

Management's Discussion and Analysis

1. Highlights of the Fiscal Year Ended March 31, 2008

Operating revenues for the year ended March 31, 2008 increased by ¥63.6 billion, or 5.4% over the previous year, to ¥1,238.1 billion thanks to an increase in gas sales volume, higher gas rates based on the fuel cost adjustment system (reflecting higher LNG prices) and business expansion at consolidated subsidiaries. Despite some contributions from consolidated subsidiaries, operating income decreased by 19.3%, or ¥18.1 billion, to ¥75.6 billion, due to an increase in LNG prices and a rise in expenses due to changes in the depreciation system as well as an unfavorable effect from the revision in gas rates for household/small commercial customers (implemented in November 2006). Ordinary profit (operating income plus non-operating profit or loss) declined by ¥13.7 billion, or 15.3%, to ¥75.8 billion, while net income decreased by 23.9%, or ¥12.6 billion, to ¥40.2 billion.

During the fiscal year under review, the price of crude oil rose from an average of US\$63.5 per barrel in fiscal 2007 to an average of US\$78.5 per barrel. Because the price of LNG, the source of natural gas, is indexed to crude oil prices, it is affected by fluctuations in the price of crude oil. However, as the sales price of gas changes each quarter in light of the actual purchase cost of LNG nationwide, the risk is essentially hedged.

Because the price of crude oil continued to climb throughout fiscal 2008, gas sales prices did not fully reflect the extent of the increase. In addition, there were a number of adjustments to the payment price for raw materials, including renewal of LNG purchase contracts. As a result, the gap between the cost of raw materials, which reflected the steep rise in the price of crude oil, and the sales price of gas grew approximately ¥32.0 billion compared to the previous fiscal year.

Operating income fell by approximately ¥18.1 billion compared to the previous fiscal year due to the increase in the cost of raw materials for gas, among other factors. However, the decline in ordinary profit was held to roughly ¥13.7 billion, boosted by non-operating income. The major factors contributing to the year-on-year improvement in non-operating income were the absence of a loss on debt assumption recorded in fiscal 2007, as well as a rise in equity in net income of affiliates.

This outcome was primarily the result of contributions from investment in oil field interests in the North Sea. Although earnings from the gas business declined year-on-year due to sharp increases in the price of raw materials, a portion of the loss was recovered through the execution and performance of investments for growth.

The number of consolidated subsidiaries totaled 133. Nine new consolidated subsidiaries were added as part of growth investment, and eight were removed due to the realignment of the Liquid Gas Group. The number of equity-method affiliates remained unchanged from the end of the previous fiscal year at four.

By category gas sales volume was affected by the increasing prevalence of energy-conservation measures, particularly at commercial and industrial customers. Nevertheless, sales volume rose 1.7%, boosted by the contributions of residential and public offices and medical customers due to cold weather conditions, and by efforts to develop demand, mainly in the commercial and industrial sectors.

Turning to growth-oriented investments in fiscal 2008, the Company invested actively in the energy business area, investing in a condensate field and an LNG terminal in the United States. In terms of existing investments up to fiscal 2007, the North Sea oil field and the U.S. IPP project performed strongly, contributing to consolidated performance.

2. Non-consolidated Gas Sales

Non-consolidated gas sales overall in the year ended March 31, 2008 increased 1.7% from the previous fiscal year.

Temperatures in January and February 2008 were lower than the previous year, prompting increased demand for heating and hot water supply among residential customers. Temperatures in April and May 2007, however, were warmer than in the previous year, leaving sales largely unchanged from the previous fiscal year.

Sales in the industrial sector rose 2.4% year on year, driven by robust development of demand.

In the commercial sector, although growth in demand was strong and demand from air conditioning climbed due to colder temperatures in January and February 2008, low temperatures in June and July 2007 and customers' increasing implementation of energy-conservation measures led to a 1.5% decline in sales.

Non-consolidated Gas Sales

(45MJ/m ³)		FY2008 (A)	FY2007 (B)	A-B	A/B(%)
Customers [meters installed] (thousands)	Residential	6,556	6,497	+60	+0.9
	Commercial/Industrial	325	323	+1	+0.5
	Total	6,881	6,820	+61	+0.9
Average monthly usage per customer (m ³ /month)		33.5	33.5	-0.1	-0.3
Gas sales (million m ³)	Residential	2,310	2,303	+7	+0.3
	Commercial/Industrial	6,115	6,018	+97	+1.6
	Industrial	4,458	4,354	+104	+2.4
	Commercial	1,021	1,036	-15	-1.5
	Public and medical institutions	636	628	+8	+1.3
	Sales to other gas suppliers	462	416	+45	+10.9
	Total	8,887	8,738	+149	+1.7
Average temperature (Celsius)		17.2	17.5	-0.3	-

Despite the increasing prevalence of energy-conservation measures in the public offices and medical sector, demand expanded

firmly. Coupled with low temperatures in January and February 2008, sales rose 1.3% year on year.

3. Overview by Business Segment

Gas Segment

Operating revenues increased by ¥34.7 billion, or 5.1% over the previous year, to ¥721.4 billion, thanks to an increase in gas sales volume and higher gas rates based on the fuel cost adjustment system, reflecting higher LNG prices. Operating income decreased by ¥19.3 billion, or 30.4%, to ¥44.2 billion, due to an increase in LNG prices and a rise in expenses caused by changes in the depreciation system as well as an unfavorable effect from the revision in gas rates for household/small commercial customers (implemented in November 2006).

LPG, Electricity and Other Energies Segment

Segment operating revenues increased by ¥30.5 billion over the previous year to ¥265.6 billion, a rise of 13.0%, driven by increased operations at overseas IPP projects and higher LPG rates. Operating income grew by ¥0.4 billion, or 3.5%, to ¥13.9 billion thanks to contributions from consolidated subsidiaries.

Gas Appliances and House-pipe Installation Segment

Operating revenues in this segment decreased by ¥11.7 billion, down 7.3% from the previous year, to ¥149.2 billion. However, operating income increased by 11.2%, or ¥0.1 billion, to ¥1.5 billion due to the absence of expenses related to inspections of bathroom heater/dryer units.

Real Estate Segment

Revenues increased by ¥2.5 billion, or 9.8% over the previous year, to ¥28.4 billion, as the result of an increase in the number of consolidated subsidiary companies. Operating income declined by ¥0.5 billion to ¥6.6 billion, a decrease of 8.1%.

Others Segment

Segment revenues increased 3.2%, or ¥4.4 billion year on year, to ¥144.3 billion thanks to growth in the information and materials businesses. Operating income rose 14.1%, or ¥1.0 billion, to ¥8.3 billion.

Fiscal 2008 Operating Revenues and Operating Income by Segment

(¥ billion)

	Gas	LPG, Electricity and Other Energies	Gas Appliances and House-pipe Installation	Real Estate	Others	Elimination and Corporate	Consolidated
Revenues	721.4 +5.1% [+34.7]	265.6 +13.0% [+30.5]	149.2 -7.3% [-11.7]	28.4 +9.8% [+2.5]	144.3 +3.2% [+4.4]	(70.9) [+3.1]	1,238.1 +5.4% [+63.6]
Operating Income	44.2 -30.4% [-19.3]	13.9 +3.5% [+0.4]	1.5 +11.2% [+0.1]	6.6 -8.1% [-0.5]	8.3 +14.1% [+1.0]	0.8 [+0.1]	75.6 -19.3% [-18.1]

% figures indicate change versus fiscal 2007. Figures in square brackets "[]" indicate absolute year-on-year change.

4. 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 around 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 new interest-bearing debt in line with the growth in shareholders' equity as profits increase.

Capital Expenditure

In fiscal 2008, non-consolidated capital expenditure totaled ¥59.2 billion. Major construction projects during the fiscal year were the continued construction of the Mie-Shiga Line, as well as continuing capital investment in peripheral facilities related to the planned construction of an electric power plant inside Osaka Gas's existing Senboku facilities.

Consolidated capital expenditure totaled ¥111.0 billion, representing an increase over the year ended March 2007, reflecting higher capital investment in the real estate business and lease business, as well as progress in investments for growth.

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 Mie-Shiga Line, the Semboku Natural Gas Power Plant, LNG carriers, and acquisition of interests in condensate fields.

Capital Expenditure

	(¥ billion)	
	FY2007	FY2008
Consolidated	95.2	111.0
Non-Consolidated	61.6	59.2
Manufacturing	3.0	2.6
Gas supply	39.3	37.5
Commercial and Industrial	19.2	19.1

Assets, Liabilities and Shareholders' Equity Analysis

Consolidated total assets at March 31, 2008 amounted to ¥1,467.9 billion, climbing ¥62.2 billion from the previous fiscal year. This rise was largely attributable to an increase in fixed assets associated with progress in growth investments. Liabilities as of March 31, 2008 were ¥801.2 billion, up ¥82.2 billion from the previous year. Total net assets decreased by ¥20.0 billion year on year to ¥666.6 billion due to a decline in retained earnings resulting from the retirement of treasury stock.

5. Cash Flow Analysis

Overview of Cash Flow

In fiscal 2008, net cash provided by operating activities rose ¥35.9 billion from the previous fiscal year, to ¥134.2 billion, due mainly to a decrease in income and enterprise taxes paid. Net cash used in investing activities increased ¥32.2 billion, to ¥132.0 billion, mainly reflecting increased expenditures for purchase of property, plant and equipment. Net cash provided by financing activities totaled ¥12.4 billion, an increase of ¥34.5 billion from the previous fiscal year,

	FY2007	FY2008	Change
Cash flow from operating activities	98.3	134.2	+35.9
Cash flow from investing activities	-99.7	-132.0	-32.2
Cash flow from financing activities	-22.0	12.4	+34.5
Change in cash and cash equivalents	-23.2	14.8	+38.0
Cash and cash equivalents at year-end	24.4	39.2	+14.7
Interest-bearing debt at year-end	487.8	566.4	+78.6

Free Cash Flow Application

Free cash flow had been projected at ¥55.1 billion at the beginning of fiscal 2008. Although income before income taxes and minority interests fell below the projected amount of ¥83.0 billion to ¥72.4 billion, due to a decrease in operating capital caused by factors such as an increase in accounts payable, free cash flow fell short of projections by approximately ¥3.8 billion.

Investment in projects for which the capital investment decision has already been made, such as the Semboku Natural Gas Power Plant, the Mie-Shiga Line, and LNG carriers, was carried out basically in line with initial plans.

Meanwhile, a separate investment framework was initially established at ¥67.0 billion. A total amount of ¥20.4 billion was invested in such projects as condensate fields and a U.S. LNG receiving terminal, with additional investment made in the U.S. IPP project.

Regarding acquisition of treasury stock, in our medium-term business plan, Design 2008, Osaka Gas established the following policy: "We will continue to consider the acquisition and retirement of treasury stock with a view to improving EPS and ROE, but it will be done

As a result, at March 31, 2008 the equity ratio was 44.2%, down from 47.6% in the previous year.

The asset, liability and shareholders' equity indicators were as follows.

Assets, Liabilities and Shareholders' Equity Indicators

	FY2007	FY2008
Equity ratio	47.6%	44.2%
Mark-to-market equity ratio	72.3%	58.5%
Interest-bearing debt to operating cash flows	5.0	4.2
Interest coverage ratio	10.3	13.6

Notes:

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.

mainly reflecting proceeds from long-term debt and the issuance of corporate bonds.

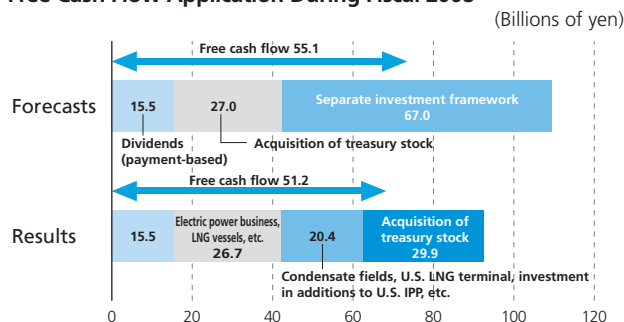
As a result, cash and cash equivalents for the fiscal year ended March 31, 2008 amounted to ¥14.8 billion.

Adding to this the balance of ¥24.4 billion in cash and cash equivalents at the start of the fiscal year, the year-end balance of cash and cash equivalents for fiscal 2008 totaled ¥39.2 billion, up ¥14.7 billion over the previous year.

	FY2007	FY2008	Change
Cash flow from operating activities	98.3	134.2	+35.9
Cash flow from investing activities	-99.7	-132.0	-32.2
Cash flow from financing activities	-22.0	12.4	+34.5
Change in cash and cash equivalents	-23.2	14.8	+38.0
Cash and cash equivalents at year-end	24.4	39.2	+14.7
Interest-bearing debt at year-end	487.8	566.4	+78.6

flexibly on condition that growth-oriented investments have been made first and that there is sufficient cash flow." Based on this policy, in fiscal 2008 we acquired approximately ¥30.0 billion in treasury stock, and completed retirement of the stock during the fiscal year.

Free Cash Flow Application During Fiscal 2008



Notes:

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

6. Basic Policy Regarding the Distribution of Profits and Dividends for FY2008 and FY2009

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 2008 and fiscal 2009, we intend to pay an annual dividend of ¥7 per share, including an interim dividend of ¥3.5 per share.

7. 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 herein 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:

a. Effect of 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 have a negative impact on the performance of the Group.

b. 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.

c. 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.

Furthermore, the results of contract renewal and price negotiations may affect operational results of the Osaka Gas Group, since there may be adjustments with respect to raw material prices.

d. 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.

e. 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.

f. Problems with gas appliances/facilities

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

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

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

Other Risks

a. Businesses other than the gas business

The performances of the Osaka Gas Group's other businesses are affected 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.

b. Concerning compliance

The Osaka Gas Group promotes strict compliance with rules and regulations. However, in the event of non-compliant behavior by the Company or its employees, subsequent expenses for dealing with such incidents and the decline in social credibility could affect the operational results of the Osaka Gas Group.

c. 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 have a negative effect on the Group's performance.