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## Solid As A Rock

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Good morning ladies and gentlemen. May I say how delighted I am to be back in Singapore and the Morgan Stanley Asia Pacific Summit.

Since the last Summit, both Singapore and Hong Kong have experienced dramatic developments with the emergence and control of SARS.

In Hong Kong in May, under the adverse economic impact of SARS, the government reduced its 2003 GDP forecast for the territory from 3% to 1.5% in real terms. In August, following the success in controlling SARS, the government revised that forecast upwards to 2%. Last month, it further revised the GDP forecast upwards to 3%.

Through it all, Hang Seng Bank has stood solid as a rock. As a prudent yet progressive organisation, the Bank's considerable strengths have allowed it to create value consistently. We have been able to balance successfully in a see-saw economic environment and to build on new opportunities.

### Hang Seng Bank today

By market capitalisation, Hang Seng is the largest local bank listed in ex-Japan Asia and the second largest listed bank in Hong Kong. It was named the Best Domestic Commercial Bank in Hong Kong by both The Asset and Asiamoney magazines this year.

We aim to further strengthen our market leadership in Hong Kong and to become an important player in mainland China.

Under our Managing for Value strategy, our objective has been to double shareholder value in the five years from 1999 to 2003. I am pleased to report that on 20 October 2003, the Bank reached this objective when it achieved a total return of 100.2% for shareholders.

This was substantially more than the average return of 40.6% recorded by Hang Seng Index constituents over the same period. In absolute terms, our total shareholder value increased by HKD132.7 billion. Due to the fall in the equity market, however, our total return figure was 94.2% from 1999 until the end of last month.

We are not complacent. Although the Hong Kong economy is improving, many structural issues need to be solved. I'd like to look first at the operating environment in Hong Kong.

### **Operating environment**

Overall, economic activity began to bottom out towards the end of May. The signing of the Mainland/Hong Kong Closer Economic Partnership Arrangement, or CEPA, was a catalyst for the dramatic turn in sentiment from pessimism to optimism.

CEPA, which comes into effect next year, provides an invaluable platform to reinforce Hong Kong's role as the gateway to the Mainland market. The removal, or easing, of a broad range of barriers permits freer flows in goods, funds, people and services between the two places.

The economic improvement has been most visible in inbound tourism and the travel-related sectors. With the early implementation of the 'individual travel scheme' under CEPA, the territory has benefited from an increase in visitors from the Mainland. The number of Mainland tourists is expected to grow from 6.8 million last year to 10 million in 2004.

The pick-up in the Hong Kong economy and in local confidence in recent months is welcome. However, the economy continues to face structural problems.

Yes, the external sector looks robust, with the government forecasting that total exports of goods will rise by 9.2% this year. The volume of retail sales resumed a year-on-year increase in August, after declining for six consecutive months. The improved sentiment has led to a significant increase in property and stock market activities.

However, the challenges remain considerable. Deflation, which was in its 59<sup>th</sup> month in September, is expected to last at least another year.

Although the unemployment rate appears to be stabilising, it was a high 8.3% in the third quarter and a skills mismatch continues in the labour market. The government also needs to find ways to solve the budget deficit through strict cost discipline in the public sector.

In order to reap long-term benefits, Hong Kong must grasp opportunities from the improved environment to speed up its structural changes.

Many difficulties also remain in the banking sector. Even before the SARS outbreak, operating conditions were challenging, with narrowing interest margins and subdued loan demand. Total loans for use in Hong Kong contracted by 13.0% from 1998 to 2002. In the first 8 months of 2003, loans for use in the territory fell further by 2.2%.

### **Building on strengths**

In view of the operating environment, Hang Seng is building on the sound fundamentals that make it a solid bank, to provide sustainable profitability. These include:

- Our financial strength
- A strong customer focus and superior service
- Operational efficiency and
- Opportune business strategies in Hong Kong and the Mainland

### **Financial strength**

Despite the effects of the SARS outbreak and sluggish economy in the first half of 2003, the Bank achieved a creditable growth in operating profit of 0.9% to HKD5,617 million, compared with the same period last year. This reflects the resilience of the Bank's core business.

Although attributable profit fell by 3.8% to HKD5,022 million, it represented a rise of 6.9% compared with the second half of last year.

The return on average shareholders' funds was 24.4%, compared with 24.1% in the same period last year.

In view of the Bank's strong balance sheet, the Directors declared a first interim dividend of HKD2.10 per share. Acknowledging the increasing importance of dividend flows to our shareholders, the Board has decided to move to a programme of quarterly dividends in 2004.

We made significant progress in expanding non-interest income and in managing costs. The ratio of other operating income to total operating income rose to a record 33.9% in the first half of 2003. This was an

increase of 5 percentage points from the same period last year and of 11.4 percentage points from the same period in 1998.

The cost-to-income ratio, among the lowest in the banking world, improved to 23.1%. This was 0.6 percentage point lower than the same period last year and 4.1 percentage points below the level of the second half of last year.

Hang Seng continued to outperform the market in Hong Kong in many areas in the first half of 2003, according to figures from the Hong Kong Monetary Authority (HKMA).

The Bank's net interest margin of 2.41% was favourable compared with the net interest margin of 1.97% recorded by retail banks in Hong Kong as a whole. Its low cost-to-income ratio of 23.1% was most attractive against the retail banks' average of 37.7%.

Reflecting the Bank's asset quality and prudent lending, its loans overdue for more than 3 months and rescheduled loans as a ratio of total loans were lower at 3.37%, compared with 3.61% for retail banks at the end of June. The Bank's non-performing loans of 2.5% compared favourably with 3.83% for retail banks.

The Bank's annualised charge-off ratio for its credit card business in the first half of this year was 8.85%, compared with 11.8% for institutions surveyed by the HKMA.

Last month, Moody's Investors Service upgraded Hang Seng's long-term foreign currency deposit rating to A1 from A3, with a stable outlook.

### **Strong customer focus and superior service**

Our strong customer focus and superior service have helped 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 customer franchise to establish and manage relationships so that they are economically viable. The focus is on meeting total customer needs and gaining a high share of customer wallet penetration.

Our segmentation strategy and integrated accounts enable us to customise solutions for different groups and deepen relationships with them. Lifestyle banking services are also becoming more important in our efforts to offer added value to customer groups. In June, Leisure Class

lifestyle services were launched for retirees and those who are planning to retire.

We intend to increase marketing efforts to migrate customers from one segment to another at appropriate stages, as part of our relationship deepening. For example, mass integrated account holders could move up to a higher end account when their wealth reaches a certain level.

### **Operating efficiency**

Our operating efficiency is highlighted by our attributable profit per employee, which was HKD0.7 million in the first half of 2003. Our total staff number of about 7,200 is a reduction of about 830 from the height in 1997.

Our one-stop solutions are supported by an integrated multi-channel delivery network, with an emphasis on automation to enhance customer convenience and reduce costs.

In marketing, sales and service delivery, we are leveraging on internet banking. The Bank offers Personal e-Banking and Business e-Banking services in Hong Kong and mainland China.

At the end of September, the number of customers registered for Personal e-Banking services in Hong Kong was about 315,000, an increase of 24.6% from the end of last year. There were about 11,000 Business e-Banking customers. The number of internet transactions had risen to 21.2% of total transactions and online share trading to 59.0% of total securities transactions.

As internet banking services become more popular, the Bank's branches are focusing on more personalised services. Counter transactions fell to 13.8% of total transactions in the first 9 months of 2003, compared with 15.9% in the same period in 2002.

### **Sound business strategies**

We are focusing on higher margin businesses that increase non-interest income, such as wealth management – an area where we have done very well. Our solid fundamentals also allow us to build on new opportunities, such as the Mainland visitor market and the Capital Investment Entrant Scheme. At the same time, we are developing growth drivers such as small and medium-sized enterprises (SMEs) and trade finance, which are expected to benefit from the improving economy.

### *Wealth management*

Income from wealth management, comprising income from investment and insurance services, grew strongly by 37.2% to HKD1,397 million in the first half of this year. It represented 52.2% of total other operating income.

Among our 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 September, the total number of capital guaranteed funds and the sub-funds under the Series for retail customers was 64 and 84 respectively. Funds managed under the Series increased by 31.6% to HKD30.4 billion in the first 9 months of 2003, compared with the end of 2002.

Our life insurance business has recorded strong growth. For the first half of this year, Hang Seng Life was ranked the No. 2 bancassurer in Hong Kong in terms of new business by annualised premiums. Our securities business has also grown in recent months in line with the increase in market turnover.

### *New opportunities*

The increasing number of Mainland visitors to Hong Kong offers new opportunities. We have extended RMB exchange services to all our branches and are promoting the sale of our God of Wealth gold ingots to Mainland visitors. Our special promotions during 'Golden Week' received a good response.

Although not many Mainland visitors have opened accounts with us so far, the potential is there for the future. Eventually, we hope to attract more from this group to use our wealth management services, especially when the Mainland relaxes its RMB exchange controls.

There has been much discussion recently about the possibility of the introduction of RMB financial services in Hong Kong, and the territory eventually evolving into an offshore centre for RMB transactions. I do not wish to make any prediction as to the timing, but given Hong Kong's strong links to the Mainland, there should be a role for the territory in the RMB's road to full convertibility when the time is ripe. We plan to take advantage when it happens.

The government's Capital Investment Entrant Scheme also offers the Bank a new market. Our Private Banking Department is offering one-stop services targeting investor immigrants under the scheme. The department

has been working with property developers and immigration consultants to explore ways to promote its services to this group.

I would like to add that in our private banking business, our aim is to become a leading domestic player in terms of assets under management, client base and profitability.

#### *Other growth drivers*

SMEs are the backbone of Hong Kong business and the Bank is expanding its customer base in this sector, partly by targeting business associations. Our cross-selling ratio for this group is improving.

Our objective is to provide total business solutions to our commercial customers. In September, we launched an Integrated Business Solutions Account, which offers one-stop financial services to businesses.

Our trade finance rose by 13.1% in the first half of this year. We intend to continue to take advantage of the robust external trade. Mainland China's export growth was over 30% in the year to September and such strong growth will benefit Hong Kong's re-exports.

To serve the trade finance needs of customers with business operations in Macau, we plan to open a branch there later this year.

#### **Expanding in the Mainland**

We are committed to long-term development in the Mainland. The implementation of CEPA will open up new business opportunities in the Mainland for Hong Kong businesses. We are expanding our services there, particularly in the rapidly growing Pearl River Delta, to help customers capture these opportunities.

Last month, our Guangzhou branch became our second Mainland branch to offer RMB services. Business development teams have been set up at the branch to better serve commercial customers and outreach prospects throughout the Delta. Our Shenzhen branch has also just received regulatory approval to operate RMB business.

In September, we formally opened our fifth Mainland branch in Nanjing and at the end of last month, we opened a sub-branch in Puxi, Shanghai. These will help us expand in the economically important Yangtze River Delta. We shall continue to grow our Mainland network with more branches and have applied to upgrade our Beijing representative office to a branch.

Hang Seng is looking to grow not just organically but by acquisition in the Mainland if the right partners can be identified. We have the advantage of being a world-class bank run by Chinese.

## **Conclusion**

This year, Hang Seng celebrated its 70<sup>th</sup> anniversary. As a fundamentally strong bank that has grown with Hong Kong through the years, we are committed to value creation for shareholders and customers alike. We are confident that our many strengths and sound business strategies will reinforce our solidness and allow us to steer steadily ahead.

Thank you.