CHIEF EXECUTIVE'S REPORT

As the Company is entering the tenth year of its public listing in Hong Kong, I am pleased to report that we have evolved into a more dynamic banking group that lives up to our pledge to create greater value for shareholders and customers. In the first half of 2012, we once again recorded solid growth in income and profit, achieving new interim heights for our net operating income and core profit attributable to the equity holders. We maintained our leading positions in key market segments and strengthened our financial positions. We also covered significant mileage in capturing new business opportunities and diversifying our income and profit streams.

The operating environment turned out to be far more uncertain and risky than a year ago. The sovereign debt crisis in the Eurozone was aggravating while the US economic recovery was losing steam. After years of fast growth, the Mainland economy was assuming a more modest pace. In Hong Kong, although inbound tourism still rendered strong support for the retail sector, the momentum for GDP growth turned weaker with sluggish external trade and domestic consumption. For the banking sector, operating costs continued to escalate though inflationary pressure as a whole moderated to some extent. Interest rates stayed at a very low level but competition for deposits intensified, thus adding to the cost of funding. On the positive side, however, new business opportunities were cropping up with the further development of offshore RMB banking business in Hong Kong and overseas.

Strategic Initiatives and Achievements

- By pursuing a proactive business growth strategy, we reinforced our core businesses and diversified our income and profit streams. Given our strong foundations and core competencies, we were able to capture various growth opportunities. Our offshore RMB banking business flourished and further strengthened the Group's leading market position. We made great progress in building up the RMB business as one of the Group's new growth engines. Our loan business registered healthy growth with satisfactory growth in RMB loans. Our strenuous effort in fostering the funds and bonds distribution business enabled us to achieve robust growth in this area, regardless of volatilities in the investment market. When the local property market showed early signs of revival in late March, we grew our residential mortgage loans and topped the market in the underwriting of new mortgage loans.

- The Group's profitability continued to improve under a proactive asset and liability management strategy, which we have been implementing over the past years and has proven to be essential in enhancing the Group's earning power. We succeeded in enhancing the deployment of RMB funds, improving the pricing of loans, boosting our deposit base through a flexible deposit-taking strategy, and controlling the cost of funding. As a result, we significantly improved our net interest margin (NIM), thus achieving solid growth in net interest income and hence overall profit.

- Our rigorous risk management policy remained effective in safeguarding the high quality of the Group's assets. With a vigilant and selective credit policy, we guarded against the formation of new impaired loans and maintained our classified or impaired loan ratio at the best level in the market. By means of a proactive yet prudent investment strategy, we better managed our investment portfolio to capture higher return and minimise risks. We refined our portfolio mix by reducing the Group's exposure to the European market and increasing the holding of high quality bonds issued by Asia-Pacific institutions and corporations.

- We succeeded in maintaining our financial strength to support business growth and development. We are well-capitalised, with our consolidated capital adequacy ratio and core capital ratio among the best in the local industry. Average liquidity ratio and loan-to-deposit ratio stayed sound and solid. Our cost-to-income ratio was also the best in industry. In consideration of such factors as financial strength, asset quality and operating efficiency, BOCHK was ranked by Bloomberg Markets in May 2012 as the world's second strongest bank and the top one among banks in Hong Kong. This is another international recognition of our core strengths in sustaining growth while fending off potential risks.

Financial Performance

In the first half of 2012, the Company's profit attributable to the equity holders was HK$11,243 million, a decrease of 6.3% as compared to the first half of 2011. This relative drop was due mainly to the net recovery of HK$2,854 million from the underlying collateral of the Lehman Brothers Minibonds in the first half of 2011. After discounting the Lehman Brothers-related factor, the Company's profit attributable to the equity holders increased strongly by 16.2% as a result of the solid growth in nearly all core business segments.

The Group's net operating income before impairment allowances was HK$18,165 million, surging by 20.1% year-on-year. In comparison with the second half of 2011, the Group's net operating income before impairment allowances, operating profit before impairment allowances and profit attributable to the equity holders increased by 15.6%, 29.7% and 33.3% respectively.

Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.35% and 16.63% respectively, versus 1.33% and 19.88% respectively for the first half of 2011.

For the period under review, net interest income rose by 23.7% year-on-year to HK$12,619 million. This increase was led by a conspicuous improvement in the NIM by 43 basis points year-on-year and 20 basis points half-on-half to 1.64%. The improvement can be attributed primarily to the increased deployment of RMB funds in lending and investment. It was also due to the better pricing of new loans extended to corporate and individual customers. In line with the new developments in offshore RMB business, coupled with the introduction of the Fiduciary Account scheme, participating banks reduced their RMB deposits with BOCHK as the clearing bank, thus alleviating the diluting effect of such deposits on the Group's NIM. As at 30 June 2012, the Group's average interest-earning assets were HK$1,544,663 million, down 9.1% due largely to the reduction of participating banks' RMB deposits.

Net fee and commission income rose by 2.9% year-on-year to HK$4,102 million. Loan commission increased strongly by 54.6%. The robust performance of the Group's funds distribution business, particularly RMB funds, resulted in the surge of 31.8% in related commission income. Fee income from credit cards increased by 15.3%. Our trust and custody as well as payment services also saw steady growth in fee income.

The Group's net trading gain increased substantially by 85.0% year-on-year to HK$1,408 million. This was due mainly to the increase in net trading income from foreign exchange and related products as well as a net gain from interest rate instruments and items under fair value hedge.

Under the volatile market conditions, the Group continued to adopt a stringent and selective credit policy to ensure quality growth. Advances to customers grew by 6.8% as compared with end-2011 to a total of HK$746,752 million. Corporate loans and personal loans increased by 7.9% and 4.2% respectively. At the same time, we achieved higher return from the lending business by raising the pricing of new loans.

The Group's deposit base expanded further in the interim period. In view of the competition for RMB deposits, we followed a more flexible deposit strategy to support business growth and manage the cost of funding. As at 30 June 2012, the Group's total deposits from customers reached HK$1,185,281 million, representing an increase of 3.4% from end-2011. The Group's loan-to-deposit ratio increased to 63.0%, up 2 percentage points from the end of December 2011.

The Group's total assets showed a decrease of 3.1% to HK$1,684,722 million as at 30 June 2012. It was mainly due to the decline in RMB funds deposited by participating banks with BOCHK as the clearing bank. We continued to implement a proactive yet balanced strategy with regard to asset deployment and risk management, thus ensuring better utilisation of funds while keeping risk under well control. The quality of our assets remained excellent. The classified or impaired loan ratio as at 30 June 2012 remained at a low level of 0.10%, the same as one year ago.

In the interim period, we continued to exercise high prudence in containing cost. Owing to the significant net recovery from the underlying collateral of the Lehman Brothers Minibonds in the first half of 2011, the Group's total operating expenses for the first half of 2012 showed an apparent increase of 170.5% to HK$5,391 million. Should the impact of Lehman Brothers-related products be discounted, core operating expenses would be seen to have increased by 11.7%. The increase was necessitated by the investment in human resources and service infrastructure to support business growth in the time ahead. It also speaks for the Group's determination to maintain the competitiveness of its remuneration for the staff. The Group's cost-to-income ratio for the first half of 2012 stayed at the low level of 29.68%.

The Group's capital and liquidity positions were strong. Consolidated CAR as at 30 June 2012 was 17.43%, up 0.53 percentage point from the end of last year. Core capital ratio was 12.96%, versus 12.51% six months ago and 12.87% a year ago. Average liquidity ratio stayed at a healthy level of 39.87%, versus 36.38% for the same period last year.

Business Review

We succeeded in attaining across-the-board growth in all of our core business segments in the first half of this year.

The Group's **Corporate Banking** business recorded outstanding results in the first half of the year. Net operating income before impairment allowances increased strongly by 15.6% to HK$6,687 million while profit before taxation surged by 15.5% to HK$5,142 million.

Our corporate segment maintained its growth momentum against the backdrop of a slower economy. Corporate loans grew by 7.9% with better pricing in new loans. The growth was driven by the sustained increase in RMB loans as well as non-RMB loans. We maintained our position as the top mandated arranger in Hong Kong's syndicated loan market, and arranged the first 100% RMB syndicated loan in Hong Kong. We enhanced our services for SMEs by offering them one-stop financial solutions via our dedicated commercial centres and extensive branch network. We gave further support to the enhanced SME Financing Guarantee Scheme launched by the Hong Kong Mortgage Corporation. Through product innovation and service enhancement, the Group's trade finance balance grew by 14.0%. By collaborating more closely with BOC and NCB (China), we increased our servicing capability for cross-border customers. Our custody service showed significant progress. We secured the mandates for a number of RMB fund products and became the largest service provider of RQFII funds in the local market. We expanded our client base by providing global custody services to QDIIs and various types of fund clients. In line with the new arrangements of the RMB RTGS system in Hong Kong from late June, we have upgraded our related services and extended our service hours for same-day RMB telegraphic transfer and express transfer, facilitating RMB trade settlement and fund transfer by corporations from around the world. Our cross-border cash management service capabilities have been greatly enhanced by the linkage of our e-banking platform with those of BOC and its overseas branches.

Our **Personal Banking** business recorded steady growth in both loans and deposits. Net operating income before impairment allowances and profit before taxation reached HK$5,616 million and HK$2,763 million respectively.

With the revival of the local property market early this year, our residential mortgage loans grew by 4.6%. For the interim period, we were the market leader in underwriting new mortgages. Although sluggish stock trading affected our brokerage fee income, our other investment services flourished, in particular the distribution of funds and bonds, and contributed significantly to the rise in fee and commission income. We were the largest retail distributor of RQFII funds in Hong Kong. The launch of the "BOCHK – World Bank Emerging Markets Bond Fund" in June marked the inaugural cooperation between the Group and the World Bank, making it the first global emerging market currency bond fund in Hong Kong with a China theme. In addition, our bonds distribution business made encouraging progress. We initiated the private placement service for bonds in the secondary market. We also led the HKSAR iBond market in terms of over-the-counter turnover. The Group's insurance business continued to develop in a healthy manner. Through product innovation and brand building, BOC Life reinforced its position as a prominent life insurer and the leader in RMB-denominated insurance market. Meanwhile, our credit card business recorded growth of 10.8% and 16.8% in cardholder spending and merchant acquiring volumes respectively. As regards wealth management, we completed the unification of our service platform as well as enhanced our brand awareness and market position.

We have been working more closely with BOC to tailor-make relevant services for select customers. While driving business growth, we kept enhancing our customer service by optimising our distribution channels. The functions of our e-banking service platform have been expanded. We pioneered the first chip-based ATM card with enhanced security.

The Group's **Treasury** segment once again recorded solid financial results in the first half of 2012. Net operating income before impairment allowances increased by 68.2% year-on-year to HK$5,291 million, led by the strong growth in net interest income, while profit before taxation increased by 64.1% to HK$4,702 million.

Under volatile market conditions, we continued with a proactive yet highly vigilant approach in managing our banking book investments, responding swiftly to any change in the market. To safeguard our asset quality and return, we further improved our investment portfolio to manage risk and maximise return. On the one hand, we continued to trim down our holdings of European bonds. On the other hand, we invested in more high quality bonds issued by Asia-Pacific institutions and corporations. On the product development front, in anticipation of customers' needs, we rolled out new product packages that aimed to reduce customers' exposure to exchange rate risk and financing costs. We remained an active participant in the underwriting of offshore RMB-denominated bonds. We launched three new offshore RMB bond sub-indices that serve as performance benchmarks for the offshore RMB bond market.

The Group's **Mainland** business registered healthy growth in the first six months. Net operating income increased by 32.7%. Advances to customers and customer deposits grew by 1.2% and 9.8% respectively. By stepping up our marketing and promotion, working closely with BOC, and exploiting the e-banking channels, we boosted our deposit base and grew our retail banking business in the Mainland. The range of wealth management products was enriched to support the growth of the wealth management segment. We have also been actively preparing for the issuance of credit cards in the Mainland. During the interim period, four new NCB (China) sub-branches were added to our Mainland network.

The **Insurance** business recorded robust growth and strengthened its position in the RMB insurance market. Net operating income before impairment allowances increased by 34.8% year-on-year to HK$570 million while profit before taxation grew substantially by 55.0% to HK$451 million. The outstanding growth in profit was mainly attributable to the better investment performance as compared to the same period last year. The increase in realised gain from equity investments as well as mark-to-market gain of debt securities contributed to the improvement of investment income. At the same time, we further enlarged our RMB product offerings with new insurance plans and solidified our position as the leading RMB insurance service provider.

Outlook

With ongoing headwinds created by the Eurozone debt crisis and the austerity measures implemented in the related countries, the global financial markets remain fragile and volatile. It seems more likely that uncertainty would still prevail over the global economy in the coming months. This inevitably implies a tougher operating environment for us. For the local banking sector, the slowdown of the Mainland and Hong Kong economies might curb loan growth in general. Moreover, persistently low interest rates, increasingly fierce competition, and higher funding costs would have a negative impact on the banking sector's net interest margin and net interest income. On the positive side, however, the further opening of the offshore RMB banking services is expected to bring us new business opportunities. The Mainland's stabilising economic measures should help to support growth across the border.

Given our core competencies and financial strength, we are in a more favourable position to pursue a proactive business strategy for a balanced and sustainable growth in the rest of the year and beyond. We will seek to maintain our growth momentum and capture new market opportunities. We will place special emphasis on the quality of growth and overall cost-effectiveness. Our financial strength enables us to invest in the enhancement and expansion of our business platforms that will offer added values to our customers. This has proven to be indispensable for a forward-looking banking group like us: we have made investments for our sustainable development in the longer term, even at the difficult times of the financial crisis and economic slowdown over the past few years.

Riding on our solid capabilities and competitive edge, we will continue to drive the growth of offshore RMB banking business. The HKMA's new regulations on RMB liquidity management allow the banking sector to have greater flexibility on RMB asset allocation, which would be conducive to our RMB business development. The recently announced arrangement whereby RMB banking services can be extended to non-Hong Kong residents has opened a new window to expand our RMB business. Since its launch in August, we have made a good start by offering an array of RMB services to global customers. To better prepare the Group for the RMB business opportunities ahead, we will persist in upgrading and optimising our product platform to enhance customer service and enlarge our clientele. As offshore RMB banking has become an integral part of BOC Group's global development strategy, we will work more closely with BOC and its overseas branches to explore new businesses and markets.

At the same time, we will reinforce our position as a leading Hong Kong-based banking group through service enhancement and innovation. While striving to maintain the growth trends and market positions of our core business segments, we will step up the development of new income streams with high potential, such as funds and bonds distribution, cash management, asset management, and custody services. In particular, we will seek to expand our wealth management services by constantly upgrading our service platform and strengthening our service capabilities for high net-worth customers. With the launch of private banking services in the second half of this year, we will be in a better position to accelerate the growth of our wealth management business. In addition to the dedicated commercial centres, the opening of more exclusive commercial counters at our branches will also be conducive to our service for commercial clients.

While striving for income and profit growth, we will stay highly vigilant over the fast-changing market conditions here and around the world, and exercise rigorous risk management to safeguard our asset quality and capital base. Despite the alleviation of inflationary pressure in Hong Kong, we will remain cost-conscious in growing our business and seek to enhance our cost efficiency.

I am pleased that we are celebrating the tenth anniversary of the Company's public listing in Hong Kong with outstanding interim results, for which I am very much indebted to the Board of Directors, shareholders, customers and all my colleagues for their continued trust and support. I am confident that the Group, supported by its strong financial positions, will be able to reach a new horizon in business growth and development, which will in turn create higher value to our stakeholders.

HE Guangbei
Vice Chairman & Chief Executive

Hong Kong, 23 August 2012