



CLSA Virtual Odyssey 2003
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Riding Out The Storm

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Good morning ladies and gentlemen. I'd like to say how much I welcome CLSA's virtual odyssey to conduct business as usual amid the atypical pneumonia outbreak. I am delighted to be here today, to update you on developments at Hang Seng Bank.

Hang Seng is a prudent yet progressive organisation, with the goals of further strengthening its market leadership in Hong Kong and becoming an important player in mainland China.

We are operating in a difficult banking environment. Before I tell you why Hang Seng is well-positioned to weather the storm and continue to create value, I'd like to look first at the operating environment.

Difficult operating environment

Atypical pneumonia (AP) is a serious challenge facing Asian economies. It has had a huge psychological impact. Here in Hong Kong, the economic impact of the virus is still significant, although the territory has made encouraging progress in its control and the daily number of new cases has fallen to single-digit levels. Many economists have reduced their GDP forecasts for the territory in 2003.

Tourism-related industries have been severely affected. After recording 19% growth in the first half of March on a year-on-year basis, tourist arrivals fell by 9.9% in the second half of that month when the effects of AP began to be felt. Sluggish domestic demand has been further weakened, with higher unemployment and bankruptcies. Property prices have also fallen.

Unemployment rose to the previous record level of 7.8% in the three months ending April. The number of bankruptcy orders increased by 122% to 8,952 in the first quarter, compared with the same period last year. The property market has fallen by about 7 to 8% in the first four months of 2003.

Nevertheless, exports remain a bright spot, growing by 17.6% by value year-on-year in the first quarter. Unless the AP outbreak affects mainland China's factories, Hong Kong's export growth should remain healthy in 2003.

In April, the government announced a HKD11.8 billion package of relief measures to reduce the economic impact of AP. This will help alleviate the hardship of severely-affected businesses and the community. In order to support the Hong Kong economy, Hang Seng is participating in the loan guarantee scheme for designated industries under this package. The Bank has also launched business initiatives to promote local consumption and provide employees of hard hit industries with short-term financial relief.

Even before the outbreak of AP, the operating conditions for the banking sector in Hong Kong had been difficult. The banking sector started 2003 under intense competition, narrowing interest margins and sluggish loan demand. Total loans for use in Hong Kong contracted by 13.0% from 1998 to 2002. In the first quarter of 2003, loans for use in the territory fell further by 0.5% from the end of 2002.

The economic impact of AP is further challenging the profitability of banks. As more people stay home, credit card spending and account receivables have fallen, and the sale of wealth management products in branches has been affected. If property prices continue to drop, it could affect the collateral value and provisioning of banks. There is much uncertainty in the sector.

However, having said that, I must stress that Hong Kong's banking system is robust. Banks are well capitalised and continue to generate profit for shareholders.

Much will depend on the duration of the AP outbreak and when the World Health Organisation lifts its travel advisory imposed on Hong Kong since early April. There are signs of improvement in some business sectors following the fall in the number of AP cases. Hopefully, with the greater understanding of the virus that is occurring on a daily basis, and with the efforts being made by all sectors of the economy, the effects of AP will be overcome soon.

Riding out the storm

Hang Seng's considerable strengths and competitive advantages have positioned the Bank strongly to meet the challenges of the difficult operating environment.

In view of our many strengths, we are confident of riding out the storm currently over Hong Kong. Our many strengths include:

- Financial soundness
- A strong customer focus
- A trusted brand

- Superior service
- Operating efficiency
- Solid business strategies in Hong Kong and the Mainland
- One-stop solutions and
- An efficient multi-channel delivery network

We are building on these strengths to create further value for shareholders and customers.

Hang Seng Bank today

I'd like to present an overview of Hang Seng before describing its strengths in greater detail.

By market capitalisation, Hang Seng is the largest local bank listed in Asia, excluding Japan, and the second largest listed bank in Hong Kong.

Earlier this month, Hang Seng was named the Best Domestic Commercial Bank in Hong Kong by Asiamoney. In January, we were named the Best Domestic Commercial Bank in Hong Kong by The Asset. In June last year, we were named the Best Local Bank in Hong Kong by FinanceAsia.

In 1999, the Bank adopted its Managing for Value strategy to maximise value creation for shareholders.

In the current bear market, we have outperformed the Hang Seng Index. Since the start of 1999 until 19 May 2003, the Bank achieved a total return of 58.3% for shareholders, compared with the average return of 3.6% recorded by Hang Seng Index constituents over the same period. In absolute terms, total shareholder value has increased by HKD77.2 billion.

Financial soundness

Hang Seng is well-positioned to meet the current challenges as a result of its financial strength and prudent management.

The Bank's results demonstrated resilience in the unfavourable operating environment of 2002. Attributable profit fell by 1.5% to HKD9,961 million, compared with 2001. The total dividend distribution for 2002 was HKD5.40 per share, including a special interim dividend of HKD0.50 per share on the occasion of the Bank's 70th anniversary in 2003. Excluding the special dividend, the total dividend payment for the year represented 94% of attributable profit.

We were able to further expand non-interest income and reduce costs in 2002. Our ratio of other operating income to total operating income rose by 3.1 percentage points to 28.4%, compared with 2001. The cost-to-income ratio fell by 0.9 percentage point to 25.4%, among the lowest in the banking world.

A review of the Bank's five-year performance reflects how it has grown from strength to strength. Attributable profit grew from HKD6,788 million in 1998 to HKD9,961 million in 2002. The return on assets grew from 1.7% to 2.1%, and the return on equity from 13.2% to 22.9% over the same period.

Gross non-performing advances as a percentage of gross advances fell from 3.9% in 1998 to 2.7% in 2002. Total provisions fell from 2.24% to 1.28%.

Hang Seng continued to outperform the market in Hong Kong in many areas in 2002, according to figures released by the Hong Kong Monetary Authority (HKMA).

The Bank's net interest margin of 2.46% was favourable compared with the net interest margin of 2.09% recorded by retail banks in Hong Kong as a whole. Its low cost-to-income ratio of 25.4% was most attractive against the retail banks' average of 40.6%.

Reflecting the Bank's asset quality and prudent lending, its loans overdue for more than three months and rescheduled loans as a ratio of total loans were much lower at 2.90%, compared with 3.60% for retail banks at the year-end. The Bank's non-performing loans of 2.7% compared favourably with 3.95% for retail banks.

The Bank's year-to-date annualised charge-off ratio for its credit card business for 2002 was 8.81%, compared with 13.25% for institutions surveyed by the HKMA.

So far this year, we have not seen any major negative signs in our business in terms of asset quality. There has been no material change in the mortgage delinquency rate to date. Despite the outbreak of AP, our credit card charge-off ratio remained below 10% in April, although it had risen from the end of 2002. Recently, there have been signs of a rebound in credit card spending by customers following the launch of promotions by the Bank.

Our retail fund sales remain robust, but inevitably the outbreak of AP reduced branch traffic in April and had some negative impact on our sales activity.

We continue to strengthen risk management and cost discipline to reinforce our financial soundness.

Strong customer focus

Hang Seng's strong customer focus and trusted brand also help to cushion the Bank in the difficult environment. We serve more than one-third of Hong Kong's population and are renowned for service excellence.

The Bank is developing its large franchise to establish and manage customer relationships so that they are economically viable. The focus is on meeting total customer needs and gaining a high share of customer wallet penetration.

Segmentation has been strengthened to deepen customer relationships, gain additional customers and increase the cross-selling ratio. The Bank's integrated accounts have become a major platform to implement segmentation.

Last year, we won the 'Yahoo! Prime Users Most Emotive Brand Award' and the 'Award for the Brand Yahoo! Users Trust the Most'.

Operating efficiency

Highlighting our operating efficiency, attributable profit per employee in 2002 rose to a record HKD1.37 million.

Our total staff number of about 7,230 at end-March was the lowest since 1994 and a reduction of about 800 from the height in 1997.

Business strategies in Hong Kong

As a premier financial services institution, we offer one-stop solutions designed to meet changing customer needs.

In the face of AP, we are further promoting remote channels such as e-Banking as alternatives to the branch channel. We are using e-Banking to do more marketing, promote product sales and as a communication channel to strengthen relationships.

In April, the daily average number of internet transactions increased by 9.8%, compared with February. Such transactions made up 18.1% of total transactions and online share trading 56.9% of total securities transactions.

e-Banking services have all along been an important part of the Bank's integrated multi-channel delivery network. The number of registered customers has been trending upwards and has reached 280,000. Alongside the increase in internet banking, counter transactions have been trending downwards. In the first four months of this year, counter transactions fell to 14.2% of total transactions, compared with 16.3% in the same period in 2002.

We are focusing on higher margin businesses, in particular wealth management and small and medium-sized enterprises (SMEs) to increase non-interest income and product cross-selling.

In Hong Kong, there is increasing awareness of the need for lifetime wealth management. Our wealth management initiatives, which comprise investment and insurance services, target both the affluent and mass affluent customer segments. In 2002, income from wealth management grew strongly by 32.6% to HKD1.6 billion.

In the low interest rate environment, the Bank has been expanding its product range. Among its most successful products are the capital guaranteed funds under the Hang Seng Investment Series – the largest group of such funds in Hong Kong. At the end of April 2003, the total number of capital guaranteed funds and the sub-funds under the Series for retail customers was 62 and 83 respectively. Funds managed under the Series increased by 43% to HKD25.2 billion at end-April, compared with a year earlier.

With the drop in branch visitors due to AP, we are using e-marketing more to encourage online trading. In a sign of the times, we have noticed more customer interest in life and medical insurance.

SMEs are the cornerstone of Hong Kong businesses and the Bank is expanding its customer base in this sector, partly by reaching out to business associations. In 2002, we launched Business e-Banking services to help commercial customers and SMEs manage their company finances more efficiently.

Given the impact of AP on businesses, we have adopted an accommodative approach when dealing with customers with short-term cash flow problems.

We shall continue to grow the credit card business prudently while trying to keep bad debts to a minimum.

We are also increasing our focus on private banking, which was launched in 1997. Our aim is to become one of the leading domestic private banks in terms of assets under management, client size and profitability.

Business strategies in mainland China

In mainland China, the Bank intends to take advantage of the vast opportunities offered by the country's WTO entry. The Bank aims to become an important player there in the long term and is looking to grow both organically and by acquisition if the right partners can be identified. It has the advantage of being a world-class bank run by Chinese.

In view of Hong Kong's increasing integration with the Pearl River Delta, we are strengthening activities in the region and increasing our customer base among Hong Kong-based firms with production facilities in the area.

We are also expanding our Taiwan-related customers across the Mainland. Our representative office in Taipei is helping to strengthen ties with this group.

To better support these customers, we have applied for our Guangzhou and Shenzhen branches to offer renminbi services. This follows the launch of RMB services at our Shanghai branch in 2002.

The Bank is planning to expand its Mainland network with more branches and sub-branches in major cities. We are preparing for the opening of our Nanjing branch and Puxi sub-branch later this year.

Personal e-Banking services were launched for customers of our four Mainland branches last year and should also make our presence felt more strongly.

Last year, our Guangzhou, Shanghai and Shenzhen branches began foreign currency services for mainland Chinese citizens and corporations, and opened Prestige Banking Centres for affluent customers.

We are currently looking into the Mainland credit card market. In addition, our investment and insurance businesses are positioning themselves in the Mainland.

Hang Seng Investment Management Limited opened a representative office in Shenzhen in March 2003. Hang Seng Securities Limited opened one in Shanghai in 2002. Hang Seng Insurance Company Limited opened its representative office in Shenzhen in 2001.

Conclusion

In 2003, Hang Seng marks its 70th anniversary. We have been through thick and thin with Hong Kong over the past 70 years. Today, we are a premier financial services provider offering comprehensive one-stop solutions.

Our financial prudence, large customer franchise, wide range of one-stop solutions and efficient delivery network will allow us to meet the challenges effectively and weather the storm over Hong Kong today.

Thank you.