CHIEF EXECUTIVE'S REPORT

I am pleased to report that in the first half of 2011, we were able to capitalise on our core competencies and premier position to achieve strong growth in income and earnings while reinforcing our market lead in major business segments. We attained record interim highs in our net operating income before impairment allowances, operating profit and profit attributable to shareholders. Our interim dividends to shareholders also increased to a new level.

During the interim period, we were operating in a mixed environment where opportunities and uncertainties appeared side by side. The external situation remained volatile, especially in Europe, the US and Japan. However, the Asian economy in general fared better, led by the strong economic performance of the Mainland of China. Benefiting from this, Hong Kong experienced robust GDP growth. For the local banking sector, the demand for credit facilities and financial services was on the rise and the market for offshore RMB banking business expanded rapidly. Yet, banks continued to be confronted with challenges like mounting inflationary pressure, exceptionally low interest rates and intensifying competition.

Fully alert to the volatilities and challenges in the market, we have been implementing a proactive management strategy to drive steady and sustainable growth. While maintaining rigorous risk management, we have been taking full advantage of the reviving economy and capturing new business opportunities to grow our income and earnings in a balanced manner. At the same time, we have been highly vigilant with regard to our major financial ratios and would adjust our strategies when and where necessary. Furthermore, as a forward-looking banking group, we put particular emphasis on the quality and sustainability of growth to ensure that we strike a right balance among growth, return and risks.

Performance Highlights

Our major achievements in the first half of 2011 once again demonstrated our capabilities in delivering solid and sustained growth for our shareholders.

- We recorded broad-based growth in income and profit. All our core businesses, including Personal Banking, Corporate Banking, Treasury, RMB Banking and Insurance, registered healthy growth. There was satisfactory growth in all our income streams, including net interest income, net fee and commission income as well as net trading income.

- We spearheaded the growth of RMB banking businesses by broadening our service scope to create new demand and enlarge our customer base. We launched a number of RMB products for individual and corporate customers. By registering encouraging growth in both business volume and income, the RMB-related business has become a new growth engine and profit stream for the Group.

- With our focus on the quality of growth, we therefore adhered to our prudent credit policy and continued to grow our lending business in a balanced manner. We also achieved an inspiring increase in customers' deposits amid keen competition in the market. As the gap between our loan growth and deposit growth was narrower than that of the industry as a whole, we kept our loan-to-deposit ratio at a healthy level.

- Capitalising on the advantages of our traditional businesses, we scored satisfactory growth in fee and commission income, covering such areas as credit cards, insurance, loans, bills, currency exchange and other services. In particular, we significantly expanded our fund distribution business on the back of improved investment sentiment. Our life insurance business maintained its strong growth momentum in both premium income and profit, and captured a bigger market share.

- While delivering robust business results, we also excelled in cost management. Our cost-to-income ratio was the best in the local market.

- Through effective management, we maintained our strong financial position and superior asset quality. We are well-capitalised, with our capital adequacy ratio among the best in the local industry. Our classified or impaired loan ratio further improved and remained the lowest in the market.

- Besides, we brought the Lehman Brothers Minibonds issue to a satisfactory conclusion, thus recovering a substantial part of the expenses previously incurred.

Financial Performance

In the first six months of 2011, the Group's profit attributable to shareholders increased strongly by 66.8% to HK$11,993 million, which was made possible by the growth in profit of our core businesses and net recovery from the underlying collateral of the Lehman Brothers Minibonds amounting to HK$2,854 million. Should the impact of the above-mentioned net recovery and the Lehman Brothers-related expenses be excluded, the profit attributable to shareholders would still have grown by a solid 33.4% to HK$9,679 million.

The Group's net operating income before impairment allowances was HK$15,126 million, up 20.6% year-on-year. Operating profit before impairment allowances was HK$13,133 million, up 64.0% year-on-year.

Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.33% and 19.88% respectively, versus 1.17% and 13.56% respectively for the first half of 2010.

Despite persistently low interest rates continuing to compress interest spreads, net interest income increased by 13.8% year-on-year to HK$10,205 million. This was mainly attributable to an increase of 48.7% in our average interest-earning assets, offsetting the narrowing of the net interest margin (NIM) by 37 basis points to 1.21% during the six-month period. The narrowing of NIM was partly caused by the diluting effect of BOCHK's function as Hong Kong's RMB clearing bank. Should this effect be discounted, the NIM would have narrowed by 16 basis points to 1.48%.

Net fee and commission income grew by 17.3% year-on-year to HK$3,986 million. This was led mainly by the surge in commission income from insurance (+177.3%), fund distribution (+162.7%) and bills business (+12.7%). There were also increases in fee income from credit cards (+31.7%), currency exchange (+79.2%), trust services (+25.5%) and payment services (+11.4%).

The Group recorded a net trading gain of HK$761 million in the 2011 interim period versus a net trading loss of HK$36 million in the same period in 2010. The rebound was led by the rise in net trading income from foreign exchange and related products as well as the drastic decrease in the loss arising from interest rate instruments.

Under a proactive management strategy, we recorded steady loan growth. Total loans and advances to customers saw a total increase of 9.7% to reach HK$672,858 million, which was mainly contributed by growth in corporate loans (+8.5%) and residential mortgage loans (+14.0%). Loans for use in Hong Kong were up 12.3% whereas loans for use outside Hong Kong, up 3.3%. In anticipation of changes in the market condition, we were more discreet in conducting our lending business while taking initiatives to improve the pricing of new corporate loans during the period.

There was an increase of 7.5% in deposits from customers to HK$1,104,004 million. As a reflection of customers' preference, RMB deposits rose by 39.9% to HK$218,823 million. The Group's loan-to-deposit ratio stayed at 60.95% as at the end of June.

The Group's total assets increased to HK$1,830,379 million as of 30 June 2011, up 10.2% over the six-month period. Effective risk management ensured the quality of our assets. The classified or impaired loan ratio for the first half of 2011 edged lower to 0.10% from 0.14% six months ago and 0.23% twelve months ago, now being the lowest in the market.

In view of escalating inflation and aiming to further enhance our productivity, we employed the same disciplined approach, as always, to managing costs. Total operating expenses dropped by 56.0% year-on-year due to the impact of Lehman Brothers-related products. Without this reversal, total operating expenses would have increased by 8.3% to HK$4,828 million. This was mainly necessitated by the rise in staff costs to reward good performance and the increase in headcount to support business development. Our core cost-to-income ratio (excluding the impact of Lehman Brothers-related products) was 31.92%, the best in the market.

Our capital and liquidity positions remained strong. As from 1 January 2011, the Group adopts the foundation internal ratings-based (FIRB) approach in calculating the capital adequacy ratio (CAR). This new approach enables us to manage our business more effectively with a greater emphasis on risk control. Consolidated CAR as at 30 June 2011 was 17.62%, of which core capital ratio was 12.87%. The Group's average liquidity ratio stayed at the healthy level of 36.38%.

CHIEF EXECUTIVE'S REPORT

Business Review

The Group's major business segments achieved higher income and profit overall.

The **Personal Banking** business maintained its growth momentum and expanded steadily. Operating income increased by 4.6% to HK$5,563 million while profit before taxation increased by 22.1% to HK$2,723 million.

The improved performance was witnessed in a wide spectrum of businesses. As the property market was thriving, we took initiatives to meet the rising demand for residential mortgage loans. By introducing new mortgage products and cooperating with major developers, we grew our residential property mortgage by 14.0%. More importantly, in view of higher funding costs, we adjusted the pricing of HIBOR-based mortgage loans to ensure improved yield. To capitalise on the surge in consumer spending by both local residents and incoming tourists, we stepped up our effort in growing our credit card business. This resulted in rapid growth in cardholder spending (+26.2%) and merchant acquiring volume (+38.4%). Through service enhancement and product innovation, we continued to lead the market in the RMB-HKD dual currency card business. Our Bancassurance business also flourished under an effective strategy covering sales, marketing and service enhancement. The development of the fund distribution business deserves special mention. By strengthening our retail fund advisory service through setting up the Investment Product Specialist Team, we grew our distribution volume by nearly 2.4 folds year-on-year.

We upgraded and optimised our distribution channels to better serve local and cross-border customers. In the Group's service network, there was a total of 132 wealth management centres and 21 dedicated Mainland customers service centres as at the end of June. In the first six months of the year, the number of wealth management customers and total assets maintained with the Group grew by 9.7% and 4.0% respectively.

The Group's **Corporate Banking** business also flourished in the interim period. Operating income increased by 29.7% to HK$5,785 million while profit before taxation went up by 32.6% to HK$4,453 million.

Corporate loans increased by 8.5% year-on-year. At the same time, the pricing of loans and loan quality improved. We upgraded and expanded our financial services for corporate clients, both local and cross-border. Underpinned by the revival of global trade, we grew our trade finance volume substantially. In particular, our cross-border trade settlement volume soared by 138%. We made further progress in developing our custody service by securing mandates to provide global custody services to a number of QDIIs and other financial institutions. At the end of June 2011, total assets under our custody were valued at HK$481.7 billion. Meanwhile, we have been on track in expanding our cash management business, especially with regard to RMB cash management. We enhanced our services for local SMEs with sound fundamentals and succeeded in growing our business.

The Group's **Treasury** segment delivered very good results in the first half. Operating income increased by 32.4% to HK$3,145 million. Profit before taxation was up 35.3% to HK$2,865 million. Under our strategy of proactive management with liquidity and safety as our top priorities, we succeeded in diversifying the Group's investment portfolio and reducing our exposure to high-risk investments. Our exposure to PIIGS, the 5 European countries affected by the debt crisis, dropped to an insignificant level. Meanwhile, we took advantage of the steepening yield curve and increased our investment in fixed-rate debt securities, particularly government-related securities and high-quality financial institution bonds and corporate bonds as well. In response to rapid changes in the market, we adjusted our investment strategy from time to time to guard against potential risks while maximising returns.

Our **Mainland** business continued to develop steadily. There was improvement in our asset and loan structure. Deposits increased by 34.9% year-on-year, leading to a substantial improvement in the loan-to-deposit ratio. There was also an increase in net interest income. We enlarged our customer base and further expanded our branch network in the Mainland. In respect of service enhancement, we have been enriching our wealth management product range and upgrading our online platform to better serve corporate customers.

The Group's **Insurance** business performed impressively in the interim period. There was an increase of 101.4% in net operating income which amounted to HK$423 million. Profit before taxation nearly tripled to HK$291 million. Thanks to the substantial growth registered by regular-premium products, gross insurance premium income surged by 132.1%. By enriching our product offerings, particularly regular-premium products (including RMB products), and enhancing our service, we succeeded in growing our market share and reinforcing our market position.

The development of our **Offshore RMB Banking** business has been one of our strategic focuses. The progress we made in this area extended to all of our business segments. We are pleased to see that RMB banking has grown into an increasingly important growth driver and profit stream for the Group. We maintained our market lead by expanding the scope of RMB products and enhancing our service capability to cater for the diverse needs of local, cross-border and overseas customers. We continued to grow our RMB deposit base and lead the market in conducting the RMB trade settlement business. Aside from introducing the BOC CUP Dual Currency Commercial Card, the first of its kind in the market, we initiated a new series of RMB insurance products, which have been very well received so far. We took the lead in offering RMB cashier service order, RMB bill payment service via cheque deposit machine as well as cross-border bill payment service. For corporate clients, we launched a number of RMB payment and receivable products, including the RMB payroll, RMB autopay and RMB dividend payment for RMB-denominated securities. To enhance the return of RMB assets within the policy framework, we expanded the use of RMB funds in our lending and investment businesses. In the interim period, we launched the first "BOCHK RMB Bond Fund" for high net-worth customers.

Outlook

The second half of the year started with tremendous market volatility, particularly after the downgrade of the US government's credit rating and the intensification of the debt crisis in the Euro zone. We expect the operating environment in the remaining months to be more challenging. While it is too early to assess the full impact of the recent developments, it is likely that the pace of economic recovery for the world as a whole would slow down. Interest rates will stay at the current low level for an extended period of time but inflation will linger. The greater volatility in global financial markets would presumably have a negative impact on investors' confidence.

Despite the above challenges, we believe there would still be opportunities for growth in Hong Kong, particularly in the RMB-related business and cross-border financial services. We will therefore continue to adopt a proactive management strategy for sustainable growth. By leveraging our core competencies and unique market positions, we will seek to drive quality growth in revenue and profit, and to maintain our solid financial position to support our growth and fend off any headwinds.

As we keep constant vigilance to changes in the market, we will strive to grow our core businesses by broadening our product and service offerings, upgrading our service capability, and improving our service quality. We will strengthen customer relationships, expand both our local and cross-border customer bases, and foster closer collaboration with BOC as well as its overseas branches. We will stay focused on core segments and formulate strategies for each of them in accordance with the changes in market situation.

More specifically, we will forge ahead with the development of the offshore RMB banking business by broadening and deepening the scope of our service. We will continue to take the lead in driving the growth of RMB-related business in Hong Kong through product innovation and service enhancement. We will also further expand the range of our cross-border banking services, with a view to providing total solutions to both individual and corporate customers. It is essential for us to step up our cooperation with BOC in this regard. We will also enlarge our presence in the Mainland by expanding the branch network of NCB (China).

While driving for growth, we will exercise a high degree of prudence in cost management. At the same time, we will continue to invest in strategic growth initiatives across the business by upgrading our service infrastructure and human resources, both indispensable for the Group's long-term development. Given the heightened market uncertainty and weaker-than-expected economic growth, it is important for us to safeguard our strong financial position and good asset quality. We will monitor our investment portfolio very closely and make adjustment as and when the situation evolves.

To conclude, I am pleased that we have been making good progress in implementing our business strategy. With the continued support of the Board of Directors, shareholders, customers and all my colleagues, we should be in a good position to withstand the challenges we face and take advantage of any opportunities the market presents in the time ahead.

HE Guangbei
Vice Chairman & Chief Executive

24 August 2011