CHIEF EXECUTIVE'S REPORT

I am pleased to report that the Group delivered a set of satisfactory results with improved core profitability and a strong financial position for the first six months of 2013. Operating performance was solid with net operating income and operating profit achieving interim highs. Both interest income and non-interest income posted decent growth. We grew our loans and deposits at a healthy pace. All key financial ratios stayed at strong levels.

During the first half, the Hong Kong banking sector faced a mixed and still challenging operating environment. The external environment remained lacklustre with weak demand. In Hong Kong, the economic growth momentum softened. With the government's tightening measures, the residential property market cooled down substantially in the second quarter. As the new banking capital requirement under Basel III came into effect from 1 January 2013, banks are required to operate on a higher capital base. On a positive note, we saw continued expansion of the offshore RMB market with further policy relaxation. Trading volume of the local stock market increased as investment sentiment improved during the period.

Performance Highlights

The solid performance of the Group in the first half of 2013 reflected the results of our consistent strategy for balanced and sustainable growth. During the period, we continued to apply strict risk policy and actively managed the Group's balance sheet. Through product and service innovation, channel optimisation as well as a more sophisticated customer segmentation strategy, we made respectable progress in enhancing customer experience.

Proactive management yielded solid results

- **Net interest margin expanded.** Under the persistently low interest rate environment and intense competition, it is indeed quite a challenge to manage the pressure on net interest margin. During the period, we took proactive measures to allocate our assets, improve loan pricing and control deposit costs. As a result of these conscious efforts, the Group's net interest margin improved further both year-on-year and half-on-half with net interest income reaching an interim high.

- **Optimised asset allocation.** Operating conditions continued to be difficult. Genuine loan demand was modest while capital markets were volatile. During the period, we cautiously allocated our assets to ensure efficient use of funds and safeguard asset quality. In terms of asset allocation, funds were deployed to support lending to core customers. We adhered to a strict credit policy, which allows no compromise on quality for growth. Staying close to market developments, we adopted timely risk control measures. We continued to conduct our Know Your Customer work conscientiously, especially for trade finance which experienced unusually fast market growth during the period. We carefully studied the business background and closely monitored the loan arrangement throughout the whole process. The Group's total loan book expanded at a healthy pace and loan quality remained sound with a low classified or impaired loan ratio. In managing our investment book, while seeking good investment opportunities to enhance return, safety and liquidity remained our primary considerations. We increased investments in high-quality financial institutions and corporate bonds with geographical exposure mainly in the US and Asia.

- **Maintained strong financial position.** Starting from this year, the new Basel III requirement came into effect. We have planned and got prepared for it well in advance. The impact of Basel III to the Group's capital level had been thoroughly considered when we formulated the business plan for 2013. After considering the Group's funding needs and cost, we repaid early the Euro sub-loans to BOC, which would be de-recognised as Tier 2 capital under Basel III. Total and Tier 1 capital ratios remained strong as at the end of June 2013. In the latter part of the first half, market volatility increased while liquidity in the Mainland interbank market tightened sharply. We continued to actively manage the Group's liquidity, reinforcing our ability to withstand unexpected market disruptions.

- **Effective cost management.** We judiciously managed expenditure to ensure cost efficiency while allowing sufficient resources to drive business growth. Our cost-to-income ratio remained at a low level in the first half of 2013. Over the years, investment in our franchise to enhance the Group's competitiveness has never subsided. In addition to building new platforms, we took measures to improve operational efficiency by streamlining and centralising business processes.

Enhanced franchise to drive business growth

- **Continued enhancement in offshore RMB business platform.** The scope of the offshore RMB business expanded on the back of further policy relaxation. The Group maintained its market leadership with steady development of its business. Leveraging the opportunities from the "Cross-border RMB Loan Trial Scheme in Qianhai", the Group acted swiftly and signed agreements with five enterprises registered in Qianhai to provide them with cross-border RMB direct loans. BOCHK was also designated as a market maker for USD/CNH (offshore RMB) futures by the Chicago Mercantile Exchange Group, being the sole bank among the first group of market makers. With the introduction of the CNH HIBOR in Hong Kong, we pioneered the launch of new treasury products using CNH HIBOR as the pricing benchmark. Our asset management company partnered with FTSE Group to develop a new "FTSE-BOCHK Offshore RMB Bond Index Series". This landmark partnership combines BOCHK's unique competitive position in the offshore RMB business with FTSE's leading index expertise.

- **Maintained efficient clearing services.** As the Clearing Bank of the offshore RMB business in Hong Kong, we further enhanced our clearing services to participating banks. During the period, we extended the operating hours for cross-border RMB payments involving the Mainland, introduced fixed deposit products, launched a tiered interest rate offering for participating banks' settlement accounts, and adjusted RMB intra-day repo limits.

- **Solid fee income growth.** In the first half, fee and commission income recorded broad-based growth. In particular, funds distribution sustained the robust growth momentum. This encouraging performance reflected the Group's ongoing efforts to enhance its service platform (e.g. setup of Investment Product Specialist Team) and broaden its product offerings. During the period, our asset management business launched a new retail fund, the "BOCHK All Weather RMB High Yield Bond Fund", which received an overwhelming response from customers. We also conducted themed marketing campaigns and investment seminars helping customers better plan and diversify their investment portfolios.

- **Focused on driving customer segmentation strategy.** With an aim to better serve the diverse needs of our customers, we continued to implement our customer segmentation strategy. During the period, we revamped our banking services for mass retail customers and launched the new i-Free Banking service, which received positive customer response. Launched in the fourth quarter last year, our Private Banking business, which targets top-tier high-net-worth individuals, has shown encouraging results in its business development. Both customer base and assets under management increased in the first half. Our Corporate Banking business continued to enhance its expertise in industry management with better customer segmentation. This facilitated not only growth in the client base but also better risk management.

- **Enhanced e-banking platform.** With advancements in technology, customers are looking for more efficient banking services. The Group has continuously improved the functions and quality of its e-banking platform. The proportion of transaction volume via e-banking increased year-on-year. In particular, transaction volume via mobile banking increased substantially. The corporate internet banking platform has also been optimised with a more user-friendly interface and enhanced transaction flow. We continued to upgrade the e-banking platform of our Mainland operation with new services, longer service hours, real-time processing on holidays and shared use of the payment platform of BOC.

- **Strong cross-border banking capabilities.** In view of the growing demand for cross-border banking services, the Group strives to provide its customers with comprehensive solutions. Together with BOC, we strengthened our cross-border RMB entrusted payments and entrusted loans businesses and established business relationships with our target customers. In custody services, we expanded our client base and successfully secured mandates to provide custody services for RQFII-ETFs, RQFII funds and Qualified Domestic Institutional Investors. In recognition of its outstanding QFII performance, BOCHK was awarded the "Best QFII Custodian" under Regional Specialist in the "Asset Servicing Awards 2013" by The Asset Magazine. In cash management business, we further strengthened our competitive edge as a cross-border fund centre for corporates in Hong Kong through close collaboration with BOC. BOCHK was granted the "Achievement Award for Best Cash Management Bank in Hong Kong" from the "Asian Banker Transaction Banking Awards 2013" organised by Asian Banker. As for our individual customers, we continued to offer a wide range of banking services to bring them added convenience in financial management across the border.

Financial Results

In the first half of 2013, the Group's net operating income before impairment allowances increased by 9.4% year-on-year to HK$19,791 million. The growth was mainly driven by the increase in net interest income and net fee and commission income. Operating expenses increased by 7.0% to HK$5,692 million with an industry low cost-to-income ratio of 28.76%. Operating profit before impairment allowances increased by 10.4% compared to the same period last year.

Despite lower net gain from fair value adjustments on investment properties and higher net impairment charges, profit attributable to the equity holders held steady at HK$11,252 million, or up 0.1% year-on-year, supported by the growth in core income. Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.27% and 14.87% respectively.

Net interest income rose by 5.6% year-on-year to HK$13,331 million, driven by the expansion in both average interest-earning assets and net interest margin. Net interest margin widened by 3 basis points to 1.67%. The increase was mainly attributable to the improved loan and deposit spread. Average interest-earning assets expanded by 4.0% year-on-year, driven by growth in loans and advances as well as debt securities investments.

Net fee and commission income grew by 16.1% to HK$4,681 million. The increase was broad-based with strong growth in fee and commission income from credit cards, funds distribution, securities brokerage, insurance and loans.

Net trading gain increased by 2.3% to HK$1,441 million. This was due mainly to the increase in net trading gain from foreign exchange and related products.

Compared to the second half of 2012, net operating income before impairment allowances, operating profit before impairment allowances and profit attributable to the equity holders increased by 13.0%, 21.7% and 16.2% respectively.

As at 30 June 2013, total assets amounted to HK$1,834.7 billion, up 0.2% compared to the end of 2012. The growth was driven by higher customer deposits, which grew by 2.9%, but was largely offset by the lower deposit balance the participating banks placed with the RMB Clearing Bank. The Group continued to adopt proactive management to optimise its asset allocation. As at end June 2013, securities investments decreased by 8.6%, with the reduction mainly in lower yielding government-related securities. Advances to customers grew 6.7% to HK$830.7 billion with growth in both corporate and personal loans. Loan-to-deposit ratio increased to 65.71% from 63.32% at last year-end. Overall loan quality remained sound with classified or impaired loan ratio at 0.26%.

Under the newly applied Basel III capital requirement, the Group maintained a strong capital position with total capital ratio of 16.40% and Tier 1 capital ratio of 11.17% as at end June 2013. Average liquidity ratio for the period stood at 38.70%.

The Board declared an interim dividend of HK$0.545 per share for the first half of 2013, which is the same as last year.

Business Review

Personal Banking business delivered outstanding performance in the first half of 2013. Net operating income before impairment allowances and profit before taxation grew year-on-year by 22.4% and 29.3% to HK$6,840 million and HK$3,572 million respectively.

The Group's residential mortgage business maintained its market leadership with 3.0% increase in loan balance. Demand for mortgage loans softened amid the tighter property measures. We continued to launch new mortgage products and services to seize business opportunities. A "Fixed-Rate Mortgage Scheme" was launched, providing homebuyers with an alternative financing option suited towards their financial needs. Our pioneering "Portable" feature for fixed-rate loans offers customers greater flexibility when moving to a new property. Investment and insurance business recorded a notable increase in net fee and commission income. Fund sales were strong generating a 90.1% increase in commission income. Credit card business grew steadily with an 8.3% increase in cardholder spending and 20.3% increase in merchant acquiring volumes. The Group's success in the credit card business was widely recognised and it received a total of 30 awards from VISA International, MasterCard and China UnionPay.

Corporate Banking business maintained its growth momentum into the first half of 2013. Net operating income before impairment allowances increased by 16.9% to HK$7,771 million, driven by strong net interest income growth. Profit before taxation grew by 14.2% to HK$5,873 million.

Our corporate loan book recorded healthy growth of 8.2% with respectable growth in offshore RMB loans. The Group remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. The Group also made solid progress in the "Supply-chain Finance" business launched in 2012. At the end of June 2013, the Group's balance of trade finance grew by 13.9% from the end of 2012. Given the market uncertainties, we maintained our discipline in extending credit to corporate customers. As a result, overall loan quality remained healthy. Meanwhile, we continued to provide "Total Solutions", offering comprehensive banking services to better meet the needs of our corporate customers and strengthen business relationships. A Corporate Services Centre was set up to further improve service efficiency.

Treasury segment recorded lower income and profit amid a volatile market and a lower interest rate environment. Net operating income before impairment allowances decreased by 15.9% to HK$4,449 million. Profit before taxation declined by 16.7% to HK$3,918 million.

During the period, we actively managed the Group's banking book investments to optimise portfolio mix and return. On the product development front, with timely response to market conditions, we promoted popular products to meet customer needs. We also made good progress in underwriting bond issuance in different denominated currencies, and saw a considerable increase in turnover over the same period last year.

Mainland business achieved encouraging growth amid a tough operating environment. Net operating income increased by 18.2% driven by higher net interest income. Yields improved given our conscious efforts to optimise asset and liability structure. Customer deposits and loans registered steady growth of 8.8% and 6.8% respectively from the end of last year.

During the first half of 2013, two new sub-branches of NCB (China) were opened. The Group's total number of branches and sub-branches in the Mainland increased to 38 as at the end of June 2013. The Group also continued to improve both its personal and corporate e-banking platforms. To meet the increasing demand for wealth management services, a series of products were launched, driving growth in commission income.

Insurance business posted satisfactory results through continuous product enhancement. Net operating income before impairment allowances and profit before taxation grew year-on-year by 20.7% and 25.1% to HK$688 million and HK$564 million respectively.

The Group maintained its leading position in the RMB insurance market. We continued to receive positive customer response for our RMB insurance products. The Group also actively explored new distribution channels and established partnerships with brokerage houses to promote insurance products. In recognition of its outstanding performance in RMB services, BOC Life was granted the honour of "Outstanding Insurance Business" under the "2013 RMB Business Outstanding Awards" organised by local media.

Outlook

The global economic recovery is progressing at a slower than expected pace. We are encouraged by some signs of gradual improvement in the US economy and the stabilising European economies. The Mainland economy is expected to slow down but in a managed manner. Nevertheless, as the key fundamental issues of major economies remain unsettled, this may continue to affect market stability. As in Hong Kong, external demand is still a crucial factor driving Hong Kong's economic growth. Locally, uncertainty surrounding the property market may also weigh on the economy. Against this backdrop, the growth outlook for Hong Kong's economy would be modest for the rest of the year.

Apart from the still challenging macro conditions, banks also need to review their business strategies and get prepared for a changing industry landscape. Under the Basel III regulatory regime, banks need to meet more stringent capital and liquidity requirements. Furthermore, with the recent interest rate liberalisation reform in the Mainland, competition may intensify going forward.

Maintaining a strong financial position has always been a key priority of the Group. We will continue to proactively manage our capital and liquidity. In implementing our business strategy, we will ensure the efficient use of our capital to support growth and drive sustainable return. Although there are signs of improvement in the global economy, the recovery is still vulnerable and sensitive to changing market conditions. We will adhere to our proactive and rigorous risk management to safeguard the Group's financial strength and asset quality.

As for the Group's business development, we see considerable growth potential given our more diversified business platform, deepened customer relationships and close collaboration with BOC. With closer integration between Hong Kong and the Mainland, we have already seen increasing demand for cross-border banking services over the past years. The Group has been strongly positioned and captured good business opportunities. We have in place a wide range of cross-border banking services to meet the needs of both individual and corporate customers. Capitalising on the Global Relationship Manager platform, we have been working closely with BOC to provide one-stop services to cater to the global needs of the leading corporate customers.

This strategy has proved to be successful in capturing new business and securing quality customers. We have invested considerable resources in enhancing our platform to provide efficient cross-border services. For example, the Group’s cash management service was upgraded by capitalising on BOC’s global cash management platform. This greatly facilitates more convenient and efficient cash management services for multi-national customers. We have also focused on driving innovation in cross-border trade finance products. We will continue to broaden our product and service scope and work closely with BOC to reinforce our competitive edge in the cross-border banking business.

Over the past few years, we have witnessed the robust and healthy development of the offshore RMB markets with RMB transactions becoming more prevalent around the world. Our development progress has been remarkable and we have firmly established our market leadership in the offshore RMB business. With the appointment of BOC’s Taiwan Branch as the Clearing Bank in Taiwan in December 2012, the BOC Group’s franchise in the offshore RMB business has been strengthened further. We will continue to exploit more business opportunities capitalising on our strong RMB franchise. We will persist in upgrading and optimising our product platform to meet the growing RMB banking needs. In close collaboration with BOC and its overseas branches, the Group is well positioned to capture the emerging market opportunities.

In an increasingly competitive environment, the need to drive innovation and efficiency becomes more apparent. Therefore, investment in enhancing our business platform for the Group’s long-term development is a continuous priority. We have been making ongoing investments in upgrading technology to drive efficiency and innovation, introducing new business capabilities to meet the diverse needs of our customers, and equipping our people with the knowledge and skills for greater performance. As inflationary pressure is expected to persist in the near term, we will remain disciplined in cost management to ensure efficiency.

Lastly, I would like to take this opportunity to welcome Mr. TIAN Guoli who joined the Company as the Chairman and Non-executive Director with effect from 4 June 2013. Under Mr. TIAN’s leadership, the Group will remain committed to driving balanced and sustainable growth to create greater value for our stakeholders.

With effect from 1 July 2013, Mr. HUANG Hong succeeded Mr. WONG David See Hong as the Deputy Chief Executive (Financial Markets) to oversee the financial market businesses. I would like to welcome Mr. HUANG joining the Group. I also wish Mr. WONG a happy retirement and thank him for his valuable contributions to the Group during his tenure of office.

Looking forward, there will be both good and bad news in the market which will affect overall sentiment and volatility may increase. We will stay vigilant of market developments and continue to pursue our balanced growth strategy. Our consistently solid results reflect the dedication and diligence of every member of the Group. I would like to thank them for their contributions. At the same time, I wish to thank our customers and shareholders for their continuous support and the Board for their wisdom and counsel. With our strong franchise and financial position, I truly believe that the Group will continue to be well positioned to capture quality growth opportunities ahead.

HE Guangbei
Vice Chairman & Chief Executive

Hong Kong, 29 August 2013