

Under the rules of Shanghai Stock Exchange on which our A shares are listed, we are required to file interim financial report containing unaudited financial statements prepared in accordance with the Accounting Standards for Business Enterprises issued by the Ministry of Finance (the “MOF”), the Accounting Regulations for Financial Enterprises (2001), and other relevant regulations issued by the MOF (collectively “PRC GAAP”). Because we released certain financial statements for the first half of 2006 (including financial statements for the same period in 2005) prior to the date of this prospectus, we have prepared interim financial report in accordance with International Financial Reporting Standards (“IFRSs”) and have incorporated such report in this prospectus.



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September 8, 2006

INDEPENDENT REVIEW REPORT TO THE BOARD OF DIRECTORS OF CHINA MERCHANTS BANK CO., LTD.

Introduction

We have been instructed by China Merchants Bank Co., Ltd. (the “Bank”) to review the interim financial report set out in Sections I to VI of this appendix.

Respective responsibilities of directors and auditors

It is the Directors’ responsibility to prepare the interim financial report to be in compliance with International Accounting Standard 34, “Interim financial reporting” issued by the International Accounting Standards Board and the relevant provisions thereof. The interim financial report has been approved by the Directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700, “Engagements to review interim financial reports” issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of

assurance than an audit. Accordingly, we do not express an audit opinion on the interim financial report.

Review conclusion

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended June 30, 2005 and June 30, 2006.

KPMG

Certified Public Accountants

Hong Kong, China

I UNAUDITED CONSOLIDATED INCOME STATEMENT
(Expressed in millions of Renminbi unless otherwise stated)

	Note	Six months ended June 30,	
		2005	2006
Interest income	3	11,965	15,270
Interest expense	4	(4,064)	(5,842)
Net interest income		<u>7,901</u>	<u>9,428</u>
Fee and commission income	5	698	1,322
Fee and commission expense		(100)	(198)
Net fee and commission income		<u>598</u>	<u>1,124</u>
Other net income	6	<u>404</u>	<u>389</u>
Operating income		8,903	10,941
Operating expenses	7	(4,163)	(4,848)
Operating profit before provisions		4,740	6,093
Provision for impairment losses	8	(1,595)	(1,698)
Profit before tax		3,145	4,395
Income tax	9	(1,216)	(1,618)
Net profit attributable to equity holders of the Bank		<u>1,929</u>	<u>2,777</u>
Dividends			
Declared and paid	22(a)	753	983
Proposed special dividend	22(b)(iii)	—	2,210
		<u></u>	<u></u>
		RMB	RMB
Earnings per share			
Basic	10(a)	0.17	0.23
Diluted	10(b)	0.17	0.23
		<u></u>	<u></u>

II UNAUDITED CONSOLIDATED BALANCE SHEET

(Expressed in millions of Renminbi unless otherwise stated)

	Note	December 31, 2005	June 30, 2006
Assets			
Cash and balances with banks and other financial institutions	11	22,491	24,513
Balances with central bank	12	62,102	65,318
Placements with banks and other financial institutions	13	46,982	65,193
Loans and advances to customers	14	458,675	516,527
Investments	15	131,902	137,710
Fixed assets		6,777	6,746
Deferred tax assets	16(a)	2,166	2,289
Other assets		3,518	6,020
Total assets		<u>734,613</u>	<u>824,316</u>
Liabilities			
Deposits from banks and other financial institutions	17	39,673	58,954
Placements from banks and other financial institutions	18	3,574	977
Deposits from customers	19	634,404	703,602
Financial liabilities at fair value through profit or loss	15(e)	86	173
Certificates of deposit issued	20(a)	1,211	1,199
Convertible bonds issued	20(b)	5,184	39
Other debts issued	20(c)	9,982	9,985
Current taxation		2,715	2,212
Other liabilities		8,286	10,932
Subordinated notes issued	20(d)	3,500	3,500
Total liabilities		<u>708,615</u>	<u>791,573</u>
Shareholders' equity			
Share capital	21	10,374	12,280
Capital reserve		6,095	9,436
Surplus reserve		1,591	2,377
Investment revaluation reserve		404	108
Regulatory general reserve		3,000	3,000
Retained profits		2,918	3,332
Proposed profit appropriations	22(b)	1,616	2,210
Total shareholders' equity		<u>25,998</u>	<u>32,743</u>
Total shareholders' equity and liabilities		<u>734,613</u>	<u>824,316</u>

III UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Expressed in millions of Renminbi unless otherwise stated)

	Note	For the six months ended June 30, 2005							Total
		Share capital	Capital reserve	Surplus reserve	Investment revaluation reserve	Regulatory general reserve	Retained profits	Proposed profit appropriations	
At January 1, 2005		6,848	9,046	962	(65)	—	3,785	1,382	21,958
Net profit for the period		—	—	—	—	—	1,929	—	1,929
Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2004		—	—	629	—	—	—	(629)	—
Dividends paid for the year 2004	22(a)	—	—	—	—	—	—	(753)	(753)
Capital reserve transferred to share capital upon issue of shares	21	3,424	(3,424)	—	—	—	—	—	—
Conversion of convertible bonds		—	1	—	—	—	—	—	1
Realised on disposal of available-for-sale financial assets		—	—	—	73	—	—	—	73
Changes in fair value of available-for-sale financial assets		—	—	—	(54)	—	—	—	(54)
At June 30, 2005		<u>10,272</u>	<u>5,623</u>	<u>1,591</u>	<u>(46)</u>	<u>—</u>	<u>5,714</u>	<u>—</u>	<u>23,154</u>

III UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)

(Expressed in millions of Renminbi unless otherwise stated)

		For the six months ended June 30, 2006							
	Note	Share capital	Capital reserve	Surplus reserve	Investment revaluation reserve	Regulatory general reserve	Retained profits	Proposed profit appropriations	Total
At January 1, 2006		10,374	6,095	1,591	404	3,000	2,918	1,616	25,998
Net profit for the period . .		—	—	—	—	—	2,777	—	2,777
Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2005		—	—	786	—	—	—	(786)	—
Dividends paid for the year 2005	22(a)	—	—	—	—	—	—	(983)	(983)
Capital reserve transferred to share capital upon issue of shares	21	971	(971)	—	—	—	—	—	—
Conversion of convertible bonds		935	4,312	—	—	—	—	—	5,247
Realised on disposal of available-for-sale financial assets		—	—	—	(7)	—	—	—	(7)
Changes in fair value of available-for-sale financial assets		—	—	—	(289)	—	—	—	(289)
Proposed dividends: 22(b)									
— for the year 2005		—	—	—	—	—	(153)	153	—
— special		—	—	—	—	—	(2,210)	2,210	—
At June 30, 2006		12,280	9,436	2,377	108	3,000	3,332	2,210	32,743

IV UNAUDITED CONSOLIDATED CASH FLOW STATEMENT
(Expressed in millions of Renminbi unless otherwise stated)

		Six months ended June 30,	
	Note	2005	2006
Operating activities			
Profit before tax		3,145	4,395
Adjustments for:			
— Impairment losses charged on loans and advances		1,468	1,602
— Impairment losses charged/(released) on deposits and placements with banks and other financial institutions		127	(66)
— Impairment losses charged on other assets		—	162
— Unwind of interest income on impaired loans		(113)	(102)
— Depreciation		410	439
— Amortisation of discount and premium of debt investments		31	4
— Amortisation of discount and premium of bonds issued		98	6
— Write-off of loans and advances, net of recoveries		59	65
— Net gain on debt investments		(135)	(97)
— Net loss on disposal of fixed assets		1	—
— Interest income on debt investments		(1,473)	(1,759)
— Interest expense on issued debts		178	238
Changes in operating assets and liabilities:			
Net increase in balances with and amounts due to central bank		(889)	—
(Increase)/decrease in balances and placements with banks and other financial institutions with original maturity over 3 months		(3,693)	621
(Increase)/decrease in discounted bills		(28,777)	3,282
Increase in loans and advances to customers		(43,697)	(62,699)
Increase in other assets		(1,780)	(2,715)
Increase in deposits from customers		73,053	69,198
Increase in deposits and placements from banks and other financial institutions ..		6,154	16,684
Increase in other liabilities		4,182	2,601
Net cash inflow from operating activities		<u>8,349</u>	<u>31,859</u>
Income tax paid		<u>(1,526)</u>	<u>(2,192)</u>
Investing activities			
Payment for purchase of debt investments		(58,004)	(54,142)
Proceeds from redemption or disposal of debt investments		53,125	50,425
Interest received from debt investments		1,549	1,945
Payment for purchase of fixed assets		(489)	(540)
Proceeds from sale of fixed assets		41	132
Net cash outflow from investing activities		<u>(3,778)</u>	<u>(2,180)</u>
Net cash inflow before financing		<u>3,045</u>	<u>27,487</u>

IV UNAUDITED CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)
(Expressed in millions of Renminbi unless otherwise stated)

	<u>Note</u>	<u>Six months ended June 30,</u>	
		<u>2005</u>	<u>2006</u>
Financing activities			
Dividends paid		(686)	(971)
Interest paid on certificates of deposit, subordinated notes and convertible bonds issued		(19)	(31)
Net cash outflow from financing activities		<u>(705)</u>	<u>(1,002)</u>
Net increase in cash and cash equivalents		2,340	26,485
Cash and cash equivalents at 1 January		95,952	120,609
Effect of foreign exchange rate changes		6	(191)
Cash and cash equivalents at June 30	23(a)	<u>98,298</u>	<u>146,903</u>
Cash flows from operating activities include:			
Interest received		10,559	13,230
Interest paid		<u>3,090</u>	<u>5,176</u>

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)**1 REPORTING ENTITY**

China Merchants Bank Co., Ltd. (“the Bank”) is a bank domiciled in the People’s Republic of China. The condensed consolidated interim financial statements of the Bank as at and for the six months ended June 30, 2006 comprise the Bank and its subsidiary (together referred to as the “Group”).

The consolidated financial statements of the Group as at and for the year ended December 31, 2005 are available upon request from the Bank’s registered office at China Merchants Bank Tower, Shenzhen, the PRC.

2 BASIS OF PREPARATION

The interim financial report has been prepared in accordance with the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, including compliance with International Financial Reporting Standards (“IFRSs”) IAS 34 “Interim Financial Reporting” issued by the International Accounting Standards Board (“IASB”). It was authorised for issuance on September 8, 2006.

This interim financial report has been prepared in accordance with the same accounting policies adopted by the Group as set out in the 2005 annual financial statements (“2005 annual financial statements”) included in the Accountants’ Report dated September 8, 2006, the text of which is set out in Appendix I to the Prospectus.

The preparation of interim financial report in conformity with IAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year-to-date basis. Actual results may differ from these estimates.

This interim financial report contains condensed consolidated financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since 2005 annual financial statements. The condensed consolidated interim financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with IFRSs and should be read in conjunction with the consolidated financial statements of the Group as at and for the year ended December 31, 2005 included in the Accountants’ report.

This interim financial report is unaudited, but has been reviewed by KPMG in accordance with Statement of Auditing Standards 700, “Engagements to review interim financial reports”, issued by the Hong Kong Institute of Certified Public Accountants.

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

3 INTEREST INCOME

	Six months ended June 30,	
	2005	2006
Loans and advances	9,749	12,213
Balances with central bank	390	480
Deposits and placements with		
— banks	312	724
— other financial institutions	72	98
Debt investments	1,442	1,755
Interest income on financial assets that are not at fair value through profit or loss	11,965	15,270

4 INTEREST EXPENSE

	Six months ended June 30,	
	2005	2006
Deposits from customers	3,283	4,963
Deposits and placements from		
— banks	158	199
— other financial institutions	347	436
Issued debts	276	244
	4,064	5,842

5 FEE AND COMMISSION INCOME

	Six months ended June 30,	
	2005	2006
Bank card fees	227	422
Remittance and settlement fees	188	280
Agency services fees	93	268
Commissions from credit commitments and loan business	76	132
Trust services fees	45	78
Others	69	142
	698	1,322

6 OTHER NET INCOME

	Six months ended June 30,	
	2005	2006
Net gain arising from foreign currency dealing	224	280
Net gain on financial instruments at fair value through profit or loss	141	104
Net gain/(loss) on disposal of available-for-sale financial assets	2	(26)
Net loss on disposal of fixed assets	(1)	—
Rental income	31	26
Others	7	5
	404	389

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

7 OPERATING EXPENSES

	Six months ended June 30,	
	2005	2006
Staff costs		
— salaries, bonuses and staff welfare	1,643	1,736
— contributions to defined contribution retirement schemes	188	232
— housing allowances	112	156
— others	71	166
	<u>2,014</u>	<u>2,290</u>
Business tax and surcharges	550	700
Depreciation	410	439
Rental expenses	325	391
Other general and administrative expenses	864	1,028
	<u>4,163</u>	<u>4,848</u>

8 PROVISION FOR IMPAIRMENT LOSSES

	Six months ended June 30,	
	2005	2006
Impairment losses charged/(released) on:		
— loans and advances (Note 14(c))	1,468	1,602
— deposits and placements with banks and other financial institutions	127	(66)
— other assets	—	162
	<u>1,595</u>	<u>1,698</u>

9 INCOME TAX

Income tax in the consolidated income statement represents:

	Six months ended June 30,	
	2005	2006
Current tax	1,369	1,689
Deferred tax	(153)	(71)
	<u>1,216</u>	<u>1,618</u>

The current tax provision is based on the estimated assessable profit for 2006, and is determined by using tax rates applicable to the Bank's operations in different areas.

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

10 EARNINGS PER SHARE

Movements of the share capital, including issuance of bonus shares and conversion of convertible bonds issued, are included in Notes 20(b) and 21.

(a) Basic earnings per share

The calculation of basic earnings per share is based on the net profit attributable to equity holders of the Bank and the weighted average number of shares in issue, calculated as follows:

	Six months ended June 30,	
	2005	2006
Net profit	1,929	2,777
Weighted average number of shares in issue (in million)	11,155	12,174
Basic earnings per share (in RMB)	0.17	0.23

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on the diluted net profit and the weighted average number of shares in issue after adjusting for the effect of all dilutive potential shares, calculated as follows:

	Six months ended June 30,	
	2005	2006
Net profit	1,929	2,777
Interest expense on convertible bonds issued	147	10
Diluted net profit	2,076	2,787
Weighted average number of shares in issue (in million)	11,155	12,174
Effect of deemed conversion of convertible bonds (in million)	1,133	114
Weighted average number of shares in issue after dilution (in million)	12,288	12,288
Diluted earnings per share (in RMB)	0.17	0.23

11 CASH AND BALANCES WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2005	June 30, 2006
Cash	3,915	3,636
Balances with banks	18,603	20,904
Balances with other financial institutions	71	2
	22,589	24,542
Less: Impairment loss		
— banks	(27)	(29)
— other financial institutions	(71)	—
	(98)	(29)
	22,491	24,513

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)

12 BALANCES WITH CENTRAL BANK

	December 31, 2005	June 30, 2006
Statutory deposit reserve funds	39,909	43,467
Surplus deposit reserve funds	21,966	20,900
Fiscal deposits	227	951
	<u>62,102</u>	<u>65,318</u>

The statutory deposit reserve funds are not available for the Group's daily operations. The statutory deposit reserve funds are calculated at 7.5% and 3% for eligible Renminbi deposits and foreign currency deposits respectively as at June 30, 2006 (December 31, 2005: 7.5% and 3% for eligible Renminbi deposits and foreign currency deposits respectively). Eligible deposits include deposits from government authorities and other organisations, fiscal deposits (other than budgets), retail deposits, corporate deposits, net credit balances of entrusted business and other deposits.

13 PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2005	June 30, 2006
Money market placements		
— banks	22,930	21,080
— other financial institutions	22	80
	<u>22,952</u>	<u>21,160</u>
Balances under resale agreements		
— banks	14,153	30,227
— other financial institutions	10,126	13,960
	<u>24,279</u>	<u>44,187</u>
	<u>47,231</u>	<u>65,347</u>
Less: Impairment loss		
— banks	(49)	(63)
— other financial institutions	(200)	(91)
	<u>(249)</u>	<u>(154)</u>
	<u>46,982</u>	<u>65,193</u>

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)

14 LOANS AND ADVANCES TO CUSTOMERS

(a) Loans and advances to customers

	December 31, 2005	June 30, 2006
Corporate loans	298,622	349,274
Discounted bills	99,527	96,245
Retail loans	74,036	86,058
Gross loans and advances to customers	472,185	531,577
Less: Allowances for impairment losses	(13,510)	(15,050)
Net loans and advances to customers	<u>458,675</u>	<u>516,527</u>

(b) Analysis of loans and advances to customers

(i) Analysed by legal form of borrowers:

	December 31, 2005	June 30, 2006
<i>Domestic enterprises:</i>		
State-owned enterprises	111,779	132,415
Joint-stock enterprises	48,576	53,282
Other limited liability enterprises	47,619	63,726
Others	43,803	45,845
	<u>251,777</u>	<u>295,268</u>
Foreign-invested enterprises	43,418	49,018
Enterprises operating in the Mainland	295,195	344,286
Enterprises operating outside the Mainland	3,427	4,988
	<u>298,622</u>	<u>349,274</u>
Discounted bills	99,527	96,245
Retail loans	74,036	86,058
Gross loans and advances to customers	<u>472,185</u>	<u>531,577</u>

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

14 LOANS AND ADVANCES TO CUSTOMERS (continued)

*(b) Analysis of loans and advances to customers (continued)**(ii) Analysed by borrowers' industry sector:*

	December 31, 2005	June 30, 2006
Manufacturing	75,735	76,751
Transportation and telecommunications	66,154	78,166
Energy and resources	44,820	54,226
Trading	33,966	38,105
Property development and investment	20,089	25,075
Investment management	16,604	20,744
Hospitality	7,513	10,638
Infrastructure and construction	11,305	12,906
Others	22,436	32,663
Corporate loans	298,622	349,274
Discounted bills	99,527	96,245
Retail loans	74,036	86,058
Gross loans and advances to customers	<u>472,185</u>	<u>531,577</u>

(c) Movements of allowances for impairment losses

	Year ended December 31, 2005	Six months ended June 30, 2006
At January 1	10,920	13,510
Charge for the year/period	4,031	2,123
Releases for the year/period	(456)	(521)
Unwinding of discount	(244)	(102)
Recoveries of loans and advances previously written off	84	150
Write-offs	(745)	(85)
Transfers out	(2)	—
Exchange differences	(78)	(25)
At December 31/June 30	<u>13,510</u>	<u>15,050</u>

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

14 LOANS AND ADVANCES TO CUSTOMERS (continued)

(d) Loans and advances to customers and allowances for impairment losses

	December 31, 2005				
	(note (i)) Loans and advances for which impairment losses are collectively assessed	(note (ii)) Impaired loans and advances		Total	Gross impaired loans and advances as a % of gross loans and advances
		for which impairment losses are collectively assessed	for which impairment losses are individually assessed		
Gross loans and advances to					
— financial institutions	2,567	—	—	2,567	0.00
— non-financial institution customers	457,451	460	11,707	469,618	2.59
	<u>460,018</u>	<u>460</u>	<u>11,707</u>	<u>472,185</u>	<u>2.58</u>
Less:					
Allowances for impairment losses on loans and advances to					
— financial institutions	(19)	—	—	(19)	
— non-financial institution customers	<u>(6,116)</u>	<u>(315)</u>	<u>(7,060)</u>	<u>(13,491)</u>	
	<u>(6,135)</u>	<u>(315)</u>	<u>(7,060)</u>	<u>(13,510)</u>	
Net loans and advances to					
— financial institutions	2,548	—	—	2,548	
— non-financial institution customers	<u>451,335</u>	<u>145</u>	<u>4,647</u>	<u>456,127</u>	
	<u>453,883</u>	<u>145</u>	<u>4,647</u>	<u>458,675</u>	

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

14 LOANS AND ADVANCES TO CUSTOMERS (continued)

(d) Loans and advances to customers and allowances for impairment losses (continued)

	June 30, 2006			
	(note (i)) Loans and advances for which impairment losses are collectively assessed	(note (ii)) Impaired loans and advances		Gross impaired loans and advances as a % of gross loans and advances
		for which impairment losses are collectively assessed	for which impairment losses are individually assessed	
				Total
Gross loans and advances to				
— financial institutions	5,030	—	—	5,030
— non-financial institution customers	514,331	533	11,683	526,547
	<u>519,361</u>	<u>533</u>	<u>11,683</u>	<u>531,577</u>
Less:				
Allowances for impairment losses on loans and advances to				
— financial institutions	(26)	—	—	(26)
— non-financial institution customers	(7,241)	(369)	(7,414)	(15,024)
	<u>(7,267)</u>	<u>(369)</u>	<u>(7,414)</u>	<u>(15,050)</u>
Net loans and advances to				
— financial institutions	5,004	—	—	5,004
— non-financial institution customers	507,090	164	4,269	511,523
	<u>512,094</u>	<u>164</u>	<u>4,269</u>	<u>516,527</u>

Notes:

- (i) These loans and advances include those for which no objective evidence of impairment has been identified on individual basis (i.e. loans which are graded normal or special mention).
- (ii) Impaired loans and advances include loans for which objective evidence of impairment has been identified:
- individually (comprising corporate loans and advances which are graded substandard, doubtful and loss); or
 - collectively; that is portfolios of homogeneous loans (comprising retail loans which are graded substandard, doubtful and loss).

15 INVESTMENTS

	December 31, 2005	June 30, 2006
Financial assets at fair value through profit or loss (Note 15(a))	15,869	9,220
Available-for-sale investments (Note 15(b))	60,086	72,614
Held-to-maturity debt securities (Note 15(c))	48,711	48,643
Receivables (Note 15(d))	7,236	7,233
	<u>131,902</u>	<u>137,710</u>

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)

15 INVESTMENTS (continued)

(a) Financial assets at fair value through profit or loss

	December 31, 2005	June 30, 2006
(i) Trading assets		
<i>Listed/quoted</i>		
In the Mainland		
— PRC government bonds	275	400
— bonds issued by the PBOC	5,081	1,920
— bonds issued by PRC policy banks	3,507	1,782
— other debt securities	1,003	88
— equity investments	30	24
Outside the Mainland		
— other debt securities	141	—
— equity investments	2	5
	10,039	4,219
Derivative financial instruments (Note 25(b))	86	142
	<u>10,125</u>	<u>4,361</u>
(ii) Financial assets designated at fair value through profit or loss		
<i>Listed/quoted</i>		
In the Mainland		
— PRC government bonds	5,248	4,368
— bonds issued by PRC policy banks	496	491
	5,744	4,859
	<u>15,869</u>	<u>9,220</u>
<i>Financial assets at fair value through profit or loss</i> <i>(excluding derivative financial instruments)</i>		
Issued by:		
Central governments	5,523	4,768
Central banks	5,081	1,920
Policy banks	4,003	2,273
Banks and other financial institutions	141	—
Corporate entities	1,035	117
	<u>15,783</u>	<u>9,078</u>

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)

15 INVESTMENTS (continued)

(b) Available-for-sale investments

	December 31, 2005	June 30, 2006
<i>Listed/quoted</i>		
In the Mainland		
— PRC government bonds	7,891	7,919
— bonds issued by the PBOC	20,612	28,092
— bonds issued by PRC policy banks	9,751	11,046
— other debt securities	6,804	4,202
Outside the Mainland		
— other debt securities	4,901	6,341
— other investments	1,211	1,245
	<u>51,170</u>	<u>58,845</u>
<i>Unlisted/unquoted</i>		
In the Mainland		
— bonds issued by the PBOC	6,890	11,857
— other debt securities	1	1
— equity investments	38	38
Outside the Mainland		
— other debt securities	1,979	1,865
— equity investments	8	8
	<u>8,916</u>	<u>13,769</u>
	<u>60,086</u>	<u>72,614</u>
Issued by:		
Central governments	7,891	7,919
Central banks	27,502	39,949
Policy banks	9,751	11,046
Banks and other financial institutions	7,627	9,127
Public sector entities	611	681
Corporate entities	6,704	3,892
	<u>60,086</u>	<u>72,614</u>

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

15 INVESTMENTS (continued)

(c) Held-to-maturity debt securities

	December 31, 2005	June 30, 2006
<i>Listed/quoted</i>		
In the Mainland		
— PRC government bonds	15,321	14,104
— bonds issued by the PBOC	1,137	1,229
— bonds issued by PRC policy banks	23,532	23,510
— other debt securities	1,934	4,112
Outside the Mainland		
— other debt securities	6,787	5,688
	<u>48,711</u>	<u>48,643</u>
Fair value	<u>48,997</u>	<u>48,671</u>
Issued by:		
Central governments	15,765	14,578
Central banks	1,137	1,229
Policy banks	23,532	23,510
Banks and other financial institutions	4,932	4,034
Public sector entities	1,821	1,646
Corporate entities	1,524	3,646
	<u>48,711</u>	<u>48,643</u>

(d) Receivables

	December 31, 2005	June 30, 2006
In the Mainland		
— PRC government bonds	5,388	5,110
Outside the Mainland		
— other debt securities	1,848	2,123
	<u>7,236</u>	<u>7,233</u>
Issued by:		
Central governments	5,596	5,264
Banks and other financial institutions	1,479	1,808
Corporate entities	161	161
	<u>7,236</u>	<u>7,233</u>

Receivables are unlisted/unquoted bearer's national bonds issued by the PRC government and other debt investments which the Group has the intention and ability to hold to maturity. These receivables are not quoted in an active market in the PRC or overseas. Accordingly, the Group is unable to disclose their market values. The Group considers the recoverable amounts from these assets upon their maturities are the same as their carrying values and no provision for impairment losses is required.

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

15 INVESTMENTS (continued)*(e) Financial liabilities at fair value through profit or loss*

	December 31, 2005	June 30, 2006
Derivative financial instruments at fair value (Note 25(b))	86	173

16 DEFERRED TAX*(a) Recognised deferred tax assets*

The components of deferred tax assets/(liabilities) are as follows:

	December 31, 2005	June 30, 2006
Impairment losses on loans and advances to customers and other assets	2,292	2,373
Investment revaluation reserve	(71)	(19)
Others	(55)	(65)
	<u>2,166</u>	<u>2,289</u>

(b) Movements of deferred tax

	Impairment losses on loans and advances to customers and other assets	Write-off of overdue interest receivable	Investment revaluation reserve	Others	Total
At January 1, 2005	1,884	86	12	(45)	1,937
Recognised in consolidated income statement	478	(86)	—	(10)	382
Recognised in reserves	—	—	(83)	—	(83)
Write-offs	(70)	—	—	—	(70)
At December 31, 2005	<u>2,292</u>	<u>—</u>	<u>(71)</u>	<u>(55)</u>	<u>2,166</u>
At January 1, 2006	2,292	—	(71)	(55)	2,166
Recognised in consolidated income statement	81	—	—	(10)	71
Recognised in reserves	—	—	52	—	52
At June 30, 2006	<u>2,373</u>	<u>—</u>	<u>(19)</u>	<u>(65)</u>	<u>2,289</u>

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

17 DEPOSITS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2005	June 30, 2006
Deposits from banks	8,928	7,405
Deposits from other financial institutions	30,745	51,549
	<u>39,673</u>	<u>58,954</u>

18 PLACEMENTS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2005	June 30, 2006
Money market takings		
— banks	424	467
Balances under repurchase agreements		
— banks	1,505	—
— other financial institutions	1,537	283
	<u>3,042</u>	<u>283</u>
Rediscounted bills	108	227
	<u>3,574</u>	<u>977</u>

19 DEPOSITS FROM CUSTOMERS

	December 31, 2005	June 30, 2006
Demand deposits		
— corporate customers	219,230	233,019
— retail customers	118,566	132,296
	<u>337,796</u>	<u>365,315</u>
Time deposits		
— corporate customers	159,245	183,808
— retail customers	137,363	154,479
	<u>296,608</u>	<u>338,287</u>
	<u>634,404</u>	<u>703,602</u>

20 ISSUED DEBT SECURITIES**(a) Certificates of deposit issued**

On June 21, 2004, the Bank issued 3-year certificates of deposit at a nominal value of US\$150 million with interest at LIBOR +0.35% per annum payable quarterly.

V NOTES TO THE INTERIM FINANCIAL REPORT
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20 ISSUED DEBT SECURITIES (continued)

(b) Convertible bonds issued

On November 10, 2004, the Bank issued a 5-year convertible bond with a nominal value of RMB6.5 billion. The interest rates are 1.0% for the first year, 1.375% for the second year, 1.75% for the third year, 2.125% for the fourth year and 2.5% for the fifth year, payable on November 10 each year. The convertible bonds can be converted into the Bank's shares at the holder's option at RMB9.34 per share during the period from May 10, 2005 to November 10, 2009. Upon maturity, an additional 6% interest will be given to bond holders who have not converted the bonds into shares.

The conversion price of the bonds was revised from RMB9.34 per share to RMB6.23 per share with effect from June 17, 2005 following the issue of bonus shares by the Bank in 2005.

The conversion price of the bonds has been further revised from RMB6.23 per share to RMB5.74 per share with effect from February 24, 2006 following the issue of bonus shares by the Bank in 2006.

The Bank has an early redemption option which commences six months after the bonds' issue date and lapses on the maturity date. During that period, the Bank may redeem any outstanding convertible bonds at 103% of the nominal value of the convertible bonds plus the accrued interest if the closing price of the Bank's listed A shares is more than 125% of the then applicable conversion price for 20 consecutive business days.

During the final year before the maturity date of the convertible bonds, if the last traded price of the Bank's listed A shares falls below 75% of the conversion price for 20 consecutive trading days, the bond holders can exercise the put option to sell to the Bank all or a portion of the outstanding bonds at 108.5% of the nominal value of the convertible bonds plus accrued interest.

Details of the convertible bonds are as follows:

	December 31, 2005	June 30, 2006
Initial recognition:		
— Nominal value	6,500	6,500
— Issuance cost	(65)	(65)
— Equity component	(918)	(918)
Liability component at issue date	5,517	5,517
Accretion	227	233
Amounts converted to shares	(560)	(5,711)
Liability component as at December 31/June 30	<u>5,184</u>	<u>39</u>

V NOTES TO THE INTERIM FINANCIAL REPORT
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20 ISSUED DEBT SECURITIES (continued)

(c) Other debts issued

<u>Particulars</u>	<u>Terms</u>	<u>Date of issue</u>	<u>Annual fixed interest rate</u> (%)	<u>Nominal value</u> (in million)
Fixed term notes	36 months	From October 13, 2005 to October 26, 2005	2.13	5,000
Fixed term notes	60 months	From October 13, 2005 to October 26, 2005	2.56	5,000

The China Banking Regulatory Commission (the “CBRC”) and the PBOC approved the Bank’s issuance of a total of RMB15 billion fixed term notes on September 29, 2005 (Yin Jian Fu [2005] No. 252) and October 9, 2005 (Yin Fu [2005] No. 75) respectively. The Bank issued a total of RMB10 billion fixed rate term notes during the period from October 13, 2005 to October 26, 2005. Interest on these notes is payable annually.

(d) Subordinated notes issued

<u>Particulars</u>	<u>Terms</u>	<u>Date of issue</u>	<u>Annual fixed interest rate</u> (%)	<u>Nominal value</u> (in million)
Fixed rate notes	61 months	March 31, 2004 and June 10, 2004	4.59 to 5.1	3,500

The CBRC approved the Bank’s issuance of RMB3,500 million subordinated notes on March 30, 2004 (Yin Jian Fu [2004] No. 36), and the amount has been included as supplementary capital in calculating the Bank’s capital adequacy ratio. Interest on the subordinated notes is payable annually.

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)

21 SHARE CAPITAL

	Registered and issued share capital	
	No. of shares	Amount
	(in million)	
At January 1, 2005	6,848	6,848
Bonus shares issued	3,424	3,424
Conversion of convertible bonds	102	102
At December 31, 2005	<u>10,374</u>	<u>10,374</u>
At January 1, 2006	10,374	10,374
Bonus shares issued	971	971
Conversion of convertible bonds	935	935
At June 30, 2006	<u>12,280</u>	<u>12,280</u>

By type of share:

	No. of shares	
	December 31, 2005	June 30, 2006
Unlisted legal person shares (note)	7,572	7,573
Listed shares	<u>2,802</u>	<u>4,707</u>
	<u>10,374</u>	<u>12,280</u>

Note: Subsequent to the completion of the Bank's Share Reform Scheme, the unlisted legal person shares become listed shares subject to trading restriction with effect from February 27, 2006.

On February 24, 2006, bonus shares were issued at a ratio of 0.8589 bonus shares for every 10 shares of the Bank by capitalisation of an amount of RMB971 million from the capital reserve. In addition, the Bank issued 935 million shares upon conversion of the convertible bonds of RMB5,151 million during the six months period ended June 30, 2006, resulting in the increase in share capital and capital reserve of RMB935 million and RMB4,312 million respectively. As a result, the Bank's registered and issued capital increased from RMB10,374 million to RMB12,280 million.

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

22 PROFIT APPROPRIATIONS

(a) Dividends declared and paid

	Six months ended June 30,	
	2005	2006
Dividends in respect of the previous year, approved, declared and paid during the period of RMB0.8 (2005: RMB1.1) per every 10 shares	<u>753</u>	<u>983</u>

(b) Proposed profit appropriations

	Amount appropriated in respect of the year ended December 31, 2005	Amount appropriated in respect of the six months ended June 30, 2006
Statutory surplus reserve	393	—
Statutory public welfare fund	393	—
Dividends		
— Final: Nil (2005: RMB0.8) per every 10 shares	<u>830</u>	—
Total	<u>1,616</u>	<u>—</u>

Notes:

- (i) 2005 profit was appropriated in accordance with the resolution passed at the twenty-fourth meeting of the sixth Board of Directors held on April 10, 2006 and as approved in the annual general meeting held on May 16, 2006. The actual amount approved increased to RMB983 million from RMB830 million (see (ii) below).
- (ii) Additional dividends totalling RMB153 million in respect of the year ended December 31, 2005 were declared on new shares issued as a result of the conversion of convertible bonds exercised during the first three months of 2006. This amount together with the original dividend of RMB830 million proposed at December 31, 2005 were paid in June 2006.
- (iii) In the light of the Global Offering, the Bank's Board of Directors approved on June 30, 2006, a special dividend distribution of RMB0.18 per share for the Bank's holders of A Shares from its distributable retained profits at December 31, 2005. The special dividend of RMB2,210 million was approved by the Bank's shareholders in an extraordinary general meeting on August 19, 2006.

V NOTES TO THE INTERIM FINANCIAL REPORT

(Expressed in millions of Renminbi unless otherwise stated)

23 NOTES TO CONSOLIDATED CASH FLOW STATEMENTS*(a) Analysis of the balances of cash and cash equivalents*

	June 30, 2005	June 30, 2006
Cash	3,539	3,636
With original maturity within 3 months:		
— balances with banks and other financial institutions	8,088	16,183
— balances with central bank	48,552	65,318
— placements with banks and other financial institutions	37,693	53,765
— investment securities:		
— at fair value through profit or loss	—	229
— available-for-sale	320	7,618
— receivables	106	154
	<u>98,298</u>	<u>146,903</u>

(b) Significant non-cash transactions

Apart from the non-cash transactions relating to the conversion of convertible bonds to share capital during the period of which the details are included in Note 20(b), there were no other significant non-cash transactions.

24 SEGMENTAL REPORTING

The Group's principal activities are commercial lending and deposits taking. The funding of existing retail and corporate loans are mainly from customer deposits.

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format as it is more relevant to the Group's operating activities.

For the purpose of segmental analysis, external net interest income/expense represents the net interest income earned or expenses incurred on banking businesses originated by these segments. Internal net interest income/expense represents the allocation of revenue to reflect the benefits of funding sources allocated to the business segments by way of internal funds transfer pricing mechanism. The internal funds transfer pricing mechanism has taken into account the structure and market returns of the assets and liabilities portfolio. Cost allocation is based on the direct cost incurred by the respective business segments and apportionment of management overheads. Inter-segment interest income and expenses recognised through the internal funds transfer pricing mechanism are eliminated in the consolidated results of the operations.

V NOTES TO THE INTERIM FINANCIAL REPORT
(Expressed in millions of Renminbi unless otherwise stated)

24 SEGMENTAL REPORTING (continued)

(a) Business segments

The Group comprises the following main business segments:

● **Corporate banking**

The provision of financial services to corporations and institutions includes lending and deposit taking activities, project and structured finance products, syndicated loans, cash management, investment advice and other investment services.

● **Retail banking**

The provision of financial services to retail customers includes lending and deposit taking activities, credit card facilities and investment services.

● **Treasury business**

It covers interbank and capital market activities and proprietary trading.

● **Others and unallocated**

These represent equity investments, and assets, liabilities, income and expenses of the head office that are not directly attributable to a segment or cannot be allocated on a reasonable basis.

	Six months ended June 30, 2005				
	Corporate banking	Retail banking	Treasury business	Others and unallocated	Total
External net interest income	5,814	372	1,715	—	7,901
Internal net interest (expense)/income	(324)	1,817	(1,493)	—	—
Net interest income	5,490	2,189	222	—	7,901
Net fee and commission income	281	269	7	41	598
Other net income	175	51	137	41	404
Operating income	5,946	2,509	366	82	8,903
Operating expenses					
— depreciation	(225)	(170)	(15)	—	(410)
— others	(2,052)	(1,479)	(220)	(2)	(3,753)
	(2,277)	(1,649)	(235)	(2)	(4,163)
Provision for impairment losses	(1,244)	(224)	(127)	—	(1,595)
Total expenses	(3,521)	(1,873)	(362)	(2)	(5,758)
Profit before tax	2,425	636	4	80	3,145
Capital expenditure	269	202	18	—	489
December 31, 2005					
Segment assets	390,429	75,331	263,748	5,105	734,613
Segment liabilities	378,475	255,929	63,210	11,001	708,615

V NOTES TO THE INTERIM FINANCIAL REPORT
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24 SEGMENTAL REPORTING (continued)

(a) Business segments (continued)

	Six months ended June 30, 2006				
	Corporate banking	Retail banking	Treasury business	Others and unallocated	Total
External net interest income	6,367	235	2,826	—	9,428
Internal net interest (expense)/income	(82)	1,893	(1,811)	—	—
Net interest income	6,285	2,128	1,015	—	9,428
Net fee and commission income/(expense)	436	641	(4)	51	1,124
Other net income	229	73	83	4	389
Operating income	6,950	2,842	1,094	55	10,941
Operating expenses					
— depreciation	(241)	(181)	(17)	—	(439)
— others	(2,319)	(1,783)	(305)	(2)	(4,409)
	(2,560)	(1,964)	(322)	(2)	(4,848)
Provision for impairment losses	(1,517)	(247)	66	—	(1,698)
Total expenses	(4,077)	(2,211)	(256)	(2)	(6,546)
Profit before tax	2,873	631	838	53	4,395
Capital expenditure	296	223	21	—	540
	June 30, 2006				
Segment assets	436,246	87,094	292,804	8,172	824,316
Segment liabilities	416,826	286,776	74,828	13,143	791,573

(b) Geographical segments

The Group operates principally in the PRC with branches located in 31 provinces, autonomous regions and municipalities directly under the central government.

In presenting information on the basis of geographical segments, operating income is allocated based on the location of the branches that generated the revenue. Segment assets and capital expenditure are allocated based on the geographical location of the underlying assets.

Geographical segments, as defined for management reporting purposes, are as follows:

- “Eastern China” region refers to the areas serviced by the following branches of the Group: Shanghai Municipality, Jiangsu Province, Zhejiang Province, Shandong Province, Fujian Province, Anhui Province, City of Qingdao, City of Ningbo, City of Suzhou and City of Xiamen;
- “Southern and Central China” region refers to the areas serviced by the following branches of the Group: Guangdong Province, City of Shenzhen, Hunan Province, Jiangxi Province, Hubei Province, Henan Province, City of Dongguan and City of Foshan;

V NOTES TO THE INTERIM FINANCIAL REPORT

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24 SEGMENTAL REPORTING (continued)

(b) Geographical segments (continued)

- “Western China” region refers to the areas serviced by the following branches of the Group: Sichuan Province, Chongqing Municipality, Yunnan Province, Shaanxi Province, Gansu Province, and Xinjiang Autonomous Region;
- “Northern China” region refers to the areas serviced by the following branches of the Group: Beijing Municipality, Tianjin Municipality, Liaoning Province, Heilongjiang Province and City of Dalian; and
- “Others” refer to operations of Hong Kong branch and the subsidiary.

	Six months ended June 30, 2005											
	Eastern China		Southern and Central China		Western China		Northern China		Others		Total	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Total operating income												
(note (i))	4,372	34	4,478	34	1,477	11	2,639	20	101	1	13,067	100
Capital expenditure (note (ii)) . . .	208	43	90	18	76	16	46	9	69	14	489	100

Notes:

- (i) Total operating income represents the operating income gross of interest expense and fee and commission expense.
- (ii) Capital expenditure represents total amount incurred for acquiring assets that are expected to be used for some periods.

	December 31, 2005											
	Eastern China		Southern and Central China		Western China		Northern China		Others		Total	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Total assets	164,978	22	407,999	56	56,696	8	98,438	13	6,502	1	734,613	100
Gross loans and advances to customers	145,287	31	192,617	41	49,085	10	82,656	17	2,540	1	472,185	100
Total customer deposits	207,412	33	189,717	30	77,353	12	154,110	24	5,812	1	634,404	100

	Six months ended June 30, 2006											
	Eastern China		Southern and Central China		Western China		Northern China		Others		Total	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Total operating income												
(note(i))	5,466	32	7,156	42	1,482	9	2,667	16	210	1	16,981	100
Capital expenditure												
(note(ii))	200	37	128	24	63	12	81	15	68	12	540	100

V NOTES TO THE INTERIM FINANCIAL REPORT

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24 SEGMENTAL REPORTING (continued)

(b) Geographical segments (continued)

	June 30, 2006											
	Eastern China		Southern and Central China		Western China		Northern China		Others		Total	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Total assets	207,799	25	433,862	53	58,230	7	115,236	14	9,189	1	824,316	100
Gross loans and advances to customers	186,572	35	188,214	35	55,633	11	97,313	18	3,845	1	531,577	100
Total customer deposits	234,101	33	218,185	31	76,303	11	167,175	24	7,838	1	703,602	100

25 OFF-BALANCE SHEET EXPOSURES

(a) Contingent liabilities and commitments

(i) Credit commitments

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amount reflected in the table for guarantees and letters of credit represents the maximum potential loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

	December 31, 2005	June 30, 2006
Contractual amount		
Irrevocable guarantees	34,691	37,068
Irrevocable letters of credit	22,436	25,782
Bills of acceptances	123,525	164,180
Loan commitments		
— with an original maturity of under one year	878	1,809
— with an original maturity of one year or over	2,455	2,818
Credit card commitments	19,731	23,663
Shipping guarantees	22	20
	<u>203,738</u>	<u>255,340</u>

Loan commitments only include credit limits granted to offshore customers, and onshore and offshore syndicated loans. The Directors are of the opinion that the Group will not assume any risks on the unused credit limits for other loan customers as such limits are revocable and subject to the loan approval process. As a result, such balances are not included in the above contingent liabilities and commitments.

V NOTES TO THE INTERIM FINANCIAL REPORT
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25 OFF-BALANCE SHEET EXPOSURES (continued)

(a) Contingent liabilities and commitments (continued)

(i) Credit commitments (continued)

These commitments and contingent liabilities have off-balance sheet credit risk. Before the commitments are fulfilled or expire, management assesses and makes allowances for any probable losses accordingly. As the facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows.

	<u>December 31, 2005</u>	<u>June 30, 2006</u>
Credit risk weighted amounts of contingent liabilities and commitments		
Contingent liabilities and commitments	<u>68,095</u>	<u>76,706</u>

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% of contingent liabilities and commitments.

There are no relevant standards prescribed by IFRSs in calculating the above credit risk weighted amounts.

The credit risk weighted amounts stated above have taken into account the effects of bilateral netting arrangements.

(ii) Capital commitments

Authorised capital commitments not provided for were as follows:

	<u>December 31, 2005</u>	<u>June 30, 2006</u>
For purchase of fixed assets:		
— Contracted for	335	240
— Not contracted for	<u>132</u>	<u>1</u>

(iii) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases of properties are payable as follows:

	<u>December 31, 2005</u>	<u>June 30, 2006</u>
Within 1 year	539	639
After 1 year but within 5 years	1,387	1,544
After 5 years	<u>425</u>	<u>448</u>
	<u>2,351</u>	<u>2,631</u>

V NOTES TO THE INTERIM FINANCIAL REPORT
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25 OFF-BALANCE SHEET EXPOSURES (continued)

(a) Contingent liabilities and commitments (continued)

(iv) Outstanding litigations

At June 30, 2006, the Group was a defendant in certain pending litigations with gross claims of RMB196 million (December 31, 2005: RMB250 million) arising from their banking activities. Many of these proceedings are in relation to steps taken by the Bank to collect delinquent loans and enforce rights in collateral securing such loans. The Directors consider that no material losses would be incurred by the Group as a result of these pending litigations and therefore no provision has been made in the interim financial report.

(v) Redemption obligations

As an underwriting agent of PRC government bonds, the Group has the responsibility to buy back those bonds sold by it should the holders decide to early redeem the bonds held. The redemption price for the bonds at any time before their maturity date is based on the coupon value plus any interest unpaid and accrued up to the redemption date. Accrued interest payables to the bond holders are calculated in accordance with relevant rules of the MOF and the PBOC. The redemption price may be different from the fair value of similar instruments traded at the redemption date.

The redemption obligations below represent the nominal value of government bonds underwritten and sold by the Group, but not yet matured at the balance sheet date:

	<u>December 31, 2005</u>	<u>June 30, 2006</u>
Redemption obligations	<u>11,604</u>	<u>14,502</u>

The Group expects the amount of redemption before the maturity date of these government bonds through the Group will not be material.

(b) Derivatives

Derivatives are off-balance sheet financial instruments which include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets.

The Group enters into financial derivative transactions for treasury business and its assets and liabilities management purpose.

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25 OFF-BALANCE SHEET EXPOSURES (continued)

(b) Derivatives (continued)

The following tables provide an analysis of the notional amounts of derivatives of the Group and the corresponding fair values at the balance sheet date. The notional amounts of the derivatives indicate the transaction volume outstanding at the balance sheet date; they do not represent amounts at risk.

	December 31, 2005		
	Notional amounts	Fair values	
		Assets	Liabilities
Interest rate derivatives			
Interest rate swaps	10,422	39	(51)
Currency derivatives			
Spot	2,826	1	(1)
Forwards	3,845	39	(34)
Foreign exchange swaps	1,070	7	—
	7,741	47	(35)
Total		86	(86)
		(Note15(a))	(Note15(e))
	June 30, 2006		
	Notional amounts	Fair values	
		Assets	Liabilities
Interest rate derivatives			
Interest rate swaps	13,054	106	(115)
Currency derivatives			
Spot	737	2	(1)
Forwards	5,234	28	(54)
Foreign exchange swaps	1,104	6	(3)
Options	128	—	—
	7,203	36	(58)
Total		142	(173)
		(Note15(a))	(Note15(e))

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25 OFF-BALANCE SHEET EXPOSURES (continued)

(b) Derivatives (continued)

The replacement costs and credit risk weighted amounts in respect of these derivatives are as follows. These amounts take into account the effects of bilateral netting arrangements.

Replacement costs

	December 31, 2005	June 30, 2006
Interest rate derivatives	39	106
Currency derivatives	<u>47</u>	<u>36</u>
	<u>86</u>	<u>142</u>

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. Replacement cost is a close approximation of the credit risk for these derivative contracts as at the balance sheet date.

Credit risk weighted amounts

	December 31, 2005	June 30, 2006
Interest rate derivatives	26	27
Currency derivatives	<u>25</u>	<u>23</u>
	<u>51</u>	<u>50</u>

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics.

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26 MATURITY PROFILE

	December 31, 2005								
	Repayable on demand	Within 1 month	After 1 month but within 3 months	After 3 months but within 1 year	After 1 year but within 5 years	After 5 years	Undated	Overdue	
Cash and balances with central bank (note (i)) . . .	25,881	—	—	—	—	—	40,136	—	66,017
Amounts due from banks and other financial institutions	10,615	33,975	8,145	11,197	1,480	146	—	—	65,558
Loans and advances to customers (note (ii))	—	37,891	84,094	204,031	67,524	61,538	—	3,597	458,675
Investments (note (iii))	1,133	7,456	7,641	34,739	57,129	23,640	164	—	131,902
— at fair value through profit or loss	—	371	1,160	6,655	6,560	1,005	118	—	15,869
— available-for-sale . . .	1,133	6,704	4,629	21,063	23,085	3,426	46	—	60,086
— held-to-maturity	—	173	1,111	6,098	22,615	18,714	—	—	48,711
— receivables	—	208	741	923	4,869	495	—	—	7,236
Other assets	660	222	626	956	452	2	9,523	20	12,461
Total assets	38,289	79,544	100,506	250,923	126,585	85,326	49,823	3,617	734,613
Amounts due to banks and other financial institutions	23,336	4,207	3,313	2,550	9,441	400	—	—	43,247
Deposits from customers . . .	387,152	33,716	56,124	129,347	27,104	961	—	—	634,404
Financial liabilities at fair value through profit or loss	—	—	—	—	—	—	86	—	86
Certificates of deposit issued	—	—	—	—	1,211	—	—	—	1,211
Convertible bonds issued . . .	—	—	—	—	5,184	—	—	—	5,184
Other debts issued	—	—	—	—	9,982	—	—	—	9,982
Subordinated notes issued	—	—	—	—	3,500	—	—	—	3,500
Other liabilities	8,706	224	1,069	705	268	29	—	—	11,001
Total liabilities	419,194	38,147	60,506	132,602	56,690	1,390	86	—	708,615
Long/(short) position	(380,905)	41,397	40,000	118,321	69,895	83,936	49,737	3,617	25,998

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26 MATURITY PROFILE (continued)

	June 30, 2006								Total
	Repayable on demand	Within 1 month	After 1 month but within 3 months	After 3 months but within 1 year	After 1 year but within 5 years	After 5 years	Undated	Overdue	
Cash and balances with central bank (note (i))	24,536	—	—	—	—	—	44,418	—	68,954
Amounts due from banks and other financial institutions	15,132	54,520	6,263	9,457	673	25	—	—	86,070
Loans and advances to customers (note (ii))	—	49,416	82,759	224,530	77,952	78,399	—	3,471	516,527
Investments (note (iii))	1,245	1,563	9,396	46,829	62,627	15,833	217	—	137,710
— at fair value through profit or loss	—	—	228	3,719	3,763	1,339	171	—	9,220
— available-for-sale	1,245	939	7,950	36,059	22,820	3,555	46	—	72,614
— held-to-maturity	—	300	1,009	6,215	30,827	10,292	—	—	48,643
— receivables	—	324	209	836	5,217	647	—	—	7,233
Other assets	3,789	1,010	788	300	121	1	9,035	11	15,055
Total assets	44,702	106,509	99,206	281,116	141,373	94,258	53,670	3,482	824,316
Amounts due to banks and other financial institutions	44,179	2,307	1,841	3,437	7,767	400	—	—	59,931
Deposits from customers	408,620	43,602	71,090	146,392	29,809	4,089	—	—	703,602
Financial liabilities at fair value through profit or loss	—	—	—	—	—	—	173	—	173
Certificates of deposit issued	—	—	—	1,199	—	—	—	—	1,199
Convertible bonds issued	—	—	—	—	39	—	—	—	39
Other debts issued	—	—	—	—	9,985	—	—	—	9,985
Subordinated notes issued	—	—	—	—	3,500	—	—	—	3,500
Other liabilities	9,517	675	1,880	943	110	19	—	—	13,144
Total liabilities	462,316	46,584	74,811	151,971	51,210	4,508	173	—	791,573
Long/(short) position	(417,614)	59,925	24,395	129,145	90,163	89,750	53,497	3,482	32,743

Notes:

- (i) For balances with central bank, undated amount represents statutory deposit reserve funds and fiscal balances maintained with the PBOC.
- (ii) For loans and advances to customers, overdue amounts represent loans of which the whole or part of the principals was overdue. The overdue amounts are stated net of appropriate allowances for impairment losses.
- (iii) The remaining maturities of trading assets and assets designated at fair value through profit or loss included in investments do not represent the Group's intention to hold them to maturity.

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27 MATERIAL RELATED-PARTY TRANSACTIONS

(a) Transaction terms and conditions

During the periods, the Group entered into transactions with related parties in the ordinary course of its banking business including lending, investment, deposit and off-balance sheet transactions. The Directors are of the opinion that the Group's material related-party transactions were all entered into on normal commercial terms. The banking transactions were priced at the relevant market rates prevailing at the time of each transaction. Interest rates on loans and deposits are required to be set in accordance with the following benchmark rates set by the PBOC:

	January 1, 2005 to April 27, 2006	April 28, 2006 to June 30, 2006
Short-term loans	5.22% to 5.58% p.a.	5.40% to 5.85% p.a.
Medium to long-term loans	5.76% to 6.12% p.a.	5.03% to 6.39% p.a.
Saving deposits	0.72% p.a.	0.72% p.a.
Time deposits	1.71% to 3.60% p.a.	1.71% to 3.60% p.a.

There were no allowances for impairment losses made on an individual basis against loans and advances granted to related parties during the periods.

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27 MATERIAL RELATED-PARTY TRANSACTIONS (continued)

(b) Shareholders and their related companies

As the Bank's largest shareholder China Merchants Steam Navigation Company Limited ("CMSNCL") and its related companies hold 21.87% of the Bank's shares as at June 30, 2006 (December 31, 2005: 24.15%), the Directors consider that CMSNCL is not a controlling shareholder of the Bank but can exercise significant influence over the financial and operating decisions of the Bank. The Group's transactions and balances with CMSNCL and its related companies are disclosed as follows:

	December 31, 2005	June 30, 2006
On balance sheet:		
Loans and advances	782	2,268
Deposits from customers	<u>667</u>	<u>13,342</u>
Off balance sheet:		
Irrevocable guarantees	70	498
Irrevocable letters of credit	101	101
Bills of acceptances	<u>328</u>	<u>244</u>
	Six months ended June 30,	2006
	2005	2006
Average balance of loans and advances	<u>684</u>	<u>1,532</u>
Interest income	15	40
Interest expense	5	28
Fees and commission (note)	<u>—</u>	<u>1</u>

Note: Apart from the above transactions, the Bank also enters into transactions with CMSNCL and its related companies in the ordinary course of its banking activities such as remittance, securities trading, etc. The activities are priced at the relevant market rates at the time of the transactions.

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(c) Companies controlled by directors other than those under Note 27(b) above

	<u>December 31, 2005</u>	<u>June 30, 2006</u>
On balance sheet:		
Loans and advances	458	1,007
Deposits from customers	445	748
Deposits from banks and other financial institutions	<u>337</u>	<u>733</u>
	<u>Six months ended June 30,</u>	<u>2006</u>
	<u>2005</u>	<u>2006</u>
Average balance of loans and advances	<u>792</u>	<u>616</u>
Interest income	16	14
Interest expense	<u>6</u>	<u>4</u>

Remuneration for key management personnel during the periods is as follows:

	Six months ended June 30,	
	2005	2006
	RMB'000	RMB'000
Salaries and other emoluments	1,455	1,599
Discretionary bonuses	—	—
Contributions to defined contribution retirement schemes	167	167
	<u>1,622</u>	<u>1,766</u>

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28 RISK MANAGEMENT (continued)

(i) Credit risk (continued)

With respect to daily operations, the Risk Management Department, as directed by the Risk Management and Internal Control Committee, monitors and coordinates the work of other risk management functions, including the Corporate Banking Department and the Legal Department.

In respect of the loan portfolio, the Group adopts a risk based loan classification methodology. Currently, the Group classifies loans into seven categories: excellent, good, general mention, special mention, substandard, doubtful and loss. Prior to September 2005, the Group classified all loans in accordance with the PBOC's 5-tier classification system. The last three categories are considered as impaired loans and advances for which objective evidence of impairment exists based on a loss event or several events and which bear significant impairment losses. The allowances for impairment losses for the impaired loans and advances are assessed collectively or individually as appropriate.

Concentration of credit risk: when certain numbers of customers are in the same business, located in the same geographical region or their industries share similar economic characteristics, their ability to meet their obligations may be affected by the same economic changes. The level of concentration of credit risk reflects the sensitivity of the Group's operating result to a specific industry or geographical region.

The Group's credit risk management policy for financial derivatives is the same as that for other transactions. In order to mitigate the credit risk arising from the financial derivatives, the Group has signed netting agreements with certain counterparties.

(ii) Market risk

Market risk is the risk of loss arising from movements in observable market variables such as interest rates, exchange rates and equity markets. The Group is exposed to market risk primarily through its proprietary trading activities. The Group considers that any market risk arising from its proprietary trading book is not material.

The Asset and Liability Management Committee ("ALCO") of the Group is responsible for formulating market risk management policies, supervising implementation of the policies and performing independent assessments of the risk status. The Risk Management Department is responsible for managing the risks arising from the day to day operation of the Treasury division.

(iii) Currency risk

The Group's foreign exchange exposure mainly comprises foreign exchange dealing by Treasury and is mitigated primarily by matching spot and forward foreign exchange contracts with foreign currency borrowings.

The Group's functional currency is Renminbi. Foreign currency transactions are mainly in US dollar and HK dollar. The Group's assets and liabilities are mainly denominated in Renminbi, with the rest being mainly in US dollar and HK dollar. The exchange rates between Renminbi and US dollar and HK dollar are determined by the PBOC, and there have been small fluctuations during the periods.

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28 RISK MANAGEMENT (continued)

(iii) Currency risk (continued)

The Group monitors daily foreign currency transactions and positions closely.

(iv) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due, and it results from amount and maturity mismatches of assets and liabilities. The Group's liquidity is managed by the ALCO. The ALCO is responsible for managing liquidity on a prudent basis to meet regulatory requirement. The day to day monitoring of future cash flows and the maintenance of suitable levels of liquefiable assets by business units are the responsibility of the head office.

A substantial portion of the Group's assets is funded by customer deposits made up of corporate and retail savings accounts and term deposits as well as deposit of banks. These customer deposits, which have been growing in recent years, are widely diversified by type and maturity and represent a stable source of funds.

The Group's loans-to-deposits ratio is maintained within 75%. 7.5% of total Renminbi deposits (December 31, 2005: 7.5%) and 3% of foreign currencies deposits (December 31, 2005: 3%) are required to be deposited with the PBOC.

VI EVENTS OCCURRED AFTER THE BALANCE SHEET DATE

In June 2006, the Bank entered into an agreement with three independent third parties and China Merchants Securities Company, a related company of the Bank, to acquire 30% and 3.4% equity interest in China Merchants Fund Management Company (“CMFM”) respectively for a total consideration of RMB197.7 million. The completion of the acquisition is subject to obtaining approvals from relevant regulatory authorities including the CSRC and the CBRC. As of June 30, 2006, the proposed acquisition has been approved by the CBRC but yet to be approved by the CSRC.

Upon completion of the transaction, the Group’s investment in CMFM will be recognised as an investment in associated company. The investment in associated company and any goodwill arising will be accounted for in the consolidated financial statements in accordance with IFRSs.

Apart from the above, the Group had no other material post balance sheet date events for disclosure.