# LETTER TO SHAREHOLDERS

**Cheong Choong Kong**
Chairman

**David Conner**
Chief Executive Officer

2006 was the first year of our New Horizons II strategy and we are pleased that it marked a good start to our five-year plan. Underpinned by healthy economic conditions in the region, and the investments we have made over the past years to improve our capabilities and competitiveness, we achieved another year of solid growth. Group net profit soared 54.3% to S$2,002 million, crossing the S$2 billion mark for the first time in our history.

## Performance Review

Our core net profit rose a healthy 11.2% to a record S$1,443 million, compared to S$1,298 million in 2005. Group net profit was boosted by one-time divestment gains of S$559 million to reach S$2,002 million. These gains resulted from our disposal of non-core assets, specifically: a residential development site at Kim Seng Road and our shareholdings in Robinsons, Straits Trading, Southern Bank and Raffles Holdings. Group core revenues grew 12.3% to S$3,242 million, while core operating profits, before allowances and amortisation of intangibles, rose 9.7% to S$1,911 million. Our return on ordinary shareholders' equity improved from 11.4% to 16.6%, or 11.8% excluding the divestment gains.

Our record earnings were a result of improved performances all round – in our key geographical markets of Singapore, Malaysia, Indonesia as well as overseas branches, and in both lending and fee-based activities.

Growth in interest earning assets and higher interest margins lifted our net interest income by 12.3% to S$1,794 million. Our total loans grew 6.9% during the year, with moderate growth in Singapore driven mainly by business lending, complemented by healthy broad-based loan growth in Malaysia and Indonesia. Our net interest margin improved by 16 basis points to reach a four-year high of 2.0%, as higher yields on loans and interbank placements more than offset rising borrowing costs. Non-interest income, excluding the divestment gains, grew 12.3% to S$1,448 million, with strong contributions from fees and commissions, insurance income and foreign exchange dealing income.

Our operating expenses increased 16.3% to S$1,331 million, attributed mainly to higher staff costs arising from increased headcount to fund our growing businesses, higher business promotion expenses, accelerated depreciation charges and one-off write-offs for fixed assets and software application systems. Our adjusted cost-to-income ratio (excluding divestment gains) was 41.1%, slightly above the 39.6% in 2005.

Continued successes in our recovery efforts for non-performing assets helped to keep overall net allowances low at S$2 million for the year, down from S$12 million in 2005. Our non-performing loans ratio improved from 4.1% to 3.0%, while overall allowance coverage of non-performing loans strengthened further from 88.3% to 100.9%.

OCBC Bank (Malaysia) Berhad achieved another year of steady growth. Operating profits before allowances increased by 19.2% to RM666 million, contributed mainly by higher net interest income as loans grew 9.6% and interest margins improved. Our bottomline net profit in Malaysia grew by a slower 4.0% to RM431 million (S$187 million), as the previous year's figure was boosted by write-back of allowances.

Following a difficult year in 2005, our Indonesian subsidiary Bank NISP delivered a strong earnings rebound as the macroeconomic environment improved. Bank Indonesia reduced its benchmark interest rate seven times during the year as inflationary pressures eased. For the year, Bank NISP achieved loan growth of 25.7%, while its net profit was IDR 237 billion (S$41 million), an increase of 15.6% over the previous year, which included a IDR 127 billion gain from the sale of an investment.

Our insurance subsidiary Great Eastern Holdings ("GEH") achieved a 27.9% improvement in its net profit to S$477 million, underpinned by new business growth, healthy underwriting profits and strong investment gains. GEH's contribution to our Group earnings, after deducting amortisation of intangible assets and minority interests, was S$357 million, including S$40 million of divestment gains.

Continuing our policy of active capital management, we commenced our third S$500 million share buyback programme in June, of which S$231 million has been utilised as of end-January 2007. During the year, we bought back approximately 65.7 million shares for S$436 million. Shares purchased since February 2006 have been held as treasury shares, partially used to satisfy the delivery of shares under our employee share option and employee share purchase plan.

Our assets growth as well as capital management efforts resulted in a slight decline in our capital ratios to 13.1% for Tier 1 and 15.8% for total capital, but these remained healthy and well above the regulatory minimums.

## Higher Dividends

As part of the ongoing assessment of our capital needs, sustainable profitability and the appropriate level of dividends to ensure a reasonable yield, we announced in August an increase in our target minimum dividend payout from 35% to 45% of the Group's core earnings.

The Board is pleased to recommend a final tax-exempt dividend of 12 cents per share for ordinary shareholders, bringing the total distribution for financial year 2006 to 23 cents (tax-exempt). This is 25.0% higher than the 18.4 cents (net of tax) paid for 2005, and represents a payout of 49.1% of our 2006 core net profit, exceeding our minimum 45% target.

As a result of our various capital management initiatives over the past four years, all our available Section 44 tax credits have been passed on to shareholders. The Bank will move to the one-tier tax system after the payment of the 2006 final dividend.

## Investing in Growth of Financial Services

A key pillar of our strategy, under both the New Horizons and New Horizons II strategic plans, has been to re-invest the gains from selling non-core assets to expand our core financial services businesses. In line with this policy, we spent about S$450 million on three major investments and acquisitions during the year – increasing our stake in GEH, and becoming the first Singapore bank to acquire stakes in banks in China and Vietnam.

In July we launched a voluntary cash offer for the remaining GEH shares we did not own, at S$16 per GEH share. We received acceptances amounting to 3.1% of GEH's issued share capital. Including our cash purchases during the year, we invested a total of S$302 million and our stake in GEH increased from 82.3% to 86.9%.

In June we completed the acquisition of a 12.2% stake in China's Ningbo Commercial Bank ("NCB") for S$122 million. We are now working closely with NCB to grow their small and medium enterprise and consumer businesses, by providing a comprehensive training and technical assistance programme aimed at developing the leadership and staff of NCB. We also launched several joint initiatives to drive business collaboration between OCBC and NCB in trade finance, investment banking, cross-border financing and treasury, all of which have begun to show promise.

In October, we acquired a 10.0% stake in Vietnam Joint-Stock Commercial Bank for Private Enterprises, or VP Bank, for S$25 million. We have an option to increase our stake to 20.0% by the end of 2007, subject to regulatory approvals and the relaxation of the current single foreign shareholder limit of 10.0%. This strategic acquisition positions us for growth in Southeast Asia's fastest growing economy, and we intend to work with VP Bank to build a leading consumer banking and SME franchise in Vietnam, leveraging on our experience in the region.

## NTUC-OCBC Partnership

In February 2007 we announced the launch of Fairprice Plus, a major collaboration with NTUC Fairprice Co-operative Limited ("Fairprice") to offer simple banking solutions at all Fairprice supermarkets and outlets in Singapore. Fairprice operates the largest island-wide supermarket chain with a total of 196 retail outlets and more than 1.5 million regular shoppers. This latest collaboration is a natural progression of our existing partnership with the National Trades Union Congress (NTUC), which started with the launch of the NTUC-OCBC debit and credit cards in September 2004, followed by the introduction of several financial solutions over the past two years.

Under Fairprice Plus, OCBC will develop appropriate products and services for shoppers at Fairprice, built on three key attributes - simplicity, transparency and value for money. The first products we will be launching in the second quarter of 2007 are a statement savings account with attractive deposit rates, and Fairprice Plus debit and credit cards which can be used for payment at the Fairprice outlets. We will also establish new ATMs at all 81 Fairprice supermarkets and hypermarkets, and eventually at other Fairprice outlets.

We are excited about this new collaboration. The powerful combination of Fairprice and OCBC will bring to the community a wide array of affordable and easily accessible financial products and services, and introduce a new way for Singaporeans to grow and manage their money.

## Looking Forward

The consensus view is for a modest slowdown in global economic growth in 2007, with the US economy achieving a soft landing. Most economists are positive on the outlook for Europe and Japan, while Emerging Asia is expected to remain the fastest growing region in the world, led by China and India.

In Singapore, where the government projects GDP growth to slow from 7.9% in 2006 to 4.5 – 6.5% in 2007, consumer confidence and business prospects remain generally upbeat, given the record number of jobs created last year, the upswing in the property market, the impact of the integrated resorts, and good corporate earnings and stock market performance. In Malaysia, the government expects GDP growth of 6%, largely similar to the estimated 5.8% achieved in 2006, while in Indonesia, the central bank forecasts GDP growth of 5.7 – 6.3%, compared to 5.5% for 2006.

Against this backdrop, we are reasonably confident that we will continue to grow and strengthen our franchise in our key markets.  Our New Horizons II strategy is showing good momentum and we intend to stay the course.

Currently one third of our Group earnings is derived from overseas operations. While we have not set a numerical target for our overseas contribution, we believe that in the medium to long term, growth prospects for financial services are stronger in developing economies like Malaysia, Indonesia and China than in the mature Singapore market. We see the medium term loan growth potential for Singapore at around mid-single digit, whereas for Malaysia we are reasonably confident of sustaining growth above 10% as in the past few years. In Indonesia, Bank NISP has the potential to grow loans by more than 20% per annum given its smaller base and rapid network expansion.

Malaysia will remain our most important overseas market for some time because of our long history there, and the customer base and deep franchise that we have. We will continue to allocate significant resources to gain market share in this market, focusing on the SME and consumer segments, and working with Great Eastern Malaysia. We are pleased to have been granted permission by the central bank to open four new bank branches last year, which will bring our branch network to 29. We now have a larger branch network to serve our customers better.

In Indonesia, China and Vietnam, our strategy is to transfer successful business models and product solutions from Singapore and Malaysia to our branches and strategic partnerships in those countries.

We will help broaden Bank NISP's product offering, including wealth management, credit cards, cash management and trade services. We will also support Bank NISP's network expansion plans as it seeks to become a top-tier nationwide bank by 2010. Bank NISP added 69 new branches and offices in 2006, bringing its network to 259 outlets, and it targets to open more than 75 new offices this year.

In China, we will continue to build on our strategic partnership with NCB and at the same time invest in organic growth through our OCBC network, which currently comprises seven branches and representative offices in six cities. In February 2007 we received approval from the China Banking Regulatory Commission to commence preparation for local incorporation. We expect to establish our subsidiary in China by the end of 2007. With local incorporation, we will be able to broaden the range of Renminbi products and services to serve both corporate and consumer customers, and have more scope and flexibility to grow our business organically in China over the longer term. For a start, we are looking to open a new branch in Guangzhou and upgrade our existing representative office in Beijing to a branch. We also plan to expand our sub-branch network in existing branch locations to provide better access to our target customers in consumer and SME banking.

In Vietnam, we will deepen the level of our cooperation with VP Bank through our training and capability transfer programmes, particularly in consumer banking and risk management. We will also jointly explore business opportunities with VP Bank.

## Acknowledgements

We thank our fellow Board members for their wise counsel and guidance in steering OCBC on a steady growth path. We must congratulate and thank our employees at all levels of the Group for their dedication, hard work and teamwork, without which we would not have achieved the good results in 2006. Finally, our appreciation goes to our loyal customers and shareholders for their continuing support and confidence in OCBC.

**Cheong Choong Kong**
Chairman

**David Conner**
Chief Executive Officer

22 February 2007