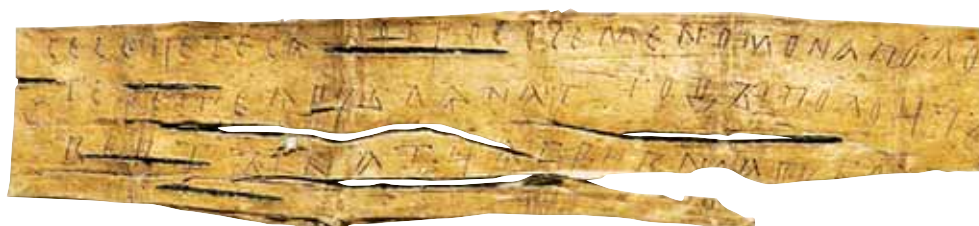


MANAGEMENT DISCUSSION AND ANALYSIS



POSITIVE P&L TRENDS

- ◆ Net interest income increased by 16.5% despite a 4% loan portfolio contraction (before impairment allowance), as lending rates grew faster than funding costs in H1 and beginning of H2 2009. Lending rates were driven by a loan supply shrinkage and an increased risk premium at a time of economic turmoil.
- ◆ This enabled PSB to maintain its net interest margin at the 2008 level (6.5%), despite a reduced share of loans to customers (57% of total asset down from 65%) and an increased portion of more liquid but less profitable assets (e.g. securities) from 28% to 33% of total assets.
- ◆ A significant improvement in the cost-to-income ratio (39.0%, down from 43.8%) was driven by a strong operating revenue growth against the backdrop of administrative expenses control under the cost optimization program.
- ◆ A strengthening in interest income and fees & commissions led to an increase in operating income, while efficient administrative expenses controls drove a 32% increase in profit before tax and provisions.
- ◆ Stronger operating income per employee (up 24%) reflects improved labor efficiency management at the Bank.

NEGATIVE P&L TRENDS

- ◆ A significant increase in non-performing loans (NPL) amid the deep economic crisis in Russia drove additional provisioning for loan impairment, which in 2009 more than doubled to RUB 39 billion.

BIRCHBARK LETTER (EXCERPT)

Novgorod {1320–1340}

Contents:

*Loan agreement
between Bobr
and Semen.*

- ◆ In 2009, PSB allocated approximately 61% of operating income to provisioning, against 47% in 2008.
- ◆ A pressure on the net interest margin started in Q4 2009 and continued into Q1 2010, driven by falling interest rates against the backdrop of limited lending opportunities and high interest expenses related to maintaining a sizeable liquidity cushion in times of economic turmoil.

KEY 2009 BALANCE SHEET CHANGE DRIVERS

- ◆ During the first 9M of 2009 total assets decreased following
 - repayments in H1 2009 of CBR anti-crisis funding obtained amid the system-wide liquidity crunch in Q4 2008;
 - cautious approach to lending;
 - PSB's policy targeted at reducing concentration levels in funding.
- ◆ In Q4 2009 a large influx of customer deposits at PSB resulted in a YoY increase in total assets. It was caused by excess liquidity in the Russian economy and limited number of banks, incl. PSB, perceived as safe enough to place that money with.

- ◆ The proportion of equity was slightly down to 8.1% from 8.5%, due to a 4% decrease in equity against the backdrop of a 2% assets growth. The key factors for the reduction in shareholders' equity were as following:
 - net loss due to a sharp increase in provisioning charge;
 - negative revaluation of fixed assets;
 - decrease in additional capital, due to acquisition of minority stakes in subsidiary banks. Had the results of the additional share issue with the participation of EBRD and Commerzbank been registered at the end of December 2009, Tier 1 and total capital adequacy ratios would have increased by 1.5 pp to 11.4% and by 1.1 pp to 15.4%, respectively.
- ◆ In 2009, the Bank operated amid, on the one hand, persisting higher credit risks across the economy and, on the other, a weakening demand for loans due to the economic crisis, which negatively affected the loan book dynamics. Loan to customers contraction (before impairment allowance) was mainly driven by:
 - suspension of most retail lending programs;
 - tighter underwriting criteria as part of a revamped credit policy;
 - declining volumes of international trade finance amid the global economic crisis.
- ◆ Nevertheless, PSB continued active credit underwriting in the areas of factoring and SME lending and strengthened its market positions in these segments. 2009 volumes of factoring financing and SME loans were over RUB 85 billion and nearly RUB 22 billion, respectively.
- ◆ In 2009, PSB securities portfolio (trading and held to maturity) more than doubled, driven by:
 - purchases of new Russian blue chip bonds since Q2 2009, when the domestic market began to recover after its collapse in October 2008;
 - placement of a part of the liquidity cushion created by PSB in Russian state and municipal bonds. Highly liquid securities included in the CBR Lombard list represent over 70% of PSB portfolio of trading and held to maturity securities.
- ◆ NPL more than quadrupled in absolute numbers from YE 2008, and their level reached approx. 12.3% of gross loans. However, NPL growth decelerated in H2 2009 when their increase (in absolute terms) was 45% lower than in H1 2009.
- ◆ Retail loans display the highest level of NPL; this is due to the portfolio shrinkage against the backdrop of very limited volumes of new retail lending. The share of NPL in the SME portfolio is also relatively high, mainly comprised of loans issued before the tightening of the SME credit underwriting criteria in Q4 2008, while the level of NPL in SME loans issued in 2009 is about 3%.
- ◆ PSB adheres to its policy of maintaining NPL coverage by provisions of no less than 100%.
- ◆ Also, as the period of increased volatility in the financial markets lingers on, PSB continues to prioritize liquidity over profitability.
- ◆ PSB retail deposits grew strongly throughout 2009, outpacing the respective average growth rate for the Russian banking sector. The positive dynamics were driven by the efficiency of PSB deposit product offering and re-orientation of the distribution network towards funding against the backdrop of higher household saving rates amid economic volatility. In 2009, the share of retail funding in PSB total liabilities was 22%, up from 13%.
- ◆ In 2009, PSB successfully diversified its funding base:
 - the relative share of 10 largest depositors in customer deposits as at 31 December 2009, was 32%, down from 38% as at 31 December 2008;
 - dependence on funding from foreign bank has significantly decreased – its share in PSB total liabilities was 23%, down from 26%.

LIQUIDITY

%	2009	2008	2007
LIQUID ASSETS (RUB BN)	154	127	67
LIQUID ASSETS/TOTAL ASSETS (%)	33	28	23
INSTANT LIQUIDITY RATIO (H2) – MIN 15%	54	76	44
CURRENT LIQUIDITY RATIO (H3) – MIN 50%	126	95	84
NET LOANS / CUSTOMER DEPOSITS	92	131	148

LOANS TO CUSTOMERS

RUB BILLION	2009	2008	2007	% CHANGE 2009/08
STANDARD LOAN PRODUCTS	183	178	116	3.1
TRADE AND LONG-TERM FINANCING	32	50	42	(36.2)
FACTORING	27	22	19	19.6
TOTAL CORPORATE LOANS	242	250	176	(3.3)
SME LOANS	23	19	8	19.3
RETAIL LOANS	41	50	29	(18.3)

SECURITIES PORTFOLIO (TRADING AND HELD TO MATURITY)

RUB BILLION	2009	2008	2007
RUSSIAN STATE BONDS (OFZ), MUNICIPAL BONDS, CBR BONDS	17	9	13
CORPORATE BONDS	26	12	5
PROMISSORY NOTES OF RUSSIAN BANKS	7	2	6
EQUITIES	-	-	1
TOTAL SECURITIES PORTFOLIO	49	23	25

FUNDING

RUB BILLION	2009	2008	2007	% CHANGE 2009/08
CORPORATE DEPOSITS	194	176	106	9.8%
RETAIL DEPOSITS	96	53	35	79.9%
EQUITY/ASSETS	8.1%	8.5%	9.4%	(0.4 pp)