

FINANCIAL OVERVIEW

In 2005, the Chinese economy continued to expand, with GDP growing 9.9% and the consumer price index rising by 1.8%. With the liberalisation of both interest rates and exchange rates and surplus liquidity in the money market, we have been facing new challenges in the management of assets and liabilities. We have responded to these market changes by actively expanding our business and continuously enhancing management processes, achieving steady growth in assets, liabilities and profit before tax.

Unless otherwise specified, all business and financial data contained in this section is based on the consolidated figures of the Group.

INCOME STATEMENT ANALYSIS

We recorded profit before tax of RMB 55,364 million in 2005, representing an increase of RMB 4,165 million or 8.1% compared to that of 2004. The increase was attributable to the increase in net interest and net fee and commission income outweighing the increase in general and administrative expenses and provisions for impairment losses. Net profit reached RMB 47,096 million, a slight decrease of 4.0% compared to the previous year, and net profit attributable to shareholders amounted to RMB 47,103 million, largely as a result of an increase in income tax following the expiry on 30 June 2005 of the Bank's tax exemption status granted as part of the Bank's restructuring. Excluding the tax exemption effect, net profit for 2005 actually increased by RMB 5,681 million, or 16.9% compared to that of 2004 on the same basis.

Net interest income

Net interest income was RMB 116,551 million, representing an increase of RMB 15,063 million, or 14.8% against 2004, and the net interest margin was 2.78%, 4 basis points lower than that of 2004.

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The table below shows the average balances of assets and liabilities, related interest income or expense, and average rates of interest.

	2005			2004		
	Average balance	Interest Income/expense	Average Yield/cost (%)	Average Balance	Interest Income/expense	Average Yield/cost (%)
(In millions of RMB, except percentages)						
Assets						
Total loans and advances to customers	2,357,586	127,105	5.39	2,137,002	110,603	5.18
Investments	1,263,384	36,379	2.88	991,627	28,196	2.84
Balances with central banks	408,599	6,675	1.63	339,378	6,119	1.80
Amounts due from banks and non-bank financial institutions	160,524	3,442	2.14	123,361	2,027	1.64
Others	—	—	—	7,958	251	3.15
Total interest-earning assets	4,190,093	173,601	4.14	3,599,326	147,196	4.09
Total allowances for impairment losses	(60,531)	—	—	(57,379)	—	—
Non-interest-earning assets	153,330	—	—	240,745	—	—
Total assets/total interest income	4,282,892	173,601	4.05	3,782,692	147,196	3.89
Liabilities						
Deposits from customers	3,757,636	52,084	1.39	3,332,966	43,051	1.29
Amounts due to banks and non-bank financial institutions	164,590	2,920	1.77	110,748	1,805	1.63
Subordinated bonds issued	39,907	1,850	4.64	8,758	414	4.73
Others	6,828	196	2.87	6,136	438	7.14
Total interest-bearing liabilities	3,968,961	57,050	1.44	3,458,608	45,708	1.32
Non-interest-bearing liabilities	72,182	—	—	58,698	—	—
Total liabilities/total interest expense	4,041,143	57,050	1.41	3,517,306	45,708	1.30
Net interest income		116,551			101,488	
Net interest spread			2.70			2.77
Net interest margin			2.78			2.82

Interest income

Interest income was RMB 173,601 million, representing an increase of RMB 26,405 million, or 17.9% against 2004, which was attributable to growth in the loan and investment portfolios, and rising interest rates during the year.

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Interest income from loans and advances to customers

The table below shows the average balance, the interest income and average yield of each component of loans and advances to customers.

	Average balance	2005 Interest income	Average yield (%)	Average balance	2004 Interest income	Average yield (%)
(In millions of RMB, except percentages)						
Corporate loans	1,723,111	96,679	5.61	1,578,513	85,669	5.43
Personal loans	429,193	23,781	5.54	394,363	19,222	4.87
Discounted bills	171,815	5,304	3.09	132,270	4,839	3.66
Overseas operations	33,467	1,341	4.01	31,856	873	2.74
Total loans and advances to customers/total interest income	2,357,586	127,105	5.39	2,137,002	110,603	5.18

Interest income from loans and advances to customers increased by RMB 16,502 million, or 14.9% against 2004. The average balances of corporate loans, personal loans, discounted bills and overseas operations increased by 9.2%, 8.8%, 29.9% and 5.1% respectively. The change in loan volume contributed RMB 12,014 million to the increase in interest income.

Yields on corporate and personal loans rose in line with the increase in the People's Bank of China ("PBOC") benchmark rates in October 2004, and further increase in the yield on personal loans was recorded as a result of the suspension of the preferential mortgage rates in March 2005. The effect was partially offset by a fall in the yield on discounted bills because of increased market competition, and led to an overall increase of 21 basis points in average interest yield and contributed RMB 4,488 million to the increase in the interest income from loans and advances to customers.

Interest income from investments

Interest income from investments increased by RMB 8,183 million, or 29.0%, primarily due to the increase in the average balance of investments of RMB 271,757 million.

The average yield on the investment portfolio marginally increased by 4 basis points, due to the increase in the yield on the foreign currency portfolio following rises in the US Federal Reserve rates, as offset by the decrease in the yield on the RMB investment portfolio following fund inflows to the PRC government bond and money markets as a result of PBOC's lowering of the interest rate for surplus reserves, and the decrease in the yield on special government bond of RMB 49.2 billion from 7.2% to 2.25% since 1 December 2004, as part of the Bank's restructuring plan.

Interest expense

Interest expense for the year was RMB 57,050 million, representing an increase of RMB 11,342 million, or 24.8% over the previous year, primarily due to increased customer deposits and higher interest rates.

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Deposits from customers have historically been the Bank's primary source of funding, and interest expense on deposits from customers represented 94.2% and 91.3% of the total interest expense for 2004 and 2005 respectively. Due to strong growth in disposable income as a result of the rapidly developing economy, lack of alternative investment channels and the PBOC's increase of the benchmark interest rates for time deposits since October 2004, the average balance of customer deposits increased by 12.7% compared to that of 2004. Meanwhile, due to the widening interest spread between time and demand deposits, the balance of time deposits increased faster than that of demand deposits and as at 31 December 2005, time deposits represented 44.6% of total customer deposits, 3.3% higher than that as at the end of 2004, thus the average cost on deposits went up by 10 basis points.

Net interest margin and net interest spread

In 2005, the net interest margin and the net interest spread decreased slightly by 4 basis points and 7 basis points to 2.78% and 2.70% respectively.

As a result of the PBOC's increase of the benchmark interest rates for both lending and deposits in October 2004, the average yield of loans and advances to customers increased by 21 basis points, which was greater than that of the average cost on deposits from customers by 11 basis points mainly due to the delayed repricing of time deposits. However, the proportion of average loans to total average interest-earning assets decreased from 59.4% in 2004 to 56.3% in 2005, and other interest-earning assets with lower yields, such as investments, represented a greater proportion of the total average interest-earning assets. Accordingly, the increase in cost of fund on interest-bearing liabilities outweighed the increase in yield on interest-earning assets. As a result, the net interest spread decreased by 7 basis points. Meanwhile, due to the proceeds from the IPO in October 2005, the increase in the average balance of interest-earning assets was greater than that of the average balance of interest-bearing liabilities, which partially offsets the effect of narrower net interest spread and helped maintain a relatively stable net interest margin.

Net fee and commission income

	For the year ended 31 December	
	2005	2004
	(In millions of RMB)	
Fee and commission income		
Bank card fees	2,618	2,316
Remittance, settlement and accounts management fees	2,116	1,486
Agency fees from securities, foreign currency dealing and insurance services	1,927	1,472
Commission on trust business	946	702
Consultancy and advisory fees	848	732
Guarantee fees	290	233
Payment and collection services fees	246	192
Others	270	219
Subtotal	9,261	7,352
Fee and commission expenses	(806)	(881)
Net fee and commission income	8,455	6,471

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In 2005, net fee and commission income amounted to RMB 8,455 million, an increase of RMB 1,984 million, or 30.7% compared to the previous year, as a result of the strategic development of fee and commission based business.

Bank card income reached RMB 2,618 million, an increase of RMB 302 million, or 13.0% compared to that of 2004, which was mainly attributable to the increase in transaction volumes as the card business continued to expand in China.

Remittance, settlement and account management fees amounted to RMB 2,116 million, an increase of RMB 630 million, or 42.4% compared to that of 2004, primarily due to larger transaction volumes of foreign currency settlements, as well as the charging of maintenance fees on customer deposit accounts with small balances in 2005.

Agency fees from securities, foreign currency dealing and insurance services amounted to RMB 1,927 million, an increase of RMB 455 million, or 30.9%, compared to that of 2004, mainly due to larger transaction volumes of underwriting for government bonds, and agency services for funds and insurance, as well as more foreign currency transactions accompanying the reform of the RMB exchange rate mechanism during the year.

Net loss arising from foreign currency dealing

We recorded a net loss in foreign currency dealing in 2005, primarily due to the effect of the appreciation of the RMB on the translation of USD denominated assets. This loss was substantially reduced by the foreign exchange derivatives utilised by us to hedge such risks.

General and administrative expenses

	For the year ended 31 December	
	2005	2004
	(In millions of RMB)	
Staff costs	27,298	22,171
Property and equipment expenses	10,552	12,094
Business tax and surcharges	7,401	6,459
Other general and administrative expenses	12,841	12,695
Total general and administrative expenses	58,092	53,419
Cost-to-income ratio	45.13%	46.87%

In 2005, general and administrative expenses amounted to RMB 58,092 million, an increase of RMB 4,673 million, or 8.7%, compared to that of 2004, primarily due to the increase in staff costs which accounted for 47.0% (2004: 41.5%) of total general and administrative expenses. The increase in staff costs was driven by the increase in salaries, bonuses and welfare payments, which was in line with the improvement in our pre-tax financial performance.

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Property and equipment expenses decreased by 12.8%, primarily due to lower depreciation expenses as a result of the diminished impact of the revaluation of our property and equipment in connection with the Bank's restructuring.

In 2005, we further strengthened the cost control measures and managed to keep the increase of other general and administrative expense items at a relatively low level compared to the large increase in operating income.

As a result, the cost-to-income ratio improved, and decreased from 46.87% in 2004 to 45.13%.

Provisions for impairment losses

	For the year ended 31 December	
	2005	2004
	(In millions of RMB)	
Loans and advances to customers	13,706	6,109
Available-for-sale securities	948	1,876
Property and equipment	293	406
Others	311	967
Total provisions for impairment losses	15,258	9,358

The charge for impairment losses on loans and advances to customers experienced a significant increase compared to 2004. Please refer to "Loan Quality Analysis" for details. In recent years, we have made greater efforts to dispose of idle assets, debt-to-equity swaps and repossessed assets, and the balances of these assets decreased accordingly. At the same time we enhanced control over the quality of newly acquired assets, therefore the allowances for other impairment losses decreased compared to that of 2004.

Income tax

The charge for income tax for the year amounted to RMB 8,268 million, an increase of RMB 6,109 million compared to that of 2004. In addition to higher taxable income, the increase was a combined effect of the following factors:

- Expiry of the Bank's tax exemption status as at 30 June 2005. As part of the Bank's restructuring, income taxes of RMB 15,473 million and RMB 7,848 million were exempted for the year ended 31 December 2004 and for the six months ended 30 June 2005 respectively.
- As part of the Bank's restructuring, from 1 January 2005 interest income derived from the corporate bond of RMB 247 billion issued by China Cinda Asset Management Company specifically to the Bank ("Cinda bond") was no longer exempt from income tax, leading to a tax liability for the year of RMB 1,834 million.
- Tax authorities raised the Bank's tax deduction limit for salary expenses in the year of 2005, which reduced income tax liability arising from non-tax-deductible staff costs from RMB 3,906 million in 2004 to RMB 403 million in 2005 accordingly.

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BALANCE SHEET ANALYSIS

Assets

As at 31 December 2005, total assets amounted to RMB 4,585,742 million, an increase of RMB 675,822 million, or 17.3% compared with 2004. Loans and advances and investments continued to be the largest classes of assets and contributed to more than 75% of the increase in the total assets. Not only did customer deposits increase significantly during the year, but the Bank also received a large amount of additional capital from its IPO, leading to a substantial increase in overall funds. We further strengthened control on granting of new loans in 2005, and in order to maintain the profitability of available funds, we increased our investment in debt instruments, leading to a higher increase in investments compared to that in loans.

The following table shows the composition of the total assets as at the balance sheet dates:

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
	(In millions of RMB, except percentages)			
Loans and advances to customers	2,458,398		2,227,426	
Allowances for impairment losses	(63,085)		(53,864)	
Net loans and advances to customers	2,395,313	52.2	2,173,562	55.6
Investments	1,413,871	30.8	1,107,636	28.3
Cash and balances with central banks	480,136	10.5	399,366	10.2
Net amounts due from banks and non-bank financial institutions	190,108	4.2	112,531	2.9
Other assets ¹	106,314	2.3	116,825	3.0
Total assets	4,585,742	100.0	3,909,920	100.0

1. Consist of property and equipment, deferred tax assets and other assets.

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Loans and advances to customers

As at 31 December 2005, loan and advances to customers amounted to RMB 2,458,398 million, an increase of RMB 230,972 million, or 10.4% compared with 2004.

The following table shows an analysis of loans and advances to customers by loan type.

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
	(In millions of RMB, except percentages)			
Corporate loans	1,775,791	72.2	1,624,419	72.9
Discounted bills	194,122	7.9	157,275	7.1
Personal loans	453,889	18.5	412,275	18.5
Overseas operations	34,596	1.4	33,457	1.5
Total loans and advances to customers	2,458,398	100.0	2,227,426	100.0

Corporate loans have remained the largest component of our loan portfolio. As at 31 December 2005 corporate loans amounted to RMB 1,775,791 million, an increase of RMB 151,372 million, or 9.3% compared with 2004. Strong growth was seen in fixed assets loans, especially in infrastructure and real estate development loans, where we historically has had a competitive advantage.

The following table sets forth the components of the corporate loans by product type.

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
	(In millions of RMB, except percentages)			
Working capital loans	908,688	51.2	893,172	55.0
Fixed asset loans				
Infrastructure loans	550,851	31.0	451,558	27.8
Real estate development loans	190,977	10.8	147,240	9.1
Technical improvement loans	98,153	5.5	99,923	6.1
Corporate mortgage loans	2,434	0.1	1,746	0.1
Subtotal	842,415	47.4	700,467	43.1
Others¹	24,688	1.4	30,780	1.9
Total corporate loans	1,775,791	100.0	1,624,419	100.0

1. Primarily consist of factoring, overdrafts, trade finance facilities and on-lending loans.

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Discounted bills continued to grow, with an increase of 23.4% compared with 2004, as a result of our strategic focus on the business in recent years due to the historically low losses associated with it. However, the rate of increase was lower than in previous years due to increased market competition. Discounted bills, as a proportion of total loans and advances to customers, increased by 0.8 percentage points in 2005.

Personal loans recorded growth of 10.1% or RMB 41,614 million in 2005, comprising 18.5% of our total loan portfolio. Residential mortgages are still the key driver of growth, although the 12.5% growth in the mortgage portfolio in 2005 is lower than that in previous years as a result of the PRC government's macroeconomic controls on the property market. Personal consumption loans showed a decline of RMB 3,359 million, due to a decrease in automobile loans resulting from a tightening of our credit policies and adverse conditions in the automobile industry.

The table below illustrates the components of the personal loans by product type:

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
(In millions of RMB, except percentages)				
Residential mortgage loans	348,219	76.7	309,401	75.0
Personal consumption loans	60,150	13.3	63,509	15.4
Others	45,520	10.0	39,365	9.6
Total personal loans	453,889	100.0	412,275	100.0

As at 31 December 2005, the largest exposure to an individual borrower was 6.7% and the largest line of credit to a borrowing group was 10.7% of the Bank's regulatory capital (total capital base after deductions). These ratios are within the approved limits of CBRC.

Investments

In accordance with IFRS, our investments are classified into receivables, held-to-maturity debt securities, available-for-sale debt and equity investments, and debt securities at fair value through profit and loss (primarily consisting of debt securities held for trading purpose). For the purpose of the following analysis, we have classified the investment portfolio into the following categories:

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
(In millions of RMB, except percentages)				
Debt instruments	958,470	67.8	657,423	59.4
Receivables	443,729	31.4	433,858	39.2
Equity instruments	11,672	0.8	16,355	1.4
Total investments	1,413,871	100.0	1,107,636	100.0

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With the increase in customer deposits, we invested surplus funds in debt instruments, especially PBOC bills. The balance of debt instruments increased by RMB 301,047 million, or 45.8% compared to the previous year.

The table below sets out debt instruments by issuer:

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
	(In millions of RMB, except percentages)			
Government	263,870	27.5	256,354	39.0
Policy banks	162,938	17.0	128,324	19.5
Central banks	328,827	34.3	120,124	18.3
Banks and non-bank financial institutions	143,614	15.0	66,524	10.1
Public sector entities	41,268	4.3	69,038	10.5
Others	17,953	1.9	17,059	2.6
Total debt instruments	958,470	100.0	657,423	100.0

Receivables are financial assets (other than derivatives) with fixed or determinable payments that are not quoted in an active market or actively traded and are classified as neither held-to-maturity nor available-for-sale. Receivables primarily include the Cinda bond of RMB 247,000 million, non-transferable bills with nominal values of RMB 63,354 million and RMB 21,000 million issued specifically to the Bank by the PBOC, and a non-negotiable bond with a nominal value of RMB 49,200 million issued by the MOF. All these bills and bonds are related to the Bank's restructuring.

Equity instruments primarily consist of equity holdings obtained through debt-to-equity swaps. The decline was primarily due to disposals during the year.

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Liabilities

As at 31 December 2005 liabilities amounted to RMB 4,298,065 million, an increase of RMB 583,696 million, or 15.7% compared with 2004.

The following table lists the composition of total liabilities as at the balance sheet dates.

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
	(In millions of RMB, except percentages)			
Deposits from customers	4,006,046	93.3	3,491,121	94.0
Amounts due to banks and non-bank financial institutions	164,524	3.8	112,039	3.0
Subordinated bonds issued	39,907	0.9	39,896	1.1
Other liabilities ¹	87,588	2.0	71,313	1.9
Total liabilities	4,298,065	100.0	3,714,369	100.0

1. Consist of amounts due to central banks, certificates of deposit issued, current tax liabilities, deferred tax liabilities, and other liabilities and provisions.

Deposits from customers

We maintain an extensive customer base and deposits from customers continue to be our major source of funding. Continuous expansion in China's economy, strong growth in public disposable income, limited alternative investment channels and rising interest rates for time deposits are the main reasons for the continued increase in the balance of RMB denominated deposits, especially in time deposits.

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The following table shows customer deposits by product type:

	As at 31 December 2005		As at 31 December 2004	
	Amounts	% of total	Amounts	% of total
	(In millions of RMB, except percentages)			
Corporate deposits				
Demand deposits	1,474,483	36.7	1,389,028	39.8
Time deposits	619,564	15.5	444,482	12.7
Subtotal	2,094,047	52.2	1,833,510	52.5
Personal deposits				
Demand deposits	708,608	17.7	633,302	18.1
Time deposits	1,188,813	29.7	1,013,998	29.1
Subtotal	1,897,421	47.4	1,647,300	47.2
Overseas operations	14,578	0.4	10,311	0.3
Total deposits from customers	4,006,046	100.0	3,491,121	100.0

As a result of the wider difference between the time and demand deposit rates following the adjustment to PBOC benchmark rates in October 2004, time deposits increased by 24.0%, while demand deposits grew at a lower rate of 7.9%.

Shareholders' funds

	As at 31 December 2005	2004
	(In millions of RMB)	
Share capital	224,689	194,230
Share premium	42,091	—
General reserve	10,332	—
Retained earnings	4,783	1,048
Other reserves	5,684	238
Total shareholders' equity	287,579	195,516

The increase in share capital and share premium were mainly due to the IPO in October 2005. Please refer to note 27 (e) of "Financial Statements" for details of the general reserve included as part of the shareholders' equity set aside in 2005.

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LOAN QUALITY ANALYSIS

In determining the classification of the loan portfolio, we apply a series of criteria that are derived from CBRC guidelines. For details of the criteria, please refer to the "Risk Management — Credit Risk Management".

Distribution of loans by grading

The following tables set forth, as of the dates indicated, the distribution of our loan portfolio by five-category loan classification, under which NPLs are classified as substandard, doubtful or loss.

	As at 31 December 2005		As at 31 December 2004	
	Amount	% of total	Amount	% of total
	(In millions of RMB, except percentages)			
Normal	2,072,969	84.4	1,768,578	79.4
Special mention	290,960	11.8	371,468	16.7
Substandard	42,456	1.7	51,430	2.3
Doubtful	45,457	1.8	31,059	1.4
Loss	6,556	0.3	4,891	0.2
Total loans and advances to customers	2,458,398	100.0	2,227,426	100.0
Non-performing loan ratio	3.84%		3.92%	

As we further strengthened our credit risk management and internal control, overall loan quality was improved, which was reflected in the decrease of both the NPL ratio from 3.92% at the end of 2004 to 3.84% at the end of 2005, and the ratio of special mention loans to total loans from 16.7% to 11.8% over the same period.

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Distribution of loans and advances to customers and NPLs by product type

The following table sets forth, as of the dates indicated, loans and advances to customers as well as NPLs by product type.

	As at 31 December 2005			As at 31 December 2004		
	Loans and advances	NPLs	% of NPLs to loans ¹	Loans and advances	NPLs	% of NPLs to loans ¹
(In millions of RMB, except percentages)						
Corporate loans						
Working capital loans	908,688	62,755	6.9	893,172	59,635	6.7
Fixed asset loans	842,415	20,560	2.4	700,467	19,095	2.7
Others ²	24,688	2,339	9.5	30,780	2,559	8.3
Subtotal	1,775,791	85,654	4.8	1,624,419	81,289	5.0
Discounted bills	194,122	—	—	157,275	2	—
Personal loans						
Residential mortgage loans	348,219	4,605	1.3	309,401	3,442	1.1
Personal consumption loans	60,150	2,221	3.7	63,509	1,204	1.9
Others ³	45,520	1,842	4.0	39,365	1,323	3.4
Subtotal	453,889	8,668	1.9	412,275	5,969	1.4
Overseas operations	34,596	147	0.4	33,457	120	0.4
Total	2,458,398	94,469	3.84	2,227,426	87,380	3.92

1. Calculated by dividing non-performing loans in each category by total loans in that category.

2. Primarily consist of factoring, overdrafts, trade financing and on-lending loans.

3. Primarily consist of individual commercial property mortgage loans, education loans and credit card overdrafts.

Corporate loans increased by RMB 151,372 million over the previous year. Despite the increase in the balance of corporate NPLs by RMB 4,365 million, the NPL ratio fell by 0.2 percentage points, of which the NPL ratio of fixed asset loans dropped by 0.3 percentage points while that of working capital loans rose by 0.2 percentage points over the previous year.

Personal NPLs increased by RMB 2,699 million in 2005 with the personal NPL ratio at 1.9% at the end of the year. The increase in residential mortgage NPL ratio was mainly because some property developers were unable to raise sufficient funds to continue their property projects due to macroeconomic measures by the

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PRC government, and as a result a greater number of borrowers did not repay their mortgage loans. The personal consumption NPLs increased by RMB 1,017 million compared to 31 December 2004, which was mainly due to the increase of defaults on automobile loans.

Distribution of corporate loans and NPLs by industry

The following table sets forth, as of the dates indicated, the distribution of non-performing corporate loans by industry.

	As at 31 December 2005				As at 31 December 2004			
	Loans and advances	% of total loans	NPLs	% of NPLs to loans ¹	Loans and advances	% of total loans	NPLs	% of NPLs to loans ¹
(In millions of RMB, except percentages)								
Corporate loans								
Manufacturing	433,104	17.6	25,967	6.0	396,631	17.8	22,511	5.7
Transportation, storage and postal services	278,532	11.3	5,512	2.0	236,033	10.6	2,643	1.1
Production and supply of electric power, gas and water	265,647	10.8	7,918	3.0	231,590	10.4	8,969	3.9
Property development	256,396	10.4	17,611	6.9	244,036	10.9	19,341	7.9
Construction	86,855	3.5	4,443	5.1	82,139	3.7	4,850	5.9
Water, environment and public utility	75,959	3.1	1,320	1.7	54,814	2.5	1,331	2.4
Education	63,395	2.6	644	1.0	51,309	2.3	553	1.1
Wholesale and retail	63,179	2.6	7,926	12.5	56,863	2.5	7,165	12.6
Telecommunications, computer services and software	60,304	2.5	1,494	2.5	72,163	3.2	1,057	1.5
Mining	49,332	2.0	717	1.5	52,637	2.4	813	1.5
Others ²	143,088	5.8	12,102	8.5	146,204	6.6	12,056	8.2
Subtotal	1,775,791	72.2	85,654	4.8	1,624,419	72.9	81,289	5.0
Discounted bills	194,122	7.9	—	—	157,275	7.1	2	—
Personal loans	453,889	18.5	8,668	1.9	412,275	18.5	5,969	1.4
Overseas operations	34,596	1.4	147	0.4	33,457	1.5	120	0.4
Total loans and advances to customers	2,458,398	100.0	94,469	3.84	2,227,426	100.0	87,380	3.92

1. Calculated by dividing non-performing loans in each category by total loans in that category.

2. Primarily consist of leasing and commercial services; health care, social security and social welfare; culture, sports and entertainment; government agencies and non-government organizations.

NPLs to the production and supply of electric power, gas and water and property development industries decreased by RMB 1,051 million and RMB 1,730 million, with the NPL ratios dropping 0.9 percentage points and 1 percentage point, respectively. We have intensified our efforts in recovering NPLs in these industries, and has gradually reduced our exposure to high risk borrowers and shifted to higher quality customers with better fundamentals.

The increase in the NPL ratio of loans to the manufacturing industry was primarily due to the fact that under the PRC government's macroeconomic control measures, some companies ran into operating difficulties and therefore were unable to meet their due loan obligations.

FINANCIAL OVERVIEW

The main reason for the increase in the NPL ratio in the transportation, storage and postal services industries from 1.1% to 2.0% was due to the adjustment of toll fee policies in certain areas, which left the repayment schedules of borrowers in the transportation industry mismatched with their expected cash flows, leading to overdue loans and downgrades.

Distribution of loans by collateral

The following table sets forth, as of the dates indicated, the distribution of the loan portfolio by the type of collaterals.

	As of 31 December 2005		As of 31 December 2004	
	Loans and advances	% of total	Loans and advances	% of total
(In millions of RMB, except percentages)				
Loans secured by monetary assets	202,546	8.2	163,452	7.3
Loans secured by tangible, other than monetary assets	935,706	38.1	790,675	35.5
Guaranteed loans	633,180	25.8	662,237	29.8
Unsecured loans	686,966	27.9	611,062	27.4
Total Loans and advances to customers	2,458,398	100.0	2,227,426	100.0
Less: Allowances for impairment losses	(63,085)		(53,864)	
Net loans and advances to customers	2,395,313		2,173,562	

As at 31 December 2005, the proportion of loans secured by tangible assets increased by 3.5 percentage points as we have strengthened credit risk management by requiring more borrowers to provide tangible assets for security. Accordingly, the proportion of guaranteed loans decreased from 29.8% in 2004 to 25.8% in 2005.

FINANCIAL OVERVIEW

Changes to the allowances for impairment losses on loans and advances to customers

The following table sets forth, for the periods indicated, the changes to the allowances for impairment losses on loans and advances to customers.

	2005 (In millions of RMB)	2004
As at 1 January	53,864	54,395
Charge for the year ¹	13,706	6,109
Unwinding of interest on impaired loans ²	(725)	(520)
Transfers out ³	(93)	(432)
Write-offs	(3,784)	(6,342)
Recoveries of loans and advances previously written off	117	654
As at 31 December	63,085	53,864

1. Represents the amount of the net allowances for impairment losses recognised in the consolidated income statement.

2. Represents the amount of increase in the present value of a loan after impairment due to the passage of time, and was recognised as interest income.

3. Consist of releases from the loan loss allowances resulting from (i) the net transfer between NPLs and repossessed assets; and (ii) the net transfer between NPLs and equity holdings obtained through debt-to-equity swaps.

The charge for impairment losses on loans and advances increased by RMB 7,597 million, as a result of increased NPLs balances and change in composition of NPLs portfolios. The balance of NPLs increased by RMB 7,089 million over the previous year. In addition, the proportions of substandard, doubtful and loss loans were 45.0%, 48.1% and 6.9% at the end of 2005 while such proportions at the end of 2004 were 58.9%, 35.5% and 5.6% respectively.

CAPITAL ADEQUACY

According to the *Regulation Governing Capital Adequacy of Commercial Banks* issued by CBRC which came into effect on 1 March 2004, our capital adequacy ratio (excluding the Bank's subsidiaries) increased by 2.28 percentage points as at 31 December 2005. The increase was primarily due to the rise in the capital base following the IPO.

FINANCIAL OVERVIEW

The following table sets forth, for the periods indicated, the information related to capital adequacy ratio.

	As at 31 December	
	2005	2004
	(In millions of RMB, except percentages)	
Core capital adequacy ratio¹	11.08%	8.57%
Capital adequacy ratio²	13.57%	11.29%
Components of capital base		
Core capital:		
Paid up ordinary share capital	224,689	194,230
Reserves	59,520	514
Total core capital	284,209	194,744
Supplementary capital:		
General provision for doubtful debts	24,563	22,256
Term subordinated bonds	40,000	40,000
Total supplementary capital	64,563	62,256
Total capital base before deductions	348,772	257,000
Deductions: unconsolidated equity investments	(1,528)	(1,012)
Total capital base after deductions	347,244	255,988
Risk-weighted assets	2,558,956	2,267,467

1 Core Capital adequacy ratio is calculated by dividing the net amount of core capital after deductions of 50% of unconsolidated equity investments by risk weighted assets.

2 Capital adequacy ratio is calculated by dividing the total capital base after deductions by risk weighted assets.