



On a consolidated basis, for fiscal 1997, ended March 31, 1998, the Bank's total income amounted to ¥490.8 billion, down 13.0% from the previous fiscal year. Total expenses declined 6.6%, to ¥522.6 billion, reflecting the low interest rates on funds during the year as well as measures to control operating expenses. As a result, the Bank recorded a consolidated net loss before income taxes and minority interest of ¥31.8 billion and a net loss of ¥16.0 billion.

During the period under review, total deposits fell ¥791.4 billion, to ¥8,963.0 billion, due mainly to low interest rates and the planned reduction of overseas deposits. Widespread uncertainty about future economic prospects in the business community and the vigorous disposal of nonperforming loans led to a ¥410.8 billion year-on-year decline in loans and bills discounted, to ¥8,037.2 billion. In addition, investment securities contracted ¥12.7 billion, to ¥1,594.9 billion, and contributed to a ¥767.6 billion fall in total assets, to ¥11,259.7 billion.

Concentrating on Home Market Retail Operations

In fiscal 1997, we continued to implement measures in line with the strategies set out in our medium-term business plan, INNOVATION 21. Since the inauguration of this plan in April 1997, these strategies are helping us raise efficiency to new levels and developing a more customer-oriented operating structure. Improvements in customers' satisfaction with our services—based on the key words **convenience**, **trust**, **efficiency**, and **speed**—give us confidence that we are moving in the right direction to achieve our goal of becoming the strongest bank in our home market.

To realize optimal resource allocation under INNOVATION 21, we have decided to reorganize our international network to one subsidiary and seven representative offices. The operations of our branch and subsidiary in Hong Kong and our subsidiary in Switzerland were wound up, and plans call for branches in New York, London, and Singapore to be converted into representative offices. In addition, we sold our British merchant bank subsidiary, Guinness Mahon Holdings plc. Rationalizing our overseas operations will yield significant cost savings and allow us to redirect resources to strengthen our management base in our home market.

Despite this reorganization, through one subsidiary and seven representative offices we are still able to provide customers with access to overseas financing as well as quality economic information on local markets. Most importantly, we are confident that this streamlined organization will continue to meet BIS capital adequacy ratio standards.

Using Public Funds to Strengthen the Regional Economy

We have taken various steps to strengthen our ability to meet the funding needs of regional customers. We raised funds through asset securitization and liquidization deals and, in March 1998, pursuant to government policies to stabilize the banking system in Japan, received a ¥20 billion capital injection in the form of permanent subordinated loans underwritten by public funds. These and other measures have increased the funds we have available for loan finance by ¥30 billion, thereby enabling us to expand our lending activities beyond our earlier plans.

Our creditworthiness in the international financial community also ensures a choice of avenues to strengthen our capital base. Moody's Investors Service, Inc., the leading U.S. ratings agency, has given us an A3 rating for our long-term debt, placing us among the top ranks of Japanese banks.

Reinforcing Core Earnings Capabilities

During fiscal 1997, the Bank aggressively implemented measures to strengthen its self-assessment activities in anticipation of the introduction of the Prompt Corrective Action principle in Japan. As a consequence of vigorous loan write-offs and increases in reserves for problem loans, we posted a net loss for the year.

However, the Bank posted net operating profit—which is regarded as the best measure of the core profitability of Japanese banks—of ¥56.2 billion (after subtracting the general reserve for problem loans), or ¥8.6 billion higher than the previous fiscal year. This reflects the fruition of rationalization and efficiency improvement measures designed to strengthen our management structure. Specifically, stable income from individual customers, centering on housing loans, and the more prudent application of risk/return principles have strengthened our core earnings capabilities. We expect our ongoing reforms will generate further benefits and, consequently, have revised our original net operating profit projection for fiscal 1998 of ¥60 billion upward, to ¥70 billion.

Building a Sound Financial Platform

The severity of the downturn in the Japanese economy since the collapse of the bubble economy is reflected in the amount of problem loans with which banks and other financial institutions are burdened.

While not immune to this contagion, the Bank has moved quickly to contain problem loans. Beginning with debtor negotiations, we have aggressively sold loan collateral, sold loans to the Cooperative Credit Purchasing Company, Limited, and pursued other recovery measures. Also, we have taken adequate measures to deal with future loan losses by substantially increasing the reserve for possible loan losses. The amounts allocated to this reserve are based on conservative recovery estimates.

As a result of these measures, in fiscal 1997 the Bank absorbed credit costs of ¥254.2 billion. The balance of problem loans at fiscal year-end—including loans to bankrupt clients, other delinquent loans, and restructured loans (previous standards)—was ¥277.5 billion. This represents declines of 40% (¥187.8 billion) and 15% (¥46.0 billion), compared with the same balances at the end of fiscal 1995 and 1996, respectively.

In fiscal 1997, we introduced new disclosure standards similar to those required by the U.S. Securities and Exchange Commission (SEC). Consequently, loans on which principal or interest is in arrears by more than three months are now added to the previous disclosure categories of problem loans. Furthermore, loans to supported clients, loans on which repayments are suspended, and other additional amounts are now included in the restructured loans by new disclosure standards. At fiscal year-end, the total balance of problem loans as defined by the new standards amounted to ¥396.4 billion.

The Bank's reserves for possible loan losses cover 91.6% of its problem loans as defined under previous disclosure standards and 64.1% under the new standards. This coverage is calculated without taking into consideration loan collateral and guarantees.

Value of problem loans (Non-consolidated basis)

	Billions of yen	Reserve coverage ratio
Previous disclosure standards		
A. Loans to bankrupt clients	98.8	
B. Other delinquent loans	164.8	
C. Restructured loans (previous standards)	14.0	
Total (A+B+C)	277.5	91.6%
(Note: Loans to supported clients)	19.5	
New disclosure standards		
A. Loans to bankrupt clients	98.8	
B. Other delinquent loans	164.8	
C. Past due loans (over 3 months)	32.0	
D. Restructured loans (new standards)	100.8	
Total (A+B+C+D)	396.4	64.1%

Prompt Corrective Action

The bad loan problem has exposed weaknesses in the management of Japanese financial institutions. In June 1996, the Diet passed the Law to Implement Measures for Ensuring the Sound Management of Financial Institutions, which led to amendments to the Bank Law of Japan.

The introduction of Prompt Corrective Action—the most important part of the law—requires banks to strengthen their risk management and achieve global standards. In this respect, in April 1997 we established a completely independent credit assessment section, the Credit Examination Office, and extensively upgraded our credit rating system for corporate borrowers. We are progressing with management structure modifications and introducing new risk management technologies to ensure our asset base is of the highest quality.

A Source of Growth ~~the~~ of Growth

Our overriding business objective is to support a sound financial order in the regional community by facilitating the smooth flow of funds and providing financial services that meet diverse business and individual needs.

In the second year of INNOVATION 21, we are moving ahead with work to restructure our branch network and expand our direct banking capabilities, keeping a close eye on the demand dynamics in our home market. Adjustments are intended to create a more flexible, higher-quality organization—based on such specialized service centers as loan operation centers for small and medium-sized companies and housing loans—that can respond quickly to specific financing needs. This strategy enables the Bank to improve the efficiency of its resource allocation.

At fiscal year-end, the balance of our domestic loans to individuals as well as small and medium-sized companies was ¥5,820.5 billion. This represents 73.8% of the Bank's total loan portfolio, up 0.7 percentage point from the previous fiscal year-end. The amount of loans to customers within the Bank's home market accounted for 83.3% of domestic loans, up 1.5 percentage points from the previous year-end.

As mentioned earlier, the Bank raised approximately ¥30 billion in funds for loan purposes. Under its Credit Policy and credit criteria, the Bank is seeking to develop a balanced loan portfolio among borrowers in diverse industry sectors. Adherence to clearly defined credit risk management principles ensures that quality is maintained as we manage our loan assets.

The net loss incurred in fiscal 1997 was due largely to a number of factors that do not significantly impact the core earnings capacity of the Bank over the long term. We anticipate a recovery in profits in the current fiscal year and have therefore decided to pay annual cash dividends per share for fiscal 1997 of ¥5.00, the same as in fiscal 1996.

Under INNOVATION 21, in fiscal 1998 we expect to move closer to realizing the strength and quality in management that is needed to generate a higher return on equity (ROE).

Amid far-reaching changes in the Japanese financial system, the demand for specifically tailored services is becoming stronger than ever. We are confident that, by building on the knowledge and experience we have gained through serving customers in our home market, we will continue to play an important role in developing the regional economy.

The Bank's capital adequacy ratio, calculated according to the BIS formula, edged up 0.13 percentage point from the previous fiscal year-end, to 9.23%.

I would like to thank our stockholders and business associates for their ongoing support and guidance and look forward to strengthening our relationships in fiscal 1998 as we work to build a management foundation that meets their expectations.

June 26, 1998


Sadaaki Hirasawa, President