MANAGEMENT DISCUSSION AND ANALYSIS

Summary

(All changes in % refer to the same period last year unless otherwise specified)

Net profit attributable to shareholders:	HK$63.0m	-29.4%
Earnings per share:	HK6.1cents	-31.5%
Interim dividend per share:	HK1.8cents	-28.0%

Given the difficult economic and business environment, Asia Financial Group's profit was dragged down inevitably by the unfavourable market condition and had decreased by 29.4% to HK$63 million for the six months ended 30 June 2001. Despite these interim results, we still saw the Group's activities continued to produce healthy operating profits, reflecting the fundamental strength of our core businesses.

Economic background

To put the results into context, it may be useful to summarize the state of the economy in the first six months of 2001.

The Hong Kong economy weakened during the period. This was partly a result of the continued deflation and poor local consumer demand that have accompanied the restructuring of the local economy since the late 1990s. However, it was compounded by the deteriorating state of the overall global economy, notably of the technology sector and the US economy.

The effects on individual parts of the Group are detailed below. Essentially, we, along with the rest of the Hong Kong financial services sector, suffered from low margins and weak demand. At the same time, world stock markets weakened, with the Hang Seng Index falling 13 percent in the first half of 2001, and 19 percent since the end of June 2000, and interest rates declined. Although we adhered to a conservative investment policy, the unfavourable investment climate during the period inevitably affected the performance of our investment portfolio.

Management efforts

Management succeeded overall in protecting both business quality and market share during this challenging period. We have remained prudent and refrained from cutting margins wherever possible. At the same time, we have remained alert to new opportunities, and we are pleased to report that, alone or in conjunction with alliance partners, all three subsidiaries of the Group were able to acquire valuable new business even in this difficult environment. In order to protect our investment portfolio during a time of market volatility, our investment strategy was to concentrate on good quality fixed income debt securities and blue chip shares. Continued management focus on costs also made a measurable contribution to the bottom line.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Banking

Net profit attributable to shareholders:	HK$36.1m	+1.0%
Total operating income:	HK$171.7m	+4.5%
Net interest income:	HK$144.9m	+5.8%
Other operating income:	HK$26.8m	-2.1%
Charge for bad and doubtful debts:	HK$16.7m	-56.8%
Total loans and advances (30 June 2001):	HK$8.4 billion	+9.3%(*)
Customer deposits (30 June 2001):	HK$10.5billion	-6.2%(*)

(*) compared with outstanding balances at 31 December 2000

Net interest margin:	2.27% (First half of 2000: 2.25%)
Cost-to-income ratio:	60.9% (First half of 2000: 49.4%)
Average liquidity ratio:	46.5% (First half of 2000: 53.0%)
Capital adequacy ratio (30 June 2001):	18.6% (31 December 2000: 19.3%)

Asia Commercial Bank (the "Bank") achieved a fair result in the first half of 2001 as a result of its efforts to control interest costs and loan provisions.

Loan business in most sectors, including trade finance, corporate loans and consumer finance, remained steady during the period. Mortgage business saw satisfactory growth, despite keen market competition, owing to pricing and marketing efforts. The Bank has also been investing in new and upgraded infrastructure, which we expect to produce positive future returns. This includes online banking capabilities, which were introduced in July 2001. There are plans to enhance the function to attract more customers from using this service.

The Bank's credit card and life insurance products, launched in February and April respectively (see under Alliances below), both got off to a good start and show every sign of doing well in the second half of the year and beyond. We also expect steady growth in such areas as hire purchase and consumer loans. Special effort and attention will be put to attract new customers so as to enable cross selling of high yield and non-interest income products/services. In addition, the Bank is exploring Mainland-related opportunities and other ways in which it can broaden its customer base.

The final deregulation of interest rates on deposits took place at the beginning of the second half of the year. At the time of writing, there had been no real impact on interest margins. We will continue to monitor the situation and will take a flexible approach as and when competition for funds increases.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Insurance

Net profit attributable to shareholders:	HK$20.6m	-33.2%
Underwriting profit:	HK$12.7m	+27.5%
Net investment loss:	(HK$5.2m)	n.a.
Interest and other income:	HK$27.2m	-15.5%
Premium turnover:	HK$229.8m	+11.8%
Operating expenses:	HK$23.7m	-1.8%

Asia Insurance experienced a very healthy 27 percent increase in underwriting profit, even as operating income showed a slight decline. This is a creditable result in view of continued over-capacity in the Hong Kong general insurance industry. The reasons include a long overdue firming of statutory liability insurance premiums, some welcome growth in market share and continued careful cost-management.

The net profit figure was depressed by the decline in value of investments and interest income, reflecting the downward trend of both interest rates and the equities markets during the first half of the year. Seen against this cyclical background, Asia Insurance continues to stand out as an exceptionally profitable Hong Kong insurer.

In June, we took a 30 percent stake in Professional Liabilities Underwriting Services Ltd ("PLUS"), which offers coverage to members of professional groups – an area of business into which Asia Insurance is expanding aggressively. Together with the continued effects of more realistic premiums, this makes the outlook for the rest of the year positive.

Investment Services

Net profit attributable to shareholders:	HK$4.3m	-70.0%
Total operating income:	HK$31.5m	-28.2%
Total operating expenses:	HK$22.9m	+11.1%

Of all the Group's divisions, Asia Investment Services is the most exposed to the performance of the stock market, and this was reflected in the results of the first half of 2001. The decline in stock market turnover had an inevitable impact on our brokerage income, while our corporate finance and advisory activities were under similar pressure as share underwriting, IPOs and other corporate business fell sharply.

Management is working hard to expand the client base and the range of services. Investment seminars and other marketing efforts are attracting more clients for our brokerage and asset management services, and we are pleased to report that the amount of funds under our asset management services rose from US$100 million to around US$150 million during the first half of 2001. We are also exploring new opportunities on the investment banking side in such areas as corporate restructuring in both Hong Kong and the Mainland. In addition, we are investing in new trading systems, which will offer greater convenience to local and international customers in the years ahead.

It is hard to predict when the markets will recover: estimates vary from the fourth quarter of 2001 to the second half of 2002. We are confident that Asia Investment Services will be well-positioned to capitalize on the upturn when it comes.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Alliances

A key part of the Group's strategy is to play a leading role in the formation and development of alliances that enable smaller financial institutions in Hong Kong to expand market share, to increase marketing and distribution power, and to exploit economies of scale. This strategy continued to yield promising results in the first half of 2001.

Bank Consortium Trust ("BCT"), in which Asia Commercial Bank and eight other banks have jointly formed a provider of Mandatory Provident Fund services, has achieved a market share of 10 percent – an excellent foundation for the future.

In conjunction with two other BCT members, Asia Commercial Bank launched credit card services in February. The three partners pool the back office and administrative activities of credit card operations. We also joined three BCT members in pooling resources in internet banking, enabling Asia Commercial Bank to launch on-line services in July 2001.

Asia Commercial Bank and Asia Insurance have also been involved in a life insurance alliance. In April, Hong Kong Life was launched in conjunction with five other members of the BCT using members' branch networks and other channels to distribute a range of life insurance products. At the beginning of the year, BC Reinsurance was launched by Asia Insurance in conjunction with three other BCT members and other institutions to offer re-insurance services. This venture is making good progress, and more institutions are showing an interest in joining. In addition, Asia Insurance joined two companies and other investors to launch Professional Liabilities Underwriting Services Ltd, or PLUS.

As can be seen from these examples, and the others in which the Group takes part, alliances can offer us new and effective ways in which to compete with larger institutions. We will continue to take a flexible and innovative approach to teaming up with like-minded partners in the future.

Outlook

After gathering strength throughout 2000, the Hong Kong economy showed signs of slowing in the first half of 2001. Much now depends on how quickly the United States and the rest of the global economy can overcome the cyclical effects of over-capacity and over-valuation of assets, notably in the technology sector. However, much also depends on how smoothly Hong Kong itself can continue to overcome its own challenges, which are of a far more structural nature. In the short term, it is difficult to be optimistic, and it may be 12 months or so before confidence and growth make a comeback either globally or locally.

Having said that, we are confident that the Group will weather these challenges well in the second half of the year. Management will continue with the prudent yet flexible approach that has served us well during this very difficult first half. Looking further ahead, that approach will leave the Group ideally positioned for future economic recovery in Hong Kong and reform-led expansion in the Mainland.

Employees and Remuneration Policy

The total number of employees of the Group is approximately 660 (December 2000: 620). Annual remuneration increments and promotions are determined through a performance-oriented appraisal system, with the basic pay structure being reviewed from time to time to reflect market trends. In addition to the basic salary, employees also receive an annual bonus based on both the Group's and their individual performance. Housing loans, and also medical and mandatory provident fund schemes are made available to all levels of personnel. There was no share option scheme in operation during the six months ended 30 June 2001. The Group also offers various training and induction programmes to its employees.