Right: Kunio Anzai
Chairman

Left: Hideharu Uehara
President

Full-fledged competition in Japan's energy sector is upon us. Gas and electricity retailing to large-volume customers has been liberalized, and electricity and gas companies are crossing into each other's fields. In this era of full-scale competition, Tokyo Gas has adopted a new corporate slogan called Energy Frontier. This slogan embodies our drive to grow as a diversified energy services company, delivering heat, electricity and gas, with natural gas as our core energy source. Four key strengths underpin our drive: positioning the outwardly expanding greater Tokyo/Kanto plain area as our central sales base; an extensive natural gas infrastructure linking LNG receiving terminals and customers; cutting-edge engineering capabilities; and strong, trusting relationships with our customers. As the 21st century dawns, we are determined to continue to play a leading role at the forefront of Japan's energy sector.

The Year in Review

In February 2001, we reduced our gas rates by an average of 3.02%, bolstering price competitiveness and responding to the needs of our customers. Having also reduced rates in December 1999, our rates have fallen by a total of 5.02% in the last 2 years.

Gas sales volume in the Tokyo Gas Group increased 5.4% to 8,879 million m^3. Gas sales in monetary terms also increased, up ¥68.6 billion to ¥740.7 billion, reflecting the higher gas sales volume and increased gas rates based on the *"gas cost adjustment rate (sliding rate)"* system. Accordingly, consolidated net sales climbed 9.5% to ¥1,086.7 billion and operating income surged 49.7% to ¥103.6 billion. Net income was held to a slight rise of 3.4%, to ¥27.5 billion, principally by the recording of a one-off charge of ¥21.9 billion for the shortfall in Tokyo Gas' corporate pension funds following the adoption of new accounting standards. Return on assets (ROA) was 1.5%. We also generated free cash flows of ¥66.5 billion, up ¥24.5 billion year on year.

Returning value to shareholders is a central element of our medium-term management plan. As such, we are pleased to announce that cash dividends applicable to the year were ¥6.00 per share, a ¥1.00 increase over previous years.

Progress of Deregulation

Japan's gas industry underwent partial deregulation in November 1999, with the lowering of the threshold at which regulations on gas supply areas and rate-setting restrictions for large-volume customers are set, from those consuming 2 million m^3 or more per year to 1 million m^3 or more. March 2000 saw the liberalization of electricity sales to large-volume customers, with revisions to the Electricity Utility Industry Law. The new regulations apply to users with a capacity of over 2,000 kW and using a supply of 20 kV or above. The scope of deregulation in both industries is expected to widen.

In the gas industry, at the end of January 2001, the Agency of Natural Resources and Energy formed a private group for the study of basic issues regarding the condition of the gas market, including LPG, over the next decade. The council will report on its finding later this year.

Tokyo Gas welcomes deregulation. We view it as an excellent opportunity to increase corporate value. Deregulation will allow us to advance into the electricity market. It will also enable us to capture demand beyond our service area. We also want to seize upon other business opportunities, including the natural gas transportation business using our powerful pipelines.

Tokyo Gas' Medium-Term Plan

Our basic strategy is to increase free cash flows and ROA. In the year ended March 2001, the first year of our 5-year medium-term plan, we achieved encouraging results. Based on this progress, we announced new projections in May 2001. By stepping up our drive to raise efficiency, we aim to achieve our goals a year ahead of our initial plan.

1. Increase Free Cash Flows

Our plan initially called for free cash flows totaling ¥250.0 billion over 5 years. We have revised our target upward to ¥287.9 billion. In the year ended March 2001, we generated free cash flows of ¥53.9 billion, far above our initial target of ¥32.0 billion.

2. Raise ROA

Here, we were originally forecasting to raise ROA to an average of 1.9% over the term of the plan. Now we are aiming for an average of 2.6% per year, with ROA of 3.8% in the year ending March 2005, the plan's final year. The result in the year ended March 2001 of 1.8%, on a non-consolidated basis, again exceeded our initial goal of 1.1%.

The actions outlined below will be instrumental to achieving our revised targets.

Stepping Up the Efficiency Drive

Personnel Reductions

We had planned to reduce the parent company head count to 10,000 by the end of March 2006. We now aim to achieve this goal by March 2004, 2 years ahead of schedule, by undertaking a rigorous review of work processes across all operations. We have decided to transfer 1,500 contract employees connected with meter reading, bill collection and other customer-service duties to a new outsourcing company at the end of March 2004. These actions are expected to yield labor cost savings of ¥37.0 billion from the year ending March 2002 through the year ending March 2005.

Controlling Operating Expenses

We have revised our initial goal of holding operating expenses to the level in the year ended March 1999 of ¥224.2 billion, from the year ended March 2001 to the year ending March 2003, through cost cutting and operational reforms. We have lowered our target to an average of under ¥221.0 billion over the 5 years of the plan. This includes the increase in fixed expenses in line with expansion of our customer base, but excludes an increase in outsourcing costs of ¥27.0 billion from the year ending March 2002 to the year ending March 2005.

Internal Financing of Capital Expenditures

We will continue to invest aggressively in new pipelines to boost gas demand and meet rising gas demand in the future. However, we intend to hold capital expenditures to around ¥100 billion, within the limits of internal financing, through cost-cutting measures.

Medium-Term Management Plan Progress Report and Outlook (As of May 2001)

<Non-consolidated>

Mar. 31		00	01	02	03	04	05
Net sales	¥ billion	869.9	965.6	976	1,005	1,036	1,065
Free cash flows	¥ billion	26.0	53.9	51	49	62	72
Total assets	¥ billion	1,493.6	1,490.1	1,450	1,465	1,462	1,460
Interest-bearing debt	¥ billion	761.9	685.5	635	627	610	570
ROA	%	1.5	1.8	2.1	2.4	2.8	3.8
Total asset turnover	times	0.60	0.65	0.66	0.69	0.71	0.73
Equity ratio	%	29.7	34.1	35.9	36.7	38.3	40.9

<Consolidated>

Mar. 31		00	01	02	03	04	05
Net sales	¥ billion	992.2	1,086.7	1,100	1,136	1,167	1,196
Free cash flows	¥ billion	42.0	66.5	67	51	65	75
ROA	%	1.5	1.5	2.0	2.3	2.6	3.5
Consolidated net income to non-consolidated net income	times	1.19	1.01	1.13	1.14	1.12	1.09

Note: Figures for the years ended March 31, 2000 and 2001 represent actual figures. Other figures are estimates.

Structural Reforms (Organizational and System)

In January 2001, we established the Energy Solution Business Department within the Energy Sales and Service Division, to advance into the electricity business. In July 2001, the Inter-Regional Sales and Service Division was launched to augment our sales strategy outside the Tokyo metropolitan area and to develop effective sales activities. In another move, we merged two functions—experimental research and development of product technologies—into the newly formed R&D Division. This division strives to apply in-house developed technologies both in and outside the company. With these actions, we have increased the number of strategic business divisions from 6 to 8. This new framework also heralds the start of a virtual in-house company system, whereby each division has been assigned free cash flow and ROA targets. Each division is striving to maximize profits. We have also carried out reviews of the remuneration system to provide added incentive to employees to improve their performance. Senior managers and above are subject to an annual salary system and regular employees are increasingly compensated by a results-based pay system.

Strategy to Expand Sales Volumes

Gas sales volumes drive sales and earnings. Our medium-term plan calls for an average annual increase in volumes of about 6.4%. To this end, we are executing a detailed strategy to expand sales in each user customer category. Our overwhelming market shares of 95% and 80% in the residential market for water heating and cooking, respectively, underpin our efforts there. Building on this base, we are popularizing gas floor heating for the home, and in the commercial sector, gas-fired air conditioning for office buildings. Furthermore, this year we launched sales of micro turbines for cogeneration for small-scale commercial use. Another focus is development of small-scale fuel cell systems for residential use. Our plan is to begin sales of these systems in 2004 and to make them commonplace by about 2010. Moreover, while expanding demand primarily for cogeneration, a strategic product, we will aggressively enter new fields. Target areas are electricity retailing, electricity and heat supply to specific areas such as redevelopment zones, and power generation businesses.

Expanding and Allocating Free Cash Flows

As highlighted above, we expect to generate free cash flows of ¥287.9 billion during our medium-term plan, ¥38.1 billion above the initial target. Combined with cash on hand, we expect to have total cash of ¥343.8 billion to invest from the year ended March 31, 2001 through the year ending March 31, 2005. Of this cash, roughly 20% is earmarked for new business investments, approximately 20% will be returned to shareholders, and about 60% will be used to strengthen our balance sheet.

Regarding new business investments, when we formulated our plan, we focused on building LNG carriers with a view to entering the LNG transportation business. This area of business has the potential to generate handsome profits. Thereafter, we established a specialist section, responsible for planning and launching new businesses, to oversee the launch of businesses outside the gas field, as well as to forge business alliances. These efforts led us to establish new companies and to take equity stakes in others (See FAQ on page 33). Moreover, in June 2001 we established Tokyo Gas Bay Power to sell electricity generated from a 100,000kW power station to be constructed within the grounds of the Sodegaura LNG Terminal. Operations are slated to start in the year ending March 2004.

Our investment in new businesses does not mean that we are sacrificing our core gas business. We are aggressively investing in new pipelines to capture new demand in the future.

For shareholders, we plan to sustain the dividend in the year ended March 31, 2001 of ¥6.00 per share in the year ending March 31, 2002 and thereafter. We expect there to be a dilutive effect on shares due to the conversion of convertible bonds into shares in line with the strong recovery in our stock price. As such, we are considering share buybacks to create shareholder value.

We hope to quickly strengthen our balance sheet by stepping up the repayment of interest-bearing debt. We aim to achieve our target of bringing interest-bearing debt down to ¥610.0 billion by the end of March 2005, a year ahead of schedule in March 2004. Our new target is to reduce interest-bearing debt to ¥570.0 billion as of March 31, 2005.

Responding to Risk

Our medium-term plan factors in business risk accompanying deregulation. This mainly constitutes the risk of competition, which can be broken down into two categories. One is the risk of losing customers to new players. The other is the risk that sales might fall as a result of having to reduce rates to remain competitive.

With regard to the former, we see our main rivals as electric utility companies. Like gas companies, they have the infrastructure in place, in the form of LNG receiving terminals, and have positioned entry into gas operations as an important strategy. Competition is expected to heat up quickly as electric utility companies attempt to drive expansion in demand by using the pipelines of other companies in addition to their own pipelines. To counter this risk of lost business, we will offer increased value to new and existing customers. For new customers, we will leverage our sophisticated engineering capabilities to cement a strong market position. For existing customers, we will compete on the basis of our price. Price competitiveness is underpinned by cost-reduction efforts. Therefore, we will accelerate cost-containment efforts to achieve cost reductions above those of electric utility companies. To hedge this risk, we aim to unlock new demand by enlarging our service area, taking maximum advantage of our pipeline infrastructure.

Regarding the second risk category, in December 1999 and February 2001 we lowered ordinary gas rates for residential and other customers. As a result, our gas rates are now among the lowest in Japan, and we feel confident that we can hold our own against other forms of energy. As such, we do not plan further rate reductions in this mid-term plan period. However, price competition with new entrants in the large-volume user domain, as well as cogeneration and air conditioning demand, may force us to reduce rates, thereby impacting sales. Reducing costs is the key to remaining price competitive and maintaining and expanding earnings.

Contributing to Local Communities

One of our greatest assets is our broad base of about 8.9 million customers. To enlarge this base we are upgrading customer services and maintaining and enhancing the safety and stability of supply. Furthermore, R&D is being emphasized to respond to diverse customer needs in an aging society which is being fundamentally altered by advances in information technology. IT is an important area of focus.

A Leader in Environmental Management

The 21st century is being hailed as the century of the environment. In the new era, corporations' actions to address environmental issues will fall increasingly under the spotlight. In 2000, Tokyo Gas revised its comprehensive environmental strategy for the first time in eight years. With this review, addressing environmental issues is one of the most important items on our management agenda. Our aim is to be a leader in environmental management. In addition to expanding the use of clean-burning natural gas—a long-standing focus—we are actively promoting environmental protection initiatives across the Tokyo Gas Group. For example, we announced our intention in January 2001 to determine the extent of possible soil contamination at several former gas manufacturing plant sites and to take whatever actions were appropriate. We will report on all our environmental actions, believing that full disclosure is the hallmark of a responsible corporate citizen.

Promoting Activities Overseas

At the threshold of an era of full-scale competition in the energy sector, overseas activities are taking on greater importance for the Tokyo Gas Group. Heretofore, our four representative offices overseas have focused mainly on gathering information and on management and technological exchanges with foreign energy-related companies and institutions. While continuing these activities, we also intend to use these offices as conduits for disseminating information to investors abroad.

Leveraging our experience and successes in overseas projects, we intend to develop overseas operations. In particular, we can point to our joint venture projects in Malaysia to demonstrate our capabilities. These included the construction and operation of a natural gas distribution system. This was the first such overseas project undertaken by a Japanese energy utility company. Gas Malaysia Sdn. Bhd., the joint venture company, started paying dividends in 1999.

In Conclusion

Deregulation heralds the arrival not just of competition, but of business opportunities. It promises to spur growth in natural gas businesses in Japan. With a core business model focused primarily on natural gas, we are well positioned to benefit. Taking on the challenges of deregulation, we aim to expand sales and to maximize earnings through top-line growth, structural reforms and cost cutting.

As always, your support will serve as inspiration and encouragement for our actions.

July 2001

Chairman

President