

CHIEF EXECUTIVE'S REPORT



We made substantial progress on many fronts in 2004. In the improving economic environment, we increased our wealth management business, expanded our loan portfolio and stepped up cross-sales to customers, all of which contributed to the Bank's solid results.

Attributable profit rose to a record HK\$11,395 million, up 19.5% compared with 2003. Non-interest income increased by 22.4%, underpinned by growth in revenue from our wealth management business. Attributable profit per employee reached a new yearly high of HK\$1.5 million, reflecting the productivity of our staff.

There was a decline in net interest income, but this was offset by the rise in non-interest income.

During the year we increased significantly our presence in the Mainland. In addition to the agreement to acquire 15.98% of Industrial Bank Co Ltd, we expanded our own network and the scope of our services and products to Mainland customers. These included renminbi (RMB) services for deposits, exchange and remittances, and additional personal financial services.

The Bank received approval from the China State Administration of Foreign Exchange for an investment quota after being granted a QFII securities investment business permit by the China Securities Regulatory Commission. This has enabled the Bank's Hong Kong and overseas customers to invest directly in the Mainland securities market and A-share related products.

The Bank's first branch in Macau, which opened in 2004 to serve the trade finance needs of customers there, recorded satisfactory progress.

In 2004 Hang Seng was named the "Best Domestic Bank in Hong Kong" by *The Asset* magazine, affirming our operating efficiency and sound management.

FINANCIAL HIGHLIGHTS

Increased consumer spending, falling bankruptcies, declining unemployment and a strong rally in the property market contributed to our record operating profit in 2004.

Operating profit before provisions increased by HK\$355 million, or 3.1%, to HK\$11,830 million. Operating profit

after provisions rose by 18.4% to HK\$12,644 million, up from HK\$10,683 million the year before, after accounting for a release of HK\$814 million in provisions.

Total other operating income rose by HK\$1,165 million, or 22.4%, to a record HK\$6,363 million in 2004 and contributed 39.6% of total operating income, compared with 33.8% in 2003.

The strong growth in other operating income offset a decline of 4.8% in net interest income, mainly brought about by the exceptionally low Hong Kong dollar interest rates that caused deposit spreads to reduce significantly throughout the year.

Also contributing to the fall in net interest income were the repricing/maturing of higher yielding debt securities, narrowing spreads on HIBOR loans and the narrowing yield on the residential mortgage portfolio. As a result, net interest margin narrowed by 24 basis points to 2.04%.

The growth momentum of our wealth management products continued with income from this business increasing by 35.1% to a record HK\$3,438 million, or 54.0% of total other operating income.

During the year we expanded our range of investment products to meet different risk appetites. New offerings included a Hang Seng Index Exchange Traded Fund, Equity Linked Investment products, and a Hong Kong Property Equity Fund, as well as a series of capital guaranteed funds.

Income from retail investment products and fund management increased by HK\$506 million, or 50.8%, to HK\$1,502 million in 2004.

The life insurance business also experienced sustained growth during the year. Cross-selling to our large established customer base enabled us to increase annualised premium growth by 43.5% and underwriting income by 22.3%. At the end of the third quarter, Hang Seng Life ranked third in terms of annualised contribution for new business in Hong Kong and achieved a market share of 11.2%, compared with 7.7% for 2003.

In 2004 we increased lending to customers as we diversified our loan portfolio into higher yielding credit card and personal advances, trade finance and SME loans.

Advances to customers (after deduction of interest in suspense and provisions) rose by HK\$22.4 billion, or 9.8%, to HK\$251.9 billion. Strong growth of 20.3% was reported in credit card advances and 23.2% in other personal lending.

Trade finance advances increased by HK\$4.2 billion, or 37.3%, compared with growth of 27.8% for the Hong Kong banking industry as whole. This reflected the success we had in further expanding the commercial banking business by leveraging our strong relationship management, customised trade services and e-services.

In a highly competitive mortgage market, we maintained our market share of residential mortgages, though our mortgage portfolio yield further declined. Private sector residential mortgages rose slightly by 0.5% but Government Home Ownership Scheme mortgages continued to fall by 12.9%. Nevertheless, Hang Seng retained its number one position in terms of market share in the primary market mortgage business in 2004 for the second consecutive year.

Gross advances for use outside Hong Kong rose by HK\$5.4 billion, or 81.0%, mainly reflecting the encouraging growth in the loan portfolios of our Mainland branches.

Total assets grew by HK\$45.7 billion, or 9.1%, to HK\$548.6 billion at 31 December 2004.

The Bank's asset quality showed improvement during the year, as non-performing advances declined sharply by 58.6% to HK\$2,169 million.

Benefiting from the recovery of bad and doubtful debts, there was a significant improvement in the release of provisions during the year. Specific provisions showed a net release of HK\$2 million, compared with a net charge of HK\$798 million last year. General provisions accounted for a release of HK\$812 million in light of historical loss experience and the improving credit environment.

Total provisions as a percentage of gross advances to customers fell to 0.42% compared with 1.10% at the end of 2003.

Operating expenses rose 8.2% to HK\$4,223 million during the year, mainly due to increases in marketing expenditure, staff costs and other investments necessary for our future development.

The cost:income ratio increased from 25.4% in 2003 to 26.3% this year, a rise of 0.9 percentage points that compared favourably with the industry average increase of 3.0 percentage points to 41.6%. Hang Seng's cost:income ratio was still among the lowest in the world.

Liquidity remained strong with a liquidity ratio of 47.2%, up from 46.2% in 2003.

The total capital ratio was 12.0% at 31 December 2004, compared with 13.2% at the same time last year. The tier 1 capital ratio at year end was 10.8%, down from 11.3% at the end of 2003.

LOOKING AHEAD

Although margin pressure is likely to remain a challenge, the improving economy will create further loan demand. We will therefore focus on developing additional loan products to capture growth opportunities in Hong Kong, while continuing to offer new wealth management products that satisfy the increasingly sophisticated investment needs of our customers.

In the Mainland, we will look to the liberalising financial markets for growth opportunities and offer new products and services whenever the time is right and the regulations allow. We will also make a strong effort to attract new Corporate and Commercial Banking customers, seek Mainland business opportunities and strengthen our trade capabilities through the launch of new trade products.

More outlets are planned for major cities in the Mainland so that we can extend our geographical reach, expand our customer base and enhance our personal wealth management business.

In addition to our partnership with Industrial Bank, we will explore opportunities for establishing alliances and co-operative arrangements with non-bank financial institutions in the Mainland.

This will be my last annual report for Hang Seng, as I will succeed Mr David Eldon as the Chairman of The Hongkong and Shanghai Banking Corporation Limited. My position as Vice-Chairman and Chief Executive will be taken over by Mr Raymond Or on 25 May 2005.

I am certain that under Mr Or's leadership and with the continuing support of the Board, staff and customers, Hang Seng will continue to deliver value for our shareholders and to provide outstanding products and services.



Vincent Cheng
Vice-Chairman and Chief Executive
Hong Kong, 28 February 2005