

EXECUTIVE CHAIRMAN'S STATEMENT



Mr Liu Lit Man GBS, JP, FIBA
Executive Chairman

Economic Review

The economy of Hong Kong grew relatively stronger in 2004. The steady recovery of the property and the stock markets, as well as the across-the-board robustness of the tourism, hotel, restaurant and retail industries, prodded the other businesses to gradually turn around. Deflation, which has persisted for years, has markedly improved. Unemployment rate has descended from its high levels to new lows in recent years. Various economic indicators all show that the Hong Kong economy has bottomed out.

During last year, the local economy took its cue from external factors. Gross domestic product grew 7 percent in the first quarter, 12.1 percent in the second and 7.2 percent in the third. It is expected that the growth for the whole year should reach between 7.5 percent and 8 percent. The performance of the Hong Kong economy as a whole was outstanding. Although the surge in crude oil prices in the international market had hindered the development of the various major industrial countries, the impact on Hong Kong was minimal thanks to her lesser reliance on crude oil. Hong Kong's three main economic pillars - stock market, property market and foreign trade - all performed well on the back of ever-increasing internal demand, continuing soar in personal consumption, and rapid development of commercial and trading activities brought about by the individual travel scheme and the Mainland and Hong Kong Closer Economic Partnership Arrangement. The Hong Kong stock market saw the Hang Seng Index rise 1,654 points from 12,576 points at the beginning of last year to 14,230 points at the end of the year. The primary and the secondary property markets were both active. According to Land Registry's statistics, the number of sale and purchase agreements for 2004 was 123,400, a significant increase of 41.4 percent over that for 2003. The consideration was \$351.8 billion, a surge of 85.7 percent over that for 2003. Such figures are indicative of the vitality of the property market. After years of economic contraction in Hong Kong, the property market has accumulated huge amounts of purchasing power. Moreover, lending rates have stayed low for a long period of time, fuelling the impulse to buy property. As such, there is no end in the development of the prospering property market. On the external trade front, total exports amounted to \$2,019.1 billion last year (an increase of 15.9 percent over the figure for the year before), while imports rose 16.9 percent to \$2,111.1 billion. On the banking front, the liquidity of the money

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*Lei Yue Mun Branch
was opened on 29 October 2004*

market and the influx of speculative funds yearning for the appreciation of the renminbi have continued to strand the interbank market in a low-rate environment. Moreover, interest rates for the Hong Kong dollar have stayed extremely low for a long period of time because they have not been raised in line with those for the greenback on a number of occasions. Narrowing interest margins have added considerable pressure to banks' profitability. Loan demand remained sluggish. Fierce competition (through such flexible financing channels as the stock and the bond markets) has drawn a sizable number of bank borrowers. As such, the banking industry could only operate under a difficult environment to strive for improvement last year.



Service lobby



Securities service corner

Results Announcement

The Bank's results for 2004 showed some improvement. For the financial year of 2004, on an audited, consolidated basis, profit attributable to shareholders amounted to HK\$349 million, an increase of 12.05 percent over that for the year before. Total customers' deposits rose 4.17 percent to HK\$33.952 billion. Total loans to customers (after accounting for provisions for bad and doubtful debts as well as interest accrued and suspended) increased 1.48 percent to HK\$20.028 billion. On 31 December 2004, the Bank's loan portfolios were made up as follows: property developments and investments (31.76 percent), personal real estate purchases (17 percent), financial and securities concerns (10.07 percent), trade finance (2.57 percent), wholesale and retail trade (3.46 percent), manufacturing, transportation and other businesses (20.30 percent), loans outside Hong Kong (9.34 percent), and others (5.50 percent). Adjusted capital adequacy ratio increased 4.24 percent

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to 19.93 percent at the end of 2004, while average liquidity ratio for 2004 decreased slightly by 0.06 percent to 52.34 percent. Loan-to-deposit ratio dropped 2.42 percent to 51.65 percent. Total assets rose 5.43 percent to HK\$42.111 billion. Shareholders' funds (after final dividend) amounted to HK\$6.029 billion, an increase of 4.09 percent. The local economy resumed its growth momentum last year and certain industries have begun to recover. Although the Bank faced fierce competition, it still managed to achieve good results. Your board has recommended paying the final dividend of HK\$0.40 per share for the financial year of 2004 to shareholders whose names appear in the Register of Members at the close of business on Friday, 22 April 2005. Total dividends for the financial year of 2004 (including the interim dividend of HK\$0.17 per share paid earlier) amounted to HK\$0.57 per share.

Profit Analysis

On an audited, consolidated basis, net interest income dropped 3.09 percent from that of 2003 to HK\$649.497 million in 2004. Interest spread decreased 6.51 percent to 1.58 percent. After accounting for the other operating income, which amounted to HK\$268.053 million, total operating income was HK\$917.55 million and total operating expenditure was HK\$462.341 million. Cost-to-income ratio amounted to 50.39 percent. Operating profit before provisions and disposal of long-term assets increased 8.16 percent to HK\$455.209 million. In order to maintain good credit quality, the Bank made provisions for bad and doubtful debts in the amount of HK\$51.175 million for 2004, a sharp fall of 18.52 percent against those made for 2003. After accounting for the provisions for bad and doubtful debts as well as the charge for taxation, the Bank recorded an increase of 12.05 percent in the profit attributable to shareholders to HK\$349 million, translating into earnings of HK\$0.80 per share. Net asset value (after final dividend) amounted to HK\$13.86 per share, an increase of 4.09 percent.

Directorate Changes

Mr Timothy George Freshwater and Mr Alfred Cheuk Yu Chow were both redesignated from independent non-executive directors to non-executive directors of the Bank on 30 September 2004. Mr Dominic Bing Hoi Lam was redesignated from executive director to non-executive director of the Bank on that same day. Mr Cheng Yuk Wo was appointed an independent non-executive director and a member of the Audit Committee of the Bank on 30 September 2004.

Economic Prospects

It is envisioned that the world economy will tend to grow at a slower pace in 2005, with the implication that the growth of the Hong Kong economy will possibly slow down as well. Be that as it may, government officials, businessmen and scholars from different walks of life are still optimistic about the prospects for the economy. The mainland's preferential policies towards Hong Kong and the host of Guangzhou-Hong Kong-Macau alliance initiatives will favour the development of the local economy to become the driving force of the economic system in the region. Hong Kong will continue to maintain her economic vitality by reducing the impact of changes in external factors.

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Hong Kong's external trade expanded rapidly last year because of the increase in demand from the international market. It is expected that the demand for products this year will still be strong and Hong Kong's import and export trade is still expected to grow. Since the cycle of raising the interest rates for the Hong Kong dollar is about to begin, the property market will only develop steadily this year with yet some room for upward price adjustments. As to the development of the local financial market, it is expected that later on this year, depending upon the flow of capital, Hong Kong dollar interest rates will be raised relatively higher. With the government's continuous efforts to perfect the securities market regime, the number of listed companies will continue to increase. Hong Kong's status as a fund-raising center in the eyes of the world in general (the Asian region in particular) will be further enhanced. As to the shipping industry, being one of the pillar industries in Hong Kong, the volume of container shipment will still maintain its steady development, thereby continuing to boast Hong Kong's status as the world's largest container shipping center. The flourishing tourism industry - riding on the coattails of the continual implementation of mainland's individual travel policy, the opening of the Hong Kong Disneyland come this September as well as Hong Kong's edge both as a melting pot where the culture of the East meets that of the West and as a shopping paradise - will continue to attract visitors from both the mainland and foreign countries. Moreover, the resulting benefits will smile on such other relevant industries as the hotel and the transportation businesses, and may even bring about limitless business opportunities for the retail consumption industry. The prospects for the tourism industry are therefore bright.

As to the prospects for the local banking industry this year, it will still be hovering for the early part of the year in the light of overflowing liquidity and sluggish loan demand. But as time moves on, local interest rates will catch up with those in the United States by shifting markedly upwards. It is hoped that this will help to boost the profits of banks with sufficient deposits. The Bank is therefore cautiously optimistic and will continue to aim at providing quality banking services, devising new products and implementing various business development plans while the economy is recovering.

Finally, on behalf of your board, I would like to sincerely thank our customers, friends and shareholders for their trust in and support for the Bank over the years, not to mention my fellow directors for the exercise of their wise judgment and all of our staff members for their hard work.

By Order of the Board
Liu Lit Man
Executive Chairman

3 March 2005