Toward the realization of a low-carbon society, we are working to promote the utilization of natural gas, which is increasingly important as a key source of energy. Moving forward, we will continue striving to develop the integrated energy business by fostering the advanced use of natural gas in a wide range of fields.

Tsuyoshi Okamoto
President and Representative Director
TO OUR SHAREHOLDERS AND INVESTORS

The Group’s management philosophy is as follows: “As an integrated energy company, the Tokyo Gas Group shall make an active contribution to pleasant living and the development of environmentally friendly society, 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.” In accordance with this management philosophy, my most important mission is to successfully pursue the Group’s medium-term management plan for fiscal years from 2009 to 2013 and to establish the route toward growth for All Tokyo Gas over the long term.

Operating Environment Remains Challenging
In the January to March quarter of 2010, there were signs that the global economic slump, which began with the financial crisis in the United States in 2008, had bottomed out. GDP growth, for example, finally turned positive, and corporate results showed signs of recovery. The moderate recovery trend in our operating environment is expected to continue over the short term. However, city gas demand, which has drastically declined, especially in the industrial sector, has not recovered to the level seen prior to the Lehman Brothers collapse. More time will still be required to reach a full-fledged recovery.

We expect the influence of the economic recession to continue in the fiscal year ending March 31, 2011. In the residential sector, due to the continued slowdown in the housing market, the number of new housing starts in our supply area is expected to decline. In addition, in the industrial sector, customers remain very cautious about future economic trends.

Competition with other forms of energy continues to intensify. In the residential sector, the aggressive promotion of all-electric houses by electric companies is spreading from new housing to existing housing. Moreover, in the commercial and industrial sectors, these promotion efforts are expanding to include all-electric commercial kitchens and manufacturing factories. It is important that we deal directly with the fact that we are in an extremely challenging operating environment.

“In the midst of the transition to a low-carbon society, the importance of natural gas is increasing. The mission of Tokyo Gas is to expand the advanced use of natural gas.”

Rising Importance of Natural Gas in the Rapidly Changing Energy Industry
Throughout the world, calls for measures to mitigate climate change appear set to bring about major changes in the energy industry.

The Japanese government, for example, has set goals of reducing emissions of greenhouse gases by 25% by 2020 and 80% by 2050, compared to the level in 1990. A number of policy measures are currently being considered to meet these goals, including the Act on Promotion of Global Warming Countermeasures and other laws, environmental taxes, and a domestic emission trading system. There is no question that some of these measures will sooner or later be adopted. In the future, in accordance with the concept of “moving toward a low-carbon society,” the Japanese government will likely conduct wide-ranging deliberations about the supply of energy in ways that transcend the traditional framework of petroleum, electricity, and gas.

With regard to the reduction of greenhouse gases, a current focus of attention is the use of renewable energies, such as solar power, solar heat, wind power, and biomass. However, renewable energies suffer from quantitative supply restrictions and problems with supply stability. These forms of energy can only account for a limited portion of total energy demand.

On the other hand, in comparison with other fossil fuels, such as petroleum and coal, natural gas has an overwhelming advantage in environmental friendliness. With a wide range of suppliers backed by substantial reserves, natural gas also offers supply stability. The convenience of natural gas facilitates flexible responses
to a wide range of demand structure, such as dispersed power generation, and natural gas also offers high heat efficiency. Clearly, natural gas has a significant range of competitive advantages. In this setting, we are seeing rapid increases in the importance of natural gas as a key source of energy.

It is our mission to expand the advanced use of natural gas in a wide range of fields. As outlined in our medium-term management plan, we want to actively contribute to the emergence of a low-carbon society through groupwide initiatives in the integrated energy business, with natural gas at its core.

Specific initiatives targeting the realization of a low-carbon society include developing and cultivating natural gas demand, establishing community-based marketing systems, and expanding basic infrastructure. Through the focused application of management resources to these three points, in particular, we are making steady progress.

“Our efforts to promote the advanced use of natural gas will center on the proposal of optimal energy solutions, principally cogeneration systems, and on expanded sales of the “ENE-FARM” residential fuel cell. We will also work to make further progress in the development of smart energy networks.”

Thorough Market Development, Centered on Advanced Use of Natural Gas
In the industrial sector, which accounts for more than 40% of our gas sales volume, there is still a substantial amount of heat demand that is being met by fossil fuels other than natural gas. This means that there is significant potential left for the switch to natural gas. In response to this demand, we do not simply propose a switch in fuel. We also propose high-value-added energy solutions that include the introduction of cogeneration systems and other high-efficiency equipment. In this way, we are taking steps to enhance convenience for customers.

In the residential sector, we are working to promote the spread of the latest appliances, including the “ENE-FARM” residential fuel cell that was launched in 2009. In fiscal 2009, 1,500 “ENE-FARM” fuel cells were sold, and in fiscal 2010, we are planning sales of 2,500 units. As we strive to foster the adoption of a new concept—an age in which energy is generated at home—and to advance the introduction of “ENE-FARM,” we are aiming for cumulative total sales of 42,000 units by the end of March 2014.

The introduction of a range of environmental regulations is currently being debated, and a growing number of commercial and industrial customers are considering specific responses. We are approaching this accelerating trend as a major business opportunity. As one facet of our energy services, for example, we are devoting resources to the provision of energy-saving diagnoses. These include support for the preparation of reports to the national government that are required under the Law Regarding the Rationalization of Energy Use, and the collection and analysis of data regarding the energy usage of customers and the preparation of reports based on that data. With these support services as a foothold, we are working to expand our energy services operations.

Moreover, to further enhance the value added of natural gas and promote its advanced use, we will undertake a full-scale initiative targeting the establishment of smart energy networks. These networks meet demand for energy, including electricity and heat, with optimal combinations of energy sources. Combining natural gas systems, centered on cogeneration systems, with other energy sources, such as renewable energy and conventionally generated power, these systems provide local communities with networked energy services. Fluctuations in demand for heat and electricity are accommodated through the network, providing outstanding results in the reduction of energy consumption and CO₂ emissions. In this way, smart energy networks exemplify a next-generation energy supply. We will continue our ongoing efforts in technical
development, which is the foundation for the growth of these operations. Meanwhile, to support concrete progress toward commercialization, in May 2010 we began a demonstration project in Tokyo’s Arakawa Ward. As we move forward with smart energy network development, we will steadily accumulate know-how and move closer to commercialization.

“Through the completion of the LIFEVAL system, we have put in place the “structure” needed to enhance services. By adding the “spirit” of community-based marketing to this “structure”, we will further enhance our brand values of security, safety, and trust.”

Implementing the Philosophy of Community-Based Marketing

One point that we are stressing is the establishment of community-based marketing. Our direct contact with 10.63 million customers is a great strength and constitutes a tremendously important management asset for the Company. With the objective of strengthening the service provided to customers, we reorganized and consolidated services that had previously been dispersed and made a step-by-step transition to the Tokyo Gas LIFEVAL system. In October 2009, we completed the establishment of our bases in 63 blocks.

In this way, we completed the “structure.” But by itself, that structure has no meaning. Moving forward, we now need to add the “spirit” to the “structure.” Building relationships of trust is a task that is accomplished through steady effort on a daily basis. Over more than 120 years, we have cultivated our brand values of security, safety, and trust by valuing our customers and supporting local communities. In the years ahead, we must further enhance those brand values.

On the foundation of the relationships of trust that we have cultivated, we will aggressively offer high-value-added proposals in our daily contact with customers. These will include explanations of the advantages of the latest gas appliances, in terms not only of environmental friendliness but also of safety, ease of use, and contribution to comfortable lifestyles for customers.

“In response to growing demand, we will accelerate the construction of our fourth LNG terminal and will implement thorough measures to acquire demand in the region extending for a 200 kilometer radius around Tokyo.”

Strategic Infrastructure Development from a Medium- to Long-term Viewpoint

To meet growing demand for natural gas through the two specific initiatives described above, we must reinforce the LNG value chain, which extends from gas fields to LNG terminals and pipelines, and finally to customers.

With our three existing LNG terminals, our current supply capacity is about 17 to 18 billion m³ a year. We are forecasting growth in demand, and it is possible that we will hit the upper limit of our supply capacity in the second half of the 2010s.

We have considered construction plans for our fourth LNG terminal, the Hitachi LNG Terminal, in the port district of the city of Hitachi in Ibaraki Prefecture, and for a high-pressure transmission pipeline connecting the Hitachi LNG Terminal with the city of Moka in Tochigi Prefecture. Originally, we were planning for the start of operations in the fiscal year ending March 31, 2018, but in December 2009 we decided to accelerate those plans by two years.

Through the completion of this project, we will ensure supply stability in the Tokyo metropolitan area and also increase our supply capacity in the northern Kanto area, centered on the area around the terminal and
along the high-pressure transmission pipeline. In the region extending for a 200-kilometer radius around Tokyo, we will be able to accelerate the advance use of natural gas, centered on industrial customers. Furthermore, we are also considering the use of the Hitachi LNG Terminal as a shipping base for LNG coastal tanker vessels. We have high expectations for the range of expansion possibilities that will be created by the new terminal, such as the opportunity to expand our supply area using pipelines, trucks, and coastal shipping.

**Steady Progress in Implementing the Medium-Term Management Plan**

In addition to the three points outlined above, we are making favorable progress in implementing the measures outlined in the medium-term management plan, even in an environment affected by the lengthening slump of the Japanese economy.

We have made progress in bolstering and expanding the LNG value chain, especially in upstream business. In the area of upstream interests, there is a natural hedging effect that moderates the pressure on gas business profits that results from the slide time lag during periods when gas resource costs are rising. Our interests in the Darwin Project, which has reached its fifth year of operations, are contributing to our profits, such as through the receipt of dividends.

We have already acquired interests in the Pluto Project. Construction work is proceeding favorably, and shipments are expected to start in the first half of 2011. In addition, in September 2009, we decided to invest in the new Gorgon Project.

Furthermore, in March 2010 we signed a heads of agreement regarding participation in the Queensland Curtis LNG Project in Australia. In this project, coal bed methane (CBM) will be converted on-site to LNG, which will then be shipped. If this project is successful, Tokyo Gas will be the first Japanese energy company to procure from and hold an interest in a CBM-derived LNG project. The Queensland Curtis LNG Project will be a milestone in expanding the range of choices that we will have in future projects and in diversifying resource procurement.

In the future, we will continue to maintain an active presence in overseas operations, including the acquisition of interests, in order to expand the scale of the LNG value chain as well as its potential.

**Results in Fiscal 2009 and Outlook for Fiscal 2010**

As described above, we have made steady progress with a range of initiatives, but our results reflect the continued sluggish business conditions.

In fiscal 2009, the number of customers rose 1.2%, or 120 thousand, to 10,630 thousand. However, the economic downturn resulted in reduced facility utilization by customers, and the gas sales volume declined by 2.0% year on year, to 13,666 million m³.

Due to the decline in gas sales volume and to lower gas unit prices under the gas rate adjustment system stemming from the decline in crude oil prices, net sales were down ¥244.4 billion, to ¥1,415.7 billion. On the other hand, due to substantial improvement in the slide time lag, operating income rose ¥20.0 billion, to ¥85.2 billion. As a result, we recorded lower sales but higher profits.

For fiscal 2010, we are forecasting gas sales volume of 14,460 million m³, an increase of 5.8%. Key reasons include higher demand as a result of the development of new demand and of improved business condi-
tions, as well as an increase in the amount of gas supplied to the Ohgishima Power Station, which started operations in March 2010.

Due to the increase in gas sales volume, and to the effect of higher unit prices due to increased gas resource costs, we are forecasting net sales of ¥1,551.0 billion, an increase of ¥135.3 billion. In profits, as a result of improvement in actuarial differences associated with accounting for retirement benefits, which will offset the negative effect of higher gas resource costs, we are forecasting operating income of ¥108.0 billion, an increase of ¥22.8 billion. In this way, we are forecasting higher sales and profits.

“Our policy for return to shareholders is to maintain a total payout ratio of 60% of net income, with consideration for higher dividends.”

In providing a return of profits to shareholders, we increased per-share dividends by ¥1, from ¥8 to ¥9. Factors behind this decision included a decline in the risk that we expected when we formulated the medium-term management plan and a forecast of stable future profits. Specifically, the price of LNG, which had fluctuated significantly due to swings in crude oil prices, regained its stability. We were also able to reduce the risk of fluctuations in pension actuarial differences in the future by changing our pension fund investment to a portfolio centered on long-term bonds from fiscal 2010. In addition, we expect to be able to absorb the increased expenses resulting from the acceleration of the construction of the Hitachi LNG Terminal by restricting capital investment as well as overall investment and financing.

We remain committed to our policy of providing a 60% total payout ratio, including dividends and purchases of treasury stock. Due to an absorption-type merger with a subsidiary, we have already purchased 14 million shares of treasury stock in fiscal 2010. Including those shares, we have purchased and cancelled 19.56 million shares of treasury stock, and as a result the total payout ratio reached 60.1%.

Maintaining the Trust of Customers, Remaining the Choice of Customers

I believe that companies are public entities that exist not for a specific group of stakeholders but for all stakeholders. This is especially true for Tokyo Gas, which conducts business operations that have a strong public interest.

It goes without saying that it is important for the Company to gain the trust of the capital markets and record continual growth. To that end, it is essential to generate a high degree of customer satisfaction and to remain the choice of customers. As an energy company that supports consumer lifestyles as well as industrial activity, this is an important social responsibility.

It is my job as chief executive to create high value-added, centered on the environment, and to demonstrate leadership in the transition to a low-carbon society. This is also corporate social responsibility that must be fulfilled by Tokyo Gas. In this way, we will meet our social responsibilities to customers and local communities through our daily operations. Moving forward, Tokyo Gas will strive to be a company that responds to the mandate of its shareholders and will work to grow together with its shareholders and investors.

July 2010

President and Representative Director, Tsuyoshi Okamoto