

CHIEF EXECUTIVE'S REPORT



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2003 was an unusually eventful year for Hong Kong. The SARS outbreak and the hardships associated with it had a negative impact on nearly all sectors of the economy in the first half of the year. Amidst diminished market demand, the finance and banking industry also experienced adverse effects. Fortunately the local economy began to recover in the latter half of the year in the wake of the SARS. The recovery has been bolstered by a series of positive factors, notably the signing of CEPA between the Central People's Government and the HKSAR Government, the implementation of the individual visit scheme by the Mainland and the announcement of the imminent commencement of personal RMB banking services in Hong Kong. With the restoration of market confidence, stabilising property prices and increasing employment figures, domestic demand has gradually picked up. The operating environment for the banking sector as a whole has improved considerably, despite continued low interest rates and intense market competition.

The Management has been taking a rational and proactive approach in managing the various challenges and capturing the opportunities. We have also been striving to grow our diversified businesses and further strengthen our capabilities in all areas. Our efforts in that regard are reflected in our 2003 financial results.

Ensuring Shareholder Return and Reinforcing Financial Strength

In 2003, we achieved a profit attributable to shareholders of HK\$7,963 million, an increase of 17.33% from the previous year. The return on average shareholders' funds rose by 1.10 percentage points to 13.62%.

During the year, interest rates kept falling to new lows, leading to a continued decrease in our net interest income. Net interest margin fell to 1.82% from 2.00% a year ago. However, the Group's other operating income increased, mainly attributable to the satisfactory

performance of our wealth management and foreign exchange businesses. The ratio of non-interest income to total operating income was up by 2.35 percentage points, reaching 25.38% in 2003.

In line with our established policy, we exercised prudent cost control and improved our overall productivity and efficiency. Operating expenses decreased by 6.09%. This was due partly to the reduction in average headcount, hence overall staff costs, and partly due to savings from the rationalisation of business operations and reduced rental expenses. Information technology expenditure increased in the second half of the year because of the implementation of certain projects that had been delayed as a result of SARS in the first half. Our cost to income ratio remained at the low level of 32.79%.

We also witnessed marked improvement in asset quality. The NPL

ratio and classified loan ratio dropped to 5.78% and 5.82% respectively, compared to 7.99% and 7.98% as at 31 December 2002, owing to effective credit risk control, collection of bad debts and write-offs. In consideration of the improvement in asset quality, we released HK\$957 million of general provisions in 2003. In the opinion of the management, the level of general provisions even after the release is adequate and conservative.

The Group's operating profit after provisions increased by 7.47%. After accounting for significant non-operating items of revaluation losses on premises and investment properties and a write-back of tax provisions, the Group's profit after taxation increased by 17.18%.

The Group's financial position has remained sound and solid. Our consolidated capital adequacy ratio increased to 15.11% at 31 December 2003 from 13.99% at 31 December

2002. BOCHK's liquidity position was maintained at high levels, with an average liquidity ratio of 37.76%.

Implementing Focused Strategies and Strengthening Market Positions

A key challenge during the year was to sustain our business growth amidst difficult market conditions. By staying focused and customer-oriented, we achieved success in implementing strategic business initiatives. Wealth management and product customisation continued to be our strategic priorities, with increased efforts in tailoring our products to the needs of customers through product development and innovation. Strong demand was experienced in most parts of our wealth management business, such as securities brokerage turnover, distribution of life insurance products and investment fund sales during the year. Furthermore, as the property market began to stabilise towards the end of 2003, residential mortgage loans increased considerably thanks to new and pent-up demand; consequently our market share in this area increased to 17%.

After a generally slow first half, our card business also recovered in the second half of 2003 as consumer spending gradually rose and the negative impact of SARS subsided. Card issuance and cardholder spending increased by 34.60% and 19.81%



respectively. Moreover, total card advances to customers grew by 5.68%, outperforming the negative market average by a wide margin. In anticipation of business co-operation with China UnionPay, we had installed over 4,000 new point-of-sale ("POS") terminals at merchant outlets in Hong Kong by the end of 2003.

In the corporate banking arena, loan demand from the industrial and commercial sectors was still sluggish. However, to pave the way for future growth, we continued to strengthen our role in arranging syndicated loans for the local market while growing overseas lending. Hence our corporate loan portfolio mix saw improvement during the year.

With our continued efforts in developing a customer-driven platform in our treasury operation, we offered a larger variety of sophisticated treasury products to customers. This has enlarged the customer base as well as led to growth in revenue. During the year, the volume of foreign exchange and bullion transactions also soared as customers regained their interest in the foreign exchange and bullion markets.

We are pleased to report that on 24 December 2003, BOCHK was appointed by the People's Bank of China as the Clearing Bank for personal RMB business in Hong Kong. This appointment has further enhanced our status as a leading

banking group in Hong Kong. It also demonstrates our solid expertise and resourcefulness in offering RMB banking services to the local market. We are well positioned to provide premier RMB services, including personal deposits, exchange, remittance and bank cards.

Progress of Medium-Term Strategic Goals

During our IPO in July 2002, we set forth five medium-term strategic goals. The progress so far is summarised as follows:

1. Leveraging our distribution network, we made much progress during the year in growing our revenue from the wealth management and treasury operations through cross selling and the launch of higher value-added products. Securities brokerage turnover increased by 79%. Investment fund and retail bond sales were up 68%. Life insurance distribution volume grew by 114%. Key products newly launched included the All-You-Want Mortgage Scheme, Smart Mortgage Scheme, SMEs Financing Scheme, and Corporate Tax Loan.
2. Our risk management mechanism was strengthened and more effectively implemented in the past year. Our asset quality has improved significantly as mentioned above.
3. The operational efficiency of the entire Group continued to rise and

a higher degree of cost-efficiency was attained. The synergies generated from the Restructuring and Merger allowed us to reduce the number of branches to 304.

4. We have witnessed higher returns on shareholders' funds and assets last year. Return on average shareholders' funds was 13.62%, up 1.10 percentage points. Return on average total assets was 1.08%, up 0.14 percentage point.
5. Co-operation with our parent company, the BOC, and the expansion of our China business continued to advance on a much broader scope.

In addition, we made considerable progress in some key areas of our overall business strategy, namely, the expansion of e-Banking services and the further development of our trade finance and remittance business.

Strategic Priorities to Drive Future Growth

As a major bank in Hong Kong, we are determined to maintain our leading position in all our businesses while serving the fast-changing and increasingly sophisticated needs of the market. At present, our chief goal is to achieve higher growth through the transformation of our business portfolio and the strengthening of our core competencies, laying stronger foundations for our long-term development.



To reach that goal, we have set forth some key strategic priorities as highlighted below.

Increasing focus on consumer credit and wealth management

We are establishing a comprehensive wealth management platform, with a view to developing and offering — on a recurrent basis — innovative products and services to our customers. By strengthening our credit card and personal banking businesses, we expect our consumer credit portfolio to expand. With a large customer base, we are well equipped to generate higher growth through bank-wide cross selling and proactive customer relationship management.

Expanding corporate and treasury services

Only by acquiring a deep understanding of the needs of our corporate and treasury customers, can

we deliver on the services they require and thereby grow our corporate lending and treasury operations.

Through active portfolio management and, again, bank-wide cross selling, we aim to increase our profitability while keeping risks at a manageable level. We shall focus mainly on better relationship management through customer segmentation and channel development. In order to increase our lending to local SMEs, one of our key initiatives is to broaden our SME loan product range. We have already gained some headway in that and will continue to do so.

Enhancing services in the Mainland

China's economy has made remarkable progress amidst the global downturn last year. With the global economy now on the rebound, the Mainland is expected to undergo even better economic development coupled with a more sustainable pace of growth than

before. By capitalising on our network of branches and solid presence in the Mainland, we are in a unique position to ride on the opportunities arising from CEPA to further expand our China business. We aim to gain a better understanding of our customers' needs in China by building stronger relationships with them. Meanwhile, through the enhancement of the operational efficiency and services portfolio of our Mainland branches, we are able to offer our customers the same high quality of service in the Mainland as they enjoy in Hong Kong.

Optimising operational efficiency

To ensure our long-term growth and enhance service quality, we strive to improve operational efficiency on a continuous basis. Business and process reengineering was implemented in recent years; we shall proceed with bank-wide efficiency enhancement programmes, encompassing technological enhancement, network rationalisation, channel modernisation and human resources development.

Implementing sound risk management

Sound risk management is a crucial part of our operation. Under the direction of the Board, we have been developing comprehensive and independent risk management measures to take into account current and future needs. Our commitment remains to build a risk-focused culture

of business development and implement appropriate risk management processes and controls. In the medium-term, we will conduct our risk management practices through the use of the risk-adjusted and economic capital allocation methodology.

Corporate Development

Our corporate culture is undergoing a transformation to meet our global and local business needs, which will lead to higher service quality and support of customer relationships. We also pursue a policy of ongoing staff development through incentives and extensive training.

In line with the service preference of and business demand in target segments, our branches will be classified into five clearly defined and focused categories, each with specific functions. This will enable us to serve the respective needs of our different customer groups even more effectively.

Besides initiating bank-wide efficiency programmes for process reengineering

and technological advancement, we have further expanded the electronic distribution channel and the scope of our e-Banking products and services to enrich customer experience.

Conclusion

Bearing in mind that the low interest rate environment is likely to persist for some time and competition for quality lending will remain intense, we are cautiously optimistic that the current economic climate will continue to be favourable for the foreseeable future. The implementation of CEPA, the launch of personal RMB banking services, the enlargement of the individual visit scheme, the revival of the local stock and property markets and the return of consumer and investor confidence, all represent greater business opportunity for the Group in 2004.

We have set out to be our customers' premier bank wherever we are. To accomplish this goal and to sustain growth and profitability in the longer term, we believe it is important to better

ourselves continuously in terms of innovation and operational efficiency. I have already outlined some pragmatic strategies to that end. These will be kept under constant review to take into account customers' changing needs.

May I take this opportunity to thank the Board for their guidance and all my colleagues for their dedication and hard work in the past year. We owe our achievements today and our success in tiding over a challenging period largely to their trust and unwavering support. I am honoured to be working with them and I stand strongly in the belief that together we can attain higher growth while our foundations continue to be strengthened.



HE Guangbei

Hong Kong, 22 March 2004





MANAGING
FOR
EXCELLENCE

Hydraulic Armillary
and Celestial Tower
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The most ancient Chinese
observational instrument
combining the functions of
measurement, observation
and timing