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Whole Business Securitization

1. Outline of Whole Business Securitization

A whole business securitization is a finance method backed by cash flows generated from "business" itself (or sometimes including cash flows generated from asset sale, etc.) rather than backed by "assets" (accounts receivables, leases receivables, etc.). It has a hybrid nature which holds characteristics of both a secured corporate finance and an asset securitization. The underlying assets are the summation of the expected cash flows generated from the business within a time limit of debt redemption, shares of stock of the operating company, which is the collateral, and its primary assets (production facilities, marketing facilities, etc.). Generally speaking, the business, which is suitable for a securitization, has the following characteristics in many cases:

(1) Its cash flows and earnings levels are high.

(2) Stabilities in business and its cash flows can be easily foreseen thanks to reasons such as a high entry barrier and a large market share.

(3) It is not impossible that its business operator is replaced with a third party.

(4) Speed of changes is relatively mild in order not to lose timing of exercise of control and not to impair effectiveness of monitoring by creditors.

2. General Scheme

The following measures are taken in order to ensure repayment of debts (bonds, loans, etc.) based on cash flows from the business (predictable cash flows including those from future asset sale).

(1) Measures for bankruptcy remoteness are taken so that the business cannot be easily caught up in legal bankruptcy proceedings against sponsor corporation, with the business being separated from its sponsor corporation.

(2) Measures to make it difficult to commence bankruptcy proceedings against the operating company (Opco) itself and measures to protect the creditors from the Opco bearing an unanticipated business risk are taken by restricting on business purpose and changes in organization such as merger or company split-off, causing therefore the Opco itself to become close to a kind of SPC (a special purpose company specializing in the business) in terms of nature.

(3) A vehicle (SPC or trust) for fundraising is established, and measures for bankruptcy remoteness and measures for prevention of a commingling of cash flows are taken here also.

(4) Arrangements, in which incentives and penalty are included so that cash flows from the business are generated stably as close to initial cash flow projection, are made.

(5) In consideration of a case where profitability of the business falls below the projection, a scheme, which allows a continuation of business, and an appointment of successor are arranged in order to

ensure continuity of the business.

(6) Liquidity facility or hedge against market risk (interest rate or currency) is arranged in order not to impair the continuity of the business as a result of temporary liquidity risk or refinance risk.

3. Rating Points

(1) Framework of rating analysis consists of the following:

(i) Analysis of the business.

(ii) Analysis of the robustness of the whole scheme from the point of view of legal matters and economic feasibility.

(iii) Analysis of cash flows from the business.

(iv) Analysis of problem area inherent in a whole business securitization and countermeasures against it.

(v) Assessment of asset sale in cases where such sale is scheduled for future cash flows.

In making an analysis (i) above, JCR makes analyses of external factors such as trend of business, its characteristics, industry structure, and competitive environment and internal factors such as positioning of the business, competitive strength, composition of sales or channels, managerial capability, business plan, asset value or leverage for each in detail.

(2) JCR assumes the following risks in addition to the matters to be kept in mind in securitization such as measures for bankruptcy remoteness for SPC, etc. and legal isolation from sponsor, and makes analyses of their impacts on debt redemption:

(i) Lower cash flows from the business and measures for this risk.

(ii) Lower entry barrier and lower margin as a result of competition.

(iii) Continuity of the business relies on the initial business operator or sponsor, and therefore risk of being influenced by it (them).

(3) In Japan, there are no such systems as a floating charge in the U.K. In corporate reorganization proceedings, risks such as limitations on exercise of a security interest or cancellation of a contract by a trustee are envisaged, and it is considered difficult to take a legally complete measure for bankruptcy remoteness. Therefore, even if there is a possibility that a petition for bankruptcy or corporate reorganization proceedings might be filed, measures to make its probability as small as possible by several policies including limitations on creditors are taken. JCR considers it necessary to examine robustness of the scheme in terms of legal aspect and economic feasibility together.

(4) In consideration of the characteristics of the business risks inherent in it, needs for periodic monitoring of the business movements, and in cases where its business performance is slumping, needs for monitoring of progress in its taking measures, having it take measures step-by-step in accordance with

the slumping conditions, become higher than in the case of ordinary type of asset securitization.

4. Principal Required Materials

(1) Materials on the Opco and the business (industry trend, business plan, financial statements, etc.)

(2) Materials on originator (sponsor) (financial statements, etc)

(3) Materials on scheme (term sheet, legal opinions, tax opinions, etc.)

Reference Report: "Whole Business Securitization and Act on Special Provisions of the Civil Code in Relation to Requirements for Perfection of Transfer of Movables and for Assertion of Assignment of Claims"
http://www.jcr.co.jp/rat_stru/pdf/20051101_s15.pdf

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