



Stability
in focus

Financial Review

Driven by the successful overseas business expansion, stringent loan purchasing criteria, prudent and proactive pre-funding and hedging operations, the Corporation achieved a record profit after tax of HK\$740.7 million in 2007, an increase of 8.5% compared with 2006, amid the global credit crunch and interest rate volatilities.

Income Statement

Financial Performance

The Hong Kong economy remained generally resilient in 2007, despite the emergence of US sub-prime crisis and global credit market turmoil. The strong economic fundamentals and improving financial positions buoyed the confidence of households and businesses, as reflected by robust domestic consumption and investment. The Hong Kong economy expanded at a strong pace of 6.3% for 2007 and the unemployment rate dipped to an average of 4.0% in 2007 from an average of 4.8% in 2006.

Although the US sub-prime woes and China's tightening measures caused significant market volatilities in the second half of 2007, the property sector had turned in a strong performance this year, benefiting from the consecutive rate cut hopes, continuing capital inflows and expectation of fund flows from China. Private residential property price rose by 11.5% for 2007.

In light of favourable economic environment, upturn in property and job markets of Hong Kong, the borrowers' credit quality has continued to improve. This has further strengthened the asset quality of both the HKMC's loan portfolio and MIP business that are subject to stringent loan purchasing criteria. The asset quality of the HKMC's investment portfolio was upheld by the prudent investment guidelines and asset and liability management. Accordingly, the HKMC has no direct or indirect sub-prime exposures. Driven by successful overseas business expansion, prudent and proactive pre-funding and hedging operations and improvement in asset quality in 2007, the HKMC has achieved an encouraging result amid the global credit crunch and interest rate volatilities. The HKMC Group achieved a record profit after tax of HK\$740.7 million in 2007, an increase of 8.5% compared with 2006. (Figures 1 and 2)

Figure 1

Summary of financial performance	2007 HK\$ million	2006 HK\$ million
Operating profit before impairment	816.8	753.8
Profit before tax	821.2	762.3
Profit after tax	740.7	682.7
Return on shareholders' equity	13.7%	13.9%
Return on assets	1.6%	1.6%
Cost-to-income ratio	13.6%	13.5%
Capital-to-assets ratio	11.2%	11.2%

Figure 2



Operating profit before impairment increased by HK\$63 million, or 8.4% to HK\$816.8 million. The significant increase in other income by 92% outweighed the decrease in net interest income by 9.5% and the increase of 9.5% in operating expenses.

The return on shareholders' equity remained strong at 13.7% (2006: 13.9%), while the return on assets maintained at 1.6% (2006: 1.6%). Operating expenses were overall well contained by effective cost control. Cost-to-income ratio rose slightly to 13.6% (2006: 13.5%). The capital-to-assets ratio maintained at 11.2% (2006: 11.2%), well above the guideline of a minimum 5% stipulated by the Financial Secretary.

Financial Review

The net interest income for the year dropped by 9.5% from HK\$717.2 million to HK\$649.3 million (Figure 3), mainly attributable to the tightening of Prime-HIBOR spread in 2007 on our prime-based loan portfolio. The Prime-HIBOR spread narrowed from a monthly average of 403bp in 2006 to 355bp in 2007. Taking into account the shareholders' equity, the net interest margin remained healthy at 1.5%.

Other Income

Other income reported a significant growth of 92% to HK\$296.5 million in 2007 (2006: HK\$154.4 million). The growth in other income was mainly underpinned by the change in fair value of financial instruments, increase in dividend income from investment portfolio, higher MIP net premiums earned and increase in early prepayment fees, partly offset by the decrease in exchange income. (Figure 4)

The fair value change of financial instruments recorded a favourable gain of HK\$116.1 million in 2007 as compared to a loss of HK\$7.5 million in 2006, mainly attributable to the positive marked-to-market gain on hedging instruments. The hedging instruments were derivatives (principally interest rate swaps and foreign exchange contracts), which were used for hedging purposes in the management of the Corporation's assets and liabilities to mitigate the interest rate volatilities and shrinkage of net interest income.

Dividend income of HK\$29.1 million from listed investment securities equivalent to a dividend yield of about 6% was received in 2007, 81.9% or HK\$13.1 million higher than 2006 (2006: HK\$16 million), mainly due to the increase in investments in bond fund and real estate investment trust.

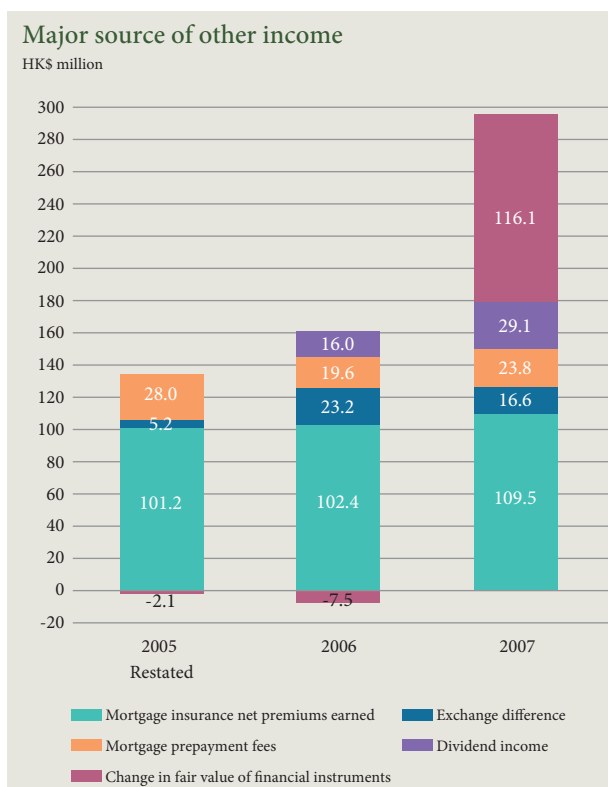
The HKMC operates the MIP business on a risk-sharing basis with four approved reinsurers and up to 50% of the risk exposure under the mortgage insurance covers.

Figure 3

Net interest income	2007 HK\$'000	2006 HK\$'000
Interest income	2,339,433	2,294,607
Interest expense	(1,690,101)	(1,577,391)
Net interest income	649,332	717,216
Average interest-earning assets	44,005,195	42,201,212
Net interest margin	1.5%	1.7%
Net interest spread on interest-bearing liabilities ¹	1.0%	1.2%

¹ Net interest spread on interest-bearing liabilities = Return on interest-earning assets – Funding cost on interest-bearing liabilities

Figure 4



With the increase in the draw loan of new residential mortgage loans in the market from HK\$115.1 billion in 2006 to HK\$173.5 billion in 2007, our underwriting of new MIP business rose from HK\$9.2 billion to HK\$13.2 billion despite a slight decrease in market penetration rate from 13.3% to 12%. The risk-in-force borne by us grew by 20.4% to HK\$3.5 billion in 2007. As a result, the net premiums earned for the year increased slightly by 6.9% from HK\$102.4 million to HK\$109.5 million.

Early prepayment fees were HK\$23.8 million, or 21.9% or HK\$4.2 million higher than 2006 (2006: HK\$19.6 million), affected by the buoyant property market and the increase in refinancing activities.

Exchange gain decreased by 28.4% or HK\$6.6 million to HK\$16.6 million (2006: HK\$23.2 million), primarily due to the revaluation on US dollar exposures.

Operating Expenses

The HKMC continued to maintain stringent cost controls to contain expenses while seeking to expand the scope of business. Operating expenses recorded an increase by 9.5% to HK\$129 million as compared to 2006. Staff costs increased by 18.1% to HK\$88.2 million, after taking into account of staff turnover and the salary adjustments, accounted for 68.4% of total operating expenses (2006: HK\$74.7 million and 63.4%). Premises rental and the related costs increased slightly by HK\$1 million to HK\$12 million, mainly attributable to the increase in rates on the rise of rateable value of existing office premises. Depreciation charges on assets fell by 4.7% to HK\$10.1 million (2006: HK\$10.6 million). (Figure 5)

Allowance for Loan Impairment

Asset quality remained strong, with the delinquency ratio of whole loan portfolio falling from 0.19% to 0.09%. Collective assessment for loan impairment of HK\$4.5 million was released to the income statement of 2007 upon the further improvement in the repayment ability of borrowers as compared to the release of HK\$8.5 million in 2006. (Figure 6)

Total allowance for loan impairment accounted for 0.04% of the outstanding principal balance (HK\$34.5 billion) of the loan portfolio as at end-2007. (Figure 7)

Figure 5

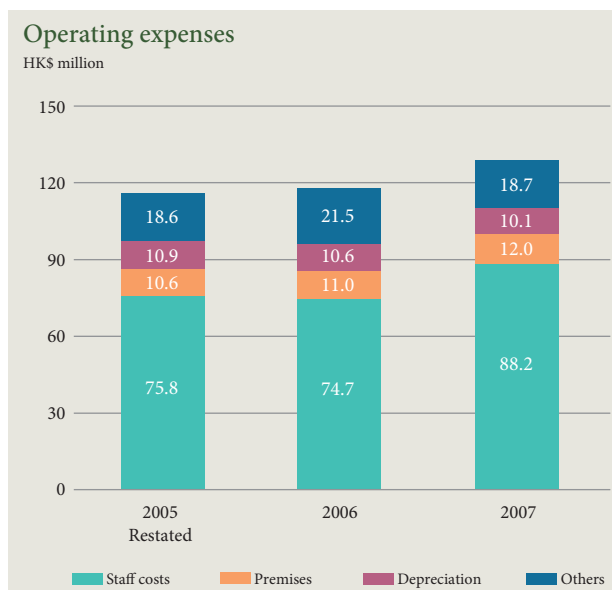


Figure 6

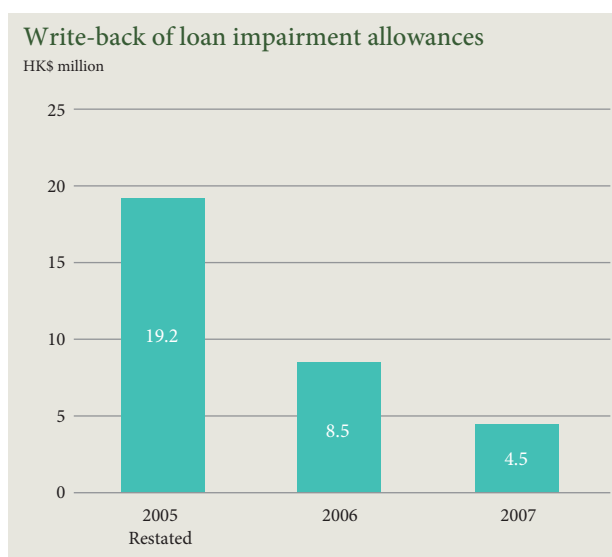


Figure 7

Ratios	2007	2006
Delinquency ratio for whole loan portfolio overdue for more than 90 days	0.09%	0.19%
Total allowance for loan impairment as a percentage of the gross loan portfolio	0.04%	0.07%

Balance Sheet

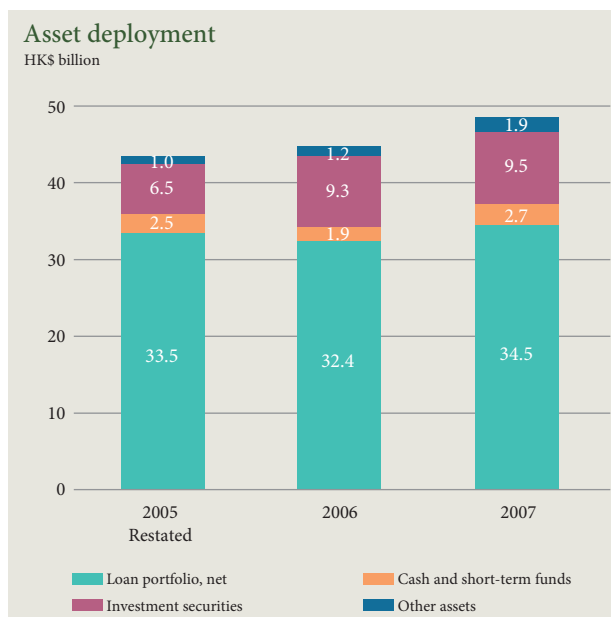
Total assets rose by HK\$3.8 billion to HK\$48.6 billion (2006: HK\$44.8 billion), mainly due to the increase in loan portfolio by HK\$2.1 billion to HK\$34.5 billion, the slight increase in investment securities portfolio from HK\$9.3 billion to HK\$9.5 billion and the rise in cash balance from HK\$1.9 billion to HK\$2.7 billion. (Figure 8)

Loan Portfolio

The HKMC purchased an aggregate amount of HK\$9.6 billion of loans in 2007 (2006: HK\$6.4 billion), including the first overseas mortgage acquisition of HK\$5.5 billion in Korea, HK\$3 billion Hong Kong residential mortgage assets and HK\$1.1 billion hire purchase assets.

After accounting for the prepayments and repayments during the year, the outstanding balance of residential mortgage portfolio and securitised portfolio, being the residential mortgages situated in Hong Kong, stood at HK\$20.4 billion and HK\$2.8 billion respectively. The commercial mortgage portfolio, which was backed by local commercial buildings, remained at HK\$4 billion at the end of 2007, the same as in 2006. During the year, the Corporation purchased more hire purchase assets, which were classified under non-mortgage portfolio, leading to the increase in outstanding balance from HK\$1.3 billion to HK\$1.8 billion in 2007. As approved by the Board in 2006, one of the Corporation's strategic moves was to develop new business in overseas markets, the Corporation had completed the first overseas mortgage acquisition of HK\$5.5 billion equivalent of Korean residential mortgages assets near the end of 2007. As such, the income contribution from Korean residential mortgage to profit before tax was marginally at HK\$275,000 for 2007.

Figure 8



The average prepayment rate of the loan portfolio (including those securitised mortgages) increased from 12.7% in 2006 to 13.7% for 2007. The high prepayment rate of the loan portfolio was offset by the increase in loan purchases in 2007; the loan portfolio recorded a net increase by HK\$2.1 billion to HK\$34.5 billion. (Figure 9)

Figure 9

Loan Portfolio, Net	2007 HK\$'000	2006 HK\$'000
Mortgage portfolio		
Residential		
– Hong Kong	20,413,884	23,313,605
– Overseas	5,458,180	–
Commercial	4,000,000	4,000,000
Securitised portfolio	2,796,551	3,796,048
Non-mortgage portfolio	1,805,606	1,291,032
	34,474,221	32,400,685
Allowance for loan impairment	(13,930)	(24,233)
Loan portfolio, net	34,460,291	32,376,452

Investment Securities

The HKMC's investment portfolio is mainly made up of bank deposits, certificates of deposit, bonds, yield-based bond funds and real estate investment trust. The portfolio serves as a liquidity buffer to support the HKMC's business operations and income enhancement. Following the approval of the Board of Directors to increase the return on investment while mindful of the need to maintain the Corporation's high credit rating and strong funding capability, the HKMC expanded its investment activities in accordance with the approved investment guidelines. As at 31 December 2007, the total investment portfolio grew slightly from HK\$9.3 billion in 2006 to HK\$9.5 billion including HK\$5.5 billion of available-for-sale investments and HK\$4 billion of held-to-maturity investments with funds redeployed from lower yielding cash and short-term funds. The increase in investment portfolio is in response to the active pre-funding activities in 2007 to set aside sufficient funds for overseas mortgage acquisition. With the prudent investment guidelines and asset and liability management, the Corporation did not directly or indirectly hold any sub-prime investment, special investment vehicles or collateralised debt obligations in available-for-sale and held-to-maturity portfolios.

Debt Securities Issued

The HKMC issued a total of HK\$16.4 billion of Hong Kong dollar and US dollar debts in 2007, comprising HK\$15.5 billion debts under the DIP and HK\$925 million retail bonds under the RBIP. As at 31 December 2007, the total outstanding balance of debts issued rose by 15.2% or HK\$4.4 billion to HK\$33.3 billion, reflecting the adoption of prudent and cost-effective pre-funding strategy in view of persistent volatility market conditions due to sub-prime mortgage crisis and global credit crunch arising in the second half of 2007. The rise reflected the net increase after redemption of HK\$12.3 billion debts matured in 2007 and the resulting change in fair value of debt

securities issued. The average life of the loan portfolio was 8 years on a contractual basis while 49.6% of the HKMC's outstanding debts would mature in the range of 1 to 5 years.

Mortgage-backed Securities Issued

As at 31 December 2007, the total outstanding balance of the mortgage-backed securities issued decreased by 22.2% or HK\$1.2 billion to HK\$4.2 billion compared with 2006. The decrease in the outstanding balance of mortgage-backed securities issued reflected the redemption of mortgage-backed securities in 2007.

Capital Management

The Financial Secretary has approved the following capital adequacy framework to account for different levels of risk embedded in the financial products under the Mortgage Purchase Programme, the two MBS Programmes, non-residential mortgage loans, the MIP and non-mortgage loans. (Figure 10)

The capital base, defined as shareholders' equity plus the allowance for loan impairment under collective assessment, grew by 10.2% from HK\$4.9 billion to HK\$5.4 billion in 2007. At the end of 2007, the aggregate amount of HKMC's on-balance sheet assets and off-balance sheet exposure was HK\$48 billion, which mainly consisted of HK\$25.9 billion and HK\$2.9 billion of risk-weighted mortgage loans and hire purchase assets respectively, HK\$9.5 billion investment securities, HK\$2.7 billion of cash and bank balances, HK\$3.5 billion risk-weighted mortgage insurance exposure, HK\$1.6 billion of replacement costs and potential future credit exposures of derivative contracts, HK\$0.6 billion risk-weighted guarantee exposure under the MBS programmes and HK\$1.3 billion other assets. The capital-to-assets ratio ("CAR") stood well above the minimum level of 5% stipulated by the Financial Secretary, at a healthy level of 11.2% (2006: 11.2%).

Figure 10

Product	Minimum Capital-to-Assets Ratio
Mortgage Purchase Programme	
(i) regular mortgage loans	5% of regular mortgage loan portfolio (based on outstanding principal balance or committed amount plus accrued interest)
(ii) loans originated under the Home Starter Loan Scheme (“HSLs”) and Sandwich Class Housing Loan Scheme (“SCHLS”)	2% of HSLs and SCHLS loans (based on outstanding principal balance or committed amount plus accrued interest)
Mortgage-Backed Securities (“MBS”)	2% of MBS portfolio (based on outstanding principal balance plus accrued interest)
Mortgage Insurance Programme	0% of risk-in-force value of exposure covered by the reinsurance arrangement with Approved Reinsurers 5% of risk-in-force value of exposure not covered by the reinsurance arrangement
Securitised mortgage loans transferred from the Corporation to the special purpose entities (“SPE”) that are qualified for derecognition from the Corporation’s balance sheet before account consolidation of the SPE	0% of securitised mortgage loans
Securitised mortgage loans transferred from the Corporation to the SPE that are not qualified for derecognition from the Corporation’s balance sheet before account consolidation of the SPE, where the mortgage-backed securities issued are:	
(i) guaranteed by the Corporation	2% of securitised mortgage loans
(ii) not guaranteed by the Corporation	5% of securitised mortgage loans
Non-residential mortgage loans	8% of the non-residential mortgage loan portfolio
Non-mortgage loans	8% of the non-mortgage loan portfolio
Overseas residential mortgage loans	The capital requirement applicable to the jurisdiction in which the overseas residential property is situated to adjust for the 5% requirement on regular mortgage loan portfolio

Dividend

At the Annual General Meeting held on 10 April 2008, Shareholders approved a final dividend of HK\$0.125 (2006: HK\$0.125) per share, totalling HK\$250 million, representing a 33.8% of the profit after tax.