

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, 160 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., Limited	Credit guarantee business
The Chugin Card Company, Limited	Credit card business
The Chugin Computer Service Co., Limited	Software business
The Chugin Lease Company, Limited	Leasing and financing businesses
Chugin Asset Management Company, Limited	Asset management business
The Chugin Operation Center, Co., Limited	Deposits, Bank Remittance, and Valuation of Collateralized Real Estate
* Chugin Business Service Company, Limited has changed its company name to CBS, Limited at June 25, 2004.	
Affiliated company	
The Okayama Prepaid Card Co., Limited	Prepaid-card business

(March 31, 2004)



Review of Operations

Performance

Based on our plan to enhance relationship banking and the medium-term plan, we are positioning ourselves as a solution providing regional financial institution that offers highly value-added financial services to regional customers. As a result, we have achieved the following results during the year under review.

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 ¥3,000,583 million, a decrease of ¥57,599 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 increased ¥72,721 million from the previous year to ¥4,883,012 million. Broken down by component, negotiable certificates of deposit rose ¥13,946 million to ¥208,229 million, investment trust funds increased ¥20,955 million to ¥76,963 million, and government bonds rose ¥104,942 million to ¥353,378 million. Thus, the aggregate amount of the assets in our custody improved by ¥198,619 million to ¥5,313,353 million.

Securities

Market interest rates remained very low throughout the year under review. This caused the investment environment for securities to be extremely severe. Despite a difficult investment climate the Bank ensured risk was well spread while actively carrying out investment. These efforts resulted in a ¥224,867 million increase on the previous year to ¥2,168,680 million.

This favorable outcome in securities pushed total assets up by ¥150,055 million, 2.7 percent to stand at ¥5,618,354 million.

Earnings

During the year under review, recurring income on a consolidated base rose ¥3,453 million from the previous year, or 2.9%, to ¥121,436 million. Transfers from general reserves, a decrease in separate lending reserves brought forward and the amortization of stockholdings increased recurring profit by ¥17,294 million, or 192.5 percent to ¥26,276 million. Net income climbed ¥9,779 million, a 245 percent increase, to ¥13,770 million.

Broken down by segment, our recurring income from the banking business was up ¥3,779 million from the previous year, a 3.7% increase, to ¥105,207 million. Recurring profit in this category increased by ¥16,779 million, or 212.5%, to ¥24,675 million.

The recurring income from our leasing business was off ¥417 million, a 2.3% decline, to ¥17,051 million, which resulted in a ¥502 million increase in recurring profit, or 47.7%, to ¥1,551 million. The recurring income from our investment advisory business increased by ¥32 million, or 31.0%, to ¥136 million, with recurring profit increased by ¥16 million from the year before, or 39.0%, to ¥58 million.

Loss on Devaluation and Reserves

In order to maintain asset soundness, the Bank has continued to implement rigorous asset assessment. The amount brought forward for the general reserve was ¥8,098 million. As a result of corporate customers' improving performance only ¥1,984 million was transferred and the non-consolidated lending reserve decreased by ¥3,188 million to ¥8,423 million. Overall disposal of reserves improved by ¥13,246 million compared to the previous year.

Cash Flows

Cash and cash equivalents as of the end of the year under review rose ¥4,764 million to ¥80,022 million. An explanation of the circumstances behind the rise follows. There was a year-on-year net decrease of ¥178,429 million in cash flow from our operating activities during the year under review. This stemmed from a reduction in the decrease range of call loans, which resulted in an inflow of ¥205,632 million. There was an outflow of ¥193,257 million in the net cash used for investing activities due to a ¥199,706 million year-on-year decrease, mainly due to higher proceeds from sales of securities. There was an outflow of ¥7,596 million in net cash used for financing activities, a ¥5,719 million year-on-year decrease.

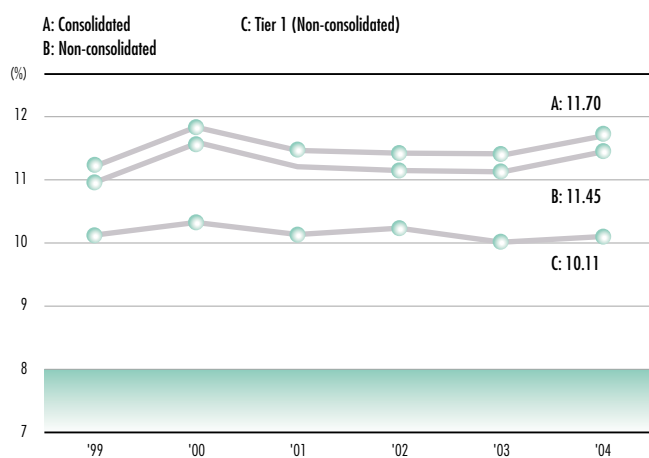
Forecast for Next Term

We anticipate the amount used for disposal of non-performing loans to remain approximately the same as last year at ¥7,000 million. We forecast a recurring profit of ¥26,500 million and a net income of ¥14,100 million on consolidated recurring revenue of ¥117,300 million. We also project ¥32,500 million in non-consolidated business profits.

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 11.70% on a non-consolidated base and 11.45% 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 10.11% on a non-consolidated base and a 10.33% on a consolidated base.



Risk-Managed Loans (Consolidated)

The aggregate amount of our managed debt, which is the total amount of the debt portfolio as a result of loans to bankrupt customers, loans past due six months or more, loans past due three months or more and restructured loans, fell ¥40,316 million from the previous year to ¥167,080 million at the end of the year under review. The reason for this decrease was the implementation of off-balancing by appropriate write-offs and sale of debt.

Risk-managed loans to total loans improved to 5.57 percent as of the end of the year under review, a decrease of 1.21 percent on the end of the first half.

Status of impaired loans

	(¥ millions)	
	End of March 2004	End of March 2003
Loans to bankrupt customers	¥ 16,068	¥ 18,957
Loans past due six months or more	83,052	84,988
Loans past due three months or more	116	208
Restructured loans	67,844	103,243
Total	¥ 167,080	¥ 207,396
Total loan balance (ending balance)	¥3,000,583	¥3,058,182

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 2004)

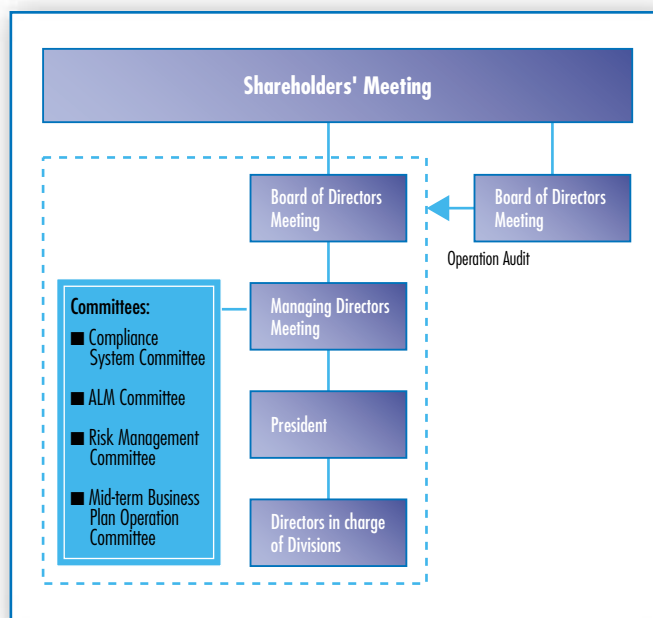
Moody's	Long-term deposit rating	A1
	Short-term deposit rating	P-1
	Bank financial strength rating	C+
R&I	Long-term credit rating	AA-

Rating symbols and gradations

Moody's			R&I
* Long-term deposit rating	* Short-term deposit rating	* Bank financial strength rating	* Long-term credit rating
Investment grade ↑ Aaa Aa1 Aa2 Aa3 A1 A2 A3 Baa1 Baa2 Baa3 Ba1 Ba2 Ba3 B1 B2 B3 Caa1 Caa2 Caa3 Ca C ↓ Speculative grade	P-1 (PRIME-1) P-2 (PRIME-2) P-3 (PRIME-3) NP (NOT PRIME)	A A- B+ B B- C+ C C- D+ D D- E+ E	Investment grade ↑ AAA AA+ AA AA- A+ A A- BBB+ BBB BBB- BB+ BB BB- B+ B B- CCC+ CCC CCC- CC C ↓ Speculative grade

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. Our specific corporate governance efforts include creating a compliance manual for the Bank, setting corporate activity protocols, a fundamental measure for ethical behavior on the part of management, and establishing employee behavioral guidelines for bank staff to observe when conducting Bank business. We have placed compliance supervisors at every department and branch and are also training staff to promote awareness of the importance of compliance practices.

In addition, we are setting annual compliance programs and assessing their progress.

With the objective of preventing inappropriate behavior by bank staff and to facilitate the early detection of unethical activities we have adopted a system wherein employees may report any wrongdoing direct to top management. Furthermore, we are fully addressing our customers' needs by making the Compliance and Risk Department independent to give a unified response to queries from customers and compliance departments.

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 have established the Risk Management Committee, ALM Committee and Compliance Committee to supervise risk management for the entire bank. The supervisory department is decided on depending on the risk category to bolster our risk management. Established this year, the new Compliance and Risk Department oversees all risk management in a comprehensive framework.

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 are using appropriate methods of risk management by comparison and analysis of risk quantity and management strength such as self-owned capital.

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 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 alterations 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.

