

# Financial Overview



## A) Consolidated Profit and Loss Account

During 2001, Hong Kong followed the consecutive interest rate cuts in the United States in an attempt to stimulate enterprise investments and personal spending. However, the move failed to push the economy out of sluggishness, mainly due to the worldwide excessive production capacity and the impact of the September 11 event to the United States on business and consumer confidence. Additionally, Hong Kong had been facing persistent deflation. These all painted a gloomy picture for the banking business.

Bank of China (Hong Kong) Limited (the "Bank") and its subsidiaries (the "Group") recorded a consolidated profit attributable to shareholders of HK\$2,768 million in 2001, a decrease of HK\$2,445 million or 46.9% compared with 2000. A fall in operating income, the occurrence of restructuring expenses and a loss on revaluation of fixed assets impacted adversely on the Group's results.

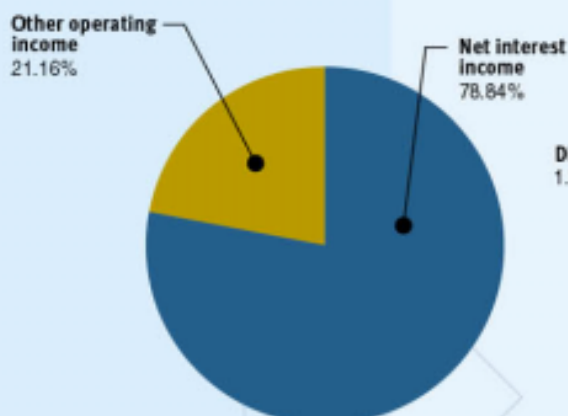
### 1) Operating profit

In 2001, operating profit before provisions was HK\$13,162 million, a decrease of HK\$1,968 million or 13.01% from 2000. In particular, net interest income was HK\$14,987 million, a decrease of HK\$1,059 million from 2000, and other operating income was HK\$4,022 million, a decrease of HK\$630 million from 2000. The decline in net interest income was mainly due to decreased return from cost-free funds resulting from the drastic fall in market interest rates during the year as well as the narrowing of net interest margin.

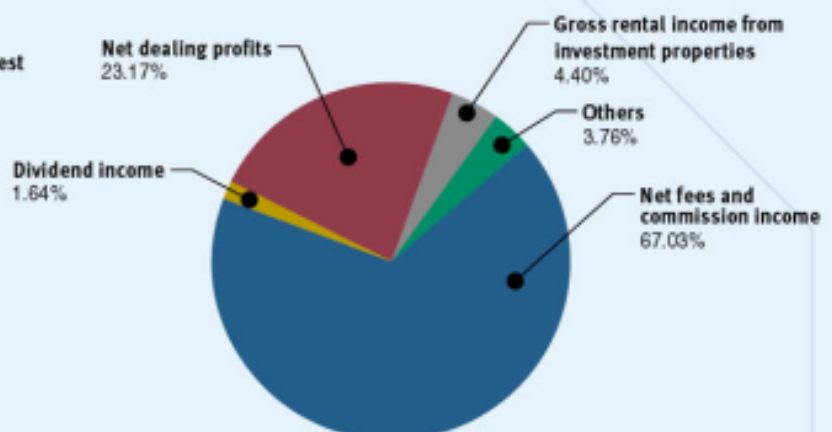
The fall in bills business volume and the shrinking of stock trading turnover in Hong Kong both led to the decline in net fees and commission income, from HK\$3,002 million in 2000 to HK\$2,696 million in 2001, a decrease of 10.19%.

Net interest income				
HK\$'m	2001	2000 (restated)	Changes	%
Interest income	38,307	55,449	(17,142)	(30.91)
Interest expense	23,320	39,403	(16,083)	(40.82)
	14,987	16,046	(1,059)	(6.60)
Other operating income				
HK\$'m	2001	2000 (restated)	Changes	%
Net fees and commission income	2,696	3,002	(306)	(10.19)
Dividend income	66	42	24	57.14
Net dealing profits	932	994	(62)	(6.24)
Gross rental income from investment properties	177	125	52	41.60
Others	151	489	(338)	(69.12)
	4,022	4,652	(630)	(13.54)

Operating income for the year 2001



Other operating income for the year 2001



## 2) Operating expenses

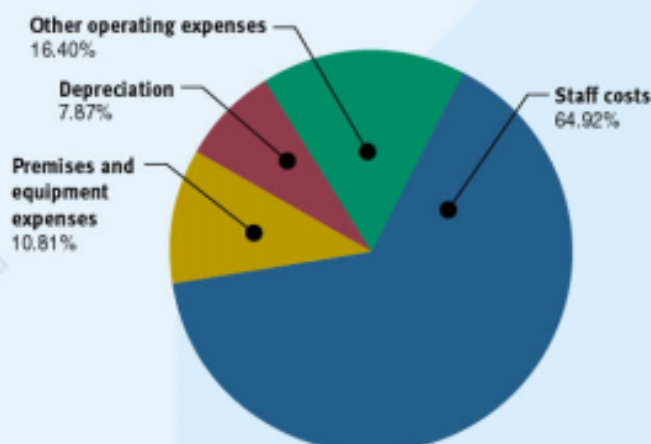
Operating expenses in 2001 amounted to HK\$5,847 million, an increase of HK\$279 million or 5.01%. Staff costs (including directors' emoluments), which represented the largest component of operating expenses (i.e. 64.92% of total operating expenses), increased by HK\$439 million or 13.08% to HK\$3,796 million in 2001. This was mainly due to a general salary increase for all employees in 2001 as well as overtime payments relating to the work performed by the employees in connection with the restructuring and merger.

In 2001, premises and equipment expenses (excluding depreciation) accounted for 10.81% of total operating expenses. This item decreased by HK\$34 million (or 5.11%) to HK\$632 million, mainly due to lower premises rental expenses. Furthermore, depreciation and other operating expenses fell by HK\$126 million (or 8.16%) to HK\$1,419 million.

### Operating expenses

HK\$'m	2001	2000 (restated)	Changes	%
Staff costs (including directors' emoluments)	3,796	3,357	439	13.08
Premises and equipment expenses (excluding depreciation)	632	666	(34)	(5.11)
Depreciation	460	514	(54)	(10.51)
Other operating expenses	959	1,031	(72)	(6.98)
	5,847	5,568	279	5.01
<b>Cost to income ratio (%)</b>	<b>30.76</b>	<b>26.90</b>		

Operating expenses for the year 2001



As a consequence of the decline in operating income coupled with an increase in operating expenses, the cost to income ratio rose from 26.9% in 2000 to 30.76% in 2001. Despite this, the cost to income ratio was still amongst the lowest of our peers in Hong Kong.

## 3) Charge for bad and doubtful debts

During 2001, the management appointed an independent third party professional firm to conduct comprehensive reviews on the asset quality of its loan portfolio. In 2001, additional specific provisions of HK\$10,649 million were made (2000: HK\$7,583 million). Together with the release of general provisions and specific provisions due to the improved quality of certain loans, the net charge for bad and doubtful debts in 2001 was HK\$7,412 million, HK\$1,181 million or 13.74% less than that in 2000. The fall also reflected the strengthening of the Bank's loan recovery function, which brought in a total recovery of HK\$530 million, an increase of HK\$431 million from the figure recorded in 2000.

## 4) Non-operating expenses

During the restructuring in 2001, the Group incurred HK\$937 million of restructuring costs, mainly for legal and professional fees, stamp duty levied on shares and immovable properties, severance payments and other related restructuring costs. In 2001, the Group changed its accounting policy on premises and investment properties from being stated at cost less accumulated depreciation and accumulated impairment losses to valuation. This resulted in a net loss on revaluation of fixed assets of HK\$1,241 million.



## B) Consolidated Balance Sheet

### 1) Assets

The Group's total assets as at 31 December 2001 were HK\$766,140 million, HK\$73,230 million or 8.72% lower than those as at 31 December 2000. This reduction was primarily due to the decline in cash and short-term funds, placements with banks and other financial institutions, in addition to advances and other accounts.

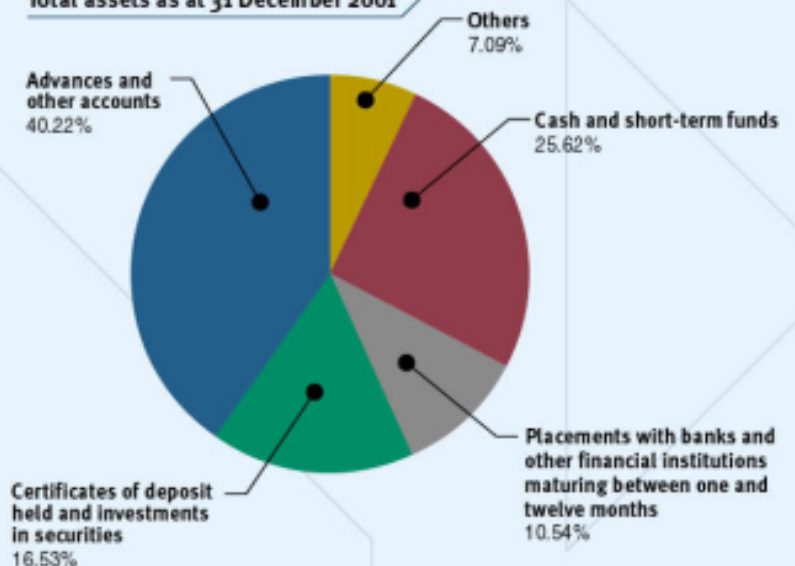
#### Cash and short-term funds

The cash and short-term funds representing 25.62% of total assets, decreased by HK\$58,993 million or 23.11% to HK\$196,255 million as at 31 December 2001 compared to the preceding year. This decrease was principally due to a decline in money at call and short notice maturing within one month as well as a reduction of balances with banks and other financial institutions.

#### Placements with banks and other financial institutions and investments in securities

After the merger, the Group changed the management of liquid and short-term surplus funds from the various bases of individual member banks of the former Bank of China Group in Hong Kong to a single basis of centralized asset and liability management. As a result of the merger, the Group repatriated approximately HK\$60,000 million interbank balances with Bank of China. The placements with banks and other financial

Total assets as at 31 December 2001



institutions maturing between one and twelve months amounted to HK\$80,773 million as at 31 December 2001, which was a 25.5% decrease from HK\$108,414 million as at 31 December 2000. In addition, the Group adjusted its investment strategy and increased its investment in relatively higher-yielding securities. The Group's certificates of deposit held, held-to-maturity securities, investment securities and other investments in securities as at 31 December 2001 amounted to HK\$126,675 million, 16.53% of total assets and the total balance increased by HK\$18,473 million from HK\$108,202 million as at 31 December 2000, an increase of 17.07%.

### Advances and other accounts

The local credit market for corporate and individual loans remained sluggish due to the weak economy and persistent deflation in Hong Kong, which suppressed capital investment and personal spending. Coupled with the bad debts written off of HK\$10,435 million for the year of 2001, the Group's advances and other accounts (net of provisions for bad and doubtful debt) decreased by HK\$17,461 million (or 5.36%) to HK\$308,108 million as at 31 December 2001 as compared to the previous year. The gross balance of advances to customers also recorded a decrease of HK\$17,001 million as compared to the previous year.

To cope with the sluggish credit market, the Group in 2001 adopted a series of strategies to expand its business, which was proved to be successful. From the sectoral analysis of advances to customers, in terms of the loans for use in Hong Kong, both the loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Schemes and the credit card advances recorded remarkable growth. The balances as at 31 December 2001 increased by HK\$6,982 million and HK\$320 million respectively, or 52.53% and 11.86%, when compared to those of last year.

After the merger, the Bank established the Risk Management Department ("RMD") and the Special Assets Management Department ("SAMD"). The RMD ensures adequate independent oversight and control over credit risk. It also enforces an appropriate credit administration and prudent credit management mechanisms to improve the asset quality. The SAMD has strengthened the monitoring, cleaning up and recovery of non-performing loans. In particular, advances overdue for more than 3 months amounted to HK\$25,298 million as at 31 December 2001, a decrease of HK\$3,925 million from 2000 and the percentage to total gross advances to customers fell from 8.59% to 7.83%, a decrease of 76 basis points.

On the other hand, the Bank strove to tackle the legacy non-performing loans. By employing a consulting firm to make an in-depth diagnosis of the non-performing loans, the Bank fully manifested these problem loans as a result. As the Group

implemented a more prudent credit rating policy, the non-performing loans increased by HK\$863 million or 2.49% to HK\$35,512 million as at 31 December 2001, as compared to the previous year. In addition to the decline in total gross advances to customers, the percentage of non-performing loans to total gross advances to customers increased from 10.19% as at 31 December 2000 to 10.99% as at 31 December 2001.

In 2002, the Bank disposed of loans with a gross book value of HK\$11,401 million net of specific provisions of HK\$2,679 million to Bank of China Grand Cayman Branch. As at 31 December 2001, the outstanding balance of non-performing loans, which were disposed of in 2002, amounted to HK\$7,269 million and specific provisions made in respect of such non-performing loans amounted to HK\$2,538 million. Had the disposal taken place as at 31 December 2001, the non-performing loans as a percentage of the total gross advances to customers would have been 9.06%.

### Provision for bad and doubtful debts

The Group has maintained an adequate provisioning level for bad and doubtful debts in accordance with the guidelines set by the Hong Kong Monetary Authority. As at 31 December 2001, the total provision for bad and doubtful debts for advances to customers was HK\$17,114 million, representing 5.3% of total gross advances to customers.

## 2) Liabilities

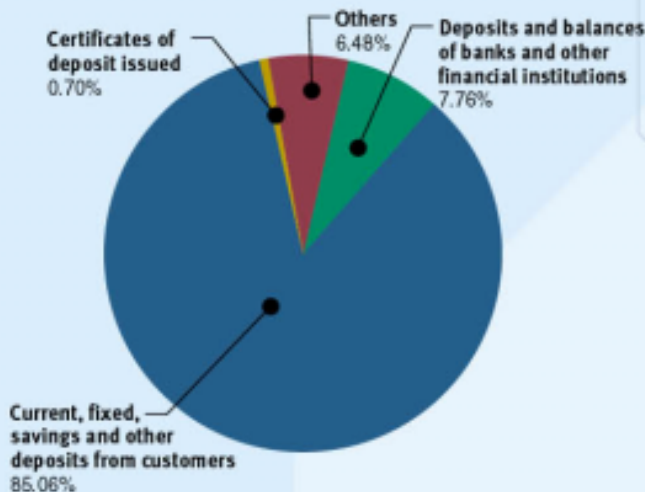
The Group's total liabilities as at 31 December 2001 were HK\$712,904 million, which was HK\$91,589 million or an 11.38% decrease from those as at 31 December 2000. This decrease was primarily due to changes in the level of deposits and balances of banks and other financial institutions and changes in the level of customer deposits.

### Deposits and balances of banks and other financial institutions

Deposits and balances of banks and other financial institutions as at 31 December 2001 were HK\$55,295 million, a decrease of HK\$74,471 million, or 57.39% from 31 December 2000. The

decrease was mainly due to the reduction of deposits with the Group by Bank of China, its subsidiaries and associates.

**Total liabilities as at 31 December 2001**



**Current, fixed, savings and other deposits from customers/ Certificates of deposit issued**

Following the deregulation of interest rates in Hong Kong from 3 July 2001, the Group has introduced a new tiered interest-rate structure and has revised some of the service charges with a view to cope with the ever-changing operating environment in the banking industry and better the customer segmentation. Moreover, by means of the above new measures and the merger, the Group effectively integrated the small deposit balance customers and thus the efficiency was amplified by reducing the workload in management of deposit accounts.

Following the restructuring and reorganisation of the Group in 2001, with a view to ensure the stability of our customer base and to maintain the high quality of services to our customers, the Group made immense efforts to smooth the transition and integration of its operations. During 2001, the tightening of the interest rate gap between fixed deposits and savings deposits resulted in fixed deposits funds being re-invested in the more liquid savings deposits. Further, through the Group's strategy to manage the funding more actively, there was a decrease in large deposits with high interest rates. This not only lowered the Group's funding

costs but also reduced the Group's reliance on certain large depositors and hence strengthened the stability of deposits.

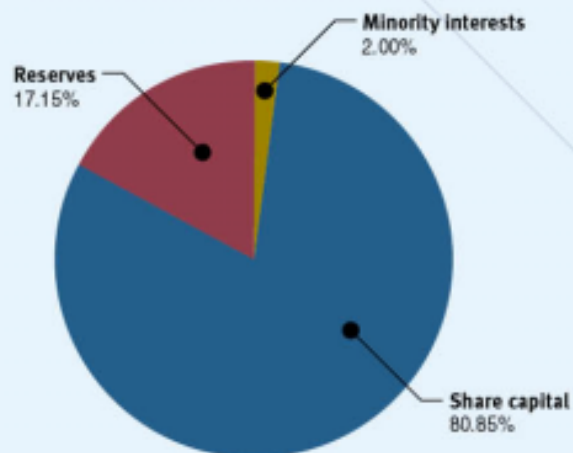
Overall, deposit balances decreased by HK\$18,298 million to HK\$606,428 million as at 31 December 2001, a decline of 2.93%, slightly less than the local industry average.

During 2001, the Group redeemed HK\$4,000 million certificates of deposit issued.

**3) Capital resources**

The capital resources as at 31 December 2001 was HK\$53,236 million, HK\$18,359 million or 52.64% higher than the level at the end of 2000, mainly due to the increase in reserves.

**Total capital resources as at 31 December 2001**



**Shareholders' funds**

As at 31 December 2001, the Group's shareholders' funds increased from HK\$33,345 million in 2000 to HK\$52,170 million, comprising issued and fully paid share capital of HK\$43,043 million and reserves of HK\$9,127 million. During the restructuring, the Group's capital base was strengthened by the capital contributions from Bank of China and the revaluation of properties.