Interview with the President

"Viewing change as opportunity, we are resolutely challenging ourselves to embrace new fields and achieve further growth."

Takehiro Honjo
President

Interview with the President Q&A

Q1 What are the highlights from your performance for the fiscal year ended March 31, 2016?

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Q8 What is the Osaka Gas Group's policy on alliances with other companies?

Q9 Please give us your thoughts on returning profits to shareholders and provide details of capital policies for the future.

Q1 What are the highlights from your performance for the fiscal year ended March 31, 2016?

A

Results for the fiscal year ended March 31, 2016 reflected impacts of the decline in crude oil prices.

We recorded ordinary income of ¥134.9 billion, up 24.8% from the previous year due to the increase in profits in the gas business resulting from the decrease in raw materials expenditures associated with the decline in LNG prices. Current net income attributable to owners of the parent increased 9.9% to ¥84.3 billion as impairment losses recorded in the upstream business were offset by increased profits in the gas business.

On the other hand, consolidated gas sales volume was down 2.9% from the previous year, reflecting a decrease in residential demand due to higher winter temperatures than the previous year and a decrease in industrial demand caused by a downturn in operations at customers' facilities.

Figures such as current net income attributable to owners of the parent, ROA, and ROE were higher than in the previous year, but we recognize that such results cannot be taken for granted in future years.

Performance (Consolidated)

	2015.3	2016.3	Change	Percentage change
Sales (billion yen)	1,528.1	1,322.0	−206.1	−13.5%
Operating income (billion yen)	105.0	146.6	+41.6	+39.6%
Ordinary income (billion yen)	108.1	134.9	+26.8	+24.8%
Current net income attributable to owners of the parent (billion yen)	76.7	84.3	+7.6	+9.9%
Time-lag gain/loss* (billion yen)	12.3	81.7	+69.3	—
ROA	4.3%	4.6%	+0.2	—
ROE	9.1%	9.4%	+0.3	—

* The Fuel Cost Adjustment System in the gas business may cause a gain or loss in profit due to the time lag between a change in LNG prices and its reflection in gas rates.

Gas Sales

	45MJ/m^3	2015.3	2016.3	Change	Percentage change
Non-consolidated	No. of customers (thousand)	7,196	7,252	+56	+0.8%
Non-consolidated	No. of new constructions (thousand)	107	109	+3	+2.5%
Non-consolidated	Sales volume per household (m^3/month)	30.9	29.3	−1.7	−5.3%
Non-consolidated	Residential	2,186	2,083	−103	−4.7%
Non-consolidated	Commercial/public/healthcare	1,465	1,410	−56	−3.8%
Non-consolidated	Industrial	4,133	4,059	−74	−1.8%
Non-consolidated	Commercial and industrial total	5,599	5,469	−130	−2.3%
Non-consolidated	To other gas providers	474	469	−5	−1.0%
	(Large customers)	(4,755)	(4,647)	(−107)	(−2.3%)
	Total gas sales volume (million m^3)	8,259	8,021	−238	−2.9%
	Consolidated gas sales volume	8,290	8,052	−238	−2.9%

Q2 What is your strategy for handling the full liberalization of the retail gas market?

A

It is still unclear what the competitive landscape is going to look like once the retail gas market has been fully deregulated, but we expect to see tougher competition just as has occurred in the retail electricity market, which was fully deregulated in April.

To win in a highly competitive market, a company must understand its customers' needs and offer them exact solutions that meet their requirements. For this to happen, it is important to have direct contact with customers, including face-to-face interactions. The Osaka Gas service chain partners have many opportunities to interact directly with customers through appliance purchases and maintenance, and we would like to further strengthen our relationships with those customers. One of our specific efforts in this area is known as our "Sumikata Services" (Home Services), which we launched in May 2016. Leveraging our strength in having close ties to our customers, this new service offers them optimal approaches to more comfortable living that best suit their lifestyles. We are expanding our conventional services to include plumbing repair and air conditioning repair services so as to be a one-stop shop where customers can solve all of their residential problems, whether related to gas or electricity. By evolving into a next-generation energy marketer that offers not only energy, but also a variety of value-added services, we hope to continue to be our customers' number one choice for energy.

Q3 Now that Osaka Gas has entered the retail electricity business, what are the business conditions and future prospects for this business?

A

In the retail electricity business, we had received approximately 150,000 applications from customers as of the end of June. In the Kansai region, we have acquired the largest share of new electricity service applications. The sales personnel of Osaka Gas service chain partners offer rate simulations at customers' homes, etc. and provide detailed explanations of our services. In doing so, they are able to convey our price advantages to customers. We regard that customers are applying for our services based on their confidence in our company, which has been supplying gas to the Kansai region for more than 110 years. For the fiscal year ending March 31, 2017, we are planning to secure 200,000 contracts. By the year ending March 31, 2021, we want to have reached 700,000 contracts and to be running a business that can steadily contribute to our profits.

Q4 What impacts did the decline in crude oil prices have on the fiscal year ended March 31, 2016?

A

From the second half of the fiscal year ended March 31, 2015 to the end of the fiscal year ended March 31, 2016, crude oil prices fell sharply and, as a result, this had a negative impact on our business performance: impairment losses were recorded in our international upstream business, and the profits in our electricity business were reduced due to the fall in trading unit prices in the Japan Electric Power Exchange (JEPX) and other factors. On the other hand, since the decline in crude oil prices pushes down LNG prices and hence gas sales prices, an increase in gas demand can be expected. In fact, we successfully developed new gas demand in the fiscal year ended March 31, 2016 and will continue our efforts to develop more in the coming years. In the meantime, we intend to compensate for profit reductions caused by low oil prices through our efforts in developing gas demand and increasing profits in life & business solutions (non-energy business), which is less subject to oil price fluctuations.

Q5 Where will future investments be directed and what is the significance of investing in the international upstream business?

A

As of the end of the fiscal year ended March 2015, we had made about 88% progress (¥650.5 billion on a commitment decision basis), on the new business expansion and investment plan for the eight years from the fiscal year ended March 2010 to the fiscal year ending March 2017 (¥740.0 billion), indicating that our investment plans are progressing steadily. Over the medium to long term, the plan generally achieves a balance between our sales cash flow and investments.

In the domestic energy business, we are continuing to explore the construction of gas trunk lines and the acquisition of new power sources.

In our international business, participating in upstream projects and having the equity LNG of certain percentage in our procurement portfolio help secure the economy, flexibility and stability of our raw materials procurement and mitigate the impact of oil price fluctuation. To this end, we will continue investing in the existing upstream projects in which we are already taking part and carefully examine proposals for new projects with a greater level of scrutiny than before with consideration of both the current situation and the long-term outlook. In our international downstream business, we will continue looking into further investment opportunities to expand our energy business in areas where our technology and know-how cultivated in our domestic energy business can be utilized.

In life & business solutions (non-energy business), we will continue exploring investments in business expansion, such as acquisitions in our information solutions business and material solutions business.

By continuing to make these investments, we will establish the domestic energy business, international energy business, and life & business solutions (non-energy business) as our three core businesses, and will strive to maximize the overall strength of the Group by developing synergies and dispersing risk among all businesses.

Q6 Why were the ROA/ROE targets in the FY2017 Plan lower than in the “Catalyze Our Dreams” medium-term business plan?

A

The FY2017 Plan was drawn up to address the fact that we will be unable to hit our targets for ROA (3.5%) and ROE (8.0%) for the fiscal year ending March 31, 2017 as specified in the “Catalyze Our Dreams” medium-term business plan. Underlying this are projections that profits in the electricity and international energy businesses are going to fall dramatically given the changing assumptions regarding oil prices and exchange rates. Decreases in gas sales volume and the effects of gas rate revisions also play a role. Furthermore the FY2017 Plan introduces cost reduction measures that go above and beyond the medium-term business plan. While integrating improvement in sales income from appliance sales and reducing overheads, we will strive for a better profit base over the course of the year.

Comparison of FY2017 Plan and Medium-Term Business Plan (2017.3) Targets

		FY2017 Plan	Medium-Term Business Plan Targets (2017.3)	Change
ROA		2.8%	3.5%	−0.7%
ROE		5.4%	8.0%	−2.6%
Assumptions:	Crude oil price (JCC) Unit: dollars/barrel	Apr–Sep: 40 Oct–Mar: 45	110	First half: −70 Second half: −65
	Exchange rate: yen/dollar	120	105	+15

Q7 The fiscal year ending March 31, 2017 is the final year of the "Catalyze Our Dreams" medium-term business plan. What kind of progress has been made on this plan thus far?

A

The FY2017 Plan foresees that the quantitative targets set in the medium-term business plan will not be met, but it concludes that genuine progress has been made on the key issues of "enhancement of the energy business in the Kansai region," "expansion of the energy business areas," and "creation of the next core businesses by expanding business in growth markets outside the domestic energy business."

In the domestic energy business, we steadily proceeded with the environment assessment for the power plant whose construction is being planned in Ube City, Yamaguchi Prefecture, and in February, we made the decision to move forward with investigating and preparing for a natural gas power generation project in Himeji City, Hyogo Prefecture. Other achievements include launching a new model of ENE-FARM that achieves higher power generation efficiency in a more compact space compared with previous models, entering into the retail electricity business and increasing our sales volume of LNG to other energy providers.

In our international energy business, we entered into a new IPP project in the USA and invested capital in a natural gas local distribution company in Italy. We made steady progress in the upstream business we have been involved in thus far, and in 2016 LNG shipment started at the Gorgon LNG Project.

In life & business solutions (non-energy business), the Group welcomed a company engaged in the manufacture and sales of inorganic adsorbent agents and resin additives in the material solutions business, and we generated synergies in sales and technology with a Swedish activated carbon company that joined the Group in 2014. In the information solutions business, we expanded system sales to financial, energy, and production companies by leveraging the strengths of each group company. Through these efforts, we are steadily expanding our business in various growth markets.

In January 2015, we revised gas rates and lowered them for small-volume customers by 1.26% on average. On the occasion of the 110th anniversary of our founding, we issued a commemorative dividend, and for the fiscal year ending March 31, 2017 and beyond, we will continue our efforts to increase ordinary dividends. Thus, in alignment with our management principle, we are unremittingly striving to create value for customers and shareholders.

Q8 What is the Osaka Gas Group's policy on alliances with other companies?

A

We have thus far engaged in partnerships with other companies that contribute to the achievement of our growth strategy and with whom we can enjoy mutual benefits, and we will continue to explore opportunities for collaboration in the future.

In response to the full deregulation of the retail electricity and gas markets, we are considering the formation of alliances that go beyond our business sectors to include not only energy companies, but companies in the communications and other industries. When it comes to alliances that will help us engage in the competitive procurement of materials or electricity, or expand our customer engagement opportunities and services, we will explore partnerships with a wide range of service providers, regardless of industry.

Q9 Please give us your thoughts on returning profits to shareholders and provide details of capital policies for the future.

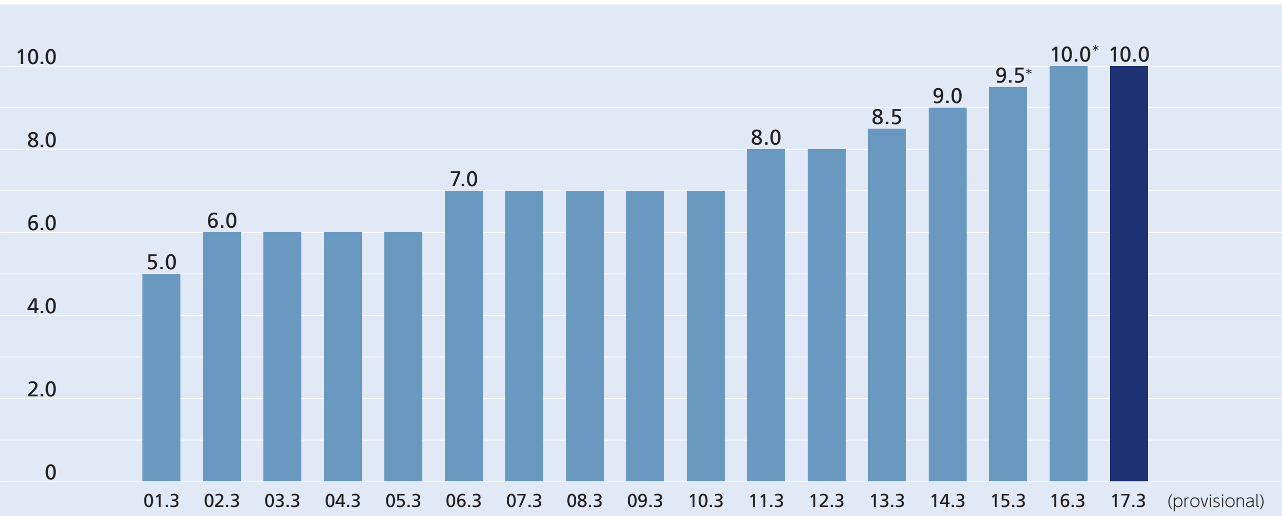
A Uncertainty in the domestic energy business is likely to increase due to the full deregulation of the retail electricity and gas markets. To steadily manage and grow our businesses even under the new conditions, we must actively make new investments. Meanwhile, we need to maintain a high credit rating with ample capital and a strong financial position by establishing the financial soundness targets of having a D/E ratio of approx. 0.7 and a shareholders' equity ratio of 50% or more.

With regard to shareholder returns, we have set a consolidated payout ratio target of 30% or more on a basis that excludes factors affecting short-term profits.

The current business landscape is likely to pose challenges, but over the medium term, we can expect profit growth in the retail electricity business and life & business solutions (non-energy business), and profit contribution from international upstream projects in which we have made investments. Because of these prospective gains and the likely implementation of further business efficiency improvements, the Board of Directors' meeting held in March 2016 decided to set the target of 10 yen per share as an ordinary annual dividend for the fiscal year ending March 31, 2017 and beyond. By continuing to promote active business expansion, improve business efficiency and raise profit levels, we hope to increase dividends and meet our shareholders' expectations.

Regarding the acquisition of treasury stock, it will be implemented by comprehensively considering factors including overall performance, future business plans, cash flow, financial conditions, and the extent of our investments.

Annual Dividends per Share (Yen)



* Fiscal year ended March 2015: ¥9.0 annual dividend, ¥0.5 commemorative dividend; Fiscal year ended March 2016: ¥9.0 annual dividend, ¥1.0 commemorative dividend