

PHILIPPINE POSTAL SAVINGS BANK, INC.
2004 PERFORMANCE REPORT

Results of Operations

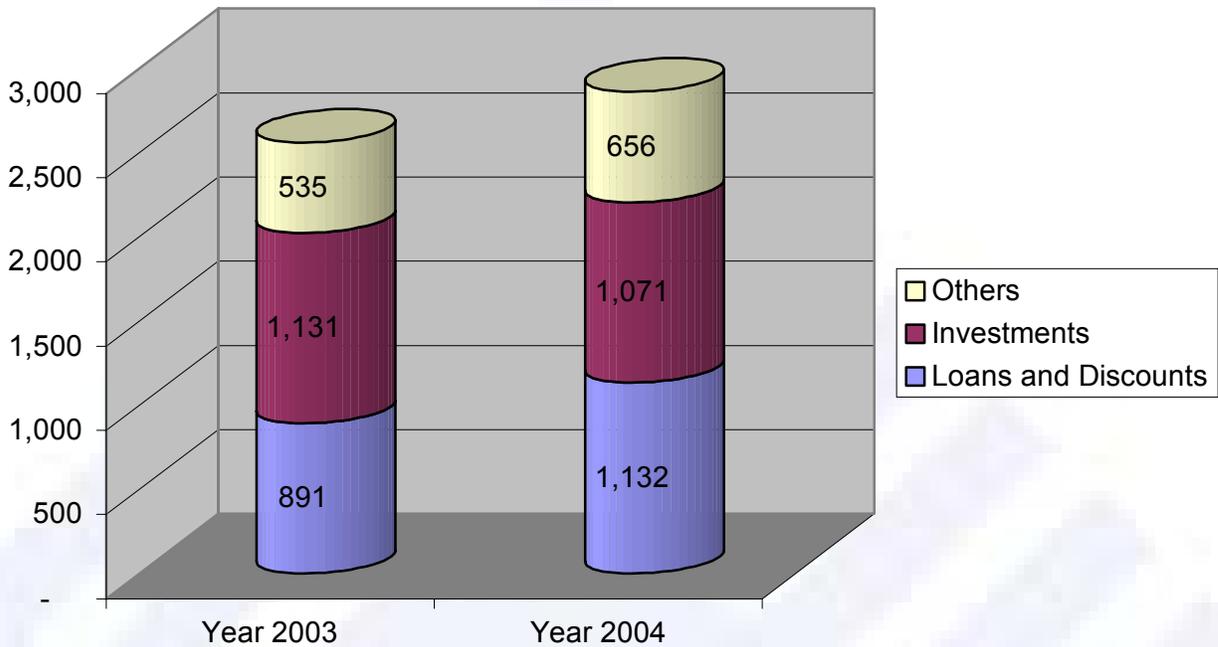
FINANCIAL CONDITION

Total Resources

PostalBank's resources as of the end of December 2004 grew by 12% from P 2.56 billion in Year 2003 to P 2.86 billion. Loans and discounts account for 40% (P 1.132 billion), while Investments in Bonds and Other Debt Instruments comprise 37% (P 1.071 million) of Total Resources. The remaining 23% is composed of ROPOA, Trading Account Securities and other assets.

On the other hand, Total Deposit Liabilities went up by 13% from P 2.04 billion last year to P 2.30 billion this year. Stockholders' equity as of the end of December 2004 is at P 320.22 million compared to P 269 million for the same period last year. Additional PhilPost equity amounting to P 155 million, in the form of lot and building has been temporarily lodged as Future Subscription on Stock Receivables, but has already been recognized by the Bangko Sentral ng Pilipinas (BSP), pending the appropriate documentation of the transfer with the Securities and Exchange Commission (SEC) and the Bangko Sentral ng Pilipinas (BSP).

TOTAL RESOURCES (in million pesos)

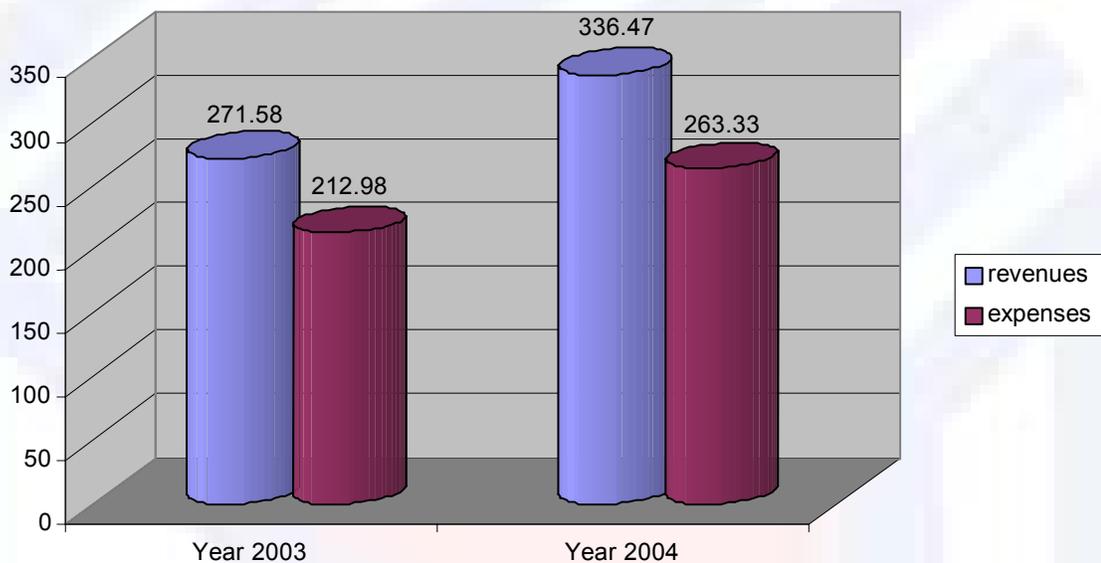


In line with its mission to mobilize savings and promote the values of thrift, industry and prudence, the Bank generated additional deposits totaling P 263 million and has extended additional loans amounting to P241 million. Total deposit liabilities is 95% of total target of P 2.431 billion for Year 2004, while total loan portfolio has reached 77% of the P 1.478 billion loanable fund target for the year.

Profitability

Total Net Income for 2004 reached P 51.62 million, 37% higher than the previous year's level of P 37.79 million. Interest income totaled P 293.20 million from P 247.16 million in the Year 2003, with interest income from loans contributing P 196.60 million, as against last year's P 147.28 million. Fee based income posted a significant increase of 95% or P 11.93 million.

REVENUES vs. EXPENSES
(in million pesos)



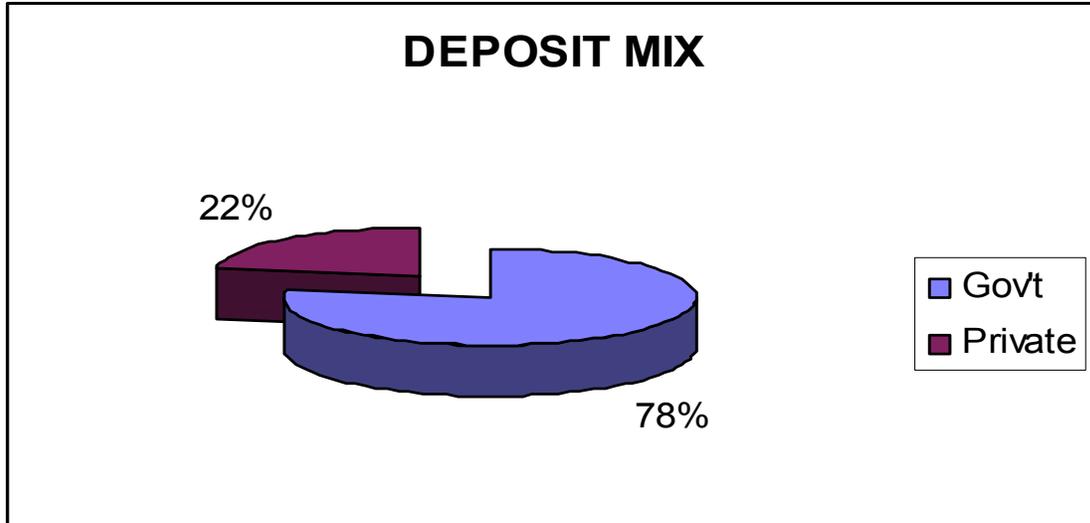
On the other hand, total expenses was managed at P 263.33 million from P 212.98 million, or 26% higher than 2003. Interest expense takes up a substantial portion, accounting for 33% (or P 87.03 million) of total expenses. Next is Compensation and Fringe Benefits at P 67.67 million accounting for 26% of total expenses. Compensation shows an increase of 9% from last year, of which salaries and wages comprise P 61.98 million.

Lastly, Other Operating Expenses reached P 108.63 million or 41% of total expenses. This is 35% higher than last year. The increase in Operating Expenses is due, among others, to the following:

- 60% increase on Management and other professional fees or P 908,159.87
- 205% increase in Taxes and licenses or P 9,444,895.40
- 73% increase in Depreciation and amortization or P 6,415,193.60
- 19% increase in Rent or P 3,039,447.02
- 92% increase in Traveling expenses or P 1,846,941.76
- 40% increase in Postage, telephone, cables & telegrams or P 1,162,694.47
- There were no significant decreases on the other accounts to counter the large increases in the enumerated ones.
- The accounts that were not mentioned are mostly comprised of increased amounts rather than decreased ones which further increased the Other Operating Expenses.

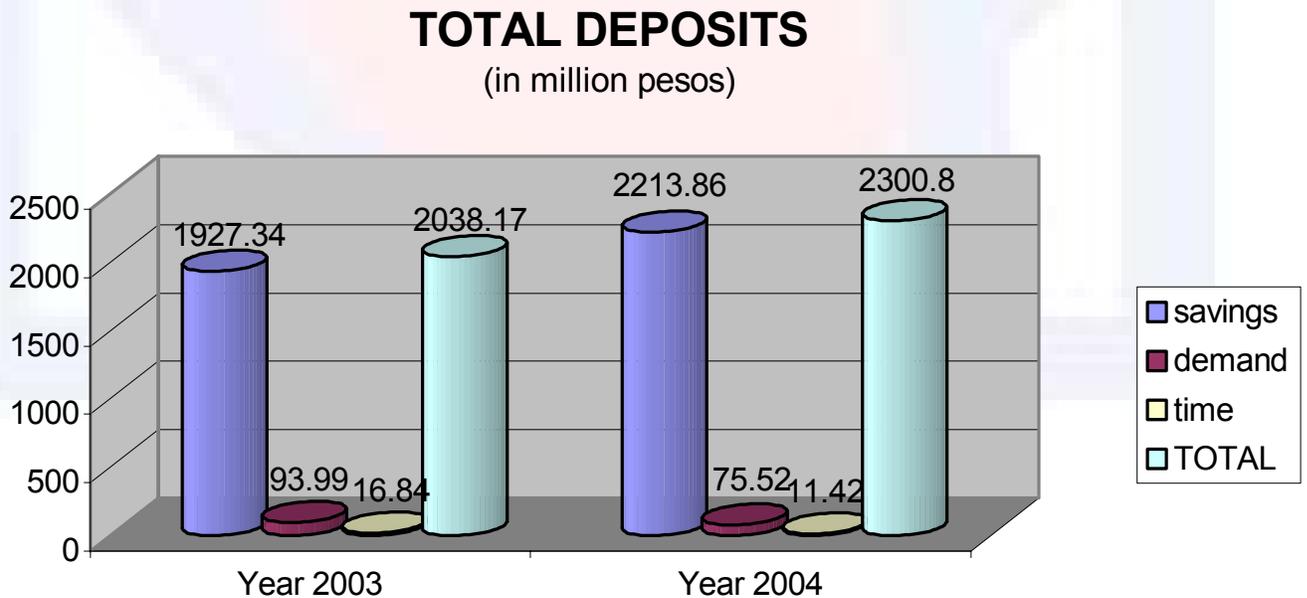
Deposits

In terms of deposit mix, the bank generated 78% of its total deposits or P 1.72 billion from government entities, while the rest which stands at P 483 million or 22% of total deposit ADB was contributed by the private sector. This is short of the Year 2004 goal of a 70:30 mix in favor of government deposits.



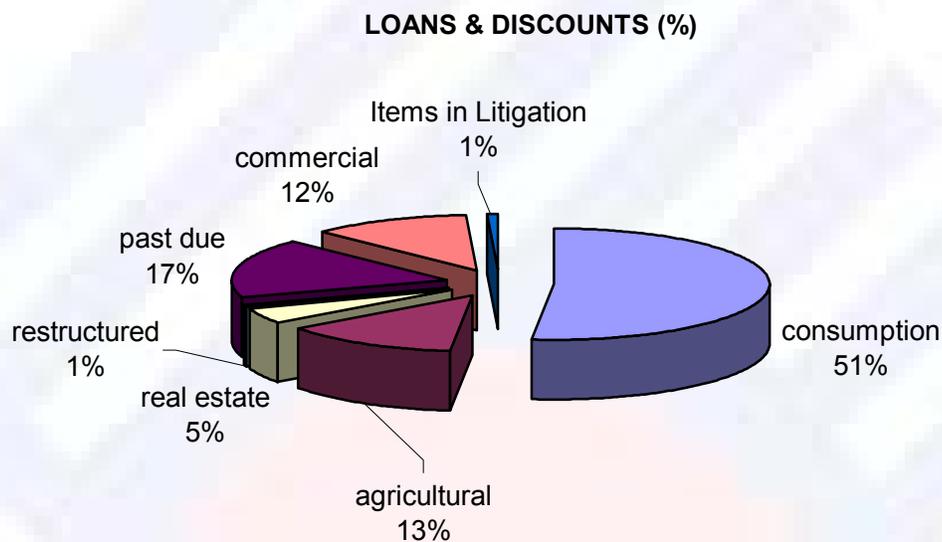
Deposit by Type

By type of deposits, 96% were savings deposits up from 95% from last year. Time deposits comprise a mere 1% of total deposit liabilities while demand deposits, 3% for the year 2004.



Lending Operations

Loans outstanding totaled P 1.132 billion, of which 63% or P 612.69 million were consumption loans while 14% or P 140.15 million were commercial loans. The inability of many debtors to settle their maturing obligations, as a result of the prevailing economic difficulties, weighed on our Non-Performing Loans by 39.07% or from P 154.60 million in Year 2003 to P 215.01 million in Year 2004. Items in Litigation, also showed deterioration from P 2.75 million last year to P 10.68 million at the end of 2004.



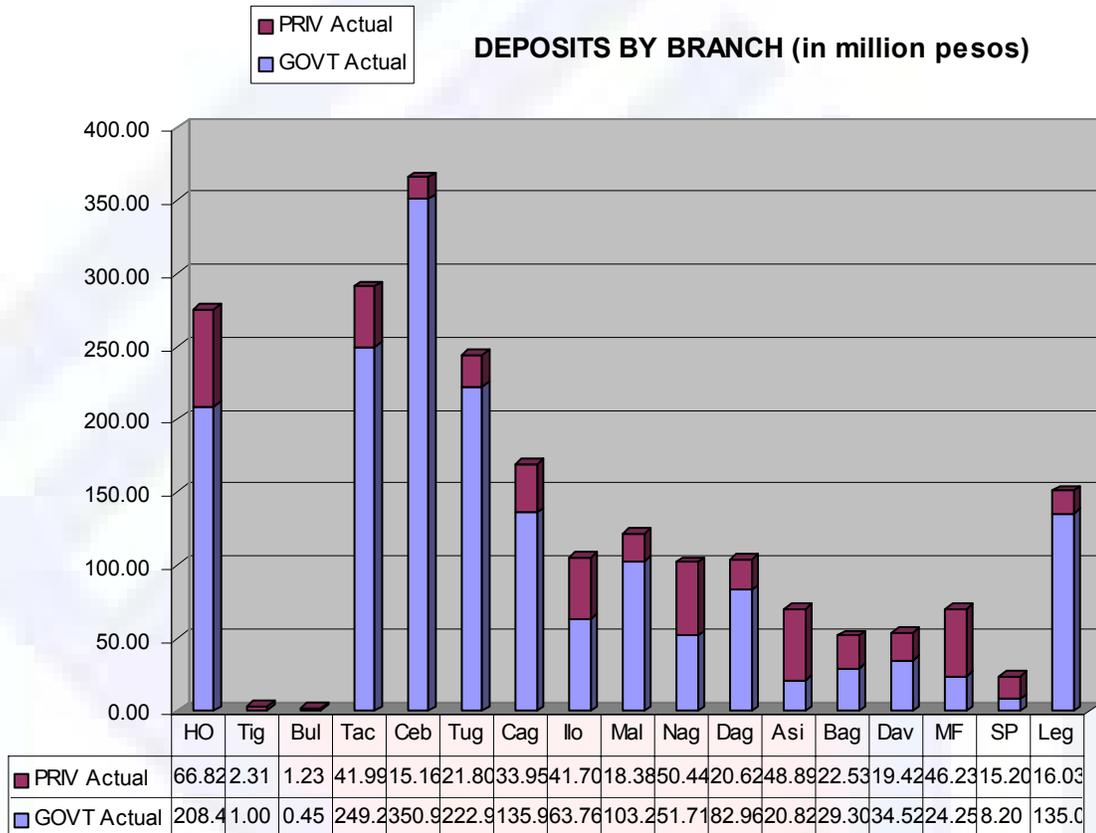
Our **Marginal Lending Efficiency** (additional loans generated as a result of additional loanable funds for the year) was at 296% with total loan portfolio increasing by P 241 million against an increase of P 81 million in total loanable funds.

Investments

Total investments went down to P 1.071 billion from P 1.131 million of last year or a 5% decrease. Major contributor was investments in bonds and other debt instruments with an 18% increase from last year's P 719.83 million to P 846.26 million as of end December, 2003.

Branch Operations

In terms of regional branch performance, the top deposit generators among the regional branches were Cebu, with P 366.08 million or 17% of total deposits, followed by Tacloban with P 291.26 million or 13%, Head Office with P 275.30 million or 12%, Tuguegarao with P 244.75 million or 11% and Cagayan de Oro with P 169.88 million or 8% of the total deposits.



Operational and Administrative Highlights

Under the watch of an active Management and the guidance of a dynamic Board of Directors, real reforms were initiated to improve operating efficiency, strengthen risk management, build-up capital base, and above-all, improve corporate governance. In fact, the Bank managed to post significant improvements in following key result areas.

- **Total capital funds now stand at P320 million, restoring the P300 million initial paid-in capital of the Mother Corporation, Philpost,** and only P5 million shy of the P325 million minimum capital required by the BSP. At the rate the Bank is going, we would have complied with this capitalization requirement by the end of the 1st quarter next year, notwithstanding the transfer of the real property investment of Philpost.
- Our deposit taking measures resulted to an increase of 13% in our deposit liabilities as compared to last year's figure with the resultant level of P2.30 billion.
- Total Loan Portfolio increased by 27% from P891 million in 2003 to P1.132 billion in 2004.
- Net Income (year-on-year) significantly increased (by 37%) from P37.79 million in December 2003 to P51.62 million as of December 2004

Towards a Lean and Mean Organization.

To improve operational efficiency and productivity, hence resulting to enhanced competitiveness in the industry, Management advocated an organizational realignment that will address the need for an ideal working organization consistent with the Bank's tactical and strategic thrusts of (1) liquidity management and investments, (2) deposit taking and lending, and (3) Management Services, supported by effective corporate governance at par with our peers in the industry.

To make the organization more responsive to the demands of the times, Management proposed the creation of three functional business groups, each with specific responsibilities under the supervision of a Group Head, reporting directly to the President and Chief Executive Officer namely:

- **Treasury Group** which will take care of liquidity position management, investment and securities trading, correspondent banking and regulations monitoring;
- **Marketing Group** which will oversee the operations of branch banking, corporate banking, credit administration , product development and remedial management; and
- **Management Services Group** with Data Center Management, Accounting and Comptrollership, and Operations Management.

New Policy Directions for PostalBank

With goal of fulfilling the vision and mission of PostalBank, Management set new policy directions that will guide the Bank in all facets of its operations, namely:

- Incentive scheme towards private deposit generation
- Standardization of credit and accounting practices
- Revision of targets for 2004
- Efforts to make PPSB an MDS Bank
- Aggressive marketing for DOTC accounts
- Adoption of austerity measures in line with AO 103
- Stricter compliance to BSP guidelines especially on mandated loan ceilings and preparations for microfinance endeavors
- Prioritization of loans with high growth and profit potentials

- A Medium-Term Plan that focuses on capital build-up and deposit generation
- Partnership with the Mother Corporation in playing actively in the money remittance business
- Beef up on investments and avoidance of high risk lending
- Disposal of ROPOAs and other non-performing assets
- Preparation for bigger loans to the Transport sector, as member of the DOTC family, and
- Boosting customer relations management

Development Initiatives

Several development projects conceptualized, carried on and/or initiated by Management were also favorably noted/ approved by the PPSB Board, and religiously pursued by Management and Staff, among others:

- The participation of the Bank in the Small and Medium Enterprise Development for Sustainable Employment Program (SMEDSEP) which culminated in the **signing of a Service Level Agreement among PPSB, SMEDSEP and the Small Business Corporation last 10 November**. The project aims at establishing a comprehensive and sustainable institutional framework for the development of the SME sector in the Philippines, particularly in the Visayas;
- **Simultaneous opening of the BSP approved Bula and Tigaon sites in Camarines Sur on Nov. 5**, which will strengthen PPSB's presence in the Bicol area, thereby enabling PPSB to assist in the development efforts of the countryside
- **Opening of the Himamaylan Branch in Negros Occidental on January 14, 2005**, hence expanding our reach in the Visayas, where there is strong SME presence.
- Implementation of the cost reduction program which seeks to generate savings of P15 million over the next three years;

- Approval of the Solo Parent Leave;
- Approval of the Policy on Drug Testing;
- Approval of the Regulatory Compliance Program of the Bank;
- Approval of the request for reverse repurchase agreement lines for BSP and investment instruments for the Republic of the Philippines;
- Approval of the Revised incentive scheme for private deposit generation;
- Approval of the Revised Anti-Money Laundering Manual;
- Approval of the reclassification of some accounting positions;
- Moves toward better monitoring especially of Past Due accounts and ROPOA.

Management was able to secure Board approval for financing of several major community based projects such as:

- P3 million Pacana-Bell loan of Cagayan de Oro;
- P2 million increase in credit line of VDN Triple R. Breeder Farm of Cagayan de Oro; and
- Enhanced financial assistance program for the officials and employees of the Albay Provincial Government.
- Under the guidance of the President and CEO, we have been able to conduct four successful area planning conferences the results of which will chart the direction of the Bank for the Year 2005.

All of which will have a tremendous impact in the operating activities of the Bank, as well as in stimulating growth in the countryside.

Paradigm Shift Towards a New PostalBank

Acknowledging that the face and character of banking is rapidly changing such that there is constant influx of new technology and demand for service is becoming more complex, Management rallied PostalBankers to innovate or

face extinction. Hence, it spearheaded the creation and packaging of new products and services that will cater to the peculiarities of our captive market, to wit:

- The Private Deposit Generation Program – a bank wide intensified private deposit drive to generate some P469 million in fresh deposits by the end of 2005, and achieve a deposit mix of 60:40 government to private accounts.
- Premium Earner Account – a 5-year term special savings deposit account that earns higher interest than time deposit targeted for middle to high net worth individuals and juridical entities.
- SAVE or the Savings Awareness and Values Education. A Revival of the Thrift Stamps Program which aims to sustain the promotion and encouragement of thrift and prudence in the youth by signing up at least 500,000 students in pre-school, elementary and secondary levels.

Improving Capital Adequacy

Finally, knowing that many of the development initiatives of the bank such as branch expansion and other allied undertakings, will depend to a large extent on our capital adequacy, Management pursued the efforts to immediately effect transfer of the ownership of the Philpost real property investment to PPSB, including coordination with the DENR and the Land Management Bureau for the expeditious issuance of a special patent providing legal proof of conveyance of the property from the Philippine Government to the Philippine Postal Corporation.

Aside from above measures, Management also introduced steps to improve profitability which will then be ploughed back as equity to restore the initial paid up capital of our majority owner, Philpost.

Vital Undertakings for Year 2005 and Beyond

With Information Technology serving as one of the important enablers towards the attainment of our mission/vision, the Bank will embark on the following significant undertakings in 2005 and beyond:

1. Pursue branch expansion (at least 20 branches for 2005), through purchase of distressed banks and locate in high volume pedestrian and vehicle traffic areas.
2. Development of additional and enhanced portfolio of products and services suited for the LGU and SME markets.
3. Private Deposit Accounts Generation Campaign.
4. Leverage technology to drive efficiencies in service delivery, effectiveness in decision-making, and overall profitability.
5. Improve the quality of our Lending Portfolio.
6. Micro-finance lending.
7. Reinforce market intelligence to keep up with competition in the industry.
8. Develop a leaner and more responsive organizational structure fueled by a stronger positive reinforcement.
9. A shift from a mindset that is activity-based to productivity-based.
10. Develop intelligent corporate policies designed to strengthen our fundamentals.
11. Develop a network of performance driven and conscious professionals.