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Hang Seng Bank: Moving Ahead

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Good afternoon, ladies and gentlemen. I am delighted to have the opportunity to speak with you today on Hang Seng Bank's first half results and our strategy going forward.

Economic data indicates that the global economy rebounded during the first half of 2010, due mainly to large-scale fiscal and monetary stimulus initiatives.

This supported an upswing in exports and economic growth in Hong Kong and mainland China, which recorded GDP growth of 7.2 per cent and 11.1 per cent respectively for the first half of the year.

However, growth of both economies eased in the second quarter compared with the first, and this trend appears set to continue into the second half of the year. Overseas trade activity will likely slow as governments around the world rein in their stimulus programmes. Officials in our key export markets have announced plans to cut spending and implement tax hikes in a bid to restore fiscal discipline and tackle serious challenges such as high levels of sovereign debt.

These developments are clouding the outlook for Hong Kong's externally orientated economy. A slowdown in external demand will also affect the Mainland, although robust domestic consumption should ensure continued growth, albeit at a more moderate pace than in the first half of the year. Consumer price inflation hit a 21-month high in July at 3.3 per cent, but recent movements in producer prices and official measures governing bank credit indicate that inflation will probably ease from its current level.

Business Development Highlights

We shall now look at key business activities in the first half. Competition intensified in Hong Kong's financial sector during the first half of the year as banks sought to capitalise on increased trade flows and an upswing in investment sentiment. Hang Seng's strong brand and fast response to the changing needs of customers were effective tools in enhancing our market position for traditional banking services and capturing more business in areas such as wealth management and cross-border commercial banking – leading to increases in our customer base and income in key business segments.

Wealth management business was a core driver of growth for Personal Financial Services. We took steps to capitalise on improved investor confidence, achieving a 28-month high in investment fund sales in March and a five-fold rise in investment fund subscriptions during the first half of this year compared with the same period last year. Enhancements to investment service delivery channels contributed to the increases in turnover and the number of accounts for foreign exchange and gold margin trading.

With narrow spreads on mortgage loans, we redeployed the commercial surplus to expand secured and unsecured lending.

We maintained our strong position in mortgage business. We achieved strong year-on-year growth in residential mortgage drawdowns during the first half and ranked first for equitable mortgages and second for new mortgage registrations in the second quarter of the year.

A series of effective card utilisation campaigns drove increases in credit card spending, receivables and the card base. We maintained our position as Hong Kong's second-largest issuer of credit cards, with over 1.9 million cards in circulation.

In February, we were named 'Best Local Private Bank in Hong Kong' in *Euromoney*'s peer-nominated Private Banking Survey 2010.

Assisted by good industry knowledge, long-term customer relationships and a broad range of cross-border services, Corporate Banking provided facilities to high-quality borrowers in a competitive environment for lenders, with notable progress in loans to large Mainland enterprises with operations in Hong Kong.

Commercial Banking capitalised on the upswing in economic activity to achieve broad-based income growth.

The strength of our cross-border proposition was an important competitive advantage in growing our Commercial Banking business. A comprehensive range of new renminbi services, close cooperation between colleagues in Hong Kong and the Mainland, and an expanding network of strategic Mainland partners enhanced our service capabilities and coverage.

At 10 August 2010, we had over 50,000 commercial renminbi savings accounts and had facilitated about RMB11.3 billion in renminbi cross-border trade business.

We further developed our corporate wealth management business, offering investment products in line with our customers' risk appetite and liquidity needs as well as a broad range of business insurance coverage. Corporate wealth management increased its contribution to Commercial Banking's total operating income by 1.9 percentage points compared with 2009.

We improved service access and banking convenience for SME customers by remodelling our Business Banking Centres, extending transaction cut-off times and expanding our Business e-Banking platform. At 3 September 2010, we had approved over 6,200 loan applications totalling more than HK$17 billion under Hong Kong government-initiated SME lending schemes.

We placed greater emphasis on sales of Treasury products to assist customers to hedge their positions. This resulted in a more than tripling of income from foreign exchange options and other structured products.

Despite low interest rates and ample market liquidity, which limited good investment opportunities, we continued to find ways to optimise returns from our balance sheet management portfolio. We maintained our prudent risk management approach while taking steps to defend the interest margin. We capitalised on market opportunities to dispose of selected instruments and invest in high-quality assets.

Mainland Business

In the Mainland, Hang Seng Bank (China) Limited opened two cross-location sub-branches under CEPA VI in the first half of 2010, bringing its total number of outlets to 38 across 13 cities.

We enhanced our commercial banking capabilities and wealth management offerings and leveraged new and existing strategic alliances.

Good growth in both the personal and commercial customer bases in the Mainland supported a significant increase in customer deposits, which further improved Hang Seng China's balance sheet strength. We expanded Mainland lending while emphasising credit quality over loan portfolio size.

Collaboration with strategic partners, Industrial Bank and Yantai Bank, continued to provide business synergy and extend our reach in regions with good economic growth potential.

Interim Results Highlights

We shall now look at the financial results. At a Bank-wide level, profit attributable to shareholders was HK$6,964 million for the first half of 2010 – up 8.4 per cent and 3.8 per cent compared with the first and second halves of last year respectively.

Earnings per share rose by 8.3 per cent compared with a year earlier to HK$3.64.

Profit before tax was HK$8,103 million – up 6.6 per cent compared with the first half of 2009 and 3.9 per cent compared with the second half.

Operating profit excluding loan impairment charges and other credit risk provisions fell by 6.3 per cent to HK$6,850 million, due mainly to the 7.7 per cent drop in net interest income. Compared with the second half of last year, operating profit excluding loan impairment charges and other credit risk provisions was up 2 per cent.

Operating profit was HK$6,697 million – up 0.1 per cent compared with the first half of last year and 2.6 per cent compared with the second half, reflecting improved economic conditions and effective credit risk management.

Total assets increased by HK$40.4 billion, or 4.9 per cent, to HK$871.1 billion – underpinned by good growth in our loan portfolios.

Average interest-earning assets rose by 7.8 per cent, but net interest income was down 7.7 per cent at HK$6,713 million, with the positive effects of the rise in customer advances and increased returns on the life insurance investment funds portfolio outweighed by reduced contributions from the Treasury balance sheet management portfolio and deposits. Compared with the second half of 2009, net interest income was down 0.5 per cent.

Net interest margin was 1.77 per cent, compared with 2.06 per cent for the first half of last year and 1.76 per cent for the second half.

We achieved a 23 per cent increase in net fee income to HK$2,369 million. Using our strong wealth management platform as a springboard, we reacted swiftly to improving market confidence with new products and services, recording a 117.3 per cent increase in fee revenue from retail investment funds. Insurance agency fee income rose by 35 per cent. Fee income from traditional banking services also registered solid growth. Card services fee income rose by 12.6 per cent. The uptick in trade flows and our cross-border commercial banking capabilities supported increases in fees from remittances and trade services.

Trading income fell by 14 per cent to HK$890 million. Foreign exchange income was down 5.4 per cent, due mainly to the decline in net interest income from funding swaps.

Increases in performance-related pay, marketing and investment in our Mainland operations resulted in a 7.2 per cent rise in operating expenses to HK$3,504 million. Excluding our Mainland business, operating costs increased by 6.1 per cent.

Net operating income before loan impairment charges was HK$10.4 billion – down 2.1 per cent on the first half of 2009, but up 1.2 per cent on the second half.

Our cost efficiency ratio was 33.8 per cent – up 2.9 percentage points compared with the first half of 2009, but a 0.6 percentage point improvement on the second half.

Return on average shareholders' funds was 22.8 per cent – compared with 23.5 per cent and 22.4 per cent for the first and second halves of 2009.

Return on average total assets was 1.7 per cent – the same as the first half of last year and up 0.1 percentage points on the second half.

We recorded further improvements in loan impairment charges, which dropped to HK$153 million, compared with HK$621 million and HK$191 million in the first and second halves of last year. Annualised impairment charges as a percentage of average advances to customers were 0.09 per cent.

At 30 June 2010, our capital adequacy ratio was 12.9 per cent, compared with 16.3 per cent at the end of 2009. The drop was due mainly to our participation in a rights issue by Industrial Bank, the repayment of HK$2.5 billion in subordinated debt and the increase in risk-weighted assets.

Our core capital ratio was 11.1 per cent, down 1.5 percentage points compared with last year-end.

Strategic Positioning

Looking ahead, our target is to be the leading personal and private bank for the rapidly growing affluent and middle-class segments in Hong Kong and the Mainland, and the leading trade bank in Greater China.

Core Strengths

The number of affluent and middle-class individuals is rapidly growing in the Mainland. A report released in April this year revealed that there were about 875,000 multimillionaires in the Mainland – an increase of 6.1 per cent compared with a year earlier[1]. While the new rich will continue to save, they will also be looking for investment opportunities in and outside the Mainland, in property, equity, fixed

[1] Source: *Hurun* Wealth Report 2010

income, investment funds, life insurance and other financial instruments. They need professional advice and they need a reputable bank that they can trust, a bank that speaks their language and understands their culture. Hang Seng fits the bill.

To be the banker of choice of the affluent and the middle class, we will capitalise on our strong reputation for personal wealth management and enhance our core strengths in service excellence and the timely launch of innovative products and services. We will step up efforts to acquire new customers in target segments. We will focus on our customers and provide tailor-made banking and wealth management propositions to meet their financial needs.

Our service excellence, time-to-market strengths, comprehensive range of products and extensive distribution network – including mobile and online channels – will support the growth of our wealth management business and help drive customer acquisitions.

Our Personal e-Banking platform marks its 10-year anniversary this year and now provides services to more than 1 million users. Our Mobile Trading services, which were introduced in 2007, have registered a cumulative turnover of HK$17 billion in securities trading and foreign exchange margin transactions. In August we launched an innovative new iPhone app that gives customers using iPhones convenient access to foreign exchange margin trading services and market information.

We will continue to invest in technology and enhance our services in support of key personal customer segments, particularly Prestige Banking and young people.

Our strong financial fundamentals will enable us to expand secured and unsecured lending, while staying vigilant in managing credit risk.

With recent regulatory changes broadening the scope of renminbi financial services in Hong Kong, we have formulated an across-the-board renminbi business strategy. We will leverage our brand, well-established business platforms and strong renminbi deposit base to capture new opportunities with the aims of attaining a leading market position and becoming the preferred bank for offshore renminbi banking. We recently introduced renminbi certificates of deposit and will launch more renminbi products and services to meet customer needs.

Intra-regional trade in Asia is growing both in volume and also as a percentage of world trade, particularly in light of the continued slowdown in the Western world. With our strong positioning in cross-border trade, our professional service and our innovative solutions, Hang Seng is well positioned to be the leading provider of Greater China trade and trade-related commercial banking services. We will leverage the competitive advantages of our well-established operations and strengthen our product and service suite to provide comprehensive financial solutions for companies with operations in both Hong Kong and the Mainland.

Since the opening up of renminbi trade settlement in October 2009, we have been a leading player in this business with RMB11.3 billion settled in the past 12 months. With the gradual regionalisation and internationalisation of the renminbi, we expect great opportunities going forward. Treasury will continue to provide hedging and exchange services to customers and Commercial Banking has enhanced corporate e-banking platforms to support renminbi account enquiries and transaction instructions. We shall continue to stay close to customers and regulators in the Mainland to ensure we stay ahead of the game.

In the Mainland, we will deepen cooperation with existing strategic partners and build new alliances to enhance service delivery, expand product offerings and generate more cross-referral business. Along with brand-building initiatives, this will underpin growth in the customer and deposit bases. In May, we underlined our long-term commitment to this important market with a RMB510 million agreement to purchase a Mainland headquarters in Shanghai.

Hang Seng will continue to make good use of its competitive strengths to further develop core business drivers, reinforce its leadership in key lines, and tap new markets and customer segments in support of long-term growth and increasing value for shareholders.

Thank you.