Conducting SUCCESS

"No one person can perform a symphony –
it takes the efforts of an entire orchestra."

Mr Raymond Or
Vice-Chairman and Chief Executive

I am pleased to report that Hang Seng gave an upbeat performance in 2006.

During our 2005 results announcement, we set out our roadmap for growth – a strategic plan to help us achieve our vision for future business success. Our hard work over the past year to put this strategy into action has yielded encouraging results.

From Vision To Action

Supported by the buoyant economic environment, we grew wealth management income by 22.7 per cent by further harmonising our service and product offerings with the investment and insurance needs of our customers.

Our Private Banking business built on its good growth momentum to achieve a 46.3 per cent increase in pre-tax profit. Given the progress made in the past year, we are confident of achieving our roadmap goal of doubling Private Banking's pre-tax profit by 2008, two years ahead of schedule.

We capitalised on strong consumer demand to expand higher-yield lending, recording significant rises of 46.4 per cent in personal loans and 22.1 per cent in card receivables. Cards in issue reached 1.4 million.

Continued fine-tuning of relationships with Commercial Banking customers, especially small and medium-sized enterprises (SMEs), drove growth in trade finance, net fees and commissions, and net trading income. We gained market share in lending to the manufacturing industry and the wholesale and retail sector. Commercial Banking's contribution to total pre-tax profit was 16.4 per cent, up from 8.8 per cent in 2005, putting us on track to achieve our five-year target of 20 per cent.

We further diversified our Treasury income base and promoted closer cooperation with other customer groups. This led to a 66.1 per cent increase in trading income, helping to offset the adverse effects of rising funding costs and flattened yield curves on the balance sheet management portfolio.

We picked up the pace of expansion in mainland China. Our number of full-time equivalent staff increased by 284 to reach 661. We became the first foreign bank to have a branch in Dongguan and opened three new sub-branches in key cities. Including a Guangzhou sub-branch opened early this year, we now have 16 outlets on the Mainland.

This expansion in service capabilities helped us achieve strong growth in Mainland deposits and advances, which rose by 51.1 per cent and 50.9 per cent respectively.

In the second half of 2006, we obtained a licence and foreign exchange conversion quota under the Qualified Domestic Institutional Investors scheme. We finished the year on a high note by receiving approval to begin preparations to establish a Mainland subsidiary bank.

We stepped up mutually beneficial cooperation with our strategic partner Industrial Bank in areas such as customer referrals, accelerated remittance services and secondment of staff. We also actively explored possibilities for working together to enhance note delivery, cash deposit and other services.

Including our share of profits from Industrial Bank, our Mainland business contributed 6.1 per cent of total pre-tax profit, up from 4.5 per cent in 2005, bringing us closer to our objective of 10 per cent by 2010.

We embarked on an integrated brand revitalisation programme designed to enhance our brand equity.

charges was HK$12,840 million, up 9.9 per cent.

Pre-tax profit rose 7.8 per cent to HK$14,395 million, affected by a significant drop in property revaluation gains. Attributable profit reached a new high of HK$12,038 million, an increase of 6.1 per cent compared with 2005.

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Emphasizing our progressive, pragmatic and thoughtful approach to service, this programme is helping us strengthen partnerships with existing customers and build relationships with new ones.

In May, we further rationalised our property portfolio with the sale of 77 Des Voeux Road Central for HK$2.26 billion. We also signed an agreement to lease 262,000 square feet of office space in Enterprise Square Five in Kowloon Bay. With occupancy planned for late 2007, moving some of our back office functions to this new site will help enhance our operating and cost efficiency.

Financial Highlights

Good growth in our core businesses and improved credit conditions saw operating profit grow 13.6 per cent to HK$12,576 million. Operating profit excluding loan impairment

Increases in lending and contribution from net free funds helped net interest income grow by 8.3 per cent to HK$11,694 million. Average interest-earning assets were up 10.6 per cent at HK$578.6 billion.

The ratio of non-interest income to net operating income excluding loan impairment charges rose to 35.3 per cent, up from 33.5 per cent a year earlier.

Net interest income rose by HK$898 million, or 8.3 per cent. The loan portfolio expanded by 7.2 per cent driven by growth in consumer finance, trade finance and Mainland lending, contributing HK$419 million. Spreads on best lending rate-based loans improved, although strong market competition continued to exert downward pressure on mortgage and corporate loan pricing. Net free funds

Operating Profit

+13.6%

Wealth Management income

+22.7%

and the debt securities portfolio of life insurance fund investments contributed HK$867 million and HK$264 million respectively to the rise in net interest income.

These increases more than offset the HK$514 million decline in net interest income from the Treasury balance sheet management portfolio and the fall of HK$138 million due to the narrowing of spreads on Hong Kong dollar savings accounts and the change in deposit mix from savings to structured deposits.

Benefiting from the active stock market and positive investor sentiment, investment services income grew by 29.6 per cent. We offered new investment funds to capture growth on the Mainland and in other emerging markets, achieving a 40.6 per cent rise in retail fund sales. Income from structured products grew by 48.1 per cent.

The introduction of new products, the recruitment of more relationship managers and a continued emphasis on personalised advice saw Private

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Net fee income grew by 18.3 per cent to HK$3,497 million. Securities-related income rose 63.3 per cent, reflecting increases in turnover, customer base and market share. Card services income was up 22 per cent at HK$860 million, driven by rises of 10.5 per cent in the number of cards in issue and 11.7 per cent in cardholder spending.

Trading income grew by HK$445 million to HK$1,330 million, attributable mainly to a 50.1 per cent growth in foreign exchange income on the back of increased customer activity and improved trading results.

Income from wealth management rose by HK$793 million to HK$4,281 million.

Banking's investment services income rise by 83.5 per cent. Assets under management increased 39.6 per cent.

Life insurance income grew by 17.5 per cent to HK$1,476 million as we further tapped the high-potential retirement and medical insurance markets.

Operating expenses rose by HK$695 million, or 15.3 percent. We made investments in staff, IT, marketing and branding to better position our Hong Kong business for continued growth and better prepare our Mainland business to take greater advantage of the growing opportunities.

Our cost efficiency ratio rose 1 percentage point to 29 per cent, but remains among the lowest in the banking industry.

Underpinned by a HK$2,992 million rise in retained profits and an increase in the available-for-sale investment reserves, shareholders' funds (excluding proposed dividends) grew by HK$4,410 million to HK$43,348 million. Return on average shareholders' funds was 27.4 per cent.

As at 31 December 2006, our total and tier 1 capital ratios stood at 13.6 per cent and 10.7 per cent respectively, up from 12.8 per cent and 10.4 per cent a year earlier.

Our average liquidity ratio for 2006 was 51.9 per cent, up from 45.1 per cent in 2005.

Increases in both lending and deposits saw total assets grow by 15.2 per cent to HK$669.1 billion. At year-end, our advances-to-deposits ratio was 51.7 per cent, compared with 54.4 per cent at the end of 2005.

Gross advances to customers rose by 7.1 per cent to HK$280.3 billion.

The good investment climate helped us grow lending to the property development sector by 9.8 per cent. Success with strengthening our Commercial Banking relationships was reflected in rises of 14.3 per cent and 18.4 per cent in lending to the wholesale and retail trade and the manufacturing sector respectively, as well as strong growth of 24 per cent in trade finance.

Lending to individuals rose 5.4 per cent (excluding the fall in Government Home Ownership Scheme mortgages) with improvement in the employment market underpinning demand. Strategic marketing, new credit card offerings and improved efficiency contributed to good growth in consumer finance. Our credit card business gained market share in terms of card base, spending and receivables.

Despite intense market competition, we increased residential mortgage lending by 5.9 per cent.

Loans for use outside Hong Kong increased by 39.8 per cent to HK$22,192 million, due largely to the 50.9 per cent rise in lending by our Mainland branches. Corporate lending on the Mainland enjoyed good growth, driven by higher-margin RMB loans. Closer collaboration between our Mainland and Hong Kong teams led to a significant increase in Mainland trade finance.

At year-end, total loan impairment allowances as a percentage of gross advances to customers were 0.33 per cent, down from 0.39 per cent at the end of 2005. Gross impaired advances as a percentage of gross advances to customers were unchanged at 0.5 per cent.

Customer deposits, including certificates of deposit and other debt securities in issue, grew by 12.8 per cent. Hong Kong and US dollar savings accounts rose, reflecting a preference for liquidity in an active investment market. Additions to our range of structured products helped drive a 31.2 per cent increase in structured deposits, structured certificates of deposit and other debt securities in issue.

Branding

In May 2006, we launched an integrated branding programme that covers advertising and key points of customer contact and is designed to establish us as the financial institution of choice for personal and commercial banking.

Strong growth in COMMERCIAL Banking


Thomas
Eugene
Alison
Michelle

Reaching NEW HEIGHTS

The professionalism and dynamic attitude of our staff help define the Hang Seng spirit. When it comes to service, every member of our team is ready to jump into action to exceed ever-increasing customer expectations.

We launched a series of testimonial-style television commercials covering our SME, wealth management and insurance businesses. We also unveiled a fresh corporate look that uses a vibrant green to reflect our progressive and proactive attitude. All branches have adopted our new bulkhead and we are steadily rolling out our new branch design.

To engage all staff in the brand-building initiative, we have developed an internal branding framework comprising seven 'Beliefs' that ensure an excellent customer experience and strengthen our corporate value. In August we kicked-off 'Live The Brand, Start With Me', a Bank-wide communication and education campaign which is helping staff move from awareness to practical application of the seven 'Beliefs'.

Focused On The Future

Efforts to reach our roadmap objectives are continuing to help us refine our business focus, putting us in a position to take better advantage of growth opportunities.

The economic outlook for the year ahead remains positive. Developments in the US housing sector may slow the pace of external trade, but increasing confidence in the local economy, the buoyant labour market and sustained growth on the Mainland should underpin domestic demand.

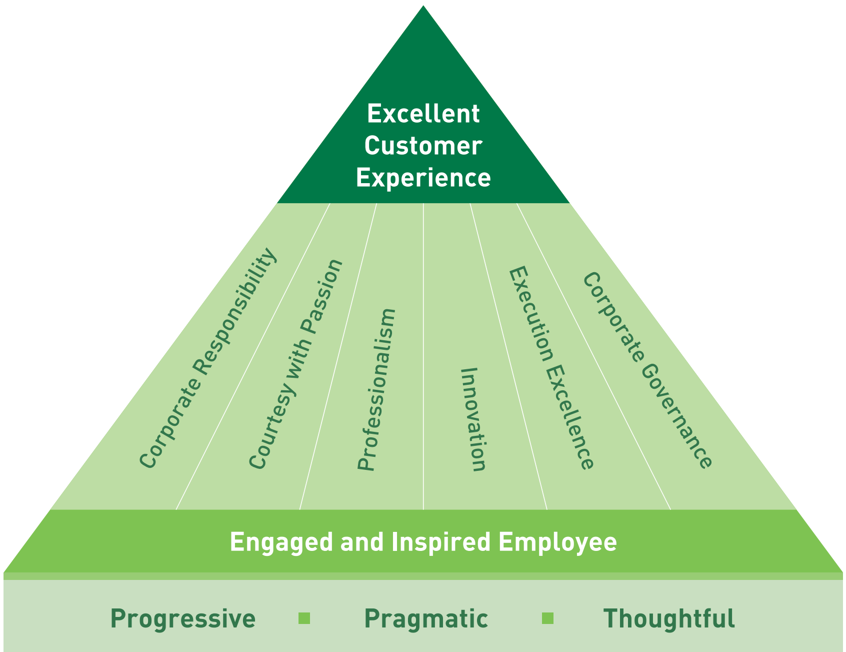
Supported by our revitalised brand, we are deepening relationships with existing customers and increasing our appeal among key customer groups.

Personal Financial Services will step up cross-selling efforts and expand its customer base by leveraging its well-developed, all-weather portfolio of investment products. Private Banking's growing service capabilities and open architecture will enable us to further tap the affluent customer segment by offering personalised financial solutions.

We have had notable success with our annuity and healthcare insurance plans and will continue to develop new products to complement our existing range.

We will capitalise on positive consumer sentiment to further grow personal lending.

On the Mainland, we will continue with our two-pronged approach of organic growth and close collaboration with Industrial Bank.



Our Seven 'Beliefs'

The establishment of our Mainland subsidiary bank, planned for the second quarter of this year, will mark a new phase of business expansion. We will take good advantage of the opportunities generated by the opening up of the retail RMB market and work to increase RMB deposits to support lending growth.

We will expand our Mainland customer base through setting up new outlets in high-growth areas, increased marketing and more promotion of our strong brand, including leveraging our role as the compiler of the Hang Seng Index series.

I am delighted to be working with a world-class ensemble whose members are in tune with each other and with our customers' needs.

In January this year we added a second Guangzhou sub-branch. We will soon open our sixth Shanghai sub-branch and have a further two planned for later in the year, giving us one of the largest networks among foreign banks in this strategic city. Other openings in the pipeline for 2007 include a branch in Hangzhou and a total of six sub-branches in Beijing, Guangzhou and Shenzhen.

By 2010, we aim to grow our Mainland business to more than 2,000 staff and over 50 outlets.

We will capitalise on our growing capabilities in southern China by offering a greater range of services to Commercial Banking customers with operations in Hong Kong and on the Mainland. Our closer partnerships with SME customers will help us grow trade finance and our corporate wealth management business.

Treasury will explore gapping opportunities while maintaining a prudent attitude towards growth in risk-weighted assets. We will further strengthen our customer-driven business and expand the scope of our proprietary trading. We will broaden our product range to include new commodity-linked, credit derivatives and hybrid instruments, and deepen our coverage in foreign exchange, interest rates and equity-linked structured products.

In a highly competitive market for corporate lending, Corporate Banking will continue to target asset yield in the year ahead. We will work to identify more cross-selling opportunities and expand corporate treasury services. We will step up efforts to acquire new customers to grow our Corporate Banking deposit base.

We will further strengthen cooperation and communication between all customer groups.

No one person can perform a symphony – it takes the efforts of an entire orchestra. I am delighted to be working with a world-class ensemble whose members are in tune with each other and with our customers' needs. Together we will continue to enhance our position as a leading financial institution in Greater China to the long-term benefit of our customers and shareholders.

Raymond Or
Vice-Chairman and Chief Executive
Hong Kong, 5 March 2007