

Japan Credit Rating Agency, Ltd. (JCR) announces the following credit rating.

JCR's Rating Review of City Gas Companies

JCR has reviewed its ratings on city gas companies and announced the results. The following are JCR's main rating viewpoints on the review of them. Please refer to JCR's press release 18-D-0120 to 18-D-0125 for ratings of individual city gas companies.

Rating Viewpoints

- (1) As a result of reviews of ratings on 6 city gas companies (TOKYO GAS CO., LTD., OSAKA GAS CO., LTD., TOHO GAS CO., LTD., HOKKAIDO GAS CO., LTD., HIROSHIMA GAS CO., LTD. and SAIBU GAS CO., LTD.), JCR affirmed all of their ratings with the same rating outlooks as before.
- (2) JCR, in its rating for city gas companies and other public utilities, places emphasis on their stable business bases under the government's regulation and protection. JCR has not changed this view since full liberalization of retail city gas market in April 2017. Although scope of regulations has been reduced due to progress of gas system reform, it has not caused any impact on the rating to date. However, trend of new entry to city gas retail market for household use differs depending on regions. JCR will substantively follow for each company changes to the conditions, including impact from progress of reforms on business base and competitive position with new entrants, to be reflected in rating.
- (3) In regions where there are new entrants, shift of existing customers to new entrants has occurred for household-use city gas. Given the number of such shifts and expansion of electricity retail sales business, however, JCR sees that impact of shift of existing customers to new entrants on city gas companies' profits is limited. The new entrants are in effect limited to local electric power companies (and their business partners), and such electric power companies have business development capabilities including raw materials procurement and are superior to city gas companies in terms of financial strength. In the midst of increasing pressure for price cut due to changes to the competitive environment, strengthening services other than price will be required for city gas companies to keep their established earnings bases. Considering that their having direct contacts with customers through security services for gas equipment is the ultimate strength in sales, JCR will pay attention to their working on maintenance of their customer bases, leveraging this strength, and the effects from these efforts.
- (4) Some city gas companies plan to make a high level of investments in the short and medium run towards diversifying their business portfolios such as overseas energy business or domestic investment on power utilities. Given this, their interest-bearing debt will increase going forward. JCR assumes, however, that they can avoid worsening their financial structure partly through accumulation of equity capital via periodic income. For large investments, JCR will confirm whether they can acquire cash flow commensurate with those investments from a medium- and long-term perspective. Each city gas company will continue to go forward with maintenance and expansion of pipeline network including investments in trunk lines. New demand development in the vicinity of new pipeline network is a common issue facing each city gas company to secure customer base under the liberalized energy market environment. JCR is paying attention to the progress.
- (5) In the changing competitive environment due to progress of gas system reform, alliances across industries with diverse enterprises in many areas, including raw materials procurement, power development, sales of city gas and electricity, offering various kinds of services, have been realized. Movements towards maintenance and expansion of customer bases through strengthening competitive strength in the midstream and downstream sectors in the value chain by leveraging alliances will increase in the future. In the city gas retail market, competition has been limited to competition among limited number of players inside individual regions due to constraint on pipeline network, but there is a case where a joint venture was established for the purpose of sales of city gas and electricity in regions other than regions where a company has its own pipeline network. Given that success or failure of these alliances may have impact on future earnings of each city gas company, JCR will closely watch the trend from a medium- and long-term perspective.

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