CHIEF EXECUTIVE'S REPORT

For the first six months of 2014, the Group's revenues and profits reached new interim heights. The financial results reflected our proactive asset allocation strategy and consistent progress in building our franchise in core businesses. During the period, we stayed alert to the changing market conditions while grasping opportunities to grow our business. The Group maintained its proactive yet prudent approach in managing its balance sheet to support its growth strategy. We recorded encouraging growth in both loans and deposits. All key financial ratios were maintained at sound levels. We also made satisfactory progress in the execution of our business strategy with positive feedback from customers. These promising developments lay a good foundation to support our future growth.

The moderate growth momentum of major economies continued in the first half of the year. Overall liquidity in the banking sector stayed abundant and market interest rates remained low. For the banking industry in Hong Kong, the operating environment was mixed. On one hand, the local stock and property markets saw reduced activities which negatively affected the securities and mortgage businesses. On the other hand, banks captured business opportunities from strong loan demand and further policy relaxation in the offshore RMB business.

Performance Highlights

Proactive balance sheet management

- **Enhanced capital strength.** Maintaining a solid capital position remains our top priority as it gives us the flexibility to manage and grow our business at all times. Total capital ratio at 30 June 2014 was 16.90%, up 1.10 percentage points from that at the end of 2013. Tier 1 capital ratio improved to 11.84%, up 1.17 percentage points. We achieved this improvement through our conscious efforts to reserve capital and optimise the management of risk-weighted assets.

- **Focused on quality loan growth.** Our overall loan portfolio grew by 10.5% as at the end of June 2014. We continued to adopt stringent risk management and credit control to deliver quality growth. Overall loan quality remained healthy with classified or impaired loan ratio staying at a low level of 0.31%.

  Our corporate portfolio did particularly well with a growth of 12.5% as we acutely seized the business opportunities amid strong market demand. Trade finance increased by 8.6%. During the period, the Group actively participated in a number of significant syndicated loans. We also arranged cross-border direct loans for leading Mainland corporates to support their overseas expansion.

  The Group's personal loan book grew by 5.8%, of which residential mortgage loans grew by 2.0%. The Group remained the market leader in new mortgage loans despite the reduced activities in local property market and keen competition. We continued to provide an extensive range of products and services and participated in joint promotions of primary property development projects.

- **Effective deposit strategy.** In view of the strong loan demand, we expanded our deposit base by 8.5% to support the expansion of our lending business. The Group's loan to deposit ratio stayed at a solid level of 65.87%, up 1.24 percentage points from the end of 2013. Our deposit strategy did not just rely on pricing but was also integrated with our customer acquisition strategy. We launched successful marketing campaigns to bundle deposit product with other products or services for targeted customer segments. As a result, this not only helped expand our deposit pool but also acquire new customers.

- **Optimised asset allocation.** During the period, we continued to optimise our asset mix to ensure efficient use of funds. We allocated more funds to loan business and RMB business in view of the market opportunities. Meanwhile, we closely monitored market changes and adjusted our investment portfolio to enhance return. We increased our holdings in certain government bonds and high-quality corporate bonds. Average yield of the Group's total interest-earning assets improved by 27 basis points year-on-year which helped drive improvement in net interest margin.

Consistent progress in business development

- **Solid progress in offshore RMB business.** The Group further upgraded its competitive edge in each business line and maintained its leadership in major offshore RMB businesses. Riding on the opportunities from the Shanghai Free Trade Zone, the Group successfully helped corporates to set up cross-border funding pools in RMB and other foreign currencies and provided cross-border RMB loans to corporates established in the Shanghai Free Trade Zone. The Group underwrote the largest offshore RMB corporate bond issuance during the period as the sole global coordinator and joint bookrunner. In the Hong Kong RMB insurance market, the Group maintained its leading position with popular RMB insurance products launched.

  As the Clearing Bank for offshore RMB business in Hong Kong, BOCHK continued to enhance its clearing services in both Hong Kong and overseas regions. We also worked closely with BOC's overseas entities to reinforce the BOC Group's position as the leading provider of clearing services for offshore RMB business in different parts of the world.

- **Enhanced wealth management proposition.** We delivered encouraging performance in our wealth management business riding on the success of our customer segmentation strategy and comprehensive product offerings. Our customer segmentation strategy aims to promote total relationship management by providing more targeted products and services to meet customers' needs. With the launch of Enrich Banking and enhancement of Wealth Management Service, we successfully acquired new customers and increased product penetration for the mid- and high-end segments. Targeting affluent private customers in need of more tailor-made services, our Private Banking business advanced well in expanding its customer base, further strengthening its business platform and increasing its brand awareness.

  In addition, we continued to deepen and broaden our wealth management products and services, covering investment products, family wealth management, financing, retirement solutions and insurance products. Sales of funds and insurance products did particularly well as we broadened our product range to meet customers' investment needs. We continued to strengthen our stock brokerage services and enriched our Monthly Stocks Savings Plan with more stock choices including RMB-denominated stocks. Our comprehensive online securities services continued to provide customers with the utmost convenience. In recognition of its service performance, BOCHK was granted the "Online Securities Platform of the Year – Hong Kong" by Asian Banking and Finance.

- **More convenient and efficient servicing platform.** To better serve our target corporate customers, we set up a Corporate Services Centre last year. We received positive customer feedback on our enhanced service efficiency and quality.

We also streamlined the application process and launched the 1-hour preliminary approval service to offer a prompt and flexible financing solution to small businesses. Our cash management services introduced same-day online payroll service, which significantly reduces the time gap between processing and payment. To enhance SME customer services, we also optimised our Business Integrated Account service to provide different products and business privileges. Over the past few years, we have been making solid progress in developing our cash management platform to provide efficient and convenient services to our customers. In recognition of its outstanding performance, BOCHK was presented the "Achievement Award for Best Cash Management Bank in Hong Kong" by Asian Banker and the "Hong Kong Domestic Cash Management Bank of the Year" by Asian Banking and Finance.

As a market leader in the mortgage business, the Group introduced the Mortgage Expert mobile application to facilitate a more convenient home-buying process for our customers. The application pioneered the property valuation price alert function plus other features, including mortgage budget planner and online appointment for mortgage application.

The BOCHK e-Wallet – Mobile Payment Services introduced in 2013 were further extended to support UnionPay QuickPass payment, which was the first-of-its-kind in the market, allowing customers to enjoy cross-border dual-currency mobile payment. The Group also launched the first 3-in-1 Contactless Payment Service in the market, allowing merchants to accept Visa payWave, MasterCard PayPass and UnionPay QuickPass with one reader.

- **Close collaboration with BOC.** Cross-border business and offshore RMB business are the two key strategic focuses of the BOC Group. We recognised a lot of synergies and captured new business opportunities in these areas through our joint efforts with BOC. During the period, we continued to deepen and expand our scope of cooperation. Together, we grew our cross-border lending business to support the financing needs of the BOC Group's major customers. In addition, we set up a regional cooperation mechanism among the Guangdong, Hong Kong and Macau operations of the BOC Group, further expanding our service capabilities in these three regions.

Financial Highlights

- Net operating income before impairment allowances increased by 9.4% year-on-year to HK$21,649 million, which was mainly driven by the increase in net interest income.

- Operating expenses increased by 9.2% to HK$6,216 million with an industry low cost to income ratio of 28.71%. Operating profit before impairment allowances increased by 9.5% to HK$15,433 million compared to the same period last year.

- Profit attributable to the equity holders increased by 7.4% year-on-year to HK$12,083 million, mainly driven by the sustainable growth in core income but partly offset by lower net gain from fair value adjustments on investment properties. Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.20% and 14.75% respectively.

- Net interest income rose by 17.4% year-on-year to HK$15,656 million, driven by the expansion in both average interest-earning assets and net interest margin. Net interest margin widened by 7 basis points to 1.74%.

- Net fee and commission income grew by 2.9% to HK$4,815 million, mainly driven by commission income from funds distribution and loans. Commission income from credit cards, bills, trust and custody services as well as currency exchange also recorded satisfactory growth.

- Net trading gain decreased by 7.8% to HK$1,329 million. The decrease was mainly attributable to the mark-to-market changes of certain foreign exchange products and equity instruments.

- As at 30 June 2014, total assets amounted to HK$2,085.2 billion, up 1.9% compared to the end of 2013. The growth was driven by higher deposits from customers, which rose by 8.5%, but was largely offset by the lower deposit balance the participating banks placed with the RMB Clearing Bank.

Business Review

Personal Banking marked steady growth during the period. Net operating income before impairment allowances grew year-on-year by 1.7% to HK$6,953 million. Due to higher expense growth, profit before taxation dropped by 5.2% to HK$3,388 million.

The Group continued to maintain market leadership in its core businesses including residential mortgage, UnionPay International merchant acquiring business and card issuing business in Hong Kong. Credit card business sustained its growth momentum in the first half of 2014. During the period, we launched various promotional campaigns to acquire new customers and encourage securities transactions. Commission income from securities brokerage business dropped on the back of lower transaction volume. Funds distribution business recorded encouraging growth as we continued to broaden our product offerings.

Corporate Banking business did well in developing its business and captured opportunities from strong loan demand during the period. Net operating income before impairment allowances increased by 6.6% to HK$8,285 million. Profit before taxation grew by 8.6% to HK$6,379 million.

The Group further enhanced its position as a prominent loan arranger in Hong Kong and recorded satisfactory loan growth. Riding on its strong franchise in the RMB business, the Group also expanded its customer coverage to overseas financial institutions and central banks. We continued to enhance our competitive edge in cross-border business and provided a full range of innovative cross-border financial services to meet the diverse needs of SMEs. Our custody business successfully enlarged its institutional customer base and established business relationships with a number of new RQFII applicants from the Mainland of China, Hong Kong, the Taiwan region and other overseas countries. Our cash management service continued to expand its service coverage.

Treasury segment recorded a strong performance in the first half of 2014. Net operating income before impairment allowances grew by 36.1% to HK$6,054 million. Profit before taxation increased by 37.0% to HK$5,367 million.

The Group took a proactive but prudent approach in managing its banking book investments and to enhance return. In view of the RMB exchange rate fluctuation, we provided value-preservation solutions to customers and received positive response. In bond underwriting business, the business volume soared as we successfully captured opportunities from increasing market demand. In banknotes business, the Group successfully completed the first banknotes transaction for a central bank in Central America.

Mainland business maintained satisfactory growth amid the challenging operating environment. Net operating income increased by 35.8% year-on-year, driven by the strong growth in net interest income and net fee income. Deposits from customers and loans grew 0.2% and 4.5% respectively from the end of last year. The slower economic growth on the Mainland posed pressure on certain industries, resulting in an increase in the amount of new classified or impaired loans in the first half of 2014. The Group remained focused on managing its asset quality through strict adherence to prudent credit policy and close monitoring on the credit situation. For our business development, we continued to enrich product offerings and enhance distribution channels. During the period, NCB (China) obtained approval to establish the Suzhou Branch and Shanghai Free Trade Zone Sub-branch in addition to the Group's existing 41 outlets. These two outlets have already commenced business in July.

Insurance business recorded robust growth in net insurance premiums in the first half of the year. However, net operating income before impairment allowances and profit before taxation dropped year-on-year by 40.3% and 50.7% to HK$411 million and HK$278 million respectively. The decline was mainly caused by a higher provision for insurance liabilities as a result of declining market interest rates.

The Group maintained its leading position in the RMB insurance market. We launched new products to meet customers' needs. The Group also actively explored new distribution channels and established partnerships with brokerage houses to promote insurance products. In recognition of the Group's outstanding performance in RMB services, BOCG Life won accolades in all of the RMB insurance product categories in the "RMB Business Outstanding Awards 2014" organised by local media.

Outlook

Looking ahead, we expect the global economy to continue its moderate pace of recovery. Nevertheless, we need to be cautious of the potential downside risks in the market, arising from uncertainty over the pace of US monetary policy normalisation and growth momentum of major economies. We expect that the Mainland economy will be stable which will continue to support Hong Kong's economic growth. As the Mainland economy is adjusting its growth model, we also need to closely monitor the changes in the operating environment, which may directly or indirectly affect our customers.

During the first half, a number of regulatory initiatives were introduced to promote the further development of the offshore RMB markets. RMB internationalisation has advanced at a rapid pace, as measured by continuous growth in offshore RMB deposits, increased RMB portfolio flows and the surging issuance in the offshore RMB bond market. This success reflects the effectiveness of a combination of policy initiatives in enhancing the importance of the RMB globally and increasing attractiveness of RMB-denominated assets.

In the second half, one of the key market focuses will be the launch of the "Shanghai-Hong Kong Stock Connect". In this ground-breaking initiative, both Mainland and Hong Kong investors will, for the first time, have mutual market access to make their investments. Riding on this unique opportunity, the Group has set up a task force for the formal launch of A-share trading service. To help customers get prepared, we organised an investment seminar to provide first-hand information about "Shanghai-Hong Kong Stock Connect" and relevant investment strategies. We also launched a new web page in our website which provides comprehensive A shares information and analytical tools, assisting customers in grasping market dynamics. While staying on top of the latest development, we will provide suitable securities services to help customers capture potential investment opportunities.

In May 2014, the implementation rules for the free trade account system in the Shanghai Free Trade Zone were announced. This will help further promote the development of the cross-border business in the free trade zone. The Group has captured the emerging opportunities and helped customers with the arrangement of cross-border funding pools and loans. To better serve our customers, through our Mainland arm, NCB (China), a sub-branch was set up in July in the Shanghai Free Trade Zone to provide comprehensive cross-border financial services to companies in the zone.

The development of the offshore RMB market has provided the Group with favourable conditions to further diversify its business by customer, geography and product. We have been making remarkable progress riding on our strong franchise and close collaboration with BOC. We will continue to work closely with BOC to further deepen and expand our collaboration to create more opportunities across the BOC Group. Apart from offshore RMB business, we jointly provide total solution services to our customers, covering cash management, custody service, wealth management, private banking and cross-border services.

Over the past few years, we have taken significant steps to build new business capabilities and enhance operating efficiency to better serve customer needs. We are pleased that our improvements were well recognised by our customers, who entrusted us with more of their assets and business. We will continue to invest in our franchise, including business platform and people. Investing in technology upgrades will also be our key focus to drive innovation and enhance customer experience. At the same time, we recognise the importance of disciplined spending. Going forward, we will continue to focus our investments on the Group's key strategic areas to support sustainable growth while ensuring efficient use of our resources.

Banks are now facing a much tighter regulatory environment, especially with regard to the capital, liquidity and risk management. While striving to capture market opportunities, we will continue to exercise stringent risk management to safeguard asset quality. We will also focus on ensuring that we are allocating capital efficiently to support our business needs, meet the regulatory requirements and generate solid returns for our shareholders. The major objective of the Group's capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. Factors including business needs, risk appetites, regulatory requirements (both existing and future) and market environment, will be thoroughly considered in our capital planning to ensure efficient use of our capital for the Group's sustainable development.

Lastly, on behalf of the Group, I would like to take this opportunity to express our sincere gratitude for the valuable contributions of three retired board directors, Mr LI Lihui, Mr ZHOU Zaiqun and Dr FUNG Victor Kwok King. I would like to welcome Mr CHEN Siqing, who joined the Company as Vice Chairman, and Mr ZHU Shumin and Mr YUE Yi, who joined as Non-executive Directors of the Company. I also wish to thank our customers and shareholders for their continuous support, the Board for their wisdom and counsel, and last but not least, every member of the Group for their dedicated efforts. By capitalising on our unique competitive edge in offshore RMB and cross-border businesses, we will continue to enhance our total solution capabilities to better serve our customers in Hong Kong, the Mainland of China and other parts of the world. 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, 19 August 2014