

Mutsutake Otsuka, President and CEO, talks about the current and future JR East.

FISCAL 2003

In retrospect, what are your impressions of the year ended March 31, 2003 (fiscal 2003)?

In June 2002, the government released its entire holdings of JR East shares into the market. This marked the start of a new era for JR East as a fully private company. Full privatization was the ultimate goal of the Japanese National Railways (JNR) restructuring plan, and JR East was the first of the JR companies to reach this milestone, in the 16th year of its establishment. Our task now is to keep JR East on a growth track that continues like rails stretching away forever. I am sure that fiscal 2003 will remain clear in our memories as a turning point in the history of JR East, both because of our achievement of full privatization, and also because of the realization of the important measures that I will describe shortly. Of course, a goal once achieved becomes just a station on a track leading to the next goal. We must not allow this milestone to obscure our vision of the new goals that we need to accomplish as we strive to build our future.

Management measures implemented in

fiscal 2003 include a major revising of our train schedules in December 2002. A major priority was the reinforcement of the Shinkansen and Tokyo metropolitan area networks, which are our key management resources. We further fulfilled our high-speed transportation network by extending the Tohoku Shinkansen line from Morioka to Hachinohe. This enhanced our ability to compete with air travel and dramatically improved the convenience of travel to the northern Tohoku region, which has wonderful tourism resources. We intend to market the new service aggressively to ensure to maximize the number of passengers traveling north on the *Hayate*, the name of our new Shinkansen railcar.

Enhancements to the Tokyo metropolitan area network included the introduction of through services with other railway companies, resulting in the establishment of a direct through service between the northern part of the Tokyo metropolitan area and the Tokyo Bay waterfront area. We also dramatically increased the frequency of trains on the Shonan-Shinjuku line, which started operation in December 2001 to link northern and

southern parts of the Tokyo metropolitan area directly. We have faced fierce competition with other railway companies on the Shonan-Shinjuku line, but further enhancements to the convenience of the service have brought considerable growth in passenger numbers.

Also in the Tokyo metropolitan area, the *Suica* IC card automatic fare collecting system, which allows passengers to pass through automatic fare collecting gates using IC cards, has been even more popular than we anticipated. The system was introduced only one and a half years ago, yet there are already more than 6.5 million users. This growth is proof of the major benefits that the system offers to passengers. We plan further fulfillment of the functionality of the cards.

Apart from the transportation business, our other main field of involvement is *lifestyle service businesses* (non-transportation businesses). Our most important management resource in this business field is our stations, and we worked dynamically under the *Station Renaissance* program to ensure that we utilize these assets to their full potential. We also continued to develop other foundations for future growth, includ-

Note: Yen figures have been translated to U.S. dollars at the rate of ¥120 to US\$1 as of March 31, 2003, solely as a convenience to readers.

Because of the achievement of full privatization and realization of the important measures, fiscal 2003 will remain clear in our memories as a turning point in the history of JR East. But, of course, a goal once achieved becomes just a station on a track leading to the next goal.

Mutsutake Otsuka
President and CEO



ing the opening of new hotels and the expansion of existing ones.

Fiscal 2003 was a very memorable year for us. Not only as it was a major turning point in the history of JR East, but it was also a year in which various initiatives helped us to achieve record earnings.

THE BENEFITS OF FULL PRIVATIZATION

What specific changes have resulted from the achievement of full privatization?

The most important change is that we no longer face the risk of political or governmental intervention in our management. Even if we come under pressure from politicians or officials in the future, we will be able to base our decisions on a clearer commitment to the enhancement of shareholder value.

Previously we required the approval of the Minister of Land, Infrastructure and Transport for important management decisions. Because that approval is no longer required, we can manage our business activities with a greater sense of speed and flexibility. For example, by the Board of Directors' decision, I, as president, can decide to finance through bond issues or

other methods up to a ceiling of ¥400.0 billion (\$3,333 million) in fiscal 2004 by my judgement, over timing and terms. We are also able to act more quickly on the disposal of major assets. In fiscal 2003 proceeds from fixed asset sales amounted to more than ¥80 billion. These sales made a major contribution to the slimming of assets and reduction of total long-term debt.

Full privatization has greatly enhanced our freedom to manage our business activities. We will use that freedom to the full to meet the expectations of our shareholders, investors and customers.

MEDIUM-TERM BUSINESS PLAN

The medium-term business plan *New Frontier 21* has established targets through fiscal 2006. How would you assess progress to date?

New Frontier 21 is a five-year plan. We are now in its third year, and I believe that we have made good progress. We have identified five numerical goals, and in November 2001 we raised our targets for two of these: free cash flows and the reduction of non-consolidated total long-term debt. Of course, new

challenges are always emerging, and we must continue to move forward by identifying and overcoming them. Fiscal 2004 will be an extremely important year, since it marks the halfway point in the plan. It is a time to reflect on what we have achieved so far, carefully assess new issues, and build momentum for the achievement of the target.

This is also a time when we need to think about the future beyond *New Frontier 21*, that is, after April 2006. When managing a company, I think that it is important to maintain multiple time frames, such as the current year, the medium-term perspective encompassing the next three years, and a longer-term view covering five or six years. With many of the measures that we implement in railway operations, a considerable period of time from concept to realization is needed. We therefore need to look to the future by making early preparations or taking specific measures.

We have already announced a number of initiatives. I referred earlier to the Shonan-Shinjuku line, and we now have started work on another direct line, the Tohoku through line, that will also link the northern

We made excellent progress in the first two years of *New Frontier 21*.



and southern parts of the Tokyo metropolitan area via central Tokyo.

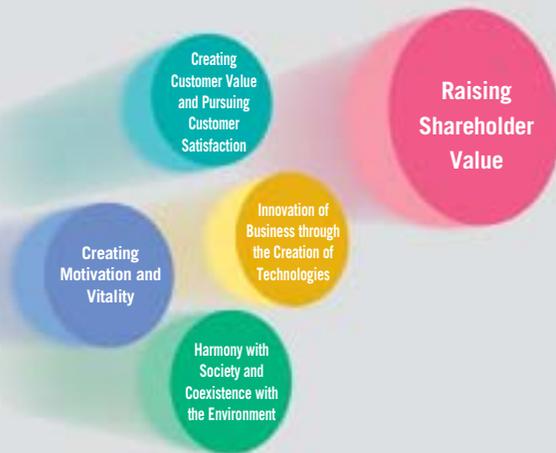
We also plan major initiatives in the *life-style service businesses*. This includes large-scale development projects around Tokyo station, which is one of Japan's most important landmarks. We are now making preparations for these projects, which will involve the effective use of our management resources to build an important income stream for the future.

New Frontier 21

Medium-Term Business Plan of JR East

Overview

In November 2000, JR East announced a medium-term business plan called *New Frontier 21*, which will cover the five-year period extending from fiscal 2002 to fiscal 2006. The plan targets a critical point in JR East's development, setting forth a vision and a concrete action plan. All actions are aimed at withstanding the dramatic changes in the group's highly competitive operating environment.



Group Vision

In this plan, our vision is to become a *Trusted Life-Style Service Creating Group*. We will strengthen our management base and push ahead with reforms to realize this vision. In particular, we will steer our operations to meet the following five criteria:

I. Creating Customer Value and Pursuing Customer Satisfaction

(Building a corporate group for providing customers with "trust," "comfort" and "excitement.")

The starting point for the development of JR East is our customers. Based on this awareness, we will commit ourselves thoroughly to a customer orientation, unite the creation of new customer value and seek to gain a higher level of appreciation from our customers.

II. Innovation of Business through the Creation of Technologies

(Building a corporate group for the integration of advanced technologies.)

JR East will integrate advanced technologies in order to create new added value and thereby refine our railway businesses. Our goal shall be to become the "World's Number-one Railway" in terms of safety, convenience, promotion of advanced technologies, comfort and efficiency.

III. Harmony with Society and Coexistence with the Environment

(Building a corporate group which harmonizes with society and gains the respect of the global community.)

While pursuing social missions such as coping with global environmental problems and the rapid aging of society, we will also maintain a fair stance towards global competition. We will enhance management transparency and go forward as a corporate group open to the world.

IV. Creating Motivation and Vitality

(Building a corporate group offering a working motivation and a sense of accomplishment through a free and liberal approach to work.)

These initiatives involve time frames that will go quite beyond the *New Frontier 21* period, but they will start working in earnest from fiscal 2004. I certainly do not intend to content myself simply with a successful conclusion to *New Frontier 21* in fiscal 2006.

SAFETY

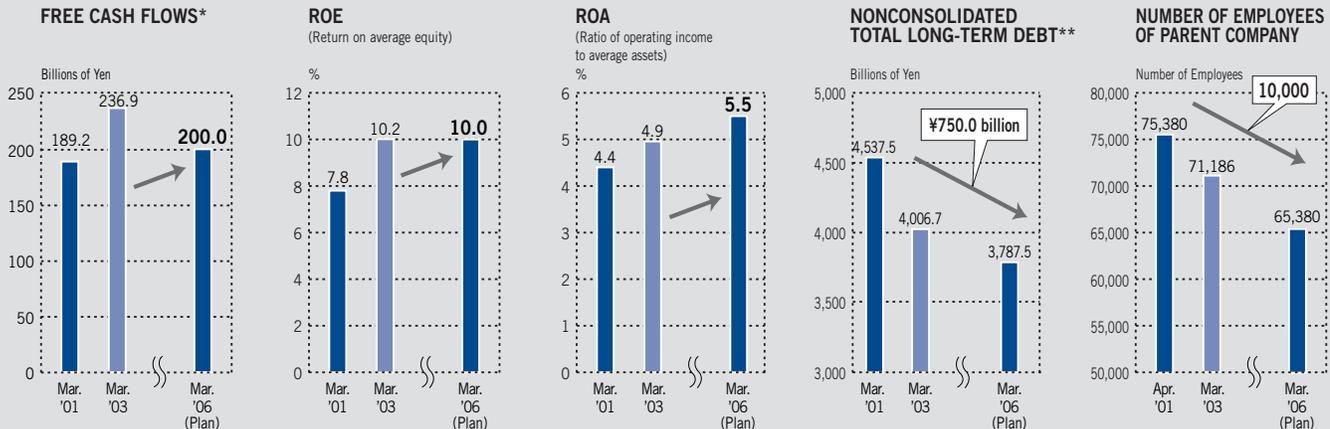
You have spoken about past achievements and future-oriented initiatives. But one

aspect of JR East's basic philosophy that never changes is its commitment to ensuring safety. What is your thinking on safety?

Since the end of the 20th century, companies in many countries have been shaken by a series of shocking scandals that have devastated their reputations overnight. I am convinced that the only companies to survive in the 21st century will be those in which the public can feel a genuine sense of trust and

confidence. I have thought carefully about this, and my conclusion is that the trust that our customers place in us is based above all on the safety and reliability of our railway operations. Ensuring safety is therefore our most important management priority.

Ensuring safety has been the focus of relentless effort for JR East ever since its establishment. Yet there can never be an absolute guarantee that accidents will not



* The original target for free cash flows was ¥180.0 billion. It was raised to ¥200.0 billion in November 2001.

** The original target for total long-term debt was ¥500.0 billion in five years. It was raised to ¥750.0 billion in five years and ¥500.0 billion in the first three years in November 2001. The target for the first three years has already been achieved in two years.

V. Raising Shareholder Value

(Building a corporate group meeting shareholder expectations through the improvement of consolidated performance.)

We have set our five numerical goals as above.

Strategies to Transform the Vision into Reality

We have formulated a number of business strategies for the purpose of fulfilling our *New Frontier 21* vision. First is our *Station Renaissance* program, which aims to achieve the best possible allocation of group business activities at railway stations, our greatest asset. Naturally, this requires that we conduct an exhaustive review of the layout of station facilities to open up new space for business activities. Another element of our *Station Renaissance* program is large-scale developments at main stations in the Tokyo metropolitan area.

Another strategy is to utilize IT and other new technologies.

One example is the creation of a new railway operating system by drawing on a broad range of IT resources. The system will improve the safety and accuracy of our railway operations. Another is the creation of business models that give us a substantial advantage over competitors making the most of our infrastructure, which is ideally suited for IT-oriented businesses. As a central part of this drive, we will use our IC card, *Suica*, which was introduced in 2001, to offer cashless and ticketless transportation services. Many other new businesses are on the drawing board.

In railway operations, we will concentrate on making more gains in safety and service quality and on improving our operating system, such as by strengthening our service network. In *life-style service businesses*, we will focus our resources on businesses where we can achieve synergies with our railway operations and where we have competitive superiority. Strategic alliances with partners outside JR East and the realignment of group companies will be central to this drive.

Our goal is to be the “World’s Number-one Railway.” We measure our achievement of that goal through comparisons not with other companies, but against our own criteria.



happen. I regard safety as a continuing and endless series of challenging issues. Our ideal is to have zero accidents and zero delays.

There were 376 accidents in fiscal 1988, when JR East was established. By fiscal 2003, we had reduced this number by more than two-thirds, to 111. Our average delay per Shinkansen train is 0.3 minutes. We have achieved an extremely accurate level by international standards. As professionals, however, we must continue to meet the challenge. Our goal is to be the “World’s Number-one Railway.” We measure our achievement of that goal through comparisons not with other companies, but against our own criteria.

Another difficult issue is the fact that the concept of safety from the perspective of railway professionals is not always the same as the way safety is perceived by passengers, that is, peace of mind. We can claim that our services are safe, but such claims are meaningless unless customers can sense that safety for themselves. Full information disclosure is crucial to this. We need to align our percep-

tions as closely as possible with the perceptions of customers.

EFFICIENCY

Although ensuring safety is your first priority, you are also working thoroughly to optimize efficiency. What progress have you made in this area?

Companies exist to earn profits, so efficiency must also be an eternal quest. We aim to achieve the triple goals of improved safety, improved convenience and improved efficiency at the same time. It would be absolutely meaningless for us to improve efficiency at the expense of safety. And we would fail as a business if we tried to ensure safety through massive capital investment that resulted in excessive expenditure. Ideally, efficiency improvements should lead to enhanced safety and better services.

When JR East was established in 1987, we had 72,000 employees working in railway operations. Today we have around 48,500. Yet there has been an increase of over 20% in our production of transportation services, as measured in rolling stock

kilometers. These figures represent a dramatic improvement in labor productivity. As I mentioned earlier, we also have reduced our accident rate by two-thirds. In other words, we have simultaneously improved safety, convenience and efficiency. These achievements have resulted from the development and introduction of new technology. We will continue to make improvements.

This process of improvement is illustrated by a recent initiative. When we revised our train schedules in December 2002, we basically eliminated on-board ticket inspections on Shinkansen trains. Conductors no longer need to inspect passengers’ tickets, since ticket information is transmitted to their portable terminals instantly when passengers pass through automatic fare collecting gates at stations. This system is extremely popular, since it allows passengers to relax in our trains without being disturbed for ticket inspections. It has also reduced conductors’ workloads, allowing us to reduce the number of conductors required. By using information technology (IT), we have been able to improve both service quality and efficiency.

We do not see the *Suica* card as something that people will use only when traveling on trains. I call this the “dream card” because it has so many possibilities.



In addition to efficiency measures targeting railway operations, you have been working energetically to reduce costs across the entire group. What has been the effect of those efforts?

We have around 100 consolidated subsidiaries. Our aim is to maximize synergy effects through ideas and measures that allow these companies to share their management resources effectively.

For example, group companies previously arranged financing, invested funds and settled payments individually. These tasks have now been integrated under our new Cash Management System, which is designed to improve financial efficiency and reduce interest-bearing debt at the group level.

Similarly, we believe that there is considerable scope for optimization of our merchandise flows, logistics and systems through integration. We have already taken the first steps toward this goal, including the establishment of a subsidiary that is specialized for that purpose.

Our group-level efforts are not limited to cost cutting. We want to strengthen

group-level planning and management capabilities so that our total resources and capabilities can be applied in various ways. For example, subsidiaries in various business areas could use railway-business related events as sales opportunities. We also want to use our group resources to recruit attractive leading tenants for the shopping centers at stations in areas remote from Tokyo.

Suica

One of your more aggressive strategies has been the introduction of the highly successful *Suica* system. What is your vision for the future of this system?

The number of *Suica* cardholders has increased steadily since the introduction of the system in November 2001. By early June 2003 the number of cardholders already exceeded 6.5 million. The pace of growth has been much faster than we anticipated. The public has responded enthusiastically to the convenience of *Suica*.

I want *Suica* to be a card that will continue to evolve every year as we add more and more new functions.

In July 2003, we started the services of the *View Suica* card, which integrates *Suica* functions with the JR East credit card, the *View Card*. A single card can be used both for rail travel and shopping.

From the autumn of 2003, *Suica* cardholders will be able to use their cards on some parts of Shinkansen lines and in the Sendai urban area. We also plan to integrate other transportation facilities into the system. West Japan Railway Company has announced that it will introduce an IC card identical to *Suica* in the near future, and we have already started discussions with other railway companies in the Tokyo region about the development of a common system.

In the spring of 2004, we plan to launch an electronic money service on the *Suica* system. Initially, customers will be able to use their *Suica* cards in stores at our stations. Electronic money has gained only limited acceptance in Japan in the past. The biggest reason for that is that people don't know the locations in which electronic money services can be used. In principle, our system will be usable in outlets at our stations, where 16 million passengers embark every day.

I know that JR East can both maintain stability and achieve its growth potential.



I believe that this will give the public greater confidence in electronic money. It will then be possible to extend the system to other shopping areas in cities as well.

We have also developed a building entry/exit control system based on *Suica*. We intend to promote this system for use in a wide range of buildings, introducing it in an office building that we will open in the spring of 2004 at Shinagawa station.

Another concept that we are studying is a *Suica* IC chip for insertion in mobile telephones. We call this concept *Mobile Suica*.

The *Suica* IC chip has huge capacity. By using the power of this chip to the full, we will turn the *Suica* dream card into a reality. I have very high expectations for this technology.

HUMAN RESOURCE DEVELOPMENT

Human resources are vital to the successful implementation of your wide-ranging measures in the various fields in which JR East is involved. What are your views on human resource development?

There is an old saying in Japan that businesses are built of people. That is very

true. To achieve continuing growth in our transportation business and *life-style service businesses* as the two driving wheels, we need to develop human resources with specialist knowledge and skills in these two core businesses. That is why we have started to recruit and evaluate personnel within each field. In addition to our intakes of new graduates, we have stepped up our recruitment of people who are already in the work force. Such people can make an immediate contribution to our business operations, and they also bring stimulating new ideas and energy to our organization.

In April 2000, we opened the JR East General Education Center. This is one of the biggest employee training facilities in Japan, and a maximum of 1,200 employees per day attend a wide range of courses. The effectiveness of course content is continually assessed and reviewed. Education based on visual and physical experience is especially effective for safety training, so we have installed simulators and other equipment. We have also established a unique museum of accident history, including those involving other railway companies

as well as ourselves, so that we can learn from the lessons of the past.

FINANCIAL POLICIES

What is your approach to financial policies and measures, including the policy on reduction of total long-term debt?

We inherited huge debts from the JNR. With the inclusion of the liability incurred in the purchase of the Tohoku and Joetsu Shinkansen lines in 1991, those total long-term debts amounted to ¥6.4 trillion. The reduction of total long-term debt has been one of the major management issues throughout the 16 years since the establishment of JR East. By March 31, 2003, we had reduced our outstanding total long-term debt to around ¥4.0 trillion.

The initial target under our current medium-term business plan *New Frontier 21* was to reduce debt by ¥500.0 billion over the five-year period of the plan. However, we achieved this in the first two years, and in fiscal 2002 we had already increased the target to ¥750.0 billion. I believe that this target is within reach.

Shareholders frequently ask me how far we intend to reduce debt and how long we intend to give priority to debt reduction. At present we are benefiting from historically low interest rates, but interest rates could rebound at any time. My basic thinking is that we must continue to give priority to debt reduction for the time being in order to reduce our exposure to this risk.

However, I also think that the time has come to look at our dividend policy. That is why we decided to pay a special dividend of ¥3,000 (\$25) per share to commemorate the completion of full privatization, in addition to the ordinary dividend of ¥5,000 (\$42) per share. This brings the total dividend for fiscal 2003 to ¥8,000 (\$67) per share. There will be no special dividend in fiscal 2004, but we hope to increase the ordinary dividend to ¥6,000 per share. These decisions are based on our judgment that we can combine a dividend increase with a ¥750.0 billion reduction in non-consolidated total long-term debt over five years, which is one of the numerical targets for *New Frontier 21*.

We will continue to optimize our capital structure and dividend policy while maintaining compatibility between financial policies and our business strategies in these areas.

FUTURE OUTLOOK

Finally, what are your hopes and expectations for the future?

We made excellent progress in the first two years of *New Frontier 21*. We have no time for complacency, however, and we will continue to strive toward ever-higher goals. In this sense, I believe that fiscal 2004 will be an extremely important year. There are still many issues ahead as we strive to build JR East into a corporate group that can earn the trust, patronage and admiration of the public. We must meet each of these issues in turn. We have already made huge progress toward the achievement of the *New Frontier 21* goals, but I am looking beyond that horizon to even more ambitious goals. I believe that we are laying the foundations for sustainable growth in the future.

My vision for JR East is a corporate group capable of combining stability with

growth potential. On the surface, these goals may seem mutually exclusive, but I reject that view. By developing an extremely stable management infrastructure, revenue flow and profitability base, we can build a foundation from which we can achieve growth by accepting a wide range of new challenges. I know that JR East can achieve both stability and growth potential.

JR East operates in a difficult and complex business environment. In addition to prolonged economic stagnation and escalating market competition, Japan's population is to start declining in 2006. We cannot afford to be complacent about the future. That is why we are working relentlessly to build a structure capable of generating sustained earnings in this environment, so that we can meet the expectations of shareholders and investors. JR East has a bright future. We look forward to your continuing understanding and support.