Principal Questions and Answers
"Top Management Seminar of Regional Banks"
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Presenter: Mr. Fukai, President

Questions Related to the Business Integration

Q. What kind of financial institution do you aim to be after the business integration with the Daishi Hokuetsu Financial Group?

A. - As we declared when we entered into the memorandum of understanding for the business integration, we aim to become one of the top financial groups in terms of quantity and quality. "In terms of quantity" means "in terms of the balance sheet," and "in terms of quality" means "in terms of profitability, ROE, and other market assessments." In connection with the business plan of the financial group to be implemented after the integration, we are discussing how to achieve the ROE target. In order to achieve this target, both banks need to further improve their ROE. In addition, in terms of quality, it is essential to analyze not only our profitability but also the initiatives of the top regional banks, including the Yokohama Financial Group and Chiba Bank, to bridge the gap between these banks and us. As the capital of the new financial group will amount to around 1 trillion yen, there will be ample room for expanding non-bank businesses. For instance, Chiba Bank added a digital business provider to its group. Exploring the possibilities of initiatives like this, we aim to create a financial group that is a leader in both quantity and quality.

Q. Following the integration, the market capitalization of the new financial group will be around 1 trillion yen. How will the quality of your decision making change?

A. - Our current management covers Gunma Bank, a single entity. While it is easier to make decisions, we are facing the challenges of limited viewpoints and an insufficient ability to analyze issues from multiple perspectives. After the integration, the quality of the management will change significantly, and top management will be required to manage the group in a way that will motivate both banks. As for human resources, the ideal form of the organization we aim to create is one where human resources with diversified values and opinions interact with one another. As we have established equal integration as one of our principles, the previous form of management based on a single culture will not work well. However, I believe that it is important to ensure that the holding company will fully demonstrate leadership, rather than allowing both banks to act freely. Based on this approach, we will aim to manage the group by adopting and implementing various opinions.

General Management

Q. The policy interest rate was raised to 0.75% as assumed in the interest rate scenario that was adopted when the current Mid-Term Business Plan was formulated. How do you expect this to affect your earnings? In addition, as you are likely to achieve the profit target of 60.0 billion yen set for the FY ending March 2028, the final year of the Mid-Term Business Plan, are you considering completing the plan ahead of schedule or setting new targets?

A. - Updating the quantitative plan to adjust it to the current situation is an option since there will be changes in the profit level and its preconditions after a few years have passed since the start of the plan. On the other hand, many of the implemented initiatives will continue for multiple years, including digital-related and other similar initiatives that will not be completed within three years. For this reason, some of the initiatives that had been included in the previous Mid-Term Business Plan continue to be included in the current plan. Currently, in the first year of the Mid-Term Business Plan, loan interest rate sensitivity is greater than expected, and the loan balance is also steadily increasing, which led to the upward revision of our earnings forecast from 49.0 billion yen to 55.0 billion yen. Furthermore, our trial calculations indicate that a 25 bps policy interest rate hike will increase our net interest income by around 6.0 billion yen in the next fiscal year. We expect to announce earnings forecasts for the next fiscal year that reflect this increase.

- In line with the business integration scheduled for April 2027, we are considering ending the current Mid-Term Business Plan one year ahead of schedule and starting a new plan in April 2027, when the new financial group’s Mid-Term Business Plan starts. However, I assume that many of the initiatives will continue to be included in the new plan even if we achieve the quantitative plan and reform it into a new one. In any case, as the quantitative targets set in the current Mid-Term Business Plan are expected to be achieved earlier, I feel that it is inappropriate to continue the plan in light of the current situation.

Q. As you enhance RORA management, are you going to change your approach to lending to local SMEs and individuals in the future?

A. - We will maintain our approach of fulfilling our responsibility to the local economy, including local SMEs, while realizing returns that are satisfactory to our investors at the same time. Still, in line with the raised RORA standards, it is possible that we may reduce loans to clients outside of Gunma prefecture, who are not our major clients and whose commission income contribution is limited, as their earnings have declined and are unlikely to recover as a result of interest rate competition.

- In addition, housing loans and other certain products have low interest rates and therefore generate limited earnings despite their high RORA. With the increasing importance of deposits, many regional banks prioritize the balance of deposits and loans. We also need to consider profitability based on the actual amount rather than solely focusing on RORA and maintain efficiency in our balance sheet. Moreover, I think that we need to consider reducing loans to large enterprises when buying back Japanese government bonds. While RORA is highly important in building a portfolio centered on loans, we need to aim for the optimization of the overall balance sheet in addition to RORA when Japanese government bonds are one of the options.

Q. Is it possible that you will end up reducing loans to SMEs, which contribute to the sustainable development of the local economy, as you increase loans to high RORA clients? How are you going to achieve RORA management and build a sustainable regional economic zone at the same time?

A. - It is true that the RORA of loans to second-tier enterprises and SMEs is not as high as that of large enterprises. However, if we work on loans to second-tier enterprises and SMEs, we can expect to increase corporate service revenue and transactions with their employees, which will result in the enhancement of our deposit base. Accordingly, we will not refrain from providing loans to second-tier enterprises and SMEs because of their low RORA. In addition, we do not intend to work on loans to large enterprises or cross-border loans of several trillion yen just because their RORA is high, and we will not refrain from providing apartment loans because their RORA is lower than the target. Since an exclusion of low RORA clients would have a negative impact, including a decrease in deposits, we cannot solely focus on RORA in our business model. Therefore, we do not intend to increase ROE by solely pursuing RORA. While loans to large enterprises and cross-border loans contribute substantially to our earnings, the loan balance mainly consists of those to second-tier enterprises and SMEs. We will continue to aim for an ROE of 11%, and then to 12%, by improving the profitability of loans to second-tier enterprises and SMEs.

Q. In a drastically changing banking environment, what aspirations and long-term vision do you have as the president of Gunma Bank?

A. - It would be wonderful if our integration were evaluated as a successful new integration model different from the one in which one company absorbs the other. Moreover, it would be ideal if multiple neighboring banks wished to join our group. If such a trend were repeated, we could possibly become an entity similar to a super-regional bank in the US. I believe such a future is conceivable. However, first of all, the most important thing is to ensure that we successfully complete the integration we are currently working on. If this integration is successful, it can be applied in other regions as a universal model. If I may dare to share my aspirational vision with you, this is what I would like to see in the future.

<u>ROE and PBR</u>

Q. Your PBR has stabilized at a level above 1.0, indicating that your bank's shares are valued at a premium compared with your current ROE. What do you think is the reason?

A. - We understand that such evaluations represent investor expectations. Trends in stock prices for the past two years show that both the Daishi Hokuetsu Financial Group and our bank have been performing very well. In particular, their performance has been considerably strong since the integration was announced. This would indicate that expectations for the integration have been reflected in the stock price and helped our PBR stabilize at 1.0. Furthermore, I suppose that another reason for this evaluation is the market recognizing that we are likely to achieve our ROE target of 10%. I believe that we successfully achieved a PBR of 1.0 because the market recognizes our ability to achieve an ROE that is commensurate with the cost of capital based on our prior announcement that our ROE for the current fiscal year is projected to be 9.5%. Some would argue that our shares are valued at a premium because PBR exceeded 1.0 before achieving the ROE target. However, we aim to stabilize our PBR at 1.0 based on our real ability, not a premium placed on our shares, and then further raise expectations for a higher PBR of 1.1 and then 1.2.

- We need to further increase our ROE because interest rates are trending upward. We are not satisfied with having our PBR at 1.0, nor with our ROE at 10%. In order to ensure that the new financial group that will be created after the integration fulfills its promise of an early achievement of a 10% ROE, Gunma Bank needs to further increase its own ROE. While our current balance sheet is working very efficiently, we intend to further improve our ROE by managing RORA more rigorously.

Questions Related to IR

Q. In Gunma Bank's shareholder structure, the ratio of financial institutions and domestic corporations is decreasing while that of foreign corporations is increasing as a result of your continued sale of shares for policy purposes. Do you think that this trend will continue? Additionally, what is your ideal shareholder structure?

A. - Firstly, I would like to talk about the reduction of shares for policy purposes. The initial plan aims to reduce the book value of listed shares for policy purposes by half during the period from the end of March 2022 to the end of March 2027. Based on the agreements for the sale, we expect to achieve this target by the end of March 2026, one year ahead of schedule. As for further reduction, we have promised to reduce those shares to less than 10% of the net assets on a market value basis by the end of March 2028 in light of rising stock prices and voting guidelines. I project that the ratio of financial institutions and business corporations in our shareholder structure will continue to decrease in line with the reduction of shares for policy purposes, as there is still room for such reduction.

- As alternative investors to those financial institutions and domestic corporations that were formerly our shareholders, we aim to increase our foreign corporate investors and individual investors in a balanced way and have been enhancing our IR activities targeting these two groups. In particular, we have recently been receiving requests for meetings from large foreign institutional investors, as our market capitalization will be around 1 trillion yen after the business integration. These institutional investors are important because they are expected to be long-term shareholders. Our policy is to actively approach not only our existing shareholders, but also the large-scale investors who have newly become our shareholders. On the other hand, the number of individual investors is slightly trending downward. Therefore, we are increasing touchpoints with them through various initiatives, including briefing sessions held locally and online briefing sessions targeting investors nationwide.

Q. Are there any changes in the quality or content of dialogues with investors and shareholders?

A. - This is a characteristic rather than a change, but large foreign institutional investors that would be required to submit a statement of large-volume holdings in connection with our shares tend to be more interested in management's opinions than in detailed numbers. More specifically, they often ask questions about my own background and activities, the management of our bank, and the business environment in Japan in general. At a meeting held in December, they asked about my view on the economic policies of the new administration. It is important for management to speak in their own words, which I feel is the final deciding factor for foreign institutional investors with regard to their investment decisions. In fact, in some cases, they increase their shareholdings after such meetings. As investors tend to make investments after meeting the relevant people and confirming their views, we intend to continue our efforts to increase the number of such meetings as much as possible.

<u>Credit Costs</u>

Q. Could you tell us your assumptions about credit costs if interest rates continue to rise?

A. - Although it is difficult to predict future credit costs accurately, our simulation suggests that the impact of rising interest rates will be limited. Rather, soaring prices of materials and resources, caused by rising prices of imported goods and increased labor costs resulting from labor shortages, may have a greater impact on corporate performance. According to our simulation, additional credit costs will be approximately 1.0 billion yen if the policy interest rate is raised to 0.75%, and credit costs will further increase by a mere 0.4 billion yen if the rate is hiked to 1%. We do not project that rising interest rates will directly cause a rapid increase in bankruptcies.

<u>Other</u>

Q. Do you have any concerns about risks associated with the macro environment or risks unique to Gunma Bank? Additionally, could you tell us which leading indicators you refer to and what measures you take to detect risks at an early stage?

A. - As many of the players in the financial industry may feel, shares, real estate, and other assets may be overvalued in the market in general, and we should always remain attentive to this mindset as a market-related risk. Since clients in the Tokyo metropolitan area, where the ratio of real estate-related loans is higher, account for a large portion of our loan portfolio, we introduced a tool last year to monitor signs of bad real estate-related loans and developed a system to detect signs of risks at an early stage.

- In the long term, the declining population is a significant risk to regional banks, and maintaining stable deposits is a challenge. Our lending has been growing steadily, as our business area is located in the Tokyo metropolitan area, but it is essential for us to acquire deposits that are commensurate with such growth. From this perspective, it is an option to increase highly profitable assets based on the actual amount, rather than focusing solely on RORA. Moreover, I am aware that the challenge we need to address after the integration is to consider how the group as a whole will utilize assets effectively.

Q. As we are currently in a rising interest environment, unrealized losses of yen-denominated bonds could affect your capital adequacy ratio. To what extent do you think rising interest rates are acceptable?

A. - In anticipation of rising interest rates, we have reduced the duration and balance of Japanese government bonds. In this fiscal year, we recorded losses on sales of bonds of 7.1 billion yen in the first half, and the balance of Japanese government bonds as of the end of September is 136.2 billion yen. In addition, the 740.5 billion yen in municipal bonds that we hold includes 456.3 billion yen in privately placed Gunma prefecture municipal bonds, of which a newly underwritten portion is classified as bonds intended to be held to maturity. Therefore, they have only a limited impact on our capital adequacy ratio. For this reason, I believe that a moderate rise in interest rates will not affect our capital adequacy ratio significantly. However, one issue with our balance sheet is that a portion of our funds is fixed to low-yielding, yen-denominated bonds, and we need to proceed with the replacement of positions. In light of rising interest rates, we are considering replacing positions in our discussions about our earnings plan following the business integration as well. While we are currently discussing the timing, we would consider utilizing gains from negative goodwill and gains on sale of shares for policy purposes as possible options for that purpose. In any case, we are not concerned about the impact of rising interest rates on our capital adequacy ratio. In light of our positions built during the period of low interest rates, the fact that the long-term interest rate is now over 2% is a significant change, but it is not necessarily strange if such a change reflects the growth rate. Considering our strength and expected future profitability, I am confident that we can fully absorb the unrealized losses on yen-denominated bonds. It seems that the biggest reason why other banks are refraining from purchasing more bonds is the increasing valuation losses on their existing positions. However, we intend to address the issue in a carefully planned way in accordance with a comparably foreseeable timeframe.

Q. Are you considering any form of financing other than deposits?

A. - I am interested in the business model of originating and distributing loans in an integrated way, which megabanks are actively developing. Although many would think that there are only small deposits in rural areas, the loan-deposit ratio of credit unions and cooperatives in Gunma prefecture is only around 50% despite their deposit share of approximately 20%. A business model that originates assets that can be distributed to these credit unions and cooperatives would be promising. Although creating an origination model locally and asking other financial institutions to assume the originated loans would not appear to be financing at a glance, it is substantively a form of financing in my opinion. Even though there are difficult obstacles to overcome, we could originate loans and distribute them to investors in a form similar to an investment product. This is one of the possible initiatives I am currently considering, although they have not taken a concrete form at the moment.

- I suppose that there are still measures to be taken to acquire deposits. One of the options is to conduct premium interest rate campaigns targeting individuals. The precondition to apply premium interest rates creates an environment that enables us to raise our loan interest rates smoothly in line with rising interest rates. We have already applied premium interest rates to our selected corporate clients, resulting in growth of approximately 6%.