

Toward realizing the “Challenge 2020 Vision”

# Tokyo Gas will confidently and boldly persist dealing with challenges

**Michiaki Hirose**

Representative Director, President

## **My mission is to create new Tokyo Gas corporate value.**

**Since 1885, Tokyo Gas has provided a stable and reliable supply of gas to industries and households in the Greater Tokyo Area to support its economic development and quality of life of its people. While doing so the company has also raised its corporate value.**

**We believe we are in the midst of an era we call the second foundation of the company as the full deregulation of the electric power and gas markets draws near. In this context, we are pledged to make our "Challenge 2020 Vision" adopted in 2011 a reality and ensure the unfaltering growth of the Tokyo Gas Group in the years to come.**

### **Fiscal 2016 will be a year to form a solid base for future growth**

In fiscal 2015, ended March 31, 2016, we achieved a record high in operating income, ¥192 billion (up 11.8% year-on-year). This was mainly due to a lagged benefit from lower oil prices, and adjusted for such extraordinary factors, operating income was estimated to be similar to that of the previous year.

For fiscal 2016, ending March 31, 2017, assuming the exchange rate of ¥115 per U.S. dollar and an oil price of \$37.5/bbl (\$35 in the first half and \$40 in the second half), operating income (initial forecast) is expected to be ¥48 billion (down 75% y-o-y). Major factors for this profit decline will be an absence of the lagged benefit of last year, pension actuarial difference, and an increase in depreciation burden following the start-up of domestic large infrastructure projects. Excluding such extraordinary factors, we do not think that our operating performance is significantly deteriorating this year. With the advent of completion of the deregulation of the electric power and gas markets, we have identified this year to be a critical year for Tokyo Gas to become a "total energy" company and a truly global company. We will make investments and implement measures for enhancing our mid- and long-term corporate value to form a solid base for our future growth.

### **We are making steady progress in the second "Step" stage measures of our Challenge 2020 Vision**

Fiscal 2015 was the first year of the second "Step" stage of our Challenge 2020 Vision. We made steady progress in its three main measures: to evolve into the total energy business; to accelerate global business development; and to reconstruct the corporate group. We will continue our progress in fiscal 2016.

### **Evolving into the total energy business**

To evolve into the total energy business, we have established our base for expanding sales of gas in the future. Specifically, we began operation of our Northern Kanto Area infrastructure, including the Hitachi LNG Terminal, our first receiving terminal located outside of the Tokyo Bay area as well as the Ibaraki-Tochigi Line. In addition, we have decided to construct the Ibaraki Line to connect Hitachi area and

Kashima area, as a last component to complete our infrastructure in the Greater Tokyo Area. Upon completion of the Ibaraki Line and pipeline loops, we can surely accommodate future additional gas demand in the Greater Tokyo Area.

Concerning the electric power business, the third unit of Ohgishima Power Station (Tokyo Gas generation capacity: 300 MW) started operation in February 2016, ahead of the full deregulation of the retail electric power market in April 2016. In January, we commenced pre-order sales of electricity to residential and commercial customers and have been steadily building up the number of customers. Our plan for the initial year is 400,000 customers but we are making group-wide efforts to achieve and exceed the target as soon as possible, with the aim of becoming the No. 1 new power entrant.

### **Accelerating global business development**

In the context of accelerating global business development, we have established new business operation sites and increased our workforces in the past two years. Specifically, our office in Houston, Texas increased the workforces to around 20 persons, while we opened new offices in Singapore, Jakarta, Bangkok, and Hanoi to make a five-office network in Southeast Asia, including the existing office in Kuala Lumpur. Having bases like these enables us to collect valuable and timely information. From fiscal 2016, we have launched two initiatives based on our enhanced new network. First, leveraging our strength as an LNG importer, we decided to get involved in upstream projects in North America. Making use of our past lesson in being forced to record impairment loss in a downward phase of oil and gas prices, we will cautiously select prime projects while carefully focusing on commodity price trends. Second, capitalizing our long-accumulated total energy business technology and know-how, with an emphasis on LNG in Japan, and through alliances with local energy companies in Southeast Asian countries, we want to take up the challenge of developing an LNG value chain business from receipt and supply to use of LNG. We recognize that it will take time to establish a deep-rooted local network. Nonetheless, with a focus on North America and Southeast Asia, we would like to develop and promote business from a medium- to long-term perspective.



### Reconstructing our corporate group

Concerning the reconstruction of our corporate group, we aim to integrate functions and operations, including those at subsidiaries and affiliates, through the selection and concentration of businesses. Specifically, we withdrew from manufacturing and sales of gas appliances by selling shares of Gastar Co., Ltd., our group company, to Rinnai Corporation, and decided to enhance sales business, which brings us closer to customers and leverages our Group's strength. In April 2016, we established Tokyo Gas Liquid Holding Co., Ltd. to control our liquid gas business, such as LPG gas and industrial gas. By having Tokyo Gas Energy Co., Ltd., Tokyo Gas Chemicals Co., Ltd., and Japan Super Freeze Co., Ltd. under the new company, the liquid gas business structure has been restructured to enhance group management.

Triggered by the fully deregulating the retail electric power and gas market, we are carrying out the reconstruction and consolidation of the Tokyo Gas Group and other structural reform, where none has been done up to now. The city gas business will always be our core business. Going forward, however, we will shift away from management focused on one dominant business in city gas, corresponding to Mt. Fuji, to management of several large businesses, including the electric power business, overseas, engineering, liquid gas, and real estate businesses, corresponding to an entire mountain range.

Going forward, to boldly and speedily promote our measures of the "Step" stage, we expect that investment in resources will temporarily have priority over establishing infrastructure,

acquiring customers in the electric power market, and achieving other objectives. This is a requisite, however, for our next "Jump" stage. I firmly believe that Tokyo Gas will continue to grow by steadily implementing the measures, looking toward the future beyond the Challenge 2020 Vision.

### Deregulation of the retail electric power and gas markets is regarded as a major business opportunity.

The electric power market is immense, at ¥3 trillion in the Greater Tokyo Area alone, and we regard the opportunity to access this market as a major business opportunity for Tokyo Gas. In addition to wholesale and large-scale customer markets, we are focusing on the sale of electricity to households and small commercial customers, the sectors that are subject to deregulation. We have a very challenging objective of satisfying 10% of demand for electricity, equivalent to 30 billion kWh, in the Greater Tokyo Area by 2020. Regarding the power supply required for electricity sale, the third unit of the Ohgishima Power Station began operation in February 2016 and power generation capacity has been raised to 1,600 MW. Moreover, due to purchase of the electricity generated at Kobe Steel's Moka Power station and other factors, we plan to expand our supply capacity to 3,000 MW by 2020. Further, in addition to competitive gas-powered thermal power sources, we will also implement renewable energy initiatives, with consideration to addressing to the issues of the climate change. As we have a clear prospect of securing adequate power sources, the next challenge is how to build a customer base, which we believe incorporates two important points. First is

## Tokyo Gas is carrying out structural reforms, looking ahead to the full deregulation of the electric power and gas business

our policy on pricing. Tokyo Gas has long accumulated added value, namely reliability, safety, and trust through its 130-year history in the gas business. It is certainly important to make certain competitive pricing relative to our competitors.

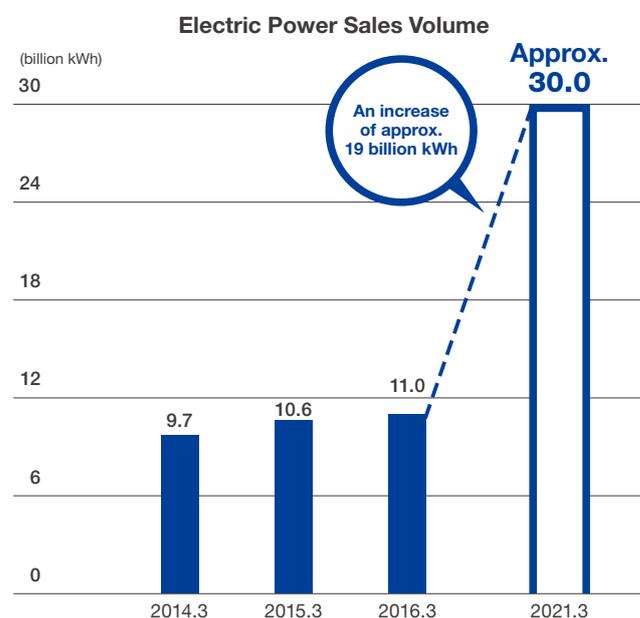
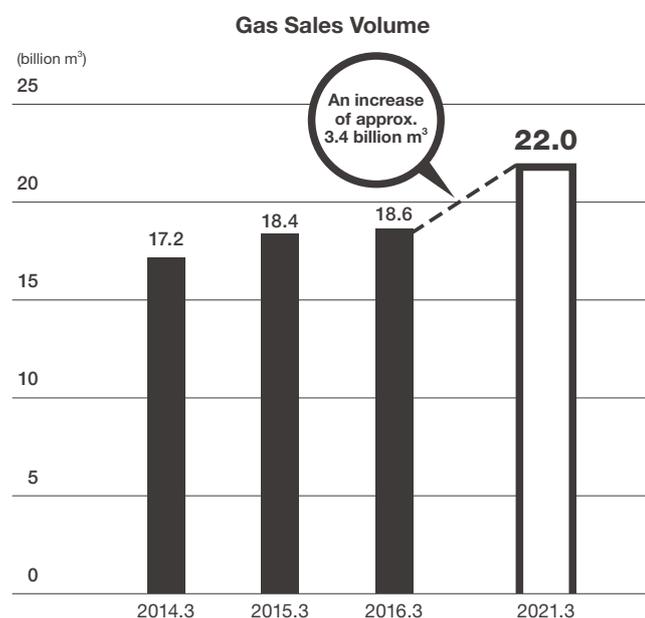
However, we believe a considerable strength of Tokyo Gas lies in its direct contact with its customers with whom the solid relationship of trust has been established and through Lifeval companies engaged in maintenance, inspection, sale of gas appliances, and others. We intend to get maximum leverage out of it.

The second important point is how to think about earnings. We hope to be widely recognized that Tokyo Gas will be the No. 1 new power entrant from the beginning of the full deregulation of the retail market and will steadily acquire a significant market share. Then after a few years, we expect that new players will be reorganized and consolidated into a fewer number. Along with such scenario, at the initial stage, costs to enter the small-scale-user electricity sales market will temporarily increase. However, as the infrastructure industry leverages economies of scale, at a stage when a certain scale of demand is acquired, our management focus can be shifted into acquiring profitability.

In April 2017, the retail gas market will be deregulated. In my view, the purpose and objectives of the Gas System Reform is slightly different from the Electricity System Reform. The Electricity System Reform aims at 1) stable supply of electricity; 2) lower electricity prices; and 3) more options of suppliers for customers, while the Gas System Reform aims at 1) stable supply and expansion of diffusion of gas use; 2)

lower gas prices and higher customer satisfaction; and 3) more options of suppliers for customers and enhanced customer safety. Differences are to include “expansion of diffusion of gas,” “higher customer satisfaction,” and “enhanced customer safety” for the gas reform’s purposes. Use of environmentally-friendly natural gas which generates low CO<sub>2</sub> emissions displaced other fuel and conversion to gas use is still advancing. While electricity is relatively easy to handle, gas requires safety to be secured up to the point of use at customers. As safety know-how is indispensable for the safe use of gas, we believe that now is precisely the time that our accumulated relationship of trust with customers will be tested. Moreover, in Japan, a country poor in natural resources, Tokyo Gas can stably procure energy resources by procuring as planned approximately 14 million tons of LNG annually, equivalent to 15% of Japan’s LNG procurement, and can utilize its existing LNG terminals and other components of its infrastructure.

As a managerial risk scenario, we need to prepare for the possibility of a certain share to be taken away by our competitors if the full deregulation triggers renewed competition in the already-deregulated large-scale customer segment of the market, in addition to competition in satisfying household gas demand. This makes us even more determined to increase profits in absolute value terms by fully utilizing our relationship of trust with customers and enhancing our unique services, and at the same time by expanding our business in the electricity market, which is bigger in size than that of gas, at an early stage.



## Enhance “invisible assets” and take up challenges of our second round of foundation

In the midst of an era of the full deregulation of the retail electric power and gas markets, we think of ourselves as being in our second foundation era. Eiichi Shibusawa, a Japanese industrialist and financier in the 19th century, who founded Tokyo Gas and established its business base, wrote in his book *Rongo to soroban* (The Analects and the Abacus) the importance of balancing the pursuit of common good and profit. For 130 years since foundation, we have kept this foremost and consistently have endeavored to contribute to society by safely and stably supplying energy, which is indispensable to people’s lives, and have achieved sustainable profit growth of the company. This dedication is shared by all of our employees and is the ultimate source of our corporate value. This underlying principle will remain unchanged when we handle not only gas but also electric power and other energy sources and when we do business not only in the Greater Tokyo Area but also Japan and the World. Since our foundation in 1885, we have accumulated “invisible value” which do not appear on financial statements, while being engaged in the stable supply of gas to industries and households and in supporting economic development and prosperous lives of people in the Greater Tokyo Area. Our sources of competence include accumulated knowledge and know-how, richly experienced human resources, a track record in stable supply, LNG procurement capacity, our

customers’ trust, the metropolitan network of Lifeval as service companies and others, and various business partners.

We are determined to enhance such “invisible value” and realize a sustainable growth as a corporate group through three avenues of contribution.

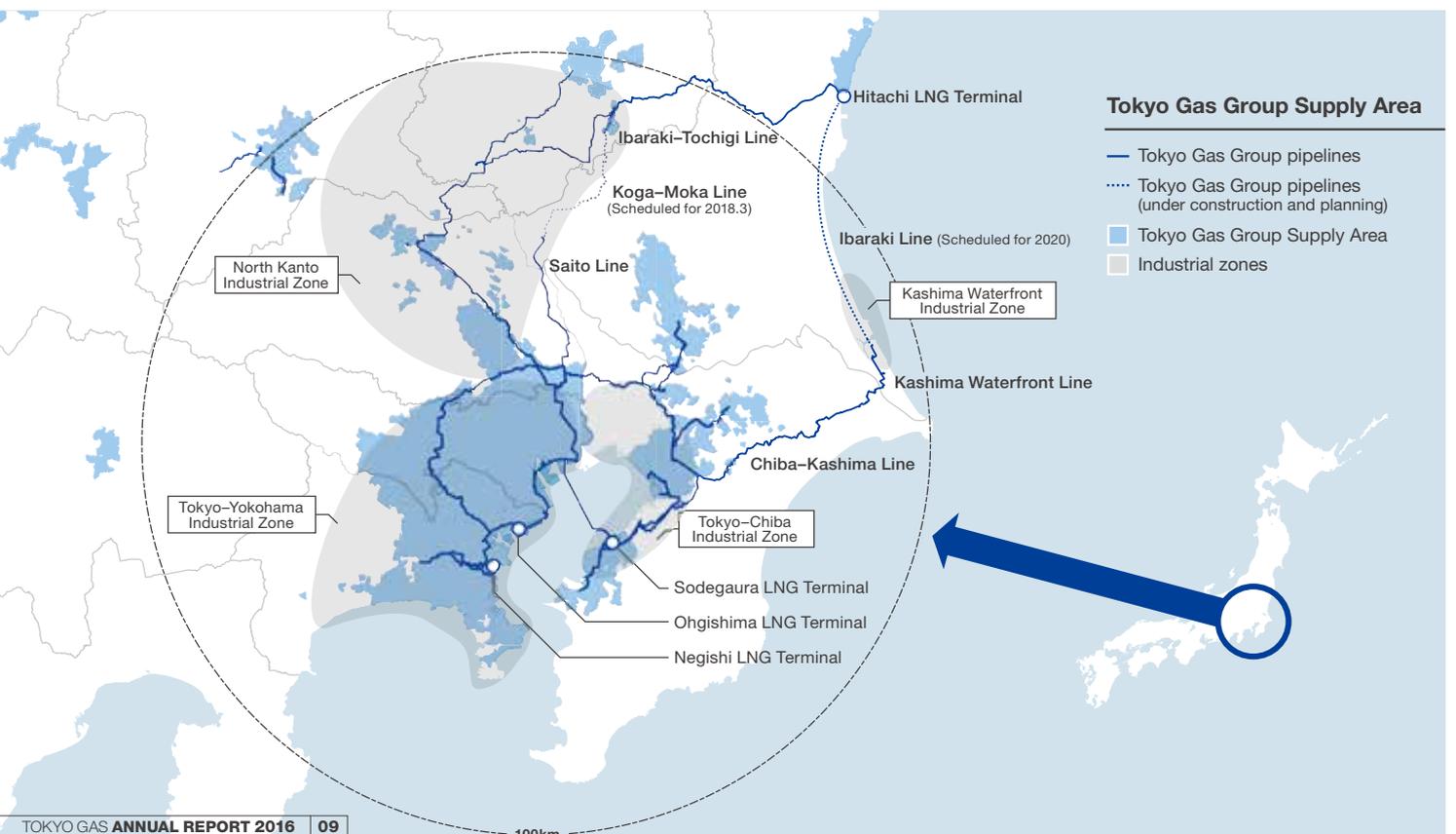
First, as a progressive public-interest energy corporate group in Japan’s energy sector, the Tokyo Gas Group stably supplies internationally-competitive energy in Japan and makes a constant contribution to people’s safe, reliable lives and Japan’s economy.

Second, Tokyo Gas will evolve into a unique total energy business to better respond to everyday needs for customers’ lives, by making use of its bonding with over 11 million customers, maintenance system and know-how, ICT and other advanced technology, and over 200 Tokyo Gas Group shops in the Greater Tokyo Area.

Third, we will contribute to economic development and people’s level of life elsewhere in Asia, by making use of our accumulated technology portfolio and know-how in Japan to respond to increasing demand for natural gas and other energy resources in Asia, and by establishing an intra-region infrastructure and value chain.

## Give our full attention to the stakeholders and committed to enhance corporate value

Tokyo Gas will be open to all of our stakeholders, including our customers, shareholders, business partners, local communities,



and employees, and contribute to enhance value for each of them. This will ultimately enhance our own corporate value. Concerning shareholder return, we intend to maintain unchanged the amount of dividend per share in fiscal 2016 despite expecting a significant decline in profit. Our policy continues to be a gradual increase in dividends over time in line with earnings growth. In addition, by combining share repurchase (assuming subsequent cancellation), our basic policy to target a total payout ratio of approximately 60% will be maintained up to 2020.

Given the strong public service nature of our business, our management stance to date has emphasized a well-balanced approach to our customers, our most important stakeholders, in our returning the company's achievements in management efficiency. Our customers benefited from the lowering of gas prices, in December 2013 and December 2015, and our shareholders benefited in the form of an increase of ¥1 in dividend per share to ¥11 in fiscal 2015. Our corporate and business philosophy will not change in principle even in this era of deregulation. Nevertheless, we will continue to steadily grow earnings after 2020 and seek to return our achievement to our shareholders.

Lastly, I will manage Tokyo Gas to keep it a growth company. First, the gas business is a growth business. While Japan's economic growth rate is now not as high as in the past, there is a potential demand for natural gas in the Greater Tokyo Area that waits to be satisfied, and continual sales growth can be projected with a high degree of confidence. Second, Tokyo Gas will evolve into a total energy company, including the electric power business, and foster businesses that have the potential to become earnings pillars alongside the gas business.

Third, we will explore overseas business opportunities, leveraging the strengths accumulated in Japan in the total energy business.

While the Gas System Reform in 2017, mainly the deregulation of the retail gas market, is likely to intensify competition, I am convinced that Tokyo Gas will make continued growth by evolving into a total energy company and by accelerating global operations over time.

The full deregulation of the retail electric power and gas markets is reshaping Japan's energy industry. At the center of this tumultuous change, the Tokyo Gas Group is transforming itself, and confidently and boldly faces challenges as the industry enters virgin territory.

I ask for the continued understanding and support of our stakeholders, including our customers, shareholders, business partners, and local communities.

Representative Director, President

広瀬 道明

Michiaki Hirose

