Chief Executive's Report

Under challenging operating conditions, Hang Seng achieved resilient results in 2012 while investing in our core businesses to drive sustainable growth. Profit attributable to shareholders increased by 15% on the prior year with return on equity reaching 22.9%.

Our balanced growth strategy drove double-digit increases in both deposits and lending, while effective funding cost management contributed to the widening of our net interest margin to 1.85%.

Successful revenue diversification and product cross-sell initiatives contributed to an 8% increase in non-funds income. We achieved revenue growth in life insurance and retail investment fund sales of 49% and 25% respectively, and our overall wealth management income grew by 14%.

Our cost efficiency ratio improved by 0.6 percentage points to 34.4% as a result of revenue growing faster than operating expenses.

The credit quality of our loan portfolio remained sound, with a reduction in loan impairment charges.

Leveraging our good China connectivity and product development strength, we continued to lead the market with innovative offshore renminbi products, including the first renminbi-denominated gold exchange-traded fund to be introduced to the market.

In mainland China, Hang Seng Bank (China) Limited continued to invest in network expansion and leverage the deepening connectivity between the Mainland and Hong Kong. We opened seven new outlets and enhanced cross-border business referral mechanisms. We also established the first joint venture securities investment advisory company in Guangdong province under the Closer Economic Partnership Arrangement (CEPA).

Profit before tax was up 15% at HK$22,113m, reflecting an increase in return from Industrial Bank Co., Ltd. and the disposal gain arising from the sale of our general insurance business in July.

Operating profit rose by 10% to HK$15,606m compared with 2011. Operating profit excluding loan impairment charges increased by 9% to HK$15,992m.

Following our continuing investment for business expansion, operating expenses rose by 6% to HK$8,389m, due mainly to increases in staff compensation and benefits, increased marketing expenditure, and higher rental and depreciation costs.

With the 8% rise in net operating income before loan impairment charges outpacing the increase in operating expenses, our cost efficiency ratio improved to 34.4% – down 0.6 percentage points compared with 2011.

Financial Performance

Total assets grew by HK$101bn, or 10%, to reach HK$1,077bn. Customer advances were up HK$56bn, or 12%, at HK$536bn, due mainly to increases in corporate and commercial lending and residential mortgage loans. Success with acquiring new personal and business customers in target segments helped drive the HK$76bn, or 10%, rise in customer deposits (including certificates of deposit and other debt securities in issue) to HK$819bn.

The return on average total assets was 1.9% – up 0.1 percentage point year on year.

The expansion in customer deposits and lending underpinned a 4% rise in average interest-earning assets. Improved deposit and loan spreads and increased return on the life insurance investment funds portfolio drove the 8% growth in net interest income to HK$16,946m. Net interest margin was 1.85% – an increase of seven basis points.

Net fee income rose by 5% to HK$5,086m. Growth in fee-related revenue from retail investment fund sales as well as credit card, insurance agency and trade-related services business more than offset the drop in fee income from stock broking and related services.

Trading income was up 15% at HK$2,063m. We recorded a net revenue gain from securities, derivatives and other trading activities compared with a net loss in 2011. Increased net income from funding swaps supported the 8% growth in foreign exchange income.

Loan impairment charges were down HK$54m, or 12%, at HK$386m. Loan impairment charges in the second half of 2012 fell by 45% compared with the first half.

Effective credit risk management ensured we maintained good asset quality, resulting in an eight-basis-point improvement in impaired loans as a percentage of gross advances to 0.25%.

Our share of profits from associates rose by 33%, driven largely by the increase in contribution from Industrial Bank. On 8 January, we announced that we will no longer account for Industrial Bank as an associate following its completion of a private placement on 7 January. We will now recognise our holding as a financial investment and will therefore not account for our proportionate share of results and net assets.

On a Basel II basis, our capital adequacy ratio at 31 December 2012 was 14.0%, compared with 14.3% a year earlier. Our core capital ratio was up 0.6 percentage points at 12.2%.

Positioning For Growth

While global macroeconomic uncertainties will persist in 2013, we expect stable economic growth on the Mainland and favourable policy development under CEPA and the Qianhai initiatives. Hong Kong's economy will be underpinned by firm domestic consumption, strong trade and capital flows from the Mainland, and will continue to benefit from initiatives to further promote the internationalisation of the renminbi.

As the leading domestic bank in Hong Kong supported by a strong brand, extensive branch network and a loyal customer base, Hang Seng is well positioned to benefit from China's economic transformation. We will maintain balanced growth in our core businesses, invest in our branch network, delivery channels and product propositions to increase target customer intake and drive wealth management revenues. We will increase connectivity to maximise cross-border opportunities from the closer integration of the Mainland and Hong Kong economies.

In 2013, Hang Seng celebrates its 80th anniversary. Throughout our history, we have upheld the principles of service excellence, integrity and sound business management established by our founders.

Our success over the years rests in large part on the professionalism and passion of our people. I wish to thank them for their ongoing drive and dedication in working to grow our business and ensure we provide a premium service. I would also like to thank our customers for continuing to place their trust in us.

True to our roots, we remain committed to the community we serve through ongoing support for sports promotion, education and care for the aged and disabled, partnering with charitable organisations, and engaging staff volunteers.

We will adhere to a high standard of corporate governance while embracing a proactive approach to business and client management to deliver quality and sustainable growth in the best interests of customers and shareholders.

Rose Lee
Vice-Chairman and Chief Executive
Hong Kong, 4 March 2013