

# An Interview with the President



*Japan's energy markets are undergoing rapid and dramatic changes. Tokyo Gas sees the intensifying competition that is resulting from deregulation as a business opportunity. Frontier 2007 is the medium-term management plan covering the fiscal years from 2003 to 2007 that will help the entire Tokyo Gas Group respond accurately to change. In the following interview, Norio Ichino, who became President of Tokyo Gas in June 2003, reports to shareholders on how Tokyo Gas is taking a comprehensive approach to transforming itself into an Energy Frontier Corporate Group.*

**Q Tokyo Gas achieved the objectives of the medium-term plan, covering the five years to the end of fiscal 2004, two years ahead of schedule. How did this recently concluded plan benefit shareholders?**

The overall thrust of the medium-term plan covering the five years through March 2005 was to transform Tokyo Gas into a public utility that serves the interests of not only our customers, but also our shareholders, by increasing our corporate value. The concept of satisfying both our customers and our shareholders has now become an accepted standard for Japanese public utilities. We are proud to say that Tokyo Gas was the first to recognize and pioneer this concept.

The most important components of the medium-term plan were increasing free cash flow, raising corporate value by deploying resources more efficiently and improving asset efficiency as measured by return on assets (ROA). Free cash flow and ROA are closely related to the earnings available to common stock. Greater free cash flow enables stable dividend payments while still allowing investment in new businesses with good potential. Moreover, the city gas business requires substantial infrastructure investment and is therefore asset intensive. Consequently, increasing asset efficiency through effective asset deployment is essential for improved performance.

Another key objective was reducing interest expenses by reducing interest-bearing debt. Tokyo Gas reduced its interest-bearing debt to ¥731.3 billion, as of March 31, 2003. As such, we have already met our target for March 31, 2005, set in November 1999, which was the reduction of interest-bearing debt to ¥786.0 billion. At the same time, we increased free cash flow to ¥88.2 billion and ROA to 3.5 percent, both substantially exceeding our objectives.

Tokyo Gas made outstanding progress in creating the foundation for future growth by achieving the objectives of the medium-term plan ahead of schedule. The most significant results have been that we have created a lean corporate organization that can respond accurately to changing market conditions, and have increased our corporate value as expressed by returns to shareholders through higher dividends and stock price increases.

**Deregulation has progressed through revisions of the Electricity Utility Industry Law and the Gas Utility Industry Law. How do you evaluate these changes, and how does Tokyo Gas plan to respond to them?**

A key element of the recent reforms was expansion in the scope of liberalization. Presently, 30 to 40 percent of total sales volume in the gas and electricity markets has been liberalized. The recent legal revisions will also result in a staged expansion in the scope of the gas and electricity market liberalization. In 2007, 50 percent of the gas market, specifically customers using over 100,000 m<sup>3</sup> annually, will be liberalized.

Deregulation presents both risks and opportunities. Among the risks, electricity companies and other

**Deregulation will generate major business opportunities.**

firms are now able to enter the gas business. Appropriate risk management, based on a clear understanding of the potential impact of the risks we face, is therefore essential. Frontier

2007 has been designed to accommodate various risks with the potential to impact cash flow. The effects that new entrants in the gas business will have on demand and the potential for new competition to result in lower rates are both addressed. Yet, these issues do not obscure a key result of deregulation: Tokyo Gas will also be able to take advantage of the many opportunities that deregulation presents, foremost among them being our ability to participate in the electricity and other businesses.

Tokyo Gas has been competing with other forms of energy, including electricity, oil and liquefied petroleum gas (LPG), since the Company's foundation more than a century ago. Our powerful competitiveness in the gas business is a core competency. Our strengths include ample free cash flow derived from cash generated by returns on our investment in gas business assets, a solid ability to generate sales proposals that meet customer needs, and leading-edge technologies for efficiently utilizing gas that will expand gas usage. These capabilities are producing business opportunities that we expect will allow us to benefit fully from deregulation. We intend to deploy the experience we have acquired over many years to create new corporate value that translates into shareholder returns.

**Tokyo Gas finalized Frontier 2007 in October 2002 and implemented it in April 2003, for the period through March 2008. What are the primary objectives of this new medium-term plan?**

**Primary Objectives of Frontier 2007**

	FY2002	FY2007
TEP*	¥3.0 billion	¥10.0 billion
ROA	2.8 percent	3.9 percent
Free cash flow	¥61.0 billion	¥105.0 billion
Interest-bearing debt	¥775.0 billion	¥627.0 billion

\*TEP: Tokyo Gas Economic Profit, Tokyo Gas's version of EVA. (EVA is a registered trademark of Stern Stewart & Co.)

Figures for fiscal 2002 are projections made when the medium-term management plan was finalized in October 2002, not the actual results.

Tokyo Gas has determined the objectives of Frontier 2007, outlined in the accompanying table, according to four management indicators: Tokyo Gas Economic Profit (TEP), which is a profitability metric that takes cost of capital into account; free cash flow; ROA; and the volume of interest-bearing debt. To achieve our objectives, we must succeed at four key tasks, which are business model innovation,

business expansion into energy-related areas, construction of a Group management system, and strengthening our corporate structure.

Frontier 2007 will help Tokyo Gas to prevail in these times of intensifying competition. It will make the next five years a period of innovating our Group structure, business areas and operating framework, in order to achieve growth. We will develop as a corporate group and will make Tokyo Gas the energy supplier of choice among customers. Frontier 2007 will also help Tokyo Gas increase its profitability over the next five years.

Tokyo Gas will increase the pace at which it moves toward its objective of transforming the Tokyo Gas Group into a public utility with emphasis on both its customers and its shareholders, as envisioned in the recently conducted medium-term plan. We intend to focus all of our resources on becoming a corporation that supplies energy and value-added energy-related products and services, with an emphasis on environmentally friendly natural gas, while continually working to be the company customers choose for their energy needs. The following feature section covers the contents of Frontier 2007 and the initiatives that Tokyo Gas is now implementing in greater detail.



### Your determination to achieve the objectives of Frontier 2007 is readily apparent.

We're not resting on our laurels after achieving the objectives of our previous medium-term plan two years ahead of schedule. Frontier 2007 is an aggressive plan with high but attainable goals, and it incorporates a clear understanding of the risks that we will face. My mission under Frontier 2007 is to facilitate the achievement of our objectives, preferably ahead of schedule, just as was the case of the previous medium-term plan.

### Frontier 2007 is an aggressive plan that incorporates risk factors associated with market changes.

One reason for my confidence in the attainability of these goals is that the energetic participation of Tokyo Gas's employees was key to creating Frontier 2007. This is not a top-down management plan. Frontier 2007 was created through the input, and was designed to use the combined strengths, of the

employees who will implement it. The role of senior management in this process was to thoroughly consider what the employees had created and to finalize the details. Employee participation in the creation of Frontier 2007 was particularly important because many issues, such as the changes in corporate organization, embodied in the plan will require the understanding and participation of each and every employee of the Tokyo Gas Group.

Another reason for my confidence is that we created Frontier 2007 through exhaustive discussions of the risks and opportunities presented by deregulation. A fact worth noting is that in creating Frontier 2007, we assumed a level of risk that exceeds the speed and scope of deregulation that the recent regulatory reforms will engender. Because we will be able to implement Frontier 2007 with a high level of risk tolerance, I have every confidence that our goals are attainable.



### The Tokyo Gas brand stands for safety and reliability, which makes the issue of compliance critical. How is Tokyo Gas ensuring appropriate compliance?

Since Tokyo Gas is a public utility, our efforts to ensure compliance are not something we started yesterday. Both management and employees are held to rigorous standards of behavior, and are both aware of and comply with all relevant laws. Compliance is, in fact, a foundation of corporate activities, for without it, a company can neither continue to exist nor develop. Moreover, Tokyo Gas intends to raise compliance to an even higher level as part of the drive to strengthen the Company's organization, which

is a core theme of Frontier 2007. In 2002, Tokyo Gas formulated a basic policy for compliance, establishing an organization with overall responsibility for compliance. The Management Ethics Committee, chaired by the president, and compliance committees within each division were also established. In March 2003, Tokyo Gas also established two Compliance Hot Lines, one in-house and the other to an outside law firm, to assist Tokyo Gas in managing its risk and to increase employee awareness of compliance-related issues. Tokyo Gas's reputation for quality and trustworthiness is an invaluable asset that we will protect through a complete commitment to compliance.



## Q Tokyo Gas takes an active approach to corporate governance that responds to the interests of shareholders. How did Tokyo Gas strengthen corporate governance during the past fiscal year?

Tokyo Gas has the highest ratio of foreign shareholders among listed companies in Japan's electricity and gas industries. Consequently, establishing a reputation among global capital markets, as a trustworthy company that acts in the interest of shareholders and investors, is extremely important for us. To do so, we strive to provide fair and timely disclosure of information to all investors, inside and outside Japan, and to maintain a high level of management transparency.

## Establishing a reputation as a trustworthy company that acts in the interest of shareholders and investors

During the past fiscal year, Tokyo Gas implemented a number of measures to further strengthen corporate governance. We substantially reduced the number of board members, from 28 to 12 at present. This includes three board members from outside Tokyo Gas's senior management. We feel that this strengthens

the checks and balances to which the board is subject and improves management transparency. We also implemented an executive officer system and have appointed 23 executive officers that include myself and business division chief executives, thus creating a system focused on business execution. We expect this system to accelerate decision-making and to raise the efficiency of business execution.

We plan to pay close attention to this area, so that these systemic initiatives will substantively improve our system of corporate governance.

## Q How will Tokyo Gas increase shareholder value?

Tokyo Gas recognizes that increased earnings per share and stable dividend distributions are essential to maintaining the trust and confidence of shareholders. A sound financial structure is crucial to maintaining stable dividends, and Frontier 2007 will continue to address this issue through measures such as emphasis on reducing interest-bearing debt.

Tokyo Gas is also implementing a share buyback program to compensate for and thus preclude the dilutive effect of the projected conversion of currently outstanding convertible bonds to common shares. Moreover, during the next five years, we will use the free cash flow we generate to maximize shareholder value, while balancing the Company's need to make new investments.

Tokyo Gas begins Frontier 2007 with high hopes and enthusiasm. We are grateful for the trust and support we have received from our shareholders, and intend to devote every effort to achieving our objectives.