

Annual Report 2004

Higo Bank



Profile

The Higo Bank is a regional bank whose main business base is Kumamoto Prefecture in central Kyushu. Possessing a varied sweep of natural beauty, including the volcano Mt. Aso, which boasts the world's largest caldera, and the scenic Amakusa area with its 200 islands of widely varying sizes, the prefecture is home to thriving agricultural, forestry, and fisheries industries.

In recent years, Kumamoto Prefecture has become a center for leading-edge industries, notably semiconductors, for which it has been called "Japan's Silicon Valley." The number of high-tech companies setting up shop in Kumamoto is still on the increase, and is expected to contribute greatly to the area's development in the near future.

The center of Kumamoto City has also been seeing the successive start-ups of a number of redevelopment projects, and accelerating progress is being made in bolstering the city's transport infrastructure, including the start of work on the extension of the Shinkansen Line from Fukuoka down the west coast of Kyushu to Kagoshima and the construction of a modern road traffic network, principally to feed the Kyushu Expressway.

These conditions offer many opportunities to vitalize the region by cultivating small and medium-sized



mainstay businesses and promoting new businesses to support these new industries. Kumamoto is home to many new industries, and we have a support organization in which the public and private sectors work together, called the Kumamoto Prefecture Business Promotion Support Center. The center was established with funds from the Kumamoto prefectural government and the Higo Bank.

In addition to our main work of banking operations, we also put our energy into creating a better living environment for the prefecture's citizens by supporting organizations such as The Distribution Economics Institute of Kumamoto Area and the Kumamoto Development Research Center. Higin Venture Capital Co., Ltd., established in 1996, also cooperates with these organizations to provide comprehensive support to match the growth stage of the venture companies.

The Bank has continued to be active in supporting cultural events such as concerts and art exhibits as well as in promoting environmental conservation efforts, with the establishment of the Higo Water Resources Protection Foundation. Believing that it will become all the more important for us to make broad social contributions, we set up a Regional Culture Department in our Head Office in 1995 to act as a organization specializing in social contributions.

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Message from the President



During the term, the Japanese financial industry began to display a number of positive signs, suggesting something of a resurgence. These signs primarily reflected progress in dealing with the bad-debt problems at major financial institutions. But the focus of financial revitalization is shifting from the major institutions to regional banks, as demonstrated by the temporary nationalization of some leading regional banks. With customers looking at financial institutions with an increasingly cautious eye, ahead of the complete abolishment of the deposit insurance system in April 2005, it is becoming more important for regional financial institutions to step up financing for small and medium-sized companies, as a measure to strengthen relationship banking and bolster the soundness and profitability of the financial sector overall.

In this environment, all employees of Higo Bank are as one in their commitment to realizing our vision of forging a robust corporate structure based on the strong support provided by our customers. This vision represents our basic goal under the three-year medium term management plan, the second of this century, which went into effect in fiscal 2003. It also reflects our long-standing corporate missions of putting the customer first, contributing to the prosperity of the region we serve while maintaining a high level of corporate ethics, and fostering a free and creative corporate culture.

This report overviews the Bank's activities and results, and has been prepared to encourage a better understanding of who we are. I would be delighted if it proves a useful reference.

I would like to thank our customers, shareholders and other stakeholders for their continued support.

A handwritten signature in black ink that reads "H. Oguri". The signature is written in a cursive, flowing style.

July 2004

Hiroo Oguri, *President*

Management Policy

The “Second Medium-Term Management Plan for the New Century”

Higo Bank’s newly launched “Second Medium-Term Management Plan for the New Century” covers the three years from April 1, 2003 to March 31, 2006. With “forging a robust corporate structure based on the strong support of the customer” as our basic goal, we aim to enhance our earning power and financial soundness by engaging in further dialogue with customers, understanding them better and supplying them with high-quality tailored financial services.

In the new plan, we will strengthen earning power by simultaneously increasing gross business profit and operational efficiency while maintaining current high level of financial soundness, with an emphasis on increasing productivity through the dedication of every individual employee in his or her role within the enhanced Bank infrastructure laid down in the previous medium term-management plan.

SLOGAN

***“Prospering with the customer, and winning the customer’s full support
(with every employee dedicated to his or her role)”***

The basic concept of the new management plan is ensuring that every employee performs his or her duties, to realize our goal of “Putting the customer first.” To this end, we have chosen as our slogan, “Prospering with the customer, and winning the customer’s full support (with every employee dedicated to his or her role).”

PERIOD OF PLAN

April 1, 2003 to March 31, 2006 (3 years)

BASIC GOAL

Forging a robust corporate structure based on the strong support of the customer

- ▶ **The strong support of the customer:** We will earn this by understanding customer needs, putting ourselves in the customer’s position and providing high-quality tailored financial services.
- ▶ **Forging a robust corporate structure:** We will achieve this by bolstering earning power and enhancing risk management by strengthening our marketing and maximizing our efficiency.

INDICATOR	TARGET
1. ROE (Return on Equity)	5% or more
2. Adjusted OHR (Ratio of expenses to core gross business profit)	Less than 65%
3. Capital ratio (domestic standards)	10% or more
4. Core net business profit per employee	¥10 million or more

CONDUCT CHARTER

1. Taking the customer’s viewpoint, we will conduct our business in a spirit of gratitude.
2. By prioritizing dialogue with customers, we will increase our understanding of customer needs.
3. By fully understanding our customer’s problems, we will solve them quickly and decisively.
4. By observing laws, regulations and in-house standards we will fully meet our social responsibilities and conduct ourselves within the bounds of common sense.

Results

Deposits and loans

Deposits

As a result of closely tailoring its marketing initiatives to customer and regional needs, Higo Bank increased total deposits by ¥58,130 million, or 2.0%, to ¥3,013,535 million. The average balance of deposits rose ¥41,088 million, or 1.4%, to ¥2,964,417 million.

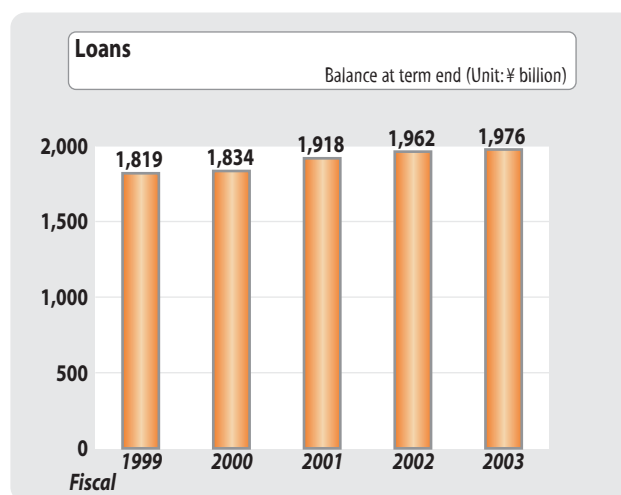
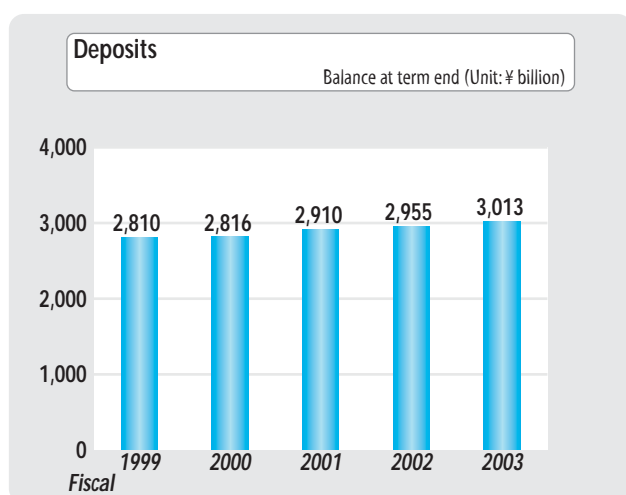
The term-end balance of negotiable certificate of deposits stood at ¥29,311 million.

The balance of customers assets — excluding yen denominated deposits — rose 44.9%, or ¥66,600 million, to ¥215,000 million.

Loans

By responding to the needs of local small and medium-sized corporations, public bodies and retail customers, Higo Bank raised its term-end balance of loans outstanding by ¥14,181 million, or 0.7% compared with the previous term-end, to ¥1,976,570 million.

The average balance of loans outstanding rose ¥21,983 million, or 1.2%, to ¥1,877,519 million.



Revenues

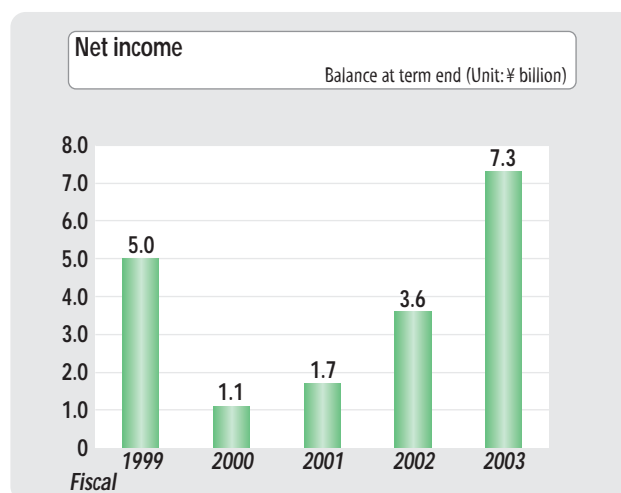
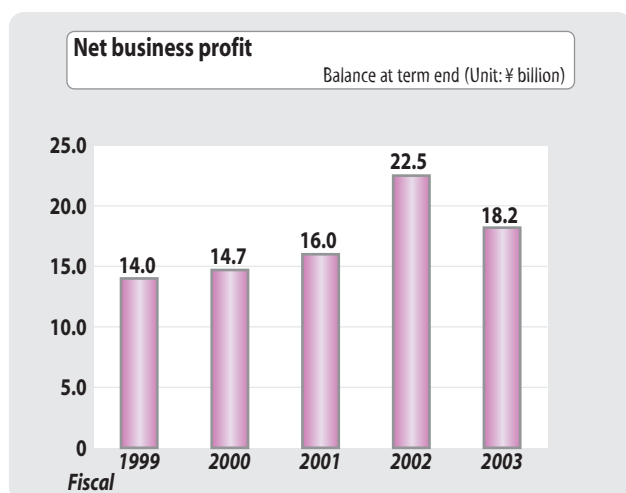
Net business profit

Net income rises ¥3,717 million

With a decrease in gross business profit and a decline in the gain on reversal of the reserve for possible loan losses, net business profit declined ¥4,281 million, to ¥18,277 million.

Net income

Net income was up ¥3,717 million, to ¥7,338 million.



Excellent Financial Indicators

High Evaluations from the Ratings Institutions

Ratings are a concise, symbolic representation of credit risk, indicating a company's degree of trustworthiness or the reliability of their performance regarding liabilities. The ratings institution, as a disinterested third party, publishes its overall evaluation of a company's financial position and earning capability.

The Higo Bank has received official ratings from 3 ratings institutions in Japan and abroad, and we received high evaluations, ranking A, for each of the long-term ratings.

(Long-term credit rating: as of April 30, 2004)

- ❖ **Moody's Investors Service** **A2**
- ❖ **Standard & Poor's** **A-**
- ❖ **Rating and Investment Information, Inc.** **A+**

*A top-class regional bank in Kyushu, with high standards among the domestic banks.

Moody's Credit Rating



S&P Credit Rating



Unrealized Gain on Securities

The Bank recorded a ¥46,700 million gain on the valuation of securities. After deducting deferred tax liabilities from gains on available-for-sale securities, ¥27,300 million was recorded as an unrealized gain on securities, net of tax in shareholders' equity.

Period ended March 31, 2004

(billions of yen)

	Unrealized gain
Held-to-maturity	0.8
Available-for-sale securities	45.8
Shares	34.4
Bonds, etc.	11.4
Total	46.7



Higo Bank has an Excellent Reputation as a Financially Sound Bank Carrying Few Non-Performing Loans

Disclosure of Claims under the Financial Reconstruction Law (non-consolidated)

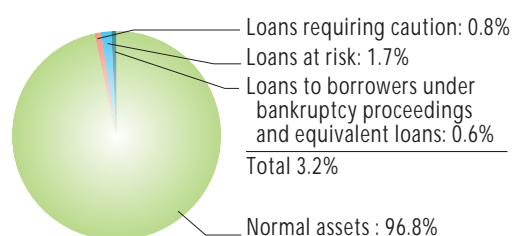
As of March 31, 2004 (billions of yen)

	Loan balance	Coverage by collateral and guarantees	Reserve for possible loan losses	Coverage ratio
Loans to borrowers under bankruptcy proceedings and equivalent loans	12.5	8.4	4.1	100.0%
Loans at risk	34.7	20.8	12.3	95.6%
Loans requiring caution	16.8	9.8	3.3	78.7%
Subtotal	64.1	39.1	19.8	92.0%
Normal loans	1,946.7			
Total	2,010.9			

Note: Figures have been rounded down to the nearest ¥100 million. Fractions in the coverage ratios up to 0.04 have been rounded down, and from 0.05 upward have been rounded up.

Higo Bank's non-performing loans under the disclosure standards mandated by the Financial Reconstruction Law stood at ¥64,148 million as of the end of March 2004, representing 3.2% of the total loan balance. This is an extremely low level compared to Japan's other regional banks.

Of these non-performing loans, 92.0% are covered by collateral, guarantees, and the reserve for possible loan losses, providing a sufficient buffer for the Bank.



Explanation of terms

Loans to borrowers under bankruptcy proceedings and equivalent loans

This category indicates loans to borrowers undergoing bankruptcy proceedings or corporate rehabilitation, or loans to borrowers in a state of virtual bankruptcy.

Loans at risk

This category indicates loans to borrowers who, while not yet in a state of bankruptcy, are suffering from a severe deterioration in financial conditions and are very likely unable to repay outstanding loans.

Loans requiring caution

This category indicates loans for which no repayments, including payments of interest, have been made for 3 months or more, or whose repayment conditions have been eased.



Note: Non-performing loans held by the entire Higo Bank group on a consolidated basis, including subsidiaries and affiliates, in accordance with the disclosure standards under the Financial Reconstruction Law, totaled ¥66,581 million, accounting for 3.3% of the group's total loan balance.

One of the Highest Capital Ratios Among Japan's Regional Banks

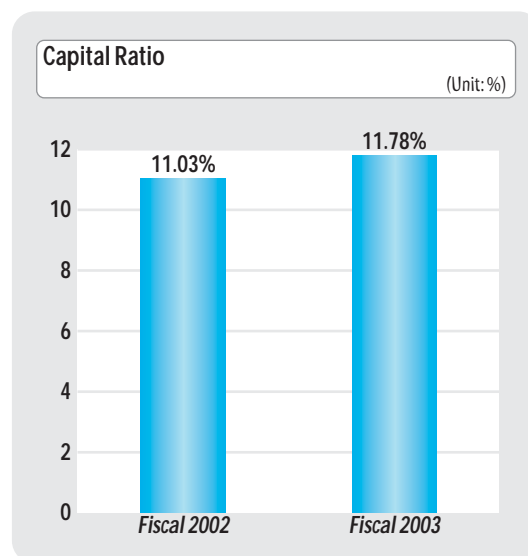
The capital ratio is the ratio of the bank's total equity (capital, retained earnings and other items) to total risk-weighted assets, including loans, marketable securities and others. This figure is growing in importance as an indicator of a bank's financial soundness and overall safety as the deregulation of Japan's financial services industry progresses.

As of March 31, 2004, Higo Bank's capital ratio was 11.78% based on domestic standards. This is one of the highest ratios of any regional bank in Japan and is far above the 4% standard for capital adequacy.

Using only Tier I capital, which includes common stock and certain other elements of equity, the capital ratio stands at 10.82%.

When applying the BIS common minimum standard, Higo Bank's capital ratio remains at a high 12.81%.

*Risk-weighted assets are calculated by multiplying assets and the credit equivalents of off-balance-sheet transactions by a risk factor that varies depending on the credit quality of each asset.



Acquisition and Retirement of Treasury Stock

To bolster investor value, in December 2001 Higo Bank began buying treasury stock as part of its capital policy. Based on the resolution made at the annual shareholders' meeting in June 2003, we instituted a policy of acquiring treasury stock, up to the closing of the 2004 annual shareholders' meeting, with a maximum limit of 5,000,000 shares of treasury stock and an outlay of up to ¥3,000 million.

From June 2003 to March 2004, we acquired 2,596,000 shares, with a total purchase price of ¥1,644 million. We then retired this stock at the end of March 2004.

Since December 2001, we have purchased a cumulative total of 9,285,000 shares at a value of ¥4,589 million. We had retired all of these shares by the end of March 2004.

By retiring treasury stock and reducing the number of shares issued, we are increasing per-share stock value and improving capital efficiency. In continuing our policy of acquiring treasury stock whenever possible and focusing on increasing profitability, I believe that we can raise investment efficiency and meet the expectations of all stakeholders.

Commencing an initiative to acquire ISO14001 certification

Higo Bank is actively addressing environmental issues, as demonstrated by our efforts over many years to protect water resources. To take these activities to a new level, we have begun efforts to acquire ISO14001 certification, the international standard for environmental management systems. These efforts include establishing environmental policies for our main building and the annex.

Environmental policies of Higo Bank

We believe that the basis of our social contribution is to serve the local community based on our corporate mission of contributing to the prosperity of the region we serve while maintaining a high level of corporate ethics.

Higo Bank's main business base is Kumamoto Prefecture in central Kyushu. Possessing a varied sweep of natural beauty, Kumamoto Prefecture is home to the volcano Mt. Aso, which boasts the world's largest caldera, plains that extend from the foot of the mountain, and woodlands that occupy 70% of the prefectural land area. The prefecture enjoys access to clean and pure groundwater that supplies drinking water to 900,000 residents in the urban area of Kumamoto, and the scenic Amakusa area fosters a rich ecological system.

All Higo Bank employees are aware of their responsibility to preserve the natural environment of Kumamoto for future generations. With this recognition, we are committed to achieving the following objectives:

1. To reduce the environmental burden generated by the corporate activities of the Bank.
2. To assist our customers in their activities to protect the environment through the operations of the Bank.
3. To make an active contribution to local communities addressing environmental issues.

To achieve these objectives, the Bank will take the following steps:

1. Build and operate an environmental management system that meets ISO14001 standards, and continue to improve the system.
2. Comply with laws and regulations related to the environment and other provisions recognized by the Bank.
3. Take measures to prevent pollution.
4. Ensure that the Bank's employees are aware of these environmental policies and disclose the policies to the general public.

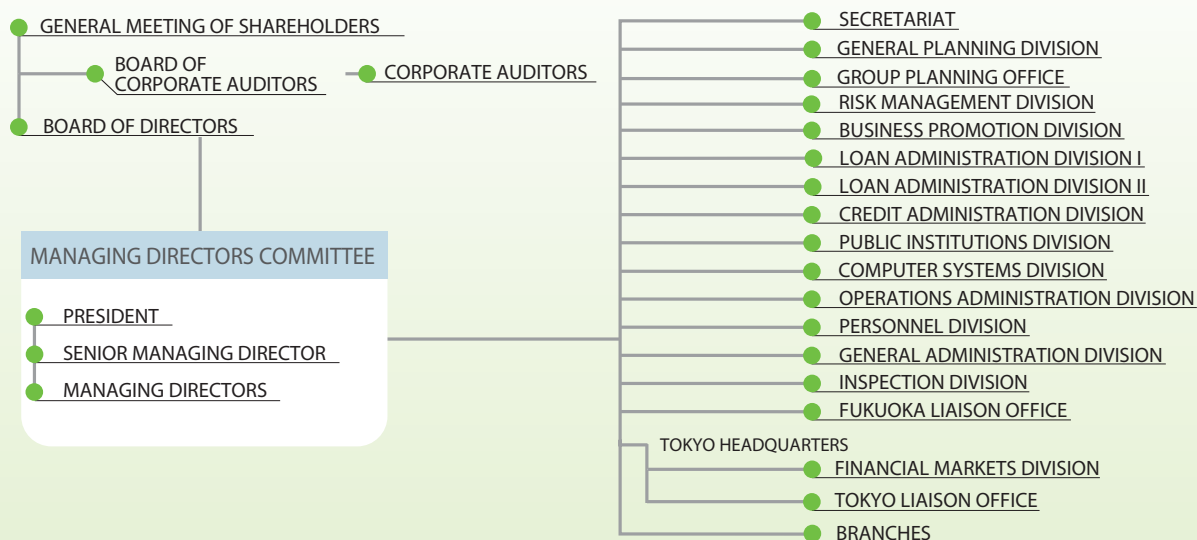
April 1, 2004
The Higo Bank
Hiroo Oguri, President

Corporate Data As of July 1, 2004

Established: July 25, 1925
 Total Assets: ¥3,325.3 billion
 Deposits: ¥3,013.5 billion
 Loans and Bills Discounted: ¥1,976.5 billion
 Capital Stock: ¥18.1 billion

Capital Ratio: 11.78% (domestic standards)
 Number of Employees: 2,177
 Number of Offices: 129
 (Head Office and 114 domestic branches, 12 sub-branches, 3 agencies)

Organization



Board of Directors and Corporate Auditors

President & Representative Director:	Hiroo Oguri		
Senior Managing Director & Representative Director:	Masaomi Mori		
Managing Directors:	Ken Inomata	Takahiro Kai	
	Hiroo Nagata	Moriaki Yamada	
Directors:	Shozo Iwanaga	Tetsuo Uemura	
	Kenichi Hida	Hisaya Kakihara	
Standing Corporate Auditors:	Tomoyoshi Kuroda	Toshiyuki Sumita	
Corporate Auditors:	Naosuke Tokuyama	Jiro Yamada	Tadasu Yonawa

Principal Shareholders As of March 31, 2004

Name	Number of shares Equity stake	
	(thousand)	(%)
Higo Bank Employees' Shareholding Association	12,098	4.88
Mizuho Corporate Bank, Ltd.	11,626	4.69
Meiji Yasuda Life Insurance Co.	11,621	4.69
Takara Kogyo Co., Ltd.	7,682	3.10
Sompo Japan Insurance Inc.	6,854	2.76
Japan Trustee Services Bank, Ltd. (trust account)	6,305	2.54
The Bank of Fukuoka, Ltd.	5,864	2.36
The Master Trust Bank of Japan, Ltd.	5,134	2.07
The Nichido Fire and Marine Insurance Co., Ltd.	4,255	1.71
Mizuho Trust & Banking Co., Ltd.	4,046	1.63
Total	75,487	30.50

Service Network

Head Office

1, Renpeicho, Kumamoto 860-8615
Phone: (096) 325-2111

Financial Markets Division

Tokyo Main Office

10-2, Kyobashi 2-chome,
Chuo-ku, Tokyo 104-0031
Phone: (03) 3535-2431

Cable Address: HIGOBANKJP

Telex: J33402

Facsimile: (03) 3535-6129

Kumamoto Office

1, Renpeicho, Kumamoto 860-8615
Phone: (096) 326-8646
Facsimile: (096) 326-8027

Foreign Exchange Offices

Head Office

1, Renpeicho, Kumamoto 860-8615
Phone: (096) 326-8642

Tokyo Branch

10-2, Kyobashi 2-chome,
Chuo-ku, Tokyo 104-0031
Phone: (03) 3561-3121

Osaka Branch

NM Plaza Midosuji 6F,
6-3, Awaji-cho 3-chome,
Chuo-ku, Osaka 541-0047
Phone: (06) 6208-6551

Fukuoka Branch

8-1, Daimyo 2-chome,
Chuo-ku, Fukuoka 810-0041
Phone: (092) 741-7935

Yatsushiro Branch

3-25, Honmachi 2-chome,
Yatsushiro 866-0861
Phone: (0965) 32-3171

Tamana Branch

550, Takase, Tamana 865-0025
Phone: (0968) 73-2151

Suidocho Branch

3-31, Kamitoricho,
Kumamoto 860-0845
Phone: (096) 352-3111

Kagoshima Branch

1-3, Yamanokuchicho,
Kagoshima 892-0844
Phone: (099) 223-7221

Amakusa Branch

1-1, Suwamachi, Hondo 863-0037
Phone: (0969) 22-2151

Ozu Branch

181-2, Muro, Ozumachi 869-1235
Phone: (096) 293-3131

Matsubase Branch

920-1, Matsubase, Matsubasemachi
869-0502
Phone: (0964) 32-1121

THE HIGO BANK, LTD.
CONSOLIDATED BALANCE SHEETS
March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
ASSETS:			
Cash and due from banks	¥ 78,650	¥ 81,814	\$ 744,157
Call loans and bills bought	15,505	13,384	146,702
Monetary claims purchased	4,138	1,128	39,152
Trading assets	2,834	4,445	26,814
Money held in trust	5,000	4,990	47,308
Securities	1,162,591	1,164,634	11,000,009
Loans	1,976,639	1,962,657	18,702,232
Foreign exchange	1,659	2,265	15,696
Other assets	27,441	21,487	259,636
Premises and equipment	45,134	45,540	427,041
Deferred tax assets	1,100	5,567	10,407
Customers' liabilities for acceptances and guarantees	31,207	46,440	295,269
Reserve for possible loan losses	(25,235)	(24,084)	(238,764)
Total assets	¥ 3,326,668	¥ 3,330,272	\$ 31,475,711
LIABILITIES AND SHAREHOLDERS' EQUITY:			
Liabilities:			
Deposits	¥ 3,040,562	¥ 2,999,329	\$ 28,768,681
Call money and bills sold	6,182	36,227	58,491
Collateral received under securities lending transactions	3,120	10,708	29,520
Borrowed money	3	27	28
Foreign exchange	10	23	94
Other liabilities	16,157	16,639	152,871
Reserve for retirement benefits	18,107	19,451	171,321
Deferred tax liabilities	0	0	0
Deferred tax liabilities related to land revaluation	6,190	6,221	58,567
Acceptances and guarantees	31,207	46,440	295,269
Total liabilities	3,121,544	3,135,070	29,534,903
Minority interests:			
Minority interests	1,222	1,087	11,562
Total minority interests	1,222	1,087	11,562
Shareholders' equity:			
Common stock	18,128	18,128	171,520
Capital surplus	8,133	8,133	76,951
Retained earnings	141,193	136,934	1,335,916
Excess of land revaluation	9,132	9,178	86,403
Unrealized gain on securities, net of tax	27,354	21,743	258,813
Less: Treasury stock	42	3	397
Total shareholders' equity	203,901	194,115	1,929,236
Total liabilities, minority interests and shareholders' equity	¥ 3,326,668	¥ 3,330,272	\$ 31,475,711

The accompanying notes are an integral part of these financial statements.

THE HIGO BANK, LTD.
CONSOLIDATED STATEMENTS OF INCOME
For the years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Income:			
Interest on loans	¥ 39,198	¥ 38,272	\$ 370,877
Interest on and dividends from securities	15,844	17,768	149,910
Other interest	226	497	2,138
Fees and commissions	9,272	9,143	87,728
Trading revenue	137	264	1,296
Other operating income	2,159	2,748	20,427
Other income	2,057	1,273	19,462
Total income	<u>68,896</u>	<u>69,968</u>	<u>651,868</u>
Expenses:			
Interest on deposits	1,227	1,711	11,609
Interest on borrowings and call money	160	425	1,513
Interest on securities lending transactions	74	68	700
Other interest	1,970	2,833	18,639
Fees and commissions	2,886	1,239	27,306
Other operating expenses	2,208	1,953	20,891
General and administrative expenses	40,836	41,073	386,375
Other expenses	6,405	11,701	60,601
Total expenses	<u>55,771</u>	<u>61,007</u>	<u>527,684</u>
Income before income taxes	13,125	8,959	124,183
Income taxes			
- Current	4,963	2,829	46,958
- Deferred	632	2,356	5,979
Minority interests	134	109	1,267
Net income	<u>¥ 7,394</u>	<u>¥ 3,663</u>	<u>\$ 69,959</u>
Per share amounts			
Primary net income	¥29.47	¥14.30	\$0.278

The accompanying notes are an integral part of these financial statements.

THE HIGO BANK, LTD.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the years ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Common stock:			
Balance at beginning of year	¥ 18,128	¥ 18,128	\$ 171,520
Balance at end of year	18,128	18,128	171,520
Capital surplus:			
Balance at beginning of year	8,133	8,133	76,951
Balance at end of year	8,133	8,133	76,951
Retained earnings:			
Balance at beginning of year	136,934	137,198	1,295,619
Reversal of excess of land revaluation	46	(4)	435
Net income	7,394	3,663	69,959
Dividends paid	(1,495)	(1,523)	(14,145)
Bonuses to directors and corporate auditors	(41)	(46)	(387)
Retirement of treasury stock	(1,643)	(2,353)	(15,545)
Balance at end of year	141,193	136,934	1,335,916
Excess of land revaluation:			
Balance at beginning of year	9,178	8,974	86,838
Reversal of excess of land revaluation	(46)	4	(435)
Effect of change in tax rates	-	200	-
Balance at end of year	9,132	9,178	86,403
Unrealized gain on securities:			
Balance at beginning of year	21,743	21,070	205,724
Unrealized gain on securities	5,611	199	53,089
Effect of change in tax rates	-	474	-
Balance at end of year	27,354	21,743	258,813
Treasury stock:			
Balance at beginning of year	3	1	28
Net change during the year	39	2	369
Balance at end of year	42	3	397
Total shareholders' equity	¥ 203,901	¥ 194,115	\$ 1,929,236

The accompanying notes are an integral part of these financial statements.

THE HIGO BANK, LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the year ended March 31, 2004 and 2003

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Cash flows from operating activities:			
Income before income taxes	¥ 13,125	¥ 8,959	\$ 124,183
Depreciation and amortization	2,787	2,475	26,369
Allowance for possible loan losses	1,150	(1,896)	10,880
Reserve for retirement benefits	(1,343)	(627)	(12,706)
Interest and dividend income	(55,268)	(56,537)	(522,925)
Interest expenses	3,434	5,039	32,491
Investment securities gains	585	1,556	5,535
(Gain) loss on money held in trust	(174)	554	(1,646)
Increase in loans	(15,310)	(48,753)	(144,857)
Increase in deposits	56,923	44,833	538,584
Increase in negotiable certificates of deposit	(15,690)	(16,448)	(148,453)
(Increase) decrease in due from banks	(5,885)	17,591	(55,681)
(Increase) decrease in call loans	(5,130)	63,418	(48,538)
(Decrease) increase in call money	(30,044)	7,711	(284,265)
(Decrease) increase in collateral received under securities lending transactions	(7,588)	10,708	(71,794)
Interest income (cash basis)	56,389	58,597	533,532
Interest expense (cash basis)	(3,984)	(5,833)	(37,695)
Other	7,000	16,315	66,231
Total	977	107,662	9,244
Payments for income taxes	(4,192)	(5,277)	(39,663)
Net cash (used in) provided by operating activities	(3,215)	102,384	(30,419)
Cash flows from investing activities:			
Payments for purchases of securities	(242,411)	(343,793)	(2,293,603)
Proceeds from sales of securities	36,988	110,117	349,966
Proceeds from redemption of securities	203,528	150,104	1,925,707
Payments for increase in money held in trust	(310)	(2,000)	(2,933)
Proceeds from decrease in money held in trust	462	6,981	4,371
Payments for purchases of premises and equipment	(1,427)	(352)	(13,501)
Proceeds from sales of premises and equipment	506	134	4,787
Net cash used in investing activities	(2,663)	(78,808)	(25,196)
Cash flows from financing activities:			
Cash dividends paid	(1,495)	(1,523)	(14,145)
Payment for purchase of treasury stock	(1,690)	(2,352)	(15,990)
Proceeds from sales of treasury stock	8	-	75
Net cash used in financing activities	(3,178)	(3,875)	(30,069)
Effect of exchange rate changes on cash and cash equivalents	8	14	75
Net (decrease) increase in cash and cash equivalents	(9,049)	19,714	(85,618)
Cash and cash equivalents at beginning of year	75,665	55,950	715,914
Cash and cash equivalents at end of year	¥ 66,616	¥ 75,665	\$ 630,296

The accompanying notes are an integral part of these financial statements.

THE HIGO BANK, LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The consolidated financial statements have been prepared from the accounts maintained by The Higo Bank, Ltd. (the “Bank”) and its consolidated subsidiaries (together referred to as the “Group”) in accordance with the provisions set forth in the Japanese Commercial Code and in conformity with accounting principles and practices generally accepted in Japan, the Banking Law of Japan, the Financial Statements Regulation (ordinances promulgated by the Ministry of Finance), and the Uniform Accounting Standards for Banks in Japan, which are different from International Accounting Standards in certain respects as to application and disclosure requirements.

Certain items presented in the consolidated financial statements filed with the Ministry of Finance in Japan have been reclassified for the convenience of readers outside Japan.

The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions outside Japan.

Amounts of less than ¥ 1 million have been omitted. As a result, the yen totals shown in the financial statements and notes thereto do not necessarily agree with the sum of the individual account balances.

2. Summary of Significant Accounting Policies

(1) Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Bank and its subsidiaries, after the elimination of all material intercompany transactions, balances, and unrealised gains and losses.

The number of subsidiaries and affiliates as of March 31, 2004 and 2003 was as follows:

	2004	2003
Consolidated subsidiaries	7	7
Affiliates (accounted for under the equity method)	1	1

(2) Fiscal year-ends of consolidated subsidiaries

Fiscal year-ends for the consolidated subsidiaries are as follows:

March 31 7 consolidated subsidiaries

(3) Summary of significant accounting policies

(a) Cash and cash equivalents

Cash and cash equivalents in the consolidated statements of cash flows are composed of cash on hand and due from the Bank of Japan.

(b) Foreign currency translation

The Bank maintains its accounting records in yen. Foreign currency assets and liabilities are translated into yen at the exchange rates prevailing on the balance-sheet dates. There were no assets/liabilities denominated in foreign currency held by consolidated subsidiaries.

In the previous fiscal year, the Bank adopted the transitional provisions of the “Accounting and Auditing Treatment relating to Accounting for Foreign Currency Transactions in the Banking Industry” (JICPA Industry Audit Committee Report No. 25). The Bank has adopted the principal provisions of the JICPA Industry Audit Committee Report No. 25 from this fiscal year, under which hedge accounting is applied to currency swaps, foreign exchange swaps and other similar transactions entered into to convert currency of funding (Japanese Yen) into currencies of investment (foreign currencies). A summary of the hedge accounting applied to these transactions is described in (d) iii).

As a result of the application of hedge accounting, currency swaps, foreign exchange swaps and other similar transactions, which were accounted for on an accrual basis in the previous fiscal year, are valued at fair value and the net amount of the credit and the debt balances are recorded on the consolidated balance sheet. As a result of this change, both “other assets” and “other liabilities” increased by ¥160 million (\$1,513 thousand) compared with the amounts that would have been recorded if the basis of presentation had not been changed. This change had no impact on net income.

In the previous fiscal year, on the basis of the temporary treatment described in the JICPA Industry Audit Committee Report No. 25, the translation differences arising from foreign exchange forward transactions other than those described above had been included in “other assets” or “other liabilities” on a net basis. However, from this fiscal year, in accordance with the provisions of JICPA Industry Audit Committee Report No. 25, they are included in “other assets” and “other liabilities” on a gross basis. As a result of this change, both “other assets” and “other liabilities” increased by ¥16 million (\$151 thousand).

(c) Trading assets and Trading liabilities

Securities, monetary receivables, money trusts, etc. included in “Trading assets” or “Trading liabilities” are stated at market value. Trading-related derivative financial instruments are valued based on the assumption that they are settled at the end of the fiscal year.

Profits and losses from trading assets and trading liabilities are recorded in “Trading revenue/expenses” on a trade date basis. In the case of securities, monetary receivables, etc., held for trading purposes, “Trading revenue/expenses” include interest received/paid during the fiscal year and the difference between the valuation profits and losses at the end of the current fiscal year and those at the end of the previous fiscal year. In the case of trading-related derivative financial instruments, “Trading revenue/expenses” include interest received/paid during the fiscal year and the difference in profits and losses at the end of the fiscal year and at the end of the previous fiscal year based on the assumption that transactions were settled.

(d) Financial Instruments

i) Securities

Held-to-maturity debt securities are stated at amortized cost as determined by the moving average method. Other securities with market quotations are stated at the market prices prevailing at the balance sheet date. Cost of sales of such securities is determined by the moving average method. Net unrealized gains or losses on these securities, net of tax, are reported as a separate item in the shareholders' equity. Other securities without market quotations are stated at cost or amortized cost as determined by the moving average method. Investments in securities included in money trusts managed separately, the primary objective of which is to invest in securities, are stated at market prices. Other investments in money trusts are accounted for in a manner consistent with those discussed above.

ii) Derivatives

All derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise, except for derivatives that are designated as "hedging instruments" (see iii) Hedge Accounting below).

iii) Hedge Accounting

a) Hedge of interest rate risks

The bank has adopted the deferral method of hedge accounting and, for specific interest rate swaps, the accrual method of hedge accounting. In the previous year, the Bank utilized a macro hedge methodology using derivatives to manage overall interest rate risk arising in various financial assets and liabilities held, including loans and deposits. The gain and loss deferred under the previous macro hedge methodology are amortized as interest expenses over 2 years from this fiscal year corresponding to the remaining periods to maturity and to the notional principal of the hedging instruments. At March 31, 2004, deferred hedge losses and profits are ¥13 million (\$151 thousand) and nil, respectively.

The previous methodology is stipulated as a "Risk Adjusted Approach" of risk management in "Tentative Accounting and Auditing Treatment relating to Adoption of 'Accounting for Financial Instruments' for Banks" (Japanese Institute of Certified Public Accountants, Industry Audit Committee Report No. 15), under which the deferral method of hedge accounting was applied on the basis of the temporary treatment described in the "Accounting and Auditing Treatment relating to the Adoption of 'Accounting for Financial Instruments' for Banks"(JICPA Industry Audit Committee Report No.24). Hedge effectiveness was assessed by checking whether the risk amounts arising from derivative instruments used as hedging instruments were within the established risk limits as set out in the risk management policy and whether the interest rate risk arising from hedged items has been mitigated.

b) Hedging foreign currency exchange risks

The bank has adopted the deferral method of hedge accounting for hedges of the risks arising from financial assets and liabilities due to the fluctuation of foreign exchange rates. In the previous year, the Bank utilized the transitional provisions of JICPA Industry Audit Committee Report No.24. However, from this fiscal year, the Bank applies the principal treatment described in JICPA Industry Audit Committee Report No.25 under which hedge accounting is applied to currency swaps, foreign exchange swaps and other similar transactions entered into to convert currency of funding (Japanese Yen) into currencies of investment (foreign currencies). Hedge effectiveness is assessed by checking that the foreign currency amounts of hedging instruments corresponds to the amount of hedged items, financial monetary assets and liabilities denominated in foreign currencies, using currency swaps or foreign exchange swaps transactions entered into to mitigate the foreign exchange rate risk arising on hedged items.

Net unrealized gain or losses on hedging instruments are included in "Other assets". Gross unrealized losses at March 31, 2004 and 2003 are ¥588 million (\$5,563 thousand) and ¥2,153 million, respectively. Gross unrealized gains at March 31, 2004 and 2003 are ¥49 million (\$463 thousand) and nil, respectively.

(e) Premises and equipment

- i) Depreciation of premises and equipment is computed as follows.

Premises: Depreciation is computed using the declining balance method over the estimated useful lives of the respective assets.

However, depreciation on buildings acquired after April 1, 1998 (excluding annex facilities of buildings) is computed by the straight-line method.

Equipment: Depreciation is computed by the declining balance method over the estimated useful lives of the respective assets.

The useful lives of premises and equipment are generally as follows:

Building 20 ~ 50 years

Equipment 5 ~ 20 years

- ii) Based on the Law Concerning the Revaluation of Land (Law 34 promulgated on March 31, 1998), land for commercial-use was revalued on March 31, 1999.

In accordance with Article 3, Paragraph 3 of Law 34, revaluations were made based on the prices that form the basis for calculating land value taxes as set out in Article 2, Subparagraph 3 of the Ordinance Implementing the Law Concerning Revaluation of Land (Government Ordinance No.119 dated March 31, 1998), with appropriate adjustments.

The unrealized gain (net of tax effect) is recorded as "Excess of land revaluation" in shareholders' equity and the tax effect is recorded as "Deferred tax liabilities" related to land revaluation. The difference between the book value of the land revalued in accordance with Article 10 of the Law Concerning the Revaluation of Land and the market value was ¥10,034 million (\$94,938 thousand) and ¥8,427

million at March 31, 2004 and 2003, respectively.

(f) Costs of computer software developed or obtained for internal use

Costs of computer software developed or obtained for internal use are deferred and amortized using the straight-line method over the estimated useful lives of 5 years.

(g) Reserve for loan losses

The reserve for loan losses is provided as follows:

- 1) The reserve for claims on debtors who are legally or substantially bankrupt is provided based on the amount remaining after deducting the amount expected to be collected through the disposal of collateral or through the execution of guarantees.
- 2) The reserve for claims on debtors who are not currently legally bankrupt but are likely to become bankrupt is provided at the amount considered necessary after due consideration of the results of a solvency assessment. The solvency assessment identifies the amounts expected to remain after deducting the amounts expected to be collected through the disposal of collateral or through the execution of guarantees.
- 3) The reserve for claims on debtors other than the above is provided based on default rates calculated using actual defaults during a certain period in the past.

All claims are assessed by the branches and credit supervision divisions based on the internal rules for the self-assessment of assets. The Asset Examination Division, which is independent from the branches and credit supervision divisions, audits these self-assessments, and the reserve is provided based on the audit results.

With respect to the claims with collateral or guarantees on debtors who are legally or substantially bankrupt, estimated uncollectible amounts have been directly charged off against claims. The charge off amounted to ¥13,113 million (\$124,070 thousand) and ¥14,058 million for the years ended March 31, 2004 and 2003, respectively.

(h) Reserve for retirement benefits

The reserve for retirement benefits, which is provided for the payment of employees' retirement benefits, represents the estimated present value of projected benefit obligations in excess of the fair value of the plan assets, taking in to account adjustments for unrecognized prior year service costs and unrecognized actuarial differences. Unrecognized prior service costs and unrecognized actuarial differences are amortized on a straight-line basis over a period of 10 years from the year following the year in which they arise.

The Bank obtained an approval for an exemption from the benefits related to future employee service by the Ministry of Health, Labor and Welfare on November 14, 2003 in connection with the substitutional portion of the Employee Pension Fund.

The substitutional portion, which will be transferred to the government in a subsequent year (minimum liability reserve) measured at the end of this fiscal year is

approximately ¥10,955 million (\$103,652 thousand). The bank has estimated a gain on exemption of ¥5,810 million (\$54,972 thousand) calculated applying the Article 44-2 of the “Practical Guideline for Accounting Standard for Employees’ Retirement Benefits” assuming that the transfer took place at March 31, 2004.

(i) Leases

Finance leases (other than those that are deemed to transfer ownership of the leased assets to the lessees) are accounted for as operating leases.

(j) Valuation of assets and liabilities in consolidated subsidiaries

Assets and liabilities in consolidated subsidiaries are revalued to fair market value when a majority interest in the subsidiaries is purchased.

(k) Per share information

Net income per share is computed based on the weighted average number of shares of common stock outstanding during the year. The Bank adopted “Accounting Standard for Earnings per Share”(Accounting Standard No. 2) and “Implementation Guidance on Accounting Standard for Earnings per Share” (Accounting Standard Implementation Guidance No. 4) from the year ended March 31, 2003.

Per share information is as follows:

	Yen		U.S. dollars
	2004	2003	2004
Net assets per share	¥ 823.90	¥ 776.04	\$ 7.79
Net income per share	29.47	14.30	0.27

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Net income	¥ 7,394	¥ 3,663	\$ 69,959
Deducting bonuses to directors	(47)	(41)	(444)
Net income attributable to common stock	7,347	3,622	69,514

	Thousand	
	2004	2003
The average number of shares outstanding during the year	249,244	253,162

(l) Treasury stock

The number of common stock held by consolidated subsidiaries and affiliates accounted for by the equity method was 68 thousand and 7 thousand at March 31, 2004 and 2003, respectively.

(m) Accounting standard for impairment of fixed assets

On August 9, 2002, the Business Accounting Council in Japan issued “Accounting Standard for Impairment of Fixed Assets”. The standard requires that fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss shall be recognized in the income statement by reducing the carrying amount of impaired assets or a group of assets to the recoverable amount to be measured as the higher of net selling price and value in use.

The standard shall be effective for the Bank for the fiscal years beginning on April 1, 2005. An earlier adoption is permitted for the fiscal years beginning on April 1, 2004. In addition, an earlier adoption is permitted for annual financial statements for the fiscal year ending on March 31, 2004.

The bank is currently in the process of assessing the potential impact that this standard will have on the Companies’ financial position.

(n) Changes in presentation

Life insurance premiums and guarantee fees paid for consumer loans were deducted from “Interest on loans” in previous years. These are included in “Fees and commissions” from this fiscal year considering the increase in such transactions and nature of these transactions. As a result of this change, interest on loans and fees and commissions both increased by ¥1,644 million (\$15,554 thousand). However, there was no impact on net income.

3. U.S. Dollar Amounts

The Group maintains its accounting records in yen. The U.S. dollar amounts included in the consolidated financial statements and notes thereto represent the arithmetic results of translating yen to dollars on the basis of ¥105.69 to US\$1, the approximate rate of exchange prevailing on March 31, 2004. The inclusion of such dollar amounts is solely for convenience and is not intended to imply that assets and liabilities originated in yen have been or could be readily converted, realized, or settled in dollars at the given rate or at any other rate.

4. Cash and Cash Equivalents

Reconciliation of the cash and cash equivalent balances on the consolidated statements of cash flows and the account balances on the consolidated balance sheets are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Cash and due from banks	¥ 78,650	¥ 81,814	\$ 744,157
Foreign currency deposits	(10,398)	(5,178)	(98,382)
Other deposits	(1,636)	(971)	(15,479)
Cash and cash equivalent	¥ 66,616	¥ 75,665	\$ 630,296

5. Securities

The following disclosure includes certificates of deposits included in “Cash and due from banks”, commercial paper included in “Monetary claims purchased” as well as “Securities” on the balance sheet.

“Securities” on the balance sheet included stocks of affiliates amounting to ¥170 million (\$1,608 thousand) and ¥141 million at March 31, 2004 and 2003, respectively.

“Other expenses” in the statements of income includes write-down of investments in stocks of ¥2,542 million for the year ended March 31, 2003.

(1) Carrying value and market value of securities

(a) Trading securities

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Carrying value	¥ 2,834	¥ 4,445	\$ 26,814
Unrealized gain (loss) charged to income	(0)	6	(0)

(b) Held-to-maturity debt securities with market value.

Municipal government bonds	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Carrying value	¥ 22,859	¥ 32,257	\$ 216,283
Market value	23,650	33,748	223,767
Net unrealized gain	791	1,491	7,484
Gains	791	1,491	7,484
Losses	-	-	-

Corporate bonds	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Carrying value	¥ 3,764	¥ 3,908	\$ 35,613
Market value	3,842	4,083	36,351
Net unrealized gain	78	175	738
Gains	92	175	870
Losses	13	-	123

Note: Market values are mainly based on their market prices at the balance sheet date.

(c) Other securities with market value

		Millions of yen				
		2004				
		Acquisition	Carrying	Net	Gains	Losses
		cost	value	Unrealized		
		¥	¥	gain	¥	¥
Stocks		35,008	69,413	34,405	35,485	1,080
Bonds						
	Japanese					
	Government Bonds	456,761	461,258	4,496	5,992	1,495
	Municipal					
	Government Bonds	172,289	175,179	2,890	3,673	783
	Corporate Bonds	263,033	264,475	1,442	1,949	506
		892,084	900,913	8,829	11,614	2,785
Others		157,781	160,443	2,661	3,300	638
	Total	¥1,084,874	¥1,130,771	¥ 45,896	¥ 50,401	¥ 4,504

		Millions of yen				
		2003				
		Acquisition	Carrying	Net	Gains	Losses
		cost	value	Unrealized		
		¥	¥	gain	¥	¥
Stocks		34,458	47,758	13,299	16,364	3,064
Bonds						
	Japanese					
	Government Bonds	418,906	428,405	9,498	10,301	802
	Municipal					
	Government Bonds	161,062	167,935	6,873	6,873	0
	Corporate Bonds	288,747	292,807	4,059	4,065	6
		868,716	889,148	20,431	21,240	808
Others		183,740	186,493	2,753	4,031	1,278
	Total	¥1,086,915	¥1,123,399	¥ 36,484	¥ 41,636	¥ 5,151

		Thousands of U.S. dollars				
		2004				
		Acquisition	Carrying	Net	Gains	Losses
		cost	value	Unrealized		
		\$	\$	gain	\$	\$
Stocks		331,232	656,760	325,527	335,746	10,218
Bonds						
	Japanese					
	Government Bonds	4,321,704	4,364,253	42,539	56,694	14,145
	Municipal					
	Government Bonds	1,630,135	1,657,479	27,344	34,752	7,408
	Corporate Bonds	2,488,721	2,502,365	13,643	18,440	4,787
		8,440,571	8,524,108	83,536	109,887	26,350
Others		1,492,865	1,518,052	25,177	31,223	6,036
	Total	\$10,264,679	\$10,698,940	\$ 434,251	\$ 476,875	\$ 42,615

Note: Carrying values on the Consolidated Balance Sheet are stated mainly based on their market prices at the balance sheet date.

In the fiscal year ended March 31, 2004 and March 31, 2003, losses on impairment of ¥449million (\$4,248 thousand) and ¥2,445 million were recorded for stocks with market value, respectively.

Losses on impairment were recorded for all securities with market value whose market values at the balance sheet dates were less than 50% of the cost of these securities. In addition, losses on impairment are recorded for certain securities with market value whose market values at the balance sheet dates fell 30% or more but less than 50% after assessment of price trends and credit risks of issuers.

- (2) Held-to-maturity debt securities sold during the fiscal years ended March 31, 2004 and 2003.

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Corporate Bonds			
Cost	¥ 49	-	\$ 463
Sold at	51	-	482
Gains (Losses)	1	-	9

The reason of sold : Early redemption of Bonds

- (3) Other securities sold during fiscal years ended March 31, 2004 and 2003.

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Amounts sold	¥ 36,398	¥108,719	\$ 344,384
Gross gains	1,060	1,889	10,029
Gross losses	682	1,201	6,452

- (4) Carrying value of securities without market value

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Held-to-maturity Debt Securities	¥ 3,250	¥ 3,199	\$ 30,750
Other Securities	1,769	1,720	16,737

- (5) Reclassified securities

The Bank and its consolidated subsidiaries had no reclassified securities.

(6) Maturities of held-to-maturity debt securities and other securities held.

		Millions of yen			
		2004			
		Within one year	Over one year but within 5 years	Over 5 years but within 10 years	Over 10 years
Bonds					
Japanese Government Bonds	¥ 24,111	¥ 336,577	¥ 50,482	¥ 50,087	
Municipal Government Bonds	23,150	123,291	51,597	-	
Corporate Bonds	73,257	179,205	19,027	-	
	<u>¥ 120,518</u>	<u>¥ 639,074</u>	<u>¥ 121,107</u>	<u>¥ 50,087</u>	
Others	27,040	72,056	55,016	-	
	<u>¥ 147,558</u>	<u>¥ 711,130</u>	<u>¥ 176,124</u>	<u>¥ 50,087</u>	

		Millions of yen			
		2003			
		Within one year	Over one year but within 5 years	Over 5 years but within 10 years	Over 10 years
Bonds					
Japanese Government Bonds	¥ 54,136	¥ 296,893	¥ 45,178	¥ 32,197	
Municipal Government Bonds	23,950	105,345	70,779	117	
Corporate Bonds	66,340	210,371	23,202	-	
	<u>¥ 144,427</u>	<u>¥ 612,610</u>	<u>¥ 139,160</u>	<u>¥ 32,315</u>	
Others	30,064	90,856	58,266	-	
	<u>¥ 174,491</u>	<u>¥ 703,467</u>	<u>¥ 197,426</u>	<u>¥ 32,315</u>	

		Thousands of U.S. dollars			
		2004			
		Within one year	Over one year but within 5 years	Over 5 years but within 10 years	Over 10 years
Bonds					
Japanese Government Bonds	\$ 228,129	\$3,184,568	\$ 477,642	\$ 473,904	
Municipal Government Bonds	219,036	1,166,534	488,191	-	
Corporate Bonds	693,130	1,695,571	180,026	-	
	<u>\$1,140,297</u>	<u>\$6,046,683</u>	<u>\$1,145,869</u>	<u>\$ 473,904</u>	
Others	255,842	681,767	520,541	-	
	<u>\$1,396,139</u>	<u>\$6,728,451</u>	<u>\$1,666,420</u>	<u>\$ 473,904</u>	

(7) Details of unrealized gain on other securities

The unrealized gain on other securities on the balance sheet consists of the following:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Gross unrealized gain on Other securities	¥ 45,896	¥ 36,484	\$ 434,251
Less: deferred tax liabilities	18,542	14,739	175,437
Net unrealized gain on other securities	27,354	21,744	258,813
Less: Minority interest	0	1	0
Unrealized gain on Other securities of Affiliates attributable to the parent company	1	0	9
Unrealized gain on Other securities on the balance sheet	¥ 27,354	¥ 21,743	\$ 258,813

6. Money Held in Trust

The carrying and market values of money held in trust, as of March 31, 2004 and 2003, were as follows:

(1) Money Held in Trust Held for Investment

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Carrying value	¥ 5,000	¥ 4,690	\$ 47,308
Unrealized gain charged to income	810	(168)	7,663

(2) Money Held in Trust Held to Maturity

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Carrying value	-	¥300	-
Market value	-	300	-

(3) Other Money Held in Trust (Money Held in Trust other than Held for Investment or Held to Maturity)

None.

7. Loans

Loans at March 31, 2004 and 2003 include the following:

	Millions of yen		Thousands of US dollars
	2004	2003	2004
Bankruptcy loans (1)	¥ 4,141	¥ 8,001	\$ 39,180
Non-accrual loans (2)	39,765	38,808	376,241
Accruing loans past due 3 months or more	1,070	617	10,123
Restructured loans (3)	15,783	20,028	149,332
Total	¥ 60,761	¥ 67,456	\$ 574,898

- (1) Bankruptcy loans represent non-accrual loans to borrowers who are legally bankrupt as defined in Article 96-1-3 and 4 of the Japanese Tax Law Enforcement Regulation (Article 97 of 1965 Cabinet Order).
- (2) Non-accrual loans represent non-accrual loans other than (i) bankruptcy loans and (ii) loans for which payments of interest are deferred in order to assist or facilitate the restructuring of borrowers in financial difficulties.
- (3) Restructured Loans represent loans on which contracts were amended in favor of borrowers (e.g., reduction of or exemption from stated interest, deferral of interest payments, extension of maturity dates, renunciation of claims) in order to assist or facilitate the restructuring of borrowers in financial difficulties.

Loans include bills discounted amounting to ¥33,482 million (\$316,794 thousand) and ¥38,350 million at March 31, 2004 and 2003, respectively. The Bank is entitled, without limitation, to dispose these bills discounted.

“Other expenses” in the statements of income includes loans written off amounting to ¥1,328 million (\$12,565 thousand) and ¥4,475 million for the year ended March 31, 2004 and 2003, respectively.

8. Assets Pledged

Assets pledged as collateral are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Securities	¥ 30,836	¥ 38,628	\$ 291,758

Liabilities related to the above pledged assets are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Deposits	¥ 7,023	¥ 12,853	\$ 66,449
Collateral received under securities lending transactions	¥ 3,120	¥ 10,708	\$ 29,520

In addition, securities totalling ¥65,231 million (\$617,191 thousand) and ¥87,151 million are pledged as collateral for settlement of exchange, short-term funding, derivatives or as variation margin, etc. at March 31, 2004 and 2003, respectively.

9. Commitment Line Agreements Related to Overdrafts and Loans

Commitment line agreements relating to overdrafts and loans represent agreements to allow customers to extend overdrafts or loans up to agreed amounts at the customers' request as long as no violation against the conditions of the agreements exists.

Unused commitment lines under such agreements are as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Original maturity within one year or cancelable by the Bank at any time without any penalty	¥ 552,642	¥ 547,312	\$ 5,228,895
Others	1,170	-	11,070
Total	<u>¥ 553,812</u>	<u>¥ 547,312</u>	<u>\$ 5,239,965</u>

The amount of unexercised commitment lines does not necessarily affect the future cash flows of the Bank and consolidated subsidiaries because many such agreements are terminated without being exercised. Many of these agreements have provisions, which stipulate the Bank and consolidated subsidiaries may deny extending loans or decrease the commitment line when there are certain changes in financial markets, certain issues in securing loans and other reasons. The Bank requests collateral in the form of premises or securities as deemed necessary upon providing such commitments. In addition, the Bank monitors the financial condition of customers in accordance with its internal rules on a regular basis (semi-annually) and takes necessary measures including revisiting the terms of commitments and other means to prevent credit losses.

10. Reserve for retirement benefits

The Bank operates defined benefit retirement plans covering substantially all employees. Pension plans have been operating since April 1, 1970 (plan under the Japanese Welfare Pension Insurance Law) and since April 1, 1995 (tax qualified pension plan) in addition to the lump-sum retirement benefit plan. The Bank obtained an approval for an exemption from the benefits related to future employee service by the Ministry of Health, Labor and Welfare on November 14, 2003 in connection with the substitutional portion of the Employee Pension Fund.

The reserve for retirement benefits as of March 31, 2004 and 2003 is analyzed as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Projected benefit obligations	¥ (62,510)	¥ (54,901)	\$ (591,446)
Plan assets	30,324	24,124	286,914
	(32,186)	(30,776)	(304,532)
Unrecognized transition amount	-	-	-
Unrecognized actuarial differences	17,706	13,088	167,527
Unrecognized prior service cost	(3,628)	(1,763)	(34,326)
	(18,107)	(19,451)	(171,321)
Prepaid pension cost	-	-	-
Reserve for retirement benefits	¥ (18,107)	¥ (19,451)	\$ (171,321)

Notes: 1. The above table includes amounts related to the portion subject to the Japanese Welfare Pension Insurance Law.

2. The substitutional portion, which will be transferred to the government in a subsequent year (minimum liability reserve) measured at the end of this fiscal year is approximately ¥10,955 million (\$103,652 thousand). The bank has estimated a gain on exemption of ¥5,810 million (\$54,972 thousand) calculated applying the Article 44-2 of the “Practical Guideline for Accounting Standard for Employees’ Retirement Benefits” assuming that the transfer took place at March 31, 2004.

3. Discretionary additional payments are not included.

4. Consolidated subsidiaries have adopted simplified methods to calculate projected benefit obligations.

Net pension expense related to the retirement benefits for the year ended March 31, 2004 and 2003 was as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Service cost	¥ 1,336	¥ 1,674	\$ 12,640
Interest cost	1,345	1,404	12,725
Expected return on plan assets	(909)	(1,228)	(8,600)
Amortization of prior service cost	(276)	(104)	(2,611)
Amortization of actuarial differences	1,469	1,120	13,899
Amortization of transition amount	-	-	-
Other	24	17	227
Net pension expense	¥ 2,991	¥ 2,883	\$ 28,299

Note: Net pension expense of certain consolidated subsidiaries adopting simplified methods is included in the service cost.

Assumptions used in the calculation of the above information were as follows:

	2004	2003
Discount rate	2.0%	2.5%
Expected rate of return on plan assets		
Japanese Welfare Pension Insurance Law	4.0%	5.0%
Tax qualified pension plan	3.0%	3.5%
Method of attributing the projected benefits to periods of services	Straight-line basis	Same as on the left
Amortization of prior service cost	10 years from the year differences arise	Same as on the left
Amortization of unrecognized actuarial differences	10 years from the year following the year differences arise	Same as on the left

11. Income taxes

At March 31, 2004 and 2003, significant components of deferred tax assets and liabilities were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Deferred tax assets:			
Reserve for possible loan losses	¥ 10,433	¥ 10,797	\$ 98,713
Reserve for retirement benefit	6,989	7,296	66,127
Depreciation	1,908	1,990	18,052
Loss on impairment of securities	2,488	2,304	23,540
Other	467	371	4,418
Total	<u>22,288</u>	<u>22,759</u>	<u>210,880</u>
Valuation allowance	<u>(2,528)</u>	<u>(2,342)</u>	<u>(23,919)</u>
Deferred tax assets	<u>19,759</u>	<u>20,417</u>	<u>186,952</u>
Deferred tax liabilities:			
Unrealized gain on Other securities	(18,541)	(14,739)	(175,428)
Excess of land revaluation real estate	(117)	(110)	(1,107)
Other	(0)	(0)	(0)
Total	<u>(18,659)</u>	<u>(14,850)</u>	<u>(176,544)</u>
Net deferred tax assets (liabilities)	<u>¥ 1,100</u>	<u>¥ 5,566</u>	<u>\$ 10,407</u>

The reconciliation of the statutory tax rate to the effective income tax rate for the year ended March 31, 2003 is as follows:

	2003
Statutory tax rate	41.7%
Increase (decrease) in taxes resulting from	
Permanent non-taxable items including dividend income	(1.5)
Permanent non-deductible items including entertainment expenses	0.7
Resident tax per capita levy	0.5
Loss on impairment of securities	11.8
Effect of change in tax rates on deferred tax assets	5.0
Other	(0.3)
Effective income tax rate	<u>57.9%</u>

The reconciliation of the statutory tax rate to the effective income tax rate for the years ended March 31, 2004 is not provided, as the difference in rates is less than 5% of the statutory tax rate.

12. Leases

(1) Information on finance lease contracts without an ownership transfer for the years ended March 31, 2004 and 2003 was as follows:

(a) Acquisition cost, accumulated depreciation, net book value, Lease expenses, depreciation expenses, and interest expense on the leased assets (assuming capitalization of finance leases) were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Acquisition cost	¥ 6,525	¥ 5,577	\$ 61,737
Accumulated depreciation	(2,940)	(2,419)	(27,817)
Net book value	<u>¥ 3,585</u>	<u>¥ 3,158</u>	<u>\$ 33,919</u>
Lease expenses	<u>¥ 1,325</u>	<u>¥ 1,440</u>	<u>\$ 12,536</u>
Depreciation expenses	<u>¥ 1,174</u>	<u>¥ 1,274</u>	<u>\$ 11,107</u>
Interest expenses	<u>¥ 164</u>	<u>¥ 182</u>	<u>\$ 1,551</u>

Depreciation is based on the straight-line method over the lease term of the leased assets. Interest expenses are determined by the allocation of the portion of the total lease payment that exceeds the acquisition cost of leased assets, using the interest method.

(b) The amount of future lease payments at March 31, 2004 and 2003, which excludes the interest portion, were as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Future lease payments:			
Due within one year	¥ 1,204	¥ 1,046	\$ 11,391
Due in over one year	2,504	2,224	23,691
Total	<u>¥ 3,709</u>	<u>¥ 3,271</u>	<u>\$ 35,093</u>

- (2) The amount of future lease payments at March 31, 2004 and 2003 were on operating lease contracts as follows:

	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Future lease payments:			
Due within one year	¥ 0	¥ 0	\$ 0
Due in over one year	0	1	0
Total	<u>¥ 1</u>	<u>¥ 2</u>	<u>\$ 9</u>

13. Derivative Financial Instruments

- (1) Derivative financial instruments used by the Bank

The Bank enters into futures and options on interest rates, currencies, stocks and bonds, and interest rate swaps and currency swaps.

The Bank enters into these derivative transactions in order to manage and hedge the risks associated with interest rate fluctuations and exposure to changes in the market value of assets and liabilities held by the Bank. In addition, the Bank enters into derivative transactions for trading purposes, within the position and loss limits set up by the Bank.

Other companies in the Group do not enter into derivative transactions.

- (2) Risks on derivative transactions

The major risks associated with derivative transactions, which have the potential to materially impact the Bank's financial condition, are market risk and credit risk.

Market risk is related to the increase and decrease in the market value of the positions held by the Bank due to changes in the market price and interest rates of the underlying assets. Market risk is also subject to changes in liquidity and the volatility of the markets. Credit risk refers to possible losses on the positions held by the Bank, which result from a counterparty's failure to perform according to the terms and conditions of the contract.

The Bank mainly applies a quantitative measurement method in order to capture market risk. The Bank monitors the outstanding balance and profit and loss for each type of transaction on a daily basis. In addition, the Bank applies a "Value-at-Risk" measurement method to transactions for which it is considered necessary to apply a more sophisticated method. The Bank manages credit risk by establishing credit limits for counterparties. Reviews of the adequacy of established credit lines are made on a regular basis and as deemed necessary.

The credit risk amounts calculated based on the capital adequacy rules as of March 31, 2004 and 2003 was ¥11,577 million (\$109,537 thousand) and ¥5,287 million, respectively.

- (3) Risk management system of the Bank

The Bank exercises and controls the derivative transactions using limits including position limits, credit limits for each counterparty and stop loss limits in accordance with the

Bank's policy on derivative transactions. Risks quantified are reported to the department and the director responsible for monitoring the transactions and the board of directors.

The front office function and the back office function are segregated. The middle office is responsible for risk management and monitors front and back offices' compliance with regulations and internal rules.

Contract amounts or notional principal amounts of derivative financial instruments disclosed represent nominal contract amounts or the notional principal amounts set up for the calculation of the settlement amounts. Generally, they do not represent the amounts for which the actual assets are exchanged. These amounts do not represent, by themselves, the volume of market risk and credit risk related to the underlying derivative financial instruments.

(4) Market value of derivative financial instruments

(a) Interest Rate Related Transactions

Millions of yen				
2004				
	Contractual value or notional principal amount	Including Over one year	Market value	Unrealized Profit/(Loss)
Over-the-counter				
Interest rate swaps				
Receipts fixed-payments floating	¥ 2,000	¥ 2,000	¥ 57	¥ 57
Receipts floating-payments fixed	2,697	2,000	(62)	(62)
Total			¥ (5)	¥ (5)

Millions of yen				
2003				
	Contractual value or notional principal amount	Including Over one year	Market value	Unrealized Profit/(Loss)
Over-the-counter				
Interest rate swaps				
Receipts fixed-payments floating	¥ 7,000	¥ 2,000	¥ 123	¥ 123
Receipts floating-payments fixed	7,000	2,000	(104)	(104)
Total			¥ 18	¥ 18

Thousands of U.S. dollars				
2004				
	Contractual value or notional principal amount	Including Over one year	Market value	Unrealized Profit/(Loss)
Over-the-counter				
Interest rate swaps				
Receipts fixed-payments floating	\$ 18,923	\$ 18,923	\$ 539	\$ 539
Receipts floating-payments fixed	25,518	18,923	(586)	(586)
Total			\$ (47)	\$ (47)

Notes: 1. Market values of exchange-traded instruments are based on closing prices of the Tokyo International Financial Futures Exchange and others.

Market values of over-the-counter transactions are based on the discounted present values or the option pricing calculation model, etc.

2. The balances as of March 31, 2004 and 2003 disclosed above exclude derivatives accounted for as hedges. The derivatives disclosed are valued at market value on the balance sheet with resulting gains and losses taken to the statement of income.

(b) Foreign exchange related transactions

i) Balance as of March 31, 2004 and 2003

	Millions of yen			
	2004			
	Notional Principal Amount	Including Over one year	Market value	Unrealized Profit/(Loss)
Over-the-counter currency swaps	¥ 80,459	¥ 46,859	¥ (56)	¥ (56)
Over-the-counter Foreign exchange forward contracts				
Sales	2,219	-	127	127
Purchase	1,257	-	(15)	(15)
Total			¥ 55	¥ 55

	Millions of yen			
	2003			
	Notional Principal amount	Including Over one year	Market Value	Unrealized Profit/(Loss)
Over-the-counter currency swaps	¥ 71,890	¥ 29,876	¥ (42)	¥ (42)

	Thousands of U.S. dollars			
	2004			
	Notional Principal amount	Including Over one year	Market Value	Unrealized Profit/(Loss)
Over-the-counter currency swaps	\$ 761,273	\$ 443,362	\$ (529)	\$ (529)
Over-the-counter Foreign exchange forward contracts				
Sales	20,995	-	1,201	1,201
Purchase	11,893	-	(141)	(141)
Total			\$ 520	\$ 520

- Notes: 1. Market values are based on the discounted present values and market prices prevailing as of the year-end date.
2. Balances as of March 31, 2004 and 2003 are valued at market value on the balance sheet with resulting gains and losses taken to the statement of income. The balance disclosed above exclude derivatives accounted for as hedges.
3. Currency swaps accounted for using the accrual method at March 31, 2003 is excluded from the disclosure of balances as of March 31, 2003.

The balances of such currency swaps as of March 31, 2003 are as follows:

	<u>Millions of yen</u>	
	<u>2003</u>	
Notional principal	¥	11,329
Market value		54
Unrealized profit/(loss)		54

Foreign exchange forward contracts and currency options which are revalued at the end of the fiscal year and resulting profit and loss taken into the statement of income, which are reflected in the balance sheet amounts of foreign currency receivables and payables hedged, or those related hedged items eliminated in the consolidation have been excluded from the above disclosure.

The balances of foreign exchange related derivatives, which were marked to market as of March 31, 2003, are as follows:

	<u>Millions of yen</u>	
	<u>2003</u>	
Over-the-counter		
Foreign exchange forward contracts		
Sold	¥	3,504
Bought		2,390

14. Appropriation of retained earnings

The annual shareholders' meeting, which was held on June 25, 2004, approved the following appropriations of retained earnings for the year ended March 31, 2004:

	<u>Millions of yen</u>		<u>Thousands of</u>
	<u>2004</u>	<u>2003</u>	<u>U.S. dollars</u>
			<u>2004</u>
Cash dividends (¥3.00 per share)	¥ 742	¥ 750	\$ 7,020
Bonuses to directors and corporate			
Auditors	47	41	444
Transfer to voluntary reserve	2,010	3	19,017

15. Segment information

(1) Segment information by Type of Business

In addition to the banking business, the Group is also engaged in the credit card business, credit guarantee business and other businesses. Such segment information has not been provided, as the percentage of those activities is insignificant to the Group.

(2) Segment information by Geographic Area

All of the Group's entities or branches are in Japan.

(3) Recurring income from international operations

	<u>Millions of yen</u>	<u>Thousands of U.S. dollars</u>
	2004	2004
Recurring income from international operations	¥ 6,958	\$ 65,834
Total operating income	68,214	645,415
International Operations' Ratio	10.2%	10.2%

Recurring income from internal operations for the year ended March 31, 2003 is not provided, as it is less than 10% of total operating income.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors of
The Higo Bank, Ltd.

We have audited the accompanying consolidated balance sheets of The Higo Bank, Ltd. and its consolidated subsidiaries (the "Group") as of March 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, all expressed in Japanese Yen. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of March 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

The amounts expressed in U.S. dollars, provided solely for the convenience of the reader, have been translated on the basis set forth in Note 3 to the accompanying consolidated financial statements.

Chuo Aoyama Pricewaterhouse Coopers

ChuoAoyama PricewaterhouseCoopers
Tokyo, Japan
June 25, 2004



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