

## Interview with the President



**Tsugiyoshi Toma**  
President

Q1

**What can you tell us about the regional economy and trends in demand for electric power now the first quarter has ended?**

### **(Regional Economy)**

Recently, the Okinawa economy has maintained strong recovery momentum.

The number of tourists in particular hit record high levels in April and May, due to the addition of new routes following the opening of new airports in Kobe and Kitakyushu in 2005.

With regard to consumer spending, we have seen 13.4% year-on-year growth in demand for domestic electrical appliances centered on flat-screen televisions, due to the opening of a large-scale Kojima Co., Ltd. store in downtown Naha and the 2006 World Cup.

However, the construction industry continues to face severe operating conditions due to the decline in public-sector investment.

Looking ahead, we expect consumer spending to maintain its current strength, led by a strong economy driven by the current firmly-rooted Okinawa tourism boom.

We also expect the worst of the depression in the construction industry to lift in the near future, as orders increasingly come from the private sector.

We expect the prefectural economy to continue to show strong recovery momentum.

### **(Demand for Electricity)**

Demand for electricity in the first quarter of fiscal 2007 increased 2.0% year-on-year to 1,683 million kWh.

Against a backdrop of population increase, non-industrial power demand grew 2.1% year-on-year due to rising demand for residential-use power reflecting growth in the number of households, and for commercial-use power following the opening of new hotels and large-scale retail stores in the prefecture.

Industrial demand increased 1.2% year-on-year reflecting increases in power use due to a rise in customers in the food processing industry and demand for seawater desalination facilities.

As of July 10, 2006, the volume of electric power sold had risen 2.3% year-on-year. On July 6, we recorded a three-year peak in electricity usage of 1.523 million kW, compared with the earlier record high of 1.506 million kW.

On that day, air conditioning operating rates soared, amid record-high temperature for July of 35°C recorded in downtown Naha.

Full-term power usage for fiscal 2007 is set to show year-on-year growth of 0.2%, to 7,358 million kWh. This translates into a year-on-year growth rate of 1.5% excluding the impact of high temperatures.

Turning to long-term demand, we assume an average growth rate of 1.8% (2.0% after adjustment for temperature factors) in demand for electric power between fiscal 2005 and fiscal 2016, reflecting a population growth rate in Okinawa Prefecture ahead of the national level, and steady growth in the food-processing and water-supply industries.

Q2

**What is the impact of continuing high crude oil prices, and what measures is your company taking to deal with it?**

### **(Short-Term Impact)**

Fuel expenses in fiscal 2006 totaled around ¥32.6 billion, a rise of approximately ¥7.7 billion (31.1%) compared with fiscal 2005, reflecting rising prices.

The cost of petroleum rose 33.3% to ¥5.0 billion for us. This was due to (1) the impact of Hurricane Katrina in the United States in the summer of 2005, (2) a global increase in demand for oil, and (3) terrorist attacks and political instability in major oil-producing countries.

Our coal costs rose 29.8% to ¥2.8 billion, due mainly to (1) tight supplies in China, which caused the Chinese government to prioritize domestic demand and reduce exports, which in turn prompted us to compensate by sourcing from Australia and Indonesia, (2) production problems due to heavy rainfall in Australia and Indonesia, and (3) occurrence of simultaneous events adversely affecting stability of supplies, which may have caused coal prices to soar.

### **(Medium- to Long-Term Impact)**

In fiscal 2007, we expect fuel prices to rise approximately ¥6.0 billion (18.4%) compared with fiscal 2006, to ¥38.6 billion.

We expect petroleum costs to rise 29.5% to ¥5.9 billion. The main reason is stagnant refining capacity and low inventory levels for petroleum products in the United States. Other factors are the ongoing chaotic situation in Iraq, terrorist and cross-border conflict in the Middle East and other regions, and uncertain economic growth prospects in newly emerging economies.

We expect our coal costs to rise 0.8% to ¥100 million. We feel that supplies are still tight despite the sharp rise in coal prices due to the severity of the winter in Japan in 2005.

### **(Our Measures)**

We intend to reduce expenses for petroleum by making spot purchases at times when fuel prices seem likely to fall, while closely monitoring oil demand trends.

We plan to expand procurement of subbituminous coal, rather than bituminous coal, as it is not only relatively environment-friendly (having low ash and sulfur content), but is also relatively inexpensive. We also intend to make additional purchases at low rates under existing supply contracts when market prices for coal are low, to further cut costs.

**Q3** What measures are you taking to cut costs on remote-island operations?

We had success in generating a more balanced stream of revenue from remote-island power supply by establishing the Remote-Island Internal Company and undertaking various other rationalization measures.

However, this internal company recorded a loss of approximately ¥6.0 billion in fiscal 2006 due to a re-categorization of heavy oil for power generation, from C to A grade, due to soaring crude oil prices, leading to a steep year-on-year increase in fuel costs, of ¥3.3 billion.

Specific measures to improve the situation included building pipelines to deliver fuel to the Miyako No. 2 power station.

As part of efforts to draw up specific countermeasures to deal with rising fuel prices, we have also set up a working group on fuel procurement for remote-island operations. It will look into development of new suppliers for C-grade heavy oil not including Fluid Catalytic Cracking (FCC) content and ways of curbing the adverse impact of FCC oil on internal combustion systems. We plan to continue trials on curbing the impact on internal combustion systems currently underway at Kume power station until October 2006.

**Q4** Why have you brought forward financial targets by a year?

We were a year early in meeting numerical targets (interest-bearing debt and shareholders' equity ratio) aimed at strengthening our financial position.

We have set new targets for recurring income and ROA as we expect to achieve three-year average targets up to fiscal 2007.

Specific targets are as follows:

- Recurring income of at least ¥11.0 billion a year on average
- ROA of at least 4.0%
- Total interest-bearing debt of approximately ¥260 billion by the end of fiscal 2011
- Shareholders' equity ratio of approximately 30% by the end of fiscal 2011.

**● Financial Target**

	Consolidated	Non-consolidated	Target year
Recurring Profit	Annual average ¥12 billion or over	Annual average ¥11 billion or over	FY2007-2011
Return on Assets (ROA)	Annual average over 4.0%		FY2007-2011
Interest-Bearing Debt	Approx. ¥270 billion	Approx. ¥260 billion	End of FY2011
Equity Ratio	Approx. 30%		End of FY2011

The main reasons for the changes are that construction of the Yoshinoura Thermal Power Plant is pending, creating strong demand for funding. It is necessary to build up retained earnings to keep this increased financial pressure under control.

**Q5** What expectations do you have for the Yoshinoura Thermal Power Plant, for which construction preparations are now underway?

Through introduction of combined cycle power generation using LNG as a fuel, we aim to (1) take action against global warming by cutting carbon dioxide emission volumes, (2) contribute to reducing environmental load by use of fuel that does not generate sulfur oxides or harmful dust, and (3) increase the security of electrical supplies by diversifying our fuel sources, using coal, heavy oil and LNG as our principal electricity-generation fuels.

At the moment, we plan to begin preparatory construction works in November 2006, with an eye to launch of operations in fiscal 2011.

We are now studying environmental impact appraisal reports, and have completed procedures for environmental assessment in August 2006.

The Federation of Electric Power Companies of Japan has set the demanding target of reducing per unit (kWh) emissions in 2010 to 80% of their 1990 level. This will be tough, but the new Yoshinoura plant will be a key facility in our efforts to achieve this level of reduction, and we aim to use the World Bank Carbon Fund.

**Q6** Please tell us something about the new businesses you are actively developing and what direction you wish to take them in going forward.

It is of course essential to establish new business fields and develop new businesses for the Group to increase its overall enterprise value and achieve sustained growth and development into the future.



For that reason we will aggressively expand existing businesses and develop new businesses by making most efficient use of the Group's management resources.

We have established five companies so far under our introduced internal venture capital system "MOVE2000 Program."

Ganju Company, a meat-packing company, was chosen as meat supplier in the "Let's Choose Japanese Umai 2006" nationwide campaign operated by Kirin Beer. Grace Rum Co., Inc., a rum distiller, plans a special product to celebrate its first anniversary. Aqua Culture Okinawa Co., Inc. can now offer decorative soft and hard coral, and has begun to increase shipments.

Looking ahead, to develop new entrepreneurial talent in-house and ensure that our venture companies succeed, we plan to upgrade support mechanisms at every stage of their growth, as well as enhance their earnings capability and establish management systems enabling them generate stable profit.