Management's Discussion and Analysis

1. Highlights of the fiscal year ended March 31, 2007

In fiscal 2007, various factors caused earnings to decline. These included revisions to contracts for LNG handling that were implemented at the end of fiscal 2006, costs associated with spot inspections of gas appliances, revised gas rates for residential and small commercial customers, and lower residential and other gas sales due to higher winter temperatures.

However, fending off the impact of mild winter temperatures, the gas sales on the whole increased from the previous fiscal year. Growth-oriented investments made in the past also contributed to profits. As a result, the decline in operating income was limited to only ¥6.9 billion compared with the previous fiscal year.

Investments in growth-oriented projects contributed approximately ¥7 billion to ordinary income (an increase of approximately ¥4 billion from fiscal 2006). Furthermore, earnings at consolidated subsidiaries were strong, especially at domestic and overseas IPP (wholesale electric power supply business).

The price of LNG, the raw material for gas, was up sharply compared with fiscal 2006. However, the time lag between reflecting higher LNG costs in selling prices and the procurement period moderated during fiscal 2007. As a result, earnings differentials based on the fuel cost adjustment system improved approximately ¥10 billion year on year.

Looking at gas sales volume, sales to the residential and commercial sectors, as well as to public offices and medical customers, declined year on year due to mild winter temperatures. Sales to the industrial sector increased 7.5%, reflecting a rise in customers' environmental consciousness.

As for growth-oriented investments, the presence of Osaka Gas Information System Research Institute Co., Ltd., in the financial information systems field was strengthened through investment in Sakura Information Systems Co., Ltd.

2. Income Analysis

In fiscal 2007, consolidated operating revenues advanced 10.2%, or ¥108.4 billion, from the previous fiscal year to ¥1,174.4 billion. Among the factors contributing to growth in operating revenues were an increase in the volume of gas sold, a higher sales price based on the fuel cost adjustment system due to the rise in the cost of LNG, and the expansion of business at consolidated subsidiaries.

Operating income declined 6.9% year on year, or ¥6.9 billion, to ¥93.7 billion. Despite contributions from consolidated subsidiaries, operating income dropped due to a lower contract volume associated with revisions to contracts for LNG handling.

Non-operating income declined ¥6.8 billion from the previous fiscal year, reflecting higher interest paid and losses on the redemption of corporate bonds, and despite higher profits of equity-method affiliates. As a result, ordinary income fell 13.3%, or ¥13.7 billion from the previous fiscal year, to ¥89.5 billion.

Net income dropped 34.4% year on year, or ¥27.7 billion, to ¥52.9 billion. The main factor was extraordinary losses due to account adjustments associated with revised contracts for LNG handling.

As of March 31, 2007, the number of consolidated subsidiaries totaled 132, a decline of four from the end of the previous fiscal year, as one new consolidated subsidiary was added and five were removed due to the organizational realignment of the Nissho Petroleum Gas Corporation Group. The number of equity-method affiliates remained unchanged from the end of the previous fiscal year at four.

3. Non-consolidated Gas Sales

Non-consolidated gas sales overall increased 3.4% from the previous fiscal year.

In fiscal 2007, sales volume of gas to residential customers fell 1.1% year on year, or 25 million cubic meters, due to mild winter temperatures. Similarly, sales to the commercial sector and to public offices and medical customers were affected by the mild winter temperatures, resulting in year-on-year declines of 3.2% and 2.1%, respectively.

Sales to the industrial sector increased 7.5% year on year on several factors, mainly higher operating rates at customer facilities against the backdrop of economic recovery. Others included strong new demand resulting from switching to natural gas from petroleum-based fuels, reflecting heightened environmental consciousness on the part of customers.

Non-consolidated Gas Sales

(45MJ/m³)		FY2007/3 A	FY2006/3 B	A–B	A/B (%)
Customers [meters installed] (thousand)	Residential	6,497	6,437	+60	+0.9
	Commercial/industrial	323	321	+2	+0.6
	Total	6,820	6,758	+62	+0.9
Average monthly usage per customer (m^3/month)		33.5	34.2	–0.6	–1.8
Gas sales (million m^3)	Residential	2,303	2,329	–25	–1.1
	Commercial/industrial	6,018	5,761	+257	+4.5
	Industrial	4,354	4,049	+305	+7.5
	Commercial	1,036	1,071	–34	–3.2
	Public and medical institutions	628	641	–13	–2.1
	Sales to other gas suppliers	416	359	+58	+16.1
	Total	8,738	8,448	+290	+3.4
Average temperature (Celsius)		17.5	16.9	+0.6	–

4. Overview by Business Segment

Gas Segment

Owing to increased sales volume and higher average unit gas rates associated with increased LNG prices under the fuel cost adjustment system, operating revenues rose 10.8%, or ¥66.9 billion year on year, to ¥686.6 billion. Although there was an adverse impact from revised gas rates for residential and small commercial customers (implemented in November 2006), LNG prices were stable from interim fiscal 2007. As a result, operating income rose 2.9%, or ¥1.7 billion year on year, to ¥63.6 billion.

LPG, Electricity and Other Energies Segment

Segment operating revenues jumped 24.4%, or ¥46.0 billion year on year, to ¥235.0 billion due to higher operating rates in the domestic wholesale electric power supply business and higher LPG handling volume alongside the start of a business alliance with Itochu Corporation through Nissho Petroleum Gas Group. Operating income fell 27.3%, or ¥5.0 billion year on year, to ¥13.4 billion despite profit contributions from consolidated subsidiaries, as contracted volumes declined in conjunction with contract revisions in the LNG handling business.

Gas Appliances and House-pipe Installation Segment

Operating revenues in this segment advanced 3.2%, or ¥5.0 billion year on year, to ¥160.9 billion due to substantial sales of large-scale gas appliances to industrial customers. Operating income dropped 72.4%, or ¥3.7 billion, to ¥1.4 billion, mainly due to expenses related to inspections of bathroom heater/dryer units.

Real Estate Segment

Segment revenues rose 0.8%, or ¥0.2 billion year on year, to ¥25.9 billion. Operating income increased 9.8%, or ¥0.6 billion, to ¥7.2 billion.

Other Businesses Segment

Segment revenues declined 3.7%, or ¥5.4 billion year on year, to ¥139.9 billion despite growth in the information and other businesses, due mainly to the sale of consolidated subsidiary Kinrei Corporation. Operating income dropped 5.9%, or ¥0.4 billion, to ¥7.2 billion.

Fiscal 2007 Operating Revenues and Operating Income by Segment

(Unit: ¥ billion)

	Gas	LPG, Electricity and Other Energies	Gas Appliances and House-pipe Installation	Real Estate	Other Businesses	Elimination and Corporate	Consolidated
Revenues	686.6	235.0	160.9	25.9	139.9	(74.1)	1,174.4
	+10.8%	+24.4%	+3.2%	+0.8%	–3.7%		+10.2%
	[+66.9]	[+46.0]	[+5.0]	[+0.2]	[–5.4]	[–4.2]	[+108.4]
Operating income	63.6	13.4	1.4	7.2	7.2	0.6	93.7
	+2.9%	–27.3%	–72.4%	+9.8%	–5.9%		–6.9%
	[+1.7]	[–5.0]	[–3.7]	[+0.6]	[–0.4]	[–0.08]	[–6.9]

Left upper % is change versus fiscal 2006. [ ] indicates absolute year-on-year change.

5. Assets, Liabilities and Shareholders' Equity Analysis

Asset Management Policies

The Osaka Gas Group views deregulation in the electricity and gas sectors as a business opportunity and intends to aggressively expand its operations in growth fields, especially electricity, while reducing assets in unprofitable business fields and day-to-day operations. To minimize investment risk caused by changes in the operating environment, Osaka Gas is further tightening its procedures for investment decisions, and subsequent follow-up and evaluation, based on the Group-wide investment criteria applied to individual investment proposals hitherto.

Osaka Gas aims to maximize capital efficiency by targeting a ratio of interest-bearing debt to equity of approximately one and a shareholders' equity ratio of more than 40%. In deciding the weighting of third-party capital versus internal capital it will pay due consideration to relative capital costs and the maintenance of a sound financial position. As the shareholders' equity ratio is now above 40%, Osaka Gas intends to promote business investment in growth fields by raising funds through interest-bearing debt in line with the growth in shareholders' equity as profits increase.

Capital Investment

In fiscal 2007, non-consolidated capital investment totaled ¥61.6 billion. The completion of the Shiga Line—part of the Kinki Trunk Line—was the major construction project during the fiscal year under review. In addition to the ongoing construction of the Mie-Shiga Line, capital investment continues for peripheral facilities in relation to the planned construction of an electric power plant inside Osaka Gas's existing Senboku facilities.

Consolidated capital investment totaled ¥95.2 billion, down from the previous fiscal year due to a reduction in investment related to the building of new LNG carriers.

The Osaka Gas Group is aggressively investing in both domestic and overseas electric power businesses as potential future growth drivers. Investment targets include such upstream operations as natural gas fields and LNG carriers, as well as IPPs and other downstream electric power businesses.

The major growth-oriented investment projects to which capital investment was allocated during the fiscal year under review were the Shiga Line, the Senboku Natural Gas Power Plant, and LNG carriers.

Capital Investment (¥ billion)

	FY2006/3	FY2007/3
Consolidated	117.4	**95.2**
Non-consolidated	75.4	**61.6**
Manufacturing	5.4	**3.0**
Gas supply	40.0	**39.3**
Commercial and industrial	29.9	**19.2**

Assets, Liabilities and Shareholders' Equity Analysis

At March 31, 2007, consolidated total assets amounted to ¥1,405.6 billion, expanding approximately ¥6.9 billion from the previous fiscal year. The increase can mainly be attributed to an increase in fixed assets, including progress in the construction of LNG vessels.

Total liabilities totaled ¥719 billion, down ¥32.4 billion from the previous fiscal year. This decrease was mainly attributable to a ¥15.8 billion drop in non-consolidated accrued corporate taxes and the transfer of ¥20.6 billion in deferred non-consolidated hedging profits to shareholders' equity in compliance with the Corporation Law. Reflecting an increase in retained earnings from net income and other factors, shareholders' equity amounted to ¥686.6 billion.

As a result, the shareholders' equity ratio at March 31, 2007, was 47.6%, up from 44.9% at the end of the previous fiscal year. The asset, liability and shareholders' equity indicators were as follows.

Asset, Liability and Shareholders' Equity Indicators

	FY2006/3	FY2007/3
Shareholders' equity ratio	44.9%	**47.6%**
Mark-to-market equity ratio	68.2%	**72.3%**
Cash flow to interest-bearing debt ratio	3.2	**5.0**
Interest coverage ratio	23.6	**10.3**

(*1) All figures are on a consolidated basis.
(*2) Mark-to-market equity ratio is based on the number of shares outstanding minus treasury stock.
(*3) Cash flow is net cash provided by operating activities.
(*4) Interest-bearing debt is all balance sheet debt on which interest is paid.

6. Cash Flow Analysis

Overview of cash flow

In fiscal 2007, net cash provided by operating activities fell ¥54.5 billion from the previous fiscal year, to ¥98.3 billion due mainly to a decrease in income before income taxes and minority interests. Net cash used in investing activities fell ¥63.2 billion, to ¥99.7 billion, mainly reflecting reduced expenditures for purchase of property, plant and equipment and purchase of investments in subsidiaries and affiliates. Net cash used in financing activities totaled an outflow of ¥22.0 billion, a difference of ¥35.2 billion from the cash inflow recorded in the previous fiscal year, reflecting mainly an increase in the redemption of corporate bonds during the fiscal year.

As a result, cash and cash equivalents totaled ¥24.4 billion at March 31, 2007, a decrease of ¥23.2 billion from a year earlier.

(¥ billion)

	FY2006/3	FY2007/3	Change
Cash flow from operating activities	152.9	**98.3**	–54.5
Cash flow from investing activities	–162.9	**–99.7**	+63.2
Cash flow from financing activities	13.2	**–22.0**	–35.2
Change in cash and cash equivalents	3.4	**–23.2**	–26.7
Cash and cash equivalents at year end	47.7	**24.4**	–23.2
Interest-bearing debt at year end	487.5	**487.8**	+0.3

Free cash flow application

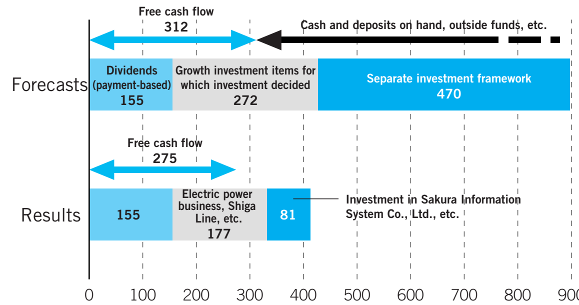
Free cash flow (cash flow from operating activities minus capital expenditures) had been projected at ¥31.2 billion at the beginning of the fiscal year. However, due to rate revisions for small-lot gas sales during the fiscal year, actual free cash flow was ¥27.5 billion.

Investment in projects for which the capital investment decision has already been made, such as the Senboku Natural Gas Power Plant, the Shiga Line, and LNG carriers, was carried out basically in line with initial plans. Meanwhile, a separate investment framework was initially established at ¥47.0 billion, but due to sharply higher resource prices, investment project costs, mainly for upstream projects, failed to conform with the Group's investment criteria. Consequently, actual investment in Sakura Information Systems Co., Ltd., was limited to only ¥8.1 billion.

The ratio of dividends to free cash flow exceeded 50%.

Free Cash Flow Application During Fiscal 2007 to Fiscal 2009

(Billions of yen)



FCF= Cash flow from opening activities – payments for capital investments
Capital investments do not include investments for growth.
Growth investment items include both capital investment items and investment-and-loan items.

7. Basic Policy Regarding the Distribution of Profits and Dividends for FY2007 to FY2008

It has been the policy at Osaka Gas to actively pursue profit growth by expanding revenues and increasing operating efficiency. We have retained these profits to strengthen our financial structure and achieve further expansion, as well as to pay stable dividends to our shareholders. Our basic dividend policy is to maintain stable interim and year-end dividend payments. In declaring dividends, we take into account the Company's overall circumstances, including performance, business plans, and other forms of returning profits to shareholders. We endeavor to keep the dividend payout ratio at 20% or greater. The remaining retained earnings are allocated to capital investments and investments in new business.

For fiscal 2007 and fiscal 2008, we intend to pay an annual dividend of 7 yen per share, including an interim dividend of 3.5 yen per share.

8. Quantitative and Qualitative Disclosure of Risk

The following are risks that could affect the business performance or financial position of the Osaka Gas Group. Forward-looking statements made herewith are based on information available to the Group as of the date of submission of its Annual Securities Report.

Risks Faced by the Gas Business

The following are the main factors that could adversely impact the performance of the Osaka Gas Group's core natural gas operations:

1. Fluctuations in weather and water temperatures on gas demand

Sales volumes of gas can be affected by fluctuations in weather and water temperatures. Therefore, these fluctuations could impact negatively on the performance of the Group.

2. Impact of foreign exchange and interest rate fluctuations on financing

Fluctuations in foreign exchange and interest rates could affect the performance of the Group. However, the potential impact of fluctuations is limited because the Group hedges foreign exchange rate risk using derivative instruments and the major portion of its debt bears fixed interest rates.

3. Fluctuations in raw material costs

The price of LNG, the raw material for gas, can be influenced by changes in foreign exchange rates. The effect may be offset by a change in the sales price through the operation of the fuel cost adjustment system. However, depending on the time required for the higher costs to be reflected in price and the composition of raw material procurement, the fluctuation in foreign exchange rates could adversely affect the performance of the Group.

4. Problems related to raw material procurement

Because LNG, the raw material for gas, is procured overseas, it is possible that problems related to the facilities or operations of the LNG supplier could have a negative impact on the performance of the Group.

5. Problems related to production and supply

A major natural disaster or accident could disrupt the production or supply of gas, adversely affecting the performance of the Group.

6. Problems with gas appliances/facilities

The Group's earnings could be adversely affected by serious problems related to gas appliances/facilities.

7. Regulatory reform in the gas industry and resulting intensified competition

Regulatory reforms could further progress through changes in the Gas Utility Industry Law and other laws, regulations, and administrative systems, causing intensified competition in the energy market and impacting negatively on the performance of the Group.

Other Risks

1. Businesses other than the gas business

The performances of the Osaka Gas Group's other businesses are impacted by conditions in their respective markets. However, the Company is working to minimize such impact by consolidating all its subsidiaries to gain an understanding of how they are being run and draw up prompt measures to deal with any issues.

2. Managing personal information (privacy policy)

Due to the nature of its business, the Group possesses a great deal of personal information about its customers. Consequently, the Group seeks to rigorously manage personal information by thoroughly complying with and educating and training its employees and service vendors about the law regarding the protection of personal information. Nevertheless, should the personal information of customers be leaked outside the Group, the incident could impact negatively on the Group's performance.