

CHIEF EXECUTIVE'S REPORT

We achieved visible success in three major areas – a successful listing, making good progress in business that delivered on our promise to shareholders, synergies beginning to be realised from the restructuring. Looking ahead, we are geared towards maximising shareholder value by enhancing revenue, strengthening risk management, improving operational efficiency, optimising asset and liability management and expanding our China business.



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This is the first time we report our annual results as a publicly listed company.

The year 2002 marked a significant milestone for the Company. We achieved visible success in three major areas. Firstly, our listing on the Stock Exchange of Hong Kong on 25 July received an enthusiastic response from the market despite the local and global economic downturn. Secondly, we made good progress in growing our business amidst a difficult operating environment. This enabled us to deliver on our promise of targeted profitability to shareholders. Finally, we pushed forward the integration process and began to realise synergies from the restructuring. Our efforts to transform the Company into an internationally recognised bank are leading to better quality service for customers and greater shareholder value.

Smooth Integration Post-Restructuring

Following the merger on an unprecedented scale in October 2001, we sought to align ourselves with the international “Best Practices” in banking. We introduced new organisational structure, business philosophy, management mechanisms and operational models for the new bank with a long history. Management and staff were quick to adjust to these changes. Meanwhile, systems being implemented were fine-tuned where necessary. Throughout this period, the negative impact on our customers or business was kept to a minimum. We can therefore describe our process of integration as having been smooth and efficient in comparison with other major banks in the world that have been merged.



With the integration of our operations on the way to completion, we witnessed the following achievements, which also reflected our strengthened competitive edges:

- Establishment of corporate governance guidelines and an organisational structure in line with the “Best Practices” that provides a solid foundation for the long-term development of the Group.
- Clearly defined objectives for enhancing return-on-equity and maximising shareholder value, forming the basis of our business strategies.
- Strengthened marketing capabilities by capitalising on a unified brand and an extensive distribution network, together with the fostering of a marketing-oriented culture.
- Introduction of comprehensive and independent risk management systems and control mechanisms, enabling improvement in asset quality.
- Enhanced operational efficiency as a result of centralisation and standardisation of back office processes.

A Successful Listing

In less than 10 months after our Restructuring and Merger, we reached another milestone in our history – the listing of the Company in Hong Kong by public offering. By undergoing a restructuring, then immediately following it with a listing, the Company positioned itself for greater challenges in the face of market competition. This helped facilitate the implementation of the new concepts, new mechanisms and new models introduced through restructuring, and accelerated the realisation of benefits from them.

Amidst bearish global equity markets, our public offering in Hong Kong received over 380,000 applications in the retail tranche alone, representing 26 times over-subscriptions. In the international offering, our public offer was 4.3 times over-subscribed. This included a Public Offering Without Listing (“POWL”) in Japan that made us the first Chinese enterprise to do so in Japan’s equity market.

It was encouraging to note that the successful listing of the Company was the largest retail share offering in Hong Kong by size, and the largest Hong Kong-only listed IPO. At the time, it was also the largest public offering of shares by a financial institution from Asia and amongst the largest of all global financial services equity

offerings in the year 2002. In as short as four months after our listing, the Company was included in the Financial Times Index, MSCI Hong Kong Index and Hang Seng Index. This was a confirmation of the importance that the market attached to our status as a major listed financial group in Hong Kong. The success of the listing will also be remembered by the numerous international and regional annual IPO awards it has won.

The favourable response to our IPO in a sluggish economic environment is a reflection of investor confidence in the Group’s fundamental strengths and of positive expectations for growth. These combined factors are the driving force behind our commitment to serving shareholders and customers.

Delivering on Our IPO Promises

We are pleased to report to our shareholders that our business continued to grow and generate good profits in 2002. Even though the Hong Kong economy was influenced by a number of unfavourable factors – weak domestic demand, contraction of deposits and loans, persistent deflation, further decline in asset prices and soaring personal bankruptcies – we were still able to deliver value to our shareholders, as promised during our public offering.

During the year, the Group achieved a profit attributable to shareholders of HK\$6,673 million, representing an increase of 141.1% compared with 2001. Earnings per share was up by the same percentage points to reach HK\$0.6311. Return on average shareholders' funds rose from 7.31% in 2001 to 12.23%.

A key contributor to our performance was the substantial fall in the net charge for bad and doubtful debts, which totalled HK\$2,855 million, a decline of 61.5% from the preceding year. New specific provisions for bad and doubtful debts shrank by 57.6% to HK\$4,519 million. The reduction in provisions offset the decrease of 8.2% in operating profit before provisions.

Our asset quality improved in a difficult economy. NPLs fell by HK\$9,853 million, or 27.7%, to HK\$25,659 million. An improved NPL ratio to 7.99% from 10.99% as at 31 December 2001 was attributable to three factors. Firstly, our loan sale to BOC Grand Cayman Branch in June 2002 carved HK\$7,029 million of NPLs from our loan book. Secondly, since the establishment of an independent Risk Management Department, we have been implementing new mechanisms, policies and procedures to ensure tightened control of credit approval and credit risk management, which was conducive to the enhancement of asset

quality. Thirdly, our newly established Special Assets Management Department, working in conjunction with various front-line departments, undertook the task of monitoring, recovering and restructuring classified loans. During the year, we collected HK\$9,545 million from classified loans through cash collection and repossessed collateral disposal.

Owing to the adoption of prudent provisioning policy and the reduction in NPLs, the specific provisions coverage ratio for NPLs improved from 29.07% as at 31 December 2001 to 33.66% at end-2002. The loan loss reserve ratio also

strengthened from 48.19% to 58.51% year-on-year.

A weak economy and soaring personal bankruptcies in 2002 pushed up the credit card charge-off ratio, adversely affecting the local banking industry across the board. However, our charge-off ratio remained lower than the industry average as at the end of the year.

Diverse and Innovative Business Development

During 2002, we introduced a diverse range of products and services that





allowed us to capitalise on opportunities existent in the market. We further made use of our extensive distribution network and strengthened capabilities, post-restructuring, in product development and marketing. Our efforts in cross-selling broadened our customer base and expanded our business. As a result, the Group's non-interest operating income increased by 3.7% to HK\$4,172 million, partially offsetting the decrease of 7.0% in net interest income to HK\$13,942 million. The ratio of non-interest income to total operating income rose to 23.03% from 21.16% last year. Net fees and commission income grew by 9.3% to HK\$2,948 million.

In retail banking, we launched a series of investment products during the year, against the backdrop of a low interest rate environment in Hong Kong. These included guaranteed funds, retail bonds, Equity Linked Deposit, Monthly Stocks

Savings Plan and various investment funds, which were well received by the market. The response to our launch of the AUD Australia Growth Guaranteed Fund, which was the first non-US dollar denominated guaranteed fund in Hong Kong and for which we were the sole authorised agent, was similarly favourable. In 2002, the sale of retail bonds and guaranteed funds amounted to over HK\$8,000 million. As a reflection of our active participation in the retail loans market, our residential mortgage lending, excluding that generated under the suspended Home Ownership Scheme, recorded a growth of 4.0%. The Group maintained its leading position in the mortgage market.

Our credit card business reported a stable growth. In 2002, BOC-CC registered double-digit growth in terms of the number of cards issued and total cardholder spending over the same

period last year. The launch of "y not" credit card, tailored to the needs of today's women, was well received by customers. Our success against fierce market competition has also been recognised by industry peers. During the year, BOC-CC won the Gold Prize for "VISA International 2001-2002 Largest Card Sales Volume Growth in Hong Kong" and a number of other prizes presented by MasterCard and VISA International. Total card receivables increased by 3.8%, exceeding the negative market average.

In corporate banking, we made progress in syndicated loans. Our transformation into a lead arranger from a participant role has placed us in the top-tier of lead arrangers in Hong Kong, as ranked by the number of deals made and funds raised. This helped increase our loan volume and non-interest income. For trade finance customers, we launched a new factoring service. Meanwhile, our corporate customers benefited from our new bond trading service and bond underwriting expertise.

Total customer deposits and advances for the banking industry were down by 2.6% and 4.9% respectively. By comparison, our customer deposits fell slightly by 0.9% to HK\$600,977 million, while our loans and advances to customers declined marginally by 0.6% to HK\$321,034 million. However, on an ex-loan sale basis, our outstanding loans

and advances to customers grew by 3.0%, mainly due to increased syndicated lending and residential mortgages.

Optimising Operational Efficiency

Targeting to strengthen asset and liability management and enhance capital efficiency, we reduced inter-bank funding arrangement with our parent BOC, increased investments in debt securities, and lowered the cost of funding through adjusting the pricing structure of deposits.

Total assets fell by 4.0% to HK\$735,489 million as at end-2002 due to an adjusted asset portfolio. Securities investments held at year-end amounted to HK\$190,232 million, an increase of 30.7%. We actively disposed of idle properties, the proceeds of which were channelled to other interest-earning assets.

During the year, net interest spread increased by 18 basis points to 1.85%. Partially offset by the reduction in contribution from net free funds, our net interest margin improved marginally by 3 basis points to 1.98%. Through the adjustment on the pricing structure of deposits and introduction of service fees on low balance deposits, we sped up the process of consolidating customer accounts, which facilitated our accounts

management. Our customers therefore benefited from these measures, in the form of improved service.

We continued to pay attention to cost discipline and operating efficiency. Although overall operating expenses increased by 3.0%, staff costs, the largest item in operating expenses, decreased by 5.7% to HK\$3,578 million mainly due to a reduction in headcount as part of our rationalisation initiatives. Premises and equipment expenses excluding depreciation reduced by 10.0% to HK\$803 million, benefiting from effective integration of operations and a decline in premises rental.

After the Restructuring and Merger, the Group has actively implemented the branch rationalisation plan in phases. As at end-2002, the Group had a total of 319 branches, a reduction of 31 branches from the preceding year and of 35 branches compared to October 2001 when the merger took place. Our new marketing strategy has addressed the issue of branches with overlapping service mandates by merging them and by kick-starting a "Model Branches Pilot Programme". Under this programme, branches will be reorganised into five groupings, comprising Full Service Branches, Investment Centres, Personal Financial Service Centres, Self Service Banking Centres and VIP Branches. We are able to better utilise our branch resources and enhance operational

efficiency by branch rationalisation, strengthening of branch marketing capabilities, shifting back office functions previously undertaken by branches to back office departments, and encouraging customers to make use of lower-cost electronic channels.

The centralisation of our back office operations, coupled with the unification of workflow and methods, enabled us to contain costs and strengthen support to our front office. We expect to realise the synergies of these strategic initiatives from 2003 onwards.

Employee productivity is another pillar of our strategy to increase efficiency gains.



Additional resources were devoted to a wide range of staff training programmes including those for middle and senior management. During the year, a total of 729 training courses were conducted with an enrolment of over 55,000 from our entire staff.

The Group's business achievements in the past two years would not have been possible if not for the energy, creativity, loyalty and professionalism of our employees. People represent our most precious asset and are the driving force behind our growth. On behalf of the Management, I would like to take this opportunity to express my heart-felt gratitude to all of my colleagues.

Strategic Opportunity in China

China business is one of the key components of our long-term growth

strategies and represents our competitive edge. During the year, we strengthened our Mainland business infrastructure and pressed ahead in exploring new business opportunities.

To facilitate the development of our business in the Mainland of China, we established the "China Business Committee" for decision-making and the "China Business Steering Committee" to provide operational guidance. The "Mainland Branches Business Department" was restructured to become "China Business Head Office" in November 2002. By strengthening our linkage and cooperation with BOC and its Mainland branches, we are trying to fully utilise the overall competitive advantage to successfully implement our "China Story". Twelve of our fourteen Mainland branches and sub-branches were granted

official approval to offer comprehensive foreign currency services. In tandem, five of our Mainland branches and sub-branches became eligible to conduct Renminbi business with foreign individuals and foreign funded enterprises.

The unique position we hold in the Mainland of China has been wholly reflected in our credit card business. In 2002, we more than doubled the number of cards issued and cardholder spending for Great Wall International Card, which was designed specifically for Mainland customers. Moreover, Great Wall Renminbi Card, the first Renminbi credit card introduced to Hong Kong consumers for use in the Mainland, grew by more than 3 times in terms of the number of cards issued. We maintained our leading position in the merchant acquiring business in the Mainland, witnessing a 19.8% growth in transaction value as compared with the previous year.

In 2002, we were mandated as the Hong Kong dollar cheque bilateral clearing agency for both Guangdong Province and Shenzhen. We were also designated to act as the Hong Kong agent in developing the Shenzhen-Hong Kong Real Time Gross Settlement System, which provides a real time, safe and low cost electronic means of cross-border fund settlement between banks in Shenzhen and Hong Kong.





To leverage our strengths in the Mainland of China, we signed a number of business cooperation agreements with our parent BOC and its Mainland branches, extending the scope of our mutual business and better serving our customers. For example, a pilot service of “Remittance Express between Hong Kong and the Mainland” was jointly launched by BOCHK and 77 BOC branches in a number of Mainland cities. We cooperated with BOC Shenzhen Branch to initiate the “Automated Fund Transfer Service”. A “Prestige Customer Referral Programme between Hong Kong and Shanghai” was introduced together with BOC Shanghai Branch. Thus, we are gradually benefiting from the cooperation between the Group and BOC, in capturing mutually rewarding business opportunities.

Towards New Goals In A New Horizon

Going forward, we will not underestimate the challenges of the

current operating environment. There remains external uncertainty because of deteriorating US-Iraq relations while internally we continue to be affected by the difficult process of economic restructuring. Given these, the pace of recovery is expected to be only moderate, with uneven growth across business sectors. A mixed economic performance, with a strong external sector but weak domestic demand, is likely to continue for quite some time. We, therefore, do not expect the banking industry to benefit immediately from any economic recovery.

We put forward the following five medium-term strategic goals during our IPO in July 2002:

- Foster cross-selling efforts and explore high value-added products by leveraging our extensive distribution network and brand franchise to enhance revenue.
- Improve risk management and asset quality.
- Realise synergies generated by the Restructuring and Merger to improve operational efficiencies.
- Strengthen asset and liability management to increase capital efficiency and return-on-equity.
- Fully utilise our cooperative efforts with BOC and our unique advantages in the Mainland market to further expand our China business.

During the year, we took our first steps towards these goals, seeing initial results. With greater effort put forth in these areas, we shall seek greater achievements.

Restructuring, merger, and then listing marked new developments in the history of the Group. We are making every endeavour to implement the new concepts, new mechanisms and new corporate culture post-restructuring. Our compliance to regulations as a major locally listed financial institution will further enhance corporate governance, increase transparency, drive business development and improve operational efficiency. With all these, we are geared towards maximising shareholder value, providing quality service to our customers, and fulfilling our responsibility as a good corporate citizen.

LIU Jinbao

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