Summary of this chapter

Although we decreased electricity rates in July 2006 to reflect the improved management efficiency, we witnessed an increase in both sales and profit in FY2007 for the first time in two years. The financial data succinctly described HEPCO's efforts to improve corporate value while trying to address two conflicting challenges – the stable supply of power and lower electricity rates. Under the Mid-Term Management Policy, we are steadily making strides toward the solution of such problems as the stable supply of electricity to customers, efforts to secure society's trust in us, and the expansion of business fields.

Outline of Business Performance in FY2007

Demand

Residential, commercial and industrial demands increased by 0.4% because all-electricity houses gained in popularity following the development of rigorous sales activities despite the fact that heating demands decreased due to higher temperatures during winter compared with the previous year.

Demands among eligible customers increased by 3.7% due to the new openings of large-scale retail stores, favorable productive activities in the iron and steel industries, as well as paper and pulp industries, and the changeover from private power generation to power purchasing owing to soaring oil prices.

As a result, the net system energy demand rose by 2.2%.

Supply

The water flow rate of the current fiscal year was 103.9%, which was higher than the average year. In addition, we ensured that supply facilities would be properly operated, for example, keeping the utilization factor of the nuclear power station high. Consequently, we were able to maintain stable supplies.

Balance

●Earnings

The earnings from residential, commercial and industrial electricity increased by 19.6 billion yen (3.9%) due to an increase in net system energy demand as well as the impact of the fuel cost adjustment system, although they were also affected by the reduction of electricity rates on July 1, 2006.

Other earnings increased by 2 billion yen (23.5%) because of the appropriation of compensation for the relocation of the hydroelectric power station and so forth.

As a result, the total ordinary revenue increased by 21.6 billion yen (4.2%).

●Expenses

Personnel expenses remained almost unchanged from the preceding fiscal year.

Fuel costs and purchased electricity charges increased by 13.3 billion yen (10.7%) despite the high utilization rate of the nuclear power station, because of skyrocketing fuel prices and an increase in net system energy demand.

Although construction costs concerning distribution equipment increased, maintenance expenses decreased by 0.5 billion yen (△0.8%) due partly to the decreased number of units receiving regular inspections at the nuclear power station.

The depreciation cost reduced by 4.9 billion yen (△7.3%) due to the depletion effect caused by fixed rate depreciation.

The interest expense increased by 1.1 billion yen (9.4%) because of the early reimbursement of high-interest rate liabilities.

Despite our efforts to enhance the efficiency of the overall management, other expenses increased by 5.1 billion yen (4.4%) because of an increase in the information processing cost, nuclear power-backend cost and the like.

As a result, the total ordinary expenditures rose by 14.1 billion yen (3.0%).

●Profits

As a consequence of the above-mentioned, the ordinary income increased by 7.4 billion yen (15.9%) to 54.5 billion yen while the post-tax current net income rose by 3.5 billion yen (11.6%) to 33.6 billion yen.

■**Net system energy demand** (Unit: million kWh)

		FY2007 (A)	FY2006 (B)	Change (A) – (B)	Year-on-year variation (%) (A) / (B)
Other than eligible customers	Residential	11,640	11,541	99	100.9
	Commercial and industrial	2,168	2,218	△50	97.7
	Total	13,808	13,759	49	100.4
Eligible customers		17,704	17,074	630	103.7
Total		31,512	30,833	679	102.2

■**Amount of electricity supplied** (Unit: million kWh)

		FY2007 (A)	FY2006 (B)	Change (A) – (B)	Year-on-year variation (%) (A) / (B)
HEPCO	(Water flow rate %) Hydroelectric power	(103.9) 3,517	(100.4) 3,352	(3.5) 165	104.9
	Thermal power	17,154	17,646	△492	97.2
	(Utilization factor %) Nuclear power	(93.0) 9,437	(87.5) 8,880	(5.5) 557	106.3
	Total	30,108	29,878	230	100.8
Electricity from other utilities		5,241	4,881	360	107.4
Interchanged power		△48	△123	75	38.8
For pumping		△67	△60	△7	112.6
Total		35,234	34,576	658	101.9

■**Balance comparative chart** (Unit: ¥ million)

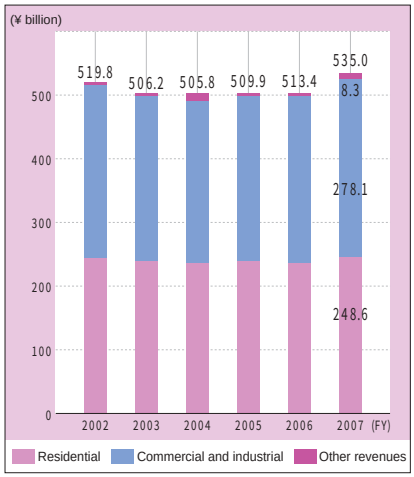
		FY2007 (A)	FY2006 (B)	Change (A) – (B)	Year-on-year variation (%) (A) / (B)
Ordinary revenue	Residential	248,606	243,219	5,387	102.2
	Commercial and industrial	278,112	263,822	14,290	105.4
	(Subtotal)	(526,719)	(507,041)	(19,677)	(103.9)
	Other	10,534	8,533	2,000	123.5
	[Sales]	[535,003]	[513,484]	[21,519]	[104.2]
	Total	537,254	515,575	21,678	104.2
Ordinary expenditure	Personnel	77,223	77,243	△20	100.0
	Fuels and electricity purchased	138,330	124,937	13,392	110.7
	Maintenance	68,225	68,775	△549	99.2
	Depreciation	62,765	67,682	△4,916	92.7
	Interest due	13,349	12,206	1,143	109.4
	Other	122,802	117,667	5,134	104.4
	Total	482,696	468,511	14,184	103.0
[Operating income]		[69,386]	[59,839]	[9,547]	[116.0]
Ordinary income		54,557	47,063	7,494	115.9
Provision for (reversal of) reserve for fluctuations in water level		1,320	103	1,216	1,281.6
Pretax current net income		53,237	46,960	6,277	113.4
Income tax		19,581	16,807	2,774	116.5
Current net income		33,655	30,152	3,503	111.6

Operating income refers to the income that a company earns from its main business while **ordinary income** means the income that a company earns from ordinary continuous activities, including its main business. **Current net income** refers to the income that ultimately remains in the company after subtracting a myriad of costs, extraordinary profits and losses, taxes, etc.

Financial Data (Unconsolidated)

Sales

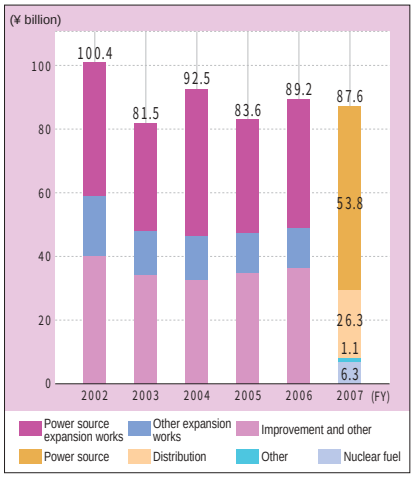
Changes in sales



Although affected by the reduction of electricity rates, we registered an increase in revenue in FY2007 due to increased net system energy demand and the impact of the fuel cost adjustment system.

Capital expenditures

Changes in capital expenditure

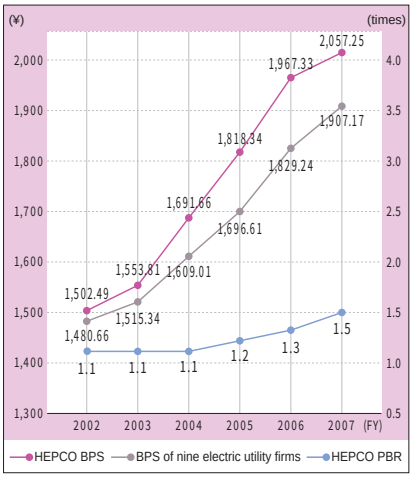


In FY2007, we kept our capital expenditure down to 87.6 billion yen, which was 0.7 billion yen below the planned value, as a result of the promotion of further efficiency enhancements.

The classification was changed to “power source,” “distribution,” “other” and “nuclear fuel,” beginning with the items announced in FY2008.

Book Value Per Share (BPS) and Price Book Value Ratio (PBR)

Book Value Per Share (BPS) and Price Book Value Ratio (PBR)

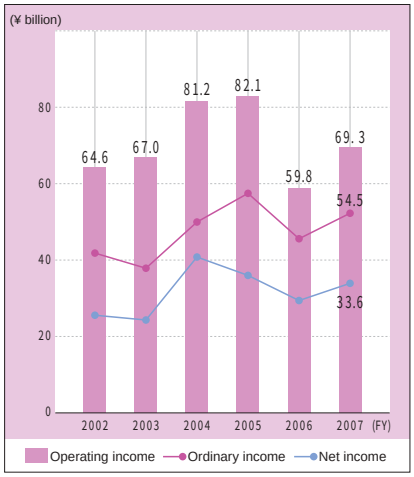


BPS is calculated by dividing the company’s net assets amount (shareholders’ equity) by the shares authorized and indicates interest of shareholders’ equity per share.

PBR is calculated by dividing the share price by the shareholders’ equity (net assets) per share. Generally, the PBR standard is considered as the lower limit of the share price.

Changes in income

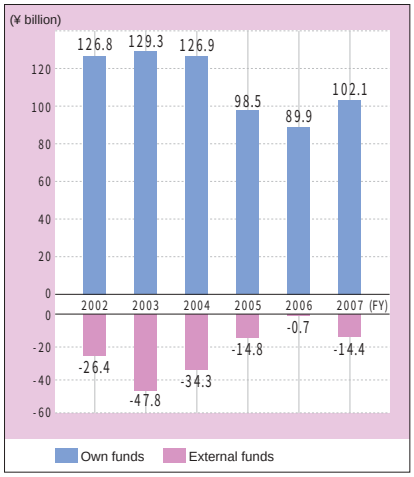
Changes in income



In FY2007, sales increased and, in terms of expenditures, there was an increase in fuel cost due to soaring fuel prices. However, the number of units subjected to regular inspection at the nuclear power station decreased, thus mitigating maintenance and fuel costs. As a result, the increase of ordinary expenditure was curbed, resulting in an increase in operating income, ordinary income and current net income.

Changes in capital procurement

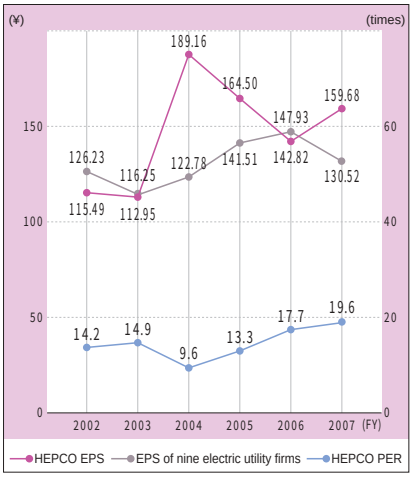
Changes in capital procurement



Since we worked hard to enhance management efficiency, e.g. restrained capital investment, we have continued to register a net reduction for external funds.

Earnings Per Share (EPS) and Price Earnings Ratio (PER)

Earnings Per Share (EPS) and Price Earnings Ratio (PER)



EPS is calculated by dividing the current net income by the average number of shares outstanding. This indicates the ultimate post-tax net income vis-à-vis per share.

PER is calculated by dividing the current share price by the earnings per share, and is a measure of the price paid for a share relative to the profit earned per share.

Residential sales refer to the sales from ordinary households, street lights and so forth, while **commercial and industrial sales are the sales** other than residential ones, such as business and industrial sales. **Other sales** are obtained through interchange for other utility companies, for example.

Mid-Term Management Policy

HEPCO drafted the Mid-Term Management Policy covering the three years from FYs 2006 to 2008 in November 2004. In FY2008, we will expend all our energies to address the management challenges enumerated in the Mid-Term Management Policy and begin drafting the Mid-Term Management Policy for the next term.

Overview

●The HEPCO Group's Ideal

- contributes to Hokkaido, with electricity industry as the core
- achieves top-level performance in the electricity industry
- fosters a corporate culture in which group companies remain enthusiastic and share a sense of fulfillment

Striving to realize the ideal HEPCO Group, we set three priority issues in this Mid-Term Management Policy and will implement specific measures. The specific measures to be taken are as follows:

●Our customers' sound decision in choosing HEPCO and expansion of business fields

- Developing strategic sales activities that aim to expand electrification in the vast thermal demand market in Hokkaido
- Preventing our customers from leaving HEPCO and promoting the changeover from private power generation to electric power selling through detailed and attentive proposal activities that satisfy diverse needs
- Reinforcing sales activities for the entire Group's products and services
- Promoting solution-oriented sales activities in which we try to solve our customers' problems by utilizing the Group's diverse technical capabilities and expertise

●Pursuit of efficiency and reliability

- Enhancing business efficiency and promoting further cost reduction by minutely analyzing the cost structure via management accounting, reviewing business processes by the SCM method, and so forth
- Steadily promoting the construction of power generation facilities, e.g. Tomari Power Station Unit No. 3, and distribution facilities, including the Central Hokkaido's Southern Trunk Line
- Strengthening and thoroughly implementing the quality control of facilities and ensuring their precise operation and maintenance

●Securing the solid trust of society

- Building a CSR promotion framework toward the establishment of the HEPCO Group Brand
- Promoting thorough group-wide compliance with laws and corporate ethics as well as environmental management
- Securing fair and transparent business operation through the timely disclosure of appropriate information as well as improved hearing activities
- Promoting regional revitalization activities, e.g. support for the industrial cluster creation activities

●Reinforcing the integrated management of the Group

- In developing specific measures, various headquarters will be established at the Group's Head Office and those headquarters will form a united front with the Group companies that they are associated with in promoting autonomous and efficient business operation

●Numerical targets

[Management Indicators]

[Improvement of profitability and efficiency]

- Return On Assets (ROA)
  (3-year average from FYs 2006 to 2008)
  4.5% or above (consolidated, unconsolidated)

[Improvement of financial standing]

- Shareholders' equity ratio (end of FY2008)
  30% or above (consolidated, unconsolidated)
- Interest-bearing debt (end of FY2008)
  720 billion yen or below (consolidated)
  700 billion yen or below (unconsolidated)

[Sales Target]

[Expansion of net system energy demand]

Expanding 1.5 billion kWh or above for three years from FYs 2006 to 2008

[Targets for Efficiency Improvement]

[Improvement of business efficiency]

- Improving 15% or above in business efficiency toward FY2007 (vis-à-vis FY2001)

We will step up our efforts to improve business efficiency in and after FY2008.

[Reduction of capital investment]

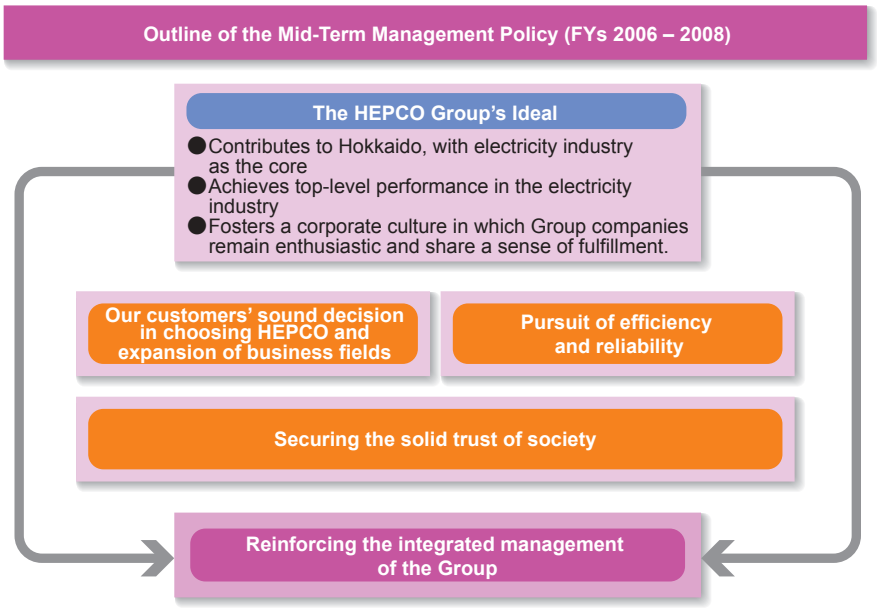
- 90 billion yen or below

(3-year average from FYs 2006 to 2008) (unconsolidated)

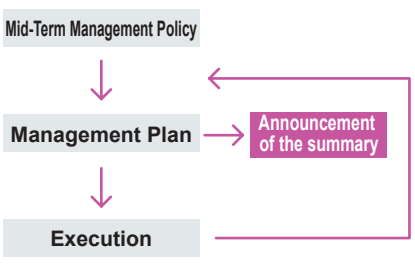
[Reduction of the number of employees]

Somewhere between 5,700 and 5,750 (by the end of FY2008) (unconsolidated)

■Mid-Term Management Policy



■Policy management cycle



State of progress of the Mid-Term Management Policy

Management Indicators

●Improvement of profitability and efficiency

• Return On Assets (ROA) (consolidated)

Although we reduced the electricity rates in July 2006, the operating income increased compared with the preceding fiscal year because sales rose due to the increased net system energy demand, and mitigated maintenance and fuel costs owing to the reduced number of units subjected to regular inspection at the nuclear power station. As a result, the ROA was 4.9%, an increase from FY2006.

●Improvement of financial standing

• Shareholders' equity ratio (consolidated)

The shareholders' equity ratio was 30.5% because of the curbed increase in total assets through thorough efficiency enhancement as well as increased surpluses.

• Interest-bearing debt (unconsolidated)

The interest-bearing debt was 699.8 billion yen as we worked hard to improve efficiency through the restraint of capital investment.

Sales Target

●Expansion of net system energy demand

All-electricity houses have been disseminated and expanded as a result of rigorous sales activities in the living-related fields. Demands in the electrification fields for corporate customers, e.g. building air-conditioning and fully electrically fitted kitchens, have achieved a sound growth in addition to the increased number of corporations having changed from private power generation owing to the reduced electricity rates and soaring oil prices. As a result, demands increased by approximately 1.25 billion kWh in accumulated total from FYs 2006 to 2007.

Targets for Efficiency Improvement

●Improvement of business efficiency

Aiming to achieve our target, we sought a drastic efficiency improvement in every aspect of our business. In FY2007, which was the target year, the progress rate was approximately 9%. However, this was caused by skyrocketing fuel prices and if the fuel cost factor were removed, the said rate would have been above the target at approximately 20%.

●Reduction of capital investment

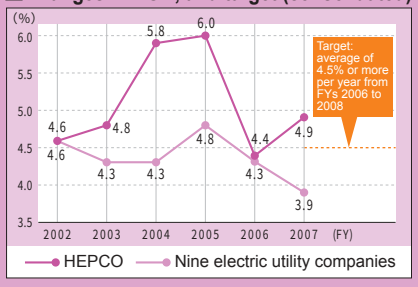
While the construction of Tomari Power Station Unit No. 3 proceeding at full swing, the amount of capital investment was restrained to 87.6 billion yen, which was a decrease of 0.7 billion yen from the initial plan, due to the cost reduction for power source equipment works in the implementation phase, for example.

●Reduction of the number of employees

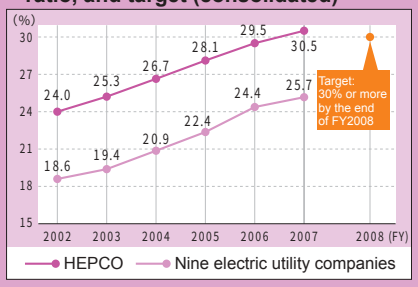
We have reduced the number of employees by steadily executing activities intended to improve business efficiency by 15% or more, and the said number of employees as of the end of FY2007 was 5,777, a decrease of 49 from the end of the previous fiscal year.

Management Indicators

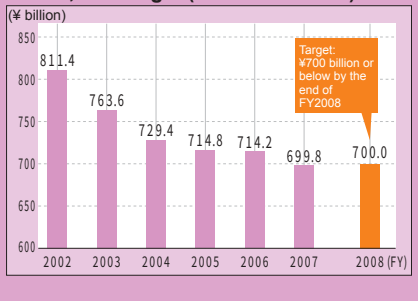
■Changes in ROA, and target (consolidated)



■Changes in the shareholders' equity ratio, and target (consolidated)

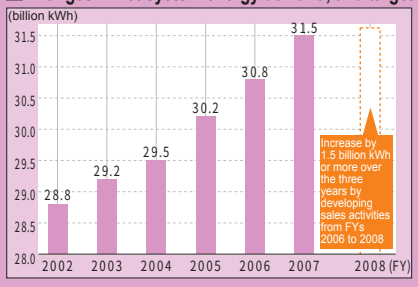


■Changes in balance of interest-bearing debt, and target (unconsolidated)



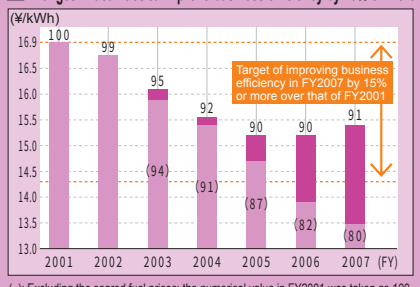
Sales Target

■Changes in net system energy demand, and target



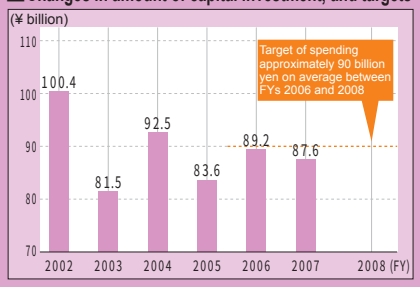
Targets for Efficiency Improvement

■Changes in activities to improve business efficiency by 15% or more

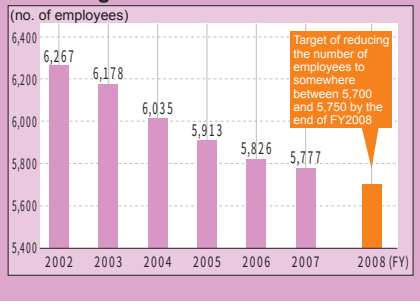


( ): Excluding the soared fuel prices; the numerical value in FY2001 was taken as 100.

■Changes in amount of capital investment, and targets



■Changes in the number of employees, and targets



Return on Asset
Return on Asset refers to the figure calculated by dividing the operating income by the total asset and is an indicator for measuring profitability in a comprehensive manner by determining how much profit has been made by efficiently utilizing the total asset invested. It is also called ROA for short.
Formula: return on asset = ratio of profit to net sales (operating income/sales) ×sales to total assets ratio (sales/total asset)

Shareholders' equity ratio
This is the indicator for financial stability, calculated by dividing the equity capital by total assets.
Formula: shareholders' equity ratio = equity capital/total assets

Nine electric utility companies
Hokkaido Electric Power Co., Tohoku Electric Power Co., Tokyo Electric Power Co., Chubu Electric Power Co., Hokuriku Electric Power Co., Kansai Electric Power Co., Chugoku Electric Power Co., Shikoku Electric Power Co. and Kyushu Electric Power Co.

Reduction of electricity rates

The reform of the electric industry system has been implemented in three phases since FY1996, and deregulation has covered all customers receiving high-voltage electricity.

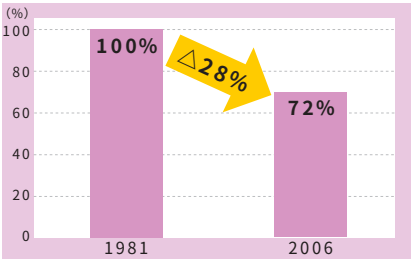
In April 2007, the Advisory Committee on Energy and Natural Resource's Electric Utility Subcommittee launched deliberations on the thorough liberalization of retailing.

In Hokkaido, we have fiercely competed with those engaging in private power generation and cogeneration for industrial purposes, and as the scope of electricity deregulation has been expanded in phases, the power market has become all the more competitive.

To cope with a period of all-out competition like this, HEPCO has been working closely with the HEPCO Group companies and doing its utmost to achieve its management goals based on the Mid-Term Management Policy (FYs 2006 – 2008), such as the improvement of customer services and the drastic enhancement of management efficiency.

HEPCO has reduced electricity rates 14 times since 1986. Following FY2006, HEPCO decreased electricity rates by an average of 2.85% in July 2006 by factoring in, to as great an extent as possible, the results of enhanced management efficiency, from the viewpoint of strengthening its price competitiveness in the competitive power market and contributing to regional revitalization as a community-based company (with the reduction rates excluding the deregulated sections). We will continue our efforts to become a reliable company that will be selected by our customers through the securement of stable power supplies with nuclear power generation as the main pillar, environmental conservation and fortifying our competitiveness by the promotion of enhanced management efficiency, and also by living up to the needs of our customers more attentively.

■**Comparison of electricity charges in 1981, when the rates were revised, and 2006, when the rates were reduced**



Note 1: Average model (excluding tax): meter rate lighting B; electric current in contract 30A
When 260 kWh of electricity is consumed monthly
Note 2: As for the figures above, the model rate as of October 1981, when the charges were revised, was taken as 100.

■**Revision of electricity rates**

	Date of implementation	Rate of revision	Background
1	October 1981	18.11%	Soaring fuel prices; a rapid increase in equipment-related costs
2	June 1986 (temporary)*1	△¥0.83/kWh	Appreciation of the yen; a decrease in oil prices
3	January 1987 (temporary)*1	△¥1.36/kWh	
4	January 1988	△11.53%	
5	April 1989	△1.76%	
6	October 1993 (temporary)*1	△¥0.88/kWh	Conversion of fuels from domestic coal-fired thermal power to nuclear power
7	November 1993 (temporary)*1	△¥0.21/kWh	Appreciation of the yen
8	October 1994 (temporary)*1	△¥1.11/kWh	Conversion of fuels from domestic coal-fired thermal power to nuclear power; appreciation of the yen
9	July 1995 (temporary)*1	△¥1.20/kWh	
10	January 1996	△12.71%	Fuel conversion; appreciation of the yen; cost reduction thanks to enhanced management efficiency
11	February 1998	△6.65%	Cost reduction thanks to the accelerated enhancement of management efficiency
12	October 2000	△5.83%*2	
13	October 2002	△5.39%*2	
14	April 2005	△4.04%*2	
15	July 2006	△2.85%*2	

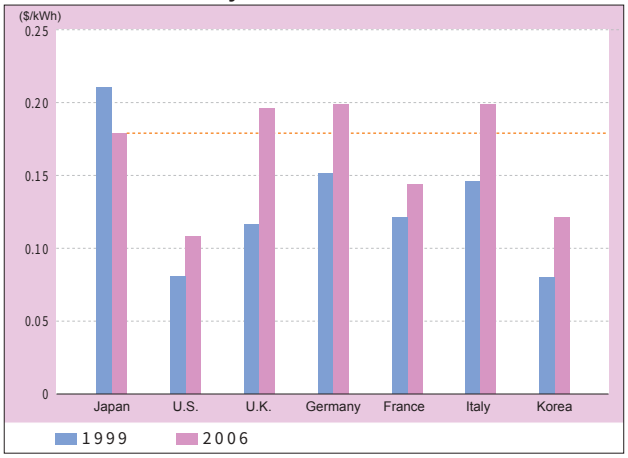
*1: The rate of revision in the temporary reduction measure refers to the average unit cost of reduction per kWh.
*2: Excluding eligible customers

Reference

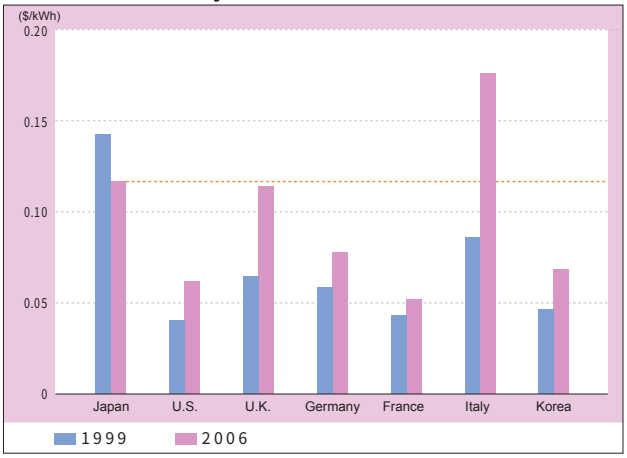
International comparison of electricity rates

Institutional reform for electric utilities, such as the deregulation of the electric power industry, has been promoted worldwide, but electricity charges have been increasing due to skyrocketing fuel prices and other reasons in many countries.

■**Household electricity rates**



■**Industrial electricity rates**



* Calculated based on the exchange rates of the aforementioned countries in 1999 and 2006 (Note: The electricity rates in the U.S. and Korea were calculated based on the exchange rates between July and September 2006; the household electricity rates and industrial electricity rates in the U.K. were calculated based on the exchange rates between July and September 2006 and between April and June 2006, respectively; the electricity rates in Italy and Germany were calculated based on the exchange rates in 2005 and 2004, respectively.)
* Some industrial rates include business (commercial) charges while others do not. The industrial rates in Japan include business charges.
* The average unit price was calculated without limiting usage patterns of each country for one year.
* Pretax prices were used for the U.S.

Sources: OECD/IEA, ENERGY PRICES&TAXES 4Q/2006
Actual power demands (Federation of Electric Power Companies), each electric power company's brief report of the settlement of accounts and financial statements