Management's Discussion and Analysis

[Main points of the fiscal year ended March 31, 2005]

· Despite a decline in gas gross margin from the previous fiscal year due to a rise in crude oil prices, revenues and profits increased for Osaka Gas through efforts to reduce costs such as labor costs.

· The earnings of consolidated subsidiaries were favorable across the board. The ratio of consolidated to non-consolidated operating revenues and operating income, which improved to 1.35 and 1.39, respectively, contributed to improving consolidated results.

· After due consideration to free cash flow and other conditions, Osaka Gas did not purchase any treasury stock nor enter into debt assumption agreements with banks. The Company retired its own shares that are susceptible to a dilution of the issuer's earnings per share.

1. Non-consolidated gas sales: Overall year-on-year growth despite the adverse affects of temperatures

In fiscal 2005, Osaka Gas supplied natural gas to 6,697,000 customers (meters installed), an increase of 63,000 from the end of the previous fiscal year. Sales volume of gas to residential customers declined 2.8% year on year to 2,238 million cubic meters due to generally warm temperatures.

In the commercial and industrial sectors, gas sales volume of the industrial, commercial and public offices/medical customers edged up 3.5%, 5.5% and 8.1% year on year, respectively, on account of the growing gas sales to air-conditioning uses in accordance with efforts to develop cogeneration and air-conditioning related demand and warmer summer temperatures compared with the previous fiscal year. Gas sales volume to the commercial and industrial customers totaled 5,509 million cubic meters, an increased of 4.3% from the previous fiscal year.

Sales volume to wholesale gas customers advanced 67.3% year on year to 305 million cubic meters, reflecting an increase in sales volume to industrial customers.

As a result, the Company's gas sales volume increased 3.7% to 8,053 million cubic meters on a non-consolidated basis while advanced 3.8% to 8,072 million cubic meters on the Group basis compared with the previous fiscal year.

Results of non-consolidated gas sales

		2005/3 A	2004/3 B	A−B	A/B
Customers [meters installed] (thousand)	Residential	6,377	6,316	61	101.0%
	Commercial/ industrial	319	318	1	100.5%
	Total	6,697	6,634	63	100.9%
Average monthly usage per customer (m^3/month)	Residential	33.1	34.3	(1.2)	96.5%
	Average of all customers	109.7	108.1	1.6	101.5%
Gas sales (million m^3)	Residential	2,238	2,304	(65)	97.2%
	Commercial/ industrial	5,509	5,280	229	104.3%
	Industrial	3,865	3,735	130	103.5%
	Commercial	1,039	986	53	105.5%
	Public and medical institutions	605	559	46	108.1%
	Wholesale	305	182	123	167.3%
	Total	8,053	7,766	287	103.7%

[Unit: 45MJ/m^3]

2. Income analysis: Marked a year-on-year revenues and profits growth by offsetting higher gas material costs reflecting crude oil prices through cost reductions.

Despite an increase in sales volume compared with the previous year, gas revenues declined ¥4.6 billion to ¥567.4 billion from the previous year, owing to lower unit costs applied to gas rates compared with the previous fiscal year reflecting the fuel cost adjustment system. However, consolidated total revenues surged 2.5%, or ¥24 billion, to ¥975.3 billion from the previous fiscal year owing to business expansion of existing consolidated subsidiaries and an increase in the number of consolidated subsidiaries.

Total consolidated operating expenses decreased ¥20.1 billion compared with the previous fiscal year on account of a ¥9.7 billion non-consolidated labor cost reductions in accordance with a revision of the retirement allowance system and efforts to reduce costs across the board, despite a ¥21.7billion increase in gas material costs from the previous fiscal year along with the rise in crude oil prices. As a result, operating income grew 4.2%, or ¥3.8 billion, to ¥95.9 billion compared with the previous fiscal year.

In other income and expenses, non-operating income rose ¥12.1 billion year on year due to the absence of loss on debt assumption, which was ¥3.7 billion resulting from early amortization in the previous fiscal year, and a ¥3.2 billion year-on-year increase in gains on the sale of securities. Ordinary profits rose 19.7%, or ¥16 billion, to ¥97.4 billion from the previous fiscal year.

In fiscal 2005, net income totaled ¥50.6 billion, an increase of 7.7%, or ¥3.6 billion, from the previous year owing to ordinary profit increase effects despite the recording of a ¥13.9 billion impairment loss under extraordinary losses as a result of the Company's adoption of impairment accounting in fiscal 2005.

(1) Gas segment

Owing to lower gas rates compared to the previous fiscal year by the fuel cost adjustment system, revenues declined 0.2%, or ¥0.9 billion, to ¥572.9 billion from the previous fiscal year. Operating income grew 9.4%, or ¥5.4 billion, to ¥63.5 billion on account of non-consolidated labor cost reductions of ¥9.7 billion reflecting the revision of the retirement allowance system and efforts to reduce costs across the board, despite an increase in gas material costs from the previous fiscal year along with a surge in crude oil prices.

(2) LPG, Electricity and Other Energies segment

The LPG segment added Daiya Nensho Co., Ltd., and Nagano Propane Gas Co., Ltd., to the scope of consolidation in the fiscal year under review.

The Electricity segment began operating a 50 MW power plant constructed at the Company's Himeji Terminal in June 2004.

Gas and Power Investment Co., Ltd., constructed and began operating 62 MW 'power source cogeneration systems' (systems designed to sell excess electricity as well as to provide electricity and heat that is required by customers through energy-efficient cogeneration systems), which is the largest system in Japan, in Uji city, Kyoto prefecture in October 2004. In addition, the Company, which took a stake in Tenaska Gateway Generating Station located in Texas, U.S.A., in June 2004, and decided to invest in the Amorebieta power plant in Spain in October 2004, has participated in overseas wholesale power generating (wholesale supply of electricity) businesses.

Owing to the aforementioned business expansion and an increase in the number of consolidated subsidiaries for LPG and electricity businesses, revenues climbed 18.9% to ¥157.1billion from the previous fiscal year.

Expenses increased due to an increase in the number of consolidated subsidiaries and the rise in material prices, especially in LP gas. As a result, operating income declined 11.2%, or ¥1.7 billion, to ¥13.9 billion from the previous fiscal year.

(3) Gas Appliances and House-Pipe Installation segment

In fiscal 2005, revenues in this segment declined 4.7% year on year to ¥136.8 billion due to the absence of sales of large-scale gas appliances recorded abundantly in fiscal 2004, and a decrease in the number of house-pipe installations resulting from a drop in new installations.

Operating profit declined 57.0%, or ¥1.2 billion, to ¥0.9 billion compared with the previous fiscal year as a result of a decline in the number of house-pipe installations.

(4) Real Estate segment

Revenues from the real estate segment increased 9.5%, or ¥3.2 billion, to ¥37.1 billion owing to an increase in new leasing properties at Urbanex Inc., one of the Company's subsidiaries, and improved condominium sales. Operating income also rose 8.2%, or ¥0.5 billion, to ¥7.6 billion from the previous fiscal year along with an increase in revenues.

(5) Other segments

Sales of other segments rose 5.3% year on year to ¥143.2 billion as a result of an increase in the number of consolidated subsidiaries and improved sales performance of Osaka Gas Chemicals' products. Operating income grew 12.1%, or ¥0.9 billion, to ¥8.3 billion along with each company's efforts to reduce costs in addition to revenue growth effects.

Kinrei Co., Ltd., currently operates a total of 47 restaurants after the opening of two Kagono-ya Chain of Japanese-style restaurants in Kashihara city, Nara prefecture, and in Kitano Hakubaicho in February 2005.

OG Sports Co., Ltd., which operates 17 COSPA fitness clubs, is preparing to open new facilities (Nagaokakyo, Mikage and Kongo) within 2005 with the goal of expanding its business.

Consolidated results by segment for fiscal 2005 (April 1, 2004 – March 31, 2005)

(¥ million)

	Gas	LPG, Electricity and Other Energies	Gas Appppliance and House-pipe Installation	Real Estate	Others	Total	Elimination and Corporate	Consolidated
(1) Operating revenues								
Operating revenues								
Outside customers	564,678	155,424	136,434	15,614	103,188	975,340	—	975,340
Inside group	8,228	1,695	377	21,504	40,061	71,866	(71,866)	—
	572,906	157,119	136,811	37,119	143,249	1,047,206	(71,866)	975,340
Cost and expenses	509,383	143,143	135,851	29,463	134,859	952,702	(73,354)	879,348
Operating income	63,523	13,976	959	7,655	8,389	94,503	1,488	95,992
(2) Identifiable assets, depreciation, and capital expenditures								
Identifiable assets	674,312	178,561	66,332	107,870	125,826	1,152,903	64,559	1,217,463
Depreciation	61,409	12,312	682	4,318	9,005	87,729	(870)	86,858
Loss from Impairment of fixed assets	10,771	743	513	1,745	135	13,910	—	13,910
Capital expenditure	39,951	8,130	650	3,800	13,354	65,889	(371)	65,517

3. Assets, Liabilities and Shareholders' Equity analysis

3-1. Asset Management Policies

The Osaka Gas Group views deregulation in the electricity and gas sectors as a business opportunity and intends to aggressively expand business investment in growth fields—especially electricity—while reducing assets in unprofitable business fields and ongoing operations. In order to minimize investment risk caused by changes in the operating environment, Osaka Gas is tightening its rigorous investment decision and follow-up/evaluation procedures based on common Group investment standards that have been applied on individual investment proposals in the past.

After due consideration of the weighting of third-party and internal capital on capital costs and maintaining a sound financial position, Osaka Gas aims to maximize capital efficiency by targeting a debt/equity ratio of approximately 10% and a shareholders' equity ratio of more than 40%. Osaka Gas, with the current shareholders' equity ratio of just above 40%, intends to promote business investment in growth fields through funding by adding new interest-bearing debt to keep up with the increase in shareholders' equity reflecting higher profits.

3-2. Capital Investment

In fiscal 2005, non-consolidated capital investment totaled ¥42.5 billion. Osaka Gas invested ¥6.6 billion during the fiscal year under review with continuing construction on the Shiga Line of the Kinki Trunk Line as a major construction project. The Company extended its gas pipelines by 437 kilometers for a total of 45,718 kilometers by March 31, 2005. In fiscal 2005, consolidated capital investment totaled ¥65.5 billion, reflecting the acquisition of assets and real estates for the leasing business at the Company's consolidated subsidiaries.

3-3. Investment Performance

The Osaka Gas Group aggressively involved in investments and loans to both domestic and overseas electric businesses including natural gas upstream operations, such as gas fields and LNG tankers, and the electricity business, such as independent power producer (IPP: wholesaling of electricity) as the Company's future growth drivers.

The Company, which decided or implemented investment in IPP in the United States and Spain and in the Hayama Wind Power Plant in Shikoku, invested approximately ¥7.1 billion during the fiscal year. The Company intends to invest a total of ¥21 billion in the following fiscal year ended March 31, 2006, as a part of the stake in Spanish IPP and investment in Japan EnviroChemicals Ltd., which was decided in March 2005.

3-4. Adoption of Impairment Accounting

Osaka Gas's grouping policies are as follows.

(1) Fixed assets used for gas operations, which generate cash flow in an integrated manner throughout manufacturing to sales of gas, are regarded to fall under one asset group.
(2) Business fixed assets excluding (1) are segmented in principle by each business administration unit.
(3) Other fixed assets are segmented in principle by individual asset.

In fiscal 2005, impairment losses recognized in accordance with this grouping totaled ¥13,910 million, of which critical impairment losses are as follows.

(million yen)

Asset	Location	Type	Impairment losses
Keihanna Land	Seika-cho and Kizu-cho, Kyoto prefecture	Land	3,189
Kamiyama Land	Kita-ku, Osaka city	Land	2,842
Adjoining land of Himeji Terminal	Himeji city	Land	1,607

Recoverable value on these assets is calculated based on the net resale price. The market value is calculated based on the real estate appraisal value in principle. These assets, which were acquired in advance to construct operational facilities or not be used as operational facilities anymore, lost their specific usage plan due to the subsequent change in the economic environment. As the investment is unlikely to be paid off, the Company recorded the decrease in value, which was calculated by reducing the book value to a recoverable value under impairment losses.

3-5. Total Assets

There were declining factors, such as a ¥32.9 billion decrease in fixed assets compared with the previous fiscal year following the adoption of impairment accounting and a year-on-year decline of ¥10.4 billion in investment securities due to the sale of securities. On the other hand, total assets increased ¥18.2 billion compared with the previous fiscal year due to a ¥28.5 billion increase in cash reserves and a ¥12.7 billion increase in prepaid pension expenses. In accordance with the postponement of investments in Spanish IPP and Japan EnvironChical Group until the fiscal year end on 31 March, 2006, cash and time deposits apparently increased temporarily as of March 31, 2005.

3-6. Interest-Bearing Debt

In addition to a certain amount of retained funds, there was no significant investment for growth that exceeded the funds. As a result, interest-bearing debt totaled ¥448.5 billion as of March 31, 2005, a year-on-year decrease of ¥7.1 billion especially of short-term funds such as commercial papers (CP).

Interest-bearing debt consists of new long-term borrowings of ¥11 billion on a non-consolidated basis and of approximately ¥27.5 billion on a consolidated basis and repayment of approximately ¥15.9 billion on a non-consolidated basis and of around ¥33.6 billion on a consolidated basis.

Osaka Gas issued ¥20 billion straight bonds in March 2005. There was no repayment of bonds during fiscal 2005.

(100 million yen)

	2005/3	2004/3	Increase/ decrease
Total Interest-Bearing Debt at year-end	4,485	4,557	-71

3-7. Employees' Severance and Pension Benefits

As of March 31, 2005, projected benefit obligations had decreased by approximately ¥24.9 billion to ¥261.3 billion compared with a year earlier reflecting the revision of the retirement allowance system on a non-consolidated basis implemented in December 2004. As a result, liability for severance and retirement benefits totaled ¥18.3 billion, a decrease of ¥24.5 billion. While the fair value of pension assets increased by approximately ¥32.5 billion owing to the rise in contributions and well-performing investments, pension assets concerning retirement benefit accounting that deduct prepaid pension costs increased by approximately ¥20.3 billion to ¥256 billion. Based on these factors, pension reserves, which are an aggregation of employee's severance and retirement benefits and pension assets, totaled ¥274.4 billion. As a result, the unrecognized actuarial difference decreased approximately ¥20.7 billion, and there are ¥13 billion overfunded assets.

Severance and retirement benefit expenses totaled ¥1.7 billion, a year-on-year decrease of approximately ¥13.7, in accordance with the write-off as past service liabilities of a part of a decrease in debt following the revision of the retirement allowance system on a non-consolidated basis and a ¥3.2 billion decrease in the actuarial difference recognized as a cost to ¥1.7 billion from the previous fiscal year reflecting improved pension asset investments in the fiscal year ended March 31, 2003.

(¥ million)

Reserve for Retirement Benefits (as of March 31, 2005)	
(1) Projected benefit obligation	(261,365)
(2) Plan assets as fair value	269,001
(3) Unfunded projected benefit obligations ((1)+(2))	+7,636
(4) Unrecognized actuarial difference	(13,076)
(5) Unrecognized prior service cost (Reduction in obligation)	—
(6) Net amount on balance sheet (3)+(4)+(5)	(5,439)
(7) Prepaid pension cost	12,903
(8) Employee's severance and retirement benefits ((6)-(7))	(18,343)

Note: Some subsidiaries employ the simple computation method for calculating retirement benefits.

(¥ million)

Information on Retirement Benefit Costs (for the year ended March 31, 2005)	
(1) Service costs	8,705
(2) Interest expenses	5,343
(3) Expected return on investments	(4,236)
(4) Actuarial difference recognized as costs	1,730
(5) Past service liabilities recognized as costs	(9,778)
(6) Retirement benefit costs (1)+(2)+(3)+(4)+(5)	1,764

Note: Retirement benefit costs of consolidated subsidiaries adopting simple computation methods are included in service costs.

Information on the basis of determining retirement benefit liabilities and other costs	
Allocation of expected amount of retirement benefits to be paid to employees	Allocation of fixed amounts to relevant periods
Discount rate	Mainly 1.8%
Expected return on investments	Mainly 1.8%
Years to amortize past service liabilities	Mainly 1year
Years to amortize actuarial difference	Mainly 10 years

3-8. Shareholders' Equity

As of March 31, 2005, shareholders' equity increased ¥35.2 billion year on year to ¥530.8 billion reflecting an intact increase in retained earnings without any acquisition of treasury stock.

4. Cash Flow Analysis

During the fiscal year ended March 31, 2005, net cash provided by operating activities declined ¥15.9 billion to ¥116.9 billion due to an increase in trade receivables and inventories, which offset the rise in operating income. Net cash used in investing activities declined ¥2.1 billion to ¥65.6 billion, reflecting an increase in gains on the sale of investment securities. Net cash used in financing activities declined ¥52 billion to ¥23.9 billion, reflecting issuance of bonds in fiscal 2005 and repayment of bonds in the previous fiscal year. As a result, cash and cash equivalents totaled ¥44.2 billion as of March 31, 2005, an increase of ¥28.5 billion from a year earlier.

(100 million yen)

	2005/3	2004/3	Increase/Decrease
Cash flow from operating activities	1,169	1,328	-159
Cash flow from investment activities	-656	-678	+21
Cash flow from financial activities	-239	-759	+520
Increase/decrease of cash and cash equivalents	273	-108	+381
Cash and cash equivalents at year-end	442	157	+285

Free cash flow (*1) 577 (100 million yen) [Previous fiscal year:732 (100 million yen)]

(*1) Free cash flow = cash flow from operating activities - capital expenditures

5. Important facts about the group companies' conditions turn up after fiscal year-end

5-1. Retirement of Treasury Stock

The Board of Directors passed a resolution on March 29, 2005, to retire 133,342,000 shares of common stock acquired in line with resolutions approved at the ordinary shareholders' meetings on June 27, 2002, and June 27, 2003, out of treasury stock and took cancellation procedures on April 12, 2005.

5-2. Acquisition of Japan EnviroChemicals Ltd. and other shares

Osaka Gas Chemicals Co., Ltd., agreed to take over all shares of Japan EnviroChemicals Ltd. (100% ownership stake), which is owned by Takeda Pharmaceutical Company Limited engaged in the living environmental business, such as production and sale of activated carbon, Minabe Chemical Industry (100%), Hakata Chemical (40%), Davao Central Chemical Corporation (80%) and Century Chemical Works Sendirian Berhad (25%), which took over shares of the former three companies with a total of ¥11.9 billion on April 1, 2005.

Osaka Gas took over 30% of Japan EnviroChemicals shares from Osaka Gas Chemicals on the same date. Osaka Gas Chemicals added ¥2.02 billion by raising new capital as of April 20, 2005.

6. Quantitative and Qualitative Disclosure of Risk

6-1. Business Risk

As an independent corporation, Osaka Gas believes it has the management resources and business strategies to prosper amid competition for the foreseeable future based on currently available information.

Profitability in the core gas business is primarily affected by the following factors:

(1) Decline in demand and prices due to the removal of barriers to outside companies participating in the gas business in accordance with deregulation in Japan's gas industry.
(2) Fluctuations in weather and water temperatures affect gas demand.
(3) Greater-than-expected fluctuations in crude oil prices and exchange rates, which form the basis for LNG prices. LNG is the primary raw material for producing gas.
(4) Problems related to raw material procurement.
(5) Problems related to production and supply.

The profitability of other businesses is affected by conditions in their respective markets. However, Osaka Gas strives to minimize the impact of other businesses on profits through a firm grasp of and swift responses to business execution conditions in concert with all Group companies.

6-2. Market Risk Management Policy

In addition to business risks, the Osaka Gas Group is exposed to market risks, including changes in foreign exchange and interest rates. To hedge against these risks, the Osaka Gas Group employs derivative transactions. These transactions are for the sole purpose of hedging against risks based on actual demand conditions. The Company does not conduct derivative transactions for speculative purposes. The execution and management of derivative transactions are based on internal rules and handled by the finance department of each Group company, and overseen on a Group-wide basis by the accounting and finance departments of Osaka Gas.

The Osaka Gas Group constantly monitors market risks by periodically evaluating the market value of derivative transactions. The Osaka Gas Group believes that credit risk is negligible for the parties with which it enters into derivative transactions, as the Company only deals with major financial institutions in accordance with requirements stipulated by internal rules.

6-3. Air and Water Temperature (Weather) Risks

Gas sales volume is affected by changes in the temperature of air and water. A 1°C change in average annual temperatures affects residential gas sales volume by approximately 4%–6%. For air-conditioning gas sales, a 1°C change in the average summer temperature affects gas sales volume by about 10%. Osaka Gas hedges against some risks from air and water temperatures by using derivative and insurance instruments.

6-4. Foreign Exchange Rate and Oil Price Risks

Changes in foreign exchange rates and oil prices affects LNG prices. For the fiscal year ending March 31, 2006, for instance, a change ¥1/US$ annually affects the cost of gas by about ¥1.7 billion, while a change of $1/bbl in the price of oil has an impact of approximately ¥3.2 billion. The impact of changes in foreign exchange rates and oil prices is offset by reflecting these factors in gas prices through the fuel cost adjustment system, but due to a time lag in reflecting these items, they are occasionally carried forward into the next fiscal year.

The Osaka Gas Group engages in forward foreign currency contracts as it procures LNG, LPG and other basic materials with U.S. dollars for foreign currency payables. Forward foreign currency contracts for this purpose are in principle settled within a short period of approximately one week, and do not substantially affect the performance of the Osaka Gas Group.
The Osaka Gas Group engages in currency swap contracts for principal on the issuance of applicable debt as a hedge against currency fluctuation risks on debt denominated in foreign currencies. These transactions are completed on the interest payment and maturity dates of the debt.

6-5. Interest Rate Risks

The Osaka Gas Group sustains an appropriate level of interest rate risk for capital procurement, and to reduce capital procurement costs over the long term, engages in interest rate swap contracts for corporate bonds and debt. Interest rate risk is determined through an assessment based on the value-at-risk (VaR) method. The Company uses interest rate swap contracts as and when necessary to fix appropriate interest rate levels against a specified amount of future cash flow.

A 1% change in annual interest rates affects the interest payments and bond interest on a consolidated basis by approximately ¥1.1 billion in the fiscal year ended March 31, 2006.

Note: The VaR method estimates the amount of maximum possible losses through a simulation of future price fluctuations on relevant assets.