CHIEF EXECUTIVE'S REPORT

Our financial fundamentals are strong and our long-term growth drivers are gaining traction. We have enhanced our position and capabilities in key areas such as wealth management, sustainability and business in the GBA.

Next month, Hang Seng Bank will celebrate our 90th anniversary. We have lived through times of turbulent changes and times of exceptional growth. The underlying strength of Hang Seng has only been increased with experience. I am confident we are well-positioned for the future and as the largest local bank in Hong Kong, we will advance inclusivity and prosperity for the betterment of our community.

2022 has been a challenging year with market volatilities arising from new COVID outbreaks, international geopolitical tensions and global economic conditions. The adverse impact on our financial performance has been exacerbated by two additional factors:

1. A significant increase in change in expected credit losses ('ECL') by 172% year-on-year, primarily related to mainland China commercial real estate. Developments in the last two years have brought the risks into sharp focus and it has been necessary to make upward adjustments to our ECL provisions.

2. A negative Market Condition Update of HK$3.1bn, caused by unfavourable performance of equities in the life insurance investment portfolio, together with the discounting impact of rising interest rates.

As a result, our attributable profit was down 27% year-on-year.

That said, the performance also reflects positive effects of the implementation of our long-term transformation strategy. The growth momentum of key future income drivers is accelerating and we are recording increased volumes in target business and customer segments. Excluding the impact of the life insurance investment portfolio, our net operating income before change in ECL grew by 12% year-on-year.

As the easing of COVID restrictions brought gradual relief to the economy, we were able to respond swiftly to customers' changing needs, capture the surge in financial activities and further harness the tailwinds provided by higher interest rates. It is encouraging to note that our second-half performance was markedly improved from the first half:

- We grew our deposit balance by 2% and achieved a 35% increase in net interest income.
- Net operating income before change in ECL increased by 27%.
- Net interest margin was up 48 basis points to 2.00%.
- Cost efficiency ratio was reduced by 9.7 percentage points to 39.2%.

New and continued investments in technology, people and innovation have made us more agile and resilient. By focusing on customer experience and value creation, we expanded core business lines and made significant in-roads into new areas. Enhancements to our branch network and digital capabilities also positioned us well to accelerate momentum. These include:

- Double-digit growth in targeted customer groups in Hong Kong, driven by new service propositions, easier onboarding journeys and wider brand exposure through strategic partnerships.
- Hang Seng Investment Management became manager of The Tracker Fund of Hong Kong. We are now Hong Kong's leading exchange-traded fund ('ETF') manager in terms of assets under management, and manage two of the first four funds made available through the ETF Connect Scheme southbound link.
- Recognition throughout the industry as a leading advocate of fintech development. We were the first foreign bank in the mainland to provide e-CNY services to corporate clients. We are also an active participant in e-HKD pilot projects led by the Hong Kong Monetary Authority ('HKMA').
- First in Hong Kong market to launch a Mobile Cheque Deposit service and US equity-linked investments on mobile and e-Banking platforms.
- Significantly increased the total amount of newly approved green and sustainability-linked loans for business clients year-on-year. Also, for personal customers, we launched Green Mortgages, Green Receipts, electric vehicle loans and the first SFC-authorised ESG ETF that invests in the constituents of the Hang Seng Index.
- Developed new infrastructure to support major emerging business themes, including a dedicated Cross-boundary Wealth Management Centre and a Business Banking Centre with an ESG-focused service concept.

The Directors have declared a fourth interim dividend of HK$2.00 per share. Together with interim dividends for the first three quarters, the total distribution for 2022 will be HK$4.10 per share. In other words, 77% of our attributable profit will be paid to shareholders.

Wealth and Personal Banking

We achieved 16% year-on-year growth in targeted Wealth and Personal Banking customer groups, with a particular focus on the young, emerging affluent and high-net-worth segments. This strengthened the balance sheet whilst loans and advances rose by 2% and customer deposits by 6%.

Investments in our mobile banking infrastructure propelled an increase of 11% in active users. We recorded a 98% rise in the number of digital deposit and loans transactions and we now provide a full range of online investment trading services. We also worked with local artists to launch our first collectible Non-Fungible Tokens. Digital transformation remains central to our strategy.

Net insurance premium income rose by 44% year-on-year and the number of digital policies increased by 135%. Also striking is that our Olive Wellness App recorded a 29% increase in active users. We maintain a top-three market position in digital insurance.

On the investment side of the business, our fixed-income offerings achieved a 291% year-on-year rise in sales turnover. Additionally, customers embraced foreign exchange products with a 166% increase in the number of customers using this service.

Commercial Banking and Global Banking

New Commercial Banking customers increased by 38% year-on-year and Financial Institution clients grew by 74%. Deposits from large corporate clients also recorded an uptick of 5%.

Our digital transformation strategy is now delivering faster turnarounds, simpler transaction journeys and more convenient services. The end result of these enhancements is that customers can better capture new developments in the rapidly changing operating environment. One main focus is to build our cross-boundary and sustainability-linked services to help clients achieve their long-term growth ambitions.

We also improved our trade platform with the introduction of digital receivables finance. This enables more efficient supply chains, particularly for businesses with a wider footprint in the Greater Bay Area ('GBA'). Our corporate API has streamlined cash management of supply chains and was publicly recognised with a 'Best in Payments and Collection' award.

By leveraging the HKMA's Commercial Data Interchange platform, collaboration with strategic partners is already enabling customers to make quicker decisions. This is making a real difference to business practices.

We achieved strong year-on-year growth in green and sustainability-linked loan approvals for wholesale customers. We are working closely with customers to support the transition to the low-carbon economy.

Customers using our new Green Deposits service can enjoy deposit returns whilst knowing that their funds will only be used to finance sustainability initiatives. Staff at our new Business Banking Centre have completed ESG training and can provide customers with information on ways to further embed sustainability into their business operations.

Global Markets

Global Markets recorded a 31% increase in non-interest income as a result of our initiatives to diversify revenue streams. Income from foreign exchange and option trading doubled. Joint initiatives between Global Markets and Wealth and Personal Banking have been effective. As an example, this resulted in an 11-fold increase in capital protected investment deposit business volume.

We continued with actions to support the development of Hong Kong's sustainability-related debt markets.

Hang Seng China

Hang Seng China leveraged its market expertise to achieve an increase of 4% in total operating income. In a very challenging environment, there has been growth in both net interest income and non-interest income.

Global markets income grew by 39% and profit before tax by 63%, with a near-doubling in year-on-year revenue from product sales in the GBA. Solid growth was recorded in trade loan revenue. The personal consumer loans portfolio balance also doubled.

Due to increased ECL provisions on lending in the commercial real estate sector, operating profit was down by 77%. However, with operating costs contained, operating profit before change in ECL was up by 9% year-on-year.

Financial Overview

We further strengthened our assets and liabilities portfolios to amplify the benefits of rising interest rates. We achieved a 22% year-on-year increase in net interest income to HK$28,981m and improved the net interest margin by 28 basis points to 1.77%. Net interest income in the second half grew by 35% compared with the first half.

Wealth management income was affected by temporary branch closures due to COVID in the first half and reduced investor activity, as well as the impact of market movements on the life insurance business investment portfolio. Fee income from credit facilities and trade business were down, but we achieved solid growth in both account services and remittance fees.

Overall, we grew net operating income before change in ECL and other credit impairment charges by 2% to HK$33,972m. Net operating income before change in ECL in the second half was up by 27% compared with the first half.

Operating expenses rose by 5% year-on-year to HK$14,778m. Our investments in people, technology and brand presence are delivering operational efficiencies and enhanced customer experiences. Excluding the impact of the life insurance investment portfolio, we achieved positive jaws of 7.5%, which is one indication that we are getting the balance right. However, we will maintain a firm hand on costs going forward, particularly in the current inflation environment.

As mentioned above, we have responded to fresh developments in the mainland commercial real estate market by making notable adjustments to our ECL provisions. We are progressively de-risking our portfolio and taking other actions to maintain the quality of our lending portfolio. We will continue to monitor the situation closely.

Year-on-year, change in ECL and other credit impairment charges rose by HK$4,819m to HK$7,626m. As at 31 December 2022, gross impaired loans and advances as a percentage of gross loans and advances to customers was 2.56% compared with 1.92% at 30 June 2022 and 1.04% at the end of 2021.

Profit before tax was down by 30% year-on-year at HK$11,439m. Attributable profit declined by 27% to HK$10,165m. Earnings per share fell by 29% to HK$4.95 per share. At a business segment level, profit before tax for Wealth and Personal Banking, Commercial Banking and Global Banking fell by 10%, 81% and 60% respectively. Global Markets' profit before tax rose by 1%.

Nonetheless, while we have been challenged by operating conditions in 2022, we have responded swiftly and effectively. The positive impacts are demonstrated in our strong second-half versus first-half performance, notably a 16% increase in attributable profit.

Return on average ordinary shareholders' equity was 5.5%, compared with 7.7% in 2021. Return on average total assets was 0.5%, compared with 0.8% in the previous year.

On 31 December 2022, our common equity tier 1 capital ratio was 15.2%, our tier 1 capital ratio was 16.8% and our total capital ratio was 18.1%. Our liquidity coverage ratio was 281.3%, which is comfortably above the statutory requirement.

Gross loans and advances to customers were down by HK$60bn, or 6%, compared with a year earlier.

We grew customer deposits, including certificates of deposit and other debt securities in issue, by HK$50bn, or 4%, compared with the end of 2021.

Values

Against a demanding environment, we have continued to deliver on our purpose which is to provide best-in-class, trusted and friendly financial services to customers to drive their success – now and for generations to come.

Our financial fundamentals are strong and our long-term growth drivers are gaining traction. We have enhanced our position and capabilities in key areas such as wealth management, sustainability and business in the GBA. We will continue with our prudent approach on risk management whilst diversifying income streams. Our investments in technology and staff development are future-proofing our operations and the skills of our colleagues.

Easing of COVID-related restrictions and opening of international borders are positive developments that will enable an upturn in commercial activity and consumer spending. New actions by the government to broaden scope of the various Connect schemes will also boost investor sentiment and help restore the confidence in financial markets.

I would like to thank my Hang Seng colleagues for their relentless commitment and positive attitude even in very difficult situations. We all continue to live and breathe our core values that put customer needs and shareholder return at the heart of our actions. This will not change.

Next month, Hang Seng Bank will celebrate our 90th anniversary. We have lived through times of turbulent changes and times of exceptional growth. The underlying strength of Hang Seng has only been increased with experience. I am confident we are well-positioned for the future and as the largest local bank in Hong Kong, we will advance inclusivity and prosperity for the betterment of our community.

Diana Cesar
Executive Director and Chief Executive
21 February 2023