Management's Discussion and Analysis of Operations

Consolidated Basis

Results of Operations

In fiscal 2018, ended March 31, 2018, transportation revenues rose amid a moderate economic expansion, mainly as a result of increased customer use, and also due to a rebound in railway used from the downturn following the Kumamoto earthquake in April 2016, marked by increased use of the Sanyo Shinkansen. The retail and real estate business also rose steadily. As a result, operating revenues, operating income, recurring profit and profit attributable to owners of the parent all experienced an increase.

Operating expenses increased 3.5% year on year, or ¥44.0 billion, to ¥1,309.0 billion. While there was a decrease in personnel as a result of lowered unit costs, costs related to beginning operations of the TWILIGHT EXPRESS MIZUKAZE, a rise in operating costs from system-related expenses, increased expenses for renovations as part of measures to improve safety, and an increase in the price of power due to fuel cost adjustments resulted in an overall increase.

Net extraordinary profit and loss improved ¥15.9 billion from the last fiscal year, to a loss of ¥7.1 billion. Key factors included a provision of loss on liquidation of railway belts for the Sanko Line in the previous fiscal year, and a recorded impairment loss.

Profit attributable to owners of the parent rose 21.0%, or ¥19.2 billion, from the preceding fiscal year, to ¥110.4 billion.

Factors Affecting Revenues

Railway transportation accounts for the bulk of revenues in the transportation operations segment. Railway transportation revenues depend mostly on numbers of passengers served, and are, therefore, affected by numerous factors such as competition with airlines and other modes of transportation, competition with rival railway companies, economic conditions, and the falling birthrate and aging population. We believe railway passengers make transportation decisions based on considerations of safety and reliability to begin with, but also travel times, the comprehensiveness of the railway network, fares, and levels of comfort.

Shinkansen revenues are determined mainly by the numbers of business and leisure passengers served, and are therefore affected by factors such as economic conditions, competition with airlines, and the number of inbound visitors.

In comparison, the Kansai Urban Area Railway Network (Urban Network) serves mainly work and school commuters, so its revenues, we believe, are much less affected by economic conditions. Urban Network revenues, however, are still susceptible to the falling birthrate, aging population, urbanization, and other demographic changes. For some of JR-West's other conventional lines, intercity transport revenues are affected by economic conditions and competition with intercity bus services and private automobiles. Local line revenues, meanwhile, are subject to the impacts of competition with private automobiles, local economic conditions, and demographic changes.

Retail business segment revenues come mainly from department stores, sales of goods, and food services. They are affected by economic conditions and competition from other department stores, retailers, and restaurants. In addition, most of the businesses in this segment operate in or near train stations, so they are also subject to the impacts of railway traffic volume. That said, however, train stations enjoy relatively stable usage, so we believe the segment's operation revenues are less affected by these factors than are the operation revenues of other companies. Other factors affecting the segment's revenues include the opening of new stores and the closing of existing stores.

In the real estate business segment, revenues come mainly from the leasing of station and nearby facilities and the sale of condominiums along train lines. These revenues are affected by economic conditions and fluctuations of sales in the condominium business, but within the real estate rental business, the relatively stable customer traffic at stations, and tenant preference for stations and nearby office buildings for their convenience, means that economic conditions are less of a concern than they are for other companies in the same business.

The other businesses segment's revenues come mainly from hotel and travel agency operations. Hotel operation revenues are affected by economic conditions, room rates, competition from other hotels, and the number of inbound visitors. Revenues for travel agency operations, meanwhile, are affected mainly by competition from other travel agencies and factors, like economic conditions and terrorism, that could discourage travel. In addition to hotel and travel agency operations, the other businesses segment includes construction, advertising, and other operations, most of which share the common purposes of strengthening the customer base for the mainstay railway operations, and enhancing station and other facilities.

Factors Affecting Expenses

Due to the age structure of its workforce and other factors, the Company is currently experiencing employee retirements at elevated levels, but through recruitment and other measures, has secured the number of personnel needed to conduct business operations. For fiscal 2018, personnel costs totaled ¥221.4 billion.

Furthermore, we are securing human resources that are more advanced in age by way of an established re-employment system for retirees. This move has been made in order to facilitate a smoother transition of skills and in response to laws such as the Act on Stabilization of Employment of Elderly Persons. We are also thinking in terms of building a system that can manage the business in the coming future. In that light, we are recruiting with a focus on new graduates for the purpose of long-term employment. In addition, we also prioritize securing a diverse set of human resources, employing contract employees and mid-career recruits. In total, we have hired about 900 employees in the current fiscal year.

As for non-personnel costs, the Company is working to achieve cost reductions through structural measures. Railway operations are characterized by (i) ownership of a large amount of facilities and equipment entailing relatively high maintenance costs to ensure safety and (ii) a high proportion of fixed costs, which are not linked to revenues. The Company, therefore, with safety as its highest priority, is striving to cut costs through steps like the introduction of rolling stock and equipment that are easily maintained, mechanization, and the improvement of existing infrastructure. At the same time, however, the Company fully appreciates the weight of its responsibility for the accident on the Fukuchiyama Line, and the Shinkansen critical incident, and is drawing upon all of its capabilities to build a railway that assures customers of its safety and reliability. Elevated costs for enhancing safety, therefore, are expected to be incurred for the foreseeable future. It is also expected that ramping up competition with other transportation modes will entail additional costs for purposes like raising service levels, introducing IT for promoting sales, and increasing outsourcing to improve operational efficiency. Furthermore, JR-West also foresees an increase in costs attributed to electricity price hikes.

Regarding railway usage charges, JR-West leases the JR Tozai Line from Kansai Rapid Railway Co., Ltd. Since fiscal 2005, the annual amount of the railway usage charge has been renegotiated every three years and set after considering interest rate changes and other factors. As a result, railway usage charges have been reduced from fiscal 2012 onward. For fiscal 2018, expenses paid were ¥15.2 billion.

Among non-operating expenses, interest expense is a major factor. The JR-West Group pays close attention to the levels of its total long-term liabilities and total interest expense with the aim of preserving the stability of operations. For fiscal 2018, the Group's interest expense declined ¥1.4 billion, to ¥20.9 billion.

Cash Flows

Net cash provided by operating activities increased ¥40.9 billion year on year, to ¥275.1 billion, due to factors such as an increase in profit before income taxes.

Net cash used in investing activities fell ¥129.4 billion year on year, to ¥166.3 billion, because of a decrease in purchase of shares of subsidiaries resulting in a change in the scope of consolidation.

Net cash provided by financing activities amounted to ¥71.4 billion, a ¥115.7 billion year-on-year change from the net cash disbursed in these activities in the previous fiscal year, due mainly to an increase in redemption of bonds.

As a result, cash and cash equivalents as of March 31, 2018, amounted to ¥101.4 billion, up ¥38.1 billion from the end of the previous fiscal year.

Capital Demand and Capital Expenditures

In fiscal 2018, the JR-West Group undertook capital expenditures totaling ¥199.5 billion, of which the transportation operations segment accounted for ¥154.4 billion, the retail business segment ¥2.8 billion, the real estate business segment ¥35.7 billion, and the other businesses segment ¥6.5 billion. Capital expenditures in the transportation operations segment consisted mainly of railroad infrastructure, primarily for safety enhancements, and purchases of new rolling stock to replace aged rolling stock. The Group's capital expenditures in the retail, real estate, and other businesses segments were mainly for construction of new facilities and renovation of aged facilities.

The JR-West Group fully appreciates the weight of its responsibility for the accident that occurred on the Fukuchiyama Line, and the Shinkansen critical incident, and is drawing upon all of its capabilities to build a railway that assures customers of its safety and reliability. All operational safety equipment and other infrastructure-based initiatives necessary for further enhancing safety are being taken and consideration of various other measures to bolster safety will continue.

Liquidity and Financing

The JR-West Group receives substantial amounts of cash on a daily basis mainly from the transportation operations segment, and believes it has secured a sufficient level of liquid assets.

At the same time, however, the Group recognizes that improving capital efficiency is extremely important for business management. Beginning in October 2002, therefore, the Group introduced a cash management service (CMS) to ensure effective utilization of Group funds.

Regarding financing, the JR-West Group procures funds for the portion of repayments of existing debt, capital expenditures, and other expenses that cannot be covered by the Group's cash flows. The Group makes determinations on financing methods, including corporate bonds and long-term bank loans, based on comprehensive consideration of market trends, interest rates, and other factors. For short-term financing needs, the basic policy is to raise the necessary capital mainly through short-term bonds.

Furthermore, we have concluded commitment line contracts allowing procurement of funds, in accordance with prescribed conditions, in the event of a major earthquake.