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Building Blocks For The Future

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Hang Seng Bank

Ladies and gentlemen. It is a privilege to be here at the Morgan Stanley Asia Pacific Summit, to address you on developments at Hang Seng Bank.

In today's banking sector, the outlook for earnings is challenging, but Hang Seng is confident in its abilities. We are a prudent yet progressive organisation with a strong brand and clear strategies to come out a winner. Our goal is to strengthen further our position in Hong Kong and to expand as a major player in mainland China, focusing on the coastal region.

We have developed the building blocks on which to grow our business. In Hong Kong, our growth strategies include wealth management and catering for small and medium-sized enterprises (SMEs). In these higher margin, value-creating businesses, we intend to increase non-interest income, product cross-selling and market share wherever we can through relationship building. In the Mainland, we are positioning ourselves for the full opening of its banking sector.

Hang Seng Bank today

Before I describe our growth strategies, I'd like to present a brief overview of Hang Seng and the difficult environment we operate in.

By market capitalisation, Hang Seng is the largest local bank in Asia, excluding Japan, and the second largest listed bank in Hong Kong. We serve more than one-third of Hong Kong's population. In June, we were named the Best Local Bank in Hong Kong by FinanceAsia magazine.

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 the end of last week (18 October), the Bank achieved a total return of 58.8% for shareholders, compared with the average return of just 6.6% recorded by Hang Seng Index constituents over the same period. In absolute terms, total shareholder value has increased by HKD77.8 billion.

Hang Seng is a principal member of the HSBC Group, 62.14% owned. In the first half of 2002, we contributed 25.4% of the Hongkong and Shanghai Banking Corporation's attributable profit and 12.7% of the HSBC Group's after goodwill amortisation.

In the first half of 2002, with the Hong Kong economy remaining sluggish, Hang Seng recorded an attributable profit of HKD5.2 billion. This was a reduction of 2.9% from the same period in 2001, compared with an 11.1% contraction in net profit recorded by Hong Kong listed banks, according to a report by KPMG. The HKD5.2 billion was, however, an increase of 10.1% compared with the second half of 2001. Our return on average shareholders' funds was 23.8% and the first interim dividend was HKD2.10 per share, unchanged from 2001.

Our focus on expanding non-interest income saw other operating income grow by 14.6% and contribute 28.9% of total operating income, an increase of 4.2 percentage points compared with the first half of 2001.

Hang Seng's financial strength is highlighted by several factors, including cost discipline and asset quality. Among the lowest in the banking world, our cost-to-income ratio was 23.7% and lower than our return on shareholders' funds in the first half of 2002.

At the end of June, our ratio of gross non-performing advances to gross advances was 2.6%, compared with the average of 4.41% recorded by retail banks in the territory, according to Hong Kong Monetary Authority figures. Loans overdue for more than three months stood at 2.2%, compared with 3.25% for retail banks.

Difficult operating environment

In the face of a weak global economy and an uncertain US recovery, the outlook for Hong Kong is for slow growth. The government has forecast real GDP growth of 1.5% for 2002.

In the first eight months of 2002, total exports rose by 0.9% by value while tourist arrivals rose by 14.4% to 10.4 million. However, the benefits from the exports of goods and services have not spilled over to the rest of the economy.

Consumer and investment sentiment is expected to remain weak as a result of continued adjustment in pricing, weak asset prices, high unemployment and pressure on salaries. These conditions are expected to continue for the next 2 to 3 years.

The banking sector will continue to face difficult operating conditions, with intense competition, narrowing interest margins and sluggish loan demand. Total loans for use in Hong Kong contracted by 15.7% from 1998 to 2001. In the first 8 months of this year, they fell further by 1.7%, despite HKD interest rates being at historical lows. Lending growth is expected to be negative or in the low single digits in the next few years.

One bright spot on the economic horizon is mainland China, which is expected to record steady 7 to 8% GDP growth in the next few years.

Expansion in mainland China

Hang Seng aims to capitalise on the financial liberalisation in China following its WTO entry. Certainly, our financial strength offers us the capital resources to expand there. We intend to be one of the most prominent foreign banks in the Mainland and we are developing our network through setting up more branches in key cities and internet banking services.

However, due to operational constraints in the Mainland, it may be some time before we harvest the seeds we are sowing. This is a time for investment and building up our capabilities and capacity in the country. Eventually, our Mainland business should increase.

We plan to grow both organically and if we can identify the right partners, through strategic alliances.

The retail market is a major focus, and we are concentrating on strategic cities with good prospects and large populations. At present, we operate four branches and two representative offices in the Mainland. The Shanghai and Guangzhou branches have set up Prestige Banking Centres to cater for affluent customers.

We intend to open more branches in strategic locations and sub-branches in major coastal cities. We have already received in-principle approval to open a branch in Nanjing. We have also applied to open a sub-branch in Puxi, Shanghai.

Internet banking should make our presence felt more strongly. Last month, we obtained approval from the People's Bank of China for our Mainland branches to offer Personal e-Banking services to local customers and expatriates in the Mainland. We hope to launch the services before the year-end.

Several developments this year have marked a milestone in our Mainland business. We began offering foreign currency services to mainland Chinese residents and enterprises, and our Shanghai branch started to offer renminbi services to expatriates and foreign-invested enterprises.

In other developments, we have started preparation to enter the Mainland credit card market pending the issue of governing regulations. In addition, our insurance, securities and investment businesses are positioning themselves in the Mainland. Hang Seng Insurance Company Limited and Hang Seng Securities Limited have set up a representative office in Shenzhen and Shanghai respectively. Hang Seng Investment Management Limited has received approval to open a representative office in Shenzhen.

Wealth management

In Hong Kong, an ageing population is expediting the need for lifetime wealth management and the business offers vast potential. To further grow this business, our strategies include:

- Growing the affluent and mass affluent customer segments.
- Focusing on customer segmentation to strengthen relationships and acquire in-depth knowledge of customers. Our integrated accounts have become a major platform to implement segmentation. Over the past two years, several such accounts have been launched with good results.
- We will also leverage on knowledge-based marketing to promote needs-based cross-selling.

We're off to a good start. Proving that our strategies are working, personal wealth management recorded a rise in contribution of 62.1% to HKD809 million for the first half of 2002.

Our wealth management initiatives comprise investment and insurance services. In the low interest rate environment, the investment fund business has been performing well. Our sales of retail investment funds, including the popular Hang Seng Investment Series, amounted to HKD15.2 billion in the first half of 2002, an increase of 156.4% over the same period in 2001. The Investment Series includes the largest series of capital guaranteed funds in Hong Kong.

In our life insurance business, growth of 59.6% to HKD142 million in distribution commissions was recorded.

We will continue to widen our wealth management product range to meet new customer demands. Our open platform allows us to offer other products that are attractive in the market. For example, we offer over 300 third party funds.

In marketing, sales and service delivery, we shall further leverage on e-Banking. At the end of September, 230,000 customers had registered for Personal e-Banking services, an increase of about 30% from the end of 2001. The number of internet transactions represented some 10% of total transactions and online share trading about 54% of total securities transactions.

We intend to migrate more trading activities to our online platform in view of the high level of acceptance by customers. Online FX Margin Trading Services were launched in August and by September, 50% of total FX Margin Trading was conducted online.

Other personal financial services

Consumer financing also offers higher margins. Given high unemployment and rising personal bankruptcies, this is not the right time to aggressively expand the business. However, this will be a medium and long-term target.

Our credit card business is still growing in terms of number of cards and receivables, but slowly and prudently. The average annualised charge-off ratio for Hang Seng was 8.12% for the first half of this year, compared with 11.24% for reporting institutions in a Hong Kong Monetary Authority survey.

The mortgage business is an important part of our loan portfolio and so far this year, we have maintained our market share.

Small and medium-sized enterprises

The majority of Hong Kong's businesses are small to mid-sized. Over 90% of Hong Kong companies employ less than 50 people. By growing services for this segment, we shall be able to put additional emphasis on fee generation.

A Business Banking Division was set up in May to increase our focus on SMEs. It helps SMEs grow their business by providing credit products and fund management services.

As part of our efforts to help commercial and SME customers manage their business and finances more efficiently, Business e-Banking services were launched in August. Online trade services will be launched later this year.

Given the improving external sector, the Bank's trade finance business recorded growth of 6.0% in the first half of this year.

We are growing our sales teams to further reach out to SMEs and intend to expand lending relationships in the next few years through more marketing and simpler procedures. We are also planning to promote more trade-related treasury products such as remittances and forex to this segment.

Conclusion

As a premier financial services provider, Hang Seng's growth strategies will allow the Bank to meet new challenges effectively as it moves forward. The Bank is well-positioned to build on its many strengths. These include prudent financial operations, a large customer franchise, superior service, one-stop solutions and an efficient multi-channel delivery network.

In the Mainland, we hold several competitive advantages. These include sharing the same language and culture, our China knowledge, our leverage on the Hang Seng Index brand name and our premium customer services.

Given our clear vision, sound business strategies and strong competitive advantages, we are confident of our abilities to seize new opportunities and create value for shareholders.

Thank you.