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From Vision to Action

Speech by Mr Raymond Or
Vice-Chairman and Chief Executive
Hang Seng Bank

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

In the past few months, emerging weaknesses in the US economy have generated considerable uncertainty in the world's financial community – most clearly reflected in the increased volatility of international and local stock markets.

At the same time, the good growth momentum created in the Greater China region during the past year continues to offer cause for optimism.

Hong Kong achieved strong year-on-year GDP growth of 6.3 per cent in the first half of 2007. Export performance held up well, expanding by 9.8 per cent. Although demand from the US slowed, Asia, particularly mainland China, and Europe picked up much of the slack.

However, it was domestic demand that was the primary driver of economic expansion. Hong Kong's unemployment rate fell to a nine-year low of 4.1 per cent in July and wages have been rising steadily. These developments helped private consumption growth reach 6 per cent for the first six months of the year. Investment spending staged an encouraging recovery, growing by 8 per cent.

Risks certainly remain. Inflation ran at a modest 1.5 per cent during the first seven months due to one-off government rent and property rate concessions. However, the prolonged period of growth in Hong Kong is putting pressure on rents and other operational costs. Renminbi appreciation and surging food prices on the Mainland are creating additional strain.

And, of course, the full effects of the US subprime problem may still be to come.

Hong Kong remains highly dependent on world liquidity conditions. Current global inflation challenges have begun to trigger monetary tightening. Any sudden contraction in global liquidity would mean less money available to chase assets such as equities, thereby posing a major risk to the performance of the territory's financial markets.

Overall, we remain cautiously optimistic about Hong Kong's prospects for the rest of 2007. Domestic demand is now a major impetus for growth and the Mainland's strong economic performance looks set to continue. Against this backdrop, Hong Kong should achieve full-year GDP growth of around 6.1 per cent.

In Action

Hang Seng is the largest Hong Kong-incorporated bank in terms of market capitalisation. In line with the roadmap for growth business strategy we set out during our 2005 results announcement, we have focused on growing wealth management and Commercial Banking services, expanding personal and commercial lending, and extending the capabilities and reach of our Mainland business.

This strategy helped us achieve record results for the first half of 2007 and continues to strengthen our long-term growth momentum. Please note that all figures are in Hong Kong dollars unless otherwise stated.

Attributable profit rose by 43.2 per cent to $8,867 million. Earnings per share were $4.64, an increase of 43.2 per cent.

Underpinned by strong growth in our wealth management and Commercial Banking businesses, operating profit excluding loan impairment charges and other credit risk provisions rose by 26.1 per cent to $8,053 million. Operating profit was up $1,420 million, or 22.4 per cent, at $7,773 million – the highest rate of growth for 11 years.

Pre-tax profit grew by 36 per cent to $10,218 million, in part reflecting an unrealised gain of $1,465 million on the dilution of our investment in our strategic Mainland partner – Industrial Bank – following its listing in February this year.

Net interest income grew by 20.8 per cent to $6,696 million, supported by a 10 per cent rise in average customer deposits and a 9.7 per cent increase in average customer advances. Net interest margin rose 10 basis points to 2.11 per cent, underpinned by improvements in deposit spreads, Treasury balance sheet management portfolio yields and contribution from net free funds.

Average interest-earning assets grew by 15.1 per cent. Total assets were up 10.8 per cent at $741.3 billion.

Our wealth management business went from strength to strength, with securities turnover and sales of investment funds and structured products breaking all previous highs. Private banking remained on a strong growth trend.

We continued to enhance services for Commercial Banking customers, strengthening our position as the preferred bank for SMEs. We capitalised on positive business sentiment to increase customer advances. We made pleasing progress with the development of our corporate wealth management business.

Treasury's balance sheet management portfolios reversed their downward trend. To further grow customer-driven business, we stepped up cross-customer group cooperation and put additional resources into structured product development. Such actions have placed Treasury in a better position to deliver profit growth.

Moves to further diversify Corporate Banking's income proved successful, with significant increases in customer deposits, trade services and credit facility fees.

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In late May, our wholly owned Mainland subsidiary bank – Hang Seng Bank (China) Limited – commenced operation, marking the start of a new era of business growth. We have also opened a third Guangzhou outlet, a Beijing sub-branch and two additional sub-branches in Shanghai since the beginning of the year. Our Hangzhou branch commenced business earlier this month.

We were recently granted approval to offer comprehensive renminbi services to local residents. We introduced these services at our Shanghai branch last week and will roll them out at other Hang Seng China outlets in due course.

Including Hang Seng Bank's foreign currency wholesale branch in Shenzhen and representative office in Xiamen, we now have 21 outlets on the Mainland.

We continue to make effective use of technology to improve our cost efficiency and offer customers more convenient banking services.

As at 31 July 2007, our number of Personal e-Banking customers had reached more than 700,000, up 20.3 per cent compared with a year earlier. The number of Personal e-Banking transactions made during the first seven months of 2007 was up 51.8 per cent compared with the same period last year.

Year-on-year, revenue from Personal e-Banking sales and transactions grew by 93 per cent to $734 million in the first half.

We have also made good progress with the expansion of Business e-Banking. At the end of July, we had over 45,000 accounts, a year-on-year increase of 34.8 per cent. The total number of Business e-Banking transactions made during the first seven months of 2007 was up 46.3 per cent year on year.

Customer Group Highlights

Personal Financial Services attained a 35.9 per cent year-on-year increase in operating profit excluding loan impairment charges during the first half to reach $5,380 million. Pre-tax profit was up 35.4 per cent at $5,278 million.

Wealth management income grew sharply by 58.2 per cent to a record $3,429 million.

Sales of investment funds and equity-linked structured products also enjoyed strong growth, rising by 88.6 per cent and 234.4 per cent respectively.

Our fund management achievements were recognised through a number of awards and number one rankings received during the first half of 2007.

Strategic initiatives taken to meet our private banking growth objectives – including hiring more relationship managers and extending our range of products – generated excellent results with total operating income increasing by 60.7 per cent. Pre-tax profit was up 62.4 per cent at $459 million. Given this progress, private banking should achieve its five-year target of doubling 2005's pre-tax profit by the end of this year – three years ahead of schedule.

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The further enhancement of our retirement planning services drove a 37.1 per cent growth in life insurance income in the first half of 2007 and helped make us Hong Kong's number one provider in terms of annualised new premiums for regular-pay (non-linked) insurance in the first half of the year.

Sustained consumer demand and a series of promotional campaigns helped us grow personal loans by 18.6 per cent during the first half and 48.8 per cent year on year. Card advances rose 3.8 per cent and 29.3 per cent over 31 December 2006 and 30 June 2006 respectively.

Commercial Banking's operating profit excluding loan impairment charges rose 15.3 per cent to $1,076 million, driven by a 22.7 per cent increase in average customer advances as well as the expansion of corporate wealth management business and improvements in deposit spreads. Pre-tax profit rose 17.2 per cent to $1,285 million.

The contribution of corporate wealth management income to Commercial Banking's total operating income grew from 7.9 per cent to 9 per cent. In particular, strengthened collaboration between commercial relationship managers and treasury and investment service teams saw treasury and investment income grow by 73.2 per cent.

We effectively promoted our banking solution for retailers, growing our market share in this key sector. We also enjoyed success with expanding our card merchant-acquiring business, resulting in a 40.9 per cent increase in related income.

Commercial Banking's average customer deposits rose 19.5 per cent, driven largely by non-borrowing SME customers.

The improved interest rate environment in the first half of 2007 saw Treasury's operating profit increase by 2.7 per cent to $456 million. Net operating income rose 5.1 per cent, with the improvement in yields on balance sheet management portfolios. Including the increase in our share of profits from associates, pre-tax profit rose by 12.8 per cent to $571 million.

Corporate Banking's 16 per cent rise in operating profit excluding loan impairment charges to $298 million was underpinned by growth of 15.7 per cent in net interest income and 35 per cent in net fee income.

Net interest income growth was largely driven by the 28.9 per cent growth in average customer deposits. Average customer advances were up 2.3 per cent. New financing for large Corporate Banking customers was active, reflected in increased lending to the property investment sector and securities companies. However, large repayments of existing loans in other sectors curtailed the growth of the overall Corporate Banking loan portfolio.

Pre-tax profit was down by $79 million at $192 million, reflecting an increase in loan impairment charges.

Mainland Business

The opening of Hang Seng China and our recent approval to offer comprehensive renminbi services have put us in a stronger position to build on the good growth momentum generated during the first half of the year.

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We continue to focus on the affluent customer segment and commercial business. Our number of Mainland Prestige Banking accounts increased by 35 per cent during the first half of the year.

Total operating income of our Mainland operations grew by 86 per cent to $225 million, supported by a 21.3 per cent increase in lending and a 42.7 per cent rise in deposits. Pre-tax profit was down $40 million, affected by the costs of establishing our Mainland subsidiary, an exchange loss on US dollar capital funds upon revaluation against the renminbi and an increase in loan impairment charges.

However, including our share of profit from our strategic partner Industrial Bank, the pre-tax profit of our Mainland business contributed 5.9 per cent of total pre-tax profit, compared with 4.3 per cent a year earlier.

Strong Financial Fundamentals

Sustainable long-term growth relies in large part on us maintaining solid financial foundations.

Shareholders' funds (excluding proposed dividends) increased by $5,580 million, or 12.9 per cent, to $48,928 million, due mainly to an increase in retained profits and the gain on the dilution of our investment in Industrial Bank.

We continue to achieve strong returns on equity. Return on average shareholders' funds was 36.6 per cent, compared with 29 per cent in the first half of 2006. Excluding the gain on dilution, return on average shareholders' funds was 30.5 per cent.

The total dividend distribution for the first half of 2007 was $2.20 per share, the same as that in the first half of 2006.

Our operating expenses rose by 24.6 per cent to $2,914 million, due mainly to investments in our Mainland business as well as increases in performance-related pay and marketing costs. Excluding Mainland-related costs and performance-based bonuses and incentives, operating expenses were up 8.9 per cent.

However, the rise in costs was outpaced by the 25.7 per cent growth in total operating income. With this positive jaw of 1.1 percentage points, our cost efficiency ratio was 0.2 percentage points lower at 26.6 per cent.

We enhanced staff productivity – operating profit per employee during the first half was over $900,000, a 14.1 per cent increase compared with a year earlier.

In June we launched a US$300 million subordinated notes offering. The proceeds will be used for general funding purposes, including our acquisition of the outstanding 50 per cent of Hang Seng Life.

At 30 June 2007, our total and tier 1 capital ratios were 12.3 per cent and 8.9 per cent respectively, as calculated under new rules issued for the implementation of the Basel II capital accord.

We continue to enjoy excellent credit ratings. Moody's Investors Service has upgraded our long-term local and foreign currency deposit ratings to Aa1 and Aa2 respectively.

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Total loan impairment allowances as a percentage of gross advances to customers improved to 0.31 per cent, compared with 0.33 per cent at the previous year-end. Gross impaired advances as a percentage of gross advances to customers remained unchanged at 0.5 per cent.

Moving Forward

Economic growth in Hong Kong will maintain momentum during the rest of the year. The economy will continue to benefit from the improving labour market, a favourable interest rate environment and strong growth on the Mainland.

Potential challenges include the spillover effects of the US subprime problem and rising inflation risks. The prospects of further macro-economic policy tightening on the Mainland may also add volatility to the performance of its economy and financial markets.

Our strategy for the long-term expansion of our business is already yielding encouraging results and has prompted the market to reassess its perception of Hang Seng as an ex-growth stock.

We will continue to build on our strong growth momentum. We will step up our efforts to transform Personal Financial Services into a top league wealth management player, focusing particularly on the affluent segment. We will also further develop our Commercial Banking and Mainland businesses as key growth drivers.

We will leverage our brand, leading market position and wide product range to attract new customers and deepen relationships with existing ones. We will capitalise on the positive sentiment of consumers and the business community to expand personal finance and commercial lending.

We will take full advantage of new business opportunities following the establishment of our Mainland subsidiary bank.

We will grow our customer base by continuing to focus on high-growth areas such as the Pearl River Delta, Yangtze River Delta and Bohai Economic Rim regions as well as exploring potential opportunities in western China.

We have received approval to begin preparations to set up a Ningbo branch and have other planned openings in the pipeline. We will take further steps to increase renminbi deposits to support lending growth. By 2010, we aim to have more than 2,000 staff and over 50 outlets on the Mainland.

The significant progress made in the first half of 2007 provides encouraging support for our strategy for long-term growth. We will continue working to further enhance our position as a leading financial institution in Greater China and achieve new heights of excellence for customers and shareholders.

Thank you.

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