

## TABLE OF CONTENTS

(A) Consolidated Profit and Loss Account (Unaudited)	2
(B) Consolidated Balance Sheet	3
(C) Consolidated Statement of Changes in Equity (Unaudited)	4
(D) Selected Notes to The Accounts	5
(E) Supplementary Financial Information	12
(F) Financial Overview	21
(G) Operations Review	25
(H) Prospects	28

The Directors of Bank of China (Hong Kong) Limited (the "Bank") are pleased to announce the unaudited consolidated interim results of the Bank and its subsidiaries (the "Group") for the six months ended 30 June 2002 as follows:

**(A) Consolidated Profit and Loss Account (Unaudited)**

	Note	Six months ended	
		30 June 2002	30 June 2001
		HK\$m	HK\$m
Interest income		10,958	23,261
Interest expense		(4,067)	(15,527)
<b>Net interest income</b>		<b>6,891</b>	<b>7,734</b>
Other operating income	2	2,010	2,256
<b>Operating income</b>		<b>8,901</b>	<b>9,990</b>
Operating expenses	3	(2,899)	(2,868)
<b>Operating profit before provisions</b>		<b>6,002</b>	<b>7,122</b>
Charge for bad and doubtful debts		(1,766)	(1,848)
<b>Operating profit after provisions</b>		<b>4,236</b>	<b>5,274</b>
Net gain from disposal of fixed assets		8	10
Net (loss)/gain from disposal of held-to-maturity securities and investment securities		(2)	7
(Provision)/write-back of provision for impairment in held-to-maturity securities and investment securities		(7)	6
Provision for impairment in investment in associates		(30)	—
Share of net profits of associates		6	77
Charge for restructuring provision		—	(295)
<b>Profit before taxation</b>		<b>4,211</b>	<b>5,079</b>
Taxation	4	(730)	(808)
<b>Profit after taxation</b>		<b>3,481</b>	<b>4,271</b>
Minority interests		(63)	(76)
<b>Profit attributable to shareholders</b>		<b>3,418</b>	<b>4,195</b>
<b>Dividends</b>		<b>1,937</b>	<b>—</b>

## (B) Consolidated Balance Sheet

		Unaudited	
		As at	As at
	Note	30 June	31 December
		2002	2001
		HK\$m	HK\$m
<b>ASSETS</b>			
Cash and short-term funds		109,408	196,255
Placements with banks and other financial institutions maturing between one and twelve months		100,918	80,773
Trade bills		584	382
Certificates of deposit held		17,471	19,474
Hong Kong SAR Government certificates of indebtedness		28,290	25,510
Held-to-maturity securities		102,555	50,988
Investment securities		50	44
Other investments in securities		48,760	56,169
Advances and other accounts	5	303,983	308,108
Investments in associates		366	416
Fixed assets		20,636	21,049
Other assets		4,757	6,972
Total assets		<u>737,778</u>	<u>766,140</u>
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation		28,290	25,510
Deposits and balances of banks and other financial institutions		16,115	55,295
Current, fixed, savings and other deposits of customers		611,470	606,428
Certificates of deposit issued		5,000	5,000
Other accounts and provisions		22,167	20,671
Total liabilities		<u>683,042</u>	<u>712,904</u>
<b>CAPITAL RESOURCES</b>			
Minority interests		1,084	1,066
Share capital	6	43,043	43,043
Reserves	7	10,609	9,127
Shareholders' funds		<u>53,652</u>	<u>52,170</u>
Total capital resources		<u>54,736</u>	<u>53,236</u>
Total liabilities and capital resources		<u>737,778</u>	<u>766,140</u>

(C) Consolidated Statement of Changes in Equity (Unaudited)

	Share Capital	Merger reserve	Premises revaluation reserve	Investment properties revaluation reserve	Translation reserve	Retained earnings	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Balance at 1 January 2001	43,043	(41,252)	—	—	(7)	31,561	33,345
Net profit for the period	—	—	—	—	—	4,195	4,195
2000 final dividend paid	—	—	—	—	—	(542)	(542)
Remittance of profits by Merging branches	—	—	—	—	—	(3,034)	(3,034)
Capital contribution from ultimate holding company	—	—	—	—	—	238	238
Balance at 30 June 2001	<u>43,043</u>	<u>(41,252)</u>	<u>—</u>	<u>—</u>	<u>(7)</u>	<u>32,418</u>	<u>34,202</u>
Balance at 1 July 2001	43,043	(41,252)	—	—	(7)	32,418	34,202
Surplus on revaluation of properties	—	—	8,408	3,159	—	—	11,567
Currency translation difference	—	—	—	—	(2)	—	(2)
Net loss for the period	—	—	—	—	—	(1,427)	(1,427)
Capital contribution from ultimate holding company	—	—	—	—	—	7,830	7,830
Capitalisation of reserves	—	41,252	(7,952)	(3,119)	—	(30,181)	—
Balance at 31 December 2001	<u>43,043</u>	<u>—</u>	<u>456</u>	<u>40</u>	<u>(9)</u>	<u>8,640</u>	<u>52,170</u>
Balance at 1 January 2002	43,043	—	456	40	(9)	8,640	52,170
Currency translation difference	—	—	—	—	1	—	1
Net profit for the period	—	—	—	—	—	3,418	3,418
Special dividend	—	—	—	—	—	(1,937)	(1,937)
Balance at 30 June 2002	<u>43,043</u>	<u>—</u>	<u>456</u>	<u>40</u>	<u>(8)</u>	<u>10,121</u>	<u>53,652</u>

## (D) Selected Notes to The Accounts

### 1. Basis of preparation and accounting policy

The accounting policies and methods of computation used in the preparation of this interim financial disclosure statements are consistent with those used in the preparation of the group's financial information adopted by its holding company, BOC Hong Kong (Holdings) Limited, as set out in Appendix 1 of the prospectus dated 15 July 2002 issued by its holding company, for the years ended 31 December 1999, 2000 and 2001. The Group has adopted the new and revised SSAPs issued by the HKSA which have become effective for accounting periods commencing on or after 1 January 2002.

Under the principles of merger accounting prescribed in the SSAP 27, "Accounting for Group Reconstructions", the interim financial statements of the Group are prepared as if the group structure and capital structure as at 1 October 2001 had been in existence from the beginning of the periods presented.

### 2. Other operating income

	Six months ended	
	30 June 2002	30 June 2001
	HK\$'m	HK\$'m
Fees and commission income	1,705	1,846
Less: Fees and commission expense	(357)	(386)
Net fees and commission income	1,348	1,460
Dividend income from investments in securities		
-listed investments	—	1
-unlisted investments	11	12
Net gain from other investments in securities	70	10
Net gain from foreign exchange activities	402	568
Net gain from other dealing activities	4	10
Gross rental income from investment properties	93	93
Others	82	102
	<u>2,010</u>	<u>2,256</u>

## (D) Selected Notes to The Accounts (continued)

### 3. Operating expenses

	Six months ended	
	30 June 2002	30 June 2001
	HK\$m	HK\$m
Staff costs (including directors' emoluments)	1,761	1,905
Premises and equipment expenses excluding depreciation		
- rental of premises	137	173
- others	223	203
Depreciation		
- owned fixed assets	359	213
Other operating expenses	419	374
	<u>2,899</u>	<u>2,868</u>

### 4. Taxation

The amount of taxation charged to the consolidated profit and loss account represents:

	Six months ended	
	30 June 2002	30 June 2001
	HK\$m	HK\$m
Bank and subsidiaries		
Hong Kong profits tax	738	819
Overseas taxation	5	10
Under/(over) provisions in prior years	(6)	(27)
	<u>737</u>	<u>802</u>
Associates		
Hong Kong profits tax	(6)	11
Attributable share of estimated Hong Kong profits tax losses arising from investments in partnerships	(7)	(34)
Investments in partnerships written off	6	29
	<u>(1)</u>	<u>(5)</u>
	<u>730</u>	<u>808</u>

Hong Kong profits tax has been provided at the rate of 16% (2001:16%) on the estimated assessable profit for the six months ended 30 June 2002 and 2001. Taxation on overseas profits has been calculated on the estimated assessable profit for the period ended 30 June 2002 and 2001 at the rates of taxation prevailing in the countries in which the Group operates.

There is no significant deferred taxation liability not provided for.

(D) Selected Notes to The Accounts (continued)

5. Advances and other accounts

	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Advances to customers	317,634	323,038
Accrued interest	1,883	2,180
	<u>319,517</u>	<u>325,218</u>
Provision for bad and doubtful debts		
- General	(6,538)	(6,538)
- Specific	(8,999)	(10,576)
	<u>(15,537)</u>	<u>(17,114)</u>
	<u>303,980</u>	<u>308,104</u>
Advances to banks and other financial institutions	3	4
	<u>303,983</u>	<u>308,108</u>

Non-performing loans are analysed as follows:

	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Non-performing loans	<u>28,498</u>	<u>35,512</u>
Specific provisions made in respect of such advances	<u>8,996</u>	<u>10,322</u>
As a percentage of total advances to customers	<u>8.97%</u>	<u>10.99%</u>
Amount of interest in suspense	<u>422</u>	<u>610</u>

Non-performing loans are defined as loans and advances to customers on which interest is being placed in suspense or on which interest accrual has ceased. The specific provisions were made after taking into account the value of collateral in respect of such advances.

## (D) Selected Notes to The Accounts (continued)

### 5. Advances and other accounts (continued)

There were no advances to banks and other financial institutions on which interest has been placed in suspense or on which interest accrual has ceased as at 31 December 2001 and 30 June 2002 nor were there any specific provisions made.

On 26 June 2002, BOCHK 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 total advances to customers would have been 9.06%.

### 6. Share Capital

	As at 30 June 2002	As at 31 December 2001
	HK\$m	HK\$m
Authorised:		
100,000,000,000 ordinary shares of HK\$1.00 each	<u>100,000</u>	<u>100,000</u>
Issued and fully paid:		
43,042,840,858 ordinary shares of HK\$1.00 each	<u>43,043</u>	<u>43,043</u>

### 7. Reserves

	As at 30 June 2002	As at 31 December 2001
	HK\$m	HK\$m
Premises revaluation reserve	456	456
Investment properties revaluation reserve	40	40
Translation reserve	(8)	(9)
Retained earnings	<u>10,121</u>	<u>8,640</u>
	<u>10,609</u>	<u>9,127</u>



(D) Selected Notes to The Accounts (continued)

8. Off-balance sheet exposures

(a) Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment:

	As at 30 June 2002 <hr/> HK\$m	As at 31 December 2001 <hr/> HK\$m
Direct credit substitutes	2,606	1,967
Transaction-related contingencies	2,551	2,273
Trade-related contingencies	17,870	16,391
Other commitments with an original maturity of:		
- under 1 year or which are unconditionally cancelable	76,318	84,497
- 1 year and over	56,432	43,879
Forward forward deposits placed	11,018	11,872
Others	—	88
	<hr/> <b>166,795</b> <hr/>	<hr/> <b>160,967</b> <hr/>

## (D) Selected Notes to The Accounts (continued)

### 8. Off-balance sheet exposures (continued)

#### (b) Derivatives

The following is an analysis of the aggregate notional amounts of each significant type of derivative:

	As at 30 June 2002			As at 31 December 2001		
	HK\$m (Trading)	HK\$m (Hedging)	HK\$m (Total)	HK\$m (Trading)	HK\$m (Hedging)	HK\$m (Total)
Exchange rate contracts						
Spot	32,548	—	32,548	18,766	—	18,766
Forward and futures contracts	711	—	711	3,224	—	3,224
Swaps	159,547	6,284	165,831	124,585	4,688	129,273
Foreign exchange option contracts:						
- Currency options purchased	903	—	903	2,195	—	2,195
- Currency options written	28,034	—	28,034	19,850	—	19,850
	<u>221,743</u>	<u>6,284</u>	<u>228,027</u>	<u>168,620</u>	<u>4,688</u>	<u>173,308</u>
Interest rate contracts						
Interest rate swaps	228	15,959	16,187	60	10,088	10,148
Forward rate agreements	600	—	600	1,280	—	1,280
Forward forward deposits borrowed	3,036	—	3,036	11,872	—	11,872
	<u>3,864</u>	<u>15,959</u>	<u>19,823</u>	<u>13,212</u>	<u>10,088</u>	<u>23,300</u>
Bullion contracts	<u>246</u>	<u>—</u>	<u>246</u>	<u>545</u>	<u>—</u>	<u>545</u>
Equity contracts						
- Equity options purchased	119	—	119	—	—	—
- Equity options written	96	—	96	—	—	—
	<u>215</u>	<u>—</u>	<u>215</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>226,068</u>	<u>22,243</u>	<u>248,311</u>	<u>182,377</u>	<u>14,776</u>	<u>197,153</u>

## (D) Selected Notes to The Accounts (continued)

### 8. Off-balance sheet exposures (continued)

#### (b) Derivatives (continued)

The replacement costs and credit risk weighted amounts of the above off-balance sheet exposures which do not take into account the effects of bilateral netting arrangements are as follows:

	Credit risk weighted amount		Replacement cost	
	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Contingent liabilities and commitments	36,752	29,490	N.A	N.A
Derivatives:				
- Exchange rate contracts	637	407	832	457
- Interest rate contracts	74	37	159	99
- Bullion contracts	2	5	3	6
- Equity contracts	7	—	5	—
	<u>37,472</u>	<u>29,939</u>	<u>999</u>	<u>562</u>

The contract or notional amounts of these instruments indicate the volume of transactions outstanding as at the balance sheet date; they do not represent the amounts at risk.

The credit risk weighted amounts are the amounts which have been calculated in accordance with the Third Schedule of the Banking Ordinance and guidelines issued by the Hong Kong Monetary Authority ("HKMA"). The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

Replacement cost is the cost of replacing all contracts which have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking contracts to market. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet dates.

## (E) Supplementary Financial Information

### 1. Overdue and rescheduled assets

#### (a) Advances to customers

##### (i) Gross amount of overdue advances

	As at 30 June 2002	% of gross advances to customers	As at 31 December 2001	% of gross advances to customers
	HK\$m		HK\$m	
Gross advances to customers which have been overdue for:				
- six months or less but over three months	2,455	0.77%	4,212	1.30%
- one year or less but over six months	5,770	1.82%	5,427	1.68%
- over one year	13,502	4.25%	15,659	4.85%
	<u>21,727</u>	<u>6.84%</u>	<u>25,298</u>	<u>7.83%</u>

At 30 June 2002 and 31 December 2001, there were no advances to banks and other financial institutions which were overdue for over three months.

##### (ii) Overdue advances are reconciled to non-performing loans as follows:

	As at 30 June 2002	As at 31 December 2001
	HK\$m	HK\$m
Advances which are overdue for more than three months	21,727	25,298
Add: non-accrual advances which are overdue for three months or less		
- included in rescheduled advances	1,480	1,315
- others	6,152	10,685
Less: advances which are overdue for more than three months and on which interest is still being accrued	<u>(861)</u>	<u>(1,786)</u>
Non-performing loans	<u>28,498</u>	<u>35,512</u>

## (E) Supplementary Financial Information (continued)

### 1. Overdue and rescheduled assets (continued)

#### (a) Advances to customers (continued)

(iii) Rescheduled advances (net of amounts included in overdue advances for more than three months and reported in item (i) above) are as follows:

	As at 30 June 2002 HK\$m	% of gross advances to customers	As at 31 December 2001 HK\$m	% of gross advances to customers
Rescheduled advances	<u>1,617</u>	<u>0.51%</u>	<u>1,814</u>	<u>0.56%</u>

At 30 June 2002 and 31 December 2001, there were no rescheduled advances to banks and other financial institutions.

#### (b) Other overdue assets

	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Overdue for:		
- six months or less but over three months	10	9
- one year or less but over six months	21	5
- over one year	19	4
	<u>50</u>	<u>18</u>

## (E) Supplementary Financial Information (continued)

### 2. Segmental information

#### (a) Gross advances to customers by industry sector

	As at 30 June 2002 <u>HK\$m</u>	As at 31 December 2001 <u>HK\$m</u>
Loans for use in Hong Kong		
Industrial, commercial and financial		
- Property development	26,818	28,300
- Property investment	44,814	47,758
- Financial concerns	6,691	7,314
- Stockbrokers	81	108
- Wholesale and retail trade	22,419	24,091
- Manufacturing	11,140	11,477
- Transport and transport equipment	9,780	8,778
- Others	51,487	51,054
Individuals		
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	20,032	20,273
- Loans for purchase of other residential properties	85,689	82,513
- Credit card advances	3,462	3,019
- Others	9,280	9,735
Total loans for use in Hong Kong	<u>291,693</u>	<u>294,420</u>
Trade finance	9,763	10,566
Loans for use outside Hong Kong	<u>16,178</u>	<u>18,052</u>
Total advances to customers	<u><u>317,634</u></u>	<u><u>323,038</u></u>

## (E) Supplementary Financial Information (continued)

### 2. Segmental information (continued)

#### (b) Geographical analysis of gross advances to customers, overdue advances and non-performing loans

The following geographical analysis of gross advances to customers, overdue advances for more than three months and non-performing loans is based on the location of the counterparties, after taking into account of the transfer of risk in respect of such advances where appropriate.

##### (i) Gross advances to customers

	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Hong Kong	305,892	310,953
Mainland China	6,348	7,753
Others	5,394	4,332
	<u>317,634</u>	<u>323,038</u>

##### (ii) Overdue advances for over three months

	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Hong Kong	19,296	21,713
Mainland China	2,294	3,465
Others	137	120
	<u>21,727</u>	<u>25,298</u>

##### (iii) Non-performing loans

	As at 30 June 2002 HK\$m	As at 31 December 2001 HK\$m
Hong Kong	25,821	30,043
Mainland China	2,483	5,130
Others	194	339
	<u>28,498</u>	<u>35,512</u>

## (E) Supplementary Financial Information (continued)

### 3. Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	Banks and other financial institutions	Public sector entities	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
As at 30 June 2002				
Asia, other than Hong Kong	65,728	7,555	9,749	83,032
North America	23,323	27,443	16,771	67,537
Western Europe	152,709	3,587	20,049	176,345
Caribbean	—	—	2,545	2,545
	<u>241,760</u>	<u>38,585</u>	<u>49,114</u>	<u>329,459</u>
	Banks and other financial institutions	Public sector entities	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
As at 31 December 2001				
Asia, other than Hong Kong	133,805	15,771	10,337	159,913
North America	34,303	18,526	8,725	61,554
Western Europe	143,297	3,172	3,934	150,403
Caribbean	—	—	3,105	3,105
	<u>311,405</u>	<u>37,469</u>	<u>26,101</u>	<u>374,975</u>



## (E) Supplementary Financial Information (continued)

### 4. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net option position is calculated based on the “worst-case” approach set out in the prudential return “Foreign Currency Position” issued by the HKMA.

As at 30 June 2002							
Equivalent in millions of HK\$							
New							
	US	Pound	Zealand	Australian	Japanese		Total
	Dollars	Sterling	Dollars	Dollars	Yen	Others	
Spot assets	181,434	11,806	8,418	25,671	13,465	22,076	262,870
Spot liabilities	(134,844)	(17,922)	(15,035)	(26,722)	(2,953)	(19,567)	(217,043)
Forward purchases	109,340	11,365	8,528	8,142	17,557	18,990	173,922
Forward sales	(145,155)	(5,229)	(1,924)	(7,111)	(28,095)	(21,375)	(208,889)
Net options position	446	7	143	146	—	39	781
Net long/(short) position	<u>11,221</u>	<u>27</u>	<u>130</u>	<u>126</u>	<u>(26)</u>	<u>163</u>	<u>11,641</u>
As at 31 December 2001							
Equivalent in millions of HK\$							
New							
	US	Pound	Zealand	Australian	Japanese		Total
	Dollars	Sterling	Dollars	Dollars	Yen	Others	
Spot assets	197,497	15,996	14,167	28,316	3,428	22,113	281,517
Spot liabilities	(134,348)	(17,971)	(14,550)	(27,380)	(2,081)	(18,859)	(215,189)
Forward purchases	70,500	5,230	1,211	1,623	10,834	12,726	102,124
Forward sales	(124,606)	(3,233)	(794)	(2,538)	(12,190)	(15,807)	(159,168)
Net options position	4,277	14	43	135	(7)	22	4,484
Net long/(short) position	<u>13,320</u>	<u>36</u>	<u>77</u>	<u>156</u>	<u>(16)</u>	<u>195</u>	<u>13,768</u>

There were no significant net structural positions for the Group as at 30 June 2002 and 31 December 2001.

## (E) Supplementary Financial Information (continued)

### 5. Capital base and capital adequacy ratio

	As at 30 June 2002	As at 31 December 2001
Capital adequacy ratio	<u>14.68%</u>	<u>14.38%</u>
Adjusted capital adequacy ratio	<u>15.02%</u>	<u>14.57%</u>

The capital adequacy ratio represents the consolidated ratio of Bank of China (Hong Kong) Limited ("BOCHK") as at 30 June 2002 and 31 December 2001 computed in accordance with the Third Schedule of the Banking Ordinance.

The adjusted capital adequacy ratio represents the consolidated ratio of the BOCHK as at 30 June 2002 and 31 December 2001 computed in accordance with the guideline "Maintenance of Adequate Capital Against Market Risks" issued by the HKMA. The adjusted ratio takes into account both credit and market risk as at 30 June 2002 and 31 December 2001.

## (E) Supplementary Financial Information (continued)

### 5. Capital base and capital adequacy ratio (continued)

The consolidated capital base of BOCHK after deductions used in the calculation of the above capital adequacy ratios as at 30 June 2002 and 31 December 2001 and reported to the HKMA is analysed as follows:

	As at 30 June 2002 <u>HK\$m</u>	As at 31 December 2001 <u>HK\$m</u>
Core capital:		
Paid up ordinary share capital	43,043	43,043
Reserves	8,631	9,481
Profit and loss account	1,610	(850)
Minority interests	850	910
	<u>54,134</u>	<u>52,584</u>
Supplementary capital:		
General provisions for doubtful debts	4,990	4,943
	<u>4,990</u>	<u>4,943</u>
Gross value of supplementary capital	4,990	4,943
Eligible value of supplementary capital	4,990	4,943
Total capital base before deductions	<u>59,124</u>	<u>57,527</u>
Deductions:		
Shareholdings in subsidiaries or holding company	(360)	(375)
Exposures to connected companies	(230)	(347)
Equity investments of 20% or more in non-subsidiary companies	(221)	(256)
Investments in the capital of other banks or other financial institutions	(1)	(1)
	<u>(812)</u>	<u>(979)</u>
Total capital base after deductions	<u><u>58,312</u></u>	<u><u>56,548</u></u>

## (E) Supplementary Financial Information (continued)

### 6. Liquidity ratio

	<u>30 June</u> <u>2002</u>	<u>31 December</u> <u>2001</u>
Average liquidity ratio – BOCHK	<u>41.26%</u>	<u>39.88%</u>

The average liquidity ratio for the six months ended 30 June 2002 is calculated as the simple average of each calendar month's average liquidity ratio of the Bank for the period.

The average liquidity ratio for 2001 is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the 3 months from 1 October 2001 (the date of the restructuring and merger) to 31 December 2001.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule of the Banking Ordinance.

Prior to the Restructuring and Merger, the liquidity ratio of each of the predecessor entities was managed on an individual basis.

### 7. Compliance with disclosure requirements

In preparing its interim report for the six months ended 30 June 2002, the Group has fully complied with the module on "Interim Financial Disclosure by Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the HKMA in November 2001.

## (F) Financial Overview

### Financial Performance

In the first six months of 2002, we strived to develop our business as planned against the backdrop of a difficult and challenging operating environment, and achieved a consolidated profit attributable to shareholders of HK\$3,418 million.

In the first half of 2002, our Group launched a range of new products and services and improved profitability through optimising our asset-liability mix and adjusting our pricing. We reduced our non-performing loan ratio through a combination of disposal of loans (including non-performing loans) to Bank of China Grand Cayman Branch, write-off of bad and doubtful debts, aggressive collection efforts, and the implementation of a comprehensive credit risk management system, etc. In addition, we continued to place emphasis on the rationalisation of our branch network and improvement in efficiency, which have significantly reduced our staff costs.

Our consolidated financial results must be viewed in light of the Restructuring and Merger as described in the Prospectus of BOC Hong Kong (Holdings) Limited dated 15 July 2002. The financial results for the first half of 2001 were the combined results of the merging entities before the reorganisation. As these entities were previously operating autonomously with different risk and financial control system, these results may not be representative of the consolidated results of the Group. After the merger, we have adopted common provisioning standard and alignment of classification to all accounts of the merging entities. It follows that the financial results of the Group for the first half of 2002 may not be fully comparable to those of the corresponding period last year.

Our Group's net profit attributable to shareholders in the first half of 2002 represented a decrease of 18.5% as compared with the first half of 2001. Operating profit before provisions decreased by 15.7% to HK\$6,002 million in the first half of 2002.

### Net interest income

Net interest income was HK\$6,891 million for the first half of 2002, a decrease of 10.9% from the corresponding period in 2001. Net interest spread rose by 25 basis points to 1.85%, while net interest margin rose marginally by 1 basis point to 1.98%. Increased holdings of higher yielding securities helped improve net interest margin by 14 basis points. This was offset by a 23 basis points reduction in contribution from cost free fund as a result of the drastic fall in market interest rates, coupled with an 11 basis points reduction in contribution from mortgages as a result of reduction in mortgage yield.

### Other operating income

Other operating income totalled HK\$2,010 million in the first half of 2002, a fall of 10.9% from the first half of 2001, partly due to a decline in fees and commission income by 7.6% to HK\$1,705 million. In the first half of 2002, we explored business opportunities and accomplished significant growth in return from sale of funds, etc. However, the increased contribution from our investment product services was offset by a drop in fees and commission income generated from bills, stock brokerage and loan origination due to poor market conditions and more intense competitions. As a result, net fees and commission income decreased by 7.7% to HK\$1,348 million as compared with the same period in 2001.

## **(F) Financial Overview (continued)**

### **Financial Performance (continued)**

#### **Operating expenses**

Operating expenses in the first half of 2002 amounted to HK\$2,899 million, representing an increase of 1.1% as compared with the same period in 2001. The increase in operating expenses was primarily due to the increase in depreciation expenses arising from the revaluation of our premises.

The depreciation expenses rose by 68.5% to HK\$359 million in the first half of 2002. If we excluded the depreciation expenses related to our own fixed assets, the operating expenses would have recorded a decrease of 4.3% to HK\$2,540 million, as compared with the corresponding period in 2001. This decline was largely due to cost synergies from the merger and ongoing restructuring.

Other operating expenses also increased by 12% to HK\$419 million, mainly attributable to the rise in advertising expenses.

The increase in depreciation and other operating expenses was partially offset by the decline in staff costs and premises and equipment expenses (excluding depreciation). Staff costs (including directors' emoluments) declined by 7.6% to HK\$1,761 million, due to a reduction in number of staff as part of our rationalisation initiatives. The number of staff was 13,191 as at 30 June 2002, representing a decrease of 8.3% as compared with the end of first half of 2001. Premises and equipment expenses (excluding depreciation) fell by 4.3% to HK\$360 million.

As a result of a decrease in operating income and a modest increase in operating expenses, the cost to income ratio rose from 28.7% for the first half of 2001 to 32.6% for the same period of 2002.

#### **Asset Quality**

##### **Net charge for bad and doubtful debts**

In the first half of 2002, the net charge for bad and doubtful debts (net of recoveries of advances and releases of specific provisions) decreased by 4.4% to HK\$1,766 million, as compared with that over the same period in 2001. Total recoveries of advances previously written off were HK\$350 million for the first half of 2002, 52.8% more than those in the same period in 2001. This improvement stemmed from our focus on loan recoveries and establishment of Special Assets Management Department by the Bank following the merger.

## (F) Financial Overview (continued)

### Asset Quality (continued)

#### Non-performing loans

As at 30 June 2002, non-performing loans decreased by 19.8% to HK\$28,498 million, as compared with 31 December 2001. The decline was a result of the disposal of loans with total gross book value of HK\$11,401 million (of which HK\$7,029 million are non-performing loans) to Bank of China Grand Cayman Branch in June 2002. The write-off of the bad and doubtful debts amounting to HK\$1,013 million also helped lower our non-performing loans. As a result, the percentage of non-performing loans to total gross advances to customers reduced from 10.99% as at 31 December 2001 to 8.97% as at 30 June 2002.

Our Group has employed a prudent and conservative policy in making provision for bad and doubtful debts, complying with the guidelines set by the Hong Kong Monetary Authority.

Specific provisions coverage ratio for non-performing loans and loan loss provision ratio improved from 29.8% and 48.2% as at 31 December 2001 to 31.6% and 54.5% respectively as at 30 June 2002. The ratio of total provisions for bad and doubtful debts to gross advances to customers fell to 4.9%, as compared with 5.3% at the end of last year.

### Financial Position

#### Assets

As at 30 June 2002, total assets decreased by HK\$28,362 million or 3.7% as compared with 31 December 2001. After the merger, operating as a locally incorporated independent entity, we have our own liquidity management policies and mechanism. Consequently, we withdrew the inter-bank placement of HK\$54,635 million with Bank of China, resulting in a drop in total assets. During the first half of 2002, the Hong Kong market continued to experience sluggish loan demand. Our gross advances to customers decreased by HK\$5,404 million or 1.7% as compared with 31 December 2001. This fall was primarily due to our loan disposal in June 2002. However, excluding the loan disposal in June 2002, the Group's advances to customers would have recorded a rise of 1.9%.

In terms of geographical dispersion of our loan portfolio, Hong Kong accounted for 96.3% of total gross advances to customers. Mainland China and other areas represented 2% and 1.7% of total gross advances to customers, respectively. We will continue to develop our Mainland China business solidly.

The Group has further optimised the asset structure by revising its investment strategies to enhance the overall yield on assets. The Group increased its exposure to debt securities relative to inter-bank placements. Certificates of deposit held, held-to-maturity securities, investment securities and other investments in securities as at 30 June 2002 amounted to HK\$168,836 million, representing an increase of 33.3% from HK\$126,675 million as at 31 December 2001.

## (F) Financial Overview (continued)

### Financial Position (continued)

#### Liabilities

As at 30 June 2002, total liabilities decreased by HK\$29,862 million or 4.2% as compared with 31 December 2001. This decline was attributable to the withdrawal of inter-bank funds of approximately HK\$41,000 million by Bank of China.

Despite the fall in customer deposits in Hong Kong during the first half of 2002, the Group was able to maintain a stable customer deposit base. Deposit balance increased by HK\$5,042 million or 0.8% from 31 December 2001. In an effort to manage the cost of funding, the Group sought to optimise the deposit structure and revised the deposit pricing strategy to be in line with our peers during the first half of 2002. The tightening of the interest rate gap between fixed deposits and savings deposits persisted in the first half of 2002, resulting in fixed deposits funds shifting to more liquid savings deposits. This lowered our overall cost of funding.

Lackluster loan demand in Hong Kong together with the loan disposal resulted in a decrease of the loans to deposits ratio from 53.3% as at 31 December 2001 to 52% as at 30 June 2002.

As at 30 June 2002, the Group had no significant mismatches between assets and liabilities in all foreign currencies and hence the exposure to currency risks was limited.

#### Liquidity and capital strength

The Group maintained ample liquidity with the average liquidity ratio of 41.3% for the first half of 2002, as compared with 39.9% for the 3 months from 1 October 2001 (the date of the Restructuring and Merger) to 31 December 2001. We remained well capitalized with a capital adequacy ratio of 14.7% as at 30 June 2002, as compared with 14.4% as at 31 December 2001.



## (G) Operations Review

In the first half of 2002, we continued to leverage our strengths and capitalise on the opportunities arising from the Restructuring and Merger. We successfully introduced a broad range of new products and services, further rationalised our branch network, and made good progress in our business.

### Retail Banking

To improve distribution efficiency, we continued to reengineer our distribution channels. In the first half of 2002, we combined 8 branches with their neighboring branches, established a new branch, and reduced our branch numbers to 358. We began our "Model branches" pilot program for different types of branches, including Full Service Branch, Investment Centers, Personal Financial Service Centers, Automated Banking Centers and VIP Centers. We are now working on site selection and layout design. We will complete the pilot program and commence its operation by the end of this year or early next year.

We have continued to provide diversified mortgage products and services. In the first half of 2002, our residential mortgages in Hong Kong, excluding those under the Home Ownership Scheme, rose by 3.9%. We also launched a number of personal loan products, such as "Standby Overdraft" and "Decoration Loan", which will further facilitate the cash management capability of our customers. We have also offered a "Fund Pledge" service to our investment customers to allow greater flexibility in their investment planning.

To better serve our customers, we have introduced a broader range of wealth management products and services, including "Guaranteed Fund", "Retail Bonds", "Equity Linked Deposit" (a product combining the features of term deposit and stock option), "Monthly Stocks Savings Plan", etc. In addition, we have begun to introduce the Customer Relationship Management ("CRM") System. We are currently expanding our financial consulting team to meet future needs.

During the first half of 2002, sale of retail bonds amounted to HK\$2,487 million. In addition, the sale of 8 guaranteed funds amounted to HK\$3,081 million. Among those, "BOCHK BOCI-Prudential AUD Australia Growth Guaranteed Fund" was the first non-US dollar denominated guaranteed fund in Hong Kong and was warmly received by the market. Another product – the "Currency Option Deposit" doubled in transaction volume when compared with that in the first half of last year.

The credit card business continues to be one of our core businesses. For the first half of 2002, the number of cards, credit card receivables and cardholder spending experienced double-digit growth compared to the same period last year. We successfully launched the "Y-not" credit card to target our female customers, which increased our customer base by about 25,000 cards. The Great Wall International Card is another focus product of our credit card business. We achieved over 110% growth in the number of Great Wall International Card issued as compared with that in the same period of last year. We were the first in the market to provide RMB credit cards to our customers. Our merchant acquiring business remains healthy with a 2% growth in Hong Kong and 17% rapid growth in China. We continue to maintain our leading position in Mainland China.

## **(G) Operations Review (continued)**

### **Retail Banking (continued)**

In light of the persistent sluggish economic environment, and rising personal bankruptcies in Hong Kong, our annualised credit card charge-off ratio increased to 7.45% in the first half of 2002. To safeguard our asset quality, we have reviewed and tightened our credit policies.

### **Corporate Banking**

We have has a strong position in the local corporate and commercial lending markets. In addition to continuously building close bilateral banking relationships with our corporate customers, we are actively leveraging our restructuring and merger and our extensive corporate customer network to develop our syndicated loan business more effectively. By shifting our focus to an arranger role rather than a participant role in syndicated loan transactions, we intend to increase our non-interest income and enhance our position in the syndicated loan market.

For our small and medium-sized enterprise ("SME") customers, we have introduced unsecured financing schemes. We have also joined and launched the SME installations and Equipment Loan Guarantee Scheme introduced by the HKSAR Government to help enhance productivity and competitiveness of our SME customers.

We have established a very cooperative relationship with our parent, Bank of China, in a variety of areas, including corporate lending, financial institution services, settlement, treasury, trade finance and custodian services, etc. Some of these areas have already shown good progress.

### **Financial Institution Services**

In addition to the unilateral clearing for HK dollar cheque for Shenzhen, we have been mandated as the HK dollar cheque bilateral clearing agency for both Guangzhou and Shenzhen in Mainland China after the signing of business and service agreements with the local authorities.

We have actively taken part in developing the Shenzhen-Hong Kong Real Time Gross Settlement ("RTGS") System in order to provide real time, safe and low cost electronic means of fund transfer between Shenzhen and Hong Kong.

### **Treasury**

We have developed a customer-driven treasury platform and set up dedicated treasury teams to provide marketing and sales support and expertise to our key customers for sophisticated treasury products. Benefiting from our large customer base, extensive distribution channels and synergies created by the restructuring, we have successfully enhanced the cross selling of our treasury products and services. By the end of June 2002, the number of our treasury customers doubled when compared with the end of last year. By expanding Mainland China related products and services, our deposits from small to medium sized Mainland China financial institutions increased 6% in the first half of 2002.

## **(G) Operations Review (continued)**

### **China Related Business and Mainland Branches**

The Group has a total of fourteen Mainland branches. Twelve of these branches are eligible for conducting full foreign currency services to all kinds of customers including local individuals and locally funded enterprises in China. Three of our Mainland branches are eligible to conduct RMB business on a limited scope. Another five branches have applied for the license to provide RMB business to foreign individuals and foreign funded enterprises.

As a result of the China's entry into the World Trade Organisation, we are cooperating closely with Mainland China to fully exploit the potential of future business opportunities. We have recently joined hands with Bank of China Shenzhen Branch to provide Automated Fund Transfer ("AFT"), a service for Hong Kong residents who have purchased properties in Mainland China. A variety of mortgage repayment plans with currency options were introduced to increase payment flexibility for our customers.

### **Back-office Operations**

We have further standardised our back-office operations. Through improving our workflow and upgrading our system functions, we have enhanced our operational efficiency, manpower and thus achieved cost savings. Also by centralising the loans documentary management, we have saved storage space and hence reduced our operating costs. During the first half of the year, we completed the feasibility study and finalised the blueprint of the Global Payment System Project and Information Processing Centralisation Project. For the Credit Workflow System Project, the first phase of system development has kicked off and it will be scheduled to launch in the fourth quarter this year. We expect most of our loan processes will be automated upon completion.

### **Information Technology**

We have begun to transform our information technology organisation and significantly upgrade our current information infrastructure to allow us to better support our current business operations as well as our business strategies. During the first half of 2002, a number of key projects made solid progress.

### **Human Resources**

In alignment with the initial public offering, we have designed the Stock Option Scheme and Sharesave Plan in the first half of this year, and are actively seeking to reform the existing compensation and incentive mechanism. At the same time, we have initiated work on enhancing our employee profile within our organisational structure. To improve the quality of employees, we have expanded the training efforts for senior to middle management and front-line staff. Coupled with this is our recruitment activity, which targets experienced professionals in the market to cater for business development needs.

In the first half of 2002, the number of employees of the Group reduced by 237 to 13,191.

## (H) Prospects

The outlook for Hong Kong's economy enters into a phase of uncertainty following the tumble of the world equity markets in July 2002. The interest rate hike in the U.S. and Hong Kong anticipated earlier this year might not come about. Instead, speculation is building up for a lowering of interest rates, which would put further pressure on the interest rate margin and return from cost free funds. Against this background, the banking environment in the second half of 2002 will remain difficult.

Despite the difficult operating environment, we will continue to build on our core strengths and exploit new opportunities arising from our restructuring and the initial public offering so as to enhance shareholders' value.

Working with Bank of China, Bank of China Group affiliates and leading third parties, we plan to develop and distribute a broader portfolio of products and services to increase our penetration rate and cross-selling ratio. We will focus on higher ROE and innovative business, particularly in the areas of wealth management.

We will continue to improve our asset quality by adopting more effective credit control and risk management systems.

We will continue to capture significant efficiency and synergy gains by upgrading information technology systems and streamlining our branch network and back offices.

We will continue to improve our overall balance sheet management so as to optimise our asset liability mix, capital sourcing and yield.

By leveraging our customer base in Hong Kong and our existing 14 Mainland branches, we will fully exploit the business opportunities resulting from the further opening of the financial and banking markets in Mainland China. With extensive branch network in Mainland China, Bank of China's franchise will give BOCHK a unique international gateway into China.

We are committed to providing efficient and quality financial services to our customers. With the continued support of our shareholders, customers and staff, we are confident that we can achieve better results in the years to come.