

Asia Financial Group experienced a very challenging operating environment during 2002, as it did the previous year. Against this difficult background, I wish to report that the Group's performance was satisfactory, with net group profit of HK\$43.3 million, a 43.8% increase on 2001.

Weak Operating Environment

The global economy remained weak in 2002 with leading economies showing continued slow growth and market weakness. Corporate accounting scandals, fears of war and uncertain economic prospects dampened consumer and business activity, despite record low interest rates. The Hong Kong domestic economy remained sluggish, with continued deflation, fears of unemployment and concerns about the Government's budget deficit keeping consumer and investor confidence low. Against this setting, 2002 turned out to be a very difficult year for the financial sector in Hong Kong.

Investment Returns and Operational Performance

Much of the increase in Group profit in 2002 is due to a significant improvement in the performance of our investment portfolio, following a period of volatility in 2001, when the value of certain strategic, long-term listed investment securities fell. Throughout the year, we put considerable effort into ensuring that our portfolio remained conservative and balanced, shifting the weight away from inter-bank deposits and equities towards high-quality debt instruments, offering higher yielding interest income. This strategy has helped to buffer Group profitability in 2002. Our remaining equities holdings out-performed market benchmarks.

The Group's operational results reflected the very difficult business environment in Hong Kong. Asia Commercial Bank Limited ("Asia Commercial Bank") saw net profit rise 2.9% to HK\$32.5 million against its results from 2001, re-stated following the merger of Asia Investment Services Limited's securities operations with Asia Commercial Bank's. Without the re-statement of merged securities activities' 2001 operating losses, Asia Commercial Bank would have reported a decline in profit of 25.8% to HK\$31.7 million. Net interest income declined, reflecting tight margins and weak demand for loans generally. On a more positive note, we made significant progress in our efforts to control costs, better manage deposit levels and minimise bad and doubtful loans.

Asia Insurance Co., Ltd. ("Asia Insurance") enjoyed continued success in its core underwriting activities, with underwriting profit showing a 45.2% increase on 2001, which had also been a good year. The overall result for Asia Insurance, a 52.9% rise to HK\$32.3 million, also reflects the improved performance of its investments portfolio following a shift in weighting away from equities and towards fixed income investments, similar to the shift in the Group's overall portfolio described above. Asia Insurance expanded into a number of new areas in 2002 and has become one of Hong Kong's market leaders in professional indemnity insurance.

With the securities business being absorbed into Asia Commercial Bank and the restructuring of other investment service units in mid-2002, Asia Investment Services Ltd. ("Asia Investment Services") incurred some one-off redundancy and consolidation costs, which account for most of the subsidiary's HK\$19.6 million losses. The consolidation of this part of the Group resulted in better containment of operating costs and should generate greater efficiencies in our securities brokerage and margin finance business.

More details about the performance and future prospects of Asia Commercial Bank and Asia Insurance appear in Management Discussion and Analysis. Our efforts on cost management and rationalisation of operations has put the Group in a better position to take opportunities when the economy recover.

Management Focus on Profitability

Group management leaned towards a defensive strategy of protecting profitability rather than chasing strong growth during the year. As mentioned above, our portfolio investment philosophy concentrated on interest income rather than capital gains. On the operational side, cost management remained a priority, and we took measures to consolidate activities and take advantage of operational economies of scale where possible. The integration of Asia Investment Services' securities business is an example, as are efforts to encourage closer sales and marketing activities between Asia Commercial Bank and Asia Insurance staff. We continued to develop our alliances and joint ventures with other companies during the year, and look forward to building on these and other partnerships offering mutual advantages in future.

The Group's liquidity and financial resources remained robust during the year. There were no significant developments affecting either the financial resources or the capital structure of the Group.

Staff

The Group had a total of 590 employees at the end of 2002, a 9.2% decrease compared with the end of 2001. Despite the need to manage costs carefully, we ensured that salaries and conditions remained in line with the market and with the need to be able to attract and retain good quality people. We also continued to ensure that adequate resources remained available for training. The dedication and hard work of our staff during 2002 is greatly appreciated.

Outlook and Strategy in 2003

As of the first quarter of 2003, the overall economic environment remained weak, reflecting continuing economic uncertainty globally which has been further tempered by the outbreak of war in Iraq.

The outlook for 2003 is hard to call. Even the most optimistic forecasts largely rule out a strong recovery in the United States, Japan and Europe. This would suggest that we cannot expect a major pick-up in confidence among Hong Kong consumers and investors. This is frustrating, because we believe there is significant pent-up consumption and investment demand as reflected in the high savings and deposit ratios in Hong Kong.

We will therefore remain more cautious than optimistic in the year ahead, broadly assuming that economic growth, interest rates and demand for bank loans and products will remain weak. This calls for maintaining a prudent and conservative strategy whilst keep an eye for renewing and taking on new opportunities in Hong Kong as well as in the Mainland and regionally. As part of this strategy, the Group's banking and insurance operations will continue to place particular emphasis on developing business with corporate clients, which generally offer more attractive prospects than the retail sector.

As a result of this overall approach, I believe Asia Financial Group will be better placed to respond to new opportunities when the economic climate becomes brighter.

I look forward to reporting healthier interim results later in the year.

Robin Y.H. Chan

Chairman & Managing Director

Hong Kong, 28th March 2003