

Hang Seng Bank's results in the first half of 2002 reflect both the success of our key strategies and the impact of the unfavourable operating environment.

Our focus on expanding non-interest income resulted in other operating income growing by 14.6% and contributing 28.9% of total operating income, compared with 24.7% for the first half of 2001. Our strict cost discipline resulted in a 2.7% reduction in operating expenses.

The results were, however, affected by a 7.6% reduction in net interest income, mainly attributable to the decline in free funds' contribution in the low interest rate environment.

Operating profit before provisions was HK\$5,849 million, a fall of HK\$118 million, or 2.0%, from the first half of 2001. However, compared with the second half of 2001, operating profit before provisions rose by 5.7%.

The increase in non-interest income indicated good progress in our wealth management initiatives. We continued to launch innovative financial services to meet more sophisticated customer needs and deepen customer relationships. Firm inroads were also made in growing our commercial banking business and mainland China operations.

### Financial highlights

Profit before tax amounted to HK\$5,978 million, a reduction of 3.3% from the first half of 2001 but an increase of 12.1% compared with the second half of 2001.

Net interest income decreased by 7.6% to HK\$5,453 million, while average interest-earning assets fell by 4.1% to HK\$442,284 million. Net interest spread improved by 17 basis points to 2.38%. This was, however, more than offset by a reduction of 26 basis points in the contribution from net free funds to 0.11%, leading to a 9 basis point compression in the net interest margin to 2.49%.

Net interest spread benefited from improved spreads on holdings of fixed rate securities in a lower interest rate environment, growth in lower cost savings deposits and a wider spread earned on time deposits. These were partly offset by a further decline in the average yield on the mortgage portfolio.

The contribution from net free funds was affected by the sharp fall in market interest rates, resulting in a reduction of HK\$623 million in net interest income compared with the first half of 2001.

Other operating income rose by 14.6% to HK\$2,212 million, with the strong growth of 27.6% in net fees and commissions to HK\$1,434 million reflecting our success in delivering wealth management services.

Reflecting the Bank's strict cost discipline, operating expenses fell by 2.7% to HK\$1,816 million. The already low cost:income ratio fell further by 0.1 percentage point to 23.7%, compared with the first half of 2001.

In the weak economy, the net charge for bad and doubtful debts for the first half of 2002 amounted to HK\$281 million, against the comparative figure of HK\$21 million which benefited significantly from the exceptionally high releases and recoveries during the first half of 2001.

New and additional specific provisions were reduced by 8.3% to HK\$528 million, with the reduction in specific charges for corporate accounts and residential mortgages offsetting the rise in specific charges for card advances and personal loans. Releases and recoveries, mainly in corporate accounts and taxi loans, reduced by 55.5% to HK\$247 million.

The ratio of total provisions as a percentage of gross advances fell to 1.38%, compared with 1.55% at the end of 2001. Specific provisions decreased by 0.16 percentage point to 0.75% and general provisions fell slightly to 0.63%.

Gross non-performing advances (after deduction of interest in suspense) fell by HK\$208 million, or 3.4%, to HK\$5,966 million, compared with the end of 2001. There was an improvement in the ratio of gross non-performing advances to total gross advances to 2.6% from 2.7% six months earlier.

We maintained strong liquidity and remained well capitalised. The average liquidity ratio for the first half of 2002 was 43.4%, compared with 46.0% for the year-earlier period. The total capital ratio at 30 June 2002 was 15.4%, compared with 15.3% six months earlier, and the tier 1 capital ratio was 12.6%, compared with 12.3%.

## Business performance

Our businesses are divided into five lines that aim at long-term higher-value creation and speedy response to customer needs.

Personal financial services remained the major profit contributor, providing 49.7% of the HK\$5,978 million profit before tax. Commercial banking contributed 9.7% of pre-tax profit, corporate and institutional banking 8.0% and treasury 17.3%. Other businesses, which mainly represent management of shareholders' funds and investments in premises, investment properties and long-term equities, provided 15.3% of pre-tax profit.

Current, savings and other deposit accounts declined by 1.5% to HK\$408.3 billion compared with the end of 2001. There was a shift of funds from time deposits to savings and current accounts, reflecting customers' preference for liquidity in the low interest rate environment.

Advances to customers (after deduction of interest in suspense and provisions) recorded growth of 1.5% to HK\$225.7 billion, despite subdued loan demand in the uncertain economic environment.

Lending to the manufacturing sector grew by 20.7%, reflecting the Bank's efforts in developing middle market and small corporate relationships. Trade finance recorded growth of 6.0%, as Hong Kong's re-export trade began to pick up in the first half of 2002.

Total advances to Mainland-related entities grew by 3.8% to HK\$9.9 billion and accounted for 4.3% of total advances at the end of June.

Residential mortgages continued to grow amid intense market competition. However, Government Home Ownership Scheme (GHOS) mortgages decreased following the imposition of a moratorium on GHOS sales between September 2001 and June 2002.

As a result of the continued reduction in the pricing of new mortgages and the repricing of existing loans, the average yield on the residential mortgage portfolio, excluding GHOS mortgages and staff loans, fell to 138 basis points below BLR for the first half of 2002, before accounting for the effect of cash incentive payments. This compared with 65 basis points and 103 basis points below BLR in the first and second halves of 2001 respectively.

### *Major businesses*

In personal financial services, growth of 7.7% in profit before tax was recorded, compared with the same period last year. Net interest income improved slightly, benefiting from the shift of customer deposits to lower cost savings although mortgage yields continued to fall.

The strong growth of 31.5% in other operating income reflected the success of wealth management initiatives. Comprising investment and insurance services, wealth management recorded a rise in contribution of 62.1% to HK\$809 million for the first half of 2002.

The investment fund business performed impressively. A rise of 210.5% to HK\$472 million in fees from distribution and management of retail investment funds was recorded.

Sales of retail investment funds, including the popular Hang Seng Investment Series, amounted to HK\$15.2 billion, an increase of 156.4% over the same period last year. The Investment Series comprised a total of 48 retail funds at 30 June, including 30 capital guaranteed funds – the largest series of guaranteed funds in Hong Kong.

Total funds under management by Hang Seng's asset management and private banking business units grew by HK\$11.3 billion, or 44.5%, to HK\$36.6 billion during the first half of the year.

The life insurance business reported good progress, with growth of 59.6% to HK\$142 million in life insurance distribution commissions.

There was a 3.2% increase to HK\$130 million in securities broking and related income.

Our integrated accounts have become a major platform to strengthen total customer relationships and expand wealth management services. In the first half of 2002, the number of Prestige Banking Centres for affluent customers increased by 26 to 59. Stamina Banking was launched in April, offering a wide variety of lifestyle privileges. ezLink Financial Services, an integrated account for customers commuting between Hong Kong and the Mainland, was introduced in February.

Credit card advances and other lending to individuals, mainly tax and personal loans, grew by 3.0% and 14.8% respectively, in line with the Bank's strategy to diversify its loan portfolios.

Commercial banking recorded a decrease of 15.8% in profit before tax. Despite the satisfactory growth in trade finance and other lending to the manufacturing sector, net interest income suffered from the reduction in lending margins. The operating result was also affected by a reduction in Mandatory Provident Fund service income and the substantial release and recovery of bad and doubtful debts in the same period last year.

A Business Banking Division was set up in May to increase our focus on small and medium-sized enterprises (SMEs), which make up the cornerstone of Hong Kong's businesses.

Corporate and institutional banking recorded a decline of 17.1% in profit before tax. The operating result was affected by the compression in corporate lending margins, a reduction in credit facilities income and lower levels of recoveries of bad and doubtful debts compared with the same period last year.

Treasury achieved encouraging growth of 19.2% in profit before tax. Interest income rose by 13.7% as the fixed rate debt securities portfolio continued to benefit in a low interest rate environment. Other operating income increased, helped by the growth in dealing profits and income from corporate treasury services. Profit on disposal of debt securities from the accrual portfolio also grew.

In mainland China, where the Bank intends to take advantage of the financial liberalisation following the country's WTO entry, there were several significant developments.

In July, our Shanghai and Guangzhou branches began offering foreign currency services to mainland Chinese residents and enterprises, while the Shenzhen branch launched the services on 5 August 2002. The Guangzhou branch opened a Prestige Banking Centre in July. The Shanghai branch moved to larger ground-level premises and opened a Prestige Banking Centre on 5 August 2002. It will shortly launch renminbi services for expatriates and foreign-invested enterprises. These developments will allow the branches to further expand their customer base and grow both their deposit base and loan portfolio.

The China Securities Regulatory Commission has granted its approval for Hang Seng Securities Limited to set up a representative office in Shanghai.

In Taiwan, we opened our first representative office in Taipei in January.

e-Banking has become an important part of our integrated multi-channel delivery network since its launch in August 2000.

At the end of June, the number of customers registered for e-Banking had grown to more than 207,000, an increase of about 17% from six months earlier. The number of internet transactions had risen to some 10% of total transactions and online share trading to about 55% of total securities transactions.

The Bank's main website, [www.hangseng.com](http://www.hangseng.com), was ranked second as at December 2001 in the list of top banking sites in Hong Kong (by reach) by NetValue, a global internet measurement company.

Meanwhile, counter transactions fell to 16.3% of total transactions in the first half of 2002 from 17.5% in the same period last year, allowing our branches to focus on product sales.

### Good citizenship

We share our success with the communities we serve through philanthropic and sponsorship activities. Our commitment is focused primarily on education, community services and sports.

Since 1995, the Bank has allocated over HK\$27 million to its scholarship schemes, benefiting more than 430 students. The award of scholarships to six Hong Kong and Mainland students to study abroad from September 2002 took the total number of students benefiting from the Hang Seng Bank Overseas Scholarship Scheme to 28.

For the fifth consecutive time, we sponsored the 'Hang Seng Bank – Help the Police Fight Youth Crime Competition'. A record number of 108,714 entries were received, the highest participation in a single crime prevention competition organised by the Police.

Almost 8,000 people have participated in about 140 activities and championships organised by the Hang Seng Table Tennis Academy so far this year. The Hang Seng All Schools Championships 2002 attracted a record 1,581 applications, an increase of 20% from the previous year. The Bank's sponsorship of the Academy will take its total sponsorship amount for the promotion of the sport to over HK\$16 million from 1991-2003. In April, the Bank won a Gold Quill Award for its role in the establishment of the Academy from the International Association of Business Communicators.

### Looking ahead

In the second half of 2002, the banking environment will remain difficult, with continued intense competition, pressure on margins, surplus liquidity and weak loan demand.

Hang Seng will put to work its considerable strengths, which include financial soundness, a large customer base, strong brand value and efficient operations, to maximise value for shareholders.

We shall continue to expand our local franchise, leverage on information technology and grow in mainland China.

Our focus on higher margin value-creating businesses, in particular wealth management and commercial banking, will be strengthened. As part of our efforts to deepen customer relationships, lifestyle banking services, segmentation and needs-based cross-selling will be emphasised. We shall also reach out to more small and medium-sized businesses.

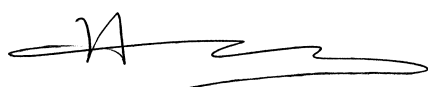
We shall leverage on information technology to improve customer convenience and cost-efficiency. Our internet banking services will be further enhanced.

We see great opportunities in mainland China, where we shall continue to expand our services and network of offices in strategically important cities. Applications have been lodged to open a branch in Nanjing and a sub-branch in Puxi, Shanghai, as well as to upgrade our Beijing representative office to a branch.

An application has also been submitted to operate personal internet banking services in the Mainland. Hang Seng Investment Management Limited has applied to open a representative office in Shenzhen.

Our financial prudence will continue in the form of asset quality control and cost leadership. Banking operations will be further streamlined for greater efficiency.

Given our solid track record and our sound growth strategies, and with the continued support of shareholders, customers and staff, we are well-positioned to meet the challenges ahead.



**Vincent H C Cheng**

*Vice-Chairman and Chief Executive*

Hong Kong, 5 August 2002