May 22, 2024
West Japan Railway Company

Main Q&A from the Small Meeting Held in May 2024

1. General Meeting Information

a. Date: Wednesday, May 22, 2024
b. Attendees Kazuaki Hasegawa, President and Representative Director
Eiji Tsubone, Director and Senior Executive
Officer, Senior General Manager, Corporate Strategy Headquarters
c. Format Q&A session

2. Main Questions and Answers (key points)

Updating of the Medium-Term Management Plan 2025

Q As a result of the updating of the Medium-Term Management Plan 2025, our stock price reacted positively to the upward revisions of target figures as well as the reference to the cost of capital. On the other hand, as changes in the business environment are occurring at faster speeds, we must continue to work quickly on issues that we have recognized and high-priority measures in order to execute our strategies. Furthermore, I would like for us to continue to discuss financial strategies, such as our capital structure strategy, in light of changes in the business environment, and present changes in approaches as appropriate.

A This Medium-Term Management Plan sets challenging targets for both the mobility service and life design fields. We will move forward quickly with initiatives aimed at achieving those targets while assessing probability and feasibility, and responding to changes in the business environment as appropriate. In regard to capital structure, it is important to balance control of the cost of capital and financial soundness. In addition, we will monitor the capital structure as that balance will change due to shifts in our business portfolio. However, in order to expand the life design field, we will need to focus on that endeavor over the long term and update specific progress.

Q What are the particular targets that will be challenging to achieve? Since it is important to respond to the external environment, including inbound tourism, what areas and initiatives in particular are you focusing on in terms of management?

A We are setting our revenue and profit targets at higher levels, targets that are not easy to achieve. The plan is based on the premise that the Company will take on various challenges, such as generating a broad range of synergies based on digital technology and improving productivity through new technologies. In order to achieve the targets, we will work to achieve our current projections although it is necessary to take into account arrange of factors in the external environment, including changing trends in inbound tourism, rising interest rates, and increasing labor shortages.
As management, we deepen discussions on the state of local lines and maintenance from a medium- to long-term perspective. We will make further efforts in business by making effective use of the funds entrusted to us by our shareholders.

Q The amount of investment and profit targets for our digital strategy and new business development have been lowered during the updating of the Medium-Term Management Plan 2025. What is your current assessment of this? We will not be able to catch up with other companies unless we speed things up more on this front, right? Although upfront costs are rising, when will the Company start generating and expanding profits?

A In terms of digital strategy, we are promoting inter-business collaboration through the use of WESTER and are currently focusing on expanding the use of WESTER points and other services to expand profits in the future.

Regarding new business development, we are also at the stage where we are preparing to expand profits by assessing how much profit can be obtained in a given business area in the future. Although the amount of investment will be decreased over a three-year period, it is in line with the previous plan when viewed over a five-year period.

In light of the COVID-19 pandemic, our basic policy for expanding the life design field in order to build a business portfolio that is not overly dependent on mobility remains unchanged. Human resources are the key to implementing measures. In order to improve our ability to respond to changes and create new products, we will promote human capital investment, such as the hiring and development of digital human resources, and promote plans while maintaining an awareness of how fast measures are being implemented. Although the timeline for our digital strategy is longer, we want to execute this strategy in a larger form.

Q I believe that the basis of this plan update is the positive approach of taking on the challenges associated with business portfolio reform, digital strategy, and new business development while recognizing a harsh external environment. Investors expect management to say that it is accumulating expenses to withstand the severe external environment and that although profits target may seem low, future profit levels will be increased. This type of message may lead to the reduced cost of capital.

A Although the current business environment remains challenging, we will transform our business portfolio and create a new JR-West Group through growth investment and human capital investment to overcome the challenging external environment. With regard to our digital strategy and new business development, I feel it is necessary to explain about specifically how and when profits will be generated. We will take various measures to meet market expectations.

ROE Targets/Cost of Capital

Q The ROE targets in the current Medium-Term Management Plan are each around 10%, but what levels should the targets be in the future? In addition to financial leverage, what do you think is necessary for increasing ROE? Also, while the portion of the Company’s operating income attributed to the life design fields will increase, ROE targets will remain at around 10% for both FY2026.3 and FY2028.3. Although the Company aims to increase the weighting of the life design field in consolidated operating profit to 40% by FY2033.3, will this contribute to improving ROE?

A In the plan update, we raised our ROE target level from 9% to around 10%. However, I do not think that this level is satisfactory. On the other hand, considering the Company’s current business structure, it is still not easy to continuously improve ROE. We will deepen discussions in Board of Directors meetings to determine whether we can make use of financial leverage to take another step forward as a business, taking into account the progress of the current Medium-Term Management Plan.

In the life design field, we are in the stage of developing businesses to maximize profits in the future. At this point, however, there are not many businesses in this field that are certain to bring in revenues and/or profits. When expanding businesses, we will identify the businesses that we need to grow and set appropriate targets in light of the ROE levels and capital efficiency levels in each industry. Since we are not satisfied with the current level of ROE, we will aim to increase returns without reducing capital efficiency.

Q While managing with an awareness of the cost of capital, aiming for a high ROE for the Group as a whole is not objectionable. However, ideas on this in regard to each business are not apparent. For example, when considering which business to invest in and to what extent, optimal capital structure for each business will determine the appropriate hurdle rate. How do you plan to incorporate this into management that also maintains an awareness of the cost of capital for each business?

A I recognize that it is very important to properly control the cost of capital when considering growth investment and business portfolio reform. The share buybacks are also the result of having an awareness of the cost of capital, not simply for shareholder return. In addition, since the cost of capital varies for each business, we set a specific hurdle rate with a risk premium for each business. On the other hand, the problem with disclosing information on capital efficiency for each business (e.g. our digital strategy), is that it is difficult to separate assets because revenues and profits are generated in each business using assets shared throughout the Group. We deepen discussions to find a solution, so we would appreciate a little more time for this.

Share Buybacks/Shareholder Return Policy

Q Regarding share buybacks, I felt the strong intent of management to do this for increasing EPS. On the other hand, looking at shareholder returns, an increasing number of companies are focusing on dividend amounts rather than share buybacks, and I think they are considering returning bringing dividend levels to pre-COVID-19 pandemic levels. Can you tell us about the background behind the share buybacks and the details on related internal discussions?

A The share buybacks are for the purpose of reducing cost of capital, not only for shareholder return. The amount of 100 billion yen was calculated as the amount that would reduce cost of capital through internal discussions simulating changes in capital structure as a result of share buybacks, involving outside directors from different industries. Although some companies have a policy of returning profits accumulated year after year to their shareholders altogether while others pay stable dividends every year, it is important to find a balance between these two approaches. Since the Company has established a dividend payout ratio of at least 35%, the dividend per share amount will increase as the number of shares outstanding decrease through share buybacks. First of all, in order to secure a source of dividends, we will promote initiatives, including control of cost of capital, in order to achieve pre-COVID-19 profit levels as soon as possible.

Q I assume that the current business environment has improved compared to the time of the capital increase, leading to the implementation of the share buyback. Please tell us your current assessment of the capital increase in light of stock dilution and other factors.

A When the company increased capital, it did so after indicating that it would be used for new rolling stock, city development, or some other purpose. The measures and investments we had been trying to implement before COVID-19 have been promoted through the capital increase, leading to a recovery in business performance. Although it is difficult to assess the situation in which cash flow has risen as a result, I recognize that the capital increase was necessary from the perspective of future and sustainable growth.

Q If cash flow increases further in the future, how do you plan to allocate resources and return profits to shareholders? The Osaka-Kansai Expo is scheduled to be held in the next fiscal year, which will probably be a factor for cash flow to increase. With regard to shareholder returns, the degree of recovery in EPS is uncertain based on the profit levels and targets that have announced. Therefore, wouldn't it be better to reduce the number of shares through share buybacks? I would like to know how enthusiastic you are regarding EPS recovery.

A Although there is a possibility that cash flow will surge as the Expo takes place, it is difficult to predict. If cash flow increases further, it will be used for growth investment and shareholder returns in accordance with the basic approach outlined in the Medium-Term Management Plan. As for shareholder returns, as the President who decided to increase capital during the COVID-19 pandemic, I will steadily work on immediate businesses to show further upward cash flow and a specific menu of additional resource allocations while maintaining a sense of gratitude for the support we have received during the difficult times we are going through.

Other Topics

Q Why should investors purchase West Japan Railway Company shares rather the shares of other railway companies? From a stock market perspective, a Company's president can be viewed as being the "top salesman" of a Company's shares, so could you tell us how our Company differentiates from others?

A The area in which West Japan Railway Company conducts business is rich in tourism resources and has many scenic spots with high potential to attract many people, including inbound visitors. The Group will continue to be involved in city development and tourism resource development to make communities shine. In addition, we are actively working to build a business portfolio that is not overly dependent on mobility, and I believe that the integrated infrastructure management business (JCLaaS) in particular will serve as the core of that effort.

Q There are many descriptions of human capital in the explanatory materials associated with the Medium-Term Management Plan update that place a strong emphasis on well-being. As part of your approach to human capital, are you implementing changes to the personnel system to improve the productivity of each employee? The combination of a business plan and human resource utilization will lead to the implementation of related measures to achieve an ROE of 10%. Can you share with us top management's thoughts regarding human capital?

A We will reform work style and motivate our employees by promoting investments that contribute to improving the workplace environment and operations. Increasing the productivity of each employee and developing businesses that require less labor will also lead to the improved management performance. With regard to personnel systems and wage systems, we have established systems for each Group company based on the standards of each industry without uniformly matching the standards of the railway industry. In particular, we launched TRAILBLAZER for digital human resources last year and have implemented a performance-based wage system that is different from our Company's standard system.

Q Regarding railway fares and rate systems, the guidelines for calculating cost of revenue under the total-cost method have been revised, but not all current issues have been resolved. What kind of discussions do you intend to hold in the future as a company and as an industry member? Under the current system, it seems like nonsense to operate railways as listed companies. If railway operators involved don't act, nothing will be initiated.

A Although the guidelines for calculating cost of revenue under the total-cost method have been revised, this does not mean that the system itself has actually changed. Therefore, I recognize that there are still many issues to be addressed. In particular, the fact that there is a cap on rates even during inflation is a major institutional issue. Privatization should have made it possible to discuss how to allocate various returns from management efforts to stakeholders. However, the current system is too rigid. The operational return rate is also at a level that is not commensurate with the cost of capital. Railway operators will of course raise and discuss issues. However, I would appreciate it if we could think together about issues and solutions under the current system from the perspective of investors.