

HONG KONG AND CHINA ECONOMIES

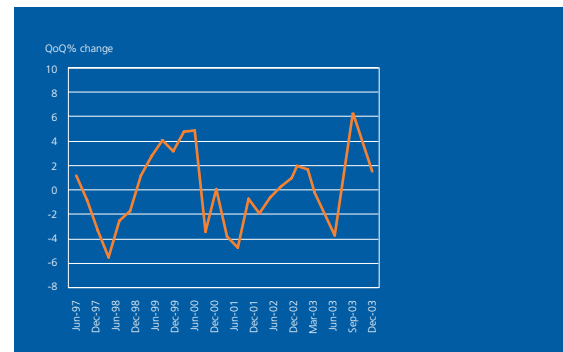
SARS brought the Hong Kong economy to a halt for almost three months in the spring of 2003. Turning to their historical sense of self-reliance, Hong Kong citizens initiated a recovery in the second half of the year, supported by CEPA and capital inflows attracted by the growing Chinese economy. China became the engine of growth for the entire region, expanding by 9.1% over 2003 despite the slowdown caused by SARS in the second quarter.

When the year of 2003 opened, most observers believed that the slowing U.S. economy and the growing likelihood of conflict in Iraq would have the greatest influence on Hong Kong, stifling growth in the export sector and further delaying a revival of domestic consumption. While both factors did indeed materialize, they were far outweighed by the impact of the outbreak of Severe Acute Respiratory Syndrome, or SARS, a form of atypical pneumonia that swept through China, Taiwan and Hong Kong, with lesser effects in Singapore, Vietnam and Canada.

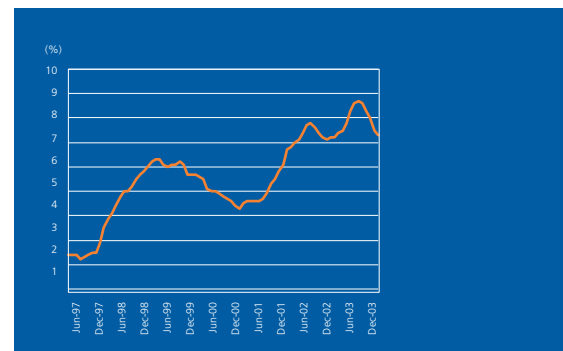
The first signs of SARS appeared in late February, but really struck with ferocity in March. Following the outbreak in the Prince of Wales Hospital early that month, the community and the economy suffered severe damage. Thousands of people were quarantined at home after being exposed to SARS victims. Streets, shopping malls, restaurants and theaters were deserted, with 300 people succumbing before the epidemic was declared over in June. There are few words to describe the fear and uncertainty that Hong Kong people faced over the five-month period. Aircraft arrivals fell by 75%, passenger loads plummeted to below 30%, hotel occupancy dropped to 10%, and retail sales fell 14% in April at the height of the outbreak.

Unemployment jumped, reaching 8.6% for the April-June period. Personal bankruptcies continued at high levels, after having surged from 9,151 in 2001 to 25,328 in 2002; in the first half of 2003 they jumped to 15,665, easing in the second half to 9,257 for a full year total of 24,922. Both consumer and corporate loan demand evaporated. Between January and September, lending fell by 3%. SARS effectively halted property sales, and the sharply reduced transactions reflected distress sales, forcing property prices down. Residential prices, which had already declined 65% from their peak in October 1997, suffered a 7-8% decline in the second quarter alone.

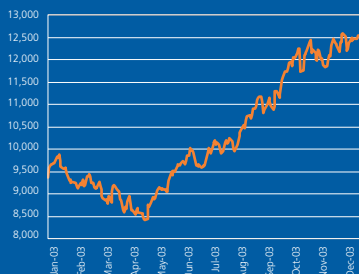
Real GDP growth



Unemployment



Hang Seng Index



Consumer Price Index



In the midst of all of these difficulties, the people of Hong Kong responded with the spirit that has been the hallmark of Hong Kong's success over the years. Facing the mystery of SARS, citizens quickly addressed environmental issues, and the medical profession was magnificent in caring for the victims of this frightening disease. A realization that Hong Kong's fate would be determined by individual efforts gave rise to a growing sense of confidence. Confidence was further fueled by the signing of the Closer Economic Participation Agreement ("CEPA"), a series of measures giving Hong Kong incorporated companies greater access to business opportunities in China. This helped to attract new foreign investment to Hong Kong, both as direct and portfolio investment, as overseas investors sought to gain a share in China's remarkable growth through the Hong Kong door.

Growing confidence and capital inflows helped initiate a revival in the second half of the year. Unemployment fell to 7.3% by the end of December. The Hang Seng Index rose to 12,594 in mid-December from its low point of 8,409 in April. 29 IPOs were launched between June and December. GDP expanded by 3.3% in 2003. Although the Consumer Price Index continued to decline year on year for the full 12 months of 2003, prices in December were higher than those in November, holding out the prospect of an end to deflation which had run 62 consecutive months since late 1998.

The Chinese economy, after growing at a 9.6% rate in the first quarter of 2003, slowed momentarily as a result of SARS, but then came roaring back. Full year GDP growth reached 9.1%, the highest rate since 1997. Exports increased 35% to US\$438 billion, while imports rose 40% to US\$413 billion. Foreign direct investment flowing into China totaled US\$53.5 billion. China was the engine that not only drove Hong Kong recovery, but also led all of Asia upward.

The CEPA agreements are an effort by the Chinese Central Government to spark renewed growth in Hong Kong. They allow Hong Kong incorporated companies to enter the China market on favorable terms. As an example, Hong Kong banks can qualify to open a branch once they have total assets of US\$6 billion, while banks incorporated elsewhere must have US\$20 billion in assets. China also loosened restrictions on tourist travel to Hong Kong. Previously, all tourists had to join official tour groups. Over 2003, residents first from Guangdong Province, then from a growing number of major cities, were permitted to cross into Hong Kong on individual visas. As a result, the number of Chinese tourists visiting Hong Kong in 2003 comprised 54% of total tourists and rose to 8.5 million. This

contributed to the 5% rise in retail sales in the fourth quarter in Hong Kong as the visitors took advantage of the range of selection and attractive prices.

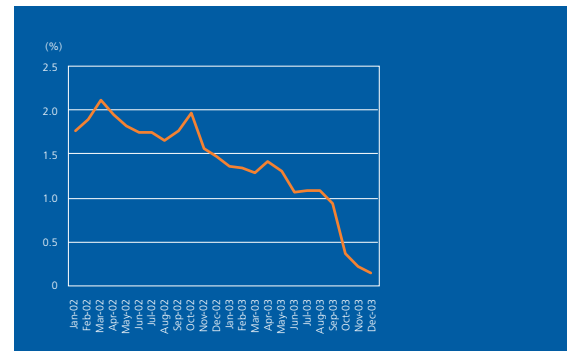
As Hong Kong entered 2004, there was a greater sense of optimism than has prevailed at any time since 1997. While government finance remained a problem, with the deficit for the fiscal year 2003-2004 standing at HK\$49 billion, the private sector seemed to be energized. China continued to enjoy strong growth in the early days of 2004, providing further momentum for Hong Kong.

IBA PERFORMANCE

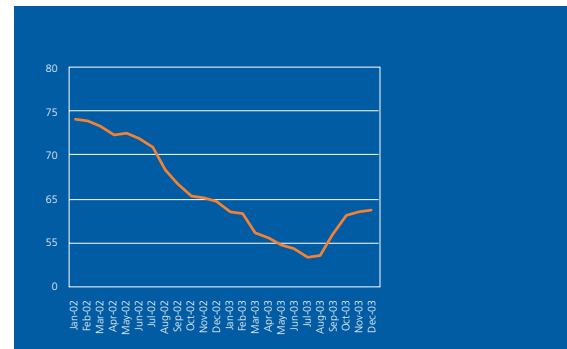
The first half of 2003 provided an extremely unfavorable environment. Banks suffered from a loss of loan demand, continuing bankruptcies, and a sharp fall in the value of repossessed assets. Although signs of recovery emerged in the second half of the year, revenues still suffered in a year on year comparison. IBA focused on banking fundamentals to mitigate the effect of these economic forces and to position itself for economic recovery. IBA focused on further strengthening its balance sheet during 2003. Although loans declined during the first months of the year, growth was achieved in the second half. Through promotion of the pacesetter Magic Money Manager account, an interest bearing demand deposit, IBA's deposit base expanded dramatically, with the proportion of low cost deposits jumping from 18% in December 2002 to 34% in December 2003. The introduction of attractive new investment products helped increase fee income, and the implementation of more advanced risk management systems cut bad debt provisions by half. Another strong year in realizing gains on investment securities helped offset the impact of SARS and provisions for decline in repossessed properties. The success in focus on fundamental banking practices resulted in a strong second half performance, and positioned the bank for economic expansion in 2004.

Profit attributable to shareholders for the twelve months ending 31 December 2003 was HK\$138 million, with net profit in the second half of the year increased by 64% compared to the first half of 2003. This compares to net profit of HK\$220 million in 2002.

3-month HIBOR



Mass Residential Property Index





▲ Tuen Mun and Kwun Tong Wealth Management Center Opening Ceremonies

Net interest income of HK\$604 million declined 14% year on year due to lower average loan outstandings, the HK\$7.6 billion increase in customer deposits and certificates of deposit outstanding, and the overall decline in interest rates - 3-month Hibor declined from 1.48% in December 2002 to 0.15% in December 2003. System wide, loans declined 2% during 2003, reflecting the weak economy and the heavy impact of SARS. IBA achieved strong performance in the second half of the year, offsetting some of the negative factors. Excellent growth in low cost deposits helped offset margin pressure.

Other operating income of HK\$202 million was up 16% year on year, and comprised 25% of total operating income of HK\$806 million, compared to 20% of operating income in 2002. The increase was driven by the introduction of new investment products, such as Equity Linked Deposits and Currency Linked Notes, along with the opening of new Wealth Management Centers in North Point, Kwun Tong and Tuen Mun, as well as a new Superbranch in Mongkok. The introduction of new products specifically designed to meet retail investors needs helped strengthen the customer base among middle-income families.

Operating expenses rose by 7% to HK\$489 million. New branches and Wealth Management Centers, along with additional resources in Treasury and in risk management, contributed to the increase. Costs associated with the potential sale of IBA, following the announcement in December 2002 that Arab Banking Corporation (B.S.C.) ("ABC") would entertain offers, were also incurred and reflected in the 2003 accounts.

Charges for bad and doubtful debts were reduced by 45% to HK\$187 million as new risk management systems and procedures substantially improved the quality of the consumer loan portfolio and economic conditions improved in the second half. Automation of application processing and a revised scoring methodology both reduced the number of existing accounts that became delinquent, and produced new accounts that have been trouble free. IBA made prudent provisions for the decline in the value of repossessed assets, adjusting the valuation on a quarterly basis according to changes in the property market. The provision for 2003 was HK\$71 million, doubling the provision for 2002, reflecting the impact of SARS in the second quarter of the year. However, the provision in the second half declined 85% to HK\$9 million, as property prices stabilized.

Operating profit after provisions but before gains on the investment portfolio increased 14% year on year to HK\$59 million, showing the combined effect of

gains in non-interest income and the sharp reduction of loan loss provisions. Although gains on the securities portfolio declined 47% to HK\$91 million, this was a very credible performance during a period of extremely low interest rates.

An increase in taxation from HK\$1.4 million in 2002 to HK\$11.6 million in 2003 produced a bottom line of HK\$138 million for the year, a 37% decline from 2002.

Total assets rose 17% to HK\$37.9 billion. After two years of gradual decline, loan growth was restored, with a \$605 million increase to HK\$15.6 billion. Growth came in residential mortgages, commercial loans and hire purchase contracts, offset by declines in consumer and syndicated loans. While IBA maintained very high liquidity (59% compared to 50% in 2002), and had cash and short term funds of HK\$7.2 billion at year-end, the investment portfolio rose to HK\$10.7 billion as of December 31, 2003. The portfolio is comprised of Hong Kong Exchange Fund paper, U.S. Treasuries, bank certificates of deposit and a small portion of high-grade corporate bonds.

IBA had great success in attracting new customer deposits, generated by the Magic Money Manager account, an interest bearing current account which meets customer needs. Total customer deposits grew HK\$7.6 billion to HK\$30.4 billion, of which HK\$1.7 billion is comprised of callable certificates of deposit subscribed to by retail customers. Low cost deposits, including the Magic Money Manager account, checking and savings accounts and call accounts, rose to 34% of total customer deposits, up from 18% at the end of 2002.

Shareholder funds stood at HK\$3.8 billion as of 31 December 2003.

During 2003 IBA expanded its branch network to 25, opening the fifth Superbranch in Mongkok. A new branch in Sheung Wan on Hong Kong Island will open in March 2004. The number of Wealth Management Centers increased to 10. New treasury systems linking the head office to branches and our partnership with iMarkets, which provides pricing and transaction processing for derivatives markets, enable IBA to deliver online quotations and completion of orders to customers throughout Hong Kong.

IBA has accelerated the transition from a traditional retail bank organized along business lines to an integrated, customer-centric institution. Product design, delivery channels, relationship responsibility and risk management are incorporated in a



▲ New Kowloon Main Branch (Mongkok)



▲ Strategic Planning Conference

continuously linked process, with key committees acting as the nodes in this chain. Semi-annual planning conferences bring together representatives from every area of the bank to analyze key issues and develop a comprehensive approach. Expanding the customer base, developing new products and services, adding delivery channels and integrating product expertise with customer relationship management reinforced IBA's franchise.



▲ Retail Products

Over the past five years the outlook of Hong Kong consumers and corporations has changed dramatically. They seek much more diversity in financial services. While continuing to expect traditional offerings from their bank, they want greater choice in the deployment and protection of their liquid assets, and more flexibility in obtaining funding. IBA has steadily developed both new products and enhanced delivery channels to meet these needs.

Prior to 2001, individuals and corporations had to maintain current accounts to meet operating requirements, and savings and fixed deposit accounts to invest surplus funds. With the elimination of statutory regulations on interest rates, IBA introduced the Magic Money Manager, or 3M, account, an interest bearing current account that meets both needs. The 3M account has gained widespread acceptance from consumers, and more recently from commercial clients. With new features being continuously added based on the research of Bank Product Development and Marketing, the Retail Banking, Investment Banking and Corporate Banking divisions have attracted HK\$5.6 billion in new 3M deposits over the course of 2003, increasing low cost funds (current, savings and call accounts) from 18% of total customer deposits in 2002 to 34% in 2003. IBA's automated Call Center has carried out telemarketing programs to invite additional subscribers to the 3M account, and has also advised 3M account holders of other offerings of the bank. By utilizing demographic data from the data warehouse that is linked to the Call Center, these programs have been highly focused, achieving higher levels of efficiency and avoiding calls that are extraneous to customer interests.



Small and medium size enterprises, the backbone of the Hong Kong economy, have opened many of the 3M accounts. IBA meets SME requirements through two business units, IBA Credit and the SME Unit. IBA Credit is the hire purchase and leasing subsidiary of the bank, and has established a leading position in the market. Over the past 15 years IBA Credit has gained expertise in a wide range of equipment and vehicle financing. This was a high growth area in 2003, providing high quality revenues at attractive yields. The SME Unit is part of the Retail

Banking Division, and is staffed by commercial lending specialists with experience in meeting the needs of businessmen. The SME Unit works closely with the Operations Division, and especially the Bills Department, to provide customized services to their clients, who require speedy and dependable service.

Retail Banking collaborates closely with Investment Banking and Treasury to package and deliver a wide range of investment products to our consumer clients. Product development has been centralized in the Treasury Division, with its extensive financial market relationships, enabling IBA to draw on expertise of investment banks to add special features and hence improve the return to our customers. These products are offered both through branches and our Wealth Management Centers. The Strategic Training and Development Department provides the training for frontline staff to ensure that they understand all features of the products before offering them to clients. In compliance with the Securities and Futures Ordinance, only qualified staff offer specialized products.

During 2003 these investment products included callable step-up certificates of deposit, equity linked deposits and notes, currency linked deposits and notes, target redemption notes, unit trusts, unit linked insurance products and full life products. With low prevailing rates on most deposits in the Hong Kong market, purchases of corporate and government bonds proved popular, and IBA was active in both the primary and secondary market, acting as agent for Hong Kong Mortgage Corporation and Hong Kong Mass Transit Corporation bonds as well as corporate issues.

The IBA Treasury Division is a Market Maker in Hong Kong Exchange Fund bills and notes, and is therefore active in both the primary and secondary market for these instruments. This has enhanced the capabilities of Treasury, which in addition to retail investment product development, is also responsible for management of cash flows, deposit rates and the securities portfolio under the guidance of the Asset and Liability Committee and the Investment Committee. The transformation of Treasury over the past two years has added substantially to our customer base and our sources of non-interest income, as well as improving the return on surplus deposits, which have now reached more than HK\$14.6 billion.

IBA, along with other retail banks in Hong Kong, plays a key role in making home ownership possible for Hong Kong citizens. With regular monthly payments and reassignments, the mortgage portfolio can run off rapidly. During 2003 we



▲ *Wealth Management Services*



▲ *Treasury Dealing Room*

expanded our offerings in mortgage financing, and had a net increase in outstandings, providing a steady source of interest income, as well as new customers to whom we offer other consumer products.

Hong Kong banks encountered a high rate of defaults on credit card lending beginning in late 2001 and continuing into 2002 and 2003. IBA installed new risk management systems with predictive capabilities, enabling us to proactively manage the portfolio and to offer risk-adjusted pricing to customers. With the new price setting mechanism, customers with good credit records no longer subsidize delinquent accounts, and the bank makes more accurate credit judgments. This risk analysis and pricing mechanism has been expanded to include personal loans and consumer leasing. Through utilization of this information, the bank carried out pre-emptive restructuring of the credit card portfolio. While this reduced outstanding advances, it also reduced specific provisions by almost HK\$127 million.

The Consumer Credit Risk Management Unit, the Corporate and Retail Banking Risk Management Unit, the Treasury Risk Management Unit and the Operations Division, along with the Internal Control Unit and Corporate Governance and Compliance Unit comprise the membership of the Risk Management Committee, which reviews methodologies and performance, and confirms compliance with all risk management guidelines. The committee has also initiated steps to introduce new approaches outlined in Basle II proposals.

The Corporate Banking Division added new officers and expanded lending selectively during the year. The client base extends from SME relationships, established prior to the introduction of the new SME Unit, to second-tier listed companies, and a handful of premier companies that have been clients of IBA for many years. Adopting the same customer-centric approach as all other divisions, Corporate Banking works closely with Treasury, Retail Banking and Investment Banking, as well as IBA Credit, to ensure that IBA meets all customer needs. With sharp currency swings in the latter part of 2003, advice from Treasury solidified our relationship with clients.

Creating a customer-centric culture in the bank has strengthened the franchise, gaining IBA a reputation for high quality products and personalized services. It has been important to expand the delivery channels to ensure that the franchise continues to grow. We added a Superbranch in Mongkok to supplement the existing Mongkok Branch, which had already reached the saturation point, raising



▲ IBA myCard



▲ Customers trading at Wealth Management Center

the number of branches to 25. Wealth Management Centers provide our customers with specialized services for stock brokerage, bond purchase and sales, unit trust investments and insurance products in a comfortable setting with on-line access to market information. New WMCs were opened in North Point, Kwun Tong and Tuen Mun in 2003.

Our Call Center staff has gained valuable experience in the application of technology and exploitation of the data warehouse. Monthly call volume has increased by 50%, and the variety of telemarketing programs has also grown. Each business unit is able to plan special promotions with the Call Center to focus on its particular client base. This has proven to be an increasingly valuable delivery channel.

IBA regards integrity as our priority, promoting this among all of our staff. The Corporate Governance and Compliance Unit plays a key role in ensuring that all staff are properly briefed on the Code of Conduct, all the numerous regulations that govern our business, and the internal policies approved by the Board of Directors. Working in association with the Internal Control Unit, Corporate Governance and Compliance clarifies new announcements from regulators and disseminates the information to staff. Their objective is to have staff internalize standards, and thus prevent errors and lapses of judgment from occurring. Their staff participate in product development discussions from the initial stage to ensure that all features are in accord with the Securities and Futures Ordinance, and work with the Strategic Training and Development staff to design the requisite training for the new products before the launch of the product.

The bank also understands its role in the community. In addition to the traditional support for families through home financing and banking services, as well as support of community service organizations, IBA has maintained its Regional Advisory Council since 1998. Community leaders from all walks of life serve as advisors to individual branches, and meet as a group with senior management once a quarter to exchange views on bank performance, service quality and needs of customers. This ensures that IBA is always in touch with the neighborhoods that it serves.

On 8 September 2003 Fubon Financial Holding Co., Ltd. ("Fubon Financial") and IBA jointly announced that, subject to the satisfaction of certain pre-conditions (such as relevant regulatory approvals being obtained), Fubon Financial would make a voluntary conditional cash offer to acquire the whole of the issued share



▲ 2003 Regional Advisory Council



▲ Fubon Bank Building



▲ IBA Senior Management

capital of IBA. ABC on the same day irrevocably undertook to accept such offer if made by Fubon Financial in respect of all of its 55% shareholding in IBA. After the pre-conditions were met, Fubon Financial made the voluntary conditional cash offer on 16 February 2004 and ABC tendered their acceptance in respect of all of their 55% shareholding in IBA on the same day. The offer closed on 8 March 2004, with Fubon Financial acquiring in aggregate 75.08% of the issued share capital of IBA. Fubon Financial will place the 0.08% of shares to independent parties to retain IBA's listed status.

ABC, based in Bahrain, has embarked on an expansion in the Middle East. In order to generate the capital to fund that expansion, ABC examined several alternatives, one of which involved the sale of subsidiaries outside of the home region. In 2002 ABC engaged BNP Paribas as a financial advisor to assist in the sale of IBA. In December 2002 ABC publicly announced that they would entertain offers that represented a fair price for the retail franchise built up by IBA over the past 15 years. Several institutions expressed their interest and conducted the due diligence process. Fubon Financial was selected because of the price, terms of the contract, and their capability of continuing to make the contributions to the community that IBA has performed in Hong Kong.

Fubon Financial provides a comprehensive range of financial products and services, including commercial banking, non-life and life insurance, securities brokerage, asset management and investment banking services, with more than 7 million customers served through a network of more than 330 bank branches and 9,000 sales and marketing representatives. As at 31 December 2003 Fubon Financial had shareholder funds of approximately US\$4.4 billion and total assets of US\$37.5 billion. It began as a property and casualty insurance company in 1961, and subsequently expanded to include securities brokerage, life insurance and banking. The holding company was established in December 2001.



▲ President George Bush visits IBA

Former President George Bush paid his third visit to IBA in October. President Bush met with students and graduates of the IBA-DePaul programs, discussing world affairs, education, citizenship and community values. The President is an enthusiastic supporter of the IBA-DePaul educational partnership which has allowed over 100 of our staff to earn BA and MBA degrees. After lunching with government officials, business leaders and IBA directors, Mr. Bush addressed 250 corporate guests and IBA staff at a dinner, speaking on global issues, American politics, the importance of China-U.S. relations and the potential of Hong Kong.

Mike M Murad

Vice Chairman, Managing Director and Chief Executive Officer

19 March 2004