An Interview with the President

Norio Ichino, President

We carried out company-wide cost cutting that enabled Tokyo Gas to overcome adverse factors in the business environment: record-breaking summer heat and higher gas resource costs caused by a sharp increase in crude oil prices. Furthermore, in January 2005, we introduced a strategic 5.8% average rate reduction.

Q Fiscal 2004 was the second year of the medium-term management plan, Frontier 2007. What progress has been made with the plan?

As set forth in Frontier 2007, we are engaged in four areas of prime focus: business model innovation, business expansion into energy-related areas, construction of a group management system and strengthening of the corporate structure.

Our aim is to transform ourselves into a company on the energy frontier whose core business is natural gas by aggressively expanding our city gas business as well as our electric power, heat and energy service operations. It is also essential to raise operating efficiency to address the risk of demand loss and revenue loss that may be brought on by liberalization.

In fiscal 2004, the second year of the plan, although record-breaking summer heat dampened growth in gas sales volume in the residential sector, in the commercial sector air conditioning demand increased 7.5% year on year due to high summer temperatures and low winter temperatures. In the industrial sector, demand increased 10.2% year on year due to the development of new demand and increased operation at existing customer facilities. In other operations, aggressive marketing activities resulted in unit sales of our high-efficiency gas water heaters of more than double the planned level. The overall operating environment in fiscal 2004 was adverse because of the high summer temperatures and higher resource costs, due to a sharp increase in crude oil prices. In addition, we reduced rates in January 2005, in accordance with Frontier 2007, to maintain our competitiveness. We implemented company-wide cost reductions that offset the impact of the rate reduction and negative business environment. These initiatives generated solid cash flows that funded an annual dividend of seven yen per share, an additional share repurchase, and steady reduction of interest-bearing debt.

On the basis of this solid footing, in fiscal 2005 we expect to achieve nearly all of the four primary management targets of Frontier 2007 (see graphs on page 13). We have also steadily expanded our move into energy-related fields, notably upstream and transport operations and energy services.

At the same time, we have begun preparations for establishing a new management plan necessary to achieve further growth in the increasingly harsh competitive environment in which we operate. We plan to announce in January 2006 the next medium-term management plan for the period from fiscal 2006 to fiscal 2010.

Q What was the purpose and impact of the gas rate reduction implemented in January 2005?

There are two purposes for the rate reduction: to return to customers benefits obtained through increased efficiency and to increase competitiveness amid advancing liberalization. The important consideration behind this rate reduction was the focused allocation of resources in business areas where intensified competition is expected. To that end, we gathered ideas for a rate strategy from salespeople working on the front lines.

In the commercial and industrial sectors, where price elasticity is high, we sought to both lower rates and institute a rate structure suited to the needs of customers. This involved simplifying the rate structure for medium-volume customers and changing the structure for comparatively high-volume customers to closely tailor it to individual corporate needs. We have also ensured ample competitiveness in the area of cogeneration, where competition with electric power companies is fierce.

In the residential sector, we have boosted marketing competitiveness by adding rate options that make using home gas clothes dryers and floor heaters, which have become a de facto standard feature in new condominiums, more economical.

Although the impact of the rate reduction on sales was about ¥8.0 billion in fiscal 2004 and will be ¥30.0 billion in fiscal 2005 from regulated customers alone, we plan, as far as possible, to counterbalance this effect through cost reductions and further expansion of gas sales.

Q What is the expected impact of the increased scope of liberalization of electric power implemented in April 2005, and what are the possible measures to be taken as a result?

With increased liberalization, competition in the electric power market might intensify owing to the elimination of transfer supply fees charged for the supply of electricity across different supply areas. We are aware that competition in the gas business might someday mirror the increased struggle in the electric power market. However, at this time, our technological capabilities and relationship of trust with customers that we have fostered over the years are great strengths, and we have felt no major impact. We do expect competition to eventually intensify in the gas market and are devising measures to strengthen our solutions capabilities and selling power.

At the same time, increased liberalization in the electric power market has provided more opportunities for us to enter the electric power business. A subsidiary, Tokyo Gas Bay Power, already operates with a generating capacity of 100 MW, and we have achieved competitive electricity prices by constructing the plant within the premises of our LNG terminal. We plan to carefully observe the electric power market and respond flexibly.

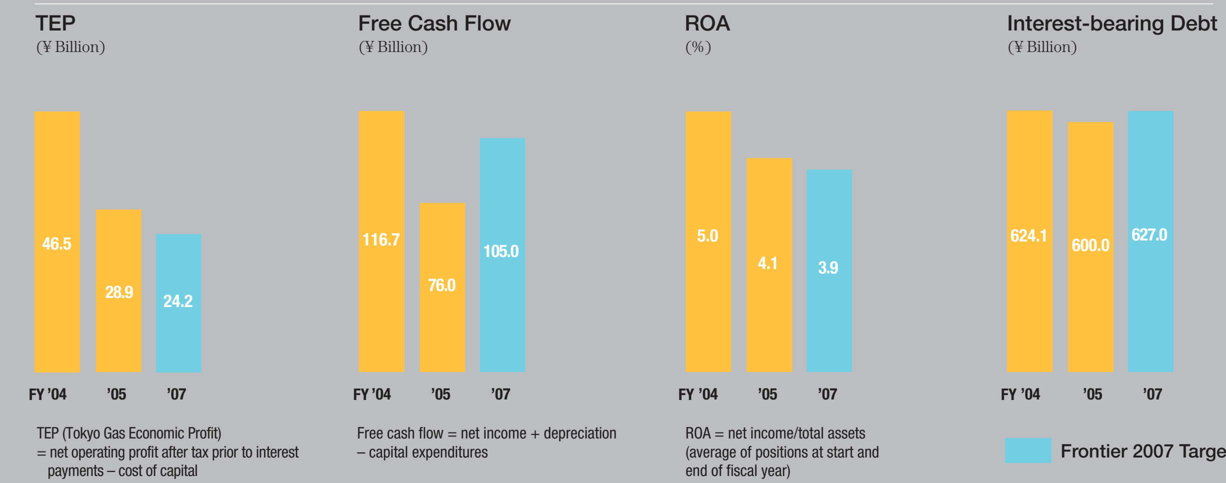
To achieve further growth in an increasingly competitive business environment, Tokyo Gas is formulating the next medium-term management plan, to be announced in January 2006.

Q What will be the areas of prime focus in the next medium-term management plan?

We believe that sustainable growth is the starting point for increasing corporate value, and there will be no change in the baseline of increasing the corporate value of Tokyo Gas over time with natural gas as the core business. I am confident that we can prevail no matter how the competitive environment changes provided that we continue to hone the products, services, maintenance and solutions capabilities in our main business.

Tokyo Gas supplies gas to 9.6 million customers and enjoys a bond of trust with customers that makes it possible for us to directly ascertain customer needs at the point of use. These on-site capabilities are a great strength of Tokyo Gas. During the past few years we have implemented a policy of transferring customer contact opportunities to affiliated companies and business partners in the interest of increasing operating efficiency and specialization. To boost competitiveness it is essential that Tokyo Gas, affiliated companies and business partners mount a united "All Tokyo Gas" effort to enhance our on-site capability to grasp customer needs and appropriately reflect that information in business strategy and management.

Meeting Management Targets Ahead of Schedule



Figures for fiscal 2005 are projections as of April 28, 2005.

Management is resolved to further sharpen our competitive edge by strengthening our comprehensive energy business strategy, in which we offer one-stop energy solutions to customers. In this age of high environmental awareness, having clean natural gas at the core of our business gives us an advantage over other types of energy providers. We intend to extend this lead through ongoing pursuit of advanced energy conservation solutions.

Q What is the policy on profit sharing with shareholders?

As liberalization progresses, so does the degree of freedom management has to distribute profits. Nonetheless, we are a public utility, whose charges to customers are still largely regulated. We believe that the balance between the return to shareholders and our responsibilities to serve the customers' interests should be considered.

Management believes it is important to continuously pay stable dividends, and the one-yen increase in the dividend implemented in the previous term was in line with that thinking. The board and I would like to continue to decide on dividend increases and other matters in connection with profit distribution on the basis of continuity.

Dividends are not the only way management returns profit to shareholders. Share repurchases are another measure. The payout ratio in fiscal 2004 was 22.1%, but if share repurchases are taken into account, the proportion of profits actually returned to shareholders was 45.9%.

To date, we have used ¥57.8 billion of the ¥100.0 billion allocation called for in Frontier 2007 and bought back 156 million shares. These repurchases were made mainly to prevent stock dilu-

tion (when outstanding convertible bonds become eligible for conversion into shares at the end of fiscal 2006 and 2008). Management plans in the future to include share repurchases among our options to increase the value per share through the retirement of treasury stock.

Strategic allocation of free cash flow and definition of capital policy, including profit sharing with shareholders, will be clarified in the next medium-term management plan.

Q What corporate governance initiatives have been implemented?

Although Tokyo Gas hasn't adopted the committee system, the Board of Auditors performs the monitoring function and I am confident that our management is sufficiently transparent.

By reducing the number of directors from the previous 28 (maximum of 30) to 12 (maximum of 15), we have increased the sense of urgency and motivated discussion at board meetings. We now have three outside directors, all enthusiastic people who actively contribute their opinions. By introducing the corporate executive officer system and delegating substantial authority to the divisions, we have increased the speed of decision making as well as operational efficiency. For fiscal 2005, we have decided to conduct a review of the officers' remuneration system to focus on the abolition of retirement benefits and the introduction of a performance-linked compensation scheme. I have been particularly eager to proceed with this reform as I think the introduction of this system will further clarify management responsibility for business performance and ensure objectivity and transparency in officer remuneration.

The corporate governance problems that have arisen at so many companies ultimately stem from a lack of internal communication. Tokyo Gas is emphasizing open and aboveboard communication throughout the Group, and this initiative is certain to contribute to strengthened governance.