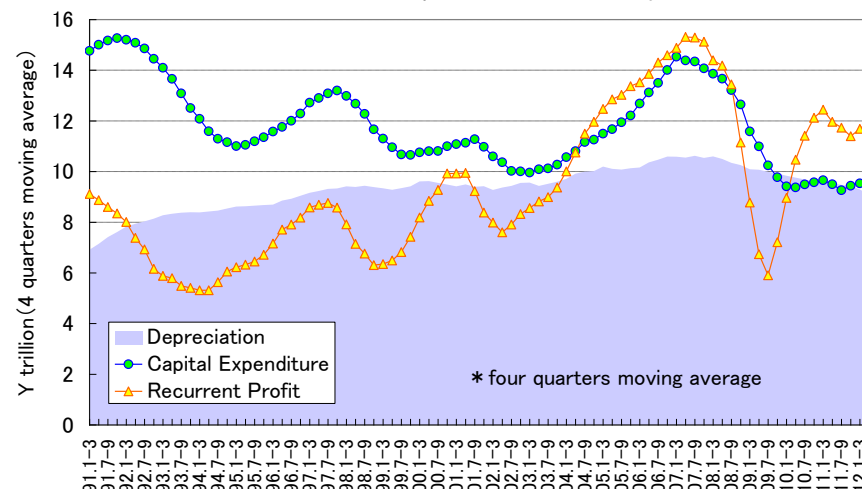
Note: Indicating not credit level but credit outlook for each sector's debt redemption capacity  
Source: Daiwa Securities

#### Recurring Profit Outlook for Daiwa 200



Source: Regular Earnings Survey (September 2012) by Daiwa Securities

#### Conservative Corporate Financial Policy

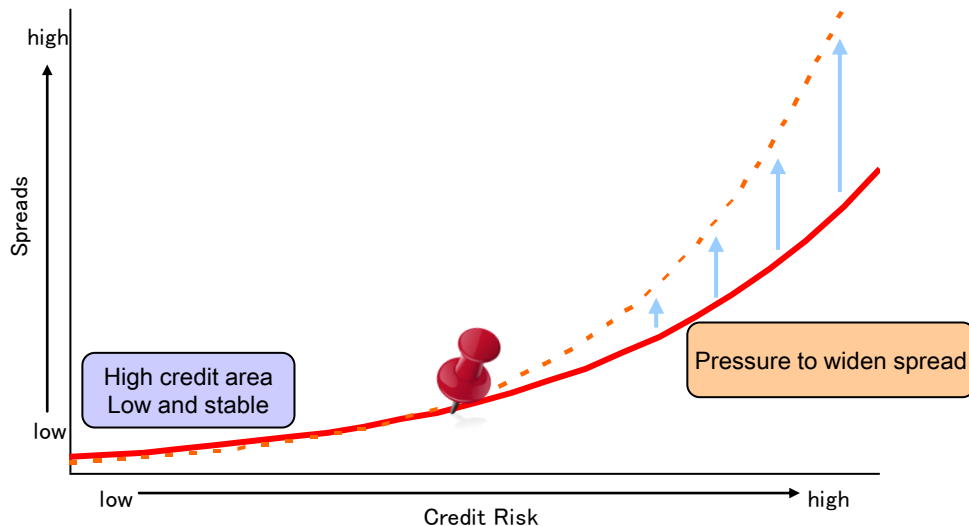


Source: Ministry of Finance; compiled by Daiwa Securities

# ■ Outlook for 2H Credit Market ⇒ “Ultra” Two-tier Picture to Continue and Flattening Area to Expand Gradually

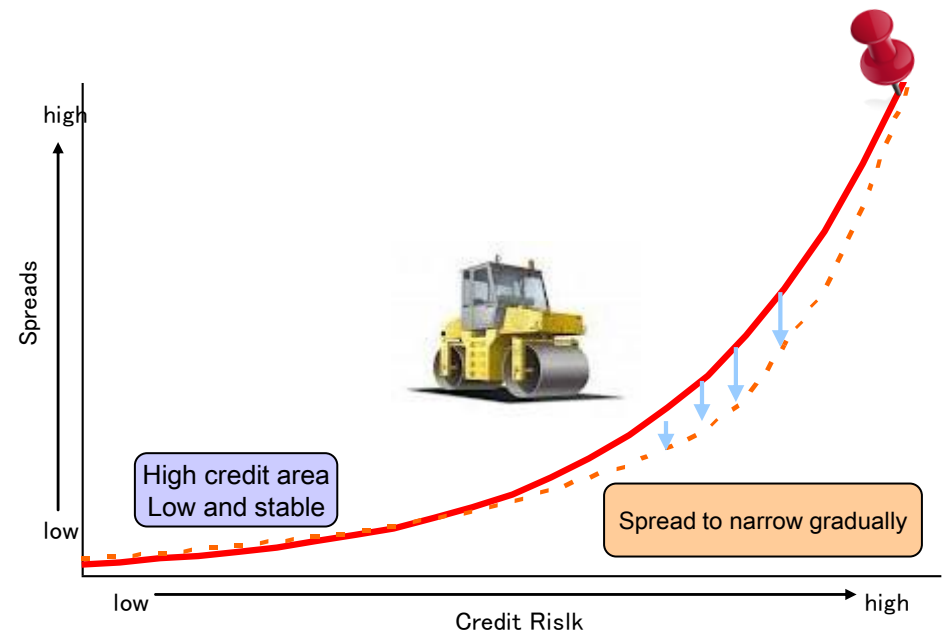
## 1H: Steepening of credit curve

- Diminished credit risk appetite due to low interest rates
- Cash: Recommended conservative management in high credit area
- CDS: Recommended companies in high credit area



## 2H: Flattening area likely to expand gradually

- Credit risk appetite to recover gradually
- Cash: Investors to start to take credit risk via company selection
- CDS: Focusing on companies having gap with cash bonds



Source: Daiwa Securities

# Electric Utility Sector : Paradigm Shift After Nuclear Plant Accident

## ■ New financial and business risks after TEPCO Fukushima nuclear power plant accident (11 Mar 2011)

- New financial risk : Risk on contingent liabilities (Burden of huge cost for compensation and decommissioning reactors)
- New business risk : Worsening earnings due to suspended nuclear power plants

Rating of Other Electric Utility Companies

【As of 23 Oct 2012】

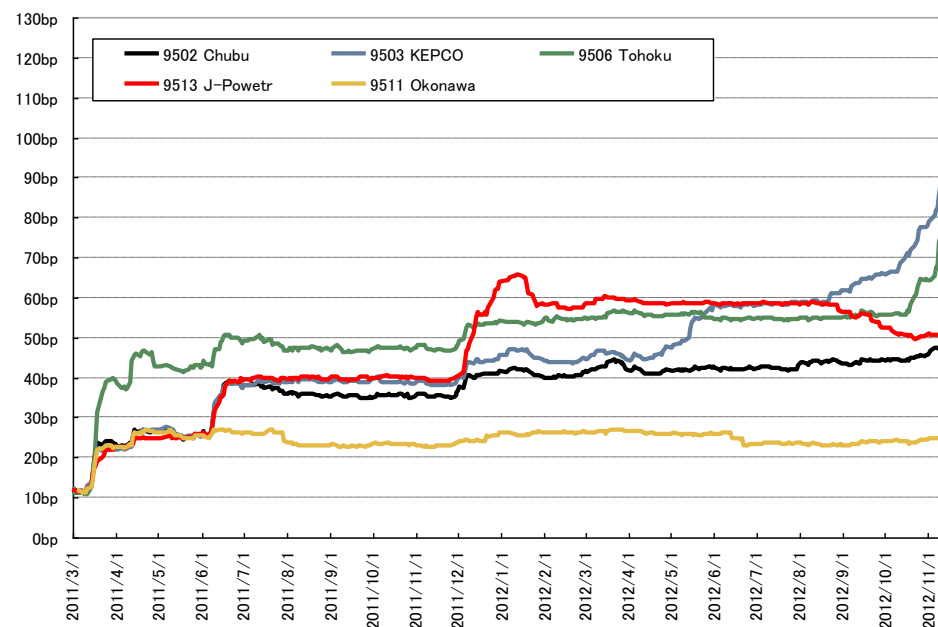
	R&I		JCR		MDY		S&P	
9502 Chubu	AA-	neg	-	-	A3	neg	A-	neg
9503 KEPCO	A+	neg	AA	neg	A3	neg	-	-
9504 Chugoku	AA-	neg	AA	neg	A3	neg	-	-
9505 Hokuriku	AA-	neg	AAp	neg	A3	neg	-	-
9506 Tohoku	A+	neg	AA	neg	-	-	-	-
9507 Shikoku	AA-	r↓	AAp	neg	-	-	A-	neg
9508 Kyusyu	A+	neg	AA	neg	A3	neg	-	-
9509 Hokkaido	AA-	r↓	AAp	neg	A3	neg	-	-
9511 Okinawa	AA+	neg	AAA	sta	Aa3	sta	AA-	neg
9513 J-Power	AA-	neg	AA+	neg	A1	neg	A	neg

【Before Great East Japan Earthquake】

	R&I		JCR		MDY		S&P	
9502 Chubu	AA+	sta	-	-	Aa2	sta	AA-	sta
9503 KEPCO	AA+	sta	AAA	sta	Aa2	sta	-	-
9504 Chugoku	AA+	sta	AAA	sta	Aa2	sta	-	-
9505 Hokuriku	AA+	sta	AAAp	sta	Aa2	sta	-	-
9506 Tohoku	AA+	sta	AAAp	sta	-	-	-	-
9507 Shikoku	AA+	sta	AAA	sta	-	-	AA-	sta
9508 Kyusyu	AA+	sta	AAA	sta	Aa2	sta	-	-
9509 Hokkaido	AA+	sta	AAAp	sta	Aa2	sta	-	-
9511 Okinawa	AA+	sta	AAA	sta	Aa2	sta	AA-	sta
9513 J-Power	AA+	sta	AAA	sta	Aa2	sta	AA-	sta

Source : Rating agencies; compiled by Daiwa Securities

Spreads of Other Electric Utility Bonds over JGBs (Ave: with 7-12Y maturities)



Source : Japan Securities Dealers Association; compiled by Daiwa Securities

# Short-term Outlook for Electric Utility Bonds

## ■ Progress in measures to cope with new financial and business risks

- Risk on contingent liabilities : Foundation of Nuclear Damage Liability Facilitation Fund (Establishment of insurance system for nuclear power plant accidents)
- Worsening earnings due to suspended nuclear power plants: Efforts to resume operations of nuclear power plants and rate hikes)

## ■ “General security ” assigned on electric utility bonds is last resort in investing in electric utility bonds General security is more senior than compensation claim and bank loan

- General security on bonds is “legal lien” next to first lien on the Civil Code ⇒ Japanese word is misleading
- Corporate bond with general security is the most senior: Senior to compensation claim and unsecured bank loan (if Corporate Reorganization Act is applied to bond issuer, corporate bond is categorized as “preferred reorganization claim” and compensation claim and unsecured bank loan as “general reorganization claim”

### Balance sheet at electric utility firm

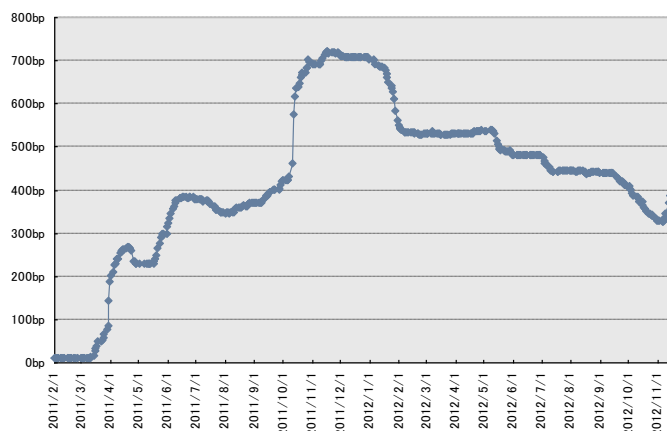
<b>【Asset】</b> Facilities for power generation, transmission, distribution, etc.	<b>【Corporate bonds】</b> with general security
	<b>【Bank loan】</b>
	<b>【Net asset】</b>

- Default risk is beyond the scope of assumption for now
- The lower the market price is, the more attractive as investment target

## Tokyo Electric Power (TEPCO) ( R&I : BBB↓、JCR : A/negative、Moody's : Ba2、S&P : BB+ )

TEPCO Bond Spread over JGBs (Ave: with 7-12Y maturities)

Note: Bond rating by Moody's and S&P.



Sources : Japan Securities Dealers Association, Daiwa Securities

- Eliminated doubt on going concern assumption
- Improved financial strength thanks to rate hikes and capital injection from government
- Virtually diminished risk of downgrading from JCR's single-A rating
- Market price is much cheaper than newly issued bonds which is privately-placed to banks

(Yield is only 1.02% for Privately-placed 5-year bond issued on 1 Aug 2012)

## Medium/Long-term Outlook for Electric Utility Bonds

### ■ Reform of electric utility business necessary, though it takes time

- Regulations on electricity rates (rates on small-lot users are still regulated) should be completely liberalized
- Business format integrating power generation, transmission, and distribution should be changed to that separating power generation from transmission/distribution
- As far as power generator bonds are concerned, general security uniformly assigned on electric utility bonds is to be abolished

- New evaluation criterion for electric utility bonds necessary over medium/long term

# Consumer Electronics Sector : Impact from Sharp's Troubles

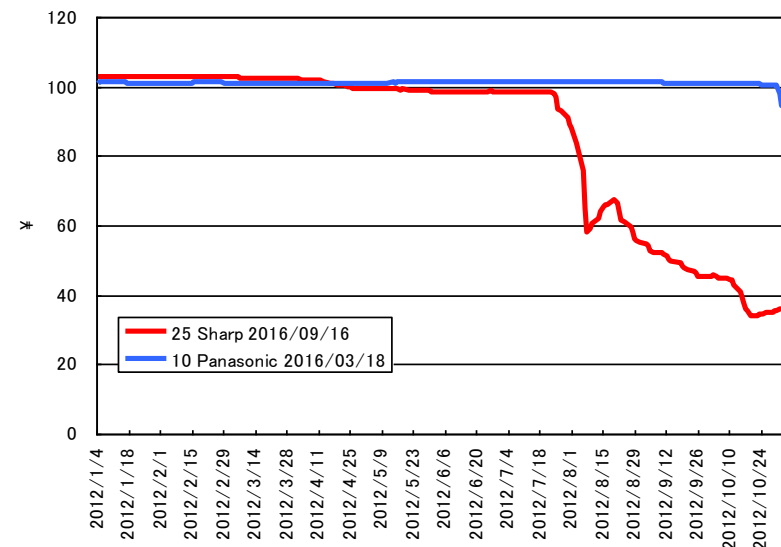
## ■ Consumer electronics firms facing needs to implement restructuring

- Panasonic, Sony, and Sharp in common need to implement business restructuring mainly in LCD/TV areas
- However, wide gap exists in stamina during restructuring (existence or non-existence of stable income sources, strength of balance sheet) and preparation for contingency (liquidity)

### Sharp's Troubles

- Heavy dependence on LCD/TV businesses backfired as they needed huge amount of capex together with high price volatility
- Significant downward revision to FY12 net loss estimate as of 1Q results release (from Y30 bil to Y250 bil)
- Mounting concerns about insufficient shareholders' equity and liquidity
- Plunge in rating since beginning of year ( R&I : A+⇒BB- (8-notch downgrade; bond rating), JCR : AA⇒BBB- (7-notch downgrade; corporate rating))
- Ongoing vicious spiral (downgrading ⇒ decline in market price ⇒ downgrading)

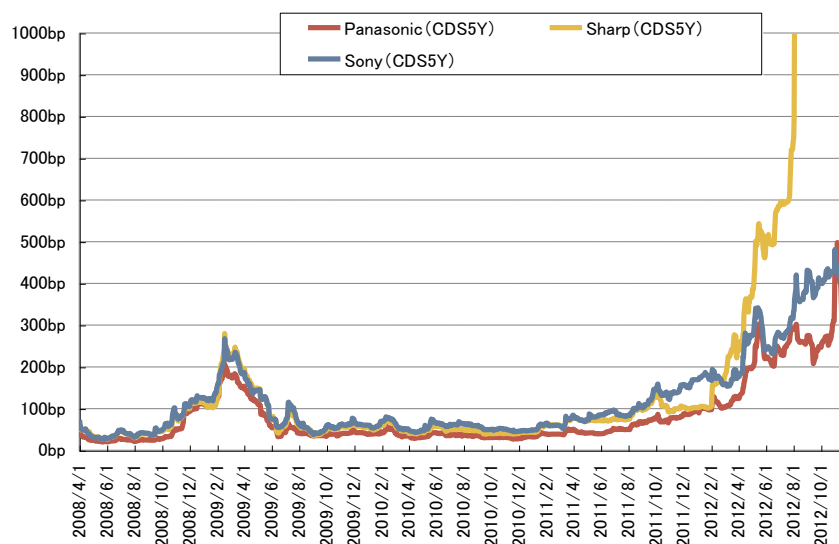
Sharp and Panasonic Bond Prices



Source : Japan Securities Dealers Association and Daiwa Securities

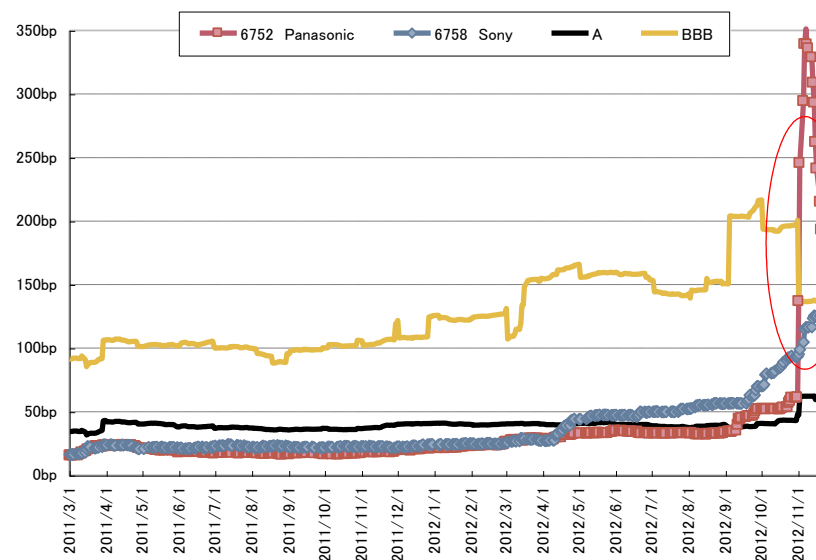
# Sharp's Troubles Negatively Affecting Other Corporate Bonds

CDS of Major Consumer Electronics Bonds (5Y)



Source: Markit and Daiwa Securities

Spread of Panasonic and Sony Bonds over JGBs (Ave. with 3-7Y maturities)



Source : Japan Securities Dealers Association and Daiwa Securities

## Credit assessment of Sharp and Panasonic

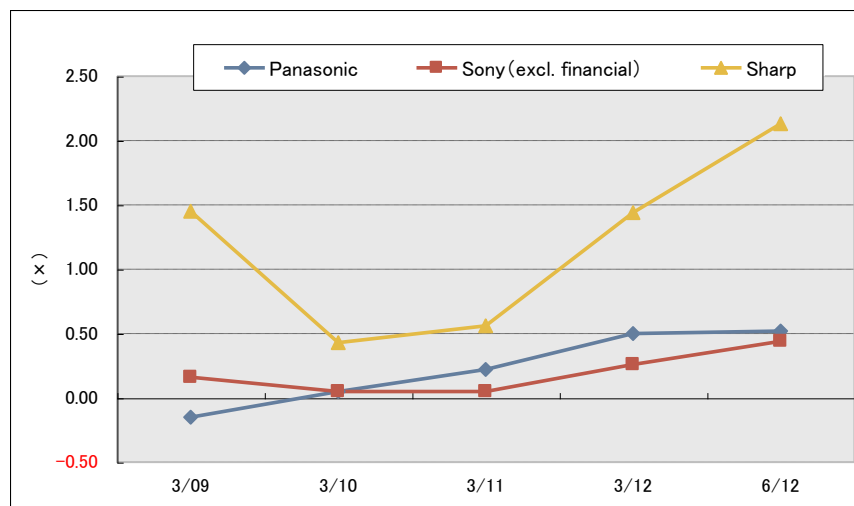
	Business Risk		Financial Risk		Rating
			B/S	Liquidity	
Panasonic	Short term	Expected Operating profit in FY12	Capital ratio will be about 20% at the end of FY12	Over Y1 trillion of liquidity on hand, including a credit line of Y600 billion	R&I : A-/st
	Mid term	focus on stable business such as Appliances			JCR : - MDY : Baa3/ng S&P : BBB/st
Sharp	Short term	Operating profit in FY12 is uncertain	Already, capital ratio is less than 10 %	massive funding needs for Y200 billion CB redemption	R&I : BB- ↓
	Mid term	Core business (S&M LCD panel) is still volatile			JCR : BBB- ↓ MDY : - S&P : B+ ↓

note: JCR rating of Sharp is for Corp. rating. Others are bond rating.

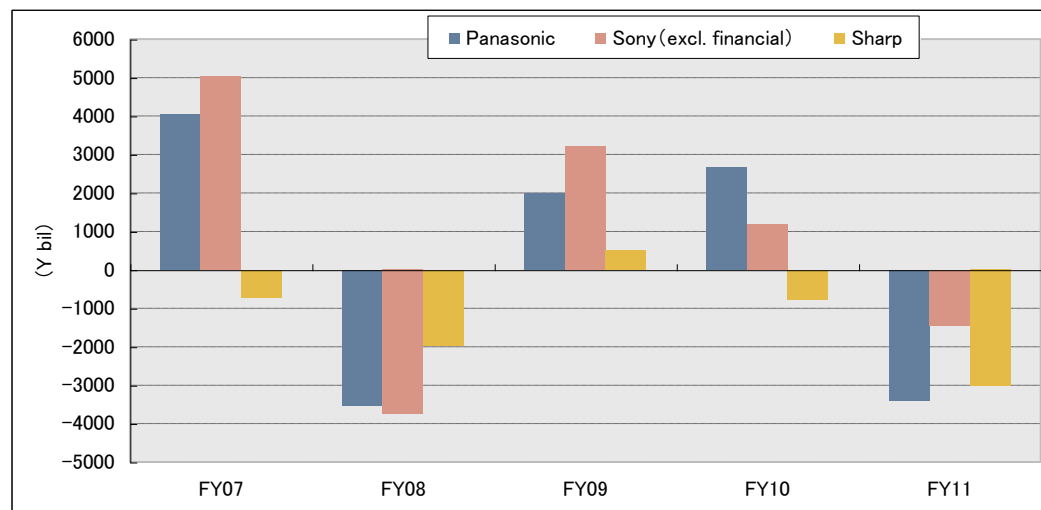
Source: Daiwa Securities, Rating companies

# Wide Gap in Credit Risk Indicators at Three Major Consumer Electronics Firms

【Net debt-to-equity ratio】

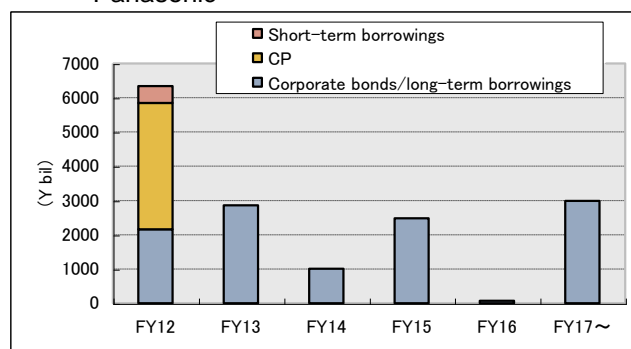


【Free cash flow】

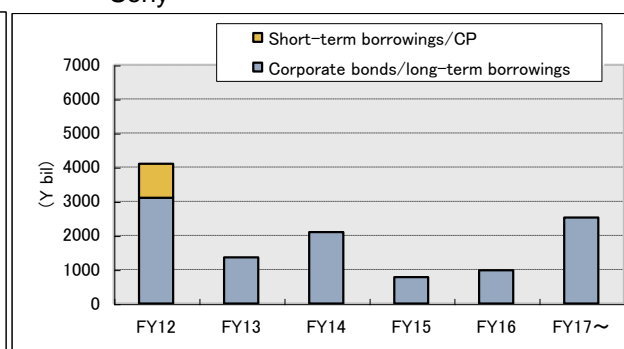


【Interest-bearing debt by maturity (as of Mar 2012)】

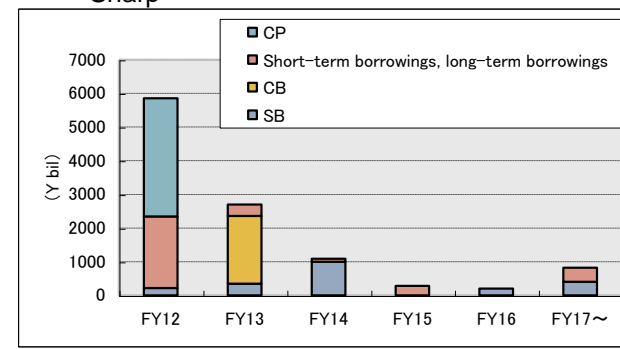
< Panasonic >



< Sony >



< Sharp >



Source: Company materials; compiled by Daiwa Securities



# What is Difference Between Sharp and Panasonic/Sony?

## Background of rapid and significant credibility erosion at Sharp

1. Heavy dependence on businesses necessitating huge amount of capex and having high price volatility. Earnings and balance sheet worsened rapidly due to lower prices.
2. Concentrated repayment timing of marketable fund, with high proportion of the amount to cash flow. Refinancing risk emerged due to shortage of prepared funds for contingency

## Different points at Panasonic and Sony

1. Stable, solid income sources exist, serving as buffer while loss-making businesses are restructured
2. Balance sheet enough to offset losses on valuation of risk assets
3. Taking some measures to expand liquidity on hand in preparation for contingency

At least over short term, credit outlook of Panasonic and Sony is stable

# What is Difference Between Panasonic and Sony?

## Outlook for business risk

1. Sony's medium-term business risk is more uncertain than peers as the firm looks to be still focusing on digital product business (B to C).
2. Panasonic's medium-term business risk is likely to diminish on beefing-up of appliances and scale-down of TV/panel businesses.

## Outlook for financial risk

1. Sony seems to have certain financial discipline in replacing business portfolio, but we doubt ability to generate positive free cash flow in FY12. With somewhat unclear financial targets, financial condition is unlikely to improve for the time being.
2. It seems difficult for Panasonic as well to improve financial balance significantly. However, expectations are increasing that company target (FCF of Y100 bil) will be achieved thanks to stable income sources and bleeding stop at troubled businesses.
3. Panasonic's financial targets at new medium-term business plan warrant attention. If the firm aims to return to positive net cash position, strict cash flow control stance would be foreseeable.

**Panasonic looks safe relative to Sony in terms of medium-term credit risk outlook**

## **Notification Items Regarding Advertising etc.**

**(Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law)**

If you decide to enter into a business arrangement with our company based on the information described in materials presented along with this cover letter, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission\* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction.

In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.

- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.  
Financial instruments firm: chief of Kanto Local The Finance Bureau (Kin-sho) No.108  
Memberships: Japan Securities Dealers Association  
The Financial Futures Association of Japan  
Japan Investment Advisers Association  
Type II Financial Instruments Firms Association