Fiscal 1997, ended March 31, 1998, proved to be a transitional, yet turbulent, year for Japan's financial industry. A detailed schedule of Japan's Big Bang financial reform program was announced in June 1997, and reform of the financial system is now under way. Furthermore, anxieties over the financial system have reached unprecedented levels, triggered by the collapse of a string of financial institutions in fall 1997 traced to the country's bad debt problem.

It has been quite a difficult year for DKB as well, as the Bank posted a net loss for the second consecutive year due mainly to the increase of total loss from bad debt. DKB has been aggressively provisioning its nonperforming loans—a major problem saddling the country's banks—and undertaken corporate streamlining efforts to restore public and market confidence in the Bank.

Under these circumstances, DKB has implemented many strategic measures and policies that will ensure its position as a leading bank in the 21st century. Measures taken in fiscal 1997 include:

- reorganizing domestic and international branch networks,
- further upgrading our market risk and credit risk monitoring systems,
- revising loan spread guidelines to reflect more accurate credit risks of borrowers and industries, and
- starting 24-hour telephone banking service for the first time in Japan.

FINANCIAL RESULTS

The hurdles that we faced in fiscal 1997 were indeed very high. However, we were able to record a nonconsolidated net operating profit—the principal gauge of the performance of a Japanese bank's business activities—of ¥323.0 billion. This proves that core earnings of the Bank were kept stable even under the difficult market conditions.

We established stringent standards for the assessment of loan assets in compliance with the new demands set by the Prompt Corrective Action system introduced in April 1998. Total losses from our bad debts amounted to ¥752.8 billion in fiscal 1997, up from ¥620.1 billion recorded in the previous year. As a result, we posted a nonconsolidated net loss of ¥146.4 billion and a consolidated net loss of ¥72.0 billion. This marked the second consecutive year of net losses.

As of March 31, 1998, risk-managed loans under objective new standards amounted to ¥1,471.3 billion. However, due to our aggressive reserve policy, we posted total loan loss reserves of ¥1,124.3 billion, which accounted for 76.4% of total risk-managed loans.

In a bid to strengthen its profitability, DKB posted a sharp ¥12.2 billion decline in nonconsolidated general and administrative expenses over the previous year, to ¥416.3 billion. This drop reflected reductions in personnel and other expenditures. Despite overall declines, we continued to make further investments in other areas, such as risk management, and in those areas that will enable us to gear up for the Big Bang reforms, such as database marketing systems, the enlargement of telephone marketing centers, and extending ATM operating hours.

We raised our risk-based capital ratio by 33 basis points, to 9.08%, in fiscal 1997.

A breakdown of DKB's capital shows that its Tier I capital increased ¥28.4 billion from the previous fiscal year-end, to ¥1,909.2 billion, and Tier II capital dropped ¥47.0 billion from the preceding fiscal year-end, to ¥1,833.8 billion. Meanwhile, we reduced our risk-adjusted assets by ¥1.7 trillion from the previous fiscal year-end, to ¥41.1 trillion, as a result of our efficient balance sheet and capital management.

Management Strategy

New Three-Year Corporate Plan

In anticipation of the continued tumultuous changes in the financial sector, DKB will conclude its Ninth Corporate Plan in fiscal 1998, one year ahead of schedule, and in fiscal 1999 will launch a three-year "First Corporate Plan" that will lead the Bank into the coming century. Under this program, DKB plans to further solidify its position as a leading bank in the Japanese financial market after the Big Bang.

We are currently working out details of specific measures for our "First Corporate Plan." A general outline of our policies is as follows:

(1) Focus on Domestic Markets—Individual and Corporate Clients

Domestic—We will focus on domestic retail markets, which we believe are the most profitable, and make aggressive efforts in meeting the financial needs of both our individual and corporate clients, especially small and medium-sized companies. DKB maintains its competitive advantage through its client base in retail and corporate markets, with more than 12 million individual accounts and over 100,000 corporate customers, most of which are small and medium-sized companies. Also, we have a strong domestic network that consists of 373 offices and 513 ATM centers throughout Japan to sufficiently serve this customer base.

Furthermore, DKB is very active in developing new types of channels and services, such as 24-hour telephone banking and Internet banking, which we expect to be efficient and cost-effective. The most successful service that we have developed is "Ace of Hearts." This service is an award program in which points are awarded to customers based on their transaction activity. "Ace of Hearts" is the largest and most sophisticated such service among Japanese banks and is used by approximately two million customers.

For our individual clients, we seek to become each customer's "lifelong financial partner." The Bank will take advantage of the latest database marketing techniques and is placing particular emphasis on providing asset management products and services as well as consulting services.

DKB is setting its sights on becoming a comprehensive advisor for the management of small and medium-sized companies. With regard to corporate strategies for such firms, the Bank will provide support not only on the financial front but also for management and project development.

Also, we will maintain business relations with large companies and their affiliates by providing them with sophisticated financial services. In addition, we retain access to a huge segment of the retail market of the work force through those relations.

Overseas—On the other hand, for overseas operations, we are working to reorganize our office network to improve efficiency, principally in the United States and Europe. The Bank has concentrated its specialized and advanced financial services in London and New York for enhanced efficiency and effectiveness. Additionally, the Bank is considering consolidating or closing certain offices while implementing measures to ensure that the quality of service is not materially affected.

The aftereffects of the 1997 Asian economic crisis will continue in the short term, and we must take further caution in credit risk management. However, as the region is expected to show further growth in the medium-to-long term, the Bank's plan calls for increased efficiency, primarily in the area of personnel resources and operating costs, with no major changes in the Bank's office network.

(2) Establishing DKB's New Organization and Personnel System

We will transform our organizational system and reexamine our personnel system. We are going to reform our organization into several management units that are grouped according to product and market. We will make all units operate more independently and efficiently. Through these measures, we also plan to reconstruct our entire personnel system to suit the business structure of the various business areas. We encourage each employee to fulfill his or her potential by rewarding those who have shown good results.

(3) Strengthening Our Financial Position—Pursuing Target Ratios

By taking such measures as those outlined above, we are determined to build a sound financial structure based on the establishment of our target ratios. We are planning to achieve a Tier I capital ratio of 6%, a total risk-adjusted ratio of 11%, and ROE of 8%.

However, banks' profitability is affected by such market conditions as interest rates and prevailing economic situations. Furthermore, fierce competition in the domestic financial market is under way. Nevertheless, we will make every effort to achieve these targets in a few years' time by increasing our interest margin and fee income as well as reducing operating costs. Specifically, in order to raise interest margin, we will achieve higher returns by setting even more stringent internal credit-rating standards.

CIT

In November 1997, we listed 20% of the shares of the CIT Group, Inc. (CIT)—a U.S. subsidiary of the Bank—on the New York Stock Exchange. This transaction gave the company access to the public equity market and further diversified its capital base.

CIT has recorded increases in operating revenues each year for the past 10 years and has posted record levels of net income for the past 7 consecutive years. The current market value of the Bank's holding in CIT is more than ¥270 billion, and the company is projected to achieve even higher levels of growth in the future.

The Disposal of Our Nonperforming Loans

During the current fiscal year, DKB will place priority on the disposal of its remaining nonperforming loans and sale of the Bank's real estate collateral pledged against these loans. For this purpose, we will undertake effective measures, such as carrying out bulk sales of nonperforming loans and programs to liquidate real estate collateral through public offerings.

Looking toward the Future

Japan initiated its Big Bang program in fiscal 1998. The enactment of the amended Foreign Exchange and Foreign Trade Law, the passage of the Financial System Reform Laws, and other reforms of the financial system that are under way will intensify competition in Japan among domestic and foreign financial institutions. These reforms will also transform the country's financial markets, leading to the introduction of a wide array of high-quality products and services.

I am convinced that Japan's Big Bang financial reforms will provide various benefits to the clients of financial institutions and, subsequently, the Japanese economy in general. In line with these financial reforms, we will offer our clients a wide range of first-rate financial products and services. Under the First Corporate Plan, DKB will continue to strive to do its utmost to reinforce its position as a leading bank. I am confident that the results of our efforts will greatly satisfy our shareholders, and I look forward to your continued advice and support.

September 1998

Katsuyuki Sugita
President and Chief Executive Officer