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## Moving Forward With Our Roadmap For Growth

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Good morning, ladies and gentlemen. I am delighted to have the opportunity to speak to you today.

At last year's forum, I noted that Hong Kong's economy was back on track after several challenging years. This economic upswing has continued into 2006, although we are now beginning to see signs of a moderation in pace.

After 11 consecutive quarters of expansion, GDP growth slowed to 5.2 per cent year on year in the second quarter, resulting in close to zero growth on a seasonally-adjusted quarter-to-quarter basis. GDP is now expected to gradually shift from a high growth track to a more sustainable one that is better in line with past growth trends.

This slowdown was due largely to a moderation in trade activity. Growth in exports of goods weakened from 14.4 per cent year on year in the first quarter to 6.4 per cent in the second. Exports to mainland China continued to show double-digit growth, compensating for some of the weaknesses in other major markets. And exports of services held up well, rising 8.6 per cent. Overall, however, net exports only contributed 0.8 percentage points to GDP in the second quarter, a drop of 1.5 percentage points from the first quarter.

Fortunately, external weakness continues to be offset by resilient domestic demand. On the back of the improving labour market and rising incomes, private consumption expenditure rose 5 per cent in the second quarter, up from 4.5 per cent for the first three months of the year. Investment spending grew by 4.3 per cent.

Expenditure on machinery and equipment, up 12.8 per cent in the second quarter, will continue to be a major impetus to overall investment growth.

Further, the recent slowdown in external trade can be attributed in part to temporary factors. While such trade is unlikely to be the primary driver of growth during the second half, we expect to see a modest recovery in exports. Figures for July appear to support this, with total exports and total imports recording year-on-year growth of 10.7 per cent and 11.4 per cent respectively. The recent pause in the US interest

rate up-cycle has helped stabilise consumer and business confidence. Along with the current upturn in Europe and Japan, this should help underpin Hong Kong's export performance going forward.

Against this backdrop, we believe that Hong Kong will achieve full-year GDP growth of around 6.3 per cent in 2006.

In this economic environment, Hang Seng will continue to focus on areas with high growth potential. We will capitalise on strong demand for wealth management products and consumer finance services. We will further build relationships with commercial customers by providing tailor-made financial packages to meet their growing needs. We will remain competitive by investing in our strong brand and continuing to provide world-class service.

### **Our Roadmap for Growth**

Our vision is to increase shareholder value by becoming the leading regional bank in Greater China, focusing particularly on southern China and the Yangtze River Delta region.

As part of our 2005 annual results announcement in March this year, we unveiled details of our roadmap for growth – a set of key priorities and targets designed to drive our business forward and achieve our vision.

Our goals include further building our wealth management business by improving cross-selling and developing innovative products to attract new customers. We plan to increase our market share among young people and become the preferred bank for SMEs by introducing services designed specifically for these customer groups.

By the end of 2010, we aim to double profits from Private Banking and increase the pre-tax profit contributions of our Mainland and Commercial Banking businesses to 10 per cent and 20 per cent respectively. Between 2006 and 2008, we plan to invest over HK\$1 billion on the Mainland to expand our service capabilities and network of outlets to more than 30.

Although still in the early stages, we have already made solid progress with our strategy.

As reflected in our new corporate tagline 'Managing wealth for you, with you', we have allocated more resources to meeting the investment and insurance needs of our customers. We have introduced a number of innovative retirement planning, medical insurance and investment products that have enjoyed an excellent market response.

Success with products offering investment exposure to the Mainland market has led to us fully utilising our existing investment quota of US\$100 million under the Qualified Foreign Institutional Investors scheme. In order to help more investors tap the good potential offered by this market, we have applied to increase our quota by a further US\$100 million.

Relationships with commercial customers have been further strengthened through the opening of more Business Banking Centres and our Business Partner Direct 24-hour hotline as well as the expansion of our team of relationship managers.

Steps taken to help us achieve a more customer-driven and diversified treasury portfolio are starting to produce encouraging results.

In May, we kicked off an integrated brand revitalisation programme that covers advertising and areas affecting customer experience, and is designed to boost our competitiveness and help grow our market share in key customer segments.

This investment in brand strengthening will help reinforce our progressive, pragmatic and thoughtful approach that places primary focus on service excellence, enhancing our leadership position as customers' bank of choice.

We are also making increased use of technology to improve our competitive edge. Around 580,000 personal account holders and nearly 33,000 companies now enjoy the advantages of e-Banking. During the first half of 2006, 38 per cent of all personal banking transactions were completed online, up from 29 per cent in the same period last year.

To help improve our cost efficiency and save natural resources, we are using incentives such as tree-planting pledges to encourage customers and shareholders to opt for receiving statements and communication materials in electronic format.

## **Mainland Business Development**

The further development of our Mainland business is a central part of our long-term growth strategy. Since the beginning of the year, we have hired around 150 new staff and added two new sub-branches in Shanghai and Guangzhou, bringing our number of Mainland outlets to 14.

We have opened offsite ATMs in Shanghai, Guangzhou and Beijing and expanded the scope of renminbi and foreign currency services at our Fuzhou branch. The introduction of new offerings such as our Equity-linked Capital Protected Investment Product is helping us grow our customer base. Trade-related insurance agency services are now available in Beijing, Guangzhou, Shanghai and Shenzhen. We are also among the first group of foreign banks on the Mainland to have received approval to offer renminbi foreign exchange swap services.

We have recently been granted a licence under the Qualified Domestic Institutional Investors scheme, which will enable us to provide a wide range of wealth management services to local enterprises and residents.

We are exploring the possibility of local incorporation and establishing our China business headquarters on the Mainland as this will also help us to further tap the local retail market.

We continue to deepen our relationship with Industrial Bank, our strategic Mainland partner. Our joint credit card business is progressing well and we are stepping up cooperation in areas such as lending and cross-referral of customers.

We remain open to considering investments in insurance, asset management and securities businesses should suitable opportunities arise.

## **Financial Performance**

Our progress is reflected in our 2006 interim results. Please note that all figures quoted are in Hong Kong dollars unless otherwise stated.

Total operating income increased by 18.1 per cent compared with a year earlier to reach \$12,396 million.

Operating profit excluding loan impairment charges and other credit risk provisions was up 7.6 per cent at HK\$6,387 million. An 88.7 per cent reduction in loan impairment allowances saw operating profit rise by 12.8 per cent to HK\$6,353 million.

Pre-tax profit grew by 6.4 per cent to reach HK\$7,513 million. Attributable profit after taxation and minority interests was HK\$6,190 million, an increase of 2.4 per cent.

Efforts to broaden our customer base led to increases in loan balances and deposits. Along with the effects of rising interest rates, these increases underpinned a 21.1 per cent growth in net interest income to \$6,375 million, excluding \$847 million in net interest expenses on the trading and fair value portfolios.

Net interest margin increased by 24 basis points to 2.37 per cent.

Average interest-earning assets grew by 8.7 per cent to \$541.3 billion. Total assets were up 8.2 per cent at \$628.3 billion.

Personal Financial Services' operating profit excluding loan impairment charges rose 7 per cent to \$3,960 million, underpinned by the 23.9 per cent growth in wealth management income to \$2,211 million.

The success of our new Monthly Income Retirement Plan drove a 28.4 per cent rise in life insurance income to \$697 million. We gained market share in terms of new annualised premiums.

Increases in customer number and assets under management saw Private Banking's total operating income rise by 42.1 per cent.

Greater stock market activity helped securities-related income rise by 83.5 per cent.

Lending to individuals (excluding GHOS mortgages) grew by 1.9 per cent. Despite intense competition in the residential mortgage sector, we achieved a 1.8 per cent increase in loan balance and gained market share.

Sustained consumer demand, underpinned by the buoyant labour market, helped personal loans grow by 16.8 per cent.

Credit card advances fell by 1.9 per cent compared with the end of 2005, due primarily to the repayment of tax bill payment balances. Year on year, card advances were up 15.2 per cent.

Commercial Banking's operating profit excluding loan impairment charges increased by an encouraging 21.8 per cent to \$933 million, within which the small business banking portfolio grew by 28.2 per cent.

The development of deeper customer relationships helped trade finance and commercial loans grow by 17.8 per cent and 18.1 per cent respectively during the first half of 2006. The introduction of corporate wealth management advisors proved effective, contributing to the 21.2 per cent rise in net fees and commissions.

High levels of liquidity and market competition among lenders continued to exert downward pressure on corporate loan pricing, leading to an 8.2 per cent fall in Corporate Banking's operating profit excluding loan impairment charges.

Treasury's trading profit grew by an encouraging \$246 million following efforts to enhance proprietary trading capability, expand corporate treasury services and increase cooperation with other customer groups. However, with interest rate rises continuing to put pressure on Treasury's balance sheet management portfolios, operating profit excluding loan impairment charges fell by 39 per cent to \$444 million.

On the Mainland, the continuing expansion of our products and services as well as our geographical reach helped deposits and lending grow by 11.2 per cent and 21.7 per cent respectively during the first half of 2006. Net profit from our 15.98 per cent strategic investment in Industrial Bank grew by 10 per cent to \$209 million.

## **Strong Foundations**

While our roadmap has provided the focus to help achieve these results, long-term sustainable growth depends on maintaining strong foundations. We enjoy excellent financial fundamentals.

Given our strong balance sheet, the total dividend distribution for the first half of 2006 was HK\$2.20 per share, the same as that in the first half of 2005.

Our return on average shareholders' funds was 29 per cent, 2.2 percentage points higher than our cost efficiency ratio, which, at 26.8 per cent, remains one of the lowest in the banking industry.

In June, we received a good market response to our first-ever US dollar subordinated notes issue. The US\$450 million offering improved our capital strength and helped expand our investor base inside and outside Hong Kong.

Our total and tier 1 capital ratios at 30 June 2006 were 14.2 per cent and 11 per cent respectively, up from 12.8 per cent and 10.4 per cent at the end of 2005.

We continue to enjoy the highest ratings given to banks in Hong Kong. In June, Moody's upgraded our long-term local currency deposit rating to Aa2. In July, Standard & Poor's raised our local and foreign currency long-term corporate credit ratings to AA.

Helped by the benign credit conditions, loan impairment allowances fell to 0.33 per cent of gross advances to customers as at 30 June 2006, compared with 0.39 per cent at the end of 2005. Gross impaired advances as a percentage of gross total advances were down 0.1 percentage point at 0.4 per cent.

### **Moving Forward**

Moving forward, we will build on the success of our wealth management business by continuing to expand and refine our range of investment and insurance products to take advantage of prevailing market conditions and meet customers' needs at all stages of life.

We will capitalise on positive market sentiment to grow commercial lending and consumer finance and expand the reach of our SME services.

We will continue to invest in our staff, brand and delivery channels.

On the Mainland, we will open a fifth sub-branch in Shanghai on Friday and in a couple of weeks we will become the first foreign bank to have a branch in Dongguan. We will take additional steps to grow our deposit base to support the expansion of our loan portfolio, increase and refine our product offerings, and further develop our wealth management and Commercial Banking services.

In a move that underlines our commitment to this important market, at the end of the week we will hold a Board of Directors meeting on the Mainland for the first time.

Early initiatives taken under our roadmap helped us return solid results for the first half of 2006, creating good momentum for the sustainable growth of our business. We will use this momentum to continue to move towards our objectives and ensure increasing value for our shareholders.

Thank you.