

Chairman's Statement

I am pleased to report that for the six months to 30 June 2004, the Group posted a profit attributable to shareholders of HK\$5,581 million, up 85.29% from the same period last year. Earnings per share was HK\$0.5279, representing an increase of 85.29%. We also recorded marked improvement in the return on average total assets and return on average shareholders' funds. The Group's total operating income for the period was HK\$8,023 million, down 9.20% and operating profit before provisions was HK\$5,356 million, down 12.75%. Our asset quality continued to improve, as witnessed by the NPL ratio falling to a new low of 4.11% as compared to 5.78% as at the end of 2003.

In view of the Group's strong balance sheet and performance during the period, the Board has declared an interim dividend of HK\$0.320 per share (2003 interim dividend: HK\$0.195 per share).

In the first half of 2004, it was becoming increasingly evident that Hong Kong was on its way to economic recovery. There was a conspicuous rise in retail sales, which was driven by the gradual return of consumer confidence as the employment situation improved and deflationary pressure subsided. The expansion of the Mainland individual visit scheme gave further impetus to business growth in the retail sector. The property market was also reviving while external trade continued to grow.

While improvement in the market situation was expected to favour the growth of business for certain sectors in Hong Kong, the operating environment for the banking industry was still challenging in the past few months. Interest rates remained at a low level, thus affecting local banks' net interest margin. Corporate demand for credit had not been growing significantly despite a better market atmosphere. As a result, competition for new business in the banking sector remained intense.

The Group has been following a market-driven and customer-oriented business strategy that emphasises innovation and customisation. Riding on the recovery of the local economy, we achieved substantial growth in revenue and profit during the interim period from our retail banking and treasury businesses. For corporate banking, we have been making conscious efforts to de-risk our corporate lending portfolio, improve our loan mix and reduce our NPL ratio through more effective recovery and write-offs. That, together with lower NPL formation during the interim period, has accounted for the substantial improvement of the Group's asset quality. The Group's Mainland operation continued to perform satisfactorily with considerable improvement in operating profit before provisions and loan quality during the period. To maintain our profitability, we have been highly prudent with regard to cost management and seeking new ways to achieve higher cost efficiency while ensuring productivity.

Since February 2004, we have been acting as the clearing bank for personal RMB banking services in Hong Kong. I am pleased to report that this part of our operation has been flawless. At the same time, we have also been the market leader in offering personal RMB banking services as well as the pioneer of RMB credit card services and RMB card merchant acquiring business in Hong Kong.

The enhancement of corporate governance, management structure and risk management has always been a priority for the Group. We have continued to follow international best practices in that regard. In January, Madam Linda Tsao Yang became a member of the Audit Committee, which now comprises all the Independent Non-executive Directors of the Company. The reform of our management structure continued as planned with the appointment of Mr. Raymond Lee as our new Chief Operating Officer in June this year. The recruitment of the Director of Risk and other senior management staff is in progress.

The Board has recently approved the Vision, Mission and Core Values for the Group. To be rolled out shortly, these are highly important to us as a dynamic banking group that is committed to ongoing betterment of its organisation and corporate culture.

Administratively, with the Board's support, the Management is embarking on a human resources reform project to ensure that our remuneration and placement system is in line with market practices, which means it is fair, reasonable and performance-based. This is crucial for us to attract, develop and retain the best talent we need for sustaining business growth, breaking new grounds and achieving our corporate goals.

Chairman's Statement (continued)

There is a more or less common consensus in the market that the Hong Kong economy would see further growth in the second half of 2004. This should favour business development but keen competition is likely to remain a key challenge and narrow interest margins may continue to affect interest income for banks at least in the near term. For the Group, we are confident that under our existing strategy, our retail banking and treasury businesses can keep up their existing growth momentum. We will continue to enhance the quality of our corporate loan portfolio and progressively expand this part of our operation through more proactive customer relationship management and cross-selling. The macro-economic adjustment in the Mainland should be conducive to more healthy long-term growth and we believe the Group's China-related business can continue to grow in a steady manner. We are also satisfied that we can maintain our leading position in personal RMB banking services in Hong Kong.

It came to our knowledge on 2 August 2004 that the judicial authorities in the Mainland were investigating two members of our top management in connection with certain allegations. The Board is gravely concerned about this. The Audit Committee and the Independent Non-executive Directors have completed their investigation and confirmed that the allegations are unconnected with and do not affect the Group's assets, liabilities and financials. In line with approved Board policies, we will conduct an open, competitive and global recruitment process to fill the senior positions.

Notwithstanding this unexpected turn of events and the challenge we face, the Group remains a solid institution and committed to serving the best interests of shareholders, customers and staff. We will also continue to observe the principles of good corporate governance and be highly transparent regarding further developments.

Lastly, I wish to extend a vote of sincere thanks to the Board of Directors and the Senior Adviser for their counsel. In particular, I would like to thank Mr. Ping Yue, who retired from the Board in February this year, for his valuable contribution in the past. I also wish to thank our customers and shareholders for their unwavering support, and the staff for their commitment and hard work.



XIAO Gang
Chairman
Hong Kong, 19 August 2004