

# Progress in Our Drive to Transform Ourselves for Future Growth



AN INTERVIEW WITH  
THE PRESIDENT

NORIO ICHINO  
{ President }

Tokyo Gas is striving to consolidate its existing customer base while aggressively taking up new challenges. By strengthening this combination of defensive and growth-oriented strategies, we aim to bring forward the achievement of the Frontier 2007 goals.



NORIO ICHINO  
{ President }

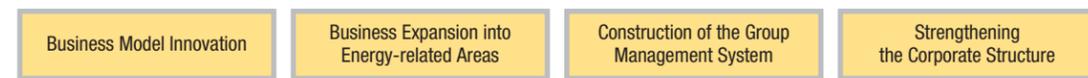
**Q Fiscal 2003 was the first year of the Frontier 2007 medium-term management plan and your first year as President. How would you review the year from this perspective?**

**A** Throughout the past year, I was constantly aware of the importance of my mission to ensure a good start, both for Frontier 2007 and for my own leadership. I am pleased to report that we set a new record for consolidated net sales, thanks to positive growth in sales of gas to commercial and indus-

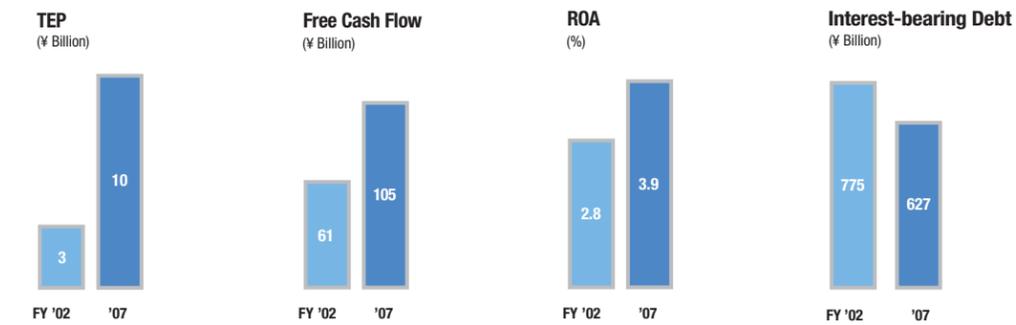
trial sectors. We also scored gains in our efforts to reduce costs, leading to clear benefit to our operating income. Net income was lower, since we decided to write off actuarial differences for retirement benefit obligations, and to bring forward the application of impairment accounting to fixed assets. Without these transient factors, our free cash flow would have been substantially above our initial target.

Because I saw the past year as a time for the Tokyo Gas Group to build foundations for new growth, I continually emphasized how important it is to

Four Areas of Prime Focus in "Frontier 2007"



Primary Management Targets



TEP (Tokyo Gas Economic Profit) = Net operating profit after tax prior to interest payments - cost of capital  
 Free cash flow = net income + depreciation - capital expenditures  
 ROA = Net income/total assets (average of positions at start and end of fiscal year)  
 Assumptions: Average cost of debt: 2.23% (after tax); Cost of equity: 6.5%

Figures for fiscal 2002 are projections made when the medium-term management plan was finalized in October 2002, not the actual results.

aggressively promote female and young employees, and to maintain close relationships with customers. The reaction was very positive. With these favorable results, I believe that we have made an excellent start overall.

**Q What are your priorities for the year ending March 2005 in line with the Frontier 2007 targets?**

**A** My aim for the coming year is to use our achievements during the first year of the plan to promote the early attainment of our targets under the plan.

Competition has arrived in earnest in the energy sector. For example, electric power companies are not only implementing marketing campaigns based on the concept of all-electric lifestyles, but are also moving into the gas market itself. To combat competition we must strengthen our business fundamentals through fine-tuned distribution of management resources: investing actively in essential areas, while streamlining as much as possible. We also need to foster a shared understanding of the fortes of the Tokyo Gas Group, and we must work together to

refine and enhance those strengths.

Our greatest strength is the trusted relationship with more than 9.4 million customers built over a history spanning 118 years, which enables our front-line operations to work directly with customers, offering suggestions on new ways to use energy and customer-oriented services. Policies formulated by our strategic departments are put into effect in the field. The effects of those policies are carefully monitored, and any errors or unsatisfactory results are reported back to the strategic departments so that the measures can be further refined. I believe that this process is the key to enhanced competitiveness for the Tokyo Gas Group.

That is why we need to put employees with the ability to perceive and understand customers' needs into front-line areas, such as sales, service and maintenance. We must build a structure that allows these needs to be incorporated into our strategies. If we can do this, I am confident that we can adapt successfully to any environmental change. My mission is to bring forward the achievement of the Frontier

2007 targets by using these strengths to enhance our offensive capability to move into new markets, and our defensive ability to deepen the bonds with our customers.

**Q Tokyo Gas increased the annual dividend. Does this signal a policy change?**

**A** The policy set down in Frontier 2007 calls for the payment of a dividend of ¥6 per share in each of the five years covered by the plan. However, we found at the end of the first year that, if we were to exclude transient factors, such as the lump-sum write-off of actuarial differences for retirement benefit obligations, our free cash flow would be substantially higher than the target level. We therefore decided to pass on this gain to shareholders by using the portion of free cash flow in excess of the planned level to increase the dividend.

The minimum requirement for our dividend policy is to maintain dividend stability, and we will continue our efforts to improve our earnings so that we may avoid ever having to reduce the dividend. We do not intend

Frontier 2007 plans to apply ¥180 billion over the five-year period of the plan for gas rate reductions. We will ensure that these funds are used beneficially to develop an effective rate strategy that expands demand and increases revenues.

at present to make major changes to the free cash flow allocations stipulated in Frontier 2007. However, if we can generate free cash flow significantly above the planned level, we will review the options to raise the dividend or buy back our stock. These options must be considered in line with other priorities, such as new business investment and the reduction of interest-bearing debt.

**Q Tokyo Gas has announced a gas rate reduction during fiscal 2004. What are the reasons, and what will be the effect?**

**A** The rate reduction is meant to improve our ability to succeed against increasingly fierce competition with other forms of energy or other gas suppliers. Another objective is to pass on the benefits of our corporate efforts to our customers.

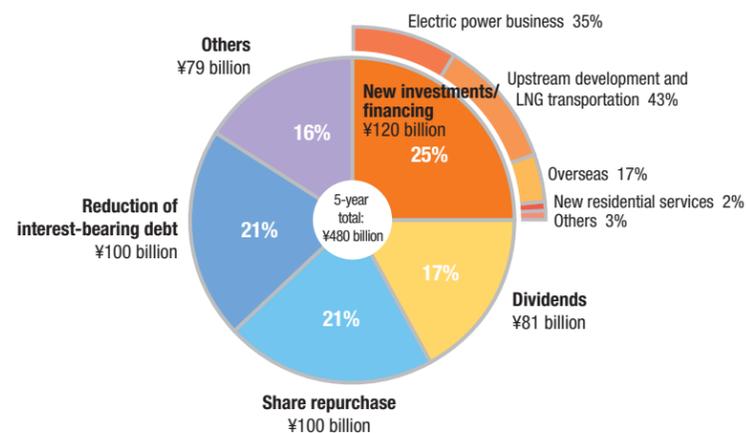
In Frontier 2007, we earmarked funds totaling ¥180 billion for use in rate reductions over the five-year period. Having completed the first year of the plan, we expect that we will be able to achieve all of the goals in the plan within the allotted time. This means we are free to spend the entire ¥180 billion effectively as planned—and the only questions now are timing and the way the funds are to be used.

Tokyo Electric Power has announced that it will reduce its electricity rates in October 2004. To enhance the competitiveness of our gas pricing, we announced that we would cut our rates in the year ending March 2005. We are determined to implement a rate strategy that will drive demand expansion, which will generate cash for future strategic developments.

**Q The scope of liberalization has expanded following regulatory reforms in April 2004. Has the competitive environment changed, as a result?**

**A** The scope of liberalization now includes retail sales of gas to customers consuming 500,000 m<sup>3</sup> or more annually. In practical terms, however, there are not many companies with sufficient capacity to sell large volumes of natural gas. Although the latest round of liberalization is unlikely to cause dramatic changes in the short-term future, the level of competition will inevitably escalate. While we are aware that our competitors are targeting large-volume customers with aggressive marketing activities, we

Deployment of Free Cash Flow



also believe that considerable engineering expertise is required to supply and sell gas, especially to industrial users. Moreover, long-standing relationships of trust with our customers cannot be broken easily. Of course, we cannot afford to be complacent, and we are building a strong defensive position by further improving our technology and marketing capabilities. We are also strengthening our aggressive marketing position by using the introduction of the strategic business unit system to offer total energy services, including gas, electric power and heat, in collaboration with Energy Advance and other Group companies.

**Q Natural gas faces increasing competition from electricity and other energy products in the household market, as seen in marketing campaigns for an all-electric lifestyle. How will you respond?**

**A** All-electric homes still make up only a small percentage of newly built homes in our service area. However, the electric power companies have set a clear target, and we expect the competition to intensify. We are preparing for this by strengthening our product appeal in areas in which competition is intense. Of particular importance are the products that we are developing to compete with electrical appliances. These include a new type of gas cooktop that is extremely easy to use and has enhanced design features, and highly efficient water heaters. Sales of these products were significantly higher than our initial targets in fiscal 2003. Another initiative is active marketing of floor-heating systems to establish a de facto standard. Now, they are installed in around 80%\* of new condominiums.

We will continue to enhance our ability to attract and keep customers by offering superior products, and by proposing lifestyle ideas based on the comfort and convenience of gas.

\* About 80% of all condominiums newly developed by the private sector in the Tokyo Gas service area have floor-heating systems.

**Q In April 2004, Tokyo Gas introduced the strategic business unit system. How does it differ from the old Group strategy?**

**A** In the past, our Group strategy was based on a policy of independence, which meant that individual Group companies pursued their own business approaches. However, given the intensifying competition in our various fields of business, we need to bring together the strengths of the entire Group by integrating the resources of the parent company and Group members, including the utilization of knowledge and commodities, and the formulation and implementation of business strategies. To achieve this, we have used our existing strategic division structure as the framework for a more evolved organizational structure in

We are leveraging the strategic business unit system to maximize Group earnings, as well as to implement agile management with quick decision-making.



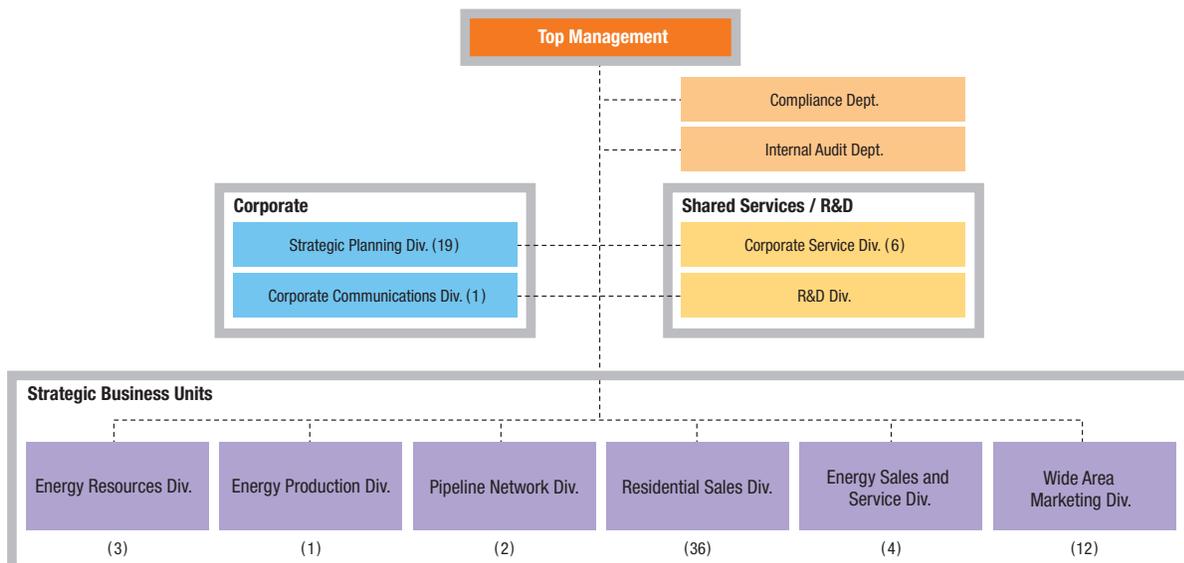
which Group companies with potential synergic benefits are integrated into strategic business units.

We believe that this unified approach will allow Tokyo Gas and its Group companies to maximize Group earnings in free and competitive markets. We also aim for **agile management with quicker decision-making** by devolving authority and accountability to the leaders of each strategic business unit.

The Tokyo Gas Group provides convenience and comfort to the lifestyle

of its customers with environment-friendly natural gas. In this sense, we are extremely fortunate, because we can contribute to society by working hard at our business activities. This is the starting point for our activities, and we will continue to focus on this role as we work to enhance our profitability and achieve growth by investing aggressively in areas with the potential for expansion.

**Tokyo Gas Group Management Structure** (As of April 1, 2004)



Figures in parentheses are numbers of Group companies in each business unit.