

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

Our loans and bills discounted for corporate customers increased ¥13,493 million to stand at ¥2,113,731 million at year end. We attribute this increase to our aggressive marketing strategies. Loans and bills discounted for individual customers increased ¥30,004 million for an end of year balance of ¥650,267 million.

During the year under review, ¥29,136 million of low-interest loans and lending on bonds to the Deposit Insurance Corporation of Japan was collected, resulting in a total of ¥3,029,956 million for loans and bills discounted at the end of the year under review, an increase of ¥29,373 million from the previous year.

Deposits and Custody Assets

As this era of very low interest rates settles in for the long term, we are making every effort to meet the asset management needs of our customers by implementing a policy of maximizing our custody assets. In addition to deposits, these custody assets include negotiable certificates of deposit, over the counter 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 ¥30,970 million from the previous year to ¥4,705,753 million. Broken down by component, negotiable certificates of deposit fell ¥66,757 million to ¥141,473 million, investment trust funds increased ¥32,799 million to ¥109,762 million, and government bonds rose ¥54,507 million to ¥386,149 million. Thus, the aggregate amount of the assets in our custody improved by ¥51,519 million to ¥5,343,136 million.

Sales of annuity insurance posted ¥33,388 million for an aggregate amount of ¥83,959 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 diverse and sophisticated forms of investment. These efforts resulted in a ¥148,127 million increase on the previous year to ¥2,316,807 million.

Earnings

During the year under review, recurring income on a consolidated base rose ¥1,303 million from the previous year, or 1.0%, to ¥122,739 million. Fees

and commissions income increased due to growth in managed assets leading to a ¥1,303 million increase of recurring profit or 4.9%, to ¥27,579 million. Return on the substitutional portion of retirement pensions led to a ¥4,153 million increase of extraordinary income or 30.1%, to ¥17,923 million.

Broken down by segment, our recurring income from the banking business was up ¥2,023 million from the previous year, a 1.9% increase, to ¥107,230 million. Recurring profit in this category increased by ¥1,677 million, or 6.7%, to ¥26,352 million. The recurring income from our leasing business was off ¥739 million, a 4.3% decline, to ¥16,312 million, which resulted in a ¥356 million increase in recurring profit, or 22.9%, to ¥1,195 million. The recurring income from our investment advisory business increased by ¥27 million, or 19.2%, to ¥109 million, with recurring profit increased by ¥19 million from the year before, or 31.5%, to ¥39 million.

Loss on Devaluation and Reserves

Efforts to improve the management of corporate customers and prevent the occurrence of non-performing loans, has led to a decrease in the Bank's non-performing loan balance. As a result of a conservative approach to reserve standards ¥1,626 million was transferred to the general reserve and ¥8,448 million to the non-consolidated lending reserve. The overall increase in transfer to reserves was due to a sizeable disposal of reserves (¥1,984 million) during the previous year.

Cash Flows

Cash and cash equivalents as of the end of the year under review rose ¥523 million to ¥80,545 million. An explanation of the circumstances behind the rise follows.

There was a year-on-year net decrease of ¥43,256 million in cash flows from our operating activities during the year under review. This stemmed from an increase in loans and a reduction in negotiable certificates of deposit, which resulted in an inflow of ¥162,376 million.

There was an increase of ¥35,585 million in the net cash used for investing activities due to a reduction in the amount used to acquire securities. This led to an outflow of ¥157,672 million.

There was an increase of ¥3,412 million in net cash used for financing activities, a ¥4,184 million year-on-year outflow due to a reduction in expenditure on acquiring treasury stock.

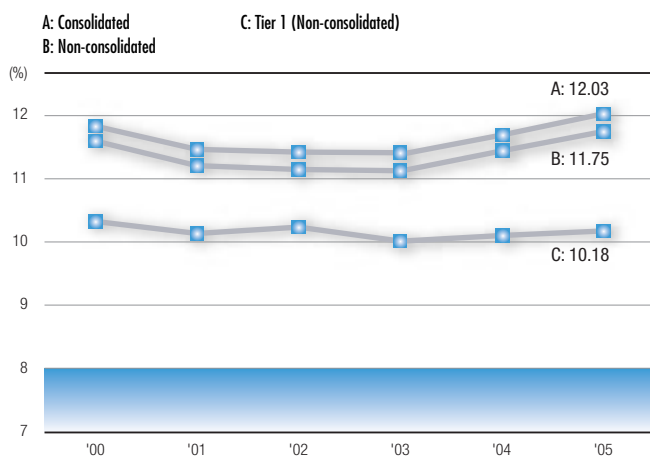
Forecast for Next Term

With a decrease in the amount used for disposal of non-performing loans as a precondition, the Chugoku Bank Group forecasts a recurring profit of ¥27,600 million and a net income of ¥13,600 million on consolidated recurring revenue of ¥124,000 million for fiscal 2005. We also project ¥31,000 million in non-consolidated net 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 11.75% on a non-consolidated base and 12.03% 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 10.18% on a non-consolidated base and a 10.42% 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 ¥13,653 million from the previous year to ¥153,427 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 5.06 percent as of the end of the year under review, a decrease of 0.51 percent on the end of the first half.

Status of impaired loans

	(¥ millions)	
	End of March 2005	End of March 2004
Loans to bankrupt customers	¥ 10,910	¥ 16,068
Loans past due six months or more	79,538	83,052
Loans past due three months or more	98	116
Restructured loans	62,881	67,844
Total	¥ 153,427	¥ 167,080
Total loan balance (ending balance)	¥3,029,956	¥3,000,583

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 2005)

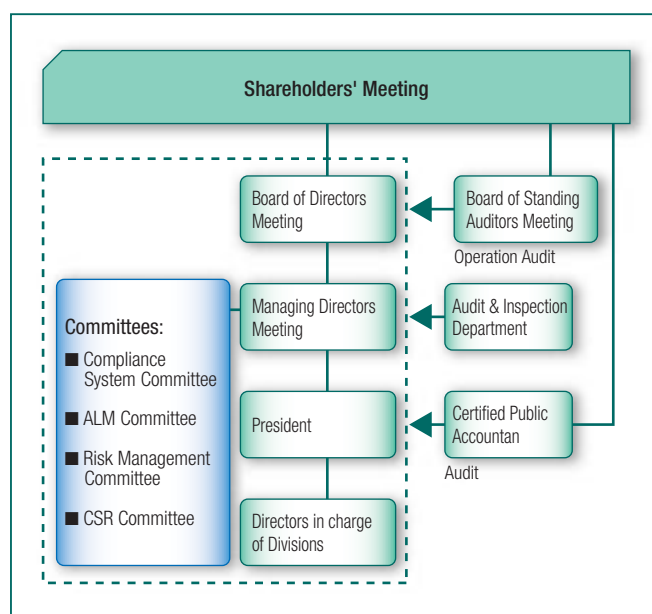
Moody's	Long-term deposit rating	A1
	Short-term deposit rating	P-1
	Bank financial strength rating	C+
R&I	Long-term credit rating	AA-

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.



Risk Management System

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 and compliance handbook 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. In June 2004, the Bank established a specialized department known as the Compliance and Risk Department to provide a full compliance framework. With the introduction of the Personal Information Protection Law in April 2005, the Bank's is making every effort to ensure rock-solid compliance to this and other laws and regulations.

The Bank takes the approach of giving compliance and morals the highest priority and is emphasizing compliance within the corporate culture.

Risk Management System

Comprehensive risk management

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.

All banks take on a variety of risks. The main types of risk are credit risk, market risk, administrative risk and information resource risk which includes systems risk. We manage overall risk at the Bank comprehensively by setting regulations, establishing risk committees and risk management departments. Meanwhile, we establish a main department for each type of risk, train staff within these departments and our Audit Department carries out regular audits.

As a countermeasure for emergencies such as typhoons and earthquakes, the Bank has compiled an emergency management manual for each type of disaster. In the event of an emergency, the Comprehensive Planning Department coordinates emergency efforts by setting up a provisional response center in order to ensure the emergency is resolved as quickly as possible.

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 security 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

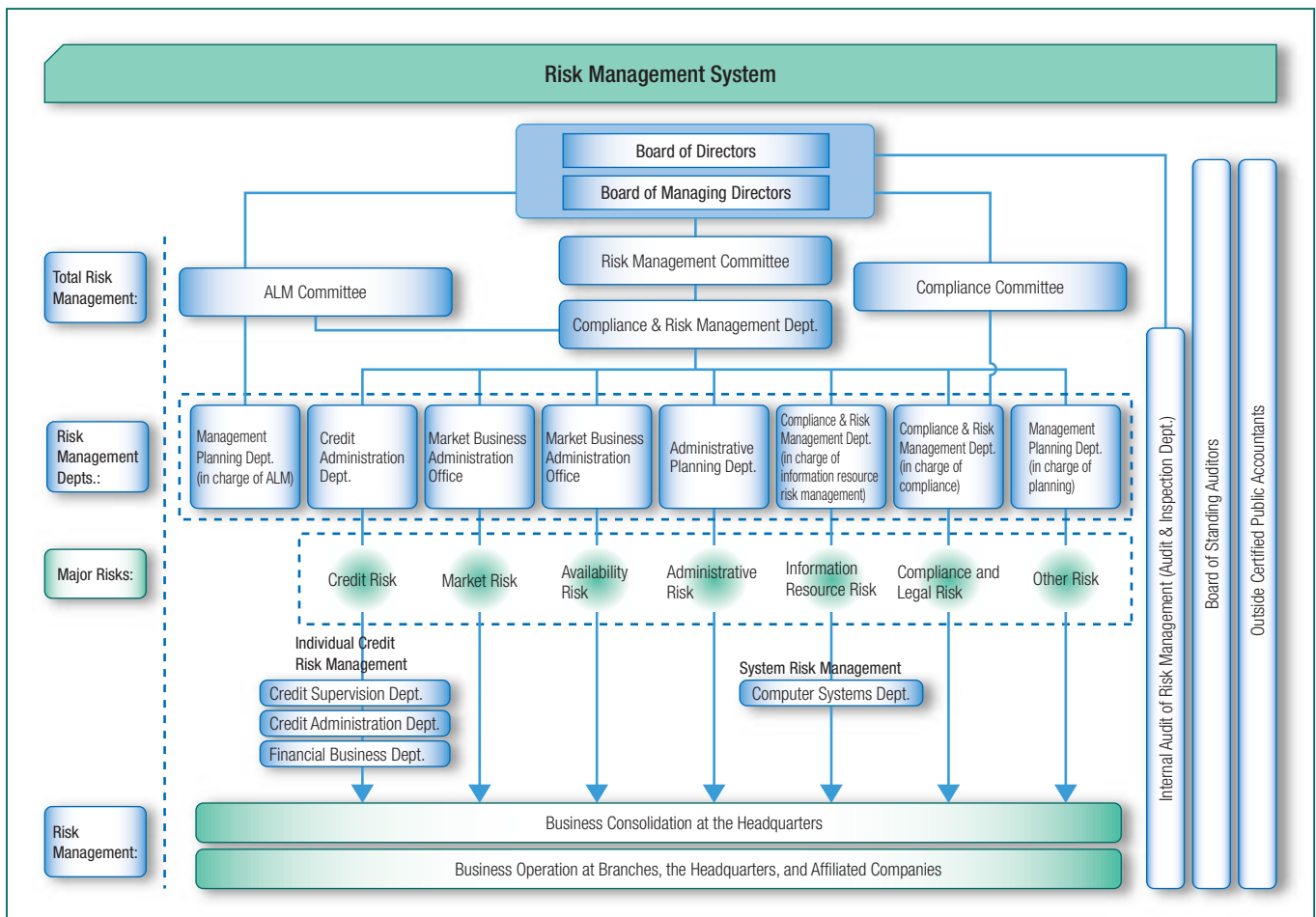
Administrative risk is that risk arising when the bank's administrative duties have not been properly carried out. At the Chugoku Bank, we are aware that administrative risk occurs in all types of work and recognize the importance of reducing that risk. Therefore, we are making every effort to improve 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. The Bank closely manages information and implements countermeasures to prevent its unauthorized usage. We ensure the safe and appropriate use of personal information by establishing the Compliance and Risk Department with four specialized staff, compiling new privacy policies for information protection and management in addition to setting other regulations, as well as confirming thorough awareness of the importance of personal information protection with all management and staff. These efforts underline the Bank's full cooperation with the Personal Information Protection Law introduced in April 2005, and also aid in lowering information resource risk.



CSRs and Regional Contributions

CSR Activities

The Bank has established a CSR Committee with the president as chairman. We consider our stakeholders to be current and future shareholders, customers, the regional community and bank employees, and the Bank's approach to CSR activities underlines this broad view.

At the heart of CSR activities is the Bank's integrity upheld through compliance and corporate governance in order to ensure the Bank is an upstanding corporate citizen when conducting its operations.

In activities contributing to society, the Bank places the highest priority on contributions to the region in its capacity as a regional financial institution. We are continuously considering bold, new approaches beyond our core operations in order to contribute to society.

Contributing to the Regional Community

Despite the Bank basing its operations in Okayama Prefecture, the merging of financial institutions from surrounding regions has spurred the Bank to grow into a regional bank with operations covering a wide area. The Bank is unfolding its marketing operations to include close ties with such regions as Okayama, Hiroshima, Kagawa, Hyogo, Ehime and Tottori prefectures.

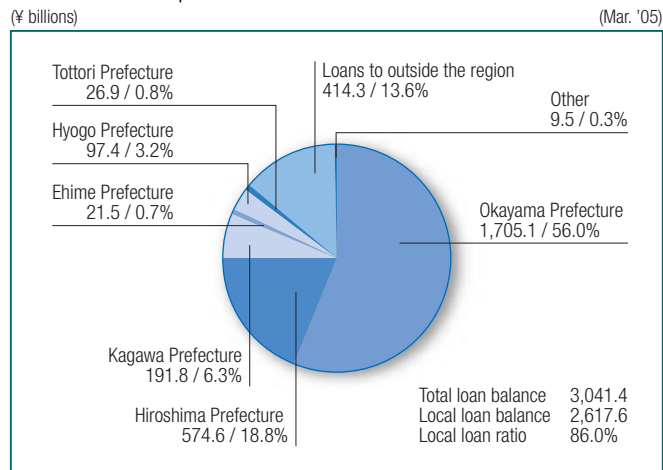
Management Support Activities for Local Companies

In order for the Bank to support the management of local companies, the Bank has positioned specialized staff in all finance departments to oversee customers and build strong relationships. Furthermore, the Bank is actively utilizing independent specialists and the Muscat Fund, a regional corporation rehabilitation fund.

In other efforts the Bank looks to the long term with its Chugoku Bank Corporate Fostering Support Framework and the Benesse Chugoku Bank Lifestyle Support Venture Fund to actively support new businesses and venture firms in the hope that new industries will be created to revitalize local industry structure for the future.

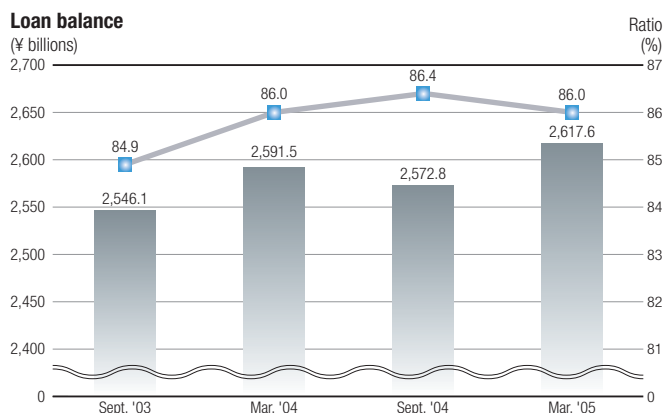
Breakdown of Loans to the Regional Community

Local loans make up 86.0% of all loans.



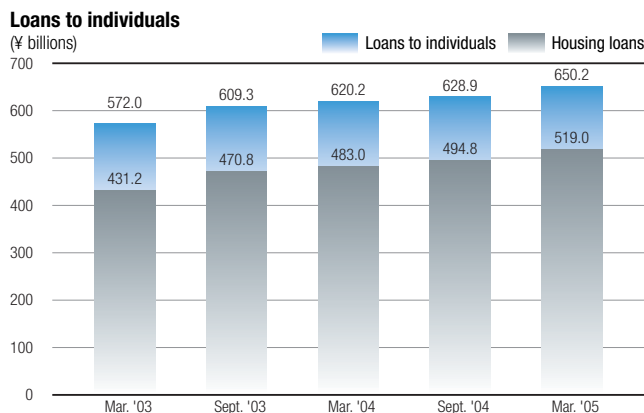
Local balance to Regionals

The Bank takes on appropriate amounts of risk while meeting the financial needs of the customers.



Loans to individuals

The Bank provides a wide range of financial services from housing loans to loans for education. In July 2004 the Bank added its Balance Plan to its product line-up, offering a loan for costs incurred when purchasing a house and incorporating long-term fixed interest with variable interest rates. This new loan and service with attention to detail has raised the end of year loan balance ¥30.0 billion to ¥650.2 billion.



Contributing to the Regional Community

The Bank participates in a wide range of activities to contribute to the regional community. Such activities include a think-tank run by the Group's Okayama Economic Research Center, activities supporting sports, culture and education and community events, as well as providing time deposits supporting the Association of Medical Doctors of Asia (AMDA), ATMs for the visually impaired. In addition, the Bank is actively engaged in cooperation between businesses and educational institutions with its framework agreements with local universities. For educational support activities the Bank holds training sessions in order to promote communication between academia and business. The Bank is also supporting a wide range of medical support activities in Japan and overseas with the volunteer organization, AMDA.