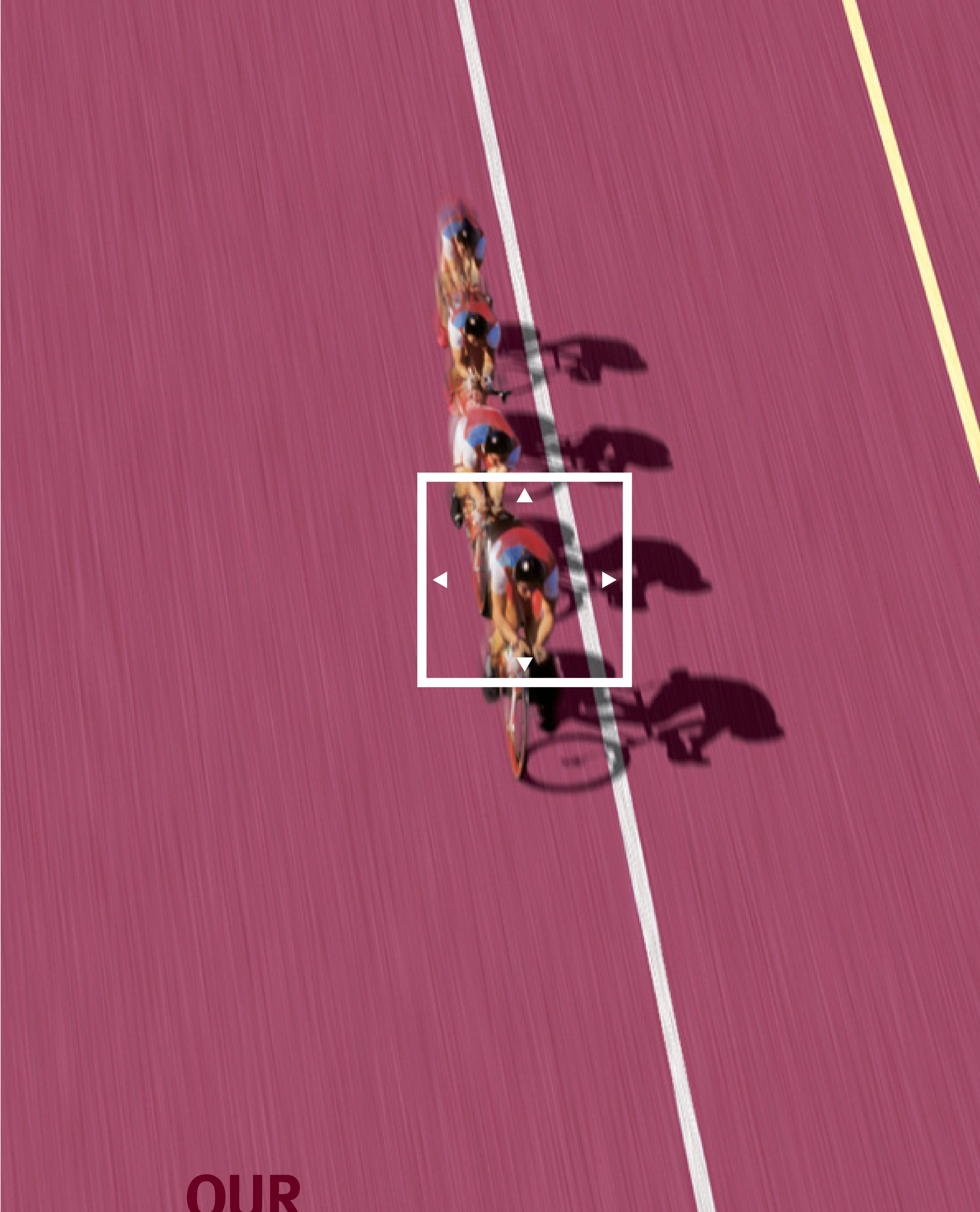


OUR STRATEGY

CHIEF EXECUTIVE'S REPORT

The economic environment in 2005 created both opportunities and challenges for Hang Seng's business.

The upward trend in interest rates improved spreads on deposits but compressed those on Treasury investments and money market portfolios, leading to a 55.2 per cent drop in Treasury's pre-tax profit to HK$1,072 million.

Against a backdrop of keen competition in the banking sector, we further refined our strategy of providing premium service and customised financial solutions. This particularly benefited Personal Financial Services, which recorded a 13.4 per cent increase in pre-tax profit to HK$7,686 million.

We maintained momentum in our wealth management business by introducing new life insurance plans and promoting investment products that offer customers attractive returns in a rising interest rate environment.

However, competitive conditions fuelled by market liquidity and slow loan demand continued to squeeze corporate lending margins. Corporate and Institutional Banking's pre-tax profit fell 37.8 per cent to HK$507 million.

Raymond Or
Vice-Chairman and
Chief Executive

Economic confidence within the business community improved during the year. We increased our focus on middle-market enterprises by appointing dedicated customer relationship managers. We also deepened relationships with small and medium-sized enterprises (SMEs) by strengthening in-branch teams and investing in business banking outlets. This helped us increase Commercial Banking's trade services volume and customer advances by 6.8 per cent and 15.5 per cent respectively.

Improving property and employment markets also helped drive borrower demand. We capitalised on this to expand lending, particularly in higher-yielding areas such as consumer finance. However, although the overall quality of our loan portfolio improved, a small number of large Commercial Banking loan impairment charges saw Commercial Banking's pre-tax profit decline by 49.2 per cent to HK$1,078 million.

We made good progress with the development of our mainland China business, adding two new sub-branches and one representative office, upgrading our Beijing representative office to a branch and expanding the size and services of our branch in Fuzhou.

Our total operating income grew by HK$3,421 million, or 17.3 per cent, to HK$23,246 million.

Pre-tax profit was up 0.6 per cent at HK$13,358 million.

Operating profit excluding loan impairment charges and other credit risk provisions and attributable profit were HK$11,686 million and HK$11,342 million respectively, representing declines of 1.1 per cent and 0.2 per cent.

FINANCIAL HIGHLIGHTS

The upward trend in interest rates and continuing consumer demand helped net interest income grow by HK$1,063 million, or 10.6 per cent, to HK$11,068 million.

Widening deposit spreads, the increased contribution of net free funds and the beneficial effects of a HK$24.9 billion rise in average interest-earning assets outweighed the impact of increasingly compressed spreads on Treasury investments and money market portfolios and the fall in mortgage portfolio yields.

Net interest margin improved by 11 basis points to 2.19 per cent, compared with an industry average of 1.68 per cent. This increase reflects the combined effects of a 6 basis point fall in net interest spread and a 17 basis point improvement in the contribution from net free funds.

Net fee income declined 16.1 per cent to HK$2,874 million.

Rising interest rates saw investors shift from capital-guaranteed funds to higher-yielding market-linked instruments, leading to a 34 per cent fall in related fee income. Increases in the number of credit cards and cardholder spending helped card services income rise by HK$107 million, or 17.9 per cent.

Net trading income fell 48 per cent to HK$579 million. This was attributable

“We made good progress with the development of our mainland China business.”

CHIEF EXECUTIVE'S REPORT (continued)

mainly to the inclusion of net interest expenses of HK$306 million, revaluation losses of HK$145 million on forward foreign exchange contracts linked to money market transactions and a change in classification of HK$89 million in life insurance related income.

Income from wealth management was HK$3,488 million, slightly up on the HK$3,472 million achieved in 2004. Investment services income fell by 10.1 per cent, but momentum was maintained by the HK$235 million, or 17.9 per cent, increase in insurance income.

We introduced new life insurance products, including the 3-Year Express Wealth Life Insurance Plan and All Years Reward Life Insurance Plan, that offer the combined benefits of life cover and savings returns. These products helped drive strong growth of HK$3,445 million, or 77.9 per cent, in net earned insurance premiums. Annualised premiums for new life insurance policies rose by 66.4 per cent.

Our Private Banking business produced significant results. Customer number and funds under management both increased and investment services and advisory fees income grew by 52.8 per cent.

> “We aim to become the preferred bank for SMEs in Hong Kong.”

Total funds under management, including discretionary and advisory, rose by 18.1 per cent to HK$106.2 billion.

We continued to invest for future growth. Operating expenses rose by HK$314 million, or 7.4 per cent, attributable mainly to increases in salaries and headcount and the further enhancement of our e-Banking services.

At 28 per cent, our cost efficiency ratio compared favourably with the local industry average of 42 per cent for 2005.

We maintained a strong liquidity position. Our average liquidity ratio was 45.1 per cent, compared with 47.2 per cent in 2004.

We raised HK$4.5 billion in subordinated debt during 2005. This helped to balance our capital structure and will be used to fund future business growth.

At 31 December 2005, our total capital ratio was 12.8 per cent, as compared with 12 per cent a year earlier. Our tier 1 capital ratio was 10.4 per cent, down 0.4 percentage points.

Shareholders' funds (excluding proposed dividends) rose by HK$1,642 million to HK$38,938 million, attributable mainly to the increase in retained profits and premises revaluation reserves.

At year-end, total assets stood at HK$580.8 billion, an increase of HK$33.9 billion, or 6.2 per cent.

Advances to customers rose by 3.6 per cent. The improving economy helped us grow lending to the wholesale, retail and manufacturing sectors by 35.3 per cent. Lending to the property development and investment sectors rose 8.4 per cent.

The buoyant labour market helped sustain demand from individuals. Card advances increased by 18.4 per cent. Personal loans grew by 51.8 per cent as we continued to promote consumer finance.

In a very competitive environment, the success of several new mortgage products helped us increase our residential mortgage lending by 1.7 per cent compared with market growth of 0.9 per cent. In December 2005, our market share for new mortgage loans approved and those drawn down stood at 17.2 per cent and 18.8 per cent respectively. During the last quarter of 2005, we were the leading bank for new residential mortgage business in Hong Kong.

Gross advances for use outside Hong Kong enjoyed strong growth of 31.1 per cent to reach HK$15,876 million, driven largely by increased Mainland lending.

At 31 December 2005, total loan impairment allowances as a percentage of gross advances to customers were 0.4 per cent, the same as a year earlier. Loan impairment allowances as a percentage of gross impaired loans were 38.9 per cent, down from 40.3 per cent. Gross impaired advances as a percentage of gross advances to customers improved to 0.5 per cent, compared with 0.7 per cent at the end of 2004. We will continue to enhance our credit risk management systems to help ensure good asset quality.

Customer deposits, including certificates of deposit and other debt securities in issue, increased by 3.4 per cent as customers looked to benefit from rising interest rates.

At the end of 2005, our advances-to-deposits ratio was 54.4 per cent, compared with 54.3 per cent a year earlier.

We made encouraging progress with our RMB business in Hong Kong. By year-end, a series of promotional offers had helped us grow our RMB deposits. Our market share was 11.6 per cent, a year-on-year increase of 3.1 percentage points.

OUR ROADMAP

With economic growth forecast to be more modest in 2006, our roadmap will ensure we continue to move forward as the competition increases. We have identified business priorities that offer good growth opportunities and set challenging targets.

In Personal Financial Services, we will further build our wealth management business by improving cross-selling and developing innovative products to attract new customers, particularly in the affluent and mass affluent segments. We aim to double Private Banking's profits within five years.

We will expand our personal lending and credit card businesses. We will increase our market share among younger customers by introducing services designed specifically to meet their needs.

We will strive to raise Commercial Banking's contribution to total pre-tax profit to 20 per cent within the next five years. Our large customer base provides an excellent platform from which to grow our lending and corporate wealth management business. We aim to become the preferred bank for SMEs in Hong Kong by increasing our investment in developing specialised product and service offerings for such companies.

We will develop a more balanced and diversified Treasury income base. Operating within prudent risk management parameters, we will work to grow income from customer-driven business and proprietary trading.

We have set a pre-tax profit contribution target of 10 per cent within the next five years for our

“We will be more progressive in implementing our business strategies while maintaining good cost efficiency.”

CHIEF EXECUTIVE'S REPORT (continued)

"We will stay focused on our objectives and further build on our strengths to create increasing value for shareholders."

Mainland business. We will increase our service capabilities by opening new outlets, particularly sub-branches, in key strategic cities. Along with recruiting new staff, this will help us attract more Personal Financial Services and Commercial Banking business.

We plan to invest over HK$1 billion during the next three years to expand our Mainland service scope and our network to more than 30 outlets.

We will deepen our co-operation with Industrial Bank in various lines of business. We will also consider investments in insurance, asset-management and securities businesses should suitable opportunities arise.

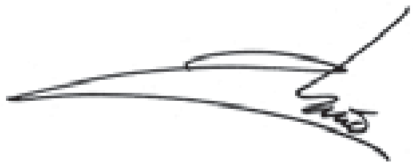
At an operational level, we will be more progressive in implementing our business strategies while maintaining good cost efficiency.

In reaction to keener competition and rising pressure on costs and margins, we will take a more critical approach in assessing resource allocation, business operations and service offerings. However, we will continue to balance the interests and expectations of shareholders, customers and staff with our responsibilities to the community as a good corporate citizen.

We will hire more staff and invest in brand rejuvenation and branch renovations to better serve existing customers and attract new ones, particularly among the younger generations. We will also make increased use of relevant new technology.

Uncertainties such as US interest rate movements and oil prices may make the journey ahead a demanding one.

However, our strong management team has the experience necessary to negotiate any economic bumps in the road. We will stay focused on our objectives and further build on our strengths to create increasing value for shareholders.



Raymond Or
Vice-Chairman and Chief Executive
Hong Kong, 6 March 2006

WEALTH MANAGEMENT

PARTNERING WITH SMEs

MAINLAND OPERATIONS

CORPORATE SOCIAL RESPONSIBILITY

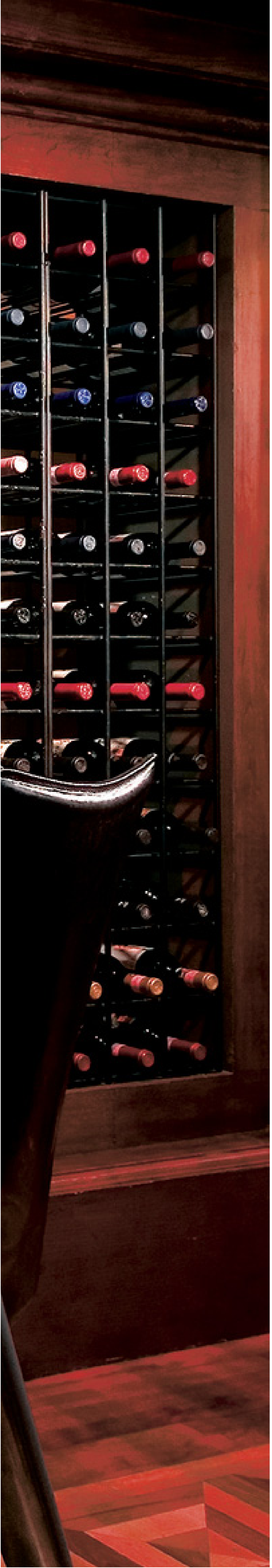
MOVING FORWARD TOGETHER

Superior customer service is central to Hang Seng's strategy for future growth.

An individualised approach to customer needs and tailor-made financial solutions are two of our most important competitive strengths.

By helping our customers succeed with their roadmaps for growth we can move forward with our own and continue to create sustainable benefits for our stakeholders.


“With the help of Hang Seng’s professional services to grow our wealth, we have more time to enjoy the finer things in life.”



WEALTH MANAGEMENT

ELVINA AND KEN KWAN

As an investment banker, Ken Kwan understands the importance of making well-informed financial decisions. That's why he and his wife Elvina, a pharmacist, chose Hang Seng for their wealth management needs.

"My parents have been Hang Seng customers for decades and Elvina and I have a joint account. Our experience of Hang Seng's premium service made the Bank the natural choice for our investment portfolio.

"Hang Seng's relationship managers take the time to understand our needs. They keep us up-to-date with how our investments are performing as well as what the markets are doing.

"With Hang Seng's help, we can look forward to a secure financial future."

PURSUING CHALLENGING CAREERS ▶
MOVING UP CORPORATE LADDER ▶
INVESTING FOR THE FUTURE ▶
ENJOYING LIFE TO THE FULL ▶


❝ Hang Seng delivers customised financial solutions that allow us to focus on growing our business. ❞

PARTNERING WITH SMEs

DENIS AU YEUNG

Denis Au Yeung, Director of Finance and Accounting at a courier business, appreciates the value of Hang Seng's made-to-measure Business Banking services.

In just 13 years, the company has grown from a small enterprise with six staff to one employing a workforce of around 22,000 and operating across 23 locations in Hong Kong and mainland China.

"Hang Seng has proved a valuable long-term business partner, providing us with customised financial solutions to meet our evolving needs. This individualised service has enabled us to focus on serving our customers.

"As our business grows, Hang Seng is always there to offer support."

STARTED WITH SIX STAFF IN 1993

STRONG FOCUS ON SERVICE

NOW EMPLOYS 22,000 STAFF

A LEADING COURIER COMPANY IN MAINLAND CHINA