

## Management Discussion and Analysis

### 1. Operating environment and performance

Hong Kong banking industry still operated in a challenging and difficult environment in the first half of 2001. The industry was pressurized by problems including sluggish loan demand across-the-board, high unemployment rate, declining loan yield as a result of severe industry competition, and the prime rate undergoing five reductions during the first half. Despite the testing operating environment, the Bank succeeded in registering a respective growth of 0.97%, 3.13% and 4.25% in total loans, total deposits and total assets in the first half as compared to the year-end of 2000. At 30 June 2001, total loans, total deposits and total assets amounted to HK\$33.1 billion, HK\$50.2 billion and HK\$59.1 billion respectively.

The slow down of loan growth was also attributed to the Bank's conscious efforts in improving its asset quality, in exercising stringent credit scrutiny over newly booked loans and in maintaining interest margins at a reasonable level.

The Bank adopted various strategies to cope with the difficult operating environment, such as active restructuring of its loan portfolio, continuous launch of new products and services, stringent control on funding cost and realignment of loans and deposits. As a result, the Bank succeeded in maintaining a growth in its net interest income in the first half of 2001 of 7.27% to HK\$581 million. Net interest margin was at 2.14% in the first half, a fall of 29 and 23 basis points from 2.43% in 2000 and 2.37% in the first half of 2000 respectively.

At the same time, the Bank actively developed non-interest income avenues, focusing on wealth management services including the sale and distribution of unit trust and insurance, bills processing and fees generated from new loan facilities. As a result, net fees and commission income surged by 25.53% during the period. Besides providing a stable source of funding, the Bank successfully capitalized on interest rate trends through various investments. Hence, other operating income reached HK\$92 million, an increase of 53.08% over the HK\$60 million recorded in the corresponding period of last year. Non-interest income rose by 31.86% to HK\$265 million during the period. The satisfactory growth in interest income and non-interest income lifted the Bank's 2001 first half's operating income to HK\$846 million, a rise of HK\$103 million or 13.93%, when versus the HK\$743 million for the first half of 2000.

## **Management Discussion and Analysis (cont'd)**

### **1. Operating environment and performance (cont'd)**

In the first half of 2001, the Bank's operating expenses increased by HK\$61 million, or 22.06%, from HK\$275 million last year to HK\$336 million, largely due to the HK\$47 million increase in staff costs. At the end of June 2001, the total number of employees stood at 1,058, representing a net growth in headcounts of 98 from 30 June 2000. The recruitment of new staff, mostly middle and top management, IT specialists and frontline marketing executives, was necessary for the Bank's business development. During the period, operating profit before provisions amounted to HK\$510 million, an increase of 9.14% over last year's corresponding period of HK\$468 million.

The Bank's problem loans issue was basically under control. In the first half of 2001, loan loss provision fell 27.86% to HK\$142 million. Operating profit reached HK\$368 million, an increase of 36.19% as compared to the same period of last year. Net profit was HK\$307 million, representing an increase of HK\$76 million, or 32.58%, over the HK\$231 million in the corresponding period of 2000.

### **2. Financial position and subordinated notes issuance**

The Bank's financial position remained stable in the first half of 2001, with an average liquidity ratio of 52.21%. At 30 June 2001, the Bank's loans to deposits ratio and unadjusted capital adequacy ratio were at 65.97% and 15.12% respectively. In July 2001, the Bank successfully issued US\$300 million 10-year, non-call 5-year, subordinated debt notes at a coupon of 7.625%. This subordinated debt issuance enables the Bank to better manage its capital more effectively and reduce its overall cost of capital. The funds raised will provide the Bank with the funding for organic growth and possible acquisitions.

### **3. Problem loans recovery**

The Bank resolved a total of HK\$350 million of problem loans in the first half of 2001. The classified exposure at 30 June 2001, including sub-standard, doubtful and loss categories, amounted to HK\$2.32 billion, representing 7.08% of total customer loans and a slight increase over 2000 year-end's 6.45%. Specific provision made against this classified exposure was HK\$560 million, with collateral amounting to HK\$1.46 billion. This represents a coverage ratio of 87.40% and an uncovered exposure of HK\$300 million.

## **Management Discussion and Analysis (cont'd)**

### **4. Major initiatives for the second half of 2001**

#### **a. Revamp core banking system**

The Bank is in the process of revamping its core banking system in order to provide an advanced and reliable operating platform for future business development. The first phase of the new system will be launched in September 2001. The Bank will ensure a smooth transition of the systems.

#### **b. Further improve and expand product range**

The Bank will launch a series of innovative products and services, including credit cards, in the second half of 2001. The further enhancement and expansion of product range will enable the Bank to provide its customers with a more comprehensive range of quality financial services.

#### **c. Strengthen co-operation with CITIC Group and other major Mainland shareholders**

The Bank will further strengthen the business co-operation with other financial members of the CITIC Group, including CITIC Industrial Bank and CITIC Securities, with a view to creating synergy. At the same time, the Bank will strengthen co-operation with other major Mainland shareholders such as China Construction Bank and China Insurance Group.

### **5. Outlook**

CITIC Ka Wah Bank has been operating in Hong Kong for over 70 years. Over the past three years, the Bank adopted the strategy of progressive business development and innovative reforms. This has resulted in great improvement in various areas such as code and system, management quality and profitability. The Bank will continue to capitalize on its competitive advantages, namely its top management which has on average over twenty years of international banking experience. This has led to a continuous improvement in the Bank's management system and professionalism. Furthermore, leveraging on the reputation and background of its parent company, CITIC, as well as the group's presence and extensive network within the Mainland, the Bank is well poised to actively participate in market competition.

Riding on this solid foundation, the Bank will continue to operate from its base in Hong Kong. With CITIC's support and the Bank's in-depth knowledge of the Hong Kong and Mainland markets, the Bank is well positioned to capitalize on the vast opportunities that arise as a result of China's entry into the World Trade Organization. The Bank will position itself as the bridge for Hong Kong customers to develop businesses and manage their personal finances in the Mainland; the window for Mainland customers to explore worldwide opportunities; and the provider of a full range of financial services.

## **Management Discussion and Analysis (cont'd)**

### **6. Interest rate deregulation**

The Hong Kong banking industry completed its final stage of interest rate deregulation on 3 July 2001. The Bank currently has no plans to change its existing deposit rates structure. It will, however, consider launching tactical deposit campaigns, such as the recent 'high rate fixed deposit' campaign which offered a relatively high fixed deposit rate at 4% to secure longer term funding sources at a reasonable cost. In the future, the Bank will closely monitor market liquidity, fluctuations in market deposit rates, as well as its own capital requirements to determine its deposit rates.

### **7. New management appointment and change of Directors**

On 6 July 2001, the Board of Directors appointed Mr. Chang Zhenming, a Director of the Bank, as President and Chief Executive Officer. The Board firmly believes that given the important positions held by Mr. Chang in CITIC and his nearly twenty years' extensive experience in the finance industry, his new appointment will definitely be beneficial to the further development of the Bank. At the same time, the Board appointed Mrs. Doreen Chan Hui Dor Lam and Mr. Kenneth Kong Siu Chee, both Directors of the Bank, as Alternate Chief Executive Officers.

During the first half of 2001, the Board of Directors appointed Mr. Kong Dan, Mr. Yang Chao, Mr. Chang Zhenming, Mr. Zhang En Zhao, Mrs. Doreen Chan Hui Dor Lam and Mr. Kenneth Kong Siu Chee as Directors of the Bank. Mr. Kong Dan was elected as the Chairman of the Bank on 12 January 2001 while Mr. Ju Weimin was appointed as Director of the Bank effective 12 July 2001. The Board of Directors deeply believes that the broad experience and extensive business connections of these newly appointed Directors will be beneficial to the Bank's business development.

The former Directors, Mr. Wang Xianzhang, Mr. Hong Yuncheng, Mr. Zhang Mingqian, Mr. Brian Tang See King and Mr. Zhou Hanrong had tendered resignations to the Board during the first half of 2001. Mr. Cai Zhongzhi also tendered his resignation as Director of the Bank effective 6 July 2001. The Board would like to take this opportunity to express again its sincere gratitude to each Director for their contribution and guidance to the Bank during their tenure of service.

By Order of the Board  
**Chang Zhenming**  
*President and Chief Executive Officer*

Hong Kong, 3 August 2001