

PRINCIPAL OPERATIONS OF THE CHUGOKU BANK GROUP

Chugoku Bank Group, which comprises the Bank along with eight 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, 165 branch offices, 9 sub-branch offices. — Overseas offices: 1 branch and 3 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
Chugin Asset Management Company, Limited		Asset management business
The Chugin Operation Center, Co., Ltd.		Deposits, Bank Remittance, and Valuation of Collateralized Real Estate
Affiliated company		
The Okayama Prepaid Card Co., Ltd.		Prepaid-card business

(March 31, 2003)



Performance

This fiscal year, the Chugoku Bank launched Powerful Step 21 — Challenge “R”, our new mid-term business plan covering a three-year period, whose primary precept is “self-reform to promote joint prosperity with our community.” We have striven to further strengthen our business operations, paying close attention to community needs, as well as further strengthen our financial structure. The following is a summary of the highlights of our business performance resulting from these efforts.

Financial Condition

Loans and Bills Discounted

While our loans and bills discounted for individual customers rose during the year under review, those for corporations declined during the same period. We attribute this decline to a slackening of fund demand stemming from the economic slump, corporate financial restructuring policies, and the falloff in loans to local governments. As a result, our total of loans and bills discounted at the end of the year under review stood at ¥3,058,182 million, a decrease of ¥159,641 million from the previous year.

Deposits and Custody Assets

We have made every effort to implement a policy of maximizing our custody assets to fulfill our customers' fund allocation needs. In addition to deposits, these custody assets include negotiable certificates of deposit, investment trust funds, and government bonds.

As a result of our efforts, our balance of deposits as of the end of the year under review fell ¥78,027 million from the previous year to ¥4,616,007 million. Broken down by component, negotiable certificates of deposit rose ¥62,213 million to ¥194,284 million, investment trust funds climbed ¥14,033 million to ¥56,007 million, and government bonds rose ¥146,469 million to ¥248,435 million. Thus, the aggregate amount of the assets in our custody improved by ¥144,688 million to ¥5,114,733 million.

Securities

With interest rates in Japan continuing at rock-bottom lows, we have increased our securities portfolio as part of our efforts to diversify and enhance the efficiency of our asset management. The result has been an increase of ¥362,144 million in the value of our securities portfolio to ¥1,943,813 million.

With the foregoing, our total assets as of the end of the year under review stood at ¥5,468,299 million, a 0.6 % year-on-year increase of ¥31,965 million.

Earnings

During the year under review, recurring revenue on a consolidated base fell ¥9,519 million from the previous year, or 7.4%, to ¥117,983 million. Our recurring profit dropped by ¥2,528 million, or 21.9%, to ¥8,982 million. Further, our net income as of the end of the year under review stood at ¥3,991 million, sliding ¥1,887 million, or 32.1%, from the year before.

Broken down by segment, our recurring revenue from the banking business was down ¥8,431 million from the previous year, a 7.6% decline, to ¥101.428 million. Recurring profit in this category fell by ¥2,340 million, or 22.8%, to ¥7,896 million.

The recurring revenue from our leasing business was off ¥17,468, a 5.7% decline, which resulted in a ¥106 million drop in recurring profit, or 9.1%, to ¥1,049 million. The recurring revenue from our investment advisory business plunged by ¥100 million, or 49.5%, to ¥104 million, with recurring profit plummeting by ¥84 million from the year before, or 67.4%, to ¥42 million.

Cash Flows

Cash and cash equivalents as of the end of the year under review fell ¥10,790 million to ¥75,258 million. An explanation of the circumstances behind the decline follows.

There was a year-on-year net increase of ¥91,298 million in cash flow from our operating activities during the year under review. This stemmed from the decline in our short-term fund investments, which resulted in a total inflow of ¥384,061 million. There was an outflow of ¥392,963 million in the net cash used for investing activities due to a ¥111,930 million year-on-year decline was mainly due to lower proceeds from sales of securities. There was an outflow of ¥1,877 million in net cash used for financing activities, a ¥131 million year-on-year increase.

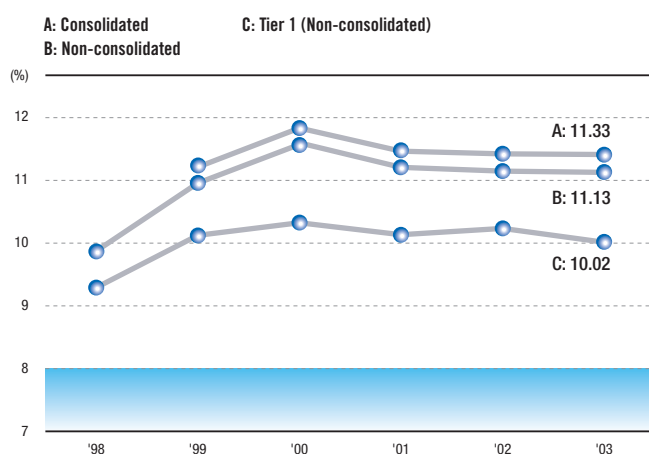
Forecast for Next Term

We anticipate a decline in earnings from our invested funds, due primarily to the falling yield from securities caused by the prolonged low interest rate environment. Therefore, for our performance on a consolidated base for the year ending March 31, 2004, we forecast recurring profit of ¥17,300 million and net income of ¥8,900 million on consolidated recurring income of ¥111,700 million. We also project ¥25,000 million in non-consolidated net income.

Capital Adequacy Ratios

The Chugoku Bank has business outlets overseas, so we are subject to the international BIS standards for the capital adequacy ratios, which call for a minimum ratio of 8%. Our capital adequacy ratios as of the end of the year under review stood at 11.13% on a non-consolidated base and 11.33% on a consolidated base. Both ratios far exceeded the minimum standards.

The ratio as of the end of the year in the basic Tier 1 capital category of capital, reserves, and surplus, omitting the difference in security valuation affected by stock price volatility at the end of the business year, was a high 10.20% on both a non-consolidated base and a consolidated base.



Risk-Managed Loans (Consolidated)

In the area of non-performing loans, the Chugoku Bank has made a practice of rigorously examining assets and conducting the appropriate write-offs and supplementation of reserves to maintain and improve the soundness of our assets. We have reevaluated our standards because we enhanced our reserves during the year under review to more broadly accept loans with less stringent lending standards. Thus, the aggregate amount of our managed debt, which is the total amount of the debt portfolio as a result of bankruptcies, delinquent loans, delinquent loans more than three months in arrears, and loans with less stringent lending standards, rose ¥93,364 million from the previous year to ¥207,396 million.

As a result, our provision of general reserves for possible loan losses rose ¥6,980 million from the previous year. Meanwhile, the amount of the transfer to individual reserves for possible loan losses declined ¥1,039 million from the year before, and the overall amount provided rose ¥5,945 million from the previous year.

Status of impaired loans

	End of March	
	2003	2002
Loans to bankrupt customers	¥ 18,957	¥ 24,340
Loans past due six months or more	84,988	53,052
Loans past due three months or more	208	725
Restructured loans	103,243	35,915
Total	¥ 207,396	¥ 114,032
Total loan balance (ending balance)	¥3,058,182	¥3,217,823

Loans to bankrupt customers

These are loans which were designated as non-accrual loans according to tax laws. 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 tax laws, 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

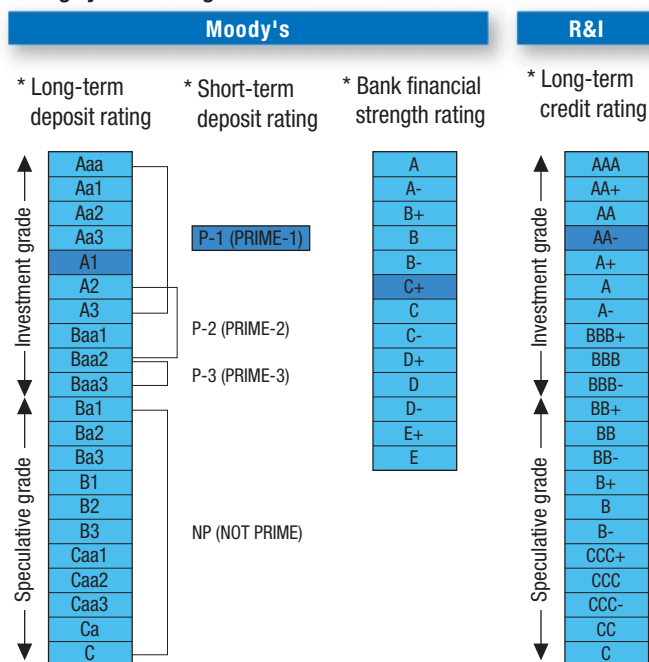
Chugoku Bank has obtained one of the best ratings among Japanese banks by Moody's, a world-renowned rating agency and Rating and Investment, Inc. (R&I). This is proof that the Bank firmly maintains an excellent operating position and sound financial constitution.

Ratings

(End of June 2003)

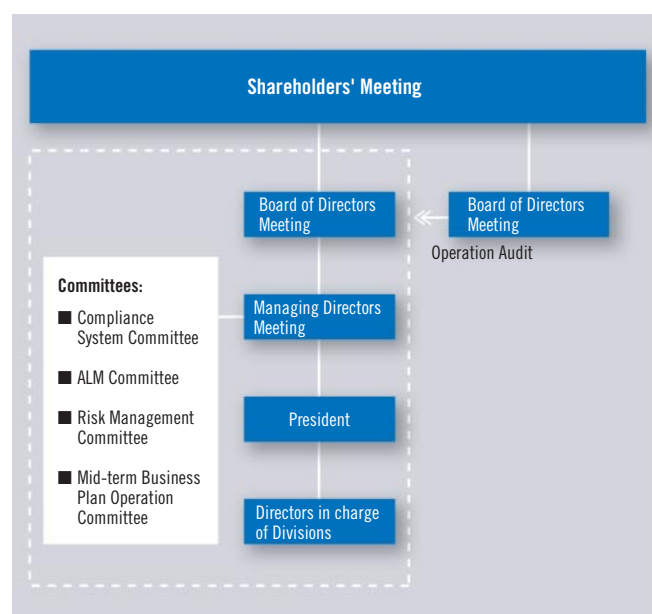
Moody's	Long-term deposit rating	A1
	Short-term deposit rating	P-1
	Bank financial strength rating	C+
R&I	Long-term credit rating	AA-

Rating symbols and gradations



Corporate Governance System

We consider it essential that each of our officers display unimpeachable ethical sense in the conduct of their duties for us to conduct business fairly. We also believe that the basis of corporate governance is monitoring the officers in the conduct of their duties and creating a mechanism for maintaining control. To achieve this objective, we believe it is of paramount importance to strengthen the functions of the Board of Directors and the auditors, and accordingly, we have strengthened the functions of both within the organization.



Compliance System Overview

All the officers of Chugoku Bank are aware of the social responsibilities that are required of us. We believe that a critical challenge in our operations is strengthening our compliance system to meet the expectations of our local customers and stockholders. Specifically, we have formulated the Corporate Standards of Conduct as the basis for the ethical behavior in our operations, and the Activity Guidelines for Bank Employees, the rules that employees should observe in the course of their duties. In addition, we are striving to further the ethical awareness of our employees by establishing of the Compliance Committee, assigning an official to be responsible for compliance in all our divisions and branches, and conducting training in ethical compliance. Every year, we formulate the Compliance Program, an action plan for compliance activities, and periodically verify the progress of its implementation.

Finally, we launched the Operations Help Line in November 2002. This enables employees to directly communicate with top management personnel to prevent or promptly uncover improprieties committed by an officer.

Risk Management System

Comprehensive risk management

The inherent risk for financial institutions has grown complex with the increasing financial deregulation and globalization and the further sophistication of financial technology. Accurately assessing and managing these risks is an increasingly important element of bank operations.

The Chugoku Bank has made risk management one of the bank's most important tasks, as our objective is to employ comprehensive risk management to achieve balanced operations with greater soundness and profitability.

Specifically, we created a company-wide organization for dealing with risk in all its aspects. We have established committees for dealing with risk and assigned the responsibility for overall risk management to the Management Planning Department. Further, we have delegated the responsibilities for risk management to departments in accordance with the categories of risk, and each of these departments ensures that this risk is controlled.

Our auditing department audits all our branches and affiliated companies internally to avoid risk and to prevent mishaps. They conduct inspections to make sure that all laws and regulations are observed, and to verify that risks of all kinds are being properly managed.

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

In order to assess our customers' financial positions in 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 deteriorates, or we incur losses from extremely high interest rates for fund procurement.

Deposits are the source of most of Chugoku Bank's fund procurement, and the bank's cash flow is stable. The Cash Flow Management Department controls cash flow risk, and takes into account the daily cash flow related to all operations, particularly 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 is that risk arising when the bank's administrative duties have not been properly carried out. At the Chugoku Bank, we are aware that administrative risk occurs in all types of work and recognize the importance of reducing that risk. Therefore, we are making every effort to improve the quality of the work performed at the bank by implementing an administrative process that covers every aspect of bank operations, conducting training sessions for different business operations, and providing administrative guidance. In addition, our efforts to achieve greater efficiency by concentrating branch operations at the Administrative Center and utilizing automated equipment improves our administrative process and reduces administrative risk.

Information resource risk management

Due to information resource risk, we incur losses from system failures in computers and networks and from illegal leakage, losses, and altercations 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.

The Chugoku Bank has formulated a Security Policy and Information Assets Management Standards to serve as the basic policies for managing our information assets. We also have devised measures for the stable operation of our computer system. In addition to formulating a management system and comprehensive rules for our information assets, and maintaining a disaster prevention system for our computers, we also have backup systems for our important equipment and networks, conduct painstaking tests for developing new products and services and maintaining safety and quality, and maintain security for systems operation. In addition, we strive to control information asset risk by formulating a management system and comprehensive regulations for stringent information management and preventing the improper use of that information.

