Review of Operations

Financial Condition

Results by business segment are as follows.

Banking business

In the banking business, recurring income decreased by ¥8,537 million year on year, or 6.8%, to ¥116,499 million, due primarily to a decrease of gain on sales of securities, and a decrease of interest and dividends on securities as a result of balance management for securities investment operations.

Meanwhile, ordinary profit decreased by ¥1,037 million year on year, or 3.5%, to ¥27,931 million, due to the large impact of downward factors such as the increase in foreign currency procurement costs, despite upward factors such as the decreases of loss on sales of securities and write-off of shares.

Leasing business

In the leasing business, recurring income decreased by ¥3,875 million year on year, or 25.6%, to ¥11,245 million, due to a drop in yields and a decrease of re-lease and installment transactions, while ordinary profit also decreased by ¥266 million year on year, or 24.4%, to ¥823 million.

Securities business

In the securities business, recurring income increased by ¥709 million year on year, or 19.7%, to ¥4,303 million, due primarily to strong sales utilizing the redemption proceeds from structured bonds which increased from the rising stock market, while ordinary profit also increased by ¥345 million year on year, or 88.0%, to ¥737 million.

Other

For other businesses, recurring income increased by ¥142 million year on year, or 2.7%, to ¥5,333 million, due primarily to an increase in guarantee commission received in the credit card business.

Meanwhile, ordinary profit increased by ¥289 million year on year, or 17.7%, to ¥1,922 million, due to a decrease in credit costs in the credit guarantee business.

Earnings

Consolidated recurring income decreased by ¥10,422 million year on year, or 7.2%, to ¥132,445 million, due primarily to a decrease of gain on sales of securities arising in view of the interest rate trend in the U.S., and a decrease of interest and dividends on securities as a result of balance management for investment operations on foreign bonds and other securities.

Ordinary profit decreased by ¥683 million year on year, or 2.1%, to ¥30,922 million, due to the large impact of downward factors such as the aforementioned decrease of interest and dividends on securities and an increase in foreign currency procurement costs, despite upward factors such as decreases of loss on sales of securities and write-off of shares.

Net income attributable to owners of parent increased by ¥935 million year on year, or 4.6%, to ¥21,258 million.

Cash Flows

Cash and cash equivalents as of the end of the current fiscal year decreased by ¥34,717 million year on year to ¥760,451 million. This was due to the policy to focus on increasing the balance of municipal and corporate bonds for securities investment operations and increasing the loan balance centered on local commercial viability, although some portions of the loss were set off by factors such as sales of foreign currency denominated securities in view of the interest rate trend in the U.S., and an increase in deposit balance.

Cash flows from operating activities

Net cash used in operating activities decreased by ¥77,167 million year on year to ¥101,208 million. This is due mainly to a decrease in payables under securities lending transactions as a result of reduction of securities balance.

Cash flows from investing activities

Cash flows from investing activities amounted to ¥73,151 million, decreasing by ¥278,202 million year on year.

This is due to a decrease in sales of securities as well as an increase in purchases of securities.

Cash flows from financing activities

Net cash used in financing activities increased by ¥6,931 million year on year to ¥6,654 million.

This is due to payments from purchases of stocks of subsidiaries not resulting in change in scope of consolidation during the corresponding period of the previous fiscal year, and a decrease in share buybacks year on year.

Forecast for Next Term

For the fiscal year ending March 31, 2019, the Chugoku Bank Group forecasts consolidated recurring income of ¥124,100 million, consolidated ordinary profit of ¥23,100 million and net income attributable to owners of parent of ¥15,400 million.

Dividend Policy

In light of the public nature and soundness of our banking business, the Bank makes it a basic policy to secure sufficient retained earnings while continuing to pay stable dividends in order to maintain a firm financial standing capable of withstanding any challenging environment. Specifically, we aim to pay a stable per-share dividend of ¥18 per year, and to achieve a total payout ratio of 35%, which includes dividends and share buybacks.

For the fiscal year ended March 31, 2018, the Bank has determined to pay an annual per-share dividend of ¥20 (year-end dividend of ¥10) as originally planned.

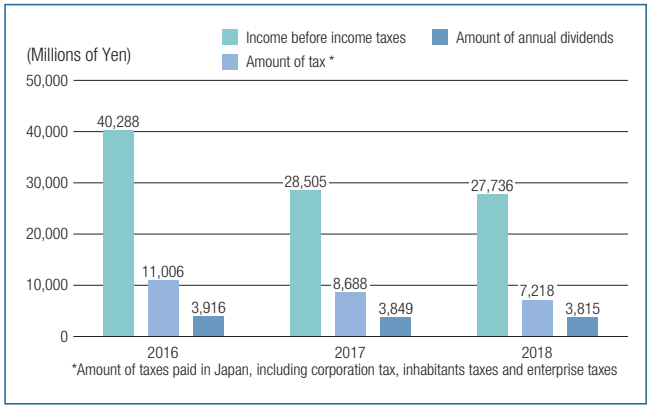
With respect to the expected dividends for the fiscal year ending March 31, 2019, the Bank plans to increase the stable per-share dividend by ¥2 and pay an annual per-share dividend of ¥20 (interim dividend of ¥10).

Under the Bank's basic policy on the number of dividend payout for each fiscal year, the Bank distributes a dividend twice a year (an interim dividend and a year-end dividend). The decision-making bodies for these dividends are the Board of Directors for the interim dividend and a general meeting of shareholders for the year-end dividend.

The Bank has also included a provision in its Articles of Incorporation, which stipulates that it may distribute an interim dividend as permitted in Article 454, paragraph 5 of the Companies Act.

The Bank will strive to continue to pay stable dividends.

Income before Income Taxes, Amount of Tax, Amount of Annual Dividends



Capital Adequacy Ratios

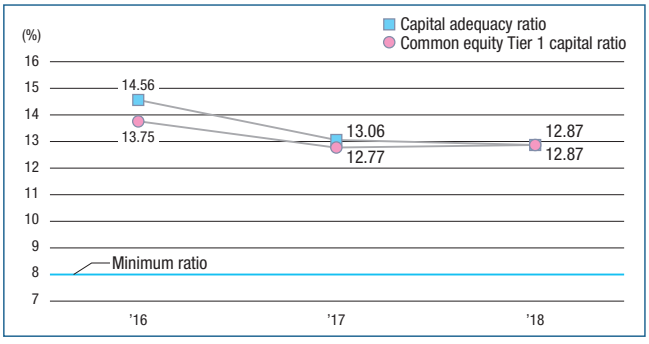
The Bank's capital adequacy ratio was 12.87% as of the end of March 2018.

The Bank calculates its capital adequacy ratio on the basis of the international BIS standards*.

*The international BIS standards call for at least 8% of capital adequacy ratio, at least 6% of Tier 1 capital ratio, and at least 4.5% of common equity Tier 1 capital ratio.

$$\text{Capital adequacy ratio (\%)} = \frac{\text{(1) Common equity Tier 1 capital} + \text{(2) Additional Tier 1 capital} + \text{(3) Tier 2 capital}}{\text{(4) Risk-weighted assets}} \times 100$$

(1) The amount of common equity Tier 1 capital represents the capital with the highest quality, comprising common stock, retained earnings and others.
(2) The amount of additional Tier 1 capital comprises preference shares, equity instruments with high loss-absorbing capacity and others.
(3) The amount of Tier 2 capital comprises subordinated bond, subordinated loans (limited to those which are assured to absorb loss, subordinated to savers and unsecured creditors) and others.
(4) The amount of risk-weighted assets is derived by integrating the values of various categories of asset commensurate with the degree of their risk.



Risk-managed Loans (Non-consolidated)

The balance of risk-managed loans decreased by ¥9,045 million year on year, to ¥71,168 million as of the end of March 2018, as a result of efforts to upgrade borrowers' status through business rehabilitation activities and reduction efforts including direct write-offs and elimination from balance sheet by debt disposal.

In addition, the ratio of risk-managed loans (against the total loan balance) deteriorated by 0.30 percentage point year on year, to 1.52% as of the end of March 2018, due to an increase in the total loan balance.

Status of impaired loans (Millions of Yen)

	End of March 2018	End of March 2017
Loans to bankrupt customers	¥ 3,881	¥ 4,625
Loans past due six months or more	50,956	59,435
Loans past due three months or more	1,509	802
Restructured loans	14,819	15,349
Total	¥ 71,168	¥ 80,213
The ratio of risk-managed loans (against the total loan balance) (%)	1.52	1.82

● Loans to Bankrupt Customers

Of the loans whose accrued interest is not recognized as revenue, loans to customers who have been bound by legal procedures under the Corporate Reorganization Act, Bankruptcy Act, or the rehabilitation procedures, as well as loans to customers whose transactions have been suspended by the Clearinghouse.

● Loans past due six months or more

Loans whose accrued interest is not recognized as revenue, excluding loans to bankrupt customers as well as those for which payment of the interest has been postponed to ensure the borrowers' business rehabilitation or to assist their management to carry on.

● Loans Past Due Three Months or More

Loans for which repayment of the principal or the interest has been overdue three months or more from the day following the due date, but not classified as either loans to bankrupt customers or loans in default defined above.

● Restructured Loans

Loans for which arrangements have been reached in the borrowers' favor to ensure their business rehabilitation or to assist their management to carry on, including reductions in or exemption of the interest rate, postponed payment of the interest, a grace period for repayment of the principal, and debt forgiveness, but not classified as either loans to bankrupt customers, loans in default or loans past due three months or more defined above.

Ratings

Ratings is a ranking in terms of its certainty in performing obligations (creditworthiness) to indicate whether it is reliable enough to repay the principal and interest of savings deposited by its customers, as well as its financial soundness, based on the examination of its financial position along with its external business environment by a rating agency operating as a fair third party. The Chugoku Bank has obtained ratings from Moody's as well as Rating and Investment, Inc. (R&I), and is ranked as one of the best among the Japanese banks.

Rating symbols and gradations