

PRINCIPAL OPERATIONS OF THE CHUGOKU BANK GROUP

Chugoku Bank Group, which comprises the Bank along with nine subsidiaries and one affiliate, is positioned to offer a wealth of financial services, including corporate and personal banking, leasing and investment advisory businesses, and more.

Organizational Chart for the Chugoku Bank Group

		Business segment
The Chugoku Bank, Limited		Banking business
<ul style="list-style-type: none"> — Domestic offices: Head office, 170 branch offices, 9 sub-branch offices. — Overseas offices: 2 branch offices and 2 representative offices 		
Consolidated subsidiaries		
Chugin Business Service Company, Limited.	Consigned administrative operations for banks	
Chugin System Development Company, Limited.	Software business	
The Chugin Credit Guarantee Co., Ltd.	Credit guarantee business	
The Chugin Card Company, Limited.	Credit card business	
The Chugin Computer Service Co., Ltd.	Software business	
The Chugin Lease Company, Limited.	Leasing and financing business	
The Chugin Investment Management Company, Limited.	Investment advisory business	
The Chugin Operation Center, Co., Ltd.	Deposits, Bank Remittance, and Valuation of Collateralized Real Estate	
Unconsolidated subsidiary		
The Kibi Enterprise Company, Limited.	Life insurance agency	
Affiliated company		
The Okayama Prepaid Card Co., Ltd.	Prepaid-card business	

(March 31, 2002)



REVIEW OF OPERATIONS

Performance

We have striven to develop our business activities with close attention to community needs, as well as further strengthen our financial structure by implementing our primary precept of “self-reform to achieve mutual prosperity with our community,” based on the principles of our mid-term business plan, Powerful Step 21. The following is a summary of the highlights of our business performance resulting from these efforts.

Loans and bills discounted

We have conducted business activities tailored to the needs of our community, but loans to corporations have declined due to the ebb in corporate fund demand and further corporate restructuring. Loans to individual customers and local governments boosted our loan portfolio to rise ¥285.5 billion from the end of the previous year to ¥3,217.8 billion as of the end of the year under review.

Deposits

With the prevailing environment of extremely low interest rates nationwide, we have made every effort to increase the amount of assets deposited with us by our customers to respond to their diversifying fund allocation needs. In addition to ordinary deposits, these assets include negotiable certificates of deposits, investment trusts, and government securities. As a result, our balance of deposits during the year under review rose by ¥159.9 billion to ¥4,694.0 billion. Broken down by component, there was a ¥15.4 billion increase to ¥132.0 billion in negotiable certificates of deposits during the same period, as well as a ¥22.3 billion rise in investment trust funds to ¥42.0 billion. The balance of government securities and other assets entrusted to us rose ¥75.2 billion to ¥102.0 billion, and the total of all assets entrusted to us rose ¥272.9 billion to ¥4,970.0 billion

Securities

As interest rates in Japan continue to be exceptionally low, we have increased our securities portfolio as part of our efforts to diversify and make our fund investment more efficient. Our securities portfolio stood at ¥1,581.6 billion as of the end of the year under review, an increase of ¥267.3 billion from the year before.

Though there was a sharp decline from the previous year in our cash and due from banks and call loans during the year under review, there was also a significant increase in securities and loans and bills discounted during the same period. Therefore, our consolidated total assets stood at ¥5,436,334 million at the end of the year, representing a 4.2% year-on-year rise of ¥218,349 million.

Earnings

Operating revenue slid ¥2,350 million from the year before, or down 1.8%, to ¥127,502 million at the end of the term. Additionally, recurring profit fell ¥6,975 million in the same period, or 37.7%, to ¥11,510 million due to the write-off of evaluation losses on securities caused by plunging stock prices. In contrast, our net income climbed ¥223 million, or 3.9% from the year before, to ¥5,878 million, as we no longer had the expense related to the change

in accounting standards for retirement benefits, as there were last year.

Broken down by segment, operating revenue from banking operations fell ¥2,401 million, or down 2.1% from the previous year, to ¥109,859 million. Further, recurring profit plummeted ¥7,193 million from the previous year, a 41.3% decline, to ¥10,236 million, which mainly resulted from the write-off of shares. In our leasing business, we posted a 9.6% increase of ¥101 million in recurring profit from the year before to ¥1,155 million, on a ¥114 million decline in operating revenue, or down 0.6%, to ¥18,526 million. In our securities consulting business, operating revenue rose ¥107 million, a 110.3% year-on-year increase, to ¥204 million, primarily from the sale of stock. Our recurring profit in this category soared six times over year-before figures, or ¥107 million, to stand at ¥126 million.

Cash Flow

Our cash and cash equivalents at the end of the term under review totaled ¥86,048 million, a climb of ¥9,994 million from the year before, as a result of our aggressive sales activities.

Cash flow from operating activities

There was a net inflow of ¥292,763 million in our cash flow from operating activities during the year under review, due to the decline in funds used for short-term investments and other factors. This was an increase of ¥251,490 million from the year before.

Cash flow from investing activities

Our cash flow from investing activities during the year under review had a net outflow of ¥281,033 million, due to increased securities investment, down ¥139,113 million from the previous year.

Cash flow from financing activities

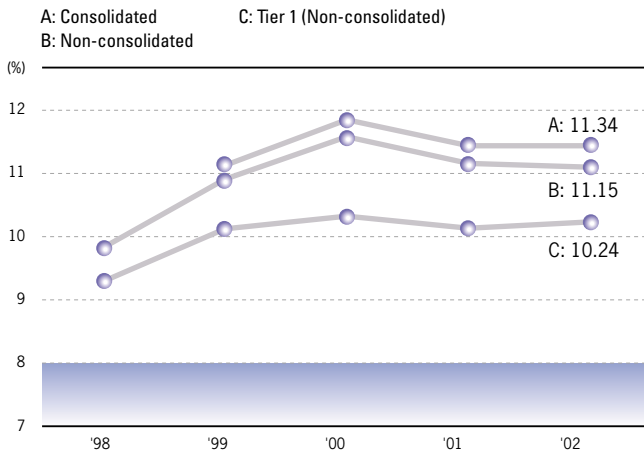
We posted a net outflow of ¥1,746 million in our cash flow from financing activities, a year-on-year increase of ¥321 million. We offered a 1.2 for one stock split in November 2000, and we maintained our dividend. Therefore, there was actually higher cash dividend in total.

Forecast for Next Term

Our forecasts for the performance of the Chugoku Bank and the consolidated group for Fiscal 2002 ending March 31, 2003 are based on the assumption of declining income against a backdrop of lower income from the yield on securities due to the continuation of extremely low interest rates. They call for consolidated recurring income of ¥114.0 billion on recurring profit of ¥14.3 billion and net income of ¥7.6 billion.

Capital Adequacy Ratios

Our capital adequacy ratio as of the end of the year under review was 11.15% on a non-consolidated basis and 11.34% on a consolidated basis. Both figures far exceed standard values. In the basic Tier 1 category of capital, reserves, and surplus, which omits the differences in security valuation affected by volatility at the end of the business year, the ratio was 10.24% on a non-consolidated basis and 10.40% on a consolidated basis, both high levels.



Risk-Managed Loans

Status of impaired loans

Consolidated	¥ millions	
	End of March 2002	End of March 2001
Loans to bankrupt customers	24,340	38,059
Loans past due six months or more	53,052	39,893
Loans past due three months or more	725	815
Restructured loans	35,915	42,428
Total	114,032	121,195
Total loan balance (ending balance)	3,217,823	2,932,259

Loans to bankrupt customers

These are loans which were designated as non-accrual loans according to the tax Law. These are loans to companies that have applied under the procedures for the Stock Company Reorganization and Rehabilitation Act or the Bankruptcy Act or the Composition Act or companies whose activities have been suspended by the Clearinghouse.

Loans in default (past due six months or more)

These are loans which were designated as non-accrual loans according to the tax Law, but not included in loans to bankrupt customers. These loans are past due six months or more.

Loans past due three months or more

These comprise loans for which neither principal nor interest has been paid for three months or more after the day following the contracted date, and which do not fall into either of the two categories defined above.

Restructured loans

These comprise loans on which terms have been renegotiated to the benefit of the customer (e.g., interest has been waived, interest or principal payments have been postponed, or a portion of the debt has been forgiven), in order to support the restructuring of customers in economic difficulties and thus secure some return on the obligation.

Ratings

Chugoku Bank has obtained one of the best ratings among Japanese banks by Moody's, a world-renowned rating agency. This is proof that the Bank firmly maintains an excellent operating position and sound financial constitution.

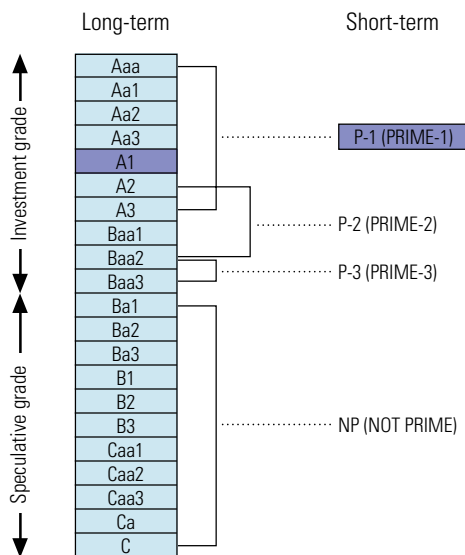
Ratings

(End of June 2002)

Moody's	
Long-term deposit rating	A1
Short-term deposit rating	P-1
Bank financial strength rating	C+

Rating symbols and gradations (Moody's)

* Long-term/short-term ratings



* Bank financial strength ratings

A
A-
B+
B
B-
C+
C
C-
D+
D
D-
E+
E

Compensatory Payoffs for Deposits

In April 2002, the lifting of restrictions on compensatory payoffs for deposits of failed financial institutions ended the special measures for protecting the full amount of deposits. In the event of a financial institution's insolvency, the return of only ¥10 million of the principal and the interest on that amount would be guaranteed to an individual depositor.

In addition to ensuring sound business operations in the future, we will further strengthen our earnings capacity. We will actively and appropriately provide information on these results to respond to customer trust.

RISK MANAGEMENT SYSTEM

Compliance System Overview

Compliance means observing laws and in-house regulations as well as the norm of conducts of society.

The Chugoku Bank is aware of its social responsibilities and public mission as a bank. We have been strengthening our compliance activities, regarding them essential to maintain customer and shareholder trust.

In this respect, we have established Chugoku Bank's Corporate Standards of Conduct and Activity Guidelines for Bank Employees. The Corporate Standards of Conduct stipulate general rules regarding ethical practices associated with corporate management and business operations, while the Activity Guidelines for Bank Employees define rules and regulations each bank employee must observe. Besides, we have established the Compliance Committee and appointed an official responsible for implementing legal compliance in each division and sales office. Every year we formulate a Compliance Program, an action plan for compliance activities, and verify our achievements in the Program.

In April 2001, we established Solicitation Policies for financial instruments, aiming to conduct appropriate solicitation activities to our customers and give full explanation about their contracts with us. We spare no effort to satisfy various requests from our customers, local communities, and shareholders, with an emphasis on observing legal compliance.

Risk Management System

Comprehensive risk management

As financial deregulation and globalization continue to spread, it has been increasingly important for a bank to identify and effectively manage the many complex risks associated with day-to-day operations.

Chugoku Bank regards risk management as one of the most important objectives we need to achieve. We, therefore, conduct a well-balanced business operation by bolstering our earning power while maintaining sound operations through comprehensive risk management.

The Bank's Department of Corporate Planning has responsibility for conducting risk management throughout the Bank, while other sections for risk management exert their efforts to enhance their capability to manage specific risks under their respective jurisdictions.

The Bank also conducts internal inspections in order to avoid administrative and other operational risks. Our Inspection Department conducts in-store inspections for all sales outlets, including overseas branch offices, Chugoku Bank's headquarters, and affiliated companies. It also ensures compliance with various laws, regulations, and manuals, while monitoring various risk management activities. In addition, we regulate periodic inspections at sales outlets to prevent errors and accidents in our daily operations.

Credit risk management

Credit risk accounts for losses incurred through non-performing loans owing to the customer's bankruptcy or poor credit standing. For credit risk management, we have separated the Credit Supervision Department from the Business Promotion Department and established Credit Risk Management Stan-

dards for loan operations to secure the bank loan assets and strengthen profitability.

In order to assess our customers' financial positions from various respects, we utilize the Corporate Rating System and the Self-Assessment System, through which we assess loan applications individually, manage credit risk associated with loans while executing appropriate write-offs and preparing provisions. At the same time, we analyze credit costs, credit risk quantification, and profits after credit costs to control credit risk and raise stable earnings.

Additionally, in order to maintain the balance between risk and return, we have developed automated loan approval systems to facilitate our loan decision to our corporate customers. Through these developments, we have been enriching our system infrastructure to increase the soundness and profitability as well as efficiency of our business.

Market risk management

Market risk means losses from assets and liabilities, whose market value fluctuates when interest rates, foreign-exchange rates, and stock prices change.

We have established market risk management policies by analyzing financial and economic environments, and corporate financial strength. Based on these policies, we use appropriate methods in controlling various market risks associated with specific business operations.

For the trading business to benefit from gains on sales and purchase of marketable securities, the Bank has set the upper limit on the amount of transactions and losses in order to avoid exceeding losses.

In the banking business (investment securities and deposit services), we take heed of the balance between risk and return through asset and liability management (ALM) analysis and VaR analysis, so that we can maintain a stable income for long-term growth.

The Bank's management receives daily reports regarding market risk management operations. The ALM Committee discusses these reports every month to improve fund management and procurement policies.

Liquidity risk management

When liquidity risk emerges, we fail to secure funds for our business operations as our credit standing deteriorate, or we incur losses from extremely high interest rates for fund procurement.

Chugoku Bank maintains a stable cash flow as the majority of our funds are provided through deposits. In our business activities, fund procurement from the market represents only a very limited portion. Bank departments that manage cash flow strive to control liquidity risk by giving due consideration to daily cash flows associated with market operations. Moreover, in case of emergencies, we utilize possible means of securing funds by allocating a certain amount of money to our daily operations and using securities we hold.

Administrative risk management

Administrative risk refers to incurred losses through errors or accidents that stem from operational negligence in banking business operations.

For appropriate administrative operations based on our codes of conduct and principles of risk management, we have developed a manual of administrative procedures encompassing every aspect of the Bank's business activities and organized various training sessions for different business operations. We are enhancing the effectiveness of administrative operations by overhauling and improving our administrative systems, relocating back-office operations at sales outlets into the Administrative Center, and automating business operations.

Information resource risk management

In the wake of information resource risk, we incur losses from system failures in computers and network and from illegal leakage, missing, and alteration of information.

We believe it is imperative to prevent information resource risk in order to gain consumer confidence and offer services of the highest quality.

At Chugoku Bank, we are currently conducting various safety measures. These measures include protecting our computer center through accident-prevention systems, providing dual-redundant systems for critical equipment and network, maintaining safety and quality assurance through administering various tests in developing new products and services, consolidating security in system operations, and fully monitoring security in system operations. In order to strictly implement information control and curb illegal information use, we strive to lessen risks in our information resources by building necessary administrative systems and formulating various regulations.

