An Interview with the President

Operating Environment and Results

In the fiscal year ended March 31, 2002, growing concerns about deflation made for difficult economic conditions in Japan. Nevertheless, the Tokyo Gas Group concentrated on expanding gas demand, aided by the high hopes that are harbored for environmentally friendly natural gas. Concurrently, we worked to curb expenses by stepping up our efficiency drive. These efforts yielded top- and bottom-line increases for the second straight year. Consolidated net sales edged up 1.0% to ¥1,097.5 billion, operating income rose 6.7% to ¥110.6 billion, and net income soared 88.1% to ¥51.9 billion. The large increase in the bottom line reflected such factors as the absence of the ¥21.7 billion charge for unfunded obligations arising from an amendment of accounting standards for retirement benefits recorded in the previous fiscal year, and ¥3.4 billion in capital gains on sale of investment securities.

Q: What makes the gas and energy business an attractive investment?

A: In a word, natural gas. Natural gas is the most environmentally friendly of all fossil fuels. What's more, unlike oil, it can be found throughout the world. For Japan, which lacks its own substantial natural energy reserves, this makes natural gas an extremely important source of energy. Natural gas offers a source of energy security and an environmentally sound energy solution.

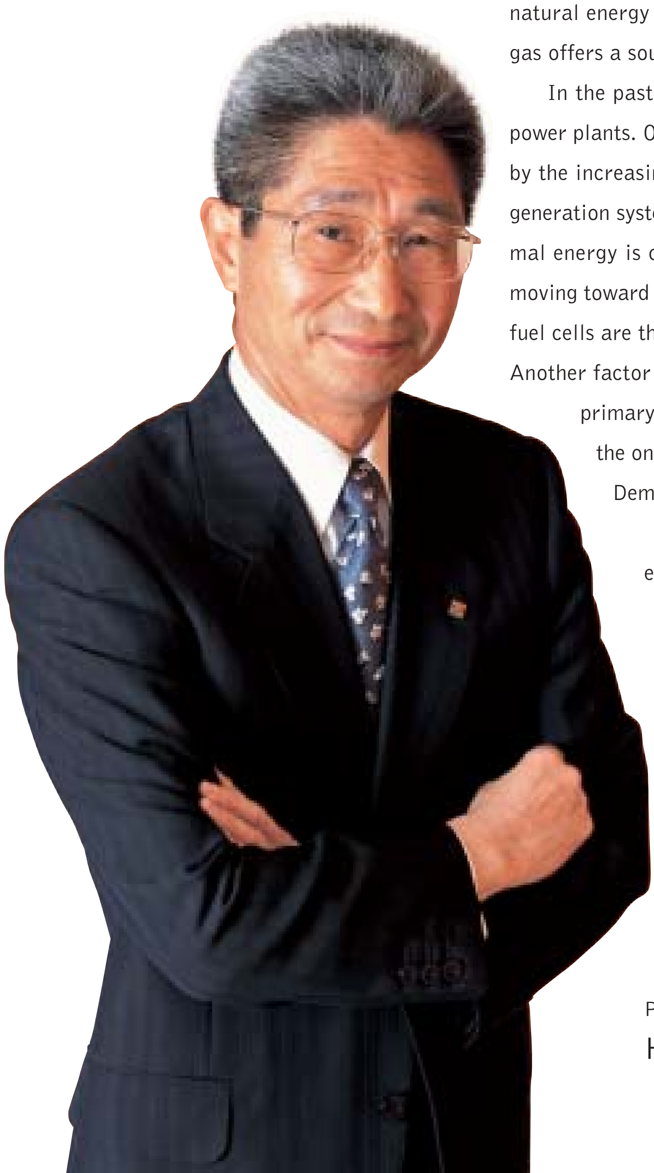
In the past, natural gas was used only for traditional consumption and as fuel at large-scale power plants. Over the last decade, however, demand from other sources has grown rapidly, spurred by the increasing use of natural gas for environmentally and economically superior on-site power generation systems—cogeneration—where electricity is generated at the same time as emitted thermal energy is captured for heating instead of being wasted. Higher demand is expected. We are moving toward the era of on-site power generation. Micro turbine cogeneration and small residential fuel cells are the main applications expected to drive this growth.

Another factor pointing to a strong future is the relatively low share of natural gas among Japan's primary energy supplies, only approximately half that of the U.S. and Europe. Natural gas is the only fossil fuel projected to see growth in the Japanese government's Long-term Energy Demand and Supply Outlook.

Supported by these trends, the natural gas business is expected to see steady expansion.

Q: Your business handles high-growth natural gas, yet you place priority on raising asset productivity as you use ROA and reductions in interest-bearing debt as management indicators. Isn't there a contradiction here?

A: Because our business requires considerable investment in facilities, we emphasize raising asset returns to make ourselves more competitive. That's why we are working to reduce total assets, and above all, interest-bearing debt. These efforts are designed to maintain and enhance our ability to



President

Hideharu Uehara

compete on the basis of price against the new players that we expect to enter our market. Our market is attractive in terms of its potential, making more intense competition inevitable. In November 1999, when we announced our medium-term plan, we set the goal of reducing interest-bearing debt, at the parent company, to no more than ¥610 billion by the end of March 2005. By March 31, 2002, we had already achieved that, three years ahead of schedule.

The strong balance sheet we have molded is a powerful competitive edge. It will underpin our future actions. We are still forecasting high annual growth of around 6% in gas sales volumes, mainly from cogeneration and the electricity business, over the next 5 years, despite the economic sluggishness in Japan. However, the expansion of gas sales isn't our only focus. We intend to strategically channel free cash flows into new businesses built on natural gas as we move onto an offensive footing to accelerate growth.

Tokyo Gas is a company with considerable potential, both in terms of sales and earnings.

Q: What is Tokyo Gas' view on the debate about deregulation in the electricity and gas industries and how do you see it developing?

A: There is considerable debate in Japan about further liberalizing the electricity and gas industries. The Study Group on Gas Market Reforms, a private study group formed by the Ministry of Economy, Trade and Industry, led this debate in the gas industry. The main themes under discussion are widening the deregulated field to include all customers, except residential and small-scale commercial customers, and opening access to pipelines and LNG receiving terminals. Plans call for an official government council to continue discussions based on the findings of the private study group. This type of discussion is also happening in the electricity industry. As with gas industry deregulation, wide-ranging discussions are taking place on issues such as expanding the scope of liberalization and deciding who will pay for maintenance of transmission lines.

Tokyo Gas views deregulation as a major business opportunity that can lead to more ways to increase our corporate value. Throughout our more than a century in business we have encountered competition from other forms of energy—gas lamps versus electric light, gas versus oil for heating, and gas versus LPG. Taking advantage of the initial deregulation in the electricity sector, the Tokyo Gas Group has already made moves to enter the electricity business in several ways—we are selling natural gas to other operators entering the electric power business, constructing power plants either by ourselves or through alliances, and developing an electricity retailing business.

While more deregulation signals the start of new competition, it also spells new opportunity.

Q: What are the risks stemming from deregulation? Electric utilities appear to have an advantage because of their much larger size. How do you intend to compete?

A: One is the risk accompanying deregulation. New market entrants might lure away existing demand in our service area. The high-potential nature of this area, comprising Tokyo and neighboring prefectures, makes it an extremely attractive market for new players. Competition is heating up in this market. Another risk is that we will have to reduce rates as this competition intensifies, dragging down our sales.

Tokyo Gas will limit the extent of lost business, while working to win new customers, by drawing on our competitive advantages—sophisticated engineering capabilities backed by combustion technologies, and a trusted reputation established over many years of dedication to promptly serving customer needs. To counter the risk of falling sales, we will push ahead with our efforts to make the company more efficient, lowering costs to enable Tokyo Gas to successfully compete on price against rival companies while still raising earnings.

Q: Specifically, what is your strategy for combating competition?

A: The lowering of rates by TEPCO in April 2002 has ignited fierce competition in the building air conditioning and cogeneration markets. Furthermore, deregulation in the gas business means that customers will soon be able to choose their gas supplier, thereby pitting gas company against gas company. We are working to ensure that we remain the preferred gas supplier by cutting costs to maintain and enhance our ability to compete on prices. Essentially, we want to offer customers an attractive rate structure. Another element of our strategy is offering high-value-added energy services that go beyond just supplying gas. Providing answers to customers' energy problems will make us more attractive in their eyes. Energy Advance Co., Ltd., which was set up in July of 2002, for example, will meet wide-ranging market needs, from individual buildings and plants to entire districts. In addition to supplying electricity and heat through cogeneration systems, this business unit will offer a full line of services from consulting to design, construction, operation and management, maintenance and finance to help customers conserve energy. In a nutshell, this new company will be a one-stop source of energy-conservation solutions.

Q: What progress have you made in the electricity business?

A: One of the major issues facing new entrants to the electricity business is procuring electricity supplies. Our wholly owned subsidiary, Tokyo Gas Bay Power Co., Ltd., is currently constructing a 100MW-class power plant within the site of our Sodegaura LNG Terminal. Electricity will be sold to an electricity retailer, ENNET Corporation, which we set up jointly with NTT Facilities, Inc. and Osaka Gas Co., Ltd. Alliances are also part of our strategy to advance our electricity business. These include establishing Tokyo City Power Co., Ltd. with the Tokyo Metropolitan Government and Shell Gas & Power Japan Ltd., as well as Kawasaki Natural Gas Generation Co., Ltd. with Nippon Oil Corporation.

Q: Many see your main rival in electricity and gas as TEPCO. Yet at the same time you jointly procure natural gas and cooperate in other ways with them. How should people reconcile these ties?

A: We procure natural gas through various alliances, not just with TEPCO. Alliances enhance our bargaining power, enabling us to procure gas in the most stable and least expensive way possible. This is the most economically sound method for an energy company such as ours to procure natural gas. Cooperating with TEPCO has also allowed us to finally realize our long-cherished goal of participating in an upstream project. Last year, we teamed up with TEPCO to jointly invest in the

Bayu-Undan Project off the coast of East Timor. Our collaboration with TEPCO extends to joint operation of the Sodegaura and Negishi LNG receiving terminals and a weather-risk-hedging contract for the summertime. All cooperative agreements are mutually beneficial for both TEPCO and Tokyo Gas.

Naturally, we recognize that selling energy to customers is a totally different story. There is inevitably going to be escalation in our competition with TEPCO. We plan to continue cooperating with TEPCO in areas where it is advantageous to both sides, while competing head to head in other areas. Ultimately, we feel that this approach is the best way to generate profits for Tokyo Gas shareholders.

Q: How do you intend to use the free cash flows you generate?

A: We plan to invest in new businesses, such as the large-scale investment we made in the previously mentioned Bayu-Undan Project. Specific projects will be incorporated into our new Group Medium-Term Management Plan that is scheduled to be unveiled in the autumn of this year. As suggested by the name of this new plan, the focus is on group-wide strategies. The plan clearly sets out uses of free cash flows for the purpose of maximizing the value of Tokyo Gas and its 54 Group members. Applications will include investments to reorganize business units through withdrawals, integrations and other means. Returning profits to shareholders is another use of cash flows. In the year ended March 31, 2001, we raised the dividend from ¥5 to ¥6 per share. Furthermore, share buybacks are included in the plan.

Q: Finally, what is the stance of Tokyo Gas on corporate governance?

A: As part of the Group Medium-Term Management Plan, we are considering a management strategy that aims to build a new business model. We plan to strengthen our management system to swiftly and resolutely execute the new plan. To that end, and ahead of the announcement of the new plan itself, we reduced the number of directors from 28 to 11 in June 2002 and at the same time established the post of corporate executive officer. These moves to enhance the execution of day-to-day operations were made with corporate governance in mind.

As deregulation advances and competition intensifies, our existing business model probably won't be able to keep pace with changes in the operating environment of the future. Based on this recognition, we established a system of business divisions to decisively overhaul our organization and systems. Each business unit will continue to work exhaustively to create new business models. Our business divisions, which are organized as virtual companies, prepare accounts separately from the head office and have their own missions, as well as free cash flow and ROA targets. Depending on how effective this structure is, we will explore the possibility of giving these divisions in-house company status—they would receive their own capital, pay dividends, extend loans internally, and so on—to maximize profits. These actions aim to produce the highest possible earnings from the Group's total pool of resources.