



Mr Liu Lit Man GBS, JP, FIBA

Executive Chairman

Economic Review

Despite a slackening growth rate compared with that of 2004, the global economy still continued to grow in 2005, as demonstrated especially by the outstanding performance in both the American and the Japanese economies. The US economy benefited mainly from the sharp increase in personal consumption and the long-term interest rates which have continued to stay rather low. The real estate market continued to prosper. The Japanese economy rebounded from the trough primarily because internal demand increased substantially and the banks' bad debt crisis was resolved.

Moreover, the deflationary situation that has plagued Japan for years is beginning to ease off. As to the performance of the euro zone, its growth rate has been rather slow because of problems with the abrupt surge of the euro, the increase in oil prices, the slackening of internal demand, etc. Overall growth, however, has been steady. The global economy is improving as a whole alongside the good performance of these three major economies. The economies of such developing countries as China and India have grown rapidly for many consecutive years and their growth rates are still leading the pack. Surges in oil prices have improved the Russian economy as well as the economies of countries as such those in West Africa. In short, the outlook for the global economy is generally optimistic.

The Hong Kong economy continued to perform well last year. Its gross domestic product, which grew more than generally expected at the outset, increased to 7.3 percent thanks to increases in exports and personal consumption. With the improvement of the economy, the number of unemployed people gradually dropped to below 200,000, a 4-year new low. Investment and consumption sentiments continued to improve bit by bit. Hong Kong registered a slight inflation rate of nearly 2 percent at the end of last year after a long period of deflation. However, frequent new highs in oil prices and successive interest rate increases by banks to mirror those in the United States have cast a shadow on the interest rate-sensitive industries. It is, therefore, inevitable that the stock and the property markets showed signs of slackening in the second half of last year.

As to the banking industry, fierce competition is still ever-increasing. Although the interest rate-hiking cycle started in the United States in mid-2004, banks in Hong Kong have put off raising interest rates for some time because of the rather high account balances in the banking system brought about by the perpetual huge influx of funds into Hong Kong speculating on the appreciation of the renminbi. It was not until March 2005 that Hong Kong formally began its interest rate-hiking cycle, a 9-month lag compared with that in the United States. Interest expenses of borrowers were thus temporarily lessened. Banks' lending activities are normally bound to benefit from the recovery of the economy. However, for the first

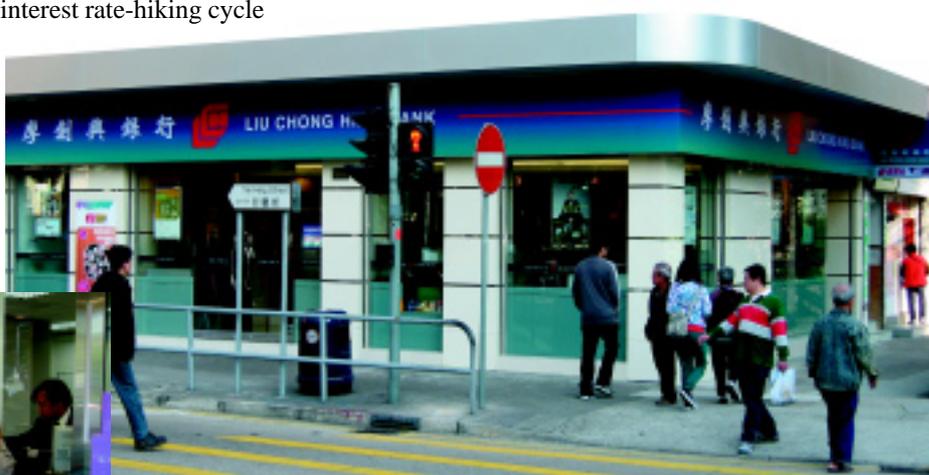
EXECUTIVE CHAIRMAN'S STATEMENT

half of last year, other than mortgage business generated by the active property market, the general demand for other commercial and industrial loans showed no conspicuous increase. The various initial public offerings of new shares have also generated some short-term fund raising and margin financing activities. Considering the amount of surplus liquidity, this is not much help because real profit is minimal.

Results Announcement

The Bank's results for 2005 show a rather satisfactory improvement. For the financial year of 2005, on an audited, consolidated basis, profit attributable to shareholders amounted to HK\$397.983 million, an increase of 10.59 percent over that for the year before. Total customers' deposits soared 22.25 percent to HK\$41.506 billion. Total loans to customers (after accounting for impairment allowances for bad and doubtful debts as well as interest accrued) increased 21.36 percent to HK\$24.306 billion. On 31 December 2005, the Bank's loan portfolios were made up as follows: property developments and investments (30.71 percent), personal real estate purchases (17.27 percent), financial and securities concerns (6.39 percent), trade finance (2.69 percent), wholesale and retail trade (2.34 percent), manufacturing, transportation and other businesses (22.69 percent), loans outside Hong Kong (12.37 percent), and others (5.54 percent). Adjusted capital adequacy ratio dropped 19.25 percent to 15.19 percent at the end of 2005, while average liquidity ratio for 2005 decreased 6.13 percent to 49.13 percent. Loan-to-deposit ratio increased 1.35 percent to 50.88 percent. During the period in question, the Bank's loan portfolios grew considerably, while customers' deposits also increased admirably. Loan-to-deposit ratio has therefore remained more or less the same. Total assets, having increased 20.82 percent to HK\$49.974 billion, have already exceeded the minimum asset requirement for setting up branches in the mainland under the Mainland and Hong Kong Closer Economic Partnership Arrangement. Shareholders' funds (after final dividend), compared with the restated shareholders' funds for the previous year, increased 4.9 percent to HK\$5.65 billion. The local economy continued to grow last year and most sectors have started to recover. The pace of growth of the economy has, however, been affected by the triggering off of the interest rate-hiking cycle

as well as the persistent fierce competition among the banks. The results of the performance of the Bank may therefore be regarded as satisfactory because, under the circumstances, they still manage to sustain a good



A more spacious San Po Kong Branch after renovation

momentum. Your board has recommended paying the final dividend of HK\$0.42 per share for the financial year of 2005 to shareholders whose names appear in the Register of Members at the close of business on Friday, 21 April 2006. Total dividends for the financial year of 2005 (including the interim dividend of HK\$0.18 per share paid earlier) amounted to HK\$0.60 per share.

Profit Analysis

On an audited, consolidated basis, net interest income rose 15.91 percent from that of 2004 to HK\$752.852 million in 2005. Interest spread increased 0.04 percent to 1.65 percent. After accounting for the other operating income, which amounted to HK\$217.129 million, total operating income was HK\$969.981 million and total operating expenditure was HK\$493.129 million. Cost-to-income ratio rose 2.03 percent to 50.84 percent. Operating profit before provisions and disposal of long-term assets increased 3.59 percent to HK\$476.852 million. In order to maintain good credit quality, the Bank made impairment allowances for bad and doubtful debts in the amount of HK\$67.807 million for 2005, an increase of 32.50 percent against those made for 2004. After accounting for the impairment allowances for bad and doubtful debts as well as the charge for taxation, profit attributable to shareholders amounted to HK\$397.983 million (an increase of 10.59 percent), translating into earnings of HK\$0.91 per share. Net asset value per share (after final dividend), compared with the restated net asset value per share for the previous year, rose 4.9 percent to HK\$12.99.



New face of Happy Valley Branch after renovation

Additional Branches

For the past few years, the Bank has slowed down its plan to open more branches because the economic environment was cloudy. With the current stabilization of the economy and the upturn of the market, the Bank will actively develop its branch network. It is expected that eight to ten additional branches will be opened within the year. The Bank will also continue to provide its staff with professional training while further enhancing its management to improve service quality and develop new products to broaden its customer base.

New Headquarters

The Bank's head office building at 24 Des Voeux Road Central, which is being redeveloped, will be topped out in March this year. It is expected that the Bank will be able to move its operations back to the new head office building by the end of this year. Quality service will then be continually provided to the community by the Bank with fresh looks.

Directorate Changes

Mr Andrew Chiu Wing Tsang and Mr George Har Kar Wong, senior managers of the Bank, were both appointed executive directors by the board on 17 August 2005. Mr Liu Guoyuan resigned as a non-executive director of the Bank on 16 November 2005 for personal reasons. Mr Wang Zhi was appointed a non-executive director of the Bank on that same day.

EXECUTIVE CHAIRMAN'S STATEMENT

Economic Prospects

It is expected that the growth of the Hong Kong economy this year will continue to be dependent on external trade and driven by internal consumption. The movement of the interest rates would, after all, be the decisive factor for economic performance. Although the new chairman has assumed his office at the United States Federal Reserve Board, he has yet to express a clear stance on monetary policy directions. Recent economic data from the United States signal mixed messages. The expectation that the interest rate-hiking cycle will peak soon is generally believed to be unrealizable for now. Interest rates will hover at high levels for a longer period of time. Besides, repercussions from such other unfavourable factors as stubbornly high oil prices and the yet-to-be fully accomplished warfare against terrorism continue to exist. It is expected that, for the first half of this year, the economy can only stroll along and take a wait-and-see attitude.

The local political and economic arenas are rather harmonious at the moment. The early resolution of the fiscal deficit problem, the timely launching of the various major public projects, the engaged cooperation between Hong Kong and Guangzhou, and the endless supportive measures made available to Hong Kong by the mainland are all conducive to improving Hong Kong's employment situation and long-term economic development.

After a round of consolidations, some new life has recently been breathed into the property market. Developers have seized upon the opportunity by launching their new property developments packaged with various preferential terms in tandem with the massive offers made by the banks to cut mortgage interest rates. This has a certain stimulating effect on the turnover of the property market. On the other hand, the market for initial public offerings of new shares is very active this year, attracting large numbers of mainland enterprises, state-owned or otherwise, to the territory. This is conducive to the development of the stock market and it is expected that more than HK\$200 billion may be raised. With the opening of the Hong Kong Disneyland in September last year, the local tourism industry has witnessed the coming to Hong Kong large numbers of visitors from both the mainland and foreign countries. Moreover, the prosperity of the tourism industry benefited such other industries as the hotel, restaurant, entertainment and retail businesses. The prospects for the tourism industry are expected to be even brighter this year.

The prospects for the banking industry this year are still laden with numerous hidden worries. On the whole, however, Hong Kong has its many blessings, backed up by the tremendous support of the motherland and the diversity of the international market. There are indeed endless business opportunities and progress can be strove for when such opportunities are seized upon in a timely manner.

Finally, on behalf of your board, I would like to wholeheartedly thank our customers, friends and shareholders for their long-standing trust in and support for the Bank, not to mention my fellow directors for the exercise of their wise judgment and all of our staff members for their dedication.

By Order of the Board

Liu Lit Man

Executive Director

10 March 2006