Rising Demand for Natural Gas in Japan

Natural gas is the most environmentally sound of the fossil fuels. While roughly 60 percent of the world’s oil reserves are concentrated in the Middle East, natural gas reserves are scattered throughout the world. Natural gas reserves are also expected to last longer than oil, making it the energy source for the future. In addition, demand for natural gas is increasing not only for its existing applications as an energy source for city gas supply and large-scale power plants, but also as a result of the rapid spread of cogeneration* systems over the past decade. Demand is also expected to rise further as we enter the age of distributed energy, such as the use of compact residential fuel cells to enable small-scale cogeneration. The share of natural gas in Japan’s primary energy supply is relatively low — about half that of Europe and the United States. However, in its report on Japan’s long-term energy demand outlook, the Japanese government has identified natural gas as the only fossil fuel for which demand is expected to grow. As such, natural gas is a high-growth business that will play an even greater role in Japan’s energy market of the future.

*Cogeneration: An ecologically and economically sound form of distributed generation in which electricity is generated while the waste heat generated in the process is recovered and used as energy, instead of being wasted (as is the usual case in thermal power plants).

Tokyo Gas: Industry Leader

Tokyo Gas is Japan’s largest city gas company, with a service area of 3,155 km², covering the Tokyo metropolitan area and the Kanto region. The Kanto region is Japan’s most densely populated area, with more than forty million residents. Tokyo is the center of the Japanese economy, and the location of many companies’ headquarters. In addition, the Kanto region contains Japan’s largest industrial area, which produces 40 percent of the country’s gross domestic product (GDP). Tokyo Gas, which is based in this area, expects growth to result not only from rising gas demand, but also from the expansion of its energy-related businesses.

Gas Sales Volume in Japan and Tokyo Gas by Sector

(Year ended March 31, 2003) (Million m³, 46.05 MJ/m³)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>3,254</td>
</tr>
<tr>
<td>Commercial</td>
<td>2,504</td>
</tr>
<tr>
<td>Industrial</td>
<td>3,599</td>
</tr>
<tr>
<td>Wholesale</td>
<td>1,107</td>
</tr>
</tbody>
</table>

Number of Gas Customers in Japan and Tokyo Gas Customers

(As of March 31, 2003) (Customers)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>8,637,347</td>
</tr>
<tr>
<td>Commercial</td>
<td>582,084</td>
</tr>
<tr>
<td>Industrial</td>
<td>24,945</td>
</tr>
<tr>
<td>Wholesale</td>
<td>17</td>
</tr>
</tbody>
</table>

* The above three graphs represent non-consolidated data.
Tokyo Gas, which supplies city gas to 9.2 million customers in the Tokyo metropolitan area and the Kanto region, where demand in Japan is the greatest, has pipeline extending a total of 49,431 km. In order to ensure the long-term, stable supply of natural gas and to accommodate this demand, Tokyo Gas has built a 300-km natural gas supply loop encircling the Tokyo metropolitan area, incorporating three LNG receiving terminals (one of which, the Sodegaura LNG Terminal, is the world's largest).

In addition, Tokyo Gas is moving aggressively into locations where demand for city gas is expected to grow, working to build and expand supply infrastructure based on an assessment of return on investment. Furthermore, the Company is actively cultivating demand in response to the liberalization of supply areas for large-volume customers following the deregulation of the gas industry.

In May 2002, Tokyo Gas completed the Yokohama-Shonan line, which was constructed to accommodate rising demand in the Seisho district of Kanagawa Prefecture, as well as large-scale demand from gas utilities such as Odawara Gas and those in the Minami-Ashigara district. In addition, the Second Joso Trunk Line, which extends through northern Chiba Prefecture and southern Ibaraki Prefecture, was completed in October. The purpose of the Second Joso Trunk Line is to ensure a stable supply by strengthening the transmission of city gas. Actively responding to increases in gas demand, Tokyo Gas is continuing to expand its supply infrastructure with projects such as the Tochigi Trunk Line, scheduled for completion in 2006.
Overview of the City Gas Business in Japan

As of April 2003, Japan had approximately 230 city gas companies. While this number may seem large, three major companies account for approximately 80 percent of total gas sales volume. In addition to these city gas companies, there are about 1,800 specific area gas suppliers and roughly 30,000 liquefied petroleum gas (LPG) companies, most of which are small or medium-sized firms. The industry is thus clearly divided into two well-defined segments — the three large participants and many small and medium-sized firms.

The raw material for approximately 90 percent of city gas used in Japan is natural gas, almost all of which is imported in the form of liquefied natural gas (LNG). Only a limited number of companies take delivery of LNG imports as well as produce and supply city gas. Unlike the United States and Europe, Japan does not have a nationwide pipeline network. Each gas company owns pipelines and supplies and markets gas within its own respective service area.

Continuing Progress in Deregulation

In Japan’s energy markets, retail sales of gas to large-scale customers was liberalized in 1995, along with the generation component of the electric power business. Factors such as the partial liberalization of the retail electricity market starting in March 2000 and the shift to the reporting system for rate reductions have increased management autonomy in both industries.

In February 2003, the schedule for regulatory reform through 2007 was determined. In 2007, customers using 100,000 m³ or more annually will be able to freely select their gas supplier. In the electric power business, the scope of liberalization will expand in 2005 to include customers with a demand capacity of 50 kW or more, and a study of full liberalization, including residential electric power, is slated to begin in 2007.

Deregulation Schedule

Gas:
- Annual usage ≥ 1,000,000 m³
- Annual usage threshold decreases to ≥500,000 m³
- Liberalization of approximately 30% of total sales volume
- Liberalization of approximately 40% of total sales volume
- Liberalization of approximately 50% of total sales volume

Electricity:
- Demand capacity ≥ 2 MW
- Demand capacity threshold decreases to ≥500 kW
- Liberalization of approximately 30% of total sales volume
- Liberalization of approximately 40% of total sales volume
- Liberalization of approximately 60% of total sales volume

Study of full liberalization
Major New Business Opportunities

Progress in deregulation is bringing about an era of "mega-competition." On one hand, competition among gas companies will intensify. On the other, heightened competition in the commercial and residential markets resulting from lower electric power rates will add to the intensity of competition between gas and electric power companies. However, while overall energy demand in Japan is not projected to grow strongly, the share of environmentally friendly natural gas is projected to expand.

As the largest city gas company in Japan, Tokyo Gas is implementing a number of initiatives to benefit from the opportunities presented by deregulation. In the gas business, Tokyo Gas has concentrated on expanding its supply network to capture new demand outside of its previous supply area. We have begun marketing natural gas to new entrants in the electric power business, and have initiated a pipeline business for third parties. Moving away from the supply of gas alone, Tokyo Gas is building its energy services business, which entails high value-added energy use proposals. In aggressively entering the electric power business, Tokyo Gas will implement initiatives that include working alone and in alliances to develop its businesses in power generation and electricity retailing, as well as on-site electricity and heat generation in specified areas. Tokyo Gas is also vigorously reducing costs in areas such as procuring LNG, a field in which the Company has a strong competitive advantage.

Tokyo Gas has many strengths. Amid increasing emphasis on environmental protection, its business centers on environmentally friendly natural gas. Leading-edge technologies for using natural gas with optimum efficiency have added to our superiority in this area, and Tokyo Gas has an established foundation of sales branches and natural gas infrastructure in the Tokyo metropolitan area and the Kanto region, where demand for energy continues to expand. Moreover, Tokyo Gas’s marketing capabilities are based on customer trust acquired over many years, and this will be a significant advantage in making comprehensive energy proposals to industrial and commercial customers. Armed with these strengths, Tokyo Gas is raising its management efficiency, countering the potential risks of reduced demand and lower revenues due to liberalization, and aggressively expanding the businesses of supplying electricity, heat and services with an emphasis on its core city gas business. Tokyo Gas aims to transform itself into an Energy Frontier Corporate Group with natural gas as its core energy source.

Ample Free Cash Flow Supports Growth

While emphasizing revenue growth, Tokyo Gas exceeded internal capital resources in investing to construct the comprehensive production and supply infrastructure needed to respond to deregulation and meet expanding demand for energy, particularly natural gas, in the Kanto region. As a result, interest-bearing debt on the balance sheets increased. However, this period of massive capital expenditures has given way to a period of return on investment, and Tokyo Gas is now able to restrain capital expenditures within the scope of depreciation. In addition, under the management plan covering the five years from fiscal 2000 to fiscal 2004, Tokyo Gas reduced total assets, raised asset efficiency and made particular efforts to reduce its large volume of interest-bearing debt. In fact, the Company achieved its target for fiscal 2004 of reducing interest-bearing debt to ¥786.0 billion two years ahead of schedule. Tokyo Gas is therefore able to capitalize effectively on the opportunities for growth presented by deregulation, and has the ample cash flow required to aggressively invest in new areas.

Cash Flow and Capital Expenditures (Non-consolidated)

Cash flow = Net income + depreciation
Frontier 2007: The Medium-Term Management Plan for the Tokyo Gas Group

In November 1999, Tokyo Gas formulated a five-year medium-term management plan to respond to changes in its operating environment, including the advent of greater competition due to deregulation and the globalization of the economy. This plan covered the five years beginning with fiscal 2000, and the entire Tokyo Gas Group implemented it in concert. As a result, Tokyo Gas achieved the objectives of the plan by the end of fiscal 2002, two years ahead of schedule.

While Tokyo Gas was implementing the recently concluded management plan, further deregulation of Japan’s energy markets resulted in increased competition. Although the operating environment has become more challenging, it also presents significant opportunities for growth for companies able to respond appropriately. In the midst of a whirlwind of change, the Tokyo Gas Group created a new Group management plan, Frontier 2007, in response to the changing operating environment with the aim of generating continued growth and development in energy-related areas, the Group’s core business domain. Announced in October 2002, Frontier 2007 covers the period from fiscal 2003 to fiscal 2007, and the Group began implementing it in April 2003. Frontier 2007 revolves around the concepts of transformation and innovation. Its aim is to lead the Tokyo Gas Group to the next stage in its development.


Deregulation as a Business Opportunity

Business Model Innovation
Construction of the Group Management System
Strengthening the Corporate Structure
Business Expansion into Energy-Related Areas

Growth and Development as an Energy Frontier Corporate Group that Continues to Earn the Trust of Customers, Shareholders and Society

Under Frontier 2007, Tokyo Gas will expand its participation throughout the natural gas value chain, adding upstream gas field development and LNG transportation to its existing business of gas distribution. We will also expand into new energy-related businesses, including the electric power business, energy services, and new residential services. Our objective is to continue to grow and develop with the trust of customers, shareholders and society by transforming ourselves into an Energy Frontier Corporate Group that supplies energy and value-added energy-related products and services.

Frontier 2007 has four pillars. Two are business model innovation and business expansion into energy-related areas. The other two, construction of the Group management system and strengthening the corporate structure, support the first two. These specific measures are the key to the sweeping transformation of the Group’s business domains and structure necessary to achieve the broader objectives of Frontier 2007.
**Primary Management Objectives (Consolidated)**

Tokyo Gas will work to broaden its earnings base, aggressively develop demand, and expand into energy-related businesses through steady progress in implementing the four pillars of Frontier 2007. Moreover, the Company intends to achieve positive Tokyo Gas Economic Profit (TEP) by fiscal 2005 for Group companies by implementing structural reform of the business of affiliates. We also intend to reduce fixed costs (per cubic meter of sales volume) by 24 percent from their fiscal 2002 level by reducing the number of employees and controlling overhead expenses. Other points of emphasis include reducing total assets, raising asset efficiency and strengthening the Group’s financial structure. These initiatives are geared to achieving the management objectives in the table below.

<table>
<thead>
<tr>
<th>Primary Management Objectives (Consolidated)</th>
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</tr>
</tbody>
</table>

**Generating Free Cash Flow and Using It Effectively**

Under Frontier 2007, Tokyo Gas has set a target for free cash flow of ¥480 billion, approximately 1.5 times the amount generated under the previous management plan. We intend to use this free cash flow effectively to maximize the value of the Tokyo Gas Group in ways such as investing in new business areas, as well as reducing liabilities and capital employed. The chart below details specific plans for deploying free cash flow. Primary uses of free cash flow will be ¥120 billion for business expansion investments in new energy-related areas, ¥100 billion for share buybacks and ¥100 billion for reducing interest-bearing debt.

**Deployment of Free Cash Flow (¥ Billion)**

<table>
<thead>
<tr>
<th>Frontier 2007</th>
<th>Five-Year Total: ¥480 billion</th>
</tr>
</thead>
</table>

**PLAN**

**Tokyo Gas Co., Ltd. Annual Report 2003**

11
Business Model Innovation

Business model innovation is central among the four pillars of Frontier 2007. Until now, Tokyo Gas used a business model that entailed the supply of gas alone, which involved the production of city gas from LNG, its supply and marketing. Under Frontier 2007, Tokyo Gas will expand participation throughout the natural gas value chain in upstream development and LNG transportation, in addition to its existing downstream gas business. We will also expand into new areas such as electricity, energy-related services and new residential services. Thus, Tokyo Gas will transform its business model into one in which we supply energy and value-added energy-related services throughout the entire value chain of the Tokyo Gas Group.

Natural Gas Procurement

Innovating toward a business model that advances into upstream development and LNG transportation to maximize the benefits of participation throughout the LNG value chain

By expanding its participation in the LNG value chain, Tokyo Gas is advancing into upstream development and LNG transportation to build synergies with raw material procurement. Tokyo Gas is participating in the Darwin LNG Project, and the construction of two Tokyo Gas-owned LNG carriers is under way. These initiatives will raise the Company’s competitiveness and flexibility.

Business Flow and Business Model Innovation

LNG Receiving Terminals

Innovating cost centers into a terminal infrastructure business

Until now, Tokyo Gas viewed LNG terminals as cost centers that focused on producing gas and ensuring safety. Looking forward, Tokyo Gas’s objective is to convert its LNG terminals into profit centers. We aim to achieve this objective by increasing revenue from allowing third parties to use our terminals, and to raise terminal efficiency by increasing capacity utilization rates, lengthening the service life of LNG facilities through preventive maintenance, and reducing production costs.
The Right Plan

Commercial and Industrial Sales
Innovating our business model to encompass one-stop supply of optimal energy solutions by fully utilizing our network of customers and companies

Tokyo Gas is moving from its previous business model of supplying gas alone to a comprehensive business model of supplying energy-related services that encompass electric power and heat in addition to gas, as well as maintenance and engineering. Tokyo Gas’s aim is to transform itself into a one-stop supplier of optimal energy solutions for its customers.

Inter-Regional Sales
Innovating to expand business areas based on the best mix of diverse commercial resources and new management techniques, with a focus on direct supply, wholesaling, energy services, LPG and LNG sales, and alliances with other companies

Key Issues
• Aggressively acquire additional customers on the periphery of pipelines scheduled for construction.
• Strengthen gas wholesale marketing capabilities through steps including strategic rates, stronger sales and technical support, and the provision of energy services in addition to gas.
• Aggressively expand the liquefied petroleum gas (LPG) business as a Group, and cooperate and form alliances with LPG enterprises in response to deregulation.
• Expand into the energy services business.
• Expand LNG sales deliveries with LNG tank lorries and vessels.
• Develop efficient infrastructure through methods such as alliances with other companies.

Commercial and Industrial Sales
Expand energy services.
Prepare an integrated electric power sales organization.
Expand one-stop energy service capabilities.

Residential Sales
Innovating our business model to provide customers with comprehensive value encompassing energy, products and services

Tokyo Gas has built a strong relationship of trust over the years with the 8.6 million households it serves. This will serve as the base for developing a residential services business. In addition to remodeling, insurance, and home security, we will commercialize and promote the spread of compact fuel cells for residential use, as well as home appliances that use gas instead of electricity, a product area where the pace of growth has been accelerating in recent years.

Residential Sales
Develop residential services including remodeling, insurance, and home security.
Count the shift from gas to electrical appliances.
Commercialize and widely distribute compact fuel cells for residential use.

Technology Development
Innovating technology development into a tool for business model innovation and creation, with an emphasis on fuel cell development

Key Issues
• Popularize residential fuel cells and expand sales channels through continuous technological development. Tokyo Gas is field testing residential fuel cell production prototypes it has developed and expects to commercialize them in fiscal 2004.
• Develop technologies that contribute to the creation of new businesses such as the supply of hydrogen.
• Develop highly efficient cogeneration systems to increase competitiveness.
• Develop and apply trenchless pipe repair methods to improve customer service, mitigate environmental impact and reduce costs.

Pipelines
Innovating our pipeline business from a cost center into a profit center

Until now, Tokyo Gas viewed pipelines the same way it viewed LNG receiving terminals: as cost centers that focus on stable gas supply and safety assurance. We have adopted more rigorous return on investment criteria, however, and are working to reduce the cost of necessary investments and strengthen their security level. The development of the wheeling business is an effort to raise capacity utilization rates and distribute costs over the added wheeling capacity, thereby lowering the effective cost of gas sold to our customers.
Business Expansion into Energy-Related Areas

Expanding our business into energy-related areas will be a major part of business model innovation. Tokyo Gas plans to take full advantage of the business opportunity represented by the growth in energy-related markets as a result of deregulation, and will expand into new value-added energy business fields in natural gas and related businesses. As a result, we are targeting net sales from new business areas of ¥50 billion in fiscal 2007 and ¥150 billion in fiscal 2010. We will further enhance our competitive edge through the construction of a value chain extending from upstream to downstream areas, consisting of the upstream development and LNG transportation business, the electric power business, energy services, overseas business, and new residential services such as insurance and home security.

<table>
<thead>
<tr>
<th>Targets for Expansion into Energy-Related Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Electric Power</td>
</tr>
<tr>
<td>Energy Services</td>
</tr>
<tr>
<td>Overseas</td>
</tr>
<tr>
<td>New Residential Services</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

(1) Electric Power

We are building power plants fueled with our natural gas to provide the foundation for expansion into the electric power business. In accordance with the progress of deregulation as well as power supply and demand trends, generating capacity will be expanded in stages, with an estimated scale of 3,000 mW in the future.

Developing a Power Generation Business

Tokyo Gas has begun working to build its power generation business, a key element of our plan to expand into energy-related areas. We have established subsidiary Tokyo Gas Bay Power Co., Ltd., and built a 100 mW power plant at the Sodegaura Terminal, where final testing is underway and full operations are scheduled to begin in October 2003. In addition to keeping installation costs and operating costs to a minimum by building the plant on our own LNG terminal site, we will use the latest high-efficiency combined-cycle generators to stay fully competitive.

We are also planning to construct a 900 mW power plant jointly with Nippon Oil Corporation (scheduled to begin operations in 2008) and a 1,200 mW power plant with the Shell Group (scheduled to begin operations in 2009).

(2) Energy Services

Business development in this area will be led by ENERGY ADVANCE Co., Ltd., which will provide onsite one-stop services covering everything from energy services, gas and electric power supply, and engineering to maintenance.

Establishment of ENERGY ADVANCE Co., Ltd.

In July 2002, Tokyo Gas established ENERGY ADVANCE Co., Ltd., with paid-in capital of ¥3.0 billion, to function as a total energy service provider for the buildings, factories and urban development projects of companies and local governments. The company will concentrate its operations in three business areas: on-site energy services, district energy services, and installation and maintenance of cogeneration systems. It also aims to provide one-stop services that meet diverse customer needs from consulting on energy-saving measures to construction, operation management, maintenance, and financing of projects.
(3) Upstream Development and LNG Transportation

Tokyo Gas is branching out into the areas of upper and midstream LNG businesses, including overseas development of gas fields and liquefaction plants as well as LNG transportation. By participation in the entire LNG value chain, we will gain synergy, ensure our competitiveness, and obtain better terms in feedstock procurement.

Investment in the Darwin LNG Project

In June 2003, Tokyo Gas officially agreed to participate in the Darwin LNG Project, located in the Bayu-Undan Gas Field in the Joint Petroleum Development Area (JPDA) shared by Australia and East Timor. Tokyo Gas and Tokyo Electric Power Co., Inc. have signed a long-term contract for the purchase of the entire yearly production of LNG (3 million tons) projected for the project. This has enabled Tokyo Gas to participate in the entire LNG chain, from gas production and liquefaction to sales and transport using our own LNG carriers and marketing, thus allowing the Company to maximize the total value of its natural gas business.

Building Our Own Fleet of LNG Carriers

Tokyo Gas is currently building two LNG carriers, which it will own and operate. The first will be completed in fall 2003 and the second in 2005. The Company will use its new carriers to expand free-on-board (FOB) transactions in order to procure competitive LNG by reducing the freight costs. Furthermore, these two carriers will be used not only for LNG transport under long-term contracts, but also in a new LNG procurement program that includes short-term contracts and spot trading, which will result in further reduction of import prices and greater flexibility in contract terms.

(4) Overseas

Tokyo Gas is moving into gas distribution, power generation and other energy-related areas overseas, increasing earnings through management that leverages our technology and know-how.

Overseas Activities

The Tokyo Gas Group has had numerous successful overseas projects over its long history, including involvement in building and managing gas supply infrastructures. The establishment of Malaysia’s first natural gas distribution business and gas-fired district cooling business was the first full-fledged international project by a Japanese energy utility, and has been regarded as a model for other Asian countries.

Tokyo Gas will continue to identify and develop investment opportunities in overseas energy-related businesses such as gas supply and electric power, while focusing closely on profitability.

(5) New Residential Services

In the residential segment, Tokyo Gas is developing businesses for electricity (residential fuel cells) and other utilities besides gas, as well as providing home-related services including remodeling, installation and maintenance of facilities and equipment, insurance, financing, and home security.

Establishment of Tokyo Gas Customer Service Co., Ltd.

Tokyo Gas established Tokyo Gas Customer Service Co., Ltd. in April 2002, and began outsourcing its customer service operations – such as periodic safety checks, meter reading and bill collection – in parts of Tokyo Gas’s service area in July 2002. Operations were transferred in all 67 sectors of our service area by July 2003 to provide high-quality service at a lower cost. Support for this outsourcing will come from Enesta*, a group of franchised, community-based outlets for gas-related operations. Enesta companies will acquire equity stakes in a new company that will be established in April 2004, to which some outsourced services will be transferred.

Entering the Non-Life Insurance Business

Aiming to become a company that provides a variety of energy solutions, products and services used in daily life, Tokyo Gas entered the non-life insurance business in January 2003. Tokyo Gas and Enesta became agents of Sompo Japan Insurance Inc. in order to sell a product that insures household effects against fire, which was jointly developed with Sompo Japan. The first step toward business model innovation will be leveraging the power of our brand, which means reliability, safety and trust to our base of loyal customers.

* Enesta: A group of companies that are part of the Tokyo Gas service network, whose customer service outlets already handle home services such as the connection and disconnection of gas service, the sale, installation and repair of gas appliances, and the remodeling of surrounding areas where equipment is installed.
In order to move forward with business model innovation and expand our business into energy-related markets, we must build a consolidated operating structure that integrates the management of Tokyo Gas and its Group companies. These Group companies have previously operated independently, but must now work together to maximize the earnings of the Tokyo Gas Group.

Frontier 2007 is a plan for shifting from a business model that revolves exclusively around the supply of gas to one that repositions the Company as a total provider of energy and value-added energy-related services. This new model will improve the competitiveness of the entire Tokyo Gas Group and generate stronger consolidated earnings.

To achieve this objective, we are building a consolidated management system that will centralize the formerly separate and independent business operations of Tokyo Gas and its Group companies. We aim to develop a business strategy reflecting the goals of the entire Tokyo Gas Group, including our affiliates, and establish an organizational structure and a management framework to support it. In centralizing business management functions, it will be particularly important to invest management resources strategically and work toward optimization of the Group as a whole. We will also work to enhance corporate functions to ensure that strategic business units (SBUs) have the freedom and flexibility to develop their operations. This will create a stronger market orientation and deepen our relationship of trust with our base of more than 9.2 million customers, our greatest asset.

Changes to the current management organization are in still in the planning stage, with the new structure scheduled to take effect in April 2004.

### Organization of the Strategic Business Unit System

**Present**

- Strategic Planning Division A
- Strategic Planning Division B
- Strategic Planning Division Z
- Affiliated Companies Division

**April 2004**

- Strategic Business Unit
  - Division
  - Executive Officers
  - Affiliate A
  - Affiliate B
  - Affiliate Z

- Corporate Division
- Senior Management
- Shared Services and R&D Divisions
Building a Group Management Structure

The core element of the Group management structure is the SBU. The existing divisions, currently organized in terms of function and business area, will be restructured and consolidated into SBUs with a strong customer-centric focus. The business areas of affiliates, which are closely related to Tokyo Gas’s operations, will be incorporated into various strategic business units, thereby consolidating the management of the parent company and affiliates. This will encourage mutual cooperation among members of the Tokyo Gas Group that will result in improved competitiveness against and differentiation from our competitors.

In addition, we will clarify functions and roles by dividing Group management into three areas: the corporate division; the SBUs; and divisions for shared services and R&D. Specifically, the corporate division, which is responsible for the management of the entire Group, will define the framework for optimization of the Group as a whole and will formulate and execute Group strategy. Each SBU will work to develop the respective business it is associated with. The shared service divisions and the R&D division will be in charge of providing services and technical support for the entire Group. By ensuring that these three areas function smoothly together in an organic fashion, Tokyo Gas will maximize the power of the Group.

Strengthening the Group Management Structure

As changes in the business environment accelerate, the functions and framework associated with optimizing the Tokyo Gas Group will become increasingly important. As a result, we are focusing on developing stronger business management capabilities.

The corporate division will clearly set forth the direction of the Group, with the responsibility and authority to make adjustments as circumstances demand. SBUs will be given the freedom to carry out plans such as reorganizing or consolidating businesses within units. In addition, we will consolidate all Group management functions under the Strategic Planning Division. This move will replace the current parallel structure where the corporate division is overseen by the Strategic Planning Division and the Affiliated Companies Division is responsible for all Tokyo Gas affiliates. This reorganization will ensure the smooth planning, implementation and management of the Group’s strategies.

Under this management structure, we will achieve a dynamic management that uses a process of selection and concentration to focus management resources in highly profitable and competitive areas.

Tokyo Gas Group Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Business</th>
<th>Capital (¥ Million)</th>
<th>FY2002 Net Sales (% of Outside Sales)</th>
<th>Operating Income (Loss) (¥ Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tokyo Gas Urban Development Co., Ltd.</td>
<td>Real estate leasing, management, brokerage</td>
<td>8,779</td>
<td>35,539 (39.6)</td>
<td>7,125</td>
</tr>
<tr>
<td>ENERGY ADVANCE Co., Ltd.</td>
<td>Energy service business</td>
<td>3,000</td>
<td>17,837 (89.8)</td>
<td>3,708</td>
</tr>
<tr>
<td>Gaster Co., Ltd.</td>
<td>Gas appliances production and sales</td>
<td>2,450</td>
<td>29,032 (55.0)</td>
<td>2,539</td>
</tr>
<tr>
<td>KANPAI Co., Ltd.</td>
<td>Design and construction of gas pipelines, waste water and air conditioning facilities</td>
<td>1,300</td>
<td>47,202 (32.5)</td>
<td>1,077</td>
</tr>
<tr>
<td>Energy LNG Tanker Co., Ltd.</td>
<td>LNG and LPG chartering, transport of carriers</td>
<td>1,200</td>
<td>1,711 (0.1)</td>
<td>586</td>
</tr>
<tr>
<td>Tokyo Gas Energy Co., Ltd.</td>
<td>Sales of energy LPG and coke</td>
<td>1,000</td>
<td>20,731 (91.7)</td>
<td>275</td>
</tr>
<tr>
<td>Tokyo Gas Chemicals Co., Ltd.</td>
<td>Sales of gas for industry and chemicals, R&amp;D of LNG cooling applications</td>
<td>1,000</td>
<td>20,313 (91.3)</td>
<td>641</td>
</tr>
<tr>
<td>Park Tower Hotel Co., Ltd.</td>
<td>Hotel (Park Hyatt Tokyo) management</td>
<td>1,000</td>
<td>8,988 (99.9)</td>
<td>764</td>
</tr>
<tr>
<td>Tokyo Oxygen and Nitrogen Co., Ltd.</td>
<td>Production and wholesale of liquefied oxygen and nitrogen</td>
<td>800</td>
<td>2,929 (44.9)</td>
<td>258</td>
</tr>
<tr>
<td>Chiba Gas Co., Ltd.</td>
<td>Gas business</td>
<td>480</td>
<td>11,174 (99.6)</td>
<td>699</td>
</tr>
<tr>
<td>TG Credit Services Co., Ltd.</td>
<td>Financing and leasing related to gas equipment and construction</td>
<td>450</td>
<td>10,940 (47.4)</td>
<td>263</td>
</tr>
<tr>
<td>TG Information Network Co., Ltd.</td>
<td>System integration business</td>
<td>400</td>
<td>14,706 (24.8)</td>
<td>(121)</td>
</tr>
<tr>
<td>Tsukuba Gakuen Gas Co., Ltd.</td>
<td>Gas business</td>
<td>280</td>
<td>5,025 (98.8)</td>
<td>375</td>
</tr>
<tr>
<td>TG Enterprise Co., Ltd.</td>
<td>Group financial administration business</td>
<td>200</td>
<td>817 (52.8)</td>
<td>(27)</td>
</tr>
<tr>
<td>Tokyo Gas Engineering Co., Ltd.</td>
<td>Comprehensive engineering services centered on energy</td>
<td>100</td>
<td>31,068 (70.8)</td>
<td>458</td>
</tr>
<tr>
<td>TG•IT Service Co., Ltd.</td>
<td>Tokyo Gas systems, network operations</td>
<td>50</td>
<td>8,394 (0.2)</td>
<td>282</td>
</tr>
<tr>
<td>Tokyo Gas Customer Service Co., Ltd.</td>
<td>Provision of periodic gas safety checks, meter reading and billing services</td>
<td>50</td>
<td>3,584 (82.8)</td>
<td>(120)</td>
</tr>
</tbody>
</table>

As of March 31, 2003
Strengthening the Corporate Structure

To succeed in this period of “mega-competition” in the energy industry, it is essential to create a stronger and more streamlined corporate organization. To this end, Frontier 2007 will focus on establishing corporate governance, strengthening our financial position, clarifying evaluation standards, and pursuing cost reductions across the board.

Establishing Corporate Governance

The underlying foundation of our business activities is delivering value to our customers. All our activities focus on our customers, as we strive to become a corporate group that is trusted by customers, shareholders, and society as a whole. With this in mind, we are working to further improve compliance while promoting active disclosure of information and stronger corporate governance.

In November 2002, Tokyo Gas established a Compliance Department and a supporting organization to bolster the Company’s compliance promotion system. Under the basic guidelines formulated by the Management Ethics Committee, which is chaired by the President, Compliance Committees established in each division are each conducting their own ongoing compliance-related measures, while the Compliance Department is responsible for company-wide educational programs. Through these efforts, we are working to create a corporate culture that encourages all executives and employees to emphasize compliance in their decisions and behavior, thereby continually improving our brand value.

In March 2003, Tokyo Gas set up two Compliance Hot Lines to accept employee questions. Employees are able to consult directly on compliance-related issues through either an in-house or external hotline. This new system enables employees to quickly resolve problems and has strengthened the Company’s ability to carry out compliance automatically and independently.

The Audit and Operational Enhancement Department also performs compliance audits to ensure compliance with governmental regulations.

To strengthen corporate governance, Tokyo Gas reorganized its governance system in June 2002. Changes included substantially reducing the number of directors, shortening their terms of service, and appointing outside directors to the board. At the same time, Tokyo Gas was the first in the industry to introduce a corporate executive officer system, which has improved the management of day-to-day operations. In the future, we will continue working to revitalize the board of directors while increasing management transparency.

Management Philosophy

As a total energy industry, the Tokyo Gas Group shall make an active contribution to pleasant living and the development of environmentally friendly cities, and also pursue ongoing advancement together with the rest of society, as a corporate group that earns and maintains the trust of its customers, shareholders and communities through its various activities.

1. Tokyo Gas shall strive to evolve into a new utility that simultaneously satisfies the goals of contribution to customers and communities as a public-minded enterprise and increases its corporate value as a joint-stock corporation.
2. Tokyo Gas shall observe the letter and spirit of laws and regulations, and work for socio-economic advancement through business activities that are both fair and transparent.
3. Tokyo Gas shall contribute to the alleviation of global environmental problems as a leading practitioner of environmental management.
4. Tokyo Gas shall remain keenly aware of its obligations to be a good corporate citizen and assist the emergence of a more fulfilling society through contributing to community activities.
5. Tokyo Gas shall pursue innovation on an ongoing basis to promote a cost effective business approach and a flexible but resilient disposition.
6. Tokyo Gas shall aspire to build organizations that are brimming with vitality based on the full exercise of and respect for the talents, desires, and creativity of each and every employee.
Strengthening Our Financial Position and Clarifying Evaluation Standards

Continued from our previous medium-term management plan, one of the goals of Frontier 2007 is to improve asset efficiency by reducing fixed, financial and other assets. We are aiming to lower the amount of interest-bearing debt by about ¥150 billion, on a consolidated basis (approximately ¥100 billion compared with actual results for fiscal 2002), in order to improve our financial position by minimizing interest-rate risk. In addition, we are establishing uniform standards for entering, maintaining, and withdrawing from businesses, as well as for investment decision-making, in order to develop more efficient and effective operations.

These evaluation standards are Tokyo Gas Economic Profit (TEP), Net Present Value (NPV) and Internal Rate of Return (IRR). TEP is Tokyo Gas’s version of Economic Value Added (EVA®), allowing us to meet the expectations of shareholders while looking for ways to generate added value, determining the future direction of our business and optimizing the allocation of management resources.

Pursuing Cost Reductions

Tokyo Gas is reducing costs through measures such as making administrative divisions more efficient, which enables increasing cash flow for investment in new businesses. The introduction of shared services for the Group as a whole will improve the efficiency of administrative operations while reducing staffing requirements and costs at the Tokyo Gas head office. In addition, any increase in fixed costs due to an increase in new customers will be absorbed through our cost cutting efforts, and overhead in fiscal 2007 should be back to fiscal 2002 levels.

Because business model innovation will require improvement in the quality of human resources and a more dynamic organization, we are focusing harder than ever on human resources development and management. At the same time, through reorganization of all businesses, Tokyo Gas will reduce personnel by about 1,700, or 16 percent, compared with the end of fiscal 2002, resulting in a total staff of no more than 8,800 by the end of fiscal 2007. In addition, expanding the merit-based system of annually salary negotiations for managers and other measures will bring compensation more closely in line with performance.