

Osaka Gas Group Medium-Term Business Plan (Fiscal years from April 1, 2006 to March 31, 2009)

# Design 2008: Progress and Policies for the Final Year

## —A Report From President Hiroshi Ozaki

The Osaka Gas Group is implementing Design 2008, its three-year medium-term business plan covering the fiscal years 2007 to 2009, based on the Group management principle of Value Creation Management. The basic framework of Design 2008 has three major components: strengthening profitability of the gas supply business, evolving into a multi-energy supplier, and maximizing Group power. In this section, our new president, Mr. Hiroshi Ozaki, reports on the financial strategies and strategies for investments for ensuring future growth to support these policies. He also provides a status report and outlook for the achievement of the plan's objectives.



Sophisticated Proposals Incorporating the Customer's Perspective	Improve Services and Ensure Safety
Pursue Greater Business Efficiency	Conduct Active Growth-oriented Investments and Optimize the Group's Asset Portfolio

Assumptions regarding the operating environment	
<ul style="list-style-type: none"> <li>• Low-growth economy</li> <li>• Stronger awareness of the environment</li> <li>• Higher emphasis on the social responsibility of companies</li> </ul>	<ul style="list-style-type: none"> <li>• Entering the era of population decrease</li> <li>• Higher expectations for better corporate performance</li> <li>• Steady development of the regulatory framework for the gas and electricity businesses</li> </ul>



Combining Our Strengths to **Maximize Value** 

1. Strengthening Profitability of the Gas Supply Business

2. Evolving Into a Multi-Energy Supplier

3. Maximizing Group Power

4. Growth-Oriented Strategy and Financial Policies

# 1. Strengthening Profitability of the Gas Supply Business

The gas supply business will remain the core of our multi-energy supply business. Together with our Group companies and external business partners, we will address the various needs of our customers based on five core principles (1) we will propose solutions supported by technological and engineering prowess developed over many years (2) we will offer comfortable, convenient, safe and energy-efficient gas systems (3) we will make our gas rates easier to use (4) the Group will supply customers with a wide range of products, including electricity, LPG, security services and Internet services, combined with a strong capability for providing services and proposing innovative solutions (5) we will thoroughly utilize our infrastructure assets, including pipeline networks, to serve customer needs. Additionally, we will find ways to cope with the population decrease in the Kansai region and the intense competition in the energy sector, all with the aim of achieving sustainable growth in our gas sales.

In addition, we will promote even greater business efficiency, based on the premise of improving service and ensuring safety, while striving to lower gas rates in order to maintain and enhance our price competitiveness.

## Overview of Fiscal 2007 and Fiscal 2008

In November 2006, we lowered gas rates for the residential and small commercial customer segments by an average of 2.33% to return the benefits of lower fixed costs achieved through past and ongoing efforts to boost operating efficiency. As part of this, we revised our system for discount options to make it easier for our customers to use gas. Called the *Gas Toku Plan*, this scheme allows residential users to select from among four types of discounted gas rates.

Looking at gas sales volumes in fiscal 2007, residential and commercial sales were higher than in fiscal 2006, when winter temperatures were mild. Despite lower demand for water heating and space heating, industrial-use gas sales volume increased due to brisk development of new users and higher operating rates at facilities of existing users. As a result, overall gas sales volume increased by 3.4% year on year, from 8.45 billion m<sup>3</sup> in fiscal 2006 to 8.74 billion m<sup>3</sup> in fiscal 2007.

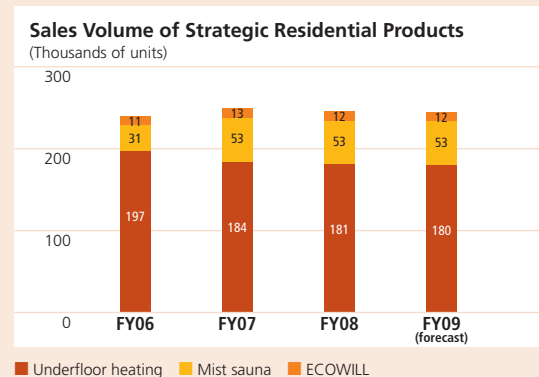
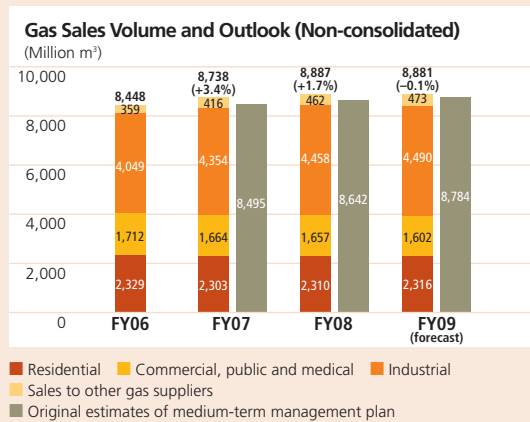
In fiscal 2008, residential gas sales volume growth was basically flat over the year. However, commercial and industrial gas sales volumes increased due to strong new demand and low temperatures in January and February 2008. Consequently, total gas sales volume increased 1.7% over the previous year, from 8.74 billion m<sup>3</sup> in fiscal 2007 to 8.89 billion m<sup>3</sup> in fiscal 2008.

In customer services, we changed the name of our outlets for addressing a broad range of customer needs from Osaka Gas Service Shop to Osaka Gas Service Shop Kurashi Plus, effective February 2007.

In activities related to the enhancement of our production and supply business base, we opened the Kinki Trunk Line—Shiga Line in October 2006. Construction on the Kinki Trunk Line—Shiga Line, a high-pressure gas supply trunk line, was started July 2003 with the aim of providing long-term, stable supply to the Shiga region. Additionally, a high-pressure trunk line that links the Kinki Trunk Line—Shiga Line with the Yokkaichi Thermal Power Plant of Chubu Electric Power is currently under construction (completion scheduled for 2010) as a pipeline aimed at further enhancing both supply stability and capacity of gas supply.

Turning to economical and stable procurement of raw materials, we concluded a contract with Malaysia LNG Sdn. Bhd. in November 2007 for the sale and purchase of liquefied natural gas (LNG) produced in Bintulu, Sarawak, Malaysia. Running for 15 years starting in 2009, the contract represents a major contribution to the Company's stable procurement of natural gas.





## Policies for Fiscal 2009

### 1. Responding to higher energy prices

As energy prices record historic highs, all Osaka Gas Group companies are making maximum efforts to generate profits. We are working tirelessly to sustain LNG procurement by diversifying and developing new supply sources, and thus provide stable gas supplies for our customers. Additionally, LNG prices are on an upward trend due to sharp increases in crude oil prices. Under these circumstances, we are doing our utmost to reduce LNG procurement costs, even marginally. Measures here include greater efficiency in inventory control and LNG terminal operations.

### 2. Promoting residential sector marketing to remain an attractive customer choice

In the residential sector, we will continue to offer gas appliances and services for modern lifestyles with gas, with the aim of meeting diversified customer needs in terms of environmental performance, economy, comfort, convenience, safety and security. Through cooking lessons, invitations to DILIPA—the Osaka Gas showroom—and other activities, we will provide opportunities for customers to experience the superiority of gas.

### 3. Establishing a strong framework for the energy businesses

In the commercial/industrial sector, we will leverage maintenance capabilities and natural gas utilization technologies, including cooling and combustion technologies developed over many years, to provide our customers with proposals for efficient energy usage, thereby contributing to higher economy and energy conservation. In addition, we will continue to promote greater use of environment-friendly natural gas with High Power EXCEL, a commercial-use gas heat pump air conditioner that simultaneously generates electricity, and Suzuchu cooking systems, which provide cool and comfortable working conditions in commercial kitchens.

### 4. Strengthening the foundations of the gas supply business

We will steadily build our core infrastructure, including the Mie-Shiga Line and the Amagasaki Line, as we seek to optimize our pipeline networks.

Moreover, we will enhance safety and security through continual enhancement of medium-term policies for our production facilities and pipelines, and by steady application of safety measures for appliances.

## » 2. Evolving Into a Multi-Energy Supplier

The Osaka Gas Group views the progressive deregulation of the energy field as a business opportunity, and intend to overcome the competition in the energy sector by establishing our identity as a multi-energy supplier.

In order to accomplish this, we are striving to achieve high profitability through expansion of business and thorough cost reductions. In turn, we are actively investing the cash flow generated by these activities for growth in two fields. One field includes those businesses that will contribute to the medium to long-term growth of our domestic energy business, such as the domestic electricity retail business or expansion of our natural gas business. The other field comprises overseas independent power producers (IPPs) or upstream interests in energy development that could be expected to quickly contribute to consolidated profits.

While developing the electricity retail business as the second core business, we will expand businesses in the energy markets both in Japan and overseas across the entire value chain of natural gas from upstream to downstream.

### Overview of Fiscal 2007 and Fiscal 2008

Construction of the Semboku Natural Gas Power Plant within the Osaka Gas Semboku terminal got under way in October 2006. The project is progressing steadily, with the start of operations targeted for 2009. Also, construction of the Hirogawa Myojinyama Wind Farm in Wakayama Prefecture, a business being pursued jointly with Gas and Power Investment Co., Ltd., and Sojitz Corporation, is proceeding, with completion scheduled for autumn 2008.

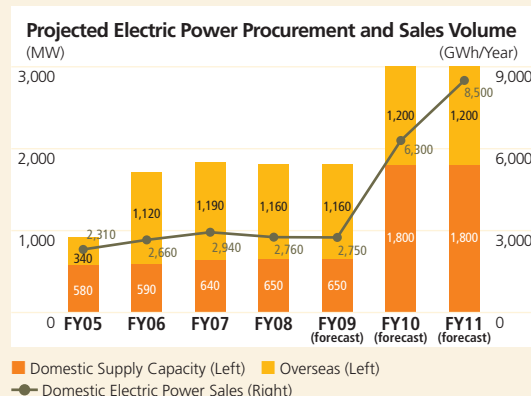
In the IPP business, with the aim of boosting profitability and acquiring expertise in the electricity business, in March 2007, an Osaka Gas subsidiary Gas and Power Investment Co., Ltd. acquired a further 50% stake in U.S.-based Marianas Energy Company LLC through Osaka Gas Energy America Corporation, a U.S. affiliate. This purchase, together with existing holdings, now gives Osaka Gas a 100% stake in Marianas Energy Company.

In upstream businesses, aiming for the acquisition of integrated technologies and business know-how while contributing to consolidated earnings, in August 2007 Osaka Gas Australia Pty. Ltd. established Osaka Gas Crux Pty Ltd. as a wholly owned subsidiary for the purpose of acquiring a 15% stake in the AC/P23 permit block located in Browse Basin offshore Western Australia from Nexus Energy Limited. Additionally, the LNG tanker LNG Dream (gross capacity of 145,000 m<sup>3</sup>) went into service in September 2006. Furthermore, we acquired 3% of the common stock outstanding of Qalhat LNG S.A.O.C, Oman's LNG production and sales company, from the government of Oman.

Osaka Gas also concluded an agreement with Contango Oil & Gas Company for the purchase of that company's entire stake in the Freeport LNG receiving terminal in the United States. In addition to securing stable earnings, this deal is aimed at broadening our base of knowledge in the United States LNG market, which is expected to grow rapidly, and expanding our business in LNG-related fields in the U.S. With this move, we have taken a 10% stake in the Freeport LNG receiving terminal product through Turbo LNG LLC, a special purpose company established in the United States.



Left to right:  
Marianas Power Plant in Guam, the Crux condensate field in Western Australia, and the LNG receiving terminal in Freeport, Texas, U.S.A.



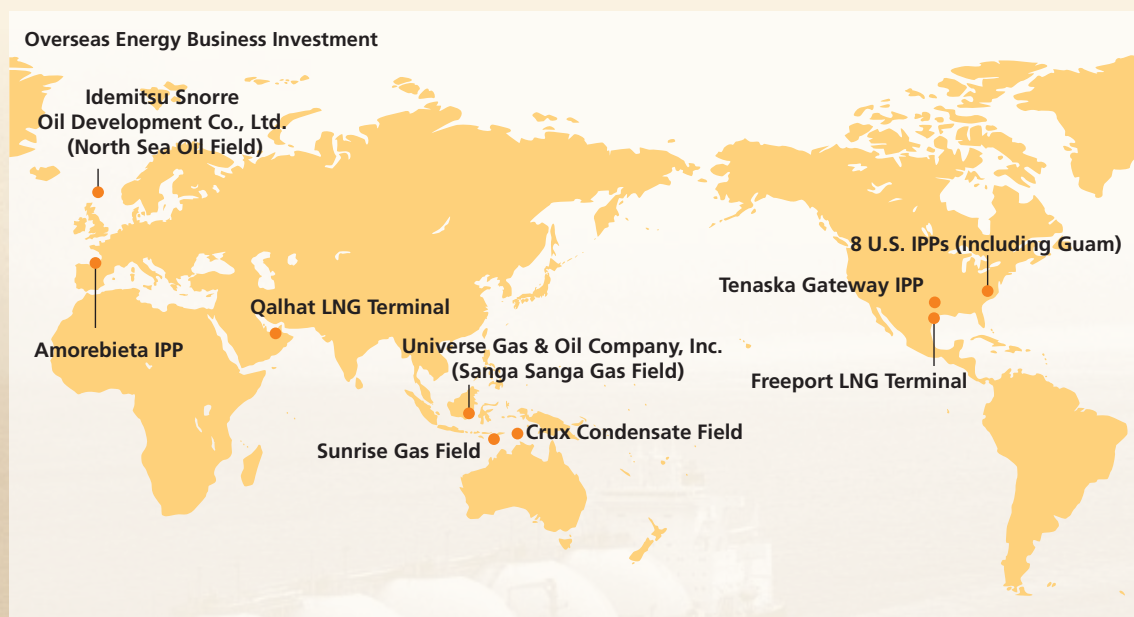
## Policies for Fiscal 2009

### 1. Steadily laying the groundwork for full-scale expansion of electricity business

With utmost priority on safety, construction of the Semboku Natural Gas Power Plant is proceeding steadily. Operations are scheduled to start in April 2009. In conjunction with this development, we are constructing an optimal business structure to demonstrate maximum performance when the power plant becomes operational.

### 2. Strengthening strategy for investing in energy-related growth

Our medium-term business plan, Design 2008, targets sustainable growth underpinned by investment in energy-related businesses. Based on this, we are pursuing growth-oriented investment by cultivating superior projects that facilitate acquiring and accumulating know-how pertaining to the multi-energy business, while also generating solid returns and strengthening relationships with partners both in the domestic and overseas markets.



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## » 3. Maximizing Group Strengths

Under the new group management organization introduced in July 2005, we are seeking to maximize the strengths of the Group. In our LPG and real estate business, we look to take maximum advantage of synergies with the energy business in pursuing growth. We will make our information-related services business and advanced materials businesses fully autonomous to enable them to pursue business outside the group and contribute to consolidated profits.

To implement these measures, we are actively undertaking growth-oriented investments in fields where there is market growth and the Group has business advantages (concentrated investment), while also actively selecting highly efficient Group businesses (selective investment). Through this process, we are optimizing the Group's asset portfolio.

### Overview of Fiscal 2007 and 2008

(For results of the real estate, information-related, and fine materials and carbon materials businesses, please refer to PP.28-29.)

In the condominium and building management business, in May 2006 Osaka Gas Security Service Co., Ltd. and its parent company OG Capital Co., Ltd. acquired shares in Osaka Housing Service Co., Ltd., which manages condominiums held by the Osaka Municipal Housing Corporation.

In July 2006, the Company transferred shares of Palette Co. Ltd., an operator of the La Palette household goods retail stores, to West Japan Railway Fashion Goods Company, which runs a large number of retail stores primarily in the area of clothing and miscellaneous household goods. This decision was based on the determination that such a transfer would be in the best interest of Palette Co. Ltd. with respect to the company's future development.

### Policies for fiscal 2009

Osaka Gas affiliates pursue maximum synergies within the energy business and seek to pursue business outside the Group.

The Liquid Gas Group and the Nissho Petroleum Gas Group (LPG business) are solidifying their business strategies to maximize profits across the entire LPG business value chain, from upstream to downstream.

The Urbanex Group is solidifying its earnings base in leased properties while engaging in the condominium business.

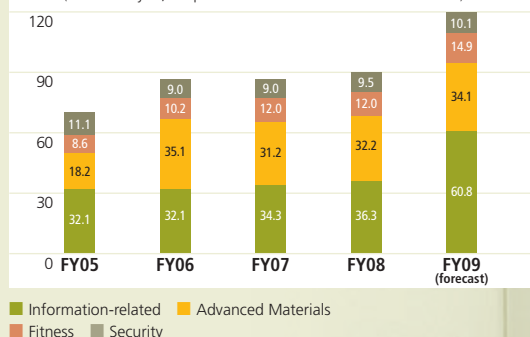
The Osaka Gas Information System Research Institute Group (information-related business) aims for steady earnings growth centered on model-based software development and by working with new Group company Sakura Information Systems Co., Ltd. on system development and business know-how with the aim of providing enhanced-quality services.

Osaka Gas Chemicals Co., Ltd. (advanced materials business) pursues business growth centered on the carbon fiber business and fine materials, which are seeing strong demand.

The OG Capital Group is moving ahead with selection and concentration in its portfolio of group companies in order to better respond to changes in the market environments of its various businesses.

#### Sales in Major Non-Energy Businesses

Sales (Billions of yen, simple total of all consolidated subsidiaries)



## Osaka Gas Group Medium-Term Business Plan

# 4. Growth-Oriented Strategy and Financial Policies

## Growth-Oriented Investment Strategy

Our previous medium-term business plan, Innovation Centennial, covered the period from April 1, 2003 to March 31, 2006. During those three years, we established a framework for growth-oriented investments aimed at building a management base that would enable the Osaka Gas Group to sustain growth. Based on the plan, we invested in the electricity business, trunk pipelines and upstream businesses. Under the current Design 2008 medium-term business plan, we are taking that strategy further, using free cash flow and additional funds procured within the scope of maintaining our sound financial position to aggressively make new growth-oriented investments.

### ● Growth-oriented investment policy:

1. Investments should be in accordance with either of our two management strategies—expansion of our multi-energy supplier business or concentrated and selective investments in non-energy businesses;
2. Investments should be in fields where the Group can leverage its strengths and where markets have growth potential; and
3. Investments should be able to quickly and substantially contribute to consolidated profits.

### ● Areas of emphasis:

1. Investments that will contribute to growth of the energy business in the medium to long term; and
2. Investments that will quickly contribute to consolidated profits.

The investments that will contribute to the growth of our domestic energy business in the medium to long term include investments in the domestic electric power business, in trunk pipelines, in the geographic expansion of the natural gas business, and in LNG vessels. Through these investments we are expanding the scope of the core energy business of the Osaka Gas Group.

Likely candidates to contribute quickly to consolidated profit include earnings-oriented investments in overseas IPPs and upstream interests. At the same time, we will actively invest in promising non-energy businesses, accelerating our concentrated and selective investment strategy.

All investment decisions are premised on maintaining a sound financial position. Other factors considered in making the investment decision include profitability, risk assessment, and whether the investment is in accordance with management strategies.

## Approach to Optimizing Capital Structure

We are continually looking at what overall composition of debt and equity will maximize our capital efficiency. Currently, we believe that an equity ratio of about 40% and a debt-to-equity ratio of approximately one will give us a capital structure that maximizes capital efficiency for each of our stakeholders.

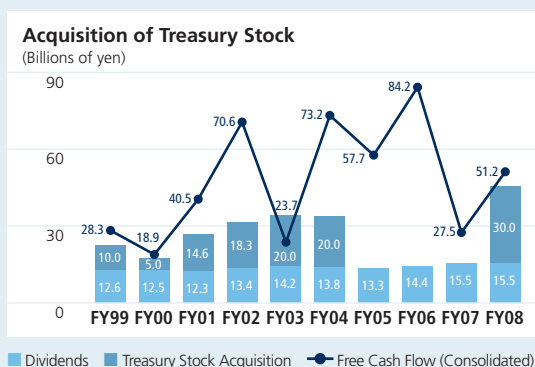
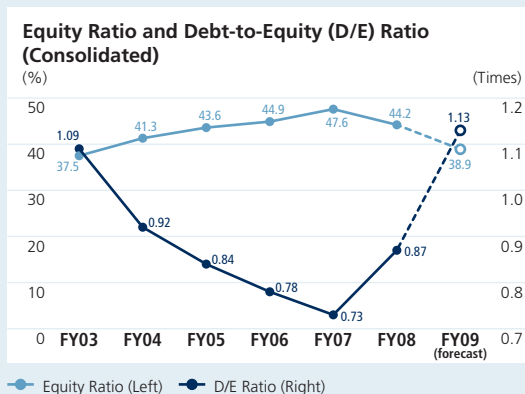
Since our current capital structure almost matches these targets, we believe it is possible to increase debt somewhat along with the growth in equity provided by retained earnings while maintaining our sound financial position.

## Policy on Treasury Stock

In the past, we have regularly used buybacks of our shares as one method of returning profits to shareholders by boosting earnings per share.

We will continue to consider the acquisition and retirement of treasury stock with a view to improving EPS and return on equity (ROE), but it will be done flexibly on condition that growth-oriented investments have been made first and that there is sufficient cash flow.

In October 2007, the Board of Directors authorized the buyback of the Company's own shares to further enhance shareholder value by boosting EPS and ROE. The buyback is also aimed at creating a financial structure that provides more flexibility in responding to the business environment. Through this buyback program, the Company had completed the repurchase of 67,286,000 shares, for approximately ¥29,999 million, by February 2008. Also, in March 2008, the Company retired a total of 77,286,000 shares, consisting of these shares together with other treasury stock.



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