

## Setting New Records

### MANAGEMENT DISCUSSION AND ANALYSIS

#### 1. Work Initiatives

In 2000, the Bank continued to adopt the proven strategy that, over the two years plus period, has gained broad market recognition. That is, the Bank shall pursue simultaneously progressive business development and dealing with historic issues, under the guiding principle of reform and innovation. This is under such strategy that has enabled the Bank to successfully handle the severe challenges brought about by the financial crisis over the past two years. As a result, the Bank recorded satisfactory business performance in 2000 and made improvement in many aspects, with profits hitting record high level.

#### 2. Business Performance

##### a. Earnings reached historic high levels

In 2000, a number of the Bank's profitability indicators reached historic heights. Operating profit before provision was HK\$952 million, representing an increase of HK\$283 million, or 42%, over the HK\$669 million in 1999. Net profit was HK\$532 million, a significant increase of HK\$423 million, or 390%, over the HK\$109 million recorded in 1999.

##### b. Sustained growth in loans and deposits

One of the factors leading to the Bank's earnings accretion was the ability to maintain commendable loan growth. At a time when the overall loan demand in Hong Kong was still shrinking, the Bank's loans increased in 2000 by HK\$4.5 billion, or 15.8%, from the 1999 level of HK\$28.3 billion, putting the 2000 year-end figure at

HK\$32.8 billion. Apart from expansion in asset size, further improvements have been made in terms of asset quality. At 2000 year-end, various asset quality indicators pointed to a further improvement in the quality of the Bank's loan portfolio.

Asset Quality	2000	1999	1998
Total Loans and Advances (HK\$ billion)	<b>32.79</b>	28.32	25.90
– Lending to Listed Companies as a percentage of Total Loans and Advances	<b>24.5%</b>	28.8%	25.8%
– Top 20 Customers Exposure as a percentage of Total Loans and Advances	<b>21.0%</b>	30.2%	33.7%
– Mainland Exposure as a percentage of Total Loans and Advances	<b>22.3%</b>	29.2%	37.0%
– Mortgage Loans as a percentage of Total Loans and Advances	<b>33.8%</b>	31.1%	23.3%

Continuous growth in loan assets has lifted the Bank's total assets to reach HK\$56.7 billion as of 2000 year-end, representing an increase of HK\$7.9 billion, or 16%, from 1999's HK\$48.8 billion. On deposits, the outstanding figure as of year-end was HK\$48.7 billion, which was an increase of HK\$7 billion, or 16.7%, when versus the HK\$41.7 billion for 1999.

In the three years from 1998 to 2000, the Bank's loans had grown HK\$12.8 billion, or 64.0%; deposits had



Back row

**Mr. Kane G. Gong**

Executive Vice President &  
Head of Group Finance & Operations

**Mr. Kenneth Kong**

Executive Vice President &  
Head of Corporate Banking Group

**Mr. Kelvin Lo**

Executive Vice President &  
Chief Group Counsel

Front row

**Mr. Zhang Mingqian**

Executive Vice President &  
Alternate Chief Executive Officer

**Mr. Cai Zhongzhi**

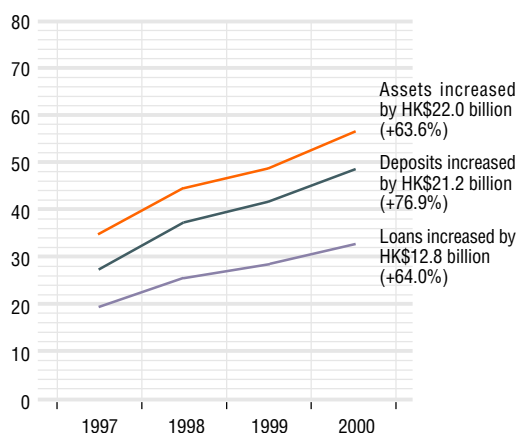
President &  
Chief Executive Officer

**Mrs. Doreen Chan**

Executive Vice President &  
Head of Retail Banking Group

increased HK\$21.2 billion, or 76.9%; total assets had risen by HK\$22.0 billion, or 63.6%.

### Three-year Growth (HK\$ billion)



#### c. Realignment of loans and deposits resulting in margin widening

The Bank's interest margins widened in 2000, a reversal of the margin squeeze situation experienced in 1998 and 1999. The prime rate in Hong Kong had been raised thrice in the first half of 2000 by an aggregate of 1% to 9.5%. Despite rising interest rates and that loan return and yield were pressurized by market competition, the Bank was able to improve its average return on loans through a combination of loan asset reshuffling and development of high yield products. The improvement in loan returns, coupled with stringent efforts on funding cost control, has resulted in a 38 basis point widening in the Bank's net interest margin in 2000.

#### d. Continuous launch of new products; hire purchase and leasing, and personal loan businesses established

To improve the overall yield of the Bank's loan portfolio, a series of new products and services was launched

during 2000, focusing on lifting overall returns on the loan portfolio and providing customers with a more comprehensive range of products.

### New Products and Services Launched in 2000

February	'The Smart MPF Master Trust Scheme'
March	'Business Account Services', 'Stock by Phone' and 'Mobile Banking Services'
April	A brand new 'Personal Line of Credit' and an enhanced 'Personal Installment Loan'. Cargary Securities launched 'Securities Margin Financing Service'
June	First phase of 'i-banking' service. Revamped corporate web site <a href="http://www.citickawahbank.com">www.citickawahbank.com</a>
September	First-in-market 'Overdraft Balance Transfer Service' and hire purchase and leasing services
October	Ka Wah Credit Limited established
November	'Tax Loan' at HK\$1 interest charge

It is worth mentioning that hire purchase and leasing facilities on machinery and vehicles were introduced towards the end of September, while Ka Wah Credit Limited was established in early October to strengthen our efforts in building personal loan business and widening our customer base. At the end of 2000, hire purchase and leasing related facilities approximated HK\$500 million, and the loans drawn down through Ka Wah Credit Limited amounted to HK\$40 million. These businesses are expected to provide more prominent returns in 2001, helping to improve the yield on the Bank's overall loan portfolio.

*e. Exploring non-interest income avenues*

Current industry trend is that banks would have to develop non-interest income streams, apart from making spreads on the granting of loan facilities. The Bank's non-interest income in 2000 was HK\$449 million, which was a major increase of HK\$197 million, or 78%, over 1999's HK\$252 million. The main impetus for the non-interest income growth was fees generated from new corporate facilities, bills, distribution of retail banking products, net gains on equity and forex investments, as well as a HK\$25 million profit from the disposal of Hong Kong Stock Exchange shares. In the long term, the Bank shall continue to explore additional non-interest income avenues, and intends to raise further the contribution of non-interest income towards overall earnings from the current level of 28%.

*f. Securities and capital market businesses expanded*

In 2000, Cargary Securities and Ka Wah Capital recruited additional professionals and intensified efforts in developing the securities and investment banking businesses. In the first half, Cargary Securities started to provide customers with margin financing and IPO financing. The first stand-alone securities distribution outlet was set up in October, aiming to strengthen customer contact and business development drive. The aggregate profit of Cargary Securities and Ka Wah Capital in 2000 exceeded HK\$100 million, and separately increased by 113% and 26% from the 1999 levels.

*g. Reform in Treasury Department initiated, aiming to enhance investment returns*

The Bank's financial position was stable in 2000: at year-end the capital adequacy ratio was 17.1%; loans to deposits ratio was 67.4%; loans to total assets ratio was

57.9%; the property-related loan ratio was 48.3% and the average liquidity ratio was 42.1%.

Having ensured financial stability, the Bank started to initiate reforms in the Treasury Department, with restructuring on the department lineup, and re-examination on the investment management strategy. The results of these reforms have led to contact reinforcement between the Bank and other financial institutions; business referrals amongst departments; new product development; and better investment returns after the Bank's liquidity requirements were guaranteed. At the same time, the Department successfully contained funding costs in the rising interest rate environment. The Department launched the Bank's certificate of deposit issuance facility in October, which was met with active market response and widened the Bank's funding sources, as well as lifting the proportion of institutional investors in the Bank's deposit base. The outstanding amount in issue as of year-end was HK\$1.65 billion.

*h. Back-office support functions improved*

Current market competition is multi-faceted. Aside from business marketing at the front line, competitiveness is also determined by the quality of the banks' support functions such as information technology and financial analysis. Therefore, in 2000, the Bank focused on strengthening its back office operations and financial management functions. Work has started to replace the Bank's core banking system in order to raise the standard of its information system, and to improve on its internal management capability and infrastructure including our capabilities in financial management, research and analysis, and operation flow. The new system is designed to cope with the Bank's long-term business development needs.

*i. Resolved HK\$1.32 billion of problem loans*

The Bank resolved a total of HK\$3.77 billion of problem loans in 1998 and 1999, putting the situation basically under control and resolution. In 2000, the Risk Assets Management Department has adopted more flexible approaches, through cash collection and asset-for-debt swaps, resolved another HK\$1.32 billion of problem loans. The classified exposure at year-end, including sub-standard, doubtful and loss categories, was reduced to approximately HK\$2.06 billion, representing 6.3% of total loans as of year-end. The further resolution of the problem loans issue has resulted in a substantial drop in loan loss provisions from HK\$938 million in 1999 to HK\$319 million in 2000.

<b>Problem Loans Recovery</b> (HK\$ million)	<b>2000</b>	1999	Total
Cash Recovery/Assets			
Collected	<b>958</b>	696	1,654
Collateral Realization	<b>132</b>	278	410
New Collateral	<b>63</b>	310	373
Debt Restructuring	<b>168</b>	658	826
<b>Total</b>	<b>1,321</b>	1,942	3,263

*j. Human resources development*

At the end of 2000, the total number of employees stood at 1,035. Management believes it is 'people' that make the difference and create success for an organization. Hence, to attract and retain people of talent and good performance, the Bank makes continuous efforts in benchmarking and improving the remuneration structure. A bonus scheme was initiated at the beginning of the year with an objective of cultivating common goals amongst employees, stimulating functional and cross-functional teamwork, driving individual performance and

results for the Bank. The scheme has linked bonus amounts in direct correlation to the Bank's profitability, departmental performance and individual contribution. Total staff costs of the Bank in 2000 was HK\$405 million.

<b>Staff Force</b>	<b>2000</b>	1999
1. By distribution:		
Head Office	<b>593</b>	463
Branches	<b>310</b>	343
Subsidiaries	<b>82</b>	54
Overseas Offices	<b>50</b>	53
Total	<b>1,035</b>	913
2. By grade:		
Assistant Manager and Above	<b>408</b>	281
Below Assistant Manager	<b>627</b>	632
Total	<b>1,035</b>	913
3. Turnover Rate	<b>29.8%</b>	22.1%

A Senior Executive Share Option Scheme is maintained by the Bank, under which eligible senior executives of the Group are granted share options for subscription of shares of the Bank. At the end of 2000, the number of shares outstanding under the Option Scheme was 32,616,928.

The Bank has also put emphasis on staff training and people development. A total of 194 classes were organized during the year, the curriculums covering a wide range of subjects such as product and computer knowledge, marketing and servicing skills.

### **3. Major Initiatives for 2001**

*a. Strive for further growth in scale*

Although the Bank's business has undergone large-scale expansion over the past three years, it is vital to pursue

further asset growth in order to cope with our long-term development. Therefore, the Bank will continue to grow its assets at an appropriate, healthy and above-market average rate. At the same time, the Bank will actively consider business expansion opportunities through mergers and acquisitions so as to elevate the Bank's scale of operations to a higher level and position the Bank as one of the leading operators amongst local medium-sized banks.

*b. Further improve profitability and operational efficiency*

Both the Bank's economic effectiveness and its ability to generate profits, such as return on equity, interest margins, return on assets and fee income, have room for improvement. Looking ahead, the Bank will strive to maximize shareholder returns by focusing on the development of high yield products and services, and the enhancement of efficiency and profitability.

*c. Stringent control on funding costs and operating expenses*

In 2000, staff costs and other operating expenses have evidently increased as a result of the Bank's business development and launch of new products. The Bank will in future exercise more stringent cost control in order to maintain operating expenses at a level that is in line with income growth. At the same time, the Bank is aware that there is a possibility for a further drop in interest rates. The Bank will closely monitor this trend and will take effective measures to control its impact.

*d. Continue to launch new products and services including credit cards*

The Bank will continue to enhance its range of products and services, encompassing credit cards, personal loans, bancassurance and electronic banking services. The Bank currently plans to launch its credit card in 2001 and promote bancassurance, thereby providing customers with a more comprehensive range of quality products and services.

*e. Further resolve problem loans issue*

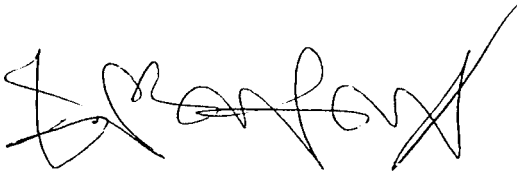
The Bank has made significant progress in the recovery of problem loans in the past three years. The Bank will continue to deal with the problem loans issue, aiming for whole resolution and improving the coverage ratio through the adoption of various approaches.

The Bank has grown from a small-sized bank to a medium-sized bank in Hong Kong as a result of vigorous efforts made over the past three years. Our goal is to position CITIC Ka Wah Bank as one of Hong Kong's best managed medium-sized banks with two more years of hard work.

**4. Chairman Hong Yuncheng Retires, Mr. Kong Dan Elected as New Chairman**

Upon reaching retirement age, our Chairman, Mr. Hong Yuncheng, has decided to relinquish his Chairmanship of the Bank. Mr. Hong was appointed as a Director of the Bank in March, 1998, and was elected Chairman in June of

the same year. Over the past three years, Mr. Hong has led the Bank in the formulation of sound operating principles and reform strategies. As such, his contribution towards the development of the Bank is inestimable. On behalf of our entire workforce, I would like to express my most sincere gratitude to Mr. Hong for his many contributions and inspired leadership. At the same time, on behalf of the Bank, I warmly welcome Mr. Kong Dan as our new Chairman. Mr. Kong has extensive finance experience and under his leadership, I am certain the Bank will reach new heights.

A handwritten signature in black ink, appearing to read 'Cai Zhongzhi', with a large, sweeping flourish at the end.

**Cai Zhongzhi**

*President and Chief Executive Officer*