Back row

Mr. Kelvin Lo
Managing Director

Mr. Kenneth Kong
Managing Director

Mr. Zhang Yichen
Managing Director

Front row

Mrs. Doreen Chan
Managing Director &
Alternate Chief Executive Officer

Mr. Chang Zhenming
Chief Executive Officer

Mr. Raymond Lee
Managing Director &
Alternate Chief Executive Officer

Report of Chief Executive Officer

Management Discussion and Analysis

1. Review of Operations

In 2002, Hong Kong's economy continued to experience difficulties, which led to a weak demand for loans. Rising personal bankruptcies, together with high unemployment and declining property prices, also put pressure on bank earnings. Operating against this challenging environment, CITIC International Financial Holdings Limited (the 'Group') continued to deliver satisfactory earnings, and successfully completed the integration between CITIC Ka Wah Bank Limited ('CKWB') and The Hongkong Chinese Bank, Limited ('HKCB'), as well as the re-organization into a holding company, laying a solid foundation for future growth.

2. Business Performance

On 25 November 2002, the Group completed the re-organization of its businesses into three distinct business lines: commercial banking, asset management and investment banking. For the year ended December 2002, CKWB contributed the majority of the Group's net profit.

(1) Earnings maintained at 2001's level

Despite a continued difficult operating environment in Hong Kong, the Group's 2002 operating profit before provisions reached HK$1,127 million, which was HK$97 million, or 9.4%, higher than CKWB's HK$1,030 million in 2001. The increase was mainly driven by a rise in net interest income. Net profit attributable to shareholders was HK$613 million, which was largely at the same level of CKWB in 2001.

(2) Net interest income

The Group's net interest income for the year amounted to HK$1,679 million, representing an increase of 34.8% compared with CKWB in 2001, mainly driven by a rise in total loans to HK$43.0 billion, and a widening of the net interest margin by 8 basis points to 2.32%. In addition, in view of the interest rate scenario, the Treasury Department of CKWB hedged its portfolio by investing in high quality fixed income securities, which also led to substantial increase in interest income.

(3) Non-interest income

Non-interest income declined by 7.3% to HK$504 million compared with CKWB in 2001. This was mainly due to the effect of hedging our treasury portfolio by CKWB's Treasury Department, which resulted in lower investment income but much higher interest income contribution. In addition, brokerage fees and commission income from investment banking recorded a drop due to the lackluster investment market. Also, CKWB reduced its interests in Ka Wah Capital Limited ('Ka Wah Capital', currently known as 'CITIC Capital Markets Limited') and Cargary Securities Limited ('Cargary Securities', currently known as 'CITIC Capital Securities Limited') from 51% to 25% in May 2002, resulting in their contribution no longer being consolidated at the subsidiary level. It is worth mentioning, however, that CKWB focused on exploring non-interest income avenues in the past, including wealth management, corporate loans, credit cards and negative equity mortgage refinancing services. During the period, HK$91 million fee income was recorded from the distribution of unit trust and Bancassurance products, representing 35.4% and 1.9 times increases respectively compared with CKWB in the same period of 2001. The Group will continue to expand its non-interest income businesses, with a view to increasing the non-interest income ratio to approximately 30%.

(4) Operating expenses

In 2002, the Group recorded HK$1,056 million in operating expenses. Excluding HK$67 million in goodwill amortization, the total operating expenses increased by 30.3%. The Group's cost-to-income ratio was 48.4% for 2002.

(5) Charge for bad and doubtful debts

Due to the continued high unemployment, rising personal bankruptcies and the weak property market, the overall asset quality of the banking industry was inevitably affected. In view of the difficult economic outlook, the Group adopted a prudent provisioning policy and increased the charge for bad and doubtful debts by 58.3% to HK$540 million. In addition, the Group made a provision of HK$35 million for devaluation of investment properties.

(6) Final dividend

The year 2002 was a landmark year for the Group's development. CKWB celebrated its 80th anniversary. It also successfully acquired HKCB and completed the subsequent integration. In addition, the Group completed its re-organization during the year, establishing a new platform for future business development. To mark these special occasions, the Board of Directors proposed a final dividend of HK$0.13 per share. The year's total dividend pay-out ratio was close to 80%.

3. Asset Quality

(1) Loans, deposits and asset size

As at the end of 2002, the Group's total assets reached HK$76.2 billion, representing an increase of HK$16.8 billion, or 28.3%, compared with CKWB's HK$59.4 billion at the end of 2001. Total loans and total deposits reached HK$43.0 billion and HK$61.4 billion respectively, representing an increase of 31.5% and 32.3% respectively compared with CKWB at the end of 2001.

(2) Problem loans

The Group resolved HK$1,091 million in problem loans last year. As at the end of December 2002, the classified exposure stood at HK$2,506 million, equivalent to 5.9% of total loans. The non-performing loan ratio declined from 6.2% at the end of June 2002 to 5.6% at the end of December 2002, while the coverage ratio rose significantly from 84% in 2001 to 91% in 2002.

(3) Financial position

As at the end of December 2002, the Group's unadjusted capital adequacy ratio was 18.9%; the loans to deposits ratio was 70.1%; and the loans to total assets ratio was 56.4%.

Asset Quality Indicators

	Group Indicators as at the end of 2002	**CKWB Indicators as at the end of 2001**
Classified Exposure	5.9%	5.5%
NPL	5.6%	4.5%
Coverage	91%	84%
Mainland Loans to Total Loans	18.2%	23.1%
Unadjusted Capital Adequacy	18.9%	20.8%
Loans to Deposits	70.1%	70.5%
Loans to Total Assets	56.4%	55.0%
Average Liquidity		51.2%
Consolidated (Jan to Oct)	46.3%	–
Solo (Nov to Dec)	547.3%	–

4. Core Business Development

(1) Commercial banking

CKWB completed the acquisition of HKCB on 17 January 2002 and the legal and operational merger on 25 November of the same year. Following the integration, CKWB is now the eighth largest locally incorporated licensed bank in Hong Kong in terms of total assets.

During the past few years, the Retail Banking Group of CKWB committed substantial efforts in promoting a service culture and enhancing service quality. By introducing innovative value propositions, CKWB has strengthened its position in the retail banking sector and expanded its market share. In December 2002, CKWB was awarded the 'Hong Kong Retail Management Association Customer Service Award', and became the only bank to receive such recognition in that year. In addition, The Asset, a reputable finance magazine in Asia, selected CKWB's Perpetual Upper Tier II Capital Security as the 'Best Hybrid Bank Bond Deal' in December 2002. These two awards represented the market's recognition of CKWB's innovativeness and customer-focused service spirit.

i. Business performance

a. Earnings

Despite the difficult operating environment for the banking industry, CKWB's 2002 operating profit before provisions reached HK$1,161 million, while net profit attributable to shareholders amounted to HK$646 million.

b. Net interest income

CKWB's net interest income for 2002 reached HK$1,707 million, mainly due to the increase in total loans to HK$42.3 billion and interest income generated by the high quality fixed income securities invested by the Treasury Department. CKWB's net interest margin was improved to 2.5% in 2002.

c. Non-interest income

In the past, CKWB focused on exploring non-interest income avenues, including wealth management, corporate loans, credit cards and negative equity mortgage refinancing, all of which delivered outstanding results. In 2002, CKWB's non-interest income reached HK$471 million. Retail banking, including wealth management, generated HK$163 million in fees and commissions, while fees from corporate loans reached HK$140 million, accounting for 34.7% and 29.7% of total non-interest income respectively.

d. Operating expenses

Following the acquisition of HKCB, CKWB formed the 'Expense Control Committee' in June 2002. The Committee issued guidelines on the control of operating costs in different areas, including the reduction in overlapping costs between the two banks, rationalization of back office operations and the enhancement of staff productivity. With the HK$93 million cost synergies from the integration, total operating costs of the two banks declined from 2001 year-end figure of HK$1,110 million before the integration to HK$1,018 million after the integration. CKWB's cost-to-income ratio was 46.7% in 2002.

e. Charge for bad and doubtful debts

In view of Hong Kong's difficult economic outlook, CKWB adopted a prudent provisioning policy by making a HK$509 million charge for bad and doubtful debts in 2002, including HK$78 million in provisions against the decline in value of collateral properties.

In addition, CKWB made a provision of HK$34 million for revaluation deficit on investment properties, of which HK$20 million was transferred from the property revaluation reserve. As a result, the net impact on profit for the period was HK$14 million.

ii. Asset quality

a. Loans, deposits and asset size

As at the end of 2002, CKWB's total assets reached HK$72.9 billion, while its total loans and total deposits were HK$42.3 billion and HK$60.7 billion respectively.

b. Corporate governance

To enhance corporate governance, CKWB established the Credit and Risk Management Committee, the Executive Personnel Committee and the Audit Committee at Board level in 2002, and appointed Mr. Ronald Carstairs, a veteran banker, and Mr. Stephen Fan, an experienced professional accountant, as independent non-executive directors. Mr. Carstairs and Mr. Fan chair the Credit and Risk Management Committee and the Audit Committee respectively.

The Credit and Risk Management Committee oversees CKWB's risk management through various committees at CKWB's management level, including Management Committee, Credit Committee, Non Performing Loan Committee, International Credit Committee, Asset & Liability Management Committee and Operations & Control Committee, with a view to optimizing CKWB's risk management system.

During 2002, CKWB carried out a review and alignment of the credit policies, including loan classification and provisioning, and credit approval hierarchy of the two banks. Control procedures for new business areas were also implemented to support the business expansion of CKWB. During the same period, CKWB revised and modified more than 400 operational policies and procedures with a view to improving overall operational efficiencies and controls.

c. Asset quality indicators

In 2002, CKWB strove to enhance the overall asset quality. During the period, CKWB resolved HK$1,075 million problem loans, and assigned over HK$800 million worth of non-performing loans and assets recovered from debt-to-asset swap to CITIC International Assets Management Limited (formerly known as 'Ka Wah Assets Management Limited') in June 2002. As a result, CKWB's non-performing loan ratio declined substantially to 4.1%. At the end of December 2002, CKWB's classified exposure was HK$1,836 million, equivalent to 4.4% of total loans. Coverage ratio stood at 90%.

d. Capital management

On the capital management front, CKWB successfully raised HK$726 million through a rights issue in January 2002. In May 2002, CKWB successfully issued US$250 million in perpetual subordinated guaranteed notes, the first-ever Perpetual Upper Tier II Capital Security in Asia (ex-Japan). During 2002, CKWB issued HK$3.5 billion worth in certificates of deposit, which effectively lowered the overall cost of funds, and prepared for future business development.

e. Financial position

As at the end of December 2002, CKWB's unadjusted capital adequacy ratio was 17.2%. The loans to deposits ratio was 69.7%. The loans to total assets ratio was 58.1%. The average liquidity ratio was 46.9% for January to October 2002, and 47.1% for November to December 2002.

Asset Quality Indicators

	CKWB Indicators as at the end of 2002
Classified Exposure	4.4%
NPL	4.1%
Coverage	90%
Mainland Loans to Total Loans	17.6%
Unadjusted Capital Adequacy	17.2%
Loans to Deposits	69.7%
Loans to Total Assets	58.1%
Average Liquidity	
Jan to Oct	46.9%
Nov to Dec	47.1%

iii. Continued business development

During 2002, CKWB launched over 30 new products and services.

New Products and Services Launched in 2002

January
- 'SME Business Installation and Equipment Loan Scheme'
- Credit Card 'Interest Free Flexi-Installment' Tax Loan Plan
- Acted as Placing Bank for HKMC's Retail Bonds
- 'Sun Savers' life insurance service

March	• Official launch of 'B2B Exchange' service • Launch of additional 'Internet Cash Management' services including Account Transaction History Enquiry, Stop Cheque Payment, Bill Payment and Transfer Payment • Sun Life FORTUNE Guaranteed Interest Fund
April	• 'Homeplus' Comprehensive Home Contents Cover • Acted as Placing Bank for MTRC's Retail Bonds
May	• First-in-Market Mortgage Refinancing Service of up to 140% of current market value • Bonanza Deposit Campaign • Financial Needs Analysis • Acted as Placing Bank for HKMC's Retail Bonds
June	• Treasury Product for Corporate Customers - FX Contract • 'Sun Educational Fund Builder'
July	• Credit Card 'Smart Balance Transfer Program' • Sun Life 'Refundable Critical Illness' Plan
August	• Interest Rate Swap • Currency Swap • Equity-Linked Deposit • Credit Card Easy Cash-in Program • Credit Card 'Happy Family Octopus Automated Add-Value Service' • Established 'Movie Club' for Credit Card members • Jointly launched 'Hospital Cash Insurance Plan' with Eagle Star Insurance
September	• Credit Card 'Gen-X Reward Scheme' Bi-monthly Offer and 'Flexi Installment' Awareness Program • 'Sun Asset Builder'
October	• Currency-Linked Deposit • Acted as Placing Bank for HKMC's Retail Bonds
November	• 'Salaries Tax Loan' • Credit Card 'Lucky "1" Program'
December	• 'SuperFirst Mortgage Home Switching Flexi Plan' • Pre-Approved 'Corporate Tax Loan'

a. 140% mortgage refinancing service

In May 2002, CKWB introduced the first-in-market 140% mortgage refinancing service targeting homeowners in negative equity (the '140% Program'). In 2002, CKWB approved more than 1,000 applications, involving a total loan drawdown of HK$1.4 billion. The 140% Program not only reflects CKWB's commitment to providing innovative service to customers, but also generates additional interest and fee income for CKWB. At the end of 2002, CKWB enhanced the service by launching SuperFirst Mortgage Home Switching Flexi Plan, which caters for negative equity homeowners who wish to switch property.

b. Credit card

CKWB launched its first credit card in November 2001, which offers innovative value propositions and brand new incentives and services. CKWB issued more than 100,000 cards with HK$336 million credit card receivables at the end of 2002.

c. Loan syndication

In March 2002, CKWB established a Syndication Desk under the Corporate Banking Group. In 2002, CKWB successfully completed nine syndicated term loan facilities, acting as sole arranger for five of the syndications, and generating approximately HK$14 million in fee income.

d. China banking

In early 2002, CKWB established the China Banking Department to organize and co-ordinate CKWB's liaison with the CITIC Group entities in the Mainland. The department also serves the planning and formulation of China business strategies, and undertakes market exploration and customer relationship development.

In 2002, CKWB conducted a number of wealth management seminars in Shenzhen, Shanghai, and Hangzhou in collaboration with CITIC Industrial Bank and CITIC Securities to develop wealth management services in the Mainland. Currently, CKWB is actively exploring the market for residential mortgages in the Mainland, targeting non-PRC residents. In respect of the credit card business jointly developed by CKWB and CITIC Industrial

Bank, the first credit card is scheduled for launch in the second half of 2003, with an issue target of 300,000 cards during the first year of launch.

On corporate banking, CKWB has been offering corporate customers with RMB loans through CITIC Industrial Bank since the beginning of 2000, and the business has been growing steadily. Recently, CKWB reached an agreement with the Guangzhou branch of CITIC Industrial Bank to offer RMB loans in the Mainland to CKWB's SME customers.

iv. The integration with HKCB

a. Integration in all areas

CKWB fully aligned and integrated with HKCB in all areas on 25 November 2002, including products and services, operations, technology, risk management policies and related procedures. The number of retail branches was reduced from 50 to 38, while the number of staff was reduced from approximately 1,600 to approximately 1,400. Following the integration with HKCB, CKWB's total number of customers increased by 20%, while the number of its SME customers surged by three times, which facilitates future business development.

b. Synergies

In 2002, CKWB recorded synergies of HK$181 million, approximately 51% of which came from cost savings and 49% from increased revenues.

v. Future development

Going forward, CKWB will continue to actively develop its Hong Kong and Greater China businesses, and strive to enhance corporate governance and management effectiveness.

a. Business development

Hong Kong market development

The operating environment in Hong Kong is expected to remain difficult in 2003, and performance of economic indicators will remain uncertain. To meet future challenges, CKWB will continue to adhere to its spirit of innovation, and will strive to achieve new business breakthroughs and develop new revenue generators. CKWB will actively consider mergers and acquisitions with a view to further expanding business scale.

Greater China development

Leveraging on the Board of Directors' extensive market network and solid Mainland business experience, CKWB will actively consider the establishment of business partnerships with CITIC Industrial Bank and China Construction Bank to promote business development.

b. Corporate governance

In 2002, CKWB implemented extensive measures to enhance corporate governance. In the future, CKWB will continue to strengthen the management and control of the eight major risks, and to further enhance the management information systems in order to cope with the implementation of the new capital adequacy requirements under the new Basel Capital Accord in 2006.

c. Enhancing management effectiveness

In November 2002, CKWB formed a Management Committee with a view to enhancing management effectiveness. CKWB will continue to strengthen its internal communications and organize quarterly CEO forums to deepen staff understanding of CKWB's vision, mission, core values and priorities, and to strengthen staff cohesiveness, with a view to developing stronger team spirit to strive for common goals.

To ensure excellence in business management, CKWB has piloted Total Quality Management ('TQM') in its Retail Banking Group which resulted in the winning of the 'Hong Kong Retail Management Association Customer Service Award' in 2002. CKWB will extend TQM throughout the organization, emphasizing leadership, strategic planning, customer service, information analysis, HR focus, process management and business results. The aim for CKWB is to build sustainable leadership and a world-class business management system.

(2) Asset management

i. Recovery and management of non-performing loans

Originated from CKWB's Risk Assets Management Department, CITIC International Assets Management Limited ('CIAM') has accumulated solid experience in the recovery of problem loans and distressed assets management. Since 1997, recoveries amounted to approximately HK$4 billion in cash and assets and the recovered assets have been effectively managed with a view to achieving preservation and appreciation of asset value.

During the Group's re-organization in 2002, more than HK$800 million in non-performing loans and recovered assets were injected into CIAM. The aim is to further drive down the non-performing loan ratio of the commercial banking arm and to chart the way forward for establishing a new line of business – direct investment – within the Group.

In the next two years, CIAM's management intends to leverage the extensive network and vast resources of the CITIC Group for further recoveries of problem loans and better management of recovered assets in order to achieve a higher recovery rate, which will lead to cash realization and profit generation.

ii. Establishing direct investment business in China

The Group plans to further develop its asset management and direct investment businesses by utilizing the experience of the team and the cash within CIAM.

In October 2002, CIAM signed an agreement with Shenzhen Guocheng Venture Capital Co., Ltd. and the Administration Center of Innofund under the Ministry of Science and Technology to form a joint venture investment company and an investment management company. To capitalize on the immense business opportunities in Mainland China, CIAM aims to establish the company as an internationally recognized China-focused direct investment house within three years. The target aggregate investment for 2003 is approximately HK$200 million.

CIAM will also offer distressed assets management and financial advisory services to other institutions, including members of the CITIC Group, to boost non-interest income.

iii. Target

The current assets of CIAM amounted to approximately HK$1.23 billion. In the future, CIAM will co-operate closely with various units within the CITIC Group, presenting CIAM with further opportunities to effectively utilize the Group's resources, and to contribute quality earnings to the Group in the near future.

(3) Investment banking

i. Shareholding structure

CITIC Capital Markets Holdings Limited ('CCMH') was established in January 2002 as the holding company of Ka Wah Capital and Cargary Securities. In May 2002, CITIC Pacific Limited ('CITIC Pacific') became a shareholder of CCMH. To unify their service brand names, Ka Wah Capital and Cargary Securities were renamed as CITIC Capital Markets Limited ('CITIC Capital Markets') and CITIC Capital Securities Limited ('CITIC Capital Securities') in September 2002. Currently, CITIC and CIFH each hold 25% of CCMH, with the remaining 50% held by CITIC Pacific. CCMH has been working closely with CKWB and CITIC Securities, with the goal of becoming a China-focused international investment bank leveraging on the strategic resources of the CITIC Group and world-class financial expertise.

ii. Performance

Despite the challenging operating environment, CCMH achieved a consolidated profit after tax of approximately HK$42 million with total assets in excess of HK$1.1 billion as at 31 December 2002.

a. Investment banking

In 2002, CITIC Capital Markets successfully raised more than HK$10 billion for clients through syndicated loans, commercial papers and certificates of deposit. It also participated in a number of equity corporate finance transactions, including the initial public offerings of China Oilfield Services Limited, Hainan Meilan Airport Company Limited, China Telecom Corporation Limited, and Kenfair International (Holdings) Limited.

b. Asset management

CCMH focuses on assisting Mainland investors to manage their investments in the global markets and global investors to invest in China-focused companies with a view to achieving capital appreciation. CCMH will soon launch its first retail guaranteed fund under the 'CITIC Capital' brand, which will be distributed through the network of CKWB.

c. Securities brokerage

During 2002, CITIC Capital Securities recorded a marked increase in the market share of brokerage transactions on the Stock Exchange of Hong Kong. Currently, CITIC Capital Securities operates three branches in Hong Kong. In addition to focusing on securities brokerage in Hong Kong, CITIC Capital Securities expanded its product range to cover securities listed on the Thailand stock market, and broadened its institutional client base.

5. China Banking Development

China business development will be a major focus of the Group. Following the establishment of CITIC Holdings in December 2002, CIFH and CITIC's financial entities will jointly develop and cross-sell financial products under the separate supervision regulatory regime, and leverage on CITIC's brand equity and synergies to enhance overall competitiveness and profitability. In January 2003, the Group attached the China Banking Department under both CIFH and CKWB to effectively integrate resources and to enhance the Group's China market development capabilities.

Three business models for market development

The Group strives to develop three business models for the China market: private enterprises, personal wealth management, and Greater China market models.

(1) Private enterprises market model

With trade financing as an entry point, the Group plans to organize seminars for private enterprises through collaboration with local business organizations, and engage the Beijing and Shanghai representative offices in front-line market development. The Group aims to attract private enterprises' funds to Hong Kong and to provide these enterprises with one-stop financial services.

To explore the vast market for private enterprises, the China Banking Department successfully organized trade finance seminars at the end of 2002 and the beginning of 2003 for private enterprises at Shenzhen, Guangzhou, Shanghai and Hangzhou to introduce the Group's one-stop financial services.

(2) Personal wealth management market model

The Group plans to develop wealth management services in collaboration with CITIC Industrial Bank, CITIC Securities and CITIC Trust, and to establish product sales teams at the representative offices in Beijing and Shanghai, targeting owners of private enterprises, and the management of PRC enterprises.

(3) Greater China market model

In December 2002, CIFH entered into separate memorandum of understanding with four Taiwanese banks: Bank Sinopac, Chinatrust Commercial Bank, Land Bank of Taiwan and United World Chinese Commercial Bank. Through collaborating with these Taiwanese banks to set up a joint financial platform, CIFH's subsidiaries such as CKWB will be able to provide a comprehensive range of financial services to Taiwanese companies operating in the Mainland.

6. Human Resources Development

As at the end of 2002, the Group employed 1,479 staff. Management believes it is 'people' that make the difference and create success of an organization. Therefore, to attract and retain people of talent and performance, it is our policy to make continuous efforts in benchmarking the remuneration structure with companies in the same sector to ensure competitiveness. All companies in the Group offer discretionary bonus schemes with an objective of cultivating common goals amongst employees, driving individual performance and generating results for the Group. All bonus schemes are in direct correlation to the Group's profitability, unit performance and individual contributions.

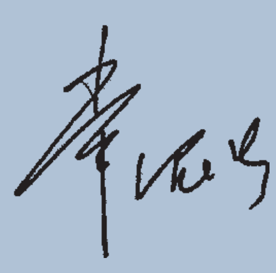
A Senior Executive Share Option Scheme was maintained by the Group, under which eligible senior executives of the Group were granted share options for subscription of shares of CIFH. As at the end of 2002, the number of options remained exercisable under the Option Scheme was 17,736,842. This Option Scheme will be terminated on 29 March 2005. In the meantime, a new share option scheme is being prepared and will be submitted to the shareholders for approval at the forthcoming general meeting of CIFH.

The Group places a high priority on ongoing staff training and people development. During 2002, the average training per employee was four days. A total of 458 classes were conducted during the year, with curriculums covering a wide range of subjects from product and computer knowledge to management, regulatory, marketing and servicing skills.

7. Future Development

The Group's structure after re-organization provides tremendous flexibility for future development. The Group will actively consider different initiatives, including the injection of CITIC's financial businesses and increasing its interests in CCMH. Such initiatives will be reviewed based on commercial feasibility, in the best interests of shareholders and in strict compliance with the relevant regulatory requirements.

Being the financial flagship of CITIC outside Mainland China, CIFH's goal is to become a financial supermarket by providing a comprehensive range of financial services, and to establish a cross-strait financial bridge by leveraging on CITIC's brand equity and synergies.



Chang Zhenming
Chief Executive Officer