Financial strategies

Supporting Our Purpose from a financial point of view and meeting stakeholder expectations

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Reflections on the pandemic, and about the new Medium-Term Management Plan

As COVID-19 moves to category 5 infectious disease classification in Japan and society returns to its pre-pandemic state, we have learned two things from the painful experience of the COVID-19 pandemic. One is our high degree of dependence on the railway business. We had been diversifying our business before the pandemic, but in fact, 80% of our profits were from the railway business and related businesses. During the pandemic, we could not ensure stable profits except for the 20% from the real estate business. The other is that due to changes in social behavior, overall rail use will only return to 90% of pre-pandemic levels. We were also reminded of the population decline. On the other hand, I once again felt the high expectations from customers and society for railways. Trust is our greatest asset.

In order to overcome these challenges, contribute to society in the future, create cash flows, and increase corporate value, we formulated Our Purpose and Long-Term Vision 2032 and the Medium-Term Management Plan 2025 to realize these. The new Medium-Term Management Plan has changed greatly from our conventional strategy. We are conscious of responding to social changes and creating change ourselves by incorporating those changes.

The strategy has three main points. The first is to establish the trust of the whole JR-West Group by further improving the safety of railways. The most important thing for us to revitalize mobility services and expand the life design field is customer trust.

The second is the revitalization of the railway business and structural reform. Our backbone is railways, and we serve 5 million customers a day, so we need to revitalize mobility services centered on railways. However, the use of railways will only return to 90% of the previous level, so we need to work with various partners to create new demand for the remaining 10%. We will implement structural reforms to increase productivity and reduce structural costs by 50 billion yen compared to before the pandemic. In terms of transportation revenues, we are targeting the same pre-pandemic level of 870 billion yen in five years.

The third is to expand the life design field. In 10 years, we hope to expand the life design field, including new areas such as city development centered on the real estate business, a digital strategy that takes advantage of our contact points with railway customers, and infrastructure management, to account for 40% of our operating income.

In the financial strategy to advance this Medium-Term Management Plan, it is important to increase synergy between businesses and optimize the business portfolio. It is the role of the CFO to support growth by allocating resources based on the fact that we are in a transition period. As financial indicators, we have set the goals of achieving operating income of 150 billion yen in fiscal 2026 and five years later 185 billion yen in fiscal 2028. For EBITDA, which indicates cash-generating ability, we have set the challenging goal of achieving 380 billion yen in fiscal 2028, which is about 20 billion yen larger than before the pandemic.

Resource allocation to support the Medium-Term Management Plan

In allocating resources to support the Medium-Term Management Plan, that is, allocating cash flow, especially at the current stage of portfolio reform, we are focusing on investments and funding to expand and maintain corporate value. Among them, the priorities are safety investment in railways and investment and funding for growth. Safety investment in railways also includes earthquake countermeasures and barrier-free measures, which are areas where society has high expectations. Growth investment and funding will be in two areas: the revitalization of mobility services, including railways, and the expansion of the life design field. In particular, in the three years of the Medium-Term Management Plan 2025, there will be major events such as the launch of various digital services, the opening of the Tsuruga extension of the Hokuriku Shinkansen, the opening of station buildings in Osaka and Hiroshima, and Expo 2025. We will concentrate on making the most of these opportunities. On the other hand, for railway restructuring and portfolio reorganization, it is necessary to take a long-term perspective of 5 to 10 years.

Regarding shareholder returns, we will pay a stable dividend with a dividend payout ratio of 35% or more. In addition, while maintaining a balance with financial soundness, we will implement a flexible capital policy, including growth investments and share buybacks, that can contribute to improving shareholder value per share.

Balance sheet and cost of capital

As a financial strategy to support the "left side of the balance sheet," financial soundness is required as a company in infrastructure services such as railways. And in order to increase corporate value, it is important to control capital costs. Balancing the two is a major role of the CFO.

In fiscal 2021, we lost 230 billion yen due to the pandemic and raised about 700 billion yen in new debt for funding. I believe we were able to maintain our rating because we have a solid financial foundation. Based on this, in the review of the Medium-Term Management Plan 2022 announced in October 2020, we set a goal of recovering to a pre-pandemic D/E ratio by the end of fiscal 2028. This is the same idea that was behind the capital increase in September 2021 during the pandemic.

In the post-pandemic Medium-Term Management Plan, the JR-West Group can now expect to recover a certain amount of operating cash flow. Therefore, we determined that it was appropriate to use the net interest-bearing debt/EBITDA ratio based on cash flow generation capabilities as a financial discipline. In general, the appropriate level is about 5x, but as a company responsible for infrastructure services such as railways, we have set a target level of about 4x in five years in order to achieve a higher level of financial soundness.

On the other hand, I believe that it is necessary to keep the WACC (weighted average cost of capital) 3.9% or less, considering our core business of railways. We have set the levels of interest-bearing debt and resource allocation from that perspective too.

■ Financial targets (financial KPIs)

		FY2023 (results)		FY2026 (targets in this plan)*2		FY2028 (targeted pre-pandemic level)*3
Ability to generate profits	Consolidated operating income	¥83.9 billion	Recovery in profit generation ability	¥150.0 billion	Generate more profits	¥185.0 billion
	EBITDA	¥243.6 billion		¥340.0 billion		¥380.0 billion
	(Reference) Transportation revenues	¥694.5 billion		¥860.0 billion		¥870.0 billion
	(Reference) Cost structure reform (vs. FY2020)	–¥26.0 billion		–¥40.0 billion		–¥50.0 billion
Management efficiency	Consolidated ROA	2.3%	Improve capital and asset efficiency	Approx. 4%	Further improvement	Approx. 5%
	Consolidated ROE	8.8%(4.4%)*1		Approx. 8%		Approx. 9%
Financial discipline	Net interest-bearing debt/EBITDA	5.6×	Recovery in ability to generate cash flow	5x or less	Create more cash flow and reduce debt	4x or less
Ratio of life design field to operating income				Approx. 25%	Further advances	Approx. 35%

*1 Figures do not reflect tax effects.
*2 This plan excludes impact from higher revenues related to Expo 2025, and track usage fees and higher revenues associated with opening of Tsuruga extension of the Hokuriku Shinkansen.
*3 Targeted pre-pandemic levels exclude impact from higher energy costs.

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This balance of financial soundness and capital cost control is not necessarily fixed. Portfolio restructuring will spread the balance of the business, which will spread risk and improve our financial health. As our portfolio changes, so will the level of our financial balance sheet. Furthermore, it is necessary to consider an optimal balance sheet that also takes into account rising interest rates and inflation. As for the financial strategy, we will update it as needed while listening carefully to the opinions of the capital markets.

Sustainability management and human capital to balance social value and economic value

Although it does not seem to be related to the financial strategy at first glance, sustainability management is also an important initiative to reduce risk and increase corporate value.

The JR-West Group co-exists with local communities, so the Group's value creation model is to create a cycle in which communities are energized through our business and this energy is returned to our business. Sustainability management is the foundation necessary for embodying Our Purpose and sustainably creating and developing social and economic value. When people think of sustainability, they often associate it with defense, but we take a unified offensive and defensive approach.

In particular, human capital is becoming more important. As labor shortages progress around the world, the relationship between companies and employees is also changing. Above all, it is important to create an environment where employees have high work engagement and work with motivation.

The pandemic may be over, but this does not mean that there will be no more changes. We are now in an era where it is no longer possible to decide on and stick to a three-year medium-term management plan. Changes come one after another, so we must respond confidently and anticipate changes. We will also create change. The biggest driving force for this is people. It is employees who respond to changes and create all kinds of value. I would like to create a company culture where there are opportunities to take on a range of challenges, and even if we fail, we can learn from those failures and move forward. Together with various partners, we will evolve our connections, move the hearts of our employees and customers, and drive the future.

Since there may well be risks such as infectious diseases in the future, we must improve our financial soundness and ensure that it is appropriate for the future challenges we will face. However, I believe that the ability to respond to risks in the true sense is down to the power of people. If we firmly acquire and cultivate human resources who can overcome risks and turn them into opportunities, we can continue to grow no matter what risks come. To this end, we will continue to invest in human capital, improve the environment, and allocate resources to various challenges.

Dialogue with stakeholders including shareholders

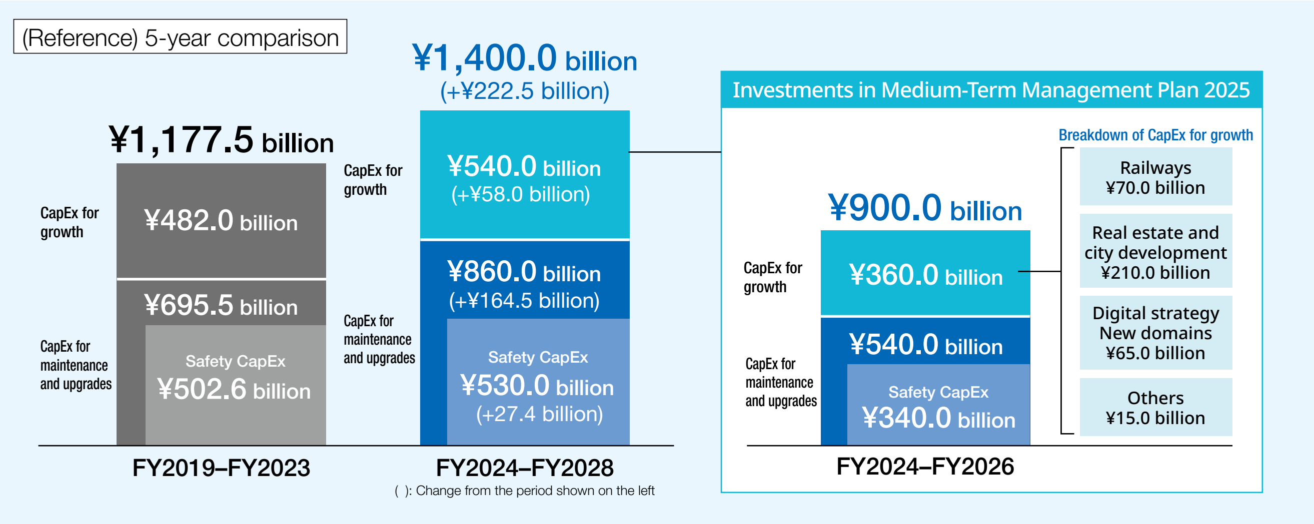
In Our Purpose shared by the whole JR-West Group, we reaffirmed our approach to our five main stakeholders (customers, communities and society, partners, shareholders, coworkers). Careful communication with each stakeholder is essential for the sustained growth of the Group. That is also the mission assigned to management.

There are three missions of the CFO: to allocate resources based on the company's strategy, to take action to ensure financial soundness and increased corporate value, and to face capital markets with sincerity. We must also further increase stakeholder value. What I value is listening to the opinions of our stakeholders and sharing them as a member of the management team. Another key point is to think from a long-term perspective. For example, with the acceleration of labor shortages across Japan in the future, it will be practically impossible to keep manned ticket booths at many stations. We must think of ways to provide value to our customers that do not rely on labor. We must always make judgments from a long-term perspective rather than a short-term perspective.

Our stakeholders include customers, communities and society, and shareholders, as well as the people who work with us. On the railways, there are group company employees working on track maintenance, electricity, and railcars, as well as specialist partner companies. They work together as one team. Partners such as startups who co-create innovation with us are also important stakeholders.

Regarding dialogue with shareholders and the capital markets, as a company that has also implemented a capital increase, we would especially like to deepen our mutual understanding through diligent dialogue and disclosure. We want to gain trust from the capital markets by disseminating our ideas for increasing corporate value and shareholder value per share in an easy-to-understand manner. To that end, we would like to hear various opinions from our shareholders. Going forward, we will continue to deal with each stakeholder sincerely and improve stakeholder value. We hope that you will continue to understand and support us.

■ Investment plan



■ Financial strategy and shareholder returns