



12<sup>th</sup> Annual CLSA Investors' Forum 2005  
13 September 2005

## Hang Seng Bank: Solid, Strong, Sound

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Good morning ladies and gentlemen. I am delighted to be able to address this annual forum for the first time as CEO of Hang Seng Bank.

Those of you who have followed the economic fortunes of Hong Kong will know that since the late 1990s, we have experienced what could be charitably referred to as 'interesting times'.

In this Chinese year of the rooster, however, Hong Kong has more to crow about.

Over the past 18 months, the economy has improved significantly. In the second quarter of 2005, GDP grew by 6.8% in real terms over a year earlier. On a seasonally adjusted basis, this was the eighth straight quarter of GDP expansion.

Merchandise exports were up 11.1% year-on-year in real terms, helped in part by robust mainland China trade flows and re-export growth. Exports of services were up 7.8%.

At 5.7%, the unemployment rate in the second quarter was the lowest for four years. Along with the buoyant property sector, the improving labour market served to underpin consumer confidence, with private consumption expenditure up 2.7% in real terms.

Business investment also reflects the continuing economic momentum, with a 10% expansion in domestic credit for the year ending 30 June 2005. Overall investment spending rose by 3.5% in the second quarter of this year.

However, despite the better-than-expected first half, the government is maintaining its full-year GDP growth forecast of 4.5% to 5.5%.

Economic growth in the second half of 2005 is likely to be more moderate. High oil prices, rising US interest rates, the recent renminbi revaluation and China's trade friction with the EU and the US all threaten to slow both the regional and global economies, which would affect Hong Kong's export trade.

This economic backdrop creates both opportunities and challenges for Hang Seng. The strengthening economy is continuing to drive commercial and personal loan demand and interest in wealth management products. Rising interest rates are improving spreads on deposits and mortgage pricing but exerting downward pressure on income from Treasury investment. Competition within the banking sector remains keen.

We will rely on our solid financial fundamentals, strong market position and sound business strategy to take advantage of new business opportunities while remaining resilient in the face of challenging market conditions.

### **Solid Financial Fundamentals**

One of the foundations of Hang Seng's success is its solid financial fundamentals.

Despite a competitive banking market in the first half of 2005, our total operating income grew by 8.9% to HK\$10,499 million. This increase was underpinned by strong growth of 18.2% in Personal Financial Services income and an improved net interest margin, which rose by 11 basis points to 2.13%, one of the highest reported in the banking industry.

Profit attributable to shareholders was HK\$6,045 million, a fall of 2.3% compared with the first half of 2004, which benefited from a HK\$698 million release in general provisions.

Operating profit before loan impairment allowances was HK\$5,934 million, down 2.2%.

In view of our strong balance sheet, the total distribution of dividends for the first half of 2005 was HK\$2.20 per share, the same as for the first half of 2004.

Our focus on prudent lending and strong credit control means we continue to enjoy good asset quality. Our gross impaired advances as a percentage of gross advances at 30 June 2005 was 0.7%.

The annualised charge-off ratio for our credit card business was 2.16%, compared with an industry average of 3.19%. Our delinquency ratio of 0.21% also compared favourably with the market average of 0.4%.

Our return on average shareholders' funds was 29.7%, three percentage points higher than our cost-to-income ratio, which, at 26.7%, remains one of the lowest in the banking industry. Our return on average total assets was 2.2%.

As at 30 June 2005, our total and tier 1 capital ratios stood at 12.4% and 10.5% respectively, well above the statutory required minimums.

Investment in the future growth of our business is a crucial part of ensuring sustained profitability. Recruitment for Personal Financial Services and our Mainland outlets, as well as investments in IT and marketing, saw operating costs rise 8.8% during the first half of 2005. Other investments in the short term are likely to include extra staff for wealth management services and Commercial Banking.

### **Strong Market Position**

Hang Seng's current market capitalisation is over HK\$200 billion. We serve more than one-third of Hong Kong's population, maintaining over 2 million accounts, through a network of more than 150 outlets.

This broad coverage and large customer base offer excellent opportunities for growing our wealth management and Private Banking businesses.

Along with our expanding Mainland network, our well-established Hong Kong business also sees us excellently placed to benefit from strong regional prospects for economic growth.

Arguably our best competitive advantage, however, is the depth and quality of our customer service. The well-respected Hang Seng brand is widely associated with value, professionalism, trustworthiness and care for customer needs. We will continue to further strengthen these associations and build customer loyalty through our strategy of market segmentation and focusing on the specific requirements of customer groups.

Our loan and deposit market shares remain among the largest in Hong Kong. As at 31 July 2005, our loan market share was 10.62% for total loans and 12.11% for loans for use in Hong Kong, while our deposits market share stood at 10.90%.

We remain a local leader in using technology to improve and expand banking services. We now have almost 500,000 Personal e-Banking customers and more than 26,000 companies use Business e-Banking. In July 2005, 29.6% of all customer transactions were conducted online, up from 24.6% in July last year.

### **Sound Business Strategy**

We believe we have a sound business strategy. We'll be more focused on areas in which we have competitive strengths, that will give us better returns and that present more growth opportunities.

#### *Personal Financial Services*

In Personal Financial Services we will capitalise on our large customer base and put additional resources into growing our consumer finance, wealth management and Private Banking businesses.

Despite keen competition, we increased our market share of new residential mortgage loan business and grew our residential mortgage lending by 1.9% during the first half of 2005.

We will continue with our strategy of loan diversification and increase efforts to promote consumer finance. Card advances and other lending to individuals, largely personal advances and overdrafts, grew by 2.3%.

Our credit card services income rose significantly, driven by growth of 10.6% and 20.6% in the card base and cardholder spending respectively. The number of Hang Seng credit cards in issue now exceeds 1.2 million.

Following the recent rising interest rate trend, investors' appetites for new investment opportunities have increased, driving demand for sophisticated wealth management products. Our large customer base and proactive approach to product development will help us capture a bigger share of this growing market.

In the first half of 2005, income from wealth management was HK\$1,759 million. This was a 3% drop compared with the first half of 2004, which saw an exceptionally high level of capital-guaranteed fund sales, but a 8.4% increase on the second half of 2004.

Total funds under management grew by 10.6% to reach nearly HK\$100 billion.

Products launched over the past year include those designed to capture the growth of various regional equities, commodity and property markets.

With the rising short-term interest rates and flattening yield curve, investors now prefer shorter tenor products with yield enhancement features. We have launched new exchange-traded funds and structured products, including capital protected investment deposits, that are designed to offer higher potential returns and increase turnover. Capital protected investment deposit sales amounted to more than HK\$7 billion in August 2005.

Our insurance business continues to enjoy steady growth. The introduction of several new insurance plans in the first half of 2005 helped insurance agency and underwriting income reach HK\$704 million, a year-on-year increase of 14.3%. Life annualised premiums rose 6.7%.

Hang Seng Life ranks third in terms of annualised contributions from new business in Hong Kong, with a market share of 11.3% in the first half of 2005, up from 11% in the first half of 2004. Going forward, our strategy will be to develop new products, encourage customers to extend their insurance coverage and increase the average ticket size of their life policies, and step up cross-selling to commercial customers.

We also plan to increase our Private Banking business, which enjoyed an encouraging 37% growth in profits in the first half of 2005.

#### *Commercial Banking*

We aim to increase the contribution of Commercial Banking to total pre-tax profit after provisions from the current 10% to 20% over the next five years. We will leverage our large customer base to identify new Commercial Banking customers. Our focus on higher margin business, such as lending to the SME and MME segments, will also play an important part in reaching our target.

The improving economy will continue to create loan demand. It should also help sustain the revival in the property market and more favourable investment sentiment generally.

Efforts to grow our commercial lending and trade finance activities are already beginning to yield positive results. During the first half of 2005, lending to SMEs and MMEs enjoyed brisk growth, with average customer advances rising by 30.9%.

We will make use of our relationship management team, strong services capabilities, and branches on the Mainland and in Macau to further extend our trade financing activities which grew by 14.1% during the first half of this year, compared with the industry average of 13.2%.

### *Mainland Business*

The expansion of our Mainland business is a central plank in our strategy for growth, with an investment to date of more than RMB3.1 billion. The Closer Economic Partnership Arrangement, continued economic development in the Pearl and Yangtze river deltas and the outward focus of a growing number of Mainland businesses are all creating new opportunities for us.

Our Mainland network now stands at 12 outlets. In January 2005, we opened a new sub-branch in Shenzhen. We also relocated our Fuzhou branch to accommodate its expansion. In the past two weeks, we have opened a third sub-branch in Xujiahui Shanghai and upgraded our Beijing representative office to a branch.

Recent financial figures have been encouraging. In the first half of 2005, lending activity by our Mainland branches grew by 21.3% to HK\$9 billion. Since the end of 2004, our Mainland headcount has risen by 57 to 340.

In May 2004, we acquired a 15.98% interest in Industrial Bank for RMB1.73 billion. This investment is already yielding positive results, contributing approximately HK\$190 million to our share of after-tax profits from associated companies in the first half of this year.

We will continue to deepen our business co-operation with Industrial Bank in consumer finance and other areas. In April 2005, we established a joint credit card centre. When regulations permit, we will take an equity interest in this centre.

### **S for Success**

As a premier financial services provider, Hang Seng's success rests on foundations of solid financial fundamentals and strong market position. We will further build on these foundations with our sound strategy that is designed to grow our business and continue to create value for our shareholders.

Thank you.