

Expressway companies

3-minute guide to investment in expressway companies' bonds

- Roles divided due to privatization—expressway companies in charge of “facility ops,” while JEHDRA in “facility holding and debt repayment”
- JEHDRA burdened with business risks and bond repayment at expressway companies
- Expressway companies' bonds issued in form of corporate bonds, but virtually equivalent to FILP agency bonds
- Issuance in form of corporate bonds and 20% risk weight enable undervalued investment

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Roles divided due to privatization—expressway companies in charge of “facility ops,” while JEHDRA in “facility holding and debt repayment”

Four former highway-related public corporations¹ (broken down by region) were privatized and reorganized into six expressway companies and Japan Expressway Holding and Debt Repayment Agency (JEHDRA) by the Koizumi administration. Since reorganization, six expressway companies² (broken down by region) have been in charge of “facility operations,” while JEHDRA has been involved in “facility holding and debt repayment.”

JEHDRA burdened with business risks and bond repayment at expressway companies

The main roles of expressway companies are (1) road management—i.e., toll collection, operations, maintenance, and repairs and (2) road construction. The point is that JEHDRA is burdened with risks on these two roles. Regarding the first, expressway companies borrow road assets from JEHDRA and pay leasing fees to JEHDRA using tolls collected from users. However, there is a framework in which leasing fees move in line with toll revenue. Once toll revenue increases, leasing fees also swell, and vice versa. In this structure, expressway companies basically book neither profits nor losses. As for the second, expressway companies construct roads by raising funds via bond issuance, but the completed road assets and corporate bonds are transferred to JEHDRA. As JEHDRA is in charge of repayment, its company name simply represents its role. Expressway companies are burdened with risks on operations of services areas/parking areas alone. However, as the scale is small, the financial impact is limited.

Expressway companies' bonds issued in form of corporate bonds, but virtually equivalent to FILP agency bonds

Expressway companies are joint-stock companies, not falling into the definition of FILP agencies. Accordingly, their bonds are corporate bonds “in form,” but they are virtually equivalent to FILP agency bonds. This is because (1) JEHDRA, a FILP agency, is burdened with business risks and debt repayment at expressway companies, (2) bonds issued by expressway companies are transferred to JEHDRA after completion of road construction, and they become FILP agency bonds in both name and reality, as mentioned above, and (3) expressway companies and JEHDRA are government agencies, which were established based on special acts via 100% funding from the government and local public bodies. In terms of creditworthiness, a key is whether issuers are government agencies. Whether issuers are FILP agencies, which obtain loans and government guarantees from the Ministry of Finance, is of minimal importance. As JEHDRA is involved in construction of expressways, which become national, prefectural, and city roads when they are provided as toll-free ones, its creditworthiness is reflecting its large public role. In addition, leasing fees from expressway companies make JEHDRA cash rich. Moreover, as JEHDRA is legally obligated to complete debt repayment by 2064, it is maintaining financial discipline.

¹ Japan Highway Public Corporation, Metropolitan Expressway Public Corporation, Hanshin Expressway Public Corporation, and Honshu-Shikoku Bridge Authority.

² East Nippon Expressway, Central Nippon Expressway, West Nippon Expressway, Metropolitan Expressway, Hanshin Expressway, and Honshu-Shikoku Bridge Expressway.

Issuance in form of corporate bonds and 20% risk weight enable undervalued investment

Expressway companies' bonds carry higher yields than FILP agency bonds because (1) they are issued not as FILP agency bonds but as corporate bonds and (2) the BIS risk weight³ is not 10% but 20%, the same as the weight of top-ranked business corporations, until the transfer to JEHDRA. If investors do not care about the form or risk weight, purchases of expressway companies bonds would realize undervalued investment in "de-facto" FILP agency bonds.

³ BIS stipulates that risk weight by asset class should be represented when total assets of financial institutions are calculated. Risk weight of sovereign and local public bonds is 0%, and that of government agencies is 10% if conditions are satisfied.

Explanatory Document of Unregistered Credit Ratings

In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

■ The Significance of Registration

Registered Credit Rating Agencies are subject to the following regulations:

- 1) Duty of good faith.
- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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■ Credit Rating Agencies

[Standard & Poor's]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: S&P Global Ratings ("Standard & Poor's")

The name and registration number of the Registered Credit Rating Agency in the group: S&P Global Ratings Japan Inc. (FSA commissioner (Rating) No.5)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating Information" (<http://www.standardandpoors.co.jp/unregistered>) in the "Library and Regulations" section on the website of S&P Global Ratings Japan Inc. (<http://www.standardandpoors.co.jp>)

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Credit ratings assigned by Standard & Poor's are statements of opinion on the future credit quality of specific issuers or issues as of the date they are expressed and they are not indexes which show the probability of the occurrence of the failure to pay by the issuer or a specific debt and do not guarantee creditworthiness. Credit ratings are not a recommendation to purchase, sell or hold any securities, or a statement of market liquidity or prices in the secondary market of any issues.

Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

Assumptions, Significance and Limitations of Credit Ratings

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Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

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[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")

The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

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The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (<https://www.fitchratings.co.jp/web/>)

Assumptions, Significance and Limitations of Credit Ratings

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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 this report, 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.

** The ratio of margin requirements etc. to the amount of the transaction 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.

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Chief of Kanto Local 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