# MESSAGE TO SHAREHOLDERS

## ECONOMIC OVERVIEW

Despite the challenging global environment, the Philippine economy remained resilient as it registered a 5.8% growth in real Gross Domestic Product (GDP) in 2015, still one of Asia's top performers. The economic expansion was propelled by sustained household consumption, strong capital formation, and accelerated government spending amid export growth slowdown. On the supply side, the growth was boosted by a substantial gain in the services sector and a modest increase in the industry sector.

The lack of supply-side pressure, aided by low oil prices, tempered inflation to an average of 1.4% in 2015, the lowest since the BSP adopted the inflation targeting framework in 2002. Interest rates were on a gradual uptrend amid uncertainties on the timing of the normalization of US monetary policy. The US Federal Reserve raised its policy rates in December 2015, its first interest-rate-raising cycle since 2008. Meanwhile, fiscal prudence resulted in a steady decline in the country's debt-to-GDP ratio, further reducing reliance on external financing.

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The country's balance of payments position improved to a surplus of US$2.6 billion as of end-2015, reversing the US$2.9 billion deficit posted a year ago. The surplus is attributed to sustained overseas Filipinos' remittances, a growing BPO industry, and net inflows of foreign direct investments. This allowed the Philippines to maintain gross international reserves at above US$80-billion level, sufficient to finance 10.3 months' worth of imports of goods services. Despite the country's strong external accounts, the peso depreciated against the US dollar by 5.4% year-on-year with the exchange rate settling at P47.17 to a US dollar at the close of 2015. The weakness of the peso was sentiment-driven, arising from uncertainties in the global market: on the timing and effect of US monetary policy on global liquidity, geopolitical tensions, and divergent economic growth across different markets.

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Total Banks' loan portfolio expanded by 11.9% against previous year's level, thus continuing the industry's double-digit pace in the last 4 years. Asset quality continued to improve as gross non-performing loan (NPL) ratio decreased to 2.1% from 2.3%as of the end of December 2015. Total Industry's gross NPL ratio was kept below the pre-Asian crisis level of 3.5% as banks adopted initiatives to improve their asset quality coupled with prudent lending regulations. The NPL coverage ratio reached 118.4%, signifying that banks had adequate buffers against potential credit losses.

The capital adequacy ratio of universal and commercial banks remained high at 15.6% on a solo basis and 16.4% on a consolidated basis as of September 2015, far above the BSP-prescribed minimum ratio of 10%. The profitable operations of banks as well as the issuance of new shares of stock and the capital infusion of foreign banks contributed to the increase in capital ratios.

## DELIVERING A STRONGER FRANCHISE

In 2015, the Philippine National Bank (PNB) started to see the fruits of the PNB and Allied Banking Corporation (ABC) merger. Maximizing the synergies from this integration the Bank started to deliver greatly improved business and financial results. Strong gains were achieved in the Bank's core business as it continues to show robust loan growth and record income performance.

**The Group's consolidated Capital Adequacy Ratio (CAR) of 19.24% and a Common Equity Tier 1 (CET1) ratio of 16.23% are well above the minimum 10% and 6% required by BSP, respectively.**

PNB concluded the year with a net income of P6.3 billion, 15% higher than the previous year's level, even as the average income growth for the industry contracted. This translates to a return on equity of 6.2%.

During the year, PNB's net interest income, comprising 67% of the total operating income, improved by 7% to P17.7 billion. Despite the squeeze in margins, interest income on loans and receivables grew by 13% to P17.1 billion. Strong lending volumes from the corporate and commercial/SME sector propelled this growth.

The loan-to-deposit ratio rose to 74%, driven by the expansion of the Bank's loans, which grew by 18%, and outpacing the industry's average growth of 13%. At the same time, the increase in interest expense on deposits was contained at 7% to P3.0 billion despite a 9% growth in deposits. A greater proportion of this increase came from low cost funds. PNB's interest expense on borrowings rose by 20% to P1.0 billion as the Bank successfully closed and signed a USD150 million 3-year syndicated term loan facility with a large group of international and regional banks in April 2015. This marks PNB's return to the syndicated loan market after more than a decade, the last being in 1998. The loan facility was 1.5 times oversubscribed, indicating the Bank's credit strength and the enhanced confidence of international creditors.

With synergies from the merger being realized and with reduced provisioning, operating expenses were lower this year at P18.9 billion compared to P19.2 billion during the previous year.

Net service fees and commissions increased by 25% to P3.6 billion, principally generated from underwriting and credit-related transactions. The improvements in core revenues compensated for the reduced trading gains that declined by 55% ending at P574 million due to challenging conditions in both the local and international financial markets. Operating income was augmented by gains from the sale of PNB's foreclosed assets, which improved by 10% to P1.6 billion.

As of the end of 2015, PNB's total consolidated resources stood at P679.7 billion, up P54.2 billion or 9% from year-ago level. Loans and receivables reached P365.7 billion, posting a significant growth of 15.7%. Asset quality significantly improved as non-performing loans were reduced to P9.0 billion by the end of 2015. Non-performing loan (NPL) ratios decreased to 0.25% (net of valuation reserves) and 2.61% (at gross) from 0.92% and 3.42%, respectively, a year ago. NPL coverage improved to 125.57% from 99.19% end of 2014. The Bank's real and other properties acquired (ROPA) declined by P7.0 billion due to sustained disposal off foreclosed properties. Hence, ratio of non-performing assets to total assets declined to 2.1% in 2015 from 3.7% a year-ago.

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As validation of PNB's efforts at fortifying its business and in recognition of the Bank's drive toward its long-term corporate goals of high profitability and a strong balance sheet, two credit rating agencies upgraded its outlook on PNB. Last May 2015, Moody's Investors Service upgraded PNB's long-term and short term rating by two levels to reach investment grade, from Ba2/NP to Baa3/P-3. In October 2015, Fitch Ratings Agency gave the Bank a higher credit rating of "BB" with a stable outlook, reflecting the Bank's strong franchise and high capital ratios.

## ADDRESSING NEEDS

The year saw the execution of key retail banking initiatives with the goal of establishing the retail segment as one of the Bank's major business pillars. Recognizing the needs of our modern-day customers and complementing the Bank's strengths in the corporate, commercial and financial market businesses, we underwent a rebranding program. We renovated our retail branches and enhanced the overall banking experience. We transformed our branches to feature the new retail branch design, which offers a more comfortable banking atmosphere with improved amenities and efficient customer service. With a combined total of 740 domestic, overseas offices and representatives in its network, PNB continues to be one of the banks with the broadest geographical reach in the industry.

In order to address the customers' evolving needs, PNB continues to listen and provide products that serve their diverse requirements. In partnership with the Social Security System (SSS), PNB launched the PNB SSS Pension Loan Program for SSS pensioners. This loan product provides a faster turnaround time at more affordable rates with value-added benefits such as Credit Insurance and ATMSafe - a pioneering product in the country which ensures the safety of ATM cardholders and their accounts. Over one million PNB clients enjoy the benefits of this revolutionary product, along with the Healthy Ka Pinoy (HKP) Emergency Medical Card. HKP provides emergency hospital care for accidents and sicknesses at a very minimal cost.

While PNB's branches continued to be the primary platform for sales and services, the Bank expanded and fortified other cost-efficient distribution channels. Out of the 1,000 ATMs ordered in 2014, 665 units were delivered in 2015. In addition, a total of 394 ATMs were upgraded with units that have: more user-friendly features, improved operating systems, and anti-skimming