Review of Operations

Financial Condition

Results by business segment are as follows.

Banking business

Ordinary income decreased by ¥3,038 million year on year, or 2.6%, to ¥113,461 million, due primarily to a decrease in interest and dividends on securities as a result of reduction of securities investment balance in light of the interest rate trend, and a decrease in reversal of reserve for possible loan losses.

Ordinary profit decreased by ¥6,012 million year on year, or 21.5%, to ¥21,919 million, due to the substantial increase in credit costs as a result of the need for an additional reserve for possible loan losses, in addition to the decrease in ordinary income as mentioned earlier, despite favorable factors such as decrease in general and administrative expenses.

Leasing business

Ordinary income increased by ¥67 million year on year, or 0.5%, to ¥11,312 million due to such factors as an increase in reversal of reserve for possible loan losses; so did ordinary profit by ¥50 million year on year, or 6.0%, to ¥873 million.

Securities business

Ordinary income decreased by ¥1,572 million year on year, or 36.5%, to ¥2,731 million as the sale of structured bonds, which was strong in the previous fiscal year, declined significantly due to the sluggish stock market in the current fiscal year, and ordinary profit decreased by ¥837 million year on year, resulting in an ordinary loss of ¥100 million.

Other

Ordinary income increased by ¥92 million year on year, or 1.7%, to ¥5,425 million, due primarily to an increase in guarantee commission received in the credit card business and the credit guarantee business. Ordinary profit, however, decreased by ¥107 million year on year, or 5.5%, to ¥1,815 million, due to the significant impact of increasing credit costs in the credit guarantee business.

Earnings

Consolidated ordinary income decreased by ¥3,824 million year on year, or 2.8%, to ¥128,621 million, due primarily to a decrease in interest and dividends on securities, and a decrease in reversal of reserve for possible loan losses.

Consolidated ordinary expenses increased by ¥3,403 million year on year, or 3.3%, to ¥104,925 million, due to the large impact of increasing credit costs and foreign currency procurement costs, despite favorable factors such as the decreases in loss on sales of securities and general and administrative expenses.

Consolidated ordinary profit decreased by ¥7,226 million year on year, or 23.3%, to ¥23,696 million, due to a decrease in the consolidated ordinary income and an increase in the consolidated ordinary expenses, as mentioned above.

Net income attributable to owners of parent decreased by ¥5,059 million year on year, or 23.7%, to ¥16,199 million.

Cash Flows

Cash and cash equivalents as of the end of the current fiscal year decreased by ¥11,069 million year on year to ¥749,382 million. This was due to the decrease in payables under securities lending transactions as a result of balance management for securities investment operations and our focus on increasing the loan balance centered on local commercial viability, although some portions of the loss were set off by such increasing factors as the restraint on reinvestments utilizing the redemption proceeds in our investments on securities, and an increase in the deposit balance due to the inflow of insurance proceeds resulting from heavy rainfall disasters.

Cash flows from operating activities

Net cash used in operating activities decreased by ¥139,591 million year on year to ¥240,799 million.

This is due mainly to a greater decrease in payables under securities lending transactions as a result of reduction of securities investment balance.

Cash flows from investing activities

Cash flows from investing activities amounted to ¥235,740 million, increasing by ¥162,589 million year on year.

This is due to the decrease in the acquisition of securities as reinvestments utilizing the redemption proceeds, in order to restrain the increase in the balance of investments on securities in view of the interest rate trend.

Cash flows from financing activities

Net cash used in financing activities decreased by ¥640 million year on year to ¥6,014 million.

This is due to a decrease in the amount of share buybacks year on year based on our policy of distributing returns to shareholders.

Forecast for Next Term

For the fiscal year ending March 31, 2020, the Chugoku Bank Group forecasts consolidated ordinary income of ¥125,700 million, consolidated ordinary profit of ¥20,700 million and net income attributable to owners of parent of ¥13,800 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, 2019, the Bank will pay an annual per-share dividend of ¥22 (year-end dividend of ¥12), an increase of ¥2.

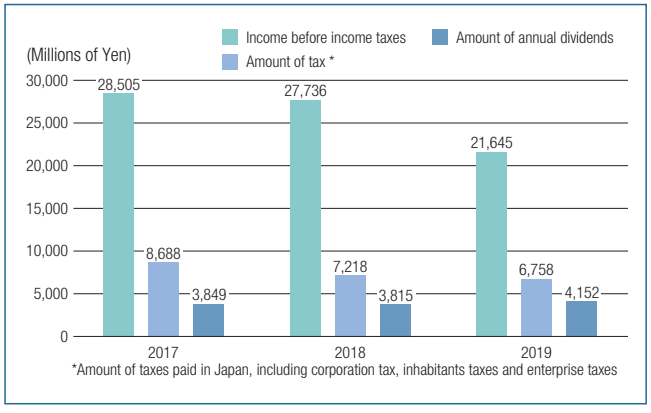
With respect to the expected dividends for the fiscal year ending March 31, 2020, the Bank plans to increase the stable per-share dividend by ¥4 and pay an annual per-share dividend of ¥22 (interim dividend of ¥11).

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.

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



Capital Adequacy Ratios

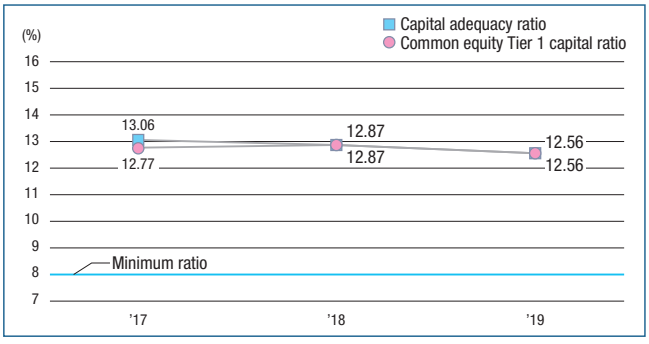
The Bank's capital adequacy ratio was 12.56% as of the end of March 2019.

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 ¥2,366 million year on year, to ¥68,802 million as of the end of March 2019, 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) decreased by 0.09 percentage point year on year, to 1.43% as of the end of March 2019.

Status of impaired loans (Millions of Yen)

	End of March 2019	End of March 2018
Loans to bankrupt customers	¥ 3,578	¥ 3,881
Loans past due six months or more	45,158	50,956
Loans past due three months or more	876	1,509
Restructured loans	19,189	14,819
Total	¥ 68,802	¥ 71,168
The ratio of risk-managed loans (against the total loan balance) (%)	1.43	1.52

● 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