December 13, 2024
East Japan Railway Company

Condensed Transcript from Q&A Session of Small Meetings

1. Summary of Implementation

Dates: December 11 and 13, 2024

Attendees: Yoichi Kise, President and CEO
Atsuko Itoh, Executive Director
Yuichi Matsumoto, Executive Officer and Department Director of Corporate Planning Department
Hiroaki Sakai, Department Director of Finance & Investment Planning Department

2. Condensed Transcript from Q&A Session

* Please note that the following is not a verbatim transcript of the question-and-answer session but a concise summary prepared at the discretion of the Company.

[Management Policy]

Q: I see that the Company is trying to change. Why do you want to change your company? Also, how do you want to change the company in the future?

A: The driving force behind the desire to change the Company is a sense of crisis that things cannot continue as they are. The current management team is of the generation that joined the Company after privatization, and we joined JR East because we saw the potential of JR East beyond just the railway business. We would like to realize our dream of making JR East a comprehensive lifestyle service company that also has a railway business, and a company that can have contact with many customers through various businesses because it has a railway business. We want to change the company into one that can promote business from a market-in perspective with a sense of speed.

Q: How do employees perceive management's desire to change the company?

A: Now, each of the operational sites is giving the company a boost. As a result of the retirement of most JNR-hired employees at the end of March 2024, JR-hired employees are beginning to proactively take on challenges. For example, the "Hako-byun" (logistics services) and produce markets, which used to be led by the head office, headquarters, and branch offices, have recently been implemented at the initiative of employees of the operational sites, and various other initiatives are being actively developed by employees.

Q: There have been problems of improper handling associated with wheel axle assembly operations, etc., but do you think the current safety awareness is sufficient? The fact that the same events as in the past have occurred again means that governance for safety is not working, so I fell that you need to fundamentally change the employees' mindset.

A: We recognize that safety is truly a matter of awareness. If the entire group had been able to share the lessons learned in the past, it is possible that this incident could have been prevented, and we regret that we were overconfident as railway professionals. We gathered all of our executives and the presidents of all group companies to reiterate thoroughly that this incident was not a problem limited to the railway business. In addition, our management team visits each workplace to deliver the message, and I (the president) myself deliver the message during compliance training for all employees.

As top management, we will continue to visit each workplace to check employee perceptions while striving to raise awareness.

[Next management vision]

Q: What kind of discussions are taking place regarding the next management vision, including the time frame?

A: As a medium- to long-term vision, we are considering making it a management vision for the next 10 years or so with backcasting, looking ahead to around 2050. The Company is considering setting the target figures on a time line that incorporates the full opening of TAKANAWA GATEWAY CITY and the opening of the Haneda Airport Access Line (tentative name).

Q: What are your thoughts on numerical targets in the next management vision?

A: From the perspective of smooth dialogue with the capital market, we are considering setting an ROE target and would like to aim for a double-digit level.

We are also discussing how the net interest-bearing debt to EBITDA ratio should be appropriate for the dual-axis management of Mobility and Lifestyle solutions. In light of the fact that strategies and KPIs are being formulated for 14 separate businesses from this fiscal year, we would like to set them at a finer granularity rather than uniformly across the entire company.

[Management conscious of cost of capital and stock price]

Q: How will you achieve ROE improvement?

A: Since we hold a large number of assets, mainly in the railway business, we aim to improve ROE mainly through higher ROA, and there is no change in this policy. Rather than improving ROE through excessive financial leverage, we aim to improve ROE as well by improving ROA.

Q: Will the concept of the net interest-bearing debt to EBITDA ratio remain the same at "about 5 times in the medium term and 3.5 times in the long term"? Is it necessary to aim "about 3.5 times in the long term"?

A: The current target regarding the net interest-bearing debt to EBITDA ratio is based on a railway business-centric approach. In promoting dual-axis management going forward, we would like to consider how interest-bearing debt should be divided between the two axes of Mobility and Lifestyle solutions. Looking at examples of other companies, the real estate business has been able to obtain the same level of ratings even at multiples higher than 5 times. We will present targets based on the current study in the next management vision, and we also want to be able to take an aggressive stance, including the idea of allocating the cash we raise to investments for growth.

Q: What exactly is the Company's portfolio strategy?

A: Starting this year, we have divided the four segments into 14 businesses and are working to clarify the strengths and weaknesses of each business. In shifting from a railway business-centered management to a two-axis management, we believe that each business needs to grow by aiming to maximize consolidated cash flow through trying to increase cash-in from outside the Group and reduce cash-out to outside the Group.

Q: What is your approach to setting KPIs for segments and businesses?

A: Various KPIs were set when "Move Up" 2027 was formulated, but some of them were not clear how they would lead to increased corporate value, so they have been reviewed from time to time. In addition to the targets set internally for each business, the Company aims to achieve growth through the achievement of KPIs for each segment as announced in the annual management strategy.

[Cash Allocation]

Q: Hasn't the Company earned income commensurate with the large amount of capital investment it has made to date?

A: In-house investment decisions are made after considering the efficiency and business profitability of the investment. In the future, we will consider how to present the information in a way that is easy to understand from outside the Company.

Q: What will be the scale of investment after the TAKANAWA GATEWAY CITY development is completed?

A: TAKANAWA GATEWAY CITY development (phase 1) will peak in FY2026.3, after which there are no development projects of the same scale as the TAKANAWA planned for time being. On the other hand, the company has a sufficient development pipeline for the next 10 years or so, and will make the necessary growth investments to generate future cash flows. We expect that the scale of investment will be approx. 600 to 700 billion yen per year. The cash allocation, which incorporates these factors, will be presented in the next management vision.

Q: Regarding shareholder returns, is there a possibility of raising the "dividend payout ratio of 30% and total return ratio of 40%" that you have set as a medium- to long-term goal?

A: We will first aim for a dividend payout ratio of 30% and a total return ratio of 40%, taking into account that the cash situation will change since FY2027.3, after the development of TAKANAWA GATEWAY CITY and OIMACHI TRACKS is completed.

[Shareholdings in selected companies]

Q: What is your policy on reducing shareholdings in selected companies?

A: We have clearly stated in our Corporate Governance Report, etc. our policy of continuously reducing the overall size of our policy shareholdings in selected companies. While keeping in mind the "ratio to net assets" guidelines set by voting advisory firms, we will continue to hold shares in companies that are worth holding, but will reduce the overall size of shares with a sense of schedule.

Q: What do you think is the appropriate shareholder structure for the future reduction of shareholdings in selected companies?

A: We would like to increase the number of individual shareholders, which currently accounts for about 20% of the total. In order to increase the number of individual shareholders, the Company has been actively communicating with them for several years by focusing on events and exchanging opinions.

[Railway Business]

Q: The Revenue Cost Calculation Guideline was revised through a series of discussions with the Ministry of Land, Infrastructure, Transport and Tourism, and this fare revision application was realized. On the other hand, the total cost method remains in place, and no fundamental solution has been reached in terms of flexible fare setting. Will you continue to negotiate for a review of the fare and charge system itself?

A: We have been requesting the government to make the fare rate system more flexible. The revision of the Revenue Cost Calculation Guidelines in April 2024 allowed for a certain degree of incorporation of price hikes, personnel expense increases, and other factors into the cost calculation. However, many issues remain, such as the adoption of operational return rates that deviate from the levels required in the capital market and the fact that Shinkansen express charges are subject to approval, and we do not believe that this revision is sufficient.

The Ministry has publicly indicated that a review of the total cost method itself will be the subject of discussion, and we consider it a major step forward that it has been taken up for discussion, but it is still a work in progress. We will continue to advocate for the implementation of a flexible fare and charge system.

Q: With limited opportunities to revise fares, how do you plan to improve the profitability of the railway business in the future?

A: In the railway business, it is important to improve profitability while achieving both stability and growth. We believe that we can apply for another fare revision in the future if the conditions are met. In addition, we would like to further increase revenues by implementing measures to meet customer needs, including flexible timetable setting. The Company also aims to improve profitability by lowering fixed costs through streamlining facilities and increasing efficiency through driver-only or driverless operations, thereby making the business even more muscular.

Furthermore, we have an advantage over other companies in that we can create synergies with Lifestyle solutions by operating a railway business. The Company can flexibly implement the setting of train schedules and the installation of new stations in accordance with the strategy of Lifestyle solutions. In our recently announced “Going beyond the norm for Suica - Suica Renaissance”, we also presented the concept of Suica subscriptions tailored to customers’ lifestyles. Through such flexible thinking, the Company hopes to build up earnings on the two axes of Mobility and Lifestyle solutions.

Note that if Suica subscriptions are realized, they will be a product that goes beyond the existing concept of commuter passes, and will help to demonstrate the limits of the current fare pricing framework. We would like to bring a windfall to the current fare and charge system from such an approach as well.

[Medium- to long-term business growth strategy “Beyond the Border”]

Q: Could you give us a more concrete picture of your strategy to double operating revenue and operating income in Lifestyle solutions in FY2034.3 (compared to FY2024.3), which you have set forth in Beyond the Border?

A: Half of the doubling of operating revenue and operating income is expected to come from growth in existing businesses. We assume growth of 3%/year in EKINAKA/ offices/ shopping centers, 4%/year in advertising, and 5%/year in hotels. The remaining half will be achieved by taking on challenges in new areas, such as the digital platform of Suica and the expansion of the real estate business domain. We would like to achieve this by building an economic zone for the Group centered on Suica, and by increasing the resolution of new businesses in the future.

[Real Estate Business]

Q: How will the speeding up of rotational business change the scale of property sales and fund asset management in the future?

A: In July 2024, we founded JR East Real Estate Co. In addition to effectively utilizing company-owned land, this company is on a mission to promote its rotational business by strengthening the acquisition, value enhancement, and sale of real estate in cities. In light of this company’s establishment, a review is underway, including the scale of property sales (averaging 20-30 billion yen per year). We also would like to update the asset management scale of private funds and private REITs, as we expect to increase it from the target of 400 billion yen in total for FY2028.3.

Q: The Company has approximately 1.6 trillion yen in unrealized value of rental properties. Do you intend to accelerate sales of real estate?

A: About half of the approximately 1.6 trillion yen is difficult to liquidate because it is developed together with the railway business. For such real estate, we are considering changing the way revenue is earned by changing the nature of the station building itself. For the remaining half, we would like to speed up the liquidation process. We are also considering consolidating underutilized business sites to create sites of a certain size and sell them.

Q: What is the current office rent level and leasing situation?

A: Our Group’s offices have the advantage of being close to stations and newer buildings, and we are able to set rents higher than those of properties in the surrounding area. Rents at the upcoming TAKANAWA GATEWAY CITY are also about 1.5 times higher than those of surrounding properties. In the future, as Suica evolves, we will also offer services that have synergy with railways to add value.

In terms of leasing, the existing office space is almost fully occupied, and when tenants move out, we are able to sign contracts with new tenants at higher rents than before. There is no significant demand swing relative to the Group's office supply.

[Suica and Finance]

Q: What are the future prospects and challenges for Suica?

A: As we recently announced, we aim to evolve Suica within the next 10 years. Although a certain amount of capital investment is required, the enhancement of Suica will contribute not only to increased revenues but also to increased income, as, for example, the realization of walk-through ticket gates will lead to a reduction in the cost of installing ticket gates.

Suica is the platform for the Group's business, and we will benefit all our businesses by further increasing contact with customers through the enhancement of Suica. Until now, the concept has been presented separately for each service, but this time it has been determined to be feasible while drawing a total concept with a time axis in mind, and a schedule has also been presented. In the future, we would like to engage in this kind of speed-conscious management.

Q: What are JRE BANK's future plans?

A: JRE BANK's target is to open 1 million accounts, and at present 450,000 accounts have been opened, which is faster than expected. By linking JRE BANK with View Card and Eki-net (the online ticket purchase service), the number of View Card and Eki-net members has increased, benefiting other businesses of the Group. The possibility of data marketing using data obtained from JRE BANK is also being studied.

[Organization/ Human resources]

Q: I understand that the Company is in the process of reorganizing, but is the organizational structure sufficient to allow it to move in a flexible manner?

A: We are currently reviewing the nature of our organization. We believe that it is necessary to separate the departments that think about strategy and tactics from those that are responsible for daily operations. Over the next one to two years, we would like to create an organizational structure that can move more flexibly and agilely to meet market needs.

In June 2023, the Company transitioned to a company with audit and supervisory committee. The criteria for items to be discussed by the Board of Directors and the Corporate Planning Committee have also been reviewed, and authority has been transferred to directors and executive officers, especially for matters related to execution. This has actually led to an increase in the speed of management, and we intend to continue to improve the level of management.

Q: In the JR East Group Report 2024, what is the reason for the slight decline in the percentage of positive responses in the employee engagement survey?

A: We are promoting various measures to improve employee engagement and will continue to focus on this. The analysis indicates that the process of reorganization may temporarily lower the percentage of positive responses. Management will actively communicate with employees on how to adapt to change, and strive to spread new ways of working.