

Management Discussion and Analysis

Banking

| | | |
|--|------------|---|
| Net profit attributable to shareholders: | HK\$56.0m | +69.5% |
| Total operating income: | HK\$284.3m | -4.8% |
| Net interest income: | HK\$226.4m | -3.9% |
| Other operating income: | HK\$57.8m | -8.2% |
| Operating expenses: | HK\$186.3m | -9.5% |
| Charge for bad and doubtful debts: | HK\$21.5m | -53.3% |
| Loans and advances: | HK\$7,342m | -5.1% |
| Customer deposits: | HK\$9,671m | -1.1% |
| Net interest margin: | 1.88% | (4 basis points lower than 2002) |
| Cost-to-income ratio: | 65.5% | (3.4 percentage points lower than 2002) |
| Average liquidity ratio: | 47.09% | (Average 2002: 52.19%) |
| Adjusted capital adequacy ratio: | 19.81% | (end-2003) |

Asia Commercial Bank achieved a welcome improvement in profit in 2003, following the general upturn in the economy during the year. However, in the face of continuing fierce competition, the Bank registered a lower business turnover in 2003. Relative to 2002, loans and advances declined 5.1% and customer deposits fell 1.1%. As a result of the decline in loans was that the general loan provisions that were required to be made fell. However the sharp improvement in economic conditions in strengthening many of the Bank's customers' financial and collateral positions enabled the Bank to make substantial writebacks which allowed its provisions for bad and doubtful loan to be reduced by 53.3%.

However, much of the improvement in profit for 2003 reflected the success of the Bank's efforts to improve cost and operational efficiencies. The staff structure has been streamlined and the branch network has been rationalized and consolidated to give greater focus to the more profitable business of commercial banking by enabling more branches to have a commercial banking capability.

The challenge for the Bank in the year ahead is to be able to take advantage of new lending opportunities and achieve good loan growth. Although market demand for residential mortgage and consumer loans is likely to rise, the Bank will be selective in growing its retail banking business as it regards such business to be highly competitive and better suited to banks with extensive branch networks. The Bank will instead focus on expanding its commercial banking business, especially to small and medium enterprises, which have been a traditional area of strength for the Bank.

The Bank will be seeking to reduce its reliance on interest based banking business and look to expanding its fee based banking business. The Bank believes that retail banking will offer good opportunities for earning fee income and in this regard will be putting greater effort to generating more fee income from services provided to retail banking customers, for example in relation to securities transactions and sales of investment linked products.

Insurance

| | | |
|--|------------|---------|
| Net profit attributable to shareholders: | HK\$123.8m | +283.3% |
| Underwriting profit: | HK\$65.0m | +67.6% |
| Investment/dividend income: | HK\$68.5m | N.A. |
| Interest and other income: | HK\$37.8m | +14.5% |
| Premium turnover: | HK\$736.9m | +29.5% |
| Operating expenses: | HK\$67.0m | +18.6% |
| Provision for mortgage loan receivables: | HK\$3.1m | +137.3% |

Asia Insurance enjoyed another successful year in 2003, with strong performance from both investment and underwriting activities.

Following closely the investment strategy adopted by Asia Financial Holdings, which saw a shift in the weighting of our portfolios towards equities in the second half of 2003, Asia Insurance was able to produce substantial investment gains when the equities markets rose in late 2003.

As business activities picked up with the upturn in the economy, there came an improved demand for general insurance cover and products. Asia Insurance benefited greatly from this as seen in the 30% increase in premium turnover and the 68% rise in underwriting profits on the previous year. During 2003, Asia Insurance further expanded its agency distribution network and gained market share. Asia Insurance continues to be a leading provider of professional liability insurance in Hong Kong.

Asia Insurance has carried a "A-" rating from Standard and Poor's since 1995.

Overall 2003, Asia Insurance achieved a net profit attributable to shareholders of HK\$124 million, which is an impressive 283% increase on 2002. The profit stated is after the making of a prudent provision for "Incurred But Not Reported Claims Reserve".