

Price-Cap Method Based on the Total Cost Method

• Total cost method (summary)

- Railway companies are required to obtain approval from the Minister of the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) prior to establishing or adjusting the upper limit on basic railway fares or express charges for Shinkansen non-reserved seats.
- Prior notification is only required to be submitted to the Minister of the MLIT when newly establishing or adjusting basic railway fares or express charges for Shinkansen non-reserved seats if the amount of the fare or charge after its establishment or after its adjustment is below the upper limit, or when newly establishing or adjusting other express train services, etc.
- Prior to giving approval for establishing or adjusting the upper limit on basic railway fares, the Minister of the MLIT must confirm that the new upper limit does not exceed total cost, which is the sum of the proper operating costs incurred by the relevant railway companies if it were to carry out efficient management and the proper profit calculated pursuant to specified methods.

• Scope of the calculation of total cost:

- Calculation of Railway business income separately from other businesses

• Period of calculation:

- Three years after the price revision

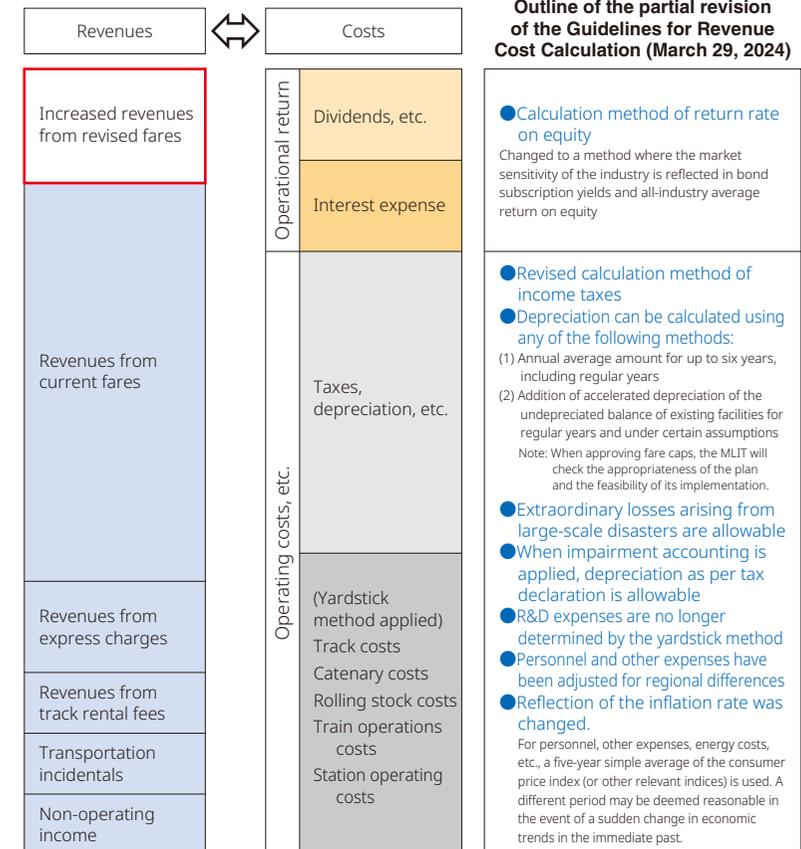
• Yardstick method (determination of cost based on the standard cost calculated from comparison of six JR companies)

- MLIT announces the standard cost, which classifies comparable costs of railway companies into five categories: track costs, catenary costs, rolling stock costs, train operations costs, and station operating costs.
- In revising prices, the standard cost is adopted in the total cost calculation. However, when the standard cost exceeds the actual cost, the actual cost is added to the standard cost for each category in the normal fiscal year and then multiplied by half.

$$\text{Total cost} = \left[\begin{array}{l} \text{Operating costs, etc.} \\ \text{Optimal cost calculated by} \\ \text{Yardstick method + Taxes,} \\ \text{depreciation, etc.} \end{array} \right] + \left[\begin{array}{l} \text{Operational return} \\ \text{Assets utilized in railway} \\ \text{business operations}^{*1} \\ \times \text{Operational return rate}^{*2} \end{array} \right]$$

*1 Assets utilized in railway business operations = Fixed assets for railway operations + Construction in progress + Deferred assets + Operating capital

*2 Operational return rate = Equity ratio (30%) × Return rate on equity + Borrowed capital ratio (70%) × Return rate on borrowed capital
Return rate on equity: Market sensitivity of the industry is reflected in bond subscription yields and all-industry average return on equity.
Return rate on borrowed capital: the actual average rate by group for, e.g., loans



Outline of the partial revision of the Guidelines for Revenue Cost Calculation (March 29, 2024)

- Calculation method of return rate on equity
Changed to a method where the market sensitivity of the industry is reflected in bond subscription yields and all-industry average return on equity
- Revised calculation method of income taxes
- Depreciation can be calculated using any of the following methods:
(1) Annual average amount for up to six years, including regular years
(2) Addition of accelerated depreciation of the undepreciated balance of existing facilities for regular years and under certain assumptions
Note: When approving fare caps, the MLIT will check the appropriateness of the plan and the feasibility of its implementation.
- Extraordinary losses arising from large-scale disasters are allowable
- When impairment accounting is applied, depreciation as per tax declaration is allowable
- R&D expenses are no longer determined by the yardstick method
- Personnel and other expenses have been adjusted for regional differences
- Reflection of the inflation rate was changed.
For personnel, other expenses, energy costs, etc., a five-year simple average of the consumer price index (or other relevant indices) is used. A different period may be deemed reasonable in the event of a sudden change in economic trends in the immediate past.

Prepared by JR-West based on the "Guidelines for Revenue Cost Calculation for JR Passenger Railway Companies, Major Private Railways, and Subway Operators"



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- adverse changes for the Company in laws, regulations and government policies in Japan;
- service improvements, price reductions and other strategies undertaken by competitors such as passenger railway and airline companies;
- infectious disease outbreak and epidemic;
- earthquake, other natural disaster risks, and failure of computer telecommunications systems disrupting railway or other operations

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