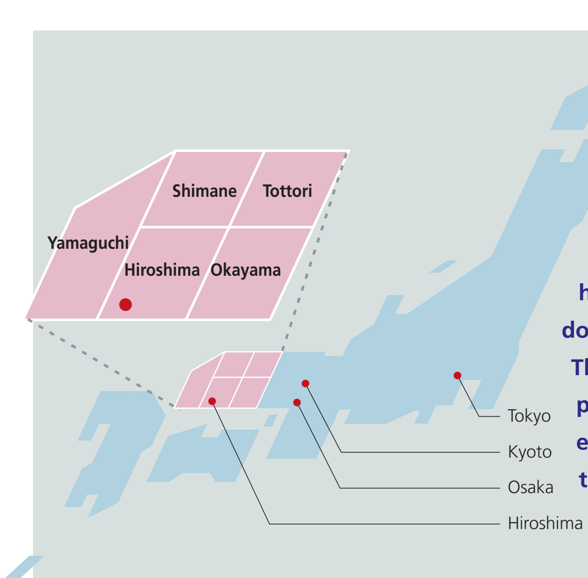
Energia

The Chugoku Electric Power Co., Inc.

Annual Report 2006



At a Glance

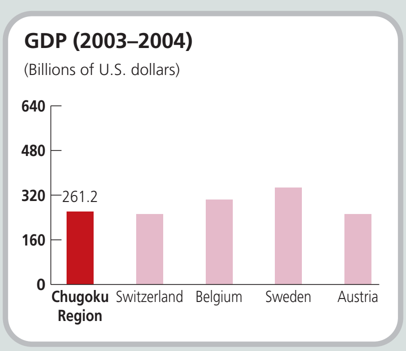
The Chugoku Electric Power Co., Inc., with total generating capacity of 12,200MW, provides stable, high-quality electric power services mainly to the Chugoku region, which is located in the western portion of Japan's main island of Honshu. Home to approximately 7.7 million people, the region has a land area of approximately 31,900km^2 and generates an annual gross domestic product of about $261.2 billion.*

The progressive deregulation of Japan's electric power industry to include retail power supply is expected to bring substantially greater competition in terms of rates charged and services offered. On the other hand, changes in the operating environment are also broadening the scope of business opportunities for Chugoku Electric.

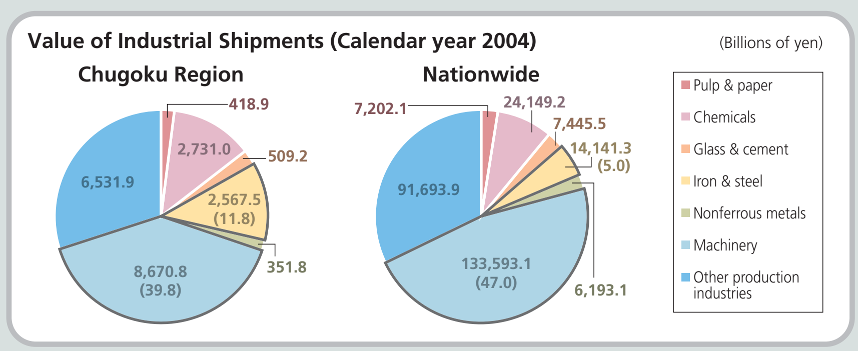
Under our new management plan, implemented Groupwide in April 2006, efforts are under way to attain further increases in efficiency and improve price competitiveness. In addition, we are working to promote our total solutions business—with electric power at its core—by offering products and services that respond to a wide range of customer needs by drawing on the experience, accomplishments, and capabilities of the entire Chugoku Electric Group.

While continuing to take initiatives to ensure stable supplies of electricity and respond proactively to environmental issues, we are aiming to secure the trust of the regional communities we serve and make sure we remain the No. 1 choice among our customers. In tandem with these activities, the Group is striving to increase its corporate value and make the world of Energia—a fresh, bright, and warm society, powered by energy and brimming with vitality—a reality.

***Year ended March 31, 2004**



Sources: 1. Regional Affairs section of the Ministry of Foreign Affairs website
2. *Overseas Economic Data* and *Fiscal 2003 Annual Report on Prefectural Accounts*, Cabinet Office
3. *The World 2005*, World Economic Information Services



Sources: *Census of Manufacturers*, Ministry of Economy, Trade and Industry
Figures in ( ) represent the percentage distribution.

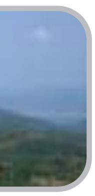
Contents

Cautionary Statement with Regard to Forward-Looking Statements

In this annual report, all nonempirical information, including current plans, forecasts, strategies, assurances, and other matters, is intended to project results based on facts available to company management at the time of writing. For this reason, we urge readers not to make investment decisions based solely on the forecasts herein. Economic and other factors may cause actual performance to differ significantly from projections.

Factors affecting performance include, but are not limited to, the systemic reform of electric power business, business other than electric power, economic conditions in the power supply area, seasonal variations in weather, changes in fuel prices, changes in interest rates, the cost and liabilities of employees' severance and retirement benefits, management of personal information, and natural disasters and other such events.

Consolidated Financial Highlights



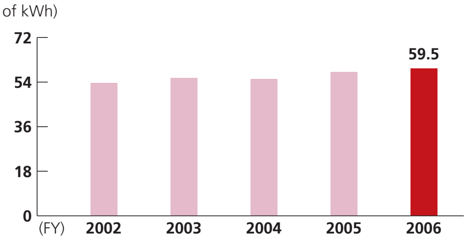
The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
For the year:				
Operating revenues	**¥1,040,290**	¥1,011,799	¥ 967,056	**$ 8,891,368**
Operating income	**100,095**	125,451	99,586	**855,513**
Net income	**45,167**	47,062	42,888	**386,043**
At year-end:				
Total stockholders' equity	**695,495**	658,209	629,604	**5,944,403**
Total assets	**2,655,468**	2,636,363	2,712,376	**22,696,308**
Interest-bearing debt	**1,575,011**	1,613,979	1,728,285	**15,083,916**

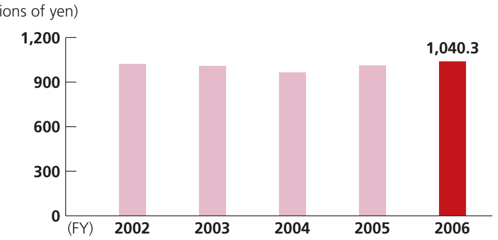
	Yen			U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Per share data:				
Net income	**¥ 123.44**	¥ 128.61	¥ 116.63	**$ 1.06**
Stockholders' equity	**1,910.41**	1,807.59	1,728.06	**16.33**
Cash dividends applicable to the year	**50.00**	50.00	50.00	**0.43**
Ratios:				
Equity ratio (%)	**26.2**	25.0	23.2	
ROE (%)	**6.7**	7.3	6.9	
ROA (%)	**2.4**	3.0	2.3	

Notes: 1. U.S. dollar amounts are translated from yen, for convenience only, at ¥117 to U.S.$1.00, the approximate rate of exchange prevailing on March 31, 2006.
2. The Company's fiscal year begins on April 1 and ends on March 31 of the following year. In this report, fiscal 2006 is used to denote the year ended March 31, 2006.

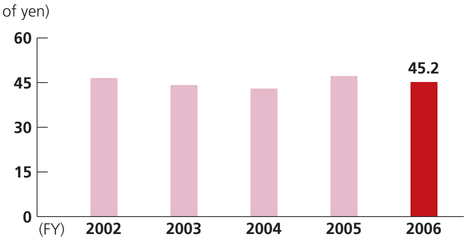
Electricity Sales
(Billions of kWh)



Operating Revenues
(Billions of yen)



Net Income
(Billions of yen)



Total Assets
(Billions of yen)

Message from the Management

In fiscal 2006, ended March 31, 2006, earnings were negatively affected by the electric power rate reductions implemented in April 2005. Nevertheless, the operating revenues of our electric power business rose as increased heating demand led to higher electric power sales volume. Higher liquefied natural gas (LNG) sales also boosted overall sales. As a result, operating revenues totaled ¥1,040.3 billion, up ¥28.5 billion from fiscal 2005.

Although the Group worked to increase management efficiencies across the board, higher fuel prices drove up materials costs, causing operating income to fall. Consequently, net income amounted to ¥45.2 billion, down ¥1.9 billion from fiscal 2005.

In fiscal 2007, we expect both revenues and profits will decline, owing to lower electric power sales volume and the impact of electric power rate reductions that went into effect in July 2006. Based on its medium-term management plan, the Chugoku Electric Group will continue working to improve profitability and increase management efficiency, with the aim of bolstering its competitiveness.

Aiming to Be a Corporate Group That Is Resilient in Times of Change

The operating environment surrounding the Chugoku Electric Group is undergoing rapid changes, including the advent of full-fledged competition as a result of electric power industry deregulation, the diversification of customer values, and issues related to the recent surge in fossil fuel prices and greenhouse gases.

The Chugoku Electric Group aims to be a corporate group that is resilient in times of change. It intends to increase enterprise value and meet the expectations of all stakeholders, regardless of what kinds of changes take place in the societal and business environments.

Tadashi Fukuda
Chairperson

Tadashi Fukuda

Takashi Yamashita
President

Takashi Yamashita

To that end, we are working diligently to fulfill the founding ethos that gave us our start as a public utility—to provide a stable supply of abundant, inexpensive, and high-quality electric power—as well as our management creed based on the brand identity of "Energia." In doing so, our intention is to win the unshakable trust of our customers and the local community and, at the same time, enhance our sensitivity to various changes in the environment as well as respond to issues that must be addressed with flexibility and agility.

Responding to the 3Es Simultaneously

In order for the Chugoku Electric Group to continue to play a central role in the energy industry of the Chugoku region and to enable sustainable growth and development into the future, it is essential to consider the 3Es—energy security, environment, and economy—a shorthand way of referring to the need to improve energy security, solve environmental issues, and generate sustainable profits by ensuring the long-term stability of power sources. Accordingly, in response to this need, we believe the fundamental challenge for the Group is to achieve the best mix of power sources.

We believe the development of nuclear energy is the key to achieving this best mix of power sources. Continuing on from the construction of the Shimane Nuclear Power Station's Unit No. 3, we continue to strive for the development of a nuclear power plant in Kaminoseki as a top management issue. We believe a crucial point in the development of nuclear power is approaching, and we are devoting ourselves to enhancing activities related to the construction of nuclear power facilities, based on the creation of relationships of trust with local communities, as well as to establishing a firm management base by securing earnings sources and maximizing efficiencies.

Moreover, we are working to improve our reputation for trustworthiness through safe and stable facilities operations, the thorough implentation of compliance, and the proper and rapid disclosure of information. At the same time, with a view to achieving our management goals, we are from fiscal 2007 adopting a Group medium-term management plan system. Through these efforts, we intend to substantially enhance our overall competitiveness and, thereby, to increase earnings.

Going forward, the Group aims to be a corporate group that remains trusted as well as the one chosen by customers, and it is working as one to increase its enterprise value. We therefore ask for the continued support and cooperation of our stockholders and investors.

June 29, 2006

Management Plan

The operating environment surrounding the Chugoku Electric Group is expected to become even more challenging as the further liberalization of the electric power business, the core business of the Group, leads to increased competition. To prevail over the competition amid such an environment, and to increase its enterprise value and meet the expectations of its various stakeholders, the Group is working together as one in conducting its business activities, based on the Basic Management Concepts of the Chugoku Electric Group and the parent company's Management Policies.

Basic Management Concepts of the Chugoku Electric Group

Goals

- Become a group of companies essential to customers by providing attractive products and services
- Remain a central contributor to the regional economy and build shareholder value
- Stabilize Group employment, bolster the technical capabilities of employees, and energize workplaces

Specific Initiatives

- As a Group centered on the electric power business, operate a total solutions business that selects and offers the best overall benefits for customers from various options
- Streamline the operations of the entire Group to efficiently utilize Group management resources

Working Together to Enha

Group Management Goals (Fiscal 2007–Fiscal 2009)

Category		Management Goal (Consolidated)
Profitability	Ordinary income	Minimum average of ¥74 billion/year in fiscal 2007–fiscal 2009
Efficiency	Return on assets	Minimum average of 2.5%/year in fiscal 2007–fiscal 2009
Soundness	Stockholders' equity ratio	Minimum of 28% by end of fiscal 2009

Notes: Ordinary income is operating income less ordinary expenses (i.e., excluding special items and income taxes).
Return on assets is operating income less taxes, divided by total assets, multiplied by 100.
The stockholders' equity ratio is stockholders' equity divided by total assets, multiplied by 100.

Electric Power

- Power generation: Use power-trading market, optimize energy mix
- Retailing: Strengthen competitiveness by becoming more customer-oriented
- New businesses: Develop independent power producer operations overseas and develop consulting business

Total Solutions Operations in the Chugoku Region

- Maximizing management resources
- Improving regional convenience and comfort

Cultivating Synergies

Comprehensive Energy Supply

- Providing "one-stop" services
- Offering an optimal energy menu
  - Cogeneration, distributed power sources
  - Fuel (LNG and coal) supply
  - Energy use

Information and Telecommunications

- Deploy solutions businesses combining information and telecommunications

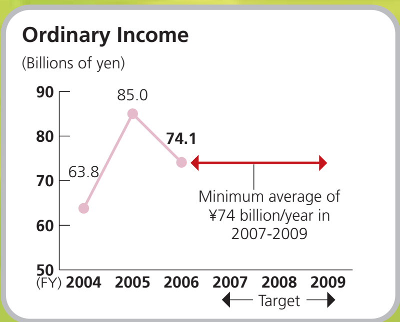
Environmental Business

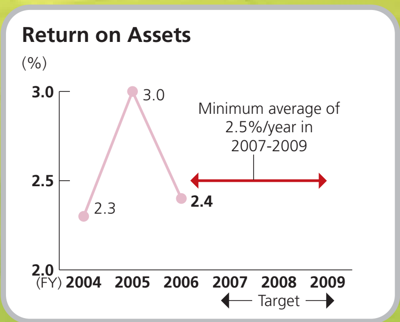
- Effective utilization of coal ash
- Measurement and analysis of dioxin, etc.

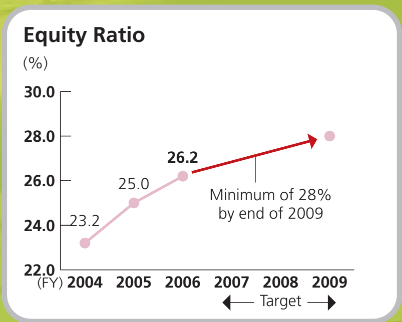
Business and Lifestyle Support

- ISO assessment and registration
- Welfare service
- Housing guarantee
- Group finance and accounting service

nce Management Strength







Chugoku Electric's Management Policies

1. Build sustainable profits
   - Reinforce competitiveness by becoming more customer-oriented
   - Strengthen Group management capabilities
2. Secure the trust of all stakeholders, including customers, stockholders, investors, and communities
   - Ensure operational fairness and transparency
   - Resolve public issues
3. Energize employees and restructure operations

Group Management Goals

The Chugoku Electric Group is working proactively to expand revenues and further promote management efficiency, and it has set concrete management goals for the levels of profitability, efficiency, and soundness it aims to achieve in the three-year period from fiscal 2007 through fiscal 2009.

Group Companies Working Together to Enhance Management Strength

Direction of Operations

We intend to meet our customers' increasingly diverse needs and boost profitability by aggressively developing a total solutions business. To that end, we have established, in addition to our core electric power business, four strategic business domains into which we are investing management resources in a concentrated manner. By doing so, the Group is working as one to develop a solutions business that leverages its strengths. In addition, we will expand our business operations basically in the Chugoku region and provide various services that contribute to the convenience and comfort of customers.

Building Group Management Foundations

We are working to enhance Group management, strengthen and promote Groupwide cost reduction and profit acquisition efforts in a planned manner, and optimally allocate the Group's management resources based on profitability assessments of individual businesses.

Starting in fiscal 2007, we will classify our Group business areas into five management segments, in addition to the accounting disclosure segments, and conduct income and expenditure management for each of those management segments. These new classifications will help clarify strategies and roles for the overall Group as well as for each business field, enhance competitiveness by forming links among Group companies, and create a structure for conducting profitability assessments of individual businesses and for flexibly and expeditiously allocating management resources throughout the Group in an optimal manner.

Outline of the Medium-Term Management Plan

	Accounting Disclosure Segments				
				Other	
Management Segments	Electric power	Comprehensive energy supply	Information and telecommunications	Environmental, electric power business support, etc.	Business/ lifestyle support
Total energy					
Energy marketing & services	●	●		●	
Power generation	●	●		●	
Power system	●			●	
Information and telecommunications			●		
Business/ lifestyle support					●

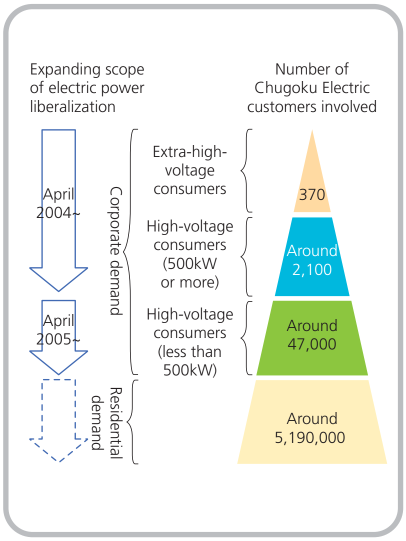
Review of Operations

Electric Power Business

Earnings Review

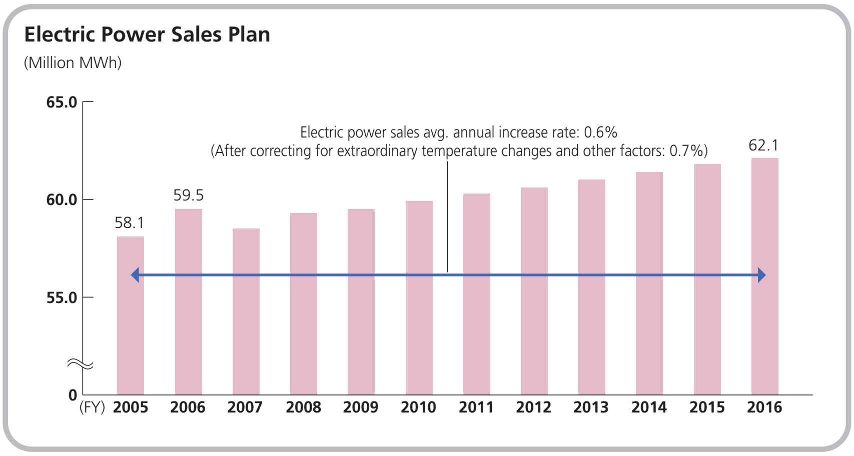
In fiscal 2006, despite the negative impact of electricity rate reductions in April 2005, electricity sales and operating revenues both rose, thanks in part to higher heating demand. However, operating expenses also increased, mainly owing to higher fuel costs. As a result, operating revenues increased by ¥17.0 billion, to ¥968.8 billion, while operating income declined by ¥27.5 billion, to ¥91.9 billion.

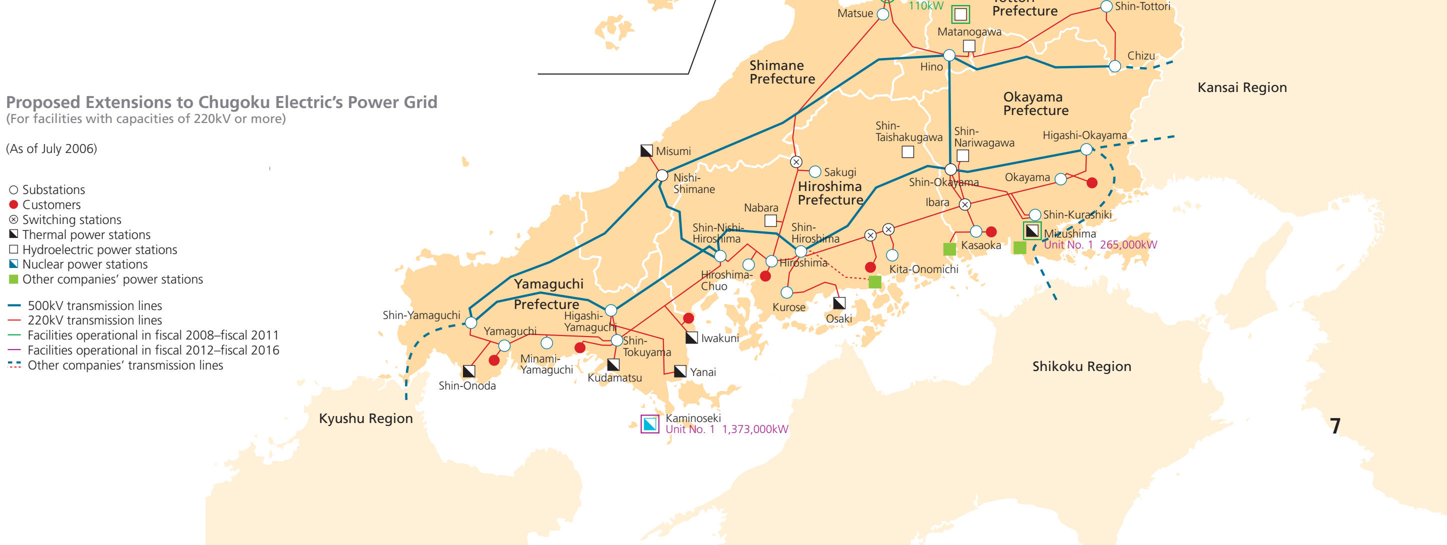
Despite certain factors, such as efforts to reduce power consumption and a decline in the population, given the likelihood of continued economic growth, we believe electric power sales volume will increase slowly but steadily going forward, driven by the advancement of the information society as well as the aging society, an increased desire to live in comfort, and a shift in energy demand to electricity stemming from the spread of all-electric homes.

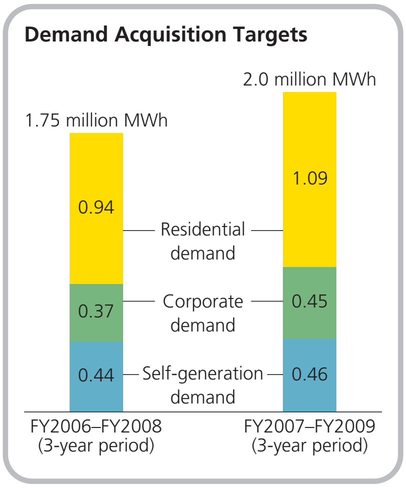


Management Environment

The deregulation of electric power for retail customers, which began in March 2000, has been proceeding in stages. In April 2005, the scope of deregulation was expanded to include consumers in all high-voltage categories. As a result, around 60% of Chugoku Electric's customers are now free to choose their electric power company. In 2007, the state of deregulation will be studied and the prospect of full deregulation will be considered.







We forecast that in fiscal 2016, electric power sales volume will amount to 62.1 million MWh, representing an average annual increase of 0.6% (0.7% after correcting for extraordinary temperature changes and other factors) between fiscal 2005 and fiscal 2016.

Thus, we think electric power usage will increase steadily going forward, and, to ensure that electricity sales rise even further, we are taking steps and pursuing sales strategies in a variety of fields, including household electricity and industrial electricity.

Tapping Demand in the Household Electricity Field

Promoting the Spread of All-Electric Homes

As a priority measure for increasing electric power sales in the household electricity field, we are working to increase electric power sales by promoting the spread of all-electric homes.

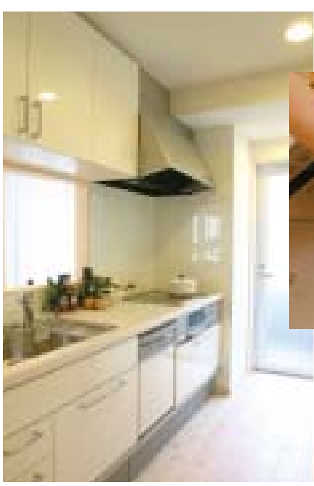
All-electric homes presently account for one-quarter of all newly built housing in the Chugoku region and, of particular note, over half of all newly built detached housing, and it can be said that all-electric homes have become mainstream. Chugoku Electric's percentage of all-electric homes among newly built housing in the region in which it is based is among the highest of any electric power company in Japan.

However, as all-electric homes still only account for around 6.5% of the roughly three million existing houses in the Chugoku region, we believe there is great potential for growth, through both penetration into the newly built housing field and the tapping of renovation demand in the existing housing field.

Leveraging the strength of having one of the nation's highest rates of all-electric homes in its region, Chugoku Electric is aggressively promoting these homes. By fiscal 2012, it hopes to have increased the penetration rate to 16.0%—the level at which it is widely believed that the spread of a new product becomes self-sustaining.

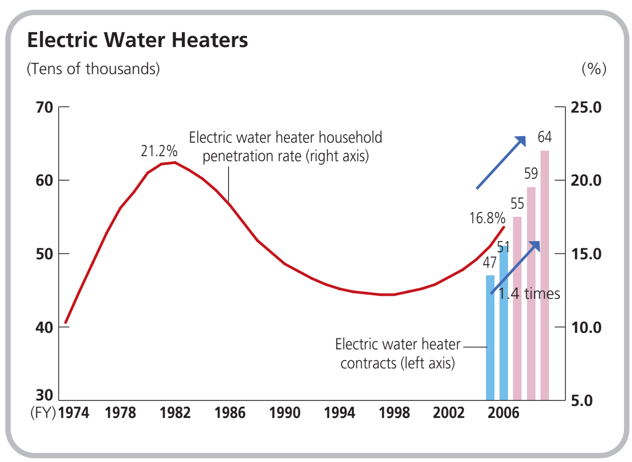
Increasing the Number of Electric Water Heaters

In the area of electric water heaters, demand is increasing rapidly for the EcoCute, an environmentally friendly heat pump system—using carbon dioxide refrigerant—that converts atmospheric heat into heat energy. Thanks largely to this demand, electric water heater sales volumes increased 28% in fiscal 2006. As a result, the number of electric water heater contracts in fiscal 2006 was



Easy-to-clean IH cooktop

Convenient and comfortable all-electric kitchen



Note: Figures for the number of households in the Chugoku region (the basis for calculating the household penetration rate) are estimates from the *Basic Residents Register Population Handbook* and the national census (the actual figure for 2005 is used for 2006 and thereafter).

513,832, exceeding the previous record of 508,000 set in fiscal 1982, for a household penetration rate of 16.8%. We are aiming for 640,000 new electric water heater contracts in fiscal 2009, representing 1.4 times the number of such contracts in fiscal 2005.

Rate Reduction Leading to Increased Competitiveness

Chugoku Electric has a long track record of cutting electricity rates to reflect the results of efforts to streamline management, and customers' electricity rates have fallen steadily. In July 2006, we lowered rates for the sixth time since 1995, when entry into the electric power wholesaling business was deregulated. For a household using an average amount of electricity (300kWh of meter rate lighting A), rates are now roughly 14% lower than in 1995.

Power Source Development Plans

Electricity demand is expected to increase slowly but steadily going forward. To meet this increased demand, we have formulated a power source development plan in consideration of maintaining stable supply capabilities and forming an efficient facilities' network. The plan takes into account that Japan is almost totally reliant on imported resources and thus focuses on diversified sourcing and environmental impact reduction to enhance energy security.

In the Company's fiscal 2007 supply plan, which reflects its power source development plan for the next 10 years, as a result of the development of the Shimane Nuclear Power Station's Unit No. 3 and the Kaminoseki Nuclear Power Station's Unit No. 1, the Company's currently low nuclear ratio in terms of installed generating capacity will meet the national average by the end of fiscal 2016.

By doing so, we expect to obtain the best mix of power sources—a balanced combination of nuclear, thermal, and other power facilities—a goal that the Company has been pursuing from the standpoint of stable supply, environmental preservation, and economy.

Efforts in Nuclear Power

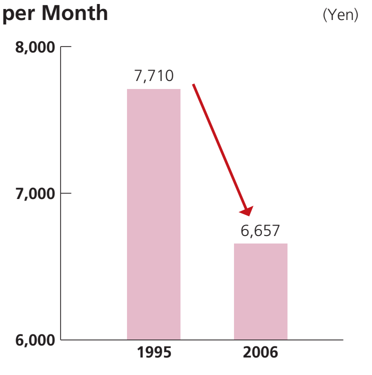
We are steadily carrying out the

Power Source Development Plan

	Fiscal year			
Classification	2007	2010	2012	2015
Facility	Mizushima Unit No. 3	Mizushima Unit No. 1	Shimane Unit No. 3	Kaminoseki Unit No. 1
Power source type (MW)	Petroleum (350) → LNG (340)	Coal (125) → LNG (285)	Nuclear (1,373)	Nuclear (1,373)

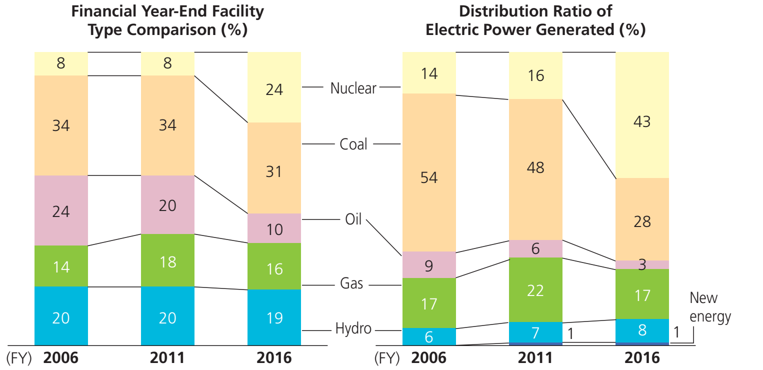
Shimane Nuclear Power Station

Household Electric Power Rates per Month



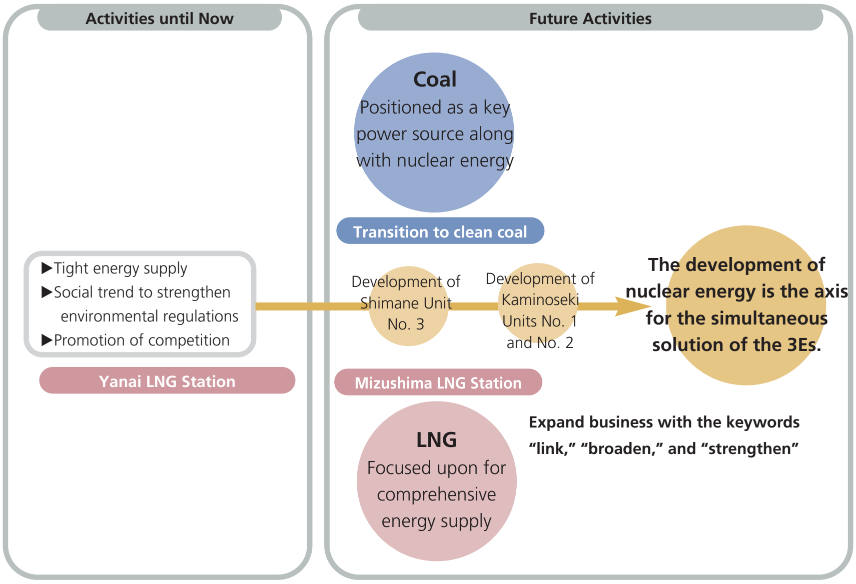
Note: Rates do not include fuel cost adjustments. Rates include consumption taxes of 3% in 1995 and 1996 and 5% in 1998 and thereafter.

Power Source Comparison (Including Purchased Power from Other Companies)



The Best Mix of Power Sources

By achieving the best mix of power sources, we can respond to the 3Es of improving energy security, solving environmental concerns, and ensuring the long-term stability of power sources that are used as the source of continual generation of profit.



development of new nuclear power facilities from the basic premise of winning the trust of the local community through the continuous and stable operation of the Shimane Nuclear Power Station's Unit No. 1 and Unit No. 2 and the proactive disclosure of information, while at the same time working to reduce the construction costs associated with new nuclear power facilities and to minimize the impact of such costs on our income statement and balance sheet.

Efforts in Coal Power

One of our main power sources is coal, which is superior to other power sources as reserves are abundant, with a high reserve-production ratio, the geographic distribution is relatively even, and supplies are stable. Moreover, even taking into account the recent surge in the price of coal, it is more economical than other fossil fuels. Chugoku Electric places importance on achieving energy security and, alongside nuclear power, views coal as one of its basic power sources. Going forward, the Company plans to further develop and promote clean-coal technology.

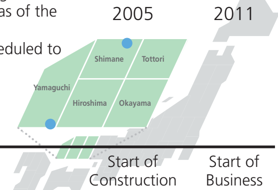
Our efforts to reduce the impact of coal power on the environment include: 1) improving thermal efficiency through integrated gasification combined cycle and other technology, 2) reducing carbon dioxide through the mixed combustion of biomass, 3) the efficient use of coal ash, and 4) long-term R&D in carbon dioxide separation, recovery, and solidification.

Efforts to Increase Management Efficiency

To help enhance our competitiveness, we are working to control capital expenditures, repair expenses,

Shimane Unit No. 3

Output (Million kW)	Conditions	Start of Construction	Start of Business
1,373	• Preparatory work is in progress (Overall progress: 10.3% as of the end of February 2006) • Actual construction is scheduled to begin in December 2006	December 2005	December 2011

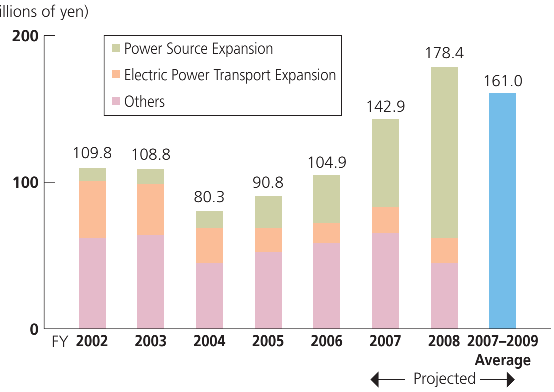


Kaminoseki

	Output (Million kW)	Conditions	Start of Construction	Start of Business
Unit No. 1	1,373	• Detailed surveys are in progress to acquire the data necessary to apply the construction of a nuclear reactor (Began in April 2005)	FY2010	FY2015
Unit No. 2	1,373		FY2013	FY2018

Capital Expenditures

(Billions of yen)



and other such operating costs. In addition, with the goal of further increasing labor productivity, we are working to increase the efficiency of business operations.

Controlling Capital Expenditures

In accordance with our Power Source Development Plan, which was formulated based on electric power demand trends, we expect capital expenditures to increase going forward. However, we are working to reduce costs by rationalizing equipment and construction techniques as well as by enhancing the efficiency of contracting and machinery and materials procurement. We are also attempting to utilize equipment and facilities even more efficiently and to control capital expenditures.

Controlling Repair Expenses

Maintaining equipment is essential to the stable and safe provision of electric power. We intend to curb repair expenses through a revision of replacement and inspection cycles, made possible by improvements in equipment condition diagnosis techniques. In addition, we are working to maximize operating cost management and lower operating costs, with an emphasis on cost-effectiveness.

Enhancing Labor Productivity

The Chugoku Electric Group aims to enhance labor productivity and is working to significantly increase the efficiency of its business operations.

Chugoku Electric has set a headcount target that calls for a reduction in the number of employees by 1,400, from 10,881 at the end of September 2004 to a maximum of 9,500 by the end of fiscal 2010. The Company is thus working to further enhance productivity.

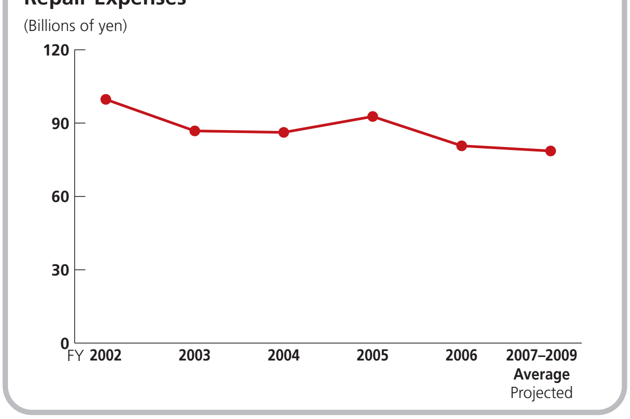
Lowering Contracting and Machinery and Materials Procurement Costs

Chugoku Electric is working to diversify contracting and machinery and materials procurement and to lower procurement costs by choosing effective ordering methods, such as reverse auctions[1] and the target price[2] method.

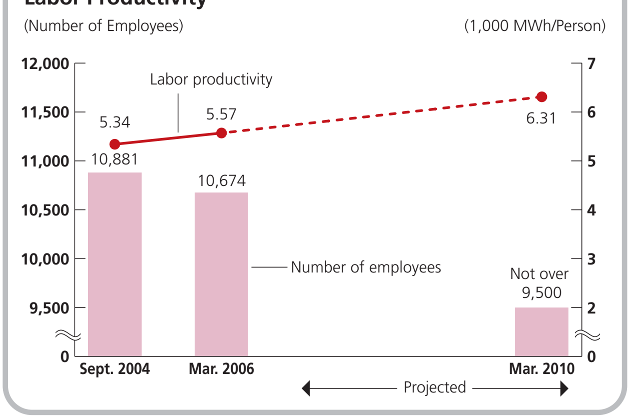
In addition, the Company is working to further reduce procurement costs, increase procurement operations overall, and achieve stable procurement by conducting supply-chain management and joint purchasing on a Groupwide basis. Moreover, the Company publicizes materials procurement related information on its website and is working to recruit new suppliers and expand open competition by using Internet-based marketplaces. Through these various efforts, the Group intends to further promote the procurement of a wide range of high-quality and economical machinery and materials, from both within Japan and abroad.

1. Reverse auctions: Internet auctions in which suppliers compete for the right to provide a good, with the lowest bidder winning the auction.
2. Target price method: A method in which the buyer sets and publicizes a suggested procurement price (maximum price) in advance and issues a request for estimates. The supplier submitting the lowest estimate below the published price wins the contract.

Repair Expenses



Labor Productivity



Labor Productivity = Electric Power Sales Quantity / Number of Employees

Comprehensive Energy Supply Business

Yanai Thermal Power Station (LNG)

Mizushima LNG Station

Earnings Review

In fiscal 2006, while operating revenues increased, thanks largely to increased LNG sales, operating expenses also rose, due primarily to increased fuel purchasing costs. As a result, operating revenues increased ¥5.8 billion, to ¥15.9 billion, and operating income declined ¥0.3 billion, to ¥0.3 billion.

LNG Supply Business

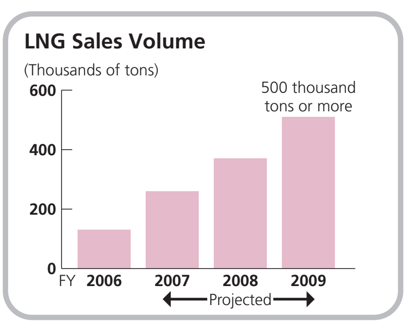
LNG supply is the core business of the Chugoku Electric Group's comprehensive energy supply business. Historically, Chugoku Electric has conducted its LNG supply operations at its Yanai LNG Station, located in western Chugoku. In April 2006, Group company MIZUSHIMA LNG COMPANY, LIMITED, began additional operations at the Mizushima LNG Station, located in eastern Chugoku, thus establishing an LNG system encompassing the entire Chugoku region. Through Group companies Energia Solution & Service Company, Incorporated, and MIZUSHIMA LNG SALES COMPANY, LIMITED, we supply LNG to customers throughout the region from the two stations using the optimal method for each customer, such as wholesale supply to regional gas companies and truck delivery for industrial users.

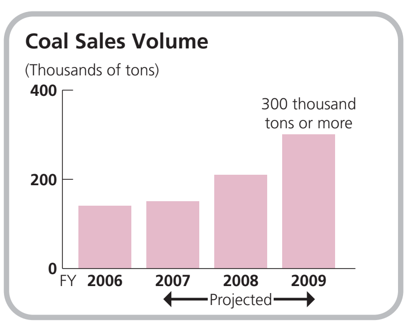
The LNG supply business carries out its operations based on the key concepts of "linking," "broadening," and "strengthening."

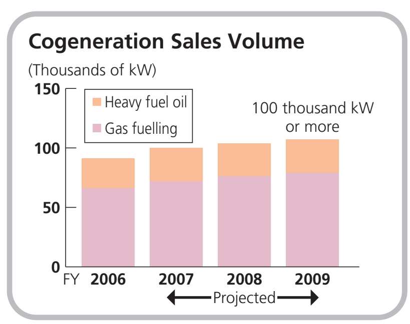
"Linking" refers to collaborating in our network business—one of our strengths—with regional gas companies, utilizing our LNG stations in eastern and western Chugoku, in the development of pipelines as well as in truck delivery of LNG.

"Broadening" refers to broadening our LNG use, with a view to the need to simultaneously respond to the increase in competition brought about by electricity deregulation as well as to environmental issues. We have converted the Mizushima Thermal Power Station's Unit No. 3 to LNG generation and plan to convert the same power station's Unit No. 1 to high-efficiency gas-combined power generation. We started up operations at Unit No. 3 together with the start of operations at the Mizushima LNG Station. In addition, we have decided to use LNG, supplied by the Mizushima LNG Station, at the Mizushima Joint Thermal Power Station, which is operated jointly with JFE Steel Corporation, in a switch from heavy oil combusted together with blast furnace gas.

"Strengthening" refers to making the Mizushima LNG Station more







Information and Telecommunications Business and Other Businesses

economical and reliable. We are working together with Nippon Oil Corporation to enhance station facilities, including an LNG storage tank. A feasibility study is currently under way.

Coal Sales Business

Even taking into account the recent surge in price, coal is still more economical than other fossil fuels. Because of this, and because supplies are likely to remain stable, demand for coal remains strong. Group company Energia Solution & Service, which conducts coal sales operations, aims to expand sales further by increasing its price competitiveness through lowering costs, including by seeking out efficient transportation methods.

Cogeneration Sales Business

Following the recent surge in oil prices, demand for cogeneration using heavy oil as fuel has stalled. However, as cogeneration using gas as fuel is price competitive, and has relatively less carbon dioxide emissions, the demand has been high in recent years. Many customers introducing cogeneration systems seek to reduce their capital investment risk, and we are working to win new business from such customers by taking this into account. For existing customers, we are working to reduce equipment problems and achieve stable operation.

Information and Telecommunications Business

Earnings Review

In fiscal 2006, while income from Internet operations increased, overall income in this segment decreased, due to the stop of PHS voice telephone services, as did income from corporate services. As a result, operating revenues fell by ¥1.5 billion, to ¥36.8 billion. However, due to increased efficiency in all facets of management, operating income rose ¥1.1 billion, to ¥2.4 billion.

Business Review

To meet the demands of an increasingly advanced information society, and in preparation for the arrival of the ubiquitous networking society, this business promotes the upgrading of the information and telecommunications infrastructure and provides a variety of services that use this infrastructure.

Primarily through Energia Communications, Inc., this business engages in data center operations, optical fiber core leasing operations, and Internet-related operations.

Environmental Business

This business provides services that are friendly to both people and the environment, with a view to achieving a recycling-oriented society.

Primarily through EnerGia Eco Materia Company, Incorporated, a company that manufactures and sells products made from the coal ash produced at our thermal power stations, the Chugoku Electric Group works together to expand the efficient use of coal ash.

Breakwater blocks made of concrete incorporated with coal ash

Business and Lifestyle Support Business

This business provides optimized support for various business and lifestyle situations, with a view to achieving a safe and comfortable society.

The Group companies offer various services, such as logistics operations within the Chugoku Electric Group, ISO assessment and registration operations, benefits services operations, housing guarantee operations, intra-Group financial and accounting services operations, real estate utilization operations, and nursing care operations, among others.

Research and Development

We conduct practical research aimed at strengthening existing operations as well as the basic research needed to continually expand into new businesses, covering the five themes shown in the diagram below. These efforts include reducing the cost and maintaining a stable supply of electricity (our main product), optimizing energy services menus and "one-stop" services that take full advantage of electricity, and improving the recycling rate and reducing environmental impact such as through the efficient use of waste matter. This work is in line with the Chugoku Electric Group's four strategic business fields.

In June 2005, we merged our Technical Research Center and our Economic Research Center to create the EnerGia Economic & Research Institute. This will enable us to improve the quality of research by leveraging technical and economic knowledge in an integrated manner as well as acquire new earnings sources and strengthen ties with our customers by expanding into new businesses.

Reducing Energy Costs and Maintaining a Stable Supply

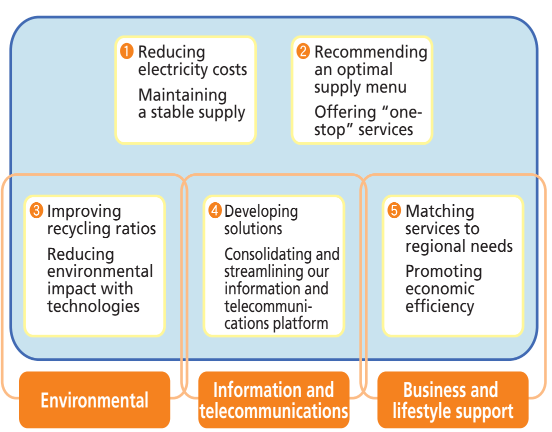
Development of Transfer Tripping Protection for Dispersed Power Sources

There is concern about the possibility that independently operating circuit breakers will not be activated and power will continue to flow during service interruption when the number of dispersed power sources, such as new energy sources, linked to identical power systems increases. The transfer tripping protection we are developing will, when an accident occurs, send a tripping signal directly to all dispersed power sources within the area in which service is to be interrupted. This will shorten the amount of time dispersed power sources operate independently and help ensure that service is interrupted, thereby alleviating concerns regarding the possibility of customers receiving electric shocks or of power equipment being damaged.

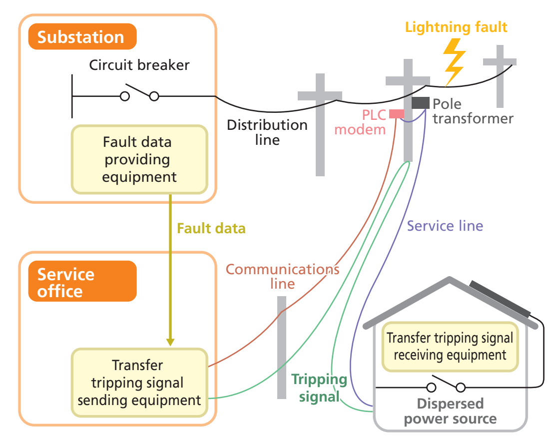
In addition, using power line communication (PLC) as the route for sending the tripping signal makes possible low-cost system construction by eliminating the need to install new signal transmission lines.

This protection, which uses PLC on dispersed power sources connected to low-voltage systems, is the first of its kind in the world.

Electric Power and Comprehensive Energy Supply Businesses



Transfer Tripping Protection for Dispersed Power Sources



Optimizing Energy Services Menus and "One-Stop" Services

NGH Manufacturing and Utilizing Systems

We are developing and testing natural gas hydrate (NGH) manufacturing, transportation, and utilization systems.

NGH is stable at around -20˚C, a less stringent temperature requirement than that of conventional LNG, which must be transported and stored at -162˚C. This simplifies the associated equipment and makes it possible to supply natural gas by truck to small and medium-sized users with which it had previously not been economically feasible to do business.

Improving the Recycling Rate and Reducing Environmental Impact

Verification Tests of Wood Biomass Cofiring

As part of our efforts to stop global warming, we are working to expand the use of new types of energy. As part of this, we have conducted verification tests of wood biomass cofiring at Unit No. 1 of the Shimonoseki Thermal Power Station, a coal-fueled plant with an output of 175MW.

In preparation for full-scale operation, we are currently conducting verification tests at the Shin-Onoda Thermal Power Station, a coal-fueled plant with two 500MW power generation units, which has greater output than the Shimonoseki facility.

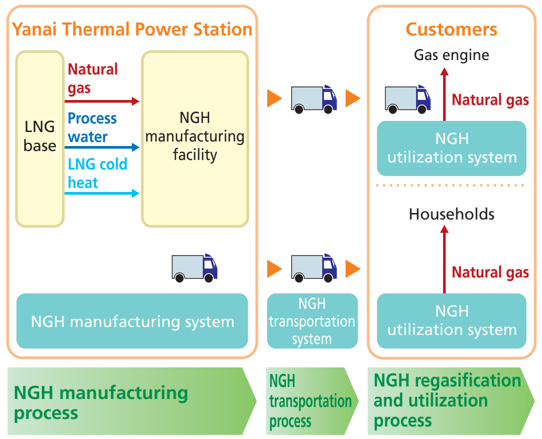
The biomass we use is primarily supplied by our partner local governments, but with a view to starting full-scale operations, we are working to create independent biomass procurement routes.

CO_2-Capturing MCFC Verification Testing

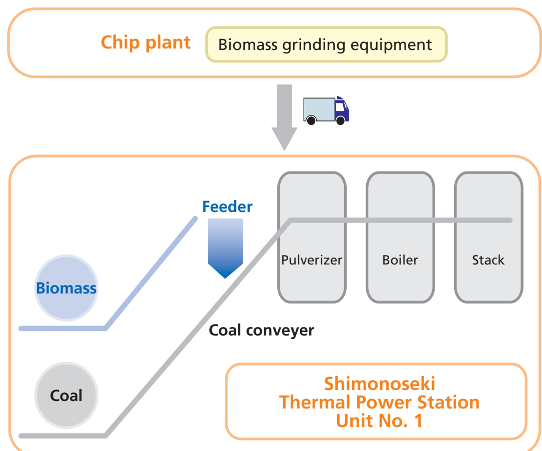
We are developing a CO_2-capturing molten carbonate fuel cell (MCFC) power generation system, which concentrates CO_2 as power is generated. As a part of this effort, we have conducted verification tests on the performance of a small test unit (a 10kW-class MCFC), using actual exhaust gas from a power plant, at the Misumi Thermal Power Station, a coal-fueled plant with output of 1,000MW.

We plan to conduct more tests using larger MCFCs.

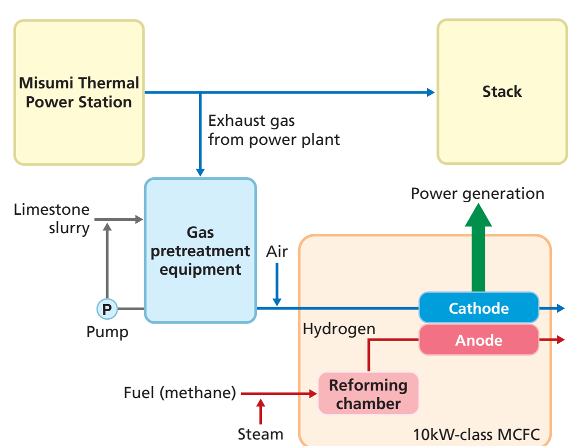
NGH Manufacturing and Utilizing System Technology



Wood Biomass Cofiring



CO_2-Capturing MCFC Verification Testing



Corporate Social Responsibility (CSR)

In March 2006, the Chugoku Electric Group formulated the EnerGia Group CSR Action Charter, indicating the direction of the Group's CSR efforts as well as principles for behavior for the Group's executives and employees. We will as a group continue conducting CSR efforts to win the trust of our stakeholders to an even greater degree.

Based on respect for basic human rights and thorough compliance—maintaining corporate ethics, adhering to the law, and protecting personal data—we will take further substantive actions in the area of CSR in our aim to supply high-quality, highly reliable products and services based on the stable supply of energy, aggressively address environmental issues, and contribute to regional development. In addition, we will proactively issue information about our CSR efforts by publishing related reports, such as a Group CSR report, and use the feedback we receive on those efforts in formulating future initiatives.

Compliance Promotion System

- Compliance-related matters debated by the Corporate Ethics Committee
- Compliance promotion activities in each division supported by the CSR Division
- Compliance promotion activities conducted at each division, led and conducted by compliance promotion leaders and sub-leaders
- Appropriate operation of the Corporate Ethics Consultation Office
- Holding of the EnerGia Group Corporate Ethics Council, established to provide a place for Group companies to share information and consider issues related to compliance

Measures for Ensuring Compliance

- Formulation of corporate ethics guidelines
- Enhancement of compliance training
- Support for Group companies' compliance training and other such measures

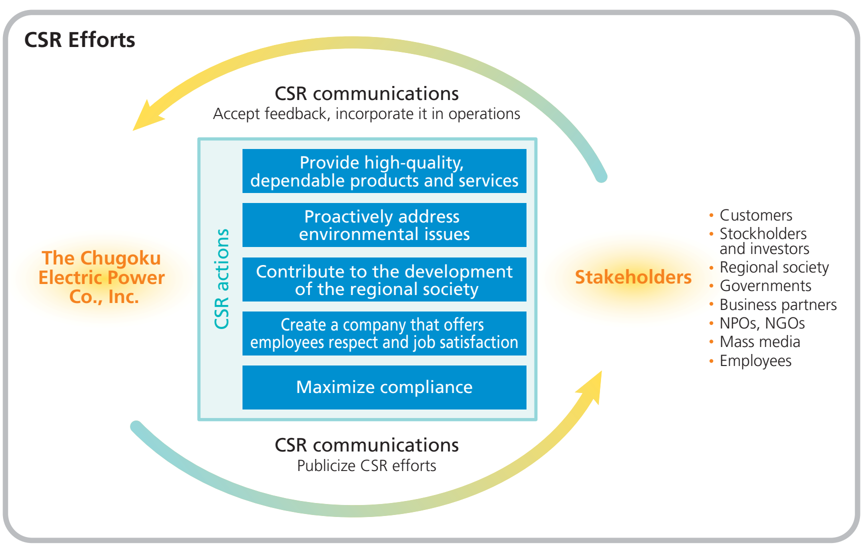
Promotion of Compliance

With an awareness of our responsibility as a member of the local community, we adhere to relevant laws, internal regulations, and a strict code of business ethics as we conduct our operations.

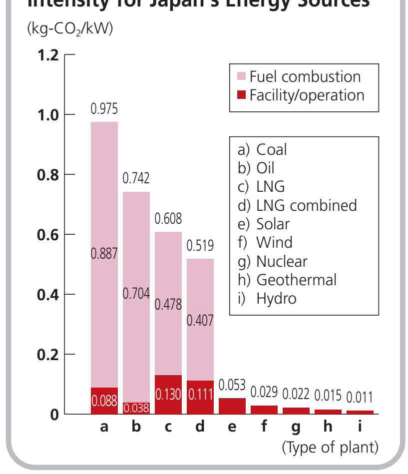
Tackling Environmental Issues

We at the Chugoku Electric Group are promoting environmental management through the formulation of the EnerGia Group Environmental Vision, based on the Group's basic environmental policy and environmental action guidelines, as well as specific plans for each Group company.

CSR Efforts



Life Cycle Assessment of CO_2 Emission Intensity for Japan's Energy Sources



Source: *Report of the Central Research Institute of Electric Power Industry*

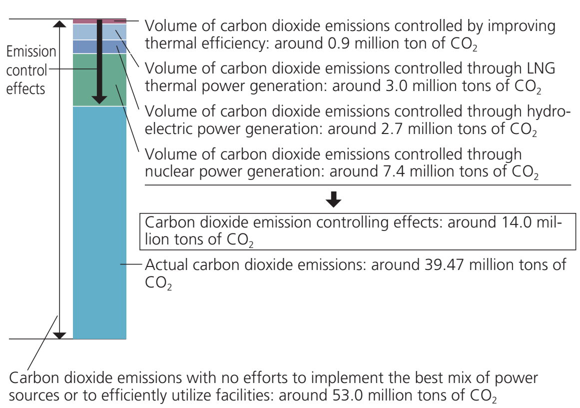
In November 2005, we revised the Chugoku Electric Environmental Action Plan, which sets out the basic policy for tackling environmental issues as well as environmental management targets for the entire company. By doing so, we aim to further step up our efforts to deal with environmental issues, in the hope of creating a society that is recycling-oriented and no longer induces global warming. The new plan steps up the Company's efforts to date to lower the burden it places on the environment, such as through controls on the emission of carbon dioxide and waste, promote environmental conservation activities, and proactively support environmental and energy-related education in schools. It also sets new targets related to these efforts.

Efforts for Prevention of Global Warming

Addressing the global warming problem is an extremely important issue for Japan's electric power industry, as it accounts for around 30% of the nation's total carbon dioxide emissions.

In the Chugoku Electric Environmental Action Plan, we set a target to reduce carbon dioxide emission intensity (emissions per unit of user-end electricity) in fiscal 2011 by approximately 20% from the fiscal 1991 level. We are taking aggressive steps to reduce emissions of greenhouse gases.

Chugoku Electric: Carbon Dioxide Emissions and Carbon Dioxide Emission Control Effects (Fiscal 2006)



Promotion of Nuclear Power Generation

Nuclear power generation is among our core power sources. It is a superior power source in terms of stability and economy. Moreover, nuclear power generation does not produce carbon dioxide during operation and, therefore, contributes to the prevention of global warming. We have made it a top priority to promote nuclear power generation. While maintaining a firm commitment to ensure safety, we aim to steadily develop nuclear power facilities in Shimane and Kaminoseki. At the same time, we are working to increase the utilization rate at the nuclear power stations currently in operation.

Carbon Funds

Carbon funds are mechanisms under which capital is collected from investors (governments and corporations of the developed countries), invested in projects aimed at reducing greenhouse gases in the developing nations and Eastern Europe, and returned to investors in the form of CO_2 credits, or credits for lowering carbon dioxide emissions.

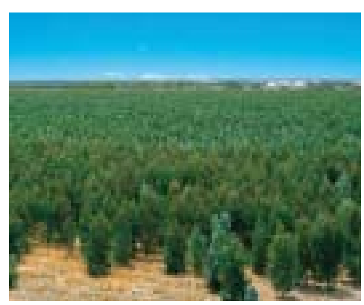
Carbon Funds in Which Chugoku Electric Participates

Name	Size of Investment	Expected Amount of CO_2 Credit	Operating Entity
Prototype Carbon Fund	$7.0 million	To be determined*	World Bank
Japan GHG Reduction Fund	$3.0 million	To be determined*	Japan Carbon Finance, Ltd.
Greenhouse Gas-Credit Aggregation Pool	To be determined*	6.6 million tons of CO_2	Natsource Asset Management Corp.

*Amount will depend on projects selected to invest in.

Afforestation in Australia

Each year, Chugoku Electric borrows around 100 hectares of land, such as unused grazing land, from local farmers, on which it plants *Eucalyptus globulus* trees. Over a 10-year period (1999-2008), this afforestation project will substantially expand forest area in Australia, by 1,000 hectares, and thereby absorb 30,000 tons of carbon dioxide per year.



Planted Eucalyptus globulus *trees*

Purchasing, Developing, and Supporting New Energy Sources

With a view to effectively utilizing unused energy, we purchase the surplus power generated by the waste power generation facilities operated by local governments. In addition, we purchase solar power at the unit retail price we charge for electricity, and we purchase wind power for business purposes on a long-term, stable basis. By taking into account purchasing conditions in this manner, we support the spread of new types of energy generation. As of the end of fiscal 2006, Chugoku Electric had around 28,000 contracts to purchase electricity from solar power providers, with a total capacity of roughly 100MW.

In addition, we have installed solar power and fuel cell equipment at our offices and are conducting verification tests of such equipment. At the same time, we are considering mixed combustion of wood biomass, such as unused lumber from forest thinning and bamboo, at our coal-fired thermal power stations and developing our own ability to generate electricity using new energy sources.

Practicing the 3Rs

Chugoku Electric is working to help achieve a recycling-oriented society by practicing the 3Rs (reduce, reuse, recycle) on the various forms of industrial waste it generates in the course of its business activities. In fiscal 2006, the Company efficiently used 95% of the 1.12 million tons of waste it generated through its business activities.

About 95% of the coal ash generated by the Company's coal-fired thermal power stations was used for cement material, civil engineering material, and the like. A Group company, EnerGia Eco Materia, manufactures and sells products made from coal ash, and the Chugoku Electric Group as a whole is working to increase its efficient utilization rate.

Contributing to Regional Development

Chugoku Electric encourages employee participation in social contribution activities that focus on the environment, welfare, and education, in line with a management philosophy of contributing to regional development.

A total of 46,845 employees participated in the Company's social contribution activities in fiscal 2006 (up 18.9% from 39,392 in the previous year). This means that, on average, each employee participated in about five such activities per year.

Environmental Conservation Activities

We took part in cleanup activities on roads and river banks, and we donated trees and flower seedlings to schools and welfare facilities.

Welfare Activities in Local Communities

In an effort to play a role in improving regional welfare, we engaged in activities that leveraged the special characteristics of our offices. For example, we inspected, cleaned, and replaced electrical equipment at social welfare facilities and the houses of senior citizens living alone. In addition, we donated books and other materials to child counseling centers and provided computer training to senior citizens.

Osmotic column, made from coal ash products, for improving soil water retention

Cleaning electrical equipment at a social welfare facility

Educational Activities

Leveraging the technology and expertise acquired through electric power operations, we worked to promote an understanding of environmental and energy-related issues, mainly among young people, as well as to increase interest in science.

Foundation Activities

The Chugoku Electric Group founded the Electric Technology Research Foundation of Chugoku in 1991 and the EnerGia Culture and Sports Foundation in 1994, and it supports technology-related, cultural, and sport events in the region. In fiscal 2006, the Electric Technology Research Foundation of Chugoku provided 52 grants, totaling ¥45.27 million, and the EnerGia Culture and Sports Foundation provided 156 grants, totaling ¥33.0 million. It also gave awards to three individuals and one organization.

Promoting Communication with Society

To translate our CSR efforts into greater customer satisfaction and community trust, we think it is essential to proactively disclose information and to accurately incorporate into our business operations feedback from stakeholders, including customers as well as shareholders and other investors.

The feedback that individual employees receive while carrying out their daily duties is shared Companywide and incorporated into activities designed to improve operations and provide new services.

The Company will continue working to enhance two-way communications between itself and its shareholders and investors through its IR activities, such as by proactively disclosing corporate data and holding an open general shareholders' meeting.

"Customer Feedback System"

Each year, Chugoku Electric receives over 11,000 messages from customers, expressing opinions, requests, and complaints. To take each item of feedback to heart and utilize it in its future services, the Company utilizes a "customer feedback system" that allows such feedback to be shared by all employees on the Company's digital bulletin board.

Enhancing IR Activities

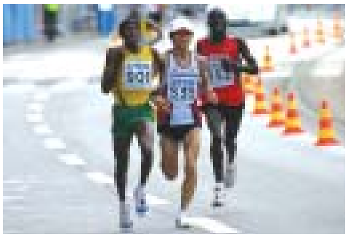
Through IR activities, such as information disclosure and the holding of company briefings, Chugoku Electric provides accurate and timely data on the management environment, the Company's financial condition, and future management strategies. By enhancing two-way communication, we aim to win the further trust and understanding of shareholders and other investors.

Formulating a New Slogan

Chugoku Electric has formulated a new slogan—"Good Things Plus EnerGia"—as a message designed to communicate to customers the stance behind its efforts. This slogan has been in Companywide use since April 2006.

The corporate stance meant by the slogan is that, based on a relationship of trust, Chugoku Electric works for the benefit of customers in its business activities, providing customers with "good things" one by one.

Creating a Dynamic Workplace



A member of our track and field team participates in a competition

We have established a fair personnel system that enables employees to have a sense of satisfaction and accomplishment as well as to manifest their abilities and aim for even greater results. At the same time, we are working to support employees in developing their skills in a planned manner and to further invigorate our human resources.

In addition, through the activities of our sports teams, including the track and field team, the women's table tennis team, and the rugby team, we are working to promote a dynamic workplace and to contribute to the development of sports in the region.

Corporate Governance

Basic Concepts

As our business operations are centered on electricity operations, a vital service to society, we have adopted an auditor system to ensure management decision making and operations execution function concurrently. The construction of a corporate governance structure that allows us to fulfill our social responsibilities by building trust and creating sustainable value is a top management priority. We will continue to enhance corporate governance as part of our efforts to reinforce Group management.

The Board of Directors comprises 19 directors, including one outside director. The board holds one regular meeting a month, at which it formulates management policies and plans and makes decisions pertaining to the execution of important operations. The board also oversees the directors' execution of their duties through reports and other means. The Management Committee, comprising representative executive directors, meets weekly to fully debate important management issues, including issues to be discussed by the Board of Directors.

The Board of Auditors comprises seven auditors, including four external auditors. They conduct strict audits of the Company directors' execution of their duties. To supplement auditing functions, we have an Auditors Office that operates independently of the president.

The Internal Audit Division conducts internal audits on the Company and its subsidiaries, verifies the appropriateness and effectiveness of the internal control system, and issues suggestions for improvement.

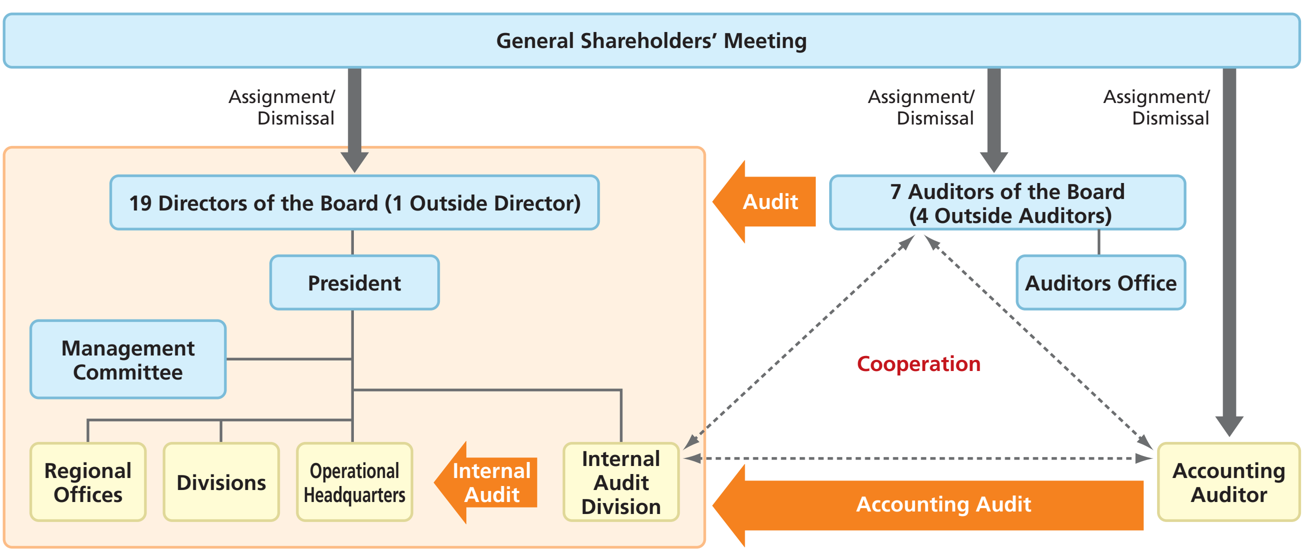
Our auditors, accounting auditors, and the Internal Audit Division share the information obtained in the course of their audits with each other and work together in other ways.

We established the Chugoku Electric Corporate Ethics Framework, consisting of a code of corporate conduct and a code of employee conduct, and set up the Corporate Ethics Committee, which the chairperson oversees, to discuss important items related to compliance.

We established a risk management organization that issues risk management related guidance and corrections as necessary. In addition, the Risk Strategies Committee, which the president chairs, meets monthly to discuss policies to tackle key management risks.

In April 2006, we formulated a basic policy on upgrading our system for ensuring fairness in business operations. In accordance with this policy, we are working to maintain and improve this system.

Corporate Governance System



Board of Directors and Auditors

(As of June 29, 2006)

CHAIRPERSON

Tadashi Fukuda

PRESIDENT

Takashi Yamashita

EXECUTIVE VICE PRESIDENTS AND DIRECTORS

Masahiro Hosoda
Hiromu Okada
Shigeo Suehiro
Masanori Fukuda

MANAGING DIRECTORS

Yoshitane Okada
Masaharu Arakawa
Hiroshi Fujii
Toru Jinde
Tadashi Watanabe
Tomohide Karita

DIRECTORS

Shuichi Shirahige
Seiki Hawaka
Kazuhisa Fukumoto
Mitsuo Matsui
Yoshio Sano
Yasuhisa Iwasaki
Kosuke Hayashi

STANDING AUDITORS

Junji Oki
Chitoshi Nishiguchi

AUDITORS

Michiho Nozaka
Kazuya Nitta
Hiroshi Nakashima
Taka Shiinoki
Michihiko Kikkawa

Organization

(As of June 29, 2006)

- **Board of Directors**
  - **Management Committee**
  - Energy Marketing and Services Division — Service Offices, etc.
  - Power Generation Division — Power Stations, etc.
  - Power System Division — Power Management Offices, etc.
  - Corporate Planning Division
  - EnerGia Business Division
  - Human Resources Development Division — Health Care Center
  - Corporate Social Responsibility Division
  - Internal Audit Division
  - Business Support Division
  - Information System & Telecommunications Division — Central Telecommunications Center
  - EnerGia Economic & Technical Research Institute
  - Regional Offices (Tottori Office, Shimane Office, Okayama Office, Hiroshima Office, Yamaguchi Office, Tokyo Office) — Health Care Center (excluding Tokyo)
  - Chuden Hospital
- Auditors — Auditors Office

Consolidated Six-Year Summary

The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries
For the years ended March 31

	Millions of yen						Thousands of U.S. dollars (Note 1)
	2006	2005	2004	2003	2002	2001	**2006**
Operating revenues	**¥1,040,290**	¥1,011,799	¥ 967,056	¥1,009,279	¥1,021,149	¥1,044,863	**$ 8,891,368**
Operating income	**100,095**	125,451	99,586	126,954	118,545	126,621	**855,513**
Net income	**45,167**	47,062	42,888	44,129	46,470	27,202	**386,043**
Total stockholders' equity	**695,495**	658,209	629,604	606,834	593,752	575,772	**5,944,403**
Total assets	**2,655,468**	2,636,363	2,712,376	2,815,189	2,846,207	2,952,869	**22,696,308**
Interest-bearing debt	**1,575,011**	1,613,979	1,728,285	1,839,175	1,904,098	2,012,672	**15,083,916**
Free cash flows (Note 2)	**48,765**	132,616	132,835	146,669	130,496	102,632	**416,794**
Other financial data							
Per share data (yen and dollars):							
Stockholders' equity (Note 3)	**1,910.41**	1,807.59	1,728.06	1,656.07	1,600.41	1,551.79	**16.33**
Net income (Note 4):							
Basic	**123.44**	128.61	116.63	119.30	125.25	73.31	**1.06**
Diluted	**123.44**	128.61	116.63	119.30	123.99	72.78	**1.06**
Cash dividends	**50.00**	50.00	50.00	50.00	50.00	60.00	**0.43**
Key financial ratios:							
Equity ratio (%)	**26.2**	25.0	23.2	21.6	20.9	19.5	
Return on equity (ROE) (%)	**6.7**	7.3	6.9	7.4	7.9	4.8	
Return on assets (ROA) (%) (Note 5)	**2.4**	3.0	2.3	2.9	2.6	2.7	
Price earnings ratio (PER) (times)	**19.8**	15.8	16.0	15.4	13.8	23.2	

	Millions of kWh					
	2006	2005	2004	2003	2002	2001
Power generated and received						
Generated:						
Hydoelectric	**3,224**	4,169	4,008	3,025	3,678	3,489
Thermal	**35,038**	33,170	31,978	31,324	30,588	34,656
Nuclear	**9,297**	7,333	7,705	10,736	10,267	6,765
Total	**47,559**	44,672	43,691	45,085	44,533	44,910
Bought from other companies	**22,171**	23,663	22,285	22,560	20,656	21,185
Sold to other companies	**(3,580)**	(3,410)	(3,961)	(5,261)	(5,251)	(4,779)
Transmission loss and other	**(6,649)**	(6,785)	(6,581)	(6,537)	(6,333)	(6,813)
Total	**59,501**	58,140	55,434	55,847	53,605	54,503
Electric sales:						
Residential (lighting)	**18,140**	17,470	16,667	16,850	16,384	16,208
Commercial, industrial and other	**3,178**	15,565	21,988	22,207	21,930	22,155
Power consumption by liberalized sector	**38,183**	25,105	16,779	16,790	15,291	16,140
Total	**59,501**	58,140	55,434	55,847	53,605	54,503

Notes: 1. U.S. dollar amounts presented are translated from yen, for convenience only, at the rate of ¥117=US$1, the exchange rate prevailing on March 31, 2006.
2. Free cash flows represent net of cash flows from operating activities and those from investing activities.
3. Stockholders' equity per share is computed using the number of shares of common stock in issue at the end of each year.
4. ROA = Operating income x (1 - Income tax rate) / Total assets x 100

Consolidated Financial Review

Summary of Operations

In fiscal 2006, ended March 31, 2006, the Japanese economy continued slow recovery focusing on domestic private demand. While against the background of the increase in corporate earnings, plant-and-equipment investment increased steadily and also personal consumption increased through the improvements in the income and employment environment. The situation was similar in the Chugoku region.

Non-consolidated sales of electricity increased 2.3% from the previous period, to 59.5 billion kilowatt hours, because the heating demand increased although electricity rates were reduced.

Operating revenues of the Chugoku Electric Power Co., Inc. (the "Company"), and its consolidated subsidiaries (the "Group") for the term were ¥1,040.3 billion (US$8,891.4 million), up 2.8%, or ¥28.5 billion (US$243.5 million), from fiscal 2005. Net income was ¥45.2 billion (US$386.0 million), a fall of 4.0%, or ¥1.9 billion (US$16.2 million). Free cash flow (net cash provided by operating activities minus net cash used in investing activities) totaled ¥48.8 billion (US$416.8 million).

The Company maintained cash dividends per share at ¥50.00 (US$0.43), in line with management's policy of providing stable returns while enhancing the financial position and otherwise solidifying the Group's business foundations.

Operating Revenues

As mentioned above, operating revenues for the term were ¥1,040.3 billion (US$8,891.4 million), up 2.8%, or ¥28.5 billion (US$243.5 million).

Operating revenues from electric power operations amounted to ¥964.1 billion (US$8,239.9 million), up 1.8%, or ¥17.5 billion (US$149.2 million). This was because the amount of electric power sold increased by the firm growth in air conditioning demand. Operating revenues from other operations such as information and communication businesses and a comprehensive energy supply business rose 16.9%, or ¥11.0 billion (US$94.3 million), to ¥76.2 billion (US$651.4 million).

Operating Expenses and Operating Income

Operating expenses for the term increased 6.1%, or ¥53.9 billion (US$460.3 million), to ¥940.2 billion (US$8,035.9 million).

Operating expenses in electric power operations rose 5.3%, or ¥44.1 billion (US$377.0 million), to ¥869.7 billion (US$7,433.3 million). This stemmed from an increase in materials expense due to the rise in fuel prices, although there were increases in management efficiency overall. In operations other than electric power operations, operating expenses were ¥70.5 billion (US$602.6 million), up 16.0%, or ¥9.7 billion (US$83.3 million).

Operating income thus fell 20.2%, or ¥25.4 billion (US$216.7 million), to ¥100.1 billion (US$855.5 million).

Other Expenses (Income), Income before Income Taxes and Minority Interests and Net Income

Total other (income) expenses decreased 39.7%, or ¥19.5 billion (US$166.5 million), to ¥29.6 billion (US$253.1 million).

As a result of these factors, income before income taxes and minority interests in net income of consolidated subsidiaries was down 3.0%, or ¥2.2 billion (US$18.9 million), to ¥72.4 billion (US$618.8 million). Net income decreased 4.0%, or ¥1.9 billion (US$16.2 million), to ¥45.2 billion (US$386.0 million). Net income per share was ¥123.44 (US$1.06), down ¥5.17, from ¥128.61.

Financial Position

Assets

At fiscal year-end, total assets were ¥2,655.5 billion (US$22,696.3 million), up 0.7%, or ¥19.1 billion (US$163.3 million), from the close of the previous term. This was largely due to increases in funds reserved for reprocessing of irradiated nuclear fuel and increase in construction in progress accompanying the Electric Power Development Plan.

Net property stood at ¥2,098.9 billion (US$17,939.2 million), down 3.1%, or ¥68.1 billion (US$582.0 million). Nuclear fuel was ¥122.0 billion (US$1,043.1 million), up 0.8%, or ¥0.9 billion (US$8.4 million). Total investments and other assets amounted to ¥284.3 billion (US$2,429.6 million), up 34.9%, or ¥73.5 billion (US$628.0 million).

Total current assets were ¥150.3 billion (US$1,284.3 million), up 9.3%, or ¥12.8 billion (US$108.8 million).

Liabilities, Minority Interests and Stockholders' Equity

Total liabilities were ¥1,955.3 billion (US$16,712.1 million), down 0.9%, or ¥18.0 billion (US$153.7 million). Of this total, short-term and long-term interest-bearing debt declined 2.4%, or ¥39.0 billion (US$333.1 million), to ¥1,575.0 billion (US$13,461.6 million), as the Group pursued capital investments within the scope of its internal funding capabilities. Other liabilities increased 5.8%, or ¥21.0 billion (US$179.4 million), to ¥380.3 billion (US$3,250.5 million).

Minority interests were ¥4.7 billion (US$39.8 million), down 4.0%, or ¥0.2 billion (US$1.7 million).

Total stockholders' equity was ¥695.5 billion (US$5,944.4 million), up 5.7%, or ¥37.3 billion (US$318.7 million). The equity ratio improved 1.2 percentage points, to 26.2%, from 25.0%.

Cash Flows

Net cash provided by operating activities for fiscal 2006 amounted to ¥158.1 billion (US$1,351.3 million), down 30.9%, or ¥70.7 billion (US$604.0 million), compared with the previous period. This was due primarily to increases in materials expense due to the rise in fuel prices and in funds reserved for reprocessing of irradiated nuclear fuel.

Net cash used in investing activities was ¥109.3 billion (US$934.5 million), up 13.7%, or ¥13.1 billion (US$112.7 million), mainly because investments in construction in progress increased accompanying the Electric Power Development Plan. Free cash flow therefore amounted to ¥48.8 billion (US$416.8 million).

Net cash used in financing activities was ¥55.1 billion (US$471.3 million), down 58.5%, or ¥78.0 billion (US$665.3 million), as combined debt repayments increased, but purchases of treasury stock decreased. Procurements of total bonds and long-term debt exceeded repayments, causing the balance to rise ¥30.3 billion (US$258.4 million) compared with the previous period. Cash dividends paid were ¥18.2 billion (US$155.8 million).

Cash and cash equivalents at end of year totaled ¥17.8 billion (US$152.6 million), down 25.2%, or ¥6.1 billion (US$51.5 million).

Summary of Cash Flows

	Millions of yen			Thousands of U.S. dollars
Years ended March 31	**2006**	2005	2004	**2006**
Net cash provided by operating activities	**¥158,097**	¥228,770	¥226,478	**$1,351,256**
Net cash used in investing activities	**(109,332)**	(96,154)	(93,643)	**(934,462)**
Net cash used in financing activities	**(55,146)**	(132,977)	(133,350)	**(471,333)**
Effect of exchange rate changes on cash and cash equivalents	**78**	—	(5)	**667**
Net decrease in cash and cash equivalents	**(6,303)**	(361)	(520)	**(53,872)**
Cash and cash equivalents at beginning of year	**23,877**	23,705	24,225	**204,077**
Increase resulting from consolidation of additional subsidiaries	**275**	533	—	**2,351**
Cash and cash equivalents at end of year	**¥ 17,849**	¥ 23,877	¥ 23,705	**$ 152,556**

Outlook

The Group expects operating revenues to decrease to around ¥1,030.0 billion in fiscal 2007, based on a decrease in sales of electricity and the influence of cuts in electricity rates which is planned for July, 2006, in spite of an increase in sales outside of the Group. Net income should be about ¥38.0 billion.

Management bases these projections on an exchange rate of ¥117 to US$1.00 and a crude oil price of US$60.00 per barrel.

Risk Factors

The following primary risk factors to which the Companies are subject may exert a significant influence on investor decisions. The Companies recognize these risk factors, and will try to prevent and address these risks.

The forward-looking statements included below represent estimates as of March 31, 2006.

1. Systemic Reform of Electric Power Business

In the electric power business, the Electricity Utilities Industry Law was revised in June 2003, and the resulting reform fully took effect in April 2005. The reforms include the expansion of the scope of liberalization into all high-voltage users, the termination of the transfer supply fee, and the establishment of the national wholesale electric power exchange. Moreover, it is anticipated that competition in prices and services will be heating up partly because it is assumed appropriate to start considering the possibilities of full liberalization in around April 2007 based on an assessment of the new regulations, according to the report of Electric Power Business Subcommittee of the Advisory Committee on Natural Resources and Energy.

As for the future of nuclear power in the liberalization of the electric power business, the report suggests the way to develop its environment for the purpose of realization of long-term stable operations. Especially the report discusses the systems and measures to promote the Back-End Project smoothly, taking into account, its super long-term aspect and its uniqueness that it will cost after power generation. Based on the report, the "Bill on the Creation and Management of Reserve Funds for the Reprocessing of Spent Fuel at Nuclear Power Stations" was enacted in May 2005, and enforced in October 2005. As a result, the risk of the business will be mitigated by such systems and measures. In addition, as for the handling of irradiated nuclear fuel generated which exceeds the capability of the reprocessing plants which will be available, the Company will inquire and correspond if needed, based on national trends.

The changing business environment, including the systemic reform and the tough competition described above, has the potential to affect the Companies' results and financial condition.

2. Business Other Than Electric Power

As well as the electric power business, the Companies run "information and telecommunications businesses," "comprehensive energy supply business," "environmental business," and "business and lifestyle support business" as far as regulations and other conditions permit. Although these businesses may be expected to make profits, they have the potential to affect the Companies' results and financial condition in case they do not grow as the Companies expect or that their profitability is reduced through intensifying competition.

3. Economic Conditions in Power Supply Area

The Company supplies electric power mainly in the 5 prefectures of the Chugoku region, and accordingly electricity sales are subject to the influence of economic conditions such as industrial activities in the power supply area. As a result, the economic conditions in the power supply area have the potential to affect the Companies' results and financial condition.

4. Seasonal Variations in Weather

Since electricity sales are subject to demand for air conditioning and heating, temperature in the power supply area have the potential to affect the Companies' results and financial condition.

A decrease in water flow rate could boost the Company's fuel cost through reduction of the Company's proportion of hydro power generation. Therefore the rainfall levels in the water resource areas have the potential to affect the Companies' results and financial condition.

5. Changes in Fuel Prices

Sources of fuel for the Company's thermal power generation include coal, liquefied natural gas (LNG) and heavy and crude oil. Therefore fluctuations in energy prices, such as coal, LNG, and heavy and crude oil, and that of foreign exchange rates may affect the Companies' results and financial condition. However, the impact of these factors is considered to be limited, because the Companies are trying to mitigate fuel price fluctuation risk by aiming at diversifying the energy mix, and because the fluctuation in fuel prices and foreign exchange rates are reflected in electricity rates through the Fuel Cost Adjustment System.

6. Changes in Interest Rates

Future changes in interest rates or credit rating resulting in changes in interest rates on borrowings have the potential to affect the Companies' results and financial condition. However, since most of the debts have been funded as long-term fixed-rate debts (i.e., bonds and loans), the impact of changes in interest rate on the Companies' results and financial condition is expected to be limited.

7. Cost and Liabilities of Employees' Severance and Retirement Benefits

The Companies' cost and liabilities of employees' severance and retirement benefits are accounted based on assumptions for actuarial calculation, such as the discount rate and the expected rate of return on pension assets. Changes in the discount rate and expected rate of return have the potential to affect the Companies' results and financial condition.

8. Management of Personal Information

The Companies maintain a large volume of personal information on individuals including that of electric power customers. The Companies established a guideline for personal information protection and rigorously administrate this personal information. However, a lapse in administration of personal information has the potential to affect the Companies' results and financial condition.

9. Natural Disasters, Troubles

The Companies have many properties, plants and equipment, mainly for the electric power business. Natural disasters, such as earthquakes and typhoons, illegal acts including terrorism, and other troubles have the potential to affect the Companies' results and financial condition.

Consolidated Balance Sheets

The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries
March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 1)
Assets	**2006**	2005	**2006**
Property:			
Utility plant and equipment	**¥5,296,606**	¥5,298,331	**$45,270,137**
Other plant	**254,352**	246,278	**2,173,948**
Construction in progress	**169,176**	137,258	**1,445,949**
	5,720,134	5,681,867	**48,890,034**
Less—			
Contributions in aid of construction	**74,769**	73,784	**639,051**
Accumulated depreciation	**3,546,478**	3,441,098	**30,311,778**
	3,621,247	3,514,882	**30,950,829**
Net property (Note 7)	**2,098,887**	2,166,985	**17,939,205**
Nuclear fuel	**122,046**	121,060	**1,043,128**
Investments and other assets:			
Investment securities (Note 4)	**64,257**	53,025	**549,205**
Funds reserved for reprocessing of irradiated nuclear fuel	**56,959**	—	**486,829**
Investments and advances to non-consolidated subsidiaries and affiliates	**90,672**	88,021	**774,974**
Long-term loans to employees	**1,656**	2,074	**14,154**
Deferred tax assets (Note 12)	**54,311**	52,996	**464,197**
Other assets	**16,412**	14,672	**140,274**
Total investments and other assets	**284,267**	210,788	**2,429,633**
Current assets:			
Cash and time deposits (Note 3)	**17,935**	24,037	**153,291**
Receivables, less allowance for doubtful accounts of ¥716 million ($6,120 thousand) in 2006 and ¥666 million in 2005	**66,258**	60,559	**566,308**
Inventories, fuel and supplies	**46,685**	29,099	**399,017**
Deferred tax assets (Note 12)	**11,668**	12,106	**99,726**
Other current assets	**7,722**	11,729	**66,000**
Total current assets	**150,268**	137,530	**1,284,342**
Total assets	**¥2,655,468**	¥2,636,363	**$22,696,308**

See accompanying notes.

Liabilities, Minority Interests and Stockholders' Equity	Millions of yen 2006	2005	Thousands of U.S. dollars (Note 1) 2006
Long-term debt due after one year (Note 6)	**¥1,378,515**	¥1,293,362	**$11,782,179**
Other long-term liabilities due after one year	**7,167**	8,609	**61,256**
Employees' severance and retirement benefits (Note 11)	**61,436**	59,136	**525,094**
Provision for reprocessing of irradiated nuclear fuel	**106,615**	102,065	**911,239**
Provision for decommissioning of nuclear power generating plants	**46,240**	42,876	**395,214**
Current liabilities:			
Long-term debt due within one year (Note 6)	**84,456**	139,377	**721,846**
Short-term borrowings	**68,990**	97,970	**589,658**
Accounts payable	**63,195**	56,167	**540,128**
Accrued income taxes	**21,211**	16,300	**181,291**
Accrued expenses	**44,625**	42,049	**381,410**
Other current liabilities (including other long-term liabilities due within one year)	**72,317**	112,932	**618,094**
Total current liabilities	**354,794**	464,795	**3,032,427**
Provision for drought	**545**	2,458	**4,658**
Contingent liabilities (Note 9)			
Minority interests	**4,661**	4,853	**39,838**
Stockholders' equity (Note 13):			
Common stock :			
Authorized—1,000,000,000 shares			
Issued—371,055,259 shares	**185,528**	185,528	**1,585,709**
Capital surplus	**16,700**	16,685	**142,735**
Retained earnings (Note 15)	**481,823**	455,821	**4,118,146**
Net unrealized holding gains on securities	**23,573**	12,130	**201,479**
Foreign currency translation adjustments	**16**	(9)	**137**
Treasury stock (7,124,776 shares in 2006 and 7,047,789 shares in 2005)	**(12,145)**	(11,946)	**(103,803)**
Total stockholders' equity	**695,495**	658,209	**5,944,403**
Total liabilities, minority interests and stockholders' equity	**¥2,655,468**	¥2,636,363	**$22,696,308**

Consolidated Statements of Income

The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Operating revenues (Note 14) :				
Electric	**¥ 964,071**	¥ 946,612	¥906,466	**$8,239,923**
Other	**76,219**	65,187	60,590	**651,445**
	1,040,290	1,011,799	967,056	**8,891,368**
Operating expenses (Note 14):				
Electric	**869,695**	825,591	804,552	**7,433,291**
Other	**70,500**	60,756	62,918	**602,564**
	940,195	886,347	867,470	**8,035,855**
Operating income	**100,095**	125,452	99,586	**855,513**
Other expenses (income):				
Interest expense	**28,624**	37,570	37,682	**244,650**
Interest income	**(124)**	(87)	(114)	**(1,060)**
Gains on sales of securities	**(755)**	(3,078)	(3,873)	**(6,453)**
Equity in earnings of affiliated companies	**(1,065)**	(1,861)	(1,909)	**(9,103)**
Loss on impairment of fixed assets (Notes 7 and 14)	**3,818**	4,447	—	**32,632**
Loss on discontinued operations	**—**	4,232	—	**—**
Other, net	**(887)**	7,874	1,963	**(7,581)**
	29,611	49,097	33,749	**253,085**
Special item:				
Provision (reversal) for drought	**(1,913)**	1,747	712	**(16,350)**
Income before income taxes and minority interests in net income of consolidated subsidiaries	**72,397**	74,608	65,125	**618,778**
Provision for income taxes (Note 12):				
Current	**28,811**	26,600	30,689	**246,248**
Deferred	**(1,892)**	666	(8,520)	**(16,171)**
	26,919	27,266	22,169	**230,077**
Income before minority interests in net income of consolidated subsidiaries	**45,478**	47,342	42,956	**388,701**
Minority interests in net income of consolidated subsidiaries	**311**	280	68	**2,658**
Net income	**¥ 45,167**	¥ 47,062	¥ 42,888	**$ 386,043**

	Yen			U.S. dollars (Note 1)
Per share data:				
Net income:				
Basic	**¥123.44**	¥128.61	¥116.63	**$1.06**
Diluted	**123.44**	128.61	116.63	**1.06**
Cash dividends applicable to the year	**50.00**	50.00	50.00	**0.43**

See accompanying notes.

Consolidated Statements of Stockholders' Equity

The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

		Millions of yen					
	Shares of common stock	Common stock	Capital surplus	Retained earnings	Net unrealized holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2003	371,055,259	¥185,528	¥16,680	¥402,971	¥ 9,170	¥17	¥ (7,532)
Net income				42,888			
Cash dividends paid (¥50.00 per share)				(18,282)			
Bonuses to directors and statutory auditors				(220)			
Effect of increase in investments accounted for by the equity method				(198)			
Increase in unrealized holding gains on securities					2,640		
Foreign currency translation adjustments						(21)	
Treasury stock purchased, net							(4,037)
Balance at March 31, 2004	371,055,259	185,528	16,680	427,159	11,810	(4)	(11,569)
Net income				47,062			
Cash dividends paid (¥50.00 per share)				(18,173)			
Bonuses to directors and statutory auditors				(227)			
Effect of decrease in investments accounted for by the equity method				(711)			
Effect of merger of consolidated subsidiaries with company accounted for by the equity method				711			
Surplus from sale of treasury stock			5				
Increase in unrealized holding gains on securities					320		
Foreign currency translation adjustments						(5)	
Treasury stock purchased, net							(377)
Balance at March 31, 2005	371,055,259	185,528	16,685	455,821	12,130	(9)	(11,946)
Net income				**45,167**			
Cash dividends paid (¥50.00 per share)				**(18,163)**			
Bonuses to directors and statutory auditors				**(226)**			
Effect of decrease in investments accounted for by the equity method				**(1,278)**			
Effect of increase in unrealized gross profit by changing holding ratio of subsidiaries				**(776)**			
Effect of increase in consolidated subsidiaries				**1,259**			
Effect of merger of consolidated subsidiaries with company accounted for by the equity method				**19**			
Surplus from sale of treasury stock			**15**				
Increase in unrealized holding gains on securities					**11,443**		
Foreign currency translation adjustments						**25**	
Treasury stock purchased, net							**(199)**
Balance at March 31, 2006	**371,055,259**	**¥185,528**	**¥16,700**	**¥481,823**	**¥23,573**	**¥16**	**¥(12,145)**

	Thousands of U.S. dollars (Note1)					
	Common stock	Capital surplus	Retained earnings	Net unrealized holding gains on securities	Foreign currency translation adjustments	Treasury stock
Balance at March 31, 2005	$1,585,709	$142,607	$3,895,906	$103,675	$ (77)	$(102,103)
Net income			**386,043**			
Cash dividends paid (¥50.00 per share)			**(155,239)**			
Bonuses to directors and statutory auditors			**(1,932)**			
Effect of decrease in investments accounted for by the equity method			**(10,923)**			
Effect of increase in unrealized gross profit by changing holding ratio of subsidiaries			**(6,632)**			
Effect of increase in consolidated subsidiaries			**10,761**			
Effect of merger of consolidated subsidiaries with company accounted for by the equity method			**162**			
Surplus from sale of treasury stock		**128**				
Increase in unrealized holding gains on securities				**97,804**		
Foreign currency translation adjustments					**214**	
Treasury stock purchased, net						**(1,700)**
Balance at March 31, 2006	**$1,585,709**	**$142,735**	**$4,118,146**	**$201,479**	**$137**	**$(103,803)**

See accompanying notes.

Consolidated Statements of Cash Flows

The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries
For the years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Cash flows from operating activities				
Income before income taxes and minority interests in net income of consolidated subsidiaries	**¥ 72,397**	¥ 74,608	¥ 65,125	**$ 618,778**
Depreciation	**150,034**	157,467	171,787	**1,282,342**
Loss on impairment of fixed assets	**3,818**	4,447	—	**32,632**
Amortization of nuclear fuel	**6,738**	5,331	5,864	**57,590**
Loss on disposal of property	**7,507**	9,991	9,320	**64,162**
Increase (decrease) in employees' severance and retirement benefits	**2,050**	(22,311)	2,395	**17,521**
Increase in provision for reprocessing of irradiated nuclear fuel	**4,551**	2,691	8,975	**38,897**
Increase in provision for decommissioning of nuclear power generating plants	**3,363**	673	—	**28,744**
Increase (decrease) in provision for drought	**(1,913)**	1,747	712	**(16,350)**
Increase (decrease) in provision for reserve for loss on discontinued operations	**(1,491)**	1,491	—	**(12,744)**
Interest and dividend income	**(845)**	(762)	(619)	**(7,222)**
Interest expense	**28,624**	37,570	37,682	**244,650**
Gains on sales of securities	**(755)**	(3,073)	(3,873)	**(6,453)**
Increase in funds reserved for reprocessing of irradiated nuclear fuel	**(56,959)**	—	—	**(486,829)**
Decease (increase) in notes and accounts receivable	**(3,048)**	(5,717)	3,208	**(26,051)**
Decrease (increase) in inventories	**(9,403)**	1,536	5,099	**(80,368)**
Increase (decrease) in notes and accounts payable	**4,083**	14,265	(2,335)	**34,897**
Increase (decrease) in liabilities for defined contribution pension and prepaid pension	**(3,453)**	9,831	—	**(29,513)**
Other	**4,348**	6,761	5,823	**37,163**
Subtotal	**209,646**	296,546	309,163	**1,791,846**
Interest and dividends received	**1,301**	1,287	1,204	**11,120**
Interest paid	**(28,795)**	(39,030)	(39,090)	**(246,111)**
Income taxes paid	**(24,055)**	(30,033)	(44,799)	**(205,599)**
Net cash provided by operating activities	**158,097**	228,770	226,478	**1,351,256**
Cash flows from investing activities:				
Purchase of property	**(113,333)**	(105,882)	(101,092)	**(968,658)**
Purchase of investments in securities	**(572)**	(1,977)	(2,583)	**(4,889)**
Proceeds from sale of investment securities	**1,463**	6,578	5,882	**12,504**
Purchase of investments in subsidiaries resulting in change in scope of consolidation	**(590)**	—	—	**(5,043)**
Other	**3,700**	5,127	4,150	**31,624**
Net cash used in investing activities	**(109,332)**	(96,154)	(93,643)	**(934,462)**
Cash flows from financing activities:				
Proceeds from issue of bonds	**—**	14,943	39,838	**—**
Repayment of bonds	**(29,900)**	(110,000)	(107,125)	**(255,556)**
Proceeds from long-term debt	**170,500**	30,790	78,700	**1,457,265**
Repayment of long-term debt	**(110,368)**	(84,606)	(75,215)	**(943,316)**
Proceeds from short-term loans	**297,670**	353,000	309,700	**2,544,188**
Repayment of short-term loans	**(326,620)**	(332,490)	(340,950)	**(2,791,624)**
Proceeds from issue of commercial paper	**742,000**	742,000	795,000	**6,341,880**
Repayment of commercial paper	**(780,000)**	(728,000)	(811,000)	**(6,666,667)**
Purchase of treasury stock	**(233)**	(430)	(3,999)	**(1,991)**
Cash dividends paid	**(18,225)**	(18,209)	(18,329)	**(155,769)**
Other	**30**	25	30	**257**
Net cash used in financing activities	**(55,146)**	(132,977)	(133,350)	**(471,333)**
Effect of exchange rate changes on cash and cash equivalents	**78**	—	(5)	**667**
Net decrease in cash and cash equivalents	**(6,303)**	(361)	(520)	**(53,872)**
Cash and cash equivalents at beginning of year	**23,877**	23,705	24,225	**204,077**
Increase resulting from merger of equity method affiliate with consolidated subsidiary	**275**	533	—	**2,351**
Cash and cash equivalents at end of year (Note 3)	**¥ 17,849**	¥ 23,877	¥ 23,705	**$ 152,556**

See accompanying notes.

Notes to Consolidated Financial Statements

The Chugoku Electric Power Co., Inc. and Consolidated Subsidiaries

1. Basis of presenting consolidated financial statements

The Chugoku Electric Power Co., Inc. (the "Company") and its consolidated subsidiaries (the "Companies") maintain their accounts and records in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and the Electricity Utilities Industry Law and in conformity with accounting principles generally accepted in Japan ("Japanese GAAP "), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of stockholders' equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation is not presented in the accompanying consolidated financial statements.

The translations of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the readers outside Japan, using the prevailing exchange rate on March 31, 2006, which was ¥117 to U.S.$1.00. The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be converted into U.S. dollars at this or any other rate of exchange.

2. Significant accounting policies

The following is a summary of the significant accounting policies used in the preparation of the consolidated financial statements.

Consolidation

The accompanying consolidated financial statements include the accounts of the Company and significant companies over which the Company has power of control through majority voting rights or existence of certain conditions evidencing control by the Company. In the elimination of investments in subsidiaries, all the assets and liabilities of a subsidiary, not only to the extent of the Company's share, but also including the minority interest share, are evaluated based on fair value at the time when the Company acquired control of the subsidiary.
Investments in non-consolidated subsidiaries and affiliates over which the Company has the ability to exercise significant influence over operating and financial policies of the investees are accounted for using the equity method.

For the year ended March 31, 2006, 24 subsidiaries (23 in 2005, 24 in 2004) were consolidated and 7 subsidiaries were excluded from consolidation due to immateriality in terms of consolidated total assets, sales and revenues, net income and retained earnings of the consolidated financial statements.

For the year ended March 31, 2006, 7 (10 in 2005, 11 in 2004) non-consolidated subsidiaries and 9 (10 in 2005, 10 in 2004) affiliates were accounted for by the equity method.

For the year ended March 31, 2006, 8 (9 in 2005, 10 in 2004) affiliates, were stated at cost without applying the equity method of accounting. If the equity method had been applied for these investments, the amounts of net income and retained earnings of the excluded affiliates would not have had a material effect on the consolidated financial statements.

Inventories, fuel and supplies

Inventories, fuel and supplies are stated at cost, determined principally by the weighted average method.

Securities

Available-for-sale securities for which market value is readily determinable are stated at market value as of the end of the period with unrealized gains and losses, net of applicable deferred tax assets /liabilities, not reflected in earnings but directly reported as a separate component of shareholders' equity. The cost of securities sold is determined by the moving-average method. Other investments for which market value is not readily determinable are stated primarily at moving-average cost.

If the market value of equity securities issued by unconsolidated subsidiaries and affiliated companies, and available-for-sale securities declines significantly, such securities are stated at fair market value, and the difference between the fair market value and the carrying amount is recognized as a loss in the period of the decline. If the fair market value of equity securities issued by unconsolidated subsidiaries and affiliated companies not accounted for by the equity method is not readily available, such securities should be written down to net asset value with a corresponding charge in the consolidated statements of income in the event net asset value declines significantly. In these cases, such fair market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

Accounting for the impairment of fixed assets

For the year ended March 31, 2005, the Companies adopted early the new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standards Board of Japan on October 31, 2003).

As a result of the new accounting standard for impairment of fixed assets, income before income taxes and minority interests in net income of consolidated subsidiaries decreased by ¥4,447 million for the year ended March 31, 2005.

Property and depreciation

Property is principally stated at cost, which includes interest on borrowed funds during construction, in accordance with rules established by the regulatory authorities. Contributions in aid of construction are deducted from the cost of the related assets when computing depreciation. Depreciation is computed using the declining-balance method, based on the estimated useful lives of the respective assets in accordance with the corporation tax law.

Easements related to lands below transmission lines, which had previously been non-depreciable assets, are depreciated on the straight-line method commencing in the year ended March 31, 2006. As a result, operating income decreased by ¥2,933 million (US$25,068 thousand) and income before income taxes and minority interests in net income of consolidated subsidiaries decreased by ¥2,934 million (US$25,077 thousand) for the year ended March 31, 2006.

Nuclear fuel and amortization

Nuclear fuel is stated at cost less amortization. The amortization of nuclear fuel is computed based on the quantity of heat produced for generation of electricity.

Allowance for doubtful accounts

The allowance for doubtful accounts is provided in an amount sufficient to cover possible losses on collection. It consists of the estimated uncollectible amount with respect to identified doubtful receivables and an amount calculated based on the Companies' historical loss rate with respect to remaining receivables.

Severance and retirement benefits

Under the terms of the retirement plans of the Companies, all employees are entitled to a lump-sum payment at the time of retirement.

The Companies, in general, have also adopted non-contributory funded pension plans which provide a part of total retirement benefits for employees.

Prior to April 1, 2003, the Company had a tax-qualified retirement pension plan to cover a certain portion of its employees' retirement benefit plans. In March 2004, however, the Company revised its rules related to retirement benefit and pension plans to mitigate the effect of the retirement benefit and pension plans on the corporate accounts, stably maintain and operate these plans for a long time period, and properly reflect employees' capabilities and achievements. Elements of the revised rules applying from April 1, 2004, are as follows:

- The Company shifted from a qualified retirement pension plan to a cash balance plan, which is a hybrid pension plan based on variable interest rates, enabling the Company to flexibly respond to market interest rate fluctuations. As the related rules were revised in March 2004, retirement benefit obligations and other items for the year ended March 31, 2004, were computed based on the new plan.
- A part of the current lump-sum retirement benefit plan was shifted to an optional system, under which the employees may choose a defined contribution pension plan or a prepayment plan.

The liabilities and expenses for severance and retirement benefits are determined based on the amounts actuarially calculated using certain assumptions.

The Companies provide for employees' severance and retirement benefits based on the estimated amounts of projected benefit obligation and the fair value of the plan assets.

Prior service costs are recognized in expenses mainly in one year within the average of estimated remaining service periods of the employees. Actuarial gains and losses are recognized in expenses using a straight-line basis over 5 years which is within the average of the estimated remaining service period commencing with the following period.

Retirement benefits to directors and statutory auditors are charged to income when approved at the stockholders' meeting.

Provision for reprocessing of irradiated nuclear fuel

A provision for reprocessing of irradiated nuclear fuel, is provided at the present value amount equivalent to the expense of the reprocessing of irradiated nuclear fuel.

Prior to April 1, 2005, the annual provision for the costs of reprocessing irradiated nuclear fuel was calculated to state the related reserve at 60% of the amount that would be required to reprocess all of the irradiated nuclear fuel in accordance with the regulatory authority.

Effective April 1, 2005, the Company adopted a revised accounting standard for provision for reprocessing of irradiated nuclear fuel. The composition of the back-end costs such as decommissioning costs of reprocessing facilities was estimated in the report published in August 2004 by the Ministry of Economy, Trade and Industry and electric utility providers have been able to estimate liabilities related to such decommissioning costs of reprocessing facilities. In accordance with the changes in the accounting rules applicable to electric utility providers in Japan, the provision is stated at present value of the amount that would be required to reprocess the irradiated nuclear fuel with definite plans for reprocessing.

As a result, compared with the former method, operating expenses increased by ¥8,714 million ($74,479 thousand) and operating income and income before income taxes and minority interests in net income of consolidated subsidiaries decreased by the same amount for the year ended March 2006.

In addition, the difference of ¥59,307 million (US$506,897 thousand) due to the change in estimating costs of reprocessing of irradiated fuel at March 31, 2005, is included in operating expenses equally over 15 years from April 1, 2005.

Also, estimated liabilities related to past generation which were estimated by using assumptions, such as discount rate, were ¥3,093 million (US$26,436 thousand) on March 31, 2006. This will be amortized over the periods of generating of irradiated nuclear fuels for which there are concrete reprocessing plans from the next period. The annual amortization is presented as operating expenses in the income statement.

However, 15 tons out of 26 tons of irradiated nuclear fuel which was derived during this period is not covered with reserves because there is no definite reprocessing plan and accurate estimation is not possible.

In May 2005, Law on the Creation and Management of Reserve Funds for the Reprocessing of Spent Fuel at Nuclear Fuel at Nuclear Power Stations was issued and the independent fund managing body was set up. According to the new law, the Company contributed to the Reserve Funds in the year ended March 31, 2006. The contributed amounts consisted of the amounts as provision for reprocessing of nuclear fuel and the unfunded parts of reprocessing costs for the irradiated nuclear fuel which was derived before April 2005 and in the year ended March 31, 2006. Under the related regulation, the Company is permitted to recover the reprocessing costs through wheeling charges and compensate unfunded portion within 15 years.

Provision for decommissioning of nuclear power plants

In accordance with the provisions of the Accounting Regulations of the Electric Power Industry, the Company provides the reserve for decommissioning of nuclear power plants by charging to income periodically the future decommissioning costs of nuclear power plants.

The provision is made based on such factors as the estimated total decommissioning costs and the (actual and estimated) total volume of nuclear power generation.

Provision for drought

The Company is required, under certain conditions, to set up a provision for drought under the Electricity Utilities Industry Law to stabilize its income position for variations in water levels.

Provision for loss on discontinued operations

Provision is made for losses on withdrawal from personal handy phone voice service of Energia Communications, Inc., a consolidated subsidiary. The amount is estimated based primarily on disposal of equipment.

Accounting for certain lease transactions

Finance leases for which ownership does not transfer to lessees are accounted for in the same manner as operating leases.

Derivatives and hedge accounting

The Companies state derivative financial instruments at fair value and recognize changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Companies defer recognition of gains or losses resulting from changes in the fair value of derivative financial instruments until the related gains or losses on the hedged items are recognized.

However, in cases where forward foreign exchange contracts are used as hedges and meet certain hedging criteria, forward foreign exchange contracts and hedged items are accounted for in the following manner:

If a forward foreign exchange contract is executed to hedge a future transaction denominated in a foreign currency and meets certain hedging criteria, the future transaction will be recorded using the contracted forward rate, and no gain or loss on the forward foreign exchange contract is recognized. In this case, assessment of hedge effectiveness is not necessary.

Also, if interest rate swap contracts are used as hedges and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed. In this case, assessment of hedge effectiveness is not necessary.

If commodity swap contracts are used as hedges and meet certain hedging criteria, the gain or loss is deferred until the gain or loss on the hedged item is recognized. In this case, hedge effectiveness is assessed based on the extent of correlation in recent years using statistical methods at the inception of the hedge, and by comparing the cumulative changes in fair value on an ongoing basis at each period-end. Commodity swap contracts that do not qualify as hedges are stated at current value and unrealized gains or losses are recognized in the statements of income.

Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value.

Bond issue expenses

Bond issue expenses are charged to income when paid or incurred.

Income taxes

The Companies use the asset and liability approach to recognize deferred tax assets and liabilities for loss carry forwards and the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Foreign currency translation

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end rate.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2006 presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

Change in useful lives

For certain fixed assets, Energia Communications, Inc., a consolidated subsidiary, changed the useful lives from those based on income tax regulations to economic useful lives.

As a result of changing the useful lives, income before income taxes and minority interests in net income of consolidated subsidiaries increased by ¥2,810 million for the year ended March 31, 2005.

Consolidated tax system

In the year ended March 31, 2005, the Companies introduced the consolidated tax system.

3. Cash and cash equivalents

The reconciliations of cash and time deposits shown in the consolidated balance sheets and cash and cash equivalents shown in the consolidated statements of cash flows at March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Cash and time deposits	**¥17,935**	¥24,037	**$153,291**
Less: Time deposits with maturities exceeding three months	**(86)**	(160)	**(735)**
Cash and cash equivalents	**¥17,849**	¥23,877	**$152,556**

4. Securities

A. The following tables summarize acquisition costs, book values (fair values) of securities with available fair values as of March 31, 2006 and 2005:

Available-for-sale securities with book values exceeding acquisition costs

	Millions of yen						Thousands of U.S. dollars		
	Acquisition cost		Book value		Difference		Acquisition cost	Book value	Difference
	2006	2005	**2006**	2005	**2006**	2005	**2006**		
Equity securities	**¥4,885**	¥4,890	**¥39,118**	¥26,541	**¥34,233**	¥21,651	**$41,752**	**$334,342**	**$292,590**
Bonds	**9**	26	**10**	26	**1**	0	**77**	**85**	**8**
Other	**24**	23	**45**	31	**21**	8	**205**	**385**	**180**
Total	**¥4,918**	¥4,939	**¥39,173**	¥26,598	**¥34,255**	¥21,659	**$42,034**	**$334,812**	**$292,778**

Available-for-sale securities with book values not exceeding acquisition costs

	Millions of yen						Thousands of U.S. dollars		
	Acquisition cost		Book value		Difference		Acquisition cost	Book value	Difference
	2006	2005	**2006**	2005	**2006**	2005	**2006**		
Equity securities	**¥14**	¥74	**¥14**	¥62	**¥—**	¥(12)	**$120**	**$120**	**$—**
Bonds	**—**	9	**—**	9	**—**	0	**—**	**—**	**—**
Other	**—**	—	**—**	—	**—**	—	**—**	**—**	**—**
Total	**¥14**	¥83	**¥14**	¥71	**¥—**	¥(12)	**$120**	**$120**	**$—**

B. Book values of available-for-sale securities with no available fair market value as of March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	Book value		Book value
	2006	2005	**2006**
Non-listed equity securities	**¥23,921**	¥24,453	**$204,453**
Other	**1,064**	1,418	**9,094**
Total	**¥24,985**	¥25,871	**$213,547**

C. At March 31, 2006 available-for-sale securities with maturities and held-to-maturity debt securities mature as follows:

	Millions of yen			Thousands of U.S. dollars		
	Within one year	Within five years	Total	Within one year	Within five years	Total
Corporate bonds	¥—	¥10	¥10	$—	$85	$85

D. Total sales of available-for-sale securities in the year ended March 31, 2006 amounted to ¥900 million (US$7,692 thousand), and the related gains amounted to ¥738 million (US$6,308 thousand), respectively. Total sales of available-for-sale securities in the year ended March 31, 2005 amounted to ¥5,316 million, and the related gains and losses amounted to ¥3,078 million and ¥5 million. Total sales of available-for-sale securities in the year ended March 31, 2004 amounted to ¥5,144 million, and the related gains amounted to ¥3,873 million.

5. Derivatives

The Company and certain of its consolidated subsidiaries enter into forward foreign exchange contracts, currency swap contracts, interest rate swap contracts, commodity swap contracts and weather derivative instruments to mitigate and avoid market risk. The Company adopts hedge accounting for these derivatives, except for currency swap contracts, some commodity swap contracts and weather derivative instruments.

The Companies' policy is to hedge risk exposure related to receivables and payables incurred in their business operations (actual demand transactions) and not to enter into contracts for speculative purposes.

Forward foreign exchange contracts, currency swap contracts, interest rate swap contracts and commodity swap contracts are exposed to market risk arising from movements of the market value and weather derivative instruments are exposed to a risk that the Companies might be obliged to pay a certain amount of money, depending on temperature changes. Management believes that the related credit risk arising from the event of nonperformance by counterparties is quite low, since the Companies use only creditable financial institutions and others as counterparties to derivative transactions.

The Company has established a management function independent from the execution function of derivatives and manages derivative transactions adequately in accordance with the internal rules providing authorization limits, methods of execution, reporting and management, etc.

The consolidated subsidiaries require such derivative financial instruments to be authorized by each representative director and executed in compliance with the respective internal rules.

Interest rate swap contracts applying the "exceptional" method in accordance with the Accounting Standard for Financial Instruments are excluded from disclosure in the notes to the consolidated financial statements as of March 31, 2006. Derivative financial instruments accounted for by hedge accounting in accordance with the Accounting Standard for Financial Instruments are also excluded from disclosure in the notes to the consolidated financial statements as of March 31, 2006.

As of March 31, 2006 and 2005, the fair value of derivatives was as follows. Disclosure of information on hedging derivatives is not required except for below.

	Millions of yen						Thousands of U.S. dollars		
	Notional amount		Fair value		Gain		Notional amount	Fair value	Gain
	2006	2005	**2006**	2005	**2006**	2005		**2006**	
Dealings outside a market									
Currency swap	**¥5,500**	¥5,884	**¥842**	¥136	**¥842**	¥136	**$47,009**	**$7,197**	**$7,197**

6. Long-term debt

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Domestic bonds due through 2029 at rates of 0.58% to 4.1%	**¥ 814,900**	¥ 844,800	**$ 6,964,957**
Loans from the Development Bank of Japan due through 2023 at rates of 0.75% to 4.95%	**246,094**	262,662	**2,103,367**
Unsecured loans, principally from banks and insurance companies, due through 2032 at rates of 0.10% to 6.45%	**401,977**	325,277	**3,435,701**
	1,462,971	1,432,739	**12,504,025**
Less amounts due within one year	**(84,456)**	(139,377)	**(721,846)**
Total	**¥1,378,515**	¥1,293,362	**$11,782,179**

At March 31, 2006 and 2005 loans from the Development Bank of Japan of ¥230,319 million (US$1,968,538 thousand) and ¥243,039 million, respectively, and all bonds were secured by a statutory preferential right which gives the creditors a security interest in all assets of the Company, totaling ¥2,453,332 million (US$20,968,650 thousand) and ¥2,447,206 million, respectively, senior to that of general creditors. Some assets of subsidiaries are being used as collateral for loans from financial institutions and other sources.

The annual maturities of long-term debt at March 31, 2006 were as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 84,456	$ 721,846
2008	145,547	1,243,991
2009	126,808	1,083,829
2010	134,824	1,152,342
Thereafter	971,336	8,302,017

7. Impairment loss on fixed assets

Since all of the properties currently being used for the electric power generation business are providing cash flows, they are considered one property group. In addition, since there are no signs of decreases in cash flows of these property groups, no loss is recognized.

Since the fixed assets currently used for the information and telecommunication business are generating cash flows, they are also considered one property group. Among these assets, assets in service which are judged as not having sufficient cash flows estimation period, are treated as an independent minimum unit. For these assets impairment loss is recognized.

The fixed assets currently used for other business are considered separately.

For the years ended March 31, 2006 and 2005, the Companies recognized ¥3,818 million (US$32,632 thousand) and ¥4,447 million of impairment losses on fixed assets which consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Construction in progress	**¥ —**	¥2,313	**$ —**
Information and telecommunications equipment	**3,336**		**28,513**
General facilities, other property, plant and equipment	**482**	2,134	**4,119**
Total	**¥3,818**	¥4,447	**$32,632**

Impairment losses relating to "construction in progress" with uncertain future cash flows are recognized by individual project. Impairment losses relating to "general facilities, other property, plant and equipment" are grouped within respective areas because these assets are supplemental in terms of generating cash flows.

The Companies determine if assets are impaired by comparing their undiscounted expected future cash flows to the carrying amounts in the accounting records.

The Companies recognize impairment losses if the undiscounted expected future cash flows are less than the carrying amount of the asset.

Recoverable amounts in "Information and telecommunications equipment" assets were measured by the reminder price.

Recoverable amounts in other assets groups were measured by the respective net selling prices. The selling prices were based primarily on appraisal valuation.

8. Leases

(As lessee)

The Companies lease certain equipment for business use.

Lease payments under non-capitalized finance leases amounted to ¥159 million (US$1,359 thousand), ¥184 million and ¥383 million for the years ended March 31, 2006, 2005 and 2004, respectively.

The present values of future minimum lease payments under non-capitalized finance leases and future minimum lease payments under operating leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen				Thousands of U.S. dollars	
	Finance leases		Operating leases		Finance leases	Operating leases
	2006	2005	**2006**	2005	**2006**	
Current portion	**¥148**	¥172	**¥ 86**	¥242	**$1,265**	**$735**
Non-current portion	**330**	339	**14**	31	**2,820**	**120**
Total	**¥478**	¥511	**¥100**	¥273	**$4,085**	**$855**

(As lessor)

Lease payments received under finance leases, accounted for as operating leases, amounted to ¥379 million (US$3,239 thousand), ¥302 million and ¥229 million for the years ended March 31, 2006, 2005 and 2004, respectively.

The present values of future minimum lease payments to be received under finance leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Current portion	**¥ 371**	¥ 354	**$ 3,171**
Non-current portion	**2,528**	1,855	**21,607**
Total	**¥2,899**	¥2,209	**$24,778**

9. Contingent liabilities

At March 31, 2006, the Companies were contingently liable as guarantor for loans of other companies and employees in the amount of ¥139,078 million (US$1,188,701 thousand), mainly in connection with the Company's procurement of fuel.

At the same date, the Company was also contingently liable with respect to certain domestic bonds, which were assigned to certain banks under debt assumption agreements in the aggregate amount of ¥5,000 million (US$42,735 thousand).

10. Research and development expenses

Research and development expenses charged to operating expenses were ¥6,648 million (US$56,821 thousand), ¥8,310 million and ¥8,788 million for the years ended March 31, 2006, 2005 and 2004, respectively.

11. Employees' severance and pension benefits

The liabilities for employees' severance and retirement benefits included in the liabilities section of the consolidated balance sheets as of March 31, 2006 and 2005 consist of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Projected benefit obligation	**¥264,648**	¥256,303	**$2,261,949**
Fair value of pension assets	**226,298**	187,107	**1,934,171**
	38,350	69,196	**327,778**
Unrecognized pension assets	**—**	31	**—**
Less unrecognized actuarial differences	**13,042**	(19,537)	**111,470**
Unrecognized prior service costs	**32**	275	**273**
Prepaid pension expense	**10,012**	9,171	**85,573**
Liability for severance and retirement benefits	**¥ 61,436**	¥ 59,136	**$ 525,094**

The effect of the transition to a defined contribution pension plan at March 31, 2005 is summarized as follows:

Year ending March 31	Millions of yen
Decrease in projected benefit obligation	¥17,478
Transferred pension assets	(1,248)
Decrease in liability for severance and retirement benefits	¥16,230

The amount of pension assets to be transferred to the defined contribution pension plan is ¥16,230 million, which are being transferred over a period of 4 years. At March 31, 2006, the amount of pension assets not yet transferred is ¥9,831 million, which is included in other long-term liabilities due after one year and other current liabilities.

Included in the consolidated statements of income for the years ended March 31, 2006, 2005 and 2004 are employees' severance and retirement benefit expenses comprised of the following:

	Millions of yen			Thousands of U.S. dollars
	2006	2005	2004	**2006**
Service costs-benefits earned during the year	**¥ 8,939**	¥ 8,753	¥10,307	**$ 76,402**
Interest cost on projected benefit obligation	**5,122**	5,037	5,913	**43,778**
Expected return on plan assets	**(7,818)**	(6,939)	(707)	**(66,821)**
Prior service costs	**(111)**	(11,371)	(1,567)	**(949)**
Amortization of actuarial losses	**10,998**	11,349	13,653	**94,000**
Severance and retirement benefit expenses	**17,130**	6,829	27,599	**146,410**
Defined contribution pension premium, etc.	**738**	717	—	**6,308**
Loss on a shift to optional system for defined contribution pension plan or prepayment plan	**—**	—	135	**—**
Total	**¥17,868**	¥ 7,546	¥27,734	**$152,718**

The estimated amount of all retirement benefits to be paid at future retirement dates is allocated equally to each service year using the estimated number of total service years. In the year ended March 31, 2006, the discount rate and the rates of expected return on plan assets used by the Company are 1.9% and mainly 4.5%, respectively.

In the year ended March 31, 2005, the discount rates and the rates of expected return on plan assets used by the Company were 2.0% and 0% to 4.5%, respectively.

In the year ended March 31, 2004, the discount rates and the rates of expected return on plan assets used by the Company were 2.0% and 0% to 1.2%, respectively.

12. Income taxes

The Company is subject to a number of taxes based on income, which, in the aggregate, indicate a statutory rate in Japan of approximately 36% for the years ended March 31, 2006, 2005 and 2004.The Companies' statutory tax rate is lower than companies in other industries because enterprise tax is included in the operating expenses of electrical utilities.

Significant components of the Companies' deferred tax assets and liabilities as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Excess depreciation	**¥18,958**	¥17,624	**$162,034**
Adjustment for unrealized intercompany profits	**14,214**	11,379	**121,487**
Severance and retirement benefits	**18,740**	14,355	**160,171**
Future reprocessing costs of irradiated nuclear fuel	**5,660**	4,742	**48,376**
Future decommissioning costs of nuclear power generating plants	**4,288**	4,288	**36,650**
Accrued bonuses and other expenses	**5,899**	5,627	**50,419**
Accrued defined contribution pension	**2,306**	3,554	**19,709**
Other	**13,476**	15,133	**115,180**
Total gross deferred tax assets	**83,541**	76,702	**714,026**
Less, valuation allowance	**(4,373)**	(3,157)	**(37,376)**
Total deferred tax assets	**79,168**	73,545	**676,650**
Deferred tax liabilities:			
Unrealized holding gains on securities	**(12,813)**	(8,120)	**(109,513)**
Other	**(376)**	(323)	**(3,214)**
Total deferred tax liabilities	**(13,189)**	(8,443)	**(112,727)**
Net deferred tax assets	**¥65,979**	¥65,102	**$563,923**

13. Stockholders' equity

Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as capital, although a company may, by resolution of its Board of Directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

The Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of legal earnings reserve and additional paid-in capital equals 25% of common stock. The total amount of legal earnings reserve and additional paid-in capital of the Company has reached 25% of common stock, and therefore the Company is not required to provide any more legal earnings reserve. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for distribution by the resolution of shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Commercial Code.

14. Segment information

The Companies classify their operations into four segments; "Electric power," "Information and telecommunications," "Comprehensive energy supply" and "Other" from the two previous segments; "Electric power" and "Other."

The "Information and telecommunications" segment involves the information technology business and telecommunications business. The "Comprehensive energy supply" segment involves cogeneration, distributed power sources, heat supply and fuel supply business. The "Other" segment involves business and lifestyle support businesses and environmental business.

A summary by segment for the years ended March 31, 2006, 2005 and 2004 is as follows:

	Millions of yen						
	2006						
	Electric power	Information and tele-communications	Comprehensive energy supply	Other	Total	Elimination	Consolidated
Operating revenues:							
Outside customers	**¥ 964,071**	**¥15,563**	**¥14,180**	**¥ 46,476**	**¥1,040,290**	**¥ —**	**¥1,040,290**
Intersegment	**4,759**	**21,196**	**1,714**	**85,030**	**112,699**	**(112,699)**	**—**
Total	**968,830**	**36,759**	**15,894**	**131,506**	**1,152,989**	**(112,699)**	**1,040,290**
Cost and expenses	**876,975**	**34,312**	**15,638**	**126,674**	**1,053,599**	**(113,404)**	**940,195**
Operating income	**¥ 91,855**	**¥ 2,447**	**¥ 256**	**¥ 4,832**	**¥ 99,390**	**¥ 705**	**¥ 100,095**
Identifiable assets	**¥2,428,013**	**¥71,419**	**¥20,121**	**¥240,708**	**¥2,760,261**	**¥(104,793)**	**¥2,655,468**
Impairment of fixed assets	**—**	**3,336**	**—**	**161**	**3,497**	**321**	**3,818**
Depreciation expense	**136,569**	**9,193**	**1,940**	**4,441**	**152,143**	**(2,109)**	**150,034**
Capital expenditures	**104,857**	**7,441**	**3,789**	**3,852**	**119,939**	**(2,028)**	**117,911**

	Thousands of U.S. dollars						
	2006						
	Electric power	Information and tele-communications	Comprehensive energy supply	Other	Total	Elimination	Consolidated
Operating revenues:							
Outside customers	**$ 8,239,923**	**$133,017**	**$121,197**	**$ 397,231**	**$ 8,891,368**	**$ —**	**$ 8,891,368**
Intersegment	**40,675**	**181,162**	**14,650**	**726,752**	**963,239**	**(963,239)**	**—**
Total	**8,280,598**	**314,179**	**135,847**	**1,123,983**	**9,854,607**	**(963,239)**	**8,891,368**
Cost and expenses	**7,495,513**	**293,265**	**133,658**	**1,082,684**	**9,005,120**	**(969,265)**	**8,035,855**
Operating income	**$ 785,085**	**$ 20,914**	**$ 2,189**	**$ 41,299**	**$ 849,487**	**$ 6,026**	**$ 855,513**
Identifiable assets	**$20,752,248**	**$610,419**	**$171,974**	**$2,057,333**	**$23,591,974**	**$(895,666)**	**$22,696,308**
Impairment of fixed assets	**—**	**28,513**	**—**	**1,376**	**29,889**	**2,743**	**32,632**
Depreciation expense	**1,167,256**	**78,573**	**16,581**	**37,958**	**1,300,368**	**(18,026)**	**1,282,342**
Capital expenditures	**896,214**	**63,598**	**32,385**	**32,923**	**1,025,120**	**(17,334)**	**1,007,786**

	Millions of yen						
	2005						
	Electric power	Information and tele-communications	Comprehensive energy supply	Other	Total	Elimination	Consolidated
Operating revenues:							
Outside customers	¥ 946,612	¥15,930	¥ 8,754	¥ 40,503	¥1,011,799	¥ —	¥1,011,799
Intersegment	5,198	22,282	1,312	84,521	113,313	(113,313)	—
Total	951,810	38,212	10,066	125,024	1,125,112	(113,313)	1,011,799
Cost and expenses	832,469	36,872	9,546	120,756	999,643	(113,296)	886,347
Operating income	¥ 119,341	¥ 1,340	¥ 520	¥ 4,268	¥ 125,469	¥ (17)	¥ 125,452
Identifiable assets	¥2,412,777	¥81,905	¥16,889	¥240,278	¥2,751,849	¥(115,486)	¥2,636,363
Impairment of fixed assets	2,313	—	—	358	2,671	1,776	4,447
Depreciation expense	144,622	9,044	1,280	4,092	159,038	(1,571)	157,467
Capital expenditures	90,770	9,446	5,726	5,948	111,890	(2,234)	109,656

	Millions of yen						
	2004						
	Electric power	Information and tele-communications	Comprehensive energy supply	Other	Total	Elimination	Consolidated
Operating revenues:							
Outside customers	¥ 906,466	¥15,331	¥ 6,308	¥ 38,951	¥ 967,056	¥ —	¥ 967,056
Intersegment	2,691	22,227	1,261	68,683	94,862	(94,862)	—
Total	909,157	37,558	7,569	107,634	1,061,918	(94,862)	967,056
Cost and expenses	809,782	39,227	7,432	107,007	963,448	(95,978)	867,470
Operating income	¥ 99,375	¥ (1,669)	¥ 137	¥ 627	¥ 98,470	¥ 1,116	¥ 99,586
Identifiable assets	¥2,482,949	¥86,225	¥11,628	¥220,708	¥2,801,510	¥(89,134)	¥2,712,376
Depreciation expense	156,469	11,852	1,098	3,949	173,368	(1,581)	171,787
Capital expenditures	80,337	13,938	2,959	6,197	103,431	(5,022)	98,409

Geographic segment information is not shown due to the Company having no overseas consolidated subsidiaries.

Information for overseas sales of the Companies for the years ended March 31, 2006, 2005 and 2004 is not shown due to aggregate overseas sales being less than 10% of total operating revenues.

As a result of depreciating easements related to lands below transmission lines, which previously had been non-depreciable assets, from April 1, 2005 (Note 2), depreciation expense of the "Electric power" segment increased by ¥2,933 million (US$25,068 thousand) and operating income decreased by the same amount for the year ended March 31, 2006.

As a result of changing the method of provision for reprocessing of irradiated nuclear fuels (Note 2), cost of the "Electric power" segment increased by ¥8,714 million (US$74,479 thousand) and operating income decreased by the same amount for the year ended March 31, 2006.

As a result of changing the useful lives of assets of a consolidated subsidiary (Note 2), cost and expenses of the "Information and telecommunications" segment decreased by ¥2,810 million and operating income increased by the same amount for the year ended March 31, 2005.

15. Subsequent events

The following appropriations of retained earnings at March 31, 2006 were approved at the annual meeting of stockholders held on June 29, 2006:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends, ¥25 ($0.21) per share	¥9,111	$77,872
Bonuses to directors and statutory auditors	120	1,026

Independent Auditors' Report

To the Board of Directors of
The Chugoku Electric Power Co., Inc.

We have audited the accompanying consolidated balance sheets of The Chugoku Electric Power Co., Inc. and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended March 31, 2006, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Chugoku Electric Power Co., Inc. and subsidiaries as of March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

(1) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2004, The Chugoku Electric Power Co., Inc. and consolidated domestic subsidiaries adopted early the new accounting standard for impairment of fixed assets.
(2) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2005, The Chugoku Electric Power Co., Inc. commenced depreciating easements related to lands below transmission lines.
(3) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2005, The Chugoku Electric Power Co., Inc. changed the method of accounting for the provision for the reprocessing of irradiated nuclear fuel.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

KPMG AZSA & Co.

Hiroshima, Japan
June 29, 2006

Non-Consolidated Balance Sheets

The Chugoku Electric Power Co., Inc.
March 31, 2006 and 2005

Assets	Millions of yen 2006	Millions of yen 2005	Thousands of U.S. dollars (Note 1) 2006
Property:			
Plant and equipment	**¥5,432,111**	¥5,414,184	**$46,428,299**
Construction in progress	**171,075**	137,451	**1,462,180**
	5,603,186	5,551,635	**47,890,479**
Less—			
Contributions in aid of construction	**73,301**	72,393	**626,504**
Accumulated depreciation	**3,499,156**	3,391,623	**29,907,316**
	3,572,457	3,464,016	**30,533,820**
Net property (Note 5)	**2,030,729**	2,087,619	**17,356,659**
Nuclear fuel	**122,046**	121,060	**1,043,128**
Investments and other assets:			
Investment securities	**55,345**	46,628	**473,034**
Funds reserved for reprocessimg of irradiated nuclear fuel	**56,959**	—	**486,829**
Investments and advances to subsidiaries and affiliated companies (Note 3)	**28,574**	40,842	**244,222**
Long-term loans to employees	**1,543**	1,953	**13,188**
Deferred tax assets (Note 9)	**36,950**	38,939	**315,812**
Other assets	**14,039**	11,843	**119,992**
Total investments and other assets	**193,410**	140,205	**1,653,077**
Current assets:			
Cash and time deposits	**11,016**	13,491	**94,154**
Receivables, less allowance for doubtful accounts of ¥610 million ($5,214 thousand) in 2006 and ¥576 million in 2005	**48,965**	45,663	**418,504**
Inventories, fuel and supplies	**28,292**	20,543	**241,812**
Deferred tax assets (Note 9)	**9,461**	9,690	**80,863**
Other current assets	**9,413**	8,935	**80,453**
Total current assets	**107,147**	98,322	**915,786**
Total assets	**¥2,453,332**	¥2,447,206	**$20,968,650**

See accompanying notes.

Liabilities and Stockholders' Equity	Millions of yen 2006	2005	Thousands of U.S. dollars (Note 1) 2006
Long-term debt due after one year (Note 4)	**¥1,346,460**	¥1,253,353	**$11,508,205**
Other long-term liabilities due after one year	**5,728**	7,441	**48,957**
Employees' severance and retirement benefits	**50,586**	48,968	**432,359**
Reserve for reprocessing of irradiated nuclear fuel	**106,615**	102,064	**911,239**
Reserve for decommissioning of nuclear power generating plants	**46,240**	42,876	**395,214**
Current liabilities:			
Long-term debt due within one year (Note 4)	**77,358**	134,601	**661,179**
Short-term borrowings	**64,450**	85,950	**550,855**
Commercial paper	**32,000**	71,000	**273,504**
Accounts payable	**48,549**	36,780	**414,949**
Accrued income taxes	**20,212**	15,633	**172,752**
Accrued expenses	**37,963**	36,302	**324,470**
Other current liabilities (including other long-term liabilities due within one year)	**31,190**	42,233	**266,583**
Total current liabilities	**311,722**	422,499	**2,664,292**
Reserve for drought	**545**	2,458	**4,658**
Contingent liabilities (Note 7)			
Stockholders' equity (Note 10):			
Common stock			
Authorized—1,000,000,000 shares			
Issued—371,055,259 shares	**185,528**	185,528	**1,585,709**
Capital surplus	**16,691**	16,685	**142,658**
Retained earnings (Note 11)	**378,308**	366,407	**3,233,402**
Net unrealized holding gains on securities	**16,602**	10,411	**141,897**
Treasury stock (6,600,275 shares in 2006 and 6,509,313 shares in 2005)	**(11,693)**	(11,484)	**(99,940)**
Total stockholders' equity	**585,436**	567,547	**5,003,726**
Total liabilities and stockholders' equity	**¥2,453,332**	¥2,447,206	**$20,968,650**

Non-Consolidated Statements of Income

The Chugoku Electric Power Co., Inc.
For the years ended March 31, 2006, 2005 and 2004

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2006	2005	2004	**2006**
Operating revenues	**¥976,835**	¥956,690	¥912,813	**$8,349,017**
Operating expenses:				
Personnel	**122,008**	113,433	132,080	**1,042,803**
Fuel	**178,649**	128,076	100,058	**1,526,915**
Purchased power	**161,771**	154,910	134,488	**1,382,658**
Depreciation	**136,569**	144,622	156,469	**1,167,256**
Maintenance	**80,747**	92,717	86,261	**690,145**
Taxes other than income taxes	**61,556**	63,266	63,220	**526,120**
Purchased services	**33,732**	38,392	35,948	**288,308**
Other	**110,001**	101,513	104,850	**940,180**
	885,033	836,929	813,374	**7,564,385**
Operating income	**91,802**	119,761	99,439	**784,632**
Other expenses (income):				
Interest expense	**27,855**	36,727	36,771	**238,077**
Interest income	**(101)**	(61)	(82)	**(863)**
Loss on impairment of fixed assets (Note 5)	**12,590**	4,089	—	**107,607**
Other, net	**(1,452)**	4,325	1,556	**(12,411)**
	38,892	45,080	38,245	**332,410**
Income before special item and income taxes	**52,910**	74,681	61,194	**452,222**
Special item:				
Reserve for drought	**(1,913)**	1,747	712	**(16,350)**
Provision for income taxes:				
Current	**25,863**	25,061	28,457	**221,051**
Deferred	**(1,287)**	1,374	(7,504)	**(11,000)**
Net income	**¥ 30,247**	¥ 46,499	¥ 39,529	**$ 258,521**

	Yen			U.S. dollars
Per share data:				
Net income:				
Basic	**¥82.66**	¥127.18	¥107.62	**$0.71**
Diluted	**82.66**	127.18	107.62	**0.71**
Cash dividends applicable to the year	**50.00**	50.00	50.00	**0.43**

See accompanying notes.

Non-Consolidated Statements of Stockholders' Equity

The Chugoku Electric Power Co., Inc.
For the years ended March 31, 2006, 2005 and 2004

	Millions of yen					
	Shares of common stock	Common stock	Capital surplus	Retained earnings	Net unrealized holding gains on securities	Treasury stock
Balance at March 31, 2003	371,055,259	¥185,528	¥16,680	¥317,201	¥ 5,719	¥ (7,111)
Net income				39,529		
Cash dividends paid (¥50.00 per share)				(18,345)		
Bonuses to directors and statutory auditors				(120)		
Increase in unrealized holding gains on securities					3,310	
Treasury stock purchased, net						(3,998)
Balance at March 31, 2004	371,055,259	185,528	16,680	338,265	9,029	(11,109)
Net income				46,499		
Cash dividends paid (¥50.00 per share)				(18,237)		
Bonuses to directors and statutory auditors				(120)		
Surplus from sale of treasury stock			5			
Increase in unrealized holding gains on securities					1,382	
Treasury stock purchased, net						(375)
Balance at March 31, 2005	371,055,259	185,528	16,685	366,407	10,411	(11,484)
Net income				**30,247**		
Cash dividends paid (¥50.00 per share)				**(18,226)**		
Bonuses to directors and statutory auditors				**(120)**		
Surplus from sale of treasury stock			**6**			
Increase in unrealized holding gains on securities					**6,191**	
Treasury stock purchased, net						**(209)**
Balance at March 31, 2006	**371,055,259**	**¥185,528**	**¥16,691**	**¥378,308**	**¥16,602**	**¥(11,693)**

	Thousands of U.S. dollars (Note1)				
	Common stock	Capital surplus	Retained earnings	Net unrealized holding gains on securities	Treasury stock
Balance at March 31, 2005	$1,585,709	$142,607	$3,131,684	$ 88,983	$(98,154)
Net income			**258,521**		
Cash dividends paid ($0.43 per share)			**(155,778)**		
Bonuses to directors and statutory auditors			**(1,025)**		
Surplus from sale of treasury stock		**51**			
Increase in unrealized holding gains on securities				**52,914**	
Treasury stock purchased, net					**(1,786)**
Balance at March 31, 2006	**$1,585,709**	**$142,658**	**$3,233,402**	**$141,897**	**$(99,940)**

See accompanying notes.

Notes to Non-Consolidated Financial Statements

The Chugoku Electric Power Co., Inc.

1. Basis of presenting non-consolidated financial statements

The accompanying financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, the Electricity Utilities Industry Law and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accompanying non-consolidated financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of stockholders' equity) from the non-consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language non-consolidated financial statements, but not required for fair presentation is not presented in the accompanying financial statements.

The translation of the Japanese yen amounts into U.S. dollars are included solely for the convenience of the readers outside Japan, using the prevailing exchange rate on March 31, 2006, which was ¥117 to U.S.$1.00.

The convenience translations should not be construed as representations that the Japanese yen amounts have been, could have been, or could in the future be converted into U.S. dollars at this or any other rate of exchange.

2. Significant accounting policies

The following is a summary of the significant accounting policies used in the preparation of the annual non-consolidated financial statements.

Inventories, fuel and supplies

Fuel and supplies are stated at cost, determined principally by the weighted average method.

Securities

Equity securities issued by subsidiaries and affiliated companies are stated at moving-average cost. Available-for-sale securities with available fair market values are stated at fair market value. Unrealized gains and losses on these securities are reported, net of applicable income taxes, as a separate component of stockholders' equity. Realized gains and losses on the sale of such securities are computed using the moving-average cost. Other securities with no available fair market value are stated at moving-average cost.

If the market value of equity securities issued by subsidiaries and affiliated companies and available-for-sale securities declines significantly, such securities are stated at fair market value and the difference between the fair market value and the carrying amount is recognized as a loss in the period of the decline. If the fair market value of equity securities issued by subsidiaries and affiliated companies is not readily available, such securities should be written down to net asset value with a corresponding charge in the non-consolidated statement of income in the event net asset value declines significantly. In these cases, such fair market value or the net asset value will be the carrying amount of the securities at the beginning of the next year.

Property and depreciation

Property is principally stated at cost, which includes interest on borrowed funds during construction, in accordance with rules established by the regulatory authorities. Contributions in aid of construction are deducted from the cost of the related assets when computing depreciation.

Depreciation is computed using the declining-balance method, based on the estimated useful lives of the respective assets in accordance with the corporation tax law.

Easements related to lands below transmission lines, which had previously been non-depreciable assets, are depreciated on the straight-line method commencing in the year ended March 31, 2006. As a result, operating income decreased by ¥2,933 million (US$25,068 thousand) and income before income taxes decreased by ¥2,934 million (US$25,077 thousand) for the year ended March 31, 2006.

Accounting for the impairment of fixed assets

For the year ended March 31, 2005, the Company adopted early the new accounting standard for impairment of fixed assets ("Opinion Concerning Establishment of Accounting Standard for Impairment of Fixed Assets" issued by the Business Accounting Deliberation Council on August 9, 2002) and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No.6 issued by the Accounting Standards Board of Japan on October 31, 2003).

As a result of the new accounting standard for impairment of fixed assets, income before income taxes decreased by ¥4,089 million for the year ended March 31, 2005.

Nuclear fuel and amortization

Nuclear fuel is stated at cost less amortization. The amortization of nuclear fuel is computed based on the quantity of heat produced for generation of electricity.

Allowance for doubtful accounts

The allowance for doubtful accounts is provided in an amount sufficient to cover possible losses on collection. It consists of the estimated uncollectible amount with respect to identified doubtful receivables and an amount calculated based on the Company's historical loss rate with respect to remaining receivables.

Severance and retirement benefits

Under the terms of the Company's retirement plan, all employees are entitled to a lump-sum payment at the time of retirement. If the termination is made voluntarily at one of a number of specified ages, the employee is entitled to certain additional payments.

The Company has also adopted a non-contributory funded pension plan which provides a part of total retirement benefits for employees with 20 years or more of service and who have reached age 55 or more.

Prior to April 1, 2003, the Company had a tax-qualified retirement pension plan to cover a certain portion of its employees' retirement benefit plans. In March 2004, however, the Company revised its rules related to retirement benefit and pension plans to mitigate the effect of the retirement benefit and pension plans on the corporate accounts, stably maintain and operate these plans for a long time period, and properly reflect employees' capabilities and achievements. Elements of the revised rules applying from April 1, 2004, are as follows:

- The Company shifted from a qualified retirement pension plan to a cash balance plan, which is a hybrid pension plan based on variable interest rates, enabling the Company to flexibly respond to market interest rate fluctuations. As the related rules were revised in March 2004, retirement benefit obligations and other items for year ended March 31, 2004, were computed based on the new plan.
- A part of the current lump-sum retirement benefit plan was shifted to an optional system, under which the employees may choose a defined contribution pension plan or a prepayment plan.

The liabilities and expenses for severance and retirement benefits are determined based on the amounts actuarially calculated using certain assumptions.

The Company provides for employees' severance and retirement benefits based on the estimated amounts of projected benefit obligation and the fair value of the plan assets.

Prior service costs are recognized in expenses as they arise. Actuarial gains and losses are recognized in expenses using a straight-line basis over 5 years which is within the average of the estimated remaining service period commencing with the following period.

Retirement benefits to directors and statutory auditors are charged to income when approved at the stockholders' meeting.

Provision for reprocessing of irradiated nuclear fuel

A provision for reprocessing of irradiated nuclear fuel, is provided at the present value amount equivalent to the expense of the reprocessing of irradiated nuclear fuel.

Prior to April 1, 2005, the annual provision for the costs of reprocessing irradiated nuclear fuel was calculated to state the related reserve at 60% of the amount that would be required to reprocess all of the irradiated nuclear fuel in accordance with the regulatory authority.

Effective April 1, 2005, the Company adopted a revised accounting standard for provision for reprocessing of irradiated nuclear fuel. The composition of the back-end costs such as decommissioning costs of reprocessing facilities was estimated in the report published in August 2004 by the Ministry of Economy, Trade and Industry and electric utility providers have been able to estimate liabilities related to such decommissioning costs of reprocessing facilities. In accordance with the changes in the accounting rules applicable to electric utility providers in Japan, the provision is stated at present value of the amount that would be required to reprocess the irradiated nuclear fuel with definite plans for reprocessing.

AS a result, compared with the former method, operating expenses increased by ¥8,714 million ($74,479 thousand) and operating income and income before income taxes and decreased by the same amount for the year ended March 2006.

In addition, the difference of ¥59,307 million (US$506,897 thousand) due to the change in estimating costs of reprocessing of irradiated fuel at March 31, 2005, is included in operating expenses equally over 15 years from April 1, 2005.

Also, estimated liabilities related to past generation which were estimated by using assumptions, such as discount rate, were ¥3,093 million (US$26,436 thousand) on March 31, 2006. This will be amortized over the periods of generating of irradiated nuclear fuels for which there are concrete reprocessing plans from the next period. The annual amortization is presented as operating expenses in the income statement.

However, 15 tons out of 26 tons of irradiated nuclear fuel which was derived during this period is not covered with reserves because there is no definite reprocessing plan and accurate estimation is not possible.

In May 2005, Law on the Creation and Management of Reserve Funds for the Reprocessing of Spent Fuel at Nuclear Fuel at Nuclear Power Stations was issued and the independent fund managing body was set up. According to the new law, the Company contributed to the Reserve Funds in the year ended March 31, 2006. The contributed amounts consisted of the amounts as provision for reprocessing of nuclear fuel and the unfunded parts of reprocessing costs for the irradiated nuclear fuel which was derived before April 2005 and in the year ended March 31, 2006. Under the related regulation, the Company is permitted to recover the reprocessing costs through wheeling charges and compensate unfunded portion within 15 years.

Provision for decommissioning of nuclear power plants

In accordance with the provisions of the Accounting Regulations of the Electric Power Industry, the Company provides for the reserve for decommissioning of nuclear power plants by charging to income periodically the future decommissioning costs of nuclear power plants.

The provision is made based on such factors as the estimated total decommissioning costs and the (actual and estimated) total volume of nuclear power generation.

Provision for drought

The Company is required, under certain conditions, to set up a provision for drought under the Electricity Utilities Industry Law to stabilize its income position for variations in water levels.

Accounting for certain lease transactions

Finance leases which do not transfer ownership to lessees are accounted for in the same manner as operating leases.

Derivatives and hedge accounting

The Company states derivative financial instruments at fair value and recognizes changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes.

If derivative financial instruments are used as hedges and meet certain hedging criteria, the Company defers recognition of gains or losses resulting from changes in fair value of derivative financial instruments until the related losses or gains on the hedged items are recognized.

However, in cases where forward foreign exchange contracts are used as hedges and meet certain hedging criteria, forward foreign exchange contracts is hedged items are accounted for in the following manner:

If a forward foreign exchange contract is executed to hedge a future transaction denominated in a foreign currency and meets certain hedging criteria, the future transaction will be recorded using the contracted forward rate, and no gain or loss on the forward foreign exchange contract is recognized. In this case, assessment of hedge effectiveness is not necessary.

Also, if interest rate swap contracts are used as hedges and meet certain hedging criteria, the net amount to be paid or received under the interest rate swap contract is added to or deducted from the interest on the assets or liabilities for which the swap contract was executed. In this case, assessment of hedge effectiveness is not necessary.

If commodity swap contracts are used as hedges and meet certain hedging criteria, the gain or loss is deferred until the gain or loss on the hedged item is recognized. In this case, hedge effectiveness is assessed based on the extent of correlation in recent years using statistical methods at the inception of the hedge, and by comparing the cumulative changes in fair value on an ongoing basis at each period-end. Commodity swap contracts that do not qualify as hedges are stated at current value and unrealized gains or losses are recognized in the statements of income.

Bond issue expenses

Bond issue expenses are charged to income when paid or incurred.

Income taxes

The Company uses the asset and liability approach to recognize deferred tax assets and liabilities for loss carry forwards and the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Foreign currency translation

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the year-end rate.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2006 presentation. These changes had no impact on previously reported results of operations or shareholders' equity.

Consolidated tax system

In the year ended March 31, 2005, the Company introduced the consolidated tax system.

3. Securities

Disclosure of market value information of securities, except for investments in subsidiaries and affiliates, with readily available market values at March 31, 2006, is required only in consolidated financial basis.

Book values and fair values of equity securities issued by affiliated companies with available fair values as of March 31, 2006 and 2005 were as follows:

	Millions of yen						Thousands of U.S. dollars		
	Book value		Fair value		Difference		Book value	Fair value	Difference
	2006	2005	**2006**	2005	**2006**	2005		**2006**	
Equity securities of affiliated companies	**¥2,493**	¥2,493	**¥50,941**	¥44,725	**¥48,448**	¥42,232	**$21,308**	**$435,393**	**$414,085**

4. Long-term debt

Long-term debt at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Domestic bonds due through 2029 at rates of 0.58% to 4.1%	**¥ 815,000**	¥ 845,000	**$ 6,965,812**
Loans from the Development Bank of Japan due through 2023 at rates of 0.75% to 4.95%	**230,319**	243,038	**1,968,538**
Unsecured loans, principally from banks and insurance companies, due through 2032 at rates of 0.10% to 6.45%	**378,499**	299,916	**3,235,034**
	1,423,818	1,387,954	**12,169,384**
Less amounts due within one year	**(77,358)**	(134,601)	**(661,179)**
Total	**¥1,346,460**	¥1,253,353	**$11,508,205**

All bonds and loans from the Development Bank of Japan are secured by a statutory preferential right which gives the creditors a security interest in all assets of the Company senior to that of general creditors.

The annual maturities of long-term debt at March 31, 2006 were as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 77,358	$ 661,179
2008	138,590	1,184,530
2009	119,913	1,024,897
2010	128,071	1,094,624
Thereafter	959,886	8,204,154

5. Impairment loss on fixed assets

Since all of the properties currently being used for the electric power generation business are providing cash flows, they are considered one property group. The fixed assets currently used for other businesses are considered separately. In addition, since there are no signs of decreases in the cash flows of these property groups, no loss was recognized in the year ended March 31, 2006.

For the year ended March 31, 2005, the Company recognized impairment losses on fixed assets which consisted of the following:

Year ending March 31	Millions of yen
Construction in progress	¥2,313
General facilities	1,776
Total	¥4,089

Impairment losses relating to "construction in progress" with uncertain future cash flows was recognized by individual project. Impairment losses relating to "general facilities" are grouped within respective areas because these assets are supplemental in terms of generating cash flows. The Company determines if assets are impaired by comparing their undiscounted expected future cash flows to their carrying amounts in the accounting records. The Company recognizes impairment losses if the undiscounted expected future cash flows are less than the carrying amount of the asset.

Recoverable amounts were measured by the respective net selling prices. The selling prices were based primarily on appraisal valuation.

6. Leases

(As lessee)

The Company leases certain equipment for business use including heating power equipment, nuclear power equipment and other assets.

Lease payments under non-capitalized finance leases amounted to ¥1,105 million (US$9,444 thousand), ¥994 million and ¥911 million for the years ended March 31, 2006, 2005 and 2004, respectively.

The present values of future minimum lease payments under non-capitalized finance leases and future minimum lease payments under operating leases as of March 31, 2006 and 2005 were as follows:

	Millions of yen				Thousands of U.S. dollars	
	Finance leases		Operating leases		Finance leases	Operating leases
	2006	2005	**2006**	2005	**2006**	
Current portion	**¥ 979**	¥ 827	**¥228**	¥386	**$ 8,367**	**$1,949**
Non-current portion	**1,572**	1,396	**70**	173	**13,436**	**598**
Total	**¥2,551**	¥2,223	**¥298**	¥ 559	**$21,803**	**$2,547**

7. Contingent liabilities

At March 31, 2006, the Company was contingently liable as guarantor for loans of other companies and employees in the amount of ¥167,715 million (US$1,433,462 thousand), mainly in connection with the Company's procurement of fuel.

At the same date, the Company was also contingently liable with respect to certain domestic bonds, which were assigned to certain banks under debt assumption agreements in the aggregate amount of ¥5,000 million (US$42,735 thousand).

8. Research and development expenses

Research and development expenses charged to operating expenses were ¥6,354 million (US$54,308 thousand), ¥8,068 million and ¥8,386 million for the years ended March 31, 2006, 2005 and 2004, respectively.

9. Income taxes

Significant components of the Company's deferred tax assets and liabilities as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Severance and retirement benefits	**¥14,699**	¥10,858	**$125,632**
Excess depreciation	**12,790**	12,392	**109,316**
Future reprocessing costs of irradiated nuclear fuel	**5,660**	4,742	**48,376**
Loss on revaluation of investments in affiliate	**4,590**	—	**39,231**
Future decommissioning costs of nuclear power generating plants	**4,288**	4,288	**36,650**
Accrued bonuses and other expenses	**4,115**	4,028	**35,171**
Amortization of deferred charges	**3,740**	4,287	**31,966**
Accrued defined contribution pension	**2,306**	3,554	**19,709**
Other	**10,607**	11,719	**90,658**
Total gross deferred tax assets	**62,795**	55,868	**536,709**
Less, valuation allowance	**(6,834)**	(1,199)	**(58,410)**
Total deferred tax assets	**55,961**	54,669	**478,299**
Deferred tax liabilities:			
Unrealized holding gains on securities	**(9,400)**	(5,894)	**(80,342)**
Other	**(150)**	(146)	**(1,282)**
Total deferred tax liabilities	**(9,550)**	(6,040)	**(81,624)**
Net deferred tax assets	**¥46,411**	¥48,629	**$396,675**

10. Stockholders' equity

Under the Commercial Code of Japan, the entire amount of the issue price of shares is required to be accounted for as capital, although a company may, by resolution of its Board of Directors, account for an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

The Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal earnings reserve until the total amount of earnings reserve and additional paid-in capital equals 25% of common stock. The total amount of legal earnings reserve and additional paid-in capital of the Company has reached 25% of common stock, and therefore the Company is not required to provide any more legal earnings reserve. The legal earnings reserve and additional paid-in capital may be used to eliminate or reduce a deficit by resolution of the shareholders' meeting or may be capitalized by resolution of the Board of Directors. On condition that the total amount of legal earnings reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for distribution by the resolution of shareholders' meeting. Legal earnings reserve is included in retained earnings in the accompanying financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Commercial Code.

11. Subsequent events

The following appropriations of retained earnings at March 31, 2006 were approved at the annual meeting of stockholders held on June 29, 2006:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
Year-end cash dividends, ¥25 ($0.21) per share	¥9,111	$77,872
Bonuses to directors and statutory auditors	120	1,026

Independent Auditors' Report

To the Board of Directors of
The Chugoku Electric Power Co., Inc.

We have audited the accompanying non-consolidated balance sheets of The Chugoku Electric Power Co., Inc. as of March 31, 2006 and 2005, and the related non-consolidated statements of income and stockholders' equity for each of the three years in the period ended March 31, 2006, expressed in Japanese yen. These non-consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these non-consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the non-consolidated financial statements referred to above present fairly, in all material respects, the non-consolidated financial position of The Chugoku Electric Power Co., Inc. as of March 31, 2006 and 2005, and the non-consolidated results of its operations for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following.

(1) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2004, The Chugoku Electric Power Co., Inc. and consolidated domestic subsidiaries adopted early the new accounting standard for impairment of fixed assets.

(2) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2005, The Chugoku Electric Power Co., Inc. commenced depreciating easements related to lands below transmission lines.

(3) As discussed in Note 2 to the consolidated financial statements, effective April 1, 2005, The Chugoku Electric Power Co., Inc. changed the method of accounting for the provision for the reprocessing of irradiated nuclear fuel.

The U.S. dollar amounts in the accompanying non-consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the non-consolidated financial statements.

KPMG AZSA & Co.

Hiroshima, Japan
June 29, 2006

Major Subsidiaries and Affiliated Companies

(As of July 1, 2006)

Name	Capital (Millions of yen)	Chugoku Electric's Ownership (%)	Business
CHUDEN KOGYO CO., LTD.*	¥77	100.0	Manufacturing of electrical equipment and painting materials, painting, construction
CHUDEN PLANT CO., LTD.*	¥200	100.0	Construction of power facilities
CHUGOKU INSTRUMENTS CO., INC.*	¥30	100.0	Assembly and repair of electric power meters
CHUGOKU KIGYO CO., INC.*	¥104	100.0	Realty and leasing
The Chugoku Electric Manufacturing Company, Incorporated*	¥150	100.0	Manufacturing of electric machine tools
CHUDEN KANKYO TECHNOS CO., LTD.*	¥50	100.0	Operation and management of thermal power station equipment
Energia Communications, Inc.*	¥6,000	100.0	Type 1 telecommunications business, data processing
EnerGia Business Service Co., Inc.*	¥490	100.0	Financial services for the Group, accounting and personnel-related services
Energia Solution & Service Company, Incorporated*	¥4,653	100.0	Fuel supply, energy utilization
EnerGia Real Estate Co., Inc.*	¥295	100.0	Housing sales, rental business
EnerGia Eco Materia Company, Incorporated*	¥300	100.0	Processing and marketing of products made of coal ash and powdered limestone
OZUKI STEEL INDUSTRIES CO., LTD.*	¥50	80.0	Manufacturing of cast steel products
CHUDEN ENGINEERING CONSULTANTS CO., LTD.*	¥100	80.0	Civil engineering and construction consulting
EnerGia Life & Access Co., Inc.*	¥65	77.7	Water heater sales, manufacture of power distribution materials
Power Engineering and Training Services, Incorporated*	¥400	72.0	Training in thermal power generation technology, engineering
The Energia Logistics Co., Inc.*	¥40	70.0	Logistics, electric cable drum leasing
International Standard Management Center Inc.*	¥100	66.0	Inspection of quality control and environmental management system
EnerGia Nuclear Technology Co., Inc.*	¥100	60.0	Maintenance and engineering of nuclear power stations
TEMPEARL INDUSTRIAL CO., LTD.*	¥150	56.0	Manufacturing of electric machine tools
CHUGOKU KOATSU CONCRETE INDUSTRIES CO., LTD.*	¥150	44.5	Manufacturing of concrete products
SANKO INC.*	¥30	46.7	Printing, advertising
Houseplus Chugoku Housing Warranty Corporation Limited*	¥50	35.6	Functional evaluation and warranty for housing
EnerGia Care Service Co., Inc.*	¥78	33.3	Management of a nursing home, daycare services, home nursing care services
EnerGia Human Resource Solutions Co., Inc.*	¥60	30.0	Personnel dispatching business
Setouchi Joint Thermal Power Co., Ltd.** (Note 1)	¥5,000	50.0	Thermal power generation
CHUGOKU HEALTH AND WELFARE CLUB CO., INC.**	¥50	50.0	Welfare agency services
MIZUSHIMA LNG COMPANY, LIMITED**	¥200	50.0	LNG station management
CHUDENKO CORPORATION**	¥3,481	37.4	Electrical and telecommunications engineering
MIZUSHIMA LNG SALES COMPANY, LIMITED**	¥175	40.0	LNG and natural gas sales
Hiroshima Cable Television Corp.** (Note 2)	¥1,200	34.9	Cable television broadcasting
EAML Engineering Company Limited**	¥50	18.0	Manufacturing of instruments for hydroelectric power generation
Bab-Hitachi & Energia Allied Techno-Research Co., Ltd.**	¥40	5.0	Dioxin measurement and analysis

* Consolidated subsidiary
** Affiliated company accounted for by the equity method

Notes: 1. Fukuyama Joint Thermal Power Co., Ltd., and Mizushima Joint Thermal Power Co., Ltd., merged on July 1, 2006, and the merged entity changed its name to Setouchi Joint Thermal Power Co., Ltd.
2. Hiroshima City Cable Television Co., Ltd., and Hiroshima Cable Vision Co., Ltd., merged on April 1, 2006, and the merged entity changed its name to Hiroshima Cable Television Corp.

Corporate Data

(As of March 31, 2006)

DATE OF ESTABLISHMENT: May 1, 1951

PAID-IN CAPITAL: ¥185,528 million

NUMBER OF EMPLOYEES: 10,674

LOCATIONS:

Head Office
4-33, Komachi, Naka-ku, Hiroshima 730-8701, Japan
Tel: +81-82-241-0211 Fax: +81-82-523-6185

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Tokyo Office
8-2, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-0005, Japan
Tel: +81-3-3201-1171 Fax: +81-3-3212-1067

NUMBER OF USERS

	(Thousands)
Residential (lighting)	4,605
Industrial and commercial*	578
Total*	5,183

*Excludes power consumption by the liberalized sector.

SUPPLY INFRASTRUCTURE

Power Stations

	Number of Facilities	Generating Capacity (MW)
Hydroelectric	95	2,894
Thermal	12	8,026
Nuclear	1	1,280
Total	108	12,200

Transmission Lines (Total Length): 8,137 kilometers

Number of Substations: 444

Distribution Lines (Total Length): 80,759 kilometers

Investor Information

(As of March 31, 2006)

INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS:
KPMG AZSA & Co.

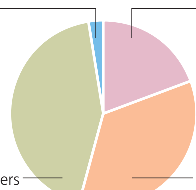
TRANSFER AGENT AND REGISTRAR:
The Sumitomo Trust & Banking Co., Ltd.

SECURITIES TRADED:
Tokyo Stock Exchange, Osaka Securities Exchange

NUMBER OF STOCKHOLDERS:
160,997

COMMON STOCK ISSUED:
371,055,259 shares

DISTRIBUTION OF COMMON STOCK ISSUED:



*Thousands of shares

MAJOR STOCKHOLDERS

Name	Number of shares held (thousands)	Percentage (%)
Yamaguchi Pref. Shinko Zaidan	49,505	13.34
Nippon Life Insurance Company	23,148	6.24
The Master Trust Bank of Japan, Ltd. (Trust account)	15,983	4.31
Japan Trustee Services Bank, Ltd. (Trust account)	15,357	4.14
The Sumitomo Trust & Banking Co., Ltd.	7,386	1.99
The Dai-ichi Mutual Life Insurance Company	6,054	1.63
Mizuho Corporate Bank, Ltd.	5,801	1.56
Company's stock investment	5,447	1.47
The Hiroshima Bank, Ltd.	5,092	1.37
The San-In Godo Bank, Ltd.	4,297	1.16

STOCK PRICE RANGE ON THE TOKYO STOCK EXCHANGE

Fiscal year	High (yen)	Low (yen)
2006 1st quarter	2,175	1,959
2nd quarter	2,390	2,120
3rd quarter	2,335	2,205
4th quarter	2,640	2,285
2007 1st quarter	2,520	2,205

The Chugoku Electric Power Co., Inc.

4-33, Komachi, Naka-ku, Hiroshima 730-8701, Japan
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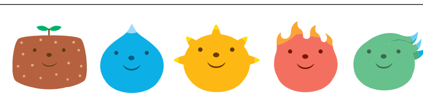
Friends from the Land of Energia



The ideal of the Chugoku Electric Group is to make the world of Energia—a fresh, bright, and warm society, powered by energy and brimming with vitality—a reality. To achieve a better understanding of this ideal among our customers, we have created a visual representation of the image fostered by Energia—namely, coexistence with the earth, which is the mother of energy—by combining a character called a light fairy (symbolizing electricity) with characters representing the terrestrial spirits residing in the earth (a ground fairy, water fairy, fire fairy, and sky fairy). We utilize these characters in our corporate communications.

Printed in Japan

This annual report was printed on recycled paper with soy ink.