



JR East Looks Ahead to a **New Era**

In 1999, 12 years after its birth, JR East stands on the verge of a dramatic new era of its development. The second public sale of government-owned shares took place in August. JR East will continue to work toward achieving full private-sector ownership at the earliest possible time. In this year's interview, President Matsuda reflects on the accomplishments and explains the direction JR East is headed.

How do you regard the Company's operating environment?

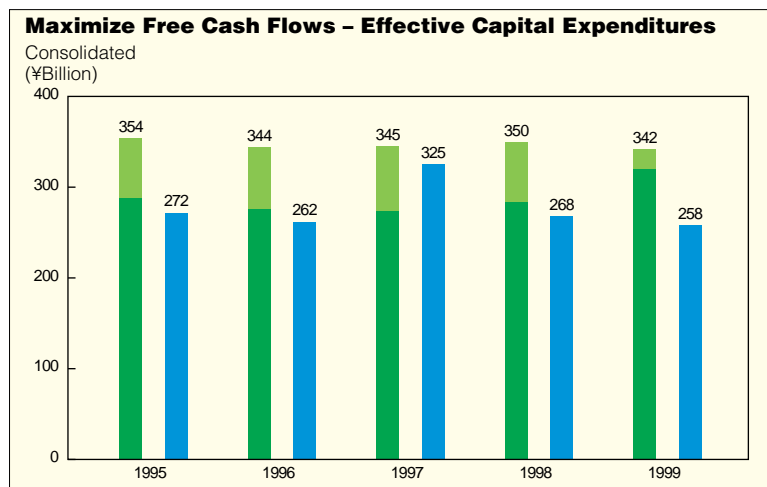
Our operating revenues are susceptible to the health of Japan's economy. I believe that the current economic weakness in Japan will drag on for some time. Faced with this situation, Japan needs to do more to deal with structural economic problems rather than rely on public works expenditures to stimulate economic activity. My feeling is that Japan needs to act quickly in this respect. If it fails on this front, the prospects for a full-scale recovery will remain poor.

In this difficult climate, we are seeing a slight decline in commuter-pass revenues as Japan's workforce shrinks and the number of students falls. That spotlights the need to increase other sources of railway revenues, mainly long- and medium-distance travel by Shinkansen and conventional limited express trains. JR East will have to work hard in many areas to increase these revenues. Better service and safety are essential. So is providing various tickets and travel packages to make our trains more appealing and accessible.

Please outline your main priorities as JR East restructures its operations and financial position.

Our consolidated operating revenues decreased in the fiscal year ended March 31, 1999 for the first time and transportation revenues were down for the second year in a row. Much of the blame rests with Japan's sluggish economy. I think that we can expect no better than flat revenues for the time being. We have already offset this by achieving large cost reductions, particularly in railway operations. In life-style services, we will continue

to make effective use of our assets, particularly our stations, where more than 16 million people embark every day. At the same time, we have been steadily reducing debt. By keeping capital expenditures within the bounds of depreciation and through other means, we have kept free cash flows needed for debt reductions as high as possible, and will continue to do so. Together, these actions are making our operations highly efficient and



profitable and will enable us to raise shareholder value over the medium and long terms.

What is JR East's policy regarding further reductions in its huge volume of total long-term debt?

During its 12 years of operations, JR East reduced nonconsolidated total long-term debt by more than ¥1.6 trillion. Still, this figure presently remains at almost ¥5 trillion. So the reduction of this debt will be a top priority for many more years. We can't build a stronger management base with our present level of debt. The railway industry is relatively stable. There are no big profit swings. But the railway industry is also a business where

it is difficult to react swiftly to shifts in the operating environment. Shedding debt is one way to make JR East more agile. I believe this agility will be the key to whether railway companies can survive and prosper over the long term. This is why JR East will continue to position debt reductions, supported by efforts to maximize free cash flows, as a central management objective.

Does JR East have plans to make more progress in lowering operating expenses?

Through the years, we have sought to make gains in safety, service and operating efficiency by taking advantage of technological progress. But more gains can still

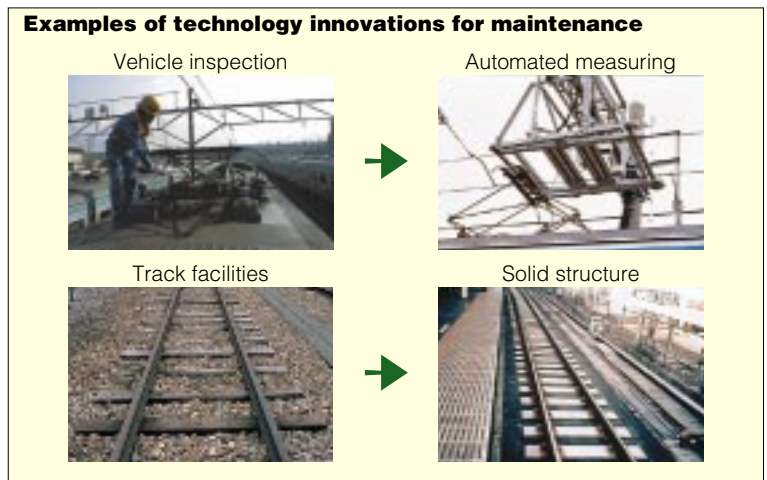
be made. For example, we are exploring ways to apply technology to cut maintenance costs of basic railway equipment like tracks and roadbeds. Much potential

for savings exists here. One achievement is a low-maintenance roadbed requiring no ballast maintenance. We are switching the main part of the Yamanote Line in Tokyo over to this system right now. Testifying to the gains that can be made from technological progress and the use of new systems is the fact that we have cut our maintenance expenses by about ¥30 billion over the past 3 years with absolutely no sacrifice in safety.

Accidents at JR East have dropped by more than 60% compared with our first year of operation. However, safety ultimately depends on the degree to which we can impart the necessary knowledge and skills to each railway employee. In 2000, we will complete construction of a new training center near Shin-Shirakawa Station on the Tohoku Shinkansen

that can accommodate about 1,000 people a day. This reflects my belief that the key to raising safety is to be certain that training programs develop at the same pace as railway operating systems and technology.

Speaking of employee, I would also like to point out that beginning in the year ending March 2001 there will be a net reduction of about 2,000 in the number of employees every year. This will equate to substantial cost savings.



How much potential really exists to create more demand for rail travel in Japan?

Other JR companies, mainly JR Central and JR West, are facing heated competition from airlines as their fares drop. But very few of JR East's services go head-to-head with airlines. Furthermore, we now have five Shinkansen routes linking Tokyo and major regional cities. This gives us unquestionable superiority over airlines.

For some time, JR East has been working to stimulate new demand for domestic travel. One way is by building reasonably priced and comfortable family-oriented lodging facilities in response to the fact that many of Japan's hotels are too expensive. We have packaged these facilities with discounted rental cars and train tickets to create travel packages with lower prices and great value. Another way to spur new demand is three-

day weekends. Two public holidays will fall on Mondays by law beginning in 2000. Families are certain to welcome the additional chances to go somewhere together. We thus regard more three-day weekends as an effective way to achieve big gains in passengers.

The expected decline in Japan's population within the next 10 years will pose a big challenge. While this means a higher share of older people, this shouldn't necessarily be viewed as a negative factor for railway demand. In fact, there are many positive aspects. Older people in Japan, especially those over 60, tend to use cars less, creating opportunities to attract drivers back to our trains. To tap this huge pool of potential passengers, we have started making our stations more accessible. All

Shinkansen stations have escalators. By March 2002, we plan to equip 80% of our stations within a radius of about 50km from central Tokyo with escalators, too.

Technological advances in commuter passes and other magnetic cards are also helping to stimulate



demand by simplifying rail travel. Costs are lower as well. In 2001, we plan to combine a commuter pass and prepaid ticket card into a single IC card. Sensors at automatic fare collection gates will eliminate the need to insert these cards. In the future, we plan to enhance JR East's *View Card* to further reduce the need to use cash at our stations. Such cards would produce huge quantities of information, thus offering many benefits. So we believe that there are many chances to take actions of our own that will attract more passengers.

To what degree is JR East succeeding in using stations and other assets for businesses other than railway operations?

JR East's stations, where more than 16 million people embark daily, offer ideal locations to develop shopping centers, hotels and other commercial facilities. We have about 220 stations which each serve more than 30,000 people daily, and we are rapidly adding life-style service businesses here. Our intention is to yield mutual benefits for these businesses and our railway operations. At this time, most of these developments which require relatively small investments can produce profits within a short time. In the fiscal year ended March 31, 1999, we made alterations to station facility layouts at about 50

locations to open up more commercial space for development. Tokyo's Shinagawa Station is a prime example. The grand opening of a shopping zone called *Flora Shinagawa* took place in November 1998 at this station, which serves 470,000 people daily. There are 18 stores in all, including restaurants and a bookstore. As part of a development project of the entire station, the shopping zone required only a small investment. It's already performing well. We estimate annual sales at roughly ¥5 billion.

Since railway operations account for such a large share of revenues, has JR East placed greater emphasis on nonconsolidated than on consolidated performance?

It's true that we are mainly a railway company. But we plan to make life-style services a significant element of our consolidated operations in the future. Our basic policy has always been to support the development of

all members of the JR East group. Now, it's even more important to strengthen the JR East group by providing a variety of information, working as a group and having our performance evaluated as a group. Consolidated

accounting is imperative. In April 1998, we formed a subsidiary to handle accounting and related services for all JR East group companies. This coincides with a shift in accounting practices in Japan that places more

importance on consolidated data. In response, JR East is moving toward a system that formulates and implements strategies and business plans from the standpoint of the entire group.

Can you list the primary risks that JR East faces in its operations and explain how the company manages those risks?

Natural disasters like heavy snow, floods and earthquakes are our biggest risk. In Japan, earthquakes are the greatest danger. We have an extensive system in place to shield ourselves from earthquakes. Our elevated tracks and other railway facilities are reinforced to withstand tremors. Furthermore, we have 13 coastal seismic sensors that allow us to stop trains soon after a tremor is sensed, and have taken other measures. A powerful earthquake, however, would obviously result in substantial damage to our railway facilities. If a tremor strikes the



capital, we are prepared to preserve the chain of command. Head Office functions can be quickly transferred to the Takasaki Branch Office, which is about 100 km to the north of Tokyo.

Another risk is Year 2000 compliance. Generally speaking, our exposure is small. We have very few date-dependent microcomputers. Furthermore, almost all of our computers operate in closed systems. Basically, this means that we only need to be concerned about remediation work on our own systems and not about the status of others. We began tackling the Year 2000 issue in earnest in 1997. Now we are confirming that we have finished the arduous process of inspecting microprocessor chips embedded in components. So I can say with confidence that we are prepared for 2000. Still, there is a remote possibility of an unforeseen problem. To prepare for this contingency, we have established a Headquarters for Year 2000 Issue Contingencies that is directly supervised by an executive vice president.

How is JR East responding to concerns about the environment?

We are determined to see that JR East's operations reflect global environmental issues. As a railway company, we are already making a substantial contribution by providing this highly energy-efficient means of transportation. To reduce the environmental impact of our operations even more, we have set numerical targets for CO₂ emissions, energy consumption and other facets of our activities to be achieved by March 2002. Our

rolling stock is designed to be extremely efficient. Many are designed to "recycle" electricity by generating power during braking and at other times. Recycling is a major theme company-wide. We have created businesses to recycle ballast and even confidential documents. JR East itself uses recycled paper made from newspapers discarded at stations.

Some people are of the opinion that JR East's greatest risks may be political in nature. Is there any danger of JR East being forced to take on more liabilities of the former Japanese National Railways (JNR)?

In 1987, the division of responsibility was clearly demarcated between the JR Companies and the Japanese government for the liabilities of Japanese National Railways (JNR). We have consistently and vigorously opposed any proposal for the JR Companies to take on additional liabilities. However, a law that became effective



in October 1998 included an article that placed an additional burden of pension transfer liabilities of JNRSC on the JR Companies. Our share was about ¥70 billion, an amount that we paid in a lump sum in March 1999. Our decision to pay this amount and not to oppose this action in the courts was rooted in the belief that settling this matter quickly and then working strenuously to achieve full private-sector ownership would best serve the interests of shareholders. The Prime Minister has stated in the Diet that the government will never again place an additional burden on the JR Companies. The Minister of Transport has repeated this pledge many times as well. But we aren't satisfied with words alone. It is imperative that the government sell all of its remaining JR East shares to completely eliminate the risk of any additional financial burden.

What are the ramifications of full private-sector ownership for JR East and its shareholders?

Presently, JR East is subject to the provisions of the Law for Passenger Railway Companies and Japan Freight Railway Company over and above the regulations that apply to all other privately owned companies in Japan. Transfers of major property, the issuance of stock and bonds, long-term borrowings, business plans, the election of representative directors and auditors, the appropriation of earnings and many other fundamental management decisions must all be approved by the Minister of Transport. Only by casting off this onerous law will we become a full-fledged member of the private sector. Managing a company demands speed, which is why we must rid ourselves of this burden as

soon as possible. Although the regulations that apply to the private sector will remain, we will nevertheless gain much more flexibility. If this can't be achieved, our political obligations could even destabilize our operations. The original intent when JR East was formed was for the government ultimately not to own a single share of JR East stock. We will thus remain resolute in our calls for the government to sell every remaining JR East share as quickly as possible. By eliminating all government ownership, we want to free ourselves and our shareholders of the risks associated with exposure to political pressure.