

Management Discussion and Analysis

Banking

Net profit attributable to shareholders:	HK\$32.5m	+2.9%
Total operating income:	HK\$298.6m	-15.9%
Net interest income:	HK\$235.6m	-17.0%
Other operating income:	HK\$63.0m	-11.7%
Operating expenses:	HK\$205.9m	-10.3%
Charge for bad and doubtful debts:	HK\$46.0m	-32.8%
Loans and advances:	HK\$7,734m	-2.4%
Customer deposits:	HK\$9,779m	-5.5%
Net interest margin:	1.92%	(23 basis points lower than 2001)
Cost-to-income ratio:	68.9%	(4.3 percentage points higher than 2001)
Average liquidity ratio:	52.2%	(Average 2001: 50.3%)
Capital adequacy ratio:	19.6%	(end-2002)

Asia Commercial Bank's 2001 results have been re-stated following the merger of Asia Investment Services' securities operations with Asia Commercial Bank's.

In common with other banks in Hong Kong, Asia Commercial Bank faced a very difficult business environment during 2002, with severe competition, thin interest margins, rising number of bankruptcies and sluggish demand for mortgages and other banking products. The weak economy dampened demand for loans from the corporate sector, while deflation and low consumer confidence discouraged personal and consumer borrowing. Commission income from securities broking fell sharply reflecting the sluggish stock markets.

In the face of contracting loan opportunities and declining margins, Asia Commercial Bank made efforts to maintain profitability by carefully managing funding and operational costs and the yield on Asia Commercial Bank's non-loan assets. A prudent lending policy contributed to a significant fall in bad debt charges.

Following the integration of Asia Investment Services' securities business into Asia Commercial Bank in mid-2002, we have become a pioneer in the local banking industry by offering a two-day trading limit (T+2 settlement) for customers in good standing, a facility previously offered only by non-bank securities houses.

Looking forward, Asia Commercial Bank has received consent to conduct Renminbi business with Hong Kong, foreign and joint-venture enterprises in nine major cities in the Mainland. In the longer term, fund-raising and lending opportunities in the Mainland will broaden, as restrictions on non-Mainland players are reduced. In the meantime, we expect a steady increase in our China business.

Banking business is expected to be slow across the board, with the retail sector expected to remain particularly weak for the foreseeable future because of thin margins on mortgage loans and the weak property market. We are therefore redirecting our strategy towards a greater emphasis on commercial business. As of March 2003, our commercial banking business has been decentralized and fully integrated with our retail distribution channels. As well as introducing more business with a faster turnover time, this is expected to leave Asia Commercial Bank better positioned for an upturn in corporate business when the economy picks up.

In all areas, we will continue to maintain a prudent lending policy while keeping an eye for greater lending opportunities. We believe this cautious approach is appropriate. It is aimed at keeping Asia Commercial Bank in a healthy condition to be ready to expand when the business environment improves.

Insurance

Net profit attributable to shareholders:	HK\$32.3m	+52.9%
Underwriting profit:	HK\$38.8m	+45.2%
Investment/dividend income:	(HK\$5.6m)	-57.3%
Interest and other income:	HK\$33.0m	-26.6%
Premium turnover:	HK\$568.9m	+26.7%
Operating expenses:	HK\$56.5m	+5.6%
Provision for mortgage loan receivables:	HK\$1.3m	-76.9%

Asia Insurance's core business enjoyed a successful year in 2002, as the rise in underwriting profit shows.

Investment provisions declined significantly after the market volatility of 2001 and a re-weighting of the company's portfolio towards good quality debt rather than equities. This improvement outweighed the negative effects of lower interest income.

Asia Insurance's operational success is partly due to a return to better and more sustainable premium pricing within the industry for motor, employees' compensation, property and casualty insurance in Hong Kong, following many years of intense competition, during which the industry as a whole had often been making underwriting loss. Combined with the effects of industry consolidation, this has resulted in increased turnover. Asia Insurance has also benefited from a prudent approach in emphasising quality rather than quantity of business. We also continued to expand our distribution network, with our products being sold through a new agency force.

After introducing professional liability insurance in 2001, Asia Insurance has become one of the Hong Kong market's leaders in this growing field. Our associated company, Professional Liability Underwriting Services Ltd - PLUS - is already profitable. In the ensuing months, we are committed to invest in: Incombank-Asia Insurance Company Ltd, a joint venture with Industrial & Commercial Bank of Vietnam ("Incombank"); Cambodia Reinsurance Company with the Royal Government of Cambodia; and PT Sampo Japan Insurance Indonesia. In addition, we are going to increase our shareholdings in The People's Insurance Company of China (Hong Kong) Ltd, previously known as Guangdong Asia Insurance Company Ltd. This is a joint venture with the Mainland's The People's Insurance Company of China.

Of the overseas investments, the Vietnamese joint venture offers particular opportunities for bancassurance. Incombank has around 600 branches and offices in Vietnam, and is well-positioned to develop a presence in that country's growing general insurance sector.

Existing alliances continued to perform well. BC Reinsurance Ltd., our reinsurance joint venture, is now profitable, while Hong Kong Life Insurance Ltd is showing signs of being a good, long-term addition to our business.

While we will continue to focus on our personal insurance lines and will continue to develop their distribution network, our strategy will also look to growth in corporate business for the foreseeable future. With some other players having to withdraw from the market as investment losses reduce their capacity, our relatively superior financial strength gives us room to take advantage of opportunities to write more good-quality corporate business.

With high standards of service and the assurance of a Standard and Poor's "A-" rating since 1995, Asia Insurance expects to continue making a significant contribution to the Group's profit in 2003.