Financial Review for 2003

Summary of Performance

The Staff of People's Bank, for the second successive year have been able to surpass all financial performance records that had been set in the previous year.

As a result, the Bank has now recorded its best ever operating performances, which signals a continuity of the "turnaround" aimed at achieving the true financial potential of an organization that had previously been described as a "sleeping giant".

Many challenges and hurdles need to be overcome to truly signify that "financial break-out" and financial independence from the State have been achieved. However, the performances of the Bank from 2001 to 2003 have clearly indicated that People's Bank truly has the clear potential to grow into a financial "power house" that reflects the earning capability arising from the unique size and scale of operations, vast outreach across the length and breadth of the country and the depth of the customer loyalty base.

Key Performance Highlights

In 2003, People's Bank was able to achieve the following:

- Highest Ever Net Profit in the 43 year history of the Bank of LKR 1,555 Mn, which in turn is a growth of 55% over last year.
- A continuation of Deposit Growth, with an increase of LKR 15.5 Bn (i.e. 11%) during the year, leading to a year end value of LKR 157.3 Bn.
- The Bank has been able to sustain the Deposit base growth, each year since 2000, as a result of innovative products and very largely due to customer confidence and loyalty.
- Operating expenses have been managed such that the Operating Cost/Net Income Ratio has decreased to 70% at the end of 2003, from a level of 89% in 2001.
- In the interest of greater prudential management of our Non-Performing Loan Portfolio, the Bank has given effect to a new rule of the Central Bank relating to the diminution of value of mortgaged property securities.

  This new rule comes into force with effect from 01-01-2004; however, the Bank has given effect to the provisions of the new rule as at the end of 2003.

  As a result, the Bank has made an additional provision of approximately LKR 1.7 Bn in relation to Loan losses.

  The Net Profit of LKR 1.5 Bn, is after charging this additional "hair-cut" provision.

Key Initiatives and Critical Success Factors in 2003

The Bank was able to sustain the improvements of operating performance, largely by focusing on certain key strategies and management initiatives.

These success factors that have contributed to the Bank's success are as follows:-

- **Continued focus on Low Cost Deposit Mobilisation**

  The Bank was able to sustain an island wide thrust on deposit mobilisation for the fourth consecutive year.

  This effort has been bolstered by a wide product range that caters to the different needs of our customer base, backed by promotion and marketing carried out at grass root levels of the Bank.

  The Jaya Sri TV Campaign has continued to add glamour to our Savings Deposit drive.

  The Savings products that have continued to achieve particular success are the Jana Jaya, Vanitha Wasana, Sisu Udana and Isuru Udana savings schemes, which encompass multiple features including life insurance and loan draw down facilities.

- **Focus on Recovery of Non-Performing Loans**

This is one of the main factors that initially caused financial distress to the Bank.

The NPL portfolio at the end of 2003 amounted to approximately LKR 21.7 Bn, of which approximately 50.2% related to a few large debtors. Legal procedures have been initiated against each of these accounts.

A significant effort is being carried out to recover the balance dues.

The fact remains that any recovery of these long outstanding balances, will contribute definitely towards resolving the Capital deficit of the Bank.

- **Growth of the Pawning Business**

The Bank remains as the clear market leader in delivery of this service across Sri Lanka.

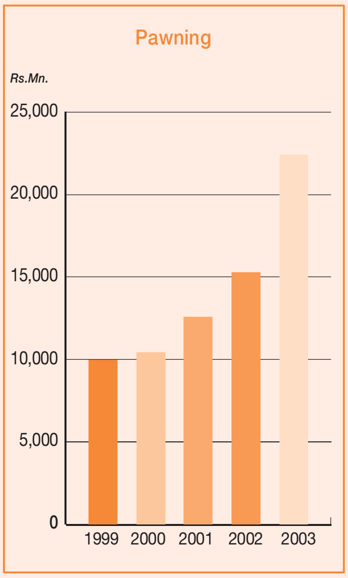
The Bank has developed this product into being an efficient and speedy means of accessing finances for any urgent need of an individual, family or business. The Bank has thus created a means whereby family gold can be productively used for the benefit and development of the family, as against being only a traditional store of value.

The outreach of the Bank, enables the delivery of this speedy means of financing, which often operates as "bridging finance", to all nooks and corners of the country.

The Bank has accordingly considered this area of service as a key success factor and has made every effort through 2003, to develop the quality and efficiency of service delivery at all our Pawning and Savings Centres.

This effort has resulted in further contribution to the growth of the Bank's profitability.

Rs. Mn.	1999	2000	2001	2002	2003
Balance at End	9,997	10,416	12,568	15,259	22,418
Annual Growth %	*(1.2%)*	*4.2%*	*20.7%*	*21.4%*	*46.9%*



- **Empowerment of Managers at all levels**

The Bank has delegated authority for business decisioning to enable improvements to the quality of customer services.

In addition, the Business Planning Process of the Bank, involves a bottom-up approach, which thereafter assigns plan delivery responsibility to the Branch Network and Business Segments.

Continued focus on this initiative has been an on-going process during the year and is considered as an important factor that underpins the Bank's continued business recovery.

- **Staff Performance Incentive Scheme**

  The scheme that was initiated in 2001 has been fine-tuned annually and has now grown into being a key management initiative in relation to business performance management and improvement of staff productivity.

  This scheme identifies areas that are critical to the success of the Bank and also links up the direction the Bank wishes to grow towards and rewards all Business segments on a "Team" basis for achievement of progress.

  This scheme has been received with considerable enthusiasm and has encouraged staff to make greater endeavours to drive for success.

  This scheme has continued to be a very significant factor that contributes to business success.

- **Management Accounting Platform**

  The Bank has developed a proactive system that encourages staff productivity.

  This platform is based on the use of multiple rate transfer pricing and management of the Bank's business on a segmental basis.

  This process has been supported by an increasingly sophisticated level of Financial MIS reports, that amongst others seeks to create healthy internal competitiveness on productivity and performance.

  Together with the attractive staff performance incentive scheme, this effort by Management is increasingly growing into being the cornerstone of business performance improvements.

- **Pulse Points Rewards Scheme**

  The Bank has also launched a further initiative to harness the creativity and innovative abilities of the staff through a scheme that departs from the traditional staff suggestions schemes.

  In this initiative that was launched in 2003, staff are rewarded for creativity and initiatives "in action" where recognition is given to actual results achieved from ideas and initiatives of staff.

  This process too has enabled a facilitation of greater interest in the business success of the Bank.

Analysis of Business Performance in 2003

The key initiatives listed above have contributed to the growth of the business. The underlying operations of the Bank are analysed hereunder as follows:-

- **Growth of the Loan Portfolio :**

  The key factor that influences our Bank's business growth is the Loans and Advances Portfolio.

  During 2003, the Bank continued with its strategy of reducing exposure to the State Sector and replacing these balances with an increased lending to existing quality private sector customers as well as winning new business relationships.

  This process has also been linked to the new stringent credit risk management policies of the Bank.

  An analysis of growth trends of the components of our Loans and Advances Portfolio amplifies the above assertions.

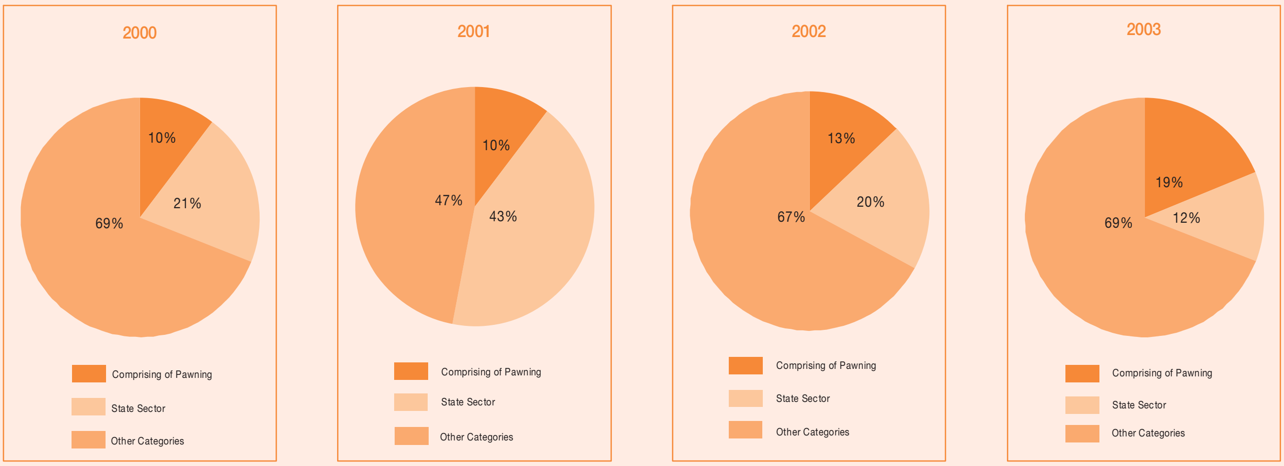
RS. Mn

	2000	2001	2002	2003	% Growth 2003 Over 2002
Total Loans & Advances	101,207	121,642	116,324	118,042	1.5%
Pawning Portfolio	10,416	12,568	15,259	22,418	46.9%
% of Total Portfolio	*10%*	*10%*	*13%*	*19%*	
State Sector Balances	21,038	51,967	23,598	14,436	(38.8%)
% of State Sector	*21%*	*43%*	*20%*	*12%*	
Private Sector Balances	69,753	57,107	77,467	81,188	4.8%
% of Private Sector	*69%*	*47%*	*67%*	*69%*	

RS. Mn

	2000	2001	2002	2003	% Growth 2003 Over 2002
NPL Balance	19,128	25,420	23,105	21,721	(5.0%)
% of NPL to Total L & A	*19%*	*21%*	*20%*	*18%*	
Provision for Loan Losses	14,716	15,499	15,194	16,970	11.7%
% of Provision for Loan Losses to NPL Balance	*76%*	*60%*	*65%*	*78%*	

Total Loans and Advances - Annual Composition Trends



- **Analysis of Deposit Growth Trends & Product Mix:**

  The Deposit portfolio remains a key competitive advantage of the Bank.

  Growth trends of this key area reflect the following:

	2000	2001	2002	2003	% Growth 2003 Over 2002
Current	16,426	15,561	19,285	23,484	21.8%
Savings	58,849	65,272	73,917	86,348	16.8%
Time	36,690	44,075	46,068	44,022	(4.4%)
C/D "s	316	330	362	405	11.9%
Others	2,726	2,305	2,203	3,052	38.5%
Total	**115,007**	**127,543**	**141,836**	**157,310**	**10.9%**

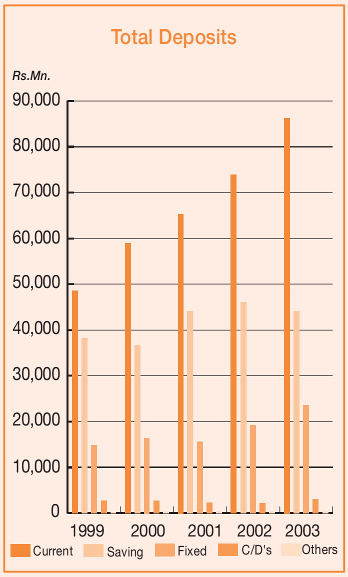
	2000	2001	2002	2003	% Growth 2003 Over 2002
Total Local Currency Deposits	107,395	117,812	129,438	144,460	11.6%
Total Foreign Currency Deposits	7,612	9,731	12,398	12,851	3.7%

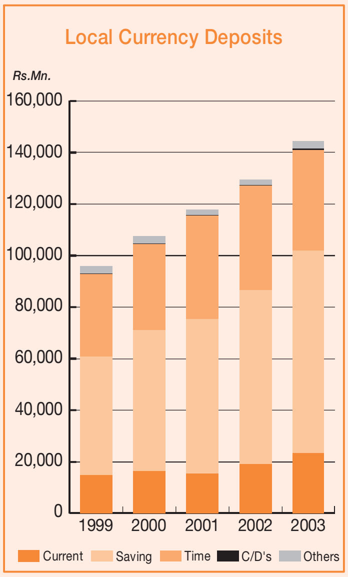
LOCAL CURRENCY DEPOSITS

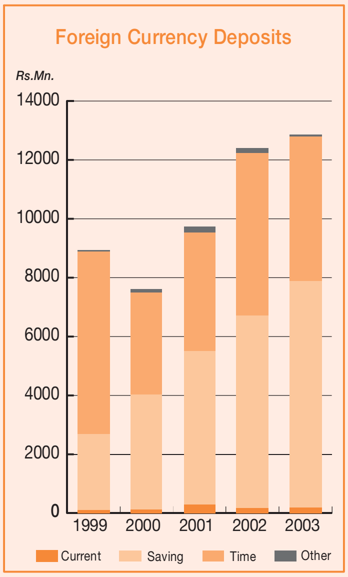
	2000	2001	2002	2003	% Growth 2003 Over 2002
Current	16,314	15,264	19,127	23,290	21.8%
%	*15.2%*	*13.0%*	*14.8%*	*16.1%*	
Savings	54,918	60,058	67,376	78,670	16.8%
%	*51.1%*	*51.0%*	*52.1%*	*54.5%*	
Time	33,236	40,053	40,543	39,092	(3.6%)
%	*30.9%*	*34.0%*	*31.3%*	*27.1%*	
Certificate of Deposits	316	330	362	405	11.9%
%	*0.3%*	*0.3%*	*0.3%*	*0.3%*	
Others	2,611	2,107	2,029	3,003	48.0%
%	*2.4%*	*1.8%*	*1.6%*	*2.1%*	
Total	**107,395**	**117,812**	**129,438**	**144,460**	**11.6%**

FOREIGN CURRENCY DEPOSITS

	2000	2001	2002	2003	% Growth 2003 Over 2002
Current	111	297	157	194	23.2%
%	*1.5%*	*3.1%*	*1.3%*	*1.5%*	
Savings	3,931	5,214	6,541	7,678	17.4%
%	*51.6%*	*53.6%*	*52.8%*	*59.7%*	
Time	3,455	4,022	5,525	4,930	(10.8%)
%	*45.4%*	*41.3%*	*44.6%*	*38.4%*	
Others	115	198	174	49	(72.0%)
%	*1.5%*	*2.0%*	*1.4%*	*0.4%*	
Total	**7,612**	**9,731**	**12,398**	**12,851**	**3.7%**







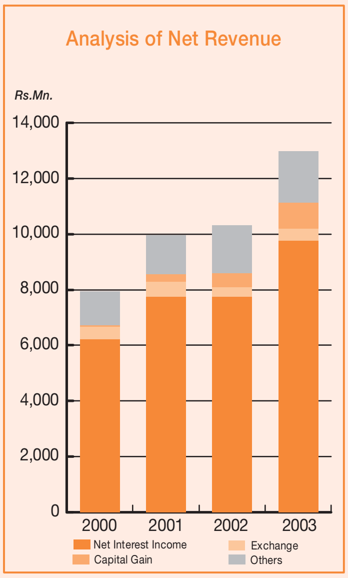
- **Analysis of Operating Performance :**

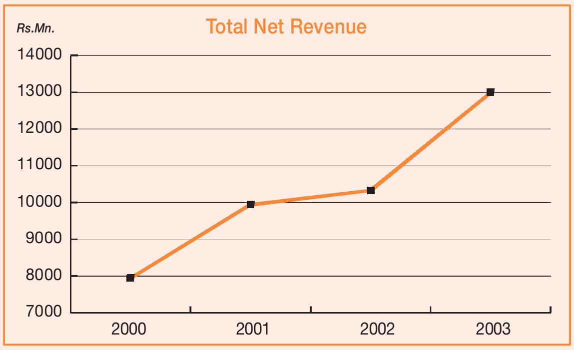
A review of the Bank's revenue generation trends indicates the following:

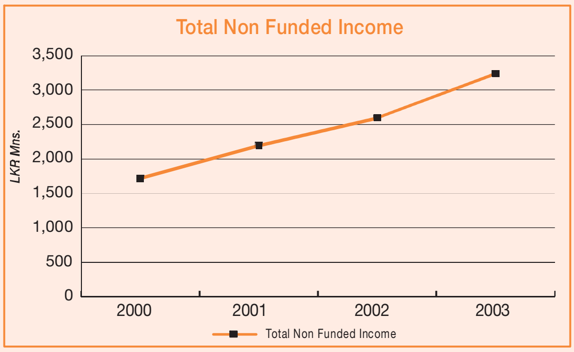
	2000	2001	2002	2003
Total net Revenue	7,940	9,941	10,331	13,003
% Annual Growth	*112%*	*25%*	*4%*	*26%*

Composition of Net Revenue

	2000	2001	2002	2003
Net Interest Income	**6,222**	**7,747**	**7,733**	**9,763**
%	*78%*	*78%*	*75%*	*75%*
Exchange	443	544	343	421
%	*6%*	*5%*	*3%*	*3%*
Capital Gain	58	266	517	950
%	*1%*	*3%*	*5%*	*7%*
Other Interest Income	1,217	1,384	1,738	1,868
%	*15%*	*14%*	*17%*	*14%*
Total Non Funded Income	**1,718**	**2.194**	**2,598**	**3,240**
%	*22%*	*22%*	*25%*	*25%*







The above evaluation reflects that in 2003, the Bank recorded exceptional levels of revenue from Capital gains.

In addition, this analysis reveals that the Bank has more potential to deliver greater levels of Non-Funded Income from various existing services and other future lines of non-funded business opportunities.

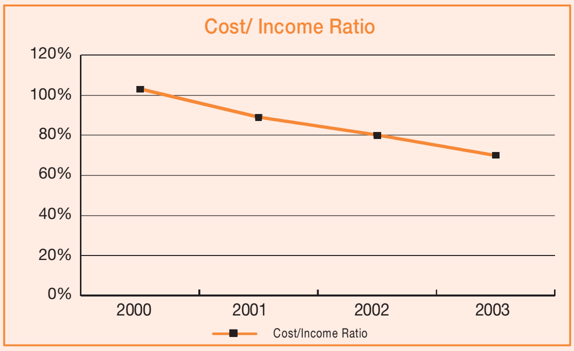
This area remains as a clearly untapped area, that can significantly contribute to future levels of profitability.

Review of Operating Costs :

	2000	2001	2002	2003
Staff Cost	4823	4738	4899	6265
%	*59%*	*53%*	*59%*	*69%*
Premises & Equipment cost	1195	1236	1342	1331
%	*15%*	*14%*	*16%*	*15%*
Administrative & Other Overhead costs	2142	2892	1994	1528
%	*26%*	*33%*	*24%*	*17%*
Total Cost	8160	8867	8235	9123
% Annual Growth of cost	***49%***	***9%***	***(7%)***	***11%***

Revenue, Costs and Cost Income Trends 2000 - 2003

	2000	2001	2002	2003
Total Net revenue	7940	9941	10331	13003
Total Operating cost	8160	8867	8235	9123
Cost/Income Ratio	***103%***	***89%***	***80%***	***70%***



The review and analysis of costs requires that the following are highlighted.

- Staff costs in 2003, reflect the 3 yearly salary increase based on the Collective Agreement with the Unions of the Bank. All staff costs are affected by this step-up increase.
- The Bank was unable to continue with the planned re-profiling of staff cadres, that was commenced in the previous year.

  This related to selective extensions being granted to staff beyond the retirement age of 55 years, based solely on performance and contribution to organisational success.

  Previously the practice had been to customarily extend staff upto 60 years of age.

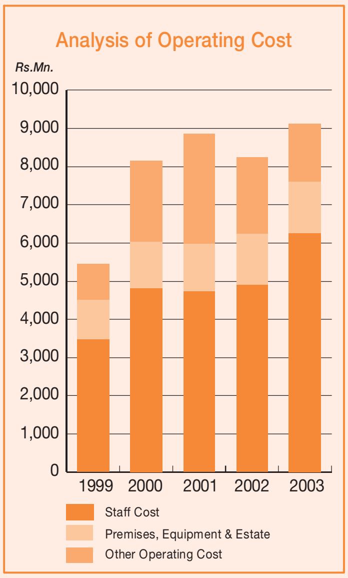
  In keeping with the strategic plan, the Bank commenced an acceleration of retirements, to enable the selective recruitment of outstanding school leavers as new Banking Assistants and the recruitment of Management Trainees as done in 2002.

The Bank however is currently facing an embargo on any type of recruitment by the Ministry of Finance. This has compelled the Bank, to scale down the extent of retirements of present staff, as the Bank would otherwise be unable to provide the level of customer services needed.

- Management has in 2003, despite receiving an actuarial valuation report that indicated a fully funded Pension Fund, increased the level of contribution to the Staff Pension Fund to 30% of annual salary value, as against the 20% of the previous year.

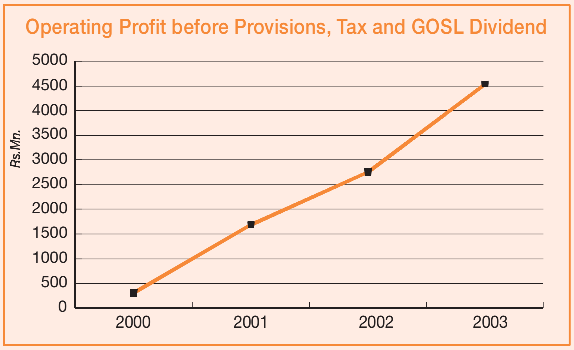
  The purpose of this was to ensure that declining interest rate trends, would not adversely affect the level of funding adequacy.

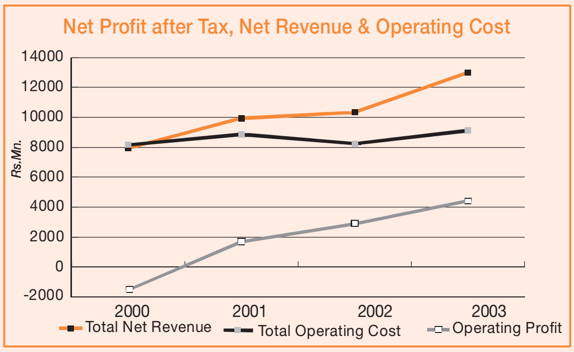
- The VAT on staff costs has also impacted the Bank, due to the large staff workforce. The VAT expenses impact will increase further in the ensuing year, due to the increased rate of 15% p.a. that will be applicable.



Review of Growth of Operating Profits & Net Profit

	2000	2001	2002	2003
Operating Profit before bad Debts, Tax, Vat and Dividend on GOSL Bonds	304	1688	2760	4542
% Of Annual Growth		455%	64%	65%
Less:				
Net Loan Loss Provision	(1,572)	(808)	(1,400)	(2,288)
Dividend on Gosl Bonds paid to GOSL	(572)	(572)	(572)	(572)
Profit Before Taxation	(1,840)	308	788	1,682
Taxation	-	-		218
Profit after Tax & before VAT on profits	(1,840)	308	1,006	1,682
VAT on Profits	-	-	-	(127)
Net Profit for the year	***(1,840)***	***308***	***1,006***	***1,555***
% of Annual Growth		117%	227%	55%



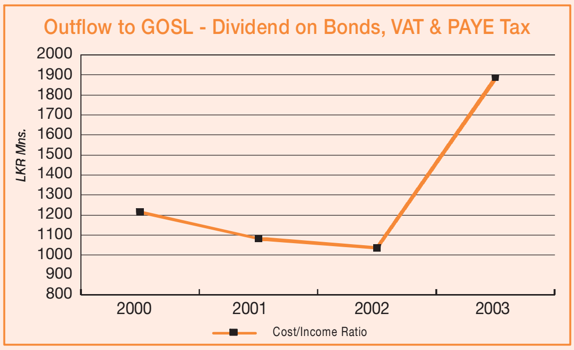


A significant feature of People's Bank operation is the quantum of Taxes and Dividends on GOSL Bonds that are paid to the Government of Sri Lanka. This is a vital yet "less prominent" aspect of People's Bank's many areas of contribution to Sri Lanka's national economy.

Cash Outflow to GOSL - Dividend on Bonds, VAT & PAYEEE Tax

	2000	2001	2002	2003
Dividend on GOSL Bonds	572	572	572	572
VAT on Staff costs	-	-	-	509
VAT on Profits	-	-	-	127
VAT on Normal Operations	-	-	59	162
PAYEE Tax Borne by the Bank	321	255	203	258
Total Outflow to GOSL	893	827	833	1,628

The combined value of the above is the direct contribution made by People's Bank towards the funding of the Government of Sri Lanka.

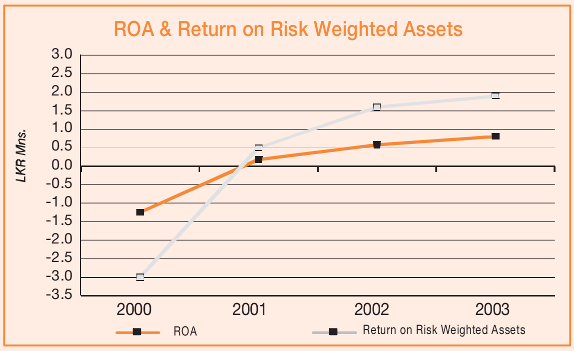


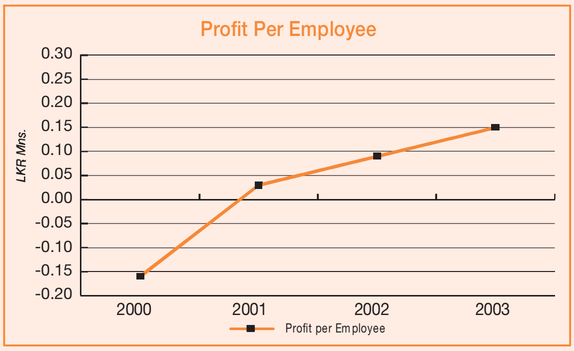
Review of Key Performance Indicators

The Growth of Business in the Bank's "turnaround" is best analysed by the following tabulation :

				LKR Mn
	2000	**2001**	**2002**	**2003**
Net Profit	(1,840)	308	1,006	1,555
Average Assets	147779	167275.5	174762	191325.5
Risk Weighted Assets	61694	63701	61351	83580
Number of Employees	11577	11401	10834	10145

				LKR Mn
	2000	**2001**	**2002**	**2003**
Return on Assets	(1.25%)	0.18%	0.58%	0.81%
Return on Risk Weighted Assets	(3.0%)	0.5%	1.6%	1.9%
Profit per Employee	(0.16)	0.03	0.09	0.15
NonFunded Income to Total Net Income	22%	22%	25%	25%





Review of Completion of First Strategic Plan

Review of Performance for 2003, must also include a comparison against the originally planned performances as set out in the Strategic Plan that was developed in 2001 for the period 2001 to 2003.

The purpose of the plan at that stage was to arrest the financial decline of People's Bank and to re-engineer the Balance Sheet and underlying performance levels in order to enable a growth of the Business to achieve financial break-out.

This fundamental objective has been largely met and a new Strategic Plan has now been drawn for the period 2004 to 2008.

Comparison of Strategic Plan with Actual Results 2001-2003

	2001		**2002**		**2003**	
	Strategic Plan	**Actual**	**Strategic Plan**	**Actual**	**Strategic Plan**	**Actual**
Net Profit After Tax	71	308	339	1,006	737	1,555
Total Deposit	135,112	127,544	154,659	141,836	172,842	157,310
Total Loans & Advances	114,460	121,642	114,792	116,324	119,321	118,042
Cost/Income Ratio	84%	89%	84%	80%	84%	70%
Profit per Employee		0.03		0.09		0.15
ROA	0.03%	0.18%	0.16%	0.58%	0.32%	0.81%

The above analysis indicates that actual performances in relation to Deposit and Loans & Advances growth did not meet targetted levels due in part to re-profiling of the Loan Portfolio where exposure to State Sector balances were reduced and the intense level of competitiveness that has made deposit growth an exciting challenge.

However, in relation to Net Profits, actual results far exceeds planned performances.

This has been due largely to a renewed performance management culture, empowerment of Managers, incentivisation of performances, Cost Management, professionalisation of all areas of business, in particular in Treasury Operations, Corporate Banking and Credit Management and above all the commitment of all levels of staff who have understood that the "need of the hour", being to awaken a "sleeping giant". This will then result in a Bank that can actually perform to its strength, experience of staff, innovativeness and broad outreach backed by a very loyal customer base !

- **Critical /Success factors for the Future**

The Bank faces numerous challenges in the journey towards achieving "Financial breakout" and Financial independence.

These issues are analysed briefly as follows:-

- **Capital Adequacy**

The Bank's one fundamental matter of concern, is the Capital deficit, that was caused by the full provisioning for non-performing loans, that was made in 2001, at the time of finalising the 1999 Annual Accounts, as part of the Re-structuring process of the Bank.

The Bank at present is dependent on a Letter of Support from the Government of Sri Lanka, in relation to assurances of keeping Capital Adequacy ratios of the Central Bank.

The New Strategic Plan recognises that organic growth to bridge the Capital deficit would take until the medium term for revolution based on current levels of performance.

Accordingly, the new plan envisages an inflow of Capital, by at least 2006 to resolve the Capital deficit issue.

Previously, in 1993 and 1996, the Bank had been provided with GOSL Bonds, to make good loan losses caused through State directed lending schemes.

A detailed analysis of the Capital requirements of the Bank and a comparison against the prior year is included in the Financial Statements section of this Report.

- **Reduction of Non-Performing Loan Portfolio**

This aspect has been analysed in this section under Key Initiatives of 2003.

This area of NPL's for People's Bank, will remain as the single most critical success factor, as early resolution of the old, long outstanding balances, will resolve the Capital Deficit issue and propel the Bank's income generation capabilities to very highly competitive levels.

- **Risk Management**

The Bank has now developed a structure and it is planned to further strengthen internal capabilities of managing and mitigating Risks relating to the Business.

This area is increasingly being considered as a critical success factor for the future, not only due to past negative experiences, but also due to the increasing scale of operation of the Bank's business and the commitment by the Bank to be professional in keeping with contemporary development and demands of the Banking industry.

Look to the future

The Bank has very successfully completed the 3 year period of the first Strategic Plan. Further, the results of the 3rd Year of the Plan, 2003, have been exceptionally positive. However, the fact remains that the year 2004, will be a very challenging year for the Bank, where the following external issues will significantly impact on financial performance. These issues are considered as challenges that will need to be positively managed.

- **Managing of Capital Deficit:**

The deficit of capital which has been analysed in a preceding section, will also limit the growth of the Bank's Loan Portfolio, as Management continues to grapple with the effort of managing the capital deficit by reducing the required level of capital that is needed, which effectively constrains taking on higher risk weighted exposure. This will need to be achieved while balancing the need of sustaining current levels of profitability.

- **Impact of higher VAT Levels**

The impact of the VAT increase is significant due to the large number of employees and also due to the increasing levels of profitability, which in turn attracts higher levels of taxes.

In 2004, we will face a VAT rate of 15% as against 10% in the previous year.

This will be an incremental expense that will have to be borne next year.

- **Reducing Interest Margins and Treasury Related Capital Gains**

The Bank has progressively been reducing the net interest margin and as done during 2003, efforts will continue to be made to proactively and gradually reduce the net interest margin in order to give better value to our customers.

This effort will be carried out, not only due to competitive pressure, but also as a stimulus by the Bank itself, to foster national economic output and growth.

A consequent result, will be the contraction of revenue, which will need to be managed.

In addition, the Capital Gains earned by Treasury in 2003 were linked to fluctuations of the LKR foreign exchange translation rate and the Treasury Bill and Treasury Bond interest rate reductions seen from time to time.

However, Financial planning that has been done for the year 2004, does not anticipate or include the impact of any such exceptional variations, thus creating a challenge for our Treasury to sustain the income levels of this year's exceptional results.

Management is however, confident that with the support and commitment of our staff, that the Bank will be able to continue with the current effort of building a performance culture that will create sustainable profitability, arising from a quality customer service platform. It is Management's expectation that this will ensure that the Bank progresses towards achieving "financial breakout" that will enable the Bank to resolve the capital adequacy issue and achieve financial independence.